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Assessment of the 2013 national reform programme and stability programme for SLOVENIA

Accompanying the document

Recommendation for a Council Recommendation

on Slovenia's 2013 national reform programme and delivering a Council Opinion on Slovenia's 2013 stability programme for 2012-2016

{COM(2013) 374 final}

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ECONOMIC OUTLOOK

After subdued growth in 2010-11, Slovenia has slipped back into recession. Real GDP declined by 2.3% in 2012 and is projected to drop a further 2% in 2013, on the back of steadily declining domestic demand before stabilising in 2014. The protracted weakness of the economy has subdued inflation and shrunk disposable income and credit supply. Unemployment is still rising and is projected to reach 10.3% in 2014. The budget deficit is projected to be significantly above 3% of GDP in 2013, the deadline set by the Council in its recommendation in 2009, and government debt is projected to rise above the 60% of GDP threshold.

KEY ISSUES

The recession is accentuating the deleveraging challenge for over-indebted enterprises. Financial distress is reportedly rising in both publicly and privately-owned enterprises, which is a major cause of high levels of non-performing loans. As a result, large domestically-owned banks have recorded sizeable losses, necessitating further recapitalisations and depressing lending to healthy firms. Barriers in the business environment and weak corporate governance in state-owned enterprises hinder investment and FDI, and the labour market is segmented and insufficiently flexible. Past cost-competitiveness losses have thus not been reversed and export market shares continue to decline. The 2013 in-depth review (IDR) highlighted important vulnerabilities. In the Communication accompanying the IDRs, the Commission concluded that excessive imbalances exist in Slovenia.

Slovenia has launched some of the reforms that are necessary to address the CSRs of the 2012 Council Recommendation. There has been some short-term consolidation of the public finances. Parliament adopted a constitutional basis for establishing a general government budget balance/surplus rule in structural terms. However, further consolidation measures and improvements in the medium-term budgetary framework are needed. A pension reform was adopted in December 2012, but it reduces the burden on public finances only until 2020. To maintain financial sector stability, parliament adopted legislation for bank restructuring, but the envisaged asset quality review is still pending, bank balance sheets remain to be cleansed, bank governance has to be improved and, relatedly, bank privatisation plans are at an early stage. An important reform tackling labour market rigidity and segmentation was adopted in March and is due to be followed by the necessary regulation of student work. The public sector wage bill has been reduced, but the minimum wage has continued to rise, and there is room for improvement in the matching of workforce skills with employer needs. The Slovenia Sovereign Holding (SHH) is not yet in place and announced legislative amendments may jeopardize necessary corporate governance improvements and envisaged privatisations. A quick sale of the 15 companies recently slated for full privatisation, including several major firms, will signal a more welcoming business environment and help to attract much-needed FDI. Albeit with some delay, the process of deregulating professional services has started, and the Competition Protection Agency has been established.

The main challenges for Slovenia are to restructure its banking sector, improve corporate governance of the state-owned enterprises (SOEs) and correct the excessive macroeconomic imbalances.

- **Public finances:** The general government deficit declined markedly to 4.0% of GDP in 2012 from 6.4% of GDP in 2011. Nevertheless, Slovenia is not expected to correct the excessive deficit by 2013, also because of the high cost of bank recapitalisation. The medium-term budgetary framework and expenditure rule need to be strengthened to secure long-term sustainability. The contingent liabilities of the state are among the highest in the EU, which calls for measures to put it on a downward path. Further pension reforms are needed to stabilise the share of pension expenditures beyond 2020.

- **Banking system**: Determined implementation of a comprehensive banking sector strategy is needed to ensure stability and a return to growth. The transmission of financial distress from firms to banks, and from banks to the state has intensified, limiting funding options for both banks and the sovereign. Economic contraction has further hindered balance sheet repair and left banks increasingly exposed to non-performing loans, which reached 14.4% in 2012 (24.5% for corporate loans). Banks are increasingly dependent on ECB funding and government deposits.

- **State-owned enterprises**: The corporate governance of SOEs, which account for one sixth of total value added, needs to be improved significantly. SOEs form a complex matrix of frequently financially-troubled banks, insurance groups and non-financial corporations, which own each other. Better-performing SOEs frequently use their financial resources to recapitalise other SOEs in difficulties. This thwarts the productive investment, FDI and privatisation necessary to boost productivity, deepen capital markets and enhance technological spill-overs. SOEs burden the public finances – capital transfers to loss-making SOEs contributed 1.4 pps to the budget deficit of 6.4% of GDP in 2011 and the total debt of non-bank SOEs reached about 30% of GDP, most of it guaranteed by the state.

- **Corporate restructuring and insolvency proceedings**: The insolvency framework lacks proper incentives and sanctions to ensure that companies file for insolvency at an early stage, and incentives for early, out-of-court, settlement are also weak. The in-court, "compulsory settlement" procedures are complex and debtor-friendly, which is particularly dissuasive for SMEs and micro companies.

- **Labour market**: The overall employment rate stagnated in 2012, while youth unemployment increased substantially. Long-term unemployment continued to increase, in particular among older workers and the low skilled. Labour market flexibility is insufficient due to high protection of permanent contracts and labour market segmentation is widespread, including due to loose regulation of student work. The minimum wage is among the highest in the EU as a percentage of the average wage and it continues to increase automatically at the beginning of every year by the level of inflation in the previous year. Despite rising unemployment participation in active labour market policies is declining while the role of employers in vocational education and training remains weak.

- **Competitiveness and business environment**: Notwithstanding wage moderation, declining productivity prevented cost-competitiveness from improving in 2012. Despite its strong potential, Slovenia has one of the lowest stocks of FDI among new EU member states (31% of GDP in 2012), and weak export performance (its export market share fell by 6.4% in the last three years). Professional services, accounting for about 10% of GVA, remain heavily regulated. The recently established Competition Protection Agency is not yet financially independent. Transposition of the 3rd energy package and improvements in the justice system are also challenges.

1. INTRODUCTION

In May 2012, the Commission proposed a set of country-specific recommendations (CSRs)[1] for economic and structural reform policies in Slovenia. On the basis of these recommendations, the Council of the European Union adopted seven CSRs in July 2012.[2] These CSRs concerned public finances and fiscal governance, pension reform, banking sector balance sheets, labour market segmentation, skills mismatches, selected aspects of the business environment and the wage setting.

The Commission's Annual Growth Survey (AGS) 2013[3] and the Alert Mechanism Report (AMR)[4] were published in November 2012. The 2013 AGS sets out the Commission's proposals for five priorities to guide Member States to renewed growth in 2013: pursuing differentiated, growth-friendly fiscal consolidation; restoring normal lending to the economy; promoting growth and competitiveness for today and tomorrow; tackling unemployment and the social consequences of the crisis; and modernising public administration. The 2012 AMR served as an initial screening device to determine whether macroeconomic imbalances exist or risk emerging in Member States. Slovenia and 13 other Member States were selected for an In-depth Review (IDR).[5]

On the basis of the 2013 IDR for Slovenia, the Commission Communication of 10 April 2013 concluded that Slovenia is experiencing excessive economic imbalances. These imbalances correspond closely to challenges identified during the 2011 and 2012 European Semester, with a focus on a credible repair of the banking system, improved governance structures, privatisation, withdrawal of barriers to FDI, improvements to the business environment, cost-competitiveness developments supportive of adjustment and the enhancement of adjustment capacity at the microeconomic level. The communication called on Slovenia to proceed swiftly and decisively to complete the reforms it has started and include comprehensive and detailed policy measures in its 2013 national reform programme (NRP) and Stability Programme (SP).

Against the background of the 2012 CSRs, the 2013 AGS, the 2012 AMR, and the 2013 IDR, Slovenia presented updates of its national reform programme (NRP) and stability programme (SP) on May 9, 2013. These programmes provide information on the progress made since July 2012 and on the government's future plans. The information contained in these programmes provides the basis for the assessment made in this Staff Working Document (SWD).

The NRP was discussed in the competent committees of the National Assembly and the Economic and Social Council, with both organisations involving representatives of employee and employer associations. The SP was discussed in the competent committees of the National Assembly.

In addition to these documents, on 23 May 2013 the Minister of Finance sent a letter to the Commission recapitulating key commitments in the NRP and adapting or clarifying these commitments in six respects relating to sections 3.2 and 3.6 of this SWD (See Box 1).

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1 COM (2012) 321 final of 30 May 2012.

2 OJ C 219 of 24 July 2012.

3 COM (2012) 750 final.

4 COM (2012) 751 final.

5 13 in-depth reviews were published on 10 April 2013. While selected for an in-depth review in the AMR, Cyprus was ultimately not reviewed under the Macroeconomic Imbalance Procedure in view of the advanced preparations for a financial assistance programme.

Box 1: Key points of the letter of 23 May 2013

from Minister of Finance to Vice President Olli Rehn

- if required, the authorities stand ready to work with the Commission and the ECB to ensure asset quality reviews are conducted for a selection of banks, as long as these reviews do not impede the timely transfer of a first tranche of assets, planned before end June. The authorities would stand ready to cover any additional capital shortfall revealed in this process;
- measures to strengthen bank balance sheets will be followed by a phase in which the banking sector is consolidated;
- the government commits to full divestment of its stakes in the 15 companies that the government earmarked for privatisation on 8 May and expects parliamentary approval before the end of the second quarter of 2013;
- the NRP commitment to submit an SOE strategy in the fourth quarter of 2013 is brought forward to the end of the third quarter of 2013;
- any outlays of public funds on corporate restructuring will be offset against other expenditure items.

Overall assessment

The analysis in this SWD leads to the conclusion that Slovenia has made partial progress towards addressing the CSRs. The NRP, the additional measures announced by the authorities and the letter of 23 May 2013 contain important new commitments. While these are welcome steps in the right direction, a comprehensive, detailed, timebound action plan would be necessary to sustainably address the policy challenges described in the IDR, on the basis of which the Commission concluded that Slovenia is facing excessive imbalances, and to improve market confidence.

Positive action has been taken to consolidate public finances in the short-term. In spite of the expenditure-based consolidation envisaged in the SP, not all expenditure measures are specified and various are not of a structural nature. The fiscal effort is strongly concentrated in 2014, while for 2013 the programme envisages only a marginal improvement in the structural balance. Projections are subject to important risks, jeopardising the planned correction of the excessive deficit by 2014 and the achievement of the medium-term objective (MTO) by 2017.

By adopting a constitutional basis for establishing a general government budget balance/surplus rule in structural terms the authorities did a first step towards strengthening fiscal governance in line with EU legislation. However, they still need to improve the medium-term budgetary framework and the fiscal rule that would underpin an appropriate medium-term objective. A pension reform was adopted in December 2012, but further reforms are needed to lower the burden on public finances in the period after 2020. Moreover, further measures need to be identified to put public debt and contingent fiscal liabilities on a downward path. In the context of necessary structural reforms, it is important that Parliament tightened rules to call and win a referendum on 24 May 2013.

For the stabilisation of banks, the letter of 23 May 2013 contains important additional commitments. As a part of a comprehensive strategy for the banking sector, the authorities aim to implement a bank asset quality review for a selected group of banks in a phased manner that would allow them to move forward in a timely fashion with the necessary restructuring of NLB, the largest domestic bank, which is already subject to a state aid procedure. The objective of this strategy is to improve corporate governance of banks and create a well-capitalised and profitable banking system which can support the real economy.

To ensure this, the authorities stand ready to provide the necessary financial backstop if banks require further capital injection. They also expressed their willingness to work closely with the Commission and the ECB to ensure that the review meets the highest international standards. If these important new measures are integrated into a time-bound and comprehensive action plan and implementation goes ahead in a determined fashion, this would result in the necessary rehabilitation of the banking sector and a lasting improvement in market confidence.

A comprehensive strategy should also identify measures to strengthen bank management, governance and supervision. In addition to the welcome decision of the government to sell its stake in NKBM, the second largest bank, a commitment to improve the ownership strategy, governance and management of NLB, the largest state-owned bank, with a view to eventual privatisation, would greatly enhance the credibility of the reforms in this area.

Regarding state ownership, a comprehensive strategy and appropriate supporting measures would greatly help addressing the challenges that were identified in the IDR. While welcome amendments to the Slovenian Sovereign Holding (SSH) law strengthen reporting and auditing requirements, further measures are necessary to ensure a fast and efficient privatisation processes. In the letter, the authorities committed to bringing forward the completion of a comprehensive privatisation strategy and classification of assets to the third quarter of 2013, which should fully address the remaining issues in this area. Separately, the government proposed to parliament on May 8, 2013 a list of 15 companies to privatise, including the second largest bank and the telecommunications incumbent and some small companies and minority stakes, and expects parliamentary adoption by the end of the second quarter of 2013, according to the letter. Experiences in the last decades underline significant implementation risks, which may be exacerbated by announced amendments to the SSH law. Defining a realistic but ambitious timetable for the privatization of these companies after parliamentary approval would help further enhance credibility and mitigate implementation risks.

Legal changes to insolvency legislation adopted by the government in April 2013 will improve the insolvency framework, but further measures may be be needed to bring about sufficient improvement in this area. Additional legal changes to facilitate out-of-court restructuring and debt conversion are not described in detail in the NRP. The law on state aid was modified. It clarifies and broadens eligibility criteria, and foresees a role for independent evaluation. These legal changes however may lead to further increases in contingent fiscal liabilities, and could possibly disincentivise private restructuring deals.

The recently adopted labour market reform goes in the right direction but a significant impact on labour market segmentation and flexibility is not yet ensured. Moreover, a study to analyse the parallel labour market caused by student work is envisaged as a basis for determining what regulation will be required. Concerning wage cost competitiveness, reduced public sector wages will help promote the necessary adjustment in the private sector. The NRP states the welcome objective of revising minimum wage setting but the corresponding measures to achieve this objective remain to be identfied. Finally, further progress is needed on matching of skills supply with labour market needs to promote employment and new investment.

Further improvements in the business environment are envisaged. The NRP presents a set of targets to improve the length of judicial proceedings and reduce the number of enforcement cases. To ensure sufficient progress in this important area, underpinning measures should be fully spelled out. The NRP also announces further measures to streamline spatial planning procedures. The process of deregulating professional services has started, although with some delay. Finally, an independent competition authority was established, but its budget has been cut which hinders its proper functioning.

2. ECONOMIC DEVELOPMENTS AND CHALLENGES

2.1. Recent economic developments

Recent economic developments

Slovenia slipped back into recession in 2012 with a 2.3% drop of real GDP. The first phase of the recession in 2009 hit an economy on the verge of overheating and spread from the trade channel quickly to gross fixed capital formation, which declined by 23%. The continued fall in gross fixed capital formation stifled the short-lived export-led recovery in 2010-11. The main drivers behind the deterioration of growth in 2012 were a sharp decline in private consumption and the protracted weakness in investment. This means the recent positive adjustment in the current account is likely to be mostly cyclical, arising from markedly lower domestic demand and employment, while cost-competitiveness losses have not been reversed. Export market shares have been lost and export performance is substantially weaker than in peer countries with growth of merely 0.3% in 2012.

Domestic demand has remained weak since 2009. Private consumption fell by almost 3% in 2012 and investment continued to drop at a high rate, falling 9% overall in 2012 as a result of a 12.6% fall in construction and a 5.9% fall in equipment, although these declines were not as sharp as in 2011. Government spending also contracted by 1.6%. This consolidation was necessitated by the pro-cyclicality of spending in the years before the crisis. Delays in urgently required enterprise restructuring and increasing unemployment were amongst the main contributors to the sharp drop of domestic demand. Deleveraging needs concentrated in the corporate sector as a result of the build-up of internal and external imbalances, depressed profit margins and constrained economic activity. Many companies, especially those targeting the local market, had difficulties with servicing debt and paying taxes on time. Banking sector rescue measures and the restructuring of the highly indebted corporate sector were postponed to 2013, pending which banks' cannot offer new credit to firms in sufficient amounts. Unemployment has been rising driven by the on-going consolidation in both public and private sectors, while legal rigidities in the labour market (particularly but not only in relation to permanent contracts) hinder adjustment at firm level and distort job creation.

The transmission of financial distress from firms to banks, and from banks to the state has intensified, limiting funding options for banks, firms and the sovereign. Economic contraction has further hindered balance sheet repair and inevitably left banks increasingly exposed to problematic loans. Non-performing loan ratios reached 14.4% in 2012 for all types of loans and 24.5% for corporate loans. As a result, banks were faced with 40% higher losses on their loan portfolios on aggregate level in 2012. Difficulties in the interbank market have left banks increasingly dependent on ECB funding and government deposits. Five of the largest domestic banks were downgraded by Fitch in April 2013 as a result of delays in tackling the problems of the banking sector and their exposure to the over-levered corporate sector. Slovenia's access to sovereign debt was limited for most of 2012, though market access was regained through a sizeable US-dollar issue in October 2012. The sovereign was able to refinance itself again, in early May 2013 on the back of ample liquidity in international capital markets. However, this bond issuance, which was completed before delivery of key reforms and before adoption of the supplementary budget, has proven rather expensive. Insufficient reform progress so far, the complexity of state ownership and lingering doubts as to the true scale of contingent liabilities continue to weigh on economic recovery in Slovenia and jeopardize the sustainability of public finances.

Economic outlook

Slovenia's recession is deepening with continuously rising unemployment and growth forecasts being revised downwards. Real GDP is expected to drop a further 2% in 2013 on the back of steadily declining domestic demand and to at best stabilise in 2014. The protracted weakness of the economy and domestic consumption has subdued inflation, labour costs and credit growth, and is pushing the current account further into surplus. Existing imbalances in the banking and corporate sectors are expected to continue weighing on growth and fiscal adjustment both in 2013 and 2014. Accordingly, the excessive deficit is not expected to be corrected by 2013 and the government debt is projected to rise swiftly above the 60% threshold. Further delays in resolving the banking crisis and restructuring the highly indebted corporate sector have already resulted in a downward revision of growth forecasts. Any postponement of the wide-ranging structural reforms that are required and which have only partly been initiated would lead to a further deterioration of growth prospects.

Strong deterioration of private consumption and subdued investment remain the main drag on growth, while exports show signs of a modest recovery. Private consumption is set to fall by 3.7% in 2013 and by 1.9% in 2014 on the back of weak fundamentals, despite a slight improvement in consumer confidence in the first few months of 2013. A further increase in unemployment, which is set to reach 10% in 2013 and 10.3% in 2014, is one of the main contributors to the negative trend in consumption. The forecast for gross fixed capital formation for 2013, though still negative, has been revised somewhat upwards to a drop of 5%, due to anticipated one-off investment in machinery for a recently constructed coal-fired power station and increased absorption of EU funds in 2013. Nevertheless, fixed investment continues to decline, in line with the corporate sector's deleveraging needs, pressure on banks' balance sheets and limited access to credit. Positive signs in export data point at a gradual recovery of volumes with anticipated growth of 1¼% in 2013 and 3¼% in 2014, and a gradual shift towards faster growing markets outside the EU. However, Slovenia continues to lose market shares against other trading partners in the EU due to existing frictions in labour and capital markets, and slow adjustment of cost competitiveness.

The macroeconomic scenario underlying the budgetary projections of the stability programme and the national reform programme was revised downwards in March 2013. According to the projections of the Institute of Macroeconomic Analysis and Development (IMAD), real GDP will continue to drop in 2013 by 1.9% and will stabilise and strengthen gradually from 2014 onwards. Assessed against currently available information, including Commission services' 2013 Spring Forecast and internal projections for growth beyond 2014[6], IMAD's macro scenario for 2013 appears reasonable, but its scenario for 2014 and beyond appears optimistic in view of the announced consolidation measures. The difference is mainly due to a quicker and stronger recovery of investments in the IMAD forecast, while the Commission has taken a more cautious view given the delay and uncertainty around bank and corporate restructuring.

2.2. Challenges

On the basis of the 2013 In-depth Review, the Commission concluded on 10 April that Slovenia is experiencing excessive economic imbalances that are rapidly building up. The 10 April Commission Communication (see also Box 2) called on Slovenia to proceed swiftly and decisively with reforms and include comprehensive and detailed policy measures in its 2013 National Reform Programme and Stability Programme, in order to reverse this trend. Addressing these imbalances, which threaten the functioning of the economy and contribute to possible adverse effects to the monetary union, represents the highest priority challenge for Slovenia at the present time. More specifically, this entails:

[6] Internal projections for growth beyond 2014, underpinning the EDP, include consolidation measures.

(i) a credible repair of the banking system through a balanced set of measures and maintenance of financial stability through prudent supervision and improved governance structures;
(ii) a sounder financing of the NIIP and growth through FDI facilitated by an improvement of the business environment;
(iii) cost-competitiveness developments supportive of adjustment and helping to avoid the re-emergence of external imbalances through continued public sector wage restraint, adaptation of the minimum wage setting and a set of labour market reforms; and
(iv) the enhancement of adjustment capacity at the microeconomic level, particularly as regards state ownership and labour market institutions.

The challenges highlighted under the Macroeconomic Imbalances Procedure in 2013 are broadly in line with those of the 2013 Annual Growth Survey and correspond closely to those identified in the 2012 SWD, namely:

(i) ensuring long-term sustainability of public finances, including by addressing the low employment rate of older workers. An additional focus for 2013 is long-term care;
(ii) repairing the financial sector;
(iii) improving Slovenia's external trade prospects, which are hampered by past losses to its cost competitiveness;
(iv) reducing labour market segmentation, including that arising from "student work" (which is increasingly relevant for labour force participation and equality reasons);
(v) improving the overall business and competition framework, particularly in services;
(vi) better harnessing research and development and meeting the needs for new skills to support growth and the upgrading of Slovenia's production structure. A new emphasis, as budget pressures mount, is the need to focus resources on key priorities and to align and promote vocational education and training in accordance with labour market needs.

Going beyond the challenges highlighted in 2012 and in the Annual Growth Survey, there are key issues in relation to:

- Energy, where Slovenia could capitalise on trade possibilities and enhance retail competition while going further to achieve targets and implement the third energy package;
- The justice system, where greater efficiency could improve the business environment by fostering trust and stability;
- Environmental sustainability, where the issues are the costs of environmental pollution, resource efficiency and green growth.

Economic policies associated with these challenges require a comprehensive reform agenda with mutually reinforcing positive impact on employment, economic activity, financial sector stability and reduction of imbalances. These measures should complement measures to correct the excessive deficit and to ensure sustainable public finances in the long-term.

Box 2. Main conclusions from the 2013 In-depth Review and key messages from Commission Communication, COM(2013) 199 final, 10.4.2013

Based on the previous In-Depth Review (IDR), in May 2012, the Commission concluded in the 2012 that Slovenia was experiencing macroeconomic imbalances, in particular as regards developments related to corporate sector deleveraging, banking stability and to some extent also external competitiveness. It highlighted the necessity of a prompt and thorough policy response to minimise the risk of existing imbalances becoming excessive. The 2013 IDR, in line with the scope of the surveillance under the Macroeconomic Imbalance Procedure (MIP), finds that the negative economic trends and imbalances identified in the 2012 IDR have aggravated. Notably:

- The level of total private debt is below the euro-area average and the alert threshold of the scoreboard, but many corporates remain over-indebted, leading to further rises in non-performing loans.

- The size of the Slovenian banking sector is less than half the euro area average, but major domestic banks face continued deterioration of their credit portfolios and consequently recapitalisations are likely to be needed. Credit is contracting and the interaction between weak banks and the sovereign has intensified. Corporate balance sheet repair and growth is hindered by a double-dip recession and poor prospects.

- Net external debt is relatively contained and the current account has turned into surplus due to historically low inward investment and reduced imports from lower economic activity and employment. Past cost-competitiveness losses have not been reversed. Export market shares have been lost and export performance is substantially weaker than in peer countries.

- Policies to address the limited adjustment capacity of the economy have yet to fully develop. Important positive steps have been the enactment of a partial pension reform in the final weeks of 2012 as well as the labour market reform adopted early March.

- The complex nexus of state ownership limits adjustment, distorts resource allocation, deters foreign-direct investment and is detrimental to the public finances.

Framework legislation for bank restructuring and privatisation was passed but still needs to be implemented effectively.

The policy challenges stemming from these developments include:

- the credible repair of the banking system through a balanced set of measures and maintenance of financial stability through prudent supervision and improved governance structures, including the eventual privatisation of state-owned banks;
- a sounder financing of the net international investment positions (NIIP) and growth through foreign direct investment (FDI) facilitated by an improvement of the business environment;
- cost-competitiveness developments supportive of adjustment and helping to avoid the re-emergence of external imbalances through continued public sector wage restraint, adaptation of minimum wage setting and a set of labour market reforms;
- the enhancement of adjustment capacity at the microeconomic level, particularly in relation to state-ownership and labour market institutions.

These conclusions were reflected in the Commission Communication, COM(2013) 199 final, 10.4.2013, which stated that: *SLOVENIA is experiencing excessive macroeconomic imbalances. Urgent policy action is needed to halt the rapid build-up of these imbalances and to manage their unwinding. […]Slovenia should now proceed swiftly and decisively by completing the reforms it has started and include comprehensive and detailed policy measures in its forthcoming National Reform Programme and Stability Programme, in order to halt and reverse this trend.*

The remainder of this SWD assesses the policy agenda in light of these challenges, with a particular emphasis on determining whether this agenda is sufficiently ambitious, time-bound and detailed to credibly address the identified excessive imbalances.

3. ASSESSMENT OF POLICY AGENDA

Overall, the NRP demonstrates that Slovenia has made partial progress towards addressing the CSRs of the Council Recommendation, while providing only limited detail on the reforms that would be needed to address the excessive imbalances and policy challenges detailed in the In-Depth Review.

It is positive that the Stability Programme announces a correction of the excessive deficit relying mainly on expenditure reductions and the strengthening of fiscal governance in line with EU legislation. However, the fiscal effort is strongly concentrated in 2014, while for 2013 the programme envisages only a marginal improvement in the structural balance.

Programme projections are subject to important risks, jeopardising the planned correction of the excessive deficit by 2014. The macroeconomic scenario underpinning the programme seems optimistic especially for 2014. Budgetary implications of some revenue increasing measures are difficult to assess, because they are not supported with sufficient information on tax rates, tax basis and possible tax exemptions. In spite of the announced expenditure-based consolidation, not all expenditure measures are specified and many of them are not of a structural nature.

Measures to put public debt and contingent fiscal liabilities on a downward path are not provided. Achievement of the medium-term objective (MTO) by 2017 is not clearly demonstrated. Moreover, the programme's MTO is not appropriate, because it does not adequately take into account the implicit liabilities related to ageing. While the recent pension reform is an important step, specific measures to contain age-related costs beyond 2020 have not been provided.

For the stabilisation of banks, the letter of 23 May 2013 contains important additional commitments. As a part of a comprehensive strategy for the banking sector, the authorities aim to implement a bank asset quality review in a phased manner that would allow them to move forward in a timely fashion with the necessary restructuring of NLB, the largest domestic bank, which is already subject to a state aid procedure. The objective of this strategy is to improve corporate governance of banks and create a well-capitalised and profitable banking system which can support the real economy. To ensure this, the authorities stand ready to provide the necessary financial backstop if banks require further capital injection. They also expressed their willingness to work closely with the Commission and the ECB to ensure that the review meets the highest international standards. If these important new measures are integrated into a time-bound and comprehensive action plan and implementation goes ahead in a determined fashion, this would result in the necesary rehabilitation of the banking sector and a lasting improvement in market confidence.

The Bank Asset Management Company (BAMC) remains the government's preferred institutional platform for bank rehabilitation. The BAMC law allows for up to EUR 4bn state-guaranteed BAMC bonds to fund asset transfers and an estimated EUR 900m for recapitalisations. The NRP includes a first attempt to quantify and describe plans for transfers to the BAMC based on bottom-up stress tests performed by the Bank of Slovenia (BoS). These in-house estimates of the BoS are based on a series of assumptions that are not made explicit in the NRP and which may need to be further refined. The letter specifies that the largest bank, NLB, will transfer selected assets to the BAMC and states that the authorities have already provided to the Commission the necessary files detailing the proposed transfers.

For the other two large state-owned banks, first a private solution is sought. This important new initiative also requires a reassessment of the plans for asset transfers to the BAMC. It would also be important to explain the interaction of the BAMC with other corporate restructuring initiatives of the authorities.

A comprehensive strategy should also ensure that bank management, governance and supervision are properly strengthened, as these elements are vital to prevent a repeat of past mistakes by rescued banks. There is no mention of this consideration in the NRP. NLB, the largest state-owned bank is set to benefit from the transfer of bad assets to the BAMC. A clear commitment to promptly improve the ownership strategy, governance and management of this bank, with a view to eventual privatisation, would be important and would usefully complement the 8 May 2013 decision of the government to sell its stake in NKBM, the second largest bank in the country. Without the prospect of an eventual sale of cleaned banks, as soon as the general market conditions are acceptable, the rationale for BAMC approach favoured by the government remains unclear.

A comprehensive strategy and supporting measures regarding state ownership in the real economy would be necessary to address the challenges identified in the In-Depth Review in this area. There is a dearth of new measures compared with the time section 3.2 of the In-Depth Review was drafted and on the basis of which the Commission concluded that Slovenia is facing Excessive Imbalances. The announced privatisation strategy and classification of assets is scheduled for the third quarter of 2013 (according to the letter). While formulating a comprehensive strategy will need more time, it would be important to state the principles and objectives that will underpin this strategy as early as possible. In the absence of an overall strategy, the NRP announces ad-hoc privatisations in May 2013 and this announcement is substantiated by the proposal to privatise 15 companies sent to parliament on May 8, 2013, with adoption expected by the end of the second quarter of 2013, according to the letter. This list includes some important companies like the second largest bank and the telecommunications incumbent, but also minority stakes and small companies. Defining a realistic but ambitious timetable for the privatization of these companies after parliamentary approval would help further enhance credibility and mitigate apparent implementation risks.

Action to improve corporate governance of companies under state ownership has been delayed. While some amendments to the sovereign holding (SSH) law strengthen reporting and auditing requirements, these are not sufficient to ensure fast and efficient privatisation processes. Experiences in the last decades underline significant implementation risks. Announced amendments to the SSH act envisage reinstating the dispersion of ownership across public and quasi-public institutions, which will not facilitate the privatisation processes.

Legal changes to insolvency legislation adopted by the government in April 2013 are improving the insolvency framework, but further measures may be needed to bring about sufficient improvement in this area. A suitable system of incentives for owners, creditors and managers would be essential for the reform to succeed. Creating such incentives could be an important step forward to facilitate corporate restructuring and stabilise the banking sector. The Ministry of Justice aims at proposing additional legal changes to facilitate out-of-court restructuring and debt conversion by the end of May 2013. However, the level of detail of the proposals in the NRP is not sufficient to assess whether the new legislation can achieve its objectives. Some limitations in the law on state aid have been lifted, potentially leading to further increases in contingent fiscal liabilities, and possibly disincentivising private restructuring deals. The NRP lists some guiding principles in the granting of state aid but provides few operational details.

The recent labour market reform goes in the right direction, but it remains to be seen whether it will have a significant impact on labour market segmentation and flexibility. The reform's impact on the labour market will be monitored and will be used as a basis for potential legal changes. There is a plan to conduct an analysis of student work as a basis for determining what regulation will be required, including introduction of social security contributions, regulation of the minimum hourly pay and prevention of abuse. The NRP states the objective of revising minimum wage setting but does not clearly define corresponding measures.

Further improvements in business environment are envisaged. The Competition Protection Agency has been set up in 2013 and the NRP presents a set of targets to improve the length of judicial proceedings and reduce the number of enforcement cases. Concerning the latter, targets are not always underpinned with concrete measures. In addition, the NRP announces further measures to streamline spatial planning procedures. Finally, a plan for deregulation of professional services is presented.

3.1. Fiscal policy and taxation

Budgetary developments and debt dynamics

The main objectives of the budgetary strategy described in the programme are to correct the excessive deficit, achieve a balanced budget position in structural terms by 2017 and stabilise the debt ratio below 55% of GDP. The programme projects correction of the excessive deficit in 2014. The headline deficit is targeted to gradually decline from 7.9% of GDP in 2013 (4.2% of GDP without bank recapitalisations) to 2.6%, 2.1% and 1.4% of GDP over 2014 – 2016. According to the programme, these headline targets represent adjustments in the recalculated ratio of the structural balance to GDP[7] by 0.1 pp., 1.2 pps, -0.1 pp. and 0.0 pp. of GDP over 2013 – 2016. The MTO is defined as a balanced position in structural terms like in the previous update. This MTO does not appear to take the implicit liabilities related to ageing sufficiently into account.[8] The programme foresees the achievement of the MTO in 2017, two years later than in the previous update. However, the current budgetary plans are unlikely to allow Slovenia to attain its objective to reach the MTO by 2017 without implementing additional consolidation measures.

The general government deficit declined markedly to 4.0% of GDP in 2012 from 6.4% of GDP in 2011. Lower-than-planned revenue growth (-0.7% *vs.* 0.4%), resulting mainly from shortfalls in taxes on income and wealth and capital transfers received, largely explains the difference to the deficit target of 3.5% of GDP[9] from the previous update. Total expenditure declined marginally more than budgeted (-5.4% *vs.* -5.3%). A combined significant cut in public investment and lower-than-budgeted interest expenditures from postponed bond issuances offset overruns in compensation of employees, intermediate consumption and capital transfers, including the recapitalisation of the largest bank. The fiscal consolidation recommended in the 2012 CSR was implemented. Although the 2012 deficit target at 3.5% of GDP was not achieved, the ratio of the structural balance to GDP improved by a significant 2.0 pps. The May 2012 Act on Balancing Public Finances is the most far-reaching consolidation act adopted since 2009 and its positive budgetary implications continue into 2013. In addition, further revenue increasing consolidation measures were adopted for 2013.

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[7] Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission services on the basis of the information provided in the programme, using the commonly agreed methodology.

[8] The Commission services calculated the MTO for Slovenia at ¼% of GDP in autumn 2012. The EPC reviewed the Slovenia's pension reform enacted in 2012 on 28 May 2013. Thus, the Commission services intend to recalculate a MTO for Slovenia in the following weeks.

[9] The October 2012 EDP notification revised the 2012 deficit target upwards to 4.2% of GDP mainly because of a downward revision in taxes on income and wealth and upward revisions in compensation of employees and intermediate consumption.

The headline deficit target for 2013 at 7.9% of GDP incorporates anticipated bank recapitalisations. Bank recapitalisation needs are estimated at EUR 1.3bn or 3.7% of GDP, whereas the Commission's 2013 Spring Forecast, finalised at end April 2013, includes the amount of EUR 420m or 1.2% of GDP for the largest two banks. Without these operations, the headline deficit target in the programme would stand at 4.2% of GDP. Thus, the 2013 deficit target[10] is higher than in the March 2013 EDP notification and previous update (which set it at 3.0% of GDP and 2.5% of GDP respectively). On top of the base effect from 2012, the 2013 revision stems to a large extent from social transfers, especially pension expenditure, as compared to the previous update. The Commission's 2013 Spring Forecast projects the headline deficit for 2013 at 4.1% of GDP. However, relative to the programme it does not incorporate an increase in interest expenditures from May 2013 bond issuances and forecasts lower capital transfers (excluding bank recapitalisations) in line with a falling trend in this item over past years. These two factors largely explain why the Commission and programme forecasts for the 2013 deficit are almost at par, despite additional consolidation measures in the programme.

The consolidation path over the programme horizon is concentrated to 2014. Headline deficit targets for 2014 and afterwards are higher relative to the previous programme mainly as a result of the base effect from 2013. The headline deficit targets for 2013 and 2014 (7.9% and 2.6% of GDP respectively) imply a substantial 5.3 pps. of GDP reduction (a 1.6 pps. of GDP reduction without bank recapitalisations). The targets for the outer years imply smaller declines by 0.5 pp. of GDP in 2015 and 0.7 pp. of GDP in 2016. Adjustments in primary balances will be slightly larger as interest expenditure keeps increasing.[11] Relative to the previous programme, the reduction of the headline deficit in 2014 is more ambitious, while in 2015 it is less so. The consolidation announced in the programme falls mainly on the expenditure side while the revenue side contributes around one third of consolidation. The revenue-to-GDP ratio is projected to increase by 0.6 pp. from 2012 to 2016 (excluding a one-off[12] in 2012). In particular, taxes on income and wealth are projected to rise as share of GDP. The expenditure-to-GDP ratio is targeted to drop by 2.1 pps. (excluding one-offs[13] recorded in 2012) over the same period with a focus on falls in compensation of employees, intermediate consumption and social transfers as a share of GDP.

Revenue increasing measures are identified more concretely than expenditure decreasing measures, but details on both are lacking[14]. In addition, the former are of a more structural (permanent) nature than the latter. Budgetary implications of most envisaged measures are quantified both for 2013 and 2014 (see Box 3). By contrast, measures and their implications are missing for 2015 and 2016. Furthermore, the programme underlines various envisaged steps to fight the grey economy and improve the collection of taxes, but these are difficult to assess and are not included in the programme projections.

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[10] This and further references to the headline deficit target for 2013 in the fiscal section mean the headline deficit excluding bank recapitalisations.

[11] Projected interest expenditure at 3.0% of GDP will have nearly tripled by 2013 relative to 2008 when they stood at 1.1% of GDP.

[12] These were revenue increasing super-dividends from energy companies amounting to 0.15% of GDP.

[13] Recapitalisation of the largest bank increased expenditure by 0.2% of GDP.

[14] The list of envisaged revenue and expenditure consolidation measures up to 2014 is attached in the Annex to the programme.

Box 3. Main measures

The programme identifies increased VAT rates, amended real estate taxation and possible crisis personal income tax as the key sources of the consolidation on the revenue side. On the expenditure side, the public sector wage bill will be further cut in 2013. This cut will expire on 31 December 2014. By contrast, other expenditure side measures are less clear. There is an intention to continue with freezes in indexation arrangements, slightly reduce some social benefit rates and cut capital expenditure. Additional unspecified expenditure consolidation measures are planned for 2014 in order to avoid the crisis personal income tax. Detailed annual budgetary impacts of major macro-structural reforms (e.g. pension reform) over the programme horizon are not presented.

Main budgetary measures

Revenue	Expenditure
2012	
• Reduction in the corporate income tax rate from 20% to 18% and higher R&D and investment allowances for personal and corporate income tax (-0.5%) • Higher excise duty rates on tobacco, alcohol and mineral oils (0.25%) • New CO_2 charge on mineral oils (full year impact 0.2%) • Higher charges (concession fees) on student work (full-year impact 0.1%)	• Canceled indexation of social benefit rates (until end-2014) (total impact in 2012 and 2013 -0.3%) • Public sector wage bill: net cut in wages by 3% (permanent), cancelled indexation of public sector wages, postponement of payment for promotions (until June 2013) (full-year impact -0.85%), and permanent cancellation of third and fourth instalments of the public sector wage increase envisaged back in 2008 (-0.6%) • Lower recreational allowance for pensioners (until the year after the year in which real GDP growth exceeds 2.5%) (full-year impact -0.15%) • Canceled indexation of pensions (2012) (-0.1%) • Lower child benefits for higher income families (until the year after the year in which real GDP growth exceeds 2.5%) (full-year impact -0.2%) • Lower increase in minimum income for socially vulnerable people (until 2015) (-0.1%) • Various cuts in social transfers (permanent) (e.g. veteran entitlements and scolarships) (full-year impact -0.1%)
2013	
• Reduction in the corporate income tax rate to 17 % (-0.1%) • Higher road user charge (full-year impact 0.1%) • New tax on financial services and amended bank assets tax (0.1%) • Increase in VAT rates to enter into force on 1 July (full year impact 0.7%) • New taxes on sugar and sweeteners in beverages and lottery tickets to enter into force on 1 August (full year impact 0.1%)	• Cut in public sector holiday allowance (-0.15%) • Cancelled indexation of public sector wages (2013) (-0.15%) • Cancelled promotions for 2013 (-0.15%) • Higher meals allowance for students (permenent) (0.1%) • Additional measures to curb the public sector wage bill to enter into force on 1 June (full year impact -0.2%) • Lower unemployment benefits to enter into force on 1 July (full year impact -0.05%) • Lower capital expenditure (full year impact -0.3%) • Lower intermediate consumption (full year impact -0.1%)
2014	
• Real estate tax (0.7%) • Crisis personal income tax[1] (0.8%)	• Cancelled indexation of pensions (-0.1%) • Cancelled promotions for 2014 (-0.15%)

Note: The budgetary impact in the table is the impact reported in the programme, i.e. by the national authorities. A positive sign implies that revenue / expenditure increases as a consequence of this measure. The degree of detail reflects the type of information made available in the stability programme and other budget documents.

[1] The crisis personal income tax will be introduced if no political agreement on structural expenditure measures is achieved by 2014.

The balance of risks to projected deficit targets is significantly tilted to the negative side. For 2013, the achievement of the headline target at 4.2% of GDP (excluding bank recapitalisations) appears within reach. However, this does not seem to be the case for 2014 and onwards for several reasons. First, the macroeconomic scenario underpinning the programme was prepared in mid-March, but the envisaged composition and size of the consolidation measures was disclosed only in early May. It is not clear to what extent it incorporates the impact of the consolidation, such as on private consumption, which is likely to be impacted by higher VAT rates, real estate tax and a possible crisis personal income tax. The Commission's 2013 Spring Forecast projects that GDP will drop by 0.1% in 2014 based on a no-policy-change assumption, a scenario which only takes into account measures that have been adopted and hence forecasts a deficit of 4.9% of GDP. In view of this, the programme macroeconomic scenario might be seen as optimistic especially for 2014. Second, the projected yield of the real estate tax and possible crisis personal income tax is not underpinned with sufficient information on tax rates, tax basis and exemptions[15]. Third, expenditure consolidation measures agreed upon with social partners are mostly of a temporary nature and many of them need to be (re-)negotiated annually to prevent expenditure growth from reviving. Furthermore, the announced possible crisis personal income tax might weaken incentives to agree on structural expenditure cuts. Fourth, the past track record indicates possible expenditure overruns especially in compensation of employees and intermediate consumption. Higher compensation of employees in 2013 might stem also from a court judgement, still challenged by the government, stipulating the payment of the postponed wage increase to public employees from October 2010. Fifth, in Slovenia any legal act change has been until recently subject to referenda risks[16]. Finally, additional capital support operations might materialise, mainly to banks and to companies calling guarantees, including guarantees yet to be granted according to the planned government schemes to assist the restructuring of overleveraged non-financial corporations[17]. The letter clarifies that any additional outlays arising from newly granted guarantees will be offset against other expenditure items, without detailing how sufficient budget flexibility would be achieved within a given fiscal year.

The above negative risks might be partially offset by factors not specified in the programme. First, emerging overruns in primary current expenditure may to some extent be offset by higher-than-planned cuts in public investment, as has happened before. However, after public investment has fallen by 45% in real terms since 2009, room for that is tighter, not to mention the impact on long-term growth of further retrenchment in public investment. Second, programme projections do not incorporate the budgetary implications of measures to (i) broaden the base for health insurance contributions; (ii) improve collection of taxes and fight the grey economy; and (iii) legalise illegal buildings. Finally, subject to as yet unspecified implementation provisions, the general government budget balance/surplus rule in structural terms is likely to have positive impacts on the consolidation.

The planned adjustments in the recalculated structural balance are too low over the entire programme horizon, except in 2014. According to the information provided in the programme, the growth rate of government expenditure, net of discretionary revenue measures, in 2016 is expected to contribute to an annual structural adjustment towards the MTO. This is because the growth rate of expenditures excluding one-offs is below -0.51%, the lower reference rate

[15] For instance, the Act on Balancing Public Finances projected in May 2012 annual revenue of €160m from the new crisis real estate tax, which was temporary introduced in July 2012, but this projection was later on revised to revenue of around €5m.

[16] Parliament approved constitutional amendments, which tighten criteria to call and win a referendum on 24 May 2013. These amendments ban referenda about *inter alia* tax and other revenue increasing measures, but it remains to be seen how they will impact possible calls for referenda against potential expenditure consolidation measures.

[17] The programme explains (see Section 5.2.) that a relatively high share of guarantees granted to private companies in difficulties is being called.

applicable to Slovenia under the expenditure benchmark. However, the recalculated ratio of the structural balance to GDP is projected to improve by 0.1 pp., 1.2 pps., -0.1 pp. and 0.0 pp. over 2013 – 2016.[18] It appears that a revenue shortfall in 2016 from non-standard behaviour of revenue elasticities – the revenue-to-GDP ratio declines by 0.5 pp. – partially explains a deviation from the adjustment towards the MTO for the change in the structural balance indicator. That said, following an overall assessment of Slovenia's budgetary plans after the planned correction of the excessive deficit, with the structural balance as a reference and including an analysis of expenditure net of discretionary revenue measures, a deviation from the adjustment path towards the MTO is to be expected in 2016. To this end, the part of the 2012 CSR1 recommending progress towards an appropriate MTO has not been implemented.

At the current level of information, the programme consolidation measures do not appear sufficient for the correction of the excessive deficit by 2014 in a credible and sustainable manner. The identified risks, especially the optimistic macroeconomic scenario for 2014 and lack of information on tax basis, tax rates and tax exemptions for the real estate tax and a possible crisis personal income tax, raise doubts on revenue programme projections. Expenditure projections do not yet seem fully underpinned with measures, which are warranted in particular for 2015 after the expiry of the possible temporary crisis personal income tax and temporary cuts in the public sector wage bill agreed upon with social partners in May 2013. The planned composition of the consolidation is also somewhat unfavourable. While some taxes are notably below the EU average, for example real estate taxation, the proposed crisis personal income tax does not support creation of jobs, is not growth-friendly and might run counter to the fight against the grey economy. Furthermore, reliance on tax increases cannot indefinitely postpone the need to tackle expenditure dynamics. For instance, higher interest expenditure and growth in the number of old age pensioners have together led to an increase in total expenditure by around ½% of GDP on average over 2010-2012. Both the Commission's 2013 Spring Forecast and the programme project an even larger increase (¾% of GDP) for 2013. Against this background, there appears a need for additional consolidation efforts through structural expenditure cuts, including also an improved systematic evaluation of public spending based on clear performance criteria[19]. This would also contribute to the efficient enforcement of the binding medium-term budgetary framework.

[18] On a no-policy change assumption, the Commission's 2013 Spring Forecast projects adjustments of 0.3% and -0.9% of GDP in 2013 and 2014, respectively.

[19] The 2011 stability programme announced that the government started a project of "*target-oriented budgeting*" for the central government budgets for 2010 and 2011. However, no concrete information on its actual implementation and budgetary impacts are publicly available.

Box 1. Excessive deficit procedure for Slovenia

On 2 December 2009, the Council decided that an excessive deficit existed in Slovenia. The Council recommended that Slovenia's authorities should put an end to the excessive deficit situation by 2013. Specifically, to this end, the Slovenian authorities should: (a) implement the fiscal consolidation measures in 2010 as planned; (b) ensure an average annual fiscal effort of ¾% of GDP over the period 2010-2013; (c) specify the measures that are necessary to achieve the correction of the excessive deficit by 2013, cyclical conditions permitting, and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than currently expected. To reduce the risks to the long-term sustainability of public finances, Slovenia should further reform the pension system with a view to curbing age-related expenditures as soon as possible. Furthermore, the Council invited the Slovenian authorities to implement reforms with a view to raising potential GDP growth. That included reforms conducive to enhancing the quality of public finances. In particular, in view of higher-than-budgeted expenditure growth in the period 2006-2008 and the reliance of the consolidation strategy on expenditure restraint, Slovenia should strengthen the enforceable nature of its multi-annual budgetary plans and improve public spending efficiency and effectiveness.

An overview of the current state of excessive deficit procedures, including also additional EDP steps adopted after the finalisation of this staff working paper, is available on (see the country sections at the bottom of the page):
http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/index_en.htm

The programme projects the general government gross debt will breach the 60% of GDP reference value in 2013. Debt is projected to rise from 54% of GDP in 2012 to 63% of GDP in 2014 and 2015 before dropping marginally to 62% at the end of the programme period. Importantly, this projection does not include debt accumulation from envisaged transfers of impaired banking assets to the Bank Asset Management Company (BAMC)[20]. The snowball effect increases the debt ratio over the entire period but at a decelerating pace. The primary deficit adds to the debt only in 2013, while stock-flow adjustments are projected to reduce debt over the entire horizon. Debt projections in previous programmes have markedly underestimated debt increases, thus risks to the debt-to-GDP ratio are tilted towards higher debt ratios. These risks arise from the factors listed above in relation to the deficit targets and from stock-flow adjustments[21] with regard to asset transfers to the BAMC. Possible privatisation proceeds, not included in the programme, constitute a positive risk. Under a no-policy-change assumption, the Commission's 2013 Spring Forecast projects the debt ratio will rise to 66% of GDP in 2014, principally due to primary deficits and accelerating interest expenditure. Following any abrogation of the EDP, Slovenia would be in a transition period of the debt criterion introduced by the "6-Pack" and, according to the programme scenario its plans would ensure sufficient progress towards compliance with such a criterion in 2016.

Long-term sustainability

Slovenia faces high sustainability risks in the medium and long term, mainly due to the budgetary impact of ageing costs. Government debt (54.1% of GDP in 2012) is expected to rise to 66.5% in 2014, above the 60% of GDP Treaty threshold. Risks would be higher in the event of the structural primary balance reverting to lower values observed in the past, such as the average for the period 1998-2012. This implies a need for a focus on resolutely continuing to implement sustainability-enhancing measures that avert potential risks to fiscal sustainability. Further

[20] The December 2012 Banking Stability Act caps these transfers to EUR 4bn (11.4% of GDP).

[21] Usual pre-financing of bonds maturing in following years only front-loads the debt profile without impacting its size (interest impacts excluded).

containing age-related expenditure growth, including through pension reform, appears necessary to contribute to the sustainability of public finances in the long term. The full implementation of the fiscal plans in the stability programme would increase the debt-to-GDP ratio by 23.7pps from 54.1% in 2012 to 77.8% in 2030.

As recommended, Slovenia adopted a pension reform in December 2012 but the reform stabilises pension expenditures only until 2020. The reform took effect as of January 2013. The reform increases and equalises the statutory retirement age for men (from 63) and women (from 61) by 2020 to the age of 65, revises the indexation system for pensions and introduces measures to increase the low effective retirement age by reducing early retirement eligibility and generosity. While the reform goes in the right direction, national public pension expenditure projections indicate a curbing effect only until 2020. Thereafter, pension expenditures are projected to increase well above the EU average trend, thus challenging fiscal sustainability in the future and necessitating additional reform efforts. Further pension expenditure reductions with a positive effect on sustainability in the medium and long run can be achieved by aligning the statutory retirement age with gains in life expectancy and by introducing further restrictions on early retirement. Other measures such as pension indexation and changes to the pension benefit calculation method are not considered. The NRP envisages that discussions on several of these measures will take place in 2013 with an analysis to be presented in 2014 to serve as a basis for a potential additional reform.

Containment of a strong projected increase in long-term care expenditure is also relevant for ensuring long-term sustainability. The 2012 Ageing Report and long-term expenditure projections for long-term care (LTC) indicate an expected increase of the expenditure-to-GDP ratio of 1.9 pps. of GDP from 1.4% in 2010 to 3.3% in 2060. Demand for these services outstrips supply and around two thirds of needs are met in institutions, while Slovenia still lags behind in the provision of community-based care. Therefore, to ensure the sustainability of public finances, age-related expenditure increases on LTC can be contained by changing the focus of LTC provision from institutional to home care. This can be done through further development of home care services, a relatively greater use of cash benefits in support of home care, as well as reduction in the unit costs of home care services, which are currently relatively high. Furthermore, a more targeted and means-tested access to publicly funded LTC benefits is particularly important in view of the combination of the fiscal challenge, high provision costs and existing demand. The strong increase in demand for LTC can also be mitigated by policies to reduce disability/ dependency, via health promotion, disease prevention, rehabilitation and independent living. Slovenia is, for the first time, in the process of preparing a comprehensive approach to regulate the system of LTC and the draft law is scheduled to be presented to the Parliament by the end of 2013. The Act will seek to ensure the transition from institutional to community-based care. Improving accessibility to LTC and ensuring a more efficient, effective and sustainable use of resources would be an essential component of the reform.

Fiscal framework

The constitution has been chosen as the legal instrument for transposing the structural budget balance rule from the Treaty on Stability, Coordination and Governance (TSCG). Slovenia ratified the TSCG on 19 April 2012, and on 24 May 2013 Parliament adopted a constitutional basis for establishing a general government budget balance/surplus rule in structural terms. The provision stipulates among others that i) general government budget revenues and expenditures shall in the medium term be balanced without borrowing, or that ii) revenues shall exceed expenditures. A temporary derogation from this principle would only be allowed in exceptional circumstances. The complete transposition of provisions of the Fiscal Compact (budget rule, independent body for monitoring, exceptional circumstances and correction mechanism) is foreseen in a special constitutional implementation act, to be approved with a two thirds majority of all members in Parliament by November 2013. Other provisions, including from

EU legislation, to improve fiscal governance will be enshrined in the amended Public Finance Act and Accounting Act. Relevant legislation is expected to be approved by end-2013.

The medium-term budgetary framework still remains insufficiently binding and transparent. For instance, there are no enforcement mechanisms in case of deviation from fiscal targets. Thus, medium-term fiscal targets can be revised, which can lead to uncorrected slippages on the expenditure side. The medium-term budgetary framework and expenditure rule are insufficiently focused on achieving the MTO and securing long-term sustainability.[22] In addition, budget constraints on certain general government units, especially indirect budgetary users,[23] do not appear to be fully enforced. Finally, the Fiscal Council does not contribute to the development of fiscal strategy and its role and visibility have actually gradually declined since 2010.[24]

The integration of the financing of indirect budgetary users into the medium-term budgetary framework appears to be incomplete. Around 1500 indirect budgetary users are established by the state and municipalities. They are mainly financed with current and capital transfers from the central government[25] or local government budgets, but it appears that budgetary discipline is not strictly imposed. Consequently, there are indications of expenditure overruns occurring especially in compensation of employees which are covered either with additional budgetary transfers or redistribution of funds among budgetary items (e.g. from investment into wages) for an individual user. The authorities could review financing and spending of indirect budgetary users[26] and correct identified shortcomings, including through possible mergers of some positions, improved transparency of aggregate spending and setting-up of expenditure sub-rules for them. This could contribute to strengthened coherence of indirect budgetary users with the central and local government budgets and facilitate their compatibility with the overall medium-term budgetary framework.

Tax system

The tax-to-GDP ratio in Slovenia is the highest of the new Member States, but at 37.2% in 2011 it remains below the EU average (38.8%). The tax burden is above the average in relation to consumption, average in relation to labour and below average on capital. A specific feature of the tax system is the relatively high share of social contributions, including at the minimum wage, which offsets a relatively lower share of labour income taxes. Overall, taxation on consumption has remained stable since 2000 with the implicit tax rate oscillating around 24%. Taxation on labour has declined, as shown by a drop of the implicit tax rate on labour from 37.3% in 2006 to 35.2 % in 2011. The low tax burden on capital is evident in the low implicit tax rate on capital, which was 20.5% in 2011 (EU-25: 29.4%).

The previous government implemented changes in the tax system that further reduced taxation of capital and slightly increased taxation of consumption. A new multi-annual programme of corporate income tax rate reductions started in 2012, which decreased the rate from 20% in 2011 to 17% in 2013. The personal and corporate income tax investment allowance was

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[22] See Fiscal Frameworks across Member States: Commission services country fiches from the 2011 EPC peer review. European Economy, Occasional Paper 92, European Union, 2012.

[23] These are mainly public institutes operating in areas of education, health, social care, culture and sport and are part of the general government.

[24] The Fiscal Council has not published the Annual Report for 2013 by 30 April 2013 as stipulated in the Public Finance Act.

[25] Around 20% of total expenditure in the central government budget in cash terms is used for transfers to public institutes established by the state.

[26] The national document Exit Strategy 2010-2013 from February 2010 envisaged a reform of the system for provision of non-commercial public services, including of their financing. Information on this reform has not been communicated.

increased to 40% (from 30%) and the R&D allowance to 100% (from 40%) in 2012. Moreover, in 2013 the threshold for the personal income tax bracket at 41% is lifted from 1.3 times to 1.5 times the average wage and a new tax bracket at 50% is introduced for high-wage earners. A simplified gross flat tax scheme for small taxpayers (sole proprietors) in the personal and corporate income tax was expanded in 2013. Finally, a transaction tax on financial services charged on fees (compensation) paid for the provision of financial services which are not subject to VAT was introduced, excise duty rates increased and environmental charges broadened. These changes would have been expected to increase growth-friendliness of the tax system. However, their growth implications are likely to be muted in conditions of falling investment for four consecutive years. Furthermore, some changes might increase distortions in the tax system (e.g. gross flat tax scheme). The new government announced higher VAT rates, a new tax on sugar and sweeteners in beverages, a new tax on lottery tickets and broader, higher real estate taxation from 2014. The government also announced the cancellation of the further cuts in the corporate income tax rate to 15% (currently 17%) which were planned for 2014 and 2015. A new crisis personal income tax might also be introduced for 2014 only.

There remains further scope for growth-friendly and revenue-neutral tax shifting that also facilitates green growth. In this context, immovable property stands out as the most obvious candidate for tax increases, also taking distributional considerations, limited scope for evasion and low current taxation into account. The new government is tackling this with the amended real estate taxation. Slovenia applies the reduced VAT rate to almost all categories of goods and services allowed for by the VAT Directive 2006/112/EC. Thus, there is potential for realising revenue increases by limiting the application of the reduced VAT rate. In addition, corporate income taxation, while being rather low, is subject to a large number of tax expenditures resulting in significant distortions. An overhaul of the corporate income tax could improve efficiency and resource allocation without discouraging investment.

There appears to be room for improving tax compliance. Available estimates of the size of the shadow economy vary greatly from 8% of GDP (National Statistical Office) to around 24% of GDP. Estimates collected by European Employment Observatory point to a share of undeclared work of around 17%. Despite the discrepancy between available estimates, the indicators suggest that the size of the shadow economy in Slovenia is above EU average[27]. To improve tax collection and free up resources to fight the shadow economy, Slovenia could improve the use of e-government, including expanding the use of third-party information to pre-fill tax returns and further upgrading the tax administration's IT system EDIS. In addition, Slovenia could broaden mandatory electronic payments for purchases over a certain threshold and possibly use electronic data on consumption patterns to detect individuals who under-declare income. In this context, the programme indicates several envisaged measures to improve the tax collection.

3.2. Financial sector

Slovenian banks face increasing challenges. The large, state-owned banks, and some other banks, need additional capital again. The necessary bank deleveraging process is accelerating as wholesale lenders are repaid. Credit quality has deteriorated further, leading to higher loan-losses now and, due to the lagged booking of impairments, also through the remainder of 2013. Downward revisions of economic forecasts imply an additional deterioration of loan portfolios also in the future. Newly available estimates of stress loan losses point to possible additional recapitalisation needs. Work-out of bad and doubtful assets remains challenging. These developments and the related policy development challenges are described in detail in the 2013 IDR.

[27] European Commission (2012), Tax Reforms in EU Member States 2012, European Economy 6/2012.

The government has accelerated its policy response to the banking sector's problems since May 2012, partially covering some of the areas of the third 2012 CSR. Efficient implementation will require a sound strategy and patient work on important technical details. A range of tools including a bank asset management company (BAMC) have been established to carve problematic assets out of banks' balance sheets, and there has been an upgrade to the legal framework for banking and bank supervision. The policy agenda now foresees implementation of balance sheet cleaning and further state recapitalisations prompted by regulatory requirements. These elements were evaluated in the IDR, which concluded that important strategic questions remain, that efficient implementation will be challenging and that technical expertise will be key. The 2013 IDR indicated three banking policy priorities: i) a new, independent and transparent assessment of banks, as a foundation for balance sheet cleaning and a wider banking sector strategy; ii) improved governance, ultimately leading to privatisation; iii) strengthened supervisory and regulatory frameworks and actions.

For the stabilisation of banks, the letter of 23 May 2013 contains important additional commitments. As a part of a comprehensive strategy for the banking sector, the authorities aim to implement a bank asset quality review in a phased manner that would allow them to move forward in a timely fashion with the necessary restructuring of NLB, the largest domestic bank, which is already subject to a state aid procedure. The objective of this strategy is to improve corporate governance of banks and create a well-capitalised and profitable banking system which can support the real economy. To ensure this, the authorities stand ready to provide the necessary financial backstop if banks require further capital injection. They also expressed their willingness to work closely with the Commission and the ECB to ensure that the review meets the highest international standards. If these important new measures are integrated into a time-bound and comprehensive action plan and implementation goes ahead in a determined fashion, this would result in the necesary rehabilitation of the banking sector and a lasting improvement in market confidence.

The Bank Asset Management Company (BAMC) remains the government's preferred institutional platform for bank rehabilitation. The BAMC law allows for up to EUR 4bn state-guaranteed BAMC bonds to fund asset transfers and an estimated EUR 900m for recapitalisations. The NRP includes a first attempt to quantify and describe plans for transfers to the BAMC based on bottom-up stress tests performed by Bank of Slovenia. These in-house estimates of BoS are based on a series of assumptions that are not made explicit in the NRP and which may need to be further refined. The letter specifies that the largest bank, NLB, will transfer selected assets to the BAMC and states that the authorities have already provided to the Commission the necessary files detailing the proposed transfers. For the other two large state-owned banks first a private solution is sought.

However, it may be difficult to keep to the ambitious timescale for commencing transfer of assets to the BAMC that is envisaged by the authorities. Effecting a first transfer by end-June seems too ambitious in light of state-aid procedures as the European Commission has not yet received all information needed. In a final restructuring decision, i.e. before any asset transfer to the BAMC can take place, the Commission needs to approve for each bank (i) the assets to be transferred to the BAMC and corresponding valuations, (ii) the public recapitalisation amounts and (iii) the restructuring plans of the participating banks. Slovenia commits, in line with the state aid rules, that assets will be transferred to the BAMC only after receiving the Commission's final approval of the restructuring plans. The potential simultaneous restructuring of several large banks will imply the need to ensure collectively rational restructuring plans that strike a balance between necessary deleveraging and servicing the economy, and rely on realistic assumptions about retail deposits. Here, the announcement in the letter that the balance sheet cleaning phase will be followed by a sector consolidation phase is relevant and important but it needs to be further specified as there is no information in the NRP on operational restructuring of banks or improvements to credit and risk processes and bank efficiency.

Thorough implementation and full compliance with state aid rules is key to credibility and would fully justify a somewhat later start of the process. The announcement of credible external adviser, process and methodology, with appropriate sequencing of portfolio and bank coverage and publishing of interim reports will also help rebuild market confidence. Current standards of transparency for such exercises include publishing of capital needs for all the banks concerned, publishing of other key findings and sharing of full findings with the European Commission and the European Central Bank on a confidential basis.

Beyond the announced full privatisation of NKBM, there is no commitment in the NRP to improve the ownership strategy and governance of state-controlled banks. The 2013 IDR detailed the poor performance and governance concerns that undermine the state-owned banks. Appropriate, arm's-length management of state-controlled banks, underpinned by transparent selection of key personnel and disclosure of financial interests, would have been a key element to ensure and demonstrate a break from past mistakes. This omission leaves the overall strategy somewhat inconsistent, since the strongest argument in favour of the BAMC approach is that cleaned banks are then easier to sell. On 8 May, the government agreed to a complete sale of its stake in NKBM, the second-largest bank. This decision will require approval by parliament, expected by the end of the second quarter in 2013 according to the letter, followed by swift progress in sale-related activities. An ambitious timetable for divestment of direct and indirect shareholdings down to significantly below blocking minority share as a first step would be key to the overall strategy. There has apparently been no decision as regards other state-controlled banks (NLB, Abanka, and Gorenjska banka).

The NRP does not describe any new initiative to strengthen bank supervision, which was identified as necessary in the 2013 IDR[28]. In terms of supervisory actions vis-à-vis banks, the only new information in the NRP relates to the new Bank of Slovenia stress tests. A range of regulatory rules and structures could usefully have been re-examined, including appropriate macro-prudential policies, readying the banking sector for the transposition of CRD IV, developing a workable recovery and resolution regime[29], progressively introducing a robust, best ex-ante financed Deposit Guarantee Scheme, enhancing supervisory resources and processes, making provisioning and pillar II capital rules more stringent, making statistical reporting and disclosure more transparent and granular and upgrading credit registries to ensure access to all relevant information.

3.3. Labour market, education and social policies

Labour market and social conditions have worsened. Employment continues to fall. The employment rate fell further, by 0.3pp to 64.1% in 2012 and youth unemployment rate increased sharply, by 4.9 pps. to 20.6%. Long-term unemployment is rising and becoming structural (the long-term unemployment rate stood at 4.6% in Q32012), comprising predominantly older workers and the low skilled. Wage dynamics have been moderate in 2012. The nominal and real growth rates in compensation per employee were negative in 2012 (-0.4% and -0.8%, respectively) as a result of cuts in public sector wages and decelerating private sector wage growth.

[28] The IDR discussed the changes arising from the modifications to the Act on Banking that came into force in December 2012. These changes are beneficial in that they allow for more forward-looking action, but it still remains to be seen how these new powers will be used. Furthermore, the recovery and resolution powers available in this law could require further strengthening, as discussed also in the OECD's 2013 Survey of Slovenia.

[29] Along the lines of the proposed Directive on Recovery and Resolution of Credit Institutions, which emphasises the importance of effective tools to ensure preparation, prevention, early intervention and resolution.

The 2012 European Semester identified several challenges related to labour market, education and social policies, in the perspective of improving cost competitiveness, enhancing adjustment capacity and supporting employment. These challenges were reflected in the Council Recommendations for Slovenia on pensions, employment of older workers, labour market segmentation, skills mismatch and wages. All recommendations have been partially implemented, broadly in line with the 2013 Annual Growth Survey priorities.

Policy action to improve cost-competitiveness has been limited so far. In 2012, the government cut nominal gross wage per employee in the public sector by around 3% and real wage growth overall became negative. A further reduction of labour costs in the public sector was agreed in mid-May 2013. The minimum wage continues to increase automatically at the beginning of every year by the level of inflation in the previous year and these increases compound the large discretionary increase in 2010. Slovenia is among the EU countries with the highest minimum wage relative to the average wage in both gross and net terms. This is despite a level of the average wage that does not appear particularly low in comparison to other EU countries (including relative to living costs). The net income of minimum wage workers does not reach the at-risk-of-poverty threshold while risks of in-work poverty, though increasing, are low in comparative perspective, including among workers with low education who tend to be low-paid workers.[30]

Sustained progress in reducing unit labour costs can help in regaining cost competitiveness. Despite the negative growth in nominal compensation per employee, nominal unit labour cost (NULC) registered a moderate positive growth in 2012 (0.7%) due to more negative productivity growth (-1.1%). However, until Slovenia can sustain nominal unit labour costs (NULC) and price growth below that of its trading partners, it will not repair previous cost-competitiveness losses, especially from the 2007-09 period. There are strong built-in dynamics in both public and minimum wages that could reignite adverse trends in the coming years. Pressures on wages are expected to pick up once economic growth resumes as employees seek to re-establish differentials that were compressed in 2010 by a hike in minimum wages and by subsequent inflation-indexation based minimum wage increases. The NRP announces adjustments to minimum wage setting in 2013 in consultation with social partners to support competitiveness and fairness, but no detailed measures are reported.

The 2012 pension reform is a valuable first step to increase the very low employment rate of older workers in order to come closer to the Europe 2020 employment target and to close the gap between the effective and statutory retirement age.[31] The reform is likely to increase labour supply as it incentivises employees to prolong their working lives. In addition, several recently adopted legal acts support labour demand by introducing financial incentives for employers to hire older workers. Protection of older workers was reduced by the new Employment Relationship Act, though older workers still remain a protected group in terms of dismissals and working time arrangements. The employment rate of older workers could be further increased by restricting the remaining opportunities for early retirement and providing additional incentives to remain in work until reaching the statutory retirement age or even beyond. In addition, the employability of older workers could be enhanced by further strengthening their participation in targeted active labour market policies and lifelong learning measures. No measures have been taken so far to adapt work environments to longer working lives despite the observed lower than the EU average healthy life expectancy (50 years).

A reform of employment protection legislation was adopted in March 2013 to reduce labour market segmentation and increase flexibility. In line with the 2012 CSR to reduce asymmetries

[30] See Stoviček, K. (2013), "Minimum wages in Slovenia", Country Focus, DG ECFIN, European Commission, and European Commission , Macroeconomic Imbalances: Slovenia 2013, European Economy, Occasional Paper142, (forthcoming).

[31] For the impact of the pension reform on the sustainability of public finances see section 3.1.

between permanent and temporary contracts, the reform reduces protection of permanent contracts by simplifying dismissal procedures. However, dismissal costs remain broadly unchanged for the majority of workers, i.e. they are reduced noticeably only for workers with contribution periods above 25 years or less than one year. At the same time the protection of fixed-term contracts is increased to prevent abuse and increase the rights stemming from such contracts. The reform also introduces occasional work for retired persons and ensures support to both employers and employees during the notice period in case of consensual dismissals. While the reform goes in the right direction, it remains to be seen whether the reform is sufficiently ambitious to have a significant impact on labour market segmentation and flexibility, and improve Slovenia's FDI-attractiveness. New restrictions on temporary agency work may have a negative impact on job creation. The NRP announces that the impact of the reform on the labour market will be monitored and, if needed, legal changes will be enacted. While no systemic measures have been taken to address the widespread and unprotected student work available to pupils and students, the financial incentive to use this labour market status has been reduced by cutting the student allowance for personal income tax by one quarter in 2013. In addition, it is announced that analysis will be conducted into labour market segmentation and abuse of the student work status. Underpinned by this analysis there would then be regulation of student work on a similar basis as other types of work, but details are not provided.

Sufficient and concrete measures to improve the matching of skills with labour market demand would help Slovenia to reach the employment rate target of 75% set for 2020. Measures to reinforce career guidance throughout the whole educational cycle have been implemented; however, there is still no effective system to forecast labour market needs. A pilot project that is currently being carried out by the Public Employment Service could be used for prioritising and assessing labour market needs. The tertiary and vocational education systems remain insufficiently oriented towards emerging labour market needs, which results in skills gaps.

Only partial measures have been introduced to improve the matching of skills with labour demand for tertiary graduates, who face difficulties to enter the labour market. The government took measures to re-direct enrolment in general secondary education and to limit enrolment to social sciences at tertiary level, introduced a database on enrolment at tertiary level, and reduced the duration of the special student status. In addition, amendments to the Law on Higher Education were adopted in December 2012 addressing the criteria for transnational higher education, introducing accreditation systems for institutions and programmes, and introducing greater autonomy of universities in changing the mandatory contents of study programmes. According to the NRP, measures presented in the Resolution on the National Programme of Higher Education 2011-2020 are to be implemented, but no explicit timetable is presented.

Progress on enhancing the role of vocational education and training has remained slow. A key challenge is the introduction of a dual vocational education and training system. Other relevant challenges remain to counter the decline in enrolment in vocational upper secondary programmes, to increase the attractiveness of vocational education and training as a whole and, finally, to intensify the involvement of employers both in defining curricula and providing apprenticeship places. Slovenia performs very well in preventing early school leaving. The NRP announces amendments to the Vocational Education, General secondary Education Act and the Slovenian Qualifications Framework Act, which will be made on the basis of discussions that will start in the second half of 2013.

Worsening labour market developments underline the need for effective active labour market policies. Despite the rising unemployment rate, participation of the unemployed in active labour market policy programmes[32] decreased according to the preliminary national data for 2012. The "Plan for the Implementation of Active Labour Market Policy Measures" for 2013 and 2014 is light on new approaches to fight unemployment with the exception of a job sharing programme

[32] These are largely co-financed by the European Social Fund.

(to be developed in 2013). Another new element is mentoring schemes (to be introduced in 2013). The effectiveness of active labour market policy measures can be improved by introducing innovative tailor-made approaches that focus on the needs of specific target groups and by conducting regular evaluations of existing programmes to make policy making more evidence-based. The announced "Strategy for Developing Social Entrepreneurship" may have a positive effect on keeping those furthest away from the labour market active if it is well designed and effectively implemented.

Since 2010, the social situation in Slovenia, including that of children and that of workers with temporary contracts, has been worsening, although it remains better than the EU average. The new social legislation implemented in 2012 rationalised social expenditures. A wider definition of means-tested income, improved targeting and restricted access to benefits reduced the number of beneficiaries, notably among pensioners, recipients of child allowance and recipients of exceptional financial assistance.[33] This new legislation will be amended by the end of 2013, according to the NRP, in order to further simplify decision making procedures and redefine property in deciding on eligibility for transfers. Several discretionary measures in the last years have reduced or frozen the indexation of pensions and temporarily cut the yearly recreational supplement, thus having an impact on the income position of pensioners. Pension policy priorities need to find a suitable balance between the objectives of ensuring sustainability of the public finances, incentivising labour market participation and ensuring pension adequacy.

3.4. Structural measures promoting growth and competitiveness

The Slovenian economy is characterised by a low FDI stock and weak export performance. Slovenia's inward FDI stock stood at 31% of GDP in 2012, which is one of the lowest among new EU Member States, despite having a high-quality workforce and being located close to main EU markets. In addition, despite economic catch-up potential, Slovenia is losing world export market shares (6.4% in the last three years). As discussed in the 2013 IDR, weak export performance reflects not only weaknesses in cost competitiveness but also non-cost competitiveness given that Slovenia's industrial structure is still dominated by low-to-medium technology and labour intensive products. FDI, company development and exports are held back by the business and competition environment, including by the role of public ownership in Slovenia.

In 2012, the Council Recommendation for Slovenia contained a CSR on streamlining regulated professions and on improvement of the administrative capacity of the Competition Protection Office. In addition, in line with the Annual Growth Survey, the business and competition environment in Slovenia could be improved by adjusting the regulatory framework, notably in case of network industries, and improving the way spectrum is awarded to operators for the rollout of mobile broadband. Slovenia's growing importance as a transit country increases the need for infrastructure improvements in the energy and transport sectors. Measures in these areas, including those that moderate unit labour cost developments and address skills mismatch (see Section 3.3), could help Slovenia to regain competitiveness.

Limited progress was achieved in 2012 regarding structural measures for growth and competitiveness. The government adopted a "Slovenian Industrial Policy" which outlines priorities over the period 2014-2020 and aims at increasing productivity from 60% to 80% of the EU average. However, the document lacks the necessary implementation plans and is insufficiently coordinated with other related policies. In April 2013 the Government appointed an inter-ministerial committee to prepare strategic guidelines for attracting FDI. In the environment of tight funding conditions, financial engineering products of the Slovenian Enterprise Fund and SID bank have helped SMEs by providing targeted public guarantees and venture capital.

[33] The reform converted the minimum pension support into the means-tested income support.

Internal market and competition environment

The Slovenian authorities launched a reform process to review numerous regulated professions in 2012. An inter-ministerial group was setup in September 2012 to review regulated professions (of which there are over 300 in Slovenia) with the objective to better define existing regulated professions, reduce the administrative cost and simplify access to professions. A first set of laws in the field of craft, tourism and construction was due to be adopted by Parliament in early 2013. However, the reform is behind schedule except for the craft sector where the Small Business Act was adopted on 28 March and entered into force on 27 April. Secondary legislation defining which craft activities will remain regulated (and under which conditions) is to be adopted by end July 2013 at the latest. As to the tourism and the construction sectors, the adoption of revised legislation is now tabled for June and end-September 2013, respectively. By end-September 2013 Slovenia also plans to revise legislation for a number of other activities and professions including those related to private investigation, real estate brokerage, driving schools, lawyers and surveying activities. The revision of other sectors will follow in the second half of 2013 and in 2014. The swift de-regulation and a significant reduction of entry barriers are of importance given the expected positive effects on employment and competition.

Slovenia could benefit from a more ambitious implementation of the Services Directive. 18 sector-specific legal acts have been amended. Professional services accounting for about 10% of GVA remain heavily regulated, which limits the growth potential of the Slovenian economy. Slovenia has developed its Point of Single Contact (PSC) separately for foreign users and national users. Despite some progress in 2012, the information currently provided through the PSC is focused on a limited number of regulated activities (e.g. crafts, construction) while online completion of procedures is not yet possible for foreign operators.

Based on legislative changes made in late 2011, the independent Competition Protection Agency (CPA) was established on January 1, 2013. The CPA replaces the previous Competition Protection Office, which operated under the responsibility of the Ministry of Economic Development and Technology. Whilst additional staff was transferred to the CPA, the authority suffers from limited financial resources which are compounded by budget cuts for 2013. Effective exercise of its competition enforcement powers cannot be ensured without sufficient and autonomous financing.

Slovenia has not yet fully transposed the 3rd Energy Package Directives, which promotes among other objectives the effective unbundling of operations to improve market functioning and the protection of consumers. Two related infringement procedures have been referred to the Court of Justice. The Slovenian authorities aim at transposing the the 3rd Energy Package Directives by September 2013. Although there are no foreign providers in the retail segment of electricity, prices for end-users are close to the EU average and the switching rate is increasing. In contrast, in the gas market, prices are among the highest in the EU. Early 2013, the Competition Protection Agency launched an investigation to verify the existence of price fixing for households between mainly municipality-owned gas distributors. The investigation followed the entrance of a newcomer to the gas market in 2012, which led to a substantial reduction in retail prices. The investigation has not been concluded yet.

Slovenian railways are dominated by one state-owned holding. Railway infrastructure and transport operators are not fully separated. The domestic rail passenger transport market is not open to competition and almost the entire Slovenian network is awarded to the incumbent railway company without competitive public tender. Conversely, the rail freight transport market is open to competition; however the market share of the incumbent rail company exceeded 90% in 2010. The loss-making national railway holding is a heavy burden for public finances and prices of passenger transport are subsidised by the state.

Research and innovation

In 2013, the main challenge will consist in preparation of an innovation strategy for smart specialization to harness the potential for smart growth and the knowledge economy. This strategy will be instrumental for investments under the European Investment and Structural Funds for 2014-2020, also in light of decreasing national public spending on R&D. R&D intensity has exceeded the EU average since 2009 due to a strong growth in expenditure by businesses. The EU 2020 research and development intensity target of 3% seems achievable. The measures outlined in the 2011 Research and Innovation Strategy and the above-mentioned National Programme for Higher Education are yet to materialise. The main challenges remain the consistency and coordination of the policies to provide support to research and to stimulate innovation, the effective implementation of these policies, and the efficient deployment of available resources (including from the European Regional Development Fund). Improved governance and clear prioritization are essential to address these challenges. Research vouchers have been introduced in 2012 to help enterprises to commission research at research institutes and higher education organisations.

Slovenia is lagging behind in the award of spectrum to operators for the rollout of mobile broadband. In addition, Slovenia has a low fixed broadband coverage, compared to the EU average. A low broadband take-up is limiting the growth potential of ICT-led innovation through the economy.

Environment and climate issues, including infrastructure

Energy and transport infrastructure is of high relevance for Slovenia given its importance as a transit country. There are gaps in the electricity network (e.g. the missing link with Hungary is currently under construction) and the most used routes require strengthening (e.g. the link with Italy). In addition, there is untapped potential to increase absorption of renewables and the efficiency of the grid through the deployment of smart grids, which could enhance the functioning of the electricity market. Slovenia improved its gas connection to Austria and Croatia. The gas connection with Hungary is under consideration. Lack of administrative capacity to prepare a comprehensive transport strategy contributes to the underdevelopment of the railway infrastructure. The one-tier Divača-Koper railway line poses the main logistic bottleneck for the port of Koper.

Slovenia will probably fail to reach the target on greenhouse gas (GHG) emissions in sectors not covered by the Emission Trading System. GHG emissions are projected to increase by 5% (compared to 2005) by 2020[34], based on existing measures, thus exceeding the 4% target. While several measures were put in place such as introduction of a carbon tax to the transport sector, there is room to build upon these measures and expand recent initiatives to foster use of public transport. GHG emissions from transport accounted for 27% of Slovenia's total emissions in 2010, the third highest share in the EU, which is related to the significant transit traffic that crosses the country (in particular road freight transport). Slovenia can achieve the GHG emissions target only if emissions from transport are tackled effectively and high-density road transport is shifted to railway. GHG emissions could also be reduced by addressing distortions generated by differential taxation across fuel types. The NRP announces an action plan to reduce GHG emissions over the period 2013-2020 in view of reaching the target of 4% by 2020.

A comprehensive set of measures has been announced to improve energy efficiency; however, their success will depend on policy commitment and available funding. The energy efficiency target notified by Slovenia is not in line with the requirements of Articles 3 and 24 of the Energy Efficiency Directive. The target of 25% share of renewable energy in gross final energy consumption by 2020 can only be achieved if further measures are put in place to develop more renewable energy sources. There has been some progress in the heating and electricity

[34] European Environmental Agency greenhouse gas emission projections 2013.

sectors, but more is needed. Special attention has to be given to the transport sector, as its share of renewable energy sources remains low (at 2.9% in 2010, against a target of 10% in 2020).

Wastewater, waste management and air quality in urban cities pose environmental challenges. Challenges related to wastewater and waste management described in the Staff Working Document 2012 remain. While the number of landfill sites is decreasing and the low rate of landfill tax does not provide incentives to start moving waste management up the waste hierarchy towards recycling, reuse and reduction. Measures have been taken recently to promote resource efficiency in the water sector. Another challenge, in particular in urban areas, is poor air quality that carries direct public health costs and also reduces crop production. As a response, Slovenia continues to put in action regional air quality plans. The effectiveness of these measures remains to be demonstrated and requires continuous monitoring.

3.5. Modernisation of public administration

Challenges are concentrated in the area of the justice system. Despite recent progress and a distinct positive trend, judicial proceedings at first instance in litigious civil and commercial cases remain long (disposition time in 2010 was 431 days[35]). The rate of resolving litigious civil and commercial cases is low (in 2010, the clearance rate was 98%[36]) while the number of pending non-criminal cases per inhabitant is high (in 2010, it was the highest among the Member States[37]), although there has been a positive sign of advancement recently, particularly in the clearance rate. The AGS outlines also other priorities in the area of public administration, which are relevant for Slovenia such as developing e-procurement capacities and simplifying business licences procedures. Additional challenges stem from municipal fragmentation.

Justice system

Justice systems that ensure predictable, timely and enforceable decisions can improve the business environment and support FDI. Long proceedings in litigious civil and commercial cases can be addressed by additional measures, including those identified as promising through pilot projects. One such project is the Triaža project for commercial disputes introduced by the Ljubljana District Court, which focuses on organisational changes, with partial rollout to at least three additional district courts planned in 2013 before complete nationwide rollout in 2014. The high number of pending non-criminal cases indicates further scope for improvement. Recently, considerable progress has been achieved in the reduction of the pending land register cases. The high number of pending enforcement cases constitutes approximately two thirds of all pending non-criminal cases. A more detailed analysis of the roles of different actors in the enforcement procedure would be needed to identify the remedial measures necessary. The introduction of an electronic automated enforcement of authentic documents (COVL) in 2008 has led to good results. Targets to increase the number of resolved enforcement cases by 5% in 2013 and a further 5% in 2014 are set as a means of reducing the number of pending cases; however, there are no details provided on the concrete measures for attaining these target values (e.g. regarding the legislative amendments to the enforcement legislation planned for 2014).

Other administrative challenges

In the area of public procurement, Slovenia has not yet adopted a plan for transition to e-procurement. Slovenia is one of the EU Member States with the least developed corresponding infrastructure. Although the new electronic portal was introduced recently, electronic tenders cannot be submitted. Thus, the benefits of e-procurement such as greater transparency, more competition and faster procedures cannot be fully exploited in practice.

[35] The EU Justice Scoreboard: a tool to promote effective justice and growth, COM(2013) 160 final, p. 6.
[36] The EU Justice Scoreboard: a tool to promote effective justice and growth, COM(2013) 160 final, p. 8. A rate below 100% means that the backlog of unresolved cases in the court systems keeps growing.
[37] The EU Justice Scoreboard: a tool to promote effective justice and growth, COM(2013) 160 final, p. 10.

Governance of spatial planning and provision of services at municipal level deliver sub-optimal outcomes. Problems linked to the management of air quality, waste and water are largely linked to the problem of municipal fragmentation that often fails to build on economies of scale. Municipal fragmentation also contributes to inefficient spatial planning. In 2012, legal changes were adopted to streamline and shorten spatial planning procedures. The NRP announces a set of additional measures in 2013 and 2014 to this end. Monitoring of implementation of these measures is needed to assess the efficiency of policy action.

Complex business licensing procedures hinder investment, including from abroad, and weigh on business dynamism. Although Slovenia performs well as far as starting up a business is concerned, it is one of the EU countries with the most complex business-licences procedures in all dimensions (costs, time, and number of licences).[38] This means that even after successfully been setting-up, new companies experience delays before they can start their operations, thus making Slovenia less attractive for investments.

The public perception of corruption is negative and deteriorating as a result of recent corruption events. Relevant measures have been taken to improve transparency of public spending by the Slovenia's anti-corruption watchdog (the Commission for Prevention of Corruption). However, further measures are needed to improve the enforcement of public procurement rules and increase effectiveness of control mechanisms.

3.6. State ownership and corporate restructuring

Many Slovenian non-financial corporations are over-indebted and face financial distress in current market conditions. The 2013 IDR outlined the economic outcomes in relation to state ownership, in terms of direct and contingent fiscal costs, and in terms of distortion of normal commercial operations, while the only drawback to the state's conduct as an owner and manager of non-financial enterprises recognised in the NRP is lack of co-ordination. As an alternative focus, the NRP goes into some detail on the need for policies to foster deleveraging and avoid the poor outcomes associated with current insolvency procedures, including through 'pre-court restructuring'. While some deleveraging is clearly necessary, and the financial distress of some companies is known (particularly those in state ownership)[39], there is no systematic information in the NRP to quantify this challenge and to properly diagnose how it has arisen.

The NRP outlines policy priorities in the areas of state ownership and corporate deleveraging. Common solutions are likely to be found in private investment, both domestic and foreign, in privatisation, in creating the right incentives and conditions for debt restructuring (hard budget constraints) and in strengthening corporate governance. In addition, the state is in an exceptionally strong position to engineer and – if needed – to force financial and operational restructuring in many private and state-controlled firms. This strength arises from the state's position as a major direct owner, a major indirect owner, a major direct creditor (in the form of unpaid tax liabilities) and a major indirect creditor (through state-controlled banks). Provided that the compatibility conditions of the European rules are met, the state can also use state aid in pursuit of these objectives, although this has some drawbacks as discussed below. The remainder of section assesses the policy response to state ownership and corporate indebtedness separately.

Policies related to state ownership

State-owned enterprises (SOEs) present an important part of the Slovenian economy and face multiple challenges.[40] SOEs accounted for one sixth of total value added of the Slovenian

[38] Business Dynamics (2011). The analysis is based on a sample of selected companies.

[39] See European Commission (2013), Macroeconomic Imbalances: Slovenia 2013, European Economy, Occasional Paper142, April 2013.

[40] See Georgieva, S., D. Marco Riquelme (2013), "Slovenia: State Ownership Holding Back Development", Country Focus, European Commission (forthcoming), and European Commission (2013), Macroeconomic Imbalances: Slovenia 2013, European Economy, Occasional Paper142, April 2013.

economy, accounted for around half the total losses in the Slovenian corporate sector and employed one out of eight people in the private sector in 2011. As detailed in the 2013 IDR, SOEs are frequently characterised by sub-optimal corporate governance. State ownership encompasses a complex matrix of frequently financially-troubled banks, insurance groups and non-financial corporations, which own each other. State ownership and influence on those SOEs that are relatively strong performing are used to reshuffle assets and indirectly recapitalise other SOEs in economic difficulties. This thwarts the privatisation process required to boost productivity, deepen capital markets and enhance technological spill-overs from FDI. A number of SOEs face challenging financial conditions that might even aggravate given the expected continued economic downturn. Most companies are highly levered and have been recapitalised. Overall, Slovenia is considerably behind its peers in large-scale privatisations, corporate governance and privatisation of the banking sector (EBRD, 2012).[41] State ownership has already had a negative impact on public finances. Capital transfers to loss-making SOEs contributed 1.4 pps to the budget deficit of 6.4% of GDP in 2011. The total debt of non-bank SOEs was at least 30% of GDP, with 5.4 pps attributable to companies consolidated with general government accounts. In addition, SOEs are the main beneficiaries of state guarantees worth 25% of GDP, which is a contingent liability for the general government[42].

Overall, while containing some positive elements, the state-ownership and privatisation policies presented in the NRP fall short of what was identified as necessary in the 2013 IDR. Credible, detailed, time-bound commitments in the following areas in the NRP would have been important to address the challenges identified in the IDR. In particular, there would have been value in establishing a specific complete timetable for the announced privatisations to capitalise on confidence effects. Measures to consolidate the state's non-core ownership stakes and specific measures to ensure a privatisation-oriented governance and management would have lent credibility to privatisation intentions. At the same time, there will be companies remaining in state ownership and it would be important to detail measures how these will be run and how to ensure a smooth interlinkage between policy and economic considerations in related areas.

Some first steps have been taken to improve corporate governance, as recommended in the CSRs, and to privatise some SOEs. Legislation setting up the new Slovenian Sovereign Holding (SSH) was enacted. The new holding is intended to consolidate management and ownership of all investments by the Republic of Slovenia and the state funds within one structure and allow for privatisation of some of these assets. To this purpose, two asset classifications underpinning the privatisation strategy of the SSH was adopted by the outgoing government in early 2013, though not approved by parliament. The NRP announces amendments to the SSH Act, in line with the 13 March coalition agreement, to repeal the provisions on centralisation of ownership, i.e. while management of state assets would remain centralised under the SSH the ownership would be dispersed across Republic of Slovenia and various funds. It is questionable whether the setting up of the SSH in itself will help overcome the slow privatisation process produced by previous state ownership structures such as the Capital Assets Management Agency (AUKN, the immediate predecessor of the SSH) over the previous years. Moreover, the envisaged ownership split is not facilitating the process.

The letter announces there will be a privatisation strategy submitted by the end of the third quarter of 2013, but neither the letter nor the NRP provides insight into the intended

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[41] Comparative analysis with peers has been done on the basis of EBRD transition and structural indicators. Comparisons are based on Slovenia's average position during the transition period and its position according to latest data (2012). Slovenia was compared against the average of three groups of CEE countries: (i) Eight EU Member States from the CEE region and Croatia, (ii) Six EU Member States which entered the EU in 2004 and (iii) the two euro-area members from the region.

[42] See Georgieva, S., D. Marco Riquelme (2013), "Slovenia: State Ownership Holding Back Development", Country Focus, European Commission (forthcoming), and European Commission (2013), Macroeconomic Imbalances: Slovenia 2013, European Economy, Occasional Paper142, April 2013.

strategic objectives and principles.[43] The NRP does not report the classification of assets and underlying criteria that is supposed to underpin this strategy. A split is envisaged into "strategic" assets (where the state could keep both either majority or minority shares) and other assets, destined for privatisation. No further details are reported on the envisaged criteria used for selecting "strategic" assets and later on managing these assets. In the absence of the key elements of this strategy, it is difficult to judge whether this plan will be sufficient to address the challenges identified in this area in the IDR.

The conduct of any privatisation process is likely to face numerous obstacles, such as thwarted previous processes over the past two decades. Regulatory, administrative and political obstacles are all potentially present.[44] These could be reduced by ensuring a competition-friendly environment[45] and by abstaining from restrictive criteria relating to the identity of purchasers, purchase prices and future business conduct when approving sales. There is currently no regularly published, detailed register of the financial interests of parliamentarians, ministers and senior officials involved in state-owned assets, which risks undermining the transparency and public trust in privatisation-related decisions. Such a register could be a basis for enforcing strict rules on managing possible conflicts of interests and prohibiting interference by ministers in ongoing commercial transactions.

Pending the elaboration of an overall strategy, the NRP announces that the government will declare some first companies for privatisation in May 2013. Accordingly, the government announced on May 8 a list of 15 companies to be privatised and submitted it to Parliament. The letter states that the state's stakes in these companies will be put on sale in their entirety and that parliamentary adoption is expected by the end of the second quarter of 2013. This list includes larger and smaller companies, majority and minority stakes, including the second largest bank NKBM and the telecommunications incumbent. No detailed timetable is suggested. Rapid progress with these privatisations would send a strong signal to investors that Slovenia is open for business and moving towards a new way of operating. However, the NRP also stresses there may be reasons to depart from commercial considerations when deciding on privatisations. While there may be justifications for some limited departures from commercial considerations in specific instances like network industries, it would be economically problematic if such considerations were also present in other decisions. Basing decisions on such considerations would also be problematic under the state-aid rules.

There is no new detail in the NRP regarding the strategic orientation for companies that will remain in state ownership. In this respect, it would have been useful to consider sector-specific strategies and measures for improving profitability by realising efficiency gains and streamlining business models where possible. Efficient, transparent and professional management would be important to ensure for all core state assets. In this regard, there is currently no obligatory and publicly available register of appointments, with requirements for disclosure of interests (e.g. real and financial property, business relationships). Efficient budgeting and auditing processes under the control of the Ministry of Finance might also help.

Corporate restructuring

The NRP asserts the need to rescue and restructure non-financial corporations in financial distress. While corporate over-indebtedness in Slovenia is problematic and specific firms certainly face financial distress, important details have not been described in the NRP. Ideally, existing impediments to successful restructuring deals would be identified and overall

[43] The statement that this strategy would be modelled on similar strategies in OECD countries does not say what is actually envisaged. Pending the adoption of such a strategy, a clear statement of principles and objectives would have added greater credibility.

[44] See section 3.2 in European Commission (2013), Macroeconomic Imbalances: Slovenia 2013, European Economy, Occasional Paper142, April 2013.

[45] E.g. Slovenia has not fully transposed the 3rd Energy Package.

restructuring needs quantified[46]. Outside of the NRP, the authorities have described the situation in general terms and highlighted the contributory problem of 'passive owners', unwilling or unable to inject fresh capital and prepared to 'wait and see' rather than accepting dilution of their ownership interests by new investors or filing for insolvency[47]. Such an approach is permitted by banks that may be prepared to 'wait and see' rather than negotiate haircuts (e.g. in a distressed sale context), and to refrain from initiating proceedings against non-payers (see section on the legal framework below). The extent of tax and social security contribution arrears may indicate that the tax authorities also refrain from initiating proceedings against non-payers. If confirmed, such a behaviour would be problematic under the state-aid rules.

The NRP presents a three-step approach to restructure illiquid and thinly capitalised but ostensibly deserving companies. In the first step, existing owners and creditors would be responsible for agreeing appropriate restructuring deals (as is already the case). In the second step, external private investors would, if necessary, be sought, including among international institutions such as EBRD and IFC (as is in principle already the case; these institutions would have their own procedures to satisfy before going ahead with further investments in Slovenia). In the third step, the state would intervene and provide additional financial support[48] to stimulate restructuring negotiations between market players and to ensure sufficient resources. Despite the overlap in terms of counterparts and aims, the necessary co-ordination between this three-step approach and the BAMC (see section 3.2) is not explained in the NRP. E.g. it is not explained if companies are to be restructured following this three-step approach prior or after the transfer of related assets to the BAMC.

The NRP provides limited details regarding the granting of potential state aid. The legislation on state aid was amended and relaxed in April 2013 in order to provide more types of aid, in larger amounts, including to state-controlled companies. According to the NRP, these amendments introduce non-cash equity investments as a form of state aid, in addition to other forms of aid previously authorised (such as loans and guarantees) within the EU legal framework. Rescue aid has already been notified to one 'pilot' company and further notifications are in the pipeline. The NRP sets out some welcome guiding principles on limiting such state aid but does not clarify how the government will bind itself to these principles. However, the reference to the SP in this respect is not reciprocated in the SP itself. The SP does not include specific compensating measures to ensure compliance with fiscal targets, if guarantees are called, while amounts might be macro-economically significant. In this respect, the letter states that any additional outlays arising from newly granted guarantees will be offset against other expenditure items, without detailing how sufficient budget flexibility would be achieved within a given fiscal year.

Affordability considerations, fiscal discipline and the rules governing state aid all place constraints on granting aid via state guarantees, loans or fresh capital to non-financial corporations. With Slovenia in EDP, recapitalisations already weigh on the public deficit and debt levels as described above. In addition, Slovenia's sovereign guarantees are the third highest in the EU as a percentage of GDP[49]. A number of rating agencies and international investors have identified this as one of the main factors threatening the sustainability of public finances and international investor confidence in Slovenia. Cross ownership and inter-linkages between SOEs, state-owned banks and insurance companies amplify the fiscal and other risks related to sovereign

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[46] Ideally, there would be a current and forward-looking assessment of the financial situation of companies not in state ownership that are reportedly in need of urgent financial restructuring, using independent and transparent criteria when assessing the viability of companies.

[47] In addition, it is worth noting that the state as owner can rectify over-indebtedness only within the applicable fiscal and state aid constraints – i.e. it is not in a position to be an active owner itself.

[48] This element was not known at the time the IDR was drafted.

[49] Eurostat (2011), Structure of Government Debt in Europe. Please note that data refers to the guarantees given by the central government only and does not include guaranteed interests.

funding. Any discretionary expenditure and callable guarantee increases related to state aid add to the pressure on other areas of the general government budget.

Overall, the policy challenge and the policy response regarding corporate restructuring need further elaboration. The currently envisaged policies entail significant risks and could run counter to the objectives of consolidating the public finances and reducing the state's role in the economy. The NRP implicitly acknowledges this risk, by stressing the principle that the state should accelerate the sale of any shares acquired in this process, but the NRP provides no information on how this principle is to be operationalised. FDI could play a key role in unblocking current bottlenecks to corporate restructuring, and there is insufficient focus in the NRP on how to attract such FDI. Public intervention needs to be duly and transparently justified while ensuring that bail-in would diminish moral hazard, preserve taxpayer resources, prevent the perpetuation of ownership models that have proven problematic and instil correct incentives for other companies. In general, the appropriate objective for such a policy would be sale of restructured companies, without involvement of state resources, rather than maintaining given employment levels, or keeping 'viable cores' of businesses in domestic ownership.

Legal framework

"Passive" owners, shortcomings in the insolvency framework and deficiencies in the enforcement of insolvency rules increase the repayment risks for creditors of over-indebted companies. The insolvency framework has insufficient incentives and sanctions to ensure companies file for insolvency at an early stage. The compulsory settlement procedures (in-court reorganisation) are complex and debtor-friendly, particularly for SMEs and micro companies. There are insufficient incentives for early, out-of-court, settlement. Early debt settlement (out-of-court or in-court), which could help ensuring the continuation of viable businesses, are not being pursued (by debtors or by creditors), and companies tend to file for insolvency at a late stage. This is due to the absence of a fully credible threat from insolvency proceedings. Correspondingly, recovery rates are relatively low, the number of insolvency procedures with insufficient assets is large and the repayment risks for creditors of over-indebted companies are elevated. An effective reform would facilitate a timely rehabilitation of viable companies, speed up the cleaning of banks' balance sheets, facilitate access to finance and give a second chance to entrepreneurs.

Slovenia is in the process of amending legislation to increase the efficiency of insolvency procedures. The amendments to the Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act (ZFPPIPP) adopted in April 2013 aim at refining the definition of insolvency and incentivising management to file for insolvency on time. As regards compulsory settlement, the main changes aim at strengthening the role of creditors, by modifying the voting rules, improving access to debtors' documentation, and facilitating debt-to-equity conversion and appointment of new management. For micro companies, the draft law envisages fast-track, simplified compulsory settlement procedures. Relevant measures have been announced to speed up and increase the efficiency of insolvency procedures such as falling price ("Dutch") auctions and regulation of mediation for settlement of disputes arising from insolvency.

However, further measures may be needed to improve enforcement of the legal obligation to file for insolvency. Key areas are changes in the criminal law (and law enforcement) and obligations for managers to provide evidence that they have not filed for insolvency too late. Additionally, as the initiative for starting compulsory settlement procedures stays with debtors, the reform may fail to substantially increase take-up. Appropriate prioritisation of pending litigation directly related to bankruptcy could be an additional way to expedite ongoing procedures (see also Section 3.5). Close monitoring will be important to determine the impact of the reform.

Early financial restructuring of over-indebted companies is not currently regulated and new legislation has been announced to fill the gap. According to the NRP, legal changes to facilitate out-of-court restructuring and debt conversion will be proposed by the Ministry of Justice end of May 2013. The NRP does not provide details about the intended changes. It is thus not possible to assess whether the new legislation can achieve its objectives. A legal framework with compatible incentives for creditors, owners and management would be essential for starting any urgent restructuring of illiquid and thinly capitalised but viable companies.

4. OVERVIEW TABLE

2012 commitments	Summary assessment
Country-specific recommendations (CSRs)	
CSR 1: Implement the 2012 budget, and reinforce the budgetary strategy for 2013 with sufficiently specified structural measures, standing ready to take additional measures so as to ensure a correction of the excessive deficit in a sustainable manner by 2013 and the achievement of the structural adjustment effort specified in the Council recommendations under the excessive deficit procedure. Thereafter, ensure an adequate structural adjustment effort to make sufficient progress towards an appropriate MTO for the budgetary position, including meeting the expenditure benchmark. Strengthen the medium-term budgetary framework, including the expenditure rule, by making it more binding and transparent.	The CSR has been partially implemented. The May 2012 Act on Balancing Public Finances underpinning the 2012 supplementary budget has contributed to a significant improvement in the structural balance by 2.0% of GDP in 2012 and its positive budgetary implications continue into 2013. Key measures limited compensation of employees and social transfers, but many measures are not of a structural nature. The 2013 budget introduced new revenue increasing measures. According to the Commission's 2013 Spring Forecast, Slovenia is not expected to correct the excessive deficit by 2013. Limited progress has been achieved in other components of CSR1. The authorities have not set an appropriate MTO. Parliament adopted a constitutional basis for establishing a general government budget balance/surplus rule in structural terms, but no other action has been taken to strengthen the medium-term budgetary framework, including the expenditure rule, by making it more binding and transparent.
CSR 2: Take urgent steps to ensure the long-term sustainability of the pension system, while preserving the adequacy of pensions, by: (i) equalising the statutory retirement age for men and women; (ii) ensuring an increase in the effective retirement age, including through linking the statutory retirement age to life expectancy; (iii) reducing early retirement possibilities; and (iv) reviewing the indexation system for pensions. Increase the employment rate of older workers also by further developing active labour market policies and lifelong learning measures.	The CSR has been partially implemented. The pension reform was passed in December 2012 and entered into force in January 2013. The reform was adopted following intensive negotiations with social partners. Different intervention acts have frozen or reduced pension indexation over 2012-2014. The reform addresses challenges identified in the CSR though not sufficiently. It increases and equalises the statutory retirement age for both genders; however it does not introduce an automatic link between the increase in life expectancy and statutory retirement age. It reduces early retirement possibilities and proposes changes to the indexation of pensions. The reform goes in the right direction but is supposed to have a visible curbing effect on pension expenditure increases only in the short-run (up to 2020). Further reform steps are needed to ensure sustainability also in the medium and long-run. No tailor-made lifelong learning or active labour market measures have been adopted to increase employment of older workers.
CSR 3: Take the required steps to build sufficient capital buffers in the banking sector and strongly promote the cleaning of balance sheets so that appropriate lending to productive activities can resume. Obtain fully-fledged third party verification of systemically important banks' stress loan-loss estimates.	The CSR has been partially implemented. Following adoption of reform bills on the recovery of the banking sector, the government has set up the Bank Assets Managing Company (BAMC) and the Bank Stabilisation Fund to repair the state-owned banks. However, the selection of banks and balance sheet cleaning tools still needs to be specified. An asset quality review is planned in 2013. Jurisdiction of Bank of Slovenia was strengthened so that the Bank of Slovenia can intervene faster, with more of a forward-looking justification, though implementation of the new powers of the bank of Slovenia is yet to be demonstrated. The

	supervisory and resolution framework has been strengthened, but more measures are required on some of the supervisory tools (e.g. provisioning) and effective action has to follow. Third party due diligence was concluded in the two largest banks (state-owned NLB and NKBM) in summer 2012 and in autumn 2012 for the third largest bank (state-owned bank Abanka), however these reports are now outdated and a more cautious assessment is required to dispel market doubts. NLB was recapitalised with a EUR 320mn contingent convertible bonds (CoCo bonds, a hybrid debt-equity instrument) in July 2012, which was triggered and converted into equity in February 2013, and further recapitalisation needs for 2013 were announced by the bank in the amount of c. 367 m EUR. NKBM was recapitalised with a EUR 100mn contingent convertible bonds (CoCo bonds, a hybrid debt-equity instrument) in January 2013, which was also triggered and converted into equity soon after. In addition recently the management board of NKBM have proposed to shareholders to approve a capital injection of up to EUR 400m over the next five years. Both banks were recapitalised in order to meet European Banking Authority capital requirements.
CSR 4: Adjust employment protection legislation as regards permanent contracts in order to reduce labour market segmentation, in consultation with social partners and in accordance with national practices. Further tackle the parallel labour market caused by student work.	The CSR has been partially implemented. A reform of employment protection legislation was adopted in March 2013 to reduce labour market segmentation and increase its flexibility. The reform reduces protection of permanent contracts by simplifying dismissal procedures. However, dismissal costs remain broadly unchanged for the majority of workers, i.e. they are reduced noticeably only for workers with contribution periods above 25 years and less than a year. At the same time the protection of fixed-term contracts is increased to prevent abuse and increase the rights stemming from such contracts. Whereas the reform goes in the right direction, it remains to be seen whether the reform is sufficiently ambitious to have a significant impact on the labour market segmentation and flexibility, also in light of Slovenia's needs to attract FDI. New restrictions on temporary agency work contracts may have a negative impact on job creation. The NRP announces monitoring the impact of the reform on the labour market and, if needed, to enact legal changes. While no systemic measures have been taken to address the widespread and unprotected student work available to pupils and students, student allowance for personal income tax was cut by one quarter in 2013. In addition, regulation of student work similar to other types of work is announced in the NRP without providing details, on basis of an announced analysis to reduce labour market segmentation and prevent its abuses.
CSR 5: Improve the matching of skills with labour market demand, particularly of low-skilled workers and tertiary graduates, and continue reforms of vocational education and training.	The CSR has been partially implemented. A pilot project on how to evaluate labour market needs is being carried out at the Public Employment Service. The first results, which will be used as a basis for policy design, are expected for the second half of 2013. The newly-adopted Industrial Strategy could also be used for assessing labour market needs. Additional career orientation measures with the aim of strengthening the human resource management function in small and medium size enterprises are also being implemented.

	There is only some progress in addressing the skills gap in tertiary education; links with enterprises have not been strengthened. Reforms of vocational education and training show limited progress and the role of employers has not been strengthened.
CSR 6: Take further steps to strengthen market opening and speed up the reorganisation of professional services. Improve the business environment through: (i) implementing the reform of the Competition Protection Office (ii) establishing a framework for state-owned enterprises guaranteeing arms-length management and high standards of corporate governance (iii) improving bankruptcy procedures, in particular in terms of timeliness and efficiency.	The CSR has been partially implemented. A reform of professional services has been launched mid-2012. An inter-ministerial group was setup in September 2012 to review regulated professions. A first set of laws in the field of craft, tourism and construction was due to be adopted by Parliament early 2013. However, the reform is behind schedule except for the craft sector. As to the tourism and the construction sectors, the adoption of revised legislation is now tabled for June and end-September 2013, respectively. By end-September 2013 Slovenia plans also to adopt revised legislation for a number of other activities and professions including those related to private investigation, real estate brokerage, driving schools, lawyers and surveying activities. The revision of other sectors will follow in the second half of 2013 and in 2014. The swift de-regulation and a significant reduction of entry barriers are of importance given the expected positive effects on employment and competition. (i) The Competition Protection Agency (CPA) was established on January 1, 2013 and replaced the previous Competition Protection Office. Whilst additional staff was transferred to the CPA, the authority suffers from limited financial resources, also in light of budget cuts for 2013. Further measures are warranted to ensure its sufficient and autonomous financing. (ii) The government abolished the Agency on Managing Capital Assets and replaced it with the new Slovenian Sovereign Holding (SSH). The new holding is intended to consolidate management and ownership of all investments by the Republic of Slovenia and the state funds under one structure and allow for privatisation of some of these assets. To this purpose, the asset classification underpinning the privatisation strategy of the SSH was adopted by the outgoing government in early 2013, though not approved by parliament. The NRP announces amendments to the SSH Act, in line with the 13 March coalition agreement, to withdraw centralisation of ownership, i.e. while management of state assets would remain centralised under the SSH the ownership would be dispersed across Republic of Slovenia and various funds. These amendments risk repeating the slow privatisation outcomes achieved by previous state ownership structures over the years, such as the Capital Assets Management Agency (AUKN, the immediate predecessor of the SSH). The state's withdrawal from the economy is important not only for decreasing debt, but also for ensuring the more efficient performance and corporate governance of companies. There would be also a positive impact on market functioning and FDI. (iii) The government adopted an amended law on Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act (ZFPPIPP) in April 2013. The amendments aim at refining definition of insolvency and incentivise management to file for insolvency on time. However, further measures may be needed to improve enforcement of the legal obligation to file for insolvency. As regards compulsory settlement, main

	changes aim at strengthening the role of creditors, by modifying the voting rights, improving access to debtors' documentation, and facilitating debt-to-equity conversion and appointment of new management. For micro companies, the draft law envisages fast-track simplified compulsory settlement procedures. Relevant measures have been announced to speed up and increase the efficiency of insolvency procedures such as falling price ("Dutch") auctions and regulation of mediation for settlement of disputes arising from insolvency.
CSR 7: Following consultation with social partners and in accordance with national practice, ensure that wage growth, including minimum wage adaptation, supports competitiveness and job creation.	The CSR has been partially implemented. The government has cut nominal gross wage per employee in the public sector by around 3% in 2012 and agreed with social partners to cut the wage bill further in 2013. The real average wage decreased in 2012 compared to 2011 while the nominal unit labour cost (NULC) registered a moderate positive growth in 2012 (0.7%) due to negative productivity growth (-1.1%). However, until Slovenia can sustain NULC growth below that of its trading partners it will not repair previous cost-competitiveness losses, especially from the 2007-2009 period. No measure has been taken to adapt the minimum wage. The NRP announces adjustments in the minimum wage setting in 2013 in consultation with social partners to support competitiveness and fairness, however, no detailed measures are reported. There are strong built-in dynamics in both public and minimum wages that could reignite adverse trends in the coming years. Pressures on wages are expected to pick up once economic growth resumes as employees seek to re-establish differentials that were compressed in 2010 by a hike in minimum wages and by its subsequent inflation-indexation based increases.
Europe 2020 (national targets and progress)	
Employment rate target: 75%	The employment rate fell from 71.9% in 2009 to 68.4% in 2011 and stagnated in 2012 (68.3%). Slovenia is moving away from the target.
R&D target: 3%	Spending on R&D rose significantly from 2.11% in 2010 to 2.47% in 2011, so clear progress is being made towards the EU 2020 target.
Greenhouse gas (GHG) emissions target: +4% (compared to 2005, ETS emissions are not covered by this national target	Change in non-ETS greenhouse gas emissions between 2005 and 2011: -1%. According to the latest national projections submitted to the Commission and based on existing measures GHG emissions are projected to increase by 5% (compared to 2005) by 2020, leading to a shortfall of the target by 1pp.
Renewable energy target: 25% Share of renewable energy in the transport sector: 10%	Share of total renewable energy in gross final energy consumption was 18.8% in 2011 and 2.1% in the transport sector. (Source: Eurostat. April 2013. For 2011, only formally reported biofuels compliant with Art. 17 and 18 of Directive 2009/28/EC are included).

National indicative energy efficiency target for 2020: 10,809 GWh savings by 2020	Slovenia has set an indicative national energy efficiency target in accordance with Articles 3 and 24 of the Energy Efficiency Directive (2012/27/EU). However, it has neither expressed it, as required, in terms of an absolute level of primary and final energy consumption in 2020, nor has it provided information on the basis on which data this has been calculated.
Early school leaving target: 5%	Early school leaving, measured by the percentage of the population aged 18-24 with at most lower secondary education and not in further education or training, fell from 5.3% in 2009 to 4.4% in 2012. Slovenia is the best achiever in terms of preventing early school leaving. The target has been achieved.
Tertiary education target: 40%	Tertiary educational attainment rose markedly between 2009 and 2012, from 31.6% to 40%. The target has therefore been achieved.
Target for reducing the population at risk of poverty or social exclusion (in number of persons): 40,000	The number of people at risk of poverty or social exclusion, which is relatively low compared to the EU average, rose markedly between 2010 and 2011, from 366 000 to 386 000. This indicates that Slovenia is moving away from the target.

5. ANNEX

Table I. Macroeconomic indicators

	1995-1999	2000-2004	2005-2009	2010	2011	2012	2013	2014
Core indicators								
GDP growth rate	4.3	3.7	2.5	1.2	0.6	-2.3	-2.0	-0.1
Output gap [1]	0.2	0.8	2.4	-2.7	-1.5	-2.8	-3.7	-3.4
HICP (annual % change)	8.1	6.9	3.0	2.1	2.1	2.8	2.2	1.4
Domestic demand (annual % change) [2]	6.2	3.1	1.9	-0.2	-0.7	-5.7	-4.5	-1.2
Unemployment rate (% of labour force) [3]	7.1	6.4	5.5	7.3	8.2	8.9	10.0	10.3
Gross fixed capital formation (% of GDP)	23.9	24.7	26.3	20.1	18.5	17.4	16.7	16.8
Gross national saving (% of GDP)	23.8	24.6	25.4	20.6	20.3	19.7	20.4	20.4
General Government (% of GDP)								
Net lending (+) or net borrowing (-)	**-3.4**	**-3.0**	**-2.2**	**-5.9**	**-6.4**	**-4.0**	**-5.3**	**-4.9**
Gross debt	**22.0**	**27.0**	**26.6**	**38.6**	**46.9**	**54.1**	**61.0**	**66.5**
Net financial assets	**n.a**	**12.2**	**9.0**	**0.7**	**-2.2**	**n.a**	**n.a**	**n.a**
Total revenue	43.1	43.4	43.0	44.5	44.4	45.0	45.0	44.2
Total expenditure	46.5	46.4	45.2	50.4	50.8	49.0	50.3	49.1
of which: Interest	2.2	2.1	1.3	1.6	1.9	2.1	2.3	2.8
Corporations (% of GDP)								
Net lending (+) or net borrowing (-)	**-1.6**	**-3.4**	**-6.3**	**0.6**	**2.1**	**2.1**	**4.6**	**4.0**
Net financial assets; non-financial corporations	**n.a**	**-93.0**	**-113.4**	**-124.8**	**-118.6**	**n.a**	**n.a**	**n.a**
Net financial assets; financial corporations	**n.a**	**7.3**	**3.9**	**4.5**	**6.3**	**n.a**	**n.a**	**n.a**
Gross capital formation	15.4	16.9	18.3	12.1	12.3	10.8	9.2	9.5
Gross operating surplus	14.5	16.8	18.7	17.4	17.8	17.3	17.6	18.0
Households and NPISH (% of GDP)								
Net lending (+) or net borrowing (-)	**3.8**	**4.9**	**5.3**	**4.8**	**4.1**	**4.1**	**5.4**	**6.1**
Net financial assets	**n.a**	**67.9**	**73.8**	**74.3**	**70.0**	**n.a**	**n.a**	**n.a**
Gross wages and salaries	46.7	45.7	44.9	47.1	46.3	46.5	46.0	45.7
Net property income	1.3	1.6	1.1	0.7	0.9	1.1	1.2	1.2
Current transfers received	20.0	21.0	19.4	21.1	21.6	21.6	22.2	22.3
Gross saving	8.9	10.3	10.3	8.9	7.7	7.0	8.1	8.9
Rest of the world (% of GDP)								
Net lending (+) or net borrowing (-)	**-1.2**	**-1.5**	**-3.2**	**-0.3**	**-0.2**	**2.5**	**4.8**	**5.2**
Net financial assets	**n.a**	**5.9**	**27.0**	**46.3**	**45.5**	**n.a**	**n.a**	**n.a**
Net exports of goods and services	-1.9	-0.9	-0.6	1.0	1.2	4.0	6.5	7.3
Net primary income from the rest of the world	0.5	-0.4	-1.7	-1.6	-1.4	-1.3	-1.5	-1.9
Net capital transactions	0.0	-0.3	-0.2	0.1	-0.3	-0.1	0.0	0.5
Tradable sector	47.5	47.2	46.0	43.7	45.0	45.8	n.a	n.a
Non tradable sector	38.7	40.1	41.6	43.3	42.0	41.0	n.a	n.a
of which: Building and construction sector	5.6	5.5	6.7	5.7	5.2	4.8	n.a	n.a
Real effective exchange rate (index, 2000=100)	102.4	98.0	103.3	109.4	107.9	105.3	104.8	103.5
Terms of trade goods and services (index, 2000=100)	100.9	101.3	100.3	98.7	97.1	96.1	96.2	95.9
Market performance of exports (index, 2000=100)	87.7	91.1	105.9	105.0	106.7	107.5	107.6	105.6

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 :

Commission services' 2013 spring forecasts (COM); Stability programme (SP).

Table II. Comparison of macroeconomic developments and forecasts

	2012		2013		2014		2015	2016
	COM	SP	COM	SP	COM	SP	SP	SP
Real GDP (% change)	-2.3	-2.3	-2.0	-1.9	-0.1	0.2	1.2	1.6
Private consumption (% change)	-2.9	-2.9	-3.7	-4.0	-1.9	-1.3	0.5	1.0
Gross fixed capital formation (% change)	-9.3	-9.3	-4.9	-0.5	0.1	0.8	1.5	1.5
Exports of goods and services (% change)	0.3	0.3	1.3	1.2	3.2	3.3	4.9	5.3
Imports of goods and services (% change)	-4.3	-4.3	-2.1	-0.7	2.0	2.4	4.4	4.9
Contributions to real GDP growth:								
- Final domestic demand	-3.7	-5.6	-3.5	-3.3	-1.1	-0.6	0.6	1.0
- Change in inventories	-1.9	-1.9	-0.8	-0.2	0.0	0.2	0.1	0.1
- Net exports	3.3	3.3	2.4	1.4	1.1	0.8	0.6	0.7
Output gap[1]	-2.8	-2.7	-3.7	-3.5	-3.4	-2.7	-1.3	0.3
Employment (% change)	-1.3	-1.3	-1.6	-1.6	-0.6	-0.8	0.0	0.2
Unemployment rate (%)	8.9	8.9	10.0	10.0	10.3	10.0	9.4	9.1
Labour productivity (% change)	-1.1	-1.1	-0.3	-0.2	0.5	1.0	1.2	1.5
HICP inflation (%)	2.8	2.6	2.2	2.1	1.4	1.6	1.9	2.0
GDP deflator (% change)	0.4	0.4	1.4	1.3	1.0	1.1	1.8	1.9
Comp. of employees (per head, % change)	-0.4	-0.5	0.1	0.0	0.7	0.7	2.1	2.6
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	2.5	2.5	4.8	n.a.	5.2	n.a.	n.a.	n.a.

Note:

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

Source :

Commission services' 2013 spring forecasts (COM); Stability programme (SP).

Table III. Composition of the budgetary adjustment

(% of GDP)	2012	2013		2014		2015	2016	Change: 2012-2016
	COM	COM	SP	COM[1]	SP	SP	SP	SP
Revenue	**45.0**	**45.0**	**45.5**	**44.2**	**46.8**	**45.8**	**45.3**	**0.3**
of which:								
- Taxes on production and imports	14.6	14.6	15.0	14.5	15.6	14.7	14.6	0.0
- Current taxes on income, wealth, etc.	7.7	7.6	7.6	7.5	8.8	8.7	8.6	0.9
- Social contributions	15.5	15.3	15.4	15.1	15.2	15.0	14.9	-0.6
- Other (residual)	7.3	7.5	7.5	7.1	7.2	7.4	7.2	-0.1
Expenditure	**49.0**	**50.3**	**53.4**	**49.1**	**49.4**	**47.9**	**46.7**	**-2.3**
of which:								
- Primary expenditure	46.9	47.9	50.7	46.3	46.5	45.1	43.7	-3.2
of which:								
Compensation of employees	12.6	12.3	12.0	12.2	11.8	11.5	11.1	-1.5
Intermediate consumption	6.9	6.7	6.8	6.7	6.7	6.5	6.3	-0.6
Social payments	19.7	20.4	20.2	20.5	20.0	19.6	19.0	-0.7
Subsidies	1.3	1.3	1.3	1.3	1.1	1.0	0.9	-0.4
Gross fixed capital formation	2.9	3.3	3.2	2.8	4.1	3.7	3.6	0.7
Other (residual)	3.4	4.0	7.2	2.9	2.8	2.9	2.8	-0.6
- Interest expenditure	2.1	2.3	2.7	2.8	2.9	2.8	3.0	0.9
General government balance (GGB)	**-4.0**	**-5.3**	**-7.9**	**-4.9**	**-2.6**	**-2.1**	**-1.4**	**2.6**
Primary balance	**-1.9**	**-2.9**	**-5.2**	**-2.1**	**0.3**	**0.7**	**1.6**	**3.5**
One-off and other temporary measures	0.0	-1.2	-3.7	0.0	0.0	0.0	0.0	0.0
GGB excl. one-offs	**-4.0**	**-4.1**	**-4.2**	**-4.9**	**-2.6**	**-2.1**	**-1.4**	**2.6**
Output gap[2]	-2.8	-3.7	-3.5	-3.4	-2.7	-1.3	0.3	3.0
Cyclically-adjusted balance[2]	-2.7	-3.6	-6.3	-3.3	-1.4	-1.5	-1.5	1.2
Structural balance (SB)[3]	**-2.7**	**-2.4**	**-2.6**	**-3.3**	**-1.4**	**-1.5**	**-1.5**	**1.2**
Change in SB	*2.0*	*0.3*	*0.1*	*-0.9*	*1.2*	*-0.1*	*0.0*	-
Two year average change in SB	*1.0*	*1.1*	*1.0*	*-0.3*	*0.7*	*0.5*	*-0.1*	-
Structural primary balance[3]	-0.6	0.0	0.1	-0.5	1.5	1.3	1.5	2.1
Change in structural primary balance		*0.5*	*0.7*	*-0.5*	*1.4*	*-0.2*	*0.2*	-
Expenditure benchmark								
Applicable reference rate[4]	0.63	0.63	0.63	-0.51	-0.51	-0.51	-0.51	-
Deviation[5] (% GDP)	-4.1	-2.9	1.5	-0.5	-7.0	0.5	-0.2	-
Two-year average deviation (% GDP)	-1.6	-3.5	-1.7	-1.7	-2.8	-3.2	0.2	-

Notes:

[1]On a no-policy-change basis.

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

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

[4] 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 lower rate applies as long as the country is adjusting towards its MTO, including in year t.The reference rates applicable to 2014 onwards have been updated in 2013.

[5] Deviation of the growth rate of public expenditure net of discretionary revenue measures and revenue increases mandated by law from the applicable reference rate. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A positive sign implies that expenditure growth exceeds the applicable reference rate.

Source:

Stability programme (SP); Commission services' 2013 spring forecasts (COM); Commission services' calculations.

Table IV. Debt dynamics

(% of GDP)	Average 2007-2011	2012	2013 COM	2013 SP	2014 COM	2014 SP	2015 SP	2016 SP
Gross debt ratio[1]	**33.1**	**54.1**	**61.0**	**61.8**	**66.5**	**63.2**	**63.2**	**61.8**
Change in the ratio	4.1	7.2	6.9	7.7	5.4	1.4	0.0	-1.4
Contributions[2] *:*								
1. Primary balance	**2.6**	**1.9**	**2.9**	**5.2**	**2.1**	**-0.3**	**-0.7**	**-1.6**
2. "Snow-ball" effect	**0.7**	**3.0**	**2.7**	**3.0**	**2.2**	**2.0**	**1.0**	**0.9**
Of which:								
Interest expenditure	1.5	2.1	2.3	2.7	2.8	2.9	2.8	3.0
Growth effect	-0.2	1.1	1.1	1.0	0.0	-0.1	-0.7	-1.0
Inflation effect	-0.5	-0.2	-0.8	-0.7	-0.6	-0.7	-1.1	-1.1
3. Stock-flow adjustment	**0.8**	**2.3**	**1.3**	**-0.5**	**1.2**	**-0.3**	**-0.3**	**-0.7**
Of which:								
Cash/accruals diff.								
Acc. financial assets								
Privatisation								
Val. effect & residual								

	2012	2013 COM/SP[3]	2013 SP[4]	2014 COM/SP[3]	2014 SP[4]	2015 SP	2016 SP
Gap to the debt benchmark[5,6]	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.
Structural adjustment[7]	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	0.0
To be compared to:							
Required adjustment[8]	n.r.	n.r.	n.r.	n.r.	n.r.	n.r.	0.0

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.

[3] Assessment of the consolidation path set in SP assuming growth follows the COM forecasts.

[4]Assessment of the consolidation path set in the SP assuming growth follows the SP projections.

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

[6]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.

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

[8]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 (SP) budgetary projections for the previous years are achieved.

Source :

Stability programme (SP); Commission services' spring 2013 forecasts (COM); Commission services' calculations.

Table V. Sustainability Indicators

	SI		EU27	
	No-policy change scenario	**Programme (SCP) scenario**	**No-policy change scenario**	**Programme (SCP) scenario**
S2	8.6	6.5	3.0	1.3
of which:				
Initial budgetary position (IBP)	1.7	-0.4	0.8	-0.9
Long-term cost of ageing (CoA)	6.9	6.9	2.2	2.2
of which:				
Pensions	4.8	4.8	1.0	1.1
Health care	0.8	0.8	0.9	0.8
Long-term care	1.0	1.0	0.6	0.6
Others	0.2	0.2	-0.4	-0.3
S1 (required adjustment)*	4.2	1.3	2.2	0.5
of which:				
Initial budgetary position (IBP)	2.4	-0.5	0.0	-1.8
Debt requirement (DR)	0.4	0.2	1.9	1.9
Long-term cost of ageing (CoA)	1.4	1.6	0.3	0.4
S0 (risk for fiscal stress)**	0.23		:	
Debt, % of GDP (2012)	54.1		87.0	
Age-related expenditure, % of GDP (2012)	23.8		25.8	

Note:
The 'No-policy change' scenario depicts the sustainability gap under the assumption that the budgetary position evolves according to the Commissions' spring 2013 forecast until 2014. The 'Programme (SCP)' scenario depicts the sustainability gap under the assumption that the budgetary plans in the programme are fully implemented.
* The required adjustment of the primary balance until 2020 to reach a public debt of 60% of GDP by 2030.
** The critical threshold for the S0 indicator is 0.44.

Source :
Commission services; 2013 stability programme.

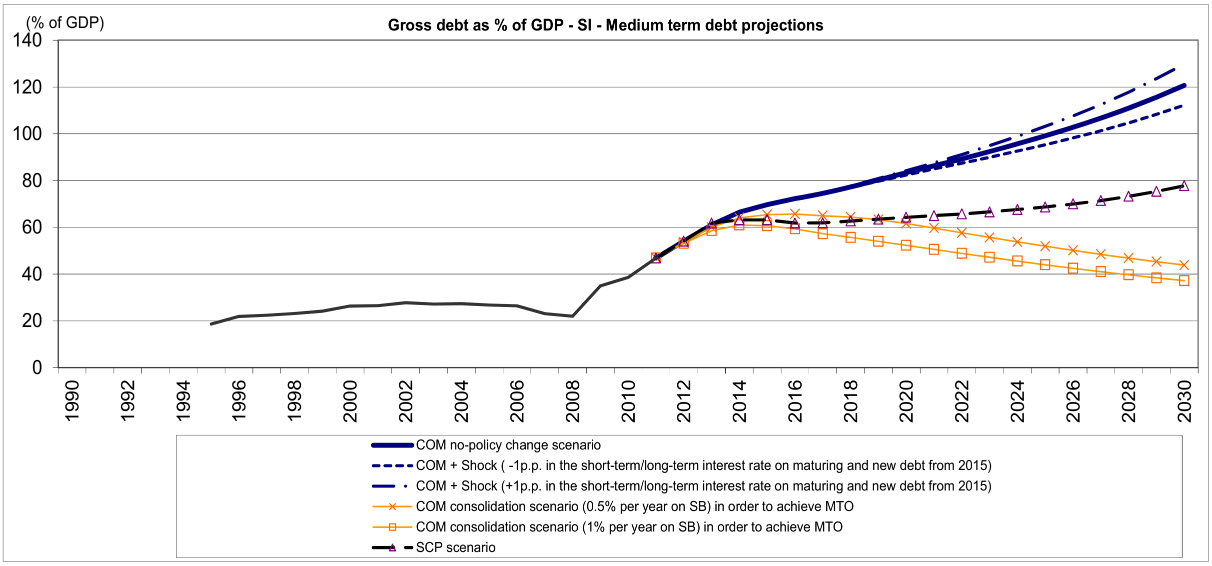

Table VI. Taxation indicators

	2002	2006	2008	2009	2010	2011
Total tax revenues (incl. actual compulsory social contributions, % of GDP)	37.8	38.3	37.3	37.3	37.8	37.2
Breakdown by economic function (% of GDP)[1]						
Consumption	13.7	13.2	13.4	14.0	14.3	14.0
of which:						
- VAT	8.5	8.5	8.5	8.4	8.6	8.4
- excise duties on tobacco and alcohol	0.9	1.1	1.1	1.3	1.3	1.4
- energy	2.6	2.3	2.3	2.9	3.0	2.8
- other (residual)	1.6	1.3	1.5	1.4	1.4	1.3
Labour employed	19.8	19.4	18.5	18.6	18.7	18.4
Labour non-employed	0.7	0.7	0.6	0.8	0.9	0.9
Capital and business income	2.8	4.3	4.0	3.2	3.2	3.1
Stocks of capital/wealth	0.9	0.9	0.9	0.9	0.9	0.9
p.m. Environmental taxes[2]	3.3	3.0	3.0	3.5	3.6	3.4
VAT efficiency[3]						
Actual VAT revenues as % of theoretical revenues at standard rate	64.4	67.6	68.3	62.7	63.0	60.0

Note:

[1] Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2013) Taxation trends in the European Union, for a more detailed explanation.

[2] This category comprises taxes on energy, transport and pollution and resources included in taxes on consumption and capital.

[3] The VAT efficiency is measured via the VAT revenue ratio. The VAT revenue ratio is defined as the ratio between the actual VAT revenue collected and the revenue that would theoretically be raised if VAT was applied at the standard rate to all final consumption. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). See European Commission (2012), Tax reforms in EU Member States, European Economy 6/2012 and Taxation Papers 34/2012 for a more detailed explanation.

Source: Commission

Table VII. Financial market indicators

	2008	2009	2010	2011	2012
Total assets of the banking sector (% of GDP)	131.6	150.2	148.8	144.9	143.2
Share of assets of the five largest banks (% of total assets)	59.1	59.7	59.3	59.3	…
Foreign ownership of banking system (% of total assets)	30.8	29.1	…	…	…
Financial soundness indicators:					
- non-performing loans (% of total loans)[1)]	4.2	5.8	8.2	11.8	15.0
- capital adequacy ratio (%) [1)]	11.7	11.7	11.3	11.9	11.9
- return on equity (%) [1)]	8.1	3.9	-2.2	-11.7	-2.5
Bank loans to the private sector (year-on-year % change)	17.3	2.3	1.6	-2.3	-4.1
Lending for house purchase (year-on-year % change)	23.0	16.0	18.4	6.2	1.8
Loan to deposit ratio	162.8	159.0	157.2	149.3	143.5
CB liquidity as % of liabilities	2.7	4.5	1.4	3.8	8.5
Banks' exposure to countries receiving official financial assistance (% of GDP)	…	…	…	…	…
Private debt (% of GDP)	84.6	91.6	94.0	90.0	87.0
Gross external debt (% of GDP)[2)]					
- Public	10.0	18.5	22.8	24.0	24.7
- Private	37.6	38.8	39.6	41.5	43.4
Long term interest rates spread versus Bund (basis points)*	0.6	1.2	1.1	2.4	4.3
Credit default swap spreads for sovereign securities (5-year)*	…	…	…	…	…

Notes:

[1)] Latest data (September 2012).

[2)] Latest data 2012Q3.

* Measured in basis points.

Source :

Bank for International Settlements and Eurostat (exposure to macro-financially vulnerable countries), IMF (financial soundness indicators), Commission (long-term interest rates), World Bank (gross external debt) and ECB (all other indicators).

Table VIII. Labour market indicators

Labour market indicators	2007	2008	2009	2010	2011	2012
Employment rate (% of population aged 20-64)	72.4	73.0	71.9	70.3	68.4	68.3
Employment growth (% change from previous year)	3.3	2.6	-1.8	-2.2	-1.6	-1.3
Employment rate of women (% of female population aged 20-64)	67.1	68.5	67.9	66.5	64.8	64.6
Employment rate of men (% of male population aged 20-64)	77.5	77.4	75.6	74.0	71.8	71.8
Employment rate of older workers (% of population aged 55-64)	33.5	32.8	35.6	35.0	31.2	32.9
Part-time employment (% of total employment, 15 years and more)	9.3	9.0	10.6	11.4	10.4	9.8
Part-time employment of women (% of women employment, 15 years and more)	11.3	11.4	13.2	14.7	13.3	13.1
Part-time employment of men (% of men employment, 15 years and more)	7.7	7.1	8.4	8.6	7.9	7.0
Fixed term employment (% of employees with a fixed term contract, 15 years and more)	18.5	17.4	16.4	17.3	18.2	17.1
Transitions from temporary to permanent employment	4.6	3.5	3.5	4.0	3.1	:
Unemployment rate1 (% of labour force, age group 15-74)	4.9	4.4	5.9	7.3	8.2	8.9
Long-term unemployment rate2 (% of labour force)	2.2	1.9	1.8	3.2	3.6	4.3
Youth unemployment rate (% of youth labour force aged 15-24)	10.1	10.4	13.6	14.7	15.7	20.5
Youth NEET rate (% of population aged 15-24)	6.7	6.5	7.5	7.1	7.1	9.3
Early leavers from education and training (% of pop. 18-24 with at most lower sec. educ. and not in further education or training)	4.1	5.1	5.3	5.0	4.2	4.4
Tertiary educational attainment (% of population 30-34 having successfully completed tertiary education)	31.0	30.9	31.6	34.8	37.9	39.2
Formal childcare (from 1 to 29 hours; % over the population less than 3 years)	3.0	4.0	4.0	4.0	3.0	:
Formal childcare (30 hours or over; % over the population less than 3 year)	27.0	27.0	27.0	33.0	34.0	:
Labour productivity per person employed (annual % change)	3.5	0.8	-6.1	3.5	2.2	-1.1
Hours worked per person employed (annual % change)	-0.8	0.9	0.0	0.3	-1.6	-0.6
Labour productivity per hour worked (annual % change; constant prices)	4.3	-0.1	-6.1	3.1	3.9	-0.5
Compensation per employee (annual % change; constant prices)	1.9	2.9	-1.7	5.0	0.6	-0.8
Nominal unit labour cost growth (annual % change)	2.6	6.4	8.5	0.4	-0.6	0.7
Real unit labour cost growth (annual % change)	-1.6	2.1	4.7	1.5	-1.6	0.3

Expenditure on social protection benefits (% of GDP)	2006	2007	2008	2009	2010
Sickness/Health care	7.12	6.67	7.02	7.78	7.86
Invalidity	1.88	1.69	1.64	1.76	1.76
Old age and survivors	10.10	9.73	9.61	10.89	11.24
Family/Children	1.90	1.73	1.78	2.09	2.16
Unemployment	0.61	0.43	0.38	0.59	0.67
Housing and Social exclusion n.e.c.	0.02	0.01	0.01	0.01	0.01
Total	22.17	20.74	20.87	23.64	24.27
of which: means tested benefits	2.02	1.79	1.77	2.02	0.00
Social inclusion indicators	**2007**	**2008**	**2009**	**2010**	**2011**
At-risk-of-poverty or social exclusion[1] (% of total population)	17.1	18.5	17.1	18.3	19.3
At-risk-of-poverty or social exclusion of children (% of people aged 0-17)	14.7	15.3	15.1	15.2	17.3
At-risk-of-poverty or social exclusion of elderly (% of people aged 65+)	22.4	24.4	23.3	22.8	24.2
At-Risk-of-Poverty rate[2] (% of total population)	11.5	12.3	11.3	12.7	13.6
Severe Material Deprivation[3] (% of total population)	5.1	6.7	6.1	5.9	6.1
Share of people living in low work intensity households[4] (% of people aged 0-59)	7.2	6.7	5.6	6.9	7.6
In-work at-risk-of poverty rate (% of persons employed)	4.7	5.1	4.8	5.3	6.0
Impact of social transfers (excluding pensions) on reducing poverty	50.2	46.5	48.6	47.5	43.8
Poverty thresholds, expressed in national currency at constant prices[5]	5944	6299	6501	6376	6385
Gross disposable income (households)	21359	22911	23060	23340	23663
Relative median poverty risk gap (60% of median equivalised income, age: total)	19.4	19.3	20.2	20.2	19.9

Notes:

[1] People at-risk-of poverty or social exclusion (AROPE): individuals who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in household with zero or very low work intensity (LWI).

[2] At-risk-of poverty rate (AROP): share of people with an equivalised disposable income below 60% of the national equivalised median income.

[3] Share of people who experience at least 4 out of 9 deprivations: people cannot 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: share of people aged 0-59 living in households where the adults (excluding dependent children) work less than 20% of their total work-time potential during the previous 12 months.

[5] For EE, CY, MT, SI, SK, thresholds in nominal values in Euros; HICP - index 100 in 2006 (2007 survey refers to 2006 incomes)

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

Table IX. Product market performance and policy indicators

Performance indicators	2003-2007	2008	2009	2010	2011	2012
Labour productivity[1] total economy (annual growth in %)	4.1	0.8	-6.1	3.5	2.2	-1.1
Labour productivity[1] in manufacturing (annual growth in %)	6.9	0.7	-8.5	14.4	3.7	0.7
Labour productivity[1] in electricity, gas, steam and air conditioning supply (annual growth in %)	4.4	3.2	-8.1	1.1	-3.4	n.a.
Labour productivity[1] in the construction sector (annual growth in %)	3.6	-6.5	-14.1	-9.2	1.2	-3.7
Total number of patent[2] applications per million of labour force	101.5	133.3	143.0	158.8	n.a.	n.a.
Policy indicators	**2003-2007**	**2008**	**2009**	**2010**	**2011**	**2012**
Enforcing contracts[3] (days)	1386	1350	1290	1290	1290	1290
Time to start a business[3] (days)	60	19	6	6	6	6
R&D expenditure (% of GDP)	1.4	1.7	1.9	2.1	2.5	n.a.
Tertiary educational attainment (% of 30-34 years old population)	26.5	30.9	31.6	34.8	37.9	39.4
Total public expenditure on education (% of GDP)	5.63	5.20	5.66	5.66	n.a.	n.a.
	2007	**2008**	**2009**	**2010**	**2011**	**2012**
Product market regulation[4], Overall (Index; 0=not regulated; 6=most regulated)	n.a.	1.5	n.a.	n.a.	n.a.	n.a.
Product market regulation[4], Retail (Index; 0=not regulated; 6=most regulated)	n.a.	0.9	n.a.	n.a.	n.a.	n.a.
Product market regulation[4], Network Industries[5] (Index; 0=not regulated; 6=most regulated)	2.7	n.a.	n.a.	n.a.	n.a.	n.a.

Notes:

[1] Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.

[2] Total number of patent applications to the European Patent Office (EPO) per million of labour force

[3] The methodologies, including the assumptions, for this indicator are presented in detail on the website http://www.doingbusiness.org/methodology.

[4] The methodologies of the product market regulation indicators are presented in detail on the website http://www.oecd.org/document/1/0,3746,en_2649_34323_2367297_1_1_1_1,00.html. The latest available product market regulation indicators refer to 2003 and 2008, except for Network Industries.

[5] Aggregate Energy, Transport and Communications Regulation (ETCR).

*figure for 2007.

Source:
Commission, World Bank - *Doing Business* (for enforcing contracts and time to start a business) and OECD (for the product market regulation indicators).

Table X. Green Growth

		2002-2006	2007	2008	2009	2010	2011
Green Growth performance							
Macroeconomic							
Energy intensity	kgoe / €	0.29	0.25	0.26	0.26	0.26	0.26
Carbon intensity	kg / €	0.81	0.71	0.71	0.70	0.69	n.a.
Resource intensity (reciprocal of resource productivity)	kg / €	1.53	1.64	1.40	1.25	n.a.	n.a.
Waste intensity	kg / €	n.a.	n.a.	0.17	n.a.	0.18	n.a.
Energy balance of trade	% GDP	-3.9%	-4.7%	-6.3%	-4.0%	-5.1%	-6.3%
Energy weight in HICP	%	n.a.	13	13	12	14	14
Difference between change energy price and inflation	%	n.a.	0.2	8	-5.1	11.5	7.8
Environmental taxes over labour taxes	ratio	15.7%	15.9%	15.7%	18.5%	18.3%	n.a.
Environmental taxes over total taxes	ratio	8.4%	8.0%	8.1%	9.6%	9.5%	n.a.
Sectoral							
Industry energy intensity	kgoe / €	0.23	0.20	0.19	0.18	0.18	n.a.
Share of energy-intensive industries in the economy	% GDP	13.8	13.4	13.3	12.1	n.a.	n.a.
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.09	0.10	0.10	0.10	0.10
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	0.03	0.04	0.04	0.04	0.05
Public R&D for energy	% GDP	n.a.	0.01%	0.01%	0.01%	0.01%	0.03%
Public R&D for the environment	% GDP	n.a.	0.01%	0.02%	0.02%	0.02%	0.02%
Recycling rate of municipal waste	ratio	31.5%	40.3%	38.0%	39.9%	47.0%	n.a.
Share of GHG emissions covered by ETS*	%	n.a.	43.7%	41.4%	41.5%	41.7%	41.0%
Transport energy intensity	kgoe / €	n.a.	0.78	0.86	0.82	n.a.	n.a.
Transport carbon intensity	kg / €	n.a.	2.32	2.57	2.48	n.a.	n.a.
Security of energy supply							
Energy import dependency	%	n.a.	52.5%	55.1%	48.1%	49.4%	48.3%
Diversification of oil import sources	HHI	n.a.	0.25	0.23	0.25	0.21	n.a.
Diversification of energy mix	HHI	n.a.	0.24	0.26	0.25	0.24	0.24
Share renewable energy in energy mix	%	n.a.	10.0%	11.0%	14.2%	14.6%	13.0%

Country-specific notes:

The year 2012 is not included in the table due to lack of data.

General explanation of the table items:

Source: Eurostat unless indicated otherwise; ECFIN elaborations indicated below

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 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

Energy weight in HICP: the share of the "energy" items in the consumption basket used in the construction of the HICP

Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual %-change)

Environmental taxes over labour or total taxes: from DG TAXUD'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)

Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP

Electricity and gas prices medium industrial users: consumption band 500 - 2000MWh and 10000 - 100000 GJ; figures excl. VAT.

Recycling rate of municipal waste: ratio of municipal waste recycled over total municipal waste

Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP

Share of GHG emissions covered by ETS: based on greenhouse gas emissions as reported by Member States to EEA (excl LULUCF)

Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transp industry gross value added (2005 EUR)

Transport carbon intensity: greenhouse gas 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. energy consumption international bunkers

Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin

Diversification of the energy mix: Herfindahl Index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels

Share renewable energy in energy mix: %-share in gross inland energy consumption, expressed in tonne oil equivalents

*Provisional data (15 April 213). Commission Services and EEA.

** For 2007 average of S1 & S2 for DE, LU, NL, FI, SE & UK. Other countries only have S2.

*** For 2007 average of S1 & S2 for IT, NL, FI, SE & UK. Other countries only have S2.