

COUNCIL OPINION
on the updated stability programme of Slovenia, 2009-2013
 (2010/C 144/05)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union,

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 5(3) thereof,

Having regard to the recommendation of the Commission,

After consulting the Economic and Financial Committee,

HAS DELIVERED THIS OPINION:

- (1) On 26 April 2010 the Council examined the updated stability programme of Slovenia, which covers the period 2009 to 2013.
- (2) In the years preceding the crisis, Slovenia enjoyed solid economic growth driven by buoyant exports and investment. Rapid expansion ended in the last quarter of 2008 when the Slovenian economy was hit hard and rather abruptly by the global crisis, chiefly through the trade channel given Slovenia's high degree of openness. The economic slowdown after a phase of emerging risks of overheating and competitiveness losses is bringing about some adjustment of the economy: since the end of 2008, the inflation differential with the euro area and the external deficit have both gradually decreased, with the latter approaching balance in 2009.

As a result of the economic downturn, in conjunction with recovery measures taken in line with the European Economic Recovery Plan (EERP) and strong in-built expenditure dynamics, the Slovenian budgetary position deteriorated rapidly. The sharp increase in the general government deficit, from 1,8 % of GDP in 2008, to an estimated 5,7 % in 2009 led the Council to decide, on 2 December 2009, on the existence of an excessive deficit in Slovenia, with a deadline for the correction of this situation by 2013. Besides returning to sound public finances, including through further reforms of the pension system, key challenges for the Slovenian economy are strengthening its resilience and regaining competitiveness so as to be able to benefit fully from the global economic

recovery. This requires a better alignment of wage and productivity developments and the implementation of structural reforms.

- (3) Although much of the observed decline in actual GDP in the context of the crisis is cyclical, the level of potential output has also been negatively affected. In addition, the crisis may also affect potential growth in the medium term through lower investment, constraints in credit availability and increasing structural unemployment. Moreover, the impact of the economic crisis compounds the negative effects of demographic ageing on potential output and the sustainability of public finances. Against this background it will be essential to accelerate the pace of structural reforms with the aim of supporting potential growth. In particular, for Slovenia it is important to increase productivity and contain unit labour cost growth i.a. by undertaking reforms in the area of innovation and research and the labour market.

- (4) The macroeconomic scenario underlying the programme envisages that real GDP will return to positive growth in 2010, at 0,9 %, from – 7,3 % in 2009 (7,8 % according to the statistical office's estimate released on 1 March 2010), and accelerate to an average rate of 3,2 % over the rest of the programme period.

Assessed against currently available information ⁽²⁾, this scenario appears to be based on plausible growth assumptions until 2011 and favourable growth assumptions thereafter. The projected employment decline and the corresponding increase in the unemployment rate could turn out worse than expected following (i) the phasing out of the temporary labour market support schemes, if not accompanied, where necessary, by activation and, training policies that favour job reallocation and workers' reskilling, as well as (ii) the planned gradual increase in the minimum wage between 2010 and 2012. The programme's projections for inflation appear realistic.

- (5) The programme estimates the general government deficit to have increased from 1,8 % of GDP in 2008 to 5,7 % in 2009. While interest expenditure is projected to have remained broadly stable as a share of GDP, the primary balance strongly deteriorated. As mentioned above, this is due to the working of the automatic stabilisers, the strong inherent dynamics of social transfers and the public sector wage bill, as well as various discretionary measures, including measures to respond to the crisis amounting to some 1,5 % of GDP, which the government adopted in line with the EERP. According to the programme,

⁽¹⁾ OJ L 209, 2.8.1997, p. 1. The documents referred to in this text can be found at the following website: http://ec.europa.eu/economy_finance/sgp/index_en.htm

⁽²⁾ The assessment notably takes into account the Commission services' autumn 2009 forecast, but also other information that has become available since then.

fiscal policy is planned to turn mildly restrictive in 2010 and more significantly so thereafter, in line with the exit strategy advocated by the Council and with a view to correcting the excessive deficit by 2013.

the programme incorporate the complete expiry of the temporary stimulus measures, after they start being gradually withdrawn in 2010.

- (6) For 2010, the programme plans the general government deficit to stabilise at 5,7 % of GDP. Given a steep rise in the interest burden, the primary deficit is targeted to narrow by 0,7 pp, to just below 4 % of GDP. Taken at face value, the budgetary strategy in 2010 is broadly consistent with the recommendation under Article 126(7) adopted by the Council on 2 December 2009 to implement the consolidation measures in 2010 as planned.

Discretionary measures on the revenue side — namely the further reduction in the corporate income tax rate and an additional tax allowance for socially vulnerable people on the one hand and the further increase in excise duty rates and revised CO₂ emission tax (which has yet to be specified and adopted) on the other — have a broadly neutral budgetary impact. Nevertheless, revenue is projected to increase by 0,8 pp of GDP compared to the estimated outcome for 2009, thanks to assumed buoyancy in indirect tax revenue ⁽¹⁾ and a slight increase in 'other' revenue. The planned measures on the expenditure side for 2010 — including a further postponement of public sector wage increases, less generous indexation rules of social benefit rates, including pensions, and lower capital transfers — should generate savings of around 1,25 % of GDP compared to a no-policy change scenario, but, given strong inherent expenditure dynamics, the primary expenditure ratio is still planned to rise slightly in 2010. Against this background, 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 set to improve only slightly, by 0,25 pp of GDP, after worsening by 0,25 pp of GDP in 2009.

- (7) The main aim of the programme's medium-term budgetary strategy is to reduce the deficit below the 3 % of GDP deficit reference value by 2013, in line with the Council recommendation under Article 126(7), with deficit targets set at 4,2 %, 3,1 % and 1,6 % of GDP for 2011, 2012 and 2013 respectively. The medium-term consolidation strategy relies on a broad-based containment of primary expenditure. The programme provides indications of the broad measures that are planned to underpin this strategy, but these still have to be fully specified and adopted. They hinge upon enhanced public sector efficiency and the rationalisation of the provision of public services and of social protection. In addition, the budgetary projections in

Over the period 2010-2013, an average annual structural improvement of somewhat below 0,75 pp of GDP is projected, which is broadly consistent with the Council recommendation under Article 126(7). The adjustment is unevenly distributed over the period, with the restrictive fiscal stance concentrated in 2011 and 2013. The programme confirms the medium-term objective (MTO) for the Slovenia budgetary position of a structural deficit of 1 % of GDP, as originally set in 2005. Given the most recent projections and debt level, the MTO does not appear to take sufficiently into account the implicit liabilities related to ageing, despite the debt being below the 60 % of GDP reference value. The structural balances corresponding to the programme's deficit targets imply that the MTO will not be reached within the programme period.

- (8) The budgetary outcomes could be worse than targeted in the programme and this possibility increases over the programme period. In 2010, the projected substantial growth in indirect taxes seems to be only partially substantiated by measures in the programme and on the high side given the subdued outlook for private consumption. Expenditure growth outcomes have exceeded plans in recent years and this situation could reoccur. From 2011 onwards, there is a greater risk of expenditure overruns, as the underlying measures have not yet been fully specified or adopted, and some of them can be expected to be subject to the outcome of negotiations with the social partners. Furthermore, the size of the envisaged retrenchment should be seen against the strong inherent expenditure dynamics in recent years, especially in the wage bill and social transfers (including pensions), both of which are planned to make a sizeable contribution to deficit reduction. The projected marked decline in capital expenditure throughout the programme period is stated to reflect an increased use of EU structural funds, which may be challenging in view of gaps in absorption capacity. Risks on the revenue side relate to the favourable macroeconomic scenario after 2011.
- (9) Government gross debt is estimated in the programme to have increased markedly from 22,5 % of GDP in 2008 to 34,4 % of GDP in 2009 (in light of the lower nominal GDP figure in the statistical office's estimate released on 1 March 2010, the 2009 gross debt could be some 1 pp of GDP higher). The main contributors to this rise are the increase in the primary deficit and a significant stock-flow adjustment reflecting recapitalisations and liquidity

⁽¹⁾ The budget for 2010 and 2011 explains that excise duties on energy products are to benefit from a rise in the quantity of mineral oils sold and VAT revenues would rise by lower VAT refunds relative to 2009.

operations to support the financial sector. The debt ratio is projected to remain below the Treaty reference value throughout the programme period but to increase by more than 8 pps by 2012, to almost 43 % of GDP, mainly on the back of primary deficits and improving nominal GDP outlook, and to record a modest fall in 2013, driven by the return to a primary surplus position. In view of the negative risks to the budgetary targets compounded by uncertainty about the stock-flow adjustment from financial sector support, the evolution of the debt ratio might be less favourable than projected in the programme.

(10) Medium-term debt projections that assume GDP growth rates to gradually recover to the values projected before the crisis, tax ratios to return to pre-crisis levels, and include the projected increase in age-related expenditure show that the budgetary strategy envisaged in the programme, taken at face value and with no further policy change, would stabilise the debt ratio for some years but would not stop it from resuming a slightly increasing trend towards 2020.

(11) The long-term budgetary impact of ageing is significantly higher than the EU average, mainly as a result of a relatively high increase in pension expenditure as a share of GDP over the coming decades. The budgetary position in 2009, as estimated in the programme, compounds the budgetary impact of population ageing on the sustainability gap.

Ensuring primary surpluses over the medium term and implementing structural reforms including curbing the substantial increase in age-related expenditure would contribute to reducing the risks to the sustainability of public finances, which were assessed in the Commission 2009 Sustainability Report⁽¹⁾ as high. The latter could usefully build on the planned two-step pension reform that is presented in the government's 'Exit Strategy 2010-2013', adopted in February 2010.

(12) The adoption of rolling two-year central government budgets and a ceiling on local government's total stock of debt are established positive features of the Slovenian fiscal framework. Still, there is room for improvement in fiscal governance. For example, a weakness of the rolling two-year budgets is that the targets set for the second year are subject to revisions in the following year's budget.

⁽¹⁾ In the Council conclusions from 10 November 2009 on sustainability of public finances 'the Council calls on Member States to focus attention to sustainability-oriented strategies in their upcoming stability and convergence programmes' and further 'invites the Commission, together with the Economic Policy Committee and the Economic and Financial Committee, to further develop methodologies for assessing the long-term sustainability of public finances in time for the next Sustainability report', which is foreseen in 2012.

Furthermore, budgetary implementation in 2006-2008 and, to some extent, 2009, show some risk of expenditure overruns. Measures to strengthen the fiscal framework in Slovenia were introduced in 2009 — i.e. performance-based budgeting and the establishment of an independent fiscal council — and others are envisaged, namely improvements in budgetary accounting and the introduction of a fiscal rule. If consistently implemented, these initiatives could help support the planned fiscal consolidation.

(13) The expenditure-based adjustment set out in the programme update hinges upon enhanced public sector efficiency and the rationalisation of the provision of public services and of social protection. Increasing spending efficiency becomes particularly important when trying to contain expenditure growth without compromising the level of services provided.

For this purpose, a number of initiatives are envisaged, such as a unified information system and a single entry point for social transfers and the redefinition of the standards for public services, taking into account quality aspects, possibly with an increase of co-financing by users. The programme expects that, together with the gradual economic recovery, these innovations will result in a decline of the social expenditure-to-GDP ratio as from 2011. On the revenue side, the 2006 tax reform, which gradually reduced the personal and corporate income tax rates, phased out the payroll tax and introduced investment tax allowances, was intended to strengthen labour supply incentives and give impetus to capital formation. An additional tax allowance for low-wage earners was introduced with the budget for 2010. These changes are being partially financed with an increase in excise duties, with further increases being announced in the programme, thus gradually moving the tax burden away from incomes, particularly of low-income earners, towards indirect taxes. Other initiatives in the taxation area concern new provisions to foster fight of tax evasion and avoidance so as to improve tax collection.

(14) Overall, in 2010 the budgetary strategy set out in the programme is broadly consistent with the Council recommendations under Article 126(7) of 2 December 2009. From 2011 on, taking into account the risks mentioned above, the budgetary strategy may not be fully consistent with these recommendations. In particular, the broad consolidation measures indicated for 2011-2013 need to be fully specified, adopted and implemented and the consolidation plans for the entire period would need to be strengthened to address the risks from less favourable GDP growth and slippages on the expenditure or revenue

side. Such a strengthening would also appear warranted in view of the above mentioned risks to long-term sustainability. Taking into account risks, the average fiscal effort over the period 2010-2013 may fall short of the 0,75 pp of GDP recommended by the Council.

- (15) As regards the data requirements specified in the code of conduct for stability and convergence programmes, the programme has some gaps in the required and optional data ⁽¹⁾. In its recommendations under Article 126(7) of 2 December 2009 with a view to bringing the excessive deficit situation to an end, the Council also invited Slovenia to report on progress made in the implementation of the Council's recommendations in a separate chapter in the updates of the stability programmes. Slovenia broadly complied with this recommendation.

The overall conclusion is that the programme plans the general government deficit ratio to stabilise at 5,7 % of GDP in 2010 and to gradually decline thereafter, thanks to an expenditure-based and relatively back-loaded consolidation effort, to well below 3 % of GDP in 2013, the deadline for the correction of the excessive deficit set by the Council. The gross debt ratio is planned to increase further, from 34,4 % of GDP in 2009, until 2011 to then broadly stabilise at some 42 % of GDP. The deficit and debt ratios could turn out higher than targeted throughout the programme period. This possibility increases over time and is related to: (i) optimistic revenue projections in 2010 followed by favourable growth assumptions after 2011; (ii) possible expenditure overruns in view of the scale of the envisaged retrenchment coupled with the strong observed dynamics in recent years of especially the wage bill and social transfers, including pensions; and (iii) the fact that the expenditure-containment measures have not yet been fully specified and adopted, with some of them still subject to the outcome of negotiations with the social partners. Nonetheless, to help support the planned containment of expenditure growth, the government is adopting measures to strengthen expenditure control and the fiscal framework. In addition, the planned initiatives to enhance public sector efficiency and rationalise the provision of public services and of social protection should work towards the same purpose.

Even if the full and consistent implementation of the planned fiscal consolidation implies the return to a primary surplus by 2013, there remain high risks with regard to the long-term sustainability of public finances. Setting a more ambitious medium-term objective (MTO) and adopting and implementing the announced change in indexation formula and further pension reform aimed at curbing the substantial increase in age-related expenditure would allow addressing these risks. The latter could usefully build on the planned two-step pension reform. Besides returning to sound public finances, key challenges for the Slovenian economy are strengthening its resilience and regaining competitiveness so as to be able to benefit fully from the global economic recovery. This requires a better alignment of wage and productivity developments and the implementation of structural reforms.

In view of the above assessment and also in the light of the recommendation under Article 126(7) TFEU of 2 December 2009, Slovenia is invited to:

- (i) rigorously implement the foreseen consolidation measures in 2010 and bring the deficit below the 3 % of GDP reference value by 2013 as planned by fully specifying, adopting and implementing the indicated expenditure-containment measures in line with the average annual fiscal effort recommended by the Council Article 126(7), while standing ready to adopt further consolidation measures in case risks related to the fact that the macro-economic scenario of the programme is more favourable than the scenario underpinning the Article 126(7) Recommendation materialise;
- (ii) pursue efforts to enhance expenditure control and the enforceable nature of the multi-annual budgetary plans and improve public spending efficiency and effectiveness;
- (iii) in view of the significant projected increase in age-related expenditure, further reform the pension system and set a more ambitious MTO that takes sufficiently into account the implicit liabilities related to ageing.

Comparison of key macroeconomic and budgetary projections

		2008	2009	2010	2011	2012	2013
Real GDP (% change)	SP Jan 2010	3,5	- 7,3	0,9	2,5	3,7	3,5
	COM Nov 2009	3,5	- 7,4	1,3	2,0	n.a.	n.a.
	SP Apr 2009	3,5	- 4,0	1,0	2,7	n.a.	n.a.
HICP inflation (%)	SP Jan 2010 ⁽⁴⁾	5,7	1,0	1,5	2,5	2,7	2,7
	COM Nov 2009	5,5	0,9	1,7	2,0	n.a.	n.a.
	SP Apr 2009	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

⁽¹⁾ In particular, data on net lending/borrowing vis-à-vis the rest of the world are not provided.

		2008	2009	2010	2011	2012	2013
Output gap ⁽¹⁾ (% of potential GDP)	SP Jan 2010	5,7	– 3,4	– 3,9	– 3,2	– 1,5	0,1
	COM Nov 2009 ⁽²⁾	5,7	– 3,3	– 3,3	– 2,8	n.a.	n.a.
	SP Apr 2009	4,4	– 2,3	– 3,5	– 3,1	n.a.	n.a.
Net lending/borrowing vis-à-vis the rest of the world (% of GDP)	SP Jan 2010	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
	COM Nov 2009	– 6,0	– 0,7	– 0,1	– 0,5	n.a.	n.a.
	SP Apr 2009	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
General government revenue (% of GDP)	SP Jan 2010	42,4	42,4	43,2	42,9	42,7	42,5
	COM Nov 2009	42,4	43,2	43,2	42,9	n.a.	n.a.
	SP Apr 2009	42,7	41,9	42,4	42,4	n.a.	n.a.
General government expenditure (% of GDP)	SP Jan 2010	44,2	48,1	48,9	47,1	45,9	44,2
	COM Nov 2009	44,2	49,5	50,2	49,9	n.a.	n.a.
	SP Apr 2009	43,6	47,1	46,4	45,8	n.a.	n.a.
General government balance (% of GDP)	SP Jan 2010	– 1,8	– 5,7	– 5,7	– 4,2	– 3,1	– 1,6
	COM Nov 2009	– 1,8	– 6,3	– 7,0	– 6,9	n.a.	n.a.
	SP Apr 2009	– 0,9	– 5,1	– 3,9	– 3,4	n.a.	n.a.
Primary balance (% of GDP)	SP Jan 2010	– 0,7	– 4,6	– 3,9	– 2,3	– 1,1	0,4
	COM Nov 2009	– 0,7	– 4,8	– 5,1	– 4,9	n.a.	n.a.
	SP Apr 2009	0,2	– 3,6	– 2,2	– 1,6	n.a.	n.a.
Cyclically adjusted balance ⁽¹⁾ (% of GDP)	SP Jan 2010	– 4,3	– 4,2	– 4,0	– 2,8	– 2,4	– 1,6
	COM Nov 2009	– 4,5	– 4,8	– 5,4	– 5,6	n.a.	n.a.
	SP Apr 2009	– 2,9	– 4,1	– 2,3	– 2,0	n.a.	n.a.
Structural balance ⁽³⁾ (% of GDP)	SP Jan 2010	– 4,3	– 4,2	– 4,0	– 2,8	– 2,4	– 1,6
	COM Nov 2009	– 4,5	– 4,7	– 5,4	– 5,6	n.a.	n.a.
	SP Apr 2009	– 2,9	– 4,1	– 2,3	– 2,0	n.a.	n.a.
Government gross debt (% of GDP)	SP Jan 2010	n.a.	34,4	39,6	42,0	42,7	42,1
	COM Nov 2009	22,5	35,1	42,8	48,2	n.a.	n.a.
	SP Apr 2009	22,8	30,5	34,1	36,3	n.a.	n.a.

Notes:

(1) Output gaps and cyclically adjusted balances from the programmes as recalculated by Commission services on the basis of the information in the programmes.

(2) Based on estimated potential growth of 3,3 %, 1,2 %, 1,2 % and 1,4 % respectively in the period 2008-2011.

(3) Cyclically adjusted balance excluding one-off and other temporary measures. One-off and other temporary measures are zero according to the most recent programme and 0,1 % of GDP in 2009, deficit-increasing, according to the Commission services autumn 2009 forecast.

(4) CPI instead of HICP inflation projections.

Source:

Stability programme (SP); Commission services' autumn 2009 forecasts (COM); Commission services' calculations.