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Analysis of the 2016 Draft Budgetary Plan of SLOVENIA

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of SLOVENIA

{C(2015) 8112 final}

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1. INTRODUCTION

Slovenia submitted its Draft Budgetary Plan (DBP) for 2016 on 15 October 2015 in compliance with Regulation (EU) No 473/2013 of the Two-pack. Slovenia is currently subject to the corrective arm of the Pact. The Council opened the Excessive Deficit Procedure (EDP) for Slovenia on 2 December 2009 and recommended to correct the excessive deficit by 2013. On 21 June 2013, the Council concluded that Slovenia had taken effective action but adverse economic events with major implications on public finances had occurred, and issued a revised recommendation based on Article 126(7) of the Treaty on the Functioning of the European Union (TFEU). Slovenia was recommended to correct the excessive deficit by 2015. Assuming the timely and durable correction of the excessive deficit in 2015, Slovenia would be subject to the preventive arm of the SGP in 2016 and should ensure sufficient progress towards its medium-term budgetary objective (MTO). During the three years following the correction of the excessive deficit, Slovenia would be also subject to the transitional debt rule.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission 2015 autumn forecast. The following section presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission 2015 autumn forecast. In particular, it also includes an assessment of the measures underpinning the DBP. Section 4 assesses the recent and planned fiscal developments in 2015-2016 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact (SGP). Section 5 provides an analysis of implementation of reforms in the area of fiscal governance in response to the latest Country-specific Recommendations (CSRs) adopted by the Council on 14 July 2015, including those to reduce the tax wedge. Section 6 concludes.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underpinning the DBP forecasts real GDP to increase by 2.7% in 2015 and 2.3% 2016. In 2014, real GDP growth was revised upwards (3% vs. 2.6% of GDP) since the publication of the 2015 Stability Programme due to a greater contribution from private and public consumption. This stronger carry-over effect, coupled with improved private consumption and increased net exports during the first half of 2015, has resulted in an increase in the authorities' real GDP growth forecasts for 2015 and 2016 since the 2015 Stability Programme (2.7% and 2.3% vs. 2.4% and 2.0% respectively). The fall in oil and commodity prices is expected to lead to negative inflation in 2015 and a low inflation rate of 0.8% in 2016. Employment and compensation of employees per head are both expected to rise due to the improved macroeconomic outlook in 2015 and 2016.

Compared to the DBP, the Commission 2015 autumn forecast projects a marginally lower real GDP increase in 2015 (2.7% vs. 2.6%) and a considerably lower real GDP increase in 2016 (2.3% vs. 1.9%), resulting from a smaller, but still strong, increase in private consumption and a smaller contribution from net exports. The Commission 2015 autumn forecast also expects private consumption and net exports to be the dominant growth drivers over the forecasting horizon. Risks to both forecasts are tilted to the downside, as events in the external environment and potentially slower absorption of EU funds than currently anticipated could hamper growth.

Assessed against currently available information, the macroeconomic assumptions for 2015 in the DBP appear plausible, while for 2016 they are considered favourable. In particular, the projected deceleration of import growth underpinning the DBP in 2016 seems inconsistent when compared with the projected further increase in private consumption in the same year. In addition, while both the DBP and the Commission 2015 autumn forecast envisage positive trends in the labour market, the growth rates of employment vs. the fall in unemployment in DBP implies a very large number of the economically inactive population returning to the labour force.

Box 1: The macroeconomic forecast underpinning the budget in Slovenia

The macroeconomic scenario underpinning the DBP is the Autumn 2015 Forecast of Economic Trends produced by the Institute of Macroeconomic Analysis and Development (hereinafter IMAD) and were made available to the Ministry of Finance on 14 September 2015.

The Ministry of Finance uses IMAD's forecast to underpin its budgetary planning documents. The independent status and tasks of IMAD are stipulated in a specific Resolution. Until the adoption of amendments to the Government of the Republic of Slovenia Act (2000), IMAD was technically a body within the Ministry of Economic Relations and Development. In accordance with this law, it was reorganised as an independent government office managed by a Director who is responsible directly to the Prime Minister.

So far IMAD has produced regular economic forecasts twice a year (in March and October) to underpin the Stability Programme in April and the draft budget in the autumn, and additional forecasts to support other possible planning documents (i.e. supplementary budgets).

In July 2015, the Slovenian parliament passed the Fiscal Rules Act (FRA). The implementation of the law will be overseen by the Fiscal Council, an independent state authority, that will comprise of three members, who are experts in the fields of macroeconomics or public finances. However, IMAD will preserve its role as the producer of macroeconomic forecasts underlying the budgetary documents.

Table 1. Comparison of macroeconomic developments and forecasts

	2014	2015			2016		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	3.0	2.4	2.7	2.6	2.0	2.3	1.9
Private consumption (% change)	0.7	1.1	2.0	1.8	1.6	2.6	2.3
Gross fixed capital formation (% change)	3.2	4.8	2.0	1.9	-2.0	-1.8	-1.8
Exports of goods and services (% change)	5.8	5.6	5.0	4.6	6.2	5.2	4.7
Imports of goods and services (% change)	4.0	5.2	4.9	3.8	4.7	3.8	4.2
Contributions to real GDP growth:							
- Final domestic demand	1.0	1.7	1.5	1.5	0.5	1.0	1.1
- Change in inventories	0.5	0.2	0.7	0.3	0.1	-0.1	0.0
- Net exports	1.6	0.7	0.5	0.9	1.6	1.4	0.7
Output gap[1]	-2.4	-1.4	-0.6	-0.5	-0.5	0.8	0.5
Employment (% change)	0.6	0.8	1.5	0.6	0.6	1.1	0.5
Unemployment rate (%)	9.7	9.2	9.4	9.4	8.6	9.0	9.2
Labour productivity (% change)	2.5	1.5	1.2	2.0	1.5	1.2	1.3
HICP inflation (%)	0.4	-0.2	-0.4	-0.6	1.0	0.8	0.8
GDP deflator (% change)	0.8	1.1	0.6	0.5	0.3	1.3	1.4
Comp. of employees (per head, % change)	1.1	0.9	0.7	0.8	2.0	2.8	1.8
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	7.0	n.a.	n.a.	8.9	n.a.	n.a.	8.3

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The DBP confirms the 2015 general government deficit target of 2.9% of GDP set in the 2015 Stability Programme, despite projected higher nominal GDP growth and lower unemployment in the DBP macroeconomic scenario. Revenues are expected to be slightly higher than in the 2015 Stability Programme due to the better economic environment; however, this is offset by upward pressure on the expenditure side, particularly from intermediate consumption and subsidies. This increase in subsidies was due to a substantial reinforcement of support provided to agriculture (notably, an increase by 166%). The increase in intermediate consumption was partially driven by the activities of the Bank Asset Management Company

(BAMC) whose overall operations have had a more adverse impact on public finances in 2015 than previously anticipated.

The Commission 2015 autumn forecast projects the 2015 deficit to be 2.9% of GDP, in line with the DBP and unchanged since the spring. Higher revenues from the improved macroeconomic environment have offset the impact of emerging pressures including from subsidies and the BAMC's activities.

For 2016, the DBP targets a further reduction in the general government deficit to 2.2% of GDP and a primary surplus of 0.7% of GDP. Compared to the 2015 Stability Programme the target deficit has improved by 0.1% of GDP. The improved macroeconomic outlook, particularly for employment, is expected to yield higher tax revenues. These revenues, however, are somewhat offset by higher expenditure, particularly on subsidies (by 0.6% of GDP), where the increase due to agriculture subsidies is expected to continue in 2016 and beyond. The DBP envisages the easing of some of the constraints on public sector pay introduced in recent years but as a percentage of GDP compensation of employees is expected to remain unchanged.

The Commission 2015 autumn forecast expects the general government deficit to fall to 2.4% of GDP in 2016, slightly higher than in the DBP. The difference is driven by a slightly smaller increase in labour taxes due to a less optimistic employment growth forecast and higher estimated EU budget contributions stemming from improvements in GNI in recent years.

Risks to the deficit projection are tilted to the downside, as the costs pertaining to refugees could be considerably higher than estimated by the government. On 29 October, the Slovenian government published a press release pointing to an additional net budgetary impact of 0.1% of GDP due to exceptional refugee-related budgetary costs in 2016 compared to the Draft Budgetary Plan. Furthermore, the activities of the Bank Asset Management Company (BAMC) in the workout of its loan book may have a greater impact on public finances than currently anticipated. In addition, the public sector pay-bill savings underpinning the DBP are still under negotiation with the Trade Unions. The non-materialisation of these savings poses a risk to the fiscal projections for 2016.

In structural terms[1], the plan implies a slight improvement in the structural balance (0.1% of GDP) in 2015 before a stronger improvement of 0.4% of GDP in 2016. The Commission 2015 autumn forecast also envisages a slight improvement in 2015 (0.1% of GDP) and a lower improvement in 2016 (0.2% of GDP). This difference in 2016 is due to a higher general government deficit due to the reasons outlined above and also the proceeds from the auction of a 4G licence (0.1% of GDP) have been treated as one-off in the Commission 2015 autumn forecast but not in the DBP.

[1] Cyclically-adjusted budget balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the DBP, using the commonly agreed methodology.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2014	2015			2016			Change: 2014-2016
	COM	SP	DBP	COM	SP	DBP	COM	DBP
Revenue	**44.8**	**44.7**	***44.8***	**44.8**	**43.1**	***43.4***	**43.4**	**-1.4**
of which:								
- Taxes on production and imports	15.0	14.7	*14.9*	14.9	14.7	*14.8*	14.8	-0.2
- Current taxes on income, wealth, etc.	7.2	6.9	*7.1*	7.1	7.0	*7.2*	7.1	0.0
- Capital taxes	0.0	0.0	*0.0*	0.0	0.0	*0.0*	0.0	0.0
- Social contributions	14.6	14.6	*14.7*	14.6	14.8	*14.7*	14.8	0.1
- Other (residual)	8.0	8.5	*8.1*	8.1	6.6	*6.7*	6.7	-1.3
Expenditure	**49.8**	**47.6**	**47.7**	**47.7**	**45.3**	**45.5**	**45.8**	**-4.3**
of which:								
- Primary expenditure	46.7	44.5	44.7	44.8	42.4	42.6	42.9	-4.0
of which:								
Compensation of employees	11.4	11.2	11.1	11.1	11.1	11.1	11.1	-0.3
Intermediate consumption	6.7	6.4	6.5	6.5	6.5	6.4	6.4	-0.3
Social payments	18.5	18.0	18.0	18.0	17.9	17.6	17.6	-0.9
Subsidies	0.9	0.9	1.0	1.0	0.6	1.2	1.2	0.3
Gross fixed capital formation	5.2	5.6	5.5	5.6	3.9	3.6	3.7	-1.5
Other (residual)	4.1	2.4	2.6	2.6	2.4	2.8	2.8	-1.3
- Interest expenditure	3.2	3.1	3.0	3.0	2.9	2.9	2.9	-0.3
General government balance (GGB)	**-5.0**	**-2.9**	**-2.9**	**-2.9**	**-2.3**	**-2.2**	**-2.4**	**2.9**
Primary balance	**-1.9**	**0.2**	**0.0**	**0.0**	**0.7**	**0.7**	**0.5**	**2.6**
One-off and other temporary measures	-1.1	0.0	0.0	0.0	0.0	-0.3	-0.2	0.8
GGB excl. one-offs	**-3.9**	**-2.9**	**-2.9**	**-2.9**	**-2.3**	**-1.8**	**-2.2**	**2.1**
Output gap[1]	-2.4	-1.4	-0.6	-0.5	-0.5	0.8	0.5	3.3
Cyclically-adjusted balance[1]	-3.9	-2.3	-2.6	-2.7	-2.1	-2.5	-2.6	1.3
Structural balance (SB)[2]	**-2.7**	**-2.3**	**-2.6**	**-2.7**	**-2.1**	**-2.2**	**-2.5**	**0.5**
Structural primary balance[2]	0.4	0.8	0.3	0.3	0.8	0.7	0.4	0.2

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

Box 2: Impact of the current low interest rate environment on compliance with the SGP

Identifying an interest rate windfall/shortfall for 2016

Sovereign bond yields have fallen sharply since end-2013 and reached historical lows in the first half of 2015, before increasing somewhat during the summer months. However, yields in Slovenia still remain well below their long-term averages (4.5% average over preceding ten years), with 10-year rates standing at 1.6%. As a result of lower interest rates, total interest payments by the general government decreased in 2015 from 2014 levels despite a considerable increase in the debt-to-GDP ratio. Interest expenditure in Slovenia is expected to increase from 2.0% of GDP in 2012 to 3.0% of GDP in 2015. This increase was due to the sharp increase in general government debt, which increased in nominal terms by almost 70% over the period (from 53.7% to 84.0% of GDP).

The interest expenditure projections for 2016 contained in the DBP are consistent with the Commission 2015 autumn forecast estimates. Both expect interest expenditure as a percentage of GDP to stand at 2.9% of GDP in 2016. The authorities have taken advantage of the improved market conditions and reduced the implicit interest rate on Slovenia's debt. In the process of this, they have also accumulated sizeable cash buffers (15% of GDP). Both the DBP and the Commission 2015 autumn forecast expect the authorities to reduce these cash buffers in 2016.

Prospects and vulnerability

Approximately 31% of Slovenia's debt is due to mature between 2016-2018. The authorities have taken advantage of the historically low interest rates in recent years and issued longer maturity debt[2]. The authorities have also undertaken considerable pre-financing and plan to reduce the cash buffers over 2016 so over the next 12 months Slovenia is relatively immune to changes in interest rates. However, as Slovenia plans to issue additional debt in 2017-2018 Slovenia is vulnerable to any sudden change in the interest rates environment.

Consequences for public finances

Comparing the interest expenditure projections across different vintages of Stability and Convergence Programmes and the DBP sheds more light on the (unexpected) interest windfall since the fall in interest rates (see Chart)[3].

The estimated increase in interest expenditure as a percentage of GDP for Slovenia has evolved broadly in line with expectations. In 2012, interest expenditure amounted to approximately 2.0% of GDP. Based on the various vintages of the Stability Programme and the DBP interest expenditure was expected to generally increase by 0.9% of GDP between 2012-2016 except in the 2014 Stability Programme when the increase was estimated at 1.1% of GDP. However, actual interest expenditure has turned out lower than anticipated given that GDP growth was higher than expected.

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[2] In July 2015, Slovenia issued its first ever 30-year bond at a coupon rate of 3.125%, the longest maturity issued to date.

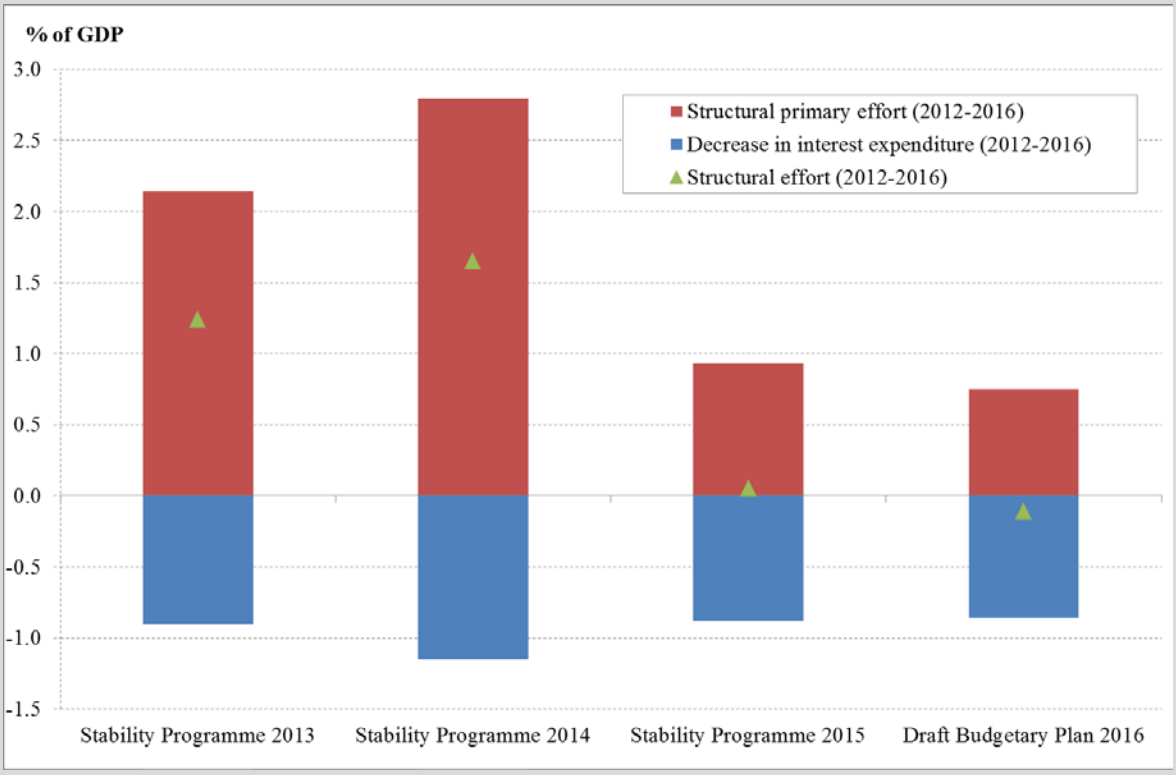
[3] Note that, while it is likely that revisions in the interest expenditure projections across different vintages primarily reflect changes in interest rates, other factors such as debt dynamics, the maturity profile of debt and statistical reclassifications (e.g. the switchover to the ESA 2010 standard of national accounts) may also have played a role.

While the increase in interest expenditure as a percentage of GDP has stayed relatively constant throughout the various programmes, there has been a sizeable change in the expected structural effort as measured by the change in the structural balance from 2012-2016. Overall, Slovenia's budget has not benefited from interest windfalls in recent years.

The forecast improvement in 2016 of 0.4% of GDP in the recalculated structural balance is therefore due to underlying fiscal discipline and not from any interest rate windfalls.

In order to access the overall impact of low inflation on public finances there is a need to look beyond interest expenditure and consider revenue and expenditure developments. A central part of the fiscal consolidation strategy implemented by Slovenia in recent years has been to decouple several expenditure components from inflation including compensation of employees and some social transfers, particularly pensions. Therefore, the effects of the low inflation environment have been less pronounced on Slovenian public finances than they may have been. However, the fiscal saving from these measures may have been less than was initially estimated given the much lower inflation environment.

Structural effort and decrease in interest expenditures between 2012 and 2016 based on government plans



Source: Stability programmes, Draft Budgetary Plan 2016 and AMECO

3.2. Debt developments

The DBP projects a sharp increase in general government gross debt in 2015 (3.3% of GDP), resulting in the debt-to-GDP ratio reaching 84%. In particular, the positive impact of real GDP growth and inflation are not sufficient to offset the significant stock-flow adjustments, which is due to the accumulation of a large cash buffer. In 2016 the debt ratio is projected to decline by the same magnitude (3.3% of GDP), again on the back of stock-flow adjustments.

According to the Commission 2015 autumn forecast, the debt profile is expected to develop in a similar manner to that of the DBP. Given the size of the cash buffer and refinancing needs of the State, it appears prudent to start to reduce this large cash reserve form 2016 onwards. The main risk to the debt projections is positive; the realisation of proceeds from the ongoing privatisation process could lead to a faster reduction in government debt than currently projected.

Table 3. Debt developments

(% of GDP)	2014	2015			2016		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**80.8**	**81.6**	**84.1**	**84.2**	**78.7**	**80.8**	**80.9**
Change in the ratio	10.0	0.8	3.3	3.4	-2.9	-3.3	-3.3
Contributions[2] :							
1. Primary balance	**1.9**	**-0.2**	**0.0**	**0.0**	**-0.7**	**-0.7**	**-0.5**
2. "Snow-ball" effect	**0.5**	**0.4**	**0.4**	**0.5**	**1.0**	**0.0**	**0.2**
Of which:							
Interest expenditure	3.2	3.1	3.0	3.0	2.9	2.9	2.9
Growth effect	-2.1	-1.9	-2.1	-2.1	-1.6	-1.9	-1.5
Inflation effect	-0.6	-0.8	-0.5	-0.4	-0.3	-1.0	-1.1
3. Stock-flow adjustment	**7.6**	**0.7**	**2.9**	**3.0**	**-3.2**	**-2.5**	**-3.0**

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the Draft Budgetary Plan

The DBP presented on 15 October envisages the prolongation of several temporary measures adopted in recent years to contain expenditure and increase revenue while easing some of the constraints on the public-sector pay-bill. On the revenue side, the authorities recently amended the Value Added Tax Act to make the temporary increase in the standard rate of VAT, introduced in 2013, permanent from 2016 onwards (0.8% of GDP). Further measures are being adopted to fight the grey economy and improve tax compliance including the introduction of compulsory cash registers from 1 January 2016 (0.2% of GDP). On the expenditure side, several measures to contain public sector pay are being prolonged, including the freeze on regular performance payments, holiday bonus, additional pension insurance (0.7% of GDP). The authorities are allowing for the current freeze on promotions to be lifted in 2016 (0.4% of GDP). These pay-bill measures are still under negotiation with the Trade

Unions. The continuation of measures to contain social transfers and pensions are estimated to yield 0.2% of GDP in 2016.

Table 4. Main discretionary measures reported in the DBP

A. Discretionary measures taken by general government - revenue side

Components	Budgetary impact (% GDP) (as reported by the	
	2015	**2016**
Taxes on production and	0.2	0.9
Current taxes on income,	n.a.	n.a.
Capital taxes	n.a.	n.a.
Social contributions	n.a.	n.a.
Property Income	n.a.	n.a.
Other	n.a.	n.a.
Total	0.2	0.9

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of

Source:

Draft Budgetary Plan for 2016

B. Discretionary measures taken by general government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the	
	2015	**2016**
Compensation of employees	0.5	0.7
Intermediate consumption	0.3	0.2
Social payments	0.2	0.2
Interest Expenditure	n.a.	n.a.
Subsidies	n.a.	n.a.
Gross fixed capital formation	n.a.	n.a.
Capital transfers	n.a.	n.a.
Other	n.a.	n.a.
Total	1.1	1.1

Note:

The budgetary impact in the table is the aggregated impact of measures as reported in the DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence

Source:

Draft Budgetary Plan for 2016

The measures underpinning the DBP are split approximately 40/60 between revenue and expenditure in 2016. The estimate of the budgetary impact of the consolidation measures specified in the DBP, particularly on the expenditure side appears broadly plausible on current information and is to a large extent reflected in the Commission 2015 autumn forecast. On the revenue side, as the Commission 2015 autumn forecast only includes the incremental impact of measures the impact in 2016 is considerably lower than that in the DBP (0.3% of GDP).

In 2016, the DBP envisages a sizeable increase in one-off expenditure (from around 0% of GDP in 2015 to 0.3% of GDP in 2016). The most significant one-off is the interest expenditure pertaining to the Court ruling regarding compensation to repay deposit holder of Ljubljanska Banka (0.2% of GDP). The authorities have also included limited costs arising from the migrant crisis as one-off expenditure in 2015 and 2016. The net impact of one-offs is lower (0.2% of GDP) in the Commission 2015 autumn forecast because (i) proceeds from the auction of 4G licences have been considered as one-off in 2016 (0.1% of GDP) and (ii) the estimated costs relating to the migrant crisis are not considered as one-off expenditure.

Overall, the measures included in the DBP assist in the durable correction of the fiscal imbalances, as requested in the CSRs issued to Slovenia in July 2015. However, the structural adjustment estimated at 0.4% of GDP is lower than the requested effort of 0.6% of GDP.

4. COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT

Slovenia is currently subject to the corrective arm of the Pact. Box 3 recalls the main features of the EDP opened by the Council on 21 June 2013 and the latest CSR in the area of public finances.

Box 3. Council recommendations addressed to Slovenia

On 21 June 2013, the Council recommended Slovenia under Article 126(7) of the Treaty to correct its excessive deficit by 2015. To this end, Slovenia should (i) put an end to the present excessive deficit situation by 2015; (ii) reach a general government deficit target of 4.9% of GDP in 2013 (3.7% of GDP without 1.2% of GDP one-off expenditure to recapitalise the two largest banks as estimated in June 2013), 3.3% of GDP in 2014 and 2.5% of GDP in 2015, which is consistent with an annual improvement of the structural balance of 0.7% of GDP in 2013, 0.5% of GDP in 2014 and 0.5% of GDP in 2015, in order to bring the general government deficit below the 3% GDP reference value in the Treaty in 2015, based on the Commission updated 2013 spring forecast; (iii) rigorously implement the measures already adopted to increase mainly indirect tax revenue and reduce the public sector wage bill and social transfers, while standing ready to complement them with additional measures if their yield would prove less than foreseen or if any measure is repealed by the justice system; and specify, adopt and implement new structural consolidation measures, on top of those already included in the Commission updated 2013 spring forecast that are necessary to achieve the correction of the excessive deficit by 2015.

On 14 July 2015, the Council addressed recommendations to Slovenia in the context of the European Semester. In particular, in the area of public finances, the Council recommended to Slovenia to ensure a durable correction of the excessive deficit in 2015, and achieve a fiscal adjustment of 0.6% of GDP towards the medium-term objective (MTO) in 2016. Adopt the Fiscal Rule Act and revise the Public Finance Act. Advance long-term reform of the pension system.

In 2015, the DBP projects a headline deficit of 2.9% of GDP, which is below the 3%-of-GDP reference value in the Treaty and in line with Slovenia's deadline for correction. Furthermore, the correction appears durable as both the DBP and the Commission 2015 autumn forecast project the deficit to decline further in 2016.

4.1. Compliance with EDP recommendations

The DBP and the Commission 2015 autumn forecast project a general government deficit below 3% of GDP in 2015 (2.9%). According to the DBP, the annual change in the (recalculated) structural balance in 2015 is considerably below the one recommended by the Council (0.1% of GDP vs 0.5% of GDP). In cumulative terms, the change in the structural balance in 2013-2015 is -0.5% of GDP, considerably below the 1.7% of GDP improvement recommended.

According to the Commission 2015 autumn forecast, after deteriorating by 0.6% of GDP in 2014, the structural balance is foreseen to improve marginally in 2015 (0.1% of GDP), while it is projected to deteriorate by 0.6% of GDP in cumulative terms over 2013-2015. This is not in line with the change in the structural balance recommended by the Council. Therefore, a careful analysis is warranted.

The adjusted structural balance[4] is estimated to deteriorate by 0.2% of GDP in 2015, following a sharp deterioration of 0.6% of GDP in 2014. In cumulative terms over 2013-2015, the adjusted structural balance is estimated to deteriorate by 0.8% of GDP, compared to a recommended improvement of 1.7% of GDP. Based on a bottom-up[5] assessment, the fiscal effort for 2015 was 1.1% of GDP, below the recommended level of 1.5% of GDP. In cumulative terms over 2013-2015, the bottom up assessment indicates a gap[6] of 2.0% of GDP vis-à-vis the recommended fiscal effort.

Based on an overall assessment of the DBP, Slovenia is projected to reduce the general government deficit to below 3% of GDP in 2015 in line with the deadline for correction of its excessive deficit. However, the recommended fiscal effort under the EDP is neither expected to be met in 2015 nor cumulatively over 2013-2015.

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[4] Adjusted for the downward revision in potential output growth since the time when the EDP recommendation was issued and the impact of the composition of economic growth on revenue.

[5] The bottom-up assessment estimates the size of the additional fiscal effort on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the June 2013 EDP recommendation and the Commission 2015 autumn forecast.

[6] Figures for the cumulative effort as calculated by the bottom-up assessment have been adversely affected (0.9% of GDP) by revisions to the historic national accounts data due to updated data sources.

Table 5. Compliance with the EDP recommendation

(% of GDP)	2014	2015	
	COM	DBP	COM
Headline balance			
Headline budget balance	-5.0	-2.9	-2.9
EDP requirement on the budget balance	-3.3	-2.5	
Fiscal effort - change in the structural balance			
Change in the structural balance[1]	-0.6	0.1	0.1
Cumulative change[2]	-0.6	-0.5	-0.6
Required change from the EDP recommendation	0.5	0.5	
Cumulative required change from the EDP recommendation	1.2	1.7	
Fiscal effort - adjusted change in the structural balance			
Adjusted change in the structural balance[3]	-0.6	-	-0.2
of which: *correction due to change in potential GDP estimation (α)*	-0.7	-	-0.5
correction due to revenue windfalls/shortfalls (β)	-0.7	-	-0.3
Cumulative adjusted change [2]	-0.6	-	-0.8
Required change from the EDP recommendation	0.5	0.5	
Cumulative required change from the EDP recommendation	1.2	1.7	
Fiscal effort - calculated on the basis of measures (bottom-up approach)			
Fiscal effort (bottom-up)[4]	1.0	-	1.1
Cumulative fiscal effort (bottom-up)[2]	1.0	-	2.0
Requirement from the EDP recommendation	1.5	1.5	
Cumulative requirement from the EDP recommendation	2.5	4.0	

Notes

[1] Structural balance = cyclically-adjusted general government balance excluding one-off measures. Structural balance based on DBP is recalculated by the Commission on the basis of the Draft Budgetary Plan scenario using the commonly agreed methodology. Change compared to t-1.

[2] Cumulated since the first year for correction in the lastest EDP recommendation.

[3] Change in the structural balance corrected for unanticipated revenue windfalls/shortfalls and changes in potential growth compared to the scenario underpinning the EDP recommendation.

[4] The estimated budgetary impact of the additional fiscal effort delivered on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the EDP recommendation and the current forecast.

Source:

Draft Budgetary Planfor 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations.

4.2. Compliance with the debt criterion

After it corrected its excessive deficit in 2015, Slovenia is in the transition period as regards the debt criterion for the following three years. This implies that, during this period, it is required to make sufficient progress towards compliance with the debt criterion as defined by the minimum linear structural adjustment (MLSA) and comply with the debt rule at the end of the transition period.

The DBP does not provide sufficient information to assess compliance with the minimum linear structural adjustment (MLSA). Based on the Commission 2015 autumn forecast, Slovenia is expected to make sufficient progress towards compliance with the debt criterion in 2016 as the projected change in the structural balance (0.2% of GDP) is above the requirement (-0.1% of GDP).

Table 6. Compliance with the debt criterion*

	2016		
	SP	**DBP**	**COM**
Gross debt ratio	78.7	80.8	80.9
Gap to the debt benchmark [1,2]			
Structural adjustment [3]	0.2	0.4	0.2
To be compared to:			
Required adjustment [4]	0.2	n.a.	-0.1

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[3] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[4] Defines the remaining minimum annual structural adjustment over the transition period which ensures that – if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.

Source:

Stability Programme 2015 (SP); Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations

* An ex-ante assessment of planned compliance with the debt criterion can be based on the DBP only for the concerned countries providing extended data series (i.e. covering years up to t+4) in the DPB on a voluntary basis, as agreed at the EFC-A on 22 September 2014 and reflected in the updated Code of Conduct of the two-pack.

4.3. Adjustment towards the MTO

Assuming a timely correction of the excessive deficit, Slovenia would be subject to the preventive arm from 2016 onwards. In July, the Council recommended a structural improvement of 0.6% of GDP in 2016 as Slovenia was forecast to have debt above 60% and the (recalculated) output gap is above -1.5% of GDP. At face value, the planned adjustment in the DBP for 2016 is in line with the requirements. However, the recalculated structural effort of 0.4% of GDP falls short of the required effort of 0.6% of GDP pointing to some deviation based on the structural balance pillar. According to the information provided in the DBP, the growth rate of government expenditure, net of discretionary revenue measures in 2016, will be lower than the applicable expenditure benchmark rate (0.7% of GDP), pointing to compliance. Given the different outcome from these two indicators, an overall assessment needs to be carried out. As the expenditure matched by EU funds is overestimated, the structural balance pillar is found to be the relevant indicator for the assessment. In light of this, based on the DBP there is a risk of some deviation from the adjustment path towards the MTO in 2016.

Based on the Commission 2015 autumn forecast, the structural balance is expected to improve by 0.2% of GDP in 2016, pointing to some but close to significant deviation from the required 0.6% of GDP adjustment towards the MTO. However, the growth rate of government expenditure net of discretionary revenue measures is expected to exceed the expenditure benchmark by 1.2% of GDP in 2016, indicating a significant deviation. The difference between the assessment based on the DBP and the Commission 2015 autumn forecast as regards the expenditure benchmark is explained by two key factors. Firstly, the DBP envisages an increase in the amount of expenditure matched by EU funds; this assumption appears inconsistent with the sharp decline in public investment planned for 2016 and the Commission 2015 autumn forecast assumes a decline in expenditure matched by EU funds to reflect this. Secondly, the DBP has included a higher yield from discretionary revenue measures than the Commission 2015 autumn forecast as outlined in section 3.3. Therefore, based on the Commission 2015 autumn forecast both indicators provide a contrasting view and an overall assessment needs to be carried out. As public investment is smoothened in the calculation of the expenditure benchmark and given that a permanent reduction in public investment is envisaged in 2016, the expenditure benchmark overstates expenditure growth in 2016. The structural balance pillar is considered a better indicator of progress towards the MTO in 2016. Therefore, the Commission 2015 autumn forecast indicates there is a risk of some but close to significant deviation from the adjustment path towards the MTO in 2016.

Following an overall assessment of Slovenia’s DBP, with the structural balance as a reference, including an analysis of expenditure net of discretionary revenue measures, there appears to be a risk of some deviation from the adjustment path towards the MTO in 2016.

Table 7. Compliance with the requirements of the preventive arm

(% of GDP)	2016	
Initial position[1]		
Medium-term objective (MTO)	0.0	
Structural balance[2] (COM)	-2.5	
Structural balance based on freezing (COM)	-	
Position vis-a -vis the MTO[3]	Not at MTO	
(% of GDP)	2016	
	DBP	**COM**
Structural balance pillar		
Required adjustment[4]	0.6	
Required adjustment corrected[5]	0.6	
Change in structural balance[6]	0.4	0.2
One-year deviation from the required adjustment [7]	-0.2	-0.4
Two-year average deviation from the required adjustment [7]	n.a. (in EDP in 2015)	
Expenditure benchmark pillar		
Applicable reference rate[8]	-0.7	
One-year deviation [9]	0.2	-1.2
Two-year average deviation [9]	n.a. (in EDP in 2015)	
Conclusion		
Conclusion over one year	Overall assessment	Overall assessment
Conclusion over two years	n.a. (in EDP in 2015)	

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 27.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 2014) was carried out on the basis of Commission 2015 spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Draft Budgetary Plan for 2016 (DBP); Commission 2015 autumn forecast (COM); Commission calculations.

5. IMPLEMENTATION OF REFORMS IN THE AREA OF FISCAL GOVERNANCE

The CSRs issued to Slovenia recommended that the authorities adopt the Fiscal Rule Act and revise the Public Finance Act. Already in 2014, Slovenia was recommended to establish the necessary legal basis for a functioning Fiscal Council. The Fiscal Rules Act (FRA) was finally passed by the Slovenian Parliament in July 2015. The implementation of the law will be overseen by the Fiscal Council, an independent state authority that will comprise of three members, who are experts in the fields of macroeconomics or public finances. It appears as though the establishment of the Fiscal Council has been further delayed and the members may not be appointed until February 2016. The council members will be proposed by the government and require 2/3 majority of the parliament to confirm their appointment. The government intends to adopt a revision to the Public Finance Act (PFA) in February 2016, to allow for the revision of the budgetary process. The intention of the proposed amendments is to strengthen the rules for all budgetary users[7] and to stipulate the role of the Court of Auditors regarding budget implementation.

A comprehensive assessment of progress made with the implementation of the CSRs will be made in the 2016 Country Reports and in the context of the CSRs adopted by the Commission in May.

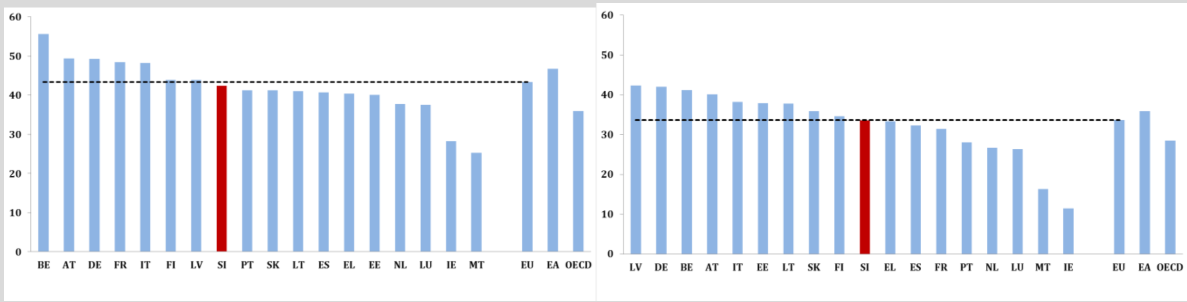
Box 4. Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to screen euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability. Furthermore, the Eurogroup expressed its intention to take stock of the state of play in the reduction of the tax burden on labour when discussing the DBPs of euro area Member States.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Slovenia for a single worker earning respectively the average wage and a low wage (50% of the average) compared to the EU average.

The tax burden on labour in Slovenia at the average wage and a low wage (2014)

[7] As of end 2014, the Slovenian General Government sector consisted of 2,539 separate units/entities, with 53% of these units classified as indirect budget users. *Direct budgetary users* are state or local authorities or organizations and the local administration. *Indirect budgetary users* are defined in Article 3 of the Act on Public Finances as public funds, public institutes and public agencies established by the state or municipality.



Notes: Data for Latvia, Lithuania and Malta is for 2013. No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

This screening is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

Slovenia's DBP does not include any measures affecting the tax wedge on labour.

6. Overall conclusion

Slovenia plans to correct its excessive deficit by the 2015 deadline set by the Council and to ensure an improvement of the structural balance of 0.6% of GDP in 2016. Based on the Commission 2015 autumn forecast, in 2015, Slovenia is indeed projected to reduce its excessive deficit below the 3%-of-GDP reference value in the Treaty. However, the fiscal effort is not projected to be delivered and the margin to the 3%-of-GDP reference value of the Treaty is narrow.

Assuming the timely and durable correction of the excessive deficit in 2015, Slovenia will be subject to the preventive arm of the Pact. As from 2016, based on the DBP recalculated by the Commission, the structural effort is estimated to fall short of the requirements, indicating a risk of some deviation from the adjustment path towards the MTO. However, the growth rate of government expenditure, net of discretionary revenue measures, in 2016 is lower than the applicable expenditure benchmark, indicating compliance. Overall, based on the recalculated DBP there is a risk of some deviation from the adjustment path towards the MTO. Based on the Commission 2015 autumn forecast, there is a risk of some but close to significant deviation in 2016 based on an overall assessment of both the structural balance and the expenditure benchmark pillar.

Based on the Commission 2015 autumn forecast, Slovenia is expected to make sufficient progress towards compliance with the debt criterion in 2016.

EDP RELATED TABLES

Table A1. Baseline scenario underlying the EDP recommendation

% of GDP	2012	2013	2014	2015
Revenues	45.0	45.0	44.2	43.9
Current revenues	44.6	44.3	43.5	43.1
Discretionary measures with impact on current revenue[1]	0.1	0.5	0.0	0.0
Expenditure	49.0	50.5	49.1	49.4
Real GDP growth (%)	-2.3	-2.0	-0.1	1.3
Nominal GDP growth (%)	-2.0	-0.6	1.0	3.1
Potential GDP growth (%)	-1.1	-1.1	-0.7	-0.2
Structural balance	-2.7	-2.6	-3.4	-4.7
General government balance	-4.0	-5.5	-4.9	-5.5
p.m CAB methodology revenue elasticity	0.9	0.9	0.9	0.9
p.m Apparent revenue elasticity	0.6	4.0	-0.9	0.8
p.m Output gap (% of potential output)	-2.7	-3.6	-3.1	-1.9

Note:
[1] Measures clearly specified and committed to by governments ahead of the recommendation
Source: Commission staff working document accompanying the June 2013 EDP recommendation to Slovenia

Table A2. EDP scenario underlying the EDP recommendation

% of GDP	2012	2013	2014	2015
Real GDP growth (%)	-2.3	-2.2	-1.2	0.3
Potential GDP growth (%)	-1.3	-1.4	-1.0	-0.5
Structural balance	-2.8	-2.1	-1.6	-1.1
General government balance	-4.0	-4.9	-3.3	-2.5
p.m Output gap (% of pot. output)	-2.5	-3.3	-3.5	-2.8

Source: Commission staff working document accompanying the June 2013 EDP recommendation to Slovenia

Table A3. Current estimates of the macroeconomic and fiscal developments

% of GDP	2012	2013	2014	2015
Revenues	44.2	44.3	45.0	44.6
Current revenues	44.1	44.2	44.5	44.2
Discretionary measures with impact on current revenue[1]	0.1	1.2	0.9	0.3
Expenditure	48.1	50.1	52.0	48.4
Real GDP growth (%)	-2.5	-2.7	-1.0	0.7
Nominal GDP growth (%)	-2.3	-1.0	0.1	1.6
Potential GDP growth (%)	-1.0	-1.9	-0.9	-0.5
Structural balance	-2.7	-2.9	-2.1	-2.8
General government balance	-3.8	-5.8	-7.1	-3.8
p.m CAB methodology revenue elasticity	0.9	0.9	0.9	0.9
p.m Apparent revenue elasticity	0.5	3.4	-9.9	0.1
p.m Output gap (% of potential output)	-2.3	-3.1	-3.2	-2.0

Note:
[1] Measures clearly specified and committed to by governments ahead of the recommendation
Source: Commission autumn 2013 forecast