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Recommendation for a

COUNCIL RECOMMENDATION TO SLOVENIA

with a view to bringing an end to the situation of an excessive government deficit

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THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 104(7) thereof;

Having regard to the recommendation from the Commission;

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 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.

(4) The Council has decided on [2 December 2009], in accordance with Article 104(6), that an excessive deficit exists in Slovenia.

(5) In accordance with Article 104(7) of the Treaty and Article 3 of Council Regulation (EC) No 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure[1] (which is part of the Stability and Growth Pact), the Council is also required to make recommendations to the Member State concerned with a view to bringing the situation of excessive deficit to an end within a given period. The recommendation has to establish a deadline of six months at the most for effective action to be taken by the Member State concerned to correct the excessive deficit 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. In deciding whether special circumstances exist, "relevant factors" as clarified in Article 2(3) of Regulation (EC) No 1467/97 should be taken into account. Furthermore, in a recommendation to correct an excessive deficit the Council should

[1] OJ L 209, 2.8.1997, p. 6.

request the achievement of a minimum annual improvement in the structural balance, i.e. the cyclically-adjusted balance excluding one-off and other temporary measures, of at least 0.5% of GDP as a benchmark.

(6) Special circumstances, which are relevant for the greater flexibility in the application of the EDP introduced with the 2005 reform of the Stability and Growth Pact, are deemed to exist in the case of Slovenia. 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 existence of special circumstances authorises the Council to allow the correction of the excessive deficit in a medium-term framework.

(7) 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 European Economic Recovery Plan 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 deficit to widen further in 2010, to 7% of GDP, and broadly stabilise in 2011, on a no-policy change basis.

(8) 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.

(9) 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 case economic or budgetary conditions turn out better than currently expected.

(10) 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).

(11) 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[2] on 'Long-term sustainability of public finances for a recovering economy' and endorsed by the ECOFIN Council[3] on 10 November 2009.

(12) 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. In this context, a separate chapter in the updates of the Slovenian stability programme which will be prepared between 2009 and 2013 could usefully be devoted to this issue.

(13) In general, 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. In addition, the functioning of the labour market should be improved.

(14) In addition, in view of the importance of achieving its medium-term objective (MTO) to provide an adequate safety margin against cyclical downturns and to ensure

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2 Available at: http://ec.europa.eu/economy_finance/publications/publication15996_en.pdf .

3 Available at: http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/111025.pdf.

convergence of the debt ratio towards a prudent level, also taking into account implicit liabilities related to ageing, Slovenia should also ensure that budgetary consolidation towards the MTO is sustained after the excessive deficit will have been corrected.

HEREBY RECOMMENDS:

(1) Recognising that Slovenia's budgetary position in 2009 resulted from recovery measures which, together with tax relief benefiting companies decided before the onset of the crisis, amounted to around 2% of GDP and were an adequate response to the European Economic Recovery Plan, and the free play of automatic stabilisers, the Slovenian authorities should put an end to the present excessive deficit situation by 2013.

(2) The Slovenian authorities should bring the general government deficit below 3% of GDP in a credible and sustainable manner by taking action in a medium-term framework. Specifically, to this end, the Slovenian authorities should:

 (a) implement the fiscal consolidation measures in 2010 as planned;

 (b) ensure an average annual structural budgetary adjustment of ¾% of GDP over the period 2010-2013;

 (c) 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.

(3) To reduce the risks to the long-term sustainability of public finances, Slovenia should further reform the pension system with a view to curbing age-related expenditures as soon as possible.

(4) The Council establishes the deadline of [2 June 2010] for the Slovenian government to take effective action to implement the fiscal consolidation measures in 2010 as planned and to outline the measures that will be necessary to progress towards the correction of the excessive deficit. The assessment of effective action will take into account economic developments compared to the economic outlook in the Commission services' autumn 2009 forecast.

The Slovenian authorities should report on progress made in the implementation of these recommendations in a separate chapter in the updates of the stability programmes which will be prepared between 2009 and 2013.

Furthermore, the Council invites the Slovenian authorities to implement reforms with a view to raising potential GDP growth. This includes reforms conducive to enhancing the quality of public finances. 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. In addition, the functioning of the labour market should be improved.

This recommendation is addressed to the Republic of Slovenia.

Done at Brussels,

For the Council
The President