SUMMARY

In the pre-crisis period, Slovenia, like other EU economies, recorded its most extensive debt accumulation before the crisis, reporting higher credit growth than the PIIGS. Just before the crisis, credit growth reached nearly 35% at the annual level. As a result, Slovenia recorded an above-average decline in lending activity during the financial crisis, and in the last few years this has been comparable to that in other more vulnerable countries in the euro area. The main reasons for higher credit growth were, as in other EU countries, inflated real estate prices, underestimation of uncertainty and lax lending standards, in addition to inappropriate development policies in the past, which were based on development by means of domestic equity. However, its level was much too low for a faster narrowing of the development gap, so the economy gave priority to foreign sources of debt financing rather than foreign ownership. Indeed the supply of these sources expanded after Slovenia's accession to the EU and with the favourable economic conditions in general. Moreover, the concept of the national interest gained popularity in this period, and through various holding companies, assisted by domestic banks, this enabled management buyouts in Slovenian companies and additionally increased their indebtedness. The high dependence of Slovenia's economy on foreign sources of finance has also been a significant factor in the deterioration of the general economic conditions in recent years, as companies have mainly had to deal with financial problems instead of focusing on their core activity.

The significant decline in lending activity after the onset of the crisis was also attributable to the bad situation in the banking system, for which reason the stabilisation of banks was carried out in 2013 on the recommendation of the EU Council. After the recapitalisations, the capital position of the Slovenian banking system improved for the first time since the tightening of the financial crisis, which has had a positive effect in terms of easing the financial constraints faced by Slovenian companies. The positive impacts of bank stabilisation have also been seen this year in the improved performance of the banking sector and higher confidence of savers. In the first quarter the banks generated a profit of EUR 56.6 m. The banks also continue to deleverage abroad. In the recent period they have also been reducing their exposure to the ECB.

Corporate indebtedness and deleveraging have been examined in detail based on the AJPES database of annual financial statements of all companies for the 2006– 2013 period. The advantage of this database is that it includes very detailed annual data on business operations. However, these being only accounting data, they do not necessarily provide a fully realistic picture of the actual economic trends. At the beginning of this section we focus on "less common" companies, such as holding, leasing and zero-employee companies, which contribute to the higher financial debt but do not represent a potentially healthy core of the economy that could pull the economy out of recession. In subsequent chapters we focus on "common" companies, analysing their indebtedness and debt concentration.

The less common companies have been deleveraging since the beginning of the crisis and account for almost 40% of financial debt. However, these companies generate less than 5% of value added and employ less than 1% of employees. They represent a significant burden in banks' balance sheets, but the recent recapitalisations of banks have made it easier to restructure their debts and some of them have also been transferred to the Bank Asset Management Company (BAMC), which is additionally easing the pressure of these companies on bank non-performing loans.

In 2013 over-indebted common companies accounted for around three quarters of bank and financial debts and slightly more than half of the total debt of common companies, and represented a third of the total number of companies and employees. They generated a quarter of value added and accounted for a tenth of total EBITDA. We regarded as over-indebted those companies whose financial debts exceed EBITDA by a factor of five and those that have debts and negative EBITDA. In 2013 more than half of the financial liabilities of over-indebted companies were concentrated in the sectors of wholesale and retail trade and the repair of motor vehicles, in manufacturing and in professional, scientific and technical activities. These three sectors account for as much as EUR 13 bn of financial debt. High shares are also recorded in construction, real estate and electricity, gas and steam supply activities, particularly by micro enterprises (80%) and enterprises oriented to the domestic market (90%). The debt is highly concentrated, with the thirty most indebted companies accounting for a third of the financial and total debts of over-indebted companies.

However, Slovenia also has a healthy core of common companies, which did not over-borrow during the crisis and managed to return to normal, or even improve, their business operations soon after the fall in demand in 2009. Some of them have been increasing both employment and their wage bill in the recent period. These include several export companies.

Deleveraging of common companies has been observed since 2009, at first largely as a result of the winding-down of companies, while in 2012 and 2013 it was also due to actual debt reductions. Financial liabilities had already started to decline in 2010, but mainly due to the closures of failing companies. Financial liabilities of surviving companies declined for the first time only in 2012, by EUR 0.4 bn, and by a further EUR 0.5 bn in 2013. Similar dynamics were seen in financial liabilities to banks: common enterprises were deleveraging only in the last three years, while in the first two years of the analysed period their bank debts had remained unchanged.

Empirical analysis has shown that unexpected and exogenously induced corporate deleveraging during the recession adversely affects economic activity, as a general decline in demand and banking system problems exacerbate the financial constraints on companies. Under such circumstances, deleveraging can mean for the most part a decline in investment activity. This is also corroborated by the analysis of investment trends and various financial indicators. Companies with high interest payments and large financial debts have lower investment rates than less indebted companies. In 2009 investment activity declined across all size classes, notably in micro and small enterprises.

International comparisons show that Slovenian companies are more indebted relative to GDP than those in economically stable euro area countries. At the same time, they have very low shares of equity in total liabilities and hence excessive debts. Both data indicate a need for the continuation of the deleveraging process, which began during the financial crisis. However, the Slovenian economy is still in the phase of recession and, according to our econometric analysis, a rapid reduction in financial leverage will have an adverse impact on investment activity and economic growth. To minimise the negative short-term effects of deleveraging on economic activity, it is therefore necessary to use deleveraging tools that are not focussed primarily on direct loan repayment but that also provide additional equity. In a period when this is difficult to achieve through the capital market, this involves a more intensive use of the debt-for-equity swap mechanism or a partial write-off of debt, followed by privatisation, where the BAMC should play an active role.

Additional capital should be mainly obtained from private – both foreign and domestic – sources of finance, while the state's ownership role should be reduced and an ownership structure put in place that will facilitate corporate development and improve corporate governance. State ownership, which is still significant in the Slovenian economy, has proved to be less than optimal in the past in our assessment.

The provision of fresh capital on the market and the deepening of financial markets would also be facilitated by additional financial incentives for financial investors, such as additional tax allowances for pension funds, and promoting the importance of old-age saving. Improving the financial structure of enterprises will also involve ensuring the functioning of other segments of financial services that are mainly based on long-term sources of finance. The instrument of securitisation could also be used, so that larger and more financially stable enterprises could also seek funding under more favourable conditions on other financial markets.

Fiscal Developments and Policy – Summary

In the 2005–2008 period Slovenia had achieved high rates of economic growth, but during the economic crisis it registered one of the sharpest slowdowns of economic activity among EU Member States, as well as one of the most severe deteriorations of public finances. Rigidity of expenditure and a high structural deficit during the peak of the economic cycle exacerbated the weakness of public finances during the crisis. The general government deficit had been contracting before the crisis, and in 2007 Slovenia had a balanced general government position. However, these trends were driven by the economic cycle, as Slovenia had recorded a structural deficit throughout the period preceding the crisis, and the deficit only widened further between 2006 and 2008. In 2006 and 2007, tax reform put in place a series of tax changes that had a significant and lasting impact on general government revenue, but there was no matching permanent reduction in expenditure. Indeed, expenditure continued to rise until 2011.

The belated, and insufficient, response to the crisis in its initial stages has now increased pressure on fiscal policy, which is pursuing the objective of bringing the deficit below 3% of GDP by 2015. The deficit having risen sharply in 2009 on the back of an increase in expenditure and decline in revenue, fiscal policy in subsequent years focused on restraining growth in spending. But given that revenue grew at a sluggish pace, the deficit remained high, at around 6% of GDP. It was not until 2012 that overall general government expenditure dropped on the back of a contraction of all expenditure categories (except interest payments), leading to the first significant narrowing of the deficit since the start of the crisis. In 2011 and 2012, when the corporate income tax rates were cut, certain measures to raise additional revenue were adopted. In 2013, meanwhile, additional increases of tax rates and measures to curtail the grey economy further increased the importance of revenue-side measures in the fiscal consolidation drive; revenue thus exceeded the 2008 level for the first time. The gap between revenue and expenditure has nevertheless been narrowing slowly, to a significant extent due to one-off factors associated with the recapitalisation of banks and certain state-owned companies. The growing debt and interest payments associated with high deficits and one-off factors, coupled with the expansion of certain social protection expenditure (pensions, healthcare) which account for the bulk of the increase in overall expenditure since the beginning of the crisis, are thus increasingly limiting the scope of fiscal policy action, as there are few prospects for tax increases given Slovenia's ranking in international taxation standings.

Fiscal consolidation stalled last year. After a significant drop in 2012, to 4.0% of GDP, the deficit widened to a record 14.7% of GDP in 2013. The bulk of the deficit, 10.3% of GDP, was associated with expenditure earmarked for strengthening the capital adequacy of the banking system. One-off expenditure excluded, the deficit (3.7% of GDP) was at a similar level to that of 2012. The improvement in the structural position of the general government balance was also smaller than in 2012. Consolidation thus stalled last year as interest expenditure rose and pension expenditure ticked up due to accelerated retirement preceding the implementation of the pension reform; the adopted measures - increased VAT rates, measures to curb the grey economy and an agreement to additionally lower wages and other labour costs – were not sufficient to produce any significant deficit reduction. Expenditure on goods and services and certain social transfers continued to drop, whereas the scaling back of subsidies stalled. Buoyed by increased receipts of EU funds, gross capital formation also rose following two years of decline.

Last year's increase of the general government debt was the steepest to date and in the period since the start of the crisis Slovenia has gone fairly quickly from the group of countries with low debt to the group of countries with medium indebtedness. The general government debt reached EUR 25.3 bn in 2013 or 71.7% of GDP, having increased by EUR 6.1 bn or 17.3 p.p. in the last year alone. More than half of last year's debt increase is a consequence of bank recapitalisation and the issuing of a bond for the Bank Assets Management Company (BAMC). Slovenia's debt increase in the past five years, amounting to almost 50 p.p., was the sixth largest among the EU Member States. Together with the fiscal effort required to reduce the deficit, the pace of the debt increase and hence interest payments creates strong pressure on the structure of expenditure.

Fiscal consolidation continued in the majority of EU Member States last year. Having already exceeded 6% of GDP in 2009 and 2010, the general government deficit in the euro area and in the EU was more than halved by 2013: it stood at 3.0% of GDP in the euro area and 3.3% of GDP in the EU. With the fiscal picture gradually improving, some EU countries have already exited EU financial aid mechanisms, though they remain subject to surveillance. Government measures to stabilise public finances, coupled with

measures executed and announced by the ECB, have also substantially reduced the spread of yields on euro area bonds since last autumn. This year the average general government debt in the euro area and in the EU is projected to drop below 3% of GDP according to the spring forecast of the European Commission. Taking into account the projected improvement, 12 EU Member States will remain subject to excessive deficit procedure after 2014. In accordance with the reformed procedures as part of the enhanced coordination of fiscal policies, the EC started implementing substantive surveillance of budgeting in several euro area countries in the autumn of 2013.

Under Slovenia's Stability Programme – Update 2014, the pace of deficit cutting is in line with the EU Council recommendations. The SP2014 pursues the objective of Slovenia reducing the general government deficit to 3.2% of GDP this year and 2.4% of GDP in 2015, one-off expenditure excluded. Considering that bank recapitalisation is planned to amount to 0.9% of GDP, this year's deficit will stand at 4.1% of GDP. The planned consolidation is also expected to result in a reduction of the structural deficit by 0.6% of GDP in 2014 and 0.5% of GDP in 2015. The deficit-reduction policy mix focuses on three areas in SP2014: revenue growth, maintaining expenditure at the 2013 level over the medium term, and reduction of the debt in 2016–2017 with privatisation proceeds, which will contribute to a stabilisation of interest expenditure towards the end of the programming period.

The expenditure growth planned in the SP2014 is based on relatively higher tax revenue compared to other general government revenue, which is largely a consequence of already adopted or planned discretionary measures. The tax revenue projections are nevertheless significantly lower than in the SP2013, largely due to the shortfall of proceeds from real estate tax due to the repealing of its legal basis by the Constitutional Court, the abandoning of the idea of a crisis tax, and partially due to the projected slower economic recovery. To a certain extent the SP2014 replaces the shortfall of this tax revenue with other, non-tax revenue. Consequently, consolidation is underpinned to a greater extent than in the SP2013 by higher non-tax revenue, which constitutes a risk since the measures to increase such revenue are only vaguely outlined in the SP2014. A portion of the planned measures to raise more revenue (some applicable in 2014) also requires legislative changes which could be delayed due to the early general election. The real estate and crisis taxes having been abandoned (notwithstanding the appropriateness of these measures), the SP2014, unlike the SP2013, assumes various one-off revenues (sale of concessions, corporate profits, certain extraordinary non-tax revenue) that does not constitute a systemic fiscal source which would address the long-term fiscal challenges; the proceeds from these sources are also less reliable than tax sources. In this respect, the stated goal in the SP2014 that the real estate tax be promulgated once again after the contested provisions are improved, appears to be an appropriate measure.

The significant increase in interest expenditure is weighing heavily on fiscal consolidation in the SP2014. The consolidation strategy under the SP2014 assumes a decrease of primary expenditure after 2014, to the extent that the surge in interest in 2014 is entirely absorbed up to 2018. In addition to growth of interest expenditure, brisk expansion of investments is planned in 2014 (partially associated with EU funds), whereupon investments are projected to drop to the 2013 level by 2018. Throughout the entire period only expenditure on social transfers and benefits is increasing, a result of the growth in pension and healthcare expenditure. Expenditure on interest and social benefits, which already accounted for the biggest share of the increase in overall expenditure in the 2008–2013 period (excluding recapitalisation of banks and state-owned companies), will thus remain the fastest growing segment of expenditure in the next five-year period. Fiscal policy action therefore remains largely focused on expenditure categories that have already seen the deepest cuts, which includes subsidies, investments, labour costs and intermediary consumption expenditure. The SP2014 projects a more restrictive policy for this type of expenditure than the SP2013. To a significant extent the implementation of the planned measures (some in 2014) to achieve expenditure targets under the SP 2014 is conditional on legislative changes that are yet to be implemented, whereas some measures are yet to be defined.

The strategy of fiscal consolidation in the SP2014 also envisages debt reduction, which decreases projected interest payments; this strategy relies on the privatisation of state-owned companies. For this year and next the SP2014 assumes further debt growth, peaking at 81.1% of GDP in 2015, whereupon debt is projected to decline. The debt reduction under the SP2014 (EUR 1.5 bn) implicitly indicates that privatisation proceeds will be used to pay down debt. The projected debt reduction is feasible given that the National Assembly has approved the sale of 15 companies whose book value as at the end of 2013 was estimated at EUR 1.3 bn. Nevertheless, the plan's feasibility hinges on the pace of privatisation, which had been delayed or abandoned in the past due to problems in achieving political consensus. The state will furthermore receive the proceeds of bank assets which will be sold by the BAMC. In order for these processes to proceed smoothly, it is paramount that the Slovenian State Holding, the manager of state assets established this year, as well as the BAMC, are fully operational. There has been no decision as yet

on the joint management of capital assets held by the SSH and the BAMC, though this will be vital given that the two institutions manage and dispose of stakes in the same companies.

Slovenia can achieve the stated objectives through the consolidation strategy defined in the SP2014, though this will require the timely adoption of measures planned in the SP2014 as well as additional measures. Fiscal policy remains committed to the goal of reducing the deficit below 3% of GDP in 2015. Given that the approach to consolidation has been inadequate in that it is not underpinned by the timely adoption of measures with lasting effects, there are downside risks to achieving the objective. In the short term the main challenge will be to adopt measures which will secure the implementation of the consolidation plan in 2014 and 2015. Given that some revenue- and expenditure-side measures have not been defined, there is a risk that the level of investments projected for individual years will not be realized. In 2014, for example, the planned investment growth outpaces the planned inflow of EU funds, which means that to a certain degree the projections of investments create some leeway for the reduction of this type of expenditure in the event that there are problems in achieving the planned level of other expenditure or revenue, and hence the target deficit.

In the short and long term, fiscal policy faces the challenge of crafting measures with more lasting effects. Owing to the slow recovery and the limited scope to raise taxes, fiscal policy is confronted with the need to proceed with consolidation by lowering expenditure and adjusting it to the capacity of the economy. In doing so, it will have to focus to a greater extent than previously on achieving consensus on measures with a more lasting effect, which will also be a result of a substantive debate about the financing of social priorities. The gradual correction of the deficit and the production of a surplus in the medium term will also stem the growth of public debt, though it will be a great challenge to reduce it as planned with proceeds from the privatisation of state-owned companies. However, this would contribute not only to consolidation and debt sustainability, and reduce the crowding out of other expenditure categories that could be leveraged to promote economic growth, it could also indirectly affect overall economic activity by improving corporate governance and reducing fiscal risks. In the long run, fiscal risks and challenges will stem primarily from the projected population ageing and the attendant adjustment of the systems of pension insurance, health care and long-term care. The biggest risk to the sustainability of public finances is the rapid growth of pension expenditure. The problem of covering pension expenditure is already pertinent and in recent years has required increasing transfers from the national budget; after 2020, it will only get worse. Studies also show that current health care and long-term care policies are unsustainable. In recent years health expenditure has been curbed chiefly through austerity measures such as the slowing of wage growth, lowering of drug prices and deferral of investments, but such measures cannot be sustainable in the long term. In health care the challenge will therefore be to put in place long-term systemic changes, but these need to be enacted concurrently with the establishment of a system of long-term care and changes to the pension system.

Summary

The labour market situation in the EU and Slovenia is still a great deal worse than before the crisis. The decline in economic activity triggered a labour market adjustment in the EU, the bulk of the adjustment taking place by reducing employment. In 2013 the employment rate in the EU (the population aged 15–64 years) was 1.6 percentage points lower, on average, than in 2008. In Slovenia, the employment rate dropped substantially more in this period (by 5.3 percentage points) due to the greater decline in economic activity and structural weaknesses of the Slovenian economy. For this reason a number of EU countries, including Slovenia, drifted away from the Europe 2020 national employment rate targets in 2008–2013.

Countries responded to the deterioration of the labour market situation by strengthening active labour market policies and labour market reforms. *In 2009 expenditure on active labour market policies had been stepped up across the entire EU, but in 2010 and 2011 it was already reduced in some countries due to fiscal consolidation, despite the further deterioration of the labour market situation.* At the beginning of the crisis Slovenia responded to the tightening labour market conditions by passing two intervention laws to preserve jobs and stepping up active labour market policies (ALMPs), but later on it turned to more passive measures to mitigate the impact of the crisis. After falling in 2011 and 2012, the number of unemployed participating in ALMPs rose in 2013. Given that the adjustment capacity of the labour market – which is significantly impacted by labour market institutions – became very important during the crisis, a number of countries also carried out labour market reforms. The number of reforms in the areas of employment protection, unemployment insurance and active employment policy thus increased in the EU in the period of the crisis. Slovenia made several changes in the area of unemployment insurance in this period. In April 2013 it also enacted changes to employment protection, which have been another important factor in labour market adjustment.

In the 2008–2013 period, in both the EU and Slovenia employment opportunities dropped substantially, particularly for youth, men and low-skilled people. During the crisis, job prospects for young people and men in particular deteriorated in Slovenia and the EU overall due to a sharp decline in activity in the construction and manufacturing sectors. This was also reflected in a sizeable decline in the job prospects for low-skilled workers. The significant deterioration of the situation of young people on the labour market in the EU was related to the above-average prevalence of temporary employment among the young (non-renewal of fixed-term employment contracts as a frequently used way of reducing employment in companies). Against the backdrop of tightened labour market conditions and modest demand, young people also find it more difficult to find a job due to their lack of experience. The decline in job opportunities for young people in Slovenia was also related to the fall in student work (by more than a third in 2008–2013, in addition to lower demand for work, also due to a rise in concession fees on student work), a significant increase in the number of graduates in recent years and a mismatch (in terms of field of study) between the supply of tertiary-educated graduates and labour market demand.

The rising long-term unemployment and the problems of young people seeking work are the key labour market issues in Slovenia. As a result of low economic activity and, consequently, poor job prospects, an increasing share of the active population is remaining unemployed for longer and longer periods of time. The long-term unemployment rate more than doubled and the very long-term unemployment rate almost tripled in 2008–2013, which is a sign of increasing structural problems. The relatively strong growth in the number of very-long-term unemployed (over 24 months) seen in the last two years is particularly worrying, as it diminishes the possibilities for reducing unemployment in the next few years and increases the likelihood of the transition of unemployed people into inactivity and migrations. Furthermore, the employment problems of young people are also increasing. Despite the high participation of young people in education, the share of unemployed youth in

the total youth population (15–25 years) rose from 4.5% in 2008 to 7.3% in 2013, and the share of youth not in employment, education or training (the NEET rate) from 6.5% in 2008 to 9.3% in 2012.

Labour market segmentation and the low employment rate of older people represent another serious problem in Slovenia. Labour market segmentation manifests itself in a high share of temporary jobs among youth – in Slovenia it is the highest in the EU. The major share of youth employment is accounted for by fixed-term employment and other types of flexible work, notably student work. The Slovenian labour market is not just segmented by type of employment, it is also segmented by age. Like the employment rate of youth (15–24 years), the employment rate of older people (55–64 years) is low in Slovenia, the lowest in the EU. In addition to the effects of early retirement in the past, this is related to certain barriers to employment for older people, which can also be attributed to systemic reasons. The pension reform, which entered into force in 2013, will contribute to a gradual increase in the employment rate of older people in the coming years. As to the tax allowances for hiring or retaining older employees – given the different definitions of these allowances in different laws, it will be necessary to reconsider their level and check if all of them are rational.

The reforms in labour market regulation in 2013 were focussed on reducing segmentation and increasing flexicurity. In April 2013 the Employment Relationship Act (ZDR-1) and the Act Amending the Labour Market Regulation Act (ZUTD-A) entered into force, the main goals of the adopted reforms being: (i) reducing labour market segmentation; (ii) increasing flexibility; and (iii) increasing legal protection of employees. The majority of changes aimed at reducing segmentation pertained to: (i) reducing the gap in firing costs for workers with fixed-term and permanent employment contracts; (ii) simplifying the termination procedures for permanent employment contracts; and (iii) limiting the possibilities for using repeated (chain) fixed-term contracts. The reforms aimed at increasing labour market flexibility involved changes towards reducing employment protection, mostly by lowering severance pay, shortening notice periods and simplifying the termination procedures for fixed-term employment contracts. Moreover, the possibility of time-limited or occasional work for pensioners was introduced, but employers used this only modestly in the initial period, even though it allows more flexibility.

Analysis of labour market conditions indicates that last year's changes to regulations contributed towards achieving the set goals. Changes in the area of regular employment protection, which declined substantially (below the OECD average), were focused on increasing flexibility. The reallocation rate of the unemployed (inflow in, and outflow from, registered unemployment compared with the average number of the registered unemployed), which is an indicator of flexibility, rose slightly. After the changes took effect, permanent employment started to increase more rapidly than fixed-term employment. The share of newly created permanent jobs in the total number of new jobs has increased since the adoption of the changes, which indicates a shift towards reducing labour market segmentation. Last year's reform in labour market legislation was a move in the right direction, but a further monitoring of its effects on the labour market is essential, as they are difficult to identify in the relatively short period since adoption. The increase in the share of self-employment and other types of employment after the adoption of changes, amid a decline in the share of permanent employment, shows the need for Slovenia to address the issue of economically dependent people and reconsider the usefulness and effectiveness of the different types of existing tax incentives for self-employment.

Another challenge in reducing labour market segmentation is a change in student work regulation. Last year's labour market reform did not interfere with the system of student work, although student work also needs to be reformed in order to reduce labour market segmentation. Student work should be more closely tied to gaining experience, which would have a positive effect on the career paths of students/pupils and facilitate their transition from education to employment. Student work should also be included in the social security system. However, finding a solution that would not excessively limit student work is a challenge, as this could significantly exacerbate the indicators of the situation of young people on the labour market and limit the possibilities of using flexibility work arrangements for employers.

In view of the significant structural problems on the labour market, strengthening and increasing the efficiency of ALMPs also represents a challenge. Slovenia is one of the EU countries with the lowest expenditures on active employment policies relative to GDP. In light of the increase in structural problems and the at-risk-of-poverty rate among the unemployed, it would be sensible to step up the ALMP programmes and increase their effectiveness. The participation rates of unemployed people over 50 years old and low-skilled people in ALPMs otherwise increased the most in 2013, but they are still relatively low. Given the rise in very long-term unemployment, it would be sensible to design and broaden programmes that prevent transition into long-term unemployment and on-the-job-training programmes that have proved the most effective in evaluation studies for other countries. It is, however, also necessary to create a system of independent evaluations of the effects of individual ALPMs in Slovenia and take them into account in the implementation of programmes. To reduce structural imbalances, in the short term, it would be sensible to increase the role of ALMPs in the area of education and training, which would better match employer needs. However, for a more systematic solution, it would be necessary to establish a system for monitoring and forecasting employers' demands for skills and knowledge in the short and long term. Given that the incentives for hiring young people are governed by several different laws and ALMPs, the level and form of these incentives should be reconsidered from the perspective of effectiveness. Increasing employment prospects for the young requires effective implementation of the Youth Guarantee scheme financed by funds to support youth employment at the EU level.

Increasing employment and improving the capacity to adapt to changes in the economic environment are also significant challenges to economic policy in the area of the labour market. The key factor in improving labour market conditions is the recovery of economic growth. Alongside the continuation of structural reforms, the efforts should be focused on fiscal consolidation, effective stabilisation of the banking system, creating a stimulating business environment and attracting foreign investment. Improving competitiveness will require further reforms, not only in the area of employment, which was tackled by last year's reforms, but also in the wage-setting system, including the minimum wage policy, and in the area labour taxation, including the introduction of appropriate work incentives.