GOVERNMENT OF THE REPUBLIC OF SLOVENIA

STABILITY PROGRAMME

AMENDMENTS 2018
under a no-policy-change scenario
(including IMAD's Spring Forecast)

Ljubljana, April 2018

Table of contents:

1. REVIEW AND GENERAL ECONOMIC STRATEGY

Status of the Stability Programme (SP) under the assumption of no policy change
The drafting of the Stability Programme for 2018 took into account the Decree on the framework for the preparation of the general government budget for the 2018–2020 period for 2018 (Decree on the framework for the preparation of the general government budget for the 2018–2020 period (Official Gazette of the Republic of Slovenia, Nos. 21/17 and 65/17)), which was adopted by the national Assembly in the autumn, together with the Fiscal Rule Act (hereinafter: ZFisP). As per the Act, the framework determines the target balance and the maximum general government expenditure for an individual fiscal year and target balances and the maximum expenditure from individual public finance budgets for the next three years, i.e. 2018, 2019 and 2020. At the same time, the changed circumstances (Spring Economic Forecast 2018; IMAD[1]) it was expected that the Ministry of Finance of the Republic of Slovenia would propose changes to the framework for 2019–2021, which was not realised due to the resignation of the Prime Minister. Article 115 of the Constitution of the Republic of Slovenia stipulates *inter alia* that regular duties must be performed even after the Prime Minister ceases to hold office or a minister resigns pending the election of a new prime minister or the appointment of new ministers. The foregoing means that the Government must not make any final political decisions during this period of performing regular duties, except decisions crucial for the functioning of the state. In the drafting of the Decree on the framework for the preparation of the general government budget, all circumstances that affect the attainment of the target general government balance must be taken into account. In other words, this means that measures must be adopted to achieve the purpose referred to in the preceding sentence, and there is no doubt that adopting measures includes political decisions, and that measures are generally adopted through laws.

Link to the Stability and Growth Pact (SGP)
In the past, the Stability Programme served as a Slovenian medium-term fiscal framework (or its upgrade). Slovenia is thus meeting the requirements of Council Directive 2011/85/EU on requirements for the budgetary frameworks of Member States. The content of the Stability Programme must comply with the requirements of Regulation (EC) No 1466/97 and the Code of Conduct of the Stability and Growth Pact, which prescribe the guidelines, content and the required format of data. The Stability Programme must present a multi-annual macroeconomic and fiscal framework, key fiscal projections, their components, and the quantification of fiscal objectives (and measures). Unlike the draft budgetary plans, it does not clearly define the period that must be included, if governments submit their SP under a no-policy-change scenario.

According to the European Semester, the Republic of Slovenian must submit its Stability Programme for the next three years, including 2021, by the end of April 2018. The Stability Programme is assessed by the EC, similar to the review of past experiences of member States (which also submitted their SP under a no-policy-change scenario, not the scenario with changed policies (with measures)), then the Council and the Commission verify compliance with the SGP (and the attainment of the medium-term objective). Pursuant to the suitable provisions of Article (5(2) of Regulation (EC) No 1466/97, the Council adopts a decision on the SP on a proposal from the Commission if necessary. The Council assesses

[1] On 14 March 2018 (Decision no. 30101-1/2018/3), the Government of the Republic of Slovenia was notified of the Spring Forecast. The Government of the Republic of Slovenia uses macroeconomic assessments and IMAD forecasts to prepare annual target scenarios in the Stability Programme.

the compliance of the objectives and content with the adjustment path to attain the medium-term objective (MTO) and, if necessary, request the member State to act or adjust its SP, which will be up to the new Government of the Republic of Slovenia.

Connection with the National Reform Programme (NRP)
The contents of the SP and the NRP complement and overlap. The SP focuses on macroeconomic development, fiscal policy and public finances, and the NRP describes measures, projected structural reforms within the European Semester and the attainment of the objectives of the Europe 2020 Strategy.

Fiscal review
In the fourth quarter of 2017, general government generated a surplus of EUR 41 million, or 0.4 per cent of GDP, while the total surplus in 2017 amounted to EUR 13 million. Since 1995, general government has been generating a deficit, which was highest in 2013 (14.7 per cent of GDP), particularly due to extensive recapitalisation of banks. Since 2013, the deficit has been declining, and reached 1.9 per cent of GDP in 2016. In 2017, total revenue and total expenditure of the government sector increased in comparison to 2016, with total expenditure increasing significantly less (the increase in revenue was faster than the increase in expenditure in all four quarters of 2017). Total revenue increased by 6.5 per cent (by 6.5 per cent in the last quarter), while total expenditure increased by 1.9 per cent (by 6 per cent in the last quarter), which was sufficient for the general government to conclude 2017 with a surplus[2].

Fiscal balance is an important achievement for Slovenia, and shows the adequacy of the balanced approach of socio-economic and fiscal policies. In three years, Slovenia achieved nominal fiscal balance following exit of excessive deficit, and eliminated macroeconomic imbalances. The more favourable balance of public finances resulted in lower general government debt, which was 73.6 per cent of GDP in 2017, and is estimated to drop below 70 per cent of GDP in 2018. With this approach, the completion of gradual fiscal consolidation may be assured, and the conditions and fiscal space may be created to increase the resilience and absorptive capacity of the economy to mitigate the effects of the next turn in the business cycle. Slovenia is a small open country, very sensitive to fluctuations in economic activities in the international environment and in financial markets. Therefore, it is particularly important to create sufficient potential in these favourable times to prevent the recurrence of the crisis we witnessed after 2008. To boost the resilience of the economy and preserve the social state in the long term, it is important, as a priority, to strengthen mechanisms which enable the potential of the economy to grow with investments, investments in knowledge, and the development and improvement of productivity.

In the autumn, the Government of the Republic of Slovenia continued on the planned path to offset the structural fiscal balance by the end of 2020, when Slovenia's medium-term fiscal objective (MTO) will have been met. Since Slovenia has not yet achieved its MTO, the transitional period and the rule of Article 15 of the ZFisP apply, i.e. that the structural deficit must be gradually reduced towards the MTO in a manner compliant with the Stability and Growth Path. During the convergence, the ZFisP does not prescribe the speed of

[2] http://www.stat.si/StatWeb/News/Index/7322

adjustment. According to the IMAD, the Slovenian economy has been sustainably growing, and most indicators show that it has not been overheating: wages continue to grow steadily, the credit activity of banks has been growing, but is still low, and the inflation rate at 1.4 per cent is steady. Prices of real estate have been rising.

The need to hold early elections suspended the negotiation activities of the Government of the Republic of Slovenia with the public sector unions regarding wages for 2019 (the agreement is valid in 2018), the adjustment of social transfers for 2018 will not take place (the ZIPRS applies), and the IMAD forecasts a drop in, and the elimination of, anchors in the adjustment of social transfers (transfers for individuals and households) in 2019, and the drawing of EU funds has been on the rise in accordance with the amendments to the Operational Programme, which is reflected in investments. All of the aforementioned was taken into account on the basis of the Spring Forecast and under a no-policy-change scenario, without evaluated and considered adopted laws after the official announcement of the dissolution of the National Assembly on 14 April 2018[3].

Economic review

The economic situation has been improving since 2014. At the beginning of 2017, gross domestic product reached the pre-crisis level. The gap in Slovenia's economic development in comparison to the EU average measured in gross domestic product per capita in purchasing power standards also began closing in 2016. Economic growth is broadly based.

Table 1: Key economic and fiscal variables

	2016	2017	2018	2019	2020	2021
Economic activity						
GDP (in %)	**3.1**	**5.0**	**5.1**	**3.8**	**3.2**	**3.0**
Prices						
GDP deflator	100.9	102.0	102.4	102.6	102.3	102.2
Average annual price increase	-0.1	1.4	1.5	1.9	2.3	2.3
Labour market						
Employment according to national accounts (in thousands)	959.7	986.4	1009.7	1025.1	1033.2	1038.6
Employment rate (20–64 yrs, in %)	70.1	73.7	76.0	77.5	78.5	79.3
Unemployment rate according to ADS (in %)	8.0	6.6	5.3	4.6	4.2	4.0
Public finances						
General government balance	-1.9	0.03	0.4	0.2	0.6	0.9
Structural balance	-0.7	0.2	-0.5	-0.9	-0.5	-0.1
Debt (end of year)	78.6	73.6	69.3	65.2	61.5	58.3

Source: IMAD, Ministry of Finance

With the simultaneous improvement in exporters' competitiveness, foreign demand enabled relatively high export growth. In this period, uncertainty declined significantly in the domestic

[3] http://www.up-rs.si/up-rs/uprs.nsf/objave/044456003D30B6D9C125826F003B5144?OpenDocument

environment, to which economic policy measures contributed greatly, particularly the rehabilitation of the banking system and gradual meeting of commitments in the fiscal field, which improved Slovenia's image in financial markets. Household consumption has been rising since the end of 2013; it is encouraged by favourable movements in the labour market and high consumer confidence. Investments in fixed assets, which fluctuated somewhat in previous years due to the dynamics of drawing EU funds at the end of the previous financial framework, visibly increased, particularly in 2017. Investments in machinery and equipment have been growing since 2014, and a revival of investments in housing started in mid-2016, which had been reduced in the crisis by almost 60%.

After 2013, the situation in the banking system visibly improved. The extensive recapitalisation of banks at the end of 2013 contributed significantly to this, including the transfer of a large share of bad loans from banks to the BAMC. The quality of bank assets was thus substantially improved. The business results of banks have also improved significantly in recent years. Due to the increase in loans to companies, total lending activity increased in 2017 for the first time since 2010. Banks are important sources of financing for companies, which, in addition to favourable business results, also began using their own funds to finance current production and investments.

After six years, Slovenia eliminated macroeconomic imbalances. Labour costs per product unit have been falling since 2011, faster in the tradable sector, where they are already lower than before the onset of the crisis. This has had a beneficial effect on the growth of Slovenian exporters' market share, which has been increasing since 2012. The indebtedness of companies with banks, which reached its peak at the onset of the crisis, decreased to the level before the acceleration in 2005, and the capacity of companies to repay their debts was also greatly improved. After multi-annual extensive deleveraging of commercial banks abroad, reducing the state's liabilities to foreign portfolio investors, and increasing foreign receivables of the banking sector, the net international investment position was also reduced in 2017 to below the indicative level.

2. GENERAL ECONOMIC POLICY

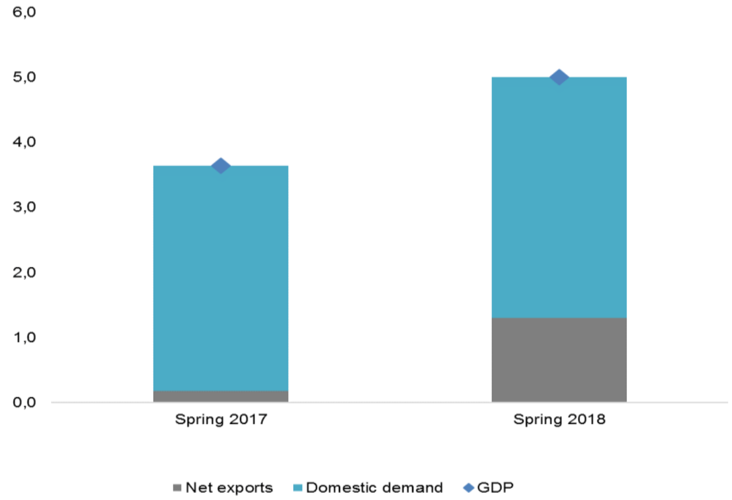
2.1. Summary

In 2018 Slovenia has entered at an stronger pace into its fifth year of sustained recovery. GDP is expected to grow at the same rate than in the previous year (5%). The economic recovery took momentum in 2017 when investment picked up following two years of slowdown in investment financed with EU funds. The strong economic performance, while underpinned by domestic demand is also the result of the net export contribution reflected in positive international trade balances that have become a salient feature of the Slovene economy in the post crisis recovery. With major macroeconomic imbalances addressed concerning the banking system, corporate sector indebtedness, sustained fiscal consolidation and improvement in corporate governance, the economy is set on a balanced growth path at an average growth rates similar to that prior to that of the economic boom (2006-2008). The balanced recovery is reflected in the sustained labour market strengthening captured by the reduction of unemployment and increase in employment underpinned by wage growth lagging that of productivity. With an envisaged supporting international environment and absence of idiosyncratic shocks the convergence of income per capita should continue at a stronger pace.

2.2. Macroeconomic review of 2017

Growth performance in 2017 (5%) was substantially better than forecasted in Stability Programme 2017 (3.6%). The main reason was stronger export performance as domestic demand grew in line with expectations including the rebound in investment. Last year's better export performance is explained by stronger external demand than anticipated in EU (higher by 0.4 p.p.) and EA (higher 0.5 p.p.) countries and improvement in export competitiveness. The improvement in the labour market was also better than anticipated. The employment growth rate was the highest in post crisis period (2.8%) and unemployment rate was lower than forecasted (6.6% compared to 7%). Notwithstanding, the improvement in labour market wage growth per employee was lower (2.7%) than envisaged in the Stability Programme 2017 (3.3%).

Figure 1: GDP growth in 2017 (forecast – Spring 2017 and realised– Spring 2018) and contribution to growth in p.p.



Source: SURS, IMAD, and own calculations

2.3. Macroeconomic projections for 2018

2.3.1. Assumptions about the international environment

The improvement in external conditions observed in 2017 is envisaged to continue in 2018. The European economy is expected to sustain its expansion at a solid pace but the cyclical momentum should moderate in 2018 (EC 2018). Growth in Europe will be underpinned by both domestic and external demand as well as loose financial conditions. External demand for Slovenia's exports should remain strong in 2018 and gradually moderate towards the end of program period Stability Programme 2018. Price of energy (oil) should remain broadly stable at current levels but will remain an important factor influencing price dynamics in Slovenia. Inflation in euro area is forecasted to be 1.5% in 2018 and the USD/€ exchange rate broadly stable at current level.

Table 2: Assumptions about the international environment

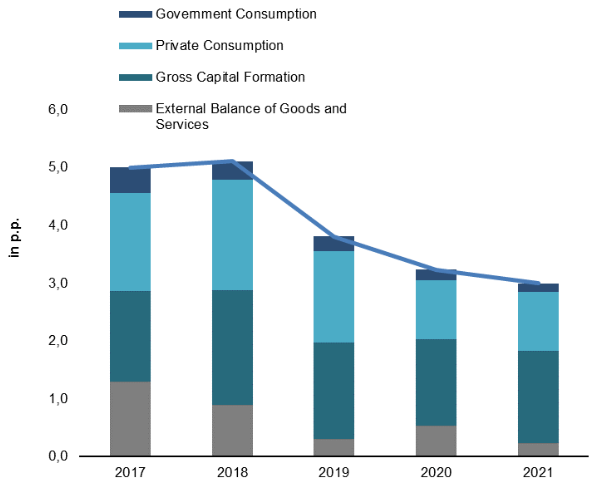
	2017	2018	2019	2020
USD/EUR ratio (annual average) (euro zone and ERM II members)[1]	1.129	1.234	1.236	1.236
Nominal effective rate	0.5	0.8	0.0	0.0
GDP growth in EU	2.4	2.3	2.0	1.6
Growth of relevant export markets[2]	6.0	5.5	4.9	4.6
Oil price (Brent, USD/barrel)	54.3	65.1	60.8	58.0

Source: IMAD – Spring Forecast 2018 Notes: [1] For the 2018–2020 period: the technical assumption on the basis of average values between 1 and 12 February 2018; [2] Real imports of goods and services from trade partners weighted by means of Slovenian export rates to these countries.

2.3.2. Short-term economic outlook in 2018.

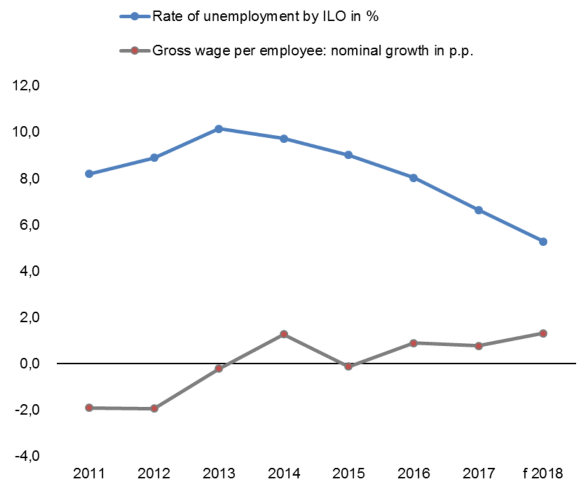
The economy should keep its strong economic expansion in 2018 (5%) and it should be also broad based. Thus, economic growth will be above potential. Domestic demand will continue expanding due to strengthening of investment and private consumption. Investment will increase in construction and machinery and equipment.

Figure 2: Breakdown of gross domestic product growth into aggregate expenditures



Source: SURS, IMAD, and own calculations

Figure 3: Unemployment and nominal growth of gross wage per employee, in p.p.



Source: IMAD and own calculations

Private consumption will remain strong based on improvement in labour market conditions and wages. Growth of government consumption will remain small. External demand will slightly decrease but remain strong contributing positively to economic growth albeit in smaller proportion than in 2017. The current account will register its higher surplus so far (6.9% of GDP) and continue improving its net international investment position.

The labour market will continue strengthening at relative strong pace. Employment will growth by 2.4% while unemployment rate will decrease to 5.3%. Notwithstanding, good labour market performance and gradual increase in labour market shortages wage growth will not accelerate significantly and will be at a rate similar to that observed in 2014. Furthermore, wage growth will remain below that of productivity.

Notwithstanding strong economic expansion inflation rate this year (1.5%) will remain on average at similar level than in 2017. This is explained in addition to the still weak acceleration of wage growth, to modest credit activity and moderate growth of oil prices. Going forward, inflation rates will gradually and by small margins surpass a 2% rate.

Table 3: Price developments

Rate of change in %	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
GDP deflator	2.0	2.4	2.6	2.3	2.2	2.2
Private consumption deflator	2.6	1.8	2.0	2.1	2.1	2.1
Consumer price index (annual average)	1.4	1.5	1.9	2.3	2.3	2.3
Government consumption deflator	2.0	3.2	4.0	3.1	3.0	3.0
Gross fixed capital formation deflator	2.0	2.4	2.4	2.2	2.2	2.2
Export price deflator (goods and services)	2.5	1.4	1.4	1.2	1.3	1.3
Import price deflator (goods and services)	3.0	0.9	1.1	1.0	1.3	1.3

Source: SURS, Spring Forecast 2018, IMAD.

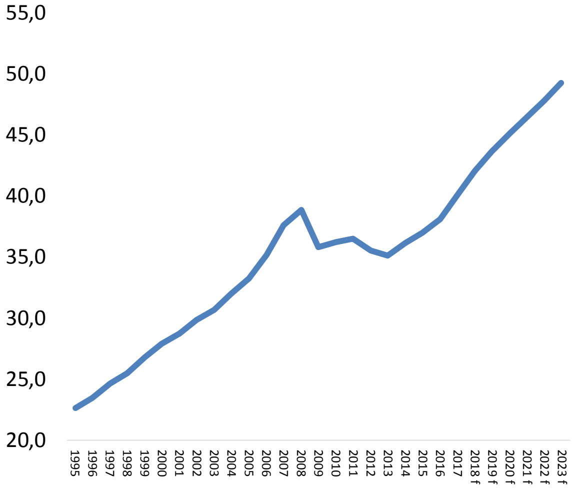
2.4. Medium-term forecast 2019–2021

After 9 years in 2017, GDP in level and in per capita terms (constant prices) surpassed those reached at their peaks in 2008 prior to the crisis. The economic recovery has gotten momentum in last and this year underpinned by a broad-based demand recovery where investment is improving in a sustained manner. Going forward the domestic demand improvement since 2014 would continue and demand will reach by 2020 the same level (constant prices) as in 2008. Export growth is expected to decelerate in 2019 and remain relatively high until the end of the program period. It is not expected to be affected by one-off type of events that importantly influenced past and this year.

Although, export growth will be lower than that of imports, net exports will contribute positive to GDP growth and the current account surplus will remain quite sizable at the level reached in 2017 (6.5%). With positive external balances leverage of corporates should remain low and credit growth is expected to be significantly lower than that prior to crisis. With the recovery, labour market conditions will continue tightening and by 2020 the number of registered unemployed will be similar to that in 2008. On average productivity growth will exceed that of wages during 2019-2021.

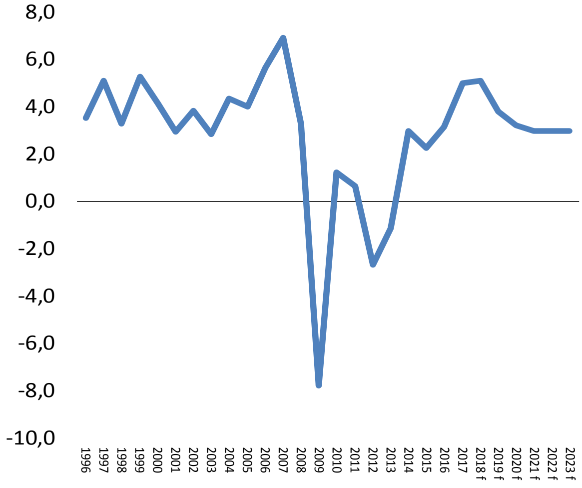
The private sector as well as the government sectors are expected to run surpluses reducing external indebtedness. The economy is expected to follow a balanced growth path where GDP growth will converge to increasing potential growth rates by 2020.

Figure 4: Gross domestic product in current prices, in EUR billion



Source: SURS, IMAD, and own calculations

Figure 5: GDP growth rate in %; constant prices 2010



Source: SURS, IMAD, and own calculations

Table 4: Key macroeconomic indicators for the period until 2023

	Spring forecast	
	2018-2020	**2021-2023**
Gross domestic product, real growth in %	4.0	3.0
Exports of goods and services	7.9	5.8
Imports of goods and services	8.1	6.3
Private consumption	2.9	2.0
Government consumption	1.4	0.9
Investments in fixed assets	8.7	7.5
Employment (SNA), growth in %	1.6	0.4
Registered unemployment rate (in %)	7.3	6.2
Survey-based unemployment rate (in %)	4.7	3.9
Average number of registered unemployed in thousands	69.6	60.0
Inflation, annual average	1.9	2.3

Source: Projections of the Spring Forecast 2018, IMAD, March 2018.

2.5. Comparison of forecasts from the 2017 and 2018 stability programmes

GDP growth rates are higher for the whole program period and particularly for the years 2017-2019. In 2018 the difference reaches up to 2 p.p. The main difference is explained by a better external performance with sizable higher external trade balances particularly in 2017 and 2018 and stronger investment. Important difference also concern the better labour market developments as reflected in lower unemployment and higher employment rates in the latest forecast.

Table 5: Comparison of economic indicators from the 2017 and 2018 Stability Programmes

% GDP	2017	2018	2019	2020	2021
Growth in GDP					
2017 Stability Programme	3.6	3.2	2.6	2.6	2.6
2018 Stability Programme	5.0	5.1	3.8	3.2	3.0
Difference	1.4	1.9	1.2	0.6	0.4
General government balance					
2017 Stability Programme	-0.8	-0.2	0.2	0.4	
2018 Stability Programme	0.0	0.4	0.2	0.6	0.9
Difference	0.8	0.5	0.1	0.2	
General government debt					
2017 Stability Programme	77.0	74.3	70.9	67.5	
2018 Stability Programme	73.6	69.3	65.2	61.5	58.3
Difference	-3.4	-5.0	-5.7	-6.0	

Source: Ministry of Finance

In general, all relevant institutions made large mistakes concerning GDP forecast in Spring 2017 for the past year. The error of the official forecast used to make fiscal projections in the SP17 was slightly smaller than that of the European Commission.

Table 6: Comparison of spring forecasts 2017 with realisation (5%)

	Forecast (2017)	Error in percentage points
IMAD	*3.6*	*-1.4*
BS	*3.5*	*-1.5*
EC	*3.3*	*-1.7*
IMF	*2.5*	*-2.5*
WIIW	*2.9*	*-2.1*
OECD	*3.8*	*-1.2*
Consensus	*2.7*	*-2.3*

Source: IMAD

2.6. Comparison of the forecast in the 2018 Stability Programme with the winter forecast of the EC for 2018, and of the forecast from the Draft Budgetary Plan

Comparison of GDP growth between that used in the Draft Budgetary Plan (UMAR Autumn 2017) and that of the latest forecast of the EC (Winter 2018) indicate that the one used in fiscal projections was less optimistic. This is primarily explained due to the lower GDP forecast of Autumn 2017 as the trend growth in 2018 and 2019 are similar in both forecasts. The GDP growth forecast of the Stability Programme 2018 for 2018 is clearly higher that of the EC and DBP.

Table 7: Comparison of the 2018 SP with the winter forecast of the EC and the forecast from the Draft Budgetary Plan

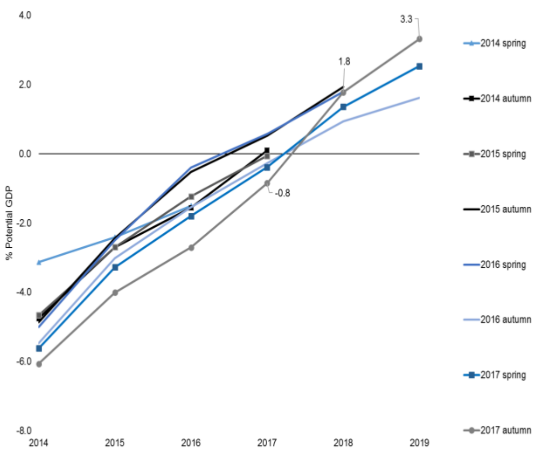
	2017	2018	2019
GDP growth in %			
DBP 2018 (autumn 2017)	4.4	3.9	3.2
EC (winter 2018)	4.9	4.2	3.5
SP 2018 (spring 2018)	5.0	5.1	3.8
General government balance as % of GDP			
DBP 2018 (autumn 2017)	-0.8	0.4	0.8
EC (autumn 2017)	-0.8	-0.0	0.4
SP 2018 (spring 2018)	0.0	0.4	0.2
General government debt as % of GDP			
DBP 2018 (autumn 2017)	75.2	71.7	68.0
EC (autumn 2017)	76.4	74.1	72.0
SP 2018 (spring 2018)	73.6	69.3	65.2

Source: IMAD; Ministry of Finance

2.7. Position in the cycle

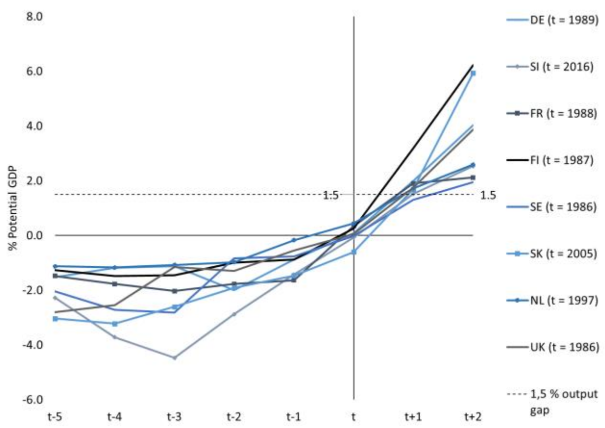
Estimates of output gap for Slovenia are subject to great uncertainty; Figure 6 shows the latest available calculations of Slovenian and international institutions, which vary depending on methodology. The key issue is correctly estimating Slovenia's position in the business cycle and particularly the numeric implications of output gaps for decisions on fiscal policy (which must reflect the path of fiscal consolidation in accordance with the ZFiSP and partially also with the SGP).

Figure 6: Latest available calculations of the output gap (as % of GDP)



Source: Ministry of Finance

Figure 7: Uncertainty of the calculation and the amount of the output gap (as % of GDP) for other Member States in 2018 and beyond



Source: Ministry of Finance

In October 2017, Slovenia filed with the Economic Policy Committee an application to consider the specific features of Slovenia ("country specific case") in the calculation of the output gap, and proposed an alternative method for the NAWRU estimate[4] which is based on the concept of an adjusted short-term unemployment rate (composed of the short-term unemployment rate and cyclical long-term unemployment). The methodology of the European Commission in the NAWRU estimate is based on the model of unobserved components. In the case of Slovenia, the results of such estimates are counterintuitive and do correspond to economic intuition and the movement of cyclical economic indicators. The NAWRU estimate in the case of Slovenia is procyclical. The NAWRU estimates for Slovenia continues increasing despite the fact that the unemployment rate has been falling since 2013. On the basis of the decision of the Output Gap Working Group (OGWG), the procyclicality of the NAWRU trend in the case of Slovenia has been mitigated with the use of medium-term NAWRU anchor since the autumn of 2016. The medium-term anchor is the "structural unemployment" assessed on panel regression; however, the anchor is not statistically significant for new EU Member States and, therefore, is questionable. Nevertheless, the use of an anchor is crucial for mitigating the procyclicality of NAWRU, but not sufficient to eliminate it. In addition, anchoring is not a systemic solution to the problem with the NAWRU estimate, since an anchor must be applied outside the model of unobserved components. Moreover the Slovenian specification of the statistical model for Slovenia also includes drift which, from a theoretical aspect, does not belong in it.

Based on arguments and additional analyses of Slovenia presented at the OGWG, the EPC adopted the following position in March 2018: "The EPC agrees that the estimated output gap in Slovenia is subject to great uncertainty, and that the Phillips curve estimates might be incorrect." This is the first official admission that the NAWRU estimates calculated according to the methodology of the European Commission are questionable.

Slovenia's efforts resulted in the NAWRU estimates for Slovenia being reduced by approximately 1.5 percentage points (1.1 percentage points due to the introduction of a medium-term anchor and 0.4 o.t. due to the elimination of the "drift") and the estimate of the output gap by approximately 1.2 percentage points. In the future, the European Commission will assess the output gap in Slovenia without the problematic drift in the specification of the model for the NAWRU estimate, and use a "suitable" anchor in medium-term anchoring. In addition, the OGWG will further strive to improve the estimate of the anchor for the NAWRU, particularly for new Member States whose estimates are not satisfactory.

Annual fiscal adjustment as economies pass from a negative to a positive output gap and exceed the 1.5 per cent threshold.

Countries when experiencing output gaps higher or equal than 1.5% are required, according to the Matrix specifying the size of adjustment depending on economic conditions, to step up fiscal adjustment from 0.6 p.p. to 1.p.p. of GDP. The conception of the matrix implicitly assumes that countries transit gently and gradually from normal times (-1.5 ≤ output gap <1.5) to good times (Output gap ≥ 1.5). This does not seem to be the case with important

[4] Non-accelerating wage rate of unemployment.

policy implications. Data show that this is not necessarily the case, which has significant consequences for economic policy. Therefore, the problem of the suitability of the provisions of the matrix relates not only to the well-known uncertainty of output gap estimates, but also to the transition from a negative to a positive output gap which is not gradual, and particularly not following a recession. Figure 6 shows, the difference between output gap estimates for the Republic of Slovenia. This suggests a prudent approach when interpreting output gap estimates in real time and of drawing conclusions regarding whether the country has reached its fiscal target or not when measured in structural balance term. Secondly, output gap estimates may suddenly jump from the area understood as a "bad" economic situation (-3 % ≤ output gap < -1.5 per cent) into the area of a "good" situation, which might not necessarily be the case, but simply reflecting the normal post crisis adjustment of the economy.

The sudden jump of output gap following a recession is shown in Figure 7 with the following implications for economic policy. Firstly, it suggests that sizable and sudden improvements in OG are frequent following protracted low period of growth or recession, which do not necessary suggest that the economy is booming but a demand correction from poor past performance. Secondly, it highlights that fiscal policy cannot be changed suddenly when there are estimates of large shift in output gap but policy should be planned in a multiyear framework and above all based on sustainable policies that avoid relaxation when times turn effectively good. This highlight policy focus on the quality of underlying policies rather than on the quantitative targets that can be breached when conditions improve in a procyclical manner.

3. FISCAL OUTLOOK, FRAMEWORK AND ECONOMIC POLICY OBJECTIVES without changes

3.1. Fiscal outlook 2017 and 2018

At the end of November, the European Commission published assessments of draft budgetary plans for 2018, and assessed that there are risks of significant deviation from the rules regarding the required reduction in structural deficit and of partial deviation from the rules regarding expenditure growth. The Stability and Growth Pact rules in so-called good economic times require increasingly faster fiscal consolidation, higher than the broad consolidation achieved in recent years: the general government deficit declined by to 1.9 per cent of GDP in 2016 since 2015, when it was 2.9 per cent of GDP, levelled balance in 2017; and in 2018, Slovenia is expected to achieve a surplus in the amount of 0.4 per cent of GDP, whereby it is strictly determined that growth in expenditure lags behind the growth in revenue. According to Slovenia, speedier consolidation is not sensible, since it may compromise economic growth. The adoption of additional measures together with the observance of the fiscal rule and the Pact is a matter for the new government; we believe the MTO or balance of the structural balance in 2020 are realistically attainable, but not without structural measures and investments in priority areas.

View of the European Union of the planned path in the Draft Budgetary Plan, autumn 2017:

Recitals of Council Recommendations of 11 July 2017 emphasise the way in which the Commission intends to address Member States for which the matrix shows fiscal adjustment in the amount of 0.5 per cent of GDP or more. *While compliance continues to be assessed with respect to the matrix-based requirement, as indicated in the Recommendations, the Commission can exercise some discretion when assessing compliance with the SGP of a Member State that is flagged by quantitative indicators as (at risk of) significantly deviating from its required adjustment. In fact, the so-called overall assessment might eventually conclude that a Significant Deviation Procedure is not warranted even in the event of the significant deviation threshold of 0.5% of GDP being exceeded with respect to the matrix-based requirement. The legal basis can be found from the specific terms of Article 6(3) of Council Regulation (EC) No 1466/97, whereby the overall assessment is linked to precise quantitative criteria without being limited to those criteria, which allows for other elements to be taken into account.*

Discretion is conceived as a means to tackle a specific situation in a time of atypical and incomplete economic recovery. *For Member States where the recovery appears still fragile, or undue fiscal tightening could jeopardise it, as in the cases of Italy and Slovenia, a fiscal adjustment that departs from the requirement may be deemed adequate. However, if these Member States also face sustainability requirements in the medium term and/or have a debt-to-GDP ratio above 60%, an important provision is that they should ensure the effective delivery of a reasonable fiscal adjustment. The latter could be roughly proxied by at least half of the requirement from the matrix, providing such a cap responds to the need to strike the right balance between the Member State's stabilisation and sustainability needs. Nevertheless, full compliance with this fiscal adjustment is required.*

The assessment of the 2018 Draft Budgetary Plan states: "For five countries (Belgium, Italy, Austria, Portugal, and ***Slovenia****), the DBPs pose a* ***risk of non-compliance*** *with the requirements for 2018 under the SGP. The DBPs of these Member States might result in a significant deviation from the adjustment paths towards the respective MTO. Slovenia is included in the preventive arm of the SGP, and must achieve/ensure a reliable path to attain the MTO of 0.25 per cent of GDP, and the fiscal effort required in 2017 is 0.6 per cent of GDP. In 2018, the Republic of Slovenia must ensure a fiscal effort which reflects a recovery situation and secures the stability of public finances. In compliance with the expenditure growth criterion, the nominal increase in primary expenditure must not exceed 0.6 per cent in 2018, which corresponds to the fiscal adjustment in the amount of 1 per cent of GDP. For 2018, the EC estimates the gap to be 0.4 per cent of GDP, and a high risk of non-compliance arising from both criteria (in the structural balance, the gap is 0.5 per cent of GDP). Nevertheless, the EC has noted that there is great uncertainty in the calculation of the output gap; therefore, to strike a balance between recovery and the stability of public finances in 2018, the EC will allow a fiscal effort of at least 0.6 per cent of GDP (which corresponds to a net decrease in primary expenditure by 1.5 per cent).*

Economic growth in 2017 had a significant impact on the improvement of public finances, which is reflected in higher tax revenues. Employment improved, and companies generated higher added value and had better operating results. A better situation in the labour market allowed pension and health care funds to meet their obligations, while at the same time, the state budget significantly contributed to improving the position of public health-care institutions. The good fiscal result is also the result of slightly restrained investment activities, where more expenditure was expected. This is reflected in the state budget and surplus at the level of local communities.

(In)ability to use flexibility (of clauses) in accordance with the SGP

The Commission announced in 2015 that, in order to strengthen the link between investment, structural reforms and fiscal responsibility, it would provide further guidance on the best possible use of the flexibility that is built into the existing rules of the Stability and Growth Pact, without changing these rules. The Pact is a cornerstone of the EU's economic governance and of decisive importance for the proper functioning of the Economic and Monetary Union. The Pact deliberately envisages flexibility in the way its rules should be applied, both over time and from country to country. Some discretion is also deliberately left, within the agreed rules, for the Commission and the Council to assess the soundness of public finances in the light of country-specific circumstances, in order to recommend the best course of action based on the latest developments and information. The flexibility varies depending on whether a Member State is in the preventive or the corrective arm of the Pact. The preventive arm aims at guaranteeing a sound budgetary position in all Member States: its core is the attainment by each Member State of its medium-term sound budgetary position (so-called Medium-Term Objective or MTO), which is set according to commonly agreed principles.

The guidance presented here focuses on the margin of interpretation which is left to the Commission, in line with the rules of the Pact. It clarifies how three specific policy dimensions can best be taken into account in applying the rules. These relate to: (i) investment, in particular as regards the establishment of a new European Fund for Strategic Investments as part of the Investment Plan for Europe; (ii) structural reforms; and (iii) cyclical conditions. However, the condition for all three dimensions or clauses is that they use benefits when their growth is negative or production is significantly below their potential (EC calculations) and the EC assessment of the distance to MTO. Slovenia has never been eligible for any form of flexibility (and is not eligible in 2018 due to its distance from its MTO in 2018 in view of the latest EC calculations and due to the matrix, since EC calculations of the output gap show that we are in a distinctly good situation).

Therefore, the Government began to gradually eliminate most of the measures taken in recent years to mitigate the consequences of the economic crisis. Pensions are indexed again, and there are more options regarding rights arising from social security. In this way, we are persisting on the planned path of gradually eliminating the structural deficit, which is assessed to guarantee the observance of EU and national fiscal rules, while at the same time, striving to preserve balanced economic growth. In 2017, gross domestic product grew by 5 per cent in real terms, and by 7.1 per cent nominally as compared to 2016, which is 2.7 or 4.0 percentage points more than anticipated in the preparation of the 2017 budget. Tax revenues of the state budget rose by 7 per cent or slightly more than EUR 500 million in 2017 as compared to 2016. This enabled Slovenia to practically halve the deficit of the state budget and improve the general government balance, which increased from EUR 781 million deficit in 2016 to a EUR 13 million surplus in 2017. The general government deficit in 2014 was as high as EUR 2.075 billion. The state spent higher revenues to increase funds for employees, which grew by 4.6 cent, and social benefits, which grew by 3.2 per cent compared to the previous year. For example, EUR 1.174[5] billion or 4.2 per cent more than in 2016 were paid from the 2017 state budget for wages and contributions. EUR 1.261 billion

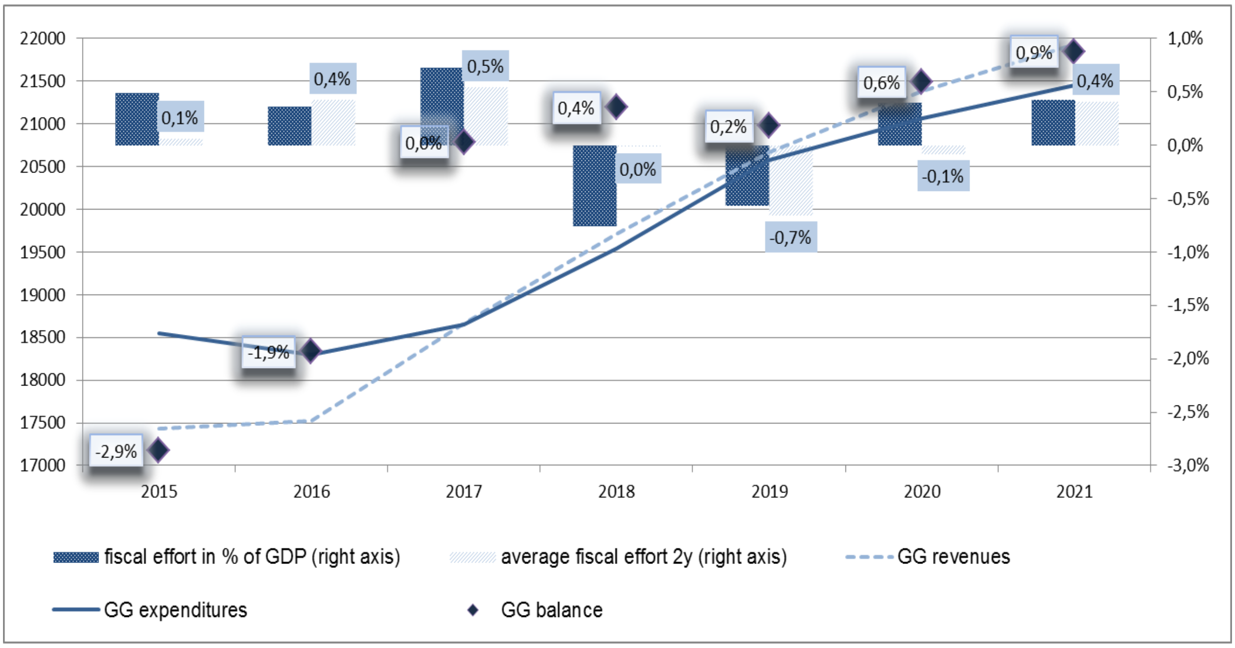
[5] Not taking into account transfer to public institutions.

were paid as transfers to individuals and households, which is 7.6 per cent more than planned, and 3.4 per cent more than in 2016.

3.2. Medium-term balance of general government under a no-policy-change scenario

In the autumn, the Government of the Republic of Slovenia continued on the path planned in 2015 so that the structural balance of the general government sector would be offset, based on assessments made by the Ministry of Finance, by the end of 2020, when Slovenia's medium-term fiscal objective (MTO) will have been met. Since Slovenia has not yet achieved its MTO, the transitional period or the rule that the structural deficit must be gradually reduced towards the MTO in a manner which is compliant with the SGP apply. The speed of convergence is not governed by the ZFisP, which also does not provide a formula for calculating the upper threshold of expenditure during the convergence (until the MTO has been attained). However, early elections have been called (end of May 2018) and the Government's margin for manoeuvre is limited (adoption of measures with financial consequences in the medium term is not deemed a regular duty of the Government); therefore, we can legitimately persist on the planned path for 2018 (surplus of the general government sector in the amount of 0.4 per cent of GDP).

Figure 8: Scenario under a no-policy-change scenario (general government sector)



Source: Ministry of Finance

The assumptions for 2018 and beyond have changed:

- the realisation for 2017 has been corrected (more favourable growth than anticipated in the autumn), better macroeconomic indicators for 2018 and beyond;
- the Government of the Republic of Slovenia suspended negotiations on wages of public employees in 2019 (no new agreement);
- the provision of the ZIPRS regarding non-adjustment of social transfers ceases to apply in 2019;

- in the light of the spring forecast, we may expect a drop in anchors used to limit the adjustment of family benefits and parental protection (on 30 September, the Government of the Republic of Slovenia will learn whether economic growth exceeded 2.5 per cent of gross domestic products, and whether the rise in the employment rate in the age group between 20 and 64 exceeded 1.3 percentage points).

The data published by the SURS (EDP reporting, September 2017[6]) on the level of the general government deficit for 2017 indicated that the deficit estimated according to the monitoring of the 2017 realisation, forecasts of the Ministry of Finance and calculations on the basis of four public finance budgets was approximately -0.8 per cent of GDP. In its 2017 Autumn Forecast, the IMAD insisted that economic growth would be below 5 per cent. In November and December, the situation regarding revenues was better, and the trend has continued at the beginning of 2018. Since the publication of the MAD Autumn and the unofficial Winter Forecast, in addition to the SURS publication (and final confirmation harmonised with Eurostat), the input data have changed significantly and made the restrictive management of fiscal policy significantly more difficult. The Government of the Republic of Slovenia would remain on the planned path to attain the MTO in 2020, but so as not to put economic growth and the well-being of its citizens at risk. As explained for 2018, the Government of the Republic of Slovenia only submits a description of the fiscal path under a no-policy-change scenario (i.e. without changes in regulations that would provide for the required fiscal path) due to its limited powers in terms of the performance of regular duties.

Table 8: Path to the target scenario for the general government sector (ESA 2010)

in EUR million	2017	2018	2019	2020	2021
Revenue	18658	19704	20666	21378	21932
as % of GDP	43.1	42.3	41.7	40.8	39.8
Expenditure	18645	19518	20007	20661	21266
as % of GDP	43.1	41.9	40.3	39.4	38.5
Target nominal deficit/surplus	13.4	186.4	659.1	717.1	666.3
as % of GDP	0.03%	0.4%	1.3%	1.4%	1.2%
Target structural deficit	92.1	-188.9	108.7	161.2	161.2
as % of GDP	0.21	-0.41	0.22	0.31	0.30
Fiscal effort as % of GDP	**0.7**	**-0.6**	**0.6**	**0.1**	**0.0**
Average fiscal effort	***0.5***	***0.1***	***-0.1***	***0.35***	***0.05***

Source: Ministry of Finance, calculation of the MF, output gap estimate SAEP, MF

[6] http://www.stat.si/StatWebArhiv/prikazi-novico?id=7030&idp=1&headerbar=0

Figure 9: General government balance and structural balance, as % of GDP – no-policy-change scenario, output gap of the MF (EC methodology)[7]

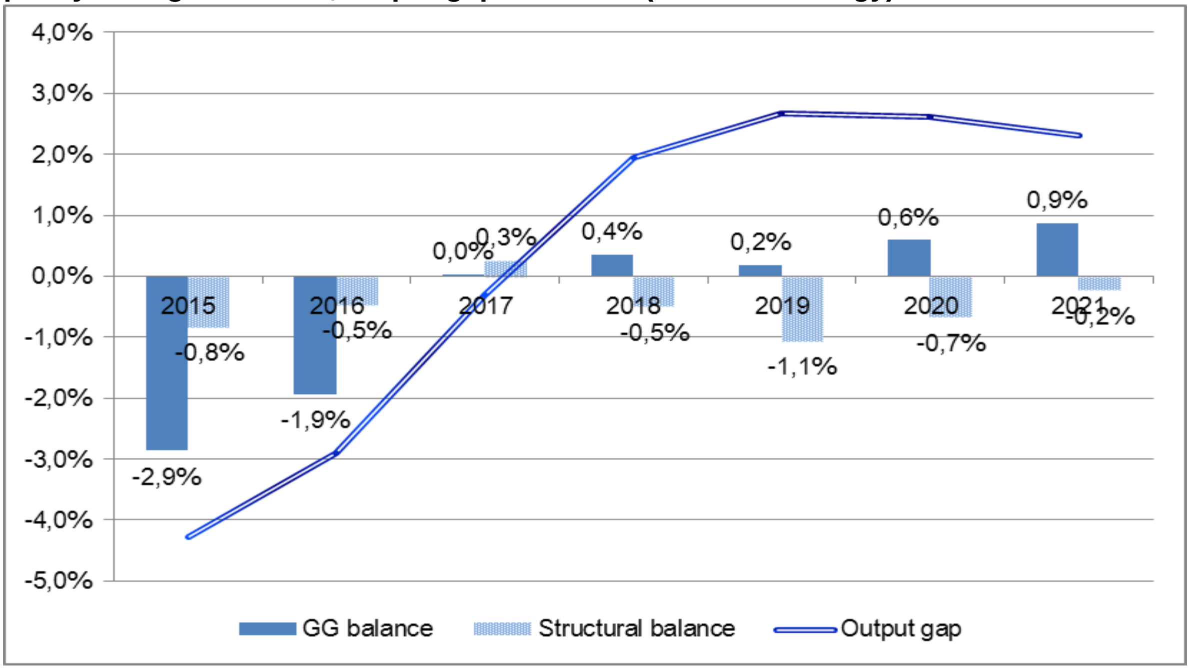
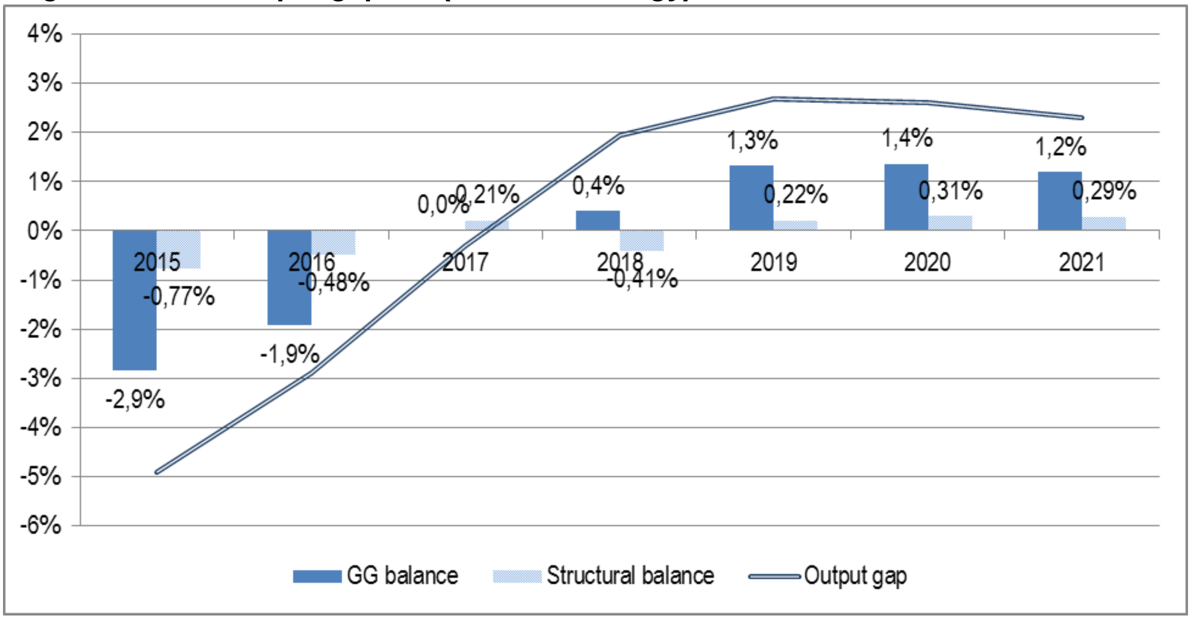


Figure 10: General government balance and structural balance, as % of GDP – required target scenario, output gap MF (EC methodology)



Source: Ministry of Finance, calculations of the MF

Tables 9 and Figure 11 show the general government balance and the structural balance under a no-policy-change scenario, and the required fiscal consolidation under the target scenario assumption (Table 8).

[7] The MF calculates the output gap according to the assumptions of the EC methodology, and the IMAD variables from the latest Spring Forecast are used. Since the SP was drafted under a no-policy-change assumption, the output gap calculated in this manner represents the average of all the latest available calculations of various institutions (MF, own calculations, EC methodology (with the same and different assumptions), IMAD, IMF, OECD and EC).

Table 9: Cyclical movements under a no-policy-change scenario (output gap – average estimate)

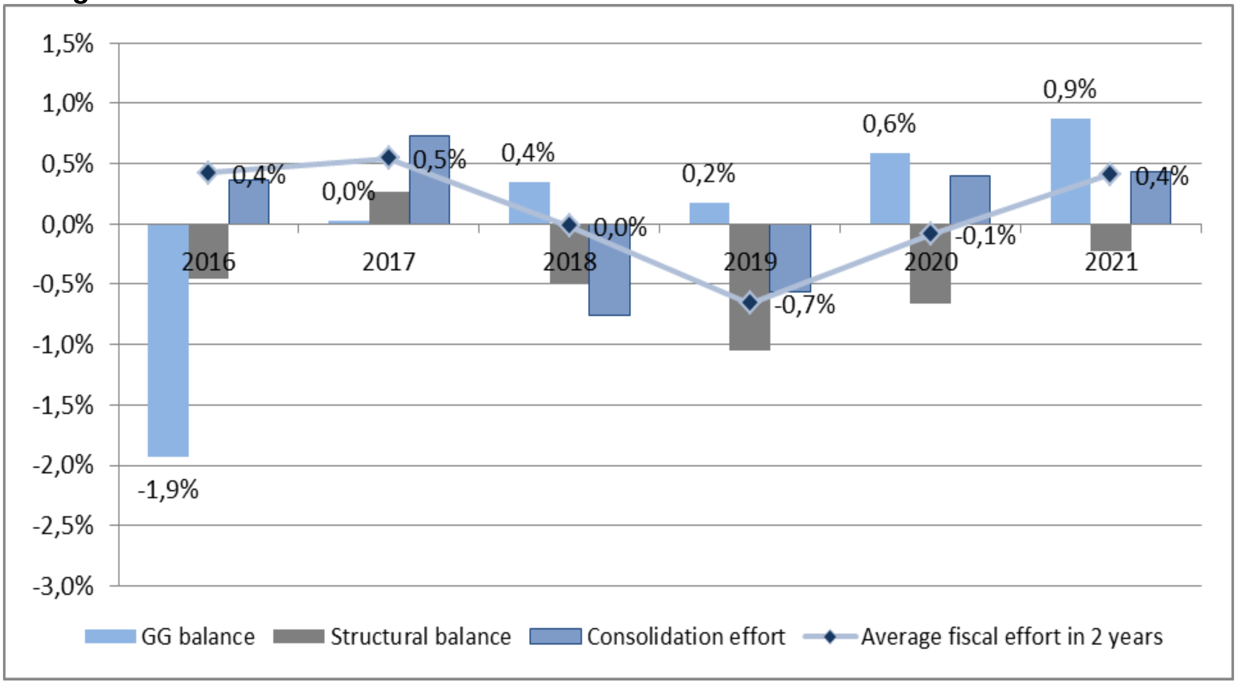
as % of GDP	ESA code	2017	2018	2019	2020	2021
Real GDP growth (%)		5.0	5.1	3.8	3.2	3.0
Actual general government balance	B.9	0.0	0.4	0.2	0.6	0.9
Interest expenditure	D.41	2.5	2.0	1.7	1.6	1.5
One-off and other temporary measures		0.09	0.09	0.05	0.0	0.0
Potential GDP growth (%)		2.3	2.8	3.1	3.3	3.3
Contributions:						
- labour		0.4	0.5	0.5	0.6	0.5
- capital		0.2	0.4	0.6	0.7	0.9
- total factor productivity		1.7	1.9	1.9	1.9	1.9
Output gap (%)		**-0.3**	**2.0**	**2.7**	**2.6**	**2.3**
Cyclical general government balance		-0.1	0.9	1.3	1.2	1.1
Cyclically adjusted general government balance		0.2	-0.6	-1.1	-0.7	-0.2
Changes in cyclically adjusted general government balance		0.7	-0.7	-0.5	0.4	0.4
Structural balance		0.2	-0.5	-1.0	-0.7	-0.2
Changes in structural deficit (fiscal effort)		**0.7**	**-0.7**	**-0.6**	**0.4**	**0.4**
Average fiscal effort		**0.5**	**-0.1**	**-0.6**	**-0.1**	**0.4**

Source: Ministry of Finance

Slovenia plans to gradually improve the general government balance and the cyclically-adjusted balance in the medium-term period. Therefore, the planning of public finances must focus on structural measures that will have a permanent impact on the structure and efficiency of public finances. In the field of government expenditure, these measures should include the elimination of short-term measures, which will affect the limited increase in expenditure (determined in the ZUJF, ZIPRS, the Agreement on measures in the field of salaries and other labour costs in the public sector aiming to balance public finances for the year 2015, and other regulations) and the introduction of systemic measures to maintain the MTO and long-term healthy structure of public finances. Opportunity savings were generated used to create fiscal space to finance legal and other priority expenditure, while in the future, an appropriate limit level of expenditure to attain the MTO will have to be provided. The specific features of small Member States and suitable achievement of sufficient potential growth, while taking account of the cost of ageing, will have to be considered.

Regarding the achievement of compliance in the past and in 2018 (and beyond) under a no-policy-change scenario, Figure 11 shows the movement of the general government balance, the structural balance, the amount of fiscal effort, and the two-year average achieved and planned fiscal effort (the Government of the Republic of Slovenia partially complied with the ZFiSP and the rules of the Stability and Growth Pact).

Figure 11: Fiscal path (not compliant with the ZFisP and the SGP) under a no-policy-change scenario

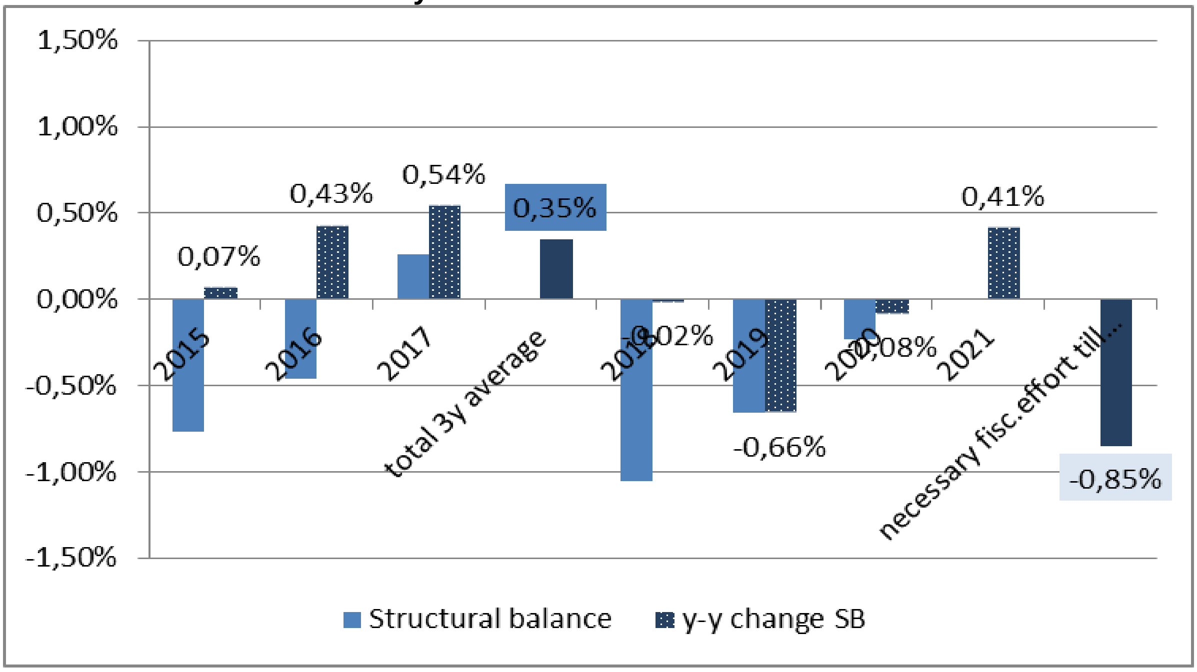


Source: Ministry of Finance

To achieve full compliance with the ZFiSP and attain the MTO, the new Government of the Republic of Slovenia will have to prepare amendments to the ordinance on the preparation of the budget for the 2019–2021 period, determine target balances for the general government sector and four public finance budgets, and determine the caps on expenditure. Depending on the call of parliamentary elections and the formation of the new government, this may take place in the autumn of 2018, which means that the requirements will be taken into account in 2019 (the required effort in the amount of 0.6 per cent of GDP), which in turn means that the new Government of the Republic of Slovenia will have to achieve the general government surplus of 1.3 per cent of GDP in 2019 (instead of 0.2 per cent of GDP) or reach an agreement on how to generate a structural surplus in 2020 of 0.25 per cent of GDP. To achieve compliance with the ZFisP, the burden of fiscal consolidation may be distributed between 2019 and 2020, whereby the SGP will only be partially taken into account.

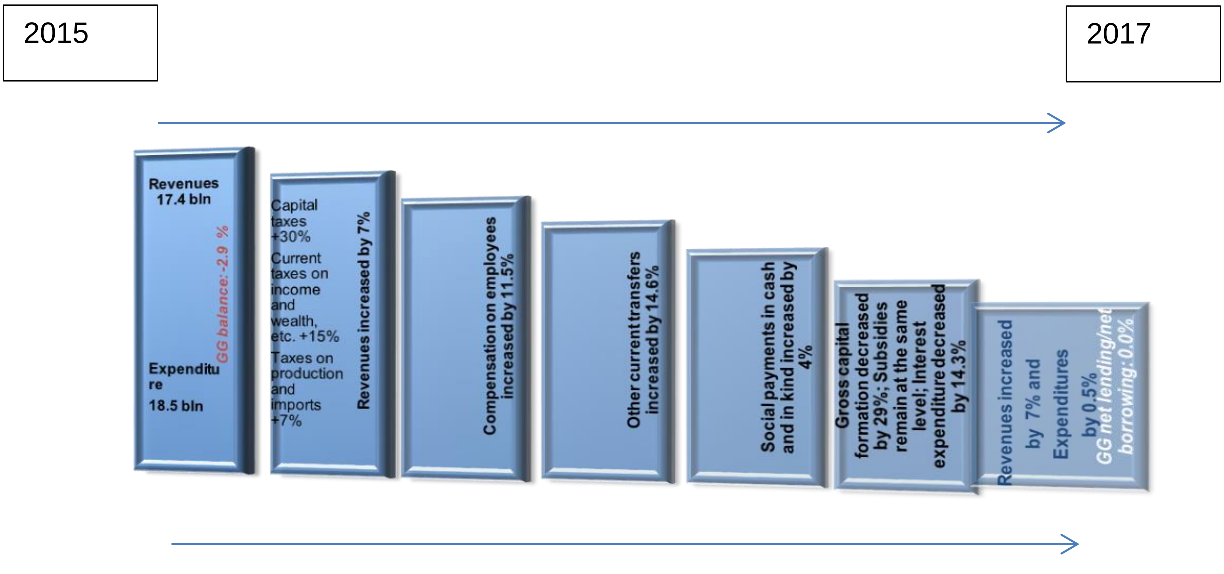
To make the required fiscal efforts, Slovenia must pursue the medium-term objective (MTO), and thus achieve minimum fiscal consolidation, starting in 2018, in the total amount of approximately 0.8 per cent of GDP (Figure 12). If we evaluate the fiscal consolidation carried out so far (a total of an average of 0.4 per cent of GDP in the 2015–2017 period), this objective may be realistically attained by 2020, regardless of the planned path (0.6 per cent of fiscal effort annually, or divided into, for example, 0.3 per cent annually in 2019 and 2020) to attain the MTO. According to the figure below, it may be concluded that Slovenia is progressing towards the medium-term objective on the planned path, particularly if the achieved fiscal effort is taken into account (on the assumption that the spring forecast is realised)

Figure 12: Interim change in the structural balance and fiscal effort (as % of GDP) achieved so far and necessary in 2019–2020



Source: Ministry of Finance

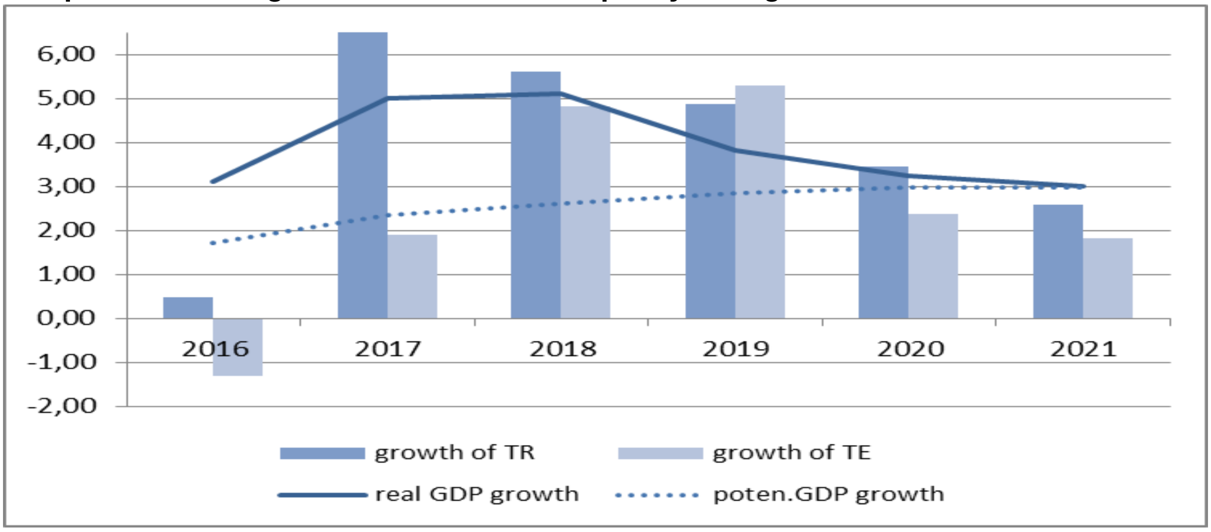
Figure 13: Effects of the three-year (2015–2017) fiscal consolidation of the general government sector as % of GDP



Source: SURS, calculations of the Ministry of Finance

In meeting the commitments of the Stability and Growth Pact and the ZFisP during the transitional period when the medium-term objective has not yet been met, Slovenia followed the requirements. Under a no-policy-change scenario, a realistically attainable objective in 2018 is a general government sector surplus of 0.4 per cent of GDP. As shown in Figure 14, it is taken into account in 2018 that the growth of general government expenditure lags behind the growth of general government revenue and potential product, so that a share is always "saved" or earmarked for progressing towards attaining the medium-term objective.

Figure 14: Growth in general government expenditure revenue and expenditure, real and potential GDP growth in % under a no-policy-change scenario



Source: Ministry of Finance

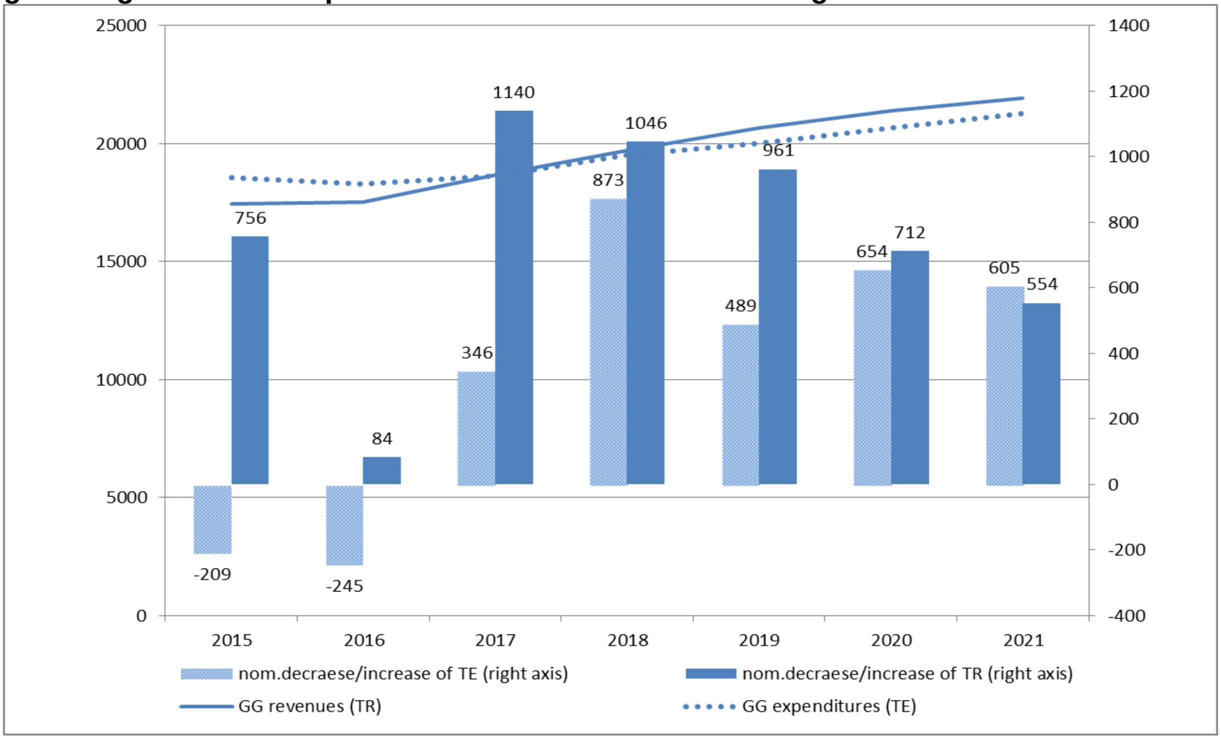
A no-policy-change scenario also takes into account that potential GDP growth is lower than real GDP growth, and the closed output gap in 2018. The MTO is attained in 2021, but with "non-limited" general government expenditure.

An additional criterion to verify compliance with the Stability and Growth Pact is a somewhat recast criterion of expenditure benchmark (or expenditure rule). According to the extended Stability and Growth Pact, the assessment of approximation to the medium-term objective, in addition to the fiscal effort, must also take into account the growth in expenditure in comparison with potential GDP growth[8]. On 12 July 2016, the Council recommended to Slovenia that it achieve an annual fiscal adjustment of at least 0.6 per cent of GDP in 2017 to progress towards attaining the medium-term budgetary objective, which Slovenia did. In addition, the Council recommended to Slovenia that it use, in view of its fiscal position and debt level in 2018, an additional adjustment to progress towards attaining the suitable medium-term budgetary objective. In accordance with the agreed adjustment matrix within the Stability and Growth Pact, such an adjustment signifies a requirement for a nominal level of growth of net primary general government expenditure[9], which does not exceed 0.6 per cent. This would correspond to the structural adjustment of 1 per cent of GDP. Under a no-policy-change scenario, Slovenia does not comply with the expenditure rule, which determines the highest permitted real or nominal level of expenditure.

[8] The expenditure growth rate should not exceed potential GDP growth, unless the surplus is balanced with discretionary revenue measures. This will enable the approximation to the target structural fiscal balance. If expenditure increases faster than potential GDP, the structural fiscal balance worsens, and vice versa.

[9] Net general government expenditure is comprised of all general government expenditure, excluding costs of interest, expenditure on Union programmes fully offset by revenue from Union funds, and non-discretionary changes in expenditure on unemployment benefits. National financial gross investments in fixed assets have been planned for a four-year period. Discretionary revenue measures or statutory increases of revenue have been taken into account. One-off revenue and expenditure measures have been offset.

Figure 15: General government revenue and expenditure, and necessary changes in general government expenditure in EUR million for the target scenario



Source: Ministry of Finance, output gap of the MF, calculations of the MF

Figure 15 shows the required changes in general government expenditure to attain public finance objectives in order to comply with the fiscal rule. The amounts of increase in revenue/expenditure from 2017 onwards are shown in EUR million on the right axis, where the increase in expenditure lags behind the increase in revenue (IMAD Spring Forecast, projections of the MF by 2021 have been taken into account). To attain a potential target scenario in 2019, taken into account Spring Forecast, for increase of general government revenue by EUR 961 million (compared to 2018) general government expenditure could grow by EUR 497 million (compared to 2018).

3.3. General government revenue under a no-policy-change scenario

High interim growth in revenue, which was EUR 1,140 million (6.5 per cent) higher in 2017 than in 2016, is a reflection of a good situation in the Slovenian economy, since it contributed significantly higher amounts to the state budget in 2017. Revenue from taxes and social contributions rose overall by EUR 848 million or 5.7 per cent in 2017. The relatively high growth in collected taxes on income and profit, whereby most of the increase in revenue from corporate income tax is a result of the economic revival and better macroeconomic situation in the country. A favourable situation in the labour market, as well as measures taken to reduce the tax burden on labour contributed to the rise in employment and higher revenue from income tax and social security contributions. Good operations of companies in which the Republic of Slovenia has equity generated an increase in non-tax revenues from profit sharing. Units of the state which are not directly included in accounts of general government also positively affected general government balance.

Table 10: Revenue of the consolidated global account of general government, February 2018

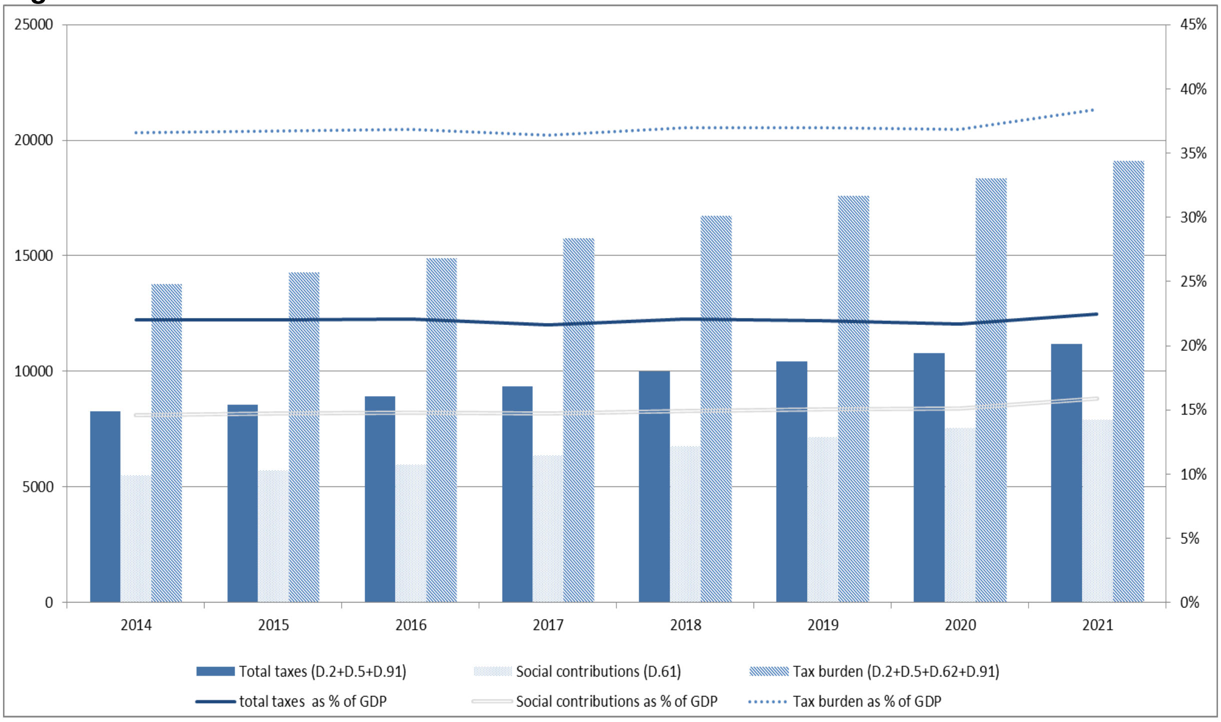
In EUR million	2016	2017 (prev.)	2017/2016 (year-on-year growth rate in %)	February 2018	Jan–Feb 2018	Jan–Feb 2018/ Jan–Feb 2017 (year-on-year growth rate in %)
REVENUE TOTAL	15,842.2	16,800.7	6.1	1,322.6	2,787.2	5.8
Tax revenues	14,240.5	15,158.5	6.4	1,245.0	2,620.9	8.1
Non-tax revenues	963.4	1,090.7	13.2	56.9	111.2	-27.6
Other revenues	638.3	551.6	-13.6	20.7	55.1	-5.2

Source: Ministry of Finance

The revenue of consolidated global accounts of general government grew year-on-year (2017 on 2016) by 6.1 per cent, with most of the increase being due to tax revenues (nominally, approximately EUR 960 million). The favourable trends continued in January and February 2018, since the consolidated revenue of accounts of general government amounted to EUR 2,787.2 million, and grew by 5.8 per cent compared to the same period last year. Tax revenues grew by 8.1 per cent, and amounted to EUR 2,620.9 million. Most of the rise in tax revenues arose from higher tax revenues in the state budget and increase in social contributions. On the other hand, non-tax revenues amounted to EUR 111.2 million in this period, and were down by 27.6 per cent compared to the same period last year. The reason lies in the exceptionally high other non-tax revenues in the state budget in January 2017 due to one-off accrued interest from issued bonds.

The increase in general government revenue is expected to continue, since a relatively favourable economic situation is expected in the coming years. The structure of tax revenues is not expected to change significantly, since it must be borne in mind that the adopted tax measures were prepared to pursue the main economic objective, i.e. fiscal consolidation within the scope of restructuring tax burdens (which is shown in the figure below, which shows taxes and tax burdens in the medium term as a percentage of GDP). Changes in the structure of tax revenues and the total amount of general government revenue in the future could be affected only by measures regarding a reduction in the extent of tax system abuses and more efficient tax collection. Measures adopted to reduce administrative burdens on liable persons who positively affect the business environment also contribute their share to efficient tax collection. A predictable, efficient and as neutral a tax system as possible is the basis for a stable business environment on the one hand and for healthy public finances on the other. Finally, improved transparency, simplicity and comprehensibility result in savings of monetary and non-monetary costs of taxable persons and tax authorities.

Figure 16: Tax and contribution burden in EUR and as % of GDP



Source: Ministry of Finance

- <u>Tax restructuring</u>

In 2017, efforts to implement measures which were used to continue working to improve the competitive image of the Slovenian business environment, the reduction of the burden on labour and the preservation of new jobs in Slovenia, as well as the generation of added value in Slovenia with knowledge individuals acquire abroad, creating high-quality jobs, were at the forefront in the tax field. The amended Personal Income Tax Act eliminated the gradual character of additional general income tax relief; introduced a special tax scheme for income from referral; regulated the reimbursement of costs related to temporary referrals of workers abroad as a result of the enforcement of the Transnational Provision of Services Act; increased relief on income from secondary school and university student work, and income paid as a reward for good business performance which is not subject to income tax. In addition to the adopted solution to include all effects of the revaluation and reclassification of all financial instruments in the tax base, the amended Corporate Income Tax Act introduced, as a result of changes in the International Financial Reporting Standards (IFRS) 9, a new provision to limit abuse in relation to the system for establishing the tax basis through flat-rate expenses, which pursued a similar solution within the new Personal Income Tax Act for persons liable for the payment of self-employment income tax.

Solutions within the amended Tax Procedure Act, which introduced non-cash payment of public charges and their payment without commission to an administrative or another authority, and the amended Fiscal Validation of Receipts Act, which provides liable persons with a free choice regarding the use of a tax invoice book when issuing invoices, contributed to additionally reducing administrative burdens and expenses.

Another step towards a better market value assessment system of real estate for tax purposes is the new Real Property Mass Valuation Act adopted in 2017. On this basis, valuation models will be upgraded or revised this year, so that values are adjusted to the latest situation in the real-estate market. This task will take a minimum of eighteen months. New generalised values will be determined in mid-2019, which means that data on values could be subsequently also used for tax purposes, but not prior to 2020.

Important changes in cooperation between countries with mandatory automatic exchange of information, which is an essential tool in combating tax avoidance and evasion, will contribute to that. In 2018 the Financial Administration of the Republic of Slovenia will commence in an exchange of information from Country Reports, which is important from the aspect of risk analysis of transfer prices. Slovenia signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting in June 2017, and ratified it in February 2018. The Convention will affect applicable bilateral double tax avoidance agreements, which it will include, by adjusting or redrafting them. Certain important solutions have been adopted recently to reduce the burden on labour, improve the administrative feasibility of the system and enhance the efficiency of public charge collection. However, work in this field must continue; key objectives will have to continue to be focused on boosting economic growth, and pursuing the stability of public finances and their sustainability in the long term. Nevertheless, systemic and general measures will have to be sought in the long term, and if the focus is merely on the pursuit of the objective of tax relief for labour, this requires consistent studying and preparation of suitable bases which would be used to pursue all of the aforementioned objectives. One important priority is clear, and Slovenia together with representatives of the OECD will manage the coordination of activities in relation to the review of broader policy on tax relief for labour within the Centre for Tax Policy and Administration. In view of the needs for systemic changes, key structural reforms will also have to be prepared, such as reforms of the pension system, the health-care system and the long-term care system, in which tax policy is only a minor element.

- Management of non-tax (and capital) revenue

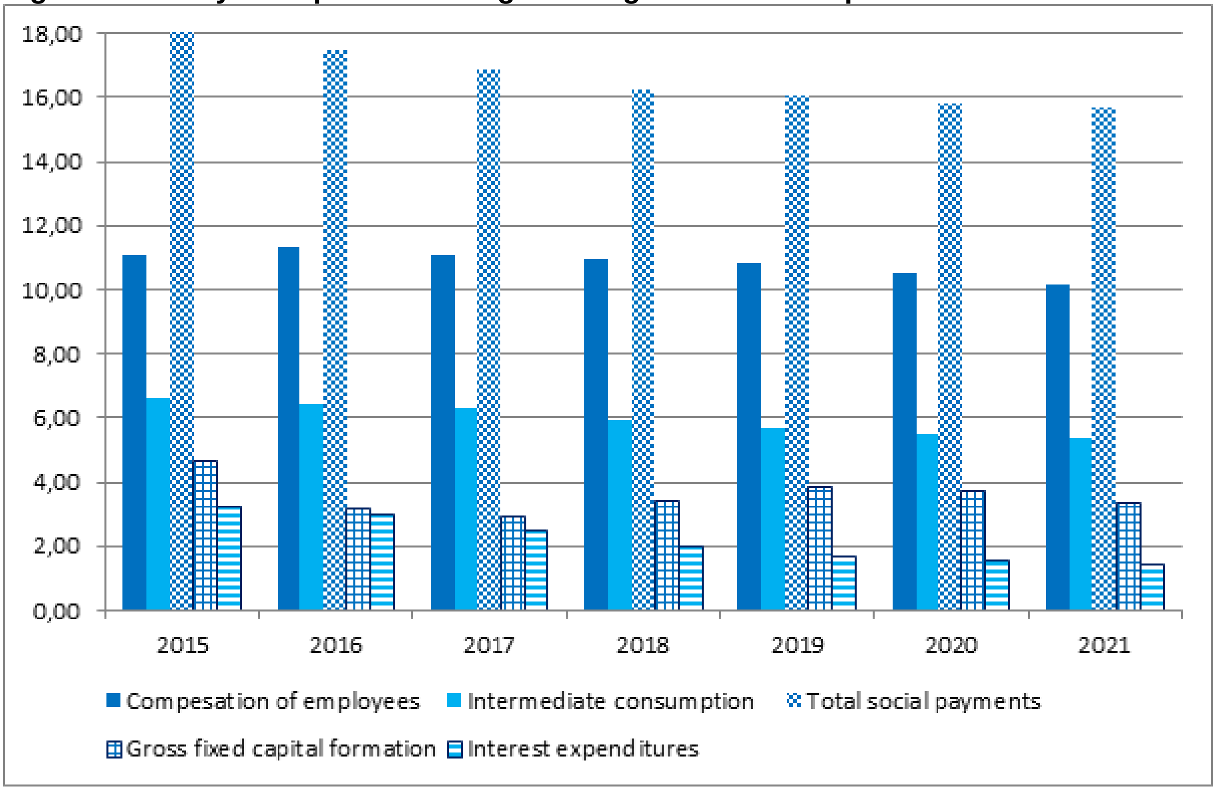
The Slovenian Sovereign Holding (SSH), as the manager of state-owned companies, will continue to ensure the conditions for the active management of investments in accordance with a multi-annual management plan (Capital Assets Management Strategy and the Annual Assets Management Plan) and for the achievement of expected returns on capital. The key objective of state asset management is to create a return on assets of 8 per cent per book value of equity in 2020. In the 2016 financial year, the SSH significantly improved the profit and loss of state-owned companies. The total return on capital of the Republic of Slovenia and the Slovenian Sovereign Holding amounted to 6.0 per cent in 2016, which is 1.3 percentage points more than in 2015. The financial year of 2016 was also successful from the viewpoint of dividends, which the companies paid in 2017. The companies owned by the Republic of Slovenia and managed by the Slovenian Sovereign Holding paid EUR 211 million in dividends for 2016, which was EUR 69 million or 49 per cent more than in the year before. From the share in the profits of companies in which it has equity shares, the Slovenian Sovereign Holding received EUR 46 million or EUR 2.1 million (4.8 per cent more than a year before). The growth in the profitability of equity points to the good management of state-owned companies, which is also reflected in the greater capacity of the companies to pay dividends and earmark part of their profits for growth and development.

The implementation of individual objectives of the Strategy is defined in the 'Annual asset management plan for 2018', which, *inter alia*, anticipates the sale of 14 state assets, including Abanka, d. d. Thoughtful privatisation in the segment of the state-owned company portfolio will thus be continued. In connection with asset management, the SSH and BAMC, especially in cases where the state is withdrawing from ownership, will pursue objectives related to ensuring company development, the preservation of jobs, retaining the company head office in Slovenia, respecting collective agreements and the employees' standard, respect for the Slovenian language and timely inclusion of employees' representatives in these procedures.

3.4. General government expenditure under the no-change scenario

From the aspect of total general government expenditure, government spending grew last year by EUR 346 million (1.9 per cent). This was partially a result of the favourable economic situation and partially of the preservation of measures to restrict expenditure growth. Funds for employees (4.6 per cent) and social benefits (3.2 per cent) contributed most to the rise in expenditure. In 2017, the state reduced interest expenditure (12.0 per cent), which amounted to EUR 1,073 million, which was 0.5 percentage points less than the long-term average of 3 per cent of GDP. The state's investments in fixed assets were relatively low. Compared to 2016, they dropped by 0.9 per cent; at the central level, they dropped by 7.0 per cent, while at the local level, they rose by 8.0 per cent. Compared to 2016, the volume of European funds drawn in the new financial perspective increased slightly, which was additionally confirmed by subsidy growth (by 2.5 per cent).

Figure 17: Key components of general government expenditure as % of GDP



Source: Ministry of Finance

General government expenditure in the amount of EUR 19.541 billion is planned for 2018, which is 4.8 per cent more than the realisation in 2017. Its share of GDP is thus reduced from 43.1 per cent to 42 per cent of GDP. The growth in general government expenditure in the share of GDP by the end of the medium term drops to 38.9 per cent of GDP even under a no-policy-change assumption This does not comply with the objective of attaining a gradual reduction in general government balance in addition to the planned higher revenue and taking into account the fiscal rule.

- Compensation of employees

In agreement with public sector unions, certain measures in the field of labour costs in the public sector, which halted growth or even, in certain years, reduced general government expenditure for this purpose, have been in place since 2009 to mitigate the effects of the economic crisis. These measures have been gradually relaxed as the economy has recovered. In 2018, lower premiums for collective supplementary pension insurance and holiday pay no longer apply; promotions do take place, but it was agreed that payments in 2018 would be delayed until December, and certain identified anomalies in the evaluation of workplaces are being eliminated in agreement with unions. Funds for employees in the structure of general government expenditure declined slightly in the programming period to below 11 per cent of GDP in 2018. However, year-on-year, they are still increasing by 6.9 per cent, while last year's increase was 4.6 per cent.

Measures in relation to regular work performance and increased workload will further be relaxed in 2019 and, in addition to regular promotions, growth is also affected by the elimination of the agreed delay of these payments. Additional funds for promotions are taken into account for 2020 and 2021, since no agreement has been reached with unions regarding other changes, and pay legislations does not determine an automatic rise, for example, of the adjustment formula (according to the law, a social agreement is required regarding the extent of adjustment). Due to the aforementioned, the increase in funds for labour costs, which, in addition to the aforementioned relaxed measures, is also affected by employment in the public sector and partially higher expenditure for police officers and medical practitioners (the result of a strike), has been evident in all years.

Regardless of the gradual relaxation of measures, certain measures or reductions (particularly those agreed in 2012) were permanent – these are reimbursements of work-related costs (transport, food, separation allowance, allowances, daily allowances) and particularly the reduction in the value of the pay scale by 8 per cent. Although these measures are permanent, unions have ben seeking negotiations/talks to have these rights restored to the pre-crisis level.

- Social benefits

According to the assessment, the volume of expenditure on social transfers (pensions excluded) will increase by 3.8 per cent in 2018 and by 5.1 per cent in 2019 under a no-policy-change assumption. This rise is largely a result of certain changes in the field of financial social assistance (pension support for a wider group of pensioners) and social benefits in kind (more beneficiaries of school meals, higher expenditure on medical products and medical technical devices). With the improved situation in the labour market, transfers for unemployed persons will drop by 12.8 per cent in 2018, and then by 5 per cent annually.

Higher growth in social benefits is also a result of the relaxation of legislation related to the following:

- the reactivation of the seventh and eighth income brackets for child benefits (an additional 50,000 children), paid 30-day paternity leave with parental allowance, EUR 280 of childbirth allowance (previously related to material threshold) and aid for the purchase of a vignette for large families. The effect of this relaxation is assessed at EUR 20 million;
- the group of children eligible for snack and lunch subsidies has also been expanding;
- the relaxation of legislation in the field of the right to financial social assistance (no notice on real estate), and expenditure on financial social assistance in 2017 were at approximately the same level as in 2016, but expenditure on income support rose by EUR 7.8 million, which is a consequence of 6,000 more receivers due to new arrangements with notice on real estate;
- a rise in minimum income by 11.34 per cent, which would amount to EUR 331.26 (EUR 297.53 so far), and the equivalent scale for financial social assistance and income support has also been changed.

Expenditure on pensions increased by 3.9 per cent in 2018 due to the agreed regular and extraordinary 1.15 per cent pension adjustment and according to the foreseen growth in the number of pensioners. The decision to pay an annual bonus to all pensioners also contributed to the increase. Pension adjustment is foreseen for 2018, pursuant to the Pension and Disability Insurance Act, i.e. according to the formula of 60 per cent of average wage growth and 40 per cent of inflation, which means an adjustment of 2.2 per cent (already taken place) along with an extraordinary adjustment of 2.2 per cent in April. At the same time, the payment of a “full” annual bonus in the amount of EUR 132 million is foreseen. Thus, pension costs will rise by a total of 3.9 per cent. Regular adjustment is foreseen for 2019 under a no-policy-change assumption.

- <u>Interest expenditure</u>

Interest expenditure, which fluctuated around 3 per cent of GDP in recent years, gradually decreased to 2.5 per cent in 2017, and according to assessments, will decrease to 2 per cent, and then gradually to the assessed level of approximately 1.5 per cent of GDP. Accordingly, active debt management and a gradual reduction of general government debt are foreseen.

- <u>Subsidies</u>

Granting subsidies will be stimulated again by initiating the drawing of funds of the European perspective. Most subsidies will be paid in agriculture, while the highest increase is expected in research, development and innovation, and employment in 2018 and 2019, when subsidies are expected to be at approximately 0.7 of GDP. A subsequent drop is expected with unchanged policies.

- <u>Gross investments in fixed assets</u>

Investments in fixed assets financed from public funds remained at the same level in 2017 as in 2016 (3 per cent of GDP), while in 2018, further growth by 25.7 per cent is anticipated with unchanged policies, which means that gross investments in fixed assets will amount to 3.4 per cent of GDP. In view of major declines in the past, growth is expected, since the level of gross investments from public funds is expected to be EUR 1.6 billion annually and still does not reach the pre-crisis level. It is also anticipated that the drawing of EU funds supporting 'classic' investments in support for 'soft content', i.e. investing in people, knowledge and development, will be redirected. Slovenia plans key investments in transport and transport infrastructure (national roads, railway infrastructure, train sets, sustainable mobility), energy (HPP on the Lower Sava River) and to establish a production zone for a major foreign investment.

Table 11: Forecast under a no-policy-change assumption

	ESA Code	2017	2018	2019	2020	2021
				as % of GDP		
Total revenues under no-policy-change	TR	43.1	42.3	41.7	40.8	39.8
Taxes on production and imports	D.2	14.2	13.9	13.4	13.1	12.8
Total expenditure under no-policy-change	TE	43.1	41.9	41.5	40.2	38.9
Funds for employees and intermediate government consumption	D.1+P.2	17.4	16.9	16.5	16.0	15.5
Social benefits	D.62+D.632	16.9	16.3	16.1	15.8	15.7
Net lending/net borrowing	**B.9**	**0.0**	**0.4**	**0.2**	**0.6**	**0.9**

Source: Ministry of Finance

From the aspect of a no-policy-change assumption, measures evaluated in 2018, the previous reduction in general government balance and planned higher revenue from 2018 may be summed up in table 10, which takes into account all of the aforementioned general government expenditure.

- Claiming one-off expenditure

In 2017, the one-off expenditure was EUR 40.4 million (settlement of unpaid old foreign-currency deposits which had been transferred in the 1990s to Croatian banks and paid to savers (unpaid deposits), payment of interest). It is assessed that one-off expenditure will remain at 0.1 per cent of GDP (in addition to the payment of interest on commitments to foreign-currency savers; and the lawsuit regarding the return of agricultural land is also taken into account) in 2018 due to lawsuits (denationalisation, investment dispute and others) and payments of liability interest related to foreign-currency savers, which is expected to double in 2017 in relation to 2016.

3.5. General government debt

Consolidated gross government debt at the end of 2017 amounted to EUR 31,860 million or 73.6% of GDP, which was EUR 107 million more than in 2016 when amounted EUR 31,753 million or 78.6% of GDP. Central government debt in 2017 amounted to EUR 31,294 million or 72.3% of GDP and represents the main decrease of government debt. Local government level debt amounted to EUR 777 million or 1.8% of GDP, which was EUR 4 million less than in 2016 when amounted EUR 781 million or 1,9 % of GDP. In 2017 social security funds generated a very low debt. It amounted to EUR 1 million.

Following the Public Finance Act, financing of the central government budget execution and debt management operations, in a given fiscal year allows the government to borrow, within a given fiscal year, for financing the deficit of central government budget including the Lending and Repayment Account deficit and financing debt repayments in the current and following two fiscal years. Due to favourable market conditions at debt capital markets in 2017 the Republic of Slovenia has used the possibility of pre-financing in a total amount EUR 382 million while following all the requirements from the SGP Debt rule.

After reaching its peak in 2015 with 82,6% GDP, the debt ratio fall to 73.6% of GDP at the end of 2017. In the next medium term, further decrease of general government debt is expected. With no privatization proceeds envisaged, the debt ratio is expected to fulfil the Maastricht debt level criteria at the end of 2021. The debt dynamics will be driven primarily by GDP growth and the central government debt movement. Local government debt is expected to remain at 2% of GDP.

Table 12: General government debt

as % of GDP	ESA Code	2017	2018	2019	2020	2021
Level of gross debt		73.6	69.3	65.2	61.5	58.3
Changes in gross debt		-5.0	-4.3	-4.1	-3.7	-3.2
Primary balance		2.5	2.4	1.9	2.2	2.3
Interest	**EDP D.41**	2.5	2.0	1.7	1.6	1.5
Adjustments (SFA)		0.3	1.3	0.3	0.4	0.8
Implicit interest rate		3.4	2.9	2.6	2.5	2.5

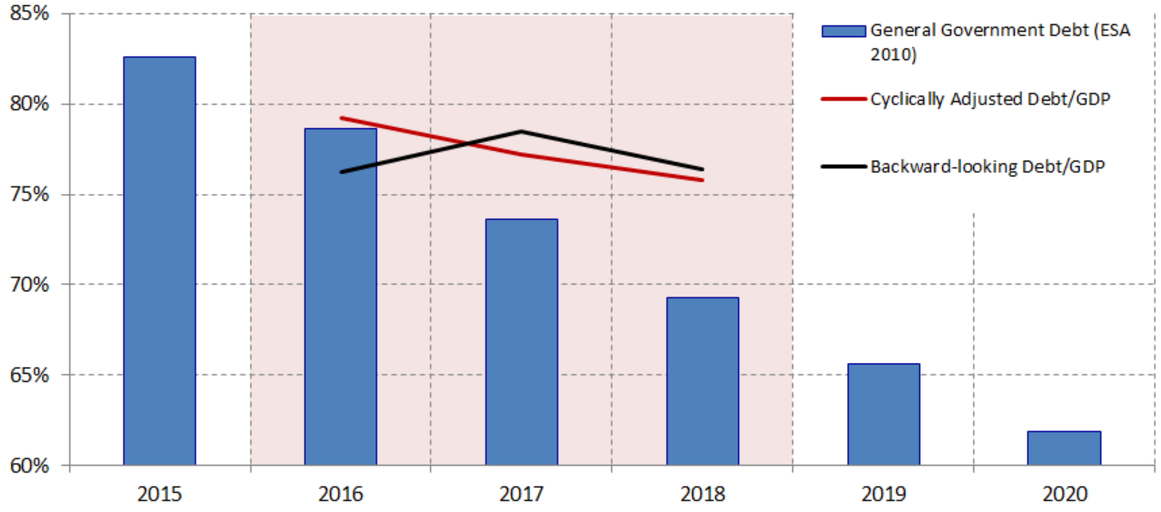
Source: Ministry of Finance, Treasury directorate

Member states, which exit excessive deficit procedure, need to comply with the diminishing debt rule, which states that a member state is non-compliant with the debt requirement, if its general government debt is greater than 60% of GDP and is not sufficiently diminishing and approaching 60% of GDP at a satisfactory pace. The concept of "sufficiently diminishing" and the "satisfactory pace" are defined in Regulation 1467/97 as being fulfilled, if the differential of the debt with respect to the reference value has decreased over the previous three years at an average rate of 1/20th per year as a benchmark. The Regulation then specifies three conditions under the Debt rule relating to various different benchmarks: backward-looking measure; forward-looking measure and cyclically adjusted debt to GDP ratio.

Since the Republic of Slovenia exited EU excessive deficit procedure in 2015 with deficit of 2.9% and with achieving the peak of general government debt of 82.6% of GDP, it now needs to comply with the EU rules tackling excessive debt procedure.

While transitional arrangements are in place until end 2018, the projections in figure below show that the debt rule would be met from 2016, i.e. the debt ratio would be below the forward-looking debt benchmark. The benchmark for 2016 requires a forecasted debt to GDP ratio in 2018 (69,3 % of GDP) to be lower, which is fulfilled. Forward-looking benchmark uses forecasts made by the European Commission on the basis of unchanged policies. As it is shown below from 2017 on, both the actual and cyclically adjusted debt ratios comply with the backward looking benchmark.

Figure 18: Development of general government debt (as % of GDP) from SGP Debt rule perspective



Source: Ministry of Finance, Treasury directorate

4. QUALITY OF PUBLIC FINANCES and IMPACT OF STRUCTURAL REFORMS

The key objective of the country's future economic policy must be to provide conditions for maintaining sustainable economic growth without overheating, and with a special emphasis on measures which ensure an increase in added value per employee. With this approach, the completion of gradual fiscal consolidation may be assured, and the conditions and fiscal space may be created to increase the resilience and absorptive capacity of the economy to mitigate the effects of the next turn in the business cycle. Further measures to make public finance transparent must be planned, including an efficient or measurable target-oriented use of public funds. With a timely reform of the pension system and prompt reform of the health system and the long-term care system, these measures address the key long-term public finance challenges of the ageing population. Therefore, key measures of the future economic policy of the state should be aimed at improving the Slovenian business environment to ensure greater competitiveness to support an export-oriented open economy; determining priority areas for public investments financed from national and European funds, and priority areas to support private investments; eliminating discrepancies between the results of the educational system and the needs of the business sector, and enhancing investments in development, research and innovation in accordance with the Skills Strategy; preparing suitable policies concerning the labour market, including a target-oriented policy for the young and the elderly.

Another of Slovenia's priorities is a levelled structural balance of the general government sector in 2020, when the medium-term objective is attained, and thus the commitments of the Fiscal Rule Act. With the adoption of the state budget, development-oriented gradual fiscal consolidation has been continued in 2018, and in accordance with the adopted priorities, policies and projects in the field of infrastructure, health, security and science are at the forefront. More emphasis will also be placed on utilising refundable funds in the form of financial instruments. A surplus of 0.4 per cent of GDP was planned in the 2018 Draft Budgetary Plan, whereby it is strictly determined that expenditure growth lags behind the growth in revenue. According to Slovenia, speedier consolidation is not suitable, since it may jeopardise the planned economic growth. Planning further consolidation policies, suitable measures etc. will be tasks for the new government (2019 and beyond).

By amending the Public Finance Act[10] linked with medium-term planning of fiscal policy, two new documents are being introduced, i.e. the National Development Priority Programme and the Medium-term Fiscal Strategy, combined in the Framework for preparing the general government budget (hereinafter: the framework) and the Stability Programme. On the basis of relevant documents, the drafting of the framework for preparing the budget and later the preparation of the state budget will be slightly delayed. However, the added value lies particularly in the fact that the framework and the state budget will be drafted in compliance with the requirements of the regulations of the European Union (consistent and full transposition of Council Directive 2011/85/EU on budgets), harmonisation with the Constitution in the operative sense, and the act adopted on its basis[11].

Health system

The new Health Care and Health Insurance Act was drafted in 2016, and submitted for public discussion and the opinion of social partners at the beginning of 2017. Harmonisation of the proposed act with representatives of the Economic and Social Council and other key stakeholders continued in the same year. At the beginning of 2018, the proposed act was submitted to the Economic and Social Council and the coalition partners. The proposed act would affect the operations of the Health Insurance Institute of Slovenia (ZZZS), the arrangement of rights and obligations arising from compulsory health insurance, procedures for exercising rights, and the package and standards of rights. It also affects fields referring to the management of occupational diseases and recourse claims. A significant section of the proposals refers to the manner and sources of financing, such as the unification of the insurance base, contribution rates and categories of insured persons. Meanwhile, the financing of certain expenditure currently paid by the ZZZS will gradually be transferred to the state budget by 2021 (amendments to the Medical Practitioners Act).

In 2017, the Act Determining Intervention Measures to Ensure the Financial Stability of Public Healthcare Institutions (at the secondary and tertiary levels) was passed, which also anticipates the reorganisation of public hospitals in addition to one-off measures for immediate financial recovery. For this purpose, 15 public hospitals received EUR 136 million of budgetary funds to settle overdue liabilities and pay off certain loans. All hospitals which received the funds must audit the use of these funds by the end of May 2018. At the same time, a reconstruction process with reconstruction managements, which are responsible for preparing and implementing restructuring programmes, was introduced in these hospitals (with simultaneous health-care services quality assurance by December 2021).

[10] Public Finance Act (ZJF-H) (Official Gazette of the Republic of Slovenia [*Uradni list RS]*, No. 13/2018).
[11] The Stability and Growth Pact, the Constitution of the Republic of Slovenia and the Fiscal Rule Act.

In cooperation with the European Commission's Structural Reform Support Service, certain projects will be implemented in 2018. One of the most important is a two-year project, 'Planning and managing the public health-care service network'. The purpose of the project is to prepare tools and establish mechanisms for managing the public health-care service network from the viewpoint of fair access, the changing needs of the population, high-quality and safe health care and the rational use of resources.

Long-term care

The ageing of the population is one of Slovenia's main long-term challenges, within which long-term care is being arranged comprehensively. The new systemic arrangement of this field was prepared in 2017 in the proposed Act on long-term care and insurance for long-term care. The proposal pursues basic objectives, such as access to high-quality services, sustainable financing, comprehensive treatment of patients, promotion of care at home or in the community. In 2017, preparations also started for the implementation of pilot projects, which will commence in 2018 within the framework of which the proposed legislative solutions regarding long-term care will be tested in three pilot environments (urban, rural and semi-rural) in Slovenia's eastern cohesion region. The projects will be supported by the European Social Fund. The testing will involve essential tools for assessing eligibility, new services and coordination between all the principle participating stakeholders. Social partners will be promptly informed of the results. In certain sections, the preparation of pilot projects is also supported by the Structural Reform Support Service of the European Commission.

Pension system

The positive effects of pension reform from 2013 and economic growth have been continuing with a slow rise in the number of newly retired persons, the extension of the period of contribution payment and the raising of the actual retirement age (see also Table 17). In recent years, the number of all new old-age pensioners was reduced from 29,914 persons in 2012 to 13,274 persons in 2017 (initial assessment of information). The rate of increase in the average number of old-age pensioners is lower than the increase in previous years. In 2017, the rate of increase of all old-age pensioners was 1 per cent (approximately 4 per cent prior to 2014). The actual average retirement age for new pensioners has also been rising. In 2017, the average age of women upon retirement was 60 years and 2 months, which is 1 year and 8 months more than in 2013. For men, the age has increased since 2013 by 1 year and 2 months to 62 years and 1 month in 2017. Thus the recent reform prevented retirement at the age of 61 for women and 63 for men with 20 years of employment, and a suitable system of rewards was introduced for people continuing to work (a bonus system for postponing retirement, 20% of pension if meeting the conditions and remaining active). The number of people taking advantage of these bonuses has been rising over the years. The reduction of early retirements (deductions in the case of early departure from the labour market) also affects the increase in the retirement age. Life expectancy is forecast to continue to show a rising trend. The ratio between the number of insured persons and compulsory insurance pension recipients is also improving, and has increased from 1.38 in 2013 to 1.49 in 2017. Increased employment and the subsequent inclusion of younger categories of insured persons in the pension and disability insurance system on the basis of student work also had a positive effect on the increase in the ratio.

In mid-2017, following the adoption of the White Paper on Pensions[1], the Economic and Social Council adopted the 'Starting points for the renewal of the pension and disability insurance system'. The joint starting points set out, among other things, a suitable amount of pension and financial sustainability for the public pension system as two equivalent objectives. Social partners agree that an additional increase in the actual retirement age is necessary, and simultaneous measures in the labour market which contribute to the early employment of young people and prolonged activity of the elderly. The objective of the document is to adopt new legislation in this field by the end of transitional periods of the current pension legislation (by 2020). A project[1] is in progress which analyses potential measures to include individuals more intensively in supplementary pension insurance. In relation to demographic trends, the Government of the Republic of Slovenia adopted the Strategy for a Long-Lived Society (see Chapter 6), and the harmonisation of the establishment of a demographic reserve fund took place in 2017. The purpose of the fund is to co-finance compulsory pension and disability insurance by managing own assets, the assets of pension funds and additional finance after a certain period. In the field of occupational pension insurance, a model to monitor risks to which workers working in difficult and harmful workplaces are exposed is expected to be developed. A new Resolution on a national programme for health and safety at work is being adopted, which will contain measures that positively affect the extension of people's labour activity.

5. SENSITIVITY ANALYSIS

5.1. Sensitivity analysis of general government balance to movements of GDP

The possibility of GDP growth higher than forecast may be a consequence of higher growth in investments and private consumption in the domestic environment. Growth may be negatively affected by the consequences of demographic trends, on which the dynamics of growth will also depend. GDP growth lower than estimated may be a consequence of negative risks in the international environment related to protectionist measures, the high valuation of assets on financial markets, the result of the exit of the United Kingdom from the EU and other global geopolitical tensions (IMAD, 2018).

The sensitivity analysis displays possible fluctuations in general government balance relating to fluctuations in economic activities. The analysis foresees higher or lower economic growth from the basic forecast used in the Stability Programme calculations. The first scenario assumes economic growth higher than 0.5 of a percentage point per year in the period from 2018–2021. The second scenario anticipates lower economic growth, by 0.5 of a percentage point. In the case of higher GDP growth, the general government balance would improve by 0.17 of a percentage point of GDP in 2018 and by 0.63 of a percentage point of GDP in 2021. Lower economic activity could cause the general government balance to worsen in comparison with the basic scenario. In 2018, the balance would decrease by 0.17 of a percentage point of GDP or 0.65 of a percentage point in 2021.

[1] The project is being carried out with the support of the Structural Reform Support Service of the European Commission.

Table 13: Sensitivity analysis of general government balance to GDP movements (deviations from the basic projection)

	2018	2019	2020	2021
GDP growth reduced by 0.5 of a percentage point				
Deficit/surplus	0.18	-0.16	0.09	0.22
Deviation from the basic projection	-0.17	-0.34	-0.50	-0.65
GDP growth increased by 0.5 of a percentage point				
Deficit/surplus	0.52	0.52	1.08	1.51
Deviation from the basic projection	0.17	0.34	0.49	0.63

Source: Ministry of Finance

Note: The analysis foresees 0.99 per cent sensitivity of revenue (in relation to revenue from taxes and social contributions) and -0.04 per cent sensitivity of expenditure. The GDP deflator, derived from the 2018 Spring Forecast, remains constant in both scenarios.

5.2. Debt sensitivity analysis

Basic influence on the level of borrowing costs and costs of servicing the existing debt in the future is expected to come from ECB monetary policy through quantitative easing program (PSPP), the level of ECB main refinancing operations fixed rate (0%), which is expected to stay such at least by the end of the year 2018, and deficit volumes of the state budget. In the sensitivity analysis we assume that the ECB will keep the interest rate at the current level in the near future, followed by a gradual increase. The impact of the term structure of interest rates is already embedded in the baseline scenario and additionally increased by 0.5 percentage points in the sensitivity analysis

In case that the ECB interest rate increases by 0.5 percentage points in 2018, this leads to an increase of costs of new borrowing by 0.0245 percentage points of GDP in 2019 and 0.0267 percentage points of GDP in 2020. In this case the state budget debt would increase by 0.0282 percentage points in 2019 and 0.0172 percentage points in 2020. In case that the government deficit increases by 1 percentage point in 2018, the interest costs as a percentage of GDP would increase by 0.0211 percentage points in 2019 and 0.0222 percentage points in 2020.

Table 14: Sensitivity of interest payments and debt repayments of the state budget (in % of GDP)

	Change in ECB interest rate		Change in deficit		Change in ECB interest rate and deficit	
	Interest	**Debt**	**Interest**	**Debt**	**Interest**	**Debt**
Year	In percentage points					
2018	0.0000	0.0000	0.0000	1.0000	0.0000	1.0000
2019	0.0245	0.0282	0.0211	0.9391	0.0456	0.9673
2020	0.0267	0.0172	0.0222	0.8889	0.0489	0.9060
2021	0.0172	0.0229	0.0244	0.8889	0.0416	0.9118

Source: Ministry of Finance, Treasury directorate

In October 2012, May 2013 and February 2014 Republic of Slovenia issued all together 9.25 billions US dollar bonds while at the same time executed USD-EUR cross currency swaps to fully hedge (i.e. for interest and principal repayments) against the exchange rate risk. Since 2016 the Ministry of Finance has carried out liability management transactions of buying back US dollars bonds (i. e. 55,1 % of the total USD debt portfolio exposure). Simultaneously, a cheaper euro bonds were issued to facilitate buybacks with a significant interest savings for the state budget and ultimately with the overall positive net present value of the carried out transactions.

The impact of change in the floating interest rate to the existing state budget debt, expressed as a percentage of GDP, is minimal as the bulk of government debt has fixed interest rate, thus the change in interest rate affects primarily new borrowing. The share of debt with fixed interest rate is estimated at 98.9% in 2018.

5.3. Risks for fiscal forecast

- Risk assessment matrix

The risk assessment matrix states the most likely risks and the probability assessment that could have an impact on the estimated economic growth. Table 14 also shows certain fiscal risks arising from the domestic environment which could threaten fiscal objectives.

Table 15: Deviation of the risk assessment matrix from the forecast economic growth

Risk	Probability	Impact
International environment		
Consequences of changes in the ECB monetary policy	Medium	Changes in monetary policy and the reference interest rate of the ECB could affect the economy.
New protectionist measures in the USA	Medium	New protectionist measures in the USA could affect the EU and Slovenia, which could be reflected in GDP growth rate.
Result of Brexit negotiations	Low	Unpredictable results of the exit of the UK from the EU, which could affect the Slovenian economy.
Domestic environment		
Pressures to increase wages	High	The requirement to increase wages in the public sector may result in an increase in funds for wages higher than forecast.
Pressures to adopt other measures related to pensions and the elimination of austerity measures.	Medium	The adoption of long-term measures could affect the revenue and expenditure of the budget, resulting in a deviation from the fiscal balance objective.
Elections to the National Assembly	High	Elections to the National Assembly will be held in 2018, and there is high uncertainty regarding future measures.
Uncertainty regarding measures to deal with demographic changes	Medium	Measures which will reduce pressure on public finances due to the ageing population in the long term are crucial. In the medium term, a forecast of measures could affect public finances.
Risk	Probability	Impact

Source: Ministry of Finance

The main negative risks arising from the international environment are related to the measures of central banks, particularly from the aspect of expectations due to more restrictive monetary policy. Further risks arising from the international environment are related to the unpredictability of the consequences of Brexit and protectionist measures of the USA. In the domestic environment, risks are related particularly to pressures to increasing wages and other measures, and uncertainty stemming from the elections to the National Assembly and local elections in 2018.

- Guarantees

According to the Constitution, the granting of guarantees in the Republic of Slovenia is possible only by virtue of a law. In the system of guarantees of the Republic of Slovenia, two types of acts have been developed, general and special. A general act regulates the granting of government guarantees to a wider range of recipients. The Act Governing Rescue and Restructuring Aid for Companies and Cooperatives in Difficulty is an example of a general act. Special acts are intended for specific recipients, e.g. the acts on guarantees to Družba za avtoceste v Republiki Sloveniji, d.d. (Motorway Company of the Republic of Slovenia), Slovenski državni holding, d.d. (Slovenian Sovereign Holding), etc.

The Republic of Slovenia may issue government guarantees to public or private sector entities. Most of the guarantees in the private sector were granted to companies in difficulties. Relatively high levels of this type of guarantee were being called on, while no guarantees for the public sector are being called on. The issuing of government guarantees of the Republic of Slovenia is regulated by the provisions of a systemic act. The annual quota is set by the act governing the execution of the state budget, while the state may issue guarantees also outside the quota if this is permitted by an individual act.

The balance of guarantees of the Republic of Slovenia as of 31 December 2017 is EUR 6,255 million, of which the balance of government guarantees for the liabilities of financial sector (S 12) is EUR 669 million.

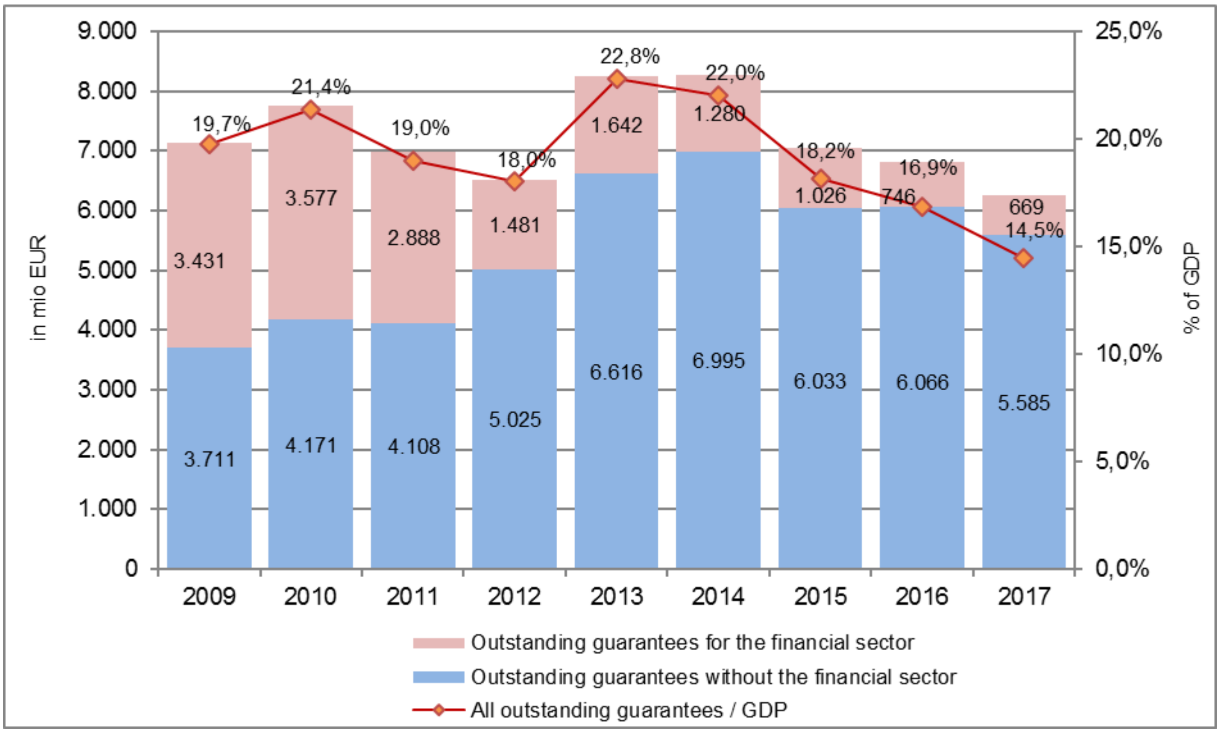
Table 16: Projection of the balance of guarantees of the Republic of Slovenia for the 2018–2021 period

	Balance as of 31/12/2018*		Balance as of 31/12/2019*		Balance as of 31/12/2020*		Balance as of 31/12/2021*	
	in EUR million	as % of GDP	in EUR million	as % of GDP	in EUR million	as % of GDP	in EUR million	in EUR million
Guarantees of the Republic of Slovenia	5,812	12.5%	5,375	10.8%	5,002	9.5%	4,544	8.7%
including: financial sector*	669	1.4%	669	1.3%	669	1.3%	669	1.3%

Source: Ministry of Finance

*Note: * In accordance with SKIS classification, legal entities with a SKIS mark S12 are included.*

Figure 19: Balance of guarantees of the Republic of Slovenia for 2008-2017



Source: Ministry of Finance

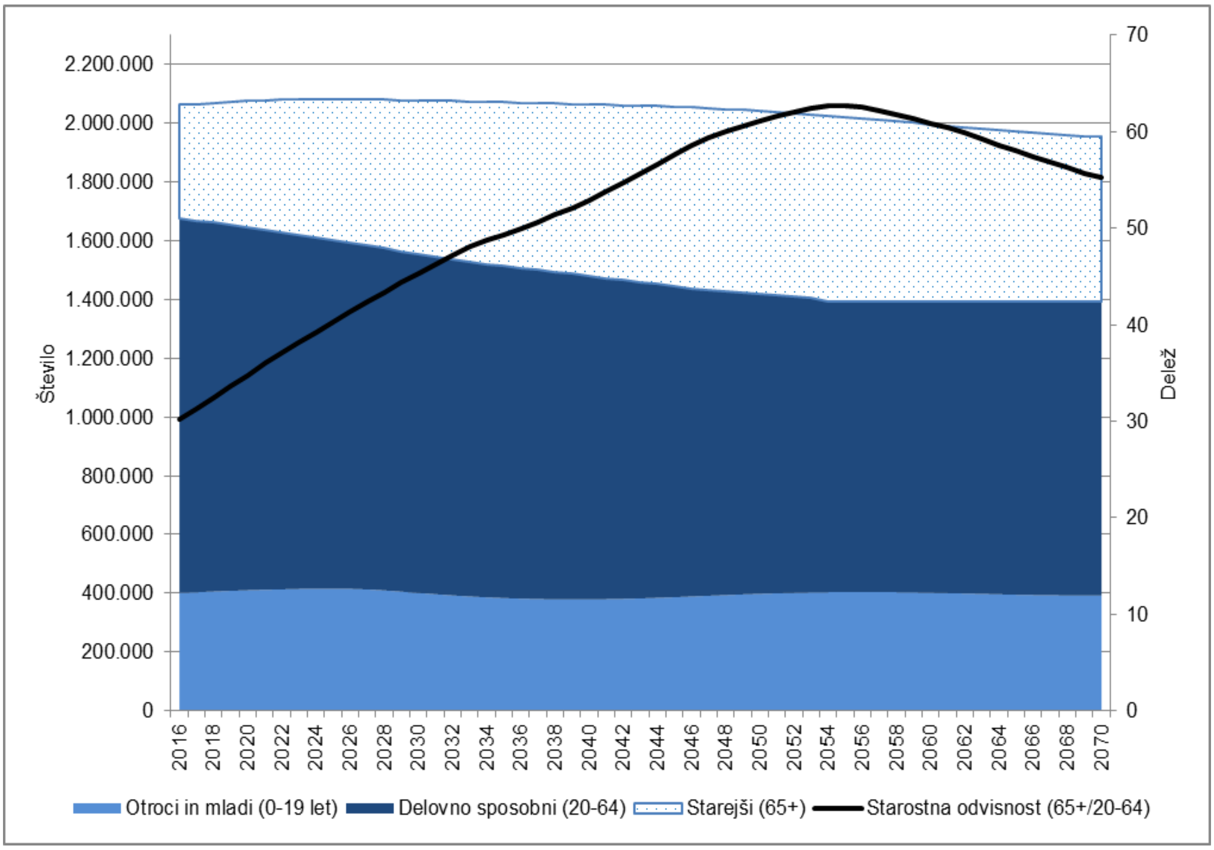
The data in Table 16 show the assessment of the balance of guarantees of the Republic of Slovenia at the end of the year, which was prepared on the basis of certain assumptions relating to the repayment of existing guarantees and approvals of new ones. The planned quota for new guarantees for 2018 pursuant to the Implementation of Republic of Slovenia's Budget AAct is EUR 500 million, and a separate EUR 350 million for guarantees of SID bank, d.d. The experience from previous years shows that the actual use of the quota is low: only 5.7 per cent in 2015 and 14.8 per cent in 2016, while it was not used at all in 2017, since all guarantees allocated to refinance existing obligations were issued in this year. The quota allocated for SID Bank d.d. was not used at all.

In 2017, EUR 0.54 million were used to call on government guarantees of the Republic of Slovenia pursuant to the Act on the Natural Persons Guarantee Scheme of the Republic of Slovenia and the Act Governing the Rescue and Restructuring Aid for Companies in Difficulty. In 2018, the use of funds in the amount of EUR 3 million is anticipated and EUR 3.6 million in 2019.

6. LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES

Demographic projections and expenditure, and related reform challenges are the key elements of further development and the long-term sustainability of public finances. According to demographic projections, the population structure will undergo major changes.

Figure 20: Population structure in Slovenia according to ESSPOS2015 and ageing index



Source: Eurostat, own calculations

While the share of children and young people (aged 0–19) will remain virtually unchanged, the share of the elderly (aged 65 and over) will increase by over a half between 2016 and 2070 (from 18.6 per cent to 28.3 per cent). The share of the elderly will rise due to a growing number of people in the generation born between World War II (baby-boom generation) and 1980 (when the fertility rate was still high) and due to the rapid rise in life expectancy. On the other hand, the share of working-age population (aged 20–64) will drop by approximately 17 per cent (from 62 per cent to 51.2 per cent of the whole population). The age dependency ratio, which shows the ratio between dependent and working age population, will double. In view of previous population projections (EUROPOP2013), Eurostat reduced the assumption on net migration, which additionally increased the level of age dependency. After 2060, demographic pressure will slightly decline (Figure 20).

Table 16: Long-term sustainability of public finances (base year 2016)

as % of GDP	2016	2020	2030	2040	2050	2060	2070	Difference 2070-2016
Total general government expenditure	41.5	41.0	43.7	48.9	55.5	61.0	66.2	24.8
Total age-related expenditure	21.9	22.1	24.0	26.7	28.9	28.9	28.3	6.4
Pensions	10.9	11.0	12.0	14.2	15.6	15.2	14.9	3.9
Old-age and early pensions	8.3	8.5	9.4	11.1	12.3	12.0	11.9	3.5
Disability pensions	1.3	1.2	1.3	1.5	1.7	1.6	1.5	0.2
Other pensions	1.3	1.3	1.3	1.5	1.6	1.6	1.5	0.2
Health care	5.6	5.8	6.3	6.7	6.8	6.8	6.7	1.0
Long-term care	0.9	1.0	1.2	1.5	1.8	1.9	1.9	1.0
Education	4.0	4.0	4.2	4.1	4.5	4.7	4.6	0.6
Unemployment	0.4	0.3	0.3	0.3	0.3	0.3	0.3	-0.1
Wage compensations	0.4	0.3	0.3	0.3	0.2	0.2	0.2	-0.1
Subsidies	1.0	1.0	1.0	1.0	1.0	1.0	1.0	0.0
State investments	2.4	2.4	2.4	2.4	2.4	2.4	2.4	0.0
Total primary expenditure	38.8	38.7	40.5	43.4	45.7	45.8	45.2	6.4
Interest expenditure	2.7	2.3	3.2	5.5	9.8	15.3	21.1	18.4
Total general government revenue	39.8	**39.3**	**39.0**	**38.5**	**38.1**	**38.1**	**38.1**	**-1.7**
Assumptions								
Labour productivity growth	0.3	1.6	2.1	1.9	1.8	1.7	1.5	1.2
Real GDP growth	2.50	1.25	1.58	1.28	1.25	1.61	1.45	-1.05
Real GDP growth per inhabitant	2.40	1.25	1.58	1.28	1.25	1.61	1.45	-0.95
Male activity rate (20-64 years)	79.3	81.3	81.3	80.4	81.4	82.1	81.4	2.1
Female activity rate (20-64 years)	72.2	75.5	77.5	76.7	77.7	78.2	77.4	5.2
Total activity rate (20-64 years)	76.1	78.5	79.5	78.6	79.6	80.2	79.4	3.3
Unemployment rate	9.0	6.7	5.9	5.9	5.9	5.9	5.9	-3.2
Share of population aged 65 years or more	18.2	20.7	25.2	28.3	30.6	30.2	28.5	10.3

Source: EC – EPC 2018 Ageing Report (forthcoming), Ministry of Finance, Institute for Economic Research.

Table 16 shows long-term projections of general government revenue and expenditure by 2070. The aforementioned Eurostat population projections and macroeconomic assumptions, as well as projections for the labour market by the European Commission[12], used in the drafting of the new 2018 Ageing Report[13] were taken into account. Age-related expenditure projections in the table are the same as, or very similar to, new EC projections which will be published in the 2018 Ageing Report.

In addition to demographic pressures, the increase in age-related expenditure is attributable to low projections of activity levels and the employment rate of the elderly, which are the lowest among all EU Member States. In addition, Slovenia is characterised by a low average

[12] EC (2017), The 2018 Ageing Report, Underlying Assumptions & Projections Methodologies, Institutional Paper 065, November 2017, https://ec.europa.eu/info/sites/info/files/economy-finance/ip065_en.pdf.
[13] EC – EPC 2018 Ageing Report (forthcoming)

age of people exiting the labour market. Therefore, the aforementioned rise in life expectancy prolongs the retirement period, which is the key factor in high expenditure on pensions expressed as a percentage of GDP (taking into account the provisions of the existing pension system).

In comparison with previous projections, the positive economic activity and labour market trends, and lower number of new pensioners in recent years due to the effects of the pension reform reduced age-related expenditure (as a percentage of GDP) at the beginning of the projection period and in the medium term. In addition to demographic factors, the rapid increase in expenditure on health and long-term care is also affected by non-demographic factors, such as technological progress and rising demand for high-quality health and long-term care in addition to GDP growth per capita and the rise in relative prices. Between 2016 and 2070, the pressure on public expenditure on education is also expected to rise for demographic reasons. An increase in the number of people enrolled in education is anticipated. Expenditure is expected to grow at all levels of education.

The results of projections point to the need for further structural reforms which will have to upgrade the existing pension insurance, health and long-term care systems, and adjust the training and education system. Otherwise, general government expenditure for this purposes will gradually crowd out expenditures for other areas.

Regarding changes in the age structure of the population, the Government of the Republic of Slovenia adopted the Strategy for a Long-Lived Society. The Strategy for a Long-Lived Society is based on the concept of active ageing, which emphasises activity and creativity in all stages of life, care for health, intergenerational cooperation and solidarity. The Strategy comprises four pillars, with guidelines for action (employment/activity; independent, healthy and safe life of all generations; inclusion in society and creation of an environment for activity throughout life). This year, the Government of the Republic of Slovenia established the Active Ageing and Intergenerational Cooperation Council. The Council is responsible for the coordinated and harmonised functioning of all stakeholders in this field, adopts guidelines for implementing the Strategy and monitors the realisation of the Strategy. Action plans with measures for implementing the Strategy are being prepared.

7. ANNEXES

Table 1.a: Economic growth and related indicators

	Rate of change in %	ESA Code	2017 level	2017	2018	2019	2020	2021
			million EUR					
1.	Real GDP	B 1 g		5.0	5.1	3.8	3.2	3.0
2.	Nominal GDP	B 1 g	43,278	7.1	7.6	6.5	5.6	5.3
	Real GDP components							
-3.	Private consumption	P3	22,844	3.2	3.6	3.0	2.0	2.0
4.	Government consumption	P3	7,908	2.3	1.7	1.4	1.1	0.9
5.	Gross fixed capital formation	P51	7,994	10.3	10.0	8.5	7.5	7.5
6.	Changes in inventories and net acquisitions of valuables (as % of GDP)	P52+ P53	353	0.8	0.9	0.8	0.8	0.8
7.	Exports of goods and services	P6	35,579	10.6	9.2	7.5	6.8	5.9
8.	Imports of goods and services	P7	31,400	10.1	9.3	8.1	6.9	6.4
	Contribution to real GDP growth (in percentage points)							
9.	Domestic consumption		39,099	3.7	4.2	3.5	2.7	2.8
	including: Changes in inventories and net acquisitions of valuables	P52+ P53	353	-0.2	0.1	0.0	0.0	0.0
10.	External balance of goods and services	B11	4,180	1.3	0.9	0.3	0.5	0.2

Source: SURS, Spring Forecast 2018, IMAD.

Table 1.b: Price developments

	Rate of change in %	2017	2018	2019	2020	2021	2022
1.	GDP deflator	2.0	2.4	2.6	2.3	2.2	2.2
2.	Private consumption deflator	2.6	1.8	2.0	2.1	2.1	2.1
3.	Consumer Price Index (average of the year)	1.4	1.5	1.9	2.3	2.3	2.3
4.	Public consumption deflator	2.0	3.2	4.0	3.1	3.0	3.0
5.	Gross fixed capital formation deflator	2.0	2.4	2.4	2.2	2.2	2.2
6.	Export price deflator (goods and services)	2.5	1.4	1.4	1.2	1.3	1.3
7.	Import price deflator (goods and services)	3.0	0.9	1.1	1.0	1.3	1.3

Source: SURS, 2018 Spring Forecast, IMAD.

Table 1.c: Labour market developments

		2017 level	2017	2018	2019	2020	2021
		in 000					
1.	Employment (number of employed)[1], growth in %	986	2.8	2.4	1.5	0.8	0.5
2.	Employment by hours, growth in %	1,632,646	2.1	2.6	1.7	1.0	0.8
3.	Unemployment rate according to labour force survey, in %	67.9	6.6	5.3	4.6	4.2	4.0
4.	Labour productivity[2] (per employee), growth in %	43.9	2.2	2.7	2.2	2.4	2.5
5.	Compensation of employees[3], in EUR million, growth in % (D.1)	21,112	6.0	7.7	6.7	5.5	5.4
6.	Compensation per employee[3, 4], growth in %	21.402	3.2	5.2	5.1	4.7	4.9

Notes: [1] Employed population, national accounts definition (domestic concept). [2] Real GDP is taken into account, [3] Nominal growth. [4] Full-time employees are taken into account. Source: SURS, Spring Forecast 2018, IMAD.

Table 1.d: Sectoral balances

as % of GDP	ESA code	2017	2018	2019	2020	2021
Net lending/borrowing	B.9 (S.1)	6.1	N/A	N/A	N/A	N/A
of which:						
Import and export balance of goods and services	B.11	9.7	10.2	10.3	10.5	N/A
Balance of primary incomes and current transfers	B.12	-2.9	N/A	N/A	N/A	N/A
Capital account	D.9 (rec-pay)	-0.7	N/A	N/A	N/A	N/A
Net lending/borrowing of the private sector	B.9 (S.1-S.13)	6.1	N/A	N/A	N/A	N/A
Net lending/borrowing of the general government	B.9 (S.13)	0.0	0.4	0.2	0.6	0.9
Statistical discrepancy		N/A	N/A	N/A	N/A	N/A

Source: SURS (publication of 30 March 2018), Ministry of Finance, 2018 Spring Forecast, IMAD.

Table 2.a: General government budgetary prospects

		ESA Code	Level 2017	2017	2018	2019	2020	2021
			million EUR			*% GDP*		
	Net lending/borrowing (EDP B.9) by subsector							
1.	General government	S.13	13.4	0.03	0.35	0.18	0.59	0.88
2.	Central government	S.1311	-66.9	-0.15	0.21	0.12	0.51	0.78
3.	State government	S.1312	…	…	…	…	…	…
4.	Local government	S.1313	30.0	0.07	0.11	0.12	0.12	0.12
5.	Social security funds	S.1314	50.4	0.12	0.03	-0.05	-0.03	-0.03
	Total general government (S.13)							
6.	Total general government revenue	TR	18,658.5	43.11	42.30	41.66	40.79	39.75
7.	Total general government expenditure	TE	18,645.1	43.08	41.94	41.48	40.20	38.88
8.	Net lending/net borrowing	EDP B.9	13.4	0.03	0.35	0.18	0.59	0.88
9.	Interest expenditure	EDP D.41	1,073.1	2.48	2.00	1.68	1.56	1.45
10.	Primary balance		1,086.6	2.51	2.35	1.86	2.16	2.32
	Selected components of revenue							
12.	Total taxes (12a + 12b + 12c)		9,365.1	21.64	21.44	21.02	20.61	20.27
a.	Taxes on production and imports	D.2	6,135.3	14.18	13.86	13.43	13.05	12.75
b.	Current taxes on income and wealth	D.5	3,217.6	7.43	7.56	7.56	7.53	7.50
c.	Capital taxes	D.91	12.2	0.03	0.03	0.03	0.02	0.02
13.	Social security contributions	D.61	6,371.0	14.72	14.47	14.42	14.36	14.35
14.	Property income	D.4	547.1	1.26	0.82	0.75	0.63	0.54
15.	Other revenue		2,375.3	5.49	5.57	5.47	5.19	4.60
16.	16.=6. Total revenue	TR	18,658.5	43.11	42.30	41.66	40.79	39.75
	Tax burden (D.2+D.5+D.61+D.91–D.995)		15,734.3	36.36	35.90	35.43	34.97	34.61
	Selected components of expenditure							
17.	Compensation of employees and intermediate consumption	D.1+P.2	7,519.4	17.37	16.93	16.53	16.04	15.52
a.	Compensation of employees	D.1	4,790.4	11.07	10.99	10.86	10.53	10.17
b.	Intermediate consumption	P.2	2,729.0	6.31	5.94	5.67	5.50	5.35
18.	Social payments		7,302.4	16.87	16.27	16.06	15.81	15.69

a.	Social transfers in kind	D.6311, D.63121, D.63131	832.5	1.92	1.87	1.86	1.85	1.84
b.	Social transfers other than in kind	D.62	6,469.9	14.95	14.40	14.19	13.96	13.85
19.	19=9. Interest expenditure	D.41	1,073.1	2.48	2.00	1.68	1.56	1.45
20.	Subsidies	D.3	322.6	0.75	0.71	0.69	0.57	0.53
21.	Gross fixed capital formation	P.51	1,276.4	2.95	3.44	3.86	3.73	3.36
22.	Capital transfers, expenditure	D.9	217.5	0.50	0.37	0.33	0.27	0.25
23.	Other expenditure		933.7	2.16	2.21	2.32	2.21	2.07
24.	23.=7. TOTAL EXPENDITURE	TE	18,645.1	43.08	41.94	41.48	40.20	38.88

Source: Ministry of Finance.

Table 2.b: No-policy-change projections

		ESA Code	2017	2018	2019	2020	2021
					as % of GDP		
1.	Total revenue with no policy change	TR	43.1	42.3	41.7	40.8	39.8
a.	Taxes on production and imports	D.2	14.2	13.9	13.4	13.1	12.8
2.	Total expenditure with unchanged policies	TE	43.1	41.9	41.5	40.2	38.9
a.	Compensation of employees and intermediate consumption	D.1+P.2	17.4	16.9	16.5	16.0	15.5
b.	Social payments	D.62+D.631	16.9	16.3	16.1	15.8	15.7
3.	**Net lending/borrowing**	**B.9**	**0.0**	**0.4**	**0.2**	**0.6**	**0.9**

Source: Ministry of Finance.

Table 2.c: Expenditure benchmark

		2017	2017	2018	2019	2020	2021
		million EUR			**as % of GDP**		
1.	Expenditure on EU programmess fully matched by EU funds revenue	395.1	0.92	1.51	1.60	1.61	1.13
a.	of which: investments fully related to EU funds revenue	74	0.17	0.62	0.63	0.66	0.27
2.	Cyclical unemployment benefit expenditure	8	0.02	0.05	0.01	0.02	0.01
3.	Effect of discretionary revenue measures						
4.	Revenues increased mandated by law						
5.	One-off and other temporary measures	39.6	0.09	0.09	0.05	0	0

Source: Ministry of Finance.

Table 3: General government expenditure by function

	*	COFOG code	2016	2011	2012	2013	2014	2015	2016
			million EUR			*as % of GDP*			
1.	Public administration	1	2,666.6	5.8	5.8	6.3	7.2	6.7	6.6
	including: Servicing of general government debt		1,258.9	2.0	2.1	2.8	3.4	3.3	3.1
2.	Defence	2	361.4	1.2	1.0	1.0	0.8	0.8	0.9
3.	Public order and safety	3	701.8	1.8	1.7	1.8	1.6	1.6	1.7
4.	Economic affairs	4	1,837.3	5.8	4.5	15.2	6.2	5.9	4.5
	- including: Bank rehabilitation		0.0	0.7	0.2	10.0	0.9	0.0	0.0
5.	Environmental protection	5	226.1	0.8	0.8	0.8	1.0	1.0	0.6
6.	Housing and community development	6	165.1	0.6	0.8	0.7	0.9	0.6	0.4
7.	Health care	7	2,710.4	7.1	7.1	6.8	6.5	6.7	6.7
8.	Recreation, culture and religion	8	576.8	1.9	1.9	1.8	1.6	1.6	1.4
9.	Education	9	2,253.0	6.4	6.4	6.5	6.0	5.5	5.6
10.	Social protection	10	6,740.1	18.7	18.5	18.6	17.8	17.3	16.7
	TOTAL GOVERNMENT EXPENDITURE	**TE**	**18,238.6**	**50.0**	**48.5**	**59.5**	**49.6**	**47.7**	**45.1**

*Prior to EDP notification.

Source: Ministry of Finance

Table 4: General government debt

	as % of GDP	ESA Code	2017	2018	2019	2020	2021
1.	Gross debt		73.6	69.3	65.2	61.5	58.3
2.	Change in gross debt ratio		-5.0	-4.3	-4.1	-3.7	-3.2
3.	Primary balance		2.5	2.4	1.9	2.2	2.3
4.	Interest	EDP D.41	2.5	2.0	1.7	1.6	1.5
5.	Adjustments		0.3	1.3	0.3	0.4	0.8
6.	Implicit interest rate of the debt		3.4	2.9	2.6	2.5	2.5

Source: Ministry of Finance.

Table 5: Cyclical developments

	as % of GDP	ESA code	2017	2018	2019	2020	2021
1.	**Real GDP growth (%)**		**5.0**	**5.1**	**3.8**	**3.2**	**3.0**
2.	Net lending/borrowing of general government	B.9	0.0	0.4	0.2	0.6	0.9
3.	Interest expenditure	D.41	2.5	2.0	1.7	1.6	1.5
4.	One-off and other temporary measures		0.09	0.09	0.05	0.00	0.00
5.	Potential GDP growth (%)		2.3	2.8	3.1	3.3	3.3
	Contributions:						
	- labour		0.4	0.5	0.5	0.6	0.5
	- capital		0.2	0.4	0.6	0.7	0.9
	- total factor productivity		1.7	1.9	1.9	1.9	1.9
6.	**Output gap**		**-0.3**	**2.0**	**2.7**	**2.6**	**2.3**

7.	Cyclical budgetary component	-0.1	0.9	1.3	1.2	1.1
8.	Cyclically adjusted general government balance (2–7)	0.2	-0.6	-1.1	-0.7	-0.2
9.	Changes in cyclically adjusted general government balance	0.7	-0.7	-0.5	0.4	0.4
10.	Structural deficit (8–4)	0.2	-0.5	-1.0	-0.7	-0.2
11.	**Changes in structural balance (fiscal effort)**	**0.7**	**-0.7**	**-0.6**	**0.4**	**0.4**

Source: Ministry of Finance.

Table 6: Comparison with forecasts in the 2017 Stability Programme

% GDP	2017	2018	2019	2020	2021
1. GDP growth in %					
2017 Stability Programme	3.6	3.2	2.6	2.6	2.6
2018 Stability Programme	5.0	5.1	3.8	3.2	3.0
Difference	1.4	1.9	1.2	0.6	0.4
2. General government balance as % of GDP					
2017 Stability Programme	-0.8	-0.2	0.2	0.4	
2018 Stability Programme	0.0	0.4	0.2	0.6	0.9
Difference	0.8	0.5	0.1	0.2	
3. General government debt as % of GDP					
2017 Stability Programme	77.0	74.3	70.9	67.5	
2018 Stability Programme	73.6	69.3	65.2	61.5	58.3
Difference	-3.4	-5.0	-5.7	-6.0	

Source: IMAD, SURS and the Ministry of Finance of the Republic of Slovenia.

Table 7: Long-term sustainability of public finances (base year 2016)

as % of GDP	2016	2020	2030	2040	2050	2060	2070	Difference 2070-2016
Total general government expenditure	41.5	41.0	43.7	48.9	55.5	61.0	66.2	24.8
Total age-related expenditure	21.9	22.1	24.0	26.7	28.9	28.9	28.3	6.4
Pensions	10.9	11.0	12.0	14.2	15.6	15.2	14.9	3.9
Old-age and early pensions	8.3	8.5	9.4	11.1	12.3	12.0	11.9	3.5
Disability pensions	1.3	1.2	1.3	1.5	1.7	1.6	1.5	0.2
Other pensions	1.3	1.3	1.3	1.5	1.6	1.6	1.5	0.2
Health care	5.6	5.8	6.3	6.7	6.8	6.8	6.7	1.0
Long-term care	0.9	1.0	1.2	1.5	1.8	1.9	1.9	1.0
Education	4.0	4.0	4.2	4.1	4.5	4.7	4.6	0.6
Unemployment	0.4	0.3	0.3	0.3	0.3	0.3	0.3	-0.1
Wage compensations	0.4	0.3	0.3	0.3	0.2	0.2	0.2	-0.1
Subsidies	1.0	1.0	1.0	1.0	1.0	1.0	1.0	0.0
State investments	2.4	2.4	2.4	2.4	2.4	2.4	2.4	0.0
Total primary expenditure	38.8	38.7	40.5	43.4	45.7	45.8	45.2	6.4
Interest expenditure	2.7	2.3	3.2	5.5	9.8	15.3	21.1	18.4
Total general government revenue	**39.8**	**39.3**	**39.0**	**38.5**	**38.1**	**38.1**	**38.1**	**-1.7**

Assumptions								
Labour productivity growth	0.3	1.6	2.1	1.9	1.8	1.7	1.5	1.2
Real GDP growth	2.50	1.25	1.58	1.28	1.25	1.61	1.45	-1.05
Real GDP growth per inhabitant	2.40	1.25	1.58	1.28	1.25	1.61	1.45	-0.95
Male activity rate (20-64 years)	79.3	81.3	81.3	80.4	81.4	82.1	81.4	2.1
Female activity rate (20-64 years)	72.2	75.5	77.5	76.7	77.7	78.2	77.4	5.2
Total activity rate (20-64 years)	76.1	78.5	79.5	78.6	79.6	80.2	79.4	3.3
Unemployment rate	9.0	6.7	5.9	5.9	5.9	5.9	5.9	-3.2
Share of population aged 65 years or more	18.2	20.7	25.2	28.3	30.6	30.2	28.5	10.3

Source: EC – EPC 2018 Ageing Report (forthcoming), Ministry of Finance, Institute for Economic Research.

Table 7.a: Projection of the balance of guarantees of the Republic of Slovenia for the 2018–2021 period

	Balance as of 31 Dec 2018*		Balance as of 31 Dec 2019*		Balance as of 31 Dec 2020*		Balance as of 31 Dec 2021*	
	in EUR million	as % GDP	in EUR million	as % GDP	in EUR million	as % GDP	in EUR million	as % GDP
Guarantees of the Republic of Slovenia	5,812	12.5	5,375	10.8	5,002	9.5	4,544	8.7
including: financial sector*	669	1.4	669	1.3	669	1.3	669	1.3

Note: * In accordance with SKIS classification, legal entities with a SKIS mark S12 are included.

Source: Ministry of Finance.

Table 8: Assumptions about the international environment

	2017	2018	2019	2020
USD/EUR ratio (annual average) (euro area and ERM II members)[1]	1.129	1.234	1.236	1.236
Nominal effective exchange rate	0.5	0.8	0.0	0.0
GDP growth in EU	2.4	2.3	2.0	1.6
Growth of export markets[2]	6.0	5.5	4.9	4.6
Oil price (Brent, USD/barrel)	54.3	65.1	60.8	58.0

Notes: [1] For the 2018–2020 period: the technical assumption on the basis of average values between 1 and 12 February 2018; [2] Real imports of goods and services from trade partners weighted by means of Slovenian export rates to these countries. Source: IMAD, Spring Forecast 2018.