1. Economic growth and the competitiveness of the economy

**SDS guidelines:** Economic growth and the competitiveness of the economy is one of the development priorities of SDS, and encompasses the following objectives: ensuring macroeconomic stability, promoting entrepreneurial development and increasing competitiveness, and improving the competitiveness of services. Since the outbreak of the international financial and economic crisis, the first objective, ensuring macroeconomic stability, mainly focuses on establishing fiscal stability, stabilising the situation in the financial sector and reviving economic growth. The second SDS objective, increasing competitiveness and promoting entrepreneurial development, focuses on the development of areas where Slovenia has a competitive advantage, encouraging entrepreneurship and development of small and medium-sized enterprises, promoting and developing an innovative environment and a culture of innovation, and supporting internationalisation and competition in the network industries market. The third objective, increasing the competitiveness of services, prioritises boosting the factors of effectiveness in services and simplifying the administrative framework for their provision. A special emphasis is placed on those services most closely linked to business operations (business, financial, distributive, infrastructural services) because these have the greatest impact on the economy’s productivity and competitiveness.

**After gradually approaching the European Union’s average level of development, Slovenia has been steadily moving away from it since the onset of the crisis.** According to Eurostat’s most recent data, Slovenian GDP per capita in PPS reached 84% of the EU average in 2011. This was the same as in the previous year and seven percentage points (pp) less than in 2008, when Slovenia came closest to the EU average; moreover, economic trends in 2012 indicate a further widening of the development gap. A decomposition of GDP per capita to productivity and rate of employment reveals that the economic development gap increased at the beginning of the crisis due to a sharp fall in productivity. In the following years (2010–2011), the gap slightly narrowed, but this resulted to a greater extent from reduction in employment than was the case in the EU (see indicator 1.11). Increasing productivity by boosting economic growth, which was weaker in Slovenia than in the EU as a whole, is of key importance for the recovery of the economic convergence process.

**Economic recession during the crisis is the consequence of structural weaknesses.** In the years before the crisis, economic growth was based mainly on favourable trends in the international environment and easy access to financial resources. These financial resources were often channelled to less productive purposes, while the restructuring of the economic sector and increasing competitiveness were too slow. Moreover, the implementation of development-oriented changes in the economy and in society was often hindered by a number of institutional weaknesses. During the crisis, the pressures on the liquidity of the Slovenian banking system increased considerably due to the heavy reliance of banks on foreign sources of financing and their significant exposure to particular industries. The banking system, due to adverse conditions on the international financial markets, was no longer able to refinance debts from the past, while at the same time it had to create provisions and impairments due to a dramatic increase in non-performing loans. Preserving the rigidity of fiscal spending and high structural deficit even during the period of high economic growth also increased the fiscal exposure. Due to the operation of automatic stabilisers, the postponement of consolidation, and the attempts at rescuing the banking sector and certain state-owned enterprises through capital injections, the deterioration in the fiscal situation in Slovenia was among the worst in the EU. The above-mentioned problems in the financial system paralysed the financing of the Slovenian economy and, through the deteriorating perception of Slovenia on international financial markets, further restricted the access to financing resources necessary for economic recovery. During the crisis, the key economic activity factor was the export sector, but this could have recovered faster under a more efficient technological restructuring of the economy in past years. During the crisis, Slovenia’s market share on the global market declined considerably and the situation of exporters was made even more difficult by deterioration in cost competitiveness.

**It is vital to stabilise macroeconomic conditions as soon as possible in order to provide for the economic recovery.** Because of the negative feedback loop between low economic activity and poor conditions in the financial sector and public finances, a prompt stabilisation of macroeconomic conditions is urgent to enable Slovenia to access financial resources, which is a prerequisite for its economic recovery. In 2012 important, though relatively late, moves in fiscal consolidation were made in this direction. The general government deficit (also structural) decreased for the first time since the onset of the crisis, but the reduction of expenditure was to a certain extent interventionist in nature, therefore drastic structural reductions in expenditure, which it would be reasonable to combine with measures aimed at increasing revenues, will be needed for medium-term fiscal sustainability. The pension reform, which will mitigate the pressure of pension expenditure on the fiscal budget in the medium term, was also adopted. The second key condition for restoring economic growth is to remedy the conditions in the banking sector. In the past year, framework legislation for the rehabilitation of the banking system was adopted. It is crucial to initiate its implementation as soon as possible and, along with
the establishment of normal conditions for corporate financing, to minimise the impact of the rehabilitation on increasing public debt.

The provision of a stable macroeconomic environment should be accompanied by the establishment of conditions for enhancing competitiveness of the economy. Measures for improving competitiveness should be focused (i) directly on increasing the value added of products and services by boosting the economy’s innovation capacity and (ii) on eliminating the barriers to the operation and development of companies. Restructuring of the economy with a view to creating higher value added for products and services for which there is a growing demand is essential. Slovenia is not competitive on the global market in terms of the implementation of labour-intensive production processes or production of technologically less demanding products. The analysis of our export market share trend indicates that a considerable part of the geographic markets which are the focus of our exports is not among those that are fast-growing. Therefore it is crucial to support the development of new products and services which are interesting for the global market and which will provide progress in the chain of value added creation. Attention should also be paid to the importance of knowledge-based services and non-technological innovation to increase the value added generated by the manufacturing sector. In recent years, domestic and foreign competitiveness analyses, in addition to severely restricted access to financial resources, highlighted in particular the lack of flexibility in the labour market, the non-stimulating tax environment and administrative barriers to the operation of companies as the barriers hindering the development of the business sector.

A further important condition for exit from the crisis is the setting up of an institutional framework that will facilitate developmental changes and provide efficient operation of the economy. The existing institutional framework in Slovenia severely hinders the formation of social consensus for urgently required developmental changes (Šušteršič et al., 2010). In consequence, adopted measures often fail to address the key shortcomings of the Slovenian economic environment to a sufficient extent or fail to address them at all. In international comparisons, Slovenia is also ranked low in terms of quality of economic institutions, while the quality of its legal institutions has been impaired considerably in the recent period. International competitiveness indicators point in particular to an ineffective legal system and the functioning of the government and state apparatus. All this is also reflected in low public trust in institutions such as government, parliament, political parties and local authorities. Institutional competitiveness is also severely hindered by the relatively large role of the state in the economy.

1.1 Macroeconomic stability

Following a two-year period of modest growth, economic activity decreased in 2012. A sharp fall in GDP in 2009 was followed by two years of modest economic growth, but in 2012 GDP declined by 2.3% owing to export stagnation, further decrease in investment activities and drop in final consumption. Growth in exports, which was the main factor in the economic recovery in the previous two years, halted last year mainly owing to a slowdown in growth and/or a decline in economic activities in main trading partners. Last year, the stagnation of foreign demand was followed by a decline in the production of manufacturing industries and, in consequence, capacity utilisation. This in turn caused another decline in investments into machinery and equipment, which in 2011 had increased by almost a tenth. Despite a slightly less pronounced decline in construction investment than in the preceding three years, the total drop in investment activities last year was thus similar to that in 2011. Of all GDP components, investments lag behind the pre-crisis level the most, i.e. by almost a half. The drop in final consumption also had a considerable impact on the decrease in GDP last year; this is to be associated with continued degradation of labour market conditions and fiscal consolidation, the latter being necessary owing to restricted foreign financing and the downgrade of the credit rating of the state and commitment in the context of the excessive deficit procedure. Since the consolidation started to be implemented relatively late (later than in the majority of other European countries), it had to be more intensive than it would have been if started earlier. Government expenditure dropped markedly last year. For the first time since the onset of the crisis, household spending also decreased, which, along with the continued adverse conditions in the labour market, was a result of the fiscal consolidation structure causing a decline in the salaries of public servants and social transfers.

Last year, economic activity in the eurozone decreased, with one of the most severe falls, as throughout the crisis, occurring in Slovenia. After growth of 1.4% in 2011, GDP in the eurozone fell by 0.5% last year. Last year, only Latvia and Greece saw a larger drop in GDP (from 2008) than Slovenia. The factors that most hinder the recovery of our economy lie mainly in our domestic environment; exports have also been recovering at a slower pace than in many other EU Member States. The most important among the domestic factors are limited access to financing and high corporate debt, which had a particularly adverse effect on investments: Ireland was...
the only country experiencing a more severe decline in investments during the crisis than Slovenia. Moreover, last year final consumption in Slovenia dropped more than the eurozone average, which is associated with the delayed start of fiscal consolidation and therefore its more severe effects. Last year, exports also lagged behind the 2008 average due to inadequate geographic and output structure, while they considerably exceeded the 2008 average at the level of the eurozone. Over recent years, exports to rapidly growing states have been increasing, but these export market shares remain relatively small. The output structure is also inadequate, since the share of high-tech products is lower than in the majority of countries where the export recovery is faster (see Chapter 1.3).

**Figure 1: Gross domestic product, exports and domestic consumption in Slovenia and the eurozone**

![Graph showing GDP, domestic consumption, and exports in Slovenia and the eurozone](source)

The potential for economic growth in the medium term remains low. Continued deleveraging of banks and enterprises and the need for further fiscal consolidation, alongside limited sources of financing for the state and private sector, will remain the main factors that will continue to hinder faster recovery of the Slovenian economy in the absence of structural changes. Insufficient progress made in the resolution of structural problems decreased competitiveness, which, together with the expected further decline in foreign demand, hinders faster export recovery. In light of these circumstances, estimations of future GDP point to a diminishing potential for growth: in the period preceding the crisis, this amounted to approximately 4%, against 1% on average likely for the next medium-term period.\(^3\)

This shows a need for urgent structural changes and reforms in order to enhance the potential for growth and to prevent the situation deteriorating to an extent which would inhibit the provision of the financial resources required for development. This would help us avoid a longer period of weak economic growth or stagnation, which was characteristic of some countries during the past decade (e.g. Portugal).

**Following a four-year period of modest growth, the rise in consumer prices was greater last year due to one-off factors which resulted from economic policy measures.** Last year, consumer prices went up by 2.7%. As in previous years, the inflation was a result of higher energy and food prices, but the higher total rise than in previous years resulted mainly from the increase in prices for services. Energy products contributed 0.7 pp to the total rise in prices, with liquid fuels again having the major share. The increase in global oil prices was smaller than in 2011, but excise duties rose, so the contribution of liquid fuel products to the total rise was similar to that in 2011. The contribution of all energy products to the total rise would have been even higher if natural gas prices had not fallen at the end of the year. The contribution of food prices (0.7 pp) was similar to the previous year; the rise in food prices resulted mainly from the increase in fresh fruit and vegetable prices. The rise in prices for services was greater last year due to one-off factors which were a result of economic policy measures; their contribution to the total rise was 0.8 pp. Under the continued weak economic activity, the increase in prices for other goods remained stable, which is reflected in a modest growth of different measures of core inflation and shows the absence of inflationary pressures related to economic activity. An international comparison based on the harmonised index of consumer prices has shown that last year, inflation in Slovenia (3.1%), given the similar factors, was higher than the eurozone level (2.2%; see indicator 1.3).

**After the slowdown of growth in the period 2009–2011, the nominal gross wage in 2012 remained at the level achieved, but in real terms it decreased for the first time in the last 20 years.** The nominal growth in average gross wage in the private sector considerably slowed down last year (0.5%), and the average salary in the general government sector decreased owing to more stringent austerity measures. In the period 2009–2011, growing unemployment, relatively low inflation and the aspirations of companies to maintain their competitive positions, in addition to the modest economic activity, influenced the average wage trends in the private sector, whereas the nominal growth was relatively high owing to a changed structure of the

\(^3\) The calculations of potential growth for the period from 2012 onwards are based on the production function method and take into account the Spring Forecast of Economic Trends 2012. Extraction of the cyclical component of total factor productivity requires application of the bivariate Kalman filter.

\(^4\) Abolishment of subsidised school meals (0.4 pp), reduced subsidy for the second child enrolled in kindergarten (0.1 pp) and increased annual road-user charge (0.1 pp) contributed most to this result.
less demanding industries experienced the most dramatic fall at the onset of the crisis and subsequently the weakest recovery. The employment in the majority of market services decreased as well. In contrast, the number of employees in the general government sector increased by 10,000 (6.5%) during the crisis, most notably in 2009 and 2010, while during the last two years, growth slowed down. According to the data on the number of active employees, the number of employees in public administration, defence and statutory social security (activity O) has even decreased during the last two years, while the increase in employees in education, health and social security has just slowed down.

Due to a sharp drop in domestic demand and continued deleveraging of the private sector, the structure of economic activity gradually resulted in a current account surplus. After the high deficit in pre-crisis years, the current account balance in the period 2009–2011 was kept near the point of balance; last year, a surplus amounting to EUR 874 million (i.e. 2.5% of GDP) was recorded. The positive current account balance was contributed to by a higher foreign trade surplus, i.e. a smaller goods deficit and a greater services surplus. The trade deficit was strongly reduced due to the fall in domestic demand, which significantly reduced imports, despite considerable slowdown in exports and further degradation of terms of trade. Adverse conditions in the domestic market were also reflected in the trade of services where the growth of exports also exceeded the growth of imports. A decline in disposable income and increased uncertainty among consumers resulted in reduced spending of the domestic population abroad, which, together with higher revenues from foreign tourists, improved the balance of inflows from tourism. The surplus in transport services trade increased as well, while the deficit in the trade of other services decreased; in particular, the balance of trade in licences, patents and copyrights and the balance in construction services improved. The latter indicates that domestic construction companies which managed to survive in the crisis are increasingly searching for opportunities abroad as a result of adverse domestic conditions. Revenue balances and regular transfers, however, deteriorated last year. In particular the revenue inflow and outflow structure reflects the adverse conditions on financial markets, since a lower deficit in the balance of interests last year was above all the consequence of the private sector’s reduction of debt and changes in the structure of instruments of general government borrowing (the issue of treasury bills on the domestic financial market). Moreover, last year the payout of profits to foreign direct investors increased while simultaneously the inflows from investments by domestic investors into foreign securities decreased. Net disbursement of EU funds improved last year compared with 2011, but despite

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5 This was the result of redundancies mostly involving employees with low wages, which in statistical terms increased the average wage level. According to our estimates, 0.5/0.2 pp of average wage growth in the private sector (of 5.1%/2.6%) in 2010 and 2011 respectively was a result of the aforementioned effect. The greatest effect was recorded in 2009 (0.9 pp of 1.8%), while last year it was the same as in 2011.

6 Particularly in 2010, when the new Minimum Wage Act took effect; according to our estimate, above 3 pp of 5.1% of growth in average gross wage in the private sector. In the following two years, the influence was much lower (below 1 pp).

7 The first austerity measures took effect in the first year following the introduction of the long-planned wage reform, which resulted in a relatively high growth of wages (2008: 10.2%; 2009: 7.0%), i.e. in the period when wages in the private sector started to level off for reasons of the economic crisis.

8 The growth in public non-finance corporations was 1.9% and in finance corporations 1.5%.

9 According to the National Accounts statistics.
this, the current transfers surplus slightly decreased, in particular owing to the increased payment of taxes and contributions abroad.

We estimate that the improved current account balance is a consequence of cyclic and partially also structural factors; in comparison with so-called vulnerable economies, Slovenia is in a relatively better position according to the external balance indicator and the changes therein. It is estimated that the current account balance movement is, on the one hand, a consequence of effects of cyclical factors, because the turning point occurred after the onset of the crisis, when, first due to a relatively low utilisation of production capacities and then due to limited financial resources and the private sector’s reduction of debt, investment activities decreased and gradual closing of the saving-investment gap began. On the other hand, certain structural shifts and/or internal adjustments, for example in the field of labour costs, were produced, which could have a positive impact on the sustainability of the current account balance. The cyclical component indicates that with enhanced economic recovery and improved accessibility to financial resources, the current account deficit could increase again. To maintain a sustainable external balance, the strengthening of structural factors that would have effect through improved cost competitiveness and increased productivity is of key importance. By improving the external balance indicator, Slovenia differs from the majority of vulnerable economies, among which it was ranked by the European Commission. In this group of states, current account deficits were reduced on average during the recession, but they still remained relatively high. Compared with these states, Slovenia has a much lower total external indebtedness (net international investment position), and in consequence lower net outflows from factor income, but at the same time, the domestic saving level is relatively high owing to private sector saving and fiscal consolidation.

Given the more difficult access to international financial markets and further deleveraging of domestic banks abroad, the foreign borrowing last year consisted of state borrowing and cash inflows from the Eurosystem within the long-term bank refinancing operations. The total gross external debt in 2012 was EUR 40.8 billion (EUR 0.6 billion more than in 2011). The structure of debt flows reflects the adverse situation in the domestic banking system and limited accessibility to foreign financial resources, as well as noticeably increased inflows of Central Bank money from the Eurosystem. Government borrowing (EUR 2.4 billion more than the year before) contributed most to an increasing debt; in February, the government paid off a 1 billion euro bond, but in October issued a ten-year dollar-denominated bond worth EUR 1.7 billion and also borrowed on international market by instruments of short-term borrowing. Last year, domestic commercial banks continued to repay foreign loans; their external debt decreased by EUR 3.6 billion (by EUR 8.6 billion in the period from September 2008 to the end of 2012). Given the more difficult access to international financial markets, part of foreign liabilities was repaid by Central Bank money; last year, the Bank of Slovenia increased its liabilities towards the Eurosystem (by EUR 1.7 billion), particularly within the long-term bank refinancing operations. Last year, corporate borrowing abroad slightly increased as a consequence of increased volume of commercial loans raised to finance imports, whereas long-term financial liabilities decreased for the third year in a row. Last year in the total external debt structure, the share of public debt increased for the third year in a row (at the end of 2012, it was 31.3% of GDP), while in terms of maturity the share of long-term debt (approximately 70%) was slightly decreased. At the end of 2012, Slovenia’s gross external debt reached 115.1% of GDP (which is 3.9 pp more than the year before) and has remained considerably below the average eurozone debt, which reached 211.1 % of GDP in 2011.

Last year, a higher gross external debt had an adverse impact on the net international investment position, where Slovenia slightly exceeds the threshold within the system of macroeconomic imbalance indicators monitored by the European Commission. At the end of 2012, the net international investment position The net financial position shows the situation in the total balance of claims and liabilities that the domestic economy has towards foreign countries at the end of each year, using a structure which is equal to the structure of the balance-of-payments financial account. Apart from debt instruments, which are included in the gross external claims and the gross external debt (the difference between the two shows the country’s net external debt), the net financial position also includes claims and liabilities relating to ownership relations.

11 Autumn forecast 2012 (European Commission), 2012. The European Commission evaluation of vulnerable states includes Ireland, Greece, Spain, Italy, Cyprus, Portugal and Slovenia. Apart from Slovenia, Ireland also recorded a current account surplus last year.
demonstrated a net external debt position amounting to 43.2% of GDP (in 2011 it was 41.2% of GDP). Thus in 2012, Slovenia again exceeded the threshold value of this indicator set by the European Commission within the system of macroeconomic imbalance indicators (−35% of GDP; see Box 1). Slovenia’s net international investment position has been deteriorating since 2005, more significantly since the onset of the crisis in 2008, when considerable negative changes in the values of equity portfolio investments were the main factor which contributed to this development, apart from the financing of the current account balance deficit. Given the more difficult access to international financial resources, the deterioration of the net debt position in the following years was the result of the general government’s higher net borrowing and increased net liabilities of the Bank of Slovenia, which provided the funds for bank system liquidity through inflows from the Eurosystem within the long-term bank refinancing operations (see Chapter 1.2.). The composition of the international investment position shows a deterioration of the general government sector position due to a long-term bond issue, although holdings of external financial assets slightly increased last year through loans provided to the euro area countries within financial assistance packages. The Bank of Slovenia’s net financial position deteriorated as well: the Bank of Slovenia reduced the value of financial assets due to the withdrawal of cash and deposits from foreign accounts, while simultaneously considerably increasing its external debt toward the Eurosystem through long-term bank refinancing operations. The private sector net debt decreased again last year due to the deleveraging of commercial banks.

After three years of maintaining the general government deficit at about 6%, the fiscal imbalance, including its structural component, was considerably reduced last year through fiscal consolidation measures. After three years of maintaining the general government deficit at around 6% of GDP, it was reduced to 4% of GDP in 2012. In comparison with 2011, the deficit was lower by 2.4 pp, and in both years, without taking into account a one-off item of government expenditure\(^1\), the deficit was lower by 1.5 pp. The reduction was reached by certain further interventions into the flexible part of budget expenditure, and in particular by bringing into effect the amendments from the Fiscal Balance Act (ZUJF)\(^2\), which refer to the budget and also to other fiscal budgets and off-budget spending units. Fiscal consolidation was based primarily on the reduction of general government expenditure and also included measures to improve the efficiency of collection and quality of general government revenue. Unlike in the preceding years, considerable fiscal efforts were made in 2012, so that the expenditure dropped for the first time also in nominal terms. Thus a positive step was made and, through the measures based on systemic changes, there was also a deviation from the former predominant approach, which consisted of merely temporary interventions in the flexible part of the budget. Reduction of budget expenditure, supported by amended legislation, was based on three modules: (i) rationalisation of the public sector operation, including reduction of wages and other labour costs and limiting employment; (ii) restriction of investments, subsidies and other programmes of spending; and (iii) adjusting labour market and social security policies. A reduction in labour costs, costs of goods and services, and social transfers contributed most to the reduction (see Chapter 3). In addition to fiscal consolidation measures, reductions in corporate income tax burden and investment reliefs were adopted with a view to stimulating economic growth, but their efficiency can only be assessed in the medium term. The adopted measures have resulted in a considerable reduction of cyclically adjusted deficit from

\(^{1}\) In 2011: the recapitalisation of the bank and some other state undertakings and the assumption of debt of certain undertakings (1.3% of GDP). In 2012: losses of state undertakings covered by recapitalisation, due government guarantees paid, recognition of claims of state undertakings and super dividends (0.4% of GDP).

\(^{2}\) The Act Amending the Fiscal Balance Act, which modifies more than 39 sector-specific acts, was adopted in the National Assembly on 12 May 2012.
Since the onset of the crisis, macroeconomic imbalance indicators have pointed to two problematic areas in Slovenia, namely the competitiveness of the economy and the international investment position; furthermore, an in-depth analysis of the EC has highlighted the bank problems in connection with high business sector borrowing. The net international investment position has been over the threshold since 2008 and reflects high exposure of domestic banks to foreign financing and general government sector debt, which has increased substantially since the beginning of the crisis. After 2007, Slovenia’s net international investment position was also greatly adversely affected by losses incurred in property values by Slovenian investors abroad (see more in Chapter 1.3.). An upward trend in unit labour costs and a downward trend in market share on the global market recorded since the onset of the crisis indicate a deterioration of competitiveness. The weakening of cost competitiveness ended in 2011, when the reading of a scoreboard indicator for assessing imbalances (referring to a three-year cost increase) dropped slightly below the threshold for the first time since 2008. Given the significantly less favourable ratio between labour costs (share of wages) and GDP compared with the EU average – which was recorded even before the crisis – and its substantial deterioration in the period between 2008 and 2010, improvement in cost competitiveness remains Slovenia’s great challenge (see more in Chapter 1.3.).

Along with an intense cost pressure and unfavourable export geographic and product structure seen at the onset of the crisis, a gradual decrease in Slovenia’s export competitiveness was also recorded in the period 2008–2010 (see more in Chapter 1.3.).

The weakening of export competitiveness ended in 2011, when the EC has highlighted the bank problems in connection with high business sector borrowing.

### Assessment of Slovenia within the framework of the European Commission’s excessive imbalance assessment procedure

With a view to revealing imbalances at an early stage, in 2012 the European Commission launched its excessive imbalance assessment procedure, which takes into account the results of a set of ten macroeconomic imbalance indicators. It includes external imbalance indicators (current account balance, net international investment position, export market shares, nominal unit labour cost and real effective exchange rate) and internal imbalance indicators (house prices, private sector debt, private sector borrowing, general government sector debt and the unemployment rate). An indicative threshold has been set for each indicator; if this is exceeded, it shows that the country concerned faces a potentially problematic imbalance in a particular area. The indicator reading provides an early warning which is followed by an in-depth analysis to determine whether the imbalance identified is truly problematic. In cases of minor imbalances, the Commission issues preventive recommendations to the Member States, while in serious cases the country concerned has to prepare a corrective action plan. In the event that a country fails to respond adequately, it may ultimately be imposed financial sanctions of up to 0.1% of GDP.

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Along with an intense cost pressure and unfavourable export geographic and product structure seen at the onset of the crisis, a gradual decrease in Slovenia’s export competitiveness was also recorded in the period 2008–2010 (see more in Chapter 1.3.). In 2011, the indicator measuring a five-year percentage change of export market share slightly exceeded the threshold value specified within the excessive imbalance assessment procedure. Given a relatively low household debt, private sector borrowing does not exceed the threshold values; however, a particular problem lies in the corporate sector deleveraging and related pressure on household debt, private sector borrowing, general government sector debt and the unemployment rate. An indicative threshold has been set for each indicator; if this is exceeded, it shows that the country concerned faces a potentially problematic imbalance in a particular area. The indicator reading provides an early warning which is followed by an in-depth analysis to determine whether the imbalance identified is truly problematic. In cases of minor imbalances, the Commission issues preventive recommendations to the Member States, while in serious cases the country concerned has to prepare a corrective action plan. In the event that a country fails to respond adequately, it may ultimately be imposed financial sanctions of up to 0.1% of GDP.

### Results of macroeconomic imbalance indicators for Slovenia

<table>
<thead>
<tr>
<th>Indicator/Threshold</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
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<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
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<tr>
<td><strong>External imbalances</strong></td>
<td></td>
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<tr>
<td>Current account, % of GDP (3-year average)</td>
<td>+6/-4%</td>
<td>-1.9</td>
<td>-0.5</td>
<td>0.1</td>
<td>-0.8</td>
<td>-1.7</td>
<td>-2.3</td>
<td>-3.0</td>
<td>-4.5</td>
<td>-3.9</td>
<td>-2.5</td>
</tr>
<tr>
<td>Net international investment position, % of GDP</td>
<td>-35%</td>
<td>-2</td>
<td>0</td>
<td>-6</td>
<td>-8</td>
<td>-11</td>
<td>-17</td>
<td>-22</td>
<td>-36</td>
<td>-40</td>
<td>-43</td>
</tr>
<tr>
<td>Real effective exchange rate (HICP deflator), 3 years % change</td>
<td>+/-11%</td>
<td>-2.5</td>
<td>0.2</td>
<td>5.3</td>
<td>4.6</td>
<td>1.7</td>
<td>-0.7</td>
<td>1.0</td>
<td>4.2</td>
<td>5.7</td>
<td>2.4</td>
</tr>
<tr>
<td>Share of world export (goods and services), 5 years % change</td>
<td>-6%</td>
<td>-6.2</td>
<td>5.4</td>
<td>3.4</td>
<td>16.4</td>
<td>27.0</td>
<td>17.6</td>
<td>18.7</td>
<td>11.1</td>
<td>6.0</td>
<td>-4.5</td>
</tr>
<tr>
<td>Nominal unit labour cost index, 3 years % change</td>
<td>+9%</td>
<td>22.2</td>
<td>24.0</td>
<td>20.6</td>
<td>14.6</td>
<td>9.7</td>
<td>6.2</td>
<td>5.2</td>
<td>10.3</td>
<td>18.4</td>
<td>15.9</td>
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<tr>
<td><strong>Internal imbalances</strong></td>
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<tr>
<td>House prices index, year-on-year % change</td>
<td>+6%</td>
<td>9.6</td>
<td>13.1</td>
<td>14.2</td>
<td>17.4</td>
<td>1.5</td>
<td>-10.4</td>
<td>-1.3</td>
<td>1.0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private credit flow in % of GDP</td>
<td>15%</td>
<td>8.6</td>
<td>8.7</td>
<td>9.6</td>
<td>13.6</td>
<td>13.9</td>
<td>23.5</td>
<td>18.3</td>
<td>4.1</td>
<td>1.8</td>
<td>1.9</td>
</tr>
<tr>
<td>Private debt, % of GDP</td>
<td>160%</td>
<td>64</td>
<td>67</td>
<td>71</td>
<td>75</td>
<td>85</td>
<td>91</td>
<td>106</td>
<td>117</td>
<td>127</td>
<td>128</td>
</tr>
<tr>
<td>General government gross debt, % of GDP</td>
<td>60%</td>
<td>27</td>
<td>28</td>
<td>27</td>
<td>27</td>
<td>26</td>
<td>23</td>
<td>22</td>
<td>35</td>
<td>39</td>
<td>47</td>
</tr>
<tr>
<td>Unemployment rate, 3-year average</td>
<td>10%</td>
<td>6.8</td>
<td>6.4</td>
<td>6.4</td>
<td>6.5</td>
<td>6.5</td>
<td>6.3</td>
<td>5.8</td>
<td>5.1</td>
<td>5.0</td>
<td>5.9</td>
</tr>
<tr>
<td>Total financial sector liabilities, unconsolidated, year-on-year % change</td>
<td>16.5%</td>
<td>24.3</td>
<td>12.6</td>
<td>11.5</td>
<td>17.7</td>
<td>13.8</td>
<td>28.5</td>
<td>6.6</td>
<td>7.4</td>
<td>-3.4</td>
<td>-1.3</td>
</tr>
</tbody>
</table>

**Source:** Eurostat portal page – Macroeconomic imbalance procedure statistics, 2013.

**Note:** Indicators found to exceed the threshold value by the EU excessive imbalance procedure are marked grey.
Fiscal balance, in % of GDP

The increase in the general government debt in 2012 was also a result of the higher debt percentage in GDP, which amounted to 54.1% of GDP, which was 7.2 pp more than the year before. In addition to a nominal increase in debt, the further growth of debt was accompanied by increased costs of its financing last year, which, in addition to domestic factors, was contributed to by the general deterioration of conditions in the Eurobond market in the middle of the year. Since March 2012, the expected yield on Slovenian government bonds has been relatively high and similar to that of the group of vulnerable economies in the euro area; their dynamics, in addition to the specific domestic factors, were influenced by the common factors in the euro area. In the middle of the year, the expected yield on Slovenian ten-year government bonds was strongly influenced by the adverse conditions in domestic banks, frequent hints that a request for foreign financial assistance may be necessary, and, towards the end of the year, factors associated with political instability. In August, all major agencies downgraded Slovenia’s credit rating and maintained the negative outlook for future ratings. General conditions on the international financial market also had a strong impact on the movement of the expected yield. Until autumn, these conditions continued to deteriorate and confidence in the majority of the euro area countries was falling. The aggravated conditions in Spain and the likelihood of its applying for financial bailout in June boosted the growth of the expected yield in other high-risk eurozone countries, including Slovenia. In September, the ECB measures and EU action regarding further economic and monetary union integration and uniform banking supervision improved the mood on the European financial markets, which contributed to lowering the expected yield on the Slovenian government bonds to around 5% at the end of the year.

The further growth of debt was accompanied by increased costs of its financing last year, which, in addition to domestic factors, was contributed to by the general deterioration of conditions in the Eurobond market in the middle of the year. Since March 2012, the expected yield on Slovenian government bonds has been relatively high and similar to that of the group of vulnerable economies in the euro area; their dynamics, in addition to the specific domestic factors, were influenced by the common factors in the euro area. In the middle of the year, the expected yield on Slovenian ten-year government bonds was strongly influenced by the adverse conditions in domestic banks, frequent hints that a request for foreign financial assistance may be necessary, and, towards the end of the year, factors associated with political instability. In August, all major agencies downgraded Slovenia’s credit rating and maintained the negative outlook for future ratings. General conditions on the international financial market also had a strong impact on the movement of the expected yield. Until autumn, these conditions continued to deteriorate and confidence in the majority of the euro area countries was falling. The aggravated conditions in Spain and the likelihood of its applying for financial bailout in June boosted the growth of the expected yield in other high-risk eurozone countries, including Slovenia. In September, the ECB measures and EU action regarding further economic and monetary union integration and uniform banking supervision improved the mood on the European financial markets, which contributed to lowering the expected yield on the Slovenian government bonds to around 5% at the end of the year.

The economic crisis has revealed the weaknesses of the Slovenian financial system, which has shrunk in recent years, and the development lag behind the EU average in most areas has been increasing. The increase in development gap is most evident in market capitalisation as an indicator in relation to GDP, as it only amounted to just over one-fifth of the EU average in 2012. Poor liquidity, poor transparency and a shrinking offer of the Slovenian capital market discourage potential investors. In the past, this strongly affected
the financial structure of the Slovenian economy, which mostly depends on debt financing, i.e. the financing that was reduced most during the crisis. Thus in 2012, the index value of total bank assets (in relation to GDP) was 16.4 pp lower than the highest level (in 2009). The least affected among all segments of financial intermediation were insurance activities, where the total insurance premiums have not shrunk significantly. It is estimated that this is the consequence of two factors: the maturity of insurance contracts, which are normally long term, and the structure of insurance premiums, because the major part of all insurance premiums still consists of non-life insurance premiums, which are thought to be less sensitive to changes in the incomes of insured persons.

An above-average share of banks in the financial system, characteristic of the financial structure of the Slovenian economy, is one of the major obstacles to the recovery of the economy, given the current problems of the banking system. Banks in Slovenia comprise more than three-quarters of financial assets of all financial intermediaries, whereas this percentage in the EU as a whole is more than 20 pp lower. Loans are thus an important source of financing for Slovenia’s economy and have shorter maturities than other financing sources, such as capital and debt securities. During the economic take-off in the period 2004–2008, loans were the main source of financing for Slovenia’s economy. During the loan expansion in the period before the crisis, the banks financed the major part of their investments through foreign borrowing and were much less focused on deposit sources of financing. In the pre-crisis period, Slovenia thus recorded one of the major increases in the ratio between loans and deposits in non-banking sectors. During the crisis, such a method of financing strongly reinforced liquidity pressures on the banking system, which, owing to the liabilities to foreign banks becoming due and very limited possibilities for their refinancing, was forced to considerably reduce its investment volume. The European Commission’s analysis within the excessive imbalance assessment procedure in the EU Member States showed that an important imbalance in Slovenia’s financial sector emerged in the period before the financial crisis, when the increase in the financial sector’s financial liabilities, in particular owing to bank borrowing over the years, exceeded the threshold value determined in the alert mechanism for the early detection of imbalances (see Box 1). The growth of financial liabilities at first slowed down upon the onset of the crisis, and the financial sector made a net repayment of liabilities in 2010 and 2011\textsuperscript{16}. An important part of this is associated with the deleveraging of the Slovenian banking system abroad. The banks largely compensated the loss of foreign sources of financing by increased ECB financing, which reached EUR 4 billion at the end of 2012, which is approximately 2.2 times more than at the end of 2008. At the beginning of the crisis, an important share of financing resources was also provided by the state, but this was brought to an end after 2011 due to adverse fiscal conditions and unfavourable trends on financial markets.

The problems in Slovenia’s banking system deepened in 2012. Banks continued to make net repayments of deposits and loans of foreign banks; moreover, bonds issued with state guarantees also matured in the same year. At the same time, banks strengthened additional provisions and impairments due to the increasing share of bad loans. Banks still did not have access to fresh sources of financing on international financial markets. This was a consequence of adverse conditions both in the Slovenian banking system and on international financial markets. In 2012, banks made net repayments of EUR 3.3 billion of liabilities to foreign banks (the total amount since the onset of the crisis was EUR 9.1 billion\textsuperscript{19}), which is about 30% more than in 2011. This prompted a further decline in investments by the banking system, which was most painfully felt by Slovenian enterprises. At the end of 2011 and the beginning of 2012, liquidity pressures were relieved by the ECB’s non-standard measures granting Slovenia’s banks long-term funds with a maturity of three years. It is estimated that this slightly slowed down the decrease in loans granted to the Slovenian economy. However, on the basis of data provided by the Bank of Slovenia, it is estimated that liquidity pressures on Slovenia’s banks will be reinforced upon the expiry of these measures, i.e. at the end of 2014. This points to the risk of further shrinking in the lending activities of Slovenia’s banks if the accessibility of fresh sources of financing is not improved.

Figure 4: Net flows of foreign sources of financing in Slovenia’s banking system

\textsuperscript{16} Reduced financial liabilities were for the most part a consequence of shrinking liabilities towards financing sources of other monetary and financial institutions (banks) and financial intermediaries with the exception of insurance companies and pension funds.

\textsuperscript{19} This comparison refers to September 2008, when the adverse conditions in the financial sector began to escalate considerably.
**Box 2: Private sector indebtedness**

The high private sector debt results from a significant increase in borrowing recorded in the period before the economic crisis. The growth in private sector credit (measured as the ratio between net credit flow and GDP) accelerated substantially in the years leading up to the crisis. In 2007 and 2008, Slovenia significantly exceeded the threshold reading on borrowing (15% GDP) in the macroeconomic imbalance scoreboard of indicators monitored by the European Commission. The onset of the crisis brought a considerable slowdown in borrowing; in 2011, for the second year in a row, borrowing was below 2% of GDP. A discontinued growth in private sector borrowing (measured as the ratio between debt and GDP) was also recorded; in 2011, it stood at the unchanged level of just over 128% of GDP and remained below the threshold value (160% GDP) set within the EU excessive imbalance assessment procedure. Household debt level (30.5% of GDP) recorded a slight further decrease, while corporate debt continued to grow and was only slightly below the EU average.

There is high indebtedness recorded in the corporate sector. A deteriorating debt-to-equity ratio indicates a problem of increasing indebtedness; in recent years, this ratio has been affected by diminished equity volume of Slovenian companies resulting from negative trends on the capital markets and also from their poor business results. Given the fact that the growth in borrowing in the period 2005–2008 originated mostly from debt financing of companies through banks, it has to be pointed out that liabilities to banks are concentrated in a relatively small number of companies. AJPES data for 2011 show that 1.6% of all companies accounted for 80% of total liabilities to banks. We estimate that larger companies had easier access to bank financing compared with smaller companies, which might be attributed to the latter’s lesser influence and weaker negotiating powers and also to the limited availability of information about their performance used by the creditors when deciding on financing. Operating liabilities were an important debt financing source for companies from the first quintile; they exceeded, almost twofold, liabilities to banks, other financial liabilities and, to a lesser extent, financial liabilities to other companies in the group. We believe that this can be attributed to the fact that the limited bank financing made the companies use other debt sources (e.g. commercial loans). Most companies are thus highly exposed to their business partners.

Last year, the quality of bank assets deteriorated drastically for the fourth year in a row. This process was still burdened by deterioration in the quality of claims in activities associated with the construction sector and takeover activities; at the same time, in 2012 there was a considerable deterioration of the claims in other activities, which is estimated to be the consequence of a general deterioration of conditions in the economy. Bad claims increased by over 20% and totalled EUR 6.7 billion at the end of the year, or 14% of total bank exposure. The volume of C-rated claims has slightly decreased, which may point to a gradual slowing down in the deterioration of the quality of bank assets, and may also be the result of a slightly increased volume of transfers among non-performing claims. These totalled EUR 1.2 billion last year and were almost 10% higher than in 2011. At the same time, a considerable decline in A-rated claims was recorded in 2012: at EUR 5.1 billion, double the amount recorded the year before. It is estimated that this is partly due to downgrading the credit ratings of individual borrowers, which turns their debts into lower rated loans, and partly also to the net repayment of loans by the high-quality borrowers, which results in a further deterioration in the quality of bank assets. Such trends may be extremely harmful for Slovenia’s banking system in the long term, because the share of clients with poor credit ratings would increase considerably, while the first-rate clients would turn to other sources of financing (foreign and commercial loans). As a result of the rapid

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1 AJPES analysis of the annual accounts of 57,177 companies registered in Slovenia in 2011; companies' financial liabilities to banks were divided into quintiles of approximately equal size. Financial sector companies (primarily leasing companies) and DARS were excluded.

2 The largest number of companies is found in the first quintile.

3 This financing method was also typical of the mainly foreign-owned companies, as they made use of the more favourable financing terms in the market available to their parent companies/owners.

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In particular manufacturing industries.

C-, D- and E-rated loans.

D- and E-rated loans.

In 2009 and 2010, A-rated debts were still increasing.

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Source: BS; calculations by IMAD.
Development by the priorities of SDS – Economic growth and the competitiveness of the economy

Development Report 2013

Box 2: Private sector indebtedness - continue

The strong indebtedness of the Slovenian corporate sector is also indicated by an unfavourable ratio of debt to free cash flow (EBITDA). Arranged by the debt-to-EBITDA ratio, only 28% of companies have a ratio lower than 5 (and higher than 0), which is a value that is regarded as sustainable for this ratio. In 36% of companies the debt-to-EBITDA ratio is higher than 5, while in all other companies, which account for only 3% of the total corporate value added, the value of the free cash flow is negative (31%) or equal to zero (4%).

Table 1: Corporate indebtedness by quintiles with regard to financial liabilities to banks, Slovenia, 2011

<table>
<thead>
<tr>
<th>Quintile</th>
<th>Financial liabilities to banks</th>
<th>Financial liabilities to companies in the group</th>
<th>Other financial liabilities</th>
<th>Operating liabilities</th>
<th>Value added</th>
<th>Average number of employees per company</th>
<th>Number of companies</th>
<th>Share of liabilities to banks in total liabilities (in %)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>v mio EUR</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>4,038</td>
<td>2,840</td>
<td>4,098</td>
<td>11,416</td>
<td>10,316</td>
<td>5</td>
<td>56,257</td>
<td>9.7</td>
</tr>
<tr>
<td>2</td>
<td>4,038</td>
<td>342</td>
<td>611</td>
<td>2,135</td>
<td>1,833</td>
<td>71</td>
<td>679</td>
<td>36.5</td>
</tr>
<tr>
<td>3</td>
<td>4,034</td>
<td>185</td>
<td>271</td>
<td>1,546</td>
<td>1,822</td>
<td>214</td>
<td>176</td>
<td>36.4</td>
</tr>
<tr>
<td>4</td>
<td>3,955</td>
<td>287</td>
<td>523</td>
<td>1,728</td>
<td>1,879</td>
<td>684</td>
<td>49</td>
<td>31.0</td>
</tr>
<tr>
<td>5</td>
<td>4,134</td>
<td>262</td>
<td>848</td>
<td>1,421</td>
<td>1,342</td>
<td>1,562</td>
<td>16</td>
<td>39.2</td>
</tr>
<tr>
<td>Total</td>
<td>20,200</td>
<td>3,917</td>
<td>6,351</td>
<td>18,245</td>
<td>17,192</td>
<td>8</td>
<td>57,177</td>
<td>23.2</td>
</tr>
</tbody>
</table>

Source: AJPES, calculations by IMAD.

Table 2: Corporate indebtedness in terms of debt-to-EBITDA ratio, group limits in indicator values of 0 and 5, Slovenia, 2011

<table>
<thead>
<tr>
<th>Groups by debt-to-EBITDA ratio</th>
<th>Financial liabilities to banks</th>
<th>Financial liabilities to companies in the group</th>
<th>Other financial liabilities</th>
<th>Operating liabilities</th>
<th>Value added</th>
<th>Average number of employees per company</th>
<th>Number of companies</th>
<th>Share of liabilities to banks in total liabilities (%)</th>
<th>Debt-to-EBITDA (group average)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>v mio EUR</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 (below 0)</td>
<td>3,207</td>
<td>1,095</td>
<td>1,446</td>
<td>2,689</td>
<td>493</td>
<td>2.5</td>
<td>17,728</td>
<td>28.0</td>
<td>-19.0</td>
</tr>
<tr>
<td>2 (0–5)</td>
<td>1,997</td>
<td>419</td>
<td>872</td>
<td>4,038</td>
<td>7,455</td>
<td>9.0</td>
<td>16,195</td>
<td>8.2</td>
<td>2.3</td>
</tr>
<tr>
<td>3 (over 5)</td>
<td>14,906</td>
<td>2,397</td>
<td>3,979</td>
<td>11,442</td>
<td>8,431</td>
<td>11.8</td>
<td>20,808</td>
<td>29.2</td>
<td>12.1</td>
</tr>
<tr>
<td>EBITDA=0</td>
<td>89</td>
<td>7</td>
<td>54</td>
<td>76</td>
<td>0</td>
<td>0.0</td>
<td>2,446</td>
<td>37.0</td>
<td>0.0</td>
</tr>
<tr>
<td>Total</td>
<td>20,200</td>
<td>3,917</td>
<td>6,351</td>
<td>18,245</td>
<td>16,379</td>
<td>7.6</td>
<td>57,177</td>
<td>23.2</td>
<td>8.6</td>
</tr>
</tbody>
</table>

Source: AJPES, calculations by IMAD.

The strong indebtedness of the Slovenian corporate sector is also indicated by an unfavourable ratio of debt to free cash flow (EBITDA). Arranged by the debt-to-EBITDA ratio, only 28% of companies have a ratio lower than 5 (and higher than 0), which is a value that is regarded as sustainable for this ratio. In 36% of companies the debt-to-EBITDA ratio is higher than 5, while in all other companies, which account for only 3% of the total corporate value added, the value of the free cash flow is negative (31%) or equal to zero (4%).

Low lending activity of banks remains one of the most important reasons for low economic activity. In 2012, the volume of loans to domestic non-banking sectors was reduced by EUR 1.3 billion, which is a reduction of 60% more than in 2011. The banks, due to strong liquidity pressures, further deterioration in the quality of bank assets and modest capital adequacy, severely limited the assuming of additional risks; at the same time, poor economic conditions kept demand for loans at a low level. The banks thus strengthened only their exposure to the state, while lending to households and enterprises decreased. The volume of loans to households was reduced by around EUR 185 million. Compared with past years, borrowing in the form of housing loans stabilised considerably also due to uncertain conditions in the real property market, while the repayment of consumer loans more than doubled. Along with poor conditions in banking, modest borrowing by households is also attributed to adverse conditions in the labour market and the resulting diminishing creditworthiness of households and highly uncertain conditions in the real property market. In 2012, the volume of loans granted to enterprises and NFIs dropped sharply and totalled EUR 1.6 billion. The sources of financing available to the Slovenian economy were limited in 2012 to such an extent that the enterprises and NFIs also repaid loans raised abroad amounting to EUR 28.4 million. The repayments made were on short-term loans, while the long-term net borrowing (EUR 50 million) even slightly increased in comparison with 2011.

In addition to their direct impact on economic activity due to the credit crunch, poor conditions in the banking system also exacerbate economic conditions through pressures on public finances; therefore the rehabilitation of the banking system is urgent. Poor conditions in Slovenia’s banking system were first reflected in the need for fresh capital, mainly in the banks in which the state is an important owner. Recapitalisations of banks by the state caused further deterioration of public finance, constituting, together with poor conditions in the financial system, the key reason for the credit rating downgrades of both banks.

deterioration in the quality of bank assets, the banks continue heavily to create additional provisions and impairments, which amounted to EUR 1.5 billion in 2012, which is by 30% more than in 2011.
and the state. This made the borrowing on international financial markets more expensive and severely limited the accessibility to such sources of financing. Thus the corporate sector’s accessibility to loans has become increasingly restricted even for those entities that are not deeply in debt and that see business opportunities in the crisis. This has further impeded economic activity, thus further increasing the pressure on public finances.

Because weak lending to clients with the best ratings is reflected in the increasingly poor business results of Slovenia’s banking system, the banks’ need for fresh capital is again increasing. This, combined with the lack of interest in Slovenia’s banks among foreign investors, could again increase the pressures on the public finances. There is a considerable risk, then, that the flow of risks between the banking system and the public finances could escalate further, so the situation in the banking system should be remedied as soon as possible in order to render it capable again of performing its function of funding the economy, in particular those enterprises that are not deeply in debt and that also have business opportunities in the crisis. With this purpose, at the end of 2012 the government adopted the Act Defining the Measures of the Republic of Slovenia to Strengthen Bank Stability24, which, in order to provide the stability of Slovenia’s financial system, determined the following measures: (i) purchase or acquisition against payment of bank assets; (ii) Government guaranties for strengthening the stability of banks; and (iii) increasing the banks’ share capital. At the same time, the Slovenian Sovereign Holding Act25 was adopted. Its main purpose is to improve the managing of state capital investments, since poor management of state-owned banks is one of the main reasons for the bad situation in Slovenia’s banking system.

1.3 Competitiveness of the corporate sector

Export competitiveness has deteriorated considerably during the crisis. During the period between 2008 and 2011, Slovenia lost approximately 15.9% of its world merchandise market share and 6.7% with its most important trade partners. The sharpest drops were recorded in 2008 and 201026, while in 2011 its share remained approximately the same as in the previous year. The falling trend in Slovenia’s market share came to a halt in 2011, this resulting from an increase in the EU market share, which was no longer much (just 1.5%) behind the pre-crisis (2007) level. The falling of the non-EU market share, which was the most dramatic during the crisis, also slowed down. The product structure in 2011 showed a growing trend in the market share of high-tech and low-tech products, whereas the falling trend in medium-tech products and labour-intensive products continued. The market share of high-tech products thus closely approached the pre-crisis level. The market shares of low-tech products and labour-intensive products lagged behind the pre-crisis level the most (by about a quarter), whereas the shares of medium-tech products and resource-intensive products were lower by around 15%. The contraction of world market shares during the crisis was characteristic for the whole of the EU; however, Slovenia was ranked eighth in the group of countries with a relatively sharp drop during the 2008–2011 period. This points to a relatively strong decline in our export competitiveness, which is worrying particularly in light of the first data for 2012, which indicate that the disruption in the falling market share trends in 2011 was only temporary.27

![Figure 6: Change in market share in the period before the crisis and during the crisis in the EU Member States](image-url)

Source: United Nations Commodity Trade Statistics Database, 2012; calculations by IMAD.

Note: The market share is calculated as the share of exports of a particular EU Member State in world merchandise exports.

In addition to reduced export performance, the decline in export competitiveness during the crisis was also due to the product and regional composition of our exports.

The regional and product composition of Slovenian exports, which is the result of the past export strategies and competitive advantages and also the geographic location of Slovenia, contributed approximately two-fifths to the decline in the world market share in the period 2008–2011, while the rest of the reduction was the consequence of poorer performance of our exports on foreign markets (e.g. due to non-competitive prices, inferior quality and lack of adaptability to the local taste). The negative impact of the regional and product export composition explains the above-average high share of goods (approx. 85%) which Slovenia exports to the EU market and the markets of the former Yugoslavia, where the growth in import demand was modest during

24 ZUKSB, Official Gazette of the RS, No. 105/2012.
25 ZSDH, Official Gazette of the RS, No. 105/2012.
26 A relatively low drop in export share in 2009 was mostly due to the temporary high increase in the export of road vehicles associated with the incentives for their purchase in certain EU Member States at the beginning of the crisis.
27 See indicator 1.12.
the crisis. Slovenia, however, was less present on the markets with a relatively high growth in import demand in that period (in particular the Asian and Latin American markets). At the same time, the import demand for food, raw materials and energy products, whose share in our exports is relatively low, increased most considerably during the crisis. The growth in import demand for manufacturing products, in particular products classified chiefly by material, machinery and transport equipment (vehicles), and partly also miscellaneous manufactured articles (furniture) with relatively high shares in the structure of our exports, was also lower. The falling export competitiveness since the beginning of the crisis can be largely attributed to insufficient past restructuring of the Slovenian economy towards high-tech products and rapidly growing markets. In addition, the European Commission (A Closer Look..., 2012) concludes that a relatively high decline or fluctuation in the market shares of small EU countries during the crisis is also a consequence of their small economies, which usually depend on a small number of products (smaller opportunities for the exploitation of the economies of scale) and export markets, which reduces the diversification of their exports.

Among price factors, increasing unit labour costs in particular affected the economic competitiveness. At the onset of the crisis in 2009, Slovenia was faced with a considerable drop in productivity, but at the same time it still recorded a relatively high growth of labour costs per employee in 2008 and 2010. In 2008, this was a result of the partial payout of wage disparities in the public sector and adjustment of wages to the inflation and productivity increase in the past, and in 2010 to the statutory increase of the minimum wage28. The combination of a drop in productivity and growing labour costs strongly accelerated the increase in unit labour costs during the first years of the economic crisis, so the deterioration in cost competitiveness (measured by real effective exchange rate and real unit labour costs) was among the worst in the EU.

The decline in cost competitiveness in the crisis period is still considerably larger than in the EU overall. The gap with the EU, where labour costs reacted more swiftly to economic changes than in Slovenia, has slightly decreased in 2011 and 2012, through a slowdown in the growth of wages, but still remains wide. In 2012, real unit labour costs in Slovenia were around 7% higher than in 2007 (in the EU around 3% higher). The real effective exchange rate29 lagged behind the pre-crisis level less due to a simultaneous drop of the euro (higher by 2.3% – data for the first three quarters of 2012), but in the majority of the EU Member States it was already lower than before the crisis. Less negative trends were recorded in terms of price competitiveness. In 2012, the real effective exchange rate deflated by consumer prices was, after a three-year depreciation, slightly below the level from the pre-crisis year 2007. However, most other EU Member States experienced an even larger fall in the

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**Figure 7:** Shift-share decomposition analysis of Slovenia’s global merchandise market share

- Geographical market gains
- Product market share gains
- Initial geographical specialisation
- Initial product specialisation

Source: United Nations, UNCTAD, 2012; calculations by IMAD.

Note: The product and geographical composition in the base year (initial product and geographical specialisation) indicate whether a country is specialised in fast-growing product markets and whether trade partners are fast-growing geographical destinations. The remaining two components, market share gains in geographic destinations or in product markets, show whether market shares increased within geographical markets and product markets. The latter two components represent the export competitiveness in the period analysed. Shift-share decomposition is made separately for the geographical and product component. Therefore the change in the market share as shown in the figure is equal to the sum of all four components divided by two (A Closer Look... V. Quarterly Report on Euro Area, 2012).

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**Figure 8:** Real unit labour costs in Slovenia and the EU

Source: Eurostat Portal Page – Economy and Finance, 2012; calculations by IMAD.

Note: Real growth in labour productivity and compensation of employees per employee (GDP deflator).

28 In March 2010, the minimum wage was increased by 22.9% by the Minimum Wage Act, but due to a possible further gradual increase (by the end of 2011), its actual increase was less (in March 2010, it increased by 15.7% compared with the previous month).

29 Deflated by relative unit labour costs.
The deterioration in cost competitiveness in the period 2008–2011 was slightly less pronounced in the tradable sector, which also differs less from the EU average in terms of unit labour costs than is the case for the entire economy. The adjustment of unit labour costs in manufacturing, as the most export-oriented part of our economy, was faster in the years following the 2009 strong increase than in the economy, so in 2012 the pre-crisis level was exceeded slightly less in manufacturing than in the entire economy. A similar trend was recorded in traditional market services (trade, transport and catering services), which are more exposed to foreign competition than other services. In both sectors, the ratio of labour costs to value added per employee (wage share) in the pre-crisis period was approximately equal to the EU average, but with the onset of the crisis, it deteriorated slightly more than in the EU. On the other hand, unit labour costs in the entire economy were higher than in the EU even prior to 2008, and during the crisis this gap has widened even more than in the tradable sector. Relatively high unit labour costs in Slovenia’s economy in comparison with the EU are the result of several factors, in particular (i) higher labour taxation on account of high social security contributions; (ii) differences in the structure of the economy; and (iii) relatively high unit labour costs in certain industries, in particular agriculture, followed by the mining industry, energy industry and water supply and professional, scientific and technical services. Due to an extreme drop during the crisis, the construction sector also has a very unfavourable ratio of labour costs to value added compared with the EU; however, the unit labour costs before the crisis were much lower than in the EU. The tradable sector records minor deviations from the EU average, which is stimulating in terms of export competitiveness, but the increase in cost-effectiveness in the non-tradable sector is also important. Its lack of effectiveness can gradually spill over into export-oriented activities through higher prices (for example services) and thus reduce their profitability and competitiveness.

Figure 9: Ratio of labour costs to value added per employee (wage share) in manufacturing (left) and Slovenian economy (right)

30 The improvement in price competitiveness in Slovenia was slightly inferior also due to an increase in relative prices, which was mostly the influence of a one-off factor, i.e. the rise in the prices of school meals owing to elimination of the government subsidy for school meals.

31 In 2012, labour costs per unit of value added in the entire economy were by 8.5% higher than in 2007, in manufacturing by 7.2% and in traditional market services (GHI) by 6%.

32 In 2011, a unit of value added was generated by 0.747 units of labour costs, whereas the EU average was 0.653. In 2007, the ratio between labour costs per employee and value added per employee was 6.5% higher than the EU average, but in 2011 it was already 12.6% higher (in manufacturing 5.7% and in traditional market services 3.7% higher).

33 See Chapter 3.1: Quality of public finances.

34 In particular due to a relatively small share of financial intermediation and real property activities, where the ratios of labour costs to value added are relatively low, and a higher share of industry, where the ratios are higher on account of a relatively high share of labour-intensive industries.

35 With a large number of small farms and considerably larger share of self-employed persons, which results in relatively high unit labour costs. By excluding the agricultural sector, the differences in the ratios achieved between Slovenia and the EU average are reduced by slightly less than a third.

36 See Chapter 1.3: Services.
The share of more technology intensive industries and products has remained higher than before the onset of the crisis despite recent reductions. A strong drop in less technology intensive and less competitive manufacturing industries during the crisis was accompanied by a considerable increase in the share of industries of higher technology intensity between 2008 and 2010, even exceeding the EU average. In 2011, it slightly decreased but still exceeded the 2007 level by around 3 pp. Similar changes were recorded in the structure of goods exports, where the share of high-tech products increased rapidly in 2008 and 2009, only to drop again slightly in the following two years, though still remaining considerably higher than before the crisis. In contrast to the structure of manufacturing industries, the technological structure of goods exports is still considerably lagging behind the EU average\(^{37}\), reducing the competitiveness of our exports. In 2011, the share of high-tech products was another 6 pp lower than the EU average and the share of low-tech and labour-intensive products was 4.5 pp higher than the EU average.

The lag of productivity in manufacturing behind the EU average has not decreased since the beginning of the crisis. Besides structure, productivity is of key importance for competitiveness (value added per employee), which has been fluctuating at around 60% of the European average in the manufacturing industry since the onset of the crisis. Such a gap in productivity is surprising considering the relatively high share of more technology intensive industries in the value added of the manufacturing industries and shows that the products of more technology intensive industries are not necessarily ranked among the products with a high value added (per employee). This points to a considerable lag behind the EU in the share of high-tech products exported, and also to the fact that the majority of more technology intensive industries (with the exception of the pharmaceuticals industry) are among those that lag considerably behind the EU in terms of productivity.\(^{38}\) Considering that in several more technology intensive industries the share of imported components in the exports is relatively high\(^{39}\), the lag in productivity is probably a consequence of the fact that more labour-intensive segments of value added generation (for example assembly) are carried out in these industries. At the same time, these industries, in the process of value added generation, include relatively less the services which are increasingly used for differentiation of products and thus increasing the competitiveness of manufacturing industries\(^{40}\) in more developed countries. In this respect it should be pointed out that certain other EU Member States (the Czech Republic, Slovakia and Hungary), under a very similar or slightly better technological structure of manufacturing industries and exports, achieve an even lower average productivity level of manufacturing activities, with the share of import components within the exports being even higher than in Slovenia (see Box 3). This could lead to a conclusion that under lower labour costs, these countries have an even higher share of labour-intensive production within the framework of otherwise technologically more-demanding activities.

The level of internationalisation of the Slovenian economy further increased in 2012, as during the crisis and in the circumstances of low domestic consumption, the key factor of economic growth was exports. In 2012, the average share of foreign trade in GDP, after a severe decline at the beginning of the crisis, increased for the third year in a row on account of exports and was at its highest so far (73% of GDP). However, these apparently positive trends are not a reflection of the improved competitiveness of the Slovenian economy. The increased intensity of Slovenia's foreign trade relations, which in the period 2010–2012 grew above the EU average and above the average of the majority of small EU economies (except the Baltic States, Malta and Slovakia), was largely the result of the fact that given the low domestic consumption, foreign demand was the only driver of the otherwise modest economic growth. However, our market shares in the EU and the rest of the world have decreased since 2007.

The prospects for increased internationalisation through foreign direct investment (FDI) remain modest. FDI stock relative to GDP increased in 2011 to the highest level so far (32.3% of GDP), but only due to the increase in net claims of foreign parent companies towards their

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\(^{37}\) See indicator 1.14.

\(^{38}\) This applies to the production of ICT equipment, production of electrical equipment, the chemical industry, and manufacturing of other machinery and equipment.

\(^{39}\) See Box 3.

\(^{40}\) The share of knowledge-intensive business services in manufacturing intermediate consumption in Slovenia was 6.4% in 2009 (latest available data) and 10% in the EU.
Box 3: Measurement of trade in value added terms

Recent decades have seen growing fragmentation of production and business processes at the global level, which necessitated a new complement approach in recording of trade flows. Global value chains play a central role in enhancing competitiveness; they comprise all phases from access to energy and raw materials through research and development to after-sales services and recycling materials. Individual phases are carried out in different countries and are effectively integrated through modern traffic and communication infrastructure services. Manufacturing is not only dependent on the input of raw materials and semi-manufactured goods but is becoming increasingly dependent on various business services, such as designing, marketing and advertising, which increase the value of a product. The final value-added of a product or service consists of value-added of individual industries. With a view to obtaining a better understanding of mutual relationships between these industries, in 2012 the OECD and the WTO started to estimate export flows by value added. The approach is based on the construction of an input–output table for the world prepared by the OECD. In January 2013, the first results of this set were published; they showed value added broken down into domestic and foreign components.

Trade in value added indicators show that Slovenia lags behind the selected EU member states especially in service export value added. Slovenia’s share of domestic value added in exports is below the level obtained by the selected developed countries (Germany, Austria, Italy, France and the United Kingdom); this can in part be attributed to the country’s size and related stronger integration in international trade flows and in part to Slovenia’s position in the value added chain generation. Domestic value added content of exports in Slovenia exceeds those recorded by some new EU member states (Hungary, Czech Republic and Slovakia). In the period 2005–2009, it increased by 6.7 pp, which was one of the largest increases among the selected countries. Slovenia records the biggest lag behind the developed countries as regards domestic value added originating (directly and indirectly) in service exports. Less than a quarter (24%) of the value of Slovenia’s gross exports originated in services, while the share of services in exports, in terms of value added, was twice as high (48%) but still behind the level recorded by developed EU countries.

Within the manufacturing sector in Slovenia, particularly certain high- and medium-high technology industries have recorded a low content of domestic value added in exports. This is evident in the manufacture of vehicles and vessels, the manufacture of electrical and optical equipment, and the manufacture of machinery and equipment. In these industries, Slovenia’s exports are positioned more to the middle part of the production chain, as we export a relatively large number of intermediate products. This is most clearly seen in the manufacture of vehicles and vessels, with almost half of the export value (46%) represented by an import component (foreign value added), which is significantly higher than that in Italy (21%), Germany and the United Kingdom (approximately one-third). A clear lag is perceived in all three before mentioned industries, primarily in terms of the service sector’s domestic value added content. This indicates that compared with other developed countries, the potential to add value and thus strengthen product competitiveness by using various services (e.g. education, marketing, servicing and designing) is exploited by the three industries in Slovenia to a significantly lesser extent. The highest domestic value added content is recorded by some low-technology processing industries (the food-processing, wood, paper and furniture industries), which can be attributed to the characteristics of the products of these industries rendering the integration into the production chains in the region relatively easier.

Figure: Shares of domestic value added in exports of the selected EU members, 2009

Source: OECD-WTO TiVA indicators, January 2013.

1 Input–output tables eliminated inconsistencies between global export and import flows caused by the differences in displaying transit flows and the re-export between individual countries.
2 OECD – WTO Database on Trade in Value-Added presents indicators for 40 countries covering three years (2005, 2008 and 2009) and broken down by 18 industries. This is the first release of date, which will be expanded by a wider set of indicators and data covering longer time series from 1995. The indicators published are estimates.
3 In 2009, the share of services in exports in terms of value added stood at 51% in Austria and Italy, at 50% in Germany, at 59% in France, and at 63% in the UK.
4 Final products represent 45% of electrical and optical equipment exports, 59% of machinery and equipment exports, and 68% of vehicles and vessels export.
Slovenian affiliates, while the equity capital remained unchanged. Outward FDI in relation to GDP decreased (to 16.7% of GDP) as the result of the share capital reduction of Slovenian investors and the increase in their net claims towards foreign branches. Notwithstanding the changes in recent years, which were also influenced by the low GDP level during the crisis, in addition to changes in FDI inflows and outflows, Slovenia has remained among the EU Member States with the lowest inward and outward FDI stock in relation to GDP. According to our estimates, there were no significant improvements in FDI flows in 2012 (see indicator 1.16). A similar picture is shown by the results of surveys among foreign affiliates in Slovenia. The share of those predicting a drop in sales in the current year has increased considerably. Moreover, according to the latest survey, the share of those expecting sales and employment to grow in the next year has decreased considerably (Rojec, Jaklič 2012). The share of foreign affiliates assessing that the situation of Slovenia as a FDI location deteriorated due to the economic recession has increased considerably since the beginning of the crisis (from 44% in the 2009 survey to as much as 74% in the 2012 survey). Considering the modest prospects for an increase, FDI remains one of the untapped sources of attracting fresh capital, and also an opportunity for obtaining knowledge and experience that might accelerate technological restructuring of the economy.

In 2012, the share of population engaged in entrepreneurship increased following three years of decline, but Slovenia is still ranked in the bottom half of the EU countries in terms of new enterprise creation. After the decrease since the beginning of the crisis, early-stage entrepreneurial activity, which measures the share of the population getting involved in entrepreneurship, increased last year. Despite the increase, the early-stage entrepreneurial activity was even lower than before the onset of the crisis (in 2008) and remained in the lower end of the EU range. Last year, the increase in early-stage entrepreneurial activity was accompanied by a slight increase in the share of established entrepreneurship, and in consequence in the overall entrepreneurial activity, which includes early-stage and established entrepreneurship. The 2012 turn in the number of new and nascent enterprises is associated with increased granting of subsidies for self-employment during the crisis, since the number of subsidy recipients increased considerably in the period 2009–2011. It is estimated that in addition to identified business opportunities, the growing number of self-employed persons is also a consequence of searching for more flexible forms of employment in the uncertain conditions of the economic crisis. Considering the fact that subsidy recipients must keep their self-employment for at least two years, it is still too early to estimate the long-term impacts of this measure on entrepreneurial activity. However, Eurostat data, which are available only until 2009 and do so not include the larger part of the economic crisis period, point to a high survival rate of enterprises in Slovenia even five years after their establishment compared with international figures. On the one hand, this is encouraging, but on the other, it may only be a consequence of low risk-taking, which is ultimately reflected in low early-stage entrepreneurial activity.

The results of various international competitiveness surveys continue to point to numerous obstacles impeding the operation of enterprises in Slovenia. Significant progress has been made over the past few years in the efforts made to simplify and accelerate business incorporation procedures, but not enough has been done to provide support to businesses in their operations. In 2012, as in the previous two years, the entrepreneurs assessed (WEF, IMD, Doing Business) that the main obstacles to the operation of enterprises in Slovenia were limited access to financing, ineffective state bureaucracy and restrictive labour legislation. The access of enterprises to sources of financing deteriorated further and the assessed liquidity of banks was poor compared with other EU countries. It should be mentioned that in international comparison, Slovenian companies are among those with higher debts. The World Bank also highlights the deficiencies in the existing legislation in this area and the lack of a quality credit information system for all users. The operation of companies is impeded by the state bureaucracy, where the procedures required to obtain various documents and permits are unreasonably lengthy, as are contract enforcement procedures. Despite all this, certain positive modifications and reductions in administrative burdens emerged over the past two years, including a simplified payment system of taxes and other compulsory contributions, and the tax rate on profits was also reduced. Measures that improved the protection of investors, shortened certain procedures referring to insolvency of companies, and increased the protection of creditors and employees in the event of bankruptcy were also adopted. In comparison with other countries, the absence of structural reforms in the labour market, where the labour legislation referring to the hiring and dismissal of employees has persisted as the main problem over many years, rigidity of permanent employment and lack of flexibility in wage determination have been pointed out several times. Corporate performance has been severely impeded by a lack of good practice in Slovenia’s business environment, as it is ranked the lowest in competitiveness surveys in terms of the effectiveness (responsibility) of supervisory boards, the enforcement of accounting standards, and management credibility. The downgraded ranking in this area during the crisis indicates inappropriate and slow adjustment of companies to the newly emerged conditions in recent years.

41 The data are taken from research by the Global Entrepreneurship Monitor (GEM). For more details, see indicator 1.17.
42 The survey is carried out in the first half of the year.
43 As compared with 22 other EU Member States included in the GEM survey.
44 See Chapter 4.1.
1.3.1 Services

During the recent period, the impact of the crisis through a drop in domestic consumption has spread increasingly to those services that are mainly focused on the domestic market and were relatively little affected at the onset of the crisis. After a drop in foreign demand in the initial period of the crisis affected mainly the export-oriented segments of services (in particular transport, catering services and partly also trade services), and also certain services associated with the domestic production and construction activities, its consequences, in combination with the deterioration of labour market conditions and implementation of austerity measures, also started to show in those market services and public services that are mainly focused on the domestic market. After a one-year improvement, the growth of value added in services slowed down considerably (a relatively strong growth in industry) in 2011, whereas in 2012 it decreased slightly due to a further drop in domestic consumption and slowing down in foreign demand. With the continuing crisis, the growth of value added in services also slowed down in the EU, but to a lesser extent than in Slovenia, in particular in market services. The share of services in the structure of the economy, which was strengthened considerably at the onset of the crisis due to a sharp drop in industry and construction, ceased to rise after 2010. This keeps Slovenia lagging behind the EU average in terms of the share of services to a relatively high extent. In terms of both the share in value added and employment, Slovenia’s lag behind the EU average continues to be the highest in market services. The lag of the public services’ share behind the EU average is lower, particularly due to certain less-developed services (primarily healthcare and social assistance) outside the general government sector.

The greatest potential for enhancing the competitiveness of Slovenia’s economy lies in the services with an intensive use of knowledge and know-how, which increased rapidly until 2010, but these services have many disadvantages which reduce their competitiveness. After 2005, knowledge-intensive services (see indicator 1.18) were the main driving force of market services growth in Slovenia. In 2010, they were already comparable to the EU average according to their share in the structure of the value added of the entire economy. However, their growth mostly originated in the great domestic boom (the construction sector and manufacturing), which in the current conditions of the crisis – collapse of the construction sector and an overall low domestic demand – strongly reduces any possibilities for their fast recovery. In 2011, the share of the knowledge-intensive services in the structure of the economy declined for the first time after 2005, which is probably mostly due to an exaggerated orientation of these services towards the domestic market, including their considerable dependence on public sector demand. Insufficient exposure of knowledge-intensive services may be performed both in the public and private sectors. For more details on access to public services, see Chapter 4: The labour market and welfare state. The fastest growing services included different information, legal and accounting services, business management and consultation services, and architectural and designing services.
services to foreign competition is reflected in their poor competitiveness and in consequence a modest share in total exports of services. This share is twice lower than the EU average and has not changed considerably in recent years. International comparisons of employment and value added shares indicate their relatively low productivity compared with the EU. In consequence, the ratio between labour costs per employee and productivity as the indicator of the overall cost competitiveness is much less favourable than in the EU, particularly in professional, scientific and technical activities. In addition to low exposure to foreign competition and considering the size structure of companies, the low productivity of these services is also due to smaller opportunities for the exploitation of economies of scale, because these are very diverse activities which need a close relationship and interaction with clients, so their process standardisation and automation using ICT is lower. The aforementioned indicates that the opportunities for knowledge-intensive services, as the most dynamic part of market services in the pre-crisis period, are quite limited for any considerable increase in employment in the short-time period without a simultaneous increase in domestic demand. This is also supported by data indicating a considerable slowdown of growth in employment over recent years after an initial relatively high increase at the beginning of the crisis.

**Figure 13: The share of knowledge-intensive services in total exports of services, 2011**

During the period 2008–2011, the competitiveness of service exports on EU markets decreased, though they experienced a slight increase in the last year. In the period 2008–2011, Slovenia increased the concentration of its service exports to EU markets, which accounted for 72% of the total service exports in 2011. The market share of Slovenian exports of services to EU markets is modest and even declined during the crisis (by 3.5%). Among the five major partner countries, the market share was strengthened only on the Italian and Hungarian markets. Travel service providers reacted best to the crisis, since they increased their market share in the EU during the period 2008–2011, despite the fact that the demand for these services in the EU decreased. The crisis most affected the exporters of other services, i.e. services which mostly use knowledge. The competitiveness of transport service exports slightly decreased as well. In 2011, both groups of services recorded a higher market share in the EU. However, it raises considerable concerns, particularly regarding the export of knowledge-intensive services, that the EU increased their imports during the crisis, which enabled the most competitive providers to maintain or expand their market share. The lack of success of Slovenian providers of these services corroborates the findings on their insufficient competitiveness on foreign markets. The crisis accentuated the disadvantages originating in insufficient productivity, in the fact that the providers of the remaining services are mainly small and micro-sized companies, in their traditional focus on the domestic market and in the limited pressure of high-quality international providers.

**Innovation activity in market services remains weak and has decreased further during the recent period.**

The share of innovation-active enterprises in market services decreased to 44.7% in the period 2008–2010. This places Slovenia far behind the leading countries Germany and Portugal, with above 73% and 63% of innovation-active enterprises in services respectively. Considering these trends, it is hard to expect increased exports of services with high value added to international markets. New technologies provide for a range of opportunities for innovations in all activities, but service-providing companies introduce almost three times more non-technological innovations (organisational and marketing) than technological innovations. In addition, more service-providing companies are engaged in non-technological innovation than in manufacturing innovation. Specificities of innovation in service activities should be taken into account in the formulation of the innovation policy measures in Slovenia, just as in the

49 Among market services, a higher share of value added and a lower share of employment (compared with the EU average) is recorded only in the group of traditional services (trade, catering, transport), whereas the majority of other marketing services lag behind the EU average in terms of their share in the overall employment less than in terms of their share in value added.

50 Italy, Austria, Germany, Hungary, the United Kingdom – this is the sequence of major partners in services exports in the years 2008–2011.

51 On average by 13.7%, in Hungary even by 40% and in Italy by almost 25%. Slovenia exports an important share of travel services to non-EU countries, particularly Croatia and Russia. During the period 2008–2011, the export of travel to Croatia decreased, whereas to Russia it increased by slightly over a half. A decline of 12.3% in the market share during the period 2008–2011.
In the area of network industries, the strongest competition is seen in broadband internet; recently, positive trends have also been perceived in the natural gas market. As regards electronic communications, the market share of the largest provider recorded the sharpest decline in fixed telephony in the period 2007–2010 (by 20 pp, but it still has considerably above the EU average); the traditional telephony segment (PSTN and ISDN) has been shrinking and replaced by internet telephony (VoIP) offered by new alternative providers (in the third quarter of 2012, the share of traditional fixed telephony was below 50%). Fixed telephony is being replaced by mobile telephony; in this segment, market concentration is significantly above the EU average. The market share of the largest service provider in individual telecommunication markets is lowest in broadband internet access, where it almost attains the average EU level. The most recent data show that in 2010, fixed and mobile telephony prices were generally lower than the EU average. In the period 2005–2012, telephone service prices decreased slightly more in the EU as a whole than in Slovenia. The smallest changes in the area of electronic communications were observed in ownership structures, which maintain a high proportion of state ownership in the largest telecommunication service provider. A similar situation can be observed in electricity supply, where competition is promoted by the ease of changing supplier. According to the AGEN–RS, the market share of the largest electricity producer was 62.4% in 2011; an HHI of 4,655 pointed to a high concentration level. A total of 16 suppliers were operating on the electricity retail market in 2011, and the HHI of 1,501 indicated a moderate concentration level. As regards the distribution customers, the concentration index (1,822) in the market continues to indicate a relatively high concentration. According to Eurostat data, retail household electricity prices (tax excluded) recorded in Slovenia in the first half of 2012 were 9.3% below the EU–27 average (10.7% for industrial users). A significant improvement in competition in the electricity supply market is shown by the data provided by the AGEN–RS on the number of changes of supplier. In 2011, there were 39,135 of these (4.2% of all customers) or almost 2.2 times the number of the year before. After the liberalisation of the natural gas market, competition is expected to continue to be limited by the long-term supply contracts. According to the AGEN–RS data, the share of the largest provider in the wholesale market stood at 72.3% (HHI 5,926), and at 62.2% (HHI 4,035) in the retail market. There were less than 0.1% of changes of supplier. In the last months of 2012, a new supplier entered the market offering significantly lower prices; it thus prompted others to provide more competitive prices. Gas prices paid by households in Slovenia in the first half of the year were higher than in the EU as a whole by a good quarter (almost by a half for industry); but at the end of the year Slovenia saw a pronounced reduction in prices (in gas for households by 15.3% in October and November 2012).

**Figure 1**: Telephone service and product prices and electricity and gas prices for households in Slovenia and EU-27

![Graph showing telephone service and product prices and electricity and gas prices for households in Slovenia and EU-27](image)

Source: Eurostat; calculations by IMAD.

**Table**: Market shares of the largest providers in the electronic communications market expressed as a percentage

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<td>Broadband internet</td>
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Source: Digital Agenda Scoreboard 2012, Electronic communication market indicators (European Commission), 2012.

Note: 1 In fixed telephony in terms of traffic expressed in minutes (in December), in mobile telephony in terms of active SIM cards (in October), and in the internet in terms of the number of connections (at the end of the year). 2 The average for the three EU Member States with the lowest shares.

1 Only the Slovenian part of the electricity produced by the nuclear power plant is taken into account. The internationally comparable Eurostat statistics (by taking into account the total energy produced by the nuclear power plant) was 55% in 2010, which almost equals the (arithmetic) EU mean.

2 The market share of the largest supplier was 22.1%.

**Figure 2**: Discrepancies in energy prices between Slovenia and EU-27

![Graph showing discrepancies in energy prices between Slovenia and EU-27](image)

Source: Eurostat; calculations by IMAD.
more developed EU countries. Moreover, the key role of knowledge-intensive services in the introduction of innovations in all activities and in boosting their competitiveness on the domestic and foreign markets should not be neglected. Analyses show that the knowledge of external providers of knowledge-intensive services (Inno-Grips, 2012) are very important for the success of organisational and marketing innovations in companies.

**A lack of competition in services in certain network industries and particular trade sectors continues to be evident despite gradual positive trends.** In the recent period during the crisis, in certain highly concentrated industries, mark-ups were reduced below the EU average. Nevertheless, they are treated as activities with a relatively low competition rate due to the large market share held by the major companies. Such are telecommunications, where the concentration index, following the merging of two large telecommunications companies in 2011, increased further. In particular telecommunications markets, the shares of the main operators were further reduced, but they are generally still higher than the EU average (see Box 4). The whole trade chain with motor fuels (wholesale and retail sale) recorded a decrease in mark-ups below the EU average, but the level of concentration has remained high in both activities. Highly concentrated industries that stood out in international comparisons in terms of relatively high mark-ups included postal services and the retail sector in non-specialised, predominantly grocery stores. In postal services, the main company still generated almost total revenues in the postal services sector. In 2011, the level of concentration in non-specialised, predominantly grocery stores was further reduced but remained high, which is, to a certain extent, also the result of the small size of the Slovenian market. A. Kuhar et al. (2012) note that the transfer of costs through the food supply chain is swift and that the response of prices in the food processing industry and retail prices to the rising prices of agricultural products is mostly swifter than in the case of a decrease, which, over a longer period, is reflected in an enhanced growth of retail prices compared with the price rise in agricultural products.

**The crisis further exposed the weaknessess in the development of market services that have been present since the beginning of SDS implementation.** Insufficient innovation activity of market services contributes to their poor productivity and the resulting falling competitiveness on foreign markets. It is expected that with the progress made in implementing the Directive on Services in the Internal Market, competitive pressures of foreign providers of services on the Slovenian market will be strengthened, which will stimulate domestic providers to increase their innovation activities. Although Slovenia has achieved a certain amount of progress in the implementation of the Services Directive, the latest report notes lagging behind with regard to ensuring effective competition to foreign providers of services. The Report on the Implementation of the Services Directive (2012) states that the use of points of single contact (PCS) in Slovenia for foreign providers of services is below the EU average, whereas domestic users find it easier to use points of physical contact. Further implementation of the Services Directive will further increase the opportunities of Slovenian providers of services for sales on EU markets, but this will be hard to implement owing to their insufficient competitiveness; therefore Slovenia has no chance of a breakthrough over a short-term period. Taking into account the nature of service activities where small companies prevail and where the possibilities for the protection of intellectual property rights are smaller than in industry, the experience of the more advanced EU members indicate that innovation policy should stimulate a swifter introduction of good innovation practices in the service sector and formation of clusters on knowledge-intensive services with higher value added (Uppenberg, Strauss, 2010). Slovenia also needs systematic efforts to enhance research and development in services, along with the possibility of a simplified utilisation of tax concessions, increased technological and non-technological innovation activities, in particular in small and medium-sized service companies, and their alliance and cooperation in taking up foreign markets.

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53 Concentration is measured in terms of the Herfindahl-Hirschman Index (HHI). According to this criterion, a high concentration is that which exceeds an index value of 1800.
54 The mark-up has been calculated as the ratio between sales revenues and the cost of acquiring goods, services and labour.
55 The HHI value for this industry dropped from 3,387 in 2006, when it reached its peak, to 2,408 in 2011.
56 The countries with the highest shares of the three largest providers of grocery goods in the EU are predominantly small: in addition to Slovenia, these are Austria, Finland and Ireland (Structural Features of Distributive Trades..., 2011).
57 As regards the operation of PCSs, Slovenia ranks among the five bottom EU Member States, together with Bulgaria, Romania, Ireland and Greece.