

Slovenia
in the New Decade:
Sustainability, Competitiveness,
Membership in the EU

**The Strategy for the Economic Development of
Slovenia 2001–2006**

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The Strategy for the Economic Development of Slovenia 2001–2006

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Foreword

In the period of transition, Slovenia followed a distinctive pattern of development characterised by balance and the gradualness of change. This pattern has resulted in a fairly high level of economic development and better outcomes in social and environmental development than one might have expected given the achieved level of economic development. However, some indicators point to weaknesses, especially in the areas of overall national competitiveness and integration of developmental goals with policies. This is why stable development in the next medium-term period requires **a qualitative shift in development policy** which will upgrade the current efforts focused on macroeconomic stabilisation, transitional reform and the building of an institutional framework for a market economy. The new Strategy for the Economic Development of Slovenia provides a conceptual basis for such a shift, gives the main mechanisms and guidelines for the state to implement this shift, and lays down an ambitious goal of sustainable development, implying that the three welfare components – economic, social and environmental – as well as all generations and regions are in balance. The Strategy proposes the three main instruments to achieve this goal, namely the creation of a knowledge-based society, the strengthening of economic competitiveness, and an efficient developmental role of the state.

It seems that the **current period of time is crucial** for development over the next five or ten years. Even though the transitional reforms have not yet been fully completed, the issue of how to put the country on a higher path of development, which will help Slovenia join the group of countries with the highest welfare levels, is coming to the fore. The Strategy suggests that economic policy should immediately focus on structural and development issues even though macroeconomic stability has still not been fully achieved, and calls for a modern industrial policy even though the restructuring of all traditional industries has not been concluded. We speak about investment restructuring to the benefit of information and communications infrastructure and public finance restructuring. That should provide greater funds for expenditure aimed at stimulating human capital and technology despite the current structural difficulties faced by public finances and shortfalls in the building up of traditional economic infrastructure. We also speak about decentralisation and local development incentives even though regions have not yet been formally established.

The Strategy's great ambition largely **stems from the openness of the drawing-up process**, which helped ensure that its proposals were met with wide support. The foundations were provided by 36 research projects and surveys, which brought together over one hundred researchers, as well as the simultaneous monitoring of development and economic trends carried out by the Institute of Macroeconomic Analysis and Development. Discussions took place at seven workshops and three expert consultations, each focusing on a particular theme, which attracted about a hundred participants, in the IB Review, on the Institute's web page, where the results of most research projects were published as they arrived, and through a special questionnaire on the 'new development paradigm.' A group of eleven co-ordinators made four draft versions of the text of the Strategy on the basis of research results and discussions and submitted them for revision to two independent referees, the professional public, non-governmental organisations, and experts from different

government departments. The first version of the text entitled ‘The New Development Paradigm’ was endorsed by the Government Council for Structural Policy in June 2000 and, while the Strategy was being drawn up, it was discussed and endorsed by the National Assembly’s Economic Committee and the Government Council for Sustainable Development. The Government of the Republic of Slovenia adopted the Strategy in July 2001. Its guidelines were taken into account in the Budget Memorandum for 2002 and 2003 and Slovenia’s Pre-accession Economic Programme.

Even though it involved a great deal of work and its main guidelines have been widely accepted, the Strategy will not fulfil its goal if it falls victim to the implementation gap – a problem that has been constantly pointed out. How can we eliminate this **implementation gap**?

The first task involves **monitoring and evaluating the level of development** and effectively implementing the Strategy. This is why a wide range of indicators was designed along with the Strategy in order to monitor its implementation. We will use these indicators and other analyses to make annual Development Reports, which will assess the extent to which actual development follows the Strategy’s goals and to what extent the quality of the main factors of development has been improved. The results of the Report will enable the Government to adjust the development and economic policy measures if necessary and focus its efforts on areas that will prove to be the most problematic. The Report will also be available to the public so that its comprehensive information about the outcome of development and main weaknesses will help lead to a consensus about the main development challenges and provide appropriate solutions. **An underlying consensus** on the path of development is a prerequisite of the Strategy’s successful implementation. Since consensus can only be reached through ongoing dialogue, the Strategy is being presented to different social players even now that it has been adopted, and the same will be done with Development Reports.

This is what the makers of the Strategy themselves can do to eliminate the implementation gap. Therefore, the main tasks are to translate the Strategy’s guidelines into concrete **action implementation plans** that cover programmes which are financially evaluated and brought into line with budgetary frameworks, and to ensure **effective co-ordination** in the processes of drawing up, implementing and monitoring the effects of these programmes. The Strategy’s main implementing document is the National Development Programme, which includes a set of programmes devised through inter-sectoral co-ordination with the aim of strengthening the main factors of development. The Programme is financially aligned with the existing budget and should be harmonised with realistic possibilities of providing additional funding from the EU in the negotiating process. However, development policy extends beyond financial incentives and development programmes. This is why it will be necessary to upgrade the system of development planning and especially the process of co-ordinating the implementation of development and economic policies. This is not solely a problem for Slovenia. Over the last ten years, the European Union has proved to be successful in co-ordinating traditional macroeconomic policies as it has created an efficient system of fiscal controls and obligatory co-operation of the ministries of finance in order to meet

the convergence criteria, but the Union is set to face a similar challenge in the area of development policy and the Lisbon Strategy. Slovenia, on the other hand, will have to carry out the tasks of macroeconomic and development convergence simultaneously if it wants to leapfrog one step and immediately join the group of the most advanced countries.



Dr Janez Šušteršič

Director of the Institute of Macroeconomic Analysis and Development

Introduction

Six years after designing its first Strategy for Economic Development, Slovenia should not only upgrade it and accommodate it to the new conditions, but also achieve a wide social consensus on what constitutes a modern concept of development and what steps should be taken to realise the related goals. In order to ensure the country's stable development in the medium-term period, it is necessary to put development policy on a higher quality level that goes beyond the current focus on macroeconomic stabilisation, transitional reforms, and the creation of an institutional framework for the functioning market economy in line with the European Union's rules. The new Strategy for the Economic Development of Slovenia provides the conceptual foundations for such a turning point in the development efforts, sets out the main mechanisms and guidelines for government policy, and offers an ambitious but feasible development scenario. The Strategy will not achieve its mission unless it remains an active document after it has been formally adopted: its approach and guidelines should provide a wide framework within which a consensus may be reached and economic and social agents and policy makers can make their decisions. Public discussion which took place while drawing up the document and supported its underlying approach, as well as the system of indicators designed to monitor the compatibility of actual development with projections, give further comfort that the Strategy will play an active role in development.

Reasons underlying the need to formulate a new development concept called the *new development paradigm* are as follows:

1. *Expiry of the current development pattern and a different role of the factors of development.* In the period of transition, the main tasks laid down in development strategies were macroeconomic stabilisation, microeconomic restructuring and the adaptation of the institutional framework to a market economy. The building up of an independent state, the institution of market rules and preparations for EU accession presented significant systemic changes, but they were neither concluded nor balanced and this is called the *implementation deficit*. In this period, the selection of different development alternatives was governed by (restrictive) financial arguments rather than substantive ones. It is therefore urgent to accelerate the conclusion of pending transitional tasks, but this in itself cannot ensure dynamic development in the forthcoming period. Progress will only be made if the factors of development are identified and strengthened in line with the new development paradigm.

2. *Integrated development goals.* The Strategy is founded on the underlying goal of equally treating the economic, social and environmental aspects of welfare. This should serve as a basis for integrating development activities at all levels of the planning process. Slovenia has opted for sustainable development. *Sustainable development* ensures that the needs of current generations are met without impeding future generations in meeting theirs to the same extent. The enrichment of current generations is acceptable only if it strengthens welfare resources and improves the factors of development, e.g. by investing in infrastructure, technological development, and human resources. This should improve the position of current generations and, at the same time, increase the development potential of future

generations. Sustainable development should result in a long-term and balanced improvement of all three components of welfare. Given the current levels of advancement in each of the three welfare components, sustainable development gives priority to reducing the development gap in the economy, which should be achieved without increasing the relatively narrower gaps in social and environmental fields. Furthermore, balanced development implies that welfare improvement does not take place only in some parts of the country, which is why particular attention has been given to balanced regional development, in addition to social and environmental issues. Sustainable development is therefore expressed in structural, temporal, and spatial dimensions (the components of welfare, inter-generational aspects, and balanced regional development). The focus on domestic development opportunities first of all means drawing on internal (endogenous) factors, which is in line with the changes in people's value orientations and the contemporary development orientation of the EU.

3. *Changes in the international environment.* With accession to the EU, the size of the domestic market as one element influencing economic conditions will expand significantly; this should help raise the minimum economic, social and environmental standards. The need for unification increases, while the identification of social and national particularities is becoming increasingly importance. Parallel to integration processes in Europe, the process of globalisation is deepening; the costs of production, trade, information exchange, and international operations are being drastically cut. International competition is becoming stiffer, while the role of adaptability, co-operation, openness, and training is enhancing. These two processes require an overall and co-ordinated strengthening of competitiveness and adaptability of the economy and the state to be able to take advantage of development opportunities and manage risks.

Development Goals

The Strategy's main goal is to increase the welfare of people living in Slovenia in a sustainable manner. Welfare is defined as a balance between economic, social and environmental components. Welfare also incorporates non-material aspects, such as personal development and self-realisation, social integration and security, co-operation, the development of individual and cultural identity. The realisation of this development goal should result in an overall increase in welfare as measured by traditional economic measures of development (gross domestic product per capita) as well as by new measures of development (human development index, genuine savings index, sustainable development index).

Factors of Development

The three components of welfare – economic, social and environmental – correspond with the economic, social and environmental factors of development. The new development paradigm is based on their role in contemporary conditions, while the mechanisms for implementation of the Strategy have been identified on the basis of the main shortcomings in the level of their development.

In contemporary conditions, the determinants of the *economic factor of development* are intensive internationalisation, innovation at all stages of the production process, and the development of new technologies, particularly in the field of information and communications technologies. Therefore, the main task is to improve corporate competitiveness and innovation, which is a prerequisite for active adaptation to global changes in technology. In this context, offensive restructuring of the corporate sector and development of information and communications technologies and infrastructure should play the central role. Given the current level of Slovenia's development, it is necessary to conclude the transitional restructuring of the corporate sector, it is urgent to restructure the financial and infrastructural sectors, and to continue to pursue the relatively demanding programme of investment in economic infrastructure.

The role of the *human factor of development* increases in step with the role played by know-how, innovation, the creative use and handling of information, organisation and management. The significance of infrastructure and institutions that contribute to labour force mobility and adaptability and lifelong learning is growing. The content of the human factor is changing: individual characteristics such as the level of education and health (the human factor) are accompanied by the growing importance of social relations shaped by interaction between people (the social capital). At the same time, the responsibility for social security and social inclusion is being transferred from the welfare state to the welfare society, with an increasing role being assumed by non-governmental bodies. The Strategy therefore points to the growing importance of social capital as one of the factors of social cohesion and inclusion, and stresses the need for achieving a wide consensus on the main development goals. A greater significance is attached to culture defined by the values of openness and co-operation, which should enable the establishment of personal, collective and national identities. Similar to other areas, Slovenia is facing some pending transitional tasks, particularly as regards the building of an efficient labour market and stimulating education and training, that of adults in particular.

Considering the *environment* as a factor of development means that the traditional activities of environmental protection should be complemented by activating natural resources and services and spatial facilities in order to create welfare from the environmental capital not utilised so far. From the point of view of sustainability, the environment should be protected from non-sustainable exploitation only (i.e. from inefficient and non-creative¹ exploitation) and not from any form of exploitation provided that it helps increase welfare. Slovenia has recorded substantial opportunity losses in welfare resulting from the non-exploitation of locally available resources, such as low levels of tree felling, particularly in overgrown areas, insufficient use of irrigation in agricultural land, passive exploitation of natural resources, environmental services and biological diversity, and poor organisation and the slow pace of changing the organisation of spatial activities. Accordingly, the institution of sustainable development does not imply a reduction of all pressures on the environment but only those overburdening the environment; furthermore, this may call for even greater exploitation of the environment provided that this contributes

¹ Non-creative exploitation of the environmental capital refers to the use of natural resources to produce goods that do not contribute to welfare increase.

to higher welfare. Environmental protection remains an important activity in areas where environmental capital has been degraded due to unsustainable exploitation. Protection of the environment by setting the lowest recovery standards and by the actual volume of recovery thus assumes an active role in development which must be systemically recognised and established. In the period covered by the Strategy, investment-related steps will aim at improving the infrastructure of local utility service providers, involving primarily the systems of wastewater treatment and solid waste management (landfill). In the part not relating to investment, priorities include institutional strengthening of environmental development policies, which differ from traditional environmental measures in the sense that they aim not only to minimise damage but also to optimise the relationship between welfare and environmental capital.

Mechanisms and Guidelines Aimed at Strengthening the Factors of Development and Realising the Strategy's goals

The new development paradigm, which has pinpointed the factors of development and the state's developmental role, and the analysis of Slovenia's main shortcomings have served as a basis for identifying the ***main mechanisms and policy guidelines in the economy*** which should help achieve the Strategy's goals. The guidelines are not broken down by activities, policy departments, or regions, but integrate sectoral and departmental policies, development issues of local communities and regions into clusters.

Mechanisms aimed at strengthening the factors of development and realising the Strategy's goals are as follows:

a/ Transition to a knowledge-based society The building up of a knowledge-based society will be supported by: (i) human resource development policy, in particular formal and informal education and training; (ii) labour market and employment policies complemented by migration policy, which will introduce greater labour market flexibility, stimulate labour force mobility, and restructure labour supply so as to stimulate creativity and enhance the contribution of human resources to development; (iii) the building of information and communications infrastructure and development of new services; (iv) research and development policy and technological development, which actively create a knowledge-based society.

b/ Strengthening economic competitiveness involves: (i) the creation of a competitive corporate sector capable of responding quickly to changes in technology and conditions in the world market; its competitiveness should be achieved by increasing the use of highly skilled human resources and by reducing the use of energy and natural resources; (ii) internationalisation of the corporate sector; (iii) networks of small and medium-sized enterprises; (iv) development of an efficient financial sector; (v) creation of an efficient public sector by increasing the role of private service providers and offering tailor-made services; (vi) the creation of an efficient non-tradable sector by price regulation, licensing and concessions.

A prerequisite of bolstering competitiveness is to further *pursue investment in economic infrastructure and the environmental protection infrastructure* coupled by the *development of local utility services of environmental protection* in order to: (i) ensure reliable, cost-effective and accessible infrastructure, which should reflect security requirements, the mobility of people and goods, efficient consumption of energy, and environmental protection; and (ii) ensure that all regions, municipalities and companies have equal access to infrastructural services regardless of their location and ensure that the minimum level of local utility services is provided to all citizens irrespective of their residence. Better access to infrastructure and a wider choice of infrastructural services will improve the state's overall competitiveness and make it more attractive as an investment location. The improved infrastructure will gradually create alternative development opportunities and conditions where the possibilities of sustainable development are greater and economically more attractive, thus contributing to an increasingly smoother transformation of conventional development into sustainable development.

c/ Improving state efficiency The state's organisational structure and its functioning must help increase the private sector's competitiveness, which is why it is necessary to create a flexible and efficient government capable of improving national competitiveness and attracting foreign capital by devising appropriate economic policy measures, creating a competitive economic environment, and providing attractive locations. Only a well-functioning state is capable of employing instruments leading to higher competitiveness of the corporate sector and the economy and better human resources. The quality of institutions and their functioning are nowadays on a par with other components of national competitiveness. The key elements in this area are to: (i) reform the public and state administration, which will create an organisational structure that is more appropriate for formulating, monitoring and evaluating development policy; (ii) further depoliticise and professionalise the administration and reduce the state's role in corporate management, and (iii) ensure a greater role of public finances in development, in particular by restructuring expenditure by purpose.

d/ Administrative capacity to implement policies under the EU's single market rules. The state's intervention in the economy and the regulative framework governing economic activities have to be changed in a way to create the best possible conditions for economic agents to be competitive in the EU and comply with its rules. Policies for efficient and operational integration into the EU's internal market are (i) competition policy, (ii) state aid policy, and (iii) the policy of external economic relations.

e/ Balanced regional and spatial development Regional development policy will be based on internal factors, i.e. better use of indigenous regional resources, and external mechanisms. It will aim to prevent the emergence of new depressed areas, maintain settlement, and conserve natural and cultural heritage in the whole of Slovenia. It will co-ordinate local initiatives and align them with those of the state and the EU, contribute to sectoral development programmes, and institute integrated development by including environmental strategic decisions in regional economic development plans. The mechanisms of promoting regional develop-

ment incorporate a mix of policies, including spatial planning and land policy, agricultural policy and rural development, and the conservation of cultural and natural heritage which, combined with greater independence of the regions in stimulating their own development, will help reduce gaps in the levels of regional development.

In addition to mechanisms described above, the Strategy proposes the main guidelines in the *fields of social and environmental development*. In the field of social development, it is necessary to maintain and upgrade social standards and maintain the current levels of development but, at the same time, ensure that this development is financially sustainable and not detrimental to economic competitiveness. If government policies are inappropriate and domestic companies not competitive, accession to the EU and exposure to global competition may result in negative social effects. The main mechanisms of social development policy are social insurance, public services provided in the field of social protection, and training for active economic participation, thereby preventing social exclusion. As far as environmental development is concerned, accession to the EU raises the issue of Slovenia's own development opportunities and particularities arising from its factor endowment and their relationship with opportunities offered by importing raw materials and energy. Environmental policy should enhance the contribution of the domestic environmental capital, which should be used within the limits of sustainability. This, at the same time, raises the issue of Slovenia's responsibility for global sustainable development. Environmental policy guidelines stress the importance of integrating environmental concerns in development programmes and sectoral policies, the significance of raising the efficiency of public funding earmarked for environmental protection, and deepening the environment-related public finance reform.

The Role of the Strategy

Slovenia as an independent state first formulated its overall strategy for economic development in 1995 and set it out in the document *The Strategy for Economic Development of Slovenia: Approaching Europe – Growth, Competitiveness and Integration* (SEDS). For the area of accession to the EU, this was extended and given a concrete form in *The Strategy of the Republic of Slovenia for Accession to the European Union: Economic and Social Part* (SAEU) from 1998.

Even though the new Strategy stems from the new development paradigm, it has not broken away abruptly and entirely from the old Strategy: the new guidelines will take effect gradually and be combined with the pending tasks necessary to conclude the processes of transitional restructuring and adjustment. The development concept applied so far has helped Slovenia create and maintain a relatively high level of welfare given its level of economic development. Transition to a knowledge-based economy, with created assets playing the main role in achieving competitiveness, is a new step in the same direction, suggesting that transition to a paradigm of sustainable development is more gradual and spontaneous than it might seem. The new paradigm is more an extension of than an opposition to the old one, as the latter already contained many of the elements put forward in the new Strategy. The SEDS

formulated in 1995 listed as its key goal ‘sustainable economic development in terms of environmental, social, national and cultural aspects.’ However, the Strategy failed to integrate these aspects into a single concept of sustainability and primarily focused on economic issues. Furthermore, some of its ambitions were to catch up with the level of development of advanced countries, promote integrated development, and maintain independence in the process of opening up. It also stressed the importance of internationalisation and the created factors of development, whose role strengthened in the course of time. Some of the main development guidelines, such as polycentric development, an open tradable economy, the maintaining of the relatively high social standards, and the integrated planning process (endorsed in principle) have been issues in development planning documents for the last twenty to thirty years. The new paradigm attempts to systematically integrate all these aspects into the framework of sustainable development and stresses the importance of increasing welfare, which is not an inevitable consequence of economic growth.

Even though the contents and guidelines of each succeeding development document have been related, Slovenia has no law to uniformly regulate the system of development planning. The government decree of 1993 that regulated this area no longer corresponds to the current situation. This has resulted in dispersion and inconsistency, particularly as regards finance, of many departmental development documents, particularly in sectoral and national programmes. Financial harmonisation is carried out each year in the process of drawing up the state budget when the envisaged funds are brought into line with the actual financial resources. In this process, short-term restrictive arguments prevail. In this respect, the SEDS of 1995 fell victim to the implementation gap as well, and this gap has been one of the main motives for drawing up the new Strategy.

The role of development planning documents has been partly defined in the Public Finance Act and its implementing regulations. Within the framework of drafting the state budget, these regulations identify long-term development planning documents which provide a strategic framework for drawing up a four-year state budget and for some documents made annually. The Strategy for the Economic Development of Slovenia is defined as *Slovenia’s main strategic document* that identifies factors of economic development, long-term goals, the target development scenario, and the main guidelines for government decisions. The Strategy has become a synthesised document that takes into account social, spatial, environmental, regional, sectoral and other potentials, restrictions and conditions. The Strategy provides a strategic framework for drawing up the budget and is used as a guideline in defining national development priorities and public finance macrofiscal frameworks. It also serves as a basis for the main programmes, sub-programmes, projects and activities within functional classification of general government expenditure.

Furthermore, the Strategy provides a starting point for preparing the National Development Programme of Slovenia (NDP). This is the Strategy’s implementing document, showing the national development priorities, the main programmes and sub-programmes. The NDP translates the Strategy’s guidelines into concrete programmes and projects for each priority area. The Strategy and its Implementation Reports will serve as a basis for defining priorities within the plan of four-year state

budget development programmes, which consists of harmonised investment and state aid plans for all budget spending units.

The Strategy also provides a wide framework for drawing up other strategic documents in a given area (regional development, spatial planning, competitiveness policy, sectoral policies – tourism, the small business sector, agriculture – labour market and employment policy, education policy and culture policy). The Strategy takes into account to the greatest possible extent the departmental policy guidelines already adopted which are in line with the new development paradigm, as well as documents drawn up during the process of adopting the Strategy (e.g. the Strategy of Regional Development). The Strategy's role in formulating concrete guidelines and policy measures is limited because this is an umbrella document. The Strategy has identified five main areas of boosting development and they should bring together and co-ordinate measures of different ministries and other bodies. It is the role of individual departments to translate the general framework into particular steps to be taken in individual areas of state competence. Hence the Strategy provides no measures or development directions for particular activities or sectors of the economy, but instead constitutes a single framework for their balanced development.

The Strategy therefore performs a dual function. It commits the Government to bring its underlying guidelines and activities into line with the Strategy. The Strategy promotes planning on a programme and project basis by defining the main development goals, key factors of development, and the main development policy guidelines, which then serve as reference points for other development programmes, it devises methodological and data tools used to monitor and direct development, and identifies the main activities to be carried out or supported by the state. Provided that the Strategy performs its role properly and its implementation leads to stronger competitiveness and a greater capacity to learn, concrete plans in particular areas of economic and social development should be reflected in development programmes of government departments, business strategies of economic agents and their associations, as well as in 'strategic' decisions made by individuals and communities. The Strategy, which commits the Government to appropriately devise its future measures, may be taken as a starting point by other entities in fulfilling their own particular interests. The role of Government's instruments is to stimulate other social agents to contribute to the realisation of broad social goals while pursuing their own private goals.

However, the Strategy provides a general framework not only for the Government but also for all social agents that steer development in accordance with their role. In addition to the Government and government agencies, many other social players co-operate in devising policies: the social partners, economic interest groups, the civil society, professional associations. The Strategy's task is to stimulate and direct social discussion, which helps achieve a wide consensus on the content and factors of development, and appropriate ways of their strengthening².

The Strategy's double role corresponds to the *two main pre-conditions for its implementation*: the widest possible consensus on development issues and the state's

² The Strategy is presented on the Internet page <http://www.sigov.si/zmar/aprojekt/seds/document.html>.

capacity to implement the Strategy. The two conditions are intertwined since both preparation and implementation involve the processes of learning and achieving consensus. In order to *make the state capable of implementing the Strategy*, we should carry out a substantial administrative reform (the creation of an adaptable and professional administration), co-ordinate more effectively the formulation and implementation of development and economic policies, and understand the state's modern role in directing development.

It is necessary to *achieve a wide consensus* on what constitutes modern development, what its factors are and what guidelines should be pursued to strengthen those factors, namely, development to a great extent depends on autonomous decisions made by different economic and social agents. Furthermore, the final evaluation as to whether development has taken the right direction is always subjective and reflects the preferences and desires of individuals, their values and needs. A wide consensus on social development is vital for social partnership and co-operation in fulfilling the nation's underlying goal of increasing welfare through the balanced development of all its components. In the long term, it will be impossible to achieve this goal if national producers and national culture are enclosed and protected. Social co-operation does not involve protection against the challenges of development or assistance for the survival of those who have mismanaged, it is instead the creation of conditions in which active domestic economic agents evolve into successful and internationally competitive companies and the national culture develops through cultural exchange and liaisons with other activities.

An effective development consensus can be achieved neither by state intervention nor market self-regulation; it should evolve through the dynamic and complex interaction of the social players. The process of achieving development consensus should be underpinned by attracting the widest possible circle of social players to administrative and management processes, particularly as regards the formulation of development goals and evaluation of the results, and by making it clear that the social players are responsible for their own situation and development. The Strategy therefore stresses the importance of a partnership between the state, civil society and the economy, the necessity to formulate mechanisms for non-governmental organisations and people to directly participate in decision-making processes, the importance of decentralising responsibility and competence (regions), the need to reduce the state's direct interference in managing economic activities (deregulation), the significance of ensuring human rights and basic social security for all, along with the development of an individual and collective identity.

The Structure of the Strategy

The Strategy is divided into three parts. Part one called the *New Development Paradigm* sets out the arguments as to *why* Slovenia needs to re-define its development and *what* constitutes this new development, and synthesises the underlying concepts and values of the Strategy. The Strategy, whose role is to provide a new conceptual basis, explains what changes may be considered as development, identifies the main development goals, the main factors of development relative to changes in the environment and internal conditions, and proposes a new role for the

state in stimulating development. At the same time, the Strategy attempts to put the national development problems into a wider perspective, proposing the widest possible range of choices and the longest possible time span. It deserves to be called a paradigm as long as it manages to bring into a consistent whole partial findings by experts at the end of the transitional phase of development and as long as it provides an underlying consensus on development despite some divergence in opinions about particular mechanisms of realising the Strategy.

Part two of the Strategy called the *Strategy for the Economic Development* deals with the issue of *how* to realise the new development paradigm. It identifies concrete development problems through the development paradigm, and proposes solutions conditioned by current circumstances and the available funds. This part first reveals the institutional and macroeconomic conditions necessary to implement the Strategy. They are the conclusion of institutional and structural reforms pertaining to transition and the building and maintaining of macroeconomic stability. Next, the Strategy explains the mechanisms of stimulating development and steps to be taken in the fields of transition to a knowledge-based society, strengthening economic competitiveness, improving state efficiency, policies for effective and operational integration into the EU's internal market, and a balanced regional and spatial development.

Even though the Strategy stems from sustainable development and integrated development goals, its guidelines and measures focus on the economic aspects of development and economic aspects of social and environmental development, while taking other aspects, such as cultural and value orientations, as its starting point. The last chapter in the Strategy's second part is dedicated to environmental and spatial development, which constitutes economic development, and sets out the main guidelines for the Government to be taken in these fields.

The effects expected to be produced by the Strategy are described and supported by figures in the *Development Scenario of the Strategy for the Economic Development of Slovenia*. The macroeconomic scenario cannot be taken as a forecast because of the unpredictability of economic and external factors in the medium-term period; instead it provides aggregate projections that could be achieved if the Strategy is properly implemented, and they are consistent as regards the factors of economic growth and its sectoral structure.

A constituting part of the Strategy is the *system of indicators for monitoring and evaluating the Strategy*. It will not be published as a separate publication but will serve as a basis for making the Strategy's annual implementation.

PART I

New Development Paradigm

1. Conceptual Expiry of the Existing Development Paradigm of Transition and Adjustment

The process of transition, to put it simply, means the transition from a socialist economy involving mostly socially-owned ownership to a market economy involving predominantly private ownership. It comprises two groups of reforms. The first group relates to macroeconomic stability, internal and external liberalisation and privatisation, and consists of those reforms that, on one hand, create the necessary basis for the gradual use of indirect instruments of economic policy (interest rates, exchange rates etc.) and hard budget constraints within enterprises while, on the other hand, open the way up to structural and institutional reforms – i.e. reforms of the enterprise, financial and infrastructural sectors, reform of the pension and budgetary systems, state administrative reform etc. – which represent transition *per se* and are long-term in their nature. In Slovenia, transition towards a functioning market economy is running parallel to the process of EU accession. In order to become an EU member-state as soon as possible, Slovenia has had to deal with all major reforms and changes which should guarantee faster economic growth and catching up with developed EU countries as well as the Slovenian economy's improved competitiveness.

The existing development paradigm of transition and adjustment is systematically elaborated in the Strategy of the Republic of Slovenia for Accession to the European Union: Economic and Social Part. Its key components are the following: (i) consolidation of macroeconomic stability in all its components (monetary, fiscal, income and foreign trade); (ii) structural and institutional reforms (in particular reforms of the enterprise, financial and infrastructural sectors, reform of the pension and budgetary systems) which should ultimately bolster market-economy institutions in Slovenia, free economic subjects from the negative structural characteristics of the old economic system and make them capable of fully operating within market economy; and (iii) harmonisation of Slovenia's legal, institutional and systemic frameworks with the EU.

Following the initial transitional recession reflected in negative GDP growth rates, Slovenia quickly succeeded in reducing its inflation rate substantially and achieving positive economic growth in 1993. Moreover, in the period of growth it managed to maintain a fiscal and external balance until 1997. The macroeconomic policies of stabilisation and liberalisation were successful and led to structural and institutional reforms. The main objective of macroeconomic policies was to create a stable environment and to provide room for the completion of transition and the EU integration process, whereas the main objective of microeconomic policies was to complete transition and to transform the Slovenian economy, i.e. its enterprises, institutions etc., into an economy that will not only be able to survive but will be competitive in the EU's internal market on a long-term basis. Within such general

objectives, the goals of structural policies were the following: (i) to create the conditions for increasing the level of investments necessary for sustainable economic growth and growing employment, (ii) to enhance the Slovenian economy's international competitiveness by improving the production factors markets; and (iii) to plan policies and measures providing for a socially and environmentally sustainable process of transition. So far, Slovenia has entirely or partially implemented several structural reforms, such as trade liberalisation, privatisation of the enterprise sector, bank rehabilitation, tax reform, pension reform etc., yet several structural reforms are still necessary to complete the transition and accede to the EU. The intensification of socio-economic structural reforms is in fact Slovenia's greatest challenge of the coming years. Continuous economic growth and strengthening of macroeconomic stability through accelerated restructuring of the enterprise sector, the creation of conditions to promote investments by enterprises and foreign direct investments, gradual implementation of changes to the pension system, final drawing up of the banking and financial legislation, consolidation of banks and insurance companies, and completion of the regulation and privatisation of public utilities, remain Slovenia's main economic challenges in the final establishment of a functioning market economy. However, such reforms are only partially included in the context of completing transition since in most cases this is the normal continuous transformation of the economy and society. The necessary structural and institutional adjustments are becoming increasingly linked to Slovenia's integration to the EU and to exploitation of the development opportunities arising from Slovenia's membership in the EU and the changed international environment influenced by globalisation, regional integration and the information society. These challenges will gradually become increasingly dominant.

The satisfactory level of macroeconomic stability achieved by Slovenia and the projections of the basic economic aggregates for the next medium-term period, in spite of the problems (moderate general government and trade deficit, persistence of inflation), mainly indicate the continuous strengthening of macroeconomic stability. Furthermore, the stage and envisaged momentum of structural and institutional reforms and harmonisation with the *acquis* as reflected in strategic documents (particularly in the Strategy of the Republic of Slovenia for Accession to the European Union: Economic and Social Part, the Europe Agreement, the Accession Partnership, the Joint Assessment of Medium-Term Priorities of Slovenia's Economic Policy, the National Programme for Adoption of the Acquis, the negotiating positions themselves), indicate that, in conceptual and normative terms, the process of transition in Slovenia has reached its final (yet perhaps the most complex) stage where the greatest transition dilemmas have been solved, the social players mostly agree on how to conclude the transition project, and transition is gradually being completed, as far as the adoption of a formal normative framework for a functioning market economy is concerned. Conceptual dilemmas about the completion of transition have largely been resolved by the decision to join the EU, since the selected market economy model, together with the appropriate legal and institutional framework, is mainly defined by the *acquis*. The process of transition will certainly have been completed by the time of EU accession in the formal or normative sense, namely in the sense of upgrading the legislative framework and the normative establishment of EU-compatible institutions. On the other hand, due to the implementation gap by the time of EU accession the transition process will

not have been completed in terms of substance, i.e. in the sense of the full functioning of all the necessary institutions, the public administrative reform and the restructuring and adjustment of the enterprise, financial and infrastructural sectors that ultimately would have been reflected in their appropriate, long-term competitive integration into the EU's internal market.

In the transition period, the relation between the contributions of the three welfare components have been changing. While the weakness of the existing quantitative information means that development directions should be interpreted with some caution, it is still possible to give a rough picture of the processes that in the decade of transition have led to the current situation. By overcoming the transformation crisis, economic development already improved in the first half of the past decade. In the same period, environmental development improved slightly, the agent for such improvement being the fact that environmentally unsuccessful enterprises were also economically inefficient and thus weeded out in the process of transition to the market system. However, as a result of the more efficient economic system certain social components of development deteriorated.

The Implementation Gap

During the completion of transition, an implementation gap is generated in terms of form and function, representing the difference between the formally accepted and the actual implementation thereof, between the normative and actual influence of the various social players. Such a discrepancy leads to a socio-economic system that functions sub-optimally and to the discrepancy in effects of development initiatives. If the legal order in different parts of the socio-economic system is enforced at different levels of efficiency, the solutions are drawn up partially. As a result: (i) the development balance is lower and intensifies pressure on inferior resources; (ii) "development" adjusts only to the interests of a limited number of players; and (iii) the substance of development is impoverished, financial arguments prevail over development. The efficient and uniform enforcement of the legal order reduces transaction costs (agreements, disagreements) in directing the development and facilitates the establishment of development coalitions. The implementation gap is a synonym for the lack of efficiency in the state administration, the Government and economic policies, and identifies the time necessary for the completion of transition. Its reduction is one of the key conditions for improving national competitiveness and bringing about sustainable development.

In the second half of the nineties, dynamic economic growth continued and, following the initial worsening, the situation also improved from a social point of view, particularly through the reduced growth and gradual fall in unemployment and relative poverty. The differences between particular population and social groups continue to grow. The share of women among the unemployed and job-seekers is increasing. The differences in income and assets between the various generations, statistical regions and municipalities are also changing and growing. It seems that,

in terms of the environment, development again turned into deterioration as a result of the restored economic growth without any sufficient parallel environmental improvement. This was due to non-concerted incentives and the development passivity of environmental policies related to extensive technological modernisation aimed at increasing microeconomic environmental efficiency (degradation of the environment caused by a product or service) and reducing macroeconomic environmental intensity (degradation of the environment per unit of GDP).

In terms of functional implementation, the “strategy of transition and adjustment” is thus still present and the economic policies based on it have not yet been exhausted since: (i) the provision and maintenance of macroeconomic stability remains a permanent and demanding task which will remain relevant when Slovenia becomes an EU member-state (see Chapter 4.1.2.); (ii) structural and institutional reforms as well as adjustment to the EU, particularly in terms of functionality, have not yet been completed (see Chapters 4.1., 5.2. and 5.3.). On the other hand, while in terms of substance and functionality certain aspects of the process of transition and EU accession will last much beyond Slovenia’s actual accession to the EU, in conceptual terms the transition development paradigm has mostly expired. New challenges set by EU membership as well as the processes of globalisation and the information society stand out. In conceptual and development terms, the strategy of transition and adjustment and the related policies only remain relevant as such a process has to be concluded and implementation of the new development paradigm should begin – in the sense of completing the creation of a modern European-type market economy - and as its elements are also important for the new development paradigm. Significant aspects of the new development paradigm remain the continuous strengthening of macroeconomic stability in all of its components and thus the creation of the basis for sustained growth, as well as structural changes and the better functioning of market economy institutions . In this sense, it will no longer be considered a “transition” but the continuous adjustment to the constant pressures of transformation occurring in all countries.

2. The Changed Environment for Realising Slovenia's Economic Development

The main purpose of this chapter is to present the trends or changes in Slovenia's international environment that will considerably affect future economic development. The following three processes will be very important for Slovenia's position in the world over the next decade: globalisation, the information society and EU accession, each of them having its own particular significance in influencing development directions.

This chapter consists of three subchapters. The first subchapter presents the main characteristics of globalisation and the relationship between the sometimes contradictory processes of globalisation and regionalisation in the world; the second subchapter deals with the information society being seen as a world challenge; and the last subchapter analyses the envisaged impacts of Slovenia's accession to the EU, as a regional organisation, on the Slovenian economy.

2.1. Globalisation of the World Economy

Globalisation is a very complex and contradictory process. So far, a universally accepted definition of the term globalisation has yet to be enforced in the world, and there is no general agreement on how to define globalisation. This term is used in its descriptive and normative senses. In the descriptive sense, globalisation is a process where the interdependence between goods producers and service providers increases and where decisions on the allocation of production factors are mostly taken at a global level. In the normative sense, globalisation can be understood as the liberalisation of trade and financial flows or as a process of opening up national economies. However, globalisation involves a number of restrictions at the global level that clearly cover social, human and environmental components, or the 'freedom' of globalisation could yet result in the tyranny of the strongest.

Experience shows that in formulating a strategy to respond to globalisation's challenges, for small countries like Slovenia it is reasonable to give priority to the process of accession to a regional integration from which they will successfully integrate into global production systems and international trade and finance. Thus, the economic 'Europeanisation' of Slovenia, namely its efforts towards accession with the EU as the 'parent' regional organisation, at the same time represent the process of globalisation of the Slovenian economy and the state as a whole.

The following arguments speak in favour of Slovenia preferring regional integration to globalisation: regional economic integration is the first efficient step towards benefiting from the comparative advantages of the individual economic factors

possessed by countries within a certain geographical region in the world. Regional integration is also a realistic reply to globalisation because nowadays it is still easier to globalise knowledge and technology than production and trade. For this reason, the internationalisation of production and trade will continue intensively within individual regions. This fact is supported by the agglomeration advantages provided by regional integration. Further, regional integration is a temporary shield protecting against certain negative effects of globalisation because collective protectionism extends the time necessary for adjusting to globalisation's challenges. Such "pragmatic liberalism", namely the combination of selective and temporary safeguarding measures within the universal liberalisation process, has been implemented by practically all advanced industrial countries for decades.

In order for regional integration to increase welfare in the long term, links within the region should be promoted together with strengthened regional co-operation. This actually means that the member-states of a regional integration should simultaneously globalise. Optimisation of the production structure should be achieved at the regional and then gradually also at the global level. This is particularly the case of intermediate products and components manufacturers who can become suppliers for big transnational companies in and outside the EU (strategy of maximising market shares in niches).

Globalisation dictates three possible responses of a development strategy:

a/ Flexible, continuously adaptable integration into international economic relations.

In the current circumstances, the capacity to adapt is at least as important as it is innovative. Choosing a priority production orientation in advance or supporting national 'champions' is prohibited by the EU's regulations as well as being economically irrational. The state must create equal conditions for all economic subjects to be able to find a niche by themselves or take advantage of opportunities determined by the external conditions at any given moment.

b/ Support of the adaptation of economic subjects to the substantially enlarged internal market. From the point of view of each economic subject, globalisation requires focusing on the European consumer and no longer on the Slovenian one, and the elaboration of a business strategy in the following directions in particular: (i) specialisation in the area of the greatest competitive advantages because it is impossible to survive as a producer and distributor in a big market without economies of scale; (ii) establishment of strategic links in networks among enterprises, including the acceptance of foreign investment and Slovenia's own investments abroad as well as acquisitions of local enterprises; (iii) growing importance of the strategy of imitation thanks to modern communications facilitating the rapid perception of new issues. The state should support such business directions, in particular by promoting inward and outward investment, agreements on international economic co-operation and by supporting the strategic integration of enterprises.

c/ Appropriate response to the social risks of globalisation and taking responsibility for sustainable global development. Globalisation brings about specific social risks that need to be dealt with by means of an appropriate policy of social development. The policy of environmental development should take into account both national and global welfare and the sustainable use of environmental capital.

2.2. The Information Society – the Global Development Challenge

One of the most important global changes in the international environment affecting Slovenia's future development is the phenomenon of the information society, based on the dynamic and continuous progress of information-communications technologies and on the key importance of knowledge and services enabled by efficient telecommunications network. Moreover, transition to the information society to a large extent determines Slovenia's new development paradigm. Despite the prevailing role of information-communications technology and its increasing use in all spheres of the economy, the public sector and society, it should be kept in mind that the transition to the information society is not only a technological problem but is explicitly a development problem of deep economic, cultural and social dimensions requiring the mobilisation of human and material potential and the greatest social consensus possible. Ignoring these factors will make it difficult to take advantage of the opportunities provided by the information society and avoid any unfavourable consequences for the economy (loss of competitiveness) or for the individual.

The development of information-communications technologies and services indicates that radical changes are to occur in the pattern of economic growth and development – through economic growth underpinned by intangible factors, pressure on degradation of the environment will decrease since many information-communications industries can grow without causing environmental degradation. Pressures are transposed from the environment to the individual and the sustainable limits of development change from environmental restrictions to psychophysical capabilities of users. The introduction of information-communications technology brings about radical changes in all spheres of economic and social life that are difficult to anticipate. Dilemmas will appear on how to work, how to communicate in private and social life, how to satisfy our needs, on the decision-making processes, on the greater decentralisation of administration and management, and integration into or exclusion from the information society.

What is required for the accelerated and integral enforcement of the information society is an information-communications infrastructure that is efficient and accessible in terms of price and, at the same time, promotes the development of a number of new services in the economy and in the public sector based on knowledge and information (for example, electronic commerce – among enterprises, between enterprises and customers, between enterprises and the state, between the state and individuals; teleworking, distance learning). The most important result of such a development will be increased economic efficiency and citizens' welfare – a direct consequence will be the reduction of environmental degradation per unit of value added.

States and economic agents have to respond to the above changes in the environment promptly and continuously and participate in creating the information society if they wish to maintain or increase their competitiveness in the globalised international environment characterised by liberalisation of movements of goods, services and

capital. Examples of the most successful states, particularly the USA, indicate that dynamic introduction of modern technologies considerably increases economic competitiveness. The state can significantly support such a process through a clearly formulated strategy regarding the necessary information-communication infrastructure, by supporting education and research in the development of new technologies and services, by introducing electronic commerce into the state administration's work and by deregulating the telecommunications and financial markets. Particular incentives are provided by the risk capital funds that contribute to expanding the enterprise sector and competition and to the fast introduction of new technologies. It can thus be confirmed that accelerated introduction of the information society is not spontaneous but requires a proactive policy by the state and the private sector.

The rapidity of changes in information-communications technology and infrastructure, the momentum of their introduction in the American economy as well as the globalisation of economic activity by its firms urge other continents, particularly Asia and Europe, to accelerate their transition to the information society and introduce further mechanisms to establish a competitive, dynamic and knowledge-based economy. In the mid-nineties, Bangemann's report provided a basic strategic document of the EU and the main directives for the transition to the information society. In its Action Plan (June 2000), the EU identified the actions intended to achieve the following three objectives by 2002³: (i) cheaper, faster and secure Internet access; (ii) investment in people and knowledges (European youth in the digital age, working in the knowledge-based economy, participation of all in the knowledge-based economy); and (iii) stimulate use of the Internet (accelerating e-commerce, electronic access to public services, health online, European digital content for global networks, intelligent transport systems).

The eEurope Initiative Action Plan spells out who should carry out the actions and the main methods for achieving the eEurope targets: accelerating the setting up of an appropriate legal environment, supporting new infrastructure and services across Europe, applying the open method of co-ordinating and benchmarking. The eEurope initiative should also become part of the EU enlargement process and this is particularly important for the future member-states to be able to fully participate in the processes and procedures based on the modern networks and services.

2.3. Slovenia's Membership in the EU

The new dimension of implementing Slovenia's economic development, as a result of its future EU membership, is a chance for the Slovenian economy to enter the great EU internal market, which will facilitate, on the basis of a more efficient division of labour, further specialisation and exploitation of the advantages of economies of scale in production and distribution offered by such a market. Through increased international trade and direct foreign investment, national enterprises will have easier access to knowledge, technology and the capital necessary for develop-

³ Presidency conclusions, Lisbon European Council, 23 and 24 March 2000, Feira European Council agreement on the eEurope Action Plan, 19 and 20 June 2000.

ment. In the EU's internal market, competition will be extremely strong, efficiency criteria will be more transparent and the nation-state will lose its protective role.

The new role of the nation-state in promoting and implementing Slovenia's economic development will be reflected in the following aspects: firstly, the state will lose certain essential, in particular macroeconomic, policies that will give way to the common EU level while other economic policies will be given a different content or weight; secondly, following EU accession, the position and role of individual levels of the state and the relation of supranational EU institutions to the nation-state, region or local community will change, not to mention the generally enhanced role of non-governmental organisations and interest groups, also in economic development terms.

The role of the nation-state in the promotion and implementation of Slovenia's economic development in the new context of EU membership is thus seen particularly in the formulation of an appropriate systemic framework (legislation, rules of the game, the rule of law) facilitating and supporting the generation of development-creating assets in the economy, in the process of searching for its own development impulses. In the conduct of its economic policies, the nation-state should focus on providing a stable macroeconomic environment (in as much as macroeconomic policies are still under its control), and particularly on the conduct of structural policies whereby it should monitor and support the generation and strengthening of development factors in the economy searching for its own development impulses in the competition and positioning in the EU internal market. In this context, the state's role in education, particularly higher education, and in scientific and research activities is very important.

An important factor is that the EU is itself a moving target since it is not yet clear how it will look like at the moment of Slovenia's accession. Final answers to existing dilemmas on the institutional organisation of the EU will be provided by its development in the next couple of years. The EU must deal with three important issues: firstly, how far will it move towards political integration, political federation or the model of the "united states" of Europe; secondly, how far will it move with regard to a multi-speed Europe, i.e. closer integration among a core of member-states with regard to other EU members; and, thirdly, through its own institutional reforms how successful will it be in becoming ready and capable of enlarging towards the East, i.e. integrating a number of new and economically less-developed countries.

As a small state in the process of the EU's development, Slovenia will have to pay attention to two particular issues. Firstly, what influence on common EU decisions will small states retain, or what will be the chances of adopting independent solutions in matters of vital importance for the state? Slovenia's foreign policy will have to enhance its engagement with regard to issues of specific national interests for Slovenia within the EU, as well as with regard to proposing solutions to common European problems in cases where Slovenia has specific expertise and knowledge; this especially relates to the knowledge of the situation in South-eastern Europe. In the common EU issues, Slovenia's foreign policy will have to change from a reactive to a proactive one, transform its defensive responding into the co-creation of common

policy, and implement it efficiently. Secondly, to what extent will the political integration that upgrades economic integration (in the sense of establishing a single internal market from which most development impulses of EU membership, considered in the Strategy, derives) be formulated towards supporting the benefits of the common market, and what possible negative effects will the uniform regulation have on the possibilities of adjusting and formulating the most efficient solutions in terms of national competitiveness? In this sense, Slovenia will have to support flexible institutional solutions at the EU level and insist on the principle of subsidiarity.

Following Slovenia's accession, the economic environment as the internal and external framework within which the Strategy of the Economic Development of Slovenia will be implemented, will change considerably although such changes are already gradually occurring in the Slovenian economy in the period of its preparation for EU membership. Changes affecting the Slovenian economy after accession may be grouped as follows:

- a/ As an EU member-state, Slovenia will become an integral part of the great EU internal market. Slovenia has been strongly linked to this economic area during its preparations for EU membership (actual economic integration based on intensive trade flows between Slovenia and the EU, i.e. on a strong geographical concentration of Slovenia's international trade on the EU), yet the prospect of membership gives the Slovenian economy's integration with the EU internal market a new dimension and quality. It brings new, different rights and duties for the Slovenian economy, new opportunities as well as new risks.
- b/ Following integration into the EU internal market, the remaining barriers to the free movement of goods, services, persons and capital in this market will be removed; on one hand Slovenia's access to the EU market will be easier while, on the other, the state will no longer be able to protect its economy against competition coming from other EU member-states.
- c/ Following accession, Slovenia will have to give up an important part of its national economic sovereignty and transfer it to common EU supranational institutions, however, it will participate as a member in this common shared sovereignty in proportion to its share and weight in the decision-making process concerning common issues.
- d/ Upon integration into the European Monetary Union, presumably some years after EU accession, the euro will become the national currency and Slovenia will be even more firmly integrated into the EU internal market since the remaining barriers to economic integration in the monetary field will have been removed (non-transparency of prices due to the existence of national currencies, conversion costs, exchange rate fluctuations).
- e/ After joining the EU, the Slovenian economy will no longer be a national economy in which the state controls all economic policies, but will become a regional economy in which at least some economic policies are transferred to the common level while others have a specifically regional nature.

By deciding to join in the European integration processes, Slovenia has also committed itself to assume the obligations and responsibilities of the European security environment and to assume, within its national security policy, the joint

responsibility to maintain peace, stability and security in the emerging European area. The formulation of national security policy takes into account foreign policy, economic, defence, national, environmental and the other aspects of modern security. In defence, a long-term process of developing defence security, civil defence as well as protection and rescue should be developed. The adopted and new strategic doctrine documents will support a balanced defence system in accordance with the financing system, the guidelines of the Euro-Atlantic Collective Security Pact and of NATO.

EU membership could speed up the realisation of sustainable development. In the social sphere, Slovenia could take advantage of the opportunities involved in the development of human resources, particularly in the internationalisation of education. In the field of the environment, EU membership could accelerate sustainable development by influencing the introduction of uniform minimum and/or degradation standards and technical standards for exploitation of the environment, by financing the reconstruction of degraded environmental capital, by improving transparency (particularly as to standardised reporting on the situation and policies in certain fields of environmental protection) and the system impact of environmental policy in directing development as well as in economic policy measures (introduction of strategic assessments of the environmental impacts of development programmes, integral pollution control, instrumentalisation and institutionalisation of sustainable development). Nevertheless, the quality of economic growth will continue to depend on Slovenia's development policy. EU accession is therefore a challenge to adjust the way of enforcing national development features in the context of strengthening the EU instruments for directing development. For Slovenia, one of the most obvious opportunities for protecting its national sovereignty in directing development, in compliance with the EU's regulations, is the realisation of sustainable development.

3. Sustainable Development and the Role of the State

3.1. Dimensions of Sustainable Development

The conditions to promote sustainable development in the national development strategies and the ambition of such orientations differ from one state to another even in Europe as one of the most propulsive regions world-wide in terms of sustainability. On average, the problem of sustainability of the current EU member-states is their high level of social and economic development and, compared to this, their relatively low level of environmental development. The developmental problem of the countries of Central and Eastern Europe, however, remains even after accomplishing their transition process, in their low level of economic, social and environmental development compared to the EU. In this comparison, Slovenia's starting position is quite satisfactory (see Box). Its development gap behind the EU is biggest on the side of the economy. In the context of sustainability, this situation requires a development strategy with a priority to reduce the arrears in economic development without lowering the levels of social and environmental progress. Sustainability of transition in Slovenia thus requires, above all, avoiding those economic decisions that base their advantages on undervalued or inexpensive environmental and social capital, which is a relatively easily controllable development task. What is needed is that economic policy creates consistent long-term economic

Slovenia's Sustainable Development

The available data lead to the conclusion that, *in the social and environmental sense, Slovenia is more developed today than could be expected considering the attained level of its economic progress* measured by gross domestic product per capita. A relatively high social development was assessed through an international comparison of the human development index and its components, but also by comparing unemployment levels, inequalities in income distribution, social differences, poverty and social exclusion in which areas Slovenia was not ranked below the EU average. The relatively satisfactory environmental development of Slovenia, in terms of its contribution to welfare, has been established in the reports made so far on the environmental situation, but also in international comparisons of the genuine savings index, especially the deductible items expressing environmental depreciation. Even opinions of the World Bank show that the level of Slovenian sustainable development is quite high compared to its economic development, and is closest to the Italian, British or Belgian ones – although these are not states with exemplary environmental achievements; however, these are states which, according to the criterion of GDP per capita, are quite ahead of Slovenia. The findings obtained through an international comparison according to Seljak's sustainable development index are along the same lines.

signals to determine the functionality of environmental and social capital, its renewal and improvement. Such a determination is necessary since experiences of the transition period show that the ratio between the contributions of individual development components can easily change. The development problem of sustainability, in the case of Slovenia, translates to the distinctive competitive quality of its companies and, even more so, of the state itself.

3.1.1. Economic Dimension of Development

The main development goal of increasing welfare translates in the present context of accomplished transition, EU integration, gradual transition to the information society and globalisation into the instrumental goal to increase the global competitiveness of the Slovenian state and its economic entities, and to catch up with the development of EU states by gradually closing in the gaps of efficiency and some factor intensities (environmental capital, less qualified labour force, human resources). Openness to the environment and the capacity for continuous learning, which are the most important conditions of increased competitiveness in modern circumstances, are reflected in the economy as:

- a/ *Gradual transition to a knowledge-based economy and society* whose competitiveness is based on the assets created with the focus on developing the human factor in its broader sense, and accelerated technological development as the basic conditions for narrowing the efficiency gaps. This not only concerns the so-called new economy based on information/communication and other new technologies with new activities and organisational forms, but also the introduction and promotion of elements of the knowledge-based economy within the “old” economy, shaping the rules of the game adapted to new conditions, and a more efficient public administration.
- b/ *Extensive internationalisation* of all activities. Implementation of the strategy is largely based on exploiting the development potential of EU membership which consists of: (i) in the economic sense, an extremely large internal market and high purchasing power on one side, and an equally high level of competition on the other; (ii) in the social sense, an integral social offer which creates a high social cohesion; and (iii) in the environmental sense, internationally co-ordinated development focused on promoting the environmental contribution to welfare to allow Slovenia to fully harness its comparative advantages in this field.

The push towards the knowledge-based society and internationalisation is motivated by the factors of international competitiveness, the specific features of Slovenia, and the significance of EU membership:

- a/ *Today, the international competitiveness of states and companies is determined primarily by created assets* (like, for example, the results of research and development, qualified work force, information technology and infrastructure, social capital and culture, protected environment and spatial structures) which, as a result of the know-ledge-based economy, are becoming ever more important factors of competi-tiveness compared to natural assets. Due to increasing costs

and transaction shares in total costs, the development of created assets often requires companies to extend their markets and production capacities to other states which offer better (the best) business opportunities. This makes useful both the input and output internationalisation with a greater variety of organisational forms (trade, contractual co-operation, networking, acquisitions and mergers, foreign direct investments) which include both competitiveness and co-operation. Internationalisation offers companies the advantages of economies of scope, specialisation, exploiting the global alternatives (in purchases, production, sales, financing, personnel, taxes, research and development etc.), and the advantages of integrated international production. In this light, even the issue of the competitiveness of Slovenian exports is not primarily a macroeconomic issue (movements of labour costs and the tolar rate), but above all a microeconomic or structural one because of the obstacles in developing the created assets (insufficient intensity of new companies entering in the new and old activities due to administrative and other barriers; dispersed ownership and the resulting inefficient governance of companies which hinders restructuring and strategic connections and, consequently, the preservation of old and non-prosperous production programmes, lack of innovations, new products and entrepreneurial initiatives).

The stress on the created assets in competitiveness also means that the social and the environmental component of development have ceased to be only a restriction or the measure of quality, but have themselves become important created assets of development, by directly contributing to the positive effects of economic policy and by creating social capital and social consent to development. In addition, various activities in the social and environmental fields are becoming independent and profitable economic activities which satisfy the sophisticated demands of the ever more conscious population (e.g. the production of environmental protection means, waste management industry, multifaceted cultural industries), intertwining at the same time with other activities (e.g. tourism, multifunctional agriculture) as important components of the state's competitive advantage.

b/ *Slovenia has certain specific characteristics which require and stimulate the internationalisation of economic activities.* They primarily concern the small size and openness of the domestic market. The domestic market's smallness is probably the strongest engine of internationalisation since companies are less and less in a position to base their growth on domestic market only. This is going to become even more evident after joining the EU. The domestic market's openness means this market is relatively speaking becoming even smaller. Conversely, a large and open foreign market, especially the EU internal market, serves as a strong magnet for the internationalisation of Slovenian companies.

c/ *From the point of view of reducing the development gap, EU membership will bring about two crucial changes.* First of all, the Slovenian economy cannot become an equal player in the internal market unless it quickly develops new created assets. Secondly, an ever larger part of economic activities will become flexible with respect to location which means that now, more than ever, the holders of these activities will be able to adapt to the changes affecting their costs and expenditures, and will locate their activities wherever they find the most favourable

conditions. The creation of favourable conditions for doing business, an attractive economic-political framework and living environment are therefore essential not only to attract foreign investment but also to prevent the ‘brain-drain’ and the emigration of business activities from Slovenia.

Slovenia can use the developmental impulses of EU membership only through the gradual *move from a defensive approach* marked by the end of transition, meeting the conditions for joining the EU’s internal market, and the capacity to use resources from the EU development funds, *to a more offensive approach* in taking advantage of its opportunities. EU membership and the economic system’s adaptation do not guarantee development by themselves but only create opportunities for *better use of the country’s own development potential* by activating the ‘endogenous’ factors – those that are autonomously controlled by the instruments of national economic policy. An offensive approach also means that economic subjects will have to regard the EU’s internal market increasingly more as their own domestic arena, accordingly adapting and planning their permanent restructuring and development. This above all means the active input-output internationalisation of the activities of economic agents (production, service, financial, and partly infrastructural activities). Such an approach requires the identification of the main specific advantages which determine the competitiveness of a company, and restructuring in the sense of focusing on the most prosperous activities. Only the economic subjects can competently establish their specific advantages, while the state has to support their offensive adaptation through the human resource development policy and by increasing their competitive ability.

3.1.2. Social Dimension of Development

Globalisation and pressures to increase the economy’s competitiveness, the effectiveness of the state and the public sector culminate in social risks. Competitive pressures on the labour market may result in higher unemployment, while opening this market up bears the risk of an irrevocable drain of quality human assets and, on the other side, immigration pressure. These processes may widen the social and regional gaps and marginalise specific groups of people. They are often combined with the creation of non-democratic and anti-globalisation values and movements. More and more sophisticated technology also means that differences in education not only affect an individual’s possibilities as a bidder in the labour market but they increasingly bring the risk of greater differences in people’s access to welfare or in their ability to make use of development’s results. The key task of the social development policy is therefore to control these risks and strengthen the social capital that the society has available.

The determination to install integrally viewed welfare as a strategic objective puts the human being into focus, a person’s needs and interests, the quality of life, and *human development* in the most general sense. It is based on expanding the possibilities and conditions to be able to choose. In order to achieve this, each person should enjoy at least *three basic conditions*: a long and healthy life, access to education and information, and access to resources that enable an appropriate living stan-

standard. Human development cannot be achieved only by supplying material goods and financial resources for adequate social security levels. Co-ordination of social development with economic possibilities is not enough; what is necessary is its inherent, contents-wise modernisation and the creation of a social policy based on a modern approach. The social development policy will try to achieve *two goals* in particular: to ensure solid social security and to allow and promote social inclusion. Therefore, it is above all necessary to lead an equal opportunities policy oriented towards facilitating social participation and the awakening of people's active roles in changing their own lives. The active role of people and the focus on their own responsibility for their situation will mitigate the problem of the so-called 'moral hazard', when a dispersed and non-selective social security system makes people passive receivers of support.

Orientation of the strategy to welfare and human development also means that the final evaluation of the relevance of social development may only be offered by the people who are part of this society. The prevailing *values and opinions of people* therefore greatly define which feasible development ways a certain society has at its disposal. Research shows that economic development and globalisation in the modern world are accompanied by the transition from the materialist to the post-materialist system of values. The social development goals are no longer restricted to material production growth but highlight the quality of life and human relationships. Even as regards the values of the Slovenian population it seems that they are in a similar 'transition', but the experience of post-socialist changes is characterised by the coexistence of contradictory attitudes. Acceptance of a market economy, stressed individualism and mutual competition exist together with egalitarian principles of income distribution and a high appreciation of social security. Determination to join the EU and the replicating of Western standards are combined with a high level of national homogeneity, ethnocentrism stressing national cultural identity and state sovereignty. On the other hand, obstacles to openness and internationalisation show a low level of democratic culture as reflected in the lack of trust in personal relationships, intolerance, and xenophobia.

Particular elements of such a complex of values may represent a serious barrier to the implementation of openness and the learning-based strategy. Its successful implementation therefore requires a broad *consensus concerning the basic values and opinions*. This can be achieved by underlining the Strategy's integrative goals which try to guarantee for each individual the conditions allowing their intricate development and social integrity, keeping the material differences within the socially acceptable limits while still encouraging development, and by promoting those elements of the Strategy which may increase the possibility of the active survival of individuals and economic agents in a globalised world, especially the development of human assets and competitive capability.

An important role in shaping values as elements of human and social capital is borne by *culture*. Culture helps develop creativity, imagination, flexibility and cooperativeness, while the development of national cultural identity increases social cohesion and adds to creating fundamental social consent concerning the promotion of developmental potential and a creative response to the challenges of globalisation as a cultural phenomenon. The important issue in the field of culture in the modern

world is democratisation, because it increases the cultural participation of citizens (both active and passive), the accessibility of culture and cultural heritage, openness, development of cultural pluralism and decentralisation going from the state down to the regional levels and civil society. Integral conservation of cultural heritage means inserting it into everyday life and in the consciousness of people as part of their living environment and economic activity. A modern cultural policy must therefore be shaped so as to encourage active involvement in the international cultural exchange aimed at creating an open multicultural society, and the development of individual and collective identity, while at the same time guaranteeing the integral preservation of cultural heritage.

Besides education and qualification, *health* is also an important component of human capital. Accordingly, health forms part of social welfare and is an indicator of the development level by reflecting the physical and psychosocial conditions of life in a particular country. Healthy people are more productive and have more opportunities to participate in social and economic activities. Promotion of the development contribution of human resources therefore requires the state's systematic activity to promote healthier lifestyles by raising awareness and providing the basic conditions to achieve this goal. People's awareness of the responsibility for their own health has to be raised, but it is also necessary to protect the rights of patients. The role of non-governmental organisations operating in this field is to increase. The progress of knowledge and new technologies will aggravate the issue of how to control the technological risks which can directly affect the health of people – for example, by the uncontrolled development of biotechnology and food-processing technology.

In the next few years the costs of health insurance will grow for demographic reasons and because of new therapeutic methods. It will therefore be necessary to define in detail the contents of mandatory and voluntary insurance; in the latter case the risk rating of the insured will have to be taken into account as well. Another necessary step will be to prepare measures to reduce absenteeism as an important restrictive factor of competitiveness. Priorities will have to be determined in providing health care rights, and conditions of asserting those not directly linked with treatment will have to change. The structural reform within the payment system of health care costs will guarantee higher equality and justice for citizens coming from various regions, and a changed or adapted system of financing the service providers, thus promoting a higher quality of health care services. Despite these changes, it is necessary to ensure equal access to health care, especially through the system of outpatient clinics and by regulating the relationship between public institutions and private concessionaires.

3.1.3. Environmental Dimension of Development

The Strategy's aim to equally treat the economic, social and environmental dimensions of development means that, if economic growth in its conventional sense wants to at least keep the same level of environmental degradation, it can only be increased to the extent to which the environmental intensity of economic growth is reduced. Here, efficient environmental protection and reduced environmental wastefulness of economic growth directly increase potential economic growth.

Improvement of the environmental efficiency of Slovenian *companies* in the past decade was primarily a response to market demands (for example, acquisition of the certificate on meeting the ISO 14000 standards of doing business, and other relevant ISO standards). The voluntary measures of companies are still an important mechanism, while in future encouragement to increase the environmental efficiency of companies will become ever more explicit (directive on integral control of environmental impacts prevents companies from freely choosing technologies when economically more acceptable and environmentally better technological possibilities exist); in future, the economic-political measures will act in this direction even more systematically, above all the price, taxation and environmental protection measures which dictate the use of natural resources, especially energy-related ones.

Aggregate indicators point to the *excessive environmental intensity* of past *development*. Energy intensity is twice the EU average, while the share of exports based on natural resources is higher than Slovenia can afford since it lacks any large stock of economically interesting mineral and energy raw materials. Typically defined ‘dirty industries’ contribute one-fifth of value added to processing activity and employ over 40,000 people. In the late nineties, their production and export levels were increasing faster than the average. The net contribution of expanded exports to the welfare of society as a whole may in future greatly increase only if we manage to link the factors which speed up export growth with the factors which affect the environmental load. The welfare effect of the environmental restructuring of companies will be favourable since the sustainable rehabilitation of dirty industry means that it is justified to demoralise only that particular economic capital with a negative global welfare effect and not each one that has a negative impact on the environment.

Because of its broad dependence on imported raw materials and energy stock and its openness to foreign trade, Slovenia is a small yet, interest-wise, a *global agent of sustainable development*, responsible for promoting the latter at home and abroad. In order to keep the current level of consumption and economic activities, Slovenia has to be a net importer of environmental capital, and a net exporter of final products or services. It is not unsustainable if one country relies on the surpluses of environmental capital of the other – on the condition that it succeeds in covering the welfare debt to present and future generations at home and abroad. Covering the current costs because of devalued environmental capital is a responsibility of the present generations while, in respect of the future ones, it is primarily necessary to cover the opportunity costs of devaluing non-renewable natural resources.

It is of great importance for a country with a modest raw material background to support global sustainable development initiatives, especially in its traditional raw materials purchasing markets. This is another reason why Slovenia declared its sustainable development orientation first at home, and then elsewhere in the world, as was defined for the whole world in Agenda 21 (UNCSD, 1992), and for the needs of directing the EU development enforced in Agenda 2000 (DOC/97/6). In line with the development orientation of the Strategy, Slovenia is expected to be most innovative in promoting sustainable EU projects and initiatives focused on the Southern and Eastern parts of Europe.

3.2. Modern Role of the State

a/ The state as a democratic social agent. Globalisation and international integrations are now, more than at any time in the past, narrowing the room for arbitrary policy-making. The reduced costs of international economic co-operation and the increased education levels of people have enabled a large part of the entrepreneurial sector, and individuals, to directly link up with international networks. International exchange is no longer restricted to goods and services but more and more encompasses information and cultural goods, and also political and philosophical standpoints. The increasing flexibility of production factors and the increasing availability of data on the economic efficiency of states are becoming an ever more important economic restriction which punishes the wrongdoings of governments with unfavourable economic results. Savers and creditors, financial investors, foreign investors, highly qualified experts may quickly respond to any inadequate policies of governments which harm the competitive ability of the economy and restrict economic initiative. Restriction is also noted by the higher number of private and public organisations which publicly assess the operational quality of governments and the institutional system of countries. An extremely important role is assigned to the EU which, within the framework of the accession process, monitors harmonisation of the candidate-countries' legislation with its own, and the results of their policies. Governments' operations are also restricted with the ever more general practice of transferring their functions to politically independent institutions, the increased transparency of decision-making and by supporting the negotiations with a broad circle of interested agents of society.

Information and knowledge in a modern society are becoming more and more disperse, while individuals and subjects in society are obtaining greater alternative work possibilities. All these changes have increased the autonomy and significance of the self-organisation of society, while the state in its managerial role is growingly restricted both at the national and supranational levels. Stricter limitations on governmental operations, on the one hand, limit their possibilities to act while, on the other hand, they reduce the risk of huge errors in policy-making, thus at least partly resolving the problem of a discrepancy between socially optimal ruling and the private interests of political decision-makers.

With the increasing role of learning and flexibility in competitiveness, the operation of governments has become an important factor of the global competitiveness of countries. For this reason, the role of the state in directing economic and social development has to be different to before. The state can induce development only as a democratic agent, which means in co-operation and partnership with other important agents in society – social partners, entrepreneurial groups, civil society or non-government organisations, professional associations, regional and local initiatives within the framework of regional economic groups and international institutions. Of course, the government preserves the responsibility of a societal agent by adopting the measures of economic and developmental policy.

b/ The state's strong concern for the rule of law and safeguarding ownership rights.
The autonomous integration of individuals into the life of a society requires the

comprehensive protection of their human rights, citizen and consumer rights in relation to the state and other disproportionately strong agents, as for example multinational companies and the media. An efficient market economy system requires a legal basis which provides market agents with the freedom of economic initiative and makes sure that the state's intervention in the private sector is transparent, efficient and suitably limited.

Since the market economic system is based on private ownership and the freedom of private initiative, the ownership right is one of its central legal institutions. If the ownership right is to be an engine of an efficient economy, it has to be legally defined and assigned to a particular subject. The legal order has to ensure that ownership rights are exchanged with the lowest possible transaction costs and that they are protected against unjustified interventions of a third party in order to avoid uncertainty in the market and such increased risk of exchange where the majority of subjects would renounce it. Therefore, the key goal of a state in fixing rights is: (i) with an efficient legal order to reduce transaction costs, including the costs of protecting these rights; and (ii) determine and distribute rights in such a way that without the exchange or after it they are allocated so that their application brings the highest yield possible. Efficient rules should reflect stable expectations of the participants in the exchange, otherwise their exchange value would be reduced, because their transaction costs are increased. It means that the regulations should 'arbitrate' disputes or arrange relationships among subjects in such a way as the majority of subjects would do if they had access to

Structural and Development Policy

Structural policy aims at establishing a competitive economic structure by implementing structural and system reforms in the entrepreneurial sector (privatisation, regulation, competition legislation, bankruptcy legislation), financial sector, economic infrastructure, labour market (social security reform), public and local administration (transparency and criteria of efficient performance), regional development, agriculture, pension and health insurance etc. Structural policy affects the structure of production, productivity, models of innovation and international competitiveness. Its typical elements are the policy of internationalisation, the policy of protecting ownership rights, competition policy, technological-information policy, research and development policy, policy of information society, trade policy, and the policy of foreign direct investment, education, regional policy, environmental policy, a large part of fiscal policy, transport policy etc. Their successful implementation depends on an appropriate understanding of the state's role which has to be based on a partnership with other agents in society.

Development policy is the set of all policies that support the improvement of development factors, long-term preservation of the development balance and the increase of sustainable welfare. Long-term economic development is feasible only by investing in key development factors (economic, human and environmental ones) and optimally contributes to increased welfare only if accompanied by suitable efforts for the social and environmental components of development.

all the information and the possibilities to negotiate solutions without restrictions, where no one is under pressure or incapable of understanding the negotiations and the transaction.

Of course, the assignment of rights by itself is not enough if their protection and execution is not guaranteed by the state with its enforcement mechanisms. If the judicial system does not operate efficiently, namely in line with the rules and relatively quickly, the risks of contractual subjects becoming involved in certain legal actions are increased. This results in lower expected gains from transactions which weakens the motivation to conclude any business. There may be a resort to concluding other businesses, perhaps with similar economic effects, but from the point of view of contractual parties they are less efficient because of the excessive costs of complying with the regulations for these transactions. Another phenomenon that occurs involves various events in society with a negative effect on the entire order of the society, for example corruption.

In Slovenia, the problem of the vague definition of ownership rights is most critical in the real estate market. Since the record of ownership rights on real estate in the form of a public and complete cadastre is not provided and since many real estate items are still undergoing a denationalisation procedure with a dubious result, many opportunities for efficient investments and transactions remain unused. The real estate market is thus inefficient and the offer is insufficient compared to demand and needs of labour mobility. Therefore, in the field of ownership rights the most important tasks concern regulating the real estate market (setting up records on ownership rights on real estate and ending the denationalisation process). Radical interventions will also be necessary in the field of the judicial system's efficiency, especially to increase the efficiency of the courts and the legal procedures themselves.

c/ Central role of the structural and developmental policy. EU membership will weaken the significance of classical macroeconomic policy, especially as regards short-term measures to ensure the national economic balance and achieving the macroeconomic goals (economic growth, low inflation and reduced unemployment). As regards the active exploitation of the development impulses created by EU membership, the development and structural policy is more important. In this sense, economic policy has to focus on (i) promoting and supporting economic subjects to start identifying and actively employing their specific competitive advantages in the international environment, especially the EU, but also more widely, and (ii) upgrading of the traditional instruments of macroeconomic policy with structural and development policies which operate through horizontal measures of 'microeconomic' policy of strengthening competitive ability, and through the stimulative and co-ordinating role of the state in various developmental partnerships where government agencies are only one of the participants. The state has to focus on stimulating improvement of the existing, and developing the newly created, assets to strengthen the competitive advantages of companies and Slovenia as a whole, that is on the accumulation of the human capital, promotion of technological development and innovativeness, establishment of flexible institutions to support the market economy, bolstering of social cohesion and openness.

In planning developmental or structural policies, the state has to consider the following principles: (i) in the first place, the policy has to derive from the actual needs of society, especially its economic agents as articulated by them. At the same time, the policy has to make sure that its measures reach their targets (prevention of so-called 'rent-seeking'); (ii) policies always have to be viewed in their mutual connection, that is, in their interdependence and interaction. The policies have to focus on issues and themes which often, if not in most cases, means to overcome the sectoral action and putting as a priority the need for co-operation among ministries; (iii) policy has to be transparent (the state has to clearly specify what and how it will operate), long-term oriented and combined with the state's clear determination regarding their implementation. Another indispensable element of the policies should be integral monitoring and evaluation of development not only in its economic contents but also the social and environmental ones.

d/ *The state's developmental role is becoming decentralised*. The partner-like role of the state includes a partial transfer of development incentives, the funding and the competences for their implementation to the regional level. This enhances the endogenous development of regions based on their internal development potential, complemented by measures for attracting new companies and investments. The policy of sustainable regional development is becoming a common denominator of a series of specific policies at the level of the state or individual regions (spatial planning, agricultural policy, promotion of small business development, tourism, preservation of natural values and biodiversity by creating protected areas, cultural heritage). Slovenia also has to firmly base its development on developing those regions which are an important generator of economic growth and allowing them to develop their own innovative potential and to overcome the current dispersion and insufficient connection among local communities.

The neglect of the regional level and, accordingly, inefficient regional policy have increased the inter-regional differences in Slovenia since independence. This has weakened economic and social cohesion and means the non-optimal utilisation of development potential. Joining the single European market will even increase the problem of the uneven regional distribution of development effects. It will result in direct connections of regional economies with the neighbouring regional ones outside national territory. At the same time, globalisation will increase the role of location as the space where economic activities are carried out. This will increase the significance of regional development focal points and their influence on the state's competitiveness. The problems of regional development will therefore not be resolved by simply relying on market mechanisms, nor on non-co-ordinated sectoral policies which ignore the regional effects.

Slovenia's development is strongly influenced by both its towns which, today, are crucial generators of development, as well as its countryside. An open town with countless possibilities of interactions in a relatively small space is an important development factor for a number of activities which are typical of the new economy and based primarily on entrepreneurship and the creativity of individuals. Equally, the countryside is changing its role as well, though it lags behind the

urban areas. The development arrears of the countryside are closely connected with its weaker economic infrastructure, which is also reflected in the more explicit presence of agriculture in the economic structure of these areas.

e/ Lower direct involvement of the state in the economy and public services. The changed role of the state will also be reflected in the fields of securing the public interest, especially as regards the operations of public services. The state should more and more become the regulator and monitor of the performance of these services, but not their major provider. This will require increased commitment and responsibility to regulate the contents, conditions and standards of providing public services. The state has to ensure organised monitoring of the situation in all spheres under its competence, information-communication systems and the necessary analytical and professional basis for the development and regulation of these spheres. In future, a basically larger share of implementation will be assumed by non-state operators who will be included in public services networks on the basis of concessions. Through the necessary regulation of the concession relationships, the state will secure the public interest, ensure the availability of services on equal conditions for all beneficiaries of public services and the necessary quality of services. The privatisation of state ownership for performing public services will be gradually carried out wherever possible so as to ensure greater cost effectiveness, while at the same time adequately protecting the public interest.

While the state's withdrawal from directly managing public services and economic infrastructure is a general phenomenon of today's world, the specific problem of Slovenian transition is the state's withdrawal from direct management of commercial companies. The problem is multifaceted and shown in the high share of state ownership in commercial companies, political and partisan influences in selecting the boards of large companies, and in indirect ownership through para-state financial funds. The problem can be solved transparently and in the long run only by selling the state's share in companies and by privatising the financial sector.

PART II

The Strategy for Economic Development

Realisation of the Strategy's goals depends on three sets of factors:

- a/ The first set relates to the conditions Slovenia needs to fulfil so that different agents can effectively implement the Strategy. It covers the conclusion of institutional reforms pertaining to transition and the building of macroeconomic stability (Chapter 4).
- b/ The second set of factors incorporates mechanisms and instruments whose common denominator is the concept of the complex competitiveness of the state. This concept defines competitiveness as a measurable capacity to produce internationally competitive products and services in a way allowing its citizens to enjoy sustainable development and satisfactory living standards (Chapter 5).
- c/ The third set of factors relates to the environmental and social aspects of sustainable development (Chapter 6).

4. Institutional and Macroeconomic Conditions Necessary for Implementing the Strategy

4.1. The Conclusion of Transitional Institutional Reforms

Slovenia is a country in transition known for its gradualist and consensual approach to institutional reforms. Such an approach managed to cushion the transitional shock, particularly in the early period of transition, and minimised people's uncertainty and social tensions. This helped achieve a high level of social consensus on the main transitional tasks. However, in later phases of transition this consensus gave way to the compromises between partial interests, which led to procrastination concerning some urgent reforms. As a result, direct political interference in the economy remains strong and some industries and labour market segments are over-regulated. Such conditions contribute to the persistence of the implementation deficit. The conclusion of pending institutional reforms therefore calls for more than just the spontaneous activities of economic and political agents or a mechanical adoption of the EU's legislation. A firm decision must be made to bring the remaining 'transitional tasks' to an end actively and as soon as possible.

Important segments of the economy are still in the process of transforming into competitive and efficient sectors capable of coping with the challenges of open international competition. They are sectors still dominated by monopolies or weak market structures protected in one way or another from the pressures of international competition. They include financial intermediation (banking, insurance), economic infrastructure (energy, telecommunications, local utility services), the public sector

(state administration, science, health care, education, culture) and agriculture.

In the *corporate sector*, three issues pertaining to transition will have to be addressed to boost competitiveness: (i) remove all administrative barriers to companies' entries and operations and build an environment conducive to business; (ii) establish an appropriate legal framework and practice in the areas of competition, intellectual and industrial property, standards and certificates, company law, state aid, and public procurement; (iii) set up an efficient ownership structure and corporate governance, and conclude the defensive restructuring of privatised companies; (iv) immediately financially restructure non-privatised loss-making companies, which includes the separation of vital parts from non-vital ones and the privatisation of the former by strategic investors.

Despite some progress, the *financial sector* is still not internationally competitive in terms of soundness, efficiency and costs, as well as the diversity of products and services. Steps to further restructure the financial sector are broken down into three groups: (i) competitiveness and restructuring, including privatisation; (ii) regulation and supervision; and (iii) full harmonisation with the *acquis* of the EU.

As far as *public utilities* and the *improvement of economic infrastructure* are concerned, the main pending reform tasks are: (i) formulate a pricing policy aimed at ensuring high-quality infrastructure and prices that reflect actual production costs; (ii) further strengthen competition and increase the involvement of the private sector, including the privatisation of existing facilities; (iii) set up an appropriate legal and regulative framework to give users a greater say in the issues of providing infrastructural services and developing infrastructural sectors.

At the same time, an appropriate *legal framework* to allow the *functioning of an efficient market economy* is not yet fully established.

Amendments to the *labour law* will reduce barriers that prevent employment flexibility and, at the same time, provide more suitable ways of protecting employees. The over-regulation of certain professions will also have to be reduced. The labour law regulating collective industrial relations is not harmonised with a number of conventions of the International Labour Organisation and EU documents. Collective agreements must reflect the true and free will of all parties involved and should not be documents that are drawn up because of legal requirements or the threat of sanctions imposed by a third party. The period of the old labour law is now coming to an end and workers and employers have managed to set up authentic and autonomous organisations, which has enabled the state to withdraw from regulating some areas of labour relations. Associative labour relations are being transformed into contractual relations.

As far as *environmental protection* is concerned, persistent institutional weaknesses result in the failure to enforce laws and introduce appropriate institutions, which leads to a deepening gap between the levels of planned and actual environmental development and the low contribution of the environment to development. It will be necessary to integrate the system of state institutions, environmental protection instruments and the institutions of sustainable development.

In the area of *regional and spatial policy*, Slovenia should set up efficient organisational structures to co-ordinate and stimulate development efforts at a regional level, which will enable efficient use of development potential in circumstances of high administrative and political decentralisation. Slovenia will also need to reform the current system of spatial planning and exploitation of natural resources.

Laws will have to be amended to enable more *flexible organisation of the judiciary* and the specialisation of courts of law to reduce the high level of backlogs. Procedures may be accelerated by means of information technologies. The introduction of free legal aid services and the toning-down of the role of the notary public will allow citizens to enjoy greater equality before the court of law than now.

4.2. Ensuring Macroeconomic Stability

The fundamental condition for effective implementation of the Strategy is the stability of the main macroeconomic aggregates; this constitutes the main tasks of traditional macroeconomic policies, i.e. monetary, incomes and fiscal policies.

Since independence, macroeconomic policies have been relatively effective in stabilisation efforts. The three-digit annual inflation rate seen upon establishing monetary independence in October 1991 dropped relatively fast in the first half of the nineties. The pace of cutting inflation slowed down in 1996-1998, while in the first half of 1999 annual inflation dropped to 4.3%. The introduction of value-added tax in mid-1999 and the strong rises in oil prices again pushed annual inflation up to 9%. Core inflation climbed as well because of shocks spreading through production processes and the internalisation of these shocks. As inflation also rose in the EU, the difference between the average annual inflation in Slovenia and the Maastricht convergence criteria remained roughly the same. In the oncoming period, it will be necessary to cut inflation more drastically in order to meet the Maastricht criteria. Macroeconomic policies will not suffice to do that, the ongoing and planned structural reforms will also have to be implemented more vigorously.

The relatively successful macroeconomic stabilisation seen in the first half of the nineties was primarily due to moderately restrictive monetary and fiscal policies, which eased pressures to increase the Government's domestic and international borrowing by maintaining public finances in balance (surpluses were even seen in some years). Since 1993, the average annual economic growth rate has been over 4% and Slovenia managed to maintain a public finance balance up to 1997 and an external balance up to 1999 (the current account deficit never exceeded 1% of gross domestic product up to 1999). The trends of a widening general government deficit and rising inflation recurred in 2000 and the deficit in the balance of payments persisted. Even though inflation and the terms of trade were mainly shaped by the rising oil prices, they were further deteriorated by long-term internal factors. The Government's priority will be to bring these trends to a halt because they are beginning to hamper implementation of the Strategy's goals (see *Development Scenario of the Strategy for the Economic Development of Slovenia*).

It is therefore urgent to stop the negative trends in public finances and the balance of payments if Slovenia wants to realise the Strategy's goals. The general government deficit leads to destabilisation, mainly because it pushes interest rates up if it is financed by domestic sources. This directly leads to higher costs in the corporate sector and higher inflation, and indirectly to lower private investment caused by tougher borrowing conditions and the transfer of domestic savings from the private to the government sector, thus hindering economic growth. If the general government deficit is financed by external financial resources, the deficit in the balance of payments rises, leading to external disequilibrium. It is difficult to justify the current level of deficit from the macroeconomic point of view, particularly as there was an

Public Finance Deficit According to the GFS and the General Government Deficit According to the ESA

In Slovenia, the public finance deficit is defined as the deficit of consolidated public finance 'budgets' consisting of the state budget, compulsory pension and disability insurance, compulsory health insurance, and municipal budgets. Slovenia's public finance accounting standards used in recording these transactions are based on the standards from the Government Finance Statistics (GFS) recommended by the International Monetary Fund. It is particularly important that flows (general government revenue and expenditure) are recorded on a cash and not an accrual basis, the latter of which is used in business accounting and national income accounting (adaptation of the GFS to the national accounting standards is foreseen only for the next version of the GFS).

Within the framework of preparations to participate in the multilateral process of monitoring and co-ordinating economic policies, which is now taking place in the Economic and Monetary Union, candidates for accession to the EU must submit to the European Commission notification about the level of public debt and the general government deficit each year before becoming full members. Slovenia has also committed itself to bring its national accounting and fiscal reports submitted to the EU into line with international standards of national accounting (SNA) and the European System of Accounts (ESA) of 1995. This is particularly important for the monitoring of progress made in meeting the Maastricht convergence criteria necessary for accession to the EMU and the euro zone (the two fiscal criteria: deficit and government debt). This commitment has been taken up by the Ministry of Finance and the Statistical Office of the Republic of Slovenia. This means that the current method used in calculating the deficit will have to be significantly modified. This involves a wider coverage of transactors (public funds and other missing institutions of the government sector will have to be added) and transactions (the institutions' own revenues, some environmental taxes), the introduction of the accrual principle in recording transactions (particularly important for interest on government debt), adjustment of the fiscal to the calendar year, changes to the consolidation method and others. No final calculations are available at the moment, but there are indications that government debt according to the ESA may be higher than that calculated on the basis of the GFS. This suggests that its reduction may be an even more difficult task than currently appreciated.

economic upturn in the last few years (high economic growth, falls in unemployment), because the deficit narrows the manoeuvring space for economic policy's anticyclical measures taken in the period of lower economic performance. The general government deficit invariably leads to higher public debt, unfavourable conditions for further borrowing, greater exposure to exchange and interest rate risks and a higher share of interest payments in general government expenditure. This in turn puts upward pressure on the tax burden. The EU's guidelines, which should be endorsed by Slovenia as well, are to gradually eliminate the public finance deficit in the oncoming years.

The deficit in the current account of the balance of payments also produces destabilisation effects, particularly when it is the cause of higher external borrowing and a higher burden of interest payments, or when it is financed by inflows of short-term speculative capital, thus affecting the stability of the domestic currency. However, a sustainable and moderate deficit may be stimulating if it contributes to fast economic growth, reflects investment opportunities, inflows of foreign direct investment or loans to profitable investment projects of the exporting sector. This is why a moderate deficit is envisaged in the macroeconomic scenario of the Strategy.

Maintaining a stable macroeconomic environment in the preaccession period is of utmost importance because accession to the EU will significantly change the role of monetary policy and bring some changes to conducting fiscal policy.

Two issues are raised in this context. First, what is the definition of a stable macroeconomic environment for Slovenia as a region in the single European market or the EMU and, second, what can Slovenia's policies do to contribute to such an environment? In order to give a clear answer to these questions, we shall draw a distinction between the period before Slovenia's accession to the EU and the period from accession to integration into the Economic and Monetary Union (EMU).

In the first period, Slovenia will maintain its monetary sovereignty (independent monetary and exchange rate policies), but this sovereignty is diminishing by obligations taken to liberalise capital flows. The range of monetary policy instruments

What is ERM2?

This is a mechanism used to manage exchange rates and is based on the principle of fixed exchange rates allowing some room for movement. What is the difference between this regime and Slovenia's managed floating exchange rate? A country participating in the ERM has an official exchange rate that has been negotiated with the European Central Bank; it should be in equilibrium, however, the definition of 'equilibrium' is not given. This exchange rate should be kept within certain boundaries (like Greece, Slovenia would probably be granted a wider band of 15% on either side of its official rate). The exchange rate moves freely within this band, so it resembles the managed floating exchange rate; however, the official rate and the upper and lower limits make it look more like a fixed exchange rate. The official rate may be changed, but only in exceptional cases and in agreement with the ECB. As a currency moves towards its outer limit, a country must intervene in the foreign exchange market, while the ECB may do the same even though this is not obligatory.

at Slovenia's disposal is already shrinking in this period, whereas risks related to the unpredictability of short-term capital flows are increasing.

In the second period, i.e. after accession to the EU, Slovenia will formally become a member of the EMU, but with a derogation as regards the euro. According to the EU, the shortest possible period from accession to the EU and the introduction of the euro is two years. This is feasible if a country enters the Exchange Rate Mechanism (ERM 2) immediately upon accession to the EU. Several EU representatives have recently pointed out the importance of achieving 'real convergence' in addition to the Maastricht criteria for introduction of the euro. This allows the EU to exercise discretion towards individual countries and postpone accession to the EMU to the point in time considered suitable by the EMU members.

A member of the ERM 2 still enjoys monetary sovereignty, but its manoeuvring space is very limited. The consequences of Slovenia joining the ERM 2 are the loss of independence in devising exchange rate policy which is instead agreed together with the ECB, transition to a mechanism of fixed and yet flexible exchange rates, and a move from monetary to exchange rate targeting, meaning that interest rates will have to be closely harmonised with the EU's interest rates. The same goes for inflation.

Monetary policy must be credible and should maintain stability, however, bringing inflation down to EU levels is not the task of monetary policy alone. It should not over-tighten monetary targets, which would have negative effects on economic growth. Cuts in inflation can be strongly influenced by fiscal and incomes policy, particularly in the environment of cost-push inflation, as well as by structural and microeconomic policies. Only co-ordinated policies will allow inflation to drop to EU-comparable levels. There are two areas where Slovenia can have a strong direct impact on reducing inflation: rules governing indexation and relative prices, i.e. prices under the Government's direct control. As long as there is formal indexation of interest rates, Slovenia cannot be compatible with the EU. The abolition of indexation mechanisms should be gradual because businesses will otherwise replace the official mechanisms with spontaneous ones. As far as the indexation of wages and pensions is concerned (these mechanisms are used in the EU as well), inflationary pressures will be reduced by replacing automatic indexation with ex-ante indexation. The gradualist approach to interest rates is subject to monetary policy measures and the deepening of the domestic financial market. In an environment where a large number of high-liquidity government securities are listed on the stock exchange, a reference interest rate may be established to replace the tolar indexation clause through price movements of these instruments and their implicit returns. In the long term, the reference interest rate should drop to EU levels in line with the liberalisation of capital flows and adjustments to exchange rate policy, and similar drops should be seen in banks' interest rates attached to the reference rate in step with the competitiveness of the financial sector. When adjusting relative prices to the EU, we should make a distinction between discrepancies that reflect the lower level of Slovenia's development compared to the EU (e.g. lower wages contribute to lower prices in service sectors) and discrepancies due to administrative measures. Within the limits allowed by active policies of privatisation, liberalisation and bolstering competitiveness of the energy sector, transport and local utility services, it will be

necessary to gradually liberalise prices still under government control. It is too often neglected that this not only pushes price indices up but also produces deflationary effects as these activities begin to rely on self-financing rather than on budgetary support. Liberalised prices will reduce inflationary pressures after a balance has been established in the market. Since it will not be possible to fully liberalise prices because of the nature of some prices, primarily in the areas of natural monopolies and economic infrastructure, the Government should draw up an appropriate regulative framework.

Monetary policy will be profoundly changed by the introduction of the euro as domestic currency. If Slovenia wants to take advantage of all development opportunities offered by the single and stable EU market, introduction of the euro should be its primary goal. The introduction of the euro would, for our trade within the EU, eliminate the cost of currency conversion and exchange rate risks, and even more importantly, the greater compatibility of prices would stimulate competition and trade, thereby producing positive effects on lowering inflation and accelerating economic growth. Following introduction of the euro, Slovenia will no longer have its own monetary policy; it will have a (minimum) say in devising the EU's monetary policy and the task of implementing it. This suggests it will not be able to buffer short-term external shocks or neutralise the trends pushing inflation beyond the EU average or leading to lower productivity relative to the EU average by adjusting the tolar's exchange rate to maintain the price competitiveness of exports and employment, which to some extent Slovenia will be allowed to do in the ERM 2. Despite these dangers, less developed EU countries have also opted for the euro since the benefits outweigh the drawbacks. It would be harder for them to achieve the stability offered by the euro on their own.

Introduction of the euro will narrow the manoeuvring space of Slovenia's policy-makers. Their concern for stability will be reflected in incomes and fiscal policies and not in monetary policy, and primarily by moving the focus from macroeconomic to microeconomic or structural policies whose main goal is to boost the productivity and competitiveness of the economy. It will be the role of employment and education policies to enable sufficient labour force mobility and flexibility, contributing at the same time to corporate restructuring and preventing the micro problems of competitiveness in some sectors of the economy spreading to Slovenia as a whole.

The EU's macroeconomic framework, as defined in the *Broad Economic Policy Guidelines of the EU* published annually, will be valid Slovenia as well. These guidelines provide a point of reference, which Slovenia's macroeconomic policies will have to target to in the forthcoming years. These policies will evolve as follows:

Monetary policy. Monetary policy's main goal is to gradually reduce inflation to levels allowing integration into the EMU. This will ensure the domestic currency's stability and the stability of the macroeconomic environment. The Bank of Slovenia will continue to pursue a restrictive monetary policy, particularly by keeping money supply in check, thus helping to bring inflation down. Slovenia's main goal in this area is to become a member of the EMU. For the time being, Slovenia will retain its managed floating exchange rate; in the long term exchange rate volatility should ease, which will allow Slovenia to gradually join the euro area after the liberalisation

of capital flows and accession to the EU. Monetary policy will go through three phases. Until accession to the EU, monetary policy will be focused on the liberalisation of international capital flows, the alignment of laws governing the Bank of Slovenia with the *acquis* and the introduction of open market operations. After accession to the EU and ERM 2, Slovenia will strengthen its co-operation with the ECB in line with the already mentioned rules. In this phase, it will be necessary to abolish formal indexation mechanisms, reduce inflation to the level of the Maastricht criterion and prepare for introduction of the euro. After joining the euro area, participation in the EU's monetary policy will involve co-operation in drawing up and passing decisions of the ECB and implementing the EU's single monetary policy.

Monetary policy priorities are as follows:

- a/ the liberalisation of capital flows with the rest of the world;
- b/ the introduction of the reference interest rate through open market operations and the deindexation of interest rates; and
- c/ integration into the ERM 2, i.e. a fixed exchange rate system allowing certain fluctuations, as a transitional period before entering the euro zone.

Incomes policy. Incomes policies of EU member-states fall within national responsibility so accession to the EU will not change Slovenia's incomes policy significantly. In line with Slovenia's current practice and the broad guidelines of the economic policies of the EU, incomes policy's goal is to keep real growth of the gross wage per employee below the rate of labour productivity growth, which should help reduce inflation and create the conditions for companies to increase investment in technologies, markets and human capital, leading to improved competitiveness and higher employment. Within the system of social partnership, this goal will be achieved by improving representation and professional support, improving adjustment formulas that link wage growth to inflation (by moving to ex ante indexation without automatic adjustments to inflation), and by developing employee profit-sharing schemes. The system of collective agreements in the public sector is planned to become more centralised, which will be supported by a single regulation of the system of public servants and by setting a more appropriate wage scale. Wage policy in the private sector will be subject to social dialogue between the Government, trade unions and employers. The Government's underlying orientation is to retain centralisation at the level where the common elements of wages policy are negotiated, such as the wage adjustment mechanisms and the minimum wage laid down in the wage agreement, while the details are defined by trade unions and employers in collective agreements for individual industries. The Government will support the process of reducing the gap between the minimum and basic wage. At the same time, incomes policy will pursue the goal of more equal wage and income distribution in order to ensure social stability, however, performance-based differentiation will have to be retained.

Incomes policy priorities include:

- a/ an agreement on wages policy in the private sector, which should ensure wage

growth is lower than labour productivity growth; and
b/ a systemic regulation of wages in the public sector.

Fiscal policy. Steps taken in the field of fiscal policy are subject to the EU's fiscal controls exercised even before Slovenia's accession to the EU; these controls aim to increase transparency and stability. Within the EU, it is up to the member-state to determine the volume and structure of its public finances, but there is a growing tendency to harmonise fiscal issues. The main restrictions in devising policy are fiscal capacity and the legal regulation governing control mechanisms. For political and economic reasons, all countries are making efforts to increase the transparency and efficiency of fiscal policy and administration. Slovenia has adopted most of the laws to achieve this; however, in the period of accession to the EU harmonisation with policies and guidelines formulated by common EU institutions will have to be enhanced.

Fiscal policy's strategic goal is to restructure general government revenue and expenditure, which should help boost economic competitiveness and bring public finances into balance without increasing their share in gross domestic product.

General government expenditure needs to be restructured because its current level relative to GDP cannot be sustained without additional government borrowing and because its current composition and non-flexibility do not allow public finances to contribute more to economic development. In the next few years, general government expenditure will have to rise more slowly than gross domestic product and its level will have to be brought gradually into line with the level of general government revenue. In order to be able to allocate more expenditure for development priorities while realising the above goal at the same time, it will be necessary to reduce the volume of expenditure prescribed by law, bring to a halt the rising share of expenditure allocated to salaries in the public sector, increase the transparency of expenditure for certain purposes, particularly sub-sidies and social benefits, and increase the efficiency of managing public funds. This reduction will be gradual because the need for easing fiscal burdens, particularly to stimulate investment, is at odds with the need to have high-quality public services like in EU countries. For a small country like Slovenia, it is relatively more demanding to provide these services and they can only be ensured by cutting costs in the process of public sector reform. It is therefore urgent to give more emphasis to the transfer of some of the tasks of providing and financing public services and goods to the private sector.

Macroeconomic projections – which forecast export growth higher than gross domestic product growth in the medium term and the lagging of household income and domestic final consumption behind economic growth – point to the gradual fall of general government revenue relative to gross domestic product despite the envisaged changes to the tax system. In order to increase the volume of public finances to offset these falls in revenues, it is necessary to consistently collect taxes and contributions, expand the tax base by reducing the level of relief which is often unjustified (particularly in corporate income tax and personal income tax), and increase non-tax revenues, i.e. capital and concession revenues and donations from abroad. After accession to the EU, Slovenia is expecting to receive EU assistance funds which will help increase its general government revenue. If Slovenia is forced

to balance its public finances by increasing domestic sources despite the EU aid, Slovenia will have to consider the possibility of introducing new taxes, particularly in areas not taxed so far (property, ecological taxes), and raising certain tax rates, while taking into account the effects on economic competitiveness. Parallel to these efforts, it will be necessary to restructure the existing tax sources, particularly to reduce the taxation of labour (lower rates in personal income and payroll tax and higher rates of taxation of consumption) with a view to bolstering corporate competitiveness.

As far as the general government deficit is concerned, Slovenia's goal is to eliminate it gradually; however, the dynamics of this elimination and the viability of a short-term general government deficit should be examined in light of the facts that the share of public expenditures in gross domestic product cannot be reduced significantly in a short period of time and that, on the other hand, concern for competitiveness prevents raising taxes above the current levels.

Fiscal policy priorities are as follows:

- a/ The restructuring of general government revenue and expenditure, which should help boost economic competitiveness and gradually bring public finances into balance without increasing revenue relative to gross domestic product.
- b/ Involve the private sector in providing public services and transfer a part of these services to private funding.
- c/ Use the proceeds from the sale of government assets to reduce public debt.

5. Mechanisms to Achieve the Strategy's Goals

Chapter 5 sets out the main mechanisms for achieving the Strategy's goals. The common denominator, or the conceptual foundation, of these mechanisms is the 'concept of the complex competitiveness of the state', which defines the national economy's competitiveness as a measurable capacity of manufacturing internationally competitive products and services in a way that ensures sustainable development and sufficiently high living standards. This definition relates the issues of international competitiveness to the fundamental issues of development. A synthetic indicator and indicators of the various factors of complex competitiveness give the business world an insight into national environments of business opportunities, they enable governments to compare the efficiency of economic and development policies, and also allow civil society and the social partners to review and examine the development of democracy and the rule of law. And with the help of measures of living standards, social cohesion and sustainable development these indicators enable an assessment of the quality of a country's development paradigm.

Although Slovenia's rank among 49 countries⁴ in the IMD's assessment of complex competitiveness improved from 40th to 35th place in 1998-2000, this in itself conceals stagnation at lower levels or even the deterioration of some factors. Undoubtedly, there is space for improving Slovenia's complex competitiveness. Slovenia's shortcomings are shown especially in the sets of government, internationalisation, financial markets, science and technology. If we look for the common denominators of shortcomings, indicators in which Slovenia's rank was below 40th position, we find that these are a lack of synergy and social consensus on development, insufficient adaptation to globalisation, insufficient customer orientation, orientation to short-term results to the detriment of sustainable development, inefficient state administration, and excessive national protectionism. According to the report of 2000, the set 'science and technology' was the only one to regress, by four positions, which was due to companies' insufficiently realised development function and the fact that they were not connected to research institutes.

The main mechanisms to achieve the Strategy's goals presented in this chapter include the orientations of active structural and development policies which will help improve the state's complex competitiveness in all the stated fields in the years to come. These orientations, along with those in the social and environmental fields which are presented in Chapter Six, and with an appropriate stabilisation policy after completing the transitional reforms presented in Chapter Five, form a consistent set of tasks for realising the Strategy and achieving its goals.

⁴ In its World Competitiveness Yearbook 2000, the Institute for Management and Development from Lausanne used 290 competitiveness indicators divided into eight groups to measure the competitiveness of 47 countries. In 2001 the methodology was changed but this did not affect the content of the analysis.

The main mechanisms to realise the Strategy are:

- a/ *Transition to a knowledge-based society.* This mechanism includes policies for developing the human factor (especially formal and informal education and training), for improved labour market flexibility, for managing migration flows, for developing information and communications infrastructure and new services, and for strengthening R&D activities and technological development, which together represent active realisation of the knowledge-based society and are key elements of increasing companies' competitiveness. These policies will contribute to greater complex competitiveness especially in the sets 'human factor' and 'science and technology'.
- b/ *Strengthening the economy's competitiveness.* The second main mechanism involves policies relating to strengthening the corporate sector and economy as such. These include company restructuring and improving the corporate sector's competitiveness, developing an efficient financial system, and developing efficient economic infrastructure. These policies will contribute to improved complex competitiveness especially in the following sets: domestic economy, management, internationalisation, financial market and infrastructure.
- c/ *Improving state efficiency.* One of the two essential features of this mechanism is the reform of the public and state administrations, which will also enable more appropriate organisation for planning and following (i.e. evaluating) of development policy. The other important issue here is the restructuring of public finances, which will enable their developmental role to be bolstered. Thus, complex competitiveness in the set government and public administration will improve.
- d/ *Policies for Slovenia's integration into the EU internal market.* Primary policies for efficient and operative integration into the EU internal market are appropriate policies of competition and state aid, and external economic relations. Through these the regulative framework will adapt in such a way that it will be possible to create the most favourable conditions possible for the economy's competitive functioning within the European rules.
- e/ *Balanced regional and spatial development.* The mechanisms of regional development comprise a network of numerous policies, from spatial planning to land or agricultural policy and rural development, through to the conservation of cultural and natural heritage which, combined with greater independence of the regions in stimulating their own development, will help reduce gaps in the levels of regional development.

5.1. Transition to a Knowledge-based Society

The knowledge-based society is increasingly becoming a reality. The OECD states that at least half of the gross domestic product of member-states is based on production, dissemination and the use of information and knowledge. According to the European Commission's definition, the knowledge-based economy is a combination of three main factors: (i) new information-communications technologies, which are a new product as such, and above all bring about a radical change in the production paradigms of all sectors, in the organisation of work and workplace contents; (ii) innovation and especially research, which represent an increasing part

of the value of products and services; (iii) education and training, which are becoming essential if workers are to adapt to technological changes and if companies are to develop innovative skills.

5.1.1. Knowledge as a Factor of Production

Knowledge is becoming an increasingly important factor of production and factor of national competitiveness, while an increase in investment in knowledge and in people is inevitable on the way towards the knowledge-based society. Sufficient investment in education and training is a prerequisite for increasing the economy's competitive capability (technological development, information and service society, public administration reform) and, at the same time, it is important for relieving the current and future problems of the labour market, reducing the social exclusion of vulnerable groups of the population, ensuring the conditions for higher living quality, and for creating social cohesion.

According to some quantitative measures of education capital, Slovenia is lagging behind the developed countries. Younger generations, however, are prolonging their initial education and are entering the labour market better educated and trained than the generations before them. In the area of educating children and young people, Slovenia is drawing nearer to the developed countries of the EU, but is achieving substantially less favourable results when comparing adults' achieved level of education and their incorporation into adult education programmes. As far as the level of adults' incorporation into education programmes is concerned (31% in 1998; in the majority of other countries included in an international study this level is around 40%), Slovenia is ranked among those countries which have just started to introduce the lifelong learning concept.

The results of assessing the functional literacy (prose, document and quantitative) of the Slovenian population are worrying, in both absolute terms and in comparison to other countries included in the international research by the OECD. The lion's share of the adult population in Slovenia (60% to 75% depending on the type of literacy) aged from 16 to 65 does not achieve the literacy level necessary for a technologically developed information society. Among the twenty countries included in this research, Slovenia is located at the bottom of the list - together with Chile, Poland and Portugal. Development here in the near future, however, will demand not only a higher level of functional, but also an increase in e-literacy, as well as good knowledge of several foreign languages.

The key issues of development in the field of the population's education in Slovenia are the low level of incorporation of adults into education processes, the low share of adults in tertiary education compared with the EU member-countries, and the low level of functional literacy. The latter is characterised by disproportionate distribution of writing skills among the population, and the high influence of the age and education level of an individual and their parents to the level of these skills.

The problem of the low qualifications and formal education of elder generations is also reflected in the high share of non-qualified people among the elder and all

unemployed, which increases the persistence of unemployment in Slovenia. It is true that, by the end of the 90s, the unemployment level was lower than that of the EU, however, in Slovenia it has remained between 7% and 8% for the past few years, while in the EU it has been falling relatively quickly. The persistently high share of non-qualified job-seekers and the strong presence of long-term unemployment indicate the predominantly structural character of unemployment. The share of unemployed without professional education remains at around 47%, despite the drop in the number of registered unemployed persons. Also, the extent of long-term unemployment is unchanged (measured as the share of the unemployed seeking employment for over a year, in the total number of unemployed), at a level exceeding 60% of all registered unemployed persons. Women, those who are older, and disabled persons also face greater problems in seeking employment.

In the coming years (especially in the second half of this decade) demographic trends will cause a gradual decrease in the supply of labour and thus employment policy will not only deal with the issues of greater labour force employability, but also with establishing the conditions for its re-allocation and the issue of activating the non-exploited, or under-exploited, human resources. This means that activity in future years will focus on the efficient allocation of labour and a sufficient absorption capacity for taking over, applying and developing knowledge. Potential problems in the labour market will also result from the still relatively high share of people employed in the agricultural sector and in those industrial sectors with a low level of added value. The lack of workers and experts in the technology, mathematics and computer fields has already started to appear in the labour market. The lack of these professionals, as well as the lack of well-educated and skilled workers in general, may become an important limiting element of development in years to come. The state's only possible response to the challenges and risks brought about by globalisation, information society development and incorporation into the EU is to provide the opportunities for achieving good education and qualification levels to as many people as possible.

5.1.1.1. Education and Training

The reform of the formal education system in the 1990s brought about a number of changes and novelties which - from the viewpoint of better preparing the younger generation to enter the world of working people - have been shown to be correct. The curricular reform emphasised implementation of the targeted programme planning, introduction of diverse methods and techniques used in working with pupils and students, and their active role in the teaching process. In the future, the programmes will have to become even more target- and problem-oriented, and interrelated.

The EU leaves its member-states absolute decision-making power in regulating national education systems. However, accession to the EU, ensuring higher competitiveness and the unsatisfactory situation revealed in the assessment of the population's functional literacy emphasise the need to provide good education at all levels.

The ever quicker pace of technological development is increasing the problem of harmonising technological needs and training which cannot be managed only through continual prolongation of the attendance of the young into primary education. Namely, today a lot of knowledge becomes obsolete even before it has been used. This is the reason why the lagging behind in education levels cannot be reduced by merely prolonging primary education and increasing the attendance of the young generation into secondary, graduate and postgraduate education. We can only reduce it through the simultaneous higher attendance of adults into education and training, and by carrying out the lifelong learning concept.

In the field of education, the state's strong presence can be felt in both terms of financing and implementation. By opening private schools in Slovenia, here the offer and demand for education are also more harmonised. This is especially so in fields where effective private demand and the state's interest to facilitate the versatility of supply suffice to cover education costs. The state is thus partially withdrawing itself as a direct provider of education and training services, however, it is retaining its regulatory role. The higher competitiveness of education and training providers in the national market will contribute to the improved quality of education through the necessary transposition of international standards, openness, and the interrelation and co-operation of domestic education institutions with foreign ones.

In the coming years, the creation of national qualification standards and recognition of the qualifications of individuals achieving these standards (certification system) will lead to a higher modular concept of programmes (transition from a subject-oriented to problem-oriented concept of programmes). It will also facilitate and increase the possibilities for the higher individualisation of education and thus enable people's better and faster adaptation to technological requirements. The recognition of knowledge acquired through work, self-education and in shorter forms of training will also improve the qualification structure of the population, which is now predominantly based on reports and other proof of education from the formal education system and it will have a positive effect on the extent of public expenditure involved.

Initial education in public education institutions at the primary and secondary levels of education will, in most cases, remain general, with the emphasis on basic knowledge. Fundamental knowledge, including so-called key knowledge - knowledge and skills in communication, problem-solving, group work, decision-making, creative thinking, computer science and continual learning, as well as social knowledge and skills - enables individuals to adapt to the constantly changing technological and organisational conditions and mobility in the labour market.

The true relationship between general and job-specific knowledge in vocational and professional schools will have to be established above all by incorporating general knowledge into discussions on professional problems. In the future the state's role in professional education should continue to shrink while the influence of employers and unions should increase, especially at the local level. This also comprises the decentralisation of management, greater autonomy of schools and teachers, adaptation of education contents to local environment needs, modernisation of programme contents and their implementation in the sense of transition from the

subject- to the problem-oriented concept, higher connection with the world of labour, attendance of the increasing numbers of adults into acquiring higher levels of professional education and improving their knowledge.

The development of tertiary education so far focused on increasing numbers of students (improved accessibility) will have to be reinforced with instruments providing higher quality studies and upgraded student mobility (decrease in losses - dropouts, repeating the same year). The development of post-secondary professional schools operating outside the high school system will have to be stimulated in regional centres which - as far as the available human resources are concerned - lag behind the average. Due to the fall in numbers of the young generation, the university education system will have to, even more than until now, orient itself towards lifelong learning which not only means the traditional graduate and postgraduate education of adults. Contents promoting entrepreneurship and creative co-operation and focusing on the creation of inventions and innovations will have to be incorporated into education and training at all levels, but especially at the level of tertiary education.

In line with the already signed Bologna Declaration, Slovenia too will follow the novel reforms in European countries in the field of post-secondary education in the years to come. The main subject here is the move towards shortening the duration of graduate and postgraduate studies (three- to four-year-long graduate studies; acquisition of a master's degree in four to five years of graduate and postgraduate studies, which are gradually becoming a whole; acquisition of a doctor's degree in eight years of graduate and postgraduate studies), the introduction of a credit points system, establishing of the system of comparable university or graduate levels and the accessibility of detailed information on their contents. By defining common basic standards and introducing national credit points systems, the possibilities for increasing the mobility of both students and professors will increase. The declaration namely binds the signatories to accelerate co-operation in ensuring quality and to connect at the inter-institutional level in the field of studies and research.

Adult education and training will be of key importance in following years for developing the ability to adapt that is necessary for a successful competitive appearance in the global market. Taking into account the decentralisation of information on the needs of economic agents, a free private choice of education programmes may be more efficient than the direct state-guided system, especially in the field of adult education. This is why, especially in this area, it is reasonable to provide different forms of the state's co-financing of the costs of education which leave the choice of education contents to individuals (for instance, vouchers or individual education accounts, or suitable programmes of the active employment policy).

The key measures to be taken in the field of education are:

- a/ Increase in total (public and private) investments in education and training, especially in the field of adult education, also by introducing individual education accounts and appropriate employment policy programmes.
- b/ Providing high quality education and training at all levels of the education process. Development of the certification system on the principle of acquiring publicly

recognised education in different ways. Particularly at the university or graduate level, the flexibility of education, international mobility and comparability of results should be increased.

- c/ Raising the education level of adults and implementing the lifelong learning concept. Development of counselling services for adult education in every region, including for education for personal and other needs not related to work activity. Orientation of measures for stimulating the attendance of adults in education programmes especially towards the unemployed, to inactive persons and those with a negative attitude towards education, and to potentially active persons who would take part in education programmes if certain conditions were met.
- d/ Improving the writing skills of the entire population and their more uniform regional distribution via a selective system of financing education and counselling services for adult education in regions and via regional strategies for raising the level of such skills, and increasing the participation of adults in education and training.
- e/ Increasing the level of responsibility and motivation of employers for the education and development of employees through diverse mechanisms (preparation of long-term and medium-term employee education plans, set the company's education goals, organise education and training counselling for the employees, establish self-learning centres, inter-corporate education centres).

5.1.1.2. Employment Policy

In 2000 Slovenia began to implement an employment policy programme which follows the employment policy orientation of the EU. The common directions reflect the new conditions and challenges. The fundamental pillars of the policy, however, will also remain unchanged in coming years: increasing the employability of the population (first pillar), promoting entrepreneurship (second pillar), facilitating and stimulating individuals' and companies' adaptability (third pillar), as well as providing equal employment opportunities for both sexes (fourth pillar). The national labour market and employment development strategy until 2006 has set as its basic goals to raise the education level of the population, to reduce discrepancies in the labour market, to increase employment hand in hand with cutting unemployment, and to quickly re-incorporate the unemployed in re-employment programmes. Implementation of the whole employment strategy which will expand the labour force and raise individuals' flexibility in the labour market will also contribute to increasing the competitiveness of the economic sector.

The new approach to employment policy complements the traditional active employment programmes with measures for increasing flexibility of operation and employment, for the promotion of entrepreneurship, for increasing the qualifications and education of the population, and providing equal opportunity in access to work to different social groups. The traditional active employment policy, which remains an important part of the broader concept of employment policy, requires the individual to take a more active role. The programmes will have to be adapted as much as possible to the needs of individuals and will have to be target-oriented. Especially education and training programmes will start playing an increasingly important role.

In the direction of stimulating the fastest renewed activity of the unemployed as possible and stimulating lifelong learning unemployment insurance systems are also developing.

In the following years the ratio between the funding intended for active programmes compared with the funds for passive employment policy programmes will have to be gradually changed in favour of active programmes. At the same time, the efficiency of their use will have to be closely monitored. In order to successfully realise the more broadly set employment policy the following years will have to witness the social partners' stronger role in shaping employment policy, the creation of a consensus on development issues, a shrinking of the number of programmes and their orientation towards cutting current and preventing the creation of new non-conformities in the labour market.

Regionalisation is becoming an important feature of the employment policy. Establishing development partnerships at the level of regions that would also tackle employment issues is one of the most important tasks of the years to come. Despite the trend towards harmonised regional development and activating local potential, the current regional mobility of labour will have to increase so as to enable better exploitation of the human resources available and other factors of development.

Relatively speaking, the active employment policy will be allocated more funds than the passive one. The role of the social partners will be more important, and the employment policy will be considerably regionalised. In order to assure the success of the employment policy and to increase national competitiveness the following will have to be done in the upcoming years:

- a/ Direct the programmes and measures for increasing the employability of the population (first pillar), towards cutting and preventing long-term unemployment, promoting lifelong learning and the employment of older people, raising computer literacy (e-literacy) and knowledge of foreign languages, establishing flexible and high quality education systems and reducing the number of potential non-conformities between supply and demand (increase in regional and professional mobility, development of fast and efficient systems of mediation between job-seekers and employers).
- b/ With programmes and measures for promoting entrepreneurship (second pillar), expand knowledge of the possibilities and risks relating to entrepreneurship, eliminate the obstacles for setting up and developing small- and medium-sized companies, gradually reduce the high taxation of labour, establish stimuli for investing in the human factor.
- c/ Promote the adaptability of companies and individuals (third pillar), which mainly depends on the agreement between the social partners. Knowledge and the preparedness of employers and employees is necessary for modernising the organisation of work; and a consensus of all social partners is required for the earliest legal regulation possible in the social partnership field. Shortening of working times and the development of atypical, more flexible forms of working relationships will remain the subject of negotiations between employers and the unions. Employment involving shorter working time will have priority over the general shortening of working time. Further, from the viewpoint of investing in knowledge,

cessation (i.e. pauses) of the working relationship for the purposes of training and education will have to be enabled and promoted. The encouraging of partial employment will have to be accompanied by the system of comparatively equal benefits and insurance from employment.

- d/ Provide equal opportunity of access to employment and promotion for both sexes, reduce the differences in payment for equal work done, and set up the conditions for easier reconciliation of business and family life. The measures within the employment policy will have to be connected to the social policy and ensure efficient and high quality services in the field of protection and care of children as well as older people and other dependant persons. It will also be necessary to ensure successful inclusion into work and life for some specific population groups and people with low employment prospects (for example, disabled persons).

5.1.1.3. Labour Force Mobility and Housing Policy

Internal moving mobility in Slovenia is at a much lower level than in the EU, although it increased again a little in the second half of the nineties after a long period of decrease. Low moving mobility, however, is not only related to tradition and culture but also to the extent, structure, exploitation and accessibility of the housing fund. The privatisation of state-owned flats at the beginning of the nineties contributed to the fact that more than 90% of households live in flats which they own or are owned by their parents or relatives, while the segment of owner-occupier flats in the EU was on average 56% in 1995. The high share of owner-occupier flats and the limited offer of both private rental, and social and non-profit flats hinder the labour force's mobility. Efficient housing policy must be capable of providing an adequate supply of flats to those who can gather the funds to buy a flat by themselves as well as people who do not have sufficient means should be given the opportunity to get a suitable flat. For this purpose, in the future we will have to increase the supply of rental flats (private, profit and social), introduce and arrange a system of object and subject subsidies, expand the system of financial networks (national housing savings scheme) and project financing of housing construction, in which co-operation and a partnership is created between the state, local community, construction companies, co-operatives and private landlords.

The migration policy in the framework allowed by EU membership will gain in importance not only because of internationalisation of the labour market, but also because of the shrinking size of the working-age population, as predicted by demographic projections. Also due to this, the approximation of the employment rate to 70%, as planned by the EU up until 2010, will be a difficult task for Slovenia. Within the EU the principle of the free movement of persons has been enforced for citizens of the EU, while the immigration policy towards citizens of non-member countries is being more and more harmonised. The principle of the free movement of persons includes the right of EU citizens to employment (an EU citizen may be employed in any EU member-country without a work permit, every person also has the right to seek employment in any EU country, any kind of discrimination on the basis of nationality with regard to employment conditions and benefits is forbidden) and residence (every employed person has the right to reside in the country hosting them, but does not need a special permit and their family may join them). After

becoming a member of the EU, Slovenia will be able to maintain control over immigration and will have the possibility of 'choice of personnel needed in the economy' only through executive provisions and not direct legal limitations, where the principle of the free movement of persons should not be violated and the rules will be substantially more rigorous for citizens of non-members than for citizens of EU member-states.

With Slovenia's accession to the EU, the extent of interstate moving will increase somewhat (emigration and immigration). Neither the European nor Slovenian traditions and cultures reveal the high mobility of citizens. The moving mobility of Slovenians, with the exception of some of the most qualified people and experts – noting that economic reasons are not among their main reasons for leaving - is quite low. The moving mobility of EU citizens has not considerably changed in the past 20 years. As the most developed candidate-country, Slovenia will in fact attract labour from less developed countries. Domestic demand will probably remain too low or not stimulating enough for certain specific domestic professional profiles. Thus, besides the immigration of foreign workers to Slovenia, there will also always be the employment of Slovenian citizens outside Slovenia. With its migration policy Slovenia should select immigration in such a way as to attract from other countries mainly those professional categories in which the gap between supply and demand in the domestic labour market will be greatest (or lowest) in the following years (which will most probably happen in technical professions and in the field of information science) and, at the same time, protect itself from any possible overflow of labour where there is already an oversupply. On the other hand, Slovenia will have to find the instruments for retaining the young and qualified staff by providing them living and working conditions comparable to those in the EU, through the creation of development centres which would attract young qualified people, and by ensuring an adequate level of income and housing supply.

The priority directions of efforts in the field of labour force mobility and housing policy are thus as follows:

- a/ increase the supply of apartments for rent and introduce object and subject subsidies, expand the financial networks system (national housing savings scheme) and the project financing of housing building; and
- b/ migration policy has to be oriented towards these two goals: (i) in immigration attract the professional categories experiencing a deficit (especially in technical professions and in the field of information science); and (ii) in emigration discourage the exodus of young and qualified staff (by providing living and working conditions comparable to those found in the EU).

5.1.2. Information-communication Infrastructure and the Development of New Services

The information society's emergence is one of the most important global changes, which will also affect Slovenia's future development. In addition to opportunities for economic progress, this phenomenon is also bringing about numerous

uncertainties. As a result, the significance of structural and allocation-related issues of development and the need for development programming remains. In the period of transformation to the information society, elements of the old and new economies are intertwined. The old economy increases efficiency, adaptability and competitiveness by introducing new technologies and skills and by renovating and introducing information technologies in the traditional processes, and it is thereby integrating into the new economy.

The information society builds on extensive use of knowledge, dynamic development of information-communication equipment and technologies and their widespread use, thereby further increasing the share of services in gross domestic product. In Slovenia, this share has reached around 60%. Despite the progress made over the last decade, Slovenia still lags behind in development terms, in particular as regards the share of high value-added services, investment in research and development, the use of information-communication technologies in the economy and state administration and the share of domestic information-communication industry in gross domestic product. After the initially rapid expansion of the use of the Internet, this growth has somewhat levelled off since 1998. This has been a consequence of various factors, including inappropriate government policy and a lack of incentive in this area.

At the turn of the millennium, Slovenia is faced with new challenges which call for an active and flexible policy to be able to provide the basic conditions for successful transition to the information society and to use information-communication technology as a lever for further development. Although in Slovenia the introduction of e-commerce in some services (health, payment transactions, banking) has been well under way, an integral approach is needed, i.e. a national strategy or action plan, for the co-ordinated and accelerated introduction of the information society which would enjoy the widest social consensus. Only in this way can the optimal results be achieved. As this is of foremost importance for Slovenia's future development, firstly appropriate plans have to be formulated, and then a government body established to be in charge of monitoring the implementation of the accepted strategy and to prepare the necessary measures. Measures pertaining to the business sector (in particular small enterprises) and social infrastructure (education, research and development, technology) should be in the focus of attention.

Such an approach is important because the introduction of information-communication technologies in enterprises has been too slow, e-business between companies has been limited, there has been a lack of personnel trained in information-communication technologies and the related services, a slowdown in growth of the Internet's uptake and of the use of computers in households, poor functional literacy of Slovenians, which in turn restrains the capacity to absorb new technologies and the use of services provided by the information-communication technologies. The strategy therefore sees it crucially important that Slovenia becomes as fast as possible part of the dynamic structural and technological changes taking place in the world and leading to establishment of the information society, as these are the determinants of the future success of economies and countries in general.

The Strategy's main orientations for more efficient promotion of the information

society are:

- a/ Within the framework of increased investment in education and professional training, those skills and knowledge enabling the population to benefit from opportunities of the information society should be specially emphasised.
- b/ Deregulation of telecommunications, establishing of a modern telecommunications infrastructure and the development of new services.
- c/ Increasing investments in R&D of new technologies that ease the transition to the information society, along with enhanced co-operation between the business, state administration, and academic and education spheres.
- d/ Introducing a modern and efficient state administration providing numerous public services to businesses and citizens via the information-communication infrastructure (e.g. personal income tax returns, input registers etc, thereby promoting the use of online services by a wider segment of the population. Introduction of a modern administration has to go hand in hand with general computerisation of the economy and society.

5.1.2.1. Information-communications Infrastructure

The speed of transformation to the knowledge-based information society will largely depend on the level of development of the information-communication infrastructure and the absorption capacity for utilisation of the new technologies. Many companies in Slovenia exploit the information-communication technology in order to increase their competitiveness. The introduction of ever-new on-line services used by businesses, the public sector, state administration as well as households can only increase the amount of data transmitted through the existing information-telecommunications infrastructure. Therefore, establishing a highly efficient and accessible (in terms of price) information-communication infrastructure and linking different data-transmission networks is a basis for the efficient functioning of the economy, public sector and administration as well as for successful participation in global integration processes.

The capacity of Slovenia's information-communication infrastructure lags behind the EU as regards the regulatory and institutional solutions applied in the EU's single market. Rapid development of information-communication infrastructure requires great investments which the state provides not so much through direct financing as through market-oriented regulation and providing stable and transparent conditions for the telecommunications market to function. Regulations should guarantee greater transparency and flexibility as this is a precondition for attracting potential investors.

Slovenia wants to reduce its lagging behind the EU countries and establish the preconditions for the efficient functioning of businesses, the public administration and households in the information society, and will therefore act in accordance with the following guidelines:

- a/ liberalise the telecommunications services market together with providing the

- security of operations to market participants , and privatise the dominant operator;
- b/ modernise as soon as possible the telecommunications network, including local loops, through joint investments of the private sector, external investors and/or strategic partners, and the state;
 - c/ provide access to the public telecommunications network on the basis of open universal access and ensure inter-connectivity between networks;
 - d/ provide fast access to the Internet at competitive prices to the whole population, enable wider segments of society to benefit from Internet services, particularly promote the access of specific groups (youth, older, disabled).

5.1.2.2. Promoting the Development of New Services

The modern information-communication infrastructure requires a number of services for its proper functioning and, on the other hand, allows – together with information-communication technology – the development of new knowledge-based services (e.g. e-commerce, e-banking, e-work, distance learning). In addition to information-communication services, the importance of business and financial services has strengthened in the developed countries. These are high value-added services and contribute to improved efficiency of the whole economy and society. Due to the lack of human and financial resources companies do not supply these highly specialised services by themselves (internally) as that would not be rational, but outsource them and buy them on the market. Modern states (administration and public services) also increasingly buy these services in the market and thus increase their own efficiency and flexibility.

In Slovenia, the level of development of these services, their efficiency, quality and variety lag behind that in the EU. Besides, in Slovenia it is all too often forgotten that new information-communication technologies, business and financial services cannot be developed by the market mechanisms alone but require a proper institutional and legal framework and innovation-friendly environment which altogether encourage the development of these services. Unlike the EU, Slovenia lacks a relevant policy for the development of modern services (business, financial, information-communication). In the EU, it is based on horizontal policies supplemented by direct policies supporting certain areas (e.g. within the Fifth Framework Programme, for the area of information society technologies).

In the future, Slovenia will form a more dynamic and flexible policy and mechanisms for encouraging the development of information-communication, business and financial services. In addition to a modern telecommunications infrastructure and a sufficient number of highly qualified staff with proper technical and managerial skills, and the policy of deregulation and liberalisation leading to greater competition between the providers of these services, the following orientations and activities will be required for new services to develop:

- a/ Setting up of various specialised networks which would provide - in particular to small- and medium-sized enterprises - a number of the specialised services they need for their operations.

- b/ Establishment of risk capital funds which support innovation and the emergence of companies offering new technologies and services.
- c/ Establishment of technological parks and incubators where enterprises developing support for e-commerce, new services and technologies would be operating.
- d/ Accelerating e-commerce between the state administration and enterprises, between the state administration and households which would, in turn, increase e-commerce between enterprises.
- e/ Attracting foreign direct investment for the development of new services and thus ensure the transfer of specific managerial, marketing and organisational skills.

5.1.3. Research and Technological Development

The new development paradigm stresses the importance of the ability to acquire global knowledge and technological progress as the main source of increasing labour productivity, national competitive ability and the quality of life of individuals and the society as a whole. The present level and structure of investment in R&D, new technologies and innovation in Slovenia is running several years behind that in the EU and therefore requires direct and indirect state intervention in accordance with the EU rules and strategic goals that have been set out. However, the main problem

The Government's Draft Programme for Stimulating Technological Development up to 2003

Slovenia's technological development policy is founded on the principle that technological development is directly or indirectly incorporated within all sectoral strategies, which is why inter-ministerial co-operation is absolutely essential. Some of the most important economic goals of the Government's draft Programme for Stimulating Technological Development are: (i) actively involving Slovenian companies in the process of globalisation; (ii) higher gross value added, which is to be achieved by increasing the share of high-technology products developed by new and innovative technological processes; and (iii) greater corporate investment in the development of advanced technologies, thereby securing their long-term economic returns. Other tasks include: (i) fostering co-operation between research institutes, universities and companies through joint research projects; (ii) accelerating the transfer of know-how from the research sector to companies; (iii) promoting strategic alliances between Slovenian companies and companies from abroad in the areas of development and marketing; and (iv) bringing together technological development and environmental investment. The effect should result in: (i) improved corporate investment in research and development; (ii) a higher number of companies actively involved in development, and more research specialists; (iii) increased gross value added per employee; (iv) more companies launching their operations in technological parks; (v) a larger share of new companies established by venture capital and fast-growing companies; (vi) more corporate consortiums and industrial clusters, especially those related to fostering internationalisation; and (vii) more patent-protected industrial assets.

of Slovenia's R&D activity and policy has not been so much the level of expenditures but rather the insufficient interconnection of knowledge, competitiveness and flexibility, which is reflected in the inadequately expressed development function of enterprises. Moreover, this has been a consequence of poor technological management and a poor environment for knowledge in the widest sense. It is these two factors that are of particular importance, as technological innovation is only one side of the story. Innovation of management in the business sector, social services and the state administration, and the expansion of participation in innovation processes to cover all employees is perhaps even more important.

On the whole, the process of transition has not had a positive impact on research and technological development: increasing the technological intensity of products has been far too slow, research and development departments in companies have been dissolved, and companies' development activities weakened. The setting-up of new, high-technology companies has come to a halt, especially in manufacturing. The underlying reason for the slowdown in research and development seen in the last ten years was transitional defensive restructuring, a process that narrowed company activities down to resolving short-term 'survival' problems. Putting aside the rare cases of offensive restructuring, companies largely have undertaken a survival strategy, which was partly due to economic policy of allocating state aid to rescue companies.

Slovenia is thus characterised by: (i) an insufficient level of applied technological research, a low level of co-operation between companies on one hand and between companies and the research sector on the other, companies' low demand for the services provided by research institutions; (ii) considerable importance attached to the technological aspects of the innovation process and technology transfer, and neglect of the managerial, organisational and marketing fields, which are crucial for the effective diffusion of an innovation; (iii) neglect of the regional aspects in the process of developing a national innovation system (insufficient and inappropriate support offered to the building of financial and institutional frameworks); (iv) poor exploitation of the institutions responsible for innovation diffusion and technology transfer, even though the Innovation Relay Centre is already in operation; (v) the lack of transparency in the current system and the lack of co-ordination between different mechanisms to promote innovation activity, which prevents co-operation and the division of tasks; and (vi) the Government's vague priorities in the field of research and development and poor co-operation between ministries.

Effective research and development and innovation policies should result in higher gross value added per employee. This can be achieved by: (i) increasing the share of high-technology products; (ii) accelerating the introduction of new and technologically advanced products (the time required to discontinue old and introduce new products should be reduced by at least one-quarter, meaning that 50% of existing products should be replaced by new ones within the next five years, (whereas currently only 37.5% of products are being replaced in this period of time); and (iii) increasing the share of sales to new, advanced and profitable markets. The active involvement of companies and the research sector in the process of globalisation should enable the faster transfer of know-how and the commercial exploitation of the fruits of research and development. Necessary preconditions for lifting the

capacity to use current and introduce new technologies are a well-functioning national technical infrastructure (e.g. a metrology system) and the significant improvement of qualifications and training of staff at all levels, especially at the level of executives and managers in companies, state institutions and public services.

It is impossible to bolster national competitiveness without any major investment in research and development (a total of 2% of gross domestic product) and any changes to the structure of research and development activities towards a larger share of applied and development research and a higher number of research staff in the corporate sector. In the future, technological development should primarily draw on the corporate sector and should become less dependent on direct state financial assistance. It is therefore necessary to increase the corporate sector's investment in order to bring about important shifts in technological development. The current level of the state's investment is satisfactory compared to international figures, however, the state will increase its investment in research and development in line with the level of the corporate sector's investment in these areas.

Slovenia's research and development policy will give priority to research institutes and units operating in the private sector. The Government will assist public research institutions in their efforts to accommodate new methods of generating know-how in companies and, at the same time, it will provide funding for new and original projects in the field of basic research. The Government will set up a system of industrial and intellectual property rights and encourage the development of spin-off companies in order to foster co-operation between different agents in the innovation process (the public and private sectors, the synergy of market-oriented research and development activities and activities run by government programmes in the areas of science, health, defence and environmental protection).

The creation of a supportive environment should play an important role in accelerating technological development. This includes the education and training system, the culture of innovation, an environment conducive to developing and transferring know-how and technology, efficient capital flows, including venture capital, physical and information-communications infrastructure, mechanisms to strengthen social cohesion and prevent social exclusion, and environmental protection infrastructure. It is particularly important for countries like Slovenia to step up the creation of such an environment, given the current level of development.

As Slovenia is an open economy acceding to the EU, the share of internal and external investment in research and development based on European and global alliances will increase in the coming years. Associate membership alone has created a wide international exchange of goods, investment, experts and new ideas. This enables the greater absorption of know-how and technology from the advanced European regions and extensive co-operation in research and development activities. The scientific and research potential of Slovenians working abroad should not be neglected, nor should the ambition of creating a coherent common intellectual environment.

Following the 13 EU guidelines for the accelerated development of innovation, Slovenia's technological and innovation policy will have to pay closer attention to

the following areas: (i) creation of a culture of innovation; (ii) faster replacement of old with new products; (iii) expansion of the use of new technologies; (iv) the orientation of technology and innovation policy towards stimulating co-operation between companies and between companies and the research sector (reinforcing current and stimulating new industrial clusters, especially as regards the exchange of know-how, information and data bases); and (v) incentives for alternative procedures to develop know-how in companies.

Drawing on the findings presented in this chapter, the priorities of the policy of stimulating research, innovation and technological development are as follows: (i) foster co-operation between companies and between companies and the research sector; (ii) increase the absorption capacity for the transfer of technology and innovation; (iii) increase investment in research and development and change its structure; (iv) set up research institutions and units in the private sector; (v) build an environment favourable to technological development; and (vi) draw on the scientific and research potential of Slovenians working abroad. It will be necessary to accommodate the old and set up new institutions to realise these goals, including risk funds and consortiums, innovators' organisations, a Slovenian innovation agency, regional centres, and research and development agencies.

The Government will realise this orientation through instruments aimed at accelerating research and development activities and technological progress. The main criteria will be value added and the number of new high quality jobs. These activities include the following:

- a/ the Government will tailor its calls for projects which are publicly funded to the innovation needs of production and service companies. Priority will be given to joint research and development projects with operational innovation;
- b/ the Government will enable new high-technology companies to raise venture and start-up loans with banks at preferential interest rates by providing guarantees and enable them to set up their facilities in technological parks at a lower rent for a given period of time;
- c/ the Government will co-finance the development of prototypes and other pre-competition activities related to the introduction of new products;
- d/ for a limited period of time, the Government will subsidise the wages of highly qualified staff in research and technological units within companies in order to maintain and increase the number of those jobs; it will co-finance additional training in the areas of (i) innovation strategies, (ii) communication with partners involving confidential information, and (iii) intellectual property and the procedures for its protection;
- e/ the Government will promote technological progress in co-operation with regional development agencies, guarantee funds, funds for promoting the small business sector, all of which play an important role in stimulating technological development;
- f/ the Government will support the development of national technical infrastructure;
- g/ technological parks will expand their activities to include innovation consultancy free of charge for a certain period of time;

- h/ the Government will support the setting-up of institutions employing public funding and private capital – venture capital funds – that will help establish high-technology companies; and
- i/ the Government will recommend that universities incorporate the basics of intellectual property rights, innovation management, and market innovation research within their curricula.

The method itself of carrying out these measures may provide considerable room for improving the policy of stimulating research and development activities and technological progress. Efforts will be focused on: (i) co-ordinated activities of the ministries responsible for these areas; (ii) repeated and open measures and invitations for tenders; (iii) flexible and simple procedures; and (iv) permanent monitoring of the results.

5.2. Strengthening Economic Competitiveness

5.2.1. Enterprise Restructuring and Boosting the Corporate Sector's Competitiveness

A continuous process of enterprise restructuring is indispensable for strengthening the competitiveness of the enterprise sector and guaranteeing further dynamic growth of the Slovenian economy. The intensity of the process of restructuring the enterprise sector is also the key determinant of the Slovenian economy's capability to cope with the competitive pressures seen in the EU's internal market.

Although the entire Slovenian enterprise sector has already reached the lowest point in the restructuring process and has passed from mostly defensive to mostly offensive restructuring, detailed analysis indicates that there are considerable differences among the various ownership categories of enterprises. In terms of restructuring, there are three groups of enterprises in Slovenia: (i) enterprises with concentrated ownership (foreign, personal, subsidiary) that have not undergone privatisation because they have been established as private enterprises; (ii) enterprises with dispersed ownership (public enterprises mostly owned by institutional owners and non-public enterprises

Defensive and Offensive Restructuring of Enterprises

In the restructuring of enterprises, a distinction should be made between *defensive restructuring*, where an enterprise adjusts to changed market and other conditions within the available possibilities through rationalisation, reduction of capacity and employment, abolition of unprofitable programmes and other similar measures, and *offensive restructuring*, where an enterprise seeks new opportunities and markets through new investments and programmes by increasing capacity and employment. In the process of transitional restructuring, enterprises first undergo defensive restructuring and thus have a new basis to deal with offensive restructuring.

mainly owned by internal owners) that have undergone privatisation; and (iii) non-privatised enterprises. Enterprises with concentrated ownership are far more successful than the others. Through new investments and employment, they grow faster and the differences between them and other enterprises in terms of return on equity, value added per employee, level of value added, number of employees and assets are increasing. The enterprises with dispersed ownership are increasing their profitability, but they are doing it slowly and mostly on the account of defensive restructuring. Non-privatised enterprises are in the red although their operating losses are decreasing and their operating cash flow and value added per employee show a positive trend.

Analysis suggests the following measures to bolster the competitiveness of the Slovenian enterprise sector which are at the same time the objectives of economic policy in this area:

- a/ completion of transition restructuring of the enterprise sector through ownership consolidation, establishment of corporate governance and the affirmation of the “proper” long-term owners in enterprises;
- b/ final solution of the problem of loss-makers without any prospects; and
- c/ creation of conditions for the offensive development of a competitive enterprise sector, particularly by promoting new domestic and foreign entries, abolition of administrative barriers to investment, promoting the internationalisation of the economy and the development of small- and medium-sized enterprises.

5.2.1.1. Completion of Transition (Defensive) Restructuring

Formal privatisation of trade and manufacturing has been completed. The ownership structure of privatised enterprises is dispersed; in small- and medium-sized enterprises a considerable amount of shares is owned by the management and employees, whereas capital-intensive enterprises are mostly owned by institutional owners. This does not enable a successful management of enterprises. The corporate governance problem occurs in both enterprises with predominantly institutional owners and in those with mostly internal owners. In most cases, neither of them are the ‘proper’ owners, but only represent an intermediate link between formal and actual privatisation. In fact, institutional owners generally consider the enterprises they own as mere financial investments and there are no strategic ownership groups in such enterprises; similarly, a great part of current internal owners will not remain in the office that has actually been attributed to them for a long time. When comparing between enterprises with predominantly institutional and those with mostly internal owners, it seems that the latter do worse. In the restructuring process, enterprises with domination of internal owners are on average a step behind those with predominantly institutional owners. Employee-owners have on average a negative effect on the size of investments in physical capital, human resources, management, and research and development. And if we add the non-privatised enterprises, which are in a poor or even critical condition, it becomes clear that the problem of actual privatisation, in terms of establishing the corporate governance and affirmation of the ‘proper’ owners and transitional restructuring has not yet been definitely resolved.

Although Slovenia's policy in the corporate sector will in the future be increasingly oriented towards eliminating the barriers and improving the conditions for the development of the entrepreneurship and increasing corporate sector competitiveness, it is obvious that if it wishes to be effective it cannot avoid measures relating to the uncompleted transition restructuring. Two issues are important here.

Firstly, the speeding up of the process of ownership consolidation, the establishing of corporate governance or the affirmation of the 'proper' long-term owners in enterprises. The gradual transformation and merging of enterprise owners' portfolios is too slow. The slow restructuring of enterprises that have undergone privatisation and are now mostly owned by internal or external owners undermines the efficiency as well as the long-term interests of such owners in the development of enterprises. Only when enterprises are owned by the 'proper' owners are fast and decisive breakthroughs possible. The state should take the following measures:

- a/ measures for faster development of the capital market together with the elimination of restrictions on its development, particularly the liberalisation of capital flows;
- b/ a policy of non-obstructing acquisitions and mergers having regard to competition rules;
- c/ promotion of foreign investment;
- d/ restricting of income division in salaries and prevention of the abuse of position of internal owners;
- e/ assertion of ownership rights and full provision of owners' control; and
- f/ assurance of the actual assertion of the rights of various owners' categories.

Secondly, in order to complete transition restructuring it is necessary to quickly reduce the number of big, non-privatised loss-makers in a financially and socially acceptable way. The urgency of finding a solution as soon as possible relates to public finance reasons as well as to adjustment to the EU with regard to state aid.

The measures will be as follows:

- a/ in state-owned enterprises included in the various schemes of rehabilitation and restructuring (Slovenian Development Corporation, sensitive sectors), the state will promote the separating out of the viable parts from problematic enterprises and their privatisation as well as the closure of non-viable parts;
- b/ the state will selectively support enterprises for the purposes of resolving and restructuring, mostly in the context of regional criteria whenever the enterprises are significant to a less-developed region; and
- c/ apart from sensitive sectors as defined in the EU, the state will carry out sectoral restructuring of the textile and leather industry.

5.2.1.2. Strengthening the Corporate Sector's Competitiveness Through Offensive Restructuring

Besides other tasks in the area of transition restructuring, there is an increasing emphasis on offensive restructuring whose main objective is to strengthen competitiveness. Boosting the competitiveness of the enterprise sector is predominantly something that occurs within enterprises. Enterprises are the genuine holders of competitive advantages based on the development of the knowledge and skills of their staff. The task of the state is, on one hand, to provide a stable macroeconomic environment and upgrade the institutional framework in order for enterprises to operate normally and plan and implement their development on a long-term basis. On the other hand, the state should (i) encourage and support economic operators in identifying and actively exploiting their specific competitive advantages within the EU and abroad, and (ii) formulate the relevant development or structural policies to stimulate improvement of the existing created assets and development of new ones in accordance with the competitive advantages of the enterprises and Slovenia as a whole. The state will thus establish economic policy to encourage enterprises to exploit their specific advantages in the international environment, mostly within the EU but also broader, and facilitate, through its instruments, effective internationalisation. In such a context, industrial policy will move from vertical to horizontal measures to strengthen the managerial, organisational and technological capacities of enterprises. The primary category of enterprises for which horizontal measures are intended includes small- and medium-sized enterprises.

The main source of economic growth is the increased efficiency and competitiveness of the enterprise sector by intensifying its capacity to respond to rapid changes in

Strategy and Development Programme for Bolstering Slovenian Industry's Competitiveness

Measures elaborated in the Strategy for Strengthening the Competitiveness of Slovenian Industry and in the Small Business Development Strategy focus on four categories of priorities: (i) modernisation of enterprises, emphasising the need for greater specialisation of enterprises; (ii) promotion of research and development and technological upgrading; (iii) promotion of investments; and (iv) promotion of small- and medium-sized enterprises' development. The interrelated horizontal measures in the Development Programme for Strengthening the Competitiveness of Slovenian Industry focus on the following key factors that affect the strengthening of enterprises' competitiveness and the promotion of new investments: (i) promotion of strategies to increase productivity, including the introduction of an integral system of constant improvement in enterprises and external benchmarking; (ii) strengthening the competitiveness of enterprises including the promotion of market-economy approaches and the technological upgrading of enterprises, (iii) promotion of the integration of enterprises and specialisation in product-service chains, and the promotion of joint development of international markets on a cluster basis; and (iv) the promotion of the internationalisation of Slovenian enterprises and new investments, including encouraging enterprises to expand to international markets as well as the rationalisation and optimisation of business, the promotion of strategic partnerships and foreign direct investments in Slovenia (Ministry of Economic Affairs 1996).

technology and the market and by promoting modernisation and the introduction of new programmes in enterprises. In terms of the objectives and purposes promoted as well as in terms of horizontal allocation of resources, the Strategy and the Development Programme for Strengthening the Competitiveness of Slovenian Industry represent a suitable foundation for future Slovenian policy to bolster the enterprise sector's competitiveness. In the future, the state will expand such foundations in terms of substance by introducing new measures and harmonise them with the EU's regulations concerning industrial policy as defined in EU documents relating to industrial competitiveness. The state will, in particular, constantly monitor the efficient implementation of the above measures.

5.2.1.2.1. Mechanisms for Strengthening the Corporate Sector's Competitiveness

Slovenian enterprises neglect certain non-price factors of competitiveness that constitute a key element in modern competition. Exports by Slovenian enterprises are thus still concentrated on non-differentiated products and services with lower value added but with an adequate level of quality. The share of exports based on natural resources is too high, and the smokestack industries contribute one-fifth of value added in manufacturing. Besides the corporate governance problem, the main barrier to the efficiency and improved competitiveness of enterprises is the lack of managerial skills that has a negative impact on the investment capacities of enterprises as well.

In the future, the competitiveness of enterprises will be increasingly based on knowledge and adaptability of enterprises and the economy as a whole. The quality of products and processes as well as the differentiation or individuality of products and services are turning into the main agents of competitiveness. The necessary condition for achieving quality and differentiation is a well-functioning national quality infrastructure. It requires greater investment in the development of human resources, organisation and knowledge and a reduction of the share of public finance funds directly allocated to investment in the economy. The adaptability of enterprises and of the economy as a whole is the second key determinant of their competitiveness. An economy is deemed adaptable if it is able to accumulate and exploit the resources as required by the new market opportunities, and if it knows how to take advantage of its competitive advantages.

The competitiveness of Slovenia's enterprise sector will be determined by events occurring in the EU internal market and the changes to the EU's industrial policy. In the EU, the following processes are taking place in the areas of enterprise restructuring and the promotion of competitiveness: (i) intense structural changes in manufacturing for the purpose of maintaining or consolidating a competitive position in the context of enlargement of the EU's internal market; (ii) structural changes in the EU are characterised by product diversification and not by specialisation and geographical diversification followed by export diversification; (iii) the intensity of the classic forms of investment has been reduced in the EU while 'soft' investments in intangible factors have increased; (iv) globalisation is one of the primary objectives of EU industrial policy, whereby new technologies, new approaches in the enterprise sector and financial innovation are the main agents

for development while the opening up of national economies is the necessary requirement; (v) the main weaknesses of EU industries are their limited specialisation, restricted use of information-communications technology, inefficient policy of investment in research and development, poor quality of management, and insufficient number of strategic partnerships; and (vi) the networks and joint activity of strategic partners is becoming an increasingly important organisational form for operating at the global level, and is based on the exchange of business data; virtual forms of operating are gaining in importance.

The key factor for strengthening the competitiveness of Slovenian enterprises is the strengthening of (i) managerial skills and (ii) investment capacities, particularly in development of the human factor, informatisation and technological development. Management is the key factor responsible for the measures to increase competitiveness or value added per employee. Strengthening of managerial skills and investment capacities at the enterprise level must be supported by suitable: (i) macroeconomic policies; (ii) institutional changes, particularly in income and employment policy regulated by the agreements between the social partners where the role of the state is to co-ordinate the interests; and (iii) adequate horizontal policies to bolster competitiveness.

The state will help enterprises overcome their internal weaknesses through the following measures:

- a/ Strengthening of managerial skills. The state will support programmes for the development and use of managerial skills. It will: (i) co-ordinate and gather in synergy different line ministries operating in this field; (ii) include training in innovation and marketing activities in its programmes; and (iii) establish regional development agencies as the key factor responsible for supporting innovative enterprises since the majority of EU aid is allocated at the regional level.
- b/ Investment with an emphasis on investment in human capital and research and development. Investments in the enterprise sector: (i) will focus on investments in knowledge and the human factor; (ii) emphasis will be diverted away from quantity and redirected to the efficiency of investments and their appropriate structures; (iii) the existing investment initiative of the public sector will be replaced by private sector initiative. Although, in terms of finance, investments in physical capital are the most demanding aspect of strategic restructuring, the weakest side of investment in Slovenian enterprises is the low level of investment in the 'soft' factors of competitiveness and development. The 'new economy' is characterised in particular by extremely fast technological development and it is necessary to concentrate the investment endeavours on the development of knowledge in the broadest meaning of the word. Therefore, investing in human resources is the key soft factor for improving competitiveness. In increasing investment, the state will act as a catalyst of change. State intervention will focus on the general and special training of employees. Industrial policy that emphasises investments in human capital and research and development also complies with policies in the EU where measures are directed towards increasing knowledge and the technology level. It would thus be possible to draw closer to the USA and Japan. If Slovenia's industrial policy does not follow these directions, the competitiveness of its enterprises in the EU's internal market will be undermined.

- c/ Promoting the establishment of new, mostly high-tech enterprises with a risk capital guarantee, placing of entrepreneurs in technological parks, introducing tax relief in the first years of doing business, and creating new jobs for highly educated persons with assistance for their wages.
- d/ Integration of enterprises in clusters or consortia. The state will create a stimulating environment for integrating enterprises in clusters or consortia, which has a positive impact on rationalising several operational aspects. The integration of small- and medium-sized enterprises among themselves as well as with bigger enterprises (clusters and networks of enterprises) is particularly important for the former because it makes it possible for them to achieve more.
- e/ Establishment of consulting offices. The state will assist management by establishing consulting offices which will be made available to it if it chooses the strategy for boosting competitiveness. Consulting will be linked with innovation and technological consulting.
- f/ Enterprise-technology centres. The state will encourage enterprises to modify internal operations and will assist them in overcoming the lack of knowledge and internal endeavours. For this purpose, it will promote and co-finance the establishment and activity of enterprise-technology centres within the existing regional development agencies.
- g/ Education. At the level of professional schools, high schools and universities, the state will supplement the programmes with microeconomic methods of improving value added and operating costs. In postgraduate education, it will encourage the temporary work of students ('professional experience') in successful domestic and foreign companies.
- h/ Support to Slovenian enterprises in introducing the EU's technical directives and standards.

5.2.1.2.2. Internationalisation of the Enterprise Sector

Internationalisation is becoming increasingly important for developing and strengthening the enterprise sector's competitiveness. The Slovenian internationalisation policy will include the following aspects:

- a/ Elimination of barriers to internationalisation. The elimination of administrative and other barriers to internationalisation is a priority – otherwise the promotion of internationalisation is senseless.
- b/ It is necessary to proceed from the actual needs of enterprises and to focus on giving support to small- and medium-sized enterprises.
- c/ Flexibility, transparency and long-term orientation. The policy should be flexible in order to be able to promptly react to the changing needs of enterprises and allow for the assessment of the actual costs and achievements of individual measures. The policy will be long-term and transparent to consolidate its original characteristics and continuity.
- d/ Policy adjustment and redefinition. The policy adjusts to continuous and fast changes in the external environment of enterprises.

e/ Proceeding from a holistic concept of internationalisation. Since the success of outward internationalisation heavily depends on the efficiency of previous or simultaneous inward international activities, and since the significance of global networks and strategic partnerships is increasing, the policy will change its orientation from export stimulation to the promotion of other forms of outward and inward internationalisation.

In this sense, the following aspects are particularly important in terms of economic policy: inward and outward foreign direct investments, financing and insuring of international economic operations.

Inward foreign direct investment (FDI). In terms of formulation and implementation of the strategy/policy concerning inward FDI, the situation in Slovenia has significantly improved in the last two years. Slovenia's membership in the EU will eliminate all prohibitions and restrictions relating to inward FDI and thus actually abolish the defensive or passive elements of FDI policy. Due to Slovenia's integration into the EU, more emphasis is given to an active policy towards FDI comprising the promotion of Slovenia as a location for FDI and actual incentives to foreign investors. When it becomes an EU member, even more stress will be put on the active policy because: (i) forming part of the common market requires a more aggressive policy towards FDI; (ii) Slovenia is attracting more export-oriented FDI requiring a more aggressive policy towards FDI; (iii) FDI is a strong factor in the Slovenian economy's integration into the EU's internal market; and (iv) FDI is among the most important mechanisms for exploiting the dynamic advantages of economic integration. Another good reason speaking in favour of an active policy towards FDI is the fact that the existing FDI has had a positive effect on restructuring the Slovenian economy since it increases allocation and industrial (enterprise) efficiency.

Slovenia's strategic orientations with regard to FDI are as follows: (i) stimulating FDI in the post-privatisation period in the form of new FDI as well as in searching for strategic foreign partners in existing enterprises that will speed up their restructuring and integration into the processes of internationalisation; (ii) opening the process of privatisation of state property for strategic and institutional foreign investors; (iii) promoting foreign investment in the business services sector in the broadest sense possible; and (iv) promoting private investments in industrial zones where the state will provide suitable infrastructure and conduct a transparent policy. Priority measures intended for realisation of the above orientations are:

- a/ Adjustment of the existing systems of economic incentives to be accessible to new foreign investors and comparable to Slovenia's competitors.
- b/ Establishment of an enterprise to administer the industrial zones and obliging state-owned enterprises with suitable premises potential to provide an internationally competitive land and premises offer for domestic and foreign investors.
- c/ Support to local communities in promoting FDI.
- d/ Establishment of an institution for promoting FDI with a clear legal mandate, professional supervision of operations and appropriate human and budgetary resources.

Outward foreign direct investment. Outward internationalisation includes exports, FDI or other contractual forms of long-term co-operation among enterprises. The state intends to supplement the elimination of barriers to outward internationalisation by means of an active policy of promoting internationalisation. The main belief of Slovenia's policy of promoting outward FDI is that FDI into and out of Slovenia is an integral part of the national economic development strategy. It is expected to have positive effects on the development, restructuring and better allocation of resources, accelerated specialisation and increased efficiency, improved exploitation of capacities, increased productivity or competitiveness. The state will support any Slovenian outward investors through the following measures:

- a/ collection and dissemination of information on investment opportunities and concrete projects, establishment of preliminary contacts with potential foreign partners and more support of diplomatic-consular missions;
- b/ improvement of the environment (climate) and regulations concerning direct investments abroad;
- c/ co-financing of preparatory activities with regard to outward FDI projects and co-financing of capital and/or facilitating access to commercial sources of finance;
- d/ support in human resources training; and
- e/ introduction of topics relevant to internationalisation to programmes of higher education, and in postgraduate courses, stimulation of temporary students' work (professional experience) in national and foreign enterprises with experience in internationalisation.

In internationalising the Slovenian economy, a significant role will be played by the *system of financing and insurance of international economic operations*, including a wide range of services and instruments of insuring and financing. In the context of globalisation, enterprises will have to use the techniques and instruments of the modern and integral administration of risks, and transfer the risks of business transactions to specialised financial institutions that will therefore have to offer a wide range of banking and insurance products. In the competitive race among financial services providers in the domestic market that will have to integrate their services within the developing e-commerce, so-called information capital will become increasingly important, comprising quality and updated databases on debtors, guarantors etc., innovations, service packages, links with clients as well as quality and adjustment of the offer of financial services and products to the needs of enterprises.

Through the measures of economic policy, Slovenia will stimulate the capacity and competitiveness of the private financial sector (banks, insurance companies, other financial institutions) to create competitive conditions for enterprises for financing of their international economic operations, including the use of and access to foreign sources, and to increase and extend the offer of instruments of protection against various risks, to develop various financial and insurance services and adjust the developed financial products to the requirements of business practice and the needs of enterprises. Due to liberalisation of the financial services market that will not be limited to the EU's common market, and due to the Slovenian economy's internationalisation, the providers of such services will have to merge with selected strategic partners.

Through the authorised export-credit agency, the state will supplement the private financial sector's range of services by helping the agency to have access to favourable funds for financing exports and outward direct investments under competitive conditions, in accordance with international rules on officially supported export credits, through the programme of interest equalisation for such credits, and insurance of international economic operations against non-marketable risks. In accordance with economic potential, the state will provide long-term stability and the liquidity of insurance schemes and the appropriate insurance capacity necessary for the Slovenian economy to compete in foreign markets.

5.2.1.2.3. Promoting the Development of Small- and Medium-sized Enterprises

Small- and medium-sized enterprises represent the category of enterprises covered by horizontal programmes for building up competitiveness. Big enterprises usually have sufficient human and financial potential to plan and implement their programmes for strengthening competitiveness and internationalisation. It is easier for them to take advantage of the differences in locational factors. Therefore, in setting-up companies and launching activities, small- and medium-sized enterprises should be facilitated in integrating themselves into the environment, representing a more decisive (entry) factor for them than for the big ones. In doing this one should proceed both from the existing economic activity and the development problems, and take account of economic as well as other, for example cultural or environmental, characteristics of a certain environment.

The main goal of the policy regarding small- and medium-sized enterprises is to create the conditions for strengthening their competitive advantages since upon EU accession they will be exposed to strong foreign competition. The state will support the entire small business sector, in particular its fast developing and innovative units. Considerable emphasis will be put on the creation of jobs in the existing and new enterprises.

Activities to promote the development of small- and medium-sized enterprises will include:

- a/ enterprise development;
- b/ transmission of technologies facilitating entry and survival in international markets;
- c/ establishment of risk capital funds and the intensive integration of public and private resources; and
- d/ development of a supporting environment for the spatial promotion of the development of small- and medium-sized enterprises. The main purpose of spatial promotion is to simultaneously promote domestic entrepreneurship and foreign investment. The state will contribute to developing such an environment by providing appropriate infrastructure and land offers under favourable conditions, providing investors for infrastructural projects, qualified managers of infrastructural institutions, financial capacities of the municipalities to support spatial solutions.

Promotion of the development of small- and medium-sized enterprises will take

place: (i) at the national level through the national development agency co-ordinating the promotion of development of small- and medium-sized enterprises and the integration into EU institutions, as well as by adopting systemic fiscal measures to promote entrepreneurship; and (ii) at the local and regional levels through regional development agencies and by adopting measures to stimulate the transmission of technologies within technological parks and innovation centres, consulting and other activities in accordance with the regional development policy.

5.2.1.2.4. The Lifting of Administrative Barriers and Improvement of the Business Environment

The lifting of administrative barriers to business and investment is an area that by definition falls within the responsibility of the state. Administrative barriers, inefficient enforcement and restrictive interpretation of regulations in practice are particularly harmful for entry and development possibilities of small- and medium-sized enterprises. The barriers are unevenly spread between the various areas of issuing permits. In taxes and customs duties, Slovenia has relatively simple, transparent and functioning systems. The same is true of industrial property rights and standardisation procedures. In the establishment of business (registration of enterprises at court, business activity permits) and the requirements to report on foreign exchange transactions, the existing systems need further simplification and upgrading. The main barriers to investors include the procedures regarding the acquisition of land for investment purposes, the issue of building permits, work permits for foreign citizens and permits to employ and dismiss workers. The problems in these areas, particularly the long duration, complexity, uncertainty and overlapping of procedures seriously hinder investments. The regulatory administrative framework is rigid and extensive, the approach of the administration towards its implementation is unfavourable and restrictive. The establishment of an enterprise-friendly administrative environment and its active and well-intentioned implementation in the sense of 'best practises' in the EU is one of the state's priorities of the future. It will certainly be a long process related to the completion of transition and EU integration, and it will be based on the co-ordinated work of all the ministries involved. In order to resolve such problems, the state will:

- a/ analyse the regulatory and administrative problems faced by enterprises in the procedures for the establishment of business, investment and operations;
- b/ compare such procedures to the most effective solutions found in EU member-states; and
- c/ implement solutions that are most favourable to enterprises.

5.2.2. Development of an Efficient Financial System

The financial system is the main mechanism through which the national economy's savings are transferred from those agents with a surplus in savings who are net savers, to those agents who lack their own savings and are therefore net investors. Therefore, the financial system's efficiency in raising and allocating these funds is

one of the crucial elements that the competitiveness of other economic agents in any state depends on.

5.2.2.1. *The Current Situation and the Problems of the Slovenian Financial Sector*

The prevailing financial agents in Slovenia are banks. So, at the end of 1998, for example, their assets equalled 74% of gross domestic product, the assets of insurance companies about 8% of gross domestic product, and the assets of investment funds and stock exchange agencies about 13% of gross domestic product. During the process of financial sector rehabilitation, the banking sector enjoyed special attention from the state, while the insurance sector was left to rehabilitate itself. The institutions of market capital were not burdened by problems from the past but provided institutional support for privatisation. That is why they still do not perform the functions of a financial agent. The distributive privatisation brought about a large number of shareholders and shareholding companies. These shares, however, are not exchanged very much, they are instead traded outside the organised securities market. Although market capitalisation of the Ljubljana Exchange reached about 22.2% of gross domestic product at the end of 1999, (without taking into account the shares of authorised investment companies), today companies practically still do not use the market capital for additional financing purposes.

The problems the financial sector in Slovenia is encountering can be approached in two basic ways: (i) by segments of the sector, or (ii) by the functions it performs.

The core problems and challenges of individual segments in the financial sector are as follows:

Banking. Despite the progress in Slovenian banking achieved in the last few years and which was the result of intense restructuring, this segment of the financial sector is still far from obtaining international competitiveness. This is confirmed both by data on the scope of the transactions performed per employee and by data on the diversity of services the banks are offering. In addition, Slovenian banking is facing problems of the structure of financial sources, which still involve a high share of short-term sources. This problem will become even more critical for banks when savers start to turn in greater numbers to other segments of the financial sector. As regards investment sources, many banks are facing the problem of losing good and major clients among those companies which seek foreign currency short-term loans. A further specific problem for Slovenian banking will be the abolition of TOM* which is urgently needed in order to reduce inflation to the European level. It will undoubtedly affect both the saving and investment structure and the financial efficiency of the banks' performance.

Insurance sector. The insurance sphere also faces numerous problems. Some of them have already become traditional, for example a high concentration of insurance activities and a relatively low share of premiums in gross domestic product. These are added to by new ones, especially the substitution between the existing life insurance and the recently introduced pension insurance, and problems connected

with the portfolio management whereby insurance companies will have to deposit both at home and abroad.

The securities market. The problems of market securities largely relate to distribution patterns following privatisation. It created a large number of shareholding companies and shareholders who want to sell their shares. Thus, such secondary trade does not assist in the additional financing of companies, but primarily serves to restructure the ownership structure of companies. The characteristics of such trade are low liquidity in exchange markets, a large scope of trade in lots and in the grey market, and a concentration of shares facilitating take-overs. The primary market is especially useful for issuing the short-term securities of the Bank of Slovenia and the Republic of Slovenia. The bonds of the Republic of Slovenia and the banks prevail among the issued short-term securities. Companies have practically stopped issuing new shares to finance real investments. When companies do issue new shares, these are as a rule intended for take-over financing through share exchange.

The problems and challenges facing the financial sector as a whole – viewed in terms of the functions it performs, are especially the following three:

Firstly, *collecting funds, and the new savings habits of the population.* In depositing current savings, Slovenians are relatively conservative and give priority to traditional forms, especially bank deposits. Changes to people's savings habits are gradual so that priority is still given to security, while the expected yield plays a minor role. A somewhat different situation is seen in savings for old age and housing. After the economic system changed, the responsibility of an individual in satisfying these needs has increased. The initial analyses show that households are ready to intensively re-orient their savings for these purposes. This is also confirmed by the significant interest of households to participate in the national savings scheme, supported by state subsidies. Programmes like this are improving the maturity structure of savings in banks but, at the same time, banks are assuming additional short-term obligations. Similar structural changes will occur when the additional voluntary pension insurance becomes fully promoted with the help of tax support. The savings and insurance parts of these pension schemes mean a huge business opportunity for all existing financial sector segments. At the same time, new system risks are appearing in the financial sector due to their mutual investment and ownership links, deeper mutual co-operation and competition. From the point of view of the national economy, they mean significant positive steps ahead in the field of saving, which the state is justified in supporting, but through financial control it has to provide for the short-term financial stability of these programmes.

Secondly, *changes in the financing of citizens, companies and the state.* Sources of additional financing are sought through financial institutions by the state, companies and citizens. The financial sector as a whole, and all its composite parts, will have to consider the changes in demand for financial sources resulting from the new economic system, or else the discouraged customers will start to seek finance from abroad. In the last few years, *the population* has managed to basically increase its share of loans from domestic banks. The largest share were consumer loans, while the new savings scheme for housing is going to increase the share of earmarked housing loans. The possibilities of financing from abroad are much more restricted

for citizens than for companies and the state. *The state and its institutions* have changed their modes of financing the most in the last few years; by issuing various securities they have become dominant in the primary market, and they also issue bonds in the international market. The smallest structural moves in financing methods were observed in the *corporate sector* that still basically rely on taking loans out from banks. The best companies which export a lot are taking ever more loans from foreign banks and domestic banks are thus losing their best clients. In the future we can expect that companies, too, will choose financing through securities. Then domestic banks, with their relatively poorly developed sphere of investment banking, will be faced by the new challenges of competition from abroad.

Thirdly, *financial system and corporate governance*. Another important role of financial institutions is to provide the efficient allocation of collected funds and to exercise control over their use, especially as regards companies. In the context of the dispersed ownership structure that emerged after Slovenian companies were privatised, this role of the financial sector became even more important. After the rehabilitation of banks was completed we can establish that this part of the financial sector already performs control over its clients, like other banks in well-developed economies. Insurance companies deposit their funds primarily in state bonds and with banks, and thus have no direct contact with companies yet. Due to a number of post-privatisation problems, trading in shares on the Ljubljana Stock Exchange also plays a very limited role in controlling companies. From this point of view, a much more important role is played by the authorised investment companies and both para-state Funds which have jointly gathered a total of about 40% of the shares in privatised companies. These are financial institutions which control the largest Slovenian companies, but which still have no clearly defined role in the companies nor in the financial system. Besides, they leave open up the possibility of politics interfering in the economy, thus jeopardising people's confidence in the newly created institutions of the capital market.

5.2.2.2. *Challenges Facing the Financial Sector After Slovenia Joins the EU*

Once Slovenia joins the EU, it is realistic to expect a substantial increase in competition by financial service providers from abroad in the Slovenian financial market. Their offer is expected to be based on the following general characteristics: (i) at least in the first phase, foreign financial agents will operate especially by providing cross-border financial services, therefore without establishing their own institutions in Slovenia; (ii) they will focus their activities basically on those segments of financial services that are either not offered by Slovenian financial institutions, or where their offer is financially or in other ways uncompetitive; (iii) their activities will be focused on those financial services that do not require a large network to be established within a state in order to be performed at a high quality level.

These general anticipations regarding foreign actors' inclusion in the provision of financial services in Slovenia after it joins the EU give grounds for the following forecasts relative to individual financial sector segments for the next five to seven years.

Banking. It is realistic to expect in this financial sector segment that the pressure of innovations will lead to increased efforts to improve the cost-efficiency of doing business. Thus, for example, the expected explosion of electronic banking will have various impacts on the structure and number of staff employed in the banking sector. It is expected that the number of banks operating in the state will drop further, as well as the number of people employed in this sector. At the same time, we can expect great changes in the structure of the people employed in banks in the direction of a higher level of education. Foreign providers of banking services will presumably focus on servicing large, high rating economic entities. Further, it is probable that they will also start offering Slovenian industry those services not previously available in our market, or where access to those services has been limited to a narrow group. One such sphere is undoubtedly investment banking; while a very active role of foreign banks is also expected in collecting and placing Slovenian savings into foreign securities. The sphere where, at least in the first phase, we can expect relatively weaker competition from foreign banks is primarily the collection of citizens' deposits and loans to small- and medium-sized companies. This expectation derives from the fact that both activities demand the physical presence of banks on the spot, and from the aforementioned assessment that, at least in the first phase, foreign banks will cover the Slovenian market primarily by offering services directly from abroad. Banks from abroad deciding to enter these segments of the Slovenian banking services market will try to achieve this goal by purchasing those Slovenian banks with an appropriate network of offices in the state and/or strong "information capital", namely good knowledge of those business actors with whom they have been co-operating for years.

Insurance. Like banking, this segment of financial services is expected to see substantially stronger foreign competition. This especially refers to different forms of life insurance as that particular segment of insurance services in Slovenia offers substantial reserves for a huge increase in the scope of business. Regarding the accelerated trend of creating the financial conglomerates we have been witnessing in Europe and around the world, it is realistic to expect that certain banks will provide various insurance services within the scope of their activities in Slovenia. In this sphere we can also expect that the activities of foreign insurance agencies will focus on providing their services to top quality clients, that is the largest and the best economic agents and the segment of population with the highest purchasing power.

Securities market. In line with the general trend observed in Europe after the introduction of the euro it is realistic to expect that the securities market, that is the issuance of bonds and shares, will also become in Slovenia the most important source of funding the business sector. As regards the issuance of bonds in domestic currency, we have to underline that the moment Slovenia joins the EMU – and the euro becomes our national currency – the problem of low liquidity as one of the main obstacles to the efficient development of the Slovenian market of debtor securities will cease to exist. As regards ownership securities, it is realistic to expect segmentation. Blue chip economic concerns from Slovenia will most probably place their shares on the appropriate stock exchanges in Europe – the central one in Frankfurt or London, or in one of the major regional stock exchanges – while the one in Ljubljana will have to pave its way in the newly emerging European structure of stock exchanges, perhaps as a stock exchange on which companies from other South-eastern states will be

quoted, apart from Slovenian ones.

5.2.2.3. Goals and Measures of Financial Sector Reform

The key goal of the process whereby Slovenia is going to put in place an efficient financial system is to increase its international competitiveness to a level allowing the successful entry and operation of this sector of the Slovenian economy in the common European financial market. In order to achieve this goal, Slovenia will need more sustainable development of all parts of its financial sector in the next few years. This means a relatively reduced role of traditional banking and a relatively increased role of other segments of the financial sector. This is going to happen both for the objective reasons of the altered demands of savers and investors, and because of the call for more equal treatment of all parts of the financial sector by economic policy, especially from the point of view of taxation and the granting of state guarantees for various financial investment forms.

The economic policy measures necessary to set up an efficient financial system can be roughly divided into the following three groups:

- a/ increased competition among financial service providers,
- b/ continued restructuring of financial service providers, and
- c/ an improvement of control. The relative importance of specific groups of measures differs among individual financial sector segments.

Bolstering competition. The issue of competition is crucial for the Slovenian banking and insurance sector which is still characterised by high concentration and a relatively low level of competition. Although the new banking and insurance legislation contains quite a few elements to increase their competition, any efficient solution requires the Slovenian financial space to open itself up more widely to new providers, while in the banking sector it is necessary to speed up the privatisation process of both large state banks, that is the NLB and the NKBM. Both activities are not only important for attracting fresh capital but will have a positive effect on the quality of management and for improving the scope and structure of the banking and insurance services available.

Unlike banking and insurance, which were weighed down by pre-transition problems, the development of market capital is a completely new segment of the financial sector in Slovenia. Although in the period after 1994 it reached extremely high growth rates, the scope of transactions in this market is still relatively low concerning gross domestic product and primarily depends on privatisation-related activities. Further development of the capital market requires the efforts of both the state and economic actors operating in this market, in practically all of its components. It implies an increase in the capitalisation of markets and an increase of its liquidity, as well as the diversification of investors and an increase in business opportunities for all participants in this market.

Restructuring. Banks and insurance companies have to continue the process of internal restructuring and consolidation – by reducing their operating costs and

increasing non-interest revenues – as well as by extending the supply of their services from the classical, ordinary, to the more sophisticated ones. The process includes a series of measures to increase their profitability, capital adequacy and economic efficiency, including the continued reduction of the number of employees and the intensified training of staff.

Control. Increased competition and internal restructuring of banks and insurance companies should be accompanied by an appropriate control system. The same applies to the efficient development of the capital market. Slovenia has not been left out of the global trend of creating financial conglomerates, although in our state these are only the beginnings. The focus is primarily on links between banks and companies providing securities-related services, and lately there have been more and more links between banks and the insurance sector. The financial legislation adopted in 1999 and 2000 was a very important positive step towards ensuring efficient control over financial services in Slovenia and, in this framework, also the financial conglomerates in our state. Pursuant to this legislation, Slovenia – for the time being – actually rejected the concept of one control institution and decided to continue its control of the financial sector through the co-ordinated activity of three supervisory institutions, each being responsible for controlling its own segment of financial services: the Bank of Slovenia for banking, the Insurance Control Agency for insurance, and the Securities Agency for the capital market.

Priorities in developing an efficient financial system are therefore as follows:

- a/ Prepare privatisation programmes for the NLB and NKBM which will support the development of a competitive banking sector in line with the above stated guidelines, and then actually implement them in accordance with the set timing;
- b/ In the field of insurance: immediately after adoption of the constitutional decree carry out privatisation on its basis and on the basis of the law; and direct economic policy measures especially towards strengthening the capital power of insurance companies and harmonising the conditions of establishment, management and control to international standards;
- c/ Carry out the exchange of ownership certificates for state ownership and thereby create conditions for the transformation of authorised insurance companies into standard financial institutions for portfolio investments or public shareholding companies for managing other companies;
- d/ Adopt measures in the field of taxation and other policies allowing the state to stimulate short-term forms of saving, like for example for housing and pension insurance. Stimulation of various investment schemes through special tax relief or exemptions is very demanding, especially from the point of view of administration and the provision of adequate control since such schemes are ideal for tax evasion or a more beneficial tax treatment of those people with a high income who can invest in these schemes.
- e/ The measures the state is going to adopt in order to create the conditions in which the primary securities market will become a more important source of financing the Slovenian entrepreneurial sector; and
- f/ Continue with improving the control over financial institutions either through a common control institution for all three segments of the financial sector or through improving the co-operation of the three existing supervisory institutions.

5.2.3. Development of an Efficient Economic Infrastructure

Economic infrastructure sectors – which include transport and communications, energy and communal infrastructure – provide services of crucial importance for the development of an economy as a whole, either by increasing the scope and selection of available services or through their geographical distribution. The efficient, reliable and consumer-oriented operation of these sectors is therefore one of the main conditions of guaranteeing the state's high and stable economic growth and improving its international competitiveness.

5.2.3.1. *The Current Situation of Transforming Economic Infrastructure in Slovenia*

In the last decade, Slovenia initiated reforms of public commercial companies but the pace of these reforms is much slower than in certain other sectors of the economy, especially in the entrepreneurial sector, and slower than what the intensively developing market economy actually needs. The pace of reforms was particularly slow in the first years of transition, and a slight acceleration was only observed in the last two years in the context of Slovenia's negotiations for full-fledged membership in the EU. Below, we are first going to present the situation, problems and results of reforming individual segments of economic infrastructure in Slovenia, and then an evaluation of the gap between the necessary investment in economic infrastructure on one hand, and the state's macroeconomic capabilities on the other.

5.2.3.1.1. **The Situation and Problems in Reforming Economic Infrastructure**

Energy sector. The chief burdens from the past are the high energy intensity of the economy, and a high level dependence on importing gas and oil. Domestic warehousing capacities for oil and oil derivatives are also quite limited. The result is that the petrol and diesel fuel stock is generally below the 90-day-consumption level called for in the existing EU Directives.

The electricity industry is still almost entirely in state ownership, while in the sector of gas and oil ownership is divided among the state, funds and employees, while in gas distribution private shareholders are also involved. The problem is not only the ownership question but, to an almost equal extent, the market structure involved. Big changes in the electric energy industry are expected from implementation of the Energy Act adopted in 1999. Before its adoption, the entire electricity industry sphere was regulated as a public commercial company, while the new Act and its implementing regulations have restricted public commercial companies merely to electric energy and gas transfer, and to electric energy distribution. In line with this Act, the production of electric energy will be therefore carried out as a market activity.

In addition, this law complies with the EU's requirements as regards the opening of electric energy markets. In April 2001, the electric energy market will be liberalised

for domestic producers and, in 2003, also for foreign ones. By granting the status of non-entitled customers to all those that consume more than 41 kW of electric energy, about 64 percent of supply will be carried out in the context of competition, whereby customers will have regulated access to the network. Due to the unfavourable composition of electric energy sources, we can expect a high level of 'stranded' investments – Šoštanj, Trbovlje – and consequently also higher prices for non-entitled customers. In line with the EU Directive, the market will also be opened up for purchases of natural gas in 2003.

Pursuant to the new law, energy sector control has become the responsibility of a special supervisory body – the Energy Agency – which will be in charge of fixing the prices of electricity and gas, network utilisation, and control over the operations of this segment of economic infrastructure. From the point of view of regulating prices in the energy sector, the Energy Act states that the state has chosen the regulative method of a 'price cap' which provides for the fixing of an upper limit of an allowable price increase ($RPI - X$)⁵.

Telecommunications. With over 40 connections per 100 inhabitants, Slovenia has quite a high penetration rate, but the quality of telecommunication services is relatively lagging behind the level required by a fast developing economy and which is typical of developed market economies. Early in 1995, the Government divided the Slovenian PTT up between Slovenian Post (Pošta Slovenija d.o.o.), and Telekom Slovenija d.d., whereby until the end of 2000 Telekom was given the exclusive right to manage the fixed public switched telephone network (PSTN) and to perform the obligatory public commercial service of voice telephony and telex. The provision of telecommunication services which are conditioned by the use of the radio-frequency spectrum, save for the services of obligatory public commercial services of transferring and broadcasting the RTVS* radio and television programmes, has already been liberalised and is based on concession licensing of individual frequencies.

The legal basis for implementing this separation of the functions of ownership, control, and managerial functions in providing telecommunication services will be established by the new Telecommunications Act to be adopted by the National Assembly. This Act will create the conditions for liberalising the telecommunications sector, and telecommunication services will lose their status of a commercial public service. The Act and the negotiating positions of the Republic of Slovenia with the EU provide that regulation of the telecommunication sector will be the responsibility of an independent agency with administrative, professional and financial autonomy.

Transport. The transport sector in Slovenia is also characterised by a number of problems. One of them is undoubtedly the high concentration of transport flows on the roads, which is directly related to the unsatisfactory situation in the field of traffic safety, and also implies heavy pressure on the environment. Among reasons why the use of railway transport is still far below the potential scope that would be attractive in commercial terms, there are, besides the developmental or economic-

⁵ This is the index where prices can be increased by RPI, that is the retail price index measuring inflation. The X index is deducted from it, meaning an estimate of increased efficiency, or cost reduction.

political reasons, the geographical characteristics of Slovenia, and the technological characteristics of railway infrastructure. But in evaluating the development possibilities of this sector, we should not neglect the advantages it has over road transport. The first advantage is that the railways are much less of a burden on the environment. Thus, the construction of railway track requires much less space than motorways, and railway transport pollutes the air much less and needs less energy per unit of service provided. Another advantage of railways is that safety is much higher than in road traffic.

In the last decade, Slovenia has seen some progress in reforming and commercialising its transport sector. Liberalisation in the road traffic sphere led to a strong rise in the number of minor hauliers which has resulted in a disequilibrium between demand and supply in the transport services market and increased pressure on the provision of services in international, especially cargo, transport. Minor hauliers are not very well prepared to meet the technological, financial, educational and social conditions in force in the EU, nor to face foreign competition. In Slovenia, railway transport services are performed by a public company. Despite a substantial drop in the number of employees and the rationalisation of other costs of doing business, it still depends a lot on the transfers of state funds. The national budget provides funds for subsidising passenger and combined transport, and all of the funds required for the maintenance and development of infrastructure. Following the EU's Directives, a reorganisation of Slovenian Railways is envisaged. They will probably remain a joint corporation with two separate companies operating within it – one for infrastructure and one for transport.

Communal infrastructure. The construction of communal infrastructure and the provision of local public services is supervised by two authorities in Slovenia, that is at the levels of the local community and the state. Although the main purpose of the legal regulation was to transfer these authorities to the local level, the solutions adopted with regard to the financing of local communities – despite enforcing the competence to fix the prices of communal services at the municipal level – do not guarantee a sufficient material basis to carry out this Directive. In addition, many local communities are simply too small and have insufficient know-how to be able to manage this segment of the economy efficiently.

The transfer of competence for fixing the prices of communal services (water, waste, gas, district heating) to the local level has resulted in a wide range of different prices in the last few years among individual local communities. This wide range calls for a serious study of the proposal to introduce a centralised system of regulation whereby the fixing of prices would not only be left to local communities but would promote competition in the provision of services.

Quality infrastructure. This sphere is divided into three key systems – the national system of measuring, the system of national standardisation and the system of monitoring compliance. A quality infrastructure includes the work of national institutions (these are proportionally financed by the state) and a large number of laboratories and other performers in this field (these are primarily market-oriented). After gaining independence, Slovenia had to establish anew national systems in the field of quality. Because of the close participation of Slovenia in international co-

operation in all fields of state activity – especially with developed states – a well-functioning and particularly a world-recognised national quality infrastructure is one of the crucial prerequisites for Slovenia's successful and equal integration into the EU and beyond. So far, Slovenia has invested in this field – as regards the part under the responsibility of the state – about three times less funding than seen in other comparable European states. The result is an inability to cover all needs adequately and, consequently, the degraded functioning of the state, unequal international co-operation and hindered access to developed foreign markets.

5.2.3.1.2. Investment in Economic Infrastructure: the Gap between What is Needed and What is Possible

Slovenia faces an urgent need to invest more in economic infrastructure. Based on data in the applicable developmental documents concerning individual sectors of economic infrastructure and data collected directly from the performers of these activities, it is estimated that the need to invest in the Slovenian economic infrastructure between 1996–1999 reached the level of over 8% of gross domestic product. If these figures are compared with the scope of the actually realised investment level – it equalled about 5% of gross domestic product which is comparable to the level of such investment in industrially developed states – we arrive at a rough picture of the gap between the investment needs of Slovenia in the field of economic infrastructure between 1996–1999 and the resources actually allocated to these purposes by the state and its economic actors. Thus, this gap equalled over 3% of the annual gross domestic product of the state.

The gap between investment needs and the actually realised investment was not evenly distributed in the three main sectors of economic infrastructure. It was by far the largest in the communal infrastructure sector where investment needs were as much as 4.5-times more than the actual investment made. This clearly shows that in the past this sector was extremely under-capitalised and it will have to receive considerably higher amounts in the future. In the energy sector, too, investment needs were evaluated at a level much higher than what was actually realised and the former was about 100% above the latter. On the contrary, the investment realised in the sector of transport and telecommunication was much closer to the desired level. However, it is necessary to note considerable differences among the various branches of transport. While the motorway programme received enough funds thanks to the guaranteed budget financing, some other segments like railways shared in common the situation of deferred investments with most other infrastructural activities.

5.2.3.2. Common European Service Market in the Economic Infrastructure Sectors

Radical changes have occurred in the last two decades in economic policies regulating the operations of various sectors of economic infrastructure in practically all states around the world. Although the goals, pace, and reform processes themselves differ markedly among individual states, a common trend is more than obvious. The basic goal of all these reforms is to ensure the most efficient operation of infrastructural

sectors possible. They are trying to achieve this goal by both increasing the role of the market in all spheres where the competition so far was too weak, and by basically changing the state's role in these economic sectors. The state is increasingly relinquishing its role as the owner of economic infrastructure and direct producer of services in this field to the private sector, while assuming ever more the role of regulator and controller, guaranteeing consumers quality- and price-efficient services. Changes in the field of regulation and control are directed above all towards creating the conditions required to reach a higher level of competition and to improve the quality of services.

In the EU, the processes of liberalisation of services in economic infrastructure and the reform of these sectors were under a strong influence of general processes of creating the conditions for the efficient operation of the internal market for services and therefore under the strong influence of achieving the goals set out in the Treaty of Rome. In order to meet these goals as efficiently as possible, the EU has adopted a series of Directives in the last few decades where it has defined in detail the pace of liberalising the market for these services and the pace of harmonising the rules involving the regulation and control of infrastructural activities. The enforcement of these Directives is being carried out gradually. While the EU single energy market – its key goals are increased competitiveness of this sector, the safe supply of energy, and environmental protection – is already operational to a great extent, implementation of the EU Single Transport Policy is still quite far from complete realisation, while the field of communal infrastructure is, at least as regards management, entirely the subject of national regulation.

Measures adopted by the EU in the field of regulating infrastructural activities can be divided into two large sets. On one hand, there are measures with the main purpose of increasing competition in all segments of economic infrastructure where possible and, on the other side, measures oriented towards defining the operating conditions in those segments of economic infrastructure where specific features make competition either impossible or unreasonable due to economic and/or other reasons. The measures in both sets are subject to common directives on opening up the market of economic infrastructure services to competition and on allowing equal, neutral, objective and transparent access to infrastructure. In addition, these directives strive for the availability of basic services to users and to linking prices to costs, which is supposed to prevent cross-subsidies and to enforce the 'consumer pays' principle.

5.2.3.3. Goals and Measures in Establishing an Efficient Economic Infrastructure

The strategic goal of Slovenia's economic infrastructure development is to ensure the reliable and cost-efficient provision of services in the field of energy, transport and telecommunications, and communal services. In this context, the development of economic infrastructure will apply the criteria of the population's security, the rational use of energy, and protection of the environment. By allowing better transport connections, improved telecommunications and easier access to environmentally-friendlier and cheaper energy sources, the economic infrastructure sectors will

contribute not only to the increased productivity of the state and consequently to its greater international competitiveness, but also to raising the general welfare of the Slovenian population. Realisation of the goals set in this field should be discussed within the framework of a realistic expectation that in the period up until Slovenia joins the EU, the internal market of economic infrastructure services will be practically completely enforced.

In order to be as successful in meeting the abovementioned goals, the state will continue structural reforms in the sector of economic infrastructure. These reforms will, in the next few years as well, include more sets of measures whose common denominator is to ensure the market-oriented development of economic infrastructure. A greater commercialisation of economic infrastructure services will be the red line of practically all the reforms the state is going to continue in this field.

Cost-effective production. One of the basic elements of a market-oriented transformation of economic infrastructure is the promotion of cost-effective production, accompanied by the necessary adaptation of prices and tariff systems for the calculation of services provided in the economic infrastructure. The reform of these systems of prices, connected with the more efficient collection of payments, is not only important for balancing the supply and demand for services but also for improving the financial position of those companies providing these services. The key orientation will be, within a reasonable time, that prices reach the level at which they reflect, in socially differentiated terms and within the obligatory scope and quality of services, economically and environmentally reasoned costs of supply, while extraordinary supply will be free to enforce the market conditions of supply.

Managerial independence of economic agents. The next urgent change will be the establishment of greater managerial independence of the economic agents providing services in this field. Although the process of the status transformation of infrastructural companies has more or less been completed, the process of the actual separation of the ownership, control and managerial functions is still in a relatively early phase. This means that the regulation of relationships in this field will require activities to limit the implementation deficit. The process of establishing greater managerial independence will be accompanied by the continued restructuring of these companies. They have to adapt to the new conditions in the market, including the demands they face on entering the EU's internal market. The state will also have to define its position on the provision of the same services by various segments of economic infrastructure whose subjects are now still owned by the state (for example, telecommunications services that are provided, apart from Telekom, or will shortly also be provided by the electric energy industry, railways and DARS).

Increased competition. The process of company restructuring will not be successful without stronger competition. The introduction of competition or the inclusion of the private sector in the provision of services can be carried out in two ways. The first way, the 'competition in the market' (this is competition where companies compete among themselves in providing the same services, for example transport between two points), is usually more appropriate for the provision of infrastructural services than for infrastructure *per se*. This form of competition which is based on

the free access of competitors to the market of services has huge prospects especially in the field of road transport of goods and passengers, allocation of railway train corridors, but also in the fields of telecommunications and partly in the field of energy. Another form of competition, the 'competition for the market' (this is competition where companies compete to obtain a licence to provide services in a certain period of time) is suitable in a number of other fields, and is even more important in small economies like Slovenia's.

Efficient regulation and control. Independent control institutions are key to the efficient monitoring of competition, where the scope and structure of control will depend to a great extent on the form of competition as presented in the previous chapter. Since the newly adopted Slovenian legislation follows the European model of establishing independent sector control institutions, it is recommended to institutionalise the mechanism of professional co-operation and harmonisation among them which would also allow the use of a single methodology and the exchange of knowledge and experience.

Investment in the economic infrastructure. In the next medium-term period, the state will direct investment to removing those gaps in the existing economic infrastructure that already represent or shall represent a restrictive factor of economic or social development. In making decisions on investments it will be necessary to consider the impact that liberalisation will have on the provision of services in various segments of economic infrastructure. Only when the state has co-ordinated its sector strategies and established a suitable legislative and institutional framework will it be realistic to expect an increased role for the private sector in financing investments. This type of investment in the form of concessions and BOT forms of project financing, as well as other forms of partnership between the public and the private sector, are indispensable if Slovenia wants to at least partly fill the above presented gap between the investment needs and the traditional sources of financing.

Priorities in the field of establishing an efficient economic infrastructure are therefore the following:

- a/ Continue realisation of the existing programmes of the construction of economic infrastructure in the field of building the road network, modernisation of railways, linking of telecommunication networks and investment in the communal infrastructure and in the transmission energy network. In line with the defined developmental priorities and the evaluation of the available public and private sources, it will be necessary to define as soon as possible and to prepare priority programmes by individual segments of economic infrastructure. In this framework, it is necessary to identify which segments will receive, in the short-term period, relatively more, and which ones relatively less resources;
- b/ Define those segments of economic infrastructure where we have planned privatisation and other ways of including private capital, those where the inclusion of private capital is accepted, and those where the inclusion of private capital has not been planned;
- c/ Prepare legislation to define the procedures of including the private sector in the construction and financing of economic infrastructure and in the provision of

- infrastructural services in this field;
- d/ Establish an institution to provide assistance to line ministries and local communities in preparing projects where the inclusion of private capital is envisaged;
 - e/ Introduce systemic solutions enabling the financing of communal infrastructure; improve the transparency of providing and charging for services in infrastructure, especially the communal level, including the public finance sources collected together with the price charged for infrastructural services;
 - f/ Ensure suitable conditions in terms of staff, organisation and finance, as needed for the quality operation of independent institutions for the control of individual segments of infrastructural activities; and
 - g/ Increase the transparency of the processes applied in public tenders.

5.3. Improving State Efficiency – An Element of National Competitiveness

5.3.1. The State's Organisational Structure Required to Conduct Economic and Development Policies

The strategy derives from an understanding of the state as a democratic actor increasingly limited in its operations by the globalisation and independence of other autonomous social agents. Qualifying the state as being able to perform its role of implementing the strategy and pursuing the economic and developmental policy requires the establishment of a flexible, professionally qualified, non-political and efficiency-motivated public administration. So far, progress in this field has been relatively moderate.

From the aspect of state efficiency, the main problems concerning the administrative reform are as follows:

Inadequate managerial organisation. A hierarchical, rigid organisation is prevailing, and the criteria of efficiency have no suitable value. There are no suitable motivating mechanisms to manage human resources, which is reflected in the inappropriate quality of staff. The users' opinions concerning the administration's services are not collected systematically.

Unsatisfactory organisational solutions incapable of ensuring the conformity of economic and development policy measures and their integration over a longer period of time. The co-ordination of policies is indispensable because measures in different fields share the same restrictions. These are not necessarily taken into account in the measures of line decision-makers because many goals may only be realised through the co-ordinated action of several ministries and because the synergetic effect of these measures can only be achieved through co-ordination. In 1993, the Government adopted a system of planning which envisaged 4-year budget

projections and the preparation of sectoral national programmes, a spatial plan of the Republic of Slovenia (it is still not elaborated), and the Strategy for the Economic Development of Slovenia. Because the planning system did not provide the binding short-term conformity of public finance decisions, we are now faced with a pile of sectoral development documents which are often equivalent to laws, but which are impossible to implement within the realistic public finance framework (the gap between the 'desires' spilling over from the programmes and the actual fiscal capacity is over 5 percent of gross domestic product). The rules in the field of public finance adopted in the last two years have included the principles of programming and incorporating development documents in the system of preparing the current budget, and they have upgraded the role of the Minister of Finance with the purpose of reducing the role of 'budgetary negotiations' and giving greater weight to content-related decisions on the policy that is implemented through public finance expenditure and revenue. However, the annual national budget is only one part of economic and development policy since many state measures have no direct budgetary impact, or they are less important in assessing the reasonability of measures than their macroeconomic or developmental consequences. Decisions on the distribution of budget funds among various users therefore cannot be made only on the basis of fiscal criteria, but it is necessary to consider their effects on all economic actors and not only on the national budget.

Excessive concentration of competence or tasks in the state administration. The state's role will be changing and it will increasingly become just one of the equal partners in social and economic life. The civil society is becoming more complex, it is ever bringing together more educated people who are functionally interdependent. This results in the autonomous self-regulation of individuals, groups and organisations. Today, the state too often directly manages organisations in the field of public services and industry, although a greater autonomy of providers could be more efficient. Institutions of developmental partnership with civil society, industry, and regions are too weak to be able to use all of the developmental potential available.

Excessive centralisation. Slovenia is heterogeneous in terms of its nature, economy and society, with a clearly expressed regional appurtenance of its population. Differences in development levels among the different parts of the country have been growing since independence. The changed circumstances require different approaches to resolving the social, economic and space-related issues in various parts of the country. They are more efficient if part of the funds and responsibilities for them are transferred from the state level to the regional level. The establishment of regions is also urgently needed to allow more equal co-operation with other European regional centres and in order to obtain funding to finance projects from the EU's structural funds and cohesion fund. For all of these reasons, the current situation, whereby the shaping of local self-government is not accompanied by the shaping of regions, does not allow an optimal developmental and regional policy.

Deriving from the crucial problem spheres explained above and with the aim of creating an efficient, flexible, professionally well-qualified and user-oriented public administration, we have determined the main guidelines of the administrative reform.

a/ Strengthening of the competence and professionalism of the state administration.

Regulation of the status of civil servants and the definition of the competence of the Government and its officials has to draw a distinction between formulating the political guidelines on one hand and the professional autonomy and responsibility of officers on the other. More resources will have to be earmarked for the training of civil servants, especially as regards alignment with the *acquis communautaire*. Professional qualification and professionalism at work should become an even more important criterion of the remuneration and promotion of civil servants. The currently non-transparent and non-harmonised way of fixing public sector salaries has to be regulated systemically and by applying standard criteria. Only suitable criteria for promotion and remuneration and the support of professional training can prevent negative selection in the employment of professional staff in the public sector.

b/ Introduction of the principles and procedures of the new public management.

Greater flexibility can only be achieved through a more flexible organisational structure, the removal of bureaucratic barriers of regulations and various procedures and practices, by modernising operations and promoting electronic communications with users, and by considering the satisfaction of users as an important measure of the efficiency of the work done. The principles of the new approach in the public management mean the greater autonomy of the users of public funds in making decisions on their use along with the simultaneous greater responsibility for the objectively measurable indicators of the efficiency of operations. In the field of social (non-administrative) activities, this means to transfer direct management from the state to the autonomous administration of contractual organisations, with the participation of the citizens or civil society in the management wherever possible, and the reasonable introduction of the market competitiveness of various suppliers, and the transfer of the performance and financing of some public functions to the private sector.

c/ Removal of non-administrative functions from direct state authority. It is necessary to remove from state authority those tasks which do not mean the performance of administrative functions, and to transfer them to be performed by other organisational forms, especially autonomous public institutes and private concessionaires. Regulatory function of the state will have to be partly transferred to independent regulatory bodies. The most important measures in this process are: (i) corporatisation of state ownership in contractual organisations (transfer of ownership rights from the state to institutes following the model of universities); (ii) removal of bureaucracy in institutes, or the abolition of the status of civil servants for employees in social services; (iii) promotion of the status of an institute for all, or the majority of organisations in the field of social (non-commercial) activities (transfer of establishment rights to institutions, except for control); and (iv) promotion of the co-participation of representatives of civil society in all centres of decision-making in programme-related or professional matters.

d/ Establishment of the regions. It is necessary to amend those provisions of the Constitution preventing the establishment of regions and those provisions hindering the decentralisation of state powers. Regions should be shaped on the basis of law, when the voluntary interest-based association of municipalities progresses to the point where they may reach an initial consensus on their borders. Because of the possibility of competition-based links and competition among regions in the internal European market, it is reasonable to create a smaller number

of larger regions. These will take on, on one hand, the operation of those matters that exceed the capability of municipalities and, on the other side, the state will transfer to them the competencies and tasks that can be more efficiently resolved at a decentralised level. The first step towards the transfer of competence and financial resources to the regional level is the enforcement of the regional partnership in decision-making at the state level, the promotion of the closer co-operation of local communities at the regional level, and the concentration of human resources and financial potential at the regional level.

e/ Establishment of a partnership relationship between the state and its citizens.

More than up until now, when the social partners focused primarily on the incomes policy and the social situation of the citizens, social dialogue will have to put emphasis on economic development and the restructuring of economic activities and, thus, on the structure of the employed, and other issues pertaining to the increased competitiveness of the Slovenian economy. Together with social dialogue, it is necessary to develop other forms of partnership as well, especially those between the state and the local communities or regions, between the state and non-governmental organisations, and between the state and industry. The state should support the self-organisation of civil society by creating a catalytic network which supports co-operation without eradicating the differences between the two spheres by creating a hierarchical structure. Furthermore, the state must ensure the efficient protection of human rights and dignity, which is a prerequisite for satisfying people's needs and for their equal participation in the managerial processes.

f/ Organisation of the Government suitable for conducting economic and developmental policies.

It will be necessary to produce formal solutions ensuring the horizontal harmonisation and co-ordination among the ministries in shaping the main guidelines and measures, and the systematic monitoring and evaluation of the results of their operation. It will be necessary to bring about a unified planning system allowing the preparation of consistent short-term developmental guidelines and their conformity with the current measures both as regards their contents (which is the task of development strategies and current policy-shaping) and finance (which is the task of development programmes and budgetary co-ordination). When setting up the state system of development planning, it will be necessary to define the minimum environmental/developmental contents.

5.3.2. The Developmental Role of Public Finance

Public finance is at the centre of economic developments in a state and is a useful instrument for achieving a number of goals. The intensity of fiscal burden contributes to a competitive environment where commercial companies operate, while the taxation structure changes the impact and significance of individual production factors. The type and scope of tax, and tax relief, are used to regulate the consumption of individual products or groups, and to bring about socially or economically desirable behaviour.

General government expenditure is designed to pay for the services performed by the state or public agencies. With their help, citizens improve their living and working

conditions. Social transfers, i.e. benefits in cash, provide (or at least should provide) a source of decent living for those citizens not constituting the labour force or those who have a very low income despite being part of the labour force. The state itself may, in the role of economic agent, direct general government expenditure to those activities and/or projects that have been set as its goals or through which these goals will be easier to achieve. It can invest in infrastructure, ensure the desired structure of settlement, or rectify damage that the commercial insurance agencies refuse and/or cannot cover.

Above all, public finance is a reflection of other policies: (i) the social policy determines a large part of general government revenue and expenditure. The social system rules adopted to implement a given social policy are integrated into the public finance rules and, consequently, influence the scope of public financing; (ii) if the government conducts a policy of encouraging the competitiveness of producers, public finance then influences economic conditions with the level or structure of tax. It can also prioritise production in its territory by means of a lower tax burden; (iii) the technological, product or areal structure of production can be stimulated by expenditures for science, education, technological parks, areal conditions, and the creation of venture capital funds serving as a basis for investment in new products, producers or productions; (iv) defence strategy and policy have their own public finance impact, as do the policy of public security, prevention of noxious or criminal behaviour and actions; (v) the policy of rural and agriculture development together with the environmental policy largely guarantee conditions needed for the development of local and non-urbanised communities, the preservation of social and environmental conditions and heritage. Their impact on public financing is shown both on the revenue and expenditure side.

Following the Maastricht Treaty criteria, Slovenia is a sound economy in terms of public finance. Unlike the majority of EU member-states, Slovenia has been increasing its general government deficit since gaining independence (or, to be precise, it moved from being in surplus to a deficit), and the public debt as well. The situation in Slovenia is similar to those EU members which have radically reduced their deficits but failed to remove it; changes to their tax systems were not carried out with a primary view to reducing the scope of compulsory levies relative to gross domestic product, but because of a more suitable and acceptable revenue structure adapted to the new economic and social conditions.

5.3.2.1. General Government Revenue

Compulsory levies (*prélèvements obligatoires*) are an obligation for taxpayers imposed by law, representing the lion's share of general government revenue in all fiscal systems. In economic terms, compulsory levies are the operating costs of the state and the cost of the social insurance system prescribed by the state. There are big differences among states as regards the amount and structure of revenues. There is no rule serving as the criterion for determining a suitable amount or an appropriate structure. It is generally accepted that indirect taxes are better and that it is better for an economy if labour is levied less and if more revenue is obtained from turnover. It is also better if the differences in tax rates compared to neighbouring economies

(states) are as small as possible.

Although the growth of general government revenue lagging behind the growth of gross domestic product has always been the goal of economic policy, the compulsory levies in Slovenia have kept growing since 1992 and even grew faster than gross domestic product. Within this framework, contributions increased very slowly, while taxes rose much faster. This was in line with the generally accepted position about the restructuring of compulsory levies to the benefit of indirect taxes.

General government revenue collected from the residents. In Slovenia and elsewhere, the population is the largest taxpayer. It pays taxes on consumption, taxes on income, property, and social security contributions. Their scope and structure change in relation to the redistribution of income or tax rate and depend on the level of activity. Economic policy can, upon achieving general objectives, change the level and structure of the tax burden imposed on its population.

Changes concerning the tax on salaries (personal income tax) will be directed towards extending the tax base and the restructuring of relief. The tax scale used for assessing income tax will be restructured and tax will increase for people in higher income brackets by extending the tax base to those sources of income so far exempt from tax.

Social security contributions paid by citizens cannot be lowered because all forecasts of this type of expenditure point to an increase. Since contributions mean the payment of a future benefit in the system of social insurance, we should not neglect the possibility of their increase, but we should guarantee greater equality among the payers of this contribution.

The property and savings that some individuals acquire for the purpose of ensuring their financial and material security in cases where this is currently covered by social insurance and managed by special institutional investors or financial agents will have to be exempt from taxation to the largest extent possible. This already holds for the acquisition of savings in additional pension insurance schemes, but it would be good to extend it to health insurance for additional payment of the full price of services, insurance for long-lasting care, and the creation of funds for schooling.

In future, **real estate** will represent a more substantial tax source. It has to be noted that introduction of the tax on real estate will not be able to entirely perform its envisaged fiscal, tax and political role in the period of this projection due to the poor records.

Tax on consumption imposed on the end-user but paid by commercial companies.

Commercial companies calculate and pay the largest amount of tax within value-added tax imposed on the end-user. Changes in taxation of final consumption should take into account both the public finance concerns and the impact of the changed rates on competitiveness of Slovenian producers in the context of entering and integrating into the EU's single market.

Public finance revenues from commercial and other companies. Commercial companies (or individual economic agents) pay taxes on the use of inputs, taxes on business results, and taxes on ownership or capital.

The effective tax rate on profit is very low in Slovenia, therefore it is unreasonable to project any reduction. The low rate of tax on corporate profit is the very reason why it would be necessary to regulate the other administrative and technical conditions influencing investment. In the case of tax on profit, it will be necessary to extend the tax base and rearrange the system of relief with a focus on the development of those components in business operations which could contribute the most to increasing value added through the human factor.

Direct payments. Direct payments by individuals (natural and legal persons) for certain services and goods provided by the state or public services and which are also included in budget revenue, are often understood as a tax on tax. Concerning services and goods which are not of a general nature and whose users are known and the cost can be defined, the individual person's payment is more economically and socially reasonable. This applies especially to the use of state-funded infrastructure, the use of substances detrimental to the environment or health and to those services that state agencies provide for the citizens on their request and are above the standard otherwise applied to all citizens. In all of these fields, direct payments may be higher, but must be linked with a person's own behaviour.

Non-tax general government revenue should increase significantly. One-off revenues generated by privatising state property should not be reflected in the state's increased current expenditure but in investment and lower public debt.

Priority measures in the field of general government revenue are therefore the following:

- a/ The need for a general government balance in the near future does not enable any further drop in the tax burden (compulsory levies relative to GDP).
- b/ Within the framework of ensuring the general government balance, the restructuring of revenues is also necessary. This should enable the abolition of those taxes which, from a social, economic or public finance point of view, are no longer suitable, acceptable or not substantial enough and, at the same time, it does not exclude the possibility of introducing new sources. The revenue structure will have to be changed towards lowering the burden on income from work, which is in line with the EU guidelines of increasing employment and Slovenia's need to ease the position of labour-intensive industries. An effective transfer of sources from the EU requires an increase in Slovenia's absorption capacity and, in this context, the administrative capacity of the public administration.
- c/ Changes in the tax on income (personal income tax) will be oriented towards extending the tax base and restructuring relief.
- d/ Social security contributions paid by the residents will not be reduced. Since contributions are, in principle, the payment of a future benefit within the system of social insurance, we should not disregard the possibility of increasing them, but we should ensure greater equality between the payers of contributions.

- e/ Savings that individuals have created within the framework of supplementary pension and additional health insurance schemes, and the possible new forms of insurance for long-lasting care and schemes within the framework of education funds, should be tax free to the largest extent possible. The taxation of property – especially real estate – will become a more substantial tax source in the future.
- f/ Within the framework of the above restructuring of revenues, while taking into account its influence on economic competitiveness, it will be necessary to re-examine the raising of the general value-added tax rate.
- g/ The effective tax rate on corporate profit is very low in Slovenia, therefore any decrease may not be envisaged. Due to the low rate of tax on profit it will be necessary to create such administrative and technical conditions that will stimulate investment.

5.3.2.2. General Government Expenditure

As far as general government expenditure is concerned, more room should be found for stimulating technological modernisation and investment in human resources, namely, education and training, research and development, information technologies, and an active employment policy. At the same time, we should reduce the share of expenditure for the production of those goods and services that could be produced and/or financed by the private sector.

General government expenditures for citizens. The payment for services provided by public and state agencies, the allocation of money to individuals who are entitled to benefits in cash, and the financing of certain activities (entitlements) constitute public finance expenditures designed for the citizens.

The benefits received by the citizens are to the largest extent related to ensuring their social security⁶. In the most financially generous social systems, the number of beneficiaries is determined, with the number being on the increase; the total amount of expenditure is regulated by the monetary value of each benefit. Therefore, the rules for determining their basic amounts are changing, relief for related persons is abolished or added, the rules for adapting the amounts of individual benefits to movements in referential values are changing as well.

Like in benefits, one of the feature of services is that their share in general government expenditure does not only depend on their type and number, but also on (in this case) the price. The main component of costs, which makes up the price, is salaries and material costs. For this reason, expenditure on services may only be controlled by means of a suitable wages policy in the public sector and by introducing such organisational structures that allow the control of the material costs. The number of services is more influenced by the organisational structures of these activities.

⁶ Slovenia's social security system is one of the alternatives that are most common in continental Europe. It is characterised by rights that are to a large extent related to labour, pay or contributions. It strongly depends on the situation in the labour market and the system itself influences the behaviour of people in relation to work. The basic types of rights are determined in advance and financed within the social insurance system through contributions. The other part of this kind of social security system is guaranteed on the basis of rules which take

As opposed to the services and benefits, it is difficult to determine output units in the activities, which is why they are usually considered as a whole. However, due to technological changes and a different attitude towards ensuring the general working and living conditions, some activities (especially in state services and agencies) can be re-organised as business activities with the nature of a public service or even as an activity which competes with others in a free market. These activities could be financed in other ways than merely from public funds or even only from general taxes.

As far as the scope of services is concerned, public services and state agencies should remove all those tasks that these organisations impose on themselves and which reduplicate procedures and costs. All of this requires a deeper reform of the state in its role of performing its public functions.

General government expenditure for commercial companies. Commercial companies receive payments for the work, products, services or materials provided for the state at its request. The state is one of the best clients for a commercial company; it is better if the state's order is large and repeated over a longer period of time.

Another source of income for commercial companies from public finances are transfers in the form of aid and subsidies. The support provided to commercial companies through public financing is more and more limited and allowed only for specific purposes. Above all, aid should not be granted in cases where this might benefit certain companies to obtain a competitive advantage in the market.

Commercial companies are trying to obtain hidden subsidies through tax exemptions or lobbying for a general reduction of taxes. Since the latter (general reduction of taxes) has been done by several countries, it is often considered in Slovenia that this would be the most efficient policy of promoting competitiveness. It is true, however, that the reduction of taxes increases the (potential or real) general government deficit.

Priorities in the field of general government expenditure are therefore as follows:

- a/ Continue to transfer general government expenditure and public services to private financing and provision and, where justified, introduce the direct payment principle.
- b/ The cost of services financed by public funds will be held in check by a suitable public sector wages policy and by introducing organisational structures capable of controlling material costs.
- c/ Public services and state agencies will have to be reorganised so that tasks incurred by these activities themselves and procedures and costs that are reduplicated are removed (a more radical reform of the state's organisation in performing its public functions).
- d/ Restructuring, which will provide more space for promoting the technological modernisation and investment in human capital, namely, education and training, research and development, information technologies and an active employment policy, and guaranteeing the suitable scope of funds and absorption capacity of Slovenia to be able to co-finance projects drawing EU aid.

5.3.2.3. *Financing of the Fiscal Deficit*

A deficit is the result of imbalance between the revenue and expenditure available to public financing. It occurs occasionally and causes liquidity problems; however, if the imbalance persists in one or more subsequent fiscal periods, the deficit becomes an indicator of inappropriate public finance management. The current deficit is financed through borrowing and/or the capital inflows and outflows, so that the entire non-financial revenues and expenditure are levelled out, or by selling off financial assets.

Slovenia is not a sufficiently large financial area in which it would be possible or reasonable to take out loans only from domestic financial agents. In order to avoid any large shares of external indebtedness, which is riskier because of exchange rate changes, greater domestic borrowing would be more suitable, but this would require a greater capacity of the domestic financial market. The most suitable form would be investment funds (savings funds) which collect non-allocated funds from natural or legal persons and the funds involved in additional health and pension insurance schemes.

Preservation of a deficit at a certain (albeit low) level over a longer period of time unquestionably leads to an increase in government debt. Furthermore, over a longer period of time, the imbalance between the sources and obligations of public financing (translated into the net current value) is shown as a fictitious – implicit – debt.

Future deficits and the growing implicit debt give enough grounds to current policy-makers to come up with a course of action that could restrict the deficit as much as possible in the future. Expenditures in the future can only be limited by changing policies and systems immediately or in the near future. Slovenia has done a lot of changes already, but will have to continue monitoring and changing the two largest systems – social insurance and the system of public and state administration.

Slovenia's main medium-term goal is to achieve and preserve a balance in non-financial transactions of the government sector, that is the surplus of revenue over expenditure.

5.4. Policies for Efficient Integration Into the EU's Single Market

5.4.1. Competition Policy

Competition legislation guarantees proper conditions for market competition, which encourages firms to strive towards the greater efficiency of their operations. The state intervenes in the economy through its measures of regulation and control in the first place to support the emergence and formation of the market and regulate its operations, with the purpose of enhancing market efficiency and justice. With its competition legislation, the state regulates the operations of monopolies and other

Normative Regulation of Competition Policy in Slovenia

The Prevention of Restriction of Competition Act (1999) was designated in line with the EU's competition *acquis* and provides for the systemic regulation of the restriction of competition: restrictive agreements between companies, abuse of dominant position, concentration of companies and restrictions of the market by authoritative legal instruments and actions. The area is further regulated by the following acts: the Decree on block exemptions (1999) regulates block exemptions, the Companies Act (1993) regulates concentrations and various forms of mergers, the Takeovers Act (1997) and the Decree on the procedure and conditions for granting an authorisation of the Government of the Republic of Slovenia for acquisition, cover takeovers. Furthermore, the issue of unfair competition is regulated by the Protection of Competition Act (1993) and the problems of dumping and subsidised imports by the Decree on dumped and subsidised imports (1994). Despite this legislation, an implementation deficit has been perceived in this area as Slovenia still lacks a clearly defined competition policy that also incorporates other policies' goals and guarantees transparent control and systematic co-ordination of the policy mechanisms.

forms of dominant market positions: cartels, vertical restrictions and mergers which restrict competition. It also incorporates prohibitions referring to acts of unfair competition. Moreover, the legislation can cover dumped and subsidised imports, illicit speculations and state restrictions on operations.

All of the developed economies possess regulations on competition policies. Since the approaches of individual countries to their competition policies differ considerably, the foundations for a global competition policy under the patronage of the WTO have only been gradually laid, with the WTO acting as an international co-ordinator and controlling authority in multilateral areas. In the EU, competition legislation exists at the level of the Union and applies to all member-states, with its implementation also being monitored by the European Commission and the European Court of Justice. The competition policy in the EU seeks to meet three goals: integration, the economic goal and the goal of equality and justice. The integration goal, in general, is one of the most important goals of the EU. With the internal market being the main driving force of economic integration, this goal cannot be achieved without efficient and controlled competition in the market. The goals of equality and justice also aim to protect consumers and small firms from the accumulated economic power and potential monopolistic dominance of a single company.

In small countries, competition policy should –because of the smallness and openness of the domestic market –be specific and subordinated to the goal of making the economy internationally competitive. In the process of accession to the EU, Slovenia's competition policy is being gradually harmonised with the EU's competition legislation but, together with its main goal –protection of competition –it is also pursuing the goal of increasing the international competitiveness of the Slovenian economy.

In the conditions of EU membership and rapid globalisation, company takeovers and mergers will become the main areas of competition policy's application. Therefore, a strategic position towards different forms of company mergers is crucial. Different forms of co-operation between groups of companies (strategic partnership if a smaller number of firms is involved, or strategic networks connecting large numbers of companies) make up a complex structure of the market. The world market is so full of different forms of relationships and co-operation that it is sometimes hard to establish whether a practice is merely a matter of co-operation or whether it involves a restriction of competition. These networks often mean not only co-operation but also competition between companies to become part of a successful network or to supply goods or services to a successful large company. In the future, the process of economic restructuring in Slovenia will start to involve more and more mergers and takeovers of companies aiming at improving their business efficiency. A study on a sample of companies has shown that in the near future around a quarter of Slovenian companies intend to take over another company, for which they have not only internal reasons but also external ones: the latter lie in Slovenia's integration into the EU's single market and the increasing importance of globalisation as a key factor in the capital connections of companies.

When dealing with competition policy in the context of the Slovenian economy's increasing international competitiveness, it is important to distinguish between two aspects. Firstly, competition is one of the main forces of economic development. It is generally known and especially important for a small economy that an open domestic market together with a strategic international orientation of the economy can substantially make up for the lack of competition at home. Secondly, competition alone does not always lead to the optimum results. This is particularly true in the conditions of globalisation where various forms of acquisitions, mergers and connecting of companies are becoming an increasingly important method of raising competitiveness. A competition policy that only pursues the goals of achieving the greatest possible competition in the domestic market by setting traditional criteria could negatively affect the international competitiveness of domestic companies. To this end, competition policy should be guided in line with the microeconomic policy and be aimed at the common goal of increasing the international competitiveness of Slovenian firms and the economy as a whole. At the same time, it has to guarantee that, at least in the areas where this is possible, neither foreign nor domestic companies use their dominant positions to limit competition in the domestic market.

Taking these two aspects into account, Slovenia's competition policy directions are the following: (i) to aim at preserving the highest possible level of competition in the Slovenian market; (ii) to allow the connecting and merging of companies if this leads to their increased international competition; and (iii) to prevent any agreements or mergers which restrict competition. In order to be able to follow these guidelines, it is necessary to:

- a/ formulate explicit goals promoting both international competitiveness and competitiveness in the domestic market, thus bringing into line the goals of microeconomic policy and competition policy with the trend of competitiveness and the competition policies in the EU and other world economies;

- b/ guarantee transparent implementation of the competition policy using modern legal and economic mechanisms, as required by the EU system and the WTO principles, as well as by carrying out the institutional practices of foreign countries that are comparable to Slovenia;
- c/ evaluate the effects of applying the microeconomic policy of increasing the Slovenian economy's competitiveness on competition and the flow-on effects on producers, consumers and the general welfare of population;
- d/ take into account the outcomes of legal proceedings before the courts regarding the fundamental rules on competition and co-operation in the market of domestic and foreign companies; and
- e/ strengthen the analytical bases of competition policy, in particular by using an empirical methodological approach of economic analysis when applying competition law, and by closely following developments in domestic and foreign markets to reduce the effects of uncertainty and risk.

Only by pursuing coherent policies of competition and economic competitiveness (microeconomic policies), will the state be able to guarantee market participation to all entities and provide for constant dynamism in new entries of competitive and exits of uncompetitive participants without jeopardising proper supply to consumers and reducing the general welfare of the population. Various state interventionist measures will be evaluated in the context of expected and achieved effects, using economic and social criteria. This will guarantee the transparent operating of the state and its institutions and allow timely corrections of negative deviations from the goals set out in the Strategy.

5.4.2. State Aid

Within the framework of the economic policy the state distributes its national income at the macroeconomic level, but also at the microeconomic level, i.e. in favour of selected companies or groups of companies. Such allocations cause market distortions by favouring the recipients of such aid and are as such strictly limited in the European and (world) legislation.

The European legal framework on state aid has a long-lasting tradition and is one of the most elaborate systems in the world, not only in terms of regulation but also control, namely ex-ante (system of notifications and authorisations of aid) and ex-post (system of annual reporting) control. Basically, the system favours the interests of the EU and its single market over the interests of the national economies of the member-states.

Slovenia has committed itself under the Europe Agreement to reflect in its legislation the European regulations on state aid even before it joins the EU. This obligation has been fulfilled by the State Aid Control Act adopted in 2000, and by the progressive setting up of institutions for ex-ante and ex-post control of state aid. These activities, however, only mean a normative basis for the European-modelled regulation of this area and efficient integration into the EU single market, but not a substantive one. So far, state aid in Slovenia has mostly served as a mechanism for

easing social tensions in ailing large enterprises and for covering regular operating costs, and only to a lesser extent for promoting development-oriented activities (R&D, environmental protection, training etc.). Because of its inappropriately defined regional policy, Slovenia has not been able to allocate regional aid, which fall within the category of less restricted aid. In Slovenia, state aid currently accounts for a larger proportion of gross domestic product than in the EU states⁷ and the allocation structure by categories and purposes is also considerably different. The forthcoming substantive harmonisation of the area of state aid, which will help reduce the implementation deficit between the formally implemented rules and the actual allocation of state aid, will require a thorough transformation of the existing microeconomic policy. It should turn from meeting its short-term goals (mostly rehabilitation of the existing large-sized companies) to reaching long-term goals of economic development, i.e. to increase the Slovenian economy's competitiveness largely by means of horizontal measures, which have proved to be most supportive of this goal.

The EU rules on state aid and microeconomic interventions of the state in the economy are adapted to the economic structure and level of development of selected sectors in the EU. Slovenia cannot avoid this context when determining its own allocation structure of state aid, therefore the correct long-term solution should be to boost competitiveness and to form an industrial structure comparable to that in the EU. In the period before actual accession to the EU, when still having the power to control its own allocation of state aid, Slovenia has to choose between two options. One is to continue with the slightly corrected system of allocating state aid, which has been used so far and allows distribution via numerous grantors (which, by the way, often double) to different more or less eligible beneficiaries. This option leads to an over-fragmentation of the sources and purposes of aid (in particular from the viewpoint of the grantors of aid) and as such cannot guarantee the suitable allocation of funds. The other option is that the state aid grantors act jointly and prepare:

- a/ a relevant policy of ensuring Slovenian industry's competitiveness (in a wider sense than just manufacturing) and a list of priorities and European-oriented programmes and measures;
- b/ a relevant policy of regional development, also offering a solution for rescuing large-sized enterprises via regional development aid; and
- c/ a set of the most efficient instruments (most efficient in terms of the economy and public finances) for implementing individual measures, including those with the character of state aid.

The second option offers much more favourable results as it guarantees coherence between the microeconomic policy, the policy on state aid and public finance policy. But it will also require a common political will to help prevent the damaging lobbying of political groups in favour of some companies (so far, the main beneficiaries have largely been poorly performing companies with greater social problems).

⁷ The figures for Slovenia, excluding local communities level and agriculture, were: 1998 – 2%, 1999 – 1.7% and 2000 – 1.2% of GDP, whereas the annual average for the EU in 1996-1998 was 1.12%. Taking into account agriculture, these figures were 2.53%, 2.44% and 2.07% of GDP respectively, and in the EU this figure was estimated at 1.28% in the 1996-1998 period.

After accession to the EU and the entry of Slovenian companies to the EU's single market, Slovenia will lose almost all of its rights to interfere in the area of state aid (except for block exemptions and 'de minimis' aid) as decisions on state aid in Slovenia will fall under the jurisdiction of the European Commission in Brussels, in accordance with the European economic orientations and rules. The only possible exceptions to the rules in the textile, footwear and steel industries will depend on the outcome of negotiations. However, the rules on state aid –with the exception of some sector-specific rules⁸ –are loose enough for Slovenia to be able to solve –with a proper systemic approach and rational selection of priorities –the currently most pressing economic problems and thus pave its way to long-term development. To succeed here, Slovenia has to take into account the following:

- a/ The most favourable solutions should be sought in the horizontal rules, which allow aid for the following activities: research and development, environmental protection, small and medium-sized enterprises, employment and training, the development of less-developed urban regions and - in specific conditions –the rescue and restructuring of small- and medium-sized enterprises.
- b/ The aid intended for the rescue and restructuring of large-sized enterprises and aid for their regular operations are rigorously restricted, and only allowed in the least-developed regions. Slovenia can solve the acute problems of restructuring its large-sized companies selectively - depending on the influence a company has on regional development –through the regional development criteria.
- c/ The increasingly important promotion of technological development can be supported by various categories of horizontal aid: aid to research and development (up to the development of a prototype), aid to environmental protection (investments in technology for more environmentally-friendly production and the development of new, more environmentally-friendly products), aid to small and medium-sized enterprises (transfer of new technologies) and regional aid (prioritised acceleration of investment in technological modernisation).
- d/ Similarly, environmental problems within the enterprises can be resolved through various horizontal aid forms and some even within the framework of special sector-specific aid.
- e/ In the pre-accession and accession periods, Slovenia also counts on the EU's structural assistance. A large part of structural assistance is directly linked to state aid. The most direct link is that between structural assistance from the EU Regional Fund and the national regional aid, as well as between structural assistance from the Social Fund and national state aid earmarked for employment and training.

As regards the selection of instruments of state aid, grants are recommended from the aspect of transparency although these are least appropriate from the point of view of public finance effects and effects on economic growth. Aid in the form of tax relief, favourable loans, state guarantees and similar instruments are cheaper for the state and its public finances and, in addition, the beneficiaries are more obliged to use them for the original purposes of the aid. If the state wanted to resort to these

⁸ The following manufacturing sectors: manufacture of synthetic fibres, motor vehicles, shipbuilding and steel industry, in addition to other sectors: agriculture, fisheries, coal-mining and transport.

instruments, it would have to build an additional system of monitoring and assessing the elements of state aid and provide for the required transparency. Besides the system of ex-ante and ex-post control laid down in the EU *acquis*, Slovenia would also have to establish a suitable system of control of the effects of granted state aid, which is properly defined in the national State Aid Control Act.

5.4.3. Policy of International Economic Relations

Slovenia considers its policy of international economic relations as an external, complementary factor of its market-oriented and structural “national” economic policy. Besides traditional foreign trade measures, the policy of international economic relations also comprises a number of “national” (complementary) policies whose importance within international competition is increasing. In the future, the policy of international economic relations will be realised at the following three levels: (i) national, (ii) supranational (EU), and (iii) international (WTO, OECD etc.).

Notwithstanding that in the context of Slovenia’s accession to the EU the main objective of policy of international economic relations is to strengthen the position of Slovenia’s economy within the EU’s internal market, in terms of international economic co-operation the Slovenian economy is globally oriented. Strengthening the Slovenian economy within the EU’s internal market means that Slovenia will try to expand its existing co-operation with the EU by overcoming the existing concentration on Germany, Italy, Austria and France, and intensifying relations with other old and new member-states. Moreover, it will upgrade co-operation with the most propulsive regions in Europe. On the other hand, the strengthening global orientation means increasing economic co-operation with the USA and partly (for certain products) also with Japan and the most propulsive developing countries. Economic co-operation with these countries is not important only because of opening of these markets to Slovenian products, but also because of broader development impulses (technology, other inputs) to the Slovenian economy. In the more remote markets, outward investments and other non-trade forms of co-operation will be particularly important.

With EU accession, Slovenia will also become a member of the customs union meaning it will have to: (i) remove the then still existing barriers to trade with other EU member-states, (ii) align its trade policy towards third countries with the Community policy (adopt the common customs tariff and assume the EU’s rights and obligations towards third countries). As an EU member-state, Slovenia will regulate its relations with other member-states through competition policy, and those with third countries through trade policy. The common commercial policy (CCP) instruments will be formulated and implemented at the EU level. The loss of national sovereignty in terms of anti-dumping measures and the conclusion of trade agreements will have a practical importance. This also apply to trade in services, yet in this context the Commission’s space for manoeuvring is limited since it needs the consent of all members of the Council of Ministers.

As a full EU member, Slovenia will lose control over several instruments of its policy of international economic relations: the common commercial policy is under the exclusive responsibility of the EU, and the same applies to entering into foreign trade agreements with third countries. Following EMU accession, Slovenia will also no longer be in a position to conduct its exchange rate policy. The EU will furthermore have a significant impact on Slovenian: (i) customs regulations, (ii) export support (export credit and promotion), and (iii) state aid to the economy. Such changes will increase the relative importance of instruments remaining at the national level. General economic competitiveness will gain in importance, including non-tradable sectors. On the other hand, the no longer independent use of the instruments of international economic relations policy will increase the need for an indirect influence on the EU's common commercial policy through the mechanisms of drawing up and adopting of decisions.

In this context, the importance of the *mechanism for insuring and financing international economic operations* will grow further. EU accession and the urgent need to create the conditions for Slovenian enterprises' competitive presence in foreign markets will require changes and a new legislative framework for the system of insuring and financing international economic operations, as well as the state's withdrawal from the marketable risks insurance sector which will in fact pass over to the domain of the private sector. In the process of Slovenia's integration to the EU, this part of the Slovenian Export Corporation's operations will be transferred to a specialised credit insurance company which, together with selected key national and foreign partners, will keep increasing the volume of its operations and developing the said services and will thus ensure the economic security of foreign markets to Slovenian enterprises.

The main objectives of Slovenia's policy of international economic relations in the framework of EU membership will remain: (i) to increase the competitiveness of domestic enterprises in foreign markets, and (ii) to keep the national market attractive to foreign investors. Rivalry mostly occurs among non-mobile production factors in different countries (including the legislative, economic, social and political systems) and between the only two really mobile production factors, i.e. capital and knowledge.

Instead of creating instruments provided by the CCP, in the future the state will concentrate on co-ordination activities:

- a/ Enhancing co-operation among subjects covered by the policy of international economic relations: (i) among Slovenian ministries implementing policies that are complementary to the EU common commercial policy, (ii) between the European Commission and the Slovenian Government, and (iii) between European bodies and Slovenian businesspeople.
- b/ Preparing Slovenian enterprises and the public administration for integration and using the services provided by various EU formal and informal structures (for example, industrial associations, interest groups, data banks, support activities at the EU level etc.). Slovenia should combine the government offices responsible for international economic co-operation, and intensify and combine various national sources of information about foreign markets and about what Slovenia

has to offer (for example, the available supply of goods, labour force and price, business premises, legal and business services, legislation). Co-ordination will be carried out by the Trade and Investment Promotion Agency, concentrating on important export projects and new markets.

- c/ Providing for quality and the continuity of human resources in the Government and in the Chamber of Commerce and Industry of Slovenia in the area of international economic relations.
- d/ Establishing a system of informing the various EU committees - comprising market policy specialists from EU member-states - about all (new) problems in international operations (for example, a barrier to trade in a third country's market) perceived by state authorities, trade associations or individual groups of businessmen. The committees' tasks are to find appropriate solutions to each barrier to trade.

As an EU member-state, Slovenia should capitalise on its specific priority position in its economic relations with the countries of South-eastern Europe. Given the EU's interest in normalising the situation in the Balkans and Slovenia's historical belonging to this geographical area, as a future EU member-state Slovenia potentially has a very constructive influence on promoting development in the region. Exercising this influence also depends on the EU's approach towards co-operation in the Balkans which could yet link history with the current development needs.

Slovenia's initiatives or activities in South-eastern Europe are based on the following specific advantages it has in comparison to EU countries: (i) knowledge of the situation in the region and it is not burdened by non-economic barriers to co-operation, (ii) knowledge of the language, (iii) economic and other links established in the past, and (iv) Slovenia's involvement in European structures. The above advantages are reflected in a number of activities. They are mostly seen in the considerable interest expressed by Slovenian enterprises for making direct investments in the countries of former Yugoslavia. As an EU member-state, Slovenia will be guaranteed more security in its operations with the countries of South-eastern Europe, particularly with regard to the introduction of any unexpected additional barriers to trade. Where any South-eastern European countries become WTO members it will be possible to apply the new mechanism of trade dispute settlement, which is seen as one of the greatest achievements of the WTO, including by the EU.

For the country's smooth development, in the area of international economic relations it is necessary to ensure the ongoing strengthening of border co-operation in order to exploit the different development possibilities of the regions on both sides of the border (for example, the Posočje and Nadiža region, Koper-Triest, Graz-Maribor), and to settle the common development challenges (Gorica-Nova gorica, co-operation in the basins of the rivers Mura, Drava, Kolpa etc.). Upon EU accession, the separation of Slovenian economic and other development actors on both sides of the border will mostly be removed, and thus development integration will become more attractive.

Slovenia will try to encourage several multilateral international institutions to choose Slovenia as their main, or at least a regional registered, office and as the springboard for their operations. This objective will be supported by successful internationalisa-

tion in most other areas of cross-border economic co-operation and also by the fact that Slovenia is a country characterised by balanced development and the attractive combination of economic development, territorial smallness, sufficient social justice or stability, promotion of high quality living in a diverse and relatively non-polluted environment.

5.5. Balanced Regional and Spatial Development

5.5.1. The Current Status and Problems of Regional Development and Spatial Planning

During the transition period differences in regional development have increased. The biggest differences concern demographic conditions, human capital, economic structure and efficiency, the situation of social and economic infrastructure, the scope of environmental problems and internal homogeneity (share of municipalities in those regions with the status of areas having special development problems). Differences are also reflected in the distribution of newly established companies among regions, since the number of registered (or active) commercial companies per one thousand inhabitants varies greatly. The increased regional differences often result from the insufficient exploitation of the endogenous development potential of regions. The accelerated establishment of institutional conditions for a more consistent and, accordingly, more creative and efficient regional policy has as yet not resulted in any shrinking of regional differences and the increased promotion of the endogenous regional development potential across Slovenia as a whole, but it does herald a switch in the current trends and promises that in the future it will also be reflected in measurable development indicators.

The prevailing type in Slovenia is the *'urban-industrial' type* of the regional development structure, which comprises four-fifths of the population living on just one-third of the national territory. Most settlements in this category have created at least a minimum number of jobs mostly to service the population living there. Another characteristic of the urban-industrial type is the rich spectrum of activities taking place between towns and their corresponding surroundings, and the physical transformation of settlements as a result of the population's social restructuring. However, the urban network is not balanced. The problems of a non-equilibrated spatial distribution of the economic and social infrastructure and structural imbalances among individual regions and regional centres are shown in the lower accessibility of certain areas and settlements, in high daily migrations, and the related individual and social costs, inefficient, expensive and scarce infrastructural equipment and in the occurrence of degraded areas. We are witnessing strong demographic pressures on the broad surroundings of towns and on quality rural areas, even in the form of illegal constructions. Urbanisation is dispersed in the space between the settlements, characterised by the lavish use of space, not very sharply defined settlement margins, poor communal infrastructure and a problematic landscape image due to poor regional organisation and regional spatial planning. The past polycentric development went towards increasing the role of municipal centres which often led to the doubling up

of activities and less efficient use of land. A tendency was observed to establish new, poorly developed municipalities as a result of the present system of financing municipalities, instead of promoting, in line with sustainable development's principles, the creation of such municipalities that would depend as little as possible on state subventions and more on developing self-initiative and linkages.

On the other side, concerning the surface of the national territory, the prevailing *traditional 'rural-agrarian' type* only scarcely contributes to both the total population size and to the creation of welfare. This concerns problematic areas in development terms, including a notable lack of jobs and low education levels of the active population. As a rule, these are adjoining areas with a clear and long-term population drain. Slovenia's development problem resulting from the existing regional differences is specific in terms of the relatively high share of border areas vis-à-vis the total surface area of the national territory due to the small size of the country. Development gaps are especially typical of municipalities in the border areas. At the same time, agriculture no longer plays a decisive role in economic development. The latter is more and more dependent on the nearby urban employment core. In future, there will be an even stronger demand for environmental protection impacting on a significant part of the country (from the current 5% to up to 30% of the territory) which, so far, has also been used for economic purposes. The protection and the use of development potential, for example of natural resources, are equal in terms of development if they allow these resources to be used to create welfare.

Natural resources are also unequally distributed in terms of regional units. Slovenia does not have rich and diverse non-renewable sources; in fossil fuels it only has lower quality coal. Important renewable sources are especially water and biomass, especially wood. The prevailing land use involves forest surfaces which represent a good half of the country. That is followed by agricultural surface areas with a bit less than 40% of the territory. Built-up or barren land represents seven percent. Unfavourable natural conditions, together with the fragmented property and production structure, radically lower the competitiveness of agricultural production. The use of land has been undergoing some major changes. In the last few decades, conflicts between individual types of land use and the charge on natural resources have increased. The destruction of the traditional way of life is a serious threat to social efforts towards the more targeted use of land, the protection of natural resources and the natural and cultural heritage. The worst problems lie in the lavish use of natural resources, the pollution of drinking water and air, devaluing of the cultural landscape and growing pressure on architectural heritage and nature which is reflected in the loss of biodiversity.

The situation in the use of *land* and other *real estate* shows a low physical planning ability and an implementation deficit in applying the norms on illegal building, the keeping of records, respect of the minimum standards of communal infrastructure etc. It concerns problems in obtaining suitably large and equipped building land in appropriate locations, determining the functional land of existing buildings, time-consuming procedures in acquiring building licenses and licences for other forms of spatial changes, the rehabilitation of illegally built houses and the subsequent equipping of construction land with the most urgent communal infrastructure.

In Slovenia, there is no prepared industrial land allowing the rapid realisation of investment; the market of vacant land and other real estate is not very flexible. A lot of real estate cannot be better used in development terms because legal transactions involving real estate are hindered by incomplete land records and legal safety and, (consequently) high transaction costs, because of unfinished procedures of denationalisation in kind, enduring co-ownership relationships arising from court backlogs and the unrealised inter-municipal division of ownership and excessively detailed (and therefore) outdated urban planning acts on the permissible use of space. The prices of real estate are excessively high due to such obstacles to supply, but also due to the absence of suitable tax initiatives and because the cost of equipping land with infrastructure is included entirely in the selling price of real estate, instead of partly transferring such costs, through financing of infrastructure with municipal bonds, to higher prices of utilities and other communal services. Because of the outdated spatial planning legislation, the state and the municipalities now have a small set of instruments at their disposal to intervene in the real estate market. That is why there is practically no large (foreign) direct investment in industry. The exception is the services sector which is focused primarily on the domestic market. Therefore, the positive effects are noticeable especially in the increased competition in individual sectors and less in the field of employment and the transfer of new technologies.

5.5.2. Orientations and Mechanisms of Regional and Spatial Development

Future development opportunities will increasingly depend on domestic desires and instruments the more the existing development is harmonious and based on the employment of local development capacities. National development is therefore subject to regional harmony as well as the growth of welfare and its balancing according to its economic, social and environmental sides. The national strategy's attention to regional development challenges is an expression of its strivings toward sustainable development. In this way, the strategy expresses its ambition to improve development potential under the direct supervision of local agents. Its leading regional message is that a sustainable increase in welfare above all requires the domestic creativity expressed in the ability to increase the contribution of local potential to welfare growth. Such an attitude towards local development potential means an increased effort to optimise the participation of domestic agents in development activities regardless of whether they use domestic or imported economic, social or environmental factors.

Harmonised and efficient regional and spatial policy is also needed because of the risks accompanying economic and cultural globalisation, especially in order to prevent devaluation of the environment, cultural landscape and the quality of residences and settlements, but also because of national characteristics like the explicit openness and transit capacity, and biodiversity. At a time when part of the national sovereignty in conventional spheres of directing development is being moved under the EU's authority, a radically more pro-active regional development policy is becoming one of the potentially most efficient instrumental and systemic responses

The Relationship Between Regional and Spatial Policy

Although the subject matter of regional and spatial policy are in practice intertwined, defining the difference in these policies' is possible by applying the theory of a regional economics which observes reality firstly through the prism of homogeneous regions and, secondly, through the prism of the functional (another term used is 'nodal') regions. In the first case, we have assumed the internal homogeneity of regions and we are interested in the differences (for example, developmental ones) among regions. These are the subject of *regional policy*. In the second case, we are dealing with the internal spatial structure of regions, therefore with the functional links between settlements ('nodes') and their hinterland. This is dealt with by *spatial policy*, which contains determinations as regards settlement networks, infrastructure and the systems of landscape areas (as a rule, the latter are dealt with as homogeneous integral parts of functional regions). Methodological specifics when expressing orientations of spatial policy are cartographic displays.

In regional orientations, the strategy of economic development relates to the Strategy of Regional Development; similarly, in the orientations of spatial development it relates to the definitions of the draft Spatial Plan and the Policy of Spatial Development.

of development policy, especially for a small state with a relatively high general development level. By adapting the state aid policy to the arrangement in the EU, regional state aid will gain in importance. Harmonious regional development is also built by adopting the European model of the multi-purpose use of agriculture. Joining the EU will, also by joining the system of Euro-regions, bring about new development opportunities. On the other hand, it is realistic to expect increased pressure to change Slovenia into a transit territory, to concentrate economic activities on the outskirts of the capital city, to concentrate foreign investment in conventional activities, to further centralise and thus to exacerbate the trend of further growth in regional differences.

The above circumstances require the *formulation of a new regional policy* which includes: (i) action directed towards improving the development functionality of local potential; (ii) the complementarity of state aid versus regional and local development stimulation, and (iii) a partnership approach between the public and private sectors to facilitate the integration of development stimulation of subregional development entities at the regional level.

Regions can themselves best identify the mutual complementarity of their local development potential and define their development ambitions. In order to enhance competitiveness in the new European context, Slovenian regions have to develop their specific competitive advantages to enable their endogenous development. However, they should network amongst themselves to make a good infrastructural, information-communication, cultural and otherwise unified Slovenian development pole. In the new European context, regional policy cannot be aimed solely at removing development differences but should especially stimulate the development

poles and international competitiveness of all parts of the country. In this context, it is necessary to intensify assistance to those regions with a lower developmental starting point, or those areas which from the aspect of Slovenian regional policy are defined at the municipal level as areas with specific development problems, but only on the basis of regional development programmes.

The main strategic *goal of regional policy* is to improve locally controlled development potential, focusing on the increased welfare of people in all Slovenian regions, with priorities in those spheres where deviations from this goal are currently biggest. Realisation of this goal should be expressed in: (i) the curtailment of the increasing differences in economic, social and environmental development, and developmental opportunities among regions; (ii) prevention of the creation of any new areas with large development problems; (iii) preservation of at least minimal functional settlements across the entire country to help preserve the cultural landscape; and (iv) improvement of the relative position of Slovenian regions measured in terms of gross domestic product in purchasing power per capita, in comparison with the border regions of neighbouring states.

The above circumstances also point to the most critical tasks *in the field of spatial planning*. Their realisation is a prerequisite for more successful spatial development which is one of the conditions of endogenous development. Spatial development is the process of developmental functional control of the spatial determinants and restrictions using the measures of spatial planning and other spatial policies so that, of the existing alternatives for its use, we choose that one which best satisfies effective welfare needs. Since the space for the small, transitory and fairly extensively settled Slovenia is a more decisive development factor than it is for bigger states, even more so because of its outstanding biotic diversity and value, this determination represents a decision in favour of preserving the national development particularities. The condition for a space becoming a more important factor of deciding among development alternatives is that the national, institutional and instrumental bases of its planning become operational. Because of the failure to fulfil this fundamental prerequisite, the last decade has witnessed a noticeable worsening of certain aspects of spatial order.

The following long-term goals can be listed among the basic orientations of spatial policy, although in the SEDS period up until 2006 they cannot be fully achieved:

- a/ *Reorientation from the previously dominant rural to an urban policy* and, thus, promoting an awareness that towns are the centres and nodes of innovations, motors and carriers of development and the contemporary habitat of most of the population. In particular, it will be necessary to stimulate the development of nationally important regional centres as development poles of larger regions which would at least minimally correspond to European norms of the NUTS 3 level. The polycentric development of centres will be based on the principle of decentralised concentration, thus involving the distribution of population among a larger number of centres along with the simultaneous concentration of the use and re-urbanisation of existing urban surfaces instead of expanding to new ones.
- b/ *Consolidation of linked communities* which, by dividing the functions and making public transport more efficient, should assume the role of the missing large centres.

They are especially important along the country's borders where they should act as partners and counter-weight to the centres found abroad.

- c/ *Spatial cohesion of the country or regions*. This is a long-term goal which, in the period of the SEDS' horizons, can be applied especially to regional centres at the motorway cross while we should later also provide transversal links to other regional centres.
- d/ *Preservation and development of the quality of the natural and cultural landscape* based on the designed division of types of landscape and thus on balancing between the use and protection of local and other renewable resources. The network of local centres should allow the population within a radius of half an hour access to supply functions and employment. What is required is the rehabilitation of the dispersed construction by filling the housing gaps and regulated new construction in these areas combined with a more efficient ban on erecting buildings on lands not designated as urban land.

Mechanisms to achieve balanced regional development include several policies, the most important of which are, besides regional policy in its the narrow meaning, spatial planning and land policy, agricultural policy and rural development, transport policy and the development of state and local self-government institutions.

- a/ *Enhancement of regional centres of national significance*. Endogenisation of regional development will be carried out especially by enhancing regional centres of national significance as centres for the preparation of regional development programmes and regional organisation. This will require, above all, the necessary 'hard' infrastructure (for example, the transport and communication links, protection of the environment), 'soft' infrastructure (for example, support to the regional development agency, preparation of development initiatives and assessments of environmental sustainability, co-ordination of advisory activities, incubators, branches of faculties), and adequate stimulation (for example, the concentration of financial stimulation, economic zones, certifications of carrying out support activities like training, consulting etc). In this context, we should not neglect the role of the countryside which plays an important economic and social function. Municipal and rural areas need to co-operate within the framework of the regional development programmes. The urban centres (and particularly the national and regional centres) which do not promote co-operation with their countryside (their influential areas) risk losing the possibility of creating (municipal) regions and thus fail to neutralise limitations on their development potential through improved integration, closer partnerships and the stressed endogeneity of development measures, and this prevents them successfully competing with other coherent urban agglomerations.

In particular, the activities needed are: (i) enhancement of the economic power of middle-sized towns; (ii) improvement of communication and more equal access by public transport; (iii) enhancement of attraction, equipment serving public functions and the attraction of towns for investments; (iv) diversification of the economic structure of towns; and (v) the well-planned and co-ordinated placement of public (education, research, health etc.) services and the remaining infrastructure.

Regional centres of national significance serve as suppliers of the population with social and economic infrastructure and service activities at the national level. They host the headquarters of the important economic, academic and research organisations, as well as important cultural, administrative and judicial activities. They have a diverse and specialised offer of services and other types of activities. They are also characterised by the diversity of jobs and large differentiation of economic activities. As a rule, their gravitational background encompasses over 150,000 residents.

The current analyses of gravitation areas show that in Slovenia it is reasonable to speak about eight regional centres of national significance and of about a three-times higher number of centres of inter-municipal significance. Regional centres of national significance should build up a network – partnership relations towards centres of lower rank and to their rural areas.

Development of regional centres of national significance is also important because in the event of a relevant political decision they could assume the role of centres of regions as the second level of local self-government. In the context of European integration, the creation of small regions without any corresponding regional centres would not suit Slovenia's strategic interests.

b/ *Inclusion into the European Regional Policy.* Mechanisms to stop the growing discrepancies in regional development are defined in detail in the Regional Development Strategy. Four levels are intertwined in implementing the regional policy: (i) the international one – Slovenia's inclusion into the structural, cohesion and spatial EU policy; (ii) the state level - mechanisms for promoting economic and spatial development; (iii) the regional one - mechanisms for promoting sustainable regional development and spatial development in connection with the EU's structural, cohesion and spatial policies; and (iv) the local one - mechanisms for promoting the development of those municipalities with special development problems.

In order to obtain funds from the EU's structural and cohesion policy and to ensure their efficient use it will be necessary to organise the state administration efficiently. It will have to be capable of preparing quality programmes, provide the necessary co-financing from Slovenia and ensure realisation of the agreed steps in line with the rules on structural funds, the rules on state aid and in line with the EU's priorities. In order to benefit from the structural funds aimed at assisting the most underdeveloped areas (Objective 1), Slovenia is going to prepare the National Development Programme.

At the national level we will consider the regional development goals in shaping and implementing sectoral and departmental policies. Funding will be increased for direct regional stimulation. These funds will be directed as a priority to those regions most lagging behind in development terms and in those municipalities defined as areas with special development problems. The funds will be used to stimulate those projects representing implementation of an agreed regional development programme.

c/ *Enhanced role of spatial planning as an economic development activity.* In conditions of the free flow of goods, labour, capital and services, the attraction of a location is extremely important for both the state and its regions, as well as for the local communities. It depends on the attraction of location factors (available and qualified work force, adequate infrastructure, acceptable quality of the environment, availability of residential areas, a friendly administrative-legal environment). Location factors are numerous and change over time. Spatial planning has no impact on many location factors, or only an indirect one, but it has a direct impact on the physical environment: adequate areas (surface, equipment), suitable infrastructure (transport, telecommunication, communal, energy), housing and the quality of life, land use permits. Among the crucial tasks of spatial planning should be defining development areas where the supply of building land is ensured and the placement of new domestic and foreign industrial and service plants is facilitated. This could be a fundamental contribution of spatial planning to improving the country's economic competitiveness.

The requisite activities that have already started especially involve the fields of: (i) insufficient systemic bases (normative, instrumental, institutional, programme); (ii) elaboration of modern regional spatial plans; (iii) an increase of efficient control over municipal planning acts; (iv) optimisation of the delegation of power, and enhancement of inter-ministerial co-ordination; (v) co-ordination of the territorial organisation; and (vi) an improvement of co-operation of municipalities and private entities: public-private partnership, contractual urbanism etc.

d/ *Formulation of a modern land policy.* In the context of private ownership and a market economy, spatial development cannot be successfully supervised and steered only by the administrative instruments of spatial planning but it is also necessary to include indirect and market instruments of land policy by which we can influence the spatial activity of market agents. In Slovenia, land policy is not developed yet and does not have any clear focal point within the state administration. We are only preparing administrative information systems for this purpose, and the project of updating real-estate records will only start to bear fruit at the end of the period covered by the SEDS.

Of the almost 50 instruments of land policy (planning, taxation, market, financial and administrative) known in Europe, less than one-fifth are applied in Slovenia. In the near future we can expect the enforcement of some important new instruments, especially a real-estate tax but given the conditions of incomplete records and the still undeveloped mass evaluation of real estate its very introduction will be demanding. In order to enforce it as an instrument of land policy it should also be adequately differentiated in terms of space. Realistically, we can expect that in the period covered by the SEDS, Slovenian land policy will only start to be shaped but it will not be in a position to influence spatial development.

e/ *Take advantage of Slovenia's position on the crossroads of the Fifth and the Tenth Trans-European Corridors.* It is necessary to create an integrated transport system in which regional centres carry out the role of nodes, especially on the basis of well-developed public passenger transport, and to promote the development of Ljubljana, Maribor and Koper as internationally important passenger and cargo

transport hubs. This would help overcome the current partial and competitive enforcement of different national programmes without any coherent long-term strategy of transport development. In terms of development, railway and road transport have to be dealt with more equally than they have been to date.

f/ Continuation of the initiated agricultural policy reform in terms of developing rural space. The multi-purpose role of agriculture is being promoted since it is an economic activity involving social and environmental functions and effects. The state has, in this field, three strategic tasks in particular: (i) introduction of a systemic environment which allows the greater impact of the market and greater possibilities for market operations; indirectly with reduced prices of raw materials it also allows increased competitiveness in vertically connected production activities; (ii) adequate assessment of agriculture's role in achieving goals of public significance like biodiversity, natural resources, cultural landscape and population density which result in the possibility of paying agriculture for its environmental and spatial services from public funds. The transparency of measures would be guaranteed by financing on the basis of individual contracts with farmers who decide to provide these services; and continuity would be guaranteed by the time commitment of their implementation; (iii) promote structural adaptation towards competitiveness and the development of alternative income sources, promote complementarity of agricultural policy measures with other development policies involving rural areas; (iv) establishment of a strategy to create conditions for settlement or the prevention of population drain from rural areas by developing the endogenous potential of the countryside, especially by encouraging sustainable management with local renewable sources and by introducing biological and environmental standards of production in farm-productive areas; and (v) maintenance of the minimum equipment of local centres.

g/ Promotion of local self-government and the establishment of regions. In the European context, Slovenia is among the most centralised countries. This is partly understandable because the country is quite small and new, but ignoring the principle of subsidiarity has negative effects for strengthening local development initiatives. A mirror image of the excessively centralised decision-making and public finance is seen in the large number of municipalities and their financial weakness. The majority, namely, is incapable of performing their basic tasks without state assistance. The main financial mechanism to resolve these problems would be a suitable amendment to the Act on Financing Municipalities.

Efficient implementation of regional policy in the first place requires a new territorial delegation of powers between the state, the region as the so far missing level of local self-government, and the municipality. Regions should carry out matters which exceed the capacity of municipalities, and matters of regional significance according to sectoral legislation. Well functioning regions may relieve the state of some of its current functions.

Introduction of regional partnership in adopting decisions at the national level is the first step towards transferring power and funding to the regional level. In order to make it possible, it is necessary to promote sustainable regional development which should: (i) promote the interest-based connections of local

communities at the regional level and thus (ii) allow the optimal use of local resources (developmental functionalisation) so that we can ultimately come to (iii) the regional concentration of human resources and financial potential for development. Therefore, it will be initially necessary to change those provisions of the Constitution which hinder the formal establishment of regions, and those provisions that limit the flow of decentralisation of power from the state to the local communities, but also the normal organisation of the state administration available on the spot.

6. Environmental and Social Development as Components of Economic Development

6.1. The Environment as a Factor of Economic Development – From Environmental Protection to Environmental Development

The reasons underlying the emergence of the environmental problem – the term describing the relatively low contribution of the ‘environment’ or the environmental capital, i.e. natural resources and environmental services, to the general welfare and economic development – are primarily economic. However, the resolution of environmental problems is hindered by social issues. And finally, environmental policy itself may contribute to the accumulation of environmental problems if it fails to follow the rules of sustainability.

Economic development is a process of overcoming the relative scarcity of resources needed to satisfy all the basic needs. This may be done by improving the principles and objectives of using resources in line with the new development challenges. The Strategy rests upon the imperatives of sustainable development because they help raise the quality of development factors in the long term and improve the level of their competitiveness, as well as strengthen the contribution of natural resources to the national welfare. However, the current economic decisions only depend on the views of present generations, which are still narrow in terms of sustainability and do not correspond entirely to the ambitions of future generations. One of the reasons is that orientation towards sustainability is more an aspiration and a method of operating than a developmental goal with a quantifiable aim. Development towards sustainability should at first contribute to more integrated comparison of the existing investment alternatives. In this respect, the application of economic principles to

The National Environmental Action Plan (NEAP)

The environmental protection policy in the NEAP sets out four priority goals: to improve the state of the aquatic environment, to introduce modern methods of waste management, to conserve and protect biological diversity and genetic resources, and to strengthen environmental protection institutions at all levels. The most vulnerable areas are: the coast region, countryside, mountainous regions and the Karst. The NEAP covers traditional environmental policy goals and is achieved by traditional measures: easing of additional pressures on the environment by large-scale polluters and limiting health-threatening forms of environmental degradation, and the rehabilitation of old and existing burdens.

the environmental capital is an inevitable, but neither first nor last, step in the process of cultivating economic use of natural wealth.

Countries compete with each other for the welfare. In order to prevent the overall overburdening of any of the three welfare components, environmental, social or economic, competition for the welfare must be balanced – sustainable – in the long term. It is the responsibility of each country to define its economic identity on the basis of its comparative advantages. Slovenia has favourable conditions for sustainable development both in terms of available resources for development and in terms of the development challenges foreseen, consisting Slovenian new development paradigm.

Sustainable development has so far entered implementation mainly in the rich countries with market economies. Given their current already high levels of welfare, they are increasingly concerned about the quality of their future development. Economic internationalisation increases the inflow and outflow (transit) of welfare – the isolation of the economic from social and environmental motives of national development can outcrowd, let flow out, or marginalise some domestic resources and lead them to passivity not to welfare creation. In the long term, such development does not stimulate the employment of domestic economic resources and hence contributes little to improving the development potential of Slovenian future generations. The consequences of non-sustainability are revealed in macroeconomic difficulties, such as unemployment, growing social and regional disparities, general government and current account deficits, inflation etc. By marginalising local resources, the future economic development of a country becomes increasingly dependent on external factors only. In Slovenia, which is on one hand poor in raw materials and on the other relatively rich in environmental and social capital, the decision for sustainable development clearly rests on the internal development needs of its national economy.

6.1.1. Sustainable Development Multiplies Domestic Development Opportunities

In the context of sustainable development, the highest possible economic growth is no longer the main goal of economic development. Similarly, environmental policy should be reoriented, as it seems to be still focused mainly on over-intensive use of environmental services, but this is insufficient from the perspective of sustainable development. To achieve sustainable results, the policies of environmental development should not only tackle the problem of excessive but also of the insufficient utilisation of environmental capital, such as reforestation, water as an energy source, river management, exploitation of biodiversity, spatial planning etc. In the past, the endogenous development potential of environmental capital was not always properly utilised for increasing welfare and, therefore, many examples of its sub-optimal use can be found, in particular of local renewable resources: (i) three-felling is significantly below the levels of increment; (ii) so is the use of surface waters for energy purposes and irrigation; (iii) some protected areas are not subject to dynamic economic development – establishing protected areas is not necessarily the most optimal and sustainable allocation of the most valuable natural areas, unless accompanied by measures leading to positive welfare results of nature protection;

Environmental Protection Expenditure

It is estimated that expenditures on environmental protection lagged by a solid one-tenth behind the projections made in the second half of the nineties. This is not a negligible gap, in particular with regard to the goals of the National Environmental Action Plan, according to which by 2006 expenditures should be increased by more than half of the present level in order to realise the priority tasks in the following 15 years. And even this would only allow Slovenia to catch up to the maximum level of expenditures in other transitional economies which, however, also have more degraded environments. Any increase in expenditures would only be justified if they were to optimise the financing of priority environmental projects. It is estimated that only the implementation of new measures related to increasing the environmental development can justify additional environmental financing in Slovenia by 2006 (estimated at 1.3% GDP in 2000).

(iv) low use of biomass and renewable secondary sources; (v) the use of public resources for environmental protection has not been efficient enough and the management of local public resources has not been satisfactory; (vi) the use and management of space involve a great deal of unused potential, not only from the perspective of the purposes and conditions of use (Slovenia uses 3-5 times more space per inhabitant than the intensively populated Denmark and the Netherlands) but also as regards optimisation of organisation and regulation etc.

Local environmental capital must have an important role in the national development strategy. Otherwise, the consequences would be reflected in social and economic development. Poor use of local environmental capital may over time result in the deprivation of some beneficiaries of welfare, mostly those in old economic sectors (small farmers, craftsmen engaged in traditional crafts and industries etc.) which, in turn, would result in unequal income distribution. Further, ignoring the importance of local development resources may result in the neglected development of some important components of capital, e.g. cultural heritage and traditional values, which would consequently hinder the development of cultural creativity and conceal its economic attractiveness. Finally, the incorporation of local capital into the development strategy is also related to the possibility of establishing national identity. The most efficient way to increase the economic importance of environmental capital is to increase its contribution to economic development and welfare. Since development also implies improving the possibilities for future development, the endogenous factor is its most primal and representative indicator of the quality of Slovenia's economic development paradigm.

6.1.2. Increasing Environmental Development

Neither traditional nor modern environmental policies offer optimal and sustainable solutions to the problem of reducing the welfare of future generations by using non-renewable environmental capital (e.g. fossil fuels) today. By following the rules of

sustainable development, this loss for future generations can be compensated for, but not (only) within the resources of environmental policy. This calls for the national earmarking of part of current national savings for the welfare of future generations, for example for investments in human resources or environmental protection infrastructure (purification facilities, landfills etc.). Thereby, national economic efficiency needs to expand to also include social and environmental aspects in addition to the economic aspect of resource allocation.

The key instrument for changing the present pattern of development and consumption of non-renewable environmental capital is a gradual increase in the prices of energy, but in a balanced way, taking into account economic (competitiveness), environmental (a decrease of the environment's irreversible degradation) and social development goals (safeguarding the relative social position of eventually exposed social groups), together with increasing the efficiency of the generation, transformation and distribution of energy and guaranteeing reliable levels of supply. In addition, European instrumental harmonisation is expected to run in this direction. The European Commission has been making efforts for some time now to achieve harmonisation either by imposing a common, albeit minimum, excise duty on oil derivatives or by implementing an environmental tax reform. The latter would, through the parallel restructuring of tax sources - first by cutting taxes on labour and then by increasing taxes on the use of environmental capital - at the same time support its plans for reducing unemployment and achieving environmental development (the double dividend effect).

Although the direct favourable effects of the next steps in the environmental tax reform can only be enjoyed on the revenue side of the budget, the tax reform, involving an increase in the prices of energy and raw materials, favourably affects the environment as well. The level of prices provides important information to small- and medium-sized enterprises and households, as usually they cannot efficiently avoid environmental response. At the same time, the abovementioned entities - as also being the most exposed victims of environmental degradation - have long borne the heavy and invisible burden of non-sustainable practices. The tax reform makes it possible to change the allocation, cultural and other patterns of behaviour. However, the full potential of the reform can only be felt once the expenditure side of the general government account is environmentally reformed as well.

The environmental tax reform measures, aimed at taking the burden off of labour costs, shall be accompanied by measures for improving the quality of labour. Slovenia's labour - becoming more educated and creative - should generate higher

CO₂ Tax on Fuel in Slovenia

Slovenia introduced the CO₂ tax and simultaneously reduced social security contributions back in 1996, and thus took the first measure within the framework of the environmental tax reform, before most EU countries and as the first Central and Eastern European country. However, not much progress has been made since then, also as a consequence of the lack of measures in EU member-states in this field.

incomes and stimulate further human development. Should this not happen, the environmental tax (and integral public finance) reform could encourage an increase in labour-intensive instead of human-resource-intensive value added and, consequently, the flow of primary incomes from labour to capital instead of from nature to labour intensive industries.

Because of international trade's strong influence on the development pattern in Slovenia, international trade movements are relatively much more important to the quality of Slovenian economic development than for larger countries. A foreign study estimates that Slovenian natural-resource intensive exports of goods have been relatively high. Therefore, Slovenia will have to support as a priority the integration of economic and environmental aspects into companies' business strategies, in particular in manufacturing of chemicals, chemical products and fibres, other non-metal mineral products, paper and cardboard, aluminium, metal products, steel and construction materials.

To ensure sustainable development, a more concerted approach of all three economic, social and environmental policies will be required. Whereas annual reporting on economic and social development is well established, regular reporting on the environmental situation has not yet been introduced. The contribution of environmental development to current development trends is thus the only aspect not monitored on an up-to-date basis. Due to the lack of information on environmental development, only a distorted picture of development is available, and this has - in the initial transition towards sustainable development - become a systemic obstacle (failure) to further improving the sustainability of economic development. The empirical findings about actual economic development trends are one of the main premises used in preparation of the budget memorandum and the budget and also serve as a basis for setting national priority development programmes and investments.

The environmental development goals can only be achieved if the formal and institutional conditions are met. So far, formal bases for aligning the economic, social and environmental aspects of development programmes have been relatively modest, but are gradually strengthening and expanding. Therefore, legislation needs to be improved to stimulate effective integration of development and initiatives (plans and programs), including strategic environmental assessment.

The priority measures for enhancing environmental development are:

- a/ to increase public finance efficiency of environmental policy and the effectiveness of the funds earmarked for environmental protection and development;
- b/ to launch systematic monitoring, analysing and projecting of (i) pressures on the environment, (ii) the NEAP implementation ; and (iii) improving welfare productivity of environmental capital;
- c/ to fully enforce the environmental protection arguments in preparing economic measures, plans and programmes; priority improvements are necessary in the management of four key renewable local resources: space, bio-diversity, surface waters and biomass;

- d/ to continue, widen and deepen the environmental tax reform – primarily by increasing the prices of energy and energy sources and generally raising the economic costs of environmental degradation; and
- e/ to amalgamate environmental protection with sector-specific and regional policies into a functional whole of environmental development, emphasising the priority increasing of the development functionality of renewable local environment capital. The expansion of integrative instruments (vulnerability studies, strategic environmental assessment etc.) is required.

6.2. Social Development

6.2.1. Goals and Principles of Social Development

The main goal of the new development paradigm is increasing the welfare of all people living in Slovenia and ensuring a better quality life. Thus, the new paradigm focuses on the individual, their needs and interests as well as their development in the broadest sense of the word. Since such an aim cannot be achieved merely by securing the necessary material goods and financial resources needed for an adequate level of social security, all aspects of social development must gravitate towards the main goal. Social development needs to be not only harmonised with economic conditions, but also internally modernised and oriented towards pursuing common goals, which will serve as a basis for a new national social policy.

At the level of sectoral goals, development orientations and strategies, Slovenia has generally set out the foundations of social development by adopting national programmes for education, employment, health care, housing and social security. To a certain extent, the foundations are linked to the programmes of fighting poverty and social exclusion. Implementation of most of these documents commenced at the beginning of 2000, and should wind up in either 2005 or 2010. Alongside a new strategy for boosting employment and combating unemployment, a reform of pension and disability insurance has also been approved. Mechanisms and measures which will be taken and implemented by the state and which will constitute policies in these areas will have to be oriented towards two strategic goals. The two goals, which are at the same time constitutive parts of the new development paradigm, are: (i) to secure a high degree of social security; and (ii) to enable and promote social inclusion. Realisation of both goals should be based on non-discrimination, social justice and solidarity.

6.2.2. Key Factors of Social Development

The factors expected to have the strongest impact on social development are (i) demographic change, (ii) transition from an industrial society to a knowledge-based society, and (iii) the changing needs of the users of social services, and the associated individualisation of services.

Demographic change. The economic sustainability of social security systems will come under pressure from the ageing of the population which results from the falling birth-rate and greater longevity, as well as from the increasing number of users of social security services and the falling share of the work force. More funds will be needed for traditional social security, chiefly pension and health insurance, and new forms of insurance. The Slovenian population's ageing will have its most serious effect on the volume and structure of health and social security programmes. It will, furthermore, also affect other spheres, calling for changes in thinking and regulations which require that people work to a greater age so that they can enjoy a better-quality old age. Moreover, middle-aged generations will have to change their attitudes towards old age and ageing, and prepare for their own old age.

Transition from an industrial society to a knowledge-based society. Post-industrial society based on knowledge brings with it new social risks, principally those of education and training which are inappropriate for the new demands at work as well as in everyday life. People with inappropriate training will be subject to a considerably greater risk of social exclusion. Those who are currently among the adequately trained may soon be hard pressed to adapt to the demands of the information society. Given that traditional systems of social security offer no solution to this issue, those risks which can be predicted will have to be taken into account when drawing up new social policy measures. Life-long education will have to become one of the main components of social policy.

At the same time, however, a society based on knowledge brings new opportunities to reduce social exclusion through faster economic growth, a higher level of employment and the opening up of new modes of social inclusion.

Changing needs of the users of social services, and the resulting individualisation (customisation). The fact that users are becoming increasingly conscious of their rights and needs, and the emergence of a number of new needs calls for the development of new services tailored to the needs of people. Thus, individualisation will be one of the key focuses of future development. Similarly, the development of a network of public services and the offering of other social security services implies a great chance to increase business activity and new job opportunities. These services also need to be developed because of the many needs currently not being met due to a shortfall in providing services. New, more varied services suited to different needs will have to be developed, with the course of their development being dictated by demand on the side of their users. Users of the social security sector can be expected to ask for better and more varied services. Furthermore, users themselves will have to assume more responsibility by participating in taking care of their own social security. Generally speaking, a rise in the volume, quality and individualisation will mark the development of the social security sector.

6.2.3. Main Orientation and Mechanisms of Social Development

The policy of social development must chiefly be a policy of equal opportunities whose aim is to facilitate social participation. All measures of the new social policy have to aim at empowering people. As a result, the policy of social development will be based principally on investing in people and on preventing social exclusion.

Moreover, while all social security systems will have to be checked against their ability to provide minimum security in all situations, including for the poorest and the most vulnerable, greater emphasis will have to be placed on the creation of broad opportunities for social participation, investment in human resources and measures tailored to individual needs. Systems of assistance should not cause or encourage passivity, but incorporate incentives to reactivate those unable, in different periods and for different reasons, to take care of themselves. The systems have to be selective, but should not jeopardise human dignity.

Measures preventing social exclusion should be given more attention in drafting the policy of social development. This approach should be applied as a matter of necessity particularly when dealing with predictable social risks where active help is required to prevent an individual or their family finding themselves in a difficult social situation. To achieve this goal, social policy should develop mechanisms enabling it to pre-empt social exclusion.

Social security. Economic development has to remain the basis of social security if social security is to be guaranteed along with the necessary long-term stability. Frequent and major changes to social security systems can lead to distrust and, often, inefficient spending.

Corrections to social security systems will focus on two goals, namely improving the social situation of the most excluded groups through general social solidarity and by creating additional systems of social security. Apart from traditional systems of social security, new arrangements guaranteeing long-term care will be necessary for a large number of old people with chronic illnesses. Systemically, active social policy will continually be encouraged, focusing on the integration and re-integration of individuals and social groups into employment and life. The systems of social security benefits will thus be linked to systems of active help (training, job adjustment, subsidised employment, psychosocial rehabilitation, adjusted forms of employment, personal assistance for the disabled etc.) which should enable a greater proportion of the population to help themselves in providing their own social security.

Public services in the field of social security. The development of public services will take into account the necessity for more accessible services in relation to both entrance mechanisms and more regionally balanced accessibility, the user's right to choose, the individualisation of services and their implementation, deinstitutionalisation, as well as pluralism and the elimination of monopolies in providing public services. Public social security networks will be based on two principles, namely eliminating inequality in accessibility and streamlining their organisation. Users necessarily have to be empowered to have a greater influence on the planning and providing of social security. The provision of public services will not solely depend on state-owned public institutes, but will also involve, on the same terms, other institutions regardless of what kind of legal entity they are, chiefly non-governmental organisations and private institutions. A system of licences will guarantee that the public interest is protected when non-state-owned institutions are involved.

The state's task is to change from being the guarantor of the provision of public services to becoming a regulator (setting the volume and conditions of providing

public services and the necessary minimum standards) and a supervisor of their provision. Rather than causing dependency and social exclusion, development of the provision of public services will have to aim to a greater extent at enabling the individual to live as independently as possible.

Furthermore, both regulators and providers of public services will have to focus on raising the quality of services, which should be achievable by adjusting the standards of public service provision to the development of individual lines of activity, by changing the role of users and by changing the mentality as well as the way in which public service providers work. In addition, the plurality of public service providers will enhance competition, which should bring about an improved responsiveness to different needs and a better quality of services.

Privatisation of state-owned property providing public services will be carried out where a significant degree of rationalisation would be enabled and, simultaneously, where the public interest would be secured to the appropriate degree. Deregulation of management systems, more streamlined organisation and cost-cutting will have to be given more emphasis in those providers that are organised as public institutes.

Thus, social development's priorities are as follows:

- a/ A greater number of sources for traditional social security, chiefly pension and health insurance, as well as the introduction of new forms of insurance.
- b/ Measures to reduce the risks of social exclusion which result from inappropriate training (life-long education is necessary).
- c/ Boosting the volume and quality of social security services as well as their individualisation, all of which increases the opportunities for economic activity and employment. The private sector will be increasingly involved in the provision of social security services, including the partial privatisation of state-owned institutions providing public services.

PART III

The Strategy's Development Scenario

*Scenarios are by definition imaginary*⁹

Introductory Notes

The Strategy's Development Scenario reveals a feasible path for Slovenia's development in quantitative terms. The medium-term projections (gross domestic product by type of expenditure, cost structure and sectors of activity, and the main national accounts aggregates) reflect a consistent vision of the economic policy necessary for the economic and social restructuring set out in the Strategy. The Scenario **reflects the main economic policy orientations** proposed by the Strategy:

- ï exports will continue to be the main lever of economic growth (real annual export growth should be 6%-7.5% underpinned by measures to boost competitiveness;
- ï investment relative to gross domestic product should be maintained roughly at the current level (around 26%), as it is sufficient and can be financed without any major deficits; however, the structure of investment will have to be improved and its efficiency raised;
- ï the general government deficit should be gradually eliminated with the help of reducing general government expenditure relative to GDP and its restructuring; and
- ï the current account deficit should be narrowed to about 1.5% of GDP.

The medium-term scenario **should not be taken as a forecast** of the actual values of macroeconomic aggregates in a particular year. Current developments are always subject to unexpected and unpredictable effects stemming from domestic economic cycles and the international environment. Current economic developments should therefore be constantly monitored and the short-term economic policy measures adjusted accordingly if there is any imbalance or discrepancy from the scenario. This should be done by monitoring current economic trends and drawing up short-term spring and autumn forecasts.¹⁰ Despite these constraints, the Scenario provides a consistent vision of the macroeconomic development which may be achieved if the strategic orientations are adhered to. Excluding short-term fluctuations, which were particularly strong in 2001 and 2002, these should result in:

- ï an increase in real economic growth from the current 4% to 5%-5.5% annually;
- ï a reduction of the unemployment rate to 5% (or to 7.5% for the registered unemployed); and

⁹ European Commission, Forward Studies Unit: "Scenarios Europe 2001", Working Paper, Brussels, July 1999.

¹⁰ The IMAD regularly draws up the Spring and Autumn Reports, whose focus is the evaluation of current economic developments and short-term projections. In addition to these documents, a new Development Report will examine the extent to which the actual trends follow the Strategy's orientation and will be made on the basis of the system of indicators devised to monitor implementation of the Strategy.

- ï the gradual reduction of inflation to below 4% annually by the end of the period covered in the Strategy.

The methodology used in making the Scenario's projections is based on national accounts balances, meaning that priorities are adjusted to possibilities, and that the projections are consistent. Changes to the aggregate structure and growth rates envisaged in these projections reflect the Strategy's main priorities, as well as the measures necessary to achieve these structures and rates. The underlying goal is to moderately accelerate the ongoing dynamic economic growth, which should enable Slovenia to catch up in the long run with the average level of development in the EU and thus integrate into this community as an equal partner. Growth must be founded on qualitative changes, which should be reflected in the restructuring of investment and increased shares of education, telecommunications, foreign trade and foreign direct investment. Development should be sustainable, which is why it is based on greater savings, better protection of the environment, and preservation of the main principles of the welfare state, all of which can be seen in the forecast national accounts aggregates. As development should not be hampered by an unstable macroeconomic environment, progress will depend on efforts aimed at cutting inflation to levels comparable to those in the EU, eliminating gradually the general government deficit and keeping a sustainable deficit in the current account of the balance of payments (meaning that the ratio of external debt to gross domestic product does not rise and increased shares of foreign direct investment allow foreign funds to bolster the investment cycle. In the period covered by the projections, Slovenia is expected to become a member of the European Union. The year 2004 is implicitly envisaged as the year of Slovenia's full membership in the EU, however, the projections show that macroeconomic developments will gradually adapt to EU conditions, as has been the case so far.

Since the Development Scenario reflects the realisation of measures set out in the Strategy, it is necessarily more optimistic than any scenario based on maintaining the current trends, but it nevertheless reveals an achievable path of development. So we have decided not to prepare alternative scenarios but prefer to point out the **main risks** that may undermine implementation of this Scenario. The first risk arises from the assumption of a **stable international economic environment**. According to alternative calculations, about 1.5 percentage points lower average economic growth in Slovenia's main trading partners could reduce Slovenia's gross domestic product growth by up to 1 percentage point through lower real export growth rates and spillover effects on domestic production and consumption. Another risk arises from the assumption of a **sufficient level of domestic savings** that are planned to be earmarked for financing the current or a slightly higher level of investment relative to gross domestic product. Should the assumptions about a moderate rise in domestic private savings and the gradual elimination of the general government deficit fail to come true, investment relative to gross domestic product would start to decline or call for greater external borrowing which would, in turn, lead to a higher deficit in the current account of the balance of payments. The third risk is rooted in the **implementation gap**, i.e. the possibility of postponed or insufficient implementation of the Strategy and structural reforms. The implementation gap would then be reflected in decelerating economic growth in the medium term (because of the reduced competitiveness and adaptability of the economy).

The Scenario was drawn up in April 2001 together with the draft Strategy for the Economic Development for Slovenia¹¹. Projections from the Scenario included a detailed presentation of the main macroeconomic indicators made on the basis of the system of national accounts and economic policy guidelines up to 2003. The Scenario provided a basis for development planning documents and economic policy measures envisaged in the Budget Memorandum (July 2001), the draft budgets for 2002 and 2003, and the Pre-Accession Economic Programme (September 2001).

In autumn 2001, gross domestic product figures for the first two quarters revealed an unexpected fall in domestic investment, while forecasts of international economic developments deteriorated significantly. This is why the IMAD made new macroeconomic forecasts for 2001 and 2002 in autumn 2001, which project substantially lower economic growth compared to the original scenario (down by 0.7 and 0.6 percentage points). These forecasts were published in the IMAD's Autumn Report 2001¹² and served as a basis for drawing up amendments to the draft budget for 2002 and 2003.

It is as yet (January 2002) impossible to say to what extent the **deceleration of economic growth in 2001 and 2002** will affect the implementation of the medium-term development scenario. The assumption of the latest forecasts is that economic growth in leading world economies will resume in the second half of 2002 and that the effects of negative global developments on Slovenia will be buffered by rapid export growth to the markets of South-eastern and Eastern Europe, the revival of domestic consumption after stalling for two years, and the greater investment activity of the Government. Under such conditions, economic growth should again achieve the levels proposed in the medium-term scenario as early as in 2003. However, the decelerated growth will also result in **structural changes**. The drop in investment at the end of 2000 and early 2001, which was primarily due to the curbing of public funding as well as the low private sector's business expectations, will reduce the level of investment relative to gross domestic product compared to medium-term projections. The structure of investment will change in 2002 as a result of the stronger involvement of budgetary funding, which is one of the economic policy's anti-cyclical measures, and the change will involve both the institutional and economic structure (a larger proportion of public sector funding and higher infrastructural investment compared to medium-term projections). Another important structural change concerns public finance. The adjustment of fiscal policy to lower 2002 economic growth forecasts (maintaining the original nominal level of general government expenditure and raising tax revenues) will result in higher general government expenditure relative to gross domestic product, however, if the anticipated level of revenue is not collected, the general government deficit could also rise.

The strength and persistence of these structural changes and their impact on the level of economic growth and other macroeconomic aggregates over the next few years can be accurately assessed when all statistical figures are available for 2001 at least. The new data will help in preparing new medium-term projections, which

¹¹ http://www.sigov.si/zmar/apublici/aanaliza/aspoml01/springr_01.html

¹² <http://www.sigov.si/zmar/apublici/aanaliza/ajesen01/ajesk01.html>

will serve as a basis for any adjustments of the state budget (particularly for 2003) and the updating of the Pre-accession Economic Programme. It is as yet impossible to carry out this task in this document. This is why we have decided to point out the Scenario's qualitative aspect of bringing together the main development guidelines and factors of development on one hand, and macroeconomic trends and structures on the other. This Scenario primarily reflects the vision of the Strategy's authors as to what is an **achievable, consistent and sustainable pattern for stable medium-term economic development** regardless of short-term cyclical discrepancies and current economic policy adjustments.

Table 1: MAIN MACROECONOMIC INDICATORS AND ASSUMPTIONS

	Real growth rates, %					
	<i>Autumn Report 2001</i>		<i>The SEDS's medium-term scenario</i>			
	2001	2002	2003	2004	2005	2006
GDP	3.7	3.6	4.5	4.8	5.3	5.7
Employment by SNA	0.7	0.6	1.0	1.0	1.5	1.9
Labour productivity	3.0	3.0	3.5	3.8	3.8	3.8
Gross wage per employee	2.5	2.5	3.0	3.2	3.1	3.2
Exports of goods and services	7.2	4.8	6.3	6.7	7.2	7.3
Imports of goods and services	3.3	4.7	6.4	7.0	7.1	7.2
Final consumption (government & private)	2.3	3.2	4.0	4.3	4.6	4.9
Gross fixed capital formation	-1.4	4.6	6.6	6.6	6.6	7.2
Current account balance (% of GDP)	-1.1	-1.2	-2.0	-1.9	-1.6	-1.4
INFLATION AND EXCHANGE RATE						
Inflation rate (annual average)	8.5	6.4	5.1	4.8	4.5	3.7
SIT/USD exchange rate	241.0	245.2	249.1	246.8	247.9	248.5
SIT/EUR exchange rate	217.2	225.6	232.0	236.7	237.7	238.2
EUR/USD exchange rate	0.90	0.92	0.93	0.96	0.96	0.96

Source: The IMAD's projections (Autumn Report 2000 for 2001-2002, November 2001; SEDS's Macroeconomic Scenario for 2003-2006, July 2001).

Economic Growth

Owing to the economy's openness, economic developments in Slovenia strongly depend on economic growth, price and financial movements in the international environment. Economic growth projections for the period up until 2006, which were made on the basis of international institutions' forecasts, envisage a pick-up in economic activity in the second half of 2002 and a relatively stable economic environment in the main trading partners in the next few years. The main macroeconomic aggregates were calculated on the assumption of a gradual strengthening of the euro against the US dollar, with the exchange rate gradually drawing near to a ratio of 1:1, and oil prices stabilised at a level of around USD 25

per barrel. As Slovenia's external trade is anticipated to further diversify, the import-export flow projections take into account the economic growth forecasts for the countries of former Yugoslavia and other countries in transition, which are expected to enjoy higher average economic growth rates than advanced economies.

The scenario for the period up to 2006 forecasts annual real gross domestic product growth of 4.5% to 5.7%, with foreign demand being the main driving force behind economic growth. On the assumption of a relatively favourable international environment and further diversification of Slovenia's external trade flows, dynamic export growth after 2003 will be achieved through production's increased export competitiveness. Bolstering real export growth will depend on the efforts to achieve higher value added per unit of exported goods, which calls for new production programmes and new products. Dynamic imports will provide the necessary import component for domestic production (imports of intermediate goods) and for growing investments (imports of machinery and equipment and technology). With the structural reforms necessary for Slovenia's full integration into the European economic area being completed, investments and technological development will enable further growth in labour productivity and the strengthening of international competitiveness. Economic growth will thus be more directly linked to new business investments. Private and government consumption will contribute less to economic growth since these two aggregates will rise more slowly than gross domestic product. The dynamics of private and government consumption growth will be highly influenced by economic policy which will have to support efforts to increase the economy's export competitiveness and ensure a sufficient level of national savings necessary for financing investment and, at the same time, maintain sustainable current account and fiscal deficits. Household spending will largely be influenced by measures of social, fiscal and wages policies as well as positive employment trends. The structure of household spending will also be influenced by the gradual transfer of costs for certain services, mainly in the sectors of health and education, from the state to the consumer; on the other hand, supplementary pension insurance schemes will further stimulate household savings.

The projections anticipate a significant rise in gross domestic savings, expanding from 24.6% of gross domestic product in 2000 to 27.0% in 2006. This will narrow the savings-investment gap from 3.2% to 1.4% of gross domestic product. A higher level of national savings is expected to be accompanied by stronger net capital inflows in the form of direct and portfolio investments, which should increase the amount of funds available for investment and facilitate the restructuring of the economy. Investment activity is forecast to be further boosted by funds received from the EU's structural funds. Investment-driven economic growth, while meeting the goals of stabilisation, can only be achieved through the policy of ongoing cost reduction. Projections of gross domestic product by cost structure envisage that incomes policy will be able to maintain the current positive trends of the gross wage per employee rising within the limits of overall labour productivity growth. Technological development should accelerate labour productivity growth, so that labour costs may rise by an average annual rate of 4.4% in 2001-2006, while their share should drop from 52.6% of gross domestic product in 1999 to 51.2% in 2006.

Real Sector

Projections of gross domestic product by kind of activity for the period up to 2006 have taken into account the processes of globalisation, European market integration, rapid technological progress, and transition to the information society. Slovenia's economic development, together with accession to the EU and harmonisation with its internal market rules, will result in further changes in the sectoral structure of the Slovenian economy. In the oncoming period, the share of service sectors in total value added will continue to increase, while the shares of industry, construction and agriculture will fall (value-added growth in construction is expected to be most dynamic among the latter three activities).

As the share of service sectors increases, both market and non-market services will achieve larger shares. Accelerated investment in human capital, research and technological development, information and communications infrastructure and new services will directly boost the growth of transport, storage and communications (telecommunications in particular), business services (especially information technologies services and research and development), and education. Education should primarily experience a larger share of adult learning. In accordance with the development of an efficient financial system, the growth of financial intermediation is expected to accelerate. Among non-market services, the public administration, defence and compulsory social insurance are forecast to increase their shares in total value added in the next few years in connection with Slovenia's accession to the EU and NATO. Demographic developments leading to the ageing of the population will be reflected in stronger growth in the activities of health care and social work. The development of services will have positive effects on the growth of other activities, particularly manufacturing, where industries which will be more affected by the promotion of technological development should experience the most rapid development. The role of industries that generate low value added, primarily labour-intensive industries, are expected to gradually decline.

Table 2: THE STRUCTURE OF GROSS DOMESTIC PRODUCT AND VALUE ADDED BY ACTIVITIES (NACE REV.1)

	% of structure, current prices	
	2001-2003	2004-2006
1. Value added	86.5	87.0
Value added	100.0	100.0
- Agriculture and fishing (A + B)	3.3	3.2
- Industry and construction (C + D + E + F)	37.0	36.1
- Services (G ... O)	61.9	62.7
- FISIM	-2.2	-2.0
2. Net taxes on goods and services	13.5	13.0
3. Gross domestic product	100.0	100.0

Source: The IMAD's projections (Autumn Report 2000 for 2001-2002, November 2001; SEDS's Macroeconomic Scenario for 2003-2006, July 2001).

International Economic Relations

The development scenario forecasts a real average annual rise of 6.9% in exports of goods and services in 2003-2006, which is to be achieved through Slovenia's increased international competitiveness. Real merchandise export growth will be boosted by greater regional dispersion. The proportion of exports of goods to EU member-states is forecast to drop (with exports to the EU rising in real terms), while the share of exports to the countries of former Yugoslavia and other countries in transition should rise. The partial re-orientation of Slovenia's merchandise trade will be partly due to the stabilisation of the economic and political situation in South-eastern Europe. The trade deficit as a percentage of gross domestic product should gradually fall to 3.6% in 2006. The boosted activity of the domestic service sectors is expected to be reflected in invigorated trade in services in 2001-2006. Taking into account Slovenia's future economic development and the growing needs of the corporate sector and public administration induced by the transition to the information society, services that should rise on both export and import sides are computer, information, communications, various business, professional and technical services. The surplus from services should settle at about 1.6% of gross domestic product. As far as the inflow side of the current account of the balance of payments is concerned, current transfers for the period up to 2003 include EU assistance funds through the programmes of PHARE, ISPA and SAPARD. From 2004 onwards, when it is expected to become a full member of the EU, Slovenia will be entitled to draw funds from the EU's cohesion and structural funds which will lead to a rise in total net current transfers from the rest of the world compared to the pre-EU accession period and thus contribute to reducing the deficit in the current account of the balance of payments. The amount of funding will depend on Slovenia's level of development, the rules regulating the EU's structural and cohesion policies, and pre-accession negotiations, which is why it is difficult to give accurate forecasts at the moment.

The current account deficit should shrink gradually to below 2% of gross domestic product in the period after 2004, whereas in 2006 it is estimated to represent 1.4% of gross domestic product. Its sustainability will strongly depend on the composition of inflows in the capital and financial account of the balance of payments. Gradual liberalisation of capital flows over the next few years will strengthen Slovenia's integration into international capital flows. In addition to stronger inflows of international loans for infrastructure projects, foreign direct investment is expected

Table 3: THE REGIONAL COMPOSITION OF TRADE

	2000	2006
	% of structure	
Exports of goods	100.0	100.0
- EU members	63.9	65.0
- former Yugoslavia	15.6	17.5
- other countries	20.5	17.5

Source: SORS, projections by the IMAD.

to increase as well which should be boosted by the completion of privatisation and restructuring processes, consolidation of the legal system, the lifting of administrative barriers to domestic and foreign investments, further macroeconomic stabilisation, and full membership in the EU. Stronger foreign direct investment inflows will help boost export efficiency and contribute to stronger export than import flows after 2004. Stronger capital outflows from the private corporate sector are also envisaged as a result of, for example, the setting-up of companies abroad or commercial credits. In this case, Slovenia's external indebtedness (measured by external debt as a percentage of gross domestic product) should not increase. The sustainability of the current account deficit might be undermined if foreign direct and portfolio investment inflows are modest, as external borrowing would continue to rise. Such a course of events would slightly expand the goods and services deficit due to the reduced impact of foreign direct investment on export performance, which would put additional pressure on the sustainability of the current account of the balance of payments.

Inflation

In order to achieve the price and monetary policies' goal of bringing inflation down to levels comparable to the EU and at the same time maintaining the external balance, it will be necessary to co-ordinate macroeconomic policies whose measures will eliminate the current generators of inflation and will to a greater extent than before neutralise external and one-off effects that push prices up.

In addition to macroeconomic policies, an important role will be played by structural reforms, mainly as regards the final liberalisation of prices or changes to the current system of price regulation, the abolition of indexation mechanisms, and the creation of a more flexible labour market. An important contribution to easing upward pressures on food prices will come from the ongoing agricultural policy reform, which will phase out the support on the price side and introduce measures on the income side.

In the process of adjusting relative prices to those in the EU, a distinction should be drawn between discrepancies caused by administrative factors and those reflecting the process of catching up with advanced economies. The reduction of the former requires the conclusion of the structural reforms listed above. The second category includes differences which are due to different factor productivity growth in particular sectors of the economy. Taking into account the differences so far seen in the dynamics of productivity growth between sectors, inflation in Slovenia is estimated to be 1 to 2 percentage points higher than in the EU over the next few years solely due to the Balassa-Samuelson effect.

The abolition of price regulation is particularly necessary in those activities where competitive structures can be established alongside the liberalisation processes, so that the equilibrium prices may mostly depend on competition within each sector and prices may thus converge. Prices still under government regulation primarily include the prices of telecommunications services and to some extent transport services. In sectors where the process of liberalisation cannot be accompanied by

the establishing of competition, chiefly due to the monopolistic nature of these sectors, a small market and the non-profitability of any higher number of providers, prices should be determined through negotiations between the distributors of those goods and services and an independent regulatory body, while taking into account world prices trends and any particularities of the local market, which is in line with EU regulation. This group includes the prices of local utility services and energy-related services.

As inflation rates are expected to fall, the need to use indexation mechanisms will ease. An argument in favour of their abolition as soon as possible is that the indexation of interest rates is one of the key factors of inflation's inertia and, at the same time, indexation hampers the financial sector's restructuring through generating accounting profits and also by reducing demand for non-indexed savings schemes and financial investments. The risk posed by immediate and total abolition of indexation mechanisms lies in the uncertainty about future inflation movements and the lack of a reference interest rate which should replace the tolar indexation clause. If the indexation abolition is merely administrative, economic agents would simply replace the official mechanisms with improvised ones, resulting in lower transparency. One of the possible short-term effects might be higher long-term nominal interest rates and lower long-term savings in domestic currency. After the abolition of indexation mechanisms is carried out in an appropriate way, the reference interest rate should gradually fall to the EU's levels in the next medium-term period in line with the liberalisation of capital flows and adjustments in the exchange rate policy, while the commercial banks' interest rates linked to the reference rate should fall in accordance with the higher competitiveness of the financial sector.

Wages Policy

The social partners are negotiating on a social agreement for the next period and the negotiations include an agreement on wages policy. The social partners have already agreed on a wages policy that pursues the goal of the gross wage per employee rising below the rate of productivity growth. This will enable fast technological development and investment in human resources in the private sector. The same orientation will have to be pursued in the next few years in order to increase the competitive edge of the private sector based on better technological equipment and qualified human resources.

In the **private sector**, wages policy will be gradually decentralised so that part of the wage increase depending on labour productivity growth will be determined in collective agreements at the level of activities. The social partners will have to agree on a scheme of profit sharing with a view to motivating workers to achieve greater productivity. A profit-sharing scheme will incorporate part of the funds for wages which have so far been given at the end of the year as performance-related pay. Wage growth at the end of the year will thus ease slightly, particularly that of management. In the **public sector**, the law on the wage system for staff employed in the public sector will provide standardised criteria for wage determination, which will introduce greater flexibility of the wages system, with wage rates then depending more on efficiency at work. The system of collective agreements in the public sector

will be centralised. In order to maintain macroeconomic sustainability, negotiations should ensure that the real gross wage per employee in the public sector does not rise higher than wages in the private sector.

Investment

The investment scenario, forming part of the SEDS' macroeconomic aggregate projections, aims to present an outline of investment structure by purpose which should enable realisation of the Strategy's main goals, and the sources of financing. The scenario breaks down the total volume of investment (relative to gross domestic product) by purpose and sources of financing in line with the development scenario. The scenario was made on the basis of the existing investment plans, evaluation of the available sources and the restructuring of investment by purpose in line with the Strategy's guidelines. The scenario's main guidelines will serve as a basis for its realisation through the budget's development programmes and the National Development Programme.

Investment structure by purpose. Investments are broken down on the basis of the three main investment purposes. Total investment is classified into investment in economic infrastructure, investment in market activities (excluding economic infrastructure) and investment in non-market activities. Investment in non-market activities is composed of two segments: investment in residential building and investment in the services of government bodies and institutions. The structure of investment by purpose for previous years has been made on the basis of the annual statistical surveys. Projections of investment in economic infrastructure and residential building for 2001-2006 have been made on the basis of the national programmes in force and the assessment of public and other funding available for investment financing; projections of investment in government services have been founded on the state budget for 2002 and 2003 and on macro-fiscal scenarios for subsequent years. Investment in market activities is defined as an endogenous variable (the difference between projections of domestic and foreign savings on one hand and planned investment in economic infrastructure and non-market activities as set out in national programmes and the state budget on the other).

In the **last medium-term period**, economic growth was underpinned by dynamic investment activity. In 1995-2000, the 10.2% average annual growth in gross fixed capital formation significantly exceeded the average annual gross domestic product growth of 4.3%. The level of gross national savings, rising by 6.9% in the given period, was not sufficient to finance the rapid investment growth. The investment-savings gap, which was mainly financed by external borrowing (mainly that of the public sector) increased from 0.6% of gross domestic product in 1995 to 3.2% in 2000. A breakdown of investment by purpose for 1995-2000 shows that investment in market activities represented 53.0% of total investment, investment in economic infrastructure held a 21.9% share, investment in residential building made up 15.4% and investment in government services 9.7% of total investment. The share of economic infrastructure in total investment increased by 2.7 percentage points from 1995 to 2000; the share of investment in market activities and non-market activities (residential building) shrank by 1.3 and 1.4 percentage points, respectively. Slovenia

invested an average of 5.4% of gross domestic product in economic infrastructure, a level that is comparable to advanced industrialised economies. Investment in economic infrastructure was predominated by investment in transport infrastructure. In 1995-2000, Slovenia earmarked an average of 3.8% of gross domestic product or 15.5% of total investment each year for the construction of transport infrastructure, including communications. The most important element was investment in the motorway network and telecommunications services. While the proportion of investment in motorways has declined since 1997, investment in telecommunications has been on a steady increase. In the last medium-term period, investment in railway infrastructure was postponed due to unresolved financing issues, and its share in total investment stagnated up to 1999. Another important segment of infrastructural investment was investment in electricity, gas and water supply, which represented 1.2% of gross domestic product, or 4.7% of total investment in 1995-2000. Unlike the transport and energy sectors, environmental protection infrastructure witnessed stagnation in the last medium-term period.

The scenario for the **period after 2003** projects a slightly faster rise of investment compared to gross domestic product, which will provide the room necessary for investment in machinery and equipment, technological progress, and information and communications technologies, enable a higher share of investment in economic infrastructure, and help realise the planned investment in residential building, while the share of government service investment will drop. A higher level of national savings is forecast to be accompanied by stronger net capital inflows in the form of direct and portfolio investments, which should increase the amount of funds available for investment and facilitate the restructuring of the economy. Investment activity is forecast to be further boosted by funds received from the EU's structural funds. According to projections, the **proportion of infrastructural investment will increase**, of which **primarily** investment in **telecommunications and environmental protection infrastructure**. Investment in telecommunications will mainly be financed by private funding, while an important part of funds earmarked for investment in environmental protection infrastructure will come from private and EU sources, as Slovenia will raise its environmental standards so as to meet the EU criteria. In conditions of a liberalised market, *investment in the energy sector* will mainly focus on increasing transmission capacity and supply reliability; energy investment relative to total investment will gradually decline. Slovenia's further integration into the European transport network and its investment in the construction of *transport infrastructure* (road, railway, airport and harbour infrastructure) will allow Slovenia to assume the role of a connector between the Mediterranean and Central and Eastern Europe. Additional funds from the EU's structural and cohesion funds employed in the financing of these projects will only offset the decline in the public sector's borrowing (in domestic and foreign markets), while the share of these investments will not increase markedly.

The growing share of infrastructural investment will be largely **counterbalanced by a smaller share of investment in non-market services**, particularly investment in *state administration services*. The quantitative rise, leading to larger office floor area, will have to be followed by a qualitative rise and investment in information technologies. The proportion of investment in *residential building* is not forecast to rise. As far as housing is concerned, the housing savings scheme will probably lead

to a peak in demand in 2005, however, demand need not be satisfied by new construction alone. Reasons for the mismatch between supply and demand are primarily structural, which is why the restructuring of the existing housing stock should result in a greater supply of flats, partly also due to the announced real estate tax. No significant rises in funds earmarked for residential building construction may be expected in the forthcoming period, despite the high increase in the number of dwellings planned to be constructed or renovated under the National Housing Programme (at least 10,000 dwellings a year; the Programme has fixed a relationship between the number of social, non-profit, profit and owner-occupier dwellings). Some positive effects leading to a lower average price may be expected from the construction of dwellings for rent, which are lacking, and whose average construction cost is lower than that of dwellings built for sale (according to official statistical figures).

Gross fixed capital formation, as the national accounts aggregate, is also composed of **investment in intangible fixed assets**,¹³ which have increased steeply over the last few years according to figures from the SORS (a rise of 134% in 2000 from 1995); the latest figures available show that intangible fixed assets account for 3.6% of total gross fixed capital formation.

Table 4: THE STRUCTURE OF GROSS FIXED CAPITAL FORMATION BY PURPOSE

	% of structure, current prices			
	1995-1997	1998-2000	2001-2003	2004-2006
1. Gross fixed capital formation (1 = 2 + 3 + 4)	100.0	100.0	100.0	100.0
2. Economic infrastructure	21.7	22.1	21.4	23.5
2.1. Energy sector ¹	4.5	4.8	3.3	2.7
2.2. Transport ²	11.2	9.6	7.7	7.9
2.3. Communications ³	4.3	5.9	8.3	10.6
2.4. Environmental protection infrastructure ⁴	1.7	1.7	2.0	2.3
3. Market activities ⁷	52.8	53.1	55.2	54.3
4. Non-market activities	25.5	24.9	23.4	22.2
4.1. Residential building ⁵	16.1	14.9	13.7	13.9
4.2. Government services ⁶	9.4	10.0	9.7	8.3

Source: The IMAD's projections (Autumn Report 2001 for 2001-2002; SEDS's Macroeconomic Scenario for 2003-2006)

Notes:

¹ including electricity, gas and water supply (SCA, section 40),

² including road, railway, airport and harbour infrastructure, and the gas distribution network,

³ including postal and telecommunications services (SCA, section 64),

⁴ including water collection, purification and distribution (SCA, section 41) and public hygiene services (SCA, section 90),

⁵ including new construction and renovation of single houses and multi-dwelling houses, the investor is a legal or natural person,

⁶ including the activities of public administration, education, research and development, health, social security and other services financed through budgetary funds,

⁷ including the activities of A to O which according to the SCA produce commercial goods and services, excluding infrastructure.

¹³ According to international definitions of the central framework of the system of national accounts SNA-93, gross fixed capital formation includes tangible fixed assets (construction works, machinery and equipment, transport equipment) and intangible fixed assets: studies, projects and research works, software, licences, patents, trademarks, and originals in the field of film, music, etc.

It is sensible to also include **investment in the soft factors of development**¹⁴ in addition to investment in intangible fixed assets, considering their developmental function and the practice of foreign development plans.

OECD countries earmark an average of 6.3% of gross domestic product for **investment in education**, around 80% of which is budget funded¹⁵. In Slovenia, public spending on education, including the pre-school level, amounted to around 6% of gross domestic product at the end of the nineties, which was the OECD's average level in the mid-nineties. Excluding the pre-school level, public spending on education represented 5.2% of gross domestic product in the mid-nineties, close to the OECD's average level and higher than in most applicant-countries for membership in the EU. The proportion of tertiary education in total current expenditure on education (excluding the pre-school level) increased gradually from the mid-seventies to the mid-nineties on account of reducing the proportion of primary education. A comparison with other countries nevertheless shows that the situation in Slovenia is better for the first two education levels (primary and secondary education) than the tertiary one in terms of public expenditure on education as a percent of gross domestic product. In the nineties, public expenditure on adult education increased the most in the total expenditure structure, but the level remains low¹⁶. Corporate investment in adult education is significantly higher than that of the government (figures for 1995 show that the former was four times higher than the latter). The investment of enterprises and organisations in lifelong learning as a percent of gross domestic product ranged at around 0.3% in 1995–1999. One of the steps necessary to implement the lifelong learning strategy is the immediate adoption of the national adult education programme. The draft programme plans a significant increase in investment by all social partners, including the government. The adult education programme should be gradually allocated 9.5% of all public funds earmarked for education a year, or 0.8% of gross domestic product, that is an almost six-fold increase from the current level of public funds earmarked for adult education. The financial sources include higher shares of investment from the state and local government budgets, the business fund, participants' contributions, international funds and other private funds.

According to figures on investment in **science and technology**¹⁷, this expenditure totalled 1.51% of gross domestic product in 1999, slightly more than in 1996 (1.44%),

¹⁴ They include financial investment in services whose impact is long term. The main financial investment criterion is the internal costs of an organisation that provides these services. They include current costs (compensation of employees and other current costs excluding depreciation), and investment costs. Definitions differ as regards the coverage of these services. The main components of these investments include education and research, constituting a part of investment in human resources. These investments are not covered in the central framework of the system of national accounts (SNA). See Wim Vosselman: *Measuring Intangible Investment, Initial Guidelines for the Collection and Comparison of Data on Intangible Investment*, OECD 1998.

¹⁵ *Human Capital Investment, An International Comparison*, OECD 1998, p. 36.

¹⁶ Milena Bevc: *Znanje in izobraževanje v Sloveniji v luči priključitve EU*, IER, January 2001, pp. 107–108.

¹⁷ The results of the annual statistical surveys conducted in scientific research and research and development organisations and the results of the annual surveys of budgetary expenditure on research and development activity. The method of evaluating research and development activity was harmonised with the OECD's international Frascati methodology in 1993.

and the proportion of the corporate sector's funding increased from 40.9% in 1995 to 56.9% in 1999. The available figures show that the National Research Programme (NRP), which was adopted by the Government in 1995 and has committed the Government to raise the budget of the Ministry of Science and Technology by 10% each year, is not being implemented, meaning that the Government's investment relative to gross domestic product is one of the lowest rates in Europe, representing just 0.60% of gross domestic product in 1999. Projections for forthcoming years have been made on the basis of a programme called the Projections of Slovenia's Technological Development in the 21st Century. Its point of departure is that a vision of Slovenia's technological development should follow global trends as well as consider the financial resources available in Slovenia. According to these projections, investment in science and technology should climb to 2.1% of gross domestic product in 2006.

Investment consists of that part of the available output which is deducted from current consumption with a view to maintaining and expanding production capacities. Investment helps raise aggregate supply in the long run, which makes it a key factor of growth and society's development. The size of this contribution depends on the **efficiency of investment**.¹⁷ One of the indicators showing the efficiency of future investment is the capital coefficient. The marginal capital coefficient is the ratio of investment to additional physical product. It shows how many units of investment need to be put in for the product to rise by one unit. The marginal capital coefficient calculated using the simple economic growth model reveals that improved investment efficiency can be expected no earlier than in the second half of the period covered by the Strategy (after 2004).

The sources of investment financing. The last months of implementing the 2000 budget and the drafting of the budget for 2001 revealed what were the real public finance frameworks and showed that budget funds for national infrastructural programmes had to be cut both compared to previous years and the levels planned in national programmes. As it is difficult to provide supplementary sources through borrowing or private investment based on concession agreements in a short period of time and under current regulation, this led to a fall in infrastructural investment in 2001. Public funds earmarked for investment increased in the budgets for 2002 and 2003, however, projections made under the assumption of balanced public finance show that the proportion of public funds in investment financing will again drop slightly. Since increased borrowing might undermine macroeconomic sustainability, the projections envisage that private capital from abroad should be involved in financing the building of infrastructure on a concession basis and that financing from EU aid should increase. The latter depends on the date of Slovenia's accession to the EU, and the possibilities of using funds from structural policy and

¹⁷ International assessments of investment efficiency are usually based on the inverse capital coefficient, which shows the ratio of capital to output. The assessment of capital input and international comparisons (the OECD's methodology) are highly demanding operations since they are based on the assessment of capital invested in a particular type of fixed asset (taking into account the initial situation, investment, and the operating life of a fixed asset), aggregation is done in a way whereby differences between services are taken into account (the cost of rent or the cost of use). There are no comparable data available for Slovenia since depreciation of fixed assets is carried out by a single consumer price index, as laid down in the accounting standards, meaning that depreciation does not reflect the replacement value of the asset.

the outcome of negotiations on the criteria and amount of future inflows; the Scenario's assessment is conservative and therefore assumes a less favourable outcome.

Tabela 5: THE SOURCES OF FINANCING GROSS FIXED CAPITAL FORMATION

	% of structure, current prices		
	1998-2000	2001-2003	2004-2006
1. TOTAL (1 = 2 + 3 + 4 + 5)	100.0	100.0	100.0
2. PUBLIC FUNDS ¹	16.3	17.0	16.7
3. CORPORATE AND HOUSEHOLD FUNDS ²	59.0	60.3	60.6
4. NET LOANS ³	20.0	17.2	14.0
5. EU AID AND OTHER SOURCES ⁴	4.7	5.5	8.7

Source: The IMAD's projections (Autumn Report 2001 for 2001-2002; SEDS's Macroeconomic Scenario for 2003-2006).

Notes:

¹ public funds in line with the SNA methodology based on investment outlays (funds for the purchase and construction of fixed assets and investment transfers from the total public finance account – consolidated balance of four public finance budgets: the state budget, municipal budgets, Pension and Disability Insurance Institute and Health Insurance Institute).

² corporate and household funds include the funds of legal entities and private individuals irrespective of ownership, including foreign direct investments (including those in economic infrastructure).

³ net loans are all loans, including loans subsidised by funds and loans taken out in domestic and foreign banks irrespective of ownership.

⁴ EU aid (PHARE, ISPA, SAPARD, structural and cohesion policies), and other sources (the issuing of new shares and bonds, supplier loans, financial leasing and other less conventional forms of investment financing).

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Research Projects and Studies Made for Drawing up the SEDS

Research Projects¹

TRP: Competitiveness of the Economy

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- ï *Slovenska industrija v pogojih notranjega trga EU - 2. del*. 2000. Centre for International Competitiveness. Head of the project: Dimovski, V.
- ï *Regulacija trgov po vključitvi Slovenije v EU*. 2000. Faculty of Economics, University of Ljubljana. Head of the project: Hrovatin, N.
- ï *Informacijska struktura - sredstvo za doseganje večje dodane vrednosti*. 2000. Faculty of Economics, University of Ljubljana. Head of the project: Jerman-Blažič, B.
- ï *Politika pospeševanja razvoja malih in srednje velikih podjetij*. 2000. Technological Park Ljubljana. Head of the project: Lesjak, I.
- ï *Slovenska industrija v pogojih notranjega trga EU - 1. del*. 2000. of Economics, University of Ljubljana. Head of the project: Prašnikar, J.
- ï *Tehnološki razvoj kot razvojni dejavnik v pogojih notranjega trga EU*. 2000. Institute for Economic Research. Head of the project: Stanovnik, P.

¹ Research projects made to provide foundations for the Strategy were carried out on the basis of two public invitations (Ur. l. RS, 51-53 of 2. 7. 1999; Ur. l. RS, 87-88 of 29. 9. 2000) within Target Research Projects (TRP). TRPs are special programmes for the implementation of the National Research Programme and they provide support for strategic documents. Summaries and reports are available at <http://www.sigov.si/zmar/sgrs/>.

TRP: Regional and Structural Development

- ï *Okolje kot razvojni dejavnik v pogojih notranjega trga EU*. 2000. Institute of Chemistry. Head of the project: Grilc, V.
- ï *Priprava strokovnih podlag za SGRS*. 2000. Institute for Economic Research. Head of the project: Majcen, B.
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TRP: Social Development and Development of Human Capital

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- ï *Trg dela in migracije v Sloveniji v luči vključitve v EU*. 2000. Faculty for Social Sciences, University of Ljubljana. Head of the project: Svetlik, I.

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Section: Economic Models for the Slovenian Economy**

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- *Ekonometrični model slovenskega gospodarstva*. 2001. Economic Institute of the Faculty of Law, University of Ljubljana. Head of the project: Križanič, F.
- *Izračunljivi model splošnega ravnovesja za Slovenijo*. 2001. Institute for Economic Research. Head of the project: Majcen, B.

Section: A System of Indicators for Monitoring the SEDS

- ï *Sistem indikatorjev za spremljanje socialnega razvoja*. 2001. Faculty for Social Sciences, University of Ljubljana. Head of the project: Adam, F.
- ï *Krovni sistem indikatorjev za spremljanje SGRS*. 2001. SICENTER – Centre for Social Indicators. Head of the project: Sicherl, P.
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