Speech by Dr Kračun, Chairman of the Fiscal Council, at the 20th emergency session of the Committee on Finance (20 April 2023)

First of all, I would like to point out that this time the draft budget documents were submitted in accordance with the legislative deadlines, including other materials required by the agreement between the Fiscal Council and the Ministry of Finance for the preparation of a comprehensive assessment. It should also be emphasised that the Fiscal Council's assessment refers to the draft and not to the final version of the Stability Programme, which may also be subject to further changes due to the uncoordinated timing with the revised budget adoption. The Fiscal Council notes that credible medium-term budgetary planning, from which, however, the current drafting of budgetary documents also deviates, will play a central role in the proposed economic governance framework in the European Union.

The key findings of the Fiscal Council, based on its review of the submitted budget documents, are the following:

– The fiscal policy stance projected in the medium-term budget documents is neutral on average over the 2023–2026 period, but the projections imply rather limited room for manoeuvre. This applies in particular to partial discretionary fiscal policy measures which were already observed after the budget documents were submitted to the Fiscal Council for assessment. Such measures should be replaced by systemic measures to ensure the long-term sustainability of public finances.

– Fiscal policy must be aware of its role in an economy that is part of the Economic and Monetary Union, and it must contain national inflationary pressures, thereby maintaining, as far as possible, consistency with monetary policy that is oriented towards the euro area average. Given the large number of non-targeted measures introduced during the two recent crises, the high general government expenditure and other adverse side-effects have made it necessary to transform these measures into targeted measures or to phase them out as energy prices moderate. At the same time, the war in Ukraine seems to have accelerated a structural change in the energy markets, also in the context of the necessary green transition. It is neither reasonable nor sustainable for the state to administratively lower the prices indefinitely. The need to reintroduce a market-based pricing mechanism that sends signals to end users about energy consumption and switching to alternative energy sources has already been highlighted by major international institutions.

– We assess the projections in the draft Stability Programme 2023 as broadly realistic under the current legislation, i.e. according to the current economic policy measures, and consider them to be in line with the precautionary principle in view of the IMAD macroeconomic forecast. This approach is appropriate given the continuing high level of uncertainty and the numerous risks. The risks arise from both the global environment and potentially ill-considered domestic decisions.

-The exceptional circumstances that have been invoked for almost four years will come to an end in 2023, but unfortunately the European Commission's recently published guidelines on the functioning of fiscal policy in 2024 continue to allow a considerable degree of discretion in the assessment of the budget documents. The fact that the period of exceptional circumstances will end in 2023 has been known since at least last autumn, but no agreement on new rules at the EU level has yet been reached. Therefore, in line with past practice, the Fiscal Council uses a wide range of indicators in its assessment, but due to all the uncertainties the calculations must still be interpreted with caution.

– By 2026, the deficit is expected to drop to -1.3% of GDP, a balance of 2.0 pp of GDP lower than in the year before the epidemic, mainly due to the projected much lower revenue-to-GDP ratio. Current spending growth is projected to be more than twice as high on average over the projection period as before the epidemic, mainly due to high inflation, but its share in GDP will remain relatively constant and will not have a significant impact on the change in the balance.

– The general government gross debt-to-GDP ratio should gradually decline to 63.5% of GDP by the end of 2026, which would be lower than before the outbreak of the epidemic. Debt reduction is expected to be facilitated in particular by maintaining the favourable relationship between nominal economic growth and the implicit interest rate on debt, despite the tightening of the government's financing conditions. The liquidity position of the state budget, which amounts to more than 10% of GDP, remains favourable. However, even small deviations can significantly worsen the debt trajectory.

– Most of the indicators used by the Fiscal Council in preparing its assessment show compliance with the rules in 2025 and 2026, assuming that the submitted budget documents are implemented. The deviations in 2024 are mainly a result of the projected high investment activity and a further decline in the revenue-to-GDP ratio and are within the range of variability of the assessments of the cyclical position of the economy. These assessments are particularly unreliable in periods of strong fluctuations in economic activity and possible structural changes in the economy.

– However, the Fiscal Council reiterates its doubts about the projection of high investment activity, both in view of the delays in meeting the milestones for the granting of funds from the Recovery and Resilience Plan and the limited absorption capacity of the administration and the economy, the latter in particular due to constraints in the labour market.

– Fiscal policy should address the sustainability of social security systems as soon as possible, curb the growth in current spending to ensure debt sustainability and properly address development challenges through systemic measures.

– The baseline scenario of the draft Stability Programme 2023 and in particular the risks associated with it, already indicate the need for the implementation of reforms to ensure the long-term sustainability of public finances. An appropriate sequencing of the introduction of these reforms should be established, supported by public and credible assessments of their fiscal and macroeconomic impacts. The Fiscal Council considers changes related to the sustainability of the financing of social security systems a priority. The European Commission's recent report on public debt sustainability, which again places Slovenia among the countries with the highest long-term risk in the EU, also draws attention to these challenges.