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SLOVENIA: MACRO FISCAL ASSESSMENT

**AN ANALYSIS OF THE NOVEMBER 2007 UPDATE
OF THE STABILITY PROGRAMME**

The Stability and Growth Pact requires each EU Member State to present an annual update of its medium-term fiscal programme, called “stability programme” for countries that have adopted the euro as their currency and “convergence programme” for those that have not. The most recent update of Slovenia’s stability programme was submitted on 30 November 2007.

The attached technical analysis of the programme, prepared by the staff of, and under the responsibility of, the Directorate-General for Economic and Financial Affairs (DG ECFIN) of the European Commission, was finalised on 27 February 2008. Comments should be sent to Jan Komarek (jan.komarek@ec.europa.eu) or Bettina Kromen (bettina.kromen@ec.europa.eu). The main aim of the analysis is to assess the realism of the budgetary strategy presented in the programme as well as its compliance with the requirements of the Stability and Growth Pact. However, the analysis also looks at the overall macro-economic performance of the country and highlights relevant policy challenges.

The analysis takes into account (i) the Commission services’ autumn 2007 forecast, (ii) the code of conduct (“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) and (iii) the commonly agreed methodology for the estimation of potential output and cyclically-adjusted balances. Technical issues are explained in an accompanying “methodological paper” prepared by DG ECFIN.

Based on this technical analysis, the European Commission adopted a recommendation for a Council opinion on the programme on 13 February 2008. The ECOFIN Council is expected to adopt its opinion on the programme on 4 March 2008.

* * *

All these documents, as well as the provisions of the Stability and Growth Pact, can be found on the following website:

http://ec.europa.eu/economy_finance/about/activities/sgp/main_en.htm

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SUMMARY AND CONCLUSIONS

As part of the preventive arm of the Stability and Growth Pact, each Member State that uses the single currency, such as Slovenia, has to submit a stability programme and annual updates thereof. The most recent programme, covering the period 2007-2010, was submitted on 30 November 2007.

Slovenia's generally strong GDP growth throughout the last decade peaked during the first year of membership in the euro area. However, a marked pick-up in inflation, mainly due to commodity price developments in conjunction with a lack of competition in some sectors, was also registered in 2007, with spill-overs to wages being a risk for 2008. Against the background of the strong economic growth during the run-up to EU and euro area entry, good progress in consolidating public finances was made. For the future, further fiscal consolidation will be needed to foster macroeconomic stability, including lower inflation. Addressing the recent acceleration of inflation in Slovenia would help preserve the competitiveness of this export-oriented economy. Moreover, the long-term sustainability of public finances remains a challenge in view of the significant expected effects of ageing on the budget in the absence of further pension reform. To support the economy's ongoing catching-up process, it will be important to continue with structural reforms, especially regarding labour and product markets. In the same context, further redirecting public expenditure towards growth-enhancing categories, while tackling budget rigidity and improving the efficiency of spending, will also be beneficial.

The macroeconomic scenario underlying the programme envisages that real GDP growth will slow from 5.8% in 2007 to 4.6% in 2008 and 4.1% in 2009 before picking up to reach 4.5% by the end of the programme period. Assessed against currently available information¹, this scenario appears to be based on plausible growth assumptions, although risks for 2008 stemming from the external environment have increased since the completion of the stability programme. The positive though narrowing output gap expected over the programme period as well as the broad economic outlook including private consumption and labour market developments indicate that Slovenia will likely experience economic good times over the medium-term. On the nominal side, after the unexpected increase in inflation in 2007, the programme's projections for inflation are significantly higher than in last year's scenario. Nevertheless, they still appear to be on the low side for 2008 given recent developments in food and energy prices. Second-round effects from the strong pick-up in inflation in 2007 and further increases in administrative prices as well as possible demonstration effects from the planned steep public sector wage increases may lead to a more persistent inflation differential with the rest of the euro area and would entail less favourable competitiveness developments than implied by the programme.

For 2007, the general government deficit is estimated at 0.7% of GDP in the Commission services' autumn 2007 forecast, against a target of 1.5% of GDP set in the 2006 programme. The difference is mainly explained by a positive base effect from the 2006 outcome and by higher-than-projected nominal GDP growth in 2007. At the same time, also according to the 2007 update of the programme, more positive-than-planned revenue developments are expected to have been offset by expenditure overruns. However, more recent information on a cash basis points to a better 2007 outturn, possibly a slight surplus.

¹ The assessment takes notably into account the Commission services' autumn forecast and the Commission assessment of the October 2007 implementation report of the national reform programme.

The main goal of the medium-term budgetary strategy in the update is to respect the medium-term objective (MTO), which is a structural deficit (i.e. a cyclically-adjusted deficit net of one-off and other temporary measures) of 1% of GDP, by a growing margin over the programme period, although some weakening is planned for 2008. This change vis-à-vis the previous programme's goal to reach the MTO by 2009 follows from the better-than-expected 2006 outturn (mainly reflecting higher nominal GDP growth), which implied that the MTO had already been broadly met in 2006. Compared to the 2006 programme, the headline deficit planned in the 2007 update is about ½ percentage point of GDP lower throughout the programme period, against the background of a better starting position. The deficit is planned to widen to 0.9% of GDP in 2008 and then to gradually close, with the largest adjustment planned in the final year. Similarly, the bulk of the 0.7 pp. adjustment envisaged to reach a nearly balanced structural position by the end of the programme period is to be realised in 2010 (0.6 pp.). The planned consolidation results from expenditure restraint more than offsetting, except in 2008, the gradual decline in the revenue ratio. The projected decline of primary expenditure over the programme period amounts to 2¼ percentage points of GDP. While relatively broad-based, it reflects especially more contained developments of social spending. Largely influenced by the ongoing tax reform, the gradual decline in the revenue ratio, by 1¾ percentage points, is mainly driven by indirect taxes, while a slight increase in the direct tax burden is projected.

The risks to the budgetary projections in the programme appear broadly balanced in 2008, whereas budgetary outcomes could be somewhat worse than targeted in the outer years. In 2008, the possibility of a positive base effect due to a potentially better-than-expected 2007 budgetary outturn counterbalances the risks associated with the current deterioration of the external environment. Thereafter, there are certain risks to the implementation of the budgetary strategy due, in particular, to the sizeable magnitude of the back-loaded planned reduction in expenditure, with not all underlying measures spelt out in sufficient detail. To some degree, these risks are mitigated by Slovenia's good track record in the recent past, which suggests that outcomes might be better than expected.

In view of this risk assessment, the budgetary stance in the programme seems sufficient to maintain the MTO throughout the programme period, but with a possibly smaller margin than planned for the outer years. The slight deterioration of the structural balance envisaged for 2008 may turn out to be pro-cyclical, which would not be in line with the Stability and Growth Pact. Furthermore, a tighter fiscal stance than presently envisaged for 2008 appears to be warranted given the current strong inflationary pressures. This would also be in line with the April 2007 Eurogroup orientations for budgetary policies, which called for carefully designing fiscal policy plans for 2008 to avoid feeding macroeconomic imbalances. After 2008, the fiscal policy stance implied by the programme is in line with the Pact.

As indicated above, Slovenia appears to be at high risk with regard to the sustainability of public finances. The budgetary position in 2007 as estimated in the programme remained roughly unchanged compared with 2006 and is just sufficient to stabilise the debt ratio over the long term before the budgetary impact of an ageing population is considered. However, the latter is well above the EU average, mainly reflecting a stronger increase in pension expenditure. High primary surpluses over the medium term and, in particular, further measures aimed at curbing the substantial increase in age-related expenditures would contribute to reducing risks to the sustainability of public finances.

Slovenia's 2005 national reform programme identifies five key challenges: a competitive economy and faster economic growth; a knowledge-based society; an efficient state; a modern social state and higher employment; and sustainable development. The Commission's

assessment of the October 2007 implementation report was that Slovenia had made good progress in implementing its national reform programme over the 2005-2007 period. Against the background of strengths and weaknesses identified and the evidence on progress made, the Commission recommended that Slovenia is recommended to give highest priority to the challenges in the areas of: pension reform and active ageing, with a view to long-term sustainability; flexible contractual arrangements to counter labour market segmentation and effectiveness of employment services, within a flexicurity approach.

The stability programme seems to be consistent with the implementation report of the national reform programme. In particular, both documents give account of the main reform measures under implementation, such as the comprehensive tax reform, infrastructure investments as well as changes to the system of social transfers. The programme does not include a detailed qualitative assessment of the overall impact of the national reform programme within the medium term fiscal strategy. However, while this is not done in a systematic way, information on the direct budgetary impact associated with major reforms envisaged is given and has been taken into account in budgetary projections.

The budgetary strategy in the stability programme update is partly consistent with the country-specific broad economic policy guidelines included in the integrated guidelines and the guidelines for euro area Member States in the area of budgetary policies issued in the context of the Lisbon strategy. In particular, it does not include significant further measures to strengthen the reform of the pension system with a view to ensuring long-term sustainability.

The overall conclusion is that Slovenia met its MTO in 2007, two years ahead of previous plans, and that the programme aims at respecting the MTO by a growing margin over the programme period. For 2007, the most recent available information points to a better-than-planned budgetary outturn, possibly a slight surplus. However, for 2008, a slight deterioration of the structural balance is envisaged, despite the continuing strong growth prospects. The risks to the budgetary projections are broadly balanced in 2008. In the outer years, budgetary outcomes might be slightly worse than targeted, mainly due to risks associated with the envisaged reliance on expenditure restraint. The expansionary stance in 2008 may turn out to be pro-cyclical. A tighter fiscal stance than presently envisaged for 2008 appears to be warranted also given the current strong inflationary pressures. The high projected increase in public sector wage settlements is also a concern for the inflation outlook. In spite of the current low debt level, Slovenia is assessed to be at high risk with regard to the long-term sustainability of public finances due to the significant projected budgetary impact of ageing.

Comparison of key macroeconomic and budgetary projections

		2006	2007	2008	2009	2010
Real GDP (% change)	SP Nov 2007	5.7	5.8	4.6	4.1	4.5
	COM Nov 2007	5.7	6.0	4.6	4.0	n.a.
	<i>SP Dec 2006</i>	4.7	4.3	4.2	4.1	n.a.
HICP inflation (%)	SP Nov 2007	2.5	3.4	3.5	2.8	2.6
	COM Nov 2007	2.5	3.5	3.7	2.9	n.a.
	<i>SP Dec 2006</i>	2.7	2.7	2.5	2.2	n.a.
Output gap ¹ (% of potential GDP)	SP Nov 2007	-0.2	0.7	0.5	0.1	0.2
	COM Nov 2007 ²	-0.2	0.9	0.8	0.3	n.a.
	<i>SP Dec 2006</i>	-0.5	-0.2	0.0	0.3	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	SP Nov 2007	-2.8	-3.5	-3.1	-2.0	-1.6
	COM Nov 2007	-2.6	-3.3	-2.6	-1.9	n.a.
	<i>SP Dec 2006</i>	n.a.	n.a.	n.a.	n.a.	n.a.
General government balance (% of GDP)	SP Nov 2007	-1.2	-0.6	-0.9	-0.6	0.0
	COM Nov 2007	-1.2	-0.7	-1.0	-0.8	n.a.
	<i>SP Dec 2006</i>	-1.6	-1.5	-1.6	-1.0	n.a.
Primary balance (% of GDP)	SP Nov 2007	0.2	0.7	0.2	0.6	1.1
	COM Nov 2007	0.2	0.7	0.3	0.4	n.a.
	<i>SP Dec 2006</i>	0.1	-0.1	-0.3	0.3	n.a.
Cyclically-adjusted balance ² (% of GDP)	SP Nov 2007	-1.1	-0.9	-1.1	-0.7	-0.1
	COM Nov 2007	-1.1	-1.1	-1.4	-1.0	n.a.
	<i>SP Dec 2006</i>	-1.4	-1.4	-1.6	-1.1	n.a.
Structural balance ³ (% of GDP)	SP Nov 2007	-1.1	-0.8	-1.0	-0.7	-0.1
	COM Nov 2007	-1.1	-1.1	-1.4	-1.0	n.a.
	<i>SP Dec 2006</i>	-1.4	-1.4	-1.6	-1.1	n.a.
Government gross debt (% of GDP)	SP Nov 2007	27.1	25.6	24.7	23.8	22.5
	COM Nov 2007	27.1	25.6	24.5	23.8	n.a.
	<i>SP Dec 2006</i>	28.5	28.2	28.3	27.7	n.a.
<p>Notes:</p> <p>¹Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the basis of the information in the programmes.</p> <p>²Based on estimated potential growth of 4.2%, 4.9%, 4.7% and 4.5% respectively in the period 2006-2009.</p> <p>³Cyclically-adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are 0.1% of GDP in 2007 and 0.1% in 2008, both deficit-increasing, according to the most recent programme. The Commission services do not consider these to be one-off measures hence there are no one-off measures in the Commission services' forecast.</p> <p>Source:</p> <p><i>Stability programme (SP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations</i></p>						

1. INTRODUCTION

Slovenia submitted the first update of its stability programme on 30 November 2007². The programme, which covers the period 2007 to 2010, reflects the Budget for 2008 and 2009 as approved by Parliament on 28 November 2007. After having been discussed by the Government the programme was forwarded to the Parliament for discussion in the working bodies. The discussion has not been called yet by the Parliament.

This assessment is further structured as follows. Section 2 discusses the key challenges for public finances in Slovenia, with a particular focus on fiscal policy facing the challenges of euro area membership. Section 3 assesses the plausibility of the macroeconomic scenario underpinning the public finance projections of the stability programme against the background of the Commission services' economic forecasts. Section 4 analyses budgetary implementation in the year 2007 and the medium-term budgetary strategy outlined in the new programme. Taking into account risks attached to the budgetary targets, it also assesses the appropriateness of the fiscal stance and the country's position in relation to the budgetary objectives of the Stability and Growth Pact. Section 5 reviews recent debt developments and medium-term prospects, as well as the long-term sustainability of public finances. Section 6 discusses the quality of public finances and structural reforms, while Section 7 analyses the consistency of the budgetary strategy outlined in the programme with the national reform programme and its implementation reports and with the broad economic policy guidelines. The annexes provide a detailed assessment of compliance with the code of conduct, including an overview of the summary tables from the programme (Annex 1) and selected key indicators of past economic performance (Annex 2).

2. KEY CHALLENGES FOR PUBLIC FINANCES WITH A PARTICULAR FOCUS ON FISCAL POLICY FACING THE CHALLENGES OF EURO AREA MEMBERSHIP

2.1. Introduction

Slovenia was the first of the new Member States to join the euro area in January of 2007. Having given up independent monetary policy has enhanced the importance of fiscal discipline for successfully meeting the challenges posed by membership in the euro area. In particular, reducing deficits and the debt level creates leeway for the fiscal stabilisers to work when shocks hit the economy, without jeopardising the fulfilment of the criteria set out in the Stability and Growth Pact. At the same time, sound public finances are also conducive to low inflation. Moreover, in the framework of the renewed Lisbon strategy, especially euro area countries are called on to review public expenditures and revenues with a view to boosting competitiveness and potential growth. Membership in the euro area thus entails the need for the Slovenian authorities to attach even greater importance than before to the conduct of fiscal policy.

Looking back at fiscal developments in Slovenia in the decade before joining the euro area shows that after an initial deterioration of public finances, fiscal consolidation efforts brought forth a considerable improvement of the situation aided by the economy's generally strong growth performance. Indeed, judging by short-run public finance indicators, Slovenia's position now appears to be rather benign compared to the average

² The English language version of the update was supplied on 7 December 2007.

performance of euro area countries. However, the current fiscal stance must also be put in the context of the long-run sustainability of public finances in order to correctly assess its appropriateness. As already stressed in the assessment of last year's stability programme, given current policies and the current fiscal position, population ageing will lead to significant public expenditure increases in Slovenia and unsustainable long-run debt levels.

Against this background, the Slovenian authorities' fiscal consolidation efforts need to be further strengthened despite the seemingly benign current situation. Indeed, counteracting the effects of ageing on the sustainability of the budget development calls for using the current favourable economic conditions for fiscal consolidation efforts going even beyond compliance with the Stability and Growth Pact. In particular, the Slovenian authorities' efforts regarding expenditures could be strengthened given that in view of the comprehensive tax reform, fiscal adjustment seems well advanced on the revenue side and since research shows that expenditure-based consolidation efforts are more sustainable.³ Calling for further adjustments of expenditure raises questions regarding their feasibility. In the assessment of last year's stability programme, it was noted that the large share of mandatory items in public expenditure impedes rapid expenditure adjustment, an issue that is to be analysed in more detail in this section. At the same time, calling for further expenditure-side adjustment presupposes that there is still sufficient scope for trimming public expenditure. In this context, analysing the efficiency with which public expenditure in Slovenia is transposed into desired policy outcomes will prove helpful for identifying areas where expenditure can be cut –and thus, the sustainability of public finances can be furthered– without compromising the level of services currently provided.

The remainder of this section is organised as follows. Subsection 2.2 reviews the development of public finances in Slovenia over the 1997-2006 period. In subsection 2.3, the effects of population ageing on the long-run sustainability of the country's public finances are assessed. Subsection 2.4 deals with the degree of rigidity of the Slovenian budget. In subsection 2.5, the efficiency of public expenditure in selected sectors is examined. Finally, subsection 2.6 draws some conclusions.

2.2. Developments in public finances 1997-2006

Slovenia's public finances were relatively sound over the entire 1997-2006 decade if compared to the other new Member States,⁴ but less so if compared to the euro area countries. Overall general government expenditure averaged 46.8% of GDP, compared to the EA-13 average of 47.7% and 44.3% for the new Member States (see Table 1).⁵ In the same period, general government revenue was also below the average level in the EA-13, but higher than the value recorded by the new Member States. This resulted in an average nominal deficit of 2.6% of GDP, half a percentage point above the EA13 average, but nearly two percentage points below the average for the 10 new Member States (4.5%). At the same time, the average Slovenian general government debt-to-GDP ratio was substantially lower than the 10 new Member States' average (39.2%) or the value for the euro area (70.1%).

³ See OECD (2007), "Fiscal consolidation: lessons from past experience", OECD Economic Outlook June 2007 and European Commission (2007), "Lessons from successful fiscal consolidations" Public finances in EMU 2007.

⁴ The term new Member States here refers to the countries which acceded the EU on the 1 May 2004.

⁵ EA13: Euro-area Member States excluding Cyprus for reasons of data availability.

Table 1: Key general government fiscal indicators for Slovenia (% of GDP)

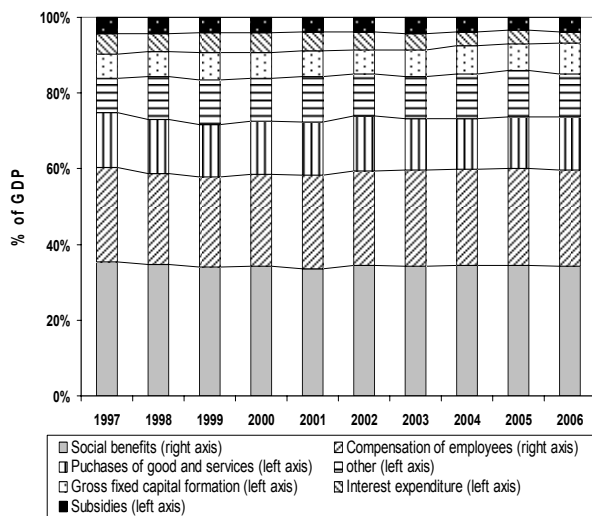
	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007*	Average for 1997-2006		
												SI	EA13	EU10
Total Expenditure	46.1	46.9	47.8	47.4	48.2	47.1	47.1	46.5	46.0	45.3	43.8	46.8	47.7	44.3
Total Revenues	43.7	44.5	44.6	43.6	44.1	44.6	44.4	44.2	44.5	44.1	43.1	44.2	45.7	39.8
Nominal Balance	-2.4	-2.5	-3.1	-3.8	-4.0	-2.5	-2.7	-2.3	-1.5	-1.2	-0.7	-2.6	-2.1	-4.5
Cyclically adjusted budget balance	-2.6	-2.6	-2.6	-4.2	-4.1	-2.2	-1.8	-1.5	-0.8	-1.1	-1.1	-2.3	-2.0	-4.3**
Debt level	21.4	22.1	24.6	27.2	27.8	28.5	27.9	27.6	27.4	27.1	25.6	26.2	70.1	39.2
P.m.: GDP growth (%)	4.8	3.9	5.4	4.1	3.1	3.7	2.8	4.4	4.1	5.7	6.0	4.2	2.2	4.2

Notes: *forecast; ** 1998-2006 average.
Source: AMECO

Developments within the decade show that there was a general deterioration of public finances in the first half. General government expenditure increased significantly, with the expenditure-to-GDP ratio peaking in 2001, after having risen by more than 2 pps. of GDP in the four preceding years. The revenue-to-GDP ratio also showed a positive trend from 1997-2002. However, expenditure growth outpaced the increase in general government revenues, resulting in a steady deterioration of the budget balance which reached a value of -4.1% of GDP in 2001, down from -2.6% in 1997 when it recorded the first negative value since independence. Correspondingly, the debt-to-GDP ratio increased by more than 6 pps. in the 1997 to 2001 period.

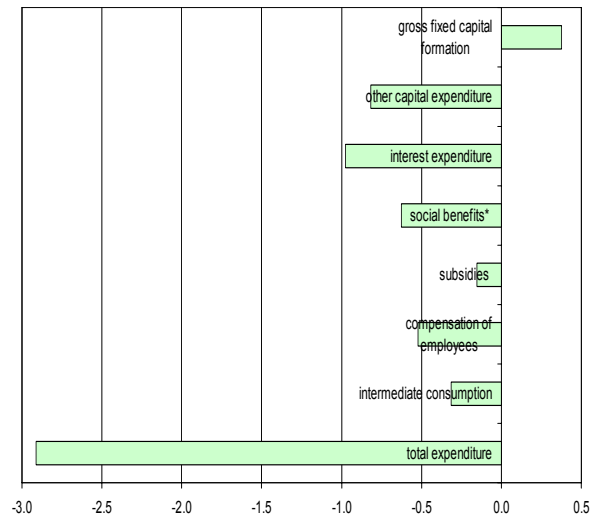
In the second half of the decade, however, fiscal consolidation efforts were successfully undertaken as Slovenia prepared for the entry into the EU and the euro area. In particular, the commitment to fiscal discipline was strengthened through the introduction of rolling two year budgeting, i.e. the yearly adoption of budgets for the two following years. Consolidation efforts resulted in slower growth of total general government expenditure, reducing the expenditure-to-GDP ratio by nearly 3 pps. between 2001 and 2006. As a consequence, expenditure was lower than the EA-13 average during the entire subperiod. Given that at the same time, revenue on average grew only slightly more slowly than GDP, the Slovenian authorities were successful in reducing the general government deficit in relation to GDP. Over the 2001-2006 period, the nominal deficit diminished by 2.8 pps. to 1.2% of GDP in 2006, while the debt-to-GDP ratio also declined slowly. These developments were facilitated by the generally strong growth performance of the Slovenian economy during this period. However, the reduction of the nominal deficit was also accompanied by improvements in the general government cyclically adjusted and structural balances. In the presence of negative output gaps, the cyclically adjusted budget balance improved by more than 3 pps. of GDP from 2001 till 2005 before slightly deteriorating again in 2006 (-1.1%).

Figure 1: General government expenditure in Slovenia - economic classification



Source: AMECO

Figure 2: Composition of general government expenditure adjustment (change in % of GDP 2001-2006)



Note: * other than social transfers in kind.

Source: AMECO

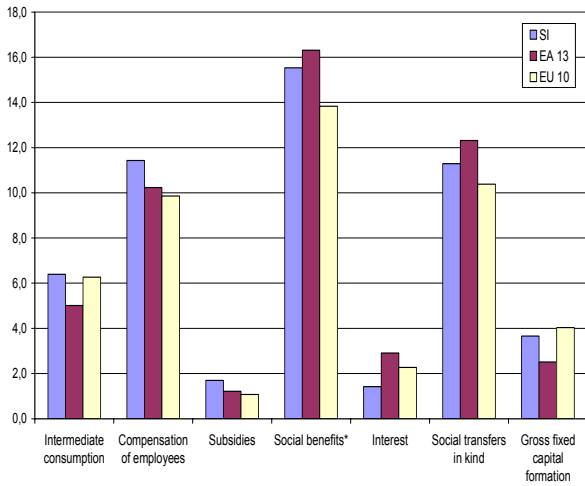
The pattern and development of public expenditure in Slovenia show that interest expenditure played an important role in cutting public expenditure. In fact, the biggest contribution to the reduction of overall expenditure by nearly 3 pps. of GDP achieved by the Slovenian authorities during 2001-2006 came from a decrease in interest expenditure by about 1 pp. of GDP (see Figures 1 and 2). This was due to the convergence process of interest rates and the lower risk premium due to the entry into the EU and euro area on the one hand and to decreasing debt levels and debt management efforts on the other hand, which included a repurchase of debt amounting to 1.2% of GDP in 2005.

In the same period, the decline in all other expenditure items was less marked, excepting gross capital formation. Spending on the latter, potentially growth-enhancing, category increased by 0.4 pp. to 3.7% of GDP in 2006, thereby exceeding the EA13 average of 2.5%, but falling short of the average of the new Member States (4.0%). Regarding the items where expenditure declined, the share of social benefits other than social transfers in kind in GDP declined by 0.6 pp. to 15.5% in 2006 (EA13: 16.3%, see Figure 3) thanks *inter alia* to the decrease in the pension share triggered by the 1999 reform. A reduction in the spending on unemployment benefits was also achieved, mainly due to positive labour market developments. Increasing conditionality and streamlining of the indexation mechanism has also contributed to this development. Compensation of employees was reduced by 0.5 pp. of GDP thanks to prudent employment and wage policies. However, the share of public sector wages in Slovenian GDP in 2006 still exceeded the shares recorded for the EA13 or the new Member States by more than one pp. (see Figure 3), pointing to scope for further reductions. Likewise, although savings on intermediate consumption and subsidies amounted to 0.3 and 0.2 pp. of GDP, the shares remain higher than those recorded for both the EA13 and the new Member States. The above developments suggest that, while a significant reduction in expenditure has already been achieved, there appears to be scope for further reductions of spending.

Figure 3: Economic expenditure categories

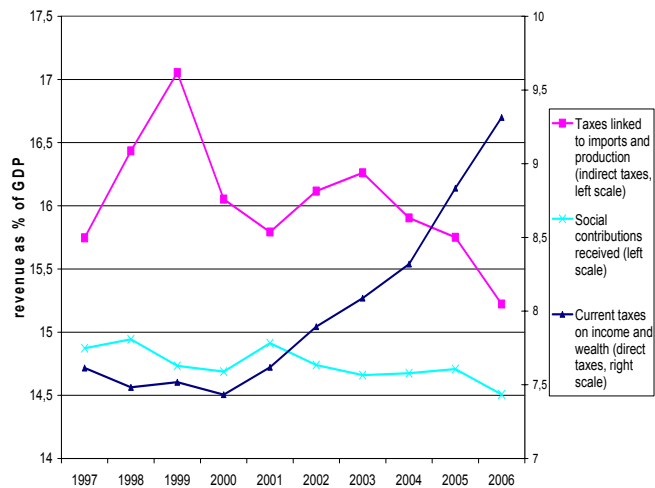
Figure 4: Main categories of general

(% of GDP in 2006)



Note: other than social transfers in kind
Source: AMECO

government revenue (% of GDP)



Source: AMECO

Looking at the main categories of Slovenia’s general government revenues shows that the pattern of tax revenues has changed significantly over time (see Figure 4). In particular, the trend development in relation to GDP was positive for revenue from taxes on income and wealth whereas revenue from taxes related to imports and production showed a slightly negative trend over most of the period after having increased in the first two years. Since 2005, taxation patterns and revenues have in particular been influenced by a major tax reform which has been implemented by the Slovenian government to further fiscal consolidation and improve the quality of public finances.⁶ The taxable base was broadened and changes to tax relief rules were introduced for both personal and corporate income taxation. For personal income taxation, the statutory tax rates were in addition reduced. More than half of the nearly 2 pps. increase in direct tax revenues in relation to GDP recorded over the 1997-2006 period was reached in the last two years, under a very favourable growth environment and as the tax reform started to be implemented. At the same time, the observed decrease in revenue from indirect taxation was inter alia due to the gradual phasing out of the payroll tax since 2005.

Summing up, while the beginning of the 1997-2006 period was characterised by a deterioration of public finance indicators in Slovenia, the second half of the decade saw significant fiscal consolidation efforts by the Slovenian authorities. These included a major tax reform, which alleviated the tax burden on labour and savings, as well as a considerable reduction of spending. Therefore, Slovenia’s current public finance position appears to be rather satisfactory when compared to the average performance of euro-area countries. However, the adequacy of a country’s current fiscal stance cannot be judged independently of projected future expenditure and revenue developments. The next section therefore analyses expected budgetary developments in the long-run, focussing in particular on the effects of ageing on the sustainability of Slovenia’s public finances.

⁶ The Personal Income and Corporate Income Tax Acts were adopted in 2004, with reform measures being gradually phased in.

2.3. Ageing of the population as a threat to the long-term sustainability of public finance⁷

As examined in the assessment of last year's stability programme and further explored in section 5.2 of the present document, Slovenia is one of the EU countries that will be most affected by the challenges of rapid ageing of the population. Although its general government debt is currently well below the euro area average, the demographic outlook for the next decades puts the long-term sustainability of public finances at high risk.

Demographic projections indicate that Slovenia will face a rapid ageing of the population in the next decades. This is best illustrated by the old-age-dependency ratio, which represents the population aged over 65 years in relation to the working age population aged 15 to 64 years. It is projected to increase from 21.7% in 2005 to 35.8% in 2025. Thereafter, the rate of increase will be even higher resulting in a ratio of 55.6% by 2050, mainly reflecting a rise in the population in the 80+ age class. This will be one of the highest rates of the EU-25, for which the average is projected to be 52.8%. At the same time, the employment rate of older workers between 55 to 64 years remains subdued. Despite an increase from 22% to 33% over the past decade (1997-2006), it is still well below the EU-25 average of 44% in 2006 as well as below the Lisbon target of 50% that is to be reached by 2010.

The demographic trends described above in conjunction with the low employment rate of older workers are projected to lead to a substantial rise in age-related public expenditure on pensions.⁸ In 2004, which is the start of the EU Economic Policy Committee's Ageing Working Group (AWG-EPC) reference period, this spending item accounted for 11.0% of GDP in Slovenia, which is very close to the EU-25 average (10.6%). However, according to the AWG-EPC projections, it will increase to 18.3% by 2050. This 7.3% pps. increase is much higher than the 2.2 pps. projected for the EU-25, which is mainly due to the fact that pensions in Slovenia have since 2006 been indexed to net wage growth. In contrast, public spending on health care, long-term care, unemployment benefits and education will broadly follow the EU trend during the reference period of 2004-2050.

Although Slovenia's current debt position with a debt-to-GDP ratio below 30% is favourable, the projections show that assuming all revenue and expenditure (other than the aged related) stay constant as a share of GDP, debt would grow to unsustainable levels, as recognised by the authorities. Consequently, based on the results of the AWG-EPC projections, the Council concluded on 14 February 2006 in its opinion on the updated Convergence Programme of Slovenia that the country appears to be at high risk high risk with regard to the long-term sustainability of public finances. To address this issue, the European Commission in its assessment of the 2007 progress report to the Slovene National Reform Programme (NRP) issued a country specific recommendation adopted by the Council calling Slovenia to "take further steps to strengthen the reform of the pension system and promote active ageing with a view to increasing the employment rate of older workers and improving long-term sustainability." Hence, bold reforms to both the pension system and the labour market are needed to curb these unsustainable developments.

⁷ Section 5 of this technical assessment will deal with this issue in more detail.

⁸ EPC and EC, DG ECFIN (2006), "The impact of ageing on public expenditure".

In 1999, Slovenia introduced a far-reaching pension reform programme. Substantial changes over a transition period ending in 2024 included a gradual decline in the replacement rates and as a consequence a reduction in the accrual rate (i.e. the rate at which pension benefits build up during working life). With longer working lives, persons can to a certain degree compensate for negative impacts of the changed method of calculation. The programme is also lengthening the period of assessment of earnings from 15 best consecutive years in 2005 to 18 years by 2008. Despite the changes, the timeframe is still quite generous compared to periods for assessing wages in other Member States, which are being extended to greater extent or simply refer to the average of lifetime wages. The programme also contains a gradual increase in the full pensionable retirement age to 63 for men and 61 for women with a minimum 20 years of service, which, however, seems still quite generous compared with many other EU countries.

A very important reform measure was the indexation formula providing for lower adjustment of pensions as compared to wages. However, this was backtracked in 2005 and pension indexation was again set to grow at the same rate as overall wage growth, adjusted for the reduced benefits under the reform plans. As a result, the favourable effects of the 1999 reform in containing the pension outlays were partially offset by the government decision, which was also taken into account by the AWG-EPC for its projections⁹. In 2006, some specific measures to promote employment of older workers were taken like a gradual increase in effective retirement age, fiscal incentives offered to private sector employers prepared to employ older people¹⁰. However, no further actions were taken in 2007 in reaction to the Council's recommendation.

In brief, Slovenia's relatively favourable initial budgetary position is not sufficient for stabilising the debt ratio over the medium term in the face of the expected budgetary impact of ageing. Although some reforms have been implemented resulting in an increased employment rate of older workers, the need for more profound structural reforms to contain the substantial increases in age-related expenditures persists. In particular, within a dearly needed pension reform, a key measure would be to abolish the indexation of pensions to wages. While further pension reform is indispensable, increased fiscal consolidation efforts leading to budgetary surpluses in the short run would contribute significantly to reducing risks to the sustainability of public finances. The next two sections deal with other key aspects to be considered for further fiscal consolidation efforts, namely, the budget rigidity and the efficiency of public expenditure. These are aspects that also respond the renewed Lisbon Strategy, which calls for fiscal policy not only to secure economic stability and safeguard fiscal sustainability, but also to promote a growth-and employment-orientated and efficient allocation of resources.

2.4. Rigidity of the budget

A high degree of flexibility of the budget is deemed desirable by researchers and policymakers since it implies the government has significant leeway to restructure its spending in the short run in response to changing policy priorities or macroeconomic circumstances. Also, rigidity of the budget may impede fast fiscal consolidation. Given that the importance of fiscal policy for absorbing macroeconomic shocks has increased now that as a member of the euro area, Slovenia cannot use its exchange rate for this

⁹ EPC and EC, DG ECFIN (2006), "The impact of ageing on public expenditure", page 72.

¹⁰ Ministry of Labour, Family and Social Affairs of Slovenia, "Active employment policy programmes 2007–2013", adopted 23. 11. 2006.

purpose, and given that, as discussed above, further fiscal consolidation seems desirable with a view to its favourable contribution to long-term sustainability, this section investigates the degree of rigidity of the Slovenian general government in some detail.

A first hint about the degree of rigidity is given by the Standard and Poor's "Fiscal Flexibility index".¹¹ Among 28 European countries including the EU-25, Slovenia ranks 14th for expenditure flexibility, with an index score slightly below (i.e. worse than) the sample average.¹² Thus, there seems to be a considerable degree of budget rigidity although it should be noted that Slovenia improved its rank in spending flexibility by several ranks vis-à-vis last year's assessment.

Potential budget rigidity is also underlined by a recent IMF study¹³ which highlights that the variability of total spending in Slovenia in 2000-2005 was much lower than for either the new Member States¹⁴ or the EU-15. In particular, the standard deviation to the mean in percent was about twice as high for the EU-15 than for Slovenia. The value for the 10 new Member states was more than three times as high as the standard deviation to the mean for Slovenia. Regarding individual expenditure categories, the standard deviation is lower in Slovenia in particular for social benefits and compensation of employees. It could be assumed that the different countries' budgets show similar elasticities with respect to cyclical conditions, whereas the size of actual output gaps faced by them differed. Simulations show, however, that the relatively modest variation in primary spending recorded for Slovenia is not fully explained by mild output growth volatility.

Figure 5 illustrates the development over time of the share of rigid expenditure items in the Slovenian budget. For the purpose of this analysis, an expenditure component is considered rigid if its inclusion in the budget is not dependent upon the discretion of the authorities in the short-term. Therefore, expenditure items which have a legislative basis, such as *social benefits* and *subsidies*, are considered as mandatory and thus rigid. In addition, other spending categories like *interest payments* and *compensation of employees*, which due to their nature are difficult to reduce at least in the short-term, are also considered as mandatory and hence fall under the rigid budget components. Looking at these categories, in 1997-2006 the average share of rigid expenditure for Slovenia (67.7%) was higher than the unweighted EA13 average (66.5%) or the value recorded for the new Member States (64.2%, unweighted country average). At the same time, as illustrated by the figure, the reductions in the rigid expenditure share achieved by the EA13 and especially the new Member States since 2000 are much more significant than in the Slovenian case.¹⁵

¹¹ Standard and Poor's (2007), "The 2007 Fiscal Flexibility Index: Continental Sovereigns Still Lagging Behind".

¹² In the Standard and Poor Index, expenditure flexibility refers to the composition of expenditure. Each of the considered spending categories (90% of total spending for the sample average) is assigned a "compression factor" measuring how significantly spending can be reduced in the short run. The compressible shares, weighted with the share of each spending category in total spending, are then added up.

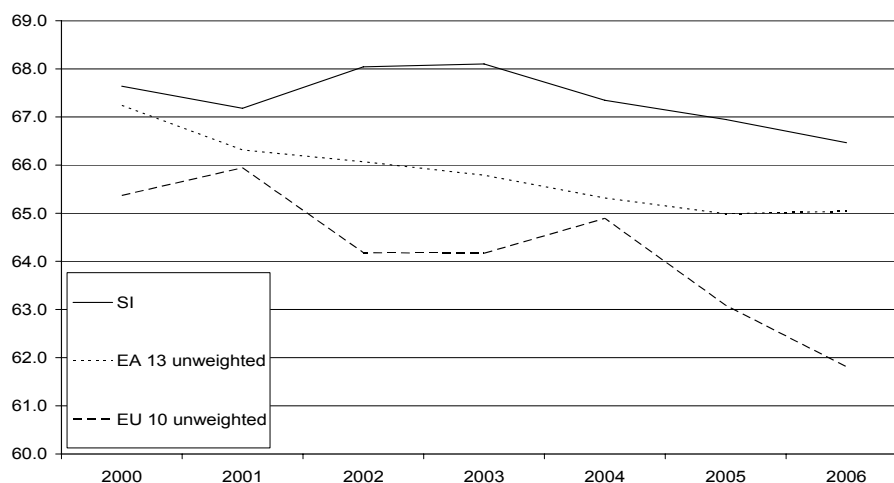
¹³ Mattina, Todd D. and Victoria Gunnarsson (2007), "Budget Rigidity and Expenditure Efficiency in Slovenia", IMF Working Paper no. 07/131.

¹⁴ Excluding Cyprus and Malta.

¹⁵ Strojan (2005) notes that the indexation of a high share of public expenditure to macroeconomic variables that are at least partly beyond the government's control (inflation, wages) adds to the inflexibility of expenditure. See A. Strojan Kastelec (2005), "Public expenditure in Slovenia: Past trends and current issues", Prikazi in analize (Surveys and analysis) series XIII/2, Bank of Slovenia.

Therefore, judging by several indicators, including the standard deviation to the mean of expenditure shares in GDP and the percentage of mandatory spending in overall public expenditure, the Slovenian budget seems to still display a relatively high level of rigidity. In order to facilitate further fiscal consolidation efforts identified as helpful for ensuring the sustainability of public finances, attention should therefore be devoted to tackling the issue of budget rigidity.

Figure 5: Share of rigid items in total general government expenditure based on ESA 95 (2000-2006)



Source: AMECO

2.5. Expenditure efficiency

This section investigates the efficiency of general government spending in Slovenia. Assessing efficiency in the context of public finances means setting policy outcomes in relation to the financial resources employed. The purpose of this exercise is twofold. First, the analysis is interesting in its own right since comparing the level of socially desired outcomes to the level of public resources spent provides important insights about the quality of public finance. Second, given that further fiscal consolidation in Slovenia is desirable to help ensure the long-term sustainability of public finances, it is noted that a consistent finding of empirical research on the determinants of successful fiscal consolidation is that expenditure-based consolidations are more successful than revenue-based efforts.¹⁶ By implementing measures which improve efficiency, expenditure on certain areas can be reduced without compromising the level of services provided. Identifying such areas therefore highlights welcome opportunities for fiscal consolidation on the expenditure side.

Several studies indeed suggest that there might be scope for improving public spending efficiency in Slovenia. Afonso et al (2006) construct a composite public sector efficiency indicator which is the average of sub-indicators relating to efficiency in the fields of administration, health, education, income distribution, economic stability and economic

¹⁶ See the literature cited in subsection 2.1.

performance.¹⁷ Sub-indicators are constructed as ratios of selected outcome indicators and the resources spent for achieving them.

In this setup, the overall efficiency score for public spending in Slovenia is found to be considerably lower than the average score of the country sample comprising the 12 new Member States, three old Member States that underwent a catching-up process after entering the EU (GR, IE, PT) and nine non-EU emerging economies. Slovenia's score is similar to the average score attained by the 10 new Member States.¹⁸ Looking at the sub-indicators, weaknesses in Slovenia's public spending efficiency can be found especially in the health sector, where the chosen result indicators relate to life expectancy and infant survival rates. Slovenia's health sector efficiency score is substantially lower than the average attained by the new Member States which in turn is lower than the overall sample average. In fact, Slovenia's score is quite close to the minimum efficiency score found in the sample. Both in the health sector and overall, spending in Slovenia is higher than both the sample average and the average of the new Member States, implying that slightly above average or even lower results are achieved with too many inputs. A caveat applies insofar as the focus in constructing this efficiency measure is on quantifiable outcomes, neglecting important aspects such as the quality of services provided. Also, only public spending is taken into account, while outcomes might also be influenced by private spending. More generally, external factors as well as sample selection might have an impact on the results.

Instead of just comparing individual country performances to sample averages, several studies assess public spending efficiency in a given policy field by first constructing an empirical "production possibility frontier" in input-output space from data on a sample of comparable countries and then ranking the countries according to the distance of their position in input-output space from that efficient frontier. The frontier connects those input-output combinations in the cross-country sample which are examples of best practice in that they are not "dominated" by other feasible combinations, i.e. for which there are no feasible combinations that reach the same (or higher) level of output using a lower level of inputs. The advantage of this approach to measuring public sector spending efficiency is its non-parametric character, i.e. the absence of assumptions about a concrete functional form for the production technology. However, the method is by its very nature sensitive to sample selection, outliers and more generally, data quality.

Using this kind of approach, both the recent IMF study mentioned in subsection 2.4, which compares Slovenia to a cross country sample including a large number of European countries based on data from the 1998-2003 period, and work by Commission services covering the period 2001-2005 for most of the EU-25 countries¹⁹ corroborate the finding that there is scope for improving efficiency in the health sector.²⁰ Relating

¹⁷ Expenditure data are from the 1999-2003 period, whereas data on outcomes basically relate to the years 2001-2003. For details cf. A. Afonso, L. Schuknecht and V. Tanzi, "Public sector efficiency. Evidence for new EU Member States and emerging markets", ECB WP no. 581, January 2006.

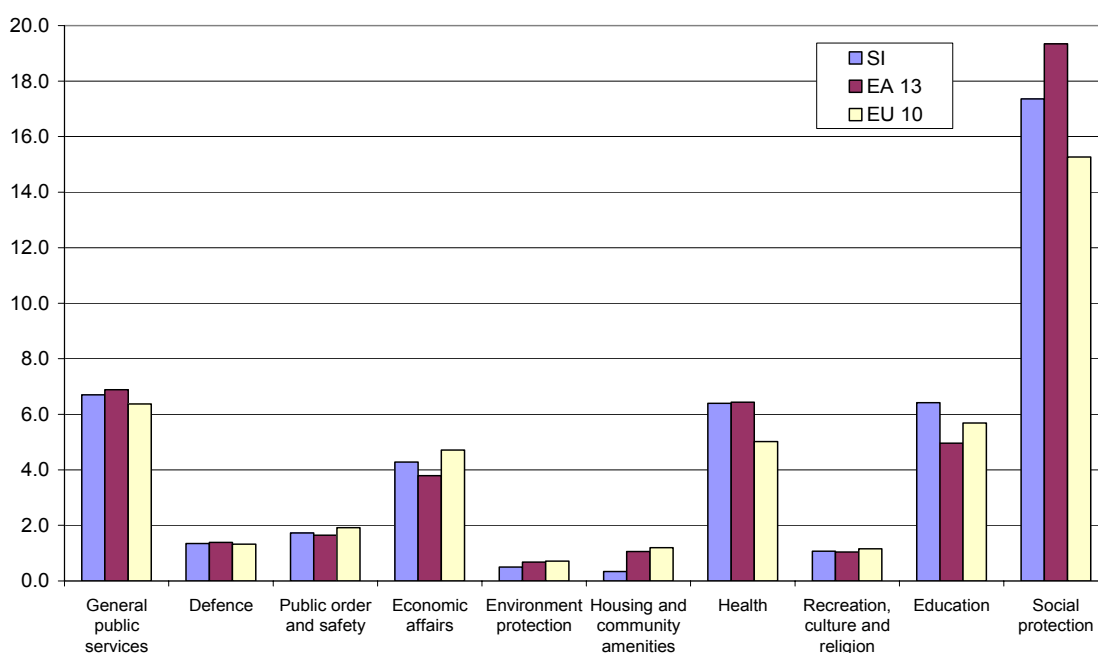
¹⁸ Although data on the 12 new Member States is included, Bulgaria and Romania are not part of the reference group in the paper since at the time of the analysis, they still had the status of candidate countries.

¹⁹ Ivan Ebejer and Ulrike Mandl, "The efficiency of public expenditure in Malta", ECFIN Country Focus (forthcoming).

²⁰ In the Data Envelopment Analysis (DEA) technique employed by the IMF study, a convex production possibilities set is assumed. Those input-output combinations are considered as efficient which are not dominated by other combinations found in the cross-country sample or by linear combinations thereof. The production possibility frontier then is a piecewise linear combination of the pairs of input-output

public health spending to child mortality, maternal mortality and standardised death rates, respectively, Slovenia ranks among the bottom 30% of countries in the IMF study. The score relating the input used by a country to the level of expenditure associated with producing the same level of output on the efficiency frontier is 0.63 on average, implying that the same level of health outcomes could efficiently be produced with 63% of the resources Slovenia is currently using for this purpose. According to Commission services' analysis, Slovenia ranks among the less efficient 50% of countries with regard to the outcome indicators life expectancy at birth, standardised death rates and infant deaths per 1000 life births. It therefore seems that expenditure for health services in Slovenia, which in 2006 was marginally higher than for the euro area and considerably higher than for the other new Member States (see Figure 6), could be cut substantially while maintaining the same level of services provided.

Figure 6: COFOG expenditure categories (% of GDP in 2006)



Source: AMECO.

Public spending on education as a per cent of GDP is around 1.5 pps. higher in Slovenia than in the euro area and 0.7 pp. higher than in the new Member States (see Figure 6). The difference is even higher when looking at the expenditure on public and private educational institutions per pupil at primary level compared to GDP per capita, which is 76% higher than in the euro area. The two studies mentioned above also analyse public spending efficiency in the education sector. While Slovenia scores above average for tertiary education and results about the efficiency of secondary education are inconclusive,²¹ there is indeed scope for enhancing efficiency in primary education.

combinations identified as efficient. The Free Disposable Hull (FDH) approach used in the Commission services' analysis relaxes the above-mentioned convexity assumption. All combinations are identified as efficient which are not dominated by other combinations found in the sample. The production possibility frontier connects the efficient combinations in a step-function like manner. The FDH approach due to the different definition of the set of feasible combinations in general identifies more countries in a sample as efficient than does the DEA approach.

²¹ In the Commission services' analysis which compares Tertiary Enrolment ratios to related public spending, Slovenia ranks 7th out of 18 countries. In the IMF study which chooses the proportion of university graduates as % of school-age population as an outcome indicator, Slovenia ranks 13th in the

When comparing student-teacher ratios in primary education to related public spending, Slovenia ranks 42nd among 45 countries in the IMF sample and last among the 19 countries of the Commission sample. The observed elevated level of public expenditure could theoretically be reduced by at least 46% while maintaining the current student-teacher ratio for Slovenia, which is close to the average ratio in the country sample.

While the results are subject to the above-mentioned caveats regarding the methodology, the analysis reported in this section thus suggests that there is significant scope for improving the efficiency of public expenditure in Slovenia's health and primary education sectors. Implementing efficiency-improving measures would at the same time create the opportunity for further expenditure-based fiscal consolidation.

2.6. Conclusions

An overview of the development of public finances in the decade preceding entry into the euro area has shown that after a period with a deteriorating public finance situation, the latter improved significantly. Thanks to the fiscal consolidation efforts underlying this improvement, the current fiscal position of Slovenia is relatively benign compared to some other euro area countries. However, a closer look at the impact of ageing on the long-term sustainability of Slovenia's public finances puts this finding into perspective. Indeed, while structural reforms – in particular including further reform of the pension system – are indispensable for tackling the fiscal sustainability challenge, further fiscal consolidation efforts going beyond the requirements of the Stability and Growth Pact also seem to be needed to achieve this aim. Against this background, the a relatively high degree of rigidity observed for the Slovenian budget should be further addressed as it is a potential obstacle for the quick and far-reaching expenditure adjustments that might prove necessary. At the same time, despite the expenditure cuts already accomplished, there seems to be scope for improving the efficiency of public expenditure in sectors such as health and primary education. Since spending efficiency was identified to be low in these areas, spending could potentially be cut without compromising the level of services provided. The importance of tackling the main challenges for Slovenia's public finances identified in last year's assessment – stabilisation, sustainability and efficiency in a broader sense including expenditure flexibility – is thus corroborated.

sample of 44 countries. Regarding secondary education, when comparing secondary enrolment rates to related public spending as done in the Commission services' analysis, Slovenia is on the efficient frontier, i.e. ranks first. When looking at international TIMMS (Trends in International Mathematics and Science Study) mathematics test scores (National Center for Education Statistics, 2003) as done by the IMF, however, Slovenia only has an intermediate position (10th out of 19 countries).

3. MACROECONOMIC OUTLOOK

This section assesses the plausibility of the macroeconomic scenario (economic activity, labour market, costs and prices) underpinning the public finance projections of the programme. It also examines whether good or bad economic times in the sense of the Stability and Growth Pact prevail. Finally, it describes macroeconomic vulnerabilities and how they are expected to develop according to the programme.

3.1. Economic activity

During the first year of euro area membership, Slovenia continued to show a strong growth performance. Real GDP increased at a rate of 1.9% quarter-on-quarter on a seasonally and working day adjusted basis in the first quarter. In the following two quarters, growth remained brisk (+1.2% and +1.6%, respectively). After the first three quarters, the carryover for real GDP growth in 2007 as a whole is estimated at 6.2%. Since currently available indicators point to continued growth in the fourth quarter, albeit at a more moderate pace, the rate of GDP growth in 2007 is likely to be the highest recorded since Slovenia's independence.

According to the November 2007 update of the stability programme, real GDP growth is going to remain strong throughout the programme period, averaging 4¾% per year between 2007 and 2010 (see Table 2).²²

After the buoyant 5.8% expansion projected for 2007, the programme expects a moderation of GDP growth to 4.6% in 2008 and 4.1% in 2009, respectively. In 2010, economic activity is expected to accelerate somewhat, with growth recovering to 4.5%. According to the Commission services' recalculations using the commonly agreed methodology based on the information provided in the programme, the output gap is expected to remain positive but gradually diminish and nearly close by the end of the programme period.

The vigorous economic growth in 2007 is attributed to strong gross fixed capital formation and better-than-expected external conditions favouring exports growth. The update projects that throughout the programme period, final domestic demand will continue to make the most sizeable contribution to GDP growth, despite a significant decrease in the growth rate of gross fixed capital formation vis-à-vis the exceptional 14.5% increase expected for 2007. In 2008 and 2009, slower investment growth is expected to be partly compensated by an improvement in the currently negative contribution of net exports to growth, which is expected to turn neutral in 2008 and positive in 2009. In particular, while both exports and imports are projected to slow down considerably against the background of a less favourable external environment, the deceleration of imports is expected to be stronger. Private consumption growth is projected to reach 4.2% in 2007 thanks to favourable labour market developments and positive effects of the personal income tax reform. On the back of strong expected wage increases, private consumption is then projected to grow only slightly more slowly in 2008 before decelerating somewhat in the context of the general slowdown of economic activity in 2009 and rebounding in 2010 due to favourable wage developments.

²² The external assumptions behind the programme's macroeconomic scenario are broadly in line with those in the Commission services' autumn 2007 forecast. However, due to the earlier cut-off date for the underlying Slovenian forecast, the values assumed for oil prices and the dollar-euro exchange rate are somewhat lower than the assumptions in the Commission services' autumn forecast.

Table 2: Comparison of macroeconomic developments and forecasts

	2007		2008		2009		2010
	COM	SP	COM	SP	COM	SP	SP
Real GDP (% change)	6.0	5.8	4.6	4.6	4.0	4.1	4.5
Private consumption (% change)	4.2	4.2	4.0	4.0	3.5	3.4	4.0
Gross fixed capital formation (% change)	14.4	14.5	6.2	6.2	3.8	2.6	4.8
Exports of goods and services (% change)	13.3	13.4	10.2	10.3	8.9	9.7	8.8
Imports of goods and services (% change)	13.9	14.2	9.8	10.1	8.0	8.2	8.0
<i>Contributions to real GDP growth:</i>							
- Final domestic demand	6.5	6.6	4.4	4.5	3.4	3.1	3.8
- Change in inventories	0.0	-0.1	0.0	0.1	0.0	0.1	0.1
- Net exports	-0.5	-0.7	0.1	0.0	0.6	0.9	0.6
Output gap ¹	0.9	0.7	0.8	0.5	0.3	0.1	0.2
Employment (% change)	2.2	2.3	0.9	0.9	0.5	0.6	0.9
Unemployment rate (%)	4.9	5.0	4.7	4.9	4.6	4.8	4.6
Labour productivity (% change)	3.7	3.4	3.6	3.7	3.5	3.5	3.6
HICP inflation (%)	3.5	3.4	3.7	3.5	2.9	2.8	2.6
GDP deflator (% change)	2.8	3.0	4.2	3.6	2.9	2.9	2.7
Comp. of employees (per head, % change)	6.2	5.9	7.0	7.3	5.9	5.6	6.1
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-3.3	-3.5	-2.6	-3.1	-1.9	-2.0	-1.6
<u>Note:</u>							
¹ In percent of potential GDP, with potential GDP growth according to the programme as recalculated by Commission services.							
<u>Source:</u>							
Commission services' autumn 2007 economic forecasts (COM); Stability programme (SP)							

The economic outlook for Slovenia over the 2007-2010 period depicted in the programme represents an improvement over historical trends. In particular, while the projected average GDP growth rate of 4¾% corresponds closely to the average increase in the years 2004-2006, it exceeds the 1996-2005 average by ¾ percentage point. Vis-à-vis this longer reference period, where the contribution of net exports to growth was neutral, the external sector is expected to play a slightly bigger role for growth at an average +0.2 pp. contribution.

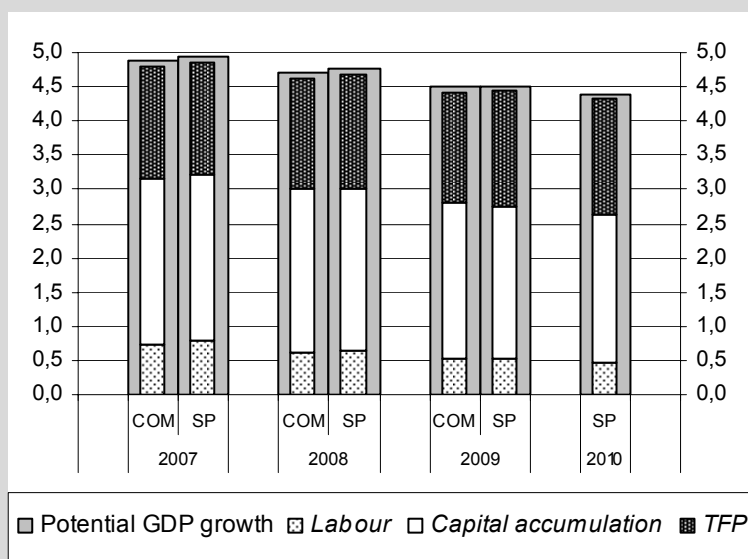
The stability programme's assumptions about economic growth for 2007-2009 are broadly in line with the Commission services' autumn forecast despite the former's somewhat more optimistic external assumptions, in particular about oil prices and foreign exchange rates. Risks associated with the external environment have increased somewhat since the completion of the programme, especially concerning 2008. However, these risks are mitigated by the fact that the programme already incorporates a slowdown in exports, while some of the drivers of domestic demand can be expected to be less sensitive to a possible change in the external environment. Regarding the last year of the programme period (2010), which is not covered by the Commission services' autumn forecast, the increase in real GDP projected in the programme is only slightly lower than the Commission services' estimate of potential output growth for 2007-2009. Further, the projected narrowing of the output gap over the 2007-2009 period is also in line with the trend projected in the autumn forecast. However, projections of the size of the positive gap are smaller in the programme than in the autumn forecast, with the difference

exceeding ¼ pp. in 2008.²³ Moreover, a comparison across the latest three programmes and Commission services' forecast rounds shows a significant degree of instability of output gap estimates which underlines the uncertainty surrounding such real-time estimates. This reinforces the need for a very cautious assessment of the underlying fiscal position as well as the progress towards the medium-term objective.

Box 1: Potential growth and its determinants

The graph below presents the Commission services' recalculations of potential growth according to the commonly agreed methodology, based on the information provided in the programme. The projected potential growth rates are very much in line with the Commission services' autumn forecast. The programme's projection for 2010 is 0.3 pp. lower than the expected average rate of potential growth in 2007-2009.

Potential growth and its determinants



At the same time, the expected average potential growth rate of 4.6% during the programme period is 0.6 pp. higher than the average actual GDP growth rate in 1996-2005 (see Annex 2). This is expected to be the result of higher contributions of all three sources of potential growth than in the past. In particular, the relative importance of the contribution of labour is projected to increase somewhat. This would be consistent with the improved incentives for work expected to be brought about by the comprehensive tax reform and with the increase in the effective retirement age planned to be achieved through the ongoing implementation of the 1999 pension reform.

The assumptions about the composition of growth are broadly in line with the Commission services' autumn forecast, although there are some small differences. In particular, in 2009, the programme gives a stronger role to net exports as a growth driver than does the Commission services' autumn forecast, while the opposite applies for gross fixed capital formation. The positive development of the contribution of net exports is considered plausible despite rising unit labour costs since it is based on the deceleration of imports, which is projected in the context of the softening of economic activity, being stronger than the deceleration of exports.

²³ There are also sizeable differences between the programme's output gaps as recalculated by the Commission services and the output gaps as presented in the programme itself, with the original estimates exceeding the recalculations in all years except 2007.

Overall, in the light of the above assessment, the programme's macroeconomic assumptions appear broadly plausible.

3.2. Labour market and cost and price developments

The programme projects an average increase in employment of nearly 1¼% throughout the programme period. Employment growth peaks in 2007 against the background of this year's strong growth performance and then subsides, reflecting the cyclical pattern of GDP growth in the following years. Unemployment is expected to continue its gradual decline, totalling 0.4 pp. over the programme period, to end at 4.6% in 2010. The average labour content of growth implied by the stability programme is broadly consistent with past values.

While projected labour market developments are in line with the Commission services' forecast, they are more favourable than past trends, based on the projected continuing strong growth performance of the economy. In particular, the average increase in employment in the 2001-2005 period equalled 0.4%, while unemployment averaged 6.4%. Expected labour productivity developments are also broadly in line with the Commission services' forecast.

HICP inflation is, according to the update, expected to reach 3.4% in 2007 and to slightly accelerate to 3.5% in 2008. After that, it is projected to return to lower levels, standing at 2.8% and 2.6% in 2009 and 2010, respectively. The increase in the GDP deflator is projected to be somewhat lower than HICP inflation in 2007 and slightly higher afterwards.

The inflation projections of the stability programme and of the Commission services' autumn 2007 forecast are broadly in line, although the programme's HICP and private consumption deflator projections for 2008 are somewhat more optimistic than the Commission services' estimates. Price developments in the other demand components are rather similar in the two scenarios. The programme, however, presents higher import prices, whereas domestic output prices (GDP deflator) are projected to rise by 3.6% in 2008 according to the programme, as opposed to 4.2% in the autumn forecast. The more pronounced increase in unit labour costs in the programme implies that the difference between the two GDP deflators is due to lower profit margins in the programme relative to the autumn forecast. However, upside risks have increased in the light of recent data on inflation developments in Slovenia. In particular, year-on-year HICP inflation stood at 5.7% in December, having exceeded 5% in each month of the last quarter of 2007. Core inflation reached 4.6% in November 2007, which was the eighth consecutive month of increases in this inflation measure. In view of these developments as well as recent movements in oil prices, the inflation projections for 2007 and 2008 made in the programme as well as the autumn forecast now seem optimistic.

Increases in the nominal compensation of employees per head are, according to the stability programme, expected to accelerate from 5.9% in 2007 to 7.3% in 2008, driven by the significant increases in the public sector planned in the context of reducing public sector wage disparities. After a deceleration in 2009, wage increases would reach 6.1% in 2010, again mainly due to public sector wage developments. Against stable increases in productivity, nominal unit labour costs are expected to increase throughout the programme period, broadly in line with the Commission services' autumn forecast. The increase in unit labour cost projected in the programme for 2008 (3.5%) constitutes an acceleration vis-à-vis 2007 (2.4%) and, against the background of the continuing inflationary pressures described above, upside risks for 2008 wage developments have in

the meantime increased. The importance of containing such inflationary pressures for a continuing strong performance of the Slovenian economy will be further discussed in the next section.

3.3. Macroeconomic challenges

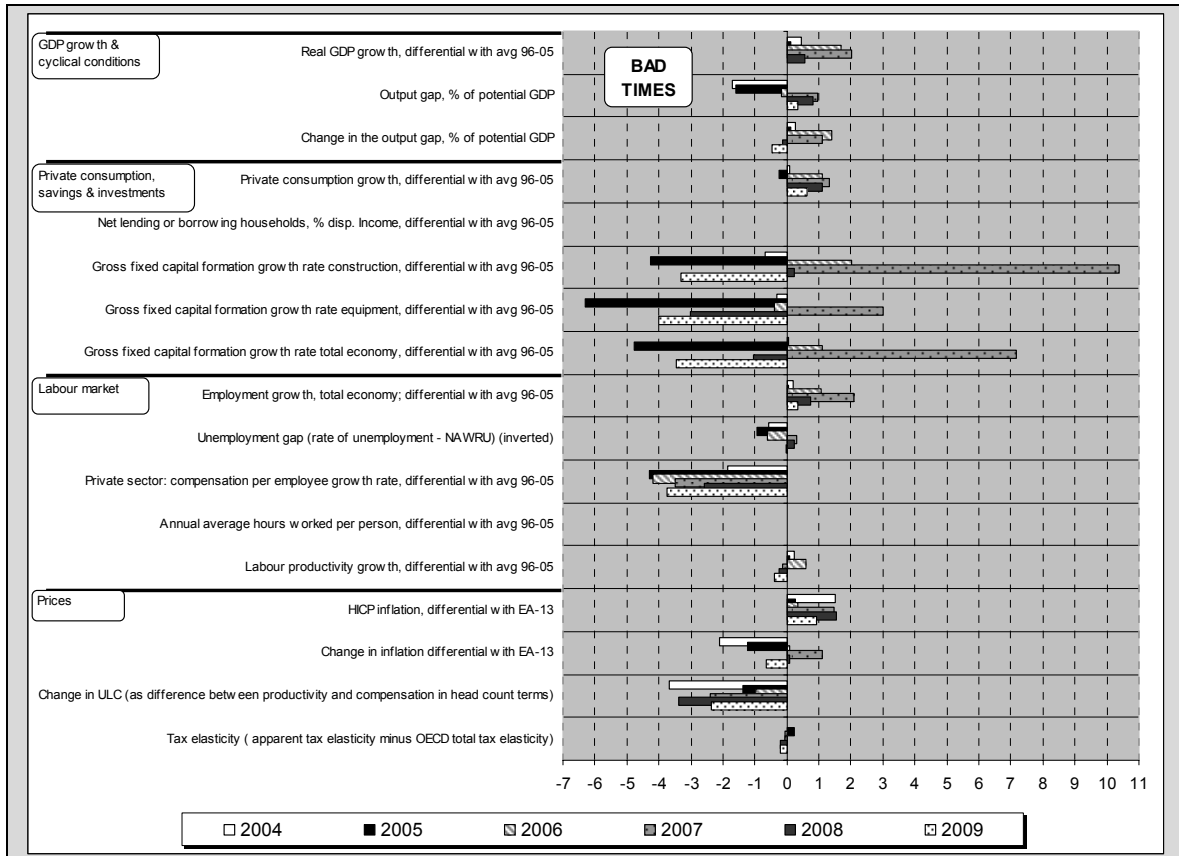
As pointed out above, Slovenia experienced a pick-up in consumer price inflation in 2007. While this was partly due to global external factors, the Slovenian economy was more affected by inflationary developments than other euro area countries. In the past, the effects of inflation on the competitiveness of the Slovenian economy could be offset through variations in the nominal exchange rate. The latter not being a policy option for euro area countries, the potential effects of inflation on competitiveness warrant increased attention. This is especially appropriate in the case of Slovenia since the economy is export-oriented, with exports amounting to 67% of GDP in 2006, and given that the share of low-technology and labour-intensive products in merchandise exports is still relatively high, albeit declining. As already underlined in the assessment of last year's stability programme, the relatively low technology content of Slovenia's exports implies a rather high sensitivity to commodity and oil price variations as well as wage pressures.

Box 2: Good or bad economic times?

According to the code of conduct, the assessment of whether the economy is experiencing good or bad economic times starts from the output gap, but draws on an overall economic assessment, which should also take into account tax elasticities. The figure below presents a set of macroeconomic indicators drawn from the Commission services' autumn 2007 forecast. Overall, the economy seems to be in good economic times taking into account tax elasticities in the period 2007-2009.

The graph shows that the output gap is expected to remain positive in 2007-2009, although narrowing somewhat in 2009. At the same time, real GDP in Slovenia is during these years projected to grow at a higher rate than in the reference period 1996-2005. Domestic demand is projected to remain solid, with consumption growth expected to stay above its historical average while the volatility of gross fixed capital formation makes it difficult to draw any conclusions. Expected labour market developments corroborate the positive outlook. In particular, the increase in the level of employment is projected to continue at an above-average pace. Wage growth is projected to remain above the euro area average, as is inflation. There is in fact a risk that this year's pick up in inflation might in 2008 feed into wages, with potential detrimental consequences for competitiveness and the good economic times Slovenia is currently experiencing. Finally, note that the tax elasticities in the autumn forecast do not reflect purely cyclical conditions but are strongly influenced by discretionary measures, in particular the ongoing tax reform.

Good versus bad times



In 2007, the competitiveness of the Slovenian economy vis-à-vis the euro area and other major European trading partners deteriorated according to indicators based on either consumer prices or unit labour cost. At the same time, indicators based on unit wage cost restricted to manufacturing continued to show a favourable development thanks to strong productivity increases. For 2008, possible second round effects from the pick-up of inflation in the previous year are a concern for competitiveness developments in the overall economy. According to the stability programme, in 2008 HICP inflation is projected to broadly remain at its 2007 level. Both the recent pick-up in inflation and the high average nominal wage increases envisaged for the public sector in 2008 in the context of reducing wage disparity may, however, lead to more unfavourable developments than projected, with potentially harmful consequences for competitiveness. This corroborates the importance of policies geared towards containing inflationary pressures and stabilising inflation expectations. In particular, the importance of a sound fiscal position in 2008 is underscored by the current inflationary pressures.

4. GENERAL GOVERNMENT BALANCE

This section consists of four parts. The first part discusses budgetary implementation in the year 2007 and the second presents the medium-term budgetary strategy in the new update. The third analyses the risks attached to the budgetary targets in the programme. The final part assesses the appropriateness of the fiscal stance and the country's position in relation to the budgetary objectives of the Stability and Growth Pact.

4.1. Budgetary implementation in 2007

Table 3 compares the 2007 revenue and expenditure targets (as a percentage of GDP) from the 2006 stability programme with the results of the Commission services' autumn 2007 forecast. The difference between the revenue and expenditure targets for 2007 and the projected outcome is decomposed into a base effect, a GDP growth effect on the denominator and a revenue / expenditure growth effect²⁴:

- The base effect captures the part of the difference that is due to the actual outcome for 2006 being different from what was projected in the previous update in the programme (either because the actual revenue / expenditure level in 2006 was different from the estimated outcome in the previous programme or because GDP turned out to be different from the scenario in the previous update of the programme). The base effect therefore also captures the effect of revisions to the GDP series.
- The GDP growth effect on the denominator captures the part of the difference that is related to current GDP growth projections for 2007 turning out higher or lower than anticipated in the previous update of the programme (therefore reducing / increasing the denominator of the revenue and expenditure ratio).
- The revenue / expenditure growth effect captures the part of the difference related to the revenue / expenditure growth rate in 2007 turning out to be higher or lower than targeted in the previous update of the programme. This would typically be due to GDP developments different from those expected in the previous update of the programme, or as a result of apparent tax elasticities different from the ex ante tax elasticities (or both).

The 2006 stability programme targeted a general government deficit of 1.5% of GDP in 2007. This compares with an estimated outcome of 0.7% of GDP in the Commission services' autumn 2007 forecast and of 0.6% in the new programme. This was the consequence of both the revenue and expenditure ratios falling short of their targets, with this gap being higher for expenditure than for revenue.

The resulting better-than-planned deficit outcome for 2007 reflects a positive base effect from the better-than-expected 2006 deficit outcome. At 1.2% of GDP, the 2006 deficit was 0.4 pp. lower than planned, mainly due to higher nominal GDP growth. Also, the 9% expected nominal GDP growth rate in 2007 is 1.5 pps. higher than projected in the 2006 programme, increasing the denominator of the ratios. At the same time, the nominal growth rates of both revenue and expenditure are expected to have exceeded their targets. In the case of revenues, the dynamics were more favourable than projected in the 2006 stability programme due to a lower-than-estimated impact of the changes in direct

²⁴ A fourth, residual component is usually small, except if there are very large differences between the autumn forecast and the target (the full mathematical decomposition is in the methodological paper mentioned above).

taxation as well as higher-than-estimated revenue in social contributions. This more than offset the overruns recorded for several categories on the expenditure side.

Table 3: Budgetary implementation in 2007

	2006		2007	
	Planned	Outcome	Planned	Outcome
	SP Dec 2006	COM	SP Dec 2006	COM
Revenue (% of GDP)	45.1	44.1	43.6	43.1
Expenditure (% of GDP)	46.6	45.3	45.1	43.8
Government balance (% of GDP)	-1.6	-1.2	-1.5	-0.7
Nominal GDP growth (%)			7.5	9.0
Nominal revenue growth (%)			3.9	6.7
Nominal expenditure growth (%)			4.0	5.5
Revenue surprise compared to target (% of GDP)				-0.5
<i>Of which</i> ¹ : 1. Base effect				-1.0
2. GDP growth effect on the denominator				-0.6
3. Revenue growth effect				1.0
<i>Of which: due to a marginal elasticity of total revenue w.r.t. GDP larger than 1</i> ²				0.5
Expenditure surprise compared to target (% of GDP)				-1.3
<i>Of which</i> ¹ : 1. Base effect				-1.3
2. GDP growth effect on the denominator				-0.6
3. Expenditure growth effect				0.5
Government balance surprise compared to target (% of GDP)				0.8
<i>Of which:</i> 1. Base effect				0.3
2. GDP growth effect on the denominator				0.0
3. Revenue / expenditure growth effect				0.5
Notes:				
¹ A positive base effect points to a higher-than-anticipated outcome of the revenue / expenditure ratio in 2006. A positive denominator effect indicates lower-than-anticipated economic growth in 2007. A positive revenue / expenditure growth effect points to higher-than-anticipated revenue / expenditure growth in 2007. The three components may not add up to the total because of a residual component, which is generally small.				
² Equal to (2)+(3). A positive sign means that the marginal elasticity of revenue with respect to GDP exceeds one.				
<i>Source:</i> Commission services				

However, it is noted that provisional information based on cash figures supplied by the Ministry of Finance of Slovenia in early January 2008 points to the possibility of a better-than-expected overall budgetary outcome. According to these data, a surplus of 0.1% of GDP is now expected. This would according to the figures be due to the expected outcome for nominal expenditure growth being lower than projected in the 2007 stability programme, which would only be partly offset by a lower-than-planned outcome for revenue growth.

In its Opinion on the first stability programme of Slovenia adopted on 27 February 2007, the Council invited Slovenia to: “taking advantage of the good economic conditions, including the better than expected budgetary outcome in 2006, speed up the achievement of the MTO”. Due to the upward revision of GDP growth for 2006, the structural balance in that year stood at around 1% of GDP, implying that the MTO was already broadly met in that year (see Table 4 in the next section). Against the background of good economic conditions, according to the update of the programme the MTO is also met in 2007, in the light of the above-mentioned provisional information, possibly with a comfortable margin. Thus, in retrospect, despite the possible expenditure overrun in 2007 as implied by the programme figures, the fiscal developments were in line with the policy invitation issued by the Council.

4.2. The programme's medium-term budgetary strategy

This section describes the medium-term budgetary strategy outlined in the programme - and how it compares with that in the 2006 stability programme - as well as the composition of the budgetary adjustment, including the broad measures envisaged.

4.2.1. *The main goal of the programme's budgetary strategy*

The main goal of the medium-term budgetary strategy is to respect the medium-term objective (MTO), which is a structural deficit (i.e. a cyclically-adjusted deficit net of one-off and other temporary measures) of 1% of GDP, by a growing margin over the programme period, although some weakening is planned for 2008. In the 2006 stability programme, the strategy was oriented towards reaching the MTO by 2009. However, as mentioned above, following the upward revision of nominal GDP growth, the MTO had already been broadly met in 2006, and according to the 2007 update of the programme it continues to be met in 2007. Hence, the update sets the target of keeping to the MTO throughout the period.

The adjustment path envisaged by the programme is back-loaded for both the nominal and the structural balance. Regarding the nominal balance, the programme actually plans a worsening of the 2008 deficit to 0.9% of GDP vis-à-vis the outturn of 0.6% in 2007 projected in the programme. Thereafter, the deficit is projected to gradually decline, with a balanced position being reached in 2010. The largest adjustment is planned in the final year. Following a similar path, the primary surplus is projected to decrease by half a pp. in 2008 before gradually increasing to 1.1% of GDP by 2010. Against the background of a positive but diminishing output gap throughout the programme period, the structural deficit, as recalculated by the Commission services on the basis of the information in the programme according to the commonly agreed methodology, is projected to increase to -1% of GDP in 2008. It is then expected to decrease by $\frac{1}{4}$ pp. in 2009 and by more than $\frac{1}{2}$ pp. in 2010, resulting in a broadly balanced structural position by the end of the programme period. Therefore, the envisaged fiscal stance is mildly expansionary in 2008, mildly restrictive in 2009 and restrictive thereafter.

Compared to the 2006 programme, the nominal and structural deficit levels planned now are lower throughout the programme period, ending in a broadly balanced budget in 2010. However, in the period covered by both the 2007 update and the 2006 programme (2007-2009) both the nominal and the structural adjustment planned is less ambitious in the 2007 programme. In particular, it had been planned in the 2006 programme to reduce the nominal deficit by $\frac{1}{2}$ pp., whereas no improvement is planned in the 2007 update. While this has to be seen against the background of a better starting position in 2007 and higher projected GDP growth in 2007 and 2008, it is also important to bear in mind that Slovenia is already at its MTO.

Table 4: Evolution of budgetary targets in successive programmes

		2006	2007	2008	2009	2010
General government balance (% of GDP)	SP Nov 2007	-1.2	-0.6	-0.9	-0.6	0.0
	SP Dec 2006	-1.6	-1.5	-1.6	-1.0	n.a.
	COM Nov 2007	-1.2	-0.7	-1.0	-0.8	n.a.
General government expenditure (% of GDP)	SP Nov 2007	45.3	43.6	43.2	42.1	41.3
	SP Dec 2006	46.6	45.1	44.4	42.6	n.a.
	COM Nov 2007	45.3	43.8	43.2	42.2	n.a.
General government revenue (% of GDP)	SP Nov 2007	44.1	43.0	42.2	41.5	41.3
	SP Dec 2006	45.1	43.6	42.7	41.7	n.a.
	COM Nov 2007	44.1	43.1	42.1	41.4	n.a.
Structural balance ¹ (% of GDP)	SP Nov 2007	-1.1	-0.8	-1.0	-0.7	-0.1
	SP Dec 2006	-1.4	-1.4	-1.6	-1.1	n.a.
	COM Nov 2007	-1.1	-1.1	-1.4	-1.0	n.a.
Real GDP (% change)	SP Nov 2007	5.7	5.8	4.6	4.1	4.5
	SP Dec 2006	4.7	4.3	4.2	4.1	n.a.
	COM Nov 2007	5.7	6.0	4.6	4.0	n.a.
<p>Note:</p> <p>¹Cyclically-adjusted balance excluding one-off and other temporary measures. Cyclically-adjusted balances according to the programmes as recalculated by the Commission services on the basis of the information in the programmes. One-off and other temporary measures are 0.1% of GDP in 2007 and 0.1% in 2008; all deficit-increasing, according to the most recent programme and zero in the Commission services' autumn forecast.</p> <p>Source: Stability programmes (SP); Commission services' autumn 2007 economic forecasts (COM)</p>						

4.2.2. The composition of the budgetary adjustment

The budgetary consolidation envisaged over the programme's horizon is to be achieved essentially through expenditure restraint. Indeed, the expenditure-to-GDP ratio is projected to decline by 2.3 pps., which more than compensates for an expected fall in the revenue ratio of 1.7 pps. (see Table 5).

The expected decline in revenue is mainly due to the ongoing implementation of the comprehensive tax reform initiated in 2005 (see section 6 for details). In particular, the revenue from taxes on production and imports is expected to decrease by 1.5 pps. of GDP over the programme period, mainly due to the gradual phasing out of the payroll tax.

Against this background, a significant reduction in expenditure is necessary to achieve the planned consolidation. In particular, primary expenditure is projected to decrease by 2¼ pps. of GDP during the programme period. The biggest reduction is foreseen in social payments, which are planned to decrease by 0.7 pp. of GDP. This is expected to be facilitated by the continued strong economic performance, including positive labour market developments as well as policy measures such as the indexation of social transfers (excluding pensions) to consumer prices instead of wages. While significant public sector wage increases are planned for 2008 and 2010, in the context of reducing wage disparities, compensation of employees is expected to decline by 0.4 pp. by the end of the programme period thanks to a planned restrictive employment policy. Further savings of 0.3 pp. are foreseen for intermediate consumption, although little information is given on the underlying measures. Despite a planned major railway investment, expenditure on gross fixed capital formation is to be reduced by 0.3 pp. during the programme period. Nonetheless, the ratio of gross fixed capital formation is expected to remain above the euro area average.

Table 5: Composition of the budgetary adjustment

(% of GDP)	2006	2007	2008	2009	2010	Change: 2010-2007
Revenue	44.1	43.0	42.2	41.5	41.3	-1.7
<i>of which:</i>						
- Taxes on production and imports	15.2	15.2	14.6	13.9	13.7	-1.5
- Current taxes on income, wealth, etc.	9.3	9.1	9.0	9.3	9.5	0.4
- Social contributions	14.5	14.4	14.4	14.3	14.2	-0.2
- Other (residual)	5.1	4.3	4.2	4.0	3.9	-0.4
Expenditure	45.3	43.6	43.2	42.1	41.3	-2.3
<i>of which:</i>						
- Primary expenditure	43.9	42.4	42.1	41.0	40.2	-2.2
<i>of which:</i>						
Compensation of employees	11.4	11.0	10.9	10.7	10.6	-0.4
Intermediate consumption	6.4	6.3	6.3	6.1	6.0	-0.3
Social payments	17.6	17.1	17.0	16.7	16.4	-0.7
Subsidies	1.7	1.7	1.6	1.6	1.6	-0.1
Gross fixed capital formation	3.7	3.6	3.6	3.5	3.3	-0.3
Other (residual)	3.0	2.7	2.6	2.4	2.3	-0.4
- Interest expenditure	1.4	1.2	1.1	1.1	1.1	-0.1
General government balance (GGB)	-1.2	-0.6	-0.9	-0.6	0.0	0.6
Primary balance	0.2	0.7	0.2	0.6	1.1	0.4
One-off and other temporary measures	0.0	-0.1	-0.1	0.0	0.0	0.1
GGB excl. one-offs	-1.2	-0.5	-0.8	-0.6	0.0	0.5
Output gap ¹	-0.2	0.7	0.5	0.1	0.2	-0.4
Cyclically-adjusted balance ¹	-1.1	-0.9	-1.1	-0.7	-0.1	0.8
Structural balance²	-1.1	-0.8	-1.0	-0.7	-0.1	0.7
<i>Change in structural balance</i>		<i>0.3</i>	<i>-0.2</i>	<i>0.4</i>	<i>0.6</i>	
Structural primary balance ²	0.3	0.4	0.1	0.4	1.0	0.6
<i>Change in structural primary balance</i>		<i>0.1</i>	<i>-0.3</i>	<i>0.4</i>	<i>0.6</i>	
Notes:						
¹ Output gap (in % of potential GDP) and cyclically-adjusted balance as recalculated by Commission services on the basis of the information in the programme.						
² Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.						
Source:						
<i>Stability programme; Commission services' calculations</i>						

Box 3: The budget for 2008

According to the Public Finance Act, the National Assembly of Slovenia has been adopting budgets for two consecutive years on a rolling basis since 2002. The two-stage process of budget formulation is designed to provide the government with the possibility of targeting more precisely and better implement fiscal discipline. The Parliament adopted the 2008 and 2009 budgets on 28th November 2007. The general government deficit target for 2008 is projected to be 0.9% of GDP. On the revenue side, the main measures for 2008 described in the stability programme correspond to the wider context of the ongoing tax reform (2005-2010). The main expenditure-increasing measures are railway investment and one-off outlays related to EU Presidency. Reductions in expenditure are planned to be achieved through changes in the public sector employment policy as well as streamlining of indexation of social transfers. It is to be noted that measures of smaller magnitude are not included in the box.

Main measures in the budget for 2008

Revenue measures*	Expenditure measures**
<ul style="list-style-type: none"> ○ Lowering the payroll tax (-0.65% of GDP) ○ Lowering the corporate tax (-0.1% of GDP) 	<ul style="list-style-type: none"> ○ Railway investment (0.4% of GDP) ○ One-off expenditures (0.1% of GDP) ○ Restrictive employment and implementation of agreed wage policy in the public sector (up to -0.1% of GDP) ○ Streamlining of indexation of social transfers (-0.1% of GDP)

* Estimated impact on general government revenues.

** Estimated impact on general government expenditure.

Sources: Commission services and Ministry of Finance of Slovenia .

4.3. Risk assessment

This section discusses the plausibility of the programme's budgetary projections by analysing various risk factors. For the period up to 2009, Table 6 compares the detailed revenue and expenditure projections in the Commission services' autumn 2007 forecast, which are derived under a no-policy change scenario, with those in the updated programme.

As discussed in section 3, the programme's macroeconomic outlook is broadly in line with the Commission services' forecast. Even though risks from the external environment for 2008 have increased since their completion, the programme's growth projections are still considered plausible as a central scenario. In case growth should nevertheless be lower than expected in 2008 as a consequence of the current deterioration of the external environment, a potential positive base effect for budgetary developments in 2008 due to the possibility of a better-than-expected overall budgetary outturn in 2007, which is implied by the above-mentioned latest information, would likely counterbalance this. The programme does in a sensitivity analysis acknowledge the possibility of lower than projected growth of Slovenia's main trading partners in 2008. If the latter were to be 0.5 pp. lower, the programme concludes that Slovenia's GDP growth rate would be 0.3 pp. lower than in the central scenario for 2008. The analysis, however, does not specify the potential impact of this reduced growth rate on the general government nominal and structural deficits. Additional sensitivity analysis carried out by the Commission services facilitates the assessment of the associated risks. In particular, simulations of the cyclically-adjusted balance under the assumptions of (i) a sustained ½ pp. downward deviation from the real GDP growth projections in the programme over the 2007-2010 period; (ii) trend output based on the HP-filter and (iii) no policy response (notably, the expenditure level is as in the central scenario), reveal that, by 2010, the cyclically-adjusted balance is more than ½ pp. of GDP below the central scenario, while the output gap would turn negative in 2009 and 2010. Therefore, in the case of persistently lower real growth, additional measures of more than ½ pp. of GDP would be necessary to keep the public finances on the path targeted in the central scenario.

Table 6: Comparison of budgetary developments and projections

(% of GDP)	2006	2007		2008		2009		2010
	COM	COM	SP	COM	SP	COM ¹	SP	SP
Revenue	44.1	43.1	43.0	42.1	42.2	41.4	41.5	41.3
<i>of which:</i>								
- Taxes on production and imports	15.2	14.8	15.2	14.2	14.6	13.8	13.9	13.7
- Current taxes on income, wealth, etc.	9.3	9.5	9.1	9.4	9.0	9.3	9.3	9.5
- Social contributions	14.5	14.5	14.4	14.4	14.4	14.3	14.3	14.2
- Other (residual)	5.0	4.4	4.3	4.2	4.2	4.0	4.0	3.9
Expenditure	45.3	43.8	43.6	43.2	43.2	42.2	42.1	41.3
<i>of which:</i>								
- Primary expenditure	43.8	42.4	42.4	41.9	42.1	41.0	41.0	40.2
<i>of which:</i>								
Compensation of employees	11.4	11.1	11.0	11.2	10.9	11.1	10.7	10.6
Intermediate consumption	6.4	6.1	6.3	5.9	6.3	5.8	6.1	6.0
Social payments	17.6	17.1	17.1	16.9	17.0	16.8	16.7	16.4
Subsidies	1.7	1.7	1.7	1.6	1.6	1.5	1.6	1.6
Gross fixed capital formation	3.7	3.7	3.6	3.6	3.6	3.4	3.5	3.3
Other (residual)	3.0	2.8	2.7	2.7	2.6	2.5	2.4	2.3
- Interest expenditure	1.4	1.4	1.2	1.3	1.1	1.2	1.1	1.1
General government balance (GGB)	-1.2	-0.7	-0.6	-1.0	-0.9	-0.8	-0.6	0.0
Primary balance	0.2	0.7	0.7	0.3	0.2	0.4	0.6	1.1
One-off and other temporary measures	0.0	0.0	-0.1	0.0	-0.1	0.0	0.0	0.0
GGB excl. one-offs	-1.2	-0.7	-0.5	-1.0	-0.8	-0.8	-0.6	0.0
Output gap ²	-0.2	0.9	0.7	0.8	0.5	0.3	0.1	0.2
Cyclically-adjusted balance ²	-1.1	-1.1	-0.9	-1.4	-1.1	-1.0	-0.7	-0.1
Structural balance³	-1.1	-1.1	-0.8	-1.4	-1.0	-1.0	-0.7	-0.1
<i>Change in structural balance</i>		<i>0.1</i>	<i>0.3</i>	<i>-0.3</i>	<i>-0.2</i>	<i>0.4</i>	<i>0.4</i>	<i>0.6</i>
Structural primary balance ³	0.3	0.3	0.4	-0.1	0.1	0.2	0.4	1.0
<i>Change in structural primary balance</i>		<i>0.0</i>	<i>0.1</i>	<i>-0.4</i>	<i>-0.3</i>	<i>0.3</i>	<i>0.4</i>	<i>0.6</i>
Notes:								
¹ On a no-policy-change basis.								
² Output gap (in % of potential GDP) and cyclically-adjusted balance according to the programme as recalculated by Commission services on the basis of the information in the programme.								
³ Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.								
Source:								
<i>Stability programme (SP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations</i>								

As already indicated in Section 4.2.2 above, the planned adjustment relies on expenditure restraint, which implies certain risks for the budgetary projections. First of all, the planned reduction in the overall expenditure-to-GDP ratio of 2.3 pps. over the programme period is quite sizeable. While the high expected average nominal growth rate of GDP over the programme period (7.9%) should facilitate the reductions, these are large especially in the outer years (-1.1 pps. in 2009 and -0.8 pp. in 2010).

Further, while sufficient information is provided about some of the measures underlying the expenditure reduction, there are other areas where measures are not described in sufficient detail to allow an assessment. As a case in point, rather vague information is provided in the programme on measures “under implementation or considered” to reduce expenditure on intermediate consumption in 2009 and 2010.

Table 7: Assessment of tax projections

	2008			2009			2010
	SP	COM	OECD ³	SP	COM ¹	OECD ³	SP
Change in tax-to-GDP ratio (total taxes)	-0.8	-0.8	0.0	-0.5	-0.6	0.0	-0.1
Difference (SP – COM)	0.1		/	0.1		/	/
of which ² :							
- discretionary and elasticity component	-0.1		/	0.2		/	/
- composition component	0.2		/	-0.1		/	/
Difference (COM - OECD)	/	-0.8		/	-0.6		/
of which ² :							
- discretionary and elasticity component	/	-1.0		/	-0.8		/
- composition component	/	0.3		/	0.3		/
p.m.: Elasticity to GDP	0.8	0.8	1.0	0.8	0.8	1.0	1.0
Notes:							
¹ On a no-policy change basis.							
² The composition component captures the effect of differences in the composition of aggregate demand (more tax rich or more tax poor components). The discretionary and elasticity component captures the effect of discretionary fiscal policy measures as well as variations of the yield of the tax system that may result from factors such as time lags and variations of taxable income that do not necessarily move in line with GDP, e.g. capital gains. The two components may not add up to the total difference because of a residual component, which is generally small.							
³ OECD ex-ante elasticity relative to GDP.							
<u>Source:</u> Commission services' autumn 2007 economic forecasts (COM); Stability programme (SP); Commission services' calculations; OECD (N. Girouard and C. André (2005), "Measuring Cyclically-Adjusted Budget Balances for the OECD Countries", OECD Working Paper No. 434).							

In addition, the nominal growth rate of expenditure in 2007 exceeded the target set in the 2006 programme (see Table 3), also according to the programme figures, suggesting that expenditure overruns might be a risk in the future, too. It is noted, however, that the better-than-targeted budgetary outturn pointed to by more recent information is likely based on slower-than-expected expenditure growth in 2007. Also, it can be noted that in the event of a revenue short-fall exceeding a certain threshold, the government can only carry out expenditures up to a limit set by the Budget Execution Law, mitigating the identified risks.

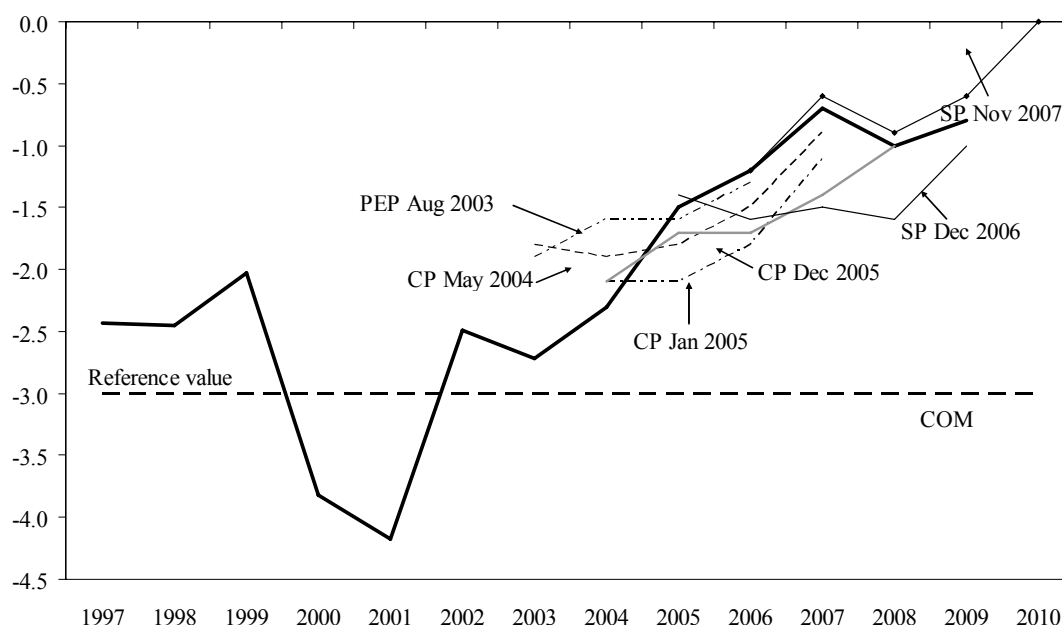
The parliamentary elections, which will be held in Slovenia on 8 October 2008, imply additional risks to the budgetary outturn, inter alia regarding the planned expenditure reductions. One of the measures possibly influenced by this event is the implementation of the planned 1% reduction of public sector employment. This measure is designed to curb expenditures on the compensation of employees. Should this employment reduction not be carried out as planned, the envisaged decrease in the compensation of employees appears difficult to achieve, also in view of the significant pay increases planned, especially for 2008 and 2010, in the framework of the above-mentioned wage equalization agreement.

While the budgetary strategy does not rely considerably on one-off measures, the programme does include two such items related to the EU Presidency (0.1% of GDP in 2007 and 2008, respectively). These expenditures are not considered as one-offs by the Commission services, implying a slightly bigger expected structural deficit in the years in question than envisaged in the programme.

The tax revenue projections of the programme embody plausible assumptions about the tax intensity of economic activity. In line with the Commission services' forecast, the latter is projected to go down by 0.8 pp. in 2008 and further decrease by about ½ pp. in

2009 (see Table 7). This development is due to discretionary measures in the framework of the above mentioned tax reform, which targets a reduction of the overall revenue-to-GDP ratio. The projections do not unduly rely on volatile revenue items.

Figure 7: Government balance projections in successive programmes (% of GDP)



Notes: PEP = pre-accession economic programme

Source: Commission services' autumn 2007 forecast (COM) and successive stability/convergence programmes

On the positive side, the track record of the budgetary projections of Slovenia has been good in the recent past (see Figure 7), since the outcomes tended to be better than projected. This good track record, which was also supported by favourable economic conditions, suggests that budgetary outcomes might be better than envisaged in the programme.

Taking into account the factors discussed in this section, the risks to the programme's budgetary strategy appear to be broadly balanced in 2008. In particular, the possibility of a positive base effect roughly counterbalances potential risks to the macroeconomic outlook. In contrast, budgetary outcomes could be slightly worse than targeted in the outer years, mainly due to risks associated with the planned expenditure reductions.

4.4. Assessment of the fiscal stance and budgetary strategy

The table below offers a summary assessment of the country's position relative to the budgetary requirements laid down in the Stability and Growth Pact. In order to highlight the role of the preceding analysis of the risks attached to the budgetary targets presented in the programme, this assessment is carried out in two stages: first, a preliminary assessment on the basis of the targets taken at face value and, second, the final assessment also taking into account risks.

Table 8: Overview of compliance with the Stability and Growth Pact

	Based on programme ³ (with the targets taken at face value)	Assessment (taking into account risks to the targets)

a. Safety margin against breaching 3% of GDP deficit limit¹	throughout programme period	throughout programme period
b. Achievement of the MTO	throughout programme period	throughout programme period (with a smaller margin than envisaged in the programme)
c. Fiscal stance in line with Pact²	Not fully in line slightly expansionary policy is planned for 2008	Not fully in line slightly expansionary policy is planned for 2008
<p>Notes: ¹The risk of breaching the 3% of GDP deficit threshold with normal cyclical fluctuations, i.e. the existence of a safety margin, is assessed by comparing the cyclically-adjusted balance with the minimum benchmark (estimated as a deficit of around 1½% of GDP for Slovenia). These benchmarks represent estimates and as such need to be interpreted with caution. ²According to the Stability and Growth Pact, countries which have already achieved their MTO should avoid pro-cyclical fiscal policies in “good times”. ³Targets in structural terms as recalculated by Commission services on the basis of the information in the programme.</p> <p>Source: <i>Commission services</i></p>		

Taking into account the risks mentioned above, the budgetary strategy as presented in the programme provides a sufficient safety margin against breaching the 3% of GDP deficit limit throughout the programme period. Moreover, the budgetary stance in the programme seems sufficient to maintain the MTO throughout the programme period. However, the margin could be smaller than planned, especially in the outer years where consolidation efforts rely on significant expenditure restraint. Slovenia’s fiscal stance in 2008 is not fully in line with the Pact. In particular, the planned reduction of the structural primary surplus by 0.3 pp. of GDP implies a pro-cyclical slightly expansionary fiscal stance in "good times" (see box in Section 3). In contrast, the fiscal stance planned for 2009 and 2010 is in line with the Pact.

5. GOVERNMENT DEBT AND LONG-TERM SUSTAINABILITY

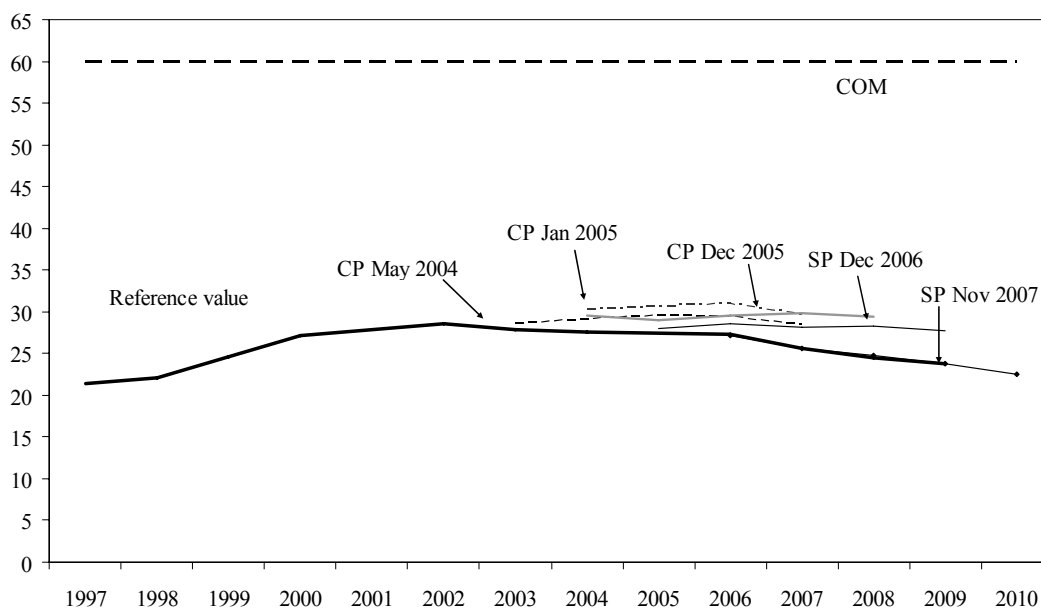
This section is in two parts. A first part describes recent debt developments and medium-term prospects, including risks to the outlook presented in the programme. A second part takes a longer-term perspective with the aim of assessing the long-term sustainability of public finances.

5.1. Recent debt developments and medium-term prospects

5.1.1. Debt projections in the programme

The government debt-to-GDP ratio of Slovenia is very low compared to the euro area average. It reached a peak of 28.5% in 2002 and has gradually declined since. The 2007 programme and the autumn forecast both foresee a 2007 outcome of 25.6% of GDP, implying a decrease of 1.5 pps. relative to 2006, as opposed to a 0.3 pp reduction projected in the 2006 programme. The 2007 programme projects a steeper decline of the debt ratio over the programme period than the 2006 programme, with debt expected to reach 22.5% of GDP in 2010.

Figure 8: Debt projections in successive programmes (% of GDP)



Source: Commission services' autumn 2007 forecast (COM) and successive stability/convergence programmes

As in the case of the budgetary projections, the track record of the debt projections of Slovenia has been good in the successive programmes, as the outcomes have been better than projected (see Figure 9). This good track record has been supported by favourable economic conditions.

The programme also stresses the use of part of privatization receipts, also utilising cash balances previously accumulated, for debt repayment in 2008 amounting to around ½% of GDP. The slightly debt-increasing stock-flow adjustments presented in the programme, however, suggests that further accumulation of assets should offset this positive effect on the debt level.

5.1.2. Assessment

The autumn forecast projects a decline in the debt ratio between 2007 and 2009 very similar to the one indicated in the programme. Taking into account latest information on government accounts, the 2007 government deficit can end up sensibly lower than the programme's projection of 0.6% of GDP (see Section 4.3). Therefore, a possible better base effect into 2008 could counterbalance the potential negative effects of expenditure overruns or lower-than-expected GDP growth in 2008.

Table 9: Debt dynamics

(% of GDP)	average 2002-05	2006	2007		2008		2009		2010
			COM	SP	COM	SP	COM	SP	SP
Gross debt ratio¹	27.9	27.1	25.6	25.6	24.5	24.7	23.8	23.8	22.5
Change in the ratio	-0.1	-0.3	-1.5	-1.5	-1.1	-0.9	-0.8	-0.9	-1.3
<i>Contributions²:</i>									
Primary balance	0.3	-0.2	-0.7	-0.7	-0.3	-0.2	-0.4	-0.6	-1.1
“Snow-ball” effect	-0.3	-0.5	-0.8	-0.9	-0.8	-0.8	-0.3	-0.4	-0.5
<i>Of which:</i>									
Interest expenditure	1.9	1.4	1.4	1.3	1.3	1.1	1.2	1.2	1.1
Growth effect	-1.0	-1.5	-1.5	-1.4	-1.1	-1.1	-0.9	-0.9	-1.0
Inflation effect	-1.2	-0.5	-0.7	-0.8	-1.0	-0.9	-0.7	-0.6	-0.6
Stock-flow adjustment	-0.1	0.5	0.1	0.2	0.0	0.2	0.0	0.1	0.3
<i>Of which:</i>									
Cash/accruals diff.	0.5	0.3		n.a.		n.a.		n.a.	n.a.
Acc. financial assets	-0.8	0.1		n.a.		n.a.		n.a.	n.a.
<i>Privatisation</i>	<i>-1.6</i>	<i>-1.5</i>		<i>n.a.</i>		<i>n.a.</i>		<i>n.a.</i>	<i>n.a.</i>
Val. effect & residual	0.3	0.0		n.a.		n.a.		n.a.	n.a.

Notes:

¹End of period.

²The change in the gross debt ratio can be decomposed as follows:

$$\frac{D_t}{Y_t} - \frac{D_{t-1}}{Y_{t-1}} = \frac{PD_t}{Y_t} + \left(\frac{D_{t-1}}{Y_{t-1}} * \frac{i_t - y_t}{1 + y_t} \right) + \frac{SF_t}{Y_t}$$

where t is a time subscript; D , PD , Y and SF are the stock of government debt, the primary deficit, nominal GDP and the stock-flow adjustment respectively, and i and y represent the average cost of debt and nominal GDP growth (in the table, the latter is decomposed into the growth effect, capturing real GDP growth, and the inflation effect, measured by the GDP deflator). The term in parentheses represents the "snow-ball" effect. The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Stability programme (SP); Commission services' autumn 2007 economic forecasts (COM); Commission services' calculations

5.2. Long-term debt projections and the sustainability of public finances

This section analyses in detail the long-term sustainability of public finances which has already been briefly discussed in section 2. It uses long-term projections of age-related expenditures to calculate sustainability gap indicators and make long-term government debt projections so as to assess the sustainability challenge the country concerned is facing.

5.2.1. Sustainability indicators and long-term debt projections

Table 10 shows the evolution of government spending on pensions, healthcare, long-term care for the elderly, education and unemployment benefits according to the EPC's projections and property income received by general government according to an agreed methodology.²⁵ Non age-related primary expenditure and primary revenue is assumed to remain constant as a share of GDP.

Table 10: Long-term age-related expenditure: main projections

(% of GDP)	2004	2010	2020	2030	2040	2050	Change
------------	------	------	------	------	------	------	--------

²⁵ See the accompanying "methodological paper" for a description of the property income projections.

							up to 50
Total age-related spending	24.2	24.0	25.5	28.6	31.7	33.8	9.7
- Pensions	11.0	11.1	12.3	14.4	16.8	18.3	7.3
- Healthcare	6.4	6.7	7.2	7.6	7.9	8.0	1.6
- Long-term care	0.9	1.1	1.3	1.5	1.9	2.2	1.2
- Education	5.3	4.6	4.3	4.7	4.7	4.9	-0.4
- Unemployment benefits	0.5	0.4	0.4	0.4	0.4	0.4	-0.1
Property income received	0.8	0.6	0.6	0.5	0.5	0.4	-0.2

Source: Economic Policy Committee and Commission services.

The projected increase in age-related spending in Slovenia is considerably above the average of the EU; rising by 9.7% of GDP between 2004 and 2050. The bulk of this increase is due to the high expected increase in expenditure on pensions, projected to rise in Slovenia by 7.3% of GDP. The increase in health-care expenditure is projected to be 1.6% of GDP, which is also the EU average. For long-term care, the projected increase of 1.2% of GDP up to 2050, is above the average in the EU.

Table 11: Sustainability indicators and the required primary balance

Value	2007 scenario			Programme scenario		
	S1	S2	RPB	S1	S2	RPB
of which:	3.5	7.0	7.3	3.0	6.5	7.3
Initial budgetary position (IBP)	-0.2	0.0	-	-0.7	-0.5	-
Debt requirement in 2050 (DR)	-0.7	-	-	-0.7	-	-
Long-term change in the primary balance (LTC)	4.4	7.1	-	4.4	7.1	-

Source: Commission services.

Based on the long-term budgetary projections, sustainability indicators can be calculated. Table 11 shows the sustainability indicators for the two scenarios; the 2007 scenario assumes that the structural primary balance in 2007 is unchanged for the rest of the programme period and the programme scenario assumes that the programme's budgetary plans are fully attained.

In the "2007 scenario", the sustainability gap (S2) which satisfies the intertemporal budget constraint would be 7% of GDP,²⁶ which is the same as the one calculated in the "2006 scenario" in the assessment of the previous update of the stability programme.

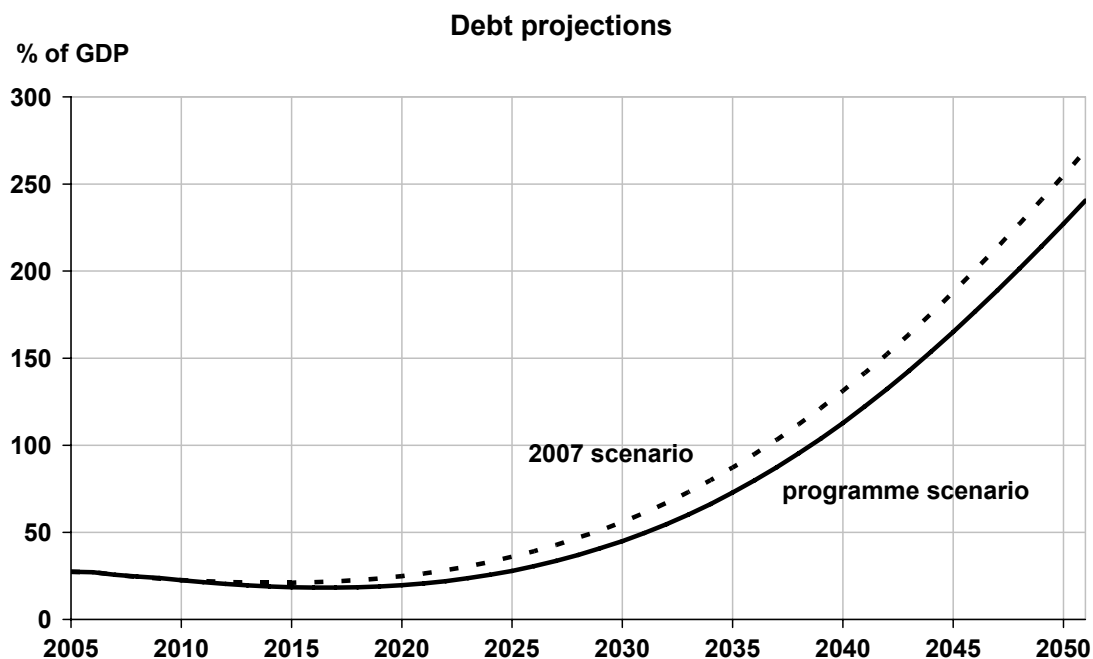
The initial budgetary position is just sufficient to stabilize the debt ratio over the long-term. According to both sustainability gaps, the long-term budgetary impact of ageing is high. The programme plans a structural primary budgetary consolidation of ½% of GDP between 2007 and 2010. If achieved, such a consolidation would reduce the S2 sustainability gap ("programme scenario"). The difference between the initial budgetary position in the '2007 scenario' and the 'programme scenario' illustrates how the full respect of the stability programme targets, would contribute to tackling the budgetary challenges raised by the demographic developments.

The required primary balance (RPB) is over 7% of GDP, higher than the structural primary balance of about 1% of GDP in the last year of the programme's period.

The sustainability gap indicators would increase by up to ½% of GDP if the planned budgetary adjustment was to be postponed by 5 years, highlighting that budgetary savings can be made if action is taken sooner rather than later.

²⁶ The sustainability gap (S1) that assures reaching the debt ratio of 60% of GDP by 2050 would be 3.5% of GDP.

Figure 9: Long-term projections for the government debt ratio



Source: Commission services

Another way to look at the prospects for long-term public finance sustainability is to project the debt-to-GDP ratio over the long-term using the same assumptions as for the calculations of the sustainability indicators. The long-term projections for government debt under the two scenarios are shown in Figure 9. The gross debt ratio is currently below the 60% of GDP reference value, estimated in the programme at 25.6% of GDP in 2007. According to the “2007 scenario”, the debt ratio is projected to decrease slightly, up to the mid-2010s and increase thereafter, exceeding 60% of GDP just after 2030 and attaining 270% of GDP by 2050. The debt path in the “programme scenario” is slightly less steep, thanks to the stronger budgetary position in 2010, attaining 240% of GDP by 2050.²⁷

5.2.2. Additional factors

To reach an overall assessment of the sustainability of public finances, other relevant factors are taken into account, which in addition allow to better appreciate where the main risks to sustainability are likely to stem from.

The programme presents a baseline scenario, which is an update on the Ageing Report by using recent budgetary information including plans until 2009, but otherwise supposedly based on the assumptions made in the Ageing Report. The programme’s baseline scenario projects mainly a less steep increase in the pension expenditure ratio until 2050 (by 6.1 pps. from a lower level in 2006) and on long-term care (by 0.9 pps.) compared with the Ageing Report. However, the Slovenian authorities project a higher increase in the health care expenditure ratio over the long-term compared with the EPC reference scenario, by about 2.7 pps.. Also due to the upward revision in GDP, the age-related

²⁷ It should be recalled, however, that being a mechanical, partial-equilibrium analysis, the long-term debt projections are bound to show highly accentuated profiles. As a consequence, the projected evolution of debt levels should not be seen as a forecast similar to the Commission services’ short-term forecasts, but as an indication of the risks faced by Member States.

expenditure ratio was lower in 2006 than projected in the Ageing Report. Still, the overall increase in the age-related expenditure as a share of GDP until 2050 in the programme is close to that of the Ageing Report (9.4 pps. in the programme against 9.7 points in the Ageing Report over the period 2006-2050) and would therefore not significantly change the sustainability outlook.

The programme further provides an alternative scenarios compared with the programme's baseline scenario, which updates demographic developments. Fertility rates in 2004-2006 turned out higher than projected in the Ageing Report. Assuming that the fertility rate would converge to that underlying the Ageing Report, the increase in age-related expenditure would become less steep by 0.4 pps. until 2050.

Further scenarios relate to policy changes.²⁸ They illustrate that additional reform measures are necessary in order to address the projected budgetary burden from ageing. However, no new measures have been implemented so far.

5.2.3. *Assessment*

Slovenia appears to be at high risk with regard to the sustainability of public finances.

The budgetary position in 2007 as estimated in the programme remained roughly unchanged compared with 2006 and is just sufficient to stabilize the debt ratio over the long-term before the long-term budgetary impact of an ageing population is considered.

However, the long-term budgetary impact of ageing is well above the EU average, with pension expenditure showing a stronger increase than on average in the EU. High primary surpluses over the medium term and further measures aimed at curbing the substantial increase in age-related expenditures would contribute to reducing risks to the sustainability of public finances.

6. STRUCTURAL REFORM, THE QUALITY OF PUBLIC FINANCES AND INSTITUTIONAL FEATURES

The analysis carried out in section 2 of this technical assessment emphasised the need for further fiscal consolidation and in this context also drew attention to possible improvements in the quality of public finances, in particular regarding the flexibility and efficiency of public expenditure. The stability programme also recognises the importance of continued fiscal consolidation and of progress with regard to the quality of public finances with a view to preserving macroeconomic stability and enhancing potential growth. Principal reform measures in this area are discussed in the programme.

On the revenue side, the comprehensive tax reform initiated in 2005 continues to be a key project. According to the stability programme, it is projected to reduce the share of tax revenue in GDP by 2 pps. in the 2006-2009 period. Positive effects on the utilisation of labour as well as on the economy's competitiveness are expected to result from this. The stability programme gives account of the main measures that are gradually being phased in until 2010. In particular, the progressive payroll tax paid by employers is

²⁸ One scenario assumes higher participation rates arising from changes in labour market policy. Such policies would align the participation rates in Slovenia to those in the most advanced EU Member States by 2050. The increase in age-related expenditure would be reduced to 6.9% of GDP over the projection period. Alternatively, an increase in the retirement age by one year would reduce the increase in age-related expenditure until 2050 by one pp. compared with the programme baseline. Limiting pension increases to 80% of wage increases would reduce the increase in age-related expenditure by 2.9 pps. compared with the baseline.

gradually being phased out and will be abolished in 2009. This is projected to be reflected in a reduction in the share of taxes on production and imports in GDP from 15.2% in 2006 to 13.7% in 2010.

At the same time, the corporate income tax rate was reduced by 2 pps. in 2007 and will be gradually reduced by a further 3 pps. to reach 20% in 2010. The taxable base was broadened while maintaining a tax relief for investment in R&D with a view to fostering competitiveness and growth. For personal income, a dual system taxing capital income at a single rate while taxing labour income progressively had been introduced in 2005. In 2007, the number of income brackets was reduced from 5 to 3, reducing the degree of progression. The reduction in the tax burden on labour brought about by the tax reform is expected to entail higher incentives for labour supply.

The measures already envisaged by the 2005 tax reform were complemented by seven tax laws implemented in 2007 regarding VAT, real estate taxes, inheritance taxation, taxes on vessels as well as corporate income taxation and tax procedures, where the latter two laws aimed at abolishing double taxation of income and enhancing the transparency of the tax system.

On the expenditure side, changes regarding the system of social transfers complemented the above-mentioned measures reducing the tax burden on labour intended to enhance its utilisation. In particular, eligibility for unemployment benefits and social assistance was linked more closely to the readiness to accept offered employment, while all social transfers except pensions are now indexed to consumer price inflation instead of wages. The change in the indexation scheme is expected to entail savings amounting to 0.1% of GDP annually.

Other measures which are expected to improve the quality of public expenditure include a planned reduction in intermediate consumption by 0.4% of GDP until the end of the programme period. However, only a very rough outline of the measures underlying this rationalisation is given. At the same time, while its share in GDP follows the projected decline of the overall expenditure share, the relative importance of public spending on potentially growth enhancing areas such as education is projected to increase, as is expenditure on active labour market policies. Funding infrastructure projects, in particular railway investments, is also a priority according to the stability programme. However, public expenditure on gross fixed capital formation is projected to decrease slightly both as a share in GDP and as a percentage of total expenditure.

As already highlighted in sections 2 and 5, further measures strengthening the pension reform, which would improve the public finance position with a view to its long-term sustainability, are not envisaged in the programme. Also, the issue of budget rigidity is not tackled specifically. In fact, the share of public expenditure on rigid items as defined in section 2 must according to the programme's projections be expected to increase from 66.3% in 2007 to 67.3% in 2010.

Regarding institutional features, the simultaneous adoption of budgets for two consecutive years on a rolling basis is maintained. With a view to improving the quality of public finances, the gradual introduction of performance-based budgeting is planned but the programme does not specify a time horizon for this.

7. CONSISTENCY WITH THE NATIONAL REFORM PROGRAMME AND WITH THE BROAD ECONOMIC POLICY GUIDELINES

The main policy measures described in the Stability programme are in line with Slovenia's 2005 National Reform Programme and the corresponding 2007

implementation report. In particular, the Stability programme contains a section summarising past and ongoing structural reform efforts which are relevant for reaching Slovenia's Lisbon targets. Both the programme and the implementation report put emphasis on the comprehensive tax reform described in section 6 as one of the central reform measures. The changes in the system of social transfers are also considered in both documents. In the context of development oriented restructuring of public expenditure, infrastructure investment, especially in the railway system, as well as R&D and education are considered key.

While mentioning that the pace of fiscal consolidation reflects the financing of major infrastructure projects (railways) and the loss of tax revenue resulting from the tax reform, the Stability programme does not include a more detailed qualitative assessment of the overall impact of the National Reform Programme within the medium term fiscal strategy. However, information on the direct budgetary costs (or savings) associated with some of the main reforms envisaged is given and has been taken into account in budgetary projections, including the tax reform and railway investments. In contrast, information on the budgetary consequences of reforms in other areas such as active labour market policies and education is scarce. Overall, the stability programme and the 2007 Implementation report seem to be consistent.

Box 5: The Commission assessment of the October 2007 implementation report of the national reform programme

On 11 December 2007, the Commission adopted its Strategic Report on the renewed Lisbon strategy for growth and jobs, which includes an assessment of the October 2007 implementation report of Slovenia's national reform programme. This can be summarised as follows.

Slovenia's national reform programme identifies as key challenges/priorities a competitive economy and faster economic growth; a knowledge-based society; an efficient state; a modern social state and higher employment; and sustainable development.

The Commission's assessment is that Slovenia has made good progress in implementing its national reform programme over the 2005-2007 period.

Against the background of strengths and weaknesses identified and the evidence on progress made, the Commission recommended that Slovenia is recommended to give highest priority to the challenges in the areas of: pension reform and active ageing, with a view to long-term sustainability; flexible contractual arrangements and effectiveness of employment services, within a flexicurity approach.

In addition, Slovenia should also focus on the areas of: research and innovation strategy; competition in the services sector; implementation of energy efficiency measures; and implementation of plans to strengthen the link between the education system and the labour market.

The tables below provide an overview of whether the strategy and policy measures in the stability programme are consistent with the broad economic policy guidelines in the area of public finances issued in the context of the Lisbon strategy for growth and jobs.

Table 12 makes the assessment against the integrated guidelines for the period 2005-2008, adopted by the Council in July 2005. Table 13 makes the assessment against the country-specific recommendations / points to watch and the recommendations for the euro area, adopted by the Council in March 2007.

The budgetary strategy in the stability programme is partly consistent with the country-specific recommendations / points to watch and the recommendations for the euro area. In particular, the stability programme does not include significant further measures to strengthen the reform of the pension system with a view to long-term sustainability.

Table 12: Consistency with the broad economic policy guidelines (integrated guidelines)

Broad economic policy guidelines (integrated guidelines)	Yes	Steps in right direction	No	Not applicable
1. To secure economic stability				
– Member States should respect their medium-term budgetary objectives. As long as this objective has not yet been achieved, they should take all the necessary corrective measures to achieve it ¹ .	X			
– Member States should avoid pro-cyclical fiscal policies ² .		X (risk that it may not be in 2008)		
– Member States in excessive deficit should take effective action in order to ensure a prompt correction of excessive deficits ³ .				X
– Member States posting current account deficits that risk being unsustainable should work towards (...), where appropriate, contributing to their correction via fiscal policies.				X
2. To safeguard economic and fiscal sustainability				
In view of the projected costs of ageing populations,				
– Member States should undertake a satisfactory pace of government debt reduction to strengthen public finances.				X
– Member States should reform and re-enforce pension, social insurance and health care systems to ensure that they are financially viable, socially adequate and accessible (...)		X		
3. To promote a growth- and employment-orientated and efficient allocation of resources				
Member States should, without prejudice to guidelines on economic stability and sustainability, re-direct the composition of public expenditure towards growth-enhancing categories in line with the Lisbon strategy, adapt tax structures to strengthen growth potential, ensure that mechanisms are in place to assess the relationship between public spending and the achievement of policy objectives and ensure the overall coherence of reform packages.		X		
Notes:				
¹ As further specified in the Stability and Growth Pact and the code of conduct, i.e. with an annual 0.5% of GDP minimum adjustment in structural terms for euro area and ERM II Member States.				
² As further specified in the Stability and Growth Pact and the code of conduct, i.e. Member States that have already achieved the medium-term objective should avoid pro-cyclical fiscal policies in “good times”.				
³ As further specified in the country-specific Council recommendations and decisions under the excessive deficit procedure.				
<i>Source:</i> Commission services				

Table 13: Consistency with the broad economic policy guidelines (country-specific recommendations and points to watch)

Broad economic policy guidelines (country-specific recommendations and points to watch)	Yes	Steps in right direction	No	Not applicable
1. Country-specific recommendations				
– Take further steps to strengthen the reform of the pension system and promote active ageing, with a view to increasing the employment rate of older workers and improving long-term sustainability.		X		
2. Points to watch				
– none.				X
3. Recommendations for euro area Member States				
– Make use of the favourable cyclical conditions to aim at or pursue ambitious budgetary consolidation towards their medium-term objectives in line with the Stability and Growth Pact, hence striving to achieve an annual structural adjustment of at least 0.5% of GDP as a benchmark				X
– Improve the quality of public finances by reviewing public expenditure and taxation, with the intention to enhance productivity and innovation, thereby contributing to economic growth and fiscal sustainability		X		
<i>Source:</i> <i>Commission services</i>				

Annex 1: Compliance with the code of conduct

This annex provides an assessment of whether the programme respects the requirements of Section II of the code of conduct (guidelines on the format and content), notably as far as (i) the model structure (Annex 1 of the code of conduct); (ii) the formal data provisions (Annex 2 of the code of conduct); and (iii) other information requirements is concerned.

(i) Model structure

The stability programme's table of content follows the model structure as described in Annex 1 of the code of conduct.

(ii) Data requirements

Not all the compulsory and optional data specified in Annex 2 of the code of as amended by the September 2007 EFC are provided in the programme.

Regarding compulsory data, in Table 8, the series "Short-term interest rate (annual average)", "Long-term interest rate (annual average)", "World excluding EU, GDP growth", "World import volumes, excluding EU" are missing, while the programme mentions that the level of interest rates equals that from the common external assumptions. Table 7 includes different headings than specified in the code of conduct. Further, there were some problems with data consistency which have, however, been resolved by the Ministry of Finance. In particular, Table 2 (Item 11) and Table 5 (Item 4) featured opposite signs for the variable "One-off and other temporary measures" and in Table 1c, the "compensation of employees (per head, % change)" data are provided in nominal terms in the Slovene version, while they are reported in real terms in the English version of the programme.

Regarding gaps in optional data, the series "Employment, hours worked" and "Labour productivity, hours worked" are missing in Table 1c. In Table 1d, the series "Net lending/borrowing of the private sector" and "Net lending/borrowing vis-à-vis the rest of the world of which: - Capital account" have not been provided. In Table 2, the information on nominal government consumption is missing. In Table 4, the different subcategories regarding the "stock-flow adjustment" of general government debt developments are not provided. The data series on "Liquid financial assets" and on "Net financial debt" are missing, too. In the table regarding the long-term sustainability of public finances (Table 7), the data on four subcategories of total expenditure is not provided ("Age-related expenditures", "Social security pension", "Occupational pensions (if in general government)", "Other age-related expenditures"). Regarding total revenue, the series on "property income" and "pension fund reserve assets" as well as the respective subcategories are not provided.

Several of the missing optional data series had also not been provided with the 2006 stability programme.

The tables on the following pages show the data presented in the November 2007 update of stability programme, following the structure of the tables in Annex 2 of the code of conduct. Compulsory data are in bold, missing data are indicated with grey-shading.

(iii) Other information requirements

The table below provides a summary assessment of the adherence to the other information requirements in the code of conduct.

The SCP...	Yes	No	Comments
<i>a. Involvement of parliament</i>			
... mentions status vis-à-vis national parliament.	X		
... indicates whether Council opinion on previous programme has been presented to national parliament.	X		
<i>b. Economic outlook</i>			
... (for euro area and ERM II Member States) uses “common external assumptions” on main extra-EU variables.	X		oil prices / dollar-euro exchange rate somewhat lower due to the earlier cut-off date
... explains significant divergences with Commission services’ forecasts ¹ .	X		
... bears out possible upside/downside risks to economic outlook.	X		Not in economic outlook but, to some extent, in section on sensitivity analysis
... analyses outlook for sectoral balances and, especially for countries with high external deficit, external balance.	X		Current account only
<i>c. Monetary/exchange rate policy</i>			
... (CP only) presents medium-term monetary policy objectives and their relationship to price and exchange rate stability.			Not applicable
<i>d. Budgetary strategy</i>			
... presents budgetary targets for general government balance in relation to MTO and projected path for debt ratio.	X		
... (in case new government has taken office) shows continuity with respect to budgetary targets endorsed by Council.			Not applicable
... (when applicable) explains reasons for deviations from previous targets and, in case of substantial deviations, whether measures are taken to rectify situation (+ provides information on them).	X		
... backs budgetary targets by indication of broad measures necessary to achieve them and analyses their quantitative effects on balance.	X		
... specifies state of implementation of measures.	X		
<i>e. “Major structural reforms”</i>			
... (if MTO not yet reached or temporary deviation is planned from MTO) includes comprehensive information on economic and budgetary effects of possible ‘major structural reforms’ over time.			Not applicable
... includes quantitative cost-benefit analysis of short-term costs and long-term benefits of reforms.			Not applicable
<i>f. Sensitivity analysis</i>			
... includes comprehensive sensitivity analyses and/or develops alternative scenarios showing impact on balance and debt of:			
a) changes in main economic assumptions	X		Effects via revenue side only Effect on debt level only Not applicable
b) different interest rate assumptions	X		
c) (for CP only) different exchange rate assumptions		X	
d) if common external assumptions are not used, changes in assumptions for main extra-EU variables.		X	
... (in case of “major structural reforms”) analyses how changes in assumptions would affect budget and potential growth.			Not applicable
<i>g. Broad economic policy guidelines</i>			
... provides information on consistency with broad economic policy guidelines of budgetary objectives and measures to achieve them.	X		
<i>h. Quality of public finances</i>			
... describes measures to improve quality of public finances, both revenue and expenditure sides.	X		
<i>i. Long-term sustainability</i>			
... outlines strategies to ensure sustainability.	X		

The SCP...	Yes	No	Comments
... includes common budgetary projections by the AWG-EPC and all necessary additional information (esp. new relevant information).	X		
<i>j. Other information (optional)</i>			
... includes information on implementation of existing national budgetary rules and on other institutional features of public finances.	X		
<p>Notes: SCP = stability/convergence programme; CP = convergence programme ¹To the extent possible, bearing in mind the typically short time period between the publication of the Commission services' autumn forecast and the submission of the programme.</p> <p><u>Source:</u> <i>Commission services</i></p>			

Table 1a. Macroeconomic prospects

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Real GDP	B1*g	<i>n.a.</i>	5.7	5.8	4.6	4.1	4.5
2. Nominal GDP	B1*g	7296627	7.8	9.0	8.4	7.0	7.4
Components of real GDP							
3. Private consumption expenditure	P.3	3896317	4.0	4.2	4.0	3.4	4.0
4. Government consumption expenditure	P.3	1403543	4.4	2.6	3.2	2.6	2.5
5. Gross fixed capital formation	P.51	1907462	8.4	14.5	6.2	2.6	4.8
6. Changes in inventories and net acquisition of valuables (% of GDP)	P.52 + P.53	<i>n.a.</i>	2.2	2.0	2.0	2.0	1.9
7. Exports of goods and services	P.6	4916115	12.3	13.4	10.3	9.7	8.8
8. Imports of goods and services	P.7	4988328	12.2	14.2	10.1	8.2	8.0
Contributions to real GDP growth							
9. Final domestic demand		-	5.1	6.6	4.5	3.1	3.8
10. Changes in inventories and net acquisition of valuables	P.52 + P.53	-	0.6	-0.1	0.1	0.1	0.1
11. External balance of goods and services	B.11	-	0.0	-0.7	0.0	0.9	0.6

Table 1b. Price developments

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. GDP deflator		<i>n.a.</i>	2.0	3.0	3.6	2.9	2.7
2. Private consumption deflator		<i>n.a.</i>	2.5	3.4	3.5	2.8	2.6
3. HICP ¹		<i>n.a.</i>	2.5	3.4	3.5	2.8	2.6
4. Public consumption deflator		<i>n.a.</i>	2.5	3.7	5.8	4.0	4.8
5. Investment deflator		<i>n.a.</i>	2.0	2.4	2.0	1.9	1.9
6. Export price deflator (goods and services)		<i>n.a.</i>	2.7	3.3	2.8	2.2	2.0
7. Import price deflator (goods and services)		<i>n.a.</i>	3.3	3.6	2.6	2.1	2.0

¹ Optional for stability programmes.

Table 1c. Labour market developments

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	rate of change	rate of change	rate of change	rate of change	rate of change
1. Employment, persons¹		934.5	1.2	2.3	0.9	0.6	0.9
2. Employment, hours worked ²		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
3. Unemployment rate (%)³		61	6.0	5.0	4.9	4.8	4.6
4. Labour productivity, persons⁴		32.6	4.5	3.4	3.7	3.5	3.6
5. Labour productivity, hours worked ⁵		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
6. Compensation of employees⁶	D.1	n.a.	4.4	5.3	4.6	3.4	4.4
7. Compensation per employee		n.a.	5.5	5.9	7.3	5.6	6.1

¹Occupied population, domestic concept national accounts definition.

²National accounts definition.

³Harmonised definition, Eurostat; levels.

⁴Real GDP per person employed.

⁵Real GDP per hour worked.

⁶ In real terms.

Table 1d. Sectoral balances

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Net lending/borrowing vis-à-vis the rest of the world	B.9	-2.8	-3.5	-3.1	-2.0	-1.6
<i>of which:</i>						
- Balance on goods and services		-1.0	-1.7	-1.6	-0.5	0.0
- Balance of primary incomes and transfers		-1.8	-1.8	-1.5	-1.5	-1.5
- Capital account		0.1	n.a.	n.a.	n.a.	n.a.
2. Net lending/borrowing of the private sector	B.9	n.a.	n.a.	n.a.	n.a.	n.a.
3. Net lending/borrowing of general government	EDP B.9	-1.2	-0.6	-0.9	-0.6	0.0
4. Statistical discrepancy		n.a.	optional	optional	optional	optional

Table 2. General government budgetary prospects

	ESA Code	2006	2006	2007	2008	2009	2010
		Level	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Net lending (EDP B.9) by sub-sector							
1. General government	S.13	-366.2	-1.2	-0.6	-0.9	-0.6	0.0
2. Central government	S.1311	-365.8	-1.2	-0.7	-0.9	-0.5	0.0
3. State government	S.1312	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>
4. Local government	S.1313	-25.4	-0.1	0.0	0.0	0.0	0.0
5. Social security funds	S.1314	25	0.1	0.1	0.0	0.0	0.0
General government (S13)							
6. Total revenue	TR	13413.4	44.1	43.0	42.2	41.5	41.3
7. Total expenditure	TE ¹	13779.6	45.3	43.6	43.2	42.1	41.3
8. Net lending/borrowing	EDP B.9	-366.2	-1.2	-0.6	-0.9	-0.6	0.0
9. Interest expenditure	EDP D.41	432.6	1.4	1.2	1.1	1.1	1.1
10. Primary balance ²		66.4	0.2	0.7	0.2	0.6	1.1
11. One-off and other temporary measures ³		<i>n.a.</i>	0.0	-0.1	-0.1	0.0	0.0
Selected components of revenue							
12. Total taxes (12=12a+12b+12c)		7476.4	24.6	24.3	23.6	23.2	23.2
12a. Taxes on production and imports	D.2	4634.8	15.2	15.2	14.6	13.9	13.7
12b. Current taxes on income, wealth, etc	D.5	2835.9	9.3	9.1	9.0	9.3	9.5
12c. Capital taxes	D.91	5.7	0.0	0.0	0.0	0.0	0.0
13. Social contributions	D.61	4417	14.5	14.4	14.4	14.3	14.2
14. Property income	D.4	193.3	0.6	0.6	0.7	0.6	0.6
15. Other ⁴		1326.6	4.4	3.7	3.6	3.4	3.3
16=6. Total revenue	TR	13413.4	44.1	43.0	42.2	41.5	41.3
p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995) ⁵			39.1	38.6	38.0	37.5	37.4
Selected components of expenditure							
17. Compensation of employees + intermediate consumption	D.1+P.2	5426.3	17.8	17.2	17.2	16.8	16.6
17a. Compensation of employees	D.1	3479.9	11.4	11.0	10.9	10.7	10.6
17b. Intermediate consumption	P.2	1946.4	6.4	6.3	6.3	6.1	6.0
18. Social payments (18=18a+18b)		5363.3	17.6	17.1	17.0	16.7	16.4
18a. Social transfers in kind supplied via market producers	D.6311, D.63121, D.63131	634.5	2.1	2.1	2.1	2.0	1.9
18b. Social transfers other than in kind	D.62	4728.8	15.5	15.0	14.9	14.7	14.5
19=9. Interest expenditure	EDP D.41	432.6	1.4	1.2	1.1	1.1	1.1
20. Subsidies	D.3	517.6	1.7	1.7	1.6	1.6	1.6
21. Gross fixed capital formation	P.51	1114.5	3.7	3.6	3.6	3.5	3.3
22. Other ⁶		925.3	3.0	2.7	2.6	2.4	2.3
23=7. Total expenditure	TE ¹	13779.6	45.3	43.6	43.2	42.1	41.3
p.m.: Government consumption (nominal)	P.3	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>

¹Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

²The primary balance is calculated as (EDP B.9, item 8) plus (EDP D.41, item 9).

³A plus sign means deficit-reducing one-off measures.

⁴P.11+P.12+P.131+D.39+D.7+D.9 (other than D.91).

⁵Including those collected by the EU and including an adjustment for uncollected taxes and social contributions (D.995), if appropriate.

⁶D.29+D4 (other than D.41)+ D.5+D.7+D.9+P.52+P.53+K.2+D.8.

Table 3. General government expenditure by function

% of GDP	COFOG Code	2005	2010
1. General public services	1	6.5	5.6
2. Defence	2	1.3	1.5
3. Public order and safety	3	1.7	1.4
4. Economic affairs	4	4.3	3.6
5. Environmental protection	5	0.5	0.4
6. Housing and community amenities	6	0.3	0.2
7. Health	7	6.4	5.7
8. Recreation, culture and religion	8	1.1	1.0
9. Education	9	6.4	6.3
10. Social protection	10	17.4	15.5
11. Total expenditure (=item 7=23 in Table 2)	TE ¹	46.0	41.3

¹Adjusted for the net flow of swap-related flows, so that TR-TE=EDP B.9.

Table 4. General government debt developments

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Gross debt¹		27.1	25.6	24.7	23.8	22.5
2. Change in gross debt ratio		-0.3	-1.5	-0.8	-0.9	-1.4
Contributions to changes in gross debt						
3. Primary balance²		0.2	0.7	0.2	0.6	1.1
4. Interest expenditure³	EDP D.41	1.4	1.2	1.1	1.1	1.1
5. Stock-flow adjustment		0.5	0.2	0.2	0.2	0.3
<i>of which:</i>						
- Differences between cash and accruals ⁴		n.a.	n.a.	n.a.	n.a.	n.a.
- Net accumulation of financial assets ⁵		n.a.	n.a.	n.a.	n.a.	n.a.
<i>of which:</i>						
- <i>privatisation proceeds</i>		n.a.	n.a.	n.a.	n.a.	n.a.
- Valuation effects and other ⁶		n.a.	n.a.	n.a.	n.a.	n.a.
p.m.: Implicit interest rate on debt⁷		5.6	5.0	4.6	4.9	4.9
Other relevant variables						
6. Liquid financial assets ⁸		n.a.	n.a.	n.a.	n.a.	n.a.
7. Net financial debt (7=1-6)		n.a.	n.a.	n.a.	n.a.	n.a.

¹As defined in Regulation 3605/93 (not an ESA concept).

²Cf. item 10 in Table 2.

³Cf. item 9 in Table 2.

⁴The differences concerning interest expenditure, other expenditure and revenue could be distinguished when relevant.

⁵Liquid assets, assets on third countries, government controlled enterprises and the difference between quoted and non-quoted assets could be distinguished when relevant.

⁶Changes due to exchange rate movements, and operation in secondary market could be distinguished when relevant.

⁷Proxied by interest expenditure divided by the debt level of the previous year.

⁸AF1, AF2, AF3 (consolidated at market value), AF5 (if quoted in stock exchange; including mutual fund shares).

Table 5. Cyclical developments

% of GDP	ESA Code	2006	2007	2008	2009	2010
1. Real GDP growth (%)		5.7	5.8	4.6	4.1	4.5
2. Net lending of general government	EDP B.9	-1.2	-0.6	-0.9	-0.6	0.0
3. Interest expenditure	EDP D.41	1.4	1.2	1.1	1.1	1.1
4. One-off and other temporary measures¹		0.0	-0.1	-0.1	0.0	0.0
5. Potential GDP growth (%)		4.4	5.8	4.3	4.2	4.7
contributions:						
- labour		0.3	1.5	-0.3	-0.1	0.3
- capital		1.6	2.0	2.1	1.9	1.9
- total factor productivity		2.6	2.3	2.5	2.4	2.4
6. Output gap		0.4	0.4	0.7	0.6	0.4
7. Cyclical budgetary component		0.2	0.3	0.2	0.2	0.2
8. Cyclically-adjusted balance (2 - 7)		-1.4	-0.9	-1.1	-0.8	-0.2
9. Cyclically-adjusted primary balance (8 + 3)		0.0	0.3	0.0	0.3	0.9
10. Structural balance (8 - 4)		-1.4	-0.8	-1.0	-0.8	-0.2

¹A plus sign means deficit-reducing one-off measures.

Table 6. Divergence from previous update

	ESA Code	2006	2007	2008	2009	2010
Real GDP growth (%)						
Previous update		4.7	4.3	4.2	4.1	4.1
Current update		5.7	5.8	4.6	4.1	4.5
Difference		1.0	1.5	0.4	0.0	0.4
General government net lending (% of GDP)	EDP B.9					
Previous update		-1.6	-1.5	-1.6	-1.0	n.a.
Current update		-1.2	-0.6	-0.9	-0.6	0.0
Difference		-0.4	-0.9	-0.7	-0.4	n.a.
General government gross debt (% of GDP)						
Previous update		28.5	28.2	28.3	27.7	n.a.
Current update		27.1	25.6	24.7	23.8	22.5
Difference		-1.4	-2.6	-3.6	-3.9	n.a.

Table 7. Long-term sustainability of public finances ¹

% of GDP	2006	2007	2010	2020	2030	2040	2050
Total expenditure	43.4	42.4	41.2	42.2	45.8	51.5	58.6
Of which: age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension expenditure	10.5	10.2	10.1	11.2	13.1	15.3	16.6
Social security pension	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Old-age and early pensions	7.2	7.0	7.0	8.3	10.2	12.4	13.9
Other pensions (disability, survivors)	1.7	1.6	1.5	1.5	1.4	1.4	1.2
Occupational pensions (if in general government)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health care	6.1	5.9	5.8	6.5	7.4	8.3	8.9
Long-term care (<i>this was earlier included in the health care</i>)	0.8	0.8	0.8	1.0	1.2	1.5	1.7
Education expenditure	5.5	5.2	4.8	4.5	4.8	4.9	5.1
Other age-related expenditures	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Interest expenditure	1.2	1.1	0.9	0.6	1.0	2.9	6.8
Total revenue	42.6	42.1	41.3	42.6	42.9	42.7	42.2
Of which: property income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>Of which</i> : from pensions contributions (or social contributions if appropriate)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Pension reserve fund assets	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
<i>Of which</i> : consolidated public pension fund assets (assets other than government liabilities)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assumptions							
Labour productivity growth	3.5	3.0	3.1	3.0	2.7	1.9	1.7
Real GDP growth	3.3	4.3	3.7	2.4	2.0	1.0	1.1
Participation rate males (aged 20-64)	74.2	74.9	76.4	77.9	77.0	75.4	76.4
Participation rates females (aged 20-64)	64.5	65.1	66.3	69.0	69.8	69.0	70.5
Total participation rates (aged 20-64)	69.5	70.1	71.5	73.6	73.5	72.3	73.5
Unemployment rate	5.7	5.5	5.5	5.4	5.4	5.4	5.4
Population aged 65+ over total population	15.7	15.9	16.5	20.6	25.3	28.6	31.2

¹ Years used are 2006, 2007, 2010, 2020, 2030, 2040, 2050.

Table 8. Basic assumptions

	2006	2007	2008	2009	2010
Short-term interest rate ¹ (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.
Long-term interest rate (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.
USD/€ exchange rate (annual average) (euro area and ERM II countries)	1.25	1.34	1.35	1.35	n.a.
Nominal effective exchange rate (for countries not in euro area or ERM II) exchange rate vis-à-vis the € (annual average)	n.a.	n.a.	n.a.	n.a.	n.a.
World excluding EU, GDP growth	n.a.	n.a.	n.a.	n.a.	n.a.
EU GDP growth	3.0	2.8	2.5	2.2	n.a.
Growth of relevant foreign markets	13.9	11.3	10.7	10.5	n.a.
World import volumes, excluding EU	n.a.	n.a.	n.a.	n.a.	n.a.
Oil prices (Brent, USD/barrel)	65.4	67.0	68.5	68.5	n.a.

¹If necessary, purely technical assumptions.

Annex 2: Key indicators of past economic performance

This annex displays key economic indicators that summarise the past economic performance of Slovenia. To put the country's performance into perspective, right-hand side of the table displays the same set of indicators for the euro area.

Table: Key economic indicators

	Slovenia						Euro area					
	Averages			2005	2006	2007	Averages			2005	2006	2007
	'96 - '05	'96 - '00	'01 - '05				'96 - '05	'96 - '00	'01 - '05			
Economic activity												
Real GDP (% change)	4.0	4.4	3.6	4.1	5.7	6.0	2.1	2.7	1.4	1.5	2.8	2.6
<i>Contributions to real GDP growth:</i>												
<i>Domestic demand</i>	4.0	4.8	3.2	2.2	5.7	6.5	2.0	2.7	1.3	1.7	2.6	2.4
<i>Net exports</i>	0.0	-0.4	0.4	2.0	0.0	-0.5	0.1	0.0	0.1	-0.1	0.2	0.2
Real GDP per capita (PPS; EU27 = 100)	78	75	81	85	87	89	113	114	112	110	110	109
Real GDP per capita (% change)	3.9	4.4	3.5	4.0	5.3	5.5	1.6	2.5	0.8	0.9	2.3	2.2
Prices, costs and labour market												
HICP inflation (%)	6.9	8.2	5.6	2.5	2.5	3.5	1.9	1.5	2.2	2.2	2.2	2.0
Labour productivity (% change)	3.9	4.6	3.2	4.0	4.5	3.7	1.2	1.5	0.8	1.0	1.4	1.1
Real unit labour costs (% change)	-1.0	-1.7	-0.4	-0.3	-1.0	-0.5	-0.5	-0.6	-0.5	-0.8	-0.9	-0.8
Employment (% change)	0.1	-0.2	0.4	0.2	1.2	2.2	1.2	1.5	0.9	0.9	1.5	1.6
Unemployment rate (% of labour force)	6.7	7.0	6.4	6.5	6.0	4.9	9.1	9.8	8.5	8.9	8.3	7.3
Competitiveness and external position												
Real effective exchange rate (% change)	-0.6	-1.9	0.8	-1.1	0.0	0.6	-1.3	-5.5	2.8	-2.6	-0.6	0.6
Export performance (% change) ¹	1.5	-0.7	3.7	4.3	3.2	6.4	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	-1.0	-1.2	-0.8	-1.9	-2.6	-3.3	0.8	0.9	0.7	0.3	0.0	0.1
Public finances												
General government balance (% of GDP)	-2.5	-2.4	-2.6	-1.5	-1.2	-0.7	-2.3	-2.1	-2.5	-2.5	-1.5	-0.8
General government gross debt (% of GDP)	25.5	23.2	27.8	27.4	27.1	25.6	70.6	72.2	69.0	70.3	68.6	66.6
Structural balance (% of GDP) ²	n.a.	n.a.	-1.4	-0.8	-1.1	-1.1	n.a.	n.a.	-2.6	-2.1	-1.1	-0.7
Financial indicators												
Short-term real interest rate (%) ³	2.0	3.0	1.4	2.3	1.1	1.4	1.3	2.5	0.6	0.3	1.2	2.0
Long-term real interest rate (%) ³	1.3	n.a.	1.3	2.1	1.8	1.8	n.a.	n.a.	1.9	1.5	1.9	2.1
Notes:												
¹ Market performance of exports of goods and services on export-weighted imports of goods and services of 35 industrial markets.												
² Cyclically-adjusted balance net of one-off and other temporary measures; available since 2003.												
³ Using GDP deflator.												
Source:												
Commission services												

