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Country Report Slovenia 2016

**Including an In-Depth Review on the prevention
and correction of macroeconomic imbalances**

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EXECUTIVE SUMMARY

This country report assesses Slovenia's economy in light of the Commission's 2016 Annual Growth Survey published on 26 November 2015. The survey recommends three priorities for the EU's economic and social policy in 2016: re-launching investment, pursuing structural reforms to modernise Member States' economies and responsible fiscal policies. At the same time, the Commission published the Alert Mechanism Report that initiated the fifth annual round of the macroeconomic imbalance procedure. The Alert Mechanism Report identified Slovenia as warranting a further in-depth review.

The Slovenian economy continued to grow strongly in 2015. Economic output is estimated to have expanded by 2.5 % in 2015, following 3 % in 2014. The rebound, which commenced in 2014, was initially driven by strong export performance supported by improved cost competitiveness. Subsequently, the recovery has become broader-based as private consumption growth has accelerated boosted by an improving labour market, rising consumer confidence and continued low energy prices. Investment in infrastructure projects co-funded by the EU also helped boost growth, while private investment began to show initial signs of recovery. The general government deficit is estimated to have decreased to 2.9 % of GDP in 2015, while the debt-to-GDP ratio is estimated to have increased to 83.5 %.

The rebound has been accompanied by job-creation. After five years of rising unemployment, the trend reversed in 2014, and the labour market conditions improved further in 2015. Nevertheless, structural challenges in the labour market remain. Long-term unemployment decreased but still accounts for over half of the total unemployed. Despite recent improvements, employment rates of low-skilled and older workers remain low. The youth unemployment rate stabilised marginally below the EU average.

Slovenia's economic growth is expected to broaden and maintain momentum. Even though growth is expected to moderate slightly in 2016, it is forecast to accelerate again in 2017. Private consumption is forecast to overtake net exports as the main growth driver and the general government deficit is projected to gradually decline due to positive cyclical conditions.

Overall, Slovenia has made some progress in addressing the 2015 country-specific recommendations. Several policy measures have been implemented to improve the long-term sustainability of the banking sector. These include reinforcing the banks' capacity to work out non-performing loans and introducing action plans with specific targets for the reduction of non-performing loans. Vulnerabilities in the corporate sector are being addressed through the operational and financial restructuring of several major corporates. Furthermore, the restructuring of several small and medium-sized enterprises is ongoing. Revisions to the legislative framework further reinforced the corporate restructuring capacity of the Bank Asset Management Company. With respect to state ownership, new supervisory and management boards of the Slovenian Sovereign Holding have been appointed. A strategy and annual management plan including performance criteria for the management of state assets have been adopted. Positive trends in the efficiency of civil justice have been maintained but this has mainly been due to reduced workload. Some measures to increase the employability of vulnerable groups and to address long-term unemployment have been adopted. The composition of the minimum wage has been reformed, despite opposition from the employers' organisations. However, less progress has been made in ensuring the long-term sustainability of public finances. The Fiscal Rules Act was passed, but an independent Fiscal Council, which will oversee the implementation of the rules, has yet to be appointed. Furthermore, progress in reforming the pension, healthcare and long-term care systems has been limited.

Slovenia is making progress towards its national target under the Europe 2020 Strategy for employment and has already achieved its national targets to reduce early school leaving and to increase tertiary education. Poverty and social exclusion rates stabilised in 2014 and the country appears to be on track to achieve its national target for renewable energy by 2020. However, additional efforts would be needed to reach the national target on energy-efficiency and Slovenia has reversed in 2014 its hitherto positive trend in R&D intensity now widening the gap towards its national target.

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

- **External sustainability continued to improve and risks have subsided.** Gains in price and cost competitiveness as well as export market shares have further improved Slovenia's external performance in terms of flows and stocks. The current-account surplus reached historically high levels and net external liabilities continued to decrease. The current account balance is projected to remain in considerable surplus in the short term, as long as deleveraging in the corporate sector continues. The correction in the net international investment position is expected to continue in the coming years, thus further reducing risks to Slovenia's external position.
- **Confidence has returned in the Slovenian banking sector. However, credit growth remains negative and the long-term profitability of the banks can be further improved.** The level of non-performing loans remains relatively high, but is decreasing. This, together with low credit demand from the real economy, deleveraging pressures and credit risk, continue to exert pressure on the profitability of the banking sector. Furthermore, increased levels of cross-border competition are posing new challenges to the business models of domestic banks.
- **Deleveraging pressures are easing but continue to dampen investment and economic growth.** Private sector indebtedness is below the euro area average, reflecting one of the lowest levels of household debt in the EU, but notably higher corporate debt. The corporate sector has considerably reduced debt levels since the indebtedness ratio peaked in 2010 and is expected to continue to do so in 2016. This will continue to weigh on the private sector's investment and growth capacity. However, the lending to the real economy is expected to start recovering soon. Lending to the household sector has already shows tentative signs of improvement due to favourable market conditions and the rapidly increasing confidence. Currently, SMEs are overly dependent on bank lending. However, new debt and equity instruments are becoming increasingly available. This could help to diversify SMEs funding sources and reduce their vulnerability to credit market developments.
- **Slovenia's business environment is hindered by a high level of administrative burden, which poses an obstacle to the inflow of productive investment.** Barriers to doing business are mainly linked to the inefficiencies of the public administration and lengthy administrative procedures. Private investment declined sharply during the crisis and its share in GDP has been decreasing since then; this has limited Slovenia's economic output and future growth prospects. With public investment being strongly dependent on EU funds dynamics, more private productive investment is needed to stimulate and sustain economic growth. Foreign direct investment in Slovenia has grown markedly in the last two years, mainly due to stepped-up privatisation efforts. However, continued effort in terms of political support and structural reforms are necessary in order to sustain the inflows.
- **The full implementation of the Slovenian Sovereign Holding's framework will promote more efficient management of state assets.** The privatisation programme initiated in 2013 is progressing. This coupled with the new strategy and performance indicators for all state-owned enterprises should reduce contingent liabilities to the general government budget from this area.
- **The deleveraging and corporate restructuring still ongoing in the Slovenian economy requires continued prudent management and monitoring.** This is essential in order to preserve the credibility of the ongoing restructuring and privatisation the transparency and legal robustness of the processes.
- **The large increase in public debt in recent years creates additional policy challenges.** A prolonged recession coupled with significant bank recapitalisations resulted in a sharp rise in public debt levels. The excessive deficit has been reduced. However, fiscal consolidation

measures in recent years, particularly on the expenditure side, have been of a temporary nature. Furthermore, the fiscal framework reform, which provides an important anchor for sustainable public finances, has yet to be fully implemented.

- **Slovenia's ageing population is a key risk to fiscal sustainability, particularly in the long term.** Slovenia's population is ageing faster than most Member States with the old age dependency ratio projected to more than double between 2013 and 2060. The Commission estimates Slovenia is facing the highest fiscal sustainability risk of all Member States in the long term.
- **This ageing population puts considerable pressure on the sustainability of the pension, health care and long-term care systems.** The 2012 pension reform stabilised pension-related expenditure but only in the short term. In the long term, Slovenia is projected to experience one of the largest increases in public pension expenditure in the EU. In health care, more efficient use of resources could contain expenditure in the long run without compromising access to quality care. In addition, the health care system is characterised by a lack of sufficient in-built automatic stabilisers schemes, which would cushion revenue fluctuations over the economic cycle. Furthermore, there is no integrated long-term care in Slovenia. The focus remains on institutional care, while community care is not well coordinated.

Other key economic issues which pose particular challenges to Slovenia's economy are the following:

- **The labour market performance is gradually improving.** However, long-term unemployment and the employment situation for low-skilled and older workers remains a challenge. Job creation has picked up considerably and unemployment is decreasing. The labour market situation for young people has improved substantially. However, participation rates of older and low-skilled workers and the level of long-term unemployment remain a challenge. Better

targeted active labour-market policy and lifelong learning measures could further boost labour market participation.

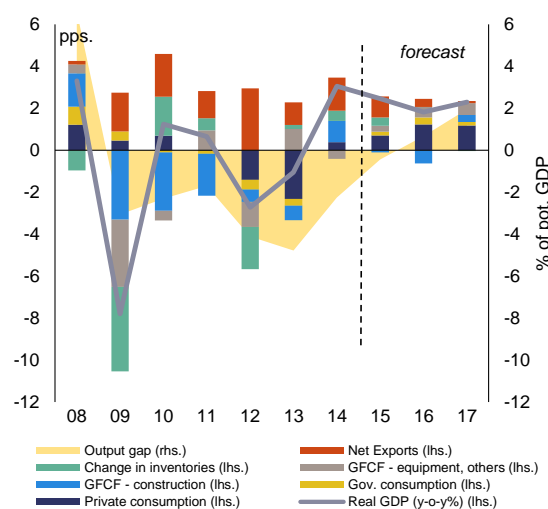
- **The Slovenian education system performs well overall, but several inefficiencies exist in the higher education sector.** Intergenerational comparison shows that labour market advantages of the high skilled have decreased while the labour market value of undergraduate programmes has diminished.
- **Social conditions stabilised in 2014 for the first time after the crisis, despite a small increase in the poverty threshold.** Despite lowering per capita social protection expenditure in most categories, the social protection system performs relatively well.
- **The current structure and functioning of the public administration poses a barrier to the business environment and to effective policy implementation.** Recent analysis has identified that substantial savings and efficiency gains could be achieved if the recently adopted strategy for the development of the public administration is fully implemented. A reform of the current organisation and culture of the public administration would help to realise the full potential savings.
- **The functioning of the justice system has improved but challenges remain.** The length of trials has been further shortened and the number of pending cases has been reduced. However, this is partly due to fewer incoming cases. Ambitious case management and digitalisation projects are planned, while at the same time emphasis is put on the quality of justice. Ongoing monitoring of the insolvency system reaffirms the effectiveness of the framework, but there are still delays in liquidation procedures.

1. SCENE SETTER: ECONOMIC SITUATION AND OUTLOOK

Growth performance

In 2015, Slovenia's economy sustained robust growth of an estimated 2.5 %, following 3 % in 2014. Slovenia has therefore emerged from the recession suffered between 2008 and 2013, when the country experienced a cumulative loss of more than 9 % of GDP, one of the largest economic contractions among euro area countries. While the rebound was initially driven by strong export performance, boosted by improved competitiveness, domestic demand has also started to strengthen. Private consumption grew strongly in the first three quarters of 2015, supported by an improving labour market, rising consumer confidence and persistently low energy prices. Investment in infrastructure projects co-funded by the EU is estimated to have contributed positively to growth in 2015, and private investment has started to show initial signs of recovery.

Graph 1.1: GDP and contributions

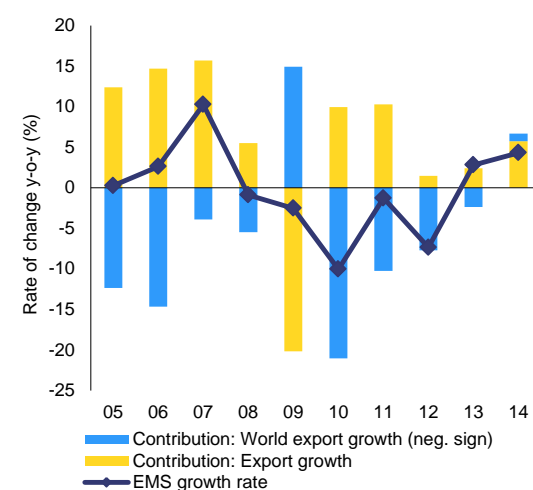


Source: European Commission.

Real GDP is projected to grow by 1.8 % in 2016 and 2.3 % in 2017 according to the Commission's 2016 winter forecast (Graph 1.1). Growth in private consumption is set to accelerate in 2016 driven by employment growth, increasing wages, recovering housing market and improving household confidence. Public consumption is also expected to increase. Some wage pressure is expected to emerge in 2017, mostly due to the reversal of certain consolidation measures in the public sector, but also because the

economy is forecast to continue to grow above the estimated potential. Public investment is forecast to decrease markedly in 2016 due to the end of the programming period of EU funding but its share in GDP is expected to remain above the EU average. Nevertheless, this decrease contributes significantly to the forecast deceleration in GDP growth in 2016. Private investment is expected to pick up as capacity utilisation levels remain above their historical average, deleveraging pressures are progressively easing and business sentiment is improving. Although exports are expected to continue to grow at a considerable pace, their contribution to GDP growth is expected to decrease progressively, as rising domestic demand fuels imports. The downside risk to the exports outlook is a recent slowdown in emerging market economies and a decrease in Chinese imports in particular. While China represents less than 1% of Slovenian exports, many of Slovenia's trading partners, such as Germany, Austria and Italy, have important trade links with China.

Graph 1.2: Export market share



Source: European Commission.

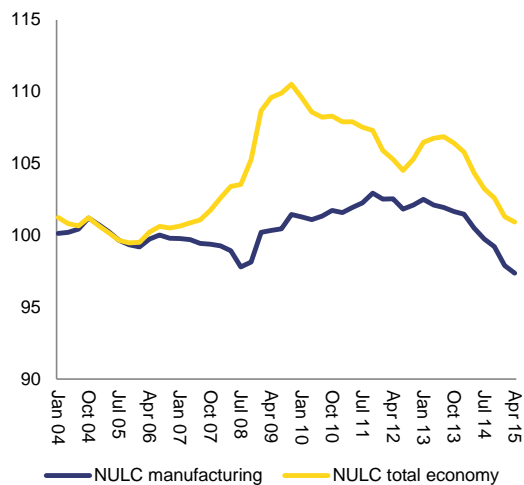
Trade performance, current account and net international investment position

Slovenia's export market share growth accelerated in 2014. Following five years of market share losses, Slovenia gained 2.8 % of export market share in 2013 and 4.3 % in 2014 (Graph 1.2). This increase was mainly driven by gains in exports of manufactured goods.

Rebalancing the economy towards tradable sectors and moderation in prices and costs after 2012 have contributed to this improved export performance.

Slovenia made considerable gains in price and cost competitiveness in 2014 and 2015. Real effective exchange rates deflated by nominal unit labour costs decreased significantly in the last two years (Graph 1.3). Competitiveness increased due to both productivity gains and continued wage moderation. The competitive gains in manufacturing drove the sector's real effective exchange rates below the pre-crisis lows.

Graph 1.3: Real Effective Exchange Rate vs IC 37



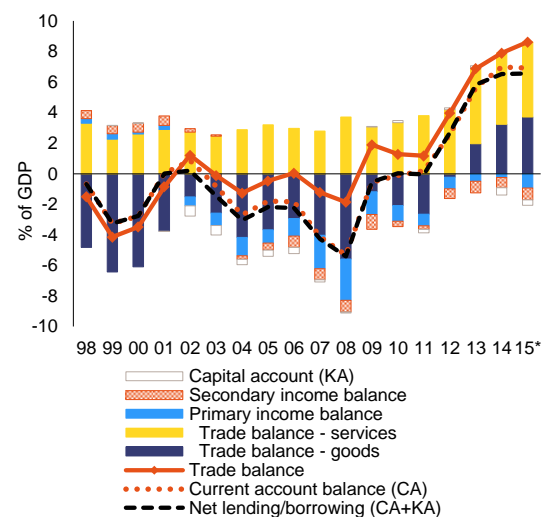
(1) Real effective exchange rates vs 37 industrialised countries deflated by Nominal Unit Labour Cost (NULC)

Source: European Commission

Strong export performance helped further increase the current account surplus, which widened to around 7 % of GDP in 2015 (Graph 1.4). The increase in the surplus on the trade balance was mainly driven by the rapidly increasing surplus in goods, which was boosted by favourable terms of trade. Services have traditionally been a positive contributor to the trade balance and the surplus in services expanded in the second and third quarter of 2015 in particular. Both balances have reached historically high levels and are expected to remain in significant surplus in the short term. Import growth is set to remain below export growth due to restrained demand and low oil and commodity prices. In the medium term, a pick-up in the recovery of domestic demand is expected to

gradually decrease the current-account surplus. In addition, a rise in import prices would also decrease the current account surplus. While the secondary income balance is expected to have remained stable, the primary income deficit is expected to have increased in 2015 due to higher costs of servicing public debt and dividend payments to foreign owners from the increased profits of non-financial corporations.

Graph 1.4: Breakdown of external balance

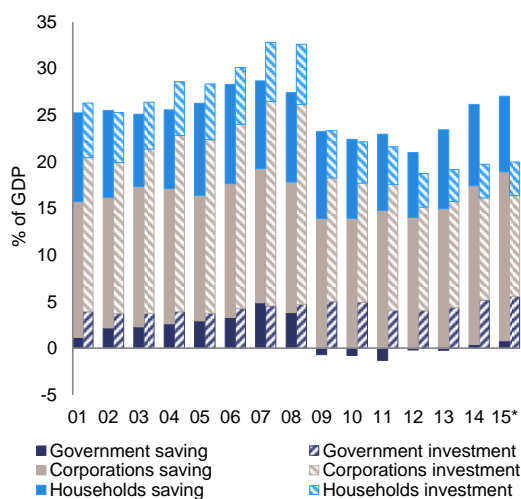


Source: European Commission.

A savings-investment approach indicates that subdued investment remains the main reason for the high surplus (Graph 1.5). Until the crisis, non-financial corporations relied on foreign credit to finance their investment. As a result, investment consistently exceeded savings in the economy during the pre-crisis years. This trend peaked in 2007/2008 when the large current account deficit reflected high investment by non-financial corporations fuelled by easy credit. The subsequent adjustment made Slovenian companies net savers. The ongoing deleveraging is very much mirrored in the growing current account surplus. Government investment has increased since the crisis, but the level of investment of corporations and households remains below its pre-crisis peak. While this peak may have been unsustainably high, reflecting overheating of the economy, the increasing savings/investment gap points to room for growth in domestically-financed corporate and household investment. The reasons for the low

investment and its consequences for the Slovenian economy are discussed in Box 1.1 and Section 2.2.

Graph 1.5: Savings and investment



Source: European Commission.

Slovenia's net international investment position (NIIP) continues to improve at a moderate pace.

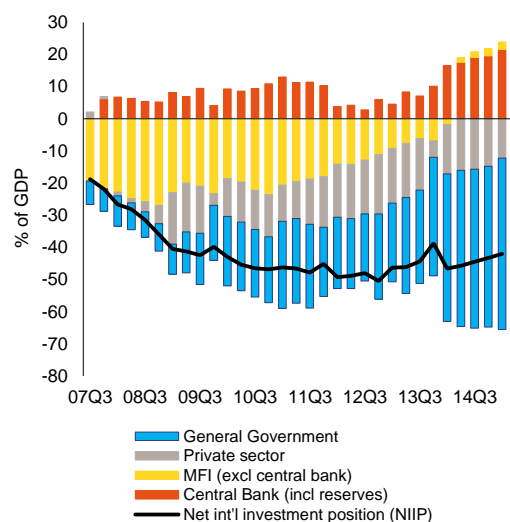
Starting from a negative level of -21.8 % of GDP in 2007, the NIIP worsened through the crisis, hitting a trough of -50.4 % of GDP in 2012. The trend was reversed in 2013, reflecting the adjustment in the current account. The NIIP improved further in 2014 and 2015, and is expected to continue to do so in the coming years, thus reducing risks to Slovenia's external position. It is important to note that a direct consequence of this crisis was a structural change in the NIIP. Slovenia's monetary and financial institutions have significantly reduced their net foreign liabilities since the height of the crisis, while the general government position has steadily worsened. The government's borrowing, apart from financing the deficit, was used mainly to complete bank recapitalisations. Consequently, at the end of 2014, the largest component of the NIIP (-50 % of GDP) arose from general government borrowing.

Public sector debt has increased significantly from 21.6 % of GDP in 2008 to 83.5 % in 2015.

While exceptional items, particularly bank recapitalisations, have contributed greatly to this increase, sustained primary deficits over the period to 2015 have also played a part. On a no-policy-change assumption, public sector debt is expected

to increase slightly to around 85 % of GDP in the medium term (i.e. until 2026). Fiscal discipline is required to reduce the debt-to-GDP ratio (see Section 2.3).

Graph 1.6: Net International Investment Position



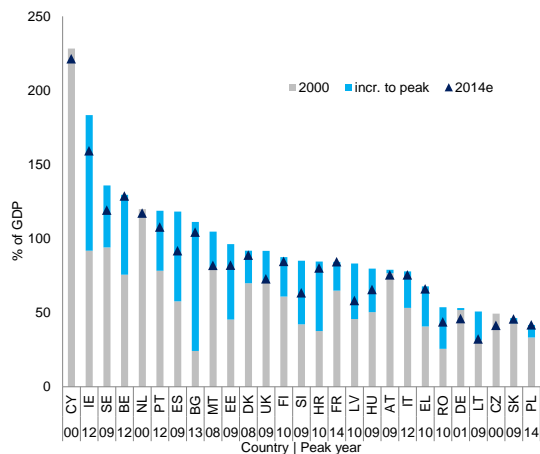
Source: European Commission.

Private sector deleveraging

Private sector indebtedness is below the euro area average. Slovenia's has one of the lowest levels of household debt, but notably higher corporate debt. Despite doubling in the 2000s, private debt decreased progressively to a comparatively low level of 91.9 % of GDP in 2014. However, there are substantial differences between households and the corporate sector. Slovenia's households are one of the least indebted in the euro area. Nevertheless, they continued deleveraging in 2014 and reduced their indebtedness by another percentage point (pp.), to 28.5 % of GDP. Slovenia's corporates deleveraged more actively and reduced their debt from 74 % of GDP in 2013 to 63.4 % of GDP in 2014 (Graph 1.7). While this is close to the euro area average, the corporate debt to equity ratio is relatively high (stable at 82 % in 2014-2015), as is the level of non-performing loans (NPL) (18.5 % in Q2-2015). However, a large share of NPL is covered by provisions (Section 2.1). The 2015 country report for Slovenia concluded that corporate debt was unevenly distributed across firms, and was high compared to their earnings and cash flow capacity to repay. However, both earnings and the cash

flow capacity to repay debt have increased significantly in the last two years, which has brought Slovenia in line with the euro area average.

Graph 1.7: **Indebtedness of non-financial corporations**

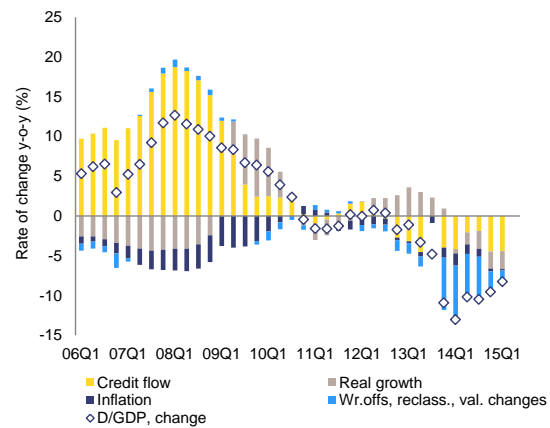


Source: European Commission.

Slovenia's deleveraging continued in 2015, supported by growing GDP. The change in the debt-to-GDP ratio can be attributed to four main drivers: net credit flows (loan repayments and lack of new lending), real GDP growth, inflation through the GDP deflator and other changes such as valuation changes or write-offs (Graph 1.8). Since the peak of indebtedness in 2010, Slovenia's corporations have actively reduced their debt, resulting in negative credit flows. Contracting GDP exerted upward pressure on the debt-to-GDP ratio until 2013. However, from 2014 onwards Slovenia benefited from a positive contribution from economic growth. At the same time, restructuring has helped reduce corporate debt. However, deflation in 2015 slightly increased the real value of the debt. Deleveraging is expected to steadily slow down but continue among the corporates in the short term. Their further deleveraging needs have been estimated around 10-20 % ⁽¹⁾. Household's deleveraging needs are negligible and the recent data on household borrowing show that the pace of household deleveraging is slowing.

⁽¹⁾ European Commission, autumn forecast 2014.

Graph 1.8: **Breakdown of non-financial corporations' debt**

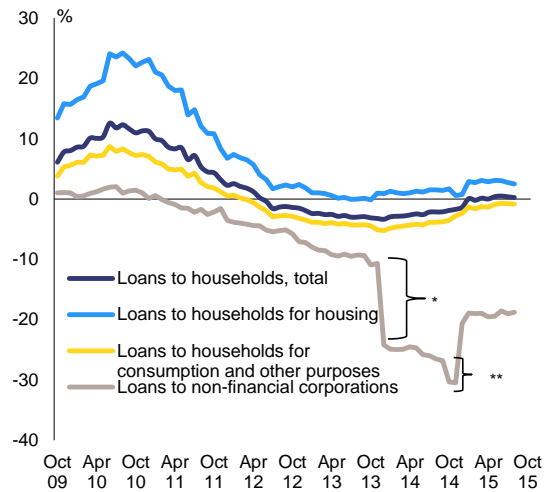


Source: European Commission.

Financing conditions

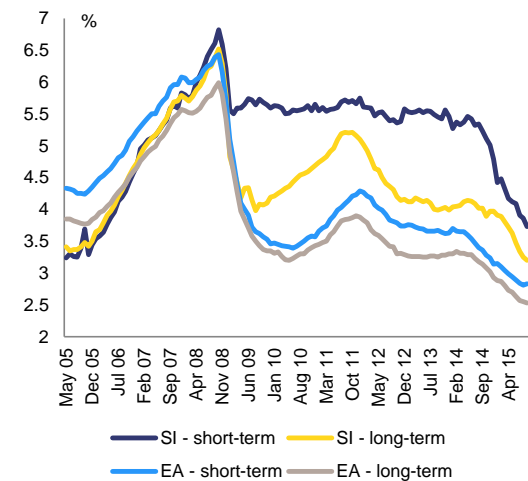
Lending to the real economy continues to contract, but it is likely to turn around in the near future. Credit in Slovenia is still contracting but the pace of contraction has decelerated since November 2014. Subdued lending to non-financial corporations is closely linked to the low cash-flow capacity and the high leverage of the Slovenian corporate sector. It is also affected by the high level of corporate non-performing loans on banks' balance sheets and the ongoing financial and operational restructuring in the corporate sector. Loans to the household sector have started to improve due to favourable market conditions and the rapidly increasing confidence (Graph 1.9). The low indebtedness of households also played a role in the banks' decisions to approve loans to the sector. Most of the well-established and financially sound companies have access to financing abroad at more competitive rates, as interest rates on loans in Slovenia (especially short-term ones) tend to be above the euro area average. However, companies such as SMEs do not have access to other financing sources and have to rely on domestic borrowing under relatively stringent conditions. From mid-2014 onwards, a rapid decline in both short- and long-term interest rates can be observed in Slovenia (Graph 1.10). In addition, some new financing options for SMEs were made available in 2015 (Section 2.1).

Graph 1.9: Credit developments — stocks



(*) Transfers from NKBM and NLB to the BAMC
 (**) Transfers from Abanka and Banka Celje to the BAMC
 Source: Bank of Slovenia.

Graph 1.10: Short- and long-term interest rates



Source: ECB.

Employment and social conditions

The labour market has continued to improve. After five years of rising unemployment, the trend reversed in 2014. Structural challenges in the labour market remain. Long-term unemployment decreased to 4.8 % in Q3-2015, but still accounts for over half of the total unemployed. The youth unemployment rate stabilised marginally below the EU average. The participation rates of older and low-skilled workers have improved but remain a

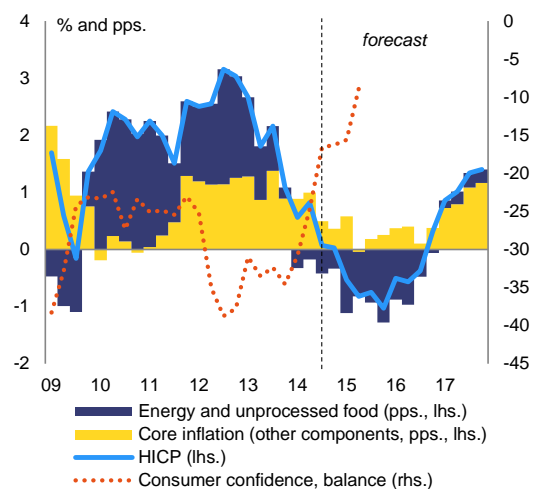
challenge. The number of people at risk of poverty or social exclusion stabilised in 2014 (Section 3.1).

In the final quarter of 2015, a large influx of refugees and migrants transited through Slovenia. They were predominately crossing Slovenia and their average stay was less than 24 hours. In 2015, 45 asylum seekers were granted refugee status in Slovenia, out of 227 asylum applicants. This is stable compared with 2014. In January 2016, the number of asylum seekers crossing the country slowed down considerably, with the average numbers falling to approximately 2 200 per day from a daily average of 7 600 in October 2015.

Inflation

Headline inflation (HICP) has been decreasing since mid-2012, driven by sluggish domestic demand and falling energy prices. In 2014 and 2015, the steep fall in oil prices and drops in food prices had a significant impact in terms of driving headline inflation down to 0.4 % in 2014 and - 0.8 % in 2015. HICP is estimated to have bottomed out in Q3-2015. However, deflation of 0.3 % is projected in 2016, before the HICP returns to a moderate increase of 1.1 % in 2017 as the economic recovery strengthens (Graph 1.11).

Graph 1.11: Inflation and confidence indicator



Source: European Commission.

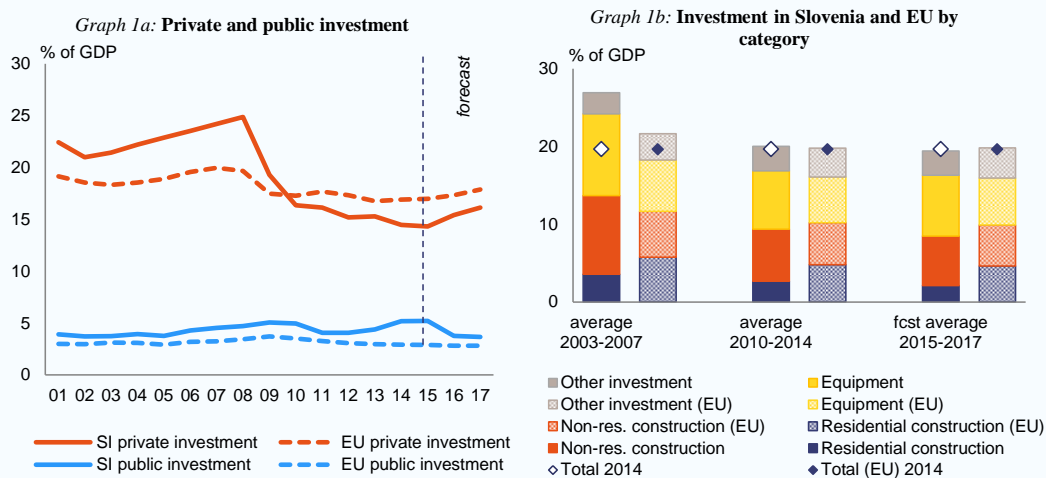
Box 1.1: Investment challenges

Section 1: Macroeconomic perspective

Investment in Slovenia dropped substantially during the crisis and has not recovered since. This is due not only to the crisis, but also to the highly-indebted corporate sector, significant state involvement in the economy, and an obstructive business environment. Companies, struggling to repay their debts, have been underinvesting compared to the historical average and their peers in the region. Weak investment warrants special attention because of its impact on domestic demand and shortfalls in investment are detrimental to the future potential growth of the Slovenian economy (Section 2.2.).

Slovenia's post-crisis underperformance in private investment has been offset by strong public investment, supported to a large degree by EU funds. Private investment dropped considerably in 2009/2010 and has remained downbeat since. Public investment has helped to prevent a large investment gap in the post-crisis years but is expected to decrease significantly in 2016 due to the end of the 2007-2013 EU-funding programming period. Both residential and non-residential construction dropped off after the pre-crisis boom; only infrastructure construction remained strong by high public spending. Investment in equipment decreased significantly from its pre-crisis peak but remained above the euro area average and is forecast to grow markedly in 2016/2017 (Section 2.2.).

Graph 1: Investment and its components as a share of GDP, Slovenia and European Union



Source: European Commission, forecast for 2015-2017 based on no-policy-change assumption

Section 2: Assessment of barriers to investment and ongoing reforms

Barriers to private investment in Slovenia are relatively high⁽¹⁾; however, signs of improvement have been noted. The country has been scoring relatively low in the World Bank's Doing Business indicators. However, as recent reforms started to bear fruit, Slovenia improved from the 35th to 29th place out of 189 countries⁽²⁾.

⁽¹⁾ See "Member States Investment Challenges", SWD(2015) 400 final/2 http://ec.europa.eu/europe2020/pdf/2016/ags2016_challenges_ms_investment_environments_en.pdf

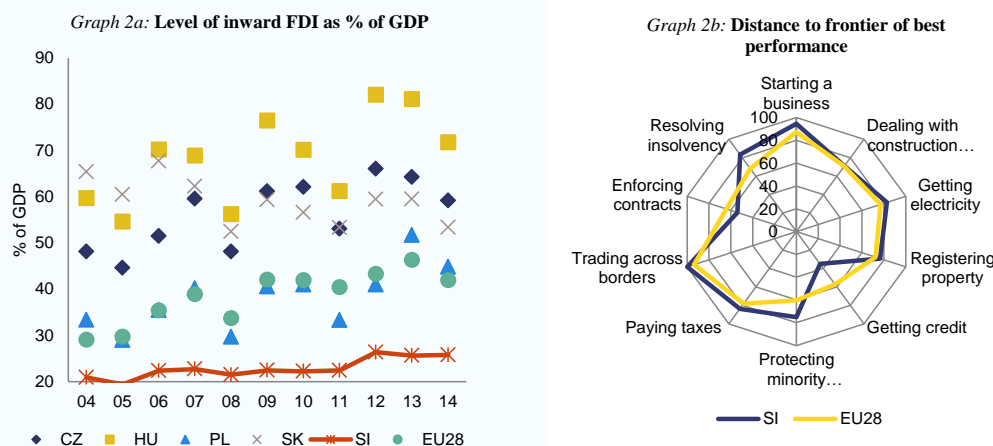
⁽²⁾ <http://www.doingbusiness.org/data/exploreeconomies/slovenia/>

(Continued on the next page)

Box (continued)

The main improvements were recognised in the fields of insolvency, real estate management and the enforcement of legal contracts. These improvements also reflected better macroeconomic conditions given that confidence increased significantly and the economy grew strongly in 2014 and 2015. Persisting barriers to investment remain in Slovenia; they are analysed in sections 2.2 and 3.2.

Graph 2: Inward FDI and ease of doing business, Slovenia and European Union



Source: Unctadstat and World Bank

The administrative burden and an inefficient public administration remain obstacles to doing business in Slovenia. Suboptimal corporate governance, significant government involvement in the economy and vested interests have negative repercussions on doing business in Slovenia⁽³⁾. Productivity remains low in a number of industrial sectors with a high concentration of public ownership, and the inflow of foreign direct investment is limited compared to the EU average and regional peers⁽⁴⁾. Frequent changes in government in the past have increased uncertainty and caused investment decisions to be postponed. Red tape remains significant, while reducing the administrative burden (Section 2.2.) and improving the functioning of public administration (Section 3.2.) and the justice (Section 3.3.) are of the key challenges to boosting investment. The capacity of Slovenia's of public administration, both at the central and local levels, has decreased in recent years (Section 3.2.). Obtaining building permits requires too much time due to the high number of steps required to get a permit, the limited administrative capacity of the units that issue building and environmental permits and spatial planning delays. Inconsistencies in local spatial planning imply higher waiting times and rules on the possible use of land are unclear. Connections between regions are often insufficient (particularly where no highway exists) making delays in the implementation of TEN-T core network projects (like for railway infrastructure) an issue (Section 3.4.).

The perceived high level of corruption and legal uncertainty remains an obstacle to investment. The legal uncertainty results from frequent revisions of the Public Procurement Act, the sometimes inconsistent jurisprudence, and the perceived widespread corruption in public procurement (Section 3.2.). Frequent appeals can delay project implementation. The high number of laws and by-laws in Slovenia and numerous changes to the legislation make it difficult to do business and comply with regulation (Section 2.2.). Lengthy court proceedings and a high number of unresolved cases remain a challenge (Section 3.3.). Investors are also put off by the frequent changes of taxation and the length of the tax compliance process.

⁽³⁾ http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_slovenia_en.pdf

⁽⁴⁾ http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_slovenia_en.pdf

Box 1.2: Contribution of the EU Budget to structural change

Slovenia is an important beneficiary of the European Structural and Investment Funds (ESIF) and can receive up to EUR 3.9 billion for the period 2014-2020. This is equivalent to 1.4% of GDP (on an annual basis) and 25% of the expected national public investment in areas supported by the ESI funds.

A number of reforms were passed as ex-ante conditionalities in areas to benefit from the Funds to ensure successful investments. Preparation of strategic documents in areas such as production of energy from renewable sources or digital growth is still ongoing, yet there has been progress in public administration, transport and health strategic planning. Where ex-ante conditionalities are not fulfilled by end 2016, the Commission may suspend interim payment to the priorities of the programme concerned.

The programming of the Funds includes a focus on priorities and challenges identified in recent years in the context of the European Semester, for instance in relation the CSRs on increasing employment of low-skilled and older workers, focusing resources on tailor-made active labour market policy measures, improving the attractiveness of vocational education and training and finalising strategies for research and innovation specialisation and the transport sector. Slovenia also benefits from the Youth Employment Initiative to support young people to find their way to the labour market, get involved into traineeship projects or continue their education. Regular monitoring of implementation includes reporting in mid-2017 on the contribution of the funds to Europe 2020 objectives and progress in addressing relevant structural reforms to maximise the use of EU financing (notably, in the R&DI, SMEs, energy efficiency, labour market, education, social inclusion, including long-term care and institutional capacity building).

Financing under the new European Fund for Strategic Investments (EFSI), Horizon 2020, the Connecting Europe Facility and other directly managed EU funds would be additional to the ESI Funds. Following the first rounds of calls for projects under the Connecting Europe Facility, Slovenia has signed agreements for EUR 53 million for transport projects. For more information on the use of ESIF in Slovenia, see: <https://cohesiondata.ec.europa.eu/countries/SI>.

Table 1.1: Key economic, financial and social indicators - Slovenia

	2003-2007	2008	2009	2010	2011	2012	2013	2014	forecast		
									2015	2016	2017
Real GDP (y-o-y)	4.8	3.3	-7.8	1.2	0.6	-2.7	-1.1	3.0	2.5	1.8	2.3
Private consumption (y-o-y)	4.0	2.4	0.9	1.3	0.0	-2.5	-4.1	0.7	1.3	2.3	2.3
Public consumption (y-o-y)	2.6	4.9	2.4	-0.5	-0.7	-2.3	-1.5	-0.1	0.9	1.8	1.0
Gross fixed capital formation (y-o-y)	7.4	7.0	-22.0	-13.3	-4.9	-8.8	1.7	3.2	0.9	-0.7	4.7
Exports of goods and services (y-o-y)	11.1	4.2	-16.6	10.2	6.9	0.6	3.1	5.8	4.5	4.4	5.1
Imports of goods and services (y-o-y)	11.4	3.8	-18.8	6.8	5.0	-3.7	1.7	4.0	3.5	4.4	5.6
Output gap	2.6	6.6	-3.1	-2.3	-1.7	-4.1	-4.8	-2.3	-0.4	0.7	1.9
Potential growth (y-o-y)	3.5	3.5	1.4	0.5	0.0	-0.3	-0.4	0.4	0.6	0.7	1.0
Contribution to GDP growth:											
Domestic demand (y-o-y)	4.2	4.1	-5.6	-2.7	-1.2	-3.7	-2.3	1.0	1.1	1.4	2.3
Inventories (y-o-y)	0.8	-1.0	-4.0	1.9	0.6	-2.0	0.2	0.5	0.4	0.0	0.0
Net exports (y-o-y)	-0.2	0.2	1.9	2.0	1.3	3.0	1.1	1.6	1.0	0.4	0.1
Contribution to potential GDP growth:											
Total Labour (hours) (y-o-y)	0.1	0.3	0.1	-0.2	-0.3	-0.2	-0.3	0.3	0.3	0.2	0.1
Capital accumulation (y-o-y)	1.6	2.2	0.8	0.2	0.0	-0.3	-0.2	-0.1	-0.1	-0.1	0.1
Total factor productivity (y-o-y)	1.8	0.9	0.5	0.4	0.3	0.2	0.2	0.2	0.4	0.6	0.8
Current account balance (% of GDP), balance of payments	-2.3	-5.3	-0.6	-0.1	0.2	2.6	5.6	7.0	.	.	.
Trade balance (% of GDP), balance of payments	-0.6	-1.9	1.9	1.3	1.2	4.0	6.9	7.9	.	.	.
Terms of trade of goods and services (y-o-y)	-0.5	-1.3	3.5	-4.0	-1.4	-1.1	0.8	1.0	0.4	0.3	-0.2
Capital account balance (% of GDP)	-0.4	-0.1	0.0	0.1	-0.2	0.1	0.2	-0.5	.	.	.
Net international investment position (% of GDP)	-13.3	-39.4	-43.6	-47.2	-45.2	-49.9	-46.1	-43.6	.	.	.
Net marketable external debt (% of GDP) ¹	.	-24.8*	-43.2	-46.9	-41.7	-44.8	-41.0	-36.3	.	.	.
Gross marketable external debt (% of GDP) ¹	67.2	101.4	110.0	110.3	105.0	110.5	107.1	114.4	.	.	.
Export performance vs. advanced countries (% change over 5 years)	30.7	29.5	18.8	6.4	2.8	-11.5	-10.5	-5.78	.	.	.
Export market share, goods and services (y-o-y)	4.4	-0.9	-2.5	-10.1	-1.3	-7.4	2.8	4.3	.	.	.
Net FDI flows (% of GDP)	0.5	0.3	1.4	-0.3	-1.7	-1.3	-0.1	-1.6	.	.	.
Savings rate of households (net saving as percentage of net disposable income)	8.6	9.7	7.7	6.1	5.5	3.2	5.7	6.5	.	.	.
Private credit flow (consolidated, % of GDP)	12.9	15.6	2.9	2.0	0.4	-2.8	-4.1	-4.6	.	.	.
Private sector debt, consolidated (% of GDP)	77.1	105.6	113.5	115.2	113.0	112.5	108.2	100.1	.	.	.
of which household debt, consolidated (% of GDP)	19.3	25.6	28.5	30.4	30.0	30.9	30.0	28.5	.	.	.
of which non-financial corporate debt, consolidated (% of GDP)	57.7	80.0	85.0	84.8	83.0	81.6	78.2	71.6	.	.	.
Corporations, net lending (+) or net borrowing (-) (% of GDP)	-5.3	-7.6	0.6	1.3	2.3	2.8	13.4	6.6	5.6	4.5	4.2
Corporations, gross operating surplus (% of GDP)	19.0	20.5	18.6	18.3	18.6	18.2	18.8	19.6	19.7	19.7	20.1
Households, net lending (+) or net borrowing (-) (% of GDP)	4.1	4.3	5.1	4.6	4.6	3.9	6.1	5.4	5.6	6.0	5.4
Deflated house price index (y-o-y)	12.8	1.3	-10.3	-1.3	0.9	-8.1	-6.0	-6.5	.	.	.
Residential investment (% of GDP)	3.5	4.6	3.8	3.1	2.8	2.6	2.4	2.2	.	.	.
GDP deflator (v-o-v)	3.4	4.5	3.4	-1.0	1.1	0.3	0.8	0.8	0.1	1.0	1.3
Harmonised index of consumer prices (HICP, y-o-y)	3.6	5.5	0.9	2.1	2.1	2.8	1.9	0.4	-0.8	-0.3	1.1
Nominal compensation per employee (y-o-y)	6.6	7.2	1.8	4.0	1.5	-1.0	0.6	1.1	0.8	2.0	2.0
Labour productivity (real, person employed, y-o-y)	3.8	0.7	-6.1	3.4	2.4	-1.8	0.3	2.5	.	.	.
Unit labour costs (ULC, whole economy, y-o-y)	2.7	6.4	8.5	0.6	-0.8	0.8	0.2	-1.3	-0.7	0.8	0.3
Real unit labour costs (y-o-y)	-0.7	1.8	5.0	1.6	-1.9	0.6	-0.6	-2.1	-0.8	-0.2	-0.9
Real effective exchange rate (ULC, y-o-y)	0.5	2.5	5.7	-0.9	-1.0	-2.1	0.4	-1.7	-3.2	0.0	.
Real effective exchange rate (HICP, y-o-y)	0.3	1.5	2.3	-2.6	-0.8	-1.2	1.3	1.1	-1.8	0.6	-1.1
Tax wedge on labour for a single person earning the average wage (%)	34.7	33.1	32.9	33.1	33.2	33.3	33.1	33.2	.	.	.
Tax wedge on labour for a single person earning 50% of the average wage (%)	29.7*	24.5	24.4	22.7	22.9	22.9	22.7	22.9	.	.	.
Total Financial Sector Liabilities, non-consolidated (y-o-y)	20.5	3.6	4.7	-2.5	-2.1	-3.4	-10.1	5.9	.	.	.
Tier 1 ratio (%) ²	.	8.7	8.9	8.3	8.8	9.1	12.9	18.9	.	.	.
Return on equity (%) ³	.	4.2	-0.1	-5.4	-16.9	-28.3	-121.9	-2.9	.	.	.
Gross non-performing debt (% of total debt instruments and total loans and advances) ⁴	19.2	17.1	16.6	.	.	.
Unemployment rate	6.1	4.4	5.9	7.3	8.2	8.9	10.1	9.7	9.1	8.8	8.4
Long-term unemployment rate (% of active population)	3.0	1.9	1.8	3.2	3.6	4.3	5.2	5.3	.	.	.
Youth unemployment rate (% of active population in the same age group)	14.7	10.4	13.6	14.7	15.7	20.6	21.6	20.2	15.7	.	.
Activity rate (15-64 year-olds)	69.9	71.8	71.8	71.5	70.3	70.4	70.5	70.9	.	.	.
People at-risk poverty or social exclusion (% total population)	17.6	18.5	17.1	18.3	19.3	19.6	20.4	20.4	.	.	.
Persons living in households with very low work intensity (% of total population aged below 60)	7.6	6.7	5.6	7.0	7.6	7.5	8.0	8.7	.	.	.
General government balance (% of GDP)	-1.4	-1.4	-5.9	-5.6	-6.6	-4.1	-15.0	-5.0	-2.9	-2.4	-1.9
Tax-to-GDP ratio (%)	37.7	36.8	36.7	37.4	37.0	37.4	37.3	37.0	37.2	37.2	37.2
Structural budget balance (% of GDP)	.	.	.	-4.5	-4.8	-2.1	-2.2	-2.8	-2.6	-2.5	-2.8
General government gross debt (% of GDP)	25.7	21.6	34.5	38.2	46.4	53.7	70.8	80.8	83.5	79.8	79.5

(1) Sum of portfolio debt instruments, other investment and reserve assets

(2,3) domestic banking groups and stand-alone banks.

(4) domestic banking groups and stand alone banks, foreign (EU and non-EU) controlled subsidiaries and foreign (EU and non-EU) controlled branches.

(*) Indicates BPM5 and/or ESA95

Source: European Commission, winter forecast 2016; ECB

2. IMBALANCES, RISKS, AND ADJUSTMENT ISSUES

This section provides the in-depth review required under the macroeconomic imbalances procedure ⁽²⁾. It focuses on the risks and vulnerabilities flagged in the Alert Mechanism Report 2016 as regards banking sector stability and the underlying non-performing loans work-out, weak investment, and the long-term sustainability of public finances. The latter gives a special focus to the health care, long-term care and pension systems, which are under increasing pressure due to the ageing population. The section concludes with the MIP assessment matrix, which summarises the main findings.

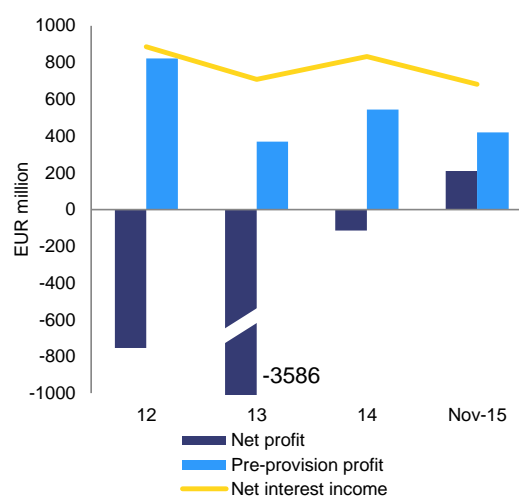
2.1. BANKING AND CORPORATE SECTOR RESTRUCTURING

Financial environment

The situation in the banking sector has improved. All banks were profitable in 2015 (Graph 2.1.1), capital ratios are rising and liquidity is adequate. Deleveraging continues, but at a lower rate. Lending to households is now increasing, while lending to non-financial corporates continues to contract. Deposits are increasing, allowing the banks to reduce their wholesale funding. Non-performing loans (NPLs) have started to decrease both in absolute and in relative terms (with respect to the stock of loans). The sector as a whole is continuing to contract, but at a slower pace. In Q2-2015, the assets of the banking sector represented 111 % of GDP as compared with 117 % at the end of 2014. The share of the largest five banks remained stable at 56 %, as did the level of foreign ownership (currently at 33 %). However, levels of foreign ownership will increase markedly with the privatisation of the Nova Kreditna Banka Maribor (NKBM), expected to be completed by June 2016.

Credit risk and pressure on profitability are two main concerns. The level of NPLs is decreasing but it remains high, especially in the SME and construction segments. NPLs keep dragging down the banks' performance and their timely resolution would allow the banks to focus on lending to the real economy and would speed the economic recovery. Profitability is under pressure due to the low interest rate environment that erodes banks' net interest margin and decreases in the volume of lending.

Graph 2.1.1: Banking sector profitability

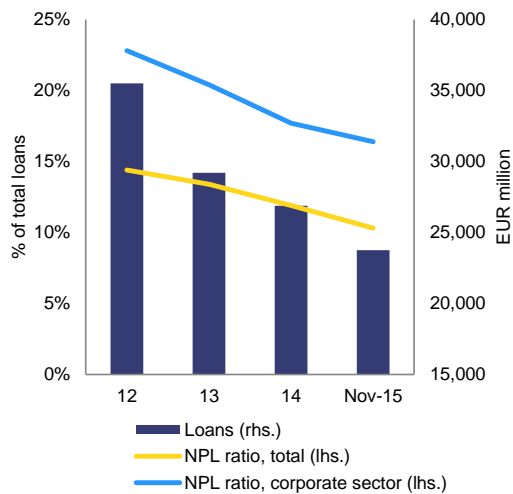


Source: Bank of Slovenia.

Non-performing loans continue to decrease but still remain at high levels. In November 2015, NPLs in the corporate sector represented 16.4 % of corporate loans, down from 17.7 % in 2014 and 20.4 % in 2013 (based on the NPL ratio definition of the Bank of Slovenia, Graph 2.1.2). The stock of loans is decreasing particularly loans to corporates and SMEs, although at a slower pace as compared with 2014. The percentage of NPLs in total outstanding loans inevitably remains high compared to most EU countries, as NPLs are not compensated by new performing loans. In terms of volume, NPLs have been contracting over the last year: total NPL volumes contracted by 7 % compared with end 2014 and by 25 % compared with end 2013 (-5 % and -30 % respectively in the case of corporate NPL). Over the same period, total loan volumes contracted by 9 % and corporate loans by 16 %.

⁽²⁾ According to Article 5 of Regulation (EU) No. 1176/2011.

Graph 2.1.2: Total loans and non-performing loans



Source: Bank of Slovenia.

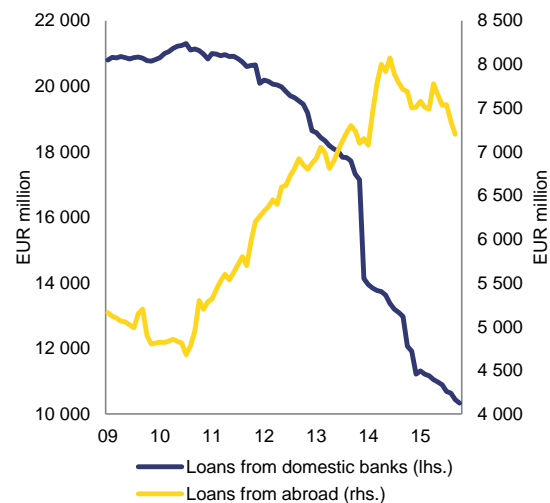
The difference between the major state-owned banks and foreign-owned banks is still marked.

In the state-owned banks, NPLs remain high relative to the pre-crisis levels despite state-owned banks transferring considerable amounts of NPLs to the public Bank Asset Management Company (BAMC) at the end of 2013 and in 2014. The high NPL ratio in state-owned banks is partly the result of continued contraction in new lending and the poor asset quality of loans to companies outside Slovenia (mainly in the Balkan countries), which could not be transferred to the BAMC.

Slovenian banks are facing increased cross-border competition.

The NPL legacy has put significant pressure on banks in recent years. In response to this, banks tightened credit standards, which pushed many large and financially viable firms to start looking for loans at better conditions abroad. From the beginning of 2009 until October 2015, the stock of banking loans to non-financial corporations (NFCs) from abroad increased by 38 % (the increased peaked in Q2 2014 at +55 %). At the same time, the stock of loans to NFCs from domestic banks dropped by 50 % (Graph 2.1.3). While this large contraction can be to some extent attributed to the transfer of NPLs to the BAMC, it was nevertheless very severe even when accounting for this transfer (-30 %).

Graph 2.1.3: Stock of loans



Source: Bank of Slovenia.

The switch by Slovenian corporations to cross-border borrowing can be partially attributed to the increased risk aversion of banks.

This is reflected in the spread of interest rates charged by domestic banks compared to banks in the euro area after the crisis. For corporate loans, this spread increased by more than 3 pps. in 2009 and remained at this level until 2014 (Graph 2.1.4). While some part of this difference could be attributed to a higher risk of Slovenian firms due to their high leverage, their leverage was not very far from the euro area average. Nevertheless, the spread narrowed significantly in 2015.

Companies in manufacturing, wholesale and retail trade sectors have been among the top borrowers from abroad.

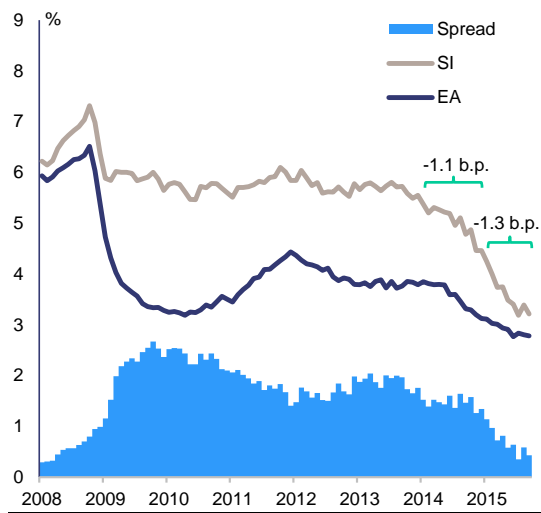
They have significantly increased their cross-border borrowing since 2010 (over +200%), during the years of substantial deleveraging in the non-financial corporate sectors. The cross-border borrowing was not limited to foreign financial institutions. In recent years, Slovenian firms have increased their borrowing from other firms abroad, mostly from foreign investors in Slovenia (Graph 2.1.5).

Exporting companies restarted to borrow in 2014, while firms in non-tradable sectors continue to deleverage

(Graph 2.1.5). As to profitability of companies the divergence between the tradable and the non-tradable sector can be identified from 2011 onwards. Since 2011 the net

profits of the tradable sector have nearly doubled whereas the profitability of the non-tradable sector has deteriorated and the sector is now loss-making (Graph 2.1.6).

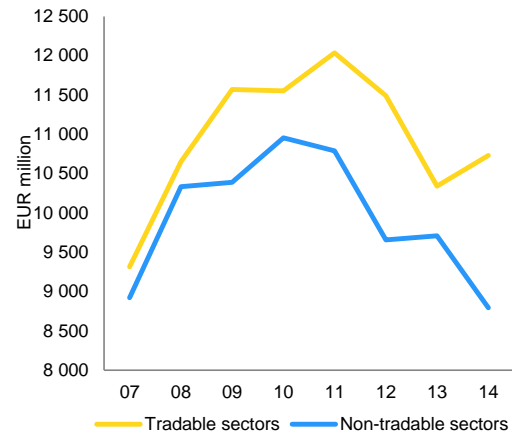
Graph 2.1.4: Interest rate on corporate loans of less than EUR 1 million



Source: Source: Bank of Slovenia

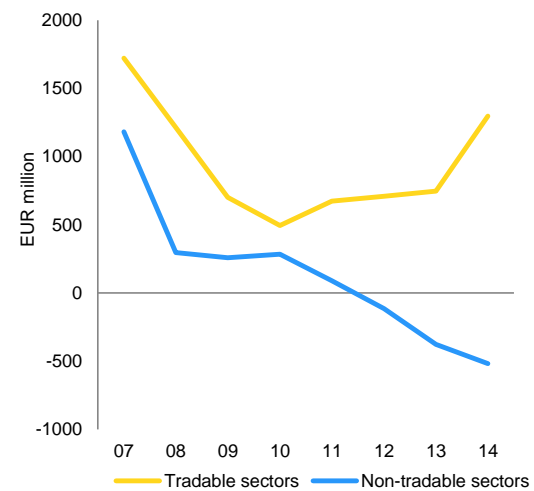
Slovenian banks’ legacy of non-performing loans and the banks’ aversion to risk may have been diverting attention from the healthy part of the economy. By spending too much time and resources on dealing with the unhealthy part of their loan portfolio, banks may have missed business opportunities with healthy corporations. As shown above, strong businesses, mainly in the export-oriented sectors, have been seeking financing opportunities elsewhere. The banks need to dedicate more targeted attention to the profitable, mainly tradable, sectors and adapt their business models to support the healthy part of the economy. This could be done through a comprehensive service package, not exclusively focused on lending.

Graph 2.1.5: Long-term financial liabilities



Source: The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES).

Graph 2.1.6: Net profits



Source: The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES).

Box 2.1.1: The role of the Bank Asset Management Company

The Bank Asset Management Company (BAMC) was established in March 2013 as a government-owned company with the task of facilitating the restructuring of banks of systemic importance that were facing severe solvency and liquidity problems. The BAMC's mission is:

- to stabilise the Slovenian financial sector by taking over non-performing assets from systemically important banks;
- to promote confidence in the financial system and to operate in accordance with the highest international standards of governance;
- to maximise the recovery value of assets acquired; and
- to facilitate and encourage sustainable corporate restructuring in Slovenia.

The BAMC was set up to restructure or recover assets and sell them when the market has recovered. The BAMC has a long-term value-based approach, similar to the bigger domestic banks, which are also looking to maximise returns.

Following the loan acquisitions from NLB and NKBM in 2013, the BAMC acquired loans from Abanka and Banka Celje in 2014. The BAMC has so far received assets with a total gross value of approximately EUR 5.0 billion (net value of EUR 1.6 billion) from these four banks. The BAMC has also acquired additional corporate exposures at market price from two smaller domestic banks in wind-down — Probanka and Factor Banka — with a view to consolidating loans to borrowers already in its portfolio. Transfer prices ranged from 27 % to 37 % of gross exposures, while loan acquisitions based on market prices were executed at around 20 % of gross exposures. The total transfer price for all six banks amounted to 31.5 % of total gross exposures,

which implies an average discount on the transfers of 68.5 %.

The BAMC developed its own internal valuation system, which provided a basis for a determination of the fair value of the NPLs because the externally-imposed transfer prices did not always identify correct fair values for individual assets and exposures.

The BAMC currently has EUR 1.35 billion in assets under management (situation at the end of H1-2015). These assets include loans, real estate, equity investments and minor non-performing bond holdings. Most of the assets (91.2 %) consist of loans and bonds amounting to EUR 1.23 billion. Their share in asset structure is gradually reducing due to loan repayments or repayments with real estate conversion, equity or other claims. In addition to claims, the BAMC also holds equity investments in 30 companies and holds both equity investments and claims in 15 others. The BAMC also manages real estate, which is of increasing importance; its book value amounts to EUR 56.7 million. The goal is to ensure that the value of the acquired real estate is maintained and to prepare the property for sale.

The BAMC's strategy is in place until 2022 in line with its prolonged lifetime. Parliament approved a new BAMC Act has been approved by the parliament in December 2015 which provides for additional tools to facilitate the restructuring of companies.

Access to finance

Lending remains subdued, particularly for the corporate sector. While lending to the household sector has remained broadly stable over the last year, the corporate sector has witnessed a further contraction, by 17 % year-on-year in August 2015. These sluggish lending developments are due not only to the banks' limited appetite for credit risk, but also to the weak loan demand, as the corporate debt leverage accumulated before the crisis has yet to be resolved. Demand appears mostly oriented towards long-term credit, indicating possible investment strategies by some firms. Demand for credit is expected to further contract among large corporates, driven by their lower financing needs for fixed investment, their access to bank lending outside Slovenia and the availability of alternative financing sources such as bonds and equity. The main factors motivating loan demand are historically low interest rates and the restructuring/refinancing needs.

Small and micro firms are overly dependent on bank lending. The share of SMEs reporting deterioration in the willingness of banks to provide loans is one of the highest in the EU. The size and scale of the capital market available to SMEs is limited, and SMEs require alternative equity sources of finance. As SMEs play a crucial role in the economy, improving financing framework conditions for creditworthy businesses is a key to improving the overall Slovenian business environment.

Debt and equity instruments for SMEs are available in the market. Several options, including grants for start-ups, seed capital, venture capital, microcredits, guarantees for bank loans with subsidies of interest rate and (direct and indirect) loans, are provided by the Slovenian Enterprise Fund (SEF) and the Slovenian Development Bank (SID). SEF has been efficient in providing funding to innovative SMEs through seed financing (seed capital in the form of convertible loans and in the form of equity capital). In addition, grants and limited equity capital are offered in combination with coaching services and infrastructure ('twin projects'). Direct credit lines offered by the SID since mid-2013 were less successful given the stringent conditions. In April and December 2015, the government negotiated with the SID less stringent credit

conditions for SMEs (no loan approval fees, lower required insurance) and further approved the extension of five SID's credit lines. These reforms are expected to have a positive impact on project financing. In late 2015, SID became the national contact point for the European Investment Advisory Hub. It carries out this role in cooperation with the European Investment Bank under the Investment Plan for Europe. SID thus has an important role to play in stimulating financing in Slovenia from the European Fund for Strategic Investments. Lastly, in late 2015, SEF signed an agreement with the European Investment Fund for the EU programme COSME, which will channel more financing to SMEs.

A central credit registry would reduce the risk of over-indebtedness of the SME sector. Bank of Slovenia, in cooperation with the banking community, is introducing an interactive central credit register for fiscal and legal entities. It is fully consistent with the analytical credit dataset project of the European Central Bank. Results arising from managing credit risk are expected at the beginning of the second quarter 2016.

Greater access for SMEs to alternative financing sources is key. Slovenia's venture capital investment is below 0.003 % of GDP. However, some regulatory constraints in Slovenia may in fact be limiting the overall supply of venture capital financing, including for innovative and high-tech companies, in particular for SMEs and start-ups with high growth potential. For instance, in principle it is possible to make cross-border investments in Slovenia, but the market is not attractive enough for foreign venture capital funds to establish a subsidiary or a branch there. Many are put off because as they would not benefit from the tax break since it is applicable only if the venture capital company is established in Slovenia. This limits the opportunities for growth of innovative companies and negatively affects start-ups. SMEs would also benefit from training and support services in order to improve 'investment readiness'.

Long term challenges and future reshaping of the Slovenian banking sector

Non-performing loan resolution and credit risk management remain a priority for the coming year. Over the last year domestic banks continued to actively manage their NPL portfolios by concentrating on increasing their capacity to work out and reduce NPLs. Some banks shed their NPL portfolios or transferred them to the BAMC, and the sustainable reduction in NPL stocks will continue. A number of measures have been adopted to improve banks' capacity to work out NPLs. Bankruptcy proceedings and simplified compulsory settlements have been steadily increasing, thanks to greater activity on this front by the banks and supported by the new insolvency regulation. Bank of Slovenia has issued guidelines for impairments of restructured loans and for NPL management in 2015 and closely monitors the implementation of action plans including specific NPL targets by the banks. While this is a welcome development, the effort put into the restructuring and resolution of NPLs absorbs important business resources away from the banks' core lending activity.

Banks are currently considering various strategies to further clear their non-performing loans. These include selling targeted portfolios to specialised investors or to the BAMC, selling foreign subsidiaries (where shedding the NPLs is particularly difficult) or creating ad hoc means to collect NPLs from different banks in order to reach a critical mass and facilitate the sale of joint portfolios to specialised investors.

There are several signs of positive change in the near future. Firstly, interest rates for newly granted loans fell in 2015 and their spread to interest rates in the euro area narrowed (Graph 2.1.4). This may reflect stronger competition from abroad as well as a reduced risk aversion and less need to charge higher rates to cover past losses. This fall in interest rates is also echoed in the latest data on the stock of corporate loans from the rest of the world. Graph 2.1.3 shows that the stock of cross-border loans contracted in 2015. Secondly, provisioning coverage of NPLs reached an historical high of 62 % in 2015. The accumulation of provisions is therefore not expected to weigh further on credit supply. In addition, coverage of the unsecured part of NPLs with provisions was

124 % in the same period. This shows that provisions cover not only the unsecured part of the NPLs but also to some extent the secured part. Lastly, macroeconomic conditions continue to improve and are expected to remain favourable in 2016 and 2017. This should positively affect the banking business by increasing credit demand and lowering the share of newly defaulted borrowers.

The implementation of the restructuring plans of the major state owned banks is on track. The Return on Equity objective set by the restructuring decision on new loans is difficult to meet and is putting banks that benefited from State aid in a challenging position vis-à-vis their peers. This kind of commitment ensures sound risk management and robust profitability, and reduces the risk of these banks repeating past mistakes.

The wind-down process of Factor Banka and Probanka was accelerated and Bank of Slovenia withdrew their banking licence ahead of schedule, in February 2016. The remaining assets will be transferred to the BAMC.

State ownership in the Slovenian banking sector is being reduced, but is still one of the highest in the EU. Even after the expected finalisation of the sale of NKBM, the second-largest Slovenian bank, to Apollo-EBRD, more than 50 % of Slovenian banks' assets will remain in the hands of state-owned banks. This poses a significant risk to the Slovenian taxpayer and to the efficiency of the banking system. Weak corporate governance and interconnectedness with other state-owned and state-controlled enterprises meant that Slovenian state-owned banks suffered significant losses during the crisis and experienced systematically higher NPL ratios compared to foreign-owned peers.

Consolidation of the Slovenian banking sector is ongoing. The legal merger of Abanka and Banka Celje was completed on 5 October 2015. The full operational migration of accounts should be completed by end-2016. The NKBM and PBS are expected to merge in 2016. The Slovenian subsidiary of the Austrian Raiffeisen bank has been sold to Biser Bidco run by Apollo Global Management. The foreign owners of Sberbank are also considering exiting the market, thus providing some potential for in-market mergers or acquisitions.

The rehabilitation of the banking sector had significant fiscal implications for Slovenia, amounting to more than EUR 5.7 billion since 2007. Although risk management in state-owned banks has been improving over the past year, the state does not have the same incentive structure, economies of scale and expertise (e.g. risk modelling, IT, data collection) that a large private banking group can offer its subsidiaries. Likewise, the state's exposure to the banking system makes it vulnerable to banking losses. Slovenia has committed to reducing the share of state ownership in the banking sector. The sale of NLB, the largest bank in Slovenia, is expected to go ahead by 2017, while the sale of Abanka-Celje, the third bank in Slovenia, should follow later. Continued progress in this area would further help to reduce the negative feedback loop between the state and the banking system.

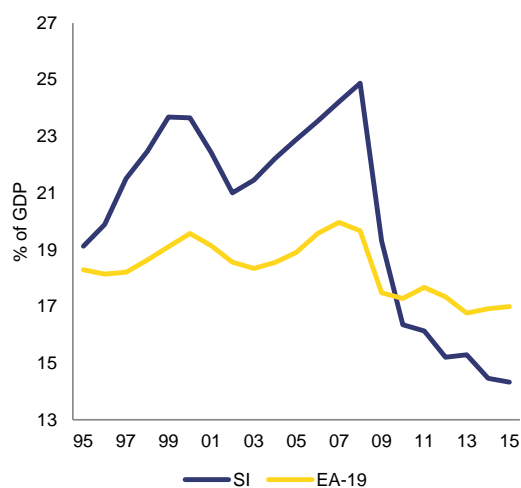
Further progress has been made in restoring stability and confidence in the Slovenian banking sector. However, credit growth remains negative and further consolidation is needed to restore the long-term profitability of the banks. Swift financial and operational restructuring of viable corporates is also needed. The level of NPLs is decreasing but remains relatively high. New equity capital is crucial, both to restore profitability in the banking sector and to encourage lending to the real economy. SMEs remain overly dependent on bank lending. However, new debt and equity instruments are becoming available. Lastly, domestic banks need to reflect upon their business models in view of the increased cross-border competition they face.

2.2. INVESTMENT

Slovenia's investment gap

The share of Slovenia's private investment in GDP decreased further in 2014/15, thus increasing the gap with the euro area. Private investment dropped considerably in 2009/2010 and has not recovered since. The large pre-crisis positive private investment gap compared to the euro area turned negative in 2010, and is still growing (Graph 2.2.1). High levels of debt in segments of the corporate sector, ongoing financial sector restructuring, the significant level of state involvement in the economy (Box 2.2.1), and a business environment with lengthy bureaucratic procedures continue to weigh on investment. While the decline in investment correlated somewhat with the decrease in aggregate demand, the decrease in demand alone cannot explain the lasting weakness in investment, as analysed in the 2015 country report. This weakness warrants special attention, as shortfalls in investment are detrimental to the future potential growth of the Slovenian economy.

Graph 2.2.1: Private investment

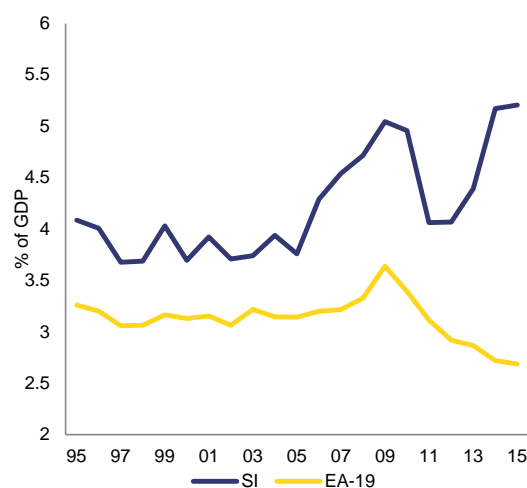


Source: European Commission.

Public investment, supported to a large degree by EU funds, has played an increasingly important role of a stabiliser. Public investment has helped to prevent a large investment gap in the post-crisis years, with the exception of the cuts during the fiscal consolidation years (Graph 2.2.2). However, public investment is expected to decrease significantly in 2016 due to the end of the 2007-2013 EU-funding programming period and is

expected to revert back to 2012 levels. This will temporarily decrease investments in 2016 while new projects come on stream under the new programming period 2014-2020 and the Investment Plan for Europe – the European Fund for Strategic Investments. The latter supports strategic investments in key areas such as infrastructure, education, research and innovation, and provides finance for small businesses. The efficiency of public investment remains low ⁽³⁾.

Graph 2.2.2: Public investment



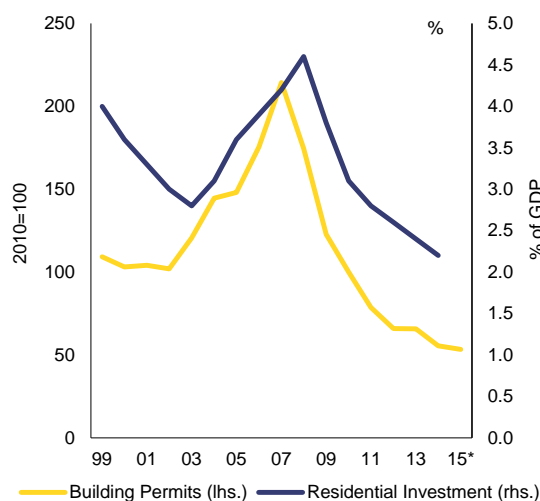
Source: European Commission.

The sizeable decline in both public and private investment largely reflected a sharp drop in construction activity (Graphs 2.2.3 and 2.2.4). Slovenia experienced a construction investment boom, mostly in infrastructure, retail, and tourism, which ended abruptly in 2009. While the construction sector appeared overinflated before the crisis, its post-crisis activity and investment in the sector have been very low. The peak-to-trough decline in construction investment was over 50 % (2008-2013) and the peak-to-trough decline in employment in this sector was 30 % (2009-2014), although this has stabilised recently. While the decline in non-residential investment was reversed in 2014, supported by public funds, residential investment has not yet bottomed out. Graph 2.2.4 shows a continuously decreasing share of residential investment in GDP, with building

⁽³⁾ Economic effects of investment are below EU average. http://ec.europa.eu/growth/industry/innovation/facts-figures/scoreboards/files/ius-2015_en.pdf

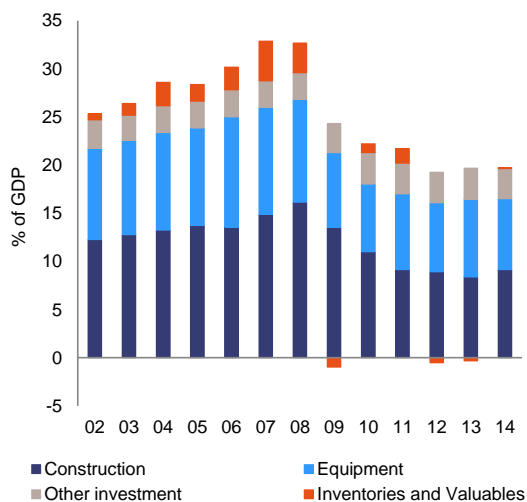
permits as a leading indicator starting to stabilise in 2015. The most recent data even point to a gradual increase in building permits. Investment in dwellings is responsible for a significant part of the private investment gap relative to the euro area. In the post-crisis period (2010-2014), overall investment in dwellings amounted to 2.6 % of GDP in Slovenia and 5.3 % of GDP in the euro area. This gap is less cause for concern than the drop in productive investment, for three reasons. Firstly, the difference between Slovenia and the euro area average reflects large differences in the structure of ownership of dwellings. Secondly, construction investment needs to be promoted only with caution, bearing in mind the 2006-2008 construction bubble and its long-lasting consequences. Thirdly, it is mainly productive investment in machinery and equipment that determines Slovenia’s long-term growth prospects.

Graph 2.2.4: Residential Investment and Building Permits



Source: European Commission.

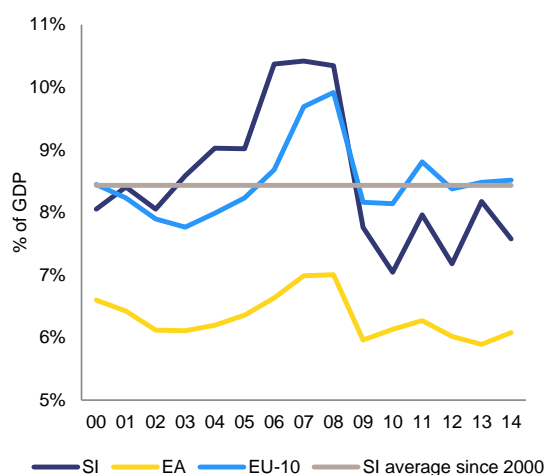
Graph 2.2.3: Investment by type



Source: European Commission.

Slovenia’s productive investment stands above the euro area average but remains below its historical average (Graph 2.2.5). Despite a dramatic drop in 2009, productive investment has stabilised in relative terms, and is expected to increase in the short term thanks to an easing of financing conditions, progress in deleveraging, high capacity utilisation and improving sentiment (see Section 1 and Section 2.1). However, regulatory bottlenecks, such as lengthy procedures in spatial planning, continue to dampen investment appetite (more details in subsection 2.2.2). Depending on the scope of the historical average used, investment in machinery and equipment is estimated to lag behind this average by 1-2 % of GDP each year, which translates into EUR 380-760 million of missing investment.

Graph 2.2.5: Investment in equipment



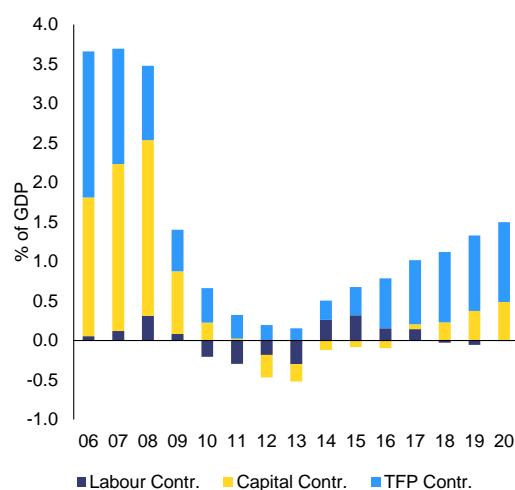
Source: European Commission.

The drop in private investment resulted in a significant downward shift in Slovenia's potential growth. A recovery to pre-crisis levels not expected in the medium term. The country's potential output substantially dropped in 2009/2010 as a result of a dramatic decline in capital accumulation, total factor productivity, and labour contribution that turned negative (Graph 2.2.6). The Commission estimates potential growth in 2015 at $\frac{3}{4}$ %, compared with 3-4 % between 2000 and 2008 ⁽⁴⁾. While Slovenia's potential growth is projected to recover gradually, the shift to lower levels is expected to persist, mainly driven by protracted low contributions from labour and capital accumulation. While labour contribution to potential growth is constrained due to demographic prospects, low capital accumulation is due to the lower investment levels (primarily construction, followed by equipment). However, investment in equipment has not dropped by as much as construction and is expected to converge towards its long-term average over the next two years. This will have a positive effect on total factor productivity (TFP), whose contribution to growth is estimated to have bottomed out in 2013 and has since resumed an increasing trend. TFP growth is an essential driver of long-term growth, capturing efficiency gains in

⁽⁴⁾ The estimates of the Slovenian and international institutions are higher. The difference in the estimates stems mainly from differences in methodology and assumptions.

the overall use of economic resources and representing technological progress reflected in capital.

Graph 2.2.6: Contributions to potential growth



Source: European Commission.

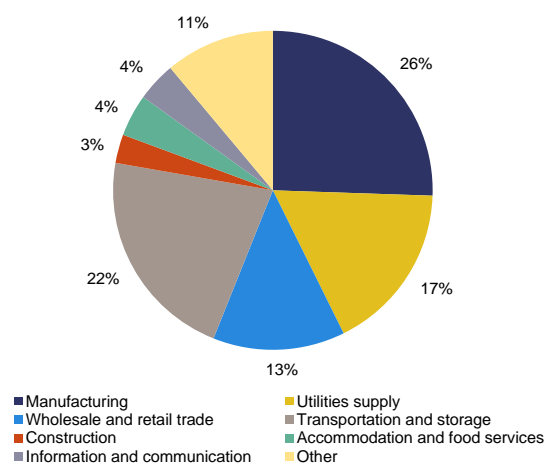
Sectoral analysis

Most investment remains concentrated in the export-oriented sectors such as manufacturing and transportation and storage. In 2014, these two sectors accounted for 47 % of total investment in fixed tangible assets in Slovenia. These include fixed assets such as machinery, buildings and land, but exclude inventories. Wholesale and retail trade amounted to 13 % of the total. Among the non-tradable sectors, supply of electricity, gas and water, (labelled as utilities in the Graph 2.2.7) amounted to 17 % of the total. Investment in these sectors was also among the fastest growing ones in recent years (Graph 2.2.9). Other smaller sectors, such as education and agriculture, also recorded positive growth rates. Investment in the construction sector, which has clearly underperformed since 2009, started growing again in 2014.

Growth of investment in non-tradable sectors outperformed the tradable sectors in the last three years, but this trend is expected to reverse in 2016 (Graph 2.2.8). The non-tradable sectors benefited from a boost from EU funds in recent years, mainly for infrastructure investment. However, as explained above, this is expected to

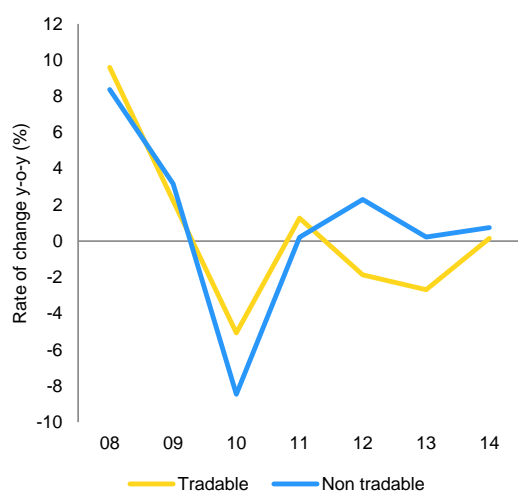
reverse temporarily in 2016. At the same time, growth of investment in the tradable sectors, notably in machinery and equipment, is expected to accelerate in the coming years.

Graph 2.2.7: Long-term tangible assets in Slovenia (2014)



Source: The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES).

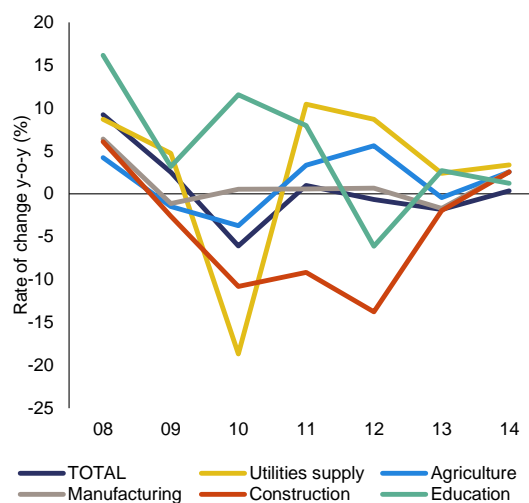
Graph 2.2.8: Growth of investment in tradables and non-tradable sectors



(1) The marked drop in 2010 reflects a break in the data series due to a change in accounting rules (related mainly to utilities and DARS).

Source: The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES).

Graph 2.2.9: Growth of long-term tangible assets



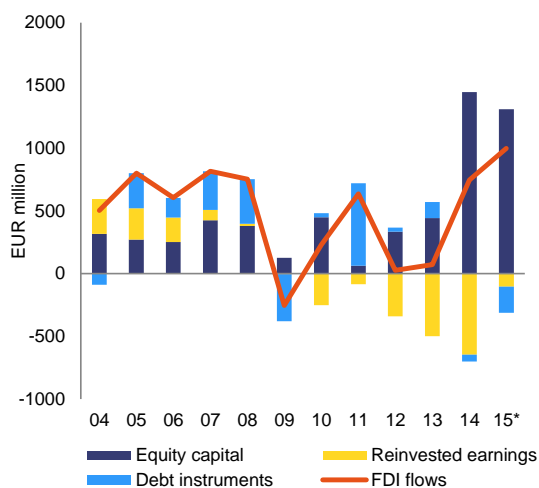
Source: The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES).

Foreign Direct Investment

FDI inflows to Slovenia increased considerably in 2014 and 2015 due to stepped-up privatisation efforts and large inflows into export-oriented companies. While the outflow of non-equity capital and reinvestment continued to increase in 2014 as companies preferred to pay out dividends to foreign owners rather than reinvest profits⁽⁵⁾, inflows of equity capital grew significantly compared with previous years (Graph 2.2.10). Sectoral data show that the main beneficiaries of this record inflow were companies in the tradable sector (Graph 2.2.11). Preliminary data for 2015 shows a continuation of the very positive trend in equity capital inflows, coupled with a significant reduction of outflows of reinvested earnings. Foreign owners acquired a few privatised companies in 2014 and 2015, thereby increasing the foreign equity capital in these firms. The stock of inward FDI amounted to EUR 11.7 billion in 2014, up 11.6 % year-on-year. The latest data for Q3-2015 shows a further increase to EUR 12.3 billion. The main sources of FDI were Austria, Italy, Germany and Croatia.

⁽⁵⁾ The aggregate negative figure reflects the profit distributions to foreign owners, which reached the highest amount to date (EUR 587.6 million) as well as negative operating result at the aggregate level (a loss of EUR 50.6 million). Source: Bank of Slovenia, Direct Investment 2014.

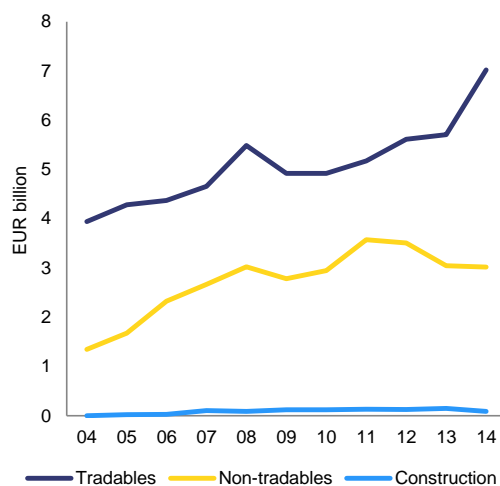
Graph 2.2.10: FDI inflows



(*) 2015 is estimated based on eleven months of available balance of payments data.

Source: Bank of Slovenia.

Graph 2.2.11: Stock of FDI per sector

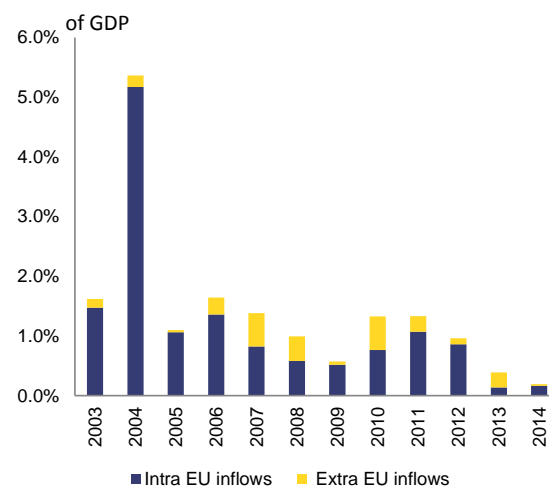


Source: Bank of Slovenia.

Despite substantial FDI inflows in 2014, greenfield FDI remained limited (Graph 2.2.12). Until 2012, greenfield FDI (tangible investment in an area with no prior physical facilities) in Slovenia was in line with the EU average of around 1 % of GDP, but has declined sharply since. While there was also a decrease in greenfield FDI inflows to the EU over the same period, the decline has been more moderate. Between 2012 and 2014, most of the greenfield

FDI to Slovenia was concentrated in manufacturing and wholesale and retail trade, which together accounted for two-thirds of total greenfield capital expenditure. Greenfield investment has numerous benefits for Slovenia as it increases the country's production capacity, thereby exerting a positive impact on economic growth and job creation. This is not necessarily the case of acquisition FDI, which essentially refers to ownership changes, and does not always imply an increase in production capacity.

Graph 2.2.12: Greenfield FDI inflows to Slovenia



Source: Financial Times FDI markets dataset

Barriers to Investment

There is scope to improve the business environment in Slovenia. Domestic and foreign investors highlight that barriers to business are mainly linked to the functioning of the public administration (Graph 2.2.13)⁽⁶⁾. Over the last 25 years, there has been a significant increase in the amount of regulation, which has made it difficult for businesses to keep up with the changes in the legislative environment⁽⁷⁾. Furthermore, a lack of coordination among relevant stakeholders hinders implementation of proposed measures for improvements to the business environment. The

⁽⁶⁾ Spatial planning and regulated services, judicial procedures (Section 3.3), labour legislation (Section 3.1) and tax compliance procedures (Section 2.3). A

⁽⁷⁾ From January 1991 to January 2015, the number of laws increased from 356 to 799 and the number of bylaws increased from 1 006 to 18 332. Source: <http://www.tax-fin-lex.si/VeljavnaZaonodajaRS.aspx>

lack of national rules on cross-border transfers makes it difficult for companies to transfer registered offices abroad ⁽⁸⁾.

Reduction in administrative burden

The quality of regulation as well as the efficiency of public administration matter for businesses (Section 3.2). The recent upgrade of the Single document is a step forward since it will promote greater ownership and help accelerate the implementation of measures ⁽⁹⁾. Measures have been made more concrete and prioritised. The fifth implementation report of the Single document from October 2015 shows that 55 % of proposed measures have been implemented ⁽¹⁰⁾. However, the implementation of measures varies greatly across ministries. Many measures that could improve the business environment (especially with respect to building permits and spatial planning) have been postponed to end-2016.

To make future laws and regulations more business-friendly, assessment of competitiveness will be introduced in the law-making process. In June 2016 the government is expected to launch the use of the 'SME test'. Every new law will have to be assessed according to the impact it will have on the businesses, especially the SMEs. The authorities have developed an online tool to implement this test, which will be available to the stakeholders in consultation process in order to conduct an alternative assessment for their proposals. If implemented properly, the test could substantially improve the process of policy making in Slovenia and provide a platform for constructive dialogue with social partners and other interested parties in the law-making process.

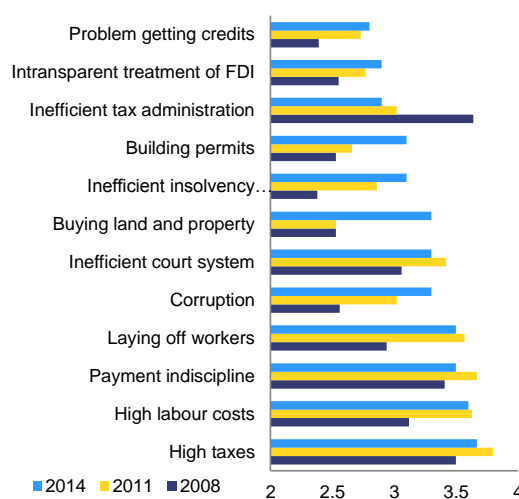
⁽⁸⁾ The direct cross-border transfer of registered offices is not possible under Slovenian law (except for European companies).

(http://ec.europa.eu/justice/civil/files/131007_study-cross-border-merger-directive_en.pdf and [http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/494460/IPOL-JOIN_ET\(2013\)494460_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/etudes/join/2013/494460/IPOL-JOIN_ET(2013)494460_EN.pdf)).

⁽⁹⁾ The Single document, adopted in late 2013, is comprised of over 250 measures for reduction in administrative burden. The revised Single document is interactive, provides for a clear ownership of the measure and a progress report. The action plan in this document used to be revised and monitored three times a year but the upgrade means also that all ministries will be able to report in real time.

⁽¹⁰⁾ http://www.stopbirokraciji.si/fileadmin/user_upload/mju/Boljsi_predpisi/Publikacije/5_porocilo_o_realizaciji_ukre_pov_iz_Enotne_zbirke_ukrepov.pdf

Graph 2.2.13: Barriers to FDI in Slovenia



Source: SPIRIT Survey 2014.

Spatial planning

Complex and lengthy spatial planning and construction permit procedures remain a major obstacle for businesses. So far, progress in reducing the costs and time of procedures has been limited. Investors have to complete several procedural steps before being able to obtain a building permit. Furthermore, the failure to apply administrative procedures weighs on the process ⁽¹¹⁾. Not all municipalities have developed local spatial plans in accordance with the provisions of the reformed spatial planning system of 2007 but still use the outdated provisions, resulting in lengthy and complex bureaucratic procedures.

The authorities plan to reform the process of spatial planning and building permits by end-2016. Three legal acts were sent for public consultation in late 2015 ⁽¹²⁾. Several improvements have been proposed, including establishing of a fast track procedure for small-scale works. A special, individualized procedure

⁽¹¹⁾ Some administrative procedures, like the "silence is consent" rule, although envisaged by the law, are not applied.

⁽¹²⁾ The Spatial Planning Act, the Construction Act and the Act on architects and civil engineers have been public consultation since November 2015. Public consultation has been prolonged on the request of social partners and will be open until the end of February 2016. The government will adopt these three acts by June 2016, while the Parliament adoption is expected for end-2016.

for enlargement of building land area for businesses through a fast-track detailed spatial planning act is also envisaged. The acts also foresee an optional pre-permit procedure, granting the investor certain rights (land & construction-wise) for a limited time, without the need to acquire the building land. This should substantially decrease legal and investment risks. Furthermore, the issuance of construction permits and environmental permits will be combined, which will speed up the process. Additionally, the responsibility for issuing standard environmental permits will pass from the Slovenian Environmental Agency to the administrative units. This solution is expected to accelerate the process, given that the agency is currently one of the major bottlenecks. Nevertheless, the agency would remain fully responsible for issuing more demanding environmental permits. Another proposal is to establish a spatial council of the government that would decide in case of inconsistencies and disputes. Introducing clear guidelines and training for staff in the use of the simplified spatial planning procedure will help greatly in quickly implementing these reforms.

Regulated services

Despite initial delays, deregulation of professions has taken place. In 2012, Slovenia adopted a programme aimed at deregulating professions. This reform has led to the full deregulation or the simplification of the access to professions in several sectors (construction, retail, tourism). The government announced that by end-2016 further reforms in land surveying and real estate services will take place. Slovenia has however still not submitted its national action plan on modernisation of regulated professions in the context of the mutual evaluation exercise. The review of the system of concessions needs to continue in 2016. Developing a fully transnational online procedure in the Slovenian point of single contact will also improve accessibility for cross-border service providers.

Promotion of Slovenia as destination for foreign direct investment

Measures to attract FDI are a key. In 2013, the Slovenian Court of Auditors analysed the efficiency of supportive measures for FDI and concluded that the actions of the authorities were

not conducive to FDI in an effective manner⁽¹³⁾. Slovenia's smart specialisation strategy identifies the low level of FDI and the low level of internationalisation as the main weaknesses of the Slovenian economy (Section 3.4.). Foreign investors see the absence of a consistent and well-targeted FDI strategy as one of the key barriers to investment. Facilitating and actively encouraging foreign investors to acquire partial or full control of a business, or entering Slovenia via greenfield investment, would create stable and lasting economic links to the country, and ensure the transfer of technological and management skills from abroad.

A number of policy measures were adopted to improve the framework conditions for attracting FDI. In 2015, the government adopted a strategy for the internationalisation and FDI 2015-2020 and its operational implementation plan for 2015-2016. The strategy aims at attracting FDI, particularly in three areas where Slovenia holds competitive advantages over regional peers: research, green economy and logistics. It also aims to further internationalise the economy by increasing exports and the inflow of FDI. The implementation plan focuses on the promotional activities needed to gain access to foreign markets. The budget of the SPIRIT (Slovenia's Agency for Entrepreneurship, Internationalization, Foreign Investments and Technology) for promotional activities in 2016 (mainly for assistance to well-known specialised fairs) doubled in comparison to 2015 budget. In cooperation with SID Bank, small businesses are to receive financial support for internationalisation, such as export credits and financing for Slovenian investments abroad (Section 2.1). Slovenia could also attract more FDI through the strategic partnerships which are to be established as part of the smart specialisation strategy (Section 3.4). Slovenia's smart specialisation strategy has a tangible objective of increasing the proportion of high-tech intensive products in exports from 22.3 % to 26.5 % by 2020.

⁽¹³⁾ [http://www.rsrs.si/rsrs/rsrs.nsf/I/KBBC3E0B189C353ACC1257B6300399B11/\\$file/Japti_TNI_SP10_12.pdf](http://www.rsrs.si/rsrs/rsrs.nsf/I/KBBC3E0B189C353ACC1257B6300399B11/$file/Japti_TNI_SP10_12.pdf)

Implementing the FDI strategy is a prerequisite

for success. In order to improve the coordination and implementation of the strategy, in September 2015 the government established the internationalisation council, which is an advisory body co-chaired by the Minister for the Economy and the Minister for Foreign Affairs. At the end-2015 the government finally prepared an investment catalogue, showing available investment opportunities in Slovenia. The catalogue incorporates available privatisation opportunities including assets held by the Slovenian Sovereign Holding (Box 2.2.1.) and the Bank Asset Management Company (Box 2.1.1.). However, the catalogue needs to be published and made available to the investors and the wider public.

More investment is needed to stimulate and sustain economic growth in the long run.

Private investment lags behind the historical and the euro-area average; public investment is strongly dependent on EU funds dynamics. FDI inflows have improved markedly in the last two years, but more effort is needed to sustain investment inflows. Slovenia could attract more direct investment by continuing to privatise state assets, which would help further disentangle the complicated web of state ownership and company cross-shareholding. The creativity and the high growth potential of the start-up community offer important opportunities for investors. The level of product innovativeness has increased significantly but there is still scope to improve the business environment and to remove administrative hurdles, especially for small businesses and start-ups with high growth potential.

Box 2.2.1: **Management of state-owned enterprises (SOEs)**

A number of initiatives taken in 2015 to empower the Slovenian Sovereign Holding (SSH) signal the end to a long process of establishing a comprehensive system for the management of SOEs. State ownership has been in the spotlight of consecutive Council recommendations since 2012 ⁽¹⁾, while at the same time Slovenia's progress in this area has been undergoing a dedicated review by the OECD as part of the post-accession reporting process. The focus on SOEs is explained by factors such as the high state involvement in the economy; a complex network of directly and indirectly owned SOEs (including also banks and insurance companies); and the weak financial performance of SOEs. This weak performance in combination with soft budget constraints and the high debt leverage of SOEs, in many cases on the brink of default, has had a negative impact on public finance ⁽²⁾. One third of the public debt increase from 2007 to 2014 was related to state interventions in SOEs. In addition, the complex network of SOEs may have masked corruption cases ⁽³⁾. In its attempt to address inefficient management of SOEs, reduce political interference and put together a privatisation project, Slovenia has vacillated between options involving different models. A new framework was finally adopted in March 2014 with the setup of the Slovenian Sovereign Holding (SSH). The SSH is fully owned by the government and is the body solely responsible for managing SOEs, with certain exceptions. The SSH released a new corporate governance code in December 2014 ⁽⁴⁾, and most recently, in July 2015, it was authorised by Parliament to manage SOEs on the basis of a fundamental management strategy ⁽⁵⁾. This progress led the OECD to officially confirm in September 2015 the completion of the monitoring process for Slovenia with respect to the recommendations relating to the corporate governance of SOEs ⁽⁶⁾. New supervisory and management boards for the SSH were appointed in July and October 2015 respectively. A set of performance criteria for SOEs and an annual management plan for 2016 were adopted in late 2015. In parallel, further progress was made in 2015 to privatise a number of companies in accordance with a 2013 Parliament decision, since 9 out of 15 companies have been sold so far ⁽⁷⁾.

The management strategy provides a classification of SOEs, confirming the extent of state's current involvement in the economy. Around 55 out of 100 directly-owned SOEs are classified as portfolio investments, thereby qualifying for possible full privatisation in the future. The remaining 45 are considered strategic or important investments and thus can be eligible only for partial privatisation, since the state is mandated to retain a stake of above 50% in strategic and above 25% in important investments. However, portfolio investments represent only 13.4% of direct state ownership in terms of book value of equity, while potential new commitments to privatise cover only 1% of the state portfolio (Graph 1) ⁽⁸⁾. Furthermore, additional restrictions are introduced, for instance preventing private investors from acquiring stakes higher than the state's 25 % threshold in important assets. Besides, the strategy lacks an insight in indirectly-held SOEs and does not offer any straightforward guiding principle as to their treatment, despite there are estimated to be more than 500 companies.

⁽¹⁾ The full set of country-specific recommendations for each year is available here: http://ec.europa.eu/europe2020/making-it-happen/country-specific-recommendations/index_en.htm.

⁽²⁾ Slovenia: State-Owned and State-Controlled Enterprises, ECFIN Country Focus, 2013, available here: http://ec.europa.eu/economy_finance/publications/country_focus/2013/pdf/cf_vol10_issue3_en.pdf. Country Report Slovenia 2015, available here: http://ec.europa.eu/europe2020/pdf/csr2015/cr2015_slovenia_en.pdf.

⁽³⁾ Case study by G Kuris, Toothless but Forceful: Slovenia's Anti-Corruption Watchdog Exposes Systemic Graft, 2004-2013 (2013), Princeton University.

⁽⁴⁾ Available here: <http://sdh.si/doc/ENG-News/Asset%20management/SSH%20Code-final.pdf>.

⁽⁵⁾ Available here: <http://www.sdh.si/doc/ENG-News/Asset%20management/State%20Assets%20Management%20Strategy.pdf>.

⁽⁶⁾ Letter by the Chair of the OECD Corporate Governance Committee, dated 9 September 2015.

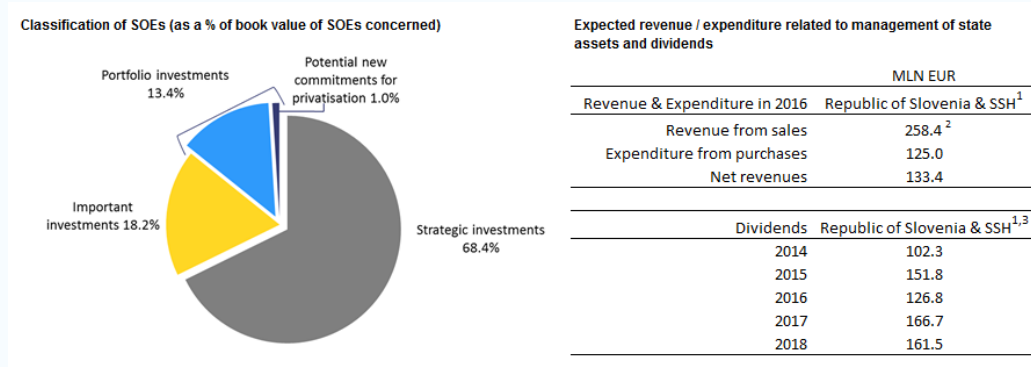
⁽⁷⁾ It is to be noted that closing of transaction is still pending for specific privatisations, notably the NKBM (a bank) and PALOMA (a hygienic products manufacturer), as they are subject to the fulfilment of certain conditions.

⁽⁸⁾ Potential new commitments refer to all portfolio assets but the SOEs falling within the 2013 list of privatisations and the Abanka and Banka Celje, whose privatisation as a merged entity has been committed in the context of the state aid procedure.

(Continued on the next page)

Box (continued)

Graph 1: SOEs portfolio and financial details of management



(1) According to the law on SSH, the totality of state assets is not consolidated under SSH's single ownership. Thus, a number of assets is managed by SSH but still owned by the Republic of Slovenia which explains the separate streams of revenue and expenditure. Also, certain categories of assets fall outside the law on SSH entirely.

(2) The largest part of the revenues is expected from the closure of the NKBM privatisation.

(3) Without Insurance Triglav. Dividends for 2016-2018 are those expected by the SSH.

Source: Asset management strategy, annual asset management plan for 2016, Commission calculations

The state's main objective is to improve corporate governance and the performance of directly-owned SOEs. The strategy sets the overall profitability target of the state portfolio at 8 % by 2020 and intermediate targets of 5.9 % in 2015, 6.3 % in 2016 and 7.1 % in 2017. Furthermore, it provides individual financial indicators for more than a half of the SOEs, classified as either strategic or important, which are benchmarked against the median and the first quartile of the industry. A number of common economic and non-economic indicators are also established for all SOEs in accordance with their classification. Those are quantified (though cannot be publicly disclosed) for each SOE in an annual management plan, which also sets targets on the basis of SSH analysis and determines proceeds from managing SOEs and anticipated privatisation programmes (see Graph 1). Similarly, the performance of the SSH is to be measured on profitability targets for the whole state portfolio, the number of successfully completed privatisations, the proceeds collected through dividends and cost effectiveness.

Recent reforms to improve the corporate governance and performance of SOEs are now going to be tested in practice. The SSH is entrusted with the task of turning around its large and highly diverse portfolio, reaching the profitability targets and continuing the privatisation projects in accordance with the management acts adopted. It is in charge of monitoring the performance of SOEs in an efficient way and taking corrective measures if performance targets are missed, for instance by replacing supervisory and management boards in the companies concerned. It is crucial that SSH acts independently of political pressure. The government has committed to a possible revision of the strategy after the first year and this may address any shortcomings noted and help to tackle any challenges that arise in practice. Other general economic implications, such as the impact of state ownership on growth, internationalisation and competitiveness of companies active in liberalised markets, could also be factored in when reconsidering the state ownership policy. A coherent system for the management of ownership oversight, potentially covering all state assets, is indispensable to ensure the separation of the government's ownership and regulatory functions and the professional management of SOEs.

2.3. FISCAL SUSTAINABILITY

Taxation

Slovenia's overall tax revenue-to-GDP rate is below the EU average. It was at 36.7 % of GDP in 2014, compared with an EU average of 38.8 % of GDP. The tax structure in Slovenia is considered more growth-friendly than the EU average, with a higher share of indirect taxes and a lower share of direct taxes as a proportion of total revenues. In 2014, revenues from direct taxes were considerably lower than the EU average (7.2 % compared with 13.1 % of GDP in the EU), but social security contributions were higher (Section 3.1).

A proposed tax reform faced considerable opposition by several stakeholders. In November 2015, the Slovenian Government proposed legislative changes to facilitate a tax shift away from labour to capital. The key proposed changes were (i) the introduction of a beneficial tax arrangement for annual performance bonuses of employees⁽¹⁴⁾, (ii) the elimination of numerous tax incentives for companies and self-employed entrepreneurs, including incentives for R&D, and (iii) the adoption of a single tax rate for capital gains (25 %). However, during the consultation process, several stakeholders raised concerns and the government subsequently announced that it would postpone the adoption of any reforms until 2016 with effect from 2017. It also clarified that any future reform would not change the taxation of capital gains. Without increased revenue from changes to the taxation of capital gains, it is doubtful that the overall tax reform package could be introduced in a fiscally neutral manner as was previously intended.

Revenues from taxes on immovable property in Slovenia are considerably below the EU average. Revenues from recurrent immovable property taxation, which is less distortive to economic growth than labour taxes, are considerably below the EU average (0.5 % compared with EU average of 1.6 % of GDP in 2014). The authorities are currently considering introducing a revised version of the real estate tax that was repealed by the Constitutional Court in early 2014. The tax would be phased in between

⁽¹⁴⁾ According to the proposal only 50 % of performance bonuses would be subject to personal income taxation and they would be fully exempt from social security contributions.

2018 and 2020 and the tax burden from a revised real estate tax would remain at the same level as under the existing system of property taxation.

Slovenia has considerably improved the effectiveness of its VAT enforcement capacity in recent years. A recent report⁽¹⁵⁾ highlights that due to an improvement in tax collection, Slovenia was able to reduce its VAT gap⁽¹⁶⁾ by one-third over the course of 2013 and it has more than halved since 2009. In 2013, Slovenia had the fifth lowest VAT gap in the EU (5.8 % compared to an EU average 15.2 % of VAT total tax liability (VTTL)) due to several measures taken in recent years to tackle the grey economy and improve the efficiency of tax collection. On 2 January 2016, the newly adopted Act on Fiscal Verification of Invoices introduced a system of cash registers connected directly to the national tax authorities. The authorities estimate that the introduction of this measure will yield additional revenue of EUR 75 million in 2016.

The administrative process with respect to tax compliance takes considerably longer in Slovenia than the EU average. Although the time needed to file and pay taxes for a mid-sized company in Slovenia decreased in 2014 from 260 to 245 hours, it remains significantly higher than the EU average (185 hours). Frequent legislative changes and the length of procedures, particularly with respect to appeals, create uncertainty and are burdensome for businesses. The Slovenian authorities have taken steps to address these issues through amendments to the Tax Procedure Act.

Fiscal Framework

The completion of the fiscal framework and its full implementation would improve the credibility of the budgetary process in Slovenia. The Slovenian Parliament passed the Fiscal Rules Act in July 2015. Its main purpose was to implement the previously adopted constitutional amendment introducing a balanced budget rule in

⁽¹⁵⁾ Study to quantify and analyse the VAT gap in EU Member States:
http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat_gap2013.pdf

⁽¹⁶⁾ The VAT gap is the difference between VAT revenues theoretically established by legislation (VAT total tax liability or VTTL) and the amounts actually collected.

structural terms for the general government. The implementation of the law will be overseen by the Fiscal Council, an independent state authority that will consist of three members. After several delays, it is now envisaged that the Fiscal Council members will be appointed in mid-March 2016 at the earliest. Following the adoption of the Fiscal Rules Act, the government intends to adopt revisions to the Public Finance Act in 2016. The proposed amendments aim to strengthen the rules for all budgetary units and enhance the role of the Court of Auditors in budget implementation. Until now, there was a lack of a multi-annual perspective in the budgetary planning process in Slovenia, and the focus has been on adopting measures on an annual basis. A multi-annual approach to budgeting, particularly binding expenditure ceilings promotes fiscal discipline and will provide greater certainty to citizens and businesses regarding policy measures in the coming years. The Fiscal Rules Act introduced a rolling three-year framework for the preparation of the budgets but its actual implementation is dependent on the revisions to the Public Finance Act, which are currently being discussed. These revisions would put a multi-annual approach to budgeting on a statutory footing.

Fiscal sustainability

The deficit continues to decline however, the structural deficit remains considerably above the euro area average. Slovenia has taken welcome steps in recent years to reduce the deficit and improve the sustainability of public finances. However, Slovenia is forecast to have the third largest structural deficit in the euro area in 2016 (after Portugal and Spain). Under a no policy change scenario, Slovenia is forecast to have the largest structural deficit in the euro area in 2017 (2.8 % compared with a euro area average of 1.4 % of GDP). The structural deficit has actually further deteriorated since 2012 while it has steadily improved in the euro area as a whole.

The budgetary strategy has focused on introducing temporary measures rather than implementing structural measures. In structural terms, Slovenia has considerably underperformed other EU countries; Slovenia is the only Member State, where the structural balance is now more negative than it was in 2012. Relative to other countries currently under the excessive deficit

procedure, Slovenia has made considerably less progress in structural terms (Graph 2.3.1). The implementation of the various outstanding structural reforms could assist in reducing this structural deficit. The deterioration of the structural balance in Slovenia is due to the output gap closing more rapidly than the euro area average and is projected to turn positive in 2016. Slovenia is projected to have the largest positive output gap of all Member States in 2017 at 1.9 %, which means that the Slovenian economy is considered to be experiencing 'good times'. While GDP growth is projected to be slightly higher than the euro area average in 2016 (1.8 % vs. 1.7 %), potential growth is projected to be lower (0.7 % vs. 1 %). The lower potential growth is mainly the result of the low level of private investment and underscores the need to adopt measures to attract foreign direct investment (Section 2.2).

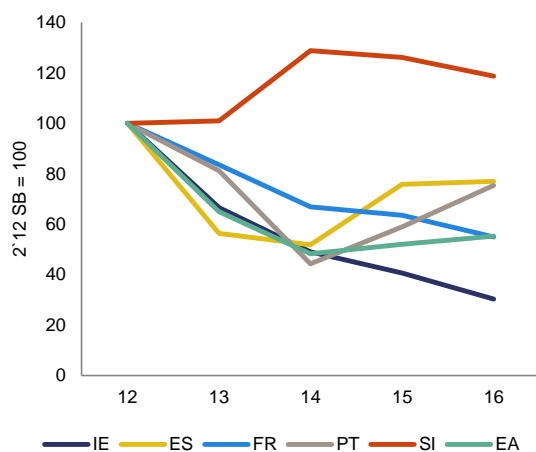
Slovenia faces considerable fiscal sustainability challenges in both the medium and long term.

⁽¹⁷⁾ Our assessment of the fiscal challenges is driven by several key components; initial budgetary and debt position, sensitivity to shocks and ageing-related costs. Our initial budgetary and debt position are based on the Commission 2016 winter forecast which projects a structural primary deficit of 0.1 pp. in 2017 and debt of 79.5 % of GDP. Ageing cost projections are based on the 2015 Ageing Report.

Public debt is expected to have stood at almost 84 % of GDP at year-end 2015. It is an increase of almost 3 pps. relative to 2014 before decreasing to 79.5 % of GDP in 2017. While this debt level is below the euro area average (94 % of GDP in 2015), the sharp trajectory represents a source of vulnerability. From 2008-2015, general government debt almost quadrupled from 21.6 % to 83.5 % of GDP.

⁽¹⁷⁾ European Commission (2016) "Fiscal Sustainability Report 2015", European Economy, Institutional Paper No. 018.

Graph 2.3.1: Evolution of structural balance



Source: European Commission 2016 winter forecast

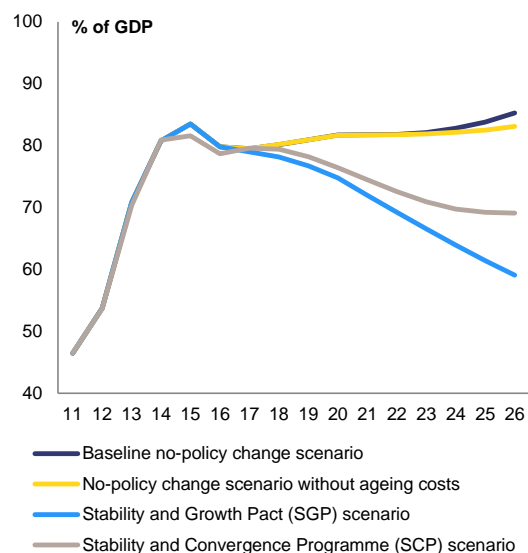
Public debt is projected to remain considerably above the 60 % of GDP threshold under a no-policy-change scenario.

Under a normal no-fiscal policy change scenario, public debt would increase slightly beyond 2017 to almost 82 % of GDP in 2020 and to around 85 % in 2026, almost 2 pps. higher than the initial level in 2015 (Graph 2.3.2) ⁽¹⁸⁾. This high level of debt leaves Slovenia vulnerable to nominal growth and interest rate shocks. A modest shock to interest rates would result in debt reaching almost 90 % of GDP in 2026 ⁽¹⁹⁾. If the structural balance converged towards the medium-term objective in compliance with the preventive arm of the Stability and Growth Pact, the public debt would decrease much more substantially than in the baseline projections, to around 59 % of GDP in 2026 (over 26 pps. less than in the baseline no-fiscal policy change scenario). However, this would require a significantly higher average structural primary balance than current projections for 2017 (i.e. it would require an average structural primary surplus of 2.4 % of GDP over 2017-2026).

⁽¹⁸⁾ The structural primary deficit remains at 0.1% of GDP as of last Commission forecast year (2017), real GDP growth rate assumptions are those agreed with the Economic Policy Committee – Output Gap Working Group. The long-term interest rate on government bonds is assumed to converge to 3 %, in real terms, within 10 years (by 2026). The inflation rate is assumed to converge to 2 % by the output gap closure year (T+5).

⁽¹⁹⁾ A +1 pp. on interest rates on new and rolled over debt from 2016.

Graph 2.3.2: Debt projections Slovenia



Source: European Commission

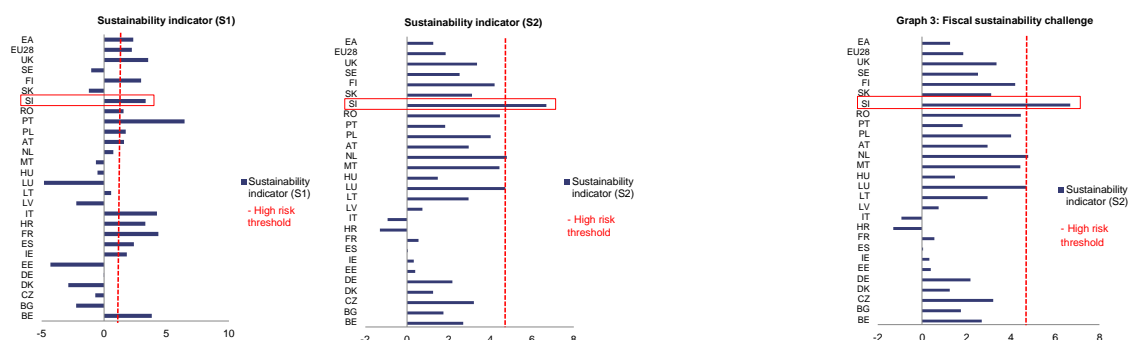
Slovenia is not at significant risk of fiscal stress in the short term, but risks are high in both the medium and long term. The medium-term sustainability gap indicator (S1) indicates that Slovenia requires a much more ambitious reduction in the structural primary balance over the next five years than under the current no policy change scenario (an improvement of 3.3 pps. of GDP until 2022) in order to reduce the debt-to-GDP ratio to 60 % by 2030 ⁽²⁰⁾. The vulnerabilities stem from the distance of the debt ratio from the 60 % reference value, (responsible for 1.4 pps. of GDP required fiscal adjustment), the projected age-related public spending (0.6 pps. of GDP) and the unfavourable initial budgetary position (0.7 pps. of GDP) ⁽²¹⁾.

Slovenia's ageing population is a key risk to fiscal sustainability, particularly in the long term. Slovenia's population is ageing faster than most Member States. The old age dependency ratio is projected to more than double between 2013 and 2060. In the long term, the fiscal adjustment would have to be even larger at 6.7 pps. of GDP to ensure that public finances are sustainable. Projected implicit liabilities related to the cost of ageing

⁽²⁰⁾ The S1 indicator measures the required fiscal adjustment needed over the next 5 years (from the last forecast year) to drive debt ratio down to 60% of GDP in 2030.

⁽²¹⁾ The initial budgetary position is defined as the gap to the debt-stabilising primary balance.

Graph 2.3.3: Fiscal sustainability challenge; S1 & S2 indicators for Member States



Source: European Commission

reflect the long-term challenges in terms of an ageing population. The steep increase in projected age-related expenditure is related in particular to pension expenditure and also healthcare and long-term care expenditure (Section 2.4.)

Slovenia has the highest long-term sustainability gap indicator of all Member States. At 6.7 pps. of GDP Slovenia's S2 indicator is considerably higher than for any other Member State and above the high-risk threshold (Graph 2.3.3)⁽²²⁾. This is primarily due to the strong projected impact of the steep increase in age-related public spending, with pensions accounting for 3.2 pps. of GDP required fiscal adjustment, and healthcare and long-term care for an additional 1.9 pps. of the required adjustment. Containing age-related spending and realising efficiency gains through reforms would improve fiscal sustainability over the medium and long term.

Long-term care

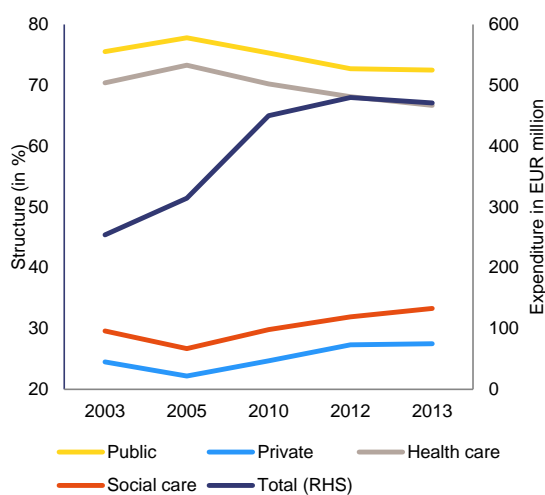
Public expenditure on long-term care is projected to more than double by 2060 due to population ageing. This poses a significant fiscal sustainability challenge for Slovenia. The share of the population aged 80 years and older is projected to rise three-fold, from 4.6 % in 2013 to 12.4 % in 2060, and the dependency ratio is projected to double, from 26.9 % in 2013 to 58.3 % in 2060, both above the EU average. At the same time,

comorbidities are increasing, and they tend to be more common among older people and typically imply higher costs of care. In 2013, the total expenditure on long-term care was EUR 471 million (1.4 % of GDP), with 72 % covered by public funds. Between 2003 and 2013, overall expenditure on long-term care increased by 85 % with private expenditure growing at a higher pace than public expenditure⁽²³⁾. As almost half the public budget for long-term care services is covered by mandatory health insurance (EUR 160 million or 47 % in 2013), the reform of long-term care is closely dependent on the healthcare reform. Other sources of funding include compulsory pension and disability insurance, national and municipality budgets and out-of-pocket payments. Multiple funding streams can give rise to cost-shunting (Graph 2.3.4).

⁽²³⁾ Private expenditure rose from 24 % of total expenditure on long-term care in 2003 to 27 % in 2013 as a result of increasing expenditure for the social component of long-term care

⁽²²⁾ The S2 indicator gives the upfront structural adjustment required to stabilise the debt-to-GDP ratio over the infinite horizon.

Graph 2.3.4: Expenditure on long-term care



Source: Statistical Office of Republic of Slovenia.

Financing through social security contributions carries implicit sustainability issues when coupled with increased longevity and a score on healthy life years at birth amongst the lowest in OECD countries. This kind of financing relies on contributions from the employed. Projected population trends indicate that the ratio between those in employment and the elderly will decrease. This scenario is aggravated by figures on healthy life years, suggesting that, in Slovenia, it is more likely than average that these additional years of longevity would be in less-than-perfect health. Hence, there is scope for Slovenia to further improve health and decrease the potential need for long-term care benefits, thus contributing to sustainable financing. Sustainable financing requires a balanced mix of funding from different sources (social contributions, taxes and out-of-pocket payments), to protect the provision of services from economic fluctuations and improve the provision of community services.

As part of the effort to rationalise and contain expenditure, work is ongoing to strengthen preventive measures. Reportedly, pilots have been launched in several areas and appear to be promising in terms of fostering greater involvement of local communities in service provision. At the current early stage, it is not possible to assess results. An additional challenge to this assessment is posed by the lack of an established set of criteria to evaluate the quality of

social services. The nature of these services means it is difficult to measure the quality of provision, as this is mainly captured by the patients' perception of the care received. As a result, the quality of social services is measured with indicators covering mainly inputs such as staff qualifications and equipment while outcomes are currently not measured.

Fragmentation of funding is reflected in the fragmentation of services. There is no unified entry point or a standard model of care-needs assessment for these services, which creates risks for 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. This has, in part, been attributed to providers operating under different regulatory systems. The providers can be public or private entities with concessions. The share of informal carers aged 50 and over is relatively low (11 % in 2013), but the intensity of care they provide is high, leading to a reduction in labour force attachment for caregivers, higher poverty rates and a higher prevalence of mental health problems. Social long-term care services are partially subsidised by the state or the municipality but these vary in their ability to provide adequate community based long-term care services.

There is no integrated long-term care in Slovenia. Slovenia focusses its spending on formal in-kind benefits, the majority of which is spent on institutional care rather than home care, although both figures are below EU average. At the end of 2012 there were a total of 59 122 recipients of long-term care. Of these, 35 % were in institutional long-term care, with another 35 % receiving home-based long-term care services. Just under 30 % of recipients received cash benefits and less than 1 % were users of organised day care services ⁽²⁴⁾.

The draft law on long-term care was due to enter public consultation in October 2015 but has been postponed. It will not be adopted until after the reform of healthcare as the latter needs to clarify the issue of financing. The analysis of needs is currently ongoing. It has been roughly

⁽²⁴⁾ European Observatory on Health Systems and Policies et al: *Analysis of the health system in Slovenia, activity 5: Optimising service delivery*, October 2015 (draft for internal use only at this stage).

estimated that an additional EUR 200 million per year will be needed, but it is not clear which additional services this would cover. Nor is it clear yet what threshold for access to LTC services will be established.

Pension system

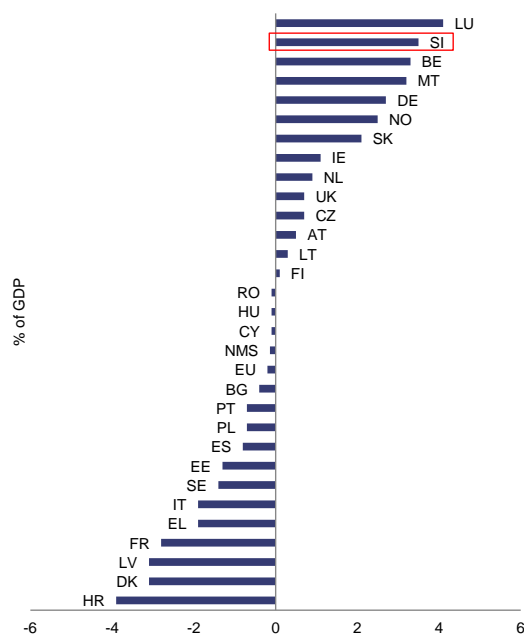
Pension expenditure is expected to increase substantially over the long term, despite positive initial effects of the 2012 pension reform. According to the 2015 ageing report, Slovenia's public pension system shows the second highest projected pension spending increase in the long run (Graph 2.3.5). Up to 2060, public pension expenditure is projected to increase by 3.5 pps. to 15.3 % of GDP. For the EU, a decrease of 0.2 pps. to 11.2 % is projected. The 2012 pension reform is stabilising pension-related expenditure in the short to medium term. Pension expenditure is projected to bottom out in 2022 (at 11 % of GDP). In subsequent decades, the sustainability risks will increase sharply (Graph 2.3.6). Between 2030 and 2040, Slovenia is projected to experience the largest increase in public pension projections in the EU (+2 pps. of GDP) and pension expenditure is projected to peak in 2053 at 15.7 % of GDP.

Population ageing is projected to contribute the most to the increase in public pension expenditure in Slovenia. Specifically, old age dependency contributes 9.7 pps. of GDP in Slovenia and 7.2 pps. in the EU. The 2012 pension reform is expected to address only partially the negative budgetary effect of demography in the long run. Slovenia has not yet adopted sufficient measures to increase retirement ages, boost the employment rate of older workers and contain pension expenditure (Graph 2.3.7).

The Slovenian pension system is designed to avoid negative pressure on the future adequacy of pensions, provided that workers have full working careers. The average pension level has stabilised at around EUR 560 and so has the pension benefit ratio. Despite restricted access to early retirement, pensions will continue to decrease until 2019 due to the increasing number of best consecutive years (from 18 to 24) for the

calculation of the pension assessment base and the new indexation rule⁽²⁵⁾.

Graph 2.3.5: Change in gross public pension expenditure between 2013 and 2060

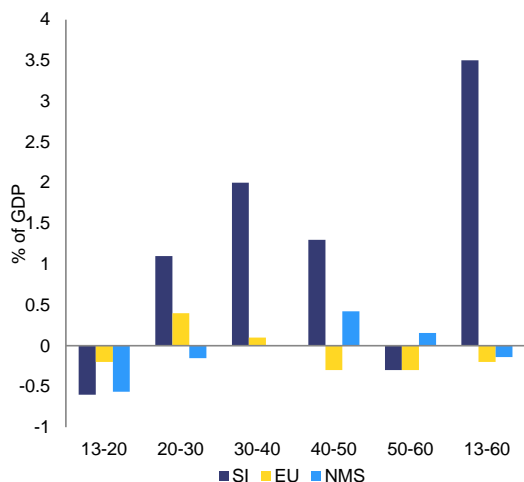


Source: The 2015 Ageing report.

Adequacy problems for workers with less than full working careers can be expected in the future. The adequacy challenge concerns those with incomplete or short working careers, also due to their late entry into the labour market, those working in intermittent jobs and those with a low contribution density. The 2008 crisis saw a further increase in the number of people working part-time and on fixed-term contracts. In addition, the younger generation tend to have relatively low contribution density. At 17.1 % the percentage of elderly at risk of poverty is above the EU average of 13.8 %. Pensions were frozen from 2012 until January 2016 when there was a one-off increase in pensions of 0.7%.

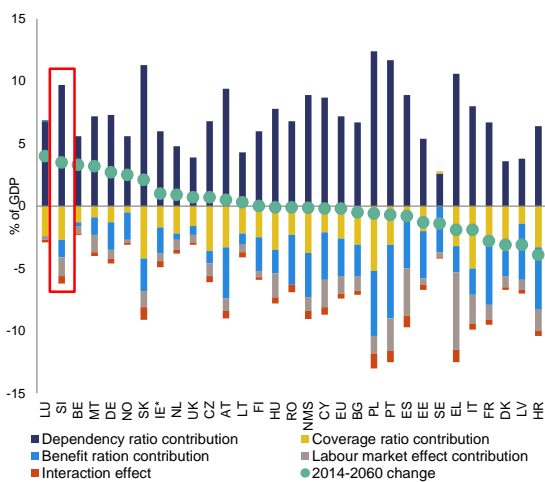
⁽²⁵⁾ 2015 Pension Adequacy Report.

Graph 2.3.6: **Change in gross public pension expenditure over the period 2013-2060**



Source: The 2015 Ageing report.

Graph 2.3.7: **Decomposition of public pension expenditure to GDP**



Source: The 2015 Ageing report.

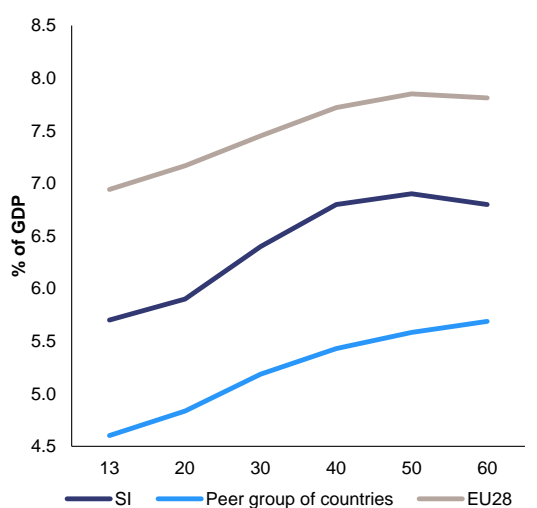
A white paper on pensions is expected to be adopted in February 2016 and will serve as the basis for a new pension reform. The white paper is expected to cover labour market developments, the link between retirement age and life expectancy, pensionable earnings base, costs of labour, a points system, the occupational pension pillar and occupational rehabilitation. Pension legislation was amended in December 2015 to modernise occupational insurance and extend the dual status of pensioners who continue working beyond retirement age.

2.4. HEALTH

Long-term trends

Expenditure on health care is driven by a number of factors such as population size and structure, population health, the individual and national income, technological progress and institutional and organisational settings. In 2013, public health expenditure in Slovenia (as % of GDP) stood at 5.7 %, which is below the EU average (6.9 %) and above the level of the peer group of countries (4.6 %) (Graph 2.4.1) ⁽²⁶⁾.

Graph 2.4.1: Public expenditure on healthcare, Ageing Working Group reference scenario



Source: The 2015 Ageing Report

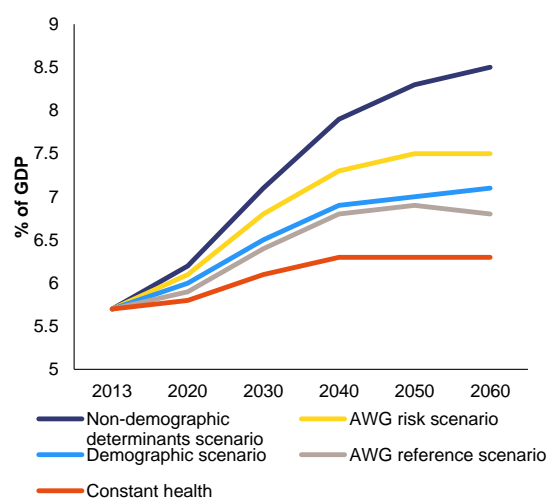
According to the projections, Slovenia will face a significant fiscal sustainability challenge in the area of health care ⁽²⁷⁾. The 2015 Ageing report reference and risk scenarios, agreed by the Ageing Working Group, suggest that over 2013-2060 public health expenditure may increase in Slovenia by between 1.2 and 1.9 pps of GDP (in the EU on average between 0.9 and 1.6 pps and in the peer group of countries between 1.1 and 2 pps) (Graph 2.4.1). Under the demographic scenario, which attempts to isolate the "pure" effect of an ageing population on health care spending, the increase will reach 1.4 pps by 2060 (Graph 2.4.2). In addition to the ageing population and according to the risk scenario, long-term sustainability is also

⁽²⁶⁾ The peer group of countries include the Member States which joined the EU after 2004

⁽²⁷⁾ Public health expenditure used for projections includes capital investment in health but excludes expenditure on long term care.

projected to come under pressure from non-demographic drivers, such as medical technology, regulation in the health sector and individual behaviour. Conversely, improvements in the health status of the population are crucial to keep expenditure on health care under control.

Graph 2.4.2: Public expenditure on healthcare in Slovenia, different Ageing Working Group (AWG) scenarios



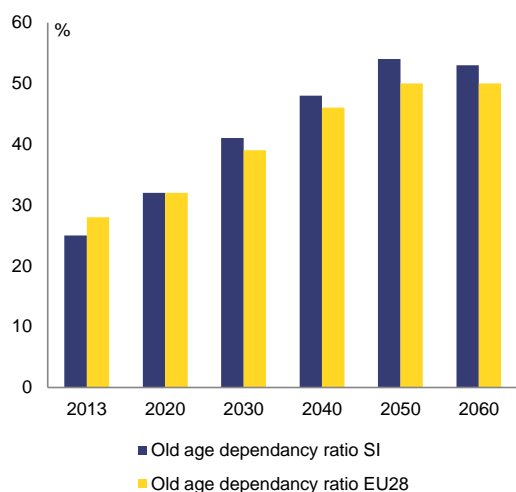
Source: The 2015 Ageing Report

Population structure and ageing is projected to be one of the key drivers of increasing healthcare expenditure. Given Slovenia's ageing population (Graph 2.4.3), a growing share of older people may require additional health care goods and services in the coming years. The relationship between the age of an individual and his/her spending on health care is shown by age-related expenditure profiles of health care. The profiles suggest that spending normally increases with the age of a person, notably from the age of 55 (for men) and 60 (for women) (Graph 2.4.4).

The ageing population and funding features of the health care system pose risks to the sustainability of health care financing. In many Member States, including Slovenia, public health care is largely financed by social security contributions made by the working age population. In Slovenia, (compulsory) health contributions are paid by employees and employers while the state, municipalities and social security funds pay contributions for non-employed population groups, notably for pensioners (pension and disability

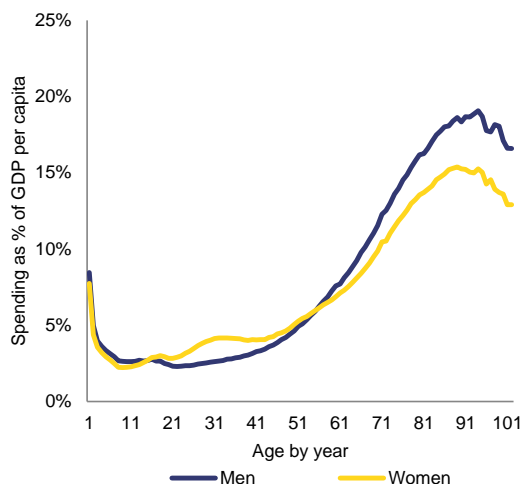
fund), people registered as unemployed (public employment service) and social assistance recipients (municipality). As of 2014, an employee on average contributed EUR 203 per month (for coverage for themselves and their household) while the average contribution per month for the unemployed (EUR 104) and pensioners (EUR 56) was substantially lower (Graph 2.4.5). In view of the increase of old-age dependency and the population groups with lower contributions (notably pensioners), healthcare revenues from health contributions are expected to shrink.

Graph 2.4.3: Old age dependency ratio



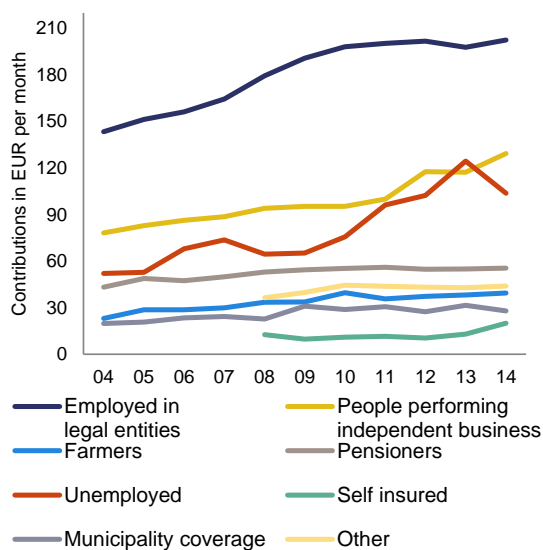
Source: The 2015 Ageing Report

Graph 2.4.4: Age-related expenditure profiles of health care provision, EU28



Source: The 2015 Ageing Report

Graph 2.4.5: Average contributions to HIIS, per person



Source: Health system expenditure review; Health Insurance Institute of Slovenia (HIIS)

Structural challenges in the short and medium term

The health care system is characterised by a lack of sufficient in-built automatic stabiliser schemes, which could cushion revenue fluctuations over the business cycle. Financing of health care in Slovenia is heavily dependent on health contributions. This is also the case in some

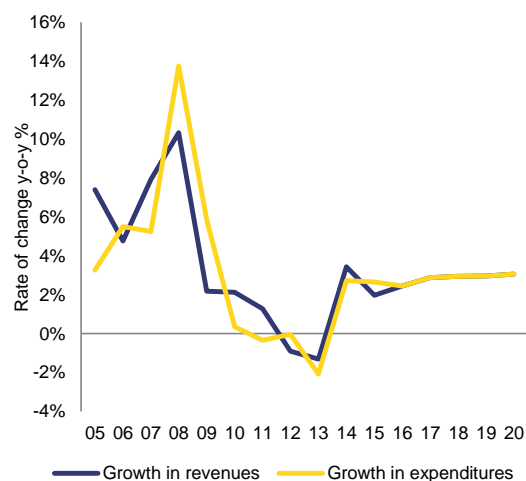
other Member States. However, in Slovenia health contributions are almost entirely financed by employees, and the state share is among the lowest in the EU. Consequently, health care revenues are strongly correlated with labour market activity. Furthermore, institutional settings require that the Health Insurance Institute of Slovenia (HIIS), which is the only institution funding compulsory health care, cannot record a loss at the end of the year or accumulate debt, although it can obtain short-term loans from the treasury throughout the year. Therefore, any fluctuations in health revenues have to be accommodated by changes in expenditure on an annual basis.

During the economic downturn over 2008-2013, the HIIS had to take several measures to accommodate lower revenue growth. The measures included lowering prices for hospital services, which contributed to losses by the hospitals, extended waiting times, and the postponement of payments to providers⁽²⁸⁾. Furthermore, the HIIS increased co-payments, which ultimately increased the premium for voluntary health insurance (with an almost universal coverage). While the ad hoc measures protected the public basket of healthcare goods and services and ensured coverage for the entire enrolled population, the adoption of systemic measures (such as strengthening of the reserve fund, diversification of funding) would be more efficient in smoothing revenue fluctuations over the business cycle.

In the short to medium term, the growth rate of health revenues is not expected to return to pre-crisis levels. According to the HIIS, the growth rate of health revenues (and expenditure) is expected to be 3 % per year between 2016 and 2020. This is much less than the 4.7 % over the period 2004-2007 (Graph 2.4.6).

⁽²⁸⁾ HIIS delayed payments of EUR 41 million in 2011, EUR 64 million in 2012 and EUR 49 million in 2013, each time for one year. In 2014 HIIS paid all liabilities.

Graph 2.4.6: **Projection of revenue and expenditure in Slovenia**



Source: Health system expenditure review

Health outcomes

Slovenia has a rather mixed performance in terms of population health. On the one hand, infant mortality is the lowest in the EU; on the other hand, the gap between life expectancy and healthy life years is one of the largest in the EU for both men and women, with both indicators for men among the lowest in the EU. Moreover, compared with other EU countries, excessive mortality from cancer and cardiovascular disease is evident.

Slovenia is underperforming in four out of seven OECD quality of health indicators⁽²⁹⁾, although some progress has been made as a result of screening programmes and early diagnosis of certain types of cancers. Better access to innovative treatments offers an important potential for efficiency gains.

Slovenia has one of the lowest levels of unmet health care needs in Europe for all income groups. However, waiting times have increased in recent years. In 2014, the number of patients waiting for health care services increased by 17 % to 182 498, and the number of patients waiting

⁽²⁹⁾ The indicators refer to case-fatality for ischaemic stroke, cervical cancer survival, breast cancer survival, and colorectal cancer survival. They provide a first impression on the relative strengths and weaknesses of healthcare systems in different OECD countries.

longer than the maximum waiting period rose by almost one third to 24 815.

The role of efficiency gains ⁽³⁰⁾

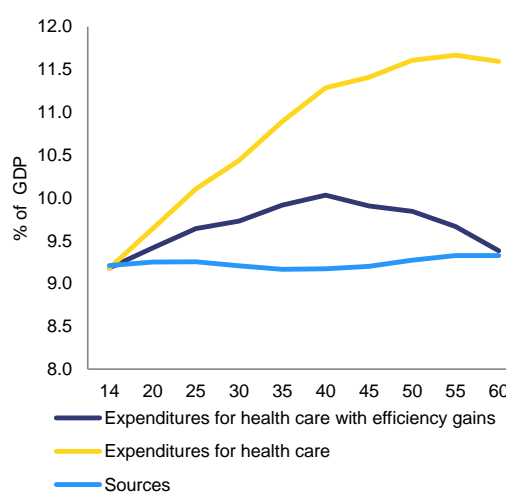
There is a significant scope for increasing the efficiency of the healthcare system. More efficient use of resources in Slovenia could translate into improved life expectancy at birth, improvements in healthy life expectancy or into cuts in the amenable mortality rate. Alternatively, it could promote savings while achieving the same health outcomes.

Improved efficiency could help to contain the total healthcare-expenditure-to-GDP ratio in the long run without compromising access to (quality) care. Using the estimates by the Institute for Economic Research (based on the 2015 Ageing Report), potential cumulative savings of 20 % over 45 years could be achieved with annual efficiency gains of about 0.5 %. These savings would entirely reverse the total increase in healthcare expenditure projections by 2060 in the reference scenario (Graph 2.4.7) and more than halve projections in the risk scenario (Graph 2.4.8) ⁽³¹⁾. This subsection explores some areas in which efficiency gains are possible. The focus is on improved performance of the health care sector and specifically on economic savings, which could help to keep healthcare expenditure sustainable in the long run. In addition, the performance of hospitals is discussed as hospitals consume a large proportion of the total budget. Several aspects relevant for hospitals also apply to other health care providers.

Slovenia spends relatively more on costly treatments with hospital admissions (in-patient care) and relatively less on services that do not need overnight stay in hospitals (out-patient

care) ⁽³²⁾. Slovenia spent more on in-patient care and medical goods compared with other OECD countries (Graph 2.4.9). This is confirmed by the relatively high number of in-patient surgical procedures (7 577 procedures vs EU average 6 779 per 100 000 persons in 2010). There have been only minor variations in the structure of current health expenditure since 2008.

Graph 2.4.7: Total expenditure on health care 2013-2060 – Ageing Working Group (AWG) reference scenario



Source: Institute for Economic Research

Some indicators suggest that the performance of public hospitals could be improved ⁽³³⁾. There is evidence of excess bed capacity given that the acute care bed occupancy rate is among the lowest in the EU (at 69 % compared with the EU average of 77 % in 2013). Similarly, the average length of stay in hospitals is relatively long (at 6.3 days compared with the EU average of 6.1 in 2013), which increases the costs per discharge. There is potential for cost savings by treating more patients as day cases.

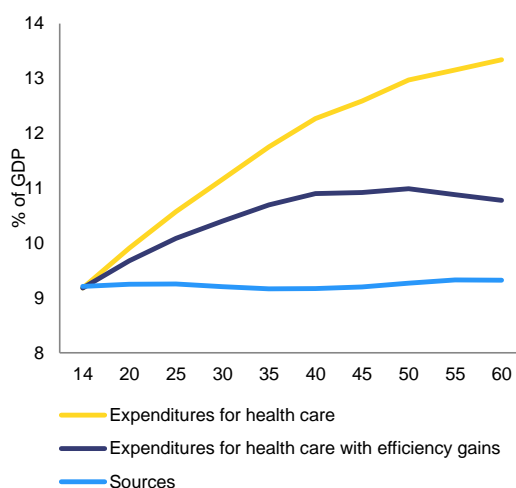
⁽³⁰⁾ The information in this chapter is largely based on the analysis of the health system undertaken by the authorities in cooperation with the World Health Organisation and the European Observatory on Health Systems and Policies. Specifically, the chapter is based on the following reports: Health System Expenditure Review, Purchasing and Payment Review, and Optimizing Service Delivery published on the website of the Ministry of Health: http://www.mz.gov.si/si/pogoste_vsebine_za_javnost/anali_za_zdravstvenega_sistema/

⁽³¹⁾ The reference and the risk scenario are the same to the Ageing Working Group scenarios, but they include private expenditure. It is assumed that private expenditure increases at the same rate as public expenditure.

⁽³²⁾ Based on the OECD Health at a glance 2015.

⁽³³⁾ There are 26 public hospitals in Slovenia, including four tertiary hospitals (University Hospitals Ljubljana and Maribor, Oncological Institute and Rehabilitation Institute) and seven specialized hospitals (five psychiatric hospitals and two obstetric hospitals). In addition, there are three small private facilities with a concession to provide public in-patient services.

Graph 2.4.8: Total expenditure on health care 2013-2060 – Ageing Working Group (AWG) risk scenario

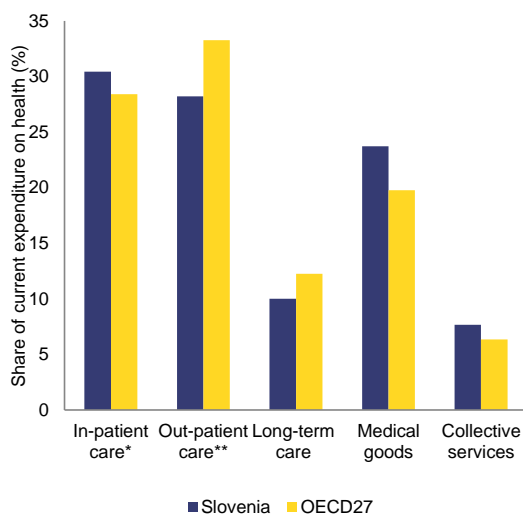


Source: Institute for Economic Research

Conversely, six hospitals, representing only about 7 % of total hospital revenues, have seen cumulative surpluses in all years since 2004. Since 2009, the accumulated indebtedness of hospitals has more than tripled. The increase of debt has been driven primarily by a group of eleven hospitals. Most of the accumulated debts are short-term liabilities to suppliers.

Hospitals have made operating losses in all years but 2008-2009 (Graph 2.4.11). The operating surpluses (excess of revenues over expenses) were remarkably high in 2008-2009, in particular in the group of highly indebted hospitals due to a one-off transfer from HIIS at the end of 2008. The total operating loss was the highest in 2013, driven by the changes in the basic salaries of public sector employees, which were not reimbursed by the HIIS. In 2014, the operating loss decreased substantially, but one quarter of hospitals, including the biggest hospital, are still loss-making.

Graph 2.4.9: Current health expenditure, 2013



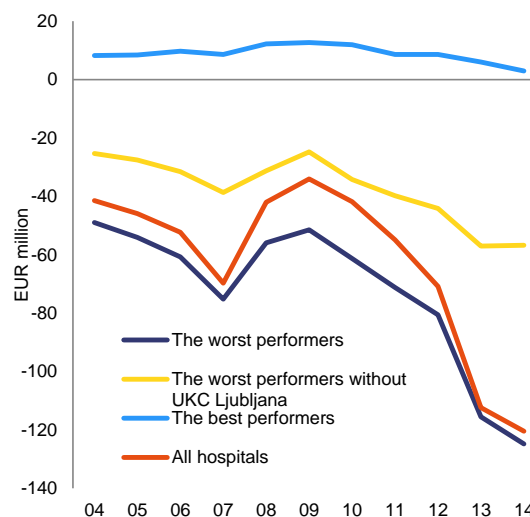
* Refers to curative-rehabilitative care in in-patient and day-care settings.

** Includes home-care and ancillary services.

Source: OECD Health Statistics 2015.

Hospitals debt has increased since 2004 (Graph 2.4.10). Eleven out of twenty six hospitals, representing more than 70 % of total hospital revenues, have been indebted in all years since 2004, in particular the biggest hospital UKC Ljubljana (35 % of total hospital revenues).

Graph 2.4.10: Accumulated debts or surpluses



The worst performers are the hospitals with cumulative debts in all years since 2004 (11 out of 26 hospitals, representing 72% of hospital revenues). The best performers are the hospitals with cumulative surpluses in all years since 2004 (6 out of 26 hospitals, representing about 7% of all hospital revenues).

Source: Report on public health providers (Poročilo o poslovanju javnih zdravstvenih zavodov in JAZMP), European Commission.

Hospitals have little incentive to effectively reduce their debt. The Public Institute Act states that the founder is responsible for the liabilities of public institutes. The government has occasionally

covered accumulated hospital debts, but not on a systematic basis. As hospital budgets are rather soft, there is little incentive for hospital management to increase productivity, either by delivering more services or refusing to accept higher costs of care (e.g. expensive technologies). These incentives are exacerbated by weak governance of hospitals and shortcomings in the purchasing process and hospital payment system.

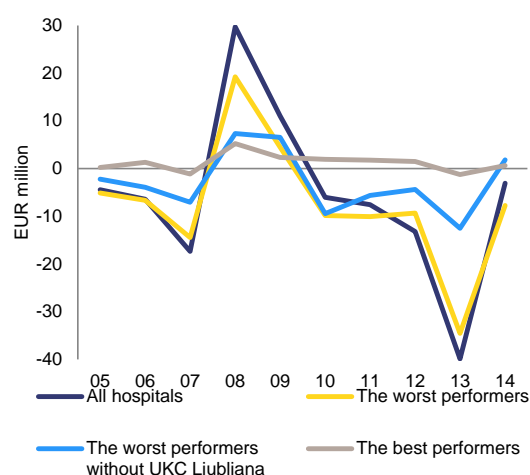
Governance of public hospitals appears weak.

The supervisory function is entrusted to the council⁽³⁴⁾. However, exactly who the council represents (e.g. the state, public interest or citizens) and the scope of its supervision are not always clear. The council appoints a manager subject to approval by the founder. The manager must have tertiary education and at least five years of work experience; however, education and work experience required is not specified⁽³⁵⁾. The current governance of hospitals is prone to political interference.

⁽³⁴⁾ The council is composed of representatives of the founder (state, commune, city), workers, insurers and other members appointed by the Health Insurance Institute of Slovenia.

⁽³⁵⁾ The only exception applies for (normally smaller) public institutes, where directors are in charge of both business management and management of professional activity. In this case, directors must have tertiary education in health sciences.

Graph 2.4.11: Excess of revenues or expenses



The data over 2005-2007 are derived from the data on accumulated debts/surpluses. The worst performers are the hospitals with cumulative debts in all years since 2004 (11 out of 26 hospitals). The best performers are the hospitals with cumulative surpluses in all years since 2004 (6 out of 26 hospitals).

Source: Report on public health providers (Poročilo o poslovanju javnih zdravstvenih zavodov in JAZMP), European Commission.

Selection criteria for the council members in hospitals have been recently adopted.

The candidates should have at least tertiary education and knowledge (or experience) about how public institutes are organised and managed, and the health system and legislation. However, it has not been ensured that the council will have specific knowledge in the field of finance, corporate governance, or other skills needed to execute efficient supervision with regard to the activity, scope of operations and other characteristics of hospitals. The final decision to appoint the council members and ensure that the different and balanced skills needed to manage hospitals efficiently remains within the competence of the Minister for Health. Furthermore, there are no specific professional qualifications required for the middle management in hospitals, which is in charge of cost control.

Hospitals have limited autonomy and responsibility in strategic decisions.

Hospital managers cannot take autonomous decisions related to new activities or the expansion of existing activities. They must seek approval from the founder, which must provide the necessary funding. In addition, employees are paid according to the wage system fixed in collective agreements

for the public sector. The hospital's management can set the variable part of wages related to employees' performance only within certain limits and cannot define the criteria to choose the size of supplements. As a consequence, management has a limited ability to reward high performing employees and incentivise others. Furthermore, hospitals do not have their own assets, so there is little incentive to manage them effectively⁽³⁶⁾.

The purchasing process does not make it easier for hospitals to take effective management decisions. The adoption of the general agreement, which stipulates the national level budget and the volume of services, is generally delayed⁽³⁷⁾. This results in health providers not knowing the terms and conditions of operations for the running years and instead receiving one twelfth of the funds of the previous general agreement on a monthly basis. As a general agreement is concluded only for one year, public health providers have limited capability to pursue long-term goals. Furthermore, individual contracts concluded between health providers and the HIIS are not sufficiently specific (e.g. in terms of services that need to be provided and timeframe, quality requirements and indicators, evidence based clinical guidelines that need to be followed). Thus, the providers have scope to change and perform activities which are not in line with population needs. Finally, control and monitoring systems are lacking as the HIIS does not systematically audit providers.

Competition in the contracting process is weak due to non-selective contracting and a decentralised concession system. The HIIS contracts individual health providers through public tenders, which are open to all public and private health providers with a concession to work in the public system. However, as the HIIS cannot selectively contract individual providers based on efficiency, all providers receive a contract. Thus, there is no true competition for contracts. In addition, concessions, which are granted by the

municipalities and for an indefinite period of time, are not strictly regulated or based on public health goals and population needs. This leads to potential sub-optimal allocation and use of resources.

Health technology assessment can help to contain expenditure growth while maintaining access to quality care. Contrary to the practice in the EU, health technology assessment is not formally established in Slovenia; having this would support the introduction of new health care technologies into the compulsory health insurance system. Specifically, there is no clear mechanism to determine which new services are to be covered by compulsory health insurance and which (obsolete) services should be removed from public coverage. Thus, the criteria such as effectiveness, safety and costs of different services to be covered are not taken into account. Health technologies are usually introduced arbitrarily and, as a result, providers have considerable leeway in what they can bill to insurance. This is the case also for medical devices.

The current hospital payment system is not specific to Slovenia. The current hospital payment system was introduced in Slovenia in 2004 based on an imported version of Australian diagnosis-related groups (DRGs)⁽³⁸⁾. This means that payments to hospitals are based on cost weights, which may lead to overpayment for some DRGs and underpayment for others. The imported DRGs weights still need to be adjusted to local conditions. Furthermore, DRGs-based payments are not adjusted for day cases, short-stay or long-stay outliers. In addition, there is no system for monitoring and managing readmissions to counter incentives for higher readmissions. Control of reported case data by the HIIS is impaired as there are very few medical reviewers and no checks of medical documentation in hospitals.

The quality of the cost information system and institutional support for adjusting and updating the current hospital payment system could be improved. There is no national DRGs institution in charge of adjusting and updating both the definitions of DRGs and DRGs cost weights. National cost weights are missing (except for a small number of DRGs) and cannot be calculated

⁽³⁶⁾ In 1991, the Public Institute Act defined that all assets of public institutes are the property of the founder while public institutes are entrusted with management of the assets. Any acquisition of new assets becomes also the property of the founder. Although this solution has been envisaged as temporary, the issue has not been revisited.

⁽³⁷⁾ The general agreement is negotiated between the HIIS, MoH and other partners, and to a large extent predetermines individual contracts between health providers and the HIIS.

⁽³⁸⁾ DRGs represents a class of patients with similar clinical conditions requiring similar hospital services

as there are no standardised rules for cost accounting and data collection in hospitals. Financial statements of hospitals are not sufficiently standardised and detailed to allow an adjustment of cost weights to the national context. Standardised high-quality cost data is essential to precisely estimate DRGs, which in turn is needed for transparency and to make managers more accountable.

Hospital budgets are fixed, so management has low incentives to make more efficient use of the available infrastructure (e.g. by increasing the number of day cases or reducing length of stay). DRGs-based hospital budgets in Slovenia are defined on the basis of the budget for the previous year and annual negotiations between the HIIS and each provider⁽³⁹⁾. Capped budgets do not provide incentives for hospitals to increase productivity. International evidence suggests that this could be achieved by focusing on DRGs allocation of resources. In Ireland, hospitals have an incentive to increase their activity as this gives them a larger share of the national hospitals budget while in Germany hospitals are paid also for DRGs beyond the capped budget, albeit at a reduced rate.

There seems to be scope for hospital network rationalisation. This is evidenced by low acute bed occupancy rates and inequities in access. Slovenia has a public network that is largely based on historically-developed supply factors, which have led to large discrepancies in the distribution of providers and health professionals. Given the large number of general hospitals in Slovenia, a shift towards specialisation of hospitals could improve efficiency.

Improvements in public procurement can help to reduce public health expenditure. In the period 2010 to 2014, EUR 995 million was spent on public procurement in the health care sector. At national level the Ministry of Health organises centralised public procurement procedures to

⁽³⁹⁾ Specifically, budgets are defined in terms of the total number of DRGs weights and the total number of cases, for which the hospital will receive reimbursement from the HIIS. In theory, hospitals receive DRGs-based case payments per treated patient and they are very rarely paid for DRGs provided in excess of the agreed DRGs-based budget. However, in practice, hospitals receive every month 1/12th of the annual budget and they usually treat patients also after having reached the DRGs-based budget cap.

purchase medical products. Yet, there is scope for a further increase in centralisation or joint procurement, not only to reduce costs but also to achieve better value for money, especially by making use of award criteria related to quality. In the period 2010 to 2014, the share of joint procurement as a proportion of the total number of contracts awarded in the health sector was only 1.4 % (7.7 % EU average). In addition, there seems to be too much focus on the ‘lowest price’ award criterion as this criterion was used in 96 % of the cases (51 % EU average). It should also be acknowledged that some purchases are still made without public procurement procedures⁽⁴⁰⁾. Finally, some perceived corruption, risk of corruption and conflicts of interest/nepotism was reported for Slovenia.

Several activities are on-going to improve public procurement in the health sector. A pilot project of joint public procurement for certain medicines in hospitals was recently established. Due to its positive results, the project expanded in 2015 to include most medicines purchased by hospitals. Joint public procurement for medicines is now obligatory for all public hospitals. To further rationalize public expenditure, in 2015, the authorities initiated activities for joint public procurement in the area of medical devices and medical equipment. These activities are being carried out gradually.

Voluntary health insurance could be used to rationalise the use of medical goods and health services. But since it is paid in nearly all instances, it cannot do this effectively. Voluntary health insurance pays the coinsurance portion of the compulsory covered services. Co-payments vary from 10 % to 90 % depending on the specific area of treatment or activity. High and unlimited co-payments mean that the coverage of the population subject to co-payments under the compulsory insurance is almost universal (at 95 %). Complementary insurance fully covers the costs of medical goods and services, so patients have no perception of the actual cost of their care other than through the insurance fee. This removes the

⁽⁴⁰⁾ For example, where big medical equipment (CT scanner) was purchased, in 2010-2013 there was a discrepancy between the de facto health sector purchases which fall under public procurement rules and the number of purchases actually carried out as such under procurement rules.

incentives to contain potentially unnecessary over-consumption of services.

Most general practitioners and specialists are public employees and are paid according to the civil servant pay scale. This type of wage setting does not seem to provide sufficient incentives for health professionals to improve their performance. The most important supplementary income is provided by payments of ‘equivalent hours’⁽⁴¹⁾. While this practice provides some flexibility in wage setting, it is highly in-transparent and can lead to work-place absenteeism. Any payment reform is likely to miss its objective if management of health providers (e.g. hospitals) has only limited autonomy to make decisions on staff and equipment and if ultimately the risk of providers is borne by the state.

There is a scope to strengthen primary care as a gatekeeper for in-patient care. Slovenia has a strong primary care foundation; however, it faces the challenge of fragmentation of service organisation and delivery. This is evident in the relatively loose coordination and collaboration between different providers and across organisation and institutions, from prevention and early detection to the management of multiple care needs by bridging health and long-term care. Options to strengthen primary care and control costs in Slovenia include standardised processes and procedures for patient handover between care levels, comprehensive support after hospital discharge, improvements in IT, better guidance and protocols, and building on recent good experience (such as family medicine ‘model’ practices).

There is no standardised framework to monitor the quality of services in hospitals. The process of collecting quality-related data and developing indicators in both the primary care and the hospital sector has started, but is only at an initial phase, particularly in the hospital sector. Current data are not yet suitable as metrics for a rigorous system for measuring or rewarding quality.

An incremental healthcare reform is foreseen in the coming years. The comprehensive analysis of the health care system undertaken in cooperation with the World Health Organisation and the European Observatory on Health Systems and Policies will serve as a basis for the reform. On the basis of the analysis, the National Health Care Resolution Plan 2016-2025 was approved by the government in December 2015 and is expected to be adopted by Parliament in March 2016. It is expected that the Health Care and Health Insurance Act will be adopted by the government in October and by Parliament end of 2016 or beginning of 2017, in line with the roadmap for future policy work.

⁽⁴¹⁾ ‘Equivalent hours’ are ‘extra’ hours worked. However, these are not true extra hours. Rather, physicians who work ‘very quickly’ might receive, for example, payment for 40 hours of work even if they have worked only 30.

Box 2.4.1: Specific monitoring of Slovenia's policy implementation under the macroeconomic imbalances procedure

In the 2015 European Semester cycle, Slovenia was found to experience macroeconomic imbalances, which require specific monitoring. To this end, the Commission presented a first specific monitoring report in December 2015 ⁽¹⁾. This box concludes the specific monitoring cycle by summarising the findings on the progress in implementing the reforms (Annex A) that relate to country-specific recommendations relevant for Slovenia's macroeconomic imbalances.

For Slovenia, all 2015 country-specific recommendations were considered as relevant for the macroeconomic imbalances procedure. The policies contribute towards the following overarching objectives:

- **Improve public finances and public debt sustainability:** The Fiscal Rules Act was adopted in 2015 and amendments to the Public Finance Act are in preparation. A comprehensive review of the health care system undertaken in cooperation with the World Health Organisation and the European Observatory on Health Systems and Policies was completed. On the basis of the analysis, the government adopted the National Healthcare Resolution Plan 2016 – 2025 at the end of 2015. It is expected to be adopted by Parliament in March 2016. In addition, the Health Care and Health Insurance Act is scheduled to be adopted by the government in October and by Parliament at the end of 2016 or in early 2017. The government is expected to adopt the act on long term care in the first half of 2016 and Parliament will adopt it by the end of 2016. A white paper on pensions is expected to be finalised in early-2016 and will open a public consultation, which will serve as the basis for a new pension reform.
- **Restructure the banking and corporate sector and better manage state-owned enterprises (SOEs):** A strategy and annual management plan, and performance criteria for

the management of state assets have been approved. New supervisory and management boards of the state holding have been appointed. Additional five SOEs from the list of 15 were privatised, including NKBM. Policy measures to improve the long-term sustainability of the banking sector have been completed. The banks' capacity to work out and reduce non-performing loans has been improved and action plans with specific targets have been introduced. The operational and financial restructuring of major corporates has been completed and the restructuring of the SMEs is ongoing. Guidelines for restructuring of SMEs are currently being implemented by the banks. The Bank Asset Management Company (BAMC) is fully operational and independent. The 2017-22 strategy has been finalised and the life span of the BAMC has been extended by five years. Additional restructuring tools have been made available. The new insolvency framework supports corporate restructuring and offers a number of different tools for the reorganisation of enterprises.

- **Improve competitiveness, the business environment and institutional capacity:** Slovenia adopted a new foreign direct investment strategy and a smart specialisation strategy in 2015. Some progress has been made in reducing the administrative burden. 50 % of the measures included in the Single document have been implemented, but the most pertinent measures have been delayed. The strategy for the development of the public administration was adopted in 2015 and an analysis of all public administration bodies was also implemented in 2015. The efficiency of civil justice increased and the length of judicial proceedings decreased. A programme to fight corruption was implemented and compulsory cash registers were introduced.

These findings are broadly consistent with those of the first specific monitoring report of December 2015. Since then, additional progress has been made regarding to the management of SOEs. However, there has been little or no progress in reforming the pension, healthcare and long-term care systems.

⁽¹⁾ European Commission (2015), *Slovenia — Review of progress on policy measures relevant for the correction of macroeconomic imbalances*. Available: http://ec.europa.eu/economy_finance/economic_governance/documents/201512_si_imbalances_epc_report_en.pdf

2.5. MIP ASSESSMENT MATRIX

This MIP assessment matrix summarises the main findings of the in-depth review in the country report. It focuses on imbalances and adjustment issues relevant for the MIP.*

Table 2.5.1: MIP assessment matrix - Slovenia

	Gravity of the challenge	Evolution and prospects	Policy response
Imbalances (unsustainable trends, vulnerabilities and associated risks)			
Financial sector and private debt	<p>Bank balance sheet contraction, a high stock of non-performing loans, the erosion of capital buffers continue to affect the Slovenian banking system (Section 2.1.).</p> <p>The high level of non-performing loans (despite transfers to the Bank Asset Management Company, remaining at 13.1%, see Section 2.1.), hinders the provision of credit to corporates and affects bank's profitability.</p> <p>High private corporate debt (at 63% of GDP, Section 2.1.) and the ongoing restructuring of the corporate sector create deleveraging pressures and have negative implications on the ability to invest and grow.</p>	<p>Although confidence has returned in the Slovenian banking sector, credit growth remains negative (Section 2.1.) and long-term profitability and viability of the banks has yet to be fully secured.</p> <p>The restored confidence in the Slovenian banking system has eased liquidity pressures. Deposit rates and margins on the asset side have considerably decreased and are converging with EA average (Section 2.1.).</p> <p>The corporate sector has completed considerable deleveraging since the peak in the indebtedness ratio in 2010 and is expected to continue to do so in the near future. Households are also deleveraging but their debt is among the lowest in the EU. Positive credit growth to households is expected to resume in 2016 (Section 2.1.).</p>	<p>Further progress has been made regarding the operational restructuring of the four major state-owned banks and the wind-down of two smaller domestic banks is on track (Section 2.1.).</p> <p>The "bad bank" BAMC set out its new strategy for 2017-22 and business plan and is fully operational. The creation of a second private "bad bank" focused on SME loans is under discussion (Section 2.1.).</p> <p>An ongoing evaluation exercise reconfirmed that the insolvency framework, as amended in 2013, supports corporate restructuring since businesses have increased opportunities for reorganisation. The authorities have been recently considering further targeted improvements (Section 3.3.).</p>
Deleveraging, investment, and growth prospects	<p>Private investment decreased dramatically in 2009/2010 and since then it has not recovered. The current level of private investment around 16% of GDP remains very low compared to the historical average of 20% of GDP and the pre-crisis peak of 25% (Section 2.2.).</p> <p>Slovenia lacks FDI inflows. Slovenia's stock of inbound FDI of 31.5% of GDP in 2014 was markedly below the EU average of about 50% (Section 2.2.).</p>	<p>Slovenia keeps underperforming in the inflow of FDI. The ongoing privatisation and corporate restructuring offer new opportunities for attracting FDI into the country, yet the business environment needs to adapt to take full advantage of foreign investments.</p> <p>FDI flows are expected to accelerate on the back of a pro-FDI reform agenda aiming at improving the business environment.</p>	<p>Slovenia adopted a new FDI strategy and a smart specialisation strategy in 2015. Some progress has been made regarding the reduction of administrative burden. 25% of measures included in the Single document were implemented.</p> <p>However, only some progress has been made in streamlining of priorities and ensuring consistency among the existing strategies.</p>

(Continued on the next page)

Table (continued)

Fiscal risks	The level of state involvement remains high relative to other Member states and has had considerable fiscal and economic implications for the State. Fiscal risks of SOEs have caused approximately one third of the increase in public debt experienced from 2007 to 2014.	Some advancement in privatisation has been achieved (Box 2.2.1.) but progress has been impaired by several hurdles. Following the publication of the asset management strategy, it appears that most SOEs are considered strategic so the level of the state involvement in the economy is expected to remain elevated.	Although some companies have been divested and progress has been made in decoupling the complex nexus of state-owned entities, significant parts of the economy are still under state ownership. The SSH has been established and its asset management strategy and a new privatisation plan have been adopted. A new supervisory board and management board of SSH have been appointed (Box 2.2.1.).
	Public healthcare and long-term care expenditure are on an unsustainable path.	Slovenia's debt is projected to stand at 81% of GDP in 2026, considerably above the 60% of GDP threshold. Due to its ageing population the pension, healthcare and long-term care system pose fiscal sustainability risks in both the medium and long term.	
	The health care system is characterised by a lack of sufficient in-built automatic stabiliser schemes, which would cushion revenue fluctuations over the business cycle (Section 2.4.). Slovenia's public pension system shows the second highest projected pension spending increase in the long-run among EU countries (from 11.8 % in 2013 to 15.3% of GDP).	Public healthcare and long-term care expenditures are projected to increase significantly until 2060 due to ageing population (from 7.1% in 2013 to 9.7% of GDP in 2060) (Section 2.3.). There is a significant scope to increase efficiency of the healthcare and long-term care system.	A comprehensive review of the health care system undertaken in cooperation with the World Health Organisation (WHO) and the European Observatory on Health Systems and Policies was completed (Section 2.4.). Based on the comprehensive review and the resolution on national health care, the new health care and health insurance act is expected to be adopted by the parliament in the second half of 2016 (Section 2.4.).

Conclusions from IDR analysis

- Slovenia remains affected by stock imbalances due to weaknesses in the banking sector, high corporate indebtedness, and fiscal risks. Although the risks of an imminent adverse shock are contained, these imbalances remain potentially harmful for the short-to-medium term adjustment of the economy as well as for its medium-to-long term prospects.
- Banking sector stabilisation continued in 2015, but the restructuring process is not yet complete. Deleveraging in the corporate sector is on-going, but it weighs on private investment and erodes Slovenia's potential growth. The business environment is still hindered by high government involvement and regulation, which hinders the new flow of domestic and foreign investment.
- Further progress has been made as regards the operationalization of the "bad bank" for the management of NPLs. Significant progress has been on the issue of state-ownership, with the asset management strategy and a privatisation plan set out and the new supervisory and management board of the SSH appointed. Only some progress has been made on minimising administrative burden and on FDI strategies. Several policy actions have been taken to contain and reduce the budget deficit. However, further decisive action is required to put debt on a downward path and improve the sustainability of public finances, especially in the health care and long-term care systems.

(*)The first column summarises "gravity" issues which aim at providing an order of magnitude of the level of imbalances. The second column reports findings concerning the "evolution and prospects" of imbalances. The third column reports recent and planned relevant measures. Findings are reported for each source of imbalance and adjustment issue. The final three paragraphs of the matrix summarise the overall challenges, in terms of their gravity, developments and prospects, policy response.

Source: European Commission

3. ADDITIONAL STRUCTURAL ISSUES

In addition to the imbalances and adjustment issues addressed in section 2, this section provides an analysis of other structural economic and social challenges for Slovenia. Focusing on the policy areas covered in the 2015 country-specific recommendations, this section analyses issues related to active labour market and social policies, the current structure and functioning of the public administration, the functioning of the justice system, and developments in research, transport and the energy sector.

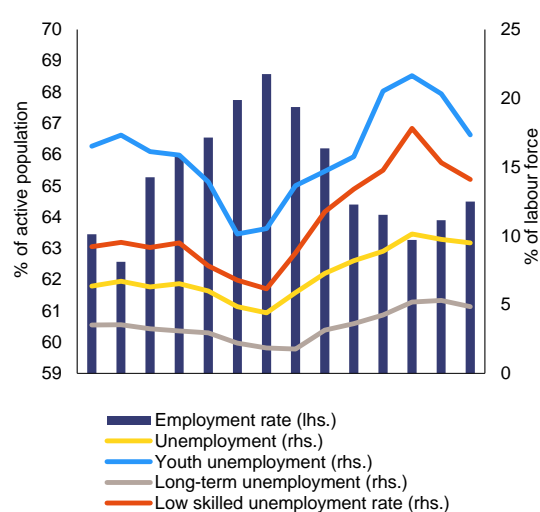
3.1. LABOUR MARKET, EDUCATION AND SOCIAL CONDITIONS

Labour market developments and adjustment

The labour market performance is gradually improving. In the period Q3 2013 – Q3 2015 the employment rate in Slovenia increased from 68.2 % to 70.2 % and the unemployment rate decreased from 9.4 % to 8.6 % while more people entered into the labour force (Graph 3.1.1). The decrease in youth and low-skilled unemployment has been particularly pronounced both due to government policies and favourable macroeconomic conditions. Long-term unemployment is only falling slightly, indicating a risk of persistent structural challenge. Labour market participation of older workers and the low-skilled remains low. Participation of women in the labour market has traditionally been quite strong⁽⁴²⁾. However, labour market participation of older women is low⁽⁴³⁾.

Since 2014, job creation has picked up strongly in the non-tradable services sector. In particular, jobs have been created in wholesale and retail, driven by rising domestic demand. Employment in the tradable services sector has also started to improve, supported by strong export performance (Graph 3.1.2)⁽⁴⁴⁾.

Graph 3.1.1: Labour market



Source: European Commission.

In 2014, more people left than entered registered unemployment for the first time since the onset of the crisis. The labour market has adjusted mainly through reducing the volume of labour as opposed to the lowering of wages. The number of registered unemployed soared in 2009, mainly due to business-related reasons such as bankruptcy and the termination of fixed-term contracts (Graph 3.1.3). Young people have been disproportionately more affected by the crisis. In August 2015, the number of registered unemployed decreased to less than 90 000 (from the peak of 150 000 in 2009). The share of the discouraged people tripled during the crisis⁽⁴⁵⁾. However, the number of discouraged people decreased in the last year and is now below the EU average.

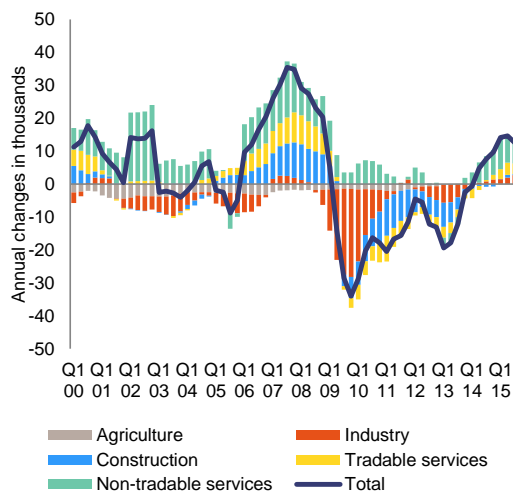
⁽⁴²⁾ The gap between the male and female employment rate decreased from 8.5 pp. in 2008 to 7.5 pp. in 2014, which is below the EU average of 10.5 pp. in 2014.

⁽⁴³⁾ The employment rate of women 55-64 years of age stood at 29 % in 2014 comparing with the EU-average of 45 % and the employment rate of 41.8 % for Slovene men 55-64 years of age.

⁽⁴⁴⁾ A substantial increase was detected in the category 'employment activities'. Since 2014, the increase is explained by legal changes, which obliged temporary work agencies to re-register their activity under 'employment activities'. As a result, there has been a substantial re-allocation of workers towards 'employment activities'. Before 2014, entities could register their activity more freely.

⁽⁴⁵⁾ Discouraged persons are aged 15-74, neither employed nor unemployed, want to work, are available for work in the next 2 weeks but do not seek work.

Graph 3.1.2: Employment by sector

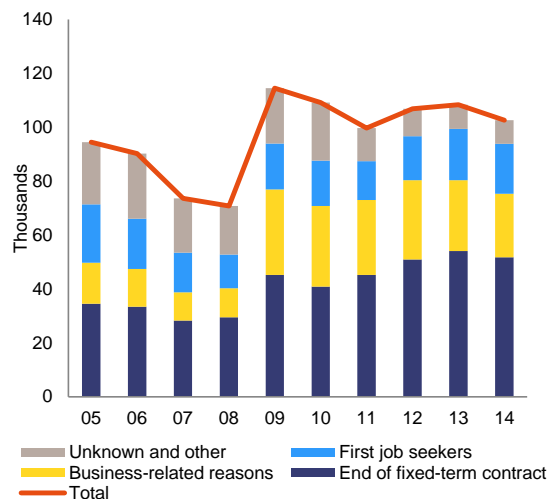


Source: European Commission.

Low-skilled were the segment of the labour market that has been most affected by the crisis, yet their situation is now improving. Unemployment among low-skilled workers increased substantially during the crisis, but started to decline in late 2013. Nevertheless, low-skilled still represent the largest share of the registered unemployed. Of those leaving unemployment in 2014, the outflow into employment is the lowest for low-skilled (56 %, as compared to 68 % for medium-skilled and 74 % for high-skilled workers). People with tertiary education found it easier to get back into employment. That was also the case before and during the crisis. In parallel, registered unemployment of people with tertiary education continues to increase. One factor contributing to this development is the fast expansion of graduate diplomas up to 2012.

Despite the strong economic rebound in 2014, long-term unemployment still represents more than half of all unemployed, indicating a risk of possibly persistent structural challenge. The number of older and high skilled long-term unemployed almost tripled during the crisis, with the sharpest increase since 2011. There are many reasons for long-term unemployment of older workers, namely low motivation and flexibility, inadequate skills and the higher labour costs associated with employing older workers and the early retirement pathways.

Graph 3.1.3: Inflow to overall registered unemployment



Source: European Commission.

The situation of young people on the labour market has improved substantially, yet youth unemployment is still above pre-crisis levels. Within all age groups, youth unemployment (15 – 24) decreased the most (from 13.4 % in Q3 2014 to 12.9 % in Q3 2015). This is well below the EU average of 19.9 %, but still higher than the pre-crisis bottom of 10.4 % in 2008. Following the introduction of the Youth Guarantee in 2013, the outflows from youth unemployment to employment increased⁽⁴⁶⁾. Participants in Youth Guarantee measures received 40 % more referrals for job vacancies than those who had not participated, 10 times more meetings with employers and 70 % more involvement in training⁽⁴⁷⁾. The share of young people not in employment, education or training remains below the EU average in spite of a strong increase during the crisis. It increased from 6.5 % in 2008 to 9.4 % in 2014 (EU 12.8 %). Currently, the new Youth Guarantee Implementation Plan 2016-2020 is being prepared, focusing on labour market segmentation, long-term unemployment and the traineeship system⁽⁴⁸⁾. The Plan is expected to be adopted in early 2016.

⁽⁴⁶⁾ <http://ec.europa.eu/social/youthguarantee>

⁽⁴⁷⁾ EEPO report and Youth Guarantee EMCO review

⁽⁴⁸⁾ Labour market segmentation is defined as the coexistence of different categories (segments) of workers on the labour market, characterised by different levels of job security and/or access to social security and by low transition rates from less secure to more secure categories. The main

Although most of newly concluded contracts are still fixed-term, the transition from temporary to permanent contracts accelerated significantly. The continued use of fixed-term contracts is largely related to the employers' lack of confidence in the economic recovery. Nevertheless, the proportion of contracts that transitioned from temporary to permanent increased from 36.9 % in 2013 to 49.5 % in 2014. The use of fixed-term contracts for young people increased from 72.2 % in Q3 2012 to 81 % in Q3 2015 despite the 2013 labour market reform and the 2013 intervention law, which exempts employers from paying social contributions for two years after employing a young worker under a permanent contract. Since 2014, the number of agency workers has increased, but their rights are aligned with workers under regular employment (Graph 3.1.4). The share of older workers in fixed-term employment has been slightly increasing throughout the years.

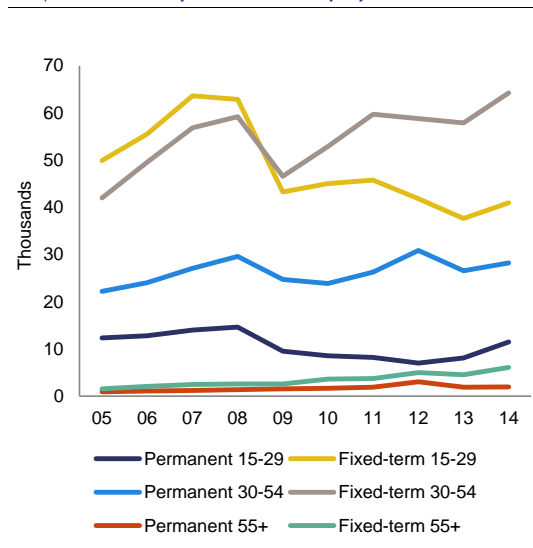
Student work continues to be attractive. Despite the revised student work regulation entering into force in February 2015, which made student work more costly, student work remains one of the cheapest and most flexible forms of work. The latest data show an increase in the number of student jobs while overall earnings of all students have remained constant, possibly indicating that students have reduced their hours.

Self-employment has increased since 2008. The share of self-employment in total employment reached 12.5 % in 2014 compared with 9.7 % in 2008, possibly also as a result of government subsidies. In parallel, the number of those performing work for only one client increased from 11.5 % in 2012 to 18.7 % in 2015, pointing to a more pronounced use of bogus self-employment. Slovenia has the second highest share in the EU of self-employed whose reported earnings are below earnings of employees.⁽⁴⁹⁾

distinction is mostly between workers with temporary contracts and those with permanent ones.

⁽⁴⁹⁾ European Commission, Employment and Social Developments in Europe 2015, p. 47.

Graph 3.1.4: Newly concluded employment contracts



Source: European Commission

As a number of legislative changes have been adopted in the last three years, the authorities are currently focusing more on monitoring and assessment. The authorities are closely monitoring the effects of the 2013 labour market reform and changes to student work. An analysis of bogus self-employment and more generally the future forms of work is underway.

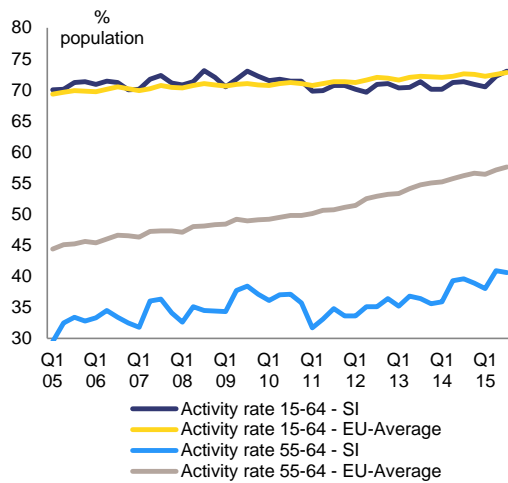
Labour market participation of older workers is well above pre-crisis levels, but remains the lowest in the EU. The employment rate of older workers was at 35.4 % in 2014 (51.8 % at EU average) and the unemployment rate of older workers has recently stabilised at 8.4 % in Q3 2015. The potential for longer working lives is hindered by barriers to take on paid work for pensioners, low participation in lifelong learning, low share of telework and of voluntary part-time.⁽⁵⁰⁾ To stimulate the employment of workers older than 55, temporary exemptions from employers' social contributions for newly-employed workers older than 55 (regardless of the type of employment contract) for the period 2016-2017 were adopted in November 2015.

The labour market situation of the low-skilled has improved slightly but remains a challenge. The unemployment rate of low-skilled workers increased from 12.7 % in Q3 2014 to 14.5 % in Q3

⁽⁵⁰⁾ European Commission, Employment and Social Developments in Europe 2015, p. 306.

2015 and is below the EU average (16.3 % in Q3 2015). The employment rate of low-skilled workers increased substantially from 33.7 % in 2013 to 36.1 % in 2014, but remains well below the pre-crisis level and EU average (43.3 % in 2014). As opposed to high-skilled workers, the low-skilled have more difficulties in finding a job, especially as the crisis hit the sectors which predominantly employ low-skilled workers.

Graph 3.1.5: Activity rate by age



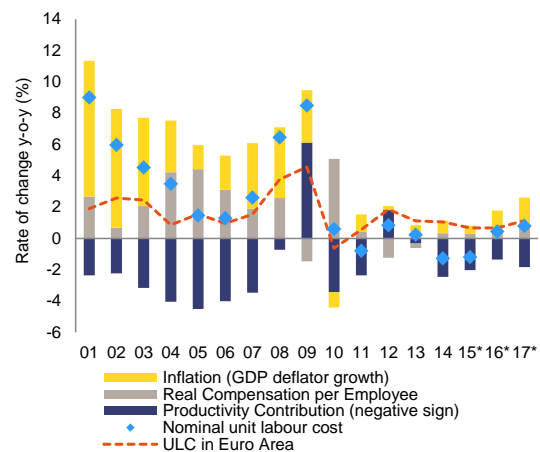
Source: Eurostat

Better-targeted active labour market policy (ALMP) measures could enable more of older, long-term unemployed and low-skilled people back into the labour market. Out of total participants in ALMP measures, 42.4 % were younger than 29, 13.7 % were older than 50, 15.8 % were low-skilled and 46.8 % were long-term unemployed. Participation in lifelong learning decreased between 2007 and 2014 and has been especially low among older workers and the low-skilled. This confirms the risk of underinvestment in the skills of the disadvantaged. The Guidelines for Active Labour Market Policy Measures 2016-2020, which have been discussed with the social partners, and the ALMP implementation plan represent a continuation of the approach implemented so far. Approximately EUR 100 million (less than 0.3 % of GDP) are earmarked for ALMPs annually, which is below the EU average of 0.5 % in 2011. In cooperation with the OECD, an activation review is under preparation and should be finalised by July 2016.

Wage and labour cost developments

Wage growth in line with productivity gains will continue to support external competitiveness. Nominal wage growth was low between 2012 and 2014. For 2015, it is expected to stay below 1 %, which is significantly less than what would be consistent with a constant external position as measured by the real effective exchange rate (Graph 3.1.6). At the same time, modest gains in productivity are expected to continue for 2015 and 2016, thereby reducing nominal unit labour costs. However, as the Slovenian economy is expected to be working close to or at full capacity by 2016, upward pressure on wages is possible (Graph 3.1.7).

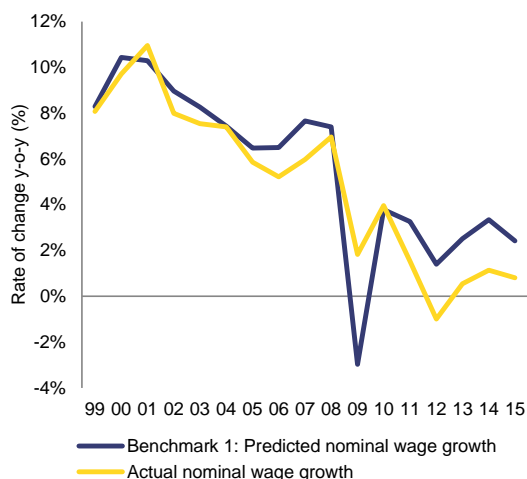
Graph 3.1.6: Inflation and labour cost developments



Source: European Commission.

The minimum wage in Slovenia is comparatively high and the wage distribution is highly condensed. Slovenia has the highest minimum wage in the EU as a proportion of average gross earnings (52.9 % in 2014). The level of the minimum wage may risk pricing some low skilled workers out of jobs. Furthermore, the wage distribution is highly condensed in the area close to the minimum wage. This is due in part to the minimum wage floor exceeding wages for low-skilled and medium-skilled income groups in several sectoral collective agreements. A low dispersion between low and medium-skilled jobs may reduce the returns to education and effort, which may have negative effects on productivity (Graph 3.1.9).

Graph 3.1.7: Benchmark for wage growth



Source: European Commission.

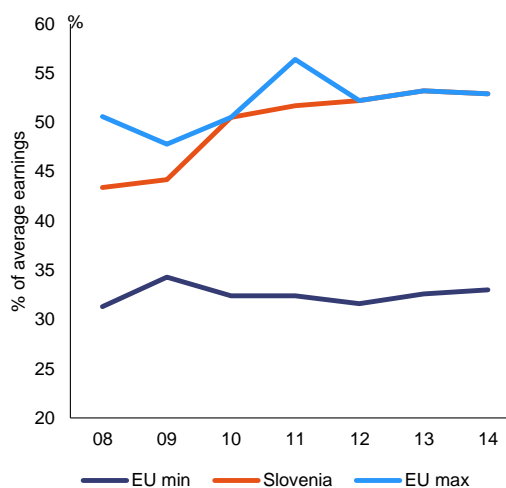
The relative level and the number of recipients of the minimum wage are decreasing. In 2015, the minimum gross wage for a full-time worker amounted to EUR 790.73, an increase of 0.2 % from 2014 in nominal terms and no increase in real terms. In January 2016, the nominal minimum wage did not increase. With nominal wages growing by 1.1 % in 2014, the relative share of the minimum wage has been decreasing slowly. At the same time, the number of minimum wage recipients decreased substantially in 2015. The highest decreases were in sectors employing the most minimum wage recipients, i.e. the manufacturing, construction and retail trade, which benefited most from the economic recovery. In the public sector, the number of workers receiving the minimum wage has increased as a result of the general wage freeze in the last 4 years and the slightly increasing minimum wage in nominal terms (Graph 3.1.9).

The minimum wage setting has been redefined despite strong opposition from employers' organisations. The minimum wage was excluded from the 2015-2016 Social Agreement, which among others established collective agreements as the basis for private sector wage setting⁽⁵¹⁾. In

⁽⁵¹⁾ The Social Agreement 2015-16 was signed on 5 February 2015 by the Ministry of Labour, Family, Social Affairs and Equal Opportunities as well as by representatives of almost all major employer organisations (Chamber of Commerce and Industry) and five major trade unions. After a standstill of six years (the previous agreement expired in 2009

November 2015, the Parliament passed a bill redefining the minimum wage and excluding the existing bonuses, which was proposed by the trade unions. These changes were not supported by the employers who consider this step as unilateral and breaching the process of social dialogue. As a consequence, all employer organisations withdrew from the Social Agreement, driving the social dialogue to a low point (especially at the tripartite level). While Slovenia's social dialogue structures are strong compared to its peers, trust has been eroded and dialogue has not been re-started yet.

Graph 3.1.8: Minimum wage

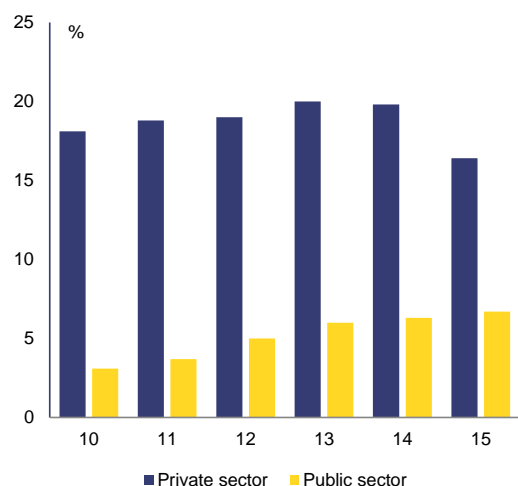


Source: European Commission

Public wages were unfrozen in 2015. An agreement reached by the government and public sector unions on wages for 2016 will increase the wage bill by approximately 0.4 % of GDP in 2016 and could also exert upward pressure also on private sector wages. The agreement stipulates that wages will return to 2013 levels, while the annual holiday allowance will increase. Promotions, which have been more or less frozen for years, will be partially relaxed.

just before the crisis), the conclusion of an agreement was seen as a revival of tripartite dialogue.

Graph 3.1.9: Share of minimum wage



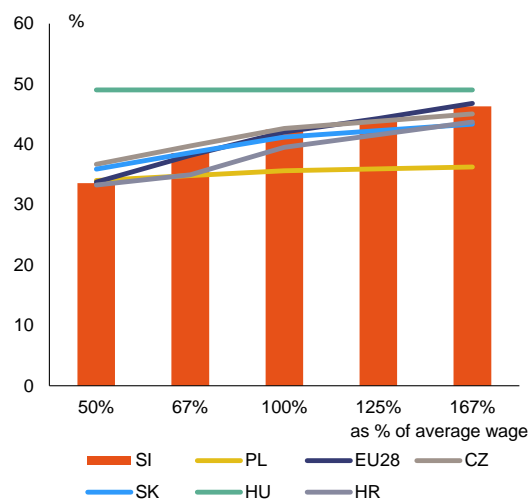
Source: European Commission

The reduction of the tax wedge could further boost labour market participation ⁽⁵²⁾. The size of the tax wedge of single earners is close to that of Slovenia's regional main competitors for various earning levels (Graph 3.1.10). Reducing the tax burden on labour, in particular for low-income earners, has the potential to boost labour market participation by further improving incentives to work. It would also make the Slovenian labour market more resilient and contribute to further reducing in-work poverty.

The tax burden has only marginally been addressed. After the government withdrew the proposal for a tax reform in November 2015 (Section 2.3), the tax brackets have been slightly adjusted. The adjustment, which has not been agreed with the social partners, is expected to have a negligible effect on reducing the tax burden. Although initially meant as a temporary measure, the top personal income bracket will continue to be taxed at 50 %.

⁽⁵²⁾ Tax wedge is the difference between the total cost of an employee's wages to a company and the employee's take-home pay.

Graph 3.1.10: Tax wedge of single earners



Source: European Commission

Education

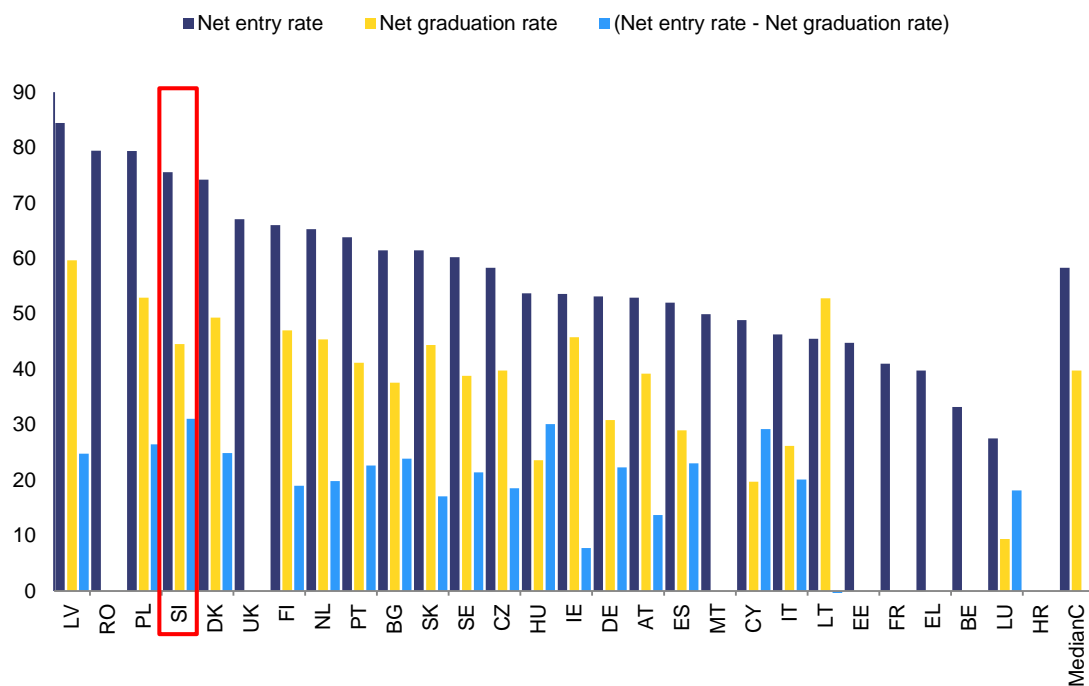
Slovenia ranks comparatively well on overall investment in education, but the efficiency of spending has been recently under review. In 2013, the percentage of GDP Slovenia spent on education rose to 6.5 %, which is above the EU average of 5 %. However, the increase expressed in % GDP since 2008 was driven by a drop in the GDP rather than an increase in the nominal expenditure. More recent national data recorded a 0.2% reduction in public expenditure for formal education in 2014 compared to 2013, with higher education most affected by the spending cut for the second year in a row. Slovenia invests comparatively more into pre-primary and primary education (2.4 % of GDP compared with 1.6 % in the EU in 2013) than into tertiary education (1.2% of GDP compared with 0.8% of EU average) ⁽⁵³⁾. This approach is in principle positive since it helps to prevent educational failure later on. Slovenian teachers' salaries, however, are below the EU21 average regardless of the education sector and years of experience ⁽⁵⁴⁾. In this respect, the IMF in its report suggested that the education sector was oversized in terms of employment ⁽⁵⁵⁾. Furthermore, a report by the Slovenian Court of

⁽⁵³⁾ Eurostat, General government expenditure by function (COFOG) (gov_10a_exp)

⁽⁵⁴⁾ OECD Education at a Glance 2015, Table D31a

⁽⁵⁵⁾ IMF Country Report No. 15/265, Technical Assistance Report – Establishing a spending review process <https://www.imf.org/external/pubs/ft/scr/2015/cr15265.pdf>

Graph 3.1.11: Share of the age entering a tertiary academic programme and of those who graduated, 2011/2012



Source: European Commission/EACEA/Eurydice (2015) The European Higher Education Area in 2015: Bologna Process Implementation Report

Auditors has found that the Ministry of Education acted inefficiently in terms of regulating teachers' working hours and working obligations⁽⁵⁶⁾. To justify the level of spending, national education stakeholders point to the political decision to safeguard small schools at local level and the forecast of larger incoming class sizes.

Overall, the Slovenian education system performs well, but the earning advantages and employment rate of tertiary graduates have been decreasing. The tertiary education graduates in Slovenia in the age group 25-34 earn 42 % more than those with only upper secondary education in the same age group. In the age group of 55-64, this difference is much more pronounced and stands at 111 %⁽⁵⁷⁾. This means that Slovenia has the highest difference in earning premiums between older and younger generations of all OECD

countries. The employment rates of recent tertiary graduates, however, are not favourable⁽⁵⁸⁾. The rate of students progressing into postgraduate studies has been increasing significantly, reaching 58.3 % in 2014 - probably as a result of the difficulty for first-cycle graduates to gain employment and the attractiveness of student benefits⁽⁵⁹⁾.

Several inefficiencies exist in the higher education sector. In 2012/2013 there were 919 study programmes across all levels, the equivalent of one study programme per 106 students, which is high compared to peer countries. This may be the result of incentives stemming from the government funding formula, combined with a shrinking number of students. The net entry rate of students to tertiary academic programmes is the fourth highest (75.6 %) in the EU, while the share of those who do not graduate is the highest in the EU (31.1 %). This difference could point to a high

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<http://www.rsr.si/rsrs/rsrs.nsf/1/KCA8424A1A91BE072C1257F40004AAB11>

⁽⁵⁷⁾ Education at a glance, Country notes: Slovenia, OECD, 2014; <http://www.oecd.org/slovenia/education-at-a-glance-2014-country-notes.htm>

⁽⁵⁸⁾ From 85 % in 2007, the rate fell consistently to 74.3 % in 2014, below the EU average of 80.5 %.

⁽⁵⁹⁾ Such as subsidised meals, transport and the opportunity to perform student work.

number of fictitious enrolments (Graph 3.1.11). While fictitious enrolments has been estimated to be a significant problem in Slovenian higher education and one that affects both the quality of education and the public finances, it is nevertheless challenging to measure and to prove.

The majority of vacancies continue to require lower formal education but skills mismatch appears to be less pronounced. Between 2011 and 2014, companies faced less difficulties in filling vacancies, presumably due to an increasing supply of skilled labour⁽⁶⁰⁾. Slovenian employers seek workers with lower formal education and general competences such as problem-solving skills, organisational skills and the ability to work in a team. However, the demand for high-skilled workers is projected to increase substantially.

Several activities in the area of education and training are ongoing. Slovenia has launched a National Skills Strategy Project, which will identify skills needs and bottlenecks and encourage cooperation between responsible government bodies. The Project is expected to be finalised in 2017. A revised Higher Education Act introducing a new funding system, increasing the responsibility of higher education institutions for quality provision and supporting internationalisation has been announced in September 2015, but the timetable for its adoption is to be clarified. There has not yet been an agreement on the new apprenticeship legislation.

Social issues

The number of people at risk of poverty and social exclusion stabilised in 2014 for the first time after the crisis despite a small increase in the poverty threshold. The rate remained at 20.4 %, with income poverty risk (at risk of poverty rate) also stable at 14.5 %, well below the EU average (24.4 % and 17.2 % respectively) (Graph 3.1.12). The at risk of poverty rate decreased slightly for some of the most vulnerable groups (unemployed and single households aged over 65) partly due to the changes to social legislation in 2013. Slovenia is therefore no longer moving away from the poverty and social exclusion target mostly due to the improved labour

market situation. In-work poverty is relatively low, partly due to the high incidence of second earners and a relatively low incidence of part-time work. In-work poverty has increased considerably since the beginning of the crisis from 4.5 % in 2008 to 9.9 % in 2014; however it remained below the EU average (12.7 %). The improved labour market situation resulted also in increased household disposable income. The continued low but increasing level of income inequality can be attributed to a compressed wage structure and a social protection system which is performing its function relatively well.

The social protection system performs relatively well, despite reductions in per capita expenditure in most social protection expenditure categories. The negative changes in the period 2010-2012 were most pronounced in pensions, health and disability while they were less pronounced in family and unemployment expenditure⁽⁶¹⁾. It can be assumed that the situation further deteriorated from 2012 onwards with the implementation of fiscal consolidation measures adopted in 2012.

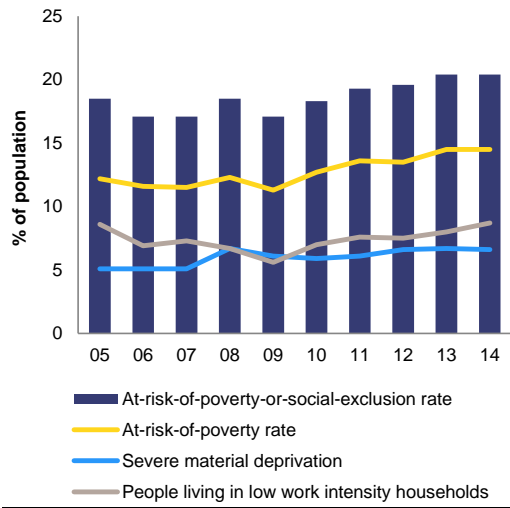
The unemployment benefit coverage of short term unemployed is low at 25 % in 2014, (12 pps. lower than the EU average). This is primarily due to low duration of benefits for short work records (maximum 14 weeks in 2015) while eligibility conditions are not particularly strict. Conversely, replacement rates after 6 months of unemployment are above the EU average.

Certain social benefits will be reinstated but only marginally. The government has proposed reinstating the full child allowance for certain income groups and increasing the minimum income. Lower benefits for big families and for childbirth and a reduced level of parental allowance will continue to be applied. In July 2015 the Act on the Conditions for the Implementation of Debt Relief was adopted, the take-up of which was much more limited than expected.

⁽⁶¹⁾ European Commission: Employment and Social Developments in Europe 2015, p. 280-284.

⁽⁶⁰⁾ European Commission: Employment and Social Developments in Europe 2015, p. 240.

Graph 3.1.12: Risk of poverty and social exclusion



Source: Eurostat

3.2. PUBLIC ADMINISTRATION

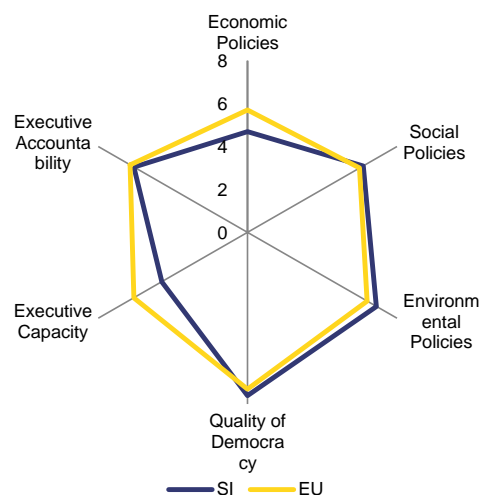
Challenges to be addressed

Since the onset of the crisis, fiscal consolidation measures put substantial pressure on the public administration to reduce operational costs. This involved a freeze in employment and across-the-board cuts to wages and bonuses rather than identifying and achieving efficiency gains. The necessary structural reforms in the public sector have been delayed as priority has been given to urgent crisis-resolution measures. The governance of the public administration has deteriorated due in part to the frequent changes in government between 2012 and 2014. As a consequence, there was a high turnover of ministers and senior staff as well as institutional changes. Several government offices and ministries were merged causing delays in their functional integration, which inhibited regular business activities. Several government offices and ministries also lack sufficient resources. Consequently, Slovenia ranks low in terms of governance in public administration. In particular, the executive capacity of Slovenia's public administration is well below the EU average (Graph 3.2.1). Consumer conditions in Slovenia are also affected by low consumers' trust in public authorities (the lowest in the EU) and in redress mechanisms, including the courts (Section 3.3.)⁽⁶²⁾.

A credible and efficient public administration is a prerequisite for the development and implementation of policies that enable further development. As the economic and political situation in Slovenia stabilised, the government's priority shifted to structural reforms in the public sector in order to reduce spending (Section 2.3.) and improve the business environment and investment climate (Box 1.1.). Fair access to employment, goods, and services is hindered by the failure to set up independent body for effective assistance in case of discrimination. The existing body, the Advocate of the equality principle, is currently under the control of the Ministry of Labour, family, social affairs and equal opportunities, is understaffed and no reform has been foreseen for improving this situation.

⁽⁶²⁾ 2015 Consumer Conditions Scoreboard.

Graph 3.2.1: Executive capacity in Slovenia



Source: Sustainable Governance Indicators 2015, Bertelsmann Foundation.

Public administration reform

The intention is to gradually reform the public administration in Slovenia. The government adopted a long-term reform strategy⁽⁶³⁾, aimed at modernising the public administration and increasing its efficiency. The strategy addresses several challenges including establishing e-government, internal reorganisation and the introduction of performance and strategic human resource management. In 2015, the strategy was implemented as planned in the two-year action plan for 2015-16. The authorities are conducting an in-depth analysis of all administrative entities and core administrative tasks with the objective of proposing an optimised model of public administration by end-2016. As an initial step, a comprehensive functional analysis was finalised in December 2015. An external consultant compared performance indicators of the public administration bodies on national level and proposed several solutions for the optimisation of common support services and administrative processes, as well as organisational changes. Substantial savings could be made if the proposals

⁽⁶³⁾ The strategy for development of public administration 2015-2020 was adopted in April 2015 and the action plan for its implementation for the period 2015-16 was adopted in July 2015. The authorities are preparing an update to the action plan for 2016-17, which will be adopted shortly. http://www.mju.gov.si/si/delovna_podrocja/kakovost_v_javnih_upravi/strategija_razvoja_javne_uprave/

for optimisation were thoroughly implemented. However, they would lead to substantial organisational changes and opposition within the current structure could inhibit successful reorganisation.

Resistance to the proposed changes poses a risk to the prompt implementation of the strategy.

Similar strategies have been prepared in the past but little action has been taken. The implementation of the strategy will have to overcome the current 'silo' structure that impedes efficient cross-ministerial coordination. A change of the institutional and organisational mind-set will also be required. Such a project requires full backing at the highest political level and the support of all relevant stakeholders. The recently established group for the coordination of the ten government's priorities seems to be a step in right direction, though a stronger and permanent coordination of key horizontal dossiers would be an important value-added. The strategy provides for the introduction of performance budgeting, which would link strategic government vision and public spending. Introducing performance budgeting is not a new idea, but has been pending since 2007-08. However, it has never been implemented. Given that almost 90 % of the budget is allocated to rigid current expenditure, only the remaining 10 % could be spent under the performance budgeting. Savings and efficiency gains are dependent on the timely adoption and implementation of the strategy for the public administration. Such savings could be invested into increasing the capacity of understaffed offices, better education and boosting civil servant motivation.

Management of civil servants

The reform targets better management and merit-based remuneration of civil servants.

In recent years, wage cuts were applied equally across the board. Cutting performance-related pay reduced the motivation of civil servants. Fiscal consolidation measures such as the freeze on recruitment and cuts in wages substantially altered the composition of the workforce in public administration, resulting in a steady increase in the age profile of the civil service. Less than 7 % of the workforce is below 30, while 30 % of the workforce is above 50. In a system where bonuses and promotions based on seniority prevail over the

possibility of merit-based rewards, the cost of labour increases and motivation of younger employees decreases. Further elements of performance management and non-monetary incentives, such as training, could form an important tool in the forthcoming reform of the Civil Service Act. Greater flexibility of the administration, the ability and willingness to learn and adopt IT solutions that are necessary for the introduction of a full-scale e-government system.

E-government

Establishing a fully-fledged e-government system is an important component of the new strategy.

A completely new version of the e-government interface was launched in November 2015. It offers simplified procedures and a better oversight of the work of the public administration. The next major step is to centralise IT services and construct a government-wide cloud-based network. A cloud-based network for direct budget users is expected to be introduced by 2017, while a fully-interoperable government IT cloud infrastructure is planned for 2020. This will also enable the establishment of the single point of contact for businesses. One objective of the single point of contact will be to grant e-permits to businesses. All companies will be able to request any government permit in electronic form (including a building and environmental permit). As many public services already offer certain e-services, it will be a challenge to harmonise existing systems and ensure full interconnectivity of existing registers and databases, which is a necessary for the introduction of the 'once only' principle of the e-government. Furthermore, since January 2015, public administration bodies have only been providing electronic invoices.

Public procurement

Despite recent improvements, several shortcomings exist in public procurement.

The main three issues are the legal uncertainty caused by frequent revisions of tenders, the inconsistent jurisprudence and the slow take-up of the e-procurement system. According to the internal market scoreboard, the percentage of contracts awarded on negotiated procedures without contract notice was relatively high (17 % in 2014). However, according to Tenders Electronic Daily, the percentage of contracts awarded on negotiated

procedures still increased to 19 % in 2015. Although basic transparency rules are respected, there are still some issues with the quality of tender documentation (clarity, precision, formal correctness, elimination of brand names, etc.). Slovenia is introducing e-procurement in several steps.

Full transition to e-procurement for all users is expected in January 2018. The law on public procurement was adopted in November 2015, making procurement simpler, more transparent and more accessible for SMEs. The law provides a base for the comprehensive transition to an e-procurement system. In 2015, reversed electronic auctions became obligatory for all government budget users for the purchases of standardised goods and services. In the first four months, 97 procedures were concluded within 17 contracting authorities and involving 83 bidders. The Ministry of Public Administration served as a pilot for the implementation of the new comprehensive e-procurement solution. Roll out of the solution to all government institutions is expected in the coming months.

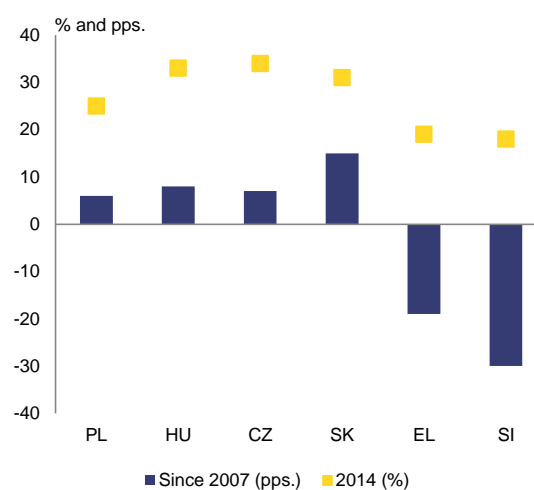
Corruption

Slovenia is the EU country in which public trust in the government and politicians decreased the most between 2007 and 2013 (Graph 3.2.2). Companies can perceive corruption as an obstacle for doing business and investing in Slovenia (Box 1.1). Often, companies in Slovenia consider it as necessary to have political connections in order to succeed in business⁽⁶⁴⁾. Additionally, 37 % of the companies, which participated in a public tender, consider that corruption prevented them from winning. The single market scoreboard assesses the overall performance of Slovenia in public procurement in 2014 as unsatisfactory and is an obstacle to doing business in Slovenia.

The government is addressing the legal void that facilitated corrupt behaviour in the past. In January 2015, the government adopted its 'A zero tolerance to corruption' programme. The first interim report on the implementation of the

programme was published in August 2015⁽⁶⁵⁾. It concludes that progress has been made in most areas. In December 2015, a code of ethics was adopted, establishing stricter ethical standards for civil servants. New legislative proposals, with the objective of preventing corruption, have been adopted for large infrastructural projects and the financial sector. However, these laws need to be implemented properly and their impact needs to be monitored over a longer time horizon in order to ascertain whether they were able to contribute to an overall change in the underlying culture.

Graph 3.2.2: Confidence into governments and its change



Source: Government at a Glance 2015; OECD 2015.

The amendments to the Act for Integrity and Prevention of Corruption have been delayed⁽⁶⁶⁾. The proposal of the amendment of the Act is to introduce the rules of procedure of the Commission for Prevention of Corruption into the law (currently in the form of a by-law), lay down criteria for the eligibility of its president, and introduce an automatic reporting obligation. However, the proposed amendments would not resolve the problems of the functioning, its credibility issues and the decreasing scope of work. The number of open investigations by this Commission has been decreasing⁽⁶⁷⁾. The capacity

⁽⁶⁴⁾ Flash Eurobarometer 428, Businesses' attitudes towards corruption in the EU.

⁽⁶⁵⁾ Both documents available at http://www.mju.gov.si/si/delovna_podrocja/integriteta_in_preprecevanje_korupcije/

⁽⁶⁶⁾ Public consultation is planned to open in March 2016, while the law is planned to be adopted by end-2016.

⁽⁶⁷⁾ Criminal statistical data show that the number of new investigations into corruption is falling but the number of

of its office decreased amid large turnover in staff in the last year, despite the fact that the budget for the salaries has increased. Trust in the government and in the institutions could be regained if the fight against corruption is stepped up.

convictions is increasing. <http://ec.europa.eu/transparency/regexpert/index.cfm?do=groupDetail.groupDetailDoc&id=21215&no=2>

3.3. JUSTICE SYSTEM

Despite further improvements, backlogs and lengthy court proceedings remain a challenge for the functioning of civil and commercial courts. In 2015, the number of pending cases in the court system decreased by 23.1 % compared with 2014⁽⁶⁸⁾. This decrease partially reflects a drop in incoming cases by 8 % during the same period and is to a certain extent determined by changes in the procedural and statistical treatment of enforcement cases. Given that the number of resolved cases in 2015 decreased by 5 % compared with 2014, the reduced backlog is not mainly the result of efficiency gains. In 2014, Slovenia had the second-largest number of non-criminal pending cases in the EU (Graph 3.3.1). The length of trials further decreased, with commercial cases taking 12.9 months on average, while high-value and low-value civil cases take 13.5 months and 11.8 months, respectively. However, disputes at first instance concerning infringements of a Community trademark take 744 days on average, among the longest in the EU⁽⁶⁹⁾. The Supreme Court continues to update business processes in courts and to reform case management systems. This has shown good results in commercial and enforcement cases and has been extended to labour and social cases.

Slovenia is shifting its focus towards improving the quality of the justice system. Ongoing projects include the online publication of first instance civil and commercial judgments as well as a comprehensive proposal on the reorganisation of the first instance courts. The Supreme Court is developing quality standards with a focus on training new judges, the quality of judgments and time frames, i.e. the expected time for completing a specific proceeding. Additional actions are being planned to promote procedural fairness, for example preparing brochures on litigant parties' procedural rights. Digitalisation projects are underway, such as electronic filing of claims (which works well in enforcement but remain unavailable in civil and commercial litigation). Furthermore, improvements in the e-service and centralised postal service of documents, which have shown good results and have freed up and reallocated courts' resources and accelerated proceedings (Supreme Court reported that in 2015,

e-delivery of court documents and centralised postal service of documents saved more than EUR 4.2 million in postal and labour costs).

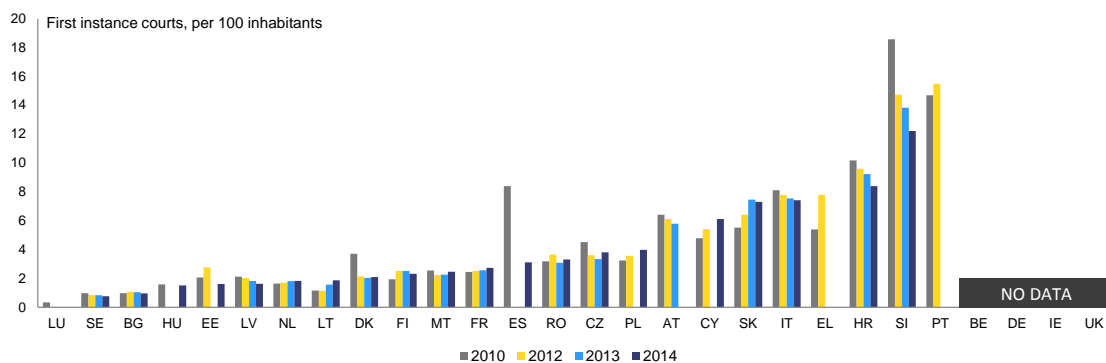
The Council for the Judiciary experienced a challenge to its role in selecting and proposing judges, as for the first time in 24 years, the National Assembly rejected the appointment of a candidate first-time judge. The extent to which the National Assembly can be procedurally involved in the selection of candidate judges has raised some concerns. However, the Council resisted the deputies' calls for data on all candidates quoting its independence in the selection of candidate judges. Although the Council is granted adequate powers (e.g. regarding the career and appointment of judges), its low administrative capacity appears to hinder its ability to follow and analyse the situation in the judiciary. A reform of the role and powers of the Council is in preparation.

Regarding insolvency, liquidation proceedings remain lengthy and ineffective despite the improved framework on corporate restructuring. An ongoing evaluation exercise reconfirmed that the insolvency framework, as amended in 2013, supports corporate restructuring since businesses have increased opportunities for reorganisation. Small and micro companies began using the new simplified compulsory settlement procedure. The more frequent use of informal out-of-court restructuring agreements led to a sharp drop in the number of formal preventive restructuring and standard compulsory settlement proceedings for large and medium companies. The average length of preliminary insolvency proceedings remains relatively short, ranging from 7 days in preventive restructuring, 20 days in personal insolvency, 23 days in simplified compulsory settlement, 41 days in compulsory settlement, to 49 days in liquidation proceedings. However, the average length of the main insolvency proceedings often remains significant and ranges from 128 days in simplified compulsory settlement, 166 days in preventive restructuring, 305 days in compulsory settlement, 374 days in liquidation without distribution, to 1 276 days in liquidation with distribution of assets. In 2015, recovery rates decreased to 37 % in compulsory settlement and to 14 % in liquidation, while the recovery rate in personal insolvency cases remained stable at 17 %. Such

⁽⁶⁸⁾ Data from the Supreme Court of Slovenia, Commission calculations.

⁽⁶⁹⁾ 2016 EU Justice Scoreboard (forthcoming).

Graph 3.3.1: Number of civil, commercial, administrative and other pending cases



Comparisons should be undertaken with care as some Member States reported changes in the methodology for data collection or categorisation (CZ, EE, IT, CY, LV, HU, RO, SI, FI). CZ and SK report it is not possible to single out the number of pending cases at first instance, as cases are considered pending until no further proceeding is possible. ES: Changes in incoming cases reportedly explain variations. PT: Data were not available due to technical constraints.

Source: 2016 EU Justice Scoreboard (forthcoming)

low recovery rates may point to continued late insolvency filings. The authorities have recently been considering targeted improvements in the insolvency framework with an aim of preventing abuses and expanding the availability of preventive restructuring to small companies.

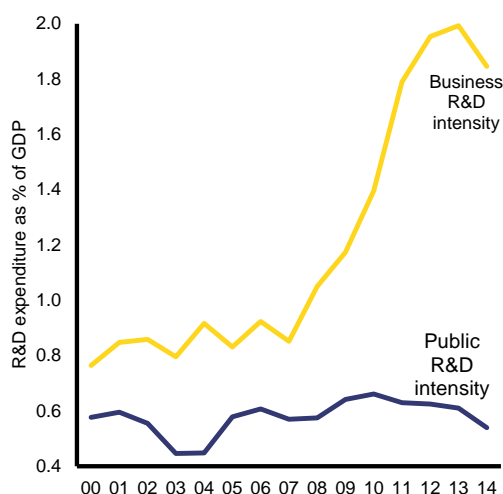
There is still scope for achieving clear efficiency gains and improving the quality of the justice system. Tackling backlogs and ensuring the swift delivery of justice, while enhancing quality, is still a priority, also because of its impact on the business environment and the investment climate (Box 1.1).

3.4. RESEARCH, TRANSPORT, ENERGY AND ENVIRONMENT

Research and development

After several years of growth, the level of research and development (R&D) intensity in Slovenia dropped in 2014. The level of R&D intensity in Slovenia (Graph 3.4.1) increased from 1.36 % of GDP in 2000 to 2.6 % of GDP in 2013 (EU average: 2.03 %), making Slovenia one of the EU leaders. This stemmed from a generous R&D tax incentive system and a set of ambitious innovation measures co-financed from the Structural Funds⁽⁷⁰⁾. However, provisional Eurostat figures show a drop in R&D investments to 2.39 % of GDP in 2014. Fiscal consolidation efforts meant that public R&D expenditure decreased from 0.61 % of GDP in 2013 to 0.54 % of GDP in 2014. This downward trend in public R&D expenditure undermines the potential of the science base to spur economic activity and hinders business R&D investments. The national target of 3 % of GDP by 2020 can still be reached but requires policies supporting the longer-term sustainability of R&D investments.

Graph 3.4.1: Business and public R&D intensity



Source: European Commission.

The performance of research and innovation outputs remains low, which calls into question the quality of the R&D investments. The relatively low level of highly cited publications in

⁽⁷⁰⁾ In November 2015 the government proposed changes to decrease the tax incentive for R&D from 100 % to 50 % of the amount invested, which might have a negative impact on investments. However the Finance Minister later announced that the proposed tax changes will not go ahead.

relation to the level of public investment in Slovenia underlines the need to put in place reforms to increase the efficiency and quality of the R&D system. These reforms will require changes such as more flexible rules for the remuneration of researchers, and allowing a performance-related differentiation of salaries.

The new smart specialisation strategy, if properly implemented, could help to prioritise investments (Section 2.2.). Streamlining and better implementing R&D policies is crucial, as one major challenge is to build a critical mass of R&D activities. Currently the efforts to maximise R&D investments are somewhat hindered by the fragmentation of activities across public research organisations. The policy reforms planned in the 2011 Research and Innovation Strategy (RISS) have suffered substantial delays in implementation, mostly due to frequent changes in the governance structure and fragmentation. This in turn jeopardises the effective and efficient use of public resources.

Effective policy responses to these challenges are not yet in place. The full implementation of RISS depends on the approval of the Law on Research and Innovation. However, the law has not yet been presented by the government. A key pending issue is to link the provision of institutional funding of universities and public research institutes to an assessment of their performance.

The lack of openness of the R&D system may affect sustainability in the long term. The share of business enterprise research and development financed from abroad was at 8.6 % in 2014 (EU average: 10.2 %). The R&D system would benefit from further internationalisation. Improving the business environment for innovative SMEs to carry out R&D and innovation activities is a crucial factor to supporting Slovenia's competitiveness. Developing a venture capital market for SMEs would be an important step⁽⁷¹⁾.

⁽⁷¹⁾ Venture capital in Slovenia was 0.0067 % of GDP in 2014 (source: EVCA/PEREP Analytics), well below EU level of 0.062 % of GDP in the same year (source: Innovation Union Scoreboard).

Transport

The development of rail infrastructure is seen as a priority. Bottlenecks in railways represent a hindrance to the multimodality between maritime and rail transport and an obstacle to the country's competitiveness. Modernising the TEN-T core network on the Mediterranean and Baltic-Adriatic Corridors, in particular for rail infrastructure, is important. Competition in the railway market remains minimal with the incumbent operator covering more than 90 % of the market in both passengers and freight services.

Public transport could be further developed.

The positive experience of Ljubljana can provide a basis for further development in other cities, which should be implemented in the context of sustainable urban mobility plans at the level of municipalities and regions. This will also help reduce the high share of transport emissions and improve air quality in urban areas. Mobility plans would also help establish a strategic basis for the integrated territorial investments, which are a significant tool for sustainable urban development and are an important element of the 2014-2020 cohesion policy.

Better use of EU funding would promote investments in transport infrastructure.

Slovenia could attract private capital to complement EU funding and national resources. The transport development strategy adopted in July 2015 is the comprehensive basis for developing the transport sector over the coming decades. To fulfil the preconditions for EU funding, the Slovenian authorities have to prepare a capacity-building plan, which is due to be published in June 2016⁽⁷²⁾.

Energy, climate and environment

The macroeconomic significance of the energy sector is higher for Slovenia than the EU average. The sector is larger than the EU average both in terms of total gross value added and total employment provided with the share increasing from 2005 to 2012. In addition, the energy trade deficit, though decreasing, is higher than the EU

average. The energy mix is broadly in line with the EU average, characterised by a higher share of nuclear (19.6 % of gross inland energy consumption) and a lower share of gas (9.9 %).

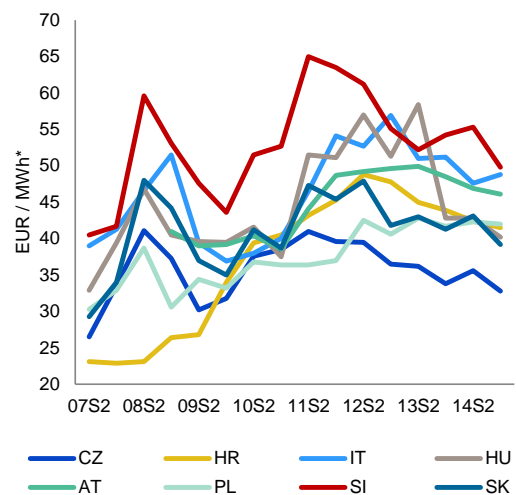
The energy market is well interconnected with neighbouring markets.

Ongoing work on projects of common interest in the supply of gas and electricity will further improve market integration, competitiveness and security of supply. The concentration on the power generation market is above the EU average, but the retail gas and electricity markets are fully liberalised and consumers seem to be broadly satisfied with their options to change supplier.

Gas prices remain higher than in most neighbouring countries.

Major domestic industrial consumers can negotiate competitive gas prices. However, both household consumers and SMEs are affected by the relatively high prices. (Graph 3.4.2). Electricity prices are more competitive than gas compared to the region. However, the recent large investment in a costly coal power project (TEŠ 6) raises concerns that electricity prices might increase in the future.

Graph 3.4.2: Retail gas prices for industrial consumers



* Excluding VAT and other recoverable taxes and levies
Consumption band I2 (1 000 GJ < annual cons. < 10 000 GJ)

Source: European Commission.

⁽⁷²⁾ This plan will encompass an in-depth analysis of the administrative capacity needed to ensure both that new transport projects are of high quality and that the existing transport network is maintained and operates effectively.

The share of renewable energy has been rising steadily and has more than doubled since 1995.

In 2014, it was 21.9 %, putting the country on track to reach its overall 25 % target in 2020, thanks to planned hydropower investments. Major barriers to further investments in renewable electricity are the lengthy spatial and environmental planning procedures and the lack of a general renewable energy development strategy in the transport sector.

Additional efforts seem to be needed to improve energy efficiency and keep Slovenia on track for its 2020 target.

There is room for realising further potential macroeconomic benefits through energy efficiency improvements in the buildings and industrial sector (including the use of European Structural and Investment Funds), where energy intensity is higher than the EU average. So far, no decoupling between primary energy consumption and GDP has been observed, therefore primary energy consumption must be kept at the current level or its increase minimised while the GDP is rising again.

Slovenia is on track to achieve its greenhouse gas emission reduction target for 2020.

Transit remains an important issue contributing to the high share of transport in the Slovenian emissions. The Energy Concept document to be prepared by the end of 2016 will propose mid-term and long-term greenhouse gas emission reduction targets in order to reduce the emissions related to energy use by at least 40 % in 2035 and at least 80 % in 2055 (compared to 1990) while providing opportunities for business development and job creation.

ANNEX A

Overview table

Commitments

Summary assessment⁽⁷³⁾

2015 Country-specific recommendations (CSRs)	
<p>CSR 1: Ensure a durable correction of the excessive deficit in 2015, and achieve a fiscal adjustment of 0.6 % of GDP towards the medium-term objective in 2016.</p> <p>Adopt the Fiscal Rule Act and revise the Public Finance Act.</p> <p>Advance long-term reform of the pension system.</p> <p>By end of 2015 adopt a healthcare and long-term care reform.</p>	<p>Slovenia has made limited progress is addressing the CSR 1 (this overall evaluation excludes an assessment of compliance with the Stability and Growth Pact).</p> <p>Some progress was made in reforming the fiscal and budgetary framework. The Fiscal Rules Act was passed by the Parliament in July 2015 but the establishment of the Fiscal Council has been delayed. It is expected that its members will only be appointed in mid-March 2016, which puts at risk the Fiscal Council's ability to assess and provide an opinion on the 2016 Stability Programme. Amendments to the Public Finance Act have been prepared and were published for public consultation at end January 2016.</p> <p>Limited Progress was made in advancing the pension reform. A White Paper on pensions is expected in early-2016. It will open a wide public consultation, which will serve as the basis for a new pension reform.</p> <p>Limited Progress was made in advancing the healthcare reform. A comprehensive review of the health care system was completed. Based on this analysis, The National Healthcare Resolution Plan 2016 – 2025 was adopted by the government end 2015 and is expected to be adopted by the Parliament in March 2016. In addition, the Health Care and Health Insurance Act is envisaged to be adopted by the Government in October and by Parliament end of 2016 or beginning of 2017.</p> <p>Limited Progress was made in advancing the long-term care reform. A draft law was due to enter public consultation in October 2015 but has been postponed. Its final adoption will await the reform of healthcare as the latter needs to clarify</p>

⁽⁷³⁾ The following categories are used to assess progress in implementing the 2014 CSRs of the Council Recommendation: **No progress:** The Member State has neither announced nor adopted any measures to address the CSR. This category also applies if a Member State has commissioned a study group to evaluate possible measures. **Limited progress:** The Member State has announced some measures to address the CSR, but these measures appear insufficient and/or their adoption/implementation is at risk. **Some progress:** The Member State has announced or adopted measures to address the CSR. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases. **Substantial progress:** The Member State has adopted measures, most of which have been implemented. These measures go a long way in addressing the CSR. **Fully addressed:** The Member State has adopted and implemented measures that address the CSR appropriately.

	the issue of financing. .
<p>CSR 2: Review, in consultation with the social partners and in accordance with national practices, the mechanism for setting the minimum wage, and in particular the role of allowances, in light of the impact on in-work poverty, job creation and competitiveness.</p> <p>Increase the employability of low skilled and older workers. Take measures to address long-term unemployment and provide adequate incentives to extend working lives.</p>	<p>Slovenia has made some progress in addressing the CSR 2:</p> <p>Some progress was made on reviewing the mechanism for setting the minimum wage. In November 2015, the Parliament adopted a proposal for excluding the existing bonuses from the minimum wage, which was put forward by the trade unions. As a result, employer organizations withdrew from the Social Agreement weakening the social dialogue considerably.</p> <p>Some progress was made regarding increasing the employability of long-term unemployed, low skilled and older workers. The government adopted the active labour market policies (ALMP) guidelines 2016-2020, which have been discussed with the social partners. The ALMP implementation plan, which represents the continuation of the approach implemented so far, was adopted in January 2016. Temporary exemptions from employers' social contributions for newly employed workers older than 55 were adopted in November 2015.</p>
<p>CSR 3: Bring down the level of non-performing loans in banks by introducing specific targets.</p> <p>Improve credit risk monitoring capacity in banks.</p> <p>Continue corporate restructuring and maintain strong corporate governance in the Bank Asset Management Company.</p> <p>Take measures to improve access to finance for SMEs and micro companies.</p> <p>Adopt a strategy for the Slovenian Sovereign Holding with a clear classification of assets, implement an annual asset management plan and apply performance criteria.</p>	<p>Slovenia has made substantial progress in addressing the CSR 3:</p> <p>Substantial progress has been made in reduction of the level of non-performing loans (NPLs). NPLs continued to decrease in absolute and relative terms; a further decrease is projected for 2016. However NPLs are still at high levels compared to pre-crisis period.</p> <p>Substantial progress has been made in improving the credit risk monitoring in banks. Action plans including specific targets have been prepared by individual banks and are continuously monitored. Banks introduced a regular data collection necessary for the adoption of the internal rating based model for credit risk reporting. Yet, it will still take several years before the model is in place for supervisory purposes (indicative objective is 2018-19).</p> <p>Substantial progress has been made in corporate and banking sector restructuring. Operational and</p>

	<p>financial restructuring of major corporates is completed and master restructuring agreements are continuously monitored. The restructuring of several SMEs has started. Guidelines for the restructuring of SMEs are currently implemented by the banks. The new insolvency framework supports corporate restructuring and offers a number of different tools for the reorganisation of enterprises. The Bank Asset Management Company (BAMC) is fully operational and independent. The strategy 2017-22 has been set out and the life span of the BAMC has been extended by five years. Additional restructuring tools are available.</p> <p>Some progress has been made regarding access to finance for SMEs and micro companies. More funding has been made available for SMEs. Gap analysis has been completed and required future financing needs of the SMEs has been estimated. Solutions to address these gaps are under preparations. Bank of Slovenia is introducing an interactive central credit register for fiscal and legal entities that should reduce the risk of over-indebtedness of the SME sector.</p> <p>Full implementation regarding the strategy for the Slovenian Sovereign Holding (SSH). In July 2015 the parliament adopted a strategy for the management of state assets held by the SSH. In December 2015, the Government approved an annual asset management plan for 2016 as well as a set of asset performance criteria. A new supervisory and management board in the SSH were appointed in July and October 2015, respectively.</p>
<p>CSR 4: Ensure that the reforms adopted to improve the efficiency of civil justice help reduce the length of proceedings.</p>	<p>Slovenia has made some progress in addressing the CSR 4:</p> <p>Falling workload of courts helped to maintain positive trends regarding the decrease of backlog and length of proceedings, and increase of clearance rates, particularly since courts resolve fewer cases every year.</p> <p>Further enhancement of case management and business processes is underway. Digitalisation projects and ICT platforms (e-filings, e-service, postal highway etc.) help to free up and reallocate the Court system's resources. Most notably, time</p>

	<p>frames for each proceeding are being developed.</p> <p>The authorities are planning a number of additional measures to strengthen the quality and the efficiency of the court system. These include amendments to the civil procedure act, e-auction system in enforcement and a major reorganisation of the first instance courts.</p>
Europe 2020 (national targets and progress)	
Employment rate (%): 75 %	In 2014, the employment rate increased compared to 2013 (67.8 % and 67.2 % respectively). The quarterly data for Q1-Q3 2015 confirms this improving trend.
Early school leaving target: 5 %	The 2020 target has been already achieved. Yet, early school leaving increased from 3.4 % in 2013 to 4.4 % in 2014.
Tertiary education target: 40 %	Tertiary education rates continuously improved and exceeded the 2020 target in 2014 (41 %).
Target for reducing the population at risk of poverty or social exclusion: 40 000 (compared to 360 000 in 2008)	After several years of deterioration, poverty and social exclusion rates stabilised in 2014. The number of people at-risk-of-poverty or social exclusion stabilised at 410 000 in 2014.
2020 Renewable energy target: 25 %	In 2014, the share of renewable energy was 21.9 %, putting the country on track to reach the target. The long administrative procedures in spatial planning and environmental permits are major barriers to further developing the electricity sector. There appears to be no renewable energy development strategy in the transport sector. With a 2.6 % share of renewable energy in transport, Slovenia should step up its efforts to reach the 10 % renewable energy target in transport by 2020.
<p>Energy efficiency target.</p> <p>Slovenia's 2020 energy efficiency target is 7.3 Mtoe expressed in primary energy consumption (5.1 Mtoe expressed in final energy)</p>	Additional efforts are needed to reach the 2020 target.

consumption.)	
R&D target: 3 % of GDP	No progress has been made towards the target. Over the past decade, the level of R&D investment in Slovenia increased at an unprecedented and unparalleled rate, making Slovenia one of the EU leaders in this respect. However R&D intensity in Slovenia decreased from 2.60 % in 2013 to 2.39 % in 2014. Slovenia will reach its national target for 2020 only if can guarantee the longer term sustainability of the investments in R&D.

ANNEX B

MIP scoreboard

Table B.1: MIP scoreboard - Slovenia

			Thresholds	2009	2010	2011	2012	2013	2014
External imbalances and competitiveness	Current account balance, (% of GDP)	3 year average	-4%/6%	-3.3	-2.0	-0.2	0.9	2.8	5.1
	Net international investment position (% of GDP)		-35%	-43.6	-47.2	-45.2	-49.9	-45.8	-43.7
	Real effective exchange rate - 42 trading partners, HICP deflator	3 years % change	±5% & ±11%	5.2	1.2	-1.1	-4.5	-0.7	1.2
	Export market share - % of world exports	5 years % change	-6%	9.5	-1.7	-5.5	-20.6	-17.6	-11.8
	Nominal unit labour cost index (2010=100)	3 years % change	9% & 12%	18.5	16.1	8.2	0.6	0.3	-0.2
Deflated house prices (% y-o-y change)			6%	-10.3	-1.3	0.9	-8.1	-6.0	-6.6
Private sector credit flow as % of GDP, consolidated			14%	2.9	1.9	0.4	-2.9	-4.0	-4.6
Internal imbalances	Private sector debt as % of GDP, consolidated		133%	113.5	115.1	113.0	112.6	108.2	100.1
	General government sector debt as % of GDP		60%	34.5	38.2	46.4	53.7	70.8	80.8
	Unemployment rate	3 year average	10%	5.1	5.9	7.1	8.1	9.1	9.6
Total financial sector liabilities (% y-o-y change)			16.5%	7.7	-3.4	-1.2	-0.7	-10.3	-0.4
New employment indicators	Activity rate - % of total population aged 15-64 (3 years change in p.p)		-0.2%	0.9	0.2	-1.5	-1.4	-1.0	0.6
	Long-term unemployment rate - % of active population aged 15-74 (3 years change in p.p)		0.5%	-1.1	1.0	1.7	2.5	2.0	1.7
	Youth unemployment rate - % of active population aged 15-24 (3 years change in p.p)		2%	-0.3	4.6	5.3	7.0	6.9	4.5

Note: Figures highlighted are those falling outside the threshold established in the European Commission's Alert Mechanism Report. For REER and ULC, the first threshold applies to euro area Member States.

Source: European Commission

ANNEX C

Standard tables

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

	2010	2011	2012	2013	2014	2015
Total assets of the banking sector (% of GDP)	146.2	142.1	141.1	129.0	116.8	108.1
Share of assets of the five largest banks (% of total assets)	59.3	59.3	58.4	57.1	55.6	-
Foreign ownership of banking system (% of total assets)	28.2	28.3	29.3	30.6	33.5	-
Financial soundness indicators:						
- non-performing loans (% of total loans) ¹⁾	8.2	11.8	15.2	13.3	11.7	11.5
- capital adequacy ratio (%) ¹⁾	11.3	11.9	11.4	13.7	18.0	18.0
- return on equity (%) ¹⁾	-3.2	-11.8	-19.6	-97.6	-1.9	3.2
Bank loans to the private sector (year-on-year % change)	1.6	-2.3	-4.1	-9.5	-9.1	-4.2
Lending for house purchase (year-on-year % change)	18.4	6.2	1.8	1.3	0.5	1.8
Loan to deposit ratio	156.5	149.0	143.8	119.0	95.9	86.4
Central Bank liquidity as % of liabilities	5.3	7.0	13.0	14.1	3.3	2.8
Private debt (% of GDP)	115.1	113.0	112.6	108.2	100.1	
Gross external debt (% of GDP) ²⁾ - public	22.5	23.6	30.8	43.1	60.3	60.7
- private	39.2	40.8	44.0	44.4	40.9	38.4
Long-term interest rate spread versus Bund (basis points)*	108.9	236.3	431.3	424.2	210.7	120.9
Credit default swap spreads for sovereign securities (5-year)*	71.2	159.1	330.1	273.2	138.5	107.8

1) Latest data Q2 2015.

2) Latest data September 2015. Monetary authorities, monetary and financial institutions are not included.

* Measured in basis points.

Source: IMF (financial soundness indicators); European Commission (long-term interest rates); World Bank (gross external debt); Eurostat (private debt); ECB (all other indicators).

Table C.2: Labour market and social indicators

	2010	2011	2012	2013	2014	2015 ⁽⁴⁾
Employment rate (% of population aged 20-64)	70.3	68.4	68.3	67.2	67.7	69.0
Employment growth (% change from previous year)	-2.1	-1.7	-0.9	-1.4	0.6	1.5
Employment rate of women (% of female population aged 20-64)	66.5	64.8	64.6	63.0	63.6	64.5
Employment rate of men (% of male population aged 20-64)	74.0	71.8	71.8	71.2	71.6	73.3
Employment rate of older workers (% of population aged 55-64)	35.0	31.2	32.9	33.5	35.4	36.9
Part-time employment (% of total employment, aged 15 years and over)	11.4	10.4	9.8	10.1	11.2	11.1
Fixed term employment (% of employees with a fixed term contract, aged 15 years and over)	17.3	18.2	17.1	16.5	16.7	18.0
Transitions from temporary to permanent employment	31.8	37.9	36.6	36.9	49.5	-
Unemployment rate ⁽¹⁾ (% active population, age group 15-74)	7.3	8.2	8.9	10.1	9.7	9.2
Long-term unemployment rate ⁽²⁾ (% of labour force)	3.2	3.6	4.3	5.2	5.3	4.8
Youth unemployment rate (% active population aged 15-24)	14.7	15.7	20.6	21.6	20.2	16.0
Youth NEET ⁽³⁾ rate (% of population aged 15-24)	7.1	7.1	9.3	9.2	9.4	-
Early leavers from education and training (% of pop. aged 18-24 with at most lower sec. educ. and not in further education or training)	5.0	4.2	4.4	3.9	4.4	-
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	34.8	37.9	39.2	40.1	41.0	-
Formal childcare (30 hours or over; % of population aged less than 3 years)	33.0	34.0	36.0	36.0	-	-

(1) 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.

(2) Long-term unemployed are peoples who have been unemployed for at least 12 months.

(3) Not in Education Employment or Training.

(4) Average of first three quarters of 2015. Data for total unemployment and youth unemployment rates are seasonally adjusted.

Source: European Commission (EU Labour Force Survey).

Table C.3: Labour market and social indicators (continued)

Expenditure on social protection benefits (% of GDP)	2009	2010	2011	2012	2013	2014
Sickness/healthcare	7.6	7.7	7.6	7.9	7.5	-
Invalidity	1.7	1.7	1.7	1.6	1.5	-
Old age and survivors	10.7	11.1	11.3	11.5	12.0	-
Family/children	2.1	2.1	2.1	2.1	2.0	-
Unemployment	0.6	0.7	0.8	0.7	0.8	-
Housing and social exclusion n.e.c.	0.0	0.0	0.0	0.0	0.0	-
Total	23.2	23.9	24.1	24.5	24.5	-
of which: means-tested benefits	2.0	2.0	2.0	1.9	1.9	-
Social inclusion indicators	2009	2010	2011	2012	2013	2014
People at risk of poverty or social exclusion ⁽¹⁾ (% of total population)	17.1	18.3	19.3	19.6	20.4	20.4
Children at risk of poverty or social exclusion (% of people aged 0-17)	15.1	15.2	17.3	16.4	17.5	17.7
At-risk-of-poverty rate ⁽²⁾ (% of total population)	11.3	12.7	13.6	13.5	14.5	14.5
Severe material deprivation rate ⁽³⁾ (% of total population)	6.1	5.9	6.1	6.6	6.7	6.6
Proportion of people living in low work intensity households ⁽⁴⁾ (% of people aged 0-59)	5.6	7.0	7.6	7.5	8.0	8.7
In-work at-risk-of-poverty rate (% of persons employed)	4.8	5.3	6.0	6.5	7.1	6.4
Impact of social transfers (excluding pensions) on reducing poverty	48.6	47.5	43.8	46.4	42.7	42.2
Poverty thresholds, expressed in national currency at constant prices ⁽⁵⁾	6501	6376	6385	6319	6009	5925
Gross disposable income (households; growth %)	0.4	1.0	1.9	-2.5	-1.2	1.4
Inequality of income distribution (S80/S20 income quintile share ratio)	3.2	3.4	3.5	3.4	3.6	3.7

(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) At-risk-of-poverty rate (AROP): proportion of people with an equivalised disposable income below 60 % of the national equivalised median income.

(3) 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.

(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) For EE, CY, MT, SI and SK, thresholds in nominal values in euros; harmonised index of consumer prices (HICP) = 100 in 2006 (2007 survey refers to 2006 incomes)

Source: For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.

Table C.4: Structural policy and business environment indicators

Performance indicators	2009	2010	2011	2012	2013	2014
Labour productivity (real, per person employed, y-o-y)						
Labour productivity in industry	-4.86	9.09	3.69	-0.22	0.41	3.52
Labour productivity in construction	-14.25	-11.68	2.42	3.78	-3.25	5.58
Labour productivity in market services	-8.98	2.88	3.57	-0.54	-0.37	1.60
Unit labour costs (ULC) (whole economy, y-o-y)						
ULC in industry	7.22	-4.48	-0.05	3.50	0.16	-1.08
ULC in construction	8.89	13.51	-3.07	-1.81	2.70	-7.01
ULC in market services	6.34	-0.71	-1.10	0.09	-1.90	-1.12
Business environment	2009	2010	2011	2012	2013	2014
Time needed to enforce contracts ⁽¹⁾ (days)	1350	1290	1290	1290	1290	1270
Time needed to start a business ⁽¹⁾ (days)	19.0	6.0	6.0	6.0	6.0	6.0
Outcome of applications by SMEs for bank loans ⁽²⁾	0.48	na	0.60	na	0.38	1.08
Research and innovation	2009	2010	2011	2012	2013	2014
R&D intensity	1.82	2.06	2.42	2.58	2.60	2.39
Total public expenditure on education as % of GDP, for all levels of education combined	5.69	5.68	5.68	5.44	na	na
Number of science & technology people employed as % of total employment	39	40	41	42	43	42
Population having completed tertiary education ⁽³⁾	20	20	22	23	24	25
Young people with upper secondary level education ⁽⁴⁾	89	89	90	90	92	90
Trade balance of high technology products as % of GDP	-1.12	-1.44	-1.01	-0.83	-0.60	-0.81
Product and service markets and competition				2003	2008	2013
OECD product market regulation (PMR) ⁽⁵⁾ , overall				na	1.89	1.70
OECD PMR ⁽⁵⁾ , retail				na	0.90	0.63
OECD PMR ⁽⁵⁾ , professional services				na	na	2.56
OECD PMR ⁽⁵⁾ , 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.5: Green Growth

Green growth performance		2009	2010	2011	2012	2013	2014
Macroeconomic							
Energy intensity	kgoe / €	0.23	0.23	0.23	0.23	0.23	-
Carbon intensity	kg / €	0.62	0.61	0.61	0.61	0.59	-
Resource intensity (reciprocal of resource productivity)	kg / €	1.10	1.03	0.92	0.82	0.81	0.79
Waste intensity	kg / €	-	0.19	-	0.15	-	-
Energy balance of trade	% GDP	-3.9	-5.0	-6.2	-6.8	-5.5	-4.1
Weighting of energy in HICP	%	11.59	13.87	14.31	14.50	14.38	14.72
Difference between energy price change and inflation	%	-5.1	11.5	7.8	2.9	0.6	-0.9
Real unit of energy cost	% of value added	10.9	10.9	10.9	-	-	-
Ratio of labour taxes to environmental taxes	ratio	5.5	5.3	5.5	5.0	4.7	4.7
Environmental taxes	% GDP	3.5	3.6	3.5	3.8	4.0	3.9
Sectoral							
Industry energy intensity	kgoe / €	0.18	0.18	0.17	0.17	0.17	-
Real unit energy cost for manufacturing industry	% of value added	13.7	13.7	13.7	-	-	-
Share of energy-intensive industries in the economy	% GDP	14.30	15.28	15.51	15.61	16.05	16.21
Electricity prices for medium-sized industrial users	€ / kWh	0.10	0.10	0.10	0.09	0.10	0.09
Gas prices for medium-sized industrial users	€ / kWh	0.04	0.04	0.05	0.06	0.05	0.04
Public R&D for energy	% GDP	0.01	0.01	0.02	0.01	0.01	0.02
Public R&D for environment	% GDP	0.02	0.02	0.02	0.02	0.02	0.02
Municipal waste recycling rate	%	20.9	23.0	35.1	40.6	43.0	-
Share of GHG emissions covered by ETS*	%	41.6	41.9	41.1	40.2	40.7	36.5
Transport energy intensity	kgoe / €	1.13	1.08	1.13	1.16	1.14	-
Transport carbon intensity	kg / €	3.48	3.15	3.37	3.52	3.34	-
Security of energy supply							
Energy import dependency	%	48.5	49.3	48.2	51.7	47.1	-
Aggregated supplier concentration index	HHI	30.8	18.3	15.6	15.1	37.9	-
Diversification of energy mix	HHI	0.25	0.24	0.24	0.24	0.24	-

General explanation of the table items:

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2005 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 a percentage of total value added for the economy

Environmental taxes and labour taxes : from European Commission, 'Taxation trends in the European Union'

Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)

Real unit energy costs for manufacturing industry: real costs as a percentage 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 000MWh and 10 000–100 000 GJ; figures excl. VAT.

Municipal waste recycling rate: ratio of recycled municipal waste to total municipal waste

Public R&D for energy or for the environment: government spending on R&D (GBAORD) for these categories as % of GDP

Proportion of greenhouse gas (GHG) emissions covered by EU Emission Trading System (ETS): based on greenhouse gas 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 2005 EUR)

Transport carbon intensity: greenhouse gas 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 over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels

* European Commission and European Environment Agency

Source: European Commission (Eurostat) unless indicated otherwise