COUNCIL RECOMMENDATION

of 12 July 2016

on the 2016 National Reform Programme of Slovenia and delivering a Council opinion on the 2016 Stability Programme of Slovenia

(2016/C 299/22)

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 November 2015, the Commission adopted the Annual Growth Survey, marking the start of the 2016 European Semester for economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 17-18 March 2016. On 26 November 2015, 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. On the same day, the Commission also adopted a recommendation for a Council recommendation on the economic policy of the euro area. That recommendation was endorsed by the European Council on 18-19 February 2016 and adopted by the Council on 8 March 2016 [3]. As a country whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Slovenia should ensure the full and timely implementation of the recommendation.

(2) The 2016 country report for Slovenia was published on 26 February 2016. It assessed Slovenia's progress in addressing the country-specific recommendations adopted by the Council on 14 July 2015 and Slovenia's

[1] OJ L 209, 2.8.1997, p. 1.
[2] OJ L 306, 23.11.2011, p. 25.
[3] OJ C 96, 11.3.2016, p. 1.

progress towards its national Europe 2020 targets. It also included the in-depth review under Article 5 of Regulation (EU) No 1176/2011. On 8 March 2016, the Commission presented the results of the in-depth review. The Commission's analysis leads it to conclude that Slovenia is experiencing macroeconomic imbalances. Weaknesses in the banking sector, corporate indebtedness, the lack of investment and long-term fiscal sustainability risks constitute vulnerabilities that will need to be addressed. Confidence has returned in the Slovenian banking sector. However, credit growth remains negative and the level of non-performing loans remains relatively high. It is essential that Slovenia tackles risks to fiscal sustainability stemming from increasing pressures on its healthcare and pension systems and reduces the increased public debt. Further reduction of obstacles to investment is required, particularly in the area of public administration. There is a need to strengthen the involvement of social partners in policy design and implementation of structural reforms in particular on pensions, health, long-term care and labour market policies.

(3) On 15 April 2016, Slovenia submitted its 2016 National Reform Programme and its 2016 Stability Programme. In order to take account of their interlinkages, the two programmes have been assessed at the same time.

(4) Relevant country-specific recommendations have been addressed in the programming of the European Structural and Investment Funds for the 2014-2020 period. As foreseen in Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council [1], where it is necessary to support the implementation of relevant Council recommendations, the Commission may request a Member State to review and propose amendments to its Partnership Agreement and relevant programmes. The Commission has provided further details on how it would make use of this provision in guidelines on the application of the measures linking effectiveness of the European Structural and Investment Funds to sound economic governance.

(5) The 2016 Stability Programme of Slovenia indicates that the budgetary impact of the exceptional inflow of refugees is significant and provides adequate evidence of the scope and nature of these additional budgetary costs. According to the Commission, the eligible additional expenditure amounted to 0,06 % of GDP in 2015 and is currently estimated at 0,07 % of GDP in 2016. The provisions set out in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the inflow of refugees is an exceptional event, its impact on Slovenia's public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the medium-term budgetary objective. Whereas this provision is not applicable for 2015 as Slovenia was under the excessive deficit procedure, a final assessment regarding 2016, including on the eligible amounts, will be made in spring 2017 on the basis of observed data as provided by the Slovenian authorities.

(6) Following the abrogation of the excessive deficit procedure, Slovenia is in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. In its 2016 Stability Programme, the Government plans a gradual improvement of the headline balance from 2,2 % in 2016 to 0,4 % of GDP in 2019. The medium-term budgetary objective — a balance budget in structural terms, which does not respect the requirements of the Stability and Growth Pact — is planned to be achieved in 2020, beyond the Programme's horizon. However, the recalculated structural balance [2] points to a structural deficit of 1,2 % of GDP in 2019. According to the Stability Programme, the government debt-to-GDP ratio is expected to fall to 80,2 % of GDP in 2016 and continue to fall to 73,8 % of GDP in 2019. The macroeconomic scenario underpinning these budgetary projections is plausible. However, the measures needed to support the planned deficit targets from 2017 onwards have not been sufficiently specified. According to the Commission 2016 spring forecast, Slovenia's output gap in 2017 is estimated at 1,8 % of GDP, while potential growth is projected at 1,1 % and real GDP growth at 2,3 % of GDP. On this basis, Slovenia is assessed to be in 'good times' in 2017, requiring a structural adjustment of 1 % of GDP. However, there is significant uncertainty regarding the calculation of potential growth and the output gap in the specific case of Slovenia because of the specific situation of the labour market, the particularly large economic contraction in 2008-2013 and the structural reforms being implemented. Alternative output gap estimations covering a longer time horizon, reflecting the ongoing review of the estimation method, suggest

[1] Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006 (OJ L 347, 20.12.2013, p. 320).

[2] The structural balance as recalculated by the Commission based on the information in the Stability Programme, following the commonly agreed methodology.

a smoother output gap profile for Slovenia, implying that it would be premature to conclude that the Slovenian economy is in 'good times' in 2017. Therefore, requiring a structural effort in 2017 in line with 'normal times' conditions appears more appropriate at the current juncture. There appears to be a risk of some deviation from the recommended adjustment towards the medium-term objective in 2016 and, under unchanged policies, a risk of a significant deviation in 2017. The conclusion for 2016 would not change in case the budgetary impact of the exceptional inflow of refugees was excluded from the assessment. Slovenia is forecast to comply with the transitional debt rule in 2016 and to broadly comply with it in 2017. Based on its assessment of the Stability Programme and taking into account the Commission 2016 spring forecast, the Council is of the opinion that there is a risk that Slovenia will not comply with the provisions of the Stability and Growth Pact. Therefore, further measures will be needed to ensure compliance in 2016 and 2017.

(7) In July 2015, the Parliament adopted the Fiscal Rules Act. However, an independent Fiscal Council to oversee the implementation of the rules has yet to be appointed. Furthermore, revisions to the Public Finance Act required to make the Fiscal Rules Act fully operational and aimed at putting a multiannual approach to budgeting on a statutory footing remain outstanding.

(8) The high level of public debt at well above 60 % of GDP makes Slovenia vulnerable to nominal growth and interest rate shocks. At the same time, Slovenia's population is ageing faster than that of most Member States. Slovenia faces high risks regarding the long-term sustainability of public finances, given that it has the highest long-term sustainability gap indicator of all Member States, stemming from the projected increase in pension-related public spending, healthcare and long-term care expenditure. Projected public spending on pensions is the highest among all Member States and is estimated to increase from 11,8 % in 2013 to 15,3 % of GDP in 2060. The old age dependency ratio is projected to more than double between 2013 and 2060, putting significant pressure on the pension systems. Projected implicit liabilities related to the cost of ageing reflect the long-term challenges in terms of an ageing population. In addition, adequacy problems for workers with less than full working careers can be expected in the future, with an increasing number of people with incomplete or short working careers, also due to their late entry into the labour market, working in intermittent jobs and with a low contribution density. A White Paper on pensions was published in April 2016 and will serve as the basis for a wide public consultation. The results of the consultation will be fed into a new pension reform that should be adopted within the current legislative term, swiftly starting by agreement with social partners on key elements of the reform, namely the retirement age, level of pensions, indexation and optimisation of the second pillar.

(9) Public expenditure on long-term care is projected to more than double by 2060 due to population ageing. This poses a significant fiscal sustainability challenge for Slovenia. The proportion of the population aged 80 years and older is projected to rise three-fold, from 4,6 % in 2013 to 12,4 % in 2060. Between 2003 and 2013, overall expenditure on long-term care increased by 85 % with private expenditure growing at a higher pace than public expenditure. There is no integrated long-term care system in Slovenia. Slovenia focusses its spending on formal in-kind benefits, the majority of which is spent on institutional care rather than home care, although both figures are below the EU average. There is significant scope for increasing the cost-effectiveness of the healthcare system by strengthening the measures for improving primary care as a gatekeeper, shifting from inpatient to outpatient care, improving the efficiency and governance of hospitals, improving contracting and payment processes for health services, developing better cost information for the adjustment of the imported diagnosis-related groups, and further development of a quality monitoring framework. The proportion of joint procurement is low and there is a strong focus on the 'lowest price' award criterion. A comprehensive review of the healthcare system has been completed and the Resolution on the National Healthcare Plan 2016-2025 was adopted by the Government at the end of 2015 and by the Parliament in March 2016. The Resolution represents a strategic plan for the development of the healthcare system. Some of its measures are being implemented, while proposals for other key binding implementing measures are in preparation and are yet to be presented. It also remains unclear whether the reform will address key issues such as in-built automatic stabiliser schemes, which would cushion revenue fluctuations over the business cycle or the access and quality of service provision. The adoption of the Long-term Care Act and the Healthcare and Health Insurance Act has been repeatedly delayed and the current roadmap for their adoption appears to be optimistic for the second half of 2016.

(10) Labour market performance is gradually improving and social conditions have stabilised. Job creation has picked up considerably and unemployment is decreasing. However, participation rates of older and low-skilled workers remain a challenge. Long-term unemployment still represents more than half of all unemployed with a significant share of the long-term unemployed being low-skilled or older than 50 years of age. The Guidelines for Active Labour Market Policy Measures 2016-2020 represent a continuation of the approach implemented so far, while

the expenditure for that policy area remains low. Temporary exemptions from employers' social contributions for newly employed workers older than 55 were adopted in November 2015. Further measures to prolong working lives, including adapting the working environment, which are relevant also for the sustainability of the pension system, are expected to be presented in 2016. Wage growth stayed in line with productivity gains and continued to support external competitiveness. In November 2015, the Parliament passed a bill proposed by the trade unions that redefined the minimum wage to exclude some bonuses. As a result, employer organisations withdrew from the social agreement, weakening the social dialogue considerably.

(11) Progress has been made on the work-out of non-performing loans, although they remain at high levels compared with the pre-crisis period. Slovenia has implemented several policy measures to improve the sustainability of the banking sector. These include strengthening the banks' work-out capacity and introducing action setting specific targets for the reduction of non-performing loans. Slovenia has also introduced several measures to manage credit risk. Positive results are expected by mid-2016. Nevertheless, the policy priorities in the short term remain the further resolution of non-performing loans and the management of credit risk. Operational and financial restructuring of major corporates has been completed and master restructuring agreements are continuously monitored. The Bank Asset Management Company (BAMC) is fully operational and its 2017-2022 strategy has been set out. While progress has been made by the BAMC in the work-out of its loan book, it remains a significant risk to the sustainability of public finances. In 2015, its activities contributed 1 % of GDP to the general government deficit of 2,9 %. Oversight of the activities of the BAMC appears to be insufficient as the authorities had considerably underestimated the deficit of the BAMC in 2015 by 0,7 % of GDP and appeared unaware of the level of write-offs performed by the BAMC. Additional restructuring tools are also available. On the back of substantial progress in restructuring of major corporates, Slovenia has started the restructuring of several SMEs. Guidelines for the restructuring of SMEs are currently being implemented by the banks. Progress has been made on access to finance for SMEs and micro companies. Nevertheless, there is limited access to alternative sources of financing such as venture capital. Small businesses are still overly dependent on bank lending despite the increasing availability of debt and equity instruments in the market. Therefore, that segment is very vulnerable to credit market developments.

(12) Investment growth has been muted in recent years, which limited Slovenia's economic output and future growth prospects. Private investment declined sharply during the economic crisis and since then its share in GDP has been decreasing. With public investment strongly dependent on the dynamics of EU funds, more productive investment is needed to stimulate and sustain economic growth. Foreign direct investment in Slovenia has grown markedly in the last two years, mainly due to increased privatisation efforts. However, Slovenia's business environment remains hindered by ongoing deleveraging and a high level of administrative burden, particularly in the areas of construction, spatial planning and tax compliance, but also due to restrictive regulation on access to and exercise of regulated professions, which impedes the inflow of investment. Making it easier to do business in Slovenia depends on increased business trust and further elimination of inefficiencies in public administration and red tape stemming from a high number of laws and by-laws and frequent changes to legislation. Around half of the administrative burden reduction measures set out in the Government's single document have been implemented, but some pertinent measures, especially on building permits and spatial planning, have been delayed.

(13) The 2015-2020 strategy for the development of public administration, adopted as part of Slovenia's compliance with the pre-conditions for accessing European Structural and Investment Funds for 2014-2020, stretches across various portfolios, making cross-ministerial coordination essential if it is to be implemented properly and in good time. In February 2016, the Government adopted the second interim report on the implementation of the 'Zero tolerance of corruption' programme. There has been some progress in the implementation of that programme. However, certain measures of the programme (joint public procurement for health, examination of crime in banking sector and adoption of the Act for integrity and prevention of corruption) have been delayed. The envisaged amendment of the Act for integrity and prevention of corruption will provide an opportunity to improve the functioning of the Commission for Prevention of Corruption, by addressing credibility issues and the efficiency of its work. In the justice system, the length of trials has been shortened further and the number of pending cases has been reduced from very high levels, partly helped by a smaller number of incoming cases. The decrease is also, to a certain extent, determined by changes in the procedural and statistical treatment of enforcement cases. The Supreme Court continues to update business processes in courts and to reform case

management systems. Despite an improved insolvency framework, offering businesses increased opportunities for reorganisation, liquidation proceedings remain lengthy and ineffective.

(14) State involvement in the economy remains high. The State is the largest employer, asset manager and corporate debt holder in Slovenia. In response to the recommendations issued to Slovenia between 2012 and 2015 on that issue, the country produced a new framework for the Slovenian Sovereign Holding. It includes a strategy on the management of State ownership, a set of asset performance criteria and a management plan for 2016. This system complements the new corporate governance code for state-owned enterprises adopted at the end of 2014. The strategy confirms the extent of State's current involvement in the economy and shifts the focus towards an improved performance of the state-owned enterprises. Therefore, implementation of the overhauled framework by the Slovenian Sovereign Holding is all the more important to ensure the separation of the Government's ownership and regulatory functions and the professional management of state-owned enterprises. This, together with further privatisation of selected assets, should reduce contingent liabilities to the budget from this area. The privatisation of Nova Ljubljanska Banka (NLB) is to be launched in 2016 in line with the Slovenian Sovereign Holding management plan.

(15) In the context of the European Semester, the Commission has carried out a comprehensive analysis of Slovenia's economic policy and published it in the 2016 country report. It has also assessed the Stability Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Slovenia in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Slovenia but also their compliance with EU rules and guidance, given the need to strengthen the EU's overall economic governance by providing EU-level input into future national decisions. The recommendations under the European Semester are reflected in recommendations (1) to (4) below.

(16) 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.

(17) 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), (3) and (4) below,

HEREBY RECOMMENDS that Slovenia take action in 2016 and 2017 to:

1. Following the correction of the excessive deficit, achieve an annual fiscal adjustment of 0,6 % of GDP towards the medium-term budgetary objective in 2016 and in 2017. Set a medium-term budgetary objective that respects the requirements of the Stability and Growth Pact. Strengthen the fiscal framework by appointing an independent fiscal council and amending the Public Finance Act. Complete and implement the reform of the long-term care and healthcare systems, making them more cost-efficient to ensure long-term sustainability of accessible and quality care. By the end of 2017, adopt the necessary measures to ensure the long-term sustainability and adequacy of the pension system.

2. In consultation with social partners, increase the employability of low-skilled and older workers, including through targeted lifelong learning and activation measures.

3. Improve the financing conditions for creditworthy business, including by facilitating durable resolution of non-performing loans and access to alternative financing sources. Ensure the proper implementation of the bank asset management company strategy.

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

4. Take measures to modernise public administration and reduce the administrative burden on business. Improve the governance and the performance of state-owned enterprises.

Done at Brussels, 12 July 2016.

For the Council

The President

P. KAŽIMÍR