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Country Report Slovenia 2017
Including an In-Depth Review on the prevention and correction of macroeconomic imbalances

Accompanying the document

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK AND THE EUROGROUP

2017 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011

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EXECUTIVE SUMMARY

This report assesses Slovenia's economy in the light of the European Commission's Annual Growth Survey published on 16 November 2016. In the survey the Commission calls on EU Member States to redouble their efforts on the three elements of the virtuous triangle of economic policy — boosting investment, pursuing structural reforms and ensuring responsible fiscal policies. In so doing, Member States should focus on enhancing social fairness to deliver more inclusive growth. At the same time, the Commission published the Alert Mechanism Report (AMR) that initiated the sixth round of the macroeconomic imbalance procedure. The in-depth review, which the 2017 AMR concluded should be undertaken for the Slovenian economy, is presented in this report.

The Slovenian economy continued to experience solid growth in 2016. Economic output is estimated to have expanded by 2.5 % in 2016, after a 2.3 % growth in 2015. The rebound, which started in 2014, was initially driven by strong export performance supported by improved cost competitiveness. Subsequently, the recovery has spread as private consumption has picked up, boosted by an improving labour market, rising consumer confidence and continued low energy prices. Growth is forecast to increase to 3.0 % in 2017 and 2018, and remain broad-based with a further shift from external to domestic demand. The general government deficit is estimated to have decreased to 2.0 % of GDP in 2016 and to decline further to 1.7 % in 2017 and 1.4 % in 2018. Public debt peaked at 83.1 % of GDP in 2015 and is projected to gradually decline to 76.7 % of GDP in 2018.

The positive labour market and social trends continued into 2016. Over a quarter of the people who found employment in the first quarter of 2016 were either long-term unemployed, low-skilled or young. However, long-term unemployment is still above pre-crisis levels and represents more than half of all people who are unemployed. Slovenia has one of the lowest levels of income inequality in the EU. In addition, the rate of people at risk of poverty and social exclusion continued to decrease.

Exporting sectors are more competitive than sectors dominated by state-owned enterprises. The high and growing share of exports in GDP is indicative of how important the tradable sector has been in supporting the economic recovery. While the economy is growing at a solid rate, state-owned entities have underperformed compared to their privately owned peers in terms of productivity and profitability. Although several important state-owned enterprises have been privatised and a comprehensive framework to manage state-owned enterprises has been put in place, remaining weaknesses of corporate governance in state-owned enterprises still have some negative impact on private investment and growth.

Overall, Slovenia has made some progress in addressing the 2016 country-specific recommendations. Limited progress has been made in ensuring the long-term sustainability of public finances. The appointment of the Fiscal Council has been further delayed and the amendments to the Public Finance Act still need to be adopted by the Parliament. The government published a white paper on pensions in April 2016, opening a wide public consultation on possible solutions for the new pension reform. The work on reforms in healthcare has yielded some progress with proposals to reform the health care system now in public consultation. Work on long-term care reform is advancing with limited progress. Limited progress has been made regarding the employability of vulnerable groups. An action plan on increasing the employment rate for older workers was adopted. Some progress has been made implementing several policy measures to enable the durable reduction of non-performing loans but only limited progress in improving access to alternative financing sources for business with relevant instruments still in preparation. In addition, revisions to the legislative framework further reinforced the corporate restructuring capacity of the Bank Asset Management Company. Thus, overall, some progress was made on this recommendation. Some progress was made on modernising public administration, reducing administrative burden and also on improving the governance of state-owned enterprises. Concerning the latter, the new comprehensive framework for the management of state-owned enterprises was implemented for the first time in 2016.

Regarding progress in reaching the national targets under the **Europe 2020 strategy**, Slovenia has already achieved its national targets to reduce early school leaving and to increase tertiary educational attainment. Poverty and social exclusion declined in 2015. However, the number of people at risk of poverty or social exclusion is still considerably higher than the intended target. While Slovenia appears to be on track to achieve its national target for renewable energy and greenhouse gas emission by 2020, additional efforts would be needed to reach the national target regarding the employment rate and to remain on track towards the energy-efficiency target. In 2015, Slovenia moved further away from its R&D intensity target.

The main findings of the in-depth review contained in this report, and the related policy challenges, are as follows:

- **Risks to external sustainability have receded.** Gains have been recorded in price and cost competitiveness and in export market shares. After the peak in 2015, the current account surplus remained high, at 7.4 % of GDP in 2016 and net external liabilities continued to decrease below 40 % of GDP. As domestic demand gradually strengthens, the current account surplus is expected to decrease but remain high in the medium term. Although it is already at a moderate level, the country's negative net international investment position is expected to improve further.

- **The profitability of the banking sector has continued to improve, due to increasing asset prices and better risk management.** Banks are well capitalised, with solvency ratios above EU average, and have access to sufficient liquidity. All banks are profitable; however the recent increase in net income is in large part due to a release of loan loss reserves that were built up over previous years. Non-performing loans have declined substantially and are expected to decline further, although they remain high.

- **Pressures to reduce debt have started to ease and external financing for firms is becoming more available.** While household debt is among the lowest in the EU, corporate debt is much higher. The corporate sector has considerably reduced its debt ratio since its peak in 2010 and is expected to continue to do so. Debt instruments are becoming increasingly available to small and medium-sized businesses but their access to alternative financing is still limited. This could help to diversify funding sources and reduce vulnerability to credit market developments. Lending to households turned positive in 2016.

- **The business environment is improving but continues to be an obstacle for more private investment**. Barriers to doing business are mainly linked to the public administration inefficiencies and complex and lengthy administrative procedures, especially in the field of construction and spatial planning. A strategy to modernise and increase the efficiency of public administration is being implemented with expected completion by end of 2017 or shortly after. Private investment is increasing but remains still relatively low and public investment is strongly dependent on EU funds. Private investment declined sharply below the euro area average during the crisis and has continued to decrease since then. At the same time, foreign direct investment in Slovenia has grown markedly in the last two years, partly supported by privatisation.

- **The performance of state-owned enterprises has started to improve, underpinned by a new corporate governance system, but risks remain.** The profitability of state-owned enterprises improved in 2015, albeit falling short of the intermediate target set in the management strategy. State ownership remains high despite the privatisation programme initiated in 2013. The implementation of professional and prudent policies on the management of state-owned enterprises are expected to reduce contingent liabilities to the general government budget from this area.

- **A prolonged recession coupled with significant bank recapitalisations has resulted in a sharp rise in public debt in recent years.** While the government deficit has been reduced and is no longer excessive, fiscal consolidation measures in recent years, particularly on the expenditure side, have been of a temporary nature. The fiscal framework reform, which provides an important anchor for sustainable public finances, is yet to be fully implemented.

- **Population ageing puts considerable pressure on the long-term sustainability and adequacy of the pension system.** Despite the 2012 pension reform, major long-term risks remain. Slovenia has a very strong projected impact of age-related public spending in particular for pensions. Workers with shorter careers and longer career breaks can expect income adequacy problems in old age. Currently, a new pension reform is under preparation.

- **The authorities presented the proposals to reform the health care system while the reform of long term care has been delayed.** A central piece of health care legislation is in public consultation. It presents an important step towards reforming the health care system. The major changes concern funding of the health care system, management and responsibilities of the single insurer for compulsory health insurance, and the contracting process with health care providers. In addition, the authorities aim to prepare act to improve governance and performance of hospitals. Remaining challenges concern primary care as a gatekeeper for in-patient care, hospital payment systems, health technology assessments, and information systems. In addition, the benefits from centralised public procurement of medical products and services remain largely untapped. The accompanying long-term care reform, which aims to achieve a sustainable, high quality and affordable care system has been delayed.

Other key economic issues analysed in this report which point to particular challenges facing Slovenia's economy are as follows:

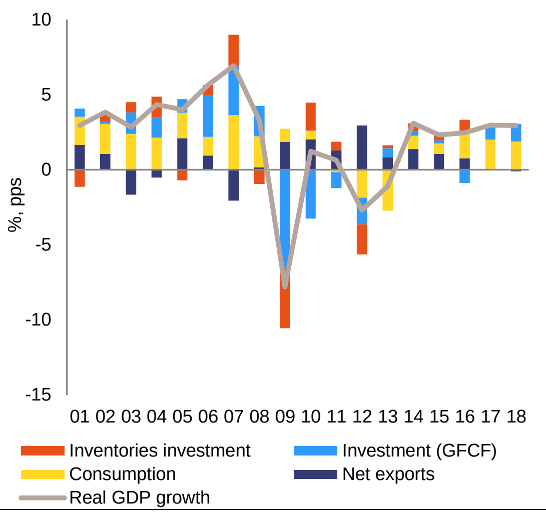
- **The improving labour market offers an opportunity to provide employment for older workers.** After five years of rising unemployment, the trend reversed in 2014 and the labour market conditions have improved further since then. Nevertheless, structural challenges in the labour market remain. Long-term unemployment is high and the employment rate of older workers is the lowest in the EU. In view of the rising labour demand and labour becoming increasingly scarce there is an opportunity to increase the labour market participation of older workers. This is also relevant in the context of the current discussion on the future pension reform.

1. ECONOMIC SITUATION AND OUTLOOK

GDP growth

The Slovenian economy expanded steadily in 2016. GDP growth of an estimated 2.5 % in 2016 was driven by rising exports and consumption, showing resilience despite a significant contraction in public investment. It is the third year of consecutive growth above 2%, following double-dip recession between 2008 and 2013 which caused a cumulative loss of more than 9 % of GDP. Strong export performance, boosted by improved competitiveness, drove the initial recovery, later supported by the strengthening of domestic demand. Private consumption and private investment grew strongly in the first half of 2016, supported by an improving labour market, rising consumer confidence and persistently low energy prices. Overall investment contracted, caused by large fall in public investment. Government consumption continued to contribute positively in 2016, after falling in 2010-2014 period.

Graph 1.1: **GDP and contributions**



Source: European Commission, 2017 winter forecast

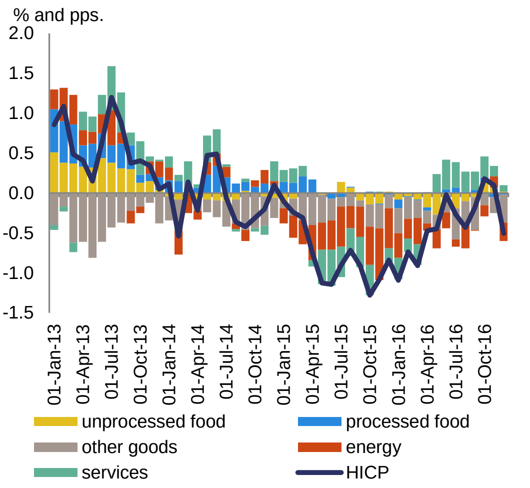
Momentum in economic growth is expected to be maintained. Real GDP is projected to grow by 3.0 % in 2017 and 3.0 % in 2018 according to the Commission's 2017 winter forecast (Graph 1.1). Private consumption, supported by rising employment and increased wages, is set to be the principal contributor to growth. Both private and public investments are expected to contribute to GDP growth in 2017 and 2018. Private investment growth is expected to be significantly higher than public, in part due to the delayed rebound in EU funding. Wages are expected to further increase in 2017 and 2018, mostly due to the reversal of certain consolidation measures in the public sector. Exports growth is expected to stay resilient, although exports could be impacted by the slowdown of demand in trading partners. The contribution of net exports to GDP growth is forecast to fall, as rising domestic demand fuels imports.

Export firms are driving the recovery, while a significant part of the economy is not contributing to the growth. The high and growing percentage of GDP represented by exports indicates how important the tradable sector has been in supporting the economic recovery. Although growing at a solid rate, a major part of the economy, namely state-owned firms and the sectors that they dominate is not adequately contributing to the recovery. Negative spill-overs from the high level of state involvement in the economy and inefficient corporate governance in state-owned firms distort resource allocation, harm the business environment and hamper overall investment. Exporting companies started to borrow again in 2014, while firms in the non-tradable sectors continue to reduce debt. This is reflected in the still contracting corporate credit growth as exporters have access to loans at better conditions from abroad.

Inflation

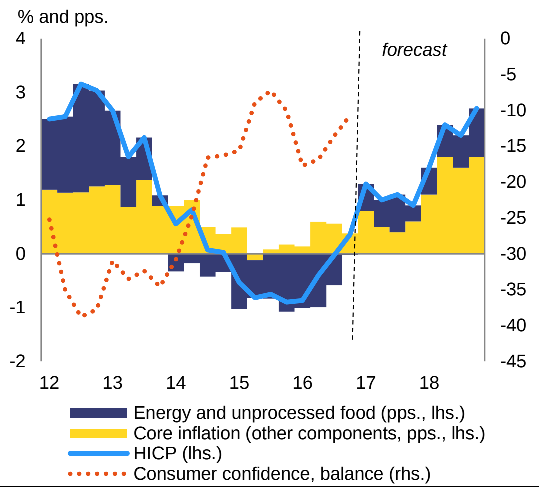
Inflation in Slovenia in the past two years was among the lowest in the euro area. Headline inflation (HICP) has been decreasing since mid-2013 and slipped into deflation in December 2014. For almost two years the growth in prices was lower than in the euro area (Graph 1.2). The fall in global oil prices had a stronger effect on the Slovenian headline inflation, due to the higher weight of energy in the consumer basket. The historically low core inflation was due to weak domestic demand.

Graph 1.2: **Differences in price growth between Slovenia and the euro area**



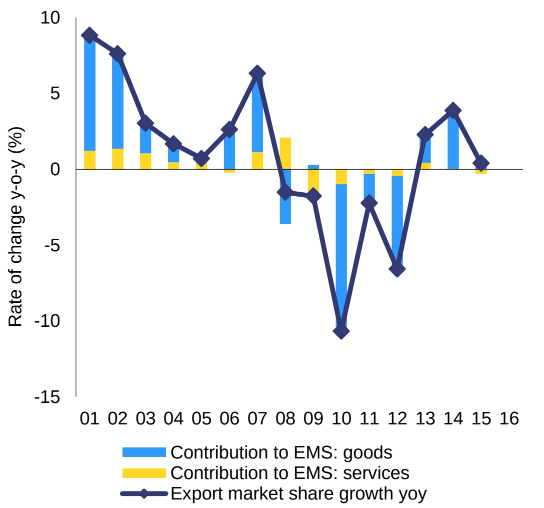
Source: European Commission

Graph 1.3: **Price growth and confidence indicator**



Source: European Commission, 2017 winter forecast

Graph 1.4: **Export market share (EMS)**



Source: Eurostat

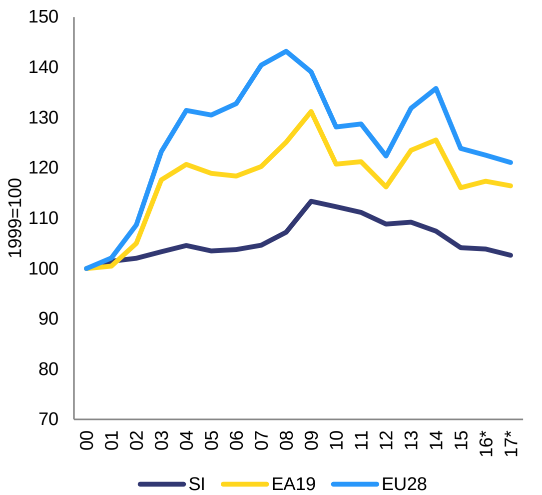
Low inflation supported real disposable income. The inflation rate was negative at -0.2 % in 2016, after -0.8 % in 2015. However, prices started to recover in the second half of 2016 due to, rebound in oil prices and private demand. The latter reflects the growth of real disposable incomes as a result of the labour market improvement, higher employment and increasing public sector wages.

Inflation is expected to pick up gradually in the coming years. Recovery of both oil and other commodity prices is expected to increase their contribution to the headline inflation. In addition, increase in wages and consequent rise in domestic demand are expected to put some pressure on price growth and bring inflation closer to the position of Slovenia in the business cycle. However, inflation might slow down due to structural changes arising from technological innovations, new shopping behaviours and demographic trends in the long run.

Competitiveness and external position

Competitiveness continued to improve. Following five years of market share losses, Slovenia gained 2.3 % of export market shares in 2013, 3.9 % in 2014 and 0.4 % in 2015 (Graph 1.4). This increase was mainly driven by gains in exports of manufactured goods. Rebalancing the economy towards tradable sectors and improved cost competitiveness have been the key underlying factors. Real effective exchange rates (Graph 1.5) deflated by nominal unit labour costs decreased significantly in the last two years. Competitiveness improved due to both productivity gains and continued wage moderation.

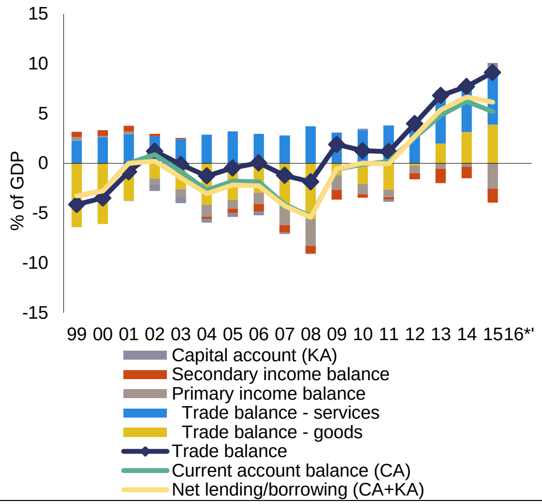
Graph 1.5: **Real effective exchange rate based on ULC, IC-37 (a group of 37 industrial countries)**



Source: Commission services (AMECO)

After peaking in 2015, the current account surplus stayed high in 2016, supported by strong export performance (Graph 1.6). Services have traditionally been a positive contributor to the trade balance. However, the recent increase in the trade balance surplus was mainly driven by the rapidly increasing surplus in goods, which was supported by favourable terms of trade, high growth in real exports and subdued import due to sluggish domestic demand prior to 2016. Both goods and services balances have reached historically high levels. As domestic demand gradually strengthens, it is expected that the current account balance will start falling but will remain in significant surplus in the medium term. The primary income deficit might deteriorate due to higher dividend payments to foreign owners of non-financial corporations while the secondary income balance is expected to remain stable. The main underlying reason for the high current account surplus is that Slovenian companies continue to deleverage and retain cash balances instead of investing them (see Section 4.4 Investment).

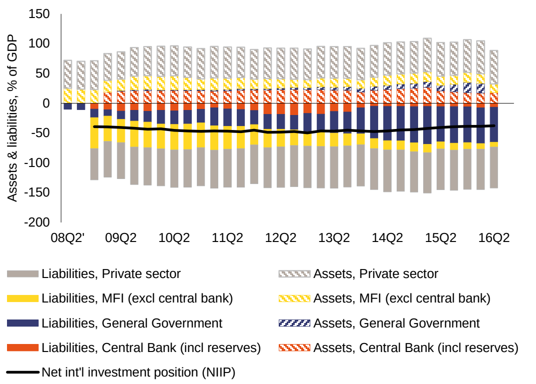
Graph 1.6: **Decomposition of external position (current and capital accounts)**



Source: Eurostat

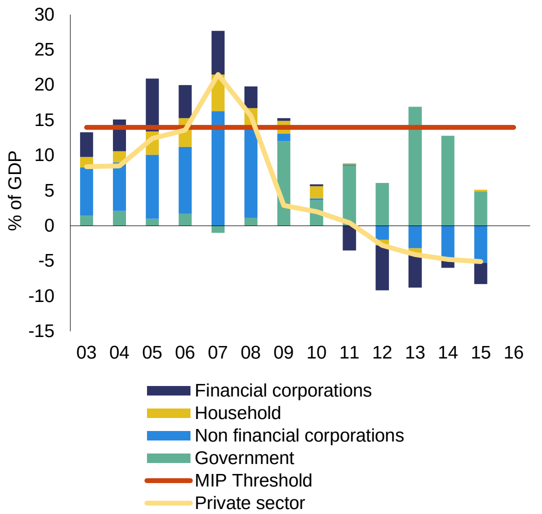
The net international investment position (NIIP) is gradually improving. The NIIP worsened during the crisis, hitting a trough of -49.9 % of GDP in 2012. The trend was reversed in 2013, reflecting the adjustment in the corporate sector behaviour. It is expected that the NIIP will continue to improve in the coming years. Thus, risks to the external position are reduced. The structure of the NIIP has changed. The monetary and financial institutions have significantly reduced their net foreign liabilities since the height of the crisis, while the general government position had worsened until 2015. The government's net borrowing, apart from financing the deficit, was used mainly to recapitalise banks.

Graph 1.7: **NIIP by sectors**



Source: Eurostat

Graph 1.8: **Decomposition of credit flows**



Source: Eurostat

Financial sector

Financial sector assets contracted in 2015, driven by further deleveraging in the private sector. The financial sector has yet to fully benefit from the improvement in the macroeconomic condition despite several encouraging signals, such as the banking sector's return to profitability and the positive trend in demand for new loans. While net credit flows remain negative for corporations (Graph 1.8), the pace of credit contraction has diminished and households' credit flows turned positive in 2015. Subdued lending to non-financial corporations is also linked to the high level of state involvement in certain sectors of the economy. It is also affected by the high level of corporate non-performing loans on banks' balance sheets and the ongoing financial and operational restructuring in the corporate sector. However, the capitalisation of the banking sector has improved while the decrease in the percentage of non-performing loans has gained momentum Non-performing loans (NPLs) have declined from 14.2 % in June 2015 to 9.1 % in September 2016 and the trend is expected to continue (Section 4.2).

Labour market and social developments

The better macroeconomic conditions help the labour market. The increase in employment and the decrease in unemployment seen in 2015 continued in the first half of 2016 with more people finding work than becoming unemployed. In the first half of 2016, 5.9 % of unemployed moved into employment, of whom 13.8 % were long-term unemployed, 7.6 % low skilled and 5.1 % young. The employment rate (in 20-64 age group) increased by 0.2 pps from Q3 2015 to Q3 2016. The increase was most significant for the age-group 25-29 (4.3 pps). Manufacturing was particularly strong while the only sectors not to witness an employment increase were construction, insurance, and financial services. Despite declining in the first half of 2016, long-term unemployment still represents more than half of all unemployed. It is still more than 10 pps (55.2% in Q2 2016) higher than before the crisis.

Income inequality remains among the lowest in the EU despite its increase during the recession. In 2015 income inequality started to decline; however it remained above the pre-crises level. ([1])

([1]) As measured by the Gini coefficient and by the income quintile share ratio. The Gini coefficient takes values between 0 and 100 with higher values indicating a higher degree of income inequality. The income quintile share ratio (80/20) is the ratio of total income received by the 20% of the population with the highest income to that received by the 20% of the population with the lowest income.

Specifically, the Gini coefficient of equivalised ([2]) disposable income remains well below the EU average at 24.5 in 2015 (EU: 30.9), even though it increased by 1.8pps over 2007 - 2014. Similar developments are shown by the income quintile share ratio (80/20). By contrast, net wealth ([3]) is not as equally distributed as income, but is within the range observed in other EU countries for which data were collected in 2013-2014 (ECB 2016).

The tax and benefit system further reduces the already low degree of market income inequality. Specifically, the Gini coefficient on market income (before taxes and social transfers) is in the EU bottom quartile. After taxes and transfers, the Gini coefficient drops to a level which is among the lowest in the EU.

The elderly are at the highest risk of poverty. The at-risk-of-poverty rate for elderly people over 65 years old is above the EU average before and after social transfers (including pensions). Almost 16% of them are at a persistent risk of poverty, which is among the highest in the EU. ([4]) The at-risk-of-poverty rate for the age group 55 to 64 years is also among the highest in the EU due to its low employment rate (see Section 4.3).

Public Finances

General government deficit and debt are projected to improve gradually reflecting the favourable macroeconomic outlook. Slovenia has taken welcome steps in recent years to reduce the deficit and improve the sustainability of public finances. The deficit decreased considerably from 2013 (-15 % of GDP) to 2015 (-2.7 % of GDP), and is expected to decrease to -2.0 % of GDP in 2016. The general government deficit is expected to decline further to 1.7 % of GDP in 2017, mainly due to buoyant tax and social contributions receipts. Conversely, the structural deficit is expected to worsen and remains above the euro area average (Section 4.1). Public debt almost quadrupled from 2008 to 2015, but after peaking in 2015 at 83.1% of GDP it is expected to decrease in the coming years.

([2]) The total disposable household income is "equivalised" to take into account differences in household size and composition. The equivalised income attributed to each member of the household is calculated by dividing the total disposable income of the household by the equivalisation factor. This indicator gives a weight of 1.0 to the first person aged 14 or more, a weight of 0.5 to other persons aged 14 or more and a weight of 0.3 to persons aged 0-13.

([3]) Difference between total assets and total liabilities.

([4]) The at-persistent-risk-of-poverty rate is defined as the percentage of the population living in households where the equivalised disposable income was below the at-risk-of-poverty threshold for the current year and at least two out of the preceding three years.

Table 1.1: **Key economic, financial and social indicators - Slovenia**

									forecast		
	2004-2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Real GDP (y-o-y)	4.9	-7.8	1.2	0.6	-2.7	-1.1	3.1	2.3	2.5	3.0	3.0
Private consumption (y-o-y)	3.0	0.9	1.3	0.0	-2.5	-4.0	2.0	0.5	2.7	3.2	2.9
Public consumption (y-o-y)	3.1	2.4	-0.5	-0.7	-2.2	-2.1	-1.2	2.5	2.3	1.5	1.9
Gross fixed capital formation (y-o-y)	7.6	-22.0	-13.3	-4.9	-8.8	3.2	1.4	1.0	-4.5	5.3	6.4
Exports of goods and services (y-o-y)	11.3	-16.6	10.2	6.9	0.6	3.1	5.7	5.6	6.4	4.3	4.7
Imports of goods and services (y-o-y)	10.9	-18.8	6.8	5.0	-3.7	2.1	4.2	4.6	6.1	4.9	5.5
Output gap	3.9	-3.2	-2.6	-2.2	-4.8	-5.7	-3.2	-1.7	-0.3	1.3	2.7
Potential growth (y-o-y)	3.6	1.5	0.6	0.2	-0.1	-0.2	0.5	0.8	1.0	1.3	1.6
Contribution to GDP growth:											
Domestic demand (y-o-y)	4.2	-5.6	-2.7	-1.2	-3.6	-2.1	1.2	0.9	0.9	2.9	3.1
Inventories (y-o-y)	0.5	-4.0	1.9	0.6	-2.0	0.2	0.6	0.4	0.7	0.0	0.0
Net exports (y-o-y)	0.1	1.9	2.0	1.3	3.0	0.8	1.4	1.1	0.8	0.1	-0.1
Contribution to potential GDP growth:											
Total Labour (hours) (y-o-y)	0.1	0.1	-0.1	-0.2	-0.1	-0.3	0.2	0.2	0.3	0.2	0.2
Capital accumulation (y-o-y)	1.8	0.8	0.2	0.0	-0.3	-0.2	-0.2	-0.2	-0.3	-0.1	0.1
Total factor productivity (y-o-y)	1.6	0.6	0.5	0.4	0.4	0.4	0.5	0.7	1.0	1.2	1.3
Current account balance (% of GDP), balance of payments	-3.2	-0.6	-0.1	0.2	2.6	4.8	6.2	5.2	.	.	.
Trade balance (% of GDP), balance of payments	-1.0	1.9	1.3	1.2	4.0	6.8	7.7	9.1	.	.	.
Terms of trade of goods and services (y-o-y)	-0.8	3.5	-4.0	-1.4	-1.1	0.8	1.0	1.3	1.9	-1.0	-0.2
Capital account balance (% of GDP)	-0.3	0.0	0.1	-0.2	0.1	0.5	0.4	1.0	.	.	.
Net international investment position (% of GDP)	-20.0	-43.6	-47.2	-45.2	-49.9	-46.6	-44.2	-38.7	.	.	.
Net marketable external debt (% of GDP) (1)	-18.8*	-43.2	-46.9	-41.7	-44.7	-41.5	-36.7	-29.0	.	.	.
Gross marketable external debt (% of GDP) (1)	78.1	110.0	110.3	105.0	110.5	107.6	114.9	107.5	.	.	.
Export performance vs. advanced countries (% change over 5 years)	34.1	18.8	6.4	2.8	-11.5	-10.5	-5.9	-1.53	.	.	.
Export market share, goods and services (y-o-y)	3.2	-2.6	-9.9	-1.7	-7.2	2.6	3.7	-0.8	.	.	.
Net FDI flows (% of GDP)	0.4	1.4	-0.3	-1.7	-1.3	-0.1	-1.6	-3.2	.	.	.
Savings rate of households (net saving as percentage of net disposable income)	9.3	7.7	6.1	5.4	2.8	5.4	5.4	6.9	.	.	.
Private credit flow, consolidated (% of GDP)	14.3	2.9	2.0	0.4	-2.8	-4.1	-4.8	-5.1	.	.	.
Private sector debt, consolidated (% of GDP)	85.6	113.5	115.2	113.0	112.5	108.2	98.2	87.3	.	.	.
of which household debt, consolidated (% of GDP)	21.3	28.5	30.4	30.0	30.9	30.0	28.5	27.8	.	.	.
of which non-financial corporate debt, consolidated (% of GDP)	64.3	85.0	84.8	83.0	81.6	78.2	69.7	59.5	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	-6.4	0.6	1.3	2.3	3.0	13.0	6.8	3.6	2.7	3.0	2.4
Corporations, gross operating surplus (% of GDP)	19.4	18.6	18.3	18.6	18.2	18.8	19.7	19.9	20.5	21.2	21.3
Households, net lending (+) or net borrowing (-) (% of GDP)	4.4	5.1	4.6	4.6	3.7	6.1	4.8	5.6	7.4	6.6	6.2
Deflated house price index (y-o-y)	10.5	-10.3	-1.3	0.9	-8.2	-6.0	-6.6	1.5	.	.	.
Residential investment (% of GDP)	3.9	3.8	3.1	2.8	2.5	2.4	2.2	2.3	.	.	.
GDP deflator (y-o-y)	3.1	3.4	-1.0	1.1	0.3	0.9	0.8	1.0	1.4	1.0	1.9
Harmonised index of consumer prices (HICP, y-o-y)	3.6	0.9	2.1	2.1	2.8	1.9	0.4	-0.8	-0.2	1.1	2.3
Nominal compensation per employee (y-o-y)	6.5	1.8	4.0	1.5	-1.0	0.5	1.3	1.4	2.0	2.2	3.6
Labour productivity (real, person employed, y-o-y)	3.3	-6.1	3.4	2.4	-1.8	0.0	2.7	1.2	.	.	.
Unit labour costs (ULC, whole economy, y-o-y)	3.1	8.5	0.6	-0.8	0.8	0.4	-1.3	0.3	0.7	0.3	1.7
Real unit labour costs (y-o-y)	-0.1	5.0	1.6	-1.9	0.5	-0.4	-2.1	-0.7	-0.7	-0.7	-0.2
Real effective exchange rate (ULC, y-o-y)	0.7	5.7	-0.9	-1.3	-2.1	0.7	-1.7	-1.9	-0.1	-0.8	0.0
Real effective exchange rate (HICP, y-o-y)	0.0	2.3	-2.6	-0.8	-1.2	1.3	1.0	-1.8	0.4	-2.3	.
Tax rate for a single person earning the average wage (%)	34.2	32.9	33.1	33.2	33.3	33.1	33.3	33.3	.	.	.
Tax rate for a single person earning 50% of the average wage (%)	28.3*	24.4	22.7	22.9	22.9	22.8	22.9	23.0	.	.	.
Total Financial sector liabilities, non-consolidated (y-o-y)	18.6	4.7	-2.5	-2.1	-3.4	-10.1	6.1	-2.2	.	.	.
Tier 1 ratio (%) (2)	.	8.9	8.3	8.8	9.1	12.9	18.9	19.3	.	.	.
Return on equity (%) (3)	.	-0.1	-5.4	-16.9	-28.3	-121.9	-2.9	5.1	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) (4)	.	.	.	.	19.2	17.1	16.6	13.3	.	.	.
Unemployment rate	5.6	5.9	7.3	8.2	8.9	10.1	9.7	9.0	7.9	7.0	6.2
Long-term unemployment rate (% of active population)	2.7	1.8	3.2	3.6	4.3	5.2	5.3	4.7	.	.	.
Youth unemployment rate (% of active population in the same age group)	13.3	13.6	14.7	15.7	20.6	21.6	20.2	16.3	15.8	.	.
Activity rate (15-64 year-olds)	70.9	71.8	71.5	70.3	70.4	70.5	70.9	71.8	.	.	.
People at risk of poverty or social exclusion (% total population)	17.8	17.1	18.3	19.3	19.6	20.4	20.4	19.2	.	.	.
Persons living in households with very low work intensity (% of total population aged below 60)	7.4	5.6	7.0	7.6	7.5	8.0	8.7	7.4	.	.	.
General government balance (% of GDP)	-1.2	-5.9	-5.6	-6.7	-4.1	-15.0	-5.0	-2.7	-2.0	-1.7	-1.4
Tax-to-GDP ratio (%)	37.6	36.7	37.4	37.0	37.4	37.3	37.0	37.1	36.7	36.5	35.9
Structural budget balance (% of GDP)	.	.	-4.4	-4.6	-1.8	-1.8	-2.4	-1.8	-1.9	-2.1	-2.6
General government gross debt (% of GDP)	24.8	34.6	38.4	46.6	53.9	71.0	80.9	83.1	80.9	78.9	76.7

(1) Sum of portfolio debt instruments, other investment and reserve assets.
(2,3) domestic banking groups and stand-alone banks.
(4) domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches.
(*) Indicates BPM5 and/or ESA95

Source: European Commission, ECB

2. PROGRESS WITH COUNTRY-SPECIFIC RECOMMENDATIONS

Progress with implementing the recommendations addressed to Slovenia in 2016 ([5]) has to be seen as part of a progress which started with the introduction of the European Semester in 2011. Since then, Slovenia has been recommended to improve the long-term sustainability of its pension system. While a comprehensive pension reform has been prepared, it was outvoted in a referendum in June 2011. A parametric pension reform was adopted in 2012 but the revisions do not safeguard the system's sustainability post-2025. Therefore the Council recommended adopting the necessary measures to ensure the long-term sustainability and adequacy of the pension system by the end of 2017.

Measures have been adopted to improve the employability of low skilled and older workers. Since 2011 the Council has recommended measures to increase the employability of low-skilled and older workers. The 2013 labour market reform and targeted active labour market policies somewhat increased employment opportunities for older and low-skilled workers, but their participation rate remains low.

There have been some important reforms to reduce the weaknesses in the banking sector. The situation in the banking sector has been severely affected by the crisis. Consequently Council recommendations in 2013-14 have been focused on this sector, including (i) the conduct of a system-wide bank asset quality review, (ii) the transfer of assets to the Bank Asset Management Company, (iii) the improvement of governance and risk management and (iv) the privatisation of state-owned banks. Since 2014 the banking sector has stabilised. Nonetheless, although gradually decreasing, non-performing loans were still high compared to pre-crisis levels and the recommendation to enable the durable resolution of non-performing loans has been maintained in 2016.

The Slovenian authorities have taken some action to improve the business environment. Specifically, the reduction of administrative burden, the restriction of barriers to regulated professions, and better governance of the state-owned enterprises (SOEs). In 2013-14 the Commission's analysis concluded that the high level of state involvement combined with weak corporate governance was hampering investment and growth and has spill over effects to the private sector. While a comprehensive corporate governance system for state-owned enterprises has been put in place over the last years, its effective implementation will be essential. After the initial progress which led to full deregulation of 40 professions in the crafts sector and 4 in culture, the reforms slowed down and have not been finalised as initially planned.

Overall, Slovenia has made some ([6]) progress in addressing the 2016 country-specific recommendations. Limited progress has been made to reduce fiscal risks and sustain public finances (CSR 1). The appointment of the Fiscal Council and the revisions to the Public Finance Act has been further delayed. The pension and long-term care reforms to ensure long-term sustainability are in the preparation phase, while the central act of the healthcare reform is in public consultation. Limited progress can be observed in addressing the employability of low-skilled and older workers (CSR 2). An action plan to increase the labour market activity of older workers was adopted. Some progress has been made to improve financing conditions for creditworthy business (CSR 3). Limited new financial instruments were offered to SMEs to improve their access to alternative equity financing sources and the authorities initiated several measures to facilitate the durable reduction of non-performing loans. Some progress has been made to reduce the administrative burden on business, modernise public administration, and improve the governance of state-owned enterprises (CSR 4). While the public administration action plan is slowly progressing, some specific measures have been substantially delayed. The new comprehensive framework for the management of state-owned enterprises was implemented for the first time.

([5]) For the assessment of other reforms implemented in the past, see in particular section 4.

([6]) Information on the level of progress and actions taken to address the policy advice in each respective subpart of a CSR is presented in the Overview Table in the Annex. This overall assessment does not include an assessment of compliance with the Stability and Growth Pact.

Table 2.1: **Summary Table in 2016 CSR assessment**

Slovenia	**Overall assessment of progress with 2016 CSRs: Some progress**
CSR 1*: *Following the correction of the excessive deficit, achieve an annual fiscal adjustment of 0,6 % of GDP towards the medium-term budgetary objective in 2016 and in 2017. Set a medium-term budgetary objective that respects the requirements of the Stability and Growth Pact. Strengthen the fiscal framework by appointing an independent fiscal council and amending the Public Finance Act. Complete and implement the reform of the long-term care and healthcare systems, making them more cost-efficient to ensure long-term sustainability of accessible and quality care. By the end of 2017, adopt the necessary measures to ensure the long-term sustainability and adequacy of the pension system.(MIP relevant)*	**Limited progress** • Limited progress was made regarding the fiscal framework. • Some progress was made regarding healthcare reform. • Limited progress was made regarding the long term care. • Limited progress has been made regarding the long term sustainability and adequacy of pension system.
CSR 2: *In consultation with social partners, increase the employability of low-skilled and older workers, including through targeted lifelong learning and activation measures. (MIP relevant)*	**Limited progress** • Limited progress has been made regarding employability of low-skilled, older workers and active labour market policies.
CSR 3*: Improve the financing conditions for creditworthy business, including by facilitating durable resolution of non- performing loans and access to alternative financing sources. Ensure the proper implementation of the bank asset management company strategy. (MIP relevant)*	**Some progress** • Some progress has been made regarding the reduction of the level of non-performing loans. • Limited progress has been made regarding the access to the alternative financing sources • Some progress has been made regarding the implementation of the BAMC's strategy.
CSR 4: *Take measures to modernise public administration and reduce the administrative burden on business. Improve the governance and the performance of state-owned enterprises. (MIP relevant)*	**Some progress** • Some progress has been made regarding the modernisation of the public administration and reduction of the administrative burden. • Some progress has been made regarding the governance of SOEs.

* This overall assessment of CSR1 does not include an assessment of compliance with the Stability and Growth Pact.
Source: European Commission.

Box 2.1: **Contribution of the EU budget to structural change in Slovenia**

Slovenia will receive EUR 3.01 billion over the period of 2014-2020 from the European Structural and Investment Funds (ESI Funds) ([1]). This is annually around 1.4 % of GDP and 32 % of national public investment ([2]). By 31 December 2016, about EUR 1 billion or 26 % of the total allocation for ESI Funds, have already been allocated to concrete projects (see Section 4.4.3. on contribution of EFSF to public investment). Another EUR 450 million is planned to be allocated through various forms of financial instruments, which is a near quadrupling compared to the 2007-13. In addition to ESI funds, Slovenia will receive financing under the Connecting Europe Facility (CEF), the European Fund for Strategic Investments (EFSI), Horizon 2020 and other directly managed EU funds. By end 2016, Slovenia has signed agreements for EUR 153 million for projects under CEF. The EIB Group approved financing under EFSI amounts to EUR 8 million, which is expected to trigger nearly EUR 387 million in total investments (as of end 2016).

Over the last two years, ESI Funds supported a number of structural reforms via ex-ante conditionalities ([3]) and targeted investment. One is the e-Spatial Planning Platform in the framework of the Digital Strategy for Slovenia, aiming at reducing administrative burden for businesses. Another, the Transport Development Strategy is the first national strategy covering all modes of transport, identifying main bottlenecks and investment priorities. Based on The National Health Care Resolution Plan 2016-2025 the strategic and legislative steps to improve the Slovenian healthcare system have been taken. Furthermore, the Public Administration Development Strategy 2015–2020 aims at modernising public administration by improving its efficiency, transparency and the quality of services. In addition, Slovenia is also benefiting from the Structural Reform Support Service, financed by the ESI Funds, and provided technical assistance to support the implementation of structural reforms.

CSRs targeting structural reforms were taken into account when designing the 2014-2020 programmes. A Smart Specialization Strategy ([4]) will improve access to finance and reduce administrative burden on SMEs. This will help support approximately 8 500 SMEs with the goal of boosting growth and jobs. Targeted employment programmes are supported by ESI Funds to improve the employability of the most vulnerable groups on the labour market and improve social inclusion and will enable people to work longer. In the field of long-term care, funds are earmarked for the development and implementation of the integrated community based services

ESI Funds also address other structural issues to growth and competitiveness. The Funds enable Slovenia to move from a position of innovation follower to a more trend-setting role by increasing the proportion of high-tech intensive products and knowledge-intensive services in total export. ESI Funds support efforts to reach the Energy Union targets and to contribute to the Digital Agenda by equipping 70 % of households with 100 Mbps broadband access. More than EUR 500 million are earmarked for infrastructure in sectors with an investment gap, mainly in transport (rail) and environment (water). The Youth Employment Initiative created job opportunities by providing incentives to employ young people from eastern Slovenia (around 2900 young people were included by end of 2016).

([1]) https://cohesiondata.ec.europa.eu/countries/SI
([2]) National public investment is defined as gross capital formation + investment grants + national expenditure on agriculture and fisheries.
([3]) Before programmes are adopted, Member States are required to comply with a number of ex-ante conditionalities, which aim at improving framework and conditions for the majority of public investments areas.
([4]) Establishes a framework for a strong entrepreneurial ecosystem through investments such as One-Stop-Shops for businesses.

3. SUMMARY OF THE MAIN FINDINGS FROM THE MIP IN-DEPTH REVIEW

The 2017 Alert Mechanism Report called for further in-depth analysis to monitor progress in the unwinding of the imbalances identified in the 2016 MIP cycle. As Slovenia was identified to have macroeconomic imbalances in the form of weaknesses in the banking sector, high corporate indebtedness and fiscal risks last year, a new in-depth review (IDR) is needed to assess how these imbalances evolved.

This report provides the in-depth review of how the imbalances identified have developed. In particular IDR relevant analysis is found in the following sections: fiscal risks related to fiscal policy, long-term sustainability and state-owned enterprises (sections 4.1.1 to 4.1.5); vulnerabilities in the banking sector (sections 4.2.1); labour market and older workers (section 4.3.1) and deleveraging and investment (section 4.4.1). Additional IDR relevant topics via their link to investment are the sections on business environment (section 4.4.2) and public administration (sections 4.5.1).

3.1 Imbalances and their gravity

Despite major improvements, the stock of non-performing loans remains at a relatively elevated level. In a context of high public and private indebtedness, the crisis put the banking sector under significant stress. Between 2008 and 2014, profitability tanked while asset quality deteriorated quickly. Although asset quality in the existing loan portfolios has improved since then, the share of non-performing loans decreased substantially but remains relatively high (9.1 % of total loans in September 2016), originating mostly from the corporate sector, notably SMEs.

High leverage in the corporate sector holds back investment and growth. In 2015, private debt fell to 87.3% of GDP, below EU average and in 2016 it further decreased. High leverage is mostly present in a handful of large companies and among SMEs (European Commission, 2015d). Conversely, household debt is among the lowest in the EU (27.8% of GDP in 2015). The high indebtedness in the corporate sector hampers investment growth. Weak private investment (16% of GDP in 2015) has in turn contributed to a significant downward shift in Slovenia's potential growth (from 3-4% prior to the crisis to less than 1% after the crisis).

Government debt has risen rapidly between 2007 and 2015 and ageing is expected to have an impact on public finances looking forward. The public debt ratio almost quadrupled between 2007 and 2015, to 83.1% of GDP. While public debt is projected to decline in 2016 and the following three years, in the absence of reforms, Slovenia is projected to see one of the largest increases in public pension expenditure in the EU until 2060.

One-third of the increase of public debt can be attributed to fiscal and economic implications of state-owned enterprises (SOEs). The level of state involvement remains high in relation to other Member States. Combined with weak corporate governance, this has had considerable fiscal and economic implications. In particular, it has hampered investment and growth. SOEs have underperformed compared to their privately-owned peers in terms of productivity and profitability (European Commission, 2015d). The implementation of professional and prudent policies on the management of state-owned enterprises are expected to reduce contingent liabilities to the general government budget from this area.

3.2 Evolution, prospects and policy responses

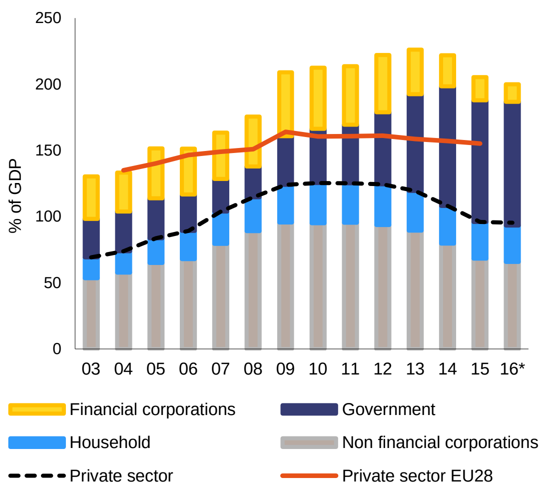
Banking sector vulnerabilities have been reduced. Non-performing loans (NPLs) have declined from 14.2 % in June 2015 to 9.1 % in September 2016 and the trend is expected to continue (Section 4.2) ([7]). They remain high compared to pre-crisis levels but are well provisioned (coverage ratio of 69.2 % in June 2016). Banks have acquired significant capacities and competences in the workout management of NPLs. The sector's profitability has improved supported by net releases of impairments and

([7]) The post-2014 NPL figures in this section are based on the European Banking Authorities definition under the Implementing Technical Standard on 'Supervisory Reporting on Forbearance and Non-performing Exposures', which was adopted by the Commission Implementing Regulation (EU) 2015/227 on 9 January 2015.

lower provisioning costs. The current context of low interest rates hampers banks' profitability further. The consolidation and restructuring of the sector is progressing, with a recent merger of three banks and the completed wind down of two smaller banks.

Private sector debt decreased in 2015 by 10pps driven primarily by a decline in firm's debt. Deleveraging pressures in the corporate sector are easing but non-financial corporations continue deleveraging, albeit with important differences between individual firms. Credit flows in the household sector turned slightly positive in the first half of 2016.

Graph 3.1: **Decomposition of debt by sector**



Source: European Commission

In 2015, private investment started to recover and foreign direct investment (FDI) inflows increased. The negative trend in private investment started to reverse in 2015 as deleveraging pressures started to ease and the government made efforts to improve the business environment. The stock of inbound foreign direct investment increased by 12.4 % in 2015 and reached 35 % of GDP, which remains below the EU average of about 50 % of GDP. Ongoing privatisation and corporate restructuring offers new opportunities for attracting FDI. Furthermore, the business environment needs to adapt to take full advantage of foreign investments.

The public debt ratio is expected to have decreased from 2016 onwards. Strong nominal GDP growth and a reduction in the general government deficit are set to put public debt on a downward trend. The White Paper on pension reform was published in April 2016. Its purpose is to begin a public debate on a new pension reform to ensure long-term sustainability and adequacy of the pension system. In addition, a central piece of health care legislation is in public consultation. The proposed measures aim at diversifying funding sources of the health care system and reducing pro-cyclicality of health care expenditure. The reform of long term care however has been delayed.

Profitability of SOEs managed by the Slovenia Sovereign Holding (SSH) has improved in 2015. The focus of the Slovenian Sovereign Holding has shifted onto improving the SOEs corporate governance and performance. The asset management strategy adopted in July 2015 sets the overall profitability target of the state portfolio as measured by return on equity at 8% by 2020, with intermediate targets at 6.3% in 2016 and 7.1% in 2017. Several important state-owned enterprises have been privatised in 2016.

3.3 Overall assessment

Positive macroeconomic developments and effective policy action have gradually reduced the remaining vulnerabilities. The economy continued to grow strongly in 2016, both in real and in nominal terms, thus reducing the risks related to large indebtedness in the public and in the corporate sector. Progress on the front of banking sector restructuring has coincided with a rapidly falling share of NPLs in total loans, which remain however elevated but well provisioned. The corporate sector has undergone a considerable deleveraging and investment, which was compressed in past years, is resuming, including FDI. Government debt has peaked in 2015 and a continued downward adjustment is expected in the coming years.

Relevant measures have been taken by the government, especially to consolidate and restructure the banking sector, and to improve the governance of SOEs. Several important bank mergers have been completed in 2016. A new comprehensive framework for the management of State-owned enterprises has been implemented. Looking forward, action is still needed to enhance the long-term sustainability of public finances,

Table 3.1: **MIP Assessment Matrix - Slovenia 2017**

	Gravity of the challenge	Evolution and prospects	Policy response
	Imbalances (unsustainable trends, vulnerabilities and associated risks)		
Financial sector	The stock of non-performing loans remains relatively high but NPLs are well provisioned. NPLs originate mostly in the corporate sector and among SMEs (see Section 4.4). As in other EU countries, the long-term profitability of the banks is under pressure in the current context of low interest rates but the capitalisation of the banking sector is strong (see Section 4.2).	The vulnerabilities in the Slovenian banking sector have reduced. NPLs have decreased fast from 17.1 % in 2013 to 12.4 % in the first half of 2016 and the trend is expected to continue The restored confidence in the Slovenian banking system has eased liquidity pressures. Deposit rates and margins on the asset side have considerably decreased and are converging with euro area average.	Further progress has been made regarding the operational restructuring of the four major state-owned banks. The wind-down of two smaller domestic banks was completed and the remaining assets transferred to the BAMC. The "bad bank" BAMC set out its new strategy for 2017-22 and business plan and is fully operational.
Deleveraging, investment, and growth prospects	Since the peak in the indebtedness ratio in 2010 (115% of GDP), private sector debt decreased to 86.3% of GDP in 2015. The current level of private investment around 15% of GDP remains low compared to the historical average of 20% of GDP (see Section 4.4). Slovenia's stock of inbound FDI of 36% of GDP in H1-2016 was markedly below the EU average of about 50%.	The corporate sector debt is expected to decrease further but at a slower pace than in the previous years. Credit flows to households turned positive; their debt remains among the lowest in the EU. After years of subdued dynamics amid deleveraging, private investment started to recover and stock of inbound FDI increased by 12.4 % in 2015. They are expected to accelerate further on the back of commitments to implement a pro-FDI reform agenda, which aims at improving the business environment.	Slovenia adopted a new FDI strategy and a smart specialisation strategy in 2015. Some progress has been made regarding the reduction of administrative burden. About a half of measures included in the Single document were implemented in 2016.

(Continued on the next page)

including on fiscal governance and on the business environment.

Table (continued)

Fiscal risks	Government debt stood at 83.1 % of GDP in 2015, and age-related government expenditures are set to increase substantially in the future due to ageing (for pension expenditure from 11.8 % in 2013 to 15.3% of GDP in 2060). The level of state involvement in the economy remains high relative to other Member states and has had considerable fiscal and economic implications for the budget. Fiscal risks of SOEs have caused approximately one third of the increase in public debt experienced from 2007 to 2014.	Public debt rose sharply in recent years, but has stabilised and is expected to decrease as of 2016 (80% of GDP) on behalf or lower general government deficit and stronger nominal GDP growth. Profitability of SOEs managed by the SSH has improved in 2015. Following the publication of the asset management strategy, it appears that most SOEs (in terms of book value) are considered strategic so the level of the state involvement in the economy is expected to remain elevated (see Section 4.1.5).	A central piece of healthcare legislation entered in public consultation in February 2017. The proposed measures aim at diversifying funding sources of the health care system and reducing pro-cyclicality of health care expenditure. The White Paper on pensions published in April 2016 represents the basis for a public debate on a new pension reform. The SSH has been made fully operational, equipped with an asset management strategy and a set of performance criteria. The government has recently approved a new plan for managing assets in 2017, quantifying the performance indicators for each SOE and updating the list of assets for divestment. The focus has shifted onto improving the SOEs corporate governance and performance. In 2017, the government will explore whether targeted changes in the newly overhauled framework on state assets management are necessary.

Conclusion from IDR analysis

- The level of non-performing loans remains elevated but NPLs are well provisioned and the capital position of banks is strong. Private debt, notably corporate, remains relatively high but is falling rapidly. The deleveraging in the private sector has been hampering investment growth in past years. Government debt has grown substantially and is currently stabilised, but pension and healthcare spending will be concerned by considerable ageing pressures looking forward.
- Stock imbalances are unwinding fast, including in light of resumed growth. The share of non-performing loans decreased, and an effective deleveraging has contributed to reduce private debt vulnerabilities. Deleveraging pressures in the corporate sector are currently easing and private investment is starting to recover while foreign direct investments are on the rise. Public debt is expected to decrease over the next few years although long-term sustainability challenges would remain.
- Relevant measures have been taken by the government to consolidate and restructure the banking sector, and to improve the governance of SOEs and civil justice. Looking forward, action is still needed to enhance the long-term sustainability of public finances, including on fiscal governance and on the business environment.

Source: European Commission

4. REFORM PRIORITIES

4.1. PUBLIC FINANCES AND TAXATION

4.1.1. FISCAL POLICY* ([8])

Deficit developments

The general government deficit is expected to decline until 2018 while the structural deficit increases. Based on a headline deficit of 2.7 % of GDP in 2015, the Council decided to abrogate the excessive deficit procedure (EDP) in June 2016. The deficit is expected to continue to decline in 2016 (-2.0 % of GDP) and in 2017 (-1.7 % of GDP) along with economic growth and better labour market conditions. However, the structural deficit is expected to worsen in the coming years. In 2017, the structural deficit of 2.1 % of GDP will remain above the euro area average of 1.2 % of GDP. Based on the commonly agreed methodology the output gap estimate of –0.3% in 2016 indicates that the Slovenian economy is experiencing 'normal times'. However, the plausibility test ([9]) projection estimates the output gap at -1.5%. Even though this is a more negative output gap, it also indicates Slovenia is experiencing normal times". Therefore, this result would not lower the required fiscal adjustment.

The positive macroeconomic outlook has been offset by expenditure pressures. The positive macroeconomic context, particularly for employment, is expected to result in buoyant tax and social contributions receipts. Nonetheless, these are offset by higher expenditure, particularly concerning public employees' salaries and social transfers. The decline in the 2017 deficit is mainly driven by the reduction of interest expenditure and low public investment levels. After falling by 40 % in 2016, public investment is expected to pick up gradually in the following years in line with the dynamics of the current EU financial programming period.

([8]) An asterisk indicates that the analysis in the section contributes to the in-depth review under the MIP (see section 3 for an overall summary of main findings).

([9]) In line with the renewed mandate provided by the ECOFIN Council on 11 October, the EPC-OGWG has worked on a 'constrained judgment' approach for cases where the common method is shown to produce counterintuitive output gap results for individual Member States.

Implementing structural measures would help reducing the structural deficit. The structural balance is expected to deteriorate in the coming years. This is to a large extent due to the quick closing of the output gap which is projected to turn positive in 2017. While GDP growth is projected to be considerably higher than in the euro area in 2017 (3 % v 1.6 %), potential growth is projected to be broadly similar (1.3 % v 1.2 %). The low potential growth is mainly the result of the low level of investment. This underscores the need to adopt measures to boost investment (Section 4.4). A budgetary strategy focused on structural measures would help reduce the structural deficit.

The highest part of public expenditure is allocated to social protection, general services, health and education. Based on the classification by function of expenditure, the largest share of expenditure goes to social protection (36 %, 2014 data), general public services (15 %), health (13 %) and education (12 %). Expenditure in general public services and education were above the EU and EA average (7.5 % and 5.9 % of GDP vs 6.7 % and 4.9 % in the EU, respectively). Performance and efficiency of public services are further important indicators to be taken into account to achieve public policy goals.

Spending reviews are a useful tool to improve budgetary performance and expenditure allocation in order to reach policy objectives. According to the 2016 Report on Public Finances in the EMU, education, general public services, R&D and infrastructure could be analysed in the context of spending reviews (European Commission, 2016d). Spending reviews would help set firm and multi-annual expenditure limits and define the key improvements that can generate savings. In 2015, at the request of the national authorities, an International Monetary Fund (IMF) technical assistance mission took place to advice on establishing a spending review process. Education, health and social protection were identified as potential targets for a spending review (IMF, 2015d). A spending review in the field of social support has been prepared and was adopted in February 2016. Spending reviews on education and culture are ongoing.

Debt sustainability

Public debt rose sharply in recent years. It increased from 21.8 % of GDP in 2008 to 83.1 % of GDP in 2015, but it is expected to decrease as of 2016. While exceptional items, particularly bank recapitalisations, have contributed significantly to this increase, sustained primary deficits were also increasing debt. The debt-to-GDP ratio is expected to have peaked at 83.1 % in 2015. Supported by the economic recovery and a reduction in precautionary cash buffers, public debt is forecast to decrease to 80.9 % of GDP in 2016. The implicit interest rate on the state debt has been decreasing since 2013. The strategy is to extend the duration of the debt portfolio, reducing the roll-over risk while taking advantage of the current environment of low interest rates to reduce current financing costs in the medium-term. In addition, the authorities plan to reduce the previously accumulated large cash buffers (estimated to have decreased from 16 % at end-2015 to 13 % of GDP at end-2016). In 2017, the debt-to-GDP ratio is projected to continue to decline to 78.9 % of GDP, on the back of a lower headline deficit and reduction of the cash-buffers.

Public debt is projected to decrease until 2023 but increase again thereafter under a no-policy-change assumption. Under the baseline scenario **(**[10]**)** of the debt sustainability analysis (DSA) public debt is expected to decrease to 76.2 % of GDP until 2023 (Graph 4.1.1). From then onwards public debt is expected to increase as a result of medium term upward pressures to 80 % of GDP in 2027, particularly due to ageing costs. Conversely, if the ageing costs were excluded from the non-policy change scenario (as it would be the case if ageing costs were reduced via reforms) the debt ratio would continue to decrease in the medium term. Under a scenario ([11]) where the structural primary balance (SPB) is assumed to converge to its historical average, debt levels would accelerate quickly on an upward trajectory from 2020 onwards. A similar result is obtained in a combined historical scenario ([12]) where all main macroeconomic variables converge to their historical average. However, if Slovenia was to fulfil its commitments under the Stability and Growth Pact (SGP) ([13]) the reduction of debt towards 60 % of GDP would occur at a much faster pace (Graph 4.1.2). If Slovenia were to adopt the fiscal commitments outlined in its own Stability Programme ([14]), the reduction would happen at a slower pace than in the SGP scenario, but still considerably faster than in the baseline scenario. Therefore, maintaining fiscal discipline is a prerequisite for debt sustainability.

The high public debt level represents a source of vulnerability for the Slovenian economy. In the medium-term, public debt poses significant risks. An increasing debt trajectory sensitive to potential macroeconomic shocks and a sizeable sustainability gap lead to high risks for public finance in the medium term. Firstly, high risks are revealed by the debt sustainability analysis (DSA). On the one hand standard sensitivity tests performed separately on nominal GDP growth, inflation and interest rates ([15]) would each entail a debt ratio that is more than 4 pps. higher than in the baseline (i.e. about 84 %) in the last year of projections (2027). On the other hand, a very large set of jointly simulated shocks to GDP growth, interest rates and the primary balance, based on the size and correlation of past shocks under stochastic debt projections, indicate a 33 % probability that the debt ratio in 2021 would be higher than in 2016 (80.9 %), which entails risks given the already high starting level. Secondly, the medium-term

([10]) Based on Commission winter 2016 forecast, EPC agreed long-run convergence assumptions of underlying macroeconomic variables (real interest rate, real GDP growth, inflation) and the assumption of constant fiscal policy beyond the forecast horizon.

([11]) The historical SPB scenario assumes gradual convergence to the historical average for the SPB over the four years following the forecast. All other macroeconomic assumptions are the same as in the baseline.

([12]) The combined historical scenario assumes gradual convergence to historical averages over the five years following the forecasts for all main macroeconomic variables, notably SPB, implicit interest rate and real GDP growth.

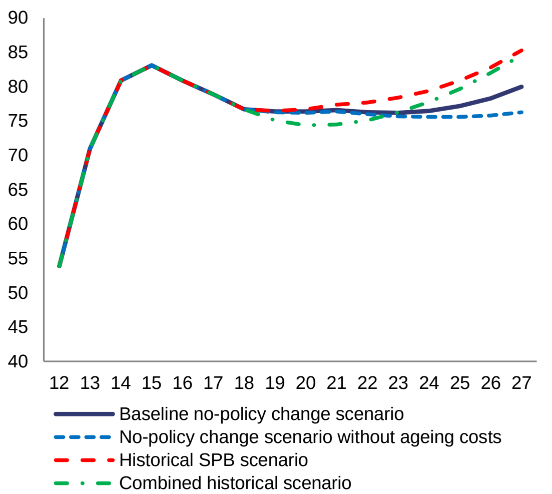
([13]) European Commission forecasts for the first projection year; thereafter assumption of full compliance with excessive deficit procedure recommendations and convergence to the medium-term objective, according to the matrix of required fiscal adjustment from Commission Communication on flexibility in fiscal rules) – see European Commission (2017) Debt Sustainability Monitor 2016, European Economy Chapter 2 Section 2.1.2. and Annex A3.

([14]) The SPB is assumed to remain constant at end-of programme value; all other macroeconomic variables – real interest rate, inflation, real GDP growth – over the programme horizon are also taken from the Stability Programme.

([15]) Specifically, -0.5 pps on GDP growth, -0.5 pps on inflation, and +1 pp. on interest rates on new and rolled over debt from 2016 onwards.

sustainability gap indicator (S1) complements the results of the DSA indicating that, overall there are high risks in the medium-term. S1 ([16]) indicates that the structural primary balance would need to improve by 2.9 pps of GDP in cumulated terms over a 5-year horizon (from 2018 until 2023) relative to the baseline no-fiscal policy change scenario to reach the 60 % public debt-to-GDP ratio reference value by 2031 ([17]). The required fiscal adjustment reflected by S1 is essentially due to the debt ratio being currently above the 60% reference value and the projected ageing costs.

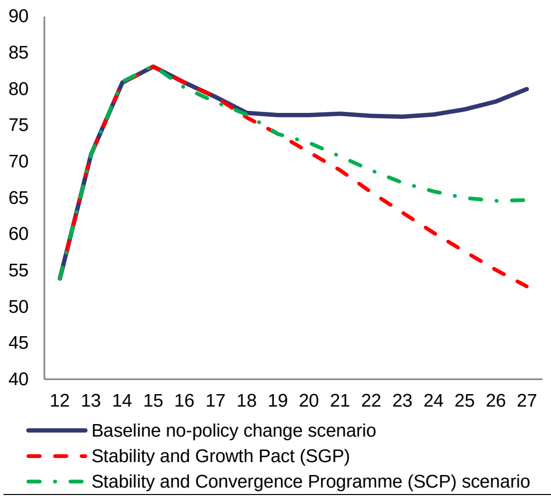
Graph 4.1.1: **Gross debt % of GDP - DSA**



Source: European Commission calculations

Age-related expenditure, namely on public pensions, healthcare and long term care puts pressure on public finances in the long run. In the long run, Slovenia is at high risk as shown by the very high value of the long-term sustainability gap indicator S2 ([18]). The indicator, calculated under a baseline of no-fiscal policy change scenario, indicates a high required fiscal adjustment of 6.9 pps. of GDP to ensure sustainability of public finances ([19]). This is primarily due to the strong projected impact of age-related public spending. Here, with pensions accounting for 3.4 pps. of GDP required fiscal adjustment. Healthcare and long-term care account for an additional 1.9 pps.

Graph 4.1.2: **Gross debt % of GDP - SGP and SCP scenarios**



Source: European Commission calculations

4.1.2. PENSION SYSTEM*

The 2012 pension reform has resulted in positive developments, but long-term sustainability and adequacy remain a challenge. In 2015, pension expenditure relative to GDP decreased by 0.6 pps to 10.9 % and the growth in the number of old-age pensioners was very low (ZPIZ, 2016). The old-age dependency ratio increased only slightly and the ratio between the retired and socially insured remained unchanged according to Eurostat and national data (MoLFSAEO, 2016a) respectively. Although the pension system is according to the Slovene Government projected to be sustainable up to 2025, an ageing population puts considerable pressure on its long-term sustainability and adequacy.

Workers with shorter careers and longer career breaks can expect income adequacy problems in

([16]) The medium-term sustainability indicator S1 measures the fiscal adjustment effort required, in cumulated terms over the next 5 years after the forecast horizon (i.e. from 2018) to drive the public debt-to-GDP ratio down to 60 % in 15 years' time (currently 2031).

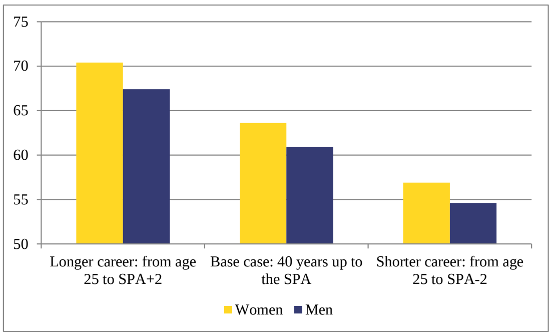
([17]) The following thresholds apply: (i) for values lower than 0, the country is assigned low risk; (ii) for values lower than 2.5 pps, it is assigned medium risk; (iii) for values greater than 2.5 the country is assigned high risk.

([18]) The long-term sustainability indicator S2 gives the upfront structural adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon.

([19]) The following thresholds apply: (i) if the value is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and, (iii) if it is greater than 6, it is assigned high risk.

old age. This is demonstrated by projections based on the current legislation (see graph 4.1.3). While the impact of a short career on the benefit level is around the EU average, it could affect a high proportion of future pensioners. This is due to the low duration of working life, an increased number of part-time and fixed-term contracts during the economic crisis and delayed labour market entry (see European Commission, 2016a; European Commission and Social Protection Committee, 2015b). These concerns are particularly relevant in the context of the country's sustainability challenges and related plans to further tighten eligibility conditions for an old-age pension.

Graph 4.1.3: **Net Theoretical Replacement Rates of pensions, for average earners, by career length, in %, in 2053**



(1) Longer career is defined as working two years beyond the Standard Pensionable Age (SPA), while shorter career is defined as retiring two years before the SPA
Source: European Commission and Social Protection Committee, 2015a

The White Paper on pensions was adopted by the Government in April 2016 to begin public discussion on a new long-term pension reform. The White Paper proposes to increase the statutory retirement age and the insurance period, to reduce the incentives to early retirement and extend the pensionable earnings base from 24 to 34 consecutive most favourable years. Nevertheless, the average career length is not projected to increase in the long-term. In addition, the White Paper proposes the point system, gradual alignment of the pension indexation to growth in prices over a period of 20 years and the options to strengthen supplementary pension provisions, especially the second pillar (MoLFSAEO, 2016a). The proposed measures would ensure long-term sustainability of the pension system under different scenarios**.** The impact of the presented scenarios on the adequacy of pensions merits further analysis taking into account the extended pension base, indexation and various employment trajectories together ([20]). As part of a comprehensive pension reform securing a sustainable and adequate system, efforts should be made to ensure that old-age poverty risks are avoided in the future ([21]).

It is uncertain when the new reform will be passed and how closely it will follow the ambition proposed by the White Paper. Timely implementation of the reform and short phase-in period is crucial to preserve fiscal sustainability while maintaining an adequate pension income for all generations. The high fiscal sustainability risk in the medium term in Slovenia calls for quick action. A faster increase of the statutory retirement age to 67 years and phasing in the price indexation rule already over the coming decade would reduce sustainability risks further. Furthermore, the White Paper does not consider an automatic link of statutory retirement age to increases in life expectancy, one of the most effective mechanisms to tackle the cost of ageing population. Such link is one of the most common and important features of many recent pension reforms (see Table 4.1.1). It pays a double dividend – it strengthens pension system sustainability while improving the adequacy of pensions by accumulating more contributions because of the extended working lives. Currently, a number of EU Members States have such a balancing mechanism in place (Carone et al., 2016, p.18). All euro area countries also supported this principle in a recent statement adopted on 16 June 2016 ([22]). Absence of such measures or their late introduction might call for additional corrections to the pension system in the future.

([20]) The Institute for Economic research in Slovenia is developing a module, which will allow a microsimulation model to take different employment biographies into account when projecting adequacy of pensions. The results of microsimulations are expected in 2017.

([21]) In December 2016, the government proposed to establish minimum guarantees for those with 40 (EUR 500), 39 (EUR 490), 38 (EUR 480) and 37 (EUR 470) years of pensionable service excluding periods of purchased service (*pokojninska doba brez dokupa*).

([22]) Eurogroup 2016 "Common principles for strengthening pension sustainability" Statement 16 June 2016. http://www.consilium.europa.eu/en/press/press-releases/2016/06/16-eurogroup-pension-sustainability/ These principles are the following: i) Safeguard against demographic and macroeconomic risks: ii) Flanking policies; iii) Broader reforms to strengthen growth and employment; iv) Anchoring political and societal support.

Table 4.1.1: **Cross-country comparison of some pension parameters**

Country	Reform	Pillars	Statutory retirement age* (2008 and 2060)	Pensionable earnings reference	General indexation variablle(s)	Change in public pension expenditure as % of GDP over 2013-2060	Automatic mechanisms		
							Automatic balancing mechanism	Sustainability factor	Retirement age linkened to the life expectancy
Belgium	2015	First	65 (64) to 67	Full career	Prices and living standard	3.3 (1.3**)			
Italy	1995 & 2010	Mixed	65 (60) to 70	Full career	Prices	-1.9		x	x
Finland	2005 & 2015	First	62:68 to 68	Full career	Prices and wages	0.1		x	x
Portugal	2007 & 2013	First	65 to 68.8	Full career up to limit of 40 years	Prices and GDP	-0.7		x	x
Greece	2010	Mixed	63 (60.5) to 65	Full career	Prices and social taxes	-1.3			x
Denmark	2011	Multi	65 to 72.5	Years of residence	Wages	-3.1			x
Netherlands	2012	Multi	65 to 71.5	Years of residence	Wages	0.9			x
Cyprus	2012	First	65 to 69	Full career	Prices and wages	-0.1			x
Slovak republic	2012	Mixed	62 to 67.8	Full career	Prices and wages	2.2			x
Spain	2011 & 2013	First	65 to 67	Last 25 years	Index for pension revaluation	-0.8	x	x	
SI current	2012	First	63 (61) to 65	Best consecutive 24 years	Prices and wages	3.5			
SI WP***	forthcomming	Multi	to 67	Best consecutive 34 years	Prices	0.5-1.0			

*Retirement age for men (women); **3.3 is the AR 2015 figure, 1.3 is projection after reform; ***as planned in the White Paper
Source: European Commission Ageing report (2009, 2015), Commission services, updated for Finland and Belgium

In the future, supplementary pension schemes could provide an important share of income for pensioners. At the end of 2015, 59.2 % of those enrolled in the first (public) pillar were contributing to a supplementary pension scheme ([23]). Yet, the average amount of supplementary savings per person is low ([24]). Nonetheless, projections show that supplementary pensions could have a major impact on the adequacy of pensions for future pensioners. This is the case especially for those retiring after 2040 and with regular payments into the scheme (MoLFSAEO, 2016a). The White Paper puts forward the options for boosting the coverage of supplementary and in particular occupational pensions through collective bargaining or automatic enrolment.

4.1.3. HEALTH CARE AND LONG TERM CARE SYSTEMS*

Health care

Long-term fiscal sustainability of the health care system remains a challenge. In 2015, total health expenditure in Slovenia decreased by 0.1 pps to 8.4 % of GDP (OECD/EC, 2016c). This percentage is below the EU average of 9.9 % of GDP. Nevertheless, public health expenditure in Slovenia is expected to increase over the medium- and long-term, due to a rapidly ageing population, medical technology and individual behaviour (European Commission, 2016a). Measures to reduce costs and increase the efficiency of health care spending can contribute to financial sustainability of the health care system (European Commission, 2016c).

The 2016 Country Report suggested that there is scope to increase the efficiency of the healthcare system in Slovenia. The efficiency gains could be made through improved governance and performance of hospitals in view of limited autonomy and responsibility of management in strategic decisions, fixed hospital budgets, weak competition in the contracting process, outdated public hospital network and inefficiencies in the purchasing process. A stronger primary care as a gatekeeper for in-patient care, supported by an adequate payment system for general practitioners and specialists, and a standardized framework to monitor the quality of services in hospitals would support the goal to curb expenditure growth. Other measures such as the use of health technology assessments and revised hospital payment system and joint public procurement to rationalize the use of medical goods and health services can help to contain expenditure growth while maintaining access to quality care. This year's report goes beyond the general assessment of the healthcare system. The report's objective is to assess current reform endeavours and analyse in-depth public procurement and recent developments in waiting times.

([23]) Supplementary pensions (the second pillar) include i) occupational compulsory supplementary pension insurance for specific professions, (ii) individual and collective voluntary supplementary pension insurance (MoLFSAEO, 2016a).

([24]) In 2015, the average amount of supplementary savings per person amounted approximately EUR 4 000 per person and did not yet substantially contribute to the income of pensioners (MoLFSAEO, 2016a).

The authorities presented proposals to reform the health care system. "The Resolution on the National Healthcare Plan 2016-2025", which represents a strategic plan for the development of the healthcare system was adopted by the Parliament in March 2016. In January 2017, the draft Health Care and Health Insurance Act, which is the central piece of the reform was presented. In December 2016, the proposals to amend the Health Services Act and the Patient Rights Act were presented to coalition partners and the new Pharmacies Act was adopted. The implementation of measures to strengthen the primary health care is in progress. The National strategy of development of primary care until 2025 is under preparation. The "family medicine model" practice which aims at better management of chronic patients is being expanded. A progress has been made over the past year in the implementation of e-Health solutions. The most important goals of the proposed reforms are to improve quality and accessibility of health care services, ensure sustainable financing of the health care system and increase transparency, whereby standards, targets and indicators will be publicly available. Higher transparency can help to achieve better allocation of resources.

The proposed draft Health Care and Health Insurance Act is an important step towards reforming the health care system. The proposed measures aim to diversify financial resources and ensure a more stable financing of the healthcare system. The contribution base for compulsory health insurance contributions is proposed to be extended by taking into account both active and passive income. The contribution rates are proposed to be unified across different categories of insured people, including pensioners. New sources are envisaged from the general budget while the budget is proposed to take over financing of some programmes (e.g. traineeships, specialisations, tertiary education). The voluntary complementary (top up) health insurance is proposed to be abolished and replaced by the income dependant health care levy as of 2019. The basket of rights is proposed to remain universal with rights being legally defined and excluding non-health services. The Health Insurance Institute of Slovenia (HIIS) is proposed to remain a single insurer for compulsory health insurance, however with the newly defined management structure and responsibilities. Specifically, the HIIS is proposed to act as an active buyer in charge of technical standards for material and medical devices, cost analysis and payment models. In addition, the HIIS is proposed to contract out health care services selectively on basis of efficiency and quality of providers and for at least two years. The adoption of the Health Care and Health Insurance Act by the Parliament is envisaged for 2017.

The authorities aim to increase incentives for hospital managers to improve cost-effectiveness and quality. As reported in the Country Report 2016 hospital managers do not have sufficient incentives to increase efficiency and productivity. The reason is that they cannot take autonomous decisions related to activities, payments for performance of employees and the budget. To improve the performance of health providers, the authorities proposed changes in the governance of the HIIS and the contracting procedure with health care providers. In addition, the authorities aim to prepare the Act on Governance and Management of Public Health Institutions.

Pharmaceutical expenditure is rising, due to higher consumption of medical products and new and very costly medicines. In 2014 pharmaceutical spending accounted for 1.7 % of GDP and 20 % of total health care expenditure, (1.5 % and 17.1 % in the EU). The latest data from 2015 suggest that overall pharmaceutical expenditure has started increasing again, most probably due to an increase in high cost medicines. The Slovene authorities also point out the specificities of the small market regarding prices and accessibility of new medicinal products to the population, which should be taken into account when different comparisons are considered. The data also suggest that consumption of medicines in Slovenia remains higher than the Organisation for Economic Co-operation and Development (OECD) average (Belloni, Morgan and Paris, 2016). Policies to improve transparency and promote the cost-effective use of pharmaceuticals would be beneficial, such as a comprehensive health technology assessment network and a fully operational system of e-prescriptions (European Commission, 2016a and 2016c).

Public procurement

Public procurement in health suffers from several deficiencies. As reported in the Country

Report 2016 there is a scope for further centralisation of public procurement and less focus on the lowest price award criterion. Many hospitals in Slovenia continue to purchase selected supplies and services in a non-standardised way, i.e. without the list of codes and a central register. This prevents tapping the potential economies of scale linked to centralised procurement. In addition, public procurement in health sector is prone to corruption (see Section 4.5.1 on corruption). As a result prices for some medicine and medical devices are unjustifiably high and with large differences in prices for the same product (Ekstravizor ([25])).

Improvements in public procurement can lead to significant savings. Recent experience shows that centralised procurement in medical devices (four items) increased the number of bids from an average of 7 to an average of 14 and reduced the bidding prices by 10-35%. A new centralised public procurement for medicines is under preparation and is mandatory for all 26 hospitals. Systematically involving relevant health professionals in the purchasing process from the very start (technical dialogue) until the evaluation of tenders received remains a challenge. In addition, the small market needs to be safeguarded from the risk of developing monopolies that might result from the choice of a single per-product supplier. This could lead to unavailability of treatment and in the long term increase prices through market concentration.

A transparent public procurement system can significantly improve resource allocation. Following public revelations of alleged irregularities in public procurement (Ekstravizor), the Ministry of Health in cooperation with all public health care providers announced at the end of 2016 to collect and publish information about hospital transactions and prices of medical products. Based on this data the central register of medical products is planned to be established in the first half of 2017. Its purpose is to increase transparency for all involved stakeholders. Easily available and transparent information about prices and characteristics of products will allow for more efficient allocation of resources. In addition, patients will have clearer information about their rights and how their money is spent.

([25]) https://ekstravisor.rtvslo.si/projekt/analize/1

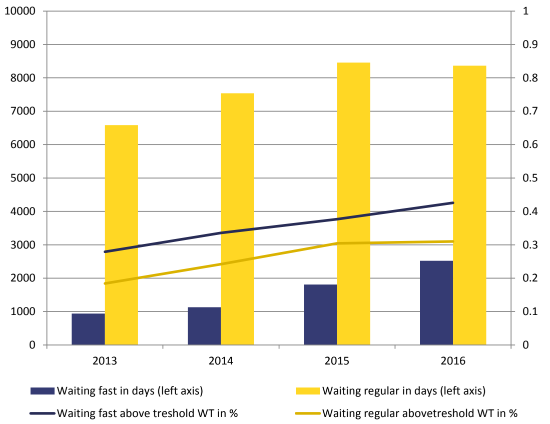
Waiting times

Waiting times for some outpatient specialist services have increased. According to the 2015 European Health Interview Survey ([26]) the share of people reporting long waiting time has increased from 6 % of population in 2007 to 13 % in 2015. Waiting times increased due to several reasons: the necessary fiscal adjustment measures during crisis, the lack of specialised doctors and "defensive medicine" (a current practice of family doctors to over refer patients to specialised services due to uncertainty on diagnosis). In addition, 15-20 % of patients on waiting lists that do not fulfil conditions for the services in question or they do not show up for the procedure. The ongoing eHealth projects such as e-appointment and e-referral are increasing transparency and can contribute to reducing waiting times. In addition, the authorities aim at strengthening the cooperation between family and specialised doctors and increasing patients' obligations. Structural improvements in the management of waiting times are the objective of the proposals to amend the Patient Rights Act.

Improved allocation of resources can contain long waiting times, which typically have a bigger impact on poorer households. A pilot project "For better waiting times management" began in 2015 to identify the reasons for waiting times. In addition, more funding was allocated to health providers for certain procedures. According to the latest available data, the waiting time for targeted procedures has decreased on average despite the increase in the number of patients (see graph 4.1.4 and 4.1.5). Nevertheless, the experience from other countries show that measures which only increase funds channelled to reduce waiting times can only be successful in the short term (OECD, 2013). Waiting times norms, more efficient allocation of human and capital resources between sectors and specialisations, and the use of ICT tend to be more successful in the durable reduction of long waiting times (European Commission, 2016 c). In addition, they can better protect poorer households that are typically more affected by longer waiting times as the burden to purchase private providers services might be too high.

([26]) http://ec.europa.eu/eurostat/web/microdata/european-health-interview-survey

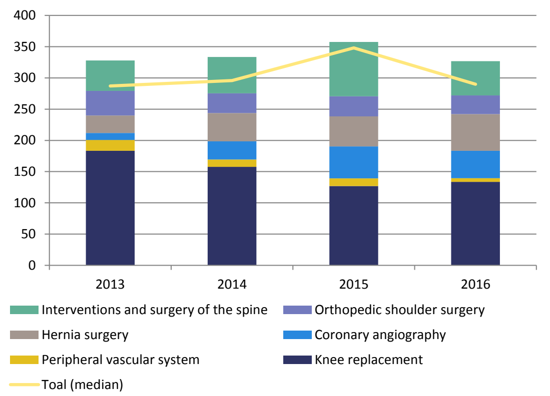
Graph 4.1.4: **Number of all patients waiting for specific procedures and the share of patient waiting above threshold time**



Threshold waiting time is a time that is legally prescribed. It is 30 days for a patient with a fast referral and 60 days for a patient with a regular referral.

Source: The National Institute of Public Health (NIJZ)

Graph 4.1.5: **Waiting times for specific procedures**



Average waiting times is weighted by total number of waiting patients for specific procedure

Source: The National Institute of Public Health (NIJZ)

Long-term care

A reform to create a sustainable, flexible, high quality and accessible long-term care (LTC) system has been under preparation since 2002. To date, no comprehensive integrated long-term care exists in Slovenia. While it is provided within institutional care, community based services are underdeveloped and not integrated. The fragmentation of services is reflected in the fragmentation of funding. LTC needs are determined under several legislative acts, which may increase the budgeting and funding challenges. In addition, the number of recipients of LTC is high and has been increasing rapidly (European Commission, 2016a). Until now, no agreement has been reached with regard to the future sources of financing for LTC. This issue is linked to the healthcare reform package currently being developed. In 2017 the Ministry of Health will launch a 2-year pilot project to assess the LTC needs and to support proposed legislative solutions in the future LTC Act.

The pilot project will be used for preparing concrete measures to reform long-term care. The authorities have planned to steer the LTC into two main directions: 1) towards the development of home care and 2) towards equality in access to long-term care. However, the ways to achieve the goals are not yet clear. Alongside the needs, the pilot will also assess the services and delivery mechanism. The threshold of eligibility for LTC services will be also decided. Based on these assessments, a one-stop-shop may be created where 'planners', with comprehensive knowledge of all services, will prepare integrated individual plans for beneficiaries, based on needs and preferences, including both health and social long-term care services. Consistently with the goals, community-based care (involvement of NGO's, volunteers and local community) would need to be prioritised and activities, training and support for family members involved in caring would need to be established.

The long-term care reform is in preparation; however several important challenges remain unclear. The authorities believe that cost effectiveness and sustainability of financing can be achieved by strengthening preventive measures, by promoting earlier rehabilitation, by improving the coordination between social and health care and through a better use of ICT (like more efficient e-public services). However, no clear quantification is yet available, as this relies on the definition of priorities in terms of needs and that of a basic basket of services. Once these are defined, it will be possible to build a microsimulation model to assess alternative financing options and their potential to that yield current and future savings.

4.1.4. FISCAL FRAMEWORK*

Implementing fully the envisaged fiscal framework would improve the credibility of the budgetary process in Slovenia. Following the adoption of the Fiscal Rules Act, the government intends to adopt revisions to the Public Finance Act. The previous deadline (December 2016) was postponed to the first quarter of 2017. The proposed amendments aim to strengthen the rules for all budgetary units and strengthen the role of the Court of Auditors in budget implementation. Until now, there was a lack of a multi-annual perspective in the budgetary planning process, and the focus has been on adopting measures on an annual basis. A multi-annual approach to budgeting, particularly binding expenditure ceilings promotes fiscal discipline and will provide greater certainty to citizens and businesses regarding policy measures in the coming years. The Fiscal Rules Act introduced a rolling three-year framework for the preparation of the budgets but its actual implementation is dependent on the revisions to the Public Finance Act. These revisions would put a multi-annual approach to budgeting on a statutory footing.

The establishment of the Fiscal Council has been further delayed. The implementation of the Fiscal Rules Act (passed by the Parliament in July 2015) will be overseen by the Fiscal Council. This is an independent state authority with three members, who are experts in the fields of macroeconomics or public finances. The Fiscal Council members should be proposed by the government and a two-thirds majority of the Parliament is required to confirm their appointment. After three unsuccessful procedures to appoint members, the government will have to restart an open call for applicants to find members of the Fiscal Council. Hence, the establishment of the Fiscal Council has been further delayed. Given the delays experienced to date and the need to operationalise the Fiscal Council, this timeline may jeopardise the Council's ability to provide its opinion on the 2017 Stability Programme.

4.1.5. STATE OWNED ENTERPRISES*

Following a series of reforms the implementation of the new comprehensive framework for the management of State-owned enterprises (SOEs) started in 2015. Equipped with a number of corporate governance tools, and mandated on the basis of an overall strategy approved by the national parliament ([27]), the Slovenian Sovereign Holding (SSH) has been taking action to ensure vigorous implementation of SOEs management policies. According to the SSH Annual report, return-on-equity for the overall portfolio increased to 4.7% in 2015 (1.8% in 2014). Dividend pay-outs in 2016 have been higher by 7.4% compared with 2015. Major deals completed in 2016, include the closing of the NKBM sale and the debt-to-equity swap in SAVA. A new management plan for 2017, quantifying the performance indicators for each separate SOE and updating a list of assets for divestment, has been approved by the government on 19 January 2017. ([28])

Signs of wavering at the political level suggest that the future of professional and independent SOEs management is still at stake. The SSH was confronted with major opposition when it tried to replace the supervisory board of the Luka Koper (Port of Koper) in July 2016. This led the head of the SSH to resign. The SSH is currently run by an interim CEO. In addition, the government appears reluctant to take the action required to fine-tune certain aspects of the SOEs management framework, despite the proposals tabled by the SSH. In particular, a revision of the strategy that was adopted in July 2015 has been advocated while not yet adopted. The revision could, amongst others, facilitate the progress in major deals, such as the NLB privatization (see section 4.2). In addition, it could make the strategy's ambitious performance goals more adaptable to changing circumstances.

4.1.6. TAXATION

Personal income tax

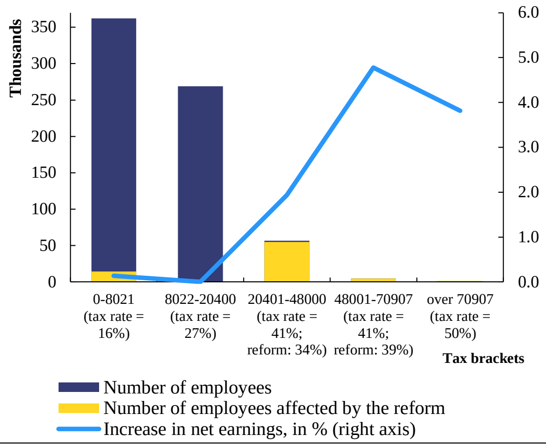
Slovenia has adopted a tax reform which shifts taxes away from labour to capital. In September

([27]) A summary of the challenges in the area of SOEs management and of Slovenia's policy responses can be found in the 2016 Country Report on Slovenia.

([28]) Further details regarding the progress made can be found in the November 2016 review of progress on policy measures relevant for the correction of macroeconomic imbalances (European Commission, 2016j).

2016 the Parliament adopted amendments to three tax laws taking effect as of 1 January 2017. The purpose of the changes is to boost the creation of high value added jobs, which would in turn support economic growth and increase fiscal revenue. ([29]) ([30]) Before the reform, the personal income tax system had four tax brackets and income was taxed progressively (16 %, 27 %, 41 % and 50 %). The aggregated taxable base could be reduced by different types of allowances. One of them targeted low wage earners, i.e. it applies to income (earnings and other income) up to an amount slightly above the minimum wage (up to EUR 10 866). The tax system was designed in such a way that about 90 % of all workers are taxed at 16 % and 27 % tax rate (Graph 4.1.6). ([31])

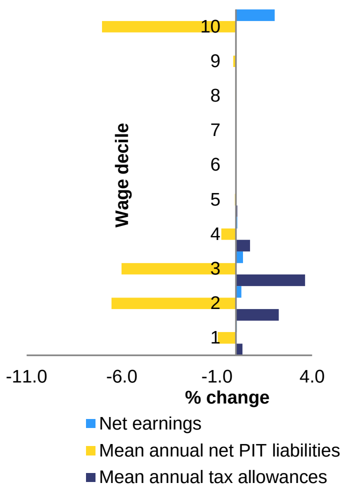
Graph 4.1.6: **The impact of the tax reform (by tax brackets)**



Source: European Commission, Joint Research Centre, based on the EUROMOD model

The overall fiscal costs of the tax reform are estimated by the authorities at EUR 106 million (0.4% of GDP). The fiscal impact is expected by the authorities to be balanced by the increase in the corporate tax rate from 17 % to 19 % and more efficient tax collection. The authorities expect the measure to be fiscally neutral. The reform can be split in three parts. The first part increases the number of tax brackets from four to five, introduces an additional tax rate of 34 % and lowers the second highest tax rate from 41 % to 39 % (Graph 4.1.6). The costs of this part of the reform are estimated at EUR 56 million. The second part of the reform increases the basic allowance threshold for low wage earners just above the minimum wage, from EUR 10 866 to EUR 11 166. The costs of this part of the reform are estimated at EUR 5 million. Finally, the third part of the reform reduces taxation on performance bonuses (13th salary), i.e. up to 70 % of the average wage is exempt from the income tax. The costs of this part of the reform are estimated at EUR 45 million.

Graph 4.1.7: **The impact of the tax reform (by wage decile)**



Source: European Commission, Joint Research Centre, based on the EUROMOD model
Net earnings and mean annual net PIT liabilities take into account both changes in tax brackets/rates and changes to the basic allowance for low wage earners.

The tax reform has the biggest impact on workers in the tenth (highest) wage decile (Graph 4.1.7). ([32]) The reason is that the major part of the reform (i.e. the changes in tax brackets and tax rates) impacts only on workers with an annual taxable base above EUR 20 400, i.e. about 10 % of all workers. In the tenth wage decile more than

([29]) The announced reform of the health care system is expected to reduce the effect of the tax reform, in particular for higher wage earners.
([30]) The personal income tax reform affects each individual who receives an active income. However, in this section the focus is on workers, i.e. individuals who receive only earnings from work.
([31]) In computing the taxable base the social security contributions and tax allowances are deducted from income (earnings and other income).
([32]) The impact of the tax reform is assessed with the EUROMOD and QUEST model. EUROMOD cannot simulate the change in taxation of bonuses and the increase in corporate tax rates due to data and model limitations. EUROMOD is a static tax-benefit microsimulation model while QUEST is a dynamic general equilibrium macromodel. EUROMOD simulations have been conducted by the Joint Research Centre of the European Commission.

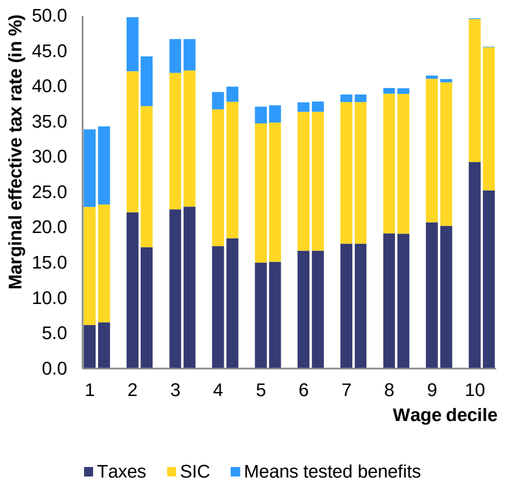
80 % of workers are affected by the reform. Their tax liabilities are reduced on average by about 7% (EUR 600 per year) while their net earnings are increased by 2 % (Graph 4.1.7). In this wage decile the main beneficiaries are workers with an annual taxable base above EUR 48 001 (Graph 4.1.6). They represent less than 1% of all workers. Their net earnings are increased on average by 4.3 % (more than EUR 2 000 per year).

A very small proportion of low wage workers benefit from the changes in the eligibility for the basic allowance. The increase in the basic allowance threshold for low wage earners has an impact on workers in the first half of the wage distribution. However only 4 % of them benefit from the reform. The main beneficiaries are workers in the second and third wage decile, although only 7.2 % of workers in the second and 10.1 % of workers in the third wage decile are affected (Graph 4.1.7). Their tax liabilities are reduced on average by about 6.5 % and 6.0 % (EUR 23 and EUR 33 per year, respectively) while their net earnings are increased on average by 0.3 %. In the remaining deciles the proportion of affected workers is below 2 % and their changes in net earnings smaller than 0.1 %.

While the tax reform is targeted, disincentives to work remain strong. The reform raises incentives to work for workers with the highest marginal effective tax rates (METR), i.e. workers in the second and the tenth wage decile (4.1.8) ([33]). However, METR for these workers remain high. Changes in the basic allowance for low wage earners reduce the METR of workers in the second wage decile by 5.6 pps. to 44.3 %. Changes in tax brackets and tax rates reduce the METR of workers in the tenth wage decile by 4 % to 46.5 %. Income taxes continue to contribute the most to the METR for workers in the tenth wage decile.

The tax reform will have a small impact on economic growth, employment and inequality. Over the next five years, GDP is expected to increase by 0.1 % and the employment rate by 0.07 % relative to the baseline. The impact of the reform is greater for high skilled workers as their employment rate is expected to increase by almost 0.3 %. The increase in the corporate tax rate is expected to reduce profits (after tax) by about 0.5 %. Inequality rises slightly as the Gini coefficient increases by 0.1pp to 24.5 %. The impact on the at-risk-of-poverty rate is insignificant.

Graph 4.1.8: **The impact of the tax reform on work incentives**



(1) The first column shows METR before the reform and the second column after the reform.
Source: European Commission

Real estate tax

The introduction of a revised version of the real estate tax was postponed until 2019. Revenues from recurrent immovable property taxation, which is less distortive to economic growth than labour taxes, are considerably below the EU average. The technical assistance provided by the IMF on the Property Tax Act, concluded that a single rate of 0.33% would generate recurrent real estate tax revenue of 1.2% of GDP (IMF, 2016g). The authorities plan to introduce a revised version of the real estate tax by 2019. Proceeds from the real estate tax will be revenues for the municipalities. Any additional income from this source will reduce the state's funding of municipalities. The broader tax base would be measured as the market value throughout a mass valuation system ([34]). In autumn 2017, the Property Tax Act is expected to be adopted by the

([33]) Marginal effective tax rate is defined as the rate at which taxes are increased and benefits reduced as earnings are increased by 3 %.

([34]) Mass valuation is characterised by use of standardized procedures and common data housed in a database (fiscal cadastre). This system provides relations among different characteristics of the items and their influence to the value.

Parliament. Mass valuation is to be applied to all properties in mid-2018. This legislation is therefore expected to be introduced in January 2019.

4.2. FINANCIAL SECTOR

4.2.1. BANKING SECTOR* (35)

The profitability of the banking sector has continued to improve in the first half of 2016, thanks to higher asset quality and lower credit risk. The recent increase in net income is in large part due to a net release of loan loss reserves that were built up in previous years. In particular, banks were able to reduce their provisioning due to improving asset quality in the existing loan portfolios and the low credit risk of new loans. Despite these positive developments, the low interest rates continue to put pressure on net interest margins as loan rates drop faster than the funding rates for banks, where deposit rates are already below euro area average.

Table 4.2.1: **Financial soundness indicators, all banks**

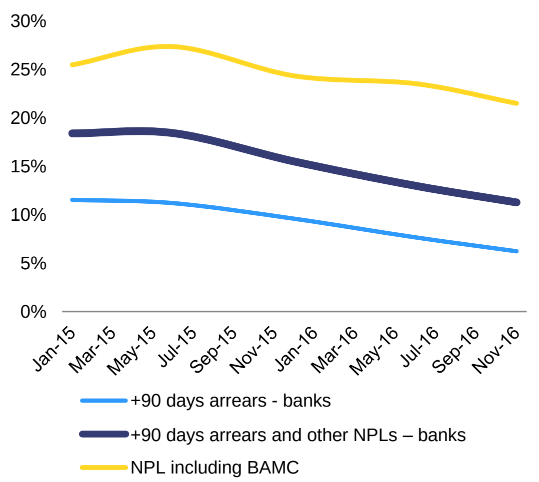
(%)	2010	2011	2012	2013	2014	2015	2016Q2
Non-performing loans	-	-	19.2	17.1	16.6	13.3	12.4
Coverage ratio	-	-	44.5	61.3	58.8	66.1	69.2
Loan to deposit ratio*	156.5	149.0	143.8	119.0	95.9	86.2	80.5
Tier 1 ratio	8.6	9.3	9.8	12.9	17.1	18.0	18.4
Return on equity	-3.1	-11.1	-19.4	-90.2	-2.5	3.5	-
Return on assets	-0.2	-0.8	-1.5	-8.0	-0.3	0.4	-

(1) ECB aggregated balance sheet
Source: ECB, CBD

The solvency positions of banks have been generally improving due to increasing profitability and asset quality. A key driver behind these positive developments was the re-classification and the deleveraging of risky activities from the banks' balance sheets. The aggregate Tier 1 ratio has steadily improved since 2013 to reach 18.4 % in June 2016. Smaller institutions and savings banks represent a higher solvency risk.

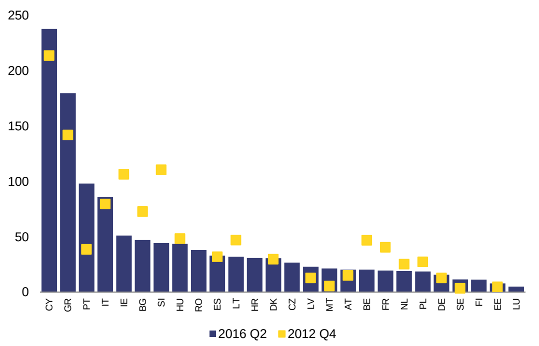
Risks related to the increasing maturity gap between assets and liabilities could develop when the interest rates rise. As loan rates have dropped, existing and new borrowers have increasingly turned to longer maturity and fixed interest rate loans. In a parallel development, increased risk aversion and a general lack of high yield instruments have led investors to put most of their savings into sight deposits, which can be withdrawn at any time. As a result, the difference between the average re-pricing periods of the assets and liabilities has increased. The increasing maturity gap could become challenging in the event of an interest rate hike, effectively leading to a further compression of the net interest margins in the short to medium term. Furthermore, the dominant use of sight deposits as the main investment vehicle suggests an increased liquidity risk.

Graph 4.2.1: **Evolution of NPL categories**



Source: Bank of Slovenia
Note: The NPL categories are based on local risk category definitions. Claims of BAMC are outside the banking system and classified as NPLs.

Graph 4.2.2: **Net NPLs to own funds (%)**



Source: ECB (consolidated banking data)
Note: No data available for GB and SK for Q2 - 2016 and for RO, HR, CZ, LU and FI for Q4 - 2012

Non-performing loans have considerably decreased over the past year partly due to portfolio sales and transfers to the bad bank. Banks have acquired significant capacities and competences in the workout management of NPLs. The share of NPLs in the banks' balance sheets is

(35) An asterisk indicates that the analysis in the section contributes to the in-depth review under the MIP (see section 3 for an overall summary of main findings).

falling and the trend is expected to continue. In particular, the local NPL measure, which includes both loans that are more than 90 days in arrears and other risk categories, dropped to 11.3 % by November 2016 from 18.4 % at the end of 2014 (Graph 4.2.1). Although the absolute level is still high in comparison to other Member States, they are well provisioned (coverage ratio of 69.2 % in June 2016). The loss absorbing capacity has increased and the remaining spill-over risks to the sector have decreased substantially over the recent years (Graph 4.2.2). In mid-2016 Nova Ljubljanska Banka (NLB) sold two packages of NPLs of retail and corporate clients in Slovenia worth EUR 500 million to institutional investors. The portfolio sales and transfers to the Bank Asset Management Company (BAMC) contributed to about 50 % of the reduction in NPLs. Write-offs and restructuring contributed to 30 % and 20 % of the reduction of the stock of bad loans respectively.

The Bank of Slovenia's actions have effectively provided direct incentives for engaging in write-offs. To speed up the process of balance sheet cleaning, the Bank has issued guidance asking banks to specify annual targets and strategies for NPL reduction, which are being regularly revised. In addition, banks are asked to derecognise assets i.e. withdraw recognition of assets, within a specific timeline depending on the type of the asset and the exposures. The Bank of Slovenia played a leading role in the successful restructuring of the banking and corporate sector. The continued respect of its independence and of its role within the ESCB while carrying out its tasks provided for by EU law, including during pending domestic investigations, is of high importance.

Banks are improving their risk management practices. Several banks are actively pursuing a strategy to shift to the internal-ratings based approach for credit risk. The current conditions do not provide immediate incentives for banks to formally apply such an approach due to the high default rates observed over the last years of crisis. However, the shift to internal-ratings based approach is seen as a longer-term ambition, which allows the banks to build up the necessary expertise and information.

The consolidation and restructuring of the banking sector are progressing. The merger of Nova Kreditna Banka Maribor, Raiffeisen banka and Poštna banka Slovenije was completed in September 2016. The remainder of Factor banka and Probanka, two banks winding down since September 2013 was transferred to the BAMC in February 2016. Sberbank and Gorenjska Banka are on sale.

State ownership in the banking sector is one of the highest in the EU. The state owns more than 50 % of the bank market, but is slowly reducing its stake. Maintaining a high level of state involvement in the longer run may entail some risks for economic efficiency and public finances. Nova Kreditna Banka Maribor was privatised in April 2016, and NLB is planned to be privatised (up to 75 %) by December 2017. The initial public offering was initially supposed to start at the end of 2016. NLB has been classified as an 'important asset' in the state assets management strategy. Therefore the government has to keep a minimum stake of 25 % (+1 vote) according to the law on Slovenian Sovereign Holding. Also, the strategy specifies that no private investor can acquire a stake higher than the government in certain firms, including in NLB. Although the legal effect of the latter provision is not clear, this is likely to reduce the attractiveness of NLB for private investors. It is also likely to decrease the sale price, unless the management of company's operations is secured via other tools, such as shareholders' arrangements on corporate governance. Finally, Abanka-Celje is expected to be privatised by June 2019, but no concrete step has been taken yet towards privatisation.

Insurers seem well capitalised and resilient to the low interest rate environment, but supplementary health insurance may face challenges. Slovenian insurers showed good resilience in the European Insurance and Occupational Pensions Authority (EIOPA) stress test of 2016, and Solvency II entered into force smoothly. The complementary health insurance, which was highly profitable in the past, has seen its profit gradually decreasing. The government is considering the option to integrate the supplementary health insurance in the public scheme and to cover 100 % of the claims (section 4.1).

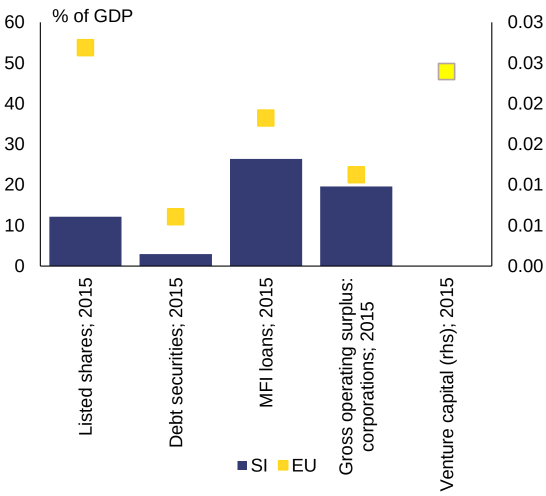
State ownership in the insurance sector is unusually high and results in questionable

investment strategies, weak corporate governance, supervisory issues, and risks for financial stability, economic efficiency and public finances. The state owns three major players of the Slovenian insurance market, representing a market share of about 60 %, which is by far the highest share in the EU. The Government seems to exert influence on the strategy of the insurers. The strategy on state assets management requires that state-owned insurers will not invest less than 30 % of their assets in domestic financial instruments. It also provides that these insurers' supervisory board must obtain an approval by the Slovenian Sovereign Holding before disposing a stake in a company classified as 'strategic' or 'important'. These restrictions on the investment strategy of state-owned insurers could hamper the asset allocations and lead to increased concentration risk.

The independence of the Insurance Supervision Agency (AZN) and the Securities Market Agency (ATVP) might be under pressure. A number of international institutions (IMF, EIOPA and OECD) have issued recommendations to strengthen the independence of the supervisors, or shared concerns that this independence could be compromised. In particular, the draft law on public agencies aims to introduce potentially problematic provisions reducing the operational independence of the AZN and ATVP. The proposal stipulates that the Ministry of Finance should set annual goals for the two agencies. The failure to achieve these goals may be considered as adequate grounds for dismissal of the responsible director. Similarly, the proposal gives the Government the ability to interfere with the staffing and salary plans as well as the financial operations of the two agencies. These provisions may lead to a conflict of interest since both agencies are responsible for the supervision of a large number of state-owned enterprises.

The market capitalisation of quoted non-financial corporations is very low compared to the EU average. While reaching EUR 19.2 billion in August 2007, it is now down to EUR 4.7 billion. The issuing of debt securities has been increasing but is still at a very low level. Non-financial corporations continue to prefer monetary financial institutions (MFI) loans as a source of funding (Graph 4.2.3), although the stock of such loans dropped from EUR 21.5 billion in July 2010 to a record low of EUR 10.2 billion (26.4 % of GDP) reflecting the transfers of impaired assets from the banks to the Bank Asset Management Company and significant deleveraging pressures.

Graph 4.2.3: **NFC funding**



Source: ECB, AMECO

Slovenia is repeatedly late with transposing EU financial directives. It is among the Member States with the highest number of open infringement cases due to non-transposition of post-crisis financial directives. According to the authorities, the lack of administrative capacity (human resources) is one of the major reasons for delayed transposition.

4.2.2. ACCESS TO FINANCE*

Access to finance for small and medium-sized enterprises (SMEs) has improved and is in line with the EU average. In 2016, some 9 % of SMEs had their loan applications rejected, down from 24 % in 2014. Both the willingness of banks to lend money and access to public financial support that include guarantees have improved. Although certain SMEs are still facing financial challenges, access to finance is no longer one of the three main obstacles for the operation of Slovenian micro and small businesses (Small Business Agenda 2016 and CCIS Analytics, 2016). This is due to the economic recovery, the cleaning-up of bank balance sheets and non-performing assets, greater responsiveness of banks, and some new government debt funding programmes (by the

Slovenian Enterprise Fund and the SID Bank). Nevertheless non-performing loans remain high among SMEs. To address the issue, a systematic approach to SME NPL work out has been prepared with the help of the World Bank. In addition, the government adopted a bill to set up a central credit register to enable more efficient risk management and reduce the risk of indebtedness. Since the trough in February 2016, household loans have grown by 1.6 %. At the same time, loans to firms and SMEs continue to contract although at a slower pace. Access to finance for businesses is expected to improve further as the deleveraging pressure eases.

Limited steps have been taken to improve access to alternative financing sources and equity financing is still lower than in the EU. The Slovenian Enterprise Fund (SEF) and the SID bank (*Slovenska izvozna in razvojna banka*) have introduced mainly new debt instruments for SMEs including measures such as microcredits. One scheme of seed capital (around EUR 3.9 million) was implemented in 2016 by the SEF and some 47 SMEs were supported. In addition, SEF has signed the Competitiveness of Enterprises and SMEs Agreement under the European Fund for Strategic Investments. This will allow the SEF to provide EUR 180 million of guarantees to SMEs in Slovenia in three years. Based on a recent gap analysis, new financial instruments that would be backed by the structural funds are being prepared. Given the importance of access to finance for growth of small businesses, a large proportion of the ESIF (approximately EUR 450 million) will be delivered through financial instruments aimed at SMEs. These funds are planned to be delivered via more standard forms of financial instruments, such as loans and guarantees but also through alternative sources of financing, such as equity investments, venture capital and mezzanine financing. Incentives for venture capital companies are abolished as of January 2017. Before such an amendment, the Corporate Income Tax Act stipulated a special 0 % tax rate for venture capital companies, but only if they were established in Slovenia.

Box 4.2.1: **Selected highlight: reforms of the banking sector**

In 2015, Slovenia introduced the Regulation on the Assessment of Credit Risk Losses of Banks and Savings Banks (henceforth, the "Regulation"). (1) A principal aim of the Regulation was to set out rules on the classification of financial assets and assessment of credit risk losses.

Under Article 20 of the Regulation, banks are required to resort to a write-off when there is an internal assessment that a loan will no longer will be repaid. Once an assessment of non-repayment is made, the bank should derecognise the asset, which would result, under local accounting rules, in an immediate loss that is equivalent to the loan's net carrying value (i.e. gross carrying value minus stock of provisions). Then, at a later stage the bank may make adjustments by factoring in the recovered amounts after the finalisation of the legal bankruptcy procedures or other settlement proceedings, if any.

The Regulation provides clear guidance on when the supervisor would like write-offs to take place but does not provide any specific criteria warranting an assessment of non-repayment. While it is not clear if the expected payments include both the interest and principal payments or comprise only of the latter, the text provides guidance on when such an assessment would be expected. In particular, an assessment of non-repayment is deemed to be justifiable for (i) all unsecured loans of debtors that are either undergoing bankruptcy proceedings or more than one year in arrears; or, (ii) all property-backed loans of debtors that are more than four years in arrears.

These time-bound write-off guidelines appear to function well and have played a positive role in the significant reduction of NPL levels and the recovery of the Slovenian banking sector. In addition, the Regulation fills an important gap in international accounting standards on the recognition and measurement of financial instruments (or, the so-called IAS-39) rules. More importantly, the rules have given banks additional incentives to engage in more sustainable NPL resolution strategies, such as asset sales, instead of lengthy restructuring proceedings.

(1) The regulation was published on Official Gazette of the Republic of Slovenia, No. 50/15, entering into force in 11 July 2015. An amended version was published on Official Gazette of the Republic of Slovenia, No. 96/15, entering into force in 12 December 2015.

4.3. LABOUR MARKET, EDUCATION AND SOCIAL POLICIES

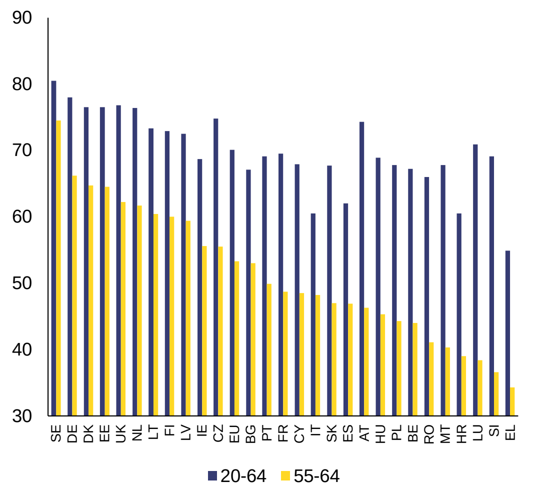
The recovery on the labour market continued in 2016. From Q3 2015 the employment rate increased by 0.2 pps to 70.4 % in Q3 2016 while unemployment rate continued to decline to 7.4 % in Q3 2016. In view of the rising labour demand there is an opportunity to activate and keep older workers in employment for longer. It is expected that demand for older workers will increase as labour shortages are expected to kick in soon.

4.3.1. LABOUR MARKET AND OLDER WORKERS* ([36])

The participation rate of older workers is well above pre-crisis levels but remains low, especially compared to other Member States (European Commission, 2016a). In the period 2011-2015, the employment rate of people aged 55-64 increased by 5.4 pps to 36.6 % (by 6.1 pps to 53.3 % at the EU average). This is the only age group to experience an increase in their employment in this period. The increase was mainly due to the 2012 pension reform (see Section 4.1.2) and the demographic effect of the 'baby boom' ([37]), which led to more employed people entering the group of older workers than exiting (IMAD, 2016a). However labour market conditions for older workers remain unfavourable. Thus, the key challenges remain how to keep older workers in employment for longer and get the long-term unemployed back into work. Effectively addressing these challenges could have a substantial positive impact on employment and economic activity. ([38])

One in three jobseekers is over 50 years old. The employment rate of older people continues to be among the lowest in the EU, despite the observed improvements and the recovery of the labour market. While the employment rate of older women (31 %) increased in 2015, it remains low compared to the Slovenian men (43 %) and the EU average for women (47 %). The retention rate of older workers is the lowest among all OECD countries. Only 18 % of those aged 55-59 who were employed in 2009 were still employed when aged 60-64 in 2014. The low retention rate is due to older workers becoming inactive. In addition, the unemployment rate of older people more than doubled since 2008, to a large extent due to termination of contracts for business reasons. More than 40 % of all long term unemployed are older than 50 and almost half of them have been unemployed for 2 years or more (37.1 months on average).

Graph 4.3.1: **Employment rate, by age groups, 2015**



Source: European Commission

Variations in adult skill levels are large with the lowest proficiency among the older people. The OECD Survey of Adult Skills (PIAAC) showed that about one in four Slovenes aged between 16 and 65 has poor literacy and numeracy skills, a slightly larger proportion than the OECD average (18.9 % and 22.7 % respectively). Nearly half of all Slovenians have poor digital problem-solving skills. Slovenian adults do better in numeracy than in literacy. This is despite a significant improvement in literacy skills compared to surveys from two decades ago. The skills of 55-64 year-olds are low both compared to the OECD average and to young Slovenians, creating one of the widest gaps across OECD countries (OECD, 2016b). Therefore, upskilling, reskilling and lifelong learning policies could improve their labour market participation. The national skills

([36]) An asterisk indicates that the analysis in the section contributes to the in-depth review under the MIP (see section 3 for an overall summary of main findings).
([37]) The demographic group born in the post-WWII baby boom, between approximately 1946 and 1964.
([38]) Simulations made by the Institute of Macroeconomic Analysis and Development in Slovenia of some labour market measures indicate a possible increase in Slovenia' GDP in the range of 0,2% to around 1% for each individual measure.
http://www.umar.gov.si/fileadmin/user_upload/sporocila_za_javnost/2016/marec/A_strukturni_ukrepi.pdf

strategy, currently being drafted, intends to assess the national skills system and pave the way for policies and strategies to meet future needs and improve the link between supply and demand for skills.

Older workers face many obstacles in staying active on the labour market despite the reform in 2013. Employers' perceptions play an important role. Employers doubt the capabilities of older workers and see them as more expensive and less flexible workers (Public Employment Service, 2015). Older workers may often not be attractive to employers due to their lower skills and the high seniority bonuses in Slovenia (OECD, 2016a). The 2013 labour market reform attempted to ensure greater competitiveness, employability and job retention of older workers. ([39]) Nevertheless, despite the reform older people remain less attractive as workers.

Older workers are approximately 15 % more expensive for employers than other workers (OECD 2016a). In addition to the basic salary, employers often have to pay more for them due to the seniority component of the salary system. In the private sector this commonly represents 0.5 % of the salary for each working year (although it may be agreed to be lower in collective agreements).

The authorities are seeking to encourage employment of older workers. Recent measures concern tax relief and exemption from paying social security contributions for employers hiring older workers (55+ unemployed). The measure reduces labour costs temporarily as an employer is exempt from paying social security contributions for up to 24 months. The measure was introduced at the start of 2016, and will likely be extended beyond 2017.

The unemployment insurance system allows people to retire as much as four years and one month earlier. In Slovenia, the duration of unemployment benefits increases sharply with work experience and age. Maximum benefit duration varies from two months for young workers with 6-8 months of prior employment, to up to 25 months. For workers over 55 years, with an insurance period of 25 years, the duration of unemployment benefit is set to 25 months as soon as nine months of contributions were made in the past 24 months. After this period unemployed older workers can receive pension and disability contributions for up to 2 years prior to fulfilling retirement conditions. This period will be reduced to 1 year as of March 2018. Because seasonal employment can be sufficient for older workers to re-establish benefit eligibility, incentives to seek permanent employment are weakened. Entering retirement via the unemployment insurance system has become increasingly common in recent years, with large spikes coinciding with anticipated pension reforms. Today, around 30 % of old-age pension recipients enter retirement via this route. (OECD, 2016a).

To increase the employment rate of the elderly the government adopted a policy paper and an action plan in 2016. The policy paper 'Older Workers and the Labour Market in Slovenia' forms a basis for discussion with social partners and may, to some extent, address the challenges of demographic trends. The document complements the White Paper on pensions. Tackling the challenges the elderly face on the labour market is seen as a key factor for a successful pension reform (see Section 4.1.1). Based on the policy paper, the action plan was adopted. It includes 34 short term measures that should either start or finish in 2017, as well as 15 measures starting only in 2018. Four different ministries are involved in the plan. Some measures are a continuation of previous policies (Section 4.3.2) while others are completely new. Implementation of the plan is a key to improve activation of older workers.

The proportion of low-skilled among all registered unemployed remains at the same high level compared to last year (at 28.8%). The employment rate of low skilled workers fell between 2008 and 2013. This was mostly the result of a significant decline in economic activity in the construction and manufacturing sectors, which employ mostly low-skilled labour. In recent years, their situation on the labour market improved: in 2015 their employment rate was up by 3.4 pps (48 %), from 2013. This is due to the structure of the economic recovery, which is based mainly on

([39]) Changes were made to the protection of workers prior to retirement if their contract is terminated, to severance grants upon retirement, to the seniority component (dodatek na delovno dobo) of the salary, and the level, duration and conditions of unemployment benefits and social insurance contributions.

manufacturing exports (IMAD, 2016a). Nevertheless, the employment rate of low skilled remains 6.8 pps below the pre-crisis level and 4.6 pps lower than the EU average.

Older and low-skilled workers continue to be underrepresented in active labour market policy (ALMP) measures. In 2015 the structure of ALMPs participants was as follows: 41.2 % young people, 47.6 % long-term unemployed, 17 % lower educated people and only 13.9 % older workers (50+) Some groups may overlap. Participation in lifelong learning in 2015 was high compared to other EU countries (11.9 % vs 10.7 % in the EU). However, it remains low among older workers and the low-skilled. The ALMP implementation plan adopted in January 2016 continues the approach implemented so far, with general measures such as subsidies for employment, encouragement of self-employment and public works. While public works seems to help in employing workers, particularly older workers, it can to a large extent represent quite an artificial reduction of unemployment, especially long-term unemployment. Since 2008, only three programmes were exclusive to older unemployed of which two were co-financed by the European Social Fund.

The Ministry of Labour is preparing two new projects to address vulnerable groups on the labour market, including older workers. One will focus on providing employment to those who are unemployed for more than 24 months and are receiving social assistance. It will have a concept similar to public works and it will provide jobs in the public sector and associations with a social mission. A second new programme, 'Active ageing at work' will start in 2017. It will provide support for employers to manage the ageing workforce and provide training programmes for older workers. Both projects will be co-financed by the European Social Fund.

4.3.2. OTHER LABOUR MARKET DEVELOPMENTS

Despite the reform in 2013 labour market segmentation ([40]) remains a challenge. The proportion of fixed-term contracts remains stable at 12.4 %. Newly concluded fixed term contracts have increased slightly among older and younger workers. However the proportion of fixed term contracts remains lower than before the reform. The number of self-employed remains stable at around 90 000. A policy paper prepared by the Ministry of Labour entitled "Decent Work" identified a number of reasons for using atypical contracts, such as rigid labour legislation and a tax system that leads to uncompetitive labour costs for permanent contracts (MoLFSAEO, 2016c). Against this background amendments of three different labour market acts are currently in public consultations. Amendments of the Labour Inspection Act will give more power to the labour inspectorate which should also help combat the increasing number of bogus self-employed ([41]). Amendments of the Employment Relationship Act on dismissals in case of inability to work aim at making permanent contracts more attractive. Finally, changes of the Labour Market Regulation Act seek to ensure greater social security for employees in case their employment is terminated. The purpose is to encourage unemployed people to look for work and intensify job search already in the notice period.

The relatively high minimum wage and the compressed wage distribution are still an issue, yet the number of minimum wage workers continues to decline. The gap between the minimum wage and average wage in 2016 has increased on account of average wage growth, while the minimum wage in 2016 remained fixed at the 2015 level (EUR 791 gross). Beginning of 2017, the minimum wage was increased by 1.8 % to EUR 805 gross or EUR 614 net. This increase is close to the average wage growth in 2016. Slovenia still has the highest minimum wage in the EU as a proportion of average gross earnings (50.8 % in 2016). However, the number of workers earning the minimum wage in the private sector has fallen from 19.8 % in 2014, to 16.4 % in 2015

([40]) The coexistence in the labour market of different categories ('segments') of workers, characterised by different levels of job security and/or access to social security and other benefits and by low transition rates from less secure to more secure categories. The main distinction is typically, but not exclusively, between workers with temporary contracts and those with permanent ones.

([41]) The number of those performing work for only one client increased from 11.5 % in 2012 to 18.7 % in 2015, pointing to a more pronounced use of bogus self-employment (European Commission, 2016a).

and to 13.4 % in the first half of 2016. Coverage of the minimum wage is nevertheless among the highest in EU.

4.3.3. SOCIAL DIALOGUE

The dialogue between the social partners is ongoing, despite the failure of the 2015 Social Agreement. In 2015, the minimum wage setting was redefined despite strong opposition from employer organisations. As a consequence, the employer organisations withdrew from the Social Agreement driving the social dialogue to a low point (European Commission, 2016a). The social dialogue is recently being slowly re-established. The government, trade unions and employer organisations reached a consensus on changes to the Economic and Social Council in December 2016. The changes aim to increase effectiveness of the Economic and Social Council and increase importance of social dialogue in the decision-making process. New rules increase competences of social partners on strategic issues and systemic legislation.

4.3.4. EDUCATION AND SKILLS

High and improving student performance in basic skills indicates that the school education system is of a high quality. The 2015 OECD programme for international student assessment (PISA) found that Slovenia was the third best performing EU country in science, a field where it achieved the highest scores. In reading, it had the second largest improvement in the EU compared to the last assessment in 2012. This is due to a large drop in the number of low achieving students (from 21 % in 2012 to 15 %) and a simultaneous increase in the proportion of top achievers (by around 4 pps). Student performance in maths also improved somewhat, while it worsened marginally in science, although not enough to compromise the high score. The proportion of low achievers is much lower than the EU average across the board (15 % in science and reading, and 16 % in mathematics), thanks in part to a small impact of socioeconomic status on student performance.

Higher education reforms feature prominently on the agenda. The tertiary education attainment rate has continued to rise in Slovenia: in 2015 43.4 % of 30-34 year-olds had obtained a tertiary-level qualification, up by 2.4 pps since 2014. This is above the EU average of 38.7 %. However, the gender gap is the second widest in the EU, with 56.4 % of women but only 32 % of men attaining higher education. Reform of Slovenia's higher education system has been debated for a number of years and the latest initiative is to launch reforms in two phases. The first phase is a revision of the Higher Education Act from November 2016, which introduces important changes to quality assurance and financing of higher education (European Commission, 2016b). The provision to internationalise higher education by allowing study programmes in foreign languages did not get the necessary political support. The second phase involves a more fundamental reform via a new Higher Education Act in 2017. This will primarily aim to regulate the system of financing higher education staff with a view to establishing an efficient balance between pedagogical, research and project activities at higher education institutions. The reform may reduce funds for some institutions, therefore the consultation process will likely be challenging.

4.3.5. SOCIAL POLICIES

The rate of people at risk of poverty and social exclusion (AROPE) decreased but remains above the EU average for elderly. The AROPE rate decreased to 19.2 % in 2015, while the rate for older people (65 and above) was 20.2 % (EU average: 23.7 % and 17.4 %, respectively). The AROPE rate is particularly high for older women over 65 years old (25.5 %; EU average: 19.6 %). Monetary poverty for elderly slightly grew to 17.2 % remaining above the EU average (14.1 %). Furthermore, the poverty gap ([42]) for this age group remained high and stood at 18.1 % (EU average: 16.5%). An ageing population (European Commission, 2016a), the low employment rate of older workers and issues with adequate pensions (see Section 4.1.2) are expected to put additional pressure on the income of elderly in the future. On the other hand, Slovenia has one of the lowest levels of income inequality in the EU (see Section 1).

([42]) Poverty gap is defined as average percentage shortfall (or gap) in income for the population (or a part of population e.g. elderly) below the poverty line.

The Social Assistance Benefits Act ([43]) **was amended.** The amended act entered into force as of February 2017 and will allow people to receive cash social assistance and income support (varstveni dodatek) ([44]) without triggering inheritance conditions for their real-estate up to EUR 120 000 ([45]). The latter conditions had been applied since 2012 and severely influenced the take-up of the measure: from 46 752 in December 2011 to 10 220 in January 2016. The amendment will have a positive impact on the old-age income however for a limited proportion of elderly population.

([43]) The Social Assistance Benefits Act was adopted in 2010 and was implemented as of January 2012.

([44]) Income support (*varstveni dodatek)* is complementary to the cash social assistance for permanently unemployable, permanently incapable of work, women older than 63 and or men older than 65.

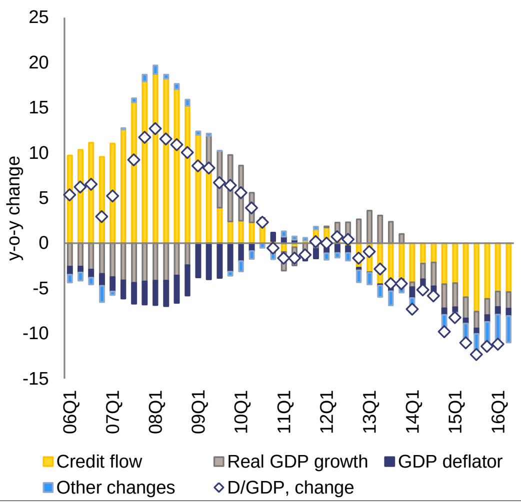
([45]) Cash social assistance and income support received no longer needs to be reimbursed to the state after the death of a beneficiary who owned and lived in a flat/house worth less than EUR 120 000. Furthermore, the beneficiary receiving support is now able to sell and mortgage such flat/house. The real-estate limit of EUR 120 000 is being introduced for the first time since adoption of inheritance conditions in 2012.

4.4. INVESTMENT

4.4.1. DELEVERAGING AND INVESTMENT* ([46])

Deleveraging pressures have started to ease but credit flows to firms continue to contract. Since the peak in the indebtedness ratio in 2010 (115 % of GDP), private sector debt decreased to 86.3 % of GDP in 2015. It is expected to decrease further but at a slower pace than in the previous years. In 2015, the decrease in private sector debt (10 pps of GDP) was driven mainly by negative credit flows to firms (Graphs 4.4.1 and 4.4.2). Most of the debt is held by non-financial corporations as households are one of the least indebted in the euro area. Private sector indebtedness is overall below the euro area average.

Graph 4.4.1: **Debt of non-financial corporations**

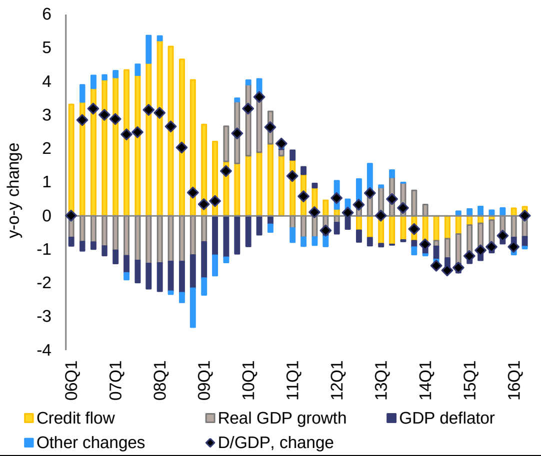


Source: Eurostat

The progress in deleveraging has been uneven across individual firms. Firms' credit flows have been negative since 2012. They reached a low in 2015, decreasing by 6 % year-on-year (y-o-y) (Graph 4.4.1). High leverage is unevenly distributed across firms, mostly present in a handful of large companies and among SMEs, as analysed in the 2015 country report for Slovenia. This report concluded that corporate debt was high compared to the earnings of firms' and their cash flow capacity to repay in 2013. However, both earnings and the capacity to repay debt have increased significantly in recent years. This has brought Slovenia in line with the euro area average.

Credit flows to households turned slightly positive in the first half of 2016, notably on the back of recovering house prices. While households actively reduced their debt between 2012 and 2015, their borrowing turned positive in 2016 (Graph 4.4.2). At the same time, the households' debt-to-GDP ratio keeps decreasing owing to positive nominal GDP growth. At 27.8 % in 2015 the ratio was one of the lowest in the EU. It is estimated to have decreased further to 27.5 % in 2016.

Graph 4.4.2: **Debt of households**



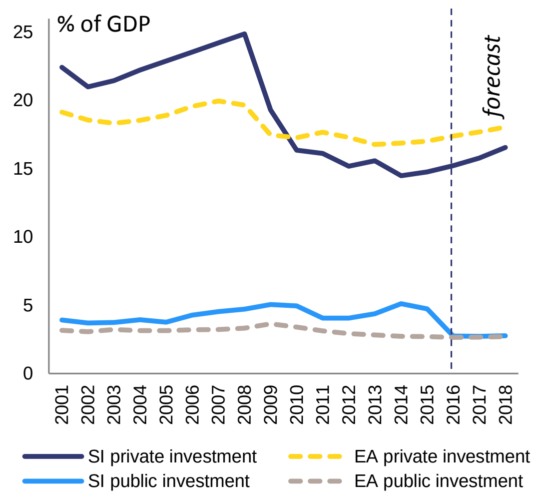
Source: Eurostat

Private investment started to recover in 2015 but remains below the euro area and historical averages (Graph 4.4.3). After dropping considerably in 2009-2010, the share of private investment in GDP remained on a downward trend until 2014. This was because the corporate sector was dealing with issues such as (i) high levels of debt, (ii) financial sector restructuring, (iii) high level of state involvement in the economy, (iv) low domestic demand, and (v) unsupportive business environment (analysed in detail in the 2016 country report). Companies, struggling to repay their debts underinvested for several years compared to the historical average and their cross-border peers. The negative trend in private investment started to reverse in 2015 as deleveraging pressures started to ease and the government made efforts to improve the business environment. Nevertheless, the high level of state

([46]) An asterisk indicates that the analysis in the section contributes to the in-depth review under the MIP (see section 3 for an overall summary of main findings).

involvement in the economy, and persisting complex and lengthy administrative procedures continue to negatively impact private investment.

Graph 4.4.3: **Private and public investment**



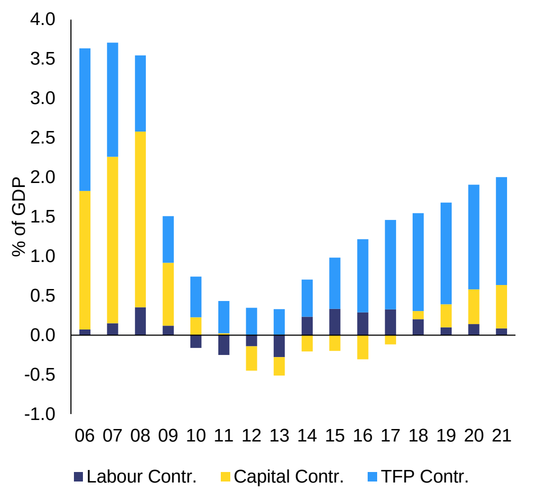
Source: AMECO

Public investment remained dependent on disbursements of EU funds. Public investment driven by infrastructure projects co-funded by the EU played a stabilising role in the post-crisis years. However, it decreased significantly in 2016 due to the end of the 2007-2013 EU-funding programming period. Public investment is expected to remain subdued before the new programming period and the investment plan for Europe / the European Fund for Strategic Investments (EFSI) gain full implementation speed.

The EFSI could be a major source of additional financing but remains largely untapped. The EFSI provides guarantees for larger and riskier projects, such as infrastructure. It also supports SMEs. This opportunity remains largely untapped, with the exception of a smaller agreement signed with the Slovenian Enterprise Fund under the Cosme programme. The available financing of EUR 8 million is expected to trigger up to EUR 390 million in investment. Some 1 500 SMEs may benefit from this support. EFSI also offers opportunities to develop more public-private partnerships by attracting private investors.

Foreign direct investment recovers, albeit from a low level. The stock of inbound FDI increased by 12.4 % in 2015, but it only reached 35 % of GDP, which remains below the EU average of about 50 % of GDP. Slovenia actively promotes FDI but several barriers keep hindering progress (Graph 4.4.5).

Graph 4.4.4: **Contributions to potential growth**



Source: DG ECFIN

Low investment has eroded the potential growth. The potential growth substantially dropped in 2009 - 2010 (Graph 4.4.4) as a result of a significant decline in capital accumulation, total factor productivity, and labour contribution turning negative. The Commission estimates potential growth in 2016 at 1 %, compared to 3-4 % between 2000 and 2008. While Slovenia's potential growth is projected to gradually recover, it is expected to remain subdued over the medium term, restrained by protracted low capital accumulation. However, total factor productivity is expected to progressively recover. As an ageing population is expected to have a negative impact on potential growth, enhancing productivity growth is crucial to return to a higher long-term growth path.

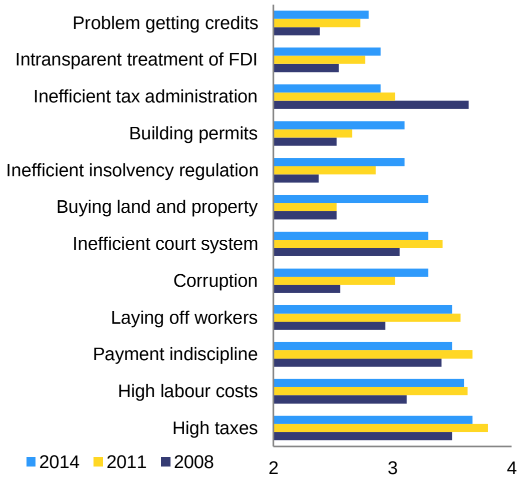
4.4.2. BUSINESS ENVIRONMENT*

Some measures have been taken to improve the business environment. The 9th progress report on the implementation of the Single Document ([47]) shows that nearly 60 % of 318 measures to reduce

([47]) The Single document identifies the measures to reduce the administrative burden for companies.

the administrative burden have been realised. Progress has been achieved on intra-ministerial coordination and prioritisation. However, complex regulation and administrative requirements remain the main obstacles for doing business. A key challenge is to implement the priority actions. Important measures such as those related to spatial planning and construction legislation and deregulation of professions have been postponed. The SME test was introduced in June 2016 but it is still too soon to assess its effects. National rules for directly transferring companies' registered offices into and out of Slovenia are missing.

Graph 4.4.5: **Barriers to FDI as seen by foreign businessmen**



Source: SPIRIT Survey on FDI

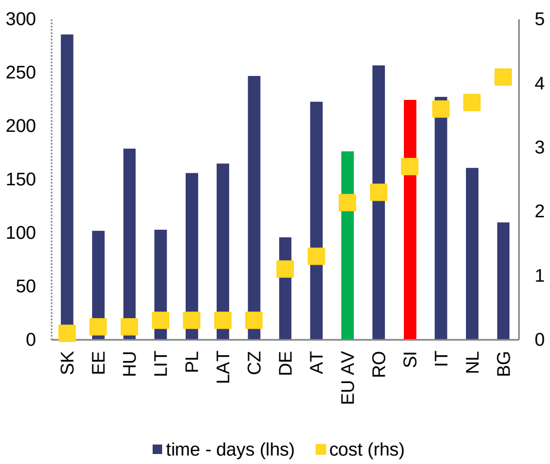
Competitiveness rankings have improved, yet certain challenges remain. According to the Competitiveness Index of the World Economic Forum, Slovenia improved its rank by 9 places between 2014 and 2017. Compared to 2016, its position remained stable in the World Bank Doing Business Report 2017, which assesses the ease for local entrepreneurs to open and run businesses. According to the survey conducted by the public agency SPIRIT, the main challenges for FDI remain the high labour costs and taxes, the payment indiscipline and the inflexible labour market regulation. In addition, the perception of investors about the quality of transport infrastructure, in particular rail infrastructure, transport and flight connectivity has substantially deteriorated over 2010-2016. Slovenian retailers assess the compliance with consumer legislation as weak, with prevalence of unfair commercial practices to be above the EU average, and enforcement of consumer and product safety legislation as below EU average (European Commission, 2017d).

Time and costs needed to obtain a building permit is among the highest in the EU (Graph 4.4.6). The Ministry of spatial planning is preparing a complete overhaul of the spatial planning and construction legislation. The adoption of the new legislation has been delayed and proposals to amend it can be still submitted until March 2017. A safer environment for investment and a better quality of spatial development could be provided by simplifying the procedures and enacting flexible mechanisms for planning and granting permits to facilities.

Restrictive barriers remain high in certain regulated professions. Slovenia has higher level of restrictiveness compared to the EU weighted average for all the professions under review in the recent Commission study (European Commission, 2017) ([48]) except for patent agents and accountants (Graph 4.4.7). Amongst the professions analysed, restrictiveness is the highest for lawyers. For example, there is a restriction that only attorneys may be shareholders or owners of an attorneys' office established in Slovenia. In addition, the business-churn rate for accounting, legal, architectural and real estate activities is lower in Slovenia compared to the EU average. This suggests relatively low dynamism and competition within regulated professions in these sectors. In 2012, Slovenia adopted a programme to reform its regulated professions. After the initial progress which led to full deregulation of 40 professions in the crafts sector and 4 in culture, the reforms slowed down and have not been finalised. Slovenia has still not submitted its national action plan in the context of the mutual evaluation exercise (due in January 2016).

([48]) European Commission has developed a new composite indicator on restrictiveness of most existing barriers to the access to and exercise of regulated professions. Such barriers entail for example reserves of activities, shareholding and voting requirements, multidisciplinary restrictions, compulsory chamber membership, authorisation schemes and professional indemnity insurance. The indicator is based on data collected from Member States.

Graph 4.4.6: **Time and cost needed to obtain a building permit**

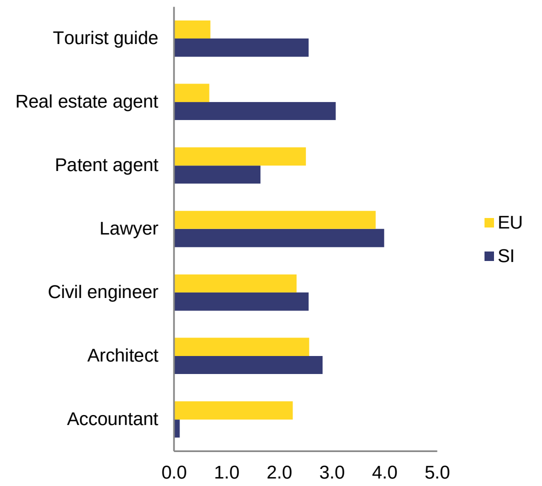


Source: World Bank Doing Business 2017

Entrepreneurship indicators remain below the EU average but the number of successful start-ups is growing. The 2016 Small Business Act fact sheet shows Slovenia with one of the lowest entrepreneurship scores in the EU. The majority of the entrepreneurship-related indicators show worsening, below-average results. The government recently adopted some policy measures promoting entrepreneurship and entrepreneurial education, but the country remains behind its EU counterparts. Although a vibrant and active start-up community is rapidly developing and there are a growing number of globally successful start-ups, stakeholders point to weak entrepreneurial education. The main challenge remains in the integration of entrepreneurship into the education curricula at all levels of education.

Improvements in the efficiency of R&D spending could help to increase productivity and potential growth. Although R&D investment as percentage of GDP is above the EU average, the efficiency of spending is low. This is due to the low performance of the public research system. ([49]) Some initial steps have been taken to foster openness of the public research system and its cooperation with businesses. ([50]) In addition, Slovenia lacks an effective governance structure for R&I in view of weak coordination across responsible departments and collaborative links between major stakeholders in innovation policy. The implementation of policy reforms in line with the research and innovation strategy appears to be on hold. Moreover, the new Law on R&D is not yet in place.

Graph 4.4.7: **Restrictiveness indicator: Slovenia and the EU weighted average (2016)**



Note: The scale is from 0 to 6. The higher the score, the more restrictive is the access to and exercise of the profession.
Source: European Commission

In Slovenia there are limited obstacles to investment deriving from the energy sector. The country is on track to achieving the target on reducing greenhouse gas (GHG) emissions with a foreseen reduction by 8.4 % in 2020, which is well above the target. With the electricity interconnection capacity at 85%, Slovenia's energy market is well interconnected with neighbouring markets. Ongoing work in the gas and electricity field will further enhance market integration, competitiveness and security of supply. Sustained effort on energy efficiency improvements in the buildings and industrial sector can keep the country on track to reach the target in 2020. Overall, Slovenia is making good progress in the energy security, energy efficiency and decarbonisation dimensions of the Energy Union. However, gas prices still remain higher than in most neighbouring countries due to high taxes and levies. Prices are high especially for SMEs and households despite a competitive market. The number of applications for Energy Union related

([49]) This is evidenced for instance by a low score on the indicator "Share of scientific publications within the top 10 % most cited scientific publications worldwide" (7.4% in Slovenia compared to 10.5% at the EU average).

([50]) Specific Support to Slovenia under the Horizon 2020 Policy Support Facility (JRC, 2016).

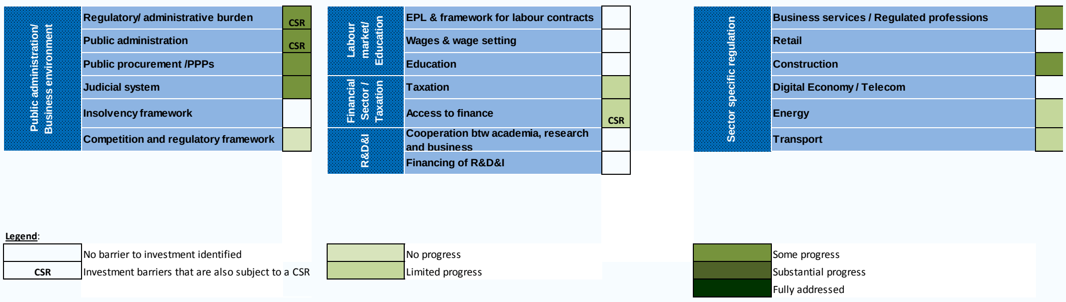
Box 4.4.1: **Investment challenges and reforms in Slovenia**

Macroeconomic perspective

Total investment in Slovenia dropped after the crisis and has not recovered. Private investment dropped considerably in 2009 and its share in GDP has continued to shrink since then. To this date, it remains markedly below the EA average. Public investment has played a role of a stabiliser, supported to a large degree by EU funds, but dropped in 2016 towards the EA average as EU disbursements slowed (see Section 4.4). The post-crisis sizeable decline in total investment largely reflected a sharp, post-boom, drop in construction activity. In contrast, productive investment in machinery and equipment showed more resilience. It has remained above the EA average and has been recovering towards Slovenia's historical average of 8.5% of GDP. Investment in intangibles assets increased only marginally in the post crisis period and is currently below EU average ([1]). According to recent surveys, weak domestic demand and high level of administrative burden are the main reasons for postponing investment decisions. Nevertheless, investment is forecast to grow at 5-6% in 2017 and 2018, driven by a double-digit expansion of investment in machinery and equipment, while construction investment is set to recover at a slower pace.

Assessment of barriers to investment and ongoing reforms

Slovenia is making efforts to reduce barriers to private investment. More than half of the identified measures to reduce the business environment have been realised. However main challenges especially for FDI remain the high labour costs and taxes, the payment indiscipline and the inflexible labour market regulation. While there are limited obstacles to investment deriving from the energy sector, the perception of investors about the quality of transport infrastructure has substantially deteriorated over 2010-2016. Restrictive barriers in certain regulated professions weigh on productivity and also reduce incentives to invest. Competitiveness of the Slovenian economy could be further enhanced by removing inefficiencies in the public administration and by reducing lengthy administrative procedures.



One major potential to improve business environment include, among others, to streamline the spatial planning and building permits procedures. Time and costs needed to obtain a building permit is among the highest in the EU. A complete overhaul of spatial planning and construction legislation is being prepared. However the adoption of the new legislation has been delayed and proposals to amend it can be still submitted until March 2017.

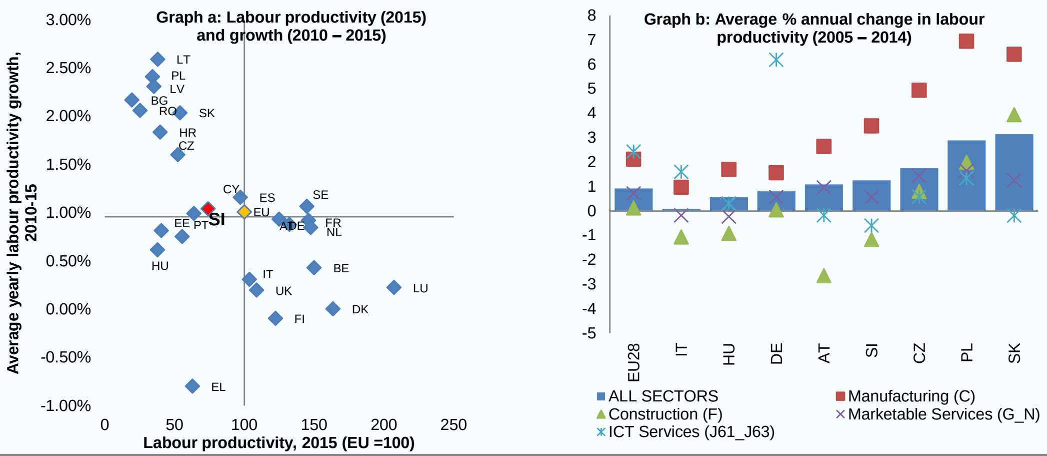
([1]) Productivity and economic growth stems not only from investment in infrastructure, in research and innovation but also in knowledge creation or investment in intangibles assets. Such assets include expenditures in human capital, e.g. in the form of education and training, public and private scientific research, business expenditures for product research and development, market development, and organizational and management efficiency.

technologies patents is below the EU average with only 0.3 patents per million of inhabitants. On renewables, the country is on track to reach its target with the renewables share at 21.9% in 2014.

Box 4.4.2: **Productivity**

Growth in labour productivity has fallen significantly in Slovenia in the post crisis period to levels particularly low for a catching up economy. Labour productivity growth (in terms of gross value added per hours worked) dropped to 1.0 % in 2010-2015 (Graph a), driven by the negative productivity growth in the ICT sector and construction (Graph b). The manufacturing sector continues to be its main growth driver. The reallocation of resources across sectors appears to have been suboptimal in the post crisis period as labour has not followed the sectors with higher productivity growth (European Commission, 2016g). This means that the aggregate productivity growth is set to decline, which calls for policies to raise productivity growth, especially in services.

Graph 1: **Labour productivity**



Note: The average % annual change is computed over 2005-2013 for CY and PT; no data is available for HR and MT.
Source: Eurostat, OECD, DG GROW calculations

Misallocation of labour is present especially in some sectors. [1] This is due, among other reasons, to market rigidities and regulatory barriers. Restrictive barriers remain high in certain regulated professions (see section 4.4). According to the OECD, Slovenia is the most restrictive among all Member States concerning access to network sectors (energy, transport and communications). The level of state involvement is important and as shown in previous country reports it distorts resource allocation. The labour market is characterised by certain inflexibilities, which especially affect older, low-skilled and young people (see section 4.3). The withdrawal of rigidities could favourably affect employment and economic activity.

Weak business environment hinders firms' growth prospects and productivity. The productivity gap between Slovenia and the EU-28 average is larger in the segment of micro companies than in the segment of larger firms (IESBM, 2015). According to Eurostat, Slovenia has one of the lowest shares of high growth enterprises. Several barriers for doing business, labour regulations and government bureaucracy have a negative impact on the ability of firms to grow. While access to finance has improved, alternative financing through venture and seed capital remains low hindering the growth of young and innovative firms. Investment in transport infrastructure has considerably decreased during the last 5 years. Continued underinvestment in infrastructure and low R&D efficiency may constrain productivity and growth in the future (see section 4.3).

Continuing the reform process will boost productivity and growth. Increasing the efficiency of R&D spending, opening up competition in services and reducing administrative barriers will lead to an increase in GDP over the long term, up to 1%. Also reducing administrative burdens and removing entry barriers to professional services to the average of more developed countries would raise GDP by 0.5 % and 0.1% respectively over the long term. Increasing the availability of human capital and the efficiency of its allocation by improving the functioning and the efficiency of labour market institutions could also boost productivity in the country (IMAD, 2016c).

1 In manufacturing allocation of labour is good and improving over time. In construction, the allocation is inefficient and deteriorating over time. In professional services and administrative services allocation is improving although from a lower level. Source: European Commission calculations based on Eurostat data.

4.5. PUBLIC ADMINISTRATION

4.5.1. EFFICIENCY OF PUBLIC ADMINISTRATION* (51)

Since the onset of the crisis, fiscal consolidation measures put substantial pressure on public administration. Measures to contain public expenditure have significantly affected public administration and services. However, in 2016, most of the measures have been reverted. The focus then shifted from temporary measures to implementing structural reforms that would durably reduce public spending and increase Slovenia's competitiveness and attractiveness for foreign investors (see Section 4.4.).

Public administration reform

Public Administration is heading for reform. In April 2015 the government adopted a long-term development strategy, aimed at modernising and increasing the efficiency of public administration. After initial delays due to the lack of resources and poor inter-ministerial coordination, the implementation has gained momentum. A special coordination office was established within the Ministry of Public Administration with the aim of facilitating and monitoring the implementation of the strategy. Most of the reform measures are of a long-term nature, with expected completion due by the end of 2017 or beyond. In 2015 a functional analysis and benchmarking performance indicators of public institutions were finalised and optimisation measures were identified. In a pilot case, financial services of nine administrative units will be merged and if successful, financial services of all 58 administrative units could be centralised. In view of the limited staff available, a number of technical assistance projects in cooperation with the Structural Reforms Support Service of the Commission have been initiated in various areas of public administration.

E- Government

The roll-out of e-public services is a priority for the authorities. The goal of their Digital Strategy for Slovenia and the Next-Generation Broadband Network Development Plan to 2020 is to achieve a coordinated digital transformation of public administration and to promote a regulatory framework for the digitalisation of the industry and businesses. Companies are performing better when it comes to the integration of digital technologies and benefit from a skilled population. The highest gap remains in digital public services, where only 24% of internet users are actively engaged in e-government and open data.

The establishment of a fully-fledged e-government system will increase the efficiency of public administration. The creation of the state cloud in December 2015 has had a great impact on the quality and efficiency of services and on budget savings. The work on the hybrid state cloud is in the testing phase and expected to be launched soon. Based on the once-only principle, the e-government portal offers more than 250 of the most frequently used electronic services, ensured by full interconnectivity of more than 30 databases. At the moment, citizens can access their personal information gathered from the central population register, records of personal documents, real estate register, register of vehicles and traffic documents. The data set will be expanded in the future. The One Stop Shop Business Portal (e-VEM) has been available since 1 January 2016 and is now mandatory for all businesses to arrange their social insurances. In 2016, more than 700 000 electronic transactions replacing paper forms were channelled through the system.

Corruption, public procurement

Perceptions of corruption remain negative and corruption has an impact on the performance of the economy. According to the control of corruption indicator Slovenia scores close to the EU average. However, in the Executive Opinion Survey 2016 corruption was identified as one of the six most problematic factors for doing business. The general perception of corruption remains a concern. According to the Global Corruption Barometer more than seven out of 10 citizens in Slovenia say that the government is not doing enough to fight corruption.

Corruption risks are high in public procurement. Public procurement represents around 13 % of GDP and is considered to be vulnerable to corruption. In 2015 almost 40 % of the contracts had only a single-bid and one fifth followed non-open tenders (European

(51) An asterisk indicates that the analysis in the section contributes to the in-depth review under the MIP (see section 3 for an overall summary of main findings).

Commission, 2016i). In the health sector, whenever public procurement is organised often only one bid is submitted. ([52]) ([53])

Corruption in public procurement takes several forms. The most common forms of corruption in Slovenia include collusive bidding, tailor-made specifications for particular companies, conflict of interests in the evaluation of bids, involvement of bidders in the design of specifications, abuse of negotiated procedures or abuse of emergency grounds to justify the use of non-competitive or fast-track procedures, and amendments to the contract terms after concluding the contract. (Flash Eurobarometer Businesses' attitudes towards corruption in the EU, 2015). To improve public procurement, Slovenia took part in a pilot initiative called "Integrity Pacts – Civil Control Mechanism for Safeguarding EU Funds against Fraud and Corruption". The purpose of the pilot is to make the procurement process more transparent and efficient. ([54])

Full transition to e-procurement for all users is expected in January 2018 and can help to reduce corruption risks. A law on public procurement, adopted in November 2015, provides the basis for the transition to a comprehensive e-procurement system. The new application Statist, which is available to the general public, provides access to comprehensive information about public procurement contracts in Slovenia. Full transition to e-procurement would reduce corruption risks by providing more transparency and accountability for contracting authorities and more security for economic operators.

Key anti-corruption reforms have been adopted and are currently being implemented. In 2015, the government adopted a two year programme of zero tolerance to corruption. The last review of the programme's implementation took place in September 2016. Monitoring over a longer time period will be required before conclusions on the programme's impact can be finally drawn. Given that it finished by end-2016, a follow-up programme or other policy options are currently under discussion. As several high-level corruption and money laundering cases were dropped after years of prosecution public opinion and businesses remain concerned about corruption.

4.5.2. FUNCTIONING OF THE JUSTICE SYSTEM

The justice system continued to reduce backlogs and the average length of proceedings. In 2016 the number of total pending cases decreased by 18 %, compared with 2015. Although the number of resolved cases decreased again in 2016 (around 79 000 cases per month compared to nearly 100 000 per month in 2012), the courts still resolved more cases than they received (overall clearance rate of 105 %) ([55]). At first instance district courts, the average length of proceedings mostly decreased to around 12 months in commercial and high-value civil cases, and to 13 months in criminal cases. However, it still takes 12.5 months until the first hearing in commercial litigious cases, an important area for a favourable business environment (in labour and in social cases it takes similarly long - around 11 months). Cases are being increasingly resolved through court settlements between parties, which reached 17 % in commercial cases and almost 20 % in civil cases. The courts are coping with a high number of personal insolvency (3 444 in 2016), liquidation (1 062) and restructuring proceedings (113). Courts resolved preventive restructuring proceedings in 280 days and liquidations in 386 days (without distribution of assets) and in 1 276 days (with distribution of assets), on average. The recovery rates ranged from 12 % (for all types of claims in liquidation and personal insolvency), to 25 % (for ordinary claims in compulsory settlement), to 39 %

([52]) Tenders Electronic Daily, 2012-2015.
([53]) For example, in case of medical imaging equipment there was no publication of tender in 25% of the cases (5% at the EU average) over 2012-2015. Moreover, whenever a public procurement procedure was organised, only one bid was submitted in 71% of the cases (28% at the EU average).
([54]) The Integrity Pact is a binding agreement between the contracting authority and the companies bidding for public contracts that they will conduct a procurement process with integrity, transparency and efficiency. To ensure accountability and legitimacy, an Integrity Pact includes a separate contract with a civil society organisation (Transparency International) which monitors that all parties comply with their commitments.
([55]) Court data from the Supreme Court. The clearance rate is the ratio of the number of resolved cases over the number of incoming cases. It measures whether a court is keeping up with its incoming caseload (European Commission, 2017b).

(for ordinary claims in simplified compulsory settlement).([56])

The quality of the justice system has improved. The Supreme Court introduced improvements following a 2015 court users survey and implemented timeframes (benchmark for number of cases to be resolved in a court within a given time) as a new management tool in the courts. The online publication of all first instance court judgments is envisaged for autumn 2017. However the timeline is still pending for introducing electronic submission of claims in civil and commercial cases (European Commission, 2017b). The courts' well-established electronic delivery and centralised postal delivery of court documents saved more than EUR 4.5 million in 2016 (more than 2 % of the courts' budget). Proposed amendments to the Civil Procedure Act aim to improve quality and efficiency by introducing (i) a preparatory hearing on evidence, (ii) enforceability of first instance small claim commercial court judgments, and (iii) a leave to appeal system for accessing the Supreme Court.

The role of the Council for the Judiciary would be enhanced. A draft law aims to introduce an independent budget of the Council, strengthen Council's role in disciplinary proceedings concerning judges, and moderately increase Council's influence on organisation and management of courts. However, with only seven officials and members who are not relieved of their work duties, the Council's administrative capacity would remain limited.

The role of the Council to select and propose judges for appointment, thereby guaranteeing judicial independence, has been put in question by a decision of the Parliament. It rejected the appointment of a judge to the Supreme Court by criticising a specific court judgment of the candidate judge.

The justice system benefitted from the successful case management reform (*Triaža* project). The reform was first introduced in commercial cases in July 2012, when the ICT system collecting granular court data revealed that nearly half of cases were resolved without a hearing and on procedural grounds (e.g. dismissals, withdrawals). An office managed by a so called triage judge was introduced, which analyses incoming cases and adopts procedural decisions. Court staff prepare draft decisions, leaving the triage judge to confirm a decision only when legally required. The triage office resolves about one-third of cases, without the need for a hearing. The remaining cases are randomly allocated to judges to decide on their merits. As a result, the clearance rate in commercial cases in Ljubljana rose from 95 % in 2011 to 124 % in 2016 and the average length decreased from 16.3 months to 13 months. The Supreme Court has extended parts of the case management reform to labour, social, civil and criminal cases.

A judicial map reform is in preparation to further improve the quality and efficiency of the justice system. Over the decades, the judicial map swayed between a single court and multiple courts of first instance (district and local). The 2009 and 2015 reforms brought local courts under the stronger control of district courts in order to even out the caseload and reduce jurisdictional conflicts. Drawing on national practices, ([57]) the reform of the judicial map aims to ensure a balanced caseload and increase specialisation, while safeguarding access to justice.

([56]) Ministry of Justice, Evaluation of the implementation of ZFPPIPP, Jan 2017. See also European Commission, 2016a, p. 62).

([57]) Workshop on judicial map reform with experts from FI and NL, 28-29 Sept. 2016, Ljubljana; funded by the technical assistance programme of the European Commission operated by the Structural Reform Support Service.

ANNEX A

Overview Table

Commitments	Summary assessment([58])
2016 Country-specific recommendations (CSRs)	
CSR 1: Following the correction of the excessive deficit, achieve an annual fiscal adjustment of 0.6 % of GDP towards the medium-term budgetary objective in 2016 and in 2017. Set a medium-term budgetary objective that respects the requirements of the Stability and Growth Pact. Strengthen the fiscal framework by appointing an independent fiscal council and amending the Public Finance Act. Complete and implement the reform of the long-term care and healthcare systems, making them more cost-efficient to ensure long-term sustainability of accessible and quality care. By the end of 2017, adopt the necessary measures to ensure the long-term sustainability and adequacy of the pension system.	Slovenia has made **limited progress** is addressing the CSR 1 (this overall evaluation excludes an assessment of compliance with the Stability and Growth Pact).
Following the correction of the excessive deficit, achieve an annual fiscal adjustment of 0,6 % of GDP towards the medium-term budgetary objective in 2016 and in 2017. Set a medium-term budgetary objective that respects the requirements of the Stability and Growth Pact.	The compliance assessment with the Stability and Growth Pact will be included in Spring when final data for 2016 will be available.
Strengthen the fiscal framework by appointing an independent fiscal council and amending the	• **Limited progress** was made regarding the

([58]) The following categories are used to assess progress in implementing the 2016 country-specific recommendations: **No progress:** The Member State has not credibly announced nor adopted any measures to address the CSR. Below a number of non-exhaustive typical situations that could be covered under this, to be interpreted on a case by case basis taking into account country-specific conditions:

• no legal, administrative, or budgetary measures have been announced in the National Reform Programme or in other official communication to the national Parliament / relevant parliamentary committees, the European Commission, or announced in public (e.g. in a press statement, information on government's website);

• no non-legislative acts have been presented by the governing or legislator body;

• the Member State has taken initial steps in addressing the CSR, such as commissioning a study or setting up a study group to analyse possible measures that would need to be taken (unless the CSR explicitly asks for orientations or exploratory actions), while clearly-specified measure(s) to address the CSR has not been proposed.

Limited progress: The Member State has:

• announced certain measures but these only address the CSR to a limited extent;

and/or

• presented legislative acts in the governing or legislator body but these have not been adopted yet and substantial non-legislative further work is needed before the CSR will be implemented;

• presented non-legislative acts, yet with no further follow-up in terms of implementation which is needed to address the CSR.

Some progress: The Member State has adopted measures that partly address the CSR

and/or

the Member State has adopted measures that address the CSR, but a fair amount of work is still needed to fully address the CSR as only a few of the adopted measures have been implemented. For instance: adopted by national parliament; by ministerial decision; but no implementing decisions are in place.

Substantial progress: The Member State has adopted measures that go a long way in addressing the CSR and most of which have been implemented.

Full implementation: The Member State has implemented all measures needed to address the CSR appropriately..

Public Finance Act. Complete and implement the reform of the long-term care and healthcare systems, making them more cost-efficient to ensure long-term sustainability of accessible and quality care. By the end of 2017, adopt the necessary measures to ensure the long-term sustainability and adequacy of the pension system.	fiscal framework. The revised Public Finance Act was adopted by the Parliament in December 2016, but the appointment of the Fiscal Council was further delayed. Following three unsuccessful public calls for applicants, the Government will have to restart an open call for applications to find members for the Fiscal Council. • **Limited progress** was made regarding long-term care reform. The pilot project to determine long-term care needs and support proposed legislative solutions is being prepared. • **Some progress** was made regarding healthcare reform. The proposed draft Health Care and Health Insurance Act, which is the central piece of the reform, has been put into public consultations in February 2017 and will be forwarded to the National Assembly in 2017. In December 2016, also the proposals to amend the Health Services Act and the Patient Rights Act were presented and the new Pharmacies Act was adopted. • **Limited progress** has been made regarding the long-term sustainability and adequacy of pension system. The White Paper on pensions was adopted in April 2016 and has opened a wide public consultation on the future of the pension system. However, the White Paper on pensions is a non-legislative act that needs to be followed up with adoption of legislative acts, needed to address the 2016 CSR.
CSR 2: In consultation with social partners, increase the employability of low-skilled and older workers, including through targeted lifelong learning and activation measures.	Slovenia has made **limited progress** in addressing the CSR 2: • **Limited progress has been made.** The analysis of the situation of older workers on the labour market has been adopted on 22 December 2016. While the spending on the active labour market policies stayed at the same level, the analysis of their effectiveness is under way. Active labour market policy measures targeting older workers still need to be intensified and the analysis of the effectiveness of active labour market policies is being prepared. It is also not yet clear what

	will be done as regards to lifelong learning.
CSR 3: Improve the financing conditions for creditworthy business, including by facilitating durable resolution of non- performing loans and access to alternative financing sources. Ensure the proper implementation of the bank asset management company strategy.	Slovenia has made **some progress** in addressing the CSR 3:
Improve the financing conditions for creditworthy business, including by facilitating durable resolution of non- performing loans and	• **Some progress** has been made on reducing the level of non-performing loans. These loans continue to fall, but their level is still high. The Bank of Slovenia has implemented a number of measures that are giving banks incentives to reduce their non-performing loans sustainably. They have also shown a willingness to take part in the Structural Reforms Support Service projects, which should further help the process.
access to alternative financing sources.	• **Limited progress** has been made regarding improving the financing conditions for creditworthy business by facilitating access to alternative financing sources. The Slovenian Enterprise Fund and the SID bank have introduced only new debt instruments for SMEs including measures such as microcredits. One scheme of seed capital (some EUR 3.9 million) was implemented in 2016 by the Slovenian Enterprise Fund and some 47 SMEs were supported. Other alternative financing instruments, including venture capital and equity are planned with use of ESIF
Ensure the proper implementation of the bank asset management company strategy.	• **Some progress** has been made regarding the implementing of the Bank Asset Management Company's strategy.
CSR 4: Take measures to modernise public administration and reduce the administrative burden on business. Improve the governance and the performance of state-owned enterprises.	Slovenia has made **some progress** in addressing the CSR 4:
Take measures to modernise public administration and reduce the administrative	• **Some progress** has been made regarding the modernisation of the public administration and regarding the reduction of the administrative

burden on business.	burden**.** The implementation the public administration development strategy 2015-2020 is ongoing; however certain specific measures from this strategy have been substantially delayed (i.e. the adoption of the Civil Servants Act). The government programme for reducing the administrative burden is estimated to have created total savings of in total of EUR 365 million of savings between 2009 and 2015. The 9th progress report of the Single Document shows that more than half of 318 measures to reduce the administrative burden have been realised. The SME test was introduced on 1 June 2016 and is now obligatory for all new laws prepared under regular procedure but it is still too soon to assess its effects.
Improve the governance and the performance of state-owned enterprises.	• **Some progress** has been made regarding the governance of state-owned enterprises (SOEs). The Slovenian Sovereign Holding (SSH) is managing SOEs in accordance with the regulatory framework in place. End-2015 results show an improved profitability of SOEs under SSH's management. An asset management plan for 2017, quantifying the performance indicators for each separate SOE and updating a list of assets for divestment has been approved by the government in January 2017. A procedure to appoint a new management board is underway, following the CEOs resignation as a result of pressures exerted on the SSH ahead of its initiative to replace the Port of Koper (*Luka Koper*) supervisory board.
Europe 2020 (national targets and progress)	
Employment rate (%): 75 %	In 2015 the employment rate in Slovenia increased by 1.3 % to 69.1 %.
Early school leaving target: 5 %	In 2015, the early school leaving rate in Slovenia further increased by 0.6 pps to 5.0 %. This is still one of the lowest rates in the EU and at the level of the national target as well as below the Europe 2020 target. However, the challenge is to prevent the rate from increasing further.

Tertiary education target: 40 %	The tertiary education rate continuously improved and exceeds the 2020 target in 2015 (43.4 %).
Target for reducing the population at risk of poverty or social exclusion: 40 000 (compared to 360 000 in 2008)	In 2015, 385 000 people were at risk of poverty or social exclusion.
2020 Renewable energy target: 25 %	In 2014, the percentage of renewable energy was 21.9 %, putting the country on track to reach the target.
Energy efficiency target. Slovenia's 2020 energy efficiency target is 7.3 million tonnes of oil equivalent (Mtoe) expressed in primary energy consumption (5.1 Mtoe expressed in final energy consumption.)	Slovenia reduced its primary energy consumption by -1% from 6.51 Mtoe in 2014 to 6.45 Mtoe in 2015. Final energy consumption increased by 2% from 4.59 Mtoe in 2014 to 4.69 Mtoe in 2015 ([59]). Even if Slovenia currently achieves levels of primary and final energy consumption which are below the indicative national 2020 targets, the trend warrants efforts to keep these levels until 2020.
Greenhouse gas (GHG) emissions target 2020: +4%, compared to 2005 emissions in the sectors not covered by the Emissions Trading Scheme (ETS).	2020 target: +4% According to the latest national projections and taking into account existing measures, non-Emissions Trading System (non-ETS) emissions will decrease by 8.4 % between 2005 and 2020. The target is consequently expected to be met with a margin of 12 pps. Non-ETS 2015 target: +3 % vs 2005. Based on proxy data, the non-ETS greenhouse gas emissions between 2005 and 2015 decreased by -12 %; which means 14 pps below the 2015 target set by the Effort Sharing Decision.
R&D target: 3 % of GDP	After years of steady growth, the level of R&D intensity in Slovenia dropped remarkably in 2014 to 2.4 % of GDP (from 2.6 % in 2013), driven by declines in both the public and private sectors. The declining trend continued in 2015, dropping

([59]) Renewable energy shares for 2015 are approximations and not official data, reflecting the available data (04.10.2016). See the Öko-Institut Report: Study on Technical Assistance in Realisation of the 2016 Report on Renewable Energy, http://ec.europa.eu/energy/en/studies

	to 2.2 % of GDP.

ANNEX B
MIP Scoreboard

Table B.1: **The MIP scoreboard for Slovenia**

			Thresholds	2010	2011	2012	2013	2014	2015
External imbalances and competitiveness	Current account balance, (% of GDP)	3 year average	-4%/6%	-2.0	-0.2	0.9	2.5	4.5	5.4
	Net international investment position (% of GDP)		-35%	-47.2	-45.2	-49.9	-46.6	-44.2	-38.7
	Real effective exchange rate - 42 trading partners, HICP deflator	3 years % change	±5% & ±11%	1.2	-1.1	-4.5	-0.7	1.2	0.6
	Export market share - % of world exports	5 years % change	-6%	-1.3	-5.4	-20.4	-17.8	-12.4	-3.6
	Nominal unit labour cost index (2010=100)	3 years % change	9% & 12%	16.1	8.3	0.6	0.4	-0.1	-0.6
Internal imbalances	Deflated house prices (% y-o-y change)		6%	-1.3	0.9	-8.2	-6.0	-6.6	1.5
	Private sector credit flow as % of GDP, consolidated		14%	1.9	0.4	-2.9	-4.0	-4.7	-5.1
	Private sector debt as % of GDP, consolidated		133%	115.1	113.0	112.5	108.2	98.1	87.3
	General government sector debt as % of GDP		60%	38.4	46.6	53.9	71.0	80.9	83.1
	Unemployment rate	3 year average	10%	5.9	7.1	8.1	9.1	9.6	9.6
	Total financial sector liabilities (% y-o-y change)		16.5%	-3.4	-1.2	-0.7	-10.3	-0.2	-3.4
New employment indicators	Activity rate - % of total population aged 15-64 (3 years change in p.p)		-0.2%	0.2	-1.5	-1.4	-1.0	0.6	1.4
	Long-term unemployment rate - % of active population aged 15-74 (3 years change in p.p)		0.5%	1.0	1.7	2.5	2.0	1.7	0.4
	Youth unemployment rate - % of active population aged 15-24 (3 years change in p.p)		2%	4.6	5.3	7.0	6.9	4.5	-4.3

Source: European Commission, Eurostat and Directorate General for Economic and Financial Affairs (for Real Effective Exchange Rate), and International Monetary Fund

ANNEX C
Standard Tables

Table C.1: **Financial market indicators**

	2011	2012	2013	2014	2015	2016
Total assets of the banking sector (% of GDP)	142.1	141.1	129.0	116.7	107.9	99.8
Share of assets of the five largest banks (% of total assets)	59.3	58.4	57.1	55.6	59.2	-
Foreign ownership of banking system (% of total assets)	28.3	29.3	30.6	33.5	34.4	-
Financial soundness indicators:1)						
- non-performing loans (% of total loans)	-	19.2	17.1	16.6	13.3	12.4
- capital adequacy ratio (%)	11.8	11.4	13.7	17.9	18.6	18.9
- return on equity (%)2)	-11.1	-19.4	-90.2	-2.5	3.5	5.0
Bank loans to the private sector (year-on-year % change)	-2.3	-4.1	-9.5	-9.1	-4.2	-0.3
Lending for house purchase (year-on-year % change)	6.2	1.8	1.3	0.5	1.8	4.2
Loan to deposit ratio	149.0	143.8	119.0	95.9	86.2	78.0
Central Bank liquidity as % of liabilities	7.0	13.0	14.1	3.3	2.8	2.0
Private debt (% of GDP)	113.0	112.5	108.2	98.1	87.3	-
Gross external debt (% of GDP)1) - public	23.6	30.8	43.7	60.8	60.2	57.7
- private	40.8	44.0	44.4	40.9	37.3	36.6
Long-term interest rate spread versus Bund (basis points)*	236.3	431.3	424.2	210.7	120.9	109.1
Credit default swap spreads for sovereign securities (5-year)*	159.1	330.1	273.2	138.5	107.8	95.0

Notes:
1) Latest data Q2 2016.
2) Quarterly values are not annualised
* Measured in basis points.
Source: European Commission (long-term interest rates); World Bank (gross external debt); Eurostat (private debt); ECB (all other indicators).

Table C.2: **Labour market and social indicators**

	2011	2012	2013	2014	2015	2016 [4]
Employment rate (% of population aged 20-64)	68.4	68.3	67.2	67.7	69.1	69.8
Employment growth (% change from previous year)	-1.7	-0.9	-1.1	0.4	1.1	1.9
Employment rate of women (% of female population aged 20-64)	64.8	64.6	63.0	63.6	64.7	66.2
Employment rate of men (% of male population aged 20-64)	71.8	71.8	71.2	71.6	73.3	73.1
Employment rate of older workers (% of population aged 55-64)	31.2	32.9	33.5	35.4	36.6	38.4
Part-time employment (% of total employment, aged 15-64)	9.5	9.0	9.3	10.0	10.1	9.3
Fixed-term employment (% of employees with a fixed term contract, aged 15-64)	18.0	17.0	16.3	16.5	17.8	17.0
Transitions from temporary to permanent employment	37.9	36.6	36.9	49.5	37.1	:
Unemployment rate[1] (% active population, age group 15-74)	8.2	8.9	10.1	9.7	9.0	8.0
Long-term unemployment rate[2] (% of labour force)	3.6	4.3	5.2	5.3	4.7	4.2
Youth unemployment rate (% active population aged 15-24)	15.7	20.6	21.6	20.2	16.3	15.5
Youth NEET[3] rate (% of population aged 15-24)	7.1	9.3	9.2	9.4	9.5	:
Early leavers from education and training (% of pop. aged 18-24 with at most lower sec. educ. and not in further education or training)	4.2	4.4	3.9	4.4	5.0	:
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	37.9	39.2	40.1	41.0	43.4	:
Formal childcare (30 hours or over; % of population aged less than 3 years)	34.0	36.0	36.0	34.0	:	:

Notes:
1) The unemployed persons are all those who were not employed but had actively sought work and were ready to begin working immediately or within 2 weeks.
2) Long-term unemployed are those who have been unemployed for at least 12 months.
3) Not in education employment or training.
4) Average of first three quarters of 2016. Data for total unemployment and youth unemployment rates are seasonally adjusted.
Source: European Commission (EU Labour Force Survey), National Accounts

Table C.3: **Labour market and social indicators (continued)**

Expenditure on social protection benefits (% of GDP)	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Sickness/healthcare	7.7	7.6	7.9	7.5	7.3	:
Disability	1.7	1.7	1.6	1.5	1.4	:
Old age and survivors	11.1	11.3	11.5	12.0	11.6	:
Family/children	2.1	2.1	2.1	2.0	1.9	:
Unemployment	0.7	0.8	0.7	0.8	0.7	:
Housing	0.0	0.0	0.0	0.0	0.0	:
Social exclusion n.e.c.	0.6	0.6	0.6	0.7	0.7	:
Total	23.9	24.1	24.4	24.5	23.7	:
of which: means-tested benefits	2.0	2.0	1.9	1.9	1.9	:
Social inclusion indicators	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
People at risk of poverty or social exclusion[1] (% of total population)	18.3	19.3	19.6	20.4	20.4	19.2
Children at risk of poverty or social exclusion (% of people aged 0-17)	15.2	17.3	16.4	17.5	17.7	16.6
At-risk-of-poverty rate[2] (% of total population)	12.7	13.6	13.5	14.5	14.5	14.3
Severe material deprivation rate[3] (% of total population)	5.9	6.1	6.6	6.7	6.6	5.8
Proportion of people living in low work intensity households[4] (% of people aged 0-59)	7.0	7.6	7.5	8.0	8.7	7.4
In-work at-risk-of-poverty rate (% of persons employed)	5.3	6.0	6.5	7.1	6.4	6.7
Impact of social transfers (excluding pensions) on reducing poverty	47.5	43.8	46.4	42.7	42.2	42.3
Poverty thresholds, expressed in national currency at constant prices[5]	6376	6384	6318	6009	5925	6112
Gross disposable income (households; growth %)	1.0	1.8	-2.5	-0.9	1.7	1.5
Inequality of income distribution (S80/S20 income quintile share ratio)	3.4	3.5	3.4	3.6	3.7	3.6
GINI coefficient before taxes and transfers	45.2	45.6	46.1	47.2	47.0	46.7
GINI coefficient after taxes and transfers	23.8	23.8	23.8	24.4	24.9	24.5

Notes:
1) People at risk of poverty or social exclusion : individuals who are at risk of poverty and/or suffering from severe material deprivation and/or living in households with zero or very low work intensity.
2) At-risk-of-poverty rate : proportion of people with an equivalised disposable income below 60 % of the national equivalised median income.
3) Proportion of people who experience at least four of the following forms of deprivation: not being able to afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour TV, or ix) have a telephone.
4) People living in households with very low work intensity: proportion of people aged 0-59 living in households where the adults (excluding dependent children) worked less than 20 % of their total work-time potential in the previous 12 months.
5) For EE, CY, MT, SI and SK, thresholds in nominal values in euros; harmonised index of consumer prices = 100 in 2006 (2007 survey refers to 2006 incomes)

Source: For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.

Table C.4: **Product market performance and policy indicators**

Performance indicators	2010	2011	2012	2013	2014	2015
Labour productivity (real, per person employed, year-on-year % change)						
Labour productivity in industry	9.09	3.69	-0.47	0.58	3.47	-0.26
Labour productivity in construction	-11.68	2.42	0.86	-3.04	8.05	-2.52
Labour productivity in market services	2.88	3.57	-1.03	-0.95	2.67	1.78
Unit labour costs (ULC) (whole economy, year-on-year % change)						
ULC in industry	-4.48	-0.05	3.47	0.11	-0.86	1.21
ULC in construction	13.51	-3.07	-1.83	2.70	-6.75	4.79
ULC in market services	-0.71	-1.10	0.08	-1.77	-1.50	-0.44
Business environment	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Time needed to enforce contracts[1] (days)	1290.0	1290.0	1290.0	1270.0	1270.0	1160.0
Time needed to start a business[1] (days)	7.5	7.5	7.5	7.5	7.5	7.5
Outcome of applications by SMEs for bank loans[2]	na	0.60	na	0.38	1.08	0.41
Research and innovation	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
R&D intensity	2.06	2.42	2.58	2.60	2.38	2.21
Total public expenditure on education as % of GDP, for all levels of education combined	5.68	5.68	5.44	5.22	na	na
Number of science & technology people employed as % of total employment	40	41	42	43	43	44
Population having completed tertiary education[3]	20	22	23	24	25	27
Young people with upper secondary education[4]	89	90	90	92	90	91
Trade balance of high technology products as % of GDP	-1.44	-1.02	-0.83	-0.60	-0.84	-0.61
Product and service markets and competition				**2003**	**2008**	**2013**
OECD product market regulation (PMR)[5], overall				na	1.89	1.70
OECD PMR[5], retail				na	0.90	0.63
OECD PMR[5], professional services				na	na	2.56
OECD PMR[5], network industries[6]				4.84	3.41	2.90

Notes:
1) The methodologies, including the assumptions, for this indicator are shown in detail at : http://www.doingbusiness.org/methodology.
2) Average of the answer to question Q7B_a. '[Bank loan]: If you applied and tried to negotiate for this type of financing over the past six months, what was the outcome?'. Answers were scored as follows: zero if received everything, one if received most of it, two if only received a limited part of it, three if refused or rejected and treated as missing values if the application is still pending or if the outcome is not known.
3) Percentage population aged 15-64 having completed tertiary education.
4) Percentage population aged 20-24 having attained at least upper secondary education.
5) Index: 0 = not regulated; 6 = most regulated. The methodologies of the OECD product market regulation indicators are shown in detail at : http://www.oecd.org/competition/reform/indicatorsofproductmarketregulationhomepage.htm
6) Aggregate OECD indicators of regulation in energy, transport and communications.

Source: "European Commission; World Bank — Doing Business (for enforcing contracts and time to start a business); OECD (for the product market regulation indicators); SAFE (for outcome of SMEs' applications for bank loans)."

Table C.5: **Green growth**

Green growth performance		2010	2011	2012	2013	2014	2015
Macroeconomic							
Energy intensity	kgoe / €	0.20	0.20	0.20	0.20	0.18	0.18
Carbon intensity	kg / €	0.62	0.61	0.61	0.59	0.52	-
Resource intensity (reciprocal of resource productivity)	kg / €	1.03	0.92	0.82	0.81	0.85	0.84
Waste intensity	kg / €	0.19	-	0.15	-	0.15	-
Energy balance of trade	% GDP	-5.0	-6.2	-6.8	-5.5	-4.1	-
Weighting of energy in HICP	%	13.87	14.31	14.50	14.38	14.72	14.23
Difference between energy price change and inflation	%	11.5	7.8	2.9	0.6	-0.9	-2.9
Real unit of energy cost	% of value added	9.2	9.7	9.7	9.6	9.1	-
Ratio of environmental taxes to labour taxes	ratio	5.3	5.5	5.0	4.7	4.7	-
Ratio of environmental taxes to GDP	ratio	3.6	3.5	3.8	4.0	3.9	-
Sectoral							
Industry energy intensity	kgoe / €	0.17	0.16	0.16	0.16	0.16	0.15
Real unit energy cost for manufacturing industry excl. refining	% of value added	16.3	16.7	16.1	15.1	14.1	-
Share of energy-intensive industries in the economy	% GDP	15.28	15.51	15.61	16.07	16.11	15.64
Electricity prices for medium-sized industrial users	€ / kWh	0.10	0.10	0.09	0.10	0.09	0.08
Gas prices for medium-sized industrial users	€ / kWh	0.04	0.05	0.06	0.05	0.04	0.04
Public R&D for energy	% GDP	0.01	0.02	0.01	0.01	0.01	0.01
Public R&D for environmental protection	% GDP	0.02	0.02	0.02	0.02	0.01	0.02
Municipal waste recycling rate	%	22.4	35.6	41.9	34.8	36.0	54.1
Share of GHG emissions covered by ETS*	%	41.9	41.1	40.2	40.7	36.9	36.4
Transport energy intensity	kgoe / €	1.08	1.13	1.17	1.13	1.08	1.02
Transport carbon intensity	kg / €	3.15	3.37	3.52	3.34	3.20	-
Security of energy supply							
Energy import dependency	%	48.7	47.7	51.2	46.9	44.5	48.7
Aggregated supplier concentration index	HHI	28.2	22.2	33.3	26.8	28.3	-
Diversification of energy mix	HHI	0.24	0.24	0.24	0.24	0.25	-

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2005 prices)
Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)
Carbon intensity: greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)
Resource intensity: domestic material consumption (in kg) divided by GDP (in EUR)
Waste intensity: waste (in kg) divided by GDP (in EUR)
Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP
Weighting of energy in HICP: the proportion of 'energy' items in the consumption basket used for the construction of the HICP
Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual % change)
Real unit energy cost: real energy costs as a percentage of total value added for the economy
Environmental taxes over labour taxes and GDP: from European Commission's database, 'Taxation trends in the European Union'
Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)
Real unit energy costs for manufacturing industry excluding refining : real costs as a percentage of value added for manufacturing sectors
Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP
Electricity and gas prices for medium-sized industrial users: consumption band 500–20 00MWh and 10 000–100 000 GJ; figures excl. VAT.
Recycling rate of municipal waste: ratio of recycled and composted municipal waste to total municipal waste
Public R&D for energy or for the environment: government spending on R&D for these categories as % of GDP
Proportion of GHG emissions covered by EU Emissions Trading System (ETS) (excluding aviation): based on greenhouse gas emissions
(excl land use, land use change and forestry) as reported by Member States to the European Environment Agency.
Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transport industry gross value added (in 2005 EUR)
Transport carbon intensity: GHG emissions in transport activity divided by gross value added of the transport sector
Energy import dependency: net energy imports divided by gross inland energy consumption incl. consumption of international bunker fuels
Aggregated supplier concentration index: covers oil, gas and coal. Smaller values indicate larger diversification and hence lower risk.
Diversification of the energy mix: Herfindahl index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels
* European Commission and European Environment Agency

Source: European Commission (Eurostat) unless indicated otherwise

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