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COMMISSION STAFF WORKING DOCUMENT

Analysis of the draft budgetary plans of Slovenia

Accompanying the document

COMMISSION OPINION

on the draft budgetary plan of Slovenia

{C(2016) 8016 final}

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1. INTRODUCTION

Slovenia submitted its Draft Budgetary Plan (DBP) for 2017 on 17 October 2016 in compliance with Regulation (EU) No 473/2013 of the Two-Pack. In accordance with Article 126(12) TFEU, on 17 June 2016, the Council decided that Slovenia has corrected the excessive deficit. Therefore, Slovenia is currently subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective (MTO). 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, Slovenia is also subject to the transitional arrangements as regards compliance with the debt reduction benchmark. In this period it should ensure sufficient progress towards compliance.

Section 2 of this document presents the macroeconomic outlook underlying the DBP and provides an assessment based on the Commission 2016 autumn forecast. Section 3 presents the recent and planned fiscal developments, according to the DBP, including an analysis of risks to their achievement based on the Commission 2016 autumn forecast. In particular, it includes an assessment of the measures underpinning the DBP. Section 4 assesses the recent and planned fiscal developments in 2016-2017 (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 12 July 2016. Section 6 concludes.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

The macroeconomic scenario underpinning the Draft Budgetary Plan (DBP) was prepared by the Institute of Macroeconomic Analysis and Development (IMAD), the independent government office in charge of macroeconomic analysis and forecasts. It forecasts real GDP to increase by 2.3% in 2016 and by 2.9% 2017. In 2015, GDP growth was lower than anticipated in the 2016 Stability Programme (2.3% vs. 2.9% of GDP), as the annual GDP outturns published in August 2016 have been revised downwards on the back of lower contributions from private consumption and inventories in the quarterly-based data. This decrease has resulted in a weaker carryover effect for 2016 but net exports and private consumption contributed more than forecast during the first half of 2016. As a result, the real GDP growth forecasts for 2016 and 2017 have been revised upwards since the Stability Programme (2.3% in 2016 and 2.9% in 2017 up from 1.7% in 2016 and 2.4% in 2017). The fall in oil and commodity prices in 2015 caused deflation in 2015. While oil and commodity prices have somewhat recovered in 2016, a period of very low overall inflation is envisaged in the DBP with some acceleration in 2017 (0.1% inflation in 2016 and 1.4% in 2017). The DBP's macroeconomic forecast projects net exports and private consumption to be the key drivers of growth in 2016, while in 2017 domestic demand (especially investment and private consumption) becomes the main contributor. The labour market is expected to continue improving. The unemployment rate is projected to decrease from 8.2% in 2016 to 7.5% in 2017. Compensation of employees per head is expected to increase by 2.7% in 2016 and by 2.5% in 2017.

The Draft Budgetary Plan’s macroeconomic projections for 2016 and 2017 appear plausible. Compared to the Draft Budgetary Plan, the Commission's autumn forecast projects a slightly lower real GDP increase in 2016 (2.2% vs. 2.3% in DBP) and in 2017 (2.6% vs. 2.9% in DBP), resulting from a smaller than in DBP, but still strong, increase in private consumption and smaller contribution from net exports than in DBP. While the economic outlook seems slightly more optimistic in the DBP, overall the drivers of growth seem to be similar. The DBP's macroeconomic scenario is more optimistic regarding the labour market and considers a lower GDP deflator for 2017 than the Commission's autumn forecast. The risks to the Commission's autumn 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.

Box 1: The macroeconomic forecast underpinning the budget in Slovenia

The macroeconomic scenario underpinning the DBP is the Autumn 2016 Forecast of Economic Trends produced by the Institute of Macroeconomic Analysis and Development (hereinafter IMAD) and was made available to the Ministry of Finance on 22 September 2016.

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 have 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

	2015	2016			2017		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	2,3	1,7	2,3	2,2	2,4	2,9	2,6
Private consumption (% change)	0,5	2,1	2,3	2,1	1,7	2,2	2,1
Gross fixed capital formation (% change)	1,0	-3,0	-4,0	-3,9	6,0	6,0	5,3
Exports of goods and services (% change)	5,6	3,7	5,7	6,2	4,8	5,5	4,0
Imports of goods and services (% change)	4,6	3,0	5,3	6,0	5,1	5,9	4,5
Contributions to real GDP growth:							
- Final domestic demand	0,9	0,9	0,8	0,9	2,1	2,5	2,5
- Change in inventories	0,4	0,2	0,7	0,7	0,0	0,1	-0,1
- Net exports	1,1	0,8	0,8	0,7	0,3	0,3	0,1
Output gap[1]	-1,5	0,2	-0,3	-0,3	1,0	1,0	0,9
Employment (% change)	1,1	0,9	1,9	1,1	0,9	1,4	0,9
Unemployment rate (%)	9,0	8,6	8,2	8,4	8,1	7,5	7,7
Labour productivity (% change)	1,2	0,8	0,4	1,1	1,5	1,5	1,7
HICP inflation (%)	-0,8	-0,3	0,1	0,1	1,3	1,4	1,5
GDP deflator (% change)	1,0	1,0	1,4	1,5	0,2	0,6	1,3
Comp. of employees (per head, % change)	1,4	2,4	2,7	1,8	2,4	2,5	1,8
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	6,4			7,7			7,5

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 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

The DBP confirms the 2016 general government deficit target of 2.2% of GDP set in the 2016 Stability Programme, despite projected higher nominal GDP growth and lower unemployment in the DBP macroeconomic scenario. Income taxes and social security revenues projections are higher than in the 2016 Stability Programme due to the better macroeconomic and labour market conditions. Public investment, however, has been revised significantly downwards, as a consequence of a strong decline due to the end of the 2007-2013 EU funding period and the slow start of the 2014-2020 funding period. However, this reduction in investment expenditure is offset by increases in compensation of employees, social transfers and subsidies. The increase in subsidies is due to a substantial reinforcement of support provided to agriculture. The easing of some of the constraints on public sector pay introduced in recent years is the main cause for the increase in compensation of employees. Restrictive public sector wage policies have been gradually and partly released in 2016 (promotions in 2016 and

increase of wage scale from 1 September 2016 on). On the contrary, capital transfers decreased, mostly driven by the activities of the Bank Asset Management Company (BAMC), whose overall operations had a less adverse impact on public finances in 2015 than previously anticipated (lower than 1% of GDP).

In its Stability Programme 2016, 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 as defined in Article 5.1 and Article 6.3 of Regulation (EC) No1466/97. More specifically, this expenditure is 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.

For 2017, the DBP targets a further reduction in the general government deficit to 1.3% of GDP. Compared to the 2016 Stability Programme the target deficit has improved by 0.3 pps of GDP. The improved macroeconomic context, particularly for employment, is expected to result in buoyant tax and social contributions receipts. Nonetheless, these are somewhat offset by higher expenditure, particularly intermediate consumption, social transfers and subsidies, including the increase of pensions and wages. The decline in the 2017 deficit is driven by the reduction of interest expenditure, a more optimistic outlook concerning the impact of the BAMC activities on public finances and a further downward revision of public investment. After falling by 44% in 2016, public investment is expected to pick-up gradually in the following years (by 5.7% in 2017 according to the DBP and by 7.5% according to the Stability Programme) along with the implementation of the EU structural funds financial programming period of 2014-2020. The BAMC is expected to contribute positively as the sale of collateral will generate additional income.

The Commission's 2016 autumn forecast expects the general government deficit to decrease to 2.0% of GDP in 2017, higher than the 1.3% projected in the DBP. The higher deficit 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 Bank Asset Management Company (BAMC). The Commission's forecast reflects a less optimistic outcome of 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 DBP are still under negotiation with the Trade Unions. Furthermore, migration related costs and possible one-off expenditures recurring from ongoing court cases, for instance from the case of the Slovenian Farmland and Forest Fund (concerning the delay in the return of the forests previously nationalised), also pose risks.

In structural terms, the DBP implies an unchanged structural balance in 2016 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's forecast and the smaller amount considered as one-offs. The Commission did not include the full amount estimated by the authorities concerning the court case of the Fund for Craftsmen and Entrepreneurs (FCE) which has also been considered as one-off expenditure. Thus, the Commission's estimations follow a more restrained approach.

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Slovenia currently standing at 0.8%. As a consequence, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the Draft Budgetary Plan, interest expenditure in Slovenia 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 further to 2.5% of GDP in 2017. Slovenia's budget has thus not benefited from interest windfalls in recent years. The increase from 2012 to 2016 was due to the sharp increase in general government debt in nominal terms by almost 70% over the same period (from 53.9% in 2012 to 80.2% of GDP in 2016, having peaked in 2015 at 83.1%). Slovenia's interest expenditure maximum was reached only in 2014 at 3.2%. The picture stemming from the DBP is broadly confirmed by the Commission forecast.

Against the background of falling interest expenditure, the projected improvement in the structural balance in 2016-17 (0% and 0.4%, respectively) is accompanied by a less pronounced deterioration in the structural primary surplus (-0.2% and 0%, respectively).

Table 2. Composition of the budgetary adjustment

(% of GDP)	2015	2016			2017			Change: 2015-2017
	COM	**SP**	**DBP**	**COM**	**SP**	**DBP**	**COM**	**DBP**
Revenue	**45,1**	**43,5**	***42,9***	**43,1**	**43,8**	***43,0***	**42,8**	**-2,1**
of which:								
- Taxes on production and imports	14,9	14,9	*14,6*	14,6	14,8	*14,5*	14,6	-0,4
- Current taxes on income, wealth, etc.	7,3	7,3	*7,3*	7,2	7,3	*7,2*	7,3	-0,1
- Capital taxes	0,0	0,0	*0,0*	0,0	0,0	*0,0*	0,0	0,0
- Social contributions	14,8	14,9	*15,0*	14,7	15,0	*15,0*	14,6	0,1
- Other (residual)	8,1	6,4	*6,0*	6,5	6,7	*6,3*	6,3	-1,7
Expenditure	**47,8**	**45,7**	**45,1**	**45,5**	**45,4**	**44,3**	**44,8**	**-3,5**
of which:								
- Primary expenditure	44,9	42,8	42,3	42,7	42,8	41,8	42,1	-3,0
of which:								
Compensation of employees	11,2	11,3	11,4	11,4	11,3	11,3	11,5	0,1
Intermediate consumption	6,7	6,6	6,6	6,6	6,5	6,7	6,5	0,0
Social payments	18,2	17,7	17,9	17,9	17,5	17,5	17,5	-0,7
Subsidies	0,8	1,1	1,1	1,1	1,2	1,3	1,3	0,4
Gross fixed capital formation	4,7	3,3	2,5	2,7	3,4	2,6	2,7	-2,1
Other (residual)	3,3	2,8	2,8	2,9	2,9	2,4	2,6	-0,7
- Interest expenditure	2,9	2,9	2,8	2,8	2,6	2,4	2,6	-0,5
General government balance (GGB)	**-2,7**	**-2,2**	**-2,2**	**-2,4**	**-1,6**	**-1,3**	**-2,0**	**1,4**
Primary balance	**0,3**	**0,7**	**0,6**	**0,4**	**1,0**	**1,2**	**0,7**	**0,9**
One-off and other temporary measures	0,0	-0,1	-0,1	-0,1	-0,1	-0,2	-0,1	-0,2
GGB excl. one-offs	**-2,6**	**-2,1**	**-2,1**	**-2,2**	**-1,6**	**-1,1**	**-1,8**	**1,6**
Output gap[1]	-1,5	0,2	-0,3	-0,3	1,0	1,0	0,9	2,5
Cyclically-adjusted balance[1]	-1,9	-2,3	-2,0	-2,2	-2,1	-1,8	-2,4	0,2
Structural balance (SB)[2]	**-1,9**	**-2,2**	**-1,9**	**-2,1**	**-2,0**	**-1,5**	**-2,3**	**0,4**
Structural primary balance[2]	1,1	0,7	0,9	0,7	0,6	0,9	0,4	-0,1

Notes:

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/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 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3.2. Debt developments

After peaking in 2015 at 83.1% of GDP, the DBP projects the general government gross debt to fall to 80.2% of GDP in 2016. The implicit interest rate on the state budget debt has been decreasing since 2014. 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.

According to the Commission 2016 autumn forecast, the debt profile is expected to develop in a similar manner. Given the size of the cash buffer and refinancing needs it appears plausible to start reducing the cash reserve from 2016 onwards.

Table 3. Debt developments

(% of GDP)	2015	2016			2017		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**83,1**	**80,2**	**80,2**	**80,2**	**78,2**	**78,2**	**78,3**
Change in the ratio	2,3	-2,9	-2,9	-3,0	-2,0	-2,0	-1,9
Contributions[2]:							
1. Primary balance	**-0,3**	**-0,7**	**-0,6**	**-0,4**	**-1,0**	**-1,2**	**-0,7**
2. "Snow-ball" effect	**0,4**	**0,7**	**-0,1**	**-0,2**	**0,6**	**-0,2**	**-0,4**
Of which:							
Interest expenditure	2,9	2,9	2,8	2,8	2,6	2,5	2,6
Growth effect	-1,8	-1,4	-1,8	-1,8	-1,9	-2,2	-2,0
Inflation effect	-0,8	-0,8	-1,1	-1,2	-0,2	-0,5	-1,0
3. Stock-flow adjustment	**2,2**	**-3,0**	**-2,2**	**-2,4**	**-1,6**	**-0,6**	**-0,8**
Of which:							
Cash/accruals difference							
Net accumulation of financial							
of which privatisation proceeds							
Valuation effect & residual							

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 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations

3.3. Measures underpinning the Draft Budgetary Plan

The DBP 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, these measures are estimated to have a net deficit-decreasing impact of around 0.5% of GDP. The Parliament adopted a tax reform in September 2016, which comprises cuts in the personal income tax and an increase of the corporate income tax rate from 17% to 19% (for more details see Box 4). The authorities expect this reform to be fiscally neutral. The reduction in revenues by almost 0.3% of GDP is expected to be partly offset by the increase in the corporate income tax (more than 0.1% of GDP). Measures to improve the efficiency of tax collection are expected to compensate the remaining cost of the reform. The introduction of the tax-certified cash registers from 1 January 2016 appears to be achieving the expected improvement in tax compliance, and consequently increasing revenue. Further steps towards the reduction of administrative barriers and simplification of tax procedures are being implemented with amendments of the VAT Act and of the Tax Procedure Act. The amendments include, for instance, the introduction of a pre-calculation provided by the tax

administration of the social security contributions to be paid by self-employed. The payment of social security contributions will be deferred for 5 days from the wage payments to avoid liquidity constraints for businesses.

On the expenditure side, the DBP considers measures to contain the public sector pay, such as the freeze on regular performance payments, holiday bonus, additional pension insurance (0.3% of GDP in 2017 and 0.1% in 2018). However, these pay-bill measures are still under negotiation with the social partners for the upcoming years. Measures to contain social transfers and pensions are estimated to yield 0.2% of GDP in 2018.

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 authorities)	
	2017	2018
Taxes on production and imports	0.2	n.a.
Current taxes on income, wealth, etc.	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	n.a.

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 this measure.

Source: Draft Budgetary Plan for 2017

B. Discretionary measures taken by general government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2017	2018
Compensation of employees	0.3	0.1
Intermediate consumption	n.a.	n.a.
Social payments	0.0	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	0.3	0.3

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 of this measure.

Source: Draft Budgetary Plan for 2017

Overall, the measures underpinning the DBP are split 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 revenue side appears broadly plausible based 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 DBP 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). Even though interest expenditure pertaining to the Court ruling regarding interest compensation to repay deposit holders of Ljubljanska Banka has been considered as one-off and revisions upwards have been taken into account, the Commission did not include the full amount estimated by the authorities concerning the court case of the Fund for Craftsmen and Entrepreneurs (FCE), which has also been considered as one-off expenditure. Concerning the latter, even though this expenditure is certain, there is relative uncertainty regarding the amount. Hence, the Commission's estimations follow a more restrained approach.

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

Slovenia is currently subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO. Box 2 reports the country specific recommendations from 12 July 2016 in the area of public finances.

Box 2: Council recommendations addressed to Slovenia

In accordance with Article 126(12) TFEU, on 17 June 2016, the Council decided that Slovenia has corrected the excessive deficit.

On 12 July 2016, the Council addressed recommendations to Slovenia in the context of the European Semester. In particular, in the area of public finances the Council recommended Slovenia to achieve an annual structural 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 Stability and Growth Pact. The Council recommended Slovenia to strengthen the fiscal framework by appointing an independent fiscal council and amending the Public Finance Act. Furthermore, the Council recommended Slovenia to complete and implement the reform of the long-term care and healthcare systems, making them more cost-efficient to ensure long-term sustainability of accessible and quality care. By the end of 2017, Slovenia was recommended to adopt the necessary measures to ensure the long-term sustainability and adequacy of the pension system.

4.1. Compliance with the debt criterion

On 17 June 2016 the Council decided that Slovenia met the conditions to exit EDP. Slovenia is subject to the transitional debt rule in the following three years. This implies that, during the three-year period over 2016-18, Slovenia is required to make sufficient progress towards compliance with the debt criterion as defined by the minimum linear structural adjustment (MLSA) and to 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's 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).

Table 5. Compliance with the debt criterion*

	2016			2017		
	SP	DBP	COM	SP	DBP	COM
Gross debt ratio	80.2	80.2	80.2	78.2	78.2	78.3
Gap to the debt benchmark [1,2]						
Structural adjustment [3]	0.5	0.0	-0.2	0.1	0.4	-0.2
To be compared to:						
Required adjustment [4]	-0.1	n.a.	-0.6	-0.5	n.a.	-0.8

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 2016 (SP); Draft Budgetary Plan for 2017 (DBP); Commission 2016 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.

4.2. Compliance with the adjustment towards the MTO

According to the information provided in the DBP, at face value, the planned adjustment in the DBP for 2016 is in line with the requirements. However, the recalculated structural balance remained unchanged in 2016, pointing to a risk of significant deviation from the required adjustment of 0.6% of GDP. The growth rate of government expenditure, net of discretionary revenue measures in 2016, is higher than the applicable expenditure benchmark rate, pointing to risk of some deviation (negative gap close to -0.5% of GDP). Given the different outcome from these two indicators, an overall assessment needs to be carried out. 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. Indeed, the latter is expected to significantly decrease in 2016 due to the spending deceleration of the EU funds and the subsequent impact on the national co-financing following the end the programming period 2007-13. Correcting the expenditure benchmark for this factor (0.5% of GDP), it would point to compliance. In light of this, based on the information provided in the DBP, Slovenia appears to comply with the required adjustment towards the MTO in 2016.

Based on the Commission 2016 autumn forecast, the structural balance is projected to deteriorate by 0.2% of GDP in 2016, pointing to a risk of a significant deviation from the required adjustment of 0.6% of GDP (gap of -0.8% of GDP). The growth rate of government expenditure, net of

discretionary revenue measures, is expected to exceed the expenditure benchmark leading to a deviation of more than -0.5% of GDP in 2016, indicating a risk of significant deviation. The gaps are thus somewhat larger than planned in the DBP. This calls for an overall assessment. As explained above, the structural balance is negatively affected by sizeable revenue shortfalls. The expenditure benchmark, which is thus a more stable indicator of the fiscal position of Slovenia, is negatively affected by the smoothing of investments. Correcting for this factor (0.2% of GDP), the expenditure benchmark would point to a risk of some deviation. This conclusion would not change if the budgetary impact of the exceptional inflow of refugees (0.1% of GDP in 2016) were deducted from the assessment. 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.

For 2017, according to the information provided in the DBP, 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 government expenditure, net of discretionary revenue measures 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, 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. As explained above, the structural balance is negatively affected by the sizeable revenue shortfalls as a result of which the expenditure benchmark provides a more stable indication of the fiscal position of Slovenia. Therefore, based on the DBP, Slovenia appears to comply with the required adjustment towards the MTO in 2017.

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 pointing 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. As previously explained, the structural balance is negatively affected by revenue shortfalls, as a result of which the expenditure benchmark provides a more stable indication of the fiscal position of Slovenia. Therefore, the overall assessment indicates a risk of significant deviation in 2017 as a result of the cumulated deviations in 2016 and 2017.

Table 6. Compliance with the requirements of the preventive arm

(% of GDP)	2016		2017	
Initial position[1]				
Medium-term objective (MTO)	0,0		0,3	
Structural balance[2] (COM)	-2,1		-2,3	
Structural balance based on freezing (COM)	-2,1		-	
Position vis-a -vis the MTO[3]	Not at MTO		Not at MTO	
(% of GDP)	**2016**		**2017**	
	DBP	**COM**	**DBP**	**COM**
Structural balance pillar				
Required adjustment[4]	0,6		0,6	
Required adjustment corrected[5]	0,6		0,6	
Change in structural balance[6]	0,0	-0,2	0,4	-0,2
One-year deviation from the required adjustment [7]	-0,6	-0,8	-0,2	-0,8
Two-year average deviation from the required adjustment [7]	-0,3	-0,4	-0,4	-0,8
Expenditure benchmark pillar				
Applicable reference rate[8]	-0,7		-0,7	
One-year deviation [9]	-0,5	-0,5	0,9	-0,4
Two-year average deviation [9]	0,4	0,3	0,2	-0,5
Conclusion				
Conclusion over one year	Overall assessment	Significant deviation	Overall assessment	Overall assessment
Conclusion over two years	In EDP in 2015		Overall assessment	Significant deviation

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 2017 (DBP); Commission 2016 autumn forecast (COM); Commission calculations.

Box 3: Implementation of the "constrained judgement" approach and its impact in the context of the fiscal surveillance

The April 2016 Amsterdam Informal ECOFIN Council requested that improvements be made to the commonly agreed methodology for the estimation of potential growth and the output gap. In response to this mandate from the Council, two concrete decisions were taken in agreement with the Member States in October 2016. First, it was agreed that a revised methodology for the estimation of the non-accelerating wage rate of unemployment (NAWRU) would be introduced in the commonly agreed methodology. This change has already been implemented in the Commission 2016 autumn forecast. Second, in line with the renewed mandate provided by the ECOFIN Council on 11 October, the Economic Policy Committee – Output Gap Working Group has worked on a "constrained judgement" approach for cases where the common method is shown to produce counterintuitive output gap results for individual Member States.

The objective of the "constrained judgement" approach is to have a transparent and economically grounded tool to statistically test the plausibility of the output gaps for individual Member States estimated on the basis of the common method. To this end, the Commission developed in cooperation with the Member States an objective screening tool to assess if the common methodology produces plausible output gap estimates for all Member States. If this "plausibility" tool identifies counter-intuitive results, the Commission has carried out an "in depth" analysis.

Regarding Slovenia, the plausibility tool provided indications that the output gap (OG) estimated on the basis of the common methodology may be counterintuitive. Based on the commonly agreed methodology, the OG for 2016 is estimated at -0.3% of potential GDP. The plausibility tool estimates the OG at -1.5% instead. This indicates that the amount of idle capacities that are available for production (manufacturing capacity and labour force) may be higher than estimated on the basis of the production function method, but can be also influenced by the relatively short time series. On the other hand, the plausibility test indications are calculated with lower output gaps, recalculated on the basis of autumn forecast using the new "anchored" NAWRU. This agreed methodological improvement, which is essentially providing less pro-cyclical NAWRU estimates, has decreased the positive output gaps between 0.6-0.8 pps per year over the 2016-2018 period.

Both the common methodology (output gap of -0.3% in 2016) and the plausibility tool (output gap of -1.5% in 2016) indicate that Slovenia is experiencing "normal times", for which the matrix of requirements foresees an adjustment of 0.6% of GDP in the case of Slovenia.

5. IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

The CSRs issued to Slovenia on 12 July 2016 recommended the authorities to appoint an independent Fiscal Council and revise the Public Finance Act.

The implementation of the Fiscal Rules Act (passed by the Slovenian Parliament in July 2015) will be overseen by the Fiscal Council, an independent state authority with three members, who are experts in the fields of macroeconomics or public finances. The council members will be proposed by the Government and require 2/3 majority of the Parliament to confirm their appointment. After three unsuccessful public calls for applicants, the Government will have to restart an open call for applicants 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.

The revisions to the Public Finance Act are expected to be presented to the Parliament by the end of 2016. The intention of the proposed amendments is to strengthen the rules for all

budgetary users[1] and to stipulate the role of the Court of Auditors regarding budget implementation.

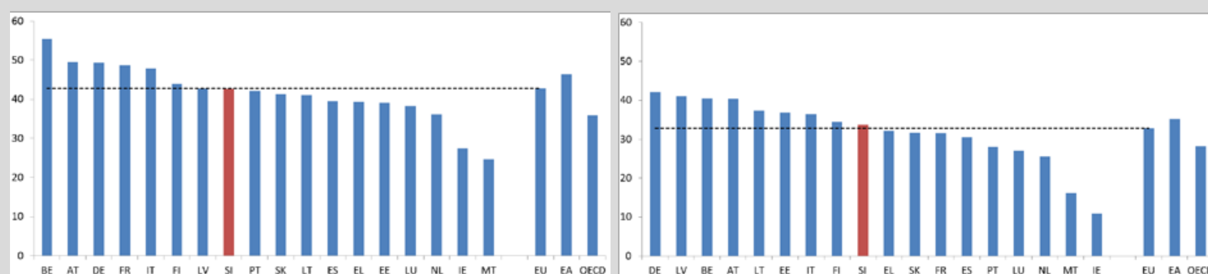
A comprehensive assessment of progress made in the implementation of the CSRs will be made in the 2017 Country Reports and in the context of the CSRs adopted by the Commission in May.

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 (2015)



Notes: 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

[1] 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.

expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

Slovenia's DBP 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 taxation of bonuses, a decrease of 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 personal income 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 measure to be fiscally neutral due to efficiency gains from tax collection as a result of tax-certified cash registers introduced in January 2016. This tax reform is taken into account in the Commission's 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.

6. OVERALL CONCLUSION

Based on the Commission's 2016 autumn forecast, the structural improvement in 2016 and 2017 ensures sufficient progress towards compliance with the debt criterion.

Following an overall assessment of the DBP, in 2016 the planned structural adjustment points to compliance with the required adjustment towards the MTO. In 2017 the adjustment path towards the MTO seems to be appropriate and compliant with the requirement of the preventive arm of the Pact. Following an overall assessment based on the Commission 2016 autumn forecast there is a risk of some deviation in 2016 and a risk of significant deviation in 2017 from the adjustment path towards the MTO. The conclusion would not change in 2016 if the budgetary impact of the exceptional inflow of refugees were deducted from the assessment.