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Analysis by the Commission services of the budgetary situation in Slovenia following the adoption of the COUNCIL RECOMMENDATION to Slovenia of 2 December 2009 with a view to bringing an end to the situation of an excessive government deficit

Accompanying the document

Recommendation dor a

COUNCIL RECOMMENDATION

with a view to bringing an end to the situation of an excessive government deficit in Slovenia

{COM(2013) 396 final}

1. INTRODUCTION

On 2 December 2009, the Council decided, in accordance with Article 126(6) of the TFEU, that an excessive deficit existed in Slovenia and issued a recommendation[1] to correct the excessive deficit by 2013 at the latest, in accordance with Article 126(7) of the TFEU and Article 3 of Council Regulation (EC) No 1467/97 of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure[2]. In order to bring the general government deficit below 3% of GDP in a credible and sustainable manner, the Slovenian authorities were recommended to implement the fiscal consolidation measures in 2010 as planned, ensure an average annual structural budgetary adjustment of ¾% of GDP over the period 2010-2013, and specify the measures that are necessary to achieve the correction of the excessive deficit by 2013 cyclical conditions permitting and accelerate the reduction of the deficit if economic or budgetary conditions turn out better than expected at the time of the recommendation.

On 15 June 2010, the Commission concluded that based on the Commission services' 2010 Spring Forecast, Slovenia had taken effective action in compliance with the Council recommendation of 2 December 2009 to bring its government deficit below the 3% of GDP reference value and considered that no additional step in the excessive deficit procedure was therefore necessary.

This document provides an assessment of whether Slovenia has undertaken effective action towards the correction of its excessive general government deficit, and suggests a new adjustment path that would durably bring the general government deficit below the 3% of GDP reference value. In particular, the document examines the budgetary developments since the Commission communication to the Council on action taken as of 15 June 2010.

2. RECENT MACRO-ECONOMIC AND BUDGETARY DEVELOPMENTS AND OUTLOOK OVER 2013 - 2015

Slovenia has seen real GDP falling considerably more abruptly than in the euro area as a whole as a result of the global economic and financial crisis as well as domestic imbalances. The real GDP drop of 7.8% in 2009 was driven mainly by trends in gross capital formation. The export-led recovery Slovenia enjoyed in 2010 and 2011, when real GDP grew by 1.2% and 0.6%, respectively, was modest due to the continued drag from weak domestic demand. While GDP growth in 2010 was almost at par with that expected in the Commission services' 2009 Autumn Forecast (see Table 1), which was underlying the EDP recommendation, GDP growth in 2011 was below the projected 2.0%. The Commission services' 2009 Autumn Forecast, which was based on an assumption of the closure of the output gap beyond the forecast horizon, implicitly assumed that the Slovenian economy would grow at a faster pace than in 2011 in outer years in order for the output gap to be closed.

In reality, the Slovenian economy slipped into a double dip recession in 2012 with a real GDP decline of 2.3%. Investment, especially construction, was held back by deleveraging of non-

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[1] All documents related to the excessive deficit procedure of Slovenia can be found at:
http://ec.europa.eu/economy_finance/economic_governance/sgp/deficit/countries/slovenia_en.htm

[2] OJ L 209, 2.8.1997, p. 6.

financial corporations, subdued credit growth, including stemming from difficulties of the banking sector, government consolidation and households refraining from new real estate purchases. As a result of falling disposable income, private consumption declined by 2.9% in 2012. A positive contribution of 3.3 pps. to growth from net external demand was a result of robust growth of export to non-EU markets and a sharp decline in imports due to weak domestic demand.

Table 1: Comparison of macroeconomic developments and forecasts

	2009	2010		2011		2012		2013		
	outturn	COM 2009 AF	outturn	COM 2009 AF	outturn	COM 2009 AF	outturn	COM AF 2009	SP 2013	COM 2013 SF
Real GDP (% change)	-7.8	1.3	1.2	2.0	0.6	n.a.	-2.3	n.a.	-1.9	-2.0
Contributions to real GDP growth:										
Domestic demand	-6.1	-0.1	-2.2	1.5	-1.3	n.a.	-3.7	n.a.	-3.1	-3.5
Changes in inventories	-4.1	0.3	1.9	0.1	0.7	n.a.	-1.9	n.a.	-0.2	-0.8
Net exports	2.4	1.1	1.5	0.4	1.3	n.a.	3.3	n.a.	1.4	2.4
Employment (% change)	-1.8	-2.0	-2.2	-0.3	-1.6	n.a.	-1.3	n.a.	-1.6	-1.6
GDP deflator (% change)	3.6	1.1	-1.1	1.9	1.0	n.a.	0.4	n.a.	1.3	1.4
Output gap (% of potential GDP)	-3.9	-3.3	-2.7	-2.8	-1.5	n.a.	-2.8	n.a.	-3.5	-3.7
Potential output growth	1.2	1.2	0.0	1.4	-0.7	n.a.	-1.0	n.a.	-1.2	-1.0

Source: COM 2009 AF - Commission services' 2009 Autumn Forecast; COM 2013 SF - Commission services' 2013 Spring Forecast; SP 2013 - May 2013 stability programme;

The Commission services' updated 2013 Spring Forecast[3] projects a further drop in real GDP of 2.0% in 2013. Private consumption is forecast to decline by 3.7% due to falling employment and negative real wage growth. The trend in gross fixed capital formation, particularly in construction, will remain negative with a decrease of 4.9% reflecting corporate sector weaknesses and subdued credit growth. Exports are forecast to modestly grow by 1.3% due to the expected slow recovery of the global economy. Meanwhile, imports are expected to fall by 2.1% because of weak domestic demand. In total, these trends are projected to result in a strong contribution of 2.4 pps. of net external demand to growth. The projected continued recession with GDP growth of -0.1% in 2014 is a result of delays in resolving the banking crisis and restructuring the highly-indebted corporate sector. Real GDP growth is projected at 1.3% in 2015 (see Table 5) on the back of gradually strengthened domestic demand resulting mainly from a rehabilitation of the banking sector, progress in the deleveraging of corporations and improved consumer confidence.

The Commission services' updated 2013 Spring Forecast projects the 2014 deficit at 4.9% of GDP under a no-policy change assumption. The 2014 budget does not incorporate new discretionary measures, except for a drop in the corporate income tax rate to 16% and broad stabilisation of the public sector wage bill at the 2013 level. On the expenditure side, in particular interest expenditure and social transfers are projected to remain dynamic because of higher debt, growing number of old-age pensioners and indexation of pensions. Under a no-policy change scenario, the deficit is projected at 5.5% of GDP in 2015. The forecast incorporates further increases in interest expenditure, higher public sector wage bill after the expiry of temporary measures curbing salaries of public sector employees and the final step of the gradual decrease in corporate income tax rate by 1 pp. to 15%.

[3] This forecast is based on the Commission services’ 2013 Spring Forecast, whose horizon has been extended to 2015. In addition, the update incorporates two bonds issued on the US market on 2 May 2013 with an impact on interest expenditure, deficit and debt. Other nominal variables in 2013 and 2014 are exactly the same as in the 2013 Spring Forecast, but cyclically-adjusted variables have been slightly modified, also for years 2013 and 2014.

Slovenia faces steeply increasing public debt due to persistantly large primary deficits and to a lesser extent stock-flow adjustments and higher interest payments. From as low as 22% of GDP in 2008, debt increased to 54% of GDP in 2012. The Commission services' updated 2013 Spring Forecast projects it to increase to 61% of GDP in 2013, thus breaching the Treaty reference value. Based on a no-policy-change scenario, debt is forecast to increase further to 69% of GDP (see Table 7) in 2015. These projections do not include up to 11% of GDP of state guarantees for asset transfers to a Bank Asset Management Company and up to 3% of GDP of cash for recapitalisations as stipulated in the Banking Stability Act.

3. EFFECTIVE ACTION

3.1. Background information

The current assessment of effective action is based on the Commission services' 2013 Spring Forecast. It incorporates the economic and budgetary developments since the last Council recommendation under Article 126(7) of the TFEU was issued in December 2009. The assessment starts by comparing the recommended fiscal effort in the Council recommendation, the apparent fiscal effort, measured by the change in the structural budget balance, and the adjusted structural effort. The adjustment of the structural balance takes into account (i) the impact of revisions in potential output growth compared to that underlying the growth scenario in the Council recommendation, and (ii) the impact on revenue of revisions of the tax content of economic activity (composition of economic growth or of other revenue windfalls/shortfalls) relative to what was assumed at the time of the recommendation. This top-down approach in the assessment is complemented by a careful analysis, including a bottom-up assessment of consolidation measures undertaken by the Slovenian authorities.

3.2. Assessment of effective action 2010-2013 - overview

The consolidation process in Slovenia was backloaded to the second half of the excessive deficit correction period. The structural balance amounted to -4¼%, -4¾%, -4¾% and -2¾% of GDP over the period 2009 – 2012. The Commission services' 2013 Spring Forecast projects the structural balance to improve further to -2½% of GDP in 2013. These developments result in an average annual apparent fiscal effort of 0.5% of GDP over the period 2010-2013. However, when adjusted for the significant downward revision in potential output growth (see Table A1 in Annex) since the time when the recommendation was issued[4] (+0.8% of GDP) and despite revenues unexpectedly falling at a lower rate than would have been implied by the GDP decline (see Table A2 in Annex) based on standard elasticities (-0.2% of GDP), the adjusted average annual structural effort amounts to 1.1% of GDP (see Table 2). This is above the average annual fiscal effort of ¾% of GDP over the period 2010-2013 required in the 2009 Council EDP recommendation.

[4] Because the 2009 Council recommendation formulates adjustment requirements as an average annual improvement in the structural balance over 2010 -2013, the correction for the forecast error involves the revision of average potential output growth over the reference period.

Table 2: Change in the structural balance corrected for revisions in potential output gap and revenue windfalls/shortfalls

Apparent annual average fiscal effort up to year				Average annual fiscal effort corrected for potential growth revision and revenue windfalls/shortfalls up to year				Required fiscal effort in 2009 Council recomendation	Deadline for correction of excessive deficit
2010	2011	2012	2013	2010	2011	2012	2013	2010 - 2013	
-0.3	-0.2	0.6	0.5	-0.8	0.0	0.9	1.1	3/4	2013

Source: Commission services' 2013 Spring Forecast and Commission services' calculations

The fall in revenues, net of discretionary measures, at a lower rate than would have been implied by the GDP decline based on standard elasticities is in particular explained through the improved absorption of EU funds in 2010 and interest revenue. Beside the traditionally accelerated absorption of EU funds towards the second half of a multiannual financial framework, a high level of EU funds is also due to recording of EU funds for which non-government units are final beneficiaries into general government accounts[5]. This expands both the revenue and expenditure ratios of the general government. Increased interest revenue by the government are explained by the pre-financing of bonds[6] maturing in the following years by the Treasury and corresponding deposits of proceeds with banks. That ensured sufficient financing of the sovereign during the crisis years.

3.3. Assessment of effective action 2010-2013 – detailed analysis of measures

The total amount of additional consolidation measures implemented by Slovenian authorities in response to the Council EDP recommendation over 2010-2013 is estimated at around 6¾% of GDP with the bottom-up approach (see Table 4). This estimate excludes consolidation measures amounting to around 0.8% of GDP from the 2010 budget already included in the Commission services' 2009 Autumn Forecast. Measures amounting to some 5% of GDP have targeted current expenditure and to a lesser extent revenues. In addition, the authorities significantly cut public investment by around 1¾% of GDP over 2010-2012 (see Table 3).

Budgetary implications of consolidation measures have been partially offset by inherent growth of certain expenditure items, in particular interest and pension expenditures, and intermediate consumption growth. The size of this dynamics is estimated at around 2½% of GDP over 2010-2013. Interest expenditure have increased annually by around 0.25% of GDP over 2010-2012 and a similar increase is projected for 2013. On average the number of old age pensioners was increasing annually at around 3.5% over 2010-2012, which annually added around 0.3% of GDP to total expenditure. A similar increase in the number of old age pensioners is projected for 2013, but then it is expected to decelerate after the implementation of the pension reform from end-2012. Finally, intermediate consumption in projected to increase by 0.2% of GDP in 2013 relative to 2009. The bottom-up calculation of the size of consolidation measures adjusted for inherent growth of expenditure items mentioned above indicates the total net fiscal effort of around 4¼% of GDP over 2010 – 2013. This is above the average annual fiscal effort of ¾% of GDP over the period 2010-2013 required in the 2009

[5] The Statistical Office of the Republic of Slovenia will soon start recording EU funds into institutional sectors which are final beneficiaries of these funds.

[6] The Treasury pre-financed some EUR 2bn of future liabilities in 2009, which added some 0.25% of GDP to interest expenditures.

Council EDP recommendation. Thus, it appears to confirm the outcome of the top-down assessment of the adjusted average annual structural effort that Slovenia has taken effective action to correct the excessive deficit.

3.4. Budgetary implementation in 2010

The general government deficit had soared to 6.2% of GDP in 2009 (from 1.9% of GDP in 2008) due to strong, in-built expenditure dynamics. The consolidation measures in the 2010 budget adopted before the Council issued the EDP recommendation, contributed to the reduction of the headline deficit to 5.9% of GDP. Most expenditure measures were ad-hoc interventions, enacted for one year only. They reduced in particular growth of the public sector wage bill and of social transfers and no recovery for the foregone increase was foreseen in future. The annual indexation of social benefits rates, including pensions, and of public sector wages was halved for 2010 (social benefits rates and public sector wages were usually indexed to 100% of CPI inflation, while pensions were indexed to 100% wage growth). In the public sector the last two instalments of the envisaged wage increase were postponed to 2011, performance bonuses were cancelled and workload bonuses were cut. The only revenue measure was higher excise duty rates on alcohol, cigarettes and mineral oils. No additional consolidation measures for 2010 were adopted in response to the Council EDP recommendation.

Table 3: Composition of the budgetary adjustment

	2009	2010		2011		2012		2013		
	outturn	COM 2009 AF	outturn	COM 2009 AF	outturn	COM 2009 AF	outturn	COM 2009 AF	SP 2013	COM 2013 SF
	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP	% of GDP
Revenue	43.1	43.2	44.5	42.9	44.4	n.a.	45.0	n.a.	45.5	45.0
of which:										
- Taxes on production and imports	14.1	14.4	14.3	14.3	14.1	n.a.	14.6	n.a.	15.0	14.6
- Current taxes on imcome, wealth, etc.	8.2	8.7	8.2	8.7	8.0	n.a.	7.7	n.a.	7.6	7.6
- Social contributions	15.2	14.6	15.4	14.5	15.3	n.a.	15.5	n.a.	15.4	15.3
- Other (residual)	5.6	5.5	6.6	5.5	7.1	n.a.	7.3	n.a.	7.5	7.5
Expenditure	49.3	50.2	50.4	49.9	50.8	n.a.	49.0	n.a.	53.4	50.3
of which:										
- Primary expenditure	48.0	48.3	48.8	47.9	48.8	n.a.	46.9	n.a.	50.7	47.9
of which:										
- Compensation of employees	12.4	12.4	12.6	12.6	12.8	n.a.	12.6	n.a.	12.0	12.3
- Intermediate consumption	6.5	6.5	6.8	6.4	6.9	n.a.	6.9	n.a.	6.8	6.7
- Social payments	18.7	18.8	19.4	18.8	19.8	n.a.	19.7	n.a.	20.2	20.4
- Subsidies	2.1	2.4	2.3	1.9	1.3	n.a.	1.3	n.a.	1.3	1.3
- Gross fixed capital formation	4.6	4.5	4.4	4.5	3.6	n.a.	2.9	n.a.	3.2	3.3
- Other (residual)	3.8	3.6	3.2	3.6	4.4	n.a.	3.4	n.a.	7.2	4.0
- Interest expenditure	1.3	1.9	1.6	2.0	1.9	n.a.	2.1	n.a.	2.7	2.3
General government balance (GGB)	-6.2	-7.0	-5.9	-6.9	-6.4	n.a.	-4.0	n.a.	-7.9	-5.3
Primary balance	-4.9	-5.1	-4.3	-4.9	-4.4	n.a.	-1.9	n.a.	-5.2	-2.9
One-off and other temporary measures	-0.1	0.0	0.0	0.0	-1.0	n.a.	0.0	n.a.	3.7	-1.2
Structural balance	-4.4	-5.4	-4.7	-5.6	-4.7	n.a.	-2.7	n.a.	-2.6	-2.4
Change in structural balance	0.1	-0.7	-0.3	-0.2	0.0	n.a.	2.0	n.a.	0.1	0.3
Real GDP growth	-7.8	1.3	1.2	2.0	0.6	n.a.	-2.3	n.a.	-1.9	-2.0
GDP deflator	3.6	1.1	-1.1	1.9	1.0	n.a.	0.4	n.a.	1.3	1.4
Nominal GDP	-4.5	2.4	0.1	3.9	1.6	n.a.	-2.0	n.a.	-0.6	-0.6

Source: COM 2009 AF - Commission services' 2009 Autumn Forecast; COM 2013 SF - Commission services' 2013 Spring Forecast; SP 2013 - May 2013 stability programme

Overall, total consolidation measures of around ¾% of GDP[7] were taken for 2010. However, they were partially offset by increasing interest burden, new old-age pensioners, including from early retirement in anticipation of the envisaged pension reform, and higher intermediate consumption. These factors in combination with other determinants of the cyclically-adjusted balance deteriorated the structural balance by 0.3% of GDP (see Table 4 for composition of the budgetary adjustment). The estimated adjusted annual structural effort was also affected by developments in revenues, net of discretionary measures, unexpectedly rising at a larger rate than would have been implied by the GDP increase based on standard elasticities. This was largely due to the high absorption of EU funds (0.5% of GDP), social contributions (0.3% of GDP), interest revenue (0.2% of GDP) and excise duties (0.2% of GDP). These revenue developments would reduce the annual apparent fiscal effort in 2010 by around 1.3% of GDP. After taking also the large downward revision of the potential output growth into account[8], the adjusted annual structural effort is estimated at around -0.8% of GDP in 2010.

[7] The estimated size of consolidation measures is expressed in net terms (excluding possible deficit-increasing measures).

[8] The contribution from the revision of average potential output growth rates over the reference period to the correction of the annual apparent fiscal efforts is constant at 0.8% of GDP.

Table 4: Main budgetary measures over 2010-2013

Revenue	Expenditure
2010	
• Higher excise duty rates on tobacco, alcohol and mineral oils (0.1%)	• Halved indexation of pensions and other social benefit rates (2010) (-0.3%) • Halved indexation of public sector wages (2010) (-0.15%), cancelled performance bonuses and lower workload bonuses (2010) (-0.25%)
2011	
• Higher excise duty rates on tobacco (0.1%)	• Indexation of pensions and other social benefit rates by ¼ of the usual size (2011) (-0.3%) • Indexation of public sector wages by ¼ of the usual size and freeze on promotions (2011) (-0.3%) • Cut in subsidies (permanent) (-0.8%)
2012	
• Reduction in the corporate income tax rate from 20% to 18% and higher R&D and investment allowances for personal and corporate income tax (-0.5%) • Higher excise duty rates on tobacco, alcohol and mineral oils (0.25%) • New CO_2 charge on mineral oils (full year impact 0.25%) • Higher charges (concession fees) on student work (full-year impact 0.1%)	• Canceled indexation of social benefit rates (until end-2014) (total impact in 2012 and 2013 -0.3%) • Public sector wage bill: net cut in wages by 3% (permanent), cancelled indexation of public sector wages, postponement of payment for promotions (until June 2013) (full-year impact -0.85%), and permanent cancellation of third and fourth instalments of the public sector wage increase envisaged back in 2008 (-0.6%) • Lower recreational allowance for pensioners (until the year after the year in which real GDP growth exceeds 2.5%) (full-year impact -0.15%) • Canceled indexation of pensions (2012) (-0.25%) • Lower child benefits for higher income families (until the year after the year in which real GDP growth exceeds 2.5%) (full-year impact -0.2%) • Lower increase in minimum income for socially vulnerable people (until 2015) (-0.1%) • Lower parental protection and other family benefits (full year impact -0.2%) • Various cuts in social transfers (permanent) (e.g. veteran entitlements and scolarships) (full-year impact -0.1%)
2013	
• Reduction in the corporate income tax rate to 17% (-0.1%) • Higher road user charge (full-year impact 0.1%) • New tax on financial services and amended bank assets tax (0.1%) • Higher excise duty rates on tobacco, alcohol and mineral oils (0.25%)	• Cut in public sector holiday allowance (2013) (-0.15%) • Cancelled indexation of public sector wages (2013) (-0.15%) • Higher meals allowance for students (permenent) (+0.1%)

Note: A positive sign implies that revenue / expenditure increases as a consequence of this measure. Annual budgetary impacts are estimated by the Commission services and expressed as a % of GDP. Measures with a budgetary implications of at least 0.1% of GDP are listed.

Full-year budgetary implications are presented for measures not introduced at the beginning of a calendar year.

All listed revenue measures are permanent, with the exception of higher excise duty rates on mineral oils which are normally bi-weekly amended in reactionte to movements in world oil prices. Listed expenditure measures have different validities as provided in the table.

3.5. Budgetary implementation in 2011

The headline deficit peaked at 6.4% of GDP in 2011. Capital support operations to loss-making state-owned enterprises and one-offs for the largest bank and the railway company together contributed 1.4% of GDP to the deficit. The 2011 budget temporarily prolonged and strengthened the consolidation measures initially envisaged to be valid for 2010 only. The indexation of social benefit rates, including pensions, and of public sector wages was reduced to ¼ of the usual size. Cancellation of performance bonuses for public employees and cut in workload bonuses were extended into 2011 and 2012. Finally, public sector promotions in salary grades were cancelled for 2011, while wage increases due to promotions in position grades in 2011 were postponed to 2012, but with no reimbursement for lost income. On the revenue side, excise duty rates on cigarettes were further augmented.

Overall, total discretionary measures of some 1½% of GDP were taken. They were partially offset by the same elements as in 2010. These elements in combination with other determinants of the cyclically-adjusted balance and after deducting one-offs related to banks and railway company kept the structural balance unchanged. Revenues, net of discretionary measures, were moving in line with the GDP increase based on standard elasticities. After taking also the large downward revision of the potential output growth into account, the adjusted annual structural effort is estimated at around 0.8% of GDP in 2011.

3.6. Budgetary implementation in 2012

The March EDP notification as validated by the Commission (Eurostat) reported the 2012 general government deficit at 4.0% of GDP. This outturn covers another recapitalisation of the largest bank by some 0.2% of GDP (€63m) in June 2012, being treated as a one-off. The 2012 budget was initially supported with the Additional Intervention Measures Act which postponed an envisaged increase in the minimum income for socially vulnerable people to 2015 and froze the indexation of social benefit rates, including pensions, and of public sector wages until 30 June 2012. This provided the previous government elected in February 2012 with sufficient time to prepare a broader set of consolidation measures in the context of the 2012 supplementary budget. Thus, the Act on Balancing Public Finances from May 2012 amended 39 different legal acts. Most expenditure-restraining measures were, however, again of a temporary nature, with either a fixed or conditional expiry date (e.g. until the year after the year in which real GDP growth exceeds 2.5%). The payment of the last two instalments of the envisaged public sector wage increase from 2008 was permanently abolished. In addition, public sector nominal wages were cut by 3% on average in net terms and are not indexed over 2012-2013. The cancellation of performance bonuses and cut in workload bonuses were extended into 2013. Furthermore, public sector promotions for 2013 were cancelled while wage increases due to promotions in 2011 and 2012 were envisaged to be paid in July 2013, but with no reimbursement for lost income in both years. Finally, the government contained some other work-related costs and successfully implemented the long-envisaged brake on new public sector employment. Consequently, public sector employment started to decline in July 2012 and currently evolves at an annual growth rate of around -1.8%. In the area of social transfers, pensions were not indexed in 2012 while the recreational allowance for pensioners was cut for high pension earners until the year after the year in which real GDP growth exceeds 2.5%. The indexation of other social benefit rates was cancelled until 2014. In addition, eligibility for child benefits was tightened for higher income families while parental protection and other family benefits were lowered. On the revenue side, the authorities have made the tax system more growth-friendly with a gradual cut in the corporate income tax rate from 20% in 2011 to 15% in 2015 and more generous investment and R&D allowances. However, this has tended to work against the consolidation effort because it largely offset permanent revenue increasing measures in the form of higher excise duty rates, new CO_2 charge on mineral oils and charges (concession fees) on student work.

Overall, total discretionary measures of around 2¾% of GDP were taken. Again, they were partially offset by the same elements as in previous years. These elements in combination with other determinants of the cyclically-adjusted balance and after deducting one-offs on the revenue (superdividends for energy companies) and expenditure side (recapitalisation of banks) improved the structural balance by significant 2.0% of GDP. The estimated change in the structural balance was also affected by revenue, net of discretionary measures, unexpectedly falling at a slightly lower rate than would have been implied by the GDP decline and standard elasticities. This was mainly due to buoyant indirect taxes after higher excise duty rates. After taking also the large downward revision of the potential output growth into account, the annual adjusted structural effort is estimated at around 2.6% of GDP in 2012.

3.7. Budgetary developments in 2013

The Commission services' 2013 Spring Forecast projects the general government deficit at 5.3% of GDP in 2013. This projection includes one-off conversions of hybrid debt-equity instruments into equity of the two largest banks together amounting to 1.2% of GDP (€320m for the NLB and €100m for NKBM). Consequently, in their absence the deficit for 2013 would be projected at 4.1% of GDP. The deficit forecast of 5.3% of GDP compares with Slovenia's deficit target for 2013 of 7.9% of GDP from the 2013 update of the stability programme, which includes larger recapitalisations of banks.

Public finances in 2013 are expected to benefit from the full-year effects of savings measures from the Act on Balancing Public Finances which entered into force in mid-2012. Slovenia is also implementing additional revenue-increasing measures, which include a new tax on financial services, an amended tax on bank assets, higher excise duty rates and higher CO_2 tax. The net effect of personal income tax changes is assessed as broadly neutral because the increase in the threshold for the tax bracket at 41% to around 1.5 times an average wage (from around 1.3 times) offsets a new highest personal income tax bracket at 50% (temporary measure over 2013 – 2014) and reductions in some personal income tax allowances. A further reduction in the corporate income tax rate by 1 pp. will also reduce revenue. On the expenditure side, the main new measure is the December 2012 pension reform. However recent increases in number of old-age pensioners indicate it will have less of an effect in 2013 than was foreseen when the budget was prepared. In addition, pension expenditure is projected to be higher by some 0.15% of GDP (including the compensatory payment for 2012) due to the March 2013 Constitutional Court judgement to repeal provisions of the Act on Balancing Public Finances stipulating the cut in pensions financed directly from the central government budget[9].

Some consolidation measures announced by the previous government and included in the 2013 budget have not yet been adopted by the cut-off date of the Commission Services' 2013 Spring Forecast. The adoption and implementation of the announced tax on sugar and sweeteners in beverages, tax on gaming tickets and higher environmental charges as well as the implementation of measures to cut the wage bill by 5% in net terms would further reduce the 2013 deficit. Their estimated budgetary implications depend on measures' details and time of implementation. These measures are not incorporated in the Commission services' 2013 Spring Forecast, with the exception of the cut in the wage bill by 3%. Finally, the new government announced the 2013 supplementary budget for summer, which will include

[9] The final decision how the compensation for lower pensions in 2012 will be recorded in ESA95 accounts stays with Eurostat.

measures announced in the 2013 update of the stability programme. However, these measures (e.g. higher VAT rates, higher and broader real estate taxation, possible crisis personal income tax, cancelation of further cuts in the corporate income tax rate from currently 17% as well as various not yet fully identifiable expenditure consolidation measures) were not included in the Commission Services' 2013 Spring Forecast because the stability programme was submitted to the Commission on 9 May only.

Overall, total discretionary measures of around ½% of GDP have already been taken for 2013. Again, they were partially offset by the inherent dynamics of previously mentioned expenditure items. These elements in combination with other determinants of the cyclically-adjusted balance are forecast to improve the structural balance by 0.3% of GDP. The estimated change in the structural balance is forecast to be affected also by revenues, net of discretionary measures, unexpectedly falling at a higher rate than would have been implied by the GDP decline and standard elasticities mainly due to weak indirect taxes (0.25% of GDP), social contributions (0.25% of GDP) and direct taxes (0.1% of GDP). After taking also the large downward revision of potential output growth into account, the annual adjusted structural effort is estimated at around 1.9% of GDP in 2013.

4. PROPOSED NEW ADJUSTMENT PATH

According to the baseline macroeconomic scenario, which is the Commission services' updated 2013 Spring Forecast, Slovenia is not forecast to correct its excessive deficit by the deadline established in the Council Recommendation of 2 December 2009, although the average annual adjusted structural effort at 1.1% of GDP is above the structural effort of ¾% of GDP recommended by the Council. At the same time, Slovenia was hit with unexpected adverse economic developments with the economy in the double dip recession, which is projected to last into 2014[10]. Employment has been affected negatively, unemployment has risen sharply and real wage growth became negative. Slovenia is also experiencing excessive macroeconomic imbalances which seriously hamper investment. Thus, domestic demand continues to decline. This is having adverse effects on both the revenue and expenditure sides compared to what was expected at the time of the Council recommendation. It therefore appears justified to issue a revised EDP recommendation to Slovenia and to extend the deadline for correction of the excessive deficit which is also in line with the flexibility foreseen in the Stability and Growth Pact.

Granting two additional years for the correction of the excessive deficit would be commensurate with intermediate headline deficit targets of 4.9% of GDP in 2013 (3.7% of GDP without 1.2% of GDP one-off conversions of hybrid debt-equity instruments into equity of the two largest banks), 3.3% of GDP in 2014 and 2.5% of GDP in 2015 (see Table 6). The underlying improvement in the structural budget balance implied by these targets is 0.7% of GDP in 2013, 0.5% of GDP in 2014 and 0.5% of GDP in 2015, the last two corresponding to the minimum improvement required by Article 5(1) of Council Regulation (EC) No 1466/97 of 7 July 1997.

The baseline scenario incorporates only adopted consolidation measures among those foreseen in the 2013/14 budget. To reach the recommended improvement in structural balance, specification, adoption and implementation of additional consolidation measures in

[10] The unexpected macroeconomic developments are reflected in the adjusted average annual structural effort.

the announced 2013 supplementary budget is required. Also for 2014 and 2015, detailed specification and adoption of structural consolidation measures which are necessary to achieve the correction of the excessive deficit by 2015 followed by rigorous implementation is requested. In total, to reach the above-mentioned structural targets, the Slovenian authorities would need to implement additional consolidation measures of 1% of GDP in 2013, 1½% of GDP in 2014 and 1½% of GDP in 2015 on top of the measures already included in the baseline scenario. These targets take into account the need to compensate for the negative second-round effects of fiscal consolidation on public finances, through its impact on GDP growth.

Public finances could benefit from a specification, adoption and implementation of consolidation measures valid over a period of a few years in order to avoid repetitive, annual lengthy negotiations on temporary measures valid in some cases for one year only. In addition, current expenditure consolidation measures appear as a preferred option relative to broad based tax increases, because the former could effectivelly decelerate inherent dynamics of expenditure and tackle expenditure inefficiencies. In this context, also a review of financing of indirect budgetary users (public institutes) and avoidance of further cuts in public investment could improve the quality of the consolidation. Furthermore, a close monitoring of public finance developments and prompt further corrective action would be warranted if slippages were to materialise. Finally, to ensure the success of the fiscal consolidation strategy, it will be also important to back the fiscal consolidation by comprehensive structural reforms, in line with the Council recommendations addressed to Slovenia in the context of the European Semester and Macroeconomic Imbalances Procedure.

Table 5 – Forecast of key macroeconomic and budgetary variables under the baseline scenario

% of GDP	2012	2013	2014	2015
Revenues	45.0	45.0	44.2	43.9
Current revenues	44.6	44.3	43.5	43.1
Discretionary measures with impact on current revenue[1]	0.1	0.5	0.0	0.0
Expenditure	49.0	50.5	49.1	49.4
Real GDP growth (%)	-2.3	-2.0	-0.1	1.3
Nominal GDP growth (%)	-2.0	-0.6	1.0	3.1
Potential GDP growth (%)	-1.1	-1.1	-0.7	-0.2
Structural balance	-2.7	-2.6	-3.4	-4.7
General government balance	-4.0	-5.5	-4.9	-5.5
p.m CAB methodology revenue elasticity	0.9	0.9	0.9	0.9
p.m Apparent revenue elasticity	0.6	4.0	-0.9	0.8
p.m Output gap (% of potential output)	-2.7	-3.6	-3.1	-1.9

Note:

[1] Measures clearly specified and committed to by governments ahead of the recommendation

Source: Commission Services' updated 2013 Spring Forecast

Table 6 - Forecast of key macroeconomic and budgetary variables under the EDP scenario

% of GDP	2012	2013	2014	2015
Real GDP growth (%)	-2.3	-2.2	-1.2	0.3
Potential GDP growth (%)	-1.3	-1.4	-1.0	-0.5
Structural balance	-2.8	-2.1	-1.6	-1.1
General government balance	-4.0	-4.9	-3.3	-2.5
p.m Output gap (% of pot. output)	-2.5	-3.3	-3.5	-2.8

Source: Commission Services

5. CONCLUSIONS

On current information, the average annual fiscal effort after correction for the effects of the revision in the potential output growth and in revenue developments is estimated at around 1.1% of GDP. This estimate is based on the Commission services' 2013 Spring Forecast, which incorporates only adopted measures among those foreseen in the 2013 budget. The calculated adjusted structural effort is above the average annual fiscal effort of ¾% of GDP over 2010-2013 required in the Council recommendation, which suggests that Slovenia has taken effective action to correct the excessive deficit.

The bottom-up approach assesses the cumulative size of consolidation measures at some 6¾% of GDP over 2010-2013, which includes a reduction in public investment by around 1¾% of GDP. A deficit-reducing effect of these measures has been partially offset by inherent growth of certain expenditure items, in particular interest and pension expenditures, and intermediate consumption growth. The budgetary impact of those items is estimated at around 2½% of GDP over 2010-2013. Consequently, the bottom-up calculation of the size of consolidation measures adjusted for inherent growth of expenditure items mentioned above indicates the total net fiscal effort of around 4¼% of GDP over 2010 – 2013. This is above the average annual fiscal effort of ¾% of GDP over the period 2010-2013 required in the 2009 Council EDP recommendation. Thus, it appears to confirm that Slovenia has taken effective action to correct the excessive deficit.

For 2013, the Slovenian authorities have adopted the budget which contains additional consolidation measures, which are however not sufficient for the correction of the excessive deficit situation by 2013, as recommended by the Council. The authorities have also adopted the 2014 budget, which does not incorporate new discretionary measures, except for a reduction in the corporate income tax rate by another 1 pp. and broad stabilisation of the public sector wage bill at the 2013 level.

The substantial deterioration in the budgetary position resulting from the weaker overall position of the economy relative to the one underlying the 2009 Council EDP recommendation suggests that a new deadline for the correction of the excessive deficit in Slovenia by 2015 is appropriate. Granting two additional years in the correction of the excessive deficit requires intermediate headline deficit targets of 4.9% of GDP in 2013 (3.7% of GDP without 1.2% of GDP one-off conversions of hybrid debt-equity instruments into equity of the two largest banks), 3.3% of GDP in 2014 and 2.5% of GDP in 2015. The underlying improvement in the structural budget balance implied by these targets is 0.7% of GDP in 2013, 0.5% of GDP in 2014 and 0.5% of GDP in 2015. To reach those structural targets, the Slovenian authorities would need to implement additional consolidation measures of 1% of GDP in 2013, 1½% of GDP in 2014 and 1½% of GDP in 2015 on top of the measures already included in the baseline scenario

Table 7: Comparison of key macroeconomic and budgetary projections

		2009	2010	2011	2012	2013	2014	2015
Real GDP (% change)	COM uSF 13	-7.8	1.2	0.6	-2.3	-2.0	-0.1	1.3
	SP 13	-7.8	1.2	0.6	-2.3	-1.9	0.2	1.2
	COM AF 09	-7.4	1.3	2.0	n.a.	n.a.	n.a.	n.a.
Output gap[1] (% of potential GDP)	COM uSF 13	-3.9	-2.7	-1.5	-2.7	-3.6	-3.1	-1.9
	SP 13	-3.9	-2.7	-1.5	-2.7	-3.5	-2.7	-1.3
	COM AF 09	-3.3	-3.3	-2.8	n.a.	n.a.	n.a.	n.a.
General government balance (% of GDP)	COM uSF 13	-6.2	-5.9	-6.4	-4.0	-5.5	-4.9	-5.5
	SP 13	-6.2	-5.9	-6.4	-4.0	-7.9	-2.6	-2.1
	COM AF 09	-6.3	-7.0	-6.9	n.a.	n.a.	n.a.	n.a.
Primary balance (% of GDP)	COM uSF 13	-4.9	-4.3	-4.4	-1.9	-2.9	-2.1	-2.4
	SP 13	-4.9	-4.3	-4.4	-1.9	-5.2	0.3	0.7
	COM AF 09	-4.8	-5.1	-4.9	n.a.	n.a.	n.a.	n.a.
Cyclically-adjusted balance[1] (% of GDP)	COM uSF 13	-4.4	-4.7	-5.7	-2.7	-3.8	-3.4	-4.7
	SP 13	-4.4	-4.7	-5.7	-2.7	-6.3	-1.4	-1.5
	COM AF 09	-4.8	-5.4	-5.6	n.a.	n.a.	n.a.	n.a.
Structural balance[2] (% of GDP)	COM uSF 13	-4.4	-4.7	-4.7	-2.7	-2.6	-3.4	-4.7
	SP 13	-4.4	-4.7	-4.7	-2.7	-2.6	-1.4	-1.5
	COM AF 09	-4.7	-5.4	-5.6	n.a.	n.a.	n.a.	n.a.
Government gross debt (% of GDP)	COM uSF 13	35.0	38.6	46.9	54.1	61.4	64.0	68.9
	SP 13	35.0	38.6	46.9	54.1	61.8	63.2	63.2
	COM AF 09	35.1	42.8	48.2	n.a.	n.a.	n.a.	n.a.

Note:

[1] Output gaps and cyclically-adjusted balances according to the programmes as recalculated by Commission services on the bass of the information in the programmes.

[2] Cyclically-adjusted balance excluding one-off and other temporary meaures

Source: *Commission services' 2013 Spring Forecast extended for year 2015 (COM eSF 13), Commission services' 2009 Autumn Forecast (COM AF 09), and May 2013 stability programme (SP 13)*

Annex

Table A1: Adjustment of apparent structural effort for the revision in potential growth – details of calculation

Average potential growth assumptions underlying Dec 2009 Council recommendation (%)	Average potential growth (COM 2013 SF) (%)	Forecast error (%)	Structural expenditure (% of potential GDP) (COM 2013 SF)	Correction for revision in potential growth (% of nominal potential GDP)
(1)	(2)	(3) = (2) - (1)	(4)	(5) = (3) * (4) / 100
1.8	0.0	1.8	45.2	0.8

Source: Commission services' updated 2013 Spring Forecast

Table A2: Adjustment of apparent structural effort for the revenue windfalls/ shortfalls as compared to standard elasticities – details of calculation

CAB methodology revenue elasticity (ε* = 0.91)	Change in current revenues (yoy) (EUR mln)	Discretionary current revenue measures (EUR mln)	Nominal growth assumptions (%)	Current revenues in t-1 (EUR mln)	Revenue gap (EUR bn)	Correction for revenue windfalls/shortfalls
2013 SF	(1)	(2)	(3)	(4)	(5) = (1) - (2)- ε*x(3)x(4)	(5) (% of nominal potential GDP)
2010	535.8	30.0	0.1	15190.7	486.0	1.3
2011	261.4	35.0	1.6	15726.5	0.0	0.0
2012	-159.6	30.0	-2.0	15987.8	93.4	0.3
2013	-203.7	162.0	-0.6	15828.2	-282.1	-0.8
Average						0.2

Source: Commission services' 2013 Spring Forecast