Analysis on Public Debt

Slovenia

CSOs as equal partners in monitoring public finances

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BALKAN MONITORING PUBLIC FINANCES

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Author:
Ajda Pistotnik, Project Coordinator, EnaBanda (ajda@enabanda.si)

Editor:
Vladimir Cvijanović, Expert on Public Debt

Formatting:
Emina Hasanagić, Administrative Manager, Krila nade (emina.hasanagic@wings-of-hope.ba)

This document has been produced as a part of the project "CSOs as equal partners in the monitoring of public finance" which started beginning of 2016 and is implemented by a consortium of 10 organizations from 7 countries and will last for four years.

The aim of the project is to improve the transparency and accountability of policy and decision making in the area of public finances through strengthening the role and voice of NGOs in monitoring the institutions that operate in the area of public finances. In this way, the project will strengthen CSO knowledge of public finance and IFIs and improve CSO capacities for monitoring. Additionally, it will help advocate for transparency, accountability and effectiveness from public institutions in public finance. Moreover, this project will build know-how in advocating for sustainability, transparency and accountability of public finance and IFIs. This project will also increase networking and cooperation of CSOs on monitoring of public finance at regional and EU level. Lastly, it will increase the understanding of the media and wider public of the challenges in public finance and the impacts of IFIs.

Key project activities are research and monitoring, advocacy, capacity building and transfer of knowledge/practices and networking in the field of the 4 specific topics: public debt, public-private partnerships, tax justice and public infrastructure.

More information about the project can be found on http://wings-of-hope.ba/balkan-monitoring-public-finance/ and on the Facebook Page Balkan Monitoring Public Finances

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CONTENT

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INTRODUCTION

The study was intended to present the foundation for understanding the recent crisis from 2008 on, to acquire an insight into the impacts on Slovenia's recent reforms, and to determine …

The analysis has an attempt to summarize the consequences of the financial crisis in Slovenia, while it also presents some new results…

The research process is a discovery and one of the most fulfilling parts of the process involves uncovering new facts and adding new insights into unresolved debates about debt economy, debt state and its related public debt...[1]

Generally, **borrowing** is understood as an instrument allows the State to bridge the discrepancies in budget revenues and expenditure. Recently Slovenia has been quite active in the field of borrowing, mostly on account of restructuring of banks with the aim to create stability in the banking sector. Furthermore, Wolfgang **Streeck's** (2014) conceptualization of the **debt state** is illustrated as "a state which covers a large, possibly rising part of its expenditure through borrowing rather than taxation, thereby accumulating a debt mountain that it has to finance with an ever-greater share of its revenue." When are we talking about the debt state, how can we determine that Slovenia is or is not the debt state? The **influence** that finance holds over politics and society is therefore a product of its position in the economy. This tendency towards concentration and centralization in the **debt** system makes everyone else in society — states, firms and households alike — increasingly dependent on an ever-smaller number of private banks and financial institutions for their own reproduction.[2]

[1] This 1st para will include the short presentation of the paper, its chapters, and methodology... in the making...
[2] Defeating the Global Bankocracy, Jerome Ross, ROAR 3, 2016, https://roarmag.org/magazine/defeating-the-global-bankocracy/

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1. CHARACTERISTICS OF PUBLIC DEBT AND ITS SUSTAINABILITY

The increase in **public debt** in Slovenia was a result of declining tax revenues due to the fall in economic activity and lowering of the corporate profit tax. It was also a **result** of a parallel rise in welfare spending triggered by the crisis. When joining EU in 2004 and Eurozone in 2007 the financial markets drove down borrowing costs and flooded our capital markets. The **consequence** was the heavily indebted corporate sector because of cheap and new loans.

Since **enterprises** were largely financed by bank loans, their losses were then accumulated on the **balance sheets** of the **banks** in the form of **non-performing loans**. Therefore, our sovereign debt also rose due to government interventions into the banking sector by decapitalizing banks to cover their losses triggered by a corporate sector.

The sovereign debt **crisis** that followed was an **outcome** of the recession and the crisis **rooted** in the corporate sector. The debt created by corporate and banking sector has been put on citizens and burdened the public money also meant for the development and their welfare.

1.1. Debt Data and Debt Sustainability

The country was badly hit by the global **financial crisis** and its **GDP** growth rate fell from impressive 6.8% in 2007 to 3.3% in 2008 and in 2009 it dropped to its lowest point -7.8%. However, last year, in 2016 it has been back on 2.6% of GDP.

When Slovenia joined the EU in 2004, the state **deficit** was only 2.4% of GDP, and it reached 6.1% of GDP in 2009, so just before the crisis. It was the highest at 15% of GDP in 2013, therefore, overlapping with the peak of financial crisis in Slovenia. This sudden hike of public deficit, alongside with accumulated minor deficits from previous years, contributed the most to the current state of the public debt.

Similar trend can be observed at our **public debt**. Firstly, it used to be stable and stagnant for more than 15 years, it was around 25% of GDP before the crisis, until 2009, then it started to increase. The outburst of the trend was during the crisis in 2014, when government started to solve the banking crisis, after the results of the stress tests, with injections of capital into banks and the formation of the so-called "bad

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bank" - following Ireland, Spain and the Baltic countries.[3] In 2015 public debt reached its peak at 83%. However, it is at **79% of GDP** now (that is around 31 billion euro); which ranks Slovenia in the middle of the EU member states. However, Slovenia is still among the states whose debt has increased the most relative to pre-crisis levels.[4]

Growth of **debt** and **interest** expenditure, together with a further growth of certain expenditures on social protection (pensions, health). The level of public debt, which in a few years moved Slovenia from low-indebted to medium indebted countries (in 2013 alone it was raised by 17.3% points), significantly contributed to the pressing situation.[5]

The **borrowing** of the state primarily comprises issuances of long term securities, i.e. **bonds**. In the period from 2012 to 2014 Slovenia borrowed for the central government budget in global capital markets by issuing bonds denominated in USD. The share of EUR denominated debt as at the end of 2014 stood at 73% of the total debt. However, 28.6% of the USD debt portfolio was changed to EUR in the three USD buyback transactions executed in 2016.[6]In March 2013, the newly PM **Alenka Bratušek** announced the end of austerity and structural reforms. In only one week, the **interest rate** on 10 year government bonds sharply increased from 5% to 6.73%. "It was at this point that we started to think about how it would be possible to buy back this expensive debt on the global market and fund it with issuance on the local market," says **Marjan Divjak**, the treasury's director general at the Ministry of Finance.[7]

[3] Miroslav Verbič, Andrej Srakar, Boris Majcen, Mitja Čok (2016) Slovenian public finances through the financial crisis. Teorija in praksa let. 53, 1/2016

[4] STAT.SI: GDP and National Accounts http://www.stat.si/StatWeb/en/Field/Index/1
April excessive
deficit procedure report, Slovenia, 2013–2016, forecast 2017 http://www.stat.si/StatWeb/en/News/Index/6630

[5] Which in 2008–2012 represented the largest increase among the total expenditure items, increasingly restricted the room for measures of fiscal policy and for the raising of taxes in relation to international comparisons of taxation levels. Miroslav Verbič, Andrej Srakar, Boris Majcen, Mitja Čok (2016) Slovenian public finances through the financial crisis. Teorija in prakasa let. 53, 1/2016

[6] Financing Program of the Republic of Slovenia Central Government Budget for the Fiscal Year 2017, Ministry of finance http://www.mf.gov.si/fileadmin/mf.gov.si/pageuploads/vrednostni_papirji/Program_financiranja/Financing_Program_2017__EN_.pdf

[7]Concerned about the cost of borrowing in the **euro-denominated** markets, Slovenia decided to look further afield. In late 2012 it had raised 2.25 billion dollar via three 10-year bonds paying a coupon of 5.5%. Another four **US dollar issues** followed over the course of the next two years. Slovenia's US dollar bonds were issued in 2012 and 2013 as the country struggled to contain a domestic banking crisis without calling on the European Union for a bail-out and submitting to the harsh economic stewardship. Slovenia's dollar-denominated debt had also risen from zero to almost 30% of its total outstanding debt in a short space of time. Slovenia's share of **euro-denominated** central government debt decreased, falling to 73% at the end of 2014 from 99.8% at the end of 2011.

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Firstly, the interest rates only decreased, when the government denounced its plans and decided to continue with the policies of previous governments.[8] And secondly, debt decreased by buying it back (2.61 billion of the US dollar-denominated bonds issued between 2012 and 2014), replacing it with cheaper euro debt in 2017. That will deliver lifetime interest and savings of 66 million euro (70.2 million dollar) and a more forgiving refinancing schedule.[9] Nowadays, Ministry of finance has been led by the opportunity to **lower interest** costs and to take advantage of improved investor confidence and low euro yields related to the ECB's **quantitative easing** programme.[10]

Slovenian economist **FrančekDrenovec** analyzed the effects of the **breakdown** in the Slovenian **banking sector** on the public **debt**. The processes of **bank rehabilitation** between 2011 and 2014 directly contributed to a 6 billion euro increase in the state debt. At the end of 2014, the accumulated debt of these operations equalled 15.8% of GDP. To some extent, the banks already rehabilitated themselves before the financial aid of the state, by large scale formation of reserves and provisions. From 2009 to 2014, the banks thus acquired 3.6 billion euros (10% of one annual GDP) from the domestic market. The immediate burden of state rehabilitation of the banks was lesser accordingly. The public costs for bank rescues were therefore much higher than 6 billion euros.[11]

IMAD/UMAR calculated in its **forecast** report that owing to the debt increase in recent years, the average annual **contribution** of **interest** will remain almost **unchanged** despite the lowering of the

Risk.net, Sovereign risk manager of the year: Treasury Directorate of Slovenia, 25.1.2017
http://www.risk.net/awards/2479838/sovereign-risk-manager-year-treasury-directorate-slovenia

[8]Maja Breznik and Sašo Furlan (2015) What is the position of Slovenia in the international debt crisis? by, Rastko Močnik and Maja Breznik (ed) Public debt: Who owes whom? *cf, Ljubljana

[9] Risk.net, Sovereign risk manager of the year: Treasury Directorate of Slovenia, 25.1.2017
http://www.risk.net/awards/2479838/sovereign-risk-manager-year-treasury-directorate-slovenia

[10]Slovenia's Launch of Debt Buyback Is Credit Positive, Moody's investor service, May 15, 2017
http://www.mf.gov.si/fileadmin/mf.gov.si/pageuploads/mediji/2017/Maj/Moody_s_Slovenia_Buyback_MCO_2017_05_15.pdf

[11] Franček Drenovec (2015) Formation of the public debt in Slovenia, Rastko Močnik and Maja Breznik (ed) Public debt: Who owes whom? *cf, Ljubljana

In addition, the state budget debt is also composed **of loans raised or assumed** from former SFR **Yugoslavia** and securities issued as legal entity for the execution of state budget. From 1996 on Slovenia was gradually signing agreements with creditors of former SFRY concerning reprogrammed liabilities from New financial Agreement (NFA) and bilateral agreements with states members of Paris Club. In 1999 the agreement with creditors from NFA and with most of Paris Club members was reached.
Bulletin of Government Finance 4/2017, Ministry of Finance
http://www.mf.gov.si/en/areas_of_work/general_government_finance/public_finances/bulletin_of_government_finance/5

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implicit interest rate and favorable borrowing terms.[12]Regarding **debt sustainability IMF** reports that **historical debt** dynamics in 2013–14 were dominated by the impact of bank restructuring, and are thus unlikely to occur again given the **banks'** good health. Slovenia's relatively **high** public debt ratio remains a **vulnerability**, while debt service is projected to remain manageable, even under the stress scenarios.[13]In other words, like the **European Commission** states in its semester report that "a prolonged recession coupled with significant bank recapitalizations has resulted in a sharp rise in public debt in recent years. The fiscal framework reform, which provides an important anchor for sustainable public finances, is yet to be fully implemented."[14]

In general, most of the **debt** can be attributed to the central **government**, with a significantly lower proportion of indebtedness of the **local** government and **social** security funds. Political reasons were among the main reasons why the spreads of Slovenian government bonds and by that, the cost of debt grew excessively (which can be verified by observing the correlation of government changes and bond spreads) and only with gradual measures and stability of each new government the situation has gradually stabilized.[15]

[12] Their analyses show that (in advanced economies) approximately 1% point of additional real GDP growth would be needed during the next 10 years, on average, in order for the debt-to-GDP ratio to return to its pre-crisis level. In Slovenia, GDP growth that is 1% point higher than assumed in the baseline scenario would reduce the share of general government debt to **around 50% of GDP by 2026**.
Economic Issues 2016, IMAD/UMAR, http://www.umar.gov.si/fileadmin/user_upload/konference/2016/AN_EI2016.pdf
[13] IMF says the debt ratio will: (i) register a further 1¾ percentage point decline in 2017, as the Treasury continues to draw down its cash buffer; (ii) continue declining at a slower pace in-2018–19, and (iii) virtually stabilize thereafter, settling at about 76 percent by 2022.
IMF, 2017, Republic of Slovenia: 2017 Article IV Consultation-Press Release; Staff Report; and Statement by the Executive Director for the Republic of Slovenia**.** Annex V. Public-Sector Debt Sustainability Analysis
http://www.imf.org/en/publications/cr/issues/2017/05/15/republic-of-slovenia-2017-article-iv-consultation-press-release-staff-report-and-statement-44921
[14]Government debt has grown substantially and is currently stabilized, but pension and healthcare spending will be concerned by considerable ageing pressures looking forward. Public debt is projected to decrease until 2023 but increase again thereafter under a no-policy-change assumption. Age related expenditure, namely on public pensions, healthcare and long term care puts pressure on public finances in the long run.
European Commission, Country Report Slovenia 2017: Including an In-Depth Review on the prevention and correction of macroeconomic imbalances. Commission Staff Working Document. 22.2.2017, Brussels
https://ec.europa.eu/info/sites/info/files/2017-european-semester-country-report-slovenia-en.pdf
[15] Miroslav Verbič, Andrej Srakar, Boris Majcen, Mitja Čok (2016) Slovenian public finances through the financial crisis. Teorija in prakasa let. 53, 1/2016

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1.2. Related Policy and its Gaps

Eurozone creditor states – led by Germany – and the European Central Bank (ECB) played a key role in the management of the Eurozone **debt crisis** of the 2010s. In Slovenian case they did not build and exercise their influence through loans (to Slovenia) and its related conditionality after 2008 **financial crisis**, but mostly through offering recommendations, adopted procedures and policy guidelines (e.g. compilation of staff papers, press releases, policy notes, working papers, missions to member states, official meetings, regular communication, etc.). Therefore, they too played a major role in shaping national policies, laws and practices[16] especially regarding state borrowing and its related fiscal policies.

The result was a privileged position of **local elites** with shared views and close ties to **foreign creditors** and the international **financial** organizations that meant a reconfiguration of domestic power relations in favor of financial and political elites, who were perceived to be capable of fulfilling a "bridging role" towards global finance.[17] For instance, in 2013 the Governor at the Bank of Slovenia, **Boštjan Jazbec**, and a former IMF employee argued that Slovenians must change their mind-set and approach to the management of the economy and the state. He added that, "we lived **beyond** our means".[18]

The restructuring of the **banking** system and stress tests have been one of the most important and, for this analysis, interesting developments directly affecting our public debt figures and policies. For instance, the Bank of Slovenia's **calculation** of the size of bank **hole** determined the level of government borrowing - public debt, and thus directly affecting a scope of a welfare state. Moreover, operational targets of state **borrowing** (underlying the financing programs for the fiscal years 2013 and 2014) were **defined** solely by **debt instruments** without any specific **directions** explaining **what risks** the Ministry of finance can bear in order to minimize the costs of borrowing and what portfolio structure it should reach.[19]

[16] What was also important was the rhetoric of the Slovenian government and the media saying: "Slovenia will not have to ask for international financial aid, if we adopt the needed reforms ourselves". The government and media have actively cultivated myths about the causes of the crisis in order to justify the prescribed neoliberal policies. In media at the national TV it was broadcasted what we need to do, if we want to ask for a financial aid and how this process will go step by step, like we are on the brink of the bankruptcy.
[17] Jerome Roos (2016) Why Not Default? The Structural Power of Finance in Sovereign Debt Crises, the European University Institute, Florence
[18] Economic Issues 2016, IMAD/UMAR, http://www.umar.gov.si/fileadmin/user_upload/konference/2016/AN_EI2016.pdf
[19] The Court believes that the Ministry adopted its decisions (on borrowing by issuing new bonds in the year 2013 and in 2014) based on the analyses performed with the aim to minimize the exposure of the debt to market risks as much as possible. In addition, the Court submitted to the Government and the Ministry several **recommendations** concerning

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1.2.1. Required Privatization

A good example of promoting and implementing the EU policies related to privatization is a **report** the View of the Bank of Slovenia conducted in 2014 on strategic challenges for economic policies in Slovenia.[20] Promoting and establishing a new institution Slovenian Sovereign Holding (**SSH**)[21] in 2014 to implement the divestment, privatization of state owned companies. In this context, the main argument the government uses in **support** of privatization is a **reduction** of the high public **debt** through selling of state-owned companies. Another commonly heard argument is that Slovenia promised to the international community to privatize state-owned companies.

However, Slovenia has kept some of the key **financial institutions - banks** (NLB, NKBM, Abanka,...), in order to build its financial infrastructure, in contrast to the vast majority of eastern European countries, which rapidly privatized the financial sector in favor of **foreign owners**. For the country, it was in the strategic and national interest that at least a part of the financial infrastructure is owned by high-quality homeowners mainly the institutional investors. It is argued by economist **Mojmir Mrak** that it turned out that we are not at our best when it comes to management of state banks. In other words, the national economic costs of state ownership of the **banks** in the form of public **debt** is too high for Slovenia.[22]

development of the medium-term borrowing strategy, implementation of stress tests, and recording of input information and different factors affecting the preparation of the annual Financing Program.
Summary of the audit report Effectiveness of planning State borrowing requirements, Effectiveness of planning State borrowing requirements in the years 2013 and first half of 2014, Ljubljana, May 18 2015

[20] It argues that a key for economic **development** is **privatization** and it also urges for the rationalization of the cost in education, health system reform, pension reform, and reform of the labor market, reorganization of local administration and more efficient use of social transfers. This way, the study highlights the three sets of measures: saving the banking system, consolidating public finances and securing the political support for these measures.
View of the Bank of Slovenia on strategic challenges for economic policies, Bank of Slovenia, 2014 https://www.bsi.si/library/includes/datoteka.asp?DatotekaId=5833

[21] To implement the divestment of 15 state-owned companies, including the second largest bank (NKBM), the largest telecom operator (Telekom Slovenije), the national airport (Aerodrom Ljubljana), the biggest national food corporation (Žito Group) and other assets.

[22] However, nowadays, in the context of a lack of high-quality domestic institutional investors and an ignored national interest, there remain two fundamental options in ownership. One is privatization in the form of sale to foreigners, and the other is the retention of a financial institution owned by the state or quasi-state institutions.
Interview with economist Mojimir Mrak, Slovencem upravljanje državnih bank pač ne gre od rok, Manager, Finance, 15.6.2017 https://manager.finance.si/8858070/%28intervju%29-Slovencem-upravljanje-drzavnih-bank-pac-ne-gre-od-rok

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1.2.2. Legal Basis for the Reforms

Government adopted **Balancing Public Finances Act** (ZUJF) in 2012 and it was one of the most important legislative changes for introducing austerity measures in various fields, it was a collection of around 30 laws advocated by many (international) policy recommendations.[23]Moreover, the **Constitutional Court** banned **referendums** that could block economic reforms. The government asked the Court to ban the referendums, claiming that the enforcement of the austerity laws was crucial to ensure the country's medium-term financial stability. The verdict can, nevertheless, also be interpreted as the limitation of the right to hold referendums or simply as an obstacle to democracy.[24]Furthermore, the **Fiscal rule** written into the Constitution in May 2013.[25]Amendment to the **Constitution** and later on the Fiscal Rule Act was meant for strengthening fiscal discipline; particularly with numerical fiscal rules has been a common response to the fiscal crisis legacy of the member states in the EU.[26]

1.2.3. Restructuring of Banking System

The figures of the Bank of Slovenia shows that the **state's** direct share in the **banking sector** was, by 2008, only **17.9%.** Bank recapitalizations in 2008-2014 alone cost the state 5.2 billion euro, while the transfer of non-performing bank assets to the state backed "bad bank" (The Bank Asset Management Company - BAMC) cost the state an additional 1.5 billion euro. Between 2007 and 2012, the state enacted several **recapitalizations** of the two biggest Slovenian banks, NLB and NKBM. In this way, the recapitalizations of NLB de facto included substantial financial support for the private Belgian bank KBC, a former co-owner of NLB. The State aid rules were not yet adopted, but it was only when the bank crisis spread to the peripheral countries that they were enforced. The peripheral states were thus

[23] Fiscal Balance Act of May 2012 brought about various measures:
- Public sector wage bill cut by 3% in 2012 (and additionally by 1.3% in 2013).
- Rationalization of other benefits and reimbursements to employees in public sector.
- New pension and labour market legislation passed.
- Cuts in certain benefits related to labour market, social and family policies.

http://ec.europa.eu/economy_finance/events/2014/20140211-meeting/documents/sessioniii3jazbec_en.pdf
Balancing Public Finances Act, PISRS, http://www.pisrs.si/Pis.web/pregledPredpisa?id=ZAKO6388#

[24] Later on the Court explained the ban by saying that constitutional values like the development of the economic system, social security and international obligations of the state have a priority over the right to demand a referendum because of the gravity of the economic crisis. Slovenia as a state was established on the grounds of referendum in 1991, therefore in Slovenia it is believed thatreferendum is a very important legal and policy democratic mechanism.

[25] The National Assembly of the Republic of Slovenia has on 31May 2013 adopted a constitutional law amending Article 148 of the Constitution of the Republic of Slovenia (Official Gazette 47/13)
Fiscal consolidation (presentation), Budget Directorate, Ministry of Finance, 2014.
http://ec.europa.eu/economy_finance/events/2014/20140211-meeting/documents/sessioniii3jazbec_en.pdf

[26] Fiscal rule, Ministry of Finance http://www.mf.gov.si/en/areas_of_work/economic_governance/fiscal_policy/fiscal_rule/

forced to recapitalize their banks under much stricter conditions of the European Commission than the core states.[27]

The data, showing that after 2008 a large amount of **foreign debt** of the **banks** was **converted** into the state's foreign debt. Economist **Franček Drenovec** underlines two crucial factors that contributed to an unprecedented increase in public debt, without having positive effects on economic growth or welfare: the cumulative pressure of tax cuts, amounting to a loss of 5.1 billion euros or 14 percent of GDP; and the collapse of the banking sector, contributing to a loss of 5.9 billion euros or 16 percent of GDP.[28]
One of the outcomes of the bank restructuring was a formation of the Bank Assets Management Company (**DUTB**)[29] and Slovenian Sovereign Holding (**SSH**) in 2014 as measures to **solve** the banking and sovereign debt crisis. The lack of **transparency** over the functioning of the BAMC raises concerns and it is an on-going issue of the BAMC.[30]

Apart from giving **BAMC** a visible role in the bank system reform and hence in the Slovenian economy, it is also worrisome that the government decided to put **foreign** managers in control of BAMC at its beginning. What was troubling was that the selected managers have an obvious connection to the "Troika" institutions.[31]

[27] In the early stage of the crisis, immediately after August 2007 when the banks of core countries, such as Germany, Britain and France, were in need of recapitalization.
Maja Breznik and Sašo Furlan (2015) What is the position of Slovenia in the international debt crisis? by, Rastko Močnik and Maja Breznik (ed) Public debt: Who owes whom? *cf, Ljubljana
[28] The latter official number does not include the aforementioned indirect costs of bank rehabilitation. If one were to add these additional expenses into the equation, the final costs would be even higher. Note that the costs of bank rehabilitation are a one-time expenditure: they only persist in the public debt, but not in the public deficit. Franček Drenovec (2015) Formation of the public debt in Slovenia, Rastko Močnik and Maja Breznik (ed) Public debt: Who owes whom? *cf, Ljubljana.
[29]In September 2012, the government adopted a bill to set up BAMC in an effort to **clean non-performing** loans from banks' balance sheets.
[30]That taxpayers' money will pay for all financially suspect aspects of the banks' non-performing loans, while the 'good parts' of the banks will be sold to foreign banks and investors at a very low price. For example, the top managers' employment contracts enclosing very high, but debatable huge **income** sums, were until recently not disclosed to the public, even though the Slovenian Information Commissioner asked BAMC to be transparent as it is fully owned by the state.
[31] These most likely explains why Slovenia was facing severe pressure to impose Troika like measures. Lars Nyberg, Arne Berggren and Carl-Johan Lindgren, were members of the BAMC's board, and have previously served as members of the ECB crisis management group or as members of a high-level expert group on financial supervision in the EU or being as members of the IMF 'Troika' team in Spain, etc. BAMC was also strongly supported by the Governor, Boštjan Jazbec, who previously worked as a consultant for the IMF as well by other Euro group institutions.
More about troika policies and its pressures and recommendations to Slovenia at TroikaWatch: http://www.troikawatch.net/

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1.2.4. Questionable Bank Stress-tests

The power of the Slovenian **central bank** is enormous and there are no institutional safeguards. An oversight of the Bank is very limited or even non-existent. The governor Boštjan Jazbec and his team of the Vice governors have been **shaping** Slovenian destiny in recent years much more than any Slovenian government or any minister. As it is now revealed by a **criminal investigation** of the Bank of Slovenia, the governor had a final say in calculating Slovenian banking "hole" through conducting a system-wide bank asset quality review – stress-tests.

However, also here in calculating banks non-performing loans the national political, financial elite cooperated fully with the European Commission and ECB suggestions and guidelines. Therefore, based on a new devastating scenario our banks were to be recapitalized for more than 3 billion euro after the transfer of assets to BAMC. On the basis of the Governor instructions, for instance, the very costly consultants (30 million euro) calculated NLB equity value at 1.55 billion.[32]

The size of bank hole also determined the level of government borrowing - public debt, and thus directly affecting a scope of welfare state. The bigger calculated banks' deficit is also consequently related to cheap sell-off of non-performing assets (bad loans) through BAMC and selling of companies. Moreover, Slovenian economist **Velimir Bole** at the Economic Institute EIPF calculated in 2017 that an **artificially** made panic, dramatization, during the crisis cost us only in dealing with our banks, NLB and NKBM 2013, at least 1.5 billion euros.[33]

Nevertheless, now we are witnessing **criminal** investigation of the Bank of Slovenia and its governor. Investigators are looking for whether the citizens invested into the NLB alone too much of public money.

[32] For the reason, the representatives of the Directorate for Competitiveness, **ECOFIN**, and the **ECB** were not convinced with our own calculations they insisted in 2013, that Slovenia should hire independent external advisers to conduct a system-wide bank asset quality review – so called bank **stress-tests**.
It should be stressed that private companies Oliver Wyman (regularly consults to ECB) and Roland Berger made two stress tests, which varied significantly. The state, however, did not hesitate to hold on to the results of the tests that implied the highest recapitalization costs. Furthermore, another two private companies, which had charge of the valuation of banks assets, Delloite and Ernst & Young, admitted that they used valuation methods not in line with international accounting standards. Maja Breznik and Sašo Furlan (2015) What is the position of Slovenia in the international debt crisis? by, Rastko Močnik and Maja Breznik (ed) Public debt: Who owes whom? *cf, Ljubljana
[33] In other words, this is in fact a surplus of money, which was unnecessarily put in to the two banks for a period of crisis and is today practically lost.
Slovenske banke boljše od nemških, Delo 25.2.2017 http://www.delo.si/sobotna/slovenske-banke-boljse-od-nemskih.html
Samopohabljanje, Davljenje slovenskih bank, Janko Lorenci, Mladina 24.2.2017
http://www.mladina.si/178853/samopohabljanje/

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According to their findings, the methodology was created promptly at the meetings of the Steering Committees, managed by the governor, and now accused of the abuse of power and position. Because of the criminal investigation the ECB's president sent **protesting** letters.[34] Moreover, ECB's member of Executive Committee, Yves Mersch, in May 2017, sent a letter to the Slovenian Parliament President, **Milan Brglez**, in which on behalf of the ECB opposes the current change of legislation the new law on the Bank of Slovenia, it is noticeable from Milan Brglez reply that ECB "requires… **re-consultation** with ECB".

[34] To the president of European commission, Juncker, to the Slovenian state prosecutor and even to the Slovenian constitutional court, arguing that investigators over breached their authority and that confiscation of the Bank's documents is against the bank's impunity

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2. LEGAL FRAMEWORK AND REGULATORY, OVERSIGHT BODIES

2.1 Fiscal Rule

The objectives of **fiscal policy** are set out in the **National Reform Programme and the Stability Programme**.[35]The key national document in the field of borrowing is the **Financing Program** of the central government budget adopted by the government, which defines strategic and operational targets of borrowing for a given fiscal year. The **borrowing strategy**[36] should mainly give a clear directive to the Ministry as to the level of the acceptable risks to minimize the costs of borrowing.[37] The Central Government **Debt Management Department** is execution of the central government budget financing as well as execution of the debt management transactions. The Department reports Central Government Debt data to international and domestic institutions as well as Rating agencies.[38] Moreover, according to **Article 84 of the Public Finance Act**, the financing of the central government budget execution and debt management operations in a given fiscal year are performed based on a **financing program**.[39]

[35] In line with the **fiscalstrategy**, Slovenia will pursue a gradual reduction of government debt, which will be possible in the medium term with the use of incomes from privatization, improvement of the state's credit rating and effective debt management.
Fiscal policy, Ministry of Finance http://www.mf.gov.si/en/areas_of_work/economic_governance/fiscal_policy/
[36] Since the Government did not adopt such guidelines, the Ministry was forced to undertake a conservative policy of borrowing in order to minimize the risks.
[37] An important step forward in this field was made by establishing a Board for risk management and debt capital markets at the Ministry. Its task is to provide for appropriate recording of the decision-making and enabling easier reproduction of circumstances at the time when the decisions were adopted. The process of recording the analyses and decisions that were adopted on the basis of such data was until now not complete.
Court of Audit, 2015, Summary of the audit report Effectiveness of planning State borrowing requirements, Effectiveness of planning State borrowing requirements in the years 2013 and first half of 2014, Ljubljana, May 18 2015
[38] The Treasury Directorate at the Ministry of finance, led by Marjan Divjak, was awarded Sovereign Risk Manager of the year 2017 by the Risk Magazine. His responsibilities are funding, liability management, state budget liquidity management and Single Treasury Account operations. He previously worked in the middle office of the Treasury Directorate. Later he has been an adviser in the Office of the Prime Minister Janez Janša first government and in his second government was he a Member of the interdepartmental group for deciding on the rehabilitation of banks. He was also a member of the supervisory board and a chairman of the Audit Commission of SID Bank and he has been the Director General of the Treasury Directorate at Slovenia's Ministry of Finance. Marjan Divjak is an external expert in the Monetary and Capital Markets (MCM) Department of the International Monetary Fund (IMF). http://efnet.si/wp-content/uploads/CV-Divjak-IMF.pdf Central Government Debt Management Department
http://www.mf.gov.si/en/about_the_ministry/direktorati/reasury_directorate/front_office/
[39] Moreover, in Article 82, debt management, the government may use proceeds from loans and from issue of securities for prepayment of existing central government budget debt instruments and/or for buybacks of own securities, when this results in:

Therefore, the state is not allowed anymore to **borrow**, so it is banned to increase the public debt. In that way, the state is **allowed** to spend just as much as it produces, which could also mean that less will be spent on the **welfare** state, on health, education, pensions, culture, etc.[40]

Nevertheless, in July 2015 a **fiscal rule** was adopted into the **constitution** whereby the state specifically defines how the commitment at the highest legal act of the country is put into practice.[41]**Golden** fiscal rule simply means that the revenue and expenditure of the Treasury should be in balance. However, as it is explained by economist Rok Kralj that fiscal rule "is something completely illusory, for the reason that the state completely lost control of monetary policy."[42]

The **Fiscal rule act**, which defines in detail the constitutional **principle** of the medium-term fiscal balance, calls for the gradual reduction of the structural government deficit.[43.44] It defines the method and timing of the implementation of the principle of medium-term balance of revenue and expenditure of budgets without borrowing and the criteria for determining the exceptional circumstances and the

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1. support of measures aimed at achieving macroeconomic equilibrium,
2. government debt costs reduction or
3. debt portfolio enhancement without increasing the outstanding central government debt amount.

Act Amending the Public Finance Act (Official Gazette of RS, no. 101/13)

[40] Fiscal rule, Ministry of Finance http://www.mf.gov.si/en/areas_of_work/economic_governance/fiscal_policy/fiscal_rule/

[41] That means public revenues and expenditures must be balanced in the medium term without borrowing or revenue must exceed expenditure (except in exceptional circumstances). These have defined the so-called fiscal rule as constitutional principle. The declaratory record of this rule as the highest legal act of the state could contribute to a greater commitment to eliminate the deficit and it might be even that the international community can acknowledge a bigger credibility of the state.
Kako bomo uresničevali fiskalno pravilo, Bine Kordež, 26.5.2013 https://damijan.org/2013/05/26/kako-bomo-uresnicevali-fiskalno-pravilo/

[42] Simply put, the word **fiscal** means budgetary; **Fiscal policy**, however, is part of the economic policy that deals with the budget, which politicians with different measures try to balance the ratio between revenues and expenditures of the state budget.
Rok Kralj, 2012, Zlato monetarno pravilo, Za-misli, 7.9.2012 https://za-misli.si/kolumne/rok-kralj/515-zlato-monetarno-pravilo

[43] Reduction of the structural deficit must be carried out in accordance with the dynamics envisaged by the EU's **Pact for Stability and Growth Pact** (SGP).
Fiscal rule, Ministry of Finance http://www.mf.gov.si/en/areas_of_work/economic_governance/fiscal_policy/fiscal_rule/

[44] In accordance with the **Fiscal rule act** sets two key objectives - targeted general government balance as a whole and the individual public finance budgets and the highest possible level of expenditure of general government and individual public finance budgets (i.e. the state budget, local government budgets, pension and health funds).
Ordinance on the framework for the preparation of government budgets for the period from 2017 to 2019, Ministry of Finance
http://www.mf.gov.si/en/areas_of_work/economic_governance/fiscal_policy/ordinance_on_the_framework_for_the_preparation_of_government_budgets_for_the_period_from_2017_to_2019/

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manner upon their occurrence.[45]Since countries **borrow** money, they have to devote a large portion of their budget revenues to servicing the debt or repaying the principal and interest on borrowed money instead for the functioning of the state. Therefore, **balancing the budget** does not mean "to waste only as much as we create", but to spend only part of what we create, the rest is intended for financial organizations.[46]

Moreover, the adoption of the **fiscal rule act in 2015** set the foundations for establishing **a fiscal council** for the independent monitoring of fiscal policy. Its president Davorin Kračun[47] put it "Due to irresponsible fiscal behavior, public debt can start to accumulate. When we need to pay for its servicing suddenly it becomes one of the most important part of public expenditures and the path downwards begins that is difficult to stop. Therefore, we must timely detect whether the country's fiscal policy is sustainable in the long run."[48] In this way, he explained that it is not about deciding on how the state uses money, but whether this ratio corresponds to macroeconomic conditions and forecasts, and its task is to firstly warns the government and then the parliament.[49]

However, despite the relatively **broad scope** of the council's tasks, members are expected to work **part time** with the assistance of only a **small** supporting staff. Therefore, how the fiscal council will be able to perform its numerous professional, highly demanding and statutory tasks? In this way, the newly appointed council will be able to perform all its statutory tasks and obligations only in cooperation with external institutions that have sufficient analytical knowledge and experience.[50]

[45] Implementation of the Fiscal Rule Act is defined in Public Finance Act.
Fiscal rule, Ministry of Finance http://www.mf.gov.si/en/areas_of_work/economic_governance/fiscal_policy/fiscal_rule/
[46] Rok Kralj, 2012, Zlato monetarno pravilo, Za-misli, 7.9.2012 https://za-misli.si/kolumne/rok-kralj/515-zlato-monetarno-pravilo
[47] The current president of the Council is Davorin Kračun, an economist and a former Minister (of LDS governments), a former ambassador in Washington DC, nowadays professor at Maribor's Faculty of Economics and Business, and the head of its Institute for Economic Diagnosis and Forecasting.
V četrto gre rado: dobili smo fiskalni svet, Delo, 21.3.2017 http://www.delo.si/gospodarstvo/finance/drzavni-zbor-imenoval-fiskalni-svet.html
[48] The Fiscal Council has three members, financial experts, that monitor fiscal rules, assess macroeconomic and budgetary forecasts, evaluate fiscal sustainability, and give opinions on draft laws that have a significant budgetary impact.
Kakšna pregretost, imamo sto tisoč brezposelnih, Večer, 31.3.2017 http://www.vecer.com/kaksna-pregretost-imamo-sto-tisoc-brezposelnih-6254604
[49]Kakšna pregretost, imamo sto tisoč brezposelnih, Večer, 31.3.2017 http://www.vecer.com/kaksna-pregretost-imamo-sto-tisoc-brezposelnih-6254604
[50] In particular, mention here is made of the IMAD/UMAR.
Economic Issues 2016, IMAD/UMAR, http://www.umar.gov.si/fileadmin/user_upload/konference/2016/AN_EI2016.pdf

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In addition, the government withdrew the part from the amendment to **Article 148** of the **Constitution** on the role of the fiscal council. It could be concluded that the government does not want **independent control** over its budget preparation. But this is precisely the **key** part of the effectiveness of the function of the fiscal rule. If the government is planning on incorrect assumptions, it will always violate its own law and will have major problems in respecting the constitution. Moreover, the **functioning** of the fiscal rule depends essentially on the accuracy of the projections of the economic growth movement. Therefore, quality forecasts of growth are the key.[51]

Nevertheless, Slovenian economist **Franjo Štiblar** is claiming that introduction of fiscal rule was damaging, because it eliminates the fiscal instrument of economic policy and leads to fiscal austerity which damages economic and social life. He argues that it is based on wrong theory and it diminishes economic sovereignty of a country all under dictate of "ordoliberals". After adoption, the application of the fiscal rule created normative exuberance, methodological discretion, based on weak statistical data, all leading to the wrong empirical calculations and suboptimal growth of the Slovenian economy thus contributing to the Slovenia's »lost decade«.[52]

2.2 Monitoring and Oversight Bodies

Slovenia reports twice a year on the deficit and debt to the **Eurostat**. The report covers a set of reporting tables with data on the country's deficit and debt. The report was prepared by the Statistical Office in cooperation with the Bank of Slovenia and the Ministry of Finance. The report includes the forecast for 2017 on general government deficit and consolidated gross debt at the end of 2017.[53]

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[51] Regarding to "prior monitoring of the compliance of the proposed state budgets with fiscal rules before their submission to the legislative procedure in the National Assembly" and this is also missing from the fiscal rule Act.
Jože P. Damijan, 2012, Fiskalno pravilo za telebane, Damijan blog, 19.9.2012 https://damijan.org/2012/09/19/fiskalno-pravilo-za-telebane/
[52] The damaging fiscal rule, Gospodarska gibanja 494, Franjo Štiblar, 2017
http://www.eipf.si/en/publications/gospodarska-gibanja/2017/gospodarska-gibanja-494/the-damaging-fiscal-rule/
[53] Deficit for 2017 is estimated at EUR 337 million or 0.8 % of GDP. Consolidated gross debt of the general government for the end of 2017 is estimated at EUR 32,052 million or 77.0% of GDP. April excessive deficit procedure report, Slovenia, 2013–2016, forecast 2017, SURS, 20. 4.2017 http://www.stat.si/StatWeb/en/News/Index/6630

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The **Court of Audit** audited public debt, firstly, in **2008**.[54]In its concluding **report** it said that the Government of and the Ministry of Finance did not act effectively in the allocation of **guarantees** in 2003-2006 because they did not adopt **strategic** guidelines at the level of the state. During that period, they were also not successful in securing dedicated financial means for the construction of motorways, to the extent prescribed by the regulations. A country-specific strategic document governing the field of granting guarantees and **document** that would regulate the field of granting Slovenia's guarantees were not drawn up.[55]

Secondly, it audited public debt, when it was about effectiveness of planning State borrowing requirements in the years 2013 and first half of 2014. The Court has decided to undertake an **audit,** which would give an **overview** of State **borrowing** and public **debt** in the years **2013** and first half of **2014**.[56] Since the **Government** did **not adopt** guidelines for defining medium-term borrowing strategy, the **Ministry** was forced to undertake a **conservative policy of borrowing** in order to **minimize the risks**. The same fact emerges from the Court's analyses of the **debt portfolio** in which **no specific risks** with regard to **debt management** were **detected**. Even though the Government did not formally adopt a medium-term strategy.[57]
According to the president of the **Court of Audit**, Tomaž Vesel, one of the institutions that is the most resilient to their controls is the **Bank of Slovenia**. For many years the financial system has **regulated** itself, but all consequences of such a self-control have been revealed by the financial crisis. And

[54] Audit was titled the efficiency of borrowing, planning, management and reporting on Slovenia's public debt in the period from 2003 to 2006. The audit **assessed** the performance in achieving the planned public debt targets, the efficiency of borrowing for the needs of financing the state budget and the repayment of the principal debt, the suitability of issuing state guarantees, the regulation and supervision of the borrowing of the remaining public sector at the state level, the economy of debt management of the state budget, and Transparency and integrity of public debt reporting.
Court of Audit, 2008, Revizija o stanju in upravljanju dolga širšega sektorja države - načrtovanje, upravljanje in poročanje o višini javnega dolga v Republiki Sloveniji v obdobju od leta 2003 do 2006, 5.11.2008 http://www.rs-rs.si/rsrs/rsrs.nsf/I/K17CAA01294CC1636C12572F2002793B4

[55] Court of Auidt, News, Javni dolg Republike Slovenije (6. 11. 2008) http://www.rs-rs.si/rsrs/rsrs.nsf/I/K2F1D46CAC6515585C12574F9002970F5

[56]In the **audit** it has been **established** that strategic **targets of borrowing** comply with **best practices recommended** by **internationalfinancial institutions** and **represent** the appropriate basis for the **future phases** of planning.

[57]In addition the **Court submitted** to the **Government** and the **Ministry** several **recommendations** concerning development of the medium-term **borrowing strategy**, implementation of **stress tests**, and **recording** of input **information** and different factors affecting the preparation of the annual **Financing Program.** Moreover, risks pertaining to effective implementation of the borrowing execution also relate to providing all necessary information on the situation of the State to possible investors by the Ministry. Specific communication channels between the Ministry and the stake holders were not well established.
Court of audit, 2013, Audit report: Effectiveness of planning State borrowing requirements, 18.5.2015 http://www.rs-rs.si/rsrs/rsrseng.nsf/I/KAC07678804F61B29C1257F46002EDD72?openDocument&appSource=91F2455D38551D7CC1257155004755A7

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therefore, the states are afraid about what kind of irregularities can audits reveal about banks and what negative impacts on the entire financial system could have disclosures of such an audit.[58]

[58] Anže Voh Boštic, 2016, Računsko sodišče: zakaj ga pravzaprav imamo in kako učinkovito je, Pod črto - medij za neodivsno novinarstvo, 19.8.2016 https://podcrto.si/racunsko-sodisce-zakaj-ga-pravzaprav-imamo-in-kako-ucinkovito-je/

RECOMMENDATIONS AND CONCLUSIONS[59]

A **debt audit** starts to ask questions: How was the debt accumulated? By whom? Who made or advised on the decisions? Who benefited from the spending of the borrowed money? The educational aspect of debt audits is in a way more important than lobbying decision-makers through available political channels, because the work is about breaking down existing power structures. Without transparency and participation, we risk replacing those in power instead of dismantling the underlying power relations.[60]

In order to reverse the **unequal power relations** at the heart of the **debt** state, we have to identify what created them in the first place. The **debt state**, in other words, has come into being because the government has come to **rely on borrowing** from the bondholding class instead of taxing it. Restoring **progressivity** to the tax system, by increasing tax rates on wealthy households and large corporations, would therefore go a long way in addressing the growing inequalities in ownership of the public debt and in the ownership of wealth and income more generally. And to deal seriously with the problem of inequality, progressive tax reform would need to be combined with substantial increases in social spending, which would be most effectively channeled through a basic income.[61]

[59] This chapter is not finished yet, still in progess...
[60] Fanny Malinen, 2016, The "Golden noose" of global finance. No.3, ROAR Magazine.
[61] Sandy Brian Hager, 2016, Public Debt, Inequality, and Power: the making of a modern debt state, University of California Press. Oakland, California

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