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COVER NOTE

From:	Secretary-General of the European Commission, signed by Mr Jordi AYET PUIGARNAU, Director
date of receipt:	15 November 2013
To:	Mr Uwe CORSEPIUS, Secretary-General of the Council of the European Union
No. Cion doc.:	C(2013) 8010 final
Subject:	COMMISSION OPINION of 15.11.2013 on the Draft Budgetary Plan of SLOVENIA

Delegations will find attached document C(2013) 8010 final.

This document is aimed for discussion in the **Eurogroup.**

Encl.: C(2013) 8010 final

EUROPEAN
COMMISSION

Brussels, 15.11.2013
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COMMISSION OPINION

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on the Draft Budgetary Plan of SLOVENIA

{SWD(2013) 611 final}

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GENERAL CONSIDERATIONS

1. Regulation (EU) No 473/2013 sets out provisions for enhanced monitoring of budgetary policies in the euro area for ensuring that national budgets are consistent with the economic policy guidance issued in the context of the Stability and Growth Pact (SGP) and the European Semester for economic policy coordination.

2. Article 6 of Regulation (EU) No 473/2013 requires Member States to submit annually to the Commission and to the Eurogroup a Draft Budgetary Plan presenting by 15 October the main aspects of the budgetary situation of the general government and its subsectors for the forthcoming year.

CONSIDERATIONS REGARDING SLOVENIA

3. On the basis of the Draft Budgetary Plan for 2014 submitted on 15 October 2013 by Slovenia, the Commission has adopted the following opinion in accordance with Article 7 of the Regulation (EU) No 473/2013.

4. Slovenia is subject to the corrective arm of the SGP. In addition to the Draft Budgetary Plan, Slovenia submitted a report on effective action and an economic partnership programme as recommended by the Council in June 2013. In order to correct the excessive deficit by 2015, Slovenia is recommended to reach headline general government deficit targets of 4.9% of GDP in 2013 (3.7% of GDP without the one-off expenditure to recapitalise the two largest banks, estimated at 1.2% of GDP in June), 3.3% of GDP in 2014 and 2.5% of GDP in 2015, which is consistent with annual improvements of the structural balance of 0.7% of GDP in 2013, 0.5% of GDP in 2014 and 0.5% of GDP in 2015.

5. The macroeconomic scenario underpinning the Draft Budgetary Plan projects real GDP to contract further by 2.4% and 0.8% in 2013 and 2014, respectively. Domestic demand will continue to act as drag on growth on the back of the ongoing deleveraging process in the economy and tight financing conditions. As GDP is set to decline, the lagged adjustment in the labour market is expected to continue, with employment and compensation of employees per head contracting in both 2013 and 2014, also under the impact of measures to contain the public sector wage bill. Relative to the 2013 Stability Programme, real GDP growth for 2013 has been revised downwards mainly due to lower-than-expected gross capital formation in the first half of the year. Compared to the Draft Budgetary Plan, the Commission 2013 Autumn Forecast projects a slightly larger real GDP decline both in 2013 and 2014, resulting from a more modest net export contribution and larger fall in final domestic demand in 2013 and more severe retrenchment in gross capital formation in 2014. Against this background, on currently available information the Draft Budgetary Plan's macroeconomic scenario for both years appears broadly plausible. Risks to

growth and domestic demand in particular are related to the financing conditions for the overall economy, which in turn hinge upon the speed of the ongoing deleveraging process and the implementation of the needed bold structural reforms.

6. The macroeconomic forecasts underlying the Draft Budgetary Plan have been produced as usual by the Institute for Macroeconomic Analysis and Development (hereinafter IMAD). The independent status and tasks of IMAD are stipulated in a specific Resolution. The authorities are currently preparing an overhaul of the legislation underpinning Slovenia's fiscal framework, including independent bodies, in order to comply with the Treaty on Stability, Coordination and Governance in EMU and the EU legal requirements on fiscal governance.

7. The Draft Budgetary Plan sets the general government deficit targets, including estimated bank recapitalisation needs, at 5.6% and 6.7% of GDP in 2013 and 2014, respectively. Without the bank support, deficit targets would stand at 3.8% and 3.3% of GDP (*vs*. 4.2% and 2.6% of GDP in the 2013 Stability Programme). The Draft Budgetary Plan sets a lower deficit target (without bank recapitalisation) for 2013 relative to the 2013 Stability Programme mainly due to higher revenue projections from sales of market output and property income and lower social transfers and intermediate consumption. For 2014, the size of the capital transfers to banks explains much of the difference between the deficit target in the 2013 Stability Programme and Draft Budgetary Plan. Beyond that, the deficit target is revised upwards mainly due to an unexplained deterioration in indirect taxes.

8. The Commission 2013 Autumn Forecast projects the general government headline deficit at 5.8% and 7.1% of GDP (4.0% and 3.6% of GDP without bank recapitalisations) in 2013 and 2014, respectively. The headline deficit projection for 2013 is slightly above the Draft Budgetary Plan deficit target because of lower revenue from social contributions and sales of market output, which is consistent with outturns over the first half of 2013. In 2014, the gap with the Draft Budgetary Plan widens, mainly due to lower projections of tax revenues and social contributions. Risks to public finance projections are tilted to the negative side for several reasons. First, there are risks that the proposed measures are cancelled or reduced during the adoption process. Second, the Supreme Court judgement repealing the postponement of the third instalment of the increase in public sector wages adopted in November 2010 is likely to entail higher expenditure in 2014. Finally, additional capital support needs might materialise in the restructuring process of overleveraged state-owned non-financial corporations. These risks might be partially compensated for by revenues from an envisaged auction of licences for the 4th generation of the mobile network. A further important element of uncertainty is related to the bank recapitalistion needs that will be correctly established only after the finalisation of the ongoing Asset Quality Reviews and Stress Tests.

9. According to the Draft Budgetary Plan, the general government gross debt ratio will reach 63.1% and 65.5% of GDP in 2013 and 2014, respectively. This is above the 2013 Stability Programme projections because of the building-up of the cash buffer through two large sovereign bond issues in May 2013 and the higher primary deficit in 2014. The Commission forecasts the debt ratio at 63.2% of GDP in 2013 and 70.1% in 2014. Its 2014 projection does not incorporate the debt-reducing contribution from the stock-flow adjustment included (but not specified) in the Draft Budgetary Plan, while the primary deficit and snowball effect add to the debt ratio in

both years. Neither the Draft Budgetary Plan nor the Commission 2013 Autumn Forecast include any debt accumulation from the envisaged transfer of impaired banking assets to the Bank Asset Management Company (BAMC).

10. After the extension of the deadline for the correction of the excessive deficit, the new government turned the consolidation towards structural revenue-increasing measures through increases in VAT rates and some other smaller taxes and charges. The new key expenditure-side measures are the temporary cut in public sector nominal wages by around 1.25% on average and the cut in work-related benefits introduced in June 2013. In 2014, the government accounts will benefit mainly from the full-year effects of the measures adopted in mid-2013; the new real estate tax; and the non-indexation of both the personal income tax allowances and bracket thresholds and the social benefit rates, including pensions. The Draft Budgetary Plan does not incorporate any of the structural measures on the expenditure side that were announced in the 2013 Stability Programme. Overall, the estimate of the budgetary impacts of consolidation measures as provided by the authorities seems plausible on current information and is as such included in the Commission 2013 Autumn Forecast.

11. The headline deficit targets planned in the Draft Budgetary Plan at 5.6% and 6.7% of GDP in 2013 and 2014, respectively, are above the EDP headline deficit targets of 4.9% and 3.3% of GDP for the same years. The Commission 2013 Autumn Forecast also projects deficits above the targets recommended by the Council in June 2013. According to the Commission 2013 Autumn Forecast, the change in the structural balance is estimated at -0.1% and 0.7% of GDP in 2013 and 2014. However, when corrected for the revenue shortfalls and revisions in potential growth calculations, the corrected structural improvement is estimated at 0.6% of GDP in both 2013 and 2014. While this is slightly short of the 0.7% of GDP annual structural effort recommended for 2013, it is just above the 0.5% of GDP recommended for 2014. Based on a bottom-up assessment, which estimates the size of the additional fiscal effort on the basis of the discretionary revenue measures and the expenditure developments under the control of the government between the baseline scenario underpinning the Council Decision and the Commission 2013 Autumn Forecast, the overall fiscal effort for 2013 amounts to around 1.1% of GDP, i.e. just above the 1% of GDP of additional consolidation measures mentioned in the June 2013 EDP recommendation as consistent with reaching the structural target for 2013. For 2014, the bottom-up analysis assesses the overall size of the consolidation measures adopted after the June 2013 EDP recommendation at around 1.4% of GDP. This falls slightly short of 1½% of GDP of additional consolidation measures mentioned in June 2013 EDP recommendation as consistent with reaching the structural target for 2014. Against this background, based on current information it appears the Slovenia has taken effective action in 2013 and seems on track to delivering the recommended structural improvement in 2014, although with no margin.

12. The authorities have recently approved several measures aimed at strengthening tax compliance. While they appear to go in the right direction, it is premature to assess them and thus compliance with the July Council recommendations issued in the context of the European Semester. Gaps in the implementation of fiscal Council recommendation are indicated by a lack of structural expenditure measures and likely delayed full transposition of the Treaty on Stability Coordination and Governance. The former could be defined by conducting systematic reviews of public expenditure at all government levels.

13. The Draft Budgetary Plan projections are conditioned also upon implementation of the July Council recommendations issued in the context of the European Semester on the banking sector and corporate governance in state-owned companies and their privatisation. These could have a significant impact on debt developments and contingent liabilities in the coming years.

14. In accordance with the Council EDP recommendation of 21 June, Slovenia has also submitted an economic partnership programme. On this basis, the Commission has made a proposal for a Council Opinion on the economic partnership programme.

15. Overall, based on the 2013 Autumn Forecast, the Commission is of the opinion that the Draft Budgetary Plan sent on 15 October is compliant with the rules of the SGP, albeit with no margin. The Commission is also of the opinion that Slovenia has made limited progress with regard to the structural part of the fiscal recommendations issued by the Council in the context of the European Semester. The Commission invites the authorities to approve the necessary consolidation measures within the national budgetary process, to rigorously implement the consolidation measures in order to ensure that the 2014 budget remains fully compliant with the SGP, and to accelerate progress towards implementation of the fiscal recommendations under the European Semester.

Done at Brussels, 15.11.2013

For the Commission
Olli REHN
Vice-President