REPUBLIC OF SLOVENIA
MINISTRY OF FINANCE

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Dear Mr. Buti,

Thank you for your letter regarding Slovenian DBP and for the opportunity to clarify the Slovenian Government's fiscal plans.

Since the Government came into power in September 2018, it was not possible to adopt all necessary policies and measures for the medium period that would have an impact starting in 2019 on the state budget or the general government sector. The Slovenian Government inherited no-policy change situation as well as massive pressure on public finance expenditures in policy areas such as public sector wage bill, social transfers etc. Any prolongation of fiscal consolidation measures was not realistic, since no social agreement was possible due to a rather long period of savings measures and only 2 months before ending not only the year, but also budgetary procedure for 2019. Any government at the beginning of its mandate needs some political time to build consensus upon fiscal sustainability and creation of growth and jobs. We strongly believe that focus with fiscal path should be recognised and viable in the medium term, not on an annual basis.

Furthermore, Slovenia has achieved substantial fiscal consolidation since 2013 - let us compare long term series of net lending/borrowing and debt:

		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	*2019*
B.9 Net lending (+) /borrowing (-)	mio EUR	-536	-2112	-2043	-2462	-1459	-5319	-2072	-1104	-781	29	386	*269*
	% GDP	-1,4	-5,8	-5,6	-6,7	-4	-14,7	-5,5	-2,8	-1,9	0,1	0,8	*0,6*
Consolidated debt, end of year	mio EUR	8275	12527	13907	17204	19404	25505	30220	32087	31753	31859	32147	*32029*
	% GDP	21,8	34,6	38,4	46,6	53,8	70,4	80,4	82,6	78,7	74,1	70,3	*66,0*
Difference B.9:													
EUR			-1576	70	-419	1003	-3861	3248	968	322	810	358	*-117*
p.p.			-4,4	0,2	-1,1	2,7	-10,7	9,2	2,7	0,9	2,0	0,7	*-0,3*
Debt:													
EUR			4253	1380	3296	2200	6101	4715	1868	-334	106	288	*-118*
p.p.			12,8	3,8	8,2	7,2	16,6	10	2,2	-3,9	-4,6	-3,8	*-4,3*

Concerning general government debt, it peaked in 2015 due to BAMC establishment, financial sector supports and ESA methodology, and in 3 years came down by over 12 p.p. with dynamics to decline further. Since the excessive deficit procedure for Slovenia was closed (2015), Slovenia has placed a special emphasis on the debt rule which is the main guideline in economic policy development, whereby Slovenia will strive to maintain the positive nominal general government balance and in the mid-term at the same time address the long-term public finance sustainability, which should be evaluated in the time span of a government mandate, not on an annual basis.

After exiting the EDP, there is no transitional period (like for debt rule). Slovenia was never entitled to any flexibility or softening of constant fiscal consolidation pressures. General government balance improved from the 2013 deficit of 14.7 % of GDP to the 2018 surplus estimated at 0.8% of GDP. Furthermore, Slovenia's nominal general government balance always performed better ex-post than at ex-ante estimations. Such an outcome was also the result of investment cuts, not only due to reforms (pension, labour market) that have had been implemented while in the EDP procedure. The matrix-demanded fiscal efforts are based only on cyclical output gap calculations we never consented to, since they are economically counterintuitive. Slovenia with sound economic growth, while performing fiscal consolidation, is an example of an effective policy mix that also results in rapid recovery of potential growth and narrowing of the output gap.

Let me reflect also on the common methodology – Slovenia deserved constraint judgement, which was recognised by Commission in 2018:

Output gap

	Current year	Year 2018
2015	-0.5	-3.2
2016	-0.3	-1.6
2017	1.8	1.1

Source: EC

The ex-ante estimations of output gaps and estimations based on the outturn data differ significantly. The estimation based on actual data in 2018 shows that the output gap in 2015 was -3.2 and not -0.5 as was estimated in 2015. According to the same estimation, the output gaps in 2016 and 2017 were -1.6 and 1.1 compared to -0.3 and 1.8 when the assessment was made in the current year. So relying only on an output gap and the mathematically determined limits in matrix for the required annual fiscal efforts does not seem to always reflect economic reality.

In the DBP 2019, the Republic of Slovenia sets out all general government revenue and expenditure for the coming year and the measures in place with their effects in 2019 in respect of wages in the public sector and social transfers, as well as increased spending from the health insurance fund and local budgets. We can announce some further discretionary revenue measures in the field of tax efficiency (new measures), hinder investment growth (after the crisis, the real growth in gross fixed capital formation remained negative and in 2017 finally reached the year-on-year growth rate of 10%, and investment estimation in 2018 finally reached 20% of GDP) and ask for flexibility (structural clause due to further labour market efficiency gains and better distribution of social transfers). So far it is not clear whether are we entitled to flexibility clause (based on Commission services calculations). Clearly the conservative approach has been successful up to now. We stay at your disposal for further clarifications.

Moreover, 2019 is the final year of the 3-year MTO achievement (from the assessment point of view). The analysis (Report on Public Finances in EMU 2018, EC 2019) shows sizable gaps between the actual fiscal efforts of the member states and the required ones (without countries with corrective arm). Beside the already mentioned matrix of the required appropriate fiscal efforts, Slovenia also finds problematic the setting of a medium-term objective (MTO), where contingent liabilities related to population ageing are overstated compared to the existing debt, meaning that meeting annual targets on the way towards the MTO is merely a mathematical calculation. If this does not accommodate, the appropriate mix of economic policies or appropriate economic growth cannot be ensured, as everything is dedicated to the required (over)rapid fiscal consolidation.

As stated in DBP under the assumption of changed policies, Slovenia complies with the requirements of the Stability and Growth Pact with regard to the debt rule. The general government debt is decreasing more than required in 2019, by 3.7 p.p. due to efficient debt management and implemented privatization (2018: 70.3 %; 2019: 66.6 %). The Slovenian Fiscal council calculations show that the MTO was reached already in 2017, but in 2018 (no policy scenario and no policy Stability programme) we were not able to keep it. This is the primary task to be addressed in the new spring cycle of EU semester (our basic assumption is new value of MTO at - 0,25 and access to the flexibility clause). Slovenia will continue activities to achieve long-term sustainability of public finances in accordance with the rules in such a way as not to inhibit economic growth, e.g. by reducing the expenditure ceiling due to the accelerated absorption of EU funds; as regards commitment appropriations, Slovenia will no longer reduce investment, but will maintain the levels achieved. For Slovenia, it is important to maintain economic growth and increase productivity in order to sustain potential GDP growth while maintaining an appropriate level of general government debt.

The sound budget strategy must balance several competing considerations: it should get as close as possible to the most economically efficient policy while remaining understandable and politically sustainable. The optimal policy from an economic standpoint would be to gradually phase in spending cuts or tax increases at a rate that would prevent perpetual growth in the national debt as a share of the economy but would avoid doing serious harm to economic demand along the way. Such an approach, however, would be complicated and difficult to understand in line with rules (evaluated on annual basis).

Sincerely yours,

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