THE REPUBLIC OF SLOVENIA

STABILITY PROGRAMME

2013 UPDATE

Ljubljana, May 2013

CONTENTS

FOREWORD

The 2013 update of the Stability programme is prepared in the framework of the so called European Semester. The Stability programme is in line with Council recommendation to Slovenia of 30 november 2009 (1570/09) with a view to bringing an end to the situation of an excessive government deficit and takes into account the Council recommendation of 13 July 2010 on broad economic policy guidelines for the of the Member States and of the Union (2010/410/EU), the Council recommendation of 6 July 2012 on the National Reform Programme 2012 of Slovenia and Council opinion on the updated Stability Programme of Slovenia, 2012-2015 (11272/12) and guidance on the fiscal consolidation and structural reforms as adopted by the European Council on 14 - 15 March 2013. The document has been prepared in accordance with Council Regulation (EC) No. 1175/2011 amending Regulation 1466/97 (as amended by by Council Regulation (EC) No. 1055/2005 and Regulation (EU) No. 1175/2011), which sets out the rules covering the content of Stability programmes.

Slovenia has been formally under an excessive deficit procedure since 2 December 2009. In line with the recommendations made by the Council, Slovenia has to bring down the general government deficit below 3% of GDP by 2013. The main objectives in presented economic policy programme are the establishment of conditions to stimulate economic growth, which also includes measures for stabilisation of the banking sector, and the continuation of public finance consolidation. The programme contains measures that will ensure a reduction of the deficit below 3% of GDP by 2014, which will be followed by further fiscal consolidation towards permanent balanced structural position, in line with the preventive arm of the Stability and Growth Pact (Regulation 1466/97 and amendments) and the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

In conformity with the guidelines of the revised Stability and Growth Pact, that enhance national ownership, the Stability programme and its updates and the draft opinion of the Council on the Stability programme of the Republic of Slovenia are discussed in the working bodies of the Parliament of the Republic of Slovenia. These bodies also considered the Recommendations of the Council for bringing an end to the situation of an excessive deficit in Slovenia.

1. OVERALL POLICY FRAMEWORK AND OBJECTIVES

The main economic policy goals are the establishment of conditions for stable economic growth and permanent structural balance of public finances. Slovenia has healthy macroeconomic foundations, but is dealing with some structural imbalances which have a negative effect on economic activity.

Imbalances in the Slovenian economy are manageable and can be corrected with a suitable combination and timetable of measures. On this basis and with this objective, the measures, which Slovenia will implement in 2013 and 2014[1] have been devised. By correcting imbalances, the conditions for achieving economic growth and creating jobs will be facilitated. In the period after 2013, the Slovenian economy is expected to gradually recover; however, GDP growth will not increase to more than 1.6% by the end of the programming period

Slovenia's priorities are aimed at measures to:
- (i) boost economic growth and
- (ii) balance public finances.

The key fiscal policy objectives:
- (i) structural balance by 2017 and the reduction of the general government deficit below 3% of GDP by 2014;
- (ii) stabilisation of the general government debt below 55% of GDP.

In accordance with the Council Decision of December 2009, Slovenia must reduce the structural deficit by ¾% of GDP on average annually by 2013, when the excessive deficit should be eliminated. Due to the significantly changed macroeconomic circumstances as compared to 2009, when the procedure of excessive deficit was introduced, a delay in the reduction of the general government deficit below 3% of GDP of one year occurred; nevertheless, Slovenia is still ensuring an average annual structural effort 0.7% of GDP. The structural balance will be achieved by 2017, which will be additionally supported by introducing the fiscal rule at the constitutional level. In line with the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, the National Assembly is holding a discussion on incorporating the balanced public finance rule into the Constitution. The discussion is expected to conclude by the end of May 2013. Within the following six months, the fiscal rule integrated into the Constitution will have to be upgraded by adopting an implementation act regarding the fiscal rule and amended Public Finance Act, in which the procedure of adopting or amending the state budget will have to be upgraded. This will fully satisfy the requirements of legal acts passed at the EU level to strengthen economic governance (Chapter 7).

Measures to boost economic growth will be based on enhancing bank stability, and corporate deleveraging and restructuring. Transfer of non-performing assets in banks on Bank Asset Management Company (BAMC) and ensuring capital adequacy to a level comparable to the EU average are the key measures for improving financing conditions. This year, the funds required for recapitalisation of banks are estimated at EUR 900 million, in addition to recapitalisations already performed worth EUR 420 million. The total estimated recapitalisations in 2013 represent a single increase in the general government deficit by 3.7% of GDP, which without recapitalisations would remain at the level of the previous year. The issue of a BAMC bonds guaranteed by the state is envisaged for the purchase of the non-performing assets of banks, with the total anticipated amount of guarantees being up to EUR 4 billion, which will signify a single increase in the general government debt by up to 11.4% of GDP; however, this will decline in the coming years in accordance with the dynamics of the sale or liquidation of the acquired assets. The debt will thus reach its peak during the programming period, but will be reduced again with an aim of stabilisation below 55% of GDP.

Corporate deleveraging and restructuring will be implemented parallel to the measures for enhancing the stability of the banking sector. The systematic approach to corporate

[1] For more details see National Reform Programme 2013 - 2014.

deleveraging will be based on three elements: (i) improving the bankruptcy framework, the legislative framework for financially restructuring companies (insolvency legislation, compulsory settlements), and a new out-of-court procedure on corporate deleveraging, which will be regulated by a special act; (ii) selective measures through the BAMC and the state to support individual companies with a successful business model and economic viability and fully in line with the state aid rules; (iii) ensuring fresh capital by the private sector through privatisation procedures. In addition to the aforementioned, measures to improve the management of state-owned companies will be implemented, and some actual privatisation procedures will commence before the summer.

To overcome the economic crisis in Slovenia, measures to consolidate public finances are as urgent as measures to boost economic growth. Given that Slovenia is a small open economy, measures to consolidate public finances must be designed in a way that they do not have significant negative effects on the competitiveness of the Slovenian economy. Thus these measures will be based primarily on measures to reduce general government expenditure. To achieve urgent rapid progress in consolidation, the Government assesses that, in addition to measures relating to expenditure, certain measures relating to revenue are required.

The objective of reducing the general government deficit below 3% of GDP by 2014 will be attained primarily through further implementation of measures to reduce general government expenditure and revenue measures. The overall effect of these measures is estimated at approximately EUR 1 billion annually. The Government's aim is that one third will be contributed by the financial effects of general government revenue measures and two thirds by the financial effects relating to general government expenditure.

Measures presented in the document do not represent the aimed structure. One half of financial effects represent measures on expenditure side and one half represent measures on revenue side not taking into account crisis tax, that is of conditional nature. The Government will prepare the second package of measures relating to decrease of general government expenditures by the end of the year, with financial effect that will compensate the crisis tax.

On the expenditure side, limiting expenditure on public sector wage bill will resume, which, in addition to measures already taken, requires new measures that the Government has been negotiating with trade unions and which will produce a financial effect in 2013. Measures to limit expenditure on pensions will also resume. The Government will implement a restrictive policy on social transfers. By revising the state budget, expenditure on goods and services and investments will be reduced. The measures are presented in more detail in Chapter 3.3 (see also table in Annex 1).

On the revenue side, two permanent measures will be most important: increasing the general VAT[2] rate by 2 percentage points and the reduced rate by 1 percentage point, and updating the property tax system. The gradual decrease in corporate income tax approved last year will come to a halt. The introduction of the tax on lottery tickets and tax on the consumption of some sweet beverages, and an increase in court fees are anticipated in mid-2013. Revenue measures are presented in more detail in Chapter 3.2 (see also table in Annex 1).

The Government is preparing a contingent measure, and is expected to come into force in 2014 if during this year no agreement would be reached on additional permanent measures that will reduce general government expenditure in the corresponding amount. This contingent measure relates to introduction of crisis tax, bound by the income of the natural persons. The final decision on introduction of crisis tax on 1 January 2014 will depend on the estimated financial effects of the second package of permanent measures relating to general government expenditure reduction to be prepared by the end of the year.

[2] The legal basis for the measure is the Value Added Tax Act, which follows the purpose of the same measure in terms of contents, which has been anticipated with the Fiscal Balance Act.

2. ECONOMIC TRENDS AND FORECASTS OF MACROECONOMIC AGGREGATES

2.1. Assumptions about the international environment

Macroeconomic forecasts in the Stability Programme are based on the Spring Forecast of Economic Trends 2013 (IMAD, March 2013).

The assumptions for the international economic environment taken into account in the Spring Forecast of Economic Trends 2013 are based on the forecasts released by international institutions in February (Table 2.1). Euro area GDP is expected to decline further in 2013, although less than last year, and then to strengthen gradually in 2014 and 2015. In line with the forecasts by international institutions, it is assumed that GDP movements in Slovenia's other main trading partners will be somewhat less unfavourable than last year, and that the decline in Croatia's GDP will be smaller than last year. As in EU Member States, the economic situation is also projected to improve steadily in these countries over the next two years. The risks to growth in the international economy nevertheless remain high and unevenly distributed towards the downside. The risk of a possible further worsening of the sovereign debt crisis therefore persists, which could lead to a deeper fall in economic activity in the euro area and the EU.

Table 2.1.: Assumptions of the Spring Forecast of Economic Trends 2013 (IMAD) for economic growth in Slovenia's main trading partners, 2013–2015, %

	2011	2012	2013	2014	2015
			Spring forecast (March 2013)		
EU	1.5	-0.3	0.1	1.2	1.7
Euro area	1.4	-0.6	-0.3	1.0	1.5
Germany	3.0	0.7	0.5	1.5	1.8
Italy	0.4	-2.2	-1.0	0.5	1.0
Austria	2.7	0.8	0.7	1.5	1.5
France	1.7	0.0	0.1	0.9	1.4
United Kingdom	0.9	0.2	0.9	1.7	1.9
Czech Republic	1.9	-1.1	0.0	1.8	2.5
Hungary	1.6	-1.7	-0.1	1.3	2.0
Poland	4.3	2.0	1.2	2.4	3.5
Croatia	0.0	-1.8	-0.4	1.0	2.2
Bosnia and Herzegovina	1.0	-0.8	0.7	2.0	2.5
Serbia	1.6	-1.8	1.7	2.0	2.5
US	1.8	2.2	1.9	2.8	3.0
Russia	4.3	3.4	3.7	3.9	3.7

Sources: Eurostat (for 2011 and 2012); Consensus Forecasts, February 2013; Eastern Consensus Forecasts, February 2013; EC Forecast Winter 2013, February 2013; IMF World Economic Outlook update, January 2013; WIIW Current Analyses and Forecasts, March 2013; IMAD's estimate.

The technical assumption for the oil price is an average of USD 113.7 a barrel in 2013, falling to USD 106.4 in 2014 and 2015. Taking into account the current trends and the forecasts by international institutions at the time when the Spring Forecast was made, non-energy commodity prices in dollars are forecast to fall in 2013 (-2.0%), and then to remain at a similar level in the next two years. The technical assumption for the US dollar exchange rate is set on the basis of movements in February 2013. The rate is forecast at USD 1.335 per euro in 2013, and at USD 1.336 in the next two years.

The assumptions for the international environment in the Stability Programme, which arise from the Spring Forecast of Economic Trends 2013, rely on the forecasts by international institutions released by the end of February 2012, in particular the European Commission's winter forecasts. In the key assumption, i.e. GDP in the euro area in 2013, IMAD's Spring Forecast takes account of the European Commission's winter forecast (-0.3%), with minimum differences in the exchange rate (USD 1.35 per euro).[3] At the time when the forecast was made, the common assumptions of the European Commission for the preparation of Stability and Convergence Programmes were not yet available. Now that they have been released, it can be seen that there is no difference between them and the assumptions in the Stability Programme.

Table 2.2.: Basic assumptions

	2011	2012	2013	2014	2015
USD/EUR exchange rate (annual average) (euro area and ERM II countries)[1]	1.392	1.286	1.335	1.336	1.336
Nominal effective exchange rate	-0.1	-1.2	1.0	0.0	0.0
EU GDP growth, %	1.5	-0.3	0.1	1.2	1.7
Growth of relevant export markets,[2] %	7.7	-0.3	0.1	2.6	5.2
Oil price (Brent, USD/barrel)	111.3	111.7	113.7	106.4	106.4

Source: IMAD, Spring Forecast 2013. Notes: [1] for 2013-2015: technical assumption based on the average exchange rate in February 2013; [2] Germany, France, Italy, Austria, Hungary, Poland, Czech Republic, Slovakia, United Kingdom, USA; weighted by their shares in Slovenian exports.

2.2. Cyclical developments and short-term prospects

GDP is expected to decline by 1.9% in 2013. These expectations are based on the assumptions of a further deterioration in the international environment, the continuing difficulties in accessing funding for the government and the banks and the on-going fiscal consolidation. The assumption of the spring forecast is that given the increased stock of non-performing and bad assets at banks in an environment of weak economic activity, the conditions for a strengthening of lending activity will not be established this year. The on-going adverse situation in the international environment will not be conducive to any significant recovery in exports, which will increase by 1.2% in real terms with the anticipated gradual revival in foreign demand in the second half of this year. This year's decline in GDP will thus arise from a substantial drop in domestic consumption, which will be down 3.4% due to a further contraction in investment and a stronger fall in private and government consumption. The decline in gross investment (-1.7%) will be much smaller than last year, primarily due to a substantially smaller fall in gross fixed capital formation (-0.5%) than in the previous four years, mainly thanks to government investment linked to the accelerated disbursement of EU funds and the construction of a major energy facility. In view of the large stock of unsold housing, a further fall in housing investment is forecast. Investment in machinery and equipment is not set to strengthen either, given the on-going adverse financial situation, the deleveraging of the highly indebted corporate sector and low capacity utilisation. The negative contribution of inventories to GDP growth is expected to be smaller (-0.2 percentage points) than in 2012, when it was relatively large. The decline in household and government final consumption is forecast at 3.7% this year. In view of the deterioration on the labour market and the projected further real decline in social transfers, a further significant decline in disposable income[4] is forecast, which will result in a real decline in

[3] The Commission's assumption is based on the exchange rate movements between 30 January and 12 February 2013, while IMAD's assumption is based on the movements throughout February.

[4] Disposable income will thus decline for the fifth successive year, and will be down 6.4% in real terms this year relative to 2008, according to our estimate.

private consumption (-0.4%) in light of the increased uncertainty and consumer caution. Given the on-going fiscal consolidation and consequent restrictive wage and recruitment policy, compensation of employees in the general government sector will also decline this year, as will other labour-related expenditure. Expenditure on goods in services will also drop further in all general government accounts. Government consumption will thus fall by 2.9% in real terms.

Table 2.3.: Macroeconomic prospects

Change, %, unless stated	**ESA Code**	**Level in 2012**	**2012**	**2013**	**2014**	**2015**	**2016**
		Level in EUR m					
1. Real GDP	B1 g		-2.3	-1.9	0.2	1.2	1.6
2. Nominal GDP	B1 g	35,466	-2.0	-0.6	1.4	3.0	3.5
Real GDP components							
3. Private consumption expenditure	P.3	20,691	-2.9	-4.0	-1.3	0.5	1.0
4. Government consumption expenditure	P.3	7,320	-1.6	-2.9	-0.6	-0.1	0.3
5. Gross fixed capital formation	P.51	6,157	-9.3	-0.5	0.8	1.5	1.5
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52+ P.53	-110	-0.3	-0.5	-0.3	-0.2	-0.1
7. Exports of goods and services	P.6	26,604	0.3	1.2	3.3	4.9	5.3
8. Imports of goods and services	P.7	25,195	-4.3	-0.7	2.4	4.4	4.9
Contributions to real GDP growth (percentage points)							
9. Final domestic demand		34,165	-5.6	-3.3	-0.6	0.6	1.0
of which: Changes in inventories and net acquisitions of valuables	P.52+ P.53	-110	-1.9	-0.2	0.2	0.1	0.1
10. External balance of goods and services	B.11	1,409	3.3	1.4	0.8	0.6	0.7

Sources: SORS; Spring Forecast 2013, IMAD.
Note: * Constant prices of the preceding year

In 2014–2016 economic growth is expected to increase largely due to the recovery in export demand, while domestic demand will start contributing more visibly to growth only at the end of this period. In 2014 GDP is projected to increase by 0.2%, and in 2015 and 2016 by an average of 1.4%. The international environment is expected to see renewed growth in these years, which will have a beneficial effect on Slovenian exports. Domestic consumption will decline further next year, under the impact of continuing difficulties in accessing financing, the deterioration on the labour market and fiscal consolidation. The expected gradual revival in domestic consumption in the following years will come from a strengthening in investment activity, public investment in particular, mainly on account of the anticipated co-financing from EU funds. Towards the end of the period, the labour market situation is expected to gradually stop deteriorating as there is a weak recovery in economic activity, and this will also be reflected in renewed growth in private consumption. Real growth in government consumption is expected to be subdued in these years.

The uncertainty surrounding the spring forecast for economic activity in 2012–2016 remains large. IMAD’s forecast is based on the assumption of an improvement in the international environment in the second half of this year, which is also expected in the winter forecast by the European Commission. In connection with a possible further worsening of the sovereign debt crisis, risks of a deeper decline in economic activity this year nevertheless persist. The key risk to the forecast for the domestic environment is related to the successful implementation of measures to stabilise the banking system, and the continuation of fiscal consolidation, where any major divergences from the set measures would make access to international funding even more difficult, not only for the government but also for the banking and corporate sectors.

Table 2.4.: Sectoral balances

% of GDP	ESA Code	2012	2013	2014	2015	2016
Net lending/borrowing vis-à-vis the rest of the world	B.9	2.5				
of which:						
Balance on goods and services		4.0	5.5	6.0	6.5	7.0
Balance of primary incomes and transfers		-1.4	-1.2	-2.2	-2.7	-3.4
Capital account		-0.1				
Net lending/borrowing of the private sector	B.9/EDP B.9	6.2				
Net lending/borrowing of general government (ESA 95)	B.9	-4.0	-7.9	-2.6	-2.1	-1.4
Net lending/borrowing of general government excluding recapitalisations of banks and non-financial enterprises		-3.8	-4.2*			
Statistical discrepancy						

Sources: SORS; MF; Spring Forecast 2013, IMAD.
Note: *On-off government expenditure for recapitalisation of banks in 2013: 3.7 % of GDP.

In 2012 the current account moved into a surplus, at 2.5% of GDP. This year the surplus will widen further (4.4% of GDP), and remain relatively high in 2014–2016 (3.8% of GDP in 2014; 3.9% of GDP in 2015 and 3.7% of GDP in 2016). The surpluses reflect the anticipated excess of national savings over investment as a result of further corporate sector deleveraging and general government austerity. Given that over the entire programming period the structure of the expected economic activity will mainly be based on the strengthening of exports (growth in imports will be low due to weak domestic demand), the trade balance is expected to turn into a surplus this year and remain positive until the end of the programming period. Amid the anticipated further growth in the surplus of trade in transport and travel services, the overall surplus of trade in services will also continue to widen gradually. The forecast also assumes that Slovenia will have a favourable budgetary position against the EU budget in 2013, but that it will deteriorate slightly in the coming years. By contrast, net payments of interest on external general government debt will grow in 2013 and in the next few years. Net outflows of dividends and reinvested earnings are also likely to rise, which will increase the deficit in factor income.

In view of the weak economic activity and the resulting restrictive recruitment and wage policy, employment is expected to fall and unemployment to rise this year and in 2014. Given the delay in the labour market's adjustment to economic activity, these trends will also continue next year, albeit to a lesser extent, while in 2015 the labour market situation is expected to stabilise. In 2013 the total number of employed persons will thus fall slightly more than in 2012. In the private sector employment is set to fall in all activities. The projected labour market developments will also be affected by the anticipated restrictive recruitment policy in the general government sector. The number of registered unemployed is thus expected to average 123.5 thousand in 2013, and the registered unemployment rate 13.4% (with a survey unemployment rate of 10.0%). Despite the anticipated beginning of economic recovery in 2014, the average number of registered unemployed will increase slightly again during that year (124.1 thousand) due to the lag in the recovery of growth and structural imbalances on the labour market. A gradual fall in unemployment is expected in 2015 and 2016.

Table 2.5.: Labour market developments

	Level 2012 (in '000)	2012	2013	2014	2015	2016
Employment (persons),[1] growth, %	935.1	-1.3	-1.6	-0.8	0.0	0.2
Survey unemployment rate, %	89.9	8.9	10.0	10.0	9.4	9.1
Labour productivity, EUR '000 per employee[2]	37.9	-1.1	-0.2	1.0	1.2	1.5
Compensation of employees,[3] EUR m	18,572	-1.8	-1.7	0.0	2.1	2.8
Compensation per employee,[3,4] in EUR '000	19.9	-0.5	0.0	0.7	2.1	2.6

Sources: SORS; Spring Forecast 2013, IMAD.
Notes: [1] Occupied population, national accounts definition (domestic concept); [2] Real GDP; [3] Nominal growth; [4] Full-timers.

This year's further contraction in economy activity and the anticipated slow recovery in the next few years, the efforts to maintain corporate competitiveness and the absence of labour market pressures amid high unemployment will have a significant impact on the future wage movements in the private sector. In 2013 nominal wage growth in the private sector will thus be similar to that last year (0.8%), and in 2014 and 2015 it will rise only slightly due to a gradual strengthening of economic activity (1.4% and 2.2%). The average gross wage in public service activities will fall further in nominal terms, primarily as a consequence of the impact of last year's reduction after the adoption of the ZUJF, and it will remain at a similar level in 2014.

Table 2.6.: Price developments

Change, %	2011	2012	2013	2014	2015	2016
1. GDP deflator	1.0	0.4	1.3	1.1	1.8	1.9
2. Private consumption deflator	2.2	1.1	1.1	1.3	1.8	1.9
3. Consumer price index (annual average)	1.8	2.6	2.1	1.6	1.9	2.0
4. Public consumption deflator	3.5	-1.2	-1.1	1.1	2.1	2.1
5. Gross fixed capital formation deflator	1.6	1.4	1.5	2.0	2.0	2.0
6. Export price deflator (goods and services)	4.2	1.3	0.6	0.5	1.0	1.5
7. Import price deflator (goods and services)	5.9	2.2	0.5	0.9	1.0	1.5

Sources: SORS; Spring Forecast 2013, IMAD.

Inflation is expected to remain low in 2013–2016. In the first months of this year, energy prices remained the main factor in consumer price developments. The continuation of weak demand and the poor prospects for economic activity are being reflected in continuing moderate core inflation. Assuming the absence of price shocks from the international environment and of changes in taxation, core inflation will stand at 1.9% at the end of 2013 and remain around 2% in the following years.

2.3. Medium-term scenario

Projections of the Stability Programme are made on the basis of the medium-term scenario of economic developments in the Spring Forecast of Economic Trends, which is based on the assumption of stable developments in the international environment and the measures presented in the Stability Programme. In the period between 2013 and 2016 economic growth will average only 0.3%. In addition to the anticipated fiscal consolidation measures and difficulties in accessing financing, which will result in weak domestic consumption, this low growth rate also reflects the projected situation in the international environment, with a decline in economic activity in euro area countries and a slow recovery from 2014 onwards. The scenario projects that, given successful consolidation, the maintenance of the deficit within the set limits and the stabilisation of the banking system, the conditions for financing the government and, indirectly, the private sector, will also improve in relative terms in the following years (2017–2018). This will have a positive impact on overall economic activity and the potential for renewed faster economic growth, expected to average around 1.7% in 2017–2018.

As a result of weak economic activity and the planned restrictive wage and recruitment policy in the public sector, the situation on the labour market will continue to deteriorate in the short term. However, with a return of economic growth and as a result of the planned measures to promote competitiveness, new possibilities for job creation will open up towards the end of the programming period, which will be reflected in a reversal in the developments in employment and unemployment, though unemployment will remain higher than in the years before the economic crisis.

Table 2.7.: Key macroeconomic indicators to 2018

	Spring Forecast	
	2013–2016	**2017–2018**
GDP, real growth, %	0.3	1.7
Exports of goods and services	3.7	5.4
Imports of goods and services	2.7	5.0
Private consumption expenditure	-1.0	1.0
Government consumption expenditure	-0.8	0.5
Gross fixed capital formation	0.8	1.5
Employment, SNA, growth, %	-0.6	0.3
Registered unemployment rate, %	13.2	11.5
Survey unemployment rate, %	9.6	8.4
Average number of registered unemployed, in '000	120.6	104.1
Inflation, annual average, %	1.9	2.0

Source: Projections from the Spring Forecast 2013, IMAD, March 2013.

2.4. Comparison of the forecast with the previous Stability Programme

The forecast for GDP growth has been revised downwards significantly for the whole period compared with the previous Stability Programme. The key reasons for the revision are a significant deterioration in the international environment and the relatively less favourable conditions in the domestic economic environment (more limited financing, a further deterioration on the labour market), which have been reflected in significantly lower growth in investment and private consumption.

Table 4.4.: Comparison with the forecasts in the April 2012 Stability Programme

% of GDP	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
1. GDP growth						
Forecast in Stability Programme 2012	1.8	-0.9	1.2	2.2	2.2	
Stability Programme 2013 (new forecast)		-2.3	-1.9	0.2	1.2	1.6
Difference		-1.4	-3.1	-2.0	-1.0	

Sources: IMAD. SORS. MF.

2.5. Impact of structural reforms on growth

Long-term sustainability of public finances and stable economic growth will be provided by economic policy measures, structural measures and institutional adjustments[5].

An important element of the institutional adjustments is a change in the decision-making process, which is based on constitutional changes, mainly on incorporating the fiscal rule and amendments to referendum legislation. The process of making decisions and adopting the required structural reforms, which are crucial to the long-term sustainability of public finances and long-term stable economic growth, will thus be enhanced and accelerated. Short- and medium-term measures to revive the economy focus on:

- restoring the banking system (through measures facilitated by the Measures of the Republic of Slovenia to Strengthen the Stability of Banks Act (ZUKSB));
- corporate deleveraging and restructuring (parallel through the BAMC and outside of this institutional framework, aimed at companies with a successful business model; for this purpose, legislation on insolvency procedures, compulsory settlement and enforcement, will be adopted or amended);
- improving corporate governance (based on the operation of the Slovenian Sovereign Holding);
- privatising state-owned companies (the entire sale strategy will be prepared in the last quarter of the year, while the first privatisation package will be implemented before the summer).

Long-term measures to revive the economy are aimed at improving the competitiveness of the economy and include measures to:

- simplify the financing and operation of companies (through measures to support the growth and development of companies during their entire life cycle in order to enhance added value per employee and create new jobs);
- encourage direct foreign investments and, at the same time, enhance the internationalisation of domestic companies and their recognisability in foreign markets;
- improve the business environment (more efficient spatial planning procedures and the acquisition of building permits, further elimination of administrative barriers, and enhancement of the efficiency of the rule of law);
- improve the functioning of the labour market (in addition to the adopted reform, changes in the field of preventing and restricting undeclared employment, regulating student work, reducing the number of regulated professions and changing the regulation of the minimum wage).

In public finance, additional measures in the medium term will be prepared which will limit and restructure general government expenditure in a manner which distributes burdens equally across all segments of public expenditure, while, on the revenue side, measures having the least possible negative effect on economic growth will be implemented.

Below, we present simulations of effects of some measures presented, assessed with the comprehensive Dynamic Stochastic General Equilibrium Model (DSGE), which explains the specifics of the Slovenian economy fairly well. The DGSE model was used to assess the effects of the following measures on GDP:

- increase in the added value tax
- introduction of a progressive personal income crisis tax
- revision of property tax.

[5] A more detailed presentation of the measures is included in the National Reform Programme 2013–2014.

The simulations show that measures to increase the tax burden must be combined with other measures, since they do not in themselves lead to eliminating the deficit. In the field of taxes, temporary measures have relatively less effect on economic growth than permanent measures. The greatest negative effects on economic growth occur in the case of non-consolidation. This assessment is based on comparing the effects of permanent consolidation measures and effects upon continuous increases in the costs of borrowing by 100 basis points (which, in current conditions, would be close to the intolerability limit), which would occur if consolidation measures were not taken. The comparison shows that the costs of non-consolidation compared to any other measure selected to reduce the deficit are higher, since the negative effect of increasing the costs of capital to GDP level is the greatest, and also permanent; it also influences the GDP growth rate.

The simulation results indicate that, in the light of the increased tax burdens, the reduction in private consumption is the most powerful factor reducing GDP. The assumed increase in VAT will have an annual effect of 0.7 p.p. of GDP. In the first year after the temporary introduction of a progressive personal income crisis tax, the multiplication factor would be -0.08, and the extension of the period would amplify the negative effect. A property tax would also affect all households – with the anticipated inflow in the budget, the multiplication factor would be greatest in the first year, i.e. -0.29.

The effects of measures to revive the economy are positive in the long term; the prerequisite to achieve these effects, however, is the efficient consolidation of public finances. If, due to non-consolidation of public finances, the access to international financial markets is denied, the negative effects of an increase in the costs of capital to the GDP level will be significantly greater and more permanent, which would have a stronger negative effect on the GDP growth rate [6].

3. GENERAL GOVERNMENT BALANCE AND DEBT

After a period of higher general government deficit at the onset of the international financial crisis due to the operation of automatic stabilisers and discretionary measures in the period 2009–2011, Slovenia significantly reduced the general government sector deficit in 2012 in spite of the continuing decline in economic activity. Forecasts for the programming period show a revival of economic growth in 2014, which, however, will not exceed 1.6% of GDP by the end of the programming period. The general government deficit, which was approximately 6% of GDP in the period 2009–2011, was reduced in 2012 to an estimated 4% of GDP by means of greater fiscal effort, while the structural deficit was reduced from 4.2% of GDP to 2.2% of GDP. However, the great fiscal effort with selected set of measures that were applied had an additional negative effect on economic activity, which subsequently put pressure on general government deficit and debt. Therefore, in order to overcome the crisis, Slovenia needs a combination of measures to boost the economy and fiscal consolidation measures, which will be prepared in a manner so that they do not have negative consequences for the competitiveness of the Slovenian economy.

[6] Models are assessed or calibrated for a normal situation and simulate economic activity in ‘normal’ times. In the current situation in the Eurozone and especially in Slovenia, the situation is heavily aggravated and an increase in interest rates could be higher than in stable conditions.

3.1. Policy strategy, excessive deficit procedure and medium term objective

The EU Council in December 2009 established the existence of an excessive government deficit in Slovenia and made recommendations for its correction. The Council emphasized the need for Slovenian authorities to bring the general government deficit below 3 % of GDP by 2013 in a credible and sustainable manner.

Specifically to this end, the EU Council recommended that Slovenia should:

1. implement the fiscal consolidation measures in 2010 as planned;
2. ensure an average annual structural budgetary adjustment fiscal effort of ¾% of GDP over the period 2010-2013;
3. specify the measures that are necessary to achieve the correction of the excessive deficit by 2013 cyclical conditions permitting and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected.

Implement the fiscal consolidation measures in 2010 as planned. In accordance with the recommendations of the EU Council within the excessive deficit procedure, fiscal consolidation measures were implemented as planned. In the process of revising the budget, further measures were taken to reduce general government expenditure as a response to the additional deterioration in economic developments.

Ensure an average annual fiscal effort of ¾% of GDP. The annual reduction of the structural deficit in the period 2010-2014 will be 0.7 percentage points on average (Table 3.3), and after that period, the structural deficit will decline towards a structural balanced position in 2017 (see also Chapter 7).

Determine measures to reduce the excessive deficit. The Government's objective is to reduce the general government deficit below 3% of GDP by 2014. The Government is planning a general government deficit of 4.2% of GDP in 2013, which, however, will amount to 7.9% of GDP due to the one-off effects of the already implemented and expected recapitalisations in the banking sector.

Fiscal consolidation measures will be based on measures on expenditure and revenue side. On the expenditure side, further measures to limit the public sector wage bill, and expenditure on pensions and social transfers will be taken, and expenditure on investments and investment expenses, will also be limited, mainly those co-financed by resources from EU funds. By the end of the year the second package of measures on the expenditure side of a permanent nature that will evenly distribute the burden across all segments of public expenditure will be adopted.

On the revenue side, several important measures to increase general government revenue will be taken during the programming period, three of which are the most important in terms of public finance effects. The first is the change in the VAT rate, which is anticipated to come into force in July this year, and the second is the update of the property tax system, anticipated to be introduced on 1 January 2014. In addition, a so-called crisis tax with an estimated annual effect of EUR 300 million will be prepared as a contingent measure, which will be introduced on 1 January 2014, only if no political agreement would be reached regarding additional permanent measures for reducing general government expenditure. The reduction in the corporate income tax rate will come to a halt at 17%, beginning in 2014. The measures are described in more detail in Chapter 6.1. The table below shows that, without introducing these changes, the share of revenue in the share of GDP would drop to 44% of GDP in the programming period, which would mean a general government deficit increase of approximately 1.3% of GDP in the period 2014–2016.

Table 3.1: Revenue and expenditure breakdown

		2012	2012	2013	2014	2015	2016
		EUR million	in % GDP				
1.	Total revenue with policies unchanged	15,895.3	44.8	45.4	44.8	44.5	44.0
2.	Discretionary revenue measures		0.0	0.1	2,0	1.3	1.3
3.	Total revenue (including discretionary measures)	15,895.3	44.8	45,5	46.8	45.8	45.3
4.	Total expenditure with policies unchanged	17,313.0	48.8	54.4	51.0	50,0	49.3
5.	Discretionary expenditure measures		0.0	-1,0	-1,6	-2.1	-2.6
6.	Total expenditure (including discretionary measures)	17,313.0	48.8	53.4	49.4	47.9	46.7

Source: MF RS.

On the general government expenditure side, measures to limit the fund for public sector pay, expenditure on pensions, social transfers and on investments will resume. Additional expenditure measures will be adopted in the programming period which will ensure an equal distribution of burdens across all segments of public expenditure.

Framework 1: Measures to enhance bank stability

Reducing the shares of non-performing assets in banks and ensuring capital adequacy at a level comparable to the EU average are the key measures to improve financing conditions and orderly corporate deleveraging. Therefore, the Measures of the Republic of Slovenia to Strengthen the Stability of Banks Act was passed in autumn 2012, the implementation of which is a priority task. The Measures of the Republic of Slovenia to Strengthen the Stability of Banks Act anticipates two key measures to enhance bank stability:

(i) the transfer of non-performing of bank assets to the Bank Asset Management Company (BAMC), and
(ii) recapitalisation of banks.

The issuing of a BAMC bonds guaranteed by the state of up to **EUR 4 billion** is envisaged for the purchase of non-performing bank assets. Since the state assumes the majority of risks, the BAMC is included in the wider government sector, which means that the BAMC bonds issued constitute a one-fold increase in the general government debt. The transfer of non-performing assets to the BAMC will be implemented in several steps with regard to the type of asset and will be concluded by September 2013, which will gradually raise the general government debt. The increased debt will be reduced in the following years in accordance with the dynamics of the sale or liquidation of the acquired assets. In accordance with the law, the BAMC purchases the bonds issued with funds acquired from the sale.

Parallel to the procedure transferring non-performing assets from banks to the BAMC, measure to recapitalise banks will be implemented. On the basis of a review of bank assets and stress tests carried out by the Bank of Slovenia, an estimated **EUR 900 million** will be required to recapitalise banks by 31 July 2013, which will give a one-off effect on the deficit increase in 2013.

3.2. Government revenue policy

The objective of the tax policy in this programming period is to ensure target-oriented changes in the tax system - which do not have excessive negative effects on the recovery of economic growth and employment - to accelerate the endeavours to consolidate public finances. The Government will devote priority attention to better and more efficient collection of existing tax duties, and to measures to reduce the grey economy and undeclared work, the fields where the risk that tax liabilities will not be met is the greatest. The grey economy includes economic activities aimed at profit and satisfying one's own needs, legal or illegal, and connected with tax evasion. Measures to reduce the grey economy will be implemented through: updated control methods; the goal-oriented supervision of transfers to tax havens; enhanced supervision in fields of high-risk activity and the payment of social security contributions; the conduct of taxation procedures; encouraging registration and the legalisation of activities, and a strict policy on sanctions. In parallel, more attention will be devoted to the insurance of tax payments, further strengthening tax enforcement procedures, and greater attention will be given to offenses procedure. The cooperation with the authorities responsible for the detection and prosecution of criminal offenses of tax evasion and other economic crime will be strengthened, and international cooperation in the field of information exchange will be enhanced. Several activities will therefore be devoted to suppressing the grey economy, with preventive and repressive measures. The presence of inspectors in the field will be strengthened. The fast-track tax audit of cash operations and inventory stock levels will be performed at an accelerated pace, computer forensics will also be implemented (capture data from taxpayers computers).

As the effects of such measures are expected to have delayed effects and are difficult to evaluate in advance, the Government will also propose an increase in the rates of some existing taxes or new tax solutions. The operation will largely be based on permanent measures to raise general government revenue, while contingent measures for 2014 in the form of crisis tax bound to income of the natural persons are also to be expected, if during this year no agreement can be reached on additional permanent measures to reduce government expenditure at the comparable level (about EUR 300 million). When designing the measures the Government will take as a basis that, in addition to ensuring conditions for the recovery of economic growth, a favourable general taxation structure is a precondition for the sustainability of public finances. The Government will consider this basic premise in planning new revenue, as well as in planning measures to improve the system of tax duty collection. Important effects in this field are expected by the Government also in relation to strengthening fiscal control, which will be achieved by merging the Tax Administration and Customs Administration of the Republic of Slovenia into a unified Finance Administration of the Republic of Slovenia.

The starting point of the general government revenue policy in 2013 and 2014 are the measures taken in 2012. They will be upgraded with additional measures which will be adopted in 2013, but implemented gradually, some in 2013 and others in 2014. The various periods of introducing individual measures depend on the ability to efficiently collect the newly defined tax duties and on the expected effects of individual measures. New measures, which the Government intends to propose to the National Assembly for approval in 2013, are described in more detail in Chapter 6.1. They refer to suspending the reduction in the corporate income tax rate, increasing the general VAT rate (by two percentage points) and reduced VAT rate (by one percentage point), introducing a new tax on lottery tickets in the system of organising conventional games of chance and on certain sweet beverages, and reforming the property tax system.

In 2012, certain tax measures were adopted to stimulate economic activity which will remain in force in 2013 and 2014. These are mainly measures referring to tax reliefs on corporate income tax and tax on income from self-employment. Furthermore, the nominal tax rate of corporate income tax was reduced from 20% to 18% in 2012 and further to 17% in 2013. According to the initial plan, the rate was also projected to be reduced in 2014 and 2015, reaching 15%, but the

Government decided due to the required enhancement of the general government revenue from corporate income tax to suspend the further reduction of the tax rate in 2014 and maintain it at 17%, which, according to the Government, still ensures a tax environment competitive enough for business, together with the continued tax relief on general investments and investments in research and development. Additional measures in this field were adopted at the end of 2012, primarily in order to reduce administrative burdens for the smallest taxpayers in meeting their tax liabilities by introducing so-called lump-sum taxation in the field of corporate income tax and tax on income from self-employment, and raising the threshold of annual taxable income of taxpayers to compulsorily enter the VAT collection system.

Regarding ensuring the consolidation of public finances, the Fiscal Balance Act (ZUJF) in mid-2012 introduced solutions which increased state budget revenues from taxes by burdening incomes and transactions which do not have a significant direct negative impact on the competitiveness of the economy. The purpose of the set of measures on the revenue side was to evenly distribute the burden of costs of consolidating public finances among taxpayers and, through additional burdening of some activities, ensure additional state budget revenues. ZUJF includes both permanent and temporary tax measures. The financial effect of some measures was seen in the second half of 2012. The majority, however, became fully-fledged at the beginning of 2013 and will produce effects in the following years, i.e.:

- the rise in the general rate of capital income tax and tax on profit generated by the disposal of derivative financial instruments from the current 20% to 25% from 1 January 2013 onwards as a permanent measure;
- in 2013, the tax scale for assessing personal income tax is modified so that the upper income limit from which the personal income tax is paid at a 41% rate is determined as a permanent measure (shifting the limit from 1.3 times the average salary to 1.5 times the average salary). As a temporary measure, a new, fourth tax bracket is added to this scale for 2013 and 2014 for incomes above the amount of five average salaries at the limit rate of 50%;
- the introduction of an additional vessel tax in 2013, which will provide revenue for the state budget, not municipal budgets (as applies to the basic vessel tax) as a permanent measure;
- the introduction (on 1 July 2012) of an additional vehicle tax applicable to vehicles with a capacity of 2,500 cc or more (or motorcycles with a capacity of 1,000 cc or more) as a permanent measure;
- the introduction of an anti-crisis tax on high-value immovable property of legal entities and natural persons; in 2012, the tax was paid only by legal entities and natural persons who owned immovable property not intended for industrial, business or public use if their value exceeded EUR 1 million. The tax is projected to be paid only temporarily, beginning in the second half of 2012 until the end of 2014, and
- the introduction of a tax on profit due to a change in land use, which introduced a new anti-speculative levy on profit, generated due to a change in land use usually from agricultural to building land.

In the field of direct taxes, the amendments to the Excise Duty Act in 2012 outlined changes in the amount of excise duties on cigarettes, and determined a gradual increase in the minimal amount of excise duties, so that, on 1 January 2013, the duty on 1,000 cigarettes amounted to EUR 97 and a change in the ratio between specific and proportional excise duty was introduced. In addition, on 1 March 2013, the excise duty on fine-cut tobacco was raised.

In the previous year, the Government continued to implement the policy of adjusting excise duties on energy products to market conditions, which will continue in this programming period; this means that it will pursue several goals, the most important of which are the consolidation of public finances, and ensuring efficient energy use and environmental protection. In 2012, the calculation and payments of the environmental tax on the use of fuels (gasoline, diesel fuel) for polluting the air with CO_2 emissions began. On 1 January 2013, the environmental tax on CO_2 emissions was additionally raised by 15%.

Other established tax measures, the effects of which will be shown in 2013 or upon tax calculations for 2013, include:

- a limitation on tax loss utilisation from previous tax periods; this right is limited to a maximum of 50 per cent of the tax base in a tax period;
- the special tax relief for students is lowered by 25%;
- the introduction of cedular taxation for income from the lease of property at the proportional rate of 25%;
- the introduction of a tax on financial services taxes commissions charged by financial institutions for performing financial services, and which in accordance with the act on value added tax are exempt from VAT, including the services of insurance brokers and agents. The only exceptions are investment fund management services and services related to securities transactions, as they are the subject of taxation by the anticipated European tax on financial transactions. The tax charges transactions paid after 1 March 2013;
- the introduction of amendments to the Tax Act on Banks' Balance Sheet Assets, which place a stronger emphasis on the fiscal aspect of charging this tax in comparison with the previous act and thus intensify the conditions to reduce tax liabilities, and also state that this tax will be charged only in 2013 and 2014;
- the change in the burdening of motor vehicles so that the annual fee for motor vehicles progressively increases;
- environmental and concessions fees were raised in order to enhance budget revenue and stimulate environmental protection;
- in order to additionally burden persons owning real estate of greater value, the subjects of anti-crisis tax on immovable property of greater value were expanded. The lower threshold of the total value of immovable property for 2013 and 2014 was lowered from EUR 1 million to EUR 500,000, and the tax includes all residential property, except properties in the public domain. Thus the burden of consolidating public finances was extended to a wider circle of taxable persons.

In the field of procedures to meet tax liabilities and measures to prevent the non-payment of taxes, amendments to the Tax Procedure Act were introduced. They mainly refer to determining the use of a computer programme or electronic device which does not support deletion, correction or any modification to an original entry saved in the device or another medium without saving initial information and all subsequent changes. This measure is a solution that has the same effect as so called tax coffers, but it is less costly for taxpayers, which means that this solution does not result in additional administrative burdens and is financially more favourable to taxpayers who wish to operate in accordance with the law. On the other hand, this measure, which will be fully operational by 1st of July 2013, is a powerful tool of the state to increase the level of voluntary tax compliance together with the execution of an active media campaign including promotion of voluntary tax compliance, the announced activities of the control and the publication of the results of control. Under construction is also the implementation of the system to send photos via MMS messaging accounts in which the state seeks to encourage consumers to demand bills for the purchase of goods and services, and to photograph them and sent them in the form of free MMS messages to the tax authorities for the purpose of further consideration.

The aforementioned change pursues the objective of reducing the grey economy and unfair competition. At the same time, the Government adopted a measure in the previous period, the original objective of which was mainly to enhance the culture of tax payment, improve payment discipline, and encourage the voluntary, correct and prompt payment of tax liabilities, which would improve the legitimacy of the tax system as such and guarantee a regular inflow of revenue to the budget. This measure is the publication of tax debtors whose debt exceeds EUR 5,000 and who have been in default for over 90 days.

The Government expects the structure of measures to adequately distribute tax burdens, simpler fulfilment of tax liabilities, and efficient control, and measures to raise awareness on voluntary tax payment to contribute to reducing the grey economy and more stable inflow of budget revenue.

The policy of general government revenue from social security contributions in the programming period will pursue the solutions established with the pension system reform. In the field of health care and health insurance, the Government plans to claim the payment of health insurance contributions to a greater extent according to the principle ‘any work or any income counts’.

Other changes in the general government revenue system refer to improving existing legislation and upgrading with new solutions. Additional measures planned by the Government in 2013 are described in more detail in Chapter 6.1.

3.3. Government expenditures policy

With the aim of achieving the fiscal policy objectives to reduce the deficit below 3% of GDP by 2014, restrictive wages policy in the public sector, and a restrictive policy on all types of transfer will continue on the expenditure side and investment expenditure will be more focused. The share of government expenditure will be reduced to 46.7% of GDP by the end of the programming period. Following a decline in the next two years, the nominal growth of government expenditures will be positive in the last year of the programming period; however, it will be significantly lower than the anticipated growth of potential output, as shown in Table 3.2. In the programming period, the Government will design additional measures to further lower government expenditure in such a way that the measures are distributed proportionally across all types of public expenditure and that no negative effects on economic growth will result.

Table 3.3: Nominal growth of government expenditures, potential output and GDP

in %	2012	2013	2014	2015	2016
Government expenditure	-5.7	8,8*	-7.2	-0.2	1.0
Potential output	-0.5	0.5	0.8	1.8	2.1
GDP	-2.0	-0.6	1.4	3.0	3.5

Source: IMAD, MF RS.

Note: *With no consideration of recapitalisation, the growth of expenditures in 2013 amounts to 1.5%.

The starting point for the actions taken by the Government are the adopted 2013 state budget (which represents a major portion of expenditures) and the budget deficit of EUR 1.0 billion and targeted reduction of the budgetary deficit to below 3% of GDP. Limiting the expenditure so that it has a significant effect requires systemic changes and, considering the situation in 2013, selective intervention in the so-called flexible part of expenditure, particularly investments. Particularly in 2013, the expenditure ceiling is also well defined by the measures introduced in 2012 by the Fiscal Balance Act (ZUJF).

The Government plans to take into consideration previously unplanned and/or additional obligations resulting from partly implemented measures to limit certain categories of expenditure and reallocate funds in order to cover plans for which funds were underestimated when the

2013 budget was being drafted, or programmes were not planned[7]. Such obligations will considering the targeted budgetary deficit be implemented by changing the implementation and financing of programmes and/or reallocation between individual programmes, having regard to the fiscal legislation.

In 2013 and thereafter, expenditures will be reduced by the further rationalisation of current operating costs in the public sector (increased efficiency by preserving standards of services within the framework of available resources or by not amending the level of financing - the level from the previous year, and by setting priorities in individual areas), the reduction of expenditure on certain programmes and policies, in particular financing infrastructure, carrying out public services, lowering and restricting subsidies to the business sector and other activities, and by focusing on projects co-financed by EU funds.

Due to the necessary adjustment in the scope of operations of the public sector to real economic viabilities, the 2013 budget planned to lower the funds for salaries and employers' social security contributions which are financed from public funds. In 2012, the Fiscal Balance Act was passed, which provides effects in the form of lower obligations in 2013 in comparison to 2012 also in the field of salaries and employers' social security contributions. The measures were applied already in 2012, but only for one half of the year, while in 2013 they will be in effect for all 12 months. At the end of 2012 and beginning of 2013, austerity measures taken for certain budget spending units, and also legal restrictions on replacing and employing staff in the public sector, resulted in a significant lowering of the number of employees, which also reduces obligations for 2013. Moreover, the Government is negotiating intensively with social partners (the Government and public sector unions) on further lowering the rights or salaries of employees. Negotiations aim at reducing the rights in a way that the nominal level of the wage bill remains unchanged with respect to the 2013 level during the whole programming period. The agreed measures will apply for 2013 and 2014, but the social dialogue will resume during the preparation of budgets for 2015 and 2016. The Government will also strictly adhere to the policy of reducing employees for 1 % per year throughout the public sector by not filling in the vacancies during the entire programming period. Reducing the number of employees is a structural measure with permanent effects.

In the field of pension and disability insurance, activities are based on the new act that entered into force on 1 January 2013 in order to ensure financial sustainability by 2020. For 2013, it is estimated that additional measures will be needed to stabilise public pension expenditure in the indicative amount of EUR 150 million regarding the adopted 2013 budget, for several reasons:

- Due to the expected adoption of the new pension legislation, many beneficiaries decided to take early retirement immediately upon fulfilling the relevant conditions. This also occurred in the public sector in the last few months of 2012. When adopting the budget, the assumption was made that annual growth in the number of people eligible for retirement would fall from 3.1% in 2012 to 1.5% in 2013; however, the growing number of retirements in the first three months of 2013 shows that by the end of this year, it will have reached 3.3%.
- The Constitutional Court of the Republic of Slovenia issued an order that repealed certain articles of the Fiscal Balance Act (ZUJF). Therefore, in April, the Pension and Disability Insurance Fund started to issue new decisions to eligible retired persons and to pay out funds as from 22 March 2013 in the amount of rights applicable before the Fiscal Balance Act came into force. For this reason, the obligation of the Pension and Disability Insurance Fund will increase in total of EUR 18 million. Considering back-

[7] e.g. change in measures provided for by the Fiscal Balance Act e.g. as the result of decisions taken by the Constitutional Court of the Republic of Slovenia, disposal of funds for labor costs of the public sector, effectiveness of performance of public services, state budget funds for the Pension and Disability Insurance Institute of the Republic of Slovenia, provision of funds for CoCo bonds issued by the bank Nova kreditna banka Maribor, additional funds for cohesion policy.

payments, namely for the period from the coming into force of the ZUJF until the order of the Constitutional Court (22 March 2013), a special act will have to be adopted by 1 June 2013. Reimbursement of parts of pensions that have not been paid to 22,000 retired persons whose decisions are already final will amount to EUR 16.3 million, and another EUR 8.4 million for 8,000 retired persons whose decisions have not yet become final since they lodged constitutional complaints with the Constitutional Court of the Republic of Slovenia. The special act should also stipulate the reimbursement of health insurance contributions for the part of pensions that has not been paid.

- The Act has been in force for only three months and also includes a transitional provision on the basis of which the fulfilment of the retirement condition (65 years of age for men and women) will not yet come into force, but will come in full effect no earlier than in 2019.

Additional funds for the Pension and Disability Insurance Fund (ZPIZ) will be provided through payments by the Capital Fund Management. The Fund is obliged to pay EUR 50 million to the Pension and Disability Insurance Fund annually; an additional payment by the Capital Fund Management to the Pension and Disability Insurance Fund in the amount of EUR 70 million is also foreseen under the provision of the annual Budget Implementation Act, from the sale of state-owned assets.

Transfers to individuals and households represent the majority of the social protection policy and is planned at a level which will not exceed the 2013 budget. The Government of the RS intends to achieve this by means of several measures:

- keeping transfers to individuals and households at the nominal level, foreseen in the Fiscal Balance Act for the entire programming period;
- linearly reducing the amount of unemployment benefit by 3%;
- limiting maternity benefit to the maximum of twice the average monthly salary in the Republic of Slovenia;
- legislative amendments and austerity measures in the field of social security already enforced in 2012, as well as new amendments to the legislation on exercising rights to public funds and social-security benefits and long-term care.

By implementing programmes within the framework of the five active labour market policy measures (training and education, replacement of a worker at a job and job sharing, employment incentives, job creation, promotion of self-employment), the number of beneficiaries of social security transfers and unemployed benefits is expected to be reduced, and consequently, expenditure on social transfers will be reduced. The funds of the European Social Fund are an important source of financing for the active labour market policy.

In the field of public health, additional intervention measures will be proposed which will generate higher revenues for the Health Insurance Fund by expanding the bases for calculating contributions from the income of different categories of insured persons under the principle ‘any income counts’, equalising different categories of insured persons in terms of the scope of rights and the existing contribution level, and determining the lowest contribution rate for self-employed persons. The rights to a funeral and death grant, which are inherently social security rights, will be restricted.

Transfers to public institutions from public funds are planned in the amount equal to that adopted in the 2013 budget and financial plans. In the years to come transfers to public institutions will remain at nominally the same level as in 2013. Although the funds for research have been reduced since 2011, Slovenia has already undertaken steps to improve the efficiency of use of available funds and to provide additional funds through structural funds projects. In the field of education, the majority of funds are allocated to transfers for the operation of public institutions, of which more than 80% are for labour costs. Due to the budgetary performance and necessary adjustment to economic viabilities, the adopted 2013 budget also planned to lower the funds for wages and employers' social security contributions for employees in education; the Government has begun negotiations with social partners on further restricting incomes. Moreover, it is anticipated that further streamlining will be necessary in this segment to ensure that the funds planned will be sufficient to fully perform the public service.

In the state budget, measures to co-finance development activities and technological investments received special emphasis, as well as support for new foreign direct investments (FDI). In 2013, the new joint agency SPIRIT was launched; it will provide a comprehensive set of information, studies and analyses in the field of FDI, and offer comprehensive support to investors in their search for adequate business opportunities. In 2013 and 2014, the activities of accelerating FDI will be focused mainly on the provision of financial incentives for initial investments. The acceleration of technological development and foreign direct investments in 2013 and 2014 will be stimulated, in particular through targeted financing and the selection of projects within the framework of the funds available from state budget subsidies. At the same time, special attention will be paid to the provision of funds to accelerate technological development and increase the scope and efficiency of exploiting structural funds.

Activities in respect of investments which are not part of European programmes are focused in particular on projects that are in their closing stages (with a total realisation of more than 70%) and so it is not practical to discontinue them or even postpone their finalisation. In this manner, a scope of expenditure on investments could be specified in 2013 that is lower by a minimum of EUR 100 million with regard to the adopted 2013 budget; the same situation is expected for the years to come, when departmental measures are foreseen by synchronising the co-financing of calls to tenders in respect of related purposes and by stimulating the cooperation of investors in large-scale joint projects in order to enhance the effectiveness of planning and implementation. In addition to the above-mentioned, the use of investment expenditure is to be selected by introducing priority spending of the earmarked funds. Since the impact of spatial planning procedures and obtaining construction permits adopted in 2012 will be evident in the next few years, the restriction of financing within the limited financial possibilities to projects with activities already on-going is a reasonable measure.

In the field of cohesion policy, activities regarding acceleration of the use of EU funds are strengthening. The successful implementation of projects and spending of European funds are the priorities for the Government, in particular for environmental and transport infrastructure projects, which in 2013 must realise reimbursements of EU funds to the state budget of at least EUR 334 million in order that the n+3/2 rule (spending funds within three or two years from the year of allocation) will be implemented.

Activities to accelerate the implementation of European programmes encompass the improvement of institutional framework (inter-organisational cooperation, in particular between institutions involved in preparing projects or obtaining permits, groups responsible for solving problems in the preparation and implementation of projects of aligning legislation, instructions and rules – advance payments, funds reallocations, public calls to tender[8] and audits of public tender procedures), amendment or termination of decisions concerning cooperation with entitled persons, provision of excessive entitlement spending and confirmation of back-up projects.

[8] An expert group on public procurements is being established at the proposal of the European Commission, which will speed up the review of contract documents.

3.4. Fiscal consolidation, structural deficit and fiscal position

Fiscal policy is focused on consolidation measures in order to reach the structural balance in 2017 and bring the deficit below 3% of GDP by the end of 2014. The dynamics of fiscal consolidation as shown in the Table 3.5 is supported by the restrictive expenditure policy as described in Chapter 3.3. and by revenue measures, as they are presented in Chapter 3.2. and 6.1. The lowering of the state budget deficit to below 3% of GDP by 2014 is executed at a constant pace, while the level of deficit envisaged for 2014 (2.6 % of GDP) provides a sufficient safety limit to the reference value. The medium–term objective (MTO) is set as a permanently balanced structural position, in line with the proposed fiscal rule for balanced budget. After bringing to an end the existence of the excessive deficit, the adjustment path toward structurally balanced budget is foreseen in line with the Regulation 1466/97 (amended by 1175/11).

The general government deficit in 2012 amounted to 4.0% of GDP and is 2.4 percentage points lower in comparison to 2011.The deficit in 2012 was 0.5 percentage points higher than the deficit envisaged in the previous year's programme, which is mainly the result of the additional deterioration in macroeconomic indicators with regard to those taken into account in the previous update of the document. A deficit of 7.9 % of GDP is envisaged in 2013 as the result of the envisaged one-off measures of recapitalisations of banks in the amount of 3.7% of GDP. Without considering these urgent measures to enhance bank stability, the deficit would remain at the level of the previous year in the deteriorated macroeconomic conditions.

Fiscal efforts to reduce the deficit and reduce government debt are foreseen in 2013 and in the next few years, resulting in an improvement in credibility and accelerating the reduction of the deficit. The fiscal consolidation measures are both permanent and temporary, helping to reduce the structural deficit.

Table 3.3: Cyclical developments

	in % of GDP	ESA Code	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
1.	Real GDP growth (%)		1.2	0.6	-2.3	-1.9	0.2	1.2	1.6	1.6
2.	Net lending of general government	B.9	-5.9	-6.4	-4.0	-7.9	-2,6	-2.1	-1.4	-0.5
3.	Interest expenditure	D.41	1.6	1.9	2.1	2.7	2.9	2.8	3.0	2.9
4.	One-off and other temporary easures		0.2	1.2	0.2	3.7				
5.	Potential GDP growth (%)		0.6	-0.3	-0.9	-0.8	-0.3	0.0	0.2	0.4
	contributions:									
	- labour		0.0	-0.4	-0.7	-0.4	-0.5	-0.5	-0.5	-0.6
	- capital		0.4	0.1	-0.2	-0.2	-0.1	-0.1	0.0	0.0
	- total factor productivity		0.1	0.0	-0.1	-0.2	0.3	0.6	0.8	0.9
6.	Output gap		-2.8	-1.9	-3.3	-4.4	-3.9	-2.7	-1.4	-0.1
7.	Cyclical budgetary component		-1.4	-1.0	-1.6	-2.4	-1.9	-1.3	-0.6	0.0
8.	Cyclically-adjusted balance (2 - 7)		-4.5	-5.4	-2.4	-5.6	-0,7	-0.8	-0.8	-0.4
9.	Changes in cyclically-adjusted balance		-0.2	-0.8	3.0	-3.2	4.9	0.5	0.0	0.4
10.	Structural balance (8-4)		**-4.3**	**-4.2**	**-2.2**	**-1.8**	**-0,7**	**-0.8**	**-0.8**	**-0.4**
11.	Changes in structural balance		-0.2	0.2	2,0	0.4	1,2	-0,1	0.0	0.4

Source: MF RS.

Table 3.3 shows the structural deficits expected to be achieved by the consolidation strategy, based on measures on the expenditure and revenue sides, which are intended to have a minimum negative impact on economic growth. In 2012, the cyclically-adjusted deficit decreased by 3.0% of GDP, which is mainly due to one-off measures in 2011 (see Stability Programme – 2012 update). The structural deficit, calculated by excluding all one-off measures, decreased by 2.0% of GDP in 2012. In the period 2012-2014, the structural deficit will decline on average by 0.7% of GDP per year.

The average potential growth rate in 2012-2016 as shown in Table 3.3 is estimated at -0.3% per year, compared to 0.6% in the last-year update of the Stability Programme. A positive increase in the potential GDP is foreseen after 2016. Negative growth is mainly the result of the negative contribution of labour and capital accumulation. In 2012 and 2013, a negative contribution of total factor productivity has been recorded. The negative contribution of labour is affected in particular by the high unemployment rate and reduction in the participation rate. The contribution of labour to potential growth in 2012 was -0.7 percentage points, while for the next period, the negative trend of the contribution of labour is expected to slow down. Capital contribution is also negative in the period 2012-2015; however, it is expected to grow at the end of the programming period. From 2009 onwards, there is a negative output gap, which describes the cyclical situation. The most negative value is expected this year.

Table 3.4. shows the structural deficits while also considering the additional permanent measures on expenditure side amounting to EUR 200 million per year from 2015 onwards in the field of wage bill, pensions, social transfers, investment and operation of municipalities, which will provide for the attainment of the medium-term objective of a balanced structural deficit in 2017. These will be finally defined by the end of the year and presented in detail in the next Stability Programme update.

Table 3.4.: Cyclical movements for attaining the medium-term objective

	in % of GDP	ESA Code	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
1.	Real GDP growth (%)		1.2	0.6	-2.3	-1.9	0.2	1.2	1.6	1.6
2.	Net lending of general government	B.9	-5.9	-6.4	-4.0	-7.9	-2,6	-1.6	-0.9	0.0
3.	Interest expenditure	D.41	1.6	1.9	2.1	2.7	2.9	2.8	3.0	2.9
4.	One-off and other temporary easures		0.2	1.2	0,2	3.7				
5.	Potential GDP growth (%)		0.6	-0.3	-0.9	-0.8	-0.3	0.0	0.2	0.4
	contributions:									
	- labour		0.0	-0.4	-0.7	-0.4	-0.5	-0.5	-0.5	-0.6
	- capital		0.4	0.1	-0.2	-0.2	-0.1	-0.1	0.0	0.0
	- total factor productivity		0.1	0.0	-0.1	-0.2	0.3	0.6	0.8	0.9
6.	Output gap		-2.8	-1.9	-3.3	-4.4	-3.9	-2.7	-1.4	-0.1
7.	Cyclical budgetary component		-1.4	-1.0	-1.6	-2.4	-1.9	-1.3	-0.6	0.0
8.	Cyclically-adjusted balance (2 - 7)		-4.5	-5.4	-2.4	-5.6	-0,7	-0.3	-0.3	0.1
9.	Changes in cyclically-adjusted balance		-0.2	-0.8	3.0	-3.2	4.9	0.4	0.0	0.4
10.	Structural balance (8-4)		**-4.3**	**-4.2**	**-2.2**	**-1.8**	**-0,7**	**-0.3**	**-0.3**	**0.1**
11.	Changes in structural balance		-0.2	0.2	2,0	0.4	1,2	0,4	0.0	0.4

Source: MF RS.

Table 3.5: General government budgetary prospects

	ESA code	2011 Level	2012 (estim.)	2013	2014	2015	2016
		m EUR	%GDP	%GDP	%GDP	%GDP	%GDP
Net lending by sub-sector (B.9)							
1. General government	S.13	-1,417.7	-4.0	-7.9	-2,6	-2.1	-1.4
2. Central government	S.1311	-1,342.5	-3.8	-7.7	-2.2	-1.7	-1.1
	S.1312	…	…	…	…	…	…
4. Local government	S.1313	33.2	0.1	0.0	0.0	0.0	0.0
5. Social security funds	S.1314	-108.5	-0.3	-0.3	-0.4	-0.4	-0.4
Total general government (S.13)							
6. Total revenue	TR	15,895.3	44.8	45,5	46.8	45.8	45.3
6. A Total revenue without EU*		15,477.6	43.6	43,4	45,2	44.1	43.6
7. Total expenditure	TE	17,313.0	48.8	53,4	49.4	47.9	46.7
7.A Total expenditure without EU*		16,895.3	47.6	51,4	47,8	46.3	45.1
8. Net lending / borrowing	EDP B.9	-1,417.7	-4.0	-7.9	-2,6	-2.1	-1.4
9. Interest expenditure	EDPD.41	747.9	2.1	2.7	2.9	2.8	3.0
10. Primary balance		-669.9	-1.9	-5.2	-0.3	0.7	1.6
11. One off expenditures**		61,0	0,2	3.7			
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		7,856.3	22.2	22.6	24,5	23.4	23.2
12a. Taxes on production and imports	D.2	5,097.8	14.4	15.0	15,6	14.7	14.6
12b. Current taxes on income, wealth, etc	D.5	2,741.6	7.7	7.6	8,8	8.7	8.6
12c. Capital taxes	D.91	16.9	0.0	0.1	0.1	0.0	0.0
13. Social contributions	D.61	5,480.0	15.5	15.4	15.2	15.0	14.9
14. Property income	D.4	348.6	1.0	0.8	0.8	0.8	0.8
15. Other		2,210.4	6.2	6,7	6.3	6.5	6.4
16. Total revenue	TR	15,895.3	44.8	45,5	46.8	45.8	45.3
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		13,336.3	37.6	38.0	39.7	38.5	38.1
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	6,909.2	19.5	18.8	18.5	18.0	17.4
17a. Compensation of employees	D.1	4,464.9	12.6	12.0	11.8	11.5	11.1
17b. Intermediate consumption	P.2	2,444.3	6.9	6.8	6.7	6.5	6.3
18. Social payments (18=18a+18b)		6,997.4	19.7	20.2	20.0	19.6	19.0
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D. 63131	757.9	2.1	2.3	2.2	2.2	2.2
18b. Social transfers other than in kind	D.62	6,239.5	17.6	17.9	17.8	17.3	16.8
19. Interest expenditure	D.41	747.9	2.1	2.7	2.9	2.8	3.0
20. Subsidies	D.3	473.1	1.3	1.3	1.1	1.0	0.9
21. Gross fixed capital formation	P.51	1,040.8	2.9	3,2	4.1	3.7	3.6
22. Other		1,144.7	3.2	7.2	2.8	2.9	2.8
23. = 7. Total expenditures	TE	17,313.0	48.8	53,4	49.4	47.9	46.7

Source: MF RS.

Note: * Revenue/expenditure without funds from the EU budget, where beneficiaries are institutional units outside general government sector.

** Recapitalization of banks and non-financial enterprises.

Table 3.6.: No-policy change projections

		2012	2012	2013	2014	2015	2016
		m EUR	in % GDP				
1.	Total revenue at unchanged policy	15,895.3	44.8	45.4	44,8	44.5	44.0
2.	Total expenditure at unchanged policy	17,313.0	48.8	54.4	51.0	50.0	49.3

Source: MF RS.

Regarding the expenditure benchmark, introduced by the new EU legislative package for strengthened economic coordination, expenditure growth in 2013–2016 will be considerably lower than the growth of potential GDP (Table 3.2.). The exclusion of certain items is taken into account, namely expenditure on EU programmes fully matched by revenue from EU funds and non-discretionary changes in unemployment benefit expenditure, as shown in Table 3.7.

Table 3.7: Amounts to be excluded from the expenditure benchmark

		2012	2012	2013	2014	2015	2016
		m EUR	in % GDP				
1.	Expenditure on EU programmes fully matched by EU funds revenue	706.4	2.0	2.5	2.8	2.6	2.6
2.	Cyclical unemployment benefit expenditure	263.1	0.7	0.8	0.8	0.8	0.7
3.	Effects of discretionary revenue measures	0.0	0.0	0.1	2.0	1.3	1.3
4.	Revenue increases mandated by law	n.a	n.a	n.a	n.a	n.a	n.a

Source: MF RS.

Data on government expenditure by functions are available until the end of 2011 only. The bulk of expenditure in Slovenia is disbursed for social protection, followed by education and health. Meanwhile, general public services and economic affairs accounted for over 5% of GDP in 2011.

Table 3.8: General government expenditure by functions

in % of GDP	COFOG Code	2008	2009	2010	2011
1. General public services	1	5.1	5.7	5.8	6.3
2. Defence	2	1.4	1.5	1.5	1.2
3. Public order and safety	3	1.6	1.7	1.8	1.7
4. Economic affairs	4	4.8	5.1	5.3	5.8
5. Environmental protection	5	0.8	0.9	0.8	0.8
6. Housing and community amenities	6	0.9	0.8	0.7	0.7
7. Health	7	6.2	7.0	6.9	6.9
8. Recreation, culture and religion	8	1.6	1.8	2.3	1.9
9. Education	9	6.1	6.5	6.6	6.7
10. Social protection	10	15.9	18.0	18.6	18.9
11. **Total expenditures**	TE	**44.2**	**49.1**	**50.3**	**50.7**

Source: SORS

3.5. Debt levels and developments

The outstanding amount of general government consolidated debt was estimated at EUR 19,189 million or 54.1% of GDP at the end of 2012. The largest share (87.6%) of total general government debt was represented by the central government debt, which has a relatively stable structure. In 2012, the general government deficit was according to the ESA 95 methodology significantly lower than in the previous year, amounting to EUR 1,418 million or 4.0% of BDP in 2012, and EUR 2,298 million or 6.4% of BDP in 2011. Following the amended Public Finance Act of 2008, which allows state budget advance borrowing to the extent of outstanding principals in the next two budget years, the Republic of Slovenia may borrow funds in the amount exceeding the extent of borrowing for financing the deficit of the balance of revenues and expenditure and the deficit in the financial assets and liabilities account, and repayments of principals of the debt in the current year. The prefinancing amount at the end of 2012 was EUR 1,639 million.

Government debt as a share of GDP increased substantially in 2009. After a further gradual increase, in the programming period following the peak in 2014 and 2015, the debt ratio will decline to 61.8% of GDP in 2016. The debt dynamics will be driven primarily by the central government debt. Local government debt is expected to remain at the level of about 2% of GDP. The borrowing capacity of local communities is constrained by the act governing the financing of local communities, according to which local community borrowing in an individual year should not exceed 20% of revenue from the preceding year. Expenditures to cover the costs of borrowing by local communities are also limited, since they may spend a maximum 5% of realised revenues from the previous year on the debt (interest and principal). The amount of outstanding debt of social security funds stood at EUR 52 million at the end of 2012, representing the borrowing by the Capital Fund Management and financial leasing by the Health Insurance Fund. The outstanding debt includes the participation of the Republic of Slovenia in the EFSF guarantees.

The increase in general government debt-to-GDP ratio is predominately due to primary deficits (negative primary balances). It is important to highlight that the above-mentioned dynamics of the debt-to-GDP ratio does not take into account the potential use of privatisation proceeds for a further reduction in overall government debt.

Table 3.8: General government debt developments

in % of GDP	**ESA code**	**2012**	**2013***	**2014**	**2015**	**2016**
1. Gross debt		54.1	61.8	63.2	63.2	61.8
2. Change in gross debt ratio		7.2	7.7	1.5	0.0	-1.5
Contributions to change in gross debt ratio						
3. Primary balance		-1.9	-5.2	0.3	0.7	1.6
4. Interest expenditure	EDP D.41	2.1	2.7	2.9	2.8	3.0
5. Stock-flow adjustment						
p.m. implicit interest rate on debt		4.4	5.0	4.7	4.5	4.9

Source: MF RS.

Note: *Without considering the effects of restoring the banking sector through the BAMC in the amount of up to EUR 4 billion.

In the next medium term, the structure of borrowing instruments, the ratio between short- versus long-term borrowing, and dynamics of how the Government borrows will be planned primarily by taking into account the strategic objectives and the principles of government debt management, as well as assessments of central government budget cash flow, which has been the case so far. The selected mix of financing instruments will support the building of a benchmark yield curve and an improvement in Slovenian government securities' secondary market liquidity. However, the strategy of borrowing execution should also be taken into account, with the main principle of combining predictability and flexibility. This will provide for a proper response to the changed market conditions and the possibility of effectively carrying out alternative plans for borrowing in such situations.

Long-term borrowing through benchmark government bonds has been the primary instrument of central government budget financing, while short-term borrowing in stable conditions has been usually resorted to budget liquidity management within a fiscal year. Among long-term borrowing instruments, the syndicated public issue of benchmark government bonds has been foreseen as the primary instrument in European and other markets. Other possible alternative long-term borrowing instruments may be: a further issue of the existing benchmark bonds (re-opening the issue of existing bonds) by the syndicated or auction method; an issue of bonds via auctions; an issue of bonds for a restricted range of investors (private placing); an issue of bonds under the EMTN programme; bank loans; or other long-term borrowing instruments enforced in the financial market.

3.6. Budgetary implications of major structural reforms

To ensure the sustainability of public finances, changes to the pension system were enforced in December 2012. The effects of the changes on the long-term sustainability of public finances, including financial implications, are presented in detail in Chapter 5.1.

Measures to enhance the stability of the banking sector will also have significant budgetary implications. One-off effects of capital increases in 2013 have been estimated at 3.7% of GDP, and of the warranties required for the operation of the BAMC in the amount of EUR 4 billion; a more detailed presentation is provided in a box on page 15 and in the National Reform Programme 2013 - 2014.

4. SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS UPDATE

4.1. Sensitivity analysis to changes in economic activity

The baseline scenario of economic activity is described in Chapter 2. The risks of a larger-than-forecast drop in economic activity this year are associated with the international situation, with regard to both the recovery in economic activity in Slovenia's main trading partners and the situation on the financial markets. Were economic growth in the euro area to be 1 percentage point lower, Slovenia's GDP would contract by around 2 percentage points more than under the baseline scenario. The largest impact would be on exports and fixed capital formation, in which harsher lending conditions would most likely also be a factor alongside a decline in export demand. In an environment of increased uncertainty and an even greater deterioration in the situation on the labour market than under the baseline scenario of the spring forecast, private consumption would also decline more. The realisation of the forecast will otherwise be significantly affected by the measures taken to stabilise the banking system, and other planned measures intended to revive lending activity, to help disburden the economy and to kick-start a new investment cycle.

4.2. Sensitivity of budgetary projections to different scenarios and assumptions

The sensitivity analysis of tax revenues and general government balance projections to changes in real growth in average gross wage, employment, GDP, inflation and real growth of private and government consumption are shown in Table 4.1 and Table 4.2.

Table 4.1 shows the current risk of underlying macroeconomic scenario on the key government revenue components and fiscal stance. Assessed macroeconomic risks include: i) lower real growth rate of average gross wages; ii) lower employment; iii) lower real growth of GDP than in previous year; iv) lower real growth of private consumption of households; v) changes in inflation (current and past years) and; vi) lower real growth of government consumption. Risk assessments were made on the basis of data from 2012. In all cases the negative trends have an affect on the tax revenues. Regarding the relative share in the total government revenues, the highest risk is associated to social security contributions and indirect taxes. In particular, social security contributions are affected by lower employment. The largest share of indirect taxes represents VAT, mostly affected by private consumption and inflation.

Table 4.1.: Sensitivity of general government balance to changes in macroeconomic variables

Tax category	Macroeconomic base	Change in macroeconomic base	Change in general government balance in 2012 (% of GDP)
Personal Income Tax	Real growth in average gross wage	Lower by 1 p.p.	-0.06
	Employment	Lower by 1 p.p.	-0.06
	Inflation	Lower by 1 p.p.	-0.10
	Last year's inflation (Nov/Nov)	Higher by 1 p.p.	-0.04
Social security contributions	Real growth in average gross wage	Lower by 1 p.p.	-0.16
	Employment	Lower by 1 p.p.	-0.16
	Inflation	Lower by 1 p.p.	-0.15
Corporate Income Tax	Real GDP growth in t-1	Lower by 1 p.p.	-0.03
	Last year's inflation	Lower by 1 p.p.	-0.02
Indirect Taxes	Real growth in private consumption	Lower by 1 p.p.	-0.12
	Real growth in government consumption	Lower by 1 p.p.	-0.03
	Inflation	Lower by 1 p.p.	-0.11

Source: MF RS.

Table 4.2 shows how changes in single macroeconomic variables affect various revenue aggregates as well as the government balance. The impact is most pronounced in the case of inflation. A 1 percentage point decrease in inflation would lead to 0.36% of GDP lower revenue. Lower real growth of wages will also result in a decline in personal income tax and social security contributions of 0.22% of GDP. A decline in employment also affects the fiscal stance to a similar degree. Lower employment and real wage growth will therefore result in lower revenue and higher expenditure, and both changes adversely affect the general government balance. A 1 percentage point changes in inflation (from the previous year) lead to a decline in personal income tax and corporate income tax by 0.12% of GDP. Decline in the real growth of private consumption has a similar effect on indirect taxes, while the effects of the changes in the real growth of government consumption are indicated only as 0.03% of GDP.

Table 4.2: Cumulative sensitivity of general government balance to changes in macroeconomic variables

Macroeconomic base	Change in macroeconomic base	Revenue category	Change in general government balance in 2012 (% of GDP)
Real growth in average gross wage	**Lower by 1 p.p.**	**Personal Income Tax, Social Security Contributions**	-0.22
Employment	**Lower by 1 p.p.**	**Personal Income Tax, Social Security Contributions**	-0.22
Inflation	**Lower by 1 p.p.**	**All**	-0.36
Last year's inflation (nov/Nov)	**Lower by 1 p.p.**	**Personal Income Tax, Corporate Income Tax**	-0.12
Real GDP growth in t-1	**Lower by 1 p.p.**	**Corporate Income Tax**	-0.03
Real growth in private consumption	**Lower by 1 p.p.**	**Indirect Taxes**	-0.12
Real growth in government consumption	**Lower by 1 p.p.**	**Indirect Taxes**	-0.03

Source: MF RS.

4.3. Sensitivity analysis on the debt service

The basic starting point for the costs of borrowing and repayment of existing debt is the level of the ECB reference interest rate and the level of deficit of the central government budget. In the sensitivity analysis, we assume that for the time being, the ECB will keep the interest rate at the current level of 0.5%, while the rise that will follow will be gradual. The impact of the time structure on interest rates is taken into account already in the baseline scenario, increased by 0.5 percentage points in the sensitivity analysis.

Table 4.3: Sensitivity of interest payments and central government debt to changes in certain macroeconomic variables (in % of GDP)

	Change in ECB interest rates		Change in deficit		Change in ECB interest rates and deficit	
	Interest	Debt	Interest	Interest	Debt	Interest
Year	In percentage points					
2013	0.0426	0.0426	0.0000	1.0000	0.0376	1.0426
2014	0.0840	0.0420	0.0479	0.9865	0.1318	1.0285
2015	0.1222	0.0407	0.0465	0.9577	0.1687	0.9984
2016	0.1378	0.0197	0.0449	0.9250	0.1827	0.9447
2017	0.1378	0.0000	0.0449	0.9250	0.1827	0.9250

Source: MF RS.

If ECB reference interest rates rise by 0.5 percentage points in 2013, this will lead to an increase in cost of new borrowing of 0.084 percentage points in 2014 and 0.122 in 2015. In this case, central government debt would increase by 0.042 percentage points of GDP in 2014 and 0.041 in 2015. If the government deficit increases by 1 percentage point in 2013, the interest cost as a percentage of GDP would increase by 0.048 percentage points in 2014, 0.047 in 2015 and 0.045 in 2016.

Central government debt is relatively insensitive to changes in exchange rates, as the share of debt denominated in foreign currencies (USD, GBP, CHF) is insignificant. In October 2012 and May 2013, when a dollar bond was issued, currency rate conversion into EUR was concluded to protect against currency risk.

In the 2013 programming year, the share of debt with a fixed interest rate is estimated at 96.6%. The impact of changes in interest rates on existing central government debt as a share of GDP is minimal, as the central government debt is comprised mainly of fixed interest instruments. Thus the change in interest rate primarily affects the cost of new borrowing.

4.4. Comparison with the 2012 Stability Programme

The forecast for GDP growth was revised downwards for the whole period compared with the previous Stability Programme. The main reasons for the revision are relatively less favourable domestic economic conditions (relatively more limited sources of finance, deteriorated labour-market conditions and greater payment indiscipline), which contributes to lower growth in investment and private consumption, as well as less favourable conditions in the international environment than expected.

Table 4.4: Divergence from the previous update (April 2012)

% of GDP	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
1. Real GDP growth						
Stability programme (previous update)	-0.2	-0.9	1.2	2.2	2.2	
Stability programme (latest update)		-2.3	-1.9	0.2	1.2	1.6
Difference		-1.4	-3.1	-2.0	-1.0	
2. General government net lending						
Stability programme (previous update)	-6.4	-3.5	-2.5	-1.5	-0.4	
Stability programme (latest update)		-4.0	-7.9	-2.6	-2.1	-1.4
Difference		-0.5	-5.4	-1.1	-1.7	
3. General government gross debt						
Stability programme (previous update)	47.6	51.9	53.1	52.6	50.9	
Stability programme (latest update)		54.1	61.8	63.2	63.2	61.8
Difference		2.2	8.7	10.6	12.3	

Source: IMAD, SORS, MF RS.

The general government deficits for the period 2012-2015 are higher than those presented in the previous update, mainly because of worse macroeconomic developments. GDP growth for 2012 is 1.4 percentage points lower than in last year’s programme update, while in this year’s forecast, the difference exceeds 3 percentage points. Last year economic growth was anticipated, which should have gained strength by the end of the programming period to 2.2%; in the current update, macroeconomic projections are presented that predict a further decline in GPD this year, followed by positive economic growth, which, however, will not exceed 1.6% by the end of the programming period. The deficit estimated for 2012 is higher by half a percentage point, which is mostly the result of the greater decline in economic activity. Differences on the debt to GDP ratio relate to lower economic growth than projected in the previous stability programme, as well as recapitalisation measures in the banking sector.

5. SUSTAINABILITY OF PUBLIC FINANCES

5.1. Long-term strategy and prospects, including implications of ageing population

The rapid ageing of the population and low employment rate were the reasons for taking measures within the framework of pension reform, which has been in force since the beginning of 2013 with the adoption of the Pension and Disability Insurance Act (ZPIZ-2). The reform was urgent for two reasons: the financial sustainability of the pension fund and preventing further reductions in pensions. By achieving these objectives, Slovenia established a fairer, more reliable and financially more efficient pension system, which is still based on intergenerational solidarity. This means that active workers pay contributions from their income, thus ensuring pensions for retirees. The pension system remains fair to all generations, as well as to future pension recipients, who provide pensions to current pensioners by paying contributions. Thus, the payments form and the contributions to the pension fund must be as balanced as possible, and the financial burden distributed fairly between generations.

The most important amendments to ZPIZ-2 are:

- equalising the retirement age for men and women by determining the ‘full’ retirement age of 65 if the insured person fulfils a minimum 15-year contribution payment period;
- restrictive deduction system (reducing pensions) in the case of early retirement – reducing pensions by 3.6% for each retirement year before the age of 65. At the same time, the retirement age for acquiring the right to early pension is raised to 60 years of age if an individual (man/woman) has accumulated the minimum 40 years of pensionable service;
- a new formula for pension indexation according to which pensions will be indexed at 60% of the average rise in pay in the Republic of Slovenia and 40% of the growth in consumer prices;
- it is possible to lower the retirement age for old-age pension due to children, compulsory military service or inclusion in the insurance scheme before the age of 18;
- the pension base for old-age and early retirement is calculated on the basis of the most favourable 24 consecutive years of insurance (previously 18).

Several measures to promote the employment of older workers, relating both to employers and workers side, have also been implemented.

The pension reform will enable sustainable growth in government expenditure on pensions at least until 2020, while additional measures will be necessary after this period. Estimates and projections which already take into account GDP for 2012 show that the pension reform will have positive effects on public finance, because the expenditure on pensions will be at 12.4% of GDP by 2020. After 2020, expenditure on pensions will increase faster and, according to Ministry of Finance estimates, will stand at 18.0% of GDP in 2060. The difference between expenditure on pensions in 2010 and projections for 2060 is 6.8 percentage points (Table 5.3).

Projections of general government expenditure related to population ageing are higher than in last year’s Stability Programme, with the main reason being the consideration of actual GDP for 2012 as the basis for projections. At this point, it should be noted that GDP in Slovenia in 2012 was lower than estimated in last year’s projection. This is why the shares in GDP are increasing slightly. The established differences in the share of all age-conditional expenditure in GDP between 2010 and 2060 are somewhat smaller, however. The effects of the pension reform in particular greatly contribute to this.

The pension reform will halt the decline in the average pension. Pensions would be 0.9% lower on average in 2020 had the reform not been undertaken. Due to the effects of the reform, the number of pensioners is expected to fall until 2020, when it is expected to be 4.8% lower than it would be without the reform. The extension of pensionable service will also result in a higher number of insured persons (contributors to the pension insurance system). This number is expected to be 3.8% higher in 2020 compared to the expected number without reform. After 2020, the growth of government spending related to population ageing is expected to increase, both because of population ageing and the reduction of the effects of the reform (Table 5.1).

Table 5.1.: The estimated change of average pension, number of pensioners and number of insured before and after the reform (no reform = 100)

TOTAL	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Average pension	99.3	99.1	98.3	98.2	98.3	98.5	98.8	99.1	99.5	99.9
Nb. of pensioners	98.7	98.0	97.3	96.6	95.9	95.3	95.2	95.2	95.3	95.5
Nb. of insured	100.9	101.4	102.0	102.6	103.1	103.6	103.8	103.8	103.8	103.8

TOTAL	2023	2024	2025	2030	2035	2040	2045	2050	2055	2060
Average pension	100.4	100.9	100.8	99.8	99.1	99.0	99.1	99.3	99.2	98.9
Nb. of pensioners	95.5	95.5	95.5	96.1	96.4	96.3	96.5	96.8	97.2	97.4
Nb. of insured	103.8	103.9	104.0	103.8	103.7	104.1	104.1	103.9	103.5	103.2

Source: IER - ZPIZ data and own calculations based on dynamic micro-simulation pension model.

According to a reference scenario, total expenditure related to population ageing (pensions, health care, education, long-term care, and unemployment benefits) is expected to increase by 1.8 percentage points to 25.5% of GDP by 2020, which is below the EU average. They are expected to increase by 8.3 percentage points to 32.0% of GDP by 2060, which is a considerably faster growth than the EU average, which will increase by only 3.7 percentage points (Table 5.2.).

Table 5.2: Long-term projections of public expenditure in connection with ageing of the population for Slovenia and EU-27, 2010-2020 and 2010-2060

	Share in GDP (%)		Reference scenario: change in percentage points of GDP				Risk scenario: change in percentage points of GDP			
	2010		2010-2020		2010-2060		2010 - 2020		2010-2060	
	SI	EU27	SI	EU27	SI	EU27	SI	EU27	SI	EU27
Total	23.7	25.9	1.8	0.3	8.3	3.7	/	/	/	/
Pensions	11.2	11.3	1.2	0.0	6.8	1.5	/	/	/	/
Health*	6.1	7.1	1.3	0.3	2.0	1.1	0.5	0.2	1.7	1.7
Long-term care**	1.4	1.8	0.1	0.3	1.6	1.5	0.3	0.3	1.6	1.7
Education	4.7	4.6	0.6	-0.2	0.9	-0.1	/	/	/	/
Unemployment benefits	0.3	1.1	0.2	-0.1	0.0	-0.3	/	/	/	/

Source: Country Fiche on Pension Projections, April 2013; European Commission (DG ECFIN) and Economic Policy Committee (AWG), 2013 Ageing report 2012.

Note: *Long-term health care expenditures excluded. **Expenditures for disabled included.

A reference scenario of government spending for health care takes into account primarily the changes in the demographic structure of the population and the impact of population ageing on increased government spending on health care. Additional assumptions are: (i) people will be healthy for half of the additional years of the expected lifespan; (ii) the income elasticity of demand or health care services is 1.1 at the beginning of the period, gradually decreasing to 1.0

until 2060. Under this scenario, government spending on health care in Slovenia in the 2010-2020 period is expected to increase by 1.3 percentage points of GDP, from 6.1% of GDP to 7.4% of GDP in 2020. In the 2010-2060 period, it is expected to increase by 2.0 percentage points of GDP, to 8.1% of GDP in 2060. The increase is somewhat higher than the average increase in expenditure in EU-27.

Under various scenarios, which in addition to demographic factors take into account other factors, projections of the growth in government spending on health care in Slovenia until 2060 range from 0.5 to 2.6 percentage points of GDP. This represents an increase in government spending of between 6.6% and 8.7% of GDP.

Taken into account in the estimate of government spending for long-term care are the effects of changes in the demographic structure of the population and, additionally, assumptions in terms of the share of the dependent population (or the share of population which is unable to perform daily tasks independently), the relationships between formal and informal care, the relationships between institutional care and home care and the costs of long-term care per recipient. Long-term projections of this type of government spending are uncertain primarily because of the input data, which is still deficient for most countries despite improvements in recent years.

The reference scenario takes into account the impact of changes in the demographic structure of population, the growth in expenditure for long-term care services and the assumption that for half of the additional years of the expected lifespan, people will not need assistance from others to perform daily tasks. Similarly to the projection of health care expenditure, it takes into account a modest improvement in people's medical condition. Under this scenario, government spending on long-term care in Slovenia is to increase in the 2010-2020 period by 0.1 percentage points of GDP, or from 1.4% to 1.5% of GDP in 2020. In the 2010-2060 period, it is expected to increase by 1.6 percentage points of GDP, i.e. to 3.0% of GDP in 2060. This increase is only slightly higher than the estimated average increase in EU-27.

The main scenario of the trend in expenditure on education has been made under the assumption of 'no policy change', and establishes only the impact of demographic changes on expenditure on education. The share of government spending on education of Slovenia's GDP in 2010 stood at 4.7%, while it is expected to increase in the 2010–2060 period by 0.9 percentage points to stand at 5.6% of GDP in 2060.

Projections of expenditure on the unemployed form part of the projections of expenditure related to ageing, primarily because of the extensive coverage of expenditure related to ageing, although expenditure on the unemployed depends more on short- and medium-term cyclical trends than long-term demographic trends. The main input for projections is average expenditure on the unemployed in the 2007–2009 period; in Slovenia, this was 0.31% of GDP; it is expected to drop to 0.27 % of GDP by 2060.

The year 2013 is dedicated to a more detailed analysis of the actual effects of the recently adopted reform, especially its influence on raising the actual retirement age, and the preparation of new incentives for the financial sustainability of the system in the light of the results acquired. Further changes to the system to secure long-term financial sustainability and decent pensions are also planned after 2020.

In 2013 a more detailed analysis of the actual effects of the recently adopted reform, especially its influence on raising the actual retirement age will be conducted, and the preparation of new incentives for the financial sustainability of the system in the light of the results acquired. Further changes to the system to secure long-term financial sustainability and decent pensions are also planned after 2020.

Table 5.5: Long-term sustainability of public finance

in % of GDP	2010	2020	2030	2040	2050	2060	Diff. 2010 -60
Total revenues	**46.2**	**51.4**	**54.4**	**59.9**	**67.6**	**74.9**	**28.7**
Age related expenditures	23.7	25.5	26.9	29.0	31.5	32.0	8.3
Pensions	11.2	12.4	13.4	15.6	17.6	18.0	6.8
Old-age	7.8	8.4	8.7	10.2	11.8	12.6	4.8
Disability	1.5	1.3	1.1	1.0	0.9	0.9	-0.6
Other	1.8	1.6	1.6	1.8	1.9	1.9	0.1
Healthcare	6.1	7.4	7.9	8.1	8.3	8.1	2.0
Long-term care	1.4	1.5	1.9	2.4	2.8	3.0	1.6
Education	4.7	5.3	5.3	5.0	5.3	5.6	0.9
Other age related expenditure	1.2	1.7	1.6	1.5	1.5	1.5	0.3
Goods and services, other transfers	13.4	11.5	11.5	11.5	11.5	11.5	-1.9
Compensations for employees	0.3	0.5	0.4	0.4	0.4	0.3	0.0
Subsidies	1.6	1.7	1.7	1.7	1.7	1.7	0.1
Government investment	4.7	5.5	5.5	5.5	5.5	5.5	0.8
Total Primary expenditures	44.9	48.7	50.2	52.9	55,7	56.4	11.5
Interest expenditure	1.4	2.7	4.2	7.0	11.9	18.5	17.1
Total expenditure	**41.0**	**46.4**	**46.7**	**46.3**	**45.8**	**45.5**	**4.5**
Primary surplus/deficit	-3.9	-2.3	-3.6	-6.6	-10.0	-10.9	-7.0
Surplus/deficit	**-5.2**	**-5.0**	**-7.7**	**-13.6**	**-21.2**	**-29.4**	**-24.2**
Government debt	37.1	65.3	100.1	168.4	286.4	440.7	403.6
Assumptions							
Labor productivity growth	3.3	1.4	1.6	1.7	1.6	1.5	-1.8
Real GDP growth	1.2	1.7	1.3	1.0	0.9	1.3	0.1
Real GDP growth p.c.	0.0	1.4	1.4	1.1	1.1	1.6	1.6
Participation rates males (aged 20-64)	75.7	78.9	77.0	76.5	77.0	76.9	1.2
Participation rates females (aged 20-64)	67.5	72.1	72.9	72.5	73.1	73.0	5.5
Total participation rates (aged 20-64)	71.7	75.6	75.0	74.6	75.0	74.9	3.2
Unemployment rate	7.2	8.1	5.8	5.5	5.4	5.4	-1.8
Share of population aged 65 years and over (%)	20.0	20.0	24.4	27.7	30.7	31.5	11.5

Source: IER, UMAR, MF RS.

Note: * Long-term health care expenditures excluded. ** Expenditures for the disabled included.

5.2. Contingent liabilities

According to the Constitution, the granting of guarantees of the Republic of Slovenia is only possible 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. The general act regulates the granting of government guarantees to a broader range of recipients. The Act Governing the Rescue and Restructuring Aid for Companies in Difficulty is an example of a general act. Special acts are aimed at specific beneficiaries, such as: the act on guarantees to DARS d.d. (Motorway

Company of the Republic of Slovenia), to SID bank d.d. (Slovenian Export and Development Bank), SOD d.d. (Slovenian Compensation Company) and the Act Regulating the Guarantees of the Republic of Slovenia for Ensuring Financial Stability in the Euro Area.

The Republic of Slovenia may issue state 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 are being called on while a relatively low number of guarantees for the public sector are being called on. The issuing of government guarantees is controlled by setting upper limits on granting state guarantees. The annual quota is set for each year by the act governing the execution of the state budget, while the guarantees are regulated by the provisions of the systemic act. The quota set by the act governing the execution of the state budget does not include guarantees that have been placed under the guarantee scheme for public entities and natural persons, guarantees given to domestic banks for the purpose of mitigating the impact of the financial crisis and guarantees to foreign entities such as EFSF and borrowers who received loans on the basis of the Cotonou II Agreement. The quota for these types of guarantee is defined in the corresponding acts.

Table 5.6: Guarantees

	31.12.2012		31.12.2013*	
	in m EUR	in % of GDP	In m EUR	in % of GDP
Guarantees	6,506	18.3	6.857	19.3
Of which: financial sector**	1,481	4.2	1.441	4.1

Source: MF RS.

Note: *Projections MF.

**Includes, SID, Deželna banka and Factor banka.

Data in Table 5.6 shows the outstanding guarantees of the Republic of Slovenia at the end of 2012 and estimates for 2013. Assumptions about the repayment of existing, and granting of new guarantees were used for the projections.

The planned quota for new guarantees for 2013 in the act governing the execution of the state budget is EUR 1,500 million and separately EUR 313 million for guarantees of SID bank. The experience from the previous years shows that the actual use of the quota is low: in 2011 only 0.92% and in 2012 only 0.15%, while it was not used at all for SID bank.

The guarantee schemes as well as guarantees to domestic banks for the purposes of mitigating the effects of the financial crisis ended in 2010, while granting guarantees to EFSF and to creditors on the basis of the Cotonou II Agreement is still possible.

6. QUALITY OF PUBLIC FINANCE

6.1. Structure and efficiency of government revenue

In the years before the economic crisis, changes to the tax system were made in order to have a positive impact on job availability and the accumulation of capital, and consequently, potential growth, with a relatively higher share of direct taxes in the overall structure of public finance revenues. The reform was intended to improve the situation by gradually lowering corporate income tax from 25% to 20% in the period between 2007 and 2010; however contrary to expectations, tax revenue from this source decreased considerably with the onset of the economic crisis. This loss at first compensated (because of the increased public finance costs needed to finance measures for mitigation of the economic and financial crisis) primarily with increased government borrowing, while in the following period the gradual consolidation of public finance focused mainly on reducing government expenditure. The Government intends to continue a similar policy in this programming period, while preparing additional measures to increase revenue in a way that creates the minimum obstacles to a recovery in economic growth. As already explained in Chapter 3.2., the Government will focus on measures to increase the efficiency of collecting of taxes and reducing the extent of the grey economy. In parallel, the Government will implement additional activities to raise the tax culture and encourage voluntary payment of tax liabilities, which will be achieved by announcing audits and publishing the results of tax control in the media to encourage the registration and legalization of activities by improving awareness of citizens. In this area, particular attention will be paid to effective control of the gap between the reported income of taxpayers and the value of their property and the possibility of quick and effective retroactive taxation on property which was not reported in the past. Just for the purpose of effective implementation of procedures relating to the declaration of assets and the related valuation, the government will during this programming period prepare some amendments that will allow the tax authority to institute a procedure for a longer period. However, the Government has assessed that changes in the rates of individual taxes or in the definition of bases on which tax is levied will be necessary.

The structure of public finance revenues in 2012 does not differ greatly from that in the previous years. The total funds for public financing in 2012 comprised EUR 13.12 billion in tax revenues, with the following being the most important categories of revenue:
- social security contributions (EUR 5.24 billion),
- domestic taxes on goods and services (EUR 4.88 billion) and
- tax on income and profit (EUR 2.66 billion).

Revenues (taxes and contributions) in 2012 were somewhat lower than in 2011 (a total of EUR 92 million less than in 2011). In comparison to 2010, revenues were somewhat higher, by around EUR 269 million. Higher revenues in 2012 in comparison to 2011 came primarily from income tax (EUR 23 million) and excise duties (EUR 98 million), while revenue from property taxes also increased (by around EUR 18 million). In comparison to 2011, considerable decreases in revenues were recorded in corporate income tax (around EUR 91 million), value added tax (EUR 87 million), social security contributions (EUR 23 million) and taxes on international trade and transactions (EUR 18 million).

The Government does not plan major changes in the structure of revenues from taxes and contributions in the programming period, except for an increase in revenues from property tax, which is to replace the existing system of taxation of real estate (property tax and charge for the use of construction land), which has been ineffective and non-transparent, and contribute to the more efficient capturing of taxation subjects. The Government expects that revenues from taxes on income and profit will somewhat decrease in 2013 and 2014 due to changes to tax legislation that have already been implemented, but the decline in revenues, primarily from corporate income tax, will at least be halted with the freeze on lowering the nominal tax rate. The Government expects somewhat higher revenues from property tax already in 2013, because the scope of the anti-crisis taxation on high-value real estate was increased as of 2013 (see Chapter 3.2.) The Government also expects minor changes in the structure of revenues from domestic taxes and services. Contributing to this is primarily the implementation of a CO_2 duty on motor fuel and an increase in certain environmental taxes and concession fees. The Government also expects that the measures planned to reduce administrative burdens, combined with measures to limit the grey economy, will redirect some of the activities taking place in the illegal market to the regulated market, which in the Government's opinion should have a positive effect on the overall amount of revenue, although it is not possible to predict to what extent these measures will be reflected as additional revenue already in 2013.

Since the system of real estate taxation in Slovenia is outdated, as it does not capture all real estate or provide economic mechanisms which contribute to attaining objectives in other areas of economic policy (rational use of space, the transparency of the real estate market, the integrity of the real estate registration, etc), the Government intends to propose its modernisation. The main objective of modernisation is to simplify the system. At the same it would like to use this tax as a complementary tool for the organization of transparent spatial planning. Above all, it will increase the transparency and fairness of taxation, by binding the tax base to the market value of real estate on one side and with more capture of the real estate in taxation on the other side. For this reason as well as for somewhat higher tax burden, the Government expects that revenues will increase in the case of an overhaul of the real estate taxation system, which could facilitate the consolidation of public finances while impeding economic growth to the smallest extent possible. The Government has assessed that the proposed solution would enable municipalities to generate around 30% more revenues than from the existing property tax, charge for the use of construction land and fee for the maintenance of forest roads, while the remaining revenue is expected to be a resource for the state budget. The Government expects that the first financial effects of these changes will be achieved in 2014.

For regularisation of the situation regarding illegal construction the Government intends to take a combination of measures, including the determination of the amount of specific compensation which aims to encourage owners to regulate the status of their property and expects from this measure additional state budget revenues. Their scope cannot be defined because it is not possible to estimate how many buildings that were constructed without proper permits should be treated in this way and also how many owners should opt for this kind of action.

At the same time, the Government intends to halt the reduction in corporate income tax rate in this programming period without hampering economic recovery, given that the tax reliefs introduced at the beginning of 2012 remain unchanged.

The Government is also preparing additional measures in legislation on the taxation of personal income of natural persons, as a response to the reforms of pension and labour legislation.

In the programming period, the Government intends to increase the general rate (by two percentage points to 22%) and the reduced rate (by one percentage point to 9.5%) of added value tax. The Government plans to implement the changes in mid-2013; the total positive effect on public finance is estimated at EUR 250 million annually.

The Government will determine the exact timetable for introducing new tax burdens in such a way that the measures are taken as soon as possible, while introducing them gradually, so that the collection of new duties is efficient and that the new burden has the minimum negative impact on recovering economic growth. The timetable for introducing these burdens also depends on the effectiveness of expenditure measures.

The Government will also temporarily enhance the efforts to consolidate public finances with possible introduction of a temporary crisis tax on the income of natural persons which would took effect in early 2014, if no additional permanent measures on the side of government expenditure were agreed.

This year the Government intends to secure additional revenue to finance government expenditure with various tax measures, including some less abundant new sources. In doing so, the Government intends to introduce a tax on lottery tickets in the system of organisation of classic games of chance and a tax on certain sweet drinks in a manner which will be both as simple and efficient as possible, and in which the tax burden will be distributed as evenly as possibly.

Greater efficiency in public finance revenues is mainly achieved by having a simpler and more transparent tax system, which will ensure that more taxes are collected whilst lowering the costs of meeting tax obligations for taxpayers and managing the tax collection system of tax authorities. In the programming period, the Government will improve the existing legislation regarding tax collection and continue to modernise the tax and customs information system in order to make tax collection more efficient in terms of administration and lower the costs of voluntary tax payments, primarily by expanding the use of e-commerce and developing the new tax information system (EDIS). The modern tools will enable more effective and faster detection of violations and their penalisation or the elimination of irregularities. As part of the customs information system, the development of new software for excise duties and environmental fees is planned, which in addition to the functions of the existing information system for excise duties will also include an e-commerce module for users in the business sector. The introduction of the new system will simplify existing procedures, which will reduce the administrative burden for those who participate in them.

An important segment of the functioning of the system of public finance revenues is effective enforcement when taxpayers fail to settle their obligations voluntarily. In order to increase the efficiency of enforcement, the jurisdiction over implementing the enforcement procedure has been redefined. The Tax Administration retains its jurisdiction over the implementation of enforcement related to public finance revenues, the collecting of which is the responsibility of the Tax Administration, while other enforcements have been transferred to the Customs Administration. This has helped to establish organisational possibilities (better utilisation of existing human resources) for more rapid enforcement in relation to public finance revenues, so the Government expects that the financial effects of this reorganisation and overhauled information support for tax enforcement will already be visible this year, and more so in the coming years.

The planned merger of the tax and customs administrations into a unified Finance Administration of the Republic of Slovenia and the expansion of powers of the customs administration in responding to cases of undeclared work will also contribute to greater efficiency in the utilisation of available human resources in the area of reducing tax evasion. The purpose of the changes in the organisation of both administrations is to increase their efficiency, while taking into consideration the essential features of the operation of each of the two administrations. The Government expects that the legal bases for reorganising both administrations will be adopted in 2013, so that the overhauled uniform administration can begin its work in 2014.

6.2. Composition and effectiveness of government expenditure

In the management of general government expenditure, primarily of the state budget, the Government will continue to strive to enforce aggregate fiscal discipline (control of government spending), distributing sources in accordance with policy priorities and improving the operational management of available assets. By determining the target amount of expenditure, the requirements of budget users are placed in a restricted framework of expenditure and thus directed towards financing priority programmes in an economical and efficient manner. Despite the greater emphasis on control over assets and resources (for which economic purposes and how much of budgetary funds are used), budget users distribute the available funds by individual budget policies.

The established budget planning and implementation enables the Government to carry out targeted and flexible management of the expenditure structure, which is particularly important in the period of consolidation. Fiscal legislation (for example, the Republic of Slovenia Budget for 2013 and 2014 Implementation Act) enables the redistribution of funds between policies, programmes and sub-programmes and at the same time determines the limits and conditions for the disposal of funds, in particular for categories of expenditure representing an important part of government spending. The operation of budget users is dependent on the aggregate amount of expenditure, primarily in certain categories of labour costs (for example, contract work, bonuses), expenditure on goods and services, subsidies, investments, etc. The Government's intent is that budget users primarily organise their work with unchanged or reduced funds, which also requires changes to the sectoral legislation.

The expenditure framework envisages restrictions on the number of employees and the stabilisation of the public sector wage bill in comparison to previous years. The nominal level of expenditure on goods and services in the state budget will be maintained at the 2012 level, while the projections of expenditure are lower than the realisation from 2012 for subsidies, current transfers to public funds, agencies and other providers of public services. The Government's projections in terms of investment expenditure and transfers arise from the schedule for implementing projects, which means that the scope of financing envisages higher expenditure than in 2012, which are nevertheless still lower than those in 2010 and 2011.

In the structure of government spending, which is programme-based at the level of 24 policies, the biggest shares are represented by policies on education, pension and social security, followed by transport and transport infrastructure, agriculture, the labour market and working conditions and policies on defence and protection, internal affairs and security. Taking into consideration the measures to balance public finance, the on-going changes to the pension system, implementation of changes in the area of employment and regulation of the labour market and streamlining of the work of the public sector, reduced participation in the expenditure of the adopted budget for 2013 was recorded for education policy (2012: 18.2%, 2013: 16.5%), pension security (2012: 15.2%, 2013: 13.8%) and social security (2012: 11.9%, 2013: 10.6%) compared to the base year 2012; this is also the case for other policies. A larger share in the structure of expenditure for 2013 compared to 2012 is recorded in transport and transport infrastructure, environmental protection and environmental infrastructure and policy on entrepreneurship and competitiveness, which is related to a greater focus on programmes and projects co-financed from the European funds at the end of the current financial perspective.

Improving the management of budgetary resources at central government level is supported by the accounting and financial system, which enables the Government to allocate and use funds efficiently. In order to make spending efficient and successful, the Government intends to link the budget system and financial management with other systems of the public sector (decision-making system, public procurement, staffing policy, the more efficient implementation of programmes on the basis of findings and recommendations from audits, international institutions, users of services, etc.).

On the basis of certain existing and additional consolidation measures, the gradual implementation of pension reform, agreements with social partners (for example, on the wage bill, staffing policy), and taking into account the budget rules and carrying out consistent supervision of resources, the Government intends to continue to stabilise and reduce aggregate government spending, while selectively directing funds to priority budget policies and projects. Since the Government will furthermore implement activities for restructuring and securing the stability of the banking system and supporting for companies, it should be taken into account that such operations will nevertheless have a one-off impact on the increase of certain categories of expenditure and the deficit.

7. INSTITUTIONAL FEATURES OF PUBLIC FINANCE

The Government is pursuing the following goals regarding the regulation of the institutional framework of public finances in this programming period:

1. introducing the fiscal rule into national legal system in order to increase fiscal discipline, responsible planning and the use of public funds;
2. securing better transparency in public finance by including all compulsory charges in the budgets under public financing and by limiting the extra-budgetary financing of public and general matters;
3. increasing the flexibility of use of public funds, with stricter compliance with the principle of the integrity of the state budget and inclusion of earmarked funds in the integrated budget;
4. increasing the efficiency of expenditure and supervision of use of public funds, and
5. increasing the efficiency of collecting taxes and other charges.

General factors, such as legislation on referenda (as presented in detail in Chapter 7.4.) also influence suitable regulation of the institutional framework of public finance.

7.1. National fiscal rules

The Government will in the legal procedure for changing constitution in the National Assembly support the solution, that Slovenia should add the fiscal rule to the Constitution, as it made commitments by signing the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. By doing so, the Government wishes to ensure greater fiscal discipline, sustainable public finances and macro-economic stability as a necessary measure for permanent and stable economic growth. Since the Constitution is the highest general legal act of the state, whereby the state lays down the general principles and forms of its political and social order, in this act the fiscal rule will be defined in general terms. It will thus be determined in the Constitution that revenues and expenditure of the government budgets (which also includes the budgets of local communities) must be balanced in the medium term without borrowing, or that revenues must exceed expenditure and that this principle can be derogated from only in exceptional circumstances.

In addition to the aforementioned, the proposed constitutional act also determines the mandatory adoption of the so-called ‘implementation act’ within six months following the implementation of the constitutional amendment. The National Assembly passes the implementation act with a constitutional (two-thirds) majority. In the implementation act, the fiscal rule will be defined in more detail in a manner which will fully implement the Directive of the Council on the requirements for the budgetary frameworks of the Member States, and at the same time be harmonised with the regulations adopted in relation to bringing down the existence of excessive deficits in Member States. In the implementation act, the Government intends to propose detailed solutions regarding the fiscal rule itself, the roles of the independent Fiscal Council and define exceptional circumstances in detail and the correction mechanism.

Considering that the Government understands the seriousness of Slovenia’s commitment for inclusion of the fiscal rule in the Constitution, the Government has assessed that, in determining the timeframe within which it is necessary to achieve full compliance with the fiscal rule, considering the current situation of public finance, the changed macro-economic circumstances in comparison to Slovenia’s situation in 2012, when the draft of the constitutional change was being prepared, have to be taken into account.

7.2. Amending the Public Finance Act

With the introduction of the fiscal rule in the Constitution of the RS and the adoption of a special implementation act, it will also be necessary to amend the Public Finance Act and the related Accounting Act. In the Public Finance Act, particular attention should be paid to changing the procedure for adopting budgets, which will have to take the fiscal rule into account, as well as all other economic governance obligations and the rules on implementing the supervisory mechanisms.

By drafting a new Public Finance Act, Government wishes to attain mainly the objectives 2 – 4 presented above and the following goals :

- harmonise with EU legislation in the area of economic governance;
- modernise the legal framework for the regulation of public finance and public finance management;
- establish a modern systemic mechanism to conducting fiscal policy including by ensuring the quality of public finances and adequate supervision of individual categories of expenditure;
- ensure macro-economic stability and permanent and stable economic growth;
- securing better transparency in collection and use of public finances by respecting the principle of disclosing all compulsory charges as well as the use of available funds in the four budgets under public financing.

The Government intends to prepare both proposed acts and send them to the National Assembly of the RS in 2013, so that they can be adopted by the end of the year. Since the procedure for adopting a revised budget for 2014 and the budget for 2015 will also take place simultaneously, it will be possible to use the new Public Finance Act for the first time in the preparation of a revised budget for 2015.

7.3. Merger of the Tax and Customs administrations into a single Financial Administration of the Republic of Slovenia as a tool to improve the efficiency

It is in the interests of the Republic of Slovenia to ensure a transparent, economical and efficient system for public tax collection, which will encourage the voluntary fulfilment of legal obligations. A precondition for the voluntary fulfilment of legal obligations is a modern and professional administrative body responsible for collecting public taxes, which ensures the transparent and equal treatment of all entities which have to fulfil obligations related to the payment of these taxes, while at the same time providing taxpayers with services at an adequate level, which will enable them to fulfil their obligations in a simple and economical manner.

A modern financial administration is a condition for lawful, professional, politically neutral, open, transparent and efficient operations. Its operations must not be determined only by the supervisory role; it must also function as a service to taxpayers and develop partnership relations with taxpayers who are willing to voluntarily and lawfully fulfil obligations to pay mandatory taxes. In this respect the financial service must operate in accordance on the principle of a user-oriented public administration. These objectives can be attained primarily by simplifying and standardising procedures, reducing administrative obstacles, reducing the administrative burden and improving the quality of work.

Proceeding from the above-mentioned, the fundamental objective of the merger of the two administrations is to ensure that the organisation and functioning of the financial service ensures that legislation on taxation is implemented in such a way that the collection of public taxes will be based on the principle of the voluntary fulfilment of obligations of taxpayers, while providing for adequate supervision if taxpayers fail to fulfil their obligations in time and in a manner determined by law.

The expected effects of the merger related to the performance of tasks are: reducing administrative burdens for taxpayers; the unification of inspection checks; the possibility to gain access to and establish joint databases, which will enable the comprehensive and qualitative treatment of taxpayers (violations, open receivables, uniform tax enforcement by taxpayer); better organisation of the combined body and more efficient organisation of work.

The expected effects related to the organisational aspect are the merger of internal organisational units performing tasks of the same kind (settlement, levying, control of the payment of mandatory taxes, enforcement and investigation to more successfully reduce and prosecute criminal acts - for example, with the introduction of mobile units for investigations related to the grey economy, which would be organised within the financial service) and efficient utilisation of personnel who will become available with Croatia's accession to the EU.

7.4. Changes to referendum legislation

The referendum model in Slovenia enables easy access to referendum and causes political instability. A proposal to amend Article 90 of the Constitution of the RS (signed by 50 members of the National Assembly) was filed in September 2012. The Constitutional Commission concluded the constitutional and auditing procedure and the proposal for amending the Constitution will be discussed for a second time at a plenary session in the week between 10 and 14 May 2013. If the result is positive, the National Assembly will adopt an ordinance designating the Constitutional Act Amending Articles 90, 97 and 99 of the Constitution of the Republic of Slovenia by 20 May 2013.

With the proposed changes:
1. Referenda are left exclusively to voters, because it has been proposed that at least 40,000 voters can call for a referendum. A referendum can no longer be requested by members of the National Assembly or the National Council.
2. It has been furthermore proposed that a limitation on the content on which a referendum can be called should be determined (on acts on emergency measures to ensure defence of the state, safety or to provide disaster relief, on acts on taxes, customs and other obligatory duties, and on the act which is adopted to implement the national budget, acts ratifying international

treaties, and on acts eliminating unconstitutionalities in the fields of human rights and fundamental freedoms).

3. The referendum rejection model is defined; an act is rejected at a referendum if the majority of voters who cast a valid vote are against it, on condition that at least one fourth of all voters vote against the act.