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COMMISSION STAFF WORKING DOCUMENT

Analysis of the updated Draft Budgetary Plan of Slovenia

Accompanying the document

COMMISSION OPINION

on the updated Draft Budgetary Plan of Slovenia

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COMMISSION STAFF WORKING DOCUMENT

Analysis of the updated Draft Budgetary Plan of Slovenia

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COMMISSION OPINION

on the updated Draft Budgetary Plan of Slovenia

1. INTRODUCTION

Slovenia submitted its updated Draft Budgetary Plan (hereafter: updated DBP) for 2019 on 25 January 2019. The DBP submitted on 15 October 2018 in compliance with Regulation (EU) No 473/2013 reflected budgetary projections for 2019 on the basis of unchanged policies as the new government only took office on 13 September 2018. In comparison with the no-policy-change DBP submitted on 15 October 2018, the updated DBP includes measures that the new government has adopted. Slovenia is subject to the preventive arm of the Stability and Growth Pact and should ensure sufficient progress towards its medium-term budgetary objective (MTO).

As the debt ratio was 82.6 % of GDP in 2015 (the year in which Slovenia corrected its excessive deficit), exceeding the 60 % of GDP reference value, during the three years following the correction of the excessive deficit Slovenia was also subject to the transitional arrangements to make sufficient progress towards compliance with the debt reduction benchmark in 2018. Following the end of the transition period, Slovenia needs to comply with the debt reduction benchmark as of 2019.

Section 2 of this document presents the macroeconomic outlook underlying the updated DBP and provides an assessment based on the Commission ad-hoc forecast[1]. The following section presents the recent and planned fiscal developments, according to the updated DBP, including an analysis of risks to their achievement based on the Commission ad-hoc forecast. In particular, it also includes an assessment of the measures underpinning the updated DBP. Section 4 assesses the recent and planned fiscal developments in 2018-2019 (also taking into account the risks to their achievement) against the obligations stemming from the Stability and Growth Pact. A box on the application of constrained judgement is contained in that section for Slovenia as it is flagged by the plausibility tool. Section 5 provides an analysis of implementation of fiscal-structural reforms in response to the latest country-specific recommendations in the context of the European Semester adopted by the Council in July 2018, including those to reduce the tax wedge. Section 6 summarises the main conclusions of this document.

[1] The Commission published its winter 2019 forecast (interim) on 7 February 2019. It only includes projections for GDP growth and inflation. In order to assess the updated DBP, the Commission complemented its winter 2019 forecast for Slovenia by a fully-fledged "ad-hoc" forecast, including in particular projections for the general government balance and the structural balance.

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2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE UPDATED DRAFT BUDGETARY PLAN

Slovenia's economic growth is expected to have reached 4.4 % in 2018, compared to 4.9 % in 2017 and below the projections in the 2018 Stability Programme. Growth was broad-based, driven by both strong investment dynamics and consumer spending, as well as net exports. Job creation remained steady and unemployment further declined to 5.0 % in the third quarter of 2018 – reaching a level last seen in 2008. Inflation was 1.9 %. According to the Commission estimate based on the commonly agreed methodology, the output gap[2] was 2.9 % of potential GDP in 2018.

The updated DBP builds on the same forecast as the no-policy-change DBP. For 2019, it projects the economy to grow by 3.7 %. The output gap estimate increases to 3.6 % of potential GDP, as recalculated by the Commission.

Based on the Commission ad-hoc forecast, the economy would grow by 3.1 % in 2019, i.e. less than according to the updated DBP. However, the Commission forecasts a slightly higher nominal GDP growth due to a stronger increase in the GDP deflator. Real GDP growth would be mainly driven by domestic demand, while the contribution of net exports would turn negative. The output gap is estimated to remain at 2.9 % of potential GDP. The risks to the forecast are mainly external and relate to demand on export markets.

Overall, the updated DBP's macroeconomic projections appear to be plausible for 2018 and favourable for 2019.

Box 1: The macroeconomic forecast underpinning the budget in Slovenia

The macroeconomic scenario underpinning the updated DBP is the Autumn 2018 Forecast of Economic Trends produced by the Institute of Macroeconomic Analysis and Development (IMAD). IMAD is an independent government office, whose management is responsible directly to the Prime Minister.

In order to ensure compliance with the requirement of Regulation (EU) No 473/2013, the draft Budget Act to be transmitted to the national parliament should be based on an independently produced macroeconomic forecast.

[2] The output gap estimates in the updated DBP are not taken at face value; instead, they are recalculated using the commonly agreed production function methodology on the basis of the Commission ad-hoc forecast.

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Table 1. Comparison of macroeconomic developments and forecasts

	2017	2018			2019		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	4.9	5.1	4.4	4.4	3.8	3.7	3.1
Private consumption (% change)	1.9	3.6	2.7	1.2	3.0	2.6	2.4
Gross fixed capital formation (% change)	10.7	10.0	9.0	9.4	8.5	8.5	7.6
Exports of goods and services (% change)	10.7	9.2	8.2	7.8	7.5	6.6	6.1
Imports of goods and services (% change)	10.3	9.3	8.0	7.7	8.1	7.1	7.1
Contributions to real GDP growth:							
- Final domestic demand	3.0	4.2	3.5	2.8	3.5	3.4	3.2
- Change in inventories	0.6	0.1	-0.1	0.7	0.0	0.0	0.0
- Net exports	1.3	0.9	0.9	0.9	0.3	0.3	-0.1
Output gap[1]	1.1	3.2	2.9	2.9	3.5	3.6	2.9
Employment (% change)	2.9	2.4	2.8	3.0	1.5	1.5	2.5
Unemployment rate (%)	6.6	5.3	5.5	5.6	4.6	4.9	5.3
Labour productivity (% change)	1.9	2.7	1.5	1.4	2.2	2.1	0.6
HICP inflation (%)	1.6	1.5	1.8	1.9	1.9	2.1	1.9
GDP deflator (% change)	1.6	2.4	1.9	1.8	2.6	2.3	3.3
Comp. of employees (per head, % change)	3.2	5.2	4.9	3.2	5.1	5.2	3.6
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	6.3			6.3			7.4

Note:

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

Source:

Stability Programme 2018 (SP); updated Draft Budgetary Plan for 2019 (DBP); Commission ad-hoc forecast (COM); Commission calculations

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3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

Despite the downward revision of the macro-economic outlook, the updated DBP doubles the 2018 general government surplus estimate projected in the 2018 Stability Programme to 0.8 % of GDP, in line with the Commission ad-hoc forecast. The upward revision of the headline surplus is mainly due to higher-than-expected tax revenues and social contributions, as well as lower public investment than projected in the 2018 Stability Programme. A downward revision of public investment compared to the Stability Programme is mainly driven by the lower-than-expected absorption rate of EU Structural Funds. Compared to 2017, the general government surplus is now projected to have increased by 0.7 percentage points. That improvement is partly explained by the favourable macroeconomic conditions and strong employment growth. Conversely, compensation of employees and social benefits are projected to have increased strongly due to the expiry of previous temporary consolidation measures and an extraordinary indexation of pensions. Intermediate consumption is also forecast to have risen. As a result of active public debt management, interest expenditure is expected to have declined significantly.

For 2019, the updated DBP plans a general government surplus at 0.6 % of GDP. On the revenue side, taxes and social contributions are expected to remain the main drivers for revenue growth and were revised upwards in nominal terms compared to the 2018 Stability Programme. On the expenditure side, the updated DBP expects higher public investment compared to the 2018 Stability Programme, also related to the implementation of the EU Structural Funds financial programming period of 2014-2020. While interest expenditure is projected to continue declining by a double-digit rate, compensation of employees and social transfers are expected to grow strongly. That strong growth is a result of further relaxation of temporary restrictive measures, of a rise in public sector pay negotiated with the labour unions in late 2018 and of an increase in pension expenditure from extraordinary indexation of pensions and higher annual pension allowances. The Commission ad-hoc forecast lies 0.1 percentage point above the updated DBP headline surplus estimate for 2019. That difference mainly arises from an assumption of a smoother public investment profile over 2019 and 2020 in the Commission projections as opposed to a large peak of public investment in 2019 planned in the updated DBP. In addition, the Commission expects slightly higher growth rates for taxes on income and wealth and social contributions.

The main downside risks to public finances in the coming years stem from building expenditure pressures, particularly on wages and social benefits. An additional risk on the expenditure side is the emergence of unexpected one-offs, for instance due to unfavourable court rulings. Proceeds from privatisations of Abanka and NLB could contribute to further reducing public debt, although the revenue from dividends would decrease.

In structural terms, the updated DBP projects no change in the structural balance[3] for 2018 and a structural deterioration of 0.7 % of GDP for 2019. The Commission ad-hoc forecast envisages a structural deterioration of 0.1 % of GDP in both 2018 and 2019. The large difference in the 2019 estimates is mainly due to lower projected public investment and output gap in the Commission ad-hoc forecast.

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

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Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Slovenia currently standing at 1.03[4]. Due to the low interest rate environment, decreasing debt-to-GDP ratio and active public debt management, total interest payments by the general government have continued to fall as a share of GDP. Based on the information included in the updated DBP, interest expenditure in Slovenia is expected to have fallen from 2.5 % of GDP in 2017 to 2.0 % in 2018 and is projected to decrease further in 2019, at 1.6 % of GDP. The picture stemming from Slovenia's updated DBP is confirmed by the Commission ad-hoc forecast.

Table 2. Composition of the budgetary adjustment

(% of GDP)	**2017**	**2018**			**2019**			**Change: 2017-2019**
	COM	**SP**	**DBP**	**COM**	**SP**	**DBP**	**COM**	**DBP**
Revenue	**43.2**	**42.3**	***43.4***	**43.4**	**41.7**	***43.0***	**42.8**	**-0.2**
of which:								
- Taxes on production and imports	14.3	13.9	*14.3*	14.3	13.4	*13.9*	13.9	-0.4
- Current taxes on income, wealth, etc.	7.5	7.6	*7.8*	7.8	7.6	*7.8*	7.8	0.3
- Capital taxes	0.0	0.0	*0.0*	0.0	0.0	*0.0*	0.0	0.0
- Social contributions	14.8	14.5	*14.9*	14.9	14.4	*14.8*	14.8	0.0
- Other (residual)	6.6	6.3	*6.4*	6.3	6.3	*6.5*	6.3	-0.1
Expenditure	**43.2**	**41.9**	**42.6**	**42.6**	**41.5**	**42.5**	**42.1**	**-0.7**
of which:								
- Primary expenditure	40.7	39.9	40.6	40.6	39.8	40.8	40.5	0.2
of which:								
Compensation of employees	11.2	11.0	11.2	11.2	10.9	11.2	11.1	0.0
Intermediate consumption	6.3	5.9	6.2	6.2	5.7	6.1	6.1	-0.2
Social payments	17.0	16.3	16.8	16.8	16.1	16.4	16.3	-0.7
Subsidies	0.7	0.7	0.7	0.7	0.7	0.7	0.7	-0.1
Gross fixed capital formation	3.1	3.4	3.5	3.5	3.9	4.3	4.0	1.2
Other (residual)	2.3	2.6	2.2	2.3	2.5	2.1	2.3	0.0
- Interest expenditure	2.5	2.0	2.0	2.0	1.7	1.6	1.6	-0.9
General government balance (GGB)	**0.1**	**0.4**	**0.8**	**0.8**	**0.2**	**0.6**	**0.7**	**0.5**
Primary balance	**2.6**	**2.4**	**2.8**	**2.8**	**1.9**	**2.2**	**2.3**	**-0.4**
One-off and other temporary measures	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0	0.0
GGB excl. one-offs	**0.1**	**0.4**	**0.9**	**0.8**	**0.2**	**0.6**	**0.7**	**0.5**
Output gap[1]	1.1	3.2	2.9	2.9	3.5	3.6	2.9	2.5
Cyclically-adjusted balance[1]	-0.5	-1.2	-0.5	-0.6	-1.5	-1.2	-0.7	-0.7
Structural balance (SB)[2]	**-0.4**	**-1.1**	**-0.4**	**-0.5**	**-1.4**	**-1.1**	**-0.6**	**-0.7**
Structural primary balance[2]	2.1	0.9	1.6	1.4	0.3	0.5	1.0	-1.6

Notes:

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

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

Source:

Stability Programme 2018 (SP); updated Draft Budgetary Plan for 2019 (DBP); Commission ad-hoc forecast (COM); Commission calculations

[4] 10-year bond yields as of 1 February 2019. Source: Bloomberg.

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3.2. Debt developments

After peaking at 82.6 % of GDP in 2015, the general government gross debt fell to 74.1 % of GDP in 2017. Based on the updated DBP projections, public debt is estimated to gradually decline, reaching 66.0 % of GDP in 2019. The contribution of interest expenditure is expected to continue falling significantly. Compared to the 2018 Stability Programme, the debt-to-GDP ratio is revised upwards in 2018, mainly due to a denominator effect from lower nominal GDP growth expectations and a bigger stock-flow adjustment. Like the updated DBP, the Commission also forecasts a declining debt ratio, at 66.2 % of GDP in 2019.

Table 3. Debt developments

(% of GDP)	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**74.1**	**69.3**	**70.3**	**69.9**	**65.2**	**66.0**	**66.2**
Change in the ratio	-4.6	-4.8	-3.8	-4.2	-4.1	-4.3	-3.7
Contributions[2] *:*							
1. Primary balance	**-2.6**	**-2.4**	**-2.8**	**-2.8**	**-1.9**	**-2.2**	**-2.3**
2. "Snow-ball" effect	**-2.3**	**-3.1**	**-2.4**	**-2.4**	**-2.5**	**-2.3**	**-2.5**
Of which:							
Interest expenditure	2.5	2.0	2.0	2.0	1.7	1.6	1.6
Growth effect	-3.6	-3.5	-3.1	-3.1	-2.5	-2.5	-2.0
Inflation effect	-1.2	-1.6	-1.3	-1.3	-1.7	-1.5	-2.2
3. Stock-flow adjustment	**0.3**	**0.8**	**1.5**	**1.0**	**0.3**	**0.3**	**1.2**
Of which:							
Cash/accruals difference							
Net accumulation of							
of which privatisation proceeds							
Valuation effect & residual							

Notes:

[1] End of period.

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

Source:

Stability Programme 2018 (SP); updated Draft Budgetary Plan for 2019 (DBP); Commission ad-hoc forecast (COM); Commission calculations

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3.3 Measures underpinning the updated draft budgetary plan

For 2019, the updated DBP includes measures to reduce expenditure with an overall budgetary impact of 0.2 % of GDP. The government has restricted promotion-related payments until December 2019, leading to a 0.1 % of GDP reduction in compensation of employees. Based on the updated DBP, another 0.1 % of GDP decrease in government spending should result from lower social payments. The decrease in social transfers is due to a partial freeze of their level and the income-eligibility criteria for individuals and households, as well as to soft measures aiming to improve the performance of social measures. The updated DBP envisages one-off expenditure of 0.1 % of GDP in both 2018 and 2019. Both the expenditure pertaining to a court ruling regarding interest compensation for deposit holders of Ljubljanska Banka and to a lawsuit concerning return of agricultural land have been considered one-off expenditure.

The Commission ad-hoc forecast considers the estimates provided in the updated DBP for the wage measures and one-off expenditure as appropriate. However, the Commission has a more conservative estimate for the measures on social payments compared to the updated DBP. In addition, the Commission ad-hoc forecast considers as discretionary expenditure measures the extraordinary indexation of pensions and the increase in the annual pension allowances in 2019 whereas they are part of the baseline in the updated DBP.

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Table 4. Main discretionary measures reported in the updated DBP

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2018	**2019**
Taxes on production and		
Current taxes on income,		
Capital taxes		
Social contributions		
Property Income		
Other		
Total	0	0

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the updated DBP, i.e. by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.
Source: updated Draft Budgetary Plan for 2019

B. Discretionary measures taken by general Government- expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2018	**2019**
Compensation of employees	0	-0.1
Intermediate consumption		
Social payments	0	-0.1
Interest Expenditure		
Subsidies		
Gross fixed capital formation		
Capital transfers		
Other		
Total	0	-0.2

Note:
The budgetary impact in the table is the aggregated impact of measures as reported in the updated DBP, i.e. by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.
Source: updated Draft Budgetary Plan for 2019

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4. Compliance with the provisions of the Stability and Growth Pact

Slovenia is subject to the preventive arm of the Stability and Growth Pact and should ensure sufficient progress towards its MTO. Box 2 reports the latest country-specific recommendations in the area of public finances. Following the end of the transitional arrangements, Slovenia is also subject to the debt reduction benchmark as of 2019.

Box 2. Council Recommendations[5] addressed to Slovenia

On 13 July 2018, the Council addressed recommendations to Slovenia in the context of the European Semester. In particular, in the area of public finances the Council recommended that the nominal growth rate of net primary government expenditure does not exceed 3.1 % in 2019, corresponding to an annual structural adjustment of 0.65 % of GDP.

4.1. Compliance with the debt criterion

After it corrected its excessive deficit in 2015, Slovenia was in the transition period for the following three years to make sufficient progress towards compliance with the debt reduction benchmark. This implies that, during that period, it was required to make sufficient progress (as defined by the minimum linear structural adjustment (MLSA)) towards compliance with the debt reduction benchmark at the end of the transition period. In 2019, as its debt ratio is still expected to exceed the 60 % of GDP reference rate of the Treaty, Slovenia needs to comply with the debt reduction benchmark.

The updated DBP does not provide sufficient information to assess compliance with either the MLSA in 2018 or the debt reduction benchmark in 2019. According to the Commission ad-hoc forecast, Slovenia is expected to have made sufficient progress towards compliance with the debt reduction benchmark in 2018. Specifically, the structural change of -0.1 % of GDP is considerably above the MLSA of -6.8 % of GDP. In 2019, the Commission expects that the debt reduction benchmark is largely met with a gap of -6.5 % of GDP.

[5] OJ C 320, 10.9.2018.

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Table 5. Compliance with the debt criterion*

	2017	2018			2019		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	74.1	69.3	70.3	69.9	65.2	66.0	66.2
Gap to the debt benchmark [1,2]					-7.1		-6.5
Structural adjustment [3]	0.7	-0.6	-0.1	-0.1	-0.4	-0.7	-0.1
To be compared to:							
Required adjustment [4]	-2.2	-7.6		-6.8			

Notes:

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

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

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

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

Source:

Stability Programme 2018 (SP); updated Draft Budgetary Plan for 2019 (DBP); Commission ad-hoc forecast (COM); Commission calculations

* An ex-ante assessment of planned compliance with the debt criterion can be based on the DBP only for the concerned countries providing extended data series (i.e. covering years up to t+4) in the DBP on a voluntary basis, as agreed at the EFC-A on 22 September 2014 and reflected in the updated Code of Conduct of the two-pack.

4.2. Adjustment towards the MTO

The Commission Communication on the 2017 European Semester of May 2017[6] stated that the Commission stood ready to use its margin of appreciation in cases where the impact of a large fiscal adjustment on growth and employment was particularly significant. The Country-Specific Recommendation adopted by the Council on 11 July 2017 mentioned that the assessment of the 2018 DBP and subsequent assessment of 2018 budget outcomes would 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.

For 2018, in line with the commonly agreed adjustment matrix under the Stability and Growth Pact, Slovenia was recommended to achieve a structural adjustment of 1.0 % of GDP, corresponding to a nominal growth rate of net primary government expenditure below 0.6 %. Based on the information provided in the updated DBP, the growth rate of government expenditure, net of discretionary revenue measures and one-offs, exceeds the expenditure benchmark derived from the matrix, leading to a gap of 0.9 % of GDP for 2018 and a gap of 0.8 % of GDP over 2017 and 2018 taken together. At the same time, the (recalculated) structural balance projected in the updated DBP indicates a gap of 1.0 % of GDP for 2018 and

[6] https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-specific-recommendations-commission-recommendations-communication.pdf.

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slightly more than 0.5 % of GDP on average over 2017 and 2018. As a result, both pillars point to a risk of significant deviation for both 2018 and over 2017 and 2018 taken together. The expenditure benchmark is strongly negatively affected by the medium-term potential GDP growth it uses, which includes exceptionally low potential GDP growth in the crisis years. It is therefore more appropriate to consider as a benchmark for growth of net primary expenditure the higher medium-term potential GDP growth rate arising from the Commission ad-hoc forecast instead of the frozen estimate from the Commision 2018 spring forecast for the same reference period (2012-2021). Compared to the expenditure benchmark, the structural balance is negatively affected by the projected revenue shortfalls, since the growth is more driven by investment and exports than by private consumption. The structural balance is also negatively affected by higher investment, which is smoothed over four years in the calculation of the expenditure benchmark. At the same time, the structural balance benefits from falling interest expenditure, a factor excluded from the expenditure benchmark pillar. Taking this into account, based on an overall assessment, the updated DBP projects a risk of significant deviation from the requirements of the preventive arm in 2018 and over 2017 and 2018 taken together.

In turn, based on the Commission ad-hoc forecast, both the expenditure benchmark and the structural balance point to a risk of significant deviation for 2018 (gap of 1.7 % and 1.1 % of GDP, respectively). The same conclusion is drawn if the deviation from the two-year average is considered, indicating an average gap of 1.2 % and 0.6 % of GDP based on the expenditure benchmark and the structural balance, respectively. As it is the case in the updated DBP, also in the Commission ad-hoc forecast, the reading of the fiscal effort based on the expenditure benchmark pillar is negatively affected by the medium-term potential GDP growth rate it uses. Similarly, when compared to the expenditure benchmark, the structural balance is negatively affected by higher investment which is fully offset by lower interest expenditure. The overall assessment based on the Commission ad-hoc forecast confirms the conclusion of a risk of significant deviation in 2018 and over 2017 and 2018 taken together. Following the Commission's assessment of the strength of the recovery in Slovenia while giving due consideration to its sustainability challenges, carried out in the context of its opinion on Slovenia’s 2018 DBP, Slovenia was required to achieve a fiscal structural effort of at least 0.6 % of GDP for 2018, without any additional margin of deviation over one year. Such a structural effort corresponds to a nominal rate of growth of net primary government expenditure not exceeding 1.5 %. Even after applying that lower requirement, the conclusion of a risk of a significant deviation is unchanged based on both the updated DBP and the Commission ad-hoc forecast.

In 2019, Slovenia was recommended to pursue a nominal growth rate of net primary government expenditure below 3.1 %, corresponding to an annual structural adjustment of 0.65 % of GDP. Over 2019, based on the updated DBP, the growth of nominal primary government expenditure, net of discretionary revenue measures and one-offs, is expected to exceed the applicable expenditure benchmark with a gap of almost 0.5 % of GDP, pointing to some deviation at the margin. The (recalculated) structural balance is expected to deteriorate by 0.7 % of GDP, pointing to a deviation of 1.3 % of GDP from the required structural adjustment. Both pillars point to a risk of significant deviation over 2018 and 2019 taken together (average gap of 0.7 % and 1.2 % of GDP based on the expenditure benchmark and the structural balance, respectively). The reading of the fiscal effort based on the structural balance, as compared to the expenditure bechmark, continues to be substantially penalised by the projected revenue shortfalls, due to the composition of growth and lower projected

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dividends. The structural balance is negatively affected by higher investment while it benefits from lower interest expenditure. Another factor relevant for the difference between the two indicators arises from the potential GDP growth estimates they use. Contrary to the assessment for 2018, the medium-term potential GDP growth rate arising from the Commission ad-hoc forecast confirms the frozen estimate from the Commission 2018 spring forecast. As the expenditure benchmark is considered to give a more accurate picture of the fiscal effort, an overall assessment based on the updated DBP points to a risk of some deviation from the adjustment path towards the MTO in 2019 over one year, although with a very small margin from a risk of significant deviation. However, over 2018 and 2019 taken together, the overall assessment points to a risk of significant deviation.

Based on the Commission ad-hoc forecast, both the expenditure benchmark and the structural balance indicate a risk of significant deviation in 2019 (gap of 0.7 % of GDP and 0.8 % of GDP, respectively). The same conclusion is drawn if the deviation from the two-year average is considered (average gap of 1.2 % and 1.0 % of GDP based on the expenditure benchmark and the structural balance, respectively). The reading of the fiscal effort based on the expenditure benchmark is penalised by the lower GDP deflator used for that indicator compared to the one underlying the structural balance pillar. At the same time, the structural balance is very negatively affected by the projected revenue shortfalls and higher investment, while it benefits from falling interest expenditure. The different estimates of the potential GDP growth used in the calculation of both indicators is another factor relevant for the difference. Following an overall assessment, Slovenia is expected to be at risk of significant deviation from the requirements of the preventive arm in 2019 and over 2018 and 2019 taken together.

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Box 3. Implementation of the "constrained judgement" approach and its impact on fiscal surveillance

The objective of the "constrained judgement" approach is to have a transparent and economically grounded tool to statistically test the plausibility of the output gap estimates for individual Member States estimated on the basis of the commonly agreed methodology. To that end, the Commission developed, in consultation with the Member States, an objective screening tool based on a set of cyclically relevant indicators as well as thresholds/ranges to signal cases when the outcomes of the common method could be interpreted as being subject to a large degree of uncertainty and therefore deserving of further investigation on the part of the Commission. In such cases, the Commission carries out an "in depth" analysis which could lead to the application of a "constrained" degree of judgement in conducting Member States' budgetary assessments.

Regarding Slovenia, the plausibility tool provided indications that the output gap for 2018, estimated on the basis of the commonly agreed methodology, may be counterintuitive. The output gap, as calculated on the basis of the common methodology, is projected to have increased to 2.9 % of potential GDP in 2018 (from 1.1 % in 2017) and to stay unchanged in 2019. The Commission estimates for the output gap are above the ones derived from the HP filter (2.5 % in 2019) and those of OECD (2.2 % in 2019) but below the estimates of IMF (3.0 % in 2019). Based on the Commission 2018 autumn forecast, the plausibility tool projects the 2018 output gap at 1.1 % of potential GDP, significantly lower than the one based on the commonly agreed methodology. Applying the same 1.8 percentage points of potential GDP difference in 2019 would lead to a range of output gap estimates from 1.1 % to 2.9 % of potential GDP. The plausibility tool estimate indicates that the amount of idle capacities that are available for production (manufacturing capacity and labour force) may be higher than estimated on the basis of the production function method; however, the estimate can be also influenced by the relatively short time series.

Those factors confirm that for Slovenia the output gap estimate based on the common methodology is subject to a high degree of uncertainty. An assessment was already carried out for Slovenia in spring 2018, which indicated that the output gap estimate for 2019 based on the common methodology was subject to a high degree of uncertainty. That finding was reflected in the 2018 Council recommendations, which include an adjustment requirement of 0.65 % of GDP for 2019 instead of the requirement of 1 % of GDP.

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Table 6. Compliance with the requirements of the preventive arm

(% of GDP)	2017	2018		2019	
Initial position[1]					
Medium-term objective (MTO)	0.3	0.3		0.3	
Structural balance[2] (COM)	-0.4	-0.5		-0.6	
Structural balance based on freezing (COM)	-1.6	-0.5		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
(% of GDP)	**2017**	**2018**		**2019**	
	COM	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.6	1.0		0.7	
Required adjustment corrected[5]	0.6	1.0		0.7	
Change in structural balance[6]	0.6	0.0	-0.1	-0.7	-0.1
One-year deviation from the required adjustment[7]	0.0	-1.0	-1.1	-1.3	-0.8
Two-year average deviation from the required adjustment[7]	-0.1	-0.5	-0.6	-1.2	-1.0
Expenditure benchmark pillar					
Applicable reference rate[8]	-0.7	0.6		3.1	
One-year deviation adjusted for one-offs[9]	-0.7	-0.9	-1.7	-0.5	-0.7
Two-year average deviation adjusted for one-offs[9]	-0.4	-0.8	-1.2	-0.7	-1.2

Notes

[1] The most favourable level of the structural balance, measured as a percentage of GDP reached at the end of year t-1, between spring forecast (t-1) and the latest forecast, determines whether there is a need to adjust towards the MTO or not in year t. A margin of 0.25 percentage points (p.p.) is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance = cyclically-adjusted government balance excluding one-off measures.

[3] Based on the relevant structural balance at year t-1.

[4] Based on the position vis-à-vis the MTO, the cyclical position and the debt level (See European Commission: Vade mecum on the Stability and Growth Pact, page 38.).

[5] Required adjustment corrected for the clauses, the possible margin to the MTO and the allowed deviation in case of overachievers.

[6] Change in the structural balance compared to year t-1. Ex post assessment (for 20XX-1) was carried out on the basis of Commission 20XX spring forecast.

[7] The difference of the change in the structural balance and the corrected required adjustment.

[8] Reference medium-term rate of potential GDP growth. The (standard) reference rate applies from year t+1, if the country has reached its MTO in year t. A corrected rate applies as long as the country is adjusting towards its MTO, including in year t.

[9] Deviation of the growth rate of public expenditure net of discretionary revenue measures, revenue increases mandated by law and one-offs from the applicable reference rate in terms of the effect on the structural balance. The expenditure aggregate used for the expenditure benchmark is obtained following the commonly agreed methodology. A negative sign implies that expenditure growth exceeds the applicable reference rate.

Source :

Updated Draft Budgetary Plan for 2019 (DBP); Commission ad-hoc forecast (COM); Commission calculations.

5. Composition of public finances and Implementation of fiscal structural reforms

In 2019, both revenue and expenditure are expected to decline relative to GDP (to 43.0 % and 42.5 % of GDP, respectively). The updated DBP indicates a strong increase in public investment, jumping from 3.1 % of GDP in 2017 to 4.3 % of GDP in 2019. As a result of active public debt management and due to favourable financial market conditions, interest expenditure is projected to decrease significantly over 2018 and 2019, from 2.5 % of GDP in 2017 to 1.6 % of GDP in 2019.

On 13 July 2018, the Council addressed recommendations to Slovenia in the context of the European Semester. In particular, with regard to the structural part of the fiscal recommendations the Council recommended Slovenia to adopt and implement the Healthcare and Health Insurance Act and the planned reform of long-term care. The Council recommended Slovenia to ensure the long-term sustainability and adequacy of the pension system, including by increasing the statutory retirement age and by restricting early retirement.

According to the updated DBP, the government submitted the draft Healthcare and Health Insurance Act to the Economic and Social Council and the coalition partners in the beginning of 2018. The draft law adresses the method and sources of financing and emphasises strengthening controls over both payers and operators. In 2019, the government will continue to work on the draft law, focussing on measures to manage waiting times and stabilize the operations of hospitals. The government expects to adopt a draft Healthcare Act by the end of 2019. At the same time, it is implementing a two-year project to build capacities, develop tools and establish mechanisms for managing the public healthcare service network.

In 2017, the Slovenian authorities prepared a proposal for an Act on long-term care and insurance for long-term care, focussing on access to high-quality services, sustainable financing, comprehensive treatment of patients and promotion of care at home or in the community. The proposed solutions are being tested in three pilot projects in eastern cohesion region that started in 2018 and are supported by the European Social Fund.

In July 2017, the Economic and Social Council adopted measures for further development of the pension system in Slovenia. Its agreed measures aim at ensuring the financial sustainability of the pension system and providing decent pensions. Based on the updated DBP, the Slovenian government should adopt new legislation regarding a raise in the actual retirement age, early employment of young people and prolonged activity of the elderly by December 2020; however, the measures have not been specified.

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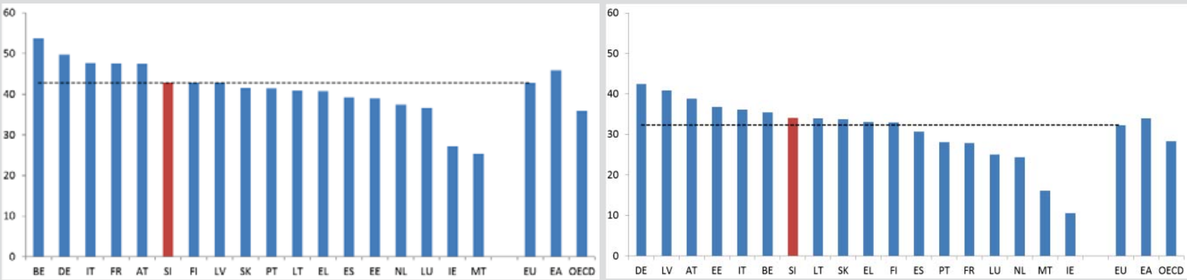
Box 4 – Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against that background, the Eurogroup has expressed a commitment to reduce the tax burden on labour. On 12 September 2015, the Eurogroup agreed to benchmark euro-area Member States' tax burden on labour against the GDP-weighted EU average, relying in the first instance on indicators measuring the tax wedge on labour for a single worker at average wage and a single worker at low wage. It also agreed to relate those numbers to the OECD average for purposes of broader comparability.

The tax wedge on labour measures the difference between the total labour costs to employ a worker and the worker's net earnings. It is made up of personal income taxes and employer and employee social security contributions. The higher the tax wedge, the higher the disincentives to take up work or hire new staff. The graphs below show the tax wedge in Slovenia for a single worker earning respectively the average wage and a low wage (50 % of the average) compared to the EU average.

The tax burden on labour in Slovenia at the average wage and at low wage (2016)



Notes: No recent data is available for Cyprus. EU and EA averages are GDP-weighted. The OECD average is not weighted.

Source: European Commission Tax and Benefit Indicator database based on OECD data.

Benchmarking is only the first step in the process towards firm, country-specific policy conclusions. The tax burden on labour interacts with a wide variety of other policy elements such as the benefit system and the wage-setting system. A good employment performance indicates that the need to reduce labour taxation may be less urgent while fiscal constraints can dictate that labour tax cuts should be fully offset by other revenue-enhancing or expenditure-reducing measures. In-depth, country-specific analysis is necessary before drawing policy conclusions.

Slovenia's updated Draft Budgetary Plan includes no measures that affect the tax wedge on labour.

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6. Overall conclusion

On the basis of the Commission ad-hoc forecast, the structural improvement in the debt-to-GDP ratio is in line with the minimum linear structural adjustment to ensure sufficient progress towards compliance with the debt criterion in 2018 and in line with the debt criterion in 2019.

Following an overall assessment of the updated DBP, the projected structural adjustment points to a risk of significant deviation from the required adjustment path towards the MTO in 2018 and a risk of some deviation in 2019. However, for 2018 and 2019 taken together, an overall assessment indicates a risk of significant deviation. An overall assessment based on the Commission ad-hoc forecast points to a risk of significant deviation from the adjustment path towards the MTO recommended by the Council in both 2018 and 2019.

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