# COUNCIL RECOMMENDATION

## of 8 July 2014

## on the National Reform Programme 2014 of Slovenia and delivering a Council opinion on the Stability Programme of Slovenia, 2014

(2014/C 247/22)

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty on the Functioning of the European Union, and in particular Articles 121(2) and 148(4) thereof,

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(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances [2], and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission,

Having regard to the resolutions of the European Parliament,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

Having regard to the opinion of the Economic and Financial Committee,

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

(1) On 26 March 2010, the European Council agreed to the Commission's proposal to launch a new strategy for growth and jobs, Europe 2020, based on enhanced coordination of economic policies, which focuses on the key areas where action is needed to boost Europe's potential for sustainable growth and competitiveness.

(2) On 13 July 2010, the Council, on the basis of the Commission's proposals, adopted a Recommendation on the broad guidelines for the economic policies of the Member States and the Union (2010 to 2014) and, on 21 October 2010, it adopted a decision on guidelines for the employment policies of the Member States [3], which together form the 'integrated guidelines'. Member States were invited to take the integrated guidelines into account in their national economic and employment policies.

(3) On 29 June 2012, the Member States' Heads of State or Government decided on a Compact for Growth and Jobs, providing a coherent framework for action at national, EU and euro area levels using all possible levers, instruments and policies. They decided on action to be taken at the level of the Member States, in particular expressing full commitment to achieving the objectives of the Europe 2020 Strategy and to implementing the country-specific recommendations.

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.
[3] Maintained for 2014 by Council Decision 2014/322/EU of 6 May 2014 on guidelines for the employment policies of the Member States for 2014 (OJ L 165, 4.6.2014, p. 49).

(4) On 9 July 2013, the Council adopted a Recommendation [1] on Slovenia's National Reform Programme for 2013 and delivered its opinion on Slovenia's updated Stability Programme for 2012-2016. On 15 November 2013, in line with Regulation (EU) No 473/2013 of the European Parliament and of the Council [2], the Commission presented its opinion on Slovenia's draft budgetary plan for 2014.

(5) On 13 November 2013, the Commission adopted the Annual Growth Survey, marking the start of the 2014 European Semester for economic policy coordination. Also, on 13 November 2013, the Commission, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report, in which it identified Slovenia as one of the Member States for which an in-depth review would be carried out.

(6) On 20 December 2013, the European Council endorsed the priorities for ensuring financial stability, fiscal consolidation and action to foster growth. It underscored the need to pursue differentiated, growth-friendly fiscal consolidation, to restore normal lending conditions to the economy, to promote growth and competitiveness, to tackle unemployment and the social consequences of the crisis, and to modernise public administration.

(7) On 5 March 2014, the Commission published the results of its in-depth review for Slovenia, under Article 5 of Regulation (EU) No 1176/2011. The Commission's analysis leads it to conclude that Slovenia continues to experience excessive macroeconomic imbalances, which require monitoring and continuing strong policy action. While imbalances have been unwinding over 2013 due to macroeconomic adjustment and policy action by Slovenia, the magnitude of the necessary correction means that substantial risks are still present. More specifically, the risks stemming from an economic structure characterised by weak corporate governance, a high level of state involvement in the economy, losses in cost competitiveness, a corporate debt overhang and a considerable increase in government debt warrant very close attention. While considerable progress has been made in repairing the banks' balance sheets, determined action with respect to full implementation of a comprehensive banking sector strategy, including restructuring, privatisation and enhanced supervision, is still required.

(8) On 5 March 2014, the Commission addressed an Autonomous Recommendation to Slovenia requesting the authorities to make further efforts to ensure full compliance with the Council recommendation under the EDP and to report on the additional measures in a dedicated section of the 2014 Stability Programme.

(9) On 15 April 2014, Slovenia submitted its 2014 National Reform Programme and, on 24 April 2014, its 2014 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(10) The objective of the budgetary strategy outlined in the 2014 Stability Programme is to correct the excessive deficit by 2015 and reach the medium-term objective by 2017. The Stability Programme confirms the previous medium-term objective of a balanced budget, which is in line with the requirements of the Stability and Growth Pact. However, the (recalculated) structural balance is not expected to reach the medium-term objective by 2017. The Stability Programme plans to bring the deficit below 3 % of GDP in 2015, in line with the target set in the Excessive Deficit Procedure recommendation. Beyond 2015, the Stability Programme envisages a steady decline in the deficit before turning to a surplus of 0,3 % of GDP in 2018. The Stability Programme projects that the government debt will peak at 81,1 % of GDP in 2015 before dropping to 76 % in 2016. Overall, the budgetary strategy outlined in the Stability Programme is in line with the requirements of the Stability and Growth Pact. The macroeconomic scenario underpinning the budgetary projections in the Stability Programme, which has been produced by an independent body (the Institute for Macroeconomic Analysis and Development), is cautious. The Stability Programme identifies some additional measures that assist in narrowing the gap with the required fiscal

[1] OJ C 217, 30.7.2013, p. 75.

[2] Regulation (EU) No 473/2013 of the European Parliament and of the Council of 21 May 2013 on common provisions for monitoring and assessing draft budgetary plans and ensuring the correction of excessive deficit of the Member States in the euro area (OJ L 140, 27.5.2013, p.11).

effort. Based on this, it is considered that the Stability Programme has partially responded to the Autonomous Commission Recommendation. Nevertheless, downside risks remain as the measures underpinning the Stability Programme are insufficiently detailed, and many of them have yet to be adopted.

Any potential additional bank recapitalisation needs, stemming from the 2013 asset quality review and stress test in Slovenia, would increase the deficit and debt ratios, while any proceeds from the successful privatisation of state owned entities or banks that have not been incorporated in programme projections would reduce the debt burden. Based on the Commission forecast, the fiscal effort over the period 2013-2014 falls short by 1,4 % of GDP in terms of (corrected) change in the structural balance and by 0,5 % of GDP in terms of the amount of required measures estimated as necessary at the time of the Excessive Deficit Procedure recommendation. For 2015, while the Stability Programme projects a deficit in line with the Excessive Deficit Procedure recommendation, the Commission services 2014 Spring forecast estimates a deficit of 3,1 % of GDP.

(11) Moreover, based on the Commission forecast, the fiscal effort measured both by the (corrected) change in structural balance and by the underlying amount of discretionary measures to be implemented is expected to fall somewhat short of the level recommended by the Council for 2015. Based on its assessment of the Stability Programme and the Commission forecast, pursuant to Regulation (EC) No 1466/97, the Council is of the opinion that additional efforts, in 2014 and thereafter, are required in order to ensure full compliance with the Excessive Deficit Procedure recommendation, including the required structural effort.

(12) With respect to the fiscal rules, in 2013 the Parliament approved a constitutional basis for establishing a general government budget balance/surplus rule in structural terms. However, the necessary implementing legislation, namely the Fiscal Rule Act, which was supposed to be in place by November 2013, has yet to be adopted. In particular, the necessary legal basis has to be established in order to define the role, remit and independence of a functioning Fiscal Council. The timely completion of a comprehensive expenditure review of all budgetary users in the key expenditure area of health could identify measures to underpin the fiscal consolidation and identify options for enhancing efficiency and cost effectiveness.

(13) In 2013, it was recommended that Slovenia strengthen the long-term sustainability of the pension system and improve the efficiency, cost effectiveness and quality of the long-term care sector. Slovenia has made limited progress on measures taken to address this recommendation. An evaluation of the 2012 pension reform was completed in April 2014 and the first findings are positive. While certain fiscal savings have been realised, the level of pensions remained unchanged. Slovenia faces high fiscal sustainability risks in the medium and long term mainly due to an increase in ageing-related spending implied by Slovenia's demographics. Thus the pension and long-term care systems will need to be reformed in the medium term if overall expenditure is to be stabilised over the medium and long term while ensuring the adequacy of pensions and access to long-term care services. The authorities plan to prepare a White Paper for a comprehensive pension reform. A blueprint for a long-term care reform was adopted at the end of 2013 and the related legislation is expected by the end of 2014. However, it risks being delayed because the ongoing reorganisation of healthcare insurance is lagging behind.

(14) The situation on the labour market has worsened. Unemployment reached 10,3 % in 2013 and youth unemployment climbed to 21,6 % in 2013 while the proportion of young people not in employment, education or training increased by 2,1 percentage points between 2011 and 2013. The evaluation of the labour market reform adopted in 2013 points towards decreasing segmentation between permanent and fixed-term contracts, albeit on the back of an increased use of other non-permanent contractual forms, while the effect of incentives for the employment of older and younger people are still unclear. Labour market segmentation is also being addressed through better regulation of student work. While a new act is pending approval, concerns remain about whether it will adequately address shortcomings of previous rules. The Government has made limited progress in implementing last year's recommendation on the minimum wage, which continues to be indexed only to inflation, while the act on minimum wage allows for indexation to other economic conditions. Limited progress has been made in developing effective tailor-made active labour market policy measures and addressing skills mismatches.

(15) The Government has made substantial progress in addressing the recommendations regarding stability in the banking sector, conducting a credible Asset Quality Review and Stress Test, prompt recapitalisations, and the transfer of non-performing loans to the Bank Asset Management Company. However, work is far from complete and determined action to finalise and implement a comprehensive banking sector strategy as announced in December 2013, including restructuring, privatisation and enhanced supervision, is required. The level of non-performing loans in the banking system remains high. It is therefore important for the banks to build internal work-out capacity for non-performing loans including strengthening the internal asset management and restructuring units, to accelerate the processing of non-performing loans while maximising recovery value and preserving viable businesses. Any further transfer of non-performing loans to the Bank Asset Management Company needs to be carefully designed in order to facilitate swift and efficient restructuring of corporate credits, particularly in the case of complex, inter-connected group loans. A comprehensive management strategy and business plan that would substantiate redemption targets for the Bank Asset Management Company is awaited. Building on the lessons from the asset quality review and stress test, further decisive measures to improve governance and supervision for all banks, and particularly for those remaining in State ownership, are warranted by strengthening risk management, enhancing credit approval processes and improving data quality and availability, with the objective of reducing the levels of non-performing loans and to contain future risks.

(16) The Government has made limited progress in implementing the recommendations on corporate governance of state-owned enterprises, which account for one sixth of total value added and form a complex nexus of domestic banks, insurance groups and non-financial corporations, with significant cross-shareholding. The level of State influence creates significant risks for the public finances both directly and indirectly, through liabilities from guarantees. A coherent strategy for the management of state-owned enterprises coupled with improved corporate governance would create a more favourable environment for attracting foreign direct investment. Although first steps were taken by compiling an initial list of 15 companies for accelerated privatisation in May 2013, progress to date has been mixed and there is a significant risk that deadlines will not be met. After some delay, the new legislation underpinning the Slovenia Sovereign Holding, a vehicle for consolidating the management of state ownership, was introduced in April 2014. A comprehensive strategy and a precise classification of core and non-core assets, including those earmarked for privatisation, are expected. There is a need to identify and implement appropriate measures to secure the restructuring process and the attainment of its goals including inter alia maximising the recovery value for creditors and establish a list of the most urgent restructuring cases for rapid work out.

(17) The insolvency framework was amended in 2013 in order to facilitate the timely resolution of non-performing loans but the new framework remains largely untested. A high level of indebtedness and financial distress has limited the corporate sector's capacity to invest in future projects. The urgently needed financial and operational restructuring of the corporate sector has yet to begin on a large scale. A consolidated view of the various credit exposures in the banking system is required to accelerate work-out of non-performing loans and to facilitate restructuring negotiations, particularly in the case of complex, inter-connected group loans. A centralised task force with experienced representatives of all stakeholders could take the initiative in supporting and accelerating this process. In the meantime, swift and efficient closure of several on-going urgent cases under the Bank Asset Management Company is crucial.

(18) Despite its potential, Slovenia has one of the lowest stocks of foreign direct investment in the Union (34,1 % of GDP as against 47,1 % of GDP on average in the Union in 2012). While privatisation and corporate restructuring offer many new possibilities for private investors, there is evidence that the insufficiently developed business environment and culture hinder Slovenia from taking full advantage of it. In 2012, a process of deregulation of regulated professions started and, until now, the number of regulated professions decreased from 323 to 262. Further deregulation of regulated professions would contribute to increasing the number of domestic and foreign services providers and thus contribute to increased competitiveness. There is a potential to increase the coherence of measures devised to improve the business environment and entrepreneurial activities. In this context, the upcoming Smart Specialisation Strategy under the European Investment and Structural Funds for 2014-20 will provide an opportunity to focus on key measures such as creating tradable, innovative products.

(19) Slovenia is in the early stages of preparing comprehensive public sector reform proposals (to be adopted by January 2015). In this context, Slovenia has to restore the quality and credibility of public administration. Slovenia has made some progress in improving the quality of the judicial system and has reduced the number of pending cases. A reform of case management in commercial and civil justice has improved the functioning of the court system. Recent positive trends in litigious civil and commercial cases have been maintained.

(20) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Slovenia's economic policy. It has assessed the National Reform Programme and the Stability Programme. It has taken into account not only their relevance for sustainable fiscal and socio-economic policy in Slovenia but also their compliance with EU rules and guidance, given the need to reinforce the overall economic governance of the Union by providing EU-level input into future national decisions. Its recommendations under the European Semester are reflected in recommendations (1) to (8) below.

(21) In the light of this assessment, the Council has examined the Stability Programme, and its opinion [1] is reflected in particular in recommendation (1) below.

(22) In the light of the Commission's in-depth review and this assessment, the Council has examined the National Reform Programme and the Stability Programme. Its recommendations under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations (1) to (8) below.

(23) In the context of the European Semester, the Commission has also carried out an analysis of the economic policy of the euro area as a whole. On this basis, the Council has issued specific recommendations addressed to the Member States whose currency is the euro [2]. As a country whose currency is the euro, Slovenia should also ensure the full and timely implementation of those recommendations,

HEREBY RECOMMENDS that Slovenia take action within the period 2014-2015 to:

1. Reinforce the budgetary strategy with sufficiently specified structural measures for the year 2014 and beyond, to ensure correction of the excessive deficit in a sustainable manner by 2015 through the achievement of the structural adjustment effort specified in the Council recommendation under the Excessive Deficit Procedure. A durable correction of the fiscal imbalances requires a credible implementation of ambitious structural reforms to increase the adjustment capacity and boost growth and employment. After the correction of the excessive deficit, pursue a structural adjustment of at least 0,5 % of GDP each year, and more in good economic conditions or to ensure that the debt rule is met in order to put the high general government debt ratio on a sustained downward path. To improve the credibility of fiscal policy, complete the adoption of a general government budget balance/surplus rule in structural terms, make the medium-term budgetary framework binding, encompassing and transparent, and establish the necessary legal basis for a functioning fiscal council defining its remit within the budgetary process and introducing clear procedural arrangements for monitoring budgetary outcomes as soon as possible. Launch a comprehensive review of expenditure covering state and local government levels, direct and indirect budget users and municipality-owned providers of utilities and services in the area of healthcare by the end of 2014 with a view to realising budgetary savings in 2015 and beyond.

2. Based on the public consultation, agree measures to ensure the sustainability of the pension system and adequacy of pensions beyond 2020, encompassing adjustments of key parameters, such as linking the statutory retirement age to gains in life expectancy and encouraging private contributions to the second pillar of the pension system. Contain age-related expenditure on long-term care by targeting benefits to those most in need and refocusing care provision from institutional to home care.

(1) Under Article 5(2) of Regulation (EC) No 1466/97.

(2) See page 141 of the current Official Journal.

3. Following consultation with social partners and in accordance with national practices, develop a comprehensive Social Agreement by the end of 2014 ensuring that wage developments, including the minimum wage, support competitiveness, domestic demand and job creation. Redefine the composition of the minimum wage and review its indexation system. Take measures for further decreasing segmentation, in particular addressing the efficiency of incentives for hiring young and older workers and the use of civil law contracts. Adopt the Act on Student Work. Prioritise outreach to non-registered young people ensuring adequate public employment services capacities. To increase employment of low-skilled and older workers, adapt the working environment to longer working life and focus resources on tailor-made active labour market policy measures, while improving their effectiveness. Address skills mismatches by improving the attractiveness of vocational education and training and by further developing cooperation with the relevant stakeholders in assessing labour market needs.

4. Complete the privatisation of NKBM in 2014 as planned, prepare Abanka for privatisation in 2015, continue the prompt implementation of restructuring plans of the banks in receipt of State aid and the necessary consolidation of the banking sector. Based on the lessons from the asset quality review and stress test finalise the comprehensive action plan for banks in August 2014, including specific measures to improve governance, supervision, risk management, credit approval process and data quality and availability. Reinforce banks' capacity to work out non-performing loans by strengthening the internal asset management and restructuring units. Clarify the mandate of the Bank Asset Management Company by publishing a comprehensive management strategy and business plan by September 2014, detailing its role in restructuring of its assets, redemption targets, budgets, asset management plans and expected returns, while ensuring adequate resources.

5. Continue to implement the privatisations announced in 2013 with the time-frames set. Adopt a strategy for the Slovenian Sovereign Holding with a clear classification of assets in line with the timeline and definitions established in the 2014 Slovenian Sovereign Holding Act. By November 2014, commit to a short-term (one- to two- year horizon) divestment schedule for a number of well-targeted assets with a clear time scale. Make it fully operational as a vehicle for the management of assets remaining in State ownership and divestment of the assets earmarked according to the management acts, within the time frame stipulated by the law. By September 2014, adopt and implement a corporate governance code for state-owned enterprises to ensure professional, transparent and independent management.

6. Finalise a corporate restructuring master plan by the end of 2014 within clear priorities and effective implementation process. Set up a central corporate restructuring task force monitoring and coordinating the overall restructuring process, providing the necessary expertise, guidance and advice, and facilitating the negotiation process between all stakeholders involved. Establish a list of the most urgent restructuring cases, while maximising the recovery value for creditors. Promote the use of the available legal mechanisms and international best practices to all stakeholders in the restructuring process. Evaluate recent changes in the insolvency legislation by September 2014, being ready to introduce any additional necessary measure. Further reduce the length of judicial proceedings at first instance in litigious civil and commercial cases including cases under the insolvency legislation, and the number of pending cases, in particular enforcement and insolvency cases.

7. Reduce obstacles to doing business in Slovenia in key areas for economic development rendering the country more attractive to foreign direct investment particularly through accelerated liberalisation of regulated professions, reduction of administrative burden including leaner authorisation schemes. Ensure sufficient budgetary autonomy for the Competition Protection Agency and increase its institutional independence. Streamline priorities and ensure consistency between the 2011 Research and Innovation and the 2013 Industrial Policy Strategies with the upcoming strategies on Smart Specialisation and Transport, ensure their prompt implementation and assessment of effectiveness.

8. Take effective measures to fight corruption, enhancing transparency and accountability, and introducing external performance evaluation and quality control procedures.

Done at Brussels, 8 July 2014.

*For the Council*

*The President*

P. C. PADOAN