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COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of Slovenia

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of Slovenia

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1. INTRODUCTION

Slovenia submitted its Draft Budgetary Plan for 2019 on 15 October 2018 in compliance with Regulation (EU) No 473/2013. The Draft Budgetary Plan provides a no-policy-change scenario as it is presented by the new government which took office on 13 September 2018. Slovenia is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium term budgetary objective (MTO).

As the debt ratio was 82.6 % of GDP in 2015 (the year in which Slovenia corrected its excessive deficit), exceeding the 60 % of GDP reference value, during the three years following the correction of the excessive deficit Slovenia is also subject to the transitional arrangements to make sufficient progress towards compliance with the debt reduction benchmark in 2018. Following the end of the transition period, Slovenia needs to comply with the debt reduction benchmark as of 2019.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2018 autumn forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2018 autumn forecast. Section 4 assesses the recent and planned fiscal developments in 2018-2019 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. A box on the application of constrained judgement is contained in this section for Slovenia as it is flagged by the plausibility tool. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations in the context of the European Semester adopted by the Council in July 2018, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

Slovenia's GDP grew by 4.9 % in 2017 in real terms, mainly driven by strong investments and exports. In 2017, employment grew by close to 3 % and the unemployment rate fell to 6.6 %. Inflation was relatively modest at 1.6 %, while the output gap, estimated by the Commission based on the commonly agreed methodology[1], was 1.1 % in 2017.

Based on the DBP, the economy is expected to grow by 4.4 % in 2018. Growth continues to be mostly driven by exports and investments, while private consumption is expected to grow quite strongly. The positive developments on the labour market are expected to continue whereas inflation accelerates to 1.8 %. Compared to the Stability Programme, the GDP growth rate has been revised downwards, in particular for consumption and exports. Inflation has been revised upwards due to the growth in energy prices. Based on the Commission 2018 autumn forecast, GDP would grow slightly less, by 4.3 % in 2018, and inflation would be slightly higher reaching 2.0 %.

In 2019, the DBP projects the economy to grow by 3.7 %, almost in line with the projection of 3.8 % in the Stability Programme. While exports of goods and services have been revised downwards compared to the Stability Programme, investment growth has remained unchanged. The unemployment rate is projected to fall to 4.4 % and inflation has been revised slightly upwards. Based on the DBP, the output gap estimate increases to 3.5 %, as recalculated by the Commission.

Based on the Commission 2018 autumn forecast, the economy would grow by 3.3 % in 2019, slightly less than according to the DBP. GDP growth would be mainly driven by private consumption, while the contribution of net exports and investment would be lower than in the DBP. The output gap is estimated to reach 3.0 %, slightly lower than in the DBP. The risks to the forecast are mainly external and relate to the demand on the export markets.

Overall, the DBP's macroeconomic projections are plausible for 2018 and slightly favourable for 2019.

Box 1: The macroeconomic forecast underpinning the budget in Slovenia

The macroeconomic scenario underpinning the DBP is the Autumn 2018 Forecast of Economic Trends produced by the Institute of Macroeconomic Analysis and Development (IMAD). IMAD is an independent government office, the management of which is responsible directly to the Prime Minister.

In order to ensure compliance with the requirement of Regulation (EU) No 473/2013, the draft Budget Act to be transmitted to the national parliament should be based on an independently produced macroeconomic forecast.

[1] The output gap estimates in the DBP are not taken at face value; instead, they are recalculated using the commonly agreed production function methodology on the basis of the Commission 2018 autumn forecast.

Table 1. Comparison of macroeconomic developments and forecasts

	2017	2018			2019		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	4.9	5.1	4.4	4.3	3.8	3.7	3.3
Private consumption (% change)	1.9	3.6	2.7	2.2	3.0	2.6	2.9
Gross fixed capital formation (% change)	10.7	10.0	9.0	9.0	8.5	8.5	7.5
Exports of goods and services (% change)	10.7	9.2	8.2	8.1	7.5	6.6	6.2
Imports of goods and services (% change)	10.3	9.3	8.0	8.0	8.1	7.1	6.9
Contributions to real GDP growth:							
- Final domestic demand	3.0	4.2	3.5	3.3	3.5	3.4	3.2
- Change in inventories	0.6	0.1	-0.1	0.2	0.0	0.0	0.0
- Net exports	1.3	0.9	0.9	0.8	0.3	0.3	0.1
Output gap[1]	1.1	3.2	2.8	2.7	3.5	3.5	3.0
Employment (% change)	2.9	2.4	2.8	3.0	1.5	1.5	2.5
Unemployment rate (%)	6.6	5.3	4.8	5.6	4.6	4.4	5.3
Labour productivity (% change)	1.9	2.7	1.5	1.3	2.2	2.1	0.8
HICP inflation (%)	1.6	1.5	1.8	2.0	1.9	2.1	2.3
GDP deflator (% change)	1.6	2.4	1.9	2.2	2.6	2.3	2.6
Comp. of employees (per head, % change)	3.2	5.2	4.9	3.3	5.1	5.2	3.3
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	6.3			7.0			7.4

Note:

[1]In percent of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology.

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

Despite the downward revision of the macro-economic outlook, the DBP increases the 2018 general government surplus target set in the 2018 Stability Programme by 0.1 percentage point to 0.5 % of GDP, in line with the Commission 2018 autumn forecast. The upward revision of headline surplus is mainly due to higher expected tax revenues and social contributions, as well as lower public investment than expected in the 2018 Stability Programme. A sharp downward revision of public investment compared to the Stability Programme is mainly driven by low absorption rate of the EU structural funds. The general government surplus is projected to increase by 0.4 percentage points compared to the previous year. This improvement is partly explained by favourable macroeconomic conditions and prevailing improvement in employment. Conversely, compensation of employees and social benefits are projected to increase strongly due to the expiry of previously taken temporary consolidation measures and an extraordinary indexation of pensions. Intermediate consumption is also forecast to continue rising. As a result of active public debt management, interest expenditure is expected to decline significantly.

For 2019, the DBP reconfirms the general government surplus target of 0.2 % of GDP, set in the 2018 Stability Programme. Taxes and social contributions are expected to remain the main drivers for revenue growth but were revised downwards compared to the Stability Programme. Conversely, the DBP expects higher public investment compared to the 2018 Stability Programme along with the implementation of the EU structural funds financial programming period of 2014-2020. While interest expenditure is projected to continue declining by a double-digit rate, compensation of employees and social transfers are expected to grow strongly, due to the upcoming negotiations with labour unions and further relaxation of temporary restrictive measures. The Commission 2018 autumn forecast lies 0.2 percentage points above the DBP headline surplus estimate for 2019. This difference mainly arises from an assumption of a smoother public investment profile over 2019 and 2020 in the Commission projections as opposed to a large peak of public investment in 2019 targeted in the DBP.

The main downside risks to public finances in the coming years stem from building expenditure pressures, particularly on wages and social benefits. An additional risk on the expenditure side is the emergence of unexpected one-offs, for instance due to unfavourable court rulings. Proceeds from privatisations of Abanka and NLB pose an upside risk to public debt, while the revenue from dividends would decrease. Under a no-policy-change scenario, no new measures are planned to strengthen public finances in 2019. However, in its assessment published on 18 September 2018, the Fiscal Council warned that the implementation of measures from the coalition agreement of the new government could potentially lead to further fiscal expansion.

In structural terms, the DBP projects a structural deficit[2] of 0.7 % of GDP for 2018, below the estimate of 1.1 % of GDP in the 2018 Stability Programme. For 2019, the (recalculated) structural deficit reconfirms the estimate of 1.4 % of GDP set in the 2018 Stability Programme. The Commission 2018 autumn forecast envisages a slightly higher structural

[2] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

deficit in 2018 (0.8 % of GDP) and a lower structural deficit in 2019 (1.0 % of GDP), due to lower estimated public investment and output gap.

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Slovenia currently standing at 1.14[3]. Due to the low interest rate environment and active public debt management, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the DBP, interest expenditure in Slovenia is expected to fall from 2.5 % of GDP in 2017 to 2.0 % in 2018 and is projected to decrease further next year, at 1.7 % of GDP. The picture stemming from Slovenia's DBP is confirmed by the Commission forecast.

[3] 10-year bond yields as of 24 October 2018. Source: Bloomberg.

Table 2. Composition of the budgetary adjustment

(% of GDP)	2017	2018			2019			Change: 2017-2019
	COM	**SP**	**DBP**	**COM**	**SP**	**DBP**	**COM**	**DBP**
Revenue	**43.2**	**42.3**	***42.9***	**42.7**	**41.7**	***42.4***	**42.2**	**-0.8**
of which:								
- Taxes on production and imports	14.3	13.9	*14.1*	14.1	13.4	*13.6*	13.6	-0.7
- Current taxes on income, wealth, etc.	7.5	7.6	*7.8*	7.7	7.6	*7.7*	7.7	0.2
- Capital taxes	0.0	0.0	*0.0*	0.0	0.0	*0.0*	0.0	0.0
- Social contributions	14.8	14.5	*14.9*	14.8	14.4	*14.6*	14.5	-0.2
- Other (residual)	6.6	6.3	*6.1*	6.0	6.3	*6.5*	6.4	-0.1
Expenditure	**43.2**	**41.9**	**42.4**	**42.2**	**41.5**	**42.2**	**41.8**	**-1.0**
of which:								
- Primary expenditure	40.7	39.9	40.4	40.2	39.8	40.5	40.1	-0.1
of which:								
Compensation of employees	11.2	11.0	11.2	11.2	10.9	11.1	11.1	-0.1
Intermediate consumption	6.3	5.9	6.2	6.2	5.7	6.0	6.0	-0.3
Social payments	17.0	16.3	16.7	16.7	16.1	16.4	16.4	-0.6
Subsidies	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.0
Gross fixed capital formation	3.1	3.4	3.3	3.2	3.9	4.0	3.6	0.9
Other (residual)	2.3	2.6	2.3	2.3	2.5	2.3	2.3	0.0
- Interest expenditure	2.5	2.0	2.0	2.0	1.7	1.7	1.7	-0.8
General government balance (GGB)	**0.1**	**0.4**	**0.5**	**0.5**	**0.2**	**0.2**	**0.4**	**0.1**
Primary balance	**2.6**	**2.4**	**2.5**	**2.4**	**1.9**	**1.8**	**2.1**	**-0.8**
One-off and other temporary measures	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0
GGB excl. one-offs	**0.1**	**0.4**	**0.6**	**0.5**	**0.2**	**0.2**	**0.5**	**0.1**
Output gap[1]	1.1	3.2	2.8	2.7	3.5	3.5	3.0	2.2
Cyclically-adjusted balance[1]	-0.5	-1.2	-0.8	-0.8	-1.5	-1.5	-1.0	-0.9
Structural balance (SB)[2]	**-0.4**	**-1.1**	**-0.7**	**-0.8**	**-1.4**	**-1.4**	**-1.0**	**-1.0**
Structural primary balance[2]	2.1	0.9	1.3	1.2	0.3	0.3	0.7	-1.8

Notes*:*

[1]Output gap (in % of potential GDP) and cyclically-adjusted balance according to the DBP/programme as recalculated by Commission on the basis of the DBP/programme scenario using the commonly agreed methodology.

[2]Structural (primary) balance = cyclically-adjusted (primary) balance excluding one-off and other temporary measures.

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

3.2. Debt developments

After peaking at 82.6 % of GDP in 2015, the general government gross debt fell to 74.1 % of GDP in 2017. Based on the DBP projections, public debt is estimated to gradually decline, reaching 66.6 % of GDP in 2019. Compared to the 2018 Stability Programme, the debt-to-GDP ratio is revised upwards, mainly due to a denominator effect from lower GDP expectations. Slovenia has been extending the duration of the debt portfolio and taking advantage of the low interest rate environment in the Eurozone by executing cross-currency transactions. As a consequence, the DBP expects the interest expenditure to continue decreasing significantly. Similarly to the DBP, the Commission also forecasts a declining debt ratio, at 66.3 % of GDP in 2019.

Table 3. Debt developments

(% of GDP)	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**74.1**	**69.3**	**70.3**	**70.2**	**65.2**	**66.6**	**66.3**
Change in the ratio	-4.6	-4.8	-3.8	-3.9	-4.1	-3.7	-3.8
Contributions[2] *:*							
1. Primary balance	**-2.6**	**-2.4**	**-2.5**	**-2.4**	**-1.9**	**-1.8**	**-2.1**
2. "Snow-ball" effect	**-2.3**	**-3.1**	**-2.4**	**-2.6**	**-2.5**	**-2.3**	**-2.2**
Of which:							
Interest expenditure	2.5	2.0	2.0	2.0	1.7	1.7	1.7
Growth effect	-3.6	-3.5	-3.1	-3.0	-2.5	-2.5	-2.2
Inflation effect	-1.2	-1.6	-1.3	-1.5	-1.7	-1.5	-1.7
3. Stock-flow adjustment	**0.3**	**0.8**	**1.2**	**1.2**	**0.3**	**0.5**	**0.5**
Of which:							
Cash/accruals difference							
Net accumulation of *of which privatisation proceeds*							
Valuation effect & residual							

Notes:

[1] End of period.

[2] The snow-ball effect captures the impact of interest expenditure on accumulated debt, as well as the impact of real GDP growth and inflation on the debt ratio (through the denominator). The stock-flow adjustment includes differences in cash and accrual accounting, accumulation of financial assets and valuation and other residual effects.

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

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

Slovenia is subject to the preventive arm of the Pact and should ensure sufficient progress towards its MTO. Box 2 reports the latest country-specific recommendations in the area of public finances. Following the end of the transitional arrangements, Slovenia is also subject to the debt reduction benchmark as of 2019.

Box 2. Council Recommendations[4] addressed to Slovenia

On 13 July 2018, the Council addressed recommendations to Slovenia in the context of the European Semester. In particular, in the area of public finances the Council recommended that the nominal growth rate of net primary government expenditure does not exceed 3.1 % in 2019, corresponding to an annual structural adjustment of 0.65 % of GDP.

4.1. Compliance with the debt criterion

After it corrected its excessive deficit in 2015, Slovenia is in the transition period for the following three years to make sufficient progress towards compliance with the debt reduction benchmark. This implies that, during this period, it is required to make sufficient progress (as defined by the minimum linear structural adjustment (MLSA)) towards compliance with the debt reduction benchmark at the end of the transition period. In 2019, as its debt ratio is still expected to exceed the 60 % of GDP reference rate of the Treaty, Slovenia needs to comply with the debt reduction benchmark.

The DBP does not provide sufficient information to assess compliance with either the MLSA in 2018 or the debt reduction benchmark in 2019. According to the Commission 2018 autumn forecast, Slovenia is expected to make sufficient progress towards compliance with the debt reduction benchmark in 2018. Specifically, the structural effort of -0.4 % of GDP is considerably above the required adjustment of -6.8 % of GDP. In 2019, the Commission expects that the debt reduction benchmark is met with a gap of 6.5 % of GDP.

[4] OJ C 320, 10.9.2018.

Table 4. Compliance with the debt criterion*

	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	74.1	69.3	70.3	70.2	65.2	66.6	66.3
Gap to the debt benchmark [1,2]					-7.1		-6.5
Structural adjustment [3]	0.7	-0.6	-0.3	-0.4	-0.4	-0.7	-0.2
To be compared to:							
Required adjustment [4]	-2.2	-7.6		-6.8			

Notes:

[1] Not relevant for Member Sates that were subject to an EDP procedure in November 2011 and for a period of three years following the correction of the excessive deficit.

[2] Shows the difference between the debt-to-GDP ratio and the debt benchmark. If positive, projected gross debt-to-GDP ratio does not comply with the debt reduction benchmark.

[3] Applicable only during the transition period of three years from the correction of the excessive deficit for EDP that were ongoing in November 2011.

[4] Defines the remaining minimum annual structural adjustment over the transition period which ensures that – if followed – Member State will comply with the debt reduction benchmark at the end of the transition period, assuming that COM (SP) budgetary projections for the previous years are achieved.

Source:

Stability Programme 2018 (SP); Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations

* An ex-ante assessment of planned compliance with the debt criterion can be based on the DBP only for the concerned countries providing extended data series (i.e. covering years up to t+4) in the DPB on a voluntary basis, as agreed at the EFC-A on 22 September 2014 and reflected in the updated Code of Conduct of the two-pack.

4.2. Adjustment towards the MTO

The Commission Communication on the 2017 European Semester of May 2017[5] stated that the Commission stands ready to use its margin of appreciation in cases where the impact of a large fiscal adjustment on growth and employment is particularly significant. The Country-Specific Recommendation adopted by the Council on 11 July 2017 mentioned that the assessment of the 2018 DBP and subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances.

For 2018, according to the commonly agreed adjustment matrix under the Stability and Growth Pact, Slovenia is recommended to achieve a structural adjustment of 1.0 % of GDP, corresponding to a nominal growth rate of net primary government expenditure below 0.6 %. Based on the information provided in the DBP, the growth rate of government expenditure, net of discretionary revenue measures and one-offs, will exceed the expenditure benchmark derived from the matrix, leading to a gap of 0.9 % of GDP for 2018 and a gap of 0.8 % of GDP over 2017 and 2018 taken together. At the same time, the (recalculated) structural balance projected in the DBP indicates a gap of 1.3 % of GDP for 2018 and 0.7 % of GDP on

[5] https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-specific-recommendations-commission-recommendations-communication.pdf.

average over 2017 and 2018. As a result, both pillars point to a risk of significant deviation for both 2018 and over 2017 and 2018 taken together.

The structural balance is negatively affected by substantial revenue shortfalls and higher investment, while it benefits from falling interest expenditure. At the same time, the expenditure benchmark is strongly negatively impacted by the medium-term potential GDP growth used therein, which includes exceptionally low potential GDP growth in the crisis years. It is therefore more appropriate to consider as a benchmark for growth of net primary expenditure the medium-term potential GDP growth rate arising from the Commission 2018 autumn forecast for the same reference period (2012-2021). Taking this into account, based on an overall assessment, the DBP projects a risk of significant deviation from the requirements of the preventive arm in 2018 and over 2017 and 2018 taken together. This conclusion is confirmed by an overall assessment on the basis of the Commission 2018 autumn forecast. Following the Commission's assessment of the strength of the recovery in Slovenia while giving due consideration to its sustainability challenges, carried out in the context of its opinion on Slovenia’s 2018 DBP, Slovenia was required to achieve a fiscal structural effort of at least 0.6 % of GDP for 2018, without any additional margin of deviation over one year. This corresponds to a nominal rate of growth of net primary government expenditure not exceeding 1.5 %. Even after applying this lower requirement, the conclusion of a risk of a significant deviation does not change based on both the DBP and the Commission forecast.

In 2019, Slovenia was recommended to pursue a nominal growth rate of net primary government expenditure below 3.1 %, corresponding to an annual structural adjustment of 0.65 % of GDP. The expenditure benchmark based on the DBP points to a risk of some deviation over 2019 (gap of 0.3 % of GDP) and a risk of significant deviation over 2018 and 2019 taken together (average gap of 0.6 % of GDP). The (recalculated) structural balance points to a risk of significant deviation both in 2019 (gap of 1.4 % of GDP) and on average over 2018 and 2019 (average gap of 1.3 % of GDP). This calls for an overall assessment. The fiscal effort based on the structural balance continues to be negatively impacted by higher investment and revenue shortfalls which are partly offset by lower interest expenditure. Another factor relevant for the difference between the two indicators arises from the potential GDP growth estimates used therein. An overall assessment based on the DBP points to a risk of significant deviation from the adjustment path towards the MTO in 2019 and over 2018 and 2019 taken together.

Based on the Commission 2018 autumn forecast, both the expenditure benchmark and the structural balance indicate a risk of significant deviation (gap of 0.6 % of GDP and 0.8 % of GDP, respectively) in 2019. The same conclusion is drawn if the deviation from the two-year average is considered, indicating a gap of 1.1 % of GDP for both pillars over 2018 and 2019 taken together. The fiscal effort based on the two pillars continues to be impacted by the same factors as outlined above. Following an overall assessment, Slovenia is expected to be at risk of a significant deviation from the requirements of the preventive arm in 2019 and over 2018 and 2019 taken together, confirming the overal assessment on the basis of the DBP projections.

Box 3. Implementation of the "constrained judgement" approach and its impact on fiscal surveillance

The objective of the "constrained judgement" approach is to have a transparent and economically grounded tool to statistically test the plausibility of the output gap estimates for individual Member States estimated on the basis of the commonly agreed methodology. To this end, the Commission developed, in consultation with the Member States, an objective screening tool based on a set of cyclically relevant indicators as well as thresholds/ranges to signal cases when the outcomes of the common method could be interpreted as being subject to a large degree of uncertainty and therefore deserving of further investigation on the part of the Commission. In such cases, the Commission carries out an "in depth" analysis which could lead to the application of a "constrained" degree of judgement in conducting Member States' budgetary assessments.

Regarding Slovenia, the plausibility tool provided indications that the output gap for 2018, estimated on the basis of the commonly agreed methodology, may be counterintuitive. The output gap, as calculated on the basis of the common methodology, is projected to increase to 2.7 % of potential GDP in 2018 (from 1.1 % in 2017) and reach 3.0 % of potential GDP in 2019. The Commission estimates for the output gap are above the ones derived from the HP filter (2.5 % in 2019), those of IMF (2.3 % in 2019) and well below the estimates of OECD (4.5 % in 2019). The plausibility tool projects the 2018 output gap at 1.1 % of potential GDP, significantly lower than the one based on the commonly agreed methodology. Applying the same 1.6 percentage points of potential GDP difference in 2019 would lead to a range of output gap estimates from 1.4 % to 3.0 % of potential GDP. The plausibility tool estimate indicates that the amount of idle capacities that are available for production (manufacturing capacity and labour force) may be higher than estimated on the basis of the production function method; however, the estimate can be also influenced by the relatively short time series.

The above mentioned factors confirm that for Slovenia the output gap estimate based on the common methodology is subject to a high degree of uncertainty. An assessment was already carried out for Slovenia in spring 2018, which indicated that the output gap estimate for 2019 based on the common methodology was subject to a high degree of uncertainty. This has been reflected in the 2018 Council recommendations which include an adjustment requirement of 0.65 % of GDP for 2019, instead of the requirement of 1 % of GDP.

Table 5. Compliance with the requirements of the preventive arm

(% of GDP)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	0.3	0.3		0.3	
Structural balance[2] (COM)	-0.4	-0.8		-1.0	
Structural balance based on freezing (COM)	-1.6	-0.8		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.6	1.0		0.7	
Required adjustment corrected[5]	0.6	1.0		0.7	
Change in structural balance[6]	0.6	-0.3	-0.4	-0.7	-0.2
One-year deviation from the required adjustment[7]	0.0	-1.3	-1.4	-1.4	-0.8
Two-year average deviation from the required adjustment[7]	-0.1	-0.7	-0.7	-1.3	-1.1
Expenditure benchmark pillar					
Applicable reference rate[8]	-0.7	0.6		3.1	
One-year deviation adjusted for one-offs[9]	-0.7	-0.9	-1.6	-0.3	-0.6
Two-year average deviation adjusted for one-offs[9]	-0.4	-0.8	-1.2	-0.6	-1.1

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 20XX-1) was carried out on the basis of Commission 20XX spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Draft Budgetary Plan for 2019 (DBP); Commission 2018 autumn forecast (COM); Commission calculations.

5. COMPOSITION OF PUBLIC FINANCES AND IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

In 2019, both revenue and expenditure are expected to further decline relative to GDP (to 42.4 % of GDP and 42.2 % of GDP, respectively). Along with the implementation of the EU structural funds financial programming period of 2014-2020, the DBP indicates a strong increase in public investment, jumping from 3.1 % of GDP in 2017 to 4.0 % of GDP in 2019. As a result of active public debt management and due to favourable financial market conditions, the interest expenditure is projected to decrease significantly over 2018 and 2019, from 2.5 % of GDP in 2017 to 1.7 % of GDP in 2019.

On 13 July 2018, the Council addressed recommendations to Slovenia in the context of the European Semester. In particular, with regard to the structural part of the fiscal recommendations the Council recommended Slovenia to adopt and implement the Healthcare and Health Insurance Act and the planned reform of long-term care. The Council recommended Slovenia to ensure the long-term sustainability and adequacy of the pension system, including by increasing the statutory retirement age and by restricting early retirement.

According to the DBP, the draft Healthcare and Health Insurance Act was submitted to the Economic and Social Council and the coalition partners in 2018. The draft law adresses financing and control issues and aims for better quality and access of service provision. In 2017, the Act on long-term care and insurance for long-term care was prepared with a focus on access to high-quality services, sustainable financing, comprehensive treatment of patients and promotion of care at home or in the community. The proposed solutions will be tested in three pilot projects in eastern cohesion region, starting in 2018 and supported by the European Social Fund.

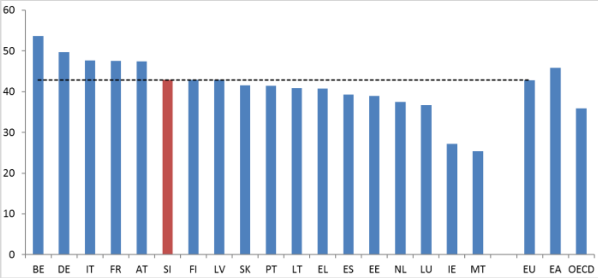
In July 2017, the Economic and Social Council adopted measures for further development of the pension system in Slovenia. Agreed measures aim at ensuring the financial sustainability of the pension system and providing decent pensions. Based on the DBP, new legislation regarding a raise in the actual retirement age, early employment of young people and prolonged activity of the elderly should be adopted by the end of 2020; however, the measures have not been specified.

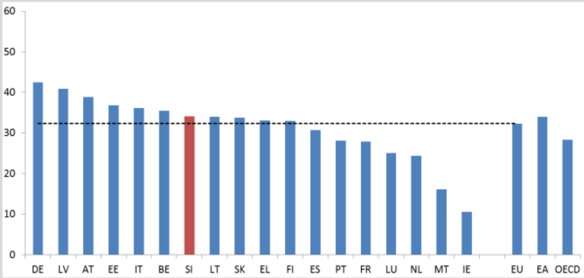
Box 4 – Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate these numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Slovenia for a single worker earning respectively the average wage and a low wage (50 % of the average) compared to the EU average.

The tax burden on labour in Slovenia at the average wage and at low wage (2016)





Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

Slovenia's Draft Budgetary Plan does not include any measures that affect the tax wedge on labour.

6. OVERALL CONCLUSION

On the basis of the Commission 2018 autumn forecast, the structural improvement in the debt-to-GDP ratio is in line with the minimum linear structural adjustment to ensure sufficient progress towards compliance with the debt criterion in 2018 and in line with the debt criterion in 2019.

Following an overall assessment of the DBP, the projected structural adjustment points to a risk of significant deviation from the required adjustment path towards the MTO both in 2018 and 2019. This conclusion is confirmed by an overall assessment based on the Commission 2018 autumn forecast.