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## **COMMISSION STAFF WORKING DOCUMENT**

### **Country Report Slovenia 2015**

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## EXECUTIVE SUMMARY

### **In 2014 the Slovenian economy grew strongly.**

After a cumulative decline of more than 9% between 2008 and 2013, real GDP is estimated to have grown by 2.6% in 2014. Growth has been predominately export-driven but domestic demand has also started to show signs of recovery. The recovery in investment expenditure has been driven mainly by construction financed through EU funds, while private sector investment remains under pressure. Growth is estimated to slow down to 1.8% in 2015, before increasing to 2.3% in 2016. The unemployment rate remains below the EU average, falling to 9.8% in 2014 and expected to decline further. Public debt is forecast to stand at 83% of GDP in 2015 and gradually increase in the medium term.

### **In March 2014, the Commission concluded that Slovenia continues to experience excessive macroeconomic imbalances.**

This Country Report assesses Slovenia's economy against the background of the Commission's Annual Growth Survey which recommends three main pillars for the EU's economic and social policy in 2015: investment, structural reforms, and fiscal responsibility. In line with the EU Investment Plan, it also explores ways to maximise the impact of public resources and unlock private investment. Finally, it assesses Slovenia in the light of the findings of the 2015 Alert Mechanism Report, in which the Commission found it useful to examine further the persistence of imbalances or their unwinding. The main findings of the In-Depth Review contained in this Country Report are:

- **The high level of non-performing loans and low credit demand from creditworthy firms may have implications on viability of the banking sector.** Although confidence in the banking sector has returned, credit growth remains negative and profitability and viability of the banks can be further enhanced. Non-performing loans to non-financial corporations are still high relative to pre-crisis levels. Continued weakness in the cash flow capacity of the firms constrains lending opportunities and presents further risks to the asset quality and profitability of the banking sector.
- **High debt, deleveraging pressures and the on-going restructuring in the corporate sector have negative implications on private investment and growth.** The corporate sector has been deleveraging since the peak in 2010 but remains undercapitalised, which affects the sector's investment capacity. Low investment has implications on productivity and competitiveness of the companies, their ability to innovate and also erodes Slovenia's potential growth.
- **High involvement of the state and weak corporate governance distorts resource allocation, and hampers investment and growth.** The state is the largest employer, asset manager and corporate debtor in Slovenia. The state involvement in the economy had significant fiscal and economic implications for Slovenian economy since the onset of the crisis. State-owned entities have underperformed compared to their private-owned peers in terms of productivity and profitability both at national and peer country level.
- **External competitiveness and external sustainability have improved considerably and risks appear to have subsided.** Wage restraint since 2011 together with increased productivity and gains in non-cost competitiveness have helped to improve significantly Slovenia's external performance and position in terms of flows and stocks.
- **The large increase in public debt in recent years creates additional challenges.** A prolonged recession coupled with significant bank recapitalisations has resulted in a sharp rise in public debt. Slovenia has undertaken fiscal consolidation in recent years but the measures, particularly on the expenditure side, have been of a temporary nature and reforms of the fiscal framework have lagged. Furthermore, the ageing population creates pressures for the sustainability of the pension and long-term care systems.
- **The labour market reform addressed segmentation and introduced greater flexibility.** The labour market situation is showing signs of improvement but structural challenges persist as regards to long-term unemployment and the low employment rates of low-skilled and older workers.



- **An improved business environment will assist in attracting foreign direct investment.** The business environment is hindered by high government involvement and regulation, which poses obstacles to the inflow of investment. The latter would be important as a source of fresh equity and alternative funding, technology transfer and increased international trade integration.
- **There is a renewed commitment to fight corruption and increase the effectiveness of public administration and the judiciary.** The new government adopted a new two-year programme in January 2015, while the strategy for public administration is expected to be adopted in February 2015. The focus is now on prioritisation and implementation of the programme.
- **Further deleveraging of the corporate sector would help restore the conditions for a rebound of private investment.** The swift restructuring of the corporate sector through the application of existing tools, including the Bank Asset Management Company and the new insolvency legislation, will boost the recovery of cash-flows in the corporate sector. Attracting fresh equity investment from abroad can help reduce the high debt leverage and restore credit worthiness, an important prerequisite for resolving non-performing loans and improving banks' profitability.
- **Further disentangling the complex network of state-owned enterprises would help mitigate possible risks to public finances.** Slovenia could take advantage from the current positive market momentum to divest selected state-owned enterprises. This would assist in attracting foreign direct investment and improving the economic outlook. Sound management and enhanced corporate governance policies for state-owned assets can assist in averting risks of future state support.

**Overall, Slovenia has made some progress in addressing the 2014 country-specific recommendations.** Policy measures to stabilise the banking sector have been completed. The Bank Asset Management Company is now fully operational. The restructuring of four major state-owned banks and the wind-down of two smaller domestic banks are on track. A corporate restructuring master plan and a centralised task force were established. A new corporate governance code for state-owned enterprises was adopted. The Slovenian Sovereign Holding, responsible for the management and divestment of state assets, is now fully operational. A draft asset management strategy is yet to be approved by the Parliament, and will be followed by the release of the divestment schedule for a number of well-targeted state assets. The privatisation programme is progressing, albeit with delays. The sales of the two largest assets are to be signed in April 2015.

The Country Report reveals the policy challenges stemming from the analysis of macro-economic imbalances, namely:

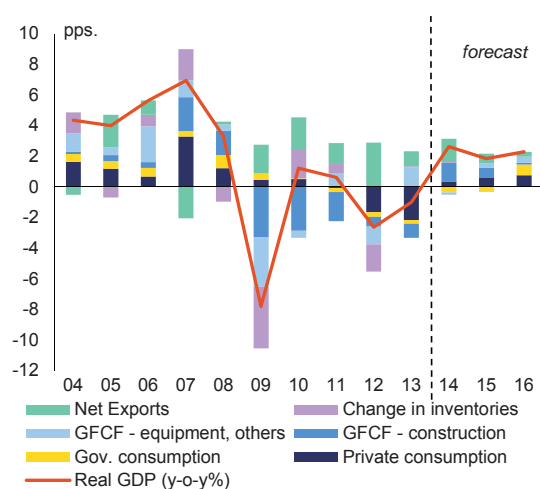
- **Reinforcing the long-term profitability and reducing non-performing loans in the corporate sector will further strengthen the health of the banking sector.** There is scope for further consolidation of the banking sector, which could be facilitated through the continuation of the privatisation process.
- **Attracting foreign direct investment will be essential in ensuring a sustainable recovery.** The new Government has set an ambitious target of reaching the EU average stock of foreign direct investment by 2017. The forthcoming strategy could include a coherent set of both facilitation and promotion measures, including substantially reducing the administrative burden on both local and foreign companies.

# 1. SCENE SETTER: ECONOMIC SITUATION AND OUTLOOK

## Growth performance

**With a loss of more than 9% of GDP, between 2008 and 2013, Slovenia experienced one of the largest economic contractions among euro area countries.** A foreign-financed credit boom facilitated by the euro adoption fuelled aggressive leveraging of the corporate sector and a construction bubble. After a sharp contraction in 2009, the economy rebounded in 2010 and 2011, but entered a second recession in 2012. While initially a large contraction in investment was the main driver of the downturn, consumption began to decline from 2012 onwards (Graph 1.1). Because of the missed pre-crisis opportunity to improve the resilience of the economy to shocks and its slow and insufficient response, Slovenia was more affected by the crisis than other member states.

Graph 1.1: Real GDP growth and contributions



Source: Eurostat, European Commission.

**In 2014, Slovenia began to re-emerge from the recession.** The Commission 2015 winter forecast ("Commission Forecast" hereafter) projects real GDP to have grown by 2.6% in 2014 (Graph 1.1). Growth has been predominately export-driven but domestic demand has also started to show signs of recovery. Private consumption supported by improving sentiment and decreasing unemployment (9.8% in 2014) have contributed to this improvement. The recovery in investment expenditure has been driven mainly by construction co-financed through EU funds. While

potential growth has begun to recover, it remains significantly below pre-crisis levels, with labour and capital accumulation providing no contribution in 2014 (Graph 3.3.13).

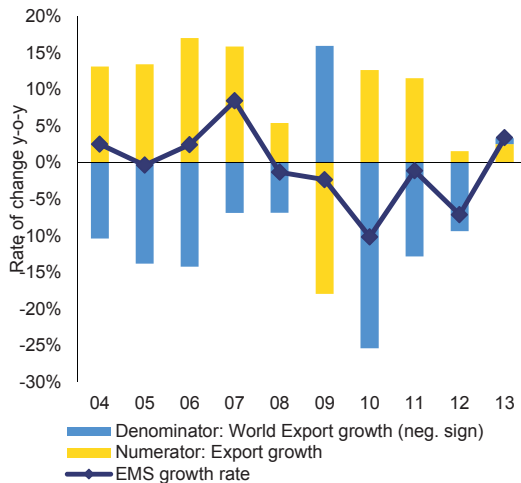
**Growth is expected to continue.** In 2015, economic growth is forecast to decelerate to 1.8%, before picking up to 2.3% in 2016 (Graph 1.1). The deceleration in 2015 is expected to be driven by a slowdown in the growth of public investment. However, private investment in equipment and machinery is expected to pick up progressively and support growth going forward. The acceleration in 2016 is mainly attributable to an assumed resumption in growth of public consumption.

## Trade performance, current account and NIIP

**On the export side, Slovenia has regained export market shares since 2013.** This trend strengthened in the first half of 2014 following the substantial market share losses suffered between 2008 and 2012 (Graph 1.2). Other indicators, such as the Commission's export performance indicator<sup>(1)</sup> offers a slightly more positive picture already as of 2010 (Graph 1.3). Despite a significant underperformance in 2009, export performance measured by this indicator evolved thereafter in line with the EA and outperformed it in 2011. Even though Slovenia lagged behind peers such as the catching up Visegrád member states Czech Republic, Hungary, Poland and Slovakia between 2009-2012, the gap was reduced significantly in 2013.

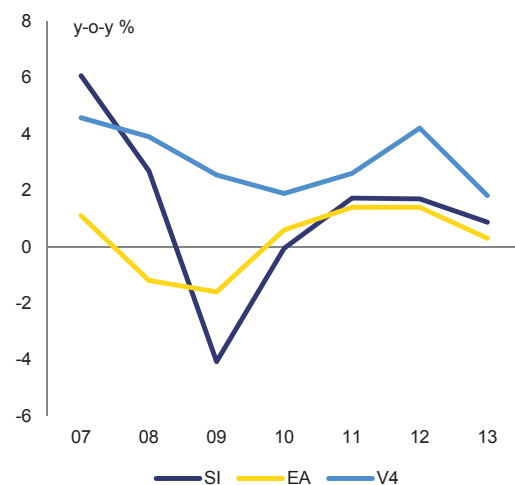
<sup>(1)</sup> The Commission's export performance indicator measures the increase in the value of exports of goods and services relative to the increase of export-weighted imports of goods and services of 36 trading partners.

Graph 1.2: Export market share



Source: Eurostat, WTO.

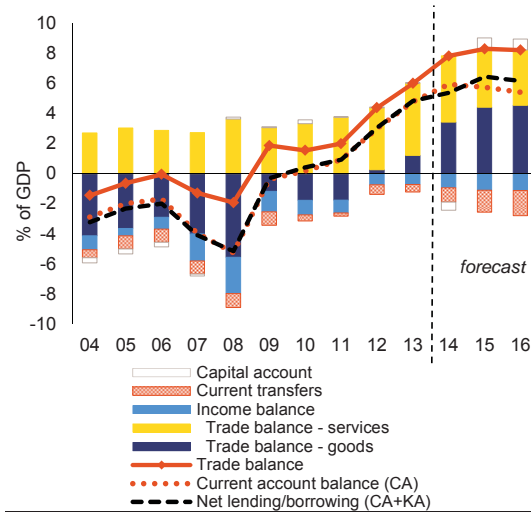
Graph 1.3: Export performance

Visegrád 4 – export weighted average  
Source: European Commission.

The current account surplus widened to 4.8% of GDP in 2013, mainly due to the increase in the trade balance (Graph 1.4). While services make up most of the trade surplus, the goods balance also turned positive in 2012 and is expected to have increased further in 2014. The rebound in exports has not yet been matched by a comparable recovery of imports, due to weak domestic demand, especially investment. Therefore, the change in the trade balance is predominantly driven by an increase in exports,

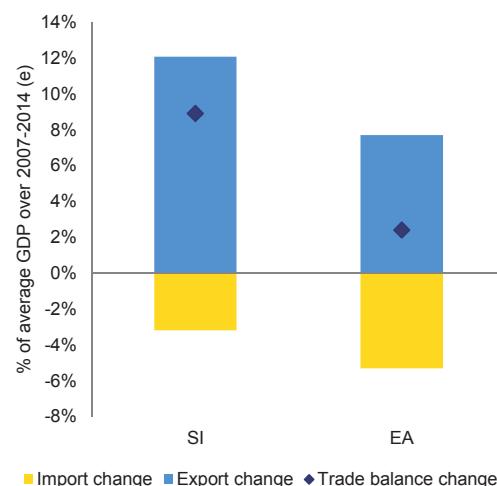
rather than by a fall in imports (Graph 1.5). The income balance remains in deficit at average levels for a converging economy with a relatively high share of foreign capital. The balance of current transfers continues to play a marginal role in the current account balance.

Graph 1.4: Current account



Source: European Commission.

Graph 1.5: Drivers of the trade balance surplus, 2007-2014



Change in trade flows, current prices, 2007-2014(e).

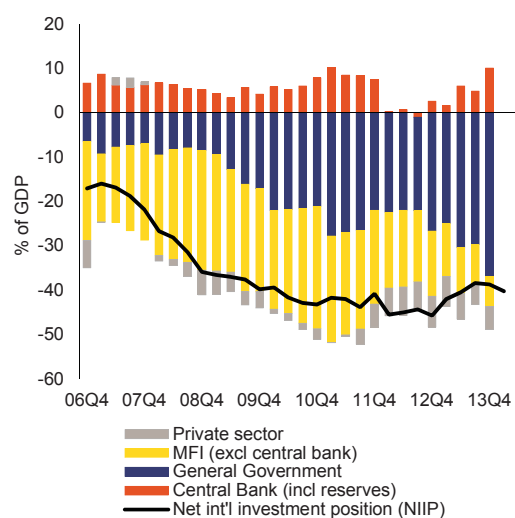
Source: AMECO.

After years of deterioration, net international investment position has started to improve (Graph 1.6). From a moderate negative level of -17.1% of GDP in 2006, the net international

investment position deteriorated rapidly during the crisis, reaching its lowest level of -45.8% of GDP in 2012. The adjustment of the current account on the back of a rise in net exports helped to revert the trend in 2013 and 2014. Driven by strong current account surpluses the NIIP is expected to continue to improve in 2015-2016. Two counteracting trends have led to a structural change of the net international investment position - the significant reduction of net foreign liabilities of monetary and financial institutions since the peak of the crisis (Section 3.1), and the increase of general government borrowing on the international markets to finance the high 2013 deficit <sup>(2)</sup>. This is consequently reflected in the increasing share of government debt securities which now form the biggest component (-18.8% of GDP) of the net international investment position in relative terms. Foreign direct investment is on the other hand limited to only -15.9% of GDP. In view of the negative net international investment position, current account surpluses are required in order to improve Slovenia's external position. The current account is expected to stabilise at around 6% in 2015 before starting to decline slowly, due to an expected progressive reduction in the trade balance surplus in line with accelerating domestic demand. Nevertheless, an elevated current account surplus is expected to persist as long as deleveraging continues.

<sup>(2)</sup> The general government deficit increased to 14.6% of GDP in 2013, of which 10.1% of GDP was related to bank recapitalisations.

Graph 1.6: Net international investment position



Source: European Commission.

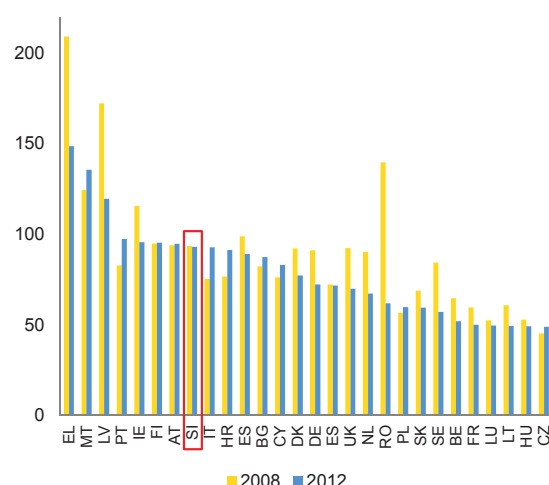
**Public sector debt has increased significantly from 22% of GDP in 2008 to 82% in 2014.** While exceptional items, particularly bank recapitalisations, have significantly contributed to this increase, sustained primary deficits over the period have also attributed to the large increase in public debt. On a no-policy change basis, public sector debt is expected to steadily increase to 87% of GDP in the medium term (i.e. until 2025). Fiscal discipline is required to reduce the debt to GDP ratio (see Section 4.1).

#### Private sector deleveraging

**Private sector indebtedness is among the lowest in the euro area, reflecting one of the lowest levels of household debt, but relatively high corporate debt.** Despite doubling in the 2000s, private debt remained at a comparatively low level of 103.6% of GDP in 2013. However, there are substantial differences between the corporate and household sector. At 29.6% of GDP in 2013, Slovenia's households had the 2<sup>nd</sup> lowest level of indebtedness in the euro area. Conversely, the indebtedness of Slovenia's corporates is considerably higher, at 74% of GDP in 2013. While this is still close to the euro area average, the ratio of the corporate debt to equity is relatively high (Graph 1.7). Further analysis of firm level data is required as corporate debt in Slovenia is unevenly distributed across firms and is high when compared to their earnings and cash

flow capacity to repay (Section 3.1). Non-financial corporations began to deleverage actively<sup>(3)</sup> in 2010 and reduced their indebtedness relative to GDP by 13 pps. by 2013.

Graph 1.7: **Private non-financial sector debt-to-equity ratios in the EU (%)**



Source: Eurostat, European Commission.

**Debt in the corporate sector remains high relative to firm's capacity to repay and is concentrated in a small number of large firms.** About 100 firms with the largest excess debt<sup>(4)</sup> held 42% of the total excess debt in 2013<sup>(5)</sup>. The ratio of excess debt to net financial debt varies from sector to sector. Excess debt accounts for 92% of net financial debt in financial and insurance activities, and 78% in real estate activities (it is primarily unprofitable firms that contribute to the high figures), while manufacturing has one of the lowest figures at 26.2%. In addition, 90% of these over-indebted companies are focused on the domestic market and

<sup>(3)</sup> The label "active deleveraging" is used when negative credit flows are the main driver of the reduction of debt/GDP ratios (because of its effect on the nominal size of the sectors' balance sheet). "Passive deleveraging" refers to the situation when nominal GDP growth drives or contributes to the debt-to-GDP reduction.

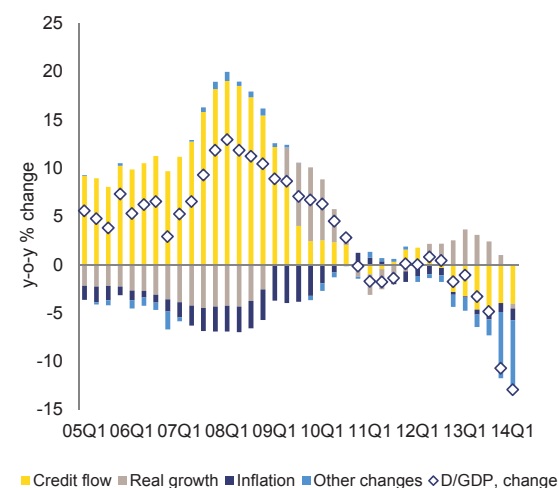
<sup>(4)</sup> "Excess debt" is the debt of companies which are highly leveraged, i.e. have a leverage ratio exceeding 5 - a commonly accepted credit risk threshold.

<sup>(5)</sup> Annex 1 of Bank of Slovenia's Stability of the Slovenian banking system report from December 2014 (<https://www.bsi.si/en/publications.asp?MapaId=1357>)

their capacity to repay the debt is thus dependent on a recovery in domestic demand<sup>(6)</sup>.

**Slovenia deleveraged actively resulting in negative credit flows but faced headwinds from contracting GDP until 2013.** The change in the debt-to-GDP ratio can be split into four main drivers: net credit flows (loan repayments and lack of new lending), real GDP growth, inflation through the GDP deflator and other changes such as valuation changes (Graph 1.8). Since the peak of indebtedness in 2010, Slovenia's corporations deleveraged actively resulting in negative credit flows but contracting GDP exerted upward pressure on the ratio. In 2014 this has changed (real GDP is estimated to have increased by 2.6%) and Slovenia is again benefitting from this deleveraging channel. In addition, valuation changes and restructurings have also contributed positively to the corporate debt reduction. However, with inflation at historically low levels (0.4% in 2014 and forecast at -0.3% in 2015), the borrowers can no longer depend on inflation to reduce the real value of their debt.

Graph 1.8: **Deleveraging contribution dynamics, debt-to-GDP change**



Source: Eurostat, European Commission.

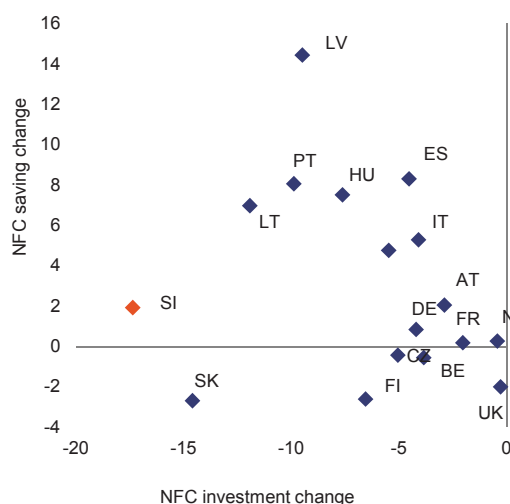
**Active deleveraging has had a negative impact on domestic demand.** Investment has been particularly affected in Slovenia. While saving rate

<sup>(6)</sup> According to analysis of the Institute of Macroeconomic Analysis and Development of the Republic of Slovenia (IMAD).

of non-financial corporations remained largely unchanged, investment took the biggest hit in Slovenia compared to the euro area (Graph 1.9). Unless reversed, this trend will have negative consequences on productivity and economic growth in the medium and long term (more information on investment in section 3.3).

**Deleveraging is expected to continue, albeit at a slower pace.** Weak credit market conditions and the remaining high indebtedness of the corporate sector relative to earnings create pressure for further active deleveraging. This process is likely to be characterised by continued loan repayments and limited new lending activity. The Commission estimates <sup>(7)</sup> that the corporate sector will keep facing deleveraging pressures in the short term. However, deleveraging needs of the households appear limited and the household sector's balance sheet is expected to stop contracting in 2015. Going forward, expected GDP growth would contribute to reducing Slovenia's debt burden. This in turn would reduce the drag on aggregate demand and stress for asset markets.

Graph 1.9: **Non-financial companies - change in investment 2008-13, % of value added**



Source: Eurostat.

### Employment and social conditions

**The labour market showed signs of improvement in 2014.** After 5 years of rising

unemployment, the trend started to reverse. However, structural challenges remain. Long-term unemployment increased in 2014 making up over half of the total unemployed. Youth unemployment rate stabilised marginally below the EU average. The number of people at risk of poverty or social exclusion has risen consistently since 2009.

### Inflation

**Three different inflationary patterns are identified over the years in Slovenia.** During the years preceding the financial crisis Slovenia experienced increasing inflation, which remained consistently above the euro area average and peaked at 6.5% in the first quarter of 2008. Between 2009 and 2012, core inflation remained at low levels and HICP developments were mainly attributable to changes in energy and unprocessed food prices. In the following period core inflation stabilised, but since the third quarter of 2013 it has gradually declined reflecting weaker domestic demand and declining import prices. In 2014, the steep fall in the oil price and declining food prices had a significant impact in driving headline inflation lower. Taking into account the improving consumer confidence and its lag with the headline inflation, the decreasing trend of HICP is expected to bottom out in the second quarter of 2015. Deflation of 0.3% is projected in 2015 before returning to a moderate inflation rate of 0.9% in 2016 as the economic recovery strengthens (Graph 1.10).

<sup>(7)</sup> Quarterly report on the euro area. [Volume 13 \(2014\) Issue 3](#).



### Box 1.1: Economic surveillance process

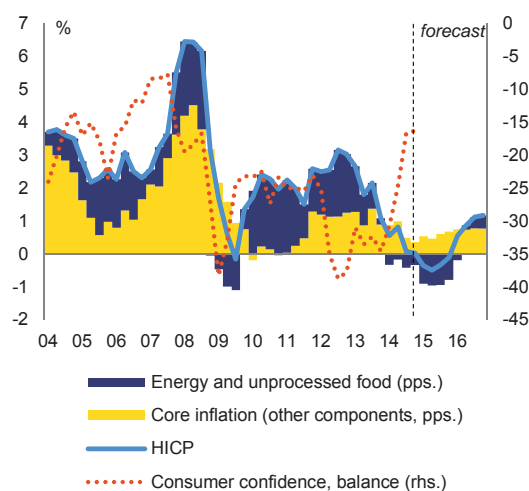
The Commission's Annual Growth Survey, adopted in November 2014, started the 2015 European Semester, proposing that the EU pursue an integrated approach to economic policy built around three main pillars: boosting investment, accelerating structural reforms and pursuing responsible growth-friendly fiscal consolidation. The Annual Growth Survey also presented the process of streamlining the European Semester to increase the effectiveness of economic policy coordination at the EU level through greater accountability and by encouraging greater ownership by all actors.

In line with streamlining efforts this Country Report includes an In-Depth Review — as per Article 5 of Regulation no. 1176/2011 — to determine whether macroeconomic imbalances still exist, as announced in the Commission's Alert Mechanism Report published on November 2014.

Based on the 2014 IDR for Slovenia published in March 2014, the Commission concluded that Slovenia was experiencing excessive macroeconomic imbalances requiring decisive policy action, in particular the risk stemming from an economic structure characterised by weak corporate governance, high level of state involvement in the economy, losses in cost competitiveness, the corporate debt overhang, and the increase in government debt.

This Country Report includes an assessment of progress towards the implementation of the 2014 Country-Specific Recommendations adopted by the Council in July 2014. The Country-Specific Recommendations for Slovenia concerned fiscal policy and long-term fiscal stability (including pension reform and long-term care); effective tailor-made active labour-market policy measures, skills mismatches, wages and labour market segmentation; restructuring of the banking and corporate sectors, including Slovenian Sovereign Holding; privatisation; selected aspects of the business environment; and fighting corruption.

Graph 1.10: HICP and consumer confidence



Source: EUROSTAT, European Commission.





Table 1.1: Key economic, financial and social indicators - Slovenia

	2008	2009	2010	2011	2012	2013	Forecast		
							2014	2015	2016
Real GDP (yoy)	3.30	-7.80	1.22	0.61	-2.64	-1.00	2.62	1.84	2.29
Private consumption (yoy)	2.39	0.90	0.95	-0.14	-2.97	-3.87	0.64	1.10	1.44
Public consumption (yoy)	4.93	2.41	0.14	-1.33	-1.48	-1.12	-1.80	-1.70	3.90
Gross fixed capital formation (yoy)	7.02	-22.01	-13.67	-4.61	-8.87	1.86	5.46	4.72	2.45
Exports of goods and services (yoy)	4.17	-16.59	10.12	7.02	0.30	2.64	5.79	4.19	5.27
Imports of goods and services (yoy)	3.85	-18.84	6.59	5.04	-3.92	1.39	4.18	3.76	5.43
Output gap	6.82	-3.05	-2.32	-1.67	-3.95	-4.63	-2.56	-1.42	-0.05
Contribution to GDP growth:									
Domestic demand (yoy)	4.09	-5.62	-2.78	-1.33	-3.75	-2.04	1.06	1.23	1.98
Inventories (yoy)	-0.96	-4.03	1.86	0.59	-1.79	0.07	0.10	0.00	0.00
Net exports (yoy)	0.17	1.85	2.14	1.35	2.90	0.98	1.46	0.62	0.32
Current account balance BoP (% of GDP)	-5.43	-0.61	-0.08	0.23	2.65	5.61	.	.	.
Trade balance (% of GDP), BoP	-1.86	1.90	1.36	1.27	4.09	6.97	.	.	.
Terms of trade of goods and services (yoy)	-1.27	3.51	-4.04	-1.43	-1.00	0.99	0.87	-0.03	-0.29
Net international investment position (% of GDP)	-35.08	-38.92	-42.36	-40.23	-45.15	-38.19	.	.	.
Net external debt (% of GDP)	30.86*	37.19*	40.34*	36.99*	41.90*	35.29*	.	.	.
Gross external debt (% of GDP)	103.57	111.75	112.75	109.29	115.27	111.24	.	.	.
Export performance vs. advanced countries (5 years % change)	26.8*	16.7*	5.2*	1.8*	-12.0*	-10.6*	.	.	.
Export market share, goods and services (%)	0.19*	0.18	0.16	0.16	0.15	0.15	.	.	.
Savings rate of households (Net saving as percentage of net disposable income)	9.69	7.85	6.25	5.82	3.52	6.76	.	.	.
Private credit flow (consolidated, % of GDP)	15.60	2.90	2.00	0.50	-2.80	-4.10	.	.	.
Private sector debt, consolidated (% of GDP)	105.60	113.50	115.60	113.50	112.80	101.90	.	.	.
Deflated house price index (yoy)	1.50	-10.00	-1.40	1.00	-8.40	-6.10	.	.	.
Residential investment (% of GDP)	4.60	3.80	3.10	2.80	2.70	2.50	.	.	.
Total Financial Sector Liabilities, non-consolidated (yoy)	3.60	4.70	-2.50	-2.20	-3.40	-10.40	.	.	.
Tier 1 ratio (1)	8.72	8.86	8.26	8.82	9.07	12.95	.	.	.
Overall solvency ratio (2)	11.67	11.68	11.32	11.84	11.41	13.67	.	.	.
Gross total doubtful and non-performing loans (% of total debt instruments and total loans and advances) (2)	.	.	.	.	.	.	.	.	.
Employment, persons (yoy)	2.39	-1.37	-1.89	-1.41	-0.52	-1.91	0.19	0.58	0.88
Unemployment rate	4.40	5.90	7.30	8.20	8.90	10.10	9.80	9.50	8.90
Long-term unemployment rate (% of active population)	1.90	1.80	3.20	3.60	4.30	5.20	.	.	.
Youth unemployment rate (% of active population in the same age group)	10.40	13.60	14.70	15.70	20.60	21.60	21.70	.	.
Activity rate (15-64 years)	71.80	71.80	71.50	70.30	70.40	70.50	.	.	.
Young people not in employment, education or training (% of total population)	6.50	7.50	7.10	7.10	9.30	9.20	.	.	.
People at-risk poverty or social exclusion (% total population)	18.50	17.10	18.30	19.30	19.60	20.40	.	.	.
At-risk poverty rate (% of total population)	12.30	11.30	12.70	13.60	13.50	14.50	.	.	.
Severe material deprivation rate (% of total population)	6.70	6.10	5.90	6.10	6.60	6.70	.	.	.
Persons living in households with very low work intensity (% of total population)	6.70	5.60	7.00	7.60	7.50	8.00	.	.	.
GDP deflator (yoy)	4.51	3.36	-1.06	1.17	0.31	1.40	0.38	0.17	0.99
Harmonised index of consumer prices (yoy)	5.53	0.86	2.10	2.09	2.81	1.92	0.37	-0.33	0.94
Nominal compensation per employee (yoy)	7.21	1.84	4.01	1.57	-1.20	1.86	0.84	1.52	2.09
Labour Productivity (real, person employed, yoy)	0.70	-6.10	3.50	2.30	-1.80	0.50	.	.	.
Unit labour costs (whole economy, yoy)	6.44	8.48	0.53	-0.69	0.64	1.37	-1.32	0.31	0.72
Real unit labour costs (yoy)	1.85	4.96	1.61	-1.84	0.33	-0.03	-1.69	0.14	-0.27
REER (ULC, yoy)	2.48	5.76	-0.86	-0.93	-2.36	1.07	-2.27	-1.46	-0.26
REER (HICP, yoy)	1.24	1.52	-2.37	-0.94	-0.72	1.20	1.04	-0.32	-0.86
General government balance (% of GDP)	-1.83	-6.13	-5.67	-6.24	-3.75	-14.55	-5.35	-2.92	-2.78
Structural budget balance (% of GDP)	.	.	-4.56	-4.46	-1.83	-1.87	-2.49	-2.25	-2.90
General government gross debt (% of GDP)	21.65	34.48	37.94	46.15	53.39	70.35	82.19	82.96	81.81

(1) domestic banking groups and stand-alone banks.

(2) domestic banking groups and stand alone banks, foreign (EU and non-EU) controlled subsidiaries and foreign (EU and non-EU) controlled branches.

(\*) Indicates BPM5 and/or ESA95

Source: Eurostat, ECB, AMECO.

Table 1.2: MIP scoreboard indicators - Slovenia

			Thresholds	2008	2009	2010	2011	2012	2013
External Imbalances and Competitiveness	Current Account Balance as % of GDP	3 year average	-4%/6%	-3.8	-3.4	-2.0	-0.2	0.9	2.8
		p.m.: level year	-	-5.4	-0.6	-0.1	0.2	2.6	5.6
	Net International Investment Position as % of GDP		-35%	-35.1	-38.9	-42.4	-40.2	-45.2	-38.2
	Real Effective Exchange Rate (42 IC - HICP deflator)	% change (3 years)	±5% & ±11%	2.1	5.2	1.2	-1.1	-4.5	-0.7
		p.m.: % y-o-y change	-	1.6	2.3	-2.6	-0.8	-1.2	1.3
	Export Market shares	% change (5 years)	-6%	12.1	6.8	-3.7	-7.0	-20.4	-16.6
		p.m.: % y-o-y change	-	-1.3	-2.3	-10.2	-1.2	-7.1	3.3
	Nominal ULC	% change (3 years)	9% & 12%	10.6	18.5	16.1	8.3	0.5	1.3
p.m.: % y-o-y change		-	6.4	8.5	0.5	-0.7	0.6	1.4	
Internal Imbalances	% y-o-y change in Deflated House Prices		6%	1.4	-10.3	-1.3	1.0	-8.1	-5.8
	Private Sector Credit Flow as % of GDP, consolidated		14%	15.5	2.9	1.9	0.4	-2.9	-4.0
	Private Sector Debt as % of GDP, consolidated		133%	105.6	113.5	115.6	113.4	112.9	101.9
	General Government Sector Debt as % of GDP		60%	21.6	34.5	37.9	46.2	53.4	70.4
	Unemployment Rate	3 year average	10%	5.1	5.1	5.9	7.1	8.1	9.1
		p.m.: level year	-	4.4	5.9	7.3	8.2	8.9	10.1
	% y-o-y Change in Total Financial Sector Liabilities		16.5%	6.6	7.7	-3.4	-1.3	-0.7	-10.5
	Note: Figures highlighted are the ones falling outside the threshold established by EC Alert Mechanism Report. For REER and ULC, the first threshold concerns Euro Area Member States. (1) Figures in italic are according to the old standards (ESA95/BPM5). (2) Export market shares data: the total world export is based on the 5th edition of the Balance of Payments Manual (BPM5).								

**Source:** European Commission, Eurostat and DG ECFIN (for the indicators on the REER).

## 2. IMBALANCES, RISKS, AND ADJUSTMENT

## 2.1. INTERPLAY OF BANKING SECTOR AND CORPORATE SECTOR RESTRUCTURING

### **Balance sheet contraction, rising non-performing loans, erosion of capital buffers and liquidity pressures affected the Slovenian banking system from the onset of the crisis.**

All Slovenian banks, large state-owned banks in particular, have suffered sizeable losses and have significantly shrunk their balance sheets since the beginning of the crisis in 2008. The first phase of deleveraging was triggered by the international financial crisis. Many Slovenian-specific elements such as the high debt leverage of the corporate sector, the significant involvement of the state in the economy and short-comings in risk management and corporate governance, were revealed and reinforced by the crisis, triggering a sharp increase in non-performing loans in banks. These credit quality trends, together with deteriorating collateral values, quickly eroded capital bases and market confidence.

### **State of play of banking and corporate restructuring**

**Following the extensive overhaul of the banking system in 2013 Slovenia has taken further policy action to stabilise the banking sector in 2014.** On 12 December 2013 the Slovenian authorities announced their strategy for the restructuring of the financial sector based on the outcome of the Asset Quality Review and Stress Test. The Stress Test identified capital deficits of up to EUR 4.8 billion, EUR 3.2 billion of which was provided by the state in December 2013. These measures were reinforced by several further policy actions to stabilise the banking sector in 2014. The recapitalisation of Banka Celje with EUR 190 million together with a transfer of assets of EUR 412 million (gross value) in December have been the latest measures taken by the Slovenian authorities. Overall six banks have received capital amounting to EUR 3.6 billion (Table 2.1.1). Foreign banks that took part in the 2013 stress test exercise (UniCredit Bank, Raiffeisen Bank, Hypo Group Alpe Adria) have also substantially improved their capital positions mainly through reduction of risk-weighted assets and/or direct capital injections by their parent banks. Although the results of the ECB comprehensive assessment published in October 2014 identified a joint capital shortfall of EUR

65.3 million for both NKBM and NLB<sup>(8)</sup>, the exercise found that the measures taken to improve structural profitability and the retained earnings of the banks in 2014 will cover the shortfalls identified for both banks. Bank of Slovenia has sought an appropriate follow-up of the shortcomings identified by the Asset Quality Review exercise of 2013 and has introduced two macro-prudential initiatives targeted at easing competition for deposits – (i) a cap on deposit interest rates introduced in 2012 and (ii) minimum requirements for the ratio of annual changes of the stocks of loans to non-bank deposits to slow the rapid decline in the loan-to-deposit ratio (Box 2.1.1).

**The Bank Asset Management Company has set out its strategy and business plan and is now fully operational.** The Bank Asset Management Company has so far received assets with a total gross value of approximately EUR 5.0 billion (net value of EUR 1.7 billion) from four state-owned banks (Nova Ljubljanska Banka - NLB, Nova Kreditna Banka Maribor - NKBM, Abanka and Banka Celje) and two smaller domestic banks in wind-down - Probanka and Factor Banka (Table 2.1.1). Approximately two thirds of the exposures are in default. The objective of the Bank Asset Management Company for these loans will be to acquire the collateral (mostly real estate but also some equity and company assets). The remaining approximately 100 cases in the portfolio of the Bank Asset Management Company are companies with potentially viable core activities, which could be maintained if they were subject to an appropriate financial and operational restructuring.

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<sup>(8)</sup> For more details, please consult information published on the ECB web page: <https://www.ecb.europa.eu/ssm/assessment/html/index.en.htm>

Table 2.1.1: Overview of executed recapitalisation measures and asset transfers to the BAMC

	Capital increase (EURmillion)		Transfer of assets to BAMC (transfer /gross value, EURmillion)	
	2013	2014	2013	2014
<b>Total</b>	<b>3 188</b>	<b>433</b>	<b>1 012/ 3 301</b>	<b>690/ 1 671</b>
NLB	1 551		622/ 2 278	
NKBM	870		390/ 1 023	
Abanka	348	243		538/ 1 087
Banka Celje		190		113/ 412
Probanka	170			28/ 118
Factor Banka	259			11/ 54

Source: Bank of Slovenia, Commission services.

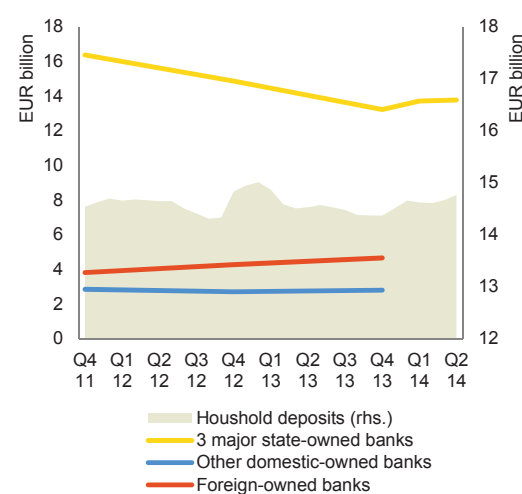
**The restructuring of the highly leveraged corporate sector remains a key challenge for the banking sector and the Slovenian economy as a whole.** The Ministry of Finance supported by the Bank of Slovenia has set up a comprehensive restructuring master plan. A task force has been established to monitor and coordinate the overall restructuring process, to facilitate the negotiation process between all stakeholders involved and to provide the necessary guidance and advice. The coordinating body of the task force is composed of representatives of the Ministry of Finance, the Bank of Slovenia, the Ministry of Economics, the Ministry of Justice and the Bank Asset Management Company and meets twice a month.

#### Credit and financial developments since mid-2013

**The restored confidence in the Slovenian banking system has eased liquidity pressures.** Confidence in the major state-owned banks has returned and there has been an inflow of retail funds since the beginning of 2014 (Graph 2.1.1). The market exit of Probanka and Factor Banka, two smaller banks that were competing intensively for deposits until September 2013, could have relieved the competition on deposits. Since mid-2013 deposit rates decreased by approximately, 150-200 basis points (Graph 2.1.2 and Graph 2.1.3). The closure of the gap in interest rates for deposits between state-owned and foreign-owned banks results from various factors, particularly the improved funding conditions of state-owned banks, the cap on deposit interest rates and the

restoration of consumer confidence in state-owned banks.

Graph 2.1.1: Household deposit of sector - total deposits by type of bank



Source: Bank of Slovenia, Fitch.

**Box 2.1.1: Measures taken by the Bank of Slovenia to improve corporate governance and risk management in banks**

Following the conclusion of the asset quality review (AQR) and the stress test carried out in 2013, which revealed serious shortcomings in the banks' business processes and risk management practices, Bank of Slovenia asked all banks involved in the exercise to respond to the AQR findings that affected them. Three banks that benefited from state aid were asked to submit an action plan by the end of March 2014 to address the deficiencies identified in the AQR and to implement their plan before the end of 2014.

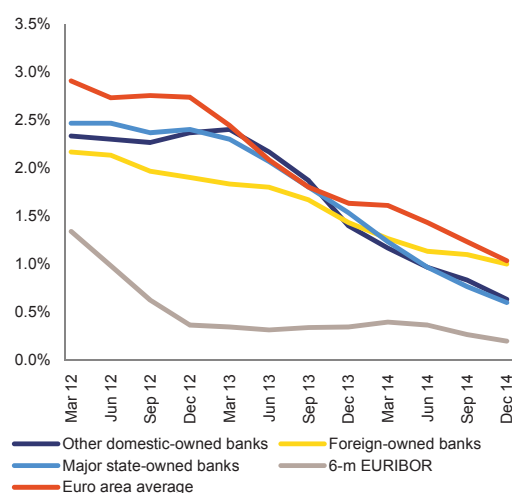
Implementation of these action plans is being assessed by Bank of Slovenia in cooperation with the single supervisory mechanism (SSM). The banks have improved practices in many areas, especially underwriting standards and NPL work-out. Since December 2014, NPL and forbearance definitions are in line with EBA definitions in all banks. New and tighter corporate governance rules were introduced during 2014, in line with international standards. Further measures could be taken to address some shortcomings identified by the AQR in 2013 (e.g. on IT, data and quantitative aspects), but overall, risk management practices appear to have significantly improved during 2014.

Bank of Slovenia has also introduced some additional regulations regarding banks' corporate governance, relating to the membership and functioning of banks' boards, strengthening the provisions on the management of credit, market and operational risks, on the internal control functions (i.e. internal audit, compliance and information security) and diligence of members of the management body, risk management and remuneration.

Bank of Slovenia has also taken steps to improve its own effectiveness on banking supervision and in the area of corporate governance. In 2012, Bank of Slovenia requested an IMF review of its supervisory practices. On the basis of IMF's recommendations, a detailed action plan was drawn up. In spring 2014, Bank of Slovenia carried out an internal reorganisation and again requested IMF technical assistance. Among other issues, this identified a lack of supervisory staff. A new central credit registry (CCR) for corporates and private persons is also being set up. This is expected to be operational from 2016 and will be connected to the other CCRs within the euro area to be used for micro- and macro-supervision and research purposes. During 2013 and 2014, with the instability in the banking sector and the AQR and stress test that followed, Bank of Slovenia's on-site supervision activity was stopped due to lack of resources. On-site supervision activities will be resumed in 2015. Following a bilateral agreement, the SSM will also support Bank of Slovenia in monitoring non-systemic banks, which will certainly contribute to carrying out supervisory activity with adequate resources, based on high international standards. It will be important to monitor closely how the banks implement the new regulatory guidance on corporate governance and risk management and how they have addressed the shortcomings identified in the two AQRs to make sure the events of the recent past are not repeated.

**Policy measures taken in 2013 and 2014 have facilitated the deleveraging of banks' balance sheets.** Since 2012, negative credit flows have led to a steady decline of the loan stock, in particular in the state-owned banks. The deleveraging process that is currently underway has contributed to this decline. However, there are several one-off factors that have also affected the stock on an aggregate level. The commencement of the orderly wind down of Factor Banka and Probanka and the additional significant amount of provisions required as a result of the 2013 asset quality review further contributed to the strong decline in 2013. The significant fall at the end of 2013 was driven by the transfers of non-performing loans from NLB and NKBM to the Bank Asset Management Company (Graph 2.1.4). The additional transfers to the Bank Asset Management Company from Abanka in October 2014 and Banka Celje in December 2014 further reduced the aggregate level across the system.

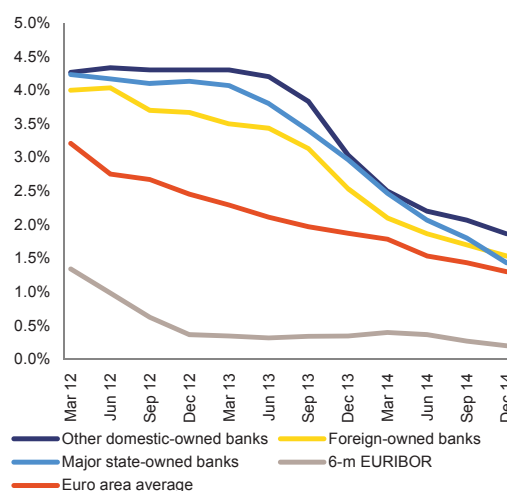
Graph 2.1.2: Deposit rates (&lt; 1 year)



Source: Bank of Slovenia.

**The improvement of the funding situation and the reduction of the loan books allowed banks to repay most of their ECB borrowing and a significant portion of their interbank debt** (Graph 2.1.5). Slovenian banks participated in the September and December 2014 Targeted Longer Term Refinancing Operations for EUR 706 million (71% of potential volume).

Graph 2.1.3: Deposit rates (&gt; 1 year)



Source: Bank of Slovenia.

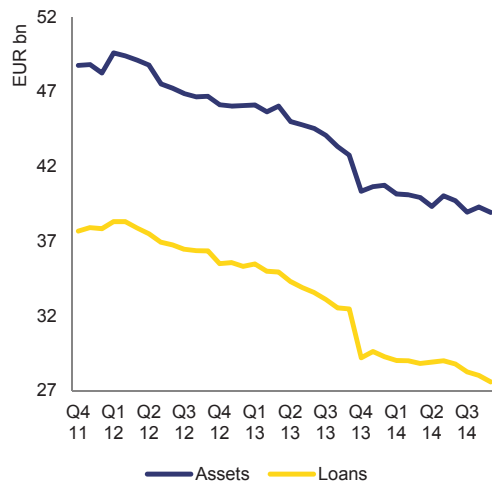
The funds helped the banks to continue the early repayment of the three-year Longer Term Refinancing Operations settled in 2011 and 2012, of which 90% have been repaid. NLB regained access to funding in the international capital markets in July 2014 supported by favourable market conditions <sup>(9)</sup>. In view of the improved funding situation in the banking system the deleveraging pressure on domestic banks is expected to ease going forward. Foreign banks have also deleveraged although the size of their balance sheets have been reducing at a slower pace <sup>(10)</sup>. Many foreign-owned banks (Raiffeisen Bank <sup>(11)</sup>, Hypo Group Alpe Adria) have actively reduced their exposure to the Slovenian market and repaid part of the intra group lending to their parent institutions (see the significant increase of foreign loans in foreign banks in Graph 2.1.15). Although loan to deposit ratios of foreign-owned banks have decreased faster than in domestically-owned banks they are still higher due to the outstanding stocks of intra group funding.

<sup>(9)</sup> NLB issued a EUR 300 million 3-year unsecured bond at a 3% yield on the Luxembourg market. Further bond offerings are envisaged in the near future.

<sup>(10)</sup> There are few exceptions. Sperbank has increased its balance sheet from EUR 904 million in 2009 to EUR 1.5 billion in 2013.

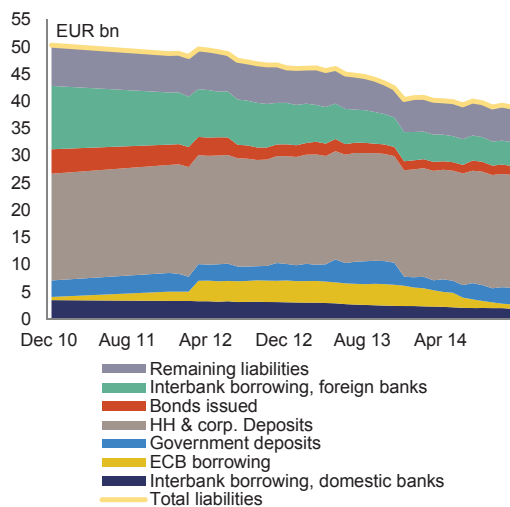
<sup>(11)</sup> Raiffeisen Bank International decided to exit the Slovenian market.

Graph 2.1.4: Total assets and loans of the Slovenian banking system



Source: Bank of Slovenia.

Graph 2.1.5: Composition of banks' liabilities

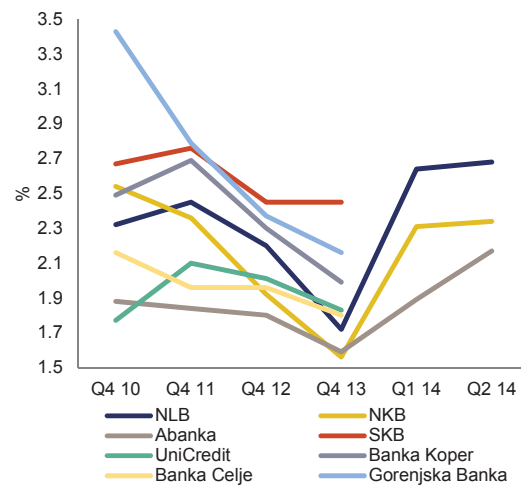


Source: Bank of Slovenia.

After the significant losses of the past three years, the banking sector has returned to profitability in 2014. Net interest margins and profitability have started to recover (Graph 2.1.6). The higher net interest margins are mainly driven by the sharp reduction of interest rates on non-banking deposits (Graph 2.1.7). The improved profitability can be attributed to the significantly lower level of impairments and provisions and the growth in net interest income. For NLB and NKBM some beneficial effects on interest income

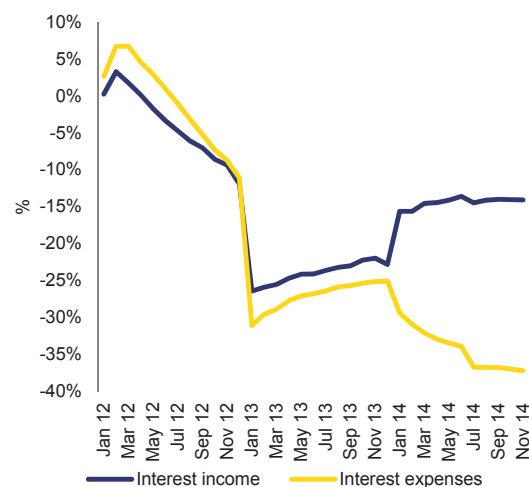
arise from the high yield (approximately 4%) on government and Bank Asset Management Company bonds the banks received in December 2013 in the context of recapitalisations and asset transfers. This source of revenue however is temporary as the bonds mature in 2015-2016. The government and Bank Asset Management Company bonds received by Abanka and Banka Celje in 2014 were issued at significantly lower yield in line with the market developments (approximately 1.5%).

Graph 2.1.6: Net interest margin by bank



Source: Fitch.

Graph 2.1.7: Growth rate of interest income and expenses of the banking sector



Source: Bank of Slovenia.

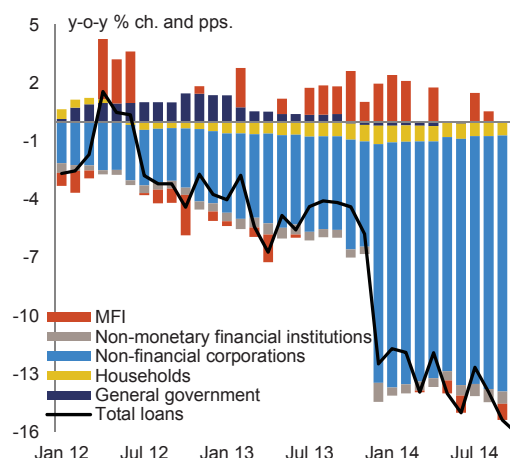


### Remaining challenges

**Lending to the real economy remains constrained.** Credit growth in Slovenia continues to be negative (Graph 2.1.8), although a large part of that negative growth is due to the one-off transfer of non-performing loans to the BAMC. The negative credit growth is more pronounced for domestic-owned than for foreign-owned banks, partly due to the speed of deleveraging of domestic-owned banks but also due to differences in market behaviour and the banks' risk aversion (Graph 2.1.9). The negative trend in lending to non-financial corporates is closely linked to the low cash-flow capacity and high leverage of the Slovenian corporate sector, the remaining high level of corporate non-performing loans on banks' balance sheets and the on-going financial and operational restructuring in the corporate sector. The number of creditworthy corporates requesting loans in the domestic market is low and competition for these clients is intense. Most of the nationally recognized, well-established and financially sound companies have access to financing abroad at more competitive rates, as loan rates (especially short-term) in Slovenia generally remain above those of their regional peers (Graph 2.1.10 and 2.1.11), or are taking the opportunity to tap international and domestic capital markets<sup>(12)</sup>. Consequently, competition between domestic banks has further increased and has started to exert pressure on corporate lending rates, which could adversely impact net interest margins and profitability of the banks going forward.

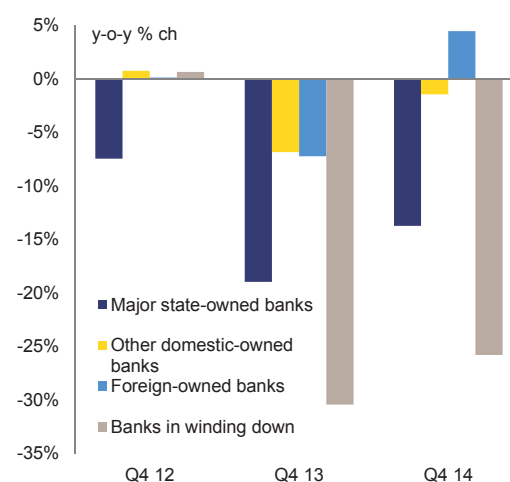
<sup>(12)</sup> In 2014 some Slovenian corporates have managed to issue unsecured bonds in the amount of EUR 200-300 million in the domestic market at lower rates than those offered by the banks.

Graph 2.1.8: **Change in stock of domestic credit and contributions**



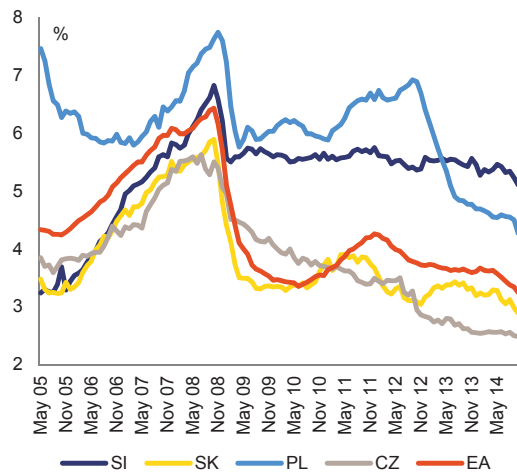
Source: Bank of Slovenia.

Graph 2.1.9: **Credit growth - Total loans**



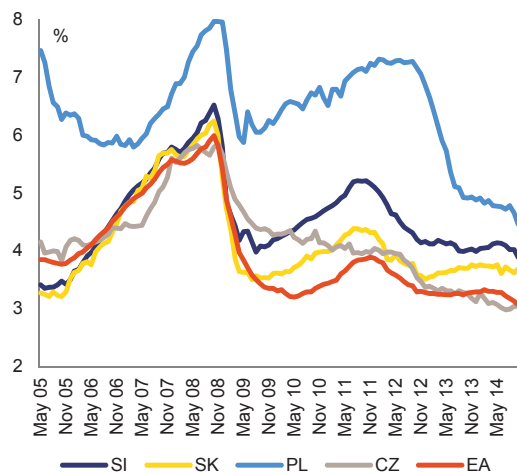
Source: Bank of Slovenia.

Graph 2.1.10: Short term interest rates (&lt; 1 year)



Source: ECB.

Graph 2.1.11: Long term interest rates (&gt;1 year)



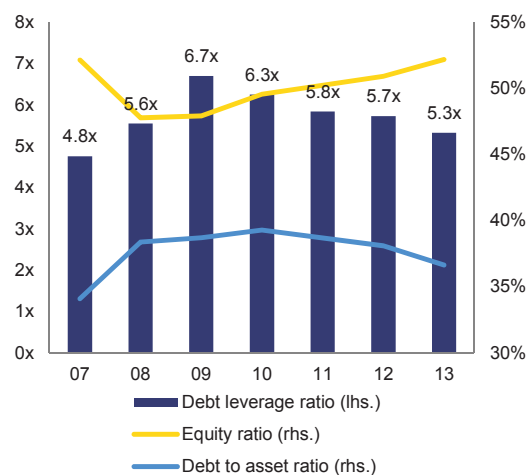
Source: ECB.

**The high debt leverage of the corporate sector is adjusting, but profitability and creditworthiness of borrowers has not yet significantly improved.** The leverage ratio<sup>(13)</sup> increased from a moderate multiple of 4.8 before the crisis (2007) to its peak of 6.7 in 2009 (Graph

<sup>(13)</sup> The debt leverage ratio represents the level of debt relative to the company's cash flow capacity. The debt leverage ratio is defined as the total financial debt net of cash and cash equivalents on balance sheet divided by the earnings before interest, tax, depreciation and amortisation. Companies are defined as "highly leveraged" if their leverage ratio exceeds 5 - a commonly accepted credit risk threshold.

2.1.12),<sup>(14)</sup> also mirrored by an increase in the debt to total assets ratio. Deleveraging started in 2010 and has been progressing since then, though in different stages, which has formed three different categories of debtors (Box 2.1.2). In 2010 - 2011, deleveraging was mainly driven by market exits (bankruptcies or firm takeovers). Since 2012 financial liabilities of ongoing businesses have been declining (by EUR 0.4 billion in 2012 and by further EUR 0.5 billion in 2013)<sup>(15)</sup>. The reduction of financial liabilities in viable firms is expected to have accelerated further in 2014 based on most recent data. Nevertheless, profit margins have not improved since their collapse during the crisis. This can be seen both in terms of operational profitability (Earnings before interest, taxes, depreciation and amortization - EBITDA margin<sup>(16)</sup>), indicating that the capacity of the corporate sectors to generate cash flows and repay debt has not yet fully recovered. It is also evident from net profit margins, which remains squeezed due to high debt service costs (Graph 2.1.13).

Graph 2.1.12: Indebtedness of the corporate sector



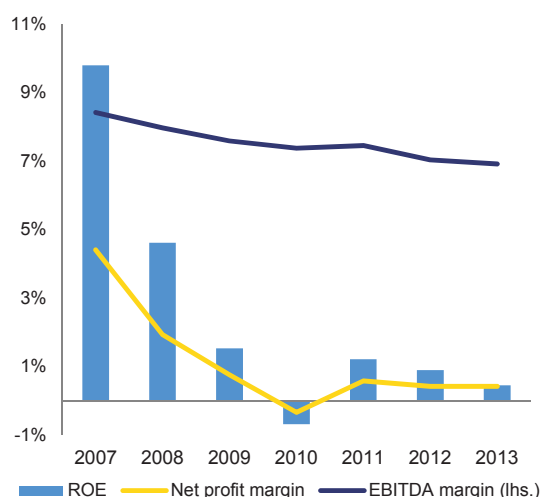
Source: AJPES, Commission services.

<sup>(14)</sup> Based on microeconomic data provided by Bank of Slovenia (see section 4 in the 2014 IDR).

<sup>(15)</sup> According to analysis of the Institute of Macroeconomic Analysis and Development (IMAD) based on data provided by the Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES).

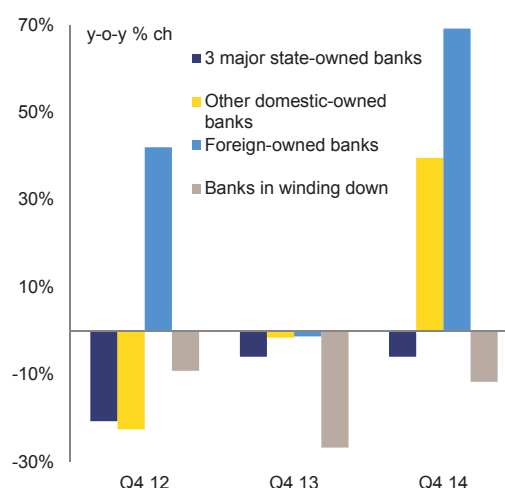
<sup>(16)</sup> EBITDA margin is defined as EBITDA divided by revenues. It is commonly used to indicate the ability of a company to service debt.

Graph 2.1.13: Cash flow capacity and profitability of the corporate sector



Source: AJPES, Commission services.

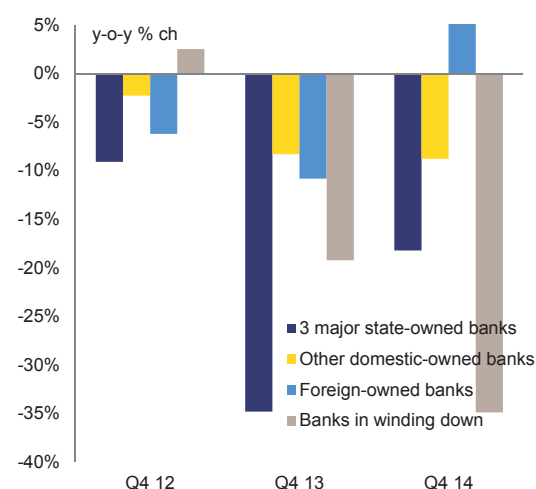
Graph 2.1.15: Credit growth - foreign loans



SID Banka not included

Source: Bank of Slovenia.

Graph 2.1.14: Credit growth - corporate loans (incl. SME)

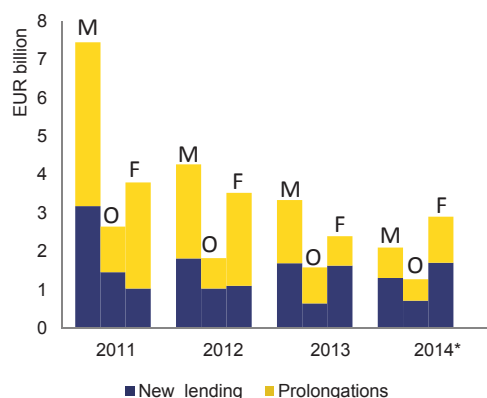


Source: Bank of Slovenia.

**The 3 major state-owned banks are particularly affected by the increased competition and the lack of good-quality credit demand.** While state-owned banks are bound by the commitments provided in the context of the state aid restructuring procedures (i.e. minimum return on equity on new loans, maximum cost income ratio), foreign-owned banks have more flexibility. As a consequence of the new risk management policy of state-owned banks, loans to clients rated below B can in practice only be provided if they are highly collateralised or secured with a guarantee (e.g. by another bank, a parent company, a subsidiary or the state). Various lending support schemes have been launched by SID Banka (the Slovenian development bank) to enhance lending to SMEs, but few companies appear to meet the criteria, so the funds remain largely undrawn (Section 4.3).

**In state-owned banks, lending has focused on the roll-over of stocks related to restructurings with new lending lower than in foreign-owned banks** (Graph 2.1.16). One reason may be that the focus of the domestically owned banks is the ongoing work-out of corporate non-performing loans which is resource intensive. A proportion of the "new lending" from foreign-owned banks is not targeted at the local economy but is linked to the reduction of the intra group lending from their parent institutions (Graph 2.1.15).

Graph 2.1.16: New lending vs. prolongation



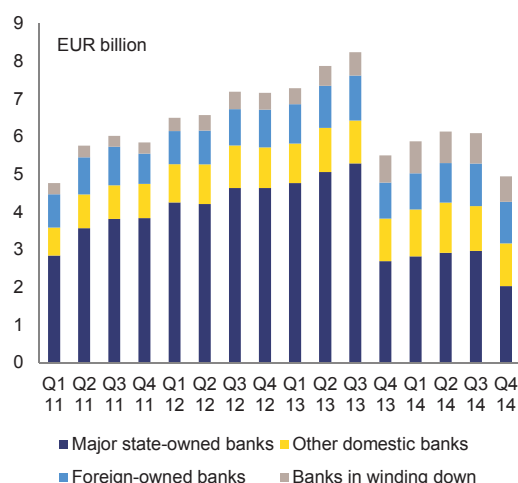
M – Major state-owned banks, O – Other domestic banks, F – foreign-owned banks  
 SID Banka is not included  
 Source: Bank of Slovenia.

The level of non-performing loans remains elevated compared to pre-crisis level, despite the transfers made by banks to the Bank Asset Management Company. In November 2014 the volume and level of NPLs in the banking system decreased to EUR 5.1 billion due to the transfer of non-performing loans to the BAMC and stands at a level of 13.1%<sup>(17)</sup>. Nevertheless, the major state-owned banks have systematically higher non-performing loan ratios than foreign-owned banks although the former have benefitted from a transfer to the BAMC (Graph 2.1.18). The still high volume of non-performing loans in domestic banks (Graph 2.1.17) is the result of the selective and only partial transfer of non-performing loans to the BAMC, a still deteriorating quality of the domestic loan portfolio, the introduction of a stricter non-performing loan definition (to align with EBA guidance) and the poor asset quality in the foreign direct lending portfolios (which were not transferred to the Bank Asset Management Company). The increased restructuring efforts will materialise in the NPL levels with a time lag as key credit risk indicators will only adjust once operational restructuring is implemented and this takes time. In addition, restructured loans have to remain classified as non-performing loans for at

<sup>(17)</sup> Based on data provided by Bank of Slovenia. The non-performing loan ratio used by Bank of Slovenia is not consistent with non-performing loan ratios reported by analysts which report significantly higher non-performing loan ratios for Slovenian banks.

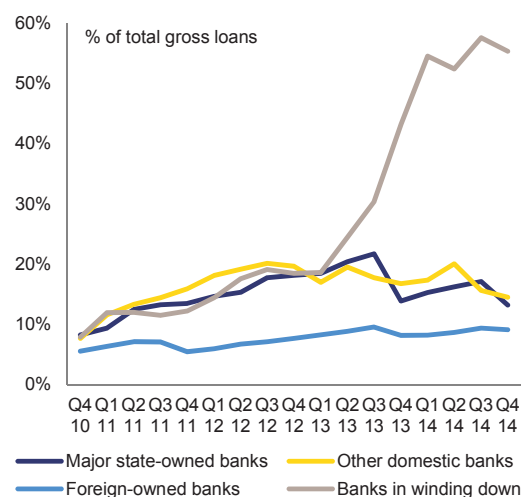
least one year after the restructuring is concluded. System wide non-performing loans ratios are also affected by the contraction of new lending and the subsequent reduction of the loan stocks, particularly for banks that are winding down.

Graph 2.1.17: NPLs by type of bank



Q4 14 contains data until November 2014.  
 Source: Bank of Slovenia.

Graph 2.1.18: NPL ratios by type of bank



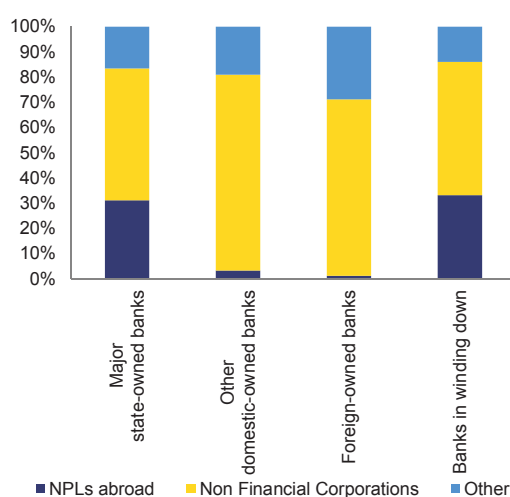
Q4 14 contains data until November 2014.  
 Source: Bank of Slovenia.

The majority of the non-performing loans are concentrated in the domestic corporate loan book. Only in the state-owned banks and in the banks in wind down the proportion of foreign corporate non-performing loans remains at levels

above 30% (Graph 2.1.19). Foreign non-performing loans were not transferred to the Bank Asset Management Company and constitute about 22% of the total remaining stock of non-performing loans in all banks. They mainly consist of lending to companies outside Slovenia (mostly ex-Yugoslav countries, Bulgaria, Romania) but also lending of subsidiaries of the domestic banks in ex-Yugoslav countries, Bulgaria and Romania. Foreign non-performing loans are diverse in terms of sector and size and are often based on bilateral agreements. It is therefore resource intensive to find a systematic solution to restructuring these wide ranging exposures.

**Coverage ratios close to 60% reinforce the capacity of banks to absorb some losses from their non-performing loans portfolios.** The relatively high coverage ratios <sup>(18)</sup> show that the remaining stocks of non-performing loans are better provisioned than in the past three years and therefore should pose less of an imminent risk to the solvency of the banks (Graph 2.1.20). The large state-owned banks report the highest coverage ratios, mainly due to supervisory actions taken by the Bank of Slovenia.

Graph 2.1.19: Structure of NPLs by bank (Q3 2014)



Source: Bank of Slovenia.

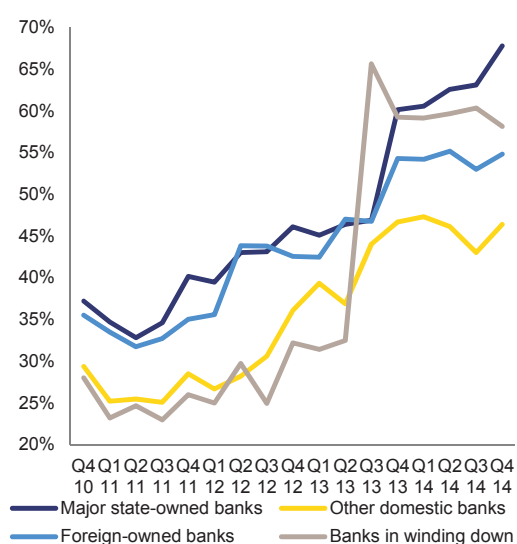
**Swift restructuring and work out of the non-performing loans is crucial for enhancing long-term profitability and viability of the Slovenian**

**banking system, boosting investment, strengthening domestic demand and supporting the economic recovery going forward.** Enhanced cooperation amongst the different stakeholders, availability of working capital financing and fresh equity for the companies in restructuring are important recipes to facilitate and accelerate the work-out process. The Bank Asset Management Company and the bigger domestic banks follow a long-term value-based approach to restructuring. Smaller domestically owned banks which are in the process of winding-down (Factor and Probanka), as well as some of the foreign-owned banks which have started to reduce their exposure to the Slovenian market, have a shorter time horizon and seek a quick exit. This may present challenges when negotiating restructuring plans for companies.

The Bank Asset Management Company has no lending capacity and domestic banks are reluctant or unable to provide working capital to companies in restructuring as they are constrained by stricter lending and risk management policies. Alternative sources of financing like asset backed securities or corporate bonds could be further developed (Section 4.3). Fresh equity needs to be available to support the deleveraging of the companies. Debt-to-equity swaps driven by the Bank Asset Management Company will further increase the level of state ownership in the economy. Privately-based structured solutions, such as the establishment of special purpose vehicles, could provide an alternative solution. The role of the recently established corporate restructuring task-force is to monitor and coordinate the overall restructuring process and to provide the necessary guidance and provide solutions to the outstanding issues.

<sup>(18)</sup> There are a couple of outliers, with Celje and SKB presenting a very high coverage ratio.

Graph 2.1.20: Coverage ratios type of bank



Q4 14 contains data until November 2014.

Source: Bank of Slovenia.

**Reinforcing the long-term profitability and reducing non-performing loans in the corporate segment are key to further stabilise the banking sector.** The ongoing restructuring and rationalisation of the major state-owned banks provides an opportunity to reduce the cost base in a sustainable manner. Furthermore, there could be scope to increase the non-interest income of banks. Macro-prudential measures introduced by the Bank of Slovenia (Box 2.1.1) are supposed to improve the quality of lending activity, though it is still too early to assess the impact of these measures. The swift restructuring of the corporate sector by making full use of all existing tools, such as the Bank Asset Management Company and the new insolvency legislation, could boost the recovery of the cash-flow capacity of the corporate sector, which is an important prerequisite for enhancing the profitability of banks.

**Further consolidation and enhanced corporate governance of the banking sector could be facilitated through the continuation of the privatisation process.** The share of state-owned and state controlled banks in Slovenia has been high and has increased even further after the crisis as a result of the banking sector restructuring.

More than 60% of Slovenian banks' assets are in the hands of state-owned banks. As a result of weak corporate governance and interconnectedness with other state-owned and state-controlled enterprises, Slovenian state-owned banks suffered significant losses during the crisis and experienced systematically higher non-performing loan ratios compared to foreign-owned peers (Graph 2.1.18). The rehabilitation of the banking sector had important fiscal implications for Slovenia, amounting to more than EUR 5.7 billion from 2007 to date (Section 3.2). Majority of these state interventions were capital injections covering past losses with a direct negative impact on both public debt and deficit (approx. EUR 4 billion), while the remaining were linked to setting up the Bank Asset Management Company<sup>(19)</sup> (EUR 1.7 billion in equity and bonds). Although risk management in state-owned banks has been improving over the past year, the state does not have the same incentive structure, economies of scale and expertise (e.g. risk modelling, IT, data collection) that a large international group can offer to its subsidiaries. Slovenia has committed to reduce the share of state ownership in the banking sector. Continuous progress in this area would further help to halt the negative feedback loop between the sovereign and the banking system.

<sup>(19)</sup> The Bank Asset Management Company is classified inside the general government sector as it is, according to Eurostat treatment, a 100 % government-owned entity with no autonomy of decision.

**Box 3.1.2: Structure of debtor companies liable for the NPLs**  
**Three main categories of debtor companies liable for NPLs can be identified:**

The first category consists of construction and infrastructure companies, where bankruptcy rates have already peaked and most of the inefficient firms have exited the market. The majority of these exposures have been transferred to the BAMC and a large proportion of the losses have already been recognised by banks. The BAMC needs to enforce the collateral of these loans, realise any possible gains and complete the insolvency procedures. The recovery value obtained by the BAMC, and subsequently the state, will mainly depend on how efficiently the stakeholders and the courts manage the insolvency procedures.

The second category consists of highly leveraged financial holdings, management buy-out companies and other highly leveraged medium-to-large size Slovenian companies. The latter include a small number (up to 100) that have a high value and are economically important (2014 in-depth review: approximately 90 % of debt carry-over is concentrated in just a handful of companies), which are mostly reliant on domestic demand, with some state-owned or state-controlled exporters as an exception (e.g. Cimos, Elan). In several cases, these companies have used a relatively large amount of (or exclusively) debt financing to acquire stakes in various businesses and have placed this debt on the balance sheet of the acquired companies. The subsidiary businesses are mostly domestically focused and many of them might have viable core activities. Many of the exposures in this category (both holdings and large companies) have been transferred to the BAMC, though some remain with the banks as a result of not having qualified for transfer. The BAMC and the corporate restructuring task-force should focus on swift financial and operational restructuring of viable companies, which will be crucial for the recovery of investment and of domestic demand in Slovenia.

The third category includes NPLs of other large corporates and SMEs with sound core business activities but which, during the boom years, expanded their activities in non-core areas such as real estate or tourism. This category also includes suppliers to companies in the second category that have suffered from reduced orders. Some of the exposures in this category have been transferred to the BAMC, but most of them are still on the banks' balance sheets, either because they did not qualify for a transfer (e.g. exposures were too small or still performing) or they are with banks that have not (yet) transferred assets to the BAMC. Due to their size, the work-out of many of these companies has yet to begin, and needs to be a priority of the ongoing restructuring efforts. There is more to be done here than in the case of the large companies and holdings, and this will most likely continue to take up significant management resources of the banks.



## 2.2. EFFICIENCY AND COSTS OF STATE OWNED S AND STATE CONTROLLED ENTERPRISES, AND THEIR IMPACT ON INVESTMENT AND BUSINESS ENVIRONMENT

**The state involvement in the economy remains elevated and it has incurred significant fiscal and economic implications for Slovenia since the onset of the crisis, amounting to over EUR 13 billion.** The state is the largest employer, asset manager and corporate debtor in Slovenia. State-owned enterprises and state-controlled enterprises<sup>(20)</sup> employ one fifth of the employees working in non-financial companies, and hold approximately one third of the total corporate assets and the total outstanding corporate debt. In the period 2007 to 2013 state-owned enterprises/state-controlled enterprises have significantly underperformed compared to their privately owned peers in terms of productivity and profitability at both a national and peer country level. Negative spill-overs from the high state involvement in the economy and inefficient corporate governance in state-owned enterprises/state-controlled enterprises distort resource allocation, harm the business environment and hamper private investment and growth. As a result, the corporate sector remains undercapitalised and the resolution of non-performing loans is progressing slowly, which in turn delays the recovery in the banking sector. This section analyses the complex nexus of state-owned banks, insurance companies and non-financial companies and the impact on the Slovenian economy.

### Importance of State-owned enterprises and State-controlled enterprises in the Slovenian economy

**A complex network of directly and indirectly state-owned or state controlled banks, non-financial companies, insurance companies and investment funds continues to weigh on the economy.** At the end of 2014, 642 State-owned enterprises/State-controlled enterprises were identified as linked to the state via a complex cross-ownership structure. State control is exercised in several ways. Most of these 642 companies (over 61% in terms of book value of assets), are directly controlled by the Republic of

Slovenia, through a single entity – the Slovenian Sovereign Holding (SSH)<sup>(21)</sup>, or quasi-directly through the municipalities or the various state management funds (KAD, PDP<sup>(22)</sup>, DSU<sup>(23)</sup>, Modra Zavarovalnica). Another 32% are indirectly controlled through the Bank Asset Management Company, the banks, the insurance companies, and other financial companies (e.g. mutual), which are all fully and directly owned by the Republic of Slovenia. While the corporate restructuring is ongoing, the state influence is likely to increase through debt-to-equity swaps in the banks and the Bank Asset Management Company. The remaining 6.5% of state-owned enterprises/state-controlled enterprises are controlled through other state-owned enterprises/state-controlled enterprises and their subsidiaries (2.2.1).

**The state is the largest asset manager and corporate debt holder in Slovenia.** Although state-owned enterprises/state-controlled enterprises represent only about 1% of the total number of companies in Slovenia, they are highly significant from an economic perspective<sup>(24)</sup> and are relatively bigger in size compared to their private owned peers (Table 2.2.2). State-owned enterprises/State-controlled enterprises account for one third of the assets, a quarter of the value added, over 40% of the equity value and one third of the financial debt obligations of non-financial companies. State-owned enterprises/State-controlled enterprises presence is particularly strong not only in transport, energy and public

<sup>(20)</sup> State-owned enterprises are defined as companies in which the state has a majority ownership (50%+1). State-controlled enterprises are defined as companies in which the state has at least a controlling minority ownership of (25%+1). The cut-off date for the ownership structure is 31 December 2014.

<sup>(21)</sup> Before the establishment of the SSH in 2014, the direct ownerships of the Republic of Slovenia were managed under the umbrella of the Capital Assets Management Agency (AUKN). AUKN was established in the context of Slovenia's OECD accession in 2010. According to the legislation adopted in December 2012, AUKN was to be replaced by the Slovenian Sovereign Holding (SSH), with the aim of consolidating and managing all state assets under one structure, and allowing for the privatisation of some of these assets. However, the political context has delayed the process of setting up SSH, and AUKN as a management structure was temporarily replaced by the state fund SOD. SOD was finally transformed into SSH in June 2014 under a new framework.

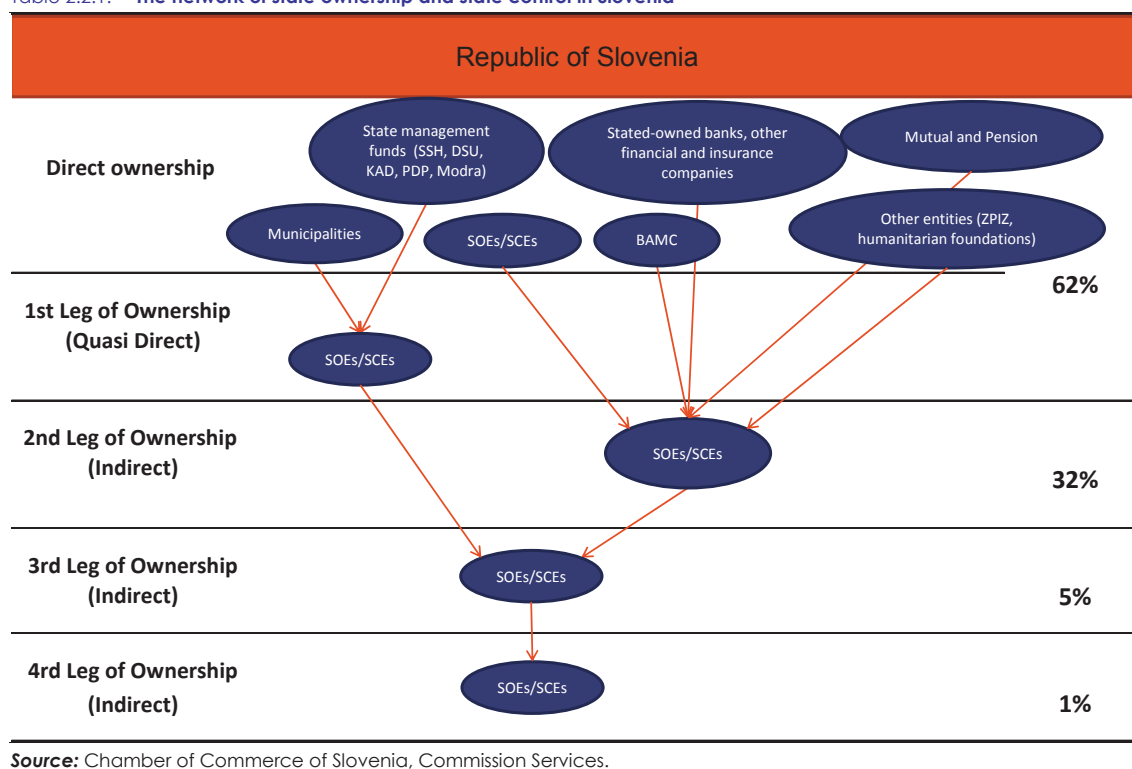
<sup>(22)</sup> PDP was gradually acquired by SSH from KAD in July 2014 and January 2015 and it will be merged into the SSH in the course of 2015.

<sup>(23)</sup> All assets (including shares in different companies) owned by DSU were acquired by SSH in October 2014.

<sup>(24)</sup> Level of importance of State-owned enterprises/State-controlled enterprises is defined according to sales, assets, equity, profit, loss, equity, financial debt, employees.



Table 2.2.1: The network of state ownership and state control in Slovenia



utilities, but also in other sectors where state involvement is less pronounced in peer countries<sup>(25)</sup> (Graph 2.2.1) such as consumer staples, chemical industry, manufacturing, tourism and leisure<sup>(26)</sup>. The state is the largest corporate debt holder in Slovenia through its prevalent ownership of the banking system (direct owner of more than 60% of the banking assets<sup>(27)</sup>). The state also manages 88% of the pension assets and 60% of all insurance liabilities. In various cases,

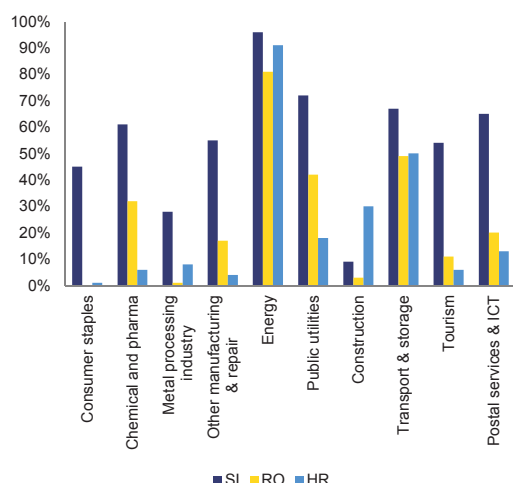
the state is present as both an equity and debt holder. The conflict between the two mandates in particular in distressed companies requires coordination in order to minimise the risks and maximise the returns for the state.

<sup>(25)</sup> Currently data is only available for Romania and Croatia.

<sup>(26)</sup> In all graphs, sector definitions follow the NACE Rev. 2 classification, e.g. consumer staples - manufacturing of consumer staples (food, tobacco, textiles, wood and cork, paper, printing etc.); other manufacturing (jewellery, musical instruments, sports goods, games and toys, medical and dental instruments and supplies); other services (legal and accounting, management consultancy, architectural, engineering, scientific research and development); materials - manufacturing of materials (rubber and plastic products, non-metallic mineral products, basic metals); ICT - information and communication technologies; durables - manufacturing of durables (fabricated metal products, electrical equipment, machinery, motor vehicles, trailers, other transport equipment); chemicals and pharma - manufacturing of chemicals and pharma (coke and refined petroleum products, chemicals and chemical products, basic pharmaceutical products).

<sup>(27)</sup> Including SID bank - the national development bank (owns 4% of total assets). Data as of end 2013.

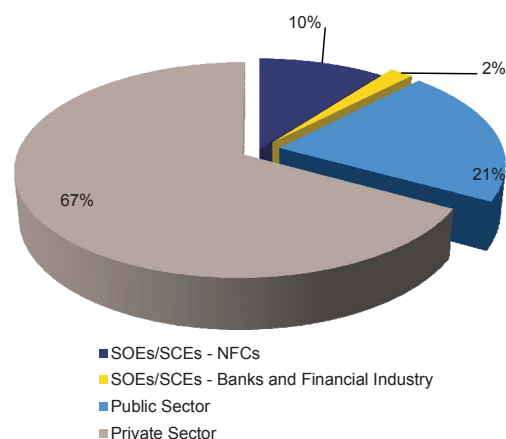
Graph 2.2.1: **Share of State-owned enterprises/State-controlled enterprises in sectoral value added (as % of total sectoral value added), 2013**



**Source:** Orbis database and Commission Services calculations.

**One third of the workforce in Slovenia is employed by the state.** state-owned enterprises/state-controlled enterprises employ one fifth (19%) of all the workers in non-financial companies (approximately 80 000), and roughly additional 15 000 employees in the financial sector. Together with the 160 000 employees in the public sector this amounts to 33% (approximately 255 000) of total employment in Slovenia (Graph 2.2.2).

Graph 2.2.2: **Employment, 2013 – public, private and State-owned enterprises/State-controlled enterprises**



**Notes:** The employment data for State-owned enterprises/State-controlled enterprises includes the total number of employees in these companies without applying the proportion corresponding to the share of state ownership.

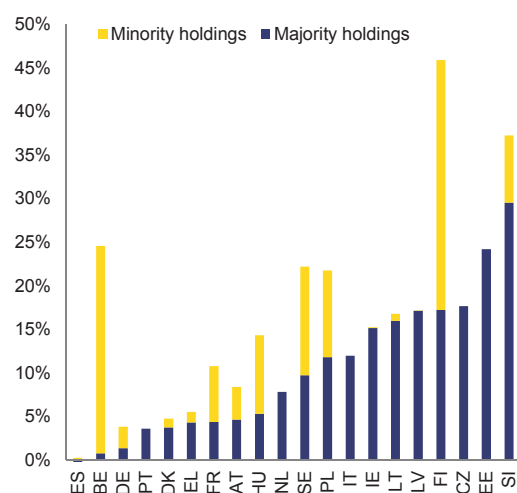
**Source:** National Statistical office of Slovenia, The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES), Commission Services calculations.

Table 2.2.2: **Relative importance of state-owned enterprises/state-controlled enterprises (as % of total non-financial companies)**

Sector Nb.	Name of the sector	Nb. of SOEs	Net sales	Assets	Employees	EBITDA	Net profit	Net loss	Equity	Financial debt	Leverage ratio
1	AGRICULTURE	0.7%	1.9%	1.9%	4.5%	1.2%	0.8%	1.4%	1.5%	1.9%	12,7x
2	MINING	8.5%	47.2%	49.2%	69.3%	n.a.	0.8%	88.5%	58.9%	37.1%	-20,8x
3	CONSUMER STAPLES	2.2%	25.8%	40.5%	27.6%	33.4%	7.3%	65.6%	36.7%	51.3%	9,8x
4	APPAREL & WOOD PRODUCTS	0.4%	1.9%	2.3%	4.3%	n.a.	0.5%	10.4%	1.9%	2.4%	-11,6x
5	PAPER PRODUCTS & PRINTING	0.7%	9.4%	6.3%	13.3%	2.8%	0.6%	22.5%	2.1%	8.8%	11,8x
6	CHEMICAL INDUSTRY	4.0%	39.7%	49.5%	41.9%	53.1%	50.9%	8.6%	58.8%	17.6%	0,4x
7	RUBBER AND NON-METALLIC PRODUCTS	0.6%	6.7%	4.1%	3.7%	5.9%	4.8%	1.4%	3.7%	3.3%	3,2x
8	METAL PROCESSING INDUSTRY	1.2%	22.8%	29.0%	18.5%	10.1%	1.3%	66.6%	21.0%	39.8%	14,2x
9	OTHER MANUFACTURING & REPAIR	1.1%	28.3%	25.8%	41.9%	11.7%	4.7%	59.4%	24.1%	27.5%	6,2x
10	ENERGY	8.4%	85.6%	89.8%	91.0%	91.3%	92.0%	39.8%	95.9%	77.2%	3,0x
11	PUBLIC UTILITIES: WATER SUPPLY, WASTE MGT.	28.7%	60.6%	59.4%	72.9%	66.0%	55.8%	38.9%	59.5%	41.4%	1,9x
12	CONSTRUCTION	0.3%	5.3%	3.9%	4.1%	5.7%	3.8%	12.6%	5.0%	3.3%	7,1x
13	RETAIL	0.2%	14.9%	13.8%	3.4%	11.9%	7.8%	5.7%	15.6%	14.7%	7,0x
14	TRANSPORT AND STORAGE	1.1%	34.7%	75.8%	37.5%	60.0%	36.6%	14.8%	74.5%	84.5%	9,1x
15	TOURISM	1.2%	33.3%	44.5%	32.4%	49.7%	21.7%	23.5%	56.2%	40.7%	7,7x
16	MEDIA	1.5%	15.0%	7.1%	15.9%	41.4%	7.0%	3.6%	9.2%	5.2%	2,4x
17	POSTAL SERVICES AND ICT	0.9%	35.5%	49.2%	44.8%	43.7%	29.6%	70.2%	57.8%	45.5%	2,1x
18	FINANCIAL AND INSURANCE ACTIVITIES	2.8%	35.6%	23.0%	15.7%	47.3%	18.9%	46.6%	22.2%	22.9%	-19,6x
19	REAL ESTATE	1.7%	11.2%	8.8%	17.8%	n.a.	4.6%	17.5%	20.3%	5.2%	-4,7x
20	PROFESSIONAL, SCIENTIFIC AND TECHNICAL ACTIVITIES	0.6%	5.2%	19.2%	6.9%	10.4%	8.0%	4.2%	21.5%	19.2%	15,2x
21	ADMINISTRATIVE AND SUPPORT SERVICE ACTIVITIES	0.6%	3.1%	8.4%	4.7%	7.8%	4.7%	0.0%	19.3%	3.6%	2,2x
22	PUBLIC ADMINISTRATION AND OTHER SERVICES	0.6%	6.2%	12.3%	7.4%	8.1%	3.0%	4.9%	13.2%	13.5%	7,4x
	TOTAL ECONOMY	0.9%	24.8%	34.2%	18.8%	32.2%	22.0%	28.8%	41.8%	32.1%	0,1x

Note: The table covers only 561 out of the total 642 companies as it excludes the banks, financial services, insurance and asset management companies (27); as well as companies in insolvency (27); newly established companies in 2014 (26) and one other company for which financial account were not available. The importance of state ownership in the banking sector is described in Section 3.1.

Source: The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES), Chamber of Commerce of Slovenia, Commission services .

Graph 2.2.3: **Book value of equity of State-owned enterprises/State-controlled enterprises in Europe (as % of GDP)**

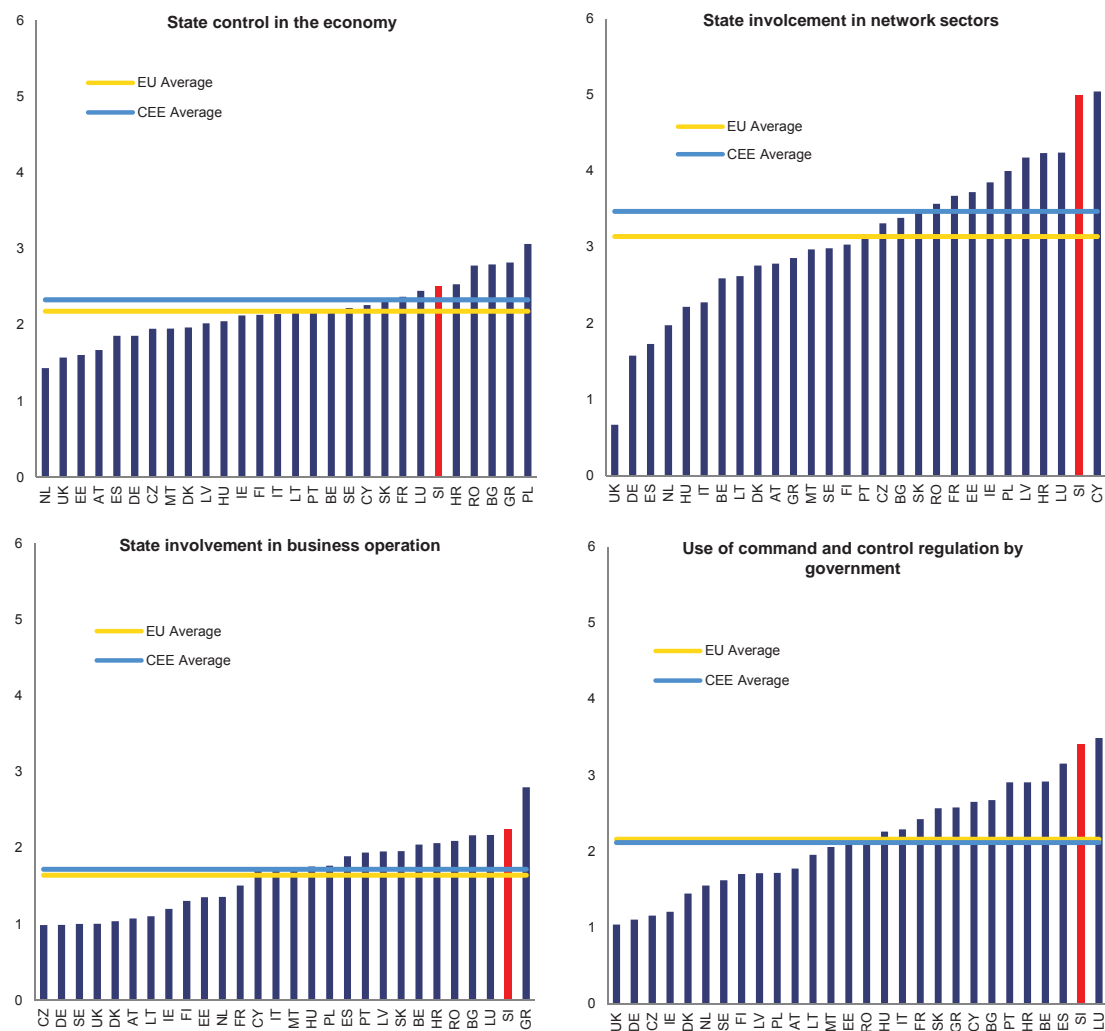
Source: 2012 OECD data on size and sectoral distribution of State-owned enterprises, Commission services calculations.

**The state involvement in Slovenia is amongst the highest in Europe.** The book value of equity of state-owned enterprises/state-controlled enterprises relative to GDP (Graph 2.2.3) is the highest in Europe if majority state-owned companies (over 50%) are taken into account and the second highest if minority stakes are also

included (between 10% and 50%), while their share in terms of employment is the third highest in both cases (Graph 2.2.5). According to a set of OECD soft indicators <sup>(28)</sup>, the extent to which the state owns, controls, or is involved in business in Slovenia (state control) is above the average in EU or in its Central and East European peers (Graph 2.2.5), particularly when it comes to government involvement in the network industries (equity shares in electricity, gas, rail, transport, air transport, postal services and telecommunications). Slovenia scores second worst in terms of involvement of the state in business operation (the extent and type of price controls and regulation) and the use of command and control regulation by the government (the extent to which government uses coercive as opposed to incentives based regulation in general and in specific sector, such as road freight, retail trade, air transport, railways, professional service). Moreover, free market principles such as price liberalisation and competitive decision-making based on incentives appear to be distorted as well relative to peers.

<sup>(28)</sup> 2013 Indicators of Product Market Regulation comprised by OECD: <http://www.oecd.org/economy/growth/indicatorsofproductmarketregulationhomepage.htm#Sources>

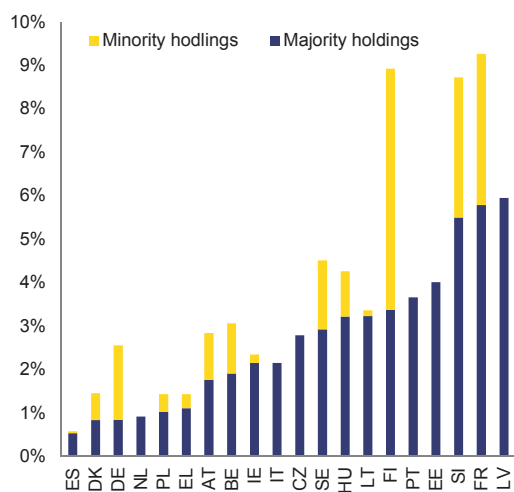
Graph 2.2.4: OECD indicators for product market regulation (2013)



**Source:** 2013 Indicators of product market regulation comprised by OECD.

The graphs display different indicators (meaning described in the title of the graphs) on a scale from 0 – least restrictive state involvement/ control, to 6 - most restrictive state involvement/ control.

Graph 2.2.5: Employment at State-owned enterprises/State-controlled enterprises in Europe (as % of total employment)



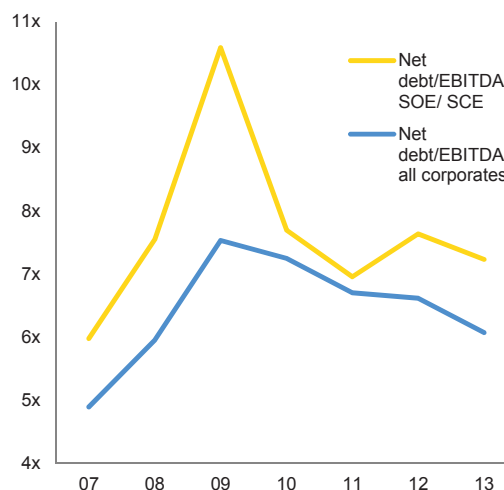
Source: 2012 OECD data on size and sectoral distribution of State-owned enterprises, Commission services calculations.

### State-owned enterprises/State-controlled enterprises financial performance and productivity <sup>(29)</sup>

State-owned enterprises/State-controlled enterprises in Slovenia continue to be highly leveraged and many of them remain at risk of default. The debt leverage of state-owned enterprises/state-controlled enterprises has been higher than the debt leverage of all corporates since the onset of the crisis (Graph 2.2.6). Based on aggregated data, the leverage ratio <sup>(30)</sup> of state-owned enterprises/state-controlled enterprises stood at 7.2 in 2013 <sup>(31)</sup>, above the 6.1 average for

all corporates. More significant differences in the debt leverage of state-owned enterprises/state-controlled enterprises emerge on sector level. In 14 sectors out of 22 state-owned enterprises/state-controlled enterprises are highly leveraged (Table 2.2.2). Particularly exposed are companies in the mining, apparel & wood production, real estate and financial services sectors <sup>(32)</sup>, as their operating profit <sup>(33)</sup> has been negative for a prolonged period and hence they are at risk of default.

Graph 2.2.6: Leverage ratio of State-owned enterprises/State-controlled enterprises and all Non-financial companies (excl. energy and public utilities sectors)



Source: The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES), Chamber of Commerce of Slovenia calculations.

Based on aggregated industry data <sup>(34)</sup>, in 2013 state-owned enterprises/state-controlled enterprises generated net losses in certain sectors. On average state-owned enterprises/state-

<sup>(29)</sup> The financial performance of the non-financial sector is analysed separately from the banking and financial sector as their performance indicators and are examined separately in Section 3.1. Comparison of financial performance (profitability and indebtedness) with national and regional peers is based on a simple regression, controlled for year, industry and type of ownership (State-owned enterprises/State-controlled enterprises, private domestic and private foreign). Financial performance and productivity of the energy, transport and utilities sector is only analysed relative to regional peers as these sectors are natural monopolies and are dominated by State-owned enterprises/ State-controlled enterprises in Slovenia and in other countries. Therefore, comparison with foreign and privately owned national peers is not relevant.

<sup>(30)</sup> The (debt) leverage ratio represents the level of debt relative to the company's cash flow capacity. The leverage ratio is defined as the total financial debt net of cash and cash equivalents on balance sheet divided by the earnings before interest, tax, depreciation and amortisation (EBITDA).

<sup>(31)</sup> Excluding the energy and the public utilities sectors, which are natural monopolies and dominated by State-owned enterprises/State-controlled enterprises and therefore are less sensitive to the economic downturn than other sectors.

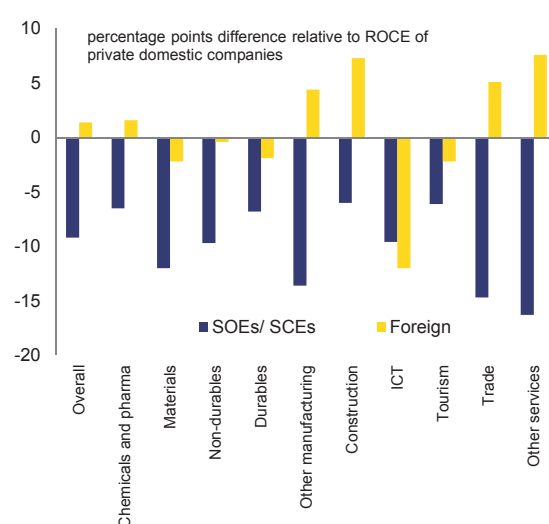
<sup>(32)</sup> Please note that the financial services sector does not include banks and insurance companies but only other financial services such as investment funds and leasing companies. This category also includes most of the financial holdings, which are specific to the Slovenian economy - funds that invested in companies using high debt and relatively low proportion of own equity.

<sup>(33)</sup> The operating profit, which is represented by the earnings before interest, tax, depreciation and amortisation (EBITDA) on the profit and loss account, is common proxy for the cash flow capacity of the company.

<sup>(34)</sup> This refers to aggregated financial data of SOE and State-controlled enterprises by sector from AJPES accounts and should not be confused with sector/industry accounts from the national accounts data.

controlled enterprises posted weaker financial results mainly due to the higher net financial losses resulting from impairments of their non-core assets (e.g. stakes in non-core subsidiaries). Gross losses were concentrated in the financial services and the metal processing industries and accounted for 64% of the total losses generated by state-owned enterprises/state-controlled enterprises. Gross profits were mainly generated by the energy, chemical industry, and transport & storage industries (70% of total profits of state-owned enterprises/State-controlled enterprises).

Graph 2.2.7: Profitability (ROCE) of State-owned enterprises/State-controlled enterprises and foreign-owned companies relative to domestic private owned companies (2004-2013 average)



Source: Orbis database and Commission services calculations.

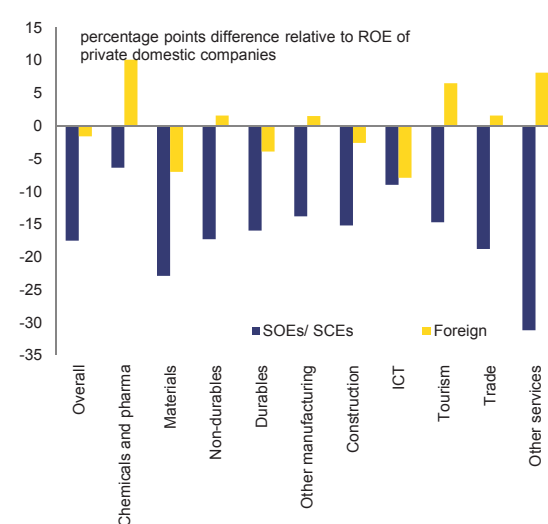
Compared to their privately owned peers in Slovenia and in other Central and Eastern European countries, State-owned enterprises/State-controlled enterprises are less efficient in deploying their resources (capital employed). In 2013, profitability of State-owned enterprises/State-controlled enterprises in terms of return on equity <sup>(35)</sup> and return on capital employed <sup>(36)</sup> was lower than that of their privately

<sup>(35)</sup> Return on equity defined as the amount of net income returned as a percentage of shareholders equity. Return on equity is a common measure of a company's profitability, revealing how much profit a company generates with the money shareholders have invested.

<sup>(36)</sup> Return on capital employed is defined as the amount of operating profit (earnings before interest and tax, EBIT) as a percentage of capital employed (the sum of shareholders'

owned peers – both domestic and foreign-owned. When compared against profitability of domestic private owned companies in Slovenia as a benchmark, State-owned enterprises/State-controlled enterprises underperform, while foreign-owned enterprises outperform in some sectors (Graph 2.2.7 and 2.2.8). Relative to State-owned enterprises/State-controlled enterprises in most other CEE countries, Slovenian State-owned enterprises/State-controlled enterprises also underperform based on industry level comparison in all sectors except for energy (Graph 2.2.8).

Graph 2.2.8: Profitability (ROE) of State-owned enterprises/State-controlled enterprises and foreign-owned companies relative to domestic private owned companies (2004-2013 average)



Source: Orbis database and Commission services calculations.

State-owned enterprises/State-controlled enterprises are amongst the companies with the highest debt leverage relative to peers in Slovenia and in other Central and Eastern European countries. State-owned enterprises/State-controlled enterprises are relatively more indebted than their privately owned peers in almost all sectors apart from the chemical and pharmaceutical sector. Foreign-owned enterprises on the contrary are relatively less indebted than domestic privately owned companies

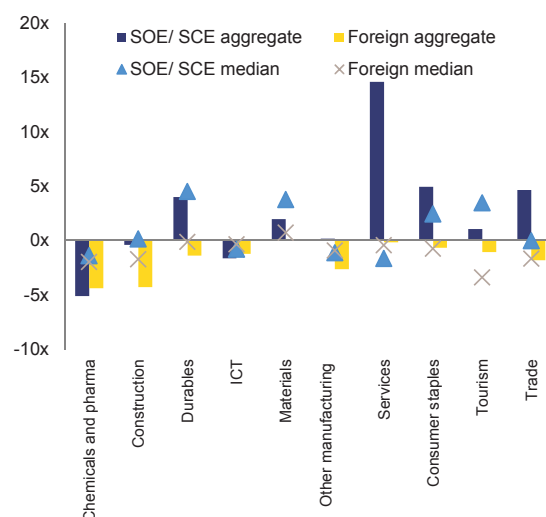
equity and debt liabilities). Return on capital employed is a common measure of a company's profitability and the efficiency with which its capital is employed.

in Slovenia in all sectors reviewed (Graph 2.2.9). Slovenian State-owned enterprises/State-controlled enterprises appear to be more indebted relative to the State-owned enterprises/State-controlled enterprises in most other Central and Eastern European countries based on industry level data (Graph 2.2.9).

**State-owned enterprises/State-controlled enterprises are less productive than their peers in Slovenia and in other Central and Eastern European countries.** Based on total factor productivity (TFP) estimations<sup>(37)</sup> for State-owned enterprises/State-controlled enterprises and foreign-owned companies in Slovenia, relative to domestic privately owned companies, underperformance of State-owned enterprises/State-controlled enterprises is observed in the majority of the sectors (Graph 2.2.10).

<sup>(37)</sup> Following the approach in a recent World Bank study (Iootty, M., P. Correa, S. Radas, B. Skrinjaric (2014). Stylized Facts on Productivity Growth: Evidence from Firm-Level Data in Croatia. Policy Research Working Paper, No. 6990, the World Bank), labour productivity and total factor productivity are used as important performance indicators. To calculate labour factor productivity value added and employment are used, while for total factor productivity (TFP), the methodology by Levinsohn and Petrin is implemented (Levinsohn, J., & A. Petrin (2003). Estimating Production Functions Using Inputs to Control for Unobservables. Review of Economic Studies, Vol. 70, No. 2, 317-342), which corrects for productivity shocks unobserved by the researcher but observed by the firm. The estimates are based on a simple regression controlled for year, industry and ownership type (State-owned enterprises/State-controlled enterprises, private domestic and private foreign ownership).

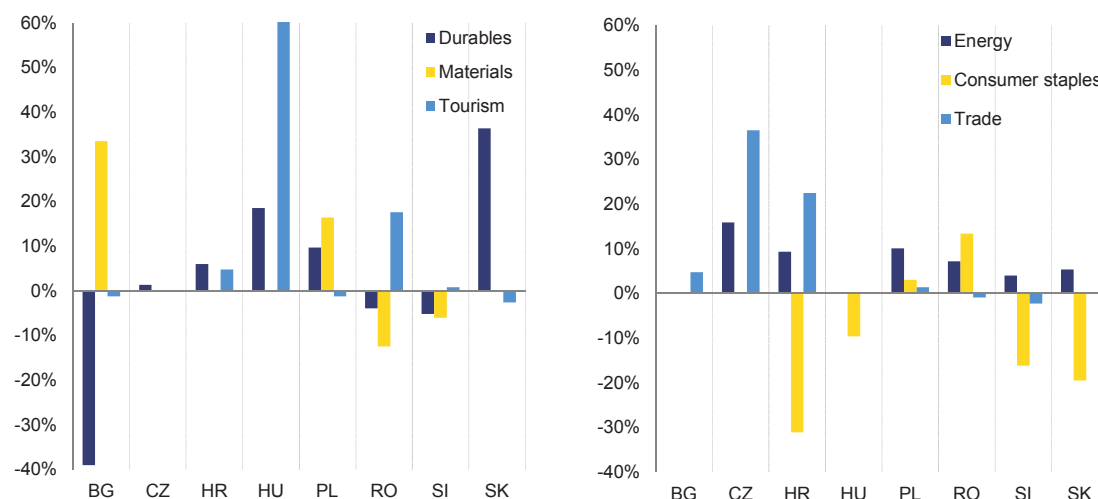
Graph 2.2.9: **Leverage ratio of State-owned enterprises/State-controlled enterprises and foreign-owned companies relative to domestic private owned companies (2013)**



**Source:** Orbis database and Commission services calculations.

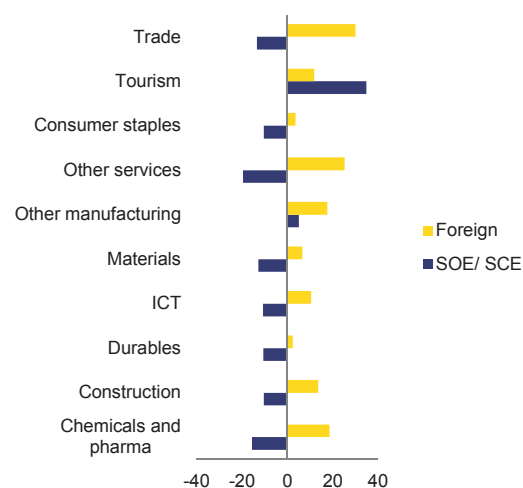
Given the large share of state owned enterprises in sectoral value added in some of these sectors (e.g. the chemical industry and postal services & ICT as described in table 2.2.2), underperformance of state owned enterprises can bear substantial economic costs.

Graph 2.2.11: Profitability (ROE) of State-owned enterprises/ State-controlled enterprises by sector in Slovenia and other CEE countries (aggregate), 2013



Source: Orbis database and Commission Services calculations.

Graph 2.2.10: Total factor productivity of State-owned enterprises/ State-controlled enterprises and foreign-owned companies relative to domestic private owned companies (in %), 2004-2013 average

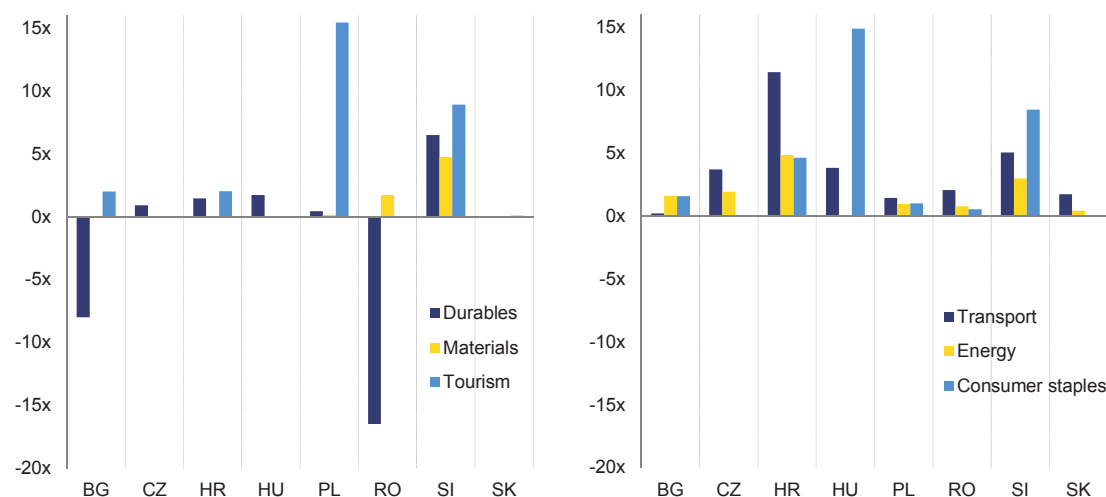


Source: Orbis database and Commission services calculations.

services (Graph 2.2.14), the costs of labour per head is higher than of those paid by private peers and similar to those paid by foreign companies (Graph 2.2.12). This indicates lower efficiency and competitiveness of State-owned enterprises/State-controlled enterprises relative to their foreign-owned and private owned peers.

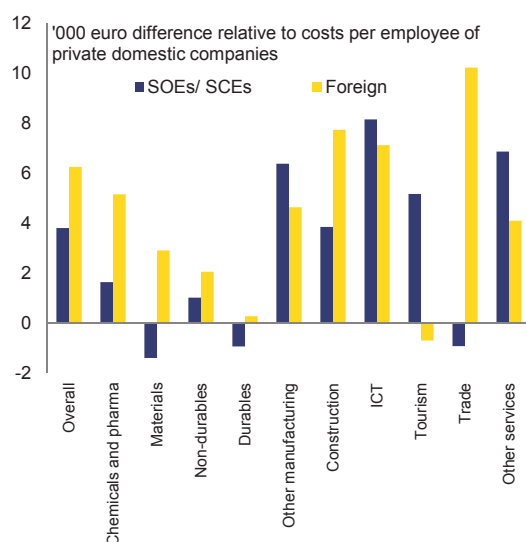
**Foreign-owned companies in Slovenia seem to be more efficient and competitive than State-owned enterprises/State-controlled enterprises.** While labour productivity of State-owned enterprises/State-controlled enterprises seems to be lower than in foreign-owned peers in most of the sectors examined, apart from tourism and other



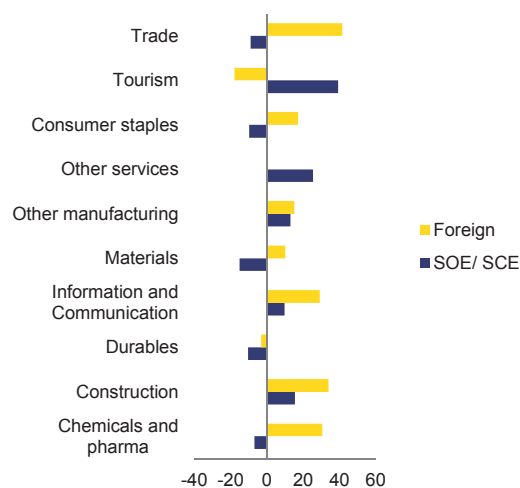
Graph 2.2.13: **Debt leverage ratio of State-owned enterprises/State-controlled enterprises in Slovenia and other CEE countries (2013)**

Notes: Due to negative value of the denominator (EBITDA) the estimates for Romania and Bulgaria are not relevant.

Source: Orbis database and Commission services calculations.

Graph 2.2.12: **Costs per employee of State-owned enterprises/ State-controlled enterprises and foreign-owned companies relative to domestic private owned companies (2004-2013 average)**

Source: Orbis database and Commission services calculations.

Graph 2.2.14: **Labour productivity State-owned enterprises/ State-controlled enterprises and foreign-owned companies relative to domestic private owned companies (in %), 2004-2013 average**

Source: Orbis database and Commission services calculations.

### Fiscal and economic implications of state ownership in Slovenia

The total fiscal and economic implications of state involvement in the economy for the period 2007-2014 are estimated at over EUR 13 billion or just over one third of 2013 GDP. The total

Table 2.2.3: **Total fiscal implications of State-owned enterprises/ State-controlled enterprises to the state and the economy**

	2007	2008	2009	2010	2011	2012	2013	2014	Cumulative (2007-2014)	Cumulative (% of 2014 GDP)
<b>Total fiscal and economic implications from state intervention</b>	1,153	1,236	1,425	842	1,342	1,015	5,180	1,151	13,345	36%
as % of GDP	3.3%	3.3%	3.9%	2.3%	3.6%	2.8%	14.3%	3.1%		
<b>with direct impact on public finances (debt, deficit or both)</b>	276	387	413	321	800	293	4,618	1,151	8,260	22%
as % of GDP	0.8%	1.0%	1.1%	0.9%	2.2%	0.8%	12.8%	3.1%		
<b>with wider economic impact (forgone profits)</b>	877	849	1,012	521	542	723	562	0	5,085	14%
as % of GDP	2.5%	2.2%	2.8%	1.4%	1.5%	2.0%	1.6%	0.0%		

**Source:** The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES), Ministry of Finance database, Chamber of Commerce of Slovenia calculations, Commission Services.

fiscal and economic implications of State-owned enterprises/State-controlled enterprises is considered as the sum of a number of transactions estimated in the following categories: (i) state interventions related to the rehabilitation of the banking sector<sup>(38)</sup>, (ii) foregone profits of State-owned enterprises/State-controlled enterprises when compared to overall profitability achieved for all Non-financial companies by sector<sup>(39)</sup>, (iii) subsidies paid by the state to companies which either became insolvent, or need external support to maintain operational profitability, (iv) equity increases of State-owned enterprises/State-controlled enterprises paid directly by the state, (v) drawn guarantees, and (vi) debt assumptions by the state. The potential future fiscal implications stemming from the drawing of outstanding guarantees and other contingent liabilities are not included in the number. While by far the largest

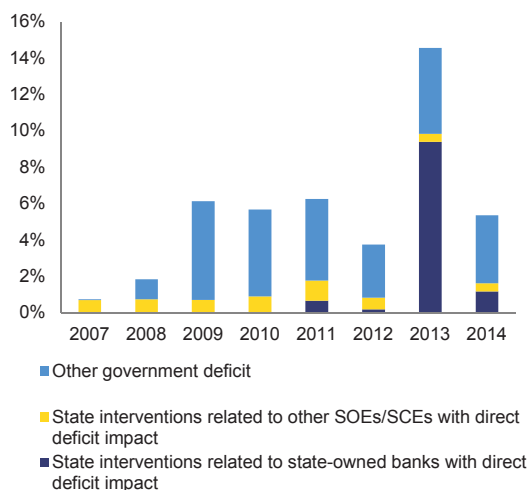
portion of the costs is due to financial sector stabilisation measures (43%), considerable amount was also associated with wider economic implications in terms foregone profits of State-owned enterprises/State-controlled enterprises compared to their private peers (38%). The former has no direct impact on public finances and is estimated just to demonstrate the amount of potential lost value added for the state and the economy. EUR 8.2 billion (62% of the total and 22% of GDP) have direct budgetary impact – either through increase of government deficit, debt or both in most of the cases (Table 2.2.3).

**A quarter of the increase of public debt from 2007 to 2014 can be attributed to state interventions related to financial and non-financial State-owned enterprises/State-controlled enterprises.** Slovenia's gross consolidated government debt almost quadrupled from 2007 to 2014 (from EUR 7.9 billion to EUR 30.3 billion at the end of 2014). In terms of GDP it increased from 22.7% to 82.2%. A quarter of this increase (EUR 5.7 billion or 15 percentage points) was due to costs related to State-owned enterprises/State-controlled enterprises, such as capital injections, debt forgiveness, drawn guarantees as well as EUR 1.5 billion of Bank Asset Management Company bonds issued to enable the transfer of Non-performing loans to the Bank Asset Management Company (Graph 2.2.16). In addition, government deficit was also negatively impacted, particularly by the recapitalisations of the state-owned and state-controlled banks during the crisis (Graph 2.2.15).

<sup>(38)</sup> This takes into account all direct capital/ equity increases of state owned or state controlled banks done by the state from 2007-2014, including the conversion of CoCo bonds (contingent convertible bonds, i.e. converted into cash if certain conditions are fulfilled) and other hybrid bonds issued by the state. It is reduced by dividends paid and any gains IPO/ SPO transactions for the period 2007-2014. It also includes the cost of setting up the Bank Asset Management Company (EUR 1.7billion in equity and bonds) as this is consolidated with general government accounts following, according to Eurostat treatment.

<sup>(39)</sup> Foregone profits are estimated by comparing the profitability of State-owned enterprises/State-controlled enterprises to profitability of all corporates in each sector (as listed in Table 3.2.2). In sectors where State-owned enterprises/State-controlled enterprises are dominant and their position is based on natural monopolies), comparing profitability to national peers is not relevant and hence the sector has been excluded from the estimate (e.g. public utilities). Foregone profits in the energy sector are based on comparison with regional State-owned enterprises/State-controlled enterprises peers, using data from Orbis database. Foregone profits are calculated by measuring the difference between return on equity of State-owned enterprises/state-controlled enterprises and return on equity of the all companies in each sector and multiplying this difference with the equity of State-owned enterprises/State-controlled enterprises in each of the years. The same approach is applied to net margins and sales of State-owned enterprises/State-controlled enterprises and finally the average based on return on equity and net margin differences is taken as the cost of foregone profits.

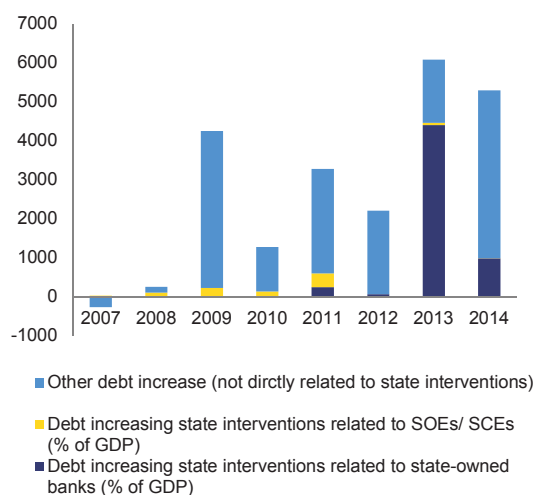
Graph 2.2.15: Total government deficit and deficit increasing state interventions related to State-owned enterprises/State-controlled enterprises



**Source:** The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES), Ministry of Finance database, Chamber of Commerce of Slovenia calculations, Commission Services.

**State-owned enterprises/State-controlled enterprises continue to pose considerable fiscal risks.** About EUR 6.4 billion of contingent liabilities to the state budget are currently outstanding in the form of guarantees (18% of 2013 GDP). The significant state involvement in the economy in terms of State-owned enterprises/State-controlled enterprises high share in total assets, equity and liabilities of the corporate sector, particularly in the banking and the insurance sector increase the risks to public finances going forward.

Graph 2.2.16: Total government debt and debt increasing state interventions related to State-owned enterprises/State-controlled enterprises

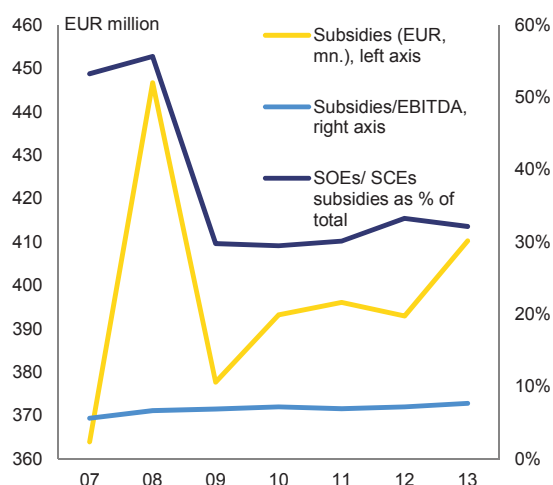


**Source:** The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES), Ministry of Finance database, Chamber of Commerce of Slovenia calculations, Commission Services.

**An important part of the profitability of State-owned enterprises/State-controlled enterprises and the corporate sector as a whole is supported by soft budget constraints<sup>(40)</sup> in the form of subsidies.** The Slovenian economy is increasingly supported by various forms of subsidies, which is a source of moral hazard at management level and may adversely distort decision-making in companies, particularly decisions related to investment. In 2007-2013 the inflow of subsidies to the corporate sector amounted to approximately EUR 400 million per annum. In several sectors, the share of subsidies is greater than 20 % of operating profits (EBITDA). These are agriculture (50%), mining (78%), public utilities (26%), media (60%) and public administration, education and health (21%). State-owned enterprises/State-controlled enterprises received one third of all subsidies in 2013. One of the main beneficiaries of the subsidies was the Slovenian Railway holding (accounting for approximately 50% of all subsidies).

<sup>(40)</sup> Soft budget constraints (a concept formulated by Kornai, 1979) arise wherever a funding source – e.g. a state-owned bank – finds it impossible to keep an enterprise to a fixed budget, i.e. whenever the enterprise can extract ex post a bigger subsidy or loan than would have been considered efficient ex ante.

Graph 2.2.17: Subsidies to all Non-financial companies relative to operating profit (EBITDA) and share of subsidies to State-owned enterprises/ State-controlled enterprises



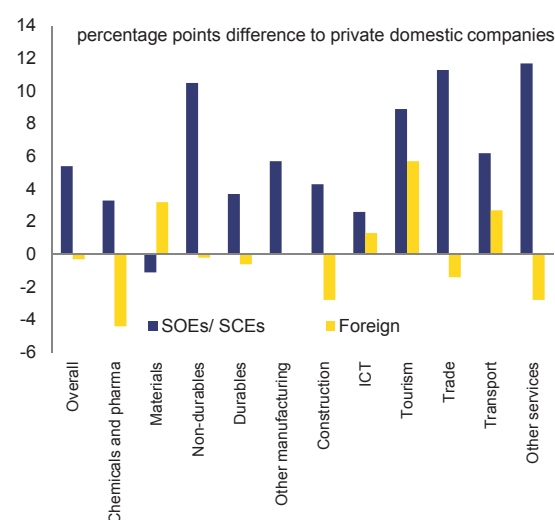
**Source:** The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES), Ministry of Finance database, Chamber of Commerce of Slovenia calculations.

**Soft budget constraints combined with a limited strategic and financial management capacity distorted resource allocation and negatively affected the profitability of State-owned enterprises/ State-controlled enterprises.** In line with the higher debt leverage, capital expenditure at State-owned enterprises/State-controlled enterprises was higher than at all corporates (Graph 2.2.19) both relative to operating profit and sales. This should have translated into higher profitability of State-owned enterprises/State-controlled enterprises compared to all corporates. Instead, available financing has been channelled to unproductive investments – i.e. less profitable (or loss-making) non-core activities as evident by the relatively higher share of non-core assets on the balance sheet of State-owned enterprises/State-controlled enterprises compared to private peers (Graph 2.2.18).<sup>(41)</sup> As these investments are less profitable than the core activities of the parent company, the overall profitability (return on equity) is negatively affected through impairments of these non-core assets. The highest level of non-core investment of State-owned enterprises/State-controlled enterprises is in the financial and insurance activities, which includes financial

<sup>(41)</sup> Please note that these numbers also include intra-company loans.

holding companies, in professional, scientific and technical activities, and in consumer staples and retail.

Graph 2.2.18: Other fixed assets of State-owned enterprises/ State-controlled enterprises and foreign-owned companies relative to domestic private owned companies (as % of total assets ), 2004-2013 average



**Source:** Orbis database and Commission services calculations.

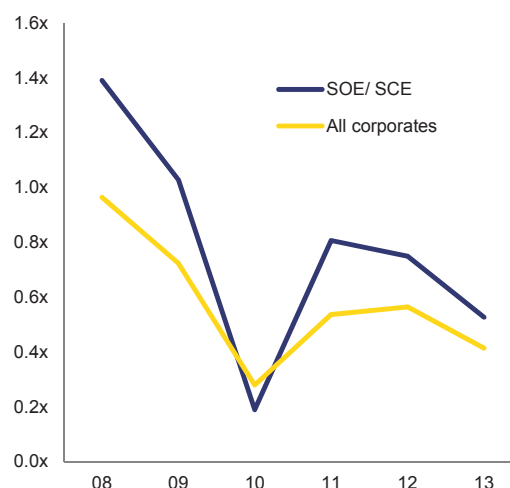
### State-owned enterprises/State-controlled enterprises Corporate governance framework and privatisation in Slovenia

**Sound management and enhanced corporate governance policies for State-owned enterprises/State-controlled enterprises can assist in mitigating the risks of future state support on public finances.** The level of state support provided to State-owned enterprises/State-controlled enterprises in Slovenia has been considerably above the EU average in recent years. State-owned enterprises have commenced the deleveraging of non-core assets accumulated during the boom, which will weigh on their profitability in the coming years. In parallel to addressing these legacy issues, the focus should shift to enhancing the core business of State-owned enterprises and identifying sectors where state involvement is not necessary. Slovenia could further benefit from the strong momentum and return of confidence after the restructuring of the banking sector in 2013 and 2014 in order to accelerate the privatisation process.

### A new corporate governance code for State-owned enterprises was adopted in December.

The new framework is reportedly in line with the basic recommendations of international practice it (i) ensures that State-owned enterprises and private companies operate on an equal footing (ii) enhances the separation of the functions of the state from its capacity as an owner (iii) applies across the spectrum of State-owned enterprises (with limited exceptions) under the "comply or explain" principle (iv) reinstates the roles of the company corpora, in particular the supervisory board, and the company's position towards the different stakeholders (v) realises the principles of transparency and touches upon a number of long-awaited issues such as the remuneration and bonuses of the company boards. Contrary to its predecessor, the new code does not exclude the parallel application of other corporate governance frameworks (e.g. that one of listed companies), thus eliminating the cases of privileged or otherwise differentiated treatment of State-owned enterprises in comparison with privately held companies. Finally, corporate governance of State-owned enterprises is explicitly connected to the goals of the forthcoming strategy on state assets, which will ensure a consistent treatment of State-owned enterprises.

Graph 2.2.19: Capital expenditure relative to operating profit (EBITDA) of State-owned enterprises/ State-controlled enterprises and all Non-financial companies



**Source:** The Agency of the Republic of Slovenia for Public Legal Records and Related Services (AJPES), Ministry of Finance database, Chamber of Commerce of Slovenia calculations.

**The Slovenian Sovereign Holding, in charge of the management and divestment of state assets is fully operational but its asset management strategy is still to be approved.** In June 2014, the ex-Slovenska odškodninska družba, d.d. ("SOD") fund was transformed into SSH following the amendment of its articles of association, in accordance with the new law adopted in late March 2014. <sup>(42)</sup> In order to perform its mandate, Slovenian Sovereign Holding requires a strategy reflecting the country's objectives and specifying the classification of state assets in strategic, important and portfolio investments. The deadline laid down in the law for the government to table its proposal in the parliament for that strategy and for a new supervisory board for Slovenian Sovereign Holding (July 2014) has passed. A plan for a new privatisation cycle, expected by November 2014 is also missing in the absence of the strategy. A draft asset management strategy entered intergovernmental consultations in January 2015 and is expected to be approved by the Parliament in March 2015. Within one month after the adoption of the strategy SSH will set up the annual asset management plan, which will include the

<sup>(42)</sup> Law: Zakon o Slovenskem državnem holding-1 ("ZSDH-1"), published on 11 April 2014 in the Official Gazette of the Republic of Slovenia (No. 25/2014).

new divestment schedule for additional state assets. A new supervisory board is expected to be appointed by the Parliament in the coming months after the Ministry of Finance completes the evaluation of the candidates in February 2015. A number of measures have been taken to make SSH operational, such as the adoption of an asset management policy in December 2014 <sup>(43)</sup>. The operational aspects regarding the establishment of the SSH, e.g. required corporate transactions and legal transformations provided for in the law, are also on track <sup>(44)</sup>.

**Slovenia could further benefit from the strong momentum and return of confidence after the restructuring of the banking sector in order to accelerate the privatisation process.** The privatization programme is making progress, albeit with delays. A list of fifteen companies was compiled in 2013 for a first cycle of expedited privatization, <sup>(45)</sup> out of which three companies

have been divested through privatisation and one company has been acquired by its creditors through a debt-to-equity swap executed as part of the restructuring process. Amongst the companies that were privatised, the sale of the airport, Aerodrom Ljubljana, was the largest transaction and was completed in October 2014. The sale process for the biggest assets on the list, Telekom Slovenije (the largest telecom and the sole owner of the telecommunication network in Slovenia) and NKBM (the second largest bank, owning 11% of total banking assets) is on-going, albeit with some delays, and is expected to be signed in April and March 2015 respectively.

**The asset management plan could enhance the transparency and credibility of the privatisation process.** As Slovenia prepares a new cycle of privatisations it is important that the list of companies is consistent with the SSH's priorities and strategy. The privatisation of selected State-owned enterprises/State-controlled enterprises in a transparent manner can assist in attracting FDI, and improve the economic outlook for the Slovenian economy. Furthermore, any proceeds from the process can assist in reducing public sector debt and enhancing the sustainability of debt going forward.

<sup>(43)</sup> According to the law on SSH, this policy establishes the principles (transparency, traceability and accountability), criteria and procedures applicable to Slovenian Sovereign Holding when discharging its duties. Amongst others, it governs the procedures on the acquisition or disposal of assets; it establishes detailed rules on the candidacy procedures for the members of supervisory boards of State-owned Enterprises/State-owned enterprises', and sets up a number of safeguards for the objectivity of the procedure (e.g. by imposing, on a contractual basis, duties of independence on the members of the personnel committee). Other measures include the conclusion in December 2014 of a management contract by Slovenian Sovereign Holding and the Republic of Slovenia, determining the payment of management fees to the first, and the appointment in January 2015 of a compliance officer by Slovenian Sovereign Holding. The criteria for measuring the performance of State-owned enterprises, shall be adopted within 1 month approximately after the endorsement of the strategy.

<sup>(44)</sup> In July 2014, Slovenian Sovereign Holding acquired 13.7% of the shares in the fund Posebna družba za podjetniško svetovanje, d. d. ("PDP") from the consultancy & management firm Družba za svetovanje in upravljanje d.o.o. ("DSU"). In October 2014, Slovenian Sovereign Holding acquired all the assets (including shares in different companies) owned by DSU. In January 2015, SSH became the sole owner of PDP after it acquired a 66.04% stake in the company from KAD for 5.7 m Euro. SSH is now expected to merge with PDP by absorbing it within the next months.

<sup>(45)</sup> The decision was taken by the Parliament on 21 June 2013 following a proposal made by the Government on 15 May 2013 (Sklep o soglasju k odtujitvi naložb Republike Slovenije, Kapitalske družbe pokojninskega in invalidskega zavarovanja, d. d., Slovenske odškodninske družbe, d. d., Modre zavarovalnice, d. d., D.S.U., družbe za svetovanje in upravljanje, d. o. o. in Posebne družbe za podjetniško svetovanje, d. d., published in the Official Gazette of the Republic of Slovenia, no. 52/2013)





## 2.3. COMPETITIVENESS, INVESTMENT AND THE ROLE OF FDI

### Price and cost competitiveness

**Since 2013, Slovenia has been performing relatively well on external markets, reflecting recent competitiveness gains.** While certain losses in external price and cost competitiveness have occurred due to wage increases between 2008 and 2010, the most recent data and a new sectoral Real Effective Exchange Rate database show relatively positive competitiveness developments, mainly owing to Real Effective Exchange Rate depreciation in the tradable sectors.

**The moderation in prices and costs after 2012 has contributed to the improvement of Slovenia's export performance.** The traditional indicator of price and cost competitiveness at the macroeconomic level, Real Effective Exchange Rate deflated by Unit Labour Costs in total economy, shows a steady retreat from the significant appreciation between 2007 and 2010 (Graph 3.3.1 – lhs). The appreciation suggested a substantial loss in cost competitiveness, which may have been partly reflected in the loss of market shares in 2009-2012. The subsequent Real Effective Exchange Rate depreciation could partially explain the improvement in Slovenia's export performance since 2013, as competitiveness shifts tend to affect trade performance with a lag.

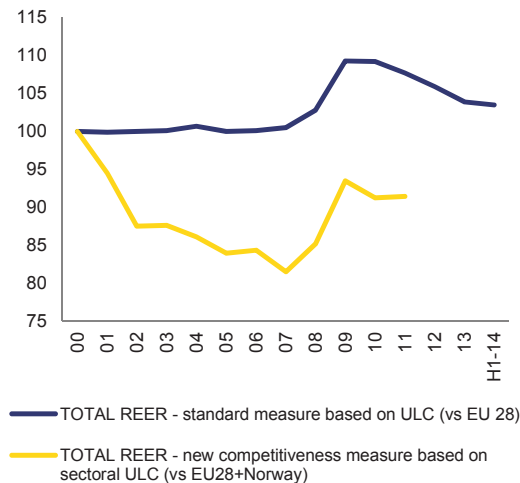
**Rapid aggregate wage growth coupled with stagnating productivity and labour hoarding had previously contributed to generating imbalances.** While part of the Real Effective Exchange Rate appreciation was due to rapid wage growth, the surge in the trend in 2009 was largely caused by an unexpected decrease of production and a resulting decline in productivity per employee. Collapsing economic activity combined with labour hoarding as workers were kept on the job through work support schemes weighed severely on firms' profitability, mainly in the non-tradable sectors. The tradable sectors adjusted quickly so as to safeguard their competitiveness. For example, Real Effective Exchange Rate based on the unit labour costs in the manufacturing sector remained broadly stable over the last 15 years (Graph– 3.3.1 rhs).

**A measure of competitiveness based on sectoral unit labour costs provides a more granular representation of competitiveness developments.** It shows that Slovenia made

considerable gains in price and cost competitiveness in the pre-crisis period but confirms deterioration in competitiveness in the run-up to the crisis that is now reversing (Graph 2.3.2). This new Real Effective Exchange Rate indicator aggregates competitiveness at sectoral level to obtain an economy-wide measure of competitiveness, which captures heterogeneous dynamics among sectors. It controls for the main limitation of the traditional Real Effective Exchange Rate, which confounds changes in the sectorial structure with changes in the unit labour costs per sector and does not account for the influence of global technological developments on different sectors.



Graph 2.3.2: **Real Effective Exchange Rate (Unit Labour Costs in total economy) and new sectoral Real Effective Exchange Rate in Slovenia**



Index 2000 = 100

Source: European Commission.

to this indicator based on unit labour costs, price and cost competitiveness has substantially improved since 2010. A recent extension of this analysis confirms that the competitive position of Slovenia returned to equilibrium in 2014.

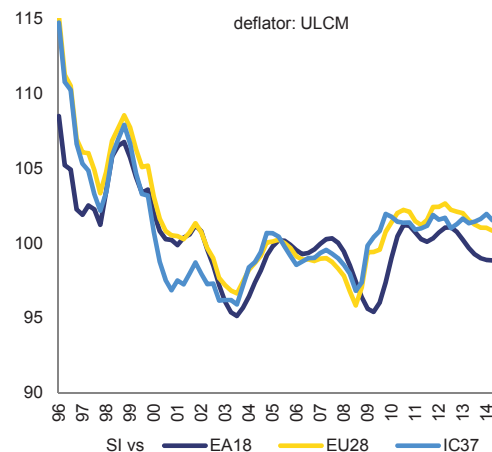
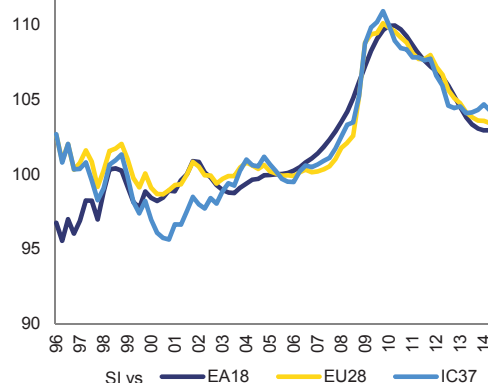
**The Nominal Unit Labour Cost index is once again approaching the euro area average** (Graph 2.3.4). This follows a period of decoupling due to the acceleration in wage growth at the time of no additional productivity gains. The three years (2008-2010) with flat hourly productivity and still growing wages adversely impacted Slovenia's price and cost competitiveness vis-à-vis the Euro Area. Nevertheless, Slovenia's Nominal Unit Labour Costs still grew slower than those of most of its peers.

**Slovenia's cost competitiveness evolution has been more favourable than that of most of its peers** (Graph 3.3.3). While this new indicator <sup>(46)</sup> is available only until 2011, it is expected to have improved further beyond this horizon due to favourable productivity developments and a very limited wage growth since 2011. In addition, Bank of Slovenia <sup>(47)</sup> estimated an equilibrium competitiveness indicator based on unit labour costs for Slovenia vis-à-vis EA-12 and compared it with those of its main trading partners. According

Graph 2.3.1: **Real effective exchange rate deflated by ULCE and ULCM**

<sup>(46)</sup> Quarterly report on the EA - Volume 13 (2014) Issue 2 - A competitiveness measure based on sector unit labour costs.

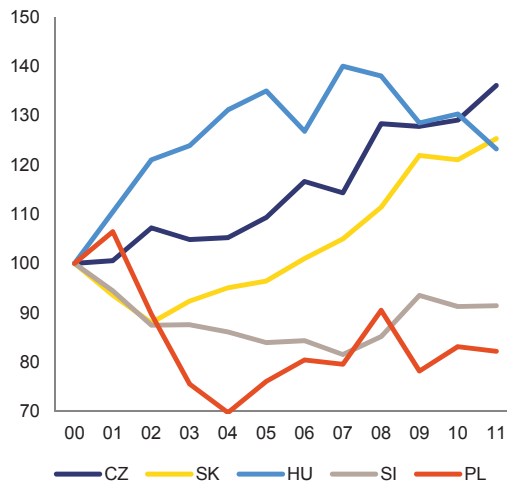
<sup>(47)</sup> Matija Lozej, Bank of Slovenia: [Ravnotezni kazalnik konkurenčnosti za Slovenijo](#) (only in Slovenian)



Index 2000 = 100

Source: European Commission.

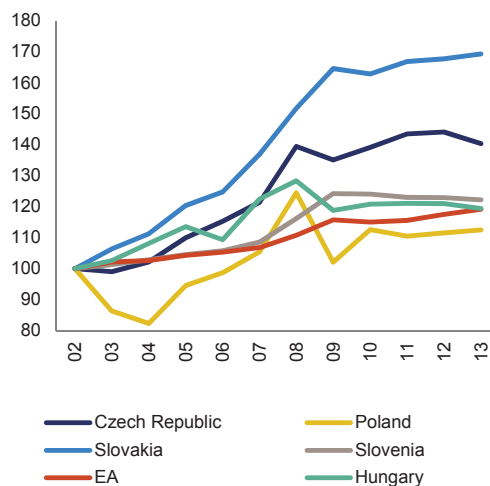
Graph 2.3.3: Sectoral Real Effective Exchange Rate aggregate in SI and V4



Index 2000=100

Source: European Commission.

Graph 2.3.4: Nominal Unit Labour Cost



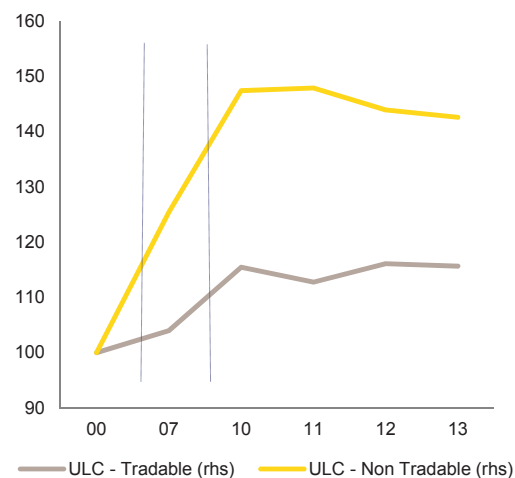
Index 2002 = 100

Source: Eurostat.

While Nominal Unit Labour Costs in the tradable sectors adjusted quickly and safeguarded their competitiveness, the adjustment in the non-tradable sectors started later and is taking more time. Non-tradable sectors (real estate activities, construction, public administration, defence, education and health, and scientific, administrative and support services) were the main contributors to the increase in the Nominal Unit Labour Cost but they have very little

impact on the external competitiveness of the Slovenian economy. The tradable sectors saw a more favourable evolution, also compared to the peers and the Euro Area. Increases in productivity and wages in the tradable sector (until 2007) inevitably translated into increases in wages in the non-tradable and less productive sectors; this fuelled inflation and led to an accelerating Nominal Unit Labour Cost. Such an evolution in Nominal Unit Labour Costs is part of the convergence process and is in line with the Balassa-Samuelson effect (Graph 2.3.5). The protracted correction of unit labour costs in the non-tradable and protected sectors could pose certain risks that their higher costs pass through into the tradable ones and affect their external competitiveness. These risks are present in particular during boom periods.

Graph 2.3.5: Slovenian Nominal Unit Labour Cost in tradable and non-tradable sectors



Tradable sectors ISIC A, C, G-I, J.

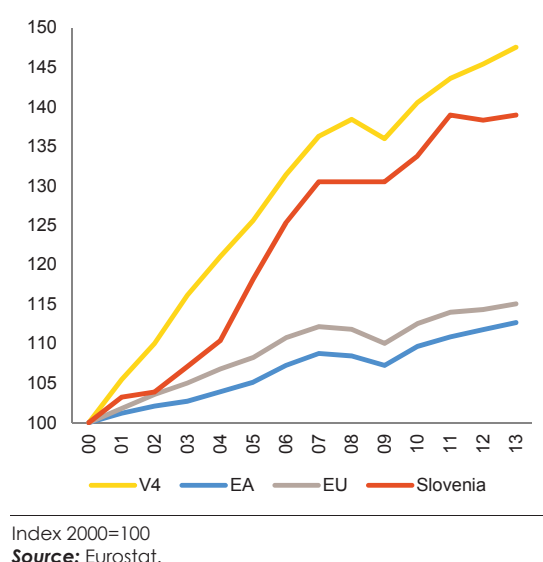
Index 2000=100

Source: Eurostat, European Commission.

**Slovenia's labour productivity continues to grow faster than the EU average** (Graph 2.3.6). Productivity gains were achieved mainly in the tradable sectors. By composition, they are positively reflected in the recent ULC trends. Productivity measured in terms of GDP per hour worked improved continuously over the last decade with the exception of stagnation around the crisis years. Although productivity per person employed dropped in 2009 as production contracted during the crisis, growth of productivity

per hour worked remained broadly in line with its Visegrád 4 peers both before and after the crisis and consistently considerably better than the EU or EA averages. Labour productivity per hour worked provides a better picture of productivity developments in the economy, as it eliminates differences in the full time/part time composition of the workforce across countries and years (it eliminates the impact of the large use of short-time work support schemes during the crisis in Slovenia, whereby headcounts were maintained but hours worked decreased).

Graph 2.3.6: **Productivity per hour worked**

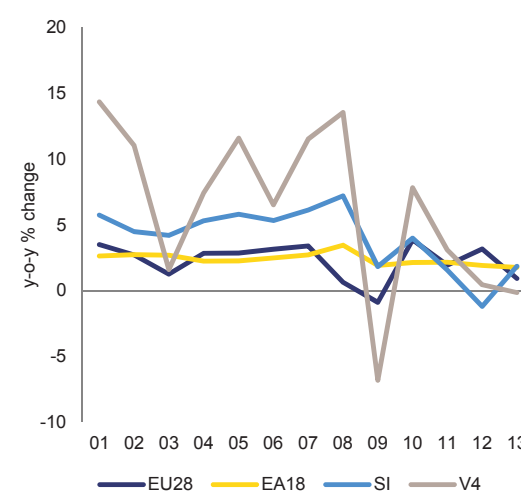


**Recent wage growth has been moderate and supportive of competitiveness** (Graph 2.3.7). Even though wage growth significantly outpaced the EU and Euro Area average between 2000 and 2008, it remained broadly in line with productivity developments and the need for convergence. The main notable exceptions are the high increases in 2008, partially attributable to the payment of wage disparities in the public sector and the indexation of wages to relatively high inflation in the previous year; and in 2010, resulting from a large increase in the minimum wage.

**The level of the minimum wage remains comparatively high.** The level of the minimum wage in relation to average gross monthly earnings remains the highest in the EU. This is partly due to the design of the minimum wage-setting system, which includes various allowances (e.g. for night

work, overtime) and a global indexation encompassing all of these components and not just basic pay. In addition, since 2008 the minimum wage increased by 33% while the gross wages per employee by 9%. The short distance of the minimum wage from the average wage is also related to the low level of wage dispersion in the country<sup>(48)</sup>. In 2014 the minimum gross wage was EUR 789.15, having grown by 0.7% from the previous year, while the ratio of the minimum wage to average gross monthly earnings was 51.4%, the highest in the EU. This is also reflected in high relative labour costs for minimum wage workers that may relate to the low employment level of the least skilled workers (see section 4.2)<sup>(49)</sup>. In January 2015, the minimum wage was increased by 0.2%. Going forward, in the current low inflation environment, the ratio between the minimum and the average wage is expected to decrease.

Graph 2.3.7: **Nominal compensation per employee**



**There have been some changes in the wage-setting system, yet excluding the minimum wage.** The new government signed the Social Agreement in January 2015 with the social partners; which will be valid for the period 2015-

<sup>(48)</sup> The proportion of employees being paid less than 105% of the minimum wage was 19.2% in Slovenia, highest among Member States that have a minimum wage.

<sup>(49)</sup> Labour costs at the level of the minimum wage that include employer social security contributions are an important determinant of labour demand and are among the highest in the EU.

2016. The agreement establishes collective agreements as the basis for private sector wage setting, while inflation and a share of sectoral productivity will be taken into account in bipartite wage negotiations. The Social Agreement also indicates that public sector wage growth has to lag behind private sector wage growth. It does however not contain any change to the setting of the minimum wage. A contribution to the continuity of wage moderation comes from further reductions in the public wage bill, which was adopted in December 2014 following an agreement between the government and trade unions. The agreement extends to 2015 the savings measures adopted in 2012 and 2013, and also introduces additional measures. In 2013, the total paybill in the public sector decreased by 4.1% as compared to 2012 and the number of people employed in the public sector by 1.5%. According to the first estimates of the government, an additional EUR 36 million EUR of savings, including reduced performance bonuses, could be achieved in 2015 with respect to 2014.

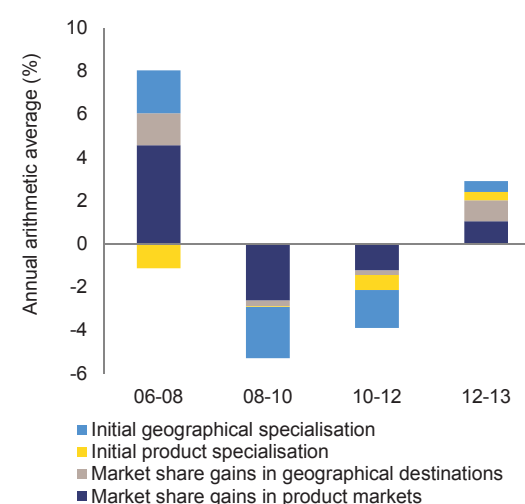
### Non-cost competitiveness

**Price and cost competitiveness can only partially explain export performance. There is evidence that non-price factors are very important, particularly in countries that have been through a real convergence process.** These factors include product and geographical specialisation, developments in quality of products, notably through research and innovation process, consumer preferences in the importing countries, as well as the ease of doing business (efficiency of public administration, taxation policies, regulation, capital and labour market conditions, access to finance and investment etc.)

**Trade developments in Slovenia have been largely driven by its geographical and product specialisation** (Graph 2.3.7). Slovenia's exporters benefited from a favourable geographical specialisation before 2008, as they were oriented towards at-the-time dynamic markets (mainly Euro Area and Balkans). They also managed to gain significant market shares in new products. Nevertheless, with the onset of the crisis, Slovenia lacked the necessary dynamism to enter new markets and lost market shares. Since 2013, Slovenia managed once again to gain market shares as well as benefit slightly from the

geographical specialisation. Overall product specialisation has been slightly negative or neutral.

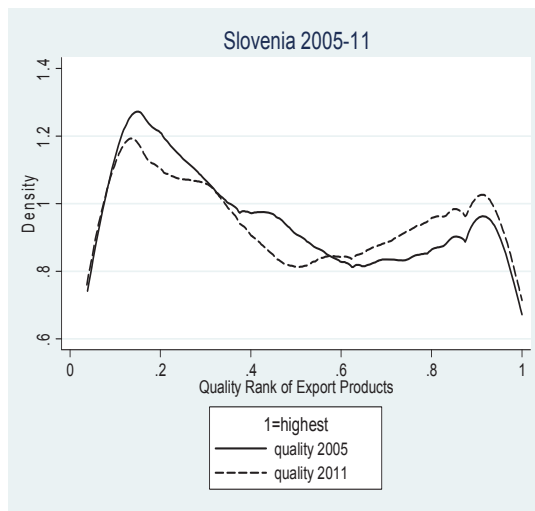
Graph 2.3.8: **Geographical and sectoral composition of nominal rate of change of goods exports**



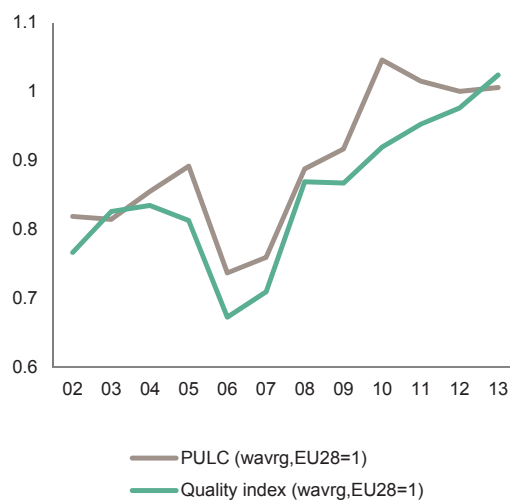
Source: European Commission.

**The composition of Slovenia's exports has improved in the last decade.** The share of high-technology products in Slovenia's exports has progressively increased (Graph 2.3.9). This is pointing to the fact that Slovene exports were able to compete in the segment of higher value added products as the quality of exports has been improving over time.

**Increase in the technological content and quality of exports contributed to the boost in export performance.** The quality of exports has been improving, relative to other trading partners. Slovenia's quality index (Graph 2.3.10) estimates how Slovene exports compete on the EU market relative to the exports of other Member States. The EU market captures more than 75% of Slovenian exports, thus it is important to benchmark how well these products are accepted compared to the exports from other Member States. The quality index of Slovenia has been improving since 2006. However it remained below the physical unit labour cost (the share of unit labour cost required to produce the value of exports) until 2012. A discrepancy between the physical unit labour cost and the quality index appeared in 2010, when the minimum wage increased substantially. Since then the physical unit labour cost moderated and adjusted to the quality of exports.

Graph 2.3.9: **Density distributions of exports (goods) by quality**

Source: COMEXT, Orbis, European Commission.

Graph 2.3.10: **Non-cost competitiveness vis-à-vis EU28**

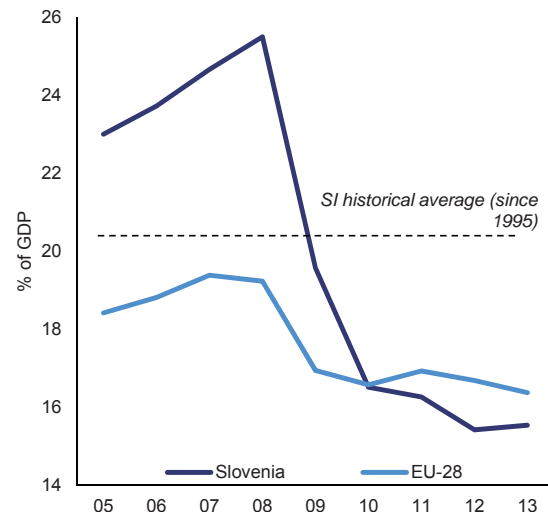
Source: European Commission, Joint Research Centre, IPTS institute, based on COMEXT data.

**Non-cost competitiveness could improve further through productive investment into innovative technologies and products.** The forthcoming Smart Specialisation Strategy (Section 4.3) could serve as a platform for channelling the EU funds into further improvement of non-cost competitiveness. Also, current business environment needs to adjust in order to support competitiveness improvements. Major weaknesses stem from the developments in the financial sector,

the slow privatisation process, lengthy administrative procedures and the risk of corruption (Section 4.3 and 4.5).

### Investment dynamics

**Private investment decreased dramatically in 2009/2010 and since then, it has not recovered** (Graph 2.3.11). This is not only due to the crisis, but also because of the highly indebted corporate sector, significant state involvement in the economy, and an unsupportive business environment. Companies, struggling to repay their debts, have been underinvesting compared to the historical average and peers in the region. Weakness in investment warrants special attention not only because of its impact on domestic demand and short-term economic outlook but also because shortfalls in investment are detrimental for the future potential growth of the Slovenian economy.

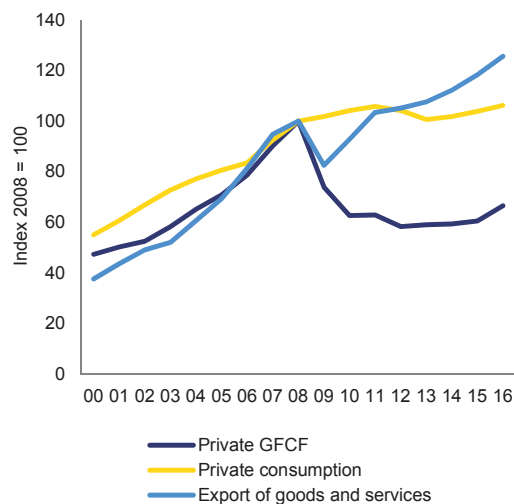
Graph 2.3.11: **Investment in the private sector**

Source: Ameco.

**The magnitude of the drop in investment is not in line with the development observed in aggregate demand.** While domestic and external demand fell considerably during the crisis, neither private consumption nor exports decreased as much as investment (Graph 2.3.12). Despite rising unemployment and wage restraint in the post-crisis years, private consumption modestly increased in nominal terms and is projected to grow in the short term. Exports contracted in 2009 but grew

thereafter, yet did not lead to a significant pick-up in investment of the exporting companies. Private investment remains 40% below its pre-crisis peak<sup>(50)</sup> and is projected to increase only marginally by 2016. This creates substantial macroeconomic costs. Through its direct impact on aggregate demand, lack of investment translates into reduced GDP growth. In addition, such development considerably reduces Slovenia's ability to grow in the medium and long term.

Graph 2.3.12: Private investment and private consumption

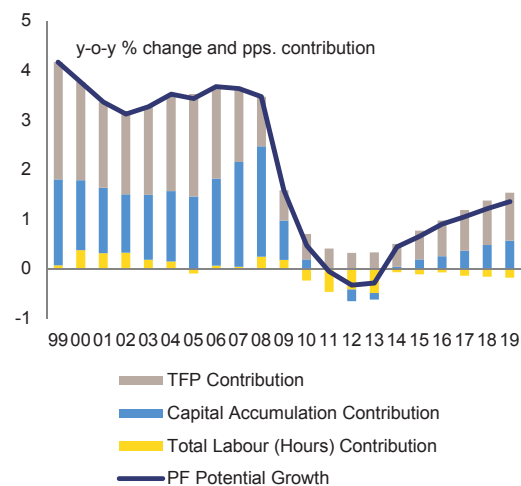


Source: Ameco.

**Low investment eroded Slovenia's potential growth.** The Commission's estimates for the Euro Area indicate that a 5 percentage point reduction in the investment rate leads to a reduction in potential growth of nearly 0.5%. Slovenia's potential output has substantially dropped since 2009 (Graph 2.3.13). The Commission's estimates potential growth in 2014 at ½%, compared to 3-4% between 2000 and 2008. This is primarily due to a large reduction in the contribution from capital accumulation, and secondarily due to lower total factor productivity. While Slovenia's potential growth is projected to progressively recover, it is expected to remain at a relatively low level over the medium term, restrained by protracted low capital accumulation as well as only slowly

recovering total factor productivity. Total factor productivity growth is an essential driver of long-term growth, capturing efficiency gains in the overall use of economic resources and reflecting technological progress reflected in capital. In 2014, the total factor productivity contribution was estimated approximately 70% lower than the 2000-2008 average. As ageing population is expected to have negative impact on potential growth, an increase in capital accumulation and productivity growth is crucial in order to return to a higher long-term growth path.

Graph 2.3.13: Potential output and components



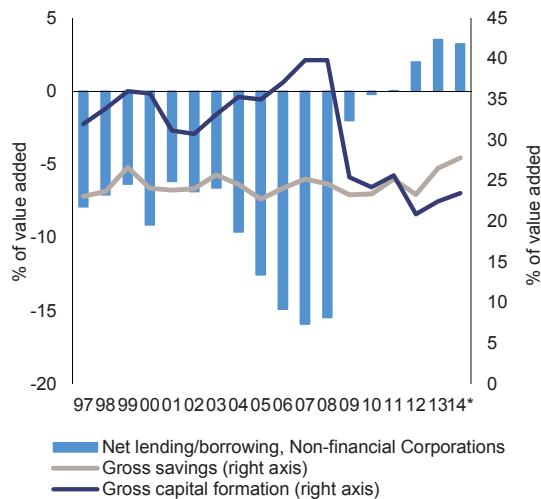
Source: European Commission.

**The crisis turned corporations from net borrowers to net lenders, reflecting the deleveraging needs of corporates.** Prior to the crisis, non-financial corporations relied on foreign credit to finance their investment. Graph 2.3.14 shows a steady net borrowing level until 2003, and then a considerable accumulation of debt. The necessary adjustment took place afterwards, but as of 2012 investment rate fell below savings rate, making Slovenian companies net savers. This reflects the ongoing deleveraging (Section 2) and is mirrored in the growing current-account surplus (Graph 2.4).

<sup>(50)</sup> The peak was to some extent inflated by the planned end of investment of the highway company DARS. This is a public company but its investment is treated as private in ESA95/2010. DARS' investment accounted for about 1½ % of GDP in 2008 and much lower thereafter.



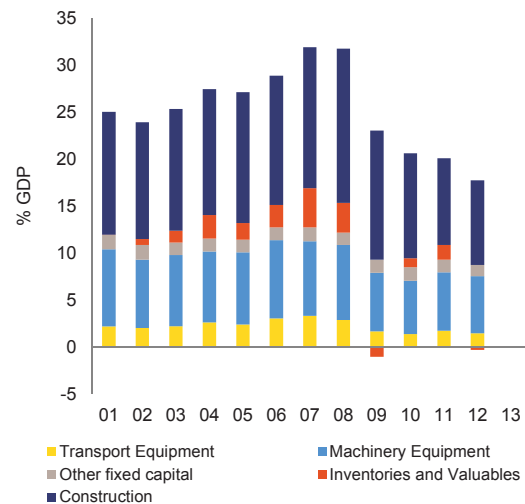
Graph 2.3.14: Non-Financial Corporations savings and investment



Source: Eurostat, ESA 2010; \* 2014 based on quarterly data.

Construction investment accounted for most of the decline in gross fixed capital formation but productive investment was also affected (Graph 2.3.15). Slovenia experienced a non-residential construction investment boom, mostly in infrastructure, retail, and tourism structures, which ended abruptly in 2009. While the construction sector appears overinflated before the crisis, its post-crisis activity and investment has been extremely low. Peak-to-through decline in employment in this sector was 30% (2009-2014) and is stabilising only now. Peak-to-trough decline in construction investment was close to 50% (2008-2012). Productive investment in machinery and equipment shrank by a third between 2008 and 2010, but grew again in 2011 and 2013.

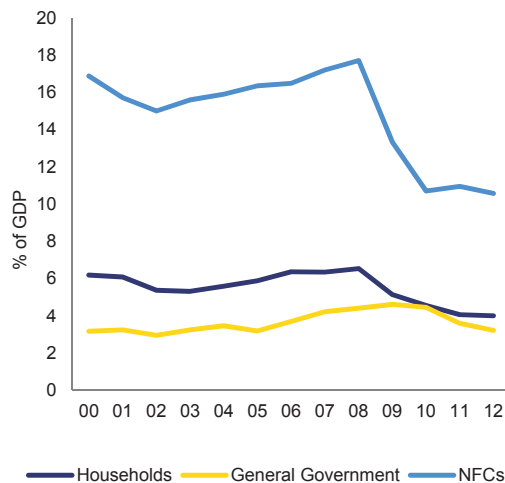
Graph 2.3.15: GFCF by type



Source: Eurostat.

Both households and non-financial corporations reduced their investment significantly at the onset of the crisis, while public investment was reduced at a later stage due to fiscal consolidation (Graph 2.3.16). Non-financial corporations and households sharply reduced their investment in terms of GDP by almost 40% between 2008 and 2009. Government expenditure on investment continued to grow until 2009, but as the recession took hold and revenue shortfalls materialised public investment was targeted as a key measure of the required fiscal consolidation. Public investment declined by 22% between 2009 and 2012 and this contraction dampened the tentative export-led recovery experienced by Slovenia in 2010-11. Since 2012, there has been a significant increase in public investment largely due to EU co-financed projects and the 2015 deadline for the drawdown of funds from the EU 2007-2013 multiannual financial framework. Consequently, public investment amounted to over 5% of GDP in 2014, one of the highest levels in the EU. Strong public investment has been one of the key drivers of the economic recovery experienced in Slovenia in 2014 and it is expected to continue to grow in 2015, albeit at a more modest pace.

Graph 2.3.16: Investment by institutional sectors



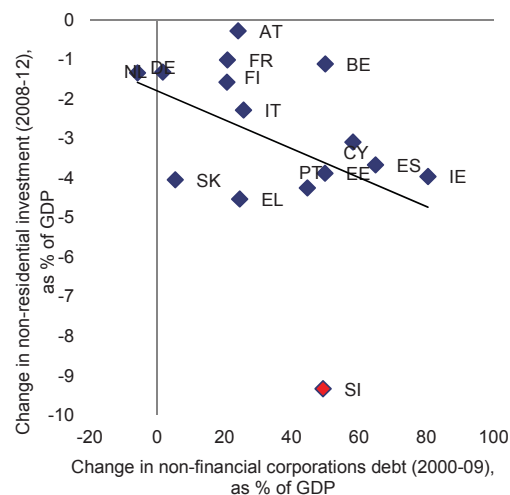
Source: Eurostat

**High level of corporate indebtedness, the need to deleverage, regulatory bottlenecks and persisting uncertainty appear to have been the main drivers of underinvestment.** Underinvestment in the private sector has been aggravated by the lack of equity among corporates. Inefficient capital structures make it difficult for companies to access bank funding to finance productive investment and at the same time erode the banks' long term profitability, as outlined in the Sections 2 and 3.1. Interest rates have decreased since the crisis peak but still remain high for corporates, especially small and medium enterprises. Uncertainty<sup>(51)</sup> also appears to have been a major factor driving the sharp contraction in investment. However, the financial markets pressures have subsided and spreads have returned to relatively low levels, thus economic uncertainty is expected to weigh less on investment going forward.

**The Commission's services estimations show a strong negative correlation between the accumulation of debt by non-financial corporations in the pre-crisis years and the change in non-residential investment since the crisis (Graph 2.3.17).** In this graph, Slovenia is an outlier, which could mean that the large decline in investment in Slovenia goes beyond the increase in

indebtedness. This may be partly explained by Graph 2.9, which reflects the inability of Slovenian firms to increase savings via profits, partly due to the wage dynamics and labour hoarding. In addition, as outlined in the scene setter (Section 2), the change in the share of the debt of non-financial corporations in GDP is less concerning than the sharp increase in the debt-to-equity ratio. This reflects the unsustainable pre-crisis growth-financing model, which was concentrated almost exclusively on debt. This underscores the importance of attracting fresh equity, in particular through alternative equity sources (venture capital) and foreign direct investment.

Graph 2.3.17: Non-residential investment and non-financial company debt



Source: European Commission.

**Improving business environment and attracting foreign direct investment is key.** Slovenia suffers from underinvestment in the private sector and difficulties of companies to access bank funding to finance productive investment, coupled with the limited availability of public investment (apart from EU co-financed investments). This underscores the need for an improved business environment and enhanced competitiveness in order to attract private investment. Ongoing corporate sector deleveraging, lack of excess savings and the tight credit conditions constrain domestic investment and underscore the need to promote Foreign Direct Investment. FDI would bring positive spill-over effects to the rest of the economy in terms of labour and capital productivity.

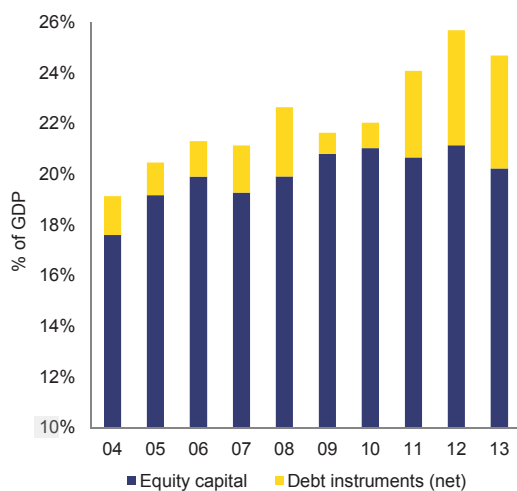
<sup>(51)</sup> Quarterly Report on the Euro Area, volume 12 (2013), issue 2. [Assessing the impact of uncertainty on consumption and investment.](#)



### The role of FDI

**FDI plays an important role as a long-term, stable source of financing for the Slovenian economy.** At the end of 2013, the stock of inward FDI in Slovenia stood at EUR 8.9 billion (24.7% of GDP), which is 3.5% lower than in 2012 (1 pp. lower in terms of GDP). The rapid increase in the pre-crisis period and relatively stable post-crisis stock show that Slovenia managed in the past to attract FDI, albeit starting from a relatively low level, and that FDI is a reasonably stable mode of financing even in crisis times (Graph 2.3.18), in contrast to portfolio and other investment.

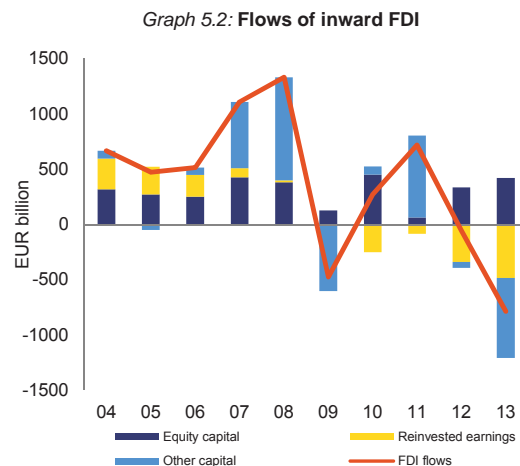
Graph 2.3.18: **Inward FDI**



Source: Bank of Slovenia.

**FDI inflows declined in 2012-2013 but considerable increase in FDI inflows is estimated for 2014.** In contrast to the pre-crisis period, Slovenia has registered outflows of non-equity capital and reinvestment as companies preferred to pay out dividends rather than reinvest profits (Graph 2.3.19). Equity was also affected due to the exit of foreign owners from financial corporations. While slower FDI-inflows are to some extent rational due to a deceleration in global activity and FDI flows, Slovenia has been more affected than its peers (Graph 2.3.20). However, preliminary data for 2014 shows positive flows in equity and debt instruments, and an increase in FDI stock by approximately 15% in the first 9 months of the year.

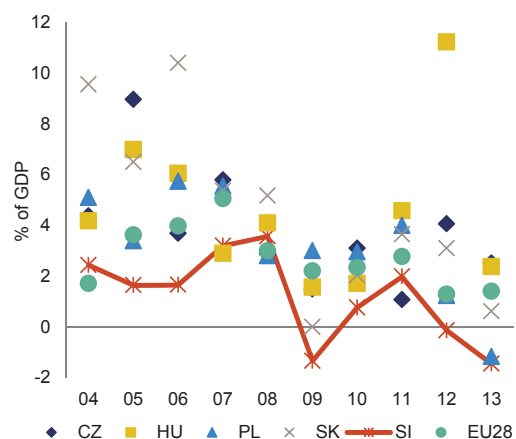
Graph 2.3.19: **FDI inflows**



Source: Bank of Slovenia

Source: Bank of Slovenia.

Graph 2.3.20: **FDI inflows in Slovenia, Visegrád 4, EU**

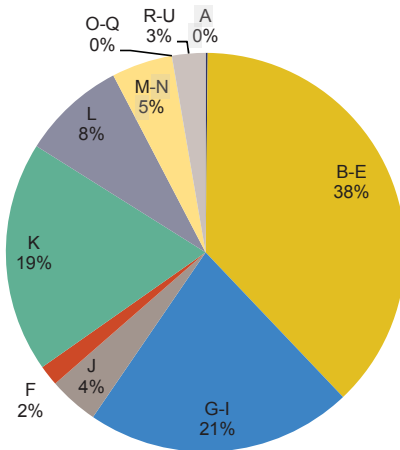


Source: Unctadstat.

**FDI stock remains concentrated in the tradable sectors and the overcapacity in the non-tradable sector is being reduced.** The largest share of the FDI stock in Slovenia is present in industry (38% in 2013), followed by wholesale and retail trade (21%). Another important FDI-attractive sector consists of financial and insurance activities (19%). Graph 2.3.21 details the distribution of FDI among sectors in 2013 and graph 2.3.23 the evolution in tradable and non-tradable sectors. In the pre-crisis period, an important part of FDI was directed into the non-tradable sector and left some

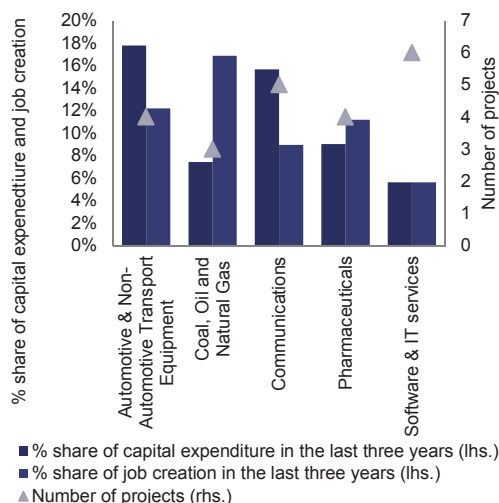
over-capacity after the bust, which has taken time to correct. Given that Slovenia was in recession in 2009 and again in 2012-2013, FDI growth remains sluggish compared to the pre-crisis period.

Graph 2.3.21: FDI stock per sector in Slovenia, 2013



(1) A - Agriculture, forestry and fishing, B-E - Industry (except construction), G-I - Wholesale and retail trade, transport, accommodation and food services, J - Information and communication, F - Construction, K - Finance and insurance, L - Real estate, M-N - Professional, scientific and technical; administrative and support service, O-Q - Public administration, defence, education, human health and social work, R-U - Arts, entertainment, recreation and other  
**Source:** Bank of Slovenia.

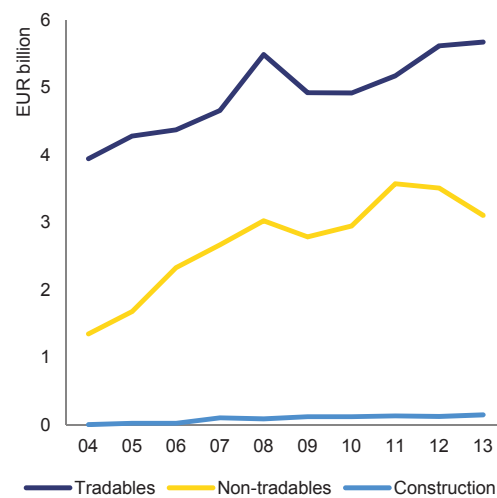
Graph 2.3.22: Sectoral composition of greenfield FDI in Slovenia, 2011-2013



**Source:** Financial Times' FDI markets dataset.

In terms of greenfield investment (<sup>52</sup>), the manufacturing sector represents almost 50% of total capital expenditure. This includes mainly transport equipment and knowledge intensive sectors. The coal, oil and natural sector and specifically the subsector of gasoline stations emerged as the first-largest job creator with FDI (Graph 2.3.22).

Graph 2.3.23: FDI stock in tradable and non-tradable sectors



**Source:** Bank of Slovenia.

Most of the inward FDI originates from European neighbouring countries. One third of the FDI stock comes from Austria, who is the main foreign investor in Slovenia. It is followed by Switzerland (12%), Italy (9%), Germany (8%), France (7%) and Croatia (6%), by 2013 data (Graph 2.3.24).

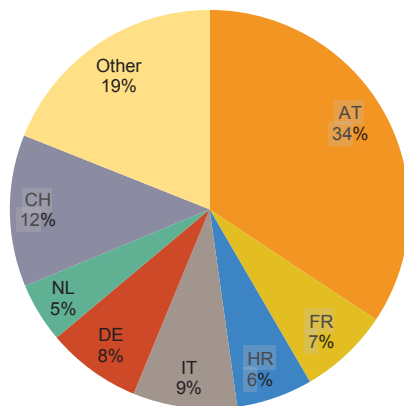
In terms of stocks of FDI, Slovenia lags severely behind other countries. According to the Unctad data (<sup>53</sup>) the level of FDI in Slovenia was markedly lower than the EU average of 49.5% of GDP (Graph 2.3.25). Moreover, Slovenia's peers registered above-average FDI stocks built up during 1990s' privatisations and more recently due to active policies to attract FDI, such as improving

(<sup>52</sup>) Tangible investment in an area where no prior physical facilities exist.

(<sup>53</sup>) Unctadstat uses a different methodology than the BoS (Graph 3.3.19) and evaluates Slovenia's stocks of FDI at 32.5% of GDP in 2013.

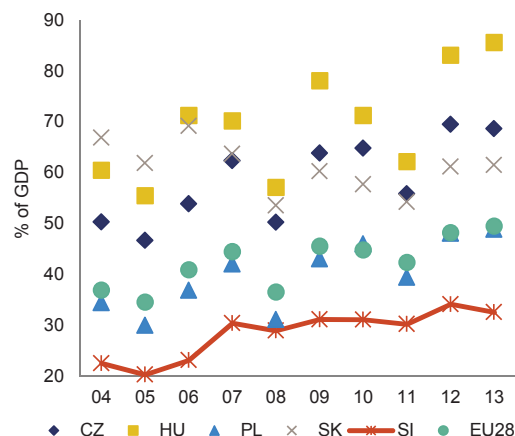
the business environment and investment incentives.

Graph 2.3.24: **Origin of inward FDI, stocks in 2013**



Source: Bank of Slovenia.

Graph 2.3.25: **FDI stocks in Slovenia, Visegrád 4, and the EU**



Source: Unctadstat.

**Weak FDI flows are linked to the quality of the business environment, whose attractiveness relative to other countries continues to deteriorate.** High regulatory cost, limited access to finance, and high taxes and costs on skilled labour force (see Section 4.2) are the three major weaknesses. These characteristics coupled with other issues in the institutional environment including corruption (see Section 4.3) deter

potential investors. The situation is aggravated by the lack of an industrial or investment policy. The European Commission's 2014 Industrial Competitiveness report <sup>(54)</sup> concludes that little has been done to address these weaknesses, making Slovenia less attractive for foreign direct investment, especially when compared to other countries in the region. The latter have been more active not only in facilitating investment through a more business-friendly environment but also in promoting it through effective investment incentive policies.

#### **The untapped stock of potential FDI limits Slovenia's investment-financing possibilities.**

Ongoing privatisation and corporate restructuring in Slovenia offer new opportunities for attracting FDI into the country, yet the business culture needs to adapt to take full advantage of foreign investments. At a time when domestic financing is scarce, and public investment dependent on capital transfers, FDI could help to fill the gap. Facilitating and actively encouraging foreign investors to acquire partial or full control of a business, or entering Slovenia via greenfield investment, would create stable and lasting economic links to the country, and acquire technological and management skills from abroad.

#### **There is room for improvement in Slovenia's efficiency in attracting FDI.**

In 2013, the Court of Audit conducted an analysis of the efficiency of supportive measures for FDI and presented its opinion that the actions of the authorities were not conducive towards attracting FDI. The audit concluded that the Ministries did not focus on the implementation of the measures that would have had the greatest impact on the attractiveness of Slovenia for FDI.

#### **The unsatisfactory trend in the inflow of FDI could be reverted through targeted measures.**

While the country implements an ambitious privatisation plan essential to attract fresh capital into the country, more has to be done on eliminating bottlenecks and unnecessary regulatory burdens and increase greenfield investment. The Single document (see Section 4.3) identifies areas where important interventions are needed to reignite investment in Slovenia.

<sup>(54)</sup> [http://ec.europa.eu/enterprise/policies/industrial-competitiveness/monitoring-member-states/index\\_en.htm](http://ec.europa.eu/enterprise/policies/industrial-competitiveness/monitoring-member-states/index_en.htm)

**The forthcoming FDI strategy would benefit from a coherent set of both FDI facilitation and FDI promotion measures.** This includes inter alia the creation of a one-stop-shop for foreign investors, the development of a coherent set of promotional activities, a set of specific industrial and tax incentives linked to existing and future policies and strategies like the 2013 Industrial policy, the 2011 Research and Innovation Strategy, and the forthcoming Smart Specialisation strategy. The creation and support of national value chains and upgrading of absorption capacities of domestic firms can boost local employment and thus help to increase public acceptance towards foreign investment. Moreover the size and fundamentals of its economy as well as its location make Slovenia the ideal location for global value chains. Equally important is the development of a communication strategy on the expected benefits of FDI for growth in the country and on the comparative advantages of Slovenia as an FDI destination due to its geographic location, natural resources or abundance of skilled labour force. The forthcoming strategy on FDI should support and complement future investment projects including those submitted in the context of the new EU Investment plan <sup>(55)</sup>.

**Concentrating efforts on additional supportive and easily attainable policies would quickly pay off.** While privatisations coupled with effective communication policies can potentially have positive long term impacts, other policies targeted on reducing regulatory burdens should be considered. Streamlining processes in the area of spatial planning and registering property, constitute easy wins because of the shorter implementation periods and the relatively low associated costs. It is important to maintain the reform momentum and not compromise on the ambition of these plans in order to boost Slovenia's attractiveness as a location for FDI and reach the authorities' ambitious FDI target for 2017 <sup>(56)</sup>.

<sup>(55)</sup> [http://ec.europa.eu/priorities/jobs-growth-investment/plan/index\\_en.htm](http://ec.europa.eu/priorities/jobs-growth-investment/plan/index_en.htm). Slovenia submitted 22 projects (mainly in infrastructure) under the new EU Investment Plan.

<sup>(56)</sup> The Ministry of Economy targets an increase in the FDI stock to the EU average by 2017.

### 3. OTHER STRUCTURAL ISSUES

### 3.1. FISCAL POLICY AND TAXATION

The fiscal situation in Slovenia in recent years has been challenging; a prolonged recession coupled with significant bank recapitalisations has resulted in a sharp rise in public debt. Furthermore, successive years of consolidation have dampened consumption and weighed on the domestic economy. As the recovery gathers pace, the focus turns to the introduction of a well-designed fiscal framework, which can assist in safeguarding debt sustainability. The focus of budgetary execution should shift from temporary consolidation measures and linear cuts to expenditure reviews, which provide a more sustainable approach to public expenditure planning and can generate considerable efficiency savings.

#### Taxation

**Slovenia tax revenue-to-GDP rate is below the EU average but the second highest<sup>(57)</sup> of new member states.** At 37.1% of GDP in 2014, it is below the EU average of 39.1% of GDP. The tax structure in Slovenia is considered more growth friendly than the EU average with a higher share of indirect taxes and a lower share of direct taxes as a proportion of total revenues. Revenues from direct taxes were considerably lower than the EU average in 2013 (7.2% vs. 12.8% of GDP EU average).

**Slovenia plans to undertake a comprehensive review of the tax system in order to restructure the tax burden, shifting tax away from labour taxes and abolish inefficient tax allowances.** The review is expected to commence in the second half of 2015. While the tax wedge for different family types and wages is at or below the EU average, the social contributions paid by employees are much higher (15% of GDP in 2013 compared to the EU average of 13.5%). This is mainly because there is no cap on social contributions for employees. However, when all elements of taxation are considered the tax wedge on labour for the average-wage single earner (42.3% in 2013) is lower than the EU average (44.8%).

**Recurrent taxation of immovable property is considerably below the EU average** with revenues amounting to 0.5% of GDP in 2012 vs. an EU average of 1.5%. This indicates scope for the introduction of further measures in this area.

The authorities are currently considering introducing a revised version of the real estate tax that was previously repealed.<sup>(58)</sup> The tax burden of a revised real estate tax if introduced would remain at the same level as under the existing system of property taxation, although minor increases in tax revenues are expected due to the broadening of the tax base. Given that the level of property taxes in Slovenia is considerably below the EU average there appears to be scope to revise the rates.

**The administrative process with respect to tax compliance in Slovenia takes considerably longer than the EU average.** According to the PwC and World Bank (2014), *Paying Taxes 2015: The global picture report*<sup>(59)</sup> the total time spent to file and pay taxes for a sample mid-sized company in Slovenia (260 hours) is significantly higher than the EU average (179 hours). The key issues for businesses is the uncertainty regarding the length of procedures, particularly with respect to appeals and the uncertainty frequent legislative changes create (Section 4.3). The authorities have indicated that there has been a reduction in the number of appeals pending in the last two years but the time for a decision in the more complex areas (i.e. VAT and corporate tax) is longer than the targeted duration. The government is addressing this issue, among others via the single document, which includes measures to simplify tax procedures (Section 4.3).

**Measures to tackle the grey economy have yielded initial positive results.** The government strengthened the programme to mitigate the impact of the grey economy, including the introduction of stricter provisions regarding the use of cash register software and strengthened presence of field inspectors. The authorities estimate the full year yield of these measures equates to 0.3% of GDP and an increase in voluntary compliance of approximately 20%. The Prevention of Undeclared Work and Employment Act entered into force in January 2015 introduced a voucher system for personal supplementary work, which is expected to further reduce the grey economy. There are plans to upgrade the existing system of tax registers by

<sup>(57)</sup> Slovenia's tax-to-GDP rate is the second highest of the new member states after Hungary.

<sup>(58)</sup> The real estate introduced in 2014 was repealed by the Slovenian Constitutional Court who indicated that the law did not specify the methods of real estate evaluation.

<sup>(59)</sup> <http://www.pwc.com/gx/en/paying-taxes/download.jhtml>

the end of 2015 subject to the impact assessment, finding an upgrade represents value for money.

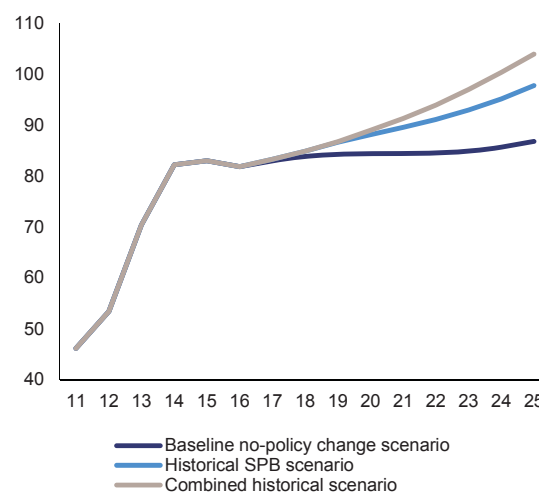
### Debt sustainability

**Slovenia's debt has risen sharply in recent years from 22% of GDP in 2008 and is expected to stand at 83% of GDP in 2015.** While exceptional items, particularly bank recapitalisations, have significantly contributed to this increase, sustained primary deficits over the period have also attributed. Furthermore, the level of contingent liabilities in Slovenia is high (government guarantees equate to 18% of GDP), largely to state-owned entities (Section 3.2). This large stock of guarantees poses an additional risk to public debt sustainability and intrinsically links the sovereign to the performance of these entities.

**Slovenia's debt is expected to continue to increase to 87% of GDP in the medium term based on a no-policy-change assumption<sup>(60)</sup>.** Under the baseline scenario of the Debt Sustainability Analysis public debt is expected to steadily increase, as a percentage of GDP, in the medium term (i.e. until 2025) (Graph 3.1.1). Under a scenario<sup>(61)</sup> where the structural primary balance is assumed to converge to a historical average, and another scenario<sup>(62)</sup> where all main macroeconomic variables converge to a historical average, debt levels accelerate quickly on an unsustainable trajectory from 2017 onwards. If however Slovenia was to fulfil its commitments (Graph 3.1.2) under the Excessive Deficit Procedure and then abides by the rules of the Stability and Growth, converging to Slovenia's current medium-term objective by 2017 and maintaining it thereafter, we would see an acceleration in the reduction of debt towards 60% of GDP. The reduction would be even faster if Slovenia were to adopt the fiscal commitments outlined in its own Stability and Convergence

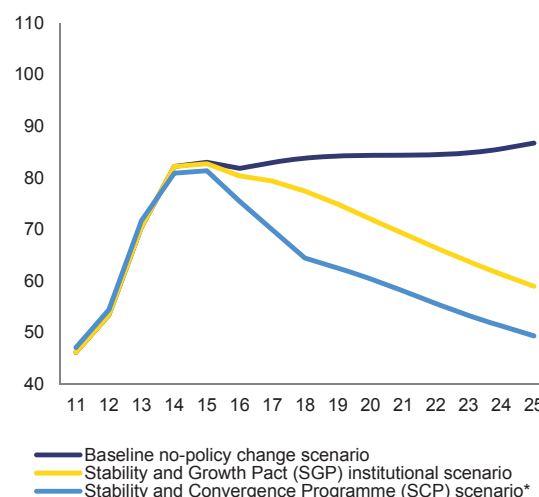
Programme.<sup>(63)</sup> This underscores that maintaining fiscal discipline is a prerequisite to debt sustainability.

Graph 3.1.1: Gross debt % of GDP - DSA analysis



Source: European Commission calculations.

Graph 3.1.2: Gross debt % of GDP - institutional scenario



Source: European Commission calculations.

### Fiscal framework

**Slovenia is one of only a few countries where the adoption of the legislation transposing the**

<sup>(60)</sup> Based on Commission Winter 2014 forecast, EPC agreed long-run convergence assumptions of underlying macroeconomic variables (real interest rate, real GDP growth, inflation) and the assumption of constant fiscal policy beyond the forecast horizon.

<sup>(61)</sup> The historical structural primary balance scenario assumes gradual convergence to the historical average for the structural primary balance beyond the forecast, all other macroeconomic assumptions as in the baseline

<sup>(62)</sup> The combined historical scenario assumes gradual convergence to historical averages beyond the forecasts for all main macroeconomic variables - structural primary balance, implicit interest rate and real GDP growth.

<sup>(63)</sup> The structural primary balance is assumed to remain constant at end-of programme value; all other macroeconomic variables - interest rate, inflation, growth - over the programme horizon are also taken from the SCPs



**directive on budgetary frameworks into the national legal order has been delayed and is still on-going.** According to the Slovenian Constitution, as amended in May 2013, the legislation implementing the general government budget balance/surplus rule (in structural terms) should have been adopted by end November 2013. However, the draft Fiscal Rules Act, implementing the constitutional amendment was only adopted by the Government and submitted to the Parliament in December 2014.

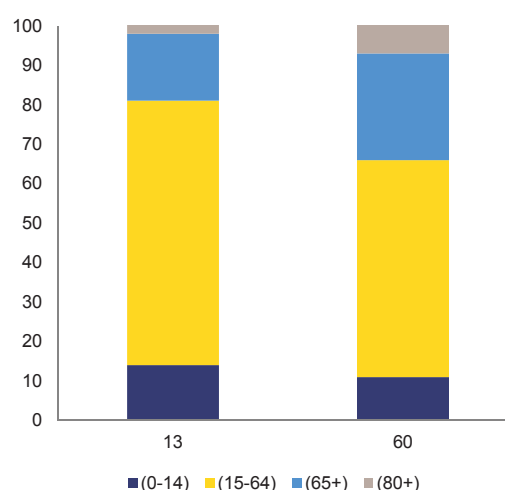
**The intention is for a new fiscal framework to be in place for the 2016 budgetary process.** The draft Fiscal Rules Act passed first reading in the Parliament and is expected to be enacted in March 2015. The draft Act indicates the minimum value of the medium-term fiscal objective as determined by the Treaty and sets out the correction mechanism, which will be triggered in the event of significant observed deviations from the medium-term objective or the adjustment path towards it. The legislation will be complemented by revisions to the Public Finance Act, which will include detailed provisions defining the drafting, implementation and monitoring of the budget of all general government institutional units. The Fiscal Council, as envisaged in the draft Fiscal Rules Act, will be an independent body charged with monitoring fiscal policy and budgetary execution and assessing compliance with the fiscal rules. The act provides that the appointment of the Fiscal Council members will commence within fifteen days of the act coming into force and the Council will establish its rules of procedure within 3 months after its members are appointed. The focus is now on having the rules and the Fiscal Council fully operational in time for the 2016 budgetary process.

#### Pension, health and long-term care system

**Risks to the sustainability of the pension system, adequacy of pensions and the sustainability of the long-term care systems persist** in light of an ageing population and increased demand for health and long-term care services. The share of the population aged over 65 years has increased steadily and currently stands at 17.1%. Projections for 2060 indicate a

considerable increase to 31.6% (Graph 3.1.3).<sup>(64)</sup> The demographic old age dependency ratio is projected to increase from 25.4% in 2013 to 52.5% by 2060.<sup>(65)</sup>

Graph 3.1.3: **Decomposition of the population by age groups in Slovenia**



Source: Ageing report 2015 for Slovenia.

#### Pensions

**Measures to underpin the sustainability and the adequacy of the pension system in the long-term are still pending.** The 2012 reform has enhanced the mid-term sustainability of pensions by increasing and equalising the statutory retirement age for both men and women, reducing the complexity of the system and eliminating some anomalies, without automatically linking the statutory retirement age to life expectancy. Initial results appear encouraging. The inflow of new pensioners has almost halted and 80% of retired people have reached full statutory retirement age.<sup>(66)</sup> Nevertheless, a slight increase of old-age pension costs coupled with a simultaneous fall in revenues resulted in a significant increase in the amount of budget transfers to the pension fund (from 29.2% of total pension pursue revenue in 2012 to 32.0% in 2013). The pension system in

<sup>(64)</sup> Peer Review in Slovenia, November 2014: Long-term care – the problem of sustainable financing – Host Country Paper.

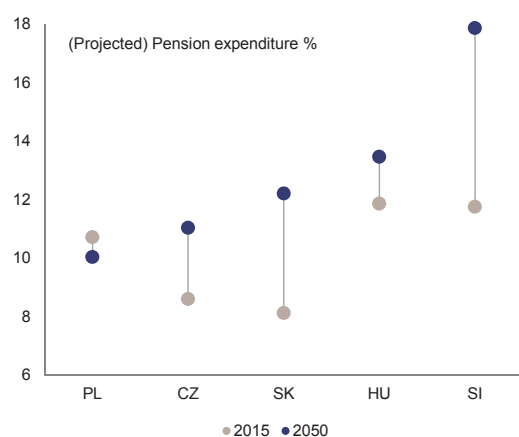
<sup>(65)</sup> The EU Ageing report 2015 for Slovenia

<sup>(66)</sup> Ministry of Labour, Family, Social Affairs and Equal Opportunities: *Monitoring of the Pension Reform*, Spring 2014.



Slovenia is facing long-term sustainability risks given the steep increase in projected pension expenditure. In 2014, the OECD estimated that expenditures will increase from the current level of 11.8% of GDP to 18% of GDP in 2050 (Graph 3.1.4). Preliminary projections for the forthcoming 2015 Ageing Report suggest lower spending needs for pensions in the long-term, but expenditure pressures in Slovenia are still higher than the EU average.

Graph 3.1.4: **Sustainability of the pension system in Slovenia**



Source: OECD 2014: Pensions outlook.

#### The 2012 reform's overall impact on pension adequacy remains contingent on labour market developments and warrants close monitoring.

The aggregate replacement ratio deteriorated by 1 pp. in 2013 to 46%. The average net pension dropped slightly in 2013 both in nominal terms and relative to the average net wage.<sup>(67)</sup> The pension benefit ratio is projected to fall further until 2020 (from 33.8% in 2013 to 28.9% in 2020) before stabilising in the long run. Longer contribution periods and stabilised entry pension levels could positively affect the adequacy of pensions, if men and women are able to remain longer in the labour market. The new indexation formula, longer reference periods for calculating the pension base and the prolonged pensions freeze might have a negative effect. Despite the modified calculation of the pension assessment base introduced by the reform to prevent a further decrease in pensions,

<sup>(67)</sup> Pension and Disability Insurance Institute: pension-to-wage ratio 56.6% for the average pension and 61.7% for the average old-age pension, both -0.3pp compared to 2012.

the adequacy of pensions is still deteriorating. Coupled with the 2012 social reform, this has significant implications on the risk of poverty in old-age, in particular for women<sup>(68)</sup> and people with disabilities (Section 4.2).

#### A White Paper on the long-term sustainability of pensions is due to be published in mid-2015.

A new comprehensive reform is envisaged for 2016-17 and will propose the reform of the first and second pillars with the objective of addressing the sustainability of the pension system in the long term (post 2030) and adequacy of pensions. A working group has been established to prepare several proposals for a pension reform (including notional defined contributions and a points system, that is, the current system with adapted parameters). The existing micro-simulation model will be upgraded in order to test various proposals. The 2012 reform envisaged the establishment of a Demographic Fund. The legal act establishing this Fund is expected to be adopted by June 2015.

#### Healthcare system

##### The ageing of the Slovene population also poses challenges to the sustainability of public spending on health care.

According to preliminary projections in the Ageing Working Group in 2015, public health expenditure (measured as a share of GDP) is projected to increase significantly in the next decade. At 7% of GDP in 2012, the rate of public spending on healthcare is close to the average of the EU (7.3%) and has remained stable since 2009.<sup>(69)</sup>

##### Health indicators for Slovenia show a mixed picture.

On the one hand, infant mortality is the lowest in the EU; on the other hand, the gap between life expectancy and healthy life expectancy is one of the largest in the EU for both men and women. While only a relatively small proportion of the population report unmet health needs, the number of patients on waiting lists increased substantially in 2014 and indicates deterioration in accessibility to medical services. According to the data on 47 selected services, in October 2014 there were more than 77 000 patients waiting, of whom almost 15 000 exceeded the

<sup>(68)</sup> 25.5% compared to 15.6% for EU 28 peers and 14.5% SI population average EU-SILC 2013.

<sup>(69)</sup> Based on Eurostat COFOG data.

maximum waiting time as established by the authorities.

**Slovenia is committed to achieving cost savings in the health care sector through rationalisation of expenditures.** The recently introduced therapeutic groups for drugs <sup>(70)</sup> and the pilot project of common public procurement are showing positive results. The pilot project of common public procurement in the health care sector shows that substantial savings can be realised if tenders are handled centrally. <sup>(71)</sup> From 2015, centralised public procurement will be obligatory for all 28 hospitals. Measures to address the challenges of suboptimal provision of health services, redefining the rights arising from compulsory health insurance, and upgrading the payment models with respect to health care providers remain outstanding. Further efficiencies could be gained through the introduction of interoperable e-health solutions.

**The comprehensive review of healthcare expenditure provides an opportunity to reallocate resources towards priorities and generate efficiency savings.** The review will be undertaken in cooperation with the World Health Organisation and the European Observatory on Health Systems and Policies. A draft scope for the review has been prepared and a workshop was held with the relevant stakeholders in January 2015 to finalise the proposal. The project will be wider than just expenditure and will include; (i) an analysis of the financing of the health system, (ii) an expenditure review (iii) a review of benefit basket and (iv) an assessment of health technology. The review will be a two prong approach – identify measures for 2016 (i.e. "quick wins") and also long term measures that will require more time to implement.

**The pending expenditure review and the National Healthcare Resolution will serve as a basis for a comprehensive healthcare reform, which is expected to enter into force in January 2016.** The National Healthcare Resolution Plan, expected to be adopted in mid-2015 will include

measures to improve access to health services, as well as measures to promote efficiency in the health sector by introducing models for provision of services and infrastructure and the monitoring and revision system.

**A reform of health care is under discussion.** The use of existing public resources could be improved by strengthening primary care, rationalising inpatient care and reforming the financing of the system. The authorities are planning to adopt the reform of the health insurance schemes by the end of 2015, in order to take effect from January 2016.

### Long-term care

**Public expenditure on long-term care is projected to more than double by 2060 due to population ageing alone.** <sup>(72)</sup> The consequences of the economic crisis are visible in the decreasing scope of formal long-term care, both institutional and community-based care (e.g. formal home help). Slovenia is characterised by prevailing institutional forms of long-term care in the public sector. The Association of Social Institutions of Slovenia estimated that in the first 10 months of 2013, approximately 3% of institutional care users left care and either returned home or were taken into the care by their relatives. The average pension is not sufficient to cover the costs of institutional long-term care.

**At the end of 2013, the government adopted a blueprint for long-term care** but the adoption of the legislation underpinning the reform has been postponed until the end of 2015. The strategy is to address long-term care in the framework of wider discussions on the sustainability of the healthcare sector, including the reform of the health care insurance schemes in order to ensure appropriate funding. The main objective of the reform is to regulate and establish sustainable funding of social and health services <sup>(73)</sup> by introducing compulsory public insurance, creating a single entry point and enabling users to choose the type of service (in-home or institutional) and the service provider. Its fiscal impact still needs to be quantified.

<sup>(70)</sup> In November 2014 additional five therapeutic groups were introduced, estimated annual savings of EUR 24.6 million.

<sup>(71)</sup> Progress on policy measures relevant for the correction of macroeconomic imbalances - Slovenia, October 2014

[http://ec.europa.eu/economy\\_finance/economic\\_governance/documents/20141224\\_si\\_imbalances\\_epc\\_report\\_en.pdf](http://ec.europa.eu/economy_finance/economic_governance/documents/20141224_si_imbalances_epc_report_en.pdf)

<sup>(72)</sup> Public expenditure on long-term care is projected increase from 1.35% of GDP in 2012 to 3.0% of GDP in 2060.

<sup>(73)</sup> Such reform will need to take in to account Member States' obligations under Directive 2011/24/EU

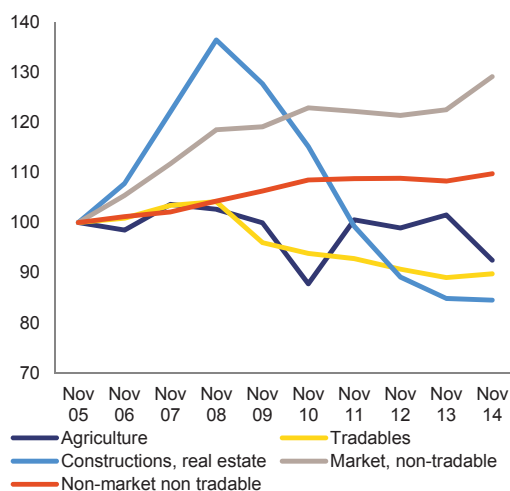


## 3.2. LABOUR MARKET, EDUCATION AND SOCIAL POLICIES

**The labour market is showing signs of improvement but structural challenges persist concerning long-term unemployment, and the employment of low- skilled and older workers.**

Unemployment rate decreased from 10.1% in 2013 to an estimated 9.8% in 2014. Job creation has been strong in the non-tradable service sectors, particularly in administrative and support services such as employment agencies. At the same time, job losses in the construction sector have slowed. Employment gains in the tradable sectors were modest (Graph 3.2.1).

Graph 3.2.1: **Employment in tradable and non-tradable sector**



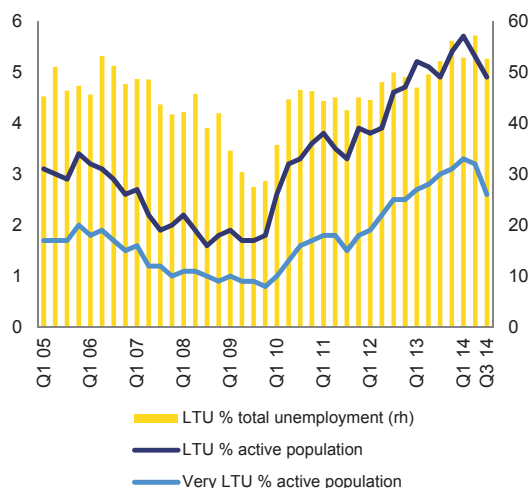
Index 11/2005 = 100

Source: SORS, European Commission calculations.

**The overall unemployment rate decreased but long-term unemployment remains high, with consequences on poverty.** The long-term unemployment rate peaked at 5.7% of active population in the first quarter of 2014 (Graph 3.2.2) but decreased thereafter. In the third quarter of 2014, it stood at 4.9% and represented half of the total unemployed. The number of very-long-term unemployed more than doubled in the period 2008–2013 but recently decreased to 2.6% (Q3-2014). The low outflow rate from long-term unemployment denotes the structural nature of certain segments of unemployment<sup>(74)</sup>. Although staying below the EU average, poverty and social exclusion continued to increase in 2013, moving Slovenia further away from the EU2020 targets.

<sup>(74)</sup> IMAD, Economic mirror, November 2014, pages 32-33.

Graph 3.2.2: **Long term unemployment as % of active population**



Source: Eurostat.

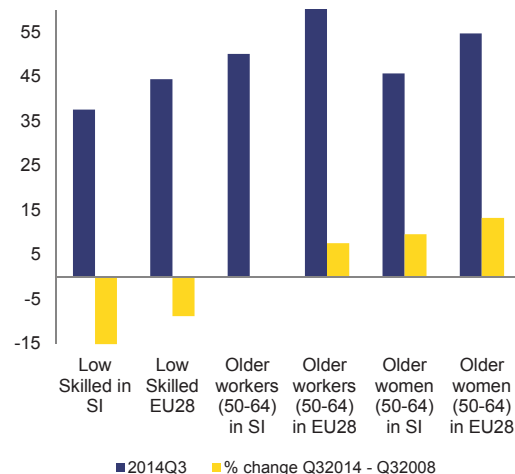
### Labour market participation

**Labour market participation of older and low-skilled workers remains a challenge.** The employment rate of vulnerable groups (such as older and low skilled workers) is persistently lower than the EU average. Moreover, the employment rate in these groups reduced substantially since 2008 due to a sharp decline in the economic activity. The sectors that predominantly employ less skilled workers (e.g. construction and manufacturing) were worst affected by the economic crisis. Consequently, the employment rate of the low skilled workers fell the sharpest (from 52% in 2008 to 37% in 2014). The employment rate of older people is the lowest in the EU (50% in 2014) and it stagnated between 2008 and 2014. The employment of older women has picked up and increased by almost 10 pps. between 2008 and Q3 of 2014 (Graph 3.2.3).

**Slovenia has made limited progress in developing an efficient and adequately funded system of active labour market policies to address these challenges.** Slovenia reduced the allocated budget for the implementation of the active labour market policy programmes in 2015, although the budget is expected to increase after the adoption of the supplementary government budget in February 2015 and the receipt of funds from the ESF. In addition, in the period 2014-2020, EUR 200 million will be earmarked for

lifelong learning measures specifically targeting older and low-skilled workers. It is important to adequately support the vulnerable groups in order to address persistent structural imbalances on the labour market as the current pattern of active labour market policy resources risks underinvestment in the skills of the disadvantaged. <sup>(75)</sup> The evaluation of the active labour market policy is foreseen in the context of the implementation of the European Social Fund, which is the main source of funding for these measures.

Graph 3.2.3: **Employment rate of vulnerable segments in Slovenia and the EU28**



Source: Eurostat.

### Labour market segmentation and youth unemployment

**High segmentation is affecting particularly the labour market entry of young people.** Youth unemployment in the age group of 15-24 peaked in 2012 and has since moderated to below the EU average. However, unemployment in the age group 25-29, has risen above the EU average and peaked at 14.6% in 2013. High unemployment in this group could be partially explained by lower employability of students who concluded their studies with delays and higher reliance on occasional student work, accounting for almost 80% of the temporary jobs occupied by young

people. Slovenia registers the highest share of young people (15-24 years) in temporary employment in the EU (73.2% in 2013).

### Labour market participation of young people has been reinforced by Youth Guarantees.

Slovenia increased the cut-off age of qualifying for the Youth Guarantee measures from 25 to 29 years and will invest EUR 157 million (mostly coming from the ESF) in the period 2014-15. The first results of the national analysis presented in Q2-2014 show that people enrolled in Youth Guarantee Schemes received 70% more trainings, 40% more job offers and ten times more job interviews with employers. The outreach to non-registered youth has improved due to the cooperation with school counsellors, who were referring drop-outs directly to the public employment services. The public employment service has adapted its online tools to extend its outreach.

### Concrete steps were taken to address the labour market segmentation for young people.

The Act on Occasional Student Work will increase social security for students, while preserving the flexibility. <sup>(76)</sup> The act introduces minimum hourly wage and social security contributions on student work. The non-wage costs for student work, which now include social contributions from employers and students, will increase substantially, however the student work will still remain one of the cheapest forms of work. These measures will yield an additional EUR 15 million, which will be partially used to finance scholarships. The evaluation of the reform is due in September 2015 and additional measures will be considered only thereafter. The outstanding measures (e.g. the official recognition of the work experience) will also be addressed.

### The 2013 labour market reform improved labour market segmentation and flexibility.

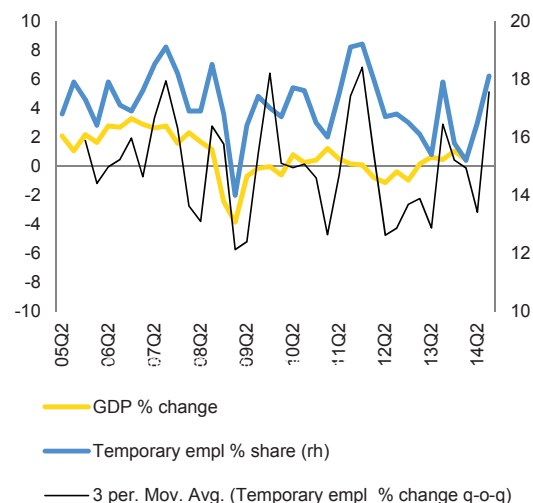
The reform simplified dismissal procedures and reduced dismissal costs, but tightened the regulation of fixed-term contracts and restricted the use of temporary agency work. The initial analysis of the impact of the reform shows positive results. The use of open-ended work contracts increased and use of fixed-term contracts fell.

<sup>(75)</sup> In 2014, only 12% of active labour market policy resources were used for education and training measures while 40% was earmarked for public works, 22% for self-employment and 16% for subsidised employment.

<sup>(76)</sup> The Act on Occasional Student work was incorporated into the Public Finance Balance Act in December 2014.

However, more recent quarterly data do not conclusively prove the decrease of temporary contracts, as their use seems to be closely dependant on the economic cycle (Graph 3.2.4). The measures promoting the use of permanent contracts for hiring young people (in the framework of Youth Guarantees) have also contributed to this result. The next full report on the effects of the reform is to be prepared in March 2015. Particular focus will be on the employment trends of self-employed, economically dependent persons and in particular, to the possible abuse of these contracts that are attractive because of low social contributions. The labour inspectorate has stepped up the investigation of contractual arrangements.

Graph 3.2.4: **Cyclicality of temporary employment**



Source: EUROSTAT.

Slovenia has also addressed segmentation through the equalisation of the non-wage costs of some forms of work contracts (other than student work) while keeping their flexibility. Since the beginning of 2014 full social contributions (15.5% to be paid by employees and 8.85% by employers) have to be paid on two other most used types of civil contracts. On the basis of an analysis of costs of various forms of work contracts, the government will propose measures for the equalisation of non-wage costs in mid-2015. While this may have a positive impact on segmentation, the impact on employment promotion may be limited as the tax wedge for employment contracts at all level of wages and

types of families in Slovenia is close to or lower than the EU average.

### Education

**Slovenia has reached the education targets of the Europe 2020 strategy.** Early school leaving is the lowest in the EU (3.9% in 2013) and 40.1% of the population aged 30-34 has attained a tertiary qualification. The focus now needs to shift to the quality in education. As measured by the Programme for International Student Assessment (PISA)<sup>(77)</sup>, the performance of 15-year olds in literacy, mathematics and science remained unchanged between 2009 and 2012 (Graph 3.2.5). While Slovene teenagers perform worse than the EU average in reading, they perform better in mathematics and science.

**The higher education system presents several inefficiencies related to the high rate of dropout and fictitious enrolment.** The dropout rate from university is estimated at 35%. Fictitious enrolment to post-secondary vocational education is estimated to account for more than half of first-year students. This is mostly due to the incentives and social benefits linked to the student status and weak administration controls.<sup>(78)</sup> Half of all students hold a job during their study years at the expense of performance and prolonged duration of study. In parallel, the quality of implementation of tertiary programmes risks being affected by the decrease in total expenditure on education. Spending of tertiary education was reduced by 13% between 2011 and 2012 or 5% between 2008 and 2012 (Graph 3.2.6).

**The amendments to the Higher Education Act are expected to address the issue of fictitious enrolments.** While the draft was prepared in October 2013, the change in government delayed its adoption. The government plans to adopt the law in 2015 in order to enter into force in academic year 2017-18. The principal objective of the act is to decouple student status from student benefits in order to remove the incentives of fictitious enrolment. An important step in this direction has been the introduction of a new electronic information system has become an official source

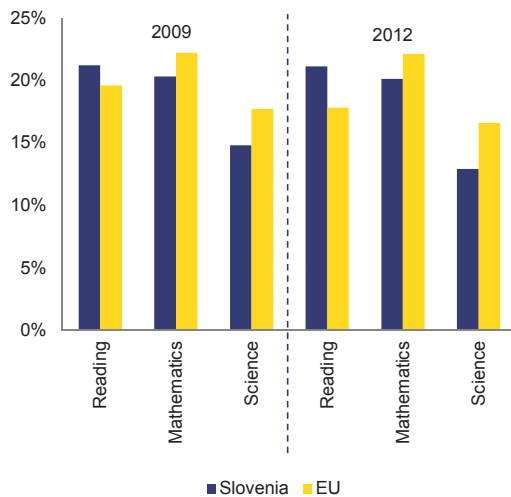
<sup>(77)</sup> <http://www.oecd.org/pisa/>

<sup>(78)</sup> Eurydice (2014) Modernisation of Higher Education in Europe: Access, Retention and Employability.



of information on student status and is used by public institutions to grant scholarships, transport and food subsidies, dormitories, health insurance and student work. In 2014/2015 it was also used for electronic enrolment into higher education. The in-built controls have already been successful at preventing some fictitious enrolment into higher vocational education and training. By the end of 2015, the system aims to become an analytical tool for evidence-based policy making.

Graph 3.2.5: % of low achievers on PISA tests in 2009 and 2012 in Slovenia

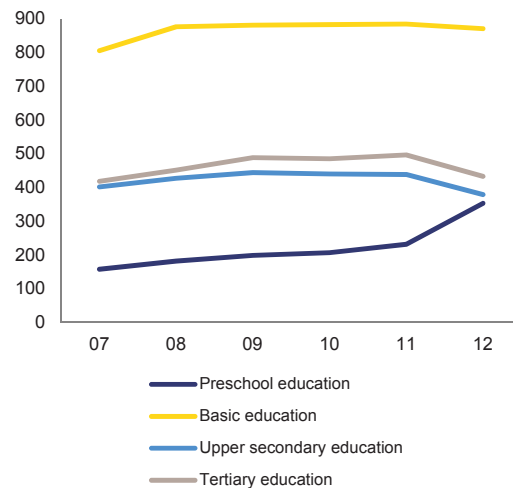


Source: OECD; Programme for international student assessment.

### Skills mismatch

**Skills mismatches have become less evident.** Slovenia displays one of the lowest shares of young people with tertiary education in jobs requiring low qualification (vertical mismatch). At 66.2%, the proportion of upper secondary students following vocational education and training remains above the EU average (50.4% in 2012). However, skills shortage in the long run could mostly affect high-skilled occupations. Demand for high skilled workers is projected to increase substantially by CEDEFOP (by 13% over the 2010-2020 period).

Graph 3.2.6: Public expenditure for formal education (in million EUR)



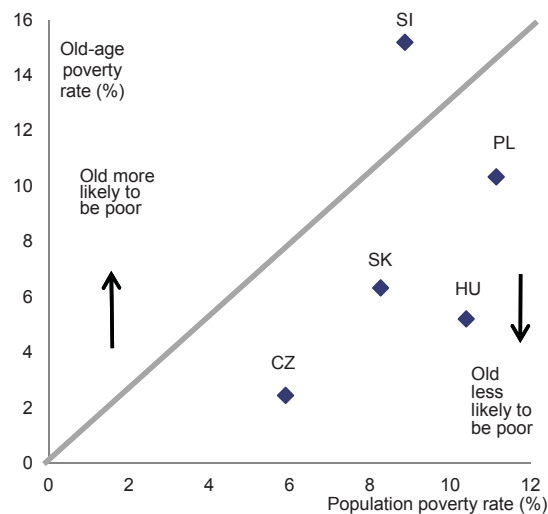
Source: SORS.

**Slovenia has undertaken several actions to address the risk of skills mismatch and numerous measures are planned until 2020.** The public employment services are currently working on a bi-annual forecast of deficit occupations in parallel to the establishment of the National Career Point, which aims to develop the methodology for better career orientation. Skills mismatch is planned to be further addressed by introducing scholarships for deficit professions, improving the link between education and the local economy. The government intends to close the gap in skills mismatch by linking study specialisations to the priority areas of the Smart Specialisation Strategy. In the field of vocational education, the government plans to introduce apprenticeships via a new law, which will primarily redefine the role of the apprentice as an employee and clarify the role of the social partners. A coordinating body for vocational education has been set up. Its role is to develop new projects and to establish the strategic direction for vocational education with stakeholders. Subsidies for apprenticeships and coordination between different ministries will play an important role in setting up the system. Finally, transparency of qualifications on the labour market will be enhanced with the new Act on the Slovenian Qualifications Framework expected to be adopted in 2015.

### Social issues

**Poverty and social exclusion continued to increase in 2013.** This development moved Slovenia further away from the poverty and social exclusion target. The number of people at-risk-of-poverty or social exclusion increased and reached 410,000 in 2013, considerably above the target of 320,000. While the poverty rate remains below the EU average, it has consistently deteriorated since 2009. The main reasons for the continuous deterioration in material welfare are a decline in employment and the rise in unemployment to the 1990s levels. Furthermore, wages, pensions and social transfers declined in real terms, and the revised regulation of social benefits implemented in January 2012 lessened somewhat the role of social transfers in alleviating poverty for certain groups.

Graph 3.2.7: The likelihood of the old-age poverty rate



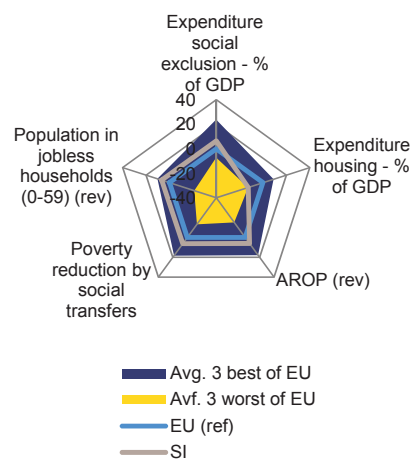
Source: OECD Pensions Outlook 2014.

**Although the social protection system is performing its function, there has been an increase in at-risk-of-poverty rates.** In 2013, total household disposable income fell by 3.3%, less sharply than the year before (5.2% in 2012). In real terms, it is now more than 9% lower than in 2008. The substantial decrease of total household disposable income in 2013 had particular repercussions for the at-risk-of-poverty rate for children (17.5% in 2013) and doubled the at-risk-of-poverty rate for young people. While income inequality remains among the lowest in the EU, it has worsened given the unequal decline in incomes

across all brackets. The persistent low income inequality can be attributed to a compressed wage structure and a well-targeted allocation of social transfers, which decreases the risk of poverty by 27.8 pps. (EU average 27.6 pps.). Access to public services has stagnated since 2012.

**Corrective measures were introduced in the 2012 social reform to improve access to social transfers.** The Act Amending the Social Assistance Benefits Act and the Act Amending the Exercise of Rights to Public Funds Act, in force since September 2014, have eased entitlement conditions for social benefits. The amendments are aimed at single-parent families, families with school-age children and large families, older recipients of social transfers and other vulnerable population categories. Restrictions in the entitlement conditions for social assistance benefits introduced in 2012 resulted in a significant decrease in take-up by older beneficiaries. In the midterm, the government plans to introduce a comprehensive social activation system, which will link rehabilitation programmes to the ALMP. By developing comprehensive services for the excluded from the labour market, the government expects to improve the social inclusion and their employability.

Graph 3.2.8: Social exclusion indicators



% of GDP  
Source: Eurostat.





### 3.3. BUSINESS ENVIRONMENT AND RESEARCH & DEVELOPMENT

#### Administrative burden and limited access to finance hinders doing business in Slovenia.

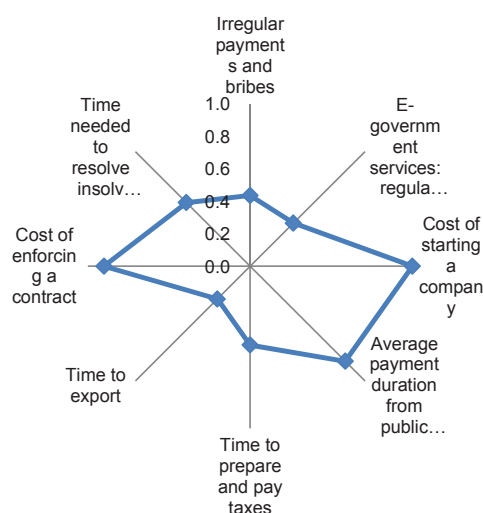
Suboptimal corporate governance, high tax wedge on skilled work force, significant involvement of the government in the economy and vested interests have negative repercussions on doing business in Slovenia. Productivity remains low in a number of industrial sectors with a high concentration of public ownership (Section 3.2) and the inflow of foreign direct investment is limited compared to the EU average (Section 3.3). Frequent changes of the governments have contributed to uncertainty and the postponement of investment decision. Nevertheless, Slovenia has developed a flourishing start-up community and numerous exporters drive the growth of the economy. In search of alternative ways of funding, several young entrepreneurs have successfully sought financing for innovative products through crowd-funding portals abroad.

#### Reduction of administrative burden

**The high number of laws and numerous changes in the legislation make it difficult to run a business and comply with local regulation.** In the recent years, Slovenia took several measures to fight red tape. The so-called one stop shop <sup>(79)</sup> has been supporting entrepreneurs in setting up their business and the use of e-government services has increased (Section 4.5). However, numerous changes in legalisation have contributed to a significant increase in the number of laws and bylaws. <sup>(80)</sup> The reduction of administrative burden is one of the key issues for many stakeholders, including investors, who point to frequent changes of regulations as a negative feature of doing business in Slovenia. Insufficient administrative capacity increases waiting times and discourages potential investors (Section 4.5). This concerns in particular the areas of spatial planning, construction permits and tax compliance. <sup>(81)</sup> Spatial planning

regulation is decentralised and complex. It falls under the remit of several government bodies, creating high entrance barriers and uncertainties for investors, both domestic and foreign. This overregulation also generates compliance issues. For instance, Slovenian retailers find it costly and difficult to comply with consumer legislation. In addition, both retailers and consumers are critical of public authorities' role in ensuring compliance with consumer legislation. <sup>(82)</sup>

Graph 3.3.1: **Components of administrative burden in Slovenia**



0 = weakest performer country, 1 = best performer country

Source: World Bank, DG CNECT, World Economic Forum, DG ENTR, Intrum Justitia, OECD.

**The government has identified several measures to cut red tape by 25%, but prioritisation and implementation is due.** The key tool in order to manage the high regulatory stock is the Single document for better regulation and business environment and increased competitiveness. <sup>(83)</sup> While the document maps the lengthy processes of licencing and authorisation, it is not contributing to shortening of the waiting times. Despite the fact

<sup>(79)</sup> A fully operational one stop shop (e-VEM) to start up a company is in place and has been very efficient: time required to start up a company is below the EU average at no cost (World Bank Doing Business report 2015).

<sup>(80)</sup> During the period January 1991 - January 2015, the number of bylaws increased from 1 006 to 18 332 and the number of laws from 356 to 799. <http://www.tax-fin-lex.si/VeljavnaZakonodajaRS.aspx>

<sup>(81)</sup> The World Bank Doing Business 2015 estimates that 212.5 days are needed in Slovenia in order to deal with construction permits – 63 days more than the OECD

average. There has not been any improvement relative to the previous year.

<sup>(82)</sup> Flash Eurobarometer 396, “Retailers’ attitudes towards cross-border trade and consumer protection”, 2014 and Flash Eurobarometer 397, “Consumer attitudes towards cross-border trade and consumer protection”, 2014.

<sup>(83)</sup> 256 measures are listed in the document, 64 have been implemented (25%), 104 are being implemented (41%) and 86 are pending for implementation (34%). <http://www.stopbirokraciji.si/en/smart-regulation/concrete-realised-measures/>

that several measures have been implemented, the Single document lacks necessary prioritisation, implementation plans and clear monitoring schemes. Coordination among several ministries and governmental bodies is equally important for successfully reducing regulatory cost. In order to make future laws and regulations more business-friendly, Slovenia plans to introduce "competitiveness proofing" and the "SME Test" (the latter has been in pilot phase for several years). However, introduction of these tools for "better regulation" has been further postponed to 2016.

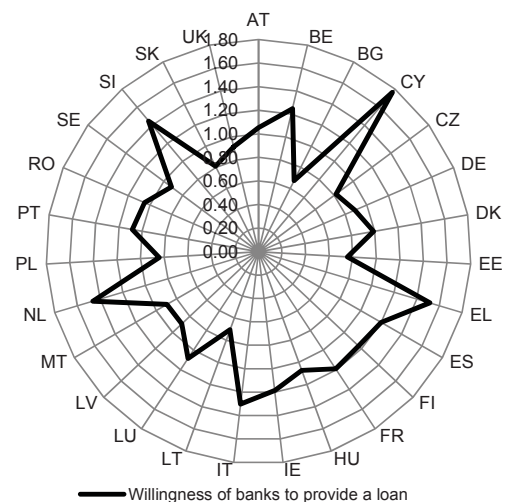
### Access to finance

**Bank lending activity continues to decline, mainly affecting SMEs.** The recent banking sector recapitalisation is expected to show full results only in 2016. Restrained bank lending and high interest rates are weighing on the financing capacity of SMEs (Section 3.1). While the share of rejected loan applications has decreased over the past six years, the share of SMEs reporting a deterioration in the willingness of banks to provide loans has increased substantially and is one of the highest in the EU (Graph 3.3.2).

**Tailor-made financial instruments for SMEs exist and scope for further upgrading exists.** While the Slovenian development bank SID Banka has had two direct credit lines for SMEs since mid-2013, only a limited number of SMEs have used them. They have drawn only a fraction of the available funds (approximately one fifth of the EUR 500 million), partly due to the stringent application conditions. The Slovenian Enterprise Fund has been more efficient in providing funding to innovative SMEs. The Slovenian Enterprise Fund also plans to introduce new debt and equity instruments, which will focus on start-ups and fast-growing micro enterprises. In addition, the government is looking into the possibility of establishing cross-border venture capital together with Austrian and Italian partners. Finally, the "twin projects" (combining seed financing and mentoring), recently introduced by the Slovenian Enterprise Fund is a positive initiative according to stakeholders that can help viable SMEs to increase their knowledge about available instrument and make them more investment-ready. However, as bank lending continues to deteriorate for SMEs, there is a need to build on these new instruments,

focusing on alternative financing mechanisms and attracting more private funding to leverage public investment.

Graph 3.3.2: **Willingness of banks to provide the loans in the last six months**



Willingness of banks to provide a loan has improved (0), remained unchanged (1), deteriorated (2).

Source: SAFE survey.

### Provision of services and regulated professions

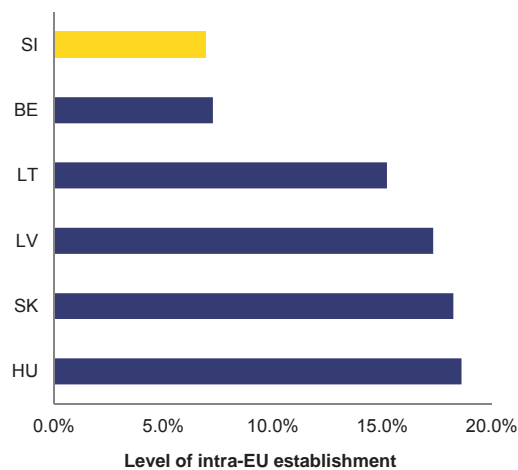
**The Slovenian services sector is marked by a low level of cross-border investments.** The level of intra-EU establishment<sup>(84)</sup> is significantly lower in Slovenia than in other EU Member States (Graph 3.3.3). Slovenia suffers from a low inflow of foreign direct investment (Section 3.3) and it is below the EU average in terms of the establishment of foreign firms in the country. This could be partly explained by the complex regulation of professions and concessions.

**A lack of modernisation of the system of concessions and regulated professions hampers competition in the Slovenian service sector.** Regulated professions and concessions limit the number of service providers and choice for consumers through quantitative and territorial restrictions and tariff setting. The OECD estimates that the environment for provision of services in Slovenia does not lead to an effective competition and presents elevated entry barriers for businesses

<sup>(84)</sup> The share of value added in the business services sector that is generated by enterprises coming from another EU Member State.

and individuals.<sup>(85)</sup> Deregulation of professions has been slowly progressing despite some delays. After deregulating the crafts and cultural sectors, the government is reviewing existing laws to ease access to regulated professions in the retail sector. Slovenia is taking part in the mutual evaluation of regulated professions at EU level. In this context, it will be assessed whether the restrictions are proportionate and justified by the general interest. Although the government undertook a review of some of the concessions, no reforms have been proposed.

Graph 3.3.3: Level of intra-EU establishment



Source: EUROSTAT

### Entrepreneurial activity

**Start-up and early-stage entrepreneurial activity continued to strengthen in 2013-2014.**<sup>(86)</sup> The state of start-up entrepreneurship in Slovenia changed considerably with the onset of the crisis. Start-ups by Slovenian founders have risen over USD 130 million since 2006, half of it in 2014. The start-up sector is growing faster than the economy's average and is creating new jobs with high added value. The Government has been

providing support to this industry.<sup>(87)</sup> In order to foster innovation, job creation and economic growth it would be important to maintain these efforts and to link all actions to the existing innovation policies and strategies.

### R&D and innovation

**The level of R&D investment in Slovenia has increased considerably but the results have lagged.** Increases in R&D investment (Graph 3.3.4) could be attributed to a favourable system of tax incentives and significant co-financing from the Structural Funds (Box 3.3.1).<sup>(88)</sup> However, the low performance regarding research and innovation outputs calls into question the quality of the investments.<sup>(89)</sup> In light of these results and the reliance on the EU funds, the innovation policy will need to be updated in order to remain sustainable in the long term.

**An effective policy response to the R&D challenges is not yet in place.** The 2011 Research and Innovation Strategy has not yet been implemented. This strategy includes important measures to foster knowledge transfer and the commercialisation of research results. The key measure is the introduction of institutional funding linked to an assessment of research performance of universities and public research institutes. Other essential measures include removing obstacles to university spin-outs and to cross-border venture capital. The Research and Innovation Strategy needs to be coordinated with the Smart Specialisation Strategy as well as the forthcoming FDI strategy in order to harness the country's potential for smart growth and the knowledge economy. In particular, implementation

<sup>(85)</sup> Indicators of Product Market Regulation, OECD <http://www.oecd.org/economy/growth/indicatorsofproductmarketregulationhomepage.htm>

<sup>(86)</sup> The rate of total early-stage entrepreneurial activity (TEAindex) grew robustly for the second year running in 2013 and achieved the pre-crisis (2008) peak of 6.5%, an increase of 1.1 percentage points over the year before. Source Global Entrepreneurship Monitor.

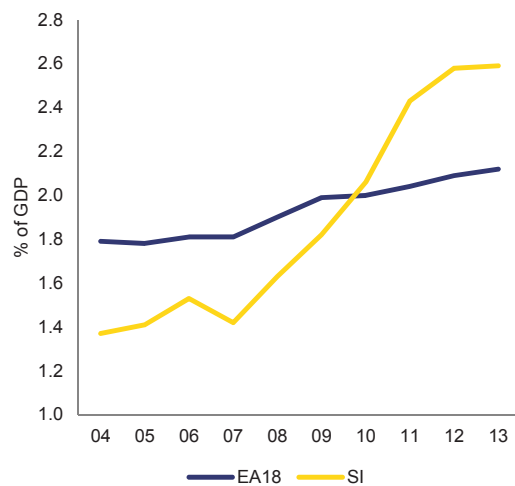
<sup>(87)</sup> Start up Manifesto, June 2014; Some insights into entrepreneurship and start-ups in Slovenia, Austria and Italy, and Prof. Prof. dr. Miroslav Rebernik Mag. Matej Rus, Dec 2014.

<sup>(88)</sup> For investments into R&D the government offers a 100% reduction rate, depreciation allowance, reduced taxable base for royalties. They also offer a 40% tax relief for investment in tangible assets. See the study on R&D Tax incentives: Final Report", written by CPB in consortium with: CAPP, CASE, CEPIL, ETLA, IFO, IFS, HIS, Taxation paper No 52, 2014.

<sup>(89)</sup> Slovenia has 3.1 PTC patents per billion GDP compare to the 3.9 at EU level (2010) and 6.9 % of high cited scientific publications compare to the 11% at EU level (2009). It also ranks below the EU average on the Innovation Output indicator (Slovenia ranks 14th showing a medium level performance) and just below the EU average on the Innovation Union Scoreboard (ranked 12<sup>th</sup>).

mechanisms are needed to direct funding towards priority areas and increase the impact. Boosting the quality of research investments, a stronger and more effective overall governance and a focus on implementation are needed to support the efficient use of resources.

Graph 3.3.4: **R&D investment**



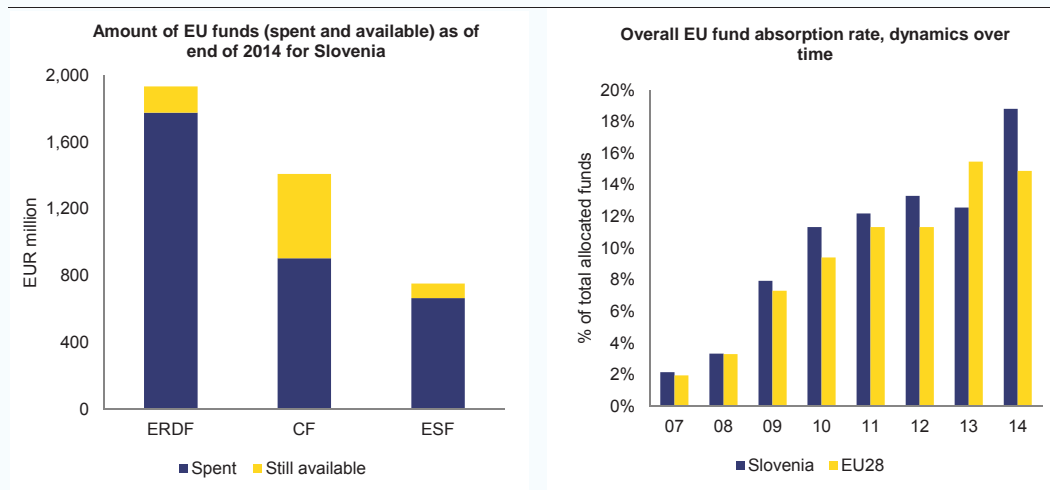
Source: Eurostat

**Finalising the Smart Specialisation Strategy will be an important milestone.** This strategy will be instrumental for investments under the European Investment and Structural Funds in the period 2014-2020. The main pending challenges are a clear prioritisation, consistency with other policies, coordination of stakeholders and an effective implementation.

### Box 3.3.1: Overview and general assessment of absorption capacity for EU funds

The overall implementation of the Slovenian Cohesion policy's operational programmes has been positive, with Cohesion fund lagging slightly behind. By February 2015, Slovenia drew 81.72% of all allocated funds for the programming period 2007-13 under the ERDF, CF and ESF facilities. This is a positive result compared to the EU28 average (76.74%) or the Visegrad Group average (71.21%). Absorption of the funds has increased in 2014, when EUR 701 million has been certified (51% of the total amount for CF certified so far was done in 2014). In comparison with 2013, Slovenia certified EUR 680 million. Given the N+2 rule for Slovenia, a sum of EUR 597 million (EUR 406 million for CF, EUR 136 million for ERDF and EUR 55 million for ESF) still needs to be spent by end-2015. No funds have been lost so far as a result of the N+2 rule and projections show that the risk of losing funds at closure is limited. However, low absorption capacity and delays related to the Cohesion Fund' implementation (mainly rail and waste-water sectors) result from the late start of the implementation, lengthy permitting and public procurement procedures (Section 3.5) as well as the economic crisis.

Graph 1: EU funds absorption and economic governance



ERDF = European Regional Development Fund; ESF = European Social Fund; CF = Cohesion Fund

Source: European Commission.





### 3.4. TRANSPORTATION, ENERGY AND ENVIRONMENT

**The level of energy consumption and CO<sub>2</sub> emissions in Slovenia is considerably higher than the EU average.** Transport is the most energy-intensive sector, with its share in energy consumption increasing since 2005. This can be partially explained by the geographical position of Slovenia and the transit passing through the country. While Slovenia has diversified its sources of energy, it remains highly dependent on its imports. The contribution of energy deficit to the trade balance is almost double the EU average (-5.7% vs. -3.1% of GDP). Slovenia's current primary energy consumption is slightly below the EU 2020.

#### **Smart, sustainable, interconnected transport network**

**A strategy for infrastructure development in Slovenia is in place.** With the adoption of the Operational Programme for the period 2014-2020, an implementation framework is now in place with clear policy priorities, coupled with planning and funding instruments targeting investment in key transport initiatives. The comprehensive transport strategy will be instrumental for investments in transport under the European Investment and Structural Funds in the period 2014-2020, also in light of the expected decrease in national investment spending. It is expected to contribute significantly to the development of the transport infrastructure by developing a mature and feasible project pipeline and thus reducing the bottlenecks especially in the railway sector.

**Development of rail infrastructure and promotion of public transport are the key priorities.** The TEN-T core network projects on the Mediterranean and the Baltic-Adriatic Corridors will be given priority under the Connecting Europe Facility. This includes the new second railway track line Divača-Koper and the upgrading and extension of the port of Koper. The need to modernise the railway infrastructure could go hand-in-hand with the removal of market barriers in the railway sector and better performance of rail services. Urban transport in Slovenia still suffers from an excessive reliance on private cars. Development of public transport in Slovenian cities remains crucial and could be inspired by the positive experiences in some cities, in particular Ljubljana.

#### **Interconnected Energy Networks**

**The Slovenian energy networks face several challenges.** The energy mix in Slovenia is mainly derived from hydrogenation (31%), nuclear power (24%) and fossil fuel.

**The electricity interconnection capacity could be further improved.** The interconnection capacity is currently at 82% of the production capacity in Slovenia, which is higher than the EU Average (at XX% in 2013). Nevertheless, Slovenia has several electricity Projects of Common Interest under the guidelines for trans-European energy infrastructure, including two electricity clusters with a high voltage transmission line between Slovenia, Croatia and Hungary and a high voltage transmission line between Slovenia and Italy.

**Competition in the electricity market has accelerated.** In 20XX, almost 50,000 customers switched their electricity supplier, with no one supplier dominating the market. The entry of a new supplier (GEN-I) in the gas sector also led to lower prices for the first time since 2009. Geoplin remained the company with the largest market share (around 63%) in gas distribution.

**Slovenia has a diversified gas supply but lacks storage facilities and is entirely dependent on imports.** A new North-South gas interconnection to the Hungarian gas transmission network and reinforcement of the interconnection to the Croatian gas transmission network will increase security of supply in Slovenia and the neighbouring countries. Several gas projects of common interest are highly relevant for Slovenia. In particular the LNG terminal in Krk (Croatia) could provide the security of supply to the region.

#### **Environmental compliance and beyond**

**Slovenia is the best performing member state in terms of municipal waste recycling among the countries that have joined the EU since 2004.** Slovenia's recycling rate reached 47% in 2012. The municipal waste generation remained relatively low, at 362 kg per capita in 2012 compared to the EU average of around 490 kg. Landfilling decreased from 58% in 2011 to 51% in 2012 but remains high. Further measures could look at penalising the excessive use of landfills.

**Investing in the water sector in order to comply with EU environmental legislation is a key priority.** In particular, compliance gaps persist as regards Slovenia's Accession Treaty obligations for the wastewater sector. The final deadline for reaching compliance with the Urban Wastewater Treatment Directive is the end of 2015. The last available data for Slovenia shows compliance rates for collection and treatment of 30% in 2009 and 2010.

**Slovenia's diverse and rich natural environment is a key element of its tourism strategy.** Its biodiversity has been well preserved and Slovenia has the biggest share of land area covered by Natura 2000 in the EU (37.85% vs. EU average of 18.4%).<sup>(90)</sup> Well-preserved nature delivers multiple socio-economic benefits. It has been recognised in the Slovenian Tourism Development Strategy for 2012-2016 as a key attraction for tourism.

### Broadband

**Broadband networks are the key infrastructure of the digital economy and society.**<sup>(91)</sup> It has been estimated that a 10 percentage point increase in broadband penetration is associated to an annual growth in per-capita GDP of some 1 to 1.5 percentage points.<sup>(92)</sup> Slovenia has a very low fixed high-speed broadband penetration (ranking 26<sup>th</sup> out of 28 member states). Also mobile broadband take-up remains comparably low. Operators indicated that this is due to lack of market demand. This might also result in comparably high prices (Slovenia ranks 19<sup>th</sup> out of the 28 member states). Slovenia is currently in the process of adopting a Broadband plan.

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<sup>(90)</sup> Natura 2000 Barometer, The Natura 2000 Newsletter, July 2014.

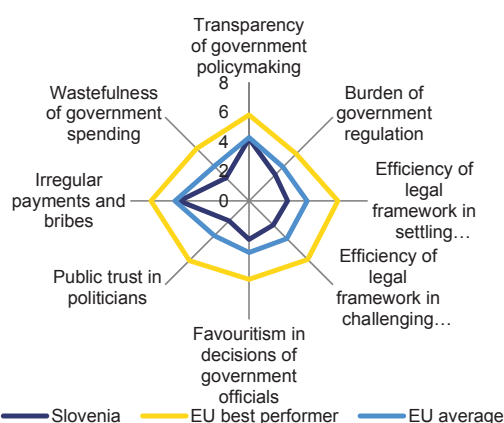
<sup>(91)</sup> As regards the five main drivers of the digital economy, Slovenia ranks 24<sup>th</sup> out of 28 Member States on connectivity, 14<sup>th</sup> on human capital, 16<sup>th</sup> as regards the use of internet services, 20<sup>th</sup> in integration of digital technologies by business, and 22<sup>th</sup> in digital public services.

<sup>(92)</sup> Czernich, N., O. Falck, T. Kretschmer, L. Woessmann (2011) Broadband Infrastructure and economic growth, The Economic Journal, 121 (552), pp. 505-532

### 3.5. PUBLIC ADMINISTRATION AND CIVIL JUSTICE

In Slovenia, the general government effectiveness score and the responsiveness of administration remain below the EU average (Graph 3.5.1).

Graph 3.5.1: **Institutional strengths and weaknesses in Slovenia**



Source: WEF Global Competitiveness report 2014-15.

#### E-government

**Slovenia shows mixed performance in adopting the use of e-government tools.** Slovenia performs rather well in indicators related to starting up a business and the increasing use of e-government. From 2015, business interaction with the authorities will be based exclusively on an e-invoicing system. However, the conversion of state services to electronic systems has not been fully implemented as administrative and business procedures have not been sufficiently computerised, and there is often inadequate connection between front and back-office activities. The transition to e-procurement is expected to take place in the course of 2015. To date, an electronic portal has been launched and e-notifications have been enabled. Other services will be introduced gradually (e-auctions, e-contracts and interoperability with other governmental databases). As the electronic tenders system is not yet operational, Slovenia currently has the lowest share of e-procurement in the EU.<sup>(93)</sup> The Point of Single Contact for services

<sup>(93)</sup> Slovenia has 0.84% share of e-procurement (in total procurement), compared to 13% reached at the EU level.

has yet to be finalised and all procedures have yet to be made available online.

#### Efficiency of Public Administration

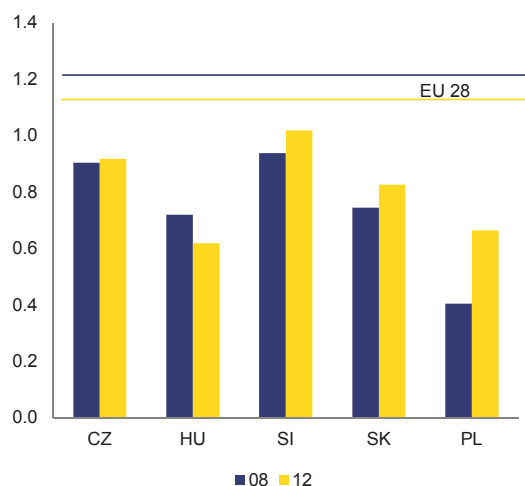
**Government effectiveness in Slovenia is below the EU average.**<sup>(94)</sup> The indicator of government effectiveness improved somewhat in the period 2008-2012 and is the highest in comparison to its regional peers (Graph 3.5.2). However, the governance effectiveness indicator in 2012 was lower than in 1996, the aftermath of the country's independence, when the institutions first had to be established. The effectiveness of public administration in Slovenia was adversely impacted by the lack of strategic planning and budgeting, weak governance and implementation of strategies, as well as insufficient rationalisation of internal functions and structures.<sup>(95)</sup> The deterioration in the perception of the government performance could be linked to the severe economic crisis and the numerous changes of the government in recent years.

**The government strategy for development of public administration 2015 – 2020 will aim at modernizing the public administration and improving its quality.** The strategy is expected to address strategic planning of legal, organisational and procedural aspects, human resource management and the fight against corruption. It is in public consultation and is expected to be adopted by the end of February 2015. The central element of the strategy is to enhance the implementation capacity of Slovenia's public administration. Various strategies already prepared in the field have lacked implementation and enforcement plan.

<sup>(94)</sup> The EU Public administration scoreboard 2013, based on WB Worldwide Governance Indicators 2009-2013

<sup>(95)</sup> OECD Public Governance Review – Slovenia 2012

Graph 3.5.2: Government effectiveness



Source: Public Administration Scoreboard 2014.

**Enhancing the administrative capacity of institutions in order to reap the full benefits from the cohesion remains a challenge.** useful tool to achieve these improvements will be the technical assistance available in the operational programme for the new financial perspective 2015-2020. In the 2007-2013 period it was underused due to a very low allocation. The increase in technical assistance funds will co-finance activities such as staffing, evaluations, communication and trainings. The spatial planning and the issuance of environmental and building permits tend to be time intensive. A national analysis of the organisation of operations of municipalities shows that the lack of staff and financial capabilities, especially of smaller municipalities, is impeding efficient organisation of work.

### Justice Reforms

**The efficiency of the courts further improved in 2014, although at a slower pace.** Positive trends in the rate of resolving civil and commercial cases and the length of proceedings have been maintained and the backlog has been further reduced by 18%. In the area of enforcement, further improvements are expected as a result of recent amendments to enforcement legislation, which improved the enforcement of real estate and the decision-making process. The remit of the Supreme Court's project of updating business processes at courts (including case management

reforms) was expanded to cover enforcement and labour and social courts. Several draft laws were proposed with the aim of providing more transparency and objectivity to the process of appointment of judges, reinforcing the Judicial Council in the area of ethical standards, and improving the procedure for acquiring free legal aid.

**The lengthy proceedings and a high number of unresolved cases remain a challenge.** The reduction in litigious civil and commercial cases can be partly attributed to a 13% decrease in the number of new cases in 2014 (compared to 2013 data), as the number of resolved cases decreased as well by 3%. Similarly, a decrease of more than 60,000 incoming cases partly helped to maintain a positive trend in the area of enforcement. Slovenia had the second highest backlog and the highest number of incoming civil, commercial, administrative and other non-criminal cases per inhabitant in the EU.<sup>(96)</sup> Uneven workload of judges is to be partly addressed through management and court specialisation measures. The Judicial Council aims to improve the quality of the justice system, particularly through improving the appointment process and the training of judges. A large surge in incoming insolvency cases has led to an increase in the pending insolvency cases before the Commercial courts. The increase can be partly attributed to new and amended reorganisation procedures and financial incentives for filing insolvency since 2013. In 2014, Slovenia had the lowest percentage of consumers in the EU who found it easy to resolve disputes with businesses through courts and through out-of-court bodies.<sup>(97)</sup>

### Insolvency legislation

**There has been progress in amending the insolvency framework.** In January 2015, the authorities presented an advanced version of the on-going evaluation exercise of the laws adopted in 2013, which amended and complemented the insolvency law. The authorities have indicated that they do not currently see a need for further amendments to the insolvency framework. The key

<sup>(96)</sup> The forthcoming 2015 EU Justice Scoreboard (March 2015)

<sup>(97)</sup> Flash Eurobarometer 397, "Consumer attitudes towards cross-border trade and consumer protection", 2014.

finding of the evaluation is that the new framework allows more restructuring opportunities to companies in financial difficulties. In addition, the existence of such legal tools has reportedly provided an indirect incentive to the parties to negotiate and reach out-of-court settlements.

### Protection of competition

**The Competition Protection Agency faces hurdles that hamper the effective enforcement of the competition rules.** The budgetary autonomy and the independence of the Competition Protection Agency have been maintained. However, the Agency continues to face challenges that reduce the effectiveness of their enforcement actions. The Competition Protection Agency lacks the power to impose fines on undertakings directly in its administrative decision, having to conduct separate minor offence proceedings. These misdemeanour proceedings involve different standards from the administrative procedure and give rise to legal uncertainty. In practice, the Agency waits until its administrative decision has become final before starting the fines proceedings. Given that the administrative judicial review until recently appeared rather lengthy, the infringement often became time-barred before the Agency was able to impose a fine. The amendments of 2013 regarding the competent court in first instance administrative judicial review of competition cases could lead to shortening the duration of the review process in cases where the first instance judgement is not appealed. Yet the existing framework affects the effective enforcement by the Competition Protection Agency and could lead to limited imposition of fines and under deterrence.

### Credibility of institutions

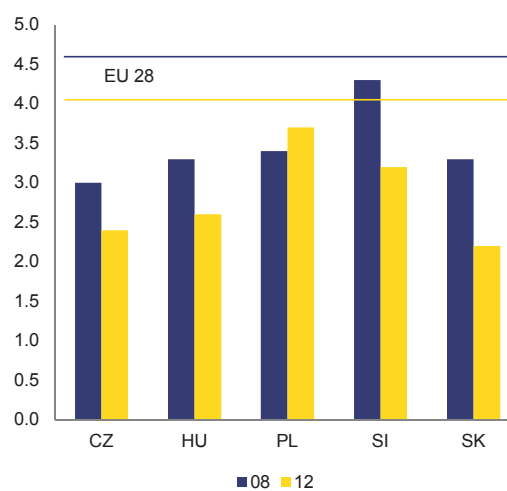
**Credibility of institutions is essential.** Allegations of corruption, political interference and doubts regarding the integrity of high-level officials within the public administration at state and local level and in state-owned companies came to public attention in 2013-2014. The perception regarding the diversion of public funds has worsened substantially in Slovenia and now stands far below the EU28 average (Graph 3.5.3).

**Irregularities in public tender procedures have led to the interruption of payments from the**

**cohesion funds.** While these particular malpractices have been corrected and payments restored the perceptions of widespread systemic corruption remains. In spite of limited progress in achieving transparency, vulnerabilities are broadly noted in the energy, construction, urban planning and healthcare sectors, where anti-corruption safeguards have limited impact.

**A new two-year programme to fight corruption was adopted in January 2015.** The first programme of 15 measures for prevention of corruption, adopted in March 2014, lacked implementation due to the change in government. The government reiterated its commitment to fight corruption. The new programme includes 11 perennial measures targeted at restoring the quality and credibility of public administration in Slovenia, including the public procurement and the ethic codex for politicians and government officials. Another major element in the fight against corruption is to enhance the credibility of the Commission for Prevention of Corruption.

Graph 3.5.3: Diversion of public funds



Source: Public Administration Scoreboard 2014.



## ANNEX A

### Overview Table

Commitments	Summary assessment <sup>(98)</sup>
<b>2014 Country-specific recommendations (CSRs)</b>	
<p><b>CSR 1:</b> Reinforce the budgetary strategy with sufficiently specified structural measures for the year 2014 and beyond, to ensure correction of the excessive deficit in a sustainable manner by 2015 through the achievement of the structural adjustment effort specified in the Council recommendation under the Excessive Deficit Procedure. A durable correction of the fiscal imbalances requires a credible implementation of ambitious structural reforms to increase the adjustment capacity and boost growth and employment. After the correction of the excessive deficit, pursue a structural adjustment of at least 0,5 % of GDP each year, and more in good economic conditions or to ensure that the debt rule is met in order to put the high general government debt ratio on a sustained downward path. To improve the credibility of fiscal policy, complete the adoption of a general government budget balance/surplus rule in structural terms, make the medium-term budgetary framework binding, encompassing and transparent, and establish the necessary legal basis for a functioning fiscal council defining its remit within the budgetary process and introducing clear procedural arrangements for monitoring budgetary outcomes as soon as possible. Launch a comprehensive review of expenditure covering state and local government levels, direct and indirect budget users and municipality-owned providers of utilities and services in the area of healthcare by the end of 2014 with a view to realising budgetary savings in 2015 and beyond.</p>	<p>Slovenia has made <b>some progress</b> in addressing the CSR 1 (this overall assessment of CSR 1 excludes an assessment of compliance with the Stability and Growth Pact):</p> <p>Progress has been made regarding the adoption of the Fiscal Rules Act (passed the first reading in the parliament in January 2015 and is expected to be adopted in Q1 2015). The Public Finance Act will be amended within six months of the adoption of the Fiscal Rules Act and will contain detailed provisions defining the drafting, implementation and monitoring of the budget of all general government institutional units.</p> <ul style="list-style-type: none"> <li>Some progress has been made regarding the expenditure review in the healthcare sector. The authorities have indicated that the review will be undertaken in cooperation with the European Observatory for Health policies and the World Health Organisation. A draft scope for the review has been prepared and a workshop was held in January 2014 to finalise the proposal. It is intended that the project will be wider than just expenditure and will include; (i) an analysis of the financing of the health system, (ii) an expenditure review (ii) a review of benefit basket and (iv) an assessment of health technology. The expenditure review and the National Healthcare Resolution will be a base for comprehensive healthcare reform.</li> </ul>
<p><b>CSR 2:</b> Based on the public consultation, agree measures to ensure the sustainability of the pension system and adequacy of pensions beyond</p>	<p>Slovenia has made <b>limited progress</b> in addressing the CSR 2:</p>

<sup>(98)</sup> The following categories are used to assess progress in implementing the 2014 CSRs of the Council Recommendation: No progress: The Member State has neither announced nor adopted any measures to address the CSR. This category also applies if a Member State has commissioned a study group to evaluate possible measures. Limited progress: The Member State has announced some measures to address the CSR, but these measures appear insufficient and/or their adoption/implementation is at risk. Some progress: The Member State has announced or adopted measures to address the CSR. These measures are promising, but not all of them have been implemented yet and implementation is not certain in all cases. Substantial progress: The Member State has adopted measures, most of which have been implemented. These measures go a long way in addressing the CSR. Fully addressed: The Member State has adopted and implemented measures that address the CSR appropriately.

<p>2020, encompassing adjustments of key parameters, such as linking the statutory retirement age to gains in life expectancy and encouraging private contributions to the second pillar of the pension system. Contain age-related expenditure on long-term care by targeting benefits to those most in need and refocusing care provision from institutional to home care.</p>	<ul style="list-style-type: none"> <li>• Some progress has been made in alleviating the pressures on the mid-term sustainability and adequacy of the pension system but key parameters still need to be adjusted. In January 2015 the results of the evaluation of the impact of the 2013 pension reform were published. Fiscal savings have been realised over 2013-14 and further containment of the pension-related expenditures is expected for the period 2014-20. Elements of a further pension system reform are to be discussed in the context of a White Book, due to be published in mid-2015. The Legal act for the Establishment and Functioning of the Demographic Fund is expected to be adopted in June 2015.</li> <li>• No progress has been made regarding the long term care reform. The blueprint for the long term care reform was adopted in September 2013. The adoption of the law will be postponed to the end of 2015 in order to match it with the reform of health insurance schemes.</li> </ul>
<p><b>CSR 3:</b> Following consultation with social partners and in accordance with national practices, develop a comprehensive Social Agreement by the end of 2014 ensuring that wage developments, including the minimum wage, support competitiveness, domestic demand and job creation. Redefine the composition of the minimum wage and review its indexation system. Take measures for further decreasing segmentation, in particular addressing the efficiency of incentives for hiring young and older workers and the use of civil law contracts. Adopt the Act on Student Work. Prioritise outreach to non-registered young people ensuring adequate public employment services capacities. To increase employment of low-skilled and older workers, adapt the working environment to longer working life and focus resources on tailor-made active labour market policy measures, while improving their effectiveness. Address skills mismatches by improving the attractiveness of vocational education and training and by further developing cooperation with the relevant</p>	<p>Slovenia has made <b>substantial progress</b> in addressing the CSR 3:</p> <ul style="list-style-type: none"> <li>• Some progress has been made regarding wages, with the exception of the minimum wage. The Social Agreement has been fully accomplished (concluded in January 2015). The Social Agreement establishes the basis for private sector wage setting on ground of collective agreements, inflation and a share of sectorial productivity while growth of public sector wages has to lag behind private sector wage growth. The Social Agreement does not address the minimum wage.</li> <li>• The evaluation of the 2013 labour market reform shows that some progress has been made in addressing labour market segmentation. Limited progress has been made in addressing the employment of low-skilled and older</li> </ul>



<p>stakeholders in assessing labour market needs.</p>	<p>workers.</p> <ul style="list-style-type: none"> <li>• The Student Work act has been fully addressed. The draft Act on Occasional Student Work was incorporated into the December 2014 Public Finance Balance Act and entered into force in February 2015.</li> <li>• Substantial progress has been made regarding the Youth Guarantee Programme. The implementation of Youth Guarantee Programme is on track. 22,000 young are included in the measures; 90% of them received an offer from the public employment services</li> <li>• Substantial progress has been made in addressing skills mismatch. In 2014 a proposal for the Act on the Slovenian Qualifications Framework was prepared and the Scholarship Act came into force. Scholarships for deficient professions will be awarded starting from January 2015. The employment services are preparing a bi-annual forecast of deficient occupations in parallel to the establishment of the National Career Point.</li> </ul>
<p><b>CSR 4:</b> Complete the privatisation of NKBM in 2014 as planned, prepare Abanka for privatisation in 2015, continue the prompt implementation of restructuring plans of the banks in receipt of State aid and the necessary consolidation of the banking sector. Based on the lessons from the asset quality review and stress test finalise the comprehensive action plan for banks in August 2014, including specific measures to improve governance, supervision, risk management, credit approval process and data quality and availability. Reinforce banks' capacity to work out non-performing loans by strengthening the internal asset management and restructuring units. Clarify the mandate of the Bank Asset Management Company by publishing a comprehensive management strategy and business plan by September 2014, detailing its role in restructuring of its assets, redemption targets, budgets, asset management plans and expected returns, while</p>	<p>Slovenia has made <b>substantial progress</b> in addressing the CSR 4:</p> <ul style="list-style-type: none"> <li>• Substantial progress has been made regarding the privatisation of NKBM. Binding offers for NKBM have been submitted. Negotiations are in the final stage and the government aims to sign the sales agreement in the first quarter of 2015.</li> <li>• The privatisation process of Abanka is expected to be launched in January 2016 once the merger with Banka Celje is completed.</li> <li>• The operational restructuring of the four major state-owned banks (NLB, NKBM, Abanka and Celje) and the wind-down of</li> </ul>

<p>ensuring adequate resources.</p>	<p>two smaller domestic banks are on track.</p> <ul style="list-style-type: none"> <li>• Substantial progress has been made regarding further stabilisation of banking sector. The recapitalisation of Abanka was implemented in October 2014 and the recapitalisation of Banka Celje took place at the end 2014.</li> <li>• Substantial progress has been made regarding the banking sector action plan. A comprehensive action plan for banks has been finalized and submitted to the Prime Minister office in January 2015. Bank of Slovenia has ensured follow-up of the shortcomings identified by the 2013 AQR and will resume on-site inspections in Q1-2015 to verify whether the recommendations have been implemented by banks.</li> <li>• Substantial progress has been made regarding the banks' workout capacity. The major banks have reorganized and reinforced their work-out and restructuring units.</li> <li>• Substantial progress has been made regarding the Bank Asset Management Company, which has set out its strategy and business plan and is fully operational. Certain amendments to the legislation still need to be adopted.</li> </ul>
<p><b>CSR 5:</b> Continue to implement the privatisations announced in 2013 with the time-frames set. Adopt a strategy for the Slovenian Sovereign Holding with a clear classification of assets in line with the timeline and definitions established in the 2014 Slovenian Sovereign Holding Act. By November 2014, commit to a short-term (one- to two- year horizon) divestment schedule for a number of well-targeted assets with a clear time scale. Make it fully operational as a vehicle for the management of assets remaining in State ownership and divestment of the assets earmarked according to the management acts, within the time frame stipulated by the law. By September 2014, adopt and implement a corporate governance code for state-owned enterprises to ensure professional,</p>	<p>Slovenia has made <b>some progress</b> in addressing the CSR 5:</p> <ul style="list-style-type: none"> <li>• Some progress has been made regarding the privatisation. Three companies from the list of 15 have been divested, including Aerodrom Ljubljana, while direct state ownership in one company has been diluted following a debt-to-equity swap. The sale of Telekom Slovenije and NKBM, the two biggest assets on the list, are in a final stage. Signing expected in April and March 2015 respectively.</li> <li>• Limited progress has been made in adopting the Slovenian Sovereign Holding strategy and the short-term divestment schedule for state-</li> </ul>

transparent and independent management.	<p>owned assets.</p> <ul style="list-style-type: none"> <li>• Substantial progress has been made regarding the operationalization of the Slovenian Sovereign Holding. In December 2014 the Slovenian Sovereign Holding has adopted an Asset Management Policy and a management contract between the Slovenian Sovereign Holding and the Government is signed, determining the payment of management fees to the first. In December 2014, an open public process was launched for compiling a list of candidate members for the new supervisory board of Slovenian Sovereign Holding. A special committee was to evaluate the submitted applications. In January 2015, a compliance officer was appointed by Slovenian Sovereign Holding. In January 2015 Slovenian Sovereign Holding became the sole owner of PDP. In October 2014 Slovenian Sovereign Holding acquired all the assets previously owned by DSU.</li> <li>• The new corporate governance code has been fully addressed. It was adopted by the supervisory board of Slovenian Sovereign Holding in December 2014.</li> </ul>
<p><b>CSR 6:</b> Finalise a corporate restructuring master plan by the end of 2014 within clear priorities and effective implementation process. Set up a central corporate restructuring task force monitoring and coordinating the overall restructuring process, providing the necessary expertise, guidance and advice, and facilitating the negotiation process between all stakeholders involved. Establish a list of the most urgent restructuring cases, while maximising the recovery value for creditors. Promote the use of the available legal mechanisms and international best practices to all stakeholders in the restructuring process. Evaluate recent changes in the insolvency legislation by September 2014, being ready to introduce any additional necessary measure. Further reduce the length of judicial proceedings at first instance in litigious civil and commercial cases including cases under the insolvency legislation, and the number of pending cases, in particular enforcement and insolvency cases.</p>	<p>Slovenia has made <b>substantial progress</b> in addressing the CSR 6:</p> <ul style="list-style-type: none"> <li>• The corporate restructuring master plan and the central task force have been both fully addressed. In December 2014 the restructuring master plan has been finalised. In January 2015 a centralised corporate restructuring task force was established to monitor and coordinate the overall restructuring process, to facilitate the negotiation process between all stakeholders involved, to promote the use of the available legal mechanisms and out-of-court solutions and to provide the necessary guidance and advice.</li> <li>• Substantial progress has been made regarding the restructuring of most urgent restructuring cases.</li> <li>• The evaluation of recent changes in the insolvency legislation has been fully</li> </ul>

	<p>addressed. In January 2015, the authorities presented the advanced version of the on-going evaluation exercise of the laws adopted in 2013 which amended and complemented the insolvency law. The authorities do currently not see a need for further amendments to the insolvency framework. The key finding of the evaluation is that the new framework allows more restructuring opportunities to companies in financial difficulties.</p> <ul style="list-style-type: none"> <li>• Some progress in reducing the length of judicial proceedings at first instance in litigious civil and commercial cases (incl. cases under the insolvency legislation) has been made, however the length of trials and backlogs remain still significant.</li> </ul>
<p><b>CSR 7:</b> Reduce obstacles to doing business in Slovenia in key areas for economic development rendering the country more attractive to foreign direct investment particularly through accelerated liberalisation of regulated professions, reduction of administrative burden including leaner authorisation schemes. Ensure sufficient budgetary autonomy for the Competition Protection Agency (CPA) and increase its institutional independence. Streamline priorities and ensure consistency between the 2011 Research and Innovation and the 2013 Industrial Policy Strategies with the upcoming strategies on Smart Specialisation and Transport, ensure their prompt implementation and assessment of effectiveness.</p>	<p>Slovenia has made <b>some progress</b> in addressing the CSR 7:</p> <ul style="list-style-type: none"> <li>• Limited progress has been made regarding the promotion of FDI. The new FDI Strategy is expected to be adopted in Q1 2015.</li> <li>• Some progress has been made regarding the deregulation of professions. The number of regulated professions has decreased from 323 to 242</li> <li>• Some progress has been made regarding the reduction of administrative burden. 25% of measures included in the Single document were implemented.</li> <li>• Substantial progress has been made in ensuring sufficient budgetary autonomy for the Competition Protection Agency and in maintaining its institutional independence.</li> <li>• No progress has been made regarding leaner authorisation schemes and the implementation of the National Research policy.</li> <li>• Some progress has been made regarding the Smart Specialization Strategy. The adoption of the Strategy is foreseen in April 2015.</li> <li>• Some progress has been made regarding the</li> </ul>

	<p>comprehensive Transport Strategy. Public and cross-border consultations on the draft strategy (dated 15 October 2014) were held and the draft is foreseen to be revised to reflect the relevant observations and comments received. The Strategy is expected to be adopted in September 2015.</p> <ul style="list-style-type: none"> <li>Limited progress has been made regarding the streamlining of priorities and ensuring consistency among the existing strategies.</li> </ul>
<p><b>CSR 8:</b> Take effective measures to fight corruption, enhancing transparency and accountability, and introducing external performance evaluation and quality control procedures.</p>	<p>Slovenia has made <b>some progress</b> in addressing the CSR 8:</p> <ul style="list-style-type: none"> <li>Some progress has been made regarding the fight against corruption. The new government reiterated its commitment to fight corruption and adopted a new two-year programme of 11 perennial measures in January 2015.</li> <li>Some progress has been made regarding the transparency and accountability. A comprehensive public-sector reform is in public consultation and is expected to be adopted by the end of February 2015.</li> <li>No progress has been made regarding report on performance evaluation and quality control procedures.</li> </ul>
<b>Europe 2020 (national targets and progress)</b>	
Employment rate (%): 75 %	<p>In 2013 Slovenia moved away from the target (63.3% in 2013 comparing with 64.1% in 2012), however quarterly data in 2014 shows some improvements.</p>
R&D target: 3% of GDP	<p>R&amp;D intensity in Slovenia increased from 1.36% in 2000 to 2.59% in 2013. During period 2007-2013, R&amp;D intensity has been growing at an annual rate of 7.8%. If this trend is sustained, Slovenia's R&amp;D intensity target of 3% for 2020 is achievable. In spite of the economic crisis business expenditure on R&amp;D as a percentage of GDP increased from 0.79% in 2000 to 1.98 % in 2013, making Slovenia one of the top</p>

	performers in the EU in terms of business R&D. Slovenia is therefore on track towards its R&D intensity target of 3% for 2020. The main challenge remains the efficient and effective use of available resources in order to secure the economic benefits of this investment.
National Greenhouse gas (GHG) emissions target:  4% increase in 2020 compared to 2005 (in non-ETS sectors)	According to the latest national projections and taking into account existing measures, Slovenia is on track to meet its target on GHG emissions in the sectors not covered by the EU Emissions Trading System (ETS), as GHG emissions are projected to increase by around 4% (compared to 2005) by 2020. By reducing emissions by 7% between 2005 and 2013, based on latest projections the interim target for 2013 will be overachieved by a margin of 9 percentage points.
2020 Renewable energy target: 25%  Share of renewable energy in all modes of transport: 10%	Slovenia has increased its renewable energy share to 23.5% (2013) from 20.9% in the previous year; the renewable share in transport has increased to 2.9% (2012) from 2.1% in the previous year. Progress is fairly steady and on track towards its 2020 target (25%). There are no complaints, EU-pilots/infringement procedures against Slovenia concerning the Renewable Energy Directive.
Energy Efficiency target: 10 809 GWh saving  By 2020: level of 7.31 Mtoe primary consumption (5.09 Mtoe expressed in final energy consumption)	Even if Slovenia's current primary energy consumption (6.9 Mtoe in 2012) is slightly below its 2020 target, additional efforts regarding EE are needed to keep the primary energy consumption at this level or to minimise its increase if the GDP increases again during the next six year period. The target was set at a rather unambitious level and Slovenia is among the very few countries which failed to submit its National Energy Efficiency Action Plan (NEEAP). Only limited progresses have been made in implementing the Energy Efficiency Directive (EED) and the Commission is monitoring closely its transposition.
Early school leaving target: 5 %	The target has been achieved. Early school leaving fell from 5.6 % in 2006 to 3.9 % in 2013.
Tertiary education target: 40 %	Tertiary education rates continuously improved

	and reached the target in 2013 (40.1 %)
Target for reducing the population at risk of poverty or social exclusion: 40 000 (compared to 360 000 in 2008)	Poverty and social exclusion have continued to increase in Slovenia in 2013, taking the country further away from its poverty and social exclusion target (320.000). The number of people at-risk-of-poverty or social exclusion increased and reached 410,000 in 2013.



## ANNEX B

Table AB.1 Macroeconomic indicators

	1996-2000	2001-2005	2006-2010	2011	2012	2013	2014	2015	2016
<b>Core indicators</b>									
GDP growth rate	4.3	3.6	1.9	0.6	-2.6	-1.0	2.6	1.8	2.3
Output gap <sup>1</sup>	n.a.	0.8	2.4	-1.7	-3.9	-4.6	-2.6	-1.4	-0.1
HICP (annual % change)	8.2	5.6	3.0	2.1	2.8	1.9	0.4	-0.3	0.9
Domestic demand (annual % change) <sup>2</sup>	4.6	3.1	1.3	-0.8	-5.6	-2.1	1.2	1.3	2.2
Unemployment rate (% of labour force) <sup>3</sup>	7.0	6.4	5.7	8.2	8.9	10.1	9.8	9.5	8.9
Gross fixed capital formation (% of GDP)	26.1	25.8	26.4	20.2	19.2	19.7	20.3	21.1	21.2
Gross national saving (% of GDP)	24.5	25.6	26.0	22.6	22.0	24.3	26.2	26.8	26.5
<b>General government (% of GDP)</b>									
<b>Net lending (+) or net borrowing (-)</b>	-2.5	-2.5	-3.0	-6.2	-3.7	-14.6	-5.4	-2.9	-2.8
<b>Gross debt</b>	23.2	26.6	28.5	46.2	53.4	70.4	82.2	83.0	81.8
<b>Net financial assets</b>	n.a.	11.3	7.1	-1.9	-7.9	-18.7	n.a.	n.a.	n.a.
Total revenue	42.6	43.2	42.6	43.6	44.4	45.2	44.9	44.3	43.7
Total expenditure	45.0	45.8	45.6	49.8	48.1	59.7	50.3	47.2	46.4
<i>of which: Interest</i>	2.2	1.9	1.3	1.9	2.0	2.5	3.3	3.2	3.0
<b>Corporations (% of GDP)</b>									
<b>Net lending (+) or net borrowing (-)</b>	-1.7	-3.3	-4.1	2.1	2.8	13.2	4.8	3.1	2.4
<b>Net financial assets; non-financial corporations</b>	n.a.	-92.7	-116.1	-116.2	-118.8	-109.7	n.a.	n.a.	n.a.
<b>Net financial assets; financial corporations</b>	n.a.	6.8	3.7	6.4	9.3	13.2	n.a.	n.a.	n.a.
Gross capital formation	16.8	17.6	17.8	13.6	11.3	11.8	11.9	12.3	13.1
Gross operating surplus	15.9	17.8	19.5	18.8	18.4	18.9	19.6	19.4	19.6
<b>Households and NPISH (% of GDP)</b>									
<b>Net lending (+) or net borrowing (-)</b>	1.8	4.0	4.9	5.0	4.0	6.2	5.9	6.3	6.6
<b>Net financial assets</b>	n.a.	68.0	72.6	68.6	71.5	75.3	n.a.	n.a.	n.a.
Gross wages and salaries	44.7	43.7	43.6	44.5	44.8	44.1	42.9	42.9	42.8
Net property income	1.4	1.5	1.2	1.1	1.1	1.1	1.4	1.6	1.6
Current transfers received	19.1	19.9	19.0	21.4	21.7	21.5	20.4	19.8	19.5
Gross saving	7.9	9.2	9.6	8.4	7.2	9.1	8.8	9.1	9.3
<b>Rest of the world (% of GDP)</b>									
<b>Net lending (+) or net borrowing (-)</b>	-2.5	-1.8	-2.2	0.9	3.1	4.8	5.4	6.5	6.2
<b>Net financial assets</b>	n.a.	7.0	33.2	44.2	47.0	40.8	n.a.	n.a.	n.a.
Net exports of goods and services	-2.4	-0.5	0.0	2.0	4.4	6.0	7.8	8.3	8.2
Net primary income from the rest of the world	0.5	-0.5	-1.5	-0.8	-0.7	-0.7	-0.9	-1.1	-1.1
Net capital transactions	0.0	-0.4	0.0	0.0	0.1	0.0	-0.6	0.7	0.7
Tradable sector	47.5	47.2	45.3	44.9	45.4	46.1	n.a.	n.a.	n.a.
Non-tradable sector	39.2	40.4	42.2	42.2	41.4	40.3	n.a.	n.a.	n.a.
<i>of which: Building and construction sector</i>	5.6	5.4	6.6	5.1	5.1	4.6	n.a.	n.a.	n.a.

Notes:

1 The output gap constitutes the gap between the actual and potential gross domestic product at 2010 market prices.

2 The indicator of domestic demand includes stocks.

3 Unemployed persons are all those who were not employed, had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. The unemployment rate covers the age group 15-74.

**Source:** European Commission 2015 winter forecast (COM); European Commission calculations

Table AB.2: **Financial market indicators**

	2009	2010	2011	2012	2013	2014
Total assets of the banking sector (% of GDP) <sup>1)</sup>	150.8	149.4	145.0	143.8	131.3	123.4
Share of assets of the five largest banks (% of total assets)	59.7	59.3	59.3	58.4	57.1	n.a.
Foreign ownership of banking system (% of total assets)	29.1	28.2	28.3	29.3	30.6	n.a.
Financial soundness indicators:						
- non-performing loans (% of total loans) <sup>2)</sup>	5.8	8.2	11.8	15.2	13.3	16.0
- capital adequacy ratio (%) <sup>2)</sup>	11.7	11.3	11.9	11.4	13.7	15.8
- return on equity (%) <sup>2)</sup>	2.0	-3.2	-11.8	-19.6	-97.6	3.8
Bank loans to the private sector (year-on-year % change) <sup>1)</sup>	2.3	1.6	-2.3	-4.1	-9.5	-10.3
Lending for house purchase (year-on-year % change) <sup>1)</sup>	16.0	18.4	6.2	1.8	1.3	0.3
Loan to deposit ratio <sup>1)</sup>	159.3	156.5	149.0	143.8	119.0	100.9
Central Bank liquidity as % of liabilities <sup>3)</sup>	4.5	1.3	3.9	9.6	10.3	3.0
Private debt (% of GDP)	113.5	115.6	113.5	112.8	101.9	n.a.
Gross external debt (% of GDP) <sup>4)</sup>						
- public	18.6	23.0	24.1	31.4	43.9	58.1
- private	39.2	40.0	41.6	44.8	45.2	45.6
Long-term interest rate spread versus Bund (basis points)*	115.3	108.9	236.3	431.3	424.2	210.7
Credit default swap spreads for sovereign securities (5-year)*	97.1	71.2	159.1	330.1	273.2	138.5

Notes:

1) Latest data November 2014.

2) Latest data Q3 2014.

3) Latest data September 2014.

4) Latest data June 2014. Monetary authorities, monetary and financial institutions are not included.

\* Measured in basis points

**Source:** IMF (financial soundness indicators), European Commission (long-term interest rates), World Bank (gross external debt) and ECB (all other indicators).

Table AB.3: **Taxation indicators**

	2002	2006	2008	2010	2011	2012
<b>Total tax revenues</b> (incl. actual compulsory social contributions, % of GDP)	37.8	38.3	37.3	37.7	37.2	37.6
<b>Breakdown by economic function</b> (% of GDP) <sup>1</sup>						
Consumption	13.7	13.2	13.4	14.0	13.9	14.2
of which:						
- VAT	8.5	8.5	8.5	8.2	8.3	8.2
- excise duties on tobacco and alcohol	0.9	1.1	1.1	1.4	1.4	1.5
- energy	2.6	2.3	2.3	3.0	2.8	3.1
- other (residual)	1.6	1.3	1.5	1.4	1.3	1.4
Labour employed	19.8	19.4	18.5	18.8	18.5	18.7
Labour non-employed	0.7	0.7	0.6	0.9	1.0	1.0
Capital and business income	2.8	4.3	4.0	3.2	3.0	2.7
Stocks of capital/wealth	0.9	0.9	0.9	0.9	0.9	1.0
<i>p.m.</i> Environmental taxes <sup>2</sup>	3.3	3.0	3.0	3.6	3.4	3.8
<b>VAT efficiency</b> <sup>3</sup>						
Actual VAT revenues as % of theoretical revenues at standard rate	64.4	67.6	68.3	59.2	59.2	58.9

## Notes:

1. Tax revenues are broken down by economic function, i.e. according to whether taxes are raised on consumption, labour or capital. See European Commission (2014), Taxation trends in the European Union, for a more detailed explanation.

2. This category comprises taxes on energy, transport and pollution and resources included in taxes on consumption and capital.

3. VAT efficiency is measured via the VAT revenue ratio. It is defined as the ratio between the actual VAT revenue collected and the revenue that would be raised if VAT was applied at the standard rate to all final (domestic) consumption expenditures, which is an imperfect measure of the theoretical pure VAT base. A low ratio can indicate a reduction of the tax base due to large exemptions or the application of reduced rates to a wide range of goods and services ('policy gap') or a failure to collect all tax due to e.g. fraud ('collection gap'). It should be noted that the relative scale of cross-border shopping (including trade in financial services) compared to domestic consumption also influences the value of the ratio, notably for smaller economies. For a more detailed discussion, see European Commission (2012), Tax Reforms in EU Member States, and OECD (2014), Consumption tax trends.

**Source:** European Commission

Table AB.4: Labour market indicators

	2008	2009	2010	2011	2012	2013	2014
Employment rate (% of population aged 20-64)	73.0	71.9	70.3	68.4	68.3	67.2	67.7
Employment growth (% change from previous year)	2.6	-1.8	-2.2	-1.6	-0.8	-1.5	0.6
Employment rate of women (% of female population aged 20-64)	68.5	67.9	66.5	64.8	64.6	63.0	63.8
Employment rate of men (% of male population aged 20-64)	77.4	75.6	74.0	71.8	71.8	71.2	71.4
Employment rate of older workers (% of population aged 55-64)	32.8	35.6	35.0	31.2	32.9	33.5	35.3
Part-time employment (% of total employment, age 15 years and over)	9.0	10.6	11.4	10.4	9.8	10.1	11.0
Part-time employment of women (% of women employment, age 15 years and over)	11.4	13.2	14.7	13.3	13.1	13.5	14.5
Part-time employment of men (% of men employment, age 15 years and over)	7.1	8.4	8.6	7.9	7.0	7.3	8.1
Fixed term employment (% of employees with a fixed term contract, age 15 years and over)	17.4	16.4	17.3	18.2	17.1	16.5	16.8
Transitions from temporary to permanent employment	38.7	40.7	31.8	37.9	36.6	36.9	n.a.
Unemployment rate <sup>1</sup> (% of labour force, age group 15-74)	4.4	5.9	7.3	8.2	8.9	10.1	9.8
Long-term unemployment rate <sup>2</sup> (% of labour force)	1.9	1.8	3.2	3.6	4.3	5.2	5.3
Youth unemployment rate (% of youth labour force aged 15-24)	10.4	13.6	14.7	15.7	20.6	21.6	21.7
Youth NEET rate (% of population aged 15-24)	6.5	7.5	7.1	7.1	9.3	9.2	n.a.
Early leavers from education and training (% of pop. aged 18- 24 with at most lower sec. educ. and not in further education or training)	5.1	5.3	5.0	4.2	4.4	3.9	n.a.
Tertiary educational attainment (% of population aged 30-34 having successfully completed tertiary education)	30.9	31.6	34.8	37.9	39.2	40.1	n.a.
Formal childcare (from 1 to 29 hours; % over the population aged less than 3 years)	4.0	4.0	4.0	3.0	2.0	n.a.	n.a.
Formal childcare (30 hours or over; % over the population aged less than 3 years)	27.0	27.0	33.0	34.0	36.0	n.a.	n.a.
Labour productivity per person employed (annual % change)	0.7	-6.1	3.5	2.3	-1.8	0.5	2.2
Hours worked per person employed (annual % change)	1.0	0.2	0.7	-1.5	-1.3	0.8	0.2
Labour productivity per hour worked (annual % change; constant prices)	-0.3	-6.3	2.8	3.8	-0.5	-0.4	2.0
Compensation per employee (annual % change; constant prices)	2.6	-1.5	5.1	0.4	-1.5	0.5	0.5
Nominal unit labour cost growth (annual % change)	6.4	8.6	0.4	-0.7	0.8	-0.8	n.a.
Real unit labour cost growth (annual % change)	2.1	5.1	1.5	-1.9	0.5	-1.8	n.a.

## Notes:

1 Unemployed persons are all those who were not employed, but had actively sought work and were ready to begin working immediately or within two weeks. The labour force is the total number of people employed and unemployed. Data on the unemployment rate of 2014 includes the last release by Eurostat in early February 2015.

2 Long-term unemployed are persons who have been unemployed for at least 12 months.

**Source:** European Commission (EU Labour Force Survey and European National Accounts)

Table AB.5: **Social indicators**

	2007	2008	2009	2010	2011	2012
Sickness/healthcare	6.7	7.0	7.8	7.9	7.8	8.0
Invalidity	1.7	1.6	1.8	1.8	1.7	1.6
Old age and survivors	9.7	9.6	10.9	11.4	11.6	11.7
Family/children	1.7	1.8	2.1	2.2	2.2	2.1
Unemployment	0.4	0.4	0.6	0.7	0.8	0.8
Housing and social exclusion n.e.c.	0.0	0.0	0.0	0.0	0.0	0.0
<b>Total</b>	20.7	20.9	23.7	24.4	24.6	24.9
of which: means-tested benefits	1.8	1.8	2.0	2.0	2.0	1.9
<b>Social inclusion indicators</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>
People at risk of poverty or social exclusion <sup>1</sup> (% of total population)	18.5	17.1	18.3	19.3	19.6	20.4
Children at risk of poverty or social exclusion (% of people aged 0-17)	15.3	15.1	15.2	17.3	16.4	17.5
Elderly at risk of poverty or social exclusion (% of people aged 65+)	24.4	23.3	22.8	24.2	22.8	23.0
At-risk-of-poverty rate <sup>2</sup> (% of total population)	12.3	11.3	12.7	13.6	13.5	14.5
Severe material deprivation rate <sup>3</sup> (% of total population)	6.7	6.1	5.9	6.1	6.6	6.7
Proportion of people living in low work intensity households <sup>4</sup> (% of people aged 0-59)	6.7	5.6	7.0	7.6	7.5	8.0
In-work at-risk-of-poverty rate (% of persons employed)	5.1	4.8	5.3	6.0	6.5	7.1
Impact of social transfers (excluding pensions) on reducing poverty	46.5	48.6	47.5	43.8	46.4	42.7
Poverty thresholds, expressed in national currency at constant prices <sup>5</sup>	6299.5	6500.5	6376.0	6384.6	6318.5	6008.8
Gross disposable income (households)	22677.0	22839.0	23043.0	23567.0	22923.0	n.a.
Relative median poverty risk gap (60% of median equivalised income, age: total)	19.3	20.2	20.2	19.9	19.1	20.4
Inequality of income distribution (S80/S20 income quintile share ratio)	3.4	3.2	3.4	3.5	3.4	3.6

Notes:

1 People at risk of poverty or social exclusion (AROPE): individuals who are at risk of poverty (AROP) and/or suffering from severe material deprivation (SMD) and/or living in households with zero or very low work intensity (LWI).

2 At-risk-of-poverty rate (AROP): proportion of people with an equivalised disposable income below 60% of the national equivalised median income.

3 Proportion of people who experience at least four of the following forms of deprivation: not being able to afford to i) pay their rent or utility bills, ii) keep their home adequately warm, iii) face unexpected expenses, iv) eat meat, fish or a protein equivalent every second day, v) enjoy a week of holiday away from home once a year, vi) have a car, vii) have a washing machine, viii) have a colour TV, or ix) have a telephone.

4 People living in households with very low work intensity: proportion of people aged 0-59 living in households where the adults (excluding dependent children) worked less than 20% of their total work-time potential in the previous 12 months.<sup>5</sup> For EE, CY, MT, SI and SK, thresholds in nominal values in euros; harmonised index of consumer prices (HICP) = 100 in 2006 (2007 survey refers to 2006 incomes)

6 2014 data refer to the average of the first three quarters.

**Source:** For expenditure for social protection benefits ESSPROS; for social inclusion EU-SILC.



Table AB.6: Product market performance and policy indicators

	2004-08	2009	2010	2011	2012	2013	2014
Labour productivity <sup>1</sup> in total economy (annual growth in %)	3.3	-5.7	3.6	2.0	-1.5	0.9	n.a.
Labour productivity <sup>1</sup> in manufacturing (annual growth in %)	5.7	-7.1	14.4	3.1	-1.4	1.6	n.a.
Labour productivity <sup>1</sup> in electricity, gas (annual growth in %)	4.2	-5.8	3.6	-5.1	-2.2	1.6	n.a.
Labour productivity <sup>1</sup> in the construction sector (annual growth in %)	1.5	-12.6	-9.7	1.4	0.3	-1.8	n.a.
Labour productivity <sup>1</sup> in the wholesale and retail sector (annual growth in %)	3.1	-9.1	-0.4	3.4	-3.3	1.7	n.a.
Labour productivity <sup>1</sup> in the information and communication sector (annual growth in %)	4.6	-8.1	2.6	-0.2	-2.5	-1.2	n.a.
Patent intensity in manufacturing <sup>2</sup> (EPO patent applications divided by gross value added of the sector)	0.0	0.0	0.0	0.0	n.a.	n.a.	n.a.
<b>Policy indicators</b>	<b>2004-08</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Enforcing contracts <sup>3</sup> (days)	1368	1290	1290	1290	1290	1270	1270
Time to start a business <sup>3</sup> (days)	51.8	6	6	6	6	6	6
R&D expenditure (% of GDP)	1.5	1.8	2.1	2.4	2.6	2.6	n.a.
Total public expenditure on education (% of GDP)	5.5	5.7	5.7	5.7	n.a.	n.a.	n.a.
(Index: 0=not regulated; 6=most regulated)	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>
Product market regulation <sup>4</sup> , overall	1.89	n.a.	n.a.	n.a.	n.a.	1.70	n.a.
Product market regulation <sup>4</sup> , retail	0.90	n.a.	n.a.	n.a.	n.a.	0.63	n.a.
Product market regulation <sup>4</sup> , professional services	n.a.	n.a.	n.a.	n.a.	n.a.	2.56	n.a.
Product market regulation <sup>4</sup> , network industries <sup>5</sup>	3.41	3.13	3.13	3.01	2.95	2.90	n.a.

(1) Labour productivity is defined as gross value added (in constant prices) divided by the number of persons employed.

(2) Patent data refer to applications to the European Patent Office (EPO). They are counted according to the year in which they were filed at the EPO. They are broken down according to the inventor's place of residence, using fractional counting if multiple inventors or IPC classes are provided to avoid double counting.

(3) The methodologies, including the assumptions, for this indicator are presented in detail here:

<http://www.doingbusiness.org/methodology>.

(4) Index: 0 = not regulated; 6 = most regulated. The methodologies of the OECD product market regulation indicators are presented in detail here: <http://www.oecd.org/competition/reform/indicatorsofproductmarketregulationhomepage.htm>

(5) Aggregate OECD indicators of regulation in energy, transport and communications (ETCR).

**Source:** Commission services, World Bank - Doing Business (for enforcing contract and time to start a business) and OECD (for the product market regulation indicators).



Table AB.7: **Green Growth**

<b>Green growth performance</b>		<b>2003-2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
<b>Macroeconomic</b>							
Energy intensity	kgoe / €	0.25	0.23	0.23	0.23	0.23	0.23
Carbon intensity	kg / €	0.70	0.64	0.63	0.62	0.62	0.61
Resource intensity (reciprocal of resource productivity)	kg / €	1.39	1.25	1.12	1.04	0.93	n.a.
Waste intensity	kg / €	n.a.	0.15	n.a.	0.16	n.a.	0.15
Energy balance of trade	% GDP	-4.2	-6.3	-4.0	-5.1	-6.3	-6.9
Energy weight in HICP	%	12.5	13.4	11.6	13.9	14.3	14.5
Difference between energy price change and inflation	%	3.3	8.0	-5.1	11.5	7.8	2.9
Ratio of environmental taxes to labour taxes	ratio	15.7%	15.8%	18.3%	18.6%	17.8%	19.4%
Ratio of environmental taxes to total taxes	ratio	8.3%	8.1%	9.6%	9.7%	9.3%	10.2%
<b>Sectoral</b>							
Industry energy intensity	kgoe / €	0.23	0.19	0.18	0.18	0.17	0.17
Share of energy-intensive industries in the economy	% GDP	15.5	14.7	13.9	14.9	15.1	15.2
Electricity prices for medium-sized industrial users**	€ / kWh	n.a.	0.10	0.10	0.10	0.10	0.09
Gas prices for medium-sized industrial users***	€ / kWh	n.a.	0.04	0.04	0.04	0.05	0.06
Public R&D for energy	% GDP	n.a.	0.01	0.01	0.01	0.02	0.02
Public R&D for the environment	% GDP	n.a.	0.02	0.02	0.02	0.02	0.02
Recycling rate of municipal waste	ratio	18.3%	20.1%	20.9%	23.0%	35.1%	40.7%
Share of GHG emissions covered by ETS*	%	n.a.	41.4	41.6	41.9	41.1	40.2
Transport energy intensity	kgoe / €	1.09	1.22	1.12	1.07	1.11	1.14
Transport carbon intensity	kg / €	3.25	3.67	3.48	3.12	3.31	3.44
<b>Security of energy supply</b>							
Energy import dependency	%	52.6	55.1	48.4	49.4	48.1	51.6
Diversification of oil import sources	HHI	0.25	0.23	0.25	0.21	0.20	0.22
Diversification of energy mix	HHI	n.a.	0.26	0.25	0.24	0.24	0.24
Renewable energy share of energy mix	%	10.6	11.0	14.3	14.3	13.5	14.8

Country-specific notes:

2013 is not included in the table due to lack of data.

General explanation of the table items:

All macro intensity indicators are expressed as a ratio of a physical quantity to GDP (in 2000 prices)

Energy intensity: gross inland energy consumption (in kgoe) divided by GDP (in EUR)

Carbon intensity: Greenhouse gas emissions (in kg CO<sub>2</sub> equivalents) divided by GDP (in EUR)

Resource intensity: Domestic material consumption (in kg) divided by GDP (in EUR)

Waste intensity: waste (in kg) divided by GDP (in EUR)

Energy balance of trade: the balance of energy exports and imports, expressed as % of GDP

Energy weight in HICP: the proportion of "energy" items in the consumption basket used for the construction of the HICP

Difference between energy price change and inflation: energy component of HICP, and total HICP inflation (annual % change)

Environmental taxes over labour or total taxes: from DG TAXUD's database 'Taxation trends in the European Union'

Industry energy intensity: final energy consumption of industry (in kgoe) divided by gross value added of industry (in 2005 EUR)

Share of energy-intensive industries in the economy: share of gross value added of the energy-intensive industries in GDP

Electricity and gas prices for medium-sized industrial users: consumption band 500–2000MWh and 10000–100000 GJ; figures excl. VAT.

Recycling rate of municipal waste: ratio of recycled municipal waste to total municipal waste

Public R&amp;D for energy or for the environment: government spending on R&amp;D (GBAORD) for these categories as % of GDP

Proportion of GHG emissions covered by ETS: based on greenhouse gas emissions (excl LULUCF) as reported by Member States to the European Environment Agency

Transport energy intensity: final energy consumption of transport activity (kgoe) divided by transport industry gross value added (in 2005 EUR)

Transport carbon intensity: greenhouse gas emissions in transport activity divided by gross value added of the transport sector

Energy import dependency: net energy imports divided by gross inland energy consumption incl. consumption of international bunker fuels

Diversification of oil import sources: Herfindahl index (HHI), calculated as the sum of the squared market shares of countries of origin

Diversification of the energy mix: Herfindahl index over natural gas, total petrol products, nuclear heat, renewable energies and solid fuels

Renewable energy share of energy mix: %share of gross inland energy consumption, expressed in tonne oil equivalents

\* European Commission and European Environment Agency

\*\* For 2007 average of S1 &amp; S2 for DE, HR, LU, NL, FI, SE &amp; UK. Other countries only have S2.

\*\*\* For 2007 average of S1 &amp; S2 for HR, IT, NL, FI, SE &amp; UK. Other countries only have S2.

**Source:** European Commission unless indicated otherwise, European Commission calculation