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Country Report Slovenia 2018
Including an In-Depth Review on the prevention and correction of macroeconomic imbalances

Accompanying the document

COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE COUNCIL, THE EUROPEAN CENTRAL BANK AND THE EUROGROUP

2018 European Semester: Assessment of progress on structural reforms, prevention and correction of macroeconomic imbalances, and results of in-depth reviews under Regulation (EU) No 1176/2011

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CONTENTS

Executive summary 1

1. Economic situation and outlook 4

2. Progress with country-specific recommendations 11

3. Summary of the main findings from the Macroeconomic Imbalance Procedure In-Depth Review 15

4. Reform priorities 18

4.1. Public finances and taxation 19

4.2. Financial sector 26

4.3. Labour market, education and social policies 31

4.4. Investment 37

Annex A: Overview Table 47

Annex B: Macroeconomic Imbalance Procedure Scoreboard 53

Annex C: Standard Tables 54

References 60

LIST OF TABLES

Table 1.1: Key Economic Indicators 10

Table 2.1: Summary Table in 2017 CSR assessment 14

Table 3.1: Macroeconomic Imbalance Procedure assessment matrix 17

Table 4.2.1: Financial soundness indicators, all banks in Slovenia 26

Table 4.4.1: Construction is expensive 43

Table B.1: The Macroeconomic Imbalance Procedure scoreboard for Slovenia (AMR 2018) 53

Table C.1: Financial market indicators 54

Table C.2: Headline Social Scoreboard indicators 55

Table C.3: Labour market and education indicators 56

Table C.4: Social inclusion and health indicators 57

Table C.5: Product market performance and policy indicators 58

Table C.6: Green growth 59

LIST OF GRAPHS

Graph 1.1:	Contributions to GDP growth	4
Graph 1.2:	Development of public and private investment	4
Graph 1.3:	Investment by type	4
Graph 1.4:	Contribution to potential growth	5
Graph 1.5:	Export market shares change with contributions	7
Graph 1.6:	Real effective exchange rate based on unit labour costs	7
Graph 1.7:	Net international investment position - by sector	7
Graph 1.8:	Debt decomposition	8
Graph 1.9:	House price developments	9
Graph 2.1:	Overall multiannual implementation of 2011-2017 CSRs to date	11
Graph 3.1:	Non-performing exposure of domestic banks (including foreign-controlled subsidiaries and branches)	15
Graph 3.2:	Arrears developments	15
Graph 4.1.1:	Gross debt - DSA	21
Graph 4.1.2:	Alcohol, overweight and obesity problems are greater in Slovenia than in most other EU countries	23
Graph 4.2.1:	Year-on-year credit growth, adjusted for sales and securitisation	26
Graph 4.2.2:	Trends in non-performing loans, including BAMC assets	27
Graph 4.2.3:	Share of forborne loans that are performing (end-June 2017)	27
Graph 4.2.4:	Annual value of private equity investments in selected Central and Eastern European countries in 2013 to 2016 (million euros)	29
Graph 4.3.1:	Activity, employment and unemployment rates (annual)	31
Graph 4.3.2:	Decomposition of rate of change of unit labour costs	35
Graph 4.4.1:	Labour productivity in Slovenia and the euro area, 1999-2016	37
Graph 4.4.2:	Labour productivity in 2010 and its average annual growth (2008-2016)	37
Graph 4.4.3:	Value added per employee, in EUR 1000, Manufacturing sector	39
Graph 4.4.4:	Value added per employee, in EUR 1000, Services	39
Graph 4.4.5:	Annual TFP for small, medium and large firms	40
Graph 4.4.6:	Annual TFP for zombie v.non-zombie firms	40
Graph 4.4.7:	Education and literacy skills	41
Graph 4.4.8:	Business environment	41
Graph 4.4.9:	Innovation and R&D	41
Graph 4.4.10:	Business and public R&D intensities in Slovenia (% of GDP), 2007 – 2015	41
Graph 4.4.11:	Impact on labour productivity in manufacturing of tackling restrictions in the service sector (measured by using the Service Trade Restrictiveness Index (SRRI)	43

LIST OF BOXES

Box 2.1: Tangible results delivered through EU support to structural change in Slovenia 13
Box 4.2.2: Policy highlight: improving the access to finance 30
Box 4.3.3: Monitoring performance in light of the European Pillar of Social Rights 32
Box 4.4.4: Investment challenges and reforms in Slovenia 38
Box 4.4.5: Drivers of productivity growth at firm level 40

EXECUTIVE SUMMARY

Slovenia's successful rebalancing sets the ground for addressing medium and long-term challenges. The sources of imbalances that led to the deep crisis of 2012-2013 have rapidly receded, also due to sustained policy action. The economy is now growing robustly. Addressing remaining weaknesses in the banking and corporate sector, unleashing investment and productivity growth and reforming the pension, health and long-term care systems remain key priorities to put the economy on a dynamic and sustainable growth path. ([1])

Slovenia is getting on a balanced growth path. In 2012-2014, the country suffered from serious problems in the banking sector and embarked on a painful corporate deleveraging process. The economy rebalanced rapidly afterwards, also helped by the well-designed policy measures, and since 2016 it has enjoyed sustained growth. Slovenia has maintained its price-competitiveness and the improving external environment is clearly reflected in the growth of exports. The expected account surplus is 5.9 % of GDP in 2017 and the net international investment position improved.

The labour market is strengthening. Employment continued to rise, unemployment further decreased and labour shortages increased. The tightening labour market is putting some upward pressure on wages, but wage growth remains moderate and in line with productivity developments. Due to positive economic developments the rate of people at risk of poverty and social exclusion continued to decrease.

The sources of imbalances have been reduced in a sustainable manner. The banking sector is improving due to better solvency, profitability and asset quality. Non-performing loans declined by almost a third in 2017 compared to 2016. Credit growth has turned positive and investments are expected to drive Slovenia's economic growth in 2018 and 2019. Government finances are expected to be in balance in 2018. Public debt continues to decline and is expected to reach 72 % of GDP in 2019, 10 percentage points below its peak in 2015.

This positive outlook opens up opportunities to increase the growth potential of the economy. Labour productivity growth in Slovenia has fallen over the past 15 years as a result of both cyclical and structural factors. Due to ageing, the labour force is shrinking. Investment and technological progress will therefore be crucial to the country's future growth.

There remain major long-term challenges linked to the ageing of the society. Expenditure on public pensions, health care and long-term care puts large pressure on the public finances in the long term.

Slovenia has made some ([2]) progress in addressing the 2017 country-specific recommendations. Political consensus, including with social partners, regarding the path towards pension reform has been reached. Some laws on reforms to the healthcare sector have been adopted while the key legislation (Health care and health insurance Act) has not been adopted yet. A proposal for reforming the long-term care has been publicly consulted but not yet put forward. Aggregated procurement is being used more widely in the healthcare sector. Some measures to increase employment of older and low-skilled workers were adopted. Significant work has been done to achieve the durable resolution of non-performing loans. The new legislative package to improve the planning and building process will also be in force from mid-2018. Supported by EU funds and the European Fund for Strategic Investments, new alternative financing sources have been developed recently.

Regarding progress in reaching the national targets under the Europe 2020, Slovenia has already achieved or is well on track to achieving its

([1]) This report assesses Slovenia's economy in the light of the European Commission's Annual Growth Survey published on 22 November 2017. In the survey, the Commission calls on EU Member States to implement reforms to make the European economy more productive, resilient and inclusive. In so doing, Member States should focus their efforts on the three elements of the virtuous triangle of economic policy — boosting investment, pursuing structural reforms and ensuring responsible fiscal policies. At the same time, the Commission published the Alert Mechanism Report (AMR) that initiated the seventh round of the macroeconomic imbalance procedure. The AMR found that Slovenia warranted an in-depth review, which is presented in this report.

([2]) Information on the level of progress and actions taken to address the policy advice in each respective subpart of a CSR is presented in the Overview Table in the Annex.

national targets for early school leaving rates, tertiary educational attainment, energy efficiency and greenhouse gas emissions. The employment rate (ages 20-64) increased by 1 percentage point to 70.1 % in 2016, moving closer to the 75 % target. The number of people at risk of poverty and social exclusion declined further in 2016, but it is still above the 2008 level. On the negative side, Slovenia moved further away from its R&D intensity target.

Slovenia performs relatively well on the indicators of the Social Scoreboard supporting the European Pillar of Social Rights. Income inequalities are low. The risk of poverty and social exclusion has decreased over the last years. However, old-age poverty still prevails. Despite improvements in labour market outcomes, the employment rates of older workers and low-skilled remain low. Outcomes are strong on education and training.

The main findings of the in-depth review contained in this report, and the related policy challenges, are as follows:

- **The banking sector has been strengthened.** The non-performing loans ratio declined by almost a third in 2017. Banks are profitable, well capitalised and have a favourable funding structure. The reserves put in place by the banks to cover the potential losses on the remaining non-performing loans are increasing. In March 2017, a toolkit to prevent, identify and manage non-performing loans was issued by Bank of Slovenia. Remaining challenges are the continued monitoring of the restructured loans (the re-default rate was 27 % in March 2017) and the long-term profitability of banks given the current low interest environment. Privatising the NLB remains essential to prevent possible future credit misallocation and ensure its long-term viability.

- **Deleveraging in the corporate sector appears to have been completed and investment is growing.** Since its peak at 115 % of GDP in 2010, private sector debt decreased to 81.4 % in 2016. Household and corporate credit is now growing robustly. Private investment growth accelerated to 5% in 2016, supported by an increase in inward foreign direct investment. Nevertheless, the level of private investment, including foreign direct investment in Slovenia remains relatively low compared to peer countries. It therefore continues to pose a challenge for the economy.

- **Public debt decreased to 78.5 % of GDP in 2016.** The debt ratio is declining on the back of strong nominal GDP growth and a reduction in the general government deficit. However, long-term sustainability remains a major challenge, as an ageing population is set to put considerable pressure on public finances. The legislation concerning pensions, the stable financing of the healthcare system and the reform of the long-term care system, which would address these problems, have not yet been adopted.

Other key economic issues analysed in this report which point to particular challenges facing Slovenia's economy are as follows:

- **The labour market continues to face challenges.** The activity and employment rates of older workers remain among the lowest in the EU. Adult learning, although still slightly above the EU average, has been falling for the last seven years. Evaluation of active labour market policies shows that the majority of programmes are performing well. However, the participation rate of unemployed in the programmes is low.

- **The healthcare system needs stable funding and its efficiency needs to be improved.** The healthcare system provides good outcomes but the ageing population is putting it and the long-term care system under strain. Therefore, increasing efficiency, including by aggregated procurement, is important to ensure the long-term sustainability of public finances and continue providing high-quality care. If adopted, the Healthcare and Health Insurance Act would help achieve this objective.

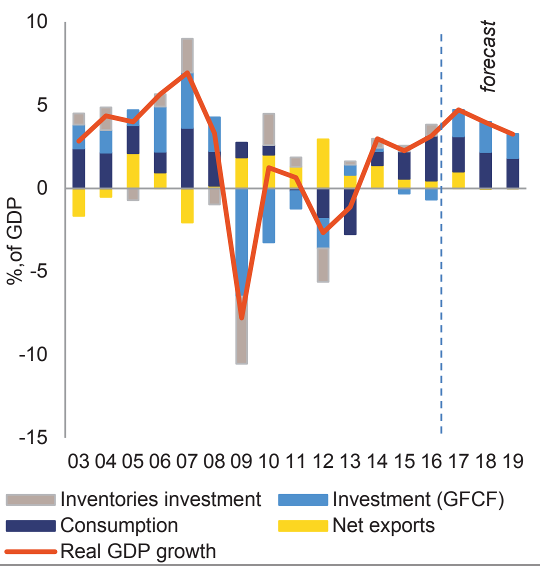
- **The business environment and access to finance have improved but challenges remain.** While useful new funding instruments have been devised, alternative sources of financing for start-ups, small businesses and scale-ups have only started to develop. Legislation to ease the planning and building processes has been adopted but administrative burden and restrictive product and service market regulation remain obstacles to growth and investment. There is room to enhance competition, professionalization and independent oversight in public procurement. Certain anti-corruption reforms are still pending. Efficiency in public research is hindered by difficulties to attract domestic and foreign talent and a lack of performance-based funding..

1. ECONOMIC SITUATION AND OUTLOOK

GDP growth

Slovenia's economy has recovered from the crisis and is now growing faster than the EU average. In 2014–2016 growth averaged 2.8 % and is set to accelerate in 2017 to 4.9 % based on the winter 2018 forecast (Graph 1.1). Real GDP in 2016 was 6.5 % higher than in the pre-crisis peak year of 2008. The economy is rebalancing rapidly and the legacy of the crisis is being prudently dealt with. The country has taken advantage of the improving external conditions, as it has kept its competitive position strong and managed to increase its export market shares by 9 % over 2014 -2016. In addition to the positive growth contribution from net exports, private consumption has been increasing. Growth was held back by investment which, mainly due to slow progress in projects supported by the EU funds, had a negative contribution in 2015 and 2016.

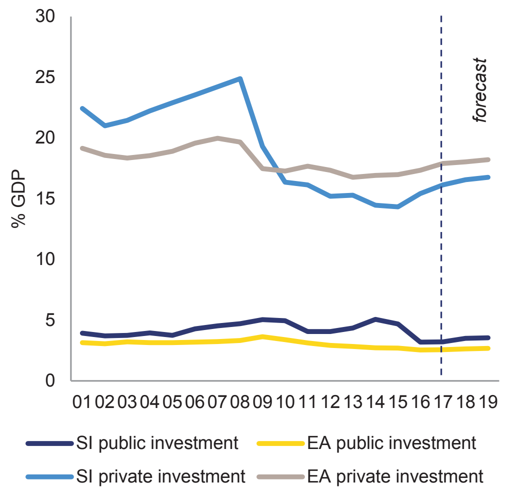
Graph 1.1: **Contributions to GDP growth**



Source: European Commission, winter 2018 forecast

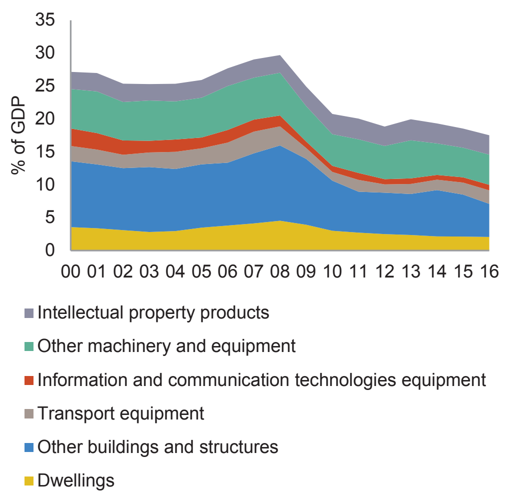
Besides export, investment became the main growth driver in 2017. Over the first three quarters of 2017, investment was up 9.1 % compared to the same period in 2016. The biggest component is non-residential construction which is growing at 16.1 %, but investments into machinery and equipment are also up 8.6 %. Residential construction investments have increased by 7.5 %. Private consumption grew by 3.3 % in 2017, boosted by growing disposable income and high consumer confidence. Export growth remained strong and outpaced import growth, further contributing to the current account surplus.

Graph 1.2: **Development of public and private investment**



Source: European Commission

Graph 1.3: **Investment by type**



Source: European Commission

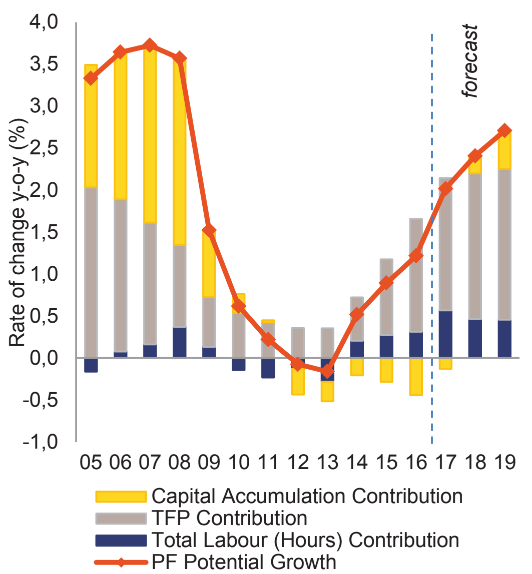
Due to the sharp fall during the crisis, investment in the private sector, as a share of GDP, remains lower than the euro area average. However, in terms of volume, investment is still at levels reached at the turn of the century. As a share of GDP, investments in 2016 were around 18 % (Graph 1.2) whereas it was 26.5 % on average in 1998-2006. While public investment has fallen, it still remains above the euro area average. However, the large fall in total investment is attributable to the fall in private investment which is now below the euro area average level. In addition to construction, investment into machinery and equipment has become much lower than before the crisis (Graph 1.3). Investment into intellectual property products has been rather stable over the years, but investment into information and communication technology has fallen markedly. Slovenia used to have low foreign investment inflows but the situation has improved since 2014. In the last 3 years foreign direct investment inflows averaged 4 % of GDP annually. Net reinvested earnings, which remained low in the post-crisis years, have helped increase foreign direct investment inflows in the last two years. Section 4.2 discusses the developments in banking sector and alternative sources of financing. Section 4.4 analyses barriers to investment and productivity developments.

GDP growth is forecast to reach 4.2 % in 2018 and 3.5 % in 2019. Growth is projected to be driven mainly by domestic demand, as private consumption is forecast to remain strong over the forecast horizon. Consumption is supported by growing employment, wages and bank lending. Similarly, investment is projected to grow at a high rate due to the combination of strong external and domestic demand with improving financing conditions and stronger corporate balance sheets. Capacity utilisation has reached a high level, industrial production is growing and export markets are expanding so additional investment is becoming necessary. In the public sector, investments are projected to be supported by the improved take-up of EU funds, including the first infrastructure project backed by the European Fund for Strategic Investments (EFSI) guarantee in November 2017. Export performance is expected to remain robust, supported by stable unit labour costs and continued gains in price competitiveness. Imports are forecast to grow in line with domestic demand, gradually neutralising the growth contribution of net exports. The current account surplus is expected to decrease moderately in 2018- 2019.

The growth potential is recovering. Before 2008, the rate of potential growth was calculated at around 3.5 % per year. The contribution of total factor productivity growth was declining, but it was more than offset by growing contribution from investment. The contribution from capital accumulation declined significantly in 2009 to 2011 and turned negative in 2012, causing the potential growth rate to become negative in 2012 and 2013 (Graph 1.4). From 2014 to 2017 the recovery was driven by growing contribution of total factor productivity, as the economy regained efficiency. The contribution from capital accumulation is expected to turn positive only in 2018. The labour contribution remains modest, which is to be expected in an ageing society. The potential growth rate is expected to stabilise at around 2.5 % to 3 % over the next 5 years (see Section 4.4 for more details on productivity).

Risks to the growth outlook are tilted to the upside. As a small open economy, Slovenia remains open to the economic developments in its export markets but also to the increases in the prices of oil and raw materials. In the domestic economy, improving economic sentiment and better access to credit could further support investment, particularly in residential properties.

Graph 1.4: **Contribution to potential growth**



Source: European Commission autumn 2017 forecast

Inflation

Inflation remains moderate. Slovenia was experiencing deflation in 2015 and 2016. This was caused by the fall in global energy prices and by on-going deleveraging. Low core inflation also reflected relatively weak domestic demand. Inflation accelerated towards 2 % (y-o-y) in the first quarter of 2017 but slowed thereafter, largely driven by base effects. Overall, consumer prices increased by 1.6 % in 2017. Both headline and core inflation are expected to remain moderate over the forecast horizon. Harmonised index of consumer prices is forecast to grow by 1.8 % in 2018 and by 2.0 % in 2019.

Labour market

Labour market performance has continued to improve on the back of strong economic growth. The rise in employment and the decrease in unemployment, which have been going on since 2014, continued throughout 2017. In 2017, unemployment (ages 15-74) fell from 8.0 % to 6.8 % on an annual basis. Between the third quarter of 2016 and the third quarter of 2017, the employment rate (ages 20-64) increased from 70.4 % to 74.1 %, while (for the same period), the activity rate (ages 20-64) increased from 76 % to 79 %, surpassing the pre-crisis level. Moreover, the share of marginally attached and discouraged workers has decreased in recent years and is now lower than before the crisis.

Employment is expected to continue to grow by 1 %-2 % annually over the forecast horizon. Growth is set to decelerate as labour shortages increase in the tightening labour market. As a result, the unemployment rate is expected to fall from 6.8 % in 2017 to 5.2 % in 2019. Nevertheless, structural labour market challenges remain. Long-term unemployment still accounts for over half of total unemployment and, despite improvements in recent years, the employment rates of older and low-skilled workers remain below the EU average and their participation in active labour market policies remains low.

The tightening labour market is putting some upward pressure on wages. Nominal compensation per employee increased by 2.8 % in 2017 and is projected to continue growing by around 3.2 % in 2018 and 2019. Real wages increased by 1.1 % in 2017 and are expected to increase by 1.5 % over the forecast horizon, remaining below productivity growth. Nominal unit labour costs increased by 0.4 % in 2017 and are expected to continue growing at a rate of 0.9 % in 2018 and 2019.

Social developments

The rate of people at risk of poverty and social exclusion has decreased, but remains high for the elderly. The at-risk-of-poverty-and-social-exclusion rate for people over 65 was 19.9 % in 2016, which is above the EU average of 17.7 %. Almost 13.8 % of these people are at a persistent risk of poverty ([3]). This is among the highest rates in the EU(see Section 4.3). In December 2016, almost half of pensioners received a pension below the poverty line. In the future, pension adequacy problems can be expected for workers with shorter careers (see Section 4.1.4).

Income inequality continued to decrease and remains among the lowest in the EU. The Gini coefficient of equivalised ([4]) disposable income declined slightly from 24.5 in 2015 to 24.4 in 2016. This is well below the EU average of 30.8 in 2016, albeit still above the pre-crisis levels (23.2 in 2007), and echoed in a relatively low income quintile share ratio (80/20) ([5]). Slovenia also displays a relatively low gender employment gap.

There are significant differences in the income levels of the different regions. GDP per capita in Eastern Slovenia is 70 % of that in Western Slovenia, which includes the capital. Based on the composite indicator of regional prosperity, all of the NUTS 3 regions in the west have scored better than all NUTS 3 regions in the east, except one (Pecar, 2017).

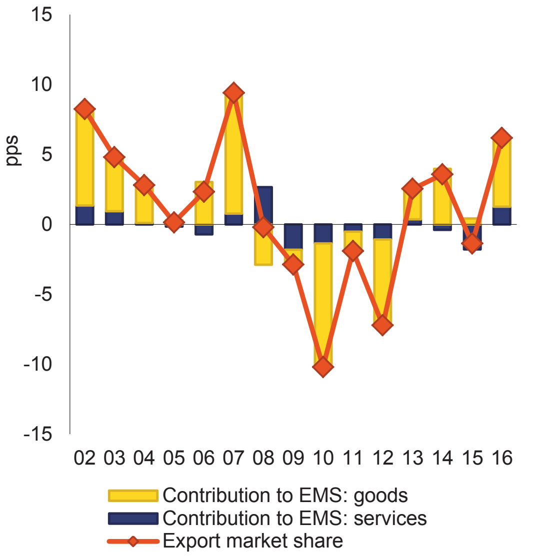
([3]) The at-persistent-risk-of-poverty rate is defined as the percentage of the population living in households where the equivalised disposable income was below the at-risk-of-poverty threshold for the current year and at least two out of the preceding three years.

([4]) The total disposable household income is "equivalised" to take into account differences in household size and composition. The equivalised income attributed to each member of the household is calculated by dividing the total disposable income of the household by the equivalisation factor. This indicator gives a weight of 1.0 to the first person aged 14 or more, a weight of 0.5 to other persons aged 14 or more and a weight of 0.3 to persons aged 0-13. The Gini coefficient values range from 0 (complete equality) to 100 (complete inequality).

([5]) The S80/S20 income quintile share ratio refers to the ratio of total equivalised disposable income received by the 20 % of the country's population with the highest equivalised disposable income (top quintile) to that received by the 20 % of the country's population with the lowest equivalised disposable income (lowest quintile).

Competitiveness

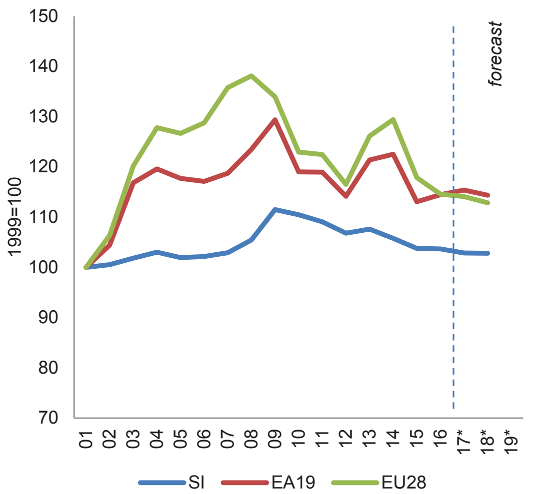
Graph 1.5: **Export market shares change with contributions**



Source: European Commission

Slovenia's competitiveness continued to improve in 2016. After a small export market share loss in 2015, Slovenia's export market share increased by 6.7 % in 2016 (Graph 1.5). This increase was driven by gains in the export of goods as well as services. Real effective exchange rates deflated by nominal unit labour costs (Graph 1.6) have been on a downward path since 2013. Competitiveness has improved thanks to both productivity gains and continued wage moderation.

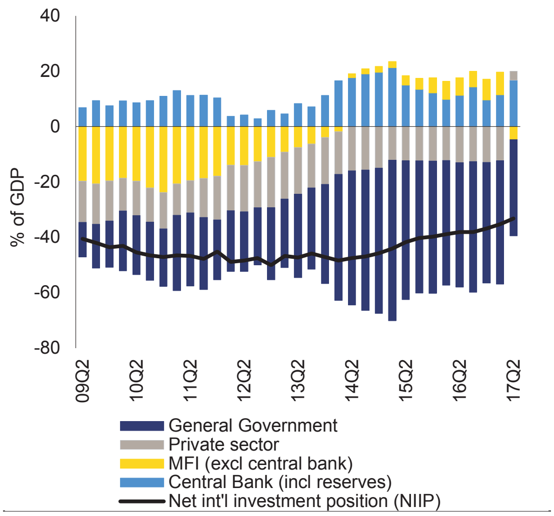
Graph 1.6: **Real effective exchange rate based on unit labour costs**



Source: European Commission calculation

External position

Graph 1.7: **Net international investment position - by sector**



Source: European Commission

Slovenia's current account has been in surplus since 2011, peaking at 5.8 % in 2014. While both goods and services balances are in surplus, the surplus in services is especially strong. The trade balance reached 9.2 % in 2016. With companies returning to profitability, the primary income balance is becoming increasingly negative as dividends are paid to the foreign owners of the exporting companies. Slovenia's current account surplus is higher than could be expected based on the fundamentals. The surplus is expected to decline over the medium term, as investment and consumption increase and fuel prices rise.

The high current account surplus has contributed to the improvement of the net international investment position. The banking sector and non-financial corporations have lowered their liabilities whereas the liabilities of the general government sector have increased (Graph 1.6).

Financial sector

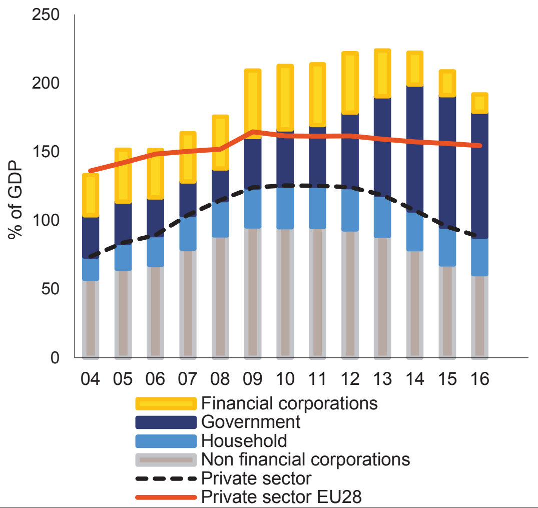
The situation of the Slovenian banking sector has further improved. All financial institutions are well capitalised. Their average capital adequacy ratio remained broadly stable over the last year (18.7 % in June 2017). Banks have access to sufficient liquidity. Their profitability has improved, with a return on equity soaring from 3.5 % in 2016 to 7.8 % in 2017 thanks to significantly lower impairments. However, maintaining this level of return on equity will be challenging because of the current low interest rate environment and the impairments that are likely to arise from the new loans issued. Credit lending is picking up strongly, with households and corporate credit growing respectively by 7.9 % and 7.1 % year-on-year in September 2017.

The rapid reduction in the non-performing loans (NPL) ratio continued in 2017. The NPL ratio for the banking sector was 10.8 % in the first quarter of 2017, down from 14.8 % a year earlier (Bank of Slovenia data – see Section 4.2). Sales continue to account for most of the NPL reduction while write-offs have slowed. The share of corporate NPLs has continued to decline to reach 23.9 % at end-June 2017, down from 31.3 % a year earlier, and is projected to decline further. The coverage ratio for NPLs has increased to 60.5 %. The overall performance of master restructuring agreements is improving, but a sizeable proportion remains unsuccessful. More generally, the durability of the restructured loans needs to be monitored due to the continuously increasing re-default rate, which had reached 27 % by March 2017.

Private debt

The household debt burden is small and non-financial corporations have deleveraged significantly. Since the indebtedness ratio peaked in 2010 (115 % of GDP), private sector debt decreased to 80.5 % of GDP in 2016. Private sector debt is now below both prudential and fundamental benchmarks ([6]), indicating that the private sector in aggregate has no further need to deleverage (Graph 1.7). High leverage remains concentrated in a handful of large companies and among SMEs.

Graph 1.8: **Debt decomposition**



Source: European Commission

Deleveraging process appears to have been completed. The credit flow from banks to the domestic economy has become positive. Both profits and wages are on the increase, domestic and export demand are forecast to grow and credit remains relatively inexpensive.

Housing market

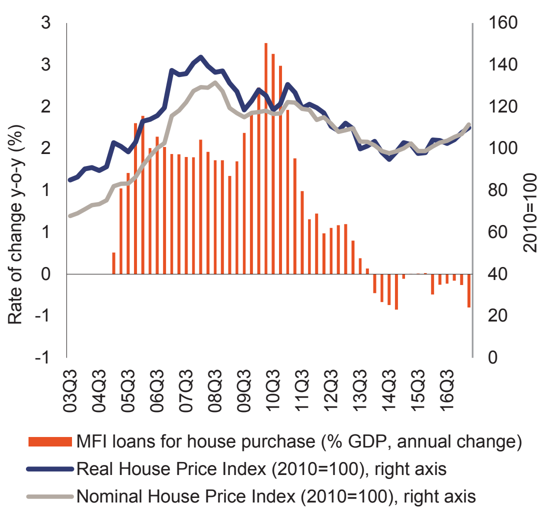
House prices bottomed out in 2014 and have since increased at a relatively modest pace. The price level remains significantly lower than before the crisis and analytical models (e.g., price-to-income, price-to-rent) do not indicate significant over-valuation (Graph 1.9). This modest growth has taken place despite rather

([6]) Fundamental-based benchmarks are derived from regressions capturing the main determinants of credit growth and taking into account a given initial stock of debt. Prudential thresholds represent the debt threshold beyond which the probability of a banking crisis is high, minimising the probability of missed crisis and that of false alerts (European Commission, 2017).

restrictive lending conditions. Loans for house purchases, as a share of GDP, have been in decline since 2013. The supply of new housing has been rather limited, as investment in housing construction is low. The market still has some inventory from the past, but this appears to be running low.

Conditions appear ripe for further price growth in the housing market. Household real incomes are on the rise, credit is again becoming more easily available for households while construction activity is currently modest. Under these conditions, price increases could be much steeper than seen in the recent past. This is also confirmed by the housing market data for the first half of 2017 published by the Surveying and Mapping Authority (GURS, 2017) which show that the total number of transactions has reached its highest level since the start of systematic surveying in 2007. The situation would be eased if supply could be more easily increased. It remains to be seen whether the new planning and building legislation, applicable from mid-2018, will allow the developers to respond to increased demand more easily.

Graph 1.9: **House price developments**



Source: European Commission, ECB

Public finances indicators

The general government headline deficit has declined in the recent years. In 2016, the general government deficit decreased to 1.9 % of GDP from 2.9 % in 2015, mainly due to higher revenues and a drop in public investment linked to the end of the previous EU funding period. In 2017, the government deficit is expected to decline further to 0.8 % of GDP as a result of strong tax revenues and social contributions. Public investment is expected to increase after a plunge of nearly 30 % in 2016. Both the compensation of public employees and pensions are expected to continue rising.

In 2018, the general government finances are expected to be in balance. Tax revenues and social contributions continue to grow strongly and interest expenditure is expected to decrease significantly. At the same time, the compensation of public employees and expenditure on social benefits are projected to increase further due to wage increases and an extraordinary indexation of pensions. Public investment is expected to grow in line with the dynamics of the current EU multiannual financial framework. Assuming no policy change, the general government balance is expected to record a surplus of 0.4 % of GDP in 2019, mainly due to economic growth and improved labour market conditions. In structural terms, Slovenia's fiscal position is expected to be broadly unchanged between 2016 and 2018, and to improve slightly in 2019.

The debt-to-GDP ratio peaked at 82.6 % in 2015, and declined in 78.5 % in 2016. Supported by the economic recovery and reduced precautionary cash buffers, public debt is forecast to decline steadily to 72.0 % of GDP in 2019. Nevertheless, the long-term perspectives are more challenging, as the expenditure of the government is forecast to increase over the longer horizon, as pension, health care and long-term care related expenditure will increase due to the ageing of the population (see Section 4.1.1).

Table 1.1: **Key Economic Indicators**

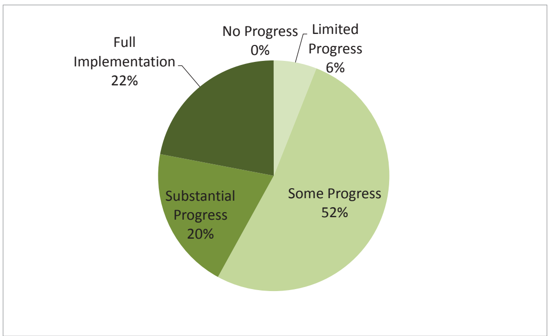
	2004-07	2008-12	2013-14	2015	2016	forecast 2017	2018	2019
Real GDP (y-o-y)	5.2	-1.1	0.9	2.3	3.1	4.9	4.2	3.5
Potential growth (y-o-y)	3.6	1.2	0.2	0.9	1.2	2.0	2.4	2.7
Private consumption (y-o-y)	3.2	0.4	-1.1	2.1	4.2	.	.	.
Public consumption (y-o-y)	2.6	0.7	-1.6	2.7	2.5	.	.	.
Gross fixed capital formation (y-o-y)	7.7	-8.9	2.1	-1.6	-3.6	.	.	.
Exports of goods and services (y-o-y)	13.0	0.6	4.4	5.0	6.4	.	.	.
Imports of goods and services (y-o-y)	12.6	-1.9	3.1	4.7	6.6	.	.	.
Contribution to GDP growth:								
Domestic demand (y-o-y)	4.2	-1.9	-0.6	1.3	2.0	.	.	.
Inventories (y-o-y)	0.9	-0.9	0.4	0.3	0.7	.	.	.
Net exports (y-o-y)	0.1	1.7	1.1	0.6	0.5	.	.	.
Contribution to potential GDP growth:								
Total Labour (hours) (y-o-y)	0.1	0.0	0.0	0.3	0.3	0.6	0.5	0.5
Capital accumulation (y-o-y)	1.7	0.6	-0.2	-0.3	-0.4	-0.1	0.2	0.5
Total factor productivity (y-o-y)	1.8	0.6	0.4	0.9	1.3	1.6	1.7	1.8
Output gap	3.4	-1.3	-5.0	-2.7	-0.8	1.8	3.3	3.9
Unemployment rate	5.9	6.9	9.9	9.0	8.0	6.8	5.9	5.2
GDP deflator (y-o-y)	2.8	1.7	1.2	1.0	0.9	1.7	1.6	1.7
Harmonised index of consumer prices (HICP, y-o-y)	3.1	2.7	1.1	-0.8	-0.2	1.6	1.8	2.0
Nominal compensation per employee (y-o-y)	6.3	2.7	0.9	1.4	2.8	2.8	3.2	3.1
Labour productivity (real, person employed, y-o-y)	4.0	-0.3	1.3	1.0	1.2	.	.	.
Unit labour costs (ULC, whole economy, y-o-y)	2.2	3.0	-0.4	0.4	1.6	0.4	0.9	0.9
Real unit labour costs (y-o-y)	-0.6	1.3	-1.6	-0.6	0.7	-1.3	-0.8	-0.7
Real effective exchange rate (ULC, y-o-y)	0.3	0.7	-0.3	-1.8	0.8	-0.4	0.0	-0.9
Real effective exchange rate (HICP, y-o-y)	-0.4	-0.2	1.2	-1.8	0.5	-0.8	0.9	.
Savings rate of households (net saving as percentage of net disposable income)	9.0	6.0	4.7	4.6	4.9	.	.	.
Private credit flow, consolidated (% of GDP)	14.0	3.6	-4.3	-5.0	-0.8	.	.	.
Private sector debt, consolidated (% of GDP)	80.6	111.9	102.3	86.9	80.5	.	.	.
of which household debt, consolidated (% of GDP)	20.2	29.1	29.0	27.6	27.3	.	.	.
of which non-financial corporate debt, consolidated (% of GDP)	60.3	82.9	73.3	59.2	53.2	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) (2)	.	19.2	16.9	13.3	9.6	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	-6.1	-0.1	9.9	4.0	2.0	3.0	2.6	1.7
Corporations, gross operating surplus (% of GDP)	19.2	18.8	19.1	19.8	19.5	20.8	21.7	22.4
Households, net lending (+) or net borrowing (-) (% of GDP)	4.2	4.2	4.9	4.5	4.3	3.3	2.7	2.7
Deflated house price index (y-o-y)	12.8	-3.7	-6.9	1.4	3.6	.	.	.
Residential investment (% of GDP)	3.7	3.4	2.3	2.1	2.1	.	.	.
Current account balance (% of GDP), balance of payments	-2.6	-0.7	5.1	4.4	5.2	4.5	4.0	3.6
Trade balance (% of GDP), balance of payments	-0.7	1.3	7.2	8.6	9.2	.	.	.
Terms of trade of goods and services (y-o-y)	-0.7	-0.9	0.9	1.3	0.9	-0.4	-0.3	-0.3
Capital account balance (% of GDP)	-0.3	0.0	0.3	1.1	-0.7	.	.	.
Net international investment position (% of GDP)	-15.2	-45.1	-46.5	-39.8	-36.9	.	.	.
Net marketable external debt (% of GDP) (1)	-8.0	-40.8	-37.2	-26.9	-22.1	.	.	.
Gross marketable external debt (% of GDP) (1)	72.3	108.2	112.4	111.5	102.9	.	.	.
Export performance vs. advanced countries (% change over 5 years)	35.2	9.2	-9.3	-2.8	1.1	.	.	.
Export market share, goods and services (y-o-y)	4.0	-4.5	3.2	-1.4	6.7	.	.	.
Net FDI flows (% of GDP)	0.5	-0.3	-0.8	-3.3	-2.2	.	.	.
General government balance (% of GDP)	-1.1	-4.7	-10.0	-2.9	-1.9	-0.8	0.0	0.4
Structural budget balance (% of GDP)	.	-3.5	-1.8	-1.6	-1.5	-1.6	-1.6	-1.4
General government gross debt (% of GDP)	25.5	39.0	75.3	82.6	78.5	76.4	74.1	72.0
Tax-to-GDP ratio (%)	37.8	37.1	36.9	36.9	36.9	36.5	36.1	35.8
Tax rate for a single person earning the average wage (%)	34.5	33.1	33.2	33.3	33.4	.	.	.
Tax rate for a single person earning 50% of the average wage (%)	29.3	23.5	22.9	23.0	23.2	.	.	.

(1) NIIP excluding direct investment and portfolio equity shares.
(2) Domestic banking groups and stand-alone banks, EU and non-EU foreign-controlled subsidiaries and EU and non-EU foreign-controlled branches.
Source: Eurostat and ECB as of 30 Jan 2018, where available; European Commission for forecast figures (Winter forecast 2018 for real GDP and HICP, Autumn forecast 2017 otherwise)

2. PROGRESS WITH COUNTRY-SPECIFIC RECOMMENDATIONS

Progress with implementation of the recommendations addressed to Slovenia in 2017 (7) has to be seen in a longer term perspective since the introduction of the European Semester in 2011. Looking at the multi-annual assessment of the implementation of the CSRs since these were first adopted, 94 % of all CSRs addressed to Slovenia have recorded at least 'some progress'. 6 % of these CSRs recorded 'limited' or 'no progress' (Graph 2.1). Full implementation has been achieved in several areas related to the fiscal framework and financial services, including for instance to conduct a system-wide bank asset quality review and to provide additional capital after the shortfall was assessed. Areas with substantial progress have been the strategy for the Slovenian Sovereign Holding, corporate restructuring and improving competitiveness.

Graph 2.1: **Overall multiannual implementation of 2011-2017 CSRs to date**



* The overall assessment of the country-specific recommendations related to fiscal policy excludes compliance with the Stability and Growth Pact
** The multiannual CSR assessment looks at the implementation until 2018 Country Report since the CSRs were first adopted.
Source: European Commission

Slovenia has secured a timely correction of its excessive deficit and strengthened its fiscal framework. Following the boom-bust cycle and the financial crisis, Slovenia went thought a period of an increasing debt-to-GDP ratio and a worsening budget balance leading to an excessive deficit. Over 2009-2016, a significant consolidation effort led to the abrogation of the excessive deficit procedure in June 2016 and ensured continuing improvement in the budgetary situation ever since. In 2017, Slovenia is expected to further decrease the deficit to 0.8 % of GDP before its balancing in 2018. Public debt has risen almost fourfold during crisis reaching a peak in 2015 at 82.6 % of GDP. In 2017, it is expected to decrease to 76.4 % due to economic recovery and a reduction in precautionary cash buffers. The Government transposed the EU Budgetary Frameworks Directive and set out the steps for multiannual medium-term budgetary planning. The appointment of the Fiscal Council means that the 2016 recommendation has been fully implemented.

However, the pressure on the public finance in the long term remains. Over the past years, Slovenia has taken some measures to address the age-related expenditure, but the pressure remains significant. Since 2011, Slovenia has been recommended to improve the long-term sustainability and adequacy of its pension system. A parametric pension reform was adopted in 2012 but the reform measures do not safeguard the system's sustainability in the longer term and income adequacy problems in old age can be expected for those with shorter careers. The reforms on health-care and long-term care are under preparation, but their adoption is delayed.

The weaknesses in the banking sector have been significantly reduced thanks to the reform measures and the improving macroeconomic environment. The situation in the banking sector was severely affected by the crisis. Consequently, the Council recommendations in 2013 and 2014 have been focused on this sector, including (i) the conduct of a system-wide bank asset quality review, (ii) the transfer of assets to the Bank Asset Management Company, (iii) the improvement of governance and risk management and (iv) the privatisation of state-owned banks. Since 2014 the banking sector has stabilised. Nonetheless, although decreasing, NPLs were still high compared to pre-crisis levels and the recommendation to enable the durable resolution of NPLs was therefore maintained in 2016 and 2017. While access to finance is also improving, the capital market is still not yet sufficiently developed to fully support growth in the real economy and safeguard financial market stability. State ownership in financial sector remains significant and the expected privatisation of NLB has been delayed.

(7) For the assessment of other reforms implemented in the past, see in particular Section 4.

Measures have been adopted to improve the employability of low-skilled and older workers. Since 2011 the Council has recommended measures to increase the employability of low-skilled and older workers. The 2013 labour market reform and targeted active labour market policies somewhat increased employment opportunities for older and low-skilled workers, but their participation rate remains low.

The Slovenian authorities have taken action to improve the business environment. Specifically, they reduced administrative burden, removed some restrictions to competition in regulated professions, and ensured better governance of state-owned enterprises (SOEs). In 2013-2014 the Commission's analysis concluded that the high level of state involvement combined with weak corporate governance was having negative spill over effects to the private sector. A comprehensive corporate governance system for state-owned enterprises has been put in place in recent years. The first steps in implementing the system point to an approach that maximises shareholder value. After the initial progress which led to full deregulation of 40 professions in the crafts sector and four in culture, the reforms slowed down and have not been finalised as initially planned. However, in 2017 the planning and construction legislation was overhauled with the aim of simplifying procedures and reducing the number of regulated professions in this area. It is to enter into force in June 2018.

Slovenia has made some ([8]) progress in addressing the 2017 country-specific recommendations. Limited progress has been made to reduce fiscal risks and sustain public finances (CSR 1). The pension, health and long-term care reforms to ensure long-term sustainability are in the preparation phase. Some progress can be observed in addressing the employability of the low-skilled and older workers (CSR 2). In particular, two new active labour market policy measures aimed at older workers and in-work incentive schemes for the low-skilled were introduced, and measures promoting employment of persons over 55 years were extended. Some progress has been made to improve the financing conditions for creditworthy businesses (CSR 3). New financial supports were offered to SMEs to improve their access to alternative financing sources and the NPLs have continued their downward trend. The Bank Asset Management Company is progressing to fulfil its mandate. Some progress has been made to reduce the administrative burden on business (e.g. new spatial and construction legislation), and improve the governance of SOEs. While the public administration action plan is slowly progressing, some specific measures have been substantially delayed. In 2017, Slovenian Sovereign Holding reached the targets set in the management acts in 2016. Dividend pay-outs in 2017 for companies managed by the SSH have been higher by 38 % compared with 2016, and hit a record high almost doubling the dividends received in 2011.

Member States can request from the Commission technical support to prepare, design, and implement growth-enhancing structural reforms. The Structural Reform Support Service (SRSS) provides, in cooperation with the relevant Commission services, tailor-made technical support, which does not require co-financing and is provided at a Member State's request. The support addresses priorities identified in the context of the EU economic governance process (i.e., implementation of country-specific recommendations), but the scope of the SRSS support is wider as it can also cover reforms linked to other Commission priorities, or reforms undertaken at the initiative of Member States.

Slovenia has requested technical support from the SRSS to help implement reforms in areas such as: public administration and justice, growth and the business environment, labour market, healthcare, and the financial sector. In particular, the SRSS provides technical support aimed at attracting foreign direct investment, tackling the issue of NPLs and establishing a health system performance assessment.

ESI Funds are pivotal in addressing key challenges to inclusive growth and convergence in Slovenia. Among other activities, they help improving the healthcare system and support low-skilled and long-term unemployed to improve their employment prospects (Box 2.1).

([8]) Information on the level of progress and actions taken to address the policy advice in each respective subpart of a CSR is presented in the Overview Table in the Annex. This overall assessment does not include an assessment of compliance with the Stability and Growth Pact.

Box 2.1: Tangible results delivered through EU support to structural change in Slovenia

Slovenia is a beneficiary of European Structural and Investment Funds (ESI Funds) support and can receive up to EUR 3.9 billion until 2020. This represents around 1 % of GDP annually over the period 2014-2018 and 29 % of public investment ([1]). By 31 December 2017, an estimated EUR 1.9 billion (49 % of the total) was allocated to projects on the ground. This has paved the way for almost EUR 3.3 million of private investment matching public support to enterprises and more than 700 new full time job equivalent hirings in ESIF-supported enterprises. Out of the EU financing, EUR 253 million of ERDF and CF and EUR 49.3 million from EAFRD is to be delivered via financial instruments, which is more than a double increase compared to the 2007-2013 period.

ESI Funds help address structural policy challenges and implement country-specific recommendations. Actions financed cover, among others, the e-Spatial planning platform which aims to accelerate and improve processes in spatial planning, construction of buildings and real estate management, thereby contributing to improved business environment; improving the effectiveness of the justice system; supporting SMEs by direct investments through debt and equity instruments, grants and also by creating an entrepreneurial-support ecosystem providing them with a good working environment and increasing the ease of doing business; supporting environmental infrastructure contributing to Slovenia's achievements of the EU environmental requirements, thus improving the investment environment. ESI Funds, in particular the European Social Fund play a key role in supporting older, low-skilled or long-term unemployed with tailor-made programmes to improve their employment prospects. Activities introducing forms of work which respond to demographic and societal challenges will enable workers to work longer and therefore support the future pension reform. ESI funds finance investments of EUR 150 million in health and social infrastructure to enhance access to affordable, sustainable and high quality services. These investments will support the reduction of inequalities in the healthcare system, and contribute to develop and implement integrated community based care services in line with the reform of long term care currently under preparation (see Chapter 4.1.5).

Various reforms were undertaken already as precondition for ESI Funds support ([2]). A Smart Specialisation Strategy for research and innovation was developed to focus efforts on strengthening the competitiveness of the economy by enhancing its innovation capacity, diversifying the existing industries and boost growth of new and fast-growing enterprises. It also aims to improve cooperation between enterprises and public research institutions. The National Transport Development Strategy was developed and is the first comprehensive strategy covering all modes of transport, which underpins all national transport projects until 2030 and beyond. It is aimed towards ensuring a timely development of the transport infrastructure in Slovenia and reducing the existing bottlenecks. Furthermore, the Sustainable Urban Mobility Plans, developed at the level of municipalities or regions, are aimed at improving the air quality in cities and urban areas, as well as promoting the shift from private to public passenger transport. To ensure a more efficient use of water resources, the Water management plans for the Danube river basin area and the Adriatic Sea basin area for the period 2016-2021 have been upgraded and updated. The strategic and legislative steps to improve the Slovenian health and long term care systems are implemented in line with the National Health Care Resolution Plan 2016-2025. The Public Administration Development Strategy 2015–2020 aims at modernising public administration by improving its efficiency, transparency and the quality of services.

Slovenia is advancing the take up of the European Fund for Strategic Investments (EFSI). As of December 2017, overall financing volume of operations approved under the EFSI amounted to EUR 59 million, which is expected to trigger total private and public investment of EUR 490 million. More specifically, one project has been approved so far for Slovenia under the Infrastructure and Innovation Window, amounting to EUR 51 million in EIB financing under the EFSI. It concerns the transport sector and is expected to trigger about EUR 102 million in investments. Under the SME Window, one agreement with financial intermediaries has been approved so far. European Investment Fund financing enabled by the EFSI amounts to EUR 8 million, which is expected to mobilise approximatively EUR 388 million in total investment. About 1 500 smaller companies or start-ups will benefit from this support.

Funding under Horizon 2020, the Connecting Europe Facility and other directly managed EU funds is

additional to the ESI Funds. By the end of 2017, Slovenia has signed agreements for EUR 209 million for projects under the Connecting Europe Facility.

https://cohesiondata.ec.europa.eu/countries/SI

(1) Public investment is defined as gross fixed capital formation + investment grants + national expenditure on agriculture and fisheries.
(2) Before programmes are adopted, Member States are required to comply with a number of so-called ex-ante conditionalities, which aim at improving conditions for the majority of public investments areas.

Table 2.1: **Summary Table in 2017 CSR assessment**

Slovenia	**Overall assessment of progress with 2017 CSRs: Some progress**
CSR 1*: *Pursue a substantial fiscal effort in 2018 in line with the requirements of the preventive arm of the Stability and Growth Pact, taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of Slovenia's public finances. Adopt and implement the proposed reform of the healthcare system and adopt the planned reform of long-term care, increasing cost-effectiveness, accessibility and quality care. Fully tap the potential of centralised procurement in the health sector. Adopt the necessary measures to ensure the long-term sustainability and adequacy of the pension system.(MIP relevant)*	Slovenia has made **limited progress** in adressing the fiscal-structural part of CSR1 (*): • Limited progress in reforming the health system • Limited progress in reforming long-term care • Some progress in centralising procurement in the health sector • Limited progress in reforming the pension system
CSR 2: *Intensify efforts to increase the employability of low-skilled and older workers, particularly through targeted lifelong learning and activation measures.*	Slovenia has made **some progress** in adressing the labour market part of CSR2: • Some progress in increasing the employability of low-skilled and older workers
CSR 3*: Improve the financing conditions, including by facilitating a durable resolution of non-performing loans and access to alternative sources of financing. Ensure the full implementation of the bank asset management company strategy. Reduce the administrative burden on business deriving from rules on spatial planning and construction permits and ensure good governance of state-owned enterprises. (MIP relevant)*	Slovenia has made **some progress** in adressing the financial conditions part of CSR3: • Substantial progress in improving the financing conditions by facilitating a durable resolution of non-performing loans • Some progress improving the financing conditions by facilitating access to alternative source of financing • Substantial progress was made in implementing the bank asset management company strategy • Some progress in reducing the administrative burden on businesses • Some progress in ensuring the good governance of state-owned enterprises

*This overall assessment of CSR1 does not include an assessment compliance with the Stability and Growth Pact.
Source: European Commission

3. SUMMARY OF THE MAIN FINDINGS FROM THE MACROECONOMIC IMBALANCE PROCEDURE IN-DEPTH REVIEW

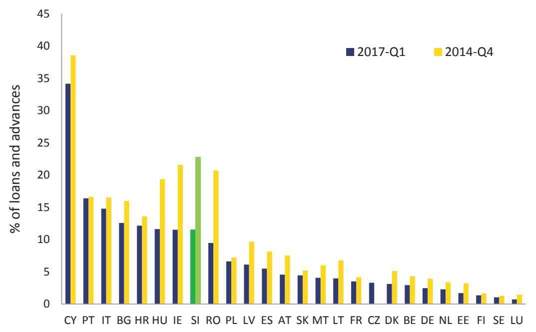
The in-depth review for the Slovenian economy is presented in this report. In spring 2017, Slovenia was identified as having macroeconomic imbalances, in particular relating to weaknesses in the banking sector, high corporate indebtedness and fiscal risks. The 2018 Alert Mechanism Report (European Commission, 2017b) concluded that a new in-depth review should be undertaken for Slovenia to assess developments relating to identified imbalances. Analyses relevant for the in-depth review can be found in the following sections: fiscal risks related to fiscal policy, long-term sustainability and state-owned enterprises (Sections 4.1.1 to 4.1.6); vulnerabilities in the banking sector and access to finance (Sections 4.2.1 to 4.2.2); deleveraging and investment (Section 1) and productivity, research and development and business environment (Sections 4.4.1, 4.4.2, 4.4.3. ([9])

3.1 Imbalances and their gravity

The situation in the banking sector has improved. The non-performing loans (NPL) ratio for the banking sector was 10.8 % in Q1-2017, down from 16.3 % a year earlier (Graph 3.1, reporting ECB data, which are comparable across countries) The stability is also confirmed by the reduction in arrears (loans with no payments within 90 days), which have almost returned to pre-crisis levels (Graph 3.2). Banks are profitable, well capitalised and have a favourable funding structure (Section 4.2). They also have access to sufficient liquidity.

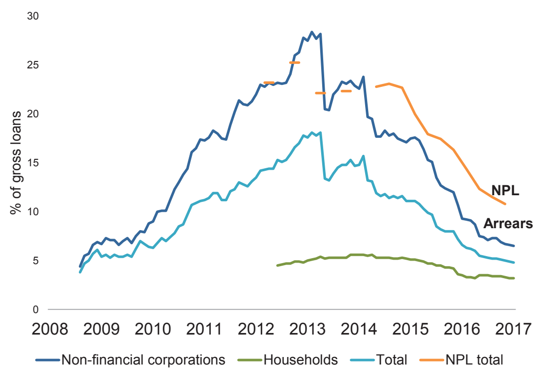
Deleveraging in the corporate sector appears to have been completed. The private sector debt-to-GDP ratio decreased to 80.5 % in 2016, which is 6.4 pps less than in 2015 and well below the Commissions' fundamental-based benchmark. In addition, the share of zombie firms has returned to pre-crisis levels (see Section 4.1.1). Credit to non-financial corporations grew by 7.1 % in September 2017, turning positive after 6 years of consecutive decline. Private investment growth accelerated to 5 % in 2016, supported by an increase in inward foreign direct investment. Nevertheless, the stock of private investment (at 14.4 % of GDP in 2016), including foreign direct investment in Slovenia (at 37.8 % of GDP in Q1-2017) remains relatively low. Weak private investment in turn contributed to a significant downward shift in Slovenia's potential growth (see Section 1).

Graph 3.1: **Non-performing exposure of domestic banks (including foreign-controlled subsidiaries and branches)**



Source: ECB (Consolidated banking statistics)

Graph 3.2: **Arrears developments**



Source: Bank of Slovenia

Public debt decreased to 78.5 % of GDP in 2016, but population ageing is set to put considerable pressure on public finances in the long term. Specifically, pension expenditures is set to increase substantially from 11.8 % in 2013 to 15.3 % of GDP in 2060.

([9]) An asterisk indicates that the analysis in the section contributes to the in-depth review under the MIP

The performance of state-owned enterprises (SOEs) managed by the Slovenia Sovereign Holding improved significantly in 2016. The overall profitability target of almost 6 % in 2016 as measured by return on equity was almost reached. Dividend pay-outs in 2017 have been 38 % higher than in 2016.

3.2 Evolution, prospects and policy responses

Banking sector vulnerabilities have been sustainably reduced. NPLs are expected to stay on a declining trend and they are well provisioned. Banks have acquired significant capacities and competences in managing the workout of NPLs. Their NPL target plans are monitored by the Bank of Slovenia and the Single Supervisory Mechanism. In March 2017, Bank of Slovenia issued a toolkit to prevent, identify and manage NPLs for SMEs (BoS, 2017a). While the overall performance of master restructuring agreements is improving, a sizeable proportion remains unsuccessful. More generally, restructured loans need to be monitored due to the continuously increasing re-default rate, which reached 27 % by March 2017. The long-term profitability of banks remains a challenge in the current low interest environment. The consolidation and restructuring of the banking sector is progressing, with a recent merger of three banks and completion of the wind-down of two smaller banks. The privatisation of Nova Ljubljanska banka is essential to ensure the bank's viability and prevent credit misallocation in the future.

Private investment is expected to grow by 10 % per year over 2017-2019. Such high growth is expected due to the combination of strong external and domestic demand, stronger corporate balance sheets and improved financing conditions. Private investment will also be supported by recently adopted measures to improve the business environment. Relevant measures are in the pipeline to attract foreign direct investment. In the first half of 2017, investment was driven by non-residential construction and machinery and equipment, which is more likely to support productivity in future.

Public debt is projected to continue declining and to reach 72 % of GDP by 2019. Strong nominal GDP growth and a reduction in the general government deficit are set to put public debt on a downward trend. The authorities are preparing reforms to ensure the long-term sustainability of public finances. The key objectives of the pension reform have been agreed but its design and adoption have been officially announced for the next government. Some parts of the health care reform were adopted but the key legislation (Health care and health insurance act) has not been adopted. The proposal for long-term care has been publicly consulted but it has not been put forward yet. The long-term sustainability of public finances remains a challenge due to the projected increase in age-related expenditure.

The focus of the Slovenian Sovereign Holding has shifted to improving the corporate governance and performance of SOEs. The asset management strategy adopted in July 2015 sets the overall profitability target of the State portfolio as measured by return on equity at 8 % by 2020, with an intermediate target of 7.1 % in 2017. Progress with pending privatisations remains limited (see Section 4.1.4).

3.3 Overall assessment

In conclusion, consistent policy actions in a context of increasingly strong recovery, have reduced the sources of imbalances in a sustainable manner. The economy continued to grow strongly in 2017, both in real and nominal terms, thus reducing the risks related to indebtedness in both the public and the corporate sectors. Progress in restructuring the banking sector has coincided with a rapidly falling share of NPLs in total loans, which remain well provisioned. No further deleveraging needs remain in the corporate sector except for in a handful of large companies and among SMEs. A healthy flow of credit to non-financial corporations has resumed. Investment was compressed in recent years, but has increased strongly, as has foreign direct investment. Government debt peaked in 2015 and a continued downward adjustment is expected in the coming years.

Table 3.1: **Macroeconomic Imbalance Procedure assessment matrix**

	Gravity of the challenge	Evolution and prospects	Policy response
	Imbalances (unsustainable trends, vulnerabilities and associated risks)		
Financial sector	The stock of non-performing loans (NPLs) is relatively high, in particular if Bank Asset Management Company (BAMC) assets are taken into account. NPLs originate mostly in the corporate sector and among SMEs. NPLs are well provisioned. Banks have access to sufficient liquidity. The return on equity more than doubled to reach 7.8% in 2016 while the average capital adequacy ratio was relatively stable at 18.7% in June 2017. The funding structure of the banks was favourable with a loan to deposit ratio of 78.8% in 2016. As in other EU countries, the long-term profitability of the banks is under pressure in the current context of low interest rate.	The vulnerabilities in the Slovenian banking sector have significantly reduced. NPLs decreased to 10.8% in Q1-2017 from 14.8% a year earlier and the trend is expected to continue. The total stock of NPLs, including BAMC assets, is also declining fast.	NPL targets of banks are monitored by the Bank of Slovenia and the Single Supervisory Mechanism. A toolkit to prevent, identify and manage NPLs for SMEs was issued by Bank of Slovenia in March 2017. The "bad bank" BAMC is following its new strategy for 2017-22 and its business plan and is fully operational. The consolidation and restructuring of the banking sector progresses with a merger of three banks and the wind down of two smaller banks. The privatisation of the major state-owned bank has been delayed.
Deleveraging, investment, and growth prospects	Private sector debt is 81.4% of GDP in 2016, substantially below the 2010 peak (115% of GDP). The vulnerabilities linked to high corporate indebtedness have largely resolved thanks to a sustained deleveraging process. Household debt is among the lowest in the EU. Partly in light of intense deleveraging, the current level of private investment at around 14.4% of GDP remains low compared to the historical average of 20% of GDP. Slovenia's stock of inbound FDI of 37.8% of GDP in Q1-2017 is markedly below the EU average of about 50%.	Private investment growth accelerated to 5% in 2016 and is expected to grow by around 10% per year in 2017-2019, driven by non-residential construction and machinery and equipment. Credit to non-financial corporations turned positive and reached 7.1% in September 2017. FDI inflows increased strongly from 2014 onwards, averaging 4% of GDP per year.	Measures on spatial planning, building permits and construction services have been adopted and will be implemented as of mid-2018. A draft act on investment promotion has been prepared but its parliamentary adoption is postponed to 2018. Some progress has been made regarding the reduction of administrative burden. The implementation of the Single document continues.

(Continued on the next page)

Table (continued)

Fiscal risks	Public debt stood at 78.5% of GDP in 2016. Age-related government expenditures are set to increase substantially in the future (e.g. pension expenditure from 11.8 % in 2013 to 15.3 % of GDP in 2060). The level of state involvement in the economy remains high relative to other Member States and has had considerable fiscal and economic implications for the budget. Fiscal risks of SOEs have caused approximately one third of the increase in public debt experienced from 2007 to 2014.	After peaking at 82.6 % of GDP in 2015, public debt is projected to stay on a decreasing path due to lower general government deficit and stronger nominal GDP growth. Profitability of SOEs managed by the Slovenian Sovereign Holding (SSH) has improved in 2016. Following the publication of the asset management strategy, it appears that most SOEs (in terms of book value) are considered strategic so the level of the state involvement in the economy is expected to remain elevated.	A central piece of healthcare legislation entered in public consultation in February 2017 and the draft version was submitted to the Economic and Social Council in December 2017, in view of submission to the Government. The draft law on long-term care has completed the public consultation stage and a new version is being prepared. The key objectives to reform the pension system were adopted by the Economic and Social Council in July 2017. The SSH has been made fully operational. The focus of the SSH is on improving the SOEs corporate governance and performance.

Conclusion from IDR analysis

- The private debt stock has been significantly reduced and the deleveraging process appears to be largely complete. The NPLs ratio is still relatively high but NPLs are well provisioned and the capital position of banks is strong. Government debt peaked in 2015 and has been on a downward trend since then. Nevertheless, pension, healthcare and long-term care spending will be affected by strong ageing pressures looking forward.
- NPLs have been falling rapidly. Deleveraging in the corporate sector is ending. Private investment growth accelerated in 2016 and is expected to increase further over 2017-2019. Foreign direct investments increased strongly since 2014. Public debt is expected to decrease over the next few years.
- Strong recovery and sustained policy actions had stabilised the banking sector and rebalanced the economy. Looking forward, long-term sustainability of public finances remains a challenge.

Source: European Commission

4. REFORM PRIORITIES

4.1. PUBLIC FINANCES AND TAXATION

4.1.1. FISCAL POLICY*

The general government headline balance continues to improve. In 2016 the deficit decreased to 1.9 % of GDP, down from 2.9 % in 2015. Based on the Autumn forecast, the deficit reached 0.8 % of GDP in 2017 and the budget would be in balance in 2018.

In structural terms, the budget remains in deficit. The structural deficit of 1.6 % of GDP in 2017 remained above the euro area average (1.1 % of GDP) and below the medium-term objective of 0.25 % structural surplus. In 2018, the structural balance is expected to remain unchanged ([10]). This indicates that the improvement in headline balance is due to the improvement in the economic conditions and falling interest expenditure, not structural measures. Structural balance is negatively affected by the low rate of potential growth. This underscores the need to adopt measures to boost investment and productivity (see Section 4.4).

Pressures to increase expenditure are mounting. The compensation of public employees and expenditure on social benefits are projected to increase further due to the public sector wage increases and an extraordinary indexation of pensions.

Tax policy has been rather stable. The reform of real estate taxation has been postponed to 2020. Revenues from recurrent immovable property taxation, which is considered less distortive to economic growth than labour taxes, are currently considerably below the EU average. The reform would link the tax base to the properties' market value, using a mass valuation system. The Mass Valuation Act was adopted and is expected to be applied to all properties in mid-2019.

([10]) In case of Slovenia, the output gap (and therefore also the structural balance) estimate is subject to uncertainty. This has been taken into account while assessing Slovenia's draft budgetary plan.

Slovenia is performing well in terms of VAT compliance. In 2015, Slovenia remained among the top five Member States with the lowest VAT gap (as a percentage of VAT theoretical tax liability) in the EU (CASE, 2017), indicating that relatively little VAT revenue is lost due to non-compliance. VAT collection in Slovenia was improved by the introduction of certified cash registers in 2015, which has eased tax payment for companies.

4.1.2. FISCAL FRAMEWORK*

In 2017, the members of the Fiscal Council were appointed and the new institution has rapidly become operational. In July 2015, the Slovenian parliament passed the Fiscal Rules Act, providing the legal basis for the establishment of a Fiscal Council that will, among other things, monitor compliance with fiscal rules. However, the members of the Slovenian Fiscal Council were only appointed in March 2017. The 2018 draft budget was the first to be assessed by the Council. In its assessment published on 19 October 2017, the Fiscal Council warned that the draft budget for 2018 was only partially compliant with the fiscal rules and called on the government to take additional measures. The legislation to transpose the EU Budgetary Frameworks Directive was adopted.

4.1.3. FISCAL SUSTAINABILITY*

Public debt rose sharply during the crisis but has started to decrease in 2016. It increased from 22 % of GDP in 2008 to 82.6 % of GDP in 2015. While exceptional items, particularly bank recapitalisations, have contributed significantly to this increase, sustained primary deficits also increased debt. In 2016, public debt decreased to 78.5 % and it is expected to further decrease to 72.0 % of GDP by 2019. The fall is supported by the economic recovery and reduced interest expenditure. The implicit interest rate on state debt has been decreasing since 2014. The strategy is to extend the duration of the debt portfolio, reducing the roll-over risk while taking advantage of the current environment of low interest rates to reduce current financing costs in the medium term. In addition, the authorities plan to reduce the previously accumulated large cash buffers (estimated to have decreased from 16 % of GDP at end-2015 to 13 % of GDP at end-2016). However, fiscal sustainability risks are low in Slovenia in the short term (European Commission, 2018a).

The high public debt level represents a source of vulnerability for the Slovenian economy. In the medium term, the debt trajectory's sensitivity to potential macroeconomic shocks and a non-negligible sustainability gap lead to medium risks ([11]) for public finance. Firstly, medium risks are revealed by the debt sustainability analysis. Secondly, the medium-term sustainability gap indicator (S1) complements the results of the debt sustainability analysis indicating that overall, there are medium risks in the medium term. S1 ([12]) indicates that the structural primary balance would need to improve by 1.4 pps of GDP in cumulated terms over a five-year horizon (from 2019 until 2024) relative to the baseline no-fiscal-policy-change scenario in order to reach the 60 % public debt-to-GDP ratio reference value by 2032 ([13]). The required fiscal adjustment reflected by S1 is essentially due to the debt ratio being currently above the 60 % reference value and the projected ageing costs.

Public debt is projected to decrease until 2026 but then increase again, assuming no policy change. Under the baseline scenario **(**[14]**)** of the debt sustainability analysis public debt is expected to decrease to 63.7 % of GDP by 2026 (Graph 4.1.1). From then onwards public debt is expected to increase to 65 % of GDP in 2028 as a result of medium-term upward pressures, particularly ageing costs. Conversely, if the ageing costs were excluded from the no-policy-change scenario (as they would be if ageing costs were reduced via reforms) the debt ratio would continue to decrease in the medium term. Under a scenario ([15]) where the structural primary balance (SPB) is assumed to converge to its historical average, debt levels would spin into an upward trajectory from 2024 onwards. However, if Slovenia was to fulfil its commitments under the Stability and Growth Pact ([16]), debt would quickly be reduced towards 60 % of GDP. If Slovenia were to adopt the fiscal commitments outlined in its own Stability Programme ([17]), debt reduction would be slower than in the Stability and Growth Pact scenario, but still be considerably faster than in the baseline scenario. Maintaining strong fiscal discipline in the long-run is thus required to reduce the debt-to-GDP ratio and ensure debt sustainability.

([11]) This represents an improvement on last year when public debt was indicating high risk. The source of the improvement is the better initial budgetary position reported in the last Commission forecast (autumn 2017).

([12]) The medium-term sustainability indicator S1 measures the fiscal adjustment effort required, in cumulated terms over the next 5 years after the forecast horizon (i.e. from 2019) to drive the public debt-to-GDP ratio down to 60 % in 15 years' time (currently 2032).

([13]) The following thresholds apply: (i) for values lower than 0, the country is assigned low risk; (ii) for values lower than 2.5 pps it is assigned medium risk; (iii) for values greater than 2.5 the country is assigned high risk.

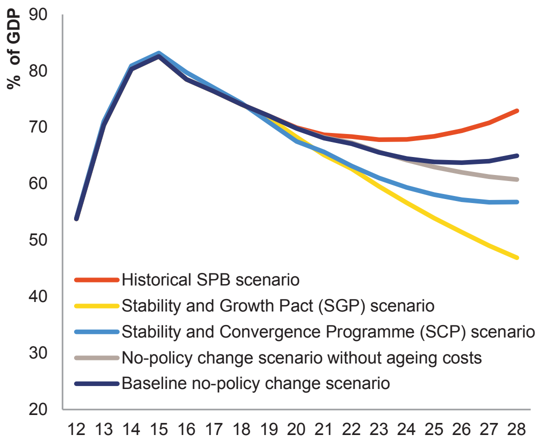
([14]) This scenario is based on the Commission's autumn 2017 forecast and on long-run convergence assumptions of underlying macroeconomic variables (real interest rate, real GDP growth, inflation) agreed by the Economic Policy Committee. Under the baseline scenario it is assumed that fiscal policy stays constant beyond the forecast horizon.

([15]) The historical SPB scenario assumes gradual convergence to the historical average for the SPB over the 4 years following the forecast. All other macroeconomic assumptions are the same as in the baseline.

([16]) European Commission forecasts for the first projection year; thereafter assumption of full compliance with excessive deficit procedure recommendations and convergence to the medium-term objective, according to the matrix of required fiscal adjustment from the Commission Communication on flexibility in fiscal rules) — see European Commission (2016a)

([17]) The SPB is assumed to remain constant at end-of programme value; all other macroeconomic variables – real interest rate, inflation, real GDP growth – over the programme horizon are also taken from the Stability Programme.

Graph 4.1.1: **Gross debt - DSA**



Source: European Commission

Increasing age-related expenditure, namely on public pensions, healthcare and long term care, puts pressure on public finances in the long term. In the long term, Slovenia is at high risk as shown by the very high value of the long-term sustainability gap indicator S2. The indicator, calculated under a baseline of a no-fiscal-policy-change scenario, shows that a very high fiscal adjustment of 6.0 pps of GDP will be required upfront to stabilise the debt-to-GDP ratio over the infinite horizon ([18]). This is primarily due to the strong projected impact of age-related public spending. Pensions account for 3.4 pps of GDP of this required fiscal adjustment while health care and long-term care account for an additional 1.5 pps (0.8 pps and 0.7 pps respectively). Indeed, according to the projections of the 2018 Ageing Report (forthcoming) health care expenditure will increase by 1.0 pps (AWG Reference Scenario; 2.0 pps according to the Risk Scenario), above the EU average of 0.9 pps. When looking at long-term care expenditure, the projected increase is above average only according to the Risk Scenario, with 3.5 pps against an average EU value of 2.7 pps (only 0.9 pps with 1.2 pps for the EU according to the Reference Scenario).

([18]) The long-term sustainability indicator S2 gives the upfront structural adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon. The following thresholds apply: (i) if the value is lower than 2, the country is assigned low risk; (ii) if it is between 2 and 6, it is assigned medium risk; and (iii) if it is greater than 6 the country is assigned high risk.

4.1.4. PENSION SYSTEM*

Despite having some positive effects, the 2012 pension reform has not ensured the long-term sustainability and the adequacy of the pension system. In 2016, the growth (0.8 %) in the number of old-age pensioners decreased compared to 2015 (1.3 %) and remains low compared to 2012 and 2013 (4 % and 4.1 % respectively). This, combined with the growth in the number of those paying pension contributions to the first (public) pillar, resulted in a significant increase in the ratio between those paying pension contributions and retired people (ZPIZ, 2017). Despite these developments, both sustainability and adequacy remain challenges for the future. There are concerns about the income adequacy of both current and future pensioners. The risk of poverty (and social exclusion) among the elderly is above the EU average (see Section 4.3.3). The ratio between average old-age net pensions and net wages is decreasing, indicating that the adequacy of the pension adequacy is worsening ([19]),([20]).

There is broad consensus on the key objectives of the pension reform but a concrete action plan to adopt it is still missing. Based on the White Paper on pensions of April 2016 ([21]) and the following public debate on a new pension reform, a document called 'Starting points for the modernisation of the Pension and Disability Insurance System in the Republic of Slovenia' was prepared and unanimously adopted by the Economic and Social Council in July 2017. The document outlines various measures to achieve adequate pensions with a minimum replacement rate of 70 %, and create a sustainable and transparent pension system. However the measures are still broadly defined and lack an action plan. It is therefore unclear how the proposed measures would be realised and key goals achieved.

([19]) National data for the ratio between net pensions and net earnings is used. The aggregate replacement ratio (Eurostat indicator) is not a suitable indicator in this context as majority of pensioners from Slovenia are exempt from personal income tax and social security contributions payment. For example, the difference between average old-age net and gross pension in 2016 was less then EUR 4 according to national data.

([20]) According to national data, the ratio has been decreasing since 2008.

([21]) See also European Commission (2017c), for more details on solutions proposed by the White Book on pensions.

Furthermore, despite the agreement between social partners and the government to adopt the pension reform by 2020, the phase-in period of the reform has not yet been outlined.

Achieving pension adequacy for workers with shorter careers will be a challenge. The length of a career significantly impacts the level of pensions. Based on the current legislation, delaying retirement of an average earner for 2 years beyond the statutory pensionable age would result in an increase of the net replacement rates (22) of 7.6 pps for men and for women. In the future special attention to pension adequacy should be given to workers with shorter careers, especially in the light of demographic changes (see Section 4.3.1), delayed labour market entry and increased use of atypical employment contracts during the economic crisis (European Commission, 2017c; calculations for the upcoming 2018 Pension Adequacy Report of the European Commission and Social Protection Committee), which may exacerbate the situation of future generations ([23]).

Old-age and disability pensions for those having full retirement conditions were increased in 2017. The Pension and Disability Insurance Act was amended and entered into force as of October 2017. The amended Act increases the minimum old-age and disability pensions to EUR 500 per month ([24]) for those fulfilling full retirement conditions. National authorities estimate that around 52 000 pensioners will benefit from the amendment and will on average receive EUR 26 higher pensions.

In their current form, supplementary pension schemes will have only a limited effect on old-age income. Analysis (Majcen et. al., 2015) shows that, despite the high number of persons covered, contributions to supplementary pension schemes ([25]) dropped between 2008 and 2012 ([26]), especially contributions from younger cohorts. While in 2016 around 63 % of those in the first (public) pillar were enrolled in a supplementary pension scheme (MoLFSAEO, 2017d and KAD, 2017), premiums for around a third of insurance policies were not paid in full in 2016 (SZZ, 2016 and KAD, 2017). The ratio between those included in the supplementary pension scheme and those employed increases with age, but entering the scheme at a higher age leads to lower savings ([27]) (Majcen et. al., 2015). According to the national authorities, only 3.2 % of all pensioners were receiving pensions from supplementary pension schemes in 2016 ([28]). Projections show that the schemes could have a major impact on the adequacy of pensions in Slovenia for those who will regularly contribute to them (MoLFSAEO, 2016). Although the importance of the supplementary pension schemes is recognised by the government and social partners, there is no clear plan on how to ensure greater take-up of the supplementary pension ([29]).

4.1.5. HEALTH CARE AND LONG TERM CARE *

The healthcare system is providing good results despite the relatively limited resources used but pressure will increase due to ageing population. In 2015, Slovenia spent 8.5 % of GDP on healthcare, which is below the EU average of 9.9 %. Slovenia is still performing well in terms of

([22]) Theoretical replacement rates are defined as the level of pension income the first year after retirement as a percentage of individual earnings at the moment of take-up of pensions.

([23]) The Slovenian Institute for Economic Research is developing a module which will allow microsimulations to take into account various employment biographies and supplementary pension schemes when projecting the adequacy of pensions. The results are expected in 2018 but were not yet available when writing the 2018 Country Report.

([24]) The amount is indexed in the same way as other pensions.

([25]) Supplementary pensions (the second pillar) include i) occupational compulsory supplementary pension insurance for specific professions, (ii) individual and collective voluntary supplementary pension insurance (MoLFSAEO, 2016).

([26]) The share of paid premiums in all active insurance policies dropped from 87 % in 2008 to 67 % in 2012 (Majcen et. al., 2015).

([27]) In 2016, the average amount of supplementary savings per person amounted approximately EUR 4 860 per person and did not yet substantially contribute to the income of pensioners (MoLFSAEO, 2017d and KAD, 2017).

([28]) Out of which 88 % were ‘accelerated pension rents’, which means that most of the amount saved is paid out in a short period (even in 1 year) and the rest is paid in small annual amounts till the end of a person’s life (for example EUR 10 per year).

([29]) The White Paper on pensions proposes collective bargaining or automatic enrolment, while the ‘Starting points for the modernisation of the Pension and Disability Insurance System in the Republic of Slovenia’ mentions the need for communication and education activities, and appropriate incentives from the state.

amenable mortality (30), but prevention can further improve the effectiveness of the healthcare system. For instance, obesity rates are far above the EU average and mortality from liver cirrhosis in men is among the highest in Europe (Graph 4.1.2). Although self-reported unmet needs for medical care are very low in Slovenia (see Box 4.3.1), the share of people reporting waiting times for some specialist services increased from 6 % in 2007 to 13 % in 2015 (OECD/European Observatory on Health Systems and Policies, 2017). However, the ageing population is putting the system under strain and would require more resources to be spent on healthcare in the future. Therefore, increased efficiency is important to continue the provision of high quality care.

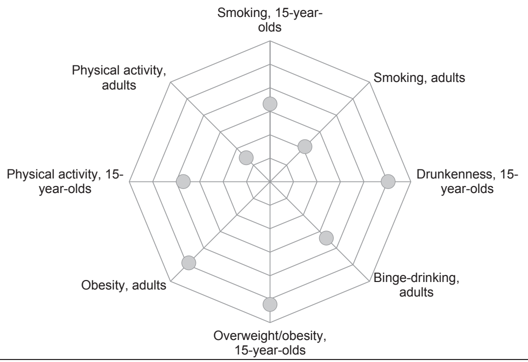
An EU-supported project to improve prevention has been launched. In 2019, 25 centres of health promotion are to be established in order to reduce lifestyle-related chronic non-communicable diseases. The project is supported by the European Structural and Investment Funds.

A reform on healthcare financing is being prepared but its adoption is delayed. The draft Health Care and Health Insurance Act has been prepared but it has not been submitted yet to the Parliament. The current form of supplementary health insurance will be abolished and transformed into a compulsory health allowance within the health insurer (HIIS).

Some elements of the reform have already been legislated in 2017. The amendments to the Health Services Act aim at improving transparency and access to health services. Changes include inter alia new regulations for concessions, the uniform arrangement of work permits and the supervision of providers. Under the Medical Practitioners Act, some expenses that are currently being paid by the health insurer (specialisations, apprenticeships, learning and training) have been transferred to the State budget. The recent changes in the Patients' Rights Act further clarify the rights and obligations for medical appointments. Furthermore, additional funding was provided in 2017 for some services with long waiting times.

(30) Amenable mortality is a dimension of avoidable mortality and is understood as deaths that could be avoided through good quality of healthcare. This indicator is a good proxy for the effectiveness of the healthcare system.

Graph 4.1.2: **Alcohol, overweight and obesity problems are greater in Slovenia than in most other EU countries**



(1) The closer the dot is to the centre the better the country performs compared to other EU countries. No country is in the white 'target area' as there is room for progress in all countries in all areas.
Source: OECD calculations based on Eurostat Database (European Health Interview Survey in or around 2014), OECD Health Statistics and Health Behaviour in School-aged Children survey in 2013-14. (Chart design: Laboratorio MeS).

The Slovenian government is making progress in implementing the National Health Care Plan for 2016–2025. Initial steps have been taken to amend legislation in the field of administration and management of health institutions. Changes concern, inter alia, business autonomy, powers of managing authorities and professional responsibility. In addition, in 2017 the parliament endorsed the emergency law for the financial stabilisation of public healthcare institutions. Around EUR 136 million emergency funding are made available to cover about 80 % of the losses that hospitals had accumulated mostly during the crisis. In order to be eligible, hospitals have to adopt restructuring plans and accept oversight by special Health Ministry committees. A national strategy for primary healthcare development by 2025 is being prepared and reference family medicine outpatient clinics are gradually being introduced. A health technology assessment system is planned to be established by 2020 for all aspects of introducing new health technologies, including optimum utilisation. ICT solutions (ePrescription, eReferral, eAppointment) will improve nationwide information.

Public procurement procedures in the health sector are not sufficiently bundled yet. In 2017, aggregated procurement was organised for nine different items. However, the share of procurement carried out centrally is low compared to other countries and human resources dedicated to the task are still limited for such a demanding activity. Pending the more active use of aggregated procurement by tendering authorities, a database prices resulting from recent procurement procedures has been created. Hospitals are required to use the lowest price in this database as the maximum price for any new supply contract for the same items.

Additional improvements in public procurement would bring efficiency gains and reduce the risk of collusion among bidders. Public procurement in the health sector requires specific knowledge and expertise and thus professionalisation of those involved. Slovenia has not yet adopted a fully-fledged professionalization strategy. Recent experience shows that well prepared aggregated procurement, notably in medical devices, can increase the average number of bids and significantly reduce the bidding prices. In addition, joint procurement between different hospitals can complement the work of the centralized purchasing body and may be more suitable for some purchases. Furthermore, a more systematic involvement of the relevant health professionals in the entire tendering process would lead to more successful tenders, as it increases the satisfaction with the purchase made. In addition, the small Slovenian market creates the risk that choosing of a single supplier per product creates monopolies. This could lead to treatments becoming unavailable and in the long term increase prices through market concentration. Slovenia does not yet have sufficient capability or the means to identify collusion among bidders and, where applicable, to punish it (see also Section 4.4.3).

To date, there is no integrated long-term care system in Slovenia. There is no unified entry point or a standard model for assessing care needs for long-term care services. This creates risks of inefficiencies and makes it more difficult for the user to navigate the system. The provision of community-based long-term care is not well coordinated and the financing of social long-term is fragmented. Until now, Slovenia has focused its limited spending on institutional care rather than home care.

A new draft legislative proposal for long-term care has been prepared. The reform aims to establish a sustainable and accessible care system which combines the health and social aspects of care with integrated long-term care services. According to the draft law, the new long-term care system would be rolled out as of 2020. The list of targeted services would include basic and support services as well as non-acute healthcare services. The draft law provides for a uniform method for assessing care needs, and involves interdisciplinary mobile teams, integrated supervision and an integrated network of providers. It encourages informal care support ([31]) in the home environment and seeks to relieve individuals and families by providing, under certain conditions, the possibility of cash receipts, training and counselling for informal care providers, as well as 14 days of substitute care a year. Beneficiaries would receive financial compensation or a paid personal assistant or paid healthcare services provided at home or in a nursing home. All beneficiaries would be fully compensated for rehabilitation services aiming to preserve or improve their independence, as well as for social and psychological support and counselling. A two-year pilot programme, partly co-funded through the European Social Fund, has been launched to test the concrete measures as proposed in the draft law.

The financing of the services provided by the long-term care Act is still not clear. According to the draft long-term care Act published in October 2017, the sustainability would be ensured partly by a new compulsory insurance fee, partly by the healthcare premiums.

4.1.6. STATE OWNED ENTERPRISES*

Slovenia's commitment to implementing professional standards in the management of state-owned enterprises (SOEs) is starting to bear fruit. The performance of SOEs in 2016, the first year in which SOEs were fully managed by the Slovenian Sovereign Holding (SSH), reached the targets set in the management acts, since an almost 6 % return on equity was achieved on an aggregated basis (SSH, 2017). In 2017, the return on equity is expected to remain at the same level as

([31]) However, the encouragement might keep some family members away from the labour market at a time when the need for labour is increasing due to population ageing.

in previous year. Dividend pay-outs in 2017 for companies managed by the SSH, acting either as an owner or on behalf of the State, were 38 % higher than in 2016, and hit a record high almost doubling the dividends received in 2011, i.e. when Slovenia first applied a centralised system for managing capital assets.

Under the new management plan for 2018 return on equity should increase slightly over the coming years. It is stated that the future focus will be placed on the quality of corporate governance, the transparency and compliance of operations of companies under management and the support for corporate transformation of companies. SSH aims to bring the SOE regular reporting to the standards applicable for listed companies.

The return of equity is lowest in the category of strategic companies. Among the SOEs, the SSH differentiates between the strategic companies, which, in addition to economic goals, also attain strategic goals. These are generally the largest companies, and 66.9 % of the portfolio is classified under this category. Whereas in general the return on equity was 6.0 % in 2017, it was 4.5 % for the strategic companies. Analysis in Section 4.4.1 confirms that the total factor productivity of large SOEs is lagging behind that of state-owned and private companies.

Certain privatisations announced are still pending. In 2017, only one privatisation process was completed (Paloma, hygienic paper products). No timeline has yet been fixed for the privatisation of Telekom Slovenije which was decided by Parliament back in 2013.

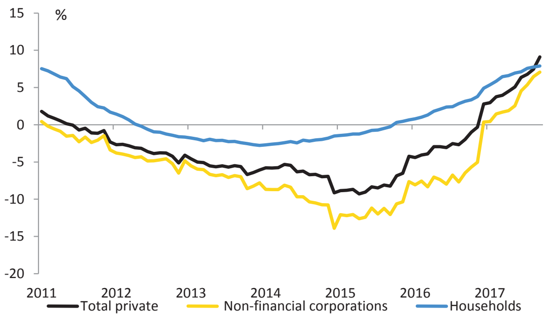
4.2. FINANCIAL SECTOR

4.2.1. BANKING SECTOR*

The situation of the Slovenian banking sector has improved significantly, due to better profitability, solvency and asset quality. The return on equity more than doubled to reach 7.8 % in 2016, mainly because of lower impairments. The average capital adequacy ratio is relatively stable (18.7 % in June 2017), although it has declined slightly since December 2016 due to renewed credit growth. The year-on-year growth rate of credit to households and to non-financial corporations reached record highs of respectively 7.9 % and 7.1 % in September 2017 (Graph 4.2.1). The funding structure of banks is particularly favourable, with a loan-to-deposit ratio of 78.8 % in 2016.

Banks need to find new sources of income and control costs to maintain profitability. Current profitability is mainly driven by lower impairments, or even by releasing previous impairments. This is bound to change as new lending progressively generates new impairments. Profitability is also likely to come under pressure from persistently low interest rates and increases in compliance, prudential, supervisory and investment costs. One possible strategy for offsetting these negative factors is to focus on fee income and to develop new lending products and services. Banks could also opt for partnership or acquisition to reduce their costs and achieve economies of scale.

Graph 4.2.1: **Year-on-year credit growth, adjusted for sales and securitisation**



Source: ECB

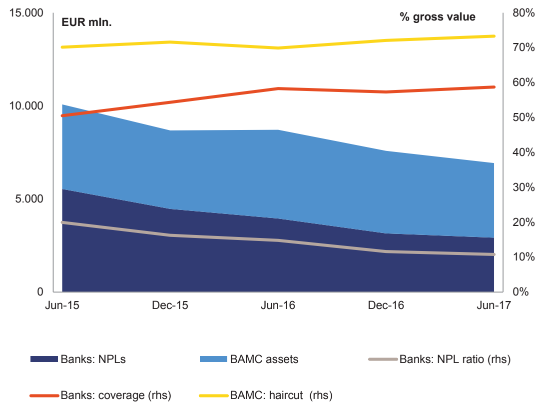
Non-performing loans (NPLs) have continued their downward trend. Declining NPLs are reported both by Bank of Slovenia and the ECB. National statistics are richer and used for the analysis in this section and in Section 1, while ECB statistics are reported in Section 3. According to the national statistics, the NPL ratio for the banking sector as a whole was 10.8 % in June 2017, down from 14.8 % a year earlier (Graph 4.2.2). In the corporate sector, the share of NPLs continued to decline to reach 23.9 % in June 2017, down from 31.3 % a year before. In 2013 and 2014 a substantial part of the NPL reduction was due to transfers of bad assets to the Bank Asset Management Company (BAMC). However, the total stock of NPLs in Slovenia, including those in BAMC's balance sheet, is also declining at relatively quick speed. Meanwhile, the coverage ratio in the banking sector (i.e. the share of accumulated provisions to gross value of NPLs) has been increasing slowly, approaching the average haircuts (i.e. fair value adjustments over gross transfer values) applicable to BAMC assets. These trends suggest that NPLs reduction has boosted banks' ability to absorb future losses on

Table 4.2.1: **Financial soundness indicators, all banks in Slovenia**

(%)	2010	2011	2012	2013	2014	2015	2016	2017Q2
Non-performing debt	-	-	19,2	17,1	16,6	13,3	9,6	8,7
Non-performing loans	-	-	-	-	22,8	17,9	12,3	11,4
Non-performing loans NFC	-	-	-	-	43,5	36,8	26,8	24,1
Non-performing loans HH	-	-	-	-	7,8	7,2	4,8	4,4
Coverage ratio	-	-	44,5	61,3	53,3	59,3	60,3	60,5
Loan to deposit ratio*	156,5	149,0	143,8	119,0	95,9	86,2	78,8	79,0
Tier 1 ratio	8,6	9,3	9,8	12,9	17,1	18,0	18,5	18,3
Capital adequacy ratio	11,3	11,8	11,4	13,7	17,9	18,6	19,1	18,7
Return on equity**	-3,1	-11,1	-19,4	-90,2	-2,5	3,5	7,8	-
Return on assets**	-0,2	-0,8	-1,5	-8,0	-0,3	0,4	1,0	-

Source: ECB Consolidated banking data the remaining NPL portfolio.

Graph 4.2.2: **Trends in non-performing loans, including BAMC assets**

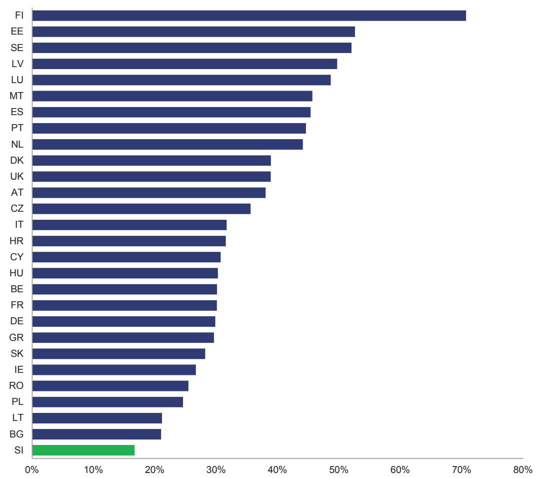


(1) The coverage ratio for the banking sector is defined as the ratio of accumulated provisions to gross value of NPLs.
(2) The haircut for BAMC assets is defined as fair value adjustment as a ratio of the gross transfer values
Source: Bank of Slovenia, BAMC

The reduction in NPLs in recent quarters has been principally driven by loan restructuring solutions, whose long-term sustainability needs to be closely monitored. The transformation of restructured loans to performing status (i.e. cures) and write-offs (i.e. mostly debt relief through loan restructuring) accounted for less than half of the change in NPL stock in the first half of 2017, down from nearly three quarters of the NPL reduction in 2016. Given that loan sales may pick up in the second half of 2017, the positive impact of loan restructuring on NPLs may be even smaller. One possible reason for this development could be that a sizeable proportion of restructuring arrangements remain unsuccessful, or at best partly successful. Indeed, the ratio of performing forborne loans to all forborne loans is around 17 % in Slovenia, (Graph 4.2.3). Among other things, this may be due to high re-default rates, which prevent forborne NPLs to migrate performing status over time. Furthermore, some of these restructured loans have been converted into bullet loans ([32]) or involve payment deferrals ([33]), whose overall performance can only be known when the increased payment schedules kick in. The sustainability of the restructured loans therefore needs to be monitored more closely. If the insolvency proceedings in the courts were accelerated (see Section 4.4.5), the reduction of NPLs could be still faster.

([32]) Bullet loans are those where the entire principal payment is delayed to the end of the loan term.
([33]) Loans involving payment deferrals are those where part or all of the outstanding past-due liabilities are converted into future liabilities.

Graph 4.2.3: **Share of forborne loans that are performing (end-June 2017)**



Source: ECB

The BAMC is progressing towards fulfilling most of its mandate, but the size and the nature of the assets remaining on its portfolio create risks that require monitoring. The business strategy adopted in December 2016 aims to ensure the highest possible return to the state and to fully redeem bonds backed by state guarantees by 2022. From its inception in 2013 until June 2017, BAMC generated cumulative cash flows of nearly EUR 1.1 billion, representing nearly 60 % of the aggregate fair value of the loans transferred. Most of these cash flows are from refinancing by banks of loans held at BAMC, but loan/collateral sales appear to be picking up. BAMC engaged in an earlier repayment of part of its outstanding debt, including a full redemption of State loans by December 2016, and turned to more flexible refinancing options. BAMC is expected to return to profitability in 2017, mainly due to lower financing costs. Going forward, a key risk is maintaining the momentum of cash-flow generation from sales, as the remaining assets in BAMC's portfolio may be more difficult to sell.

Recent reforms aim to maintain stability within the banking sector. The consolidation and restructuring of the sector progressed with a merger of three banks and the completed wind-down of two smaller banks. Banks are following their NPL target plans which are monitored by the Bank of Slovenia and the Single Supervisory Mechanism. Backed by the technical assistance of the European Commission and in cooperation with the World Bank, in March 2017 the Bank of Slovenia issued the Handbook for Effective Management and Workout of SME NPLs (Bank of Slovenia, 2017a). The handbook includes a complete toolkit to prevent, identify and manage NPLs in this segment.

The impact of upcoming regulatory changes is expected to be relatively limited. In particular, for most banks the gradual implementation of the upcoming IFRS 9 accounting standards are not expected to imply any significant new provisioning ([34]). According to a supervisory assessment at end-2016, some of the smaller and less complex banks may suffer more than their peers, especially due to the data needed to obtain estimates of expected credit losses. The impact of the upcoming minimum requirement for own funds and eligible liabilities ([35]) on most banks will be very limited, owing to the level of excess capital held. However, less capitalised banks may face significant shortfalls, which will need to be filled by issuing eligible liabilities.

The persistent involvement of the Slovenian state in the financial sector entails some risks for financial stability. The Slovenian state controls a significant share of the financial sector through its stakes in NLB, Abanka-Celje and Sava Re, and recent developments show that there is little political will to improve the situation. The government has failed to privatise at least 50 % of NLB by the end of 2017, as committed to in the revised state-aid decision on the recapitalisation of NLB in 2013([36]). In line with the government commitment, the privatisation of Abanka-Celje is scheduled for 2019. Two attempts by a foreign insurance group to increase its stake in Sava Re were rejected. As demonstrated by the crisis that hit Slovenia in 2013, maintaining a high level of state involvement may entail in the longer run some risks for financial stability, economic efficiency and public finances.

4.2.2. ACCESS TO FINANCE FOR SMALL AND MEDIUM-SIZED COMPANIES*

Financing conditions have eased but less for SMEs. Interest rates on business loans and spreads over German 10-year government bonds have fallen but they remain above those in the euro area. Banks in Slovenia remained cautious on lending to SMEs (IMAD, 2016). The costs of borrowing for small loans relative to costs of borrowing for large loans have increased over the past years. Furthermore, there is a lack of financial literacy in SME and a lack of business finance advice to help SMEs dealing with complex procedures for obtaining bank loans ([37]), various public financial incentives, and emerging alternative financial sources. These developments are also supported by the recent firm level survey by the European Investment Bank (EIB, 2017). According to the survey, 8 % of firms are finance constrained, which is close to the EU average. The survey shows a clear recent improvement in firms' satisfaction with the components of external finance offers like cost and collateral requirements. Overall, the survey indicate that significantly fewer businesses perceive access to finance as a barrier to investment than in 2016 (down from 48 % to 29 %). However, SMEs consider access to finance to be a long-term growth barrier more often than large firms.

([34]) The International Financial Reporting Standard (IFRS) 9 will be the new accounting standard for financial instruments, replacing the current IAS39 from 1 January 2018. It will have a significant impact on banks, especially in impairment methodology, as the focus on expected credit losses will require banks to recognise their losses earlier.

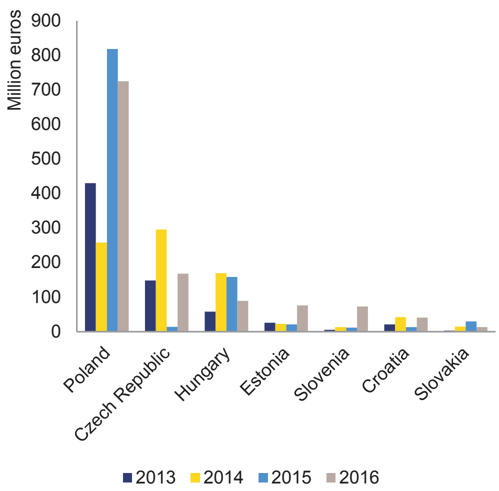
([35]) The minimum requirement for own funds and eligible liabilities (MREL) determines the financial resources that need to be set aside to absorb any losses and to meet recapitalisation needs during the resolution of a failing bank. Introduced in the Bank Recovery and Resolution Directive, these requirements will be phased in between 2020 and 2022.

([36]) http://europa.eu/rapid/press-release_IP-18-482_en.htm

([37]) The percentage of rejected loan applications and unacceptable loan offers increased significantly (from 5.6 % in 2015 to 13.9 % in 2016). This may suggest that SMEs' applications are sometimes not sufficiently well prepared, or that the effects of SMEs' improved access to loans remained limited due to unfavourable loan conditions and related costs in absolute terms being too high for Slovenian SMEs.

Alternative financial instruments like venture capital and other equity-type capital are only emerging in Slovenia. Alternative financing represents only a minor share of financial resources available for SMEs. Despite a modest increase, private equity in Slovenia is still low. (Invest Europe, 2017) (Graph 4.2.4). Overall access to alternative finance, especially venture capital, is improving in Slovenia, albeit from a very low level. The country still ranks among the last across the EU Member States in its venture capital share as a percentage of GDP ([38]). It is possible that not just the limited availability of bank credit, but also a lack of venture capital and other equity financing prevent innovative SMEs from scaling up (Van Roy and Nepelski, 2016).

Graph 4.2.4: **Annual value of private equity investments in selected Central and Eastern European countries in 2013 to 2016 (million euros)**



Source: Invest Europe CEE Private Equity Statistics 2016

There has been a concerted policy response to improve access to finance. Box 4.2.1 discusses the funding opportunities created using the EU funds and mechanisms. Financial support has been directed to SMEs also through the Slovene Enterprise Fund (SEF) financial instruments (both debt- and equity-type instruments: grants for start-ups, seed capital, convertible loans, equity, microcredits and guarantees for bank loans with subsidies of interest rate). However, these financial instruments are considered important by only about one out of nine SMEs due to the limited overall amount of funding available (Bank of Slovenia 2017b). Nevertheless, the SEF report shows that several thousand new jobs have been created through its financial support measures. Moreover, the national development bank (SID Bank) has offered specific financial instruments to SMEs.

New technologies are helping to finance Slovenian start-ups. They have had a very high success rate on several international crowdfunding platforms and recently raised a large amount of funding through the initial coin offering platforms. Slovenia is well positioned to become a regional block-chain hub. These improvements are yielding visible results with 'unicorns' such as Outfit 7 and several other globally successful start-up cases (see also Section 4.4.5 on the business environment).

([38]) Venture capital in Slovenia was 0.0067 % of GDP in 2014, well below the EU level of 0.062 % in the same year (European Commission, 2017e).

Box 4.2.1: Policy highlight: improving the access to finance

In 2017, there were two positive developments to stimulate further alternative investments. First, in autumn 2017 the SEF invested EUR 8 million ([1]) into a new cross-border equity initiative called the Central Europe Fund of Funds that is managed by the European Investment Fund (EIF). The Funds' main objectives are to boost equity investments in the region's SMEs and small mid-caps, establish a sound market-based infrastructure for risk financing, implement and introduce the best market standards for equity investments in enterprises and attract institutional investors and fund managers to Central Europe. In total, investments in five to eight venture capital funds are envisaged to increase the amount available for investments into Central European businesses to about EUR 160 million. Second, in mid-November 2017 the EIF and the national promotional bank SID Bank launched the first Slovenian capital growth investment programme. EUR 100 million, backed by the European Fund for Strategic Investments guarantee, will be made available for innovative and fast-growing SMEs.

Additional financial instruments co-financed by the EU structural funds (ESIF) are being prepared. In June 2016, the Slovenian government decided to allocate EUR 253 million of ESI Funds to a fund of funds. The fund of funds manager (the SID Bank) prepared a market test in August 2017, which provided the basis for their investment strategy. The agreement with the SID Bank was signed in November 2017 ([2]) and the first instalment of EUR 63 million was transferred to them in early December 2017 ([3]). It is expected that in early 2018 the SID Bank will issue public calls to select financial intermediaries in four different areas: RDI, SMEs, energy efficiency and urban development. The funds are expected to reach the final recipients in the second half of 2018. A total of EUR 88 million is to be delivered through loans, EUR 60 million through microloans, EUR 95 million through portfolio guarantees and EUR 10 million through equity financing. Equity financing is allocated solely to support SMEs.

Guarantees in combination with grants supported by the European Agricultural and Rural Development Fund will be used for agricultural and forestry businesses. This is a significant step, marking a departure from supporting agricultural, rural and forestry businesses exclusively by way of grants. It is envisaged that the fund of funds will accommodate risks related to the referred businesses' loans by managing EUR 65 million. The selection of the fund of funds manager is ongoing. The final recipients are expected to benefit in 2018.

(1) http://www.podjetniskisklad.si/en/news/458-new-opportunities-for-growth-financing-will-be-offered-to-ambitious-slovenian-small-and-medium-sized-enterprises-and-small-mid-caps.
(2) https://english.sta.si/2453914/economy-ministry-and-sid-bank-set-up-fund-of-funds
(3) https://english.sta.si/2460153/fund-of-funds-receives-first-batch-worth-eur-63-25m?q=fund,of,fund

4.3. LABOUR MARKET, EDUCATION AND SOCIAL POLICIES

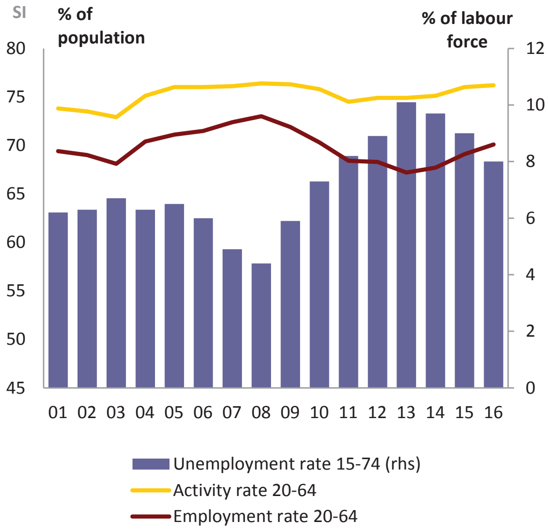
4.3.1. LABOUR MARKET

The labour market situation continues to improve. With the economic recovery, the employment rate has risen for the third year in a row, and unemployment is falling (Graph 4.3.1). In 2017, unemployment (ages 15-74) fell from 8.0 % to 6.8 % on an annual basis. In the third quarter of 2017, the employment rate was 74.1 %, up 3.7 pps compared with the same period in 2016. In the same period, the employment rate of low-skilled workers also improved (Q3-2016: 44.2 %, Q3-2017: 50.2 %) although it remains below the EU average (55.7 %). In spite of these positive trends, challenges remain, in particular for older workers (55-64). In 2016 the employment rate of older workers increased by 1.9 pps and was the highest ever recorded at 38.5 %. Nonetheless, it still lags significantly behind the EU average (55.2 %). Furthermore, the activity rate for this age group is the lowest in the EU. In December 2017 the parliament adopted the Intervention Act and extended measures of promoting employment of persons aged over 55 years ([39]).

A rapidly ageing society means the working age population and labour supply are shrinking. This could hamper economic growth. The Institute of Macroeconomic Analysis and Development of Slovenia forecasts that by 2020 the labour force could contract by 8 000 persons per year on average (0.82 % of the total active population aged 20-64), causing both the number of employed and unemployed people to drop (IMAD, 2016a).

The old-age dependency ratio is projected to double by 2060. This means that today's young workers and future generations are likely to face a double burden. Their contribution to social security could rise, which would reduce take-home pay, ceteris paribus. These generations are also likely to receive lower pensions, relative to wages, than today's pensioners (European Commission, 2017f) (see Section 4.1.3). The 65+ proportion of the population is projected to reach 31.6 % by 2060, from 17.1 % currently.

Graph 4.3.1: **Activity, employment and unemployment rates (annual)**



Source: European Commission

In response to this trend, the government has prepared an Active Ageing Strategy. It is focused on four pillars: i) employment/activity; ii) independent, healthy and safe life of all generations; iii) social inclusion, and; iv) creating an environment to foster activity throughout the lifespan (IMAD and MoLFSAEQ, 2017). The relevant ministries have not yet prepared their six month action plans with concrete proposals although these were due by the end of 2017.

Net migration after the economic crisis has been very low. In the last 10 years, immigration was the highest in 2007-2009 and was driven by rapid growth of individual sectors (for example construction) rather than by a comprehensive strategy. In the absence of migration growth in the future, and assuming birth rates and life expectancy will be stable, by 2060 the working age population would be up to half a million individuals smaller than in 2013 (IMAD and MoLFSAEQ, 2017). The strategic migration policy has not helped to attract workers into bottleneck professions.

([39]) Notably, employers are exempted from the payment of social security contributions for up to 24 months for employment of older workers. The measure is in place from 1.1.2016 and will now be extended until 31.12.2019.

Box 4.3.1: Monitoring performance in light of the European Pillar of Social Rights

The European Pillar of Social Rights, proclaimed on 17 November 2017 by the European Parliament, the Council and the European Commission, sets out 20 principles and rights to benefit citizens in the EU. In light of the legacy of the crisis and changes in our societies driven by population ageing, digitalisation and new ways of working, the Pillar serves as a compass for a renewed process of convergence towards better working and living conditions.

SLOVENIA		
Equal opportunities and access to the labour market	Early leavers from education and training (% of population aged 18-24)	Best performers
	Gender employment gap	Better than average
	Income quintile ratio (S80/S20)	Best performers
	At risk of poverty or social exclusion (in %)	Better than average
	Youth NEET (% of total population aged 15-24)	Better than average
Dynamic labour markets and fair working conditions	Employment rate (% population aged 20-64)	On average
	Unemployment rate (% population aged 15-74)	On average
	GDHI per capita growth	To watch
Social protection and inclusion	Impact of social transfers (other than pensions) on poverty reduction	Better than average
	Children aged less than 3 years in formal childcare	On average
	Self-reported unmet need for medical care	Better than average
	Individuals' level of digital skills	On average

Members States' are classified according to a statistical methodology agreed with the EMCO and SPC Committees. The methodology looks jointly at levels and changes of the indicators in comparison with the respective EU averages, and classifies Member States in seven categories (from "best performers" to "critical situations"). For instance, a country can be flagged as "better than average" if the level of the indicator is close to EU average, but it is improving fast. For methodological details, please consult the draft Joint Employment Report 2018, COM (2017) 674 final.

Slovenia performs relatively well on the indicators of the Social Scoreboard ([1]) supporting the European Pillar of Social Rights. Income inequality is low and so is the share of early school leavers. The risk of poverty and social exclusion has decreased over the last years. However, old-age poverty remains frequent. The low employment rate of older workers and low-skilled is a concern in terms of equal opportunities of under-represented groups. Gross disposable household income has declined significantly during the crisis but is currently growing again.

The low employment rate of older workers and low-skilled reflects low participation in adult learning and active labour market policies. Both adult learning and active labour market policies are important to tools to improve access to the labour market. They can help persons wanting to work to gain new skills or incentives for employment. Participation in adult learning is falling since 2010 and has been especially low among older workers and the low-skilled. Participation in active labour market policies is also very low in Slovenia.

Slovenia provides high quality general education, successfully containing early leaving from education and training. Additionally, Slovenia has continued increasing its tertiary education attainment rate. In 2016 44.2 % of 30-34 year-olds had obtained a tertiary-level qualification, up by 3.2 pps since 2014. A high level of public regard for teachers, combined with robust social dialogue in the education field and a relatively high level of investment in education, all contributed to the traditionally good performance of the Slovenian education system.

[1] The Social Scoreboard includes 14 headline indicators, of which 12 are currently used to compare Member States performance. The indicators "participants in active labour market policies per 100 persons wanting to work" and "compensation of employees per hour worked (in EUR)" are not used due to technical concerns by Member States. Possible alternatives will be discussed in the relevant Committees. Abbreviation: GDHI – gross disposable household income.

There are signs of labour shortages in a number of vocational occupations. According to the Manpower Talent Shortage Survey, the share of employers reporting skills shortages increased from 28 % in 2012 to 33 % in 2016. A survey by the Employment Service of Slovenia shows similar results, especially for drivers of heavy vehicles and tugs, workers in manufacturing, welders, masons, cooks, waiters, toolmakers and salesmen (ESS, 2017). Adjusting education programmes and offering enrolment places could help reduce these gaps. Most workers are well matched with their current jobs but there are indications that the system is not fully able to provide in-demand skills (OECD, 2017a).

Population ageing accentuates the need to increase participation in adult learning. While in 2016 the participation of adults in learning was 11.6 % and still slightly (0.8 pps) above the EU average, it has fallen steadily since 2010. Participation in adult learning has been especially low among older workers and the low-skilled. This causes concerns as improving skills through adult learning could increase the chances of being in employment.

The participation rate in active labour market policies (ALMP) in Slovenia was among the lowest in the EU, while long-term unemployment (LTU) remains high. In 2016, LTU represented 4.3 % of the active population, which corresponds to 53.3 % of all unemployed people. According to national data, in 2016 the transition rate of LTU to employment was 25.2 % and the share of LTU participants in ALMP programmes represented 48 % of all participants. Around EUR 189 million is earmarked for ALMPs in 2017 and 2018, an increase from previous years but low compared to other OECD countries. In 2017, two new measures are aimed directly at older workers ([40]). Regardless of progress, older and low-skilled workers remain under-represented in ALMP and could benefit from implementation of the Upskilling Pathways Recommendation.

Despite the low participation rate, Slovenia's most important ALMP programmes ([41]) perform rather well, if judged by labour market impact and cost-effectiveness. In September 2017, the University of Primorska prepared an impact assessment of key employment programmes in Slovenia. Short and longer-term effects are positive with the exception of public works, the programme catering to the jobseekers furthest away from the labour market. Although the programme has some positive effects such as skills development, activation and social inclusion, its labour market impact is modest and the programme's computed net benefit is negative. (MoLFSAEO & UoP, 2017). Despite these overall good results, low participation rate in the activation measures remains a concern.

Incentives to become employed in a low-wage position when on benefits are rather weak. During the first months of unemployment, the net replacement rate of unemployment benefits is very high (above 80 %) for low-wage earners. The unemployment trap for the beneficiaries is high compared to other EU countries. However, employers in Slovenia are required by law to pay a travel and daily meal allowance. These are not subject to taxation and amount to approximately 13 % of the average wage bill. Net wages in Slovenia are therefore some 10 % higher than reported in official statistics. Unemployment benefit recipients do not receive these allowances. Taking them into account reduces the unemployment trap by approximately 10 pps, although it remains above the EU average. Furthermore, only a relatively small share of the unemployed (24 % in 2015) receive unemployment benefits, and for a shorter period than in other EU Member States ([42]). A significant number of unemployed people receive other forms of income support (OECD, 2016a).

In September 2017, the Act Amending the Labour Market Regulation Act was adopted with the main aim of accelerating activation of the unemployed. An incentive for low- and medium-educated beneficiaries of unemployment benefits was prepared. If they enter full-time employment they will continue to receive 20 % of

([40]) Active until retirement (subsidy programme) and Support for companies for active aging of the workforce (workshops).

([41]) The following programmes were evaluated: Institutional training 2009-2012; On-the-job training 2009-2012; 'Employ.me' ('Zaposli.me') 2009-2012; and Public works 2012-2014.

([42]) This depends upon length of insurance and partly also on age. For example, an unemployed person is entitled to 2 months of unemployment benefit if younger than 30 and insured for at least 6 months in the last 24. This decreases to 3 months of unemployment benefit if they were insured for at least 9 months in the last 24. A full comparison of unemployment benefits and active labour market policies across EU countries is part of the benchmarking exercise published in the draft Joint Employment Report 2018.

the latest unemployment benefit amount until the end of the period for which the benefit was originally awarded, but no longer than 12 months after the start of employment. This incentive could further reduce the unemployment trap.

The 2013 Employment Relationship Act, introduced to reduce labour market dualism and increase flexibility, appears to have paid off, at least for older workers. A study 'Equity and productivity effects of the New Labour Code' ([43]) evaluates the short-term equity and productivity effects of the Employment Relationship Act ([44]). It shows favourable outcomes for older workers in terms of higher transition rates from fixed-term to permanent contracts, and higher transitions from unemployment to employment (MoLFSAEO and UoP, 2017). However, the analysed period was rather short and next- to-permanent, fixed-term hiring is also rising. While the reform clearly helped certain vulnerable groups enter employment, temporary employment remains an issue.

Young people have seen their job situation improve but are often employed under non-standard and precarious contracts. The share of temporary employment among young people is still the highest in the EU (IMAD, 2017a). In 2016, more than 7 out of 10 young workers in Slovenia had a temporary contract, compared to 13.1 % of workers aged 25-49 (European Commission, JER 2018c). They are also overrepresented in involuntary part-time work and lower wage jobs. This is largely due to the prevalence of student work contracts, which increased despite the recent introduction of employer social security contributions for these contracts (IMAD, 2017a). In addition, women in Slovenia are more often employed on fixed-term contracts than women on average in the EU-28 and more often than men. Workers with shorter careers and longer career breaks could face pension adequacy problems in the future, reinforcing the already existing problems (see Section 4.1.4). The Slovenian Statistical Office estimates that the share of possible bogus self-employment almost doubled between 2012 and 2015 (SORS, 2016). The share of self-employed in total employment has been slowly increasing from 9.5 % in 2008 to 11.6 % in 2016.

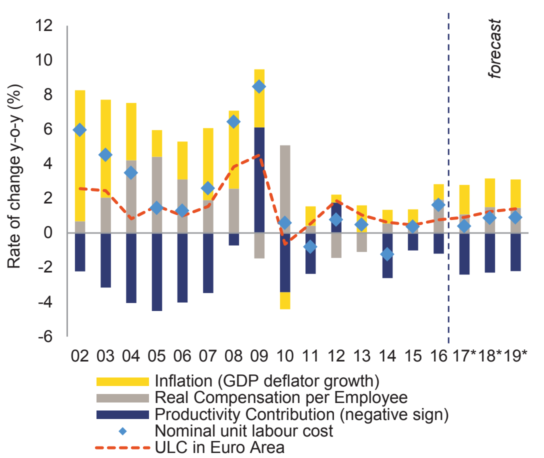
Wage growth in Slovenia remains moderate and in line with productivity developments. In 2016 nominal wages increased by 2.8 % in Slovenia. Combined with modest productivity gains, this resulted in an increase in nominal unit labour costs. The further tightening of the labour market is expected to put continuous upward pressure on wages. Nominal wages are projected to continue to increase by 2.8 % in 2017 and by around 3.2 % in 2018 and 2019, remaining both below the rate consistent with internal labour market conditions, and below the rate consistent with a stable evolution of cost competitiveness([45]). Nominal unit labour costs are also projected to increase, at a rate slightly below the euro area average (Graph 4.3.3). Real wage growth accelerated in 2016 and — after several years of significantly lagging behind — exceeded productivity growth by roughly 0.7 pps in 2016. In the coming years real wage growth is expected to remain somewhat below productivity growth.

([43]) Prepared by the Ministry of Labour, Family, Social Affairs and Equal Opportunities in cooperation with the University of Primorska.

([44]) The Act reduced job security for permanent workers and increased costs tied to fixed-term employment. The law notably removed special dismissal protection for older workers (55 and older).

([45]) The European Commission regularly assesses whether wage developments support macroeconomic rebalancing or, on the contrary, are a source of potential macroeconomic imbalances. The assessment relies on comparing actual wage developments with two hypothetical benchmarks consistent with Member States' internal or external economic equilibrium: (i) the wage growth which would be predicted on the basis of changes in labour productivity, prices and the unemployment rate; (ii) the wage growth which would be consistent with a constant real effective exchange rate based on unit labour costs. Nominal wage growth in Slovenia was below both in 2016.

Graph 4.3.2: **Decomposition of rate of change of unit labour costs**



Source: European Commission

The minimum gross wage increased to EUR 804.96 in 2017, about EUR 14 (1.8 %) higher than in the previous year. Considering that this increase was relatively small and less than the increase of average wages (2.2 %), this is not expected to put pressure on competitiveness. Growth in gross disposable household income (GDHI) per capita however, has been relatively modest since 2008. Despite increases in recent years, it remains below the pre-crisis level.

The framework of tripartite social dialogue in Slovenia is relatively well developed, but there are still some weaknesses. Social partners are involved in shaping policy through the Economic and Social Council, where the government, trade unions and employer organisations are represented. Despite general satisfaction with the consultation process, social partners note that social dialogue can be further improved by ensuring they are involved at an early stage in the preparation of legislative proposals and reform measures. Lack of resources due to falling rates of union and employer's organisations' membership influences greatly the social partners' ability to participate effectively in the social dialogue.

4.3.2. EDUCATION AND SKILLS

The basic skills of Slovenian pupils and the equity of the education system are generally high and improving, but certain inequalities persist. Slovenian 15-year-olds perform well in all three fields tested in the OECD's 2015 Programme for International Student Assessment (PISA) survey — science, mathematics and reading. The rate of underachievement among students from the bottom socioeconomic quartile is 25.1 %, against only 6.3 % for students from the top quartile, but the variability in science performance associated with students' socioeconomic status improved from 17.5 % in 2006 to 13.5 % in 2015. Slovenia has seen the largest improvement in gender equality among the EU Member States between PISA 2012 and PISA 2015, but the performance of boys in reading literacy is still a concern since 12.1 % more boys than girls underachieve in reading (EU average 9.6 %). A working group established by the Ministry for Education, Science and Sport stared working on including digital skills in the official curriculum in 2017. The proportion of early school leavers is still among the lowest in the EU.

Reforms on the financing of tertiary education are continuing, but a legislative overhaul has been postponed. With the aim of more strongly aligning the national strategies and missions of tertiary education institutions, the 2016 amendments to the Higher Education Act and the corresponding Decree redesigned the financing principles and set out the foundation for signing multiannual funding agreements. However, the planned comprehensive new Higher Education Act has been delayed.

Education spending as a share of GDP was reduced during the crisis but remains above the EU average. Between 2012 and 2015, government expenditure on education as a percentage of GDP declined by 0.9 pps, which is among the highest declines in the EU. The 2015 educational expenditure of 5.6 % of GDP remained, however, above the EU average of 4.9 %. The education Ministry's budget which was reduced by 6.8 % between 2013 and 2016, has since been increasing in line with the economic recovery, but in tertiary education the budget remains below 2014 level.

Slovenian schools have started to prepare students for careers in entrepreneurship. According to the OECD, the percentage of people who believe that they have the required skills and knowledge to start a business is low (OECD, 2017c, d). In the Global Entrepreneurship Monitor report 2016/17 the entrepreneurship education in

Slovenia scored below the EU average. Efforts to promote entrepreneurship in schools are under way, and involve developing, testing and implementing a model that promotes entrepreneurial skills in primary schools. A public tender to reach this goal was published by the Ministry of Education, Science and Sport in 2017.

In vocational education, the link between studies and practical experience has been improved. The Apprenticeship Act is in use since December 2017, defining apprenticeships as part of the vocational education system. An apprentice has the status of a secondary school student, and must receive at least 50 % practical education (work) with the employer. The practical education may be carried out with more than one employer, within international mobility programmes and educational centres. Apprentice status can also be obtained by unemployed people or workers in order to obtain a secondary vocational education or when they need further training or retraining. In school year 2017/2018, apprentice status can be obtained in four programs: metalworker-toolmaker, stonecutter, carpenter, and gastronomic hotelier. Although the Ministry of Education, Science and Sport expected up to 200 apprentices per generation, so far only 53 students are participating.

4.3.3. SOCIAL POLICY

Slovenian society is rather egalitarian, but old-age poverty is frequent. The rate of people at risk of poverty and social exclusion (AROPE) ([46]) decreased by 0.8 pps to 18.4 % in 2016. The poverty gap (age 18-64) is slightly below the EU average. At 19.9 %, the AROPE rate for the elderly is above the EU average of 17.7 % and is particularly high for women over 65 (25.0 %; EU average 20.1 %). Although the latest information ([47]) shows that monetary poverty will decrease again, Slovenia ranks among the countries where the rate of people over 65 at risk of poverty is significantly higher than in the part of the population aged 18-64 (IMAD, 2016a). Pensions are the principal source of income for elderly people and they are frequently below the poverty line. In 2016, the average net old age pension amounted to EUR 612; however in December 2016 almost half of pensioners received less than EUR 600. The situation faced by many pensioners today is also worrying for future generations (see Section 4.1.4). In this context, the delay in reforming the pension system is a concern.

The government adopted measures to address long-term dependency on cash social assistance. In August 2017, the Ministry of Labour started with social activation programmes which aim to encourage social and labour market inclusion of the 12 500 most-hard-to-employ and vulnerable people. This action will be co-financed from the European Social Fund. The government also adopted the 2017-2018 National Implementation Plan of the National Programme of Social Assistance and Care. Most of its measures are aimed at decreasing the risk of poverty and are related to social activation. In 2018, a number of cuts in child allowances (from June 2012) were abandoned, benefiting 45 000 children (MLFSAEO, 2017a, b, c). The adequacy of the minimum income benefits in Slovenia is comparable to other Member States ([48]) In Slovenia, access to social protection is ensured for all, including the self-employed. However, people with civil law contracts cannot receive sickness benefits in case of illness.

([46]) AROPE: At-risk-of-poverty or social exclusion rate (% of total population). People who are at-risk-of poverty (AROP) and/or suffering from severe material deprivation and/or living in household with zero or very low work intensity.
([47]) Eurostat flash estimates for income reference year 2016.

[48] According to the benchmarking exercise in the area of minimum income schemes conducted within the Social Protection Committee, see the draft Joint Employment Report 2018.

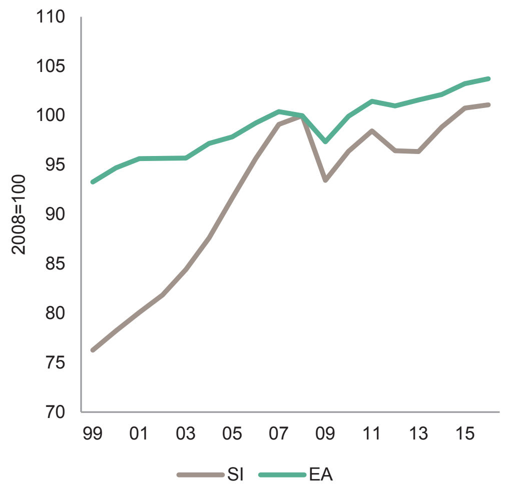
4.4. INVESTMENT

4.4.1. PRODUCTIVITY*

There has been little convergence in labour productivity growth to the euro average in the last decade. Labour productivity was converging fast to the euro area average up until 2009, primarily driven by strong capital accumulation (Graph 1.4). During the crisis, labour productivity growth in Slovenia dropped significantly and also with the recovery its level converged only slowly to the euro area average (Graph 4.4.1). Graph 4.4.2 shows that Slovenia's labour productivity growth over 2008-2016 was lower than in other countries with similar productivity level. This mirrors the nature of the post-crisis recovery, which has been characterised by low capital accumulation only partly offset by total factor productivity gains (Graph 1.4 and Box 4.4.1). Understanding the drivers of productivity in Slovenia is important to ensure that the current high economic growth remains sustainable and underpin convergence with the EU and the euro area income levels. Increasing productivity growth is also relevant in the context of a relatively high wage level in Slovenia, and wage pressures which are expected to emerge in the long-term as the labour market tightens.

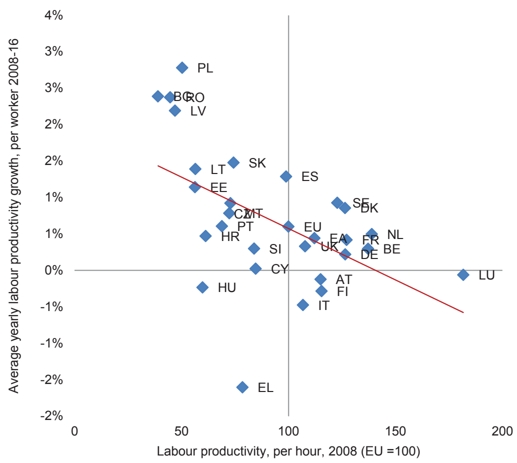
Looking forward, Slovenia's economy shows both strengths and weaknesses that may affect productivity growth in the longer term. The level and composition of investment, the quality of human capital, the ability to innovate and adopt innovation, and the efficient allocation of resource in the economy are the crucial factors affecting productivity trends going forward. With regard to investment, Box 4.4.1 shows that, although recovering, investment remains low and highlights the barriers that may hamper a faster recovery. The analysis of productivity at firm-level shows that good technology transfer and a declining share of resources locked in inefficient firms may favour future productivity growth while certain state-owned enterprises still represent a drag. The analysis of macro-factors, suggests that Slovenia perform well in terms of the quality of the education system, connectivity, business R&D and low barriers to entry and connectivity. On the contrary, the relative low level of skill in the overall adult population and the underdeveloped capital markets may weigh on future productivity trends.

Graph 4.4.1: **Labour productivity in Slovenia and the euro area, 1999-2016**



(1) Labour productivity is per worker
Source: European Commission

Graph 4.4.2: **Labour productivity in 2010 and its average annual growth (2008-2016)**



Source: Eurostat

Productivity analysis at firm level

The gap in labour productivity between the most productive and other firms has remained relatively stable in the last 20 years (Domadenik et al., 2018)**.** This is the case in particular for services, where the gap between the 5 % of most productive firms (frontiers) and other firms (laggards) has not changed. Nevertheless, the gap in the services sector is much larger than in the manufacturing sector (Graphs 4.4.3 and 4.4.4).

Box 4.4.1: **Investment challenges and reforms in Slovenia**

Section1: Macroeconomic perspective

Investment bounced back in 2017 and is expected to grow above 9 % in 2017 and 2018. The recovery is associated with strengthening demand, diminishing uncertainty in the business environment and favourable financing conditions. In addition to the private investment, governmental investment will strengthen again as a result of faster disbursement of EU funds, and as a result of an electoral cycle effect. However, the level of investment is remaining below the historical and EU average (Graph 1.2) and its structure remains weak from the perspective of development such as investment in intangibles assets. Since the crisis, the decline in total investment in Slovenia has been sharper than in the EU on average. The fall in investment spending concerned both private and public investment. Private investment dropped considerably in 2009 and its share in GDP has continued to shrink until 2015. The decline largely reflected a sharp drop in construction activity. In contrast, productive investment in machinery and equipment showed more resilience. Public investment has played a role of a stabiliser, supported to a large degree by EU funds, but dropped in 2016 towards the EA average as EU disbursements slowed.

Section 2: Assessment of barriers to investment and ongoing reforms

Public administration / business environment	Regulatory/administrative burden	CSR
	Public administration	CSR
	Public procurement / public-private partnerships (PPPs)	CSR
	Judicial system	
	Insolvency framework	
	Competition and regulatory framework	
Labour market / education	Employment protection legislation / framework for labour contracts	
	Wages & wage-setting	
	Education	

Financial sector / taxation	Taxation	
	Access to finance	CSR
R&D and innovation	Cooperation between academia, research and business	
	Financing of R&D and innovation	
Sector-specific regulation	Business services / regulated professions	
	Retail	
	Construction	
	Digital economy / telecom	
	Energy	
	Transport	

Legend:

	No barrier to investment identified
CSR	Investment barriers also subject to a country-specific recommendation
	No progress
	Limited progress
	Some progress
	Substantial progress
	Fully addressed

Section 3: Main barriers to investment and priority actions underway

1. Slovenia is making efforts to reduce barriers to private investment. Nearly 70 % of the identified measures to reduce the administrative burden have been realised. However main challenges especially for FDI remain the high labour costs and taxes, the payment indiscipline and the inflexible labour market regulation. Competitiveness and productivity of the Slovenian economy could be further enhanced by removing inefficiencies in the public administration, reducing lengthy administrative procedures and barriers in certain regulated professions.

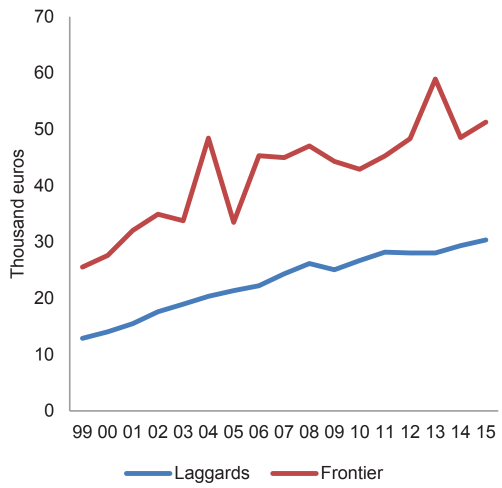
2. One major potential to improve business environment include, among others, to streamline the spatial planning and building permits procedures. Time and costs needed to obtain a building permit is among the highest in the EU. In October 2017, a new legislation was adopted that aims to simplify and accelerate the acquisition of building permits, decrease administrative burden for SMEs and envisages regional spatial plans.

3. Firms' access to finance remains heavily biased towards limited availability of bank credit, while alternative sources of financing are still lacking. Despite some improvement in the the access to venture capital the level is still the lowest across the EU Member States. While fewer businesses perceive access to finance as a barrier to investment than in last year, it represents a long term barrier for growth and innovations to SMEs. Financial support to SMEs has been directed through the Slovenia Enterprise Fund financial instruments, the national development bank SID Bank as well as international funding mechanisms (see Section 4.2.2).

The drag of zombie firms on productivity has declined since its peak in 2011. Herein below, it is defined 'zombie' a firm whose earnings before interest and taxes have not exceed interest expenses over the previous three years. The share of such firms among all firms peaked at 15.2 % in 2011 and returned to pre-crisis levels in 2015. The share of zombie firms is the highest among large firms (with more than 250 employees). In 2011, each fifth large firm was a zombie, but this number had almost halved by 2015.

Large corporates experienced the highest increase in total factor productivity (TFP) in the period 1995-2015. As a result, the gap in TFP between large and other firms has further widened (Graph 4.4.3) ([49]). Large firms' TFP increased by 57 %, followed by medium-sized and small firms which increased by 49 % and 23 % respectively. The better performance of large and medium-sized firms is driven by their export orientation, while the smallest firms lost sales due to the decline in domestic consumption and cost-cutting incentives by larger firms.

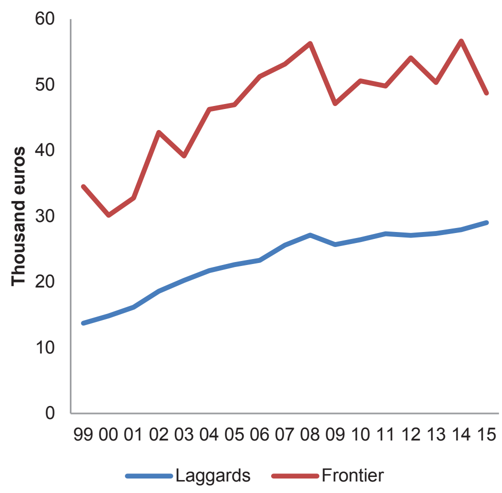
Graph 4.4.3: **Value added per employee, in EUR 1000, Manufacturing sector**



Source: Domadenik, Ivanc and Marinšek (forthcoming)

The more export-oriented a firm is, the higher its TFP. Firms with more than 80 % of exported sales increased their TFP by 51 % whereas firms with a low export share or even none at all (<30 %) experienced a more modest improvement of 17 %. The gap has widened since the 2008 crisis. This finding is consistent with the literature that shows that exporters tend to be larger and more productive.

Graph 4.4.4: **Value added per employee, in EUR 1000, Services**



Source: Domadenik, Ivanc and Marinšek (forthcoming)

Zombie firms saw a declining trend in total factor productivity over 1995-2015. During this period, their TFP decreased by 30 %, dropping well below the TFP of other firms (Graph 4.4.6). Furthermore, during the crisis their performance deteriorated sharply due to negative cash flow as banks reduced financing and tightened credit standards. A spike in TFP in 2013 was primarily due to survivorship bias, since the increased default rate of poorly performing zombie firms (with lower TFP) increased the TFP of several other firms that survived in the following years.

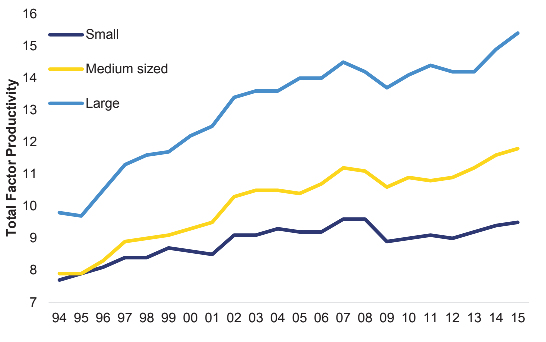
([49]) Total factor productivity is the portion of output not explained by the amount of inputs used in production. As such, its level is determined by efficiency and intensity of utilising the inputs in the production.

Box 4.4.2: **Drivers of productivity growth at firm level**

Investment in R&D has been a consistent driver of productivity before and after the crisis. Dynamic panel data model for total factor productivity were estimated at firm level for the period before the crisis (1994-2008) and after (2009-2015). The result shows that firms with higher R&D spending outperformed other firms before and after the crisis. Interestingly, firm's size does not have an impact on productivity once other characteristics of firms are taken into account.

The relevance of other firm's characteristics for productivity growth depends on the period. Before the crisis, foreign-owned firms performed better than their counterparts while firms that were privatised in the nineties seem to have performed worse than new firms, ceteris paribus. Receiving subsidies or being state-owned did not appear to have significant impact on firm's total factor productivity. After the crisis, firms that were able to invest more than the industry average were more productive while state-owned enterprises and those receiving subsidies were instead less productive than their peers from the same industry and region. The latter results probably reflect the difficulties that state-owned enterprises faced during the crisis and that subsidies were granted primarily to firms in difficulties (full details in Domadenik, Ivanc and Marinšek, forthcoming).

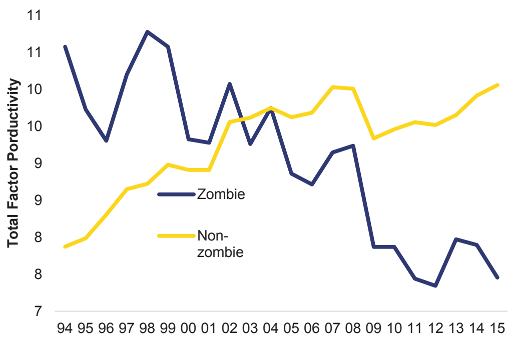
Graph 4.4.5: **Annual TFP for small, medium and large firms**



Source: Domadenik, Ivanc and Marinšek (forthcoming)

Small SOEs were the most successful in increasing their TFP compared to all other small firms, but medium-sized and large SOEs are losing their competitive edge. Specifically, small SOEs had a TFP 3.4 % below that of all other small firms (21 years average), but their TFP increased by 46 % over 1994-2015 compared to 24 % in other small firms. The TFP of medium-sized SOEs was 2.5 % above that of other medium-sized firms (21 years average) but their TFP increased by 40 %, underperforming other medium-sized firms (49 %). Large SOEs had a TFP 17 % above that of other large firms, but their TFP increased by only 36% compared to a 62 % increase among other large firms. Among large firms, SOEs are overachieving only in the ICT sector, and are underperforming in particular in the hotel, energy and transportation sectors.

Graph 4.4.6: **Annual TFP for zombie v.non-zombie firms**

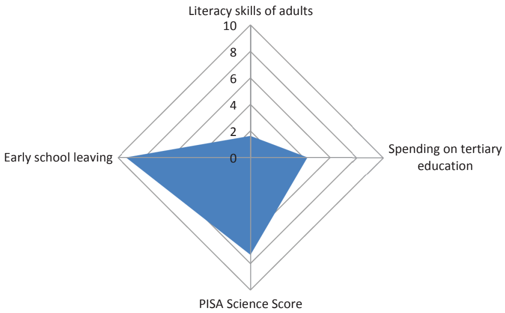


Source: Domadenik, Ivanc and Marinšek (forthcoming)

The framework for productivity

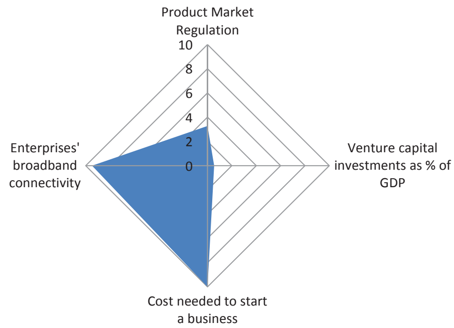
A closer analysis to some relevant policy areas highlights different productivity challenges and strengths of the Slovenian economy. Compiling indicators from Section 4.4.2 and 4.4.3, as well as from Section 4.2.2 it is possible to explore the factors that may affect productivity growth in Slovenia. In education, Slovenian students perform well in the OECD's PISA Science Score and the proportion of early school leavers is among the lowest of the EU. By contrast, expenditure on tertiary education is below the EU average and so are the literacy skills in adults. Whereas the cost to start a business in Slovenia is particularly low and the enterprises' broadband connectivity is among the leaders of the EU, the Product Market Regulation (PMR) and the number of venture capital investments as % of GDP lag well behind the EU average, therefore hindering the business environment in terms of access to market and finance. R&D intensity in private sector is high and large firms are among the leaders in terms of innovations undertaken in the EU.

Graph 4.4.7: **Education and literacy skills**



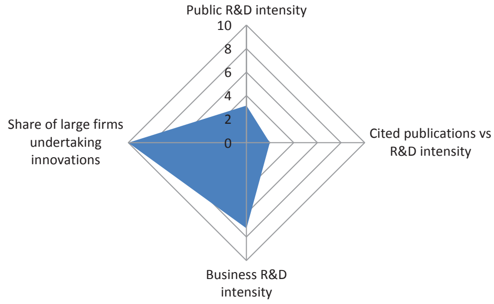
Methodology: Scale 0-10. For every indicator, Slovenia's distance to frontier was calculated as (worst - Slovenia)/(worst – frontier). Value equal 10 (zero) means that Slovenia is the best (worst) performer.
Source: European Commission based on:
Literacy Skills of Adults: OECD (2012, 2015) ; Spending on Tertiary Education: OECD (2017); PISA Science Score: OECD (2017); Early School Leaving: Eurostat (2017).

Graph 4.4.8: **Business environment**



Methodology: See Graph 4.4.7 above.
Source: European Commission based on: Product Market Regulation: OECD (2017); Venture capital investments: OECD (2016); Cost Needed to Start a Business: European Commission (2016); Connectivity: OECD (2017).

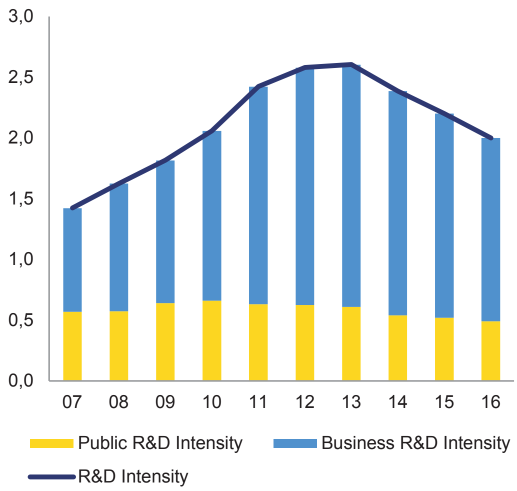
Graph 4.4.9: **Innovation and R&D**



Methodology: See Graph 4.4.7 above
Source: European Commission based on:
Public R&D Intensity: European Commission (2016).;
Cited Publications vs R&D Intensity: European Commission (2016).
Business R&D Intensity: European Commission (2016).
Share of Large Firms Undertaking Innovations: OECD (2015).

4.4.2. RESEARCH AND DEVELOPMENT

Graph 4.4.10: **Business and public R&D intensities in Slovenia (% of GDP), 2007 – 2015**



Source: Eurostat

The share of R&D to GDP in Slovenia is in line with the EU average but has declined since 2013. Investment in R&D as a share of GDP (R&D intensity) amounted to 2 % of GDP in 2016, down from 2.6 % in 2013. The decrease in business R&D intensity (-0.5 pps, over the same period) accounts for most of the total reduction. However, business R&D intensity remains well above the EU average and Slovenia leads in the EU in terms of the share of its large firms undertaking innovations. Slovenia is likely not to meet its national R&D target of 3 % of GDP in 2020 unless its policies change.

Slovenia's R&D system shows weaknesses with regard to coordination, internationalisation and connection with the market. Public governance of the national innovation system is fragmented and frequently changed. Coordination of ministries, agencies and with stakeholders is proving difficult. The implementation of the 2011 Research and Innovation Strategy is lagging behind (Bučar, Jaklič and Gonzalez Verdesoto, 2017).

Difficulties for public research institutions to attract domestic and foreign talent and lack of performance-based funding of research institutions, limit the performance of public research and innovation. The domestic market is small, therefore the demand for the specialised services of public research institutions is low and science-business cooperation remains sporadic and small scale. The number of foreign researchers working in Slovenia's public research system remains low and financial support is not available for top researchers to get their work patented or presented abroad. This limited openness of the Slovenian research system is also a challenge given that in more open research systems scientists have a greater impact (Jonkers and Wagner, 2017). Overall, Slovenia underperforms in terms of cited publications given the R&D intensity levels, which may reveal a problem of efficiency.

A EUR 10 million programme 'Support for Strategic Development and Innovation Partnerships (SRIP)' has been developed to overcome these problems. This represents a new governance model of public R&D activities in the country. The governance of smart specialisation is entrusted to around 500 non-governmental stakeholders, thereby effectively empowering and strengthening the innovation ecosystem of Slovenia.

Several measures are in place to support R&D investment in the business sector. Corporate R&D investments are stimulated by tax incentives and direct grants. Companies are able to deduct all costs related to their internal R&D activities and purchased R&D services from their taxable income. In addition, Slovenia is implementing its smart specialisation strategy (S4), which aims to improve access to finance and reduce administrative burden. It will support 8 500 SMEs. Furthermore, Slovenia's public agency SPIRIT has announced measures to promote R&D, internationalisation and entrepreneurship, aiming to complement its previous measures to back institutional capacity building for entrepreneurship.

4.4.3. BUSINESS ENVIRONMENT*

There was a significant increase in the share of opportunity-driven entrepreneurship in 2016. The share of established entrepreneurs (those who have been in business for more than 42 months) also increased after having declined over the last years, suggesting a favourable shift in business development and support for new micro and small enterprises. The rates of early-stage and total entrepreneurial activity also surpassed the EU average (GEM, 2017; IMAD, 2017a; Rebernik et al., 2016). A still small but vibrant start-up community is being established through the 'Start:up Slovenia' initiative, an open platform that organises start-up weekends, national campaigns and international start-up and entrepreneurship events. However, certain weaknesses remain with regards the conditions for high-growth companies (scale-ups), for transfers of businesses, and the development of alternative source of financing, such as venture capital (see Section 4.2.2).

Administrative burden remains an obstacle to growth and investment in Slovenia. Red tape is considered to be one of the most problematic factors in terms of doing business in Slovenia. The OECD Product market regulation index shows that Slovenia's regulation is more restrictive than OECD average and in peer countries such as Hungary, Slovakia, Czech Republic and Poland. Also, the country ranks only 118th out of 137 countries in the burden of government regulation (World Economic Forum, 2017) ([50]). The World Bank's doing business report 2018 found that administrative process with respect to tax compliance in Slovenia takes considerably longer than the EU average. There is also high uncertainty

([50]) The Global Competitiveness report of 2012-2013 previously ranked Slovenia as 124th of the 144 countries assessed; significant improvements on this still seem yet to be made.

regarding the length of tax procedures (PWC and World Bank, 2018), particularly with respect to tax appeals and potential tax audits. Companies also face continued difficulties in directly transferring their registered offices into and out of Slovenia due to a lack of national rules and procedures. In order to reduce administrative burden, Slovenia presented the 'Single Document'. The implementation of this instrument is progressing, but more than a third of measures still need to be implemented ([51]). One important implemented measure is regulatory impact assessments (including an SME test). These are now compulsory for legislative initiatives (laws) under regular parliamentary procedure, but sometimes failed to appropriately quantify overall economic impacts.

Table 4.4.1: **Construction is expensive**

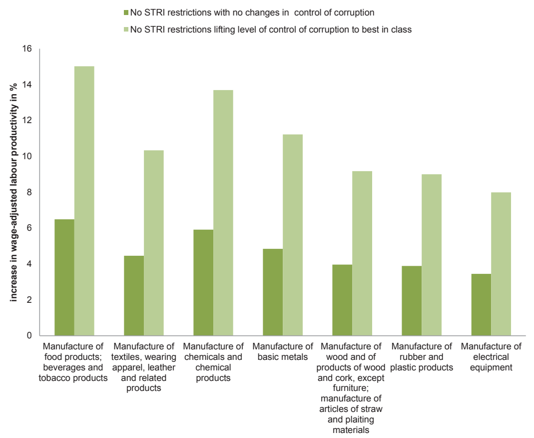
Indicator	Slovenia	OECD high income	Overall best performer
Procedures (number)	14,0	12,5	7.0 (Denmark)
Time (days)	239,5	154,6	27.5 (Korea Rep.)
Cost (% of warehouse value)	2,9	1,6	0.1 (5 economies)
Building quality control index (0-15)	12,0	11,4	15.0 (3 economies)

Source: Doing Business 2017, World Bank

Progress has been made in the areas of spatial planning and construction. These areas have been previously been known for especially cumbersome procedures and high costs (Table 4.4.1). New legislation adopted in October 2017 (entering into force in mid-2018) aims to simplify and accelerate the acquisition of building permits and at the same time decrease legal and environmental risks and administrative burden for SMEs. It also envisages regional spatial plans which will improve the coordination between the municipalities and improve the use of resources. Overall, the adopted laws are expected to fasten the construction application procedure and strengthen the legal certainty of investors, thus providing more incentives to invest. Moreover, the European Regional Development Fund is supporting the development of an e-Spatial planning platform which will simplify administrative procedures.

Reducing regulatory burdens could yield considerable economic benefits. According to the OECD, regulatory reforms already implemented could increase the level of GDP by 1.3 % over a 10-year period. Aligning the regulatory stance with that of the top five performers could increase future gains threefold.

Graph 4.4.11: **Impact on labour productivity in manufacturing of tackling restrictions in the service sector (measured by using the Service Trade Restrictiveness Index (SRRI)**



Source: Curnis and Manjón Antolín, 2017

Reforms to tackle restrictive barriers in certain regulated professions are ongoing. Slovenia has a higher level of restrictiveness compared to the EU weighted average for the professions under review: lawyers, architects, civil engineers, real estate agents and tourist guides (European Commission, 2017g). The business-churn rate for accounting, legal, architectural and real estate activities is lower in Slovenia than the EU average, indicating relatively low dynamism and competition within regulated professions in these sectors. Reforms that aim at tackling restrictions in access to and the exercise of the professions concerned are currently ongoing in Slovenia. In October 2017, the Act on architectural and civil engineering activities was adopted and will reduce the number of regulated professions in these areas. High levels of regulatory restrictions in services hinder competitiveness and the potential productivity growth of downstream manufacturing firms (Van der Marel et al., 2016) (Graph 4.4.11). This is reflected in the overall Product Market Regulation that includes, among others, the state-ownership indicator.

Businesses appear to be avid users of digital technologies but broadband access remains low.

([51]) According to the latest, 9th report, the share of implemented priority measures increased by 11.5 %, representing three new implemented measures.

Slovenia ranks above the EU average in the 2017 Digital Economy and Society Index. Digital skills levels have improved and Slovenians engage in a variety of online activities. However, connectivity remains below the EU average, driven by the low take-up of fast and mobile broadband, possibly caused by network services dominated by the incumbents. The delivery of online public services is progressing thanks to efforts in open data (European Commission, 2017h). The Slovenian government plans to increase both private and public investment into broadband infrastructure, especially in rural areas. The Ministry for Public Administration and the Ministry of Agriculture, Forestry and Food plan to launch,, in the first half of 2018, two tenders for investing in broadband construction in »white areas« without broadband access. All remaining households will be tested for market interest in the second half of the year. Further, Slovenia has created a Digital Coalition to support the development and implementation of its Digital Slovenia 2020 Strategy ([52]). The Digital Coalition comprises stakeholders from trade and industry, science, education, public administration, public sector, local government and civil society.

Competition, professionalization and independent oversight remain issues in public procurement markets in Slovenia. Slovenia has a high share of single bids received in tenders as well as a high percentage of negotiated procedures without a prior call. These indicators measure the level of competition in public procurement. The lack of such competition decreases the overall quality of bids and products delivered, has an adverse impact on innovation in public procurement and leads to lock-in in certain sectors, especially in IT-procurement. In spite of efforts (setting up a helpdesk, offering monthly trainings by the Official Gazette), the Slovenian Court of Auditors has identified many problems in the field of public procurement stemming from insufficient professionalisation (poor planning, unjustified use of less competitive procedures or of exemptions, access to technical specifications before publication of the tender). Corruption risks in public procurement persist and the application of public procurement law in Slovenia is marked by legal uncertainty. In addition, the independence of the review body – National Review Commission - lacks certain safeguards: for instance, its members are not proposed for appointment by an independent body and such a body is not conducting disciplinary proceedings. The number of suppliers who state that corruption has prevented their companies from winning a tender appears to be increasing (44 %, EU average 31 %). Tailor-made specifications and collusive bidding are perceived to be the most widespread corrupt practices in public procurement in Slovenia ([53]). These types of problems are also highlighted in the 2017 Report of the Commission for Prevention of corruption, where the major identified issues include conflict of interest in the evaluation of bids and collusive bidding ([54]). On the positive side, Slovenia is likely to provide support for e-procurement in 2018 by implementing an upgraded electronic European Single Procurement Document.

4.4.4. ENERGY UNION AND TRANSPORT POLICIES

Slovenia performs comparatively well with regard to energy and climate. The energy sector in Slovenia has a higher macroeconomic importance than the EU average and employs about 1% of the workforce. Electricity and gas market concentration is above EU average. In general, the country is on track to reach its 2020 targets with a renewables share of 21.3 % in 2016, and a greenhouse gas emission reduction of 7 % below 2005 levels in 2016 for the non-ETS sectors. In terms of energy efficiency, although continued efforts are needed, primary as well as final energy consumption are already below the indicative national 2020 targets. While energy intensity in industry decreased by an average of 3.3 % between 2005 and 2015, it is still more than a third above the EU average.

Slovenia's economy is more carbon intensive than the EU average. The carbon intensity reduction rate since 1990 has been below the EU average. Regarding competitiveness, real unit energy costs — an indicator for measuring the amount of money spent on energy sources needed

([52]) http://digitalna.si/en/

([53]) Flash Eurobarometer 457 Businesses' attitudes towards corruption in the EU (December 2017).

([54]) https://www.kpk-rs.si/sl/komisija/letna-porocila.

to obtain one unit of value added — have decreased in Slovenia since 2005 contrary to the EU average. Electricity prices for industrial consumers in Slovenia are lower than the EU average, while gas prices for households and SMEs remain higher than in most neighbouring countries and are higher than the EU average for industrial consumers.

The European Regional Development Fund and the Cohesion Fund are helping to improve the performance of the energy sector. Over EUR 300 million will be provided during the current programming period to promote the shift towards a low-carbon economy in all sectors, including energy efficiency in public building and households, renewable sources and smart distribution systems. To achieve the climate change objectives, European Structural and Investment (ESI) funds will contribute around EUR 1 billion, which constitutes a third of the overall ESI funds allocated to Slovenia. To fulfil the conditions attached, Slovenia has established a strategic framework for climate change adaptation.

As part of the transport policy measures to support the transition to sustainable mobility, a free flow tolling system for heavy duty vehicles was introduced. This was also the first major infrastructure project from Slovenia to benefit from the European Fund for Strategic Investment (EFSI), with an EUR 51 million loan for a project totalling EUR 105 million. The new system will allow a more refined application of user and polluter-pay principles. The system still needs to be made interoperable with other electronic tolling systems in the EU, in line with the requirements of the European Electronic Toll Service.

In terms of investments in transport infrastructure, the main focus is on the development of railway infrastructure with priority projects in the TEN-T network, including the construction of the second track on the Divača-Koper railway line. These investments are supported by the Connecting Europe Facility — Transport programme, where the current action portfolio currently ([55]) comprises 32 grant agreements (calls 2014-2016) and 1 blending call in 2017, allocating altogether EUR 318 million to Slovenian beneficiaries. The rail actions are also the ones which had received the highest share of funding from the Connecting Europe Facility by the end of 2016 (84.9 % of actual funding).

([55]) The latest figures for 2017 are not yet available. The amounts include ongoing projects as well as grant agreements under preparation for the calls published in 2014, 2015 and 2016.

4.4.5. JUSTICE SYSTEM AND PUBLIC INTEGRITY

The justice system further reduced backlogs and the average length of proceedings. The 2018 EU Justice Scoreboard (European Commission, 2018b) shows improved efficiency in most areas. In 2017, the total backlog decreased by 13 % compared to 2016. The courts continued to resolve more cases than they received (clearance rate of 103 %), despite resolving fewer cases than in the past (about 74 000 per month compared to nearly 100 000 per month in 2012). The average length of proceeding increased to 16.6 months in labour cases but further decreased to around 11 months before first instance district courts in civil and commercial cases. Despite an improvement, it still takes 12 months until the first hearing in commercial litigious cases. Compared to 2016, even more cases are being resolved through court settlements between parties, reaching 19 % in commercial cases and around 21 % in civil cases

A well-functioning insolvency and restructuring framework is essential for an effective reduction of non-performing loans. In 2017, the influx of personal insolvency and all type of restructuring cases decreased by 32 % and by 46 % compared to 2016, respectively, but liquidation cases (corporate bankruptcies) increased by 13 %. While the duration of all preliminary insolvency proceedings increased (measuring from the receipt of an application until the first decision of the court in the procedure), the duration of proceedings until a decision of the court on merits of insolvency cases mostly decreased (to 350 days in liquidations without distribution of assets, and around 200 days in restructuring proceedings). However, it still takes 1 449 days on average to terminate a liquidation with distribution of assets. Recovery rates mostly remained stable (around 12 % in liquidation, 13 % in personal insolvency and 36 % in simplified compulsory settlement) but further decreased in compulsory settlement (to 19 %).

Criminal justice has some efficiency challenges. More than half of criminal courts resolved fewer cases than they received (overall clearance rate remained at 99 %). This is apparently due to the complexity of cases that remained after the less complex ones were resolved through the now-implemented case management reform. The length of proceedings in first instance criminal cases increased in district courts to 14.1 months, and decreased slightly in local courts (to 8.9 months). The Prosecution Service has recently been reinforced with new prosecutors and its ICT system is being upgraded so it can be used as a management tool. However, concerns about the quality of expertise of prosecutors in certain complex areas with an international character, particularly relating to economic and financial crime, are being addressed through a focused internal analysis and additional specialist training (Moneyval, 2017). Decisions of the State Prosecutorial Council on the responsibility and status of a high-ranking prosecutor have faced criticism, as they could be seen to limit the liability of prosecutors in the performance of their management function.

Additional projects are being implemented to further improve the quality of justice, but the judicial map reform is facing delays. Several projects, including on publishing all first instance judgments and on informing parties about the progress of their case, are being implemented. However, the judicial map reform, currently in consultation with the courts, is facing delays and risks remaining unfinished during Parliament's current term. Timeframes will be further enhanced by judges calculating the optimal length of different types of cases, based on procedural phases.

The draft law on public agencies continues to raise concerns regarding the independence of regulatory agencies. This concerns in particular the independence of the insurance and capital markets supervisory agencies and of the energy agency (Slovenian energy regulatory authority).

Perceptions of corruption are improving, but problematic areas still remain. The 2017 General Eurobarometer on corruption shows increased public intolerance of corruption, higher than the EU average (77 % in 2017, v 70 % on average for the EU). Slovenia has also registered the largest drop in the EU in the percentage of businesses that believe corruption is widespread (22 % compared to 2015). Despite a significant decrease in the percentage of businesses that believe that bribery and connections are the easiest ways to obtain certain public services in Slovenia (70 % compared to 84 % in 2015), 87 % of business respondents still consider that corruption and favouritism hamper business competition in Slovenia (EU average 74 %). In their assessment of how much the different institutions are trusted to deal with corruption, Slovenian respondents to the Eurobarometer expressed greater trust in all institutions compared to 2013, with the notable exception of the healthcare system. Recent disclosures of corruption allegations in the public procurement procedures of stents by public hospitals led the Slovenian parliament to establish an inquiry commission.

Anti-corruption reforms are still pending. Economic crime and corruption is estimated by the authorities to have caused significant financial damage (EUR 2 285.2 million or 81.7 % of all recorded criminal pecuniary damage for the period 2009-2014). In 2017, both GRECO (2017) and Moneyval (2017) recommended that Slovenia increase the funding and staffing of the Commission for the Prevention of Corruption in the areas of reporting personal assets, lobbying and conflict of interest. The Moneyval (2017) report also notes the risks related to the country's geographical position and its exposure to the risk of foreign bribery, given Slovenia's strong economic links to countries with high corruption risks. The planned amendments in the legal framework for the work of the Commission for the Prevention of Corruption have still not been adopted. In the recent years, the Government of the Republic of Slovenia has adopted two integrity action plans (the Integrity Programme 2015-2016 and the recent Programme of the Government of Slovenia for enhancing Integrity and Transparency 2017-2019. The legal amendments to the Integrity and Prevention of Corruption Act were prepared in 2017 and confirmed by the Government in January 2018. The proposal was sent by the Government to the National Assembly for the approval.

ANNEX A: OVERVIEW TABLE

Commitments	**Summary assessment** ([56])**: Some progress**
2017 country-specific recommendations (CSRs)	
CSR 1: *Pursue a substantial fiscal effort in 2018 in line with the requirements of the preventive arm of the Stability and Growth Pact, taking into account the need to strengthen the ongoing recovery and to ensure the sustainability of Slovenia's public finances. Adopt and implement the proposed reform of the healthcare system and adopt the planned reform of long-term care, increasing cost-effectiveness, accessibility and quality care. Fully tap the potential of centralised procurement in the health sector. Adopt the necessary measures to ensure the long-term sustainability and adequacy of the pension system.*	Slovenia has made **limited progress** in addressing CSR 1 (this overall assessment of CSR 1 does not include an assessment of compliance with the Stability and Growth Pact):
– Pursue a substantial fiscal effort in 2018 in line with the requirements of the preventive arm of the Stability and Growth Pact, taking into account the need to strengthen	– The assessment of compliance with the Stability and Growth Pact will be made in Spring.

([56]) The following categories are used to assess progress in implementing the 2017 country-specific recommendations (CSRs):

No progress: The Member State has not credibly announced nor adopted any measures to address the CSR. This category covers a number of typical situations, to be interpreted on a case-by-case basis taking into account country-specific conditions. They include the following:
no legal, administrative, or budgetary measures have been announced
in the national reform programme,
in any other official communication to the national Parliament/relevant parliamentary committees or the European Commission,
publicly (e.g. in a press statement or on the government's website);
no non-legislative acts have been presented by the governing or legislative body;
the Member State has taken initial steps in addressing the CSR, such as commissioning a study or setting up a study group to analyse possible measures to be taken (unless the CSR explicitly asks for orientations or exploratory actions). However, it has not proposed any clearly-specified measure(s) to address the CSR.

Limited progress: The Member State has:
announced certain measures but these address the CSR only to a limited extent; and/or
presented legislative acts in the governing or legislative body but these have not been adopted yet and substantial further, non-legislative work is needed before the CSR is implemented;
presented non-legislative acts, but has not followed these up with the implementation needed to address the CSR.

Some progress: The Member State has adopted measures
that partly address the CSR; and/or
that address the CSR, but a fair amount of work is still needed to address the CSR fully as only a few of the measures have been implemented. For instance, a measure or measures have been adopted by the national Parliament or by ministerial decision, but no implementing decisions are in place.

Substantial progress: The Member State has adopted measures that go a long way towards addressing the CSR and most of them have been implemented.

Full implementation: The Member State has implemented all measures needed to address the CSR appropriately.

the ongoing recovery and to ensure the sustainability of Slovenia's public finances.	
– Adopt and implement the proposed reform of the healthcare system	– **Limited progress.** Key legislation like the draft Health Care and Health Insurance act has not been adopted yet. Other health reform milestones have been reached. These include amendments to the Health Services Act, the Medical Practitioners Act, the Patient Rights Act, an Act on intervention measures to ensure the financial stability of public health care institutions.
– and adopt the planned reform of long-term care, increasing cost-effectiveness, accessibility and quality care.	– **Limited progress.** A draft law on long term care has been published in October 2017, and it is under the public consultation. The final draft has yet not been submitted to the National Assembly.
– Fully tap the potential of centralised procurement in the health sector.	– **Some progress.** In 2017, centralised procurement was organised for nine different items. The total amounts were however low compared to other countries and the number of officials in charge of centralised procurement remains limited for such demanding activity. A database of recent procurement result has been created. Hospitals are required to use the lowest price in this database as the maximum price for any new supply contract for the same item.
– Adopt the necessary measures to ensure the long-term sustainability and adequacy of the pension system.	– **Limited progress.** The document called 'Starting points for the modernisation of the Pension and Disability Insurance System in the Republic of Slovenia' was prepared and unanimously adopted by the Economic and Social Council in July 2017. It outlines various measures to improve the adequacy and sustainability of the pension system. However, it is still unclear how and by when the proposed measures would be implemented. Effective since October 2017, the Pension and Disability Insurance Act, increases the minimum old-age and disability pension for those fulfilling full retirement conditions.
CSR 2: *Intensify efforts to increase the employability of low-skilled and older workers, particularly through targeted lifelong learning and activation measures.*	Slovenia has made **some progress** in addressing CSR 2:
– Intensify efforts to increase the employability of low-skilled and	– **Some progress**. In 2017 two measures (a subsidy scheme and support activities to help companies for

older workers, particularly through targeted lifelong learning and activation measures.	active ageing of the workforce) aimed at older workers and an in-work incentive scheme for the low-skilled were introduced. In December 2017 the Intervention Act was adopted by the parliament. The Act extends measures of promoting employment of persons aged over 55 years where an employer hiring older worker is exempted from the payment of social security contributions for up to 24 months. The measure is in place from 1.1.2016 and will now be extended until 31.12.2019. Improvements on life-long learning should be made as improving skills through adult learning could increase employment of vulnerable groups.
CSR 3: *Improve the financing conditions, including by facilitating a durable resolution of non-performing loans and access to alternative sources of financing. Ensure the full implementation of the bank asset management company strategy. Reduce the administrative burden on business deriving from rules on spatial planning and construction permits and ensure good governance of state-owned enterprises.*	Slovenia has made **some progress** in addressing CSR 3:
– Improve the financing conditions, including by facilitating a durable resolution of non-performing loans	– **Substantial progress.** Non-performing loans (NPLs) have continued their downward trend, reflecting the improving asset quality in the Slovenian financial system. Declining NPLs are reported both by Bank of Slovenia and the ECB. Banks are following their NPLs target plans which are monitored by the Bank of Slovenia and the Single Supervisory Mechanism (SSM). Backed by the technical assistance of the European Commission and in cooperation with the World Bank, the Bank of Slovenia issued in March 2017 the Handbook for Effective Management and Workout of SME NPLs. The handbook includes a complete toolkit to prevent, identify and manage NPLs in this segment.
– and access to alternative sources of financing	– **Some progress**. Financial support has been directed to SMEs through the Slovene Enterprise Fund (SEF) financial instruments (both debt- and also equity-type of instruments) as well as the national development bank SID Bank. In autumn 2017 the SEF invested 8 million euros into a new cross-border equity initiative called the Central Europe Fund of Funds (CEFoF), aimed at boosting equity investments in the region's SMEs and small mid-caps. In mid-November 2017 EIF and the national promotional bank SID Bank launched the first Slovenian capital growth investment programme. EUR 100 million, backed by the European Fund for Strategic

	Investments (EFSI) guarantee, will be made available for innovative and fast-growing SMEs
– Ensure the full implementation of the bank asset management company strategy.	– **Substantial progress**. The Bank Asset Management Company is progressing to fulfil its mandate. The business strategy adopted in December 2016 aims to ensure the highest possible return to the state and to fully redeem bonds backed by state guarantees by 2022. From its inception in 2013 until June 2017, BAMC generated cumulative cash-flows of nearly EUR 1.1 billion, representing nearly 60 % of the aggregate fair value of the loans transferred. BAMC is expected to return to profitability in 2017, mainly due to lower financing costs. Going forward, a key risk is maintaining the momentum of cash-flow generation from sales, as the remaining assets in BAMC's portfolio may be more difficult to sell.
– Reduce the administrative burden on business deriving from rules on spatial planning and construction permits	– **Some progress**. A new legislation, adopted in October 2017, aims to simplify and accelerate the acquisition of building permits and at the same time, to decrease legal and environmental risks and administrative burden for SMEs. It also envisages regional spatial plans which will improve the coordination between the municipalities and improve the use of resources.
– and ensure good governance of state-owned enterprises.	– **Some progress**. The new comprehensive framework for the management of state-owned enterprises was implemented for the first time in 2016. Performance of SOEs in 2016 reached the targets set in the management acts, since an almost 6 % return-on-equity was achieved on an aggregated basis. Dividend pay-outs in 2017 for companies managed by the SSH, acting either as an owner or on behalf of the State, have been higher by 38 % compared with 2016, and hit a record high almost doubling the dividends received in 2011, i.e. when Slovenia had first applied a centralised system for the management of capital assets.

Europe 2020 (national targets and progress)	
Employment rate (%): 75 %	The employment rate for 20-64 years old workers increased by 1 pp. to 70.1 % in 2016 remaining slightly below the EU average (71.0 %).
Early school leaving target: 5 %	In 2016 Slovenia retained the early school leaving rate under the national target by 0.1 pps. With early school leaving well below the Europe 2020 target of 10 %, Slovenia is placed among the

	leading EU Member States.
Tertiary education target: 40 %	The tertiary education attainment continuously improved. After exceeding the 2020 target in 2013, in 2016 there were 44.2 % Slovenian young adults (30-34 years old) with a tertiary degree.
Target for reducing the population at risk of poverty or social exclusion: 40 000 (compared to 360 000 in 2008)	In 2016 the number of people at risk of poverty and social exclusion fell for the second consecutive year. 371 000 people were still at risk of poverty or social exclusion.
2020 Renewable energy target: 25 %	In 2016, the share of renewable energy was 21.3 %, (provisional data) which is slightly above the indicative trajectory and therefore puts the country on track to reach the target.
Energy efficiency target. Slovenia's 2020 energy efficiency target is 7.3 million tonnes of oil equivalent (Mtoe) expressed in primary energy consumption (5.1 Mtoe expressed in final energy consumption.)	Slovenia's energy consumption reached 6.7 Mtoe of primary energy consumption and 4.9 Mtoe of final energy consumption in 2016 (preliminary data). These figures are lower than the Slovenia's indicative national 2020 target, but it is still desirable to continue the effort to keep these levels until 2020.
Greenhouse gas (GHG) emissions target 2020: +4%, compared to 2005 emissions in the sectors not covered by the Emissions Trading Scheme (ETS).	2020 target: +4 % According to the latest national projections and taking into account existing measures, non-Emissions Trading System (non-ETS) emissions will decrease by 9 % between 2005 and 2020. The target is consequently expected to be met with a margin of 13 pps. Non-ETS 2015 target: +5 % vs 2005. Based on proxy data, the non-ETS greenhouse gas emissions between 2005 and 2015 decreased by 9 %; which means 14 pps below the 2015 target set by the Effort Sharing Decision.
R&D target: 3 % of GDP	R&D intensity in Slovenia is in declining path since 2013, reaching its lowest level (2.0 %) in 2016. Both the public and private expenditure has fallen.

	The declining R&D intensity shows a clear risk of Slovenia's not meeting its national R&D target of 3 % of GDP in 2020.

ANNEX B: MACROECONOMIC IMBALANCE PROCEDURE SCOREBOARD

Table B.1: **The MIP scoreboard for Slovenia (AMR 2018)**

			Thresholds	2011	2012	2013	2014	2015	2016
External imbalances and competitiveness	**Current account balance, % of GDP**	3 year average	**-4%/6%**	-0.2	0.7	2.2	4.1	4.9	5.1
	Net international investment position	% of GDP	**-35%**	-45.2	-50.1	-47.2	-45.8	-39.8	-36.9
	Real effective exchange rate - 42 trading partners, HICP deflator	3 year % change	**±5% (EA) ±11% (Non-EA)**	-1.1	-4.5	-0.6	1.2	0.4	-0.5
	Export market share - % of world exports	5 year % change	**-6%**	-5.7	-20.6	-18.0	-12.5	-4.2	4.0
	Nominal unit labour cost index (2010=100)	3 year % change	**9% (EA) 12% (Non-EA)**	8.3	0.6	0.5	0.0	-0.4	0.7
Internal imbalances	**House price index (2015=100), deflated**	1 year % change	**6%**	0.9	-8.5	-7.2	-6.5	1.4	3.6
	Private sector credit flow, consolidated	% of GDP	**14%**	0.4	-2.9	-4.0	-4.7	-5.0	-0.8
	Private sector debt, consolidated	% of GDP	**133%**	113.0	112.3	107.2	97.4	86.9	80.5
	General government gross debt	% of GDP	**60%**	46.6	53.8	70.4	80.3	82.6	78.5
	Unemployment rate	3 year average	**10%**	7.1	8.1	9.1	9.6	9.6	8.9
	Total financial sector liabilities, non-consolidated	1 year % change	**16.5%**	-1.2	-0.7	-10.3	-0.2	-3.7	3.2
Employment indicators	**Activity rate - % of total population aged 15-64**	3 year change in pp	**-0.2 pp**	-1.5	-1.4	-1.0	0.6	1.4	1.1
	Long-term unemployment rate - % of active population aged 15-74	3 year change in pp	**0.5 pp**	1.7	2.5	2.0	1.7	0.4	-0.9
	Youth unemployment rate - % of active population aged 15-24	3 year change in pp	**2 pp**	5.3	7.0	6.9	4.5	-4.3	-6.4

(1)) This table provides data as published under the Alert Mechanism Report 2018, which reports data as of 24 Oct 2017. Please note that figures reported in this table may therefore differ from more recent data elsewhere in this document.
(2) House price index: e = NSI estimates.
Source: European Commission 2017, Statistical Annex to the Alert Mechanism Report 2018, SWD(2017) 661.)

ANNEX C: STANDARD TABLES

Table C.1: **Financial market indicators**

	2012	2013	2014	2015	2016	2017
Total assets of the banking sector (% of GDP)(1)	140,8	127,8	115,8	107,1	99,4	93,3
Share of assets of the five largest banks (% of total assets)	58,4	57,1	55,6	59,2	61,0	-
Foreign ownership of banking system (% of total assets)(2)	29,5	31,3	33,6	34,0	46,1	45,6
Financial soundness indicators:2)						
- non-performing loans (% of total loans)(3)	19,2	17,1	16,6	13,3	9,6	8,7
- capital adequacy ratio (%)	11,4	13,7	17,9	18,6	19,1	18,7
- return on equity (%)(4)	-19,4	-90,2	-2,5	3,5	7,8	5,1
Bank loans to the private sector (year-on-year % change)(1)	-4,1	-9,5	-9,1	-4,2	2,8	9,1
Lending for house purchase (year-on-year % change)(1)	1,8	1,3	0,5	1,8	4,2	5,6
Loan to deposit ratio(1)	143,8	119,0	95,9	86,2	78,8	78,9
Central Bank liquidity as % of liabilities	-	-	3,3	2,8	2,3	3,6
Private debt (% of GDP)	112,3	107,2	97,4	86,9	80,5	-
Gross external debt (% of GDP)(2) - public	30,7	42,7	62,4	64,1	56,8	54,4
- private	43,9	44,0	40,6	37,1	35,3	33,9
Long-term interest rate spread versus Bund (basis points)*	431,3	424,2	210,7	120,9	105,9	66,5
Credit default swap spreads for sovereign securities (5-year)*	330,1	273,2	138,5	107,8	95,0	72,5

(1) Latest data Q3 2017. Includes not only banks but all monetary financial institutions excluding central banks
(2) Latest data Q2 2017.
(3) As per ECB definition of gross non-performing debt instruments
(4) Quarterly values are not annualised
* Measured in basis points.
Source: European Commission (long-term interest rates); World Bank (gross external debt); Eurostat (private debt); ECB (all other indicators).

Table C.2: **Headline Social Scoreboard indicators**

	2012	2013	2014	2015	2016	2017 [5]
Equal opportunities and access to the labour market						
Early leavers from education and training (% of population aged 18-24)	4.4	3.9	4.4	5.0	4.9	:
Gender employment gap (pps)	7.2	8.2	8.0	8.6	6.6	7.3
Income inequality, measured as quintile share ratio (S80/S20)	3.4	3.6	3.7	3.6	3.6	:
At-risk-of-poverty or social exclusion rate[1] (AROPE)	19.6	20.4	20.4	19.2	18.4	:
Young people neither in employment nor in education and training (% of population aged 15-24)	9.3	9.2	9.4	9.5	8.0	:
Dynamic labour markets and fair working conditions†						
Employment rate (20-64 years)	68.3	67.2	67.7	69.1	70.1	73.0
Unemployment rate[2] (15-74 years)	8.9	10.1	9.7	9.0	8.0	6.8
Gross disposable income of households in real terms per capita[3] (Index 2008=100)	:	:	92.9	94.8	99.0	:
Public support / Social protection and inclusion						
Impact of social transfers (excluding pensions) on poverty reduction[4]	46.4	42.7	42.2	42.3	42.8	:
Children aged less than 3 years in formal childcare	38.0	39.0	37.4	37.4	39.6	:
Self-reported unmet need for medical care	0.1	0.0	0.2	0.2	0.4	:
Individuals who have basic or above basic overall digital skills (% of population aged 16-74)	:	:	:	51.0	53.0	54.0

† The Social Scoreboard includes 14 headline indicators, of which 12 are currently used to compare Member States performance. The indicators "participants in active labour market policies per 100 persons wanting to work" and "compensation of employees per hour worked (in EUR)" are not used due to technical concerns by Member States. Possible alternatives will be discussed in the relevant Committees.
(1) People at risk of poverty or social exclusion (AROPE): individuals who are at risk of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in households with zero or very low work intensity (LWI).
(2) Unemployed persons are all those who were not employed but had actively sought work and were ready to begin working immediately or within two weeks.
(3) Gross disposable household income is defined in unadjusted terms, according to the draft Joint Employment Report 2018.
(4) Reduction in percentage of the risk of poverty rate, due to social transfers (calculated comparing at-risk-of poverty rates before social transfers with those after transfers; pensions are not considered as social transfers in the calculation).
(5) Average of first three quarters of 2017 for the employment rate and gender employment gap.
Source: Eurostat

Table C.3: **Labour market and education indicators**

Labour market indicators	**2012**	**2013**	**2014**	**2015**	**2016**	**2017 [5]**
Activity rate (15-64)	70.4	70.5	70.9	71.8	71.6	:
Employment in current job by duration						
From 0 to 11 months	11.1	10.7	8.8	12.4	10.9	:
From 12 to 23 months	7.1	7.0	7.1	7.8	8.3	:
From 24 to 59 months	14.8	13.1	14.2	13.7	14.2	:
60 months or over	67.0	69.2	68.3	66.2	66.5	:
Employment growth* (% change from previous year)	-0.9	-1.1	0.4	1.2	1.9	2.8
Employment rate of women (% of female population aged 20-64)	64.6	63.0	63.6	64.7	66.7	69.3
Employment rate of men (% of male population aged 20-64)	71.8	71.2	71.6	73.3	73.3	76.5
Employment rate of older workers* (% of population aged 55-64)	32.9	33.5	35.4	36.6	38.5	42.3
Part-time employment* (% of total employment, aged 15-64)	9.0	9.3	10.0	10.1	9.3	10.4
Fixed-term employment* (% of employees with a fixed term contract, aged 15-64)	17.0	16.3	16.5	17.8	16.9	17.9
Transition rate from temporary to permanent employment (3-year average)	35.4	37.1	41.0	41.2	:	:
Long-term unemployment rate[1] (% of labour force)	4.3	5.2	5.3	4.7	4.3	3.3
Youth unemployment rate (% active population aged 15-24)	20.6	21.6	20.2	16.3	15.2	11.7
Gender gap in part-time employment	5.9	6.1	6.9	6.7	7.1	7.3
Gender pay gap[2] (in undadjusted form)	4.5	6.3	7.0	8.1	:	:
Education and training indicators	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Adult participation in learning (% of people aged 25-64 participating in education and training)	13.8	12.5	12.1	11.9	11.6	:
Underachievement in education[3]	20.1	:	:	16.1	:	:
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	39.2	40.1	41.0	43.4	44.2	:
Variation in performance explained by students' socio-economic status[4]	15.6	:	:	13.5	:	:

* Non-scoreboard indicator
(1) Long-term unemployed are people who have been unemployed for at least 12 months.
(2) Difference between the average gross hourly earnings of male paid employees and of female paid employees as a percentage of average gross hourly earnings of male paid employees. It is defined as "unadjusted", as it does not correct for the distribution of individual characteristics (and thus gives an overall picture of gender inequalities in terms of pay). All employees working in firms with ten or more employees, without restrictions for age and hours worked, are included.
(3) PISA (OECD) results for low achievement in mathematics for 15 year-olds.
(4) Impact of socio-economic and cultural status on PISA (OECD) scores Values for 2012 and 2015 refer respectively to mathematics and science..
(5) Average of first three quarters of 2017, unless for the youth unemployment rate (annual figure).
Source: Eurostat, OECD

Table C.4: **Social inclusion and health indicators**

	2012	2013	2014	2015	2016	2017
Expenditure on social protection benefits* (% of GDP)						
Sickness/healthcare	7.9	7.5	7.2	7.6	:	:
Disability	1.6	1.5	1.4	1.3	:	:
Old age and survivors	11.5	11.9	11.5	11.3	:	:
Family/children	2.1	1.9	1.8	1.8	:	:
Unemployment	0.7	0.8	0.7	0.6	:	:
Housing	0.0	0.0	0.0	0.0	:	:
Social exclusion n.e.c.	0.6	0.6	0.7	0.7	:	:
Total	24.4	24.3	23.5	23.4	:	:
of which: means-tested benefits	1.9	1.8	1.8	1.8	:	:
General government expenditure by function (% of GDP, COFOG)						
Social protection	18.5	18.6	17.8	17.3	16.7	:
Health	7.1	6.8	6.5	6.7	6.7	:
Education	6.4	6.5	6.0	5.5	5.6	:
Out-of-pocket expenditure on healthcare (% of total health expenditure)	:	:	13.0	:	:	:
Children at risk of poverty or social exclusion (% of people aged 0-17)*	16.4	17.5	17.7	16.6	14.9	:
At-risk-of-poverty rate[1] (% of total population)	13.5	14.5	14.5	14.3	13.9	:
In-work at-risk-of-poverty rate (% of persons employed)	6.5	7.1	6.4	6.7	6.1	:
Severe material deprivation rate[2] (% of total population)	6.6	6.7	6.6	5.8	5.4	:
Severe housing deprivation rate[3], by tenure status						
Owner, with mortgage or loan	5.6	4.5	4.7	3.5	3.3	:
Tenant, rent at market price	30.5	18.9	18.8	18.9	12.2	:
Proportion of people living in low work intensity households[4] (% of people aged 0-59)	7.5	8.0	8.7	7.4	7.4	:
Poverty thresholds, expressed in national currency at constant prices*	6320	6010	5925	6113	6157	:
Healthy life years (at the age of 65)						
Females	6.9	7.6	8.6	7.6	:	:
Males	7.3	7.2	7.8	8.2	:	:
Aggregate replacement ratio for pensions[5] (at the age of 65)	0.5	0.5	0.5	0.5	0.5	:
Connectivity dimension of the Digital Economy and Society Inedex (DESI)[6]	:	:	47.1	51.8	55.0	57.6
GINI coefficient before taxes and transfers*	46.1	47.2	47.0	46.7	46.1	:
GINI coefficient after taxes and transfers*	23.8	24.4	24.9	24.5	24.3	:

* Non-scoreboard indicator
(1) At-risk-of-poverty rate (AROP): proportion of people with an equivalised disposable income below 60 % of the national equivalised median income.
(2) Proportion of people who experience at least four of the following forms of deprivation: not being able to afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour TV, or ix) have a telephone.
(3) Percentage of total population living in overcrowded dwellings and exhibiting housing deprivation.
(4) People living in households with very low work intensity: proportion of people aged 0-59 living in households where the adults (excluding dependent children) worked less than 20 % of their total work-time potential in the previous 12 months.
(5) Ratio of the median individual gross pensions of people aged 65-74 relative to the median individual gross earnings of people aged 50-59.
(6) Fixed broadband take up (33%), mobile broadband take up (22%), speed (33%) and affordability (11%), from the Digital Scoreboard .
Source: Eurostat, OECD

Table C.5: **Product market performance and policy indicators**

Performance Indicators	2010	2011	2012	2013	2014	2015	2016
Labour productivity (real, per person employed, year-on-year % change)							
Labour productivity in Industry	9,09	3,69	-0,36	0,46	3,51	-0,56	3,83
Labour productivity in Construction	-11,68	2,42	0,88	-3,07	9,25	-2,89	-1,67
Labour productivity in Market Services	2,88	3,57	-1,08	-0,97	2,32	2,01	2,41
Unit labour costs (ULC) (whole economy, year-on-year % change)							
ULC in Industry	-4,48	-0,05	3,35	0,24	-1,01	1,50	0,89
ULC in Construction	13,51	-3,07	-1,85	2,74	-6,37	4,98	5,54
ULC in Market Services	-0,71	-1,10	0,08	-1,66	-1,06	-0,61	0,57
Business Environment	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Time needed to enforce contracts[1] (days)	1290.0	1290.0	1290.0	1270.0	1270.0	1160.0	1160.0
Time needed to start a business[1] (days)	7,5	7,5	7,5	7,5	7,5	7,5	7,0
Outcome of applications by SMEs for bank loans[2]	na	0,60	na	0,38	1,08	0,41	0,67
Research and innovation	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
R&D intensity	2,06	2,42	2,57	2,58	2,37	2,20	2,00
General government expenditure on education as % of GDP	6,50	6,40	6,50	6,50	6,00	5,60	na
Persons with tertiary education and/or employed in science and technology as % of total employment	40	41	42	43	43	44	44
Population having completed tertiary education[3]	20	22	23	24	25	27	27
Young people with upper secondary level education[4]	89	90	90	92	90	91	91
Trade balance of high technology products as % of GDP	-1,44	-1,02	-0,83	-0,60	-0,83	-0,60	na
Product and service markets and competition					**2003**	**2008**	**2013**
OECD product market regulation (PMR)[5], overall					na	1,89	1,70
OECD PMR5, retail					na	0,90	0,63
OECD PMR5, professional services					na	na	2,56
OECD PMR5, network industries[6]					4,84	3,41	2,90

(1) The methodologies, including the assumptions, for this indicator are shown in detail here: http://www.doingbusiness.org/methodology.
(2) Average of the answer to question Q7B_a. "[Bank loan]: If you applied and tried to negotiate for this type of financing over the past six months, what was the outcome?". Answers were codified as follows: zero if received everything, one if received most of it, two if only received a limited part of it, three if refused or rejected and treated as missing values if the application is still pending or don't know.
(3) Percentage population aged 15-64 having completed tertiary education.
(4) Percentage population aged 20-24 having attained at least upper secondary education.
(5) Index: 0 = not regulated; 6 = most regulated. The methodologies of the OECD product market regulation indicators are shown in detail here: http://www.oecd.org/competition/reform/indicatorsofproductmarketregulationhomepage.htm
(6) Aggregate OECD indicators of regulation in energy, transport and communications (ETCR).
Source: European Commission; World Bank — Doing Business (for enforcing contracts and time to start a business); OECD (for the product market regulation indicators); SAFE (for outcome of SMEs' applications for bank loans).

Table C.6: **Green growth**

Green growth performance		2011	2012	2013	2014	2015	2016
Macroeconomic							
Energy intensity	kgoe / €	0.20	0.20	0.20	0.18	0.18	0.18
Carbon intensity	kg / €	0.54	0.54	0.52	0.46	0.46	-
Resource intensity (reciprocal of resource productivity)	kg / €	0.81	0.72	0.72	0.75	0.74	0.69
Waste intensity	kg / €	-	0.13	-	0.13	-	-
Energy balance of trade	% GDP	-6.2	-6.7	-5.5	-4.1	-3.1	-2.1
Weighting of energy in HICP	%	14.31	14.50	14.38	14.72	14.23	12.99
Difference between energy price change and inflation	%	7.8	2.9	0.6	-0.9	-2.9	-2.6
Real unit of energy cost	% of value added	9.7	9.7	9.6	9.1	-	-
Ratio of environmental taxes to labour taxes	ratio	0.18	0.20	0.21	0.21	0.21	-
Environmental taxes	% GDP	3.5	3.9	3.9	3.9	3.9	3.9
Sectoral							
Industry energy intensity	kgoe / €	0.16	0.16	0.16	0.15	0.15	0.15
Real unit energy cost for manufacturing industry excl. refining	% of value added	16.7	16.1	15.1	14.1	-	-
Share of energy-intensive industries in the economy	% GDP	13.89	13.96	14.36	14.50	14.08	14.16
Electricity prices for medium-sized industrial users	€ / kWh	0.10	0.09	0.10	0.09	0.08	0.08
Gas prices for medium-sized industrial users	€ / kWh	0.05	0.06	0.05	0.04	0.04	0.03
Public R&D for energy	% GDP	0.02	0.01	0.01	0.01	0.01	0.01
Public R&D for environmental protection	% GDP	0.02	0.02	0.01	0.01	0.03	0.03
Municipal waste recycling rate	%	35.6	41.9	34.8	36.0	54.1	-
Share of GHG emissions covered by ETS*	%	40.5	39.7	40.4	36.9	36.4	37.0
Transport energy intensity	kgoe / €	1.08	1.12	1.08	1.04	0.98	0.96
Transport carbon intensity	kg / €	3.23	3.37	3.20	3.07	2.91	-
Security of energy supply							
Energy import dependency	%	47.7	51.2	46.9	44.5	48.8	48.4
Aggregated supplier concentration index	HHI	22.2	33.3	26.8	26.6	24.2	-

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2010 prices)
Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)
Carbon intensity: greenhouse gas emissions (in kg CO2 equivalents) divided by GDP (in EUR)
Resource intensity: domestic material consumption (in kg) divided by GDP (in EUR)
Waste intensity: waste (in kg) divided by GDP (in EUR)
Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP
Weighting of energy in HICP: the proportion of 'energy' items in the consumption basket used for the construction of the HICP
Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual % change)
Real unit energy cost: real energy costs as % of total value added for the economy
Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2010 EUR)
Real unit energy costs for manufacturing industry excluding refining : real costs as % of value added for manufacturing sectors
Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP
Electricity and gas prices for medium-sized industrial users: consumption band 500–20 00MWh and 10 000–100 000 GJ; figures excl. VAT.
Recycling rate of municipal waste: ratio of recycled and composted municipal waste to total municipal waste
Public R&D for energy or for the environment: government spending on R&D for these categories as % of GDP
Proportion of GHG emissions covered by EU emissions trading system (ETS) (excluding aviation): based on GHG emissions (excl. land use, land use change and forestry) as reported by Member States to the European Environment Agency.
Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transport industry gross value added (in 2010 EUR)
Transport carbon intensity: GHG emissions in transport activity divided by gross value added of the transport sector
Energy import dependency: net energy imports divided by gross inland energy consumption incl. consumption of international bunker fuels
Aggregated supplier concentration index: covers oil, gas and coal. Smaller values indicate larger diversification and hence lower risk.
Diversification of the energy mix: Herfindahl index covering natural gas, total petrol products, nuclear heat, renewable energies and solid fuels
* European Commission and European Environment Agency
Source: European Commission and European Environment Agency (Share of GHG emissions covered by ETS); European Commission (Environmental taxes over labour taxes and GDP); Eurostat (all other indicators)

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