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Fiscal Instability in Slovenia during the Economic Crisis

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Abstract: The changed macroeconomic conditions brought about by the global financial and economic crisis are posing an increasing challenge to economic policymakers to achieve the objectives of the planned consolidation. The fiscal situation in Slovenia, as in other EU Member States, remains tight; the current priority is therefore to ensure the sustainability of public finances and to create conditions for stable economic growth. Slovenia faces the challenge of reducing the public finance deficit below 3% of GDP in 2013. If it does so, it will fulfil its commitment to bring its excessive deficit under control and re-establish opportunities for financing on international markets. Long-term sustainability of public finances and stable economic growth will be ensured by economic policy measures, structural measures and institutional adjustments. If the economy is to function successfully, appropriate management frameworks are required in which the government plays a key role. Long-term economic success can be achieved with high-quality government institutions. The objective of this paper is to show the current state of public finances and to outline the features of the austerity measures being conducted in Slovenia. The need to balance public finances in order to ensure a stable and sustainable macroeconomic environment and meet the requirements of the EU, has led to amendments to legislation in Slovenia that are radically affecting the size and structure of public expenditure. On the other hand, Slovenia is also adopting measures to promote economic activity.

Keywords: Economic crisis, Fiscal instability, Austerity measures, Public finance deficit, Economic growth

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Current Fiscal and Economic Situation in Slovenia

The global financial and economic crisis is placing strong constraints on the Slovenian economy and the economies of most of the other EU Member States. A system of

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economic governance in the context of the so-called 'European semester' has been in place since 2011 aimed at strengthening fiscal discipline and introducing broader economic supervision and control. Under this scheme, Member States are obliged to follow the public finance situation more closely and to take the necessary steps to remedy the situation (Government of the Republic of Slovenia, 2012a).

Unfortunately, negative attitudes towards the state and public administration have informed the opinions and actions of the present and previous governments, with the figures showing a comparable proportion of civil servants in Slovenia and in the developed countries of the EU. The proportion of public employees in health and social care is approximately one-third lower than in other EU countries (Svetlik, 2012). Vague assessments of public administration and the public sector as generators of the crisis overlook the fact that people increasingly depend on the extent and quality of childcare services, education, healthcare and welfare, and that the crisis is having an increasing impact on public sector employees' efficiency and productivity. The possibility of reducing the number of public sector employees by 20% was introduced, without a proper analysis having been made. For example, reducing the number of ministries on the basis of an unofficial analysis, while it might be politically desirable, certainly does not guarantee that the savings made will outweigh the harm done. It is quite clear that the crisis in Slovenia was caused to a much greater extent by the extreme indebtedness of the private sector in the 2004–2008 period than by government borrowing between 2009 and 2011 (Tajnikar, 2012).

Economic Growth and the Public Finance Deficit and Public Debt

The sharp deterioration in the fiscal position is inhibiting economic recovery. Borrowing costs are increasing, while limited access to state financial resources is further eroding private sector borrowing conditions; this is affecting competitiveness and reducing the potential for further economic development. Fiscal policy is one of the tools with which national authorities support an active economic policy of macroeconomic stabilization (Government of the Republic of Slovenia, 2012a; Mencinger & Aristovnik, 2013).

Slovenia saw a sharp fall in GDP of 7.8% in 2009, modest growth of 1.2% in 2010 and of 0.6% in 2011 and a fall of 2.3% in 2012 (Statistical Office of the Republic of Slovenia, 2012a). Following a significant decline in economic activity in 2009, the recovery in Slovenia was slower than the EMU and EU average. The European Commission predicted a fall in GDP for the entire Euro area in 2012 as a result of poor business and consumer confidence and of uncertainty in the financial markets. Measures to consolidate public finances are a further reason for the slowdown in economic activity. These measures will have a short-term negative impact on economic activity; on the other hand, they are essential if funding is to be restored to allow economic recovery in the years to come (Government of the Republic of Slovenia, 2012a).

Table 1: Real GDP growth rate 2007–2012 (% of GDP)

	2007	2008	2009	2010	2011	2012
Slovenia	7.0	3.4	-7.8	1.2	0.6	-2.3
EMU	3.0	0.4	-4.4	2.0	1.4	-0.6
EU-27	3.2	0.3	-4.3	2.1	1.5	-0.3

Source: Eurostat, 2013.

In 2009 and 2010 the general government deficit in the Euro area and the EU exceeded 6%. In 2011 the situation improved markedly, with the deficit in the Euro area falling to 4.5% of GDP (EU average of 4.1%). In 2012 most EU countries still formally had an excessive deficit. In 2011, 17 countries exceeded the maximum permissible limit of 3% of GDP and 12 countries exceeded this limit in 2012. For most countries, including Slovenia, the European Commission has imposed a deadline of 2012 and 2013 for reducing the deficit below the limit (Institute of Macroeconomic Analysis and Development, 2012a).

Table 2: Public finance deficit (in the table as PFD) and public debt (in the table as PD) in the selected EU countries, 2007–2012 (% of GDP)

	2007		2008		2009		2010		2011		2012	
	PFD	PD	PFD	PD	PFD	PD	PFD	PD	PFD	PD	PFD	PD
Slovenia	0.0	23.1	-1.9	21.9	-6.0	35.0	-5.7	38.6	-6.4	46.9	-4.0	54.1
Netherlands	0.2	45.3	0.5	58.5	-5.6	60.8	-5.1	62.9	-4.7	65.2	-4.1	71.2
France	-2.7	64.2	-3.3	68.2	-7.5	79.2	-7.1	82.3	-5.2	86.0	-4.8	90.2
Italy	-1.6	103.1	-2.7	105.7	-5.4	116.4	-4.5	119.2	-3.9	120.7	-3.0	127.0
EMU	-0.7	66.3	-2.1	70.1	-6.4	79.9	-6.2	85.6	-4.1	88.0	-3.7	90.6
EU-27	-0.9	59.0	-2.4	62.5	-6.9	74.8	-6.5	80.2	-4.5	83.0	-4.0	85.3

Source: Institute of *Macroeconomic Analysis and Development,* 2012a; Eurostat, 2013.

The public finance deficit increased sharply to 6.0% of GDP in Slovenia in 2009. There was no significant shift in 2010, but in 2011 the state of public finances worsened still further, with the deficit reaching 6.4% of GDP (Statistical Office of the Republic of Slovenia, 2012b). Up to 2010, Slovenia had a lower public finance deficit compared to the eurozone and EU-27 averages; in 2011, with a deficit of -6.4% of GDP, it recorded a higher deficit compared to those averages, but in 2012 the level of Slovenian deficit fell to -4%, which was similar to EU average. Compared to some selected EU member states, in 2009, Slovenian public finance deficit was lower than in France (-7.5% of

GDP) but higher in Italy (-5.4% of GDP) and the Netherlands (-5.6% of GDP). In 2010 and 2011 the deficit fell in all the selected countries, except in Slovenia in 2011. In 2012, positive results are seen towards a reduction in the public finance deficit in all selected member states. Due to past excessive deficits that exceeded the permitted upper limit of 3% of GDP, the European Commission launched an excessive deficit procedure for Slovenia at the end of 2009, with the country being obliged to reduce the deficit below 3% of GDP by 2013 (Government of the Republic of Slovenia, 2012a).

On the other hand, Slovenia is still recording a significantly lower public debt (as a % of GDP) compared to the eurozone and EU-27 averages. In 2011 Slovenia's debt reached 46.9% of GDP and, in 2012 it was 54.1% of GDP, which is still below the upper limit of 60% of GDP permitted under the Stability and Growth Pact. But in the 2009–2012 period, public debt in Slovenia increased relative to the eurozone and EU-27 averages. According to the selected EU member states, the public debt in these countries is increasing, and did so throughout the whole period 2007-2012. The estimate for 2012 does not show any improvement, with public debt being predicted to increase even further in all these countries. Slovenia has much lower public debt than France, Italy and the Netherlands, which have all exceeded the permissible limit since 2009 (Institute of Macroeconomic Analysis and Development, 2012a).

Austerity Measures in Slovenia

Radical structural interventions and structural reforms are needed if public finances are to be sustainable. These solutions must include a rationalisation of the public sector, with structural measures to increase efficiency, and restructuring that focuses on strengthening the role of development expenditure in order to promote competitiveness and ensure long-term sustainability. In most EU countries, measures to consolidate public finances are aimed at reducing government expenditure; these mainly include changes to the way the public sector is organised, and to social security and pension transfers. Most countries have begun to streamline the public sector and to freeze or reduce employment in that sector, with several countries also reducing public sector pay. At the same time, countries are also applying measures on the revenue side, mainly by raising and introducing new taxes. Slovenia has also adopted the same or very similar measures as most other EU countries, both on the expenditure and the revenue side (Institute of Macroeconomic Analysis and Development, 2012a).

General Overview of Austerity Measures in Slovenia

In November 2008 the Slovenian government set up a crisis team of key ministers tasked with actively tackling the financial and economic crisis. Its fundamental task was to initially develop measures to mitigate the impact of the crisis on the Slovenian economy, and then to focus on an exit strategy from the crisis and on post-crisis economic recovery. The first set of measures was adopted in December 2008, followed by a set of measures in February 2009. Public sector measures consisted mainly of the reconstruction of public infrastructure and the construction of broadband for public institutions. Austerity measures in the public sector covered wage costs, organisational and staff-related measures, and measures to reduce the costs of material and technology for the functioning of state and public administration bodies (Government Office for Development and European Affairs, 2012).

In March 2012 Slovenia adopted a package of proposed austerity measures to balance the public finances. These were measures relating to internal savings in the public sector, as well as various programmes and policies. The proposed internal savings measures included organisational measures to streamline costs, along with other rationalisation measures. The proposed public sector measures included adjustments to the functioning of the public sector and adjustments in civil servants' salaries. The proposed measures relating to programmes and policies covered investment, subsidies and programmes, labour market policy and social security policy. Through organisational measures, the government sought to optimise public spending. The measures included the abolition of certain government bodies and the transfer and redistribution of tasks to existing government bodies. Through rationalisation, the government aimed to merge and transform a number of public institutions, as well as reduce budget funding (Government of the Republic of Slovenia, 2012a).

One of the main segments of the public sector austerity measures is the rationalisation of costs; therefore, the Slovenian government began to consolidate the expenditure side of the budget in 2012, which partly addressed the costs of the public sector. The government identified those items which would reduce expenditure. The measures would reduce transport costs, phase out some types of education, and reduce the price-technical standards for medical devices. In addition, agricultural policy would be rationalised and transfers to municipalities and income for investment reduced. These measures prevent or reduce the costs of operations that involve public expenditure. With these measures the government aims to tighten the criteria for the allocation of company vehicles, prevent the establishment of new organisational units, transfer and merge public sector functions, cut allowances to members of parliament and reduce the size of consular offices, among other things. In addition, adjustments to the public sector could also be included in public sector rationalisation, as the public sector failed to adjust to the requirements of society in the past. Due to the inflexibility of the system, the government prepared a set of adjustments to allow for the best possible performance. These adjustments involved, for example, changes to standards and norms in education, a reduction in the number of committees, and a reduction in the number of public contracts (Balancing of Public Finances Act, 2012).

Cost-Saving Measures in Slovenia

The need to balance public finances in order to ensure stable and sustainable macroeconomic environment and to meet the requirements of the European Union has led to changes in the legislation affecting the first radical reduction in the size and structure of public spending; these are requirements which many other EU Member States have already met. In May 2012, at the proposal of the Slovenian government, the National Assembly adopted the Balancing of Public Finances Act (hereinafter: the Act), which aims to achieve the following objectives: ensure sustainable public finances, provide a legal framework for the effective management of public finances, ensure macroeconomic stability, provide for the sustainable and stable development of the national economy, and establish rules for greater fiscal discipline. The Act follows the principles of prudent use of resources and the achievement of maximum impact in the implementation of certain tasks using minimum resources. One general solution introduced by the Act is a reduction in public expenditure, with measures to reduce expenditure covering all areas (Balancing of Public Finances Act, 2012).

The following sections will describe the measures taken in relation to civil servants, welfare, pensioners, the labour market, taxes and the promotion of economic growth.

Cost-Saving Measures in Relation to Civil Servants

Under the relevant legislation, the government has made much larger cuts to the salaries and other benefits of civil servants. The basic salaries of civil servants were progressively reduced by 8% and the protected salary was abolished. Performance-related pay for increased workload in 2012 and 2013 shall not exceed 20% of the basic salary. The Act also restricts promotion to a higher pay grade and more senior job title (Balancing of Public Finances Act, 2012).

The Act determined the payment of the salary bonus for 2012 and a reduction in the bonus in 2013; it also set a reduction in the travel expenses (only those who live more than two kilometres from their place of work are entitled to a reimbursement of travel expenses). The Act also reduces expenses for meals, long-service awards, social assistance, severance pay and mileage, etc. It also reduces daily subsistence allowances and limits the duration of service contracts. A maximum number of days of annual leave is also determined (Balancing of Public Finances Act, 2012).

The accepted measures relating to salaries and other benefits in the public sector will contribute to the long-term sustainability of public finances. If the 3% deficit limit was to be achieved, an intervention in wages and other employee benefits in the public sector could not be avoided, as the total wage bill in the public sector amounts to EUR 4.1 billion. The total wage bill in the public sector has also increased during the period of implementation of the intervention measures, demonstrating that this intervention was necessary. In addition to measures affecting the salaries of civil servants, the government has also had to take measures to change conditions and reduce a number of work-related and other benefits in order to bring down the budget deficit and establish greater sustainability of public finances. This should also help to achieve the objective of standardising work-related and other receipts from employment, which have so far been arranged differently for different entities (Government of the Republic of Slovenia, 2012a).

Cost-Saving Measures in the Fields of Welfare, Pensioners and the Labour Market

Wages and social transfers represent over half of all state expenditure. The increase in unemployment, lower wages and a lack of liquidity, as well as the current method of adjusting pensions, have given rise to additional transfers from the state budget to the pension fund. The Act sets out to reduce the period of receipt of unemployment benefit for recipients who are over 50 years old and those who are over 55 years old and who have an insurance period of 25 years. The percentage of the baseline from which the benefit amount is determined is to be reduced to 70% of the baseline in the first two months and 60% of the baseline in the third month, with the maximum amount of benefit also being reduced. The Act also abolishes sick leave for benefit recipients. Pension and disability insurance measures provide for the harmonisation of pensions and other pension and disability insurance benefits in such a way that, by the end of 2014, pensions and other benefits will no longer be indexed and pension supplements will be temporarily reduced (Government of the Republic of Slovenia, 2012a).

In addition to the austerity measures of unemployment, consideration also needs to be given to employment policy measures related to the needs of the economy. Measures will focus on the development of the concept of ‘flexicurity’, which will give companies the opportunity to adapt to market conditions more effectively. There are various measures and incentives which are designed to promote the formation and development of jobs that are adapted to the needs of the elderly, are harmless to health and contribute to sustainable development. The focus will therefore be on the implementation of measures to support a healthy lifestyle and enhance health and safety at work with a view to encouraging longer periods of employment. All types of employment should be promoted, with a particular emphasis on a change from more flexible employment to permanent employment. Attention will also be given to renewed active employment policy measures, with the aim of reducing the fragmentation of programmes and strengthening the concept of corporate social responsibility. In this context, the government is seeking to rationalise procedures for the inclusion of unemployed persons and to monitor the effectiveness of individual programmes, as well as programmes to help the long-term unemployed (Government of the Republic of Slovenia, 2012b; Government of the Republic of Slovenia, 2012c).

Measures in the Field of Taxes and the Promotion of Economic Growth

There are tax relief measures for companies to promote economic activity and growth. Tax relief will be focused chiefly on measures to promote the formation of new businesses and jobs, investments in funds, and investment in knowledge and development (Government of the Republic of Slovenia, 2012c; Government of the Republic of Slovenia, 2012d).

In addition to the austerity measures adopted in various fields, solutions designed to increase state revenues from taxes which have no direct negative impact on the competitiveness of the Slovenian economy must also be enforced. The Act introduces an anti-crisis tax on real estate of higher value, to be paid by companies and individuals in Slovenia who own real estate worth over one million euros. Tax will be valid till the end of 2014. The Act also introduces a tax on profits generated by a change in land use (imposed upon the sale of land), an additional tax on vessels and an additional tax on motor vehicles. The Act also introduces an additional fourth income tax class for 2013 and 2014 and raises the rate of taxation on all income from capital from 20 to 25% (Government of the Republic of Slovenia, 2012e).

The Role of Public Administration in Promoting Economic Activity

Economic performance requires the appropriate management frameworks. The government plays a series of significant roles, as legislator, owner and entrepreneur, customer, promoter, facilitator and revenue manager, and requires an international representative. Public administration therefore plays an important role in providing frameworks and conditions for the functioning of the economy. Long-term economic success can be achieved with high-quality government institutions. The competitiveness of a country depends largely on the competitiveness of its economy, and companies are able to compete only if their business environment enables development and growth (Petkovšek, 2012).

Public administration must build such an institutional framework to ensure that tasks are performed efficiently. The institutions provide a legal and administrative framework within which individuals, businesses and governments generate income and wealth in the economy. The quality of institutions has a significant impact on competitiveness and economic growth through its effect on investment decisions and the organisation of production. The role of public institutions is, in this respect, given the greatest weight. At a time of economic crisis, in particular, and in order to aid recovery, government institutions play a crucial role, as the appropriate institutional environment will lead to a better business environment, which is vital for the operation of businesses, for domestic and foreign investments, and for the creation of economic activity (Petkovšek, 2012; Slabe Erker & Klun, 2012).

The institutional competitiveness of Slovenia has fallen in recent years. The fall in Slovenia's institutional competitiveness in the post-crisis period is largely due to the delay in institutional changes to adapt to global challenges, a lack of enforcement of adopted regulations, and a deterioration in social relations and values. For example, the WEF economic survey results show a strong dissatisfaction with the functioning of institutions, particularly government and the central bank, and also with the poor implementation of government decisions and an increase in bureaucracy and corruption. Political uncertainty and low confidence in institutions have had a major effect on the results of a number of key structural reforms rejected in popular referendums. People are acknowledging the urgency of measures to consolidate public finances; at the same time, they do not believe the government is able to take appropriate and fair measures (Institute of Macroeconomic Analysis and Development, 2012b).

The measures that have been adopted in relation to employment, salaries and other benefits in the public sector will contribute to the long-term sustainability of public finances. If the 3% deficit limit is to be achieved, an intervention in employment, salaries and other employee benefits in the public sector cannot be avoided. But, also the fact that public sector also generates GDP and has a significant impact on aggregate demand, must be taken into consideration. Most of the measures adopted to restore public finances have had a negative impact on changes in the volume of demand. The austerity measures adopted have resulted in a decrease in government spending, which has affected demand in the market of goods and services. The cuts have reduced state demand which has had a negative impact on economic activity in the private and public sectors and this has led to a major fall in GDP (Pevcin, 2012).

Data for Slovenia for 2012 show a decline in total domestic consumption, a reduction in average wages, particularly in the field of education and healthcare, a decline in government revenues, shrinking industrial production, a growth in living costs, and a fall in loans to domestic enterprises and households. Several promising shifts in demand were seen in January 2013. Even more worrying is the fact that unemployment is growing. When government adopts radical austerity measures or increase the competitiveness of the economy, more and more people remain jobless. Labour demand depends primarily on economic activity and an employment system. Unemployment is primarily structural. This cannot be reduced by means of lower wages, lower prices of goods and services, and greater labour market flexibility (Bole, Mencinger, Štiblar & Volčjak, 2013). The measures adopted to restore public finances are defined as a necessary first step – one which needs to be followed by measures to create jobs and employment opportunities for the unemployed and first-time jobseekers.

Conclusion

Slovenia has responded to the global financial and economic crisis with measures on the expenditure and revenue sides. The goal of the measures is to consolidate public finances and ensure sustainable economic growth.

Slovenia's deficit still exceeds the 3% of GDP allowed by the Stability and Growth Pact. Measures to consolidate public finances aim to reduce expenditure, mainly by rationalising the public sector, placing restrictions on recruitment, and making interventions in wages and social transfers. Short-term austerity measures are a necessary step to reduce the deficit below 3% of GDP. At the same time, it should be pointed out that the measures in this regard do not provide for a sustained reduction in the government deficit, as they can, in certain segments, lead to a deterioration in the quality of public services in the medium term.

Radical structural interventions are needed if public finances are to be sustainable. These solutions need to include a further rationalisation of the public sector, with structural measures to increase efficiency and restructuring that focuses on strengthening the promotion of competition and ensures the long-term sustainability of social security systems. The challenge remains to create a sustainable solution in terms of employment in the public sector which, with a combination of more flexible employment and wage policies, allows for a more stimulating environment for employees and employee efficiency (Institute of Macroeconomic Analysis and Development, 2012a). Active employment policy measures and measures to promote economic growth could, together with measures to balance public finances, lead the country out of the fiscal and economic crisis. Measures to encourage enterprise and attract investment are also vital for the promotion of economic activity.

The crucial question relates to the efficiency and productivity which affect the relationship between the investments and the generated GDP. This added value is a measure of competitiveness, which is increasingly dependent on services and the public sector. Since the indebtedness of the private sector (resulting in the difficult situation faced by the financial sector) is a major problem in Slovenia, the abolition of imbalances in the state budget will be a political project with a limited positive impact on the economy.

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