

II. Fiscal Development and Policy

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Fiscal Development and Policy

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Summary

As economic conditions deteriorated in 2008, general government deficits rose in the majority of EU countries. The negative trend is accelerating this year and as many as 21 EU countries will breach the 3% of GDP deficit ceiling prescribed by the EU's Stability and Growth Pact. Deficits are soaring as a result of automatic stabilisers and expansionary fiscal policy, which has a counter-cyclical impact in an economic downturn, and due to the shortfall in budget revenue, a consequence of measures taken during the period of economic growth. The increase in actual deficits is accompanied by a rise in cyclically adjusted deficits of the general government.

Public finances in Slovenia are in similar shape. Having recorded a surplus of 0.5% of GDP in 2007, Slovenia's fiscal position deteriorated by 1.4 p.p. in 2008 and the general government balance turned from surplus to deficit. Higher expenditure is the main reason behind the swelling deficit, but revenue as a share of GDP declined as well. Moreover, the gap between expenditure and revenue is widening at an accelerated pace in 2009. As a result, the general government deficit will surge this year, exceeding 5% of GDP. The rapid deterioration of public finances is partially a consequence of the economic slowdown and the resulting impact of automatic stabilisers, but it is also an upshot of fiscal policy measures taken this year and in the years before.

In the past several years, high revenue from taxes and contributions had made it possible to systemically cut certain tax sources without there being a tangible negative effect on the fiscal position. In 2006–2008, the payroll tax was phased out, personal and corporate income tax rates were cut and several new tax benefits were introduced. The shrinking of tax sources reduced the tax burden on households and businesses, and altered the tax structure. However, the systemic scale-back of revenue was not matched by expenditure-side measures: in the years when the deficit was shrinking, expenditure did not undergo much needed restructuring that would have accelerated the reduction of overall general government spending. Indeed, other expenditure even increased on average.

The movement of the cyclically adjusted deficit also indicates that the structural reforms of public finances were insufficient. Even in the face of a less propitious macroeconomic environment, last year's deterioration of the fiscal position was largely structural. Given the positive output gap, the rise in the cyclically adjusted deficit in 2008 meant that fiscal policy was expansionary and cyclical, whereas in 2007 it was still counter-cyclical and mildly restrictive. The factors that contributed to looser fiscal policy last year mainly included measures which accelerated the growth of expenditure (increased expenditure on investment, more funds for social transfers, wage growth in the public sector with the introduction of a new wage system combined with more hiring), but there were also changes that reduced revenue (larger general tax breaks implemented with new income tax legislation and lower corporate tax rates). Yet in order to perform a stabilising role, fiscal policy should have combined tax cuts and higher tax breaks during good (economic) times – when realised revenue was higher than planned – with a more robust curbing and restructuring of expenditure.

The counter-cyclical impact of fiscal policy, the key stabilising instrument in a financial and economic crisis, has its limits. This year and next, fiscal policy will be expansionary, which, given the slowdown, will give it a counter-cyclical direction. The expansiveness is largely a consequence of the effect of automatic stabilisers, the growth in certain statutory expenditure and, to a lesser extent, discretionary counter-cyclical measures. This means that even though the orientation of fiscal policy is appropriate, it can only constitute part of the reaction to the current circumstances: given that revenue and expenditure are structurally unbalanced, and taking into account the projected increase in the general government debt and deficit, the scope for anti-crisis measures is relatively limited, since medium- and long-term risks to the stability of public finances are increasing.

In the EU, tax systems are generally being reformed towards providing better support of competitiveness and other policies, notably in the labour market. The present-day challenges associated with the consequences of the financial crisis and the efforts to mitigate it have set in motion a process of tax changes that is leading to a very slow convergence of tax systems. Slower economic growth means smaller tax bases

and hence lower tax capacity. One of the challenges of the current tax policies is therefore to find alternative and new tax sources that the Slovenian tax system has yet to implement (e.g. new environmental and property taxes). During and after the crisis, tax policy must focus on raising tax revenue with the lowest feasible tax rates and the broadest possible tax base.

Slovenia needs far-reaching changes to general government expenditure if it is to achieve its development goals. Structural changes had been laid out in the 2005 Strategy of Slovenia's Development, and the present financial crisis is lending increasing urgency to changes designed to improve the flexibility, productivity and efficiency of spending. This can only be achieved by selecting efficient spending programmes that will underpin balanced development (economic growth, welfare state and environmental protection) and ensure efficient drawing of available EU funds.

Structural changes in expenditure and other public finance instruments are also essential from the long-term perspective. The ageing of the population and increasing longevity call for structural changes in spending in order to cope with the growing demand for health services, long-term care and social security. At the same time, future generations face the prospect of becoming increasingly weighed down by public debt as the result of investments increasingly financed with borrowing rather than expenditure (motorway construction, the planned construction of railways) and measures taken to tackle the financial and economic crisis.

Introduction

The deepening of the financial and economic crisis is putting pressure on public finances. In the current economic climate, the proper alignment of fiscal policy represents a key challenge along with preserving the competitiveness of the economy and providing an efficient social security system. A counter-cyclical fiscal policy – rising expenditure when revenue is dropping – is appropriate in an economic downturn, but the gap between revenue and expenditure cannot be left to widen over a prolonged period of time; bringing them back into balance with fiscal policy measures must be a constituent element of efforts to ensure macroeconomic stability. Lacking that, the balance will re-establish itself through other mechanisms, which heightens the risk of inflation.

In this year's fiscal chapter, emphasis has been placed on the stabilising aspect of fiscal policy and the structure of aggregates of the general government. The first section presents trends in public finances in the EU and the second section provides a detailed look at the development of budget aggregates and flows in Slovenia, including an analysis of cyclical and structural factors and elements of sustainability. Bearing in mind that the general government deficit is rising rapidly, the third section provides a detailed analysis of revenue structure in the period after 2000; the structure of budget aggregates is one of the key aspects in monitoring the quality of public finances. The key findings and recommendations are provided in the fourth section.

1. Fiscal development and policy in the European Union¹

The general government deficit of euro area countries, which at 0.6% of GDP in 2007 was the lowest in years, increased to 1.9% of GDP last year in the face of the global financial and economic crisis. EU Member States responded to the sharpest and deepest plunge in economic activity after the Second World War with measures designed to avert a collapse of the financial sector and economic stimulus packages (See Box 1). Discretionary counter-cyclical economic policy measures, coupled with automatic stabilisers, severely weakened the balance of public finances. The European Commission expects that the impact of the crisis will further increase the general government deficit of the euro area this year, to 5.3% of GDP, a figure that is projected to swell to 6.5% of GDP in 2010 in the absence of new measures. The forecast is similar for the EU as a whole, where the general government deficit rose from 0.8% of GDP in 2007 to 2.3% last year and is projected to expand to 6% of GDP this year and 7.3% in 2010.

Public finances deteriorated in all EU Member States in 2008. Last year, five euro area countries and five Member States outside the euro area breached the deficit ceiling of 3% of GDP set down in the EU Treaty (up from one country in the year before). This year, only three of the 16 euro area countries and three of the 11 EU countries without the euro are expected to keep the deficit below 3% of GDP (see Table 1). By the end of June 2009, excessive deficit procedures had been initiated for 19 countries, among them 13 members of the euro area.²

In the euro area and across the entire EU, the cyclically adjusted general government deficit also deteriorated in 2008 along with the increase in actual deficit. In the euro area the cyclically adjusted deficit increased by 1 p.p. to 2.9% of GDP. The cyclically adjusted deficit had not improved in previous year either, as governments had not taken sufficient measures to increase revenues or cut spending even though economic activity had been very robust. This confirms that the continued reduction of the actual deficit in 2007 was mostly a result of economic growth factors and hence only temporary.

¹ This chapter is based on work by Martin Larch (advisor at the European Commission president's Bureau of European Policy Advisers BEPA).

² A Council decision in accordance with Article 104(6) of the Treaty means a formal confirmation of excessive deficits for France, Ireland, Greece, Spain, the United Kingdom and Hungary. The European Commission issued excessive deficit warnings under Article 104(3) of the Treaty to Lithuania, Romania, Poland and Malta, and then in June to Belgium, Germany, Italy, the Netherlands, Austria, Portugal, Slovenia and Slovakia.

Table 1: Actual and cyclically adjusted government balances in EU countries

	Actual balance (% of GDP)						Cyclically adjusted balance (% of GDP)					
	2005	2006	2007	2008	2009	2010	2005	2006	2007	2008	2009	2010
Belgium	-2.8	0.2	-0.2	-1.2	-4.5	-6.1	-2.9	-0.5	-1.6	-2.2	-3.1	-4.0
Germany	-3.3	-1.6	-0.2	-0.1	-3.9	-5.9	-2.8	-2.1	-1.5	-1.7	-2.3	-4.0
Ireland	1.7	3.0	0.2	-7.1	-12.0	-15.6	0.9	1.9	-1.8	-7.5	-9.2	-12.2
Greece	-5.3	-3.1	-3.6	-5.0	-5.1	-5.7	-5.7	-3.7	-4.7	-6.1	-4.9	-4.7
Spain	1.0	2.0	2.2	-3.8	-8.6	-9.8	1.1	1.8	1.6	-4.2	-7.5	-8.2
France	-3.0	-2.3	-2.7	-3.4	-6.6	-7.0	-3.5	-3.1	-3.8	-4.2	-5.5	-5.5
Italy	-4.4	-3.3	-1.5	-2.7	-4.5	-4.8	-4.6	-4.3	-2.8	-3.2	-2.6	-2.7
Cyprus	-2.4	-1.2	3.4	0.9	-1.9	-2.6	-2.3	-1.4	2.7	0.1	-2.1	-2.1
Luxembourg	0.0	1.4	3.6	2.6	-1.5	-2.8	-0.4	-0.6	0.9	2.0	0.6	0.1
Malta	-2.9	-2.6	-2.2	-4.7	-3.6	-3.2	-2.3	-2.5	-2.7	-5.4	-3.6	-2.8
Netherlands	-0.3	0.6	0.3	1.0	-3.4	-6.1	0.2	0.2	-1.0	-0.5	-2.3	-4.3
Austria	-1.7	-1.7	-0.5	-0.4	-4.2	-5.3	-1.4	-2.2	-1.8	-1.8	-3.2	-3.8
Portugal	-6.1	-3.9	-2.6	-2.6	-6.5	-6.7	-5.7	-3.8	-3.2	-3.0	-5.3	-5.1
Slovenia	-1.4	-1.3	0.5	-0.9	-5.5	-6.5	-1.3	-2.1	-1.7	-2.5	-4.9	-5.2
Slovakia	-2.8	-3.5	-1.9	-2.2	-4.7	-5.4	-2.6	-4.0	-3.8	-4.5	-4.9	-4.7
Finland	2.6	3.9	5.2	4.2	-0.8	-2.9	2.9	2.8	3.2	2.8	0.8	-0.9
EMU-16	-2.5	-1.3	-0.6	-1.9	-5.3	-6.5	-2.5	-1.9	-1.9	-2.9	-3.9	-4.7
Bulgarij	1.9	3.0	0.1	1.5	-0.5	-0.3	0.8	1.8	-1.2	0.2	0.3	1.6
Czech Rep.	-3.6	-2.6	-0.6	-1.5	-4.3	-4.9	-3.9	-4.0	-2.8	-3.4	-4.0	-3.7
Denmark	5.0	5.0	4.5	3.6	-1.5	-3.9	4.7	3.6	3.0	3.7	1.1	-1.0
Estonia	1.5	2.9	2.7	-3.0	-3.0	-3.9	0.2	0.2	-0.5	-4.0	-0.4	-0.7
Latvia	-0.4	-0.5	-0.4	-4.0	-11.1	-13.6	-1.7	-3.3	-4.5	-5.8	-9.0	-10.7
Lithuania	-0.5	-0.5	-1.0	-3.2	-5.4	-8.0	-1.8	-2.1	-3.4	-5.2	-3.8	-4.8
Hungary	-7.8	-9.2	-4.9	-3.4	-3.4	-3.9	-8.6	-10.8	-6.4	-4.8	-1.7	-2.0
Poland	-4.3	-3.8	-1.9	-3.9	-6.6	-7.3	-4.4	-4.6	-3.2	-5.3	-6.0	-5.8
Romania	-1.2	-2.2	-2.5	-5.4	-5.1	-5.6	-1.8	-3.8	-4.5	-7.9	-5.2	-4.7
Sweden	2.0	2.4	3.8	2.5	-2.6	-3.9	1.3	0.7	1.9	2.0	-0.4	-1.9
U. Kingdom	-3.4	-2.7	-2.7	-5.5	-11.5	-13.8	-3.7	-3.3	-3.7	-6.1	-10.2	-12.2
EU-27	-2.5	-1.4	-0.8	-2.3	-6.0	-7.3	-2.6	-2.1	-2.1	-3.3	-4.6	-5.6

Source: European Commission.

The deterioration of public finances in times of economic crisis largely reflects the fundamental macroeconomic role of fiscal policy – to act as a damper of cyclical shocks. Fiscal policy has two levers with which to act as a stabiliser: automatic stabilisers and stimulus measures. According to European Commission forecasts, in 2009 and 2010 both levers will exert a combined effect of about 4.5% of GDP in the euro area and 5% of GDP at the level of the EU as a whole. It is believed that the bulk of “budgetary support” will be in the form of automatic stabilisers,³ which is favourable in terms of the subsequent

consolidation of public finances. According to theory, the burden on public finances will gradually ease off and, in time, disappear as economic activity returns to previous growth rates. However, the theoretical presumption that past macroeconomic conditions will return is not a given. The European Commission⁴ forecasts that the potential growth rate⁵ will be substantially lower, down from 1.5% annually before the crisis to around 0.75% in 2009 and 2010. Member States which had enjoyed high growth rates in the years before the economic crisis will have to consolidate public finances in an environment

³ Automatic stabilisers include progressive taxation of income and unemployment benefits, but fixed public expenditure relative to GDP has the greatest impact. As long as governments can borrow on the capital markets without limitations, they can maintain public expenditure at the same (planned) level. This also means that despite a temporary slowdown in economic activity, they are not cutting payrolls in the public sector or reducing pensions and other transfers.

⁴ The European Commission Spring Forecast, May 2009.

⁵ Estimates of potential growth have turned out to be problematic, in particular in periods of severe oscillations in economic growth. For individual countries these estimates were often revised, whereas any estimates for a group of countries (e.g. the EU) are made difficult by the fact that the aggregate assessment involves different specific economic conditions in each country.

Box 1: Measures mitigating the effects of the financial and economic crisis and their projected impact on the public finances of EU countries

The international financial and economic crisis has had a disproportionately greater impact in Europe on open, export-oriented economies with large or specialised industrial sectors. At the end of 2008, EU leaders adopted the European Economic Recovery Plan as part of efforts to coordinate economic policies. It was agreed that all measures must be aligned with long-term development goals, targeted at structural reforms and in conformity with internal market regulations. The key in responding to the crisis is to take measures that are targeted, timely and temporary. Measures with negative long-term effects on economic growth (e.g. subsidies for automobile purchases, subsidising shorter working hours) must be temporary and should show effects in the shortest time possible.

Discretionary fiscal measures amount to roughly 1.8% of the EU's GDP in 2009 and 2010. Among the euro area members, Spain adopted the largest fiscal stimulus package, worth 3% of GDP. Measures at the national level are accompanied by measures by the European Central Bank (for example with the cutting of the benchmark interest rate or assisting Hungary with a EUR 5bn money market refinancing), the European Investment Bank (additional loans of EUR 15bn annually in 2009 and 2010), temporary adjustments of state aid provisions, as well as a simplification of procedures and acceleration of EU-funded programmes.

In accordance with the plan, all Member States adopted measures to support the financial sector and the real economy in their quest to improve liquidity and facilitate access to fresh capital for both banks and companies. Many countries improved access to capital with state guarantees (France, for example, will provide banks guarantees worth EUR 320bn and Germany EUR 400bn) or the use of state aid with direct financial injections (e.g. Belgium invested assets worth 7% of GDP in the four largest financial institutions and Austria set aside the equivalent of 5.5% of GDP). Aid to the financial sector was crucially matched with support for the business sector, especially small and medium-sized enterprises (SMEs), in the form of accelerated depreciation of fixed assets (Germany), shortened VAT refund periods (multiple countries, including Slovenia where it enters into force on 1 January 2010), additional credit lines (Spain, Portugal) and faster payment of liabilities by the state (Netherlands, Belgium, Portugal). Some Member States have also permanently reduced the corporate income tax (most such measures had been conceived before the onset of the crisis), yet others have reduced it on a temporary basis.

Several countries also provided substantial assistance to specific industrial sectors, notably construction and the automotive industry. Countries with highly developed automotive industries put in place subsidies for the purchase of new, more ecological vehicles (EUR 2,500 in Germany, EUR 1,000 in France and GBP 2,000 in the United Kingdom) or provided direct incentives in the form of loans and guarantees (France, Spain, Italy, Sweden). Additionally, several countries started to subsidise real estate purchases (France, Ireland, United Kingdom, Belgium) to provide a boost to the construction sector. In Mediterranean countries, tourism in particular has received strong support, mainly in the form of VAT waivers or reductions.

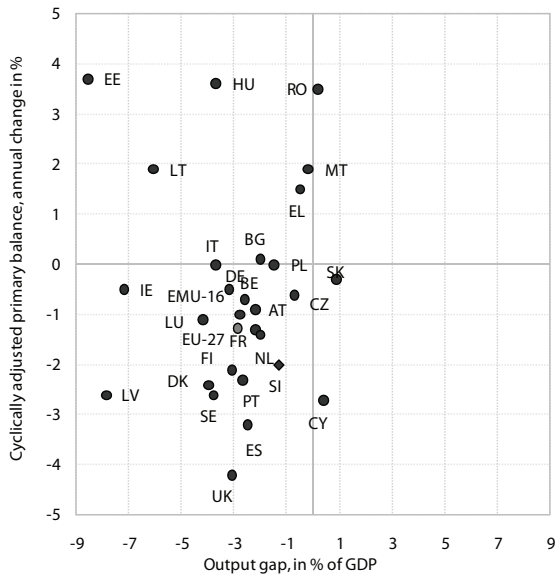
In many countries, measures were taken to improve energy efficiency, but only a few have significantly bolstered investment in the "green economy" and innovation (e.g. Denmark adopted a plan of investment in green transportation worth EUR 12.5bn between 2009 and 2020, and Sweden included an environmental criterion in guarantees for loans for research and development). Despite a precipitous drop in R&D investment by the private sector, some governments focused on strengthening such investment, among them Slovakia, which intends to double the share of GDP it spends on R&D.

of slower economic growth. Even if they manage to achieve potential growth rates, the general government deficit this year excluding cyclical factors would average 3.9% of GDP in the euro area and 4.6% of GDP in the EU as a whole (and rise in 2010 in the absence of further measures). This is significantly above what medium-term budgetary frameworks with a stable public debt as a share of GDP would suggest. The Member States will therefore need to place greater emphasis on systemic adjustments to ensure the long-term sustainability of public finances.

The general government deficit is rising due to the impact of automatic stabilisers and expansive fiscal

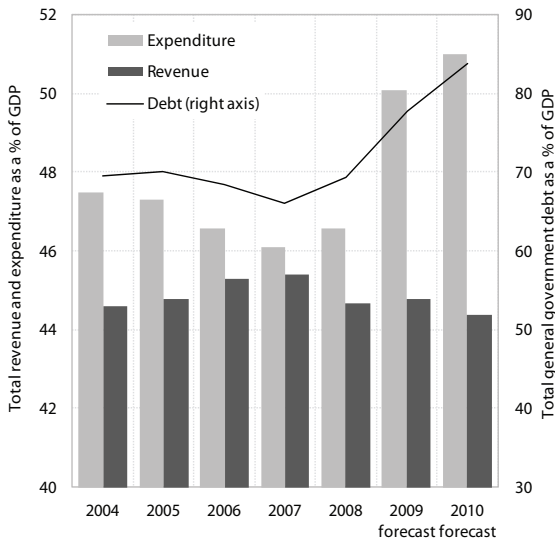
policy, which acts counter-cyclically in an economic downturn, but it is also affected by the shortfall in budget revenues, which is a consequence of measures taken in boom times. The latest European Commission forecasts for 2009 show that this year the majority of EU countries will pursue expansive fiscal policies (see Figure 1), which act counter-cyclically when there is a negative output gap. Furthermore, in 2008 and 2009 many Member States experienced a turnaround in erstwhile fast-growing tax revenues, which forced governments to cut taxes and/or increase spending with the presumption that revenues would remain at high levels in the future.

Figure 1: Cyclical conditions and public finances in 2009



Source: Eurostat.

Figure 2: Total general government revenue, expenditure and debt in the euro area



Source: Eurostat.

In 2008, the average general government debt rose to 69.3% of GDP in the euro area and 61.5% of GDP in the whole of the EU. The European Commission's projections suggest general government debt will continue to increase, in particular in Member States outside the euro area. By the end of 2010, the average debt in the EU will be just below 80% of GDP, whereas the average indebtedness in the euro area will be about 4.5 p.p. higher. Debt levels are rising due to many off-budget expenditures, in particular capital increases in financial firms. In many countries, measures which directly raise deficits and debt have been coupled with extensive

Box 2: Estimate of potential cost to public finances of supporting the banking sector¹

The financial and economic crisis, which undermined the stability of the banking sector, has led to increased public debt levels in many countries. Considering how important the banking system is for macroeconomic stability and sustainable economic growth, state aid to banks is a priority in a systemic financial crisis. This is reflected in recent measures undertaken by countries across the world to ensure the stability of national banking systems and maintain the flow of credit to businesses.

In estimating the potential burden on public finances, it is necessary to take into consideration the total expected costs that would be incurred in the worst-case scenario. It makes sense to take into account an analysis of banking assets, as it is highly likely that a rise in gross bad assets will increase the overall burden on public finances. The potential direct costs of maintaining the stability of the financial sector can be estimated as the share of loans to the private sector and non-financial public corporations that could sour during a crisis. This affects the scope of the necessary bank capital increases and reflects the potential burden on public finances. Figure 3 (left axis) shows the highest expected amount of potential government liabilities depending on the estimated share of bad loans in the banking system.¹ At the top of the chart are countries where lending to the private sector was especially brisk in the past few years, but after the period of high credit growth ended, these countries are seeing a steep decline in economic activity and a rapidly growing share of bad loans in the banking system. Great Britain and Ireland in particular have been badly hit and their public debt could exceed 100% of GDP² in the medium term due to the high level of financial support they have provided to the banking system. Countries whose domestic banks have a relatively high exposure to foreign investments (e.g. Austria, Sweden, Italy and Belgium, which have major investments in Eastern Europe) could also have higher potential loss estimates, presuming that the parent banks provide full support to their subsidiaries abroad in the event of a banking shock there. However, as it turned out this is not necessary (e.g. when Fortis Bank was bailed out, the Dutch government took on only the costs of salvaging the subsidiary in the Netherlands, not the parent bank).

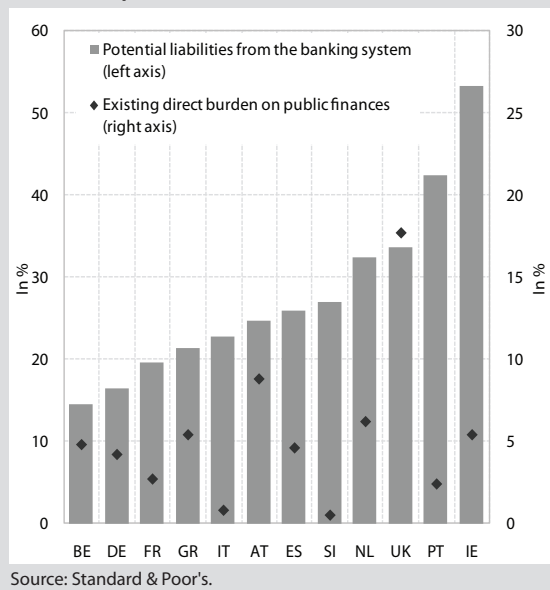
¹ Marko Mršnik, Standard & Poor's.

² The estimates of loans to the private sector and non-financial public corporations are in the 5–15% range for Belgium, France, Germany, the Netherlands, Spain and Great Britain, 10–20% for Austria, Greece, Ireland, Italy and Portugal, and 15–30% for Slovenia. Source: Standard & Poor's (2009), Banking Industry Country Risk Assessments.

³ In Great Britain, net public debt was 49.0% of GDP in 2008. In Ireland, where the net debt was 18.7% of GDP, the government set up a "bad bank", but the effect on government balances is not clear yet.

Current government measures, which included capital increases or auctions of state bonds used for refinancing with the ECB, resulted in rising public debt (see Figure 3, right axis). Public finances would come under additional pressure if creditors were to call the state guarantees that the financial sector received to overcome the credit freeze in the aftermath of the bankruptcy of Lehman Brothers in September 2008.

Figure 3: Estimate of potential liabilities originating from the banking system and the current direct burden on public finances (as a % of GDP)



guarantees⁶ (see also Box 2). In accordance with existing rules on state aid, the European Commission approved guarantees worth nearly 24% of GDP as part of the anti-crisis measures, with about 7% of GDP confirmed by May.

⁶ Guarantees are potential liabilities which affect the deficit only if they are actually called.

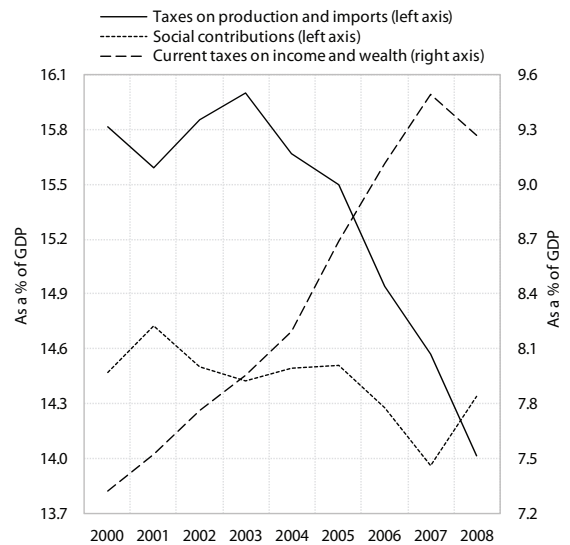
2. Fiscal development and policy in Slovenia

2.1. Main aggregates of the general government⁷

In 2008, the general government deficit stood at 0.9% of GDP. After 2000, the general government deficit was gradually dropping until 2007, when the balance was positive for the first time since 1997 (0.5%). In 2008, the fiscal position deteriorated by 1.4 p.p. and the general government balance turned from surplus to deficit. Total nominal government revenues rose at a significantly slower pace than total expenditures, which in turn substantially exceeded GDP growth in 2008.

The jump in general government expenditure, coupled with lower revenues as a share of GDP, was a key factor behind the increase in the deficit in 2008. In a deteriorating macroeconomic environment the share of total general government revenue dropped compared

Figure 4: Groups of general government revenue with the greatest change over the year before, as a % of GDP



Source: SORS, Main aggregates of the general government; calculations by IMAD.

⁷ The analysis enables comparison with trends in the EU, since it is based on the ESA-95 national accounts methodology, which has been available for Slovenia since 1995. ESA-95 provides a broader view of the economic role of general government. For the purposes of fiscal policy, inflows and outflows are planned and monitored with a national methodology based on the methodology (GFS) used by the International Monetary Fund. Slovenia's methodology is based on the cash flow principle and serves as the basis for the display, implementation and planning of expenditures and revenues of the state budget, local budgets and both social security funds.

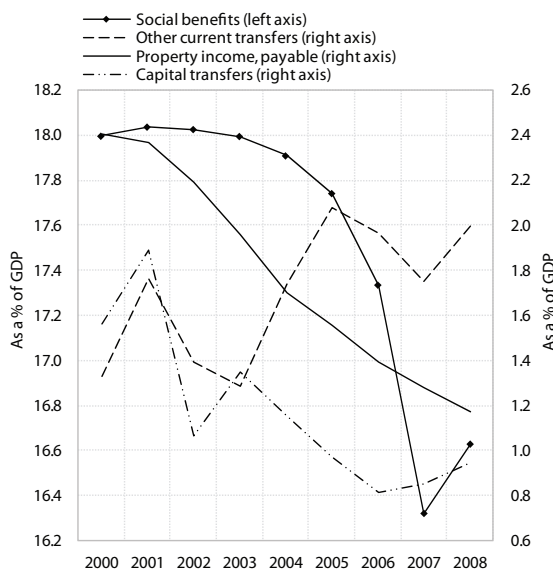
Table 2: Revenue, expenditure and balance of the general government sector, as a % of GDP

	2000	2001	2002	2003	2004	2005	2006	2007	2008	Change 2007–2008, p.p.
Total general government revenues, % of GDP	43.0	43.6	43.9	43.7	43.6	43.8	43.3	42.9	42.7	-0.2
Total general government expenditure, % of GDP	46.7	47.6	46.3	46.4	45.8	45.3	44.6	42.4	43.6	1.2
Net lending (+) / net borrowing (-), % of GDP	-3.7	-4.0	-2.5	-2.7	-2.2	-1.4	-1.3	0.5	-0.9	-1.4

Source: SORS, Main Aggregates of the General Government 2005–2008; for 2000–2004 Non-financial sector accounts; calculations by IMAD.

to the year before. The share of taxes on production and imports dropped the most as a result of the slowdown in economic activity and the phase-out of the payroll tax. Due to amended legislation on personal and corporate income taxes, the share of the current tax on income and property fell as well (see Section 3.1). The only major category where revenues rose was the share of social security contributions relative to GDP, which increased due to the relatively high growth of the wage bill. Total general government expenditure, having hit the lowest level in 12 years in 2007 (42.4% of GDP), rose again. The share of gross capital formation increased the most. The share of social benefits in cash and kind increased in particular after a new mechanism was put in place to adjust them to inflation twice a year (except pensions), but also with the valorisation of pensions⁸ and increases in certain types of transfers.⁹ The share of

Figure 5: Groups of general government expenditure with the greatest change over the year before, as a % of GDP

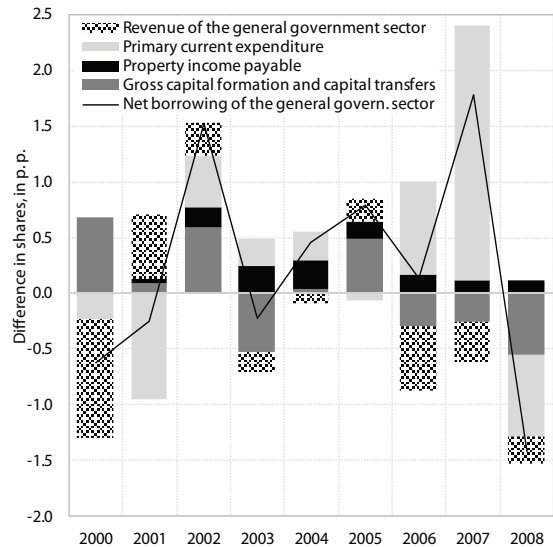


Source: SORS, Main aggregates of the general government; calculations by IMAD.

⁸ The increase in expenditure on pensions as a share of GDP is attributed mainly to the growing number of pensioners, but given the current formula the fact that wages outpaced productivity gains also had a great impact.

⁹ The payment of a one-off pension allowance, an unscheduled increase in child benefits, greater subsidies for kindergarten fees, free meals for secondary school students.

Figure 6: Contributions to changes in the general government deficit



Source: SORS, Main aggregates of the general government; calculations by IMAD.

Note: A positive change in a relative share of the deficit means a reduction of the deficit in the current year compared to the previous year. An increase in expenditure and a decrease in revenue are shown as negative values, since they contribute to a widening of the deficit.

funds for employees also increased as a result of a rise in the number of public sector employees and the growth of the average wage in the public sector following the payout of the first quarter of money earmarked for the elimination of wage disparities.¹⁰ The breakdown of expenditures (see Figure 5) shows that primary current expenditure increased the most last year. Expenditure on investment and capital transfers also edged up.

Last year, as well as in previous years, the general government deficit was generated mainly at the central government level.¹¹ As a result the balance of the central government deteriorated, turning from a surplus to a deficit of 0.5% of GDP. Local government units also ended 2008 with a higher deficit than in the

¹⁰ Wages in the public sector rose by the first quarter of the total planned increase in August 2008 (which included a back payment).

¹¹ According to the Standard Classification of Institutional Sectors, the central government level includes direct users of the state budget, state funds and other central government units.

Table 3: Net borrowing of the general government by subsector (as a % of GDP)

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Net general government borrowing (deficit)	-3.7	-4.0	-2.5	-2.7	-2.2	-1.4	-1.2	0.5	-0.9
of which:									
Central government	-3.2	-3.8	-2.2	-2.5	-2.1	-2.2	-1.2	0.4	-0.5
Local government	0.0	0.0	-0.2	-0.1	-0.1	0.0	-0.1	-0.1	-0.4
Social security funds	-0.5	-0.2	-0.1	-0.1	-0.0	0.8	0.1	0.2	0.0

Source: SORS, Main aggregates of the general government 2004–2007; for 2000–2003 Non-financial sector accounts; calculations by IMAD.

year before, whereas social security funds had balanced positions (see Table 3).¹²

The economic downturn in 2009, the consequent effect of automatic stabilisers as well as the impact of fiscal policy measures taken this year and in the years before, increased the gap between general government revenue and expenditure. Revenue from most taxes and contributions is dropping this year – only the revenue from excise duties is rising. The slowdown has also increased general government expenditure, as the ranks of the unemployed and the number of recipients of social transfers have been rising due to unfavourable conditions on the labour market. Moreover, in the period 2006–2008 there was a marked increase in expenditure that had been curbed in the years before, which will step up pressure on public finances in the coming years. These expenditures rose in particular due to: an agreement to eliminate wage disparities with the payout of the remaining three-quarters of the earmarked funds in 2009 and 2010, the effect of a new mechanism for the adjustment of pensions and higher social transfers agreed as part of measures to alleviate the impact of higher inflation on people's livelihood. The growth in expenditure was also accelerated by counter-cyclical measures designed to cushion the impact of the economic crisis. Judging by the draft of the second supplementary budget, the general government deficit will soar this year, exceeding 5% of GDP.¹³

One essential factor behind the change in the fiscal position through the end of 2007 was the rapid growth of tax and contribution bases in the period of fast economic growth. Growth in wages, income and consumption had exceeded projections in every fiscal year. This was coupled with a reduction in certain types of general government expenditure, in particular expenditure that dropped automatically due to lower unemployment and a rise in people's income. These high revenues from taxes and contributions made it possible to scale back certain tax sources, with no negative

consequences for the fiscal position. In 2006–2008, the payroll tax was phased out, personal and corporate income tax rates were cut and several other tax breaks were introduced. The tax cuts reduced the tax burden and changed the tax structure.

Yet the systemic reduction in sources of revenue was not matched by measures on the expenditure side. In the period 2000–2007, reform of the pension system had a stabilising effect on general government expenditure relative to GDP. There were few other systemic changes that limited or reduced the scope of public expenditure, the exceptions being a streamlining of the system for the adjustment of social transfers, which was adopted in 2006, and public sector wage policy. But the effect of wage policy was only temporary, as subsequent reform of public sector wages increased this type of expenditure. Another reduction in expenditure came when funding of motorway construction was removed from the state budget and instead the state started issuing guarantees for loans taken out by the motorway corporation DARS, which means a transition to potential public debt. However, in this period there was an absence of necessary restructuring of other general government expenditure that would have accelerated the reduction in total expenditure. Indeed, other expenditure even increased on average.

The change in the cyclically adjusted deficit also shows that structural reforms of public finances were insufficient: despite the worsening of the macroeconomic environment, last year's deterioration of the fiscal position was largely structural. After decreasing for several years, the cyclically adjusted deficit rose last year.¹⁴ The cyclically adjusted deficit of the general government was dropping in the period 2000–2007 (with the exception of 2006), which indicates that until 2008 the total general government deficit was diminishing due to economic growth as well as structural adjustments of public finances. In 2007, in a period of high economic growth, the cyclical component was the dominant factor in improving the fiscal position, and it continued to exert a strong influence in 2008, mostly due to a favourable macroeconomic environment in the first half of the year. But the cyclically adjusted deficit jumped

¹² The pension fund is balanced because of a regulatory requirement that any deficit be covered with transfers from the state budget. In 2008, EUR 446m was transferred from the state budget for statutory rights and an additional EUR 666m for the coverage of the deficit, which was 3.4% more than in the year before (cash flow data).

¹³ In the first quarter of 2009 the general government deficit stood at 6.0% of GDP.

¹⁴ The cyclically adjusted balance is the financial position when the actual GDP of the economy and the potential GDP are equal. The degree of cyclicalities is shown by the difference between actual and potential output – the output gap.

Table 4: Actual, cyclical and cyclically adjusted¹ general government balance, as a % of GDP

	Actual balance (1)	Cyclical balance ¹ (2)	Cyclically adjusted balance ² (3 = 1 - 2)	Change of cyclically adjusted balance ³
2000	-3.7	0.3	-4.0	-1.7
2001	-4.0	-0.1	-3.9	0.2
2002	-2.5	-0.3	-2.2	1.6
2003	-2.7	-0.7	-2.0	0.3
2004	-2.2	-0.5	-1.7	0.2
2005	-1.4	-0.6	-1.3	0.5
2006	-1.3	0.8	-2.1	-0.9
2007	0.5	2.2	-1.7	0.5
2008	-0.9	1.6	-2.5	-0.8
2009	-5.1	-0.7	-4.4	-2.0

Source: SI-Sat data portal – Economy – National accounts – Main aggregates of the general government (SORS), 2009 (for the actual balance); AMECO, European Commission (cyclical components for the period 2000–2008), Stability Programme – update 2008 (cyclical components for 2009 and 2010).

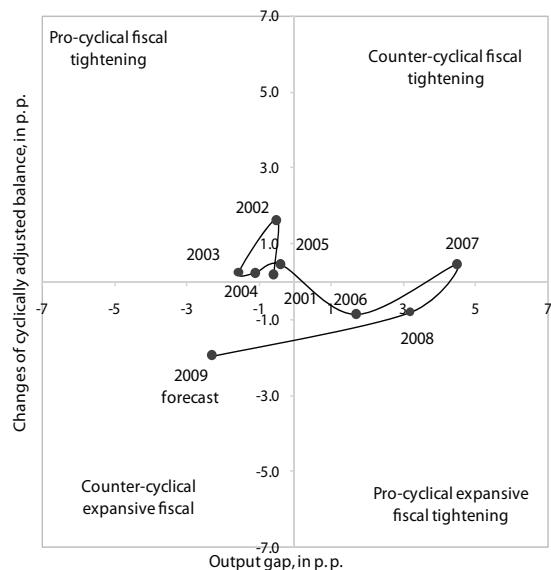
Notes: ¹Cyclical balance indicates to what extent (and in which direction) macroeconomic conditions affected the fiscal position. It is calculated with the production function method based on potential GDP growth estimated after the publication by SORS of GDP growth data for 2008, and the latest realisation of general government revenue and expenditure. ²The cyclically adjusted or structural balance shows what kind of fiscal position could be achieved simply with the operation of fiscal policy measures, i.e. without the influence of cyclical factors. ³ Positive change means an improvement of the balance. The figures do not always add up because they are rounded off. Change in the cyclically adjusted balance indicates the fiscal impulse, i.e. the orientation of fiscal policy.

substantially with the implementation of concurrent yet uncoordinated systemic measures on the revenue and expenditure sides. General government revenues and expenditures, and consequently the fiscal position, reacted to the change in the economic cycle, which reduced the cyclical balance by 0.6 p.p. compared to 2007. The deterioration in the cyclically adjusted deficit was even more severe, as it rose by 0.8 p.p. in 2008, exceeding the actual deficit by 1.6 p.p. This indicates that the fiscal balance in 2008 excluding the impact of the economic cycle (taking into account only the impact of fiscal policy measures) would have been considerably worse.

A comparison of the dynamics of the cyclically adjusted deficit and output gap shows either pro-cyclical or counter-cyclical orientations of fiscal policy. Changes in the cyclically adjusted balance in consecutive years indicate the orientation of fiscal policy, i.e. the fiscal impulse. By comparing the change in the cyclically adjusted balance and output gap between individual years, which shows oscillations in the economic cycle, it is possible to assess the orientation of fiscal policy, i.e. the fiscal stance. In Figure 7 we defined four distinct quadrants with regard to changes in fiscal impulse and output gap, which determine the fiscal stance. Fiscal policy is counter-cyclical if the combination of both parameters lies in the first or third quadrant. This means that when economic growth falls below its potential, fiscal policy responds expansively; when actual growth exceeds potential GDP growth, it responds restrictively.

Fiscal policy is pro-cyclical if the combination of both parameters lies in the second or fourth quadrant. This means that when economic growth falls below potential, fiscal policy responds restrictively; when actual growth exceeds potential GDP growth, it responds expansively. A pro-cyclical orientation means that fiscal policy does not allow for automatic stabilisers to operate, the result being that, for example, expenditure fluctuates in accordance with changes in economic growth, and not as planned. This means that when economic growth is higher than initially planned, cyclical budget revenues are used to finance tax cuts and increased expenditure, not to curb the deficit.

Figure 7: Cyclical orientation of fiscal policy



Source: SI-Sat data portal – Economy – National accounts – Main aggregates of the general government (SORS), 2009 (for the actual balance); AMECO, European Commission (cyclical components for the period 2000–2008), Stability Programme – update 2008 (cyclical components for 2009 and 2010).

Note: A positive fiscal impulse, for example, means an increase of the cyclically adjusted deficit in the current year compared to the year before. The varying distances of separate points from the axes show fiscal policy intensity.

In 2007, fiscal policy was restrictive and counter-cyclical, whereas in 2008 it became cyclically expansive. Having compared the dynamics of the cyclically adjusted balance and output gap¹⁵ in the period after 2000, we assessed that fiscal policy in the first five years was mildly restrictive and cyclical, in particular in 2002. In this period the main goal of economic policy was to fulfil the requirements to adopt the euro, which is why fiscal policy measures, targeting a deficit of 1% of GDP, limited the activity of automatic fiscal stabilisers. Fiscal policy remained restrictive in the years when actual GDP growth was below potential, thereby keeping the general government deficit below the Maastricht

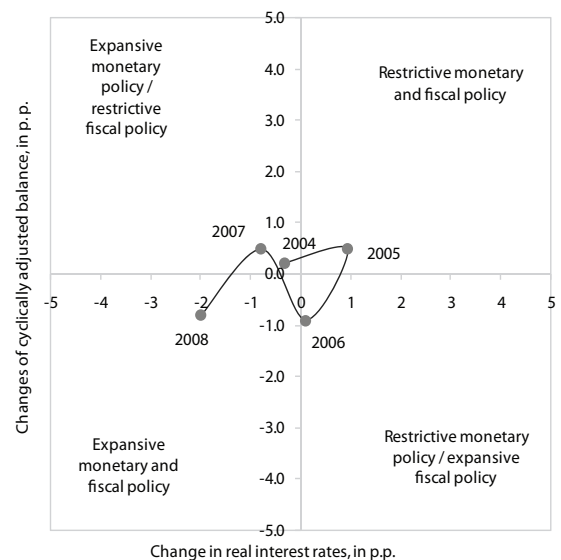
¹⁵ The output gap is assessed based on a production function approach used by the European Commission.

threshold. Yet in 2006, despite the fact that the output gap turned positive due to accelerated economic growth, fiscal policy became expansive and hence continued to act cyclically. In 2007, certain measures taken to reduce general government expenditure and fiscal policy thus acted mildly restrictively and, given the favourable cyclical environment, counter-cyclically. In 2008, the cyclically adjusted deficit expanded, but since the output gap was still positive, fiscal policy was in effect expansive and cyclical. The factors that contributed to expansion mainly included measures which accelerated the growth of expenditure (increased expenditure on investment, more money for social transfers,¹⁶ wage growth with the introduction of the new wage system in the public sector amid new hiring), but there were also changes that reduced revenue (larger general tax breaks implemented with new personal income tax legislation and a lower corporate income tax rate). Yet in order to perform a stabilising role, fiscal policy should have matched tax cuts and higher tax breaks in good economic times – when realised revenues were higher than planned – with more robust curbing and restructuring of general government expenditure. This would give it greater leeway to adapt to altered economic conditions and act counter-cyclically in accordance with EU guidelines for the coordination of fiscal policies.

This year and next, fiscal policy is expected to remain expansive, which will have a counter-cyclical effect in conditions of an economic slowdown. Estimates of the cyclically-adjusted deficit for 2009 from the Stability Programme¹⁷ show that the cyclically-adjusted deficit will swell this year, which will have a counter-cyclical impact given the severely deteriorated economic conditions and the negative output gap.

Fiscal and monetary policy measures were not always coordinated. The orientation of monetary policy is assessed looking at the changes in real short-term interest rates. Until 2007, the Bank of Slovenia carried out independent monetary policy, but when Slovenia joined the EMU, the ECB rate became the key instrument of monetary policy.¹⁸ In the period 2004–2008, monetary and fiscal policy were not always coordinated. In 2004, when the output gap was negative, restrictive fiscal policy was pro-cyclical given expansive monetary policy. This was also the case in 2006, when fiscal policy was expansive and monetary policy restrictive. The two

Figure 8: Combination of fiscal and monetary policy



Source: SI-Sat data portal – Economy – National accounts – Main aggregates of the general government (SORS), 2009 (for the actual balance); AMECO, European Commission (cyclical components for the period 2000–2008), Stability Programme – update 2008 (cyclical components for 2009 and 2010).

Note: Real interest rates for the period between 2003 and I-V 2009 are annual averages of interest rates on loans to companies of up to EUR 1m with a maturity of up to one year, which are deflated with the average annual inflation. The exception is the period I-V 2009, where the average interest rate is deflated with the average inflation in the first five months (I-V 2009/I-V 2008).

policies were also out of lockstep in 2007, when fiscal policy was restrictive and counter-cyclical but real interest rates in Slovenia were low compared to the euro area due to relatively high inflation; this was reflected in expansive monetary policy. Bearing in mind that common monetary policy measures at euro area level have a crucial impact on interest rate changes, achieving an appropriate combination of macroeconomic policies at the national level requires that fiscal policy be more flexible. Given that the output gap was positive in 2007, fiscal policy should have been even more restrictive in order for the combination of both policies to be more counter-cyclical. In the second half of 2008, real interest rates started to drop along with the deterioration of economic conditions and fiscal policy again became expansive. Considering the movement of real interest rates, which continued to fall in the first half of this year, and the increase in the cyclically adjusted deficit, we estimate that both policies are relatively better coordinated this year.

¹⁶ Expenditure on medicines increased substantially, as did expenditure on social benefits and assistance to households due to measures taken in May 2008 to alleviate the negative impact of high inflation on people's livelihood (existing measures such as subsidising transport, food and rent, and new measures such as free meals for secondary school students and greater kindergarten subsidies).

¹⁷ Stability Programme – update 2008.

¹⁸ Key nominal interest rates in Slovenia (e.g. rates for corporate lending) followed changes in the ECB benchmark rate, but because inflation was high, real interest rates were relatively low in the period from the end of 2007 to mid-2008.

2.2. Financial flows between Slovenia and the EU budget

*The net position of the Slovenian budget relative to the EU budget was negative in 2008 according to data from the Ministry of Finance.*¹⁹ Slovenia's liabilities to the EU budget stood at EUR 427.9m whereas the inflow of EU funds to the state budget amounted to EUR 363.2m. European Commission data which show Slovenia's net position relative to the EU budget (see footnote 22) are not yet available for 2008, but it is expected that, as in previous years, they will show a positive net position (see Table 5).

Table 5: Net position of the Republic of Slovenia with respect to the EU budget, 2004–2007

	v mio EUR			
	2004	2005	2006	2007
Total funds received from the EU budget	282.0	366.2	406.1	390.1
Total funds paid to the EU budget	170.4	274.7	279.1	359.4
Net position - accounting definition*	111.6	91.5	126.9	30.7
Net position** - (operating budgetary balance)	109.7	101.5	142.7	88.5

Source: EU Budget 2007 Financial Report.

Notes: *Net position based on the accounting definition is calculated as the difference between total receipts and total payments.

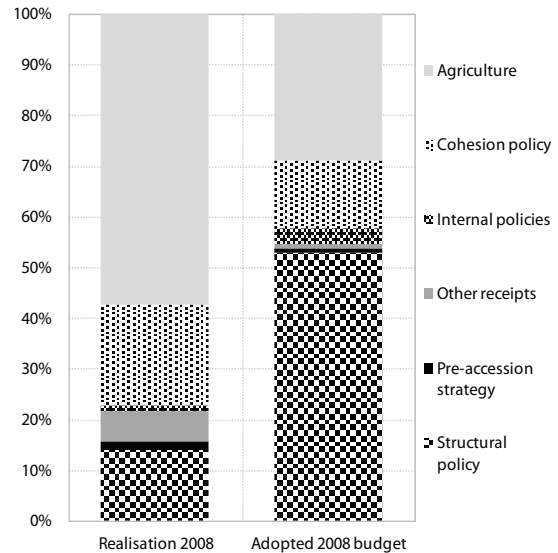
** Net position is calculated as the difference between allocated and contributed funds, excluding administrative expenditure, and taking into account adjusted national contributions based on the UK rebate.

In 2008, the absorption of EU funds was lower than in the year before, in particular due to lower receipts from cohesion funds. Funds for the implementation of Common Agricultural Policy were almost fully realised, that is, in the same scope as last year compared to the plans. Slovenia received marginally more funds than planned from pre-accession programmes (PHARE and ISPA). Funds for internal policy were lower than expected, but given that their share of total planned funds is small, they did not have a significant impact on overall absorption. The mismatch between payments and receipts is largely a consequence of drawing allocated cohesion and structural policy funds in the new financial perspective, as last year the bulk of the absorbed cohesion policy funds came from funds allocated under the previous financial perspective. Of the planned EUR 105m from the Cohesion Fund, Slovenia absorbed only EUR 72m. The absorption of structural funds was even lower than planned (only EUR 51m of the planned EUR 414m).

Slovenia was relatively successful in drawing funds under the old financial perspective, as it absorbed

¹⁹ The European Commission releases data on total funds allocated to Slovenia, which includes funds channelled through the state budget as well as funds transferred by the Commission directly to the final beneficiaries. This means that the Commission monitors all of the allocated funds, whereas the Ministry of Finance only has oversight of funds that go through the state budget.

Figure 9: Structure of funds planned and allocated from the EU budget to the state budget in 2008



Source: Ministry of Finance.

the bulk of the allocated funds. According to data from the Slovenian Government Office for Local Self-Government and Regional Policy (hereinafter: SVLR),²⁰ Slovenia absorbed 95% of the total allocated structural policy funds (EUR 226m) and 61% of all cohesion policy funds, of which it absorbed 50% of the allocated funds for the environment and 73% of the allocated funds for transport. The drawing period is not over yet, as the European Commission extended the deadline for the drawing of structural funds until the end of June of this year (the original deadline had been the end of 2008) and the deadline for cohesion policy funds until 2010 (from the end of June 2009), due to the global economic crisis, which aggravated the conditions for carrying out projects.

There are several reasons for the poor absorption of EU funds. Owing to changes in conditions, criteria and rules, the absorption of cohesion policy funds allocated under the new financial perspective is not yet smooth. Member States need some time to adapt to the changes and start the process. Data on Slovenia's absorption of funds allocated under the old financial perspective indicate that the first refunds to the state budget had not been received before the second half of 2005, while the most successful year was 2006. Another reason why the response time is longer is the fact that funds are available from two financial perspectives, especially considering

²⁰ The Slovenian Government Office for Local Self-Government and Regional Policy conducts in-depth monitoring of the allocation and use of cohesion policy funds, and it has access to data on tendered projects, signed contracts, allocated funds and paid funds. Ministry of Finance data, on the other hand, includes funds paid out from the state budget as well as actual repayments of paid funds through budget revenues. The overall picture of the success of drawing may therefore differ.

Table 6: Drawing of cohesion policy funds from the 2007–2013 financial perspective (as at 30.4.09)

		In EUR m					
		OP ETID*		OP SRDP*		OP HRD*	
		As at 30 April 2009	% with regard to eligibility 07–09	As at 30 April 2009	% with regard to eligibility 07–09	As at 30 April 2009	% with regard to eligibility 07–09
Eligibility 2007–2009	EU part	434.0		869.7		362.0	
	SI part	76.6		153.5		63.9	
	Total	510.6		1023.2		425.9	
Confirmed operations	EU part	256.9	59.2	664.2	76.4	240.3	66.4
Executed payments	EU part	42.8	9.9	179.5	20.6	18.3	5.1
Submitted expense claims		38.2	8.8	60.3	6.9	3.9	1.1
Certified expense claims		0.0	0.0	0.0	0.0	3.2	0.9

Source: Slovenian Government Office for Local Self-Government and Regional Policy; calculations by IMAD.

Note: * OP ETID – Operational programme of environmental and transport infrastructure development, OP SRDP – Operational programme for strengthening regional development potentials, OP HRD – Operational programme for human resource development.

the rule that funds allocated in the previous financial period must be utilised by a certain date.

The second reason for the poor absorption is the complex and demanding approval procedures. These procedures are prescribed by European and domestic regulations, and companies frequently quoted the complex and extensive documentation required in Slovenia as a major obstacle in applying for projects. The procedures were simplified with the new financial period.

The third reason is administrative barriers. Slovenia framed a conservative system for the absorption and monitoring of EU funds. It was confirmed by the European Commission, which granted Slovenia a certificate for the established information system. Projects co-financed with EU funds are first entirely paid for with domestic funds. When the managing authority confirms the eligibility of the money spent, the funds are transferred to the account of the state budget and recorded as revenues from the EU budget. Delays tend to occur between the use and refunding of the money, but there should be no major gaps, as refunds are made in all phases of a project. Moreover, new criteria and demands for the 2007–2013 financial period require an upgrade of the information system, which also takes some time.

The fourth reason is the financial and economic crisis, the consequences of which will be felt this year in particular, as it makes it more difficult for companies to secure own funds for the financing of projects. Companies and other contractors must secure a part of the funding for a project themselves, but obtaining financing without appropriate guarantees has become a problem for most contractors in the last nine months. SVLR data on the absorption of allocated cohesion policy funds in the period 2007–2009 (see Table 6) show that the use of the bulk of the allocated funds has already been confirmed. But implementation has largely not yet occurred, there were very few payment claims and there were almost no certified claims, except for the Operational

Programme for Human Resources Development. The global economic crisis and the consequent halt in drawing in all Member States prompted the European Commission to propose an additional simplification of procedures and approve an increase in advance payments for co-financing projects from EU funds.

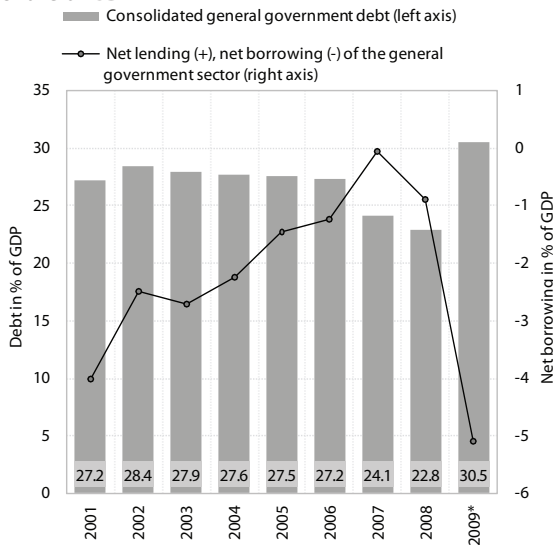
At the end of last year the government started taking measures to speed up the drawing of cohesion policy funds. In addition to introducing the option of providing advance payments from EU funds (see above) and a media campaign that the SVLR launched at the behest of the European Commission, it amended the Public Finances Act. The amendments allow for a redistribution of funds from projects that are found to be impossible to implement to projects that could be carried out in the current year.

The effects of these measures are difficult to forecast considering the uncertain conditions. Slovenia can successfully conclude the new financial perspective, but the effect on the state budget will still be negative this year. Like last year, it is expected that the drawing of agriculture policy funds will be successful, but the realisation of the planned funds for operational programmes based on the adopted state budget remains a challenge.

2.3. General government debt and debt guaranteed by the Republic of Slovenia

After plunging in 2007, consolidated general government debt was reduced by a further 0.6 p.p. in 2008, to 22.8% of GDP. The entire reduction was achieved at the central level (even the nominal size of this part of the debt shrank in 2008), whereas the debt at local level edged up and the debt of social security funds remained at the same level as in 2007.

Figure 10: General government debt and deficit as a share of GDP

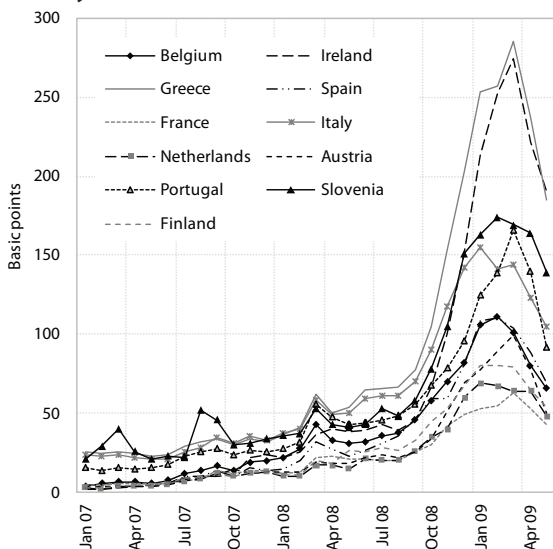


Source: Ministry of Finance.

Note: * Forecast for 2009 from the Stability Programme – update 2009.

The currency and maturity structure of the debt remain relatively stable. At the end of 2008, debt at the central level accounted for 98.8% of the general government debt. The bulk of the debt is long-term (at the end of 2008 the average time to maturity was 5.8 years), denominated in euros and hence insensitive to exchange rate changes, and the share of debt with fixed interest is high (99.0% in 2008). Consequently, debt at the central level is particularly sensitive to changes in ECB interest rates in terms of financing costs, but the impact of changes over the short and medium term is moderate, since most of the debt is long-term.

Figure 11: Change in 10-year treasury bonds of selected euro area countries relative to the German 10-year treasury bond



Source: Eurostat, IMAD calculations.

Against the backdrop of difficult conditions on the bond markets, the government issued two bonds in the first half of 2009. The demand for more borrowing is rising as the general government deficit soars due to increased expenditure and lower revenue, but the conditions for bond issuance have become more difficult. As early as in mid-2008, rising credit and liquidity risk pushed investors to start differentiating between bonds issued by individual countries. Some countries were therefore forced to increase short-term borrowing. As conditions deteriorated in the last quarter of 2008, the spreads on bonds issued by individual EMU countries started to expand (see Figure 11). Countries which had not created a good investor base are thus having trouble attracting investors, who are increasingly placing emphasis on greater liquidity. It was in such conditions that Slovenia issued two bonds worth a combined EUR 2.5bn in the first half of 2009. Most of the bonds were purchased by “old” investors and the depth of the market enabled smooth financing.

The latest forecasts of the Ministry of Finance suggest that general government debt will expand to 30.5% of GDP²¹ by the end of 2009. The projection is based on the forecast that the general government deficit will rise to 5.1%. The bulk of the deficit will be generated at the central level as a result of lower tax revenues and higher expenditures, including due to measures taken to tackle the crisis. A part of the rise is also attributed to greater indebtedness of the Health Insurance Institute (which was negligible in the past three years) and the local government. The gap between the interest rate and GDP, which will further increase public debt as a share of GDP given greater borrowing and a plunge in GDP growth, will also have a significant impact on rising debt levels.

In 2008, guarantees worth EUR 1.04bn were issued, bringing the total amount to EUR 4.7bn for 87 guarantees by the end of that year. A total of 73% of the guarantees were for external debt. Broken down by activity, the bulk of the guarantees were issued for transport and storage (almost 62%), mostly to the motorway company DARS (a total of nearly EUR 2.7bn) and to the financial and insurance sectors (34%). In 2008,²² the quota for new guarantees was set at EUR 1bn, but only 49% of it was used: EUR 0.51bn in new guarantees were issued, of which EUR 413m were for DARS, EUR 45m for Slovenian Railways, EUR 30m for the Ecological Fund and EUR 22m for Infra d.o.o.). Apart from that, a quota of EUR 0.53bn was set, and used, for borrowing by SID Banka d.d.

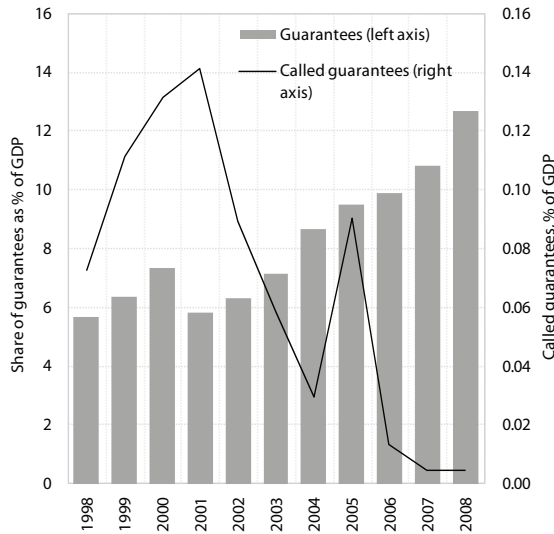
In 2009, only one guarantee, worth EUR 5m, was issued by the end of April. In all, EUR 297,000 in guarantees were called and paid out, and EUR 1.1m in back claims from called guarantees were recovered.

The amount of called guarantees may increase due to harsher conditions and the continued uncertainty. In

²¹ Stability Programme – update 2008.

²² Budget Implementation Act for 2009.

Figure 12: Issued and called guarantees of the Republic in Slovenia, 1998–2008, as a % of GDP



Source: Ministry of Finance.

the past there were no major calls on guarantees,²³ as the volume of called guarantees was below 1% of GDP in the last seven years. But in the current crisis conditions, there is a possibility that guarantees could be called, including guarantees that the state will issue as part of the guarantee scheme. Indeed, calls are more likely than for previous guarantees considering the purpose of their issue. The Guarantee Scheme Act was adopted in April to make it easier for businesses to obtain bank credit, and hence to facilitate companies' continued operation. The recipient companies are expected to spend the money on working capital, new investments and the completion of

existing investments. SID Banka has been put in charge of issuing, calling, recovering and overseeing the use of these funds. The guarantee scheme was launched only when the appropriate regulation was adopted. The first auction was carried out in mid-June.

2.4. Long-term sustainability of public finances²⁴

Over the long term the fiscal position crucially depends on demographic change, where current projections show an even more unfavourable trend than projections from 2005. Population projections in 2008²⁵ confirmed that populations in all EU countries, in particular Slovenia, are ageing rapidly. This means greater demand for pensions and services for the elderly, but it also signals problems in funding increased expenditure, since the share and size of the working-age population are shrinking at the same time.

Pensions account for the bulk of expenditure related to population ageing. Since projections were made in 2004, there have been no major systemic changes to the pension system (nor were any planned in this period), so the latest projection retains the same presumptions that have the most significant impact on expenditure. Long-term projections of pension expenditure from 2004 and 2008 are therefore very similar.²⁶

The main reason for increased public expenditure on pensions is the rising share of the elderly. The total increase remains very high even though some factors are mitigating its impact.²⁷ The coverage ratio was the

Table 7: Change (in % of GDP) in public expenditure on pensions between 2007 and 2050 in projections from 2005 and 2008

SLOVENIA	Change in the share of total public expenditure on pensions in GDP, 2007–2050, in p.p.	Changes			
		Age dependency ratio	Coverage ratio	1/employment rate	Benefit ratio
In 2005 projection	6.5	8.9	0.1	-0.6	-1.9
In 2008 projection	8.3	10.3	-0.45*	-0.38	-1.15

Source: Report on projections of public expenditure that is a consequence of population ageing, with results of projections, IMAD 2009. Note: *The coverage ratio (ratio of the number of pensioners to the population over 55) reduces the projected increase in pension expenditure due to population ageing by 0.45 p.p. (5 %).

²³ Governments must assume obligations under the guarantees if a debtor cannot repay its liabilities to creditors and the creditor calls upon the state to pay up with the liability covered by the guarantee. The government usually recovers the money from the debtor at a subsequent time. But a guarantee becomes problematic when the debtor loses its long-term ability of settling its liabilities, in which case the entire liability is assumed by the state.

²⁴ The results of projections of expenditure associated with population ageing are taken from Reports on projections of public expenditure that are a consequence of population ageing, with results of projections, IMAD, documents for the Government, 12.1.2009. The working group for ageing and sustainability at the European Commission later updated the data, but the differences are minimal: they occurred in the projections of expenditure on healthcare and long-term care, where the European Commission's methodology is slightly different than that used in Slovenia.

²⁵ Eurostat: Population Projections EUROPOP2008.

²⁶ Since the projection from 2008 was extended to 2060, it only makes sense to compare the two for the period until 2050.

²⁷ The results of the projections are affected by many factors, but in particular (1) dependency ratio, (2) coverage ratio, (3) employment rate and (4) benefit ratio.

$$\frac{\text{Pension expenditure}}{\text{BDP}} = \frac{\overbrace{\text{Population 55+}}^{\text{Dependency ratio}}}{\text{Population 15 – 64}} \times \frac{\overbrace{\text{Number of pensioners}}^{\text{Coverage ratio}}}{\text{Population 55+}} \times \frac{\overbrace{\text{Population 15 – 64}}^{1/\text{Employment rate}}}{\text{Workingpeople}} \times \frac{\overbrace{\text{Average pension}}^{\text{Benefit ratio}}}{\text{GDP}} \times \text{Workingpeople}$$

Table 8: Projection of public expenditure on pensions, healthcare and long-term care, as a % of GDP

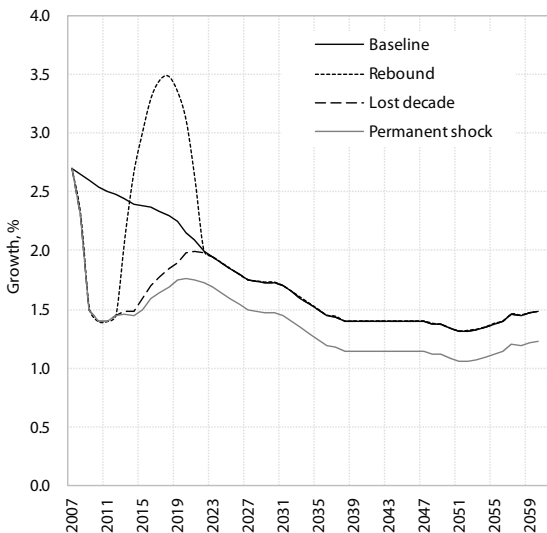
	2007	2020	2030	2040	2050	2060	Peak year
Social security pensions	9.85	11.09	13.27	16.12	18.19	18.62	2060
Healthcare	6.1	6.8	7.8	8.8	9.6	9.9	2060
Long-term care	1.0	1.4	1.8	2.4	2.9	3.2	2060

Source: Report on projections of public expenditure that are a consequence of population ageing, with results of projections, IMAD 2009.

main reason why the projected share dropped between the 2005 and 2008 projections. The impact of other factors was smaller. The combined projection of public expenditure on pensions, healthcare and long-term care as a share of GDP (see Table 8) clearly shows the potentially greatest increases in public expenditure and hence the greatest sources of risk to public finances.

The effects of the financial and economic crisis, which are not included in the projections, will further undermine the long-term sustainability of public finances. A rapid slowdown in economic activity, and hence lower growth or even falling employment and wages, worsen the ratio between expenditure related to population ageing and the sources of finance, and increases the share of such expenditure relative to GDP. The long-term sustainability of the pension system is thus becoming increasingly problematic. Years in which economic activity slows down will be particularly sensitive, especially if the rules governing expenditure remain rigid and fail to follow changes in macroeconomic parameters. Estimates of the consequences of the crisis depend on the scenarios of economic activity in the coming years. To test the consequences, the European Commission came up with three scenarios of GDP growth: (i) rebound scenario, where labour productivity and labour input²⁸ recover quickly, reaching the baseline level by 2020; (ii) lost

Figure 13: Potential GDP growth in the EU-27 under different scenarios



Source: European Commission, EPC.

²⁸ Labour input is measured as total hours worked.

Figure 14: Impact of the crisis on public finances in the EU-27 under different scenarios, 2007–2060

Figure 14a: Pension expenditure

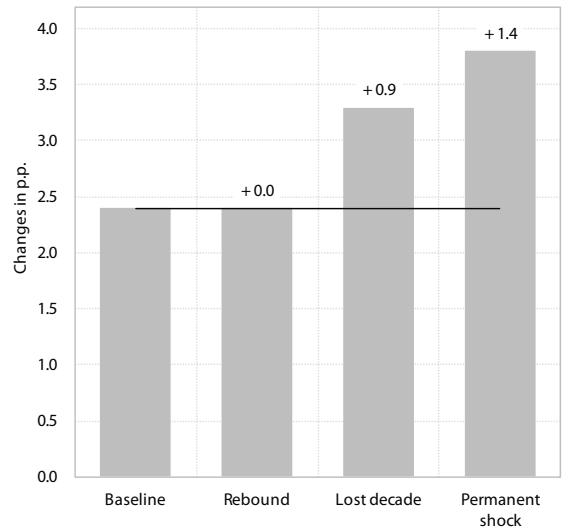
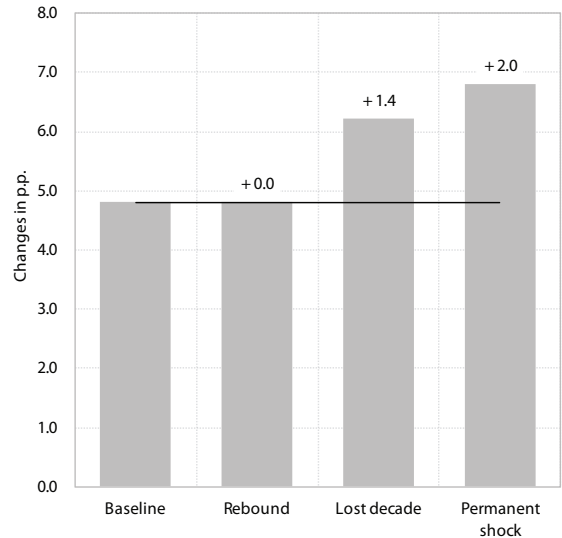


Figure 14b: Costs of ageing



Source: European Commission, EPC.

decade scenario, where labour productivity and labour input will gradually improve and reach the baseline growth rate by 2020; and (iii) permanent shock scenario, where growth in productivity and labour input are permanently reduced because of the crisis. According to the lost decade and permanent shock scenarios, by 2060

per capita GDP in the EU would be significantly lower than in the baseline projection. Pension expenditure, which depends mainly on how pension growth is linked to productivity gains, would soar across the EU (see Figure 14a). Calculations for Slovenia are more favourable, as pensions expenditure is projected to actually decrease as a result of the crisis. But the applied elasticity method uses data from previous years, when elasticity was negative because wage growth lagged behind pension growth and valorisation was restrictive. It is presumed that the situation has been different from 2006 onwards and elasticity would be positive.

Table 9: Difference in per capita GDP in case of various shocks compared to the baseline scenario, EU-27, in %

	2010	2015	2020	2040	2060
Rebound	-2	-6	0	0	0
Lost decade	-2	-9	-11	-11	-11
Permanent shock	-2	-9	-12	-16	-20

Source: European Commission, EPC.

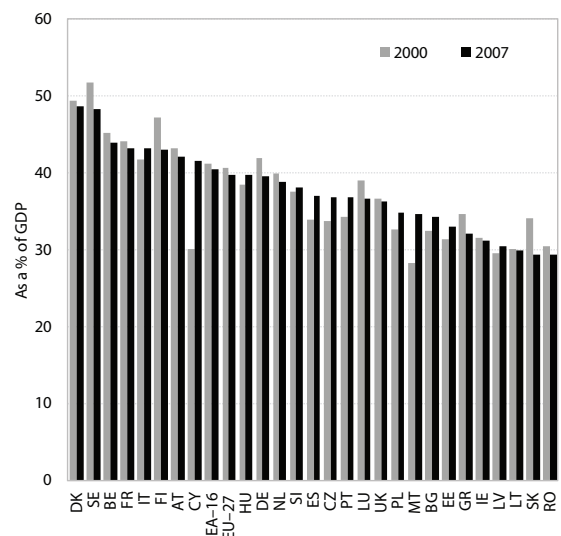
3. Quality of public finance revenue and expenditure

3.1. Analysis of revenue structure

3.1.1. Overall burden of taxes and social security contributions by EU countries

The overall burden of taxes and social security contributions, measured as a share of GDP, is slightly below the EU-27 average, but it is still relatively high considering Slovenia's level of development. Comparable data show that it stood at 38.2% of GDP in 2007 (EU-27: 39.8%, EA-16: 40.4%).²⁹ Eleven Member States have higher burdens, of which in seven the level of development is above-average.³⁰ The highest overall burdens are registered in the most developed Member States, in particular the Scandinavian countries. The differences in the total burden of taxes and social security contributions are considerable (19.3% of GDP), but they have been narrowing since 2000. In Slovenia the overall burden of taxes and social security contributions was shrinking in the period 1995–2000. Between 2000 and 2005 it rose but is now dropping again.

Figure 15: Overall burden of taxes and contributions in EU Member States in 2000 and 2007, as a % of GDP



Source: Eurostat, Taxation trends in the EU 2009.

3.1.2. Tax structure

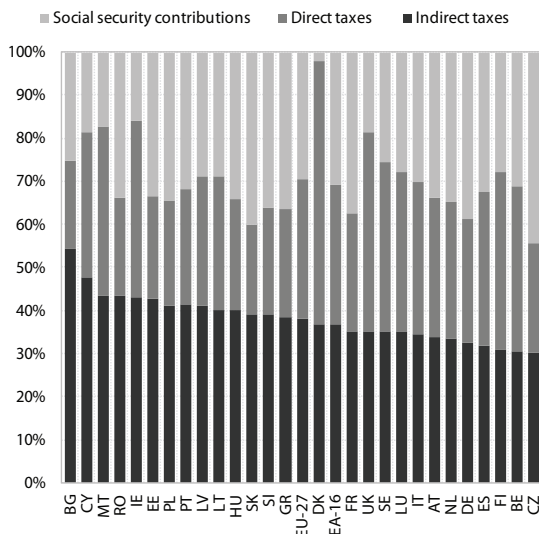
Slovenia is among the countries with developed social security systems that are based predominantly on

²⁹ The latest comparable data are for 2007.

³⁰ In per capita GDP in PPS.

a system of social insurance, which is reflected in the tax structure (the structure of three tax pillars: indirect taxes, direct taxes and social security contributions). The share of indirect taxes in overall taxes and social security contributions is slightly above the EU average (2007: Slovenia: 39.2%, EU: 38.4%). The share of direct taxes is relatively low compared to other EU countries³¹ (Slovenia: 24.9%, EU: 32.3%) and it will continue to fall as a result of the 2007 tax reform. The effects of the reform will be greatest in personal and corporate income taxation, which represent the bulk of direct taxes in Slovenia. The share of social security contributions is above the EU average as well (2007: Slovenia: 36.0%; EU-27: 29.5%). Slovenia also deviates from the EU average in terms of the distribution of employers' and employees' social security contributions: the share of employers' contributions in total contributions is at 42.7% compared to the EU-27 average of nearly 65%.

Figure 16: Indirect taxes, direct taxes and social security contributions, structure (in %) by country, 2007



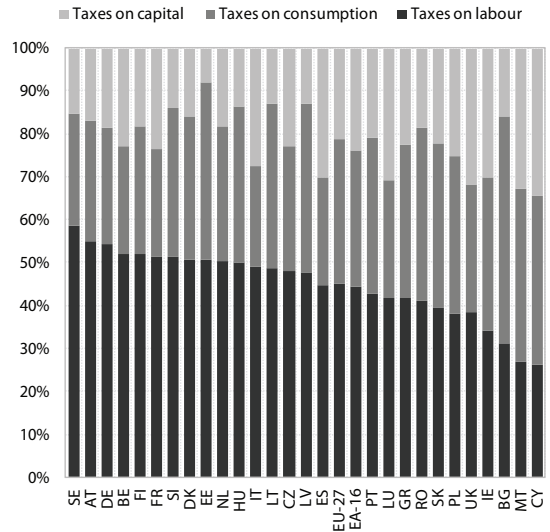
Source: Eurostat, Taxation trends in the EU 2009.

The economic structure of taxes (taxes on consumption, labour and capital) also shows significant differences between European countries. In Slovenia, taxes on consumption account for 34.7% of overall taxes and contributions, which is slightly higher than the EU average (33.6%), whereas the share of taxes on labour, at 51.5%, is well above the EU average (45.2%). The share of taxes on capital is low and, at 13.8%, is at only two thirds of the EU average (21.3%).

The fact that Slovenia has a high burden on consumption and labour is also evident from the implicit tax rates on consumption and labour, which

³¹ Countries with a low share of direct taxes include mostly the less developed Member States, which have lower personal and corporate income tax rates. Some even have systems with a flat tax rate.

Figure 17: Economic structure of taxes and social security contributions in EU Member States, 2007



Source: Eurostat, Taxation trends in the EU 2009.

were above the EU average³² in 2007. Between 2000 and 2007 the *implicit tax rate on consumption*³³ rose slightly, to 24.1%, exceeding the EU-27 average of 22.2%. The rise occurred in 2002, when the standard and reduced VAT rates were increased. After 2002, the implicit tax rate gradually dropped, but then it edged up in 2006 and 2007. The *implicit tax rate on labour*³⁴ dropped after 1996, when social security contributions were reduced, whereupon it stabilised at about 37.5%. In 2007, it fell to 36.9%, but that was still above the EU-27 average of 34.4%. The *implicit tax rate on capital* was not calculated, but the low share of taxes on capital in the economic structure of taxes suggests that it is significantly below the EU average.

There are considerable differences between EU Member States in the amount of individual types of taxes that they collect as a share of GDP, which is attributed to differences between tax systems. Income tax revenue measured as a share of GDP is below the EU average in Slovenia. In 2007, it accounted for 5.7% of GDP (EU average: 9.4% of GDP). Like most other EU countries Slovenia taxes personal income with a progressive tax scale, however since 2006 a dual system has been in place: all capital gains are taxed at a single, lower rate and exempt from the progressive taxation system. After 2006, **corporate income tax revenue** first jumped above and then dipped below the EU average (3% of GDP).

³² EU countries with above-average development have the highest implicit tax rates on consumption.

³³ The *implicit tax rate on consumption* is defined as the ratio between taxes on consumption and final household consumption in the country using the methodology of national accounts.

³⁴ The *implicit tax rate on labour* is defined as the ratio between taxes in labour and compensation of employees based on the national accounts methodology, increased by the payroll tax.

As a result of the 2007 tax reform, which cut corporate income tax rates (from 25% in 2006 to 23% in 2007 and gradually to 20% by 2010) and severely restricted tax breaks, corporate income tax revenue rose to 3.4%, but then dropped to 2.5% in 2008 as the economic slowdown eroded the tax bases (revenue), while at the same time the tax rate dropped and tax breaks increased. **Value added tax revenue**, at 8.5% of GDP in 2007, was above the EU average (7.1% of GDP). Only six EU countries had higher VAT revenue as a share of GDP than Slovenia. All Member States except Denmark and Slovakia levy the standard VAT rate as well as the reduced rate for special types of consumption.

3.1.3. Structural changes of tax systems

In the EU, tax systems are generally being reformed towards providing better support of competitiveness and other policies, notably in the labour market. The present-day challenges associated with the consequences of the financial crisis and the efforts to mitigate it have set in motion a process of tax changes that is leading to a slow convergence of tax systems. Slower economic growth means smaller tax bases and hence lower tax revenue. One of the challenges of current tax policies in terms of tax revenue is therefore to find alternative and new tax bases in Slovenia (e.g. new environmental taxes, property tax). During and after the crisis, tax policy must focus on raising tax revenue with the lowest feasible tax rates and the broadest possible tax bases.

Within existing tax systems, governments have been looking for new combinations of tax rates and tax sources (e.g. lower rates of contributions coupled with higher top personal income tax rates). The tendency lately has been to raise indirect taxes. Direct taxes (the basis of direct taxes are income and profit) are being replaced by indirect taxes – which are much less dependent on the economic cycle – including higher VAT rates and excise duties (e.g. with emphasis on the environment).

Social security contributions are being reduced as a share of the overall burden in an effort to boost competitiveness and keep labour costs low. A high burden on labour, combined with cash assistance systems and problems in the labour market, represents a challenge that has spurred governments to seek taxes which work better in addressing labour market problems. Equity of the tax system and a broad social consensus are key aspects in this process. Some countries with developed welfare systems and consequently high social security contributions are replacing a part of the funding of social security with higher taxes.

Tax competition between Member States for a “mobile tax base” is a major challenge in the EU. In their desire to attract foreign capital, countries have cut corporate income tax rates, increasing the pressure on non-mobile

tax bases. In recent years, therefore, there has been a significant convergence of corporate income taxes. In order to protect mobile tax bases, Slovenia became one of the countries to introduce a dual tax system where individual sources of personal income are treated differently.

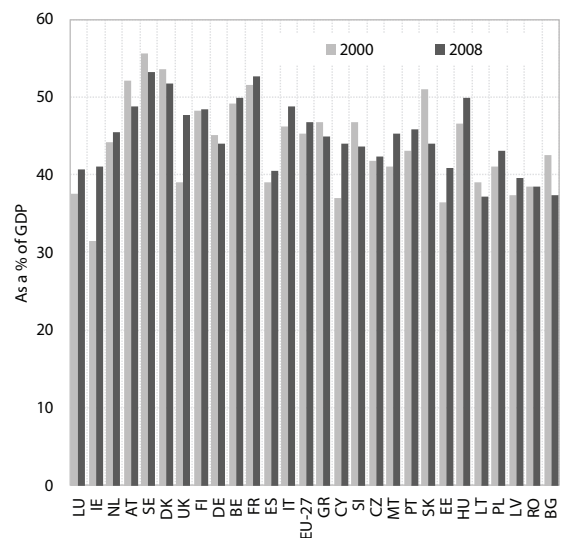
Property taxes, on the other hand, have been losing ground in the EU in recent years. Indeed, there is even a tendency to abolish them, which for example has been done in Sweden, Spain, Austria and Denmark.

3.2. Analysis of expenditure structure

3.2.1. Changes in general government expenditure

General government expenditure as a share of GDP dropped by 4.3 p.p. in Slovenia in the period 2000–2007, but rose 1.2 p.p. in 2008. Recommendations by experts and the European Commission to reduce general government expenditure in order to boost economic growth were taken up by the majority of EU-27 countries in the period 2000–2007. Nevertheless, in 2008 expenditure as a share of GDP swelled in all but four Member States. The rise in expenditure in 2008 is to a large extent attributed to the beginning of the financial crisis and recession, but in Slovenia measures to help the poorest cope with high inflation also played a part.

Figure 18: General government expenditure, as a % of GDP



Source: Government expenditure by function (COFOG). Available at: <http://epp.eurostat.ec.europa.eu>.

Note: Countries are listed left to right in descending order of per capita GDP in PPS in 2008.

General government expenditure as a share of GDP is below the EU-27 average in Slovenia, and only nine Member States had lower expenditure than Slovenia in 2008. The main reason for the shrinking expenditure in the period 2000–2007 was that GDP growth outpaced spending and spending on automatic stabilisers (unemployment benefits and transfers to the poorest) was lower. Except in social protection, there were no major systemic changes that would have reduced expenditure. The main reason for the rise in 2008 was the fact that expenditure was not adjusted to the change in GDP (negative growth), which did not drop drastically until the last quarter. Additionally, spending on social protection in particular edged up.

The financial crisis and the recession are also affecting general government expenditure in 2009. Expenditure on social protection (social transfers to the unemployed, social assistance to the poorest) and stimulus spending are increasing, whereas spending on all functions of intermediate consumption is dropping. The rise in actual expenditure is coupled with higher potential expenditure for tackling the financial crisis and the recession (various forms of borrowing with state guarantees), which will be shouldered by future generations. Some other reasons why expenditure is rising are explained in greater detail in the next section.

3.2.2. Structure of general government expenditure (by function) in terms of productivity of spending

In Slovenia the decrease in general government expenditure as a share of GDP in the period 2000–2007 (by 4.3 p.p.) was achieved mainly with the reduction of productive expenditure³⁵ (by 2.3 p.p.), but social protection expenditure (by 1.8 p.p.) and non-productive expenditure excluding social protection expenditure³⁶ dropped as well (by 0.2 p.p.).³⁷

The share of productive expenditure in Slovenia dropped in the period 2000–2007. Having been at 20% of GDP in 2000, it fell below the EU-27 average by 2007; only eight Member States have lower shares than Slovenia. The relative expenditure on productive functions actually declined only in health and education, where intermediate consumption was scaled back. Slower growth in compensation of employees in the 2000–2007 period extended into the last quarter of

2008, when corrections to wage ratios led to significantly higher compensation of employees, especially in health. We estimate that this also increased health expenditure as a share of GDP. In economic affairs, meanwhile, expenditure has been displaced by borrowing with state guarantees as a source of money for transfers, and local governments were allowed to borrow more to carry out projects. This means that future generations may have to carry the burden of the present potential liabilities of the general government.

Social protection expenditure³⁸ as a share of GDP, which is classified as non-productive, shrank by 1.8 p.p. in the period 2000–2007 and is well below the EU-27 average. The relative drop in expenditure between 2000 and 2007 was underpinned by the effects of pension reform and the introduction of a single mechanism for the adjustment of social transfers to inflation in 2007. We estimate that in 2008 relative social protection expenditure rose due to the introduction of a twice-a-year adjustment of transfers, high valorisation of pensions (pensions are tied to wages, which grew faster than productivity), the payment of a one-off pension allowance and growth in other benefits (e.g. child benefits). Special measures to mitigate the effects of the economic crisis, which are targeted at the swelling ranks of the unemployed and at the poorest, continue to increase relative social protection expenditure in 2009.

As a share of GDP, other non-productive expenditure (excluding social protection) shrank by 0.2 p.p. in the period 2000–2007 and is slightly below the EU-27 average. In this expenditure group it is worth mentioning spending on general public services: it did drop, largely as a result of saving on intermediate consumption, but it is still high compared to other EU-27 countries. It is estimated that, when wage disparities were resolved in 2008, compensation of employees and, consequently, expenditure on general public services rose. It therefore makes sense to embark on a reorganisation that would reduce the size of and expenditure on public services.

3.2.3. Structure of general government expenditure (economic classification) in terms of productivity of spending

Expenditure on gross investment grants, which is productive according to the economic classification, is above the EU-27 average in Slovenia and rose 0.5 p.p. as a share of GDP in the period 2000–2007. However, the structure of this expenditure is less favourable, as investment for productive purposes has been shrinking (2000: 50.2%; 2007: 49.5%). Expenditure on gross investment grants as a share of GDP also depends on how efficient the drawing of EU funds is, as regional and

³⁵ Productive expenditure includes expenditure on economic affairs, education, health, public order and safety, and environmental protection.

³⁶ Non-productive expenditure comprises spending on public services, defence, housing and community amenities, and expenditure on recreation, culture and religion, as well as social protection expenditure, which is grouped separately.

³⁷ The terminology is from the SORS release General government expenditure by function. Available at <http://www.stat.si>.

³⁸ This group includes expenditure on sickness and disability, old age, survivors, family and children, unemployment and housing.

cohesion policy funds are largely earmarked for gross investment grants and capital transfers.

As for other key expenditure groups, Slovenia's expenditure relative to GDP is above the EU-27 average in compensation of employees and in subsidies, but expenditure on intermediate and final consumption, and capital transfers is below the average. The economic classification, like the classification by function, clearly shows a need to change the structure of general government expenditure. Public services need to be reorganised to reduce the relative expenditure on compensation of employees, and some programmes which have been ongoing for over a decade (e.g. the closure of coal mines) ought to be phased out to reduce subsidies. At the same time, it would be reasonable to increase gross investment grants and capital transfers for programmes which have a productive impact on economic growth.

3.2.4. Structural changes in general government expenditure

General government expenditure as a share of GDP is lower than in the majority of EU-27 countries, and there are three reasons for the drop in the 2000–2008 period. Firstly, expenditure growth did not keep pace with rapid GDP growth. Secondly, some liabilities were deferred (restrained wage growth) and were not incurred until the wage reform and resolution of wage disparities which led to soaring compensation of employees in the final quarter of 2008. Thirdly, motorway construction is financed with borrowing with state guarantees instead of general government spending as before, and municipalities are allowed to increase their debt burdens; the potential liabilities have thus been carried over from the present to future generations.

The structure of general government expenditure clearly shows that Slovenia has not restructured spending towards increasing productive expenditure and reducing total expenditure. Expenditure did drop significantly in the 2000–2007 period, but most of the reduction came from cuts in productive expenditure, which runs contrary not only to the strategic priorities laid out in the Strategy of Slovenia's Development but also to trends in the EU-27, in particular in countries which have the highest per capita GDP in PPS. Developmental activities were nevertheless being carried out, but with a deferral of financing: current compensation of employees, in particular in healthcare, rose as a result of the wage reform, and the bill for motorway construction and municipal development projects will be paid by future generations.

Expenditure rose additionally in 2008 due to high inflation and the financial and economic crisis, and continues to increase even faster in 2009. The recession is having a strong impact on the size and structure

of expenditure in 2009. Actual expenditure on social protection (social transfers to the unemployed, social assistance to the poorest) and stimulus spending are increasing, whereas expenditure on all types of intermediate consumption in particular is dropping. The rise in actual expenditure is coupled with higher potential expenditure for coping with the financial crisis and the recession, which is implemented through various forms of borrowing with state guarantees.

Slovenia needs a far-reaching overhaul of general government expenditure if it is to achieve its development goals. Structural changes had been laid out in the 2005 Strategy of Slovenia's Development and the present financial crisis is lending increasing urgency to changes designed to improve the flexibility, productivity and efficiency of spending. This can only be achieved by selecting efficient spending programmes that will underpin balanced development (economic growth, welfare state and environmental protection) and ensure efficient drawing of available EU funds.

Structural changes in expenditure and other instruments of public finance are also essential from the long-term perspective. The ageing of the population and increasing longevity call for structural changes to public spending to meet the growing demand for health services, long-term care and social security. At the same time, future generations face the prospect of becoming increasingly weighed down by public debt, as investment is increasingly financed with borrowing rather than expenditure (motorway construction, the planned construction of railways), and measures taken to address the financial and economic crisis.

4. Key findings and recommendations

In a financial and economic crisis, a counter-cyclical fiscal policy is a vital stabilising instrument of economic policy. However, its scope is limited.

As the financial and economic crisis deepened, tremendous pressure built up on public finances, which accelerated the widening of the gap between expenditure and revenue in 2009. As a result, the general government deficit will surge this year, to more than 5% of GDP. The rapid deterioration of general government balances is partially a consequence of the economic slowdown and the resulting impact of automatic stabilisers, but also an upshot of fiscal policy measures taken this year and in the years before that. In the past several years high revenue from taxes and contributions had made it possible to systemically cut certain tax sources without there being a tangible effect on the fiscal position. However, the systemic scale-back of sources was not matched by expenditure-side measures: in the years when the deficit was shrinking, expenditure did not undergo the much needed restructuring that would have accelerated the reduction of overall general government spending. This year and next, fiscal policy will be expansionary, which, given the economic slowdown, will give it a counter-cyclical direction. The expansiveness is largely a consequence of the effect of automatic stabilisers, the growth in certain statutory expenditure and, to a lesser extent, discretionary counter-cyclical measures. This means that even though the trajectory of fiscal policy is correct, it can only form a part of the reaction to the current circumstances: given that revenue and expenditure are structurally unbalanced, and taking into account the projected increase in general government debt and deficit, the scope for anti-crisis measures is relatively limited since medium- and long-term risks to the stability of public finances are increasing.

In the coming years, deficit reduction will depend on the pace of revival of economic activity and the associated impact of automatic stabilisers, the phasing out of temporary crisis measures and, to a large extent, structural reforms. The deficit generated by the mismatch between revenue- and expenditure-side measures remains a challenge in public finance. Even after the expenditure associated with the economic crisis gradually drops and revenue rises as the economy revives, the structure and scope of expenditure in Slovenia will continue to put pressure on public finances and generate a substantial mid-term deficit given the current revenue system. Considering the results of analysis of the scope and structure of public expenditure and revenue, it is uncertain to what extent a balance between expenditure and revenue can be restored just by curbing expenditure. On the expenditure side it is crucial to use a new approach that will redefine the scope of public services and transfers that the state can and must provide, and restructure the distribution of

liabilities and the funding thereof between the state, individuals and social protection systems. At the same time it is no longer feasible to avoid increasing and restructuring the sources of revenue, where it will be necessary to take into account the need to improve the competitive ability of the Slovenian economy and achieve other development goals.

On the expenditure side, first steps have been taken towards the drafting of a development-based budget, which will be applied in budgeting for 2010–2011.

According to plans, budget planning will be extended from two to four years, but the budgets for the last two years will be merely indicative. The change also involves expenditure planning, which will be policy-based. This will ensure: (i) the introduction of a fiscal rule based on available funds for expenditure which may not increase in the budget adoption phase; (ii) the consideration of national development priorities defined by spending programmes; (iii) the reduction and elimination of insufficiently development-oriented, expensive and inefficient spending programmes. Effectiveness will be verified with a system for monitoring the effects by policy and spending programme. The system will be devised so as to gradually balance expenditure as well as other instruments of public finance (tax relief, loans, borrowing, guarantees, etc.) with which the government implements policies but where it currently redistributes the burdens or carries them over to future generations. A system conceived this way will actuate gradual and urgently needed systemic changes in the provision of public services and transfer payment rights.

On the revenue side, the creation of a stable and effective tax system that will provide sufficient tax revenue remains a challenge.

But this is also an opportunity to do away with ineffective tax measures (e.g. various forms of tax relief) which are not producing the desired results. After the crisis ends, higher economic growth will boost tax revenue, but all structural problems will remain. In the future the principal way to raise tax capacity will be by expanding the tax bases. It is also recommended to change the tax bases, preferably with changes that have the least distorting effect on the economic system, for example with property taxes, environmental taxes and taxation of consumption. Having higher indirect taxes (taxes on consumption) coupled with lower direct taxes, which are more susceptible to economic cycles, is also the trend in modern tax systems. Personal and corporate income taxes, the most important direct taxes, have already been cut, and indirect taxes were scaled back with the abolition of the payroll tax. Direct taxes can thus be increased either by expanding the tax base or by raising tax rates. Since the share of social security contributions in the tax structure is high, transposing a part of social security contributions to general taxes would also be an appropriate solution. Another key challenge is consistent implementation of the existing tax system in order to crack down on tax evasion. This would raise tax revenues and make the tax system more equitable for taxpayers..

5. Analytical supplement to Chapter 3

5.1. Analysis of revenue structure

5.1.1. Overall burden of taxes and social security contributions in EU countries

In Slovenia the overall burden of taxes and social security contributions³⁹ as a share of GDP is slightly below the EU average. In 2007, it stood at 38.2% of GDP in Slovenia, 39.8% of GDP in the EU-27 and 40.4% of GDP in the EA-16, according to comparable data. Over time the macroeconomic environment, with its fluctuating economic activity, current economic policy measures and tax changes, alters the overall burden of taxes and social security contributions as well as their structure. Many changes to tax systems were made when Member States, including Slovenia, were joining the European Union, as they had to adapt their tax systems to European standards in the accession process.

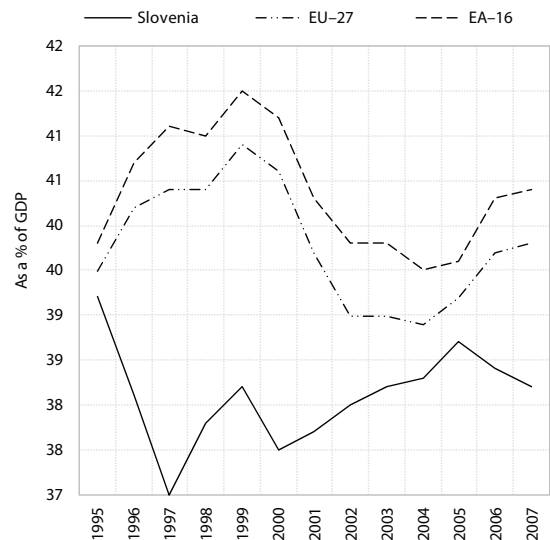
In Slovenia the overall burden of taxes and social security contributions was shrinking in the period 1995–2000. Between 2000 and 2005 it expanded but now is dropping again. In the mid-1990s, the Slovenian tax system was characterised by high social security contribution rates, which hampered competitiveness by keeping labour costs high. To improve the situation, in 1996 and 1997 the rates of employer social security contributions were gradually cut and replaced by the payroll tax. Being progressive, it taxed higher wages more and reduced the burden on lower wages. In 2005, the burden increased in Slovenia as well as in the EU on average. Thereafter, the average burden started increasing in the EU-27⁴⁰ but it dropped in Slovenia as a result of tax reform that involved a phase-out of the payroll tax and reform of personal and corporate income taxes.

The differences between Member States in the overall burden of taxes and social security contributions are substantial. In 2007, Denmark had the highest burden (48.7% of GDP) and Romania the lowest (29.4% of GDP). The difference between the highest and the

³⁹ Data on the burden of taxes and social security contributions need to be reported by the EU members to the European Commission in precisely prescribed standard tables: they have to be identical to the data in the Report on general government debt and deficit which Member States must send to the European Commission twice a year for the purposes of monitoring the general government deficit with the excessive deficit procedure.

⁴⁰ In this period, countries with above-average development in particular reduced the burden; the increase in the average EU burden was caused by countries which had breached the 3% of GDP deficit ceiling and raised taxes in order to bring the deficit below the reference threshold.

Figure 19: Overall taxes and social security contributions, as a % of GDP, 1995–2007



Source: Eurostat, Taxation trends in the EU 2009.

lowest burden was thus a high 19.3 p.p., but it has been shrinking since 2000.

In 2007, the burden of taxes and social security contributions in Slovenia was marginally lower than in the Netherlands (38.9% of GDP); 15 countries had a lower burden, of which seven had above average per capita GDP in PPS.⁴¹ Some of the countries with the highest per capita GDP in PPS have low overall burdens (Ireland 31.2%, Luxembourg 36.7%). However, low burdens are typically registered in countries with low and the lowest per capita GDP in PPS, where they can even be below 30% (Latvia, Slovakia and Romania).

5.1.2. Tax structure in EU countries: indirect taxes, direct taxes and social security contributions – the three tax pillars

Comparative analyses of tax systems are typically made using analyses of the structure of taxes and contributions broken down into indirect taxes, direct taxes and social security contributions. Direct taxes comprise current personal and corporate taxes on income and property, and taxes on capital. Indirect taxes are taxes related to production and imports; they are payable whether or not profits are made. Social security contributions are payments by employers and employees into social security funds.

There are considerable differences in tax structure between EU Member States. In the old Member States

⁴¹ For the purposes of the research, EU Member States were classified by order of per capita GDP in PPS in 2008 (SORS, First release, 26.06.2009), which is the measure of development in the EU.

the proportions of direct taxes, indirect taxes and social security contributions are roughly equal. New Member States, on the other hand, tend to have a lower share of direct taxes and a higher share of indirect taxes.

In Slovenia the share of indirect taxes in total taxes and social security contributions is slightly above the EU-27 and EA-16 averages (2007: Slovenia: 39.2%, EU-27: 38.4%, EA-16: 37.1%). The majority of countries with an above-average share of indirect taxes have low per capita GDP in PPS. Most of them are new Member States (Bulgaria, Romania, Cyprus, Malta, Estonia and Poland); Ireland is the only old Member State in this group.

In Slovenia the share of direct taxes in total taxes is low, well below the EU average (2007: Slovenia: 24.9%, EU-27: 32.3%, EA-16: 32.5%). Indeed, Slovenia has one of the lowest shares of direct taxes in the EU (behind Estonia, Romania, Bulgaria and Slovakia). Countries with a low share of direct taxes include mostly the less developed Member States which have lower personal and corporate income tax rates. Some have systems with a flat tax rate. Among the countries with the highest per capita GDP in PPS, only Denmark has a share of direct taxes that is well above the EU average (61.2%).

After 2007, the share of direct taxes will keep dropping in Slovenia as the effects of the 2007 tax reform will be greatest in personal and corporate income taxes, which represent the bulk of Slovenia's direct taxes.

The share of social security contributions is also above the EU average (2007: Slovenia: 36.0%, EU-27: 29.5%). In 2007, only five countries had a higher structural share of social security contributions than Slovenia: Czech Republic (44.2%), Slovakia (39.8%), Germany (38.5%), France and Greece. Denmark has by far the lowest share of social security contributions (2.0%), as general taxes are the main source of social security funds there. Ireland (15.9%), Malta (17.1%) and the UK and Cyprus (18.4%) also have very low shares of social security contributions. Different national insurance systems are the main reason behind the inter-country differences in the structural share of social security contributions. The shares of social security contributions are high in Central European countries, which have a long tradition of national insurance systems, and in Scandinavian countries, but lower in Anglo-Saxon and Mediterranean countries.

Slovenia also diverges from the EU average in terms of the distribution of employers' and employees' contributions: The share of employers' contributions in total contributions stands at 42.7%, compared to the EU-27 average of nearly 65%. Only employers in the Netherlands (41.1%) and Denmark (which does not have a system of social security contributions) pay less in contributions than employers in Slovenia. The original 50:50 ratio between employees' and employers' contributions collapsed with the introduction of the payroll tax, which replaced a portion of employers'

contributions. As a result, the share of employers' contributions dropped to 42.7% and the share of employees' contributions rose to 57.3%.

5.1.3. Taxes and contributions by economic function in the EU

In order to analyse the impact of the tax system on the economy, it is necessary to classify taxes and contributions by economic function: taxes on consumption, taxes on labour and taxes on capital.⁴²

A classification of taxes into three economic functions and the framework of national accounts make it possible to define potentially taxable bases and calculate the implicit tax rates on consumption, labour and capital. This provides a more relevant picture of the burden placed on production factors by taxes and contributions.

In 2007, taxes on consumption⁴³ accounted for 34.7% of overall taxes and contributions, which is slightly higher than the EU average (33.6%). A high share of taxes on consumption is characteristic of Member States with the lowest per capita GDP in PPS. Bulgaria had the highest share, at 53.7%. Among the old Member States only Ireland and Greece had higher shares of taxes on consumption than Slovenia, whereas the other developed European countries have below-average shares of taxes on consumption.

The share of taxes on labour⁴⁴ in Slovenia (51.5%) is substantially above the EU-27 average (45.2%). In only six countries do taxes on labour account for a larger share of overall taxes and social security contributions than in Slovenia: Sweden (58.6%), Austria (55.2%), Germany (54.6%), Belgium (52.2%), Finland (52.0%) and France (51.8%).

⁴² The division of taxes into three economic categories is based on the classification of taxes in the methodology of national accounts using pre-defined basic rules. Some borderline taxes cannot be unequivocally classified in one of the categories, so approximations need to be used. The most complex and therefore the hardest task is to place certain types of burdens either among taxes on consumption or taxes on capital. In order to correctly determine their economic function and categorise them, taxes need to be very precisely analysed. When such analysis is not possible, classification into three economic functions is difficult. Moreover, every country's tax system has specifics which need to be considered in the analysis.

⁴³ *Taxes on consumption* are defined as taxes on transactions between businesses and final consumers, regardless of whether or not the taxpayer generates any income. According to the ESA-95 classification, taxes on consumption in Slovenia include the value added tax, import duties, customs, other taxes on imports, excise duties, agricultural duties on imports, customs and excise duties, tax on motor vehicles, gaming tax, tax on insurance services, municipal taxes and environmental taxes and duties.

⁴⁴ *Taxes on labour* include all taxes directly related to wages that are payable by employees and employers, including compulsory social security contributions.

In 2007, the share of taxes on capital⁴⁵ stood at 13.8%, which is less than two thirds of the EU-27 average (21.3%). Only Hungary, Latvia, Estonia and Lithuania have lower shares than Slovenia. Among the old Member States with the highest per capita GDP in PPS, Sweden (15,2%), Austria (17%) and Denmark (16%) have similar shares of taxes on capital in total taxes and contributions as Slovenia.

5.1.4. Implicit tax rates in the EU⁴⁶

The comparison of implicit tax rates is even more useful than the economic structure of taxes for the purposes of economic analysis of tax systems: within the framework of national accounts, and using the same ESA-95 methodology, taxes and contributions are compared by identically defined tax bases.

The implicit tax rate on consumption is defined as the ratio between taxes on consumption and final household consumption in the country using the methodology of national accounts.

For Slovenia the implicit tax rate on consumption has been calculated at 24.1%, which is above the EU-27 average (22.2%). The figure is slightly higher than in 2000; the rise occurred in 2002, when the standard and reduced VAT rates were raised, whereupon it gradually dropped and finally stabilised in the last two years.

In the EU, countries with above-average development have the highest implicit tax rates on consumption. In 2007, the highest rate was recorded in Denmark (33.7%). The United Kingdom and Germany stand out with very low implicit tax rates on consumption that are below 20%. Countries with similar per capita GDP in PPS than Slovenia have lower implicit tax rates on consumption. On the other hand, among the countries with low per capita GDP in PPS, Hungary (27.1%) and Bulgaria (25.4%) have higher rates than Slovenia.

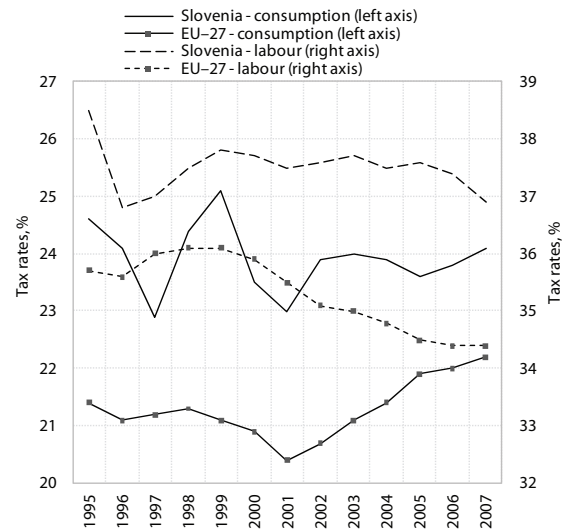
The implicit tax rate on labour is defined as the ratio between taxes on labour and compensation of employees based on the national accounts methodology, increased by the payroll tax.

The implicit tax rate on labour stood at 36.9% in Slovenia in 2007, exceeding the EU-27 average of 34.4%. Ten EU countries have a higher implicit tax rate on labour than Slovenia: five with above-average per capita GDP in PPS, foremost among them Italy (44%) and Sweden (43.1%), as well as the Czech Republic (41.4%)

⁴⁵ The category *taxes on capital* includes taxes paid on corporate income and capital, a portion of the income tax levied on household capital gains (annuities, dividends, other income from property), capital gains tax, property tax (buildings, second homes, boats), taxes on inheritance, gifts and real estate transactions, tax for the use of building land, etc.

⁴⁶ Calculation by the European Commission.

Figure 20: Implicit tax rates on consumption and labour, as a % of the base



Source: Eurostat, Taxation trends in the EU 2009.

and Hungary (41.2%) among the new Member States. Countries with low per capita GDP in PPS tend to have lower implicit tax rates on labour. The lowest rates, below 30%, have been reported in Ireland (25.7%), the United Kingdom (26.21%), Cyprus (24%) and Malta (20.1%).

Since 2000, the implicit tax rate on labour dropped on average in the EU, as Member States, seeking to boost their international competitiveness, reduced the burden on wages. In Slovenia the implicit tax rate on labour started dropping after 1996, when social security contributions were reduced, whereupon it stabilised.

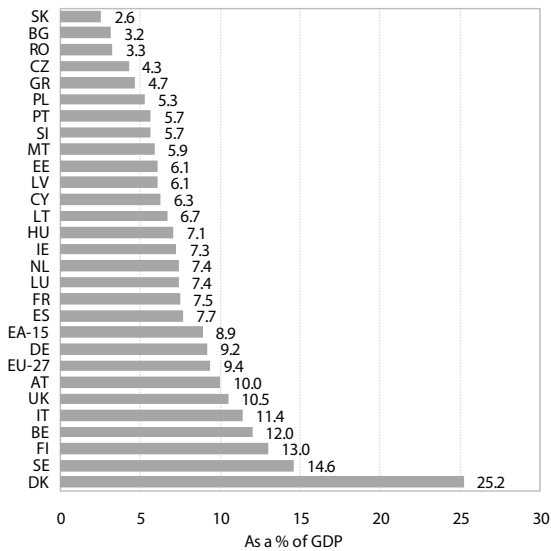
The implicit tax rate on capital has not been calculated yet due to a lack of data and lingering questions over the definition of a comparable basis in Slovenia and in several other, mostly new, Member States.

5.1.5. Overview of selected key taxes in EU Member States

Income tax in EU countries

Income tax revenue measured as a share of GDP is below the EU average in Slovenia. In 2007, it accounted for 5.7% of GDP (EU-27 average: 9.4% of GDP). Some new Member States with lower per capita GDP in PPS have lower shares than Slovenia (Slovakia, Bulgaria, Romania, Czech Republic, Poland, Greece), in particular those which introduced a flat tax rate. The highest shares were registered in countries with the highest top marginal income tax rates and the most progressive income taxation: Denmark (25.2% of GDP) and Sweden (14.6% of GDP).

Figure 21: Income tax as a % of GDP in EU countries, 2007



Source: Eurostat, Taxation trends in the EU 2009.

Most Member States tax personal income with progressive rates except the six that have a flat rate (Estonia, Latvia, Lithuania, Slovakia, Bulgaria and Romania). Progressive taxation with three brackets is also used for most types of personal income (except capital gains) by Slovenia, which has a top marginal rate of 41%. In 2006, Slovenia instituted a dual system where all capital gains are taxed with a single, lower rate and exempt from the progressive taxation system. This system significantly reduced the tax burden on capital gains, and all taxpayers (especially those in the top income classes) who generated capital gains have benefited. This tax advantage motivated taxpayers to have a part of their salaries paid in various forms of capital gains in order to avoid progressive taxation and the payment of social security contributions.

Ten Member States which use progressive tax rates have a higher marginal top rate for personal income tax than Slovenia. Denmark (59%) and Sweden (58%) have the highest marginal rates, while the others have top rates of between 42% and 52%. Ireland has the same top rate as Slovenia (41%) and the remaining nine countries

Table 10: Top marginal personal income tax rates in EU countries, 2004 and 2007

Member state	2004	2007
Belgium	Progressive scale, top rate 50%	Progressive scale, top rate 50%
Czech Republic	Progressive scale, top rate 32%	Progressive scale, top rate 32%
Denmark	Progressive scale, top rate 59%	Progressive scale, top rate 59%
Germany	Progressive scale, top rate 42% plus 5.5% contribution	Progressive scale, top rate 47.5%
Estonia	Flat tax rate 24%	Flat tax rate 22%
Greece	Progressive scale, top rate 40%	Progressive scale, top rate 40%
Spain	Progressive scale, top rate 45%	Progressive scale, top rate 43%
France	Progressive scale, top rate 48.09%	Progressive scale, top rate 40%
Ireland	Progressive scale, top rate 42%	Progressive scale, top rate 41%
Italy	Progressive scale, top rate 43%	Progressive scale, top rate 43%
Cyprus	Progressive scale, top rate 30%	Progressive scale, top rate 30%
Latvia	Flat tax rate 25%	Flat tax rate 25%
Lithuania	Flat tax rate 33%	Flat tax rate 27%
Luxembourg	Progressive scale, top rate 38.95%	Progressive scale, top rate 38.95%
Hungary	Progressive scale, top rate 38%	Progressive scale, top rate 40%
Malta	Progressive scale, top rate 35%	Progressive scale, top rate 35%
Netherlands	Progressive scale, top rate 52%	Progressive scale, top rate 52%
Austria	Progressive scale, top rate 50%	Progressive scale, top rate 50%
Poland	Progressive scale, top rate 40%	Progressive scale, top rate 40%
Portugal	Progressive scale, top rate 40%	Progressive scale, top rate 42%
Slovenia	Progressive scale, top rate 50%	Progressive scale, top rate 41%
Slovakia	Flat tax rate 19%	Flat tax rate 19%
Finland	Progressive scale, top rate 33.5% + local tax and church tax	Progressive scale, top rate 50.5%
Sweden	Progressive scale, top rates 53–58%	Progressive scale, top rates 53–58% (56.6%)
United Kingdom	Progressive scale, top rate 40%	Progressive scale, top rate 40%
Bulgaria		24%
Romania		16%

have lower rates. Cyprus has the lowest marginal top rate on a progressive scale (30%).

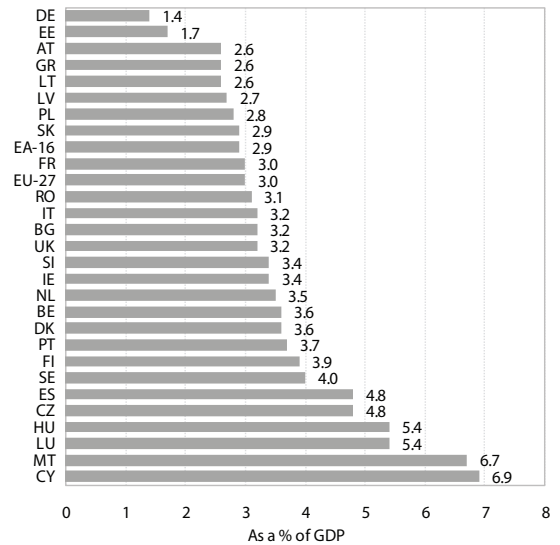
Slovenia cut the top tax rate from 50% to 41% with the 2007 tax reform. Other countries have also altered the progressivity of income taxation: in 2007 the top rates were cut compared to 2004 by Spain, France and Ireland, while Germany, Hungary, Portugal and Finland increased it.

Corporate income tax in EU countries

Slovenia's corporate income tax revenue measured as a share of GDP was on par with the EU average in 2006 (3% of GDP), whereupon it first rose above and then dropped below the average. As a result of the 2007 tax reform, which cut the top corporate income tax rate (from 25% in 2006 to 23% in 2007 and gradually to 20% by 2010) and substantially restricted tax relief, income tax revenue rose to 3.4% of GDP. In 2008, partially due to the looming crisis, tax relief was expanded again, which, coupled with the reduced tax rate and a moderate slowdown in economic activity, cut revenue to 2.5% of GDP.

Corporate income tax revenues differ substantially across the EU. Countries with above-average per capita GDP in PPS typically collect more revenue, between 4% and 5% of GDP. In 2007, corporate income tax revenue was highest in Cyprus (6.9% of GDP), Malta (6.7% of GDP), and Luxembourg and Hungary (5.4% of GDP). Countries with lower per capita GDP in PPS (new Member States Slovakia, Bulgaria, Poland, Lithuania, Hungary and Estonia) have lower shares, in particular those that introduced a flat tax rate in order to attract foreign capital or cut the statutory rate substantially. Germany is also among the countries with a low share of

Figure 23: Corporate income tax as a % of GDP, 2007



Vir: Eurostat, Taxation trends in the EU 2009.

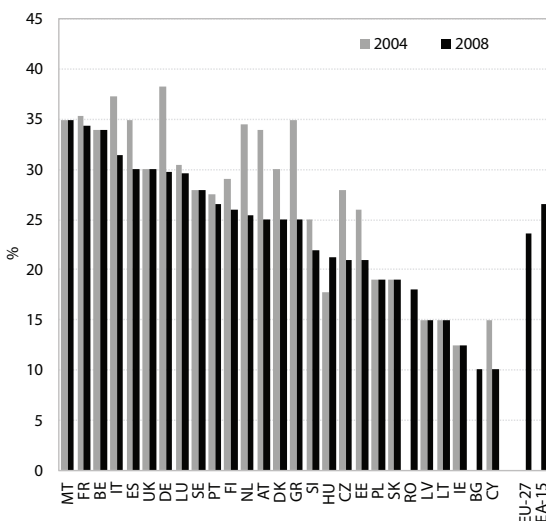
corporate tax revenue; indeed, at 1.4% of GDP its share is the lowest in the EU. Since 2004, 15 Member States have cut corporate income tax rates.

Value added tax in EU countries

Value added tax (VAT) revenue in Slovenia, at 8.5% of GDP, was above the EU average (7.1% of GDP) in 2007.

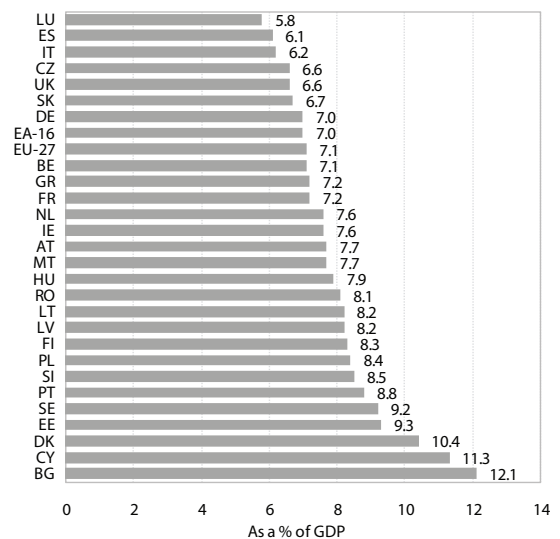
Six EU countries had higher VAT revenue as a share of GDP than Slovenia. They included countries with high per capita GDP in PPS such as Denmark and Sweden, as well as countries with lower per capita GDP in PPS like Poland, Estonia, Bulgaria and Cyprus. Twenty EU countries had

Figure 22: Statutory corporate income tax rates in EU countries, 2004 and 2008



Source: Eurostat, Taxation trends in the EU 2009.

Figure 24: Value added tax as a % of GDP in EU countries, 2007



Source: Eurostat, Taxation trends in the EU 2009.

Table 11: Standard and reduced VAT rates in EU countries, 2007

Country	Standard rate	Reduced rate	Further reduced rate
Belgium	21	6/12	
Bulgaria	20	7	
Czech Rep.	19	9	
Denmark	25		
Germany	19	7	
Estonia	18	5	
Ireland	21.5	13.5	4.8
Greece	19	9	4.5
Spain	16	7	4
France	19.6	5.5	2.1
Italy	20	10	4
Cyprus	15	5/8	
Latvia	21	10	
Lithuania	19	5/9	
Luxembourg	15	6/12	3
Hungary	20	5	
Malta	18	5	
Netherlands	19	6	
Austria	20	10	
Poland	22	7	3
Portugal	20	5/12	
Romania	19	9	
SLOVENIA	20	8.5	
Slovakia	19	10	
Finland	22	8/17	
Sweden	25	6/12	
U. Kingdom	15	5	

Source: Eurostat, Taxation trends in the EU 2009.

lower VAT revenue than Slovenia, Luxembourg having the lowest (5.8% of GDP).

All Member States except Denmark and Slovakia levy a standard VAT rate as well as a reduced rate for special types of consumption. Denmark and Sweden have the highest VAT rate (25%). Seven EU countries have a higher standard VAT rate than Slovenia, four have the same 20% rate (neighbouring Austria, Italy and Hungary, as well as Bulgaria), and the standard rates in the remaining 15 are lower. In 2007, the standard VAT rate was raised in Germany, Ireland, Lithuania and Latvia, and cut in Poland and the United Kingdom. The reduced VAT rate was increased in the Czech Republic and Lithuania, whereas Belgium and Luxembourg added a higher non-standard rate.

5.2. Analysis of revenue structure

5.2.1. Impact of the size of general government expenditure on economic growth

General government expenditure as a share of GDP dropped by 4.3 p.p. in the period 2000–2007, but it rose 1.2 p.p. in 2008. Recommendations⁴⁷ by experts and the European Commission to reduce general government expenditure in order to boost economic growth were taken up by the majority of the EU-27 countries in the period 2000–2007, in particular after 2005. The most significant cuts in expenditure were achieved by Member States with the lowest and most countries with the highest per capita GDP in PPS.⁴⁸ However, only Slovakia and Lithuania (2007) followed the theoretical findings of Tanzi and Schuknecht (2005, p. 7) and reduced expenditure to below 35% of GDP, with six other countries bringing expenditure below 40% of GDP (Aristovnik et al., 2009, p. 28). With expenditure at 42.4% of GDP, Slovenia exceeded both thresholds. But in 2008 expenditure as a share of GDP swelled in all but four Member States. The only exceptions were Germany, the Czech Republic and Bulgaria, which reduced spending, and Austria, where it remained level. In relative terms expenditure increased the most (by over 5 p.p.) in countries with relatively low public spending (Slovakia, Estonia and Ireland). Not a single Member State had expenditure below 35% of GDP in 2008 and only four were under 40% of GDP. The rising expenditure in 2008 is to a large extent attributed to the beginning of the financial crisis and the recession, but in Slovenia measures to help the poorest cope with high inflation also played a part.

General government expenditure as a share of GDP is below the EU-27 average in Slovenia and only nine Member States had lower expenditure

⁴⁷ Many other studies show that a higher share of public spending has a negative impact on economic growth and that over the long term an increase in total expenditure leads to cumulatively slower economic growth: in the long run, a 1% increase in total expenditure reduces economic growth by 3.1% (Romero and Strauch, 2003, p. 22). Tanzi and Schuknecht (2005, p. 7) emphasise that public spending has a falling yield curve: the social benefits disappear when expenditure exceeds the optimal level of around 35% of GDP. Similarly, Rihterič (2001, p. 482) claims that a rise in government spending increases economic growth until it reaches an optimal level, whereupon it weighs down on growth as the effect of taxation and inefficiency of state intervention in the economy are stronger than the productive effect of state investment and aid. When the state's influence exceeds a certain share of total final consumption in a national economy, it stifles business initiative and hampers the flexibility of business.

⁴⁸ For the purposes of this analysis, EU Member States were ranked in the order of per capita GDP in PPS in 2008 (SORS, First release, 26.06.2009), which is the measure of development in the EU.

Table 12: Total general government expenditure, as a % of GDP

Countries by GDP per capita in PPS	2000	2005	2006	2007	2008	2000–2008 (change in p.p.)	GDP/per capita in PPS 2008	GDP 2000–2008 (av. growth)
EU-27	45.2	46.9	46.3	45.7	46.8	+1.6	100	2.2
EU-25	45.3	47.0	46.4	45.8	46.9	+1.6		2.2
EU-15	45.4	47.1	46.6	46.1	n. p.			2.1
GDP/per capita in PPS > 100								
Luxembourg	37.6	41.6	38.6	37.2	40.7	+3.1	253	4.1
Ireland	31.5	33.7	34.0	35.7	41.0	+9.5	140	5.2
Netherland	44.2	44.8	45.6	45.3	45.5	+1.3	135	2.2
Austria	52.1	49.9	49.4	48.7	48.7	-3.4	123	2.3
Sweden	55.6	55.2	54.1	52.5	53.1	-2.5	121	2.6
Denmark	53.6	52.8	51.6	51.0	51.7	-1.9	119	1.5
U. Kingdom	39.1	44.1	44.2	44.0	47.7	+8.6	117	2.5
Finland	48.3	50.3	48.7	47.3	48.4	+0.1	116	3.1
Germany	45.1	46.8	45.3	44.2	43.9	-1.2	116	1.4
Belgium	49.2	52.2	48.5	48.3	49.9	+0.7	115	2.1
France	51.6	53.4	52.7	52.3	52.7	+1.1	107	1.9
Spain	39.1	38.4	38.5	38.8	40.5	+1.4	104	3.3
Italy	46.2	48.2	48.7	47.9	48.7	+2.5	100	1.2
GDP/per capita in PPS < 100								
Greece	46.7	43.3	42.2	44.0	44.9	-1.8	95	4.1
Cyprus	37.0	43.6	43.4	42.9	44.0	+7.0	95	3.7
Slovenia	46.7	45.3	44.6	42.4	43.6	-3.1	90	4.3
Czech Rep.	41.8	45.0	43.8	42.6	42.4	+0.6	80	4.3
Malta	41.0	44.7	43.7	42.6	45.3	+4.3	76	2.2
Portugal	43.1	47.6	46.3	45.8	45.9	+2.8	75	1.3
Slovakia	50.9	38.2	36.9	34.4	43.9	-7.0	72	5.7
Estonia	36.5	34.0	34.2	35.5	40.9	+4.4	67	6.9
Hungary	46.5	50.1	51.9	49.7	49.8	+3.3	63	3.6
Lithuania	39.1	33.3	33.6	34.9	37.2	-1.9	61	7.0
Poland	41.1	43.4	43.8	42.1	43.1	+2.0	57	4.2
Latvia	37.3	35.6	38.2	35.9	39.5	+2.2	56	7.3
Romania	38.5	33.5	35.3	36.6	38.5	0.0	46	5.8
Bulgaria	42.6	39.9	36.5	41.5	37.4	-5.2	40	5.6

Source: Total general government Expenditure; General government. Available at: <http://epp.eurostat.ec.europa.eu>.

Notes: For the purposes of this analysis, EU Member States were ranked in order of per capita GDP in PPS in 2008 (SORS, First release, 26.06.2009), which is the measure of development in the EU. N/A – not available.

in 2008. The shrinking expenditure in the period 2000–2007 was largely the result of rapid GDP growth outpacing spending, and lower spending on automatic stabilisers (unemployment benefits and transfers to the poorest). Except in social protection, there were no major systemic changes that would have reduced expenditure. The main reason for the rise in 2008 was the fact that expenditure was not adjusted to the change in GDP (negative growth), which plunged in the last quarter. Additionally, spending on social protection in particular edged up. Since expenditure is slow to adjust to changes in GDP, it is expected that in 2009 general government expenditure as a share of GDP will continue to rise due to the slowdown in economic

activity and greater spending targeted at ameliorating the consequences of the crisis.

5.2.2. Structure of general government expenditure (by function) in terms of productivity of spending

In Slovenia the decrease in general government expenditure as a share of GDP in the period 2000–2007 (by 4.3 p.p.) was achieved principally with the reduction of productive expenditure (by 2.3 p.p.), but also with cuts to social protection expenditure (by 1.8

p.p.) and non-productive expenditure not including social protection expenditure (by 0.2 p.p.). Productive expenditure⁴⁹ includes expenditure on economic affairs, education, health, public order and safety, and environmental protection. Non-productive expenditure (social protection expenditure is excluded as it is dealt with in a separate group) comprises spending on general public services, defence, housing and community amenities, and expenditure on recreation, culture and religion.

EU Member States with the highest per capita GDP in PPS increased productive expenditure relative to GDP in the 2000–2007 period, but in Slovenia it dropped.

Having been among the highest, at 20% of GDP in 2000, it fell below the EU-27 average by 2007; only eight Member States have lower productive revenue than Slovenia. Spending on economic affairs, which dropped the most (by 1.2% of GDP), was above the EU average in 2007, but more than half the Member States spend more on the economy than Slovenia. The precipitous drop in expenditure occurred in 2004, when borrowing with state guarantees became the main source of funding motorway construction. Education expenditure registered a marked drop in 2007 (it was stable between 2000 and 2006), largely because intermediate consumption grew at a slower nominal rate. However, spending on education is still above the EU-27 average and Slovenia places in the middle of Member States' rankings in this field. Health spending has been dropping since 2001, and by 2007 it had fallen well below the EU average. Only ten Member States have a lower level of health expenditure, the majority of them having among the lowest per capita GDP in PPS in the EU. The relative drop in spending is a consequence of slower nominal growth in compensation of employees and expenditure on intermediate and final consumption. Spending on public order and safety has been relatively stable; it dropped only marginally in the period 2000–2007 and is just below the EU average. Compensation of employees as well as intermediate and final consumption grew slowly in nominal terms. Expenditure on environmental protection has been very low, and flat, since 2000; only Cyprus and Finland spend less on environmental protection, while Romania and Sweden are on par with Slovenia. There was a change in the economic structure of environmental expenditure: the share of subsidies tumbled, whereas the share of gross capital formation, albeit minimal, increased.

⁴⁹ The European Commission classified productive general government expenditure into three indicators. The first indicator comprises expenditure on transport, R&D and education; the second the expenditure under the first indicator plus spending on health; and the third includes the second indicator plus expenditure on public order and safety, and environmental protection (European Commission, 2008, p. 6). Since data on second-level general government expenditure by function (COFOG) are not available for Slovenia and several other Member States, total spending on economic affairs was included instead of just transport. Additionally, R&D expenditure was left out (it is included at the second level in all ten groups of expenditure).

The relative expenditure on productive functions actually fell only in health and education, due to savings in intermediate consumption. Slower growth of compensation of employees in the 2000–2007 period extended until the last quarter of 2008, when corrections to wage ratios led to significantly higher compensation of employees, especially in health, which consequently increased healthcare expenditure as a share of GDP. In economic affairs, meanwhile, general government expenditure has been displaced by borrowing with state guarantees as a source of money for transfers, and local governments were allowed to borrow more to carry out projects. This means that future generations may have

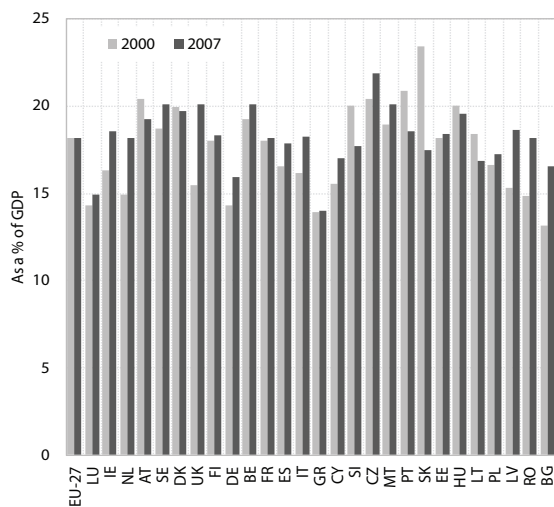
Table 13: Productive expenditure (on economic affairs, education, health, public order and safety, and environmental protection), as a % of GDP

Countries by GDP per capita in PPS	2000	2005	2006	2007	2000–2007 (change in p.p.)
EU-27	N/A	18.1	18.3	18.1	
EU-25	N/A	18.1 (p)	18.3 (p)	18.0 (p)	
EU-15	16.2 (p)	18.2 (p)	18.3 (p)	18.0 (p)	+1.8
GDP/per capita in PPS > 100					
Luxembourg	14.3	16.4	15.6	14.9	+0.6
Ireland	16.3	17.8	17.7	18.5	+2.2
Netherlands	14.9 (p)	16.8 (p)	18.1 (p)	18.1 (p)	+3.2
Austria	20.4	20.0	19.7	19.2	-1.2
Sweden	18.7	20.6	20.2	20.1	+1.4
Denmark	19.9	20.3	19.8	19.7	-0.2
U. Kingdom	15.4	19.1	19.7	20.1	+4.7
Finland	18.0	19.5	19.0	18.3	+0.3
Germany	14.3	16.2	15.8	15.9	+1.6
Belgium	19.2	22.7	20.1	20.1	+0.9
France	18.0	18.5	18.2	18.1	+0.1
Spain	16.5	17.1	17.5	17.8 (p)	+1.3
Italy	16.1	18.1	19.1	18.2	+2.1
GDP/per capita in PPS < 100					
Greece	13.9	14.3	13.7	14.0	+0.1
Cyprus	15.5	17.4	17.5	17.0	+1.5
Slovenia	20.0	18.6	18.3	17.7	-2.3
Czech Rep.	20.4	22.3	22.6	21.8	+1.4
Malta	18.9	21.5	20.8	20.1	-1.2
Portugal	20.8	21.9	20.4	18.5	-2.3
Slovakia	23.4 (p)	15.5 (p)	16.6 (p)	17.4 (p)	-6.0
Estonia	18.1	17.3	18.0	18.4	+0.3
Hungary	N/A	20.0	20.7	19.5	
Lithuania	18.4	16.7	16.8	16.8	-1.6
Poland	N/A	16.6	17.4	17.2	
Latvia	15.3	15.7	17.1	18.6	+3.3
Romania	N/A	14.8	17.4	18.1	
Bulgaria	13.1 (p)	19.0 (p)	16.6 (p)	16.5 (p)	+3.4

Source: Government expenditure by function (COFOG). Available at: <http://epp.eurostat.ec.europa.eu>

Notes: Same as for Table 12; (p): provisional data.

Figure 25: Productive expenditure (on economic affairs, education, health, public order and safety, and environmental protection), as a % of GDP



Source: Government expenditure by function (COFOG). Available at: <http://epp.eurostat.ec.europa.eu>.
Note: Data for the EU-27, Hungary, Poland and Romania are not available for 2000 and are therefore provided for 2005.

to shoulder the burden of present potential liabilities of the state.

Social protection expenditure⁵⁰ as a share of GDP, which is classified as non-productive, shrank by 1.8 p.p. in the period 2000–2007 and is well below the EU-27 average. This expenditure has been decreasing since 2004 in Slovenia and since 2003 in the EU-27, but the drop has been much steeper in Slovenia. Only countries with the lowest per capita GDP in PPS and the richer Spain, United Kingdom and Ireland have a lower level of social protection expenditure than Slovenia. Social benefits excluding social transfers in kind account for 93.6% of the expenditure, a share that remained unchanged between 2000 and 2007.

The relative drop in expenditure between 2000 and 2007 was underpinned by the effects of pension reform and the introduction in 2007 of a single mechanism for the adjustment of social transfers to inflation. It is estimated that in 2008 relative social protection expenditure rose due to the introduction of twice-a-year adjustment of transfers, high valorisation of pensions (pensions are tied to wages, which grew faster than productivity), the payment of a one-off pension allowance and increases in other benefits (e.g. child benefits). Special measures to mitigate the effect of the economic crisis, which are targeted at the swelling ranks of the unemployed and at the poorest, continue to increase relative social protection expenditure in 2009.

⁵⁰ This group includes expenditure on sickness and disability, old age, survivors, family and children, unemployment and housing.

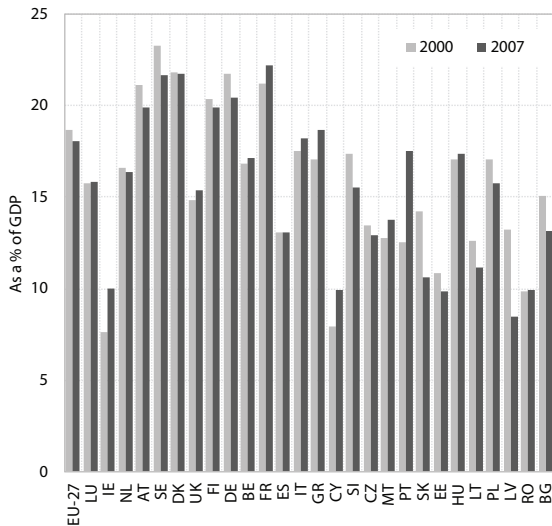
As a share of GDP, other non-productive expenditure (excluding social protection) shrank by 0.2 p.p. in the period 2000–2007 (effectively from 2006) and is slightly below the EU-27 average. There are considerable differences in non-productive expenditure among EU countries and Slovenia places in the middle of the rankings. In the period 2000–2007 there was a significant drop in expenditure on general public services, in particular due to slow nominal growth in spending on intermediate consumption, but it remains above the EU average. Defence spending rose as a result of more funds for compensation of employees and fixed capital formation. Expenditure on housing and community amenities dropped between 2000 and 2007 even though

Table 14: Social protection expenditure, as a % of GDP

Countries by GDP per capita in PPS	2000	2005	2006	2007	2000–07 (change in p.p.)
EU-27	N/A	18.6	18.3	18.0	
EU-25	N/A	18.7 (p)	18.4 (p)	18.1 (p)	
EU-15	18.4 (p)	18.9 (p)	18.5 (p)	18.3 (p)	-0.1
GDP/per capita in PPS > 100					
Luxembourg	15.7	17.4	16.4	15.8	+0.1
Ireland	7.6	9.3	9.7	10.0	+2.4
Netherland	16.6 (p)	16.5 (p)	16.4 (p)	16.3 (p)	-0.3
Austria	21.1	20.6	20.3	19.9	-1.2
Sweden	23.2	23.4	22.7	21.6	-1.6
Denmark	21.8	22.6	22.0	21.7	-0.1
U. Kingdom	14.8	15.8	15.4	15.3	+0.5
Finland	20.3	21.1	20.4	19.9	-0.4
Germany	21.7	22.2	21.4	20.4	-1.3
Belgium	16.8	17.6	17.2	17.1	+0.3
France	21.2	22.3	22.3	22.2	+1.0
Spain	13.0	12.9	12.9	13.0 (p)	0.0
Italy	17.5	18.1	18.1	18.2	+0.7
GDP/per capita in PPS < 100					
Greece	17.0	17.7	17.9	18.6	+1.6
Cyprus	7.9	10.7	10.4	9.9	+2.0
Slovenia	17.3	17.3	16.9	15.5	-1.8
Czech Rep.	13.4	12.8	12.7	12.9	-0.5
Malta	12.7	14.1	13.9	13.7	+1.0
Portugal	12.5	15.7	15.9	17.5	+5.0
Slovakia	14.2 (e. p)	13.2 (p)	12.4 (p)	10.6 (p)	-3.6
Estonia	10.8	9.9	9.6	9.8	-1.0
Hungary	N/A	17.0	17.6	17.3	
Lithuania	12.6	9.9	9.9	11.1	-1.5
Poland	N/A	17.0	16.9	15.7	
Latvia	13.2	9.8	9.8	8.4	-4.8
Romania	N/A	9.8	9.7	9.9	
Bulgaria	15.0 (p)	11.1 (p)	12.2 (p)	13.1 (p)	-1.9

Source: Government expenditure by function (COFOG). Available at: <http://epp.eurostat.ec.europa.eu>
Notes: Same as for Table 12; (p): provisional data.

Figure 26: Social protection expenditure, as a % of GDP



Source: Government expenditure by function (COFOG). Available at: <http://epp.eurostat.ec.europa.eu>

Note: Data for the EU-27, Hungary, Poland and Romania are not available for 2000 and are therefore provided for 2005.

it was already below the EU-27 average at the start of the period. Expenditure on recreation, culture and religion remained level compared to 2000 and is on par with the EU-27 as a share of GDP.

In this expenditure group, where the relative size of spending hardly budged in the period 2000–2007, it is worth mentioning spending on public services. This expenditure did drop, largely as the result of savings on intermediate consumption, but it is still high compared to other EU-27 countries. It is estimated that when wage disparities were resolved in 2008, spending on wages and, consequently, expenditure on public services rose. It therefore makes sense to launch a restructuring that would reduce the size of and expenditure on public services.

A European Commission survey of spending on research and development⁵¹ in the period 2000–2006 ranked Slovenia among those countries which are catching up with countries with high R&D spending⁵² and in 2007 this expenditure increased further. Member States were ranked in four groups based on the size and growth of R&D spending in 2000–2006. The first group comprised countries with high R&D spending and rapid growth of such spending in the period 2000–2006 (Sweden, Finland, Denmark, Germany and Austria). The second group included catch-up countries with low baseline R&D spending but above-average spending growth in the period 2000–2006 (Estonia, Spain, Hungary, Czech Republic, Lithuania, Latvia, Cyprus, Portugal,

⁵¹ Many studies place R&D expenditure among spending whose spillover effects have the greatest impact on economic growth and development.

⁵² Measuring the efficiency of public spending on R&D, 2008, p. 16.

Table 15: Non-productive expenditure excluding social protection, as a % of GDP

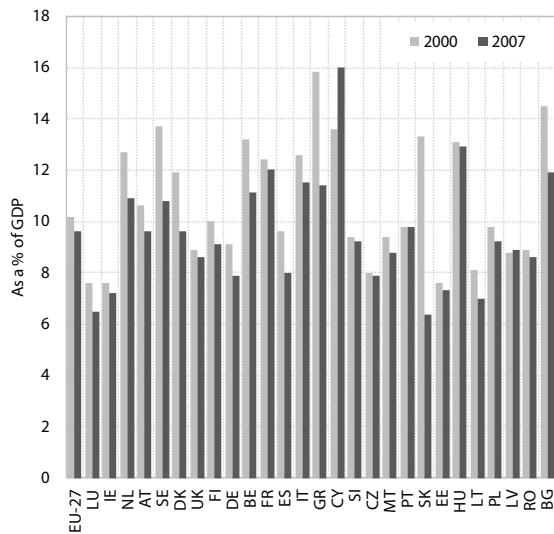
Countries by GDP per capita in PPS	2000	2005	2006	2007	2000–07 (change in p.p.)
EU-27	N/A	10.2	9.7	9.6	
EU-25	N/A	10.2 (p)	9.7 (p)	9.7 (p)	
EU-15	10.8 (p)	10.0 (p)	10.0 (p)	9.8 (p)	-1.0
GDP/per capita in PPS > 100					
Luxembourg	7.6	7.8	6.6	6.5	-1.1
Ireland	7.6	6.6	6.3	7.2	-0.4
Netherlands	12.7 (p)	11.5 (p)	11.1 (p)	10.9 (p)	-1.8
Austria	10.6	9.3	9.4	9.6	-1.0
Sweden	13.7	11.2	11.2	10.8	-2.9
Denmark	11.9	9.9	9.8	9.6	-2.3
U. Kingdom	8.9	9.2	9.1	8.6	-0.3
Finland	10.0	9.7	9.3	9.1	-0.9
Germany	9.1	8.4	8.1	7.9	-1.2
Belgium	13.2	11.9	11.2	11.1	-2.1
France	12.4	12.6	12.2	12.0	-0.4
Spain	9.6	8.4	8.1	8.0 (p)	-1.6
Italy	12.6	12.0	11.5	11.5	-1.1
GDP/per capita in PPS < 100					
Greece	15.8	11.3	10.6	11.4	-4.4
Cyprus	13.6	15.5	15.5	16.0	+2.4
Slovenia	9.4	9.4	9.4	9.2	-0.2
Czech Rep.	8.0	9.9	8.5	7.9	-0.1
Malta	9.4	9.1	9.0	8.8	-0.6
Portugal	9.8	10.0	10.0	9.8	0.0
Slovakia	13.3 (p)	9.5 (p)	7.9 (p)	6.4 (p)	-6.9
Estonia	7.6	6.8	6.6	7.3	-0.3
Hungary	N/A	13.1	13.6	12.9	
Lithuania	8.1	6.7	6.9	7.0	-1.1
Poland	N/A	9.8	9.5	9.2	
Latvia	8.8	10.1	11.3	8.9	+0.1
Romania	N/A	8.9	8.2	8.6	
Bulgaria	14.5 (p)	9.8 (p)	6.8 (p)	11.9 (p)	-2.6

Source: Government expenditure by function (COFOG). Available at: <http://epp.eurostat.ec.europa.eu>

Note: Same as for Table 12; (p) – provisional data.

Italy, Ireland, and Slovenia). In the third group were countries with R&D spending around the EU average whose relative spending shrank between 2000 and 2006 (France, United Kingdom, Belgium, Luxembourg and the Netherlands). The fourth group comprised countries with below-average expenditure which dropped even further in the period 2000–2006 (Greece, Romania, Bulgaria, Poland and Slovakia). Slovenia's R&D spending is below the EU average; nevertheless, it is the closest to the average among all the catch-up countries. However, in terms of relative growth, Slovenia, as well as Italy and Ireland, were increasing spending relatively slowly, barely outpacing the EU average.

Figure 27: Non-productive expenditure excluding social protection, as a % of GDP



Source: Government expenditure by function (COFOG). Available at: <http://epp.eurostat.ec.europa.eu>
Note: Data for the EU-27, Hungary, Poland and Romania are not available for 2000 and are therefore provided for 2005.

Even though Slovenia was ranked among countries that are catching up with the most developed countries, the pace of catching up was very slow. In 2007, the increase in spending was minimal, which means the gap to the most developed countries will probably widen. In fact, Slovenia could be overtaken by countries with lower expenditure but significantly faster spending growth.

5.2.3. Structure of general government expenditure (economic classification) in terms of productivity of spending

Expenditure on gross investment grants, which is classified as productive, is above the EU-27 average in Slovenia and rose by 0.5 p.p. as a share of GDP in the period 2000–2007. Ten Member States have higher relative expenditure than Slovenia and one is on par with it. Six Member States with the lowest per capita GDP in PPS (below 75% of the EU average) and four others have significantly higher spending. The structure of Slovenia's spending is less favourable, however, as investment for productive purposes has been shrinking (2000: 50.2%; 2007: 49.5%). Expenditure on gross investment grants also depends on drawing EU funds, in particular from the regional and cohesion policy funds, which are allocated mostly for gross investment.

In other key expenditure groups Slovenia's expenditure relative to GDP is above the EU-27 average in compensation of employees and in subsidies, but expenditure on intermediate and final consumption, and capital transfers is below the average. Despite a

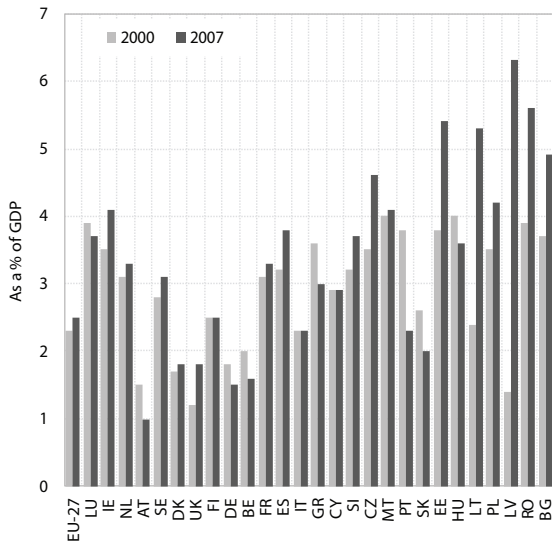
Table 16: Gross investment grants, as a % of GDP

Countries by GDP per capita in PPS	2000	2005	2006	2007	2000–2007 (change in p.p.)
EU-27	N/A	2.3	2.5	2.5	
EU-25	N/A	2.2 (p)	2.5 (p)	2.5 (p)	
EU-15	2.2 (p)	2.2 (p)	2.4 (p)	2.4 (p)	+0.2
GDP/per capita in PPS > 100					
Luxemburg	3.9	4.5	3.6	3.7	-0.2
Ireland	3.5	3.5	3.6	4.1	+0.6
Netherlands	3.1 (p)	3.3 (p)	3.3 (p)	3.3 (p)	+0.2
Austria	1.5	1.1	1.0	1.0	-0.5
Sweden	2.8	3.0	3.1	3.1	+0.3
Denmark	1.7	1.7	2.0	1.8	+0.1
U. Kingdom	1.2	0.7	1.8	1.8	+0.6
Finland	2.5	2.7	2.4	2.5	0.0
Germany	1.8	1.4	1.4	1.5	-0.3
Belgium	2.0	1.8	1.6	1.6	-0.4
France	3.1	3.3	3.2	3.3	+0.2
Spain	3.2	3.6	3.7	3.8 (p)	+0.6
Italy	2.3	2.4	2.3	2.3	0.0
GDP/per capita in PPS < 100					
Greece	3.6	2.9	3.0	3.0	-0.6
Cyprus	2.9	3.1	3.0	2.9	0.0
Slovenia	3.2	3.2	3.7	3.7	+0.5
Czech Rep.	3.5	4.9	5.0	4.6	+1.1
Malta	4.0	5.0	4.2	4.1	+0.1
Portugal	3.8	2.9	2.4	2.3	-1.5
Slovakia	2.6 (p)	2.2 (p)	2.0 (p)	2.0 (p)	-0.6
Estonia	3.8	4.0	5.1	5.4	+1.6
Hungary	N/A	4.0	4.4	3.6	
Lithuania	2.4	3.5	4.2	5.3	+2.9
Poland	N/A	3.5	3.9	4.2	
Latvia	1.4	3.6	5.1	6.3	+4.9
Romania	N/A	3.9	5.2	5.6	
Bulgaria	3.7 (p)	4.1 (p)	4.2 (p)	4.9 (p)	+1.2

Source: Government expenditure by function (COFOG). Available at: <http://epp.eurostat.ec.europa.eu>.
Note: Same as for Table 12; (p) – provisional data.

drop of 0.7 p.p. between 2000 and 2007, compensation of employees is still above the EU-27 average; twelve Member States have higher expenditure than Slovenia. Public order and safety, and health stand out from among the other spending functions with their low nominal growth rates. Following a 0.7 p.p. drop in the period 2006–2007, expenditure on intermediate consumption is below the EU-27 average. Most EU countries with the highest per capita GDP in PPS and, with the exception of Slovakia and Lithuania, all Member States with the lowest per capita GDP in PPS (below 75) have higher relative expenditure than Slovenia. Low nominal growth of intermediate consumption was achieved between

Figure 28: Gross investment grants, as a % of GDP



Source: Government expenditure by function (COFOG). Available at: <http://epp.eurostat.ec.europa.eu>.

Note: Data for the EU-27, Hungary, Poland and Romania are not available for 2000 and are therefore provided for 2005.

2000 and 2007 in particular in general public services and in social protection. Slovenia also has below-average expenditure on final consumption, which dropped by 1.1 p.p. and is lower than in all but eight Member States and the same as in Cyprus.

Capital transfers in Slovenia are well below the EU-27 average owing to a halving in the 2000–2007 period due to a reduction in spending on economic affairs.

Transfers for economic affairs accounted for 74% of all capital transfers in 2000, but by 2007 their share fell to 28.6% as motorway construction started to be financed with borrowing. Only eight Member States have lower shares than Slovenia and three are at the same level. Subsidies, on the other hand, are far above the EU-27 average despite a drop between 2000 and 2007 of 0.3 p.p. of GDP. Only four Member States (Austria, Belgium, Malta and the Czech Republic) have higher subsidies. Capital transfers and subsidies, like gross investment grants, also partially depend on the scope of drawing EU funds.

Like the classification by function, the economic classification clearly shows the need to change the structure of general government expenditure.

Public services need to be reorganised to reduce the relative expenditure on compensation of employees, and some programmes which have been ongoing for over a decade (e.g. the closure of coal mines) ought to be phased out to reduce subsidies. At the same time, it makes sense to increase gross investment grants and capital transfers for programmes which have a productive impact on economic growth.

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