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Country acronyms:
A-Austria, **B**-Belgium, **BG**-Bulgaria, **BY**-Belarus, **CH**-Switzerland, **HR**-Croatia, **CZ**-Czech Republic, **CY**-Cyprus, **DK**-Denmark, **D**-Germany, **E**-Spain, **EE**-Estonia, **EL**-Greece, **F**-France, **FIN**-Finland, **HU**-Hungary, **I**-Italy, **IRL**-Ireland, **L**-Luxembourg, **LT**-Lithuania, **LV**-Latvia, **NL**-Netherlands, **MT**-Malta, **NO-**Norway, **PL**-Poland, **P**-Portugal, **RO**-Romania, **RU**-Russia, **S**-Sweden, **SI**-Slovenia, **SK**-Slovakia, **TR**-Turkey, **UA**-Ukraine, **UK**-United Kingdom.

Foreword

The *Development Report's primary purpose is to monitor implementation of the Strategy for the Economic Development of Slovenia (SEDS)* adopted in July 2001. The Report assesses the extent to which the country's development is following the goal of a sustainable improvement in the welfare of Slovenians and analyses the degree to which the development factors and mechanisms set out in the SEDS have been further carried out. The Report is already recognised by the government and the professional public.

The Report is largely based on a ***list of indicators designed to monitor development*** that were tentatively formulated when the SEDS was being prepared. Selection of the indicators was based on the SEDS' content and data provided by the Statistical Office of the Republic of Slovenia (SORS) and other institutions. When choosing the structural indicators, we attempted to achieve maximum compatibility with those developed by the European Union to monitor the Lisbon Strategy. This year's list of indicators does not differ significantly from that used in previous years. Some indicators have not been updated, either because no new data were provided or because they are too complex to be updated every year. The following indicators have been added to those used last year: innovation active enterprises and the number of patent applications per million residents filed at the European Patent Office, public expenditure on education and long-term unemployment rate.

Slovenia's entry to the EU has brought the issue of reconciling Slovenia's national development strategies with those in the Lisbon Strategy to the fore. Slovenia's main strategic document for economic development is the Strategy for the Economic Development of Slovenia 2001-2006 (SEDS) from 2001. The counterpart in the EU is the Lisbon Strategy, which was adopted in 2000 and updated subsequently at several European Council meetings (Gothenburg, adding environment-related guidelines, and Barcelona, adding R&D guidelines, for example). These two documents raise several fundamental questions. First, to what extent are they compatible and, second, how can Slovenia align its national strategy with the Lisbon Strategy bearing in mind the issues that are most important for Slovenia, as well as determining how Slovenia's national interest should affect its implementation? The problem is being resolved through the creation of a new strategy (Slovenia's Development Strategy, Draft for Public Debate, 2004).

The decision to prepare a new Strategy for Slovenia's Development (SSD) was taken by the government in July 2003. The reasons were the following. First, the new strategy would be drafted so as to better facilitate its implementation as past Development Reports had found that the previous SEDS was only being partially implemented. This was to be achieved with a more detailed description of the short-term priorities and the means for achieving them. A similar process is already taking place at the European level with the drafting of a new, better-focused Lisbon Strategy which the European Council will adopt at its March meeting in a new push to stimulate its implementation. Second, a new, comprehensive development strategy not focussing primarily on economic issues was needed. Third, accession to the EU formally ends the transition period and Slovenia must thus formulate its own national goals and strategy for the first decade of its membership in the EU.

The Strategy for Slovenia's Development is expected to be adopted in the first half of 2005, at which point it will replace the existing SEDS. It will also be the basis for a National Lisbon Action Plan that is set to be drafted in autumn, which will generate the institutional mechanisms for implementing the development strategy. After its adoption, the IMAD's focus will be to develop the appropriate methodological tools to follow the progress towards the designated goals and priorities. The majority of the indicators developed for monitoring fulfilment of the SEDS' objectives are also suitable for monitoring those set out in the SSD. In those areas which the SEDS did not cover new indicators will need to be developed. The progress towards the stated goals and developmental priorities will be reported in a similar fashion – with an annual *Development Report*.

This is the fourth consecutive year for which we have prepared a Development Report. It focuses mainly on an indicator-based assessment of the initial conditions for the new strategy (SSD) and it is also the final report on implementation of the SEDS. Less attention is paid to progress in structural reforms because a special report, *the Report on Structural Reforms*, was prepared using the European Union's methodology for the second consecutive year. Moreover, the Report does not give guidelines for implementing the strategies and priorities as these will comprise an integral part of the Strategy for Slovenia's Development.

The Report utilises the latest official data, spanning different time periods (although mainly 2002 and 2003), and hence it does not present cross-sectional statistics for a given moment. The analytical appendix presents the latest available international comparisons while the text of the report was enriched with the newest national statistics in order to clarify trends and place them in the international context. The period covered by the Report is therefore determined by the data available by 28 February 2005.

Summary of the main findings

Due to the duality of the Report, as mentioned in the Foreword, the contents of this year's Report have been modified somewhat from previous years. As in previous years, the central part of the Report presents Slovenia's achieved development level and the degree to which the SEDS' goals and directives have been fulfilled. The concluding sections include a new chapter on how Slovenia's development is being viewed by the European Commission via structural indicators and on how Slovenia is fulfilling the Lisbon Strategy's goals. With this approach, developmental progress at the national level is thus being integrated with an assessment of progress in achieving larger goals set at the international level.

1. Implementation of the SEDS

As in previous years, we may conclude that **the concept of balanced economic, social and environmental development** is not being realised in its entirety (Table 1). The level of economic development is steadily increasing as Slovenia is gradually closing its developmental gap relative to the EU-15 average, but at a rate slower than in some other new EU members. Slovenia's economic development is being accompanied by developmental and structural weaknesses in various areas, and these are only slowly being eradicated. The results of social development are favourable in many areas, with some levels of development already being comparable to the most developed EU members. Environmental development has been slower due to the sluggish pace of change in economic structures, production processes and environmentally-destructive behaviour of the population; however, some positive changes have nevertheless been taking place.

In terms of ***economic development*****,** favourable results have been achieved in the area of **macroeconomic stability**. Real GDP growth improved in 2004 and reached 4.5% in the first nine months compared to the same period in 2003. It was driven by export activity and further growth in domestic consumption. This strong growth had a positive impact on labour market conditions. These favourable trends occurred in a stable macroeconomic environment. The co-ordinated macroeconomic policies of the government and the Bank of Slovenia, particularly regarding stabilisation of the exchange rate after entrance to the ERM II, helped further dampen the growth in consumer prices which decreased from 4.6% to 3.2% during the course of 2004. The current account deficit increased slightly and both exports and imports grew at a higher rate than before. The government deficit reportedly remained stable in 2004 relative to 2003. The labour market witnessed a shift in the structure of registered unemployed, with an increase in the proportion of first-time job-seekers and women.

Structural changes have been occurring slowly, mainly because the government has not been quick enough in adopting transition and other structural reforms. The government managed to partly catch up with those countries that were the quickest to adopt reforms in the late 1990s, although the relative pace of its reforms has slowed since 2001. Reform remains most urgent in the non-banking financial sector

as well as in competition policy legislation as is evident in the economic composition of gross value added. The share of agriculture and industry relative to services is decreasing too slowly and thus the disparity between the structural composition of Slovenia and the EU is increasing. In the services sector, growth has especially been too slow in the business, financial and information services sectors. In manufacturing, restructuring in the direction of technologically more intensive industries needs to intensify. The main reasons for the unacceptably slow pace of structural change lie in the insufficient development of the key developmental factors, namely human resources, research and development activity, innovation, and other factors fostering development. The EBRD and the WEF have also taken note of the unfavourable structural changes in Slovenia. The WEF finds that while Slovenia's degree of national competitiveness is improving it is still gradually being overtaken by countries previously ranked lower – a serious indication that, without accelerating the country's structural reforms, the relatively positive economic and social development trends could potentially halted.

According to the SEDS, the key development factors include the formation of a knowledge-based society, increasing the competitiveness of the economy, liberalising infrastructure and changing the state's role in economic development. Slovenia is only slowly decreasing its gap vis-ŕ-vis the EU-15 in its goal of becoming a **knowledge-based society** and this is despite progress in certain areas (e.g. increased tertiary education enrolment, business sector R&D expenditure, Internet access). The shortcomings in the area of education and training mainly lie in its efficiency and quality, while the problems in R&D activities are chiefly tied to insufficient innovation activities by firms and an inadequate institutional support framework, which has also been hindering technological modernisation of the economy. Such results are insufficient to ambitiously close the gap relative to advanced countries in the area of moving towards a knowledge-based society. An analysis of **the business sector's competitiveness** yields findings pointing to the unacceptably slow structural reforms. Despite positive trends in certain areas, the process of restructuring towards products with higher value added needs to be intensified in order to strengthen long-term international competitiveness and cut labour costs per unit of output. The current labour costs are only sustainable with a shift towards output with higher value added. The entrepreneurship which would foster dynamic structural changes is being insufficiently developed, the number of firms has been steadily dropping since 1999, the population's enthusiasm for entrepreneurship is low, and the rate of failed businesses is among the highest in the world. The **financial system** remains poorly developed. After several years of a gradual shrinking of the developmental gap vis-ŕ-vis developed EU countries, the gap has increased in the past year. Banks are not quite fulfilling their role in economic development. A somewhat smaller, albeit still significant, developmental gap persists in the area of insurance. The capital market's development is also lacking. Greater efficiency in the financial system will require the establishing of a stable ownership structure for the main financial intermediaries. No progress was witnessed in terms of **infrastructural** liberalisation or privatisation in the past year. According to the European Commission, these restructuring processes appear to be too slow in all new EU members, particularly in the energy and natural gas sectors. The EBRD has particularly noted Slovenia's limited competition levels in the telecommunications sector, especially in land-line telephony. In terms of the **state's role** in setting the rules governing economic activity,

court backlogs continue to decrease quite quickly in general and also in the domain of land registries, yet backlogs continue to grow in the economically crucial area of executing and enforcing court orders. Antitrust policy remains institutionally weak. Regarding the management of economic resources, the trend of increasing public finance revenues has been stopped, but expenditure on wages and transfers continues to grow. The decrease in the government budget deficit after 2000 has been accomplished almost exclusively with an increase in revenues as a share of GDP – that is, by increasing the fiscal burden – which is a development that contradicts the SEDS' directives. Positive changes have occurred in the structure of government aid, although remaining weaknesses include an insufficient consideration of regional goals and a lack of support for aid that would directly follow regional developmental directions. The state's organisational and operational efficiency has improved in terms of the quality of both public institutions and the business climate.

Regional disparities in levels of economic development remain relatively low compared to other EU members, and they have stayed unchanged over the last few years. The disparity in GDP between the most and least developed regions has increased slightly, while differences in unemployment rates have been decreasing for some time. The most significant problems in both levels of development and

Table 1: **Overall evaluation of development achieved by areas**

AREA	IMPROVEMENT	WEAKNESSES
Sustainable increase in welfare	Narrowing gap in economic development; favourable outcome in social development.	Slow improvement in environmental development.
Changes in the economic structure (measured by the structure of GDP)	Gradual increase in the share of services.	Excessive share of industry; business and financial services lagging behind; slow changes in manufacturing towards higher value-added and technology-intensive production.
Macroeconomic stability	Strong economic growth; lower rise in consumer prices; balance of payments in equilibrium.	Public finance expenditures not developmentally oriented; economic growth could be stronger; increase in the fiscal burden; low rate of employment among younger and older workers.
Transition reforms	Business sector reforms pursued further, but still too slowly.	Slow reforms in the areas relating to the financial sector, antitrust policy, and economic institutions.
Knowledge-based society	Population's education level and enrolment; increased investment in research and development; Internet use.	Inferior efficiency and quality of education, institutional organisation of R&D activities; slowness of introducing competition in electronic communications, low level of firm innovation.
Economic competitiveness	Increase in productivity; increasing market shares in the most important foreign markets (albeit at a progressively slower rate).	Insufficient enterprise restructuring towards higher value-added and technology-intensive production; lack of long-run viability in current export structure; low level of entrepreneurship.
Financial sector	Creating conditions for raising the financial sector's competitiveness; growth of mutual funds.	Introducing efficient ownership structure in banks and insurance companies; capital market development.
Infrastructure	Increase in infrastructural investments.	Inefficient public companies in public water and municipal waste services; liberalisation of railway transport.
The state	Reduced court backlogs in the most important cases; halt in public finance expenditure growth; improved quality of public institutions and investment climate.	Court backlogs important for the functioning of economic subjects, antitrust policy, growth of wages and social transfers in public finance expenditures.
Regional development	Relatively low developmental disparities; decreasing disparities in unemployment rates.	Lagging development of the Pomurska region and increases in the lagging behind of the Zasavska and Savinjska regions.
Environmental development	Institution-building and implementation; organic farming; high share of renewable energy sources.	Energy intensity; increase in environmentally-unfriendly industries; agriculture intensity; emission of greenhouse gasses.
Social development	Social cohesion and poverty reduction; relatively low income inequality in general and between the sexes; completion of the majority of social protection reforms.	Slow preparation of health reforms; low employment rate among older workers.

Source: IMAD.

unemployment remain in the Pomurska region, while the development gap has increased in other regions, in particular the Zasavska and Savinjska regions. Central Slovenia is the most developed region, having already attained 98% of the EU-15 average.

Structural changes in economic development continue to negatively influence **environmental development**. The many recently passed environmental measures have thus failed to yield the desired results, an outcome largely resulting from a lack of co-ordination in economic and environmental development. Slovenia suffers from energy-intensive industries that are only slowly on the decline, an increasing share of environmentally hazardous industries, and an agricultural sector unusually (although decreasingly) reliant on fertilisers. Above-average results relative to the EU have been achieved in the areas of the environmental impact of traffic, organic farming and the use of renewable energy sources.

Favourable **social development** results have been achieved with increases in life expectancy and decreases in both income inequality and risk of poverty rates before and after social transfers. The resources dedicated by the state to the population's welfare have been gradually increasing – this applies, for example, to compulsory social, health and pension-disability insurance systems – but are still below the EU average, and individual indicators (e.g. the difference between risk of poverty rates before and after social transfers) indicate that the target effectiveness of transfers needs to be improved. The effects of pension reform can be seen in the increase in the retirement age and the decrease in the wage-pension ratio.

2. Meeting the Lisbon Strategy objectives

According to its ***achieved development results in terms of structural indicators*** based mainly on data for 2002 and 2003, on average Slovenia remains less developed than the EU average, and particularly so relative to the EU-15 average. It is, however, more developed than the average new EU member state. Slovenia is ahead of the EU average in individual indicators such as youth educational attainment, long-term unemployment rates, risk of poverty rates after social transfers, business investments and scale of freight transport. Slovenia lags behind the EU average according to general economic indicators in the realm of innovation and research activities, labour market indicators and environmental protection.

Regarding areas where it lags behind the EU, Slovenia has managed to reduce the developmental gap according to the general indicators of economic development (using the latest available data). Developmental gaps have expanded, however, in areas relating to the labour market, innovation and research activities and environmental protection. Labour market trends were considerably more favourable in 2004 than in 2003 so the developmental gap has actually also decreased.

The degree to which the Lisbon Strategy's individual goals are being fulfilled varies in Slovenia, as in other EU members. Slovenia has been successful in its goals of increasing female employment, Internet access, implementing directives from the Lisbon Strategy and increasing the share of renewable energy sources in

primary electricity use. Some of these goals have already been attained. Slovenia has been less successful in achieving other goals but, if the favourable trends continue, some goals seem realistic for the future. However, others continue to be unrealistic as progress in many areas – despite the positive trends – simply appears to be too slow, for example in employing older workers, raising the average retirement age, or increasing the level of gross domestic expenditure on R&D activity.

3. Conclusion

The Development Report is designed to monitor implementation of the SEDS' objectives and priorities through a system of indicators. As in the last three years, we find that the SEDS' goal of balanced economic, social and environmental development is not being realised in its entirety, in particular in the area of changing the economy's sectoral composition in which high value-added activities are only slowly increasing their market shares on one hand, and changes in the direction of more environmentally-friendly production are also too slow on the other. Slovenia's problems thus largely stem from its excessively slow transition to a free market which have resulted in a relatively low level of competitiveness and entrepreneurial initiative, factors which are the fundamental drivers of faster economic growth and development.

The reasons for the slow realisation of the priorities and structural changes can be found both within the business sector, which has been too slow to restructure and seek new business opportunities, as well as in the state's poorly co-ordinated and fragmented developmental policies. **The weaknesses of current economic, social and environmental development, as shown by the SEDS' system of indicators and the European Commission's structural indicators, should provide the basis for a new set of priorities in the new Slovenia's Development Strategy (SDS).** This Strategy should focus mainly on national objectives (while taking supranational objectives into account), with particular emphasis on rapid structural adjustment and achieving a reduction in the development gaps relative to the average development level of EU members (catching-up objectives) and improved recognition especially in areas where Slovenia enjoys comparative advantages against (current and new) EU members.

Assessing the role of the government through development results alone has at least two shortcomings. First, there is a time lag between when the government introduces new measures and when visible results arise from these changes. Second, another factor that should be assessed is the connection between the measures taken and results achieved as well as the flexibility of these measures in relation to the underlying conditions and changes. The co-ordination of measures should also be verified as certain measures can have both positive and negative effects (for example, some social measures may undermine the motivation to be economically active, or the promotion of dirty and energy-intensive industries may be detrimental to the environment). ***The main guidelines for improving the government's developmental role*** are to: (i) define the most important short-term actions and measures for each priority, including the clearly defined agents in the new SDS; (ii) break down and co-ordinate measures in the new National Development Programme; (iii) set up a

monitoring system for measures and their effects on the main components of development; and (iv) make regular reports on development results and the effectiveness of various measures.

Development Report

Editor in Chief:

Ana MURN

1. Development results

The new understanding of development outlined in the document **Slovenia in the New Millennium: Sustainability, Competitiveness, Membership in the EU** – Strategy for the Economic Development of Slovenia 2001-2006 (SEDS) – is described in two separate parts. The first part focuses on the long-term balanced development of the different, yet inter-related developmental components, presented in the new development paradigm. The second part of the document sets the course of economic development in the medium-run (until 2006) and provides measures to gradually bring Slovenia's development level and its economic structure closer to that of developed economies.

1.1. Balanced economic, social and environmental development

THE SEDS' OBJECTIVE: The developmental paradigm presented in the SEDS arises from an equal consideration of the economic, social and environmental dimensions of both welfare and sustainable development, ensuring that the needs of current generations are met without impeding the ability of future generations to meet their own needs. Sustainable development manifests itself in three ways: structurally (through three sources or components of welfare), temporally (through multiple generations), and spatially (by emphasising regional development). Based on Slovenia's progress in each of these three spheres of development, the SEDS gives priority to reducing the economy's development gap, which is to be achieved without increasing the relatively narrower gaps in social and environmental development.

FINDINGS: Slovenia's level of development is steadily increasing and Slovenia is gradually reducing the developmental gap relative to the EU-15 and EU-25 average. Economic development is still hindered by many structural problems which have even been expanding Slovenia's gap with developed countries in certain areas. As in the previous year, economic development was achieved concurrently with social development but with slower environmental development. Regional disparities remain largely unchanged.

ANALYSIS:

In terms of **economic development**, Slovenia is gradually closing its gap against the European average, as indicated by the synthesised indicators and individual analytical indicators. Based on one synthesised indicator, namely gross domestic product per capita at purchasing power standards (PPS)[1], Slovenia has attained significant economic progress in last seven years (1995-2003), as its development

[1] Purchasing Power Standard (PPS) is an artificial general reference value used in the EU to express the volume of economic aggregates. Economic volume aggregates in PPS are obtained by dividing their original value in national currency units by the respective purchasing power standards (currency conversion rates that eliminate the effect of different price levels). Since Purchasing Power Standards are statistical calculations which are the result of some conceptual assumptions, methodological determinations and derivation procedures, they can be used with an assumed error level of 5%.

level has moved from 61 to 71 percent of the EU-15 average. After the decrease in the EU average due to the entry of new members (GDP per capita at PPS in the EU-25 is 92 percent of the EU-15 average), Slovenia reached 77 percent of the average in the EU-25 and thus exceeded the threshold for the least developed regions (countries) in the EU.[2] Among the EU-15, Slovenia has surpassed Portugal in terms of economic development but remains behind Greece, which lagged behind Slovenia during the 1999-2001 period. Amongst the new EU members, only Cyprus is better than Slovenia (with 83% of the EU average). Slovenia's development pace exceeded that of the EU during the 1995-2001 period but remained behind the development pace achieved by the new EU members Estonia, Latvia, Lithuania and Hungary.

Similar results can be found by examining the analytical indicators (Table 2) which, in addition to the indicator for economic development, point to developmental imbalances in different areas that reflect the progressively exacerbating structural problems. Labour market indicators, which showed a drop in employment and an increase in unemployment for 2003, have improved considerably for 2004.

In terms of **social development**, measured by the synthesised human development index,[3] the new figures for 2002 yield positive changes from previous years. In 2002, Slovenia received both a higher index value and a higher rank (going from 29th to 27th amongst 177 countries). The values of the sub-indexes that form the basis of the human development index also increased; the greatest positive change occurred in the education subindex, with somewhat lower increases in the subindex of GDP at PPP. Slovenia's lowest subindex rank (in 33rd place) comes from life expectancy. A comparison with the EU-25 indicates that Slovenia ranks below Portugal (26th place) but above all other new EU members. It is followed by Cyprus, Malta and the Czech Republic (ranking from 30th to 32nd places, respectively). Other countries from the group of new EU members have steadily increased their index values, although not quickly enough to increase their rank. Social development is described in even greater detail by the analytical indicators (Table 2), which indicate slow yet steady development and a decrease in poverty hazard rates.

The **environmental development** and long-term goals of the SEDS for the current year are again described not with a synthesised indicator[4] but with a collection of partial indicators (Table 2). As in the previous year, Slovenia still suffers from a high, albeit slowly decreasing, energy intensity, as well as excessive fertiliser and

[2] Individual EU members' levels of development range from 40% to 215% of the EU average. New EU members are much less developed, on average, than the EU-15 and achieved 53% of the EU average.

[3] The Human Development Index (HDI) is a measure of development that, despite some methodological limitations, most broadly presents a country's level of social development. The HDI is comprised of subindices that reflect various aspects of a country's development. The chosen subindicies are not optimally selected. For example, measures of the quality of life might improve the poverty index but these are only calculated for 17 OECD countries. The education subindex is also increasingly criticised for its failure to account for the difficulties of comparing schooling systems and its lack of insight into actual literacy.

[4] Two synthesised indicators have been used thus far in previous Development Reports. In the first Report (Development Report, 2002), a special index for balanced development was used. Although it is a good statistic its complexity (it comprises around 150 indicators) makes its use in every report impractical. The index of balanced development was replaced by an index of genuine savings in previous reports (Development Report 2003, 2003) but it has been since omitted because it is a relatively poor proxy for environmental development.

Table 2: **Development indicators**

Development indicators	Unit	2000	2001	2002	2003	2004
1. ECONOMIC DEVELOPMENT						
Gross domestic product per capita in purchasing power standards	EU = 100	73	75	75	77	-
Gross domestic product growth	Real annual growth (%)	3.9	2.7	3.3	2.5	-
Unemployment rate	Labour force survey (%)	7.0	6.4	6.4	6.7	6.3
Employment rate	Labour force survey (%)	62.9	63.9	63.4	62.5	65.6
Educational attainment structure of people in employment	Average number of school years according to the labour force survey	11.4	11.4	11.5	11.6	-
Population with a completed secondary education	Population aged 25-64 with a completed secondary education (%)	75.5	76.2	77.5	78.3	-
Researchers	Number of researchers per thousand labour force	4.5	4.6	4.7	5.0	-
Public education expenditures	Public expenditures as a % of GDP		6.1	6.0		-
R&D expenditure	Gross expenditure on R&D as a % of GDP	1.44	1.56	1.53	1.53	-
Labour productivity	GDP growth per employee (%)	3.1	2.2	3.7	2.8	-
Unit labour costs	Rise in labour costs per unit of GDP (%)	3.2	0.1	-2.0	-0.5	-
Market share	Share of exports/imports in the main trading partners (%)	0.478	0.500	0.528	0.531	0.541
Composition of merchandise exports according to factor intensity	High-technology-intensive products (%)	15.3	15.9	16.5	18.1	17.6
Gross fixed capital formation	As a % of GDP	25.1	24.5	23.3	23.9	-
Foreign direct investment	Inward investment as a % of GDP	15.1	13.5	16.9	20.7	-
Total assets of banks	Assets as a % of GDP	75.1	81.4	85.7	88.0	-
Insurance premiums	As a % of GDP	4.6	4.9	5.1	5.2	-
Market capitalisation	As a % of GDP	16.6	17.9	23.2	23.3	-
2. ENVIRONMENTAL DEVELOPMENT						
Share of dirty industries in manufacturing	Index of production volumes growth in dirty industries	108.2	105.4	104.8	107.6	111.8
Energy intensity	Primary energy consumption (toe/mill. EUR)	332.8	336.7	333.5	327.6	-
Renewable sources	Renewable sources in total primary energy consumption (%)	11.9	11.7	11.2	10.8	-
Environmental impact of transport	Road transport in total freight transport in tkm (%)	64.8	65.8	65.8	65.8	-
Agricultural intensity	Use of NPK fertilisers (kg/ha)	172.3	166.4	162.3	155.9	-
Tree-felling intensity	Removal relative to wood increment (%)	38.0	37.7	37.3	41.2	59.2
3. SOCIAL DEVELOPMENT						
Human Development Index	Index value	0.879	0.881	0.895	-	-
Life expectancy	Men, number of years	71.9	72.1	72.3	73.2	-
Infant mortality	Per 1000 live-born children (%)	4.9	4.2	3.8	4.0	-
Poverty	Population in jobless households (%)	10.1	9.9	8.1	-	-
Poverty risk	Risk of poverty rate after social transfers	13.0	12.9	11.9	-	-
4. REGIONAL DEVELOPMENT						
Variation of gross domestic product across regions	Coefficient of variation (%)	23.9	24.4	25.0	-	-
Variation of unemployment across regions	Coefficient of variation (%)	31.2	33.5	34.8	33.9	30.7
5. NATIONAL COMPETITIVENESS						
National competitiveness - Growth Competitiveness Index	Index value		4.70	4.64	4.70	4.75

Source of data: Development indicators.
Notes: These results are discussed in the section above, and explained in greater detail in the Analytical Appendix. Some data for 2003 and 2005 are preliminary. An empty box indicates statistics are unavailable.

pesticide use in agriculture, which is also decreasing. The share of road transport in freight transport is still relatively small and has remained constant for three years. Renewable energy use has declined marginally, while the tree-felling intensity increased slightly.

The adoption of various measures for reducing pollution only constitutes the first step to a cleaner environment; larger changes can only come about with a structural shift towards more ecologically-friendly production technology and products.

Regional disparities[5] measured by GDP per capita at PPS are relatively small and increasing very slowly. The coefficient of variation[6] indicates that these differences increased by 1.1 p.p. between 2000 and 2002, from 23.9% to 25%, and remained relatively low by international standards. According to an international comparison of the variation coefficients for 1995-1999 (using the old methodology[7]), Slovenia recorded one of the lowest regional disparities in the EU (placing it alongside Sweden, Greece and the Netherlands). In 2003, the previous trend of growing regional disparities in unemployment was reversed. From 2002 to 2004, the variation coefficient fell from 34.8% to 30.7%.

1.2. Changes in the economic structure[8]

THE SEDS' OBJECTIVE: The SEDS does not deal with sectoral policies directly. It does, however, point to some basic changes in the production structure of GDP expected to be brought about by Slovenia's economic development and its integration with the EU. At the same time, the SEDS takes into account globalisation processes, the integration of European markets, intensive technological progress, and the transition to a knowledge-based society.

THE REPORT'S FINDINGS: Analysing the structure of gross value added during the 1995-2003 period reveals a drop in the proportion of agriculture and a rise in the proportion of services. Compared to the EU, Slovenia had a relatively higher proportion of industry (mining, manufacturing and energy) and a smaller proportion of services in 2003, and the disparity between the economic structures of the two increased from 1995 to 2003. An alarming fact is that the development gap in Slovenia is greatest in the proportion of financial and business services. In addition, the proportion of knowledge-intensive market services in Slovenia was much smaller than in the EU-15 in 2000 (the latest year for which data are available). A positive trend was witnessed in manufacturing where the proportion of technologically-

[5] Regional development is presented separately in Section 3.4.: Balanced regional and spatial development.

[6] The coefficient of variation is defined as the ratio of the standard deviation to the average, and this calculation is modified to take a region's size into account.

[7] We expect that a comparison using the revised methodology for calculating GDP would reveal a similar relationship between Slovenia and other EU members.

[8] Changes in the economic structure can be monitored from different points of view. This chapter focuses on changes in the production structure of gross domestic product which, however, does not reflect all important structural changes in the economy. Some of these other aspects are discussed in other sections of the Report (changes in merchandise exports according to factor intensity, electricity use etc).

advanced sectors increased in 2003. The structural changes in these sectors were considerably greater than in previous years; however, they remain too slow from the point of view of increasing the gross value added.

ANALYSIS: The past ten years have witnessed an increase in services and a decrease in agriculture in the **structure of gross value added**, with the share of industry remaining relatively constant. The share of agriculture in total value added in the Slovenian economy fell by 1.7 structural points, while services rose by 1.9 structural points, to 63.1% of total value added in 2003. The share of industry decreased by 0.3 structural points which is mainly associated with the declining economic importance of mining (which edged down by 0.5 of a structural point). While the share of manufacturing decreased only by 0.1 of a structural point, the structure within this industry changed markedly. The share of construction grew (by 0.3 of a structural point), an increase largely attributable to increased motorway construction. The share of agriculture decreased in 2003 from the previous year (due to unfavourable weather), while the share of industry increased.

Compared to the EU, Slovenia has a considerably larger share of industry and a smaller share of financial and business services. In 1995, the proportion of industry was 6.4 structural points higher than the comparable figure in the EU-25, a difference which grew to 9 structural points by 2003. Conversely, Slovenia has a considerably smaller share of financial and business services: it lagged behind by 5.8 structural points in 1995, a difference which increased to 7.1 structural points by 2003.

In 2000, the **proportion of knowledge-intensive market services**[9] in Slovenia was considerably lower than in the EU-15 (Figure 1). These accounted for only 14.5% of total value added, while the comparable figure for the EU-15 was 18.7%. The difference is largely attributable to the relatively undeveloped business services sector, in which Slovenia lagged behind the EU-15 by 3.9 structural points.[10]

In 2003, the **manufacturing sector** saw accelerated structural changes after the relatively slow changes during the 2000-2002 period.[11] Calculations indicate that

[9] The OECD defines knowledge-intensive market services based on input-output tables, data on R&D and composition of workforce skills by activity. Using the OECD methodology, knowledge-based market services include the following SIC codes: division 64 (Postal and telecommunication services), divisions 65-67 (financial intermediaries), and divisions 71-74 (business services excluding real estate services).

[10] Internationally comparable statistics for later years are unavailable but we estimate that the gap had not decreased by 2003 (indeed, it may have grown). The disparity in the share of business and financial services (which contributes the most to knowledge-based market services) between Slovenia and the EU-15 grew further in the 2000-2003 period. It should be noted that the lower share in Slovenia may also have resulted from a lower propensity to outsource these services.

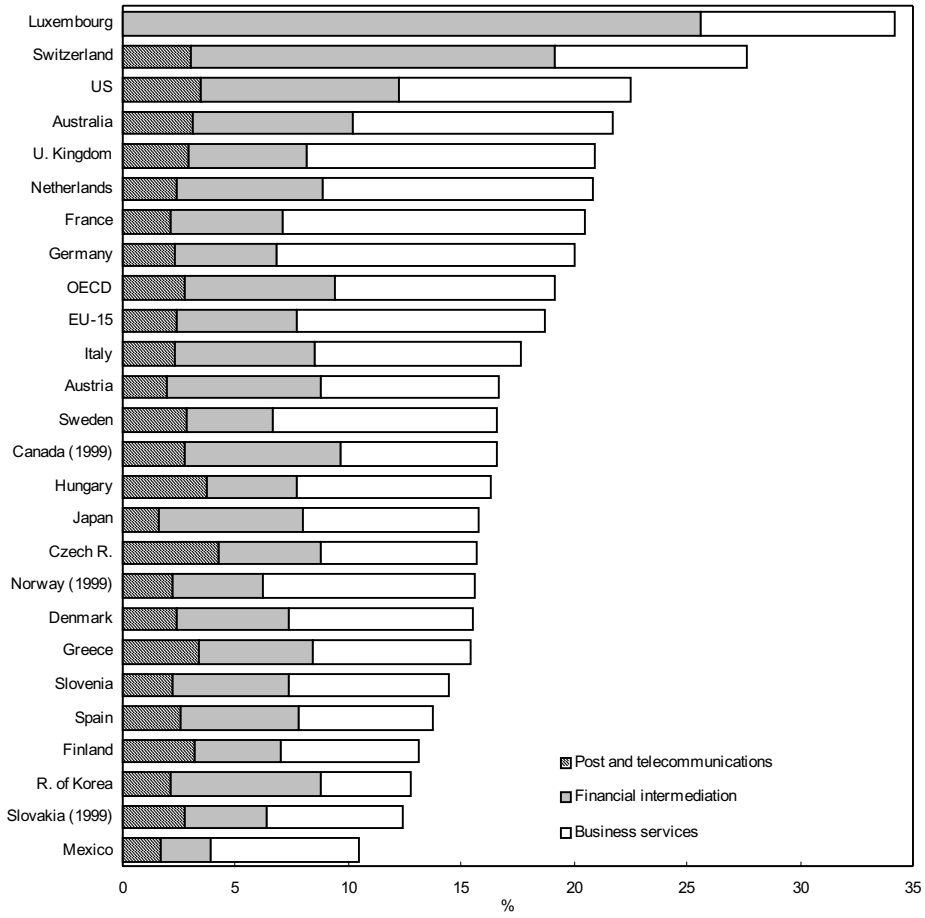
[11] The indicator of the intensity of structural changes (Landesmann, 2000, p. 21): *(S)* reflects the dynamic adaptive abilities and mobility of the factors of production for individual manufacturing sectors in a certain time period.

$$S = \sqrt{\sum_{i=1}^{m} \left[\left(sh_{i,t+k} - sh_{i,t} \right)^2 \cdot \left(\frac{sh_{i,t}}{100} \right) \right]}$$

sh_i: share of the i-th of m sectors in total value added or employment in manufacturing (which was divided into 14 sectors according to the SIC codes)

t: base year or period; $k = 1 \ldots\ldots n$

Figure 1: **Share of knowledge-intensive market services in total value added, in 2000**



Source: OECD, Technology and Industry Scoreboard, 2003.

the restructuring intensity in the manufacturing sector, measured by changes in the employment structure and value added, were at a very low level during 2001 and 2002 (with indicator values of between 0.14 and 0.33).[12] In 2003, however, the process of structural adjustment intensified (the indicator value, measured by changes in the structure of value added, increased to 1.02, although the comparable figure measured by changes in the employment structure did not significantly deviate from the average of previous years).

In 2003, the share of technologically advanced sectors grew. Using the established OECD methodology for measuring the distribution of industries by technological advancement (Hatzichronoglou, 1997, pp. 6-23), we find a marked increase in the

[12] If the value of the indicator is low (close to zero), the intensity of structural changes in manufacturing is low during the relevant time period. Conversely, the higher the indicator value the more intense the structural changes that are taking place.

share of high- and medium-high technology industries (from 37.6% in 2002 to 40.4% in 2003). The share of medium-low technology industries remained at 26.4% in 2003, the same level as in the previous year; while the share of low-technology industries dropped by 2.5 structural points in 2003 compared to the previous year, to 33.3%. The changes were to a large degree induced by a considerable increase in the share of chemicals and chemical products, which are within the first group, along with a concurrent decrease in the proportion of man-made fibres, paper and publishing as well as textiles and leather goods, which fall into the low-technologically category.

Changes in the employment structure by industry for the manufacturing sector based on technological advancement were not as favourable. The share of high and medium-high technology industries was 31.9% in 2003 and improved by only 0.7 of a structural point over the previous year, the share of medium-low technology industries remained at the level of the previous year, 27.4%, while the share of low technology industries decreased to 41.7%, a decrease of 0.9 of a structural point from 2002.

2. Preconditions for implementing the development strategy

According to the SEDS, the preconditions for implementing the development strategy include ensuring macroeconomic stability and completing institutional reforms. The first is implemented through classical macroeconomic (monetary, wage and fiscal) policies, while the second requires the establishing of a functional market economy.

2.1. Macroeconomic stability

THE SEDS' OBJECTIVE: Basic macroeconomic stability is a fundamental requirement for effectively achieving the SEDS' objectives. Achieving it requires addressing the classical monetary, revenue and public finance policies of macroeconomics. Monetary policy's main goal must be to gradually reduce inflation to a level suitable for integration into the Economic and Monetary Union. According to basic macroeconomic constraints and the broad guidelines of the EU's economic policies, the goal of wage policy must be to keep real growth in the gross wage per employee below the rate of labour productivity growth, which should help reduce inflation and create conditions for firms to increase their investment in technology, markets and human capital, leading to improved competitiveness and higher employment. Fiscal policy's strategic goal must be to restructure general government revenue and expenditure, which should help boost the economy's competitiveness and bring public finances into balance without increasing the share of expenditure in gross domestic product in the medium term.

THE REPORT'S FINDINGS: Real GDP growth improved in 2004 and reached 4.5% in the first nine months compared to the same period in 2003. It was driven by export activity and further growth in domestic consumption. This strong growth had a positive impact on labour market conditions. These favourable trends occurred in a stable macroeconomic environment. The co-ordinated macroeconomic policies of the government and the Bank of Slovenia, particularly regarding stabilisation of the exchange rate after entrance to the ERM II, helped further dampen the growth in consumer prices which decreased from 4.6% to 3.2% during the course of 2004. The current account deficit increased slightly and both exports and imports grew at a higher rate than before. The government deficit reportedly remained stable in 2004 relative to 2003. The labour market witnessed a shift in the structure of registered unemployed, with an increase in the proportion of first-time job-seekers and women.

In 2004, economic activity began to accelerate again after several years of relatively slow growth that had coincided with the unfavourable international economic conditions. **Real gross domestic product (GDP) growth** reached a year-on-year rate of 4.5% in the first three quarters of 2004 (compared to annual growth of 2.5% in 2003), driven by a higher export rate and sustained growth in domestic consumption. The boost in export growth was influenced by one-off factors prior to EU accession, a trend which was further reinforced by renewed economic growth

in the EU. The former trend can be gleaned from examining the quarterly export dynamics as export growth was highest prior to entry to the EU – in the second quarter – with a year-on-year rate of 13.7%. At the same time, the high level of export activity which persisted in the third quarter reflects the positive effects of improved international economic conditions in 2004. In this context, it was somewhat disturbing that economic growth in several key trading partners (Germany, Italy) was rather slow despite an increase over 2003. The favourable international economic trends were accompanied by positive trends in Slovenia. The strongest growth in investment was recorded among investments in equipment and machinery as well as housing, with the latter mainly being due to the anticipated effects of the conclusion of the first National Housing Savings Scheme. Investments in highway construction also remained high. The growth in domestic consumption was also aided by the increased availability of bank credit, due to both lower interest rates and changes in the monetary policy of the Bank of Slovenia after entry to the ERM II, during which Slovenian banks have gradually begun to lower the share of central bank notes in their portfolios (a trend previously associated with the sterilisation of currency inflows and depreciation of the tolar).[13] Fastest growth was recorded in long-term, tolar-denominated household loans and foreign currency loans to enterprises from domestic banks. The structure of domestic consumption exhibited some one-off effects associated with favourable expectations arising from EU entry as well as changes in the foreign trade and tax regimes, which were reflected in the contribution of inventory growth to the growth of GDP. However, based on the data available for 2004 the lower nominal interest rates did not lead to excessive growth in domestic consumption. Since nominal interest rates fell concurrently with inflation, the changes in real interest rates were relatively small. Moreover, the non-interest-rate costs associated with borrowing remained high and the slow growth in consumption was also the result of the sluggish growth in the real wage rate, which grew by just 2 percent in 2004.

Trends in the labour market in 2004 followed the favourable general trends, with higher economic growth enabling an increase in employment and a decrease in unemployment. The **employment rate** thus grew from 62.5% in 2003 to 65.6% in the second quarter of 2004. The **unemployment rate according to labour force surveys** fell from 6.7% in 2003 to 6.3% in the second quarter of 2004, while the **registered unemployment rate** dropped from 11.2% to 10.6%. The business services sector posted the highest growth in employment, and relatively strong increases also occurred in the public administration, health, financial intermediaries, education and agricultural sectors, while the rate continued to fall in industry and transportation. In manufacturing, the decrease in employment was most pronounced in labour-intensive sectors and sectors most affected by entry to the EU (textiles, leather products, and food processing), while the increase occurred mainly in sectors where sales to foreign markets grew significantly (vehicle manufacturing, machinery, rubber and plastic products, with somewhat lower growth in the chemicals sector). In addition to the favourable economic conditions, the fall in unemployment was significantly influenced by active employment policies focusing on unemployed people with poor employment prospects, enabling a positive change in the structure

[13] Jazbec and Masten (2004) also point this out in their paper 'The Development of the Slovenian Banking-Financial Sector through the Viewpoint of Entry into the EMU: Expected Effects on Macroeconomic Stability and Economic Growth.'

of the unemployed. This lowered the share of older and long-term unemployed workers as well as the share of the uneducated, with the latter being attributable to educational programmes for the unemployed.

The favourable economic trends occurred within a stable macroeconomic environment largely resulting from the co-ordinated macroeconomic policies of the government and the Bank of Slovenia, which were adopted in November 2003 based on guidelines from the Programme for Entry to the ERM II and Adoption of the Euro. The stable macroeconomic environment and credibility of Slovenia's projected economic policies enabled its early entry to the ERM II exchange stabilisation mechanism in the first group of countries (alongside Estonia and Lithuania) in June, 2004. One of the key achievements of its macroeconomic polices in 2004 was the further cutting of **inflation**, a decrease which began in earnest in 2003. By the end of 2004, the rise in the consumer price index was 3.2 percent – a growth rate that was 1.4 p.p. lower than in 2003. In 2003, the lower inflation rate resulted from actions taken in the areas of price regulation and fiscal policies; in 2004, the further fall in inflation resulted mainly from stabilisation of the tolar upon entry to the ERM II. The government concurrently began implementing the Plan for the Increase of Administered Prices in 2004 and 2005 as well as co-ordinated changes in fiscal burdens. In contrast to 2003, the primary goal of price regulation policy – to ensure that growth in regulated prices is in line with the growth of unregulated prices – was not achieved. Regulated price growth outpaced the growth of other prices mainly due to external factors (growth in global oil prices). The government attempted to cushion the negative influence of these factors by counter-cyclically adjusting excise duties; thus, the higher oil prices[14] contributed relatively less to inflation than they otherwise would have. Further, entry to the EU and the ERM II favourably influenced inflationary expectations, as did lower food prices due to the abolition of tariffs upon entry to the EU – this effect was on the upside of what was expected. Sustaining the co-ordinated macroeconomic policies will be key to the further lowering of inflation in 2005 and for approaching the Maastricht convergence criteria in the Euro adoption reference period.

The **current account of the balance of payments** increased in 2004 (to EUR -179 m), but remained under one percent of GDP. The continued growth of exports in the second half of the year indicates that the stabilisation of the exchange rate did not have a negative influence on export trends, while the continued low current account deficit indicates that the central exchange rate between the tolar and the euro that was determined upon entry to the ERM does not deviate significantly from the equilibrium rate. **Gross external debt** increased by approximately EUR 1.5 bn during the first nine months of 2004, which is approximately 50% more than in the same period in 2003. As in previous years, a large share of this debt can be attributed to banks' borrowing from abroad and subsequently using these funds for foreign-currency denominated loans to domestic enterprises. Liquidity and solvency indicators deteriorated compared to 2003 to a level comparable to that in 2001; the country's position as a net debtor worsened as well, with the net position of the banking sector worsening but the net debtor position of enterprises and other non-banking sectors posting moderate improvements.

[14] Higher oil and transport/heating fuel prices contributed 1.0 p.p. to inflation in 2004, amounting to 71% of the total increase in regulated prices.

According to preliminary estimates, the **government sector deficit** – which had decreased from 3.4% of GDP in 2000 to 2.0% in 2003 – did not change significantly in 2004 (amounting to 1.9% of GDP). Calculations from the IMAD's macroeconomic model indicate that, in addition to the significantly higher economic growth compared to 2003, the outcome resulted from changes in several macroeconomic factors, especially an inflation level that was much lower than projected in the Budget memorandum. Macroeconomic outcomes – differing significantly from those projected in the Budget memorandum – influenced mainly budget revenues, while budget expenditures – of which 80% to 90% are already determined by law – cannot be modified as easily to adapt to changes in macroeconomic outcomes. The share of total government expenditure remained at a level similar to that in 2003 (48.2% of GDP according to the ESA 95 methodology), while the share of revenues (46.1%) decreased slightly. A significant part of the decrease is attributable to the reduced revenues from customs tariffs associated with Slovenia's entry to the EU and the slower growth in revenues from mandatory social security contributions, which followed the wage growth in 2004. Moreover, revenues from excise duties and corporate income tax increased in 2004 relative to GDP.

The **general government debt** increased marginally in 2003 (as it did in 2002) due mainly to growth in the debts of direct users of the government budget and government funds, but also due to the greater indebtedness of local governments and social security funds. Further, the gross public debt decreased by 0.1 p.p. in 2003, to 29.4%. In 2003, the structure of government debt financing continued to change. Thus, the share of loans in 2003 decreased while the share of securities increased. The share of financing instruments with a fixed interest rate continued to increase, as did the share of tolar-denominated debt.

2.2. Completion of institutional reforms from the transition period

THE SEDS' OBJECTIVE: As a result of uncompleted institutional reforms from the transition period, Slovenia continues to exhibit excessive direct political interference in the economy and an over-regulation of particular sectors of the economy and the labour market. These circumstances allow the implementation gap[15] *to persist. In order to complete institutional reforms from the transition period, the SEDS envisaged completing the necessary transition reforms in the corporate and financial sectors, along with reforms of public utilities, the labour market, the pension system, as well as in regional policy and areas where gaps were identified.*

THE REPORT'S FINDINGS: Slovenia has been relatively slow to implement transition reforms and it was not until the late 1990s that the government managed to partly catch up with countries that have been the fastest to adopt reforms. The pace of reform has again slowed in recent years and thus some remain unfinished. No progress was achieved in this regard in 2004. The need for reform remains most urgent in the non-banking financial sector and legislation relating to competition.

[15] The implementation gap is the difference between the formally adopted measures and their actual implementation, that is the difference between the formal and actual influence of various social players.

The slow pace of reforms is also reflected in the competitiveness of the economy, in which incongruent developments threaten the relatively positive progression of the reforms.

ANALYSIS: An analysis of the individual indicators used to calculate the **transition index**[16] (Table 3) indicates that Slovenia's *main backlogs* remain in reforms of the non-banking financial sector and competition policy, with somewhat better results being seen in the privatisation of large enterprises and institutional reforms in the business sector. From 2000 to 2003, the index recorded progress in the areas of price liberalisation and business sector reform. There was no progress in 2004, however. Levels corresponding to values for market economies (the highest value of the index) were achieved in international trade liberalisation and the exchange rate system, as well as in the privatisation of small enterprises where the transition processes was almost completed by 1995.

A comparison of the *average annual transition index* (the non-weighted arithmetic mean of the nine indicators) between the eight most advancing transition economies[17] shows that, in 2004, Hungary's index value of 3.8 was closest to levels characteristic of market economies while Slovenia's value of 3.4 was the farthest away. In 2001

Table 3: **Values of the EBRD indices for Slovenia**

	1991	1995	2000	2003	2004
Price liberalisation	3.0	3.0	3.3	4.0	4.0
Exchange rate system and trade liberalisation	3.0	4.0	4.3	4.3	4.3
Privatisation of small enterprises	3.0	4.0	4.3	4.3	4.3
Privatisation of large enterprises	1.0	2.7	3.0	3.0	3.0
Reform of the corporate sector	1.0	2.7	2.7	3.0	3.0
Competition policy	1.0	2.0	2.7	2.7	2.7
Reform of the banking sector	1.0	3.0	3.3	3.3	3.3
Reform of non-banking financial institutions	2.0	2.7	2.7	2.7	2.7
Infrastructural reform	-	1.7	3.0	3.0	3.0
Legal extensiveness[1]	-	-	4.0	-	-
Legal effectiveness[2]	-	-	3.7	-	-
AVERAGE OF ANNUAL VALUES OF EBRD INDEXES	1.9	2.9	3.4	3.4	3.4

Source: EBRD Transition Reports 2000, 2002, 2003 and 2004.
Notes: [1]the indicator shows to what degree the legislation meets minimum international legal standards; [2]theindicator shows to what extent legally acknowledged rights can be realised through legal proceedings. No data are available for these two indicators for 2003 and 2004.

[16] The European Bank for Reconstruction and Development (EBRD) has been measuring transition reform progress in 27 countries since 1994 with its special transition index. The transition index uses eleven indicators to cover six main reform areas: liberalisation, privatisation, enterprises, infrastructure, financial institutions and the legal environment. Each indicator is a synthesised assessment of progress made in a particular area, established on the basis of various data, descriptive information and analyses. The indicator values range from 1 to 4, where a plus or minus sign can be added to the basic value. In this case, a value of 0.3 is added to or subtracted from the basic value for the purpose of quantitative analysis. An index value of 1 means that a country is still at the level of a centrally-planned economy in the given area of transition; an index value of 4.3 means that a country has achieved the level of a market economy.

[17] The comparison includes the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovakia, and Slovenia.

Slovenia was ahead of Slovakia, Lithuania and Latvia, but these countries stepped up their reform efforts considerably and overtook Slovenia as a result. Slovenia has recorded the relatively slow pace of reforms throughout the transition period. It has been behind Hungary and Poland since the start of the transition in terms of the achieved level of reforms and it has lagged behind Estonia since 1994. It overtook Slovakia in 1997 and reached the level of the Czech Republic and the average of all eight countries in 1999. However, all countries overtook Slovenia in the last four years in terms of the level of completed reforms.

While synthesised indicators have the benefit of enabling international comparisons, their composite nature means that their weighting of the various indicators may be questionable. Hence, it is necessary to **further discuss necessary reforms, especially those with a strong impact on competitiveness**. In order to improve the economy's competitiveness, Slovenia needs to address several of its weaknesses, particularly those singled out by the European Bank for Reconstruction and Development – namely, reforms relating to the non-banking financial sector, competition policy and those addressing the inefficiency of the judicial system (EBRD, 2004, p. 178). The key reforms are classified into four groups.

The first group comprises *reforms in the areas of liberalisation and privatisation,* with particular reference to the drawbacks of slowly privatising large state-owned firms, banks and insurers and the high proportion of prices that are regulated (according to the EBRD and IMAD[18] the proportion of regulated prices in the consumer price index amounts to 18% and 16.1%, respectively). The second group consists of *reforms of the business and competitive environment*, where tax reform and other potential ways of improving competitiveness are considered improvements, and the main barriers mentioned include the lengthy procedures for registering new businesses and deleting bankrupted businesses from the registers, as well as high business registration costs which are even above the OECD average. The third group comprises *reforms liberalising network industries*, in which particular warning is given to the slowness of the energy sector's liberalisation process and the distorted price of electricity, which is much lower for large, energy-intensive state users than for other users. The considerable progress in liberalising the telecommunications sector is viewed positively but the report notes the limited degree of competition – especially for land-line telephony – and the fact that prices are determined independently of actual costs. The fourth group consists of the *social sector*, in which Slovenia is mentioned as preparing a health insurance reform in the 2003-2004 period. The EBRD notes the financial goal of the reforms (eradicating the deficit and stabilising healthcare expenditures to 9% of GDP), changes in the contributions for voluntary health insurance, and a change in the payment policy of hospitals. The last change is already being implemented.

Institutional reforms are also partially reflected by **national competitiveness**, measured by the WEF[19] index of growth potential and business competitiveness (WEF Global Competitiveness Report 2003/2004). In terms of growth potential, Slovenia's rank, despite a faster growth rate of its index value than the EU-25 and

[18] Spring Report 2004, 2004, p. 89.

[19] World Economic Forum.

EU-15, has fallen for two consecutive years, but by one place less in 2004 than in the previous year. Amongst EU members, Slovenia is more competitive than Lithuania, Hungary, Greece, Cyprus, the Czech Republic, Slovakia, Latvia, Italy and Poland. Slovenia's rank on the index of business competitiveness also fell and, amongst EU members, it ranks higher than the countries listed above, as well as Malta and Portugal. For the second consecutive year, the difference between the ranking of business competitiveness and GDP adjusted for PPS has increased, which the WEF interprets as placing Slovenia in a position in which the microeconomic fundamentals cannot support the attained level of income.

The drop in Slovenia's growth potential ranking in 2004 is the result of lower values of the indices for technological competitiveness and the macroeconomic environment. Slovenia is ranked among peripherally innovative countries according to the technological competitiveness index, a ranking substantiated (in terms of indicators) by its low levels of foreign direct investment and technological transfers, inadequate technology policies, low competition levels for Internet services, poor government promotion of information-communications technology, and inadequate technology absorption amongst businesses. The deterioration of the macroeconomic environment can mainly be explained through the potential inefficiency of public expenditures, termed 'government waste' by the WEF.[20]

[20] Government waste comprises three components: the scale of subsidies negatively affecting competitiveness; the extent of public resource redistribution; and the degree of public trust in the financial integrity of politicians (Development Report 2004, 2004).

3. Mechanisms for implementing the development strategy

A common feature underlying the mechanisms for implementing the development strategy is the concept of complex national competitiveness. The SEDS sets out the following main mechanisms for improving complex national competitiveness based on structural and developmental policy guidelines in the following fields: (i) transition to a knowledge-based society; (ii) boosting the economy's competitiveness; (iii) state efficiency; (iv) effective integration into the EU's single market; and (v) balanced regional and spatial development.

3.1. Transition to a knowledge-based society

THE SEDS' OBJECTIVE: A knowledge-based society is characterised by a number of interrelated factors. They refer mainly to the creation and diffusion of knowledge to all spheres of the economy and society: for example, investing in education, research, technological development and innovation, transfer of research results into practice, using information and communication technologies. Only when the above factors are developed parallely can Slovenia become a knowledge-based society in the long run and, thus contribute to the sustainable development outlined in the SEDS.

THE REPORT'S FINDINGS: The achievements in the development of a knowledge-based society show that although Slovenia has made progress in some areas (e.g. considerably higher enrolment levels in tertiary education, the business sector's R&D expenditure, access to the Internet), the gap in regard to the EU-15 has only been narrowing slowly. These modest shifts suffice neither for ambitiously closing the gap vis-à-vis advanced countries nor for swiftly modernising the economy, a fact especially evident in the low levels of innovative activity in enterprises and consequently in patent applications, where Slovenia's gap relative to the EU average is massive. The main deficiencies in the areas of education and training relate to its efficiency and quality, although the improvement of quantitative indicators has also been too modest. Unfinished institutional reorganisation and reforms in R&D, combined with sluggish implementation of the new regulations in the electronic communications market, are further hampering the move to a knowledge-based society. If such trends continue, especially considering the low innovation activity of enterprises, Slovenia's developmental prospects in the enlarged European Union will be jeopardised.

ANALYSIS: The **population's education and proficiency levels** are the two key drivers for building a knowledge-based society. They are both interrelated with and dependent on other complementary factors such as investing in research and technological development, transferring research findings into practice, innovation, and the extensive use of information technology. Human resources, whose development is largely underpinned by education and training, are the basis of all developmental change. Knowledge (education) has become the key development

factor of the 21st century. Many experts believe that education and training is the only possible response to the challenges posed by modern technological and structural changes and the population's ageing since only lifelong learning can ensure active ageing. Slovenia appears well above the European average in this regard: 15.1% of the adult population in 2003 were involved in education and training, according to Eurostat's most recent survey, comparing favourably with the EU average of 9% and the 12.5% target set by the Lisbon Strategy. Since these data are not methodologically comparable with figures for the period prior to 2003, we cannot conclusively say that Slovenia has made any substantial progress. However, preliminary results obtained by the Slovenian Institute for Adult Education indicate that relatively modest headway has been made.

With the increased involvement of youth in secondary and tertiary education, the **education structure of the labour force** is slowly improving although the progress since 2000. However, improvement measured by the average number of schooling years has been modest. Workers with a tertiary education most often find jobs in education and public administration. Slovenia has a relatively high share of adults with secondary education, while it lags behind in the share of the population with a tertiary education, which econometric analyses of economic growth factors (e.g. Gemmell, 1996) often identify as a vital development indicator. Slovenia's share of the adult population (those aged 25-64) with a tertiary education stands at 17.7%, compared to the EU-15 average of 21.2%. In this regard, the USA – in which 38.1% of adults have completed tertiary education – is considerably ahead of the European Union where countries with the highest recorded shares are Finland and Sweden (33.2%), Denmark (31.9%) and the UK (30.6%) (EIS, 2004, p. 11). Although the number of students (both full-time and part-time) per 1000 inhabitants has climbed to over 50, high drop-out rates and prolonged study durations are still a major problem in Slovenian tertiary education. Enrolment figures indicate that the progression rate from 1st to 2nd year standing ranged from 60% and 68% in the 1991-2001 period (Zgaga, 2004, p. 44), pointing to the relatively poor cost-effectiveness of tertiary education. Contrary to common estimates, the share of Slovenia's public expenditure in this area is in fact relatively high (1.36% of GDP, i.e. at the average EU level). The problem of protracted study durations was also addressed by Bevc and Ložar (2001) who, applying a longitudinal analysis, found that only 50% of a given cohort graduated within eight years, 6% required more than eight years, and 44% never received a degree. The long study duration may be partly attributable to the benefits of being a student. Total public expenditure on education in Slovenia is also relatively high (over 6% of GDP) and exceeds the EU average. According to data from 2001, only Denmark, Finland, Sweden, Norway and Cyprus spend more on education than Slovenia.

The problem of inadequate quality in Slovenia's education system is pervasive at all levels. This is shown by the results of a **functional literacy** survey from both 1998 and a newer study, 'TIMSS 2003', on trends in mathematics and science competency among ten and fifteen year olds. Studies examining writing skills have shown that as much as 65%-75% of people (aged 15-65) do not achieve level 3 literacy, i.e. they are not capable of searching for and understanding information from different written sources and reusing it in new circumstances (Bevc, 2001, p. 30). The latest Trends in International Mathematics and Science Study survey

(TIMSS 2003) raises similar concerns as the share of pupils who attained the highest scores in mathematics in Slovenia was 4-times lower than the international average, 7-times lower than in England and 5-times lower than in Russia, Belgium, Lithuania, Latvia and Hungary (Ministry of Education and Sport, 2004).[21]

Combined with the relatively large amount of resources devoted to education, these findings indicate that Slovenia's main problems in its education system arise from its **inefficient use of resources and insufficient quality.** Education reforms should therefore be primarily oriented towards solving these problems. Since it is still too early to assess the results of introducing the nine-year primary school, the quality of instruction and the knowledge acquired by pupils should be improved in both primary and secondary education. Similarly, it is unclear how implementing the Bologna Declaration's directives will affect the efficiency and quality of tertiary education.

Since 1996, Slovenia has been increasing its **research and development** expenditure measured as a proportion of GDP (with the exception of 1997 and 2002, when decreases from the previous year were reported). In the process, it has been slowly closing the gap relative to the EU-15, although the growth has been too small to rapidly approach the EU-15 average and even less so for achieving the objectives set in the SEDS (2% of GDP by 2006) or at the Barcelona summit (3% by 2010). In terms of gross domestic expenditure on R&D and the number of researchers per 1000 of the labour force, Slovenia is ahead of the other new EU member states and some of the old ones; however, this is not sufficient for a rapid convergence to the levels of the most advanced EU member states. The shifts seen in the structure of R&D expenditure were more favourable in the aforementioned period: **the increase occurred mainly in the business sector's share**, which financed 60% of total R&D expenditure in 2002. Nevertheless, the business sector's expenditure on R&D as a share of GDP is still much lower than in the EU-15. Moreover, the proportion of researchers employed in the business sector is too low despite the observed increase between 1996 and 2003.

Although the financial resources allocated to R&D constitute only one of the many factors which influence the level of **innovation** in enterprises, these other factors also do not produce an environment conducive to innovation. Such factors encompass mechanisms for transferring knowledge from the research to the business sector (which includes protection of property rights), the availability of highly qualified staff in enterprises, environment conducive to the development of entrepreneurship and the availability of support services enabling the transformation of inventions into marketable innovations. Since the effects of these factors are not enhancing the innovation sufficiently, the share of innovation active enterprises is very low. Compared with the EU-15, where 44% of are innovation active, Slovenia has a share that is less than half (21.1%) and lags behind all EU-15 countries as well as many new member states. Although the gap vis-à-vis the EU-15 is wide in all size classes of enterprises and across sectors, it is especially critical in small enterprises and in the service sector (European Trend Chart on Innovation, Slovenia, 2004).

[21] The TIMMS results also raise questions about the quality of science teaching and the interest in science studies in Slovenia, which is insufficient in view of the future development and needs of the economy. Further, the results of the study indicate that potential long-term emigrants amongst Slovenian researchers mostly specialise in technical, scientific, medical and biotechnical fields (Bevc, 2004, p. 84).

This calls not only for radical changes to create a more innovation-supportive environment but also for special measures targeted at boosting innovation activity in small enterprises and service providers. Given that the share of services in GDP is still rising, non-technical changes (organisational changes, new business models, new distribution methods) should also be considered in order to promote future development as these particularly affect innovation activity in service industries (EIS, 2004).

The intensity of innovation activity is partly reflected in **patents**. Slovenia also lags well behind the EU in this respect, having filed just a quarter of the EU-25 average number of patent applications per million inhabitants in 2002 at the European Patent Office. Even though Slovenia is ahead of all the new and some of the old EU member states, it cannot anticipate any faster progress towards technological transformation without profound changes in this area.

Although the government fosters technological development and innovation through various measures, studies have shown that funding for these purposes tends to be too dispersed – hence, it does not focus on the key priorities – and that there are too many different programmes, which hinders their transparency. On the other hand, these measures have proven to be useful since more than half of the projects[22] would not have been realised without the development incentives (Final Report, 2004). Continued support for development-oriented projects will be crucial for a shift towards accelerated technological modernisation and increased value added per employee in the future.

The **unfinished institutional reorganisation and reforms in R&D** are further hampering faster progress in this area. Although a new law on R&D, which establishes two new agencies to promote research and technological development, was already passed in 2002, so far only the Science Agency has been founded (in autumn 2004). Due to reorganisation of the ministries and the slow pace with which the Agency for Technological Development is being created, the establishment of an institutional framework to promote R&D and innovation is being delayed. Moreover, another obstacle (and one that stands in the way of achieving the EU's Barcelona objectives) is that, even after more than two years of preparations and negotiations, Slovenia still lacks a national R&D document to set out the priorities and promotional measures in this area.

In the past few years, Slovenia has achieved relatively good results in building a modern telecommunications infrastructure and in the **use of information and communication technologies** (Stare, Kmet, Bučar, 2004). While household Internet access is at a similar level as in the EU-15, Slovenia lags behind in the share of Internet users among individuals. One reason for this disparity is Slovenia's lower share of the population with a tertiary education (a demographic group which tends to be more likely to use the Internet). The progress observed in introducing e-commerce has been sluggish, notably in commerce between enterprises and between enterprises and the government, while somewhat better results have been achieved in the provision of e-services for citizens.

[22] Referring primarily to technology networks, clusters, technology centres, technology parks and incubators, investment in new technology, technological modernisation of enterprises, entrepreneurial incubators at universities.

Despite the favourable trends, Slovenia has regressed in some areas relating to the introduction of information and communication technologies (e.g. the decrease in investment in information and communication technologies as a share of GDP – EIS, 2004). In some other areas, its progress has been too slow (e.g. in introducing e-commerce) or it has not implemented legislation (e.g. in introducing competition in the electronic communications market, EC, 2004). Consequently, the potential of information and communication technologies has been exploited only to a limited extent, even though analyses have confirmed their positive impact on efficiency at the macro, sectoral and firm levels (OECD, 2003).

The lack of highly qualified staff weakens the capacity of enterprises to innovate; similarly, an increase in education levels will be crucial for the more widespread use of information and communication technologies. This confirms the interdependency of the factors underpinning a knowledge-based society.

3.2. Strengthening the economy's competitiveness

According to the SEDS' objectives, strengthening economic competitiveness encompasses the following: (i) creating a competitive ***business sector*** capable of quickly responding to changes in technology and in the global marketplace, as well as one which fosters competitiveness through an increased reliance on highly skilled human capital and a decreased emphasis on energy and natural resource usage; (ii) internationalising the business sector; (iii) promoting partnerships between small and medium-sized enterprises; (iv) developing an efficient ***financial system***; (v) creating an efficient ***public sector*** by enhancing the role of private service providers and offering custom-made services; and (vi) creating an efficient ***non-tradable sector*** through price regulation, licensing and concessions.

3.2.1. Improving the business sector's competitiveness

THE SEDS' OBJECTIVE: The SEDS proposes the following measures to strengthen the business sector's competitiveness: (i) conclude transition restructuring by consolidating ownership, and establishing ownership and corporate governance structures which will be efficient in the long-run; (ii) find a definitive solution for the loss-making companies without any prospects; (iii) create conditions for developing a competitive business sector, particularly by accelerating the entry of domestic and foreign firms, lifting administrative barriers to investment, stimulating the internationalisation of the economy, and by fostering the development of small and medium-sized firms.

THE REPORT'S FINDINGS: An analysis of the factors relating to the competitiveness of the business sector in the Development Report reveals that structural reforms in the business sector are progressing too slowly. Despite growth in Slovenian market shares in foreign markets and steady growth in productivity, the restructuring processes in the Slovenian business sector lack the intensity needed for robust growth in international competitiveness. While labour costs per unit of output are decreasing, they remain the highest in the European Union which indicates that the current

export structure is becoming increasingly unviable. The existing labour costs can only be sustained by the production of goods with higher value added, which naturally requires the accelerating of the restructuring process. Excessively slow structural reforms and the lack of competitiveness in the business sector are not conducive to foreign direct investment. A lack of firm entries pervades the business sector, with a decreasing number of entrants since 1999 and a below-average market success rate amongst entrants.

ANALYSIS: Increasing the **competitiveness of the business sector** will be a key determinant of real convergence of the Slovenian economy with the European Union. Trends in the business sector's competitiveness can mainly be discerned through changes in productivity, market shares abroad and in the degree of structural change. Despite the unquestionable progress Slovenia has achieved in these areas, an increasing number of studies indicate that these changes are not occurring quickly enough, thus endangering the future competitiveness of the Slovenian economy in general and the business sector in particular (see, for example, WEF, 2004; IMD, 2003; Rojec et al. 2004). Among the 60 countries monitored by the IMD, Slovenia's rank for business efficiency fell from 36th to 51st place during the 2000-2004 period (IMD, 2004); among the 93 countries tracked by the WEF, Slovenia's rank for business efficiency fell from 27th place in 2002 to 30th place in 2004 (WEF, 2004). Existing studies propose that Slovenia should accelerate its structural reforms, continue internationalising its economy, strengthen the relationship between the business and research spheres, complete the privatisation of the services sector, and so on. The structural inviability of the Slovenian business sector is perhaps best witnessed through the bankruptcies and dismissals seen at labour-intensive firms.

Labour productivity is one of the main ***indicators of an economy's competitiveness***. The relatively high growth in labour productivity in the 1995-2000 period (averaging 4.7% per year; 6.9% per year in manufacturing) was followed by a cyclical fluctuation in productivity growth during the 2001-2003 period (ranging from 2.2% in 2001, 3.7% in 2002, and 2.8% in 2003). The cycles resulted mainly from the delayed reaction of employment dynamics relative to dynamics in the economic growth. Labour productivity growth was approximately 3.6% in 2004 according to our estimates. Slovenia's gap relative to average productivity in the European Union continues to close (Slovenia's productivity relative to the EU-25 average stood at 52.0% and 56.3% in 2001 and 2003, respectively). **Labour costs per unit of output**, an alternative indicator of competitiveness, suggest the situation is more problematic. While the 1995-1999 period witnessed a significant improvement in the relationship between labour costs and GDP per employed worker, the 2000-2003 period was characterised by fluctuations and only modest decreases in labour costs per unit of output (with increases of 3.2% and 0.1% in 2000 and 2001, respectively, and decreases of 2.0% and 0.5% in 2002 and 2003, respectively). Moreover, the decreases in labour cost per unit of value added were significantly higher in manufacturing than in the rest of the Slovenian economy (mainly non-tradable sectors). This points to the unfinished reforms and protectionism in the non-tradable sector (insufficient liberalisation, deregulation and privatisation)[23] which brings about increases in labour costs and prices, whereas competition induces the manufacturing industry to

[23] This is discussed further in *Section 2.2: The completion of institutional reforms from the transition period.*

constantly lower its costs (Rojec et al. 2004). Comparisons of trends in labour costs per unit of output with other EU countries yield two findings. First, the swift gains in the Slovenian economy's competitiveness in the second half of the 1990s slowed considerably during the 2001-2003 period; in the former, labour costs per unit of output in Slovenia fell, on average, by 2 p.p. faster than in the EU-25, while falling only 0.7 p.p. faster in the latter period. Second, Slovenia had one of the highest labour costs per unit of output among EU members in 2003. The share of wages in value added amounted to 60% in Slovenia (the EU-15 average is 56%, and 49% among new entrants), which is also the result of a higher tax burden on labour (data refer to 2002, Revue Regionale, 2004, p. 2).

After the fall in Slovenia's **market share** in its most important trading partners from 0.58% in 1996 to 0.48% in 2000, this share began to climb again, reaching 0.54% in the first nine months of 2004. The growth in market share in the last four years indicates that, in the context of the considerable slowdown in the economic growth of Slovenia's most important trading partners, the relatively high growth of Slovenian exports after 2000 (with an annual 6% average real growth rate) is the result of the improved export competitiveness of Slovenia's economy. During the 2001-2003 period, Slovenia was ranked in the upper half of the EU-25 in terms of its growth rate in both global market share and market share within the European Union. The growth of its market share was faster than that of the majority of Euro area members, but much slower than the market share growth of a large proportion of other countries, particularly new EU members.

One ***indicator of structural change*** is **investment activity**. After the transition depression ended in 1993, Slovenia's investment activity gained momentum, reaching its peak in 1999 when the share of gross fixed capital formation in GDP was 26.3%, 5.7 p.p. more than in 1995. Gross fixed capital formation relative to GDP declined from 2000 to 2003, falling to 23.9% in 2003. The trends in the technical structure of gross fixed capital formation in the 1995-2003 period indicate the following: (i) the share of gross investment in machinery and equipment, after a sharp increase during the 1999-2001 period, settled down at 10.5% of GDP; (ii) a similar trend occurred for housing investments which, after an increase in the 1996-2001 period, went back down to 3.4% (a figure which presumably increased in 2004, although official statistics are not yet available); (iii) the share of investments in non-housing construction relative to GDP was constantly growing during the 1995-2000 period and, after a fall in 2001-2002, increased to a record 9.1% in 2003 (compared to only 6.2% in 1995). While the share of gross fixed capital formation in GDP is larger in Slovenia than in more developed countries, Slovenia lags behind in its investments in housing and information technology. As expected, the share of investments in machinery and equipment is higher than in more developed countries. However, the relatively small share of investments in housing is surprising given the relatively low number of apartments[24] and the fact that Slovenia is in the midst of implementing its National Housing Savings Scheme. Thus, there must be other explanations of

[24] According to the UNECE (United Nations Economic Commission for Europe), the number of apartments per 1000 inhabitants in Slovenia in 2000 was lower than in most other EU countries: of the 18 member states for which data are available, this figure is lower only in Ireland, Slovakia, and Poland. Similarly, according to the Quality of Life in Europe study conducted by the European Foundation for the Improvement of Living and Working Conditions, Slovenia was placed last in the EU in the number of rooms per inhabitants in 2003.

the low housing construction levels although they are probably related to high prices, risk levels and limited land supply.

Analysing the **composition of merchandise exports according to factor intensity** shows some positive developments; on the whole, however, these do not suffice for reducing Slovenia's structural lag behind the EU. Positive developments include a decrease in the share of products requiring the intensive use of natural resources (which has already reached EU-25 levels), as well as a sharp decrease in the share of labour-intensive products (from 25.6% in 1995 to 17.9% in the first nine months of 2004). Despite the decrease, the share of these products in Slovenian exports is still much higher than in the EU-25. Slovenia's structural surplus in its exports of labour-intensive products relative to the EU-25 decreased by only 3.8 p.p. in 1995-2002 A breakdown of exports based on technological intensity of products shows a sharp increase in the export share of high- and medium-technology products (from 14.8% in 1995 to 17.6% in the first nine months of 2004 for the former, and from 31.9% to 37.7% during the same period for the latter), although this was accompanied by a small increase in low-technology products (from 9.7% to 11.6% for the same period). These fundamentally favourable trends mask some less positive aspects – most notably, that Slovenia's structural lag behind the EU-25 with respect to high-technology products increased during the 1995-2002 period. During this period, however, its structural advantage in medium-technology products increased. Thus we can see that restructuring in the EU-25 is mainly emphasising the development of high-technology industries while Slovenia has been developing its medium-technology industries. The guidelines set out in the SEDS mandating an increase in exports based on created factors of competitiveness are therefore being satisfied mainly through a decrease in the share of labour-intensive products and an increase in the shares of high- and medium- technology products. However, the structural lag behind the EU-25 persists as the Slovenian economy has a significantly higher share of labour-intensive products and an increasing structural lag in the high-technology sector. The latter must be partially associated with Slovenia's lag in terms of the share of innovation active firms.[25]

Analysing the structural changes in domestic and foreign-owned manufacturing firms in the Czech Republic, Estonia, Hungary, Poland, Slovenia and Slovakia indicates that Slovenia ranks among those countries which were relatively slow to restructure and, in particular, that were least likely to incorporate foreign direct investment in the restructuring process. Analysis shows that the restructuring processes in manufacturing sectors of the analysed countries were largely driven by foreign-owned firms, which were significantly more likely to become involved in medium-high- and high-technology sectors. In the 1993-2001 period, the structural share of high-technology industries in total value added created in manufacturing in the analysed countries increased by 1.3 p.p. among domestically-owned firms and 14.3 p.p. among foreign-owned firms (in Slovenia, only by 1.7 p.p.), while the structural share of medium-high-tech firms increased by 1.5 p.p. among domestically-owned and 7.9 p.p. among foreign-owned firms (in Slovenia, the relevant figure decreased by 12.7 p.p.). Among all the countries analysed in the study, it was precisely Slovenia that harnessed the potential of foreign direct investment the least (Damijan and Rojec, 2004).

[25] The findings are presented in *Section 3.1: Transition to a knowledge-based society.*

The SEDS considers internationalisation as crucial for development and increasing the competitiveness of the business sector. **The share of exports and imports** as well as **inward and outward foreign direct investment (FDI)** in GDP are the most basic ***internationalisation indicators*** of an economy. The stock of incoming FDI in GDP increased from 9.5% to 20.7% in the 1995-2003 period, while the stock of outgoing FDI in GDP increased from 2.6% to 7.5%. After a large increase in FDI inflows in 2001 and 2002 which resulted from several large foreign acquisitions, inflows in 2003 and 2004 returned to their pre-2001 levels. FDI outflows from Slovenia have been constantly increasing, leading Slovenia to become a net direct foreign investor in 2003 and 2004, an unusual situation for a country at its level of development. These trends point to the increased importance of FDI for the incoming and outgoing internationalisation of the Slovenian economy, but they also reaffirm the fact that Slovenia is incapable of attracting new, greenfield FDI. A comparison with EU countries indicates that Slovenia remains among those countries with the lowest stock of inward FDI in GDP. Slovenia ranks somewhat better compared to new EU member states in terms of its outward FDI. Thus, despite the swift increase in FDI in 2001 and 2002, Slovenia still ranks among countries with a relatively limited degree of internationalisation through FDI (in 2003, its global stock of inward FDI was 0.0769%, and 0.0282% for outward FDI). Its degree of integration with the global economy is much greater in terms of its exports since Slovenia's share of total exports in 2003 amounted to 0.1699%. In 2003, Slovenia increased its share in each of the three indicators over the previous year.

The success with which a country attracts FDI can be measured by the degree to which it exploits its potential for attracting FDI. This can, in turn, be measured by comparing its ranking on the index of potential for attracting FDI and its rank in success in attracting FDI. Slovenia's actual success in attracting FDI has lagged considerably behind its rank for its potential. Slovenia's rank according to its potential for attracting FDI among 140 countries improved from 45th to 27th place among 140 countries during the 1995-2002 period, while its rank in the index measuring actual success in attracting FDI dropped from 94th to 109th place; an improvement was not witnessed until 2002 (to 59th place), and even this occurred mainly as a result of unique factors resulting in extremely high FDI inflows (several larger acquisitions from abroad - UNCTAD, 2004; Stanovnik and Rojec, 2004).

The business environment is ill-suited not only for FDI but also for **the creation of new domestic firms**. In fact, Slovenia is experiencing a fall in the number of firms, which decreased by 10,000 from 1999 to 2003, a 10% drop (SORS, 2004). The GEM[26] study of entrepreneurship (Rebernik et al., 2004, 2005) finds that Slovenia's score according to the TEA index[27] of 2.6 in 2004 places it only in 22nd place among the 34 countries worldwide in the study. The mortality ratio[28] in 2004 stood at 2.72 (compared to 2.14 in 2002), meaning that only one in 2.72 newly-created

[26] Global Entrepreneurship Monitor, Slovenia, 2002.

[27] The TEA index (Rebernik et al., 2002, p. 7) measures the share of adults aged 18 to 64 who are either in the process of establishing a company or are the owners/managers of a young company that has not been paying wages for more than 42 months.

[28] The mortality ratio (Rebernik et al., 2004, pp. 14 and 46) originates from the relationship between TEA companies in the process of being created and TEA new companies.

firms survive at least three-and-a-half years. The low level of entrepreneurial activity and the high mortality rate – one which places Slovenia among entrepreneurially undeveloped countries in a European and global sense – point to excessively high and unrealistic entrepreneurial expectations on one hand, and to high barriers in the entrepreneurial environment on the other.

3.2.2. Financial sector

THE SEDS' OBJECTIVE: Slovenia's gradualist approach to financial sector reforms has had an inhibiting effect over the last few years. The basic purpose of the reform process is to improve the financial sector's international competitiveness and enable it to effectively integrate into the EU's common financial market. Achieving this requires a balanced development of all the elements in a financial market. The SEDS distinguishes between three groups of measures for further restructuring: (i) establishing a competitive structure and completing the restructuring process, including privatisation; (ii) completing the process of regulation enforcement and control; and (iii) harmonising the related legislation with the acquis communautaire.

THE REPORT'S FINDINGS: While Slovenia is one of the most developed new EU member states according to the basic indicators of its financial system's development, it is still well behind developed EU member states. After several years of a gradual decrease in its gap relative to these countries, the gap has expanded in the past year. Slovenia lags behind similarly developed countries in terms of its financial sector's development (including Greece, Portugal, the Czech Republic, Cyprus, and Malta). Banks are the key financial intermediaries in Slovenia's financial market yet their assets as a proportion of GDP do not even amount to one-third of the EU-25 average. A large, albeit smaller, gap remains in the insurance industry (measured as the amount of premiums as a share of GDP). The capital market's development is also lagging behind, in part due to the fact that several large firms' stocks were withdrawn from the stock exchange in 2003, significantly decreasing the growth in market capitalisation as a share of GDP. Reforms are being effectively adopted only in the areas of regulation, supervision and alignment of Slovenia's legislation with EU directives. In order to boost the efficiency of the financial system, however, further privatisation will be imperative since this would establish a stable ownership structure for the main financial intermediaries.

ANALYSIS: Even though the **Slovenian financial market development indicators** are improving from year to year, a considerable development gap with more developed countries persists. The gap, measured by the total banking assets as a proportion of GDP, has in fact increased somewhat relative to the previous year. The poor development of the financial sector is apparent when comparing its inferior indicator values to those of similarly developed countries (including Greece, Portugal, the Czech Republic, Cyprus, and Malta). Banks are the key financial intermediaries in Slovenia's financial market, but the value of the indicator measuring their total banking assets as a proportion of GDP does not even amount to a third of the EU-25 average. The smallest developmental gap is seen in the insurance sector, a fact resulting from the high share of non-life insurance policies among total insurance premiums. The capital market's development is also lagging behind, in part due to

the fact that several large firms' stocks were withdrawn from the stock exchange in 2003, significantly reducing the growth in market capitalisation as a share of GDP. The savings patterns of the population are clearly changing as bank deposits are increasingly only very slowly, while investments in mutual funds and life insurance are rapidly increasing. Reforms are being effectively adopted in the areas of regulation, supervision and alignment of Slovenia's legislation with EU directives. In order to boost the efficiency of the financial system, further privatisation is imperative since this would establish a stable ownership structure for the main financial intermediaries.

Banks held almost 60% of the assets of the entire financial sector at the end of 2003. The value of the indicator measuring total banking assets as a share of GDP has been rising from year to year, increasing by 2.3 p.p. over the previous year to reach 88% in 2003. In 2001 and 2002, the growth in assets was mainly the result of investments in securities (largely securities issued by the central bank), while increases in bank assets in 2003 and 2004 were fuelled by the issuance of credit to non-bank customers (foreign-currency-denominated loans to firms and other financial organisations and tolar-denominated household loans). The amount of securities began to fall in 2004 largely due to the changed monetary policies of the Bank of Slovenia arising from entry to the ERM II. The increase in credit issuance resulted largely from interest rate decreases,[29] which have been dropping since the second half of 2002 when the indexation of short-term assets and liabilities was abolished, while the indexation of long-term assets and liabilities remains in place. Despite this fact, long-term interest rates fell, as the indexation factor (TOM) is lower than in previous years and the decrease was also influenced by a drop in the real interest rate. These interest rate trends negatively influenced interest revenues and decreased savings flows into banks. Banks reacted to these savings trends by expanding their traditional offerings to include investment banking services, new forms of saving, e-banking services, banking via the phone and bank assurance services. Thus, the revenue structure of Slovenian banks has been changing accordingly, seeing an increase in the share of non-interest revenue. These new forms of saving have enabled banks to acquire more long-term assets, which is very important for the adjustment of the term structure of banks' balance sheets. Banking services are increasingly being integrated with the services of the other two segments of the financial intermediary sector, that of insurance and the capital market. Thus, in 2003 the share of insurance premiums collected by banks stood at 5.8%, while banks created more than half of the turnover on the Ljubljana Stock Exchange.

Among new EU members, Slovenia registered the highest value of the indicator for the amount of **insurance premiums** relative to GDP, with 5.2% in 2003 (among other EU members, Luxembourg and Greece also have lower indicator values), but this figure still only amounts to about 60% of the EU average. A comparative analysis indicates that Slovenia's non-life insurance sector is well developed (at 4% of GDP it amounts to 110% of the EU average), while the life-insurance sector is not (at just 1.2% of GDP it only amounts to about a quarter of the EU average). The latter has been increasing faster than the former for several years, attaining an annual real

[29] The higher consumer debt in 2004 also resulted from the National Housing Savings Scheme and the payment of debt issued in 1999, thus resulting in a new cycle of borrowing.

growth rate of almost 20 percent in the past ten years, increasing by 9.5 p.p. to 23.5%. A similar increase in the share of life-insurance can be expected in the future, particularly due to the growing importance of saving for retirement, the expanded offers from foreign insurers, and the integration of banking and insurance services. The ownership restructuring procedure for the largest insurer began in 2003.[30] Creating a stable ownership structure will be a key goal of privatisation since that would improve the accessibility of capital needed for swifter development. The latter will, in turn, improve the competitiveness and efficiency of the Slovenian insurance sector within the financial system of the European Union.

The **capital market's** development is also lagging behind that of the European Union. The indicator of market capitalisation as a share of GDP stood at a little over one-third of the EU-25 average in 2003, at 23.3% of GDP – 0.1 p.p. more than the previous year. This indicator value locates Slovenia in the lower half of new EU members. Higher values were attained by Estonia, Malta, Cyprus, Latvia and the Czech Republic. The main underlying reason can be found, as in previous years, in the withdrawal of several acquired firms. However, its growth was also stunted by a fall in stock prices during the first half of the year, resulting in the annual growth of market capitalisation of 8.6%. Even less developed is the primary capital market in which government securities dominate and initial public offerings basically do not exist. In order to remain feasible and successfully develop, it will be necessary for the Slovenian capital market to become better linked to foreign institutions, accelerate the primary market's development and list more companies on the stock exchanges (to give institutional investors more investment options in the domestic capital market).

Important parts of the financial sector – banks and insurers – remain in government hands and thus the privatisation processes currently underway need to be accelerated so as to establish the conditions for faster growth in the sector's efficiency. Further reforms regarding the establishing of a common EU financial market[31] are needed (mainly in the areas of regulations and oversight). The reforms must fully exploit the potential benefits of the European Monetary Union.

3.2.3. Infrastructure

THE SEDS' OBJECTIVE: The strategic goal of developing the economic infrastructure is to ensure reliable, cost-effective service in the energy, transport, telecommunications and local utility sectors. The main priorities are: (i) the continuation of economic infrastructure construction; (ii) the liberalisation and privatisation of infrastructure; (iii) the entry of private capital into infrastructure construction and financing; and (iv) the provision of quality economic infrastructural services to companies and the population at large.

[30] Based on the Law on Insurer Ownership Restructuring, the government issued two declarations in 2003, one for resolving the capital structure for the Triglav Insurance Company and the other for determining the capital shares in the nondenominated capital of the Triglav Insurance Company and those entitled to those shares.

[31] The Financial Services Action Plan, ratified in 1999, outlines the requisite measures for establishing a common financial market. The European Commission monitors implementation of this plan semiannually.

THE REPORT'S FINDINGS: After several years of decline, investment in infrastructure construction has increased recently (in 2003), mainly in the area of road infrastructure. Private capital is still not involved in the construction and financing of investments, although preparations are underway to raise private funds through bonds. The liberalisation and privatisation of infrastructure achieved no progress in the past year, although the EBRD estimates the pace is comparable with the average in other new EU entrants. Independent regulators (agencies) have been largely established, but start-up difficulties have resulted in operational inefficiencies that need to be improved. Liberalisation and privatisation have not yet significantly affected the quality of supply nor have they increased competitiveness.

ANALYSIS: In previous years, Slovenia began to liberalise its network activities[32] which will presumably increase the number of competitors and improve product variety for consumers on one hand, and force firms to rationalise, improve the quality of their services and lower their prices on the other.

The Slovenian **telecommunications** market is relatively small, constituting only 2.6% of GDP, the lowest share among all new EU entrants.[33] From 2001 and 2003, the market grew by approximately 8%.[34] This growth was particularly pronounced in the mobile telephone segment where 93% of the population were already mobile phone users by 2004, while there were 41 land lines per 100 inhabitants.[35] [36] The market penetration of mobile phone users in Slovenia is about 10 p.p. higher than in the EU, and mobile telephony is more developed in only 6 member states. Prices in land-line telephony are low compared to other EU countries, as are prices in mobile telephony. Competition is present in all sectors of the telecommunications market with the exception of land-line telephony for internal calls, where the monopoly has been abolished by law, but not quite yet in practice. Permits for providing these services were already obtained by two operators in 2002, and five more have obtained them since the Electronic Communications Act was adopted in April, 2004. An important form of competition for the national operator, Telekom Slovenije, comes via the Internet protocol (VoIP, with 22 operators) and the operators of international wireless networks who offer to forward international calls (11 operators). In the area of mobile telecommunication services, Slovenia has three mobile telephone providers (two have significant market power). The largest one has a 76 percent market share which, with the exception of Cyprus (where one provider has a perfect monopoly), is significantly more than in other EU countries where the largest player typically commands less than half of the market. Ten narrowband Internet providers operate in the market (none have a majority market share; the new operators control 56% of the market), while broadband access is available via ADSL (Siol controls two-thirds of the market) and cable networks. Cable Internet already has approximately 8,000 subscribers.

[32] Reforms are described in greater detail in the Report on Structural Reforms, October 2004, pp. 8-13.

[33] 4th Report on Monitoring of EU Candidate Countries, 2003.

[34] 10th Report, European Electronic Communications Regulation and Markets, 2004.

[35] Study on the Use of Information-Communication Technology IKT, 2004.

[36] The degrees to which the population is equipped with information-communications gadgets in 2004 are as follows: 98% of households had television receivers; 90% had land-line telephones; 87% had mobile phones; 58% had a personal computer; 55% had cable TV; and 47% had Internet access.

In addition to the Slovenian Postal Service, which is the main and sole provider of general **postal services**, five minor suppliers operate in the field of courier services. Slovenia is a well-developed European country in terms of the number of square kilometres and population per one post office (Postal Outlook, 2004), covering 3,585 people and 36.4 square km (compared with 4,943 people and 66.2 square km on average in the EU).[37] Slovenia aligned its legislation with the *acquis* through the 2002 Law on Postal Services (and the ensuing amendments and supporting clauses). The market was liberalised as legal obstacles to the entry of competitors were abolished and a public service for universal postal services was established to provide users with basic postal services at affordable price. The role of independent regulator has been given to the transformed Post and Electronic Communications Agency.

Mandatory **state** economic **public companies for environmental protection** are comprised of agencies for dealing with radioactive waste, incinerating municipal waste, dealing with animal waste, collecting, processing and removing other types of waste, carrying out measurements, monitoring and cleaning heating devices, chimney and air vents, monitoring hydrological, geological, seismological and other geophysical events and monitoring the state of the environment. Ensuring the provision of **municipal services** is the responsibility of local governments. Public environmental protection companies – which are responsible for the public services of providing potable water, wastewater collection and treatment, and solid waste management and disposal – have been carried out by 62 contractors on average in recent years (of which 51 carried out all four main functions). Most providers are public enterprises or mixed organisations and the rest are concessionaires in private or mixed ownership. The present organisation of public services is inappropriate, as shown by the inefficient organisation structures and excessive number of companies dealing with local utility services. Establishing the conditions for improved efficiency and professionalism will require better oversight of the cost efficiency and joint investment by several municipalities, which requires increasing the public service providers' area of operation. In addition to their public services, the majority of providers in Slovenia operate other (profit-making) ventures which often results in insufficient transparency of their basic public service. The Rules on the pricing of services provided by the mandatory municipal public utility services in the field of environmental protection adopted in 2004 should resolve this problem by more clearly delineating between the different costs incurred by these firms.

Deregulation of the **electricity sector** has separated the activities of production, transmission, distribution and supply. Beginning on 1 July, 2004, the electric energy market was liberalised for all users other than households. The number of users entitled to freely choose their supplier has grown significantly from the previous figure of 8,000. Total energy use among these eligible customers – combined with the new, smaller ones – increased from almost 68% to approximately 75% of total Slovenian electricity consumption, which indicates the degree of the market's openness. Half of all electricity is produced by the Holding Slovenske elektrarne (HSE),[38] 40% by the Krško Nuclear Power Plant and the remaining 10% by two

[37] Annual Report of the Slovenian Postal Service 2002.

[38] Large public hydro-electric power plants and two thermal power plants have operated within the HSE since summer 2001.

large thermal power plants and several smaller producers. Slovenia has five regional distribution companies and one transmission company. After a public tender in 2003, 16 eligible customers and five electricity producers were granted access to international transmission lines (some were later also granted so-called uncertain capacity rights). The Slovenian part of transmission capacities was granted according to published guidelines using a capacity pro-rating, which will be in use after the changed EU regulations commence on 1 July 2007. The prices of electric energy for eligible customers[39] increased for some categories of users in 2003 and 2004, but decreased for others. The price for tariff users increased by 3.9% on 1 May, 2003, with a further 4.0% increase on 1 February of last year. The average price of Slovenian electricity before tax for a consumer with 3500 kWh of annual usage was 6.4% lower than the unweighted EU-25 average in January 2004, while the price for an industrial user with 2000 MWh of annual usage exceeded the European average by 0.7% (Povšnar, 2004). Quantities traded on the daily electricity exchange market rose by 45% in 2003 relative to 2002 and totalled 3.1% of Slovenian energy use.

By adopting the changes and supplementary clauses of the Energy Law in April 2004 Slovenia appropriately modified its legislation to suit the common market directives regarding **natural gas**. As a result of these legislative changes, the activities of the gas transmission network system operator will be legally and functionally separated from other market activities. Access to the network is no longer negotiated, but regulated. The methodology for pricing network access, transmission and distribution costs has already been determined by the Energy Agency of the Republic of Slovenia, as sanctioned by the government. Beginning 1 July 2004, all non-household users became eligible natural gas users while household-users will gain this right on 1 July 2007. Despite the 50% openness of the market that started on 1 January 2003, only one supplier and distributor exists for larger industrial users but this firm has not been the gas transmission network system operator since 1 January 2005. Most larger energy users have a long-term natural gas contract with this supplier until 2007.

In **railway transport**, freight transport operates as a market activity while internal passenger transport operates as a public utility. Access to the public railway infrastructure is unrestricted in a similar way as in the European Union. Licenses for engaging in railway transport issued in the EU are also recognised in Slovenia. The Slovenian Railways Company, which has been reorganised into the Slovenian Railways Holding Company, is in practice still the only carrier in Slovenia. This holding company is comprised of three legal partnerships, each governing different parts of its operations: passenger traffic, freight, and management and public railways infrastructure maintenance. A business reorganisation of the Slovenian Railways Holding Company was also undertaken. The Directorate for Railway Traffic was reorganised into the Public Railway Traffic Agency, becoming the infrastructure manager. Freight carriers in **road transport** also operate as independent market participants and Slovenia's entry to the EU means that Slovenian carriers can now operate in the common EU market more competitively and without the many previous restrictions and barriers.[40] In the area of public passenger transit, a new law passed

[39] SI-STAT Database, SORS.

[40] Various permits, prohibition on foreign carriers to haul freight internally etc.

in 2004 governing concessions for operating public passenger transport along established routes in internal traffic, and concession contracts for the period until 2008 have already been signed. Such companies had previously received a SIT 50 bonus per kilometre travelled (EUR 0.2, representing more than a two-fold increase over the previous subsidy) but, beginning in January 2004, this bonus depends on the difference between costs and revenues for various routes, calculated for kilometres travelled. Thus Slovenia has progressed from a system of subsidising public passenger transit into one of implementing and co-financing public services for carrying out this activity. In 2004, a new state company owned by the government for operating navigational services in **air transport** was formed and thus the regulatory duties and public services functions have been separated. Regarding **sea transport**, the first concession agreement was reached with the Luka Koper company in 2003 to manage, develop and maintain the harbour infrastructure for Slovenia's only port in Koper.

3.3. Improving state efficiency

THE SEDS' OBJECTIVE: The state fulfils its developmental role in three main ways: (i) it sets and enforces the main rules of economic activity by protecting economic agents' rights and engaging in contract enforcement (through an effective legal system) and by establishing a framework which enables the market to function efficiently (through competition policy); (ii) it manages economic resources directly as the owner or supervisor of public and mixed companies, as the manager of public systems (health, education etc.) and as the manager of public resources (general government revenues and expenditure), and indirectly through regulations and financial instruments, with which it oversees independent economic initiative and influences the allocation of resources; and (iii) it ensures that it functions efficiently internally in its management and co-ordination of economic and development policies.

THE REPORT'S FINDINGS: In terms of the rules governing economic activity, court backlogs continue to decrease quite rapidly in general and in the realm of the land registry, a problem mentioned in our previous reports. However, backlogs continue to grow in the economically crucial area of court order enforcement. Competition policy remains institutionally weak even though the Competition Protection Office has had its mandate broadened. Regarding the management of economic resources, the trend of increasing public finance expenditures has been stopped, but expenditure on wages and transfers continues to grow which has necessitated decreases in investment expenditure, an unfavourable outcome for development. Positive changes have occurred in the structure of state aid in 2003, with a decrease in agricultural goals and an increase in aid aimed at horizontal goals, in particular R&D, as well as industry. Remaining weaknesses include an insufficient consideration of regional goals and a lack of aid to directly support regional developmental goals. The state's organisational and operational efficiency – in which improvements were deemed crucial for national competitiveness last year – has improved in terms of the quality of both public institutions and the business climate.

ANALYSIS: ***Rules of economic activity.*** In 2003, the number of court backlogs continued to fall in important areas (the magnitude of the decrease, 10 percent, is similar to that achieved in the previous year). A positive development is that land registry backlogs decreased for the first time, a result likely attributable to the use of information technology. However, the rise in backlogs of less important areas continues to be troublesome, particularly in the economically crucial area of enforcing court orders, which constitute almost half of all court backlogs. As emphasised in previous reports, such long backlogs in enforcement raise transaction costs and decrease legal security, hurting social welfare by reducing the number of transactions in the economy. We estimate that the direct cost of these backlogs amounts to approximately 0.3% of GDP.[41]

The efficiency of the judicial system is related to its institutional setup. The number of resolved court cases dropped significantly in the 1990s, particularly after the 1995 judicial reform. This period was accompanied by a decrease in the number of court judges. The situation of the early 1990s has still not been restored despite positive shifts in resolving important cases since 1998. The legal changes adopted in mid-2004 are thus welcome developments in the further cutting of backlogs. The new Courts Act introduced legal aides intended to help judges with their 'non-judicial' duties; the legal means for case-management complaints are also to be strengthened in an attempt to create incentive for cases to be settled within a more reasonable timeframe; and a new Centre for Judicial Education will be established with the aim of constant and comprehensive educating of judicial employees. The new Judicial Service Act puts a limit of maximum two assignments of judges to a case, a measure that would shorten many of the unnecessary delays witnessed in practice. To address the considerable differences seen in the efficiency of various courts – partly resulting from the discrepancy in the number of judicial employees in certain types of courts and the demand for them – it would be sensible to attempt to forecast trends in types of court cases and to thus improve the respective allocation of financial and human resources.

Despite gradual changes in antitrust policy, the conclusion that this area is institutionally under-developed is still valid, both from the perspective of capacities and the jurisdiction of the relevant authority. The new Minor Offences Act, with which the Competition Protection Office acquired jurisdiction to impose sanctions, is a welcome development. In the legal processes, emphasis continues to be placed on industry concentration. In 2003, 54 of the 63 legal notices issued by the office were based on this measure. The structure of these cases is changing with greater emphasis being given to hearing more complex cases of antitrust infringement such as cartel agreements or the abuse of a dominant position.

Managing economic resources. No new data are available again on the share of the public sector in the economy, but we estimate that the state's indirect influence on the economy has changed little because there have been no major sales of state-owned assets or significant institutional changes. The share of monitored prices in the consumer price index has not changed.

[41] The calculations are described in the Analytical Appendix under the Court Backlogs indicator.

The share of public finance expenditures relative to GDP remained essentially constant last year, which is a positive development after the significant increase in 2003. The expenditure levels have thus increased by only 0.1 p.p. since 2001, while they increased by 2.9 p.p. from 1996 to 2001. Despite these positive trends in public finances, they are still not in accord with the goals of the SEDS which prescribed an upper limit of 43% of GDP. Such a figure would – based on later methodological changes in the GDP calculations – translate to 41% of GDP today. The SEDS also assumed that public finances would be balanced without an increase in the total fiscal burden, but in fact the decrease in the government budget deficit was accomplished almost exclusively through an increase in revenues as a share of GDP.

Concurrent with the halt in the growth of public finance expenditures as a share of GDP in recent years came significant changes in their structure. A larger share of expenditure is now devoted to wages, even in 2004 and despite the decrease in the average real wage per worker, which reflects the continued growth in employment. Increases also occurred in the share of expenditures for transfers to the population. Last year, a new item on the list of expenditure included payments into the EU budget amounting to 0.7% of GDP. The biggest burden of these changes was borne by government expenditures on goods and services, and the situation was ameliorated by the results of the pension reform since the share of expenditure on pensions has been consistently decreasing since 2000. Investment expenditures and interest payments also dropped somewhat last year, the latter for the first time. The shifting structure of expenditures is not conducive to development and indicates that changes in the wage and transfers indexation mechanisms are insufficient for addressing the main expenditure problems. Thus, the flexibility of employment in the public sector must improve, wage determination will need to be tied to efficient human resource management, the target efficiency of social transfers must improve, and investments must rely more on European funds and public-private partnerships.

The quality of public finances and developmental policies can also be evaluated through an analysis of state aid. The changes in its structure tended to be positive and also reflected the advice from previous Development Reports. After several years of increases, state aid for agriculture thus decreased while state aid for the manufacturing and transportation sectors increased. The share of horizontal aid also increased, constituting more than 75%, meaning that the EU-15 average of 50% has already been surpassed by a large margin. State aid increased for the following purposes: aid for rescue and restructuring, research and development, small and medium-sized enterprises and the environment. Current remaining weaknesses lie in the underutilisation of the regional aid criterion (only 3.7%) and, within the manufacturing industry, an excessive focus on low-tech activities. Although this indicates that the state was reacting to the difficulties certain sectors face due to their lack of competitiveness upon EU entry, Slovenia will achieve more rapid restructuring only by channelling part of its aid to more developmentally viable activities.

From the viewpoint of the SEDS' directives for establishing a knowledge-based society, the state aid most conducive to development is that earmarked for training, R&D and the development of information technology. Progress has been made

chiefly in the area of R&D aid, although aid for highly technologically advanced telecommunications has also increased.[42]

In terms of the SEDS' directives for lifting the competitiveness of the economy, the most important state aid comes in the form of investments, supporting small and medium enterprises, and creating new jobs. Investment aid is very meagre,[43] as is aid for small and medium enterprises. State aid for job creation has also been quite scarce.[44] Instead of giving aid which would accelerate competitiveness, 2003 in particular was characterised by aid for failing firms – thus, aid which does not foster competitiveness or economic growth.

Achieving the strategic goals will thus require not only retaining the current level of state aid but also changing its structure. Channelling state aid towards development will require reducing aid for sectoral goals and other purposes that do not support the goals of competitiveness and economic growth (rescue and restructuring, untargeted tax breaks and exemptions, covering various extraordinary costs and other purposes intended either as income support systems or as aid to preserve the existing business), and increasing funds for purposes that foster competitiveness and economic growth (R&D, training, small and medium enterprises, start-up investments and new job creation especially in high-unemployment areas). Regarding the aid recipients, it would be advisable to direct most of the aid towards the most developmentally viable activities. Among services, these would include the business, financial and information services and tourism; in manufacturing, these would include firms from high or medium-tech industries and viable firms in less technologically advanced industries. Research and development funds should be directed more towards projects which stimulate co-operation between research, higher educational and health institutions and firms, thus accelerating the transfer of knowledge to firms and their innovation activities.

The state's organisational and operational efficiency. While the inefficiency of the state in 2003 was a key reason for the decrease in Slovenia's international competitiveness according to the WEF analysis, 2004 offered some improvements in this regard. The value of the public institution quality index increased significantly, jumping 4 places in its rank in this area. Significant improvements also occurred in the area of corruption, while critical problems remain in the areas of legal and contractual safety. Business environment quality improved by two places. Further, the latest report highlights the gap in technological development and innovation. This problem is naturally directly related to the state's efficiency in redirecting government aid to applied research based on clearly stated priorities.

[42] Aid for R&D among all government aid increased from 4.9% in 2001 to 8.6% in 2003. The share of aid for basic research dropped from 52% in 2001 and 2002 to 49.5% in 2003, while the share of industrial and manufacturing-related research increased. There has also been a favourable increase in the share of research aid for firms (comprising only a quarter in 2001, but a third in 2003), while the remaining resources are still dedicated to research, university and health institutions. Aid for training, which also encompasses general and special training for workers employed by firms as well as guidance counselling, constitutes a minimal share of the government aid (ranging from 1.7% in 2001 to merely 1.3% in 2003).

[43] 2001: 6.1%, 2002: 2.8% and 2003: 4.9% of all aid.

[44] Aid for this purpose among total aid fell from 4.8% in 2001 to a mere 2.7% in 2003, which is mainly the result of lower aid in the form of social security contribution exemptions.

3.4. Balanced regional and spatial development

THE SEDS' OBJECTIVE: According to the SEDS, balanced regional and spatial development constitutes an integral part of development. The guiding strategic principle in regional development is that national development is subject to a regional balance, and the main goal of regional policy is to improve regional development potential through local oversight, focusing on the welfare of all of Slovenia's regions, but giving priority to areas with large current deviations from these goals. The main goal in spatial development is to activate space as a production factor and protect it from wasteful exploitation with the appropriate systemic, institutional and instrumental means.

THE REPORT'S FINDINGS: Regional disparities in levels of economic development are relatively low compared to other EU members, and they have stayed unchanged over the last few years. The disparity in GDP between the most and least developed regions has increased slightly, while the differences in unemployment rates have been decreasing since 2002. The most significant problems in both levels of development and unemployment remain in the Pomurska region, while the development gap has increased in other regions, in particular Zasavska and Savinjska. Central Slovenia is the most developed, having already attained 98% of the EU-15 average. Certain progress thus appears to have been attained in terms of spatial development, although not on a sufficient scale to meet the SEDS' goals.

ANALYSIS: ***Balanced regional development.*** Slovenian regional policies have achieved some positive results, although unrealised potential remains (Report on the Execution of Regional Policies 2004, 2004, p. 7). Variation in **gross domestic product per capita**, measured by the variation coefficient,[45] has been increasing slightly since 1995. The variation coefficient in 2002 was 2.3 p.p. higher than in 1995 and stood at 25% for 2000 and 23.3% for 2001. If we exclude the most developed (highest GDP per capita) Central Slovenia region, the coefficient of variation drops to about 15%. This suggests this region serves as the core of the national economy and that it significantly contributes to the regional disparities in Slovenia.

Since 1995, the two regions with above-average levels of GDP per capita were the Central Slovenia (42% above the average in 2002) and the Obalno-kraška region (3% above the average in 2002). Goriška is also close to the average, falling behind the average by 3.3% in 2002 (in 1997, its gap was only 0.9%). During the entire period, the lowest GDP per capita was seen in the Pomurska region which achieved only 69% of the national average in 2002, and whose gap has increased by 7 p.p. since 1995. The gap relative to the Slovenian average from 1995 to 2002 increased the most in the Zasavska region (by 11 p.p.), mainly the result of the closure of lignite mine. The gap vis-à-vis the Slovenian average also increased in Savinjska, Gorenjska, and Notranjsko-kraška. The regions that reduced the gap the most are Podravska (by 3 p.p.) and Spodnjeposavska (by 2 p.p.). The ratio between the most and least developed region according to GDP per capita grew from 1.8:1 in 1995 to

[45] The coefficient of variation is defined as the ratio of the standard deviation to the average, and this calculation is modified to take a region's size into account.

2.1:1 in 2002. Central Slovenia region achieved 98% of the GDP per capita at purchasing power parity of the EU-15 in 2002 and 107% of the EU-25 average, while the region with the lowest GDP per capita, Pomurska, achieved just 48% of the EU-15 and 52% of the EU-25 average.

Central Slovenia typically creates more than a third of total Slovenian gross value added (35% in 2002). One-third of gross value added is also created by the Podravska, Savinjska and Gorenjska regions combined, while the rest is created by the eight other regions. Central Slovenia created almost three-quarters of its gross value added in the services sector, a share which is surpassed only by the share of Obalno-kraška. Koroška and South-eastern Slovenia are anomalies because of their gross value added in industry and mining, and Notranjsko-kraška is an anomaly in terms of construction. The Pomurska region creates an above-average share of its value added in agriculture.

Decreases in **inter-regional differences in unemployment**, measured by the variation coefficient, began after 2002 and gained momentum in 2004. The lowest inter-regional differences were attained in 1999 (with a variation coefficient of 29.8%), which was followed by a period of increase from 2000-2002 (up to 34.8%). The differences have again been decreasing since 2003 and the variation coefficient thus achieved a value of 30.7% in 2004.

After several years of unequal drops in the unemployment rates in all regions (during the 1997-2001 period), unemployment rates began to increase somewhat once again after 2001 in certain regions (Koroška, Zasavska, Pomurska and Goriška). The trend stopped in 2004 since the unemployment rate increased only in the Goriška region. This region has had the lowest registered unemployment rate for a number of years, although this figure has been slowly but steadily growing; however, it remains significantly below the Slovenian average (amounting to about 65% of the Slovenian average). In 2004, the highest registered unemployment rate was in Pomurska (exceeding the Slovenian average by almost 60%) and, although the figure was somewhat lower than in the previous year, its decrease has tended to be slower than the fall in the Slovenian average. Apart from Pomurska, the Slovenian average was exceeded in Podravska, Zasavska, Spodnjeposavska, Savinjska and Koroška.

The problem of **structural unemployment** manifests itself differently in each region and presents problems even in regions with below-average levels of registered unemployment. Long-term unemployment continues to drop further across all regions. It is highest in the Spodnjeposavska region and above-average in South-eastern Slovenia, Podravska, Pomurska, Savinjska, Zasavska and Koroška. The underlying causes lie in the low education levels of the unemployed (South-eastern Slovenia and Pomurska) or in the lack of jobs for job-seekers with a tertiary education (Central Slovenia, Goriška, Obalno-kraška, Notranjsko-kraška, and Gorenjska). Unemployed workers above 40 years of age are also difficult to employ; while their share has been decreasing after 2001, they continue to constitute almost half of the unemployed in Gorenjska and Spodnjeposavska regions. The trend of more women joining the ranks of the unemployed has been halted in some regions, albeit in most regions they still comprise more than half the unemployed.

Regional differences in Slovenia can also be measured through other indicators (Pečar, 2003, pp. 6-7) and these reinforce the findings of relatively small differences in the development of the most and least developed regions. Regional differences, measured in terms of GDP per capita at purchasing power standards, are among the lowest of all countries in the newly expanded Union. Studies indicate that regional differences in development – despite considerable investments through cohesion policies for the least developed regions – have been decreasing very slowly in the European Union (A New Partnership for Cohesion, 2004, p. 149).

Spatially balanced development.[46] The long-term problems and goals in the area of spatially balanced development remain unchanged, although some positive developments have occurred. Regarding the assumed mechanisms and working goals for achieving spatial development according to the SEDS, three have posted no gains, two have yielded mixed (positive and negative) tendencies, while two have witnessed relatively positive changes.

The SEDS emphasises a greater role for regional centres and the formation of regions as mechanisms for improvements. The process of forming regions has been slow, in particular due to the lack of suitable mechanisms of local self-management, which also influences goal attainment and the need to increase the role of cities, particularly regional centres of national importance.

Two important mechanisms also include improving spatial planning and developing a zoning policy. Spatial planning theoretically plays a developmental role – at least that is the purpose of spatial planning legislation – but in practice it still needs to overcome the developmental hurdles posed by the lagged implementation period and its own inherent imperfections. The land policy is also not currently serving its developmental function. Partial explanations can be found in its official overseer, the Housing Fund of the Republic of Slovenia, which had been burdened with other duties until now; further, records and statistics are lacking and thus preparations for introducing real-estate taxes came to a halt.

The spatial cohesion of the country is undoubtedly improving with the further completion of the national highway programme. Slovenia is successfully using the highway programme to utilise the benefits offered by European traffic corridors as traffic accessibility is greatly improving. However, it has not been using these corridors as successfully to accelerate its railway and other public passenger transit.

Inclusion in the European regional policy mechanism was successful at least formally following adoption of the Single Programming Document as a joint pact between the EU and Slovenia, which encompasses regional development projects. European funds were still not utilised in the past year as projects that could have been financed through the EU structural funds were mainly financed through domestic sources.

In the area of agricultural policy, two programmes relevant to spatial development were underway in 2004: (i) the Rural Development Programme 2004-2006, which

[46] We still lack suitable synthesised statistical indicators to assess the results of spatial development and thus we must restrict ourselves to merely qualitative evaluations.

uses mainly spatial measures and transfer payments for regions with limited activities in order to promote the multi-purpose role of agriculture; and (ii) the Single Programming Document 2004-2006, where one of the four key priorities is to restructure agriculture, forestry, and fishing. For 2004, the planned measures from the first document were entirely realised and thus European funds earmarked for them have not yet been utilised.

4. Environmental development

THE SEDS' OBJECTIVE: Environmental development, as defined here, refers to the progressively improving utilisation of natural resources for the purposes of achieving greater prosperity. Environmental capital is given economic significance through environmental services: the growth, reproduction, differentiation and other economic services that maintain and preserve the animate and inanimate worlds. Hence, there is an important distinction between protecting and developing the environment since the former is primarily concerned with managing excessive pressure on the environment, while the latter refers to managing environmental capital so as to maximise renewable environmental welfare in the long term.

THE REPORT'S FINDINGS: Despite the numerous recent measures adopted in the area of environmental protection and development, the current situation is still unsatisfactory. Slovenia is burdened by energy-intensive industries that are only slowly on the decline, an increasing share of environmentally hazardous industries, and above-average, albeit decreasing, agricultural intensity in terms of fertiliser use compared to the EU. Better results than in the EU have been achieved in the areas of the environmental impact of traffic, organic farming and the use of renewable energy sources.

ANALYSIS: To examine realisation of the SEDS' goals we should look not at the state of the environment but at the relationship between economic and environmental development. Thus, evaluating the extent of greenhouse gas emissions and environmental damage requires the examining of underlying economic structures: trends in the share of dirty industries in the composition of manufacturing, the share of energy-intensive industries and road traffic, renewable energy sources and tree felling. Agricultural intensity is an indicator of the environmental burden of chemicals, environmental protection and food safety.

The **share of dirty industry** – industry with the highest share of environmentally destructive emissions per unit of output – in total value added in the manufacturing sector has been increasing since 1999, and the rise was particularly pronounced in 2003 as a result of growing value added in the production of chemicals. Output in these industries has been growing faster than output in all other manufacturing sectors combined, especially in recent years. Industries that place the biggest burden on the environment and are most energy-intensive created almost one-quarter of total value added in manufacturing in 2003, generating a developmental conflict between the goals of economic growth and development on one hand and environmental development on the other. A particularly alarming fact is that in 2002 current and capital expenditures for environmental protection dropped significantly, mainly in the chemicals industry.

The existing Slovenian economic structure, in which manufacturing comprises 27% of total value added (the highest proportion in the EU-25), and among which more than a third are energy-intensive industries like the metal, paper and chemical industry (creating 9.7% of total value added, the highest in the EU-25), is one of the reasons for the Slovenian economy's high **energy intensity**. While falling considerably

during the 1995-1999 period (on average by 2.3%), energy intensity has been decreasing only slowly more recently (even rising somewhat in 2001, and dropping by 1.8% in 2003). The National Energy Programme adopted last year sets improved energy efficiency as one its strategic long-term goals (it targets a 2.5% lower annual growth rate of end-energy needs relative to GDP growth). The main measures for improved energy-use efficiency include: introducing an energy tax, a tax on carbon dioxide emissions, financial incentives for eco-friendly manufacturing,[47] spreading awareness among energy users, energy advisory network, promoting the use of energy services (contract-based energy saving or energy supply, i.e. demand-side management), and support for research, development and demonstrative projects.

The **road transport of goods** is significantly overtaking railway transport in both Slovenia and the rest of the world since it is the more competitive alternative due to its flexibility and non-included external environmental costs. Its share in Slovenia in total goods transport is somewhat lower than the EU average: it has remained constant over the past three years (at 65.8%) but our estimates indicate that it increased slightly last year and moved towards the EU average. The structure of goods transport is also a function of the geographical characteristics of a particular country and its traffic policies. The railway services market was liberalised with Slovenia's entry to the EU and the sole provider has been restructured. Future increases in railway traffic will also be influenced by the further development of related infrastructure (which includes both the railway network and the Koper harbour).

The increased use of **renewable energy sources** is consistent with the concept of sustainable development and significantly contributes to attaining the Kyoto Protocol's goals, albeit it is also subject to natural factors. The share of this energy in total energy use in Slovenia is – largely due to the high share of hydroelectric energy – almost twice as high (10.8% in 2003) as the EU average. Recent droughts have decreased this share, with slight increases in biomass usage. The drop in hydroelectric power in the EU has been counterbalanced by increased biomass and wind energy. According to natural endowments, Slovenia still has considerable potential for increasing the usage of the so-called classical sources of renewable energy (biomass, hydroelectricity) as well as non-classical sources (wind, solar). The biomass is related to the **management of forests**, which are one of Slovenia's few natural resources, and Slovenia appears to be managing this task poorly. Despite the increase in 2003 the intensity of tree felling appears too low, particularly due to tending (thinning for the purposes of natural or artificial regeneration). Compared to the EU, Slovenia is lagging behind in the production of forest assortments. A long-term development policy aimed at boosting ecological stability and economic valuation of forests would improve the situation.

Slovenia's agricultural intensity has been falling in recent years, a favourable development from an environmental protection and food safety viewpoint. In 2003, decreases were posted in the use of both macrofeed in mineral fertilisers per unit of fertilised land, as well as total sales of pesticides (after the increase in 2002), and organic and integrated farmland areas expanded. The use of mineral fertilisers in Slovenia is above the EU average, as is the share of organic farmland. We expect

[47] Subsidies, low-interest loans, tax exemptions or tax deductions.

that the adoption of European agricultural policies tying financial incentives to higher environmental standards will continue to reduce mineral fertiliser and pesticide use and expand the scale of organic and integrated farming.

A new Environmental Protection Act was adopted last year, regulating the protection of human existence with the inseparably linked natural environment and general conditions of the use of natural resources. The most important innovations of the new act are the introduction of strategic environmental assessment, the environmental protection licence for the operation of certain installations, the strengthening of public participation and rights of access to environmental information, and the systematic improvement of the economic instruments of environmental protection with the aim of putting into practice the 'polluter pays principle'. A resolution on the National Environmental Action Programme has also been proposed (for the period to 2008) with the aim of generally improving the state of the environment, the quality of life, and the protection of natural resources. Based on the National Allocation Plan for the 2005-2007 period, greenhouse gas emissions rights were granted free of charge to the operators of certain equipment[48] that produce such emissions. This is one of the instruments[49] whose aim is to reduce greenhouse gas emissions and attaining an 8% decrease in these emissions by the 2008-2012 period relative to the 1986 base year, a responsibility which arises from Slovenia's ratification of the Kyoto Protocol. From a natural habitat and heritage conservation perspective, Slovenia protected more than one-third of its territory with Nature 2000 and thus restricted both intrusions and other uses of this space for the purposes of developing certain economic activities. Nature conservation can simultaneously provide both a developmental advantage and a developmental hurdle, and thus the conservation functions will have to be reconciled with the developmental purposes in order to ensure an appropriate level of economic and social development for the residents of protected areas.

[48] This refers to the operators of devices who are obliged to obtain permission for the emission of greenhouse gases in order to operate theses devices, pursuant to the new Environmental Protection Act.

[49] Currently several measures in the area of emissions reductions are in use such as taxes for carbon dioxide emissions, promoting the efficient use of energy among consumers, promoting an increase in renewable energy source use, energy labelling of house appliances, thermal insulation characteristics of building materials, waste management, power and natural gas trading, spreading awareness among consumers regarding the carbon dioxide emissions of motor vehicles, promoting the use of biofuels, introducing excise duties for fossil fuels and electricity.

5. Social development

THE SEDS' OBJECTIVES: The SEDS sets down three basic conditions in social development which, if met, would lead to an increase in welfare and facilitate human development: a long and healthy life; education and access to information; and access to the resources needed for a decent standard of living. The SEDS also highlights the problem of increasing income differentials among different social groups, generations and regions, as well as the growing share of unemployed women. It sets sound social security and social cohesion as the goals of social development policy.

THE REPORT'S FINDINGS: ***Social development*** *is bringing positive results: while life expectancy is increasing the risk of poverty rate before and after social transfers and income inequalities are falling. Although still below the European Union average, the funds allocated by the government for welfare through the systems of mandatory social, health, pension and disability insurance and other systems of public funding are gradually rising. However, some indicators (for instance the difference between the risk of poverty rate before and after social transfers) show that the transfers are not yet efficient enough. Moreover, the effects of pension reform can be seen in the rising average retirement age and the falling ratio of pensions to wages.*

ANALYSIS: The **human development index** (HDI)[50] shows the level of social development and general welfare. The 2002 index reveals a dual rise: a rise in the value of the index and a rise in Slovenia's ranking among 177 countries (Slovenia was ranked 27th). Promising social development is also revealed by several other indicators. **Life expectancy**, which is an indicator of health and general welfare, increased in 2003. Men and women born in 2003 can therefore expect to live 73.2 and 80.7 years, respectively. While the gaps are narrowing, Slovenia still lags behind the EU-25 average. In 2002[51] its life expectancy gap with the EU-25 was 2.5 years for men and 1.2 years for women. The longest life expectancy was recorded in Spain for women (83.7 years) and in Sweden for men (77.9 years). With 4.0 babies dying per 1000 live born babies in 2003, **infant mortality** increased slightly over 2002, when it reached a record low of 3.8. Nevertheless, it remained below both the EU-25 and EU-15 averages, the latter being 4.3. Meanwhile, Sweden has the lowest and Latvia the highest infant mortality (2.8 and 9.4).

Another key indicator of social development is the **volume of public funds** (calculated by way of ESSPROS) which is earmarked for welfare and social protection through systems of mandatory social, health, pension and disability insurance, as well as through other systems of public funding. Besides raising the quality of life of children and families, the government also uses these funds to secure social protection for the elderly, sick, disabled, unemployed and poor as well as for war veterans and the victims of war. Slovenia allocated 25.4% of its gross domestic product[52] for social protection in 2002. On average, the EU-15 earmarks

[50] HDI results are presented under 1.1. Balanced economic, social and environmental development.

[51] The latest data available for the EU-25 are from 2002.

[52] The figure for 2002 is somehow lower than that published in the 2004 Development Report because the estimate of Slovenia's gross national product was revised in the meantime.

1.9 p.p. more than Slovenia yet there are considerable differences among EU members. As for the share of **social protection funds** in the GDP, Slovenia was placed after Finland (25.8%) in 2001 (the latest available data for the EU), but ahead of Portugal (23.9%), Luxembourg (21.2%), Spain (20.1%) and Ireland (14.6%). Slovenia was also placed ahead of all three new EU member states for which the figure is available for 2001, namely Hungary (19.9%), Slovakia (19.1%) and Malta (18.3%). Comparing the structure of **social protection** funds with the EU-15, Slovenia earmarked more for sickness and health care, for children and families as well as for disabilities in 2001. Less money went for unemployment and survivors, while the share allocated for other forms of social exclusion was practically the same as in the EU-15. However, both Slovenia and the EU-15 assign the greatest amount of social protection funds for old age (2002: 44.7%), and sickness and health care (2002: 31.3%). The two categories take up as much as over three-quarters of all funds.

The risk of poverty rate keeps falling in Slovenia, reaching 11.9[53] in 2002, which is 2.1 p.p. below the EU-15 and 4.6[54] p.p. lower than in the EU-25. Moreover, the inequality of income distribution has been dropping since 1997 in Slovenia, and so has the depth of poverty[55] since 1999. The comparison of the Gini coefficient (22.0) and income quintile share ratio (3.1) shows that in Slovenia inequality is substantially below that of the EU-25, whose Gini coefficient was 28.0 in 2001 and the income quintile share ratio was 4.4. In the absence of a system of social transfers, the risk of poverty would increase by 7.3 p.p. in Slovenia and 9 p.p. in the EU-15. This comparison reveals that Slovenia's social policy is slightly less effective than that of the EU-15, meaning that even better results could be achieved with the funds currently available for this purpose.

Apart from low education, unemployment[56] is the prime contributor to poverty risk and consequently a social exclusion factor. This is the reason why the risk of poverty and social exclusion is measured indirectly with the share of the population living in jobless households. 8.1% of people aged from 18 to 64 lived **in jobless households** in Slovenia in 2002. As a result, the same share lived in a non-stimulating environment, simultaneously losing touch with the labour market which makes the risk of long-term inactiveness increasingly more likely, particularly for the elderly. (In Slovenia 23.5% of people aged 55 to 64 were employed in 2003 as compared to 40.2% in the EU-25). Nevertheless, the share of the Slovenian population living in jobless households in the 1996-2002 period was 2.2 p.p. below that of the EU-15, and was decreasing faster than in the EU-15. Further, Slovenia's share in 2002 was 4 p.p. below the average of EU-25 which, however, witnesses great differences among individual member states. With 5.4%, Portugal had the lowest share of jobless households, Spain's rate matched Slovenia's at 8.1%, followed by Luxembourg (8.9%). Belgium (16.3%) and Hungary (15.6%), on the other hand, posted the biggest shares of jobless households.

[53] The calculation includes only monetary sources.

[54] The figures include not only financial resources but also income in kind.

[55] The share of people who are far away from the poverty threshold.

[56] The risk of poverty is much higher among the unemployed than the employed, reaching 39.3% in the first group and 3.7% in the second in 2002.

Although not very high in Slovenia, **long-term unemployment** makes job seekers more passive which further narrows their chances to re-enter the labour market. While long-term unemployment[57] stood at 3.4% in 2003 in Slovenia (3.3% among men and 3.6% among women), more than half of all unemployed were long-term unemployed people (54.7%). Slovenia had a rate of very long-term unemployment[58] of 2%, which is almost the same as in the EU-15 (1.9%) and well below the 4% average of the new EU member states.

Enhancing one's prospects to find a job considerably, education and training seem to be a good preventive measure against poverty and social exclusion. According to econometric calculations, the likelihood that a person gets a job increases by 0.4 p.p. if they increase their time for education and training by 10%. Moreover, the likelihood of remaining jobless decreases by 0.2 p.p. (OECD, 2004, p. 185). The structural indicator of **early school leavers**, which indirectly increases the risk of poverty due to more limited access to the job market, is better in Slovenia (2001: 7.5%) than in the EU-15 (18.9%) or the EU-25 (17.3%).

Welfare, however, cannot be measured merely by one's material resources as represented by the volume of funds the government allocates for social protection. What also matters is people's perceptions and impressions, which are reflected in a **subjective evaluation of the satisfaction with the quality of life and the perception of social exclusion.** People have their own way of understanding welfare and their ability to cope with life situations, which shapes their own view of life[59]. Compared to the EU-25[60], the inhabitants of Slovenia have expressed the lowest level of the subjective perception of social exclusion[61]. As many as 81% of respondents are generally satisfied with their lives. They are most satisfied with their home and family life (94%), and named employment as the most important welfare factor.

Three years after it began to be implemented, **pension reform** has already yielded its first **results**. The average retirement age is rising, reaching 59 years and 11 months for men and 55 years and 8 months for women in 2003. The ratio of the average old-age pension to the average wage fell to 71.1% in 2003 (2000: 75.3%). Its results can moreover be seen in public finance: the share of pension expenditure in gross domestic product fell to 11.4% in 2002. The reform also envisages the

[57] The share of people who are jobless for at least a year in the entire active population.

[58] The share of people who are jobless for more than two years in the entire active population.

[59] A study on the quality of life carried out in the EU-25 plus three candidate countries in 2004 by the European Foundation for Improvement of Living and Working Conditions and the European Commission is based on a multidimensional concept of the quality of life: six core areas were selected for the survey: (1) relations with family and friends; (2) emotional welfare; (3) health; (4) work and production activities; (5) attachment to the community; and (6) personal security.

[60] Ibidem.

[61] Measured by the social exclusion index, the index consists of reactions to four statements with which the survey monitors: (1) the feeling of influence in society (my contribution is not recognised by society); (2) the feeling of community inclusion/exclusion (I feel excluded from society); and (3) the feeling of anomie (I believe I have no chance of being a useful member of the community; some look down on me due to my job or income). In Slovenia, 81% of respondents disagree with all statements, 6% agree with two or more.

possibility of capital-funded supplementary pension insurance financed by premiums paid by workers or employers, or part of the premium by each. Insurance can be collective or individual. Pension funds are being set up in Slovenia that offer voluntary supplementary pension insurance. This service was previously only offered by insurance companies. The number of people insured in pension funds and the amount of premiums that the funds collect is rising[62]. This trend is expected to continue as a result of the collective pension insurance scheme for civil servants.

[62] At end-2004, nearly 400,000 people were estimated to take part in supplementary pension insurance, which is almost half of all active persons insured under mandatory pension insurance (around 80,000 at end-2001). The bulk of the rise results from a collective supplementary insurance scheme for public servants in which some 160,000 people are taking part. Premiums totalled SIT 6.4 bn in 2001, SIT 23.8 bn in 2002, and are expected to reach SIT 58 bn in 2004 for the entire period of insurance, of which SIT 16 bn comes from public servants

6. Meeting the Lisbon Strategy objectives

The profile of Slovenia's development broken down by structural indicators. The European Commission has short-listed fourteen general structural indicators[63] to assess implementation of the Lisbon Strategy (Table 4). Compared to the EU-25 average, **Slovenia is better positioned** according to several structural indicators: youth education attainment level; share of business investment in gross domestic product; volume of freight transport relative to gross domestic product; and social cohesion indicators (poverty-risk rate after social transfers and the long-term unemployment rate). Moreover, from the aspect of these structural indicators Slovenia is also better positioned than the other new EU member states.

Table 4: **Slovenia's Profile in Terms of Structural Indicators**

	LISBON PROCESS STRUCTURAL INDICATORS (14) - SLOVENIA'S PROFILE AND CHANGES COMPARED TO THE YEAR BEFORE	
	Slovenia places better than or around the EU-25 average	**Slovenia lags behind the EU-25 average**
Improvement (from the year before)	❖ **Youth education attainment level**[1], 2003 (SLO: 90.7%, EU-25: 76.7%, EU-15: 73.8%) ❖ **Poverty risk rate after social transfers**, 2001 (SLO: 11.9%[2], EU-25: 15%, EU-15: 15%) ❖ **Long-term unemployment rate**, 2003 (SLO: 3.4%, EU-25: 4%, EU-15: 3.3%) ❖ **? Business investment**[3], 2003 (SLO: 21.1% BDP, EU-25: 16.8% BDP, EU-15: 16.7%)	❖ **GDP p.c. in PPS**, 2003 (EU-25=100) (SLO: 76.8, EU-15: 109.2) ❖ **Labour productivity in PPS**, 2004 (EU-25=100) (SLO: 75.6, EU-15: 106.4) ❖ **Comparative price levels**, 2002 (EU-25=100) (SLO: 75.5, EU-15: 103.8)
Deterioration (from the year before)	❖ **Volume of freight transport relative to GDP**, 2002 (1995=100) (SLO: 93.3, EU-25: 99.7, EU-15: 100.6)	❖ **R&D expenditure relative to GDP**, 2002 (SLO: 1.53% BDP, EU-25: 1.93% BDP, EU-15: 1.99% BDP) ❖ **Employment rate**, 2003 (SLO: 62.6%, EU-25: 62.9%, EU-15: 64.4%) ❖ **Employment rate of older workers**, 2003 (SLO: 23.5%, EU-25: 40.2%, EU-15: 41.7%) ❖ **Greenhouse gas emissions**, 2002 (1990=100) (SLO: 98.7, EU-25: 91, EU-15: 97.1) ❖ **Energy intensity of the economy**, 2002 (SLO: 342.8 kgoe/1,000 EUR; EU-25: 209.3 kgoe/1,000 EUR, EU-15: 191.1 kgoe/1,000 EUR)

Source of data: Eurostat, New Cronos database.
Notes: [1]The share of people aged 20 to 24 who have at least finished secondary school. [2]Income in kind is not used in calculation of the rate. If income in kind is taken into account, then the rate is 10.6%. [3]The share of GDP allocated for investment by the private sector.
Note: data for the indicator of the dispersion of regional employment rates are not available for Slovenia.

Slovenia lags behind the EU-25 average in more than half the indicators yet it is placed better than most new EU member states in most indicators. The country lags behind in general economic indicators (gross domestic product per capita in PPS, labour productivity in PPS), in innovation and research indicators (volume of R&D expenditure relative to the gross domestic product), labour market indicators (the employment rate of older workers in Slovenia is one of the lowest in the EU) and environmental protection indicators (reduction of greenhouse gas emissions and energy intensity of the economy).

[63] Indicators are regularly published by the European Commission on the website of the Eurostat, and are analysed by it in the Spring Report to the European Council. Eurostat publishes not only the short listed indicators but also the complete database of structural indicators.

Measured against the values of indicators in the previous year, **Slovenia managed to reduce its gap in several indicators where it was placed below the average of the EU-25**. Gaps were reduced in labour productivity, gross domestic product per capita in purchasing power and in comparative price levels. On the other hand, the indicators of employment (employment rate[64], employment rate of older workers), research and development expenditure and both environmental indicators show lower values than in the previous year.

When analysing **the entire set of indicators** one can establish that in some indicators of the knowledge-based society Slovenia comes in above the EU-15 average, for instance in life-long learning and the level of households with Internet access. Social cohesion, most notably inequality of income distribution, the poverty-risk rate before and after social transfers and the difference in gross pay by gender, is another indicator where Slovenia beats the EU-15 average. On the other hand, some development indicators, such as patent registration and IT expenditure, are a cause for concern.

Implementation of the Lisbon Strategy in Slovenia. The initiatives adopted in Lisbon and then upgraded at later sessions of the European Council set goals and measures in a number of areas. The goals are defined in terms of quantity and quality[65]. Moreover, many are "pan-European" which means their progress is hard or even impossible to monitor at the national level.

The implementation of the Lisbon Strategy goals differs among EU member states.[66] Like with the structural indicators, Slovenia is doing better than the rest of the new EU member states but lags considerably behind the most successful EU members. However, the levels of attainment of individual goals differ in both Slovenia and the other EU member states (Table 5). In **employment**, Slovenia achieved the employment rate goal for women set for 2005 as early as 2000. The rate further improved in the period from 2000 to 2004, meaning that the goal for 2010 has also already been reached. The employment rate increased in 2004 over 2003 by a great deal, yet the Lisbon goal for 2005 will only be achieved if the 2004 employment trend continues in 2005. On the other hand, Slovenia is far from achieving the two other goals. The employment rate of older workers and the average retirement age are rising, yet too slowly to reach the set goals by 2010. As for the **knowledge-based society** goals, Slovenia achieved the goal of integrating adults in lifelong education as early as 2003, yet methodological differences put the value of data and consequently the achievement of the goal in question[67]. In all other indicators Slovenia is lagging far behind. Results are improving for expenditure on research and

[64] Data for 2004 show considerably better results. With a 65.6% employment rate in 2004, Slovenia outperformed the average of the EU-25 and the EU-15 for 2003.

[65] Progress is hard to measure in goals which, for instance, define business incentives. Another problem is the non-adoption of a uniform methodology for a regulatory framework or administrative obstacles (for instance, Belgium, Denmark and the Netherlands have decided to cut administrative obstacles for companies by 2010 by 25%).

[66] In the year of adopting the Lisbon Strategy, the EU-15 posted a relatively high economic growth rate of 3.6%, which however dropped to 1.2% in the period from 2001 to 2003, well below the set goal of 3%. EU member states had different growth rates and also differed in the implementation of other partial goals. The closest to achieving the goals were Denmark, Luxembourg, the Netherlands, Austria, Sweden and Great Britain.

[67] Methodological differences are explained under 3.1. Transition to a knowledge-based society.

Table 5: **Implementation of the Lisbon Strategy goals**

Selected Lisbon Strategy goals	Quantification of goals	Slovenia's achievements
EMPLOYMENT		
- Total employment rate	67% until 2005, 70% by 2010	2000: 62.8%; 2004: 65.6%
- Employment rate for women	57% until 2005, 60% by 2010	2000: 58.4%; 2004: 61.3%
- Employment rate of older workers (55-64 years)	50% by 2010	2000: 22.7%; 2003: 23.5%
- Prolongation of average retirement age	by 5 years by 2010	2000: 57.2 years; 2003: 57.8 years
KNOWLEDGE-BASED SOCIETY		
- R&D expenditure relative to GDP	3% of GDP by 2010, of which two-thirds from the business sector	2000: 1.44%; 2003: 1.53%
- Internet access at schools	100%	
- Inclusion of adults in lifelong education	12.5% of all adults	2001: 7.6%, 2004: 17.9%
- Early school leavers	To halve the number of dropouts by 2010.	2001: 7.4%; 2004: 4.2%
INTERNAL MARKET		
- Transposition of internal market directives to national legislation	98.5% transposition by 2010	2004: 96.8%
- Timely transposition of directives on the basis of the Lisbon Strategy to national legislation	In two years at the latest.[1]	2004: backlog of 20 directives
- State aid	Drop to 1% of GDP.	2000: 2.07% GDP; 2003: 1.52% GDP
ENVIRONMENT, SUSTAINABLE DEVELOPMENT		
- Production of electricity from renewable sources	22% of total consumption by 2010.	2000: 31.4%; 2002: 25.9%

Source of goals: Conclusions of the European Councils in Lisbon, Barcelona, Stockholm and Gothenburg, various documents of the European Commission.
Sources: Eurostat, New Cronos database and SORS.
Note: [1]The »zero tolerance rule« does not apply to the new EU members states yet.

development relative to GDP, yet too slowly to achieve the goal by 2010 if the trend continues at the current pace. With the number of early school leavers falling a great deal in the 2000 to 2003 period this goal has almost been reached, yet the value of the data is questionable due to methodological differences.[68] The goal of Internet access at schools has nearly been achieved, but the country lags behind in the number of computers at schools. Moreover, the level of use of information and communication technologies in the education process[69] and the level of specialised didactic skills in the education of workers are too low.

In the area of the **internal market**, Slovenia has adjusted its legislation on the free movement of goods and services, including competition protection, in line with the acquis. Together with Lithuania, it has the lowest, namely 5.7%, deficit[70] among all the new EU member states in the transposition of internal market directives[71]. Until the beginning of January 2005, 56 of a total of 73 directives[72] adopted on the basis

[68] The problem of early school leavers is described in detail under 3.1. Transition to a knowledge-based society.

[69] The differences in the intensity of use of ICT in the education process are much bigger. Teachers and pupils in the EU use personal computers twice as much as in Slovenia (the example of primary schools - Slovenia: 1.1 hours a week, EU-15: 3.6 hours).

[70] Second Implementation Report of the Internal Market Strategy 2003-2006, 27 January 2005.

[71] Slovenia had failed to transpose 36 of a total of 1,579 directives by December 2004, which represents a 3.2% transposition deficit.

[72] The directives aim at a greater degree of harmonisation and a common legislative framework in order to strengthen the internal market, upgrade competitive ability and increase the potential for economic growth.

of the Lisbon Strategy were planned to be transposed to the national legislation. Slovenia had fully transposed 44, while 8 were transposed only partly. As a result, it has a 78% Lisbon directives transposition rate, which places Slovenia among the best performing countries (the average rate is only 58.3%). Slovenia is also rapidly reducing the amount of state aid, whereby it is moving closer to the goal.

In **environmental protection**, Slovenia had a larger share of renewable energy in the consumption of primary energy than set in the relevant Lisbon Strategy goal.

As part of new economic and employment cycles, the European Commission suggests[73] a comprehensive approach to streamlining the existing broad guidelines for economic policy and employment. Therefore, like the other EU member states Slovenia has to carry out a nation-wide debate on the basis of which it should pass a national action plan for economic growth and jobs with commitments and goals. This means that the goals of the Lisbon Strategy will no longer be the same for all EU member states but will differ according to the level of economic development and development orientation of each member state.

[73] A communiqué to the spring session of the European Council, 2005, pp. 10-11.

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Analytical Appendix

Indicators

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List of Indicators

Syntesised development indicators:

Indicators of economic development:

Macroeconomic stability

Knowledge-based society

Competitiveness of the economy

Developmental role of the state

Indicators of environmental development:

Indicators of social development:

Gross domestic product per capita in purchasing power standards

In December 2004, Eurostat released new data on gross domestic product per capita expressed in terms of purchasing power standards (GDP in PPS) for 32 countries for the 1995-2003 period. The figures for 2002 are final, while those for 2003 are provisional. According to the latest data, the member states of the European Union ranged from 40% and 215% of the EU-25 average in terms of GDP per capita in PPS. After the accession of the generally less developed ten new countries, the average GDP per capita in PPS in the EU-25 fell in 2003 and reached 92% of the EU-15 average (90% in 1995). Due to the so-called statistical effect, this also produced a commensurate rise in Slovenia's level of development in 2003, estimated at 71% of the EU-15 average and 77% of the EU-25 average. GDP per capita in PPS of the ten new member states achieved 53% of the EU-25 average in 2003, according to provisional figures. In the group of candidate countries, Bulgaria and Romania reached 30% of the EU-25 average in 2003, and Turkey achieved 28%, which almost equalled their levels achieved in 1995. Eurostat also estimated Croatia's level of development, which totalled PPS 9,700 in 2003 (46% of the EU-25 average).

Having reached 77% of the EU-25 average in 2003 Slovenia overtook Portugal, while amongst the new member states only Cyprus is ahead of Slovenia in terms of GDP in PPS. Luxembourg reached the highest level of development in 2003 in terms of GDP per capita in PPS in 2003 which totalled more than twice the EU-25 average (215%). Ireland was one-third above the average, while Denmark, Austria, the Netherlands and the United Kingdom surpassed the average by about 20%. Sweden and Finland were 15% above the average, while France, Germany and Italy recorded figures around 10% above the average. Lithuania was the least developed country in 2003, achieving 41% of the EU average. Among the new members 2003, only Cyprus was more developed than Slovenia in 2003 (83% of the average). Among the old EU-15 members, Slovenia scored PPS 16,400 and outperformed Portugal (PPS 15,900), while it lagged behind Greece which had been ranked lower than Slovenia in 1999-2001.

The GDP per capita in PPS indicator is mainly used for cross-country comparisons within one year[1], while year-on-year comparisons between its values require some caution in interpretation due to the methodology applied, notably when minor changes in subsequent years are involved. Year-on-year comparisons of the indicator's value are hence more reasonable when comparing longer periods. The average GDP per capita in purchasing power standards in the EU-25 totalled PPS 15,200 in 1995 and PPS 21,400 in 2003. The rankings of EU countries by GDP per capita in PPS indices achieved within a longer period are relatively stable. Only Luxembourg and Ireland climbed significantly in their rankings from 1995 to 2003. Luxembourg improved its position relative to the EU by 36 p.p. (from 179% of the average in 1995 to 215% of the average in 2003), while Ireland moved up 34 p.p. (from 99% to 133% of the average). Germany, France, Italy and the United Kingdom remained 10%-20% above the EU average throughout the observed period. Nevertheless, significant differences exist between these countries. The United Kingdom reveals a rising trend in its relative level of development, while Germany and Italy have recorded a downward tendency. France maintained its level 13%-15% above the average throughout the period and exceeded this average by a further 11% in 2003. In the 1995-2003 period, Germany and Italy, in addition to Austria, were among those countries whose position in relative terms worsened most markedly compared to the EU average (Germany's by 9 p.p., Italy's by 8 p.p. and Austria's by 7 p.p.).

Since 1995, when Slovenia achieved 68% of the EU average, it has improved its position relative to the European average by 9 percentage points. Among the new member states Slovenia was ranked second, except in 1999 and 2000 when Malta did better, while the gap between Slovenia and Cyprus (the most developed country in the group) has narrowed. It totalled 6 p.p. in 2003 (18 p.p. in 1995). In the group of new member states compared with the EU, only the Czech Republic and Cyprus recorded a lower level of development in 2003 than in 1995 (down 1 and 3 p.p., respectively), while all other countries improved their levels of development. In the 1995-2000 period, Estonia was the only country to outpace Slovenia while since 2001 Latvia, Lithuania and Hungary have also progressed at a faster pace, which indicates a relative slowdown in Slovenia's economic growth.

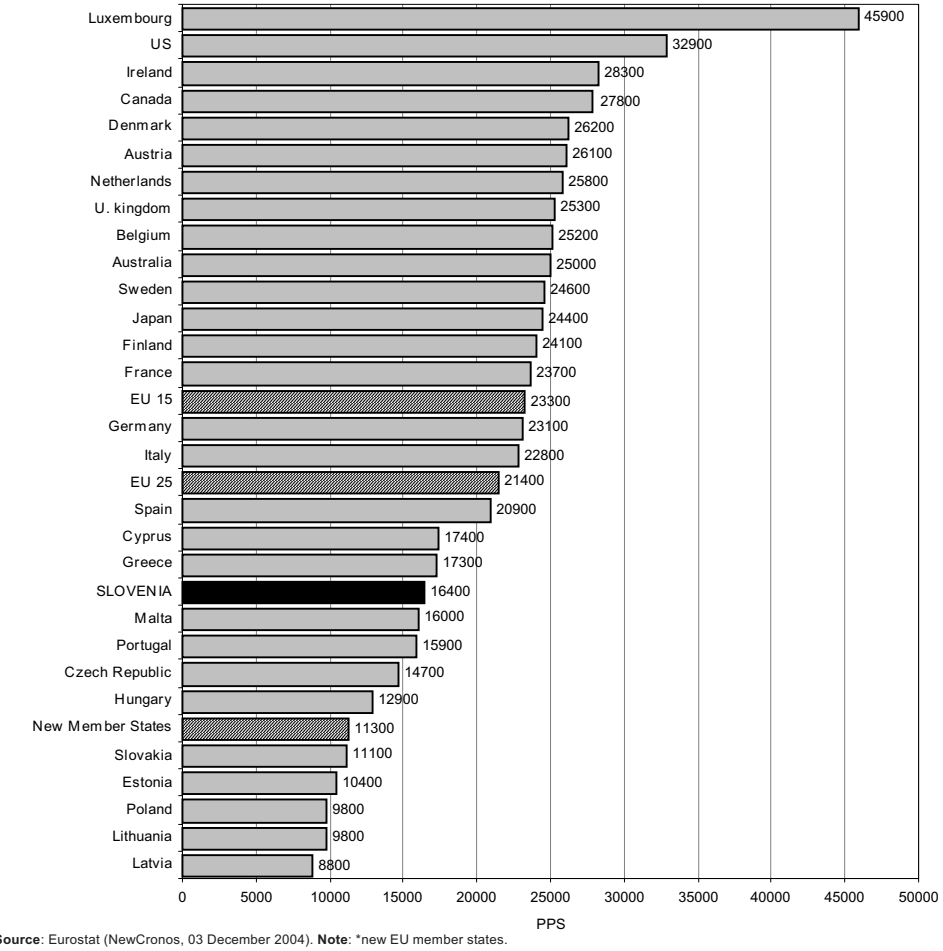
[1] Eurostat notes that caution should be exercised when ranking countries according to GDP in PPS since purchasing power standards used as conversion rates and a means of calculating GDP in terms of purchasing power are statistical constructs based on certain conceptual assumptions, methodological definitions and implementing procedures. A 5% error should therefore be taken into account when calculating purchasing power standards. Relatively small differences in GDP in PPS between countries may hence be the result of methodological factors rather than actual differences between countries (source: Purchasing Power Parities 1999 Benchmarking Results, OECD, 2002).

Table: **Gross domestic product per capita in purchasing power standards for the new EU member states, 1995-2003; volume indices, EU 25 = 100**

	1995	1996	1997	1998	1999	2000	2001	2002	2003[P]
EU 25	100	100	100	100	100	100	100	100	100
Cyprus	86	85	84	84	85	86	89	83	83
Slovenia	68	70	71	72	74	73	75	75	77
Malta	-	-	-	-	78	79	75	74	75
Czech Republic	70	72	70	67	66	65	66	68	69
Hungary	50	49	51	52	53	53	56	59	61
Slovakia	45	46	47	48	47	48	49	51	52
Estonia	34	35	39	40	39	42	43	46	49
Lithuania	34	35	37	39	38	39	41	42	46
Poland	41	42	44	45	46	46	46	46	46
Latvia	30	31	33	34	34	35	37	39	41
New member states - 10	-	-	-	-	50	50	51	52	53
EU 15	111	110	110	110	110	110	110	109	109

Source: Eurostat (NewCronos, 03 December 2004). **Note**: [P] - provisional data.

Figure: **GDP per capita in purchasing power standards in 2003 by countries**



Source: Eurostat (NewCronos, 03 December 2004). **Note**: *new EU member states.

Human development index

The human development index (HDI) measures a country's social development in its broadest meaning despite having certain methodological limitations. Hence it measures one of the basic objectives of the Strategy of Slovenia's Development – to sustainably raise the level of welfare for the people living in Slovenia. HDI is supposed to include indicators that reflect countries' achievements in different areas and at different development levels; the current indicators, however, merely reflect minimum differences between the highly ranked countries[1].

The calculated human development index of Slovenia for 2002 brings a number of positive changes in comparison with previous years. Slovenia namely recorded both a higher index value and a better ranking in 2002. With a significant rise in its index value (from 0.881 to 0.895), it climbed from 29th to 27th place among 177 countries[2]. In that year, Slovenia also recorded a noticeable increase in the values of all the sub-indices of which the HDI is composed. The biggest change was observed in the education index, the most disputed index in methodological terms[3], which rose by 0.02 of an index point compared with 2001. Due to the methodological control, the higher GDP value (in purchasing power standards, per capita in USD) was not reflected in a commensurate rise in this index that merely rose by 0.01 of a point from 2001. According to input sub-indices, Slovenia is still ranked lowest (33rd) by the life expectancy index whose value totalled 0.85.

At the global level there were no significant surprises in the calculated human development index for 2002. Of the 177 countries included in the calculation in 2002, 31% recorded an index value higher than 0.80 (the maximum value is 1.00). A slight increase was seen in the number of countries having an HDI above 0.90 (25), while 35 countries recorded values lower than 0.50. Sierra Leone had the lowest index value (0.273), while East Timor (0.436, rank: 158) was the only non-African country among the last twenty.

In both European and global terms Norway remains in the lead. Norway recorded an index value of 0.956 in 2002. It was followed by Sweden (0.946) and the Netherlands (0.942), while Finland was ranked 13th with an index value of 0.935. Greece (0.901) was ranked 24th, Portugal (0.897) was 26th. Slovenia assumed the highest place among the new member states. It is followed by Cyprus (0.883, rank: 30), Malta (0.875; rank: 31) and the Czech Republic (0.868) which remains in 32nd place. Other countries from the new EU member states group have been improving their index values steadily yet still not rapidly enough to move up in their rankings.

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[1] The human poverty index could perhaps shed some more light on the measures needed to improve the quality of life, yet it is still calculated for only 17 OECD countries. The education index has also been subject to growing criticism for not taking account of the school systems' incomparability and not revealing the population's actual (il)literacy.

[2] These changes should be considered with some reserve – namely, input data change due to the revisions of estimates during the years, which is why using data from different annual reports is inappropriate for trend analyses. For easier and more accurate international comparisons, the UNDP calculates and publishes year-on-year trends (in 5-year intervals since 1975); the last published calculation showed, for instance, that the value of the HDI index for Slovenia for 2000 has risen from 0.879 to 0.883.

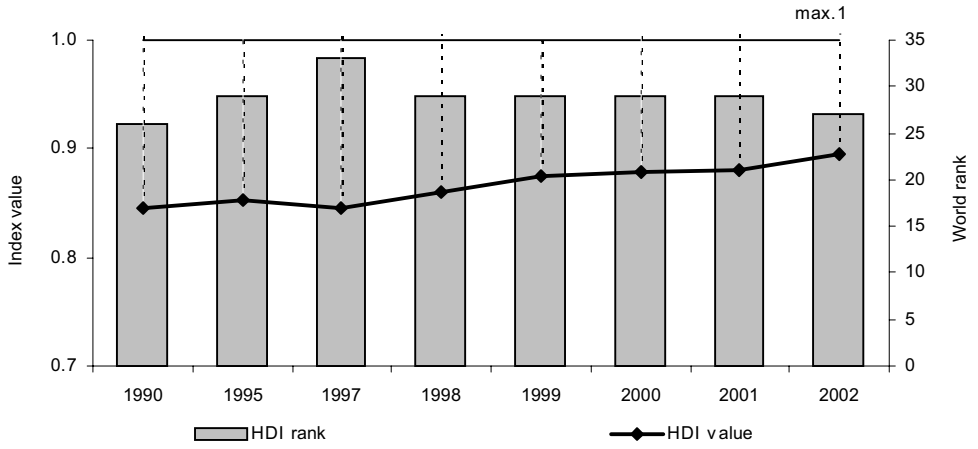
[3] Due to the inadequately chosen methodology of measuring literacy for countries with a high human development level and the differences in the definitions of literacy. Namely, different kinds of literacy (numeric, reading, functional etc.) are an important factor of development hence the UNDP, in addition to its other attempts to adjust methodologies, is developing through UNESCO a new methodology (LAMP – Literacy Assessment and Monitoring Programme) aimed at encompassing different kinds of literacy relevant to both countries with higher and lower levels of human development.

Table: **Values of the human development index (HDI) and its components for Slovenia in the 1995-2002 period**

	1995[1]	1997[1]	1998[1]	1999[2]	2000[2]	2001[2]	2002[2]
HDI	0.852	0.864	0.864	0.874	0.879[3]	0.881	0.895
Global ranking (no. of countries covered)	28.	28. (174)	28. (174)	29. (162)	29. (173)	29. (175)	27. (177)
Life expectancy	74.52	74.90	75.00	75.30	75.50	75.9	76.2
Index	0.83	0.83	0.83	0.84	0.84	0.85	0.85
Gross enrolment ratio	79.1	82.0	82.0	83.0	83.0	83.0	90.0
Education index	0.924	0.93	0.93	0.94	0.94	0.94	0.96
GDP in purchasing power standards[4]	12,600	14,000	14,800	15,977	17,367	17,130	18,540
Index	0.81	0.825	0.83	0.85	0.86	0.86	0.87

Sources: (1999) Human Development Report - Slovenia 1999. Hanžek, M. (ed.). Ljubljana: UNDP, IMAD, p. 17. (2001) Human Development Report - Slovenia 2000-2001. Hanžek, M. (ed.). Ljubljana: UNDP, IMAD, p. 24. (1999-2004) Human Development Report. UNDP Oxford University Press: New York, Oxford.
Notes: [1]calculations by IMAD, [2]calculations UNO, [3]revised value 0.883 (see note 3 in the text), [4]per capita in purchasing power standards (in USD) - figures are not comparable with the calculation of GDP per capita in PPS (see note 1 on p. 72).

Figure: **Dynamics of human development index values and Slovenia's global ranking in the 1990-2002 period**



Source: (1998-2004) Human Development Report. UNDP, Oxford University Press: New York, Oxford.

National competitiveness according to the WEF

Slovenia's ranking by national competitiveness measured by the WEF's[1] growth competitiveness index and business competitiveness index fell for the second consecutive year in 2004, albeit by one place less than in 2003[2]. Nevertheless, Slovenia retained or even improved its competitiveness relative to that of the EU-25 and EU-15 since its growth competitiveness index actually rose. The value of Slovenia's *growth competitiveness index* ***(GCI)*** has been rising steadily since the 0.06 index-point drop (to 4.64) seen in 2002. In 2004, Slovenia's GCI gained 0.05 of an index point to total 4.75, thereby exceeding the value recorded in 2001. The increase in Slovenia's GCI value in 2004 was by 0.02 i.p. higher than the average GCI increase in the EU-15, which reduced its gap vis-ŕ-vis the world's most competitive/developed countries (at present, Slovenia hence lags behind the EU-15 by 0.38 points). Slovenia's GCI growth in the observed year was also higher than the average change of indices in the EU-25 and the new member states (NMS). Nevertheless, Slovenia's ranking among 104 economies fell below its 2001 level in 2004[3], from 31st to 33rd place in the overall rankings (since 2003, Slovenia's performance has also been affected by the higher number of countries under observation). The drop in Slovenia's ranking equals the drop of the EU-25, while being smaller than the fall of the NMS (down 4 places) and bigger than that of the EU-15. In terms of its *GCI*, Slovenia is more competitive than Lithuania, Hungary, Greece, Cyprus, the Czech Republic, Slovakia, Latvia, Italy and Poland, while Estonia and Portugal, which further improved their rankings in 2004, are placed almost beyond reach for Slovenia. Slovenia's position in the *business competitiveness index* ***(BCI)*** also declined for the second year in a row. It was ranked 31st among 103 countries, which is still one place higher than in 2001 (32nd place). Hence the gap between Slovenia's ranking by the BCI and its ranking by GDP p.c. in PPS (27th place) also widened for the second year running, this time from three to four places, which the WEF regards as a warning sign that the microeconomic base in Slovenia is not sustaining the achieved income level which may as a result become unsustainable in the future. In absolute terms, Slovenia's drop in business competitiveness equals the average EU-15 drop and is smaller than the drop of both the EU-25 and NMS. Slovenia scores relatively higher compared to EU countries in its business competitiveness since it is also ranked higher than Malta and Portugal in addition to those countries it already outperforms according to its GCI.

Slovenia's fall in its GCI ranking in 2004 was due to the lower values measured in the indices of technological competitiveness and the macroeconomic environment, while the index measuring the competitiveness of public institutions – Slovenia's main weakness in 2003 – recorded a visible improvement exceeding that of the EU-15. The value of the *technology index* declined by 0.02 of an index point (to 4.71) compared to the previous year, and Slovenia was ranked 26th in this index, which is two places lower than in 2003. Within the technology index, the largest drop was registered in the innovation sub-index[4] (down 0.07 i.p. to 3.44, rank: 23), which is the main national weakness having the relatively lowest value compared to the (high) index value achieved by the highest-ranking country and the relatively high value of the lowest-ranking country. The technology transfer sub-index (4.36) remains one of Slovenia's weaknesses although it moved up in its ranking (from 51st to 46th place). The value and ranking of the information and communication technologies sub-index (ICT) remain essentially unchanged (+0.01 to 5.29, rank: 26). Despite the progress made so far, Slovenia has not yet geared itself up for a more innovative phase of development and remains one of the non-core innovators dependent on technology transfer and, even here, it scores poorly (South Africa is in the lead with 5.54, followed by Slovakia with 5.47). The most visible indicators that contributed to Slovenia's poor performance in technological competitiveness were its low rankings in FDI and technological transfer (88th place), government prioritisation of ICT (61st place), competition quality in Internet service providers (57th place), government success in ICT promotion (53rd place), technology absorption capacity in enterprises (50th place), technological readiness (48th place) and foreign technological licences (45th place).

Within the aggregate GCI, the value and ranking of the *macroeconomic environment index* dropped in 2004 (by -0.01, from 37th to 39th place). Due to the change in methodology in the sub-index measuring the potential inefficiency of public expenditure[5] in 2003, Slovenia was ranked 32 places lower in 2004 in this index (to 63rd place) which is, however, still better than in 2002 when it was ranked 68th. In other components of the macroeconomic environment, Slovenia performed better than in 2003, occupying 48th place in macroeconomic stability and 27th place in country credit rating. The biggest positive shift within the aggregate GCI was seen in the *public institutions index* where Slovenia moved up four places and whose value rose by 0.17 points. Of the components of this index, the value of the contracts and law sub-index dropped by 0.06 i.p. which pushed Slovenia down from 43rd to 47th place. In contrast, Slovenia's corruption sub-index improved significantly (by 0.40 i.p. and moved up 9 places to 23rd position.

Slovenia's ranking by the business competitiveness index (BCI) fell by one place in 2004 despite the improved quality of the national business environment and the unchanged estimates of the sophistication of company operations and strategies[6]. In the *business environment quality index*, Slovenia moved up from 34th to 32nd

place, while the rankings of the EU-15, EU-25 and NMS fell (by 1, 1 and 2 places, respectively). Slovenia's ranking in the *sophistication of company operations and strategy index* is still relatively good (27th place), whereas the EU-15, EU-25 and NMS dropped in rankings (by 1, 3 and 4 places, respectively).

Table: **National competitiveness of Slovenia, other EU members and the USA in 2003 and 2004 measured by the WEF's growth competitiveness and business competitiveness indices**

WEF Report[1] 2004–2005	WEF aggregate indices				GCI components						BCI components			
	Growth competitiveness (GCI)		Business competitiveness index (BCI)		Technology index		Public institutions		Macroeconom. environment		Company operations and strategy		Quality of the national business environment	
	04	03[2]	04	03[2]	04	03[2]	04	03[2]	04	03[2]	04	03[2]	04	03[2]
Countries[3]	r/v	r/v	r	r	r/v	r/v	r/v	r/v	r/v	r/v	r	r	r	r
Finland	1 / 5.95	1 / 6.01	2	1	1 / 6.24	2 / 6.00	3 / 6.48	1 / 6.52	3 / 5.47	2 / 5.54	7	4	1	1
Sweden	3 / 5.72	3 / 5.80	4	3	4 / 5.80	4 / 6.00	6 / 6.31	7 / 6.28	17 / 4.99	8 / 5.13	5	3	6	5
Denmark	5 / 5.66	4 / 5.61	7	4	6 / 5.34	8 / 5.25	1 / 6.59	1 / 6.56	4 / 5.36	5 / 5.38	9	7	3	3
U.K.	**11 / 5.30**	15 / 5.23	6	6	18 / 4.92	16 / 4.96	7 / 6.23	12 / 6.01	8 / 5.11	12 / 4.99	8	8	4	6
Netherlands	12 / 5.30	12 / 5.24	9	9	16 / 4.98	18 / 4.93	13 / 6.08	11 / 6.02	7 / 5.13	9 / 5.07	6	10	9	11
Germany	13 / 5.28	13 / 5.24	3	5	12 / 5.08	14 / 5.03	11 / 6.21	9 / 6.10	26 / 4.77	21 / 4.78	1	1	5	9
Austria	17 / 5.20	17 / 5.07	16	17	22 / 4.85	27 / 4.69	15 / 5.99	14 / 5.83	10 / 5.11	10 / 5.07	14	13	17	18
Estonia	20 / 5.08	22 / 4.96	27	28	15 / 5.01	10 / 5.16	26 / 5.59	28 / 5.36	30 / 4.65	34 / 4.37	33	36	24	27
Spain	23 / 5.00	23 / 4.94	26	25	20 / 4.86	25 / 4.72	34 / 5.16	31 / 5.28	16 / 4.99	17 / 4.83	25	25	26	26
Portugal	24 / 4.96	25 / 4.92	**33**	36	23 / 4.78	22 / 4.82	23 / 5.69	22 / 5.52	34 / 4.42	31 / 4.41	46	46	33	33
Belgium	25 / 4.95	27 / 4.88	14	15	31 / 4.59	29 / 4.65	22 / 5.71	27 / 5.41	19 / 4.92	19 / 4.82	11	11	19	17
Luxembourg	26 / 4.95	21 / 4.99	N/A	N/A	41 / 4.28	42 / 4.30	14 / 5.99	13 / 5.92	6 / 5.23	3 / 5.44	N/A	N/A	N/A	N/A
France	27 / 4.92	26 / 4.91	12	10	30 / 4.65	28 / 4.67	25 / 5.62	23 / 5.50	25 / 4.78	20 / 4.80	10	9	16	14
Irland	30 / 4.90	30 / 4.73	22	21	37 / 4.43	38 / 4.37	17 / 5.87	25 / 5.46	21 / 4.85	22 / 4.74	22	17	22	22
Malta	32 / 4.79	19 / 5.03	50	42	21 / 4.85	17 / 4.95	30 / 5.39	18 / 5.68	47 / 4.11	29 / 4.47	57	47	47	42
Slovenia	33 / 4.75	31 / 4.70	31	30	26 / 4.71	24 / 4.73	**31 / 5.28**	35 / 5.11	39 / 4.26	37 / 4.27	27	27	32	34
Lithuania	36 / 4.57	40 / 4.39	**36**	40	33 / 4.51	36 / 4.43	43 / 4.75	41 / 4.71	33 / 4.46	41 / 4.04	36	41	33	41
Hungary	39 / 4.56	33 / 4.61	42	38	29 / 4.66	32 / 4.57	37 / 5.07	33 / 5.18	55 / 3.95	38 / 4.09	47	45	36	37
Greece	37 / 4.56	35 / 4.58	41	39	38 / 4.42	30 / 4.64	44 / 4.74	42 / 4.71	31 / 4.52	33 / 4.38	39	39	40	40
Cyprus	38 / 4.56	N/A	45	N/A	39 / 4.36	N/A	33 / 5.18	N/A	45 / 4.14	N/A	56	N/A	39	N/A
Czech Rep.	40 / 4.55	39 / 4.48	35	35	19 / 4.88	21 / 4.84	51 / 4.56	47 / 4.51	41 / 4.22	39 / 4.08	31	33	35	38
Slovakia	43 / 4.43	43 / 4.23	**39**	42	28 / 4.67	33 / 4.55	49 / 4.64	51 / 4.33	54 / 3.98	50 / 3.82	40	44	37	42
Latvia	44 / 4.43	37 / 4.54	49	29	36 / 4.46	26 / 4.71	52 / 4.55	45 / 4.61	37 / 4.27	36 / 4.31	50	29	46	31
Italy	47 / 4.27	41 / 4.38	34	24	50 / 4.08	44 / 4.24	48 / 4.64	46 / 4.56	38 / 4.27	28 / 4.48	26	24	41	23
Poland	60 / 3.98	45 / 4.15	57	46	45 / 4.19	34 / 4.44	80 / 3.70	58 / 4.17	51 / 4.05	49 / 3.83	46	43	62	44
EU 25	27/ 4.90	25 / 4.90	27	24	26 / 4.78	24 / 4.82	29 / 4.90	27 / 5.39	28 / 4.64	25 / 4.63	27	24	26	25
NMS[4]	39/ 4.57	34 / 4.57	41	37	29 / 4.63	26 / 4.71	43 / 4.87	40 / 4.85	43 / 4.21	39 / 4.14	42	38	39	37
EU 15	20 / 5.13	20 / 5.10	15	14	23 / 4.89	23 / 4.88	19 / 5.82	19 / 5.71	18 / 4.93	16 / 4.92	15	14	16	15
USA	2 / 5.82	2 / 5.81	1	2	3 / 5.92	1 / 6.30	21 / 5.74	17 / 5.71	15 / 5.04	14 / 4.94	2	2	2	2

Sources: WEF Global Competitiveness Report 2004-2005; WEF Global Competitiveness Report 2003-2004; http://www.weforum.org.
Notes: [1]WEF Global Competitiveness Report 2004/2005 (the WEF again included two new countries to this year's report and increased the number of returned questionnaires by 11%; on average, there were 84 respondents' replies per country); [2]WEF Global Competitiveness Report 2003/2004; [3]Reference countries include EU member states and the USA; [4]New EU member states; r - ranking, v - index value; bold numbers indicate a rise in the country's competitiveness by at least three places; dark cells indicate a fall in the country's competitiveness by at least three places.

[1] World Economic Forum.

[2] WEF Global Competitiveness Report 2003/2004.

[3] WEF Global Competitiveness Report 2001/2002.

[4] In the sub-index measuring the country's innovation capacity there was a change in the questionnaire in 2003: the question 'Does continuous innovation play a major role in generating revenue for your business?' was replaced by the question 'Are companies in the country aggressive in absorbing new technology?'.

[5] See Development Report 2004. This sub-index is originally called Government Waste and consists of three components: the extent of distortive government subsidies; the diversion of public funds; and public trust in the financial honesty of politicians.

[6] The increased number of countries under observation resulted in Slovenia being placed one rank lower (31 instead of 30).

Cross-regional variation in gross domestic product

Slovenian statistical regions differ in both the volume and structure of value added, with Central Slovenia standing out notably. Central Slovenia generates over one-third (35% in 2002) of Slovenia's gross value added (GVA). A third of GVA comes from Podravska, Savinjska and Gorenjska together, while the remainder is generated by the eight other regions. Almost three-quarters of Central Slovenia's GVA came from the service sectors, a share that was exceeded only by Obalno-Kraška. Koroška and South-eastern Slovenia generated the largest shares of GVA in manufacturing and in mining and quarrying, Spodnjeposavska and Zasavska in energy, and Notranjsko-kraška in construction. The Pomurska region generates an above-average share of GVA in agriculture.

The period between 1996[1] and 2002 saw a shift in the regional GVA structure to the benefit of the service and industrial sectors. The increase in the service sector's share was largest in Zasavska, Central Slovenia and Pomurska. Of all regions, Zasavska recorded the biggest fall in its shares of manufacturing industries and mining and quarrying (-7.2 p.p.). This was, in turn, reflected in the growing shares of other sectors of the economy in the Zasavska region, primarily of services. Central Slovenia reduced its GVA shares in agriculture, industry and construction and increased its share of services, which is strongly linked to the strengthened administrative role of the capital city located in this region. Discernible changes in the GVA structure were also indicated by the expansion of the industrial sector (along with energy and mining) in Spodnjeposavska, Koroška, South-eastern Slovenia and Notranjsko-Kraška.

Central Slovenia also reached the highest level of development measured by GDP per capita. The differences between regions along these lines widened slightly between 1995 and 2002. Central Slovenia and Obalno-Kraška have recorded above-average GDP per capita since 1995. In some years during this period, Goriška also drew very close to the average (recording a 3% gap in 2002 and a 1% gap in 1997 when it came closest to the average). Central Slovenia exceeded the Slovenian average by 42% in 2002. This region's GDP per capita rose throughout the analysed period, while the opposite was true for Obalno-Kraška that recorded a GDP of merely 3% above the average in 2002. It was highest above the Slovenian average in 1996 (by 9%). During the entire period, Pomurska had the lowest GDP per capita (recording 69% of the Slovenian average in 2002). Compared to 1995, its gap widened further (by 7 i.p.). The widening of the gap behind the Slovenian average in 1995-2002 was most pronounced in Zasavska (by 11 i.p.). Lignite mines were closed in the region in that period and the number of jobs in the industry dropped, which is also reflected in the GVA structure. Although the region received state aid, it has not yet managed to create enough jobs to make up for these losses. In the 2000-2003 period alone, the number of jobs in the region fell by 11.7%, which was the biggest drop recorded in any Slovenian region. Savinjska, Gorenjska and Notranjsko-Kraška also increased their gaps vis-a-vis the Slovenian average. Regions that recorded the largest reduction of this gap in 1995-2002 were Podravska (by 3 i.p.) and Spodnjeposavska (by 2 i.p.). In that period the ratio of the best-performing to the worst-performing region in terms of GDP per capita increased from 1.8:1 to 2.1:1. Central Slovenia reached 98% of the EU-15 average of GDP per capita and 107% of the EU-25 average, while Pomurska with the lowest GDP per capita achieved just 48% of the EU-15 average and 52% of the EU-25 average (in PPS).

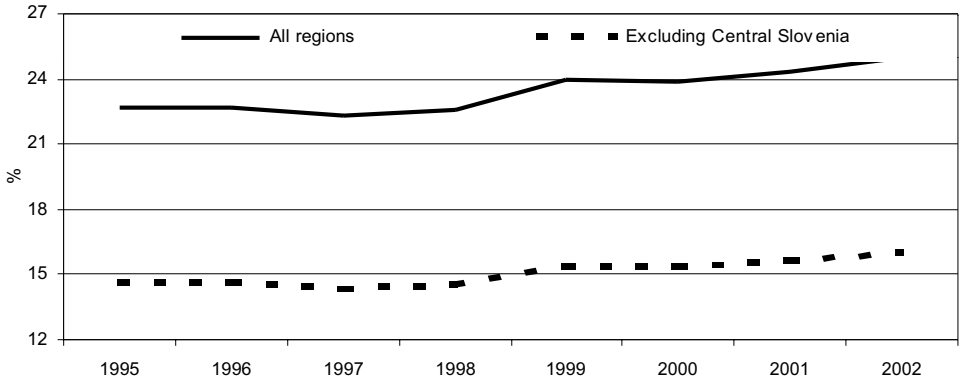
Cross-regional differences in gross domestic product per capita, as measured by the coefficient of variation, have been widening slightly since 1995. The coefficient of variation is defined as a ratio of the standard deviation from the average, the formula being adjusted for the regions' different sizes. In 2002 the coefficient of variation rose by 2.3 p.p. compared to 1995 to total a high 25%. If Central Slovenia, enjoying the highest GDP per capita, is excluded from the analysis, the coefficient of variation decreases and comes in at 14.7% to 16.1%. The disparities between these two sets of coefficients indicate that Central Slovenia has a firm role of the national centre of the economy that strongly affects cross-regional variation in Slovenia.

Table: **Gross domestic product per capita in statistical regions, 2001-2002**

Statistical regions	GDP per capita in SIT thousand		GDP per capita, in PPS[1]		Index, SLO=100		GVA[2] structure in 2002[3]			GVA[2] strukture SLO =100%
	1995	2002	1995	2002	1995	2002	A to B	C to F	G to P	2002
Central Slovenia	1,645	3,778	14,374	22,611	138	142	1.3	24.7	74.1	35.0
Obalno-Kraška	1,292	2,753	11,292	16,477	108	103	1.6	23.4	75.1	5.4
Gorenjska	1,073	2,339	9,379	13,996	90	88	2.3	43.6	54.1	8.7
Goriška	1,167	2,575	10,196	15,411	98	97	3.3	39.9	56.8	5.8
Savinjska	1,110	2,372	9,704	14,198	93	89	3.9	46.7	49.5	11.5
South-Eastern Slovenia	1,067	2,401	9,327	14,367	89	90	5.7	48.7	45.6	6.3
Pomurska	903	1,839	7,894	11,004	76	69	10.0	35.5	54.6	4.3
Notranjsko-Kraška	949	2,080	8,295	12,451	80	78	6.5	44.2	49.3	2.0
Podravska	970	2,234	8,475	13,370	81	84	3.9	35.6	60.5	13.4
Koroška	949	2,130	8,293	12,747	80	80	4.0	51.0	45.0	3.0
Spodnjeposavska	978	2,235	8,549	13,378	82	84	6.5	49.8	43.7	2.9
Zasavska	1,005	1,938	8,785	11,598	84	73	2.0	49.4	48.6	1.7
SLOVENIA	1,194	2,664	10,432	15,942	100	100	3.1	35.4	61.4	100.0
EU 15	-	-	16,800	23,200	-	-	-	-	-	-
EU 25	-	-	15,200	21,200	-	-	-	-	-	-

Source: SORS, calculations by IMAD.
Notes: [1]PPS - purchasing power standards, [2]GVA - gross value added, [3]activities according to SCA.

Figure: **Coefficient of variation in gross domestic product per capita in statistical regions, 1995-2002**



Source: SORS, calculations by IMAD.

[1] Figures on the GVA structure are only available for the 1996-2002 period.

Cross-regional variation in unemployment rates

In 2004, unemployment fell slightly in most regions, while the gap between regions recording the lowest and highest unemployment also narrowed. After the unemployment rate had been declining irregularly in all regions from 1997 to 2001, it started to rise again slightly in some regions after 2001 (in Koroška, Goriška, Pomurska and Zasavska). The rates of registered unemployment fell as a result of the decrease in the number of unemployed people, which was declining in all regions in 1997-2003, albeit unevenly. The number of unemployed fell because more jobs were on offer in the regions and also due to deletions from unemployment registers for various reasons. After 1997, the registered unemployment rate fell the most in Podravska and South-eastern Slovenia (by 7.8 and 5.6 p.p., respectively) and the least in Pomurska and Koroška (by 1 and 1.2 p.p.). A comparison of 2001 with 2003 reveals a slightly different picture. Podravska and South-eastern Slovenia are still among those regions where registered unemployment dropped the most, while unemployment was up in as many as half the regions (Koroška, Zasavska, Pomurska, Spodnjeposavska, Goriška and Savinjska), most markedly in Koroška. This trend stopped in 2004 when a rise in the unemployment rate was only observed in Goriška. This region has had the lowest rate of registered unemployment for several years, yet it has been rising slowly but steadily since 2002. It is nevertheless still markedly below the Slovenian average (totalling around 65% of the average). Pomurska had the highest rate of registered unemployment in 2004, although it was slightly lower than the year before. Its registered unemployment rate has been falling at a slower pace than in Slovenia on average. Like in 2003, it still exceeded the Slovenian average by almost 60% in 2004. Other regions exceeding the national average were Podravska, Zasavska, Spodnjeposavska, Savinjska and Koroška. The registered unemployment rate was 2.4 times higher in Pomurska than in Goriška. This ratio has been improving since 2000, albeit partly on account of the increase in unemployment in the Goriška region, which is unfavourable.

The narrowing of cross-regional disparities in unemployment measured by the coefficient of variation, which began in 2002, continued in 2004. The variation coefficient is a better indicator of cross-regional differences than the ratio between two regions at the two extreme ends. It is defined as a ratio of the standard deviation from the arithmetic mean, taking into account the regions' sizes. The coefficient reached its lowest value in 1999 (29.8%). Thereafter it began to rise slowly, peaking in 2002 (34.8%), after which it started to fall again and totalled 30.7% in 2004. If this trend continues in the future, we can expect a further reduction of cross-regional disparities.

Structural unemployment is still a major problem, surfacing in a specific way in each region, including those with below-average registered unemployment rates. Although long-term unemployment has seen a continued decline in all regions, it remains a serious concern in most regions. It is highest in Spodnjeposavska, where more than 50% of the unemployed have been out of work for over a year. Long-term unemployment is also high in South-eastern Slovenia, despite its below-average registered unemployment rate, and in Podravska, Pomurska, Savinjska, Zasavska and Koroška. This tends to be related to the poor education structure of the unemployed, as is the case in South-eastern Slovenia and Pomurska. On the other hand, people who have completed higher education may also find it difficult to get a job. The share of the unemployed with a higher education continued to increase in 2004; these shares were the largest and above the national

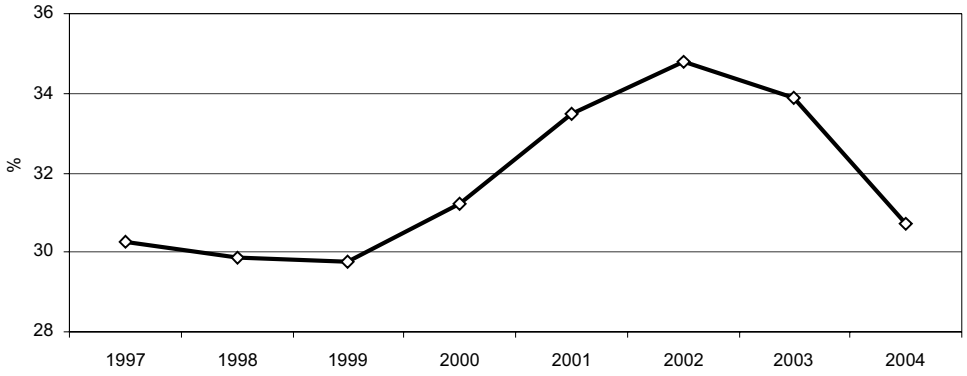
average in Central Slovenia, Goriška, Obalno-Kraška, Notranjsko-Kraška and Gorenjska. People aged 40+ also have poor employment prospects. Although their share has generally been falling since 2001, they still account for almost 50% of all unemployed in the Gorenjska and Spodnjeposavska regions. In some regions the rise in female unemployment came to a halt; nevertheless women still represent more than half of all unemployed people in most regions.

Tabela: **Registered unemployment and employment rates by regions, 1997-2004**

	Registered unemployment rate, %				Registered employment rate, %			
	1997	2002	2003	2004	1997	2002	2003	2004
SLOVENIA	14.4	11.6	11.2	10.7	53.7	55.9	55.3	55.7
Central Slovenia	10.2	7.9	7.8	7.8	57.0	58.9	58.4	58.2
Obalno-Kraška	11.0	8.6	8.3	8.1	54.0	56.6	56.2	56.4
Gorenjska	12.0	8.5	8.3	7.9	54.5	56.6	56.4	56.7
Goriška	9.6	6.3	6.4	6.9	55.2	57.9	57.2	57.1
Savinjska	16.1	14.0	13.5	13.0	53.6	55.1	54.6	54.9
South-eastern Slovenia	14.0	9.9	8.6	8.4	55.8	58.9	58.1	58.5
Pomurska	17.8	17.6	17.5	16.8	52.6	53.5	51.9	53.0
Notranjsko-Kraška	12.0	9.1	8.8	8.3	54.9	58.7	58.6	59.0
Podravska	22.4	17.6	16.2	14.8	48.0	51.1	50.8	51.6
Koroška	13.0	11.6	12.6	11.9	52.1	54.6	53.1	53.7
Spodnjeposavska	16.4	14.4	14.9	13.4	52.9	54.6	52.9	53.8
Zasavska	17.9	15.3	16.1	15.1	50.0	52.6	52.0	52.3

Source: SORS, calculations by IMAD.

Figure: **Variation coefficient of regional unemployment in Slovenia in 1997-2004, in %**



Source: SORS, calculations by IMAD.

Indicators of economic development

Macroeconomic stability

Knowledge-based society

Competitiveness of the economy

Developmental role of the state

Macroeconomic stability

Real growth of gross domestic product

The revision of the national accounts resulted in a minor change of the GDP estimate for 2002 and the first release of the 2003 figure. After the SORS' last release of the revised annual national accounts estimate since 2000 (in September 2004), the estimate of economic growth for 2002 was 0.1 p.p. below the earlier estimate (3.3% instead of 3.4%), while the estimates for 2000 and 2001 remained the same (3.9% and 2.7%, respectively). The first annual economic growth estimate for 2003 was 2.5%, which is 0.2 p.p. above the estimates based on quarterly figures and at the same time the lowest figure after 1992. The cooling down of economic growth in Slovenia in 2003 was induced by the modest growth of foreign demand, even more so than in the two previous years when economic growth was also below the average of the previous medium-term period (4.4% in the 1996-2000 period). Despite this substantial slowdown, GDP growth in 2003 was nevertheless more than 1.5 p.p. above the averages of the EU-15 (0.8%) and EU-25 (0.9%).

The economic situation in 2003 was strongly affected by the unfavourable trends in the international economic environment. There was also a shift in the GDP growth structure. The modest real export growth in 2003 (3.2%, compared with 6.7% in 2002) was mainly due to the weak economic growth in Slovenia's main trading partners in the EU[1]. Unlike 2002, 2003 also saw a drop in the levels of exports to the countries of former Yugoslavia, except Croatia. Exports to Russia and the CEFTA countries sustained their relatively strong growth from the previous year. On the other hand, domestic demand gained momentum in 2003 after a three-year period of modest growth, which led to changes in the GDP growth structure. Total domestic demand rose by 4.7% in real terms and became the main driving force of the growth. For the first time after 1999, domestic consumption growth (2.7%; 0.3% in 2002) exceeded GDP growth. It was largely spurred on by the beginning of the new purchasing cycle enabled by the disburdening of income from old loans and new borrowing opportunities with significantly improved terms. Gross investment growth also picked up to total 10.5%. Within this growth, gross fixed capital formation rose by 6.3% (mainly as a result of investment in motorway construction). The contribution of inventories to economic growth was also substantial (1.1 p.p.). The high growth of domestic demand influenced the stronger import growth which, coupled with the laggard export growth, resulted in the high negative contribution of the foreign trade balance to economic growth (-2.2 p.p.).

In the first three quarters of 2004, economic growth picked up markedly (4.5% year on year). It was largely underpinned by accelerated export growth and maintenance of the relatively high growth rates of domestic demand. In the final quarter of 2003, economic growth began to strengthen (from 2.6% in Q3 to 2.9%) on the back of the stronger real export growth, notably in the EU, and the sustained high export growth to the CEFTA countries and Russia. GDP continued to grow rapidly in 2004 to average out at 4.5% in the first three quarters of the year. Real GDP growth in the third quarter (4.9% year on year) was slightly higher than the growth in the first and second quarters and was also the highest quarterly growth since 2000. Like in the first half of the year, it was generated more by exports and than domestic consumption.

The high export growth was largely the result of one-off effects prior to EU accession and the pick-up in economic growth in the EU. Although real export growth fell slightly in Q3 over Q2 (from 13.7% to 11.9%), it recorded a much higher average rise in the first three quarters than in the year before (11.6% over 3.2%). The slowdown in the robust growth of foreign trade from the second quarter implies that this growth was driven mainly by the one-off effect of adjustments to changes in the foreign trade regime since the growth rates of exports to the countries of former Yugoslavia fell markedly, especially to Macedonia and BiH. Export growth to the EU-25 continued to intensify in Q3, notably to Italy and France. The growth of exports to the new EU countries and Austria also remained at a high level, while it slowed down to Germany. Similarly, Q3 saw continued export growth to some non-EU countries – Russia, Serbia and

Croatia. Against the background of the relatively high sustained growth rates, the slightly faster deceleration in import growth in Q3 resulted in the positive contribution of foreign trade to economic growth (after its contribution had been negative for a year and a half).

Within domestic consumption, which rose by 4.7% in real terms in the first nine months, the relative contribution of final consumption strengthened in the third quarter. The growth of final consumption rebounded slightly in the third quarter (3.4% year on year). It was primarily based on the stronger growth of private consumption (3.8% over 3.1% in Q2) and partly of government consumption (2.4% over 1.6%). The growth of gross fixed capital formation was high in Q1 (7.9% year on year) and remained at a level above 6% in Q2 and Q3, while recording a change in its structure in Q3 in favour of construction investment. The positive contribution of changes in inventories to economic growth, which was particularly high in Q2 (1.8 p.p. over 0.6 p.p. in Q1), turned into a negative contribution in Q3 (-0.2 p.p.).

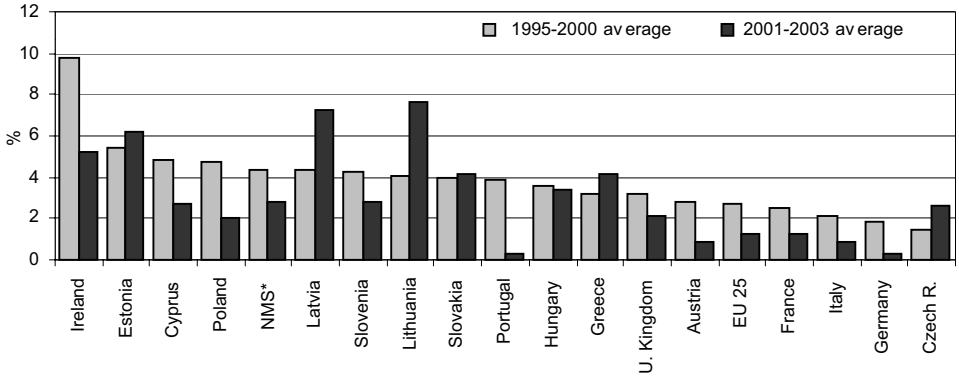
According to Eurostat's first release, real GDP growth in the EU-25 totalled 2.1% in the first three quarters of 2004. In these three quarters, the highest average real GDP growth was seen in Q2 (2.4%). The year-on-year growth rates recorded in the new EU member states in the first nine months generally exceeded the average of the EU-25 (except for Malta, 0.6%) and ranged between 3.7% (Czech Republic, Cyprus) and 8.5% (Latvia). Real GDP growth in Slovenia's main trading partners in the same period totalled 1.2% in Germany, 1.1% in Italy, 1.9% in Austria and 2.2% in France. In these countries economic growth picked up in comparison with 2003.

Table: **Contribution of expenditure components to gross domestic product (GDP) growth in Slovenia in 1996-2003**

	1996	1997	1998	1999	2000	2001	2002	2003
Real GDP growth, in %	3.6	4.8	3.6	5.6	3.9	2.7	3.3	2.5
Contribution of individual components to GDP growth, in p.p.								
Foreign trade balance	0.2	-0.3	-1.8	-3.9	2.4	1.7	1	-2.2
Private consumption	1.6	1.5	1.7	3.4	0.2	1.3	0.2	1.5
Government consumption	0.6	0.4	1.1	0.6	0.5	0.8	0.3	0.5
Gross fixed capital formation	2.3	3.0	2.4	5.4	0.2	1.0	0.8	1.6
Changes in inventories and valuables	-1.1	0.2	0.2	0.1	0.6	-2.1	1.0	1.1

Source: SORS.

Figure: **Average GDP growth rates by countries in 1995-2000 and 2001-2003**



Source: Eurostat (NewCronos, 03 December 2004); SORS.
Notes: figures for the Czech Republic are included from 1996 on; in the EU-25 aggregate figures for Malta are included from 1999. *New member states.

[1] Like Slovenia, EU countries recorded their lowest economic growth after 1993 in 2003.

Employment rate

The employment rate[1], which is relatively high in Slovenia (around 63% since 1997), has been rising rapidly since the final quarter of 2003. The male employment rate rose from around 68% (after having fallen to 66.6% in Q1 of 2003) to 71.5% in Q3 of 2004, while the female rate was up from about 59% to 62.0% of the working-age population[2] (after having dropped to 57.6% on average in 2003). Compared with the EU average, where the employment rate rose relatively fast in the last ten years, Slovenia's male employment rate was slightly lower while the female employment rate was higher (see table). Regarding age, the employment of youth (15-24 years) and elderly people (50+) is below the EU average (employment is worryingly low in the 55-64 age group, where the Lisbon goal is set at 50% by 2010, while the Slovenian figure for 2003 was 23.5%). The gap in youth employment was due to the relatively high youth enrolment in secondary and tertiary education (see the indicator on the population that has completed secondary education) and the relatively high youth unemployment compared with the EU average. The employment rate of the elderly is linked to the high structural unemployment that mainly affects older unemployed people (see the indicator on the unemployment rate). The lower employment rate of people aged over 50 was also due to the relatively early retirement, although the average retirement age is rising – in 2003 it stood at 57 years and 8 months for the old-age pension and 51 years and 8 months for the disability pension (in 1995 the respective ages were 55 years and 7 months and 47 years and 1 month) – yet it is still below the EU average (59.9 years). In addition, the low employment figures for the elderly are in part still attributable to the mass early retirements witnessed at the beginning of the 1990s.

The higher employment rate seen in 2004 was largely generated by the strong rise in informal employment that followed the higher economic growth, whereas formal employment continued to increase at a relatively slow pace. The number of people in employment according to the labour force survey, which fell by 0.7% in 2002 and by 1.4% in 2003, rose substantially from Q4 of 2003 to Q3 of 2004. Compared to 2003, their average number was up 5.7% in 2004. Since the monthly figures on the number of formally employed workers (i.e. employees) and those who are self-employed (farmers, individual private entrepreneurs and own-account workers) for 2004 indicate a smaller rise (only 0.6%), we can infer that different types of informal employment[3] which had been in decline in previous years surged again in 2004 (up 38.3% over 2003).

According to the monthly statistics, business services recorded the relatively highest rise in formal employment in 2004. The total number of people in formal employment as measured by the monthly statistics (covering employees and self-employed workers) rose by 0.6% in 2004, primarily in business services (up 4.3%). A relatively high increase (2.7% or more) was registered in the public administration, health and social work, and agriculture, while in financial intermediation and education it was up 2.2%. In relative terms, the largest drops were seen in mining and quarrying (down 9.6%) while in absolute terms, employment fell most markedly in manufacturing (by 2,103 or 0.9%) and transport (by 1,139 or 2.3%). It also dropped in fishing, electricity, gas and water supply, and in private households. In all other groups of activities, employment either stagnated or its growth remained below 1%.

Within manufacturing, there was a sharp rise in employment in the car and machinery industries concurrent with a drop in the textile, leather and food-processing industries. The number of people in employment rose in just four manufacturing sub-industries, three of which also recorded high employment growth: 5.4% in the manufacture of transport

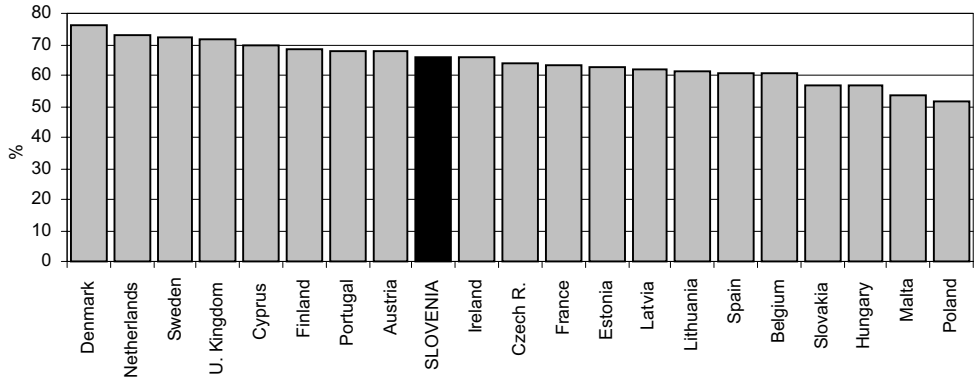
equipment, 4.2% in the manufacture of machinery and equipment, and 2.7% in the manufacture of rubber and plastic products. In the manufacture of chemicals and chemical products, employment edged up a mere 0.2%. All other sub-industries within manufacturing saw a drop in the number of people in employment in 2004, which was most pronounced in labour-intensive industries, notably the textile, leather and food-processing industries where it dropped by 6.6%, 5.0% and 3.0%, respectively.

Table: **Employment rates (people aged 15-64) according to labour force surveys in Slovenia and the EU in 1995-2004 (Q2), in %**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Slovenia (15-64)	**62.9**	**61.7**	**62.8**	**63.5**	**62.5**	**62.7**	**63.6**	**64.3**	**62.5**	**65.6**
Men	67.7	66.0	67.1	67.5	66.8	66.7	68.5	68.7	67.2	69.9
Women	58.0	57.5	58.4	59.5	58.1	58.5	58.6	59.8	57.7	61.3
15-24	33.8	35.5	38.5	36.2	32.9	31.2	30.3	31.1	28.6	33.8
25-49	87.0	82.0	81.3	82.2	82.2	82.6	83.8	84.1	82.6	84.0
50-64	35.8	19.9	22.7	25.9	23.4	22.3	23.4	25.9	22.7	30.1
EU 15 (15-64)	**59.9**	**60.1**	**60.4**	**61.1**	**62.2**	**63.2**	**64.0**	**64.2**	**64.4**	**n/a**
Men	70.3	70.0	70.3	71.0	71.7	72.5	73.0	72.9	72.6	n/a
Women	49.6	50.1	50.6	51.3	52.7	53.9	54.9	55.5	56.1	n/a
15-24	37.2	36.4	36.4	37.6	38.7	39.9	40.6	40.5	39.7	n/a
25-49	73.2	73.4	73.7	74.3	75.4	76.4	77.1	77.2	77.3	n/a
50-64	35.8	36.1	36.4	36.4	36.9	37.5	38.3	39.8	41.6	n/a
EU 25 (15-64)	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**62.2**	**62.8**	**62.8**	**63.0**	**n/a**
Men	n/a	n/a	n/a	n/a	n/a	71.1	71.3	71.0	70.8	n/a
Women	n/a	n/a	n/a	n/a	n/a	53.5	54.2	54.7	55.1	n/a
15-24	n/a	n/a	n/a	n/a	n/a	37.6	37.9	37.5	36.7	n/a
25-49	n/a	n/a	n/a	n/a	n/a	77.1	77.6	77.5	77.6	n/a
50-64	n/a	n/a	n/a	n/a	n/a	36.4	37.1	38.5	40.1	n/a

Source: SORS; Eurostat (NewCronos).

Figure: **Employment rates in Slovenia and other EU member states[1] in Q2 of 2004, in %**



Source: Eurostat.
Note: [1] No data are available for Germany, Greece, Italy and Luxembourg.

[1] Calculated using survey data that also include informally employed people who can, in principle, at the same time be students among the young, or retired people among the elderly.

[2] Employment rate is calculated as the ratio between persons in employment aged 15-64 and total population of the same gender and age.

[3] Informal employment includes people who work either as unpaid family workers, on contractual basis or in the shadow economy.

Unemployment rate

In 2004, registered unemployment continued to fall; survey unemployment also declined after the halt seen in 2003. The *number of people registered as unemployed* hovered around 125,000 in 1993-1998 while the registered unemployment rate was between 14% and 14.5%. Up until 2001, the number of the registered unemployed fell to an average of 102,000 and the registered unemployment rate to 11.6%. In 2002, both the number and rate of registered unemployment stayed at the level of the previous year, while they again dropped slightly in 2003 and 2004. The average number of people registered as unemployed was 92,826 in 2004 (90,728 in December), while the average rate of registered unemployment totalled 10.6%. The *number of unemployed people according to the labour force survey* hovered around 70,000 in 1995-2000, while the survey unemployment rate ranged between 7% and 8%. The number of unemployed dropped to 62,000 by 2002, then rose to 64,000 in 2003 and remained at that level (on average) in 2004. The survey unemployment rate, which had already dropped to 6.4% in 2001 and 2002, rose to 6.7% in 2003, then fell to 6.3%[1] in 2004. Slovenia's unemployment measured by the international methodology has been below the EU average ever since it started to be measured and has hovered around the average of the OECD countries.

Registered unemployment flows in 2004 show a comparatively more favourable picture than in previous years. For the first time in four years, the number of unemployed people who found a job in 2004 was higher than the year before. 54,257 unemployed people were hired (7.4% more than in 2003). The figure includes the substantial rise in jobs subsidised through active employment policy measures (up 30.1%). Within these jobs, the number of participants in the public works scheme increased after several years of decline (up 28.9%). Other subsidies recorded a 33.5% rise last year. Non-subsidised jobs that accounted for 86.7% of the total hiring of unemployed people in 2004 was up 4.6% compared with 2003. Up until November it seemed that the inflow into unemployment due to a job loss, which had been rising since 1999, would be lower than the year before in 2004. December's inflow, however, was very high, therefore a total of 69,577 employees lost their jobs in 2004 (1.1% more than in 2003). The annual inflow of first-time job-seekers was again slightly higher than in 2003 (up 2.2%), while the number of deletions for other reasons decreased by 1.6%. The deletions from unemployment registers for other reasons were mostly voluntary or due to a failure to report at the employment service offices (17,600); in addition, over 4,000 deletions were due to retirement and over 7,000 due to a return to education activities. A further 2,268 people were transferred to another register in 2004 in accordance with other laws[2], which was 70% less than in 2003. The overall number of people registered as unemployed thus dropped by 5.5% by the end of 2004 compared with December 2003.

The structure of registered unemployment is changing: the shares of older, long-term and unskilled unemployed people are declining while the shares of unemployed first-time job-seekers and women are on the increase. This was partly due to high deletions from unemployment registers for various job-unrelated reasons, in addition to targeted active employment policy measures, especially subsidies for new jobs and training programmes for the unemployed. The average share of women already exceeds 53% (52.8% in 2003), while the share of first-time job-seekers totalled 25% (23.2% in 2003). The share of young unemployed people remains almost unchanged (26.2%). On the other hand, the share of the unemployed aged over 40 dropped to below 43% (compared with 44.1% in 2003 and 51.7% in 2000 when it was the highest). The shares of jobless people also fell in the following groups: people aged over 50 (21.0% over 21.4% recorded in 2003 and 27.5% in 2000), the long-term unemployed (46.2% over 48.6% in 2003 and 63.7% in 1999) and the unskilled unemployed (41.6% over 44.2% in 2003 and around 47% in the 1995-2002 period). The average duration of unemployment shortened by over 2 months (to 22 months and 24 days) compared with 2003. Both the registered and survey female unemployment rates remained significantly higher than the respective male unemployment rates (see table). Youth unemployment (ages 15-24) remains relatively high, although it is falling.

The government continues to pursue the goals of the National Programme of the Labour Market Development and Employment by 2006 and the European Employment Strategy. Since 1999, the Slovenian government's employment policy has taken into consideration and applied the European Union's recommendations and guidelines in the field of employment. In September 2004, the government adopted its first National Action Plan for Employment[3] which is entirely on a par with the national plans of the EU member states in content and form and is adjusted to both the European Employment Strategy and the Lisbon employment objectives. The key activities include raising the education levels or vocational

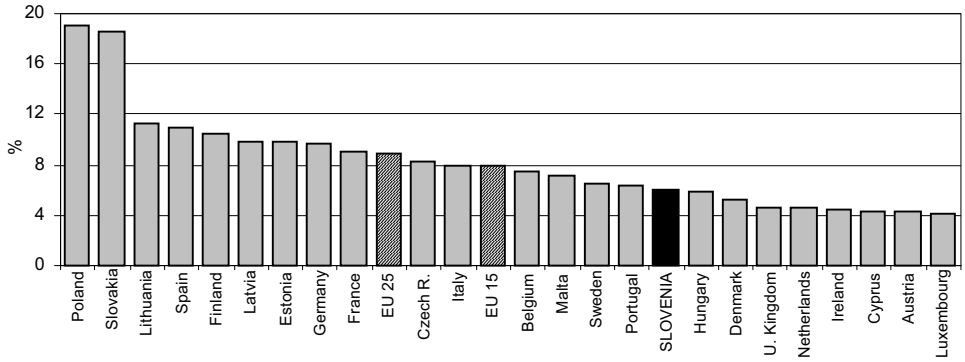
qualifications of the labour force, reducing structural imbalances (cutting the shares of long-term unemployed people and the unemployed with no vocational training), the participation of all young unemployed people who have not found work within 6 months and all other people out of work for 12 months or more in active employment policy programmes, reducing regional imbalances in the labour market, control over fulfilment of the obligations of unemployed people, preventing the shadow economy and illegal employment, and further development of the social partnership.

Table: **Unemployment rates in Slovenia, the EU and OECD in the 1995-2004 period, in %**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Survey unemployment rate										
Slovenia	7.4[1]	7.3	7.4	7.9	7.6	7.0	6.4	6.4	6.7	6.1[1]
men	7.7[1]	7.5	7.1	7.7	7.3	6.8	5.9	5.9	6.4	5.7[1]
women	7.0[1]	7.0	7.6	8.1	7.9	7.3	7.0	6.8	7.1	6.4[1]
young people (aged 15-24)	18.8	18.8	17.6	18.6	18.1	16.8	18.1	16.7	17.4	14.2[1]
EU 25	n/a	n/a	n/a	9.4	9.2	8.8	8.5	8.9	9.1	8.9[1]
EU 15	10.1	10.2	10.0	9.4	8.7	7.8	7.4	7.7	8.1	7.9[1]
OECD	7.7	7.7	7.4	7.1	6.8	6.3	6.5	6.9	7.1	-
Registered unemployment rate										
Slovenia	13.9	13.9	14.4	14.5	13.6	12.2	11.6	11.6	11.2	10.6
men	14.1	13.7	13.6	13.4	12.4	11.1	10.4	10.4	9.7	9.1
women	13.7	14.0	15.3	15.7	15.0	13.5	12.9	13.1	13.0	12.4

Source: SORS, Eurostat, OECD. **Note**: [1]Q2.

Figure: **Survey unemployment rate in Slovenia and other EU countries, Q2 of 2004**



Source: Eurostat.

[1] The IMAD's calculations based on the quarterly data released by the SORS.

[2] Pursuant to amendments to the Employment and Insurance Against Unemployment Act, Rules on the Contents and Method of Keeping Public Employment Records were adopted in October 2002, determining the criteria for the transfer of people from unemployment registers to registers established in accordance with other laws. These criteria were laid down by the Employment Service of Slovenia (ESS) in co-operation with the competent institutions referred to in each particular law. The transfer to other records is based on an employment plan. In accordance to these Rules, in co-operation with the Pension and Disability Insurance Institute (PDII), the ESS prepared a regulation for disabled workers – recipients of the PDII's disability allowance. The institutes began to examine the employment prospects of disabled workers and to establish the criteria for their transfer to unemployment register based on other laws. The following categories were taken into consideration: (i) people registered at the ESS for at least two years; (ii) people who were sent to employers but failed to get a job due to their disability; (iii) people for whom no suitable jobs were available during the period; and (iv) people who remained jobless even after having participated in the active employment policy programme.

[3] A new programme aimed at achieving strategic goals in the area of labour market and employment in 2005, to be distinguished from the similarly titled programme adopted by the government in December 2003 for the implementation of employment goals in 2004.

Inflation

After having persisted at the 7%-10% level in 1995-2002, inflation fell to below 4% in 2004. Inflation's fluctuation at a relatively high level in the period after 1995 was mainly the result of economic policies that had not pursued price stability as their main goal, i.e. their irresponsiveness to changed macroeconomic conditions. In part, the long-lasting high inflation levels were also fuelled by the unfinished structural reforms related to indexation, to the composition and level of general government expenditure and to the increase in efficiency (restructuring) in sectors where competition is still insufficient.

The sustainable lowering of inflation seen in the past two years has resulted from co-ordinated measures carried out by the Bank of Slovenia and the government of RS. When the BS and the government decided to enter the exchange rate mechanism ERM II and to introduce the euro early, they adopted measures that have led to a sustainable lowering of inflation in the last two years. While in 2003 the main driving forces behind the inflation decline were measures taken through administered prices and fiscal policies, the further lowering of inflation seen in 2004 was essentially hinged on the tolar exchange rate's stabilisation upon entry to the ERM II at the end of June. Taking into account the almost complete pass-through of the exchange rate rises to price rises, the tolar's exchange rate stabilisation abolished a key inflationary factor which in previous years had contributed around 50% to overall price rises. Nevertheless, the year-on-year growth of the exchange rate totalled 1.3% due to its gradual depreciation seen in the first half of 2004. Simultaneously, the government continued to carry out the Administered Prices Rise Plan for 2004 and 2005 and co-ordinated the adjustment of fiscal burdens. In contrast to 2003, the main objective of administered prices policy (to ensure consistent rises of administered and market-determined prices) was not achieved in 2004. However, the faster growth of administered prices (up 9% in 2004) than market-determined prices (up 2.1%) was chiefly attributable to external factors. Higher prices of oil and hence of liquid fuels for transport and heating contributed 1.0 p.p. to inflation (71% of the overall administered prices increase). As oil price changes have a comparatively stronger impact on inflation in Slovenia than in other EU countries (due to the bigger share of fuels in the price index, the relatively low tax share in retail prices and the economy's relatively high dependence on fuels), the government also continued its counter-cyclical adjustment of excise duties on liquid fuels for transport and heating, thereby cushioning the volatility of liquid fuels prices (when oil prices surged by about 70%, the adjustment of excises prevented an additional increase of inflation of 0.4 p.p.). Higher excise duties on liquid fuels contributed 0.2 p.p. to end-year inflation; another 0.2 p.p. came from the further harmonisation of excises on tobacco products with the EU tax system.

Slovenia's entry to the EU contributed to the further reduction of inflation. In addition to the tolar's exchange rate stabilisation following entry to the ERM II, EU accession also led to changes in trade regimes, particularly the elimination of customs duties on food products. At the end of 2004, food prices were lower than the year before which is why inflation was 0.2 p.p. lower in 2004 compared to their 0.8 p.p. contribution to inflation in 2003.

In spite of its considerable lowering, inflation still deviates sharply from the Maastricht criterion. The Maastricht criterion, calculated on the basis of average (HICP[1]) inflation, totalled 2.2% in December 2004, while the average (HICP) inflation in Slovenia came in at 3.7% at the end of 2004. The further sustained lowering of inflation that will enable the fulfilment of the Maastricht criterion in 2006 in accordance with the Programme for

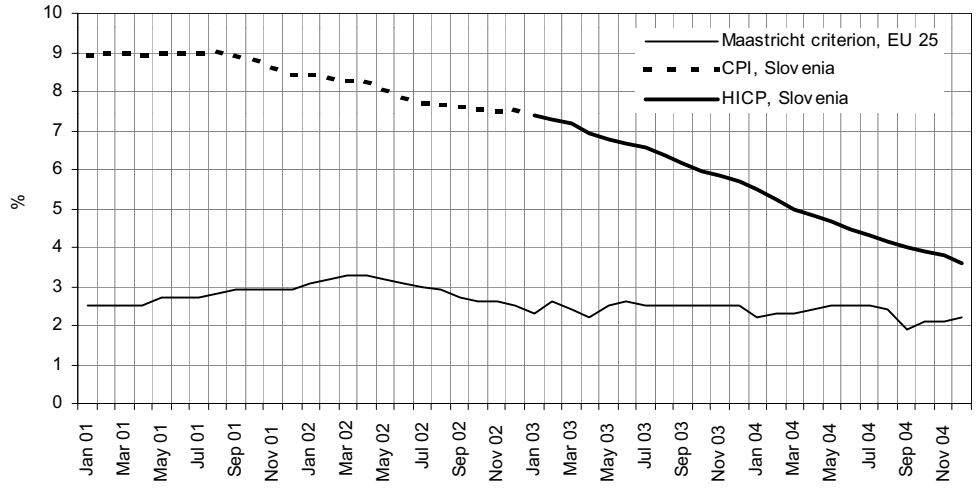
Entering the ERM II and Introducing the Euro will thus require not only the strict implementation of the adopted policies, but above all the reduction of factors creating upward pressure on inflation due to structural imbalances.

Table: **Consumer price rises in Slovenia and the EU in 1995-2004**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Slovenia, year-on-year growth rates, in %										
Consumer prices	9.0	9.0	8.8	6.5	8.0	8.9	7.0	7.2	4.6	3.2
Goods	7.1	8.0	8.5	5.6	7.8	8.8	6.2	6.4	3.9	2.5
Services	15.9	12.2	9.8	9.3	8.8	9.2	9.6	9.4	6.5	4.9
Administered prices	10.0	8.4	16.9	11.1	10.4	16.0	10.5	9.2	4.0	9.0
Energy	8.2	5.6	20.9	13.2	11.0	18.9	6.7	5.5	3.5	10.3
Other	11.4	10.6	12.4	8.6	9.6	12.0	17.0	14.7	4.8	6.1
Core inflation	N/A	7.2	6.4	5.0	4.1	6.9	7.4	6.9	4.2	2.7
European Union[1], year-on-year growth rates, in %										
Consumer prices	2.5	2.1	1.5	0.9	1.7	2.5	2.0	2.4	2.0	2.3

Source: SORS (consumer prices), IMAD's estimates (administered prices, core inflation), Eurostat (consumer prices in EU).
Note: [1]euro area.

Figure: **Average inflation (HICP) in Slovenia and the Maastricht criterion**



Source: SORS, Eurostat, IMAD's estimate.
Note: inflation in Slovenia: Expressed as CPI until 2003 and as HICP thereafter.

[1] The Harmonised Index of Consumer Prices (HICP) is based on the composition of expenditure of residents and non-residents in Slovenia, while the Consumer Price Index (CPI) is based on the expenditure composition of Slovenian residents. Due to the different weighting of goods and services, the values of the two indices differ; however, the difference in average inflation measured by both indices did not exceed 0.1 p.p. in the past two years.

General government sector balance

Since Slovenia entered the European Union it has had to adhere to the provisions of the Stability and Growth Pact, according to which the general government sector deficit must not exceed 3% of GDP. In line with the EU rules Slovenia has to submit the 'Report on Government Debt and Deficit' to the European Commission twice a year which enables the Commission to monitor Slovenia's public finance position. The report is prepared in compliance with the uniform methodology of the European System of Accounts of 1995 (ESA-95) that has to be strictly observed by all member states. The upper ceiling of the allowed budget deficit (3% of GDP) equals the Maastricht convergence criterion that Slovenia has to meet prior to entering the EMU (foreseen for the beginning of 2007). Slovenia fulfilled this criterion in the 2001-2003 period and, according to preliminary estimates, also in 2004.

In 2000, the share of the general government sector deficit in GDP totalled 3.4% and decreased gradually over the next three years. In the period from 2000 to 2003, the general government sector deficit fell by 1.4 p.p. from the 3.4% of GDP recorded in 2000 to 2% of GDP in 2003. The general government sector deficit narrowed most markedly in 2001 (by 0.6 p.p. to total 2.8% of GDP); in the next two years, it shrank by a further 0.4 p.p. per year (to 2.4% of GDP in 2002 and to 2% of GDP in 2003).

The gradual narrowing of the general government sector deficit was largely underpinned by the increase in overall general government sector revenues. In 2000, the share of general government sector revenue in GDP totalled 44.7% (according to the ESA-95 methodology). In the period from 2001 to 2003, this share was rising gradually: by 0.4 p.p. in 2001, by 0.6 p.p. in 2002 and by a further 0.5 p.p. in 2003. On the whole, the share of general government sector revenue in GDP rose by 1.5 p.p. in the 2000-2003 period to total 46.2% of GDP in 2003.

Overall general government sector expenditure similarly increased during this period, edging up from 48.1% of GDP in 2000 to 48.2% of GDP in 2003. The improvement in the fiscal position in 2001 when the general government sector deficit narrowed by 0.6 p.p. was mainly driven by the sale of mobile telephony licences which, according to the national accounts methodology, counts among the sale of non-financial non-produced assets, thus reducing general government sector expenditure. Excluding this transaction, general government sector expenditure rose by a further 0.4 p.p. that year. An actual improvement in the general government's position occurred in 2002 when the increase in the share of its revenue (up 0.6 p.p.) exceeded the increase in the share of its expenditure (up 0.2 p.p.). 2003 saw a continuing improvement in Slovenia's fiscal position as the general government sector deficit shrank to 2% of GDP. The shares of general government sector expenditure in GDP were up 0.1 p.p., while the shares of general government sector revenues in GDP rose by 0.5 p.p.

According to preliminary estimates for 2004, the general government sector's fiscal position did not change fundamentally relative to 2003. The share of general government sector expenditure in GDP is estimated to have remained at the same level as in 2003, while the share of general government sector revenue edged down 0.1 p.p. In our estimate, the share of revenues from customs duties and import taxes in GDP fell by 0.3 p.p. due to Slovenia's accession to the EU. The share of revenues from compulsory social security contributions fell by 0.1 p.p. (according to preliminary data). The shares of revenues from personal income tax, corporate income tax and excise duties in GDP each rose by 0.1 p.p.. The share of general government sector deficit is thus estimated at 2.1% of GDP, indicating a slight deterioration relative to 2003 (the deficit widened by 0.1 p.p.).

Compared with other EU countries, Slovenia had one of the highest general government sector deficits in 2000. Just a few other acceding countries (the Czech Republic, Slovakia and Malta) recorded an even bigger deficit in that year. In 2000, the EU-15 even achieved an average general government sector surplus totalling 1% of GDP, and the EU-25 on average recorded a surplus of 0.8% of GDP.

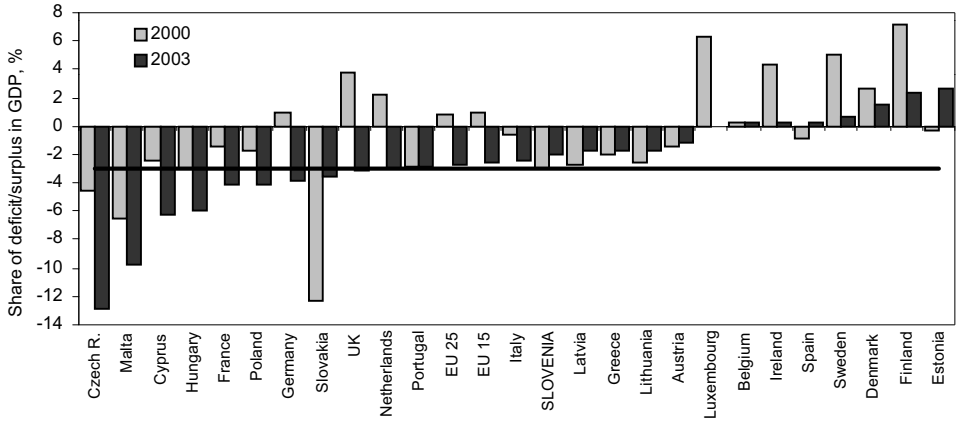
In the 2001-2003 period, the share of the general government sector deficit in GDP was narrowing in Slovenia whereas it was generally increasing in the EU. Although in 2001 the share of the general government sector deficit shrank in Slovenia it was still 1.7 p.p. above both the EU-15 average (1.0% of GDP) and above the EU-25 average (1.1% of GDP). Only Portugal among the EU member states and the Czech Republic, Hungary, Malta, Poland and Slovakia among the acceding countries recorded a higher deficit in that year. In 2002, the share of the general government sector deficit in GDP narrowed further in Slovenia (to 2.4%); nevertheless, it still exceeded the EU average (2.0% of GDP in the EU-15 and 2.1% of GDP in the EU-25). In 2002, the share of the deficit in GDP increased by one whole percentage point in European countries. Among EU member states, Portugal, Germany and France had a higher deficit than Slovenia that year, while all of the acceding countries except Estonia and Lithuania recorded a bigger deficit. In 2003, the deficit as a share of GDP widened further in other European countries while dropping slightly further in Slovenia where it fell to below the average of the EU-15 (2.6% of GDP) and the EU-25 (2.7%). As many as 12 EU countries recorded a higher budget deficit than Slovenia that year, 10 of which overshot the allowed ceiling set by the Stability and Growth Pact.

Table: **Shares of general government sector revenue, expenditure and deficit by subsectors, according to ESA-95 methodology in % of GDP**

	2000	2001	2002	2003
General government revenue	44.7	45.1	45.7	46.2
General government expenditure	48.1	47.9	48.1	48.2
General government deficit (revenue minus expenditure)	-3.4	-2.8	-2.4	-2.0
Central government	-3.0	-2.5	-2.1	-1.9
Local government	0.1	0.0	-0.2	0.0
Social insurance funds	-0.5	-0.3	-0.1	-0.1

Source: SORS, National accounts, First Release No. 128 of 31 August 2004, calculations of shares in GDP based on SORS First Release No. 149 of 22 Sept. 2004.

Figure: **Shares of general government sector deficit/surplus in the EU-25 in 2000 and 2003, % of GDP**



Source: Eurostat: Euro-indicators, 16 March 2004.

General government debt

In 2003, general government debt[1] decreased by 0.1 of a percentage point relative to GDP, mainly due to the fall in the relative debt share of direct budget users which totalled 29.4% of GDP at the end of the year. In nominal terms, general government debt rose during the same period to total SIT 1,687.2 bn at the end of 2003 (SIT 1,569.3 bn at the end of 2002).

Central government debt rose by SIT 104.3 bn and amounted to SIT 1,628.8 bn, equalling 28.3% of GDP (28.7% of GDP at the end of 2002). The debt of the state budget's direct users increased by SIT 62.5 bn from 1 January 2003 and totalled SIT 1,467.3 bn on 31 December 2003. SIT 18.4 bn thereof came from financing general government revenues, expenditure, lending and repayments, SIT 15.5 bn was generated by basic development programmes, SIT 8.25 involved taking over Slovenian Railways' debt and SIT 19.95 bn represented the debt position of one-month treasury bills. The increase in the debt of direct state budget users totalling SIT 28.1 bn resulted from value changes. Due to the partial early settlement of liabilities arising from RS15 and RS04 bonds out of NLB proceeds, the debt decreased by SIT 28.4 bn. Until the end of 2001, the debt structure dynamics were mainly linked to the relative smallness of the Slovenian financial market and the process of assuming former Yugoslavia's debt. Since 2001, the Republic of Slovenia has not borrowed in foreign financial markets. For this reason, the internal debt of direct state budget users has been growing since 2001 and represented 61.2% of the total debt on 31 December 2003 (49.8% in 2000). Despite the relatively rapid growth of short-term debt seen in the past, direct state budget users have mainly incurred long-term debt which accounted for 94.8% of the total RS' debt at the end of 2003. 2003 also saw a continuation of the established trends in the debt structure in terms of debt instruments. The share of loans in debt thus fell in 2003 while the share of instruments involving a fixed interest rate that will in the long run ensure lower financing costs increased. The share of tolar debt, which has been rising since 2001, increased further to reach 48.3% of the total debt at the end of 2003. On the other hand, the share of debt in US dollars has been on a rapid decrease since 2000 and amounted to just 1.2% of the total debt at the end of 2003. Debt denominated in euros represented 50.0% of total debt at the end of 2003.

The debt of state funds and other central government units totalled SIT 159.6 bn (2.8% of GDP) at the end of 2003. The biggest shares in state funds' debt were taken by the Environmental Protection Development Fund (75.4% of total state fund debt) and Public Regional Development Fund (24.6% of total state fund debt). Among other central government units, the Slovenian Compensation Company generated 89% of the total debt.

Local government debt and debt of the Pension and Disability Insurance Institute (PDII) and the Health Insurance Institute (HII) rose by a total of 0.1% of GDP in 2003. Due to restrictive legal restrictions, the indebtedness of local governments has been low for several years and composed of just internal debt. At the end of 2003, local government debt amounted to SIT 18.4 bn (0.3% of GDP). The PDII and the HII only borrow in the domestic financial market, taking out short-term loans and liquidity loans within the Treasury Single Account system. At the end of 2003, the debt of the PDII and HII totalled SIT 40.1 bn or 0.7% of GDP.

Slovenia's level of indebtedness is one of the lowest in the EU in terms of debt and interest payments relative to GDP. The only countries that were less indebted than Slovenia were Luxembourg, Estonia, Latvia and Lithuania. In addition, Slovenia has continuously fulfilled the Maastricht convergence criterion concerning the general government debt position.

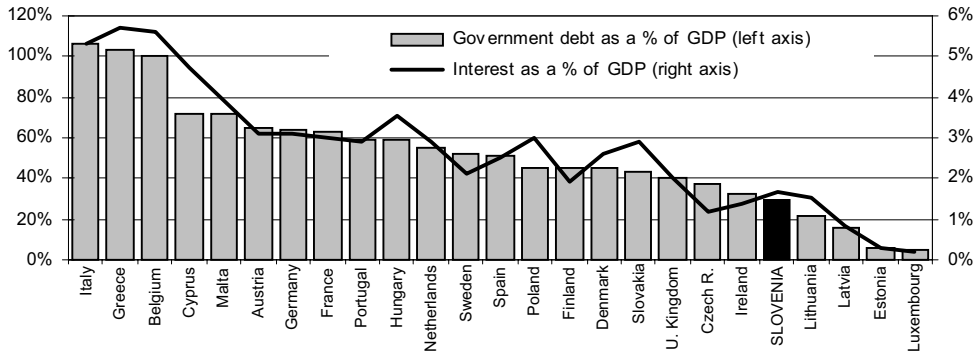
[1] General government debt (burdening the budget financing costs) includes central government debt, local government debt and the debt of social insurance funds (Pension and Disability Insurance Institute and Health Insurance Institute). Central government debt according to the Standard Classification of Institutional Sectors (SKIS) comprises the debt of direct state budget users, state funds and other central government units.

Table: **General government debt in 2000-2003, SIT bn and as a % of GDP**

	2000	2001	2002	2003
Debt of direct state budget users	1,013.4	1,227.1	1,404.8	1,467.3
as a % of GDP	23.8	25.8	26.4	25.5
Securities	839.0	1,000.6	1,195.3	1,295.0
as a % of GDP	19.7	21.0	22.5	22.5
Loans	174.4	226.5	209.5	172.3
as a % of GDP	4.1	4.8	3.9	3.0
Debt of state funds	6.8	13.9	15.3	18.2
as a % of GDP	0.2	0.3	0.3	0.3
Securities	2.6	4.6	4.4	4.1
as a % of GDP	0.1	0.1	0.1	0.1
Loans	4.1	9.2	10.8	14.1
as a % of GDP	0.1	0.2	0.2	0.2
Debt of other central government units	41.4	66.8	103.0	141.4
as a % of GDP	1.0	1.4	1.9	2.5
Securities	40.9	66.4	102.2	128.4
as a % of GDP	1.0	1.4	1.9	2.2
Loans	0.5	0.4	0.8	13.0
as a % of GDP	0.0	0.0	0.0	0.2
Assets on accounts	0.8	1.0	1.4	1.9
CENTRAL GOVERNMENT DEBT	1,062.3	1,308.7	1,524.5	1,628.8
as a % of GDP	25.0	27.5	28.7	28.3
LOCAL GOVERNMENT DEBT	7.3	8.1	14.3	18.4
as a % of GDP	0.2	0.2	0.3	0.3
Securities	0	0	0	0
as a % of GDP	0.0	0.0	0.0	0.0
Loans	7.3	8.1	14.3	18.4
as a % of GDP	0.17	0.17	0.27	0.32
DEBT OF SOCIAL INSURANCE FUNDS	23.2	22.8	30.5	40.1
as a % of GDP	0.5	0.5	0.6	0.7
Securities	0	0	0	0
as a % of GDP	0.0	0.0	0.0	0.0
Loans	23.2	22.8	30.5	40.1
as a % of GDP	0.5	0.5	0.6	0.7
GENERAL GOVERNMENT DEBT	1,092.9	1,339.6	1,569.3	1,687.2
as a % of GDP	25.7	28.1	29.5	29.4

Source: Ministry of Finance.

Figure: **General government debt in Slovenia and EU member states in 2003, as a % of GDP**



Source: Ministry of Finance, Eurostat.

Balance of payments

In 1997, the current account that had been balanced until then turned into a deficit which peaked in 1999; thereafter it began to narrow subsequently and returned to a surplus in 2001 and 2002. In *1995-1997* the current account was balanced. The trade deficit totalled 4.3% of GDP, however, the surplus in trade in services (3.1% of GDP) and positive net factor incomes and current transfers enabled the current account to achieve a balance. In 1998-2000 the current account deficit averaged out at 2.2% of GDP (the trade deficit totalled 5.2% and the services deficit came in at 2.1%). The current account began to record a deficit in *1998* when Slovenia's real export growth slowed down under the indirect impact of the financial crises in Asia and Russia. At the same time, strong domestic investment encouraged high import growth. In *1999*, the growth of goods exports slowed down strongly (due to the stagnant exports to the countries of former Yugoslavia, the sharp fall in exports to Russia and the relatively modest increase in exports to the EU), while imports of goods surged (as a result of high domestic spending prior to introducing VAT). As a result, the trade deficit reached 5.8% of GDP that year. 1999 also recorded a fall in the surplus in trade in services due to the smaller net foreign exchange receipts from tourism (the Kosovo crisis), net imports of construction services and faster import growth of other (non-traditional) services. The current account deficit thus reached 3.3% of GDP, the biggest share in the observed period. In *2000*, export growth was boosted by favourable international economic conditions (strong foreign demand), while the relatively modest imports growth was chiefly due to the sluggish domestic demand. The surplus in trade in services widened significantly (from 1.6% of GDP in 1999 to 2.4% of GDP), which helped the current account deficit to narrow to 2.8% of GDP. *In 2001*, the real export growth of goods and services (6.3%) decelerated by more than half compared to 2000 (13%) as a result of the softening seen in the economic activity in the EU countries. On the other hand, the increased sales of goods in the markets of former Yugoslavia and Russia prevented an even bigger drop in the real growth rate of exports. The modest real growth of goods and services imports was linked to weak domestic demand. With the further narrowing of the trade deficit (to 3.1% of GDP) and the sustained level of surplus in services (2.4% of GDP), factor incomes and current transfers, the current account turned into a surplus of 0.2% of GDP in 2001. *In 2002*, the current account surplus increased significantly, to 1.4%. This rise was underpinned by modest imports (small increase in domestic demand) on the one hand, and sustained exports growth at the 2001 level along with improved terms of trade (by 2 p.p.) on the other. The trade deficit narrowed from 3.1% of GDP to 1.1% of GDP. Trade in services picked up considerably from the previous year and resulted in a slight increase in the surplus in services (to 2.6% of GDP).

In 2003, the current account surplus turned into a slight deficit (-0.4% of GDP) which was, along with slightly improved terms of trade, due to the modest growth of exports and the increase in imports on the back of the accelerated growth of domestic demand. Against the background of the less favourable economic situation in EU countries, the growth of goods exports slowed down noticeably in 2003. As export revenues in EU markets rose only modestly, Slovenian exporters increased their exports to the CEFTA markets, non-European countries and the Russian Federation. As a result, the real growth of goods exports reached 4.4% (6.5% in 2002). The rapid increase in domestic spending seen in 2003 gave rise to the stronger growth of imports that came in at 7.3% in real terms (4.4% in 2002), pushing the trade deficit up to 2.2% of GDP (the terms of merchandise trade improved by 0.5 p.p.). The volume of trade in services rose more slowly than that of the trade in goods in 2003, while exports of the three main groups of services (transport, travel and other services) grew at a slower pace than their imports. The surplus in services trade was lower than in 2002 (2.2% of GDP) even though the terms of trade in services improved thanks to the higher export prices of transport, restaurant and hotel services. The deficit in factor incomes widened compared to 2002, largely due to the higher reinvested earnings by foreign investors and higher interest rates on foreign loans. The positive current transfers balance decreased by a third compared to the previous year: transfers from abroad fell in both government and other sectors, while other sectors' transfers abroad increased (insurance and other transfers).

In the first eleven months of 2004, the current account surplus retained almost the same level as in the same period of 2003, while the flows of goods and services strengthened considerably. Exports of goods and services expressed in euros were up 10.6% in nominal terms (10.2% in goods and 12.3% in services), while imports of goods and services rose by 11.2% in nominal terms (11.6% in goods and

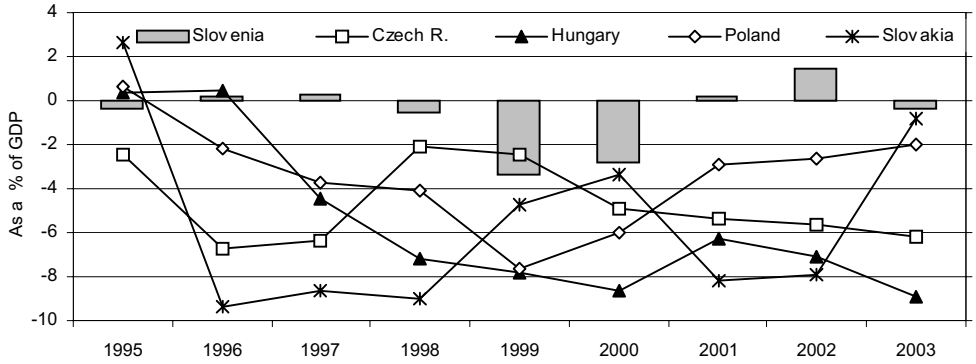
9.1% in services). As expected, merchandise exports accelerated within the EU-25 market: the highest rise in Slovenia's main trading partners was recorded in exports to Austria and France, while the upturn was more modest in Germany and Italy. The level of exports to 'non-traditional' trading partners (Belgium, Spain, Greece, Denmark) also rose sharply. Exports of goods to the countries of former Yugoslavia increased above expectations, notably in April prior to Slovenia's accession to the EU and prior to the expiry of the free-trade agreements with these countries, which was followed by an increase in the customs duties on imported Slovenian goods. Similarly, exports to Russia surged as the high oil prices and the consequent strong growth of the Russian economy boosted the country's imports demand. On the import side, consumer and intermediate goods were up most markedly as a result of the stronger growth of private consumption and the increase in the volume of industrial production. Of all end-use product groups, investment goods recorded the smallest rise in imports. The growth of services exports strengthened as well, mainly on the back of the strong increase in transport and other services (especially communication, construction, IT and other business services). In services imports, the highest rise was recorded in the imports of transport services, which was in line with the rise in goods imports. In the first eleven months of 2004, the balance of goods and services registered a surplus of EUR 45.7 m, which was nevertheless more than 50% lower than in the comparable period of 2003 due to the increasing goods deficit (EUR 579.8 m) and in spite of the higher services surplus (EUR 625.5 m). The smaller deficit in the balance of factor incomes was largely the result of lower estimates of the reinvested profits of foreign investors than in the same period of 2003. The surplus in the balance of current transfers remained at approximately the same level as in the same period the year before. Within their structure, net inflows from the EU budget and net outflows of other sectors (workers' remittances and other transfers) enjoyed the highest increase. The ***current account balance*** recorded a surplus of EUR 30.8 m in the first eleven months of 2004.

Table: **Current account of the balance of payments in Slovenia (as a % of GDP) and real growth rates of trade in goods and services (in %), 1995-2003**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Current account, % of GDP	-0.3	0.2	0.3	-0.6	-3.3	-2.8	0.2	1.4	-0.4
Trade balance	-4.7	-4.2	-4.0	-3.8	-5.8	-5.9	-3.1	-1.1	-2.2
Services balance	2.9	3.2	3.3	2.4	1.6	2.4	2.4	2.6	2.2
Real growth rates of trade in goods and services, in %									
Exports of goods	3.0	2.4	13.1	9.4	2.7	12.9	7.0	6.5	4.4
Exports of services	-6.3	4.4	3.8	-1.9	-3.7	13.6	3.1	7.9	-2.4
Imports of goods	13.1	2.1	13.0	10.8	8.6	7.7	3.2	4.4	7.3
Imports of services	-1.2	3.5	1.9	6.5	4.2	6.9	1.9	8.1	3.3

Sources: SORS, BS, calculations by IMAD.

Figure: **Current account balance in Slovenia and some new EU member states in 1995-2003, as a % of GDP**



Sources: SORS, BS, OECD Economic Outlook, December 2004.

Gross external debt

After rising relatively modestly in the first half of the 1990s, external debt started to accelerate in 1995 primarily due to the private sector's increased borrowing. In 1995-2002, non-guaranteed private debt rose faster than public and publicly-guaranteed debt. Non-guaranteed private debt increased by an average annual rate of 15.6% in the 1995-2002 period, slightly faster than public and publicly-guaranteed debt (14.9%). From end-1995 to end-2002, non-guaranteed public debt rose from EUR 3,097 m to EUR 8,254 m, while public and publicly-guaranteed debt increased from EUR 1,178 m to EUR 3,201 m. The bulk of non-guaranteed private debt was made up of loans to other sectors (non-financial corporate sector in particular)[1], while the government sector mainly borrowed by issuing Eurobonds. Public and publicly-guaranteed debt increased further when Slovenia assumed 18% of former Yugoslavia's non-allocated debt in accordance with the New Financial Agreement (NFA) of 1996 and 16.39% of Yugoslavia's non-allocated debt following bilateral negotiations with individual countries of the Paris Club. Total debt assumed from former Yugoslavia amounted to EUR 523 m, which represented 15.6% of the total public and publicly-guaranteed debt at the end of October 2003.

In 2003, gross external debt mainly rose on account of the borrowing of domestic commercial banks. Slovenia's total gross external debt increased by EUR 1,850 m in 2003 to total EUR 13,305 m at the end of 2003. Current transactions pushed gross external debt up by EUR 1,934 m, while exchange rate differences (euro's appreciation against the basket of currencies) reduced it by EUR 84 m. Loans to the banking sector (EUR 1,010 m) and to other sectors (EUR 648 m) accounted for 89.6% of the rise in the gross external debt; the external borrowing of these sectors was encouraged by the tolar's slow depreciation against the euro and the difference between domestic and foreign interest rates. In 2003 over 2002, the smallest increase in indebtedness among the analysed sectors was seen in the government sector (EUR 74 m). The borrowing of affiliated enterprises – legal entities affiliated to non-residents through equity capital, owning 10% or more – rose by EUR 118 m year on year. The largest part of this increase (83.4%) was generated by debt owed to investors, the rest came from affiliated enterprises.

The increase in the position of Slovenia's gross external debt in the first three quarters of 2004 was largely fuelled by commercial banks' increased borrowing abroad; enterprises, on the other hand, borrowed less than the previous year, while the government sector further reduced its indebtedness. From end-2003 to end-September 2004, Slovenia's gross external debt rose by EUR 1,520 m to EUR 14,825 m. Like in the previous year, this rise predominantly resulted from commercial banks' borrowing to meet the increased domestic demand for foreign exchange loans, while corporate borrowing abroad was in decline for the second year in a row. As a result of the relatively uniform domestic and foreign interest rates on foreign exchange loans, enterprises took out foreign currency loans in the domestic market more extensively. The government sector repaid more foreign loans than it took out in the observed period. The repayment of matured Eurobonds of the Republic of Slovenia issued in 1997, totalling EUR 204.5 m, represented the bulk of government loan repayments. Compared to end-2003, there was a higher share of commercial banks (up 4.6 percentage points to 30.2%) in the structure of external debt, and a lower share of the government sector (down from 18.9% to 15.8%) and other sectors – including enterprises – (from 47.1% to 46%), while the share of affiliated enterprises shrank only slightly (from 8.4% to 7.6%).

[1] Other sectors include non-bank financial corporations, non-financial corporations and households, and non-profit institutions serving households.

Net external debt also increased in the first three quarters of 2004. Net external debt, defined in the new IMF standards as the difference between liabilities (gross external debt) and debt-instrument claims, totalled EUR 1,089 m at the end of September 2004 (EUR 456 m at the end of December 2003). The government sector recorded net external liabilities amounting to EUR 2,337 m (EUR 2,505 m at the end of December 2003), mostly in the form of issued bonds and debentures. The Bank of Slovenia manages international reserves on behalf and on account of the government and recorded net external claims totalling EUR 6,613 m (EUR 6,860 m at the end of December 2003). Commercial banks recorded net external liabilities of EUR 2,451 m in the first three quarters, or EUR 828 m more than at the end of 2003. Other sectors registered net liabilities of EUR 3,131 m (EUR 3,226 m at the end of December 2003), while affiliated enterprises had net external claims totalling EUR 218 m at the end of September 2004 (EUR 38 m in December 2003).

Dynamic indicators of external indebtedness have deteriorated for the second consecutive year. Nevertheless, international monetary reserves and total foreign exchange reserves still suffice to cover short-term debt by the remaining maturity, which is important in view of the economy's liquidity and solvency. However, gross external assets in debt instruments no longer cover gross external liabilities (gross external debt), which reflects Slovenia's net debt position (see Table 1).

Table 1: **Dynamic debt indicators, position at year-end, EUR m**

	1999	2000	2001	2002	2003	30 Sep. 2004
A. Short-term debt by remaining maturity[1]	3,374	4,382	4,569	4,448	4,555	5,182
B. International monetary reserves of the BS	3,159	3,436	4,984	6,781	6,879	6,547
C. Foreign exchange	4,104	4,705	6,513	7,842	7,703	7,382
D. Gross external claims in debt instruments[2]	7,697	8,700	10,825	12,580	12,848	13,736
E. Gross external liabilities in debt instruments[3]	8,012	9,490	10,403	11,455	13,305	14,825
Debt indicators						
- international reserves to short-term debt (B/A)	0.94	0.78	1.09	1.52	1.51	1.26
- foreign exchange to short-term debt (C/A)	1.22	1.07	1.43	1.76	1.69	1.42
gross external claims in debt instruments/gross external debt (D/E)	0.96	0.92	1.04	1.10	0.97	0.93

Source: Bank of Slovenia.
Notes: [1]Short-term debt by remaining maturity includes short-term debt and part of long-term debt falling due within one year. [2]Gross external claims in debt instruments include all claims in Slovenia's balance of assets, except equity. [3]Gross external liabilities in debt instruments include all debt liabilities in Slovenia's balance of assets (gross external debt).

Table 2: **Slovenia's gross external debt position by maturity and by liabilities to affiliated entities, EUR m**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	30 Sep. 2004
Total gross external debt	4,275	5,381	6,165	6,459	8,012	9,490	10,403	11,455	13,305	14,825
Short-term debt	1,470	1,503	1,819	1,838	2,155	2,283	2,223	2,305	2,447	2,579
Public and publicly-guaranteed debt	0	0	0	0	0	0	15	66	40	33
Private non-guaranteed debt	1,470	1,503	1,819	1,838	2,155	2,283	2,208	2,239	2,407	2,546
Long-term debt	2,083	2,968	3,347	3,726	4,811	5,895	7,348	8,147	9,737	11,084
Public and publicly-guaranteed debt	1,178	1,657	1,875	2,007	2,462	2,883	3,107	3,135	3,525	3,706
Private non-guaranteed debt	905	1,311	1,472	1,719	2,350	3,012	4,241	5,012	6,212	7,378
Liabilities to affiliated entities	722	910	999	895	1,045	1,312	832	1,002	1,120	1,162
Public and publicly-guaranteed debt	0	0	0	0	0	0	0	0	0	0
Private non-guaranteed debt	722	910	999	895	1,045	1,312	832	1,002	1,120	1,162

Source: Bank of Slovenia.

Country risk

The first assessment of Slovenia's country risk was made by the agencies Moody's, Standard & Poor's and Fitch Ratings in 1996 when Slovenia was given the highest initial ratings among Central and Eastern European countries. The relatively high initial ratings of Slovenia's country risk[1] given by all agencies were due to the favourable assessments in all three components of country risk (political, social and economic). The initial high rating remained unchanged for several years despite the undermined general government balance in 1997 and external balance in 1999 because these two indicators nevertheless remained within sustainable limits.

In the following years, all three agencies revised their initial ratings upwards, to a large extent due to Slovenia's successful accession negotiations and entry to the EU. *Moody's assessment* was first revised upwards in 2000 (from A3 to A2) which was, despite the substantial deficit widening in the current account of the balance of payments seen in 1999 and 2000, primarily due to the enforcement of the EU Association Agreement of 1999. The successfully concluded negotiations with the EU were also the reason for Moody's upward revision (to Aa3) in November 2002, when the outlook for the future was again assessed as stable. As a result of this improvement in its rating, Slovenia was ranked among the countries with a low-risk assessment (high quality) according to Moody's classification. Since Slovenia's entry to the EU in May 2004, Moody's assessment has remained unchanged. However, in a special report released in July 2004 the agency pointed out that the key criteria for assessing country risk in all new member states in the future would be, in particular, an efficient mix of economic policies during participation in ERM II, a further deepening of the financial market and a sustainable medium-term fiscal position where pressure on general government expenditure caused by additional financial burdens (co-financing the additional inflow of funds from the European budget, setting up the Schengen border) after accession is indicated as the main risk. The agency also drew attention to the need to carry on with the unfinished structural reforms. *Standard & Poor's* high initial country risk assessment (A) was revised upwards to A+ when the Treaty of Accession between Slovenia and the EU was signed in May 2003. Following accession to the EU in May 2004 it was raised further to AA-. Standard & Poor's similarly emphasised that the implementation of structural reforms (labour market reform, privatisation of the energy sector, development of the financial sector) is of paramount importance for improving the country's rating. The assessments of *Fitch Ratings* have seen three upward revisions: in December 1999 (from A- to A), in May 2003 (from A to A+) and in July 2004 (from A+ to AA-).

Slovenia enjoys the highest country risk rating of the new EU member states while, among the old members, only Greece's rating was lower than Slovenia's in 2004. Ever since the upward revision of November 2002, Moody's has given Slovenia the highest country risk rating of the new EU member states.It is also higher than the rating of Greece that was lowered from Aaa (the highest rating) to A1 in autumn 2004 due to Greece having reported false figures for the country's budget deficit from 2000 on. With the exception of Greece, Belgium (Aa1), Italy and Portugal (both Aa2), Moody's gave all euro area countries and the remaining three 'old' EU members the highest rating (Aaa). Standard & Poor's also ranked Slovenia highest among the new member states and higher than Greece whose future outlook assessment was revised from stable to negative in September 2004. All 'old' EU members were assessed better that Slovenia (Italy and Portugal with AA-, Belgium and Spain with AA+, and others with AAA). Also Fitch Ratings' rating for Slovenia was the highest among the new EU members

and higher than Greece's, while all other countries received better ratings (AA for Belgium, Italy and Portugal and AAA for the rest).

Table 1: **Initial and latest available country risk assessment for Slovenia (long-term foreign currency rating) made by Standard & Poor's, Moody's Investors Service and Fitch Ratings**

Standard&Poor's		Moody's Investors Service		FitchRatings	
8 May 1996	A	8 May 1996	A3	8 May 1996	A-
13 May 2004	AA-	26 November 2004	Aa3	7 December 2004	AA-

Source: Standard & Poor's, Moody's Investors Service, FitchRatings.

Table 2: **Initial and latest available assessments of country risk and outlooks for the future[1] made by Moody's, Standard & Poor's and Fitch Ratings for Slovenia, other new EU member states, Greece and Portugal**

	Initial assessment		Latest assessment		
	Standard&Poor's		Standard&Poor's (13 May 2004)	Moody's (26 November 2004)	FitchRatings (7 December 2004)
Slovenia	A/Stable/	May 96	A+/Stable/	Aa3/Stable/	AA-/Positive/
Cyprus	AA-/Stable/	August 91	A/Stable/	A2/Stable/	A+/Positive/
Czech Republic	BBB/Positive/	July 93	A-/Stable/	A1/Stable/	A-/Stable/
Estonia	BBB+/Stable/	December 97	A-/Stable/	A1/Stable/	A/Positive/
Latvia	BBB/Stable/	January 97	A-/Stable/	A2/Stable/	A-/Positive/
Lithuania	BBB-/Stable/	June 97	A-/Stable/	A3/Positive/	A-/Positive/
Hungary	BB+/Positive/	April 92	A-/Stable/	A1/Stable/	A-/Negative/
Malta	A/Stable/	March 94	A/Stable/	A3/Stable/	A/Positive/
Poland	BB/Positive/	June 95	BBB+/Stable/	A2/Stable/	BBB+/Stable/
Slovakia	BB-/Stable/	February 94	BBB+/Positive/	A3/Stable/	A/Stable/
Greece	BBB/-/	September 88	A+/Negative/	A1/Stable/	A+/Negative/
Portugal	A/-/	October 88	AA/Negative/	Aa2/Stable/	AA/Stable/

Sources: Standard & Poor's, Moody's Investors Service, FitchRatings.
Note: [1]outlook for the future, i.e. an assessment of further economic, social and political development is given in the descriptive form: Positive, Stable and Negative.

[1] This analysis focuses on the country risk assessment for the issuing of long-term government bonds denominated in a foreign currency, which is important for estimating the risk premium in issuing long-term government securities.

Knowledge-based society

Total public expenditure on education

Total public expenditure on education expressed as a share of GDP serves as a structural indicator measuring the level of investment in education, which is one of the main factors of knowledge-based societies' development. In European countries, the share of total public expenditure in total expenditure on education ranges between 85% and 95% (91% in Slovenia in 2002). In international comparisons the total share of public expenditure on education in GDP is used as the main indicator due to the lower reliability of figures on private expenditure on education. This year this indicator has been included in the Development Report for the first time. The data for Slovenia, published at the end of 2004 by the SORS, were collected according to an internationally comparable methodology[1] for the first time. It should be noted, however, that the indicator's values differ across countries with regard to the organisation of their education and training systems, education financing systems, their inclusion of youth and adults in education and the demographic structure of the population.

The share of total public expenditure on education in Slovenian GDP totalled 6.02% in 2002, which is significantly above the EU-25 average. Compared with the previous year, the GDP share of total public expenditure on education fell by 0.11 p.p. in 2002, while provisional data for 2003 indicate a slight increase to 6.09%. This figure places Slovenia above the level achieved by most European countries (between 4% and 6% of GDP) and well above the EU-25 average (5.37% in 2001; see table). Individual countries' shares of total public expenditure on education have not changed significantly over these years; however, in general a falling trend was observed in the 1995-2000 period while the shares have begun to increase again after 2000, which is in line with the Lisbon Strategy objectives. The relatively high share of Slovenia's total public expenditure on education is nevertheless lower than the shares achieved by some Northern European countries, notably Denmark, Sweden and Finland which are also in the lead according to some other education indicators – share of the population completing tertiary education, writing skills and the inclusion of adults in education – where Slovenia still lags behind significantly.

Slovenia also exceeds the EU-25 average by the share of its total public expenditure on tertiary education in GDP. According to the SORS' first estimate, the share of total public expenditure on tertiary education edged up slightly further in 2003, from 1.33% in 2001 to 1.36%. This increase is in line with the SEDS guidelines. The share of total public expenditure on primary education recorded an even higher increase (from 2.51% in 2001 to 2.69% in 2003), largely due to increased investment linked to the launching of the nine-year primary school. Total public expenditure on education shrank primarily in secondary education (from 1.69% of GDP in 2001 to 1.48% in 2003) and slightly in pre-school education (from 0.59% to 0.56%)[2]. If we compare Slovenia's total public expenditure by levels of education with other European countries, we can see that already in 2001 Slovenia's share of total public expenditure on education in GDP allocated for tertiary education was above the EU-25 average (1.24%) and just a fraction below the EU-15 average (1.36%). Among the new EU member states, only Lithuania spends roughly the same share of GDP as Slovenia on tertiary education (see figure). The GDP share of total public expenditure for all lower-than-tertiary education levels together totalled 4.73% in 2003 (4.80% in 2001), which is more than the 2001 averages of the EU-15 (4.16%) and EU-25 (4.19%). Also in these expenditures, Denmark and Sweden had the highest shares in GDP (5.8% and 5.3%, respectively).

[1] Data on education are acquired by the UOE questionnaire common to three international organisations: **U**NESCO, **O**ECD and **E**urostat. The questionnaire consists of a non-financial and a financial part. Slovenia has reported the non-financial data since the school year 1996/97, while data for the financial part for the 2001-2003 period have been prepared this year for the first time. Data in the UOE questionnaire cover formal education only.

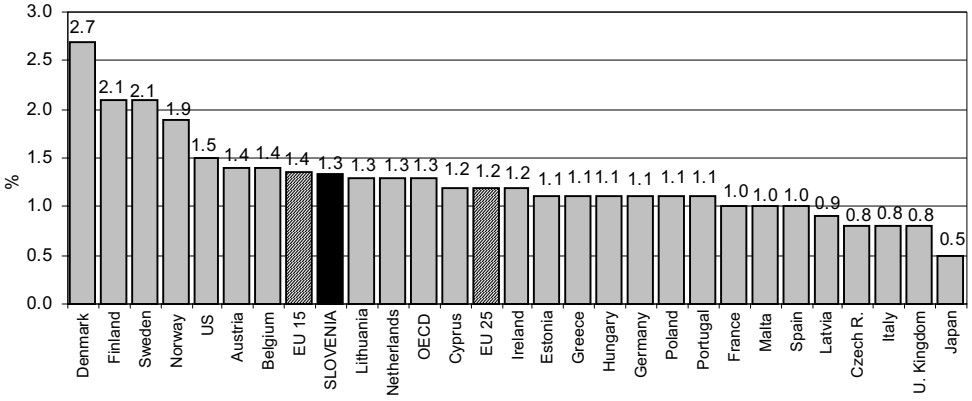
[2] Figures for 2003 are provisional estimates.

Table: **Public expenditure on education[1] in Slovenia, other EU member states and some OECD countries, as a % of GDP**

	1995	1996	1997	1998	1999	2000	2001	2002[3]
Slovenia	**-**	**-**	**-**	**-**	**-**	**-**	**6.13**	**6.02**
EU 25[2]	**5.36**	**5.31**	**5.29**	**5.43**	**5.33**	**5.22**	**5.37**	**5.60**
EU 15[2]	**5.42**	**5.53**	**5.40**	**5.57**	**5.45**	**5.40**	**5.42**	**5.64**
Austria	6.04	5.9	5.8	5.77	5.8	5.66	5.7	-
Belgium	-	-	-	-	-	-	6.11	-
Danmark	7.67	8.09	7.94	8.32	8.14	8.39	8.50	8.51
Finland	6.85	7	6.52	6.29	6.31	6.12	6.24	6.39
France	6.04	6.01	6.03	5.95	5.93	5.83	5.76	5.81
Greece	2.87	3.07	3.44	3.47	3.64	3.79	3.9	3.96
Irland	5.07	5.33	5.15	4.87	4.57	4.36	4.35	-
Italy	4.85	4.85	4.53	4.7	4.79	4.57	4.98	4.75
Luxembourg	4.26	4.00	4.11	-	-	-	3.84	3.99
Germany	4.62	-	4.63	-	4.58	4.53	4.57	-
Netherland	5.06	4.99	4.75	4.8	4.77	4.87	4.99	5.08
Portugal	5.37	5.54	5.60	5.62	5.74	5.74	5.91	5.83
Spain	4.66	4.68	4.54	4.49	4.5	4.42	4.41	4.44
Sweden	7.22	7.37	7.62	7.71	7.47	7.39	7.31	7.66
U.K.	5.24	5.06	4.88	4.79	4.58	4.58	4.69	-
Lithuania	5.08	5.14	5.42	5.96	6.14	5.67	5.92	5.89
Latvia	6.27	5.29	5.19	6.29	5.78	5.43	5.75	5.82
Estonia	5.83	6	5.91	5.66	6.13	5.59	5.48	-
Cyprus	4.81	5.01	5.66	5.77	5.65	5.60	6.28	6.83
Czech Republic	4.62	4.48	4.43	3.93	4.05	4.04	4.16	4.41
Hungary	5.37	4.48	4.61	4.56	4.66	4.54	5.15	5.39
Poland	5.14	4.73	4.84	5.09	4.88	4.99	5.56	5.41
Slovakia	4.98	4.5	4.8	4.51	4.4	4.15	4.03	-
Malta	-	-	-	-	4.77	4.55	4.47	4.54
Norway	7.4	-	-	-	-	6.7	7.0	-
U.S.A.	-	-	-	-	-	5.0	5.6	-

Sources: Eurostat for EU countries, SORS for Slovenia, OECD for Norway and USA, IMAD's calculation for the EU 15 and EU 25 aggregates.
Notes: [1]According to the UOE methodology, public expenditure on education comprises total budgetary expenditure on the formal education of youth and adults at national and municipal levels. Public direct expenditure on education institutions (both instructional and non-instructional) is covered, as are transfers and payments to households and other private entities. [2]Calculations of averages for EU 15 and EU 25 include countries for which annual data are given in the table. [3]Data for 2002 are provisional for all countries.

Figure: **Total public expenditure on tertiary education in Slovenia, other EU member states and some OECD countries, as a % of GDP in 2001**



Sources: SORS, Eurostat, OECD.
Note: According to the ISCED, tertiary education comprises levels 5 and 6; the expenditure on R&D in tertiary education is included.

Average number of schooling years of people in employment

According to provisional data for 2004[1], the average number of schooling years of people in employment in Slovenia continued to rise, albeit at a slower pace than in the previous two years. In 2004, people in employment completed an average 11.7 years of schooling according to the labour force survey and 11.5 years of schooling according to the SORS' employment statistical register, respectively 0.05 and 0.04 more than in 2003. In contrast to 2003, when the education levels of employed people rose in all groups of activities, 2004 only saw a rise in mining and quarrying, financial intermediation, education and other community, social and personal services. Education levels fell in agriculture and fishing and in those employed in private households, while it remained at approximately the same level as in the previous year in all other activities. The highest average number of schooling years was again recorded in education, public administration and financial intermediation (see table).

The share of people in employment with a higher education has been growing relatively fast, notably in public services, financial intermediation and electricity, gas and water supply. In the past four years, (according to the statistical employment register), it rose by an average of 0.7 p.p. per year to reach 20.7% in 2004, which is 5.8 p.p. more than in 1995 and 2.9 p.p. more than in 2000. Generally, the highest and most rapidly rising shares of employed people with a higher education are observed in those activities which also have the highest number of school years. In the 1995-2004 period, the share of highly educated workers rose fastest in education, public administration and financial intermediation (between 10.1 p.p. and 10.5 p.p. during the whole period), where the shares were also the highest (59.6%, 44.9% and 37.3%, respectively). The share of employees with a higher education also increased considerably in electricity, gas and water supply (by 9.5 p.p. to 21.1%), and in 2000-2004 also in health and social work where 34.4% of employees were highly educated in September 2004. A similar share (around 30%) was seen in the groups real estate, renting and business services, and other community, social and personal services.<0) In all other industries of a predominantly manufacturing character, there were less than 12% workers with a higher education, the lowest share being observed in the groups construction and hotels and restaurants (about 5%)

Persons in employment with a completed higher education continue to work mainly in education, the public administration and high value added services, while their concentration in industrial activities remained unchanged in 2004. Most of the highly educated workforce is employed in education, accounting for 21.9% of the total number of people in employment with a higher education. The education activity is followed by the manufacturing industries (14.9%), the public administration (14.1%), business activities (12.9%), health and social work (9.8%) and wholesale and retail trade (7.9%).

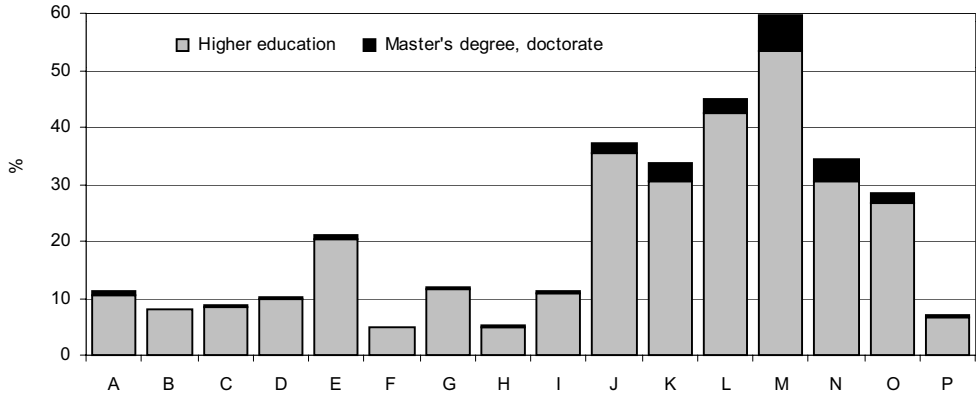
[1] Figures from the labour force survey for Q2 of 2004 and the statistical employment register for September 2004.

Table: **Average number of schooling years of persons in employment in Slovenia in 1995-2004**

		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
	People in employment according to the labour force survey	**11.0**	**11.1**	**11.0**	**11.2**	**11.3**	**11.4**	**11.4**	**11.5**	**11.6**	**11.7**
	People in employment according to the SORS register	**11.0**	**11.0**	**11.1**	**11.1**	**11.2**	**11.2**	**11.3**	**11.4**	**11.5**	**11.5**
A	Agriculture, forestry, hunting	10.3	10.5	10.5	10.6	10.7	10.7	10.6	10.4	10.5	10.4
B	Fishing	10.1	10.2	10.4	10.4	10.5	10.4	10.5	10.6	10.7	10.4
C	Mining and quarrying	10.3	10.3	10.4	10.4	10.5	10.6	10.6	10.7	10.9	11.0
D	Manufacturing	10.1	10.1	10.2	10.2	10.3	10.3	10.3	10.4	10.5	10.5
E	Electricity, gas and water supply	11.2	11.3	11.4	11.5	11.5	11.6	11.6	11.6	11.7	11.7
F	Construction	10.2	10.1	10.0	10.0	9.9	9.9	9.9	9.9	10.0	9.9
G	Wholesale and retail trade; repair of motor vehicles	11.2	11.2	11.3	11.3	11.3	11.4	11.4	11.4	11.5	11.5
H	Hotels and restaurants	10.2	10.2	10.3	10.3	10.3	10.4	10.4	10.4	10.4	10.5
I	Transport, storage and communications	10.9	11.0	11.0	11.0	11.0	11.1	11.1	11.2	11.2	11.3
J	Financial intermediation	12.6	12.7	12.8	12.7	12.8	12.9	12.9	13.0	13.1	13.2
K	Real estate, renting & business activities	12.0	12.0	12.0	12.0	12.1	12.1	12.2	12.2	12.3	12.3
L	Public administration, defence and social insurance	12.9	12.9	13.0	13.2	13.1	13.2	13.3	13.4	13.4	13.4
M	Education	12.9	13.0	13.1	13.2	13.2	13.4	13.4	13.6	13.7	13.8
N	Health and social work	11.9	11.9	11.9	11.8	11.8	11.8	11.9	12.5	12.5	12.5
O	Other community, social and personal services	11.8	11.8	11.8	11.9	11.9	11.9	11.9	12.0	12.1	12.2
P	Private households with employed persons	10.1	10.2	9.9	10.1	10.2	10.1	10.3	10.2	10.2	10.1

Source: SORS, calculations by IMAD.

Figure: **Share of employed people with a higher and post-graduate education by activities, September 2004 (in %)**



Source: SORS, calculations by IMAD.

Share of the population with a completed secondary or higher education

The population's education structure keeps improving as a result of the increased attainment of the secondary and tertiary levels of formal education. Those who have completed at least secondary education represented as much as 78.3% of the population aged 25-64 in 2003 according to the labour force survey (68.7% in 1995), and 75.9% according to the 2002 census (59.1% in 1991). The fastest increase was seen in the share of people who have finished a 4-5 year secondary school (general or technical programmes) and in the share of high education graduates. In 2002 (the latest data), 80.3% of the generation completed a secondary education (of which 27.2% were in vocational and 53.1% in technical and general secondary education programmes), while 8.6% of the generation passed an additional final examination in 3+2 programmes. In 1995, by comparison, 72.9% of the generation completed secondary schooling. Secondary programmes for adults were completed by 6,184 people in 2002, which is 3.4-times more than in 1995. 12,900 students graduated in 2002, while 500 fewer finished their studies the following year when there were no more graduates at the higher level (as opposed to the university level) in university programmes.

In comparison with other countries, Slovenia has a relatively high share of its population with a completed secondary education, while it lags behind in its share of the population with a completed tertiary education. International comparisons are unreliable for methodological differences, especially as regards secondary education, while the comparisons of tertiary education produce better results. According to the share of the population aged 25-64 with a completed secondary education, Slovenia was the seventh among EU countries (the Czech Republic had the highest share: 76.5%, while Malta recorded the lowest percentage: 11.4%). In its share of the population with a tertiary education, Slovenia is still far behind the more developed and propulsive European countries although the gap narrowed somewhat in 2002 and 2003 with the increase in the number of graduates. Finland again recorded the highest share of the population having a tertiary education in 2003 (32.8%), while Malta was again the last among the current member states (9.0%). Slovenia occupied 16th place. Of the new member states, Estonia (30.4%), Cyprus and Lithuania had higher shares than Slovenia, while four of the old member states had lower shares (Austria, Luxembourg, Italy and Portugal).

The inclusion of youth in education rose further in 2002/2003, while the inclusion of adults dropped slightly. In the school year 2002/2003, the number of students enrolled in secondary schools represented 76.8% of the total generation aged 15-19 (67.2% in 1994/95; Lisbon Strategy goal: 80%); enrolment is rising especially in grammar school, where it reached 28.4% of the generation aged 15-19 (compared to 19.8% in 1994/1995). In the reference generations[1], the shares of students enrolled in secondary technical schools and vocational technical education have been rising, while enrolment in secondary vocational schools and lower vocational programmes has declined. The number of regular students also rose and accounted for as much as 37.4% of the generation aged 19-23 (23.6% in 1994-1995). The number of adults in formal secondary education, which had already exceeded 20,000 in 2000/2001 (8,460 in 1994), dropped slightly in the following year. It fell by almost 1,000 in general and technical schools, while rising in secondary vocational schools and in technical vocational programmes. The number of part-time students in university programmes also declined in 2003/2004, while their number in

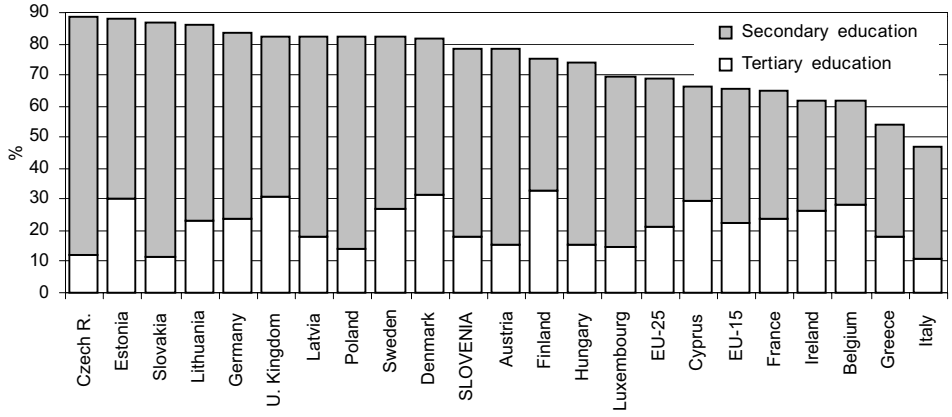
vocational colleges is rising constantly. The total number of students (full-time and part-time) per 1000 people exceeded 50 already in 2002/2003.

Table: **Percentage of the population aged 25-64 with a completed secondary education in Slovenia in 1995-2003, in %**

	According to the Labour Force Survey									Census
	1995	1996	1997	1998	1999	2000	2001	2002	2003	2002
Slovenia										
% of population with at least a secondary education	**68.7**	**70.1**	**70.3**	**72.5**	**73.5**	**75.5**	**76.2**	**77.5**	**78.3**	**75.9**
Secondary education	**54.5**	**56.7**	**56.4**	**57.2**	**57.9**	**59.5**	**60.0**	**60.5**	**60.6**	**58.8**
vocational	28.8	30.5	30.4	30.6	30.0	28.3	28.9	28.9	29.2	31.0
technical or general	25.7	26.3	26.1	26.7	28.0	31.2	31.1	31.5	31.4	27.8
Tertiary education	**14.2**	**13.4**	**13.9**	**15.3**	**15.6**	**16.0**	**16.3**	**17.1**	**17.7**	**17.1**
high-level vocational programmes	7.5	6.9	7.2	7.7	7.6	7.4	6.9	6.6	6.4	6.6
university	6.1	5.8	6.0	6.8	7.2	7.7	8.5	9.5	10.2	9.2
postgraduate studies	0.7	0.7	0.7	0.7	0.8	0.9	0.9	0.9	1.1	1.3
EU 25										
% of population with at least a secondary education	**-**	**-**	**-**	**-**	**-**	**63.9**	**64.7**	**65.6**	**64.0**	**-**
Secondary education	-	-	-	-	-	44.5	45.1	45.7	44.2	-
Tertiary education	-	-	-	-	-	19.4	19.6	19.9	19.8	-
EU 15										
% of population with at least a secondary education	**52.2**	**54.9**	**56.5**	**30.2**	**59.8**	**60.9**	**61.9**	**62.8**	**60.6**	**-**
Secondary education	35.5	37.0	38.1	20.0	40.1	40.5	41.0	41.6	39.8	-
Tertiary education	16.6	17.8	18.4	10.2	19.8	20.4	20.8	21.2	20.8	-

Sources: SORS, Eurostat.

Figure: **Percentage of the population aged 25-64 with a completed secondary education in selected EU member states in 2003 (Q2)**



Source: Eurostat.

[1] According to the legally defined enrolment age (e.g. 15-17 for secondary vocational schools, 15-18 for technical secondary schools and grammar schools etc.).

Internet use

Frequent methodological changes concerning the estimates of Internet use indicators make their statistical monitoring demanding and impede trend analyses and cross-country comparisons. In the past few years, assessments of the current level and dynamics in Internet use were based on data obtained through the project 'Internet Use in Slovenia (IUS)'. In 2004 the SORS launched a survey on the use of information and communication technologies in households and enterprises[1] which serves as the data source for the IMAD's estimates for 2004 and beyond. These surveys will be conducted annually in future and will also serve as the basis for all official comparisons with other EU member states in the information society field. The adoption of the SORS' data does not enable a direct comparison with the data on Internet use for previous years based on the IUS[2]. A methodologically correct comparison with other member states will also not be possible until 2005 when Eurostat is set to release the complete official data for the EU-25.

The SORS' data for 2004[3] indicate that 43% of Slovenian residents aged 16-74[4] used the Internet last year; there were, however, considerable differences between different education levels of users. The share of users who used the Internet in the past three months totalled 37%. The SORS' survey shows there are no major differences in Internet use with regard to gender (men 44.4%, women 42%), while there are significant differences with regard to the education level of users. In the population that has completed tertiary education aged 16-74, Internet penetration was 90%, in the population that has completed secondary education 44% and in the population with a lower education just about 20%. The SORS' one-year figures do not enable trend growth estimates of Internet use; together with the IUS data, however, we can infer that growth rates of Internet use are decreasing in Slovenia.

According to indicative comparisons of the shares of individuals using the Internet regularly[5], Slovenia is lagging behind both the EU-15 and the EU-25 averages. The SORS' data on the Internet usage of individuals in 2004 can be compared with estimates for the EU-15 and EU-25. While the share of regular Internet users in Slovenia totalled 33%, the average for the EU 15 was 42% of the population aged 16-74 and 39% for the EU-25 (Policy Indicators, 2005). These are Eurostat's indicative estimates, and the data are still being completed. Among the new member states, Slovenia was left behind only by Estonia while, among old members, Greece, Ireland, Italy and Portugal did worse than Slovenia. One possible reason for this gap in Internet use *by individuals* is the relatively low share of the population with a tertiary education in Slovenia compared with the EU-15 average, bearing in mind that highly educated people are the most frequent Internet users.

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[1] SORS, 2004.

[2] The main difference between the IUS and the SORS' analyses is in the methodology applied (different surveying methods, different sample sizes and sample structures, different questionnaires). The SORS conducts its survey in line with the Eurostat's instructions and recommendations.

[3] The survey was conducted in April 2004.

[4] The IUS comprises the population aged 10-75. It should be noted here that while the SORS' survey is in line with the Eurostat's methodology according to which the population aged 16-74 is included in the survey, it thus disregards an important segment of the population aged 10-16 which intensively uses the Internet (IUS, 2004). This is why the SORS' data can be originally lower than the data obtained by the IUS methodology.

[5] Weekly Internet usage within the population aged 16-74.

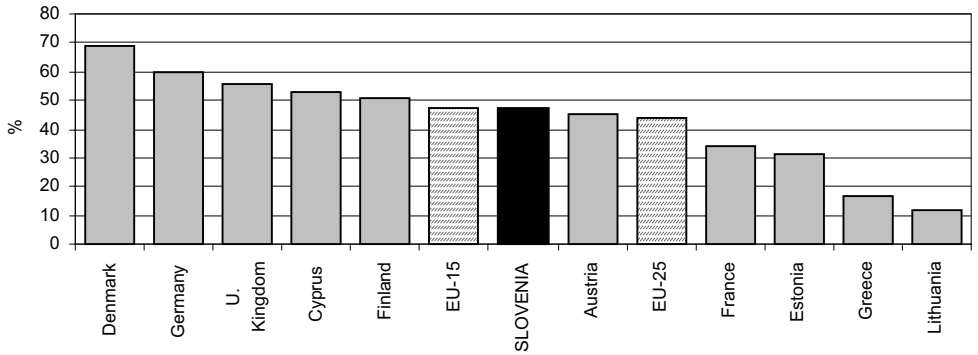
[6] Figures released on 22 February 2005 were used.

According to the SORS, 47% of Slovenian households had access to the Internet in 2004, a figure exceeding both the EU-25 and EU-15 averages. A comparison with the IUS survey (40% of households had Internet access in December 2003) shows significant differences which is probably attributable to the fact that the SORS' survey also includes households that can access the Internet via mobile phone although they do not necessarily use this possibility. According to the latest data on structural indicators released by Eurostat[6], the share of households with Internet access in Slovenia (47%) is bigger than the averages of the EU-15 (45%) and EU-25 (42%). Moreover, Slovenia by far exceeds the other new member states except Cyprus (see the figure). The relatively smaller number of *individual Internet users* in Slovenia and its higher share of *households with access* to the Internet indicate that fewer household members use the Internet in Slovenia than in the EU-15.

Slovenia has achieved a solid starting point in household Internet access. To increase its share further, however, it needs to address several problems. The SORS' survey observes that the main factors preventing wider Internet access by households are excessive equipment and access costs and the fact that some households do not want to have the Internet. The last factor implies that there are not enough e-services available that would be useful to household users, while the first two indicate a need to further increase the price accessibility of Internet use, primarily by ensuring the conditions for greater competition in offering broadband Internet access (leasing broadband access capacities to niche operators on the same conditions as to the main provider). Also in its latest report the European Commission calls attention to the fact that the prices of leased lines in Slovenia are still too high (EC, 2004: 199-203).

Broadband Internet access is also an important factor in the further expansion of e-commerce, where Slovenia's progress has been very slow. According to the eEurope Summary Report (2004) it is obvious that Slovenia is particularly weak in *introducing e-commerce between enterprises*, where it lags behind not only the EU-15 average but also some new member states (e.g. Czech Republic, Estonia, Poland), while it exceeds the EU-15 average and all new member states regarding *Internet access by enterprises*. Efficient implementation of the E-administration Action Plan until 2004 can speed up the launching of e-services and the dynamics of introducing e-commerce in Slovenia. The September 2004 report on its implementation (Action Plan, 2004) reveals that Slovenia is more successful in introducing e-services for the citizens, where it does better than most EU-15 countries, while it falls behind with regard to the available e-services for enterprises, notably in the areas of company registration and customs declarations.

Figure: **Household access to the Internet in Slovenia and EU-15 in 2004, in %**



Source: SORS, 2004, Structural Indicators, 2005.
Note: since data for the Czech Republic, Malta, Belgium, Sweden and the Netherlands for 2004 are not available, these countries are not included in the presented EU-15 and EU-25 aggregates.

Gross domestic expenditure on research and development

Following a perceptible increase in the share of gross domestic expenditure on research and development (GERD) seen in 2001, there was a slight decrease or stagnation in its value in 2002 which had a negative impact on Slovenia's convergence towards the EU-15 average[1]. According to the revised estimate of Slovenian GDP, the average annual expenditure on research and development (R&D) in Slovenia in 1996-2002 totalled 1.43% of GDP. After the 0.12 p.p. rise in 2001, it fell by 0.03 p.p. to 1.53% of GDP in 2002 (latest available data)[2]. The fall in the indicator's value in Slovenia and the slight increase in its average value in the EU-15 (up 0.01 p.p. to 1.99% compared to 2001) widened Slovenia's gap behind the EU-15 average to 0.46 p.p. This is 0.04 p.p. more than in 2001 but still less than the average gap recorded in the 1996-2002 period. According to this indicator, Slovenia is ahead of other new member states of the EU-25 and still better than Ireland, Italy, Spain, Greece and Portugal.

2002 saw continued favourable changes in the R&D structure by source of funds on the back of the perceptible rise in the Slovenian business sector whose share in the financing structure exceeded the EU-15 average of 2001. The average real annual growth rate of the business sector's expenditure on R&D in 1996-2002 totalled 11.1%, which was 7.1 p.p. more than in the government sector and 3.9 p.p. above the average real growth rate of total R&D expenditure[3]. The highest real growth rate (19.6%) of the business sector's expenditure on R&D in the analysed period was recorded in 2002 (15.2% in 2001). The favourable growth rates contributed to the increase in the business sector's share in the total expenditure on R&D from 49.1 structural points (s.p.) in 1996 to 60.0 s.p. in 2002. The 2002 figure was the highest in the observed period and came relatively close to the Lisbon Strategy's Barcelona objective concerning the business sector's share of R&D expenditure (2/3 or 67% of total R&D expenditure, which should amount to 3% of GDP). In 2001 (still the latest available data) the business sector in the EU-15 financed 55.9% of the total R&D expenditure on average, which is 4.1 p.p. less than the Slovenian business sector's share in 2002. According to the latest available data for the EU-25, only Germany (65.5 s.p.) and Finland (69.5 s.p.) were ahead of Slovenia in their business sector's shares in R&D financing in 2002. It should be noted, however, that both Slovenia and the EU still markedly lag behind the Barcelona objective, according to which the business sector should spend 2% of GDP on R&D until 2010 (Slovenia in 2002: 0.92% of GDP; EU-15 in 2001: 1.11% of GDP). By merely maintaining the current growth rates of R&D expenditure it will be difficult to attain this goal. Therefore, investment in this area should be increased if the EU wants to approach the set objective by 2010. By increasing private investment in R&D, the financial role of the government in this field is diminishing. The share of the Slovenian government sector in the R&D expenditure structure totalled 35.6 s.p. in 2002 (34.4 s.p. in EU-15 in 2001), the smallest share seen in the analysed period.

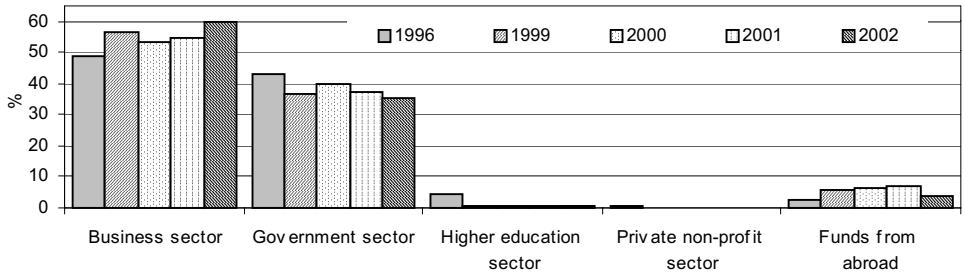
Although the business sector has steadily reduced its gap behind the European average according to the amount of resources spent on R&D performance, the dynamics of closing this gap have been too slow for any faster convergence. In 2002, the Slovenian business sector earmarked 0.92% of GDP for R&D performance, 0.02 p.p. more than in 2001. As the average EU-15 business sector's share in total R&D performance did not change in 2002 over 2001 (EU-15 in 2002: 1.30% of GDP), the difference between the Slovenian and European business sectors decreased by 0.02 p.p. in that period. The trend seen throughout 1996-2002 of closing the gap between the R&D performance in the Slovenian and European business sectors thus continued. In that period, the gap narrowed by 0.12 p.p., from 0.50 p.p. in 1996 to 0.38 p.p. in 2002. In 2002 over 2001, the share of the government sector in total R&D performance fell most markedly, i.e. by 0.04 p.p. to 0.35% of GDP (EU-15 in 2002: 0.26% of GDP). Its gap vis-a-vis the EU-15 average thus shrank to 0.09 p.p. (0.14 in 2001). The higher education sector's share fell by 0.01 p.p. to 0.24% of GDP, thereby falling behind the EU-15 average by 0.18 p.p., which was 0.02 p.p. more than in 2001.

Table: **Gross domestic expenditure on R&D in Slovenia and other EU-25 member states, as a % of GDP**

	1996	1997	1998	1999	2000	2001	2002
Slovenia[2]	1.33	1.32	1.38	1.42	1.44	1.56	1.53
EU 15	1.88	1.87	1.88	1.92	1.95	1.98	1.99
EU 25	1.84	1.83	1.83	1.88	1.91	1.93	-
Austrija	1.60	1.71	1.78	1.91	1.95	2.07	2.19
Belgium	1.80	1.87	1.90	1.96	2.04	2.17	-
Cyprus	-	-	0.23	0.25	0.25	0.27	0.32
Czech Republic	0.98	1.09	1.16	1.16	1.23	1.22	1.22
Denmark	1.85	1.94	2.06	2.10	2.27	2.40	2.52
Estonia	-	-	0.58	0.70	0.62	0.73	0.75
Finland	2.54	2.71	2.88	3.23	3.40	3.41	3.46
France	2.30	2.22	2.17	2.18	2.18	2.23	2.26
Greece	-	0.51	-	0.67	-	0.64	-
Ireland	1.32	1.28	1.25	1.19	1.15	-	-
Italy	1.01	1.05	1.07	1.04	1.07	1.11	-
Latvia	0.42	0.39	0.41	0.37	0.45	0.41	0.42
Lithuania	0.51	0.55	0.55	0.51	0.59	0.68	0.67
Luxembourg	-	-	-	-	1.71	-	-
Hungary	0.65	0.72	0.68	0.69	0.80	0.95	1.02
Germany	2.25	2.29	2.31	2.44	2.49	2.51	2.53
Netherlands	2.03	2.04	1.94	2.02	1.90	1.89	-
Poland	0.67	0.67	0.68	0.70	0.66	0.64	0.59
Portugal	-	0.62	0.69[1]	0.75	0.79[1]	0.85	0.78[1]
Slovakia	0.92	1.09	0.79	0.66	0.65	0.64	0.58
Spain	0.83	0.82	0.89	0.88	0.94	0.95	1.03
Sweden	-	3.55	3.62	3.65	-	4.27	-
U.K.	1.90	1.82	1.81	1.85	1.85	1.89	1.87

Sources: Eurostat (NewCronos); OECD Science, Technology and Industry Scoreboard 2003; SORS.
Notes: [1]this figure is taken from the OECD Science, Technology and Industry Scoreboard 2003; [2]figures for 1996-2001 have been corrected in line with the revised GDP estimate (GDP revision for 1995-2002 resulted in a 6.6% average annual GDP increase which reduced the indicator's value); data for Malta are unavailable.

Figure: **Structure of financing sources for gross domestic expenditure on R&D in Slovenia in 1996, 1999, 2000, 2001 and 2001**



Source: SORS.

[1] At the time of preparing data for the above indicator (December 2004), figures for R&D for the EU-25 average in 2002 were still unavailable hence data for the EU-15 average are used in the text.

[2] The SORS made a first estimate of GERD in 2003 for Eurostat (1.53% of GDP) based on R&D performance; however, the GERD financing structure for the same year was not estimated. Due to this 'deficiency' the GERD is not commented on in the text, since the estimate for 2003 will probably be revised. Eurostat released the first estimate of GERD for 2003 on 24 February.

[3] Real growth rates are calculated on the basis of the SORS' figures in constant prices from 1996.

Number of researchers per thousand of the labour force

The number of researchers per thousand of the labour force rose slightly in 2002[1] for the second consecutive year, which nevertheless did not help Slovenia significantly improve its position relative to the EU-15 average[2]. The value of the analysed indicator totalled 4.7 in 2002. In 1996-2002 this value was exceeded only in 1996 (by 0.1 researcher)[3]. In addition to improving the indicator's value, Slovenia recorded the highest number of researchers in 2002 (4,642, or 620 researchers more than in 1997 when their number was the lowest). The average Slovenian annual growth rate of the number of researchers totalled 0.7% in the observed period, i.e. 2.2 p.p. less than in the EU-15 on average, mainly as a result of the negative growth rates recorded in 1997 and 2000. In 2001 and 2002, the respective annual growth rates of the number of researchers in Slovenia (3.7% and 3.2%) exceeded the EU-15 growth rates by 0.9 p.p. and 1.2 p.p., respectively. A continuation of this trend could help Slovenia catch up with the EU-15 average number of researchers per thousand of the labour force (5.7% in 2001).

2002 saw relatively favourable shifts in the sectoral distribution of researchers. For the second consecutive year, the highest growth rate was registered in the business sector (7.3%; 9.4% in 2001), where compared to 2001 the share of researchers was up by 1.3 p.p. and totalled 34.9%, the biggest share seen in 1996-2002. The number of researchers also rose in the government sector (up 2.8%) and the private non-profit sector (up 3.8%), while it fell in the higher education sector (down 0.9%) where the share of researchers shrank by 1.3 p.p. to 29.4%.

The continuation of high growth rates in the number of researchers in the Slovenian business sector would help further reduce the differences between the sectoral distribution of researchers in Slovenia and the EU-15 average. The average annual growth rate of the number of researchers in the Slovenian business sector totalled 3.1% in 1996-2002, which was 0.8 p.p. below the EU-15 average in the same period. Although the respective Slovenian growth rates for 2001 and 2001 were by 5.2 p.p. and 5.8 p.p. higher than the EU-15 growth rates in these two years, the average share of researchers in the EU-15 business sector was still 16.1 p.p. bigger than in Slovenia in 2002, albeit this share was 2.7 p.p. smaller than in 2000 and 1.6 p.p. smaller than in 2001. Despite the increase in the share of researchers seen in the Slovenian business sector in 2001-2002, these shifts were too slow to allow any faster closing of the gap as against the EU-15 average[4]. The share of the government sector's researchers was 19.3 p.p. above the EU-15 average in 2002, which is 0.3 p.p. less than in the previous year and 1.0 p.p. below the average of the analysed period. Much smaller differences were observed in the shares of researchers working in the higher education sector, where the EU's share was 5 p.p. larger than Slovenia's in 1996-2002 on average.

To reduce Slovenia's gap behind the European average more rapidly, it would among other things make sense to intensify the young researchers programme in the future. After the sharp decline in the number of young researchers seen in 2001 their number rose by a modest 1.4% in 2002. The dynamics of the number of young researchers working in the business sector is even less encouraging. Their number halved from 1996 to 2002 (down from 91 to 42), while their share in the total number of young researchers dropped from 9.5% to 5%. The Ministry of the Economy and the Ministry of Education, Science and Sports have launched an instrument entitled Young Researchers for the

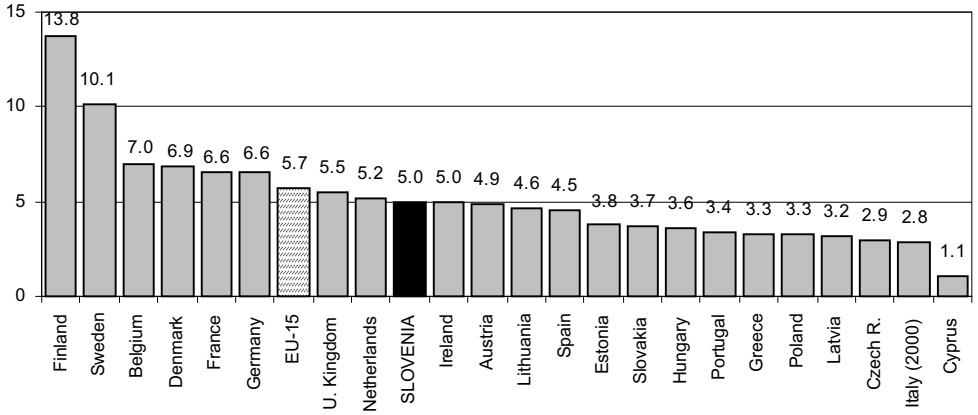
Economy aimed at fostering the inflow of R&D staff into the business sector to strengthen the transfer of knowledge from universities and research institutes into companies; according to the currently available data, however, the results of this measure have been modest, at least as regards the number of young researchers in the business sector.

Table: **Number of researchers in Slovenia expressed in full-time equivalent, 1996-2003**

	No. of researchers per 1000 of the labour force[1]	No. of researches	Distribution of researches in employment sectors, %			
			Business sector	Government sector	Tertiary education sector	Private non-profit sector
1996	4.8	4,489	30.5	35.2	31.4	2.8
1997	4.2	4,022	34.0	34.8	28.4	2.8
1998	4.4	4,285	34.0	35.0	28.8	2.2
1999	4.6	4,427	34.8	34.1	29.5	1.6
2000	4.5	4,336	31.8	34.5	30.9	2.8
2001	4.6	4,498	33.6	32.3	30.7	3.5
2002	4.7	4,642	34.9	32.2	29.4	3.5
2003	5.0[2]	4,789[3]	36.2	32.0	28.3	3.7

Sources: SORS; Eurostat (NewCronos); calculation by IMAD.
Notes: [1]figures for the number of researchers per 1,000 of the labour force in 1996-1999 are taken from Eurostat's NewCronos database; [2]the indicator's value rose largely due to the drop in the labour force (down 2.2%); [3]first estimate for 2003.

Figure: **Number of researchers in the full-time equivalent per 1,000 of the labour force in Slovenia and other EU-25 member states**



Sources: Eurostat (NewCronos); European Commission: Towards a European Research Area – Science, Technology and Innovation – Key Figures 2003-2004; SORS; calculations for Slovenia made by IMAD.
Notes: *the figure is taken from Towards a European Research Area – Science, Technology and Innovation – Key Figures 2003-2004, **an estimate; data for Malta and the EU-25 aggregate are unavailable.

[1] At the time of preparing data (December 2004) for the above indicator, figures for the EU-15 average and the EU-25 member states (except Slovenia) for 2002 were still not available. Also unavailable were the figures for the EU-25 average. On 24 February this year, however, Eurostat released the SORS' first estimate of the number of researchers for 2003, expressed in the full-time equivalent, for Slovenia. As we expect that the final figure released by the SORS will be revised, only an estimate is given in the table.

[2] For a broader international comparison see Development Report 2004, p. 96.

[3] The number of researchers is expressed in the full-time equivalent.

[4] In order to make employment of new researchers easier for enterprises, the Corporate Income Tax Act passed in 2004 enforces corporate tax relief for the hiring of PhDs in commercial companies by reducing the tax base in the amount of 30% of the salary of these employees for the first 12 months of their employment

Innovation active enterprises & the number of patent applications per million residents filed at the European Patent Office

The share of innovation active enterprises in industry and services in Slovenia still lags[1] strongly behind the EU-15 average. According to the SORS, an average of 21.1% of the total enterprises in Slovenia were innovation active[2] within the 2001-2002 period, which is 22.9 p.p. below the EU-15 average for 1998-2000 (data for the EU-25 are not available yet). The share of Slovenian innovation active enterprises fell behind the EU-15 average by 19.4 p.p. in *industry*[3] and by the high 27.2 p.p. in *services*[4]. A comparison of shares of innovation active enterprises (in the total number of enterprises in industry and services) classified by size classes[5] shows that Slovenian small and medium-sized enterprises had the widest gap behind other EU members. Slovenian large enterprises in industry recorded a 61.8% share of innovation active enterprises and came closest to the corresponding EU-15 average. According to latest available data, Ireland (65%) and Germany (61%) are in the lead among EU member states by their shares of innovative enterprises. The only countries that Slovenia left behind were Latvia, Slovakia and Poland (see the table).

In Slovenia and most other EU countries alike, the shares of innovation active enterprises are higher in industry than in services. In the EU-15, the average share of innovation active enterprises in industry was 7 p.p. higher than the corresponding share in services, while the comparable difference in Slovenia was 14.8 p.p. Exceptions in the EU were Portugal and Greece whose respective shares of innovation active enterprises in services were by 5 p.p. and 6 p.p. bigger than in industry. Among the analysed countries, Slovenia had the lowest share of innovation active enterprises in services, while in industry only Greece, Latvia, Slovakia and Poland had lower shares than Slovenia (see the table).

Patents reflect the level of invention activity in a country and indicate the economy's capacity to exploit new knowledge and transform it into potential economic benefits. Within this context, indicators based on patent statistics are widely used as benchmarks of R&D output for assessing the invention activity of countries, regions, industries and enterprises and their innovation potential. Patent indicators not only enable the monitoring of technological changes but also measure activities that are closely linked to competitiveness in international markets. One of the main drawbacks of patents as technology output indicators lies in the fact that not all inventions are patented and that patents differ sharply from one another in terms of their marketability. Since the Slovenian economy exports about two-thirds of its total exports to the EU market, the number of patent applications per million residents filed at the European Patent Office (EPO) is the most relevant analysis for Slovenia.

Slovenia perceptibly lags behind the EU-25 average by the number of patent applications per million residents filed at the EPO; moreover, if the present dynamics in the number of applications continue then convergence in that field is unattainable. The number of Slovenian patent applications at the EPO is highly variable in year-on-year terms. In 2002 (the latest available figures) Slovenia had 32.8 patent applications per million residents at the EPO, which was a quarter less than in 2001 yet still 7.4 applications above the 1995-2002 average. The average indicator value rose by 2.2 applications per year in the analysed period, which was 6.5 applications below the corresponding EU-25 average

[1] In past periods, the share of innovation active enterprises in Slovenia's manufacturing was 31.9% (1994-1996), 32.6% (1997-1998) and 28.3% (1999-2000), while the EU share totalled 51% (1994-1996) and 47% (1998-2000). The decrease in the share of these enterprises in the 1998-2000 period was due to methodological changes concerning the population of enterprises included in the innovation activity survey (before: enterprises employing at least 20 workers, now: enterprises employing at least 10 workers; see Development Report 2003, p. 144).

[2] Innovation active enterprises are those which introduced product innovation or process innovation, or had on-going or abandoned innovation activity in the observed period.

[3] Industry: C – mining and quarrying, D – manufacturing and E – electricity, gas and water supply (according to the SCA).

[4] Service sectors: 51 – wholesale trade, I – transport, storage and communications, J – financial intermediation, 72 – computer and related activities, 73 – research and development, 74.2 – architectural and engineering activities, 74.3 – technical testing and analysis (according to the SCA).

[5] Enterprise size is defined in terms of the number of employees: small enterprise: 10 – 49 employees; medium-sized enterprise: 50 – 249 employees; and large enterprise: 250 or more employees.

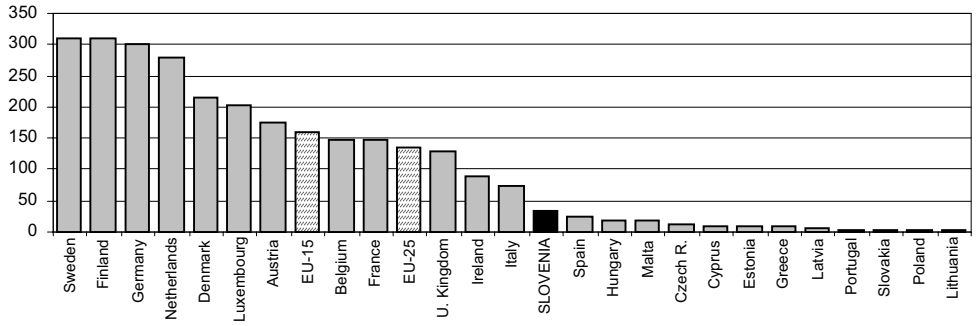
in 1996-2002. In 2002, Slovenia thus reached a mere 24.6% of the average number of patent applications per million resident recorded in the EU-25. The highest indicator values in 2002 were achieved by Sweden (311.5) and Finland (310.9). Slovenia's gap vis-a-vis the best performing EU countries is striking; what is more, with the presently recorded growth rates Slovenia cannot hope to catch up with them in the foreseeable future. Nevertheless, Slovenia was ahead of all other new EU member states with its indicator value, and it also outperformed three old member states – Spain, Portugal and Greece.

Table: **Innovation active enterprises by activities and size classes in Slovenia and other EU 25 member states[1], % of total enterprises**

	TOTAL	Small	Medium-sized	Large	INDUSTRY	Small	Medium-sized	Large	SERVICES	Small	Medium-sized	Large
Ireland[2]	65	-	-	-	75	-	-	-	52	-	-	-
Germany	61	55	72	86	66	58	72	89	57	53	70	82
Belgium	50	45	64	76	59	53	70	82	42	39	57	66
Austria	49	42	65	89	53	42	72	94	45	41	56	74
Luxembourg	48	42	59	95	49	37	68	96	48	43	56	93
Sweden	47	42	60	72	47	41	61	79	46	44	57	60
Portugal	46	40	67	76	45	38	65	75	50	46	74	77
Finland	45	40	54	74	49	43	55	86	40	36	53	47
Netherlands	45	39	59	79	55	46	71	85	38	35	47	70
EU 15[3]	**44**	**39**	**60**	**77**	**47**	**40**	**63**	**80**	**40**	**36**	**54**	**69**
Denmark	44	40	54	67	52	47	65	79	37	35	41	49
France	41	31	52	76	46	34	55	78	34	29	45	71
U.K.	36	32	47	57	39	33	51	66	33	30	40	42
Estonia	36	31	48	75	38	32	48	79	33	30	49	64
Italy	36	33	56	71	40	37	60	77	25	22	42	60
Spain	33	30	45	67	37	34	49	73	25	22	36	57
Czech Rep.	30	25	42	66	32	25	42	68	27	25	42	53
Greece	28	26	32	45	27	26	30	45	33	30	42	47
Lithuania	28	21	40	64	35	26	44	64	22	19	33	65
Hungary[4]	23	21	28	44	28	25	32	46	16	15	17	37
Slovenia	**21.1**	**12.7**	**28.3**	**55.4**	**27.6**	**14.1**	**32.7**	**61.8**	**12.8**	**11.6**	**15.5**	**26.0**
Slovakia[5]	19	15	24	47	22	15	26	50	16	15	19	31
Latvia	19	14	33	58	23	17	35	62	15	12	29	49
Poland[6]	17	13	25	53	18	11	26	57	16	15	21	32

Source: European Commission: Innovation in Europe - Results for the EU, Iceland and Norway, 2004; Eurostat: Statistics in Focus - Science and Technology (12/2004); SORS. **Notes**: [1]figures for Slovenia are for 2001-2002; figures for the Czech Republic, Hungary, Lithuania, Latvia and Slovakia are for 1999-2001; figures for Poland are for 1998-2000 (industry) and 1997-1999 (services); figures for other analysed countries and EU-15 aggregates are for 1998-2000; figures for Malta, Cyprus and EU-25 aggregates are unavailable; [2]data for Ireland on shares of innovation active enterprises by size classes are unavailable; [3]EU-15 aggregates do not include figures for Ireland, Luxembourg and the UK; [4]data for Hungary exclude activity C - mining and quarrying; [5]data for Slovakia exclude activity 74.3 - technical testing and analysis; [6]data for Poland exclude activity 73 - research and development, and for enterprises employing less than 50 workers in activities C - mining and quarrying, and E - electricity, gas and water supply (according to the SCA).

Figure: **Number of patent applications per million residents filed at the EPO in Slovenia and other EU-25 member states, 2002**



Source: Eurostat (New Cronos). **Note**: figures for 2002 are provisional.

Competitiveness of the economy

Labour productivity

After the relatively high growth in the 1990s, a softening was observed in labour productivity in 2001 and 2003, followed by another pick-up in 2004. According to the latest revised data from the national accounts statistics, labour productivity (expressed as GDP per person in employment according to the national accounts methodology) increased by the average annual rate of 4.7% (6.9% in manufacturing) in 1995-2000. Since 2001, productivity growth has been oscillating cyclically, primarily due to the delayed reaction of the employment dynamics relative to the dynamics of economic growth. Economic growth began to soften in 2001, while employment growth set off in 1999 continued so that productivity growth fell to 2.2%, the lowest increase since 1992. In the following year, employment began to decrease against the still subdued economic growth. Similarly as in the first part of the transition period, this resulted in a rebound in productivity which rose by 3.7% (6.9% in manufacturing). The relatively slow economic growth continued in 2003 along with a further decline in employment. Productivity growth fell to 2.8%. In 2004 economic growth saw another shift, rising to 4.5% in the first three quarters, while the first national statistics accounts data release still recorded negative growth of employment. On the basis of these figures we can infer high productivity growth in the first three quarters of 2004 (4.6%). However, since employment growth was exceptionally high in the first three quarters of 2004 (6%) according to the labour force surveys, the final calculation of productivity growth for 2004 is expected to be lower (the estimate in the Autumn Report was around 3.6%).

Slovenia's gap behind the average labour productivity growth in the EU continues to narrow, yet any faster convergence in this area will be impossible if the competitiveness of the Slovenian economy is not improved substantially. The average productivity growth in the EU has been appreciably lower than in Slovenia ever since 1993, decelerating even further in 2001-2003. Recording EUR 27,533[1] of GDP per person in employment, Slovenia achieved 50.5% of the average productivity of the EU-15 in 2003 (current prices), or 56.3% of the average productivity of the EU-25. Slovenia's gap behind the average productivity in the European Union has been narrowing steadily. In 2003 over 2002, the gaps behind the EU-25 and EU-15 averages shrank by 2 p.p. and 1.7 p.p., respectively (see the table). Faster catching-up with the European average and the more advanced EU member states would, however, require even higher productivity growth in future. This acceleration should be underpinned by a more qualified labour force and sophisticated technology in production, which would allow the faster growth of competitiveness of the Slovenian economy in turn leading to export expansion and economic growth.

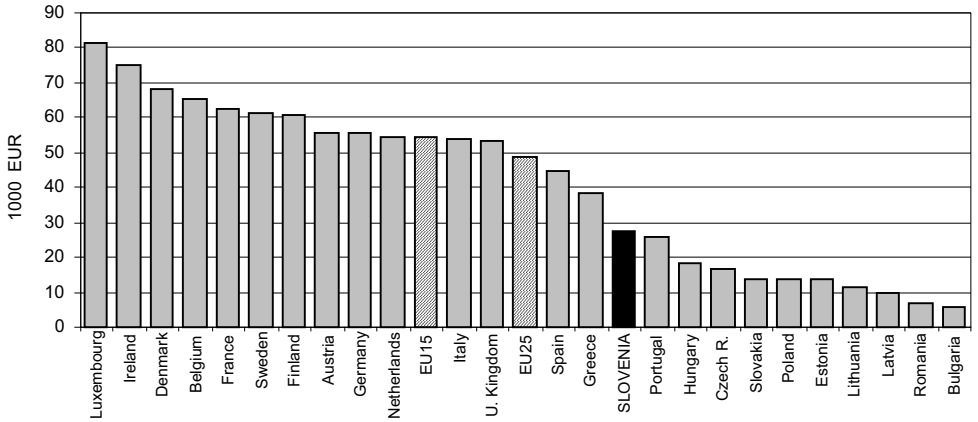
[1] Source: Eurostat (NewCronos, 7 January 2005).

Table: **Labour productivity[1] in Slovenia and the EU in 1995-2004 (Q1-Q3), in %**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	Q1-Q3 2004
Real labour productivity growth, %										
Slovenia	3.0	5.8	7.0	3.6	4.1	3.1	2.2	3.7	2.8	4.6[2]
EU 15	1.7	1.0	1.5	1.2	1.1	1.5	0.4	0.6	0.6	N/A
EU 25	N/A	N/A	N/A	N/A	1.8	2.1	0.8	0.9	0.7	N/A
Level of productivity in Slovenia										
EU 15 = 100	39.8	40.4	42.8	45.1	45.9	45.0	46.5	48.8	50.5	N/A
EU 25 = 100	N/A	N/A	N/A	51.4	52.1	50.7	52.0	54.3	56.3	N/A

Source: SORS, Eurostat, OECD.
Notes: [1]GDP per employee in full-time equivalent; [2]an estimate based on the first statistical release of the quarterly national accounts.

Figure: **Labour productivity (GDP per employee, current prices) in EU member states and acceding countries in 2003**



Source: SORS, calculations by IMAD.

Unit labour costs

In 2003, the Slovenian economy saw a continued slow improvement in the ratio of labour costs to GDP or to value added per employee. After the relatively rapid fall in unit labour costs expressed as labour costs to GDP seen in the second half of the 1990s was broken off by a two-year rise, they dropped again by 2% in 2002 and by a further 0.5% in 2003. Unit labour costs measured by labour costs to value added fell by 1.9% in 2002 and by 0.4% in 2003 (see the table). The decelerated decrease in 2003 was due to the considerable slowdown in the growth of labour productivity coupled with the smaller deceleration in the growth of labour costs per employee.

In 2003 the ratio between labour costs and value added per employee improved appreciably more in manufacturing than in the Slovenian economy as a whole. In the first half of the 1990s, manufacturing's unit labour costs recorded an even more substantial fall than in the economy as a whole. In 2000 they rose considerably less than in the economy as a whole (see the table), while they fell by 0.8% in 2001, by 1.3% in 2002 and by 3.5% in 2003. The accelerated fall of unit labour costs was generated by the strong growth of labour productivity in manufacturing against the otherwise less substantial slowdown in the growth of labour costs per employee compared with the total economy.

A comparison with EU member states shows that the Slovenian economy's competitiveness continued to improve slowly in 2003. Nevertheless, Slovenia still counts among the countries with the highest unit labour costs despite having appreciably reduced the differences (see the graph). After the substantial improvement in the Slovenian economy's competitiveness measured by *labour costs to GDP* (an average annual rise of 2 p.p.) compared with the EU-25 and EU-12 in the second half of the 1990s was broken off for one year, the pick-up continued after 2000, albeit at a much slower pace. Although the fall of unit labour costs also eased off in the EU-25 and the EU-12, the competitiveness of the Slovenian economy measured by this indicator recorded a mere 0.7 p.p. average annual rise against the two groups of countries in 2001-2003. In 2003 the average unit of GDP was produced by 0.60 of a single labour cost unit in the EU-25, 0.59 in the EU-12 and 0.64 in Slovenia. The dynamics of the Slovenian economy's competitiveness were similar to the EU-25 and EU-12, taking into account the ratio of *labour costs to value added per employee* (see the table). One unit of value added was produced with 0.66 of a labour cost unit in the EU-25, 0.64 in the EU-12 and 0.72 in Slovenia.

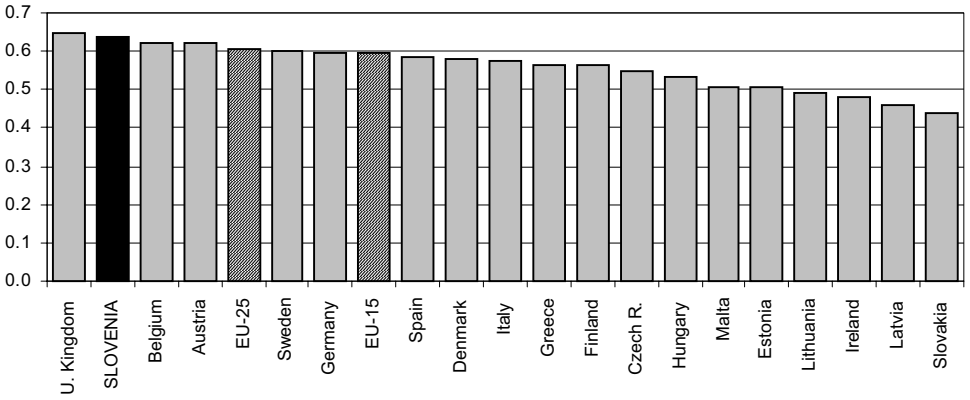
The competitiveness of the Slovenian manufacturing rose faster than the competitiveness of the total economy compared with those EU countries for which data are available. Following the substantial reduction of differences, notably in the second half of the 1990s, unit labour costs in the manufacturing industries of Italy, Poland, Greece and Spain were higher than in Slovenia, while they were lower in France, Lithuania, Latvia, Estonia, the Czech Republic and Slovakia. In 1995-1999 the competitiveness of Slovenian manufacturing rose compared with all EU countries for which data are available, except Ireland. The same holds for the 2001-2002 period, except in comparison with Lithuania, Latvia and Greece.

Table: **Unit labour costs in Slovenia and the EU, 1996-2003**

Growth rates, %	1996	1997	1998	1999	2000	2001	2002	2003
Unit labour costs per unit of GDP[1]								
Slovenian economy	-3.1	-3.1	-2.5	-2.2	3.2	0.1	-2.0	-0.5
EU 25	-0.8	-0.8	-1.0	0.0	0.4	0.5	-0.6	-0.3
EU 12 (euro area)	-1.0	-1.2	-1.4	-0.2	-0.1	0.2	-0.3	-0.1
Unit labour costs per unit of value added[2]								
Slovenian economy	-3.8	-4.0	-2.1	-1.7	1.5	0.2	-1.9	-0.4
EU 25	-0.7	-0.4	-0.6	0.5	0.3	0.3	-0.7	-0.3
EU 12 (euro area)	-1.1	-0.9	-1.0	0.4	-0.1	-0.1	-0.3	-0.1
Slovenian manufacturing	-7.1	-7.0	-1.7	-2.4	0.7	-0.8	-1.3	-3.5

Source: SORS, Eurostat.
Notes: [1]compensation of employees in current prices divided by GDP per employee in current prices; [2]compensation of employees in current prices divided by value added per employee in current prices.

Figure: **Unit labour costs (relative to GDP) in Slovenia and the EU – ratios in 2003**



Sources: SORS, Eurostat, calculations by IMAD.

Market share

The increase in Slovenia's aggregate market share from 0.48% in 2000 to 0.53% in 2003 indicates that the still relatively high growth of Slovenian merchandise exports seen after 2000 (up by an annual rate of 6% in real terms) ***against the strong slowdown in the economic activity in Slovenia's main trading partners was the result of an improvement in Slovenian economy's export competitiveness[1].*** After two years of slightly stronger growth, the growth of the Slovenian aggregate market share decelerated strongly in 2003 (from 4.4% in 2001 and 5.6% in 2002 to 0.7% in 2003). The subdued growth was largely due to the resumed decline in two important markets for Slovenian exporters: the German one (after two years of growth) and the French one (after three years of growth), and the accelerated fall in the Croatian market, which had already hit an all-time low in 2002. On the other hand, Slovenia's market share continued to rise robustly in the Italian and US markets. After a one-year decline, a renewed pick-up was also recorded in the Russian market.

In the breakdown of industrial products, the groups machinery and transport equipment as well as chemicals recorded the biggest market share growth in the global market in 2001-2003. While Slovenian machinery and transport equipment exporters were also in the lead in the EU-15 market, Slovenia's market share of chemicals in the EU-15 stagnated at the 2000 level in 2003. Market share growth was below the average in iron and steel, other semi-manufactures, textiles and other consumer goods. Despite the slower fall in 2003, the market share of clothing dropped sharply in 2001-2003 – by almost a quarter in the world market, and by over a third in the EU-15. After 2000, Slovenian exporters' market position improved considerably better in the markets outside the EU-15 than in the EU-15 countries. Slovenia's global market share, albeit substantially smaller, rose by one-quarter, hence its growth was much faster than in the EU-15 where the market share increased by one-tenth (see the graph).

In 2001-2003, Slovenia was approximately in the middle among the 25 EU member states in terms of the growth of its market share in the global and EU markets. Slovenia's market share grew faster than the share of most euro-area countries while markedly lagging behind the growth of most other countries, especially the new EU members.

In the first nine months of 2004, the growth of Slovenia's aggregate market share strengthened slightly compared to 2003 albeit it still lagged behind the growth achieved in 2001-2002. The increase in Slovenia's aggregate market share (from the 0.53% average of 2003 to the 0.54% average of the first nine months of 2004) was largely the result of the renewed growth of Slovenia's market share in the French and Croatian markets following the drop seen in these markets last year, and of accelerated growth in the Austrian and Russian markets. The continued slow decrease of Slovenia's market share in the German market was accompanied by a drop in the Italian and US markets after the robust growth there last year.

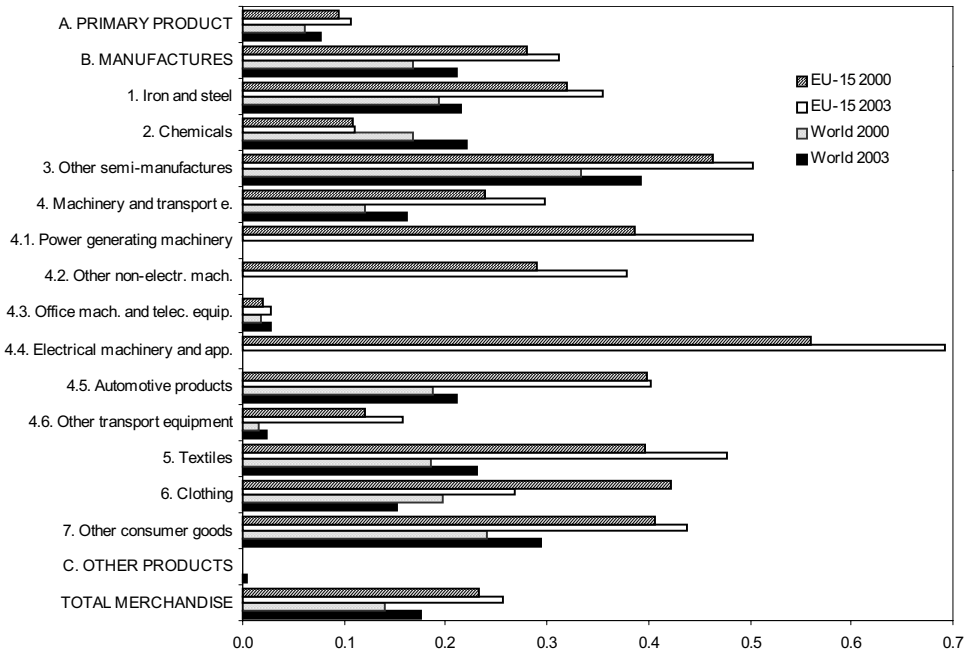
[1] Conversely, the fall in Slovenia's market share from 0.58% in 1996 to 0.48% in 2000 reveals that the otherwise vibrant aggregate growth of Slovenian merchandise exports in that period (up by an annual rate of 9.4% in real terms) was more the result of export markets growth than any improvement in the Slovenian economy's export competitiveness. The drop in Slovenia's market share in 1996-2000 was at least partly due to the predominantly defensive restructuring of the corporate sector and the related processes of rationalisation, reducing capacity, discontinuing non-profitable product ranges, and other measures aimed at adjusting production to the changed market and other conditions.

Table: **Slovenia's market share[1] in the main trading partners, %**

	1996	1997	1998	1999	2000	2001	2002	2003	2004[2]
Total (15 countries)	0.583	0.574	0.584	0.511	0.478	0.500	0.528	0.531	0.541
Germany	0.562	0.553	0.544	0.554	0.478	0.500	0.523	0.489	0.479
Italy	0.537	0.595	0.571	0.533	0.499	0.489	0.506	0.574	0.564
France	0.206	0.163	0.242	0.155	0.183	0.191	0.211	0.184	0.193
Austria	0.816	0.864	0.892	0.873	0.911	0.928	0.935	0.942	0.999
Netherland	0.067	0.065	0.073	0.070	0.069	0.074	0.079	0.084	0.074
Belgium	0.046	0.053	0.093	0.081	0.055	0.056	0.046	0.045	0.059
Spain	0.037	0.046	0.050	0.056	0.054	0.058	0.066	0.089	0.100
UK	0.057	0.049	0.050	0.052	0.055	0.078	0.073	0.073	0.076
Czech Republic	0.536	0.542	0.488	0.558	0.477	0.464	0.467	0.453	0.434
Slovakia	0.621	0.484	0.562	0.546	0.550	0.565	0.753	0.815	0.750
Hungary	0.665	0.571	1.533	0.517	0.525	0.466	0.490	0.529	0.509
Poland	0.386	0.370	0.384	0.416	0.462	0.484	0.521	0.515	0.470
USA	0.031	0.028	0.028	0.025	0.022	0.021	0.024	0.037	0.034
Croatia	10.980	9.206	9.723	8.615	8.733	8.741	8.429	8.030	8.849
Russia	0.443	0.457	0.409	0.329	0.433	0.526	0.495	0.521	0.565

Source: SURS, Eurostat (NewCronos), WIIW (Monthly Report, various issues), U.S. Census Bureau (Foreign Trade Division).
Notes: [1]market shares are calculated as the weighted average of Slovenia's merchandise exports in the imports of its main trading partners determined by the size of their shares in Slovenia's exports. The shares of individual trading partners in Slovenia's merchandise exports are also used as weights in calculating the weighted average (using Fisher's formula). [2]data for nine months.

Figure: **Slovenia's market shares in 2000 and 2003, %**



Sources: SORS, WTO, calculations by IMAD.

Composition of merchandise exports according to factor intensity

Over the last few years, the structure of Slovenia's merchandise exports recorded the biggest increase in the total share of medium- and high-technology-intensive products*[1]*, which is favourable in terms of effective allocation of available resources. In *1995-1998*, the share of these products in total merchandise exports increased by 5.3. p.p. in Slovenia (EU-25 average: 3.9. p.p.) mainly due to increased exports of medium-technology-intensive products (personal vehicles, household equipment, pumps and compressors). In 1998, medium- and high-technology-intensive products accounted for 52% of Slovenia's merchandise exports, 5.9 percentage points less than the average of the EU-25. In *1999-2002*, growth in Slovenia's exports of medium- and high-technology-intensive products slackened and fell to below the EU-25 rate. While the share of medium- and high-technology-intensive products exports increased by an average of 1.8 p.p. annually in Slovenia in 1995-1998 (by 1.3 p.p. in the EU), growth in the share of these exports declined to 0.8 p.p. annually in 1999-2002 (0.9 of a percentage point in the EU). Medium and high-technology intensive products comprised 54% of Slovenian merchandise exports in 2002 (61.2% in the EU). According to the latest available comparable data, the gap behind the EU average was hence similar as it was in 1995 (around 7.2 p.p.). It is encouraging that the share of high-technology-intensive products in total exports increased more rapidly in Slovenia than in the EU-25 over the last few years. In 2002, the share of high-technology-intensive products in total exports was modest in Slovenia compared to the EU-25 (16.5% and 28.2%, respectively), however, this share rose faster in Slovenia than in the EU-25 in 1999-2002 (by 0.2 p.p.). While in 2003 the share of high-technology-intensive products in total exports fell in the EU countries for which comparable data are available, Slovenia again recorded a considerable increase in these exports (up 1.6 p.p.) mainly on account of the rapidly growing share of pharmaceutical products exports. The share of high-technology-intensive products thus reached 18.1% of Slovenia's total merchandise exports in 2003.

The period after 1995 has been characterised by the falling share of low-technology-intensive and labour-intensive products in total merchandise exports*[2]*. In 2002, these products accounted for 30.0% of Slovenia's exports of goods (17.5% in the EU-25) after their share had fallen by 1.6 p.p. since 2000 (by about 0.8 p.p. annually). The share of these products in total merchandise exports continued to decline in 2003 (see the table).

The share of natural resource-intensive products*[3] ***in Slovenia's merchandise exports shrank at a slower pace than in the EU in 1995-1998; since then, this share has stagnated in Slovenia while falling further in the EU.*** In 1995-1998, the share of resource-intensive products in Slovenian exports fell by about 0.4 p.p. per year, and only 0.2 p.p. per year in 1999-2002. In 1995, Slovenia's share of resource-based exports in the total exports of goods was 3.4 p.p. lower than the EU-25 average. However, Slovenia's share (14.6%) almost equalled the average share recorded in the EU-25 in 2002 (14.8%) because Slovenia's exports of resource-based products decreased at a much slower pace than in the EU-25. According to figures for 2003, the share of these products in Slovenia's merchandise exports sustained the level of the previous year, while in the EU countries for which data are available it generally shrank by 0.2 p.p. (see Note 1 under the table). The main groups of natural-resource intensive products in Slovenia's exports of goods were: aluminium, finished mineral manufactures, electricity, rough and worked wood, veneer and other manufactured wood, wood manufactures,

and non-alcoholic and alcoholic beverages. The slower declining in the share of these products seen after 1999 has largely been underpinned by the growing shares of aluminium and electricity exports. The available figures for 2004 (the first nine months) show a considerable decrease in the share of resource-intensive products in total exports (down 0.7 p.p.) largely due to the appreciable drop in the shares of wood manufactures and non-alcoholic & alcoholic beverages.

Table: **Structure of merchandise exports by factor intensity in Slovenia and the EU 25 in 1995-2003, in %**

		1995	1996	1997	1998	1999	2000	2001	2002	2003[1]
Resource-based	Slovenia	16.6	16.1	16.6	15.4	15.1	15.3	15.1	14.6	14.6
	EU 25	20.0	19.7	19.0	17.5	17.5	18.0	17.6	14.8	16.4
Labour-intensive	Slovenia	25.6	24.2	23.0	22.5	22.8	21.7	21.4	20.1	18.6
	EU 25	12.1	12.0	11.9	11.6	11.2	10.6	10.6	10.4	10.5
Low-technology intensive	Slovenia	9.7	9.2	8.9	8.8	9.1	9.9	9.8	9.9	10.1
	EU 25	8.1	7.6	7.5	7.6	7.1	6.9	6.9	7.1	7.6
Medium-technology intensive	Slovenia	31.9	33.6	34.5	37.3	36.7	36.4	36.4	37.5	37.3
	EU 25	30.1	31.0	30.8	31.7	31.3	30.1	30.7	33.1	33.7
High-technology intensive	Slovenia	14.8	15.5	15.7	14.7	14.9	15.3	15.9	16.5	18.1
	EU 25	23.9	24.4	25.6	26.3	27.3	28.6	28.5	28.2	26.3

Source: United Nations Conference on Trade and Development: Handbook of Statistics 2004, Trade structure by product and country group, Classification of world merchandise exports: Trade and Development Report 2002, Annex 1 to chapter III, Report by the secretariat of United Nations Conference on Trade and Development; IMAD's calculations.
Notes: The classification of products into groups is based on the UN methodology (United Nations Conference on Trade and Development: Classification of world merchandise exports, Trade and Development Report 2002, Annex 1 to chapter III); this classification does not comprise all products, therefore the sum of the five product groups does not necessarily equal 100; 1 data for the EU do not include external trade data for Greece, Ireland, Luxembourg, Malta, the Netherlands, Portugal and Spain.

[1] Medium- and high-technology-intensive products comprise merchandise goods with the most dynamic global growth, the highest share of expenditure on R&D in value added (chemicals, pharmaceutical products, plastic products, machinery and equipment, telecommunications equipment, equipment for medical and scientific purposes and measurements, cameras and photographic equipment, personal vehicles, household equipment). The classification into medium- and high-technology intensive products is based on the UN methodology (United Nations Conference on Trade and Development: Classification of world merchandise exports, Trade and Development Report 2002, Annex 1 to Chapter III).

[2] The groups of low-technology-intensive and labour-intensive products include products with the lowest value added per employee, such as: clothing, textile products, footwear, furniture, glass and glass products, flat-rolled iron products, base metal products.

[3] Cutting the share of products that involve intensive exploitation of natural resources is key from the viewpoint of sustainable development. This group of products is characterised by low value added per unit of production, a high content of natural resources, and relatively simple production technology. It comprises the manufacture of food, beverages, raw materials, mineral fuels, animal and vegetable oils and fats, leather, veneers and other manufactured wood (boards), and ferrous and non-ferrous metals.

Share of gross fixed capital formation in GDP

The revision of the national accounts in 2004 has not revealed any essential changes in the share of gross fixed capital formation in GDP. On average, the share of gross fixed capital formation in GDP rose by 0.2 p.p. in 1995-2002. Relatively more significant changes were recorded at the end of the analysed period: according to the latest available data, the share of gross fixed capital formation in GDP was revised downwards for 2000 (by 0.6 p.p.) and upwards for 2001 and 2002 (by 0.5 p.p. and 0.7 p.p., respectively).

The share of gross fixed capital formation rose appreciably in the second half of 1990s while decreasing in 2000-2002. The technical composition[1] of investment shows that all types of investment recorded a real increase in 1995-2002. In the first period, the increase was largely underpinned by *investment in non-residential construction* (due to the construction of transport infrastructure), in addition to the rise in investment in machinery and equipment and dwellings. After 2000, the share of investment fell in machinery and equipment, dwellings and other construction (due to slower building of transport infrastructure).

In 2003, the share of gross fixed capital formation in GDP rebounded. Increases were recorded in investment in machinery and equipment (notably transport equipment) and non-residential construction (transport infrastructure), while investment in dwellings dropped again.

In comparison with more advanced countries, Slovenia has a bigger share of gross fixed capital formation in GDP but a smaller share of housing investment. Slovenia's share of investment in machinery and equipment is higher than in more developed countries, which is expected considering Slovenia's lower physical capital position. The relatively low share of housing investment (see the graph below), on the other hand, is surprising especially when considered together with the figure indicating the number of dwellings per thousand inhabitants. According to the UNECE (United Nations Economic Commission for Europe), Slovenia's number of dwellings per thousand inhabitants was lower than in most EU countries in 2000[2].

[1] By technical composition, investment is divided into tangible and non-tangible fixed assets. Tangible fixed assets are further divided into 'construction', 'machinery and equipment', and 'land improvement and breeding stock'. Investment in construction and in machinery & equipment represented the lion's share of total investment.

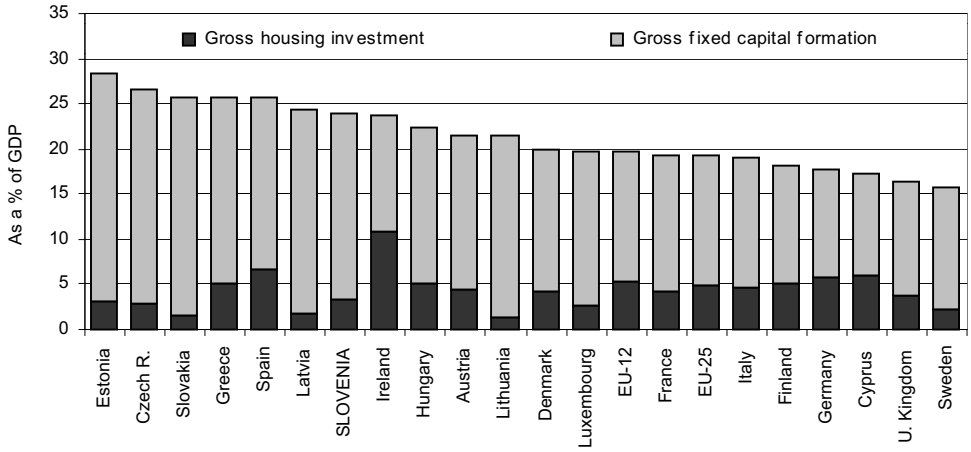
[2] Among the 18 countries for which data are available, the number of dwellings per 1000 inhabitants was lower than in Slovenia just in Ireland, Slovakia and Poland, while all other countries for which data are available recorded higher shares (among others Latvia, Estonia, Hungary, Spain and Greece). Similarly, Slovenia was at the bottom of the EU countries by the number of rooms per inhabitant in 2003 according to the survey entitled Quality of Life in Europe (European Foundation for the Improvement of Living and Working Conditions).

Table: **Technical structure of gross fixed capital formation in GDP in Slovenia in 1995-2003, in %**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Machinery and equipment	10.6	9.8	10.2	10.7	12.0	11.5	11.1	10.3	10.5
- transport equipment	2.4	2.1	1.8	2.1	2.2	2.5	2.3	2.2	2.4
Construction	9.6	11.3	11.9	12.2	13.3	12.7	12.2	11.9	12.5
- dwellings	3.4	3.8	3.8	3.9	4.5	3.7	3.8	3.5	3.4
Other	0.5	0.6	0.8	0.8	1.1	1.0	1.0	0.9	0.9
Total	20.6	21.7	22.8	23.8	26.3	25.1	24.5	23.3	23.9

Source: Eurostat (New Cronos).

Figure: **Share of gross fixed capital formation and share of gross housing investment in GDP for EU countries in 2003**



Source: Eurostat (New Cronos).
Note: data for Belgium, Malta, the Netherlands, Poland and Portugal are unavailable for 2003.

Foreign direct investment

The share of inward FDI stock in GDP climbed from 9.5% to 20.7% in 1995-2003, while the share of outward FDI in GDP rose from 2.6% to 7.5%. This seemingly favourable result conceals the actually much less favourable trends and characteristics since it was largely the consequence of specific developments in 2001 and 2002 when relatively high (for Slovenian circumstances) FDI inflows were recorded, totalling EUR 412.4 m in 2001 and the record-high EUR 1,750.4 m in 2002. Following the strong increase in FDI inflows in Slovenia in 2001 and 2002 these returned to the levels seen before 2001 and came in at the modest EUR 298.8 m in 2003. There was no improvement in 2004 when the FDI inflows in the January-August period totalled a mere EUR 127.0 m, which is even less than in the same period of 2003 (EUR 163.9 m). The high FDI inflows in 2001 and especially 2002 were underpinned by a number of large foreign acquisitions, primarily the takeover of Lek by the Swiss company Novartis and the purchase of a 34% share in the NLB bank by the Belgian KBC bank. The FDI outflows from Slovenia have been on a steady increase: they rose from EUR 161.2 m in 2001 to EUR 168.1 m in 2002 and to the high EUR 413.7 m in 2003. Hence, Slovenia was a direct net outward investor, which is not a normal situation for a country at Slovenia's level of development. The situation remained similar in 2004. FDI outflows in January-August were once again at a record level, EUR 297.7 m (EUR 264.6 m in the same period of 2003). Data indicate that in 2004 Slovenia again recorded net FDI outflows.

As far as inward FDI is concerned, a comparison with EU member states shows that Slovenia is among those countries with the lowest shares of FDI stock in GDP. The only old EU member states that recorded lower shares in 2003 were Italy and Greece while all new members had higher shares of FDI in GDP than Slovenia. Among the new member states the highest shares of FDI in GDP were found in Estonia (77.6%), Malta (63.5%), Hungary (51.8%) and the Czech Republic (48.0%). All countries included in the analysis significantly increased their shares of FDI stock in GDP in 1995-2003: by 19.6 p.p. in the EU-15 as a whole and by 11.2 p.p. in Slovenia. In none of the new member states was the increase less than 20 p.p. – in most of them it was actually appreciably larger (UNCTAD 2004). ***Slovenia recorded better results than other new member states in the area of outward FDI.*** Nevertheless, Cyprus and Estonia were ahead of Slovenia by this indicator as well in 2003. As expected, Slovenia was way behind old EU member states (except Greece) in terms of outward FDI in GDP.

The Slovenian economy's internationalisation is primarily taking place through external trade flows rather than FDI. It should be noted that Slovenia increased its shares in all relevant indicators in 2003 over the year before. The biggest rise was seen in FDI inflows as a result of significant one-off inflows seen in the analysed period. The analysis of the degree of internationalisation of the Slovenian economy shows interesting results if we look at Slovenia's shares in different global macroeconomic aggregates. In 2003, these shares were as follows: (i) global FDI inflows (2001-2003): 0.1164% (an increase of 0.0414 over the year before); (ii) global inward FDI stock: 0.0769% (an increase of 0.0196); (iii) global FDI outflows (2001-2003): 0.0396% (an increase of 0.0277); (iv) global outward FDI stock: 0.0282% (an increase of 0.0067); (v) global GDP: 0.0765% (an increase of 0.0084); and (vi) global exports: 0.1699% (an increase of 0.0067). What stands out is the wide difference between the high share in exports and the substantially lower share in inward and outward FDI.

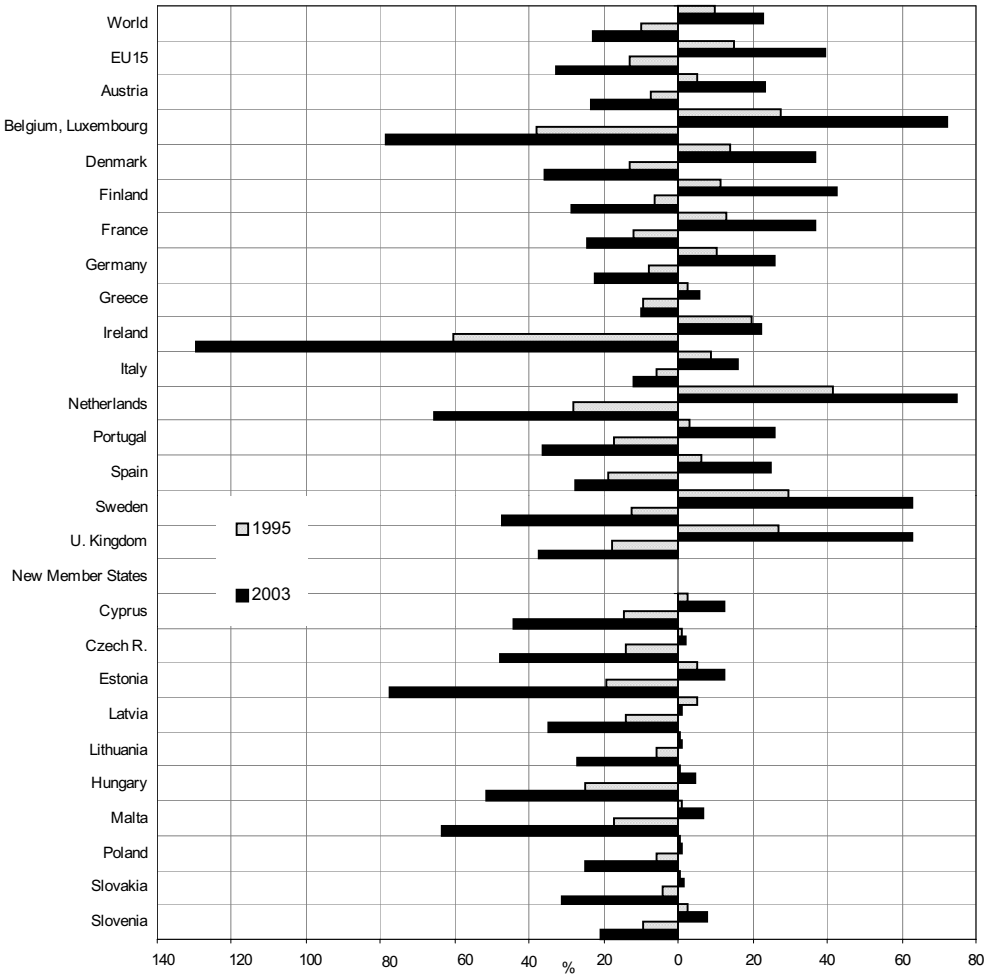
Slovenia's performance in attracting FDI is far below its potential. The performance of a country in attracting FDI is measured by how successfully the country exploits its potentials to attract FDI. This performance can be seen from a comparison between the FDI Potential Index and the FDI Performance Index (for the definition of both indices see UNCTAD 2004). In 2000-2002 Slovenia was ranked 27th among 140 countries according to the FDI Potential Index while it was ranked much lower, 59th, according to the FDI Performance Index. Without the high FDI inflows of 2002 Slovenia would have dropped below the 100th place according to its actual performance. This result indicates that the situation in Slovenia is unconducive to foreign investment and that policy has not been overly successful in attracting FDI.

Table: **Flows and stocks of inward and outward FDI[1] in Slovenia in 1994-2003[2], EUR m**

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Inward FDI										
Year-end stock	1,080.8	1,376.0	1,611.6	1,999.8	2,369.5	2,675.0	3,109.8	2,952.4	3,967.9	5,069.7
Annual inflows[3]	98.3	117.4	138.2	294.9	194.3	99.2	149.1	412.4	1,750.4	298.8
Stock as % of GDP	9.2	9.5	10.7	12.4	13.6	14.2	15.1	13.5	16.9	20.7
Outward FDI										
Year-end stock	288.6	382.3	370.6	416.2	542.8	624.7	825.3	1.139.2	1,461.5	1,848.9
Annual outflows[4]	10.9	7.8	-5.6	-27.7	4.9	-44.7	-71.7	-161.2	-168.1	413.7
Stock as % of GDP	2.5	2.6	2.5	2.6	3.1	3.3	4.0	5.2	6.2	7.5

Source: Bank of Slovenia.
Notes: [1]FDI whereby a foreign investor holds a 10% or higher share in a company; [2]from 1996 onwards FDI in indirectly affiliated enterprises is also included; [3]inflows are in principle lower than changes in stock because international payments transactions only cover part of changes in stock. The main difference is that inflows do not cover changes in net liabilities to foreign investor, while inflows do not include figures on companies in second affiliation. From 1995 onwards data on reinvested earnings are also included in inflows and, consequently, in the balance of payments. [4]The minus sign indicates an outflow.

Figure: **Inward and outward FDI stock as a percentage of GDP in old and new EU member states in 1995 and 2003, %**



Sources: UNCTAD. 2004. World Investment Report 2004. New York and Geneva: United Nations; for Slovenia: Bank of Slovenia.

Total assets of banks

Due to the banking sector's importance the indicator of total assets of banks relative to gross domestic product is one of the key indicators of the Slovenian financial sector's development level. Its value has been rising constantly yet it remains below the levels achieved by advanced countries. The ratio of the banks' total assets relative to GDP increased by 2.3. p.p. to total 88% in 2003. The indicator's value rose by 11.9 p.p. in 1995-2000 and by a further 12.9 p.p. in 2000-2003. If we analyse the banking sector's balance sheets from previous years we find that initially growth was largely underpinned by stronger lending, while later on it was primarily generated by investment in securities. In 2003 and 2004 the banking sector's assets increased again on the back of the pick-up in lending activity, notably in foreign currency loans to enterprises and OFO and in household loans.

Total assets of the banking sector (excluding savings banks and savings co-operatives) rose by 11.1% in 2003 (the smallest increase so far) and continued to grow at a softer pace in 2004. The highest rise in the banking sector's total assets was recorded in long-term investment in the client capital that rose by over a quarter and contributed around 0.3 p.p. to growth. The largest contribution (8 p.p.) came from loans to the non-banking sector whose share strengthened by 2.5 p.p. at the end of 2003 year on year to total 50.2%, which was due to their 16.8% nominal growth. These loans thus represented by far the most important item in the banking sector's total assets. A lower growth rate relative to 2001 and 2002 was recorded in investment in non-tradable debt securities which were up 12.9% compared to the year before (57.5% in 2002), contributing 3.7 p.p. to growth. The volume of tradable securities increased by just over 1% while its contribution to growth was negligible because of its small share (4.6% of the banks' total assets). The gradual easing of growth in the banking sector's total assets continued in the first ten months of 2004 – compared to end-2003 it grew by 8.4% (9.4% in the same period of 2003). In contrast to the previous years, however, the level of non-tradable debt securities dropped by 10%.

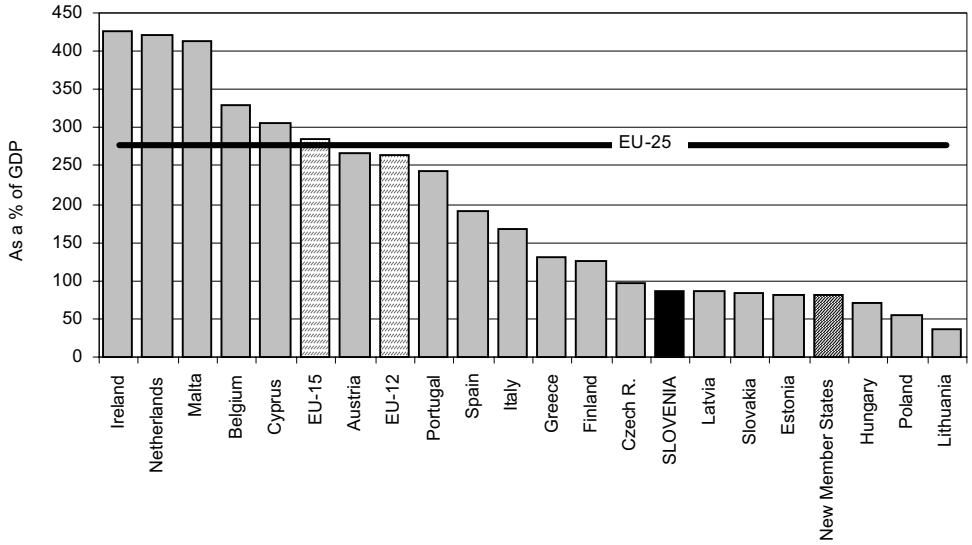
Despite the continued increase in the indicator's value since 1993 in Slovenia (from 65.2% to 88%) Slovenia's gap behind the EU-15 increased in both absolute and relative terms. The ratio of banks' total assets to GDP averaged 285.4% in the EU-15 in 2003 and was by 16.3 p.p. higher than the year before[1]. In the EU-25 the value of the indicator stood at 276%. The small difference between the EU-25 and EU-15 (relative to the difference between the new member states and the EU-25) confirms the insignificance of the banking system of the new EU member states (whose indicator's value totalled 79.9%) in the European Union's banking system since their total assets represented a mere 1.3% of the entire European banking sector's total assets. Bearing in mind that new member states account for less than 5% of the EU-25 GDP, we can establish that the banking sector's gap behind the EU average is even wider than in other sectors of the economy. According to the value of the indicator measuring total assets relative to GDP Slovenia is far behind the comparably developed countries such as Greece and Portugal (130.5% and 244%, respectively). Among the new member states (79.9%), Malta, Cyprus and the Czech Republic have recorded higher values than Slovenia (412.3%, 307% and 97.7%, respectively). Assuming that the need for financing will become even greater with further economic development, and in view of the anticipated levelling out of the differences between domestic and foreign financing costs, the value of the indicator of banks' total assets relative to GDP is set to continue rising.

Table: **Structure of banks' total assets for 1995-2003, in SIT bn**

	1995	2000	2001	2002	2003
Assets	1,475.3	3,125.3	3,876.8	4,553.2	5,057.5
% of GDP	63.2	75.1	81.4	85.7	88.0
Loans to the banking sector	253.6	364.4	396.2	373.1	345.2
Loans to non-banking sectors	607.8	1,635.2	1,913.9	2,172.5	2,538.1
Securities	414.7	793.2	1,109.3	1,546.7	1,719.7
Other assets	199.3	332.5	457.3	460.9	454.5

Source: Bank of Slovenia's Annual Report (various volumes).

Figure: **Total bank assets in selected EU member states in 2003, as a % of GDP**



Sources: Bank of Slovenia, central bank bulletins, annual reports of supervisory institutions, European Banking Federation.
Note: *new EU member states.

[1] This leap in the indicator's value was largely produced by the 14.6% increase in the banking sector's total assets in the UK representing over 30% of the EU-25 banking sector's total assets.

Insurance premiums

After the slightly higher growth rates seen in 2001 and 2002 the year-on-year nominal growth of insurance premiums fell slightly in 2003 although it still totalled over 10%. In the breakdown of insurance premiums, life insurance is still on the increase and represents almost a quarter of the total insurance premiums. Its growth rate in 2003 was nearly twice as high as the growth rates in non-life insurance. In 2003 the volume of insurance premiums[1] reached SIT 298.2 bn, recording a 11.7% nominal rise compared to the previous year. In 2003, insurance premiums achieved 5.2% of gross domestic product, 0.2 p.p. more than the year before. The volume of life insurance rose by 17.8% in nominal terms; the largest, two-thirds increase, was recorded in life insurance tied to mutual funds' points. The increase in this type of insurance is most probably attributable to the high yield rates of mutual funds and the new insurance schemes on offer. A significant contribution also came from supplementary pension insurance that was up 17.4% in 2003. The volume of life insurance rose by 19% in real terms over the past ten years and by 11.6% in 2003.

The value of Slovenia's indicator of insurance premiums relative to gross domestic product is at a low level compared to the European Union. The average in the European Union (excluding Estonia) stood at 8.6% (8.8% in the EU-15). Slovenia still has the highest value in this indicator among the new member states. It has also come ahead of some EU-15 countries (Greece, Luxembourg). While Slovenia's relative gap behind the EU average in the insurance industry was smallest relative to other segments of financial intermediation, it should be noted that this was largely due to the high level of non-life insurance that achieved 4.0% of GDP in 2003. Only Great Britain, which has one of the most developed insurance markets, recorded a higher value in this indicator.

The gap was appreciably wider in life insurance which accounted for 23.9% of all insurance premiums collected in Slovenia in 2003 (19.4% in 2000) and achieved 1.2% of GDP. The indicator's value edged up by 0.1 p.p. for the fourth consecutive year. The shares of life insurance premiums totalled 5% in the EU (excluding Estonia) and 5.1% in the EU-15, while their shares in the total premium stood at 57.8% for the former and 58.2% for the latter. The volume of life insurance premiums in new member states amounted to a mere 1% of the total EU-25 and came in at 1.3% of GDP. Slovenia therefore also lags behind the average of the new EU member states by its level of life insurance. Compared with the year before no change was observed since Malta, Cyprus, the Czech Republic and Slovakia still have higher shares of life insurance in GDP than Slovenia. In future we can expect a further increase in life insurance especially due to the rising importance of old-age saving, the expanded offer of foreign insurance companies and the combined banking and insurance services (in 2003 the share of premiums collected in banks was 5.8%).

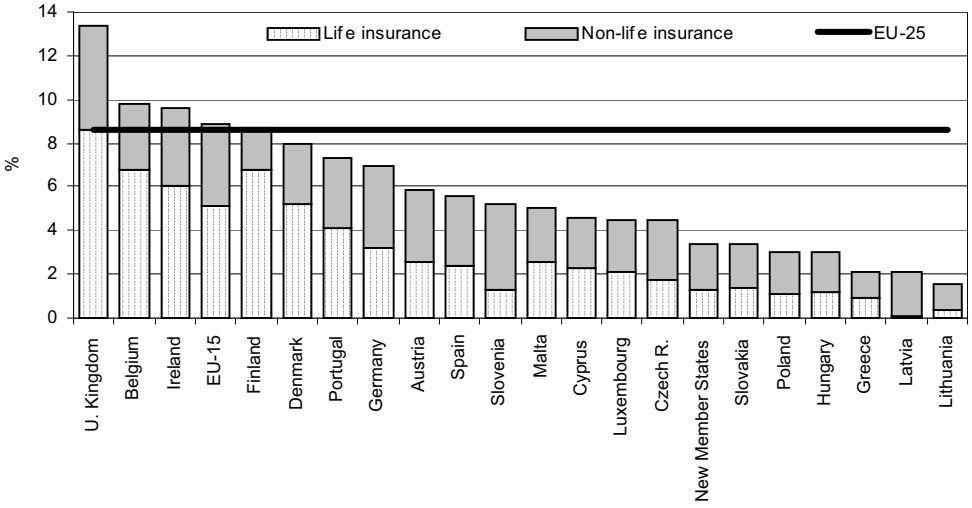
[1] The calculation includes institutions that are not legally operative as yet (KAD – the Slovenian capital company, Fund for Craftsmen and Entrepreneurs, Slovenian Export Corporation)

Table: **Insurance premiums by type of insurance, Slovenia 1995-2003**

	1995	2000	2001	2002	2003
As a % of GDP					
Insurance premiums total	4.3	4.6	4.9	5.1	5.2
Life insurance	0.6	0.9	1.0	1.1	1.2
Non-life insurance[1]	3.7	3.7	3.8	3.9	4.0
Structure, %					
Insurance premiums total	100.0	100.0	100.0	100.0	100.0
Life insurance	14.8	19.4	21.4	22.7	23.9
Non-life insurance	85.2	80.6	78.6	77.3	76.1
Year-on-year nominal growth rates, %					
Insurance premiums total	62.6	12.5	19.3	16.1	11.7
Life insurance	67.8	20.9	31.5	23.2	17.8
Non-life insurance	61.7	10.7	16.3	14.1	9.9

Source: Statistical Insurance Bulletin 2003.
Note: [1]The main types of life insurance include: health insurance, insurance against liability with regard to the use of motor vehicles, land motor vehicles insurance, accident insurance, and fire and natural disaster insurance.

Figure: **Volume of all insurance premiums, life insurance and non-life insurance relative to GDP in selected EU member states in 2003, %**



Sources: Swiss reinsurance company (Sigma No. 3/2004), Slovenian Insurance Association.

Market capitalisation

In 2003 the growth of the indicator showing the development level of Slovenia's capital market slowed down. This deceleration was largely underpinned by the withdrawal of shares of a leading pharmaceuticals company and by the somewhat lower growth of stock exchange indices since the value of the main index (SBI20) increased by 17.7%, i.e. 37.5 p.p. less than the year before. Turnover in the secondary market of the Ljubljana Stock Exchange totalled SIT 340.2 bn and was 29.3% lower than in 2002. The smaller turnover volume resulted in the lower turnover ratio of shares[1] which more than halved compared to 2002 and totalled 0.11, a value way below the levels recorded in developed capital markets[2]. The primary market remained at the same development level as in previous years: government debt securities still represented the bulk of all issued certificates, and 2003 again saw no public offering of shares upon the issuance.

The volume of market capitalisation of shares excluding shares of investment funds rose by 8.6% in 2003, reaching less than one-fifth of the growth seen in 2002. As mentioned earlier the main reason for this hitherto lowest growth was the withdrawal of shares owned by a pharmaceuticals company that had accounted for over 10% of market capitalisation. In addition, owners of several other acquired companies also opted for the withdrawal from the stock exchange. Growth was further held back by the drop in the value of stock exchange indices in the first half of the year. The market capitalisation of shares listed on the stock exchange thus dropped by 3.2% while the value of shares in the free market surged by 62.5%, which was partially also due to the restructuring of investment funds. With the small increase, the value of the indicator showing the level of market capitalisation[3] relative to GDP edged up just 0.1 p.p. to total 23.3% in 2003.

The growth of market capitalisation strengthened again in 2004 and stood at 26.1% in the first eleven months, which is the second highest growth seen in the last five years. The biggest increase (by almost 30%) was registered in market capitalisation of shares listed in the free market. The main reason for this rise was the general increase in the value of shares (IPT rose by over 20% in the first eleven months of 2004), while part of the growth was also due to the restructuring of investment funds into regular joint-stock companies. The growth of market capitalisation of shares listed on the official market was almost as high – it increased by almost a quarter. Opportunities for further growth of market capitalisation in 2005 lie in the listing of new companies (especially domestic ones) on the Ljubljana Stock Exchange.

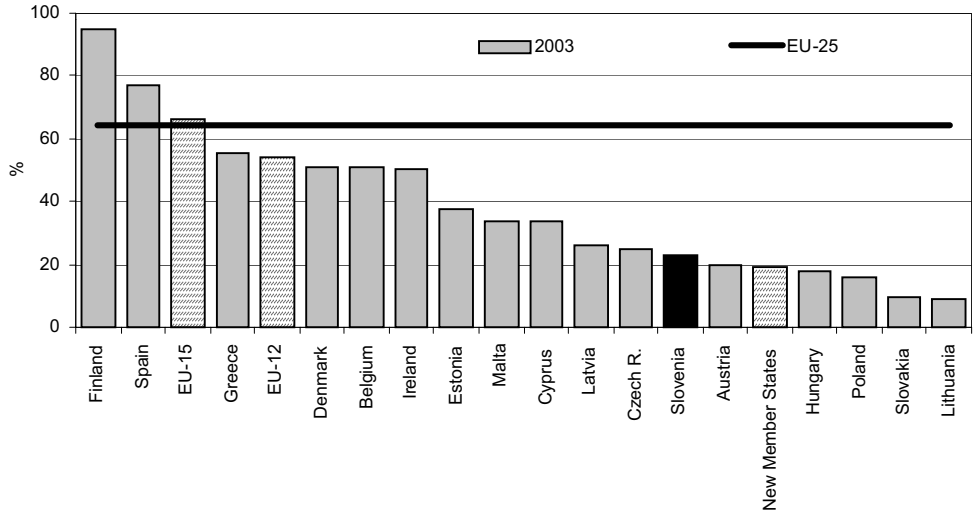
Despite constant growth Slovenia's capital market remains poorly developed and lags strongly behind the EU-25 average in terms of market capitalisation relative to GDP (the respective values of this indicator for 2003 were 64.2% of GDP for the EU-25 and 23.3% of GDP for Slovenia). If we compare the indicator's values of the new member states (averaging out at 19.1%) we find that Slovenia is placed around the upper-half boundary – higher values were achieved by Estonia, Cyprus, Malta, Latvia and the Czech Republic. It should be noted, of course, that even in these countries the capital market is relatively poorly developed. The new member states thus accounted for just 1.3% of the total EU market capitalisation of shares, hence the indicator's value excluding the new member states rose by a mere 2.2 p.p. to 66.4%.

Table: **Selected capital market development indicators for Slovenia, 1995-2003**

	1995	2000	2001	2002	2003
Market capitalisation of shares, excluding investment funds, SIT bn	41.1	705.1	850.0	1,233.1	1,339.7
Market capitalisation of shares, excluding investment funds, as a % of GDP	1.7	16.6	17.9	23.2	23.3
SBI20	1,448	1,808	2,152	3,340	3,932
BIO	111.7	109.0	109.2	111	117
PIX	-	1,521	1,588	2,730	3,372
Number of securities	49	267	270	265	254
Shares	27	197	193	172	162
of which shares of investment funds	0	44	37	33	26
Bonds	22	68	76	92	92
Pension coupons	0	1	1	1	0

Source: Ljubljana Stock Exchange, the Securities Market Report for 2003 (Securities Market Agency), SORS, IMAD.
Notes: SBI - Slovenian stock exchange index, BIO - bond index, PIX - index of shares of authorised investment companies.

Figure: **Market capitalisation in selected EU member states and candidate countries in 2003, as a % of GDP**



Sources: Eurostat (New Cronos), Ljubljana Stock Exchange, SORS.

[1] The share turnover ratio is the ratio between the annual turnover of shares and market capitalisation at the end of a period.

[2] The indicator value can exceed 1 in these markets.

[3] Including the market capitalisation of shares listed on the Ljubljana Stock Exchange and excluding shares of investment funds and bonds.

Developmental role of the state

General government expenditure

In 2004, consolidated general government expenditure[1] totalled 42.8% of the estimated gross domestic product according to provisional figures, i.e. 0.1 of a percentage point more than in 2003 given the slightly changed economic structure. As far as the economic structure of general government expenditure is concerned, there was an increase in the shares of expenditure on wages and contributions in GDP (estimated at 0.2 p.p.), transfers to individuals and households (0.1 p.p.) and payments to the European budget (0.7 p.p.). The shares of expenditure on goods and services in GDP dropped in 2004 (by 0.4 p.p.) alongside expenditure on pensions and investment (by 0.2 p.p. each) and expenditure on interest payments in GDP (estimated at 0.1 p.p.). The share of expenditure on subsidies within GDP stayed at about the same level as in 2003.

In 1996-2004 general government expenditure relative to GDP grew by 3.1 percentage points (up from 39.7% in 1996 to an estimated 42.8% in 2004). In this period consolidated general government expenditure increased by an average annual rate of 4.3% in real terms, 13% faster than the average annual real GDP growth in the same period (estimated at 3.8%).

The upper ceiling for the share of general government expenditure in GDP (43%) that was laid down in the Strategy for the Economic Development of Slovenia (SEDS) was overshot every year since 1998. Given the methodological changes in calculating GDP that pushed the latter up by an average of around 5%, the newly assessed share of general government expenditure corresponding to the upper ceiling as defined by the Strategy for the Economic Development of Slovenia would total about 41% of GDP.

The overall rise in the share of general government expenditure in GDP in 1996-2004 was mostly underpinned by expenditure on wages, contributions and other allowances for employees in government and public institutions. The share of this expenditure increased from 8.6% in 1996 to an estimated 10% of GDP in 2004 (up 1.4 p.p.). The Act Regulating Wage Ratios in Public Institutions, State Bodies and Local Community Bodies was passed in mid-1994, resulting in the first wave of higher public expenditure on wages. This first wave was followed by additional increases, primarily on account of wage supplements defined in sectoral collective agreements and the government's decree on wage supplements for government and administrative employees. Further, the number of employees rose, mainly because of new tasks related to the process of Slovenia's integration with international associations. Expenditure on wages, contributions and other allowances for people employed in the administration and public institutions, which represented 22%-23% of total expenditure, recorded a 5.9% real average annual rise in 1996-2004.

The share of expenditure on social transfers to individuals and households **also climbed in this period**, from 4.9% of GDP in 1996 to an estimated 6.1% of GDP in 2004 (up 1.2 p.p.). The relatively well-developed social security system was amended by new laws which further expanded the range of social protection rights. A universal child benefit was introduced, and the new laws prescribed family benefits and parental allowance, the rights of war veterans and casualties of war, and introduced new social protection rights. All rights involve indexation mechanisms tied to the guaranteed wage, average wage, or inflation. At the same time the number of people entitled to various forms of social transfers increased. Expenditure on social transfers to individuals and households, representing between 13% and 14.3% of total general government expenditure, recorded a 6% real average annual rise in the given period.

The increasing expenditure on pensions put significant pressure on public spending in the early 1990s owing to demographic, economic and social changes. This pressure eased after 2000 when the pension reform halted the further growth of expenditure on pensions. Expenditure on pensions, representing between 26% and 28% of total expenditure, recorded a

3% real average annual rise in 1996-2004. Its share in GDP fell from 11.4% in 1996 to an estimated 10.9% in 2004.

The increase in general government expenditure was also significantly fuelled by domestic interest payments and interest payments abroad. This expenditure rose from 1.1% of GDP in 1996 to an estimated 1.5% in 2004. It involved the payment of interest on government external and domestic debt incurred by financing previous budgets, corporate and banking sector restructuring, and obligations from succession. Expenditure on domestic interest payments and interest payments abroad, representing just 3% to 4% of total expenditure, recorded the biggest rise in the composition of general government expenditure in 1996-2004, going up by an average of 7.4% in real terms a year.

As a result of efforts to curb expenditure on goods and services in both government and other public institutions, this spending hovered around 8% of GDP in 1996-2004 and even fell to an estimated 7.5% of GDP in 2004. Expenditure on goods and services, representing between 18% and 19% of total expenditure, rose by an average annual rate of 2.1% during this period, i.e. slower than the growth of total general government expenditure.

In 1996-2004 expenditure on subsidies fell by an average of 0.3% per year in real terms to total an estimated 1.2% of GDP in 2004. The share of subsidies in GDP was already shrinking before 1995 when it represented 1.8% of GDP and in 2004 it accounted for around 3% of total general government expenditure. Expenditure on subsidies mainly involved subsidies for agriculture, the active employment policy and restructuring of the economy.

The share of capital expenditure in GDP stood at around 4% in 1996-2004, hence the SEDS objective regarding the restructuring of general government expenditure in favour of investment was still not achieved. In the processes of adjusting general government expenditure, capital expenditure is being cut on account of the traditional (and statutorily defined) government spending. Expenditure on investment thus increased by a real annual rate of 3.6% in 1996-2004, i.e. slower than the growth of total general government expenditure.

The structure of general government expenditure (according to the economic classification) changed slightly in the observed period. Compared with 1996, 2004 recorded bigger shares of expenditure on wages and contributions for employees (1.7 p.p.), transfers to individuals and households (1.9 p.p.) and interest payments (0.6 p.p.). On the other hand, smaller structural shares were seen in expenditure on goods and services (down 2.9 p.p.), pensions (3 p.p.), subsidies (0.3 p.p.) and investment (0.7 p.p.).

Table: **Share of consolidated general government expenditure relative to GDP in 1995-2003, %**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
General government expenditure, total	40.4	39.7	40.4	41.1	41.6	41.9	42.6	42.1	42.7
Wages and contributions	8.2	8.6	9.2	9.0	9.0	9.1	9.6	9.7	9.8
Expenditure on goods and services	8.5	8.0	7.8	8.0	7.6	7.9	8.1	7.9	7.9
Interest payments	1.1	1.1	1.1	1.2	1.3	1.4	1.5	1.6	1.6
Transfers to individuals and households	5.0	4.9	5.4	5.2	5.3	5.7	5.9	5.8	6.0
Pensions	11.5	11.4	11.3	11.3	11.4	11.5	11.4	11.3	11.1
Subsidies	1.8	1.3	1.3	1.4	1.6	1.4	1.3	1.1	1.2
Other current transfers and reserves	0.4	0.5	0.4	0.8	1.0	0.8	0.7	0.9	1.1
Capital expenditure	3.9	3.9	3.9	4.1	4.3	4.0	4.2	3.9	4.1
Total general government revenue	40.4	40.0	39.3	40.3	41.0	40.6	41.3	39.2	41.3

Source: Ministry of Finance: Public Finance Bulletin; calculations by IMAD.

[1] General government expenditure comprises the mutually consolidated expenditure of four public finance budgets: state budget and municipal budgets, compulsory health insurance, and compulsory pension and disability insurance.

State aid

Slovenia's state aid as a share of GDP rose last year and exceeded the EU-15 average, albeit it was substantially lower than in the other new member states. The synthesised indicator shows that Slovenia's share of *state aid in GDP* totalled 1.52% in 2003, i.e. 0.08 p.p. more than in 2002 and 0.44 p.p. less than in 2001. The increase in state aid in 2003 was largely due to the increase in horizontal aid, among other reasons generated by the relatively high aid for rescue and restructuring. *State aid excluding agriculture, fishing and transport* rose significantly in 2003 both as a share of GDP (0.48% in 2002, 0.66% in 2003) and as a share of total state aid (33.6% in 2002, 43.6% in 2003). The increase in aid pushed Slovenia further away from the EU-15 average after it had already come very close to it in 2002 when it occupied fifth place among member states. In 2003 only Denmark of the EU-15 member states had a (0.06 p.p.) higher share of state aid in GDP than Slovenia, while Germany, Spain and Portugal spent just 0.1 p.p. less on state aid than Slovenia. Compared with the average of the new member states, Slovenia's aid is lower by 0.76 p.p. of GDP. Slovenia's *state aid per capita* in 2003 (excluding aid to agriculture, fishing and transport) was close to the level of the EU-15 annual average for 2000-2002 (PPS[1] 100 in Slovenia, PPS 94 in the EU-15) and one-third below the amount recorded by the new EU member states in 2000-2003 (PPS 150).

After several years of growth, aid to agriculture was cut while aid for transport and manufacturing rose. Aid to agriculture and fishing, which had previously been rising in both real and structural terms, dropped in 2003 – by one-tenth in nominal terms and by as much as 13 p.p. as a share of total state aid (59.7% in 2002, 46.7% in 2003). The two-thirds nominal increase in transport pushed its structural share up by 3 p.p. (6.6% in 2002, 9.6% in 2003). Since 2003 also saw a drop in aid to the coal industry, aid to manufacturing and other sectors rose both as a share of total state aid and in comparison with the value added produced (2.0% in 2002, 3.1% in 2003). Thanks to these structural changes state aid given to manufacturing and services in 2003 returned to a level above the EU-15 average (3.1% of value added in Slovenia, 1.5% of value added in the EU-15) and was just slightly below the level recorded in 2001 (3.5% of value added).

Horizontal aid rose while regional aid remains an unexploited opportunity. The share of horizontal aid in total state aid excluding agriculture, fishing and transport already exceeds 75% in Slovenia while representing half of total aid in the EU-15 and just 13% in the new member states. The biggest increase in horizontal aid was registered in aid for rescue and restructuring in 2003 (5.6% of total aid) compared with 2002 when this aid was almost non-existent. An increase in aid was also seen in environmental protection, research and development, and in small and medium-sized enterprises. The increase in aid allocated for R&D was qualitative (seen especially in applied research and R&D activities), while the rise in aid for environmental protection was largely quantitative. The share of regional aid is still low in Slovenia (below 10%) while almost a quarter of total aid is allocated for this purpose in the EU-15. The reason for Slovenia's low share of regional aid lies in the marginal aid given to initial investment and to the creation of new jobs, the two top-priority development-oriented measures in the European Union.

Despite changes, state aid as an industrial policy instrument is still insufficient in sectors with development potential. Industrial policy analysed by objectives and final aid recipients reveals a less favourable picture. In all three years around 30% of the total aid was allocated to *agriculture*, the activity recording the lowest structural shares in gross value added and in people in employment. Aid to *industry* has been growing steadily and rapidly, exceeding the structural shares of industry in gross value added and in people in employment in

2003. Aid to manufacturing has primarily been directed to the most economically threatened industries. Over 70% of this aid goes to low-technology-intensive industries, and almost one-third thereof to the food-processing industry. Over one-tenth of state aid supports medium-high technology-intensive industries, and a further tenth is allocated to medium-low technology-intensive industries. The smallest share of state aid (just around 2%) is earmarked for high-technology-intensive industries. Aid to *market-oriented services*, recording exceptionally high levels in 2001 due mainly to the restructuring of collapsing non-privatised companies dropped substantially in subsequent years to below the level achieved by this group in gross value added and in people in employment.

The share of aid fostering economic development is still too small. Development-oriented state aid[2] in Slovenia is relatively low: just one-fifth of total aid promotes competition and economic growth (20% in 2001, 21.3% in 2002 and 24.6% in 2003); this share is, however, gradually increasing. Particularly low shares of development aid are given to agriculture, fishing, mining and quarrying, electricity supply and transport. On the other hand, business activities, education and health recorded a developmentally favourable structure of state aid. However, these activities receive the bulk of aid for research and development (76.1% in 2001, 73.9% in 2002 and 67.8% in 2003), which means that the effects of this aid, albeit favourable, are appreciably less beneficial than they would be if they were given to market producers. In manufacturing the shares of development aid correlate with the technological intensity of manufacturing industries. With the exception of 2001, high-technology-intensive industries generally received the largest share of development aid. A similar percentage of development aid was also allocated to medium-high-technology intensive industries in 2002 and 2003. Following the relatively positive result in 2001, this aid has since been shrinking in medium-low technology-intensive industries as a result of the growing problems in their regular operations. Low-technology-intensive industries, which receive substantial aid for resolving their current structural and social problems, are given the smallest share of development aid.

Table: **Synthesised and analytical indicators of state aid in Slovenia and the European Union (EU 15 and new member states)**

Indicators	Slovenia			European Union (EU 15), 2000-2002 (annual average)	New EU member states, 2000-2003 (annual average)
	2001	2002	2003		
Synthesised indicator					
Total state aid, % of GDP	1.96	1.44	1.52	N/A	N/A
Analytical indicators					
Total state aid per employee, EUR	548.88	432.38	479.78	N/A	N/A
State aid (excluding agriculture, fishing and transport), % of GDP	0.84	0.48	0.66	0.39	1.42
State aid for agriculture and fishing, % of total state aid	48.6	59.7	46.7	27.2*	N/A
State aid for manufacturing, % of gross value added	3.8	2.0	3.1	1.5	N/A
Horizontal state aid , % of total state aid excluding agriculture, fishing and transport	68.6	74.0	75.6	50**	13
Regional state aid , % of total state aid excluding agriculture, fishing and transport	9.8	10.6	8.6	23**	9
State aid for R&D, % of total state aid excluding agriculture, fishing and transport	12.6	22.8	19.6	15**	2
State aid for rescue and restructuring, % of total state aid excluding agriculture, fishing and transport	20.2	1.7	12.8	N/A	N/A

Source: IMAD's calculations based on data from the Ministry of Finance: Sixth Annual Survey on State Aid in Slovenia (for 2001, 2002 and 2003), Ljubljana, June 2004 (for Slovenia), and the European Commission's data: State Aid Scoreboard, Spring 2004, update (for the EU 15) and State Aid Scoreboard, Autumn 2004 update (for new EU member states). **Note**: *excluding railway transport; **figure for 2002. N/A - not available.

[1] PPS – in purchasing power standards (European Commission's calculation).

[2] According to theoretical findings, development-oriented state aid comprises aid for investment, R&D and training, while aid to agriculture also includes aid to livestock breeding (the gene programme) and eradicating plant and animal diseases.

Court backlogs

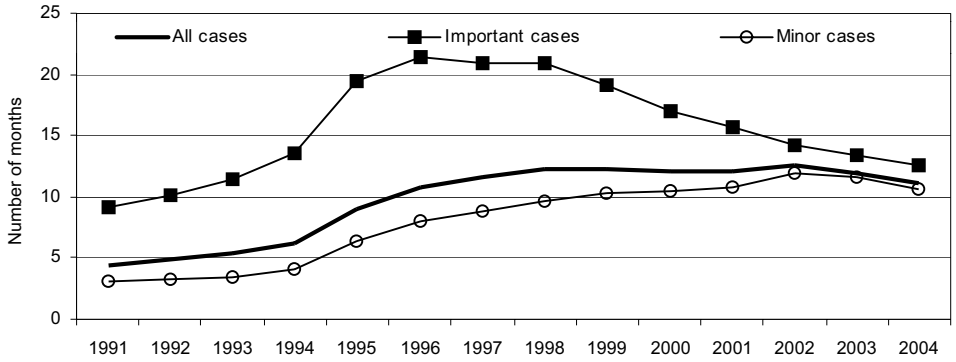
Court backlogs*[1] *of major cases dropped by over 10% in 2003 while the increase in backlogs in enforcement procedures remains critical. Based on data on court cases taken from the judicial statistics for 2002 and 2003 we estimate that the total number of cases brought before the judiciary (courts of both general and special jurisdiction) rose by 8.4% in 2003. In those cases where backlogs are measured, they were up 3.4% (reaching 83.1% of all cases brought before the court in 2002-2003). A positive shift was seen in court backlogs of major cases which dropped by 12%, and in the land registry due to computerisation of the system. At the same time, however, backlogs of minor cases increased (by 6.6%), notably in the enforcement area where backlogs already represented 44.2% of total court backlogs. The number of judges and judicial staff rose by 1.8% in 2003, and they settled 12.2% more cases; this increase, however, was recorded almost entirely in minor cases, especially in land registry procedures.

The situation in 2003 differed considerably in different types of courts. 11.6% more cases were filed at *county courts* in 2003 (5.2% of which were major cases). Court backlogs increased by 4.7%, mainly in enforcement (up 60.4%), hence as many as 37.8% cases were not settled within the year deemed appropriate. An expected positive shift was recorded in land registry cases where court backlogs were cut by 20.9%, i.e. to approximately one-third of all pending land registry cases[2,3]. Backlogs in major cases were reduced in all courts (by 13.4% on average). County court judges were assigned 112.5 pending cases each in 2003 on average, i.e. 14.6% more than the year before (the figure excludes cases not settled by judges – land registry cases and enforcement). The output of judges dropped by 16 cases per judge in major cases; we assume, however, that courts concentrated on the settling of minor cases whose caseload and backlogs rose substantially in 2003 (up 12.5%). *District courts reduced backlogs in commercial matters while their backlogs in criminal matters escalated.* Like in 2002, the demand for district courts' services fell in 2003 (by 1.4%). Total backlogs in these courts dropped by 17.6%, dramatically in cases related to the register of companies (down by 61.2%), and substantially in commercial civil matters (down by 24.8%). In criminal matters, however, backlogs increased by 12.3%. 58.3 pending cases were assigned to each district judge (excluding cases in the register of companies which are not settled by judges), i.e. 7.3 cases less than the year before. The output of judges[4], measured for all cases, dropped by 7.7%. At the same time, the number of judicial staff per judge rose slightly (to 3.5). *Higher courts tried fewer cases and reduced their backlogs.* They received 4.9% fewer cases in 2003 over 2002. This decrease may reflect the higher quality of work at the courts of first instance or a lower propensity to launch appeals; the data are, however, insufficient to draw such conclusions. The backlogs in these courts fell by 6.6%. Although the number of cases filed at higher courts dropped further in 2003, three additional judges were employed there while the judges' output fell by 11.1%.

In our estimate the number of new cases continued to rise in 2004. The number of cases in the judiciary as a whole is estimated to have risen by 6.3%, specifically by 3.8% in major cases and by 7.0% in minor ones. The number of pending cases remains at approximately the same level as in the previous year (-0.5%). A considerable increase was perceived in demand for land registry services (18.9%) which can be attributed to the rapid settling of cases and consequently lower costs for clients following computerisation of the land registry. On the other hand, we assume that for the opposite reason the number of civil matters shrank (-10.7%) while the number of criminal matters increased (by 11.8%). District courts recorded the biggest increase in demand for free legal aid (up 100%) and a criminal investigatory action (50%), which is why following a two-year drop the number of cases in these courts rose again (by 15.1%), and over one-third of these cases remained unsettled. Given the changes in tax legislation we estimate that the volume of new cases in the register of companies has also risen and will continue to rise. Higher courts are estimated to have received about 3.8% more cases in 2004 over 2003 while their number of unresolved cases rose by 8.4%.

The costs of court backlogs in the area of enforcement are estimated at almost 0.3% of GDP. In enforcement, the bulk of cases are regular matters followed by commercial enforcement, real-estate enforcement, enforcement of non-pecuniary claims and insurance matters. Most enforcement cases are based on authentic documents, among which the recovery of claims from unpaid bills predominate, followed by extracts from account books certified by the person liable[5]. We calculated the costs of court backlogs in the enforcement area. Since no data are available on the value of enforcement cases, we assumed that the average value of an enforcement case before a court totalled SIT 200,000[6]. Assuming that the financing costs equalled the real interest rate on late payments (11.3%) and that the age of pending enforcement cases was distributed equally as the age of cases dealt with by bailiffs on 1 January 2004, these costs are estimated to have totalled SIT 17.6 bn or 0.28% of GDP in 2004. If enforcement procedures had been shortened, SIT 21.8 m would have been saved each day of the shortening[7]. Indirect costs of court backlogs and costs of enforcing judgements are not included in this calculation.

Figure: **Assessment of the duration of settling a case in 1991-2004, excluding new cases**



Source: Ministry of Justice, judicial statistics for 1990-2004 (I-VI).

[1] This analysis was prepared by Dr Katarina Zajc (Faculty of Law, Ljubljana) and Aco Trampuž (Ministry of the Economy) using the judicial statistics covering the period from 1990 to the first half of 2004 (Ministry of Justice). For detailed methodological explanations (the difference between unresolved cases and court backlogs, definition of major cases), see Development Report 2002.

[2] The Hercules Project was set up to cut backlogs and will continue until mid-2006 in the land registry while in other areas it was concluded on 15 November 2004 (Delo, a Slovenian daily newspaper, 1 December 2004).

[3] Alenka Jelenc-Puklavec, 2004, 'O projektu in vzpostavitvi elektronske zemljiške knjige', Pravna praksa No. 25, p. 30.

[4] The indicator measures the judges' output indirectly and is misleading for district and high courts where judges can work in panels of different sizes.

[5] Based on the given data an analysis conducted at the Ministry of Justice (analysis of the state of affairs in the area of enforcement in the Republic of Slovenia, Ljubljana, January 2004) found that the frequency of enforcement based on authentic documents indicates the financial indiscipline present in our society. However, such a conclusion would be too hurried since the exact causal link between the non-payment of bills and the consequent lawsuits, enforcement and court backlogs is unknown. One possible reason for the non-payment of bills may also lie in protracted enforcement procedures, hence debtors have no motivation to pay invoices when they fall due, knowing that creditors will be unable to recover them in a very short time. Some other data, however, indicate a slight improvement in financial discipline (figures of the rating agency 'I d.o.o.', business information, Finance daily, November 2003).

[6] The assumption is arbitrary due to the unavailability of actual data. According to the abovementioned analysis of the Ministry of Justice regarding the judiciary, 7,711 enforcement proposals with a principal amount below SIT 25,000 were filed between 1 January 2003 and 1 October 2003, representing just 2.6% of the total pending enforcement cases, hence the estimate of the average principal seems reasonably realistic.

[7] Indirect costs of court backlogs and costs of enforcing judgements are not included in this calculation.

Indicators of environmental development

Share of "dirty industries" in manufacturing

Over the last few years Slovenia has recorded the negative net contribution of structural reforms to the reduction of manufacturing's overall environmental impact[1]. Slovenia's total output of 'dirty' industries, i.e. sectors that have the highest emission intensity per unit of output[2], recorded a bigger annual average increase in 1995-2001 (3.4%) than manufacturing industries as a whole (2.5%). In the following three years the gap in the production growth of dirty industries and manufacturing as a whole widened even further. In 2002, the production level of dirty industries increased by 4.8% while that of total manufacturing was up just 2%. In 2003 (and in the first nine months of 2004) this gap increased to 6 p.p. and was the biggest in the analysed period (see table). Due to qualitative shifts in other manufacturing industries resulting in their higher value-added (VA) growth than production volume growth, the share of dirty industries in the total VA of manufacturing stagnated in 1995-1998. Their overall share started to increase after 1999. The relatively modest increases in this share observed in 2001 (0.1 p.p.) and 2002 (0.3 p.p.) were followed by a more substantial increment in 2003 (1.9 p.p.). The increase in the share of dirty industries in 2003 was due solely to the increase in the share of VA produced in the manufacture of chemicals (the shares of other dirty industries were lower or equal to those achieved in 2002).

While the value added of dirty industries has been growing rapidly, according to recent data these industries have been cutting their investment in environmental protection. As shown in the figure the bulk of the increase in the VA of dirty industries came from growth in the manufacture of chemicals. This industry characteristically records robust production growth and tends to invest in new technologies in order to sustain and increase its global competitiveness. The manufacture of chemicals is traditionally labelled a dirty industry, which is why it was in the vanguard of attempts to integrate the principles of environmental protection into production. According to the latest data (2002), this industry's current expenditure on environmental protection reveals a falling tendency (a 10.6% nominal drop over the previous year), having accounted for 23.2% of total manufacturing's current expenditure on environmental protection (31.5% in 2001). The chemical industry's investment in environmental protection also dropped (by 43% in nominal terms in 2002 over 2001). While about 10% of the chemical industry's investment was spent on environmental protection in 2001, this share shrank to 5.4% in 2002.

Following the qualitative changes in the development of manufacturing industries their energy intensity fell after 1994, albeit this downward trend has slowed down markedly in the last few years. The consumption of final energy per unit of VA, the main energy-related indicator of qualitative changes, fell at an average annual rate of 6.6% in 1995-2001. In 2002 the consumption of final energy per unit of VA generated in manufacturing dropped only by 2.5%. An even stronger slowdown in the reduction of manufacturing's energy intensity was recorded in 2003 when the consumption of final energy per unit of VA remained at the level of the previous year. The reason that the lessening of manufacturing's energy intensity faltered was the increased consumption of electricity (in chemical and metal industries) in 2002 and the higher consumption of electricity (in paper and chemical industries) and natural gas (chemical industry) in 2003. The increased use of final energy pushed CO_2 emissions from manufacturing up by 3.2% in 2003.

The new Environmental Protection Act[3] (EPA) launched the Greenhouse Gas Emissions Trading Scheme, an instrument aimed at reducing greenhouse gas

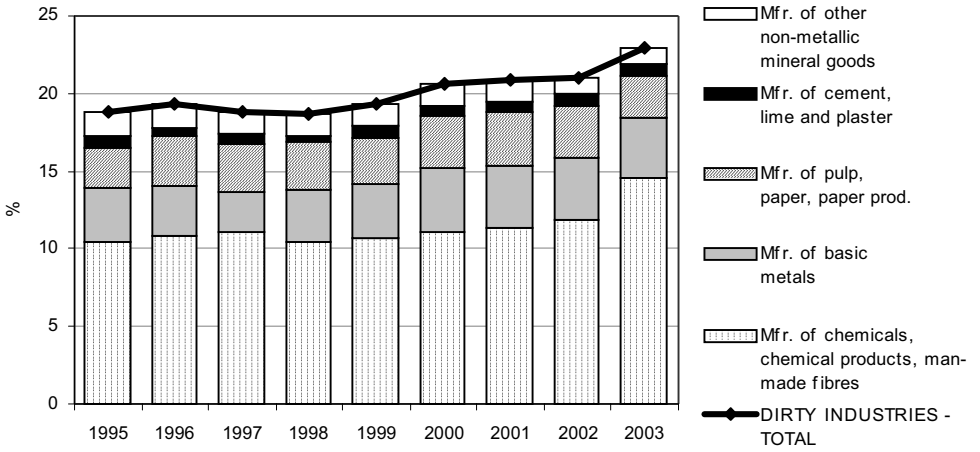
emissions, on 1 January 2005. This scheme is expected to encourage the use of cleaner, energy-efficient technologies. The ministry responsible for environmental protection granted the operators of machinery producing greenhouse gas emissions the right to emit greenhouse gases in accordance with the National Plan for the Allocation of Emission Coupons in 2005-2007. The criteria for determining the total number of emission coupons are adapted to the country's obligations under the Kyoto Protocol and its technological potential to reduce greenhouse gas emissions. If an enterprise produces more emissions than allowed by the issued coupons it must buy more coupons in the market to cover the difference. The European emission coupon market was due to start operating on 1 January 2005.

Table: **Indices of growth in production volumes and value added in manufacturing and dirty industries, 1995-2004**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004[1]
Index of manufacturing's value added growth	102.5	105.4	107.4	103.4	103.7	108.9	105.1	104.8	103.9	106.4
Index of manufacturing's production volumes growth	102.8	100.9	100.2	103.9	100.0	107.0	102.8	102.0	101.6	105.8
Index of production volumes growth in dirty industries	102.4	100.5	100.4	104.5	102.4	108.2	105.4	104.8	107.6	111.8
Pulp, paper and paper products	98.0	98.0	99.0	101.9	98.0	104.7	99.0	108.1	94.0	106.8
Chemicals, chemical products, man-made fibres	103.2	103.4	103.8	105.1	101.6	110.4	108.1	105.9	111.8	117.0
Other non-metal mineral products	101.0	106.3	104.8	106.7	103.9	96.4	100.1	100.8	100.7	100.2
Manufacture of metals	103.3	89.5	88.5	102.4	105.8	111.9	104.5	102.9	106.8	107.3
Index of manufacturing's production volumes growth excluding dirty industries	102.9	101.0	100.1	103.8	99.4	106.7	102.2	101.3	100.2	104.4

Source: SORS; calculations by IMAD.
Note: [1]Figure for the period from January to September 2004.

Figure: **Value added of dirty industries as a share of manufacturing's value added in Slovenia in 1995-2003 (%)**



Source: SORS: Gross domestic product, 1995-2003, current prices, 1 December 2004; Agency for Payments – statistical data on companies' balance sheets.

[1] The total environmental impact of production in manufacturing industries can be reduced by: (i) structural changes (cutting the environmentally most problematic sectors); and/or by (ii) technological or other quality improvement (aimed at reducing the total environmental impact per unit of production).

[2] Iron and steel, non-ferrous metals, industrial chemicals, pulp and paper, and non-metal mineral products.

[3] Official Gazette of the Republic of Slovenia, No. 41/2004.

Energy intensity

Sustainable development requires the reduction of energy intensity[1]. Today's society largely depends on exploiting fossil fuels, some of which (oil) are expected to be in short supply in the next few decades, hence the efficient use of energy will become increasingly important. Economic growth will have to be achieved with appreciably lower rises in energy consumption. The European Commission's scenarios[2] project that GDP in the EU will double between 2000 and 2030 while total energy consumption is to go up by a mere 19%. These favourable forecasts presuppose a considerable improvement in energy efficiency (in terms of higher utilisation rates) and a shift in the economic structure in favour of less energy-intensive activities.

Slovenia consumes much more energy per unit of GDP than the old EU member states (on average), while most other new members have even higher energy intensity rates. In 2003 Slovenia[3] consumed 328 toe (tonnes of oil equivalents) of primary energy to produce EUR 1 m of GDP expressed in constant 1995 prices, as against the 209 toe consumed in the EU-25 in 2002. Slovenia hence consumed 57% more energy than the average EU country to produce one unit of GDP. The differences in the EU countries' energy intensity increased significantly after the accession of ten new countries. While prior to enlargement the ratio between the least wasteful Denmark and the most energy intensive Finland was just slightly above 1:2, the current corresponding ratio between Denmark and Lithuania totals 1:10 (see graph).

Slovenia's relatively high energy intensity can partly be explained by its development gap behind the EU average and partly by structural factors. Slovenia's energy consumption per capita was just 8% below the EU-25 average, while its level of development in terms of GDP per capita (at constant EUR prices, 1995) was 43% lower. The huge developmental gap was thus one of the reasons for Slovenia's poor ranking according to the energy intensity indicator. The pace of reducing energy intensity will largely depend on whether Slovenia manages to keep its economic growth some percentage points above the EU's level and at the same time sustain its energy consumption at a minimum or even zero growth rate. On the other hand, Slovenia's high energy intensity is also linked to the current economic structure where manufacturing industries hold a 27% share in value added (the highest share in the EU-25). Among these, a large part is taken up by industries in which energy consumption represents the bulk of production costs (metal, paper, chemical industries). These industries generated 9.7% of Slovenia's total value added in 2002, which is one of the highest percentages in the EU.

The Slovenian economy's energy intensity dropped considerably between 1995 and 1999, yet the process of its reduction has slowed down in the last four years. In 1995-2003 Slovenia's energy intensity fell by an annual rate of 2.3%. This pace was, however, still too slow considering Slovenia's excessive level of energy consumption relative to its level of economic development, especially in view of the fact that in this period (up until 2002) energy intensity also fell in the EU-25 (by 1.4% per year). The halt in the reduction of energy intensity has been particularly strong since 1999; 2001 even saw a slight increase in energy consumption per unit of GDP. In 2003 Slovenia's energy intensity fell by 1.8% (GDP grew by 2.5% while primary energy consumption was up 0.7%). The increase in energy consumption was mainly due to the 10.6% increase in the consumption of natural gas (which was structurally positive), the 0.9% increase in the consumption of liquid fuels, and net electricity imports that had not been seen in many years. The latter

resulted from the 5.0% lower output of electricity and the concurrent 6.4% increase in electricity consumption.

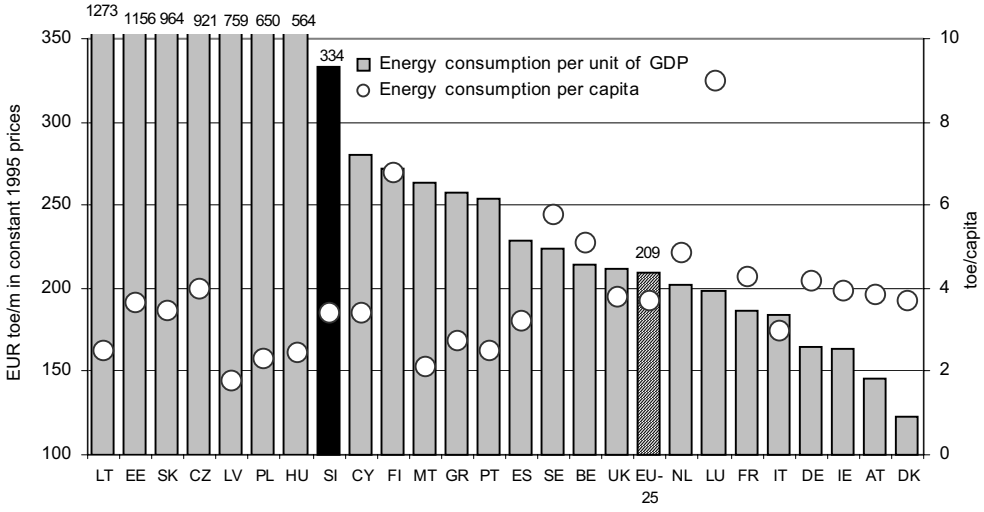
Slovenia can follow the example of several EU countries in reducing its energy intensity. Energy intensity fell by an annual average of 1.1% in the EU in 1991-2001, notably in Luxembourg (by 4.6% annually) and Ireland (3.9%). In the 1990s, the EU achieved positive results in this field mainly by replacing obsolete technologies (the *länder* of former East Germany), strong economic growth in energy non-intensive and service sectors in particular (Ireland), and by reducing the level of heavy industry (Luxembourg). The level of services has been rising only slowly in Slovenia; 2003 even saw an increase in the shares of several energy-intensive manufacturing industries in value added.

Table: **Energy intensity (primary energy consumption per unit of GDP) in Slovenia and the EU in 1995-2003, toe/mio EUR$_{1995}$**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Slovenia[1]	394.2	397.5	386.4	365.1	338.5	332.8	336.7	333.5	327.6
EU-25	230.3	235.0	227.6	224.2	217.2	211.6	212.4	209.0	N/A

Sources: Eurostat (New Cronos); SORS; calculations by IMAD.
Note: [1]data on energy consumption and GDP for Slovenia taken from the SORS; calculations in EUR$_{1995}$ constant prices by IMAD.

Figure: **Primary energy consumption per unit of GDP and per capita in Slovenia[1] and EU member states in 2002, toe/mio EUR$_{1995}$**



Sources: Eurostat (New Cronos); SORS; calculations by IMAD.
Note: [1]data on energy consumption and GDP for Slovenia taken from the SORS; calculations in EUR$_{1995}$ constant prices by IMAD.

[1] Energy intensity is the ratio of total energy consumption to GDP.

[2] EC, Energy & Transport, Report 2000-2004.

[3] Using the SORS' data on primary energy consumption.

Renewable energy sources

Promoting the use of renewable energy sources (RES) is one of the main objectives of EU energy policy. More extensive use of RES can significantly contribute to achievement of the Kyoto objectives since the exploitation of e.g. solar, wind, geothermal and hydro-energy does not raise the level of greenhouse gases. Increased use of renewable sources, enabling the economising on fossil fuels whose reserves are limited, goes hand in hand with the concept of sustainable development. As a rule, RES are domestic energy sources and hence a bigger share of their consumption means more reliable energy supply and less of a dependence on imported energy.

Slovenia is one of those countries with a relatively large share of RES in its total primary energy consumption. RES represented 10.8%[1] of Slovenia's total primary energy consumption in 2003, almost twice as much as in the EU-25 (5.7% in 2002). Latvia had the highest RES share (over one-third) in the EU; Sweden, Finland and Austria also recorded high shares of over 20%. The lowest use of renewable sources (less than 2% in total consumption) was observed in the UK and Luxembourg. These differences mainly depend on the countries' natural conditions.

The structure of renewable sources varies considerably across countries; in general, however, traditional RES such as biomass, waste and hydro-energy predominate. In 2002 the average structure of RES in the EU-25 was as follows: biomass and waste 65.4%, hydro-energy 26.9%, geothermal energy 3.9%, wind energy 3.2%, and solar energy 0.5%. According to the SORS' data, Slovenia had the following structure of renewable sources that year: biomass, biogas, and industrial and municipal waste 61.3%, hydro-energy 38.7% (other sources are not covered in the SORS' data[2]). The non-traditional RES such as geothermal, wind and solar energy make up marginal shares in the countries' total primary energy consumption. The only exceptions are Denmark (2.1% of wind energy), Italy (2.0% of geothermal energy) and Cyprus (1.4% of solar energy). In all other EU countries, the share of non-traditional RES in total energy consumption is lower than 0.5% (see graph).

In Slovenia the share of renewable sources in total primary energy consumption has been on a modest decrease in the last three years. While in 2000 the share of RES already achieved 11.9% of total primary energy consumption it shrank to 10.8% by 2003. The reason for this fall was the increasingly long spells of drought within the year resulting in lower water levels of Slovenian rivers. Hence Slovenia's hydro-electric output in 2003 was over 17% lower than in 2000. Although the exploitation of wood and wood waste rose slightly in that period it could not balance out the huge shortfalls in hydro-energy production. The total exploitation of RES dropped by 2.9% from 2000 to 2003 while total primary energy consumption in Slovenia increased by 7.1% during that time.

The EU's share of RES has been creeping up slowly in recent years, while the European Commission's guidelines envisage much faster growth in this area up until 2010. In 1995-2002 the share of RES in the EU-25 rose from 5.0% to 5.7% (in 2002 over 2001 it even edged down 0.1 p.p.). Consumption of primary energy increased by 6.7% in the said period while the consumption of RES rose by 20.9%. The biggest (almost nine-fold) increase in RES was observed in the exploitation of wind energy, while in absolute terms (measured by heat units) the consumption of energy from biomass and waste rose the most. The modest increase in the consumption of hydro-energy seen in 1995-2001 was followed by its sharp drop to below the 1995 level in 2002, a droughty year in most parts of Europe. With a view to achieving the Kyoto objectives the EU intends to double its RES share to 12% by 2010. The contributions of individual countries to this goal should be commensurate with their natural endowments. Given the current trends the set goals are unlikely to be met without immediate financial aid such as tax relief or financial assistance.

Slovenia promotes the exploitation of RES through investment subsidies, the CO_2 emission tax and the priority dispatching of electricity produced by qualified producers. The national

Agency for Efficient Energy Use allocated about SIT 495 m for efficient energy use and renewable resources in 2003, thereby stimulating investment worth approximately SIT 2.8 bn. The CO_2 emission tax is still one of the key instruments helping Slovenia meet the Kyoto commitments. Namely, tax exemption is granted for measures taken to enhance efficient energy use in industry, launch the combined heat and power production, replace fossil fuels with renewable sources, rebuild heat distribution systems etc. Price incentives for RES are also provided through the priority dispatching of electricity produced by qualified producers (mainly small hydro-electric power plants) at a price higher than the market price.

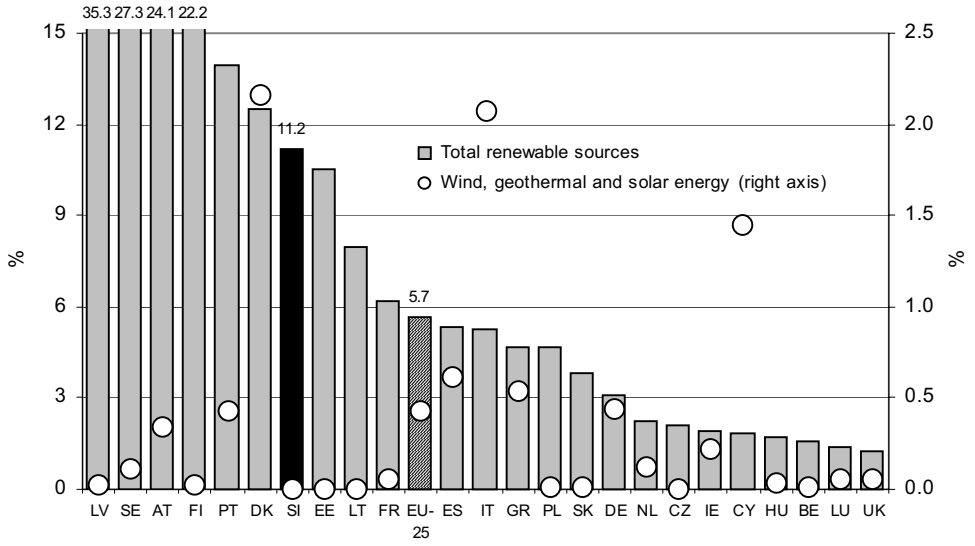
Slovenia still has considerable potential to develop its traditional renewable sources. By 2013 Slovenia should increase its exploitation of the technically exploitable hydro-potential from the current 43% to 52% by building a chain of hydro-electric power plants along the Sava river. Forests cover 54% of Slovenia's territory, one of the largest percentage shares in Europe, and its annual wood increment exceeds the level of tree-felling. Hence, growing emphasis has recently been placed on the exploitation of wood biomass.

Table: **Renewable sources relative to total primary energy consumption in Slovenia and the European Union in 1995-2003, %**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Slovenia[1]	8.9	9.1	8.2	8.9	9.5	11.9	11.7	11.2	10.8
EU 25	5.0	4.9	5.1	5.3	5.5	5.6	5.8	5.7	N/A

Sources: Eurostat (New Cronos); SORS; calculations by IMAD.
Note: [1]SORS' statistics on renewable sources include industrial waste while excluding wind, geothermal and solar energy.

Figure: **Total share of renewable sources and the share of wind, geothermal and solar energy in total primary energy consumption in Slovenia and EU member states in 2002, %**



Sources: Eurostat (New Cronos); SORS; calculations by IMAD.
Note: [1]excluding wind, geothermal and solar energy.

[1] Using SORS' data on renewable sources that include industrial waste.

[2] Records and statistical data collection for RES, in particular for solar, geothermal and wind energy, are still incomplete in some other EU countries as well.

Share of road transport in freight transport

In most countries road freight transport strongly outweighs other freight modes such as transport by rail and on inland waterways (rivers, lakes). The large share of road transport in total freight transport (by roads, railways, and inland waterways) in most European countries is the result of the great flexibility of this mode of transport (door to door) and higher external costs not included in the price of transport. If these costs were taken into account, the competitiveness of road freight transport would drop appreciably while the comparative advantages of rail transport would become more evident. The construction of railways requires significantly less space than motorways. Further, transport by rail is much less polluting, uses less energy per unit of service, and ensures greater safety.

Compared to other countries Slovenia has a relatively low share of road freight transport, consisting predominantly of international transport, which is typical of small inland countries. In 2003 the share of road freight transport in Slovenia totalled 65.8%[1] while this share already exceeded 70% in the EU as a whole in the early 1990s to total 76.3%[2] in 2002. Cross-country differences in the volume of road freight transport are in many respects linked to historical and geographical factors. The Baltic states have the lowest shares of road freight transport (between 30% and 50%) in the EU-25. Below-average and highly uniform shares (around two-thirds) of road freight transport are found in the countries of the former Austrio-Hungarian Empire (see graph) where the basic rail network was already built in the second half of the 19th century. The well-developed railway network in these countries accounts for their relatively bigger competitiveness of rail vis-a-vis road transport. In 10 out of the 25 EU countries over 90% of freight is carried on roads. Cyprus, Malta, Greece and Ireland, small insular countries where road transport prevails because it is more competitive over short distances, record the biggest shares (over 95%) of road freight transport.

Regarding the composition of road freight transport, large countries tend to have higher shares of inland transport while small inland countries generally have bigger shares of international transport. Hence in Italy, the UK, France, Germany, Finland and Sweden the shares of international road transport in total road freight transport do not exceed 20%. In Luxembourg, on the other hand, almost all road freight transport is international; similarly, Lithuania's share totals 80% while Slovenia has 70% of international road freight transport.

The share of road transport in total freight transport is rising steadily in the EU, which also applies to Slovenia where, according to the first estimates for 2004, the share of road transport is approaching the EU average. According to the European Commission's data, total freight transport in the EU-15 measured by tonne kilometres rose by 30% in 1993-2003. Specifically, road freight transport was up 38% while rail freight transport increased by a mere 3%. In the EU-25 the share of road transport in total freight transport rose from 72.1% in 1995 to 76.3% in 1995. In Slovenia, according to revised SORS' data, this share did not change in 2001-2003, totalling 65.8%, which is 14.0 p.p. more than in 1995. Figures for the first half of 2004 indicate that the share of road transport for that year may draw close to 70%.

Transport policy in both Slovenia and the EU strives to increase or at least preserve the share of rail in freight transport, having several measures at its disposal to achieve this goal. The EU is trying to revitalise rail transport by harmonising rules and procedures regulating this sector (licences, permits) and by liberalising the European market of railway transport services. The EU's objective is to create a single European railway system that will be more competitive with road transport. The liberalisation of road transport within the EU was finalised in 1998 when cabotage (the transport of goods between two countries, neither of which is the operator's domicile country) between member states was opened up; in the railway sector, however, international freight transport between the EU countries was not opened up until

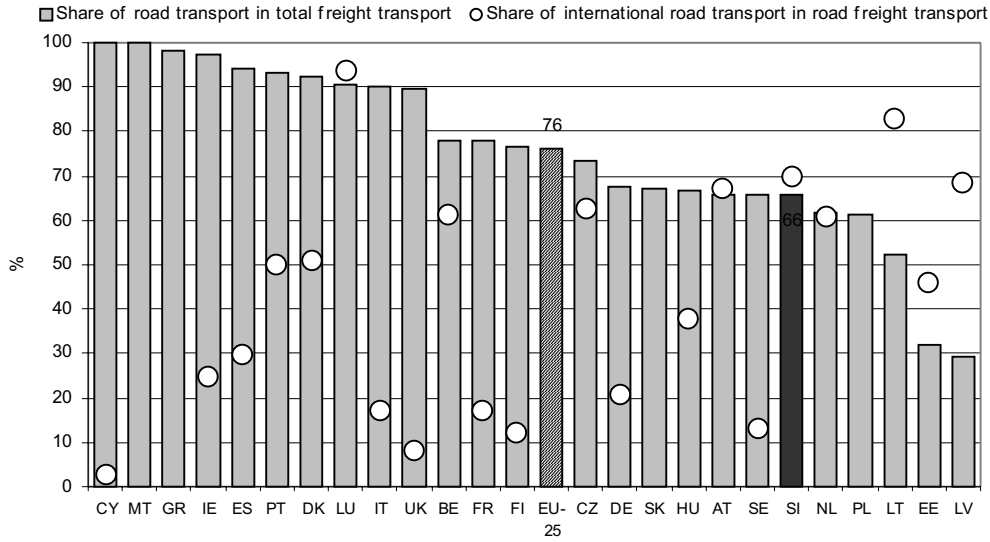
2003. In Slovenia, railway services were liberalised upon its entry to the EU yet at the moment the question of how to reorganise Slovenia's only national rail operator (Slovenian Railways) is more critical than the arrival of potential competitors in the market. The national rail operator was transformed into the Slovenian Railways Holding formally consisting of three separate companies for freight transport, passenger transport and infrastructure. Since 2002 when the company's losses climbed to SIT 12.5 bn their business results have improved considerably so that a positive balance can be expected for 2004. Factors that may help maintain the share of rail freight transport in Slovenia at the achieved level are appropriate price and tax policies that should incorporate to a greater extent the external costs of road freight transport within its price. This indicator may also be improved (i.e. its value should decrease) by further development of the port of Koper to which rail transport is closely linked, and by upgrading the Slovenian railway network (construction of the second rail track on the Divača-Koper railway line) so as to enhance the capacity of the railway network.

Table: **Share of road transport[1] in total freight transport (roads, railways, inland waterways) in Slovenia and the European Union in 1995-2003 (tkm), %**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Slovenia	51.8	57.6	57.6	57.3	60.4	64.8	65.8	65.8	65.8
EU 25	72.1	72.6	72.3	73.6	74.8	74.7	75.7	76.3	N/A

Sources: Eurostat (New Cronos); SORS; calculations by IMAD.
Note: [1]in road transport, the statistics covers the volume of carriage by freight vehicles registered in the country, while in rail and inland waterway transport the figures indicate the volume of carriage on the national territory.

Figure: **Share of road transport[1] in total freight transport (roads, railways, inland waterways) and the share of international road transport in total road freight transport in Slovenia and EU member states in 2002 (pkm), %**



Sources: Eurostat (New Cronos); SORS; calculations by IMAD.
Note: [1]in road transport, reports are compiled by the countries where vehicles are registered.

[1] According to SORS' data.

[2] According to the EUROSTAT, data on road transport refer to vehicles registered in a country, while data on railway and inland waterway transport refer to transport on the territory of a country.

Agricultural intensity

The average agricultural intensity[1] should drop in the future in both the EU and in Slovenia, whereby food safety and environmental protection should increase. The relatively high financial incentives provided by the EU's common agricultural policy for agricultural producers to compensate for their income loss in the market are becoming increasingly conditional on the strict fulfilment of environmental standards restricting agricultural intensity.

In 1995-2002 agricultural intensity, measured by the use of macro-nutriments in mineral fertilisers and the level of integrated and organic farming, fell in Slovenia while total pesticide sales increased. Although the total *consumption of mineral fertilisers* rose by 4% in 2002 over 1995, the consumption of the three main macro-nutriments contained in them – nitrogen, phosphorous and potassium (NPP) – dropped by 1%[2] (see table). Since the fertilised agricultural area[3] increased in that period, NPP consumption per unit of these areas dropped even more markedly, by 9%. At the same time, the number of farms and agricultural area engaged in *integrated and organic farming* increased relatively fast. While integrated farming has been common in Slovenia for quite a while, the first organic farms began to emerge in 1998. Their number rose to 1,150 in 2002, accounting for just over 1% of total farms and 3% of total cultivated agricultural area in Slovenia. In *pesticides*, however, the results achieved were not environmentally favourable since their sales surged by over 16% in 2002 over 1997[4]. A particularly strong increase was seen in the sales of herbicides and insecticides, while the rise in the sales of fungicides was lower.

2003 recorded environmentally favourable results in all of the observed indicators: a decrease was seen in both the consumption of macro-nutriments in mineral fertilisers per unit of fertilised area and in the total sales of pesticides, while the area farmed using organic or integrated methods increased. Close to 178,000 tonnes of *mineral fertilisers* containing 70,000 of plant macro-nutriments were spent in agricultural production. This is slightly more than in the previous year yet less when measured per unit of fertilised area[5]. According to this calculation, NPP consumption fell by 4%: potassium, phosphorous and nitrogen consumption dropped by 7%, 6% and 1%, respectively. *Pesticide sales*, after having increased in 2002, fell to 1,434 tonnes of active substance (down 3%). The consumption of fungicides, which have the biggest share in total pesticide use, dropped by almost 10%; on the other hand, an increase was recorded in the consumption of insecticides. This is partly due to the dry and hot weather in 2003 resulting in a lower level of infectious plant diseases and an increased risk of insect attacks. The number of *controlled organic farms* kept rising; 1,415 such farms cultivated 20,000 ha of agricultural land using organic methods, i.e. 30% more than the year before and 4.2% of the total utilised agricultural area. The number of farms using integrated farming methods and the area they cultivate increased as well. 12,000 ha of land was farmed in this way, representing 2.5% of the total agricultural land utilised.

Compared with European agricultural intensity, Slovenia still consumes more NPP fertilisers than the EU-15 on average but it has a higher share of organically farmed area. In 2002, the consumption of NPP fertilisers per unit of utilised agricultural area[6] totalled 137 kg/ha in Slovenia and 114 kg/ha in the EU-15. Only the Netherlands, Belgium and Germany recorded higher fertiliser consumption. Compared with the previous year the consumption per area rose by an average of 4.2% in the EU-15 countries and by just 0.8% in Slovenia. A comparison for pesticide sales is inappropriate (only the growth rates are compared in the graph) because the figures are a sum of active substances with varying levels of toxic intensity. Pesticide sales in Slovenia record a high share of biologically weaker pesticides that are hence used in much larger quantities. In spite of this, a simple comparison of sales per unit of agricultural area for 2001 (latest available figures) reveals a relatively favourable picture in environmental terms – these sales dropped in 2001 over 2000 and almost equalled the EU-

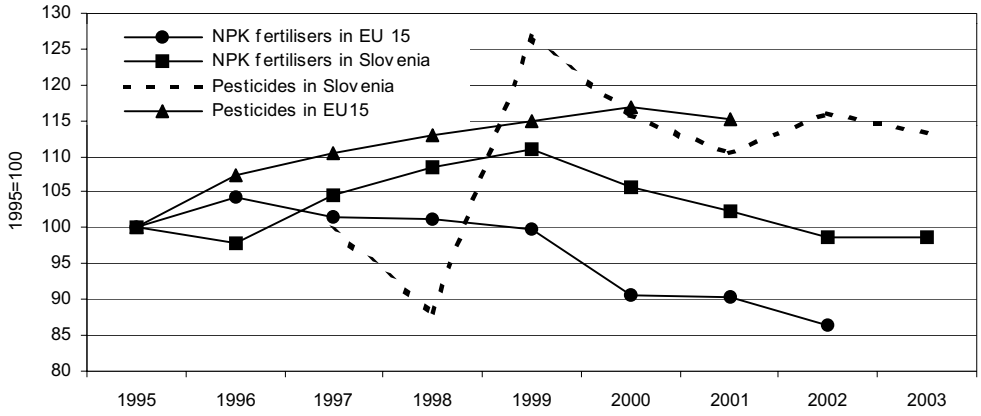
15 average. In terms of the share of *organically cultivated area* in total utilised agricultural area, according to the first preliminary data Slovenia has already surpassed the EU-25 average in 2003 (3.4% in the EU-25, 4.2% in Slovenia). There are still large differences between individual European countries in their relative levels of this type of farming; the biggest increase in 2003 was observed in France and Spain.

Table: **Agricultural intensity indicators for Slovenia for 1995-2003**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
NPK fertiliser use									
total, thousand tonnes	70.6	69.2	73.9	76.6	78.5	74.6	72.3	69.8	69.8
per unit of agricultural area, kg/ha	178.9	176.9	179.7	187.2	189.3	172.3	166.4	162.3	155.9
Pesticide sales									
active substance, thousand tonnes	-	-	1.27	1.12	1.61	1.47	1.40	1.47	1.43
Organic farming									
number of farms	-	-	-	41	331	596	883	1,150	1,415
area, thousand hectares	-	-	-	-	-	5,280	10,828	15,404	20,018

Source: SORS, Ministry of Agriculture, Forestry and Food, Forestry Institute of Maribor, calculations by IMAD.

Figure: **Comparison of growth in NPP fertiliser use and pesticide sales in Slovenia and the EU-15, 1995-2003 (1995=100, except in pesticides where Slovenia 1997=100)**



Sources: Eurostat, EAA, SORS, Ministry of Agriculture, Forestry and Food, calculations by IMAD.
Note: The EU-15 pesticide sales aggregate for 2000 is calculated with 1999 figures for Spain and Luxembourg. For Luxembourg, the same figure is also used in the calculation of pesticide sales in the EU-15 for 2001.

[1] Agricultural intensity is measured by the consumption of mineral fertilisers and pesticide sales, and the level of organic and integrated farming. In addition, another important indicator is the consumption of organic fertilisers which can also be environmentally harmful when used in large quantities but are not included in our analysis due to the lack of data.

[2] In 2004 the SORS revised its data on the consumption of mineral fertilisers in Slovenia in 1995-2002. The revision is based on more exact estimates of their production and the elimination of mistakes made due to occasional double-counting from imports and domestic manufacture.

[3] Fertilised agricultural areas comprise all cultivated agricultural areas except permanent pastures and meadows to be used once and common grassland. According to revised statistical data, their area increased by 8.9% in 1995-2002, from 395,000 to 430,000 hectares.

[4] Since 1997 data on pesticide sales are collected by the Phytosanitary Administration of the Republic of Slovenia.

[5] In 2003 total fertilised area increased by 4%, from 430,000 ha to 448,000 ha.

[6] For this comparison a calculation per unit of utilisable agricultural area was made since no data on fertilised area was available from abroad.

Tree-felling intensity

Tree-felling intensity[1], the main indicator of the economic utilisation of forests, is relatively low in Slovenia despite wood being one of its rare natural resources. The forest area, covering over half of Slovenia's territory, is still expanding even though this is not planned in the Forest Programme of Slovenia (OG No. 14/1996). Remote areas unsuitable for agricultural production are overgrowing faster than forests in suburban and intensive agriculture areas are shrinking.

The existing trends from previous years continued in 1995-2002: expanding forest area and increasing growing stock, followed by higher annual felling which nevertheless remained at an extremely low level. The forest area increased by 5% in 1995 over 2002, growing stock was up 21% and annual felling rose by over a quarter (see table). Nevertheless the volume of wood removed in that period was the lowest in the past few decades. Tree-felling intensity rose by a mere 2.4 p.p. in the analysed period and lagged behind the forestry plans by 22 p.p. in 2002.

Better results were recorded in 2003 when tree-felling intensity was among the highest in the last few years. The forest area totalled 1,158,000 ha at the end of the year, 1% more than the year before. The growing stock and wood increment rose by 3% while felling surged by 14%. Since the annual tree removal volume increased appreciably more than the annual increment, tree-felling intensity also rose considerably, from 37.3% to 41.2%. This level of tree felling was once again the highest seen in the last few years although it still totalled just 73% of the annual tree felling levels planned in forestry plans for 2001-2010. The increase in felling was mainly due to forest sanitation after summer's high temperatures when drought and insect attacks badly damaged the already weakened trees. On the other hand, figures for tree-tending, the most vital part of forest development, are unfavourable – it has been insufficient in Slovenia for decades. In 2003 it dropped by a further 1% compared with the previous year. Foresters observe this problem only in privately-owned forests, especially in technically or physically demanding or dangerous thinning operations where revenues from timber sales do not cover the costs of its acquisition and transport.

Tree-felling intensity in Slovenia is very low in comparison with most other European countries. Slovenia's tree-felling intensity was 21 p.p. below the EU average in 1995-2000, the period for which the latest comparable figures are available (Development Report 2002). Slovenia also lags behind in other related indicators of forest exploitation such as *the production of raw wood categories (logs, pulpwood & other industrial wood, and fuelwood)* per unit of forest area (see graph). In 1998-2002 this indicator averaged 2.15 m^3/ha in the EU-25 while Slovenia recorded just 1.89 m^3/ha.

Making forestry one of the priorities of the Single Programming Document of the RS (SPD) 2004-2006, which provides the foundations for implementing long-term development policy and long-term budgeting in this area, should be conducive to improving Slovenia's forest management. The SPD allocates EUR 4.7 m for forestry (half of which will be provided by the EU), 2.5-times the amount appropriated in the national budget for tending and protecting forests in 2003. These funds are aimed at restructuring forestry in order to increase the ecological stability and commercial value of forests and enhancing the exploitation of their economic potential.

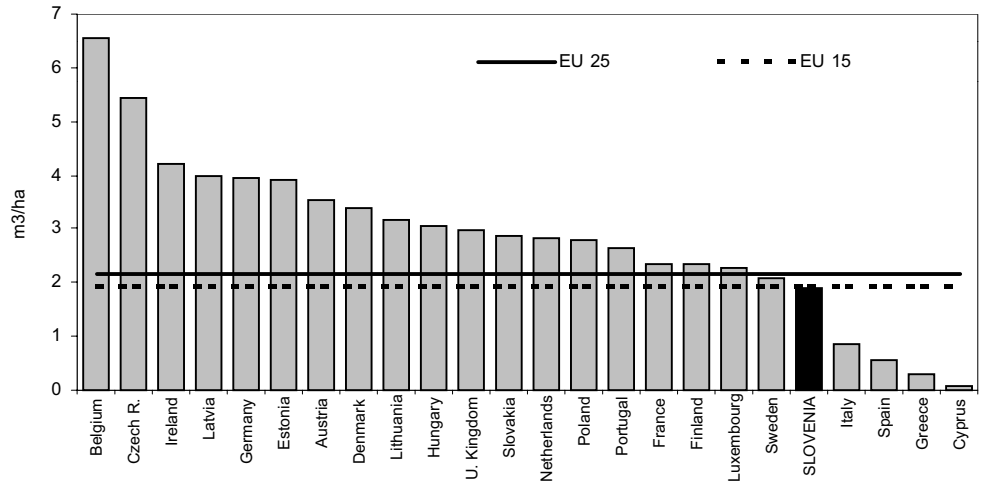
[1] Tree-felling intensity is the ratio of annual removal levels to the annual wood increment.

Table: **Tree-felling intensity in Slovenia in 1995-2003**

	1995	1996	1997	1998	1999	2000	2001	2002	2003	FP* 2001–2010
Forest area, thousands hectares	1,098	1,099	1,110	1,111	1,116	1,134	1,143	1,150	1,158	1,142
Growing stock, thousands m3	228,493	231,521	231,663	232,688	237,276	262,795	267,912	276,574	285,735	266,704
Annual increment, thousands m3	5,995	6,086	6,124	6,140	6,248	6,872	6,925	7,102	7,290	6,923
Annual removal, thousands m3	2,092	2,330	2,567	2,470	2,396	2,609	2,614	2,646	3,007	4,101
Tree-felling intensity, %	34.9	38.3	41.9	40.2	38.3	38.0	37.7	37.3	41.2	59.2

Sources: SORS, Slovenian Forest Service.
Note: *Forestry plans for 2001-2010..

Figure: **Average annual production of raw wood categories in Slovenia and the EU-25, 1998-2002**



Source: Eurostat (New Cronos).

Indicators of social development

Long-term unemployment rate

The long-term unemployment rate[1] is an important indicator of the situation in the labour market and problems in the area of social cohesion. Recently this rate has been relatively low in Slovenia. Its value peaked in 2000 at 4.1% (the EU-25 average at that time was 3.8%); thereafter it had already dropped to 3.5% in 2001 and remained at roughly this level in 2002 and 2003 (see the table)[2]. Like the overall unemployment rate, the long-term unemployment rate is slightly higher for women than for men. While the number of unemployed people and the overall unemployment rate increased in 2003, the long-term unemployment rate did not increase since the share of long-term unemployed people in total unemployment shrank slightly. In 2003 (according to the SORS' labour force survey) there were 54.7% long-term unemployed in total unemployment, while 34.8% were unemployed for a very long time (2 years or more). Slovenia's rate of very long-term unemployment[3], having peaked in 2000 (2.7%) has fallen since and totalled 2% in 2003, substantially less than the average of the new member states (4%) and about the same as the EU-15 average (1.9%) (EC, 2004).

Long-term unemployment raises the passivity of job seekers. This significantly contributes to the difference between registered and survey unemployment since those who do not actively seek work are not unemployed, according to the labour force survey. Long-term unemployment also affects the working habits of the unemployed and reduces their chances of re-employment . Slovenia is aware of this problem and has prepared special programmes for the long-term unemployed within its active employment policy.

The poverty at risk rate including income in kind is much higher among the unemployed (38.4% in 2002) than among those who work (3.7%). Although the long-term unemployment rate and the overall unemployment rate are slightly higher for women than for men, the poverty risk rate is somewhat higher among unemployed men than unemployed women.

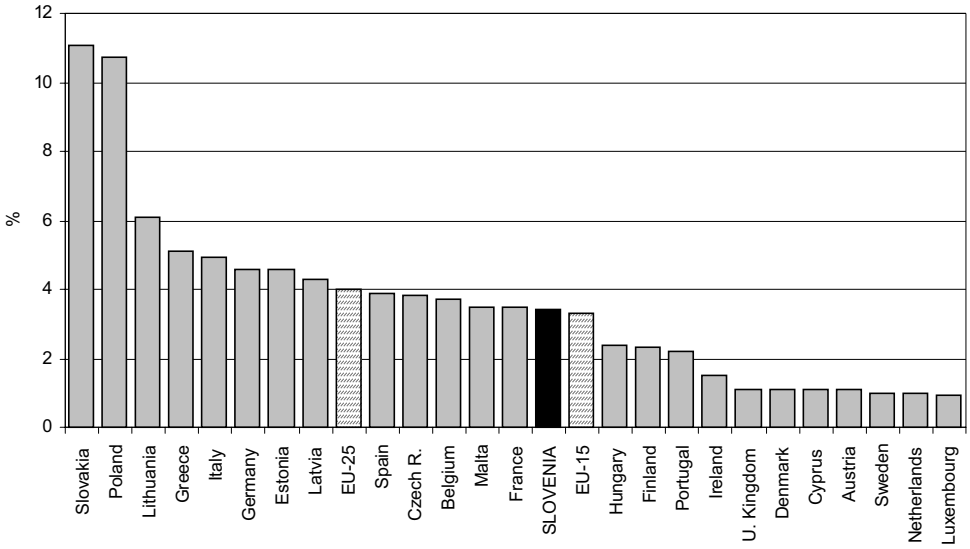
Education and proficiency levels are significant factors of employment and an efficient safeguard against poverty. Like in other countries, unskilled people take up the largest share of those unemployed for a long time. Almost one-third of the long-term unemployed have not completed primary school or have only completed primary school. They are followed by a large share of long-term unemployed people with lower or vocational secondary education, representing typical structural unemployment in profiles for which there is no longer any demand by enterprises. As a rule, unemployed people with higher education levels find work more easily. This is also confirmed by unemployment rates according to education levels attained: the unemployment rate among low-skilled people (with finished or unfinished primary school and lower technical education) totalled 11.2% in 2003 while there were only 3.7% unemployed people among those with tertiary education. The OECD calculated that, on average, a 10% increase in time spent by adult individual on education or training is estimated to be associated with: a) an increase of the probability of that person being active by 0.4 p.p. and b) a fall in probability of being unemployed by almost 0.2 p.p. (OECD, 2004, p. 185). The share of people in the lower quarter of income distribution who left school before their 16th year of age totals 52% in Slovenia, which implies a high correlation between leaving early school and poverty (Russell, H. and Whelan, C., 2004, p. 10). According to EUROSTAT's data, the structural indicator of early school-leaving is not critical for Slovenia: according to comparable data for 2001, this share (7.5%) was way below the averages of the EU-15 (18.9%) or EU-25 (17.3%).

Table: **Long-term unemployment rates in Slovenia and the EU, %**

	1996	1997	1998	1999	2000	2001	2002	2003
Slovenia								
Total	3.4	3.4	3.3	3.2	4.1	3.5	3.4	3.4
Men	3.7	3.6	3.3	3.4	4.0	3.4	3.4	3.3
Women	3.1	3.3	3.3	3.0	4.1	3.6	3.4	3.6
EU 15								
Total	4.9	4.9	4.4	4.0	3.5	3.1	3.1	3.3
Men	4.2	4.2	3.7	3.3	2.9	2.7	2.7	2.9
Women	5.9	5.8	5.4	4.7	4.2	3.7	3.6	3.7
EU 25								
Total	N/A	N/A	4.4	4.1	3.8	3.8	3.9	4.0
Men	N/A	N/A	3.7	3.5	3.4	3.3	3.4	3.6
Women	N/A	N/A	5.4	5.0	4.7	4.5	4.5	4.5

Source: Eurostat.

Figure: **Long-term unemployment rates in the EU-25, 2003**



Source: SORS.

[1] The long-term unemployment rate is one of the 18 Laeken indicators of social cohesion used to measure progress in the area of reducing poverty and social exclusion. It is measured as a share of long-term unemployed (unemployed for over 1 year) in total labour force.

[2] To ensure international comparability we used the EUROSTAT's data gathered by the European labour force survey rather than data from the SORS' labour force survey that records a slightly higher long-term unemployment rate (e.g. 4.4% in 2000).

[3] The very long-term unemployment rate is measured as the share of unemployed people unemployed for over 2 years in the total labour force.

Life expectancy and infant mortality

Life expectancy in Slovenia increased once again in 2003 – slightly more for men than women. After a short halt in the first half of the 1990s life expectancy in Slovenia began to increase again after 1995. In 1995-2003 it rose by 2.9 years for both genders alike to total 73.2 years for men and 80.7 years for women. The difference between female and male life expectancy, which narrowed from 8 to 7.2 years in 1996-2000 and re-widened to 7.6 years in 2001 and 2002, narrowed slightly again in 2003 when it totalled 7.5 years.

In 2003 the mortality rate of men dropped more than that of women in most age groups. In 1995-2000 the male mortality rate decreased in almost all age groups. It dropped faster in the age group below 65 years than in the group aged over 65. The mortality rate of women aged below 30 (being low) stagnated; in the age group of 30-64 it fell at a slower pace than the male rate while it dropped faster than for men in the group of women aged over 65. After 2000 mortality rates continued to fall. The female mortality fell in almost all age groups in 2001 and 2002. In 2003 mortality rates fell only in the group of children and in most age groups between 30 and 64 years, while female mortality in the age groups 15-29 and 65+ rose slightly. The drop in mortality rates of men was slightly slower until 2003 while that year recorded a faster fall compared to women in most age groups. At the age of 65, the gap between male and female life expectancy remained unchanged in 2003 over 2002, i.e. 4.4 years, while at the age of 85 it narrowed from 1.4 years recorded in 2002 to 1.1 years in 2003.

Slovenia's rate of male life expectancy is still somewhere between the rates of the old and the new EU member states, while it already exceeds Denmark and Portugal in female life expectancy. In 2002 (latest available data), average life expectancy in the EU-25 was 74.8 years for men (2.5 years more than in Slovenia) and 81.1 years for women (1.2 years more than in Slovenia). Spanish women continued to enjoy the longest life expectancy in the EU (83.7 years in 2003), followed by women from France and Italy (82.9) and Sweden (82.4). Men recorded the longest life expectancy in Sweden (77.9 years), Spain (77.2) and Italy (76.9). Slovenia still has higher life expectancy than other new EU member states from Eastern and Central Europe; the female life expectancy in Slovenia also exceeds the rates recorded by Denmark and Portugal. Among the present EU members the lowest life expectancy in 2003 – both male and female – was registered by Latvia (65.5 and 76.8 years, respectively).

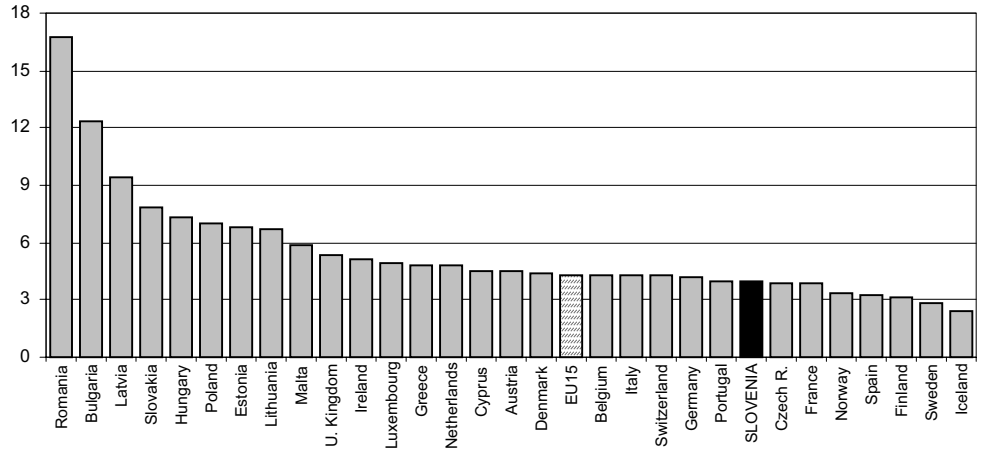
Slovenia's infant mortality rate fell to its lowest level in 2002; in 2003 it rose slightly again but remained below the EU average. The number of dead babies aged less than one year per 1000 live-born children has dropped by 75% since 1980: it fell from 15.3 in 1980 to 5.5 in 1995, hovered between 4.5 and 5.5 in the second half of the 1990s and dropped further to 3.8 in 2002, the lowest rate recorded to date. In 2003, infant mortality in Slovenia rose to 4.0, which is still less than the EU-15 average (see the table). Infant mortality in the EU-15 fell by 0.1 last year to total 4.3 dead infants per 1000 live-born babies. In 2003 the lowest infant mortality rates among the present EU member states were again recorded in Sweden (2.8), Finland (3.1) and Spain (3.2); lower infant mortality than Slovenia's was also recorded by the Czech Republic, France and Portugal. Latvia has the highest infant mortality among the present EU members (9.4 in 2003). Like in other industrialised countries, infant mortality levels are on a downward trend in Slovenia primarily due to specific preventive measures taken in the area of prenatal and neonatal health care, and due to the impact of economic growth on the common well-being of society.

Table: **Life expectancy and infant mortality in Slovenia and the EU, 1995-2003**

	1995	1996	1997	1998	1999	2000	2001	2002	2003
Life expectancy									
Slovenia									
men	70.3	70.3	71.0	71.1	71.4	71.9	72.1	72.3	73.2
women	77.8	78.3	78.6	78.7	78.8	79.1	79.6	79.9	80.7
difference	7.5	8.0	7.6	7.6	7.4	7.2	7.5	7.6	7.5
EU 15									
men	73.9	74.2	74.6	74.6	74.9	75.3	75.5	75,8	N/A
women	80.4	80.6	80.9	80.9	81.2	81.4	81.6	81.6	N/A
difference	6.5	6.4	6.3	6.3	6.3	6.1	6.1	5.8	-
Gap between the EU 15 and Slovenia									
men	3.6	3.9	3.6	3.5	3.5	3.4	3.4	3.5	-
women	2.6	2.3	2.3	2.2	2.4	2.3	2.0	1.7	-
EU 25									
men	72.8	73.2	73.5	73.5	73.8	74.4	74.7	74.8	N/A
women	79.7	79.9	80.2	80.2	80.4	80.8	8.1	81.1	N/A
difference	6.9	6.7	6.7	6.7	6.6	6.4	6.3	6.3	-
Gap between the EU 25 and Slovenia									
men	2.5	2.9	2.5	2.4	2.4	2.5	2.6	2.5	-
women	1.9	1.6	1.6	1.5	1.6	1.7	1.4	1.2	-
Infant mortality (per 1000 live-born)									
Slovenia	5.5	4.7	5.2	5.2	4.5	4.9	4.2	3.8	4.0
EU 25	6.7	6.4	5.9	5.7	n.p.	5.2	5.0	N/A	N/A
dirrerence	1.2	1.7	0.7	0.5	-	0.3	0.8	-	-
EU 15	5.6	5.5	5.2	5.1	5.0	4.7	4.6	4.4	4.3
dirrerence	0.1	0.8	0.0	0.0	0.5	-0.2	0.5	0.7	0.3

Sources: SORS, Eurostat.

Figure: **Infant mortality per 1000 live-born children in selected European countries, 2003**



Source: Eurostat.

Population in jobless households

The jobless households indicator[1] is a structural indicator of social cohesion used for the indirect measuring of poverty risk and social exclusion. Apart from low education, unemployment is the main driver of poverty risk and social exclusion. Further, a household composed of active-age members of whom no one is employed is non-stimulating since people in such environments lose contact with the reality of working life. Owing to the lack of material resources, people living in jobless households also have limited access to the means required for a decent standard of living – one of the principal objectives of social development set by the Strategy for the Economic Development of Slovenia 2001-2006. In the long run, a better education structure of the population achieved through youth involvement in education programmes, increased formal and informal education and training of adults, and an efficient active employment policy helps improve the material and indirectly also the social status of households.

In Slovenia, the share of people aged 18-64 living in jobless household totalled 8.1% in 2002. This share was dropping from 1996 to 1998, then rose to 10.2% in 1999 and began to fall again in 2000 to record a 2.1 p.p. lower level in 2002 over 1999. In 1996-2002, Slovenia's share of these people was on average 2.5 p.p. lower than in the EU-25, where the decrease was also considerably slower.

Slovenia's rates of poverty risk and social exclusion measured by the share of people living in jobless households was around 4 p.p. lower than in the EU-25 in 2002. Among the old EU member states, Belgium had the largest share of people living in jobless households (16.3%) while Portugal recorded the smallest percentage (5.4%). Considerable if slightly smaller differences were also observed between the new member states where the average rate in 2002, according to the Eurostat's estimate, was 12% (see the table). The highest rate among the new member states was recorded in Hungary (15.6%), whereas Slovenia had the lowest rate (8.1%), followed by the Czech Republic (9.9%).

[1] Potentially active households where none of the members aged 18-64 is employed.

Table: **Share of people aged 18-64 living in a jobless household in Slovenia, European Union, Bulgaria and Romania, 1996-2002, %**

	1996	1997	1998	1999	2000	2001	2002
Slovenia	9.7	9.5	9.3	10.2	10.1	9.9	8.1
EU 15	13.8s	13.7s	13.4s	12.9s	12.4	12.2s	12.1
10 new member states together	N/A	N/A	N/A	12.5s	12.6s	12.3s	12.0s
Austria	9.5	9.1	9.7	9.5	9.9	9.9	10
Belgium	16.7	16.6	16.9	15.5	15	16.5	16.3
Germany	13.8	14.5	14.5	14.1	13.8	13.8	13.8s
Greece	10.8	10.9	10.6	10.7	10.5	10.5	10.1
Spain	12.8	12	10.9	9.4	8.3	8.1	8.1
France	13.8	14.2	14.1	14	13.5	13	13.1
Irland	14.5	14	np	10.9	9.8	10	9.9
Italy	13.6	13.6	13	12.8	12.3	11.9	11.5
Luxembourg	9.8	8.9	9	8.5	8.2	8.9	8.9s
Netherlands	12.6	11.6	11.4	10.5	10.7	9.7	9.5
Portugal	7	6.9	5.9b	5.4	5.2	5	5.4
UK	16.7	15.9	15.7	15	14.4	14.2	14.3
Czech Republic	N/A	7.4	8.3	9.4	10.2	10.5	9.9
Estonia	N/A	11.7	10.1	11.6	11	12	11.3
Latvia	N/A	np	14.5	15.4	15.9	14	11.8
Lithuania	N/A	np	11.4	9.6	10.2	11.2	10.2
Hungary	18.3	18.1	18	16.8	15.8	15.6	15.6
Poland	N/A	11.3	N/A	N/A	N/A	N/A	N/A
Slovakia	N/A	N/A	N/A	11.8	13	11.6	12.9
Bulgaria	N/A	N/A	N/A	N/A	17.1	19.1	18.3
Romania	N/A	N/A	N/A	N/A	9	8.9	11.8

Source: Eurostat (New Cronos).
Notes: s) - Eurostat's estimate; b) - a break in the series; the data for Scandinavian countries (Denmark, Sweden, Finland) are missing due to differences in labour force surveys conducted in these countries - figures for households are unavailable, hence the analysed indicator cannot be calculated; data for Malta, Cyprus and the EU 25 aggregate are unavailable.

Poverty risk

The risk of poverty rate in Slovenia has been falling since 1997; concurrently, the relative risk of poverty gap has also been declined since 1999. The risk of poverty rate totalled 11.9% in 2002, indicating that 11.9% of people lived in households with a net equivalent income totalling SIT 79,172 per person[1] or less (the risk of poverty threshold). The risk of poverty rate fell by 2.1 p.p. in 2002 over 1997 (and by 1 p.p. over 2001). If income in kind is included in household income, the risk of poverty rate is even lower (9.9%) since income in kind substantially improves household income and thus reduces poverty. The risk of poverty rate calculated by including income in kind is on average 2 p.p. lower than the rate calculated by including solely income in cash. The relative risk of poverty gap[2] totalled 20.1% in 2002 (22.0% in 1999). This figure tells the people's distance below the poverty threshold and best indicates the depth of poverty. The relative gap narrowed by 1.5 p.p. in 2002 over the year before. The risk of poverty rate differs across age and gender groups, and even more noticeably across socio-economic classes. People aged over 65 record a higher poverty rate (21.4%) than children aged under 15 (10.5%). The risk of poverty rate of women has also been consistently higher than that of men. This difference even widened slightly in 2002 (the respective rates were 12.6% for women and 11.1% for men). If we observe poverty rates in different socio-economic groups we see that the highest risk of poverty rates are recorded among the unemployed (39.1% since 2002) and people living alone; within the latter, single male households have the highest poverty rate (38.4%). Compared with 2000 and 2001, the risk of poverty rate dropped in all socio-economic and age groups (the only exception were tenants whose risk of poverty rate increased slightly). Poverty risk also dropped significantly in single-parent households (18.0% in 2001, 14.8% in 2002) and in households with three or more children (18.7% in 2001, 13.4% in 2002).

According to the poverty risk and income inequality indicators, Slovenia has recorded more favourable results than both the EU-15 and the new member states; social transfer efficiency is the only area where the EU-15 average is slightly better. Slovenia's risk of poverty rate in 2001 (the latest available data for the EU are for 2001) was 2.1 p.p. lower than the average rate in the EU-15 (12.9% vs. 15%), noting that there are considerable differences between countries. The lowest risk of poverty rate was recorded in Sweden (9%) and the highest in Ireland (21%) where the risk of poverty rate is rising (see the table). Compared with the average of the new member states where household income also includes income in kind, the risk of poverty rate in Slovenia was 4.4 p.p. lower in 2001. The differences between the new member states are also appreciable. The Czech Republic has the lowest poverty rate (8%) while Slovakia has the highest one (21%; see the graph). In comparison with the EU-15 average, Slovenia also recorded lower inequality of income distribution expressed as a ratio of the highest to the lowest income quintiles. It totalled 3.6% in 2001 (the EU-15 average was 4.4%). Similarly, inequality measured by the Gini coefficient was lower in Slovenia (24%) than in the EU-15 (28%) in 2001. Compared with the EU-25, income inequality in Slovenia (according to both indicators) is even lower. The data on risk of poverty rates before and after social transfers indirectly indicate the slightly higher efficiency of the European social policy compared with Slovenia's policy. Without the social benefits granted to households by the state, Slovenia's risk of poverty rate in 2001 would have been 7.3 p.p. higher (9 p.p. higher in the EU-15).

[1] The threshold for calculating the risk of poverty rate for a four-member family totals SIT 166,262.

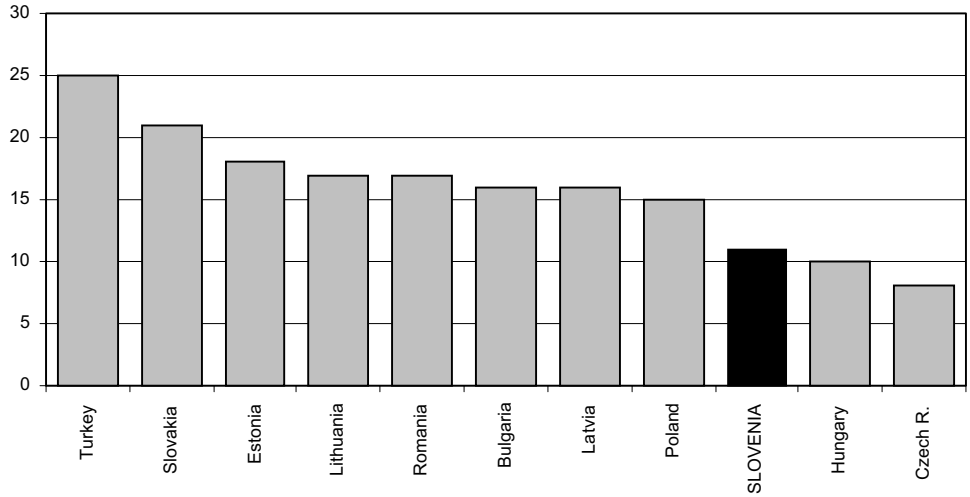
[2] The relative risk of poverty gap is the difference between the risk of poverty threshold and the median of equivalised income of people living below the threshold of poverty risk; it is expressed as the percentage gap to the poverty risk threshold.

Table: **Poverty risk rate before and after social transfers in Slovenia and the EU-15 in 1996-2002 (excluding income in kind)**

	Poverty risk rate after social transfers							Poverty risk rate before social transfers						
	1996	1997	1998	1999	2000	2001	2002	1996	1997	1998	1999	2000	2001	2002
Slovenia	12.2	14.0	13.8	13.6	13.0	12.9	11.9	np	19.5	19.8	20.5	20.2	20.2	18.8
EU 15	16 s	16 s	15 s	15 s	15 s	15s	N/A	25 s	25 s	24 s	24 s	23 s	24	N/A
Austrija	14	13	13	12	12	12	N/A	25	24	24	23	22	22	N/A
Belgium	15	14	14	13	12	13	N/A	27	26	26	25	24	23	N/A
Denmark	9	9	12	11	11	10	N/A	28	27	27	24	23	29	N/A
Germany	14	12	11	11	10	11	N/A	22	22	22	21	20	21	N/A
Greece	21	21	21	21	20	20	N/A	22	23	22	22	22	23	N/A
Spain	18 p	20 p	18 p	19 p	18	19	N/A	26 p	27 p	25 p	23 p	22	23	N/A
France	15	15	15	15	16	15	N/A	26	26	25	24	24	24	N/A
Irland	19	19	19	18	20	21	N/A	34	32	32	30	31	30	N/A
Italy	20	19	18	18	18	19	N/A	23	22	21	21	21	22	N/A
Luxembourg	11	11	12	13	12	12	N/A	24	22	23	24	23	23	N/A
Netherland	12	10	10	11	10	11	N/A	24	23	21	21	21	21	N/A
Portugal	21	22	21	21	21	20	N/A	27	27	27	27	27	24	N/A
Finland	8	8	9	11	11	11	N/A	23	23	22	21	19	19	N/A
Sweden	N/A	9	10	9	11	9	N/A	N/A	28	28	28	27	17	N/A
UK	18	18 p	19 p	19 p	19	17	N/A	29	30 p	30 p	30 p	29	29	N/A

Sources: For the EU 15: Eurostat (NewCronos); for Slovenia: SORS, First statistical release, Structural Indicators of social cohesion adopted in Laeken, 1997-2002; No. 135, September 2004. For Slovenia, we used figures that exclude income in kind to allow a comparison with the EU 15. Figures for the new EU member states on the poverty risk rates excluding income in kind are unavailable, except for Slovenia.
Notes: 'p' a country's assessment, 's' Eurostat's assessment, 'N/A' not available.

Figure: **Risk of poverty rate after social transfers in Slovenia and selected new EU member states and candidate countries in 2001 (including income in kind)**



Sources: Eurostat (NewCronos); SORS.
Notes: Data in the graph include income in kind and are mutually comparable for the analysed countries; Slovakia – data for 2003; Latvia and Turkey – data for 2002.

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