REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Assessment of the Draft Revised Budget of the Republic of Slovenia for 2023

May 2023

Document No: 30-4/2023/3

This assessment is made on the basis of the Draft Revised Budget of the Republic of Slovenia for 2023, which was received by the Fiscal Council on 21 April 2023. Data available up to and including 4 May 2023 were used.

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EXECUTIVE SUMMARY

This year's Draft Revised Budget foresees a high general government deficit (-4.5% of GDP), similarly affected by the intervention measures to mitigate the effects of the of the cost-of-living crisis and the epidemic and the "core" deficit (excluding the impact of intervention measures). The latter is also the only reason for the significant increase in the deficit compared to last year (by 2.2 percentage points of GDP), which is largely due to the assumed decline in the revenue-to-GDP ratio and the further strengthening of the already high level of investment activity. Growth in "core" current spending is also expected to be significantly higher this year than its long-term average and the current estimate of medium-term economic potential growth, mainly reflecting the high inflation and, to some extent, discretionary measures. Its ratio to GDP will not increase significantly, so that core current spending will not contribute significantly to the increase in the deficit-to-GDP ratio.

According to the Government's assurances, the Draft Revised Budget is in line with the Stability Programme 2023 and therefore the assessment of compliance with the fiscal rules made by the Fiscal Council in April this year remains unchanged. According to this indicative assessment, most of the indicators used for 2023 point to a deviation in fiscal policy from compliance with the fiscal rules. In particular, due to the high inflation and the projected further strengthening of investment activity, the projections for the general government balance in the Stability Programme 2023 suggest an expansionary fiscal policy stance this year, while exceptional circumstances still apply. In this context, it should be noted that the set high level of government expenditure in 2023 and the declining cyclical revenue-to-GDP ratio also contribute significantly to the limited room for manoeuvre for additional fiscal policy measures in the coming years, which would worsen the structural position of public finances and thus affect the medium-term sustainability of public debt.

The lower deficit in the Draft Revised Budget compared to the current budget adopted last autumn is mainly due to lower expenditure related to the cost-of-living crisis, partly reflecting the new measures, and partly due to more appropriate projections of certain items, the shortcomings of which were already highlighted by the Fiscal Council in the autumn. Nevertheless, budgeting remains deficient due to the inadequate classification of measures as intervention measures, insufficient assessment of the impact of discretionary measures, systematic under- or overestimation of individual revenue and expenditure categories, and uncoordinated processes for the preparation of budget documents.

The legislative basis and background for drawing up the assessment of the Draft Revised Budget for 2023

On 21 April 2023, the Government of the Republic of Slovenia submitted the Draft Revised Budget of the Republic of Slovenia for 2023 to the Fiscal Council for an assessment of compliance with the fiscal rules (hereinafter: the Draft Revised Budget). In accordance with the Cooperation Agreement[1], the Ministry of Finance also provided the Fiscal Council with other information necessary to make the assessment. At the time of receiving the Draft Revised Budget for its assessment, the Fiscal Council did not receive the revised framework for drafting general government budgets for the 2022–2024 period.[2]

Pursuant to point two of paragraph two of Article 7 of the Fiscal Rule Act (hereinafter: the ZFisP), the Fiscal Council is obliged to make an assessment of compliance with the fiscal rules on the basis of a draft revised state budget. The assessment of compliance with the fiscal rules is made for the general government sector as a whole in accordance with paragraph one of Article 1, the definition in Article 2 and the definition of the implementation of the medium-term balance in Article 3 of the ZFisP. Pursuant to paragraph two of Article 9f of the Public Finance Act (ZJF-H), the Fiscal Council is obliged to make an assessment of the Draft Revised Budget within fifteen days of its receipt. The deadline for the Fiscal Council to submit its assessment of the Draft Revised Budget to the National Assembly and the Government is 6 May 2023.

The Fiscal Council made its assessment of the compliance of budget documents with the fiscal rules in mid-April 2023 as part of the assessment of the draft Stability Programme 2023, which covered the 2023–2026 period, and submitted it to the National Assembly and the Government.[3] In its comments, the Fiscal Council drew attention to a possible inconsistency between the Stability Programme 2023 and the Draft Revised Budget, which was still being drafted at the time of the assessment of the draft Stability Programme 2023. In its response[4] to the Fiscal Council's assessment prior to the adoption of the Draft Revised Budget, the Government explained that the general government revenue and expenditure estimates included in the draft Stability Programme 2023 mainly contain data on the revised state budget for 2023. According to the Government, possible deviations can only occur in individual categories of the economic classification of the state budget and not at the overall level of revenue and expenditure. As the Fiscal Council did not receive updated data for the general government sector at the time when the Draft Revised Budget was submitted for assessment, it concludes that the data for 2023 included in the draft Stability Programme 2023 are also consistent with the Draft Revised Budget. Thus, all the assessments contained in the assessment of the draft Stability Programme 2023 also apply to the Draft Revised Budget.

The data in the stability programmes cover the general government sector as a whole, based on the methodology of the European System of Accounts (ESA, 2010), according to which the Fiscal Council is required to monitor compliance with the fiscal rules in accordance with Articles 3 and 15 of the ZFisP. The Government must ensure compliance with the fiscal rules by including all public finance budgets

[1] https://www.fs-rs.si/fiscal-council/co-operation/

[2] The latest applicable framework for the preparation of the general government budgets for the 2022-2024 period was published in Official Gazette No 146/2022 (assessed by the Fiscal Council in October 2022) and projected state budget expenditures of EUR 16,700 million in 2023.

[3] Fiscal Council (2023b).

[4] Government of the Republic of Slovenia (2023b).

and institutional units that constitute the general government sector. The state budget constitutes the largest unit, but still only slightly more than one third of the entire general government sector and is like other public finance budgets (social protection systems, local communities) drawn up according to the methodology of the International Monetary Fund for monitoring government financial statistics (GFS) based on the cash flow principle.[5]

In September 2022,[6] the Fiscal Council assessed that the outlook for 2023 was shrouded in extreme uncertainty and characterised by a high risk of further deterioration of the economic growth outlook, which could have significant financial implications for the financial situation of the general government sector, calling for flexible action by the Government. Thus, the exceptional circumstances allowing a temporary deviation from the medium-term fiscal balance under Article 12 of the ZFisP continue to be invoked in 2023 for a set of measures to address their consequences. For similar reasons, the European Commission, in its press release on the European Semester Spring Package, also recommended the extension of the general escape clause to 2023 at the EU level, based on the May 2022 forecast.[7]

In view of the already assessed draft Stability Programme 2023, which includes an assessment of the fiscal policy stance and an assessment of the compliance of the general government balance sheets with the fiscal rules also for 2023, the Fiscal Council at this point only provides an assessment of the realism of the Draft Revised Budget and its amendments with respect to the amended state budget for 2023 of October 2022 (hereinafter: the Budget Amendment). Therefore, the Fiscal Council does not assess in this document the compliance of the Draft Revised Budget with the fiscal rules, which is in line with the provisions of the ZFisP, due to a narrower concept and a different methodology on the basis of which the state budget is drawn up.

[5] The structure of the general government sector is available at:
http://mf.arhiv-spletisc.gov.si/si/delovna_podrocja/javne_finance/tekoca_gibanja_v_javnih_financah/sektor_drzava/ (Only in Slovene).

[6] https://www.fs-rs.si/wp-content/uploads/2022/10/Exceptional-circumstances_September-2022.pdf

[7] EU (2022).

1. Assessment of the revenue and expenditure projections in the Draft Revised Budget

Key findings

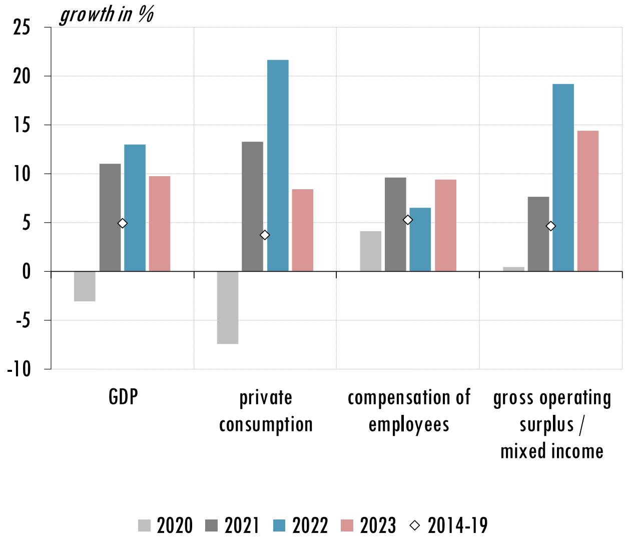
- The projected high state budget deficit (-4.5% of GDP) in 2023 is similarly driven by intervention measures and the "core" deficit, which is the only reason for the expected increase in the deficit compared to last year (by 2.2 percentage points of GDP), given the projected decline in the revenue-to-GDP ratio and the further strengthening of investment activity. As a result, the opportunity to reduce government debt through inflation will be used to a lesser extent.
- The macroeconomic background remains favourable and significantly higher than when the budget documents were drafted last year. However, the growth of tax bases is expected to slow down this year. Despite the reduction compared to the current budget, the projections for revenues from European funds remain optimistic.
- After two years of high growth, investment spending is expected to increase by more than half this year, which we consider unrealistic given the limited absorption capacity of the administration and the economy.
- Growth in "core" current spending is also expected to be significantly higher this year than its long-term average and the current estimate of medium-term economic potential growth. This is contrary to EU recommendations, but mainly reflects high inflation and, to a lesser extent, discretionary measures. Its ratio to GDP will increase slightly, despite continued high nominal GDP growth, and it will not contribute significantly to the increase in the deficit.
- The lower deficit in the Draft Revised Budget compared to the current Budget Amendment adopted last autumn is mainly due to lower expenditure related to the cost-of-living crisis, partly reflecting the new measures, but also due to more appropriate projections of certain items, the shortcomings of which were already highlighted by the Fiscal Council in the autumn.
- Budgeting remains deficient due to the inadequate classification of measures as intervention measures, insufficient assessment of the impact of discretionary measures, systematic under- or overestimation of individual revenue and expenditure categories, and uncoordinated processes for the preparation of budget documents.

Despite the expected slowdown in the growth of the nominal tax bases, the macroeconomic background for the preparation of the budget documents is more favourable than when the budget documents were drawn up last autumn. The IMAD forecast of the nominal tax bases[8] is key to the projections of tax and other cyclical government revenue[9]. While growth in most nominal tax bases is expected to slow down this year, it will remain well above the average of the pre-epidemic period, mainly due to the persistence of high inflation. Nominal GDP is expected to reach EUR 64.7

[8] IMAD (2023). The IMAD forecasts provide the basis for budgeting as laid down in the Decree on development planning documents and procedures for the preparation of the draft state budget and draft local government budgets (Official Gazette of the Republic of Slovenia, Nos 44/07 and 54/10).

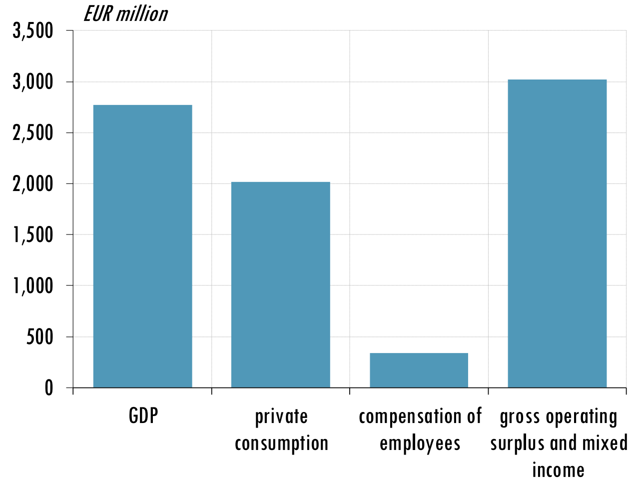
[9] For more information, see Ministry of Finance (2019).

Figure 1.1: Nominal tax bases



Source: SORS, IMAD, FC calculations.

Figure 1.2: Change in nominal tax bases forecasts for 2023 between Autumn forecast 2022 and Spring forecast 2023

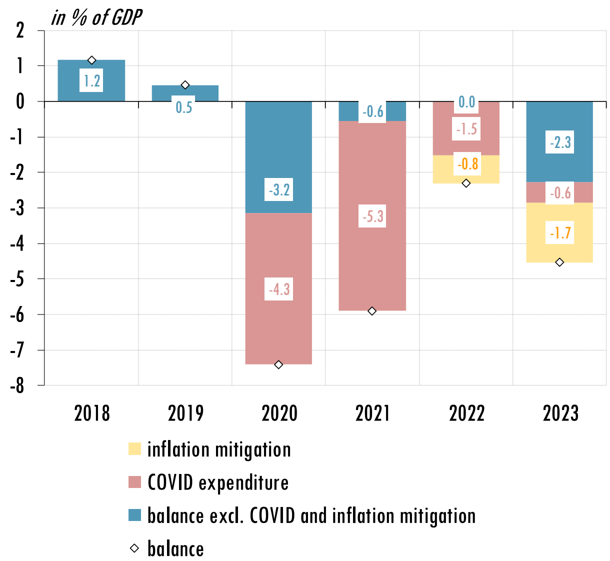


Source: IMAD, FC calcautions.

billion this year, almost a tenth or EUR 5.7 billion higher than last year and EUR 2.8 billion higher than the forecast used in the preparation of the budget documents last autumn. Most of the difference is due to an increase in nominal domestic consumption, or household consumption. Growth in the latter is projected to be the slowest of all tax bases this year, but it is still expected to be well above the average for the 2014-2019 period. Growth in gross operating surplus, which forms the basis for the corporate income tax revenue projections, is expected to remain exceptionally high. Growth in the compensation of employees is expected to pick up this year, reflecting the expected increase in wage growth due to both inflationary adjustments and labour shortages amid the increasingly pronounced impact of demographic changes.

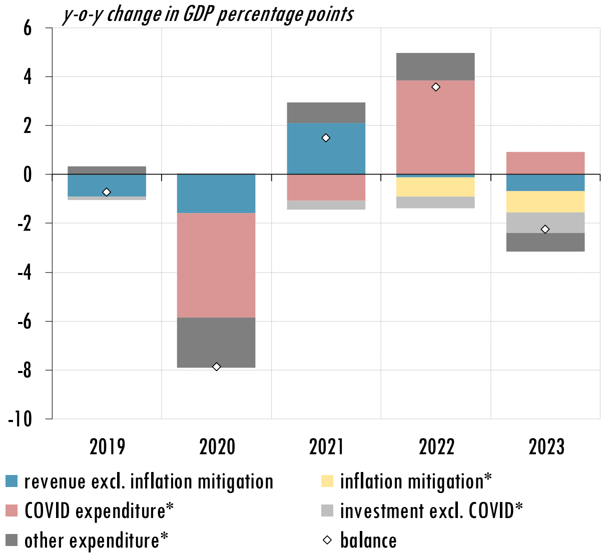
The state budget deficit is expected to increase significantly this year, largely due to a decline in the revenue-to-GDP ratio and a further strengthening of investment activity growth. According to the Draft Revised Budget, *the overall deficit* for this year is estimated at EUR -2,938 million (-4.5% of the projected GDP), which is EUR 1,574 million or 2.2 percentage points higher than last year. The measures mitigate the effects of the cost-of-living crisis are expected to contribute EUR 1,089 million to the deficit, or 1.7% of GDP, while EUR 371 million, or 0.6% of GDP, is earmarked for COVID-19 response measures (see Box 1.2). The assessment places emphasis on the *projections without taking into account the direct impact of measures to mitigate the impact of the epidemic and cost-of-living crisis,* which gives a more appropriate picture of fiscal trends. The "core" balance, which was offset last year, is projected to show a deficit of -EUR 1,478 million (-2.3 % of GDP) this year according to the Draft Revised Budget, and is therefore entirely responsible for the projected increase in the total deficit. The deterioration in the "core" balance compared to last year is expected to be largely due to a projected decline in the revenue-to-GDP ratio, in particular the tax revenue ratio, and to an even higher growth in investment activity than in the previous two years. Growth in "core" current spending, which excludes investment and interest expenditure as well as the impact of measures to mitigate the effects of the epidemic and the cost-of-living crisis, is expected to accelerate further this year, driven mainly by high inflation and also partly by discretionary measures taken since the beginning of last year. Given the continued high nominal GDP growth, its share in GDP is not expected to increase

Figure 1.3: State budget balance



Source: MoF, SORS, IMAD, FC calculations.

Figure 1.4: Factors of state budget balance change



*Source: MoF, SORS, IMAD, FC calcualtions. Note: *positive sign denotes a decrease, negative sign denotes an increase.*

significantly. Even without taking into account the large EU funds in reserve[10], growth in "core" current spending is projected to exceed the current estimates of medium-term growth in economic potential. This would also run counter to the European Commission's guidelines, which call on Member States to contain current spending growth.[11]

"Core" revenue growth is expected to be practically halved this year. Revenue growth will be lower mainly due to lower tax revenue growth, largely stemming from the forecasted lower growth in tax bases. With a projected slowdown in private consumption growth, VAT revenue growth is predicted to be around half of last year's level, while growth in excise revenue is expected to pick up slightly.[12] Growth in state budget revenue from income tax is expected to ease further, mainly due to the increase in lump-sum payments to municipalities. Corporate income tax revenue is expected to fall this year on the back of a lower settlement than last year,[13] but following the current published data on the further strengthening of corporate profit growth last year,[14] we estimate that the final outturn could be higher than projected in the Draft Revised Budget. The expected decrease in non-tax revenues stems from lower expectations for dividend income from companies in which the State has an ownership interest and the assumption of lower inflows from Treasury operations. These are difficult to estimate in advance, but in recent years revenues have been relatively high. By contrast, interest income on deposits in the Treasury Single Account (TSA) is expected to increase significantly as interest rates rise, which is another indicator of the effectiveness of the Treasury's debt management.[15]

[10] The Draft Revised Budget foresees EUR 391 million of RRP expenditures under the item "reserve". The same amount is also recorded as revenue under EU funds. These funds therefore have no impact on the projection of balance, but make a significant contribution to the projected revenue and expenditure dynamics. If this effect were eliminated from the expenditure side of the reserve, as these funds are mainly recorded as investments when actually realised, growth in "core" current spending would be 11.0% instead of 14.8%. This would still be well above the current estimate of medium-term growth in economic potential (6.2%).

[11] European Commission (2023).

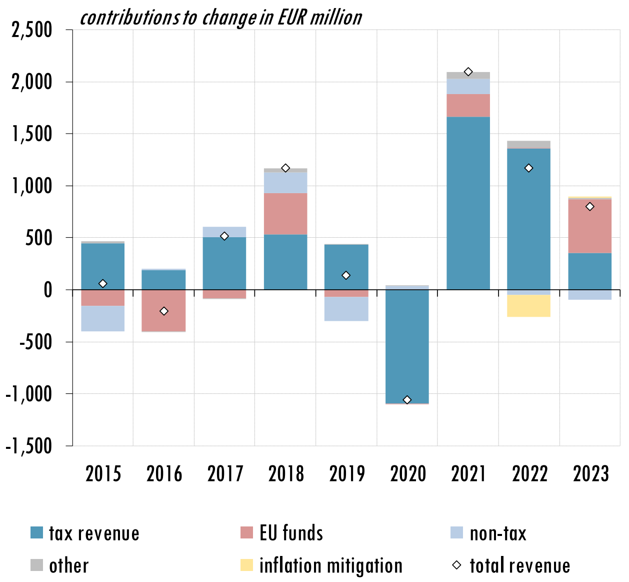
[12] Excise duties on motor oils were increased in January, and excise duties on tobacco products will be further increased in May and November, following the increase in April. The increase will also be affected by the delayed payment of excise duties granted last year to a larger taxpayer, according to the explanatory memorandum to the Draft Revised Budget.

[13] In fact, the corporate income tax revenue in a given year largely depends on the business performance of companies in the previous year. In the spring months, after submitting the business reports, the liabilities for the previous year are settled and an advance payment is made based on the previous year's actual business. Last year's settlement payment was a record high (EUR 350 million), but this year it is expected to be much lower (EUR 116 million), according to the estimates of the Ministry of Finance.

[14] According to the Statistical Office of the Republic of Slovenia (hereinafter: the Statistical Office), growth in gross operating surplus further strengthened from 7.6% in 2021 to 19.2%, and its share in GDP reached an all-time high (38.9%).

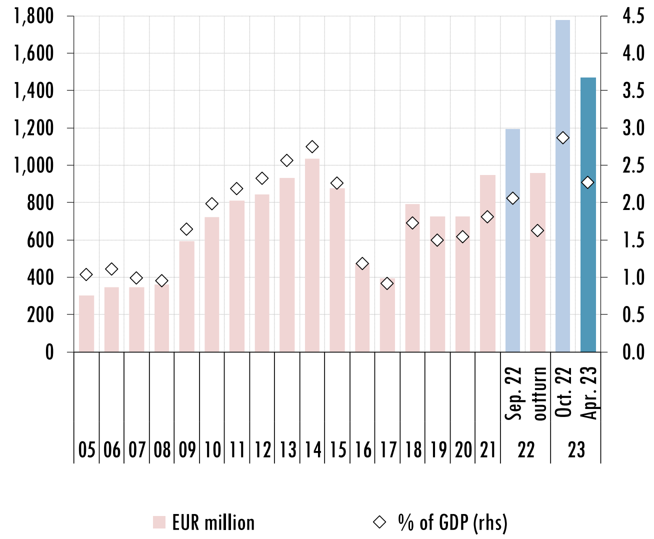
[15] The large liquidity reserve, which amounted to EUR 8.9 billion at the end of March (13.7% of the projected GDP), not only strengthens the resilience of the state budget to the tightening of financial markets amid the current rise in interest rates, but also has a positive impact on higher budget revenues.

Figure 1.5: State budget revenue change



Source: MoF, FC calculations.

Figure 1.6: State budget receipts from the EU budget



Source: SORS, MoF, IMAD, FC calculations.

The key factor behind the projected revenue growth this year is the projections of the EU funds received, which remain optimistic according to the Fiscal Council's assessment, despite the reduction compared to the current budget. Revenue from the EU funds is expected to increase by more than half this year to reach EUR 1.5 billion, almost EUR 0.5 billion more than the all-time high in 2014. Despite the downward revision compared to last autumn's Budget Amendment, we still consider the projection to be overestimated. The high level of envisaged EU funds is mainly due to the closure of the 2014–2020 financial framework, from which another EUR 960 million is planned, of which around EUR 600 million is still available from Cohesion Policy funds. The projections also include EUR 105 million of funding from the new 2021-2027 financial framework, of which around a quarter will come from the Cohesion Policy funds, according to the programme's implementation plan.[16] A total of EUR 391 million is foreseen from the Recovery and Resilience Plan (hereinafter: the RRP). This year, before the assessment of the Draft Revised Budget, Slovenia has received EUR 50 million of the first instalment of the grant under the RRP, which was already foreseen last year. However, the remaining two instalments of the grant and the first instalment of the reimbursable funds, which were also scheduled for last year according to the initial time frame, have been subject to significant delays in meeting the milestones for the disbursement of funds.[17]

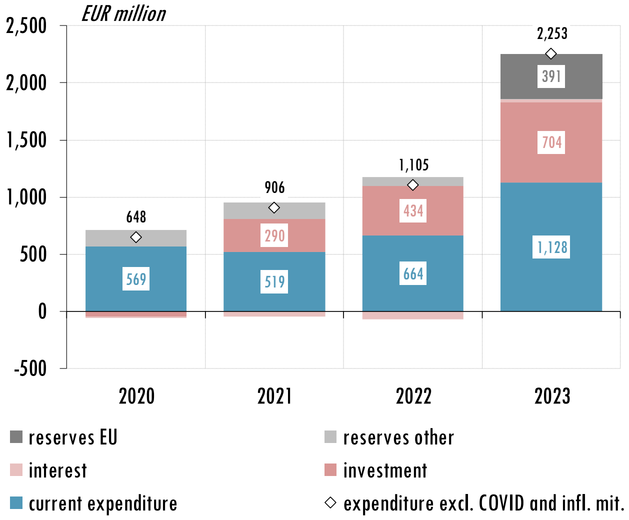
High expenditure growth, excluding the direct effect of measures in response to the epidemic and the cost-of-living crisis, will continue this year. Under the Draft Revised Budget, "core" expenditure is projected to increase by 17.9% this year, largely on the back of a reserve amounting to EUR 1.0 billion. The largest part of this is European funds under the RRF (EUR 391 million), which we estimate that will not be spent in the foreseen amount.[18] Some two thirds of this growth is expected to come from higher current spending, including the reserve, and one third from the further strengthening of high investment activity.

[16] The Ministry of Cohesion and Regional Development (2023).

[17] The Office of the Republic of Slovenia for Recovery and Resilience (2022).

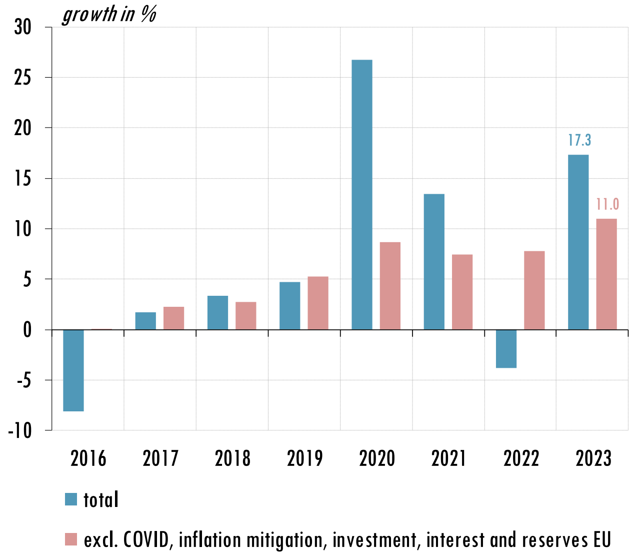
[18] The remainder of the reserve (EUR 566 million), which is at a similar level as last year, comprises EUR 247 million for the current budget reserve, almost EUR 300 million for various budget funds, EUR 10 million for natural disasters and EUR 10 million for the contingency reserve managed by the SID Bank.

Figure 1.7: Factors of state budget expenditure change (excluding COVID and inflation mitigation)



Source: MoF, FC calculation.

Figure 1.8: State budget expenditure



Source: MoF, FC calcualtions.

After two years of high growth, investment spending is expected to increase by more than half this year, which we consider unrealistic given the limited absorption capacity of the administration and the economy. Investment expenditure is projected to increase by almost EUR 800 million compared to 2022. The realisation of the investment expenditures foreseen in the state budget would imply that they would represent 3.8% of GDP, which is almost twice the long-term average. The investment expenditure projection is again assessed as unrealistically high,[19] on the back of the optimistic assumptions about projects financed by European funds and the limited absorption capacity of the economy.[20] The European Commission has called for the level of domestically-financed investment to be maintained, but also for its effective implementation.[21] In the current macroeconomic environment, the rapid increase in public investment increases the risk of inefficiencies[22] and contributes to the persistence of high inflation and low multiplier effects. According to the Fiscal Council, having an improved investment planning system would make an important contribution to increasing the transparency and reliability of budget plans without jeopardising the realisation of investment projects.

Growth in "core" ***current spending*** **is also projected to be significantly higher this year than its long-term average and the estimate of medium-term economic potential growth.** For a proper analysis of the current spending projection, it is appropriate this time to deduct from the total expenditure, in addition to the direct effect of the measures in response to the epidemic and the cost-of-living crisis and investment and interest expenditure, EUR 391 million of European funds under the RRP, which are held in reserve under the Draft Revised Budget. We estimate that these assets will not be fully realised, while the bulk of what will actually be realised will be recorded as investments. It would therefore not be appropriate to include this part of the reserve in the analysis of current

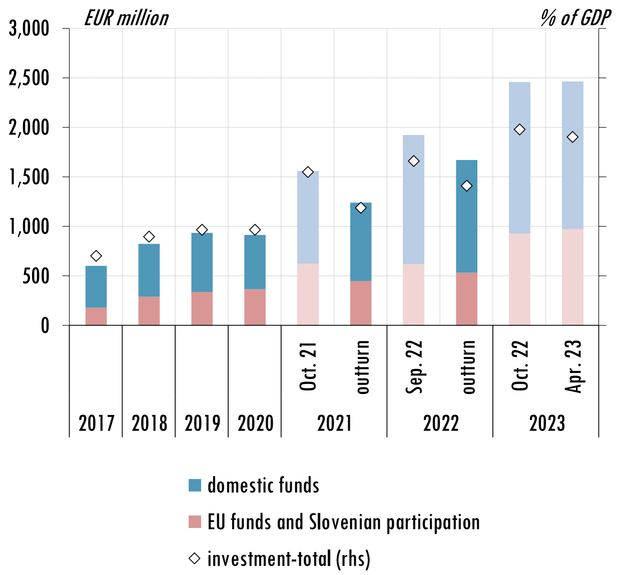
[19] In the last two years, investment plans have increased significantly, but their implementation has fallen noticeably behind. In 2021, the actual outturn was 37% below the autumn 2020 plans and one fifth below the autumn 2021 plans, i.e. three months before the end of the year. Similarly, last year's outturn was a quarter lower than the autumn 2021 projection and 13% lower than envisaged in the revised budget three months before the end of the year.

[20] More than half of construction firms reported a shortage of labour as the main constraint on their activity, which is the highest share among all sectors and the highest level since 2007.

[21] European Commission (2023).

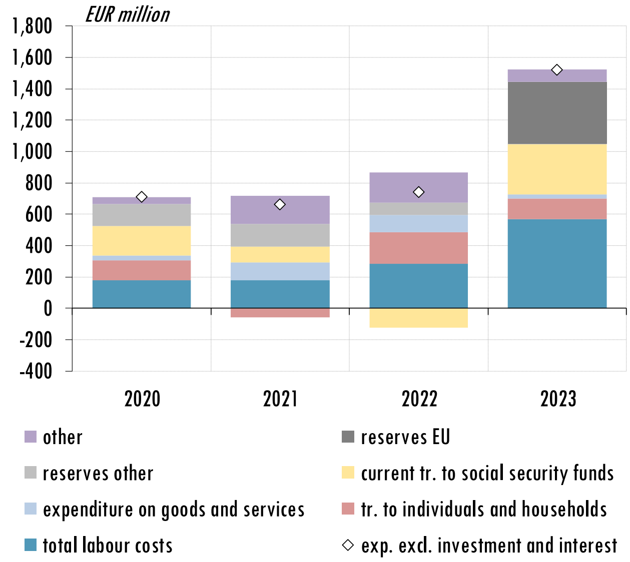
[22] In recent years, the Fiscal Council has repeatedly warned of the risks posed by a sharp surge in public investment. For more information, see the Fiscal Council (2020, 2021).

Figure 1.9: State budget investment expenditure



Source: MoF, SORS, IMAD, FC calculations.

Figure 1.10: Factors of current expenditure change (excluding COVID and inflation mitigation)



Source: MoF, FC calculations.

spending. After all these adjustments, growth in current spending is thus projected to increase to 11.0% this year, well above its long-term average and about twice the current estimate of medium-term growth in economic potential. Half of this growth will come from higher labour costs[23], largely as a result of the agreement reached with the trade unions last autumn.[24] We believe that the projection implies higher growth than would be justified by the agreement reached and taking into account the effect of regular promotions and employment growth. This applies in particular to the planned transfers to public institutions to cover labour costs. The other key driver of the projected increase in current spending is transfers to the social security funds. These are projected to increase by around a quarter due to a significant increase in transfers to the Health Insurance Institute of Slovenia. The latter is expected to surge from around EUR 100 million last year to over 400 million this year, excluding the impact of the COVID-19 response measures.[25] Part of the increase is due to the effect of the Emergency Measures to Ensure the Stability of the Healthcare System Act,[26] part due to the coverage of increased costs of sickness benefits,[27] while a significant part of the remaining increase, according to our estimates, is related to the increase in wages in certain parts of the healthcare sector, which was financed last year as part of the COVID-19 response measures.[28] The inappropriate classification of this expenditure has been regularly highlighted by the Fiscal Council,[29] as it is a clear example of a quasi-intervention measure that is in fact structural in nature and will continue to be a burden on public finances in the future. Transfers to individuals and households, which were underestimated in last year's revised budget in line with our expectations, are projected to increase by about half of last year's level, with the projection mainly reflecting the statutory adjustment of the level of transfers to last

[23] State budget expenditure on wages and social contributions, including transfers to public institutions for this purpose.

[24] Official Gazette (2022a).

[25] According to the financial plan of the Health Insurance Institute of Slovenia, the revenue from transfers from the state budget is expected to amount to EUR 419 million this year.

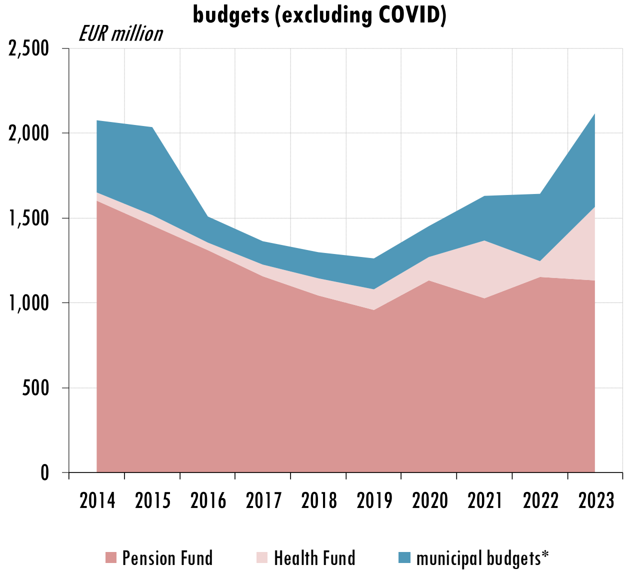
[26] It follows from the proposed Act that the financial impact is expected to increase by about EUR 80 million this year.

[27] Article 79 of the Implementation of the Republic of Slovenia Budget for 2023 and 2024 Act (ZIPRS2324) stipulates that the state budget shall provide the Health Insurance Institute of Slovenia with funds for the compensation paid during temporary absence from work exceeding the amount of compensation paid in 2019.

[28] These are the obligations under Article 80 of the Additional Measures to Prevent the Spread of, Mitigate, Control, Ensure Recovery and Remedy the Consequences of COVID-19 Act (ZDUPŠOP), which stipulates in its paragraph two that the state budget shall cover the increased liabilities of the Health Insurance Institute of Slovenia as a result of salary increases for individual occupational groups in the healthcare sector.

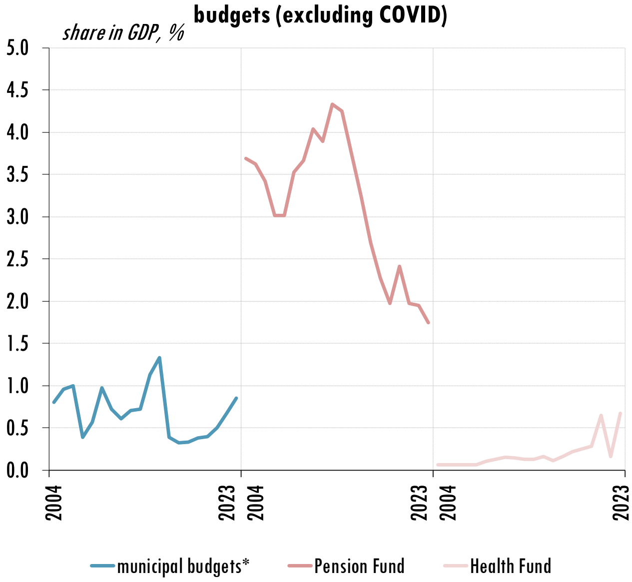
[29] Fiscal Council (2021, Box 2.3).

Figure 1.11: State budget transfers to other public finance budgets (excluding COVID)



*Source: MoF, FC calcualtions. Note: * current and capital transfers.*

Figure 1.12: State budget transfers to other public finance budgets (excluding COVID)



Source: MoF, SORS, IMAD, FC calculations. Note: current and capital transfers.*

Table 1.1: State budget

	2022 (outturn) EUR million				2023 (Revised budget proposal) EUR million				2023/2022 in %		2023/2022 EUR million	
	total	COVID	inflation mitig.	ex. COVID and infl. mitig.	total	COVID	inflation mitig.	ex. COVID and infl. mitig.	total	ex. COVID and infl. mitig.	total	ex. COVID and infl. mitig.
Revenue	**12,345**		**-217**	**12,562**	**13,144**		**-202**	**13,346**	**6.5**	**6.2**	**799**	**784**
VAT	4,747		-58	4,805	5,082		-73	5,155	7.1	7.3	335	349
Excise duties	1,446		-99	1,545	1,606		-33	1,639	11.1	6.1	160	94
Personal income tax	1,586			1,586	1,625			1,625	2.5	2.5	39	39
Corporation tax	1,553			1,553	1,415			1,415	-8.9	-8.9	-138	-138
Receipts from the EU budget	957			957	1,470			1,470	53.5	53.5	513	513
Non-tax revenues	770			770	672			672	-12.7	-12.7	-98	-98
Other	1,284		-60	1,344	1,274		-96	1,370	-0.8	1.9	-11	25
Expenditure	**13,709**	**885**	**253**	**12,570**	**16,082**	**371**	**887**	**14,824**	**17.3**	**17.9**	**2,374**	**2,253**
Total labour costs	3,751	37		3,714	4,328	40	3	4,285	15.4	15.4	577	571
Tr. to individuals and households	1,965	134	104	1,727	1,897	11	29	1,858	-3.4	7.6	-67	131
Expenditure on goods and services	1,526	156		1,370	1,416	19		1,397	-7.2	1.9	-111	26
Investment	1,669	55		1,614	2,465	147		2,318	47.7	43.6	796	704
Current tr. to social security funds	1,526	279		1,246	1,565	0		1,565	2.6	25.6	40	319
Subsidies	632	51	150	432	856	97	349	409	35.3	-5.2	223	-22
Interest	655			655	681			681	3.9	3.9	26	26
Payments to the EU budget	730			730	730			730	0.1	0.1	1	1
Reserves	561			561	1,460		503	957	160.2	70.6	899	396
Other	694	172		522	685	58	3	624	-1.3	19.5	-9	102
Expenditure excl. invest. and interest	*11,385*	*830*	*253*	*10,302*	*12,937*	*225*	*887*	*11,825*	*13.6*	*14.8*	*1,552*	*1,524*
Balance	**-1,364**	**-885**	**-470**	**-8**	**-2,938**	**-371**	**-1,089**	**-1,478**			**-1,574**	**-1,470**
Balance (in % of GDP)	**-2.3**	**-1.5**	**-0.8**	**0.0**	**-4.5**	**-0.6**	**-1.7**	**-2.3**			**-2.2**	**-2.3**

Source: MoF, SORS, IMAD, FC calculations.

year's inflation. Growth in expenditure on goods and services is predicted to slow considerably this year to be about five times less than in the previous two years. The overall projected slowdown is based on the assumption of a significant drop in transfers to public institutions for this purpose, which in our assessment is not realistic.[30]

The Draft Revised Budget foresees a significant increase in transfers from the state budget to other public finance budgets this year, which limits the central government's room for manoeuvre in performing its tasks due to the structural nature of many transfers. Transfers to municipalities[31] and social security funds are expected to increase by almost 30% in total this year, accounting for 14.3% of the total "core" state budget expenditure, or 3.3% of GDP. With the exception of last year, there has been a visible increase in transfers since 2020. Higher transfers to municipalities are partly due to the adoption of the Municipal Costs Reduction Act,[32] and partly to higher investment transfers in connection with the closure of the EU 2014-2020 Multiannual Financial Framework. Large transfers to the Health Insurance Institute are associated with the adoption of a number of discretionary legislative measures, and with the announced reforms in the healthcare sector we estimate that social contributions will continue to be insufficient to cover the liabilities of the Health Insurance Institute. The nominal volume of transfers to the Pension and Disability Insurance Institute of Slovenia, however, has been at a similar level since 2017, reflecting favourable labour market conditions and the resulting relatively high level of social contributions paid. As a share of GDP, the decrease in transfers to the Pension and Disability Insurance Institute is the main reason why, despite its increase since the beginning of the epidemic (by 0.7 percentage points of GDP), total transfers from the state budget to other public finance budgets are lower than they were less than a decade ago, but will also increase in the medium term due to demographic changes. The introduction of new statutory and consequently structural transfers from the state budget to other budgets thus increasingly limits the central government's room for manoeuvre in performing its tasks.

[30] Transfers to public institutions for goods and services (excluding the impact of COVID-19 response measures) are expected to fall by a third this year to their lowest level since 2004.

[31] Current and investment transfers.

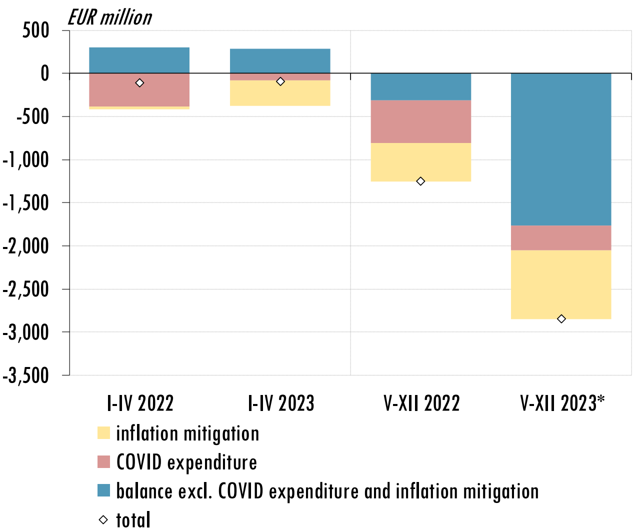
[32] Official Gazette (2020).

Box 1.1: The state budget outturn January–April 2023

In the first four months of the year, the state budget recorded a deficit (-EUR 93 million) and a surplus (EUR 283 million) excluding the impact of expenditure to contain the epidemic and the measures to ease the cost-of-living crisis. Total revenue in the first four months of this year was 1.1% higher on a year-on-year basis, particularly due to higher VAT and excise duty revenue. VAT revenue growth has stabilised in recent months at a lower level than last year, while excise duty revenue growth is strengthening as a result of an increase in excise duties on motor fuel and tobacco products. After four months, revenue from EU funds and non-tax revenue remained down year-on-year. Total expenditure in the first four months of this year was up 0.7% year-on-year, while "core" expenditure, which excludes COVID-19 response measures and measures to ease the cost-of-living crisis, increased by 4.5%, mainly reflecting higher expenditure on labour costs (10.1%) as a result of the wage increase agreement reached last autumn. Its growth is expected to strengthen further in the coming months due to the second tranche of higher wage payments agreed for April. Growth in "core" expenditure was further boosted to the same extent (1.2 percentage points) by higher investment expenditure amid a continuation of relatively high investment activity and, following the high growth in March, by higher expenditure on transfers to social security funds.[1] Transfers to individuals and households and expenditure on goods and services were also higher than in the same period of the previous year. Growth in "core" spending was constrained by lower year-on-year expenditure on subsidies, payments to the EU budget and other expenditure.[2]

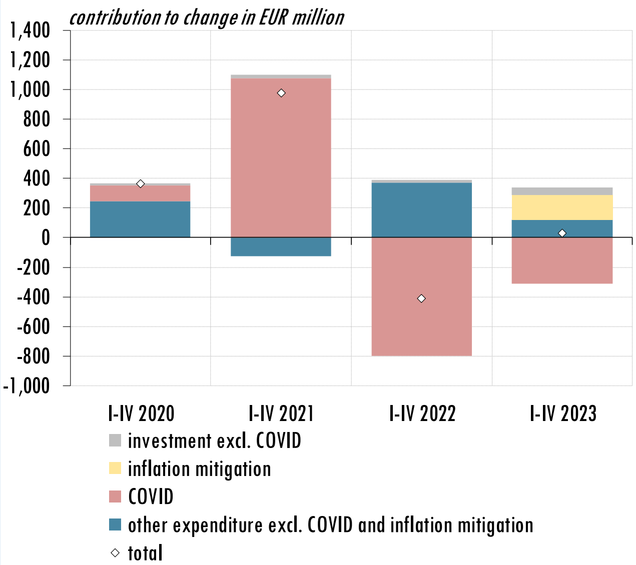
The state budget expenditure on COVID-19 response measures amounted to EUR 77 million in the first four months of this year, while the impact of the measures to ease the cost-of-living crisis amounted to EUR 298 million. The bulk of this year's COVID-19-related expenditure incurred so far includes expenditure related to wage compensation due to isolation (EUR 39 million) and expenditure related to vaccination costs (EUR 23 million). Among the measures to ease the cost-of-living crisis, the Ministry of Finance estimates that maintaining the current level of reduced excise duties, the lower VAT rate on energy products and the CO_2 tax exemption reduced revenues by EUR 133 million. Expenditure to ease the cost-of-living crisis in the same period totalled EUR 165 million, the bulk of which (EUR 104 million) was in the form of subsidies to businesses under Article 14 of the Act Regulating the Aid to Businesses to Mitigate the Impact of the Energy Crisis (ZPGOPEK).

Figure 1: State budget balance



*Source: MoF, FC calculations. Note: *implictly calculated based on Proposed revised budget (Apr. 23).*

Figure 2: Structure of state budget expenditure growth



Source: MoF, FC calculations.

[1] Starting with the March outturn, the daily data on transfers to the Health Insurance Institute of Slovenia (ZZZS), which according to the final data were the main reason for the surge in total transfers to the social security funds in March, are no longer available on https://proracun.gov.si/ (Only in Slovene).

[2] Due to the effect of last year's high base. The RRP funds received in January last year were transferred to the budget fund and were at the same time recorded as reserve expenditure on the expenditure side.

Box 1.2: Measures to mitigate the effects of the epidemic and the cost-of-living crisis

After three years of high expenditure to mitigate the impact of the epidemic, this year's expenditure is expected to decrease significantly, and what stands out in our assessment of the Draft Revised Budget is the inappropriate classification of projects as part of this expenditure. After reaching EUR 5.7 billion in the 2020-2022 period, the state budget expenditure to mitigate the impact of the epidemic will fall to EUR 371 million this year, according to the Draft Revised Budget. Taking into account the outturn in the first three months of this year (EUR 58 million), we estimate that the actual outturn will be lower year-on-year. Of the actual measures taken to mitigate the impact of the epidemic, the bulk of the expenditure is expected to be spent on the purchase of vaccines, vaccination, the payment of compensation for self-isolation (although this measure expired on 31 March), and investments in the healthcare and social sectors. Throughout the duration of the measures, the Fiscal Council drew attention to the inappropriate classification of some of the measures as intervention expenditure to mitigate the impact of the epidemic, while what is of particular note is the EUR 64 million foreseen in the Draft Revised Budget for investments in tourism infrastructure.[1] These are to be funded under the European ReactEU programme, which aims, among other things, to improve capacities in response to health crises, and to contribute to economic recovery, but such projects are not, in our view, directly related to the epidemic.

Expenditure to ease the cost-of-living crisis is expected to increase significantly this year, with the bulk of it going on subsidies to businesses. The state budget expenditure to ease the cost-of-living crisis is expected to rise from EUR 253 million last year to EUR 887 million this year, according to the Draft Revised Budget. While last year's expenditure was similarly focused on transfers to the most vulnerable groups and on subsidies to the economy and agriculture, this year's expenditure will be predominately earmarked for subsidies to businesses. In addition to the expenditure estimates for individual measures, the Draft Revised Budget also includes a reserve of EUR 503 million for the cost-of-living crisis. Compensation to electricity and natural gas suppliers, estimated by the Government at approximately EUR 300 million,[2] is not included in the individual measures. Consequently, we estimate that the actual reserve amounts to about EUR 200 million. In addition to expenditure, measures with an impact on the revenue side (a lower VAT rate on energy products, lower excise duties, exemption from the environmental tax on air pollution from carbon dioxide emissions) also have an impact on the state budget accounts. Their impact is estimated by the Ministry of Finance to be similarly negative this year as last year (about EUR 200 million). The Government also extended administratively reduced electricity and natural gas prices for various users until the end of the year.[3] The Fiscal Council assesses

Table 1: State budget expenditure to mitigate the impact of the epidemic

in EUR million	Revised budget 23 (April 23)	Outturn January–April 23
Vaccines	40	5
Vaccination	35	9
Testing	8	3
Wage compensation for self-isolation (Article 17 of the ZNUNBZ)[1]	52	32
Investment-healthcare infrastructure	29	1
Investment-long-term care	63	3
Investment-tourism infrastructure	64	0
Other	80	5
TOTAL	**371**	**58**

Source: Ministry of Finance; FC calculations. Notes: [1] The measure was in force until 31 March 2023.

[1] NRP 2023-2026 (2023).

[2] Government of the Republic of Slovenia (2023a).

[3] Official Gazette of the Republic of Slovenia (2023).

Table 2: State budget expenditure to ease the cost-of-living crisis

in EUR million	Revised budget 23 (April 23)	Outturn January-April 23
Aid to businesses, temporary lay-off, reduced working hours (ZPGOPEK)	318	79
Aid to businesses (ZPGVCEP)	22	22
Inflation allowance for children (ZZUODOD)	20	20
Aid to agriculture	9	
School meals, residence halls for upper secondary and tertiary students (ZIUVI)	7	3
Co-financing of the costs of services to social care providers (ZNUPPU)	6	6
Energy allowance for the most vulnerable	2	2
Reserve[1]	503	
TOTAL	**887**	**130**

Source: Ministry of Finance; FC calculations. Notes:[1] On 23 March, the Government estimated that compensation for electricity and gas suppliers would amount to EUR 296 million. Consequently, we estimate that the actual reserve amounts to about EUR 200 million.

that the war in Ukraine has accelerated structural changes in energy prices and recalls the view of all relevant international institutions (the EC, IMF, and OECD) that a market-based mechanism for energy prices should be restored, also with a view to promoting the green transition. Following extensive government action during the last two crises, the private sector should also bear most of the burden of adjusting to higher energy prices. The existence of room for manoeuvre for this is indicated, among other things, by last year's historically high gross-operating-surplus-to-GDP ratio.

Box 1.3: A comparison of the 2023 Draft Revised Budget (April 2023) and the 2023 Budget Amendment (October 2022)

The lower overall deficit in the Draft Revised Budget compared to the current Budget Amendment adopted last autumn is mainly due to lower expenditure related to the cost-of-living crisis, partly reflecting the new measures, but also due to more appropriate projections of certain items, the shortcomings of which were already highlighted by the Fiscal Council.[1] According to the Draft Revised Budget, the overall deficit is expected to be lower by EUR 376 million this year. The impact of the measures to ease the cost-of-living crisis is expected to be lower by EUR 330 million and the expenditure to contain the epidemic by EUR 74 million. In both cases, the reduction is mainly due to the lower reserve set aside for this purpose. In the case of measures to soften the blow of the cost-of-living crisis, almost half of the reduction in the reserve was offset by an increase in subsidies, as the impact of the aid to the economy under the Act Regulating the Aid to Businesses to Mitigate the Impact of the Energy Crisis (ZPGOPEK) is already known when the Draft Revised Budget is being prepared. The impact on revenue will also be more negative, as the suspension of the tax on CO_2 emissions has been extended until September this year.[2] The "core" deficit, which excludes the impact of the measures in response to the epidemic and the cost-of-living crisis, is not significantly different under the Draft Revised Budget than in the autumn, but there are significant differences in individual items.

Table 1: A comparison of the 2023 Draft Revised Budget and the 2023 Budget Amendment

	Oct. 22 EUR million				Apr. 23 EUR million				Apr. 23 - Oct. 22 EUR million			
	total	COVID	inflation mitig.	ex. COVID and infl. mitig.	total	COVID	inflation mitig.	ex. COVID and infl. mitig.	total	COVID	inflation mitig.	ex. COVID and infl. mitig.
Revenue	**13,377**		**-120**	**13,497**	**13,144**		**-202**	**13,346**	**-233**		**-82**	**-151**
VAT	5,038		-72	5,110	5,082		-73	5,155	44		-1	45
Excise duties	1,452		-48	1,500	1,606		-33	1,639	154		15	140
Personal income tax	1,719			1,719	1,625			1,625	-94			-94
Corporation tax	1,516			1,516	1,415			1,415	-101			-101
Receipts from the EU budget	1,778			1,778	1,470			1,470	-308			-308
Non-tax revenues	542			542	672			672	130			130
Other	1,332		0	1,332	1,274		-96	1,370	-59		-96	37
Expenditure	**16,691**	**445**	**1,299**	**14,947**	**16,082**	**371**	**887**	**14,824**	**-609**	**-74**	**-412**	**-123**
Total labour costs	4,180	10		4,170	4,328	40	3	4,285	148	30	3	115
Tr. to individuals and households	1,864	9	49	1,806	1,897	11	29	1,858	33	1	-20	52
Expenditure on goods and services	1,411	70		1,342	1,416	19		1,397	4	-51		55
Investment	2,452	143		2,309	2,465	147		2,318	12	4		8
Current tr. to social security funds	1,844			1,844	1,565	0		1,565	-278	0		-279
Subsidies	502	62	40	399	856	97	349	409	354	35	309	10
Interest	646			646	681			681	35			35
Payments to the EU budget	654			654	730			730	76			76
Reserves	2,494	60	1,210	1,224	1,460		503	957	-1034	-60	-707	-267
Other	645	91		554	685	58	3	624	41	-33	3	71
Expenditure excl. invest. and interest	*13,593*	*302*	*1,299*	*11,992*	*12,937*	*225*	*887*	*11,825*	*-656*	*-78*	*-412*	*-166*
Balance	**-3,314**	**-445**	**-1,419**	**-1,450**	**-2,938**	**-371**	**-1,089**	**-1,478**	**376**	**74**	**330**	**-28**
Balance (in % of GDP)	**-5.3**	**-0.7**	**-2.3**	**-2.3**	**-4.5**	**-0.6**	**-1.7**	**-2.3**	**0.8**	**0.1**	**0.6**	**0.1**

Source: MoF, SORS, IMAD, FC calculations.

***"Core" revenue* for this year is expected to be EUR 151 million lower than forecast in the autumn.** This is largely due to a downward revenue forecast for EU funds, which the Fiscal Council assessed in the autumn as having been too optimistic. The downward revision of the Cohesion Policy revenue forecast of the new EU 2021-2027 Multiannual Financial Framework has been expected, while the RRP funds have remained unchanged and, with delays in meeting milestones, in our assessment remain optimistic. The lower revenue from the corporate income tax is projected to be mainly due to the expected lower settlement for the previous year, while the lower revenue from personal income tax is due to the agreement on the increase in the lump sum payments and thus a higher share of the personal income tax allocated to municipalities. We also note that the lower projection for personal income tax is also due to the correction of unrealistic assumptions for receipts of income from self-employment based on flat rate expenses and for rental income. By contrast, the Draft Revised Budget foresees higher excise duty revenues than in the autumn, due to the increase in excise duties on motor oils and tobacco products and the effect of the authorised instalment payment of excise duties to a larger taxable person. The same applies to non-tax revenues, which will be higher this year than expected in the autumn, due to high interest income on deposits in the Treasury Single Account (TSA) as interest rates rise.

The *"core" expenditure* in the Draft Revised Budget is projected to be EUR 123 million lower than in the autumn forecast. The largest decreases were in the projections for transfers to social security funds and reserves. Transfers to the social security fund will be lower partly due to lower additional transfers to the Pension and Disability Insurance Institute of Slovenia (ZPIZ) as a result of favourable labour market conditions and partly due to the correction of an unrealistic projection of the transfers to the Health Insurance Institute of Slovenia (ZZZS) to cover the salaries of trainees, interns, and specialist trainees, which had already been discontinued in the course of the previous year. The decrease in the reserve is due to the withdrawal of the EU 2021-2027 Multiannual Financial Framework funds from the reserve and a reduction in the funds for natural disasters. On the other hand, the projection for labour costs has increased, reflecting the recognition of the impact of the wage agreement on wage transfers to public institutions, whereas this impact on labour costs in the state budget was already recognised in the autumn of last year. Payments to the EU budget are also expected to be higher than in the autumn forecast, largely due to a revised estimate of the volume of customs duties collected, as well as transfers to individuals and households and expenditure on goods and services, which the Fiscal Council assessed as underestimated in the autumn.

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[1] Fiscal Council (2022).

2 According to the Ministry of Finance, this could not be foreseen when the Budget Amendment was drawn up.

2. The compliance of the Draft Revised Budget with other budget documents and fiscal rules

The projected state budget expenditure is lower than that in the current framework for drafting general government budgets, and the consistency of the current budget documents cannot be fully verified. At the time of receiving the Draft Revised Budget for its assessment, the Fiscal Council had not received the revised framework for drafting the general government budgets. The current framework for drafting the general government budgets, which includes 2023, was adopted in November 2022,[33] and the proposed framework was assessed by the Fiscal Council in October 2022.[34] The framework increased the state budget ceiling by around EUR 3.3 billion compared to the previous framework of September 2022. In assessing the draft framework, which was indicative for 2023 due to the existence of exceptional circumstances, the Fiscal Council drew particular attention to the uncertainties associated with determining the cyclical position of the economy, the high reserve and the relatively high overshooting of the sum of the increased expenditure ceilings on the individual public finance budgets in view of the change in general government expenditure. The expenditure foreseen in the Draft Revised Budget for 2023 is EUR 600 million lower than in the current framework. The comparison of the growth of revenue and expenditure and their individual components in the Draft Revised Budget with those for the general government sector in the projections of the Stability Programme 2023 suggests some similarities, but also a number of deviations, although methodological differences and differences in institutional coverage do not allow conclusions to be drawn as regards the consistency of the projections in the two documents.

The Fiscal Council does not directly assess the compliance of the state budget with the fiscal rules, and the high level of expenditure limits the room for manoeuvre of fiscal policy in the coming years. The compliance of the Draft Revised Budget with the fiscal rules has been indirectly assessed by the Fiscal Council as part of the assessment of the general government balance sheets in the Stability Programme 2023, which covered the 2023-2026 period.[35] The Fiscal Council assumes that the Draft Revised Budget and the Stability Programme 2023 are consistent, as it did not receive, upon receipt of the Draft Revised Budget, any revised general government projections for 2023 in relation to the Stability Programme 2023 for the assessment thereof. At the time of the assessment of the Stability Programme 2023, most of the indicators used pointed to a deviation in fiscal policy from compliance with the fiscal rules in 2023 with the expansionary fiscal policy stance mainly driven by increased investment activity. Part of the deviation from the fiscal rules was also attributable to high inflation this year and the previous year, as, for example, growth in net domestic primary general government expenditure did not exceed the estimated nominal potential output growth in 2023. Against this background, the deviations in 2023 are slightly lower for most indicators than in 2022, when exceptional circumstances also applied. It should be added that the assessment of compliance with the fiscal rules during a period of exceptional circumstances is particularly uncertain due to the volatility of the input data, especially when the estimates refer to only one year. Nevertheless, it should also be noted that the set high level of government expenditure in 2023 and the declining cyclical revenue-to-GDP ratio also contribute significantly to the limited room for manoeuvre for additional fiscal policy measures in the coming years.

[33] Official Gazette (2022b).

[34] Fiscal Council (2022).

[35] Fiscal Council (2023b).

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