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COMMISSION OF THE EUROPEAN COMMUNITIES

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Recommendation for a

COUNCIL DECISION

on the existence of an excessive deficit in Slovenia

EXPLANATORY MEMORANDUM

1. THE APPLICATION OF THE STABILITY AND GROWTH PACT IN THE CURRENT CRISIS SITUATION

Many EU countries are presently facing general government deficits above the 3% of GDP reference value set in the Treaty. The often strong deterioration in the deficit as well as the debt positions must be seen in the context of the unprecedented global financial crisis and economic downturn in 2008/09. Several factors are at play. First, the economic downturn brings about declining tax revenue and rising social benefit expenditure (e.g. unemployment benefits). Second, recognising that budgetary policies have an important role to play in the current extraordinary economic situation, the Commission called for a fiscal stimulus in its November 2008 European Economic Recovery Plan (EERP), endorsed by the European Council in December. The Plan explicated that the stimulus should be timely, targeted and temporary and differentiated across Member States to reflect their different positions in terms of public finance sustainability and competitiveness and should be reversed when economic conditions improve. Finally, several countries have taken measures to stabilise the financial sector, some of which have impacted on the debt position or constitute a risk of higher deficits and debt in the future[1], although some of the costs of the government support could be recouped in the future.

The Stability and Growth Pact requires the Commission to initiate the excessive deficit procedure (EDP) whenever the deficit of a Member State exceeds the 3% of GDP reference value. The amendments to the Stability and Growth Pact in 2005 aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation, and thereby ensuring long-term sustainability of public finances.

2. PREVIOUS STEPS IN THE EXCESSIVE DEFICIT PROCEDURE

Article 104 of the Treaty lays down an excessive deficit procedure (EDP). This procedure is further specified in Council Regulation (EC) No 1467/97 "on speeding up and clarifying the implementation of the excessive deficit procedure"[2], which is part of the Stability and Growth Pact.

According to Article 104(2) of the Treaty, the Commission has to monitor compliance with budgetary discipline on the basis of two criteria, namely: (a) whether the ratio of the planned or actual government deficit to gross domestic product (GDP) exceeds the reference value of 3% (unless either the ratio has declined substantially and continuously and reached a level that comes close to the reference value; or, alternatively, the excess over the reference value is

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1 See the Eurostat decision of 15 July 2009 on the statistical recording of public interventions to support financial institutions and financial markets during the financial crisis, Eurostat News Release No 103/2009.

2 OJ L 209, 2.8.1997, p. 6. Account is also taken of the Opinion of the Economic and Financial Committee on the "Specifications on the implementation of the Stability and Growth Pact and guidelines on the format and content of stability and convergence programmes", endorsed by the ECOFIN Council of 11 October 2005, available at: http://ec.europa.eu/economy_finance/other_pages/other_pages12638_en.htm..

only exceptional and temporary and the ratio remains close to the reference value); and (b) whether the ratio of government debt to GDP exceeds the reference value of 60% (unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace).

Article 104(3) stipulates that, if a Member State does not fulfil the requirements under one or both of these criteria, the Commission has to prepare a report. This report also has to "take into account whether the government deficit exceeds government investment expenditure and take into account all other relevant factors, including the medium-term economic and budgetary position of the Member State".

On the basis of the data notified by the Slovenian authorities in April 2009[3] and taking into account the Commission services' spring 2009 forecast, the Commission adopted a report under Article 104(3) for Slovenia on 7 October 2009[4].

Subsequently, and in accordance with Article 104(4), the Economic and Financial Committee formulated an opinion on the Commission report on 27 October 2009.

3. THE EXISTENCE OF AN EXCESSIVE DEFICIT

According to data notified by the Slovenian authorities in April 2009, the general government deficit in Slovenia was planned to reach 3.7% of GDP in 2009, thus exceeding the 3% of GDP reference value. The Commission report under Article 104(3) considered that the planned deficit was not close to the 3% of GDP reference value but that the planned excess over the reference value could be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact, on the basis of the information available at the time of the report. Furthermore, the planned excess over the reference value could not be considered temporary.

According to more recent data notified by the Slovenian authorities in October 2009 the general government deficit in Slovenia is now planned to reach 5.9% of GDP in 2009, thus remaining above and not close to the 3% of GDP reference value. Based on the Commission services' autumn 2009 forecast, the planned excess over the reference value still qualifies as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it results, among other things, from a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact. Real GDP growth, which halved between 2007 and 2008, is projected to be sharply negative in 2009 (-7.4%) according to the Commission services' autumn 2009 forecast. Although Slovenia's budgetary outcomes have been good in the recent past when economic conditions were still favourable, thanks to higher-than-budgeted revenue growth, budgetary execution was marked by expenditure overruns. Furthermore, also on the basis of the Commission services' autumn 2009 forecast, the planned excess over the reference value cannot be considered temporary since the deficit would widen from 6.3% of GDP in 2009 to around 7% of GDP in 2011 on a no-policy change assumption, while real GDP is forecast to recover to moderate positive growth. This assumption takes into account that, according to government plans, most measures of extraordinary nature linked to the

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3 According to Council Regulation (EC) No 479/2009, Member States have to report to the Commission, twice a year, their planned and actual government deficit and debt levels. The most recent notification of Slovenia can be found at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/procedure/edp_notification_tables.

4 All EDP-related documents for Slovenia can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

crisis in line with the EERP, amounting to almost 1¼% of GDP in 2009, will be gradually rolled back in 2010 and 2011. The deficit criterion in the Treaty is not fulfilled.

According to data notified by the Slovenian authorities in October 2009, the general government gross debt remains well below the 60% of GDP reference value and is planned to stand at 34.2% of GDP in 2009. According to the Commission services' autumn 2009 forecast, the debt ratio would, on a no-policy change basis, rise further, to some 48% of GDP by 2011.

In line with the provisions in the Treaty and the Stability and Growth Pact, the Commission also analysed in its report "relevant factors". According to the Stability and Growth Pact, these can only be taken into account in the steps leading to the decision on the existence of an excessive deficit if the deficit satisfies the double condition of closeness and temporariness. In the case of Slovenia, the double condition is not met. Considered on their own merit, the relevant factors in the current case on balance present a mixed picture.

The opinion of the Economic and Financial Committee in accordance with Article 104(4) of the Treaty is consistent with the assessment in the Commission report under Article 104(3).

The Commission, having taken into account its report under Article 104(3) and the opinion of the Economic and Financial Committee under Article 104(4), is of the opinion that an excessive deficit exists in Slovenia. This opinion, adopted by the Commission on 11 November 2009, is herewith addressed to the Council according to Article 104(5). The Commission recommends that the Council shall decide accordingly, in conformity with Article 104(6). In addition, the Commission is submitting to the Council a recommendation for a Council recommendation to be addressed to Slovenia with a view to bringing the situation of an excessive deficit to an end according to Article 104(7).

4. RECOMMENDATIONS TO END THE EXCESSIVE DEFICIT SITUATION

According to Article 3(4) of Council Regulation (EC) No 1467/97, the Council recommendation under Article 104(7) has to establish a deadline of six months at most for effective action to be taken by the Member State concerned as well as a deadline for the correction of the excessive deficit, which "should be completed in the year following its identification unless there are special circumstances". Article 2(6) of the Regulation implies that the "relevant factors" considered in the Commission report under Article 104(3) of the Treaty have to be taken into account in deciding whether special circumstances exist. Article 3(4) of the Regulation specifies that the Council has to recommend that the Member State achieves a "minimum annual improvement of at least 0.5% of GDP as a benchmark, in its cyclically adjusted balance net of one-off and temporary measures, in order to ensure the correction of the excessive deficit within the deadline set in the recommendation".

In the case of Slovenia, special circumstances are considered to exist. In particular, due to its very high degree of openness, the Slovenian economy has been severely hit by the global crisis. According to the Commission services' autumn 2009 forecast, real GDP growth, which halved between 2007 and 2008, is projected to be sharply negative in 2009 (-7.4%, one of the worst performances in the euro area) before turning moderately positive in 2010 and 2011. The general government deficit, planned to reach close to 6% of GDP by the authorities in 2009, is projected in the Commission services' autumn 2009 forecast to widen further in 2010, to 7% of GDP, and broadly stabilise in 2011, on a no-policy change basis.

The widening deficit in 2009 is the result of (i) the working of automatic stabilisers (estimated at around 2¼% of GDP in the October 2009 implementation report on the NRP);, (ii) recovery measures in line with the EERP as well as tax relief benefiting companies decided before the onset of the crisis, together amounting to some 2% of GDP, which represents an adequate response to the downturn in view of the moderate deficit and debt levels going into the crisis; and (iii) the strong dynamics of social transfers (especially from indexation arrangements) and compensation of employees (owing to the agreement to address "wage disparities"). At the same time, as the room for fiscal manoeuvre is constrained by the long-term sustainability challenge, several consolidation measures were taken in 2009 to help finance the stimulus measures. The draft budget for 2010/2011 confirms the authorities' intention to pursue fiscal consolidation in 2010 and 2011, mainly focused on the expenditure side, especially on government consumption (including public sector wages) and social transfers (including pensions). Taking into account budget measures that are fully specified and the subsequent agreement between the government and the trade unions on public sector wages over the period 2010-2011, the Commission services' autumn 2009 forecast projects the government deficit to increase further in 2010 and to stabilise in 2011 at around 7% of GDP, on a no-policy change basis.

Considering the special circumstances and the EERP framework, an average annual structural budgetary adjustment is recommended. The required adjustment should take into account the fiscal room for manoeuvre which is assessed on the basis of all factors relevant for achieving the fiscal policy objectives, starting with the level of the general government deficit and gross debt as well as other indicators, such as the current account position, the level of contingent liabilities of the financial sector, interest payments, risk premia and the expected change in age-related expenditure in the medium term. In calculating the average annual adjustment, the 2011 deficit in the Commission services' autumn 2009 forecast is taken as the starting point. The total structural adjustment needed to reach the nominal deficit target of 3% by the deadline is then calculated by assuming a gradual closure of the output gap by 2015.

Against this background, it is appropriate to consider the correction of the excessive deficit in a medium-term framework with a deadline for the correction of 2013. In particular, in view of the widening of the government deficit and rising debt level (albeit from a low level) in conjunction with the long-term sustainability challenge and sizeable government guarantees extended as part of the measures to help stabilise the financial sector, a credible and sustainable adjustment path would require the Slovene authorities to implement the fiscal consolidation measures in 2010 as planned; ensure an average annual structural budgetary adjustment of ¾% of GDP over the period 2010-2013; 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.

Although debt remains well below the 60% of GDP reference value, it is planned to rise significantly in 2009 and would increase further on a no-policy change basis according to the Commission services' autumn 2009 forecast. Fiscal consolidation with a view to bringing the deficit below the reference value in 2013 would help stop this rise. Part of the increase in the debt ratio in 2009 reflects recapitalisations and liquidity operations to support the financial sector. Contingent liabilities arising from the sizeable government guarantees provided to support the financial sector and lending to businesses and households could lead to more adverse deficit and debt developments (expenditure would increase if and when guarantees are called).

The long-term budgetary impact of ageing in Slovenia is well above the EU average, mainly as a result of a relatively high increase in pension expenditure as a share of GDP over the coming decades. The budgetary position in 2009 compounds the budgetary impact of population ageing on the sustainability gap. High primary surpluses over the medium term and a further pension reform aimed at curbing the substantial increase in age-related expenditures would contribute to reducing the risk to the long-term sustainability of public finances as defined by the Commission Communication[5] on 'Long-term sustainability of public finances for a recovering economy' and endorsed by the ECOFIN Council[6] on 10 November 2009.

Budgetary consolidation measures should secure a lasting improvement in the general government balance, while being geared towards enhancing the quality of the public finances and reinforcing the growth potential of the economy. In particular, in view of higher-than-budgeted expenditure growth in the period 2006-2008 and the reliance of the consolidation strategy on expenditure restraint, Slovenia should strengthen the enforceable nature of its multi-annual budgetary plans and improve public spending efficiency and effectiveness to make room for enhanced expenditure on research, innovation and human capital formation, while better integrating young and old people into the labour market. In addition, the functioning of the labour market should be improved.

Enhanced surveillance under the EDP, which seems necessary in view of the deadline for the correction of the excessive deficit, will require regular and timely monitoring of the progress made in the implementation of the fiscal consolidation strategy to ensure the correction of the excessive deficit. In this context, a separate chapter in the updates of the Slovenian stability programme that will be prepared between 2009 and 2013 could usefully be devoted to this issue.

Key macroeconomic and budgetary projections

	2007	**2008**	**2009**	**2010**	**2011**
Real GDP (% change)	6.8	3.5	-7.4	1.3	2.0
Output gap[1] (% of potential GDP)	5.5	5.7	-3.3	-3.3	-2.8
General government balance (% of GDP)	0.0	-1.8	-6.3	-7.0	-6.9
Primary balance (% of GDP)	1.3	-0.7	-4.8	-5.1	-4.9
Cyclically-adjusted balance (% of GDP)	-2.6	-4.5	-4.8	-5.4	-5.6
Structural balance[2] (% of GDP)	-2.6	-4.5	-4.7	-5.4	-5.6
Government gross debt (% of GDP)	23.3	22.5	35.1	42.8	48.2

Notes:
[1] Based on estimated potential growth of 3.4%, 3.3%, 1.2%, 1.2% and 1.4% respectively in the period 2007-2011.
[2] Cyclically-adjusted balance excluding one-off and other temporary measures. There is a deficit-increasing one-off measure of 0.1% of GDP in 2009 in the Commission services' autumn 2009 forecast.
Source:
Commission services' autumn 2009 forecasts.

[5] Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf .
[6] Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf.

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(6) thereof,

Having regard to the recommendation from the Commission,

Having regard to the observations made by Slovenia,

Whereas:

(1) According to Article 104 of the Treaty Member States shall avoid excessive government deficits.

(2) The Stability and Growth Pact is based on the objective of sound government finances as a means of strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation.

(3) The excessive deficit procedure (EDP) under Article 104, as clarified by Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[7] (which is part of the Stability and Growth Pact), provides for a decision on the existence of an excessive deficit. The Protocol on the excessive deficit procedure annexed to the Treaty sets out further provisions relating to the implementation of the EDP. Council Regulation (EC) No 479/2009[8] lays down detailed rules and definitions for the application of the provision of the said Protocol.

(4) The 2005 reform of the Stability and Growth Pact sought to strengthen its effectiveness and economic underpinnings as well as to safeguard the sustainability of the public finances in the long run. It aimed at ensuring that in particular the economic and budgetary background was taken into account fully in all steps in the EDP. In this way, the Stability and Growth Pact provides the framework supporting government policies for a prompt return to sound budgetary positions taking account of the economic situation.

(5) Article 104(5) of the Treaty requires the Commission to address an opinion to the Council if the Commission considers that an excessive deficit in a Member State exists or may occur. Having taken into account its report in accordance with Article 104(3) and having regard to the opinion of the Economic and Financial Committee in

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[7] OJ L 209, 2.8.1997, p. 6.
[8] OJ L 145, 10.6.2009, p. 1-9.

accordance with Article 104(4), the Commission concluded that an excessive deficit exists in Slovenia. The Commission therefore addressed such an opinion to the Council in respect of Slovenia on 11 November 2009[9].

(6) Article 104(6) of the Treaty states that the Council should consider any observations which the Member State concerned may wish to make before deciding, after an overall assessment, whether an excessive deficit exists. In the case of Slovenia, this overall assessment leads to the following conclusions.

(7) According to data notified by the Slovenian authorities in October 2009, the general government deficit in Slovenia is planned to reach 5.9% of GDP in 2009, thus exceeding and not close to the 3% of GDP reference value. The planned excess over the reference value can be qualified as exceptional within the meaning of the Treaty and the Stability and Growth Pact. In particular, it results, among other things, from a severe economic downturn in the sense of the Treaty and the Stability and Growth Pact. Real GDP growth, which halved between 2007 and 2008, is projected to be sharply negative in 2009 (-7.4%) according to the Commission services' autumn 2009 forecast. Although Slovenia's budgetary outcomes have been good in the recent past when economic conditions were still favourable, thanks to higher-than-budgeted revenue growth, budgetary execution was marked by expenditure overruns. Furthermore, the planned excess over the reference value cannot be considered temporary since, according to the Commission services' autumn 2009 forecast, the deficit would widen from 6.3% of GDP in 2009 to around 7% of GDP in 2011 on a no-policy change assumption, while real GDP is forecast to recover to moderate positive growth. This assumption takes into account that, according to government plans, most measures of extraordinary nature linked to the crisis in line with the European Economic Recovery Plan, amounting to almost 1¼% of GDP in 2009, will be gradually rolled back in 2010 and 2011. The deficit criterion in the Treaty is not fulfilled.

(8) According to data notified by the Slovenian authorities in October 2009, the general government gross debt remains well below the 60% of GDP reference value and is planned to stand at 34.2% of GDP in 2009. According to the Commission services' autumn 2009 forecast, the debt ratio would, on a no-policy change basis, rise further, to some 48% of GDP by 2011.

(9) According to Article 2(4) of Council Regulation (EC) No 1467/97, "relevant factors" can only be taken into account in the steps leading to the Council decision on the existence of an excessive deficit in accordance with Article 104(6) if the double condition - that the deficit remains close to the reference value and that its excess over the reference value is temporary - is fully met. In the case of Slovenia, this double condition is not met. Therefore, relevant factors are not taken into account in the steps leading to this decision.

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[9] All EDP-related documents for Slovenia can be found at the following website: http://ec.europa.eu/economy_finance/netstartsearch/pdfsearch/pdf.cfm?mode=_m2.

HAS ADOPTED THIS DECISION:

Article 1

From an overall assessment it follows that an excessive deficit exists in Slovenia.

Article 2

This decision is addressed to the Republic of Slovenia.

Done at Brussels,

For the Council
The President