



EUROPEAN COMMISSION
DIRECTORATE GENERAL
ECONOMIC AND FINANCIAL AFFAIRS

Brussels, 26 May 2016

**Assessment of the 2016 Stability Programme for
Slovenia**

(Note prepared by DG ECFIN staff)

CONTENTS

| | | |
|------|--|----|
| 1. | INTRODUCTION..... | 3 |
| 2. | MACROECONOMIC DEVELOPMENTS | 3 |
| 3. | RECENT AND PLANNED BUDGETARY DEVELOPMENTS..... | 5 |
| 3.1. | Deficit developments in 2015 | 5 |
| 3.2. | Medium-term strategy and targets..... | 6 |
| 3.3. | Measures underpinning the Stability Programme | 9 |
| 3.4. | Debt developments | 11 |
| 3.5. | Risk assessment..... | 12 |
| 4. | COMPLIANCE WITH THE PROVISIONS OF THE STABILITY AND GROWTH PACT | 14 |
| 4.1. | Compliance with EDP recommendations | 14 |
| 4.2. | Compliance with the debt criterion | 16 |
| 4.3. | Compliance with the required adjustment path towards the MTO | 17 |
| 5. | FISCAL SUSTAINABILITY | 21 |
| 6. | FISCAL FRAMEWORK | 23 |
| 7. | CONCLUSIONS | 24 |
| 8. | ANNEX..... | 25 |

1. INTRODUCTION

This document assesses Slovenia's April 2016 Stability Programme (hereafter called Stability Programme), which was submitted to the Commission on 28 April and covers the period 2015-2019. It was approved by the government and presented to the national parliament for a debate without a vote.

Slovenia is currently subject to the corrective arm of the Stability and Growth Pact (SGP). The Council opened the Excessive Deficit Procedure (EDP) for Slovenia in December 2009. Slovenia was recommended to correct the excessive deficit by 2015. Following the abrogation of the Excessive Deficit Procedure (EDP), Slovenia will be subject to the preventive arm of the Stability and Growth Pact (SGP) from 2016 and should ensure sufficient progress towards its medium term objective (MTO). As the debt ratio was 83% of GDP in 2015 (the year in which Slovenia corrected its excessive deficit), exceeding the 60% of GDP reference value, Slovenia is also subject to the transitional arrangements as regards compliance with the debt reduction benchmark during the three years following the correction of the excessive deficit. In this period, it should ensure sufficient progress towards compliance. After the transition period, as of 2019, Slovenia is expected to comply with the debt reduction benchmark.

This document complements the Country Report published on 26 February 2015 and updates it with the information included in the Stability Programme.

Section 2 presents the macroeconomic outlook underlying the Stability Programme and provides an assessment based on the Commission 2016 2016 spring forecast. The following section presents the recent and planned budgetary developments, according to the Stability Programme. In particular, it includes an overview on the medium term budgetary plans, an assessment of the measures underpinning the Stability Programme and a risk analysis of the budgetary plans based on Commission forecast. Section 4 assesses compliance with the rules of the SGP, including on the basis of the Commission forecast. Section 5 provides an overview on long-term sustainability risks and Section 6 on recent developments and plans regarding the fiscal framework and the quality of public finances. Section 7 provides a summary.

2. MACROECONOMIC DEVELOPMENTS

Following growth of 3.0% in 2014, the Slovenian economy grew by 2.9% in 2015. The 0.5 pps. higher growth in 2015 than envisaged in last years' Stability Programme, was predominately driven by exports, a recovery in private consumption and by a large contribution from inventories. Exports grew faster than imports (5.2% vs. 4.4%), resulting in a large current account surplus of 7.0% in 2015. Investment growth was notable at 3.2%, with a contribution from both public projects and private investment in machinery and equipment. Employment grew by 1.4% and unemployment fell to 9.0%, in line with the improved macroeconomic environment.

The macroeconomic projections underpinning the Stability Programme¹ prepared by the Institute of Macroeconomic Analysis and Development (IMAD), projects real GDP growth of 1.7% in 2016, 2.4% in 2017 and 2.3% in 2018 and 2019. Growth is expected to be supported by net exports and the further recovery in private consumption. Investment is forecast to turn

¹ External environment assumptions of the Stability Programme are in line with the assumptions of the Commission's 2016 spring forecast with no expected gains in competitiveness on foreign markets and a period of lower but steadily rising oil prices.

negative in 2016, before reverting to a positive trend in 2017-2019. The drop in 2016 is due to a considerable decline in public investment caused by the transition to the new EU funds 2014-2020 financial perspective. Overall growth projections for both 2018 and 2019 appear plausible. However, the projected 5-6% annual growth in investment in three consecutive years looks optimistic considering that there are no specific projects underpinning it. The Stability Programme assumes the continuation of fiscal consolidation and projects a low growth rate of public consumption. The impact of potential reforms is not quantified.

The Commission's 2016 spring forecast projects real GDP to grow by 1.7% in 2016, in line with the Stability Programme, but considerably below the DBP 2016 (2.3%), mostly due to a decrease in net exports and gross fixed capital formation projections. The key driver of the projected growth in 2016 is private consumption, followed by net exports. The Commission's 2016 spring forecast also envisages a fall in government investment, resulting in a deceleration of growth. In 2017, the Commission's forecasts an acceleration of real GDP growth to 2.3%, also in line with the Stability Programme.

The composition of growth as projected by the Commission's 2016 spring forecast however differs from that underpinning the Stability Programme. The Stability Programme envisages a sharper drop in investment in 2016 than the Commission's 2016 spring forecast (-3.0% vs -2.6%), and the Stability Programme contains a more positive view on net exports. On the other hand, the Stability Programme forecasts of private consumption is more conservative; private consumption is forecast to grow by 2.1% in 2016 and 1.7% in 2017, compared to the Commission's 2016 spring forecast of 2.3% and 2.5%. The view on employment and unemployment developments is almost the same in both the Stability Programme and the Commission's 2016 spring forecast. IMAD's inflation outlook (-0.3% in 2016 and 1.3% in 2017) is broadly in line with the Commission's 2016 spring forecast (-0.2% in 2016 and 1.6% in 2017). Overall, assessed against the Commission's 2016 spring forecast (and taking into account relevant recent developments) the Stability Programme's macroeconomic assumptions appear plausible.

The economic outlook is more pessimistic than in the previous Stability Programme for 2016-2017, where real GDP growth of 2.0% in 2016 and 2.1% in 2017 was expected. The dominant driver of this revised outlook is a much stronger decline in public investment for 2016, reverting to the historical average after two years of exceptionally high investment at the end of the drawdown period of EU funding.

The Commission's 2016 spring forecast output gaps² are larger than the recalculated ones from the Stability Programme. The recalculated output gap in this year's Programme is estimated to close in 2016, one year earlier than last years' Stability Programme update.

² The recalculated output gaps are considerably lower than the ones presented in the Stability Programme; with the recalculated output gap turning positive in 2016 compared to 2018 in the Stability Programme.

Table 1: Comparison of macroeconomic developments and forecasts

| | 2015 | | 2016 | | 2017 | | 2018 | 2019 |
|---|------|------|------|------|------|------|------|------|
| | COM | SP | COM | SP | COM | SP | SP | SP |
| Real GDP (% change) | 2.9 | 2.9 | 1.7 | 1.7 | 2.3 | 2.4 | 2.3 | 2.3 |
| Private consumption (% change) | 1.7 | 1.7 | 2.3 | 2.1 | 2.5 | 1.7 | 1.7 | 1.4 |
| Gross fixed capital formation (% change) | 0.5 | 0.5 | -2.6 | -3.0 | 5.6 | 6.0 | 5.0 | 5.0 |
| Exports of goods and services (% change) | 5.2 | 5.2 | 3.9 | 3.7 | 4.9 | 4.8 | 4.9 | 4.6 |
| Imports of goods and services (% change) | 4.4 | 4.4 | 3.7 | 3.0 | 5.8 | 5.1 | 5.0 | 4.7 |
| <i>Contributions to real GDP growth:</i> | | | | | | | | |
| - Final domestic demand | 1.2 | 1.9 | 1.2 | 0.9 | 2.7 | 2.1 | 1.9 | 1.8 |
| - Change in inventories | 0.8 | 0.8 | 0.0 | 0.2 | -0.2 | 0.0 | 0.0 | 0.0 |
| - Net exports | 0.9 | 0.9 | 0.5 | 0.8 | -0.1 | 0.3 | 0.4 | 0.5 |
| Output gap ¹ | -0.4 | -0.5 | 0.6 | 0.2 | 1.8 | 1.0 | 1.5 | 1.7 |
| Employment (% change) | 1.4 | 1.4 | 0.7 | 0.9 | 0.7 | 0.9 | 0.7 | 0.5 |
| Unemployment rate (%) | 9.0 | 9.0 | 8.6 | 8.6 | 8.1 | 8.1 | 7.5 | 7.0 |
| Labour productivity (% change) | 1.4 | 1.4 | 1.0 | 0.8 | 1.6 | 1.5 | 1.7 | 1.7 |
| HICP inflation (%) | -0.8 | -0.5 | -0.2 | -0.3 | 1.6 | 1.3 | 1.3 | 1.7 |
| GDP deflator (% change) | 0.4 | 0.4 | 1.1 | 1.0 | 2.1 | 0.2 | 0.8 | 1.5 |
| Comp. of employees (per head, % change) | 0.8 | 0.7 | 1.7 | 2.4 | 2.0 | 2.4 | 2.3 | 2.7 |
| Net lending/borrowing vis-à-vis the rest of the world (% of GDP) | 8.2 | n.a. | 7.5 | n.a. | 7.6 | n.a. | n.a. | n.a. |
| <u>Note:</u> | | | | | | | | |
| ¹ In % of potential GDP, with potential GDP growth recalculated by Commission services on the basis of the programme scenario using the commonly agreed methodology. | | | | | | | | |
| <u>Source:</u> | | | | | | | | |
| Commission 2016 spring forecast (COM); Stability Programme (SP). | | | | | | | | |

3. RECENT AND PLANNED BUDGETARY DEVELOPMENTS

3.1. Deficit developments in 2015

The deficit in 2015 amounted to 2.9% of GDP (down from 5% of GDP in 2014), in line with the target in the 2016 Draft Budgetary Plan and the previous Stability Programme. Higher current revenues were offset by a higher than anticipated adverse impact on the general government of the activities of the Bank Asset Management Company (BAMC), which contributed 1% of GDP to the deficit in 2015. With respect to current revenues, social contributions growth was considerably higher than what was expected in the 2016 Draft Budgetary Plan (4.4% vs 3.5% previously expected) due to better than expected improvements in employment and in turn compensation of employees. While gross fixed capital formation (GFCF) increased in 2015 (by 3.3%) the increase was less than what was expected at the time of the Draft Budgetary Plan (5.5% of GDP) and the previous Stability Programme (5.6% of GDP). Despite this, public investment remained at historically high levels amounting to 5% of GDP in 2016. The lower expenditure on GFCF was broadly offset by lower capital transfers received from the EU budget. Expenditure controls also appear to

have played a role in meeting the deficit targets, with local authorities and several government funds recording a surplus instead of an anticipated deficit.

3.2. Medium-term strategy and targets

The objective of the Stability Programme is to reduce the headline deficit from 2.9% of GDP in 2015 to 0.4% of GDP in 2019. By then, the planned structural deficit would be brought to 0.6% of GDP. However, the recalculated³ structural balance would only decline to 1.2% of GDP by 2019.

The medium-term objective chosen in the Stability Programme corresponds to a balanced budget to be achieved in 2020, after the Stability Programme horizon. This MTO is below the updated minimum MTO for Slovenia as revised earlier this year to 0.25% of GDP for the period 2017-2019. The MTO in the Stability Programme is thus not in line with the requirement of the SGP. Therefore, the MTO does neither adequately take into account the need to bring debt below the Treaty reference value nor the implicit liabilities related to ageing.

In 2016, the authorities target a headline deficit of -2.2% of GDP, in line with the deficit projection in the 2016 Draft Budgetary Plan and slightly below the target in last year's Stability Programme (2.3% of GDP). In 2016, both, total revenue and expenditure are expected to decrease. Tax revenue is expected to increase year-on-year due to favourable macroeconomic conditions but capital transfers received are projected to fall considerably due to the lower projected EU financing for public investment. Since the 2016 Draft Budgetary Plan, the authorities are more optimistic regarding current revenue, namely taxes on income and wealth, social contributions and sales. On the expenditure side, due to the conclusion of the wage bill negotiations with unions after the finalisation of the 2016 Draft Budgetary Plan and an increase in migrant related expenditure, the expected compensation of employees and intermediate consumption for 2016 increased since the 2016 Draft Budgetary Plan (17.8% vs. 17.5% of GDP). A large decline in public investment following the ending of the drawdown period of EU funding for 2007-13 is expected to offset these expenditure pressures.

Overall, the 2016 deficit target in the Stability Programme is lower than the Commission's 2016 spring forecast (2.2% vs. 2.4% of GDP). The composition of the public finances in 2016 in the Commission's 2016 spring forecast is broadly the same as in the Stability Programme, as expenditure is 45.7% of GDP and revenue 43%. The Stability Programme envisaging higher expenditure related to social transfers (mostly due to pensions) but also less capital transfers from the EU budget. Measures underpinning the 2016 target remain largely unchanged since the 2016 Draft Budgetary Plan.

For 2017, the Stability Programme projects a deficit of 1.6% of GDP, slightly lower than the 2015 Stability Programme. The 2016 Stability Programme projects considerably higher revenues (43.8% vs. 42.5% of GDP) and higher expenditure (45.4% vs. 44.3% of GDP) in 2017 than the 2015 programme. The higher revenues are driven by more favourable tax revenues projections in particular from taxes on production and imports and social

³ Cyclically-adjusted budget balance net of one-off and temporary measures, recalculated by the Commission on the basis of the information provided in the Stability Programme, using the commonly agreed methodology.

contributions due to the improved macro outlook. The Commission's latest forecast projects a higher deficit in 2017 than the Stability Programme (2.1% vs. 1.6% of GDP) due to less optimistic assumptions regarding tax developments, in particular social contributions and a larger impact from the BAMC's activities.

According to the Stability Programme, further investment may be required for the network of main and regional roads in addition to the presented budgets for the years 2016-2018, representing a risk to the deficit targets.

Relative to the 2015 Stability Programme the authorities now project a larger decline in the headline deficit over the Stability Programme horizon falling to 0.4% of GDP in 2019 (vs. 0.9% in the 2015 Stability Programme). The 2016 Stability Programme backloads the effort with the largest year-on-year decline in the structural deficit projected for 2019 but neither the 2015 Stability Programme nor the 2016 Stability Programme specify the measures that underpin the projections for the later years. This decline is driven by higher projected revenues as expenditure as a % of GDP remains broadly unchanged. Despite this lower projected headline deficit the recalculated structural deficit at the end of the Stability Programme horizon is broadly the same (-1.2% vs. -1.3% of GDP) due to more positive output gaps.

Table 2: Composition of the budgetary adjustment

| (% of GDP) | 2015 | 2016 | | 2017 | | 2018 | 2019 | Change: 2015-2019 |
|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------------|
| | COM | COM | SP | COM | SP | SP | SP | SP |
| Revenue | 45.1 | 43.4 | 43.5 | 43.2 | 43.8 | 43.2 | 42.3 | -2.8 |
| <i>of which:</i> | | | | | | | | |
| - Taxes on production and imports | 14.8 | 14.7 | 14.9 | 14.7 | 14.8 | 14.6 | 14.6 | -0.2 |
| - Current taxes on income, wealth, etc. | 7.3 | 7.4 | 7.3 | 7.4 | 7.3 | 7.3 | 7.2 | -0.1 |
| - Social contributions | 14.8 | 14.8 | 14.9 | 14.5 | 15.0 | 14.9 | 14.7 | -0.1 |
| - Other (residual) | 8.2 | 6.5 | 6.4 | 6.5 | 6.7 | 6.4 | 5.8 | -2.4 |
| Expenditure | 48.0 | 45.7 | 45.7 | 45.2 | 45.4 | 44.3 | 42.7 | -5.3 |
| <i>of which:</i> | | | | | | | | |
| - Primary expenditure | 45.1 | 42.9 | 42.8 | 42.6 | 42.8 | 41.8 | 40.3 | -4.8 |
| <i>of which:</i> | | | | | | | | |
| Compensation of employees | 11.1 | 11.3 | 11.3 | 11.5 | 11.3 | 11.0 | 10.6 | -0.5 |
| Intermediate consumption | 6.5 | 6.6 | 6.6 | 6.4 | 6.5 | 6.4 | 6.3 | -0.2 |
| Social payments | 18.0 | 17.9 | 17.7 | 17.4 | 17.5 | 17.3 | 16.8 | -1.2 |
| Subsidies | 0.8 | 1.0 | 1.1 | 1.1 | 1.2 | 1.0 | 1.0 | 0.2 |
| Gross fixed capital formation | 5.1 | 3.3 | 3.3 | 3.6 | 3.4 | 3.4 | 3.2 | -1.9 |
| Other (residual) | 3.5 | 2.8 | 2.2 | 2.6 | 2.3 | 2.4 | 2.1 | -1.4 |
| - Interest expenditure | 3.0 | 2.8 | 2.9 | 2.6 | 2.6 | 2.5 | 2.4 | -0.6 |
| General government balance (GGB) | -2.9 | -2.4 | -2.2 | -2.1 | -1.6 | -1.0 | -0.4 | 2.5 |
| Primary balance | 0.0 | 0.5 | 0.7 | 0.6 | 1.0 | 1.5 | 2.0 | 2.0 |
| One-off and other temporary | 0.0 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | 0.0 | 0.0 |
| GGB excl. one-offs | -2.9 | -2.2 | -2.1 | -2.0 | -1.6 | -1.0 | -0.4 | 2.5 |
| Output gap ¹ | -0.4 | 0.6 | 0.2 | 1.8 | 1.0 | 1.5 | 1.7 | 2.1 |
| Cyclically-adjusted balance ¹ | -2.7 | -2.6 | -2.3 | -2.9 | -2.1 | -1.7 | -1.2 | 1.5 |
| Structural balance² | -2.7 | -2.5 | -2.2 | -2.9 | -2.0 | -1.7 | -1.2 | 1.5 |
| Structural primary balance ² | 0.3 | 0.3 | 0.7 | -0.2 | 0.6 | 0.8 | 1.2 | 0.9 |

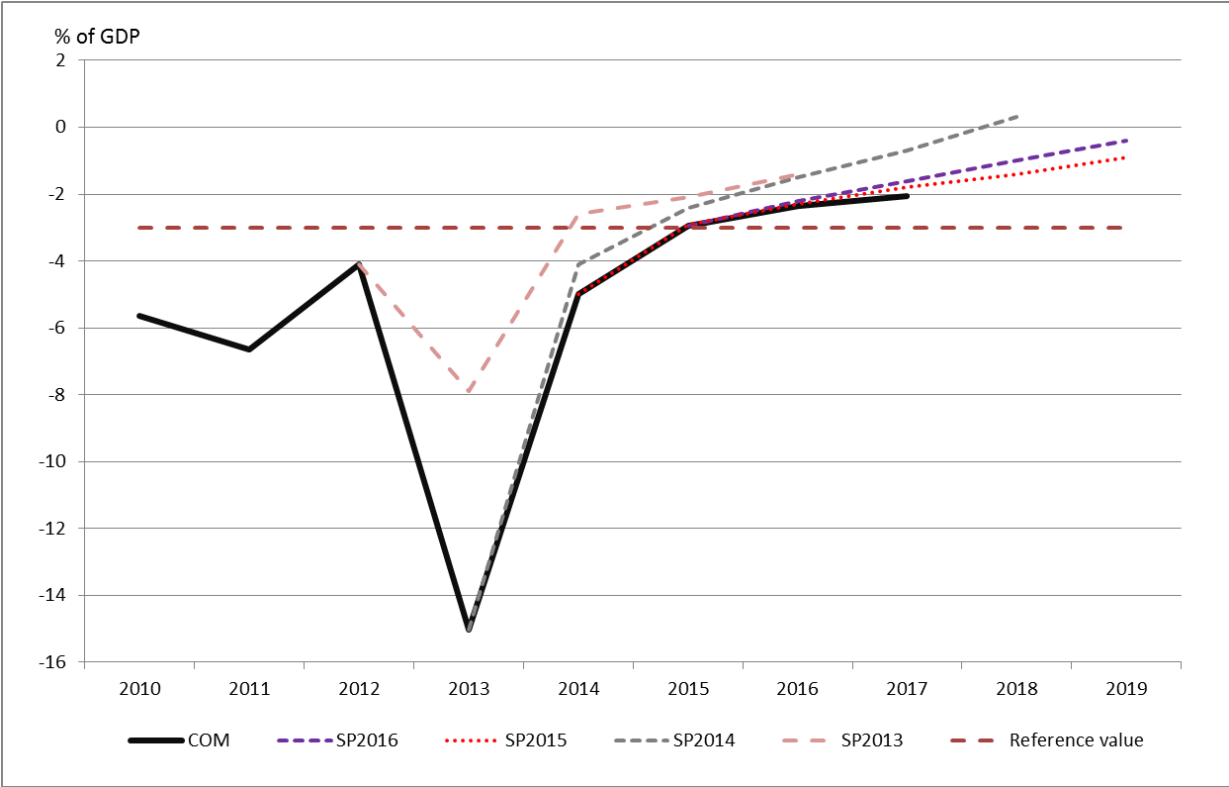
Notes:

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

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

Source:
Stability Programme (SP); Commission 2016 spring forecasts (COM); Commission calculations.

Figure 1: Government balance projections in successive Stability Programmes (% of GDP)



Source: Commission 2016 spring forecast; Stability Programmes

3.3. Measures underpinning the Stability Programme

The Stability Programme indicates areas in which the authorities will seek to generate saving and efficiency gains. Nevertheless, the specific measures and timeline for the introduction are not always specified. Measures underpinning the Stability Programme remain largely unchanged from the 2015 Stability Programme and 2016 Draft Budgetary Plan. With respect to 2016, on the revenue side the authorities indicate that the measures will include actions to restructure the burden of public levies (including modernisation of the system of taxation of immovable property and the implementation of Base Erosion and Profit Shifting (BEPS) measures), reducing administrative burdens in order to improve the business environment and improve the effectiveness of the collection of public duties. However, no timeline for the introduction or quantification of the projected yield from these measures has been provided.

The authorities' goal is to reduce the tax burden on labour by modifying the tax base. The authorities reaffirm their commitment to introduce a revised real estate tax regime with a 2016 deadline for presenting measures to the National Assembly. However, no details have been specified regarding its design. In order to reduce administrative burden and to improve the business environment measures to simplify tax procedures are also envisaged in the Stability Programme, namely through the new package of the tax procedure act, a new excise duty act and a new law on the application of customs legislation of the European Union. The Stability Programme indicates that the relevant tax amendments will be prepared in 2016.

On the expenditure side, the authorities indicate that short-term measures introduced in recent years to contain the pay bill, social transfers and subsidies would be replaced by other measures with comparable financial effect. The Stability Programme includes a 2.6% increase in the public sector pay bill in 2017, which is considerably lower than what the increase would be if all the measures currently in place to contain the pay bill were reversed. However, no agreement has been reached with the trade unions for 2017 and beyond and negotiations are ongoing.

Main budgetary measures

| Revenue | Expenditure |
|---|--|
| 2015 | |
| <ul style="list-style-type: none"> • Increased efficiency of collection of public duties (0.1% of GDP) • Increase sales tax on insurance services (0.04% of GDP) • Regulation on environmental duties for CO₂ – decrease exemptions (0.1% of GDP) • Excise on additive sugar and additional dividends (0.03% of GDP) | <ul style="list-style-type: none"> • Increase in pensioners recreational allowance (+0.1% of GDP) • Abolition of seniority bonus (-0.1% of GDP) • Restrictions on subsidies (-0.2% of GDP) • Various measures on intermediate consumption (-0.1% of GDP) |
| 2016 | |
| <ul style="list-style-type: none"> • Temporary personal income tax bracket taxed at 50% in 2016-17 (0.04% of GDP in 2016) • Introduction of cash registers – to fight grey economy (0.1% of GDP) • VAT increase made permanent (0.1% of GDP) | <ul style="list-style-type: none"> • Investment on the main regional roads (+0.03% of GDP in 2016, 0.05% - 0.1% of GDP in 2017, 0.1% of GDP in 2018) • Limit of recreational pension allowance (-0.1% of GDP) • More efficient public procurement (-0.1% of GDP) |
| <p><u>Note:</u> The budgetary impact in the table is the impact reported in the Stability Programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure.</p> | |

3.4. Debt developments

Since 2008, public debt has increased considerably from 21.6% of GDP to 83.2% of GDP in 2015. Both the Stability Programme and the Commission's 2016 spring forecast expect debt to have peaked in 2015. The 2 pps. increase in debt in 2015 was in line with the 2016 Draft Budgetary Plan projections but higher than that of the 2015 Stability Programme update (81.6% of GDP). The higher ratio was due to larger stock flow adjustments as the authorities took advantage of favourable market conditions and continued to accumulate cash buffers.

In 2016-2017, the Stability Programme projections of public debt levels are broadly in line with the Commission's 2016 spring forecast. Both expect sizeable negative stock flow adjustments as the authorities start to reduce their precautionary cash buffers.

Despite the higher debt level in 2015, the 2016 Stability Programme projects lower debt levels in 2019 than the 2015 Stability Programme (73.8% vs. 78.2% of GDP). This change to the profile for debt is predominantly driven by changes regarding projected stock flow adjustments; the 2015 Stability Programme envisaged that Slovenia would continue to accumulate positive stock flow adjustments in 2017-19 whereas the Stability Programme plans steady negative stock flow adjustments over the programme horizon. The Commission's forecast is slightly more optimistic regarding debt to GDP ratio due to the macroeconomic context and expected reduction in precautionary cash buffers.

Table 3: Debt developments

| (% of GDP) | Average 2010-2014 | 2015 | 2016 | | 2017 | | 2018 | 2019 |
|-------------------------------------|----------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| | | | COM | SP | COM | SP | SP | SP |
| Gross debt ratio¹ | 58.1 | 83.2 | 80.2 | 80.2 | 78.0 | 78.2 | 76.5 | 73.8 |
| Change in the ratio | 9.3 | 2.3 | -3.0 | -3.0 | -2.3 | -2.0 | -1.7 | -2.7 |
| <i>Contributions²:</i> | | | | | | | | |
| 1. Primary balance | 5.0 | 0.0 | -0.5 | -0.7 | -0.6 | -1.0 | -1.5 | -2.0 |
| 2. "Snow-ball" effect | 1.8 | 0.4 | 0.6 | 0.7 | -0.7 | 0.6 | 0.2 | -0.4 |
| <i>Of which:</i> | | | | | | | | |
| Interest expenditure | 2.3 | 3.0 | 2.8 | 2.9 | 2.6 | 2.6 | 2.5 | 2.4 |
| Growth effect | -0.2 | -2.3 | -1.4 | -1.4 | -1.8 | -1.9 | -1.7 | -1.7 |
| Inflation effect | -0.2 | -0.3 | -0.9 | -0.8 | -1.6 | -0.2 | -0.6 | -1.1 |
| 3. Stock-flow adjustment | 2.4 | 1.9 | -3.0 | -3.0 | -0.9 | -1.6 | -0.3 | -0.3 |
| <i>Of which:</i> | | | | | | | | |
| Cash/accruals diff. | | | | | | | | |
| Acc. financial assets | | | | | | | | |
| <i>Privatisation</i> | | | | | | | | |
| Val. effect & residual | | | | | | | | |

Notes:

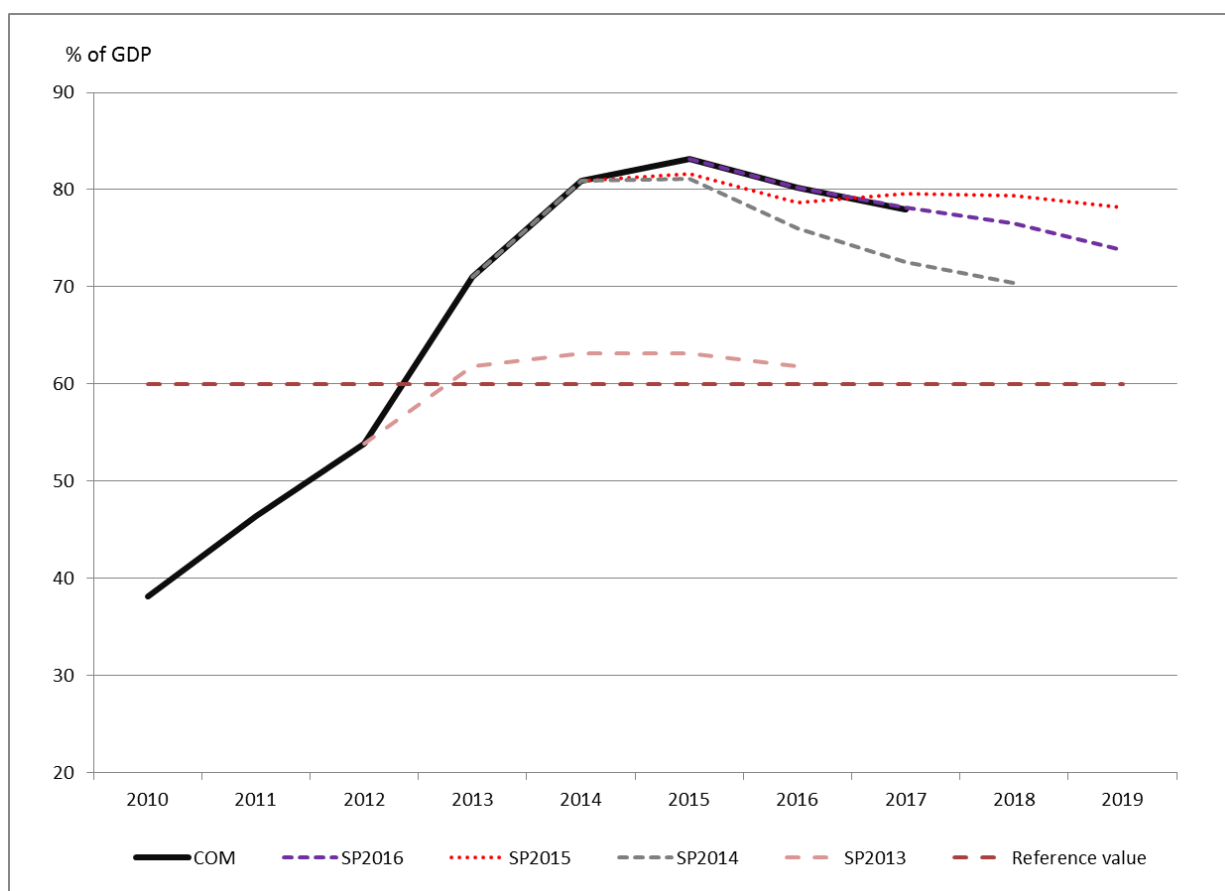
¹ End of period.

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

Source:

Commission 2016 spring forecast (COM); Stability Programme (SP), Commission calculations.

Figure 2: Government debt projections in successive Stability Programmes (% of GDP)



Source: Commission 2015 2016 spring forecast; stability and convergence Stability Programmes

3.5. Risk assessment

The risks underlying the Stability Programme regarding deficit projections are the BAMC activities, the potential cost of migrants, unforeseen one-off expenditure items, the non-adoption of measures producing sufficient structural effort and external factors that can impact the macroeconomic outlook.

The main risk to the deficit projections in the Stability Programme is a greater than anticipated impact of the activities of the BAMC on general government finances. In 2015, the BAMC undertook several activities as part of the work out of its loan book which included debt for equity swaps, debt for real estate swaps and debt write offs. At the time of the 2016 Draft Budgetary Plan, the authorities estimated that this would result in capital transfers amounting to 0.2% of GDP. However, the outturn data for 2015 indicates that total capital transfers arising from the operations of the BAMC in 2015 amounted to 1% of GDP. For 2016, based on information received from the Slovenian authorities the level of capital transfers arising from the activities of the BAMC is expected to fall to 0.2% of GDP. For 2017, the Stability Programme assumes no impact of BAMC on public finances, whereas the Commission's 2016 spring forecast factors in an adverse impact of 0.2% of GDP in 2017. In order to mitigate this risk the Stability Programme indicates that the Slovenian Government will, if necessary, use a single tier management system within the BAMC as to ensure the achievement of the medium term objective (MTO). The Stability Programme also indicates

that the Government is examining the possibility of removing the BAMC from the general government.

A further risk to the deficit projections in the Commission's 2016 spring forecast is the potential cost of migrants transiting through Slovenia. The Slovenian authorities estimated the impact of migrant related expenditure at 0.1% of GDP in 2016. If there was to be a large spike in the number of migrants entering Slovenia there is a risk that expenditure could be considerably more.

An additional risk to the headline deficit targets is the emergence of unforeseen one-off expenditure items and possible expenditure slippage. The materialisation of one-off expenditures in particular with respect to the financial sector restructuring, but also following court rulings, have resulted in sizeable increases in the deficit in Slovenia in recent years. Indeed, one-offs contributed 12.2% of GDP to the total deficit over 2014-15.

The key risk to the structural balance targets is that measures producing a sufficient structural effort might not be adopted in time to achieve the desired structural improvements. The Stability Programme indicates that the authorities plan to replace temporary consolidation measures with structural measures that derive a similar fiscal yield. However, the specific measures and the timeline for implementation remain unclear.

The risks to the macroeconomic outlook are to the downside and mainly due to external factors. Exports to Slovenia's main trading partners could be indirectly affected by the slowdown in emerging markets. In addition, slower absorption of funds under the new EU fund in 2016 may result in an even greater decline in public investment in 2016 than currently anticipated. On the positive side, a faster-than-expected stabilisation in Russia and Ukraine could boost demand for Slovenia's exports.

With respect to the projected level of debt in Slovenia, both the Stability Programme and the Commission's 2016 spring forecast project negative stock flow adjustments as the authorities reduce their sizeable cash buffers. If this was not to materialise it could result in higher debt levels throughout the programme's horizon. However, on the other hand proceeds from the ongoing privatisation process represent a positive risk to the projected debt levels. According to the Stability Programme, the level of guarantees provided by Slovenia will fall considerably over the programme horizon from 15.6% of GDP in 2016 to 8.2% of GDP in 2019. Within this, the amount of guarantees to the financial sector is projected to fall by over 40% from 3.5% to 1.9% of GDP. Breaking the sovereign banking loop will help to mitigate a key risk to potential debt levels.

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

4.1. Compliance with EDP recommendations

In 2015, Slovenia achieved a headline deficit of 2.9% of GDP, above the target under the EDP but below the 3% of GDP reference value of the Treaty. According to the Commission's spring forecast, this correction is durable over the forecast horizon, with the deficit being projected at 2.4% of GDP in 2016 and 2.1% of GDP in 2017.

Overall, it appears that Slovenia has durably corrected its excessive deficit by the recommended deadline. On this basis, on 18 May 2016, the Commission has issued a Recommendation for a Council Decision in accordance with Article 126(12) of the Treaty abrogating the Decision on the existence of an excessive deficit in Slovenia.

Box 1. Council recommendations addressed to Slovenia

On 21 June 2013, the Council recommended Slovenia under Article 126(7) of the Treaty to correct its excessive deficit by 2015. To this end, Slovenia should (i) put an end to the present excessive deficit situation by 2015; (ii) reach a general government deficit target of 4.9% of GDP in 2013 (3.7% of GDP without 1.2% of GDP one-off expenditure to recapitalise the two largest banks as estimated in June 2013), 3.3% of GDP in 2014 and 2.5% of GDP in 2015, which is consistent with an annual improvement of the structural balance of 0.7% of GDP in 2013, 0.5% of GDP in 2014 and 0.5% of GDP in 2015, in order to bring the general government deficit below the 3% GDP reference value in the Treaty in 2015, based on the Commission updated 2013 spring forecast; (iii) rigorously implement the measures already adopted to increase mainly indirect tax revenue and reduce the public sector wage bill and social transfers, while standing ready to complement them with additional measures if their yield would prove less than foreseen or if any measure is repealed by the justice system; and specify, adopt and implement new structural consolidation measures, on top of those already included in the Commission updated 2013 spring forecast that are necessary to achieve the correction of the excessive deficit by 2015.

On 14 July 2015, the Council addressed recommendations to Slovenia in the context of the European Semester. In particular, in the area of public finances, the Council recommended to Slovenia to ensure a durable correction of the excessive deficit in 2015, and achieve a fiscal adjustment of 0.6% of GDP towards the medium-term objective (MTO) in 2016. Adopt the Fiscal Rule Act and revise the Public Finance Act. Advance long-term reform of the pension system.

Table 4: Compliance with the requirements of the corrective arm

| (% of GDP) | 2015 |
|---|------|
| | COM |
| Headline balance | |
| Headline budget balance | -2.9 |
| EDP requirement on the budget balance | -2.5 |
| Fiscal effort - change in the structural balance | |
| Change in the structural balance ¹ | 0.0 |
| Cumulative change ² | -0.6 |
| Required change from the EDP recommendation | 0.5 |
| Cumulative required change from the EDP recommendation | 1.7 |
| Fiscal effort - adjusted change in the structural balance | |
| Adjusted change in the structural balance ³ | -0.7 |
| of which: | |
| <i>correction due to change in potential GDP estimation (α)</i> | -0.6 |
| <i>correction due to revenue windfalls/shortfalls (β)</i> | 0.1 |
| Cumulative adjusted change ² | -1.3 |
| Required change from the EDP recommendation | 0.5 |
| Cumulative required change from the EDP recommendation | 1.7 |
| Fiscal effort - calculated on the basis of measures (bottom-up approach) | |
| Fiscal effort (bottom-up) ⁴ | 0.9 |
| Cumulative fiscal effort (bottom-up) ² | 1.6 |
| Requirement from the EDP recommendation | 1.5 |
| Cumulative requirement from the EDP recommendation | 4.0 |
| Notes | |
| ¹ Structural balance = cyclically-adjusted government balance excluding one-off measures. Structural balance based on programme is recalculated by Commission on the basis of the programme scenario using the commonly agreed methodology. Change compared to <i>t-1</i> . | |
| ² Cumulated since the latest EDP recommendation. | |
| ³ Change in the structural balance corrected for unanticipated revenue windfalls/shortfalls and changes in potential growth compared to the scenario underpinning the EDP recommendations. | |
| ⁴ The estimated budgetary impact of the additional fiscal effort delivered on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the EDP recommendation and the current forecast. | |
| <u>Source</u> : | |
| Stability Programme (SP); Commission 2016 spring forecasts (COM); Commission calculations. | |

4.2. Compliance with the debt criterion

Assuming that the EDP for Slovenia is abrogated based on the 2015 outturn data, Slovenia would be subject to the preventive arm of the SGP from 2016 onwards. As Slovenia was under the EDP on 8 November 2011, Slovenia would be in a transition period in 2016 regarding compliance with the debt rule and therefore subject to the Minimum Linear Structural Adjustment (MLSA).

According to the Stability Programme, Slovenia is expected to make sufficient progress towards compliance with the debt criterion in 2016. Specifically, the recalculated structural effort of 0.5% of GDP in 2016 is considerably above the required structural adjustment of -0.1% of GDP. For 2017 and 2018, the recalculated structural effort underpinning the Stability Programme indicates sufficient progress towards compliance with the debt criterion.

Based on the Commission's 2016 spring forecast Slovenia is making sufficient progress towards compliance with the debt criterion in 2016 (with a margin above the required adjustment by 0.3% of GDP) as well as in 2017, when the structural effort is marginally below, but within the 0.25% allowed deviation from the required adjustment.

Table 5: Compliance with the debt criterion

| | 2016 | | 2017 | | 2018 |
|--|-------------|-------------|-------------|-------------|-------------|
| | SP | COM | SP | COM | SP |
| Gross debt ratio | 80.2 | 80.2 | 78.2 | 78.0 | 76.5 |
| Gap to the debt benchmark ^{1,2} | | | | | |
| Structural adjustment ³ | 0.5 | 0.2 | 0.1 | -0.4 | 0.4 |
| <i>To be compared to:</i> | | | | | |
| Required adjustment ⁴ | -0.1 | -0.1 | -0.5 | -0.3 | -0.5 |

Notes:

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

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

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

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

Source:
Commission 2016 spring forecast (COM); Stability Programme (SP), Commission calculations.

4.3. Compliance with the required adjustment path towards the MTO

Following the abrogation of the EDP, Slovenia will be subject to the preventive arm from 2016 onwards. The recommendation for Slovenia, which is not yet at its MTO, can be considered to be in "normal times"⁴ (i.e. with an output gap between -1.5% and 1.5% of GDP) and has a general government debt ratio above 60% of GDP, is to deliver a structural adjustment of 0.6% of GDP in 2016 so as to make sufficient progress towards the MTO.

Assessment of eligibility to the "unusual events" provision

The Stability Programme indicates that due to the exceptional inflows of migrants transiting through Slovenia in 2015, the additional expenditure amounted to 0.06% of GDP in 2015 and is currently estimated at 0.07% of GDP in 2016. According to the Stability Programme, the number of migrants transiting through Slovenia peaked in November 2015, when 164,313 migrants crossed the border into Slovenia. These expenditures largely stem from administrative costs (wages and social contributions) and from transport and medical costs. In recent weeks, there has been a sharp decline in the flow of migrants and the estimated expenditure for 2016 as a whole arising from migrant related activities resulting in a fall in the estimated impact.

The provisions defined in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97 allow catering for this additional expenditure, in that the inflow of refugees is an exceptional event, its impact on Slovenia's public finances is significant and sustainability would not be compromised by allowing for a deviation from the adjustment path towards the MTO. The amounts mentioned above appear plausible. However, as Slovenia was under EDP in 2015, a deviation was not applicable that year. For 2016, a final assessment, including on the eligible amounts, will be made in spring 2017 on the basis of observed data as provided by Slovenian authorities.

Adjustment towards the MTO

According to the Stability Programme for 2016, the annual change in the (recalculated) structural balance of 0.5% of GDP in 2016 falls slightly short of the required effort of 0.6% of GDP pointing to some deviation based on the structural balance pillar. The growth rate of government expenditure, net of discretionary revenue measures, is expected to be below the applicable expenditure benchmark rate by 0.4% of GDP in 2016, pointing to compliance. Therefore, an overall assessment needs to be carried out. While the structural balance is negatively affected by significant revenue shortfalls, the expenditure benchmark is negatively affected by the smoothing of investment in 2016 due to the end of programming period of EU funding (2007-2013). After correcting for these factors, both indicators point to compliance. The conclusion of the overall assessment based on the recalculated programme would not change in case the budgetary impact of the exceptional inflow of refugees was excluded from the assessment.

Based on the Commission 2016 spring forecast, the structural balance is projected to improve by 0.2% of GDP in 2016, pointing to a risk of some deviation from the required adjustment of 0.6% of GDP (gap of -0.4% of GDP). The growth rate of government expenditure, net of

⁴ Commission Communication on "Making the best use of the flexibility within the existing rules of the Stability and Growth Pact" of 13 January 2015, and the "Commonly agreed position on Flexibility in the Stability and Growth Pact", as endorsed by the Council on 12 February 2016..

discretionary revenue measures, is expected to exceed the expenditure benchmark by 0.4% of GDP in 2016, indicating a risk of some deviation. Therefore, both indicators point to a risk of some deviation from the requirements in 2016. This requires an overall assessment. The structural balance is negatively affected by revenue shortfalls. At the same time, the expenditure benchmark is negatively affected by the smoothing of investment as a result of the largely permanent reduction in public investment in 2016 due to the end of programming period of EU funding (2007-2013). After correcting for these factors, both pillars still point to a risk of some deviation from the adjustment path. Therefore, there is a risk of some deviation from the required adjustment path towards the MTO in 2016. The conclusion of the overall assessment based on the Commission 2016 spring forecast would not change in case the budgetary impact of the refugee flows was excluded from the assessment.

Box 2. Impact of extended forecast horizon for the estimation of potential growth and structural adjustment requirement

Eight Member States, including Slovenia, expressed their concern regarding the commonly agreed methodology for the estimation of the output gap in a letter sent to the Commission on 18 March 2016. The letter highlighted some criticalities affecting the current methodology for the estimation of the output gap, particularly “*in times of persistently weak economic growth, in times of changes in economic cycles and when implementation of reforms brings about structural shifts*”. The EPC-OGWG has been mandated to analyse the issues raised by Slovenia and other Member States.

There is significant uncertainty regarding the calculation of potential growth and the output gap in the specific case of Slovenia because of the peculiar situation of the labour market, the particularly large economic contraction in 2008-2013 and the structural reforms being implemented. Therefore, the Commission has already tentatively compared potential growth estimates based on an ad-hoc four-year forecast (i.e. over 2016-2019) with those based on the two-year horizon (i.e. over 2016-2017) of its 2016 spring forecast.

Based on the Commission 2016 spring forecast, Slovenia's output gap in 2017 is estimated at 1.8% of GDP, while potential growth is projected at 1.1% and real GDP growth at 2.3% of GDP. On this basis, Slovenia would be assessed to be in "good times" in 2017, requiring a structural adjustment of 1% of GDP. Alternative output gap estimations covering a longer time horizon suggest a smoother output gap profile for Slovenia, implying that it would be premature to conclude that the Slovenian economy is in good times in 2017. Differences between output gap T+4 and the T+2 are notable as the longer forecast horizon with projected recovery in investment increases potential GDP, resulting in postponed closure of the output gap. The forecast in two added years is based on the continuation of the trends projected in Commission's 2016 spring forecast: strong contribution of private consumption to GDP growth and increase in investment, returning slowly to long-term average investment/GDP ratios after years of underinvestment. In addition, it forecasts increasingly negative contribution of net exports due to rising imports and only marginal contribution of government consumption to growth due to debt-reduction constraints.

Using the extended T+4 forecast horizon and accordingly recalculated output gaps, Slovenia's output gaps would be -0.3% of GDP in 2016 and 0.6% of GDP in 2017. That means the output gaps would only close during 2017 (one year later) and still be well below the 1.5 threshold for good times. Therefore, requiring a structural effort in 2017 in line with normal times conditions has appeared more appropriate at the current juncture.

For 2017, according to the programme, the (recalculated) improvement in the structural balance of 0.1% of GDP falls short of the required effort of 0.6% of GDP pointing to a risk of some but close to significant deviation based on the structural balance pillar. The growth rate of government expenditure, net of discretionary revenue measures, will exceed the applicable expenditure benchmark rate by 0.2% of GDP in 2017, pointing to a risk of some deviation. However, over 2016 and 2017 taken together, the structural balance points to a risk of significant deviation (annual average gap of -0.3% of GDP) while the expenditure benchmark pillar points to compliance. This requires an overall assessment. While the structural balance is affected by revenue shortfalls, the expenditure benchmark is positively impacted by one-offs. After correcting for these factors, the overall assessment points to a risk of some deviation from the recommended adjustment path over the years 2016 and 2017 taken together.

In the Commission's spring forecast for 2017, under the usual no-policy change basis, the projected 0.4% of GDP deterioration in the structural balance would lead to a significant deviation from the required 0.6% of GDP adjustment towards the MTO. In addition, the growth rate of government expenditure net of discretionary revenue measures is expected to exceed the expenditure benchmark by almost 0.5% of GDP in structural balance terms, pointing to a risk of some deviation in 2017. However, over 2016 and 2017 taken together, both the structural balance and the expenditure benchmark pillars point to a risk of significant deviation (annual average gap of -0.7% and -0.4% of GDP respectively). Therefore, the overall assessment points to a risk of significant deviation from the recommended adjustment path over the years 2016 and 2017 taken together.

Table 6: Compliance with the requirements under the preventive arm

| (% of GDP) | 2016 | | | | 2017 | |
|---|-----------------------|------------------------------|--------------------|------------------------------|--------------------|-----------------------|
| Initial position¹ | | | | | | |
| Medium-term objective (MTO) | 0.0 | | | | 0.3 | |
| Structural balance ² (COM) | -2.5 | | | | -2.9 | |
| Structural balance based on freezing (COM) | -2.5 | | | | - | |
| Position vis-a-vis the MTO³ | Not at MTO | | | | Not at MTO | |
| (% of GDP) | 2016 | | | | 2017 | |
| | SP | | COM | | SP | COM |
| | Vis-à-vis the CSR | Including additional clauses | Vis-à-vis the CSR | Including additional clauses | Vis-à-vis the CSR | |
| Structural balance pillar | | | | | | |
| Required adjustment ⁴ | 0.6 | | | | 0.6 | |
| Required adjustment corrected ⁵ | 0.6 | 0.5 | 0.6 | 0.5 | 0.6 | |
| Change in structural balance ⁶ | 0.5 | | 0.2 | | 0.1 | -0.4 |
| One-year deviation from the required adjustment ⁷ | -0.1 | -0.1 | -0.4 | -0.3 | -0.5 | -1.0 |
| Two-year average deviation from the required adjustment ⁷ | N.a. (in EDP in 2015) | | | | -0.3 | -0.7 |
| Expenditure benchmark pillar | | | | | | |
| Applicable reference rate ⁸ | -0.7 | -0.6 | -0.7 | -0.6 | -0.7 | |
| One-year deviation ⁹ | 0.4 | 0.4 | -0.4 | -0.3 | -0.2 | -0.5 |
| Two-year average deviation ⁹ | N.a. (in EDP in 2015) | | | | 0.1 | -0.4 |
| Conclusion | | | | | | |
| Conclusion over one year | Overall assessment | Overall assessment | Overall assessment | Overall assessment | Overall assessment | Overall assessment |
| Conclusion over two years | N.a. (in EDP in 2015) | | | | Overall assessment | Significant deviation |
| Notes | | | | | | |
| ¹ The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO. | | | | | | |
| ² Structural balance = cyclically-adjusted government balance excluding one-off measures. | | | | | | |
| ³ Based on the relevant structural balance at year t-1. | | | | | | |
| ⁴ Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.). | | | | | | |
| ⁵ Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers. | | | | | | |
| ⁶ Change in the structural balance compared to year t-1. Ex post assessment (for 2014) is carried out on the basis of Commission 2015 spring forecast. | | | | | | |
| ⁷ The difference of the change in the structural balance and the corrected required adjustment. | | | | | | |
| ⁸ Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t. | | | | | | |
| ⁹ Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate. | | | | | | |
| <i>Source:</i> Stability Programme (SP); Commission 2016 spring forecast (COM); Commission calculations. | | | | | | |

5. FISCAL SUSTAINABILITY

Slovenia does not appear to face fiscal sustainability risks in the short run⁵. Based on the Commission forecasts and a no-fiscal policy change scenario beyond forecasts, government debt, at 83.2% of GDP in 2015, is expected to decrease (to 80.9% in 2026), thus remaining above the 60% of GDP Treaty threshold. Over this horizon, government debt is projected to have peaked in 2015. This highlights high risks for the country from debt sustainability analysis in the medium term. The full implementation of the Stability Programme would put debt on a decreasing path by 2026, although remaining above the 60% of GDP reference value in 2026 (at 64.6% of GDP).

The medium-term fiscal sustainability risk indicator S1 is at 3.0 pps. of GDP, primarily related to the high level of government debt and the initial budgetary position (contributing 1.3 pp. and 1 pps. of GDP respectively), thus indicate high risks in the medium term. The full implementation of the Stability Programme would put the sustainability risk indicator S1 at 0.9 pps. of GDP, leading to lower medium-term risk. Overall, risks to fiscal sustainability over the medium-term are, therefore, high. Fully implementing the fiscal plans in the Stability Programme would decrease those risks.

The long-term fiscal sustainability risk indicator S2 (which shows the adjustment effort needed to ensure that the debt-to-GDP ratio is not on an ever-increasing path) is at 6.9 pps of GDP. In the long-term, Slovenia therefore appears to face high fiscal sustainability risks, primarily related to the projected ageing costs (contributing with 5.5 pps. of GDP). Full implementation of the Stability Programme would put the S2 indicator at 5.5 pps. of GDP, leading to a lower long-term risk.

Given the sustainability risks faced by Slovenia in 2015 a CSR was issued seeking the advancement of long-term reform of the pension system and the adoption, by end 2015, of a healthcare and long-term care reform. Overall limited progress has been made by Slovenia in addressing these issues. A White Paper on pensions has been delayed. It was published in April 2016 and a public consultation was launched, the results of which will feed into a new pension reform. There has been some progress in advancing the healthcare reform. A comprehensive review of the health care system was completed and the National Healthcare Resolution Plan 2016-2025 was adopted by the government at the end of 2015 and the Parliament in March 2016. It remains unclear whether the reform will address key issues such as in-built automatic stabiliser schemes, which would cushion revenue fluctuations over the business cycle or the access and quality of service provision. Both the Long-term Care Act and Health Care and Health Insurance Act are envisaged to be adopted by the Government by the end of 2016 and by the Parliament in the beginning of 2017.

⁵ This conclusion is based on the short-term fiscal sustainability risk indicator S0, which incorporates 14 fiscal and 14 financial-competitiveness variables. The fiscal and financial-competitiveness sub-indexes (reported in table 5) are based on the two sub-groups of variables respectively. For sustainability risks arising from the individual variables, by country, see the Commission's Fiscal Sustainability Report 2015 (page 67).

Table 7: Sustainability indicators

| <i>Time horizon</i> | No-policy Change Scenario | | Stability / Convergence Programme Scenario | |
|---|----------------------------------|-----------|---|-------------|
| Short Term | LOW risk | | | |
| S0 indicator ^[1] | 0.1 | | | |
| Fiscal subindex (2015) | 0.1 | LOW risk | | |
| Financial & competitiveness subindex (2015) | 0.1 | LOW risk | | |
| Medium Term | HIGH risk | | | |
| DSA ^[2] | HIGH risk | | | |
| S1 indicator ^[3] | 3.0 | HIGH risk | 0.9 | MEDIUM risk |
| <i>of which</i> | | | | |
| IBP | 1.0 | | -1.0 | |
| Debt Requirement | 1.3 | | 1.2 | |
| CoA | 0.7 | | 0.7 | |
| Long Term | HIGH risk | | MEDIUM risk | |
| S2 indicator ^[4] | 6.9 | | 5.5 | |
| <i>of which</i> | | | | |
| IBP | 1.4 | | -0.1 | |
| CoA | 5.5 | | 5.6 | |
| <i>of which</i> | | | | |
| Pensions | 3.2 | | 3.4 | |
| HC | 0.9 | | 0.8 | |
| LTC | 1.0 | | 1.0 | |
| Other | 0.4 | | 0.4 | |

Source: Commission services; 2016 stability/convergence programme.

Note: the 'no-policy-change' scenario depicts the sustainability gap under the assumption that the structural primary balance position evolves according to the Commissions' spring 2016 forecast until 2017. The 'stability/convergence programme' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented over the period covered by the programme. Age-related expenditure as given in the 2015 Ageing Report.

[1] The S0 indicator reflects up to date evidence on the role played by fiscal and financial-competitiveness variables in creating potential fiscal risks. It should be stressed that the methodology for the S0 indicator is fundamentally different from the S1 and S2 indicators. S0 is not a quantification of the required fiscal adjustment effort like the S1 and S2 indicators, but a composite indicator which estimates the extent to which there might be a risk for fiscal stress in the short-term. The critical threshold for the overall S0 indicator is 0.43. For the fiscal and the financial-competitiveness sub-indices, thresholds are respectively at 0.35 and 0.45.

[2] Debt Sustainability Analysis (DSA) is performed around the no fiscal policy change scenario in a manner that tests the response of this scenario to different shocks presented as sensitivity tests and stochastic projections. See Fiscal Sustainability Report 2015.

[3] The medium-term sustainability gap (S1) indicator shows the upfront adjustment effort required, in terms of a steady adjustment in the structural primary balance to be introduced over the five years after the forecast horizon, and then sustained, to bring debt ratios to 60% of GDP in 2030, including financing for any additional expenditure until the target date, arising from an ageing population. The following thresholds were used to assess the scale of the sustainability challenge: (i) if the S1 value is less than zero, the country is assigned low risk; (ii) if a structural adjustment in the primary balance of up to 0.5 p.p. of GDP per year for five years after the last year covered by the spring 2015 forecast (year 2017) is required (indicating a cumulated adjustment of 2.5 pp.), it is assigned medium risk; and, (iii) if it is greater than 2.5 (meaning a structural adjustment of more than 0.5 p.p. of GDP per year is necessary), it is assigned high risk.

[4] The long-term sustainability gap (S2) indicator shows the immediate and permanent adjustment required to satisfy an inter-temporal budgetary constraint, including the costs of ageing. The S2 indicator has two components: i) the initial budgetary position (IBP) which gives the gap to the debt stabilising primary balance; and ii) the additional adjustment required due to the costs of ageing. The main assumption used in the derivation of S2 is that in an infinite horizon, the growth in the debt ratio is bounded by the interest rate differential (i.e. the difference between the nominal interest and the real growth rates); thereby not necessarily implying that the debt ratio will fall below the EU Treaty 60% debt threshold. The following thresholds for the S2 indicator were used: (i) if the value of S2 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.

6. FISCAL FRAMEWORK

The Fiscal Rules Act (FRA) was finally passed by the Slovenian Parliament in July 2015. The act introduced a numerical rule, which establishes limits for general government expenditure that vary depending on whether there is a positive or negative output gap. Overall, growth in expenditure should be contained to below growth in revenue taking into account where the economy is in the cycle as measured by the potential growth. However, this rule is only applicable after a country has reached its MTO. Given that the Stability Programme envisages this in 2020 it is therefore not applicable over the programme horizon. According to the FRA, during the period when Slovenia converges towards the MTO the adjustment path will be in line with the requirements of the SGP. A detailed assessment of this is provided in Section 4.3. Based on the information provided in the Stability Programme, in 2015 Slovenia was compliant and the Commission has recommended the abrogation of the EDP. Planned fiscal performance in Slovenia appears to be only partially compliant with the requirements of the applicable national fiscal rules.

The FRA provides the legal basis for the establishment of a Fiscal Council, an independent state authority that will - among other things – monitor the respect of the above-mentioned rule. Despite the Act providing for the commencement of the appointment of the Fiscal Council within fifteen days of the act coming into force, an independent Fiscal Council has yet to be appointed. In February, the Government proposed three candidates for the Fiscal Council following several calls for interest. However, these candidates failed to secure the required two third majority of the national parliament. The Stability Programme provides no update regarding the anticipated timeframe for the Fiscal Council to be established and operational.

The Stability Programme indicates that it constitutes the national medium-term fiscal plans (NMTFPs), as required by Art. 4.1 of Regulation No 473/2013. However, neither the Stability Programme nor the National Reform Programme includes specific indications on the expected economic returns on non-defence public investment projects that have a significant budgetary impact.

The macroeconomic scenario underpinning the Stability Programme is the Spring 2016 Forecast of Economic Trends produced by IMAD and was made available to the Ministry of Finance on 16 March 2016. The independent status and tasks of IMAD are stipulated in a specific Resolution. IMAD produces economic forecasts twice a year (in March and October) to underpin the Stability Programme in April and the draft budget in autumn, and additional forecasts to support other possible planning documents (i.e. supplementary budgets).

7. CONCLUSIONS

In 2015, Slovenia achieved a headline deficit of 2.9% of GDP, above the target under the EDP but below the 3% of GDP reference value of the Treaty. The Commission's 2016 spring forecast indicates that the correction appears durable as the deficit is projected to remain below the 3% reference value throughout the forecast horizon.

After the correction of the excessive deficit, Slovenia plans to ensure an improvement of the structural balance in order to reach the MTO – a balanced budget - to be achieved in 2020, after the Stability Programme horizon.

The (recalculated) structural balance is projected to improve by 0.5% of GDP in 2016 and 0.1% of GDP in 2017. The planned progress towards the MTO in 2016 appears appropriate. Over the two year horizon 2016-2017, the (recalculated) structural balance points to a risk of significant deviation, while compliance is foreseen for the expenditure benchmark. The overall assessment points to the risk of some deviation over 2016 and 2017 taken together.

Based on the Commission 2016 spring forecast, the structural balance is projected to improve by 0.2% of GDP in 2016, pointing to a risk of some deviation from the required adjustment of 0.6% of GDP (gap of -0.4% of GDP). The growth rate of government expenditure, net of discretionary revenue measures, is expected to exceed the expenditure benchmark by 0.4% of GDP in 2016, indicating a risk of some deviation. Following an overall assessment, both indicators point to a risk of some deviation from the requirements in 2016. In 2017, under the usual no-policy change basis, the projected 0.4% of GDP deterioration in the structural balance would point to a risk of significant deviation from the required 0.6% of GDP adjustment towards the MTO. In addition, the growth rate of government expenditure net of discretionary revenue measures is expected to exceed the expenditure benchmark by almost 0.5% of GDP in structural balance terms, also pointing to a risk of some deviation in 2017. However, over 2016 and 2017 taken together, both the structural balance and the expenditure benchmark pillars point to a risk of significant deviation (annual average gap of -0.7% and -0.4% of GDP respectively). Therefore, the overall assessment points to a risk of significant deviation from the recommended adjustment path over the years 2016 and 2017 taken together.

With respect to the debt criterion, the recalculated structural effort of the Stability Programme and the Commission's 2016 spring forecast indicate sufficient progress towards compliance with the debt criterion in 2016 and 2017.

8. ANNEX

Table I. Macroeconomic indicators

| | 1998- 2002 | 2003- 2007 | 2008- 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
|--|---------------|---------------|---------------|---------------|---------------|-------------|-------------|-------------|
| Core indicators | | | | | | | | |
| GDP growth rate | 3.9 | 4.8 | -1.1 | -1.1 | 3.0 | 2.9 | 1.7 | 2.3 |
| Output gap ¹ | -0.1 | 2.7 | -1.0 | -5.0 | -2.5 | -0.4 | 0.6 | 1.8 |
| HICP (annual % change) | 7.8 | 3.6 | 2.7 | 1.9 | 0.4 | -0.8 | -0.2 | 1.6 |
| Domestic demand (annual % change) ² | 3.7 | 5.0 | -2.7 | -2.2 | 1.6 | 2.1 | 1.3 | 2.8 |
| Unemployment rate (% of labour force) ³ | 6.8 | 6.1 | 6.9 | 10.1 | 9.7 | 9.0 | 8.6 | 8.1 |
| Gross fixed capital formation (% of GDP) | 26.5 | 26.9 | 22.9 | 19.7 | 19.6 | 19.4 | 18.6 | 19.3 |
| Gross national saving (% of GDP) | 25.0 | 26.8 | 22.8 | 23.2 | 26.3 | 27.2 | 26.4 | 26.7 |
| General Government (% of GDP) | | | | | | | | |
| Net lending (+) or net borrowing (-) | -3.0 | -1.4 | -4.7 | -15.0 | -5.0 | -2.9 | -2.4 | -2.1 |
| Gross debt | 25.1 | 25.7 | 38.9 | 71.0 | 81.0 | 83.2 | 80.2 | 78.0 |
| Net financial assets | 14.6 | 11.3 | -0.1 | -13.8 | -19.1 | n.a | n.a | n.a |
| Total revenue | 42.9 | 43.0 | 43.2 | 45.2 | 44.9 | 45.1 | 43.4 | 43.2 |
| Total expenditure | 46.0 | 44.5 | 48.0 | 60.3 | 49.9 | 48.0 | 45.7 | 45.2 |
| <i>of which: Interest</i> | 2.3 | 1.5 | 1.6 | 2.6 | 3.2 | 3.0 | 2.8 | 2.6 |
| Corporations (% of GDP) | | | | | | | | |
| Net lending (+) or net borrowing (-) | -1.8 | -5.3 | -0.1 | 13.4 | 6.6 | 5.1 | 4.6 | 5.4 |
| Net financial assets; non-financial corporations | -89.3 | -103.2 | -116.4 | -115.6 | -111.7 | n.a | n.a | n.a |
| Net financial assets; financial corporations | 8.4 | 4.9 | 4.7 | 12.1 | 11.6 | n.a | n.a | n.a |
| Gross capital formation | 17.2 | 19.4 | 14.4 | 11.4 | 11.0 | 11.6 | 12.4 | 12.6 |
| Gross operating surplus | 16.8 | 19.0 | 18.8 | 18.8 | 19.6 | 20.4 | 20.6 | 21.5 |
| Households and NPISH (% of GDP) | | | | | | | | |
| Net lending (+) or net borrowing (-) | 2.5 | 4.1 | 4.5 | 6.1 | 5.4 | 5.2 | 5.2 | 4.3 |
| Net financial assets | 62.6 | 72.8 | 64.9 | 67.9 | 70.3 | n.a | n.a | n.a |
| Gross wages and salaries | 44.1 | 42.9 | 44.5 | 43.9 | 43.1 | 41.8 | 41.7 | 41.0 |
| Net property income | 1.5 | 1.4 | 1.4 | 1.3 | 1.4 | 1.2 | 1.5 | 1.4 |
| Current transfers received | 19.7 | 19.1 | 20.2 | 21.4 | 20.3 | 19.5 | 19.4 | 18.8 |
| Gross saving | 8.3 | 9.2 | 8.5 | 8.5 | 8.7 | 8.4 | 8.7 | 7.6 |
| Rest of the world (% of GDP) | | | | | | | | |
| Net lending (+) or net borrowing (-) | -2.3 | -2.7 | -0.3 | 4.5 | 7.0 | 8.2 | 7.5 | 7.6 |
| Net financial assets | 3.7 | 14.2 | 46.9 | 49.4 | 48.9 | n.a | n.a | n.a |
| Net exports of goods and services | -1.9 | -0.7 | 1.5 | 5.9 | 7.9 | 9.4 | 10.0 | 9.9 |
| Net primary income from the rest of the world | 0.2 | -1.0 | -1.2 | -0.6 | -0.2 | -0.8 | -1.3 | -1.3 |
| Net capital transactions | -0.1 | -0.2 | 0.6 | 0.6 | 0.5 | 1.2 | 0.5 | 0.7 |
| Tradable sector | 47.5 | 47.0 | 44.6 | 46.1 | 46.5 | 47.4 | n.a | n.a |
| Non tradable sector | 39.6 | 40.7 | 42.6 | 40.1 | 39.8 | 39.0 | n.a | n.a |
| <i>of which: Building and construction sector</i> | 5.6 | 5.9 | 6.0 | 4.6 | 4.9 | 4.7 | n.a | n.a |
| Real effective exchange rate (index, 2000=100) | 90.9 | 92.6 | 98.4 | 97.3 | 95.6 | 92.7 | 92.5 | 91.4 |
| Terms of trade goods and services (index, 2000=100) | 103.0 | 102.7 | 100.2 | 98.4 | 99.4 | 100.6 | 101.3 | 101.7 |
| Market performance of exports (index, 2000=100) | 80.2 | 92.2 | 101.9 | 104.6 | 106.4 | 105.8 | 105.3 | 105.0 |
| Notes: | | | | | | | | |
| ¹ The output gap constitutes the gap between the actual and potential gross domestic product at 2005 market prices. | | | | | | | | |
| ² The indicator on domestic demand includes stocks. | | | | | | | | |
| ³ Unemployed persons are all persons who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74. | | | | | | | | |
| Source: | | | | | | | | |
| AMECO data, Commission 2016 spring forecast | | | | | | | | |