



REPUBLIC OF SLOVENIA
FISCAL COUNCIL

**Assessment of budgetary documents for 2025 and 2026
and
opinion on the Medium-Term Fiscal and Structural
Plan 2025–2028**

October 2024

Document No.: 30-2/2024/6

The Government of the Republic of Slovenia has provided the Fiscal Council of the Republic of Slovenia (hereinafter: the Fiscal Council) with the following materials for the preparation of this assessment and opinion:

- On 30 September 2024: the *Draft Amending Budget of the Republic of Slovenia for 2025* and the *Draft Budget of the Republic of Slovenia for 2026*, together with related documents (hereinafter: the Draft Budgets). Pursuant to Article 28 of the Public Finance Act, the Government is required to submit the two documents to the National Assembly of the Republic of Slovenia (hereinafter: the National Assembly) by 1 October. The Ministry of Finance of the Republic of Slovenia (hereinafter: the Ministry of Finance) and the Fiscal Council have concluded a Memorandum of Understanding which sets out, with agreed deadlines, the supporting documentation that should accompany the budget documents which should be sent by the Ministry of Finance to the Fiscal Council. The Ministry of Finance sent the above-mentioned documents to the Fiscal Council on 30 September and 1 October 2024.
- On 4 October 2024: 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). The amendment concerns only the expenditure ceiling of the Pension and Disability Insurance Institute of Slovenia (hereinafter: the Pension and Disability Insurance Institute) and not the entire general government sector, for which the current Fiscal Rule Act requires the Fiscal Council to prepare a fiscal rules compliance assessment.
- On 11 October 2024: the *Medium-Term Fiscal and Structural Plan of the Republic of Slovenia* (hereafter: the Plan), although this is not required by EU and current national legislation. The Plan should also constitute an exit strategy after the end of exceptional circumstances (Article 14 of the Fiscal Rule Act).
- On 11 October 2024: the *Proposed Ordinance amending the Ordinance on the framework for the preparation of the general government budgets for the 2025–2027 period*, which, in light of the amended EU legislation and the unadjusted Fiscal Rule Act, sets the average growth in net general government expenditure over the period of the framework. The growth is in line with the average growth of net expenditure resulting from the Plan.
- On 11 October 2024: the projections of the general government balance in the *Draft Budgetary Plan for 2025* with projections of the general government balance for the 2024–2026 period according to the ESA 2010 methodology.

Data available up to and including 15 October 2024 were taken into account.

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EXECUTIVE SUMMARY

The Draft State Budgets for 2025 and 2026 foresee an increase in the deficit compared to 2024. Intervention measures totalling more than EUR 8 billion over the period 2020–2024 are no longer expected to have a negative impact on the balance from 2025 onwards, as flood recovery expenditure will be financed from earmarked funds. Thus, the increase in the deficit to EUR 1.9 billion in 2025 is expected to be solely due to stronger non-intervention spending growth, which at 12% is expected to be three times higher than the long-term average. The Fiscal Council considers that spending in the Draft Budgets is again set at a high level, which makes a thorough assessment difficult. The continuation of insufficiently realistic planning is a consequence of the fragmentation of the budgetary process, characterised by rendering individual users' demands rather than by clear economic policy orientations. The Fiscal Council estimates that the level of spending, and hence the deficit, could be lower in 2024 and 2025 than in the Government's projections. Nevertheless, spending growth would increase due to the expected strengthening in investment and as a result of the wage settlement.

The Government has submitted to the Fiscal Council the Medium-Term Fiscal and Structural Plan 2025–2028, which Slovenia has prepared for the first time under the EU's reformed economic governance framework. The Plan sets a maximum growth rate of net expenditure that is conducive to the sustainability of public finances in the medium term and in formal terms meets the requirements. To identify risks to the fulfilment of the Plan's commitments, the Fiscal Council has prepared fiscal projections. These, taking into account the measures expected to be in place in the period 2025–2028, suggest that deviations from the balance and debt targets could occur, in particular in the second part of the implementation of the Plan. Specifically, a higher deficit would predominantly result from an increase in expenditure on wages and salaries, as well as on healthcare. The measures already taken on the revenue side, which include in particular an increased tax burden, would thus not be sufficient to finance the expected increase in expenditure in full. This suggests the need for additional compensatory measures to meet the Plan's commitments. This is unlikely to be achieved by the measures set out in the Plan alone, which also constitutes the exit strategy under the Fiscal Rule Act.

The deterioration in the balance at the transition to the new fiscal rules compared to the last year before the epidemic is mainly due to the large-scale intervention measures. The gross debt-to-GDP ratio is only slightly higher than in 2019, despite the three shocks. The ample liquidity buffer also provides room for manoeuvre to address potential new shocks, and credit ratings are higher than before the epidemic. The stronger medium-term orientation of the new economic governance framework offers an opportunity to plan and implement fiscal policy more robustly and to address a number of challenges prudently. At the same time, economic policy should take into account that delaying appropriate reforms raises fiscal costs and increases uncertainties in terms of the response of economic agents. Adopting the presented pension reform would already allow some fiscal policy room for manoeuvre during the period of this Plan and, above all, would make an important contribution to debt sustainability.

1. Basis for the assessment of the Draft Budgets and opinion on the Plan

1.1 Legislative and formal basis

In April this year, the European Parliament and the Council of the EU endorsed changes to the economic governance framework in the EU. The changes are regulated by two Regulations (the "preventive" Regulation (EU) 2024/1263 and the "corrective" Regulation (EU) 2024/1264) and a Directive (Directive (EU) 2024/1265).¹ The two above-mentioned Regulations entered into force immediately, while the Directive has to be transposed by the Member States by the end of 2025.² The "preventive" Regulation defines the steps, contents and rules related to the preparation of the Plan. The rules set out a path of public finances that would ensure the sustainability of public finances in the medium term. The path represents the growth of the so-called net general government expenditure³ over the medium term, depending on the length of the legislature's mandate (four or five years). The same Regulation also sets the deadlines by which the country has to submit the Plan to the European Commission (hereinafter: the EC). This year, due to the transition period, the deadline is set for 20 September 2024, or later if agreed between the EC and the Member State.

As expected, the current Fiscal Rule Act and the Public Finance Act are not yet aligned with the changes to the EU's economic governance framework. The inconsistencies and the resulting uncertainties in the light of the present assessment and the opinion of the Fiscal Council relate to:

a) *the role of the Fiscal Council in the process of adopting the Plan:*

Article 11 of the "preventive" Regulation provides that the Government may invite an independent fiscal institution to provide an assessment on the adequacy of the macroeconomic forecast and assumptions used in the Plan. From 2032 onwards, the Regulation will require independent fiscal institutions to carry out such an assessment even without a call by the government. The same Article also stipulates that the opinion, if available, must be attached to the Plan when it is submitted to the EC. The reformed EU legislation stresses in its preamble the importance of maintaining the existing role of the independent fiscal institutions, which, under the existing Fiscal Rule Act, also includes the assessment of the medium-term budgetary documents.

b) *the deadlines for the Fiscal Council to deliver its opinion on the Plan:*

Due to the undefined role of the Fiscal Council in the adoption of the Plan, the deadlines are currently not set and are expected to be known once the relevant national legislation is reformed.

c) *the Plan's link with annual and medium-term planning at the national level:*

This should be established when the Directive is transposed into national law by the end of 2025.

d) *the definition of the domestic fiscal rule and the indicators used in this respect:*

The expenditure targets can no longer be set in the way provided for in the existing Fiscal Rule Act, due to the omission of certain indicators at the EU level. The Fiscal Council is therefore not in a position to assess the received Draft Budgets and Plan in accordance with Article 3 of the Fiscal Rule Act. The same applies to the Framework Proposal.

¹ All the above-mentioned documents are available at <https://eur-lex.europa.eu/homepage.html>.

² This is becoming the central medium-term budgetary document at the EU level. The methodology used to determine the paths of the net expenditure in the Plan is presented in EC (2024a). Guidance on the information to be taken into account by EU countries in doing so is provided in the Official Journal of the EU (2024).

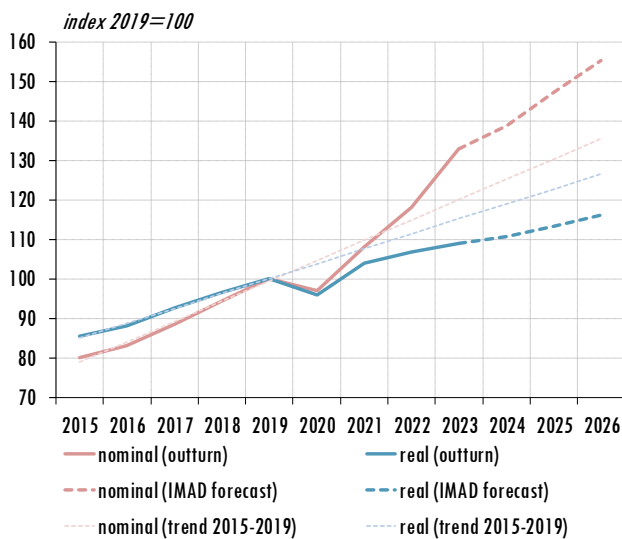
³ General government expenditure less interest expenditure, expenditure on EU programmes fully financed by EU programmes, national expenditure related to the co-financing of EU programmes, cyclical unemployment expenditure, one-off and temporary measures, and discretionary revenue measures.

On the basis of the documents received, and in view of the above-mentioned uncertainties and inconsistencies, the Fiscal Council is examining in this assessment the risks to realisation of the projections contained in the Draft Budgets and giving an opinion on the risks to the achievement of the public finance path presented in the Plan.

1.2 Macroeconomic basis

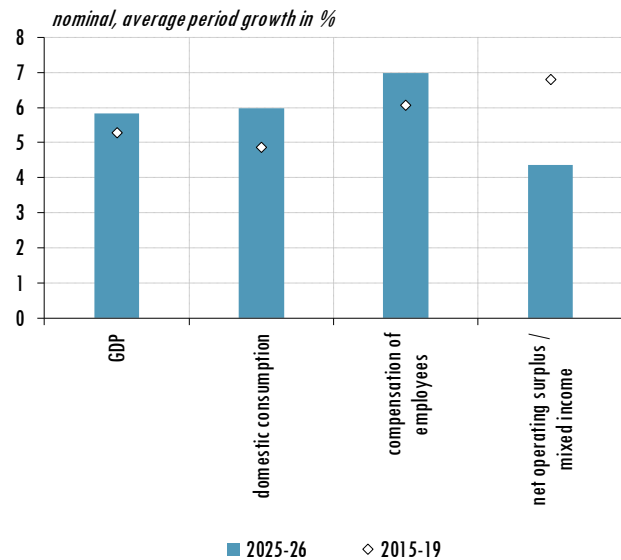
The macroeconomic assumptions of the Budget Proposals and the Plan⁴ are based on the IMAD⁵ forecast and the Debt Sustainability Analysis (hereinafter: the DSA) methodology.⁶ The IMAD has published forecasts up to 2026, but in setting the path of net expenditure in the Plan, this forecast is used only up to 2025. From 2026 onwards, the Plan uses macroeconomic assumptions based on the DSA methodology.⁷ Due to the length of the period covered by the DSA, even relatively small changes in the assumptions can lead to large deviations in setting the Plan's parameters. The Member State shall justify the choice of assumptions in the current Plan, which we consider to be consistent with the precautionary principle, in bilateral negotiations with the EC.

Figure 1.1: GDP



Source: SORS, IMAD, FC calculations.

Figure 1.2: Tax bases



Source: SORS, IMAD, FC calculations.

⁴ The assumptions on which the EC will assess the path of net expenditure are currently unknown. The EC usually publishes its updated autumn macroeconomic forecasts in mid-November.

⁵ IMAD (2024). In national legislation, IMAD forecasts form the basis for budgetary planning. This is laid down in the Decree on development planning documents and the procedures for preparing the draft national budget (Official Gazette of the Republic of Slovenia [Uradni list RS], Nos 54/10 and 35/18).

⁶ In addition to macroeconomic aggregates, the DSA also includes market expectations and ageing cost projections from the Ageing Report 2024 (EC, 2024b). Market expectations refer in particular to assumptions on price growth and short- and long-term interest rates, which enter into the calculation of the required path of net expenditure.

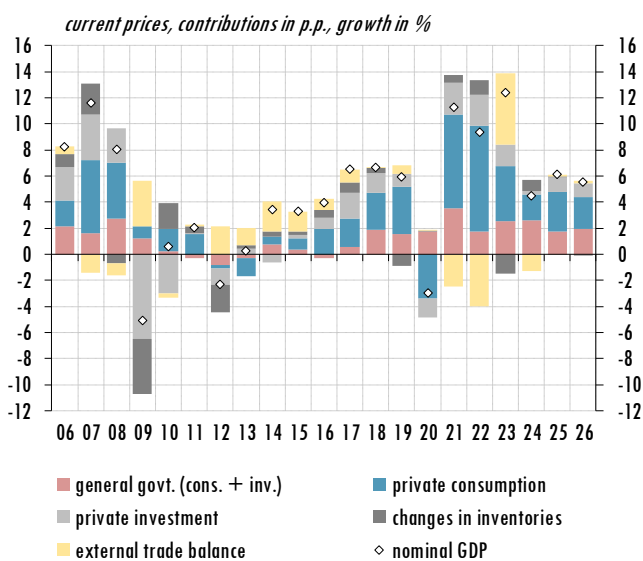
⁷ This methodology (see Box 1.2.1 in EC (2024a) and Box 1.2.1 in EC (2022)) allows, inter alia, the use of a technical assumption for the growth of the GDP deflator. Under this assumption, the growth of the deflator from the baseline (in the current Plan for 2025) converges linearly to the average of long-term market expectations for euro area inflation and the ECB's target inflation of 2%. The assumption of linear convergence is not problematic when inflation is similar to the target inflation. However, it can lead to larger deviations in the calculation of the allowed growth rate of net expenditure if inflation or its short-term forecast deviates significantly from market participants' long-term expectations. In this case, a gradual or linear convergence towards longer-term inflation expectations is reflected in an assumption of an extended period of persistent low or high inflation, which may (procyclically) lower or raise the allowed growth of net expenditure. The unusual dynamics in the baseline scenario of the current Plan can also be seen in the assumption of real GDP growth of 2.4% in 2025, declining to 1.9% on average over the period 2026–2028, rising to 2.4% in 2029–2031 and then gradually approaching 1.8% in 2038. The latter is not due to a discretionary decision of the Ministry of Finance, but is derived from the DSA methodology and does not have a significant impact on the growth of net expenditure. These facts lead to divergences between the assumptions used in the Plan and the IMAD forecasts that enter into short-term budgetary planning (contained in the Draft Budgets), and also to inconsistencies between the forecasts for economic growth and inflation. The calculations also use a stock-flow adjustment assumption, in line with the DSA methodology, which allows for a value different from 0 in 2024 and in the first year of the Plan (in the current Plan: -0.8% of GDP), while stock-flow adjustments should not impact the level of public debt in the subsequent period of the Plan.

Real economic growth will be subdued in the coming years, with nominal growth still characterised by relatively high increases in the price components. Real economic growth in the coming years will be less than half of the pre-crisis figures according to the assumptions of the Plan (2025–2028: around 2.0% per annum; 2017–2019: 4.4% per annum). The level of real GDP will remain below the pre-crisis trend (Figure 1.1). This may indicate the lasting effects of successive crises and structural pressures (geopolitical and demographic changes) to which the economy is exposed. Nominal GDP is projected to grow by 5.2% per annum over the Plan period, one-fifth less than the average of the three years preceding the crisis. In addition to the projected strengthening of labour productivity, the main contributor to nominal growth will be price growth (Figure 1.4).

The evolution of the tax base will be relatively favourable, with growth roughly comparable to that of the pre-epidemic period (Figure 1.2). Domestic consumption will grow even slightly faster. Household consumption will be boosted by higher real incomes, which will strengthen on the basis of wage growth and falling inflation. At the same time, wage growth will contribute, among other things, to a significant moderation in profit growth. Government consumption will also remain strong, driven by the extension of social security to long-term care. Solid investment growth will be supported by both government investment activity in the context of flood recovery and the use of EU funds and by the expansion of private sector productive capacity.

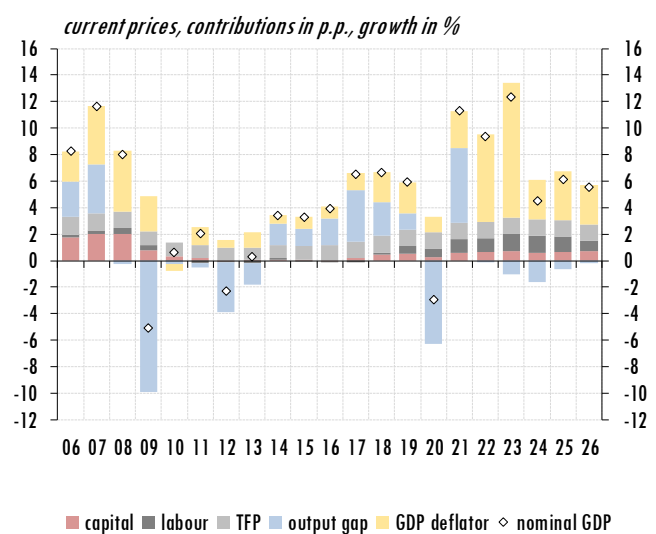
Demographic pressures will increasingly be reflected in the labour market. Over the next two years, the total number of people in employment is projected to increase by around 11,000, but at a moderating pace and at a slower pace than the long-term average. The growth in hours worked and the increase in the participation rate are also expected to slow, as the limits of full employment will be reached due to a limited supply of an active population. This is also the case when assuming that immigration and employment of foreigners remain high. The decline in unemployment is therefore also expected to slow, with the unemployment rate reaching 3.7% according to the labour force survey. The increase in labour costs in the public sector will be mainly driven by the implementation of the reformed wage system, but also by labour market constraints, which, in addition to the envisaged tax changes, will also raise labour costs in the private sector. This could further weaken the competitiveness of the export part of the economy, despite a gradual recovery in productivity.

Figure 1.3: Demand factors and GDP



Source: SORS, IMAD, FC calculations.

Figure 1.4: Supply factors and GDP



Source: SORS, IMAD, FC calculations.

Inflation in the coming years will be higher than in the pre-inflation period. Higher inflation will largely reflect labour market pressures, which are expected to drive up services prices in particular, keeping underlying inflation relatively high. A temporary acceleration of inflation to above 3% in 2025 will be due to the end of the support measures from the energy crisis. Price inflation is expected to moderate to an average of 2.3% in 2026.

2. Assessment of the revenue and expenditure projections in the Draft Budgets

The state budget planning process is characterised by systemic weaknesses. The unrealistic nature of the state budget projections has increased further in recent years (Figure 2.1). Such an assessment is independent of the uncertainty about intervention measures to address the effects of the various shocks in recent years.⁸ The unrealism is evident in the systematic overestimation of both investment and other spending. This is due to the fact that the preparation of the national budget is a fragmented process, characterised by the perceived needs of individual budget spenders, rather than being guided to a greater extent by economic or fiscal policy priorities. In addition, there are formal aspects which contribute to unrealistic planning. This is particularly the case for the over-optimistic way in which revenue from European Union funds is projected, which also has a direct impact on the projections of related investment spending. The excessive short-term orientation is generally reflected in rather unrealistic draft budgets two years in advance. The continuation of the current approach to the preparation of the government budget poses a serious risk to the achievement of the allowed growth in core general government expenditure, of which the state budget is the largest part. The change in the European rules to a more medium-term orientation therefore also presents an opportunity to improve the state budget planning process.

The updated estimate of expenditure outturn for 2024 is also overestimated and does not provide an adequate basis for the assessment of the dynamics in the Draft Budgets. The Ministry of Finance expects an overall deficit of EUR 1.4 billion in the updated estimate of the state budget outturn for 2024.⁹ This is EUR 800 million lower than in the current budget adopted last year (Figure 2.2). Around EUR 300 million each of higher "core" revenues and lower impact of intervention measures and around EUR 150 million of lower "core" expenditure contribute to the reduction. Despite the reduction in the estimate of this year's deficit, based on the nine-month outturn (Figure 2.3), we assume that the "core" expenditure is again overestimated in the last three months of the year (Figure 2.4). The unrealistic nature of the Government's projections, which the Fiscal Council had already pointed out at the time of the adoption of the current budget last year,¹⁰ thus does not stem only from the creation of room for manoeuvre linked to uncertainty and shock mitigation. At least to the same extent, it is also the result of overestimated projections of normal consumption, which, even in the updated outturn estimate, are not adequately adjusted to actual developments and measures in place. As a result of this year's lower outturn, the projected expenditure levels for 2025 will thus show even higher growth than in the projections of the Draft Budgets. This has been a recurrent practice over the last few years.

The deficit is projected to increase in 2025, but with current policies it should be much smaller than in the Government's projections. The overall state budget deficit is projected to widen to EUR 1.9 billion (2.6% of GDP) next year. The direct effect of the intervention measures is no longer expected to have an impact on the balance (Figure 2.5). Indeed, with the removal of the epidemic and cost of living mitigation measures, the impact of the flood recovery measures is expected to be neutral.¹¹ The "core" deficit excluding the impact of the intervention measures is expected to increase

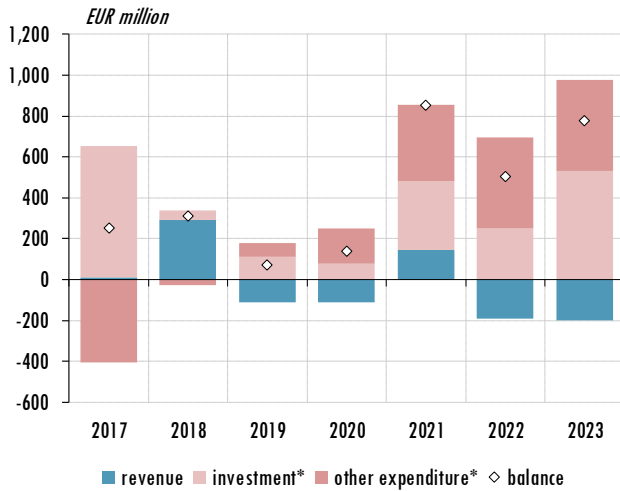
⁸ Since the beginning of the epidemic, the Fiscal Council has emphasised trends without the direct impact of intervention measures when considering budget documents. Such an approach more accurately reflects the risks to fiscal sustainability. Indeed, in periods of heightened uncertainty, an appropriate no-policy-change scenario is a necessary precondition for identifying room for manoeuvre. Thus a dominant part of the criticism of budget documents in recent years relates to the unrealistic projections of fiscal aggregates without taking into account the direct impact of intervention measures.

⁹ This was sent to the Fiscal Council together with the Draft Budgets.

¹⁰ Fiscal Council (2023).

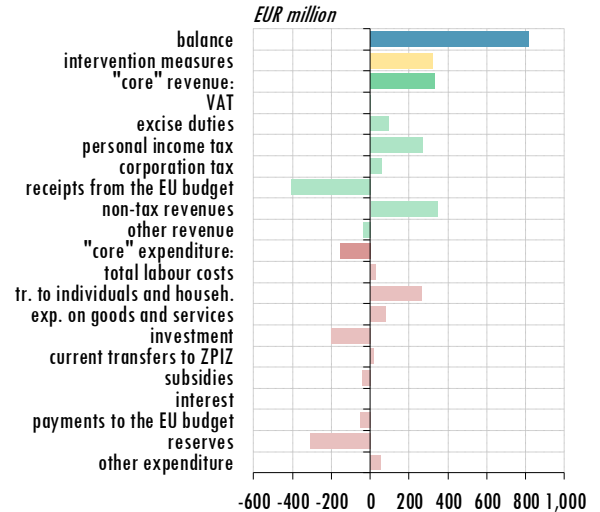
¹¹ All the planned renovation expenditure is to be financed from intervention revenue. In addition to the EU Solidarity Fund, the Reconstruction Fund is financed by the increased corporate tax rate, the profits of Slovenian Sovereign Holding (SSH) and a tax on banks' total assets.

Figure 2.1: Deviation of state budget outturn from autumn estimates (excluding intervention measures)



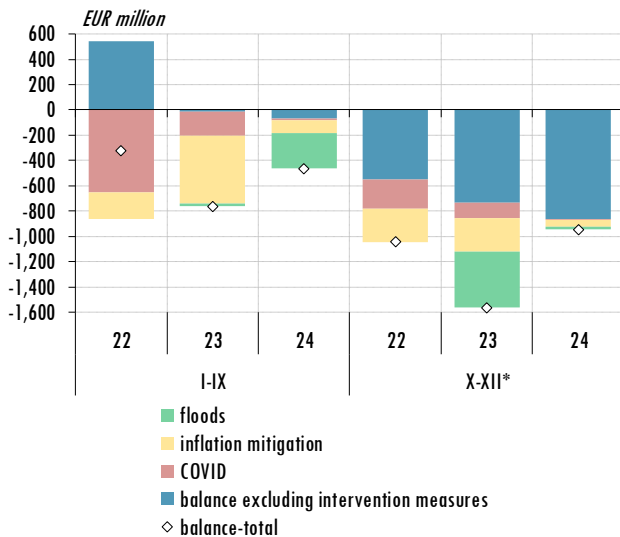
Source: MoF, FC calculations. Note: *positive sign denotes overestimation, negative sign denotes underestimation in the autumn MoF estimate.

Figure 2.2: Difference between the autumn estimate and Amendments to the Budget for 2024



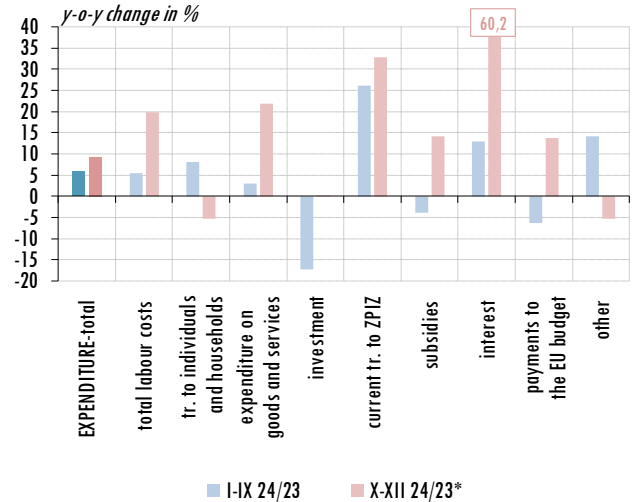
Source: MoF, 2024 estimate (Sep. 24) in Amendments to the Budget of the Republic of Slovenia for 2024 (UL RS 123/2023), FC calculations.

Figure 2.3: State budget balance structure (within year)



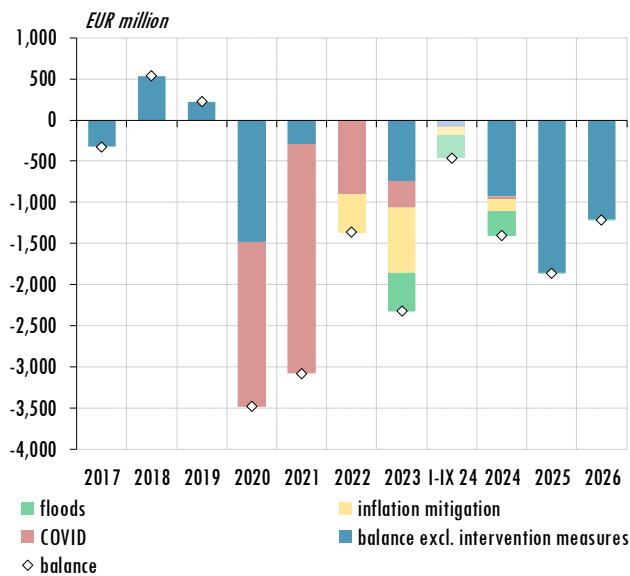
Source: MoF, FC calculations. Note: *2024 implicitly considering the 2024 MoF estimate (September 2024) and actual outturn for the first nine months of 2024.

Figure 2.4: State budget expenditure in 2024 (excluding intervention measures)



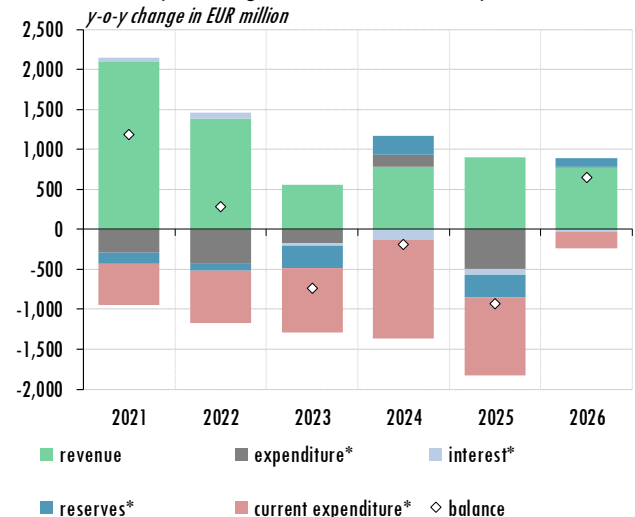
Source: MoF, FC calculations. Note: *2024 implicitly considering the 2024 MoF estimate (September 2024) and actual outturn for the first nine months of 2024.

Figure 2.5: State budget balance structure



Source: MoF, FC calculations.

Figure 2.6: Factors of state budget balance change (excluding intervention measures)



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

by around EUR 900 million to EUR 1.8 billion. While maintaining the revenue-to-GDP ratio at a similar level, this is expected to be solely due to an increase in "core" expenditure. Again, the key reason for this is expected to be the marked increase in investment spending, which is projected to rise by almost a third (Figure 2.6). If, in the view of the Fiscal Council, a more realistic estimate of this year's outturn is taken as the starting point for 2025, taking into account the macroeconomic baselines of the IMAD projections and the measures currently in force, the "core" expenditure, and hence the deficit next year, could be much lower than in the Draft Budgets. The deficit would still increase compared to 2024, but less than projected in the Draft Budgets.

Revenue growth without intervention measures is expected to strengthen further next year. The level of *total revenue* in the period 2024–2026 is also significantly affected by the intervention measures to provide financial resources for the reconstruction after last year's floods (Figure 2.7). The state budget projections include the resources of the Reconstruction Fund established this year and the EU Solidarity Fund.¹² Without this effect, the main contributors to the strengthening of "core" revenue growth in 2025 are expected to be higher European funds. Based on the repeated deviations of outturn from projections in the past, we also assess the projection of European funds this time as optimistic (Figure 2.8).¹³ Key tax revenues are also expected to make a significant contribution to revenue growth. They are expected to contribute around two-thirds of the increase, which would be similar to this year and broadly in line with macroeconomic assumptions. Only the composition of growth is expected to change. In particular, the contribution of income tax revenue is expected to be significantly lower than this year, as a result of the alignment of income tax brackets and relief with wage growth.¹⁴

Consumption growth excluding the impact of the intervention measures is projected by the Ministry of Finance to pick up next year. According to the Draft Budgets, growth is projected at 12.3%, which would be around three times the long-term average.¹⁵ Again, we would point out that the estimate for 2024 is, in our view, too high, so that the level of "core" *spending* in the Draft Budgets in 2025 could show growth of more than 15%, after the outturn for this year will be known. Key reasons for the projected high growth include the assumption of almost one-third higher investment and the growth in reserve expenditure (Figure 2.10).¹⁶ The projected level of investment excluding the intervention measures is 3.0% of GDP.¹⁷ Based on past under-performance, this assumption is again assessed as optimistic (Figure 2.12). The over-programming is partly due to the investment planning system, which, if improved, would lead not only to more realistic budget documents but also to more efficient public spending.¹⁸ The growth of "core" *current spending*, which excludes investment, interest and reserves in addition to intervention measures, is projected to slow slightly next year on the basis of

¹² Over the period 2024–2026, EUR 1.4 billion is expected to be raised for flood reconstruction, almost half of it this year. As a result, their contribution to overall revenue growth is expected to be most pronounced in 2024.

¹³ This is particularly the case for the projection of cohesion revenue for the 2021–2027 perspective. However, higher Recovery and Resilience Plan funding is also expected to contribute significantly to the growth in European revenue.

¹⁴ The alignment of income tax brackets and relief, the transformation of supplementary health insurance into a compulsory contribution, and the introduction of a long-term care contribution will, in our estimate, reduce income tax revenues by around EUR 170 million in 2025 compared to a scenario where income tax brackets and allowances are aligned in 2024 and 2025 only with the minimum legal requirement (half of the nominal growth of the average gross wage in the previous year).

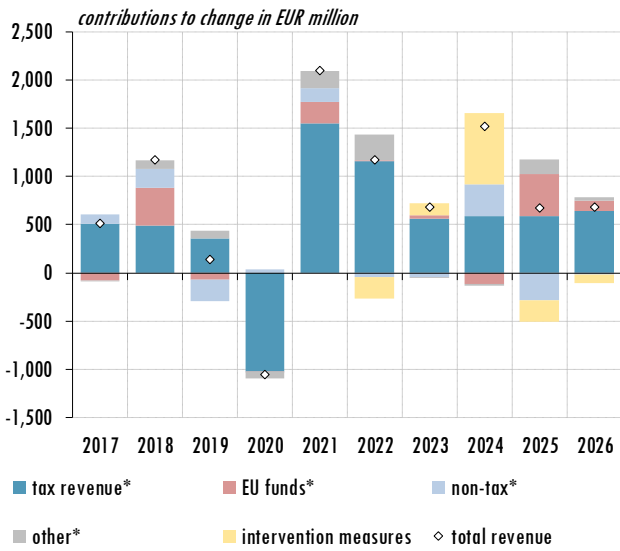
¹⁵ The average growth rate of government expenditure (excluding intervention measures) over the period 2005–2023 was 4.0%.

¹⁶ The increase in expenditure under the Reserve heading in 2025 is due to higher payments to budgetary funds (the revenue of budgetary funds is recorded as an expenditure of the state budget; this comparison does not include the Reconstruction Fund, which is considered as an intervention measure) and the creation of a general budget reserve of EUR 140 million.

¹⁷ This is 0.6 percentage points of GDP more than it is expected to be this year, when it is overestimated in our assessment.

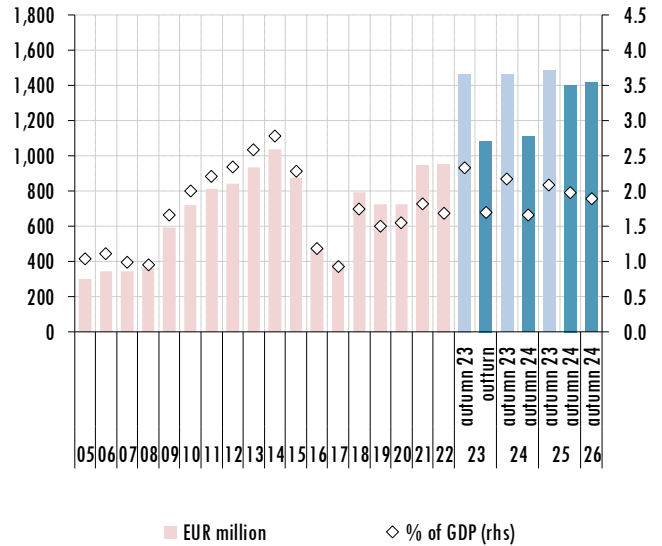
¹⁸ The International Monetary Fund (IMF) (2024) published an assessment of public investment management in Slovenia, concluding that the efficiency of public investment in Slovenia lags behind the most efficient countries by almost a fifth. Among the biggest shortcomings, it cites inadequate appraisal of projects before they are included in budget documents and excessive fragmentation of investment planning and implementation.

Figure 2.7: State budget revenue change



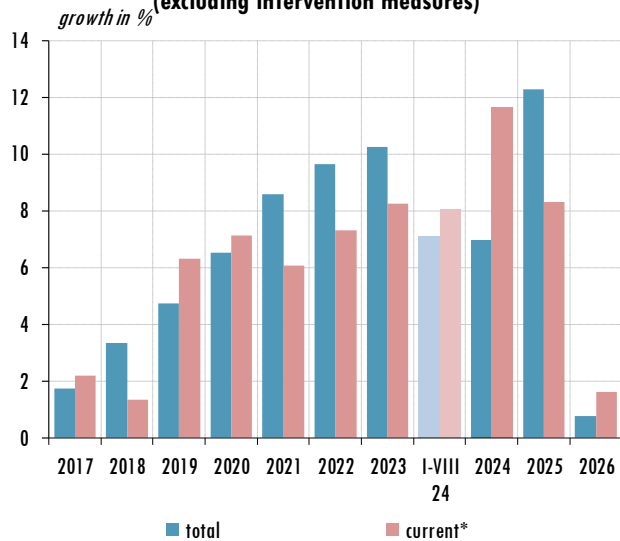
Source: MoF, FC calculations. Note: * Excluding direct effect of intervention measures.

Figure 2.8: State budget receipts from the EU budget



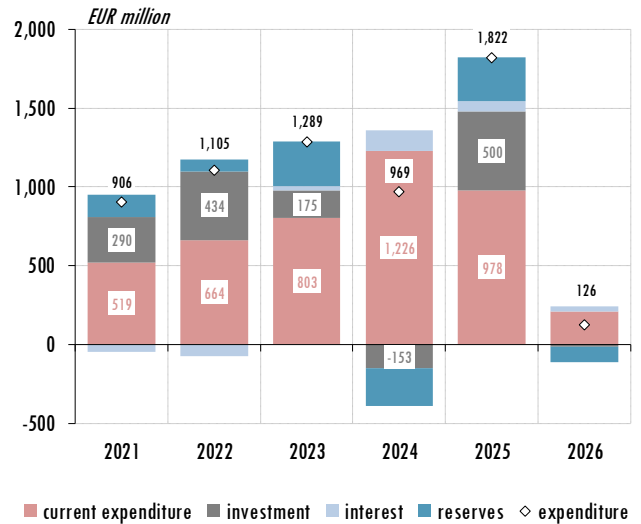
Source: SORS, MoF, IMAD, FC calculations.

Figure 2.9: State budget expenditure (excluding intervention measures)



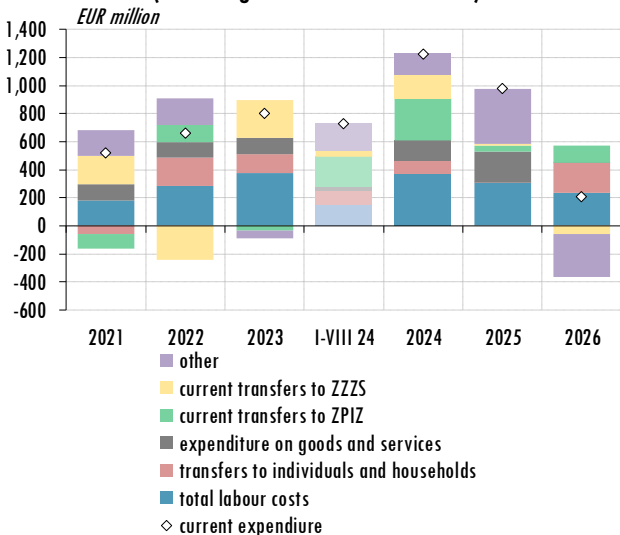
Source: MoF, FC calculations. Note: * excluding investment, interest and reserves.

Figure 2.10: Factors of state budget expenditure change (excluding intervention measures)



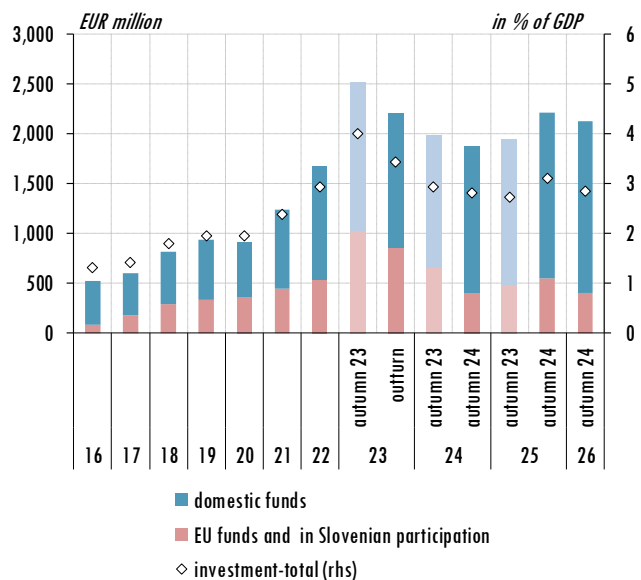
Source: MoF, FC calculations.

Figure 2.11: Factors of current expenditure change (excluding intervention measures)



Source: MoF, FC calculations. Note: * excluding interention measures, investment, interest and reserves.

Figure 2.12: State budget investment expenditure



Source: MoF, FC calculations.

the Draft Budgets (Figure 2.9). Taking into account that the estimate of the outturn for this year is overestimated, the projected level of "core" current spending for 2025 actually implies a pick-up in growth to over 10%. The high growth would be mainly due to higher labour costs as a result of the wage agreement. The contribution of higher intermediate consumption and some other expenditures is also expected to be significant (Figure 2.11).¹⁹ Against this background, the continued inappropriate approach in the projections of transfers to individuals and households should be highlighted. These are projected to remain at the same level next year as this year, which is unrealistic given the statutory adjustment for this year's inflation without a reduction in the number of beneficiaries or a reduction in statutory entitlements.

A significant deficit reduction is projected for 2026, but again the projection does not meet the criteria of the appropriate no-policy-change scenario. The "core" deficit (excluding the impact of the intervention measures) is projected to fall to EUR 1.2 billion in 2026 or 1.6% of GDP. The projection should be the result of a no-policy-change scenario or reflect the legislation and measures currently in force. In particular, in our assessment, the projection of "core" spending does not reflect this, as it is projected to increase by only 0.8% according to the Draft Budgets. If the projected level in 2025 materialises, the projection of growth in "core" spending in 2026 is not realistic without additional measures.

According to the Draft Budgets, transfers from the state budget to other public finance budgets are projected to increase to EUR 4 billion over the period 2024–2026. Transfers to municipalities²⁰ and social insurance funds are projected to increase by a total of EUR 0.5 billion this year (Figure 2.13). However, they are projected to represent almost a quarter of total "core" state budget expenditure in 2026, or 5.3% of GDP, after further increases over the next two years. Compared to the pre-epidemic period, transfers to the Health Insurance Institute of Slovenia have increased most rapidly, linked to the adoption of a number of discretionary legislative measures. In the context of the announced health reforms, we estimate that revenues from social contributions will continue to be insufficient to cover the liabilities of the health insurance budget. Transfers to the Pension and Disability Insurance Institute of Slovenia and the municipalities are also increasing in nominal terms, but their share in GDP is still lower than a decade ago (Figure 2.14).²¹ Nevertheless, we point out that the additional transfer to the Pension and Disability Insurance Institute of Slovenia,²² which ensures the balance of the pension insurance budget, is expected to average 1.5% of GDP over the period 2024–2026. This level is estimated to be high, given the fact that social contributions paid are at a historically high level, driven by a record level of employment and high wage growth. In the absence of pension reform, demographic changes can also be expected to increase this share in the future. The nominal increase in transfers to municipalities compared to the pre-epidemic period is mainly due to the adoption of the Municipalities' Financial Burden Reduction Act.²³ However, an amendment to this Act is expected to enter into force in 2026, which is expected to reduce transfers.²⁴

¹⁹ Taking into account the lower and, in the view of the Fiscal Council, more realistic estimate of this year's outturn than the Ministry of Finance projections for next year, the projected high growth in expenditure on subsidies and transfers to non-profit organisations and non-budgetary public service providers stands out.

²⁰ Current and investment transfers and the share of income tax based on a lump sum.

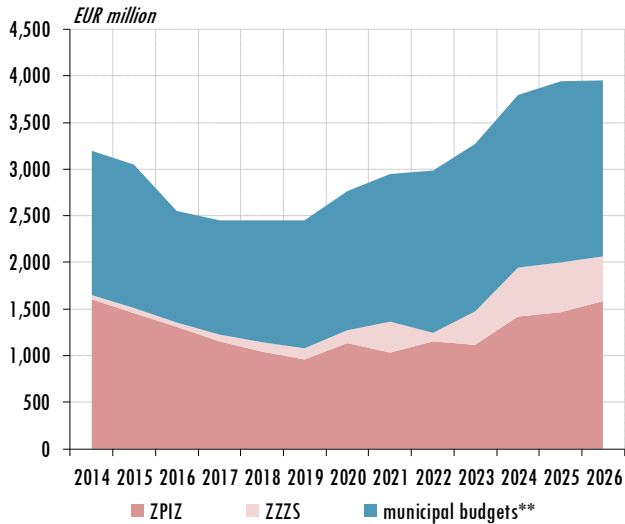
²¹ Negotiations are still ongoing on the levels of the lump sum for 2025 and 2026, which are included in the proposed Act Regulating the Implementation of the Budgets of the Republic of Slovenia for 2025 and 2026 unchanged from 2024.

²² In addition to regular transfers, which cover payments of pension and invalidity insurance contributions for civil servants and certain other groups of the population.

²³ Official Gazette of the Republic of Slovenia, No 189/20.

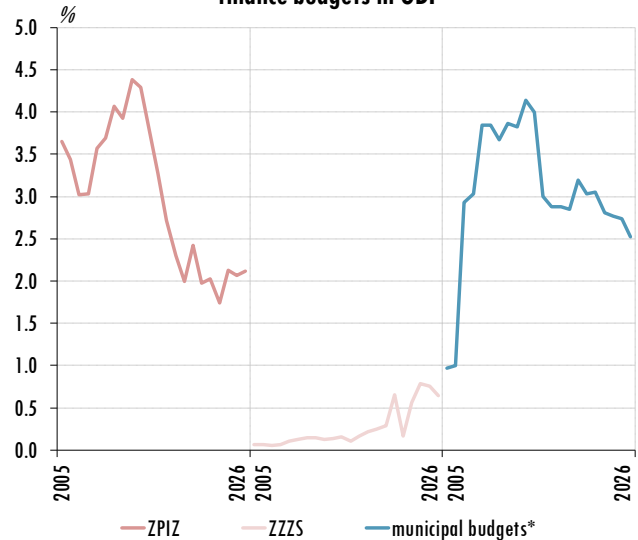
²⁴ Ministry of Finance (2024).

Figure 2.13: State budget transfers to other public finance budgets (excluding intervention measures)



Source: MoF, FC calculations. Note: * current and capital transfers and income tax resources ceded to local government levels.

Figure 2.14: Share of state budget transfers to other public finance budgets in GDP



Source: MoF, SORS, IMAD, FC calculations. Note: * current and capital transfers and income tax resources ceded to local government levels.

Table 2.1: State budget projections 2024-2026

	EUR million				growth in %*			contribution to growth in p.p.		
	2023	2024	2025	2026	2024	2025	2026	2024	2025	2026
Excluding intervention measures										
Revenue	13,115	13,895	14,792	15,562	5.9	6.5	5.2	5.9	6.5	5.2
VAT	5,219	5,379	5,698	5,979	3.1	5.9	4.9	1.2	2.3	1.9
Excise duties	1,728	1,659	1,740	1,738	-4.0	4.9	-0.1	-0.5	0.6	0.0
Personal income tax	1,716	2,067	2,120	2,365	20.5	2.6	11.5	2.7	0.4	1.7
Corporation tax	1,393	1,542	1,676	1,799	10.7	8.7	7.4	1.1	1.0	0.8
Receipts from the EU budget	988	873	1,313	1,412	-11.6	50.4	7.5	-0.9	3.2	0.7
Non-tax revenues	729	1,055	772	754	44.7	-26.8	-2.3	2.5	-2.0	-0.1
Other	1,342	1,320	1,474	1,515	-1.7	11.6	2.8	-0.2	1.1	0.3
Expenditure	13,859	14,828	16,650	16,777	7.0	12.3	0.8	7.0	12.3	0.8
Total labour costs	4,093	4,468	4,776	5,013	9.2	6.9	4.9	2.7	2.1	1.4
Transfers to individuals and households	1,856	1,943	1,946	2,158	4.7	0.1	10.9	0.6	0.0	1.3
Expenditure on goods and services	1,491	1,636	1,854	1,858	9.7	13.4	0.2	1.0	1.5	0.0
Investment	1,789	1,636	2,136	2,122	-8.5	30.5	-0.6	-1.1	3.4	-0.1
Transfer to ZPIZ	1,116	1,420	1,464	1,585	27.2	3.1	8.3	2.2	0.3	0.7
Transfer to ZZS	360	526	535	478	46.1	1.6	-10.5	1.2	0.1	-0.3
Subsidies	377	379	508	498	0.6	34.0	-1.8	0.0	0.9	-0.1
Interest	684	818	888	923	19.5	8.6	3.9	1.0	0.5	0.2
Payments to the EU budget	672	667	731	622	-0.7	9.6	-15.0	0.0	0.4	-0.7
Reserves	842	604	879	777	-28.3	45.5	-11.6	-1.7	1.9	-0.6
Other	578	732	934	742	26.6	27.6	-20.5	1.1	1.4	-1.2
Balance (excl. interv. measures)	-744	-933	-1,858	-1,215	-189	-925	643			
<i>in % of GDP</i>	<i>-1.2</i>	<i>-1.4</i>	<i>-2.6</i>	<i>-1.6</i>						
Intervention measures	-1,583	-474	-9	-1	1,109	466	8			
Balance (total)	-2,327	-1,407	-1,866	-1,216	920	-459	651			
<i>in % of GDP</i>	<i>-3.6</i>	<i>-2.1</i>	<i>-2.6</i>	<i>-1.6</i>						

Sources: MoF, FC calculations. *Changes in balance, intervention measures and balance excluding intervention measures in EUR million.

3. Fiscal Council Opinion on the Medium-Term Fiscal and Structural Plan

The Plan outlines a path for public finances that would lead to public debt sustainability in the medium term, while at the same time presenting a commitment to growth in net expenditure.²⁵

The path outlined represents only the maximum growth in net expenditure that would lead to public debt sustainability in the medium term. In the case of Slovenia, the increase in net expenditure could average 4.5% per year over 2025–2028. While this is similar to the average growth over 2004–2023, it is about half the average growth over the last three years (Figure 3.1). In order to assess the credibility of the Plan, it is crucial to determine whether the currently known measures that will be in place over the Plan period will ensure that the commitment to net expenditure growth is respected. Any deviations from the path outlined will be identified for each year of the Plan's validity and reflected in the "control account". The deviations at the annual and cumulative levels of the Plan period may not exceed the values provided in the "corrective" Regulation.²⁶

Government debt would gradually approach 60% of GDP if the Plan commitments are respected, without additional shocks. The average annual debt reduction over the Plan period is projected to be 1.4 percentage points of GDP, which exceeds and thus satisfies the reduction requirement of the "preventive" Regulation (the so-called debt safeguard).²⁷ Debt is projected to be only slightly above 60% of GDP at the end of the Plan period in 2028 and to hover around 55% of GDP for several years thereafter. This is assuming that no new exceptional circumstances arise during the period, due to possible additional shocks, that would allow a deviation from the set path of net expenditure. Debt would also decline in the context of a structural adjustment of the primary balance, and due to the persistence of a favourable interest-growth differential. The interest expenditure-to-GDP ratio is not projected to change significantly from 2024.

Slovenia's deteriorated fiscal position at the time of the transition to the new fiscal rules compared to the last year before the epidemic is mainly due to the large-scale intervention measures taken to mitigate the effects of three shocks in four years. From a surplus in the last year before the epidemic (2019: 0.7% of GDP), the general government balance had declined by 3.2 percentage points of GDP by 2023, the last year before the adoption of the new fiscal rules (Figure 3.2), to a deficit of -2.6% of GDP. Last year's deficit was overwhelmingly driven by large-scale intervention measures, while over the 2019–2023 period, the reduction in the "core" revenue-to-GDP ratio was similar to the increase in the "core" expenditure ratio. Among revenues, the share of excise duties and environmental taxes decreased the most, while the share of revenue from European funds in particular increased. Among expenditure, the share of investment in GDP increased the most, while the share of social compensation and interest expenditure decreased the most. Gross public debt stood at 68.4% of GDP last year, 2.4 percentage points higher than at the end of 2019.

Current estimates suggest that the general government deficit in 2024 will be smaller than projected in the previous medium-term budget documents. The Stability Programme of April this year²⁸ projected a general government deficit of -3.6% of GDP for this year. The latest Ministry of

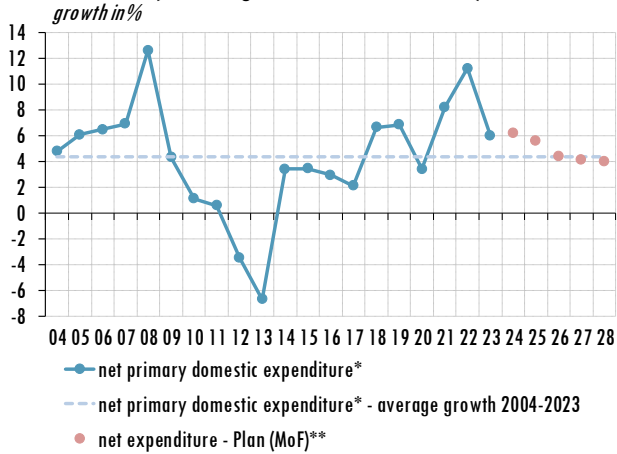
²⁵ General government expenditure less interest expenditure, expenditure on EU programmes fully financed by EU programmes, national expenditure related to the co-financing of EU programmes, cyclical unemployment expenditure, one-off and temporary measures, and discretionary revenue measures.

²⁶ An EU Member State may be subject to an "excessive deficit procedure" if its government debt exceeds 60% of GDP, the general government balance deficit exceeds 0.5% of GDP, and the "control account" balance exceeds 0.3 percentage points of GDP (or around 0.7 percentage points measured by growth in net expenditure) on an annual basis or 0.6 percentage points of GDP (around 1.4 percentage points measured by growth in net expenditure) on a cumulative basis (Article 1(1) of the "corrective" Regulation).

²⁷ For Member States with a government debt ratio between 60% and 90% of GDP, this amounts to 0.5 percentage points of GDP on average in the Plan, while it amounts to 1 percentage point of GDP per annum for countries with a ratio above 90% of GDP.

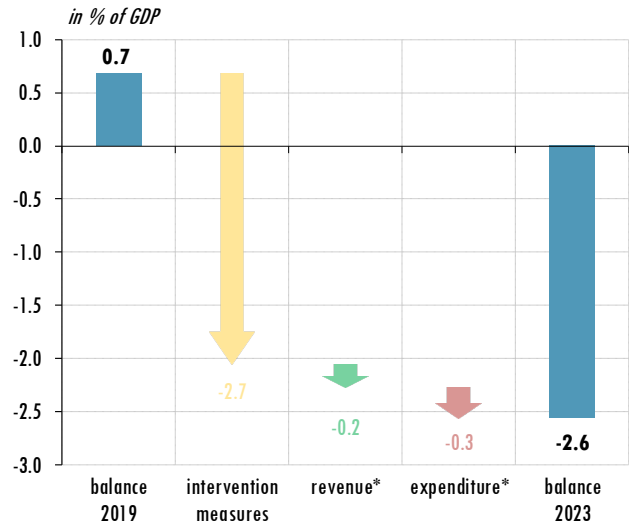
²⁸ On 10 April 2024, the Government submitted the draft Stability Programme 2024 to the Fiscal Council.

Figure 3.1: Net expenditure (excluding intervention measures)



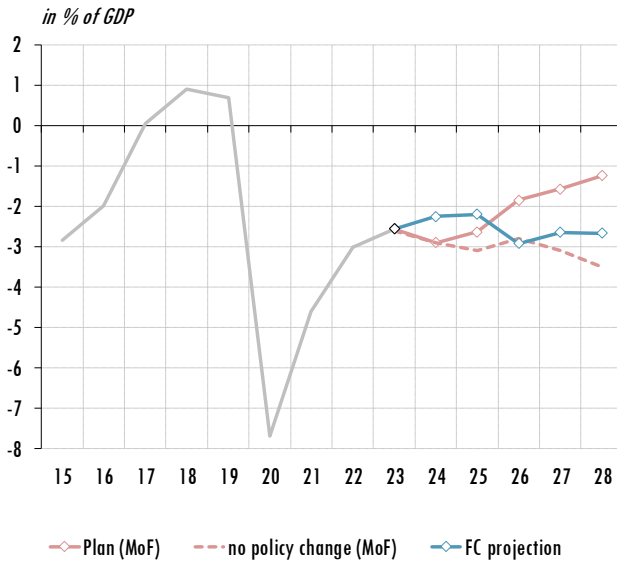
Source: MoF, SORS, FC calculations. Notes: *interest expenditure, expenditure matched by EU funds revenue, cyclical unemployment benefit expenditure, measures on revenue side are excluded along with intervention measures, **in addition to all of the above national expenditure on co-financing of programmes funded by the EU is also excluded.

Figure 3.2: Factors of general government budget balance change 2019-2023



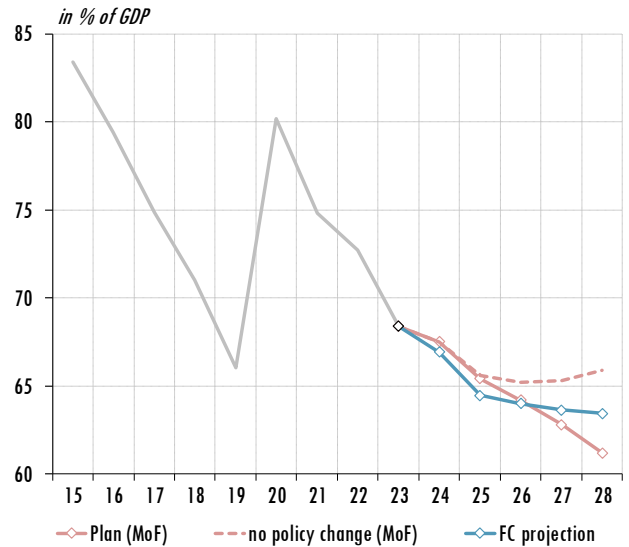
Source: MoF, SORS, FC calculations. Note: * excluding intervention measures.

Figure 3.3: General government budget balance



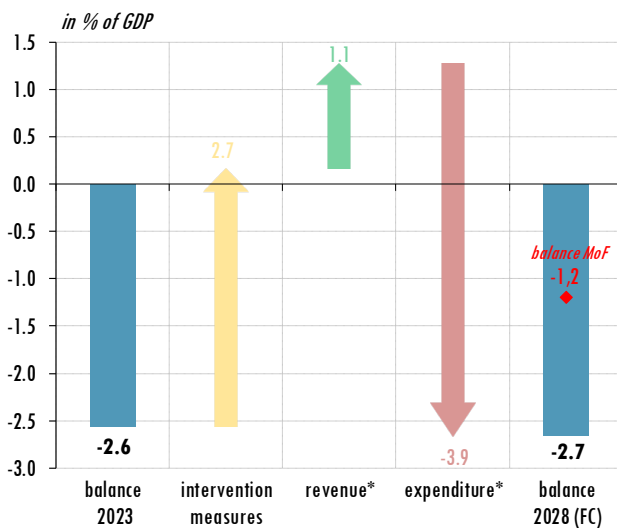
Source: FC, MoF, SORS, IMAD.

Figure 3.4: General government gross debt



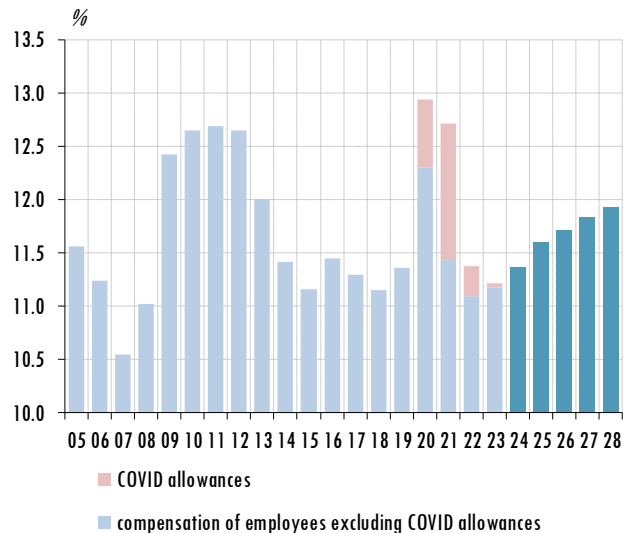
Source: FC, MoF, SORS, IMAD.

Figure 3.5: Factors of general government budget balance change 2023-2028



Source: MoF, SORS, IMAD, FC calculations. Note: * excluding intervention measures.

Figure 3.6: Share of general government compensation of employees in GDP



Source: SORS, IMAD. Note: Compensation of employees projection 2024-2028 FC.

Finance estimates suggest a lower deficit. This is based on both the estimate provided in the Draft Budgets and the Draft Budgetary Plan, according to which the general government deficit is projected at -2.9% of GDP this year. According to the Fiscal Council estimate, the deficit could be even lower this year, between -2% and -2.5% of GDP. Despite the relatively subdued economic activity, government revenues are high this year, due to the growth of important tax bases, in particular the wage bill. Revenue growth is also driven by higher tax burdens on household incomes and corporate profits and the transformation of supplementary health insurance into a compulsory contribution. Expenditure growth is expected to be broadly in line with revenue growth. The main contributors to keeping it at a high level are the growth in employee compensation as a result of wage agreements, the growth in social transfers as a result of inflation adjustments and the methodologically-driven growth in the funds financed by the introduction of the compulsory health contribution. The impact of the intervention measures on the balance is expected to be less than a third lower compared to last year.

The Fiscal Council public finance projection suggests the possibility of deviating from the commitments set out in the Plan. The general government balance deficit could be cumulatively higher than the targets by around EUR 2.5 billion over the Plan period, which amounts to a good 3% of GDP, or 0.8% of annual GDP on average (Figure 3.3).²⁹ This is illustrative because, under the reformed governance system, an annual or cumulative deviation from the commitments beyond the tolerance limit could lead to a requirement to take compensatory measures. In this case, general government debt would exceed the level that ensures medium-term sustainability at the end of the Plan period (Figure 3.4).³⁰ Nevertheless, the average annual reduction would still meet the debt safeguard requirements. The Fiscal Council projection takes into account currently installed measures, i.e. those that are operational and those that have already been adopted and will enter into force over the Plan period. An important assumption is that the funds raised for flood recovery and long-term care will be fully spent and will consequently have a neutral impact on the balance.³¹ In the initial period of the Plan, the deficit target could be higher than the Fiscal Council projections in 2024 and also in 2025 (see also Section 2), due to overestimated spending. However, in the following years, the deficit target is always lower than the Fiscal Council projection. In 2028, the final year of the Plan, the Plan's deficit target is projected to be 1.4 percentage points of GDP lower than the Fiscal Council projections. The Plan's projection of the no-policy-change scenario, which is prepared according to a different methodology than the Fiscal Council projection, shows an even larger deviation from the targets over the whole period.

Revenue measures are unlikely to be sufficient to finance the full expected increase in expenditure over the Plan period. Revenue measures already adopted include in particular the increased tax burden to finance flood recovery and long-term care and the adjustment of the compulsory health contribution. The latter indirectly reduces income tax receipts, as does the alignment of income tax brackets and of allowances in 2025. Under the given projections of tax bases and the projected high inflows from various EU sources (which, with the exception of loans, are largely neutral on the balance), the above measures will not be sufficient to cover the rising liabilities (Figure 3.5). These stem from the expected growth in health expenditure and in particular from the reform of the public

²⁹ Without taking additional measures over the Plan period, Slovenia would, according to this assessment of the Fiscal Council, fulfil at least two of the three conditions (debt and deficit) for the initiation of an "excessive deficit procedure" described in footnote 26.

³⁰ With a debt level of around 63.5% of GDP, the overshoot would be around 2.2 percentage points of GDP. The same stock-flow adjustment assumption as in the Plan is taken into account (see footnote 7).

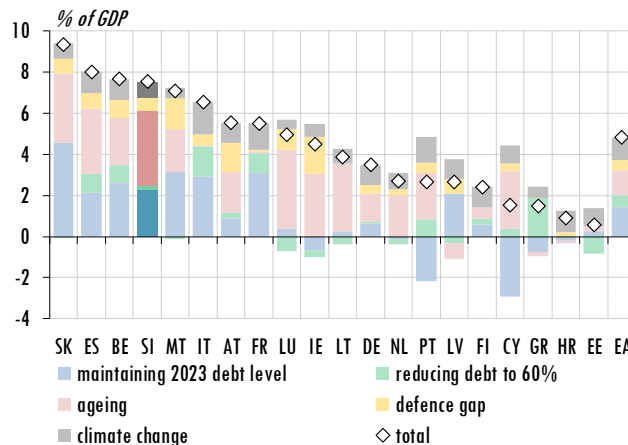
³¹ In the event that these resources are not fully used, the deficit could be closer to the target.

sector wage system. Indeed, the ratio of government compensation of employees to GDP is projected to reach its highest level at the end of the Plan period, excluding the period after the previous wage reform, which coincided with the financial crisis (Figure 3.6). The same applies to the share of social transfers in GDP, but the Fiscal Council estimates that these will be financed, at least to some extent over the Plan period, by the earmarked resources generated by the above-mentioned higher tax burdens. Thus, while the Plan's growth target for net expenditure is formally in line with the requirements of the correction mechanism (in line with Article 14 of the Fiscal Rule Act), the Fiscal Council projections suggest that, with currently known measures, there are serious risks to ensuring medium-term sustainability.

The longer-term projection of the debt ratio suggests that the debt level will start to increase after 2035. This is true both for the simulations with fiscal policy adjustment in the Plan's baseline scenario, to which standard shocks are added, and to an even greater extent for the simulations without fiscal policy adjustment,³² which are also part of the Plan. The simulations with no policy change show that debt would be around 66% of GDP at the end of the Plan period, rising to almost 85% of GDP in the following ten years. The projected increase in ageing costs would contribute significantly to this (see also Box 3.1 for further simulations of debt dynamics). In this case, interest expenditure would almost double in the ten years after the end of the Plan relative to 2024. This further underlines the need for reforms to contain such dynamics and to create room for manoeuvre in the event of future shocks or the materialisation of currently perceived risks. Otherwise, fiscal policy will not be able to avoid the requirement for further structural adjustment and its potential negative macroeconomic consequences in order to ensure sustainable public finances in the future.

We expect certain other pressures on public finances, not included in the DSA methodology, which pose important risks to ensuring their sustainability to intensify in the coming years. In comparison of the total public finance risks currently perceived, Slovenia ranks among the EU countries with the highest long-term risks according to the ECB's assessment³³ (Figure 3.7). In addition to short- and

Figure 3.7: Fiscal efforts required in response to long-term public finance challenges



Source: ECB (2024). Note: *the chart depicts the required immediate and permanent one-off improvement in the GDP ratio of structural primary balance to bring the debt ratio to 60% of GDP by 2070, incorporating financing for any additional expenditure until 2070 arising from an ageing population, defence and climate.

³² Fiscal policy adjustment in medium-term fiscal-structural plans is laid down in the "preventive" Regulation. The minimum adjustment to the structural primary balance is 0.4 percentage points of GDP in the case of a 4-year adjustment period or 0.25 percentage points of GDP if the adjustment period is 7 years.

³³ ECB (2024).

medium-term factors, the public finances risks also include elements that will have an impact on debt sustainability in the longer term. These include, in addition to ageing costs, green transition costs, where ageing and green transition could also have a significant impact on the revenue side of the budget.³⁴ Increased defence spending also poses additional risks. A significant part of these risks is not included in the baseline scenario of the Plan, in line with the DSA methodology. Taking these risks into account would reduce the allowed growth in net expenditure by around 0.3 percentage points per annum.³⁵

To maintain sustainable public finances and ensure acceptable financing conditions, the Government should address the risks as soon as possible. In our view, the set of measures presented is not sufficient to meet the requirements of the Plan. Moreover, some of the measures addressing risks have a significant lag in their impact on public finances. This is shown, inter alia, by the results of the simulation of the impact of the adoption of the pension reform (together with increased net migration) on public debt dynamics (second simulation in Box 3.1). In this case, debt would only decrease significantly 10 years later than in the Plan's debt projection. While the adoption of the pension reform would not significantly alter the public finance developments over the current Plan period due to the transition periods, the way in which the growth of net expenditure is determined would provide additional room for manoeuvre in other priority areas already over the Plan period. On the other hand, delaying action may directly and indirectly increase the fiscal costs and shorten the period and increase the order of magnitude of the adjustment of reform parameters. This would also increase the unpredictability of the response of economic agents.

³⁴ See e.g. Figure 2.6 in Fiscal Council (2024).

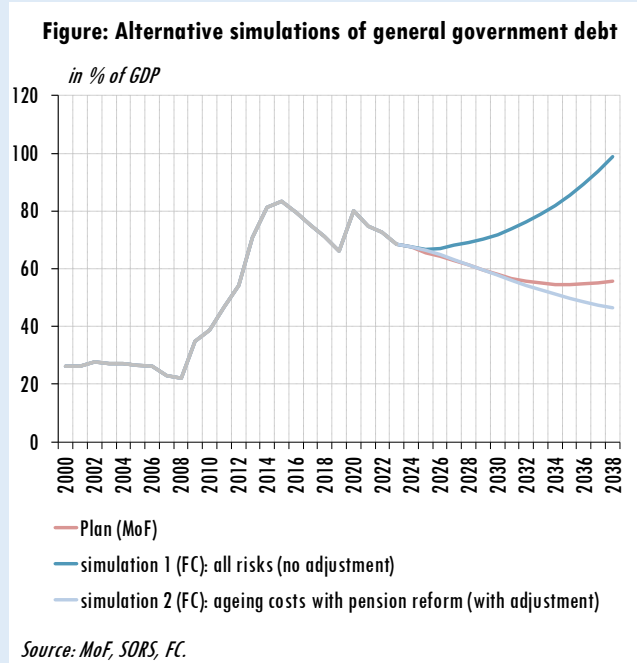
³⁵ Calculation based on the first simulation in Box 3.1.

Box 3.1: Plan and alternative scenarios: Impact on public debt

We have added two simulations to the debt sustainability analysis, which forms a core part of the preparation of the Plan. The main results of the debt sustainability analysis are presented in Figure 3.4. The two simulations illustrate the marginal scenarios of public debt without and with fiscal policy action.

In the first simulation, we add to the increased costs of ageing, which are the only ones that change the fiscal policy stance in the DSA methodology, other fiscal costs that represent future fiscal risks. This scenario, which does not include fiscal policy adjustment over the Plan period, assumes a cost of additional risks equal to the projected increase in ageing costs, which is roughly the result of the calculations presented in Figure 3.7. In the second simulation, which, like the DSA baseline scenario, does not take into account all risks but only ageing costs, we assume that the pension reform materialises, leaving pension costs unchanged in the long run, as implied by the Institute for Economic Research (IER) simulations in the Plan. All other variables in the second simulation are kept the same as in the baseline scenario, which includes fiscal policy adjustment over the Plan period.

The results suggest that, in the first case, government debt would accelerate to around 100% of GDP by the end of the next decade, with interest costs exceeding 3% of GDP. In the second case, debt could gradually decline to around 45% of GDP, with the interest-to-GDP ratio unchanged.



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