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Recommendation for a

COUNCIL RECOMMENDATION

on the 2017 National Reform Programme of Slovenia

and delivering a Council opinion on the 2017 Stability Programme of Slovenia

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THE COUNCIL OF THE EUROPEAN UNION,

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

Having regard to Council Regulation (EC) No 1466/97 of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies¹, and in particular Article 5(2) thereof,

Having regard to Regulation (EU) No 1176/2011 of the European Parliament and of the Council of 16 November 2011 on the prevention and correction of macroeconomic imbalances², and in particular Article 6(1) thereof,

Having regard to the recommendation of the European Commission³,

Having regard to the resolutions of the European Parliament⁴,

Having regard to the conclusions of the European Council,

Having regard to the opinion of the Employment Committee,

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

Having regard to the opinion of the Social Protection Committee,

Having regard to the opinion of the Economic Policy Committee,

Whereas:

- (1) On 16 November 2016, the Commission adopted the Annual Growth Survey⁵, marking the start of the 2017 European Semester of economic policy coordination. The priorities of the Annual Growth Survey were endorsed by the European Council on 9-10 March 2017. On 16 November 2016, on the basis of Regulation (EU) No 1176/2011, the Commission adopted the Alert Mechanism Report⁶, in which it identified Slovenia as one of the Member States for which an in-depth review would be carried out. On the same day, the Commission also adopted a recommendation for a Council Recommendation on the economic policy of the euro area. That Recommendation was endorsed by the European Council on 9-10 March 2017 and adopted by the Council on 21 March⁷.

¹ OJ L 209, 2.8.1997, p. 1.

² OJ L 306, 23.11.2011, p. 25.

³ COM(2017) 523 final.

⁴ P8_TA(2017)0038, P8_TA(2017)0039, and P8_TA(2017)0040.

⁵ COM(2016) 725 final.

⁶ COM(2016) 728 final.

⁷ 2017/C92/01

- (2) As a country whose currency is the euro and in view of the close interlinkages between the economies in the economic and monetary union, Slovenia should ensure the full and timely implementation of the Recommendation for the euro area which is reflected in recommendations 1 to 3 below.
- (3) The 2017 country report for Slovenia⁸ was published on 22 February 2017. It assessed Slovenia's progress in addressing the country-specific recommendations adopted by the Council on 12 July 2016, the follow-up given to the recommendations adopted in previous years and Slovenia's progress towards its national Europe 2020 targets. It also included an in-depth review under Article 5 of Regulation (EU) No 1176/2011, the results of which were also published on 22 February 2017.⁹ The Commission's analysis leads it to conclude that Slovenia is experiencing macroeconomic imbalances. In particular, weaknesses in the banking sector, corporate debt, and fiscal risks constitute vulnerabilities. Stock imbalances are gradually unwinding in light of resumed growth. The corporate sector has undergone a substantial debt reduction, and private investment, including in the form of foreign direct investment, has resumed, although stocks from inbound foreign direct investment remain low compared to regional peers. Public debt has peaked in 2015, and a downward adjustment is expected in the coming years. Progress on the front of banking sector restructuring has coincided with a rapidly falling share of non-performing loans, which is expected to continue to decline. Relevant measures have been taken by the government to consolidate and restructure the banking sector, and to improve the governance of State-owned enterprises. However, further policy action is needed to address corporate debt and remaining weaknesses in the financial sector, to ensure the long-term sustainability of public finances, and improve the business environment.
- (4) On 28 April 2017, Slovenia submitted its 2017 Stability Programme and on 3 May 2017 Slovenia submitted its 2017 National Reform Programme. To take account of their interlinkages, the two programmes have been assessed at the same time.
- (5) The relevant country-specific recommendations have been taken into account in the Member States' programmes for the European Structural and Investment Funds (ESI Funds) covering the 2014-2020 period. As foreseen in the legislation governing the ESI Funds,¹⁰ where it is necessary to support the implementation of relevant country-specific recommendations, the Commission may request a Member State to review and amend its relevant ESI Funds programmes. The Commission has provided further guidelines on the application of those rules.¹¹
- (6) Slovenia is currently in the preventive arm of the Stability and Growth Pact and subject to the transitional debt rule. In its 2017 Stability Programme, the government expects that the headline deficit will improve to 0.8 % of GDP in 2017 and then

⁸ SWD(2017) 89 final.

⁹ COM(2017) 90 final.

¹⁰ Article 23 of Regulation (EU) No 1303/2013 of the European Parliament and of the Council of 17 December 2013 laying down common provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund, the European Agricultural Fund for Rural Development and the European Maritime and Fisheries Fund and laying down general provisions on the European Regional Development Fund, the European Social Fund, the Cohesion Fund and the European Maritime and Fisheries Fund and repealing Council Regulation (EC) No 1083/2006, OJ L 347, 20.12.2013, p. 320.

¹¹ COM(2014) 494 final.

reach a surplus of 0.4 % of GDP in 2020. The medium-term budgetary objective — a balanced budget in structural terms, which does not respect the requirements of the Stability and Growth Pact — is planned to be reached by 2020. However, based on the recalculated¹² structural balance, the medium-term budgetary objective would not be met by the programme horizon. According to the Stability Programme, the general government debt-to-GDP ratio is expected to fall to 77.0 % of GDP in 2017 and continue to fall to 67.5 % of GDP in 2020. The macroeconomic scenario underpinning these budgetary projections is plausible. At the same time, the measures needed to support the planned targets from 2017 onwards have not been sufficiently specified.

- (7) The 2017 Stability Programme indicates that the budgetary impact of the exceptional inflow of refugees is significant in 2016 and 2017 and provides adequate evidence of the scope and nature of these additional budgetary costs. According to the Commission, the eligible additional expenditure for the exceptional inflow of refugees in 2016 amounted to 0.07% of GDP. This amount is unchanged compared to the 2017 draft budgetary plan, which confirmed the projections of the 2016 Stability Programme. For 2017, the Stability Programme included a request for 0.07% of GDP, of which the Commission will consider the incremental impact amounting to 0.01% of GDP. The provisions set out in Article 5(1) and Article 6(3) of Regulation (EC) No 1466/97 cater for this additional expenditure, in that the inflow of refugees and security-related measures are related to unusual events, their impact on Slovenia's public finances is significant and sustainability would not be compromised by allowing for a temporary deviation from the adjustment path towards the medium-term budgetary objective. Therefore, the required adjustment towards the medium-term budgetary objective for 2016 has been reduced to take into account these costs. Regarding 2017, a final assessment, including on the eligible amounts, will be made in spring 2018 on the basis of observed data as provided by the Slovenia authorities.
- (8) On 12 July 2016, the Council recommended Slovenia to achieve an annual fiscal adjustment of at least 0.6% of GDP towards the medium-term budgetary objective in 2017. Based on the Commission 2017 spring forecast, there is a risk of some deviation from that requirement in 2017.
- (9) In 2018, in the light of its fiscal situation and notably of its debt level, Slovenia is expected to further adjust towards an appropriate medium-term budgetary objective. According to the commonly agreed adjustment matrix under the Stability and Growth Pact, that adjustment translates into a requirement of a nominal growth rate of net primary government expenditure¹³ which does not exceed 0.6 %. It would correspond to a structural adjustment of 1% of GDP. Under unchanged policies, there is a risk of a significant deviation from that requirement in 2018. Slovenia is projected to comply with the debt rule in 2017 and 2018. Overall, the Council is of the opinion that Slovenia needs to stand ready to take further measures in 2017 and that further measures will be needed in 2018 to comply with the provisions of the

¹² Cyclically-adjusted balance net of one-off and temporary measures, recalculated by the Commission using the commonly agreed methodology.

¹³ Net government expenditure is comprised of total government expenditure excluding interest expenditure, expenditure on Union programmes fully matched by Union funds revenue and non-discretionary changes in unemployment benefit expenditure. Nationally financed gross fixed capital formation is smoothed over a 4-year period. Discretionary revenue measures or revenue increases mandated by law are factored in. One-off measures on both the revenue and expenditure sides are netted out.

Stability and Growth Pact. However, as foreseen in Regulation (EC) No 1466/97, the assessment of the budgetary plans and outcomes should take account of the Member State's budgetary balance in the light of the cyclical conditions. As recalled in the Commission Communication accompanying these country-specific recommendations, the assessment of the 2018 Draft Budgetary Plan and subsequent assessment of 2018 budget outcomes will need to take due account of the goal to achieve a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Slovenia's public finances. In that context, the Commission intends to make use of the applicable margin of appreciation in the light of the cyclical situation of Slovenia. Furthermore, there is significant uncertainty regarding the cyclical position in the specific case of Slovenia because of the particularly large economic contraction in 2008-2013 and the major structural and financial sector reforms being implemented.

- (10) The Fiscal Rules Act adopted in July 2015 introduced a medium-term budgetary framework for the general government. In order to make it operational, certain amendments to the Public Finance Act are necessary. Initially the government committed to having the revised Public Finance Act adopted within six months following the adoption of the Fiscal Rule Act. However, this deadline was repeatedly postponed and the revised act has not yet been submitted to the Parliament for deliberation. The revised Public Finance Act constitutes one of the legal vehicles transposing into the national legislation the EU Directive 2011/85 on requirements for national budgetary frameworks, which Member States were obliged to complete by the end of 2013. The members of the Fiscal Council were appointed on 21 March 2017.
- (11) The high public debt at 79.7% of GDP in 2016 represents a source of vulnerability for the public finances in Slovenia. The country's population is ageing faster than that of most Member States. Slovenia faces high risks on the long-term sustainability of public finances and its long-term sustainability gap indicator is the highest of all EU Member States, stemming from the projected increase in pension-related public spending, healthcare and long-term care expenditure.
- (12) The government has presented proposals to reform the healthcare system. The draft Healthcare and Health Insurance Act, which is the central piece of the reform, was put to public consultation in February 2017 and is scheduled to be forwarded to the National Assembly by summer 2017. Respecting the envisaged timing is important and should allow the act to become law still in 2017. In December 2016, the proposals to amend the Health Services Act and the Patient Rights Act were presented and the new Pharmacies Act was adopted. Remaining challenges concern the governance and performance of hospitals, primary care as a gatekeeper for in-patient care, hospital payment systems, health technology assessments, and information systems. In addition, the benefits from centralised public procurement of medical products and services remain largely untapped while a new centralised public procurement for medicines is under preparation that could help procurement to become more transparent and cost-efficient. Advancing in long-term care reform is also a significant challenge. To date, there is no integrated long-term care system in Slovenia. A pilot project to determine the long-term care needs is being prepared.
- (13) The White Paper on pensions was adopted by the government in April 2016 and has opened a public consultation on the future of the pension system. However, concrete legislative proposals are still lacking. Challenges on the way ahead are to ensure the long-term sustainability and adequacy of the pension system by adjusting the

statutory pension age to life expectancy gains and promoting later retirement, to boost the coverage of the supplementary pension schemes, to adequately address varying career paths and to reduce old-age poverty risks.

- (14) Labour market and social trends continued to improve. Job creation has picked up and unemployment is decreasing. The rate of people at risk of poverty and social exclusion decreased but remains above the EU average for the elderly. The improving labour market offers an opportunity to provide employment for older workers, but their participation rates remain low. Entering retirement via the unemployment insurance system has become increasingly common in recent years. Long-term unemployment remains above pre-crisis levels and represents more than half of all unemployed. More than 40 % of all long-term unemployed are over 50 and almost half of them are unemployed for two years or more. An analysis and an action plan that aims to increase the employment rate of older workers has been prepared and discussed with social partners. Timely implementation of the action plan can help to improve the activation of older workers. The employment rate of low-skilled workers remains low and well below the pre-crisis level and the EU average. The active labour market policy implementation plan adopted in January 2016 continues the current approach, while expenditure in this field remains low. Older and low-skilled workers continue to be underrepresented in active labour market policy measures. Labour market segmentation remains a challenge despite the reform in 2013.
- (15) The level of non-performing loans, while still high, is on a solid downward path. The Bank of Slovenia has implemented a number of measures that are giving banks incentives to reduce their non-performing loans sustainably. Debt reduction pressures have started to ease but credit flows to firms continue to contract. The progress in debt reduction has been uneven across individual firms. The consolidation and restructuring of the banking sector are progressing with the merger of three banks in 2016. The privatisation of Nova Ljubljanska Banka is planned by December 2017. Revisions to the legislative framework further reinforced the corporate restructuring capacity of the Bank Asset Management Company. Non-performing loans remain high among SMEs. To address the issue, a systematic approach to SME work out of non-performing loans has been prepared with the help of the World Bank. In addition, the government adopted a bill to set up a central credit register to enable more efficient risk management and reduce the risk of indebtedness.
- (16) Access to alternative financing sources for a creditworthy business is very limited. The Slovenian Enterprise Fund and the *Slovenska izvozna in razvojna banka* (SID bank) have mainly introduced new debt instruments for SMEs including measures such as microcredits. One seed capital scheme was implemented in 2016 by the Slovenian Enterprise Fund with under 50 SME beneficiaries. Other alternative financing instruments, including venture capital and equity with use of the European Structural and Investment Funds, could be a major source of additional financing but remain largely untapped.
- (17) The implementation of the public administration development strategy 2015-2020 is underway, and some progress has been made. However, some specific measures, like the adoption of the Civil Service Act, have been further delayed. The government programme for reducing the administrative burden is estimated to have created total savings of EUR 365 million between 2009 and 2015 and almost 60% of 318 measures to reduce the administrative burden have been achieved. Private investment however continues to be hindered by complex and lengthy administrative procedures,

especially in construction and spatial planning. While the efficiency and quality of the justice system have further improved, in commercial cases it still takes a long time to schedule first hearings and claims cannot be submitted by electronic means. Despite the adoption of some key anti-corruption reforms like the zero tolerance to corruption programme, perception of corruption remains negative and appears to influence business decisions. After the initial progress in modernising the regulation of professions, the reforms have slowed down. Lifting restrictive barriers in regulation of professions could support competition in these markets.

- (18) State involvement in the economy remains high despite the privatisation programme initiated in 2013. The state is the largest employer, asset manager and corporate debt holder in Slovenia. Combined with weak corporate governance, high state ownership has had considerable fiscal and economic implications. They are estimated at EUR 13 billion or about one third of GDP in 2007-2014, primarily due to financial sector stabilisation measures and foregone profits of state-owned enterprises compared to their private peers. The performance of state-owned enterprises has started to improve, underpinned by a new corporate governance system, but risks remain. By the end of 2015 results showed an improved profitability of the enterprises under the management of the Slovenian Sovereign Holding, albeit falling short of the intermediate target set in the management strategy. An asset management plan for 2017, quantifying the performance indicators for each separate state-owned enterprise and updating a list of assets for divestment, has been approved by the government in January 2017. At the same time, a revision of the asset management strategy, first approved by the national parliament in 2015, is still pending, with the government having deferred its decision to the second half of 2017. Although a new president of the management board was appointed at the end of February 2017, the full supervisory board is not in place yet.
- (19) In the context of the European Semester the Commission has carried out a comprehensive analysis of Slovenia's economic policy and published it in the 2017 country report. It has also assessed the Stability Programme and the National Reform Programme and the follow-up given to the recommendations addressed to Slovenia in previous years. It has taken into account not only their relevance for sustainable fiscal and socioeconomic policy in Slovenia, but also their compliance with EU rules and guidance, given the need to strengthen the EU's overall economic governance by providing EU-level input into future national decisions.
- (20) In the light of this assessment, the Council has examined the Stability Programme and its opinion¹⁴ is reflected in particular in recommendation 1 below.
- (21) In the light of the Commission's in-depth review and this assessment, the Council has examined the National Reform Programme and the Stability Programme. Its recommendations made under Article 6 of Regulation (EU) No 1176/2011 are reflected in recommendations 1 and 3 below,

HEREBY RECOMMENDS that Slovenia take action in 2017 and 2018 to:

- 1. Pursue its fiscal policy in line with the requirements of the preventive arm of the Stability and Growth Pact, which translates into a substantial fiscal effort for 2018. When taking policy action, consideration should be given to achieving a fiscal stance that contributes to both strengthening the ongoing recovery and ensuring the sustainability of Slovenia's public finances. Adopt and implement the proposed

¹⁴ Under Article 5(2) of Council Regulation (EC) No 1466/97.

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.

2. Intensify efforts to increase the employability of low-skilled and older workers, particularly through targeted lifelong learning and activation measures.
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.

Done at Brussels,

*For the Council
The President*