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COMMISSION OPINION

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on the Draft Budgetary Plan of Slovenia
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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS CONCERNING SLOVENIA

3. On the basis of the Draft Budgetary Plan for 2017 submitted on 17 October 2016 by Slovenia, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.

4. The Commission opinion is to be seen in light of the latest economic and budgetary data. In this context, as indicated in the Commission recommendation for a Council Recommendation on the economic policy of the euro area as well as in the Commission Communication 'Towards a positive fiscal stance for the euro area', it is important that the aggregate fiscal stance of the euro area is positive and supports the ongoing recovery, while ensuring the long-term sustainability of national public finances.

5. Slovenia is currently subject to the preventive arm of the SGP and should ensure sufficient progress towards its minimum medium-term budgetary objective (MTO) of 0.25% of GDP. In particular, the Council on 12 July 2016 recommended Slovenia to achieve an annual fiscal adjustment of 0.6% of GDP towards the medium-term budgetary objective in 2016 and in 2017 and to set a medium-term budgetary objective that respects the requirements of the SGP. As the debt ratio was 83.1% of GDP in 2015 (the year in which Slovenia corrected its excessive deficit), exceeding the 60% of GDP reference value, during the three years following the correction of the excessive deficit (2016-2018), Slovenia is also subject to the transitional arrangements as regards compliance with the debt reduction benchmark. In that period it should ensure sufficient progress towards compliance.

6. The Draft Budgetary Plan’s macroeconomic projections for 2016 and 2017 appear plausible. Compared to the Draft Budgetary Plan, the Commission 2016 autumn forecast expects a slightly lower real GDP increase in 2016 (2.2% vs. 2.3% in the Draft Budgetary Plan) and in 2017 (2.6% vs. 2.9% in the Draft Budgetary Plan), resulting from a smaller than in the Draft Budgetary Plan, but still strong, increase in private consumption and smaller contribution from net exports than in Draft Budgetary Plan. While the economic outlook is somewhat more optimistic in the Draft Budgetary Plan, overall the drivers of growth seem to be similar. The Draft Budgetary Plan's macroeconomic scenario is more optimistic regarding the labour
market and considers a lower GDP deflator for 2017 than the Commission 2016 autumn forecast. The risks to the Commission forecast for Slovenia are broadly balanced and mainly external. Exports could be affected by the slowdown in world trade, and the rebound in public investment might be delayed. On the positive side, the faster than assumed implementation of large investment projects might help the struggling construction sector and a quicker-than-expected recovery in Russia could increase exports further.

7. Slovenia complies with the requirement of Regulation (EU) No 473/2013 that a Draft Budgetary Plan must be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic scenario underpinning the Draft Budgetary Plan is the autumn 2016 Forecast of Economic Trends produced by the Institute of Macroeconomic Analysis and Development (IMAD). The independent status and tasks of IMAD are provided for in the Act amending the Government of the Republic of Slovenia Act adopted on 22 December 2000.

8. The Draft Budgetary Plan confirms the 2016 general government deficit target of 2.2% of GDP set in the last Stability Programme despite the improved macroeconomic environment. For 2017, the Draft Budgetary Plan targets a further reduction in the general government deficit to 1.3% of GDP, 0.3 percentage points lower compared to the Stability Programme. The lower deficit target in the Draft Budgetary Plan compared to the Stability Programme is due to a further revision downwards of public investment and a more optimistic outlook concerning the impact of Bank Asset Management Company (BAMC) activities on public finances. The Draft Budgetary Plan implies an unchanged structural balance in 2016, as recalculated by the Commission, before a 0.4% of GDP improvement planned in 2017. The Commission 2016 autumn forecast envisages a slight worsening of the structural balance in 2016 (from 1.9% to 2.1% of GDP), deteriorating further in 2017 (by 0.2% of GDP to 2.3% of GDP). The difference in 2017 is due to a higher general government deficit in the Commission 2016 autumn forecast and the smaller amount considered as one-offs.

After peaking in 2015 at 83.1% of GDP, the Draft Budgetary Plan projects the general government gross debt to fall to 80.2% of GDP in 2016. The strategy is to extend the duration of the debt portfolio, reducing the roll-over risk while taking advantage of the current environment of low interest rates to reduce current financing costs. At the same time, the authorities plan to reduce the previously accumulated large cash buffers (16% GDP at end-2015). In 2017, the debt-to-GDP ratio is projected to continue to decline to 78.2% of GDP, on the back of a lower headline deficit and reduction of the cash-buffers.

Interest expenditure as a percentage of GDP has increased significantly in recent years from 2.0% of GDP in 2012 to 2.8% of GDP in 2016 and is projected to decline slightly to 2.5% of GDP in 2017 according to the Draft Budgetary Plan. Slovenia's budget has thus not benefited from interest windfalls in recent years.

9. In its 2016 Stability Programme, Slovenia indicated that the budgetary impact of the exceptional inflow of refugees is significant and should be considered as an unusual event outside the control of the government for the purposes of Article 5(1) and Article 6(3) of Regulation (EC) No1466/97. The provisions set out in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the inflow of refugees is an exceptional event, their impact on Slovenia's public finances is significant and sustainability would not be compromised by
allowing for a deviation from the adjustment path towards the medium-term budgetary objective. More specifically, that expenditure was estimated at 0.1% of GDP in 2016. In relation to this, Slovenia requested a temporary deviation from the adjustment path towards the MTO in 2016. The Commission will make a final assessment, including on the eligible amounts, in spring 2017 on the basis of observed data as provided by the authorities.

10. The Draft Budgetary Plan envisages a tax reform, measures to improve efficiency of tax collection, measures in the area of social care and pensions, and a restrictive wage policy in the public sector. Altogether, those measures are estimated to have a net deficit-decreasing impact of around 0.5% of GDP. On the revenue side, the tax reform comprises cuts in taxation of personal income tax and bonuses and an increase of the corporate income tax rate from 17% to 19%. The authorities expect that reform to be fiscally neutral. The reduction in revenues by almost 0.3% of GDP is expected to be offset by the increase in the corporate income tax and by a more efficient tax collection. On the expenditure side, the Draft Budgetary Plan considers measures to contain public sector pay (0.3% of GDP in 2017 and 0.1% in 2018). However, those pay-bill measures are still under negotiation with the social partners for the upcoming years. Measures to contain social transfers and pensions are estimated by the Slovenian authorities to yield 0.2% of GDP in 2018. The estimate of the budgetary impact of the consolidation measures specified in the Draft Budgetary Plan, particularly on the revenue side appears broadly plausible on current information and is to a large extent reflected in the Commission 2016 autumn forecast. On the expenditure side, the Commission 2016 autumn forecast only includes the impact of adopted measures. In 2017, the Draft Budgetary Plan envisages an increase in one-off expenditure (from around 0.1% of GDP in 2016 to 0.2% of GDP in 2017). The net impact of one-offs is slightly lower in the Commission 2016 autumn forecast (0.1% of GDP), since it did not include the full amount estimated by the authorities concerning the impact of the ongoing court case concerning the Fund for Craftsmen and Entrepreneurs, which has also been considered as one-off expenditure. Even though that expenditure is certain, there is relative uncertainty regarding the amount. Thus, the Commission's estimations follow a more conservative approach.

11. The Commission 2016 autumn forecast projects the 2016 deficit to be 2.4% of GDP, unchanged since the spring and slightly above the 2.2% planned in the Draft Budgetary Plan. For 2017, the Draft Budgetary Plan targets a further reduction in the general government deficit to 1.3% of GDP, while the Commission forecasts a general government balance of 2.0% of GDP. The difference is mainly explained by a higher estimated increase in the compensation of public employees and social transfers, a somewhat smaller increase in social security contributions and a more cautious approach concerning the impact of the BAMC activities. The Commission 2016 autumn forecast reflects the reversal of several consolidation measures and a less optimistic outcome expected from the wage bill negotiations, alongside pressures for pension increases. Risks to the public finances projections are tilted to the downside. Uncertainty remains regarding BAMC's activities, as the workout of its loan book may have a larger impact on public finances than currently anticipated. Moreover, the public sector pay-bill savings underpinning the Draft Budgetary Plan are still under negotiation with the trade unions. Furthermore, migration-related costs and possible one-off expenditures arising from ongoing court cases, for instance from the case concerning the Slovenian Farmland and Forest Fund (concerning the delay in the return of the forests previously nationalised), also pose risks.
The Draft Budgetary Plan does not provide sufficient information to assess compliance with the minimum linear structural adjustment. Based on the Commission 2016 autumn forecast, Slovenia is expected to make sufficient progress towards compliance with the debt criterion in both years. In 2016, Slovenia makes sufficient progress as the projected change in the structural balance (-0.2% of GDP) is above the requirement (-0.6% of GDP). The same applies to 2017, when the projected change in the structural balance (-0.2% of GDP) is again above the requirement (-0.8% of GDP).

According to the information provided in the Draft Budgetary Plan, at face value, the planned adjustment in the Draft Budgetary Plan for 2016 is in line with the required adjustment towards the MTO. However, the recalculated structural balance points to a risk of significant deviation in 2016. The expenditure benchmark points to a risk of some deviation. This warrants an overall assessment. The structural balance is negatively affected by significant revenue shortfalls largely driven by a lower, less tax-rich revenue growth than suggested by standard elasticities, which do not appear currently adequate for Slovenia. The expenditure benchmark is negatively affected by the smoothing of investment which overestimates the actual dynamic of public investments in 2016. Correcting the expenditure benchmark for that factor (0.5% of GDP), it would point to compliance. In light of this, based on the information provided in the Draft Budgetary Plan, Slovenia appears to comply with the required adjustment towards the MTO in 2016. The same arguments are valid for the overall assessment based on the Commission 2016 autumn forecast. However, once corrected for the smoothing of the investment, the expenditure benchmark would in this case still point to a risk of some deviation. That conclusion would not change if the budgetary impact of the exceptional inflow of refugees (0.1% of GDP in 2016) were deducted from the requirement. The Commission will make a final assessment, including on the eligible amounts, in spring 2017 on the basis of observed data as provided by the authorities.

In 2017, according to the information provided in the Draft Budgetary Plan, the recalculated structural improvement of 0.4% of GDP is below the required effort of 0.6% of GDP leading to some deviation based on the structural balance pillar. The growth rate of net government expenditure is lower than the applicable expenditure benchmark rate, pointing to compliance (positive gap of 0.9% of GDP). Over 2016 and 2017 taken together, the structural balance points to a risk of significant deviation from the required adjustment path, while the expenditure benchmark points to compliance, suggesting that the deviation in 2016 is planned to be corrected in 2017. Thus, an overall assessment needs to be carried out. Given that the structural balance is negatively affected by the sizeable revenue shortfalls, the expenditure benchmark provides a more stable indication of the fiscal position of Slovenia. Therefore, based on the Draft Budgetary Plan, Slovenia appears to comply with the required adjustment towards the MTO in 2017 as well as in 2016 and 2017 together. However, based on the Commission 2016 autumn forecast, the projected 0.2% of GDP deterioration in the structural balance in 2017 points to a risk of significant deviation from the required 0.6% of GDP adjustment towards the MTO. The growth rate of government expenditure net of discretionary revenue measures is expected to exceed the expenditure benchmark point to a risk of some deviation in 2017 (gap of 0.4% of GDP). In addition, over 2016 and 2017 taken together, both pillars indicate a risk of significant deviation. Therefore, the overall assessment indicates a risk of significant deviation in 2017 as a result of the cumulated deviations in 2016 and 2017.
Concerning fiscal governance, revisions to the Public Finance Act are expected to be presented to the Parliament by the end of 2016, but the appointment of the Fiscal Council was further delayed. After three unsuccessful public calls for applicants, the Government will have to restart an open call for applications to find members of the Fiscal Council. Hence, the establishment of the Fiscal Council has been further delayed and the members may not be appointed until 2017. Slovenia's Draft Budgetary Plan comprises a tax reform which is expected to affect the tax wedge on labour. The reform aims at boosting the creation of high-value-added jobs by shifting taxes away from labour to capital, which would in turn support economic growth and increase fiscal revenue. In September 2016, the Parliament adopted amendments to three tax laws with effect as of 2017. The amendments comprise a decrease in the personal income tax and an increase of the corporate tax from 17% to 19%. Specific measures include lower taxation of performance-based salary (so-called 13th salary), changes in the income tax brackets, and higher income threshold for low wage allowance. The cuts are estimated to result in a EUR 106 million loss of tax revenue in 2017, which is expected to be partly offset by the increase in corporate income tax (EUR 60 million). The authorities expect the cuts to be offset by efficiency gains from tax collection as a result of tax-certified cash registers introduced in January 2016. That tax reform was incorporated in the Commission 2016 autumn forecast both in terms of cost and revenues. A comprehensive assessment of the reform in terms of job creation and distributional effects will be made in the 2017 Country Report.

Overall, the Commission is of the opinion that the Draft Budgetary Plan of Slovenia, which is currently under the preventive arm and subject to the transitional debt rule, is at risk of non-compliance with the provisions of the SGP in 2017. The Commission 2016 autumn forecast for 2017 projects a significant deviation from adjustment path towards the MTO over 2016 and 2017 taken together. In line with the Commission Communication 'Towards a positive fiscal stance for the euro area', the Commission therefore invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2017 budget will be compliant with the SGP rules.

The Commission is also of the opinion that Slovenia has made limited progress with regard to the structural part of the fiscal country-specific recommendations issued by the Council in the context of the 2016 European Semester and invites the authorities to accelerate progress. A comprehensive assessment of progress made with the implementation of the country-specific recommendations will be made in the 2017 Country Report and in the context of the country-specific recommendations to be adopted by the Council in 2017.

Done at Brussels, 16.11.2016

For the Commission

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