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COMMISSION OPINION

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on the Draft Budgetary Plan of Slovenia

{SWD(2017) 526 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 CONCERNING SLOVENIA

3. On the basis of the Draft Budgetary Plan for 2018 submitted on 16 October 2017 by Slovenia, the Commission has adopted the following opinion in accordance with Article 7 of Regulation (EU) No 473/2013.
4. Slovenia is subject to the preventive arm of the SGP and should ensure sufficient progress towards its medium term budgetary objective of 0.25 % of GDP. In 2017, it should achieve an annual fiscal adjustment of 0.6 % of GDP. In 2018, it should pursue a substantial fiscal effort, taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of Slovenia's public finances. According to the commonly agreed adjustment matrix under the SGP, that adjustment translates into a requirement of a nominal growth rate of net primary government expenditure which does not exceed 0.6 % in 2018. It corresponds to an annual structural adjustment of 1.0 % of GDP. As the public debt amounted to 82.6 % of GDP in 2015, the year in which the excessive deficit was corrected, Slovenia also needs to make sufficient progress towards compliance with the debt reduction benchmark.
5. The macroeconomic assumptions of the Draft Budgetary Plan for 2017 and 2018 appear plausible. The Draft Budgetary Plan forecasts the economy to grow by 4.4 % in 2017 and 3.9 % in 2018. Domestic demand is considered to be the key contributor to growth, as consumption growth remains high and investments recover. The growth forecast in the Draft Budgetary Plan is higher than that of the 2017 Stability Programme, mainly due to a stronger growth contribution from net exports. The macroeconomic scenario underlying the Draft Budgetary Plan is broadly in line with the Commission 2017 autumn forecast, with the latter projecting a slightly higher pace of economic expansion.
6. Slovenia complies with the requirement of Regulation EU No 473/2013 that the draft budget has to be based on independently endorsed or produced macroeconomic forecasts. The macroeconomic forecasts underlying the Draft Budgetary Plan have been produced by the Institute of Macroeconomic Analysis and Development (IMAD).

7. The Draft Budgetary Plan confirms the 2017 general government deficit target of 0.8% of GDP, which was set in the 2017 Stability Programme and is in line with the Commission 2017 autumn forecast. In 2017, the headline deficit is expected to improve significantly, by 1.1% of GDP, compared to the previous year. The positive macroeconomic context, particularly for employment, is expected to result in higher revenues from taxes and social contributions. Nonetheless, public wages, social transfers, intermediate consumption and subsidies are expected to continue rising comparing to the previous year. For 2018, the Draft Budgetary Plan targets a general government surplus of 0.4 % of GDP, instead of the deficit of 0.2 % of GDP targeted in the 2017 Stability Programme mainly due to higher expected revenues. The recalculated¹ Draft Budgetary Plan targets an unchanged structural balance of -1.5 % in 2017, improving to -1.0% in 2018. The public debt-to-GDP ratio is planned to decline by 3.3 percentage points in 2017, to 75.2 % of GDP and further to 71.7 % of GDP in 2018 on the back of robust economic growth, lower interest expenditure and a reduction in the previously accumulated cash-buffers. Against the background of falling interest expenditure, the projected improvement in the structural balance in 2018 (by 0.5 % of GDP) is accompanied by an improvement in the structural primary balance (by 0.2 % of GDP).
8. In its 2017 Stability Programme, Slovenia indicated that the budgetary impact of the exceptional inflow of refugees is significant and should be considered as an unusual event outside the control of the government, as defined in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97. The provisions set out in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in which the inflow of refugees is an exceptional event, their impact on the country's public finances is significant and sustainability would not be compromised by allowing for a deviation from the adjustment path towards the MTO. Specifically, Slovenia requested a temporary deviation from the adjustment path towards the MTO of 0.07% of GDP in 2017 in relation to the inflow of refugees. Slovenia's 2018 Draft Budgetary Plan confirms this amount. The Commission provisionally assessed Slovenia to be eligible for an allowance of 0.01 % of GDP in relation to costs considered by the Commission to have a clear and direct link to the exceptional inflow of refugees. The Commission will make a final assessment, including on the eligible amounts, in spring 2018 on the basis of observed data as provided by the authorities.
9. The Draft Budgetary Plan includes measures to contain public sector pay, in particular by maintaining in force also in 2018 the restrictive payments of the bonuses for work performance and the lagged payments related to work promotion (0.3 % of GDP in 2018). However, the government also took measures to remove inconsistencies of the wage system (classification and comparison of different jobs) which will have a partly offsetting effect. Therefore, overall, the Commission considers the yield coming from the wage measures submitted in the Draft Budgetary Plan in 2018 to be limited. Measures to contain social allowances are estimated to reduce spending by 0.1 % of GDP in 2018. Several consolidation measures taken in 2012 in the context of the Additional Intervention Measures Act regarding social transfers will be prolonged into 2018. These measures include the parental leave compensation, which remains at a rate of 90 % with a limited maximum amount, and the restriction of the employment incentive for elderly employees. In addition, the

¹ Cyclically adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

restrictive income eligibility criteria for social scholarships will be partly extended into 2018.

10. The Commission 2017 autumn forecast also expects a further improvement of the headline general government balance, to a budget in balance in 2018. The Commission forecast projects a slightly higher growth in public wages, an increase in intermediate consumption in 2018 and a smoother dynamics regarding the absorption of EU funds comparing to what is planned in the Draft Budgetary Plan. The Commission projects an increase of 15 % in public investment, while the Draft Budgetary Plan plans a growth rate of almost 34 %. Therefore, the Commission expects capital transfers to increase at a slower pace than projected in the Draft Budgetary Plan and expects other capital expenditure to remain stable. The main downside risks to public finances in the coming years stem from the building expenditure pressures, particularly on wages and pensions. Similarly to the Draft Budgetary Plan, the Commission forecast expects a continued decline in the debt ratio, to 74.1% of GDP in 2018. The difference from the ratio of 71.7% forecast in the Draft Budgetary Plan is mostly due to different projections regarding the general government balance and more conservative assumptions concerning the stock-flow adjustment.
11. The Draft Budgetary Plan does not include sufficient information to assess compliance with the transitional arrangements regarding the debt reduction benchmark. On the basis of the Commission 2017 autumn forecast, Slovenia is projected to make sufficient progress towards compliance with the debt reduction benchmark in 2017 and 2018.
12. In 2017, Slovenia was recommended to achieve a structural adjustment of 0.6 % of GDP. The expenditure benchmark pillar based on the Draft Budgetary Plan indicates compliance. By contrast, the change in the (recalculated) structural balance planned in the Draft Budgetary Plan points to a risk of a significant deviation, both over one year (deviation of 0.6 % of GDP) and two years (average annual deviation of 0.4 % of GDP). This calls for an overall assessment. The expenditure benchmark pillar is considered to appropriately reflect the underlying fiscal effort planned by Slovenia, while the reading of the fiscal effort based on the structural balance pillar is negatively impacted by large revenue shortfalls. Therefore, the Draft Budgetary Plan submitted by Slovenia is assessed to plan compliance with the requirements of the preventive arm in 2017. According to the Commission autumn forecast, both the structural balance and the expenditure benchmark point to a risk of a significant deviation in 2017 (gap of 0.7% of GDP and 0.6% of GDP respectively). As indicated above, the expenditure benchmark pillar appears to more appropriately reflect the underlying fiscal effort of Slovenia. However, the expenditure benchmark is affected by the medium-term potential GDP growth rate used therein, which is much lower than the potential GDP growth rate emerging from the forecast for that year due to the large negative impact of the crisis years. At this stage, after taking into account into the expenditure benchmark the point estimate of potential growth of the Commission autumn forecast, Slovenia would appear to be at risk of some deviation in 2017. This conclusion would not change in case the budgetary impact of the exceptional inflow of refugees was excluded from the assessment.

In 2018, the nominal growth rate of net primary government expenditure should not exceed 0.6 %, corresponding to an annual structural adjustment of 1.0% of GDP. The expenditure benchmark based on the Draft Budgetary Plan points to a risk of some deviation over 2018 (gap of 0.4 % of GDP) and over 2017 and 2018 taken together

(average annual deviation of 0.2 % of GDP). At the same time, the (recalculated) structural balance planned in the Draft Budgetary Plan points to a risk of a significant deviation, both in 2018 (gap of 0.5 % of GDP) and over 2017 and 2018 together (gap of 0.6 % of GDP). This calls for an overall assessment. Given that the structural balance continues to be negatively impacted by revenue shortfalls in 2018, the expenditure benchmark pillar is again considered to reflect more appropriately the underlying fiscal effort. Therefore, the Draft Budgetary Plan is assessed to plan a risk of some deviation from the requirements of the preventive arm in 2018. According to the Commission's autumn forecast, both pillars point to a risk of a significant deviation (gap of 1.2% and 1.0% of GDP based on the expenditure benchmark and the structural balance respectively). An overall assessment confirms the conclusion of a risk of significant deviation.

The country-specific recommendations adopted by the Council on 11 July 2017 stipulate that the assessment of the 2018 Draft Budgetary Plan and the subsequent assessment of 2018 budget outcomes will need to take due account of the goal of achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of public finances. The Commission has carried out a qualitative assessment of the strength of the recovery in Slovenia while giving due consideration to its sustainability challenges. Slovenia does not face short-term sustainability challenges although in the medium term the overall risks to fiscal sustainability are assessed as high. The recovery in Slovenia does not appear fragile. Nonetheless, the estimated output gap is subject to uncertainty as flagged by the plausibility tool and the fiscal adjustment of 1.0% derived from the matrix may withdraw policy support too abruptly and have too strong negative impact on economic growth in Slovenia, in particular for investment that remains below the pre-crisis levels. In order to balance the current stabilisation needs with the existing sustainability challenges, according to the Commission, a fiscal structural effort of at least 0.6% of GDP is required, without any additional margin of deviation over one year. This corresponds to a nominal rate of growth of net primary government expenditure not exceeding 1.5%. Taking that into account in the overall assessment, however, Slovenia's fiscal adjustment cannot be considered adequate, in light of the sustainability challenges that Slovenia faces, on the basis of the Commission 2017 autumn forecast.

13. In the aftermath of the crisis, consolidation measures were taken both on the revenue and on the expenditure side. The share of investment in total government expenditure has decreased since 2011, while the share of social benefits and wages has increased. The Draft Budgetary Plan plans a sizeable increase in public investment in 2018. The Draft Budgetary Plan reports on measures taken to reform the healthcare system, in particular the launch of a public consultation on the draft Health Care and Health Insurance Act, extension the mandatory joint public procurement to medical devices over two years' time, implementation of e-health solutions, and preparation of a new law on long term care. These measures address the structural part of the fiscal recommendations contained in the Council Recommendation of 11 July 2017². The Council also recommended Slovenia to ensure the long-term sustainability and adequacy of the pension system: the Draft Budgetary Plan reports that measures will be prepared to ensure the fiscal sustainability of the pension system and to provide decent pensions; the measures would take effect after 2020.

² OJ C 261, 9.8.2017.

14. Overall and after considering the need to balance the objectives of strengthening the ongoing recovery and of ensuring fiscal sustainability, the Commission is of the opinion that the Draft Budgetary Plan of Slovenia, which is currently under the preventive arm and subject to the transitional period to make sufficient progress towards compliance with the debt reduction benchmark, is at risk of non-compliance with the provisions of the Stability and Growth Pact. The fiscal adjustment projected in the Commission forecast for 2018 is not adequate in light of the medium-term sustainability challenges that Slovenia faces. The improvement in the headline deficit and the debt-to-GDP ratio is partly explained by the favourable economic environment. The firming recovery provides the conditions for Slovenia to restore sufficient fiscal buffers needed to weather future downturns. Therefore, the Commission invites the authorities to take the necessary measures within the national budgetary process to ensure that the 2018 budget will be compliant with the SGP.

The Commission is also of the opinion that Slovenia has made some progress with regard to the structural part of the fiscal recommendations contained in the Council Recommendation of 11 July 2017 in the context of the 2017 European Semester and thus invites the authorities to make further progress. A comprehensive assessment of progress made with the implementation of the country-specific recommendations will be made in the 2018 Country Reports and in the context of the Commission proposal for country-specific recommendations to be proposed in May 2018.

Done at Brussels, 22.11.2017

For the Commission
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Member of the Commission