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Subject:	Slovenia's Stability Programme 2014

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Delegations will find attached Slovenia's Stability Programme for 2014 in English.

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GOVERNMENT OF THE REPUBLIC OF SLOVENIA

## STABILITY PROGRAMME

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*AMENDMENTS 2014*

Ljubljana, April 2014

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## INTRODUCTION

The Stability Programme is a **medium-term plan of the Government of the Republic of Slovenia** regarding measures to achieve the fiscal policy goals. This document, together with the National Reform Programme, is the basis for the preparation and implementation of economic policy measures, enabling the achievement of the economic and fiscal goals of the country.

The Stability Programme for 2014 has been prepared within the framework of the European Semester. The Stability Programme is in conformity with the Council Recommendation to Slovenia of 30 November 2009 (1570/09) with a view to eliminating the excessive government deficit, and takes into account the Council Recommendation of 13 July 2010 on broad guidelines for the economic policies of the Member States and of the Union (2010/410/EU), the Council Recommendation of 19 June 2013 on Slovenia's 2013 National Reform Programme, and the Council opinion on the updated Stability Programme of Slovenia for the period 2013–2016. The document has been drawn-up in compliance with Council Regulation No. 1466/97, which sets out the rules covering the content of Stability Programmes and amendments (Regulation No. 1055/2005 and Regulation No. 1175/2011).

Slovenia has been formally in an excessive deficit procedure since 2 December 2009. In line with the recommendations made by the EU Council in June 2013, Slovenia has to reduce the general government deficit below 3% of GDP by 2015. The Stability Programme contains policies and measures adopted for attaining this goal, to be followed by further fiscal consolidation until a permanent structural balance is achieved, in compliance with the preventive arm of the Stability and Growth Pact (Regulation 1466/97 and amendments) and the international Treaty on Stability, Coordination and Governance in the Economic and Monetary Union.

## 1. ECONOMIC POLICY FRAMEWORK AND GOALS

In the years 2014–2015, the Slovenian Government will continue with and enhance the implementation of measures and activities aimed at promoting economic growth and increasing the welfare of the population. The following priorities are crucial for attaining these goals:

- **Fiscal stability** by achieving a structurally balanced budget by 2017;
- **Increasing employment** to an active working population of 850,000.

This year, Slovenia will achieve 0.5% economic growth and in 2015 0.7% economic growth, based on the further strengthening of export growth and stabilisation of household consumption. The increase in investments at the end of 2013 has had a significant impact in terms of this year's higher level of economic activity, thus paving the ground for the gradual elimination of macroeconomic imbalances, primarily for once again achieving economic growth and creating jobs. In order to boost economic growth, Slovenia will give priority to the implementing measures set out **in the three key pillars** described in the National Reform Programme:

- **Financial pillar:**
  - Recovery of the banking system
  - Corporate deleveraging and restructuring
  - Insolvency
- **Corporate governance and privatisation**
  - Slovenian Sovereign Holding (SSH)
  - Ongoing privatisation
- **Fiscal pillar**
  - The fiscal rule
  - Medium-term fiscal planning.
  - Long-term fiscal sustainability and consolidation.

Equally important are the measures for **reviving economic growth in the short term** through the process of restructuring the banking and corporate sectors and improving competitiveness for long-term sustainable growth.

**The goals of Slovenia's fiscal policy** for 2014 and 2015 comply with the requirements and recommendations of the European Council based on the commitments under the Stability and Growth Pact, and in accordance with the Excessive Deficit Procedure (EDP). In order to achieve this scenario with medium-term fiscal effort, the strategy sets out a combination of economic policy and structural and institutional changes. The changes must reflect measures of a permanent and structural nature while also taking into account the fiscal risks involved.

Slovenia will pursue its fiscal target of achieving a general government deficit of 3.2% of GDP in 2014 and 2.4% in 2015, excluding any one-off expenditure. Recapitalisations of banks in the amount of 0.9% of GDP is planned in 2014 and this in fact entails the completion of or is due to the delay in the process of recapitalisation from 2013. By taking into account this expenditure, Slovenia will achieve a general government deficit of 4.1% of GDP in 2014. Further reduction of the general government deficit to 2.4% of GDP is planned for 2015.

Due to fiscal policy measures, Slovenia plans to achieve the required improvement in the general government structural balance and the medium-term fiscal objective. The cyclically-adjusted general government balance, excluding the impacts of the economic cycle and one-off measures, will decline by an average of 0.48% of GDP annually in the programming period 2014–2017, whilst the annual fiscal effort will be within the framework of adopted commitments (0.6% of GDP in 2013 without one-off effects, 0.5% of

GDP in 2014, and 0.5% of GDP in 2015). The fiscal effort in 2012 was 2% and its average for 2012 to 2015 amounts to 0.7%. The general government primary balance net of all interest costs will still be negative in 2014, amounting to 0.7% of GDP, but from 2015 onwards it will be positive and will significantly improve over the programming period, achieving a 3.3% surplus in 2018.

The achievement of fiscal goals in the years 2014–2015 was aggravated by the decision of the Constitutional Court abrogating the tax on real property. The Government intends to improve the contested provisions of the law and propose the tax again in the next period. Following this decision of the Constitutional Court, the Government took immediate steps to adopt measures that would fully compensate for the loss of general government revenue: increased excise duties, higher revenue from the surpluses of state-owned enterprises, more efficient collection of taxes, and streamlining the operations of public funds and public institutes. Moreover, the Government has the possibility to adopt other measures that may limit general government expenditures if deviations from the set goals are detected.

Slovenia is counting on the favourable effects of measures adopted in the past years in the area of labour costs and social transfers, and in particular on increased tax revenues due to higher economic growth (higher VAT). A gradual transition from non-refundable to refundable funding is also expected to yield positive effects. A new round of negotiations with the public sector trade unions to limit labour costs and extend indexation-based measures is planned for 2015.

In 2013, Slovenia adopted the following measures to improve imbalances with effects over a number of years, which are being implemented intensively:

- Fiscal balance measures and constitutional amendments. According to the ESA 95 methodology, the general government deficit reached an estimated 4.4% of GDP in 2013 (14.7% of GDP – bank recapitalisation included) and the general government debt was estimated at 71.7% of GDP.
- The stabilisation of the banking system, the establishment of an environment for the restructuring of businesses, the Bank Assets Management Company (BAMC), (ensuring financial strength).
- Business restructuring is being carried out intensively under the combination of a harmonised process and adopted legislation between banks, the BAMC and the Bank of Slovenia.
- Full BAMC functionality has been ensured in cooperation with independent experts.
- The effects of the pension reform and labour market reform are visible and some new measures are being prepared (the rationalisation of the healthcare system).
- Improvement of the business environment (increased efficiency of judicial proceedings, initiation of privatisation processes, reduced administrative barriers).

The recapitalisation of the banks significantly increased the general government debt, which at the end of 2013 amounted to 71.7% of GDP. In 2014, the general government debt will continue to increase due to new borrowing and pre-financing needs, and is estimated to amount to 80.9% of GDP. After 2015, the general government debt will cease to increase, with its share in GDP decreasing to 70.4% by the end of the programming period. The increase in the general government debt-to-GDP ratio is mostly due to primary deficits and the recapitalisation of the banks. The anticipated dynamics of the debt-to-GDP ratio does not take into account the potential use of proceeds from the privatisation of state-owned property for a further reduction in overall government debt, which represents a positive risk to debt stability in the programming period.

## **2. ECONOMIC TRENDS AND FORECASTS OF MACROECONOMIC AGGREGATES**

### **2.1. Assumptions regarding the international environment**

Macroeconomic forecasts in the Stability Programme are based on the Spring Forecast of Economic Trends 2014 (IMAD, March 2014). The assumptions regarding the international environment taken into account in

the Spring Forecast of Economic Trends 2014 are based on the forecasts released by international institutions in February (Table 2.1). The strengthening of economic activity in the main trading partners in the euro area will gradually increase this year and the following year. The ECB and the European Commission (Winter Forecast 2014) foresee that economic growth in the euro area and the EU will gradually strengthen this year and next year due to the expected increase in companies' confidence in an environment of reduced uncertainty, the gradual improvement of access to sources of funding, and a relatively less restrictive fiscal policy. Exports will remain an important factor in the recovery and the contribution of domestic consumption will gradually increase as well. The forecasts of international institutions with regard to economic growth in the majority of the main trading partners for this year and next year are higher than they were at the time last year's Stability Programme was being drawn up. Expectations are slightly lower only with regard to the countries of the former Yugoslavia and the former Soviet Union. Technical assumptions consistent with the expectations of international institutions have been taken into consideration with regard to the prices of raw materials.<sup>1</sup>

**Table 2.1: Assumptions of the Spring Forecast of Economic Trends 2014 (IMAD) for economic growth in Slovenia's main trading partners, 2014–2016**

	2012	2013	2014	2015	2016
			Spring forecast (March 2014)		
EU	-0.4	0.1	1.5	2.0	2.0
Euro area	-0.7	-0.4	1.2	1.8	1.8
Germany	0.7	0.4	1.8	2.0	2.0
Italy	-2.4	-1.9	0.6	1.2	1.2
Austria	0.9	0.3	1.5	1.8	1.8
France	0.0	0.2	1.0	1.7	1.7
United Kingdom	0.3	1.9	2.5	2.4	2.4
Czech Republic	-1.0	-0.9	1.8	2.2	2.2
Hungary	-1.7	1.1	2.1	2.1	2.1
Poland	1.9	1.6	2.9	3.1	3.1
Croatia	-1.9	-1.0	0.5	1.2	1.2
Bosnia and Herzegovina	-0.5	1.0	1.5	2.5	2.5
Serbia	-1.5	2.4	1.3	2.2	2.2
USA	2.8	1.9	2.9	3.2	3.2
Russia	3.4	1.3	2.3	2.7	2.7

Source: Eurostat (for 2012 and 2013); Consensus Forecasts, February 2014; Eastern Consensus Forecasts, February 2014; EC Winter Forecast, February 2014; IMF World Economic Outlook Update, January 2014; IMAD estimate.

The assumptions for the international environment in the Stability Programme, which arise from the Spring Forecast of Economic Trends 2014, rely on the forecasts by international institutions released by the end of February 2014, in particular the European Commission's Winter forecast. In the key assumption, i.e. the expected GDP trend in the euro area in 2014, IMAD's Spring Forecast takes account of the European Commission's Winter Forecast, with minimum differences in the exchange rate (USD 1.36 per euro).<sup>2</sup> At the time when the forecast was made, the common assumptions of the European Commission for the preparation of Stability and Convergence Programmes were not yet available. Now that they have been

<sup>1</sup> The Spring forecast is based on the technical assumption that the average of this year's and next year's crude oil prices will fall slightly following last year's decline. In the first two months of this year, the price of Brent crude averaged 108.5 USD/barrel, whilst the average for the year will amount to 104 USD/barrel. In the next two years it should settle at 100 USD/barrel, in accordance with assumptions. Dollar prices of non-energy raw materials should again fall this year, following last year's 1.2% decline, while they are expected to increase slightly in the next two years. The assumption of the euro exchange rate against the U.S. dollar is USD 1.366 for EUR 1, using the average exchange rate value in February this year.

<sup>2</sup> The Commission's assumption is based on an exchange rate of USD 1.36 per euro, while IMAD's assumption is based on currency movements for the entire month of February (USD 1.366 per euro).

released, it can be seen that there is no difference between them and the assumptions in the Stability Programme.

**Table 2.2: Assumptions for the international environment**

	2012	2013	2014	2015	2016
<b>USD/EUR exchange rate (annual average) (euro area and ERM II countries)<sup>1</sup></b>	1.286	1.328	1.365	1.366	1.366
<b>Nominal effective exchange rate</b>	-1.2	1.0	0.6	0.0	0.0
<b>EU GDP growth</b>	-0.4	0.1	1.5	2.0	2.0
<b>Growth of relevant foreign markets</b>	-0.3	3.3	5.5	6.4	6.6
<b>Crude oil price (Brent crude, USD/barrel)</b>	111.7	108.6	104.0	100.0	100.0

Source: IMAD, Spring Forecast 2014. Notes: <sup>1</sup> For the years 2014–2016: Technical assumption based on the average exchange rate in February 2014; <sup>2</sup> Germany, France, Italy, Austria, Hungary, Poland, the Czech Republic, Slovakia, the United Kingdom, the USA, weighted by the shares of these countries in Slovenia's exports.

## 2.2. Cyclical developments and short-term prospects

Given the reduced uncertainty in the international and domestic environments, IMAD expects that due to further strengthening of export growth and a slow-down in the drop in household consumption, the gross domestic product this year will increase by 0.5%. The positive developments in the last quarter of the previous year have had a significant impact on this year's higher level of economic activity. The strengthening of economic activity in the main trading partners will accelerate this year, which will have a positive impact on export growth.

The increased growth in exports of goods will result from accelerated growth of exports to the main EU trading partners. The growth in exports to non-EU countries, which increased relatively more rapidly in 2011 and 2012, will remain at a similar level as last year and will continue to be based primarily on exports to Russia. In terms of technological complexity, a further increase in the growth of exports of more technology-intensive products, in particular medicinal and pharmaceutical products, is expected. The expected increase in this year's total export growth will also be boosted by the export of road vehicles.<sup>3</sup> Moreover, the export trend of less technology-intensive activities will be more favourable than last year and growth in the export of commodities associated with the re-export of imported products (mainly oil and petroleum products, electricity, cars) will continue. Growth in the export of services will be similar to last year with a slightly modified structure. Growth in the export of business services, mostly agency services and other trade-related services, and the export of construction services will slow down, while the export of transport and travel will strengthen.

In the domestic environment, the onset of the recovery of the banking system has enabled the government easier access to financing and has thus contributed to reducing uncertainties among business entities. IMAD expects less severe deterioration on the labour market than in the previous two years, which will result in a significantly lower reduction in private consumption with the improved mood of consumers. Private consumption will fall by 0.4% this year, since consumers are expected to remain cautious in their purchases while the adverse conditions in the labour market continue, although their disposable income is expected to remain at a similar level as last year. After an 8.6% real drop in the previous two years, disposable income this year will remain at a similar level as last year. Employee compensation, with a modest growth in the average gross wage and a further drop in the number of wage earners, will remain at a similar level as last year. Pensions will be slightly higher, primarily due to the continued growth in the number of pensioners. Given the continued high level of unemployment and the expected further drop in employment, it is expected that consumers will remain cautious, especially when deciding on large purchases. This trend is also indicated by various consumer mood indicators.

The continued fiscal consolidation will lead to further reductions in government spending (-1.5%). This year, the drop will be slightly lower than last year because of the expected lower decrease in employee compensation. The forecast takes into account the continuation of the restrictive policy in the area of employment and labour costs. The average gross wage will increase due to the payment of overdue

<sup>3</sup> In connection with the planned start of production of a new car model at Revcoz in the second half of the year.



remuneration for regular promotions from 2011 and 2012, while other expenditure connected with labour will significantly decrease.<sup>4</sup> As in the past year, the streamlining of expenditures on goods and services will continue and social benefits in kind will be also reduced.

This year, growth in investment activities is not expected, as funding sources will remain limited for the relatively highly indebted corporate sector. In preparing the forecasts, IMAD assumes that this year, despite the initiated rehabilitation of the banking system, the recovery of lending activities will not be visible as yet. Public investments related to the utilisation of EU funds will contribute to maintaining investments at a similar level as in the previous year. Due to still limited access to financing and high indebtedness, private construction and business investments will continue to decrease this year. In the area of construction investment, this trend is indicated by the data on the issued building permits and contracts signed in the construction sector, with poor expectations regarding business investments also being a result of continued low capacity utilisation.<sup>5</sup> The expected investment trend is also significantly affected by the schedule of an investment in a major energy facility, with the estimated value of works implemented this year similar to that of the last year.

In the period 2015-2018, economic activity is expected to increase largely due to the recovery in export demand, while domestic demand will start contributing more significantly to growth only in 2016. In 2015, GDP is expected to grow by 0.7% and will gradually rise above 1%, fluctuating around 1.7% in 2017 and 2018. The international environment is expected to see renewed growth these years, which will stimulate the growth of Slovenian exports. Total domestic consumption will increase slightly next year owing to the expected modest growth in private consumption and investment activity. Private consumption will be favourably affected by the expected stabilisation of the labour market conditions, while investment activity will be enhanced by the gradual strengthening of private investments under less adverse conditions in the banking system and increased production capacity utilisation due to increased domestic and foreign demand. It is expected that government consumption will continue to decline slightly in these years.

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<sup>4</sup> According to the agreement with the public sector trade unions, the amount of funds earmarked for the holiday bonus in 2014 will be considerably lower than in 2013, when, in addition to the reduced payment in accordance with the Fiscal Balance Act, back-pay for 2012 was also paid. Additionally, the reduction in premium payments for supplementary pension insurance throughout 2014 will have an effect on the reduction in other work-related expenditures.

<sup>5</sup> The utilisation of production capacities in processing industries slightly increased in the first quarter of 2014 (rising to 79.3%), but still remains below the multi-year average.

**Table 2.3: Economic growth and related indicators**

<i>Rate of change in %</i>	<b>ESA Code</b>	<b>Year 2013</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
		in EUR millions						
<b>1. Real GDP</b>	B 1 g		-1.1	0.5	0.7	1.3	1.7	1.7
<b>2. Nominal GDP</b>	B 1 g	35,275	-0.1	1.0	1.7	2.7	3.2	3.2
<b>Real GDP components</b>								
<b>3. Private consumption</b>	P3	19,749	-2.7	-0.4	0.7	1.8	1.8	1.8
<b>4. Government consumption</b>	P3	7,132	-2.0	-1.5	-0.9	-0.9	-0.9	-0.9
<b>5. Gross investments in fixed assets</b>	P51	6,304	0.2	-0.5	1.0	0.0	2.5	2.5
<b>6. Changes in inventories and net acquisition of valuables (% of GDP)</b>	P52+ P53	-263	-0.7	-0.5	-0.3	-0.2	-0.2	-0.1
<b>7. Exports of goods and services</b>	P6	27,566	2.9	4.2	4.8	5.2	5.3	5.3
<b>8. Imports of goods and services</b>	P7	25,213	1.3	3.5	5.2	5.3	5.3	5.4
<b>Contribution to real GDP growth (in percent)</b>								
<b>9. Domestic consumption</b>		32,922	-2.4	-0.4	0.6	0.9	1.3	1.3
<b>of which: Changes in inventories and net acquisitions of valuables</b>	P52+ P53	-263	-0.5	0.2	0.2	0.1	0.0	0.0
<b>10. External balance of goods and services</b>	B11	2,353	1.3	0.8	0.1	0.4	0.4	0.4

Source: SORS; IMAD, Spring Forecast 2014

The risk of lower than expected economic activity remains high; however, after such a prolonged period of time, there is also the possibility of higher than estimated economic growth (see point 4.1.).

In the 2014–2016 period, the current account of the balance of payments will record a relatively significant surplus. This year, the surplus will increase slightly (to 6.9% of GDP) due to factors similar to last year. The trade surplus in goods will increase further due to faster growth in exports than imports, and also due to better terms of trade. Following the expected gradual recovery in domestic consumption, its growth in the next two years will slow considerably. With the modest growth in the trade surplus in transport and travel services and the reduction in the trade deficit regarding other services, the trade surplus regarding services will continue to grow. This year, the surplus in current transfers will increase, particularly because of the plan to increase utilisation of European funds. In the next two years, the volume of such utilisation will again decrease slightly, and this trend will be mirrored in the surplus in the balance of current transfers. Following last year's decline, the deficit in factor income will increase this year and in the next two years. This will be mainly due to higher interests payments on external debt, where the volume of repayments by the general government will increase further as a consequence of increased borrowing. The increased deficit in factor income will be mitigated by still relatively high net income inflows from the work of daily migrant workers abroad.

**Table 2.4: Sectoral balances**

% of GDP	ESA Code	2013	2014	2015	2016	2017	2018
<b>Net lending / borrowing</b>	B.9	5.4	n.a.	n.a.	n.a.	n.a.	n.a.
Of which:							
<b>Import and export balance of goods and services</b>		7.6	8.6	8.8	9.1	9.5	<b>9.7</b>
<b>Balance of primary incomes and current transfers</b>		-1.4	-1.8	-2.4	-2.9	-3.3	<b>-3.9</b>
<b>Capital account</b>		-1.1	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Net deficit/surplus of the private sector</b>	B.9	20.0	n.a.	n.a.	n.a.	n.a.	n.a.
<b>Net deficit/surplus of the general government</b>	B.9	-14.7	-4.1	-2.4	-1.5	-0.7	0.3
<b>Statistical discrepancy</b>		n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Source: SURS, MF, Spring Forecast 2014, IMAD.

**Table 2.5: Labour market trends**

	2013 level	2013	2014	2015	2016	2017	2018
<b>Employment (number of employed)<sup>1</sup>, growth in %</b>	920.6	-2.0	-0.4	0.0	0.5	0.7	0.8
<b>Survey-based unemployment rate (number of unemployed), rate in %</b>	101.9	10.1	10.2	10.0	9.7	9.1	8.6
<b>Labour productivity (in EUR 1000 per employee)</b>	38.3	0.9	0.9	0.7	0.8	1.0	0.9
<b>Compensation of employees<sup>3</sup>, in EUR millions</b>	18,086	-2.3	0.2	1.2	2.5	3.0	3.1
<b>Compensation per employee<sup>3,4</sup>, in EUR 1000</b>	19,646	-0.3	0.6	1.1	2.0	2.2	4.3

Source: SORS, IMAD, Spring Forecast 2014

Notes: <sup>1</sup> Employed population, national accounts definition (domestic concept); <sup>2</sup> Real GDP is taken into account; <sup>3</sup> Nominal growth; <sup>4</sup> Full-time employed are taken into account.

With the modest growth in economic activity this year, the drop in employment will be lower than last year, and its recovery in the next two years will only be gradual because of the characteristic delay in the response of the market. This year the drop in employment will level off in most of the private sector, whereas the number of employees in the public services sector will increase slightly mostly due to new employments associated with alleviating the consequences of the weather-related disaster. At the beginning of the economic recovery, it is expected that companies will first increase the number of hours worked per employee and not the number of employees, while a faster improvement in labour market conditions will also hold back the needed restructuring of indebted companies. The average number of registered unemployed persons (124,600) this year will be slightly higher than last year, in particular owing to an increase in registered unemployment at the end of the last and the beginning of this year. For this reason, the rates of registered unemployment (13.6%) and survey-based unemployment (10.2%) will also be higher than last year. In the rest of the year, no significant deterioration is expected also due to the supplemental enhanced active employment policy programmes. In the next two years, stabilisation followed by a slow increase in employment is expected and the number of registered unemployed will decrease gradually.

The nominal average gross wage in the private sector and public services sector will increase modestly in this and the next two years. The gradual strengthening of private-sector wage growth in the 2014–2016 period will result from economic recovery and further growth in productivity, whereas faster growth will be impeded by continued high unemployment and low inflation. In the public service sector, the average nominal gross wage will rise for the first time after four years due to the payment of overdue remuneration for regular promotions from 2011 and 2012, with the carry-over effect also reflected in growth next year. Because of the limited public finances, restrictions in the growth of public sector wages will continue to apply for the next two years.

**Table 2.6: Price trends**

<i>Rate of change in %</i>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
<b>1. GDP deflator</b>	0.2	1.0	0.5	1.0	1.4	1.4	1.5
<b>2. Private consumption deflator</b>	1.6	0.9	0.0	0.8	1.2	1.3	1.4
<b>3. Consumer price index (annual average)</b>	2.6	1.8	0.3	1.1	1.5	1.6	1.7
<b>4. Government consumption deflator</b>	-1.4	-0.8	0.8	0.8	1.2	1.2	1.3
<b>5. Gross fixed capital formation deflator</b>	1.7	0.3	0.5	1.3	2.0	2.0	2.0
<b>6. Export price (goods and services)</b>	1.2	-0.3	0.2	0.5	1.6	1.5	1.5
<b>7. Import price (goods and services)</b>	2.2	-1.1	-0.1	0.3	1.6	1.5	1.5

Source: SORS, IMAD, Spring Forecast 2014

Assuming the further absence of price shocks from the international environment and a weak recovery in economic activity, inflation will remain low this year and for the next two years. In the period 2014–2016, the recovery of domestic consumption, particularly household consumption, will be weak and very gradual. This will not lead to any significant increase in consumer prices, so inflation will remain relatively low, i.e. well below 2%. Unlike in the previous two years, no measures that would have a significant impact on inflation are envisaged in the tax field. The assumption is that there will be no major price shocks in the international commodity markets this year and in the next two years.

### **2.3. Medium-term scenario**

The medium-term scenario of economic development in the Spring Forecast of Economic Trends is based on the assumption of stable development in the international environment and the adopted measures. In the period between 2013 and 2016, economic growth will average only 0.8%. The key economic activity factor will be exports, along with the expected gradual acceleration of economic recovery in the main trading partners. Gradual improvement in the domestic consumption trend is expected, which will have a positive impact on GDP in 2015, the first time since the beginning of the crisis. The scenario foresees that, given successful consolidation, the maintenance of the deficit within the set limits, and the stabilisation of the banking system, the conditions for financing the government and, indirectly, the private sector, will be relatively stable in the subsequent years (2017–2018). This will have a positive impact on overall economic activity and the potential for renewed faster economic growth, expected to average around 1.7% in the years 2017–2018.

As a result of weak economic activity and the planned restrictive wage and recruitment policy in the public sector, the situation on the labour market will continue to deteriorate in the short term. However, with a return to economic growth and the planned measures to promote competitiveness, new possibilities for job creation will open up towards the end of the programming period, which will be reflected in a reversal in the developments in employment and unemployment, although unemployment will remain higher than in the years before the economic crisis.

**Table 2.7: Key macroeconomic indicators for the period until 2018**

	Spring forecast	
	2014–2016	2017–2018
<b>Gross domestic product, real growth in %</b>	0.8	1.7
Exports of goods and services	4.8	5.3
Imports of goods and services	4.7	5.3
Private consumption	0.7	1.8
Government consumption	-1.1	-1.0
Gross fixed capital formation	0.2	2.5
<b>Employment</b> (number of employed), growth in %	0.0	0.8
<b>Registered unemployment rate (in %)</b>	13.4	12.3
<b>Survey-based unemployment rate (in %)</b>	10.0	8.9
<b>Average number of registered unemployed in thousands</b>	122.3	112.5
<b>Inflation, annual average</b>	1.0	1.7

Source: IMAD, Spring Forecast 2014, March 2013

### 3. GENERAL GOVERNMENT BALANCE AND DEBT

After a period of higher general government deficit during the period of reduced economic activity due to the operation of automatic stabilisers and discretionary measures in the period 2009–2011, Slovenia has been implementing an active fiscal balance policy based on expenditure and revenue measures since 2012, and has maintained the general government deficit, in spite of the slow economic recovery in 2013, at the level of 4.4% of GDP – excluding the bank recapitalisation, or 14.7% including the bank recapitalisation.

In December 2009, the EU Council established the existence of an excessive government deficit in Slovenia and made recommendations for its elimination. Although Slovenia, according to the conclusions of the European Commission, successfully implemented the fiscal balance measures, the European Commission adopted a new recommendation in June 2013, extending Slovenia's deadline for reducing the excessive deficit to 2015 due to the deterioration of the macroeconomic situation.<sup>6</sup>

The EU Council recommended that Slovenia should:

- implement fiscal consolidation measures in 2014–2015 as planned;
- ensure a fiscal effort (i.e. decrease the structural deficit) amounting to 0.7% of GDP in 2013 and 0.5% of GDP in 2014 and 2015;
- determine measures to reduce the excessive deficit by 2015.

Pursuant to the European Union's provisions<sup>7</sup>, Slovenia will also address the excessive debt, so that immediately following the end of the excessive deficit procedure it will be committed to bringing its debt below 60% of GDP, as required by the Stability and Growth Pact.

The goals of Slovenia's fiscal policy for 2014 and 2015 comply with the requirements and recommendations of the European Council within the frame of the commitments under the Stability and Growth Pact, and are in accordance with the excessive deficit procedure.

<sup>6</sup> [http://ec.europa.eu/economy\\_finance/economic\\_governance/sgp/pdf/30\\_edps/126-07\\_council/2013-06-21\\_si\\_126-council\\_en.pdf](http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/30_edps/126-07_council/2013-06-21_si_126-council_en.pdf).

<sup>7</sup> Treaty on Stability, Coordination and Governance in the Economic and Monetary Union, Article 4.

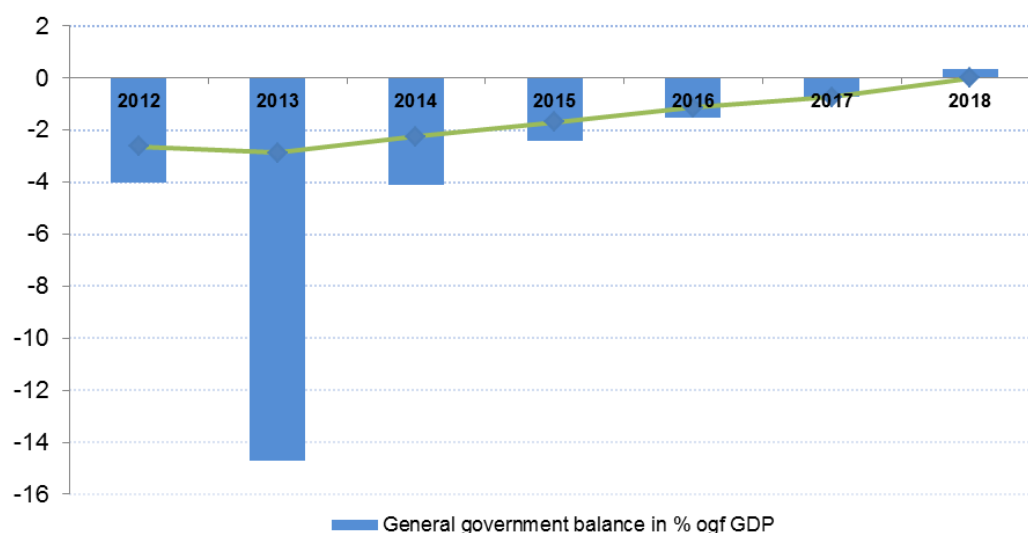
### 3.1. Public finance strategy, elimination of the excessive deficit, and medium term objective

The general government deficit, which was approximately 6% of GDP in the period 2009–2011, was reduced in 2012 to an estimated 4% of GDP by means of greater fiscal effort, while in 2013 it amounted to 4.4% of GDP (bank recapitalisation excluded). However, in 2012 the large fiscal effort with its raft of implemented measures had an additional negative effect on economic activity. Forecasts for the programming period show a revival of economic growth in 2014, which, however, will not exceed 1.7% of GDP by the end of the programming period, which subsequently puts pressure on the general government deficit and debt.

**Slovenia plans to further reduce the general government deficit** to 3.2% of GDP in 2014 – bank recapitalisation excluded, or to 4.1% of GDP – bank recapitalisation included. Recapitalisations of banks in the amount of 0.9% of GDP is planned in 2014 and in fact entails the completion of or is due to the delay in the process of recapitalisation from 2013. A further improvement in the general government deficit to 2.4% of GDP is planned for 2015. Due to fiscal policy measures, Slovenia plans to achieve the required improvement in the general government structural balance and the medium-term fiscal target.

**The cyclically-adjusted general government balance**, excluding the impacts of the economic cycle and one-off measures, will decline by an average of 0.48% of GDP annually in the programming period 2014–2017, whilst the fiscal effort will remain within the framework of adopted commitments (0.6% of GDP in 2013 without one-off effects, 0.5% of GDP in 2014, and 0.5% of GDP in 2015). The fiscal effort in 2012 was 2% and the average for 2012–2015 amounts to 0.7%.

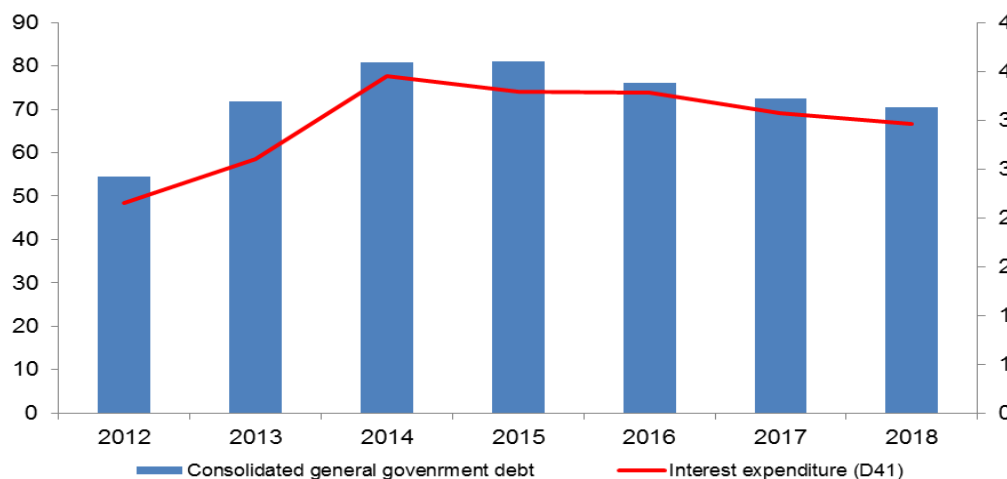
**Figure 3.1: General government balance and cyclically-adjusted general government balance, ESA95, as a % of GDP**



Source: Ministry of Finance

**The general government primary balance** net of all interest costs, will still be negative in 2014, amounting to 0.7% of GDP, but from 2015 onwards it will be positive and will significantly improve over the programming period, achieving an estimated 3.3% surplus in 2018. Annual debt interest charges for Slovenia amount to close to 3% of GDP.

**Figure 3.2: General government debt and interest payments, as a % of GDP**



Source: Ministry on Finance

In order to correct the excessive deficit in a sustainable manner, Slovenia strengthened its strategy for fiscal balance in 2013. It introduced additional measures in the area of wages and labour costs in the public sector, and limited the increase in pensions and social transfers. Its fiscal policy will also focus on measures aimed at increasing general government revenue. The key measures were an increase in VAT and an active approach to curbing the shadow economy. Both measures have had significant favourable effects on revenue in 2014.

Preliminary estimates show that Slovenia's measures enabled it to conclude the 2013 financial year within the set objectives. The general government deficit according to ESA95 is estimated at 4.4% of GDP. Central government budget revenue was 1.4% lower than planned, which is primarily due to lower revenues from personal income tax resulting from lower wages. This was also reflected in lower expenditures in relation to wages and social contributions. Expenditures did not meet the target values, which was primarily due to poor implementation of projects co-financed by European Union funds. Total expenditure was 3.3% lower than planned.

In order to ensure the stability of the banking system, asset quality reviews and stress tests were carried out in Slovenia in the second half of 2013. In December 2013, Slovenia earmarked a total of EUR 3.012 billion for the recapitalisation of the three biggest banks in which the state has holdings. Slovenia provided cash (in the amount of two thirds of the required funds) and market government bonds (one third) for the recapitalisation. The state also provided capital for two banks in the process of an orderly wind-down. Recapitalisation in 2013 thus totalled EUR 3,633 million or 10.3% of estimated GDP.

The recapitalisation of the banks significantly increased the general government debt, which at the end of 2013 amounted to 71.7% of GDP. For this reason, Slovenia spends 3% of its GDP or almost a billion euros annually on the payment of interest alone. In 2014, the general government debt will continue to increase due to new borrowing and pre-financing needs, and is estimated to amount to 80.9% of GDP. After 2015, the general government debt will cease to increase, with its share in GDP decreasing to 70.4% by the end of the programming period.

Slovenia returned to the euro bond market with the issuance of bonds in April 2014. This has significantly reduced the cost of borrowing, which has a favourable effect on interest costs in the coming years. Interest rates, economic growth, and particularly coordinated action in the areas of privatisation, corporate deleveraging, and fiscal balance, will be key to a system-wide reduction of debt. Only a consistent and credible economic policy coupled with a stable economic environment will lead to stable reductions.

### 3.2. General government revenue policy

The primary objective of tax policy in the programming period is to speed up fiscal consolidation so as not to hinder economic recovery and to support economic policy measures for stimulating growth and employment. Measures aimed at expanding the tax base and increasing the nominal tax rate were adopted in the previous period in order to stabilise general government revenue.

In the field of **personal income tax**, solutions have been adopted that will have a positive effect on general government revenue in 2014. In terms of substance, the elimination of the automatic harmonisation of tax reliefs and the tax base on the personal income tax scale with the growth in consumer prices is the most important. The personal income tax relief for those aged 65 or over and a special income tax relief for cross-border migrant workers have also been abolished.

Measures gradually reducing the **corporate income tax** rate from 20% to 17% were adopted in 2012. Although it was initially planned to reduce the corporate tax rate even further, i.e. to 15% in 2015, the planned reduction was halted due to fiscal consolidation in 2013. In order to increase predictability and ensure fiscal consolidation, a measure allowing a reduction in the tax base due to tax losses from previous tax periods by a maximum of 50% was adopted in 2012; given the dynamics of revenue, the effects of this measure may be expected in 2014.

In the field of indirect taxes, the general rate and reduced rate of the **value added tax** were increased by two percentage points (from 20% to 22%) and by one percentage point (from 8.5% to 9.5%), respectively, in July 2013. In the previous year, the Government continued to implement the policy of adjusting excise duties on fuels to the situation on the market; apart from amendments contained in the Amendment to the Excise Duty Act of 2012, which provided for a gradual increase in the minimum excise duty on cigarettes and a change in the ratio between specific and proportional excise duties, the Government did not draw up any amendments concerning other products subject to excise duty. In addition, in March 2013, the excise duty on fine-cut tobacco was raised.

At the end of 2013, Slovenia adopted **the Real Property Tax Act** as an important element of the tax policy. The aim was not only to reform the real property tax system but also to increase general government revenue without compromising competitiveness and growth. One of the objectives of the act was a moderate tax increase, whereby the proportion of real property tax, which amounts to only 0.6 percent of Slovenia's GDP, would be doubled. Accordingly, some of the revenue that currently belongs to municipalities under the system in force would instead be allocated to the central government budget. At the end of March of 2014, the Constitutional Court of the Republic of Slovenia abrogated the Real Property Tax Act in whole as a systemic regulation pursuant to which the real property tax was to replace all existing duties (the land use fee, the property tax, the fee for the maintenance of forest roads, and the tax on high-value real property). The Government intends to improve the contested provisions of the act and propose the tax again in the next period. Following the decision of the Constitutional Court, the Government adopted measures that will fully compensate for the loss of general government revenue.

In the field of tax revenues, the following excise duties increased in April 2014: the duty on tobacco products by 0.5%, the duty on alcohol and alcoholic beverages, except wine, by 10%, and the duty on certain fuels. The exemption from the excise duty on bio fuels enjoyed by petroleum product retailers as compensation for the higher cost of purchasing or producing bio fuels has been abolished. This will provide additional revenue amounting to EUR 52 million to the central government budget for the purposes of fiscal consolidation as early as in 2014; the overall fiscal effect is estimated to amount to EUR 90 million annually.



An important element of the functioning of the system of general government revenue is also the effective **recovery of public duties** when liable persons fail to settle their obligations voluntarily. Considering the increase in the public debt, which also includes social security contributions and taxes, the Government is drawing up two measures to improve the efficiency of the aforementioned recovery. The two measures will help mitigate the effects of the financial crisis in the short term, while contributing to the establishment of conditions aimed at boosting economic recovery and economic growth in the long term. The first measure enables companies that are unable to pay their taxes on a regular basis to reschedule their tax debt from previous years so that their social security contributions are paid first, while their taxes are paid within a reasonable period. In this period, companies would be charged revaluation interest instead of the default interest in an amount indicating that the measure is not state aid. The second measure is aimed at restructuring companies on the basis of the amended Financial Operations, Insolvency Proceedings and Compulsory Dissolution Act (the ZFPPIPP) in such a manner that companies with regard to which creditors and owners reach an agreement on restructuring are enabled to reschedule their tax debt so that it does not endanger the restructuring. The two measures, which are still in the process of being drawn up and have not yet been adopted, will help companies overcome liquidity problems. Companies will thus be able to use the funds they would otherwise use to pay their tax debt to make investments, which will enable them to improve their market position, increase their operations, and preserve jobs or take on new employees during this difficult economic situation. In the first year of the two measures taking effect, i.e. in 2015, the Government anticipates that they will have positive financial consequences, particularly for the pension and health insurance funds, while their effects on the central government budget are to be seen in the following years.

In view of the anticipated more favourable economic situation, the Government also anticipates higher **dividend revenues** from state-owned companies.

Due to the abolition of the bank balance sheet tax, the **tax rate on financial services** is planned to increase from 6.5% to 10% in 2015; the tax rate on insurance transactions is planned to be raised to the same level. The first financial effects of these changes are to be seen as early as in 2015, resulting from an increase in less abundant tax resources, which would not have a negative impact on competitiveness.

As one of the measures in the programming period, the Government also plans to **extend the validity of the fourth income tax bracket**, which applies to those earning more than five times the average wage, which was introduced as a temporary measure for 2013 and 2014 and was part of the measures adopted within the Fiscal Balance Act (the ZUJF) in mid-2012. By means of this measure, an additional EUR 16 million in revenue will be provided annually from personal income tax.

Slovenia will continue to **improve the collection of public duties** and implement **measures to curb the shadow economy** and undeclared work. Measures to curb the shadow economy will also be applied through the tax and customs administrations which have been merged into the Financial Administration of the Republic of Slovenia; this will improve the efficiency of tax collection, also by means of increased tax inspection. The Government anticipates that the effects of the functioning of the Financial Administration will not yet be fully seen in 2014, but can be expected in the following years of the programming period.

Regarding **the payment of tax liabilities** and measures to prevent tax avoidance, amendments to the Tax Procedure Act have come into force that refer mainly to requiring the use of a computer programme or electronic device that does not support deletion, correction or any change of the original entry saved in the device or another medium without saving initial information and all subsequent changes. This measure has the same effect as certified tax registers, but it is less costly for taxpayers and does not result in any additional administrative burdens.

In adopting relevant amendments to the legislation, the Government devoted particular attention to effective **control of the gap between the declared income of taxpayers and the value of their property**, and the possibility of rapid and effective taxation on income or property that was not declared in the past. This has been made possible with the introduction of a longer tax period that is to be taken into account in the tax assessment procedure. All the aforementioned amendments pursue the objective of curbing the shadow economy and unfair competition. In the previous programming period, the Government devoted particular attention to improving the tax culture, curbing the culture of late payment, and encouraging the voluntary, correct and prompt payment of tax liabilities, which, in turn, increases the legitimacy of the tax system, while providing a regular inflow of funds to the budget. The Government will continue to pursue the same policy in this programming period.

### 3.3. Government spending policy

In the past years, a number of **measures were adopted to limit expenditure growth** in the areas of labour costs, employment in the public sector, social policy, pensions, and the labour market. They were based on amendments to the legislation and agreements with stakeholders (by means of intervention acts, amendments to acts and/or agreements with social partners) and were planned to be permanent measures. However, some of these have already been amended by subsequent acts, agreements and court decisions. Savings were realised particularly in the year a particular measure came into effect, while in the following years, the effects involve the stabilisation of expenditure at a particular level.

The basic government measures are **the amended central government budget for 2014** (which represents the largest share of general government expenditures) and the general government deficit targets of 3.2% of GDP for 2014 and 2.5% of GDP for 2015 without including the recapitalisation of the banks. Ensuring the appropriate level of expenditure in relation to statutory and fixed liabilities (interest, transfers to individuals and households, and transfers to the pension insurance fund) is given priority over the availability of funds for other aspects of budget policies. Budget programmes are also financed through borrowing, which affects the structure of expenditures by increasing the amount of interest in proportion to other categories of expenditure.

**Table 3.2: Nominal growth of general government expenditure, potential output and real GDP**

as %	2012	2013	2014	2015	2016	2017	2018
General government expenditure	-5.3	22.6	-14.1	-3.5	-1.2	-0.4	-0.1
- without bank recapitalisation		1.7	2.1	-1.8			
Potential output	-0.7	-1.0	-0.2	0.2	0.5	0.6	0.7
GDP	-2.5	-1.1	0.5	0.7	1.3	1.7	1.7

Source: Ministry of Finance of the Republic of Slovenia.

**The share of total general government expenditure will be reduced to 45% of GDP by the end of the programming period.** In 2014, nominal expenditure will be lower than in the previous year due to streamlining and the continued implementation of measures already in force, and will remain below the general government deficit ceiling (without one-off effects). It is important that the current trend towards reducing general government expenditure continues (with the exception of one-off measures in 2013 and 2014). After a decrease in the next two years, nominal expenditure will continue to decrease, as is evident from Table 3.2, in accordance with the fiscal policy commitments (the fiscal rule). In the programming period, the Government will draw up additional measures to further reduce general government expenditure, distributing them proportionally across all segments of public spending so that they will not have any negative effects on economic growth.

Additional measures to stabilise and reduce expenditure target statutory and fixed expenditures, as well as the flexible part of spending. In addition to the regulation of fixed and statutory liabilities (70%), the flexible part of spending is being reduced by stimulating the **economical operation of all institutional units of the general government sector and selective implementation of projects**. Available flexible expenditure is used for activities that boost economic growth and create new jobs, thereby increasing competitiveness: providing access to inexpensive funding sources, investment in research and development, new investments, the promotion of exports, education and employment, and a stimulating business environment for the growth and development of companies.

**On the expenditure side, public funds and institutes will be streamlined in 2014<sup>8</sup>** and transfers from budgets to them reduced by using surpluses from the previous years<sup>9</sup>. The operations of these legal entities must be kept separate by certain criteria such that records on the performance of commercial activities and the activities of non-commercial public services are kept separate. Indirect budget users, which are mainly financed through transfers from the budget to public funds, public institutes, and public agencies, account for a significant part of labour costs. Labour costs, to which the aforementioned solutions with respect to employment and wage policy apply, account for more than 80% of regular transfers from budgets. Indirect budget users perform services of general interest within the limits of available budget funds, whereby savings are realised primarily by containing expenditures on goods and services and the optimisation of operations and investments. With respect to the operation of indirect budget users, a part of the surpluses from the previous years is planned to be used in 2014, resulting in reduced transfers from the central government budget to services of general interest.

In 2015, expenditure will be limited by an **extension of the validity of measures from 2013 and 2014<sup>10</sup>** in connection with achieving the target of an active working population of 850,000 people. The Government will continue **its policy of reducing the number of employees in the public sector** by not filling vacancies throughout the programming period. According to the data provided by the Agency of the Republic of Slovenia for Public Legal Records and Related Services, there were 158,000 persons employed by legal entities in the public sector in December 2013, which is 0.7% less than in December 2012. In the same period, the number of persons employed by direct budget users decreased by 2.6%, while the average number of persons employed by indirect budget users remained unchanged. In order to include all public sector activities in the reduction of the number of employees as evenly as possible, an amendment to the Budget Implementation Act has been adopted, which increases the responsibility of the heads of budget users in drawing up staffing and financial plans. Accordingly, new employment is balanced against available financial resources.

Since the current agreements with the trade unions contain permanent measures as well as measures that will cease to apply as of January 2015, e.g. a temporary reduction of wages, lower premiums for collective supplementary pension insurance for public employees, a freeze on promotions and the regular work performance-related bonus, the Government will re-enter negotiations with social partners in order to reach an agreement for 2015. Certain elements are not yet agreed on (holiday pay, indexation). The objective pursued in negotiations with the representative public sector trade unions is to reduce **labour costs** by 5% in 2015. An extension of the validity of all measures adopted (in the Fiscal Balance Act – the ZUJF, the Budget Implementation Act – the ZIPRS, and the Act Amending the Public Sector Salary System Act – the ZSPJS-R), including a reduction in the number of employees and certain additional measures, will be proposed in order to achieve this objective.

<sup>8</sup> In accordance with OECD recommendations on the simplification of legal and organisational forms used by the public sector, and with IMF recommendations.

<sup>9</sup> Amendment to the Republic of Slovenia Budget Implementation Act.

<sup>10</sup> From the Fiscal Balance Act and the Republic of Slovenia Budget Implementation Act

In 2015 and thereafter, expenditures will be reduced by **further streamlining in the general government sector** (increasing efficiency while maintaining the same standard of services provided within the limits of available resources or at a lower level of financing compared to that of the previous year, and setting priorities), regular and major maintenance, determining conditions for the performance of services of general economic interest, the reduction or restructuring of subsidies for economic and other activities, and accelerating the implementation of the Cohesion Policy Operational Programme for the period 2014–2020. By doing so, it is expected that total expenditure will be reduced below the 2012 level.

Additional influence in terms of consolidation at the local level is planned through **a change in the system of financing municipal budgets** so that the determination of adequate spending will no longer be based on the non-standardised spending of all municipalities in the previous four-year period, but on the standardised and limited share of expenditures for the functioning of a given municipality. In addition to personal income tax, other municipal sources will be used to cover adequate spending. The change will encourage municipalities to connect with each other (in particular regarding the currently dispersed funds for investments), and municipal budgets will be subject to systematic supervision by the Court of Audit.

**Social policy measures** regarding **transfers** will be extended in 2015 with regard to 2014, or until the target of an active working population of 850,000 is achieved. In accordance with the Implementation of the Republic of Slovenia Budget for 2014 and 2015 Act, **pensions** will not be indexed until 31 December 2015. The Budget Implementation Act provides that, in addition to the mandatory EUR 50 million annually, additional funds may be provided to the pension insurance fund (the Pension and Disability Insurance Institute of the Republic of Slovenia) through payments by Kapitalska družba d.d. in the amount of state-owned financial assets sold. In addition to the non-indexation of pensions, the Budget Implementation Act limits the adjustment of the financial obligations of the state for:

- contracts concluded for a period of up to one year by direct and indirect users of the central government budget and municipal budgets, public utility institutes, and public companies established by the state or a municipality; and
- transfers to individuals and households until 31 December 2015 (with the exception of the amount of the minimum income).

**Transfers to individuals and households for the period 2014–2018 are planned to remain below the 2012 level**, with their volume being reduced to under 15% of all expenditure. The assessments are based on the trends to date, business cycle forecasts, and legal regulations (e.g. the Exercise of Rights to Public Funds Act, the Act on Emergency Measures in the Field of the Labour Market and Parental Care, the Labour Market Regulation Act, the Parental Protection and Family Benefits Act). Reducing the number of recipients of social transfers in order to ensure social security and transfers to the unemployed and reduced expenditure on social transfers are based on a comprehensive implementation of active employment policy programmes (training and education, substituting for a worker in a work position and work sharing, the creation of new jobs, and the promotion of self-employment).

**The restructuring of subsidies** to non-financial companies from the central government budget continues, as it is planned that such expenditure will be reduced. In 2012 and 2013, 80% to 90% of all subsidies were granted to companies and sole traders, while the remainder were granted to public companies. The share of refundable funds is planned to increase as of 2015, resulting in a larger share of financial mechanisms, such as loans, guarantees, equity capital, and venture capital. Subsidies will be limited primarily to providers of services of general interest (e.g. mines, the provision of public transport services by Slovenian Railways) and complex subsidies to agriculture under rural development programmes and direct payments.

**Funds for investments** which are not part of European programmes are primarily focused on finishing projects, preparatory work, and shortlisting the set of domestic investments. After 2015, the volume of integral funds for investment will be limited and the earmarked funds will be planned in line with the inflows and taking into account the potential carry-over with a view to managing the amount of spending from carryover; the timelines of the common European policy projects will follow the planned operative programme framework. Given that an important part of investment activities is implemented at the local level through co-funding under the cohesion policy and the fact that municipalities manage some public tax proceeds or revenue (e.g. charges for the use of construction land), the central government budget funds allocated to local levels will be reduced. In line with the central government budget restrictions on the purchase of premises, vehicles and other equipment, these investments will also be limited in other central government units, such as public institutes, funds and agencies.

The **centralisation of public procurement** in some horizontal segments will continue (e.g. the purchase of IT products and services, hardware and software, the purchase of vehicles, office equipment, etc.) and enable direct and indirect savings (lower operating costs for administration). The above-mentioned areas have an impact on the central government budget and/or central government units (including 10 state funds, 354 central government units in education, 29 in health, 28 in social assistance, 39 in culture and research, 16 in agriculture and forestry, and 31 other units) and on social insurance funds (The Pension and Disability Insurance Institute, The Health Insurance Institute, and KAD). They also have a significant impact on the 2,138 units at the local level.

### **3.4. Fiscal consolidation, the structural deficit and the fiscal situation**

Fiscal policy is focused on consolidation measures with a view to achieving the structural balance by 2017 and bringing the deficit below 3% of GDP by 2015. The lowering of the deficit to below 3% of GDP by 2015 is to be carried out at a constant rate. The dynamics of fiscal consolidation, as shown in Table 3.3, is supported by the restrictive expenditure policy described in Chapter 3.3. and by the revenue measures presented in Chapter 3.2.

Medium-term objective is established as sustained structural balance that is in compliance with the proposed constitutional rule of a balanced budget. Once the excessive deficit has been corrected, the adjustment path toward a structurally balanced budget is foreseen in line with Regulation 1466/97 (as amended).

In 2013, the general government deficit amounted to 4.4% of GDP – bank recapitalisation excluded – or 14.7% of GDP – bank recapitalisation included. The 2013 deficit was 10.7 percentage points higher than envisaged in the previous programme, which is mainly due to the substantial bank recapitalisation, amounting to 10.3% of GDP. A deficit of 4.1% of GDP is envisaged in 2014 on account of the delay in finishing the bank recapitalisation process in 2013, amounting to 0.9% of GDP. Excluding these urgent measures for the recovery of the banking system, the deficit would have dropped to 3.2% of GDP.

In the 2014–2017 programming period, relatively steady fiscal efforts averaging 0.48% of GDP per year are envisaged. These will influence the deficit and government debt reduction and thus improve the country's credibility. Most fiscal consolidation measures are sustainable and will help reduce the cyclically adjusted deficit.

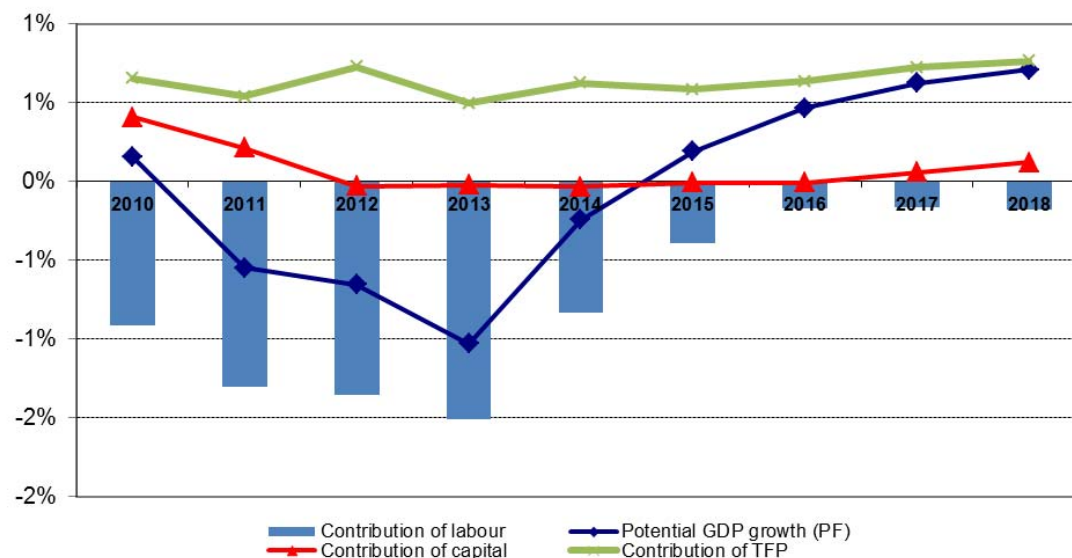
Table 3.3 shows the structural deficits under the fiscal consolidation strategy based on the expenditure and revenue measures and with a view to having a minimum negative impact on economic growth. In 2013, the cyclically-adjusted deficit increased by 10.2% of GDP, which was mainly due to the one-off measure of substantial bank recapitalisation in that year. The structural deficit for 2014 – one-off bank recapitalisation costs excluded – increased in 2013 by 0.1 percentage point, to stand at 2.6% of GDP. If the one-off measures also include the expenditure for eliminating the third quarter of wage disparities and the payment of compensation to the “erased persons”, the structural balance improves by 0.6 percentage points to 1.9% of GDP. Structural fiscal balance will gradually be established by the end of the programming period.

**Table 3.3: Cyclical developments**

	% of GDP	ESA	2010	2011	2012	2013	2014	2015	2016	2017	2018
1.	Real GDP growth (%)		1.3	0.7	-2.5	-1.1	0.5	0.7	1.3	1.7	1.7
2.	General government deficit or surplus	B.9	-5.9	-6.4	-4.0	-4.4	-3.2	-2.4	-1.5	-0.7	0.3
	- recapitalisation of banks included					-14.7	-4.1				
3.	Interest expenditure	D.41	1.6	1.9	2.1	2.6	3.4	3.3	3.3	3.1	3.0
4.	One-off and other temporary measures		0.2	1.2	0.2	10.3	0.9				
	- incl. one-off expenditure for the "erased persons" and the elimination of the third quarter of wage disparities					11.0					
5.	Potential GDP growth (%)		0.2	-0.5	-0.7	-1.0	-0.2	0.2	0.5	0.6	0.7
	Social contributions:										
	- labour		-0.9	-1.3	-1.4	-1.5	-0.8	-0.4	-0.2	-0.2	-0.2
	- capital		0.4	0.2	-0.0	-0.0	-0.0	-0.0	0.0	0.1	0.1
	- total factor productivity		0.7	0.5	0.7	0.6	0.6	0.6	0.6	0.7	0.8
6.	Output gap		-2.4	-1.1	-3.0	-3.1	-2.3	-1.8	-1.0	0.1	1.0
7.	Cyclical budgetary component		-1.2	-0.6	-1.5	-1.8	-1.2	-0.9	-0.5	0.0	0.4
8.	Cyclically-adjusted balance (2 – 7)		-4.8	-5.8	-2.8	-13.0	-3.0	-1.5	-1.0	-0.7	-0.1
9.	Changes in the cyclically-adjusted balance		-0.5	-1.0	3.0	-10.2	10.0	1.4	0.5	0.4	0.7
10.	Structural deficit (8 – 4)		<b>-4.5</b>	<b>-4.6</b>	<b>-2.5</b>	<b>-2.6</b>	<b>-2.0</b>	<b>-1.5</b>	<b>-1.0</b>	<b>-0.7</b>	<b>-0.1</b>
11.	Changes in the structural deficit		-0.3	0.0	2.0	-0.1	0.6	0.5	0.5	0.3	0.6
	- incl. one-off expenditure for the "erased persons" and the elimination of the third quarter of wage disparities					0.6					

Source: Ministry of Finance of the Republic of Slovenia.

**Figure 3.3: Potential GDP and contributions to growth**



As shown in Table 3.3, the average potential growth rate in 2013–2017 is estimated at 0.0% annually; positive figures are again anticipated from 2015 onwards. The negative growth in 2013 and 2014 is mainly influenced by the negative contribution of labour; in the following years, the total factor productivity contributes significantly to gradual positive potential growth, while the labour contribution remains negative. This is primarily due to the high unemployment rate and decrease in the participation rate.

In 2013, labour's contribution to potential growth was –1.5 percentage points; the negative trend of labour's contribution is expected to slow down in the subsequent period. In the period 2012–2015, a slightly negative trend is noted regarding the contribution of capital, which is expected to reverse and increase towards the end of the programming period. The output gap had an increasing trend by 2013 and is expected to gradually decrease and record a positive trend by the end of the programming period.

**Table 3.4: General government budgetary prospects**

	ESA Code	2013 level	2013 (estim. )	2014	2015	2016	2017	2018
		EUR million	% GDP	% GDP	% GDP	% GDP	% GDP	% GDP
<b>Net lending / borrowing by sub-sector (B.9)</b>								
1. General government	S.13	-5,188.4	-14.7	-4.1	-2.4	-1.5	-0.7	0.3
2. Central government	S.1311	-5,133.1	-14.6	-3.7	-2.0	-1.4	-0.7	0.4
	S.1312	...	...	...	...	...	...	...
4. Local government	S.1313	-69.1	-0.2	0.0	0.0	0.0	0.0	0.0
5. Social security funds	S.1314	13.8	0.0	-0.5	-0.4	-0.1	-0.1	-0.1
<b>Total general government (S.13)</b>								
6. Total revenue	TR	15,766.8	44.7	46.4	45.5	44.6	43.8	43.4
7. Total expenditure	TE	20,955.3	59.4	50.5	47.9	46.1	44.5	43.1
8. Net lending / borrowing	B.9	-5,188.4	-14.7	-4.1	-2.4	-1.5	-0.7	0.3
9. Interest expenditure	D.41	916.5	2.6	3.4	3.3	3.3	3.1	3.0
10. Primary balance		-4,271.9	-12.1	-0.7	0.9	1.8	2.4	3.3
11. One-off expenditures**		3,632.6	10.3	0.9				
Net lending / borrowing, one-off recapitalisation expenditure excluded		-1,555.8	-4.4	-4.1	-2.4	-1.5	-0.7	0.3
<b>Selected components of revenue</b>								
12. Total taxes (12a + 12b + 12c)		7,929.6	22.5	23.5	23.0	22.9	22.7	22.6
12a. Taxes on production and imports	D.2	5,312.2	15.1	15.9	15.5	15.5	15.3	15.2
12b. Current taxes on income, assets, etc.	D.5	2,590.9	7.3	7.5	7.5	7.4	7.4	7.4
12c. Capital taxes	D.91	26.6	0.1	0.1	0.0	0.0	0.0	0.0
13. Social contributions	D.61	5,377.2	15.2	15.3	15.2	15.2	15.1	15.0
14. Property income	D.4	446.7	1.3	1.1	0.8	0.6	0.6	0.6
15. Other revenue		2,013.2	5.7	6.5	6.5	5.9	5.4	5.2
16.=6. Total revenue	TR	15,766.8	44.7	46.4	45.5	44.6	43.8	43.4
p.m. p.m.: Tax burden (D.2+D.5+D.61+D.91-D.995)		13,306.9	37.7	38.8	38.2	38.1	37.8	37.6
<b>Selected components of expenditure</b>								
17. Compensation of employees and intermediate consumption	D.1+P.2	6,686.5	19.0	18.5	18.1	17.1	16.4	15.9
17a. Compensation of employees	D.1	4,323.5	12.3	12.0	11.6	11.2	10.7	10.3
17b. Intermediate consumption	P.2	2,363.0	6.7	6.5	6.5	6.0	5.7	5.6
18. Social payments		7,005.7	19.9	19.8	19.6	19.3	18.8	18.4
18a. Social transfers in kind	D.6311, D.6312 1, D. 63131	769.9	2.2	2.3	2.3	2.3	2.3	2.3
18b. Social transfers other than in kind	D.62	6,235.8	17.7	17.5	17.3	17.0	16.6	16.2
19=9. Interest expenditure	D.41	916.5	2.6	3.4	3.3	3.3	3.1	3.0
20. Subsidies	D.3	351.7	1.0	0.9	0.6	0.6	0.6	0.5
21. Gross fixed capital formation	P.51	1,312.1	3.7	4.6	4.3	3.9	3.6	3.2
22. Other expenditure		4,682.7	13.3	3.2	2.0	2.0	2.1	2.0
23.=7. Total expenditure	TE	20,955.3	59.4	50.5	47.9	46.1	44.5	43.1

Source: Ministry of Finance of the Republic of Slovenia. Notes: \*Revenue / expenditure – without the EU budgetary funds for legal entities outside the general government sector.



**Table 3.5: No-policy change projections**

		ESA Code	2013	2014	2015	2016	2017	2018
			EUR millions	% of GDP				
1.	Total revenue at unchanged policy	TR	15,766.8	44.7	46.3	45.2	44.3	43.5
2.	Total expenditure at unchanged policy	TE	20,955.3	59.4	50.5	49.4	47.9	46.4
a	Compensation of employees and intermediate consumption	D.1+P.2	6,686.5	19.0	18.5	19.2	18.2	17.5
b	Social payments	D.62 +D.631	7,005.7	19.9	19.8	19.6	19.5	19.3
c	Subsidies	D.3	351.7	1.0	0.9	0.9	1.0	1.0
3.	<b>Net lending / borrowing</b>	<b>-5.188,4</b>	<b>-14.7</b>	<b>-4.3</b>	<b>-4.2</b>	<b>-3.6</b>	<b>-2.9</b>	<b>-2.0</b>

Source: Ministry of Finance of the Republic of Slovenia.

Relative to the expenditure growth benchmark introduced by the new EU legislative package on enhanced economic policy coordination, expenditure growth from 2013–2018 will be considerably higher than potential GDP growth (Table 3.2.). It should be noted that the exclusion of certain government expenditure items that are fully matched by revenue from the EU budget and non-discretionary changes in unemployment benefit expenditure, as shown in Table 3.6., is taken into account.

**Table 3.6: Amounts to be excluded from the expenditure growth benchmark**

		2013	2013	2014	2015	2016	2017	2018
		EUR millions	% of GDP					
1.	Expenditure fully covered by revenue from EU budgetary funds*	832.7	2.4	3.4	3.1	2.4	1.7	1.4
2.	Non-discretionary changes in unemployment benefit expenditure	260.2	0.8	0.7	0.6	0.6	0.6	0.6
3.	Effects of discretionary revenue measures	211.2	0.6	1.9	0.5	-	-	-
4.	Revenue increases mandated by law	n.a.	n.a	n.a	n.a	-	-	-

Source: Ministry of Finance of the Republic of Slovenia.

Notes: \*Expenditure from EU budgetary funds.

In 2012, more than half of general government expenditure was allocated for social protection (18.9% of GDP) and healthcare (7.0% of GDP). In comparison with 2011, social protection expenditure decreased by 2.9% (from EUR 6,863 million to EUR 6,666 million) in nominal terms, mostly owing to decreased social benefits (which dropped from EUR 6,326 million to EUR 6,184 million). According to the Ministry of Finance, these were the only government expenditure items (bank recovery and interest payments excluded) that recorded an almost one percentage point increase in 2013 (compensation to the *erased persons* included). In 2012, spending on education was 6.4% of GDP and was 0.2 percentage points of GDP below the value for the previous year; the trend continued in 2013. In 2012, expenditure on general public services amounted to 5.8% of GDP; in 2013, the percentage rose to 6.3% (Ministry of Finance estimates) due to servicing the debt. The main type of expenditure for general public services is interest payments; expenditure on interest payments increased from EUR 807.1 million in 2012 to EUR 973.4 million in 2013.

**Table 3.7: General government expenditure by function**

<b>% of GDP</b>	<b>COFOG Code</b>	<b>2013</b> EUR million	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
1. General public services	1	2,205.3	5.5	5.6	6.0	5.8	6.3
<i>of which, servicing the debt</i>		973.4	1.4	1.7	2.0	2.3	2.8
2. Defence	2	336.1	1.5	1.5	1.2	1.1	1.0
3. Public order and safety	3	612.2	1.9	1.9	1.9	1.8	1.7
4. Economic affairs	4	8,899.2	4.7	4.6	5.1	3.9	25.2
<i>of which, bank recapitalisation</i>		3,632.6					10.3
5. Environmental protection	5	253.4	0.9	0.7	0.8	0.7	0.7
6. Housing and community amenities	6	241.7	0.8	0.7	0.7	0.7	0.7
7. Health	7	2,423.3	7.0	6.9	6.9	7.0	6.9
8. Recreation, culture and religion	8	606.5	1.8	2.2	1.9	1.8	1.7
9. Education	9	2,180.5	6.5	6.6	6.6	6.4	6.2
10. Social protection	10	6,955.9	18.1	18.6	19.0	18.9	19.7
<b>11. Total expenditure</b>	<b>TE</b>	<b>24,714.0</b>	<b>48.7</b>	<b>49.4</b>	<b>49.9</b>	<b>48.1</b>	<b>70.1</b>

Source: SORS; Ministry of Finance estimates for 2013

### 3.5. General government debt

The general government consolidated debt was estimated at EUR 25,307 million or 71.7% of GDP at the end of 2013. The largest share (86.6%) of the total debt was represented by the central government budget debt, which has a relatively stable structure. On account of bank recapitalisation, the total 2013 current general government deficit is estimated at EUR 5,178 million or 14.7% of GDP. The total cost of bank recapitalisation amounted to EUR 3,633 million or 10.3% of GDP in 2013; in the previous year, it only amount to EUR 61 million or 0.2% of GDP. On the basis of the amended 2008 Public Finance Act, which enables the central government budget to borrow funds in advance up to the amount of the principals falling due in the next two budget years, Slovenia's borrowings may surpass the extent of borrowing to fund the revenue and expenditure balance deficit and the financial assets and liabilities account deficit and debt principal repayment falling due in the current budget year. Slovenia made use of this option also in 2013 in the amount of EUR 1,343 million.

After an increase in 2013 and 2014, the debt ratio will decline to 72.5% of GDP in the programming period by 2017. The debt dynamics will be driven primarily by the central government debt. Local government sector debt is expected to remain at approximately 2% of GDP. The borrowing capacity of local communities is limited by the act governing the funding of local communities, according to which annual local community may borrow if repayment of liabilities from loans, finance leases and trade credit (repayments of principal and interest or installments) and contingent liabilities from issued guarantees indirect budget users and public enterprises founded by the municipality in a given year does not exceed 8% of realized revenues of the budget of the previous year, less grants received, transfer income from the state budget for investments and funds received from the EU budget and revenues overhead installations. The amount of outstanding debt of social insurance funds stood at EUR 1.7 million at the end of 2013, representing financial leasing borrowings by the Health Insurance Institute.

The increase in the general government debt-to-GDP ratio is mainly due to the primary deficit and bank recapitalisation. The anticipated dynamics of the debt-to-GDP ratio does not include the potential use of financial asset sale proceeds to reduce the debt and carries a positive risk regarding debt stability in the programming period.

**Table 3.8: General government debt developments**

	ESA Code	2013	2014	2015	2016	2017	2018
In EUR millions							
<b>1. Gross debt</b>		<b>25,307.1</b>	<b>28,815.5</b>	<b>29,400.1</b>	<b>28,304.6</b>	<b>27,833.2</b>	<b>27,930.2</b>
<b>2. Change in the gross debt ratio</b>		6,117.8	3,508.4	584.6	-1,095.5	-471.4	97.0
<b>3. Primary balance</b>		-4271.9	-236.1	317.3	656.1	906.7	1,312.8
<b>4. Interest expenditure</b>	D.41	916.5	1,228.7	1,192.6	1,220.0	1,179.1	1,175.4
% of GDP							
<b>1. Gross debt</b>		<b>71.7</b>	<b>80.9</b>	<b>81.1</b>	<b>76.0</b>	<b>72.5</b>	<b>70.4</b>
<b>2. Change in the gross debt ratio</b>		17.4	9.1	0.2	-5.0	-3.6	-2.0
<b>3. Primary balance</b>		-12.1	-0.7	0.9	1.8	2.4	3.3
<b>4. Interest expenditure</b>	D.41	2.6	3.4	3.3	3.3	3.1	3.0
<b>5. Implicit interest rate on the debt</b>		4.8	4.9	4.1	4.1	4.2	4.2

Source: Ministry of Finance of the Republic of Slovenia.

In the next medium term, the structure of borrowing instruments, the ratio between short- and long-term financing and debt dynamics to finance the budget of the Republic of Slovenia will be planned by taking into account the strategic objectives and the principles of borrowing for the budget of the Republic of Slovenia, as well as assessments of budgetary cash flows. The selection of budgetary financing instruments will be based on market conditions and the existing debt maturity profile, as well as on the objectives of developing the government bonds yield curve and improving the liquidity of the secondary market for Slovenian government securities. The principle of combining predictability and flexibility will be followed as it enables an appropriate response to the changed market conditions and the consequent efficient implementation of alternative borrowing scenarios, where necessary.

Long-term borrowing has been the primary instrument of central government budgetary financing, while short-term borrowing in stable conditions has been resorted to for the purposes of budget liquidity management during the fiscal year. Syndicated benchmark government bond offerings on European and other markets are foreseen as the primary long-term borrowing instrument. Other alternative long-term borrowing instruments may include a further issue of the existing benchmark bonds (re-opening the issuance of existing bonds), the issuance of bonds by the auction method; an issue of bonds open to a restricted range of investors (private placement); an issue of bonds under the EMTN programme; bank loans; "schuldschein", or other long-term borrowing instruments well established in the financial markets.

## **4. SENSITIVITY ANALYSIS AND COMPARISON WITH THE PREVIOUS UPDATE**

### **4.1. Sensitivity analysis to changes in economic activity**

The baseline scenario of economic activity is described in Chapter 2. The risks of a larger-than-forecast drop in economic activity this year are associated with the international situation, particularly with the potential escalation of the dispute between Russia and Ukraine, which would have direct and indirect impacts on the Slovenian economy. The direct effect would be shown in trade with Russia and Ukraine, which account for almost 6% of Slovenia's goods exports and are important markets for medicinal and pharmaceutical products (almost one quarter of Slovenia's total export of these goods). Russia is also an important natural gas supplier, accounting for more than half of Slovenia's imports of this energy product (petroleum imports from Russia are substantially lower and would, in the event of termination, have no significant direct impact on the Slovenian economy). Indirect impacts on economic activity in Slovenia may be expected if the situation between the two countries worsens, as this could impede or slow down the economic recovery expected in important European trading partners. The euro area undergoing 1 percentage point lower economic growth would contract Slovenia's GDP (taking into account indirect impacts) by approximately 2 percentage points more than under the baseline scenario. The largest impact would be on exports and fixed capital formation. The assessment is also based on the assumption that there will be an increase in commodity prices in the event this risk materialises.

The risks of lower than expected economic activity remain high; however, IMAD assesses that after a prolonged period of time, there is a so-called positive risk of higher economic growth occurring. This positive risk is mainly associated with the international environment, given that Slovenia's trading partners might experience economic recovery even faster than currently anticipated by international institutions; with a successful conclusion to the comprehensive review of the European banking system, access to funding sources might improve more than expected at present, which would also have a positive impact on economic activity.

The forecast under the baseline scenario will be significantly affected by the measures taken to stabilise the banking system and other planned measures intended to gradually revive lending activity, help disburden the economy, and kick-start a new investment cycle.

### **4.2. The sensitivity of budgetary projections**

Following a further deterioration of the situation, the economy is recovering slowly, as the risk of lower economic growth cannot be excluded. The effects of the crisis are primarily noted in general government revenue. Despite the tax changes and the measures addressing the economic downturn, general government revenue remains below the level of 2008. Therefore, the sensitivity analysis focuses on the key tax categories and changes in the general government balance triggered by changes in average (gross) real wage growth, employment, inflation, GDP, and real growth in private and government consumption.

**Table 4.1: The sensitivity of the general government balance to changes in macroeconomic variables (% of GDP)**

Macroeconomic base	Change in the macroeconomic base	Tax category	Change in the general government balance in 2013 (% of GDP)
Real growth in the average gross wage	Lower by 1 percentage point	Personal income tax, social contributions	-0.20
Employment growth	Lower by 1 percentage point	Personal income tax, social contributions	-0.20
Inflation	Lower by 1 percentage point	All	-0.35
Real growth in GDP in the previous year	Lower by 1 percentage point	Corporate income tax	-0.02
Real growth in private consumption	Lower by 1 percentage point	Indirect taxes	-0.12
Real growth in Government consumption	Lower by 1 percentage point	Indirect taxes	-0.03

Note: Under the assumption that a change in inflation has a 100% influence on a change in deflators

Table 4.1 shows the current risk and consequences of the underlying macroeconomic scenario as regards the key government revenue components and fiscal position. The assessed macroeconomic risks include: i) lower real growth of average gross wages; ii) lower employment; iii) a change in inflation; iii) lower real growth of GDP than in the previous year; iv) lower real growth of final household consumption; and; vi) lower real growth of government consumption. Risk assessments were made on the basis of data from 2013. In all cases, the negative trends have an effect on revenue (and inflation on all tax categories) and consequently on the general government balance.

### 4.3. Sensitivity analysis of the debt service

The level of financing borrowing and the repayment of existing debt is based on the ECB reference interest rate and the volume of the central government budget deficit. The sensitivity analysis assumes that the ECB will continue to keep the interest rate at the current level of 0.25%, followed by a gradual upward movement. The interest rate term structure implications have been taken into account in the baseline scenario and are increased by 0.5 percentage points in the sensitivity analysis.

Should the ECB increase its reference interest rate by 0.5 percentage points in 2014, the costs of new borrowing, expressed as a share of GDP, will increase by 0.1113 percentage points in 2015 and by 0.1621 percentage points in 2016. In this case, the central government debt, expressed as a percentage of GDP, would increase by 0.0345 percentage points in 2015 and by 0.0537 percentage points in 2016. If the government deficit increases by 1 percentage point in 2014, the costs of borrowing, expressed as a percentage of GDP, will increase by 0.0213 percentage points in 2015 and by 0.0207 percentage points in 2016.

**Table 4.2: The sensitivity of interest payments and central government debt to changes in certain macroeconomic variables (% of GDP)**

	Change in the ECB interest rate		Change in the deficit		Change in the ECB interest rate and the deficit	
	Interest	Debt	Interest	Debt	Interest	Debt
Year	In percentage points					
2014	0.0782	0.0782	0.0000	1.0000	0.0782	1.0782
2015	0.1113	0.0345	0.0213	0.9829	0.1326	1.0173
2016	0.1621	0.0537	0.0207	0.9574	0.1829	1.0111
2017	0.1831	0.0260	0.0201	0.9276	0.2032	0.9537
2018	0.2026	0.0252	0.0195	0.8984	0.2221	0.9237

Source: Ministry of Finance of the Republic of Slovenia.

The central government debt is relatively insensitive to exchange rate changes, as the share of debt denominated in foreign currencies (USD, GBP, CHF) is insignificant. In October 2012, May 2013 and February 2014, when dollar bonds were issued, a currency rate conversion into EUR was concluded with a view to mitigating currency risk.

In the 2014 programme year, the share of debt with a fixed interest rate is estimated at 97.4%. The impact of changes in interest rates on existing central government debt, expressed as a percentage of GDP, is relatively limited as most of the debt carries a fixed interest rate. A change in interest rates primarily affects the cost of new borrowing.

#### **4.4. Comparison of the forecast with the previous Stability Programme**

Compared with the previous Stability Programme, the GDP growth forecast for 2014 was revised upwards; a more gradual recovery is predicted in this year's Stability Programme. The main reasons may be attributed to faster improvement in the international environment and a relatively lower decrease in private consumption resulting from a slightly less unfavourable labour market situation. Faster recovery is hindered by difficulties in accessing finance and the urgent need for fiscal consolidation.

**Table 4.3: Comparison with the forecasts in the May 2013 Stability Programme**

% of GDP	2013	2014	2015	2016	2017	2018
<b>1. GDP growth</b>						
2013 Stability Program forecast	-1.9	0.2	1.2	1.6		
2014 Stability Program (latest forecast)	-1.1	0.5	0.7	1.3	1.7	1.7
Difference	0.8	0.3	-0.5	-0.3		
<b>2. General government balance</b>						
2013 Stability Program forecast	-4.0	-7.9	-2.6	-2.1	-1.4	
2014 Stability Program (latest forecast)	-14.7	-4.1	-2.4	-1.5	-0.7	0.3
Difference	10.7	-3.8	-0.2	-0.6	-0.7	
<b>3. General government debt</b>						
2012 Stability Program forecast	54.1	61.8	63.2	63.2	61.8	
2014 Stability Program (latest forecast)	71.7	80.9	81.1	76.0	72.5	70.4
Difference	-17.6	-19.1	-17.9	-12.8	-10.7	

Source: Ministry of Finance of the Republic of Slovenia, IMAD, SORS

In 2013, the general government deficit exceeded the planned deficit due to bank recapitalisation; deficits for the 2013–2016 period are lower than those forecasted in the previous update, mainly due to gradual recovery and accelerated fiscal consolidation in accordance with the adopted fiscal rule. GDP growth for 2014 is 0.3 percentage points higher than in last year's programme update; the deficit for 2014 is estimated to be lower by 3.8 percentage points. Differences on the debt side, expressed as a percentage of GDP, result from government deleveraging and privatisation (proceeds).

The table below presents the disparities between the IMF, European Commission, OECD, Bank of Slovenia, and IMAD forecasts, as a revised forecast triggers substantial forecast changes in GDP, calculated potential GDP, and the resulting general government balance and output gap. The annual disparities average up to 3 percentage points; the disparity has been slightly reduced in the autumn forecast (on average, the disparities stand at 1.5% of GDP); the spring forecasts are only made available at a very late date but the differences over the previous year (spring 2013) are at least 1% of GDP.

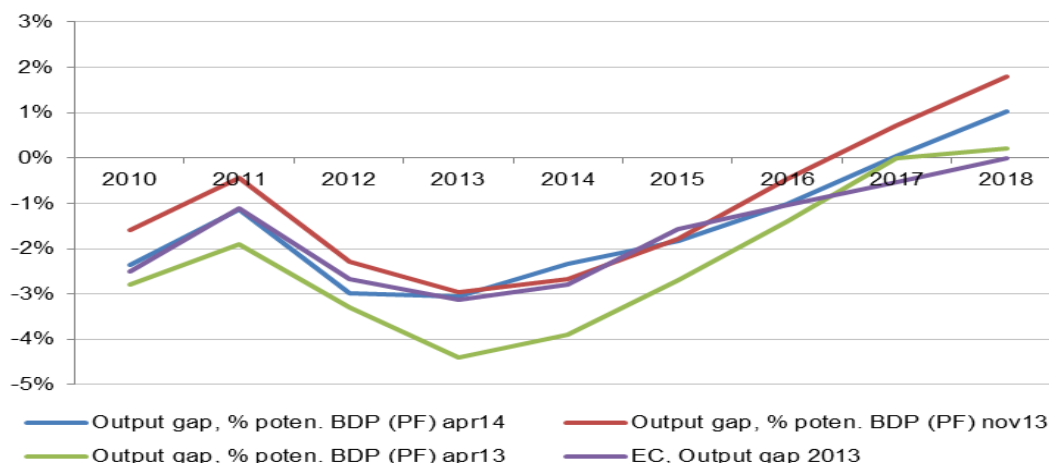
**Table 4.4: Forecast comparison for Slovenia in spring 2013 and 2014 (GDP growth in %)**

	Spring 2013		Autumn 2013		Spring 2014**	
	2013	2014	2013	2014	2013*	2014
IMF	-1.9	1.5	-2.6	-1.4	-1.1	0.3
European Commission	-2.0	-0.1	-2.7	-1.0	-1.1	-0.1
OECD	-2.3	0.1	-2.3	-0.9	-1.1	-0.9
IMAD	-1.9	0.2	-2.4	-0.8	-1.1	0.5
Bank of Slovenia	-2.0	0.5	-2.6	-0.7	-1.1	0.6

\* Realisation 2013, SORS, published in March 2014; \*\* IMF, March 2014, European Commission – winter forecast, January 2014, OECD, November 2013, IMAD, March 2014, BS April 2014

The calculation of the output gap is particularly sensitive as the methodology allows for substantial deviations and changes; considerable disparities are noted when comparing the output gap calculations under the European Commission methodology for April 2013, April 2014, November 2013, and the European Commission calculation for 2013.

**Figure 4.1.: Changes in the output gap calculation under the EC methodology**



Source: Ministry of Finance of the Republic of Slovenia.

## 5. THE LONG-TERM SUSTAINABILITY OF PUBLIC FINANCE

### 5.1. The long-term strategy and prospects, including the implications of the ageing of the population

The first assessments of the **pension reform** show positive short-term effects, as well as favourable medium-term effects on public finance sustainability. Compared with expenditure before the reform, pension expenditure will decrease in the first seven years of the pension reform and afterwards note a gradual increase but maintain the difference attained in the aforementioned years; total pension expenditure will be lower than it would be without the reform. The share of pension expenditure will rise from the current 11% of GDP to just over 16% of GDP by 2060. The effects of the transitional period contributed to the positive results of the pension reform even in the first year, given that the growth in new old-age pensioners virtually ceased. The inflow of new applications for old-age retirement (15,512) in 2013 was lower than in previous years (25,262 in 2012).

In 2013 – the first year of the reform – the actual retirement age of new old-age pensioners increased by two months for women, whereas for men the retirement age fell (by 4 months). This decrease was primarily due to the fact that in 2013 retirement was taken mainly by individuals who completed a relatively long period of pensionable service with no additional purchase at an early age, while the other insured persons who were older and had completed fewer years of pensionable service were not able to retire as the reform no longer allows for recognition of an added qualifying period (years of study, years of military service). In addition, in 2013 retirement was taken mostly by those persons who were entitled to protection of their expected rights under the previous legislation, whereby men could still claim a lower pensionable age based on the children they had. By contrast, a positive trend regarding women was recorded, with their actual retirement age increasing by 2 months within a year. In 2013, the completed pensionable service of new (old-age) male pensioners rose by 10 months, whereas for female pensioners this period increased by almost a year.

With due consideration of various studies, the following aspects are being examined: changes to **health insurance** benefits, the shift from in-patient to out-patient treatment and care, a strengthened role of primary healthcare, streamlining funding schemes, the health insurance contribution basis to cover students who work, the adjustment of insurance for pensioners, and funding for long-term care. The key measures in the coming period are the rationalisation and optimisation of public healthcare service providers with the introduction of centralised public procurement and new solutions to centralised implementation of services, e.g. centralised implementation of support services. The e-Health project will be continued and will significantly contribute towards the rationalisation of healthcare.



Public and private **expenditure on long-term care accounted for 1.32% of GDP in 2011**, of this, 0.98% of GDP was public expenditure and 0.31% of GDP was private expenditure. From 2003 to 2011, such expenditure increased more than nominal GDP, which led to an increase of 0.31 percentage points in its share of GDP in the same period. Slovenia does not have a comprehensive long-term care system; instead, the range of services and benefits intended for people who need long-term care are provided within the healthcare system, the pension and disability insurance and welfare systems, and special care systems for persons with disabilities. The same applies to the personal assistance for persons with disabilities. The introduction of a long-term care system will be closely linked to adjustments in the healthcare system.

**Table 5.1: The long-term sustainability of public finance**

% of GDP	2010	2020	2030	2040	2050	2060	Difference 2060-2010
<b>Total public expenditure</b>	<b>47.0</b>	<b>48.4</b>	<b>52.3</b>	<b>58.1</b>	<b>65.3</b>	<b>71.2</b>	<b>24.2</b>
Total age-related expenditure	24.3	25.7	27.3	29.4	31.2	30.8	6.5
Pensions	11.3	11.5	12.8	14.7	15.9	15.5	4.2
Old-age and early pensions	7.8	8.7	10.1	11.9	13.0	12.6	4.8
Disability pensions	1.5	1.3	1.1	1.0	1.0	0.9	-0.6
Other pensions	2.0	1.5	1.6	1.8	1.9	2.0	0.0
Healthcare	5.9	6.1	6.3	6.5	6.6	6.4	0.6
Long-term care	1.0	1.3	1.4	1.7	1.8	1.9	0.9
Education expenditure	4.8	5.2	5.3	5.1	5.4	5.6	0.8
Other age-related expenditure	1.5	1.6	1.4	1.4	1.5	1.5	0.1
Goods and services, other transfers	12.3	11.8	11.8	11.8	11.8	11.8	-0.5
Wage compensations	0.5	0.4	0.3	0.3	0.3	0.3	-0.2
Subsidies	1.6	1.4	1.4	1.4	1.4	1.4	-0.3
Government investments	4.8	3.9	3.9	3.9	3.9	3.9	-1.0
Total primary expenditure	45.7	45.0	46.6	48.8	50.6	50.2	4.6
Interest expenditure	1.4	3.4	5.7	9.3	14.7	21.0	19.6
<b>Total revenue</b>	<b>41.7</b>	<b>41.4</b>	<b>41.4</b>	<b>40.9</b>	<b>40.5</b>	<b>40.4</b>	<b>-1.3</b>
<b>Assumptions</b>							
Labour productivity growth	3.5	1.4	1.6	1.7	1.6	1.5	-2.0
Real GDP growth	1.2	1.5	1.3	1.2	1.2	1.6	0.4
Real per capita GDP growth	0.2	1.3	1.4	1.2	1.3	1.8	1.6
Participation rate males (aged 20-64)	80.2	83.2	82.4	81.4	82.1	82.8	2.6
Participation rate females (aged 20-64)	71.6	76.4	78.4	77.4	78.1	78.7	7.1
Total participation rate (aged 20-64)	76.0	79.9	80.5	79.5	80.1	80.8	4.7
Unemployment rate	7.3	8.1	5.9	5.6	5.6	5.5	-1.8
Share of population aged 65+	16.5	20.4	24.8	27.8	29.8	29.5	13.0

Source: IER, IMAD, Ministry of Finance of the Republic of Slovenia, EC.

Model simulations in Table 5.1. are based on a set of assumptions, of the European Commission from 2012 on productivity trends, levels of activity, unemployment, etc. to 2060 and on the model that we used in 2013 for long-term simulations of pension expenditure to meet the needs of the AWG. The key difference between the demographic projections EUROPOP 2013 and EUROPOP 2010 is in the proportion of the population aged 65 years and over having a significant impact on the results of the projections of public pension expenditure.

According to the reference scenario, the total expenditure associated with an aging population (pensions, health, education, long-term care, compensation unemployed) in Slovenia in 2020 increased by 1.8 percentage points to 25.7% of GDP, which is lower than the average the EU. By 2060 it is expected to increase the total by 6.5 percentage points to 30.8% of GDP (Table 5.1.).

## 5.2. Contingent liabilities

According to the Constitution, guarantees of the Republic of Slovenia may only be granted on the basis of a law. In the system of guarantees of the Republic of Slovenia, two types of laws have been developed, general and special. The general act regulates the granting of government guarantees to a broader range of recipients. The Rescue and Restructuring Aid for Companies in Difficulty Act is an example of a general act. Special acts are aimed at specific recipients, such as DARS d.d. (Motorway Company of the Republic of Slovenia), SID banka d.d. (Slovenian Export and Development Bank), and SOD d.d. (Slovenian Compensation Company). The Act Regulating the Guarantees of the Republic of Slovenia for Ensuring Financial Stability in the Euro Area is also an example of a special act.

The Republic of Slovenia may issue government guarantees to public or private sector entities. Most of the guarantees in the private sector were granted to companies in difficulty. Relatively high levels of this type of guarantee are being used, while a low number of guarantees for the public sector are being used. The issuance of government guarantees is controlled by setting upper limits on granting government guarantees. The annual quota is set for each year by a law governing the implementation of the central government budget, while the guarantees are regulated by the provisions of a systemic law. The quota set by the law governing the implementation of the central government budget does not include guarantees that have been placed under the guarantee scheme for legal and natural persons, guarantees given to domestic banks for the purpose of mitigating the impact of the financial crisis, guarantees to banks and the BAMC for the purpose strengthening financial stability, and guarantees to foreign entities, such as the EFSF and borrowers who received loans on the basis of the Cotonou II Agreement. The quota for these types of guarantees is defined in the corresponding laws.

**Table 5.2: Guarantees**

	Status as at 31 December 2013		Status as at 31 December 2014*	
	in EUR million	% of GDP	in EUR million	% of GDP
Guarantees of the Republic of Slovenia	8,258	23.4	7,693	21.9
of which: financial sector**	1,642	4.7	1,707	4.9

Source: Ministry of Finance of the Republic of Slovenia.

Notes: \*Projections of the Ministry of Finance.

\*\*According to the Standard Classification of Industrial Sectors, this includes SID banka, Deželna banka, Factor banka and Probanka.

The data in Table 5.2 show the outstanding guarantees of the Republic of Slovenia at the end of 2013 and estimates for 2014. Assumptions about the repayment of existing and granting of new guarantees were used for the projections.

In accordance with the law governing the implementation of the central government budget, the planned quota for new guarantees in 2014 amounts to EUR 1.6 billion and separately EUR 350 million for the guarantees to SID banka. The experience from the previous years shows that actual use of the quota is low: in 2011 only 0.92% and in 2012 only 0.15%, while it increased to 39.99% in 2013 due to a reduction in the planned quota (EUR 1.5 billion) and the issuance of three guarantees for large amounts (EUR 440 million for TEŠ and EUR 110 million for DARS). The quota for SID banka was not used.

Following the end of 2010, no guarantees were issued under the guarantee schemes for legal and natural persons and no guarantees were granted to domestic banks for the purpose of mitigating the impact of the financial crisis. Guarantees to the EFSF and borrowers who receive loans on the basis of the Cotonou II Agreement were discontinued but guarantees for the purpose of strengthening financial stability are still available.

## **6. THE QUALITY OF PUBLIC FINANCE**

### **6.1. The structure and efficiency of general government revenue**

Taxes are the main source of revenue in Slovenia as they account for almost 80% the general government revenue. In the years before the economic crisis, changes to the tax system were made in order to have a positive impact on job and the accumulation of capital, and consequently, potential growth, with a relatively higher share of indirect taxes in the overall structure of general government revenues. The reform was intended to improve the situation by gradually lowering the corporate income tax from 25% to 20% in the period from 2007 to 2010, and by continued gradual reduction of the general rate of corporate income tax from 20% to 17% in 2013, along with an increase in tax relief for investment in general and investment in R&D. This ensures a competitive tax environment, but the deepening of the economic crisis and lower profits have significantly reduced tax revenues from this source. This loss was first compensated for (because of increased general government expenditure needed to finance measures for mitigating the economic and financial crisis) with increased government borrowing, while in 2012 gradual fiscal consolidation focused mainly on reducing general government expenditure, and in 2013 taxes had to be increased to attain the fiscal objectives, including higher VAT rates as the key measure introduced in mid 2013 which will have an important impact on revenue in 2014.

In 2013, the structure of tax revenues in cash flow terms did not differ greatly from that in the previous years. The public finance budgets in total received EUR 12.6 billion in tax revenues in 2013, with the following being the most important categories of revenue:

- social security contributions (EUR 5.13 billion),
- domestic taxes on goods and services (EUR 5.03 billion), and
- taxes on income and profit (EUR 2.14 billion).

The realisation of the general government revenues (taxes and contributions) in 2013 was somewhat lower than in 2012 (a total of EUR 470 million less than in 2012). Revenues were lower than in the previous year as similar levels of revenue were recorded in 2009 and 2007. Higher revenues in 2013 compared to 2012 were primarily generated by VAT (EUR 124 million), property tax (approximately EUR 13 million), tax on financial assets (approximately EUR 7.8 million) resulting from changes to the bank balance sheet tax in 2013, and the tax on specialised services (approximately EUR 25 million) resulting from the tax on financial services introduced in 2013. Compared to 2012, considerable decreases in revenues were recorded in corporate income tax (approximately EUR 311 million), income tax (approximately EUR 209 million), social security contributions (approximately EUR 117 million), excise duties (EUR 69 million) and the tax on international trade and transactions (EUR 5 million).

For the programming period, Slovenia does not envisage any significant changes in the revenue structure, but minor shifts in the structure may be expected due to the already adopted VAT measures. The Government expects that revenues from taxes on income and profit will not decrease further due to the changes in tax legislation that have already been implemented; this primarily refers to the corporate income tax, where a further decrease in the nominal tax rate was halted and losses from previous tax periods limited to 50% of the tax base.

In addition to the already adopted measures and planned measures, somewhat higher economic growth and subsequently additional revenues are expected in the programming period. The Government also expects that the measures planned to curb the shadow economy will redirect some of the activities taking place in the illegal market to the regulated market, which in the Government's opinion should have a positive effect on the overall amount of revenue, as should the planned additional taxation measures for fiscal consolidation, while taking into consideration that these measures will not adversely affect the economic recovery and the income of citizens in general.

## 6.2. The composition and effectiveness of general government expenditure

The central government budget is managed in conditions of fiscal consolidation and with the objective to reduce the budget deficit. Measures primarily target contents financed with integral funds so that this year integral expenditure accounts for 82% of the total budget, while in 2012 it represented 88%. Expenditure on the majority of categories in the structure of integral expenditure has been reduced in recent years.

**Table 6.1: Structure of central government expenditure (integral funds as a % of GDP)**

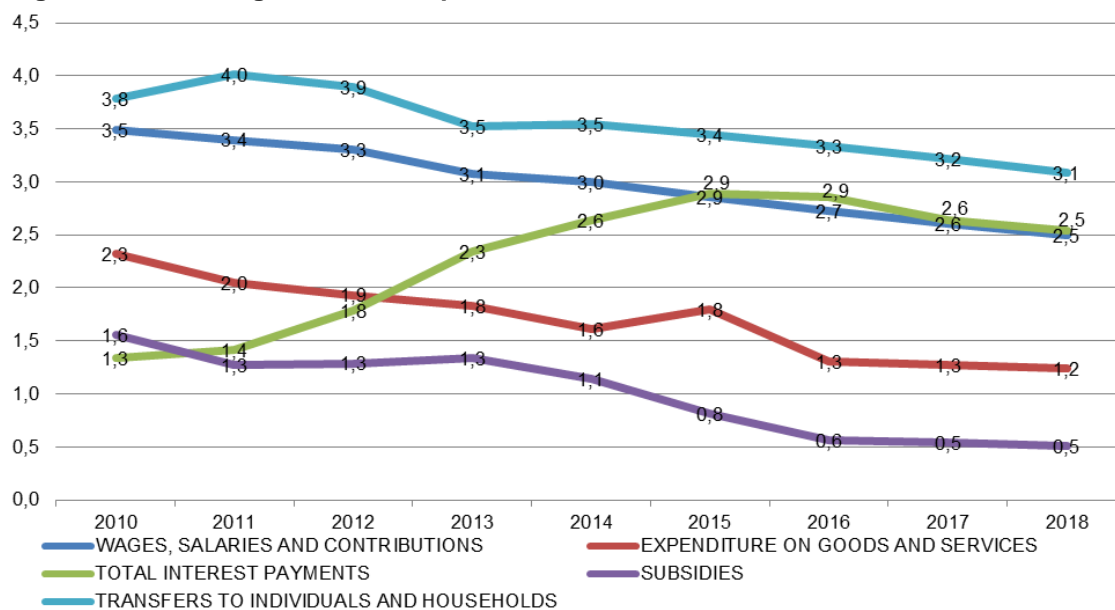
	2010	2011	2012	2013	2014	2015	2016	2017	2018
Integral funds	100	100	100	100	100	100	100	100	100
Salaries and salary-related costs	12.53	12.12	12.23	11.27	11.15	10.99	11.00	11.02	11.05
Employers' social security contributions	2.29	2.27	2.34	2.07	2.09	2.06	2.06	2.07	2.07
Expenditure on goods and services	9.47	8.23	7.66	7.12	5.51	4.76	4.75	4.87	4.87
Payment of domestic interest	4.56	5.25	7.11	7.41	7.62	7.68	7.99	8.34	8.63
Payment of foreign interest	1.17	0.79	0.86	2.95	4.25	5.71	5.77	4.92	4.75
Reserves	0.12	0.44	0.24	0.41	0.87	0.24	0.24	0.25	0.25
Subsidies	3.06	2.15	1.97	1.72	1.74	1.76	0.85	0.91	0.85
Transfers to individuals and households	16.09	16.95	17.25	15.36	15.86	15.91	16.06	16.18	16.26
Transfers to non-profit organisations and institutions	0.85	0.82	0.76	0.71	0.70	0.71	0.52	0.53	0.53
Other current domestic transfers	40.06	41.73	41.85	42.75	41.95	41.87	43.93	43.90	43.83
Current transfers abroad	0.30	0.30	0.35	0.31	0.22	0.30	0.33	0.33	0.36
Acquisition of capital assets	2.67	2.10	0.93	1.10	1.92	1.72	0.43	0.48	0.60
Investment transfers to legal and natural persons that are not budget users	0.35	0.54	0.33	0.27	0.16	0.19	0.20	0.08	0.01
Investment transfers to budget users	1.69	1.53	1.21	1.22	0.92	0.91	0.59	0.73	0.38
Payments to the EU budget	4.79	4.79	4.92	5.33	5.02	5.19	5.26	5.40	5.56

The share of this type of expenditure, which together with Slovenia's co-financing represents almost 15% of the central government budget, has been increasing in the total central government budget due to the intensified implementation of EU programmes and closing phase of the previous financial perspective.

With respect to international liabilities and agreements with social partners, the budget focuses on the following:

- covering the labour costs of public sector employees,
- maintaining the welfare state;
- providing pension security;
- servicing the public debt;
- co-financing programmes financed primarily from EU funds.

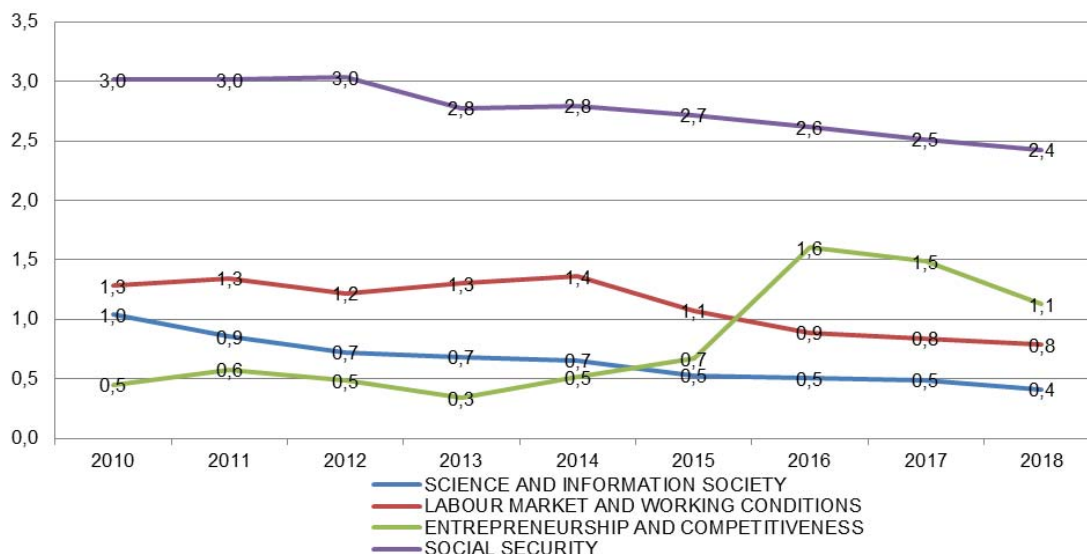
**Figure 6.1: Central government expenditure as a % of GDP**



Source: Ministry of Finance of the Republic of Slovenia.

Despite the prepared and drafted measures, in the management of general government expenditure, i.e. the central government budget in particular, the Government will continue to enforce aggregate fiscal discipline (control of government spending), allocate resources according to policy priorities, and improve the operational management of available assets. By determining the target amount of expenditure, the requirements of budget users are restricted and thus directed towards financing priority programmes in an economical and efficient manner. Although more emphasis is placed on the control of assets and resources (for which economic purposes and the amount of budget funds used), budget users distribute the available funds in accordance with individual budget policies.

**Figure 6.2: Central government expenditure by policy (as a % of GDP)**

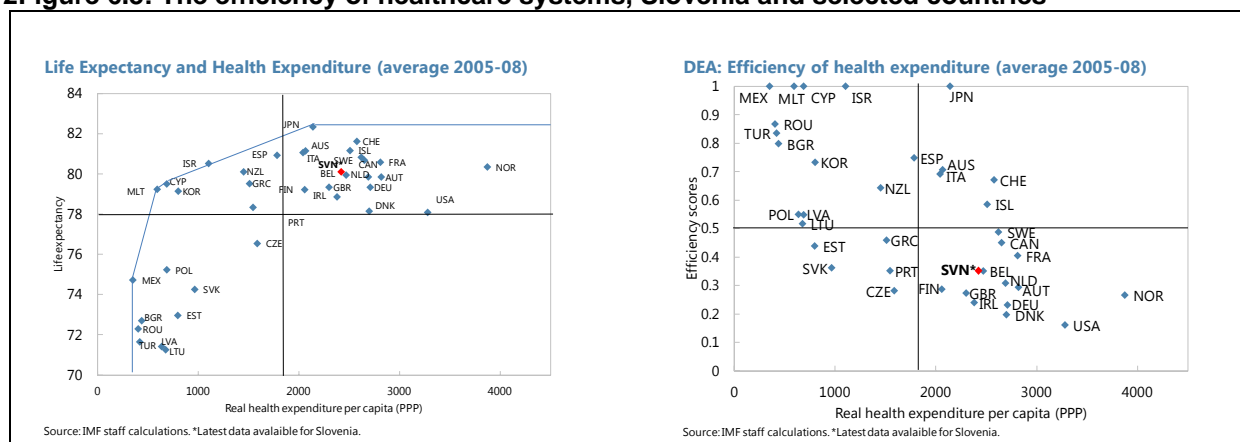


Source: Ministry of Finance of the Republic of Slovenia.

In the structure of budget expenditure, which is planned for 24 policies, the biggest shares are accounted for by the following policies: education and sport, pension security, the servicing of the public debt, social security, transport, transport infrastructure and the labour market. Total expenditure is decreasing due to fiscal balance measures, continued streamlining in the public sector, the determination of conditions for the performance of services of general economic interest, a selective approach to domestic investment, lower central budget funds at the local level, a reduction in the number of recipients of social transfers owing to the extensive implementation of the active employment policy programmes, and reductions or restructuring of subsidies for economic and other activities. Several measures have been adopted to limit and stabilise expenditure (measures enacted by laws and agreements with social partners), and measures streamlining the public sector will continue to apply in the coming years. Budget expenditure on local self-government policies is expected to decrease in 2015 and 2016 compared to 2014 (2014: 1.49%; 2015: 1%; 2016: 0.31%), on the labour market (2014: 5.02%; 2015: 4.12%; 2016: 3.64%) and on transport and transport infrastructure (2014: 7.62%; 2015: 7.08%; 2016: 4.16%). Planned expenditure on most of the other policies is decreasing in a similar manner. Expenditure on public debt servicing, payments to the European Union, pension and social security, energy sources and better energy efficiency, entrepreneurship and competitiveness will increase in 2015 and 2016 compared to 2014.

The **healthcare sector** accounts for 9% of GDP. With the extensive reform of the healthcare sector in 2003, Slovenia introduced a general payment system for healthcare services. At the state level, the Health Insurance Fund of Slovenia (ZZZS) sets the prices of services and procedures. Although liabilities are still moderate, signs of increasing financial strain can be observed. Slovenia does not prepare reports on the efficiency of expenditures but uses various other sources of information and comparative studies. The IMF Data Envelopment Analysis (an analytical method used to define efficiency by comparing public expenditure on healthcare with the relevant effects of the healthcare sector, e.g. regarding life expectancy) of the efficiency of healthcare expenditure opened a debate on potential savings – Slovenia is below the efficiency threshold (result: 0.35; with the same results Slovenia could save 5.75% of GDP).

12Figure 6.3: The efficiency of healthcare systems, Slovenia and selected countries



Source: IMF

This IMF study indicates potential savings that will be addressed by the new healthcare reform:

- a review of the basket of health insurance benefits, a shift from treatment in hospitals to out-patient clinics, and the promotion of general practitioners;
- rationalisation of the funding scheme; students who work will pay for health insurance; harmonisation of insurance with pensioners; an increase in expenditure on long-term care;
- the organisation of long-term care (by law and, for example, the introduction of vouchers).

The share of expenditure on **pensions** will rise from the current 11% of GDP to just over 16% of GDP by 2060. In the long term, the volume of central government budget transfers to the pension fund to cover pension expenditure should stabilise due to the effects of the pension reform. Consequently, a suitable return on state assets should be arranged and used to co-finance the pension fund (ZPIZ).

**The local level of the general government** comprises 211 municipalities. National statistics recognise 12 geographical regions but they do not have an administrative role (except for EU programmes). The majority of municipalities are small, i.e. below the legislative threshold (more than 50% of municipalities have less than 5,000 inhabitants). Municipalities have more than 2,000 budget users, of which 50% are indirect users of municipal budgets. Financial management varies greatly between municipalities. Municipalities may borrow funds for investment and short-term liquidity. Long-term loans, however, must be approved by the Ministry of Finance.

## 7. INSTITUTIONAL FEATURES OF PUBLIC FINANCE

### 7.1. Enforcement of EU provisions

Slovenia has amended Article 148 of the Constitution of the Republic of Slovenia to implement the provisions of the Treaty<sup>11</sup>. In this manner, the fiscal balance principle, which in the long term limits government borrowing by preventing the government from increasing its debt to pay for current operations, has been implemented at the highest level. The Constitutional Act lays down that an act adopted by the National Assembly by **a two-thirds majority vote of all deputies** is to regulate the implementation of the constitutional principle and defines exceptional circumstances in which derogation may be possible. Therefore, the drafting of such an act requires political consensus and, at the same time, the Slovenian Government aims to draft the text of the aforementioned act in such a manner that would facilitate its actual implementation.

Drafting the aforementioned act requires broad consensus and the presentation of possible scenarios of fiscal projections that are highly sensitive to macroeconomic assessments and forecasts. This is also a reason why Slovenia is slightly lagging behind in its adoption of the Fiscal Rule Act and, consequently, in amending the Public Finance Act. This does not mean that Slovenia is breaching the dynamics of alignment with the fiscal objective laid down in the EU rules. To the greatest extent possible, Government policy stems from these guidelines and takes them into consideration. In this regard, the Government seeks solutions that will ensure medium-term macroeconomic stability and balance by regulating economic measures through institutional changes, while taking into account the necessary structural changes.

- The Fiscal Rule Act will lay down the method and time-frame for the implementation of the medium-term balance between the revenues and expenditures of central government budgets and define the medium-term fiscal target, the fiscal rule itself and those exceptional circumstances in which a derogation from the fiscal rule may be possible, and establish a fiscal council as an independent government authority and determine its competences as well as the method of abrogating its derogations from the fiscal rule.
- The Public Finance Act: will specifically regulate the preparation, implementation and monitoring of the budget of all general government institutional units (besides the central government budget, also pension and health insurance funds, municipal budgets and other institutional units which are included in sector S.13 under the Decree on the Standard Classification of Institutional Sectors). Moreover, the aforementioned Act will also define the mandatory conduct of all public finance users. This conduct applies to the drafting of budgets, their implementation, borrowing, the assumption of liabilities, keeping records, etc. Special attention has been paid to supervision, and the Act will also define sanctions for violations. As a result, the supervisory mechanisms for the management of fiscal imbalances will ensure the medium-term balance.

In March 2014, the IMF conducted a review entitled: Strengthening the Public Financial Management Framework in Slovenia. Since the basic recommendation that budget documents submitted to the National Assembly must present a comprehensive fiscal picture (the general government and all its components) remains in place, the following activities will be conducted in 2015:

- a junction table will be prepared to present medium-term fiscal objectives for the general government which follow the ESA 95 methodology (accrual principle) and are described in the Stability Programme, and an explanation provided on how to present them in the central government budget (the cash-flow principle);
- budget documents will provide a comprehensive financial commitment for the wider public sector that includes entities outside the general government that pose the biggest potential risk for the budget;

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<sup>11</sup> Treaty on Stability, Coordination and Governance in the Economic and Monetary Union or the Fiscal Compact.



- provisions on the financial management of all general government units will in the long term be joined under one umbrella law – the Public Finance Act; financial management of all small entities, including municipalities and their indirect budget users, will also be included;
- a comprehensive audit of all indirect budget users will be conducted according to their category, status, financing method and relationship to the relevant ministry.

In strengthening public finances, the **main priority** is the introduction of a suitable **top-down budgetary process**. The legislative framework for the adoption of the medium-term budgetary framework (MTBF) must be enhanced. It will provide binding guidelines for setting the medium-term fiscal objectives – medium-term frameworks for every primary component of the general government (the central government budget, municipalities, the Health Insurance Fund of Slovenia (ZZZS), and the Pension and Disability Insurance Fund (ZPIZ)) will be determined. In the first phase of the process, the Government and the National Assembly will undertake to comply with the macro-fiscal objectives and strategy. The Fiscal Rule Act and the amendments to the Public Finance Act that are to govern these issues are being drawn up.

**Control exercised over indirect budget users and municipalities** will be tighter as they will have to submit reports also during the financial year. Their excessive fragmentation (according to function, status, financing method, etc.). Indirect budget users differ in type and are governed by different laws – the fragmented and complex structure causes problems associated with transparency, accountability and effectiveness. Although municipalities are autonomous, the management of their finances must be strengthened to ensure that their budget aggregates comply with the Stability Programme. At the same time, their finances must be equipped with better safeguards: security alerts during implementation, and procedures addressing detected financial difficulties.

**The budget implementation process** is regulated by the Public Finance Act and Budget Implementation Act adopted for the relevant year, but supervision of indirect budget users and municipalities will be strengthened. The role and accountability of ministries supervising municipalities and indirect budget users will be defined. The budget implementation process has a number of disadvantages for indirect budget users and municipalities:

- it is not supported by a uniform system of implementation, payment, accounting and reporting;
- it lacks a standard mechanism for automatic financial control of accounts;
- the quality and scope of internal and external control systems differ greatly between municipalities and indirect budget users;
- the Ministry of Finance and the relevant ministries have limited control of municipalities and indirect budget users;
- the Public Finance Act is less binding for indirect than direct budget users.

## **7.2. Changes to referendum and electoral legislation**

In 2013, Slovenia adopted amendments to the legislation regulating referendums in order to limit the topics on which a referendum may be called and introduce more stringent criteria as to who may propose a referendum. In accordance with these amendments, a referendum shall be called if requested by at least 40,000 voters. A referendum can no longer be requested by members of the National Assembly or the National Council. Limitations on the content of a referendum are defined (referenda on laws dealing with the following matters are no longer allowed: emergency national defence measures; security or the elimination of the consequences of natural disasters; taxes, customs and other duties; the implementation of the central government budget; the ratification of treaties; and the elimination of unconstitutionality in the field of human rights and fundamental freedoms). The model for rejecting a referendum is also determined: a law is rejected in a referendum if a majority of voters who have cast valid votes vote against the law, provided that at least one fourth of all qualified voters have voted against the law.

Slovenia will also discuss the proposed amendments to the electoral legislation. By changing the electoral system, Slovenia will enable more unified and stable governing coalitions, provide transparency and enhance the possibility of choosing among individual candidates.

## **7.3. Increasing the efficiency of the collection of public duties**

It is in the interests of the Republic of Slovenia to ensure a transparent, economical and efficient system for public duties collection that encourages the voluntary fulfilment of legal obligations. A modern financial administration is a precondition for lawful, professional, politically neutral, open, transparent and efficient operations. According to the principles of a user-oriented public administration, these objectives can be attained primarily by simplifying and standardising procedures, reducing administrative obstacles and the administrative burden, and improving the quality of work. The merger of the Tax Administration and the Customs Administration, which began last year, guarantees the application of tax laws in such a manner that the collection of duties will be based on the principle of the voluntary fulfilment of the obligations of taxpayers, while providing for adequate supervision if taxpayers fail to fulfil their obligations in a timely manner determined by law. The first results of this merger can already be seen: the unification of inspections; the possibility to gain access to and establish joint databases, which will enable comprehensive and quality treatment of taxpayers (violations, unpaid claims or receivables, uniform tax enforcement per taxpayer); better organisation of the joint body and more efficient organisation of work.