THE REPUBLIC OF SLOVENIA

STABILITY PROGRAMME

2012 UPDATE

Ljubljana, April 2012

CONTENTS

FOREWORD

The 2012 update of the Stability programme follows the guidelines in the so called European semester whereby the Stability and Convergence programmes are presented to the European Commission during the month of April. The Stability programme is in line with Council recommendation to Slovenia 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 guidelines for the economic policies of the Member States and of the Union (2010/410/EU), the Council recommendation of 12 July 2011 on the National Reform Programme 2011 of Slovenia and delivering a Council opinion on the updated Stability Programme of Slovenia, 2011-2014 (2011/C 217/01) and conclusions on the fiscal consolidation and structural reforms as adopted by the European Council on 1 - 2 March 2012. The document has been prepared in accordance with Council Regulation (EC) No. 1175/2011 amending Regulation 1466/97, 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 of the economic policy over the medium-term are the achievement of a permanently balanced structural position and establishing of conditions for stable economic growth. The programme contains measures that will ensure a reduction of the deficit below 3 % of GDP by 2013, 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 1175/2011) 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 goal is to achieve a permanent general government structural balance and to create an environment for a stable economic growth. In the period after 2012 the economy is expected to recover, however, growth will not accelerate to more than 2.2 % by the end of the program period.

Procedures aimed at incorporating the balanced budget rule into the Constitution in line with the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union are underway in the Parliament (Chapter 7). The structural balance is planned to be reached in 2015 after the reduction in structural deficit by 0.9 %age points on average annually. Cyclically adjusted deficit is expected to decrease in the same period on average by 1.25 basis points annually.

The key fiscal policy objectives for the program period are the following:

i) a reduction of the general government deficit below 3 % of GDP by the year 2013 as required by the Stability and Growth Pact and related Council recommendations;
ii) structural balance by the end of the program period;
iii) strengthening of the financial sector through bank recapitalisation, envisaged without participation of budgetary funds and strengthening of banks' balance sheets;
iv) structural reforms in the labour market, pension and health insurance;
v) setting a favourable environment for economic activity and job creation, by reducing administrative restrictions for economic activity, actively supporting domestic and foreign investments and reducing relatively high tax burden on labour and economic activity.

In view of the high general government deficit in the year 2011 and the strict timeframe to fulfill the bank capital requirements set by the banking regulator, the Government has focused immediately upon taking office in February 2012 on the implementation of measures aimed at balancing the general government budget and strengthening the banking system. The necessary further structural reforms and growth–enhancing measures as presented in the national reform program will be put forward by the end of this year.

The reduction of the deficit below 3 % of GDP by the year 2013 will be ensured primarily through expenditure reducing measures. Structural balance by the end of the program period in 2015 will be achieved by lower expenditures resulting from the pension and the health reform, through measures on the revenue side, primarily more efficient tax system as well improved tax collection, accelerated growth and if necessary higher rates on taxes with the lowest impact on competitiveness.

In order to reduce a relatively high share of obligatory government expenditures based on current legislation, changes are underway of more than 50 laws underlying the corresponding entitlements. Structural measures are expected to reduce expenditures by around 2 % of GDP. Additional reduction of expenditures will be achieved by rationalizing current administrative expenditures. As far as the aggregate demand is concerned, although a negative short term impact of these measures is unavoidable, in the medium term an important positive overall contribution to growth is foreseen primarily through improved country's credibility allowing higher investment, better financing conditions and finally higher economic growth.

The envisaged expenditure–reducing measures include:

(i) reduction of the public sector administrative costs, mainly by downsizing the number of government institutions and other organizational changes, strengthening the control over expenditures and less contracting of external services providers, better efficiency of public procurement and informatics, better management of public real estate holdings and lowering transfers from the state budget to the local governments;

(ii) changes in the scope and the quantity of public sector activities, primarily by more demanding working standards in the education, changes in the financing of the higher education, lowering of the wages effectively by 5 % across the entire public sector (through a combination of linear cuts and a parallel implementation of increases agreed already in the past aimed at eliminating certain disparities in the wage system), cutting certain benefits and reimbursements to employees.

(iii) reduction of expenditures for certain programs and policies, mainly financing of infrastructures and housing, lower subsidies to real sector and for other activities, temporary reduction of pensioners' benefits which are not entitlements–based on paid social contributions (annual bonus, exceptional pensions), cuts in some entitlements related to labor market, social and family policies, except for the beneficiaries with lowest incomes, and cuts in certain reimbursements from public health insurance.

Changes in the tax system will also be important, aiming at:

(i) stimulating economic activity, investment, research and development and job creation;

(ii) measures ensuring that wealthier population contributes more to the government revenues.

For more growth–friendly fiscal consolidation certain tax burdens are being reduced. The Parliament already adopted legislative changes increasing tax reliefs for research and development from 40% to 100%, while tax reliefs for investments are increased from 30% to 40 % and upper threshold for the nominal amount was abolished. Corporate income tax was reduced from 20% to 18% with further decreases each year by 1 percentage point down to 15 % rate at the end of the program period.

In order to increase government revenues, broadening of tax bases, improvement of the tax collection system and systemic as well as structural measures aimed at reducing the scope of informal economy are envisaged (Chapter 3.2. in 6.1.).

Changes of the pension system will be gradual, as after the rejection of the pension reform in the referendum last year, the Government cannot present to the Parliament a new proposal for at least one year. Meanwhile a reduction of incomes from pensions that are not based on paid contributions is foreseen, as well as transfer of so called "protection allowance" from pension to social security system, where entitlements are linked to individual beneficiary's wealth. Furthermore, annual bonuses for pensioners will be temporary decreased. Negotiations with social partners on a pension system reform are planned already for this year and the implementation of a new reform is foreseen by the end of 2013. Its contents will be presented in next year's update of the program. Main changes foreseen in a new reform relate to higher effective retirement age.

As far as the strengthening of the banking system is concerned, the Government's objective is to ensure an ownership structure that would provide for effective management free of political interference and stability of financial institutions in the long run. This will be achieved through recapitalizations and sales of Government shareholdings. Additional bank capital will contribute also to restoring the credit activity and consequently contribute to an accelerated growth of the economic activity of the private sector. The recapitalization of the Nova Ljubljanska banka d.d. until the 30 June 2012 as required by the European Banking Agency (EBA) and the Bank of Slovenia, should be made without state budget involvement as other investors are expected to participate and the Government intention is to substantially reduce its share in the bank's capital.

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 2012 (IMAD, March 2012), which takes into account the measures presented in the Stability programme.

The Spring Forecast of Economic Trends 2012 takes into account the assumptions for international economic developments based on the forecasts released by international institutions in February (Table 2.1). They envisage a decline of GDP in the euro area for 2011 and a gradual strengthening for 2013 and 2014. According to the forecasts by international institutions, we expect that economic growth in Slovenia's other main trading partners will also slow relative to last year, while GDP in Croatia is projected to decline. In these countries the economic situation is also projected to improve gradually in the next two years, as it is at the level of the EU. In the international environment the risks to growth remain high and asymmetrically distributed towards greater probability of downside risks. The risks related to a possible further tightening of the sovereign crisis thus persist, which could lead to a deeper drop in economic activity in euro area and EU countries this year and the next. The risks are also related to the movement of commodity prices, particularly prices of oil, which despite the moderation of global economic growth remain high due to uncertain geopolitical conditions in some oil producing countries.

Table 2.1: Assumptions of the Spring Forecast (by IMAD) regarding economic growth in Slovenia's main trading partners in 2012–2014

	2010	2011*	2012	2013	2014
			Spring forecast (March 2012)		
EU	2.0	1.5	0.0	1.2	1.7
Euro area	1.9	1.4	-0.3	0.9	1.5
Germany	3.7	3.0	0.6	1.5	1.7
Italy	1.8	0.4	-1.3	0.1	0.6
Austria	2.3	3.1	0.7	1.6	1.7
France	1.5	1.7	0.4	1.0	1.5
United Kingdom	2.1	0.8	0.6	1.8	2.2
Czech Republic	2.7	1.7	0.0	1.9	2.6
Hungary	1.3	1.7	-0.5	1.3	2.6
Poland	3.9	4.3	2.5	3.2	4.0
Croatia	-1.2	0.3	-0.5	1.0	2.0
Bosnia and Herzegovina	0.7	1.7	0.8	2.0	3.0
Serbia	1.0	1.9	0.7	2.0	3.0
Macedonia	1.8	3.1	2.3	3.0	4.0
USA	3.0	1.7	2.2	2.5	3.2
Russia	4.0	4.3	3.5	3.8	4.2

Source: Eurostat (for 2011; EC Interim Economic Forecast, February 2012; Consensus Forecasts, February 2012; Eastern Consensus Forecasts, February 2012; EIU Country Reports, February 2012; IMF World Economic Outlook update, January 2012; WIIW Monthly Report, November 2011 IMAD's estimate.

Note: * preliminary data available at the time of finalising Spring forecast. Data for France and the Czech Republic for 2011 are EC forecasts (February 2012), while 2011 data for Croatia, Bosnia and Herzegovina. Serbia. Macedonia and Russia are Consensus estimates (February 2012).

The technical assumption for the price of oil is 115 USD a barrel in 2012, on average, 112 USD a barrel in 2013, and 110 USD a barrel in 2014. According to the current trends and the forecasts by international institutions at the time of the preparation of the Spring Forecast, non-energy commodity prices in dollars are assumed to drop this year (-9.5%) and then remain stable in the next two years. The technical assumption for the US dollar exchange rate is set on the basis of the movements in February 2012. The assumed ratio between the two currencies in 2012 is 1.322 USD to 1 EUR; in the next two years 1.322 USD to 1 EUR.

The assumptions about the international environment in the Stability Programme, which arise from the Spring Forecast of Economic Trends 2012, are based on the forecasts by international institutions released by the end of February 2012, including the Interim Forecast of the European Commission. There were no differences between IMAD's Spring Forecast and the Interim Forecast by the European Commission neither in the key assumption, i.e. the expected GDP movement in the euro area in 2012 (-0.3%), nor in the exchange rate (1.320 USD to 1 EUR). At the time of the preparation of the forecast, the common assumptions of the European Commission[1] for the preparation of Stability and Convergence Programmes were not yet available and could therefore not be taken into account. The differences between the two sets of assumptions are relatively small. In the assumptions for economic growth in the EU, the common consumption is only slightly higher in both years. The difference in assumptions for this year's economic growth in the US is also minimal, while the common assumption for the next year is slightly lower. With regard to the share of the US in Slovenia's foreign trade (1.5% of total merchandise exports), we estimate that the difference does not have a significant impact on the forecast of macroeconomic aggregates. The common assumption for the dollar price of oil in 2012 is around 5 USD higher, while the difference in the assumptions for 2013 is smaller. The foreseen decline in non-energy commodity prices in 2012 in the common assumptions is somewhat smaller, while in 2013 the difference is negligible. There are no differences in the exchange rate (USD/EUR). As these differences are relatively small, we estimate that the forecasts of macroeconomic aggregates for next year would not change significantly if the common assumptions for commodity prices were taken into account. The expected movement of short-term interest rates also diverges somewhat from the common assumptions, which is also due to the difference in time when the forecasts were made. At the preparation of the Spring Forecast, somewhat higher short-term interest rates were therefore taken into account (based on the ECB's projections from December, 2011) than in the common assumptions.

Table 2.2: Basic Assumptions

	2010	2011	2012	2013	2014
USD/EUR exchange rate (annual average)[1] (Euro area and ERM II countries)	1.327	1.392	1.320	1.322	1.322
Nominal effective exchange rate	-2.1	-0.1	-0.8	0.0	0.0
EU GDP growth	1.8	1.5	0.0	1.2	1.7
Growth of relevant foreign markets [2]	10.2	8.2	0.4	5.4	6.1
Oil prices (Brent, USD/barrel)	79.6	111.0	115.0	112.0	110.0

Source: IMAD, Spring Forecast 2012.
Notes: [1] For 2012–2014: technical assumption based on February 2012 average exchange rate; [2] Germany, France, Italy, Austria, Hungary, Poland, Czech Republic, Slovakia, United Kingdom, USA, weighted by shares in exports.

[1] In the comparison of the assumptions, the common assumptions of the European Commission from 10 April 2012 are taken into account.

2.2. Cyclical developments and short-term prospects

GDP is expected to be down 0.9% in 2012 in comparison with the previous year. These expectations are based on the assumptions of a further deterioration in the international environment and tighter financing conditions for the government and banks, which are in the process of deleveraging. We expect that due to a rising volume of non-performing and bad assets in banks against the background of weak economic activity, this year the circumstances will not yet be conducive to the expansion of banks' lending activity. Economic activity will also be significantly affected by fiscal consolidation measures, which are focussed on streamlining and cutting all categories of expenditure. This year's deeper decline in GDP is thus expected to reflect a strong deceleration of export growth and an even more pronounced decline in domestic consumption. Amid modest foreign demand, the real growth of Slovenian exports will thus slow significantly relative to that in 2011 (to 1.4%). Amid a further contraction of investment and a stronger decline in private and government consumption, domestic consumption will shrink by 3.0% this year. Gross capital formation is set to drop by 7.4%, which is, due to the expected decline in inventories, more than last year. Because of lower construction investment, we anticipate a further decline in gross fixed capital formation (-1.5%). Investment is projected to grow only in industry, relatively strongly in the energy sector and more modestly in manufacturing. This will contribute to positive growth in investment in machinery and equipment, which was also present in the previous two years. After continuing to grow in 2011, inventories are expected to decline in 2012 and thus make a negative contribution to GDP growth in the amount of 1.3 percentage points. The decline in household and government final consumption is expected to total 1.8% this year. In view of the growing tensions on the labour market and the foreseen measures in the area of social transfers, we expect a further contraction of disposable income (-1.3%), and in the circumstances of increased uncertainty and more cautious behaviour of consumers, a 1.2% real decline in private consumption. Disposable income will thus shrink for the fourth successive year and will be 4.7% lower in real terms than in 2008, according to our estimate. The foreseen fiscal efforts to reduce the public finance deficit will also weigh on government consumption. It is expected to be 3.5% lower than in 2011 in real terms, as a result of the foreseen restrictive wage and personnel policy, while the reduction of expenditure on goods and services in all government accounts will also contribute to a further decline in government intermediate consumption.

In 2013–2015, economic activity is expected to increase due to the recovery of export and domestic demand. GDP is projected to increase by 1.2% in 2013, and 2.2% in 2014 and 2015. Economic growth in the international environment is expected to rebound in these years, which will boost the growth of Slovenian exports. Growth in domestic consumption will remain relatively low, also due to further consolidation of public finances, but at the same time successful consolidation will help restore confidence and improve the availability of sources of finance. A gradual improvement can therefore also be expected in access to sources of finance for the private sector, mainly as a result of improved conditions on interbank markets abroad and in the domestic banking sector. The rebound of domestic consumption will also be underpinned by the pick-up of investment activity, both business investment and the realisation of construction projects that were interrupted or postponed during the crisis. With the softening of labour market conditions, we also expect a recovery of private consumption, especially towards the end of the forecasting period. Real growth in government consumption is expected to be low in these years.

Table 2.3: Macroeconomic prospects

Change in %	ESA code	Level in 2011	2011	2012	2013	2014	2015
		in m EUR					
1. Real GDP	B 1 g	35,354*	-0 .2	-0 .9	1 .2	2 .2	2 .2
2. Nominal GDP	B 1 g	35,639	0 .6	0 .0	2 .7	4 .0	4 .1
Real GDP components							
3. Private consumption expenditure	P3	20,226	-0 .3	-1 .2	0 .2	1 .5	1 .5
4. Government consumption expenditure	P3	7,347	-0 .9	-3 .5	-0 .7	0 .3	0 .5
5. Gross fixed capital formation	P51	6,941	-10 .7	-1 .5	4 .0	3 .0	3 .0
6. Changes in inventories and acquisition of valuables (% of GDP)	P52+ P53	753	2 .1	0 .8	0 .7	0 .7	0 .7
7. Exports of goods and services	P6	25,765	6 .8	1 .4	5 .4	6 .1	6 .1
8. Imports of goods and services	P7	25,393	4 .7	-1 .6	4 .9	5 .5	5 .5
Contributions to real GDP growth (in percentage points)							
9. Final domestic demand		-	-1 .6	-3 .0	0 .7	1 .5	1 .5
Of which: Changes in inventories and net acquisition of valuables	P52+ P53	-	1 .0	-1 .3	0 .0	0 .0	0 .0
10. External balance of goods and services	B11	372	1 .4	2 .1	0 .5	0 .7	0 .7

Source: SORS, Spring Forecast 2012, IMAD.
Note: *Constant prices of the previous year.

Uncertainty about the Spring Forecast for economic activity in 2012-2015 remains high. The forecast is mainly based on the assumptions that the international environment will improve in the second half of this year as a result of restored confidence as euro area countries will be gradually overcoming the sovereign debt crisis. These assumptions are also used in the baseline forecasts of economic trends by international institutions. Due to a possible further tightening of the sovereign debt crisis, the forecasts nevertheless remain subject to the risk of an even deeper drop in economic activity this year and the next. The IMF's simulations of the consequences of such a scenario for euro area countries and the global economy (WEO Update, January 2012) show that this would deepen the decline in Slovenia's economic activity this year (-2.8%), and that the decline would continue into the next year (-2.2%).

Table 2.4: Sectoral balances

in % of GDP	ESA code	2011	2012	2013	2014	2015
Net lending/borrowing vis-à-vis the rest of the world	B.9					
of which:						
Balance on goods and services		1 .0	2 .9	3 .3	3 .9	4 .4
Balance of primary incomes and transfers		-1 .4	-2 .1	-2 .0	-2 .2	-2 .2
Capital account						
Net lending/borrowing of the private sector	B.9/EDP B.9					
Net lending/borrowing of the government sector (ESA 95)	B.9	-6 .4	-3 .5	-2 .5	-1 .5	-0 .4
Statistical discrepancy						

Source: SORS, MF RS; Spring Forecast 2011, IMAD.

The current account of the balance of payments is expected to turn into a surplus in 2012–2015. This year the current account is set to run a surplus of 0.6% of GDP, which will widen somewhat in the next few years (1.2% of GDP in 2013, and 1.5% and 2.0% of GDP in 2014 and 2015, respectively). The surpluses reflect the foreseen excess of national savings over investment due to corporate sector deleveraging and general government savings. Amid the expected economic activity, which will in the whole programming period result from the strengthening of exports rather than higher domestic consumption, and under the assumption of relatively stable terms of trade, the deficit in merchandise trade is projected to decline. The overall surplus in services trade will also continue to increase gradually with anticipated further growth in the surplus in trade in transport and travel services. Slovenia's budgetary position against the EU budget in 2012-2015 remains relatively favourable in the forecast. On the other hand, net payments of interest on general government external debt will keep growing, as will net outflows of dividends and reinvested profits, which will increase the deficit in factor incomes.

In light of weak economic activity and the foreseen restrictive personnel policy in the general government sector, we expect a further decline in employment and increase in unemployment this year and the next, and then a stabilisation of labour market conditions in 2014 and 2015. In 2012, total employment will thus drop somewhat more than in 2011. As employment tends to adjust to economic activity with a delay, the decline will also continue in 2013, but at a less vigorous pace. In the private sector, employment is expected to drop further in most activities except some business services, but more slowly than in previous years. The movements on the labour market will also be impacted by the foreseen restrictive employment policy in the general government sector. Besides the weak business cycle accompanied by a fall in employment, age structure and low educational attainment of the unemployed will be another factor of the further increase in unemployment in 2012 and 2013 (the number of older unemployed persons and those with a lower education increased, particularly at the beginning of the economic crisis). The number of registered unemployed persons is thus set to average 118.8 thousand in 2012, the registered unemployment rate 12.9 % (the survey unemployment rate 8.8 %). Despite the expected beginning of the economic recovery in 2013, the average number of registered unemployed will increase further (123.9 thousand) due to a lag in the recovery of growth and structural imbalances on the labour market. A gradual decline in unemployment is expected for 2014 and 2015.

Table 2.5: Labour market developments

	Level 2011 (in 000)	2011	2012	2013	2014	2015
Employment, persons[1], growth in %	942 .5	-1 .7	-2 .2	-1 .2	-0 .3	0 .0
Survey unemployment rate, in %	84	8 .2	8 .8	9 .3	9 .1	8 .7
Labour productivity (in EUR 1000 per employee)[2]	37 .8	1 .6	1 .4	2 .4	2 .5	2 .2
Compensation of employees[3], in EUR m	18,956	-0 .2	-0 .6	0 .7	2 .6	3 .2
Compensation of employees per employee[3,4], in 1000 EUR	20.1	1 .5	1 .6	1 .9	3 .0	3 .2

Source: SORS, Spring forecast 2012, IMAD
Notes: [1] Persons in employment, national accounts definition (domestic concept), [2] Real GDP per person employed, [3] Nominal growth, [4] Full timers

A further contraction of the economy this year and the anticipated slow recovery in the next two, the efforts of businesses to preserve their competitive position and the absence of labour market pressures amid high unemployment will have a significant impact on the future movements of wages in the private sector. In 2012 and 2013, the nominal wage growth in the private sector will thus be similar to that last year (2.4% and 2.6%, respectively), and in 2014 and 2015 only slightly higher as a result of a gradual strengthening of economic activity (3.2%

and 3.5%, respectively). The contribution of the final adjustment to the new level of the minimum wage in 2012 is estimated at around 1 p.p.

Inflation is expected to remain low in 2012–2015. In the first months of this year, consumer price movements were still mainly under the influence of prices of liquid fuels (and other energy prices). The continuation of weak demand and poor prospects for economic activity continue to show in very moderate movements of core inflation, which totals around 2 % y-o-y. We estimate that after a transient increase at the beginning of the year, y-o-y inflation will decline again in the coming months and, assuming the absence of price shocks from the international environment, total 2.0 % at the end of this year. Concerning tax policy, the forecast assumes the foreseen rises in excise duties on tobacco, tobacco products and alcoholic beverages (a contribution of 0.3 p.p.) and a 2 % increase in prices under direct government control. Consumer price growth is projected to remain around 2 % by the end of the programming period.

Table 2.6: Price developments

Change in %	2010	2011	2012	2013	2014	2015
1. GDP deflator	-1 .1	0 .8	0 .9	1 .4	1 .8	1 .9
2. Private consumption deflator	1 .4	2 .2	1 .8	1 .6	1 .7	1 .8
3. Consumer price index (annual average)	1 .8	1 .8	2 .0	1 .8	1 .9	2 .0
4. Government consumption deflator	1 .5	0 .7	-0 .3	0 .8	1 .9	2 .0
5. Gross fixed capital formation deflator	0 .9	1 .6	1 .0	2 .0	2 .2	2 .2
6. Export price deflator (goods and services)	2 .6	4 .1	1 .9	1 .9	2 .0	2 .0
7. Import price deflator (goods and services)	6 .6	5 .6	2 .4	2 .0	2 .0	2 .0

Source: SORS, Spring Forecast 2012, IMAD.

2.3. Medium-term scenario

Projections of the Stability Programme are made using the medium-term scenario of economic developments in the Spring Forecast of Economic Trends, which is based on assumptions of stable movements in the international environment and measures presented in the Stability programme. In the period of fiscal consolidation and deficit reduction below the upper ceiling of 3% of GDP (i.e. in 2012 and 2013), economic growth will average only 0.2%. In addition to the anticipated fiscal consolidation measures, which will weigh down on weak domestic consumption, this low economic growth is also a consequence of the expected deterioration in the international environment in view of the anticipated decline of economic activity in euro area countries and the forecast of slow recovery in 2013. Weak economic growth is anticipated for the whole programming period (2012–2015), 1.2%, on average. The scenario assumes that, with successful consolidation and by keeping the deficit within the margins set, the conditions for financing the government and indirectly, the private sector, will improve in relative terms in the following years (2016–2017). This will have a positive impact on the overall economic activity and Slovenia's potential to accelerate economic growth, which is expected to average around 2.3% in 2016–2017.

As a result of weak economic activity and the foreseen restrictive wage and personnel policy in the public sector, labour market conditions will continue to deteriorate in the short term. However, with a return of confidence and economic growth and as a result of 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 shift in the movement of employment and unemployment, though unemployment will still be higher than before the economic crisis.

Table 2.7: Medium term scenario

	Spring Forecast	
	2012-2015	**2016-2017**
Gross domestic product, real growth in %	1 .2	2 .3
Exports of goods and services	4 .7	6 .1
Imports of goods and services	3 .6	5 .5
Private consumption	0 .5	1 .5
Government consumption	-0 .9	0 .5
Gross fixed capital formation	2 .1	3 .0
Employment, SNA, growth in %	-0 .9	0 .1
Registered unemployment rate, in **%**	13 .1	11 .8
Survey unemployment rate, in %	9 .0	8 .1
Registered unemployed, annual average in thousands	120 .0	106 .5
Inflation, CPI, annual average	1 .9	2 .0

Source: Spring Forecast 2012, IMAD, March 2012.

2.4. Impact of structural reforms on growth

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

The National Reform Programme for 2012 and 2013 contains an overview of structural changes and a survey of programme measures and projects for the period of two years. Key measures in the National Reform Programme are divided by groups of measures to promote smart, sustainable and inclusive growth. Over the program period the government plans to make adjustments that will foster economic activity and implement measures and institutional changes, that will ensure long-term sustainability of public finances and restore confidence in our economy.

Measures that will foster economic recovery include lowering the tax burden for the economy. The government will continue lowering the administrative barriers and provide support for domestic and foreign investment through “one-stop-shop” investment and through enhancing coordination between institutions supporting the operations of the enterprises (TIA, JAPTI, STO). Support for development of products that broaden the sources of financing of the companies is envisaged as well as the simplification of processes for spatial planning.

In the field of education, measures will aim at rationalization of the functioning of the system and increasing the attractiveness of the vocational education. Structural and institutional changes in the labour market are also foreseen. Measures for increasing the efficiency of the employment fund and active labour market policy are proposed. The existing funds dealing with the labour market issues will be merged into one Social Fund. Investment in human resources by enterprises and more intensive cooperation between young people and employers will be stimulated. In the social area, emphasis will be given to activation measures (programmes for social activation of long term beneficiaries of social assistance will be prepared) and modernisation of social services. This will include better targeting, activation of users of the services and better result orientation for individuals from vulnerable population. In the area of family policy, measures aiming at improving the work and family life balance are envisaged.

Simulations of the effects of certain measures which increase economic competitiveness are presented in more detail in the National Reform Programme. These effects have been quantified using a comprehensive dynamic stochastic general equilibrium model (DSGE model), which illustrates the specific features of the Slovenian economy relatively well. By using the DSGE model, we have estimated the potential impact of the following measures on GDP in 2020:

- tax incentives for R&D activities;
- reducing administrative barriers (by 25 %);
- progressive improvements in the educational structure;
- reducing the rate of corporate income tax.

Cumulative effect of the first three measures would be 1.9 % higher GDP in 2020 (0.4 due to tax incentives, 1.2 due to reduction of administrative barriers and 0.3 due to improvement in the educational structure). Tax incentives for R&D activities enable patent providers to reduce prices, which increases the demand for patents and stimulates production in the R&D sector, attracting some highly skilled workers from other sectors. GDP growth is limited in the short term due to the loss of production as a result of the reallocation of highly skilled workers from other sectors, at the same time the supply of highly skilled workers in the labour market is also a limiting factor, therefore a portion of the R&D incentives is channelled into their wages. The long-term impact on GDP is positive and lasting. The reduction of administrative barriers increases corporate income, investments and labour demand. This, however, is lower than the decrease in labour demand due to a reduction in the corporate overhead labour, the result being an overall fall in labour demand. The improvement in the educational structure results in a transition of medium-skilled labour to highly skilled labour in the sector of final products.

A result of a progressive reduction in the rate of corporate income tax is an increase in investment. A higher demand for labour at first results particularly in increased employment (in the medium and long term it stabilises at a 0.5% higher level) and later in the real wage increases.

3. GENERAL GOVERNMENT BALANCE AND DEBT

The international financial crisis, the collapse of external trade and the decline in economic activity in the last quarter of 2008 reversed the fiscal consolidation process. The government balance changed from a marginal surplus to a deficit in 2008 (1.8% of GDP). In 2009 the government deficit widened to 6.1% of GDP as a result of lower government revenues, automatic stabilizers and discretionary policy measures in response to the crisis. In 2010 the government deficit remained on the same level at 6.0 % of GDP.

The deficit target for 2011 was 5.5 % of GDP, but the general government deficit reached 6.4 % of GDP at the end of 2011. The key drivers behind this adverse development were a decrease in the economic growth by 0.2 % instead of envisaged 1.8 % growth of GDPcoupled with one-off and extraordinary expenditure that amounted to 459 million of EUR or 1.3 % of GDP. These include capital increase in NLB, d. d. (243 m EUR), Adria Airways (49 m EUR), Peko, d. d. (6 m EUR) and Nafta Lendava (10 m EUR). The increase includes also the assumption of claims of Slovenian Railways in the amount of 119 m EUR, payment of 20 m EUR of guarantees due and assumption of debt of public company for construction of power plant on River Sava – INFRA, d.o.o. in the amount of 10 m EUR. In absence of these one-off transactions, the general government deficit in 2011 would decline to 5.1 % of GDP.

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.

Ad 1) In line with the EU Council recommendations, the government implemented fiscal consolidation measures as planned. When adopting the revised budget, additional measures where taken by the government to lower government expenditures as response to additional deterioration in the economic developments.

Ad 2) In line with Council recommendations the annual reduction of the structural balance in the period 2010-2013 will be 1 % of GDP on average (Table 3.4), after that the structural deficit will be declining towards a structurally–balanced position in 2015.

Ad 3) The main fiscal consolidation measures for reduction of general government deficit below 3 % of GDP by the end of 2013 and towards a permanently balanced structural position will include a lowering of general government expenditures and rationalization of public administration (Chapter 3.3) with supporting measures on the revenue side (Chapter 3.2), introducing additional tax reliefs for R&D and investments, aiming at fostering economic activity. The fiscal consolidation strategy will be backed by measures for improving the efficiency of tax collection and quality of government revenues (Chapter 6.1). As a framework for fiscal planning, the government adopted and submitted to the Parliament a proposal for the introduction in the constitution of a balanced budget fiscal rule. Deviations from the rule will be possible only in exceptional circumstances. The level of government expenditure will be determined by the level of trend growth of revenues (Chapter 7).

After slight increase in the first year, government revenue as a share of GDP will be reduced by 1 percentage point and will reach the level of 43.7 % of GDP by the end of the programme period. Government expenditure as a share of GDP will be reduced in the programme period by 4.1 percentage points from 48.2 % of GDP in 2012 to 44.1 % of GDP in 2015. Interest payments will increase to 2.5 % of GDP this year, from 1.1 % of GDP in 2008. Over the programme period the interest payments are not projected to decrease significantly, since the general government debt level is projected to peak in 2013, followed by a gradual decrease from 2014 onwards.

Table 3.1: Revenue breakdown

		2011	2011	2012	2013	2014	2015
		m EUR	% of GDP				
1.	Total revenue at unchanged policies	15,859.5	44.5	44.9	44.3	43.9	43.6
2.	Discretionary revenue measures	0.0	0.0	-0.2	-0.2	-0.1	0.1
3.	Total revenue (including discretionary m.)	15,859.5	44.5	44.7	44.1	43.8	43.7

Source: MF RS.

As a first step in fiscal consolidation, the state budget deficit will be lowered to 3 % of GDP in 2012 by means of a supplementary budget for 2012 and a comprehensive law to balance public finance[2], which will ensure a restriction of government expenditure. This will lower the government deficit according to ESA 95 methodology to 3.5 % of GDP in 2012. Given that economic conditions remain uncertain and risks in the macroeconomic projections remain on the negative side, the government together with the supplementary budget also proposed amendmends to the budget implementation act, which among other things, introduces a new provision enabling the government, on the proporsal of the finance minister, to temporary suspend the execution of individual state budget expenditures for more than 45 days, if negative economic trends result in increased expenditure or reduced revenues.

In 2013 the general government deficit will be reduced by 1 percentage point and will reach a level below 3 % of GDP. The government targets deficit of 2.5 % of GDP. Experience from the previous year shows that unexpected expenditure during the budget year, not influencing the government deficit according to the national methodology, can according to the established EU ESA-95 methodology considerably increase the general government deficit. The government is fully committed to put an end to the existing excessive deficit in line with the Council Recommendations by the end of 2013 and further decrease the government deficit by 2.1 percentage points by the end of the programme period to the level of -0.4 % of GDP and balanced structural position. This consolidation path will also limit the growth of government debt.

With the exception of 2012, when the deficit of the local government level is projected at 0.1 % of GDP, the budgets of local government level and social security funds are expected to be balanced. During the programme period the deficit will be generated primarily on the central government level and will be declining annually by 1.5 percentage points of GDP on average.

3.2. Government revenues policy

The goal of tax policy in this programme period is to ensure tax conditions that would stimulate economic recovery and support other measures of the economic policy for recovering the economic growth. Increases in individual types of government revenue are possible through broadening the taxable base for certain types of revenues. The Government does not intend to increase nominal tax rates with the exception of excise duties levels (increases of excise duties on cigarettes, cut tobacco, alcohol and alcoholic beverages are foreseen) and other limited duly justified cases. Improved revenue collection procedures and measures to combat grey economy will further contribute to the increase of public revenues.

In 2011 no new systemic solutions with respect to personal and corporate income taxation were adopted in Slovenia. Nevertheless, a special law was adopted that provides for special tax allowances for investment and employment in certain regions that are underdeveloped in comparison to the Slovenian average. In the year 2011 this possibility was not used in practice (expect for Pomurje region where a separate set of measures was adopted), while in 2012 the tax allowance was introduced for Pokolpje region. The Bank Balance Sheet Tax Act was adopted and enacted in 2011 with the aim of applying tax instruments to promote an increase of credit activity. The first impacts of this Act will be known in the second half of 2012, after the analysis is done on the basis of annual tax returns for 2011.

[2] The Law is a single legal instrument amending 44 other laws by means of permanent expenditure-reduction changes as well as additional temporary changes in the provisions of some other laws.

In the area of indirect taxes two amendments to the Value Added Tax Act were introduced in 2011. The aim of those changes was to reduce the administrative burden of taxable persons linked to tax compliance. At the same time new VAT treatment of tax burden connected to claims in bankruptcy procedures and compulsory settlement procedures was introduced. The main purpose of those changes was to moderate critical conditions in economy. In the area of excise duties the policy of gradual increasing the excise duties on cigarettes and cut tobacco was continued as well as the policy of adjustment of excise duties on mineral oils to the prices in the world oil market.

With respect to the social security contributions, no new systemic solutions were introduced in 2011 as they need to be coordinated with structural reforms in the area of social insurance and social security system. Therefore possible changes to the social security contributions system will be introduced in forthcoming years, simultaneously with the agreed structural reforms.

In 2012 the Parliament on the proposal from the Government adopted measures for promoting economic activity; an increase in the level of tax allowances for investment in research and development to 100 % of the amount invested and to abolish at the same time tax allowance for such investment in underdeveloped Slovenian regions that was very burdensome for taxable persons in terms of administrative burden. This change will be valid for legal persons and for individuals performing business activity. At the same time the general tax allowances for investment will be increased to 40 % of the amount invested (again for legal persons and individuals performing business activity alike). Furthermore the nominal tax rate of corporate income tax will be reduced from 20 % to 18 % in 2012 and than gradually by one percentage point to reach 15 % of taxable base after expiry of the transitional period. These changes were proposed to the extent allowed by the fiscal consolidation.

In addition to the above described measures for reducing the burden, the government proposed measures with an aim to increase the government revenues in the areas which do not significantly affect the competitiveness of Slovenian economy and the income position of the majority of the individuals. The comprehensive law to balance public finance includes also measures for increasing public revenues that will become effective already in 2012 or by 1 January 2013:

- Increase of general tax rate for tax on income from capital and profit from transfer of derivatives, from 20 to 25 %;
- Introduction of a supplementary tax on vessels, that will represent state budget revenue and not local budget revenue as the existing tax on watercrafts;
- Introduction of a supplementary motor vehicle tax, that will be applied on motor vehicles of 2.500 ccm or more engine volume (1.000 ccm or more for motorcycles);
- introduction of an anti-crisis tax on immovable property of all legal persons or individuals, providing that individual or a legal person holds immovable property of a value of more than 1 m EUR and the property is not used for business use. This tax will be introduced temporarily until the end of 2014 and
- Introduction of a tax on profit on disposal of land where the use of land was transformed into building land.

Estimated financial impact of the measures described above is about 40 m EUR per year.

To improve further the competitiveness of Slovenian tax system, further changes of tax laws are envisaged. Impact and relevance of the existing measures will be studied as well as possibilities to introduce new tax measures. Special attention will be given to quick and simple tax compliance procedures and to micro and small enterprises (possible extensive use of flat-tax scheme for the smallest enterprises; reduction of administrative burden, increase of use of electronic exchange of information with tax or customs service, review of some measures where the practice points to some problems etc.). The Government intends to examine the possibility of renovation of the system of taxation of immovable property and property and possible introduction of a financial transaction tax at national level.

In 2011 it was expected that part of the excise duty on mineral oils will be replaced by CO_2 tax with the aim to charge environmental costs also to business use of mineral oils. Due to the difficult situation in the economy, the Government decided to continue with the existing policy in the area of taxation of mineral oils in 2012, abandoning previously planned changes.

In 2012 further changes in financial burden of CO_2 emissions are foreseen. We expect that public revenues from auctioning of CO_2 emission coupons for a certain segment of the economy will increase. As the introduction of auctions will be gradual, the Government does not expect significant public revenues from this source already in 2012 (only about 8 m EUR). In 2013 we expect these revenues to increase (over 40 m EUR)[3], if the system of public auctions will function well, having an important impact on fiscal consolidation.

Furthermore, the Government expects that the combination of measures – reduction of tax burden, simplification of tax compliance procedures, more effective supervision, and structural reforms in the area of social insurance and social security, as well as measures to improve the level of voluntary tax compliance – will contribute to reduction of grey economy.

Other changes in the system of government revenues relate to improvement of existing legislation and/or introduction of new measures (Chapter 6.1.).

3.3. Government expenditures policy

Fiscal consolidation strategy is focused on reduction of government expenditures as share of GDP, their rationalization and increased efficiency. The general government expenditure as share of GDP will decline from estimated 50.9 % of GDP in 2011 to 48.2 % of GDP in 2012, to be followed by gradual decline by the end of the programme period to 44.1 % of GDP.

A wide range of measures have been proposed on the expenditure side in order to reduce the general government deficit to below 3% of GDP by 2013, and to achieve fiscal balance over the medium term. With these measures Slovenia for the first time makes significant adjustments in the areas where changes in legislation are required. Total government expenditure will decline in nominal terms in 2012 and 2013; in 2014 and 2015 there will be a positive growth, but will remain considerably below the nominal GDP growth (Table 3.3).

Table 3.2: Nominal growth of government expenditures, potential output and GDP

in %	2011	2012	2013	2014	2015
Government expenditure	2.0	-5.3	-0.7	1.1	1.3
Potential output	0.6	0.1	0.4	0.8	0.9
GDP	0.6	0.0	2.7	4.0	4.1

Source: IMAD, MF RS.

The Government submitted a supplementary budget for 2012 to the Parliament, proposing a 3.7 % nominal reduction of the total budget expenditure in comparison to the outturn for 2011. In this respect, the Government also had to take into consideration previously not planned and/or additional obligations, such as higher interest payments, underestimated level of the budget transfers to the pension fund, referendum costs, additional expenditure for compensations to

[3] Data are from the draft Climate strategy of Slovenia. The strategy allows for large range of possible revenues (from 40 to 160 mio EUR/year). In the document we use restrictive estimations of possible additional revenues.

former members of the Parliament, payments into the EU budget, and other expenditures, either not taken into account or not anticipated at the time od the preparation of the 2012 budget.[4] Reduction of budget expenditure and covering of non-planned budget commitments require austerity measures estimated at approximately 1.6 % of GDP in 2012 alone and approximately 3.0 % in 2013. In addition to the measures affecting the national budget, this estimate also includes measures relating to other units of governments such as municipalities, health fund, pension funds and public institutes ("javni zavodi").

The new recapitalisation of NLB d.d., which is a systemically important credit institution and the largest bank in Slovenia, has been scheduled for mid-2012 in accordance with the requirements of the European Banking Authority (EBA) and the Bank of Slovenia, which is the sole responsible banking system regulator in Slovenia. The Government is determined to pursue a recapitalisation through investors ouside the state budget.

The austerity measures included in the draft supplementary budget will be implemented by the adoption of a comprehensive law to balance public finance that affects more than 50 sector-specific acts.[5]

Measures on the expenditure side are based on internal savings measures, adjustments to the operation of the public sector, and adjustments to programmes and policies. The measures are both horizontal and vertical. Horizontal measures apply to all budget spending units (restrictions on certain categories of labour costs, costs of goods and services, investment costs, etc.). Vertical measures include financial savings from amended legislation within individual policies and ministries.

Horizontal measures which relate to the labour costs of public sector employees include measures regarding the salaries of public sector employees and measures concerning the reimbursement of expenses and other incomes of public sector employees. The most important measures relate to the reduction in public sector wages. Under this scheme, the third quarter of salary disparity will be eliminated in accordance with the Wage System in the Public Sector Act in the second half of the year, the elimination of which was blocked by the Intervention Measures Act in 2010. The last quarter of wage disparity will be eliminated in 2013. Cumulative effect of the described changes (reduction of wages and elimination of wage disparities) would effectively result in a 5 % reduction of average level of wages in the public sector. In addition to the supplementary budget, the Government also prepared the amendments to the Intervention Measures Act. The aim of these changes is to reduce the amount of holiday allowance in the public sector. Low-income employees will receive the full amount of holiday allowance, whereas the amount those in higher wage brackets will be progressively reduced up to a minimum of 10 % of the original amount planned for 2012.[6] The effects in the area of wages and labour costs have been estimated at 244 m EUR or 0.7 % of GDP in 2012 and 477 m EUR or 1.3 % of GDP in 2013.

[4] Increase of funds for interest payments (EUR 668.1 m or EUR 158.1 m more than in 2011 or EUR 72.6 m less than anticipated in the adopted 2012 budget), social assistance in cash to the unemployed, scholarships, child benefits and parental allowances under the new social legislation (EUR 104 m); payments into the EU budget (the estimated obligation of the Republic of Slovenia for 2012 is 14 m EUR higher than for 2011); international liabilities on the national level (EUR 11 m for the UN, the Arbitration Agreement, the European Development Fund, etc.); compensation to members of the Parliament on the termination of their term (EUR 2.5 m); the creation of contingency reserves (on the basis of the average for the past ten years), including funds for the co-financing of projects financed from the EU budget during the year.

[5] The proposal of this act was adopted by the Government on 12 April 2012. The discussion in the Parliament is envisaged at the beginning of May.

[6] At the same time, the Government plans to temporarily reduce holiday allowances in all organisations in which the Government has at least a 25% stake to the minimum wage level up to and including the year when economic growth again reaches 2.5 % of GDP.

The Government's rationalisation measures will also affect investment for which a reduction by 69.2 m EUR or 21.5 % is planned for 2012 compared to 2011. Investment expenditures from the state budget for 2012 have been planned at 253.3 m EUR. In the programme structure, 52 % of investments are intended for transport and transport infrastructure (the bulk of funds is earmarked for railway and road infrastructure) and 11 % for environmental and spatial planning policy (the sustainable management of natural resources and the construction of environmental infrastructure). The draft supplementary budget for 2012 provides 42 % for the construction of new buildings and premises, reconstruction and adaptation, 16% for major maintenance and renovation, 13% for project feasibility studies, project documents and investment engineering, 11% for the acquisition of intangible assets, and 8% for the acquisition of equipment. The planned investment transfers from the national budget to legal entities and individuals other than budget spending units, which are treated as grants, will be reduced by one third. By contrast, expenditure for investment transfers to the budget spending units as a result of higher investment transfers to municipalities (limited by intervention laws in the previous years) will rise by approximately 11.8 % compared to 2011. Transfers to public funds and agencies will account for only 30.7 % of 2011 figures since the responsibilities and duties of such funds and agencies will be mostly transferred back to the respective ministries.

Total government investment expenditures will remain at approximately 3.8 % of GDP throughout the programme period, of which from the domestic budgetary sources between 3 and 3.5 % of GDP and around 0.8 % of GDP from EU funds (Table 3.3). Special emphasis will be given to increasing the amount and effectivness of spending from EU structural and cohesion funds. With the aim of preserving the investment activity in the economy as a whole, the government will take measures aimed at stimulating private investments and public – private partnerships.

Table 3.3: Gross fixed capital formation, other capital transfers and investment from the EU budget sources

in % of GDP	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Gross fixed capital formation	4.3	3.6	3.2	3.2	3.1	3.1
Of which: - from the budgetary sources	4.2	3.5	3.0	2.8	2.8	2.6
- from the EU budget sources	0.1	0.1	0.1	0.4	0.4	0.5
Other capital transfers*	1.1	2.0	0.7	0.7	0.7	0.7
*Of which: - from the budgetary sources**	0.7	1.7	0.5	0.4	0.4	0.3
- from the EU budget sources	0.5	0.4	0.2	0.3	0.3	0.4
Total general government gross fixed capital formation and other capital transfers	5.4	5.6	3.9	3.9	3.8	3.8
Of which: - from the budgetary sources	4.9	5.2	3.5	3.2	3.1	2.9
- from the EU budget sources	0.6	0.5	0.4	0.7	0.7	0.8

Source: MF RS.
Note: * Includes recapitalization of NLB, assumption of obligations of Slovenian Railways, recapitalization of Adria Airways and some other companies in total amount of 1.3 % of GDP.

The draft supplementary budget for 2012 cuts subsidies to private and public enterprises by 19.3 % compared to 2011 figures. According to the programming structure, the bulk of subsidies (52.6 %) are intended for agriculture, forestry, fisheries and food, followed by subsidies in the area of active labour policy (14 %), entrepreneurship and competitiveness (11.5 %), and transport and transport infrastructure (13.4 %). According to the draft supplementary budget, 5.2 % of the total subsidies are intended for higher education, science, technology, and the information society.

The downsizing of the number of ministries and government services, agencies, offices and public institutes[7] will have an additional impact on cost reduction. This will be accompanied by a horizontal reduction in direct costs and business travel expenses, the rental of ministry premises, car parks, IT equipment, etc.

Vertical measures will have an impact on the volume and structure of public expenditure through programmes and policies. In 2010,[8] the majority of general government expenditure was intended for social protection[9] (18.7 % of GDP), health care (6.9 % of GDP) and education (6.6 % of GDP). The share of expenditure for social protection in GDP rose by 0.8 percentage point compared to 2009 level.

In the field of education, measures for rationalising the educational system have been prepared in accordance with the OECD recommendations (OECD Economic Survey Slovenia, 2011). These measures comprise changes to standards and norms in schools and pre-school education, as well as changes in the method of financing of public institutes in this area. Costs will also be cut by raising teaching obligations, increasing the maximum number of students per class and introducing a new standard for the minimum number of students per class. This will be achieved by amending the existing legislation,[10] which will result in reduced budget expenditure totalling approximately 28 m EUR in 2012 and 130 m EUR and 160 m EUR 2013 and 2014 respectively.

Reforms and the modernisation of the policies presented in the National Reform Programme will also reduce the costs of implementing labour market, health care and social protection policies.[11] On this basis, government expenditure is expected to be reduced by a total of 137 m EUR, 232 m EUR and 145 m EUR in 2012, 2013, and 2014, respectively. This reduction is expected to be the result of the following:

- changes in the existing level of benefits for unemployment in the direction of reduction of the benefit ceiling and lowering of the assessment base;
- reduction of the parental benefit for child care and nursing ;
- selective reduction of child benefits without affecting the socially weak population; means-testing will be introduced for government gifts at childbirth and large family allowances;
- pupil and student subsidies under the School Meals Act will be only intended for pupils and students from socially weak families, and student meal subsidies will be abolished in the period between 15 July and 15 August;
- subsidies for self-employed persons in culture will be dependent on their wealth position;
- annual bonuses to pensioners will be reduced in inverse proportion to the levels of pensions;
- pensions "granted under special conditions", i.e. pensions that are not based on paid contributions, will be reduced;

[7] Among other things, it includes the following: the merger of the customs and tax administrations; coordination of institutions in support of the operation of the companies TIA, JAPTI, STO; Incorporation of the Public Procurement Agency into the Ministry of Finance; changes to the operation of the Slovenian Book Agency and the Slovenian Film Fund; the merger of some public institutes in the area of sport and education, etc.

[8] SORS, 2011.

[9] This area covers the expenditure associated with various types of risks and needs, such as illness, disability, old age, children, unemployment and other forms of social exclusion (the bulk of this expenditure was earmarked for old-age pensions and other social benefits). The share of social protection expenditure in GDP rose by 0.8 percentage point (275 m EUR) compared to 2009. (SORS, 2011).

[10] Organisation and Financing of Education Act, Elementary School Act, Kindergarten Act, Placement of Children with Special Needs Act, School Meals Act, Subsidised Student Meals Act, Scholarship Act, Book Agency Act, Slovenian Film Centre, Public Agency of the Republic of Slovenia Act.

[11] Health Care and Health Insurance Act, Pension and Disability Insurance Act, Exercise of Rights to Public Funds Act, Labour Market Regulation Act, Parental Protection and Family Benefit Act, War Veterans Act, War Disabled Act, Victims of War Violence Act.

- the concession fee for student labour will increase from 14 % to 25 %[12] and reduce the proportion of this fee received by student labour recruitment consultancies, so that the major share of this fee will be allocated to the scholarship fund.

In the field of health care, the level of sickness benefits covered by the health insurance fund will be reduced, and sickness benefits for the unemployed will be abolished. In the field of health care, the planned measures also include changes in the standard rates for medical technical aids and a reduction in the amount of medical services covered by the compulsory health insurance. These measures will result in a reduction of the health fund expenditure.

The anticipated effect of these measures is a reduction in labour costs (wages and other labour related incomes) from 4.5 billion EUR in 2011 to 4.3 billion EUR in 2012, and a gradual decline of this expenditure from 12.1 % of GDP in 2012 to 11.1 % of GDP in 2015. Last year's decline in intermediate spending is expected to continue. The result of the measures adopted will be a decrease in intermediate government expenditure by 0.3 percentage point of GDP in 2012 compared to the previous year and by an additional 0.9 percentage point to 5.3 % of GDP by the end of the programme period. Social benefits have risen by 3.5 percentage points since 2008. After a slight decline in 2012, they will decline by 1.8 percentage points of GDP compared to the 2011 level by the end of the programme period. Subsidies will decline by 0.6 percentage point of GDP. This year, interest payments will increase by 0.5 percentage point of GDP to 2.5 % of GDP and will remain at this level throughout the programme period.

3.4. Fiscal consolidation, structural deficit and fiscal position

Fiscal policy is focused on consolidation measures in order to bring the deficit below 3 % of GDP by the end of 2013 in line with the Council recommendation on the excessive deficit procedure. 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. The government's 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 in 2013, the adjustment path toward structurally balanced budget is foreseen in line with the Regulation 1466/97 (amended by 1175/11).

Table 3.4 shows the structural deficits expected to be achieved by the consolidation strategy, based on the measures on the expenditure side, with incentives to accelerate economic growth on the revenue side. In 2011 cyclically adjusted deficit increased by 0.1 % of GDP, which is mainly due to previously described one-off and temporary measures. Structural deficit, calculated excluding all one-off and other temporary measures, decreased by 1.2 % of GDP in 2011. In the period 2011-2015 the structural deficit will decline on average by 1.0 % of GDP, with annual fiscal effort evenly distributed over the years (slightly higher in 2012).

The average potential growth rate in 2010-2014 as shown in Table 3.4 is estimated at 0.6 %, compared to 1.6 % in the previous update of the programme. In 2011 the decline is predominantly explained by the decline of the capital accumulation (to 0.28 percentage points). The estimates show slight growth of the capital accumulation from 2013 onwards. As shown in the table, the contribution of labour to growth is relatively low. After negative contribution of labour to growth in 2009 and slight positive contribution in 2010 and 2011, the contribution is again expected to be negative in the following years. In 2012 to 2014 this is mainly the consequence of expected increase in the natural rate of unemployment and demographic trends in the following years, especially reduction of the population in the labour active age. In

[12] The additional 2 % concession fee for the purpose of constructing students' homes is included.

the time of the crisis we record a big decrease in the contribution of total factor productivity, while further increase is foreseen in the years from 2013 onwards.

Table 3.4: Cyclical developments

	in % of GDP	ESA Code	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
1.	Real GDP growth (%)		-8.0	1.4	-0.2	-0.9	1.2	2.2	2.2
2.	Net lending of general government	B.9	-6.1	-6.0	-6.4	-3.5	-2.5	-1.5	-0.4
3.	Interest expenditure	D.41	1.4	1.6	2.0	2.5	2.6	2.5	2.5
4.	One-off and other temporary easures				1.3				
5.	Potential GDP growth (%)		0.8	1.2	0.6	0.1	0.4	0.8	0.9
	contributions:								
	- labour		-0.6	0.2	0.2	-0.2	-0.4	-0.7	-0.8
	- capital		1.1	0.7	0.3	0.2	0.3	0.4	0.5
	- total factor productivity		0.2	0.3	0.1	0.2	0.5	1.1	1.2
6.	Output gap		-2.5	-2.3	-3.0	-3.9	-3.2	-1.8	-0.6
7.	Cyclical budgetary component		-1.1	-1.0	-1.3	-1.8	-1.4	-0.8	-0.3
8.	Cyclically-adjusted balance (2 - 7)		-5.0	-5.0	-5.1	-1.8	-1.1	-0.7	-0.1
9.	Changes in cyclically-adjusted balance		-0.2	0.0	-0.1	3.3	0.7	0.4	0.6
10.	Structural balance (8-4)		**-5.0**	**-5.0**	**-3.8**	**-1.8**	**-1.1**	**-0.7**	**-0.1**
11.	Changes in structural balance		-0.2	0.0	1.2	2.0	0.7	0.4	0.6

Source: MF RS.

Table 3.5: General government budgetary prospects

	ESA code	2011 Level	2011 (estim.)	2012	2013	2014	2015
		m EUR	%GDP	%GDP	%GDP	%GDP	%GDP
Net lending by sub-sector (B.9)							
1. General government	S.13	**-2,289.5**	**-6.4**	**-3.5**	**-2.5**	**-1.5**	**-0.4**
2. Central government	S.1311	**-2,281.2**	**-6.4**	**-3.4**	**-2.4**	**-1.4**	**-0.3**
	S.1312						
4. Local government	S.1313	**-29.1**	**-0.1**	**-0.1**	**0.0**	**0.0**	**0.0**
5. Social security funds	S.1314	**20.9**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**
Total general government (S.13)							
6. Total revenue	TR	**15,859.5**	**44.5**	**44.7**	**44.1**	**43.8**	**43.7**
6. A Total revenue without EU*		**15,509.5**	**43.5**	**43.9**	**43.1**	**42.8**	**42.6**
7. Total expenditure	TE	**18,148.9**	**50.9**	**48.2**	**46.7**	**45.3**	**44.1**
7.A Total expenditure without EU*		**17,799.0**	**49.9**	**47.5**	**45.7**	**44.3**	**43.0**
8. Net lending / borrowing	EDP B.9	**-2,289.5**	**-6.4**	**-3.5**	**-2.5**	**-1.5**	**-0.4**
9. Interest expenditure	EDPD.41	**695.5**	**2.0**	**2.5**	**2.6**	**2.5**	**2.5**
10. Primary balance		**-1,594.0**	**-4.5**	**-1.0**	**0.1**	**1.0**	**2.1**
11. One off expenditures**		**462.0**	**1.3**				
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		**7,952.3**	**22.3**	**22.4**	**22.1**	**22.1**	**22.2**
12a. Taxes on production and imports	D.2	5,021.6	14.1	14.3	14.4	14.6	14.7
12b. Current taxes on income, wealth, etc	D.5	2,918.8	8.2	8.0	7.6	7.5	7.4
12c. Capital taxes	D.91	11.8	0.0	0.0	0.1	0.1	0.1
13. Social contributions	D.61	**5,534.8**	**15.5**	**15.4**	**15.1**	**15.0**	**15.0**
14. Property income	D.4	**248.9**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**
15. Other		**2,123.5**	**6.0**	**6.1**	**6.2**	**6.0**	**5.9**
16. Total revenue	TR	**15,859.5**	**44.5**	**44.7**	**44.1**	**43.8**	**43.7**
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		**13,487.1**	**37.8**	**37.8**	**37.3**	**37.1**	**37.2**
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	**6,870.4**	**19.3**	**18.3**	**17.5**	**16.9**	**16.4**
17a. Compensation of employees	D.1	4,537.7	12.7	12.1	11.5	11.3	11.1
17b. Intermediate consumption	P.2	2,332.7	6.5	6.2	6.0	5.6	5.3
18. Social payments (18=18a+18b)		**7,180.4**	**20.1**	**19.8**	**19.3**	**18.7**	**18.3**
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D. 63131	811.9	2.3	2.2	2.1	2.1	2.1
18b. Social transfers other than in kind	D.62	6,368.5	17.9	17.6	17.1	16.6	16.2
19. Interest expenditure	D.41	**695.5**	**2.0**	**2.5**	**2.6**	**2.5**	**2.5**
20. Subsidies	D.3	**682.3**	**1.9**	**1.6**	**1.3**	**1.4**	**1.3**
21. Gross fixed capital formation	P.51	**1,283.9**	**3.6**	**3.2**	**3.2**	**3.1**	**3.1**
22. Other		**1,436.5**	**4.0**	**2.8**	**2.7**	**2.6**	**2.6**
23. = 7. Total expenditures	TE	**18,148.9**	**50.9**	**48.2**	**46.7**	**45.3**	**44.1**

Source: MF RS.

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

** Recapitalization of NLB, Adria Airways, and some other companies, assumption of obligations of Slovenian Railways and payments of due guarantees.

Regarding the expenditure benchmark, introduced by the new legislative package for strengthened economic coordination, expenditure growth in 2012 – 2015 will be considerably lower than the growth of potential GDP (Table 3.2.). Exclusion of certain government expenditure is taken into account, namely expenditure on EU programmes fully matched by EU funds revenue and non-discretionary changes in unemployment benefit expenditure, as shown in Table 3.6.

Table 3.6: Expenditure to be excluded from the expenditure benchmark

		2011	2011	2012	2013	2014	2015
1.	Expenditure on EU programmes fully matched by EU funds revenue	639.2	1.8	1.9	2.8	2.7	2.7
2.	Expenditure fully matched by mandated revenue increases	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
3.	Non-discretionary changes in unemployment benefit expenditure	286.3	0.8	0.7	0.7	0.6	0.6

Source: MF RS.

Data on government expenditure by functions are available until 2010 only. The bulk of expenditure in Slovenia is spent on social protection, followed by education and health. More that 5 % of GDP were spent in 2010 also for general public services and economic affairs.

Table 3.7: General government expenditure by functions

in % of GDP	COFOG Code	2007	2008	2009	2010
1. General public services	1	5.3	5.1	5.7	5.7
2. Defence	2	1.5	1.4	1.5	1.5
3. Public order and safety	3	1.6	1.6	1.7	1.8
4. Economic affairs	4	4.1	4.8	5.2	5.1
5. Environmental protection	5	0.8	0.8	1.0	0.8
6. Housing and community amenities	6	0.6	0.9	0.8	0.7
7. Health	7	5.9	6.2	7.1	6.9
8. Recreation, culture and religion	8	1.2	1.6	1.8	2.2
9. Education	9	5.9	6.1	6.5	6.6
10. Social protection	10	15.5	15.9	17.9	18.7
11. **Total expenditures**	TE	**42.5**	**44.2**	**49.3**	**50.1**

Source: SORS

3.5. Debt levels and developments

The outstanding amount of general government consolidated debt is estimated at 16,954 m EUR or 47.6 % of GDP at the end of 2011. The largest share (87.4%) of the total general government debt is represented by the central government debt, which has a relatively stable structure[13]. Following the Article 84 of Public Finance Act financing of the central government

[13] The average weighted maturity of central government debt was 6.6 years as of 31.12.2011 in line with the planned borrowing strategy (instruments with longer maturities), slightly increased compared to previous years. At the end of

budget execution and debt management operations in a given fiscal year allows the government to borrow, within a given fiscal year, for financing of the deficit of central government budget including lending minus repayment operations, and debt repayments in the current and the following two fiscal years. Prefinancing amount at the end of 2011 was 1,021 m EUR.

Government debt as share of GDP increased substantially in 2009. After a further increase in 2010 and 2011 and after reaching 53.1% of GDP in 2013, the debt ratio will gradually decline to 50.9 % of GDP in 2015. The debt dynamics will be driven primarily by the central government debt. Local government debt is expected to remain on the level below 2 % of GDP. The borrowing capacity of local governments is constrained by the act governing the financing of local communities, according to which local communities can only borrow domestically for begdeted investments[14]. If the repayment of debt is not in the same budgetary year, they need a permission from the Ministry of Finance to borrow. Expenditures to cover costs of borrowing are also limited[15]. The amount of outstanding debt of social security funds stood at 52 m EUR at the end of 2011 and is not expected to increase in the programme period.

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 privatization proceeds for a further decline of the overall government debt.

Table 3.8: General government debt developments

in % of GDP	**ESA code**	**2011**	**2012**	**2013**	**2014**	**2015**
1. Gross debt		47.6	51.9	53.1	52.6	50.9
2. Change in gross debt ratio		9.0	4.3	2.5	1.5	0.4
Contributions to change in gross debt ratio						
3. Primary balance		-4.5	-1.0	0.1	1.0	2.1
4. Interest expenditure	EDP D.41	2.0	2.5	2.6	2.5	2.5
5. Stock-flow adjustment						
p.m. implicit interest rate on debt		5.1	5.3	5.1	4.9	5.0

Source: MF RS.

The strategy of issuing government securities on the integrated EU market in line with guidelines adopted in 2007 continued in 2011. Two benchmark bonds were issued in 2011 with 10 and 15 year maturity, each in a size of 1.5 bn EUR. The majority of the bonds were sold to European investors. The participation of Slovenian investors was in the range of 8 – 10 %. In 2011 in line with the auction calendar in addition to two benchmark bond issues 3-month treasury bills were issued (four treasury bill auctions were executed, the nominal amount of the treasury bills issued ranged between 22 and 28 m EUR per auction) and 18-month treasury bill in the amount of 907 m EUR. The government bond exchange as the only debt management transaction was executed in 2011. No government bond buyback transaction took place.

In the next medium term the structure of financing instruments, the size of short- versus long term borrowing, and dynamics of the government borrowing execution will be planned primarily taking into account the strategic objectives and the principles of government debt management as well as the central government budget cash flow assessments, as it has been the case so

2011 the share of debt in EUR was 99.8 %. The share of fixed rate instruments is increasing in the last years and represented 97.4 % of total central government debt at the end of 2011.

[14] They can exceptionaly borrow for liquidity purposes and for co-financing of investments from the EU budget.

[15] The costs of repayment of the principal and interest can be maksimum 8 % of revenues of the previous budget year, decreased for the grants received, transfers for investments and funds received from the EU budget and revenues from overheads.

far. The selected mix of financing instruments will support building of the benchmark yield curve and the improvement of Slovenian government securities' secondary market liquidity.

Since Slovenia's entrance in the eurozone long term borrowing through benchmark government bonds issued in domestic currency (EUR) has been the primary instrument of the central government budget financing, while short term borrowing in domestic currency has been earmarked for budget liquidity management within a fiscal year. Long term borrowing through benchmark government bonds issued in domestic currency will remain the primary instrument of the central government budget financing in the medium term.

3.6. Budgetary implications of major structural reforms

Significant structural changes are enacted in the comprehensive law to balance public finance with effects described in Chapter 3.3 in more detail.

To ensure the sustainability of public finances changes to the pension system will be made. These will be gradual and implemented in a manner that will ensure long term sustainability of public finances. Changes in the health system will also be made, aiming towards greater transparency and control over spending and greater autonomy and responsibility of providers of health care services. The Government is expecting to agree on these reforms with the social partners in 2012.

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 and represents the central forecast that is based on economic policies that are aimed at lowering the government deficit. In the environment of uncertain economic recovery the policy scenario is subject to various risks. Major risks affect developments in the international environment, especially in connection with possible further deepening of the debt crisis in euro area and changes in financing conditions. In case of lover economic activity in the euro area if the downside risks materialize (for approximately 1 percentage point in 2012 and around 2.5 percentage points in 2013), the gross domestic product in Slovenia would further shrink in 2012 and 2013 (-2.9 % in 2012 and -2.2 % in 2013).

4.2. Sensitivity of budgetary projections to different scenarios and assumptions

The sensitivity analysis of tax revenues and government deficit 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 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 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. The assessments are made on the basis of data from 2011. 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 2011 (% 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.	-0.15
	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.	-0.04
	Last year's inflation	Lower by 1 p.p.	-0.04
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: 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 2011 (% of GDP)
Real growth in average gross wage	Lower by 1 p.p.	Personal Income Tax, Social Security Contributions	-0.21
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	-0.13
Real GDP growth in t-1	Lower by 1 p.p.	Corporate Income Tax	-0.04
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.

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 0.21 % of GDP. A decline of employment also affects the fiscal stance in a similar magnitude. A lower employment and real wage growth will therefore result in a lower revenue and higher expenditure both changes affecting adversely the fiscal stance.

4.3. Sensitivity analysis on the debt service

Central government debt is relatively insensitive to changes in exchange rate as the share of debt denominated in foreign currencies (USD, GBP, CHF) is insignificant. In 2012 the share of debt with fixed interest rate is estimated at 98.1 %.

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**	**Debt**	**Interest**	**Debt**
Year	In percentage points					
2012	0.0206	0.0206	0.0000	1.0000	0.0206	1.0256
2013	0.0466	0.0266	0.0433	0.9672	0.0947	0.9938
2014	0.0767	0.0319	0.0416	0.9292	0.1230	0.9612
2015	0.0921	0.0184	0.0400	0.8931	0.1366	0.9115
2016	0.1105	0.0184	0.0400	0.8931	0.1550	0.9115

Source: MF RS.

The biggest influence on the cost of servicing of existing debt and repayment of existing debt instruments in future would have changes of ECB interest rates and deficits of the central government budget. In the sensitivity analysis we assume that in the middle term the ECB interest rate policy will remain unchanged. The impact of movements of the interest rates is taken into account already in the baseline scenario, increased by 0.5 percentage points in the sensitivity analysis.

In Table 4.3 shows the analysis, where we test the sensitivity of central government debt and interests to changes of interest rate and central government deficit, separately for each variable and simultaneously. In case interest rates of the ECB would increase by 0.5 percentage points in 2012, this would lead to an increase of cost of new borrowing for 0.046 percentage points in 2013 and 0.076 percentage points in 2014. In this case, the level of central government debt as a percentage of GDP would increase by 0.026 percentage points in 2013 and 0.032 percentage points in 2014. In case the government deficit increases by 1 percentage point in 2012, the interest cost as a percentage of GDP would increase by 0.043 percentage points in 2013, 0.042 percentage points in 2014 and 0.04 percentage points in 2015.

The impact of changes in interest rate is limited as the central government debt is comprised mainly of fixed interest instruments. Thus the change in interest rate affects primarily the cost of new borrowing.

4.4. Comparison with the 2011 Stability Programme

The forecast for GDP growth was revised downwards significantly 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 a greater lack of payment discipline), which contributes to lower growth in investment and private consumption, as well as less favourable than expected international environment conditions.

Table 4.4: Divergence from the previous update (April 2011)

% of GDP	2010	2011	2012	2013	2014	2015
1. Real GDP growth						
Stability programme (previous update)	1.2	1.8	2.2	2.3	2.8	
Stability programme (latest update)		-0.2	-0.9	1.2	2.2	2.2
Difference		-2.0	-3.1	-1.1	-0.6	
2. General government net lending						
Stability programme (previous update)	-5.5	-5.5	-3.9	-2.9	-2.0	
Stability programme (latest update)		-6.4	-3.5	-2.5	-1.5	-0.4
Difference		-0.9	0.4	0.4	0.5	
3. General government gross debt						
Stability programme (previous update)	38.0	43.3	45.3	46.2	46.0	
Stability programme (latest update)		47.6	51.9	53.1	52.6	50.9
Difference		4.3	6.6	6.9	6.6	

Source: IMAD, SORS, MF RS.

The general government deficits for the period 2012-2015 are lower than those presented in the previous update due to measures adopted by the government accompanying the revised state budget for 2012. Estimated deficit for 2011 is 0.9 percentage points higher than previously projected, due to one-off measures (Chapter 3) and a new decline in economic activity as opposed to almost 2 % growth as a base for the preparation of the previous update. Differences on the debt side concern lower than projected economic activity, inclusion of guarantees to the EFSF in government debt, assumptions of debt and new borrowing as prefinancing for the redemption of principle in the future budgetary years.

5. SUSTAINABILITY OF PUBLIC FINANCES

5.1. Longterm strategy and prospects, including implications of ageing population

In order to maintain sustainable public finances, Slovenia will induce changes of the pension system. Changes will be incremental and implemented in a way that allows both, a long term sustainability of public finances and adequate pensions. After the rejection of the proposed reform in the referendum last year, the government will start negotiations with social partners, with an aim that new legislation on pension reform is adopted by the next year. Within the reform of the pension system, measures to rise the actual retirement age are envisaged.

It 2012 it is envisaged that income from above-average pensions that are not based on paid contributions would be lowered. The Government is holding back the increase of pensions (i.e. indexation) with an intervention law. Thus in 2010 pensions were adjusted by a range of only 50

% of planned adjustment and only 25 % in 2011. The adjustment for 2012 is currently frozen until 30 June 2012. A law is pending that would prolong this freeze for the rest of the year.

Alongside anticipated changes in pension and healthcare systems, structural reforms that will pave the way for the economic growth, will play the key role in strengthening the sustainability of public finance on the long run.

Without the implementation of the reforms, age–related public expenditure would rise substantially solely due to demographic trends during the period from 2010 to 2060. While the increase for EU-27 average amounts to 4.1 percentage points by 2060 from 25 % of GDP in 2010, In Slovenia, according to referential scenario, they would increase by 10.3 percentage points from current 23.5 % of GDP.

These projections are based on demographic projections EUROPOP2010, estimating that fertility rate in Slovenia in the year 2010 was 1.54 and assuming that it will rise up to 1.65 in 2060. Life expectation for men at birth will rise from 75.8 (2010) to 84.0 (2060) years, and from 82.3 to 88.8 years for women. During the same period net migration will fall from 11,000 (2010) to 4,000 (2060). Using these assumptions the population of Slovenia will remain unchanged (2.1 m). However, rates of demographic and economic dependency[16] will increase substantially (from 23.7 to 57.5 and from 44.0 to 82.4, respectively).

In this period it is assumed that there will be an increase in employment for the age bracket 15-64 (from 66.4 to 70.5); GDP will rise 1.3 % per year on average; the rate of unemployment will converge to long term NAIRU; the level of long term real interest rate should stay at 3.0 %.

Reference scenario considers primarily those pressures on public finances that are the result of the ageing of the population. In addition to reference scenario, projections of public expenditures related to the ageing of the population according to the risk scenario were prepared. The latter assumes higher potential increases of public expenditures for healthcare and long-term care and consequently, likely higher pressures on long term sustainability of public finances. The purpose of this scenario is essentially to warn that structural reforms in the area of the healthcare and long-term care are key.

Table 5.1: Long-term projections of public expenditure in connection with ageing of the population for Slovenia and EU-27, 2010-2020 and 2010-2060

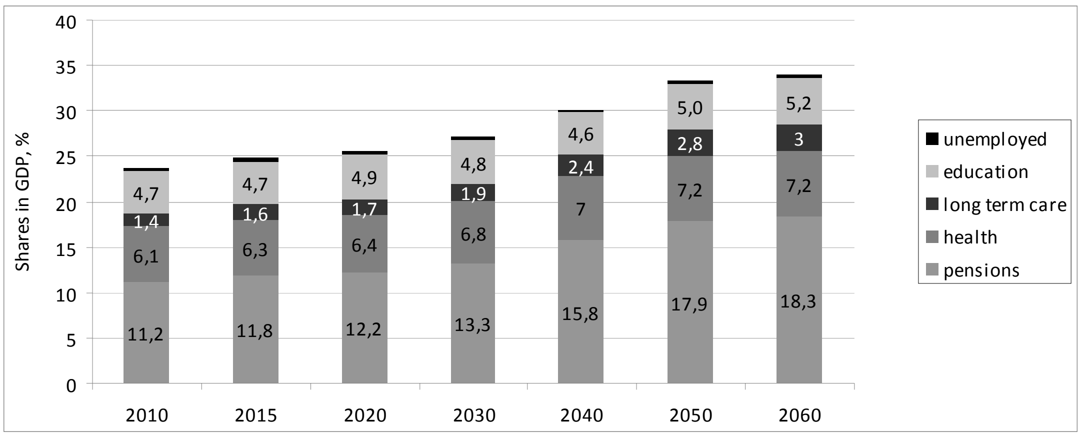
	Share in GDP (%)		**Reference scenario**				**Risk scenario**			
			change in percentage points of GDP							
	2010		**2010-2020**		**2010-2060**		**2010-2020**		**2010-2060**	
	SI	**EU27**	**SI**	**EU27**	**SI**	**EU27**	**SI**	**EU27**	**SI**	**EU27**
Total	23.5	25.0	1.7	0.2	10.3	4.1	1.9	0.4	10.8	4.9
Pensions	11.2	11.3	1.0	-0.1	7.1	1.5	/	/	/	/
Health*	6.1	7.1	0.3	0.3	1.1	1.1	0.5	0.5	1.7	1.7
Long-term care**	1.4	1.8	0.3	0.2	1.6	1.5	0.3	0.3	1.6	1.8
Education	4.7	4.6	0.1	-0.3	0.5	-0.1	/	/	/	/
Unemployment benefits	0.3	1.1	0.1	-0.1	0.0	-0.3	/	/	/	/

Source: European Commission (DG ECFIN) and Economic Policy Committee (AWG), Draft 2012 Ageing Report – February 2012.
Note: *Long-term health care expenditures excluded. **Expenditures for disabled included.

[16] Demographic dependency is ratio of number of alder non-active population and number of employed. Economic dependency is ratio of number of all active population and number of employed.

According to the reference scenario, age-related public expenditures for Slovenia are projected to increase from the level of 23.5 % of GDP in the year 2010 to 25.2 % in 2020 and up to 33.8 % in 2060 (Table 5.1). The higest increases in the period 2010 - 2060 will be for pensions (7.1 percentage point of GDP), long-term care (1.6 percentage point of GDP), healthcare (1.1 percentage point of GDP), and education (0.5 percentage point of GDP). According to the risk scenario, the overall increase in the age related expenditure by 2020 would be by 1.9 percentage points to the level of 25.4 % of GDP and to 342 % of GDP in 2060.

Figure 1: Long-term age-related public expenditure projections for Slovenia (AWG Reference scenario), 2010-2060



Source: European Commission (DG ECFIN) and Economic Policy Committee (AWG), Draft 2012 Ageing Report.

Taking into consideration the current legislation regulating the pension system (ZPIZ-1) and before mentioned demographic assumptions, projections show (Table 5.2) that public expenditures on pensions in Slovenia would to increase from 11.2 % of GDP in 2010 up to 18.3 % of GDP in 2060, while collected contributions for pension fund would increase from 9.2 % of GDP to merely 96 % of GDP in the same period.

Table 5.2: Projected pension spending and contributions 2010-2060 (% of GDP)

	2010	2020	2030	2040	2050	2060	Peak year
Expenditure							
Gross public pension expenditures	11.2	12.2	13.3	15.8	17.9	18.3	2057
Occupational pensions	:	:	:	:	:	:	:
Private pensions	:	0.1	0.2	0.3	0.3	0.3	2051
Mandatory private	:	:	:	:	:	:	:
Non-mandatory private	:	0.1	0.2	0.3	0.3	0.3	2051
Net public pension expenditure	11.2	12.2	13.3	15.8	17.9	18.3	2057
Contributions							
Public pension contributions	9.2	9.7	9.8	9.7	9.7	9.6	2027

Source: Country Fiche on Pension Projections, January 2012.

The main reason for such movements is a dependency ratio (Table 5.3.) which is assumed to rise constantly during this period due to ageing of the population (and which suggests the need for prolongation of the working period as a basis for a full pension in the new legislation). The impact is by 2024 partly debilitated by the effect of a benefit ratio, as a consequence of a decrease in the share relative to wages when determining new pensions (from 85 % of a wage in 2000 to 72.5 % in the year 2024).

Table 5.3: Factors behind the change in public pension expenditure

	2010-20	2020-30	2030-40	2040-50	2050-60	2010-60	Average annual change
Public pensions in GDP	1.0	1.1	2.5	2.1	0.4	7.1	0.142
Dependency ratio effect	3.2	3.4	2.3	3.0	0.9	12.8	0.251
Coverage ratio effect	-0.4	-1.3	-0.2	-0.7	-0.4	-3.1	-0.064
Employment ratio effect	-0.3	-0.5	0.1	-0.2	-0.2	-1.0	-0.020
Benefit ratio effect	-1.2	-0.2	0.4	0.1	0.0	-0.9	-0.017
Labour intensity effect	0.0	0.0	0.0	0.0	0.0	0.0	0.000
Residual	-0.3	-0.4	-0.1	-0.2	0.1	-0.8	-0.008

Source: Country Fiche on Pension Projections, January 2012.

An important aspect of pensions is their adequacy, because too radical reduction of the pension benefit ratio leads not only to lower pension expenditures but could for some individuals also spur social distress and qualify them for another kind of social transfers. Such result is suggested by the fall of benefit ratio (calculated as a first pension of an individual that is eligible for a retirement without reductions, divided by the base for pension) from current level of 59.0 % to 53.7 % by the year 2024 (and further). The support ratio is worrying (i.e. number of people that pay contributions into pension fund, divided by the number of retired persons, Table 5.4.) showing a sharp decrease from the current level of 1.5 below the level of 1.0 in 2050, meaning that there will be more than one retiree per person that pays contributions in Slovenia after 2050.

Table 5.4.: Number of pensioners and contributors in the public scheme, population over 65 years and total employment (in thousands) and related ratios

	2005	2010	2020	2030	2040	2050	2060
Number of pensioners (I)	:	573.2	700.2	769.9	852.1	894.1	872.1
Number of people aged 65+ (II)	314.9	338.5	429.4	525.2	592.0	648.3	647.5
Ratio of (I) and (II)	:	1.7	1.6	1.5	1.4	1.4	1.3
Number of contributors (III)	:	882.0	887.9	880.9	837.6	780.5	748.6
Employment (IV)	944.7	966.0	973.5	970.5	928.8	866.8	828.3
Ratio of (III) and (IV)	:	0.91	0.91	0.91	0.90	0.90	0.90
Support ratio (ratio of (III) and (I))	:	1.5	1.3	1.1	1.0	0.9	0.9

Source: Country Fiche on Pension Projections, January 2012.

Current picture of pension expenditure is worse than the one shown in the last update of the programme, due to the fact that respective projections assumed different pension systems. In the Stability Program 2011 the projections of the public finances sustainability were based on adopted new legislation (ZPIZ-2), that prolonged the necessary years of work for an individual to become eligible for an old age pension; it also prolonged the period for calculation of the basis for calculation the pension and altered the indexation of pensions. The presented projections for 2012 take into account the “old” legislation, because the adopted pension reform was rejected on the referendum in June 2011. However the increase of pension expenditure is projected somehow lower than in previous year, mainly because of more favorable demographic projections EUROPOP2010 (compared to projections EUROPOP2008), assuming constant migration flows, as a consequence of which the overall population in Slovenia is maintained at the currents level (2 million) and not decreasing.

The reference scenario of public healthcare expenditure assumes mainly changes in the demographic structure of the population, i.e. an impact of ageing of the population on the increase of healthcare expenditure. Additional assumptions are: (i) half of additional years of life expectancy people remain healthy; (ii) income elasticity of the demand for healthcare services is 1.1 at the beginning of period and gradually decreases to 1.0 by 2060. According to this scenario healthcare expenditures in Slovenia during the period 2010 - 2020 would increase by 0.3 percentage points from 6.1 % of GDP in 2010 to 6.4 % of GDP in 2020. During the period 2010 - 2060 expenditure would increase by 1.1 percentage points up to 7,2 % of GDP in 2060. This increase is the same as estimated average increase of healthcare expenditure for EU-27.

According to different scenarios that include other factors besides demographic, the projected growth of healthcare expenditure in Slovenia by 2060 ranges within the interval of 0.5 to 2.6 percentage points of GDP. That implies an increase of healthcare expenditures to the level in the range of at least 6.6 % of GDP to maximum 8.7 % of GDP.

In estimating long-term care expenditure the effect of changes in demographic structure of the population are considered as well as some additional assumptions about the dependency ratio (i.e. share of the population that is limited in their day to day business), ratio of formal and informal care, ratio of institutional care and home care and about the expenditure of long term-care per user. Long term projections remain uncertain mainly because of input data, which are despite some improvement in recent years still incomplete.

Projections include seven different scenarios about the increase of public expenditure for long-term care. Scenarios are intended mainly to help in formulating health and social policies as a basis in the process of preparing the changes in the area of financing and insurance for long-term care. Each scenario considers changes in demographic structure of the population and most of the scenarios consider that long term care services are highly labor intensive.

According to selected scenarios the projections of the increase in long-term care expenditure in Slovenia by 2020 range within the interval from 0.3 to 0.8 percentage points of GDP and in the interval from 1.4 to 4.2 percentage points by 2060. This means an increase to the level of at least 2.8 % of GDP and maximum of 5.6 % of GDP by 2060.

Reference scenario considers the impact of changes in the demographic structure of the population, an increase of expenditure for home care services and is based on the assumption that a half of additional years of life expectancy people will not need help in their day to day activities. Similarly to the projections of healthcare expenditure, reference scenario considers modest improvements of health. According to this scenario long-term care expenditures in the period from 2010 to 2020 in Slovenia will increase by 0.3 percentage points which means from 1.4 to 1.7 % of GDP. In the period 2010 -2060 they would increase by 1.6 percentage points to 3.0 % of GDP in 2060. This increase is slightly higher than estimated average increase of the long-term expenditures for EU-27.

The health care expenditure projections (and the long-term care expenditure projections) are higher than those in the previous update. The main reason for this is higher starting point level. That change occurred during the process of preparing the projection, when some methodological issues were resolved, primarily in the field of long-term care. Baseline scenario for projection of developments in education expenditures was prepared based on the assumption of no policy change and therefore considered only the impact of demographic changes on public education expenditure. Share of education expenditure in GDP in 2010 in Slovenia was 4.7%, while during the period 2010 - 2060 the share is expected to increase by 0.5 percentage points to 5.2 % of GDP in 2060.

Projections of unemployment allowances are part of overall age related expenditure projections, mainly due to extensive data collection, while expenditure for unemployment allowances are usually more dependent on the short and middle term cyclical movements than on the long term demographic developments. Average expenditure for unemployment allowances in the years 2007 – 2009 are an input data for the projections. For Slovenia that value during the same period was 0.31 % of GDP, and is expected to decrease to 0.27 % of GDP by the year 2060.

Table 5.5 shows projections of selected public finance categories by 2060. They underline the need to implement structural reforms in the pension and healthcare systems.

Table 5.5: Long-term sustainability of public finance

in % of GDP	2010	2020	2030	2040	2050	2060	Diff. 2010 -60
Total revenues	**41.0**	**42.3**	**42.6**	**42.2**	**41.7**	**41.5**	**0.5**
Age related expenditures	24.6	26.3	27.7	30.8	34.0	35.1	10.5
Pensions	11.2	12.2	13.3	15.8	17.9	18.3	7.1
Old-age	7.8	9.3	10.6	12.9	14.7	15.1	7.2
Disability	1.5	1.4	1.1	1.1	1.1	1.1	-0.4
Other	1.8	1.6	1.5	1.7	2.0	2.1	0.3
Healthcare	6.1	6.4	6.8	7.0	7.2	7.2	1.1
Long-term care	1.4	1.7	1.9	2.4	2.8	3.0	1.6
Education	4.7	4.9	4.8	4.6	5.0	5.2	0.5
Other age related expenditure	1.2	1.1	0.8	1.0	1.1	1.4	0.2
Goods and services, other transfers	13.4	12.9	12.9	12.9	12.9	12.8	-0.5
Compensations for employees	0.5	0.5	0.4	0.4	0.4	0.4	-0.1
Subsidies	1.6	1.5	1.5	1.5	1.5	1.5	-0.1
Government investment	4.7	5.1	5.1	5.1	5.1	5.1	0.4
Total Primary expenditures	44.9	46.2	47.5	50.6	53.9	54.9	10.0
Interest expenditure	1.4	3.0	5.2	8.8	15.0	23.0	21.7
Total expenditure	**46.2**	**49.3**	**52.7**	**59.4**	**68.8**	**78.0**	**31.7**
Primary surplus/deficit	-3.9	-4.0	-4.9	-8.3	-12.1	-13.4	-9.5
Surplus/deficit	**-5.2**	**-7.0**	**-10.1**	**-17.2**	**-27.1**	**-36.5**	**-31.2**
Government debt	37.1	74.7	125.6	213.1	359.4	548.6	511.4
Assumptions							
Labor productivity growth	3.3	1.4	1.6	1.7	1.6	1.5	-1.8
Real GDP growth	1.2	1.5	1.4	1.0	0.9	1.3	0.1
Real GDP growth p.c.	0.0	1.3	1.4	1.1	1.1	1.6	1.7
Participation rates males (aged 15-64)	75.7	78.1	76.7	76.1	76.6	76.6	0.9
Participation rates females (aged 15-64)	67.5	71.1	72.6	72.5	73.0	72.9	5.4
Total participation rates (aged 15-64)	71.7	74.7	74.7	74.3	74.8	74.7	3.0
Unemployment rate	7.2	8.1	5.8	5.5	5.4	5.5	-1.8
Share of population aged 65 years and over (%)	16.5	20.0	24.4	27.7	30.7	31.5	15.0

Source: IER, UMAR, MF RS.

The differences between public expenditure projections presented in the 2011 update of the Stability Program and projections in this document are mainly due to the pension reform adopted and later rejected on the referendum that was taken into account in the projections last year. This caused an increase in estimated pension expenditures from of 11.2 % GDP in 2011 to 18.3 % by 2060. Expected implementation of changes in the pension system with similar effects as the rejected pension reform would keep the expenditure for pensions on the current level for at least two decades.

5.2. Contingent liabilities

According to the Constitution granting guarantees in the Republic of Slovenia is only possible by virtue of a law. In a system of guarantees of the Republic of Slovenia two types of laws were developed, namely general and special law. The general law regulates giving government guarantees to a broader range of receivers. Law on aid for rescuing and reconstruction of companies in difficulties (Official Gazette 91/0544/2007) is an example of a general law. Special laws are aimed at specific beneficiary. An example are laws on giving guarantees to DARS (Highway Company of the Republic of Slovenia), to bank SID d.d. (Slovenian exports and development bank), SOD d.d. (Slovenian Restitution Fund) and Law on guarantee of the Republic of Slovenia for ensuring financial stability in the euro area (Official Gazette 59/10 and 79/10).

The Republic of Slovenia may issue state guarantees to public or private sector entities. Most of the guarantees in the private sector were given to companies in difficulties. Relatively high levels of this type of guarantees are being called, while a relatively low amount of guarantees given to the public sector is being called. Issuance of government guarantees is controlled by setting upper limits for granting state guarantees. The annual quota is set for each year by the law governing the execution of the state budget, while the guarantees are regulated by the provisions of the systemic law. The quota set by the law governing the execution of the state budget does not include guarantees that have been placed under the guarantee scheme for public entities and private entities, guarantees given to domestic banks for the purpose of mitigation the impact of the financial crisis and guarantees to entities from abroad such as EFSF and borrowers who received credits on the basis of the Cotonou II agreement. The quota for these types of guarantees is defined in the corresponding acts.

Table 5.6: Guarantees

	31.12.2011		31.12.2012*	
	in m EUR	in % of GDP	In m EUR	in % of GDP
Guarantees	6,996	19.6	6,393	17.9
Of which: financial sector**	2,888	8.1	1,620	4.5

Source: MF RS.
Note: *Projections MF.
**Includes NLB, SID, Deželna bank, Factor bank and Abanka Vipa.

Data in Table 5.6 shows outstanding guarantees of the Republic of Slovenia at the end of 2011 and estimates for 2012. Assumptions about the repayments of existing and granting new guarantees were used for the projections. Planned quota for new guarantees for 2012 set in the law governing the execution of the state budget is 2,000 m EUR for this year. The experience from the previous years shows, that the actual use is normally substantially lower. In 2010 only less than 20 percent of the quota was used and in 2011 only 1 %. 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 guarantees to EFSF and on the basis of Cotonou II agreement are still possible, an estimate of which is included in the Table 5.6.

6. QUALITY OF PUBLIC FINANCE

6.1. Structure and efficiency of government revenue

In the years before the crisis, changes to the tax system were introduced to increase the share of indirect taxes in total tax revenue and to influence positively the level of labour supply and accumulation of capital and thus potential growth. To that end a tax reform was introduced to provide for gradual reduction of corporate income tax rate to 20 % over a period from 2007 to 2010. Contrary to the expectation due to deep economic crisis the measure resulted in big decrease of tax revenues from corporate income tax. This reduction in revenues was at first (due to the necessary increase in public expenditures for financing of measures to mitigate the impact of the financial and economic crisis) compensated with increased government borrowing. In the second stage gradual fiscal consolidation concentrated on the reduction of government expenditures, policy that the government intends to continue in the programme period and thus does not foresee measures that would considerably increase tax burdens.

The structure of government revenues in 2011 does not diverge significantly from the structure of revenues in previous years. In 2011 government tax revenues amounted to 13.21 billion EUR. The main categories of the revenues were:
- Social security contributions (5.27 billion EUR),
- Domestic taxes on goods and services (4.86 billion EUR) and
- Taxes on income and profit (2.72 billion EUR).

In 2011 government revenues (taxes and contributions) were higher than in the year 2010 or 2009 (total collected revenues were around 360 m EUR higher than in 2010 and arround 260 m EUR higher than in 2009). Higher revenues resulted mainly from higher outturn for corporate income tax (220 m EUR higher than in 2010), personal income tax (15 m EUR), social security contributions (33 m EUR), VAT (52 m EUR), excise duties (23 m EUR) and taxes on international trade and transactions (10 m EUR). In comparison to 2010 only taxes on property decreased slightly.

The government does not plan any major changes in the structure of tax revenues, including social contributions, in the programme period. However the possibility of introduction of a new financial transaction tax is being studied. Major changes can be expected with respect to the non-tax revenues. Namely in 2012 a gradual introduction of public auctions of CO_2 emissions coupons begins, increasing the state budget revenues in 2013. First estimates show an increase of 8 mio EUR in 2012 and over 40 m EUR in 2013. More precise estimates will be available during this year.

In 2012 and 2013, the Government expects that revenues from taxes on income and profit will be subject to some decrease due to the changes in tax legislation. However, these reductions of tax burden will support quicker recovery of the Slovenian economy, higher growth of GDP and therefore higher public revenues in the mid-term. Furthermore, the Government expects that planed measures for reduction of administrative burden, and measures for reduction of grey economy, will re-direct some activities from illegal market to legal activities. Consequently, this will have a positive effect on public revenues. Measures for balancing the public finances in the tax area (Chapter 3.2.) will have a positive impact on the overall level of tax revenues in the state budget without negative impact on economic recovery income status of broader population.

Taking into account that the system of taxation of immovable property in Slovenia is out of date, does not cover all immovable property and does not offer economic leverages that would contribute to achieving goals in other areas of economic policy (extension of market of renting apartments, goals in the area of climate change and effective use of energy), the Government intends to re-examine possibilities for its modernisation. The aim of modernisation is primarily simplification of the system, improvement of transparency and more comprehensive inclusion of immovable property into taxation, which would increase the government revenues from this source, but this is not the main goal of the envisaged changes. Financial impact of possible changes is not expected beyond 2013.

In 2012 the Government intends to examine and take decisions about limitation of the highest bases used for calculation of social contributions. These changes will have to be linked to structural reforms in the area of social security and insurance and broadening the scope of income that is subject to social contributions.

Simple and transparent tax system can contribute to efficiency of collection of public revenues. Tax system must insure more complete collection of taxes while reducing the costs of tax compliance at the level of individual taxable person and costs of collection at the level of tax administration. In this programme period, the Government intends to improve the existing legislation and to continue with the modernisation of the tax information system to achieve more efficient collection of taxes and reduction of costs for both, taxable persons and tax administration. Within this framework, the Government plans further changes in tax procedures, simplification of some tax returns, alignment of VAT legislation with latest changes of EU legislation (Invoice Directive), upgrading of rules on administrative cooperation and assistance among tax offices within EU with an aim to prevent tax avoidance in intra-community trade.

Important part of functioning of public revenues' system is effective forced collection when tax obligation is not met voluntarily. To improve effectiveness of forced collection in the past years the Government implemented changes in defining the responsibilities for the collection of public revenues. Thus, tax administration remains responsible for forced collection of tax revenues that fall within their competence all other forced collections now fall under competencies of customs administration. This change improves organisation of forced collection and contributes to faster procedures. The Government expects that financial impact of this reorganisation that was completed in the beginning of 2012 will be seen already in 2012, and more in the next years.

At the end of 2011, a decision of the Constitutional Court tightened conditions for temporary delay of payment of social contributions that are paid in the form of withholding tax, and possibilities for payment of social contributions in instalments. Therefore, the Government expects that in year 2012 there will be less delays and payments in instalments approved by the tax administration and also that the conditions for forced collection will be tightened.

Amendments to the Tax Administration Act, adopted in 2011, transferred some responsibilities from local tax offices to the General Tax Office. A special unit (Office for Tax Accountancy and Finance) was established within the General Tax Office. Some identical tasks, performed by individual tax office due to unconnected information system, will be gradually transferred in the competencies of Office for Tax Accountancy and Finance and will be performed uniformly at one place, with the assistance of the new tax information system. This will improve the efficiency and effectiveness of tax administration. Centralisation of accounting and financial tasks will provide for completeness of book-keeping records. These records provide for information and data about tax obligations, payments, refunds and debts of individual taxable person. These data are important for efficient forced collection, tax supervision, planning and supervision of public revenues and thus for execution of budgets.

Furthermore, in 2011 changes to the system of paying government revenues were introduced. The number of accounts to which taxable persons pay taxes and duties was reduced from over 3000 to one account for state budget, one for each social security fund and one for each municipality. This simplification caused major changes in organisation of work of tax administration and changes in reporting on revenues received by each recipient of the tax. On the other hand, this simplification brought savings to taxable persons in the amount of more than 5.5 m EUR.

The Government intends to continue with the project of modernisation of the tax information system that will contribute to more efficient forced collection, more efficient supervision of tax returns and to the quality of the selection of taxable persons for tax audit. All this measures should have preventive effect and should contribute to higher degree of voluntary tax compliance. In the period of 2012 and 2013 the Government does not expect major impacts on the level of tax revenues yet as the new information system is being introduced gradually and will not be fully in use before 2014. It is estimated that with full implementation of the new system, government revenues could increase up to 3 % of all revenues collected by the tax administration.

It is expected that planed reorganisation of tax and customs administration and extension of competencies of the customs administration in the case of illegal employment will contribute to efficient use of the human capital in both institutions. The purpose of organisational changes in both administrations is to increase their efficiency while respecting the differences in the working methods. The Government plans to prepare a legal framework for reorganisation already in 2012, so that the new combined single administration could start to operate in 2013. Organisational changes that are planed represent up-grading of the changes already introduced in 2011.

6.2. Composition and effectiveness of government expenditure

Program-oriented budget preparation in recent years was partly the basis for improvements in the budgetary process from planning to adoption as well as for establishing effectiveness of the adopted policies, programs, projects and individual measures. Development priorities have not been adequately reflected in the government expenditure in the past, as the budgets were more or less prepared on the basis of requests from budget users, mainly respecting the existing legislation and partial development guidelines. The program-oriented budget allocates government expenditures to thirteen spending policies in three other expenditure policies. The economic downturn and mitigating its effects in 2009 changed the structure of government spending and sharply increased the share of expenditure for development policies. With the supplementary budget for 2012, the share of expenditure compared to outturn in 2011 increased in the energy, environmental and planning policy and for debt servicing and payments into the EU budget. The share of expenditure for policies to promote entrepreneurship and competitiveness, for institutions of the political system and civil society are maintained approximately at the same level. Increase or maintenance in the scope of development incentives has been achieved by reducing the shares of other development policies (education, culture and sports, higher education, science, technology and information society, transport and transport infrastructure and agriculture, forestry, fisheries and food), and reducing the share of expenditure for fundamental policies, especially for national security policy, defence and external affairs and public administration system.

In order to improve the system of social transfers (which in 2009 accounted for 38% of total government expenditures), the act governing the rights from public funds was adopted in 2011. The criteria for allocation of four types of transfers and nine types of subsidies and exemptions from payment were unified. The procedure for granting rights for social transfers and subsidies was simplified; the system will be more transparent and effective, while the possibilities for abuse will be reduced by cross-checking revenues and assets. Social work centres became "a single entry point" in the system of social rights. Their work is supported by a central information system with on-line programme inter-linkage of various data bases. The government will continue the reform of social transfers in 2012, predominantly targeting the weaker population and by lowering or abolishing certain rights for the wealthier part of the population.

The government's intermediate consumption, predominantly expenditures on goods and services, will be rationalised by introducing a unified system of public procurement. Current agency will be reorganised into a directorate within the Ministry of Finance and will be in charge of tender conditions that will enable signing up of small and medium enterprises. Through this approach a lower price could be achieved, because there will be no room for cartel agreements about the price. In addition it will also be provided for greater regional dispersion, which will stimulate a more balanced development of companies in various regions.

The Government will streamline the management of equity investments, namely the Agency for the Management of Capital equity will be reorganised in an appropriate way. Strategy for selling of government assets will be prepared. The government intends to sell all non strategic assets, based on the findings of the analysis. In all non-financial and financial companies where the state will retain ownership shares, these will be lowered to 25% plus one share. For recapitalization of NLB d.d., which must be carried out by the end of June 2012, the Government will deploy investors from outside the state budget.

7. INSTITUTIONAL FEATURES OF PUBLIC FINANCES

7.1. National fiscal rules

The Government has put forward a proposal to change Article 148 of the Constitution enacting a fiscal rule in line with the requirements of the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union. The proposed amendment to Article 148 stipulates that the budgetary position of the general government should be balanced or in surplus. Should the balance exhibit a deficit in any of the years, it shall be offset with surpluses of other years. The proposed amendment allows for an exception in case of natural disasters with serious budgetary implications or for other exceptional circumstances. In this case the general government may incur a deficit provided that a 2/3 majority votes for it in the Parliament. The national fiscal rule of a general government balance will be applicable as of 2015 onwards. A more detailed mechanics of the fiscal rule will be set forth in an accompanying act, also to be adopted by a 2/3 majority. The Government has already submitted a proposal to this purpose to the Parliament which is to be adopted within one year after the adoption of the Constitutional amendment.

The implementing act stipulates that an expenditure ceiling is set taking into account the foreseen revenue limit multiplied by a coefficient between trend and forecasted GDP level. This will enable the full functioning of automatic stabilizers. The implementing act also strengthens the role of the fiscal council as an independent advisory body for fiscal policy. The fiscal council will provide an ex-ante opinion on the foreseen level of revenue and expenditure to be taken into account by the Government when deliberating on the draft budget.

The Parliamentary Constitutional Committee has already unanimously supported the motion to amend the Constitution and a decision to this purpose was also adopted by the Parliament.

7.2. Performance-based and development planning

In 2009, simultaneously with the preparation of state budgets for 2010 and 2011, the government launched a project of development performance based budgeting. Working groups for different spending areas evaluated and set measurable objectives and indicators to measure the effectiveness of individual programmes. The government adopted in 2010 a new Decree on Development Planning Documents and Procedures for the Preparation of the National Budget, which newly regulates the process of development planning, the designing of development priorities and ties it closer to the preparation of the programme budget. The Decree has also set up a new framework for the coordination of development policies: an umbrella group for development planning, a fiscal policy group and working groups for individual policies.