COUNCIL OPINION

of 14 February 2006

on the updated convergence programme of Slovenia, 2005-2008

(2006/C 55/12)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community,

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies ([1]), and in particular Article 9(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

(1) On 14 February 2006 the Council examined the updated convergence programme of Slovenia, which covers the period 2005 to 2008.

(2) Following a transition recession in the early nineties, the Slovene economy fully restored robust GDP growth averaging nearly 4 % over the last decade. By the end of 2005, inflationary pressures have been curbed and consumer price growth approached the EU average. The general government balance slipped in 1997 and has stayed negative since then, with deficits averaging 3 % of GDP on an ESA95 basis in the period 2000-2004.

(3) In its opinion of 8 March 2005 on the previous update of the convergence programme, covering the period 2004-2007, the Council invited Slovenia to (i) seize all opportunities to accelerate the reduction of the general government deficit, and (ii) undertake further measures to improve the long-term sustainability of the public finances, including the reforms of the pension and health-care systems.

(4) As regards budgetary implementation in 2005, the general government deficit for 2005 is estimated at 1,7 % of GDP in the Commission services' autumn 2005 forecast, against a target of 2,1 % of GDP set in the previous update of the convergence programme. The preliminary outcome is better than expected as a result of better revenue collection and a net 0,5 % GDP lower general government expenditure.

(5) The updated programme broadly follows the model structure and data provision requirements for stability and convergence programmes specified in the new code of conduct ([2]).

(6) The macroeconomic scenario underlying the programme envisages that real GDP will grow steadily at around 4 % beyond 2005. Assessed against currently available information, this scenario appears to be based on plausible growth assumptions. Cyclical conditions are likely to improve gradually; the negative output gap, estimated to have stood at 1 % of GDP in 2005, is forecast to close by the end of the period. The programme's projections for inflation also appear realistic. The programme lists a comprehensive set of socio-economic reforms aiming at enhancing the competitiveness of the Slovene industry, the modalities and implementation of which will be determined in the course of 2006. However, the projections consistently follow a no-policy change approach.

([1]) OJ L 209, 2.8.1997, p. 1. Regulation as amended by Regulation (EC) No 1055/2005 (OJ L 174, 7.7.2005, p. 1). The documents referred to in this text can be found at the following website:
http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm

([2]) The programme has gaps in the compulsory and optional data prescribed by the new code of conduct. In particular, compulsory data on labour productivity growth are not available. Also missing are certain optional data concerning labour market developments, sectoral balances and general government debt developments. The table on general government expenditure by function is not included.

(7) The updated programme aims at creating conditions for a successful EMU integration while catching up with average EU income levels. The budgetary strategy is geared to keeping the general government deficit well below 3 % of GDP and targets to achieve the medium-term objective (MTO) for the budgetary position as meant in the Stability and Growth Pact by 2008. The programme announces tax reform measures, leading to a drop in the share of revenue as a percentage of GDP by 1,8 %, and measures on the expenditure side, resulting in a decline in the expenditure ratio by 2,5 % of GDP. The programme envisages a back-loaded consolidation path. In the beginning of the programme period, the general government deficit is expected to linger at 1,7 % of GDP and then slowly decrease to 1,4 % in 2007 and further to 1,0 % of GDP in 2008. Compared with the previous programme, the new update postpones the target of achieving a deficit of 1 % of GDP by one year against a modified fiscal policy orientation and a broadly unchanged macroeconomic scenario.

(8) Over the programme period, the structural balance (i.e. the cyclically-adjusted balance net of one-off and other temporary measures) calculated according to the commonly agreed methodology is planned to improve by around 0,25 % of GDP. The programme sets the medium-term objective (MTO) for the budgetary position at a structural deficit of 1 % of GDP and aims at achieving this position by 2008. As the programme's MTO is more demanding than the minimum benchmark (estimated at a deficit of almost 2 % of GDP), its achievement should fulfil the aim of providing a safety margin against the occurrence of an excessive deficit. The programme's MTO lies within the range indicated for euro area and ERM II Member States in the Stability and Growth Pact and the code of conduct and reflects the debt ratio and average potential output growth in the long term.

(9) The risks to the budgetary projections in the programme appear broadly balanced. On the one hand, Slovenia has established a track record of better-than-projected budgetary outcomes in recent years, also supported by an effective budgetary mechanism of containing general government expenditures in response to an unexpected revenue shortfall. Furthermore, the assumptions on growth may turn out better than projected, should the structural reforms be implemented timely. However, the need for rigorously implementing policies to reduce government spending in order to offset the revenue loss due to the tax reform, and the recent decision to modify the indexation of pensions, may create a risk for the realisation of the targets. In particular, the high share of mandatory expenditure is rooted in the rigid regulatory framework, which still awaits political consensus to be restructured in a more flexible way.

(10) In view of this risk assessment, the budgetary stance in the programme seems to provide a sufficient safety margin against breaching the 3 % of GDP deficit threshold with normal macroeconomic fluctuations throughout the programme period. Furthermore, it seems sufficient to ensure that the programme's MTO is reached in 2008, as planned. As the structural deficit in 2005 is close to the MTO, the pace of the adjustment towards the programme's MTO implied by the programme is slower than the annual improvement of the structural balance of 0,5 % of GDP as a benchmark (higher in good economic times) as specified in the Stability and Growth Pact. A moderate adjustment in 2006 would have brought the budget in line with the MTO.

(11) Gross public debt is estimated to have reached 29,0 % of GDP in 2005, well below the 60 % of GDP Treaty reference value. The programme projects a slight increase in the debt ratio in the next two years, peaking at 29,8 % in 2007. By 2008, the debt is forecast to fall to 29,4 % of GDP.

(12) With regard to the sustainability of public finances, Slovenia appears to be at high risk on grounds of the projected budgetary costs of ageing populations [1]. The relatively low debt ratio will contribute to limit the budgetary impact of ageing. However, Slovenia will still face a very large increase in government expenditure. Even though the 1999 pension reform has significantly alleviated future increase in expenditure, its effects have been partly offset by the modification of the indexation rule. Further changes in the pension schemes, as recognised by the programme, will prove necessary at

[1] Details on long-term sustainability are provided in the technical assessment of the programme by the Commission services (
http://europa.eu.int/comm/economy_finance/about/activities/sgp/main_en.htm).

some point to contain future increase in government expenditure and reduce the risk to long-term sustainability. If no further measures are taken to relieve the pressures of age-related expenditure, the long-term sustainability of public finances will be undermined. A careful planning and timely adoption of measures are key in this regard.

(13) The envisaged measures in the area of public finances are broadly consistent with the broad economic policy guidelines included in the integrated guidelines for the period 2005-2008. However, long-term sustainability of public finances is not explicitly identified as the policy priority. Measures remain vague and do not allow an assessment of the feasibility of the strategy in the longer term.

(14) The National Reform Programme of Slovenia, submitted on 28 October 2005 in the context of the renewed Lisbon strategy for growth and jobs, identifies adoption of the euro in 2007 as the key priority. Geared to create conditions for a successful EMU integration, including by improving the quality of the public finances, the updated convergence programme bears a close link with the NRP's comprehensive list of policy measures. However, as a number of measures remain largely unspecified, the budgetary implications of the actions outlined in the National Reform Programme have not been included in the budgetary projections of the convergence programme.

In view of the above assessment, the Council notes that the programme aims at containing inflation close to the EU average while projecting a gradual fiscal adjustment path. The Council invites Slovenia to:

i) make a more rapid progress towards achieving the programme's MTO, especially by implementing the measures underlying the planned reduction of the expenditure ratio as well as by frontloading the adjustment effort;

ii) undertake measures to improve the long-term sustainability of the public finances, particularly in relation to the pension system.

Comparison of key macroeconomic and budgetary projections

		2004	2005	2006	2007	2008
Real GDP (% change)	**CP Dec 2005**	**4,2**	**3,9**	**4,0**	**4,0**	**3,8**
	COM Nov 2005	4,2	3,8	4,0	4,2	n.a.
	CP Jan 2005	*4,0*	*3,8*	*3,9*	*4,0*	*n.a.*
HICP inflation (%)	**CP Dec 2005**	**3,6**	**2,5**	**2,5**	**2,4**	**2,4**
	COM Nov 2005	3,6	2,6	2,5	2,5	n.a.
	CP Jan 2005	*3,6*	*3,0*	*2,7*	*2,6*	*n.a.*
Output gap (% of potential GDP)	**CP Dec 2005** (1)	**– 1,4**	**– 1,2**	**– 0,7**	**– 0,3**	**0,0**
	COM Nov 2005 (5)	– 1,2	– 0,9	– 0,5	0,2	n.a.
	CP Jan 2005 (1)	*– 1,2*	*– 1,2*	*– 1,3*	*– 1,3*	*n.a.*
General government balance (% of GDP)	**CP Dec 2005**	**– 2,1**	**– 1,7**	**– 1,7**	**– 1,4**	**– 1,0**
	COM Nov 2005	– 2,1	– 1,7	– 1,9	– 1,6	n.a.
	CP Jan 2005	*– 2,1*	*– 2,1*	*– 1,8*	*– 1,1*	*n.a.*
Primary balance (% of GDP)	**CP Dec 2005**	**– 0,5**	**– 0,2**	**– 0,3**	**– 0,1**	**0,2**
	COM Nov 2005	– 0,2	– 0,1	– 0,4	– 0,2	n.a.
	CP Jan 2005	*– 0,3*	*– 0,4*	*– 0,2*	*0,4*	*n.a.*

		2004	2005	2006	2007	2008
Cyclically-adjusted balance (% of GDP)	**CP Dec 2005** (1)	**– 1,4**	**– 1,2**	**– 1,4**	**– 1,3**	**– 1,0**
	COM Nov 2005	– 1,5	– 1,5	– 1,7	– 1,7	n.a.
	CP Jan 2005 (1)	*n.a*	*n.a*	*n.a*	*n.a*	*n.a.*
Structural balance (2) (% of GDP)	**CP Dec 2005** (3)	**– 1,4**	**– 1,2**	**– 1,4**	**– 1,3**	**– 1,0**
	COM Nov 2005 (4)	– 1,5	– 1,5	– 1,7	– 1,7	n.a.
	CP Jan 2005	*n.a*	*n.a*	*n.a*	*n.a*	*n.a.*
Government gross debt (% of GDP)	**CP Dec 2005**	**29,5**	**29,0**	**29,6**	**29,8**	**29,4**
	COM Nov 2005	29,8	29,3	29,5	29,2	n.a.
	CP Jan 2005	*30,2*	*30,7*	*30,9*	*29,7*	*n.a.*

Notes:

(1) Commission services' calculations on the basis of the information in the programme.
(2) Cyclically-adjusted balance (as in the previous rows) excluding one-off and other temporary measures.
(3) There are no one-off and other temporary measures in the programme.
(4) There are no one-off and other temporary measures in the Commission services' forecast.
(5) Based on estimated potential growth of 3,7 %, 3,5 %, 3,5 % and 3,5 % respectively in the period 2004-2007.

Source:

Convergence programme (CP); Commission services' autumn 2005 economic forecasts (COM); Commission services' calculations.