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Review of progress on policy measures relevant for the correction of Macroeconomic Imbalances

Executive Summary

Following unsustainable trends in corporate indebtedness and lending practices in the pre-crisis boom years, Slovenia faces risks in corporate and bank balance sheets. The deterioration of asset quality on banks' balance sheets (non-performing loans, NPL) mirrors over-indebtedness of some corporates and requires urgent repair to restart an efficient financial intermediation of the banking sector and redeployment of capital to support the productive capacity of the economy. These risks are compounded by an economic structure dominated by state ownership, insufficient legal framework for corporate restructuring and by limited adjustment capacity in labour markets.

On April 10 2013, the Commission concluded that "*Slovenia is experiencing excessive macroeconomic imbalances. Urgent policy action is needed to halt the rapid build-up of these imbalances and to manage their unwinding*". In July, the Council addressed to Slovenia a set of country-specific recommendations (CSRs) mostly directed to support the correction of these imbalances, and it was agreed to monitor policy progress in October 2013 and in January 2014. This is consistent with the policy recommendations addressed to the euro area Member States, one of which made a specific call for an assessment of progress of MIP relevant commitments and country specific recommendations. In this context, this report reviews the latest economic developments and the main relevant policy measures taken by Slovenia over the last months.

Economic developments since April – with quarterly GDP outturns confirming that Slovenia's recession is lasting longer than anticipated - reinforce this challenge. Investment remains the strongest drag on growth, which arises from a negative feedback loop of corporate weakness, low domestic demand and slow adjustment in capital and labour markets, while exports are the only GDP segment that contributes to growth. The interplay of these factors in the corporate sector further deteriorates the quality of banks' credit portfolios, putting pressure on already thin capital buffers and consequently on banks' ability to perform their intermediation function. The sustained increase in NPL is also putting pressure on profitability. Uncertainties about the potential contingent fiscal liabilities arising in the banking sector have been a major factor in raising borrowing costs for the sovereign and for the economy as a whole.

Looking at the pace of reforms against MIP relevant policy commitments, tangible progress has been made in some policy areas, notably in the urgent banking and fiscal spheres, ; while several reforms in other policy areas are still in the preparatory phase.

Reforms to fiscal governance and policies ensuring long-term fiscal sustainability are in preparation. A reform of the fiscal framework is being drafted, a Working Group will start to reflect on possible reforms to the pension system and adoption of a new insurance-based system for long term care is envisaged for the first half of 2014. The authorities will be undertaking a spending review which could be supported by technical assistance. It will be important to step up the pension reform process well before unsustainable trends resume.

Measures to stabilise the banking sector have started with a thorough Asset Quality Review (AQR) and Stress Tests (ST) covering almost 70% of the banking sector and due to be completed before end-2013. This exercise is designed to provide a credible diagnosis of the health of the banking system. Such an assessment is necessary prior to any transfer of non-performing assets from bank balance sheets and any subsequent recapitalisations or restructuring of the sector. In parallel, the supervisor is proceeding with an orderly winding down of two small banks. After the release of the AQR-ST outcome and its accompanying recapitalisation and restructuring measures, the national authorities are expected to outline their plans for the divestment of direct and indirect public sector participations in domestic banks for which the deadline indicated in the recommendations has been missed.

Several of the key reforms supporting adjustment and growth are still in preparation, with notable delays in some cases. The general concept of the proposed changes to the insolvency code, including new provisions for out-of-court restructuring, appears appropriate, but a draft consolidated text is still needed for a full assessment and the September deadline provided in the MIP relevant recommendation is not met.

The proposed amendments to the Slovenia Sovereign Holding Act bring some notable improvements. However, the September deadline for classifying state-owned assets has been missed. As an early action, the identification of core and non-core assets is an important preliminary step to underline the authorities' commitment to initiate a credible privatisation process and attract new investors to unlock medium and long term results. A first company on the list of 15 companies for privatisation, Helios, was sold on October 16, but privatisations of some of the remaining companies are proving challenging. Firms remaining in state ownership face continued risks in terms of governance, efficiency and financing.

In the labour market area, a thorough monitoring of the impact of the March 2013 reform is underway while revisions to the minimum wage act and student work are under consideration, but no structural reform as such is planned. As regards regulated professions, this process has not advanced since May, and some elements of the calendar appear to have slipped. Finally, improvements in case management appear to have had a positive effect on judicial efficiency.

Over the last months, there has been a stepping up of the pace of structural reforms relevant for the adjustment of imbalances. Crucial progress is being achieved in the area of the banking sector. The restructuring and consolidation strategy following the release of the AQR-ST will be key in delivering confidence and attracting foreign investors in Slovenia. Nevertheless, swifter progress with reforms of corporate governance and with privatisation would have allowed Slovenia to fully benefit from the positive synergies created by a comprehensive strategy.

1. Introduction

On 28 November 2012, the European Commission presented its second Alert Mechanism Report (AMR). The AMR served as an initial screening device to identify Member States that warrant further in-depth analysis into whether imbalances exist or risks have emerged. The subsequent "in-depth review" (IDR), published on 10 April 2013, examined the nature, origin and severity of macroeconomic developments in Slovenia.[1] The Commission concluded that *"Slovenia is experiencing excessive macroeconomic imbalances. Urgent policy action is needed to halt the rapid build-up of these imbalances and to manage their unwinding."*[2] The IDR assessment revealed risks in corporate and bank balance sheets. These are intertwined in a vicious circle of concentrated over-indebtedness of some corporates mirroring a deterioration of asset quality on banks' balance sheets (NPL) and requiring urgent restructuring and repair to restart an efficient financial intermediation of the banking sector and redeployment of capital supporting the productive capacity of the economy.

On 30 April 2013, the Slovene authorities submitted the Stability Programme and the National Reform Programme (NRP). Following the assessment of the two packages, the Commission proposed a set of policy recommendations to address macroeconomic imbalances which were reflected in the CSRs in the framework of the European Semester and eventually adopted by the Council on 9 July 2013.[3] The scope of the MIP-relevant Recommendations aimed at addressing macroeconomic imbalances is wide-ranging and covers (i) fiscal sustainability; (ii) repair of private sector balance sheets; (iii) other policies supporting competitiveness and adjustment. An overview of the MIP-relevant recommendations, NRP commitments and related deadlines is provided in Annex 1.

Moreover, in policy recommendation number 5 addressed to the euro area Member States, a specific call for an assessment of progress of MIP-relevant commitments and CSRs was made.[4] This report by the Commission services reviews the main measures taken by Slovenia over the last six months that can contribute to the rebalancing process. To underpin the analysis a fact-finding mission took place on 1-3 October 2013. As agreed by the EPC and EFC, an update of this report will be produced in January basing its findings on a second fact-finding mission.

The Commission assessment of effective action in the framework of the EDP, together with the assessment of Slovenia's DBP and its EPP, will be presented in November. Though clearly also MIP-relevant, these issues will not be covered in this report, in order to avoid an overlap of surveillance processes.

[1] http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/ocp142_en.pdf
[2] http://ec.europa.eu/economy_finance/publications/occasional_paper/2013/pdf/com(2013)_199_final_en.pdf
[3] http://register.consilium.europa.eu/pdf/en/13/st10/st10655-re01.en13.pdf
[4] http://register.consilium.europa.eu/pdf/en/13/st11/st11216.en13.pdf: "Take the necessary steps for an effective implementation of the Macroeconomic Imbalances Procedure, in particular by assessing progress in reform commitments in Member States experiencing excessive imbalances and in reform implementation in Member States with imbalances requiring decisive action to limit negative spillovers to the rest of the euro area."

2. Recent macroeconomic developments

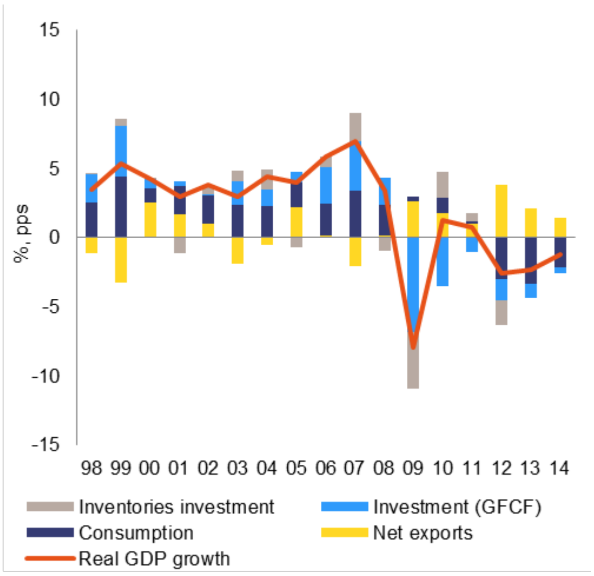
In 2012, real GDP in Slovenia stood 8.5% below its 2008 peak level. The Commission services Spring 2013 forecast expected output to drop by a further 2% in 2013 on the back of steadily declining domestic demand. Negative quarterly outturns in 2013, which amounted to a 3.2% contraction of real GDP in the first half of the year and confirmed that the recession is lasting longer than anticipated, have prompted substantial downwards revisions of GDP growth by the Slovenian authorities (both IMAD and Bank of Slovenia) and the IMF in its recent WEO. The unemployment rate has rapidly increased to 10.8 % in 1Q 2013 from below 9% at the end of 2012 as a large number of temporary contracts expired in the beginning of the year and were not renewed, nor turned into other types of contracts. Positive signs in export data in the first quarter of 2013 point at a slow recovery of volumes with anticipated growth of 1¼% in 2013 and 3¼% in 2014 according to the spring forecast. However, data for Q2 and recent downwards revisions of export forecast by the Bank of Slovenia suggest, particularly for 2014 and 2015, that the recovery is very fragile and hinges on rapid deleveraging of the banking and the corporate sector.

Weak domestic demand is pushing the current account further into surplus, widening up to 4.8% of GDP over the forecast horizon. In the absence of large valuation changes, these trends would improve the negative net international investment position from its elevated 44.9% of GDP level. Pressure on external imbalances could rapidly re-emerge in the medium term when the economy recovers, bringing a revival of domestic demand and putting pressure on wages and cost-competitiveness. Notably, there would be significant pressure to re-establish wage differentials above the minimum wage that were eliminated or compressed by large cumulative minimum wage increases since 2010.

Investment remains the strongest drag on growth, -5% in 2013 according to the spring forecast, on the back of corporate weakness, lacklustre export performance, low domestic demand and slow adjustment in capital and labour markets. Private credit flow declined by 4.1% in 2012. In particular, banks are deleveraging fast in the corporate segment, cutting exposures by 13.3% in the year to July and funding costs for firms are between 200 and 300 bps higher than the euro area average. Poor domestic and export revenues, combined with elevated costs of labour and capital, continue to prevent some firms from generating the cash flows needed to maintain working capital, pay down debt, create and attract equity and ultimately restore creditworthiness over the medium term. Further, the restructuring of firms is severely limited by the current legislative framework for restructuring and insolvency and by corporate governance, particularly but not only in state owned enterprises. As a short term result of these imbalances and rigidities, more fragile but viable firms fail, productive capacity is lost, and over the medium term domestic investments are postponed, foreign direct investment is not attracted and growth opportunities do not materialise. Efforts to improve the economic environment will take some time to bear fruit and to have an evident impact on the real economy.

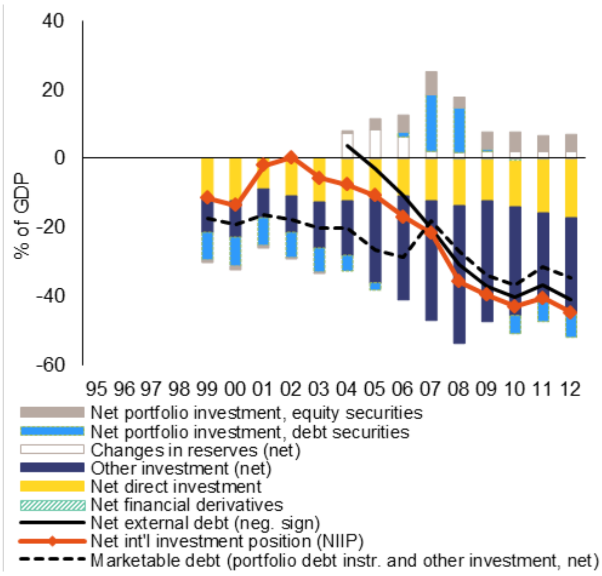
The interplay of these factors in the corporate sector further undermines the quality of banks' credit portfolios, increasing the NPL ratio from 14.4% in December 2012 to 17.2% in July 2013 (from 24% to 28.7% in the corporate segment over the same period). This puts pressure on already thin capital buffers, with the capital adequacy ratio declining from 11.6% to 11.2% in the first two quarters of 2013, and consequently on banks' ability to perform their intermediation function. Additional bank losses will also emerge from collateral valuations, as the adjustment in the housing market appears to have resumed, with prices in the second quarter down 4.6% year-on-year. Banks therefore need additional capital, and, failing to raise fresh capital in the markets, will likely have to recourse to public support (in particular in already state-owned banks). The state itself faces elevated funding costs, with the yield on 10 year bonds persistently above 6.5%, due to prolonged difficulties in reform implementation and uncertainty about the true scale of its contingent fiscal liabilities in the banking sector. Excessive deficit will remain in 2013 and government debt, which has breached the 60% of GDP threshold in 2013, will continue to rise.

Graph 1: GDP growth



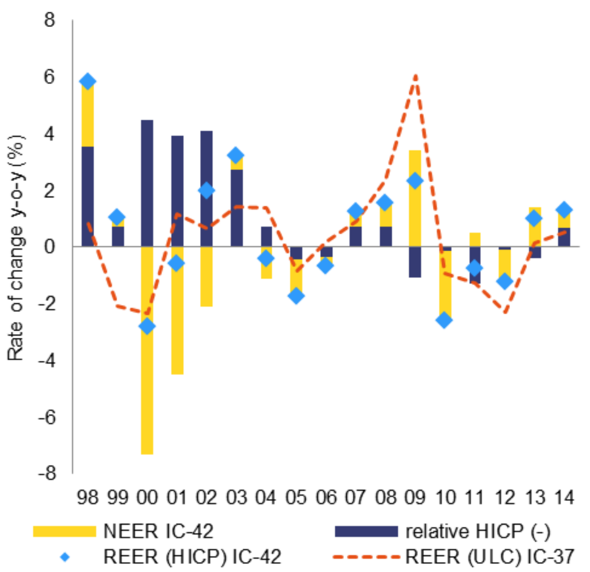
Source: Eurostat and Commission services' 2013 Spring Forecast

Graph 2: Net external debt and composition of Net International Investment Position



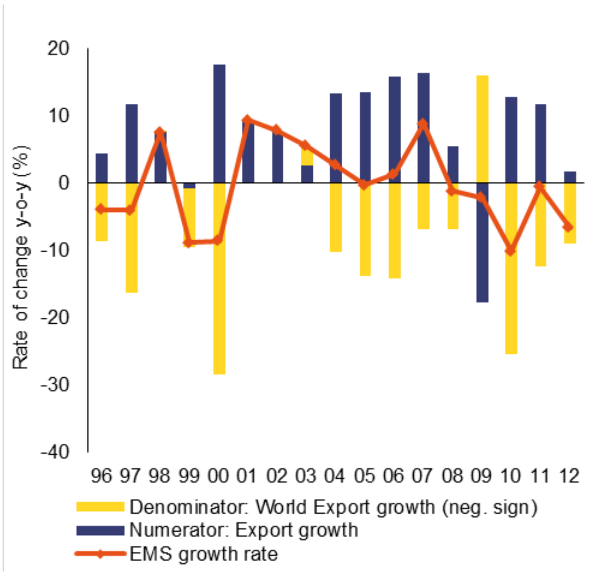
Source: Eurostat

Graph 3: Developments in Real Effective Exchange Rates



Source: Eurostat and Commission services' 2013 Spring Forecast

Graph 4: Export market share



Source: Eurostat

3. State of play with MIP-relevant reforms

3.1. Measures to support fiscal consolidation and enhance the quality of public finances

The general government deficit in Slovenia reached 3.8% of GDP in 2012. The large improvement from 6.3% of GDP in 2011 was partially due to lower capital support operations in 2012, i.e. lower expenditure for recapitalizations. The Commission Services' 2013 Spring forecast projected the deficit to increase to 5.3% of GDP in 2013 (including 1.2 pps worth of bank recapitalisations) and 4.9% of GDP in 2014. Against the background of adverse economic developments, the Council extended in June the deadline for correcting the excessive deficit by two years, to 2015. The Council recommendation under the EDP specifies the adjustment path, in both nominal and structural terms that Slovenia needs to embrace with a view to correcting the excessive deficit situation, while highlighting the importance of implementing growth-friendly consolidation that gradually decreases the current expenditure ratio to GDP.

MIP relevant commitments also cover issues linked to safeguarding growth-friendly spending and underpinning consolidation with systematic spending reviews, improving tax compliance and strengthening the fiscal framework to support the credibility of consolidation. Nevertheless, short and medium term fiscal consolidation strategies, which are key policy objectives and can provide a relevant contribution to the unwinding of macroeconomic imbalances, will be examined under the forthcoming assessment of effective action and assessment of the DBP and EPP. In this report the focus is on structural measures to strengthen public finance management and to contain longer term adverse fiscal dynamics.

The authorities are preparing an overhaul of the legislation underpinning Slovenia's **fiscal framework**, in compliance with the Treaty on Stability, Coordination and Governance in EMU (TSCG) and the secondary European legislation on fiscal governance. The Constitutional amendment setting the basis for the general government budget balance/surplus rule, which was finally adopted on 24 May, stipulates that "*Revenues and expenditures of the budgets of the state must be balanced in the medium-term without borrowing, or revenues must exceed expenditures*". Two legislative acts are under preparation to specify its implementation: (i) the new Fiscal Rule Act; (ii) the amended Public Finance Act. The former, to be adopted by Parliament with a two thirds majority still in 2013, is the main vehicle to specify the relevant concepts (e.g. revenue and expenditure, general government, medium-term objective, structural balance, as well as the format and mandate of the new fiscal council, etc.). More detailed implementing provisions will be enshrined in the revised Public Finance Act, which is expected to be adopted by Parliament in early 2014. The government also envisages revisions to the planning documents and procedures for the preparation of the central government budget. The new legislation will require a detailed assessment of compliance with the exigencies of the TSCG, which will be provided by the Commission in due time for all relevant Member States.

A **parametric pension reform** in force since January 2013 stabilises pension expenditure, but only until 2020. Thereafter, pension expenditure is projected to increase well above EU average -- by 5.9 pps. of GDP to 17% of GDP by 2060, while the average increase in the EU is 1.4 pps. of GDP. Further reform efforts were thus considered necessary in the country-specific recommendations to Slovenia with a view to strengthening the long-term sustainability of the pension system beyond 2020, including linking the statutory retirement age to gains in life expectancy, while preserving the adequacy of pensions.

The Ministry of Labour is monitoring the impact of the pension reform. After a significant increase in the number of pensioners at the end of 2012, as eligible workers decided to retire in anticipation of further changes in the pension system, a moderation of growth in the number of pensioners is observed. The government has established a working group to consider options for further pension reform, drawing its members from academia and ministries. Under consideration is, on the one hand, a pension point system that would bring the defined-benefit nature of the pension system very close to a defined contributions system, also by linking the benefits to changes in the dependency ratio and aligning the pensionable age with the increases in life expectancy and, on the other hand, a strengthening of the second pension pillar.

Longer term sustainability pressures also stem from the projected increase of both demand for **long-term care and related expenditure**, in light of population ageing. In this area, expenditure is still relatively low, but demand for services outstrips supply. An important aspect for Slovenia is therefore to contain the increase in expenditure on long-term care and improve access to services by refocusing the care provision from institutional to home care, better targeting benefits and reinforcing prevention. A "Resolution for a social care programme 2013-2020" issued by the government in May 2013 (in line with plans presented in the National Reform Programme) lays out plans for strengthening the community-based long-term care (to partially replace and complement institutional care). The adoption of the new Act on long-term care and personal assistance and of the new insurance-based system for long-term care is foreseen in the first half of 2014. The funding of the compulsory insurance-based system has to be clarified, but it will likely be based on compulsory contributions from the active and inactive population. The new system is not expected to increase social security contributions paid by the active population but would re-allocate a part of funding from current health care and pension and invalidity insurance to long-term care contributions.

While it is too early to make an assessment of the changes envisaged in the fiscal framework, the steps taken regarding the pension system and long-term care appear to go in the right direction to address the budgetary impact of population ageing, but need to be followed up by concrete actions. To this end, it would be important to prepare a clear timeline for implementation.

3.2. Repair of bank and non-financial sector balance sheets

The Slovenian banking sector is relatively small, at around 130% of GDP, which is less than half the euro area average (around 330%). However, several banks have been experiencing sustained pressure on capital buffers, which remain low in regional comparison, and their dependence on the state for capital is a substantial threat to fiscal sustainability.

Despite repeated recapitalisations, concentrated in state-owned banks, concerns as to the remaining scale of contingent fiscal liabilities in the banking sector persist. To regain confidence and credibility, in August 2013, the Bank of Slovenia hired independent consulting firms with relevant international experience to conduct an **Asset Quality Review (AQR) and Stress Testing (ST)** exercise (bottom-up and top-down). The exercise is covering almost 70% of the banking sector and is being closely monitored by a Steering Committee that includes as observers representatives of the European Commission, ECB and EBA. Some delays have emerged due to operational difficulties but the overall process seems to remain on track to deliver system-wide results by year-end. As observers in the Steering Committee, the representatives of the European Commission, ECB and EBA are given the opportunity to challenge, discuss and influence the methodological assumptions of the exercise.

The Slovenian authorities have committed to publish detailed methodological descriptions and results for the whole exercise (on a bank by bank basis) at the end of the process. This will be an important communication exercise requiring close co-ordination within Slovenia and with European Institutions. The communication will have to include elements on the backstops and contingencies should the capital shortfall strain currently earmarked fiscal resources. All state aid measures including for the asset transfers to the Bank Asset Management Company need Commission's approval and work is already on-going to ensure a swift process. The announcement should also describe key elements of the banking sector strategy currently being elaborated by the Bank of Slovenia, including expectations regarding the consolidation of the sector. After the AQR and ST, the crucial follow-up in terms fundamental repair of the sector, hinging on restructuring and privatisation, is still undefined. In particular, the September deadline for the announcement of an ambitious timetable for the divestment of direct and indirect state shareholdings of banks has not been met.

The **Bank Asset Management Company** (BAMC) is from an operational point of view largely ready to receive assets. However, key elements of its operating model are still being discussed, including issues such as additional provisioning on acquired assets, loss bearing capacity, ownership of bank equity and funding of going concern companies. Furthermore, the BAMC intends to build its work-out strategy from the bottom up, based on synergies that emerge among the assets actually transferred, rather than devising this a priori. Thus, while bank balance sheets will be relieved, the medium term impact on the public finances and on the underlying assets remains difficult to assess.

Looking forward, a firm supervisory stance, underpinned by workable powers, will be important to limit the build-up of risks and prompt medium to long term improvements in banks' processes and governance. In the context of MIP commitments, Slovenian authorities should review their framework for bank regulation by end-2013 and **strengthen supervisory capacity**, transparency and statistical disclosure. In this respect it is notable that the **framework legislation for bank restructuring** introduced in December 2012 is now being used in an orderly winding down of two small banks. This legislation is being further refined, with input from the European Commission and the ECB[5], to be able to operationalise the new state aid guidelines on burden sharing. Drawing on the lessons from the AQR-ST exercise, the Bank of Slovenia should strengthen its analytical and supervisory capacity.

As indicated in section 2, impaired bank balance sheets and deteriorating repayment capacity of over-indebted companies are intertwined. Barriers to timely restructuring of NPL to over-indebted companies (compulsory settlement procedures and early debt options) lead to low recovery rates and the number of insolvency procedures with insufficient assets is large as recovery value decline over time. The NRP stressed the urgent need for financial restructuring of many potentially viable but over-indebted companies.

Regarding the lengthy court proceedings, data reported by Supreme Court appear to confirm that certain positive trends in **judicial efficiency** have continued. For instance, since 2012, the number of civil and commercial pending cases was reduced by about 6% according to the preliminary data. Sharper drops saw commercial cases at certain district courts, where the Triaža project focusing on case management has been implemented. Disposition time in civil and commercial cases was further shortened, from 16 months in 2012 to 11 months in August 2013 according to preliminary data. The Ministry of Justice attributes these improvements to

[5] See the ECB opinion CON/2013/73.

a range of administrative enhancements, including a data warehouse, increased managerial accountability for court presidents and prioritisation of longest-pending cases. While continuous monitoring and refinements will be important, progress in this area appears to be broadly on track. In the area of enforcement, a slight reduction of pending cases can be observed but the overall number remains significant. Sustained improvement in these fields would substantially improve the business environment in the medium to long term and possibly send an important signal to existing and potential foreign direct investors.

A framework for **out-of-court financial restructuring** of non-financial companies is under preparation but the September deadline as outlined in the Council recommendations has been missed. . As long as such a framework is missing, restructuring is hindered by creditor hold-out and co-ordination problems. Restructuring incentives for owners are also weakened by the absence of a credible threat from insolvency procedures, despite the enactment of a partial overhaul in 2013. An expert working group was formed in mid-September to incorporate out-of-court restructuring options (previously entitled Systemic Debt Deleveraging Act) within the **insolvency code**. The Slovenian authorities are sourcing technical assistance from the IMF and the EBRD for the design of the law but the BAMC has not so-far been involved, despite its anticipated role in driving many restructuring and insolvency processes. At this stage, the overall concept appears adequate, but a full assessment of its economic consistency and effectiveness will be needed on the basis of the final text. According to the Ministry of Justice, the consolidated law should be ready for government adoption in early November. With high and rising financial distress in non-financial corporations, these legal changes are urgently required for short term stabilisation as well as for longer term investment and growth.

3.3. Other policies supporting competitiveness and adjustment

In 2011, state-owned enterprises accounted for one sixth of total value added of the Slovenian economy, around half of the total losses in the corporate sector, and employed one out of eight people. Moreover, state-controlled funds and enterprises have an impact on public finances through the interaction of elevated debt levels, recapitalisation needs and significant government guarantees. The size and weakness of state-owned enterprises hinder economic development and growth and contribute to existing imbalances. The cross-ownership of state-owned enterprises in the non-financial sector with state-owned financial institutions creates contagion risks, limits adjustment and distorts resource allocation, especially with regard to new credit and investment.

The key September deadline for classifying state-owned assets has been missed. The identification of core and non-core assets would have been an important preliminary step to underline the authorities' commitment to initiate a credible privatisation process after many years of standstill and attract new investors. Furthermore, given the long lead times inherent in privatisation processes, early actions are necessary even to unlock medium and long term results.

The Ministry of Finance has prepared a new draft law establishing the **Slovenia Sovereign Holding (SSH)** in September**,** which is envisaged as a vehicle for consolidating the indirect ownership stakes of the Republic of Slovenia and facilitating privatisation of non-core assets. The amended SSH Act would require the Ministry of Finance to submit to the government a strategy classifying individual assets in three groups (strategic, relevant and portfolio assets) according to certain criteria within three months after the law enters into force. The strategy would then have to be adopted by the government and by the National Assembly. Potential safeguards have been included in the new law, which ensure continued application of the strategy once adopted. In the transitional period before the first strategy enters into force, all assets will be considered "portfolio assets" except those in which the SSH has a share of more than 25% and with total book value in excess of EUR 20 million. This criterion may, however, be of limited relevance to avoid delays in adoption of the first strategy, as total book value of many state-owned companies exceeds EUR 20 million. Meanwhile, the sale processes for the 15 companies earmarked for ad-hoc privatisation in May 2013 is underway, albeit with uneven progress. While prospects for the Telekom privatisation are reportedly good and Helios is expected to be sold on October 16, a number of companies may prove difficult to sell. Further substantial delays to commit to a comprehensive and credible privatisation and asset management strategy would constrain disposal of non-core assets and lead to accumulation of further losses for the state.

The proposed amendments to the SSH Act, published on 17 September, seek to address a number of concerns identified by international organisations (including the OECD), mainly related to the governance structure of the SSH and an insufficient level of ownership consolidation. Adoption by parliament is expected in November 2013. Upon adoption, the SSH will come into force immediately. According to the new draft SSH law, the management of all assets directly and indirectly owned by the state will be centralised by fully merging all state-owned funds (SOD, KAD, DSU and PDP) and by transferring all voting rights and managerial functions for other assets directly owned by the Republic of Slovenia. Although ownership will remain partly decentralised, these changes would theoretically facilitate privatisation and asset management, making them more efficient and transparent.

The incentive-compatibility of the framework will be key to ensure effective and independent arm's length management in order to instil credibility of the SSH as a reputable manager of state-owned assets. A clear requirement to publish annual reports would be important to enhance accountability. The Commission welcomes the new chapter on enhanced integrity, which introduces the role of the compliance officer and obligations to disclose conflicts of interest, although for the latter more clarity is needed on exact scope of publicly available information. The public disclosure of the register of management and supervisory board appointments in state-owned enterprises is also an important step towards meeting a key requirement of the recommendations. The appointment of management and board members has been brought closer to international best practices, but transparency of the selection process still needs to be ensured through an open procedure where possible. For instance, while there is no imperative to regulate this aspect by law, an international call published by the supervisory board would improve the recruitment process of the management board of the SSH. In addition, new provisions on human resources and expert committee should be duly implemented in a transparent way. Finally, continuity of management and supervisory boards of state-owned enterprises and the SSH could be improved by clearly defined dismissal criteria for board members.

Regarding **labour market reforms**, a working group has been created and tasked with reporting on the implementation and impact of the March 2013 reform by March 2014. The possible impacts in terms of increased flexibility and reduced segmentation are considered the most important. This responds to the request for close monitoring of the reform. The work is indicator-based and, while the end result will be an ad-hoc report, it could lay the foundation for a richer database to use for regular monitoring. Preliminary observations provide encouraging signs. Slovenia's ranking on the OECD's EPL index (employment protection legislation index) has improved, younger workers appear to have had greater access to permanent contracts, suggesting a decrease in segmentation, and there is some evidence of flexibility in wage and non-wage setting through the renegotiation of collective agreements. The new student work regulation, which is under preparation, would aim to preserve flexibility while introducing social security contributions to reduce distortions and would be flanked by measures in the education sector to limit access to student status.

However, the high and uniform level and automatic indexation of the minimum wage in Slovenia hinders employment and reduces adjustment capacity in the short term. This is now acknowledged by the authorities and the government will enter into negotiations with social partners to make first steps toward the necessary adjustment. Revision of the minimum wage setting mechanism is however politically sensitive as social partners strongly oppose any reductions in the minimum wage. The approach being negotiated with social partners is to start in 2014 with an ad hoc freeze to the level of the minimum wage, combined with some refinements to the definition of the minimum wage. A more structural reform, such as introducing separate wage floors for certain categories of workers (such as the young) would be preferable. It is also important to explore all the available means for ensuring that wage developments and labour market institutions support competitiveness and job creation, including adjusting the tax wedge in a targeted way and more broadly supporting productivity improvements. The tax break on employer social security contributions for the first two years upon hiring unemployed young people on a permanent contract adopted in summer goes in this direction.

The government initiated an inter-ministerial process in 2012 to streamline Slovenia's numerous **regulated professions** with a view to enhancing employment creation and competitiveness. In terms of milestones, this process has not advanced since May, and some elements of the calendar appear to have slipped, particularly as regards the passing of secondary legislation to complete the first package (tourism and construction). However, for subsequent packages the original calendar remains valid: further milestones in the second and third packages of professions are due by the end of 2013. There has been no apparent effort to accelerate the process. Consultation with stakeholders in the policy development phase is reportedly one of the main hurdles.

The newly independent **Competition Protection Agency** has assigned the additional staff it received from other Ministries to reduce its backlog of cases and to focus on investigations in the energy sector, particularly gas. Just like any other budget user, the agency faces further cuts planned for 2014. In addition, investigations into the Agency's work in 2013 temporarily exerted external pressures. Overall, there still appears to be some way to go before the agency's independence is fully assured and before it can play a more pro-active role in wider economic policy development, including in the privatisation process.

Annex I – State of play of MIP relevant recommendations

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
I. Measures to improve fiscal outcomes and quality of public finances			
Safeguard growth-friendly spending, adopt measures to improve tax compliance and implement measures on the expenditure side underpinned by systematic reviews of public expenditure at all government levels.	- improved tax inspections and supervisions - control of transfers to tax havens - better supervision of high-risk activities - promotion of declaring business activities - strengthened tax enforcement procedures and sanctions	n/a	Throughout 2013: Adopted various measures aim at strengthening: - supervision and restrictions of cash operations - prevention of illegal work and employment - cooperation of inspection services - disincentives for illegal construction activities - supervision of specific risky sectors - awareness and sense of responsibility
To improve the credibility of consolidation, complete the adoption of a general government budget balance/surplus rule in structural terms, make the medium-term budgetary framework binding, encompassing and transparent, and strengthen the role of independent bodies monitoring fiscal policy by end 2013.	- Constitutional provision on general government budget balance/surplus rule in structural terms - New Fiscal Rule Act - Amended Public Finance Act - Amended Accounting Act	n/a	24/05/2013: The Constitution was amended and now provides a basis for establishing a general government budget balance/surplus rule in structural terms from the Treaty. The Fiscal Rule Act, implementing the constitutional provision, will be adopted by the end of 2013. The approval of the amended Public Finance Act is expected in early 2014.
Take measures to gradually reduce the contingent liabilities of the state.	/	n/a	21/06/2013: the government adopted a list of 15 companies earmarked for accelerated privatisation.

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
Strengthen the long-term sustainability of the pension system beyond 2020 by further adjusting all relevant parameters, including through linking the statutory retirement age to gains in life expectancy, while preserving the adequacy of pensions.	Discussion paper on the pension and disability insurance system after 2020	n/a	The government has established a reflection working group with members from academia and ministries on a further pension reform to preserve sustainability of the system beyond 2020
Contain age-related expenditure on long-term care and improve access to services by refocusing care provision from institutional to home care, sharpening targeting of benefits, and reinforcing prevention to reduce disability/ dependency.	Act regulating the activity of long-term care and insurance for long-term care	n/a	The Act is foreseen to be adopted in the first half of 2014.
II. Measures to repair bank and non-financial sector balance sheets			

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
Take the necessary steps, with input from European partners, to contract an independent external adviser in June 2013 to conduct a system-wide bank asset quality review.	Not in NRP, but in Minister Čufer's letter (23 May 2013)	n/a	The AQR/ST is on-going and covers 8 banks.
Complete this exercise in 2013, with faster progress in the cases of the two banks already subject to the state aid procedure, to accelerate their balance sheet repair.	Not in NRP, but in Minister Čufer's letter (23 May 2013)	n/a	Final system-wide report expected by end-2013, although some slippages are likely. Authorities now leaning towards system-wide announcement and measures rather than early transfers from NLB.
Stand ready to provide additional capital should the asset transfer or asset quality review reveal additional shortfalls.	Not in NRP, but in Minister Čufer's letter (23 May 2013)	n/a	Discussions on backstops and the communication strategy are on-going, in cooperation with COM and ECB.
Develop by March 2014 and implement a comprehensive sector strategy to ensure arms-length management of reformed banks and to substantially improve governance, risk management and profitability in the sector, including through consolidation where appropriate.	None	n/a	BoS has already performed some analysis of the consolidation needed in the banking sector to achieve long-term sustainability and profitability. Orderly wind-down of two banks (Factor Banka and Probanka) is ongoing. Takeovers/mergers are to be expected. No concrete progress regarding substantially improved governance, risk management and profitability in the sector seems to have been achieved.
Swiftly proceed with preparations for the announced privatisation of NKBM and establish, by September 2013, an ambitious timetable for the	None	n/a	Potential investors are waiting for the AQR/ST results and the transfer of impaired assets to the BAMC.

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
divestment of direct and indirect state shareholdings of banks.			
Review the bank regulatory framework by end 2013	None	n/a	Proposed amendments to the Banking Act adopted by the government in October 2013 allow for bail in of subordinated debtors in bank reorganisation processes. Parliamentary approval is still required.
(Based on this review) strengthen supervisory capacity, transparency and statistical disclosure.	None	n/a	None pending completion of AQR/ST
III. Other measures supporting competitiveness and adjustment			
Ensure that wage developments, including the minimum wage, support competitiveness and job creation	Change in the minimum wage setting in consultation with social partners to support competitiveness and make it fairer.	n/a	In consultation with social partners, the government aims to freeze temporarily the level of the minimum wage in 2014 and introduce some changes in the definition of the minimum wage.
Monitor closely the effects of the recent labour market reform and if necessary identify the areas where further action is needed to foster job creation and tackle segmentation, including through the regulation for student work.	Indicator based monitoring of the impact of the labour market reform in terms of increased flexibility and reduced segmentation. A survey among employers and employees whose contractual relations were discontinued. Monitoring of sectoral collective agreements. Overhaul of student work regulation.	n/a	A working group has been created and tasked with reporting on the implementation and impact of the March 2013 reform by March 2014. Introduction of social security contributions for student work and new measures in the education sector to limit access to student status by March 2014.

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
Take further measures to increase employment of young tertiary graduates, older persons and the low-skilled by focusing resources on tailor-made active labour market policy measures while improving their effectiveness. Address the skills mismatch by improving the attractiveness of the relevant vocational education and training programmes and by further developing cooperation with the relevant stakeholders in assessing labour market needs.	Amendments to the Vocational Education Act, General High School Act, new Slovenian Qualifications Framework Act.	n/a	Some new tailor-made ALMP measures were prepared and implemented; however, it is not clear how their effectiveness is being monitored. The new act on Emergency Measures in the field of Labour Market and Parental Care Act introduces a tax break for social security contributions for young workers on permanent contracts.
Accelerate the reform of regulated services, including a significant reduction of entry barriers.	De-regulation of regulated services/activities over 2013-2015	n/a	The inter-ministerial process to streamline regulated professions has not advanced since May, and some elements of the calendar appear to have slipped, particularly as regards the passing of secondary legislation to complete the first package (tourism and construction). However, for subsequent packages the original calendar remains valid: further milestones in the second and third packages of professions are due by the end of 2013.
Improve the business environment, including through ensuring the independence of and providing sufficient and autonomous financing to the Competition Protection Agency.	Additional staff	n/a	Further budgetary cuts planned for 2014 (as for other budgetary users). Overall, it still appears it will take some more time before the agency's independence is fully in place.

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
Build on previous efforts to further reduce the length of judicial proceedings at first instance in litigious civil and commercial cases and the number of pending cases, in particular enforcement cases.	Organisational changes in the judiciary in the area of civil and commercial disputes: extending the Triaža project for commercial disputes with partial rollout to at least three additional district courts planned in 2013 before complete nationwide rollout in 2014. Increase in the number of resolved enforcement cases by 5% in 2013 and a further 5% in 2014 through a combination of organisational measures and amendments to the enforcement legislation (planned for 2014).	n/a	July 2013: Amendments to the Law on courts July 2013: Amendments to the Law on the Judicial Service Organisational changes in the area of civil and commercial disputes (e.g. project Triaža at the Ljubljana Commercial Court) have been extended to several courts. Amendments to the Law on Execution and Security are envisaged by December 2013.
As part of the planned strategy of the government, to be completed by September 2013, classify core and non-core state assets according to economic criteria, with a view to divesting non-core assets.	Announcement of the strategy and the classification of assets	2013 Q3	The government published a new SSH Act for public consultation in September. According to the draft law the Ministry of Finance should submit to the government a strategy which will identify objectives of individual assets and classify them in three groups (strategic, relevant and portfolio assets) within three months after the law enters into force.
Make the Slovenia Sovereign Holding (SSH) fully operational in a timely manner, and transfer both ownership and management of all stakes to the SSH, potentially excluding those that are on the list for immediate full privatisation.	Announcement of amending the SSH Act, in line with the 13 March coalition agreement. The amendments would repeal the provisions on centralisation of ownership.	June 2013	According to the new draft law, the SSH will be set up immediately once the law enters into force. Management of all assets directly and indirectly owned by the state will be centralised, while ownership will remain partly decentralised. Although assets directly owned by the Republic of Slovenia will formally remain under state ownership, all

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
			voting rights and managerial functions will be transferred to the SSH. 21/06/2013: the government adopted a list of 15 companies earmarked for accelerated privatisation.
Ensure professional management of the SSH from the outset, potentially including international expertise, and a clearly defined arms' length relationship with the companies involved.	No measures announced	n/a	The appointment of management and supervisory board members has been brought closer to international best practices. The law strengthens arms' length relationship of the SSH with the SOEs by introducing an integrity plan, the role of the compliance officer and legal obligation of the SSH board to disclose any illegal action. In addition, any guidelines from the SSH to companies in which the SSH has a capital investment should be in line with the Management Code.
For core stakes, develop sector-specific strategies to improve profitability and corporate governance.	The NPR refers only to the overall strategy	n/a	The strategy with possible additional sector-specific strategies for core stakes will be adopted within three months after the SSH law enters into force.
Introduce an obligatory and publicly available register of management and supervisory board appointments in state-owned enterprises with requirements for disclosure of interests.	No measures announced	n/a	The new draft law introduces public disclosure of both the register of board appointments in state-owned enterprises and conflicts of interest.
Ensure that the regulatory framework facilitates divestment of non-core state assets and that	No measures announced	n/a	The agreement with trade unions in the energy sector may pose a barrier to divestment of assets in this sector.

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
administrative hurdles are minimised.			
Identify and start to work on removing all existing legal and administrative impediments to sustainable restructuring of over-indebted/undercapitalised but viable companies through market-based solutions. In this context, take measures to ensure sufficient private burden sharing, to increase private investment, including foreign direct investment, and to achieve efficiency gains in troubled companies as part of the restructuring process.	No measures announced	n/a	A new draft Systemic Debt Deleveraging Act to facilitate out-of-court restructuring along with further amendments to the insolvency code was published for public consultation on September 9th.
Adopt the necessary legal framework for out-of-court restructuring by September 2013, ensuring that it is coherent with the existing provisions on insolvency and provides incentives for both creditors and shareholders to reach out-of-court restructuring agreements.	A new Systemic Debt Deleveraging Act to facilitate out-of-court restructuring was announced to be prepared by the MoF by May 2013.	September 2013	A new Systemic Debt Deleveraging Act and further amendments to the insolvency code (Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act) were published for public consultation on 9 September, 2013.

Main components of CSR	Measures announced in NRP	Ddl NRP	Progress
Improve the enforcement of corporate insolvency procedures and in-court settlements, including swiftly resolving pending court cases related to bankruptcy procedures, in order to maximise recovery value and to facilitate the timely and efficient resolution of non-performing loans.	Measures to strengthen role of creditors in insolvency procedures; New fast track compulsory settlement procedures for micro companies; falling price ("Dutch") auctions; Regulation of mediation for settlement of disputes arising from insolvency; refined definition of insolvency	Adoption in the Parliament by June 2013.	15/06/2013: Amendments to the Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act.