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COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of Slovenia

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of Slovenia

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COMMISSION STAFF WORKING DOCUMENT

Analysis of the Draft Budgetary Plan of Slovenia

Accompanying the document

COMMISSION OPINION

on the Draft Budgetary Plan of Slovenia

1. INTRODUCTION

Slovenia submitted its Draft Budgetary Plan for 2020 on 10 October 2019 in compliance with Regulation (EU) No 473/2013. Slovenia is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective. As the debt ratio was 70.4% of GDP in 2018, exceeding the 60% of GDP reference value of the Treaty, Slovenia also needs to comply with the debt reduction benchmark as of 2019.

Section 2 of this document presents the macroeconomic outlook underlying the Draft Budgetary Plan and provides an assessment based on the Commission 2019 autumn forecast. The following section presents the recent and planned fiscal developments, according to the Draft Budgetary Plan, including an analysis of risks to their achievement based on the Commission 2019 autumn forecast. In particular, it also includes an assessment of the measures underpinning the Draft Budgetary Plan. Section 4 assesses the recent and planned fiscal developments in 2019-2020 (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 this 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 2019, including those to reduce the tax wedge. Section 6 summarises the main conclusions of the present document.

2. MACROECONOMIC DEVELOPMENTS UNDERLYING THE DRAFT BUDGETARY PLAN

Slovenia's GDP grew by 4.1% in 2018 in real terms. Growth was driven by strong domestic demand whereas net exports had a negative growth contribution. Employment grew by 3.2% and unemployment rate fell to 5.1%. Inflation stood at 1.9%. The output gap, estimated by the Commission based on the commonly agreed methodology, was 3.2% of potential GDP in 2018.

Based on the Draft Budgetary Plan, the economy is expected to grow by 2.8% in 2019, driven by domestic demand. Both private consumption and investment are expected to grow strongly. Positive developments on the labour market are expected to continue whereas inflation is forecast to fall to 1.8%. Compared to the 2019 Stability Programme, the growth projection has been revised downwards, in particular for net exports. Inflation has been revised upwards. Based on the Commission 2019 autumn forecast, the GDP is projected to grow slightly less, by 2.6% in 2019. The Commission forecast on inflation is the same as the Draft Budgetary Plan forecast.

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In 2020, the Draft Budgetary Plan projects the economy to grow by 3.0%, almost in line with the projection of 3.1% in the 2019 Stability Programme. While investment and exports of goods and services have been revised slightly downwards compared to the 2019 Stability Programme, private consumption growth has been revised upwards. Unemployment is projected to fall to 4.0%. Inflation has been revised slightly upwards. Based on the Draft Budgetary Plan, the output gap, as recalculated by the Commission, remains unchanged at 3.3% of potential GDP.

Based on the Commission 2019 autumn forecast, the economy is expected to grow slightly less, by 2.7% in 2020. Compared to the Draft Budgetary Plan, private consumption growth would be faster whereas investments would grow less. Net exports would have a slightly more negative contribution to growth. The output gap is estimated to reach 3.1% of potential GDP, narrowing by 0.2 percentage points of potential GDP compared to the estimate for 2019. The expected increase in employment is similar to the Draft Budgetary Plan forecast, but the forecast on the increase of the compensation of employees is lower. The risks to the forecast are mainly external and relate to the demand on the export markets.

Overall, the Draft Budgetary Plan's macroeconomic projections appear to be plausible for 2019 and favourable for 2020.

Box 1: The macroeconomic forecast underpinning the budget in Slovenia

The macroeconomic scenario underpinning the Draft Budgetary Plan is the Autumn 2019 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.

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Table 1. Comparison of macroeconomic developments and forecasts

	2018	2019			2020		
	COM	SP	DBP	COM	SP	DBP	COM
Real GDP (% change)	4.1	3.4	2.8	2.6	3.1	3.0	2.7
Private consumption (% change)	3.4	2.9	3.4	3.0	2.4	2.7	2.9
Gross fixed capital formation (% change)	9.4	7.7	6.8	6.1	7.0	6.8	6.0
Exports of goods and services (% change)	6.6	5.1	7.8	7.9	5.3	5.0	4.9
Imports of goods and services (% change)	7.7	6.0	9.2	9.2	5.8	5.8	5.8
Contributions to real GDP growth:							
- Final domestic demand	4.1	3.4	3.3	3.1	3.0	3.2	3.0
- Change in inventories	0.2	0.1	-0.2	-0.2	0.0	0.0	0.0
- Net exports	-0.2	-0.1	-0.5	-0.3	0.1	-0.2	-0.3
Output gap[1]	3.2	3.4	3.3	3.3	3.0	3.3	3.1
Employment (% change)	3.2	2.0	2.5	2.3	1.0	1.4	1.5
Unemployment rate (%)	5.1	4.3	4.3	4.4	3.9	4.0	4.2
Labour productivity (% change)	0.9	1.4	0.3	0.3	2.1	1.5	1.2
HICP inflation (%)	1.9	1.6	1.8	1.8	1.9	2.0	1.9
GDP deflator (% change)	2.2	2.7	2.5	2.7	2.5	2.5	2.4
Comp. of employees (per head, % change)	3.9	5.4	4.9	3.6	5.6	5.1	3.6
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	5.3			5.3			5.0

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 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations.

3. RECENT AND PLANNED FISCAL DEVELOPMENTS

3.1. Deficit developments

Compared to the 2019 Stability Programme, the Draft Budgetary Plan reduced the general government surplus projection for 2019 by 0.1 percentage point of GDP to 0.8% of GDP. This is mostly due to an upward revision in social transfers, which is only partly offset by lower public investment, and higher social security contributions than expected in spring 2019. Compared to the Draft Budgetary Plan, the Commission projects a lower surplus of 0.5% of GDP in 2019. This is mostly due to a different growth composition and a significant negative impact on personal income tax revenues expected from the reduced tax burden on the annual holiday allowance (0.2% of GDP). In structural terms, the Draft Budgetary Plan projects the (recalculated) structural balance[1] to deteriorate by 0.1 percentage point of GDP to -0.7% of GDP, whereas the Commission projections show a worsening of 0.3 percentage points of GDP to -1.0% of GDP.

For 2020, the Draft Budgetary Plan projects the general government surplus to increase by 0.1 percentage point of GDP, to 0.9% of GDP, similar to the increase in the 2019 Stability

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

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Programme. The expenditure is forecast to grow less strongly than in 2019, thanks to restricted bonus payments, labour market activation measures, abolished work activity benefit and lower public investment growth. On the revenue side, loss of personal income tax revenues due to the adopted measures reducing the tax burden on labour is expected to be fully compensated by higher revenues from capital gains, rental income and corporate income taxes and higher efficiency of tax collection. Property income is forecast to further decrease, due to lower dividends related to the privatisations of 10% of Nova Ljubljanska Banka (NLB) and 100% of Abanka which took place in 2019. The Commission forecasts the general government balance to remain at 0.5% of GDP. Next to a negative expected impact from the adopted tax measures (0.1% of GDP), less favourable macroeconomic projections and a different growth composition are among the main reasons for this difference (see section 3.3). Based on the Draft Budgetary Plan, the (recalculated) structural balance is expected to improve by 0.1 percentage point of GDP in 2020, in line with the Commission projection.

The main downside risks to the Draft Budgetary Plan and the Commission projections of public finances in 2020 stem from building expenditure pressures, particularly on wages and social benefits. An additional risk on the expenditure side is the emergence of further one-offs, i.e. due to unfavourable court rulings, or adoption of new expenditure increasing measures. These measures can include, for instance, lowering the real growth threshold rate for extraordinary indexation of pensions from 3% to 2.5% for 2020 or abolishing the voluntary health insurance. On the revenue side, lower-than-expected economic growth and less efficient tax collection than expected in the Draft Budgetary Plan pose a negative risk.

Euro area sovereign bond yields remain at historically low levels, with 10-year rates in Slovenia currently standing at 0.11%[2]. Due to low interest rate environment, general government surplus and active public debt management, total interest payments by the general government have continued to decrease as a share of GDP. Based on the information included in the Draft Budgetary Plan, interest expenditure in Slovenia is expected to fall from 2.0% of GDP in 2018 to 1.6% in 2019 and is projected to decrease further next year, to 1.5% of GDP. The picture stemming from Draft Budgetary Plan's plans is matched by the Commission 2019 autumn forecast.

The Fiscal Council concluded that Slovenia would respect the Stability and Growth Pact and the national numerical fiscal rule next year and that the envisaged level of general government expenditure would be below the recalculated level set in the medium-term budgetary framework[3]. However, the Fiscal Council points to significant downside risks for compliance, stemming from inconsistencies between the projections and the adopted or proposed measures, the possibility of adopting some pending measures with a negative budgetary impact and risks related to the macroeconomic environment. Further, the Fiscal Council emphasises significant negative risks for long-term sustainability of public finances from the new pension reform. Based on the assessment by the Fiscal Council, the legislation adopted by the government would increase the pension expenditure by 1 percentage point of GDP by 2040 and even more in the years thereafter[4].

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[2] 10-year bond yields as of 28 October 2019. Source: Bloomberg.

[3] The framework for the preparation of budgets over 2020-2022 adopted in April 2019. The projected level of the general government expenditure exceeds the ceiling laid down in the framework, which is due to the revision of the national accounts data after the deadline by which amendments to the framework could be made. Once the ceiling is recalculated to take into account the data revisions, the general government expenditure is expected to remain below such revised value. http://www.fs-rs.si/wp-content/uploads/2019/10/Ocena-oktober-2019.pdf.

[4] http://www.fs-rs.si/wp-content/uploads/2019/09/Position-of-the-Fiscal-Council-September-2019.pdf.

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Table 2. Composition of the budgetary adjustment

(% of GDP)	2018		2019			2020			Change: 2018-2020
	COM	**DBP**	**SP**	**DBP**	**COM**	**SP**	**DBP**	**COM**	**DBP**
Revenue	**44.3**	**44.3**	**43.2**	***44.5***	**44.0**	**42.6**	***43.9***	**43.6**	**-0.4**
of which:									
- Taxes on production and imports	14.1	14.1	14.0	*13.9*	13.9	13.7	*13.7*	13.8	-0.4
- Current taxes on income, wealth,	7.8	7.8	7.8	*8.0*	7.8	7.8	*8.0*	7.7	0.2
- Capital taxes	0.0	0.0	0.0	*0.0*	0.0	0.0	*0.0*	0.0	0.0
- Social contributions	15.8	15.8	15.1	*16.0*	15.9	15.1	*16.1*	15.9	0.3
- Other (residual)	6.6	6.6	6.3	*6.6*	6.4	6.0	*6.1*	6.1	-0.5
Expenditure	**43.5**	**43.5**	**42.2**	**43.7**	**43.6**	**41.6**	**43.0**	**43.1**	**-0.5**
of which:									
- Primary expenditure	41.6	41.6	40.6	42.1	41.9	40.2	41.5	41.6	0.0
of which:									
Compensation of employees	11.1	11.1	11.2	11.3	11.4	11.1	11.3	11.4	0.2
Intermediate consumption	6.2	6.2	6.0	6.1	6.1	5.9	6.0	6.0	-0.2
Social payments	17.6	17.6	16.3	17.6	17.6	16.2	17.4	17.4	-0.2
Subsidies	0.8	0.8	0.8	0.7	0.7	0.8	0.8	0.7	0.0
Gross fixed capital formation	3.6	3.6	4.1	3.8	3.8	4.1	3.9	3.9	0.3
Other (residual)	2.4	2.4	2.2	2.6	2.3	2.1	2.1	2.2	-0.3
- Interest expenditure	2.0	2.0	1.6	1.6	1.6	1.5	1.5	1.5	-0.5
General government balance (GGB)	**0.8**	**0.8**	**0.9**	**0.8**	**0.5**	**1.0**	**0.9**	**0.5**	**0.1**
Primary balance	**2.8**	**2.8**	**2.6**	**2.4**	**2.1**	**2.4**	**2.4**	**2.0**	**-0.4**
One-off and other temporary measures	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	0.0
GGB excl. one-offs	**0.8**	**0.8**	**1.0**	**0.9**	**0.5**	**1.1**	**1.0**	**0.6**	**0.2**
Output gap[1]	3.2	3.1	3.4	3.3	3.3	3.0	3.3	3.1	0.2
Cyclically-adjusted balance[1]	-0.7	-0.7	-0.6	-0.7	-1.0	-0.4	-0.7	-1.0	0.1
Structural balance (SB)[2]	**-0.7**	**-0.6**	**-0.6**	**-0.7**	**-1.0**	**-0.3**	**-0.6**	**-0.9**	**0.1**
Structural primary balance[2]	1.3	1.4	1.1	0.9	0.7	1.1	0.9	0.6	-0.4

Notes:

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

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

Source:

Stability Programme 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations.

3.2. Debt developments

After peaking at 82.6% of GDP in 2015, general government gross debt fell to 70.4% of GDP in 2018. Based on the Draft Budgetary Plan projections, public debt is estimated to decline to 66.3% of GDP in 2019. Compared to the 2019 Stability Programme, the debt-to-GDP ratio is revised upwards, mainly due to the denominator effect from lower nominal GDP and higher-than-expected stock-flow adjustment, even after including the privatisation proceeds in the amount of 1.5% of GDP from the 65% of NLB privatisation carried out in 2018. According to the Draft Budgetary Plan, public debt is expected to decrease further next year, to 62.1% of GDP. The Commission projects somewhat higher debt in both years, at 66.7% and 63.1% of GDP in 2019 and 2020, respectively. This is mostly due to the lower projected surplus and the denominator effect from somewhat lower nominal GDP.

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Table 3. Debt developments

(% of GDP)	2018	2019			2020		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio[1]	**70.4**	**65.4**	**66.3**	**66.7**	**61.3**	**62.1**	**63.1**
Change in the ratio	-3.7	-5.0	-4.1	-3.8	-4.1	-4.2	-3.6
Contributions[2]:							
1. Primary balance	**-2.8**	**-2.6**	**-2.4**	**-2.1**	**-2.4**	**-2.4**	**-2.0**
2. "Snow-ball" effect	**-2.4**	**-2.4**	**-2.0**	**-1.9**	**-2.0**	**-1.9**	**-1.7**
Of which:							
Interest expenditure	2.0	1.6	1.6	1.6	1.5	1.5	1.5
Real growth effect	-2.9	-2.3	-1.9	-1.7	-1.9	-1.9	-1.7
Inflation effect	-1.6	-1.8	-1.7	-1.8	-1.6	-1.5	-1.5
3. Stock-flow adjustment	**1.6**	**0.0**	**0.3**	**0.3**	**0.4**	**0.2**	**0.2**
Of which:							
Cash/accruals difference							
Net accumulation of financial							
of which privatisation proceeds			-1.5				
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 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations.

3.3 Measures underpinning the draft budgetary plan

For 2020, the Draft Budgetary Plan includes measures to reduce expenditure with an overall budgetary impact of 0.3% of GDP. Social transfers are expected to decrease by 0.1% of GDP, as a result of several measures. In particular, the parliament has adopted changes to the Social Assistance Benefits Act, which exclude the supplement for active work from cash social assistance. Also, the government has adopted amendments to the Labour Market Regulation Act, which would increase the minimum unemployment benefit from EUR 350 to around EUR 530 but decrease the maximum duration of receiving the unemployment benefit from 25 to 19 months for older workers. In addition, the contributory period for being eligible for the unemployment benefit would increase from 9 to 10 months in the last 24 months. Moreover, tighter sanctions would be implemented in case of a refused participation in active employment policy programmes, together with stricter requirements for non-Slovenian citizens regarding the command of the Slovenian language. The adopted changes to the pension legislation would link the extraordinary indexation of pensions to previous year's real GDP growth, constraining the discretion of the government when setting the rate. The Draft Budgetary Plan expects part of the decrease in social transfers to result from a more appropriate consideration of personal assets in the means test to determine the entitlement for social transfers and a lower hourly pay rate for personal assistance services. However, there is large uncertainty regarding these two latter measures as they have been withdrawn by the coalition partners.

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Table 4. Main discretionary measures reported in the Draft Budgetary Plan

A. Discretionary measures taken by General Government - revenue side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2019	**2020**
Taxes on production and imports		
Current taxes on income, wealth, etc.		
Capital taxes		
Social contributions		
Property Income		
Other		
Total	**0.0**	**0.0**

Note:

The budgetary impact in the table is the aggregated impact of measures as reported by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source:

Draft Budgetary Plan for 2020.

B. Discretionary measures taken by General Government - expenditure side

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2019	**2020**
Compensation of employees	0.0	-0.1
Intermediate consumption		
Social payments	0.0	-0.1
Interest Expenditure		
Subsidies		
Gross fixed capital formation	0.0	-0.1
Capital transfers		
Other		
Total	**0.0**	**-0.3**

Note:

The budgetary impact in the table is the aggregated impact of measures as reported by the national authorities. A positive sign implies that expenditure increases as a consequence of this measure.

Source:

Draft Budgetary Plan for 2020.

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Next to lower social transfers, the Draft Budgetary Plan projects measures to decrease the compensation of employees by 0.1% of GDP compared to unchanged policies, due to the adopted Act Regulating Measures Relating to Salaries and Other Labour Costs and Other Measures in the Public Sector for 2020 and 2021. According to the Act, the payment of performance bonus will be postponed to July 2020, while the highest possible amount of the bonus for increased workload will be reduced. Another 0.1% of GDP expenditure savings would come from the reduction in public investment thanks to Slovenia's promotional development and export bank's instruments for "Financial Instruments 2014-2020". The Draft Budgetary Plan also projects one-off expenditure of around 0.1% of GDP in both 2019 and 2020, pertaining to court rulings, arbitration and other proceedings (i.e. compensation for erased deposit holders of Ljubljanska Banka, return of agricultural land).

On the revenue side, the Draft Budgetary Plan includes measures to the tax legislation adopted by the parliament this autumn with a neutral overall budgetary impact in 2020.[5] The amendments to the personal income tax contain lowering the tax rate for the second and third tax brackets by 1 percentage point, raising the income level for all the tax brackets and increasing the general allowance by up to EUR 200. Those changes are expected to reduce tax revenue by around 0.2% of GDP. Part of the revenue loss will be offset by somewhat higher taxes on capital gains, rental and corporate income. The Draft Budgetary Plan expects the remaining difference to be fully compensated by higher revenues due to a more efficient tax collection.

[5] The tax measures were not included in the Draft Budgetary Plan submitted on 10 October 2019, even though they have been adopted by the government on 3 October 2019. After those measures have been adopted by the Parliament on 23 October 2019, Slovenia sent an addendum to the submitted Draft Budgetary Plan, including those measures, to the Commission on 6 November 2019.

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Main discretionary measures reported in the addendum to the Draft Budgetary Plan submitted on 6 November 2019

Components	Budgetary impact (% GDP) (as reported by the authorities)	
	2019	**2020**
Taxes on production and imports		0.1
Current taxes on income, wealth, etc.		-0.1
Capital taxes		
Social contributions		
Property Income		
Other		
Total	**0.0**	**0.0**

Note:

The budgetary impact in the table is the aggregated impact of measures as reported by the national authorities. A positive sign implies that revenue increases as a consequence of this measure.

Source:

Addendum to the Draft Budgetary Plan for 2020.

For 2019, the Commission considers that the adopted increase in the exemption of annual holiday allowance from personal income tax and social security contributions up to 100% of average wage as a revenue measure will imply a significant negative budgetary impact of 0.2% of GDP. This tax relief appears to be considered as part of the baseline in the Draft Budgetary Plan, while the estimated impact and potential compensating measures are not specified. The 2020 estimates for expenditure measures as well as one-offs provided in the Draft Budgetary Plan are broadly in line with the Commission 2019 autumn forecast. However, the Commission does not incorporate in its forecast the increase in tax efficiency as a revenue measure in 2020, which according to the government projections should fully offset the above-mentioned tax reform.

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

Slovenia is subject to the preventive arm of the Pact and should ensure sufficient progress towards its medium-term budgetary objective. Box 2 reports the latest country specific recommendations in the area of public finances. Slovenia is also subject to the debt reduction benchmark.

Box 2. Council Recommendations[6] addressed to Slovenia

On 9 July 2019, the Council addressed recommendations to Slovenia in the context of the European Semester. In particular, in the area of public finances the Council recommended to achieve the medium-term budgetary objective in 2020. This is consistent with a maximum

[6] OJ C 320, 10.9.2018.

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nominal growth rate of net primary government expenditure of 4.0%, corresponding to an annual structural adjustment of 0.5% of GDP.

4.1. Compliance with the debt criterion

As the debt ratio is expected to be 66.3% of GDP in 2019, Slovenia needs to comply with the debt reduction benchmark. The Draft Budgetary Plan does not provide sufficient information to assess compliance with the debt reduction benchmark in both 2019 and 2020. According to the Commission 2019 autumn forecast, the debt reduction benchmark is expected to be met in both years, with a gap of -6.5% and -6.2% of GDP in 2019 and 2020, respectively.

Table 5. Compliance with the debt criterion

	2018	2019			2020		
		SP	DBP	COM	SP	DBP	COM
Gross debt ratio	**70.4**	**65.4**	**66.3**	**66.7**	**61.3**	**62.1**	**63.1**
Gap to the debt benchmark [1,2]		-7.4		-6.5	-7.5		-6.2
Structural adjustment [3]	-0.1						
To be compared to:							
Required adjustment [4]	-6.2						

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 2019 (SP); Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations.

4.2. Adjustment towards the medium-term budgetary objective

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. In 2019, based on the Draft Budgetary Plan, the growth rate 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 0.2% of GDP, pointing to a risk of some deviation. The (recalculated) structural balance is expected to deteriorate by 0.1% of GDP, pointing to a risk of significant deviation with a gap of 0.7% of GDP. Both pillars point to a risk of significant deviation over 2018 and 2019 taken together (average gap of 0.6% and 0.8% of GDP based on the expenditure benchmark and the structural balance, respectively). The reading of the fiscal effort based on the structural balance is substantially penalised by the projected revenue shortfalls, which do not affect the expenditure benchmark. These are only partially compensated by the reduction in interest expenditure and the higher potential GDP growth estimates used in the underlying calculations. As the expenditure benchmark is considered to give a more accurate picture of the fiscal effort, an overall assessment based on the Draft Budgetary Plan points to a risk of some deviation from the adjustment path towards the medium-term budgetary objective in

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2019. However, over 2018 and 2019 taken together, the overall assessment points to a risk of significant deviation.

Based on the Commission 2019 autumn forecast, both the expenditure benchmark and the change in the structural balance indicate a risk of significant deviation in 2019 (gap of 1.3% and 0.9% of GDP, respectively). Compared to the Draft Budgetary Plan, the Commission 2019 autumn forecast leads to significantly higher gaps based on the expenditure benchmark pillar. This can be mainly explained by a negative impact of discretionary revenue measure in the Commission projections, which is not expected in the Draft Budgetary Plan. In addition, the Commission forecasts a higher increase in nationally financed primary expenditure, especially on compensation of employees and intermediate consumption. According to the Commission 2019 autumn forecast, compared to the expenditure benchmark, the change in the structural balance is negatively affected by the projected revenue shortfalls which are more than offset by 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.

In 2020, Slovenia was recommended to achieve its medium-term budgetary objective of a structural deficit of 0.25% of GDP. Based on the Commission 2019 spring forecast, this is consistent with a maximum nominal growth rate of net primary government expenditure of 4.0%, corresponding to a structural adjustment of 0.5% of GDP. Based on the information provided in the Draft Budgetary Plan, the growth rate of government expenditure, net of discretionary revenue measures and one-offs, is expected to stay significantly below the applicable expenditure benchmark, pointing to compliance over one year and over 2019 and 2020 taken together. The (recalculated) structural balance is forecast to improve by 0.1% of GDP, pointing to a risk of some deviation in 2020 (gap of 0.4% of GDP) and a risk of significant deviation over 2019 and 2020 taken together (average gap of 0.6% of GDP). The reading of the change in the structural balance continues to be substantially penalised by the projected revenue shortfalls, while it continues benefitting from lower interest expenditure and higher potential growth than the 10-year average used in the expenditure benchmark. Part of the difference between the two pillars is also explained by a higher increase in the four-year average of nationally financed investment used for the calculation of the expenditure benchmark compared to an annual increase used in the structural balance. As the expenditure benchmark is considered to give a more accurate picture of the fiscal effort, an overall assessment based on the Draft Budgetary Plan points to compliance in both 2020 and over 2019 and 2020 taken together.

According to the Commission 2019 autumn forecast, both the expenditure benchmark and the change in the structural balance point to a risk of some deviation in 2020 (gap of 0.2% and 0.5% of GDP, respectively), while both point to a risk of significant deviation over 2019 and 2020 taken together (average gap of 0.8% and 0.7% of GDP, respectively). Compared to the Draft Budgetary Plan, the different assessment based on the expenditure benchmark pillar is due to a negative expected impact from discretionary revenue measures and a higher increase in nationally financed primary expenditure in the Commission projection due to other expenditure. According to the Commission 2019 autumn forecast, compared to the expenditure benchmark, the change in the structural balance benefits from lower interest expenditure and investment as well as higher potential growth, while it is negatively affected by the projected revenue shortfalls and lower GDP deflator, compared to the spring estimate used for the calculation of the expenditure benchmark. Taking all this into account, the overall

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assessment points to a risk of some deviation in 2019 and to a risk of significant deviation over 2019 and 2020 taken together. However, this assessment is subject to a high degree of uncertainty regarding the output gap estimates for Slovenia (see Box 3).

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 2019, 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 reach 3.3% of potential GDP in 2019 and to decrease to 3.1% of potential GDP in 2020. These estimates for the output gap are above the ones derived from the HP filter (2.1% in 2020) and those of OECD (2.0% in 2020) and IMF (0.9% in 2020). Based on the Commission 2019 autumn forecast, the central estimate of the confidence band of the plausibility tool projects the 2019 output gap at 1.7% of potential GDP, i.e. significantly lower than the 3.3% of potential GDP based on the commonly agreed methodology. Applying the 1.6 percentage points of potential GDP difference in 2020 would lead to a plausibility range of output gap estimates from 1.5% to 3.1% of potential GDP. The plausibility tool estimate indicates that the amount of idle capacities that are available for production (productive 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. Extrapolating the 1.6 percentage points of potential GDP difference between the common methodology and the plausibility tool output gap estimates in 2019 could lead, after a constrained judgement, to a reduction of the forecast structural deficit in a range from 0.9% to 0.2% of GDP in 2020. This could suggest that Slovenia may be expected to be closer to its medium-term budgetary objective of a structural deficit of 0.25% of GDP in 2020. If in spring 2021 the plausibility tool also indicates a high degree of uncertainty surrounding the output gap estimate for 2020, an in-depth analysis will be carried out in the Commission’s assessment of compliance with the requirements of the preventive arm for 2020.

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Table 6. Compliance with the requirements of the preventive arm

(% of GDP)	2018	2019		2020	
Initial position[1]					
Medium-term budgetary objective (MTO)	0.25	0.25		-0.25	
Structural balance[2] (COM)	-0.7	-1.0		-0.9	
Structural balance based on freezing (COM)	-0.5	-0.8		-	
Position vis-a -vis the MTO[3]	Not at MTO	Not at MTO		Not at MTO	
	2018	**2019**		**2020**	
(% of GDP)	**COM**	**DBP**	**COM**	**DBP**	**COM**
Structural balance pillar					
Required adjustment[4]	0.6*	0.65		0.54	
Required adjustment corrected[5]	0.6*	0.65		0.54	
Change in structural balance[6]	-0.2	-0.1	-0.3	0.1	0.1
One-year deviation from the required adjustment [7]	-0.8	-0.7	-0.9	-0.4	-0.5
Two-year average deviation from the required adjustment [7]	-0.4	-0.8	-0.9	-0.6	-0.7
Expenditure benchmark pillar					
Applicable reference rate[8]	1.5	3.1		4.0	
One-year deviation adjusted for one-offs [9]	-1.1	-0.2	-1.3	0.4	-0.2
Two-year average deviation adjusted for one-offs [9]	-0.9	-0.6	-1.2	0.1	-0.8

Notes

* In 2018, Slovenia has a requirement of 0.7% of GDP corresponding to the distance to MTO. However, following the Commission's assessment of the strength of the recovery while giving due consideration to its sustainability challenges, the Commission considered that a fiscal structural effort of at least 0.6% of GDP would be adequate in 2018, without any additional margin of deviation over one year. That corresponded to a nominal rate of growth of net primary expenditure not exceeding 1.5%.

[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 is allowed in order to be evaluated as having reached the MTO.

[2] Structural balance corresponds to 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 ed. 2018, 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 2018) was carried out on the basis of Commission 2019 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 :
Draft Budgetary Plan for 2020 (DBP); Commission 2019 autumn forecast (COM); Commission calculations.

5. COMPOSITION OF PUBLIC FINANCES AND IMPLEMENTATION OF FISCAL STRUCTURAL REFORMS

In 2019, both revenue and expenditure are expected to increase relative to GDP (to 44.5% and 43.7% of GDP, respectively), before decreasing in 2020 (to 43.9% and 43.0% of GDP, respectively). The Draft Budgetary Plan indicates an increase in public investment, from 3.6% of GDP in 2018 to 3.9% of GDP in 2020, driven by a higher expected absorption of EU funds. As a result of active public debt management, favourable financial market conditions and general government surplus, interest expenditure is projected to continue declining, from 2.0% of GDP in 2018 to 1.5% of GDP in 2020. Lower tax burden on labour income is expected to positively contribute to sustainable economic growth (see Box 4).

On 9 July 2019, the Council addressed recommendations to Slovenia in the context of the European Semester. In particular, with regard to the structural part of the fiscal

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recommendations, the Council recommended Slovenia to adopt and implement reforms in healthcare and long-term care that ensure quality, accessibility and long-term fiscal sustainability. The Council recommended Slovenia to ensure the long-term sustainability and adequacy of the pension system, including by adjusting the statutory retirement age restricting early retirement and other forms of early exit from the labour market.

According to the Draft Budgetary Plan, the draft Healthcare and Health Insurance Act is currently being supplemented by the Ministry of Health, with expected adoption by the National Assembly in autumn 2020. The draft law adresses the method and sources of financing, including introducing counter-cyclical elements into the healthcare financing segment, and emphasises higher quality, efficiency and equal access to healthcare services. The proposal of the Act on long-term care is expected to be submitted for public discussion at the end of 2019. The draft law focuses on equal access to high-quality services, comparability of rights for comparable needs, sustainable financing, comprehensive treatment of patients, promotion of care at home or in the community, suitable working conditions for formal care providers and support for informal care providers.

In October 2019, the government adopted amendments to the Pension and Disability Insurance Act with the aim to prolong the working lifes of older workers and to improve the adequacy of the pension system. In particular, the changes include a gradual raise of the pension replacement rate to 63.5% for both men and women, including an additional rate of 1.36% for childcare periods. Further, the pension rate for persons who remain in employment after being eligible for retirement is set to increase from 20% to 40% in the first three years. No new measures have been adopted to address the long-term sustainability of the pension system.

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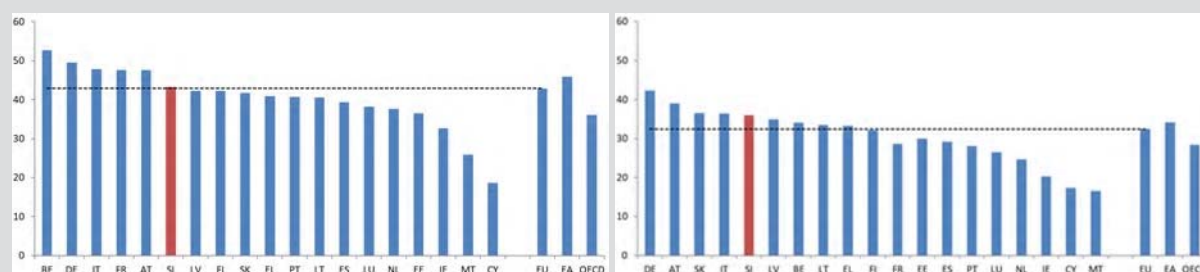
Box 4. Addressing the tax burden on labour in the euro area

The tax burden on labour in the euro area is relatively high, which weighs on economic activity and employment. Against this 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 these 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 (2018)



Notes: 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 Draft Budgetary Plan contains measures that affect the tax wedge on labour by increasing the exemption of annual holiday allowance from personal income tax and social security contributions up to 100% of the average wage in 2019 and by reducing the personal income tax through tax rate cuts, increase in tax brackets and general allowance in 2020. The Draft Budgetary Plan expects the measures to be financed by higher taxes on capital gains, rental and corporate income and by more efficient tax collection. Overall, those measures are expected to positively contribute to sustainable economic growth, business competitiveness, consumption and employment.

6. Overall conclusion

Based on the Commission 2019 autumn forecast, the debt-to-GDP ratio is in line with the debt criterion in both 2019 and 2020.

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Following an overall assessment, the Draft Budgetary Plan points to a risk of some deviation in 2019, while it points to a risk of significant deviation in 2018 and 2019 taken together. In 2020, the Draft Budgetary Plan points to compliance. However, following an overall assessment based on the Commission 2019 autumn forecast, there is a risk of significant deviation in 2019 from the adjustment path towards the medium-term objective recommended by the Council, and a risk of some deviation in 2020. In addition, based on the Commission 2019 autumn forecast, there is a risk of significant deviation in 2019 and 2020 taken together. The output gap estimate based on the common methodology is subject to a high degree of uncertainty, as confirmed by the fact that Slovenia has been flagged by the plausibility tool. The output gap as suggested by the plausibility tool would imply a lower structural deficit in 2020, bringing Slovenia closer to its medium-term budgetary objective. Given the high volatility of the relevant estimates, this would only be taken into account, if confirmed, in the ex post assessment of compliance with the requirements of the preventive arm in spring 2021.

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