Chapter 1

Economic and fiscal context

This chapter presents Slovenia's economic and public finance position. It starts by considering the key features of Slovenia's economy, and how these have affected its ability to navigate the global economic and fiscal crisis. It goes on to consider the size and structure of government revenues and expenditure, against the background of Slovenia's public debt and the need for fiscal consolidation. Due to its impact on the public administration, particular attention is paid to the fiscal consolidation strategy that Slovenia has enacted as a means to restore public finances.

Table 1.1. **Basic statistics on Slovenia, 2010**

Land			
Area (km²)	20 273	Major cities (thousands inhabitants)	
Agricultural (2006)	4 700	Ljubljana	277.2
		Maribor	112.9
		Kranj	54.4
People			
Population (thousands)	2 047	Labour force (thousands)	936
0-14 (%)	14	Employed (thousands)	835
15-64 (%)	69	Agriculture (%)	
65+ (%)	17	Industry (%)	
Urban settlements (%)		Services (%)	
Rural settlements (%)		Public sector, 2008 (%)	27.9
Slovenians (%)	96	Private sector, 2008 (%)	72.1
Non-Slovenians (%)	4	Unemployed (% of labour force)	7.2
Inhabitants per km²	101		
Government			
General government expenditure (% of GDP)	49.1	Coalition government, as of December 2011*	Seats
General government revenue (% of GDP)	43.7	Social Democrats (SD)	29
General government deficit (% of GDP)	-5.6	Liberal Democracy of Slovenia (SDS)	5
General government debt, Maastricht definition (% of GDP)	38.0	Total	90
Economy			
GDP, current prices (millions EUR)	35 416	Origin of value added, 2008 (%)	
GDP per capita (EUR, current prices)	17 286	Agriculture	2.4
Gross fixed capital formation (% GDP)	22.6	Industry	33.9
Real GDP growth (% annual change)	1.4	Services	63.7
Exports of goods and services (% GDP)	65.4	Imports of goods and services (% GDP)	64.9

Note: * While elections were held in Slovenia on 4 December 2011, the government remained acting until 10 February 2012. The coalition formed after the 4 December elections and in place as of 10 February 2012 is comprised of: Slovenian Democratic Party (SDS): 26 seats; Gregor Virant's Civic List (*Lista Virant*): 8 seats; Slovenian People's Party (SLS): 6 seats; Democratic Party of Pensioners of Slovenia (DeSUS): 6 seats; New Slovenia-Christian People's Party (NSi): 4 seats.

Source: OECD (2011), *Government at a Glance 2011*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/gov_glance-2011-en*; *OECD Statistical Database*; *OECD National Accounts*; OECD (2011), "OECD Economic Outlook No. 89", *OECD Economic Outlook: Statistics and Projections* (database), OECD, Paris, *http://dx.doi.org/10.1787/data-00539-en*; Statistics Slovenia; Eurostat; *International Labour Organisation Statistics*.

Introduction

Since independence in 1991, Slovenia has successfully transitioned to an advanced economy. It is, however, challenged by a constrained resource-base that limits its potential for economies of scale, by import dependence, and by sensitivity to the economic difficulties experienced by key trading partners. In 2009, Slovenia suffered a severe economic recession, resulting in a strong deterioration in public debt. Since then it has implemented a series of urgent fiscal consolidation measures driven by expenditure reduction-measures focused on reducing public sector employment and the public sector wage bill. While Slovenia's fiscal consolidation strategy is ambitious in its aims, it may negatively impact the efficiency and effectiveness of the public administration in serving the government agenda, as well as its sustainability.

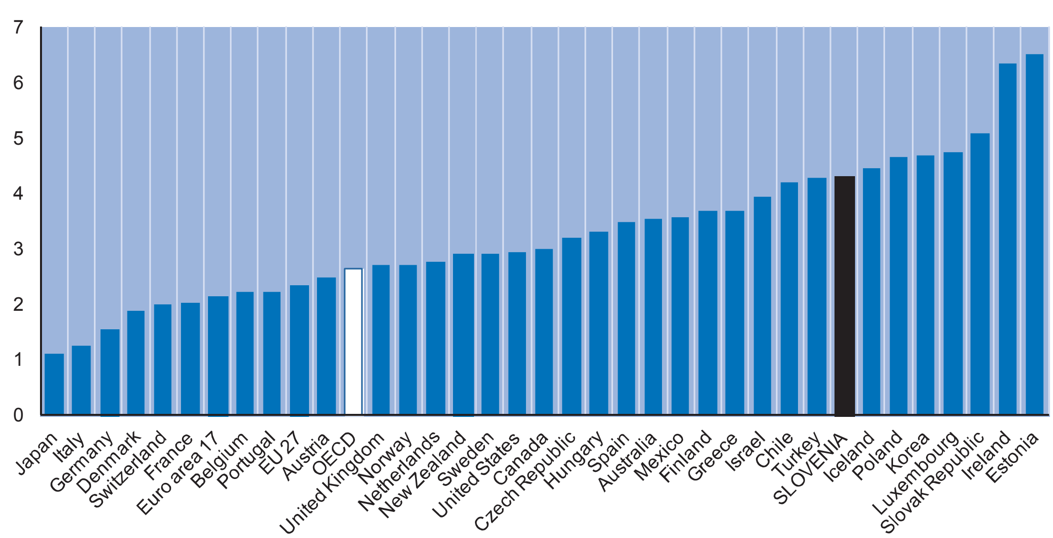
Economic context: features of the Slovenian economy

Prior to the global financial crisis, Slovenia had achieved strong economic growth

Since independence Slovenia has successfully transitioned to an advanced economy, though starting from a relatively favourable position compared to other former Yugoslav Republic (FYR) countries.[1] Between 1996 and 2008, compared with other OECD countries, Slovenia was one of the fastest growing economies, averaging a 4.3% growth of GDP per year, higher than the OECD average of 2.6% (see Figures 1.1 and 1.2).

Figure 1.1. **Real GDP growth, 1996-2008**

Average annual rate of growth, in %

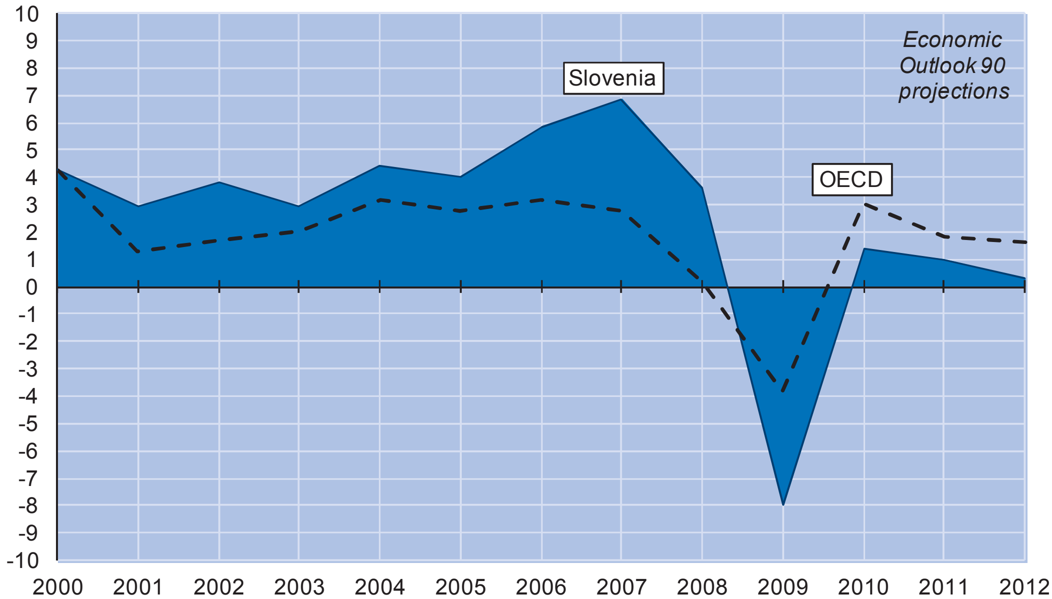


Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD National Accounts.

Figure 1.2. **Real GDP growth, 2000-2012**

Annual % change



Source: OECD National Accounts; OECD (2011), "OECD Economic Outlook No. 90", *OECD Economic Outlook: Statistics and Projections* (database), OECD, Paris, *http://dx.doi.org/10.1787/data-00588-en.*

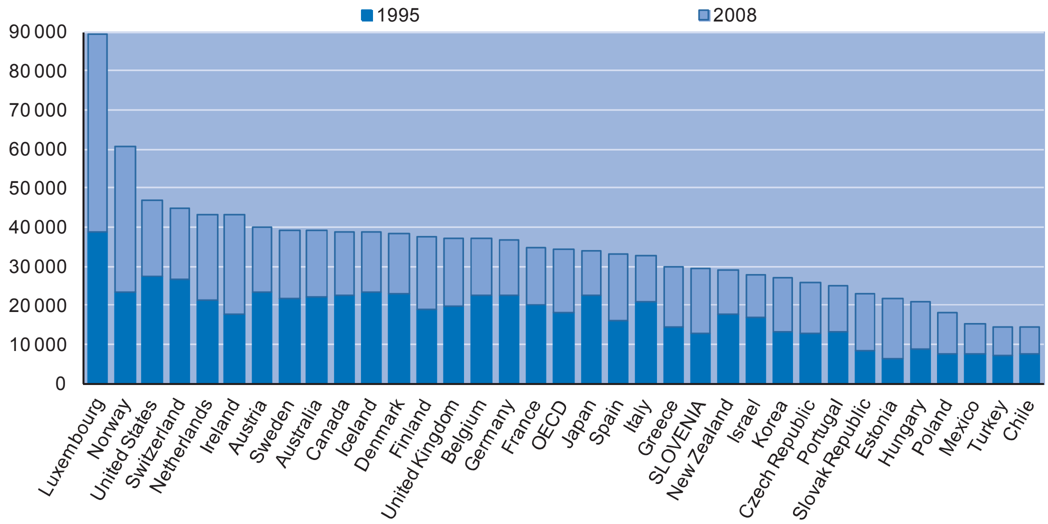
In 1995, Slovenia's level of GDP per person was 66% of the OECD average. During the period from 1995 to 2008, Slovenia's resilient efforts to integrate the EU Single Market were rewarded and significant progress was made in "catching up" with other OECD countries: GDP per person represented 85% of the OECD average in 2008, at USD 29 300, a level similar to New Zealand, and only USD 3 000 lower than the EU27 average (see Figure 1.3).

A small and open economy especially exposed to global developments and crises

While Slovenia has experienced strong economic growth since gaining independence, it still remains a relatively small economy. In 2008, Slovenia was the fourth smallest OECD member country in terms of economic size, with a level of GDP close to USD 56 billion – only Estonia, Iceland and Luxembourg have smaller economies. In comparison, New Zealand, which falls just above Slovenia in the rankings, is twice its size with USD 116 billion. Demographically, Slovenia is also the fourth smallest OECD country, with a population just above 2 million.[2]

Figure 1.3. **GDP per head, 1995 and 2008**

USD, purchasing power parities



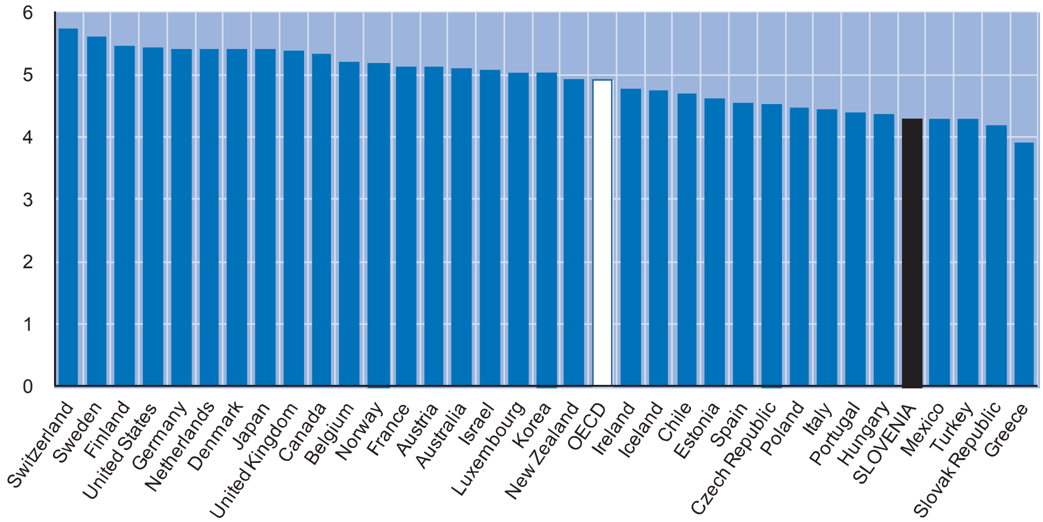
Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD Statistical Database.

Due to its small size, geographical location and historical ties, Slovenia has adopted an openness to trade policy. This is illustrated by a relatively high level of international trade in goods and services, representing almost 70% of GDP,[3] a level considerably higher than the OECD average of 29%. Compared to most other OECD member countries, this high degree of openness makes the Slovenian economy vulnerable and exposed to economic difficulties faced by its main trading partners,[4] and also much more dependent on its international price competitiveness.

Slovenia is challenged by a constrained resource base that limits its potential for economies of scale, and a resulting dependency on imports. In the years preceding the global financial crisis, the current account deficit expanded significantly, mostly as the result of an overheating economy, a rise in commodity prices, an appreciation of the euro, and rising labour costs. Although some sectors of the economy improved their export competitiveness, Slovenia's level of competitiveness[5] was very low compared to other OECD member countries, ranking 30th in the Global Competitiveness Index (GCI), with a score similar to Mexico and Turkey (see Figure 1.4).

Figure 1.4. **Competitiveness Index, 2011-2012**



Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

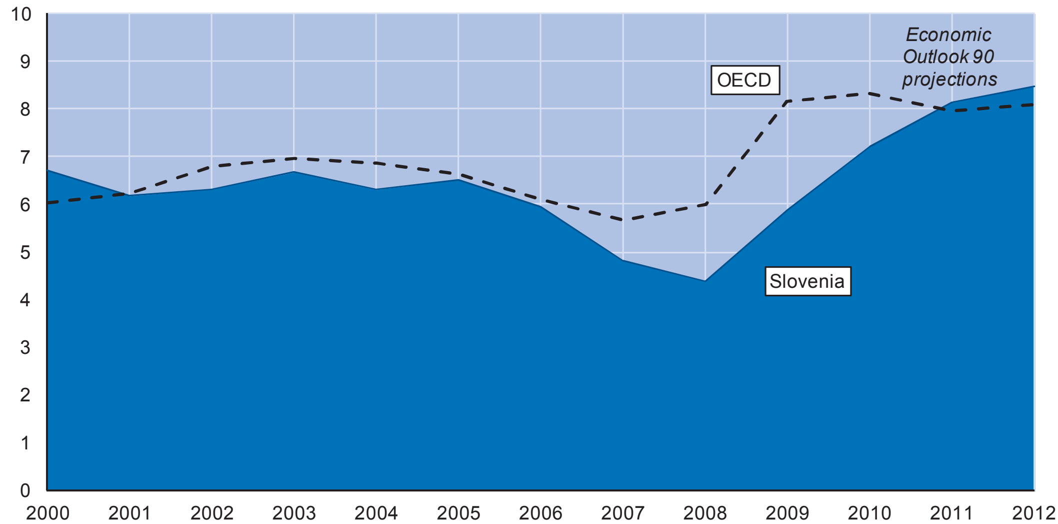
Source: World Economic Forum (2011), *Global Competitiveness Report 2011-2012*, World Economic Forum, Geneva.

Also according to the *Global Competitiveness Report*, Slovenia ranks particularly low in the areas of innovation (26th), labour market efficiency (27th), financial market development (31st), and market size (31st). However, Slovenia's score for health and education (both pillars for "health and primary education" and "higher education and training") is equal to the OECD average. The only pillar for which Slovenia ranks above the OECD average is the macroeconomic environment (13th).

Unemployment, which was below the OECD average, has increased

As an indication of successful economic progress, the unemployment rate in Slovenia continuously decreased between 2000 and 2008, from 6.7% to 4.4% (see Figure 1.5). It has been below the OECD average since 2001. However, like most other OECD member countries, the Slovenian labour market has been deeply affected by the global financial crisis. Unemployment started rising in 2008, and continued to rise even in 2011, while across the OECD it started to decrease in 2011. The December *OECD Economic Outlook* (OECD, 2011c) estimates that Slovenia's unemployment rate will overtake the OECD average in 2011 and reach its peak in 2012 before starting to decrease from 2013 onwards.

Figure 1.5. **Unemployment, 2000-2012**



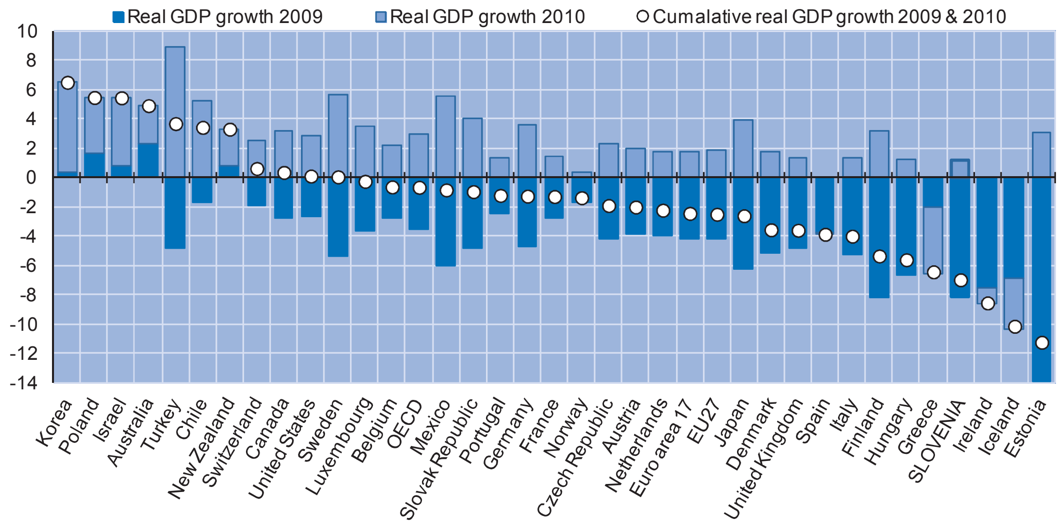
Source: OECD (2011), "OECD Economic Outlook No. 90", *OECD Economic Outlook: Statistics and Projections* (database), OECD, Paris, *http://dx.doi.org/10.1787/data-00588-en.*

Slovenian authorities report that the number of registered unemployed was approximately 110 000 in July 2011, which represents a 9% annual increase. These levels should be taken with caution because the statistical methodology for calculating unemployment in Slovenia tends to show higher levels compared to that of the OECD.

The global financial crisis exposed significant weaknesses in Slovenia's economy

Despite its economic success between 1992 and 2008, Slovenia's frailties were severely exposed during the global financial crisis. The economy faced the second worst recession among OECD member countries in 2009, when GDP declined by 8.0% (OECD average was -3.4%). Finland faced a similar contraction while Estonia's GDP dropped by almost 14%. Five OECD member countries experienced positive economic growth in 2009 – Australia, Israel, Korea, New Zealand and Poland – while most other OECD member countries went through a recession in the same year. All OECD member countries, except Greece, Iceland and Ireland, recovered with growth in 2010, but at very different levels. Turkey experienced the strongest growth with 9% of GDP in 2010 whereas Slovenia experienced the third slowest growth with 1.2% (after excluding the three countries that went through a recession). Over the two last years, Slovenia has had a cumulative negative real GDP growth of 7%. In order to return to its 2008 level of GDP by 2013, the Slovenian economy would have to grow by a minimum of 2.4% per year between 2011 and 2013 (see Figure 1.6).

Figure 1.6. **Impact of the crisis on real GDP growth, 2009 and 2010**



Note: Arranged in descending order according to cumulative growth in 2009 and 2010. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD National Accounts.

Due to a drastic decline in liquidity during the crisis, Slovenia's financial sector required significant support from the government and the European Central Bank. Households and businesses were financially affected by lower incomes, asset prices and an ensuing restriction of credit. Despite a strong recovery of exports during 2009, domestic demand was constrained by an insufficiently responsive labour market and continuous deleveraging by financial institutions and businesses.

Before the crisis, economic output mostly relied on credit and the construction sector, while exports were driven by cyclically-sensitive goods, such as automotive components. The banking sector now requires further capitalisation in order to dampen the risk of credit rationing. Although the overall banking system is sufficiently capitalised, smaller banks could be further exposed to adverse economic and sovereign debt shock scenarios. Additional stress tests covering all Slovenian banks are expected to be carried out in order to identify those which will require restructuring or recapitalising. Furthermore, because the level of product differentiation for exported goods is relatively low, and due to a small number of trading partners, the economy is further exposed to global recessions and vulnerable to external adverse economic shocks.[6] The key challenge now for Slovenia is how to diversify its production and improve productivity and competitiveness by intensifying labour market flexibility, encouraging innovation, facilitating foreign direct investment and for the public administration to steer and support reforms more effectively.

Like many other OECD countries, Slovenia's economic recovery will likely be slow

The Slovenian economy is sluggishly recovering from the crisis. The deleveraging of the corporate sector and a weak external environment will impede growth through the first half of 2012 (OECD, 2011c). Consumption and investment are expected to remain flat until growth recovers in the second half of 2012 as confidence strengthens and world trade improves. The *OECD Economic Outlook* (2011c) predicts real GDP to grow by 1% in 2011 and 0.3% in 2012. Like most other OECD member countries, Slovenia's overall economic recovery post-global financial and economic crisis is characterised by sluggish growth, persistent long-term unemployment, deteriorating public finances and continuously high financial vulnerability. Economic growth could further dampen due to rising commodity prices that wear down the purchasing power of consumers, but also to a lack of capital liquidity in financial markets, constraining business investment. Future improvements towards sustainable growth strongly depend on the capacity of euro area policy makers to restore confidence in financial markets, and on the ability of the Slovenian Government to consolidate its public finances.

The size and structure of government revenues and expenditure

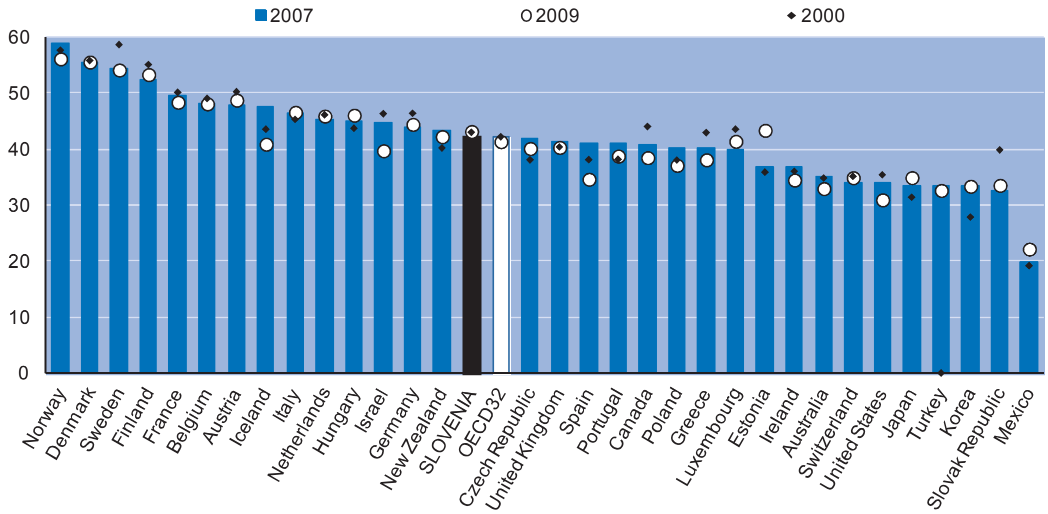
The financial crisis hit Slovenia's government expenditure harder than its revenues

Between 2000 and 2009 the size of Slovenia's public revenue was relatively stable compared to most other OECD member countries, averaging between 42% and 43% of GDP (see Figure 1.7). In 2007, before the global financial and economic crisis, government revenue in Slovenia represented 42.4% of GDP, one percentage point above the OECD average of 41.4%, and similar to that of the Czech Republic (41.8%) and New Zealand (43.2%). Between 2000 and 2007, government revenue as a share of GDP across 31 OECD countries decreased on average by 0.1 percentage point. After the global financial crisis, revenues across the OECD declined even further, averaging a 0.7 percentage point drop between 2007 and 2009. Slovenia, however, followed a different pattern, similar to the Netherlands and Switzerland: government revenue decreased by 0.4 percentage points, and then strongly increased after the global financial crisis, by 0.8 percentage points during 2007-2008. This relative increase in revenues was mostly explained by the strong fall in GDP over the same period. By 2010, general government revenue in Slovenia reached 43.5% of GDP, a level that had not been reached since 2005.

When compared to other OECD countries, government revenue in Slovenia is mostly raised by taxes. In 2009, taxes other than social contributions accounted for 52.1% of total government revenue, 8.8 percentage points below the OECD average of 60.9%. In comparison, social contributions accounted for 35.3% of total revenues, 10.7 percentage points above the OECD average. The remaining 12.6% of revenue was provided by grants and other revenues, only 1.9 percentage points below the OECD average.

Figure 1.7. **General government revenue, 2000, 2007 and 2009**

% of GDP



Notes: Arranged in descending order according to 2007 data. Chile data for 2008 instead of 2007. OECD average for 2000 does not include Chile, Mexico or Turkey. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

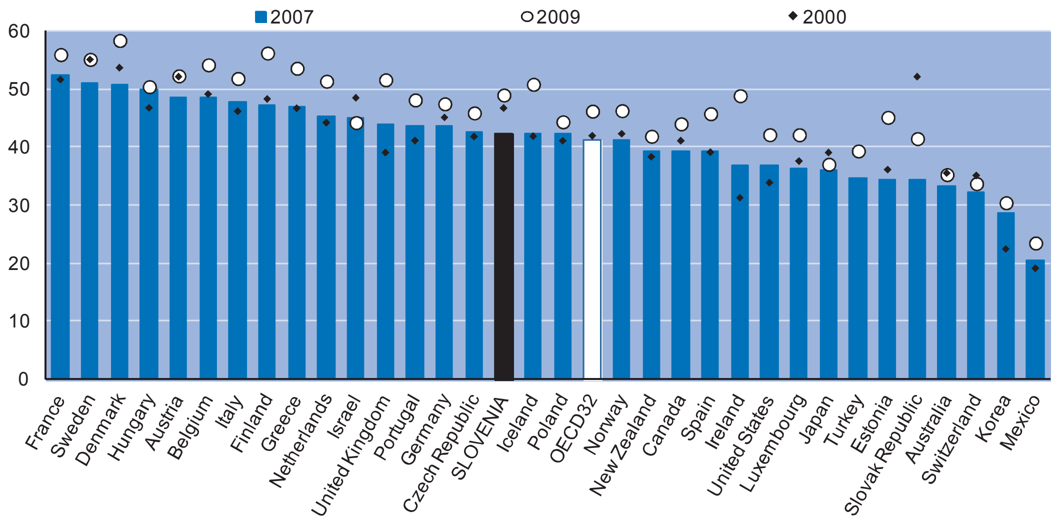
Source: OECD National Accounts.

Between 2000 and 2007, OECD member countries had decreased their level of public spending by an average of 0.6 percentage points of GDP (see Figure 1.8). During the same period, with the exception of the Slovak Republic (17.8 percentage points) and Sweden (4.1 percentage points), Slovenia experienced the greatest decrease in government expenditure, with a 4 percentage point decrease. In 2007, government expenditure in Slovenia represented 42.5% of GDP, 1.9 percentage points above the OECD average, almost level with expenditure in the Czech Republic (42.5%), Iceland (42.3%) and Poland (42.2%).

In the aftermath of the crisis, the share of government spending increased by 4.9 percentage points of GDP across the OECD. Only a portion of this increase can be explained by declining GDP, however, as it also reflects expenditure measures taken to stabilise the financial sector and to stimulate the economy. Between 2007 and 2009, Slovenia's government expenditure increased considerably by 6.7 percentage points of GDP, with the largest increases occurring in Ireland (11.4 percentage points) and Estonia (10.8 percentage points). By 2010, Slovenia's government expenditure had reached its highest level in over a decade, at 49.1% of GDP. It is worth noting that between 2000 and 2008 public expenditure did not increase as fast as GDP – real GDP grew on average at an annual rate of 4.3%, whereas public expenditure trailed with an average annual rate of 3.5% (see Figure 1.9). However, government expenditure per person increased faster than government revenue per person between 2000 and 2009, by 2.6% and 3.1% respectively (OECD, 2011a).

Figure 1.8. **General government expenditure, 2000, 2007 and 2009**

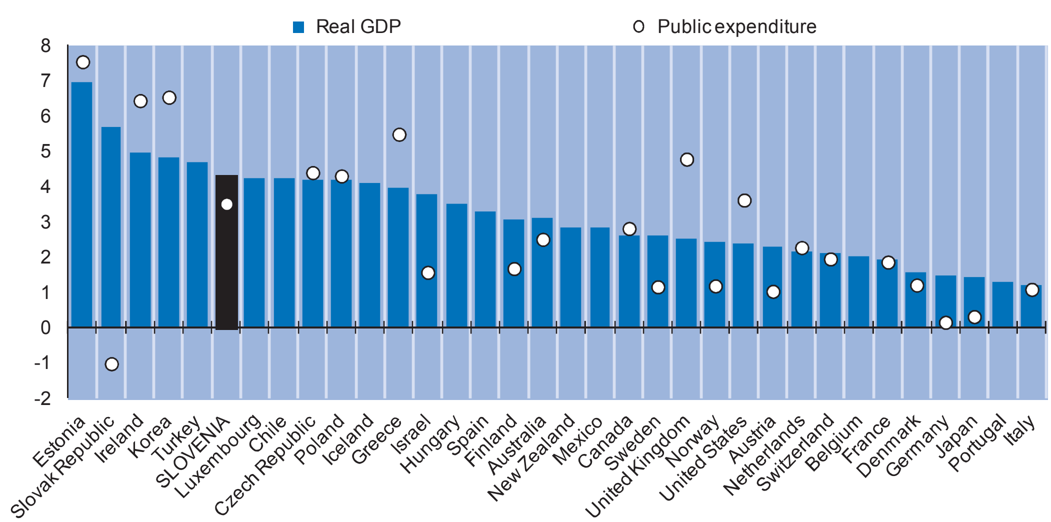
% of GDP



Notes: Arranged in descending order according to 2007 data. Chile data for 2008 instead of 2007. OECD average for 2000 does not include Chile, Mexico or Turkey. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD National Accounts.

Figure 1.9. **Real GDP and public expenditure average annual growth rate, 2000-2008**

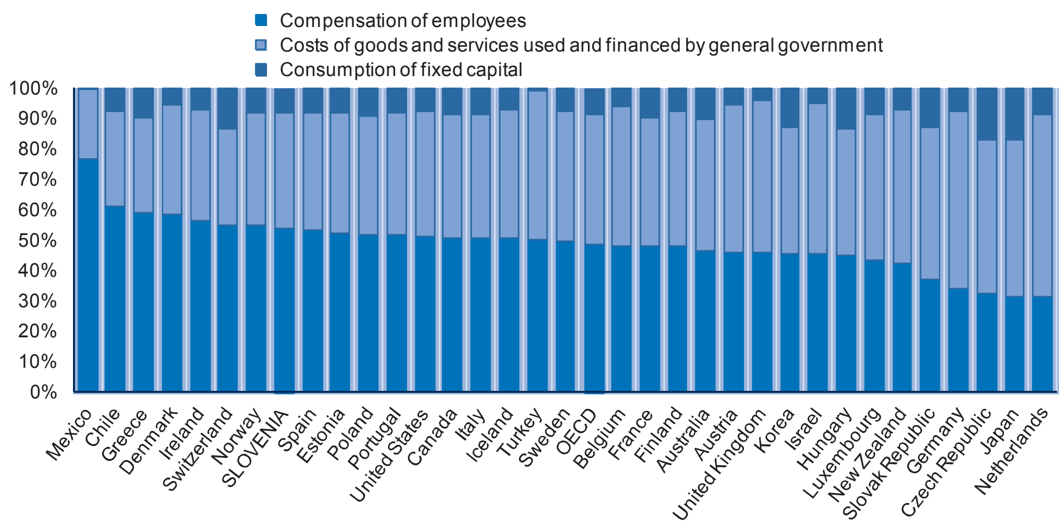


Note: Public expenditure data for the Slovak Republic for 2000-2007 and for Japan for 2000-2006. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD National Accounts.

In 2009, approximately a quarter of the Slovenian economy was devoted to producing public goods and services, which is very close to the OECD average. In terms of the production and funding of public goods and services, Slovenia relies more on government employees in the production process than most other OECD member countries, therefore relying less on outsourcing. In 2009, the compensation cost of employees represented 54% of total production costs in Slovenia, 5.3 percentage points above the OECD average of 48.7% (see Figure 1.10). In other words, public sector wages account for a relatively large share of the cost of delivering public services (Slovenia's public sector salary system is further discussed in Chapter 4).

Figure 1.10. **Structure of production costs, 2009**



Notes: Australia, Japan, Korea, New Zealand and Russian Federation: 2008. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD National Accounts. Data for Australia are based on a combination of Government Finance Statistics and National Accounts data provided by the Australian Bureau of Statistics.

According to the international Classification of the Functions of Government (COFOG), the structure of general government expenditure in Slovenia is very similar to the OECD average. In 2008, almost two-thirds of Slovenia's total government expenditure was allocated to three main spending functions: social protection, 36% of total expenditure, was slightly higher than the OECD average (33.9%); education (13.9%) and health (13.8%) were almost equal to the OECD average. Spending on economic affairs and general public services was lower than the OECD average.

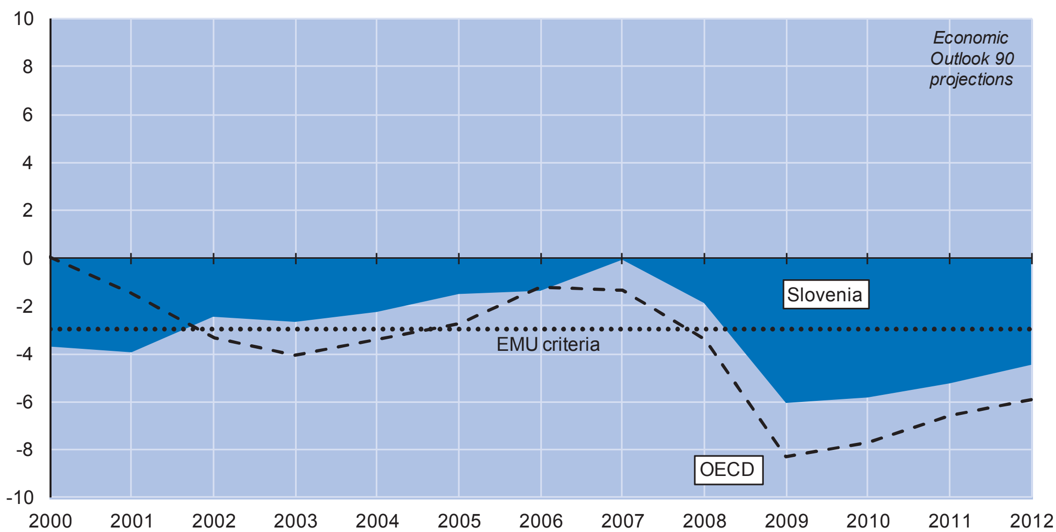
Public finances, which were under control, are now showing signs of relative strain

The global financial and economic crisis led to a strong deterioration in both public deficits and debt in most OECD member countries. Governments were confronted with a combination of diminishing revenues, due to economic slowdown, and increased spending, due to support to the financial sector and an expansion of social transfers acting as automatic stabilisers. As a result, most OECD member countries have had to implement fiscal consolidation programmes to avoid an unsustainable deterioration of their public finances, and in turn maintain investor confidence in their future potential.

Between 2000 and 2008, the Slovenian Government successfully kept its public finances within the limits imposed by the Stability and Growth Pact (i.e. budget deficit lower than 3% of GDP, and public debt lower than 60% of GDP), averaging a budget deficit of 2.2% of GDP per year and maintaining a level of public debt below 30% of GDP (see Figures 1.11 and 1.12). However, inflation remained high, mirrored by high interest rates and a depreciated national currency (the tolar) against the euro. Significant efforts were therefore required to reduce the inflation rate, down from a level close to 9% in 2000.

Figure 1.11. **General government fiscal balance**

% of GDP



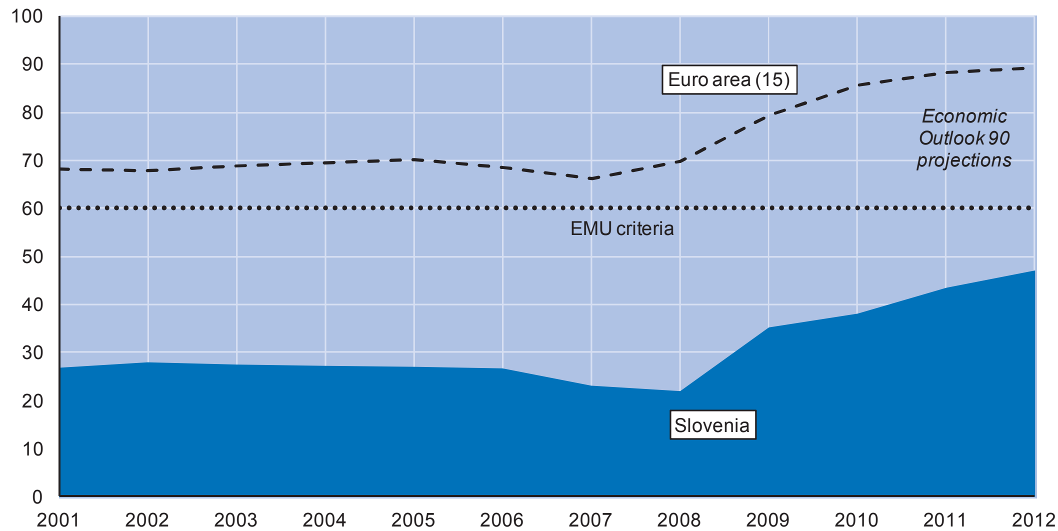
Source: OECD National Accounts; OECD (2011), "OECD Economic Outlook No. 90", *OECD Economic Outlook: Statistics and Projections* (database), OECD, Paris, *http://dx.doi.org/10.1787/data-00588-en*.

Since the global financial and economic crisis, while both the budget deficit and the level of public debt deteriorated significantly, only the fiscal balance breached the Maastricht criteria. Nevertheless, both have remained and are expected to stay below the OECD and euro area average until at least 2012. Despite the necessary fiscal consolidation measures currently in place, Slovenia is not expected to present a budget deficit within the Maastricht criteria before 2013. The level of public debt will remain one of the lowest amongst OECD member countries but it is expected to increase further and reach 48% by 2012. Furthermore, because the Slovenian population is rapidly ageing, the rejection by referendum of proposed pension reform in June 2011 leaves the issue of long-term fiscal sustainability unresolved.

Compared to other OECD member countries, Slovenia's fiscal balance before the crisis was highly favourable, slightly below 0% of GDP in 2007 (see Figure 1.13). Slovenia is among the OECD member countries that managed to significantly decrease its public deficit between 2000 and 2007, from 3.7% of GDP, to 0.1% in 2007.[7] Only Japan and the Slovak Republic managed to reduce their public deficit by a larger extent over the same period. However, within a year after the start of the global financial crisis, Slovenia's budget deficit reached 6% of GDP in 2009, a level similar to many other OECD member countries.

Figure 1.12. **General government debt**

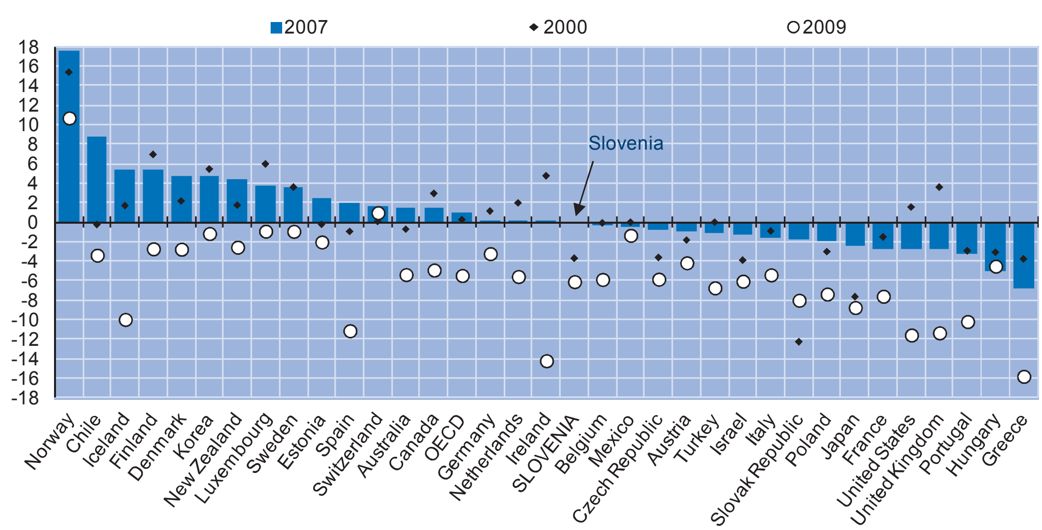
% of GDP



Source: OECD National Accounts; OECD (2011), "OECD Economic Outlook No. 90", *OECD Economic Outlook: Statistics and Projections* (database), OECD, Paris, *http://dx.doi.org/10.1787/data-00588-en*.

Figure 1.13. **General government fiscal balance, 2000, 2007 and 2009**

% of GDP



Notes: Arranged according to 2007 level. The OECD average for 2000 does not include Mexico or Turkey. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

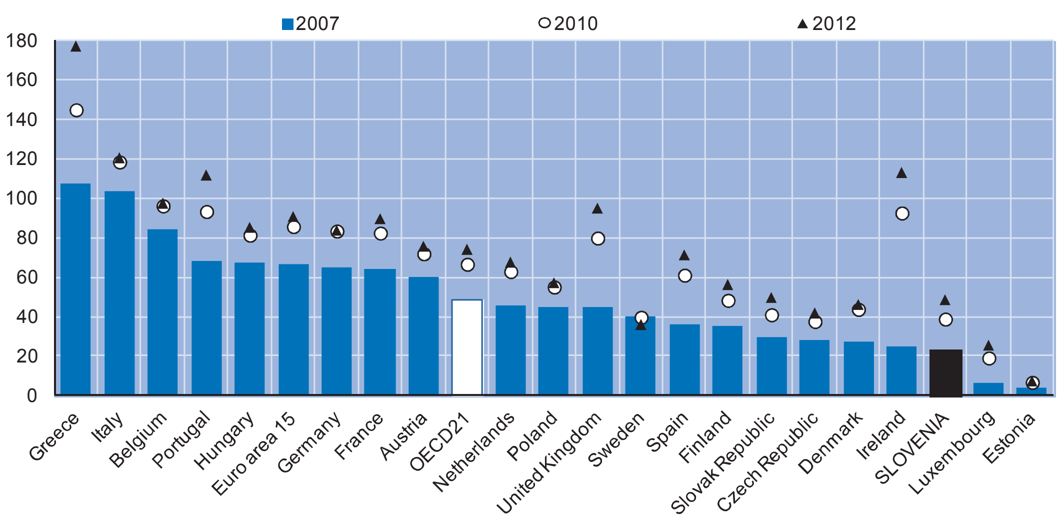
Source: OECD National Accounts.

The increase in Slovenian public debt is worrying and must be addressed

Before the global financial and economic crisis, Slovenia had kept its public debt under control. In 2007, its public debt according to the Maastricht definition was one of the lowest amongst the 21 OECD-EU member countries, representing 23.1% of GDP, higher only than that of Luxembourg and Estonia. The OECD 21 average was almost twice as high, at 48%. Slovenia had successfully managed to decrease its level of public debt from 27% of GDP in 2000. However, public debt increased dramatically between 2007 and 2010 and is expected to further increase until at least 2013. Slovenia's public debt reached 39% of GDP in 2010 and is expected to reach 48% in 2012. In nominal terms, Slovenia's public debt increased by almost 73% between 2007 and 2010, from EUR 8 billion to EUR 13.7 billion. This was the fourth largest increase within the OECD 21 – only Ireland (212%), Luxembourg (206%) and the United Kingdom (86.1%) had higher levels of public debt during this period. Although Greece saw its public debt increase by 37% over the same period in nominal terms, the strong fall in GDP is one key reason why its debt to GDP ratio reached 145% in 2010 (see Figure 1.14).

Figure 1.14. **General government debt, Maastricht criteria, 2007, 2010 and 2012**

% of GDP



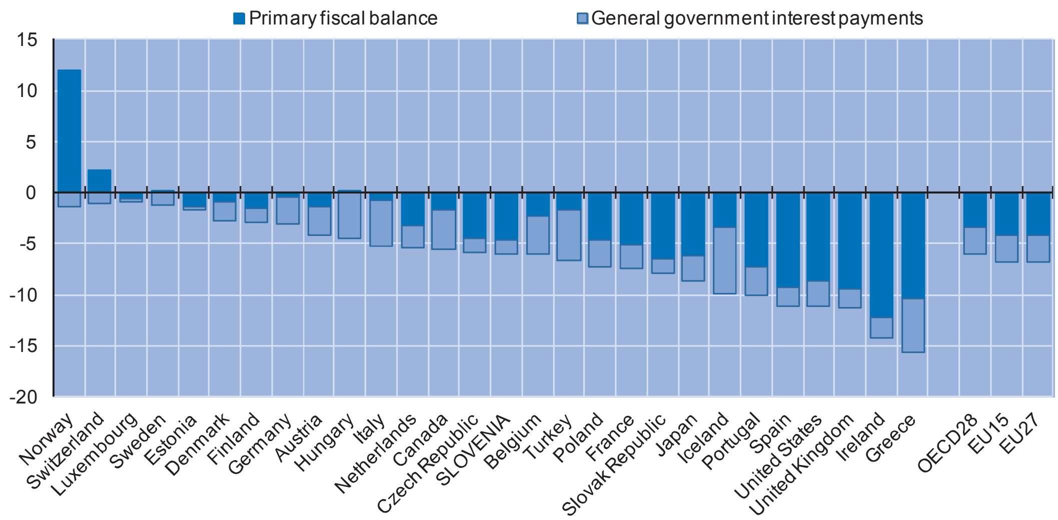
Notes: Arranged in descending order according to 2007 data. OECD 21 does not include Australia, Canada, Chile, Iceland, Israel, Japan, Korea, Mexico, New Zealand, Norway, Switzerland, Turkey or the United States.

Source: OECD (2011), "OECD Economic Outlook No. 90", *OECD Economic Outlook: Statistics and Projections* (database), OECD, Paris, *http://dx.doi.org/10.1787/data-00588-en*.

Compared to other OECD member countries, Slovenia's fiscal deficit is mostly comprised of a primary fiscal deficit and a short amount of interest payments (see Figure 1.15). A high level of structural fiscal consolidation is therefore required to tackle the primary fiscal deficit in order to restore public finances.

Figure 1.15. **General government fiscal balance: primary and interest payments**

% of GDP, 2009



Source: AMECO Database.

Fiscal consolidation in response to the global financial and economic crisis

In response to the 2009 global financial crisis, governments urgently implemented stimulus packages to soften the blow. These tended to increase general government expenditures (fiscal stimulus) directly as well as indirectly through increased debt financing, resulting in higher interest payments. In the aftermath of the crisis, budget deficits in most OECD member countries grew as a result of these stimulus measures, with other contributing factors being lower revenues as GDP plummeted, and in some cases banking assistance packages. The already unsustainable levels of budget deficit – an average of 8.3% of GDP in 2009 across the OECD – will further deteriorate in countries like Slovenia where future public costs related to ageing populations can be expected.

The initial stimulus measures are now being followed by fiscal consolidation in many countries, designed to rebalance public finances, summon investor confidence and put the economy back on a sustainable development path. Across OECD member countries, most fiscal adjustments have been based on structural measures, though there are some exceptions: for example, changes in the pension accounting system and temporary taxes (OECD, 2011e). Expenditure reductions, either operational or on programmes, tend to be given priority over revenue increases.[8] Some countries have also announced other types of expenditure cuts, i.e. overall spending freezes (OECD, 2011a).

Achieving fiscal consolidation in Slovenia has been a matter of urgency

In 2009, Slovenia implemented a series of urgent fiscal consolidation measures designed to dampen the initial impact of the financial crisis by lowering and optimising government expenditures in order to offset a decline in tax revenue. However, despite these measures, but mostly due to the deep economic recession, Slovenia's fiscal situation deteriorated considerably in 2009. The budget deficit reached 6.1% of GDP in 2009, the highest level since joining the euro area. Public debt soared from under 21.9% of GDP in 2008 to 35.3% of GDP in 2009.

In December 2009, having exceeded its obligations under the Stability and Growth Pact to keep a budget deficit within 3% of GDP, the European Commission placed Slovenia under an excessive deficit procedure imposing that the budget deficit be brought back to below 3% of GDP by 2013. In its recommendation, the European Commission particularly highlighted the potential risks posed by an ageing population and financial sector stabilisation schemes on long-term public finance sustainability. As a result, Slovenia is required to submit an annual Stability Programme to the European Commission demonstrating how it plans to achieve the 3% of GDP budget deficit target. The three main policy objectives outlined in the 2009 Stability Programme for the 2010-2013 period included:

- progressively withdrawing financial support measures and fiscal stimulus by the end of 2010;
- implementing an expenditure-driven fiscal consolidation strategy, with the aim of phasing out the excessive deficit below 3% of GDP and general government debt below 45% of GDP by 2013; and
- setting a long-term structural reform agenda, with the aim of boosting Slovenia's potential growth and guaranteeing long-term fiscal consolidation.

In February 2010, the Slovenian Government released the Slovenian Exit Strategy 2010-2013,[9] which reinforces the policy objectives set in the 2009 Stability Programme and sets forth a path for sustainable economic growth by combining economic policy measures with structural reforms and institutional adjustments. The strategy aims to guarantee the consistency between short-term anti-crisis measures and long-term structural reforms. The guiding principle for the economic policy measures relies on an expenditure-based strategy by implementing programme and operational measures rather than relying heavily on revenue measures such as tax increases.

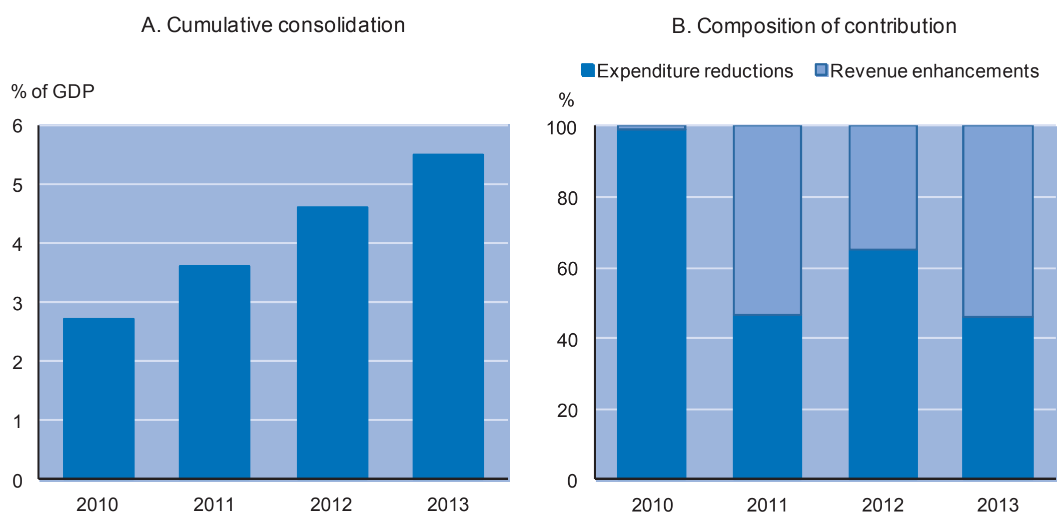
In support of this, the government implemented a new system for determining expenditure ceilings (fiscal rule) that limits expenditure increases to potential GDP growth, and introduced programme budgeting to improve the quality of public finance mechanisms. In addition, a significant aspect of the fiscal consolidation strategy was to improve the absorption of EU funds to finance investment, and to gradually replace some elements of domestic spending.[10] Medium- and long-term structural reforms with a positive impact on public finances also contributed to short-term fiscal consolidation efforts. Such structural measures were targeted at reforming the pension system, the health system, social security rights, and the public sector.

Achieving fiscal consolidation in Slovenia is critical. Between September 2011 and January 2012, Slovenia received credit rating downgrades. This was based on the perception of a weakening banking system position with spillovers to public finance, and low policy implementation. Also cited was the resulting political instability, and a sentiment that the pace of fiscal consolidation and structural reforms is too slow. An additional factor was the result of a referendum which rejected a proposed pension system reform that was a key component of Slovenia's fiscal consolidation strategy. Continued persistently high budget deficits will likely impede Slovenia's macroeconomic stability and impact its economic recovery, which is particularly vulnerable to financial markets in the current economic environment.

Fiscal consolidation has been driven by expenditure reduction measures[11]

Slovenia's fiscal consolidation programme represented 2.7% of GDP in 2010, without taking the value added tax (VAT) reduction into consideration. In 2010, fiscal consolidation was driven solely by expenditure reductions. Additional fiscal consolidation measures valuing an additional 2.8% of GDP are expected to be implemented during 2011-2013 (see Figure 1.16).

Figure 1.16. **Fiscal consolidation strategy**



Source: OECD (2011), "Restoring public finances: fiscal consolidation in OECD countries", *Special issue of the OECD Journal on Budgeting*, Vol. 2011/2, OECD Publishing, Paris.

While fiscal consolidation was achieved solely by expenditure reductions in 2010, between 2011 and 2013 revenue enhancements will account for approximately half of fiscal consolidation measures (OECD, 2011e) (see Figure 1.16 and Table 1.2).

The composition of consolidation plans varies across OECD member countries, particularly the distribution of consolidation between 2009-2010 and 2011-2012. Estonia "front loaded" its strategy, with most consolidation occurring in 2009-2010, whereas the Netherlands planned the greatest portion of its consolidation for 2013-2015. Slovenia's strategy has been to spread the majority of its consolidation efforts between 2009-2012 in an effort to meet obligations in the Stability Programme, with little consolidation planned for 2013-2015 (see Figure 1.17).

Table 1.2. **Major consolidation measures**

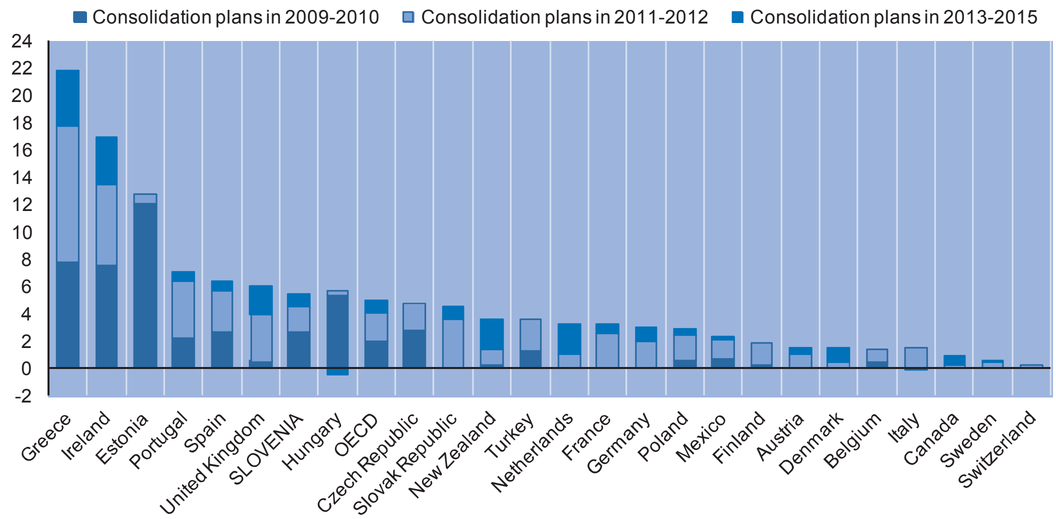
Millions EUR (% of GDP)

		2010	2011	2012	2013
Expenditures		**879 (2.44)**	**1 039 (2.79)**	**1 287 (3.33)**	**1 457 (3.61)**
1. Operational measures		273 (0.76)	273 (0.73)	378 (0.98)	483 (1.20)
Compensation of employees		202 (0.56)	202 (0.54)	277 (0.72)	352 (0.87)
	Wage limitation	limited to 1.2% annually			
	Reduce the number of public employees in 2010 and 2011	-1%	-1%		
Intermediate consumption	(The public sector wage bill and intermediate consumption will be cut by -14%)	71 (0.20)	71 (0.19)	101 (0.26)	131 (0.33)
2. Programme measures		606 (1.68)	765 (2.06)	908 (2.35)	973 (2.42)
Pensions		74 (0.21)	112 (0.30)	162 (0.42)	212 (0.53)
Social transfers		22 (0.06)	22 (0.06)	47 (0.12)	62 (0.15)
Health	Reduce medicine prices. Restrictive policy on sick leave benefits and the amount of payments for extra time in health institutions	n.a.	n.a.	n.a.	n.a.
Investments	Reduced by	266 (0.74)	266 (0.71)	334 (0.86)	334 (0.83)
Other expenditure	Reduced by	244 (0.68)	366 (0.98)	366 (0.95)	366 (0.91)
Redefinition of standards	Redefining public service standards, reconsider the price of services and increase use of user fees				0.4% of GDP by 2013*
Revenues		**6 (0.02)**	**189 (0.51)**	**322 (0.83)**	**521 (1.29)**
VAT	Reduced	-100 (0.28)	-100 (0.27)	-100 (0.26)	-100 (0.25)
Excise duties	Mineral oil and gas	40 (0.11)	56 (0.15)	56 (0.14)	56 (0.14)
	Alcohol	4 (0.01)	4 (0.01)	4 (0.01)	4 (0.01)
	Tobacco	21 (0.06)	45 (0.12)	71 (0.18)	86 (0.21)
	Electricity	21 (0.06)	141 (0.38)	141 (0.37)	141 (0.35)
Motor vehicles	To limit possible tax evasions and introduce environmental criteria	19 (0.05)	28 (0.07)	28 (0.07)	28 (0.07)
Administrative	New tax information system		15 (0.04)	122 (0.32)	306 (0.76)
Real estate	A property tax is planned for implementation in 2011		n.a.	n.a.	n.a.

Notes: OECD calculations using OECD forecasts of nominal GDP for 2010-2013. * Not included in calculations.

Source: OECD (2011), "Restoring public finances: fiscal consolidation in OECD countries", *Special issue of the OECD Journal on Budgeting*, Vol. 2011/2, OECD Publishing, Paris, based on "OECD Fiscal Consolidation Survey".

Figure 1.17. **Announced consolidation plans vary**



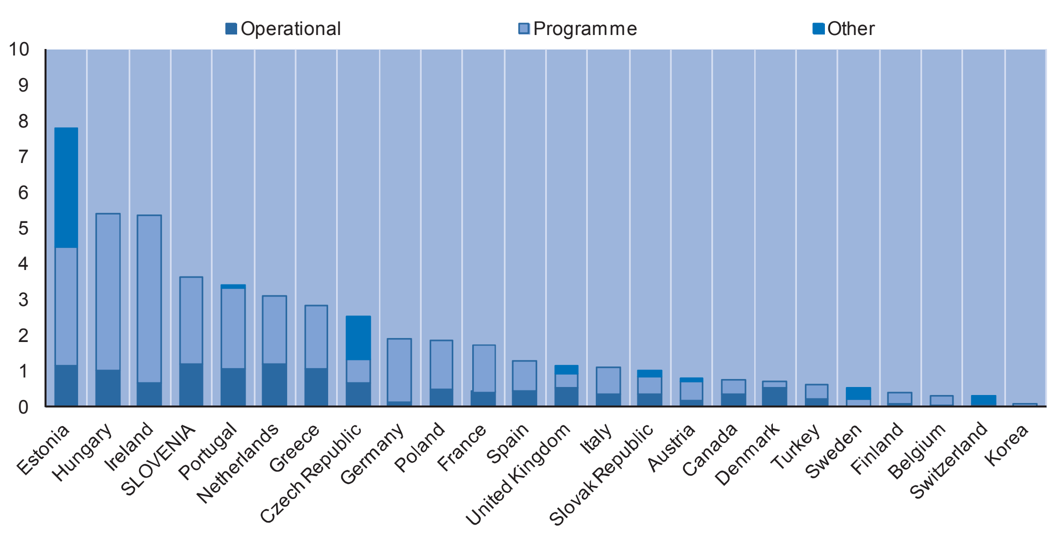
Note: The figures are the sum of annual incremental consolidation for 2009-2015 as reported by the national authorities and/or calculated by the OECD Secretariat. The figures include Estonia's and Ireland's 2009 consolidation. Hungary's 2007-2008 consolidation is not included. Canada and the Netherlands report consolidation until 2015.

Source: OECD (2010), "OECD Fiscal Consolidation Survey 2010", OECD, Paris.

Slovenia reports that the impact of quantified expenditure measures cumulate to over 3.5% of GDP, which is relatively high compared to other OECD countries (see Figure 1.18).

Figure 1.18. **Quantified expenditure reductions**

Cumulative impact, % of GDP



Source: based on responses to the "OECD Fiscal Consolidation Survey 2010"; OECD (2011), "Restoring public finances", *Special issue of the OECD Journal on Budgeting*, 2011/2, OECD Publishing, Paris.

Programme measures dominated expenditure reductions

Two-thirds of Slovenia's expenditure measures are programme related, which in absolute terms is one of the highest among OECD member countries, representing over 1% of GDP. As part of its programme measures, Slovenia indicated an intention to reduce its infrastructure spending by 0.8% of GDP between 2010-2013. Additional programme measures included lowering spending on pensions by 0.5% of GDP and on welfare by almost 0.2% of GDP (see Table 1.2).

The Slovenian Government's planned pension reform, while having been adopted by the Parliament, was rejected by referendum in June 2011. This was due to a combination of the political divergence between the parties within the fragile coalition government and to a strong societal attachment to a redistributive welfare state. The reform, which had been planned to take effect from 2015, focused on modernising the existing pension scheme by increasing the retirement age, establishing a more sustainable indexation formula, and providing incentives for longer activity.

The pension reform was a centrepiece of Slovenia's long-term fiscal consolidation strategy. In the 2011 *Economic Survey of Slovenia* (OECD, 2011d), the OECD recommended that further pension reforms were required. The rejection by referendum of the pension system reform considerably impedes the success of the fiscal consolidation strategy as set out in the Exit Strategy and the Stability Programmes. The estimated impact of the pension reform on public expenditure was a reduction representing between 1.5% and 2% of GDP by 2060.[12] In addition to the risk of not meeting the 3% of GDP budget deficit by 2013, the resulting political instability and credit rating downgrade in September 2011 may increase the cost of borrowing and add to the further deterioration in competitiveness and potential output growth. At the time of writing, it was too early to measure the full impact of the failed pension reform. However, the government[13] will be challenged by considerable budgetary pressures in 2012 if it aims to meet the fiscal consolidation targets set out in the Exit Strategy and Stability Programmes.

Operational expenditure reductions have hit the public service hard

As the public wage bill accounts for a large share of public expenditures, and public employment is often substantial, most OECD member countries have announced operational savings in their consolidation plans, though the ambition and level of detail vary (OECD, 2011e). Compensation costs can be lowered by reducing the size of the workforce and/or by cutting wages. Reducing the wage bill has provided immediate relief on stretched budgets. While government employment across the OECD has generally been stable over the past decade, at least 17 governments across the OECD have announced workforce reduction measures and/or cuts to salaries and benefits in order to reduce costs. On average, OECD member country governments employ 15% of the labour force. The size of the Slovenian public sector is very close to the OECD average, where the share of employment in general government is 14.7% of the labour force (OECD, 2011a).

OECD data on remuneration for key public sector positions show that wages and salaries represent on average 80% of total compensation. Twenty OECD member countries have announced plans to freeze or cut public sector wages. The range of wage cuts is wide and crosses categories of countries, from a two-year wage freeze in the United Kingdom to a 10% wage cut in the Czech Republic and approximately a 14% wage reduction in Ireland. The cutbacks are even higher in Greece if reductions in allowances and earlier implemented cuts from 2009 and 2010 are included.

Limiting public wage and consumption increases are the most important operational expenditure measures in Slovenia, contributing 0.8% of GDP to consolidation in 2010. In the OECD's "Fiscal Consolidation Survey 2010", Slovenia reported that it would achieve savings by implementing operational measures, including a 1% personnel cut from 2010-2011, and a 14% wage and intermediate consumption reduction target. Slovenia planned to reduce the cost of its public sector workforce through three key measures:

- amendment of rules and criteria regarding the number of organisational levels and the unification of procedures relating to the adoption of job classification acts;
- reduction of the number of employees in the public sector by 1%, i.e. approximately 1 600 public servants per year; and
- measures regarding salaries and other receipts from employment to be in force until November 2011 (Government Office for Development and European Affairs, 2011).[14] Specifically, Slovenia has looked to cut operational spending through staff reductions, wage and performance pay freezes.

Some countries have announced savings by reorganising the way the public administration functions, but only the United Kingdom has detailed plans for such reorganisation. In addition to the cost-cutting initiatives, it is understood that Slovenia is looking at opportunities to reorganise the way its public administration functions.

Beyond fiscal consolidation – increasing the efficiency and effectiveness of the public service

To date, Slovenia's fiscal consolidation strategy has focused primarily on reducing public sector employment and the public sector wage bill. Though the fiscal consolidation strategy is ambitious in its aim to reduce expenditures, it does not include a specific strategy to help the public administration become more efficient and effective, and thus sustainable in the longer run.

The subsequent chapters of this report present the major challenges faced by Slovenia, as well as the changes that are needed to assist the public administration to be more efficient and effective in implementing the government's agenda and delivering services to the public.

Notes

1. Since independence in 1991, Slovenia's economic transition from being a part of a federal republic to an independent country was immediately confronted by two opposing forces: from the east, the contraction of Central Eastern and European (CEE) markets due to the break-up of Yugoslavia and the collapse of the USSR; and on its western border, a diffuse economic recession across the EU. Slovenia's resilient efforts to integrate into the Single Market were rewarded by becoming the only former-Yugoslavian republic to join the European Union (May 2004), successfully meeting the economic and fiscal criteria required to join the euro area (January 2007), and to join the OECD (2009).

2. The three OECD member countries that are smaller than Slovenia in terms of population size are Estonia (1.3 million), Luxembourg (0.5 million) and Iceland (0.3 million).

3. *OECD Factbook 2010*, international trade in goods and services, for exports and imports, as a percentage of GDP. The rates shown correspond to imports and exports of both goods and services at current prices as a percentage of GDP.

4. Slovenia's main trading partners are European countries, accounting for 90% of traded goods. In 2007, the EU absorbed 71% of Slovenia's exports of goods and provided 79% of Slovenia's imports. Slovenia's main EU trading partners are Germany (accounting for 19% of total exports and imports), Italy (13% of exports and 18% of imports) and Austria (7.8% and 12.5%). Slovenia exports 16% of its goods to former Yugoslavia republics, mostly to Croatia (8%), Serbia (3.5%) and Bosnia and Herzegovina (3%). Croatia is not only the biggest purchaser but also the biggest provider of goods to Slovenia among former Yugoslav republics, accounting for 4% of total imported goods. Slovenia has a relatively large current account surplus with its Balkan neighbouring countries in traded goods.

5. It is widely accepted that competitiveness and productivity can be improved by developing various, mutually interdependent factors, such as human capital, infrastructure, education and training, technological know-how, macroeconomic stability, market efficiency and good governance. The World Economic Forum's *Global Competitiveness Report* measures competitiveness according to 12 pillars that cover these and additional factors. Public administration reforms can improve a country's competitiveness in many different ways. For example, a more efficient public service can cut down the cost of delivering public services, better regulation leads to market efficiency gains, and budgetary procedures consolidate public finances, which in turn boost confidence to invest in more productive human and financial capital. Thus, to differing degrees, public administration reforms can have an impact on all of the Global Competitiveness Index pillars.

6. Slovenia's structure of exports is composed rather highly of cyclically-sensitive (such as automotive components) and low and medium-technology goods that were hit the hardest by the crisis.

7. Although in structural terms the reduction in the public deficit was not as impressive compared to other OECD countries, it was still significant: in 2006, the level of public deficit in structural terms represented less than two-thirds of its 2000 level.

8. **Programme spending** – such as health, changes to social benefit systems, old-age pensions, capital infrastructure and official development assistance, which includes all spending except for compensation costs; and **operational spending** – by cutting compensation costs (through staff reductions or wage and benefit cuts), reorganising government, or implementing across-the-board efficiency cuts.

9. The adoption of the Exit Strategy 2010-2013 resulted in an amendment to the Development Strategy 2005-2013. See Chapter 3.

10. Measures that were not affected by the expenditure reductions included subsidies for research and development and labour market programmes that provide employment opportunities and training for the unemployed.

11. Although Slovenia has declared that its fiscal consolidation strategy will not rely on increasing taxes, a new tax information system will be implemented to fight against tax fraud and is expected to raise an additional 0.76% of GDP by 2013. Slovenia has not declared any other significant revenue measures apart from increased excise duties. However, they have announced neutral tax packages, where the overall level of tax burden will remain constant, but the composition of certain taxes might be altered.

12. OECD (2011d), referencing M. Cok, J. Sambt and B. Majcen, (2010), "Financial implications of the proposed reforms", report of the Faculty of Economics, University of Ljubljana.

13. National elections were held in Slovenia on 4 December 2011.

14. Due to the continuing economic crisis Slovenia adopted the Act of Intervention Step on 23 December 2011 (enforced from 1 January 2012). As part of this, performance-related payments will not be reinstated until November 2012.

Bibliography

European Commission, Directorate General for Economic and Financial Affairs (DG ECFIN), *Annual Macroeconomic Database* (*AMECO).*

Eurostat database (2011)

Government Office for Development and European Affairs (2011), *Competitiveness of the Slovenian Economy*, Government Office for Development and European Affairs, Ljubljana.

International Labour Organisation Statistics 2011

OECD (2010), "OECD Fiscal Consolidation Survey 2010", OECD, Paris.

OECD (2011a), *Government at a Glance 2011*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/gov_glance-2011-en.*

OECD (2011b), National Accounts

OECD (2011b), "OECD Economic Outlook No. 89", *OECD Economic Outlook: Statistics and Projections* (database), OECD, Paris, *http://dx.doi.org/10.1787/data-00539-en.*

OECD (2011c), "OECD Economic Outlook No. 90", *OECD Economic Outlook: Statistics and Projections* (database), OECD, Paris, *http://dx.doi.org/10.1787/data-00588-en.*

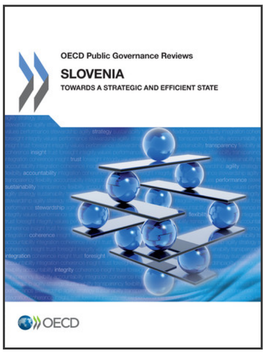
OECD (2011d), *OECD Economic Surveys: Slovenia 2011*, OECD Publishing, Paris, *http://dx.doi.org/10.1787/eco_surveys-svn-2011-en.*

OECD (2011e), "Restoring public finances: fiscal consolidation in OECD countries", *Special issue of the OECD Journal on Budgeting*, Vol. 2011/2, OECD Publishing, Paris.

OECD (2011f), Statistical Database

Statistical Office of the Republic of Slovenia (2011), *http://www.stat.si/eng/index.asp*

World Economic Forum (2011), *Global Competitiveness Report 2011-2012*, World Economic Forum, Geneva.



Please cite this chapter as:

OECD (2012), “Economic and fiscal context”, in *Slovenia: Towards a Strategic and Efficient State*, OECD Publishing, Paris.

DOI: https://doi.org/10.1787/9789264173262-5-en