REPUBLIC OF SLOVENIA
FISCAL COUNCIL

Assessment of budgetary documents for 2024 and 2025

(Proposed Ordinance amending the Ordinance on the framework for the preparation of the general government budgets for the 2022–2024 period, Proposed Ordinance amending the Ordinance on the framework for the preparation of the general government budgets for the 2024–2026 period, Draft Amending Budget of the Republic of Slovenia for 2024 and Draft Budget of the Republic of Slovenia for 2025)

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This assessment is based on the Draft Amending Budget of the Republic of Slovenia for 2024, the Draft Budget of the Republic of Slovenia for 2025, the Proposed Ordinance amending the Ordinance on the framework for the preparation of the general government budgets for the 2022–2024 period and the Proposed Ordinance amending the Ordinance on the framework for the preparation of the general government budget for the 2024–2026 period (received between 29 September and 5 October 2023). Data available up to and including 11 October 2023 were used. On 12 October 2023, the Government took note of the Draft Budget Plan of the General Government Sector for 2024. The data contained therein are identical to the data under the ESA 2010 methodology received by the Fiscal Council from the Ministry of Finance on 5 October 2023.

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List of abbreviations

AMECO – Annual macro-economic database of the European Commission

BQ – Blanchard-Quah

COVID – Coronavirus disease

GDP – gross domestic product

CPI – Consumer Price Index

DZ RS – National Assembly of the Republic of Slovenia

EC – European Commission

ECB – European Central Bank

EFB – European Fiscal Board

EIB – European Investment Bank

EIOPA – European Insurance and Occupational Pensions Authority

EM-DAT – The Emergency Events Database (Centre for Research on the Epidemiology of Disasters)

ESA – European System of Accounts

EU – European Union

EU IFI – The EU Independent Fiscal Institutions Network

EUR – euro

FC – Fiscal Council

FRA – Fiscal Rule Act

HP – Hodrick-Prescott

IER – Institute for Economic Research

IMAD – Institute of Macroeconomic Analysis and Development

IMF – International Monetary Fund

max E – maximum general government expenditure

MFF – Multiannual Financial Framework

MoF – Ministry of Finance

MTO – medium-term budgetary objective under the European Commission rules

OBR – Office for Budget Responsibility

OECD – Organisation for Economic Cooperation and Development

OG – Official Gazette of the Republic of Slovenia

PDNA – Post-Disaster Needs Assessment

p.p. – percentage point

REACT-EU – Recovery Assistance for Cohesion and the Territories of Europe

RRP – Recovery and Resilience Plan

SORS – Statistical Office of the Republic of Slovenia

SP – Stability Programme

URSOO – The Office of the Republic of Slovenia for Recovery and Resilience

USD – US dollar

VAT – Value Added Tax

ZIUOPZP – Act Determining Intervention Measures for Recovery from the Floods and Landslides of August 2023

ZOPNN – Natural Disaster Recovery Act

ZPIZ – Pension and Disability Insurance Institute

ZZZS – Health Insurance Institute

EXECUTIVE SUMMARY

The budgetary documents submitted indicate a deteriorating fiscal situation and a continuation of pro-cyclical expansionary fiscal policy this year and next, if we consider a more realistic assessment of fiscal developments this year than the assessment presented in the documents. This conclusion is independent of the extensive funding foreseen for reconstruction after the August natural disaster. In the context of relatively high nominal economic growth and supply-side constraints, additional fiscal stimulus in the face of necessary intervention measures is not appropriate, as it may contribute, inter alia, to a prolonged persistence of high inflation. The challenges of recovering from a natural disaster further underline the need for a counter-cyclical fiscal policy, which would, in a favourable economic cycle, also create adequate room for manoeuvring in the event of emergency situations. As has been the case for many years, budgetary documents are failing to address important and growing long-term challenges, which therefore pose an increasing risk to fiscal sustainability. In contrast to the budgetary plans presented, in the context of high uncertainty, the starting point for budgetary planning should be a credible no-policy-change scenario, which is a prerequisite for identifying manoeuvring room for intervention and other discretionary measures. Once again, the budgetary documents submitted to the Fiscal Council for assessment, while taking into account the understandable uncertainty about the post-flood costs, are not comprehensive and sufficiently credible; they deviate from good medium-term budgetary planning practice and do not allow for a comprehensive assessment of compliance with the fiscal rules laid down in the legislation.

* * *

The budgetary documents submitted imply that fiscal policy is expected to remain stimulating over the projection period, which is inappropriate, does not ensure compliance with fiscal rules and is also at odds with the tightening of monetary policy. In addition to the current estimates of the structural balance and the structural effort, this is also suggested by various indicators of expenditure growth, which are to a lesser extent subject to methodological uncertainties. Even after excluding the direct impact of all intervention measures, the spending indicators are well above the long-term sustainable levels and growth rates, while at the same time exceeding the values recommended by the Council of the EU. In calculating the indicators, the Fiscal Council has been excluding all intervention measures (epidemic, cost of living crisis, floods) since the beginning of the epidemic, as these are time-limited and do not affect the structural position of public finances. Most of the indicators, used by the Fiscal Council to assess the state of public finances, show a worse position at the end of the period of exceptional circumstances than in the period before the start of the epidemic. The possibility of temporary deviation from the fiscal rules has been abused many times in the past four years by adopting discretionary measures unrelated to crises. At the same time, such actions, combined with large-scale intervention measures that have often not been properly targeted, have created expectations for more sustained government action that are increasingly difficult to manage and have increased risks to the sustainability of public finances in the medium term. The debt sustainability analysis also points to increasing risks associated with postponing addressing long-term challenges and to the likely unsustainable public debt if these challenges are not addressed in time.

The expansionary fiscal policy orientation is inefficient in the current context and goes against both the Government's efforts in the light of the implementation of the cost of living and post-flood measures and the recommendations of international organisations. This is because additional fiscal policy stimulus, independent of the expected large-scale intervention measures, puts additional pressure on the persistence of high inflation in the face of supply-side constraints, especially in the labour market. This is associated with a loss of household purchasing power and a deterioration in the competitiveness of the economy, which could in turn lead to additional demands to compensate for high prices and increase direct pressures on public finances. Therefore, in addition to avoiding stimulus that overstimulates demand in the face of supply constraints, it would also be necessary to ensure a sensible sequencing of action in post-flood reconstruction, thereby maximising the efficiency of the use of public funds. The progressiveness of the post-flood measures will be affected to some extent by the already limited capacity of administration and the construction sector.

The budgetary documents submitted are not comprehensive, which prevents the Fiscal Council from producing an assessment that complies with the requirements of the Fiscal Rule Act. The Government did not provide the Fiscal Council with a projection of the general government balance for 2025 harmonised with the draft state budget, based on the internationally comparable ESA methodology, which is the legal basis for the assessment of compliance with the fiscal rules. The Fiscal Council is therefore not in a position to assess the compliance of the draft state budget for 2025 with the legally prescribed fiscal rules.

Budgetary projections again lack credibility to an important extent. As the Fiscal Council has repeatedly pointed out, the estimate of the state budget outturn for 2023 is unrealistic and does not allow for an adequate assessment of the dynamics of the fiscal aggregates in the draft budgets for the next two years. This is particularly the case for the so-called “core” spending, excluding the impact of intervention measures, which in our assessment is even more overestimated than in the previous three years. This approach to planning allows for growth in individual categories of expenditure in 2024 beyond that justified by current legislation. Unrealistic estimates of budgetary developments for 2023 just a few months before the end of the year thus obscure the fact that the budget deficit is likely to widen in 2024, contrary to the projections of the budgetary documents submitted. This is even more the case for the so-called “core” balance than for the overall deficit, which will be determined to an important extent by the understandably not fully evaluated post-flood measures. However, the draft state budget for 2025 does not meet the criteria of a credible no-policy-change scenario. This, together with other factors, suggests a lack of readiness to accept the proposed changes to the economic governance framework at the EU level, in which such a scenario would play a fundamental role. This is one of the reasons why the Government should pay more attention to it.

Only credible budgetary projections based on a no-policy-change scenario would give the Government and the general public insight into the extent of room for manoeuvre. On this basis, the Government would be better able to determine in a more meaningful way the type and scope of measures needed for current and intervention action, and households and businesses would be better able to formulate expectations about future fiscal policy action with less uncertainty. While fiscal policy room for manoeuvre is shrinking due to a number of discretionary measures taken in the past, the existing room is currently mainly due to the relatively random concentration of the large resources available from the various EU mechanisms and the favourable liquidity position of the budget.

One of the important risks to the public finances, which we address more broadly in this assessment, is the expected cost of natural disasters. According to current estimates, the damage caused by this year's floods is the largest ever caused by a natural disaster in independent Slovenia, and, given the size of the country and the size of its population, it will also be high on a European scale. The available estimates of the damage and reconstruction costs raise a certain degree of doubt due to their scale and uncertainty, and it is therefore not yet possible to give a credible estimate of the required public financial resources. These will certainly be high, which is why a high level of transparency is essential when estimating the cost of renovation. However, decisions on the sources of financing also require a comprehensive assessment of their appropriateness, taking into account the impact on the behaviour of households and firms in a cyclical slowdown and the efficiency of recovery measures, including from a moral hazard perspective. Limiting the high impact of natural disasters in the future will require proper risk assessment and timely and targeted action.

Legislative framework

The Government of the Republic of Slovenia submitted to the Fiscal Council on 29 September 2023 the Proposed Ordinance amending the Ordinance on the framework for the preparation of the general government budgets for the 2022–2024 period, the Proposed Ordinance amending the Ordinance on the framework for the preparation of the general government budgets for the 2024–2026 period (hereinafter: the Framework Proposal) and the Draft Amending Budget of the Republic of Slovenia for 2024 and the Draft Budget of the Republic of Slovenia for 2025, together with related documents (hereinafter: Draft Budgets). The Ministry of Finance and the Fiscal Council have concluded a Memorandum of Understanding,[1] which sets out, within agreed deadlines, supporting documentation that should accompany budgetary documents, that should be sent by the Ministry of Finance to the Fiscal Council. This documentation was sent by the Ministry of Finance to the Fiscal Council between 29 September 2023 and 5 October 2023. The projections of the general government balance according to the ESA 2010 methodology were sent by the Ministry of Finance to the Fiscal Council on 5 October 2023; the Ministry did not, however, send the Draft Budgetary Plan based on the projections. The projections received do not include projections for 2025, which prevents the Fiscal Council from assessing the compliance of the Draft Budgets with the fiscal rules in that year. Pursuant to Articles 2 and 3 of the Fiscal Rule Act (FRA), compliance with fiscal rules is assessed with respect to the general government sector, so that the projections under the ESA 2010 methodology provide the basis for an overall assessment of compliance with fiscal rules and with the fiscal policy stance in the Draft Budgets. In accordance with the Memorandum of Understanding (see footnote 1), on 19 September 2023, IMAD presented the Fiscal Council's Analysis Service with economic trends and risks based on the autumn forecast.

Pursuant to Article 28 of the Public Finance Act, the Government is required to submit a budget proposal to the National Assembly of the Republic of Slovenia by 1 October. If, upon submitting budgetary documents or their amendments, the Government finds there has been a change in the circumstances based on which the framework was adopted, it must also submit a framework amendment to the National Assembly and the Fiscal Council. Pursuant to Article 9f of the Public Finance Act, the Fiscal Council is required to submit the assessment of compliance with the fiscal rules in the aforementioned documents to the National Assembly and the Government no later than 15 days after receiving the Framework Proposal, i.e. by 14 October 2023, and the assessment in respect of the Draft Budgets no later than 20 October 2023.

[1] Agreement including annex available at https://www.fs-rs.si/fiscal-council/co-operation/(Only in Slovene).

1. Macroeconomic conditions and forecasts

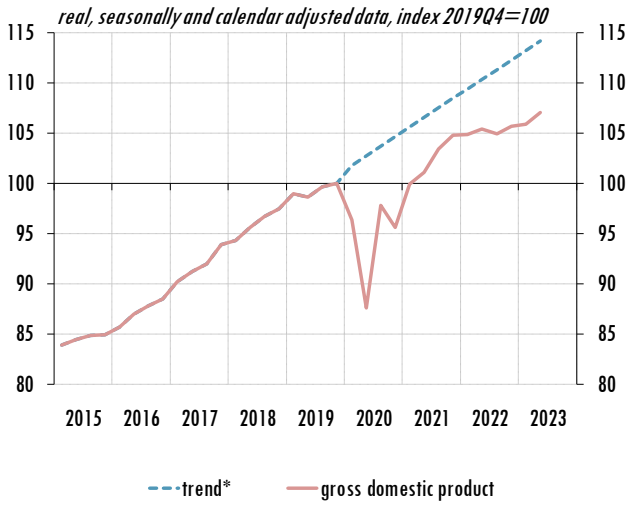
Key findings

- The recovery in economic activity after the epidemic already slowed over the past year; after a further slowdown this year, economic growth is expected to pick up slightly over the next two years, averaging around the long-term average over the period 2023–2025.
- Following the revision of the national accounts, the nominal tax bases, which have a key impact on general government revenue projections, are less favourable than in the spring, when the Stability Programme was prepared. While growth in the tax base is expected to moderate in the 2023–2025 period from the very high levels of the previous two years, the average growth in the projection period will still be higher than in the pre-epidemic period. This will largely be due to only a gradual moderation of high inflation.
- After peaking last year, the economic cycle is expected to moderate over the period 2023–2025 but despite the moderation in demand, price and cost pressures are expected to remain relatively high due to supply-side factor constraints.
- This year's revision of the SORS national accounts data is the largest ever. Given that, even over a longer period, the changes in data for Slovenia largely exceed those in other EU countries, the scope of this revision calls for additional efforts to improve the quality of national accounts data.

1.1 Overview of macroeconomic conditions and forecasts

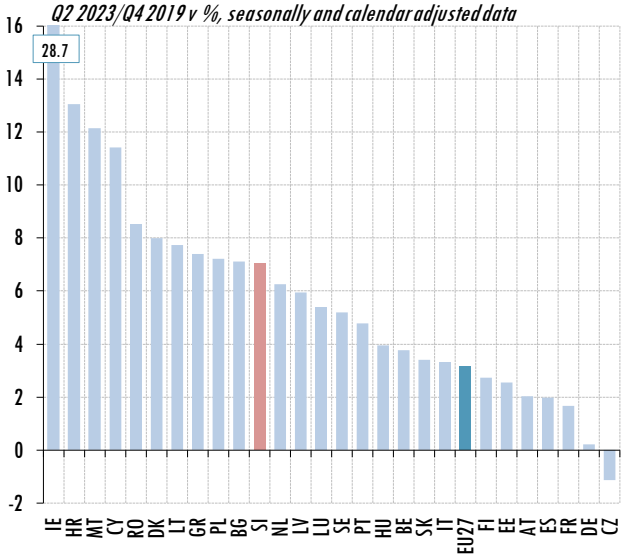
The recovery in economic activity after the epidemic already slowed over the past year. Following the published revision of the national accounts data (see Box 1.1), the pronounced cyclical momentum following the expiry of the restrictive measures during the epidemic, turned out to have run its course last year, also due to external shocks, notably in the form of increased energy prices (Figures 1.1 and

Figure 1.1: GDP compared to pre-crisis trend



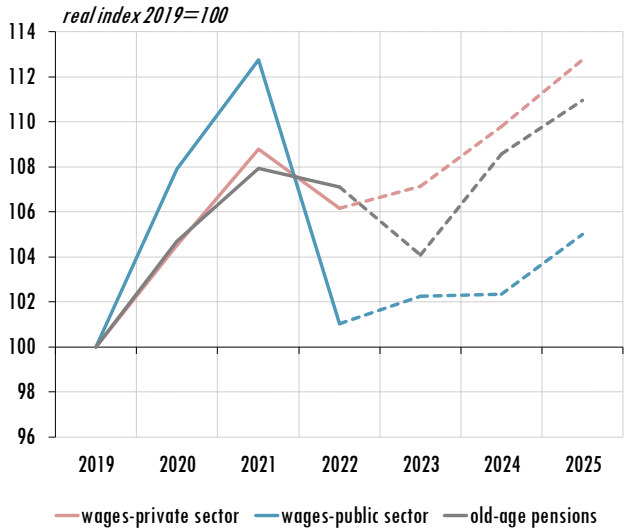
*Source: SORS, FC calculations. Note: *Trend is based on the 2015-2019 period.*

Figure 1.2: Real GDP change



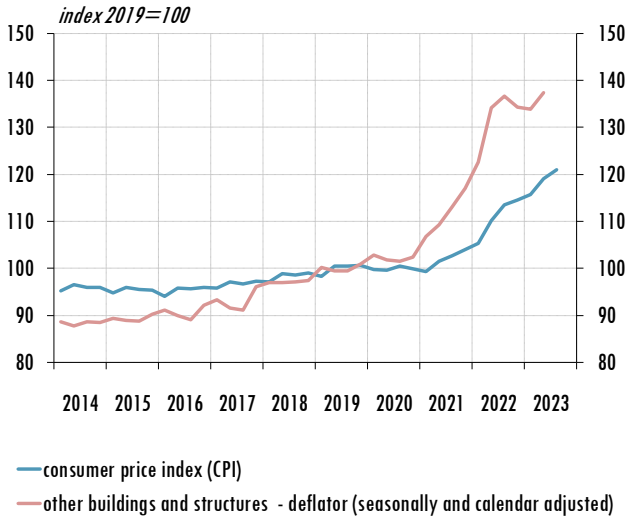
Source: Eurostat, FC calculations.

Figure 1.3: Real purchasing power



Vir: ZPIZ, IMAD, FC calculations.

Figure 1.4: Consumer price index and gross fixed capital formation in other buildings and structures deflator



Source: SORS, FC calculations.

1.8). While the recovery in Slovenia was among the fastest in the EU according to the initially published data, it is slightly closer to the average according to the revised data (Figure 1.2). The reasons for the slowdown in economic activity are multifaceted. Less positive impulses from abroad and increased uncertainty have slowed both export growth and investment in equipment and machinery. Investment has slowed despite companies maintaining a favourable financial position[2] and that in order to maintain growth potential despite labour shortages require gains in productivity and consequently in investment, which still lags behind pre-financial crisis levels.[3] Private consumption, which had been the main generator of the recovery, slowed markedly towards the end of last year, despite continued growth in real purchasing power (Figure 1.3). This was due to the excess savings accumulated during the epidemic being partly used up and partly to uncertainty largely stemming from markedly elevated inflation, which had not reached such levels since the end of the last century. The persistence of price pressures also stemmed to some extent from last year's continuation of a markedly expansionary fiscal policy, which was pro-cyclical. At the same time, it was also ineffective: with limited capacity of the construction sector accompanied by an increase in housing construction, mostly privately financed, the state has further strengthened its own investment activity. As a result, price growth in the construction sector was even significantly higher than the already elevated overall price growth (Figure 1.4).

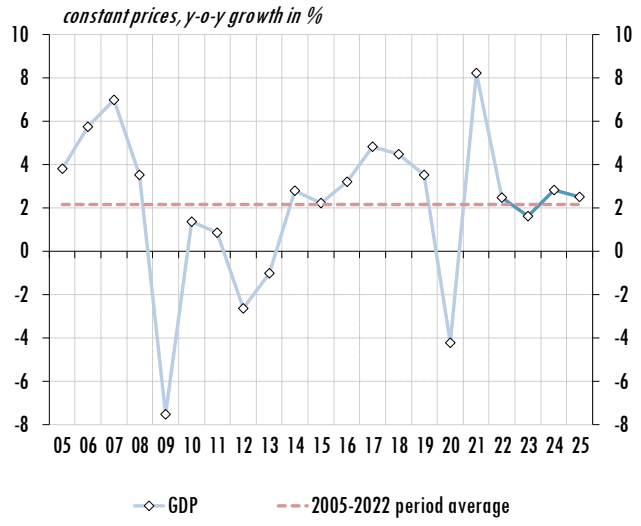
After a temporary slowdown this year, economic growth is expected to pick up slightly over the next two years, hovering around the long-term average over the period 2023–2025. This year's expected slowdown in economic activity will be mainly due to the ending of the positive cyclical momentum after the epidemic, which is expected to turn negative. IMAD[4] expects real GDP growth of only 1.6% this year. Export and private investment growth are expected to decline further, owing to the uncertain situation and the deteriorating outlook for foreign demand. The slowdown in household consumption growth is also expected to be pronounced, which, together with the continuation of real wage and pension growth, is to a large extent due to uncertainty and the associated caution in the

[2] Deposits of non-financial companies with banks amounted to EUR 9.5 billion in May this year and EUR 6.8 billion in December 2019 before the epidemic.

[3] The share of investment in equipment and machinery is about 2 percentage points of GDP below the level reached before the 2008 financial crisis.

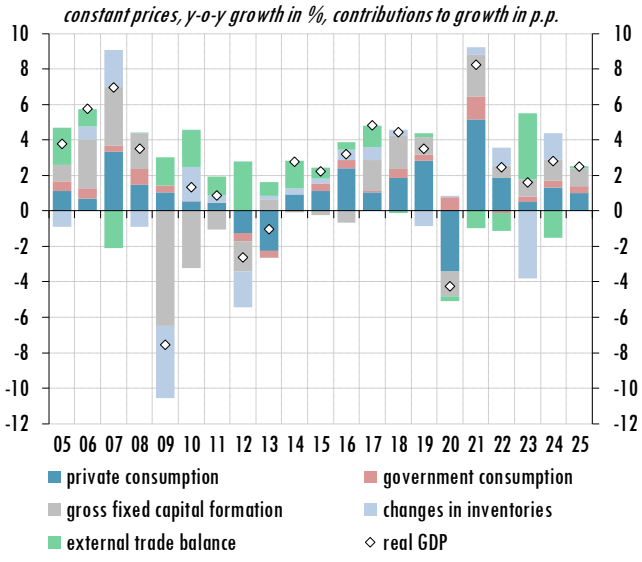
[4] IMAD (2023a).

Figure 1.5: Gross domestic product



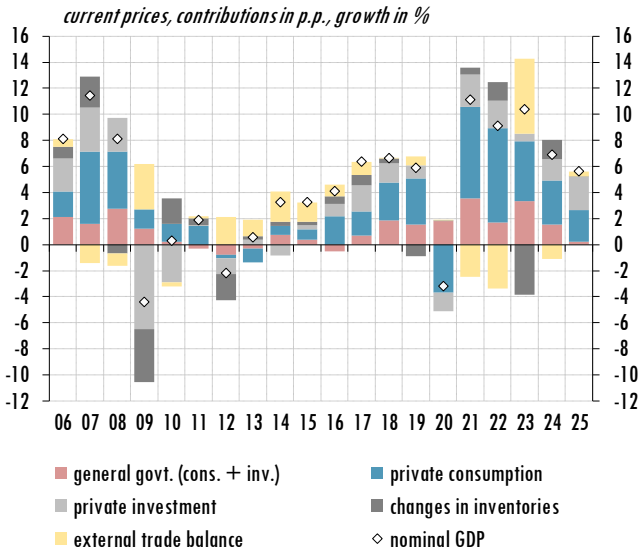
Source: SORS, IMAD, FC calculations.

Figure 1.6: Gross domestic product



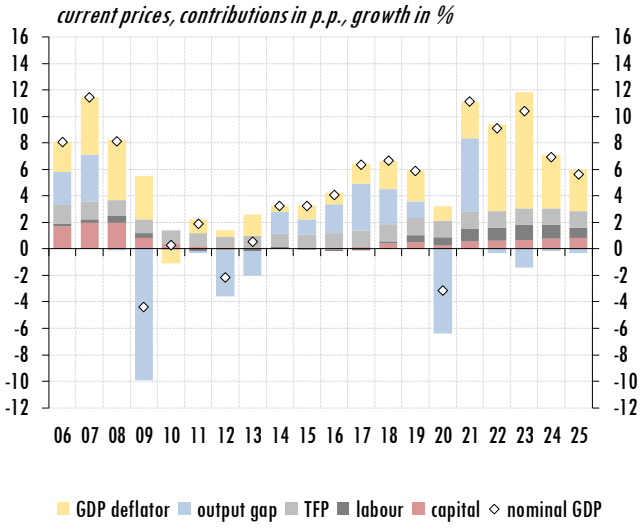
Source: SORS, FC calculations.

Figure 1.7: Demand factors and GDP



Source: SORS, IMAD, MoF, FC calculations.

Figure 1.8: Supply factors and GDP

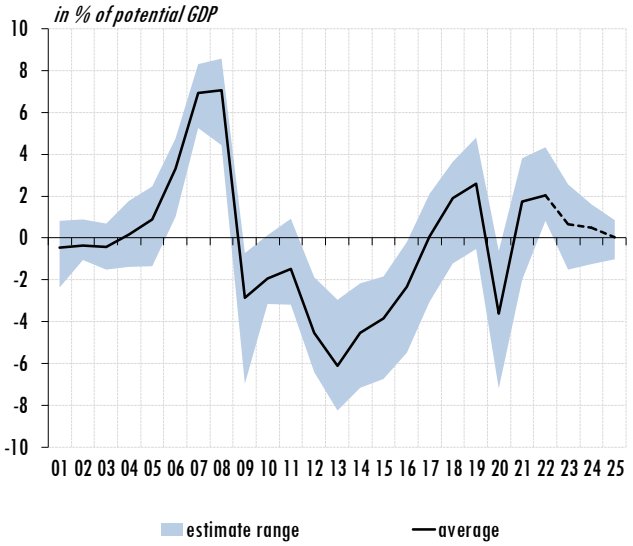


Source: SORS, IMAD, FC calculations.

consumption of non-essential goods and services. The fiscal stimulus[5] is set to strengthen noticeably this year on the back of a continued strong increase in investment activity (Figure 1.7), but this will only compensate for the slowdown in private demand growth to a limited extent. Over the next two years, economic growth is expected to pick up slightly and hover around the long-term average (Figure 1.5), mainly reflecting an assumed reduction in uncertainty and thus a renewed strengthening of both foreign and domestic private demand, while the fiscal stimulus is expected to decrease. Labour market conditions are expected to remain favourable, with the unemployment rate and the number of unemployed expected to remain at historically low levels throughout the forecast period. The IMAD forecast suggests that the cyclical stimulus is expected to be neutral and that nominal GDP growth, similar to that of the few years preceding the epidemic, will be largely due to a gradual moderation of inflation.

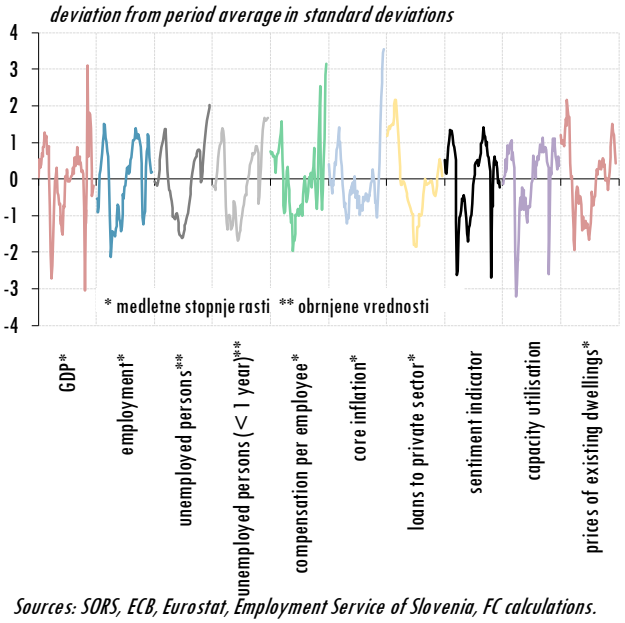
[5] According to IMAD projections, the direct contribution of government spending and investments to nominal GDP growth is estimated to be around one-third or 3.3 percentage points.

Figure 1.9: Output gap estimates



Source: IMAD, EC, OECD, IMF, MoF, FC calculations. See note under Table 6.1.

Figure 1.10: Indicators of economic cycle dynamics 2005–2023



Sources: SORS, ECB, Eurostat, Employment Service of Slovenia, FC calculations.

1.2 Assessment of the cyclical position of the economy

The business cycle is expected to moderate over the period 2023–2025, and despite weaker demand growth, price and cost pressures in the product and labour markets are expected to remain relatively high due to the persistence of supply-side constraints. Current estimates suggest that, following the opening-up of the economy after the epidemic and the rapid recovery in 2021, the output gap reached the cyclical peak in 2022. It is expected to remain positive in the period until 2025 but to gradually close, despite the currently estimated solid growth in supply potential.[6] The rapid recovery from the epidemic also stemmed to some extent from large-scale government measures and led to a rapid and significant surge in demand, which, together with external shocks, was also reflected in pronounced price pressures. Despite the cyclically driven moderation in demand, both the data and the latest IMAD forecast point to significant supply-side constraints. These are particularly pronounced in the labour market and are reflected, inter alia, in the historically low unemployment rate. Labour market constraints are increasingly driven by demographic changes; according to the IMAD's forecast, they are expected to be partly reduced by the further employment of non-residents in the future. Despite the increase in net immigration, the pressure to raise wages continues unabated. Demand stemming from wage growth, together with the persistence of external price pressures, is contributing to the persistence of high core inflation.

1.3 Comparison of macroeconomic scenarios of the Stability Programme 2023 (SP23) and the Draft Budgets

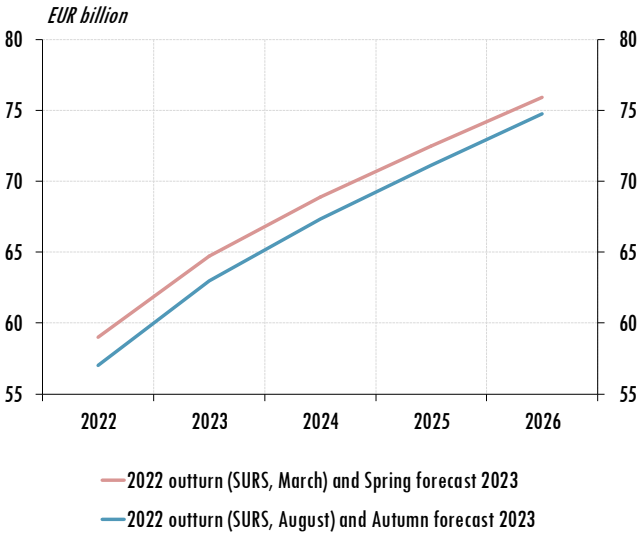
The macroeconomic scenario for 2023–2025[7] is less favourable than that in the SP23,[8] which is largely due to the revision of last year's national accounts data. The SORS revision (see Box 1.1)

[6] The latter is hovering at an average of just below 3% over the period 2023–2025, by about 0.5 percentage point above the long-term average.

[7] IMAD (2023a) from September 2023.

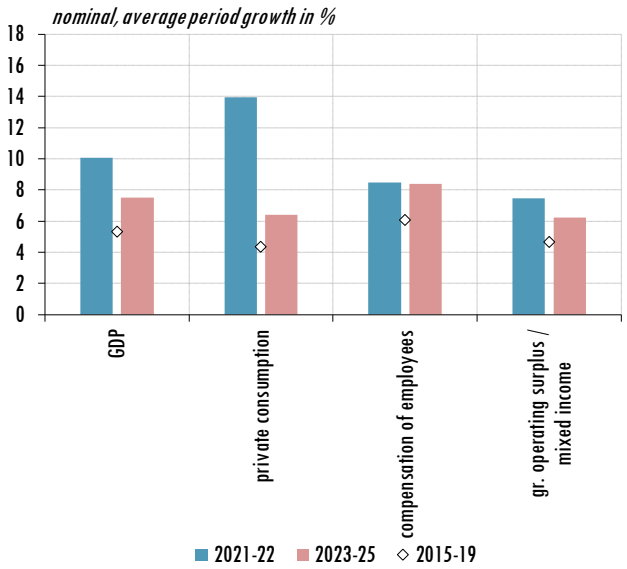
[8] The SP23 fiscal projections (April 2023; Government of Slovenia, 2023a) are based on the IMAD (2023b) of March 2023.

Figure 1.11: Nominal GDP



Source: SORS, IMAD, FC calculations.

Figure 1.12: Tax bases



Source: SORS, IMAD, FC calculations

Table 1.1: Comparison of the macroeconomic scenarios from March and September 2023

	2022			2023			2024			2025		
	Mar. 23	Sep.23	*diff.*	Mar. 23	Sep.23	*diff.*	Mar. 23	Sep.23	*diff.*	Mar. 23	Sep.23	*diff.*
Real GDP, change in %	5.4	2.5	*-2.9*	1.8	1.6	*-0.3*	2.5	2.8	*0.4*	2.6	2.5	*-0.1*
Nominal GDP, EUR million	58,989	57,038	*-1,951*	64,723	62,970	*-1,753*	68,896	67,318	*-1,578*	72,462	71,105	*-1,358*
Nominal GDP, change in %	13.0	9.1	*-3.9*	9.7	10.4	*0.7*	6.4	6.9	*0.5*	5.2	5.6	*0.4*
Private consumption, EUR million	32,463	30,787	*-1,675*	35,192	33,409	*-1,783*	37,348	35,525	*-1,823*	38,951	37,158	*-1,793*
Compensation of employees, EUR million	29,456	29,672	*216*	31,960	33,084	*1,124*	34,037	35,599	*1,561*	36,026	37,934	*1,909*
Gross operating surplus,* EUR million	22,916	20,639	*-2,278*	26,220	23,368	*-2,852*	27,193	23,840	*-3,352*	28,376	24,862	*-3,514*
Inflation-average, %	8.8	8.8	*0.0*	7.1	7.6	*0.5*	4.2	3.9	*-0.3*	2.4	2.7	*0.3*
GDP deflator, change in %	7.2	6.5	*-0.7*	7.7	8.7	*1.0*	3.9	4.0	*0.1*	2.5	3.1	*0.6*

*Source: SORS, IMAD, FC calculations. Note: * operating surplus and mixed income.*

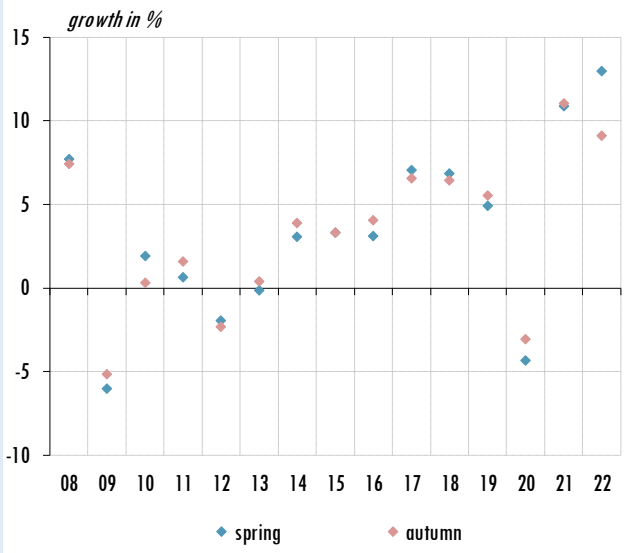
has significantly lowered the nominal levels of the tax bases, which, even in cases where growth for 2023–2025 is projected to be higher in the autumn than in the spring, are significantly lower than expected in the spring (Figure 1.11). Thus, the starting position for the general government revenue projections is worse than at the time when the budgetary documents were drafted in the spring (see Table 1.1). Nominal GDP in 2025 is thus projected to be EUR 1.4 billion lower than expected in the spring before the revision. The levels of other key tax bases are also expected to be significantly lower, with the exception of compensation of employees. While growth in the tax base is expected to slow in comparison to the previous two years, it would still be higher than the average in the pre-epidemic period (2014–2019). Nominal GDP is thus expected to grow at an average rate of 7.6% over the 2023–2025 period (4.9% in the pre-epidemic period) and to be EUR 14.1 billion higher in 2025 than last year. Growth is thus expected to be driven by favourable labour market conditions, with employment continuing to grow and wage growth remaining relatively high, companies performing well and high inflation moderating only gradually. We interpret with caution the forecast of a relatively high growth in the operating surplus this year; the reason for this is the extensive revision for last year, when the surplus was reduced by EUR 2.3 billion.

Box 1.1: Revisions of national accounts estimates

This year's revision of SORS national accounts data is the largest on record, while also over the last decade the changes in the data for Slovenia have largely exceeded those in other EU countries. Revisions of national accounts data are an integral part of the statistical data compilation process. Revisions occur with different time lags depending on the period to which they relate and are usually made due to different or additional data sources or methodological changes in the monitoring of a particular variable.[1] Given the importance of changes in historical data for the conduct of economic policy, institutions in some countries also include revision probabilities in their forecasts, considering the statistical properties of historical changes in data.[2] The revision for 2022[3] was the largest ever for both real and nominal GDP growth, amounting to around 3 percentage points in both cases, while the change in the GDP deflator contributed around one-fifth to the revision of nominal GDP.[4] The revision of the growth rate was about twice as high for real GDP and three times as high for nominal GDP as the previous all-time high in 2020. In line with the revisions carried out so far, the change in the level and growth of private consumption and the level of the gross operating surplus, two important determinants of general government revenues, for 2022 was even larger than the change in the growth and GDP figures respectively. Revisions to GDP data in Slovenia are among the largest in the EU; data revisions in Slovenia were among the three largest in more than two-thirds of the period 2010–2022 and even the largest among EU countries in four years.

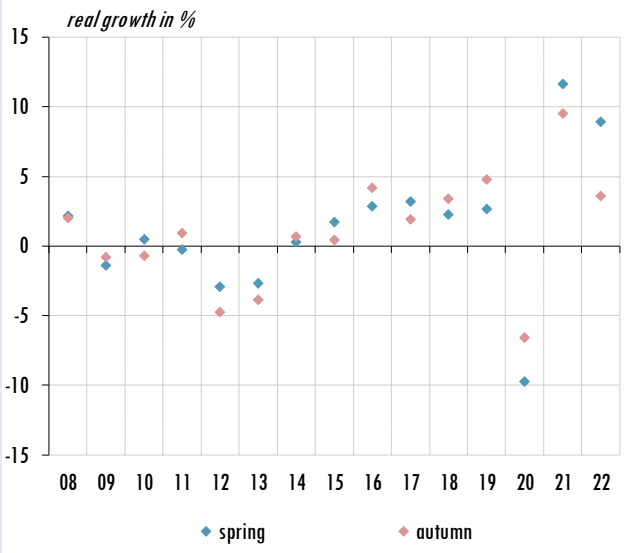
Institutions involved in economic analysis and forecasting need a comprehensive set of data that are as stable as possible; the usefulness of data publications is also undermined by incomplete releases of national accounts data. SORS publishes GDP data together with data on the structure of consumption and production 45 days after the end of the quarter to which the publication relates, while data on the income structure of GDP are published with an additional 15-day delay. Following the release of partial data for the second quarter in mid-August, revised annual data on GDP developments over the previous year are also published at the end of August.[5] The latter are only reconciled with the previous year's quarterly data at the end of September. In September, a month of intensive work on macroeconomic forecasts, which serve as the basis for the budgetary documents, the quarterly GDP dynamics of the previous year are not known. These can affect the level of activity due to the so-called "carry-over effect"[6] and the dynamics of GDP in the current year due to seasonally adjusting the time series. The staggered publications and the high number of successive revisions, which do not ensure that the data are consistent every time, reduce the usefulness of the data thus published.

Figure 1: Nominal GDP



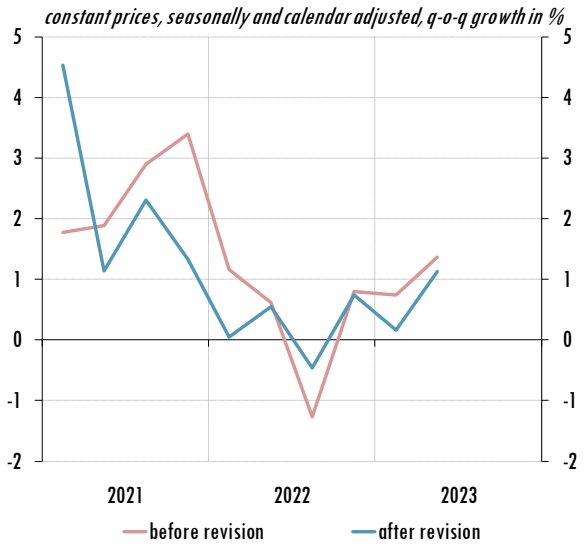
Source: Eurostat, AMECO.

Figure 2: Private consumption



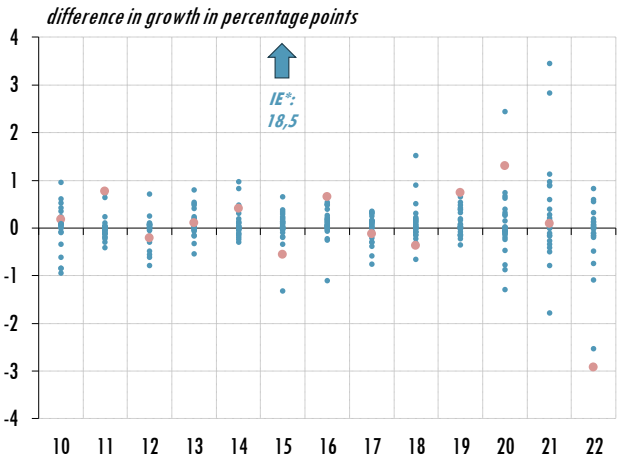
Source: Eurostat, AMECO.

Figure 3: Gross domestic product



Source: SORS.

Figure 4: Difference between spring and autumn releases of real GDP growth for the previous year for EU member states



*Source: AMECO, Eurostat. Slovenia is shown in red. Note: *Explanation regarding Ireland for 2015 is available at: https://ec.europa.eu/eurostat/documents/24987/6390465/Irish_GDP_communication.pdf*

The scope of the most recent revision calls for additional efforts to improve the quality of national accounts data. Macroeconomic analyses underpinning recommendations for economic policy action, including the preparation of budgets, depend to a large extent on stable and reliable data. Changing data and the high order of magnitude of such changes introduce additional risks in ensuring the reliability of analyses and estimates. The Fiscal Council regularly draws attention to this fact, as macroeconomic variables are key inputs for statutory analyses, which also include identifying the position and stance of fiscal policy.[7] Already in 2020, the Fiscal Council published an analysis of deviations of forecasts of macroeconomic and fiscal aggregates,[8] pointing out high revisions of private consumption. At that time, it recommended that the Statistical Office should make additional efforts to improve the quality of the data on the aggregate developments, which, along with the gross operating surplus, had been subject to the largest revision among the components of GDP at the time of this year's August revision. SORS announced an independent peer review of the data sources, methods and production process used to calculate quarterly gross domestic product.[9]

[1] See e.g. McKenzie (2006: Table 3.1).

[2] See e.g. fan charts at the Bank of England (2023). Estimates of the likelihood of revisions to historical data are made here for GDP but not for price trends, where the data are not subject to revisions.

[3] https://www.stat.si/StatWeb/en/News/Index/11325

[4] According to SORS, price trends are supposed to contribute significantly to the revision of GDP data. See the press release following the 69th session of the Government of the Republic of Slovenia on 13 September 2023. Available at: https://www.gov.si/assets/vlada/Seja-vlade-SZJ/2023/09-2023/sevl_69.docx (Only in Slovene).

[5] The first data on GDP developments over the past year are published in mid-February, with data for the last quarter of the previous year.

[6] See e.g. Section 5.1 in Banka Slovenije (2022). https://bankaslovenije.blob.core.windows.net/publication-files/review-of-macroeconomic-developments-june-2022l.pdf

[7] See e.g. Box 4.1 in the FC (2020a) or Box 4.2. in the FC (2021).

[8] FC (2020b).

[9] Press release following the 69th session of the Government of the Republic of Slovenia on 13 September 2023. Available at: https://www.gov.si/assets/vlada/Seja-vlade-SZJ/2023/09-2023/sevl_69.docx (Only in Slovene).

2. Fiscal conditions and forecasts

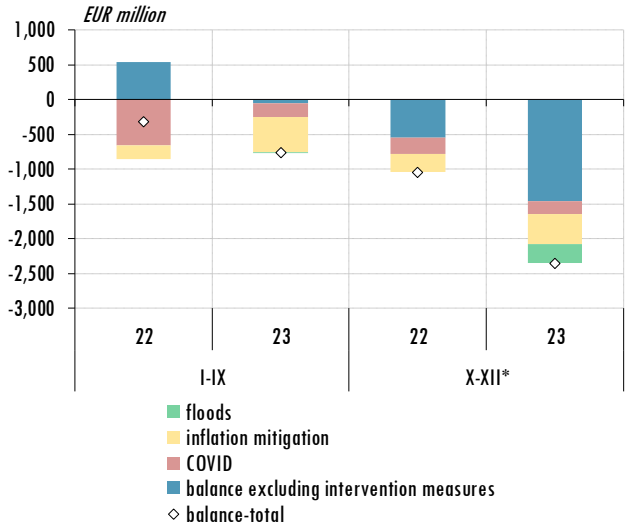
Key findings

- The estimate of expenditure for 2023, similarly as in the previous three years, is exaggerated and does not provide an adequate basis for assessing the dynamics of fiscal aggregates in the projections of the Draft Budgets for the next two years. We estimate that (excluding the direct effect of intervention measures) "core" expenditure for 2023 is overestimated by at least EUR 1 billion. Once this year's actual outturn is known, the projections for 2024 will therefore show even higher expenditure growth than foreseen in the Draft Budgets.
- The projected government budget deficit next year will be at least similar to this year's level, or even slightly higher, once the actual outturn for this year, which we estimate will be lower than the official estimates, is known. Without taking into account the direct effect of the intervention measures, next year's deficit is expected to amount to EUR 1,1 billion or 1.7% of the projected GDP. However, due to inadequate projections for some revenue categories (income tax, EU revenue) and expenditure (transfers to individuals and households), we estimate that it could be higher than that.
- The projection of the level of primary current spending (excluding intervention measures) in the Draft Budgets for 2024 will show growth of over 10% this year once this year's actual outturn is known. This would be well above the long-term average and well above the estimated potential GDP growth, and also contrary to the EC recommendations. In addition, we consider the renewed considerable cuts in transfers to individuals and households to be unrealistic, despite the decision to freeze the statutory adjustment for inflation.
- In our assessment, the draft budget for 2025 does not meet the criteria of a credible no-policy-change scenario, which should reflect the current legislation and measures. Given that the medium-term fiscal framework is supposed to be one of the cornerstones of the revised economic governance system at the EU level, this, together with the continuation of unrealistic projections already for a shorter period, points to an unpreparedness for the announced changes.
- The general government debt-to-GDP ratio is projected to continue declining at a slower pace in 2023 and 2024 but to remain above the pre-crisis level next year. Due to its relatively high level and tight financing conditions, the costs of debt financing are expected to increase in the future. At the same time, last year's high increase in revenues due to a jump in inflation was not sufficiently used to bring about a more significant reduction in debt. Although the debt sustainability analysis suggests increased risks in the absence of addressing long-term challenges, fiscal policy room for manoeuvre in the short term is ensured by the high level of liquid assets in the budget.

2.1 Assessment of the projected revenues and expenditures in the Draft Budgets

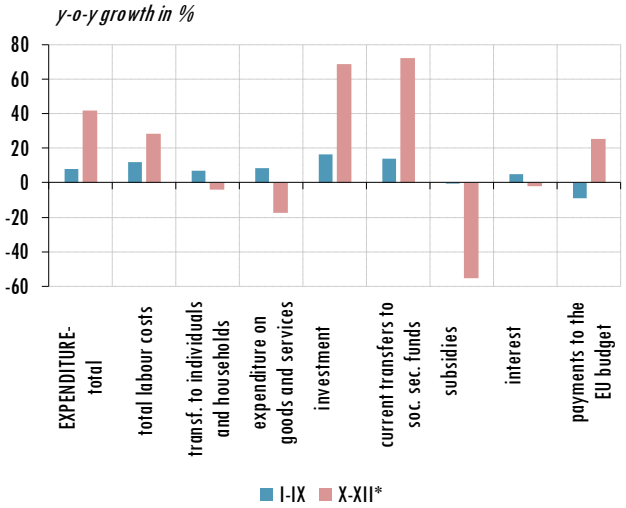
The estimate of expenditure for 2023 is again exaggerated and does not provide an adequate basis for assessing the dynamics of fiscal aggregates in the projections of the Draft Budgets for

Figure 2.1: Structure of state budget balance



*Source: MoF, FC calculations. Note: *2023 implicitly considering the 2023 MoF estimate (September 2023) and actual outturn for the first nine months of 2023.*

Figure 2.2: Expenditure excluding intervention measures in 2023



*Source: MoF, FC calculations. Note: *Implicit growth considering the 2023 MoF estimate (September 2023) and actual outturn for the first nine months of 2023.*

the next two years. The updated estimate of the state budget outturn for 2023 (hereinafter: the 2023 Estimate) received by the Fiscal Council together with the Draft Budgets and the outturn for the first nine months of 2023 show that year-on-year "core" expenditure growth, excluding the direct effect of the intervention measures, is expected to accelerate significantly over the last three months of this year. After year-on-year growth in the first nine months stood at 8.0%, it is expected to pick up to as much as 41.7% in the last three months, and from 7.2% in the first nine months to 33.7% at the end of the year if investment expenditure is also excluded. The unrealistic projections thus not only stem from the creation of the room for manoeuvre associated with shock mitigation, but are largely the result of exaggerated projections of normal consumption. Based on the long-term average share that spending in the last three months of the year represents in year-round consumption, which makes it possible to take into account seasonal expenditure dynamics, we estimate that, excluding the direct effect of intervention measures, expenditure is overestimated by at least EUR 1 billion in the 2023 Estimate. This is a continuation of the inappropriate practice during the enforcement of exceptional circumstances whereby "core" spending in the budgetary documents in particular was planned well above what would be justified on the basis of the measures in force and beyond the limits justified by precarious circumstances. In each of the years 2020–2022, it turned out that a few months before the end of the year, expenditure projections were overestimated, on average by around EUR 800 million. Since the Government again did not adjust regular commitment appropriations (not related to the intervention measures), despite the need for appropriate identification of the room for manoeuvre, to lower actual spending than that foreseen under the current budget for 2023, the projected expenditure levels for 2024, given this year's lower actual outturn than the current official estimate, will show higher growth than projected in the Draft Budgets.

Due to the overestimation for this year, we estimate that the projected government budget deficit for next year will be at least similar to this year's or even slightly higher. The total deficit should amount to EUR 2,221 million next year (3.3% of the projected GDP) under the Draft Budgets. This is EUR 900 million less than in the 2023 Estimate, wherein the projected deficit is in fact too high by at least EUR 1 billion according to the Fiscal Council. The volume of intervention measures is expected to

Table 2.1: State budget projections 2023–2025

	total (EUR million)				growth in %*			contribution in p.p.		
	2022	2023	2024	2025	2023	2024	2025	2023	2024	2025
Revenue	**12,345**	**13,151**	**14,006**	**14,561**	**6.5**	**6.5**	**4.0**	**6.5**	**6.5**	**4.0**
VAT	4,747	4,977	5,375	5,624	4.8	8.0	4.6	1.9	3.0	1.8
Excise duties	1,446	1,647	1,561	1,559	13.9	-5.2	-0.1	1.6	-0.7	0.0
Personal income tax	1,586	1,725	1,896	2,105	8.8	9.9	11.0	1.1	1.3	1.5
Corporation tax	1,553	1,402	1,484	1,561	-9.8	5.9	5.2	-1.2	0.6	0.5
Receipts from the EU budget	957	1,470	1,464	1,485	53.5	-0.4	1.4	4.2	0.0	0.1
Non-tax revenues	770	705	869	824	-8.4	23.2	-5.2	-0.5	1.2	-0.3
Other	1,284	1,225	1,358	1,403	-4.7	10.9	3.4	-0.5	1.0	0.3
Expenditure	**13,709**	**16,272**	**16,227**	**15,824**	**18.7**	**-0.3**	**-2.5**	**18.7**	**-0.3**	**-2.5**
Total labour costs**	3,751	4,370	4,440	4,560	16.5	1.6	2.7	4.5	0.4	0.7
Tr. to individuals and househ.	1,965	1,973	1,681	1,678	0.4	-14.8	-0.2	0.1	-1.8	0.0
Exp. on goods and services**	1,526	1,480	1,641	1,643	-3.0	10.9	0.1	-0.3	1.0	0.0
Investment	1,669	2,526	1,981	1,945	51.3	-21.6	-1.8	6.3	-3.3	-0.2
Current tr. to soc. sec. funds	1,526	1,560	1,925	1,991	2.3	23.4	3.4	0.3	2.2	0.4
Subsidies	632	875	588	582	38.4	-32.8	-1.0	1.8	-1.8	0.0
Interest	655	681	818	888	3.9	20.2	8.6	0.2	0.8	0.4
Payments to the EU budget	730	730	719	736	0.1	-1.5	2.3	0.0	-0.1	0.1
Reserves	561	1,364	1,731	1,100	143.1	26.9	-36.5	5.9	2.3	-3.9
Other	694	713	702	701	2.7	-1.5	-0.2	0.1	-0.1	0.0
Balance	**-1,364**	**-3,121**	**-2,221**	**-1,263**	**-1,757**	**900**	**957**			

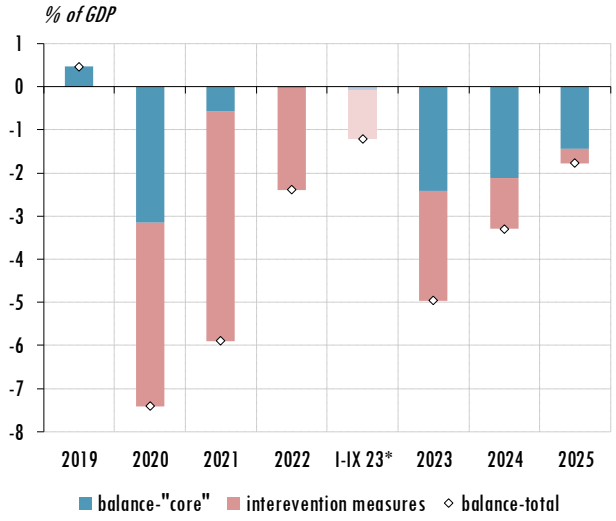
*Source: MoF, FC calculations. *change in balance in EUR million; **including transfers to public institutions for this purpose.*

Table 2.2: State budget projections 2023–2025 (excluding intervention measures)

	excl. intervention measures (EUR million)				growth in %*			contribution in p.p.		
	2022	2023	2024	2025	2023	2024	2025	2023	2024	2025
Revenue	**12,556**	**13,315**	**13,560**	**14,305**	**6.0**	**1.8**	**5.5**	**6.2**	**1.9**	**5.3**
VAT	4,805	5,050	5,375	5,624	5.1	6.4	4.6	2.0	2.5	1.8
Excise duties	1,539	1,690	1,561	1,559	9.8	-7.7	-0.1	1.2	-1.0	0.0
Personal income tax	1,586	1,725	1,796	2,105	8.8	4.1	17.2	1.1	0.5	2.2
Corporation tax	1,553	1,402	1,484	1,561	-9.8	5.9	5.2	-1.2	0.6	0.5
Receipts from the EU budget	957	1,470	1,278	1,390	53.5	-13.0	8.7	4.2	-1.5	0.8
Non-tax revenues	770	705	709	664	-8.4	0.5	-6.4	-0.5	0.0	-0.3
Other	1,344	1,273	1,358	1,403	-5.3	6.7	3.4	-0.6	0.6	0.3
Expenditure	**12,570**	**14,837**	**14,983**	**15,335**	**18.0**	**1.0**	**2.4**	**16.5**	**0.9**	**2.2**
Total labour costs**	3,714	4,320	4,440	4,560	16.3	2.8	2.7	4.4	0.7	0.7
Tr. to individuals and househ.	1,727	1,801	1,674	1,678	4.3	-7.0	0.2	0.5	-0.8	0.0
Exp. on goods and services**	1,370	1,362	1,555	1,641	-0.6	14.1	5.5	-0.1	1.2	0.5
Investment	1,614	2,321	1,839	1,767	43.8	-20.8	-3.9	5.2	-3.0	-0.4
Current tr. to soc. sec. funds	1,246	1,560	1,925	1,991	25.2	23.4	3.4	2.3	2.2	0.4
Subsidies	432	366	419	576	-15.3	14.6	37.3	-0.5	0.3	1.0
Interest	655	681	818	888	3.9	20.2	8.6	0.2	0.8	0.4
Payments to the EU budget	730	730	719	736	0.1	-1.5	2.3	0.0	-0.1	0.1
Reserves	561	1,154	915	812	105.7	-20.7	-11.3	4.3	-1.5	-0.6
Other	522	543	679	689	4.0	25.0	1.4	0.2	0.8	0.1
Balance	**-14**	**-1,522**	**-1,422**	**-1,030**	**-1,508**	**100**	**392**			

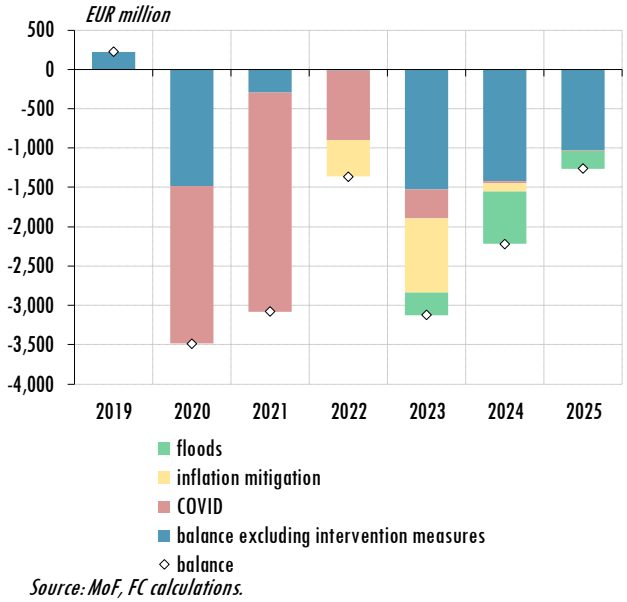
*Source: MoF, FC calculations. *change in balance in EUR million; **including transfers to public institutions for this purpose.*

Figure 2.3: State budget balance



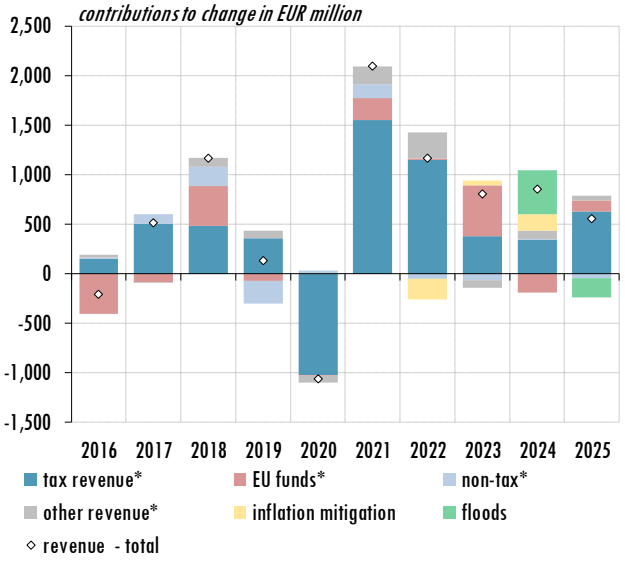
*Source: MoF, SORS, IMAD, FC calculations. Note: *Outturn in the first nine months of 2023 as a share of the forecast GDP.*

Figure 2.4: Structure of state budget balance



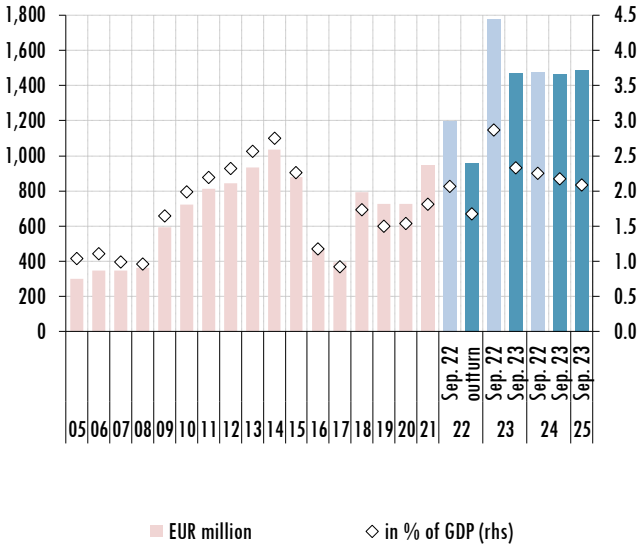
Source: MoF, FC calculations.

Figure 2.5: State budget revenue change



*Source: MoF, FC calculations. Note: * Excluding direct effect of intervention measures.*

Figure 2.6: State budget receipts from the EU budget



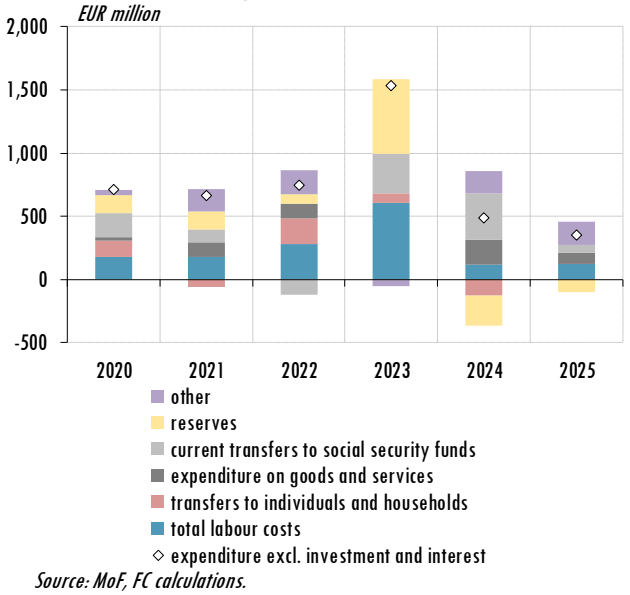
Source: SORS, MoF, IMAD, FC calculations.

be around EUR 0.5 billion lower next year than estimated for this year. Indeed, the reduction of the negative impact of the epidemic and cost of living crisis mitigation measures is expected to more than compensate for the currently indicated extensive resources for post-flood reconstruction (see Box 2.2). Without taking into account the direct effect of the intervention measures, the deficit, which gives a more appropriate picture of fiscal trends, is expected to amount to EUR 1,136 million next year (1.7% of the projected GDP), which is EUR 386 million lower than estimated for this year. Since we estimate that this year's "core" deficit will be at least around EUR 0.5 billion lower than the official estimate, the projection therefore effectively implies an increase in the deficit in 2024.

Following this year's moderation revenue growth is expected to stabilise at a similar level over the next two years. After strong growth in the previous two years, initially driven by a rebound in demand after the restrictive measures to contain the epidemic and then by the impact of stronger

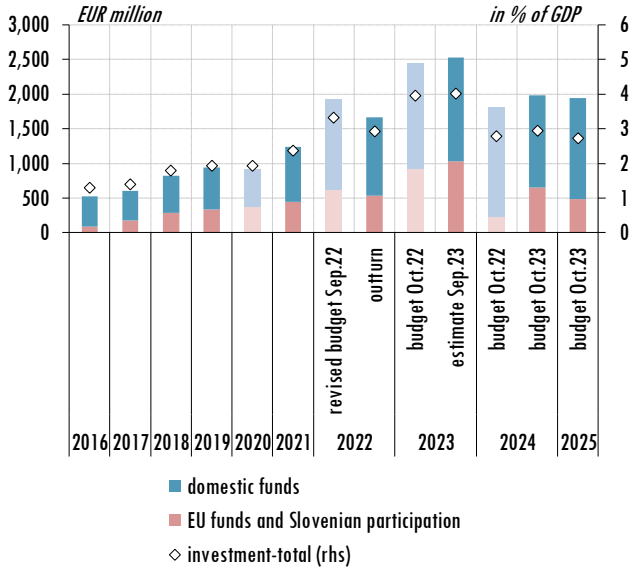
inflation, growth stalled in the first nine months of this year due to a moderation in demand and the continued lagging of EU funding spending behind plans. Growth over the next two years is expected to be similar to this year. VAT revenue growth is projected to pick up slightly in line with the outlook for nominal domestic consumption, partly also due to the unwinding of the negative impact of the reduced rates on energy products that were in place until the end of May this year. Excise duties revenues are expected to decrease according to the projections of the Draft Budgets, which, assuming unchanged excise duties, is considered a conservative assumption. Following this year's decline, which was mainly due to a high balancing payment for the last year, growth in corporate tax revenue is expected to be relatively modest over the next two years, which is a reasonable assumption given the considerable uncertainties about the performance of businesses. In particular, we view the projection of around 10% growth in income tax revenues as optimistic. According to the Government, revenues will be EUR 100 million higher next year because of the non-harmonisation of the income tax scale, but the same amount lower due to the abolition of complementary health insurance. Taking these two effects into account, the projected growth significantly exceeds the projected evolution of the macroeconomic base. The expected high growth in non-tax revenue in 2024 is mainly due to the expected solidarity contributions of EUR 160 million. After a significant increase this year, which we consider to be overestimated based on the nine-month outturn, revenue from EU funds is expected to remain at a similar level over the next two years.[9] Maintaining the high level in the next two years is to a large extent due to the projections for cohesion spending in the 2021–2027 Financial Perspective, which, based on past experience, we consider to be extremely optimistic for the initial period of the Perspective.[10] The Draft Budgets envisage obtaining funds in the amount of EUR 357 million next year and EUR 401 million in 2025 under the Recovery and Resilience Facility (RRF). Given the absence of reforms and the resulting delays in meeting the milestones that are a condition for the disbursement of funds, we consider this assumption to be optimistic as well. The level of expected EU

Figure 2.7: Factors of current expenditure change (excluding intervention measures)



Source: MoF, FC calculations.

Figure 2.8: State budget investment expenditure



Source: MoF, FC calculations.

[9] Revenue from EU funds was 7.5% lower on a year-on-year basis in the first nine months of this year. The 2023 Estimate thus shows that in the last three months of the year, it is expected to be twice as high as in the same period last year. We consider this to be an overly optimistic assumption, despite the submission of the request for the second instalment of the RRP and the conclusion of the 2014–2022 Financial Perspective.

[10] Achieving these projections would mean that we would be able to spend more than 40% of the total funds available in the first three years of the MFF, which would be a significant efficiency gain compared to the experience with the previous MFF.

funding in the next two years is also significantly influenced by the retained funds from the 2014–2021 Perspective (EUR 226 million in total) and the Solidarity Fund (EUR 282 million in total).

"Core" spending (excluding the effect of intervention measures) is projected by the Ministry of Finance to remain similar next year to this year, but due to the exaggerated estimate of the outturn for 2023, we assess that the projections in the Draft Budget imply growth of more than 10%. The Ministry of Finance's estimate of expenditure in 2023 implies that "core" spending growth is expected to be 18.0% this year. Our estimate is that growth will be around 8% at most, which is still quite high but similar to the average of the previous three years. On this basis, we estimate that the growth in "core" spending in the Draft Budgets in 2024 will be more than 10%, once this year's actual outturn is known. This would be well above the long-term average and well above the estimated potential GDP growth, and also contrary to the Council of the EU recommendations. In this context, it should be underlined that the Draft Budget for 2024 envisages cuts in transfers to individuals and households, which is unrealistic in our assessment, despite the decision to freeze the statutory adjustment for inflation. This implies that the actual growth of "core" spending would be even higher. We assess that the growth in "core" spending in 2024 will be mainly driven by an increase in the transfer to the social security funds. This will result from an increase in the transfer to the Pension and Disability Insurance Institute of Slovenia, due to the projected 8.2% regular adjustment of pensions, and a further high increase in the transfer to the Health Insurance Institute of Slovenia, also due to the abolition of supplementary health insurance. The Draft Budget also allows for an almost 10% increase in labour cost expenditure, when taking into account the exaggerated estimate for 2023, which is unrealistic given the projected delay in the implementation of the wage reform. After a prolonged period, interest expenditure is also expected to make a more pronounced contribution to spending growth, reflecting an increase in the required rate of return in the context of tighter monetary policy and the persistence of a relatively high level of nominal state budget debt. Investment spending is projected to decrease in 2024, but with a significant overestimation of this year's outturn, we estimate that the Draft Budget implies maintaining the level achieved. The projected volume of investment represents slightly less than 3% of GDP, which would be similar to 2022. The structure of investment funding is also expected to be similar to that in 2022, with around a third to be financed by EU funds. After a longer period, we consider this investment projection to be relatively realistic.

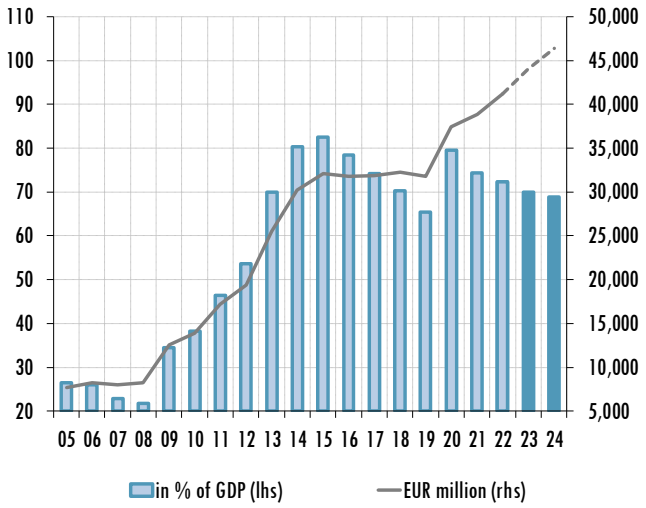
In our assessment, the Draft Budget for 2025 does not meet the criteria of a credible no-policy-change scenario. The total deficit is projected to fall to 1.8% of GDP in 2025 and the "core" deficit (excluding the impact of the intervention measures) to 1.3% of GDP. Our assessment is that the projection of "core" spending in particular, which should reflect the corresponding projections of the no-policy-change scenario, does not reflect the legislation and measures currently in force. In particular, the projections for transfers to individuals and households and transfers to social insurance funds are underestimated in our assessment. Taking into account the adjustment of transfers with inflation and pensions according to the statutory formula, as well as the increasing negative impact of the abolition of supplementary health insurance, would imply higher growth than projected in the Draft Budget for 2025. On the revenue side, we view as overly optimistic in particular the projection of growth in income tax revenue, which is clearly above the projected growth in the macroeconomic base.

2.2 General government gross debt

After a significant increase in 2020, the general government debt-to-GDP ratio is expected to slightly decline by the end of 2024, but it will nevertheless remain higher than before the current crisis. The decline in the debt-to-GDP-ratio from 79.6% in 2020 is assumed to be somewhat more gradual than in the previous two years, with an expected drop of just under 4 percentage points of GDP over the period of the Framework Proposal (2023 and 2024). With the continuing primary balance deficit and the realisation of the predicted nominal GDP growth, which is expected to be higher than the implicit interest rate on the back of the high contribution of inflation, the debt ratio is projected to reach 68.9% of GDP by the end of 2024.

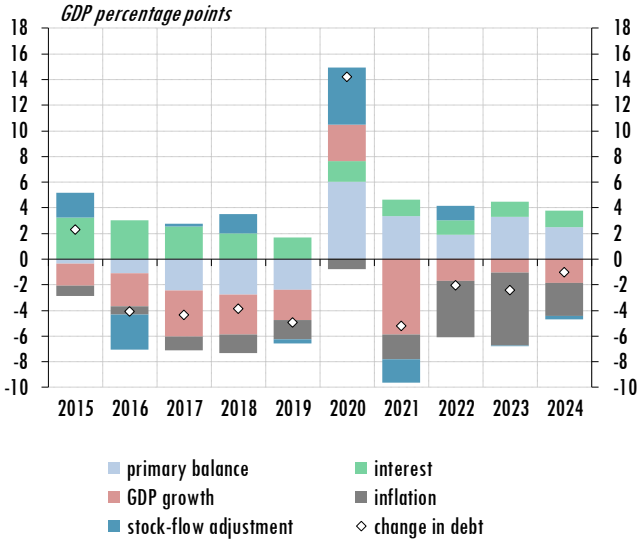
The tightening financing conditions of the government has been slower than last year for most of this year, but recent weeks have been marked by an acceleration in the growth of required yields.

Figure 2.9: General government debt



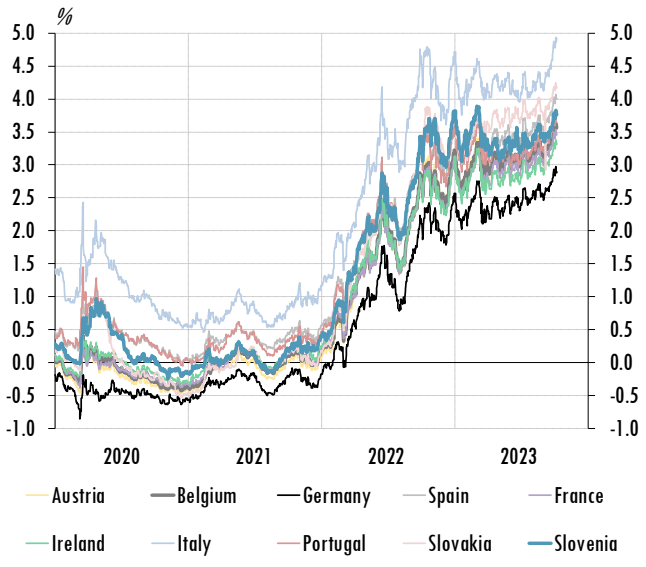
Source: SORS, MoF.

Figure 2.10: Change in general government debt



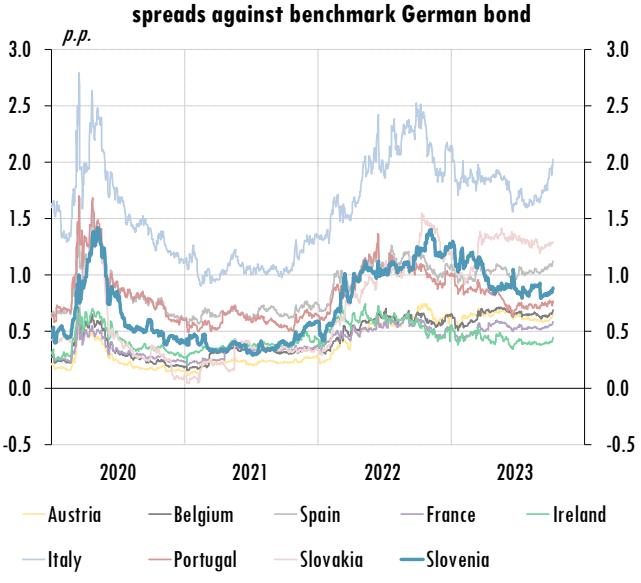
Source: SORS, MoF, IMAD, FC calculations.

Figure 2.11: Yields on 10-year government EUR reference bonds



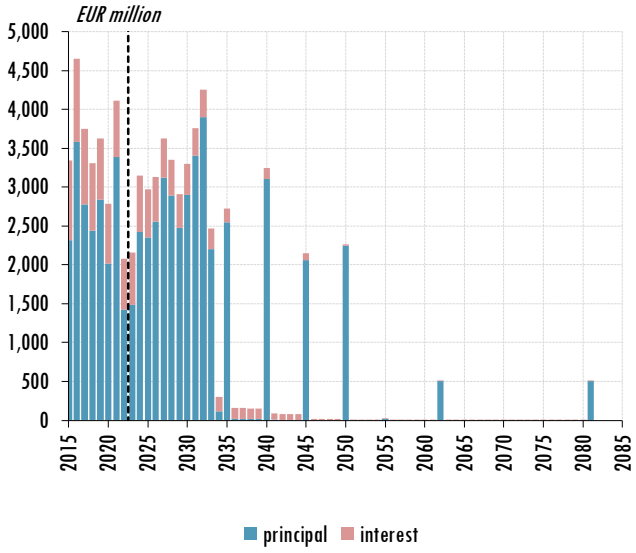
Source: Bloomberg.

Figure 2.12: Reference 10-year government bond spreads against benchmark German bond



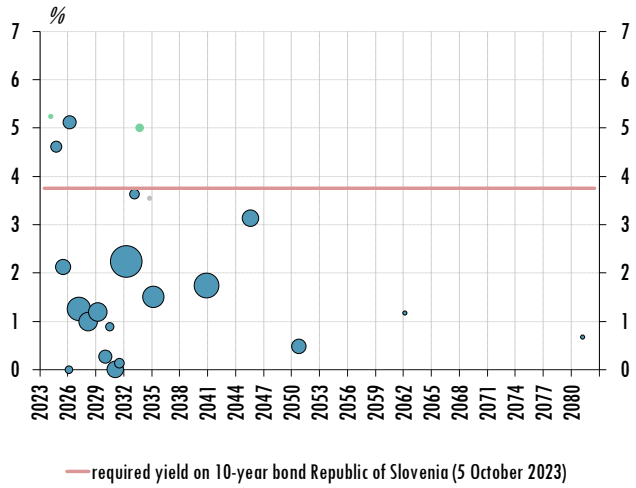
Source: Bloomberg, FC calculations.

Figure 2.13: State budget debt repayment schedule



Source: MoF.

Figure 2.14: Key characteristics of debt maturities and current required yields



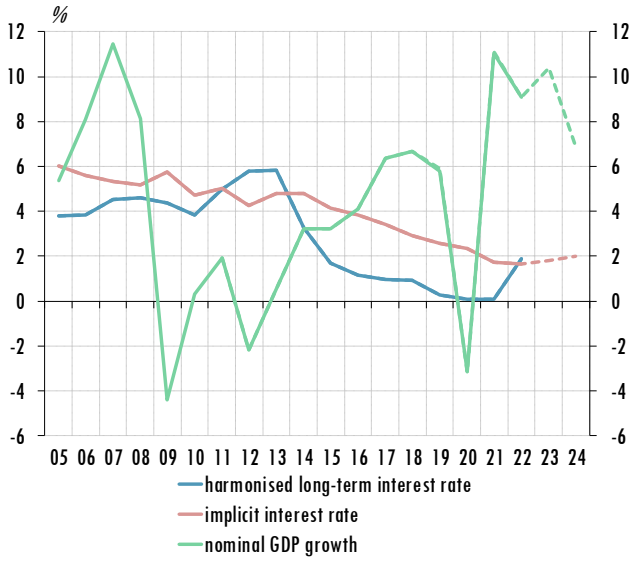
Source: MoF, FC calculations. Note: The size of circles represents the volume of liabilities based on long-term bonds maturing in that year. The green colour marks the bonds issued in USD, grey color marks inflation-linked bonds.

The required yield on Slovenian government bonds, which averaged 3.5% in September, is rising more slowly this year than last year, in line with the less aggressive monetary policy tightening. However, in the first week of October, the required yield rate already reached 3.8%, a similar jump to the rest of the eurozone. This should reflect, in particular, changes in the perception of the outlook for future economic developments and the associated extended maintenance of restrictive monetary policy, as well as changes in the portfolios of large investors. Compared to December last year, the required return on Slovenian bonds increased by 0.2 percentage points on average in September. At the same time, the required yield spread for German government bonds fell by 0.4 percentage points by September. The reduction in the spread was thus larger than in the case of Portuguese and Italian (-0.2 percentage points) and Spanish and Slovak (spread unchanged) government bonds. The harmonised interest rate has exceeded for over a year the current implicit interest rate, calculated over total debt. This, together with the relatively high level of debt and the expected persistence of tighter financing conditions, implies a future increase in interest costs and thus pressure on other government expenditure. Debt ratings remain unchanged, with two of the three most important agencies – Fitch (May) and S&P (June) – confirming stable rating outlooks this year.

In 2023, borrowing was relatively modest. At the beginning of the year, a ten-year sustainability bond was issued for a total of EUR 1.25 billion, with a coupon rate of 3.625%; in September, the first inflationary bond was issued, worth EUR 100 million, maturing in 2034 and yielding 0.826% plus euro area inflation.[11] In September, a ten-year bond was issued for a total of USD 1 billion, with a coupon rate of 5.0%. By the end of June, additional issues of two existing bonds were made in the total value of EUR 450 million. The two bonds have a long remaining time to maturity, one maturing in 2045 and the other in 2050. In 2023, the Treasury also carried out two partial early redemptions of existing bonds with total value of nearly EUR 100 million. One of these bonds matured this year and the other will mature next year. It has issued around EUR 1.1 billion of treasury bills in regular auctions until mid-September 2023. By September, all liabilities for this year (around EUR 3.5 billion) arising from long-term bonds had already matured, and around EUR 0.3 billion of treasury bills are still due by the end of the year.

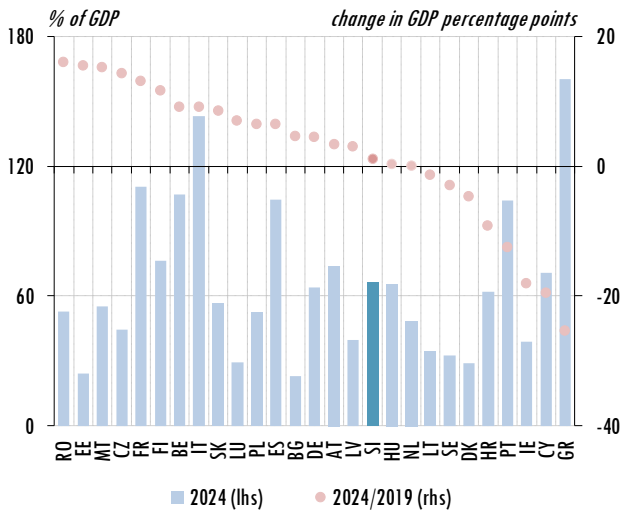
[11] After the interest rate risk management operations, the interest cost of this bond for the state budget is 3.555%.

Figure 2.15: Harmonised long-term interest rate, implicit interest rate and nominal GDP growth



Surce: ECB, SORS, IMAD, MoF, FC calculations.

Figure 2.16: Gross general government debt



Source: IMF, FC calculations.

Even in a less favourable financial market environment, the current favourable liquidity position of the government budget provides some room for manoeuvre. The balance in the treasury single account further rose by EUR 0.6 billion to total EUR 8.3 billion (just over 13% of the GDP projected for 2023) by the end of September this year. In the Draft Budgets,[12] the Government announces its intention to reduce debt by using part of high liquidity reserves created through pre-financing cumulatively over the 2023–2025 period by around EUR 2 billion (around 3% of projected GDP for 2023). This is reasonable given the current increase in financing costs. The volume of outstanding liabilities from long-term bond and treasury bill issues (around EUR 2.4 billion in total, or just under 4% of GDP, of which the principal of long-term bond issues is around EUR 2 billion) in the coming year is among the average for this decade. Government guarantees, which stood at EUR 4.2 billion or about 6.7% of GDP at the end of the second quarter of 2023, are expected to decline to 5.3% of GDP by 2025 according to the 2023 Stability Programme data from April this year.[13]

Given that the relatively high level of debt may impair fiscal stability in the event of new shocks, it is necessary to exercise particular caution when it comes to additional borrowing. Two consecutive shocks have led to a significant increase in public debt at the global level, mainly due to extensive measures to contain their effects, which has been accompanied by a recent tightening of monetary policy. Slovenia is among the EU countries with the smallest increase in public debt in 2024 compared to 2019, according to the latest IMF forecast (it is not clear whether this includes flood-related intervention measures).[14] Over the same period, debt is expected to fall in eight EU countries. Despite the need to finance the consequences of the natural disaster, it is essential to avoid decisions that would lead to an unnecessary increase in debt and to make use of all available resources, both through more efficient public spending and the use of grants and, in particular, with the cautious use of the liquid resources available to the state budget (see also Section 5.2). By maintaining

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

[13] Government of the Republic of Slovenia (2023a). The Implementation of the Republic of Slovenia Budget for 2024 and 2025 Act (Government of Slovenia, 2023c) allows new state guarantees to be issued for EUR 1.4 million of principal every year (2.1% and 2.0% of GDP respectively).

[14] IMF (2023a). The forecast is not made under the ESA 2010 methodology but is the latest forecast (October) that enables a comparison between countries. The last forecast by the EC that included the projection for the general government debt under the ESA 2010 was made in spring 2023. According to that forecast as well, the increase in debt in 2024 in Slovenia compared to 2019 levels is expected be among the smallest among EU Member States.

debt at relatively high levels, it becomes more sensitive to possible additional shocks or changes in macroeconomic trends, which may crowd out other expenses and cause instabilities in the implementation of the fiscal policy.[15]

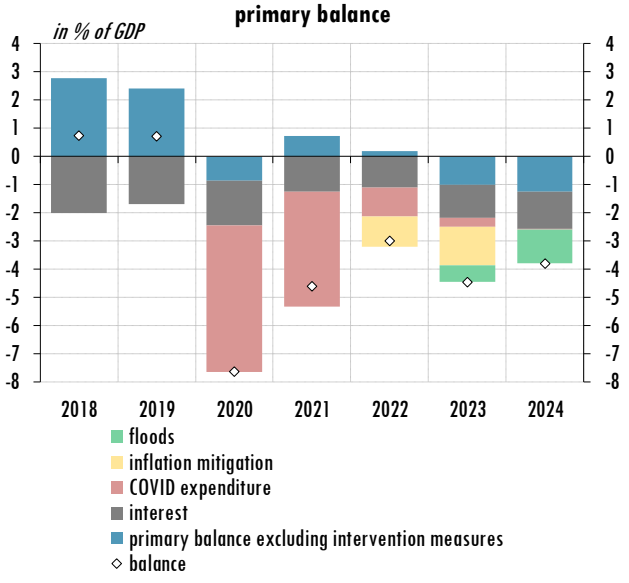
[15] See, for example, Delakorda (2021).

Box 2.1: Projections for the general government balance for 2023 and 2024 according to the ESA 2010 methodology

Similarly as last autumn, this assessment of the budgetary documents pays more attention to the state budget than to the projections of the general government balance, because state budget projections give rise to the unreliability of the projections of the general government sector, which are to some extent beyond the control of the Ministry of Finance. Like last autumn, the main reason for the unreliability is associated with the large reserve in the state budget projections, a category that does not exist in the accounting methodology according to which the general government balances are managed. In the state budget projections, EUR 0.2 billion this year and EUR 0.8 billion next year of the reserve are earmarked for as yet undefined measures to mitigate the effects of the cost of living crisis and for post-disaster recovery, and around EUR 350 million per year for the purpose of using up the proceeds of the RRP funds, which is also not yet known. The Ministry of Finance thus had to allocate these resources in the general government sector projections to the categories of general government sector expenditure without a proper basis. It should be pointed out, moreover, that the Ministry of Finance did not provide the Fiscal Council with general government projections according to the ESA 2010 methodology, reflecting the proposed state budget for 2025. As the assessment of compliance with fiscal rules is made on the basis of the general government balance, it is therefore not possible for 2025 (see also "Legislative basis" chapter). As one of the basic elements of the revised EU economic governance framework is to be a 4-year fiscal plan, this may be an indication of the administration's unpreparedness for the proposed changes.

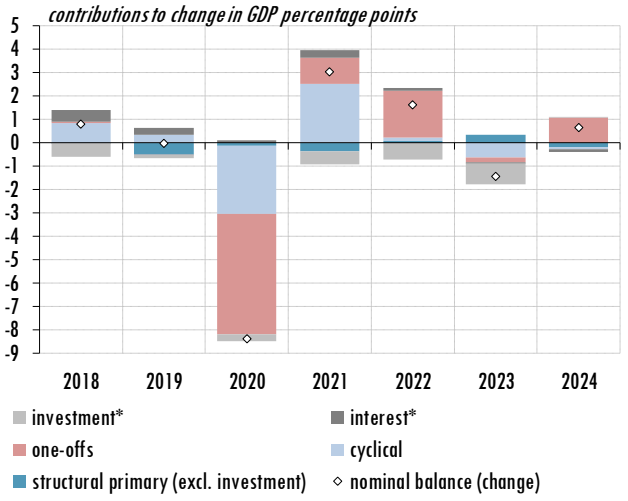
Excluding the direct effect of emergency-related measures,[1] the general government deficit is expected to further grow this and next year. The overall general government deficit stood at 3.7% of GDP in the first half of this year and is projected by the Ministry of Finance to widen in the second half of the year to 4.5% of GDP for the full year. This would be 1.5 percentage points higher than last year's outturn. At the same time, the total direct impact of the intervention measures is expected to be 2.3% of GDP, only slightly higher than last year. The deficit excluding the impact of the intervention measures is therefore projected to widen significantly this year, from 0.9% of GDP last year to 2.2% of GDP. Thus the projected deterioration in the overall deficit this year is almost entirely due to developments unrelated to intervention measures to mitigate the impact of shocks. In addition, the cyclically adjusted balance will turn from positive to negative on the back of the projected deterioration in economic conditions, and investment expenditure is expected to increase further.[2] In 2024, the overall deficit is projected to decline to 3.8% of GDP, but excluding intervention measures,

Figure 1: General government budget balance and primary balance



Source: SORS, MoF.

Figure 2: Factors of general government balance change



*Source: MoF, SORS, FC calculations. *Positive sign denotes a decrease, negative sign denotes an increase.*

which are projected to be half this year's level, the deficit is projected to be 0.4 percentage points of GDP higher than projected for this year.

Table 1: General government balance projections

EUR million, unless stated otherwise	outturn SORS	MoF (Oct. 23)		change in %			GDP share		
	2022	2023	2024	2022	2023	2024	2022	2023	2024
Revenue	**25,182**	**27,691**	**29,602**	**7.4**	**10.0**	**6.9**	**44.1**	**44.0**	**44.0**
Total taxes	12,156	13,042	13,971	6.2	7.3	7.1	21.3	20.7	20.8
Taxes on production and imports	7,590	8,015	8,554	7.8	5.6	6.7	13.3	12.7	12.7
Current taxes on income, wealth	4,546	5,006	5,394	3.4	10.1	7.8	8.0	7.9	8.0
Capital taxes	20	21	23	37.5	3.3	10.7	0.0	0.0	0.0
Social contributions	9,307	10,180	11,414	6.5	9.4	12.1	16.3	16.2	17.0
Property income	405	477	489	27.9	17.8	2.5	0.7	0.8	0.7
Capital transfers	480	823	711	22.6	71.5	-13.6	0.8	1.3	1.1
Other	2,834	3,170	3,017	11.1	11.9	-4.8	5.0	5.0	4.5
Expenditure	**26,899**	**30,498**	**32,157**	**4.0**	**13.4**	**5.4**	**47.2**	**48.4**	**47.8**
Compensation of employees	6,474	7,188	7,568	-2.1	11.0	5.3	11.4	11.4	11.2
Intermediate consumption	3,739	4,039	4,268	10.1	8.0	5.7	6.6	6.4	6.3
Social benefits	10,579	11,068	12,292	10.0	4.6	11.1	18.5	17.6	18.3
Interest	639	734	880	-1.8	15.0	19.9	1.1	1.2	1.3
Subsidies	684	1,299	845	-46.3	89.9	-34.9	1.2	2.1	1.3
Gross fixed capital formation	3,082	3,961	4,230	26.2	28.5	6.8	5.4	6.3	6.3
Other	1,703	2,209	2,073	-8.9	29.7	-6.2	3.0	3.5	3.1
Balance	**-1,717**	**-2,807**	**-2,555**				**-3.0**	**-4.5**	**-3.8**

excluding intervention measures *EUR million, unless stated otherwise*	outturn SORS	MoF (Oct. 23)		change in %			GDP share		
	2022	2023	2024	2022	2023	2024	2022	2023	2024
Revenue	**25,393**	**27,695**	**29,342**	**8.3**	**9.1**	**5.9**	**44.5**	**44.0**	**43.6**
Total taxes	12,367	13,046	13,711	8.0	5.5	5.1	21.7	20.7	20.4
Taxes on production and imports	7,801	8,179	8,554	10.8	4.8	4.6	13.7	13.0	12.7
Current taxes on income, wealth	4,546	4,846	5,134	3.4	6.6	5.9	8.0	7.7	7.6
Capital taxes	20	21	23	37.2	3.3	10.7	0.0	0.0	0.0
Social contributions	9,307	10,180	11,414	6.5	9.4	12.1	16.3	16.2	17.0
Property income	405	477	489	27.9	17.8	2.5	0.7	0.8	0.7
Capital transfers	480	823	711	22.6	71.5	-13.6	0.8	1.3	1.1
Other	2,834	3,170	3,017	11.1	11.9	-4.8	5.0	5.0	4.5
Expenditure	**25,921**	**29,064**	**31,076**	**9.3**	**12.1**	**6.9**	**45.4**	**46.2**	**46.2**
Compensation of employees	6,342	7,132	7,563	5.5	12.4	6.1	11.1	11.3	11.2
Intermediate consumption	3,673	3,983	4,263	13.0	8.4	7.0	6.4	6.3	6.3
Social benefits	10,334	11,012	12,292	11.5	6.6	11.6	18.1	17.5	18.3
Interest	639	734	880	-1.8	15.0	19.9	1.1	1.2	1.3
Subsidies	397	635	836	-43.5	59.9	31.6	0.7	1.0	1.2
Gross fixed capital formation	2,969	3,850	3,770	27.7	29.7	-2.1	5.2	6.1	5.6
Other	1,566	1,719	1,471	3.6	9.8	-14.4	2.7	2.7	2.2
Balance	**-529**	**-1,369**	**-1,734**				**-0.9**	**-2.2**	**-2.6**

Source: SORS, MoF, FC calculations.

[1] Since the beginning of the epidemic, the Fiscal Council has been paying more attention to fiscal developments which do not include the effect of intervention measures to mitigate the consequences of shocks, given that such an analysis more adequately shows the state of public finances and the emergence of potential risks to the sustainability of public finances in the medium term. The measures to mitigate the effects of the epidemic and the cost of living crisis have been supplemented in this year's projections by measures to recover from the natural disaster.

[2] The projection of capital expenditure on the general government balance remains optimistic. In the first half of the year, general government investment amounted to 5.4% of GDP and is projected to reach 6.3% of GDP in the whole of 2023. This implies a marked acceleration of growth in the second half of this year.

Box 2.2: Intervention measures to mitigate the effects of the epidemic, cost of living crisis and natural disaster

Unexpected events with significant public finance implications require significant improvements in budgetary planning. The period 2020–2025 is marked by three unexpected events with a significant negative impact on public finances. With an overall state budget deficit of EUR 14.5 billion over the period, the direct impact of the intervention measures already implemented and foreseen amounts to EUR 9.2 billion. The uncertainty associated with the direct fiscal impact of measures to mitigate the negative consequences of these events reduces the transparency of public finances.[1] At the same time, uncertainty has also been exploited to some extent to adopt discretionary measures of a structural nature with purely negative consequences for the sustainability of public finances (see Box 2.3). Recognising that the likelihood of negative shocks is increasing, budgetary planning should be based to a much greater extent than in the past on credible projections of the so-called no-policy-change scenario, which captures the effects of the legislation and measures in force at the time of the adoption of the budgetary documents. Only such a starting point allows adequate identification of the room for manoeuvre for intervention and other discretionary measures unrelated to dealing with the consequences of unexpected events. A credible medium-term budgetary framework under a no-policy-change scenario is also a fundamental element of the revised system of the EU economic governance framework.[2]

State budget expenditure to mitigate the effects of the epidemic has been further considerably reduced this year, with a total of around EUR 30 million foreseen over the next two years under the Draft Budgets. The expenditure to mitigate the effects of the epidemic amounted to EUR 5,678 million over the period 2020–2022. It totalled EUR 189 million in the first nine months of this year, while a total of EUR 371 million has been budgeted for this purpose this year in the 2023 Estimate. The bulk of expenditure outturn in the first nine months of this year is accounted for by investments (EUR 79 million) mostly financed under the REACT-EU programme, wage compensation due to isolation (EUR 46 million), which ended at the end of March, and expenditure related to the cost of vaccination and testing (EUR 47 million). We reiterate the warning made in the May assessment of the revised budget about the inappropriate classification of certain measures as intervention expenditure to mitigate the effects of the epidemic.[3] This year, EUR 64 million is earmarked for investment in tourism infrastructure funded under the European REACT-EU programme. While this is aimed at increasing resilience to potential epidemics and the associated economic recovery, investments in modernising tourism infrastructure are not, in our view, directly linked to the epidemic.

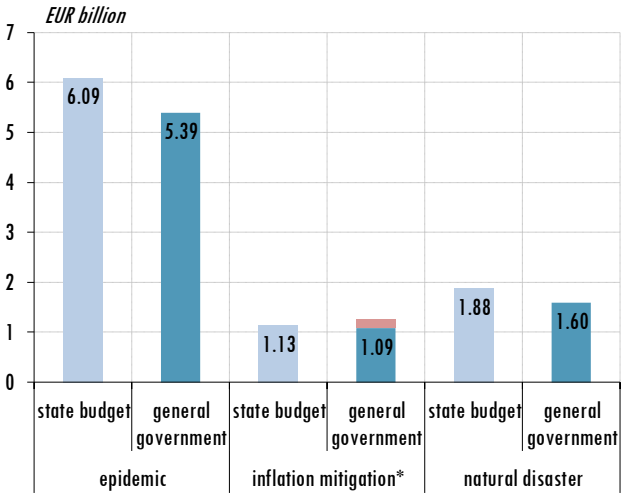
The direct impact of the measures to ease the cost of living crisis is expected to be about twice as large this year as last year, with the bulk of it coming from subsidies to business. The state budget expenditure to ease the cost of living crisis is expected to rise from EUR 253 million last year to EUR 779 million this year, according to the 2023 Estimate. While last year's expenditure was similarly focused on transfers to the most vulnerable groups and on subsidies to business and agriculture, this year's expenditure will be predominately earmarked for subsidies to businesses (EUR 436 million). In the first nine months, expenditure amounted to EUR 329 million, including EUR 182 million in subsidies to businesses and EUR 72 million in compensation to electricity and gas suppliers. By the end of the year, EUR 88 million of the measures not yet implemented are foreseen for pensioners' benefits. The EUR 210 million reserve also represents an important part of the total envisaged volume of measures to address the cost of living crisis. 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 somewhat less negative this year than last year, amounting to about EUR 160 million. The Government also extended administratively reduced electricity and natural gas prices for various users until the end of the year.[4] Based on an assessment that the war in Ukraine has accelerated structural changes in energy prices and the publicly available information that the Government is considering the extension of administratively set prices to next year, the Fiscal Council 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, both from the point of view of increasing energy efficiency and addressing the need for providing funds for the post-flood recovery. Next year, the Draft Budget foresees EUR 100 million in expenditure on the cost of living crisis, two-thirds of which will be spent on subsidies to business, with the rest in the reserve line.

The state budget currently earmarks EUR 1.9 billion for disaster recovery in the period 2023–2025. Most of the funds are in the reserve line (EUR 1.1 billion), which is understandable given that the measures have not yet been decided. The current level of funding is not sufficient to cover the damage (see Section 5.2). At the same time, it is likely that part of the funds for the recovery will not be provided in the state budget but in a special extra-budgetary fund. Recognising that the recovery will be a multi-year process, the Fiscal Council expects, above all, that it will be financed in a transparent and targeted manner.

The differences in the estimates of the size of all intervention measures between the state budget and the general government balance go beyond the differences that could be explained only by the use of different methodologies. Given that the intervention measures known so far are financed exclusively through the state budget, which is the largest part of the general government sector, the differences between the estimates of their scope, as a result of different methodologies, are mainly due to differences in the time of accounting. For example, these are the funds from the foreseen solidarity contribution.[5] An additional potential reason for the differences is the fact that the state budget foresees a significant amount of resources under the reserve line, which does not exist in the general government balance methodology. As a consequence, the funds from the state budget reserve have to be booked to the categories of general government expenditure without a proper basis. Taking these differences into account, we would nevertheless expect the total volume of intervention measures to be the same over the whole period of validity if the state budget and general government balance are aligned. We find that this is not the case, and that the differences are significant. Together, the three fields of application of the intervention measures amount to more than EUR 1 billion over the whole period of validity (see Figure).

Figure: Total volume of intervention measures expenditure in general governement and state budget balances



Source: MoF. Note: ELES recapitalisation was financed from state budget B balance and is therefore not a part of state budget expenditure while influencing general government budget balance.

[1] The Fiscal Council, within its sphere of competence, is also trying to contribute to addressing this shortcoming, including by publishing up-to-date information on the fiscal implications of intervention measures, in particular through its regular publication Monthly Information, which it started publishing in January 2021. Even before this, the Fiscal Council regularly published information on the public finance implications of measures to contain the epidemic on its website.

[2] Brložnik (2023).

[3] Fiscal Council (2023).

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

[5] Under the cash flow methodology (GFS), on which the state budget is based, these revenues are accounted when they are paid in, while under the accrual methodology (ESA 2010), on which the general government balance is based, they are accounted when the liability is incurred. Thus in the state budget, these revenues are accounted in 2024 and 2025, while in the general government balance sheet they are accounted in 2023 and 2024.

Box 2.3: Impact of discretionary measures on the general government balance[1]

A number of discretionary measures unrelated to the crises were taken in times of exceptional circumstances and will have a lasting negative impact on public finances. The direct impact on the deterioration of the general government balance of discretionary measures taken from the beginning of 2022 is estimated at over 3.0% of GDP. The measures adopted after the May budget revision alone will directly contribute around 1.0% of GDP to the deficit in 2025.[2] As this is only the direct or static effect of the measures, we also assessed their reverse effects using dynamic simulation. Most of the measures increase household disposable income or have a positive impact on domestic demand through other levers, with an indirect positive impact on general government revenues. In particular, the temporary increase in inflation stimulated by the measures in the simulation contributes to this effect, bearing in mind that the increased inflation has an impact on the nominal level of economic activity and thus on the size of the denominator in relative comparisons. Thus we estimate that the actual impact of discretionary measures on public finances will be about half of the static estimate. Nevertheless, the discretionary measures adopted will have a significant negative impact on the general government balance and public debt in the medium term, extending beyond the period of the simulations shown.

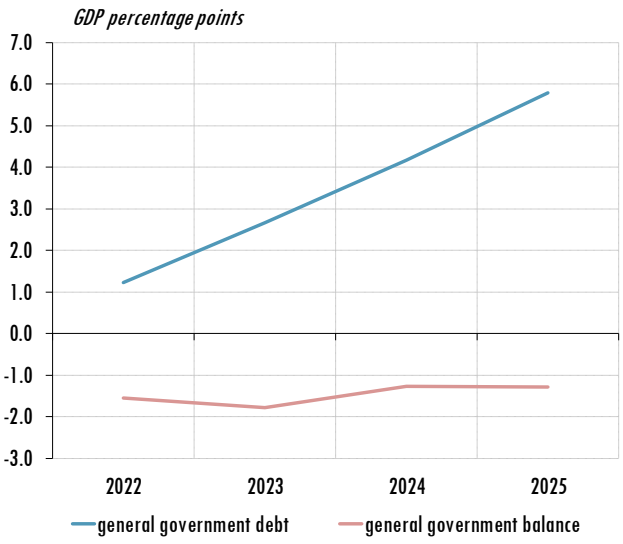
Adopting discretionary measures with an exclusively negative impact on public finances significantly limits the room for manoeuvre for future fiscal policy action. Discretionary measures have been taken since the beginning of the epidemic, with an overall negative direct impact on the general government balance. Thus, measures will be needed to counteract their negative impact to ensure the sustainability of public finances in the coming years. This can be done either by structurally increasing revenues or by limiting other drivers of public spending. Our overall assessment is that the adoption of discretionary measures does not adequately reflect their impact on the sustainability of public finances. At the same time, preliminary estimates of their financial impact are in most cases non-transparent, incomplete and inadequately explained, including estimates of the impact of the amendments, and there is almost no monitoring of their actual financial impact after their adoption. At

Table: Direct impact of discretionary measures unrelated to alleviating the impact of the epidemic and the cost of living crisis

in % of GDP	entry into force	2022	2023	2024	2025
Act Amending the Personal Income Tax Act	Mar. 22, Jan. 23	-0.5	-0.6	-0.5	-0.5
Agreement on raising the salaries of doctors	Jan. 22	-0.2	-0.2	-0.2	-0.2
Scientific Research and Innovation Activity Act	Jan. 22	-0.1	-0.1	-0.1	-0.1
Extraordinary indexation of pensions – ZPIZ-2L	Jan. 22	-0.3	-0.2	-0.2	-0.2
Act Amending the Health Care and Health Insurance Act	Feb. 22	-0.1	-0.1	0.0	0.0
Students Status Act	Apr. 22	-0.1	-0.1	-0.1	-0.1
Act Determining Emergency Measures to Ensure Stability of the Healthcare System	July 22	0.0	-0.2	0.0	0.0
Agreement on measures relating to salaries and other labour costs in the public sector for 2022 and 2023	Oct. 22	-0.2	-0.7	-0.8	-0.7
Point 5 of the general agreement (health, nursery assistants, young researchers)	Dec. 22	0.0	-0.1	-0.2	-0.2
Agreement on the settlement of strike demands in healthcare and social care activities	Dec. 22	0.0	-0.1	-0.1	-0.1
Act Regulating Alternative Fuels Infrastructure and Promoting the Transition to Alternative Fuels in Transport	May 23	0.0	0.0	-0.1	0.0
Act Amending the School Meals Act	June 23	0.0	0.0	0.0	-0.1
Act Amending the Health Care and Health Insurance Act	July 23	0.0	0.0	-0.4	-0.4
Long-Term Care Act	July 23	0.0	0.0	-0.1	-0.4
Other measures[1]		-0.1	-0.4	-0.3	-0.1
TOTAL		**-1.5**	**-2.7**	**-2.8**	**-3.0**

Sources: Government of the Republic of Slovenia, DZ RS, IMAD; FC calculations. Note: the line indicates the measures taken since the adoption of the April 2023 revised budget. [1] All other discretionary measures with an impact of less than 0.1% of GDP in a given year.

Figure: Simulation of impact of discretionary measures on general government budget balance and debt



Source: FC estimate.

the same time, the accumulation of discretionary measures increases the expectations of economic agents for additional measures in the future.

[1] The Fiscal Council regularly monitors discretionary economic policy measures and their impact on the general government balance. In addition to assisting in the analysis of regular budgetary developments, the monitoring of such measures also serves as an important input for assessing how realistic the projections contained in the budgetary documents are.

[2] The magnitude of direct or static impacts is mostly taken from the official explanatory notes at the time the legislation was adopted; in some cases, we have assessed the magnitude of the impact ourselves, while in some cases we have asked the relevant ministries to update the impact assessment based on the latest available information.

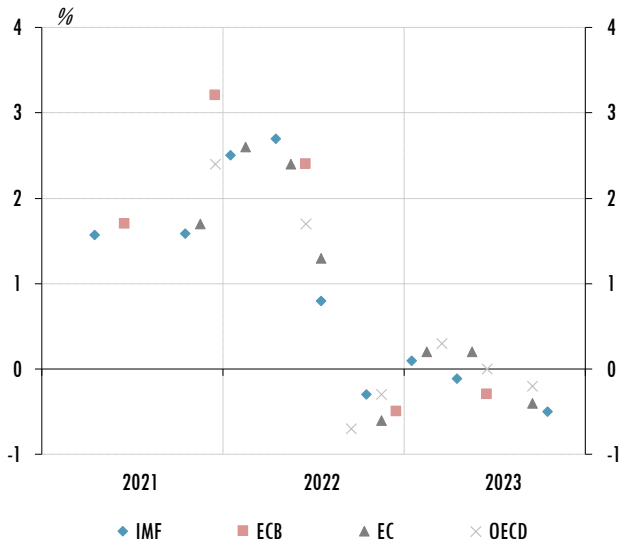
3. Risks to the macroeconomic and fiscal scenarios

Key findings

- The prevailing negative macroeconomic risks relate to both the international and, to an increasing extent, the domestic environment, including subsequently announced economic policy orientations and measures that were not included in the baseline macroeconomic scenario.
- The main risk to the budgetary projections is the potential deviation from the fiscal implications of the post-flood recovery estimated and included so far.
- Budgetary documents contain a number of risks resulting from unrealistic projections for individual categories, and the risks are compounded by possible additional demands from stakeholders that could worsen the public finances.
- Once again, the budgetary plans fail to address a number of challenges, most importantly demographic change and the implementation of the green transition commitments, and thus the long-term fiscal risks, which are therefore deepening. Spontaneous scenarios in the debt sustainability analysis suggest that debt dynamics could become unsustainable in the medium term in the absence of an economic policy response, even if only a small share of the identified long-term risks were to materialise.

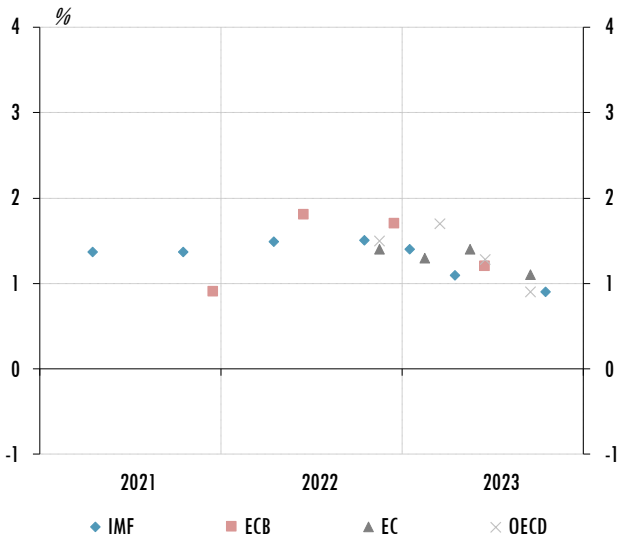
The macroeconomic scenario underlying the budget is dominated by downside risks. Risks from the international environment are increasingly accompanied by risks from the domestic environment. In addition to geopolitical risks, especially those related to the wars in Ukraine and the Middle East, the risks from the international environment relate in particular to a moderation or even a decline in activity in the most important trading partners. Most recent forecasts suggest that Germany's GDP will

Figure 3.1: Real GDP growth forecasts for 2023 for Germany



Source: IMF, EC, OECD, ECB.

Figure 3.2: Real GDP growth forecasts for 2024 for Germany

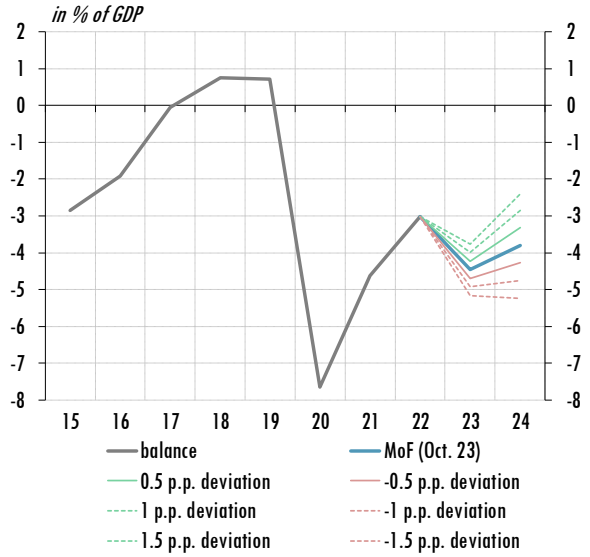


Source: IMF, EC, OECD, ECB.

fall this year and grow by only around 1% next year. Indirect downside risks to domestic economic activity also relate to the slowdown in the Chinese economy. This could slow GDP growth in Slovenia's major trading partners, as suggested by scenarios in recent ECB[16] and OECD[17] forecasts. A cut in foreign demand would hit the export side of the Slovenian economy, which has been facing relatively high labour cost growth and domestic price increases compared to its trading partners over the past year, weakening its competitive position. Additional risks to domestic economic developments come from the subsequently announced economic policy orientations, which were not included in the IMAD baseline macroeconomic scenario (IMAD, 2023a), in particular the ways of financing costs of post-flood reconstruction. In addition to having a direct impact on the functioning of the private sector and reinforcing inequalities in the household sector, where the propensity to spend is higher in the lower income brackets, this could further increase uncertainty and, as a consequence, constrain the dynamics of already slowing economic activity.

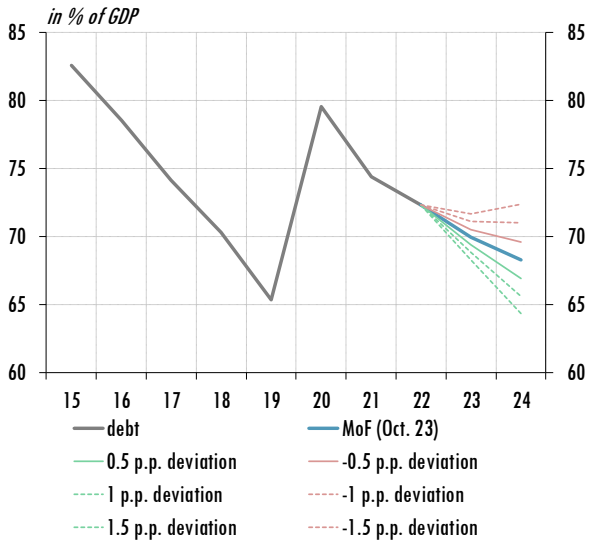
The materialisation of the predominantly downside macroeconomic risks could lead to a postponement of the planned fiscal consolidation. To simulate potential deviations from budget plans, we used a simple model enabling the analysis of the effects of various economic growth assumptions on public finance while considering reverse effects of fiscal policy on economic growth.[18] Estimates suggest that, with economic growth 0.5 percentage points lower than that in the baseline scenario in each year over the 2023–2024 period (real GDP would grow by 1.7% per year on average rather than by 2.2%) and with an unchanged fiscal policy, the general government deficit could exceed 4% of GDP in 2024 rather than amount to 3.8% of GDP. However, if economic growth in 2023 and 2024 period were 1.5 percentage points lower than that projected in the baseline scenario, the deficit in 2024 could approach 5.5% of GDP.[19] In the latter case, the general

Figure 3.3: Estimates of sensitivity of general government balance (ESA) to deviation in GDP growth



Source: SORS, MoF, FC calculations.

Figure 3.4: Estimates of sensitivity of general government debt (ESA) to deviation in GDP growth



Source: SORS, MoF, FC calculations.

[16] The scenario presented in ECB (2023) would lead to a slowdown in euro area GDP growth of around a quarter of a percentage point in the event of a Chinese GDP slowdown.

[17] In the OECD scenario (2023a), the assumed lower Chinese GDP growth in the first year after the shock could reduce GDP growth in EU OECD countries by just under a percentage point.

[18] In this model, economic activity affects public finances through automatic stabilisers, while fiscal policy affects economic activity reversely through multipliers. For a more detailed explanation of the model, see: http://www.fiscalcouncil.ie/wp-content/uploads/2012/09/FAR_Sept2012.pdf (Annex B).

[19] Figures 3.1 and 3.2 show the possible general government balance and debt developments with regard to different economic growth assumptions. The baseline scenario indicates the projection of the general government balance and debt set out in the fiscal projections under the ESA methodology (see Box 2.1). According to the baseline scenario of the IMAD forecast (2023), the economic growth assumptions are 0.5, 1.0 and 1.5 percentage points higher or lower in 2023 and 2024. The maximum shock with regard to the deviation of GDP growth by ±1.5 percentage points is determined based on average absolute errors in the IMAD forecasts in the current and next year in the 2002–2019 period.

government debt ratio would increase to levels close to 72% of GDP in 2024, contrary to the projected gradual decline in the baseline scenario.

The main risk to the budgetary projections is the potential deviation from the fiscal implications of the post-flood recovery estimated and included so far. The budgetary documents were prepared before the final assessment of the damage caused by natural disasters in 2023 and the related costs to be borne by the general government (see also Chapter 5). Any deviations from the estimates of these costs included in the budgetary documents will also have a direct impact on the deviations of the projections. In addition, the speed of the reconstruction is also unknown. This will have an impact on the dynamics of budgetary spending and the related possible need to reduce the volume of other spending or on still undetermined measures to finance the renovation. The recovery will also determine the dynamics of macroeconomic aggregates, in particular economic activity and employment, as well as inflation in relation to labour market conditions or capacity utilisation. At the same time, the dynamics and quality of reconstruction will depend on the absorption capacity of the economy and the administration.

The remaining major risks to the baseline fiscal scenario relate both to the projections of some budget categories and to certain potential liabilities, which could have a predominantly negative impact on budgetary outcomes. In addition to the Fiscal Council's assessment of an unrealistic outturn estimate for 2023 (see Chapter 2) also in the other years covered by the Draft Budgets, the budgetary projections contain some items, on both the revenue and expenditure side, which could have the effect of making the actual government deficit larger than projected in the baseline scenario (e.g. underestimated transfers to households and overestimated income tax revenues in 2024 and 2025 and underestimated transfers to social security funds in 2025).[20] In a context of a large number of extensive discretionary measures (see Box 2.3), uncertain economic conditions and persistently high inflation, the likelihood of additional demands from stakeholders that could worsen the public finances is increasing. Despite the envisaged delay, the planned reform of the wage system, which should in particular allow for efficient and accessible public services, will also have negative consequences for the fiscal position, at least in the medium term; the magnitude of these consequences is difficult to assess at this time. The fiscal implications of some pending trials (e.g. in relation to expropriated junior bondholders) are also uncertain but potentially high and with a one-off effect. Central bank decisions carry the risk of lower interest income on government deposits.[21] In addition to more realistic budgetary documents, we believe that more transparent and credible official estimates of the fiscal impact of discretionary measures would contribute to reducing risks.[22]

Once again, the budgetary plans fail to address a number of structural challenges and thus the long-term fiscal risks, which are therefore exacerbated. According to the EC[23] and OECD[24] analyses, Slovenia is among the countries with the highest long-term fiscal risks, which in these analyses relate only to the increased costs of social security systems. According to the internationally comparable projections from the latest Ageing Report,[25] the annual fiscal cost of population ageing under existing social protection systems in Slovenia is projected to increase by around 4 percentage points of GDP by 2040 compared to 2019.[26] This increase is mainly due to the failure of social protection systems to

[20] Za See Chapter 2 for more information.

[21] See the explanation of the general part of the revised budget of the Republic of Slovenia for 2025 (Government of the Republic of Slovenia, 2023b).

[22] At the same time, the monitoring of the fiscal impact of past measures is completely absent from the budgetary documents.

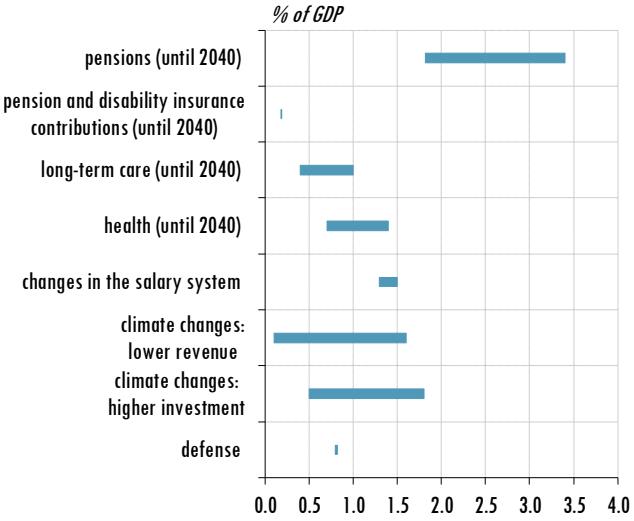
[23] EC (2023a).

[24] OECD (2023a).

[25] EC (2021a).

[26] The IER (2023) projections, which refer only to public pension expenditure, imply an increase of around half of the EC (2021a) projections for pensions.

Figure 3.5: Estimates of impact of long-term fiscal risks



Source: Brložnik (2022), Casey and Carroll (2023), EC (2021), IER (2023), media releases, OBR (2021), SORS, FC calculations.

adapt to demographic change. In addition to increasing the number of people covered by social protection systems while reducing the size of the working population, a long-lived society could in the future have a significant impact on the slowdown in economic activity and thus on general government revenues. Another important risk for public finances is the cost of the green transition. The Fiscal Council[27] assesses that the annual investment gap required in achieving the milestones of the green transition set out in the National Energy and Climate Plan[28] could be close to 2% of GDP by 2030. Given the lack of interest from the private sector, most of the burden could be borne by the state.[29] The green transition is also likely to be reflected in lower general government revenues, resulting from lower consumption of current energy sources and, at least temporarily, reduced activity in the more resource-dependent branches of industry. According to IMF simulations, delaying the start of a gradual adaptation to climate change would weaken economic growth in advanced economies by 0.1-0.2 percentage points per year,[30] which would also worsen the fiscal position.[31] Climate change risks also relate to the potentially increasingly significant fiscal implications of future weather-related natural disasters (see Chapter 5). With all the stated risks, the debt sustainability analysis (see Box 3.1) suggests that its dynamics could become unsustainable in the medium term in the absence of an economic policy response, even if only half of the lower limit of the identified long-term risks were to materialise.[32]

[27] Brložnik (2022).

[28] Government of the Republic of Slovenia (2020). A revised plan is under preparation, which at the time of writing does not yet include an assessment of the impact of the planned policies and actions – see https://www.energetika-portal.si/dokumenti/strateski-razvojni-dokumenti/nacionalni-energetski-in-podnebni-nacrt-2024/dokumenti/ (Only in Slovene).

[29] The assumptions used in the OBR (2021) assessments suggest that, for example, public finances in the UK are expected to bear half of the total cost of the green transition. The relatively low share reflects in particular the modest funding that the general government is expected to contribute to the transition to carbon-free energy sources, where the initiative is consequently left to the private sector.

[30] IMF (2022a).

[31] IMF estimates (2023b) suggest the possibility of an increase in public debt in developed countries of between 0.8 and 2 percentage points of GDP for each year of delay in carbon price increases.

[32] The estimates are based on various available sources. In most cases, estimates for Slovenia are used and in some cases (lower general government revenues resulting from climate change adaptation) defined by analyses for other countries. Instead of a point score, ranges of scores are sometimes shown (where several different scores were available for the same category), indicating the risks associated with such scores. The values represent the ultimate impact (in 2040 for pensions, pension and disability contributions, long-term care, and healthcare) and the expected ongoing impact (after the introduction of the other categories) of the selected risks. The figure can thus be interpreted as the lower and upper bounds (sum of the minimum and maximum points respectively) of the currently estimated risks to the general government balance in 2040.

Box 3.1: Slovenia's general government debt: A medium-term sustainability analysis

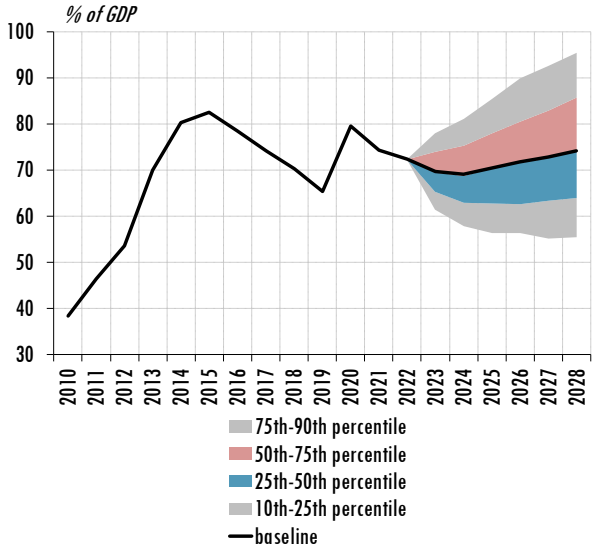
A debt sustainability analysis shows the ability of a country to finance the liabilities stemming from its past fiscal policy in the face of potential macroeconomic and fiscal shocks. Within the framework of the debt sustainability analysis carried out using a template developed by the IMF,[1] a baseline scenario is prepared based on macroeconomic and fiscal projections and alternative scenarios showing the debt responsiveness to different shocks. The responsiveness and changes in the dynamics and the level of the general government debt indicate the vulnerability of public finances to shocks other than those included in the baseline scenario; however, the actual shocks may deviate from those used in the analysis in terms of both their direction and magnitude.

This time, the usual analysis period of the medium-term sovereign debt sustainability has been extended to the analysis period that is expected to apply under the reformed EU economic governance framework. The simulations extend across the period of 2023–2038, significantly beyond the typical analysis period of six years. A short sustainability analysis period may not necessarily capture all the risks associated with debt developments, while a longer analysis period is also envisaged as one of the key elements of the reformed EU economic governance framework.[2] In the initial phase of the debt sustainability analysis, we took into account the general government fiscal projections submitted by the Ministry of Finance to the Fiscal Council together with the budgetary documents, as well as IMAD's autumn forecast for 2023. The macroeconomic aggregates have been extended beyond the end of the IMAD forecast based on the 2026 projection values. The projections of fiscal aggregates from the end of the projection period (2024) to the end of the analysis period were supplemented with standard elasticities for revenue, while expenditure was set by assuming that the difference between revenue and expenditure growth would be the same as in the long-term 2000-2019 period.[3] In view of the growing long-term fiscal risks, we have also taken into account the expected increased costs of demographic change and the cost of the green transition.[4] This is also a significant difference in the assumptions used in the medium-term debt sustainability analysis of the 2023 Stability Programme (Government of the Republic of Slovenia, 2023a). The underlying assumption was a gradual tightening of financing conditions, with the implicit interest rate on the general government debt close to 2.1% in 2026, which is some 2.4 percentage points below projected nominal GDP growth, and rising to 3% by the end of the analysis period. The baseline scenario also included the assumption that the high level of cash balance and deposits (the Treasury Single Account balance) would be reduced by EUR 1.2 billion, EUR 0.6 billion and EUR 0.1 billion in 2023, 2024 and 2025 respectively as evidenced by the Draft Budgets.

The medium-term debt sustainability analysis provides several alternative scenarios, in which shocks are standardised, primarily related to the historical fluctuations of the variables subject to shocks in these scenarios. According to the *alternative scenario of lower real GDP growth*, shocks are set at one standard deviation of real GDP growth in the 2012–2021 period, taking into account the elasticity of the response of inflation and interest rates to the change in GDP growth and the worsening of the primary budget balance by 0.25 and -0.25% respectively. According to this scenario, real GDP would fall by around 1% on average in 2024 and 2025 alone (it would grow by around 2.5% according to IMAD's projections). The scenario of a *worsened primary balance* is also based on a long-term deviation and the response of the interest rate to the same extent as in the event of a real GDP shock. In this scenario, the primary balance deficit would be roughly twice as high in 2024–2025 as in the baseline scenario. The *interest rate shock* is implemented by increasing the interest rates from the baseline scenario by 100 basis points over the entire period of the simulations. None of these alternative scenarios assume a fiscal policy response and therefore present the results of spontaneous scenarios.

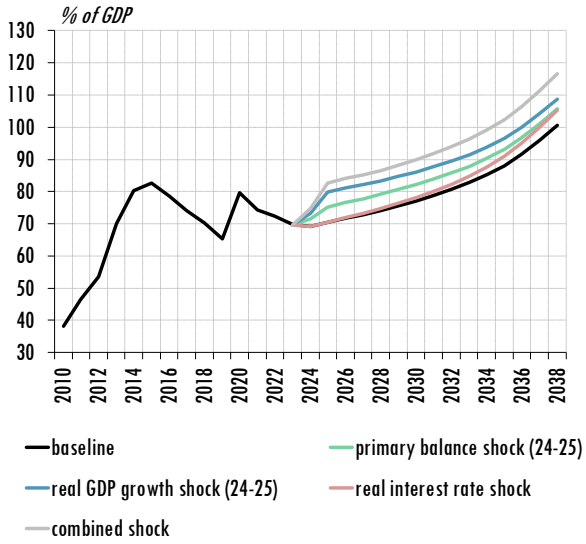
The analysis suggests that government debt dynamics are unsustainable in the longer term. The simulations under the baseline scenario of the debt sustainability analysis suggest an increase in debt that, under the assumptions used, starts shortly after the end of the period covered by the Framework Proposal and the Draft Budgets. Risks are asymmetric and concentrated in the upper part of the projected debt distribution (see Figure 1). The risk assessment confirms the assessment of debt

Figure 1: Probability distribution of general government debt simulations



Source: SORS, MoF, FC calculations and simulations.

Figure 2: General govenment debt response to shocks



Source: FC.

unsustainability in the medium term, stemming mainly from the possibility of lower economic growth, while a deterioration in the primary balance would also have an impact in terms of higher risk assessment. In these cases, the debt-to-GDP ratio could increase by around 10 percentage points of GDP relative to the baseline scenario, in which the ratio is around 100% of GDP at the end of the simulation period,[5] and by around 20 percentage points of GDP in the case of a combined macroeconomic and fiscal shock, reaching almost 120% of GDP at the end of the period.[6] The relatively high nominal economic growth implied by the IMAD projections would thus not ensure sustainable debt levels, assuming that current financing conditions persist and taking into account demographic change and green transition costs. Such findings are an indication that simulations of unchanged policies over a period of several years should be an important part of risk analysis. The results are at the same time a warning against a purely short-term focus of economic policy, as delaying action may have significant negative long-term consequences for public finances and thus for economic stability.

[1] The currently available basis is available at: https://www.imf.org/external/pubs/ft/dsa/mac.htm.

[2] See also simulations and discussions in Brložnik (2023) and Delakorda (2023).

[3] The difference was 0.25 percentage points.

[4] We have assumed cost increases due to demographic change, which only includes the Institute for Economic Research (IER) pension projection (2023). In this case, the general government deficit would increase by just under 0.1 percentage point of GDP per year (after 15 years of simulations, the deficit is therefore higher by around 1.4 percentage points of GDP), while if the European Commission's projections (2021) are taken into account, the deficit would increase by around 0.2 percentage points of GDP per year. It should be noted that only half of the estimated investment needs for the costs of the green transition have been taken into account (the general government deficit would be around 1 percentage point of GDP higher per year), assuming a substantial financing of the green transition by the private sector.

[5] Excluding from the simulation the expected higher costs of demographic change and the costs of the green transition, the general government debt would be around 70% of GDP at the end of the period. Its dynamics would be sustainable even in the presence of the simulated shocks.

[6] The analysis of the long-term sustainability of public finances in the 2023 Stability Programme (Government of the Republic of Slovenia, 2023a) only contains projections of age-related revenues and expenditure. The aggregation of these data into a total balance indicates of an even larger increase in debt than our analysis would suggest.

4. Fiscal policy orientation and stance

Key findings

- Notwithstanding the fact that fiscal policy faces a number of challenges and uncertainties, the budgetary documents submitted to the Fiscal Council for assessment lack credibility, are incomplete and do not allow compliance with the fiscal rules to be assessed in a manner consistent with the Fiscal Rules Act.
- Fiscal policy should ensure that room for manoeuvre is restored and that prudent and efficient measures are taken in the aftermath of the floods despite the uncertain situation; additional fiscal stimulus beyond the post-flood recovery is not warranted at present due to supply-side constraints.
- Fiscal policy should, as far as possible, avoid measures that weaken the effects of its other actions, in particular efforts to alleviate the effects of the cost of living crisis, while taking into account, as far as is possible, the broader context in which the measures operate and their medium-term effects.
- The limited room for manoeuvre and the risks to the long-term fiscal sustainability call for a thorough review of statutory public spending with a view to increasing its efficiency.
- Given the lack of clarity of the reformed economic governance framework at the EU level and the withdrawal of exceptional circumstances, as well as the shortcomings of the existing methodology for determining the fiscal position, the Fiscal Council has continued to use a wide range of indicators in its assessment.
- Most indicators point to an inappropriate fiscal policy stance, taking into account the planned financing of flood recovery, which is not in line with the cyclical position of the economy, does not ensure compliance with the fiscal rules and is also contrary to the recommendations of international institutions.

4.1 Fiscal policy management

There are many challenges and uncertainties facing fiscal policy. The main fiscal challenge in the short and medium terms is to support households and businesses and to rebuild infrastructure after the floods that hit Slovenia in August (see Chapter 5). The full financial extent of the damage caused and the State's involvement in reconstruction are not yet known, nor are the ways in which the damage will be repaired and financed. Understandably, the budgetary documents submitted thus do not yet allow a comprehensive assessment of the fiscal policy measures and orientations for this year and next year. Nevertheless, the budgetary documents already indicate that the crisis management of the general government budgets of the past three years, when a significant part of the budget items were funds related to mitigating the impact of the epidemic and the cost of living crisis, will be transferred to crisis management in the area of post-flood reconstruction. This is not the only challenge facing economic policy, which is currently navigating through a period of considerable global economic and

geopolitical uncertainty. Fiscally sustainable measures need to be adopted as soon as possible to address these challenges in a credible manner, together with a number of discretionary measures taken and announced to avoid adverse long-term fiscal consequences, in particular those stemming from demographic change and the green transition. Addressing the challenges to the long-term fiscal sustainability also requires a systematic review and rationalisation of the existing legal bases that largely pre-determine government budgetary expenditure.

The current situation suggests the need to create sufficient room for manoeuvre, also on the basis of a risk analysis, so that fiscal policy can be applied not only during a normal economic cycle but also in emergency situations. The increased likelihood of occurrences leading to unforeseeable fiscal burdens, the renewed commitment to comply with the fiscal rules and the worsening financing conditions amid tighter monetary policy call for a more prudent fiscal policy than in recent years (see Figure 4.1 and Figure 3 in Box 4.3). Only prudent fiscal policy can create sufficient room for manoeuvre for counter-cyclical and crisis responses. The large volume of discretionary measures adopted in recent years, which have only worsened the structural position of public finances (see Box 2.3), limits the fiscal policy's room for manoeuvre also in the event of emergencies such as natural disasters. It is therefore essential for the effective fiscal policy management to be aware of the impact of such discretionary measures on fiscal sustainability. Similarly, in a high-risk situation, budgetary documents should strengthen the role of the risk impact analysis, which should be based on a credible no-policy-change scenario reflecting the current fiscal stance in the future in the absence of action. This is because the presentation of spontaneous fiscal developments is crucial for identifying the room for manoeuvre that would allow both intervention and discretionary measures to address structural challenges, while their transparency can also play an important role in shaping the private sector expectations.

Fiscal policy should, as far as possible, avoid measures that weaken the effects of its actions in other areas, in particular by stimulating price growth. Elevated price growth persists on a global scale and it is even more pronounced in the European economy. This is particularly evident in Slovenia. In a situation of tight labour market conditions, which are increasingly structural in nature and have existed for a long time in most sectors, coupled with the ongoing government measures to combat the cost of living crisis, economic policy should exercise prudence and prioritise efficiency when putting in place measures to stimulate additional spending, even within post-flood reconstruction. This approach is crucial, particularly given the existing monetary policy stance. In view of the experience of the epidemic and the findings of the Court of Audit (see Chapter 5) on the emergency response to natural disasters, it is imperative that actions are highly targeted and that complete transparency is ensured. Against this background, capacity limitations and the current elevated prices of materials and services,[33] as well as the need to ensure efficient use of public funds, call for a gradual approach even in the post-flood recovery, wherever this is feasible. Failure to adopt such an approach could result in inflation persisting high for a prolonged period, which would adversely affect household purchasing power and the competitiveness of the economy and eventually reduce economic growth. This could also trigger additional demands to compensate for high price inflation, with a direct impact on the fiscal position. This would be the case, in particular, if inflation were to exceed the euro area average for a prolonged period and the difference could not be offset by other factors that could affect competitiveness.

[33] The service sector has been showing a capacity utilisation rate above the long-term average for the past two years, with the utilisation rate rising this year.

When choosing short-term measures, fiscal policy must take into account the broader context and the medium-term effects of its actions. While avoiding a possible feedback loop on inflation and limiting the stimulus to short-term inflation expectations,[34] fiscal policy must ensure the stability and predictability of the business environment in the given circumstances. In this context, even the mere announcement of measures can contribute to the existing high level of uncertainty that households and the economy are currently facing (see Chapter 3). Measures to finance post-flood reconstruction must therefore be well thought out. It is important to consider their impact on the inequality and purchasing power of households, and, in a situation of relatively high inflation, on the introduction of partiality in the treatment of individual sectors of the economy and, therefore, on the generation of changes in relative costs and on firms' business decisions. All of the above may have an impact in terms of changing the behaviour of the private sector, thereby reducing the predictability of future fiscal developments. It is inappropriate to adopt measures that reduce purchasing power, create additional uncertainty and, against the background of a slowdown in the cyclical dynamics of economic activity, act in a pro-cyclical manner, risking a more pronounced slowdown in economic activity. This is particularly true in the absence of a realistic ex ante adjustment of the estimate of "core" spending.

4.2 Fiscal policy stance

Overall, the budgetary documents lack credibility and do not allow the Fiscal Council to make a comprehensive assessment of compliance with the fiscal rules in line with the legislation. We assess the projections of the general government and the state budget as largely inconsistent (see also Boxes 2.1 and 2.2). The simultaneous projection of the revised budget in 2024 adds an additional element of uncertainty.[35] The Draft Budgets are unrealistic, especially in the assessment of the 2023 budget outturn, as pointed out by the Fiscal Council in all procedures related to the adoption or amendment of the budgets for that year (see Chapter 2). Moreover, the general government projections (2024) do not cover the entire period to which the projections of the Draft Budgets (2024–2025) refer, which prevents the Fiscal Council from assessing compliance with the fiscal rules in accordance with the provisions of the FRA. As a result, we assess the majority of the budgetary documents as lacking credibility and incomplete. They are a continuation of poor budgeting practice, especially given that medium-term planning should be the basis of the reformed economic governance framework in the EU.

The quantitative assessment of compliance with the fiscal rules remains subject to a number of uncertainties. After the cessation of the exceptional circumstances that, in conjunction with the activation of the general escape clause, permitted a substantial deterioration in the structural position of public finances in Slovenia and the EU,[36] the existing rules are set to formally enter into force in 2024. During the period in which public finances deviate from the structural balance, compliance with the domestic rule under Article 3 of the FRA is linked to the required adjustment matrix[37] and to the minimum structural balance indicator under the EU rules (MTO). Following the review of medium-term

[34] The expectations of all economic sectors and consumers regarding price developments in Slovenia have declined over the past year, but there were some signs of a rebound in the middle of this year. An analysis by the IMF (2023a) shows that short-term inflation expectations in particular have a significant impact on actual price developments. In this context, inflation expectations tend to be higher in countries with less sustainable public finances. Simulations from the same analysis also suggest that fiscal consolidation can have a significant impact on both inflation expectations and inflation, but that its impact on the resulting contraction in economic activity is also greater than that of a restrictive monetary policy.

[35] This further contributes to the inefficient use of human resources in public administration.

[36] See e.g. EFB (2022).

[37] Box 1.6 in EC (2019).

budget plans in the spring of this year, the European Commission has also issued quantitative recommendations for the first time since the beginning of the epidemic.[38] In view of the high risks to fiscal sustainability, it recommends that Slovenia should start consolidation in 2024 with a structural effort of at least 0.5% of GDP (see Box 4.1).[39] The methodological challenges of calculating the parameters that influence the assessment of the structural balance, and hence structural adjustment, are particularly pronounced in a period of large fluctuations in economic activity.[40] This also applies to the situation following the two crises of the last four years, in which the structure of the economy and hence the determinants of potential growth have changed. Changes in output gap estimates therefore remain significant and, in addition to the usual methodological reasons, are this time associated with a significant revision to GDP data (see Box 1.1). Thus, the output gap estimate used by the Fiscal Council in the calculations of the structural indicators has changed by about 0.3 percentage points on average for the 2023-2024 period since last year's April estimate of the Stability Programme, while the IMAD estimate has changed by about 0.9 percentage points. The proposed new rules at the EU level cannot be fully taken into account in the assessment of the current budgetary documents, due to the absence of a final agreement on the reform of the EU economic governance framework and the ambiguity of the definition of the net primary domestic expenditure indicator.[41] In view of all these uncertainties, the Fiscal Council uses a wide range of indicators also in this assessment of the compliance of the submitted budgetary documents with the fiscal rules.

Given the stage of the economic cycle and the orientations of international institutions, we assess the fiscal stance for next year as inappropriate. With nominal economic growth expected to remain relatively high and the economy in positive territory under normal economic conditions (see Section 1.2), the structural deficit should be reduced in a countercyclical manner rather than being allowed to widen, as suggested by available estimates. In this way, fiscal policy would help to contain excess demand and hence inflationary pressures, which are expected to arise not only due to high capacity utilisation and labour market constraints, but also from the additional demand generated by post-flood reconstruction. However, we note that fiscal policy in 2024 will not facilitate the restoration of the fiscal room for manoeuvre, which, in addition to the lack of credible budgetary planning, runs counter to the recommendations of international organisations (see Box 4.1).

The conclusion of an inadequate stance is corroborated by all the fiscal stance indicators used, except for the reduction in the government debt-to-GDP ratio. The currently estimated widening of the structural deficit is the result of a number of discretionary measures taken in recent years, the effects of which accumulate over time (see Box 2.3). Net primary domestic expenditure, a key

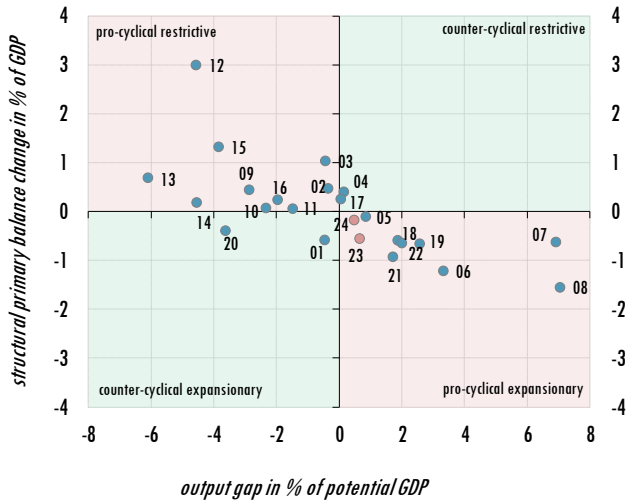
[38] Given the high level of uncertainty, the EC has advised against the use of a structural adjustment matrix in the fiscal guidance for 2024. The matrix is defined in Box 1.6 in EC (2019). According to the FRA, its parameters also determine the dynamics of the adjustment of the structural balance in Slovenia in the period of Slovenia's adjustment towards the medium-term budgetary objective (Article 15 of the FRA), defined in accordance with assumed international obligations or rules and acts governing economic governance in EU Member States (Article 2 of the FRA).

[39] EC (2023b).

[40] See e.g. Box 4.1 in FC (2020a).

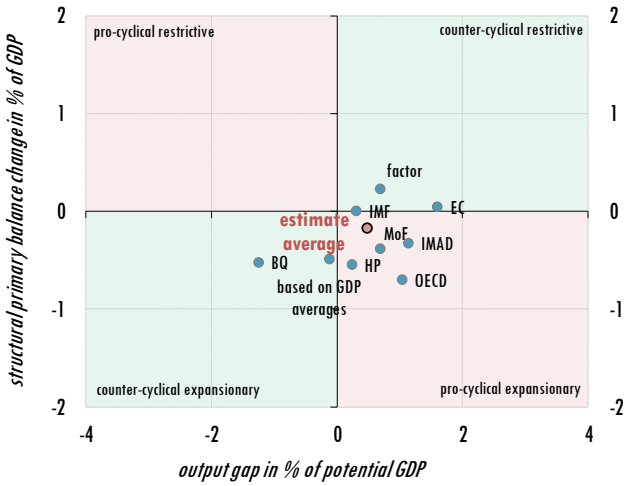
[41] The EC defines this indicator as domestically financed general government expenditure excluding discretionary measures on the revenue side, interest expenditure and cyclical unemployment expenditure. The EC started to use a similar indicator during the epidemic period, mainly because of unreliable estimates of the output gap. The EC also included EU-funded expenditure in the calculation of the fiscal policy stance indicator. In the assessments of the budgetary documents, this indicator was also calculated by the FC. For both indicators, the EC has not made it clear whether the effect of one-off measures is excluded from the calculation of total expenditure. This is also one of the concerns of the Network of Independent Fiscal Institutions about the proposal for changes to the EU governance framework (EU IFI, 2023). The Fiscal Council considers that the exclusion of this effect allows for a more appropriate assessment of the sustainability of public finances. This decision also has a significant impact on the current assessment of the structural balance and on the differences between the institutions. Since the beginning of the epidemic, the Ministry of Finance has maintained the position that the funds allocated for COVID-related expenses and for addressing the cost of living crisis were not one-off measures, while the funds designated for flood relief are categorised as a one-off. In its assessments, the Fiscal Council upholds its initial decision to exclude all impacts associated with COVID-19, the cost of living crisis and the floods when determining the fiscal stance. None of these events is of a permanent nature and consequently none has an impact on long-term fiscal sustainability.

Figure 4.1: Fiscal policy stance



Source: SORS, MoF, FC estimates.

Figure 4.2: Fiscal policy stance in 2024



Source: SORS, MoF, FC estimates.

indicator of the proposed EU economic governance framework, is projected to grow faster than medium-term potential output growth on average in the 2023-2024 period. A significant boost to investment is foreseen in 2023, although it may not materialise completely,[42] and there are also expectations of increased subsidies in both years. EU funds are an important part of investment financing, so the actual use of these funds will have an important impact on the fiscal stance, while the efficiency of their use will shape the development potential in the coming years. All indicators point to a declining debt-to-GDP ratio. Nevertheless, the results of the shock analysis (Figures 3.1 and 3.2), the debt sustainability analysis (Box 3.1) as well as the projected further increase in transfers from the state budgetary to the social security funds[43] indicate that the baseline scenario of the submitted budgetary documents is subject to a number of risks, also with regard to the projected decline in the debt ratio. These could delay the consolidation[44] and thus hinder the reduction in the debt ratio in the baseline scenario. This could be the case even in the event of minor negative deviations of economic growth from the currently projected levels, the adoption of discretionary measures with a negative impact on public finances without compensatory measures and the absence of structural adjustments to tackle long-term challenges.

Fiscal policy needs to respond to the increasing structural challenges with a view to mitigating the risk to debt sustainability. Budget documents do not address the medium- and long-term challenges facing Slovenia's public finances. The documents also lack explicit assumptions, such as those regarding the costs associated with an ageing population and the green transition, that would allow for the incorporation of these challenges into the fiscal projections presented.[45] With the approaching window for addressing the long-term challenges due to the increasing risks to government debt sustainability, any delay in addressing them will also result in a shorter transition period during which the expected gradual changes should occur. A shorter transition period means that the challenge-related changes in

[42] See Chapter 2.

[43] For the 2023–2025 period (excluding intervention measures), these are around 60% (EUR 675 million) higher than the average for 2017–2019.

[44] According to the EC Communication (2023c), an excessive deficit procedure is expected to be initiated against the Member State in spring 2024 if the general government balance deviates from the target of 3% of GDP in 2023.

[45] The medium-term debt projections (Box 3.1) suggest that the fiscal impact of these assumptions would not be large over the short projection horizon included in the Draft Budgets.

parameters will have to occur more rapidly, potentially leading to more significant shifts in the behaviour of economic agents. The same applies to the adaptation to climate change.[46] With all challenges, it will be essential in the future to ensure more efficient public spending, which must lead to a high level of quality and accessibility of public services. It will also be necessary to consider possible tax revenue measures to ensure sustainable public finances, while improving the business environment and creating the conditions for higher growth in economic potential.

[46] See Chapter 3 and the results of the IMF analyses cited there.

Box 4.1: Fiscal policy recommendations of international organisations

International institutions have highlighted a number of fiscal challenges in the aftermath of recent crises. Growing fiscal challenges due to increased debt and pressures to increase public spending in the long term (ageing population, mitigating the effects of climate change, increasing defence costs) require the restoration of fiscal space and the establishment of credible medium-term planning. Restoring fiscal space through credible medium-term fiscal consolidation is a key priority to address the challenges currently known and potential future crises.[1] Indeed, fiscal policy should work in concert with monetary policy to contain price pressures.[2] Further increase in public spending to contain the impact of high inflation could lead to additional and prolonged monetary policy tightening, thereby increasing risks to macroeconomic and financial stability.[3] The decrease in energy prices necessitates the withdrawal of general support measures, especially those related to price support, and can only be warranted for the continuation of specific measures targeting the most vulnerable groups of the population and sectors of the economy.[4] This is a considerable challenge, as expectations about possible fiscal policy interventions have risen considerably as a result of the large-scale measures taken during the epidemic and the energy crisis.[5] A strengthened and credible medium-term fiscal framework, with clear spending and tax policy guidelines, plays a key role in ensuring fiscal consolidation and managing stakeholders' expectations.[6] Debt sustainability should be the primary objective of medium-term fiscal frameworks, and more emphasis should be placed on risk assessment and management than in the past.[7] In this context, the epidemic and the energy crisis have clearly shown that fiscal policy can also be an important tool to strengthen the resilience of the economy as a whole.[8]

According to the EC, the primary objective of fiscal policy in 2024 should be to strengthen fiscal sustainability through gradual consolidation, while maintaining only targeted measures to cushion the impact of higher energy prices.[9] The general escape clause in force since 2020 will expire at the end of 2023. The EC called on Member States to ensure that the general government deficit does not exceed or is brought below 3% of GDP in the period up to and including 2026, and that it is credibly kept below that threshold in the medium term under a no-policy-change scenario. On the basis of this year's result, the EC will propose initiating excessive deficit procedures in spring 2024. To achieve consolidation, countries should curb the growth of domestic current expenditure, preserve domestic investment and maximise the efficient utilisation of EU funds. These guidelines imply a restrictive fiscal impulse[10] of 0.8% of GDP in 2024, which is appropriate according to the assessment of the European Fiscal Board (EFB).[11] In addition, the EFB calls for the withdrawal of measures to cushion the impact of high energy prices, noting that even in the event of a recurrence of the energy shock, broad-based support measures on a similar scale as in 2022 would not be warranted. Only targeted measures would be justified, and these would have to be financed either by additional revenue sources or by redirecting existing public spending.

In 2024, the EC has provided Member States with quantitative recommendations for the first time since the onset of the pandemic. These recommendations advise Slovenia to initiate a consolidation phase in 2024, following two years of expansionary fiscal policies in 2022 and 2023, driven by the significant risks to the sustainability of public finances.[12] In its recommendations based on the projections of the 2023 Stability Programme, the Commission noted that the expansionary fiscal stance in 2023 is contrary to previous recommendations and is not the result of the targeted measures taken to mitigate the impact of the cost of living crisis. For 2024, it recommends a reduction in the structural deficit by at least 0.5% of GDP, which implies that domestic primary expenditure growth[13] should not exceed 5.5%. It also recommends the lifting of measures to ease the cost of living crisis, which should translate into a lower government deficit. This should be accompanied by maintaining domestic public investment and ensuring efficient use of the Recovery and Resilience Facility (RRF) and other EU funds. Looking beyond 2024, the EC recommends that Slovenia pursues a gradual and sustained consolidation and implements investments and reforms that would contribute to sustainable growth and ensure the sustainability of public finances.

[1] IMF (2023c), OECD (2023b).
[2] ECB (2023).
[3] IMF (2023d).
[4] IMF (2023c), OECD (2023b).
[5] OECD (2023b).
[6] OECD (2023b).
[7] IMF (2023d).
[8] IMF (2023d).
[9] EC (2023c).
[10] The fiscal impulse is defined as the change in the structural primary balance.
[11] EFB (2023).
[12] EC (2023b).
[13] Excluding interest payments, expenditure financed by European funds and one-off expenditure for flood reconstruction.

Box 4.2: Assessment of compliance with the fiscal rules in the Framework Proposal

The Government's Framework Proposal should outline the medium-term fiscal policy stance for the 2024–2026 period, while the proposed changes confirm only the formalistic role of the Framework. The Framework, which sets expenditure ceilings for the general government sector and public finance budgets, was first prepared for this period in April 2023 and is being amended for the first time. The changes only apply to 2024, to a relatively high amount for the general government sector and the state budget.[1] The revision for only one year again shows the lack of credible medium-term budget planning and reduces the relevance of the Framework to an accounting category. The Government also proposes a revision of the Framework for the 2022–2024 period, which was first drafted in April 2021 and is being revised for the fifth time. The changes only apply to 2023. The largest increase, around 6.6%, is in the municipal expenditure ceiling, while the proposed increases in expenditure for the two social security funds are considerably more modest.

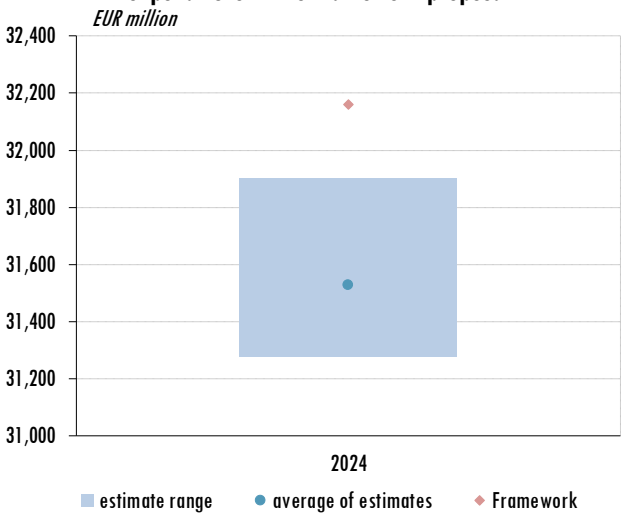
The expenditure ceilings outlined in the Framework Proposal, taking into account the assessment-related uncertainties, exceed the range of estimates necessary to ensure compliance with the domestic fiscal rules. The Framework is assessed in the light of currently applicable domestic fiscal rules, as exceptional circumstances will no longer apply after 2023. The allowed range of government expenditure ceilings has been determined on the basis of a set of output gap estimates that are regularly used in preparing the assessments of compliance of budgetary documents with the fiscal rules by the Fiscal Council.[2] This calculation excludes the impact of all intervention measures taken to mitigate shocks, such as the floods. The estimates of the expenditure ceilings, which are set in accordance with Articles 3 and 15 of the Fiscal Rule Act (FRA),[3] are on average lower in 2024 than the expenditure set out in the Framework Proposal. In this context, we consider that deviations are not acceptable, even taking into account the uncertainties related to the calculation of the output gap estimates.[4] The calculation thus indicates a lack of effort to shape the fiscal policy's room for manoeuvre in the budgetary documents.

Table: Frameworks for 2022-2024 and 2024-2026

	General government		State budget		Local govt.	ZPIZ	ZZZS	GDP
	targ. balance	max E	targ. balance	max E	max E	max E	max E	EUR
	% GDP	EUR million	% GDP	EUR million	EUR million	EUR million	EUR million	million
Framework, Oct.2022 (OG 146/2022)								
2023	-5.0	30,055	-5.4	16,700	2,955	7,065	4,340	61,951
Proposed Framework 2022-2024, Sep. 2023								
2023	**-4.5**	**30,500**	**-5.4**	**16,700**	**3,150**	**7,115**	**4,430**	**62,970**
Framework, April 2023 (OG 47/2023)								
2024	-2.8	30,670	-2.3	15,275	2,990	7,800	5,000	68,896
2025	-2.2	31,750	-1.6	15,865	3,030	8,280	5,225	72,462
2026	-1.3	32,500	-1.2	15,850	3,035	8,680	5,580	75,929
Proposed Framework 2024-2026, Sep. 2023								
2024	**-3.8**	**32,160**	**-3.3**	**16,230**	**3,200**	**7,800**	**5,350**	**67,318**
2025	**-2.2**	**31,750**	**-1.6**	**15,865**	**3,030**	**8,280**	**5,225**	**71,105**
2026	**-1.3**	**32,500**	**-1.2**	**15,850**	**3,035**	**8,680**	**5,580**	**74,758**
Difference								
2023	0.5	445	0	0	195	50	90	1,019
2024	-1.0	1,490	-1.0	955	210	0	350	-1,578
2025	0	0	0	0	0	0	0	-1,358
2026	0	0	0	0	0	0	0	-1,172

Source: Official Gazette of the Republic of Slovenia, MoF, IMAD, FC calculations.

Figure: General government maximum expenditure and expenditure in the Framework proposal



Source: MoF, FC calculations. Note: Calculation treats all intervention measures as one-off measures.

[1] Since the initial framework designed for the preparation of general government budgets, which encompassed 2024 (Framework 2022–2024 of April 2021), general government expenditure has increased by around EUR 6.7 billion leading up to the current Framework Proposal. Over the same period, the GDP forecast for 2024 has increased by EUR 10.5 billion. Core expenditure (excluding intervention measures) of the general government sector increased by EUR 5.7 billion in 2024.

[2] See Box 2.1 in FC (2018a). The expenditure proposed in the Framework Proposal exceeds the capacity for calculations based on all individual output gap estimates. If only the flood-related measures are counted as one-offs, the expenditure in the Framework Proposal complies with the domestic fiscal rule (see also footnote 41).

[3] For derivation of the formula, see Box in FC (2018b).

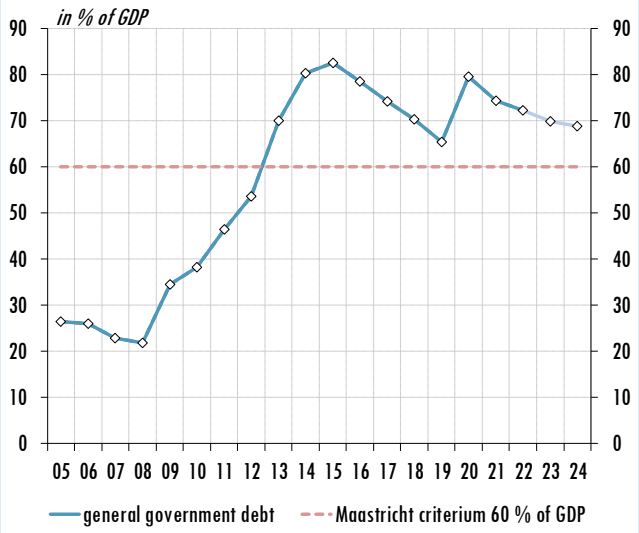
[4] The average deviation of the estimated expenditure ceilings from those specified in the Framework Proposal is about 1.9%. The average change in the output gap estimate for 2024 applied in the last five Fiscal Council calculations is -0.2% of GDP or an average absolute change of 0.6% of GDP.

Box 4.3: Quantitative assessments of compliance with fiscal rules

The quantitative assessment of compliance with the fiscal rules remains subject to many uncertainties, but almost all of the indicators point to non-compliance, also after excluding the impact of intervention measures. In response to the heightened uncertainties brought about by two consecutive crises, additional indicators monitored by the European Commission have been added to a number of rules derived from national and EU legislation. The methodological challenges in calculating the parameters that influence the assessment of compliance with a number of fiscal rules are particularly pronounced during periods of significant fluctuations in economic activity. These challenges are further exacerbated when there is a substantial revision of GDP coinciding with a large supply shock or terms-of-trade shock.[1]

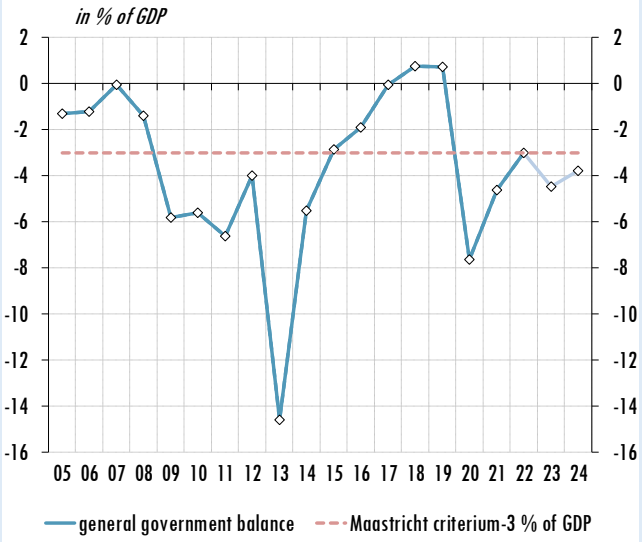
The headline general government deficit is projected to remain above the 3% of GDP threshold in 2024, mainly as a result of continued high expenditure growth. This occurs despite the fact that budget revenue growth is also projected to remain robust. The risk analysis (see Chapter 3,

Figure 1: General government debt



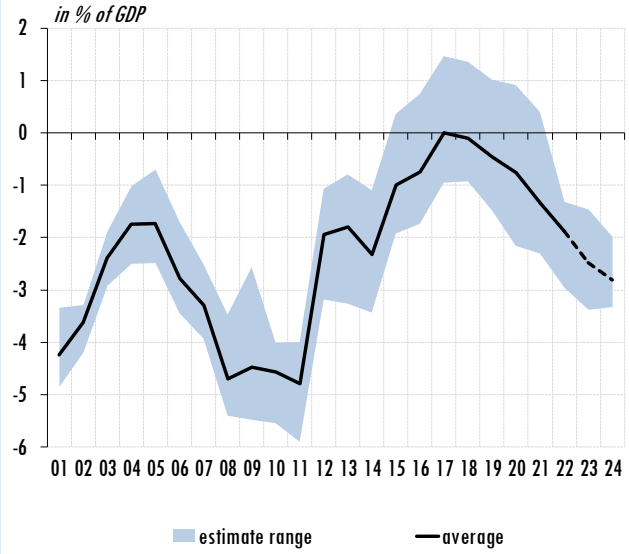
Source: SORS, MoF.

Figure 2: General government balance



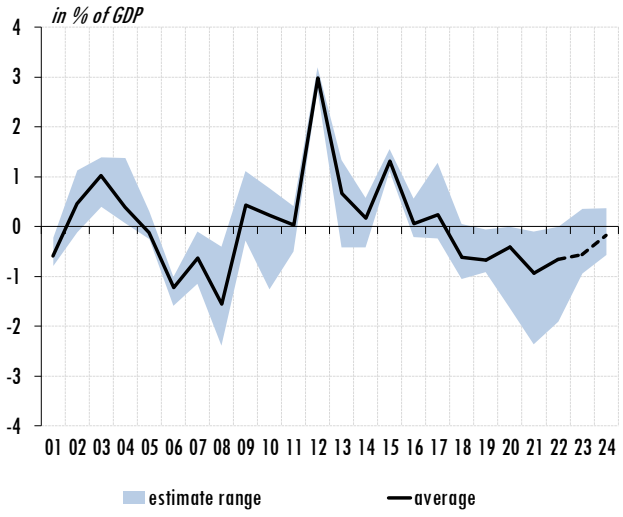
Source: SORS, MoF.

Figure 3: Structural balance estimates



Source: IMAD, EC, OECD, IMF, MoF, FC calculations. See note under Table 6.1.

Figure 4: Strucural primary effort estimates



Source: IMAD, EC, OECD, IMF, MoF, FC calculations. See note under Table 6.1.

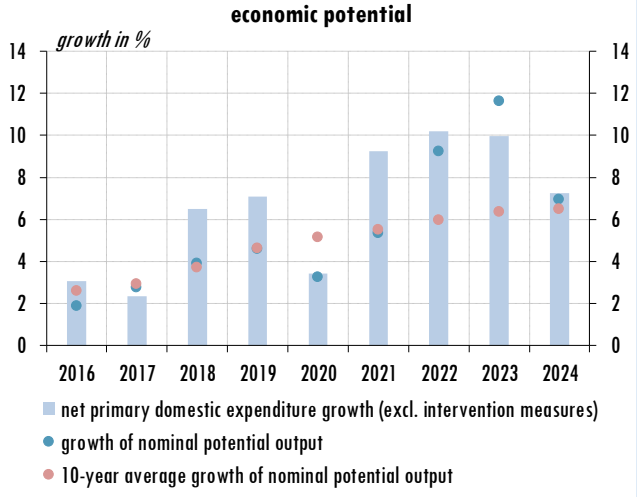
particularly Figure 3.1) also suggests a fairly high likelihood of failing to meet the Maastricht reference value for the general government balance should economic growth deviate even slightly from the projections outlined in IMAD's baseline scenario. Should the official projections materialise in 2023, the EC would initiate an excessive deficit procedure against Slovenia in the spring of 2024.[2]

The projected structural deficit is set to deviate considerably from the minimum permitted structural balance calculated on the basis of EU rules (MTO), while the anticipated structural effort is expected to be negative, contrary to the requirements of the fiscal rules. Based on the Fiscal Council's current calculations, the structural deficit, which is estimated to have worsened annually from 2017, is expected to reach approximately 2.8% of GDP in the next two years (with a primary structural deficit of about 1.5% of GDP).[3] This would be a significant deviation from Slovenia's currently estimated medium-term objective (MTO) of 0.75% of GDP.[4] Taking into account the deviation of the structural deficit from the MTO, the debt level and its sustainability assessment, and in accordance with the provisions of the FRA (Article 15) and the EU rules (EC, 2019), the structural effort should amount to at least 0.6% of GDP per year during periods of the normal economic cycle. This was also a recommendation from the EC following the assessment of this year's Stability Programme (see Box 4.1). According to the proposed budgetary documents, the average effort in 2023 and 2024 is expected to be approximately -0.4% of GDP, which falls short by 1% of GDP of the required effort.

The proposed levels and growth rates of expenditure are above the limits set on the basis of long-term potential output. The increase in net domestic primary expenditure, which is expected to be a key indicator in the reformed EU economic governance framework, surpasses the projected medium-term nominal potential output growth in 2024 and also exceeds the EC's[5] recommended threshold of 5.5%. When comparing expenditure levels to what would be achievable solely through nominal growth in the estimated economic potential,[6] it becomes apparent that the "core" general government expenditure is excessively elevated. The growth of "core" expenditure outlined in the Framework Proposal in 2023 and 2024 is higher than the currently estimated growth in both long-term and annual potential output.[7] A further expansionary fiscal policy impulse in the 2023 and 2024 averages, which would be inappropriate given the current cyclical position of the economy, is also indicated by the calculation based on the EU expenditure rule and by the alternative indicator introduced by the EC during the crisis period amid uncertainties related to the calculations of the structural indicators of the state of public finances.[8]

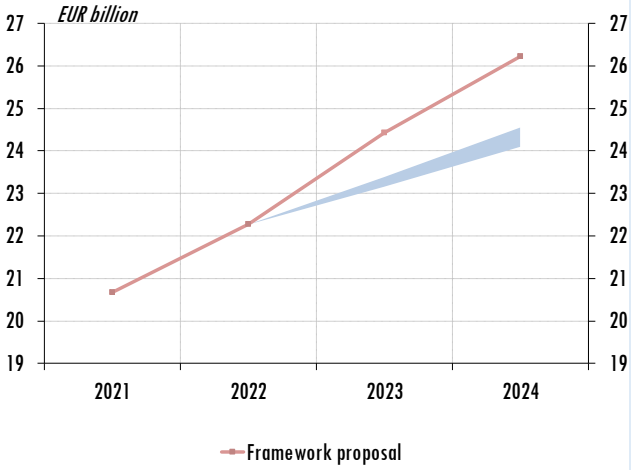
While general government debt currently exceeds the 60% of GDP threshold, it is expected to be reduced appropriately by 2024 in compliance with the rules of the Fiscal Compact under the

Figure 5: Net primary domestic expenditure and economic potential



Source: SORS, MoF, IMAD, FC calculations. Note: Net primary domestic expenditure is general government expenditure excluding interest expenditure, expenditure matched by EU funds revenue, cyclical unemployment benefit expenditure, measures on revenue side and intervention measures.

Figure 6: Simulation of general government expenditure excluding intervention measures, interest and investment



Note: Shaded area represents levels of expenditure, consistent with potential growth between 4 % and 5 %.
Source: SORS, MoF, FC calculations.

Table: Overview of fulfilment of fiscal rules

Macroeconomic variables		2021	2022	2023	2024
Real GDP growth (%)	IMAD	8.2	2.5	1.6	2.8
GDP nominal (EUR million)	IMAD	52,279	57,038	62,970	67,318
GDP deflator (%)	IMAD	2.7	6.5	8.7	4.0
Potential nominal GDP growth (%)	IMAD	5.4	9.4	11.9	7.1
Medium-term potential nominal GDP growth (%)[1]	IMAD	5.6	6.0	6.2	6.2
Output gap (in % of potential nominal GDP)[2]	FC	1.7	2.0	0.7	0.5
National fiscal rule					
General government expenditure (EUR million)	MoF	25,861	26,899	30,498	32,157
National rule - maximum general government expenditure (EUR million)[3]	FC				31,528
Frameworks for the preparation of the gen. government budgets (EUR million, Sep. 2023)	MoF			30,500	32,160
EU fiscal rules					
General government balance (% of GDP)	MoF	**-4.6**	**-3.0**	**-4.5**	**-3.8**
Maastricht criterium (% of GDP)	EC	-3.0	-3.0	-3.0	-3.0
Gross general government debt (% of GDP)	MoF	**74.4**	**72.3**	**69.9**	**68.9**
Maastricht criterium (% of GDP)	EC	60.0	60.0	60.0	60.0
Permitted debt level according to EU rules (% of GDP):					
- 1/20th rule[4]	FC	...	...	72.2	71.5
- backward-looking benchmark[4]	FC	...	...	73.8	70.9
- forward-looking benchmark[4]	FC	...	...	69.3	68.3
- cyclically-adjusted debt reduction benchmark[4]	FC	...	...	75.1	69.5
Structural balance (% of GDP)	FC	-1.3	-1.9	-2.5	-2.8
Medium term objective according to EU rules - MTO (% of GDP)	EC	...	...	...	0.75
Change in structural balance (% of GDP)	FC	-0.6	-0.5	-0.6	-0.3
Required annual fiscal adjustment (% of GDP)[5]	FC	...	...	...	0.5
EU expenditure benchmark - net expenditure nominal growth (%)	FC	**6.8**	**4.4**	**11.7**	**5.8**
Permitted nominal annual net expenditure growth (%)	FC	5.0	9.1	11.5	5.3
EU expenditure benchmark - net expenditure nominal growth excl. one-offs (%)	FC	**9.1**	**9.0**	**11.1**	**8.4**
Permitted nominal annual net expenditure growth excluding one-offs (%)	FC	5.0	9.1	11.5	5.3
Alternative indicators					
Net primary domestic expenditure growth (%)[6]	FC	9.2	10.2	10.0	7.3
Fiscal stance - with EU funds, excl. intervention measures (% of GDP)[7]	FC	-2.1	-0.4	-0.7	-0.3

Source: SORS, MoF, IMAD, EC, Official Gazette of the Republic of Slovenia, FC calculations.

[1] 10-year average, which takes into account previous five years, current year and next 4 years.

[2] Average of 9 estimates used by the FC. See Table 6.1 in the Annex.

[3] Taking into account Framework Proposal revenue projections and FC estimates.

[4] The base year for calculations is 2022.

[5] In 2021-2023 structural effort is not required due to general escape clause. In 2024 FC estimate is based on EC recommendation (2023b).

[6] Excluding expenditure on interest, investment, COVID measures, inflation mitigation, floods and other one-off expenditure. Growth is adequate if it does not exceed medium-term growth of potential nominal GDP and vice versa.

[7] Negative sign denotes expansionary fiscal policy and vice versa.

preventive arm of the Stability and Growth Pact. Slovenia is expected to comply with these rules in 2024, although debt is projected to remain above the 60% of GDP threshold. As the debt-to-GDP ratio over the period covered by the Framework Proposal exceeds the reference value set in the Maastricht Treaty establishing the EU, Slovenia is required to reduce its general government debt in line with the yearly dynamics, which on average over the past three years corresponds to a 1/20 deviation in the debt level from the 60% of GDP in the base year. This means that the debt is to be decreased by approximately 0.7 percentage points of GDP per year on a three-year average. Despite the high increase in debt in 2021, which affects the calculation of the average in the following three years, this rule is also expected to be met in 2024 as a result of the high economic and inflationary cycle in 2022 and 2023. The debt level is expected to be below at least one of the limits, i.e. the backward-looking debt limit, the forward-looking limit or the cycle-observing limit, as set by

[1] See e.g. Box 4.1 in FC (2020b) and Box 1.1 in this document.

[2] See footnote 44.

[3] The assessment takes into account the direct impact of measures in response to the epidemic, the impact of the cost of living crisis and the flood-recovery measures on the general government balance as one-offs, which are therefore not included in the calculation of the structural balance.

[4] The lowest value of the structural balance under EU rules (MTO) for Slovenia in the 2020–2022 period was most recently set at -0.25% of GDP in spring 2019 (EC, 2019). However, by the time the Stability Programme for 2023 was assessed, this figure had risen to 0.75% of GDP (EC, 2023d). In light of the currently applicable fiscal rules, a rise in the MTO reflects the need for stricter fiscal policy to ensure the medium-term fiscal sustainability in the future.

[5] EC (2023b).

[6] Government expenditure growth is sustainable in the long term if it increases in line with the economic potential growth. In the long term, we conservatively estimate expected potential growth to be between 4% and 5%, in line with IMAD's forecast for potential GDP growth in the decade to 2025 (around 2.5%) and the ECB's inflation target (2%). In addition to cyclical reasons, revenue growth may deviate from economic potential growth, in particular in the case of discretionary tax changes; therefore expenditure would normally also need to be adjusted for such structural changes.

[7] Comparisons with annual estimates of growth in nominal potential GDP are less appropriate in a situation of high inflation. Taking into account high inflation, the nominal economic potential can be overestimated, which, based on such indicators, can have a pro-cyclical effect. However, this is not necessarily reflected in the fiscal policy stance (i.e. level) , given the concomitant increase in the level of revenues due to inflation.

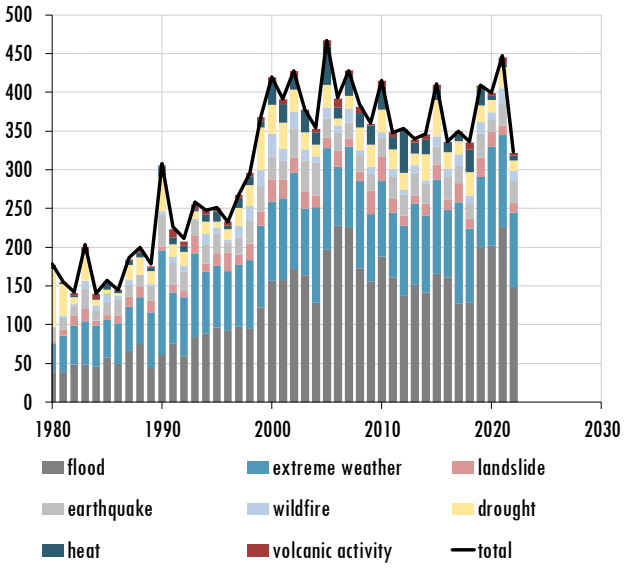
[8] See e.g. Box 2 (pp. 14–15) in EC (2021).

5. Special topic: Natural disasters and public finances

5.1 Natural disasters and their financial consequences

Natural disasters are a global phenomenon with increasing frequency. The EM-DAT[47] database has documented nearly 1,200 events classified as natural disasters in EU Member States over the 1980–2023 period. On average, this is 27 disasters per year, with data for the last three years (2021–2023), while incomplete figures for 2023 (until mid-July), suggest an approximate rate of 33 natural disasters per year. Between 1980 and 2020, weather-related natural disasters accounted for around 80% of the total damage caused by all natural disasters, with floods accounting for almost half of the total damage. The total cost of natural disasters is expected to further increase in the

Figure 5.1: Number of reported natural disasters



Source: EM-DAT.

Table 5.1: 10 biggest floods in the EU in the 1980-2022 period based on damage

year	country	size of affected area (in 1000 km^2)	total affected inhabitants (thousands)	damage (EUR million, 2022 prices)	damage (EUR/inhabitant, 2022 prices)	damage/GDP (%, current prices)	damage/GDP of the affected area (%, current prices)
2021	Germany	8	1.0	39.6	476	1.1	46.6
2002	Germany	...	330.1	17.3	210	0.5	...
2013	Germany	241	6.4	14.9	184	0.5	0.7
1983	Spain	...	506.0	10.5	275	2.7	...
1997	Poland	35	224.5	5.9	152	2.5	22.3
2010	Poland	...	100.0	3.8	100	0.9	...
2002	Austria	...	60.0	3.6	442	1.1	...
2002	Czechia	8	200.0	3.6	351	2.7	27.1
1997	Czechia	35	102.1	3.1	300	3.4	7.6
1987	Spain	...	2.0	3.0	78	0.5	...

Source: EM-DAT database, World Bank; FC calculations. Calculated using average EUR/USD exchangee rate in the 6-month period up to September 2023, damage is adjusted for inflation.

[47] Available at: https://www.emdat.be/. In order to be entered in a database, one of the following conditions must be fulfilled: a) deaths (10 or more); b) affected people (1000 or more); c) declaration of a state of emergency or request for international assistance. The data within the database (as per the information it entails for Slovenia) may not be the most accurate ones, but they provide one of the few comprehensive perspectives on natural disasters on a global scale.

future. According to some estimates,[48] it could even double or triple in the coming decades compared to the current situation even if the more optimistic scenario (the Paris Agreement to limit temperature increase to 1.5°C) materialises or expand more than tenfold in scenarios with higher temperature increases (2–3°C).

The impact of natural disasters on economic activity is not uniform and depends largely on the type of shock and the level of the country's development. The impact of natural disasters is expected to be negative in the short term due to supply and demand side disruptions, but it may also be positive in the medium and long terms due to investments needed to compensate for the destruction of fixed assets.[49] The IMF's[50] analysis suggests that developing countries, where the economic structure is more concentrated on weather-dependent activities (usually agriculture) and which do not have adequately developed social security and civil protection systems, are more affected by natural disasters. A country's development is significantly determines its institutional framework and fiscal space, which together enable an efficient economic policy response. In addition, the level of property insurance plays a key role in shaping the private sector's response by determining its behaviour both prior to and following a disaster and can thus significantly influence the macroeconomic impact of natural disasters.[51] The impact of natural disasters on economic activity is therefore more pronounced, statistically more significant and longer lasting in underdeveloped countries than in developed countries.[52] Initial estimates by the Bank of Slovenia[53] suggest that the contribution of the most severely affected businesses to the value added of the Slovenian economy due to this year's floods is relatively modest (around 1%) and that, given the maximum effect of the scenarios used in the assessment, this year's GDP growth could be reduced by 0.5 percentage points. In its autumn economic forecast, IMAD[54] projects a limited negative impact of the floods on economic activity in the short term and a positive impact of investment on GDP growth as infrastructure is rebuilt, although this impact is likely to be relatively limited or spread over a longer period given the high capacity utilisation in the construction sector.[55]

The increasing frequency of natural disasters can have a significant impact on public finances. Natural disasters have a direct and indirect impact on public finances. The direct impact comes in the form of decreased revenue due to destroyed infrastructure, which prevents the private sector from operating, and increased expenditure due to aid to victims and reconstruction of infrastructure. Indirectly, natural disasters can lead to higher financing costs as a result of increased funding needs and to a downgrading of sovereign debt ratings.[56] The share of the general government sector in disaster financing has historically been increasing, as it is usually the government sector that first offers

[48] Feyen et al., (2020).

[49] Gagliardi et al. (2022).

[50] Cevik and Jalles (2023).

[51] Radu (2022). The proportion of insured assets is typically greater in developed countries. The BIS analysis (von Peter et al., 2012) distinguishes between economies with a significant proportion of insured assets and those with a minimal proportion of insured assets and shows that the former experience a lesser economic impact from natural disasters compared to the latter. This is primarily due to their higher level of insured assets and income derived from claim settlements following damage. This allows for a faster recovery and, consequently, the resumption of economic activity after damage has occurred.

[52] Cevik and Jalles (2023). The estimates are, however, rather unreliable due to the relatively poor research in the field, the possible non-linear effects and the unpredictability of the future intensity of weather patterns and are likely to underestimate the future impact of natural disasters on economic activity in both developing and developed economies.

[53] See Box 3.3 in Bank of Slovenia (2023).

[54] IMAD (2023).

[55] A similar observation was made by Deutsche Bank (2021) in the wake of the floods in Germany, suggesting the possibility of crowding out investments in other areas in favour of reconstruction activities in flood-affected areas. This was in contrast to the floods in 2002 and 2013, when the construction sector had much lower capacity utilisation, which in turn offered better prospects for boosting economic growth.

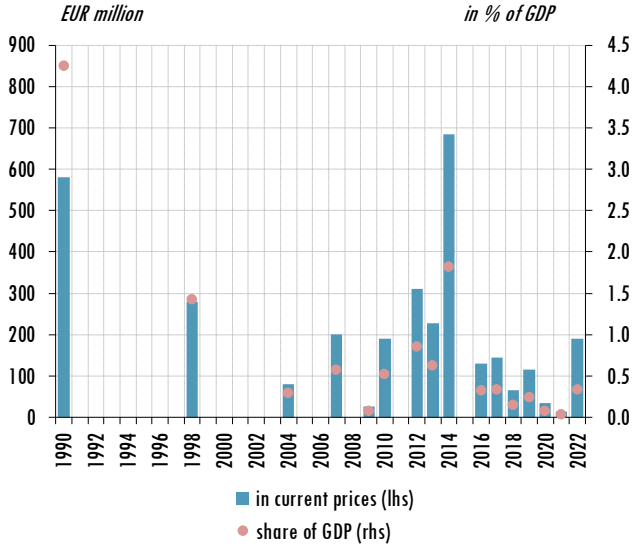
[56] OECD and World Bank (2019). The sovereign rating methodologies employed by major rating agencies all indicate the potential inclusion of the impact of natural disasters in their credit ratings assessments. See Fitch (2022), Moody's (2022) and S&P Global (2014).

assistance to the private sector when natural disasters occur. Furthermore, the State is also a major player in financing the reconstruction of public infrastructure, and its involvement in climate change mitigation is likely to increase in the future. The growing role of the State in disaster relief is also reflected in the increase in requests for funding from the EU Solidarity Fund over the last decade.[57] Drawing on the experience of the recent floods in Central Europe[58], it was found that the general government sector suffered just over 50% of the total damage due to public infrastructure damage, while the household sector suffered around 30% of the total damage, with the rest of the flood-related damage affecting the business sector. The State has altogether financed around 75% of the total damage.[59] The burden on the State to deal with the consequences of natural disasters also depends to a large extent on the share of insured property.[60]

5.2 Fiscal implications of natural disasters in Slovenia

Natural disasters with significant fiscal implications have also become more frequent in Slovenia in recent years. According to the Slovenian Environment Agency, Slovenia stands out as one of the areas where global warming tends to be more pronounced. Between 1961 and 2016, our atmosphere recorded an average temperature increase of 2.0 degrees Celsius, and an additional 1.0–2.5 degrees Celsius rise is projected between 2021 and 2050.[61] As a result, the occurrence of natural disasters with substantial fiscal implications has considerably increased over the past 15 years. In addition to floods, which are the most common form of natural disaster, the period since Slovenia's independence has also seen storms, droughts, fires, frost, icing and non-weather-related earthquakes. According to the law, the state budget funds are activated when the estimated direct damage to property exceeds 0.3 per mille of the planned state budget revenue.[62] As a result, an annual average of around 0.5% of GDP was allocated over the 2007–2022 period to directly address the

Figure 5.2: Fiscal costs of natural disasters in Slovenia 1990–2022



Source: Government of the Republic of Slovenia, SORS, IMAD, FC calculations.

[57] See data available at: https://ec.europa.eu/regional_policy/funding/solidarity-fund_en

[58] See Weichselgartner and Mechler (2003).

[59] Damage to the business or private sector depends on factors such as industrialisation and the intensity of tourism in the areas affected by natural disasters.

[60] Radu (2022). See EIOPA (2020) for information regarding the adequate level of insurance coverage against specific natural disasters in EU countries.

[61] Government of the Republic of Slovenia (2018).

[62] Paragraph three of Article 11 of the Natural Disaster Recovery Act (Official Gazette of the Republic of Slovenia [*Uradni list RS*], No 114/2005).

consequences of natural disasters. Given the growing frequency of flood events, the potential for damage is also on the rise. This is also due to inadequate planning for urban expansion and a significant reduction in water management resources and staff.[63] Moreover, existing funds have not been used efficiently. The latest Natural Disaster Risk Assessment in 2018[64] revealed the need for a proactive approach with concrete on-site measures, including both construction and non-construction methods, to improve flood safety. Regrettably, a considerable amount of resources and time have been devoted to analysis and studies which all too rarely yielded concrete measures. Since then, the risks have continued to increase, with the number of areas at significant risk of flooding rising from 61 to 86 between 2018 and 2023. Against this background, this year's update of the Flood Risk Reduction Plan[65] for the 2023–2027 period estimated the package of measures and projects at around EUR 550 million, with a realistic amount available and achievable expected to be around EUR 680 million.

The direct financial damage caused by the natural disaster in August will be by far the largest of its kind during the period of independence. According to currently available data,[66] the direct damage amounts to around EUR 3 billion, or 4.8% of this year's projected GDP (Table 5.2). According to the Administration of the Republic of Slovenia for Civil Protection and Disaster Relief, municipalities reported EUR 2.5 billion worth of damage to the AJDA application (the Slovenian application for damage assessment on agricultural products and property) by 10 October. Almost half of this amount was attributed to damage to watercourses and around EUR 0.5 billion each to buildings and civil engineering works. The estimated damage to public infrastructure thus accounts for slightly less than a tenth of the total.[67] In addition to this, there is the estimated damage to businesses (EUR 0.4 billion). The August event thus clearly exceeded even the negative scenario of the 2018 Natural Disaster Risk Assessment[68] that assumed that more than half of Slovenia's territory would be flooded, that the probability of an event occurring would be between 25 and 100 years, and that the damage would

Table 5.2: Estimation of direct damage caused by the natural disaster on 4 August 2023

in EUR million	
Reported by municipalities (assessment of 10 October 2023)	**2,509**
Watercourses	1,322
Civil engineering works	490
Damaged or destroyed buildings	381
Partial damage to buildings	118
National and forest roads	116
Agricultural land, forests, animals	82
Businesses	**381**
Machinery and equipment	168
Inventories	91
Loss of income	122
TOTAL	**2,890**

Sources: Administration of the Republic of Slovenia for Civil Protection and Disaster Relief, Government of the Republic of Slovenia.

[63] Government of the Republic of Slovenia (2018).

[64] Government of the Republic of Slovenia (2018).

[65] Ministry of Natural Resources and Spatial Planning (2023).

[66] 10 October 2023.

[67] According to the latest available data from the Statistical Office of the Republic of Slovenia, the value of all non-residential buildings and structures owned by the State in 2021 is EUR 27.3 billion.

[68] Government of the Republic of Slovenia (2018).

exceed 1.2% of GDP. It should also be noted that the fiscal impact of this year's natural events was already almost as high as the average of previous years before the August floods.

Based on the application for funding from the Solidarity Fund,[69] the total impact of damage and reconstruction is expected to amount to EUR 10 billion (Table 5.3), or more than 15% of this year's projected GDP. The estimate was prepared by the Government using the internationally recognised Post-Disaster Needs Assessment (PDNA) methodology, which includes an estimate of recovery and reconstruction costs in addition to the direct damage assessment. Taking into account the direct damage assessment based on the reports to the AJDA application and the reports from businesses, the total cost of reconstruction is estimated at around 2.5 times the direct damage, or EUR 7 billion,[70] of which the public finance cost of reconstruction is estimated at EUR 6.4 billion and when adding the cost of intervention and clean-up at EUR 6.5 billion. Within this figure, the bulk of the cost estimate is earmarked for the reconstruction of public infrastructure (EUR 3.2 billion). It is worth noting that the total volume of investment in non-residential buildings and structures at the level of the national economy (not just the general government sector) in 2022 was EUR 4 billion. Assuming that the reconstruction cost estimates are realistic, which is somewhat unlikely given that the specific rehabilitation and reconstruction projects, and hence their costs, are understandably not yet fully specified, it is reasonable to expect that the reconstruction process will take more than a few years, given the limited absorption capacity of both the administration and the construction sector.

Table 5.3: Flood damage assessment

in EUR billion	
Infrastructure	**5.055**
Road	1.357
Railway	0.249
Telecommunication	0.018
Energy	0.026
Water supply and sewerage system	0.084
Watercourses	3.322
Public services	**0.097**
Healthcare	0.011
Education	0.055
Other	0.032
Economy	**0.985**
Agriculture, fishery, forestry	**0.287**
Agriculture and fishery	0.237
Forestry	0.050
Housing	**0.712**
Culture	**0.087**
Environment and soil stability	**2.636**
Landslides	1.919
Protected areas	0.077
Soil contamination	0.641
Clean-up	**0.015**
Intervention costs	**0.118**
TOTAL	**9.993**

Source: Government of the Republic of Slovenia (2023d).

[69] Government of the Republic of Slovenia (2023d).

[70] An estimate of the total cost of damage and reconstruction, excluding direct damage reported by municipalities and businesses, and excluding intervention and clean-up costs.

Table 5.4: Actual fiscal costs in the aftermath of the natural disaster of 4 August 2023

in EUR million, as at 10 October 2023	
Advances from municipalities	222
Advances - the economic sector	32
Intervention measures for water infrastructure	47
Intervention measures for road and rail infrastructure	50
Intervention costs	109
Emergency financial assistance	43
Wage compensation	3
Co-financing of the purchase of the most urgent assets and the implementation of the most urgent rehabilitation works	1
Funds from humanitarian organisations	10
TOTAL	**517**

Source: MoF, Government of the Republic of Slovenia.

According to currently available data,[71] around EUR 0.5 billion has been earmarked so far for measures related to the August floods (Table 5.4).[72] Approximately EUR 250 million is currently earmarked for compensating municipalities and businesses. The total reimbursement to the business sector, contingent on insurance status,[73] will be between 50% and 60%, which corresponds to a maximum of around EUR 230 million based on the damage reported or around EUR 190 million after the advance payments have been disbursed. The current budget for intervention measures in the infrastructure sector is around EUR 100 million, which is also close to the cost of intervention. A further EUR 50 million has been earmarked for other relief measures and for the funding of humanitarian organisations. The draft state budget currently earmarks EUR 1.9 billion to remedy the consequences of the August disaster in the 2023–2025 period.

The actual and potential financial resources available to deal with the consequences of the August disaster are currently estimated at around EUR 3.8 billion (Table 5.5). The bulk of the funding comes from European sources (EUR 1.8 billion), of which slightly less than EUR 0.4 billion has already been committed. The remainder depends on the actual amount of funds secured from the Solidarity Fund, on the efficient use of the planned additional resources outlined in the Recovery and Resilience Plan (RRP), with a spending deadline mid-2026, and, most importantly, on the actual reallocation of cohesion funds designated for the 2021–2027 period. According to our assessment, the latter is an optimistic assumption, implying that more than a quarter of the available funds would be used for disaster recovery. Around EUR 1 billion is potentially available from the already defined and still forthcoming changes in the taxation of employees and banks. When looking for other potentially available resources, it should be noted that five budget funds[74] have about EUR 350 million per year at their disposal. Given the multi-year nature of the reconstruction process and the other tasks to be carried out by these funds, part of this allocation could be used to address the consequences and improve preparedness for future weather-related events. This should go hand in hand with increasing the transparency and efficiency of their operation. Part of the necessary funds could also be provided through loans from the EIB, which has direct experience in this type of projects. These loans are expected to be priced in line with RRP loans. It is important to note that, unlike RRP loans, EIB loans are not subject to conditions or time limits. Potential sources of financing come from more efficient public

[71] 10 October 2023.

[72] The actual payments by the end of September amount to EUR 12 million.

[73] Article 44f of the Natural Disaster Recovery Act (ZOPNN).

[74] Natural Disasters Fund and Climate, Water, Forest and Fire Funds.

Table 5.5: Assessment of potential financial resources needed to deal with the aftermath of the natural disaster

in EUR million	
Revised state budget (August 2023)	520
Solidarity contribution[1]	320
Personal income tax scale mismatch 2024[2]	100
Cohesion funds 2014–2021[3]	70
Cohesion funds 2021–2027[4]	132
RRP – current programme in force	160
Insurance companies[5]	260
TOTAL – guaranteed	**1,562**
Taxation of banks' total assets	513
RRP additional resources[6]	320
Reallocation of cohesion funds 2021–2027[3]	800
Natural Disaster Fund[7]	190
Water Fund	97
EU Solidarity Fund[2]	282
TOTAL-potential	**2,202**
TOTAL-guaranteed and potential	**3,764**

Sources:

[1] Article 102 of the ZIUOPZP.

[2] Draft amending the 2024 state budget.

[3] Announcement by the Minister for Cohesion.

[4] Programme for the Implementation of the EU Cohesion Policy in the 2021–2027 Period in Slovenia.

[5] Insurance Supervision Agency.

[6] The Office of the Republic of Slovenia for Recovery and Resilience (URSOO).

[7] Fund balance as at 31 December 2022.

spending and from changes in the dividend policy of public enterprises and the possible use of the relatively large state budget liquidity (13% of GDP). In our view, the latter could only be used with extreme caution or only to the extent allowed by the Treasury's debt management strategy and to an extent that does not jeopardise the financial markets' perception of fiscal sustainability.

5.3 Ensuring fiscal sustainability in the event of natural disasters

In order to ensure fiscal sustainability, the State should respect the basic principles of disaster risk management. The financial impact of natural disasters represents a category of contingent liability within the general government sector and has the potential to reach exceptionally high levels. The IMF[75] categorises natural disasters as a fundamental fiscal risk, encompassing not only macroeconomic shocks, but also the costs associated with the financial sector and the impact of rulings and the operation of lower levels of the general government sector, state-owned enterprises, the non-financial private sector and public-private partnerships.[76] In this risk categorisation, natural disasters are identified as a moderate but relatively common source of fiscal risk in terms of costs. As a general rule, budgetary documents should to a greater extent include risk analysis. Fiscal risks are typically

[75] IMF (2016).

[76] Risks are listed in order of average cost relative to GDP, from highest to lowest.

addressed within regular budgetary documents in a somewhat fragmented and primarily qualitative manner. A comprehensive analysis and proper assessment of risks and their subsequent management can contribute to better public finance management, including the setting of fiscal targets. Such risk analysis can complement the traditional debt sustainability analysis, which usually only includes macroeconomic risks (see Box 3.1). Assessing the magnitude and frequency of risks can also help to set the institutional framework within which the general government sector responds to natural disasters.[77]

Given the increasing risks associated with the frequency and intensity of natural disasters, the State should develop stable additional sources of funding and ensure that the measures taken are efficient and well targeted. The State should encourage self-protection within the private sector and, as far as possible, prevent the moral hazard of too low a share of insured property.[78] In some countries, state aid is limited in cases where the property has not been insured, if the insurance terms would have allowed it.[79] Typically, the regular budget reserve is the primary source of funding for the expenses associated with natural disasters. Its size should ideally align with the assessment of potential damage determined within the framework of risk analysis. Measures that either prevent the occurrence of natural disasters or at least mitigate their potential consequences in advance can significantly reduce the fiscal impact of natural disasters. However, in the aftermath of a natural disaster, the efficiency of the state support to the private sector, both in terms of rapid response and its targeting, becomes paramount.[80] The Court of Audit carried out an audit of Slovenia's disaster relief more than a decade ago.[81] The audit found that the assistance provided by civil protection and disaster relief services proved highly efficient in dealing with the consequences of natural disasters, even to the point of safeguarding basic living conditions. Meanwhile, the system for allocating funds for the implementation of intervention measures was not uniform and did not ensure equal treatment of victims, while the impact of the aid was not fully in line with the purpose of allocating funds from the state budget. As per the Court of Audit, the aid provided by the Republic of Slovenia on the basis of the adopted damage repair programmes could have also been more efficient in ensuring rapid safe housing and the rapid resumption of activities or the use of property.

In order to establish adequate funding resources for dealing with natural disasters, the State should create fiscal space. This can be accomplished through a counter-cyclical fiscal policy, a practice that has not been consistently implemented in Slovenia (see Figure 4.1 and Figure 3 in Box 4.3). Creating a sufficient fiscal space means first and foremost finding reserves in current spending, but also finding ways to improve the efficiency of tax collection. A sufficient fiscal space not only allows for more favourable funding of natural disaster costs but also guards against the potential downgrade of sovereign debt ratings.[82] Some countries (e.g. New Zealand due to the experience of the sovereign debt downgrades following earthquakes in 2010 and 2011, which led to an increase in

[77] IMF (2018). If the projected costs of natural disasters are expected to be low, regular budget reserves should be sufficient. In cases where the estimated cost of natural disasters is high and their expected frequency is significant, establishing a dedicated fund for natural disasters is advisable.

[78] IMF (2018).

[79] German Insurance Association (2013). The Natural Disaster Recovery Act (ZOPNN) makes a distinction between the funds allocated by the State for the reconstruction of property in relation to the insurance of property. However, the difference between the funds allocated for insured and uninsured property is relatively small (10% to 20% of the total damage – see Articles 23 and 25 of the Natural Disaster Recovery Act (ZOPNN)).

[80] For example, the OECD (2016) recommends pre-defined rules for supporting the private sector in the aftermath of natural disasters. Such rules serve a dual purpose: they shape private sector expectations regarding potential financial aid and prevent arbitrary political discretion in aid allocation. This, in turn, helps maintain reasonable private sector expectations of the state aid. For example, the Natural Disaster Recovery Act (ZOPNN) establishes thresholds of funds (including payments of insurance sums) allocated to legal persons under private law for the business premises or dwelling reconstruction, ranging from 80% to 90% of the total damage – see Articles 23 and 25 of the ZOPNN.

[81] Court of Audit (2010).

[82] Although S&P Global (2022) also notes that the higher frequency of natural disasters could lead to sharp falls in GDP in the future, the agency does not incorporate this consideration in its sovereign debt ratings. Simulations conducted by S&P Global (2015) based on contingency scenarios for natural disasters suggest that earthquakes and cyclones could lead to the largest downgrades, with country-specific downgrades of up to 2.5 points.

general government debt by around 10 percentage points of GDP) therefore explicitly incorporate in their fiscal strategies the creation of adequate fiscal space to deal with contingencies.[83]

The legislation adopted in August provides for the establishment of a special solidarity fund. Article 156 of the Act Determining Intervention Measures for Recovery from the Floods and Landslides of August 2023 (ZIUOPZP) provides for the establishment of the Fund for the Reconstruction of Slovenia to collect funds from the state budget, European funds and funds from other sources. The aforementioned Act lacks specific details regarding the nature of the fund's establishment, whether it will take the form of a budgetary or extra-budgetary fund, and whether it will predominantly involve public or private participation. Furthermore, the Act does not specify the fund's intended purpose and mode of operation. Presently, the fund is envisaged to rely on contributions generated from solidarity-based Saturday work or through solidarity contributions from individuals liable for personal income tax and legal entities subject to corporate income tax.

Extra-budgetary funds offer significant advantages, but they also pose numerous risks to the long-term stability of public finances. According to the IMF[84] definition, extra-budgetary fund transactions are those that are excluded from the regular annual budgetary documents and legislation, even though they relate to the general government sector. One of the most important reasons for the existence of extra-budgetary funds is that they are exempt from standard parliamentary procedures, allowing for simpler and faster decision-making on the purpose of using such funds. The establishment of extra-budgetary funds is driven by their strict purpose of operation. The existence of such funds can ensure that projects are treated in isolation, rather than as one of the budget components subject to political decisions at any given time. A major drawback associated with extra-budgetary funds is the reduced control over their operations, which, in turn, leads to reduced transparency. This can increase the risks to sustainable public finances, especially when the general government sector is a minority shareholder.[85]

When establishing extra-budgetary funds that may have an impact on the fiscal situation, it is essential to provide an appropriate institutional framework for their operation. According to the IMF (2018), the following rules should apply in particular:

- The reports on the fund's operations should be reconciled with the budgetary documents, providing a comprehensive picture of the fiscal situation;
- The fund must always have resources available for immediate action when natural disasters strike;
- The operations and management of the fund must be fully transparent;
- The fund may only be used for large-scale natural disasters, subject to a pre-specified threshold for the cost of the disaster triggering the fund's utilisation;
- The fund's size is determined by estimating potential costs associated with natural disasters. However, the fund's resources only partially cover the expected medium- and long-term costs (thus reducing the risk of using too much accumulated fund resources contrary to the fund's intended purpose; longer-term financing can be arranged in the aftermath of the disaster);

[83] OECD and World Bank (2019).
[84] Allen and Radev (2010).
[85] Shick (2007).

- The fund's own investment policy should aim at maintaining a relatively high level of liquidity, while avoiding further shocks during a natural disaster (e.g. excessive accumulation of funds in deposits with the domestic banking system and their use at a time when the operation of the banking system is already under strain due to a natural disaster).

Another possible reason for using extra-budgetary funds is to circumvent national fiscal rules. To this end, Germany[86] has also set up a number of extra-budgetary funds in recent years, including funds for the reconstruction of infrastructure and the economy following the floods of 2002, 2013 and 2021. Against this background, international organisations have warned Germany and other countries[87] about the pitfalls of excessive use of extra-budgetary funds, which limit a comprehensive and up-to-date view of the true state of public finances. However, according to the ESA 2010 methodological rules, the transactions of extra-budgetary funds – similarly as applicable to other institutional units that are not direct budget users but are part of the general government sector – are also reflected in the general government balance, debt or other indicators, as well as in the fiscal compliance indicators at the EU level, which are also monitored by the Fiscal Council in accordance with the Fiscal Rule Act (FRA).[88]

Slovenia's existing budgetary funds also lack transparency and the Court of Audit has highlighted weaknesses in their operation. Information on the operation of budgetary funds is not regularly and directly accessible to the public, and the respective Act Regulating the Implementation of the Republic of Slovenia's Budget merely lists the budgetary funds operating each year.[89] Data on budget funds are not available in standard explanatory notes to the budgets, both in terms of their allocation by sector or by budget user. This significantly diminishes transparency and hinders effective oversight of their operation by both the public and the National Assembly. Moreover, the Court of Audit does not conduct regular audits of the budgetary funds' operations. In its regular audits of the executed budget accounts, it consistently refers to the establishment and legal bases for the operation of individual budgetary funds in a given year. Yet it has not undertaken a comprehensive analysis of these funds thus far. However, the Court of Audit has examined the operation of individual funds as part of wider audits[90] and has identified shortcomings in the planning and management of expenditure in funds such as the Water and Climate Funds.

[86] See e.g.: https://country.eiu.com/article.aspx?articleid=982925281&Country=Germany&topic=Politics&subtopic=Forecast&subsubtopic=Political+stability&u=1&pid=172836800&oid=312836814

[87] See e.g. the IMF (2022b), the EC (2023e) and the OECD (2023c) warnings for Germany and the IMF (2023e) warning for Poland.

[88] See e.g.: https://www.europarl.europa.eu/doceo/document/E-9-2023-001558-ASW_EN.html

[89] The draft Act Regulating the Implementation of the Budgets of the Republic of Slovenia for 2024 and 2025 (Article 44) provides for the following budgetary funds: 1. a regular budget reserve; 2. a fund for investments in public health care institutions; 3. a fund for the repayment of loans to finance higher education institutions and student accommodation facilities in public institutions of which the Republic of Slovenia is the founder; 4. a fund for scholarships; 5. a fund for climate change; 6. a water fund; 7. a forest fund; 8. a demographic fund; 9. a fund for the development of non-governmental organisations; and 10. a fund for recovery and resilience.

[90] E.g. the performance of the Water Fund as part of the audit "The efficiency of the environmental tax payment system pertaining to water use" (Court of Audit, 2022) and the performance of the Climate Fund as part of the audit "Means of climate change mitigation and adaptation to consequences of climate change" (Court of Audit, 2015), the audit "Effectiveness of meeting the targets to reduce greenhouse gas emissions" (Court of Audit, 2021) and audit on "The efficiency of the Ministry of Agriculture, Forestry and Food in adapting agriculture to climate change" (Court of Audit, 2023).

6. Annex

Table 6.1: Output gap estimates

	IMF (Oct.23)	EC (May 23)	OECD (Jun.23)	IMAD (Sep.23)	MoF (Oct.23)	HP filter	based on GDP averages	factor models	Blanchard-Quah	average of all estimates	average of institutions	average of estimates based on prod. funct.
2002	-1.1	0.9	-0.2	0.0	-0.6	-0.8	-0.5	...	-0.5	-0.3	-0.2	0.1
2003	0.1	0.7	-0.4	0.0	-0.7	-1.5	-1.4	0.3	-1.0	-0.4	-0.1	0.0
2004	-1.4	1.8	0.9	1.1	0.5	-0.8	-1.1	1.1	-0.7	0.2	0.6	1.2
2005	-0.5	2.5	1.8	2.1	1.4	-0.5	-1.3	2.0	0.3	0.9	1.5	2.0
2006	2.8	4.7	4.5	4.6	3.9	2.0	1.0	4.1	2.3	3.3	4.1	4.4
2007	5.3	8.1	8.3	8.2	7.4	6.4	5.7	6.8	6.2	6.9	7.4	7.9
2008	5.4	7.7	8.6	8.1	7.2	8.3	7.5	4.4	6.3	7.1	7.4	7.7
2009	-3.0	-2.8	-2.0	-2.3	-3.2	-0.7	-1.6	-7.0	-3.1	-2.9	-2.7	-2.8
2010	-1.0	-2.8	-2.3	-2.4	-3.1	0.1	-0.4	-2.9	-2.8	-1.9	-2.3	-2.8
2011	0.6	-2.8	-2.6	-2.5	-3.2	0.6	0.9	-2.5	-1.7	-1.5	-2.1	-2.8
2012	-2.0	-6.0	-6.1	-5.9	-6.4	-2.5	-1.9	-5.5	-4.7	-4.5	-5.3	-6.1
2013	-3.0	-7.7	-8.2	-7.6	-8.1	-4.3	-3.6	-4.7	-7.6	-6.1	-6.9	-7.8
2014	-2.3	-6.1	-7.1	-6.1	-6.6	-3.0	-2.2	-2.5	-4.8	-4.5	-5.6	-6.3
2015	-1.8	-5.0	-6.7	-5.1	-5.5	-2.7	-2.0	-1.9	-3.8	-3.8	-4.8	-5.2
2016	-0.2	-3.0	-5.5	-3.0	-3.5	-2.0	-1.6	-0.3	-1.8	-2.3	-3.0	-3.2
2017	0.0	0.3	-3.0	0.4	-0.3	0.0	0.4	2.1	0.9	0.1	-0.5	0.1
2018	0.3	2.6	-1.2	3.0	2.2	1.7	2.1	2.7	3.6	1.9	1.4	2.6
2019	1.0	3.5	-0.5	4.2	3.2	2.6	2.6	2.1	4.8	2.6	2.3	3.6
2020	-2.6	-3.2	-7.2	-2.3	-3.4	-4.2	-4.5	-4.6	-0.6	-3.6	-3.7	-2.9
2021	2.0	2.1	-2.0	3.0	2.0	1.0	0.8	3.8	2.9	1.7	1.4	2.3
2022	1.6	4.3	1.0	2.7	1.9	0.9	0.8	3.3	1.8	2.0	2.3	3.0
2023	0.9	2.6	0.4	1.3	0.7	-0.1	-0.3	2.0	-1.5	0.7	1.2	1.5
2024	0.3	1.6	1.0	1.1	0.7	0.2	-0.1	0.7	-1.2	0.5	1.0	1.1

Source: IMAD, EC, IMF, OECD, MoF, FC calculations.

Note: The table shows estimates of the output gap by domestic and international institutions that provide these estimates for Slovenia (IMAD, MoF, EC, IMF, OECD). In addition, the table also shows estimates of the output gap generated by statistical models in which the potential product is determined by: (i) HP filters at different values of the parameter λ (10, 100, 400), ii) the 3-, 5- and 7-year average of GDP, (iii) factor models estimated on the basis of survey about limitations in the economy and forecasts of a simple VAR model that includes these factors, as well as factor models that take into account a large number of IMAD and EC macroeconomic variables in its estimates and forecasts, (iv) SVAR model based on the Blanchard and Quah methodology (1989), which uses restrictions with regard to the assumption that GDP is affected in the long term only by shocks to the aggregate supply, while demand shocks affect activity levels only in the short term.

Table 6.2: Structural balance estimates

	IMF (Oct.23)	EC (May 23)	OECD (Jun.23)	IMAD (Sep.23)	MoF (Oct.23)	HP filter	based on GDP averages	factor models	Blanchard-Quah	average of all estimates	average of institutions	average of estimates based on prod. funct.
2002	-3.3	-4.2	-3.7	-3.8	-3.5	-3.4	-3.6	...	-3.5	-3.6	-3.7	-3.8
2003	-2.7	-2.9	-2.4	-2.6	-2.3	-1.9	-1.9	-2.7	-2.1	-2.4	-2.6	-2.6
2004	-1.0	-2.5	-2.1	-2.2	-1.9	-1.3	-1.1	-2.2	-1.4	-1.7	-1.9	-2.2
2005	-1.1	-2.5	-2.2	-2.3	-2.0	-1.1	-0.7	-2.3	-1.4	-1.7	-2.0	-2.3
2006	-2.5	-3.4	-3.3	-3.4	-3.0	-2.2	-1.7	-3.2	-2.3	-2.8	-3.2	-3.3
2007	-2.5	-3.8	-3.9	-3.9	-3.5	-3.1	-2.7	-3.2	-3.0	-3.3	-3.5	-3.7
2008	-3.9	-5.0	-5.4	-5.2	-4.8	-5.3	-4.9	-3.5	-4.3	-4.7	-4.8	-5.0
2009	-4.4	-4.5	-4.9	-4.7	-4.3	-5.5	-5.1	-2.6	-4.3	-4.5	-4.6	-4.5
2010	-5.0	-4.2	-4.4	-4.4	-4.0	-5.5	-5.3	-4.1	-4.2	-4.6	-4.4	-4.2
2011	-5.8	-4.2	-4.3	-4.3	-4.0	-5.8	-5.9	-4.3	-4.7	-4.8	-4.5	-4.2
2012	-3.1	-1.3	-1.2	-1.3	-1.1	-2.9	-3.2	-1.5	-1.9	-1.9	-1.6	-1.2
2013	-3.3	-1.1	-0.8	-1.1	-0.8	-2.7	-3.0	-2.4	-1.1	-1.8	-1.4	-1.0
2014	-3.4	-1.6	-1.1	-1.6	-1.4	-3.0	-3.4	-3.3	-2.2	-2.3	-1.8	-1.5
2015	-1.9	-0.4	0.4	-0.4	-0.2	-1.5	-1.9	-1.9	-1.0	-1.0	-0.5	-0.4
2016	-1.7	-0.4	0.7	-0.4	-0.2	-0.9	-1.1	-1.7	-1.0	-0.8	-0.4	-0.4
2017	0.1	-0.1	1.5	-0.1	0.2	0.0	-0.1	-0.9	-0.4	0.0	0.3	0.0
2018	0.6	-0.4	1.4	-0.6	-0.2	0.0	-0.2	-0.5	-0.9	-0.1	0.1	-0.4
2019	0.3	-0.9	1.0	-1.2	-0.7	-0.5	-0.4	-0.2	-1.5	-0.5	-0.3	-0.9
2020	-1.2	-1.0	0.9	-1.4	-0.9	-0.5	-0.3	-0.3	-2.2	-0.8	-0.7	-1.1
2021	-1.5	-1.5	0.4	-1.9	-1.4	-1.0	-0.9	-2.3	-1.9	-1.3	-1.2	-1.6
2022	-1.7	-3.0	-1.4	-2.2	-1.8	-1.3	-1.3	-2.4	-1.8	-1.9	-2.0	-2.3
2023	-2.6	-3.4	-2.4	-2.8	-2.5	-2.1	-2.0	-3.1	-1.5	-2.5	-2.7	-2.9
2024	-2.7	-3.3	-3.1	-3.1	-2.9	-2.7	-2.5	-2.9	-2.0	-2.8	-3.0	-3.1

Source: IMAD, EC, IMF, OECD, MoF, FC calculations based on Table 6.1.

Table 6.3: Structural effort estimates

	IMF (Oct.23)	EC (May 23)	OECD (Jun.23)	IMAD (Sep.23)	MoF (Oct.23)	HP filter	based on GDP averages	factor models	Blanchard-Quah	average of all estimates	average of institutions	average of estimates based on prod. funct.
2002	0.1	0.5	0.6	0.4	0.5	0.8	0.8	...	1.3	0.6	0.4	0.5
2003	0.6	1.3	1.3	1.2	1.2	1.5	1.6	...	1.4	1.3	1.1	1.2
2004	1.6	0.4	0.3	0.4	0.3	0.6	0.8	0.6	0.8	0.6	0.6	0.4
2005	-0.1	0.0	-0.1	-0.1	-0.1	0.2	0.4	-0.1	-0.1	0.0	-0.1	-0.1
2006	-1.4	-1.0	-1.2	-1.1	-1.0	-1.1	-1.0	-0.9	-0.8	-1.1	-1.1	-1.0
2007	0.0	-0.4	-0.6	-0.5	-0.5	-0.9	-1.0	-0.1	-0.7	-0.5	-0.4	-0.4
2008	-1.4	-1.2	-1.5	-1.3	-1.3	-2.2	-2.2	-0.3	-1.4	-1.4	-1.3	-1.2
2009	-0.5	0.5	0.5	0.4	0.4	-0.2	-0.1	0.9	0.0	0.2	0.3	0.5
2010	-0.6	0.3	0.5	0.3	0.3	-0.1	-0.2	-1.6	0.2	-0.1	0.2	0.3
2011	-0.8	0.0	0.2	0.1	0.0	-0.2	-0.6	-0.2	-0.5	-0.2	-0.1	0.0
2012	2.6	2.9	3.1	3.0	2.9	2.9	2.7	2.8	2.8	2.9	2.9	2.9
2013	-0.1	0.2	0.4	0.2	0.2	0.3	0.2	-0.9	0.8	0.1	0.2	0.2
2014	-0.1	-0.5	-0.3	-0.5	-0.5	-0.4	-0.5	-0.8	-1.1	-0.5	-0.4	-0.5
2015	1.5	1.1	1.5	1.1	1.2	1.5	1.6	1.4	1.1	1.3	1.3	1.2
2016	0.2	0.0	0.4	0.0	0.0	0.6	0.7	0.2	0.0	0.2	0.1	0.0
2017	1.8	0.4	0.7	0.3	0.3	0.9	1.0	0.8	0.6	0.8	0.7	0.3
2018	0.6	-0.4	-0.1	-0.5	-0.4	0.0	-0.1	0.5	-0.5	-0.1	-0.2	-0.4
2019	-0.3	-0.4	-0.3	-0.6	-0.5	-0.4	-0.2	0.3	-0.6	-0.4	-0.4	-0.5
2020	-1.5	-0.1	-0.1	-0.2	-0.1	0.0	0.1	-0.1	-0.7	-0.3	-0.4	-0.1
2021	-0.2	-0.5	-0.5	-0.6	-0.6	-0.5	-0.6	-2.0	0.2	-0.6	-0.5	-0.6
2022	-0.2	-1.4	-1.8	-0.3	-0.4	-0.3	-0.4	-0.1	0.1	-0.5	-0.8	-0.7
2023	-0.9	-0.4	-1.0	-0.6	-0.7	-0.8	-0.7	-0.7	0.3	-0.6	-0.7	-0.6
2024	-0.1	0.0	-0.7	-0.3	-0.4	-0.5	-0.5	0.2	-0.5	-0.3	-0.3	-0.2

Source: IMAD, EC, IMF, OECD, MoF, FC calculations based on Table 6.1.

Table 6.4: Structural primary balance estimates

	IMF (Oct.23)	EC (May 23)	OECD (Jun.23)	IMAD (Sep.23)	MoF (Oct.23)	HP filter	based on GDP averages	factor models	Blanchard-Quah	average of all estimates	average of institutions	average of estimates based on prod. funct.
2002	-1.1	-2.0	-1.5	-1.6	-1.3	-1.2	-1.4	...	-1.4	-1.5	-1.5	-1.7
2003	-0.7	-1.0	-0.5	-0.7	-0.3	0.0	0.0	-0.8	-0.2	-0.5	-0.6	-0.7
2004	0.6	-0.8	-0.4	-0.5	-0.3	0.4	0.5	-0.5	0.3	-0.1	-0.3	-0.5
2005	0.4	-0.9	-0.6	-0.8	-0.5	0.4	0.8	-0.7	0.1	-0.2	-0.5	-0.7
2006	-1.2	-2.1	-2.0	-2.0	-1.7	-0.8	-0.3	-1.8	-0.9	-1.4	-1.8	-1.9
2007	-1.3	-2.6	-2.7	-2.6	-2.3	-1.8	-1.5	-2.0	-1.7	-2.0	-2.3	-2.5
2008	-2.8	-3.9	-4.3	-4.1	-3.7	-4.2	-3.8	-2.4	-3.2	-3.6	-3.8	-3.9
2009	-3.1	-3.2	-3.5	-3.4	-3.0	-4.2	-3.7	-1.3	-3.0	-3.2	-3.3	-3.2
2010	-3.4	-2.6	-2.8	-2.7	-2.4	-3.9	-3.7	-2.5	-2.6	-2.9	-2.8	-2.6
2011	-3.9	-2.3	-2.4	-2.4	-2.1	-3.9	-4.0	-2.4	-2.8	-2.9	-2.6	-2.3
2012	-1.1	0.8	0.8	0.7	0.9	-0.9	-1.2	0.5	0.1	0.1	0.4	0.8
2013	-0.7	1.5	1.7	1.5	1.7	-0.1	-0.4	0.1	1.5	0.7	1.1	1.6
2014	-0.1	1.7	2.1	1.7	1.9	0.2	-0.2	0.0	1.1	0.9	1.4	1.7
2015	1.3	2.8	3.6	2.8	3.0	1.7	1.4	1.3	2.2	2.2	2.7	2.9
2016	1.3	2.6	3.8	2.6	2.9	2.1	1.9	1.3	2.0	2.3	2.6	2.7
2017	2.6	2.4	4.0	2.4	2.7	2.5	2.4	1.6	2.1	2.5	2.8	2.5
2018	2.6	1.6	3.4	1.4	1.8	2.0	1.8	1.5	1.1	1.9	2.2	1.6
2019	2.0	0.8	2.7	0.5	1.0	1.2	1.3	1.5	0.2	1.2	1.4	0.8
2020	0.4	0.6	2.5	0.2	0.7	1.1	1.3	1.3	-0.6	0.8	0.9	0.5
2021	-0.2	-0.3	1.6	-0.7	-0.2	0.2	0.4	-1.1	-0.7	-0.1	0.1	-0.4
2022	-0.5	-1.8	-0.3	-1.1	-0.7	-0.2	-0.2	-1.3	-0.7	-0.8	-0.9	-1.2
2023	-1.4	-2.2	-1.2	-1.6	-1.3	-1.0	-0.9	-2.0	-0.3	-1.3	-1.6	-1.7
2024	-1.4	-2.0	-1.8	-1.8	-1.6	-1.4	-1.2	-1.6	-0.7	-1.5	-1.7	-1.8

Source: IMAD, EC, IMF, OECD, MoF, FC calculations based on Table 6.1.

Table 6.5: Structural primary effort estimates

	IMF (Oct.23)	EC (May 23)	OECD (Jun.23)	IMAD (Sep.23)	MoF (Oct.23)	HP filter	based on GDP averages	factor models	Blanchard-Quah	average of all estimates	average of institutions	average of estimates based on prod. funct.
2002	-0.1	0.3	0.5	0.3	0.3	0.6	0.7	...	1.1	0.5	0.3	0.3
2003	0.4	1.0	1.0	1.0	1.0	1.3	1.4	...	1.2	1.0	0.9	1.0
2004	1.4	0.2	0.1	0.1	0.1	0.3	0.5	0.3	0.5	0.4	0.4	0.1
2005	-0.2	-0.1	-0.2	-0.3	-0.2	0.1	0.3	-0.2	-0.2	-0.1	-0.2	-0.2
2006	-1.6	-1.1	-1.3	-1.2	-1.2	-1.2	-1.2	-1.0	-1.0	-1.2	-1.3	-1.2
2007	-0.1	-0.5	-0.7	-0.6	-0.6	-1.0	-1.1	-0.2	-0.8	-0.6	-0.5	-0.6
2008	-1.6	-1.3	-1.6	-1.4	-1.4	-2.4	-2.4	-0.4	-1.5	-1.6	-1.5	-1.4
2009	-0.3	0.7	0.8	0.7	0.6	0.0	0.1	1.1	0.2	0.4	0.5	0.7
2010	-0.3	0.6	0.8	0.7	0.6	0.3	0.1	-1.3	0.5	0.2	0.5	0.7
2011	-0.5	0.3	0.4	0.3	0.3	0.0	-0.4	0.1	-0.2	0.0	0.2	0.3
2012	2.7	3.0	3.2	3.1	3.1	3.0	2.9	2.9	2.9	3.0	3.0	3.1
2013	0.4	0.7	0.9	0.8	0.8	0.8	0.7	-0.4	1.3	0.7	0.7	0.7
2014	0.6	0.2	0.4	0.2	0.2	0.3	0.2	-0.1	-0.4	0.2	0.3	0.2
2015	1.4	1.1	1.4	1.1	1.1	1.5	1.6	1.3	1.1	1.3	1.3	1.1
2016	0.0	-0.2	0.2	-0.2	-0.2	0.4	0.6	0.0	-0.1	0.1	-0.1	-0.2
2017	1.3	-0.2	0.2	-0.2	-0.2	0.4	0.4	0.2	0.1	0.2	0.2	-0.2
2018	0.1	-0.9	-0.6	-1.0	-0.9	-0.5	-0.6	0.0	-1.1	-0.6	-0.7	-0.9
2019	-0.7	-0.8	-0.7	-0.9	-0.8	-0.8	-0.6	-0.1	-0.9	-0.7	-0.8	-0.8
2020	-1.6	-0.2	-0.2	-0.3	-0.2	-0.1	0.0	-0.2	-0.8	-0.4	-0.5	-0.2
2021	-0.6	-0.9	-0.9	-0.9	-0.9	-0.9	-0.9	-2.4	-0.1	-0.9	-0.8	-0.9
2022	-0.3	-1.6	-1.9	-0.4	-0.5	-0.5	-0.5	-0.3	0.0	-0.7	-0.9	-0.8
2023	-0.9	-0.4	-0.9	-0.6	-0.6	-0.7	-0.7	-0.6	0.4	-0.6	-0.7	-0.5
2024	0.0	0.2	-0.6	-0.2	-0.2	-0.4	-0.3	0.4	-0.4	-0.2	-0.2	-0.1

Source: IMAD, EC, IMF, OECD, MoF, FC calculations based on Table 6.1.

Table 6.6: Maximum general government expenditure and deviation from the framework

	IMF (Oct.23)		EC (May 23)		OECD (Jun.23)		IMAD (Sep.23)		MoF (Oct.23)		HP		based on GDP averages		factor models		Blanchard-Quah		*average of all estimates*		*average of institutions*		*average of estimates based on prod. funct.*		**Framework**
	max E	*diff.*	*max E*	*diff.*	*max E*	*diff.*	*max E*	*diff.*	*max E*	*diff.*	*max E*	*diff.*	*max E*	*diff.*	*max E*	*diff.*	*max E*	*diff.*	*max E*	*diff.*	*max E*	*diff.*	*max E*	*diff.*	
2024	31,659	*-501*	31,681	*-479*	31,279	*-881*	31,531	*-629*	31,492	*-668*	31,383	*-777*	31,423	*-737*	31,903	*-257*	31,400	*-760*	31,528	*-632*	31,528	*-632*	31,568	*-592*	**32,160**

*Source: IMAD, EC, IMF, OECD, MoF, FC calculations. Note: *The calculations of expenditure thresholds are based on Framework Proposal for 2023, while structural adjustment in 2024 is required in line with current fiscal rules.*

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