



REPUBLIC OF SLOVENIA

***REPORT ON STRUCTURAL
REFORMS
2004***

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I. INTRODUCTON

Slovenia is adapting its economic structure to the new European and global trends. A competitive economy requires well-structured public finance, market liberalisation and stimulation of market competitiveness, as well as a suitable environment for the development of entrepreneurship. Being a member state of the EU, Slovenia is thus building its national vision and basic strategic objectives on the Lisbon development strategy targets: higher competitiveness, employment growth, and balanced social and environmental development.

After its accession to the EU, Slovenia now faces the issue of how to make the most of new development options and how to avoid the risks presented by membership. The benefits include equal access to the large common market of the EU, integration into a more stable and predictable business environment and increased internationalisation of the country's economy. The risks, on the other hand, involve higher internal competition, pressures on business performance and, at the macro-economic level, increased pressures on public finance. To enhance the economy's competitiveness in the new environment, structural reforms are essential. The Government is responding to these challenges with measures stimulating the economy's restructuring and further liberalisation, as well as with measures aimed at stimulating economic growth and employment.

The Economic Policy Committee listed the following concrete recommendations for Slovenia in its Annual Report on Structural Reforms 2003: (i) continue to ensure productivity growth. Scope for improvements exists in a broad range of areas, in particular by encouraging entrepreneurship and by further promoting R&D and innovation; (ii) promote the development of effective competition in product markets, and notably in network industries; (iii) further promote the inflow of FDI. Take steps to free up the supply of land, so that this is not an obstacle; (iv) intensify measures to increase employment rates for older workers, and the low retirement age, and closely monitor the impact of the measures against the envisaged objectives.

In its Report on Structural Reforms, the Economic Policy Committee presented an accurate survey of the progress made in the field of structural reforms, and the survey served as a valuable basis for the identification of guidelines for future activities. The recommendations of the Economic Policy Committee are also in line with the Broad Economic Policy Guidelines (BEPGs).

In the past year, positive development changes have been recorded, resulting among other things from the measures adopted by Slovenia in response to the recommendations of the BEPGs and the Economic Policy Committee. The entry into ERM-II and further reduction of inflation are creating a more stable macro-economic environment. Corporate competitiveness was positively influenced by higher productivity and lower costs per unit of value added, reflected in increased shares in the principal foreign markets. The Government adopted measures to improve the efficiency of the institutional regulatory framework and public administration, including measures aimed at improving the business environment, as well as others to increase investment in research and development. The liberalisation process in the network industries continued and progress resulted in higher competitiveness, in particular in the telecommunications and energy sectors. In financial services, progress has been made in the implementation of reforms in the field of regulation and harmonisation of legislation with the European directives, creating possibilities for enhancing the sector's competitiveness. Institutionally and financially, the role of the foreign investment promotion agency was enhanced, and special measures were adopted addressing the issue of available building land for investment. The Government's active employment policy implements employment measures aimed at individual target groups, including older unemployed persons.

II. STRUCTURAL REFORMS IN THE PRODUCT AND CAPITAL MARKETS

Structural reforms are essential if Slovenia wants to function successfully in the EU, i.e. reforms which will bolster the economy's competitiveness and increase its flexibility. Policies aimed at increasing the economy's competitiveness and promoting the transition to a knowledge-based society will make it easier for Slovenia to control the risks involved, make good use of the benefits of its accession to the new economic environment, and achieve economic and employment growth in the coming years. The adopted national budgets for 2004 and 2005 increased the funds allocated for purposes which will contribute most to economic growth and real convergence¹: (i) science and technological development by 24.4%; (ii) promotion and support of economic activities by 62.4%; (iii) infrastructure by 16.2%; (iv) education by 10.2%; (v) active employment policy by 19.9%.

The structural policy measures specifically address the following objectives: (i) strengthen competitiveness and scientific technological development, stimulate entrepreneurship and eliminate administrative barriers; (ii) increase the competitiveness and professional efficiency of the infrastructure and network industries, especially in telecommunications, postal services, transport and electrical energy, either through efficient regulation of natural monopolies or through privatisation and liberalisation, whilst establishing efficient competition protection and ensuring reliability of the energy supply; (iii) restructure non-competitive branches (textile, leather, steel, and food industries) and regionally targeted use of state subsidies; (iv) reduce the tax burden of labour and provides incentives for investment in research and development in terms of profit taxation through the adopted tax reform; (v) increase the volume and efficiency of the financial markets.

II.A. PRODUCTIVITY AND GROWTH

Survey of the structural indicators of the Lisbon Process

Based on the structural indicators of the European Commission and taking account of 9 (out of 14) indicators in the analysis of the Report on Structural Reforms, Slovenia ranks higher than the EU average in youth education attainment and the share of business investment in GDP. Slovenia's employment rate is close to the average of the EU-25, whilst the long-term unemployment rate is below the average. In all the mentioned indicators, Slovenia ranks higher than most of the new member states.

Slovenia's achievements are below the EU average in five out of nine indicators, but in most indicators the country ranks higher than most of the new EU member states. A gap with the EU average is recorded for the general economic indicators (GDP per capita in PPS, labour productivity in PPS). In innovation and research activities, Slovenia lags behind in terms of the volume of expenditure on R&D activities as share in GDP, and in the labour market in terms of the employment rate of older workers. The employment rate of older workers in Slovenia is among the lowest in Europe and largely results from mass early retirement in the first years of the transition.

In the past year, Slovenia recorded progress in five out of nine indicators, reducing in particular the gap in the labour productivity indicator, while also continuing to reduce the gap with the EU average regarding gross domestic product per capita in PPS. The share of youth with a secondary school education increased, whilst the long-term unemployment rate remained at approximately the same level as the year before. Compared to the year before, worse results seen in the employment indicators (general employment rate, employment rate of older workers) and in the indicator of the share of business investment in GDP; both developments probably resulted from relatively low economic growth over several years. The

¹ The figures refer to the 2004 budget compared with 2003.

gap with the EU average also increased in innovation and development activities (expenditures on R&D activities as share in GDP).

STRUCTURAL INDICATORS OF THE LISBON PROCESS – SELECTED FOR THE REPORT ON STRUCTURAL REFORMS		
THE POSITION OF SLOVENIA AND CHANGES COMPARED TO THE PREVIOUS YEAR		
	SLOVENIA IS ABOVE OR AROUND THE EU-25 AVERAGE	SLOVENIA IS BEHIND THE EU-25 AVERAGE
IMPROVEMENT (COMPARED TO PREVIOUS YEAR)	<ul style="list-style-type: none"> ❖ Youth educational attainment, 2003 (SLO: 90.7%, EU-25: 76.8%, EU-15: 74%) 	<ul style="list-style-type: none"> ❖ GDP p.c. in PPS, 2003 (EU-25=100) (SLO: 77.3, EU-15: 109.6) ❖ Labour productivity in PPS, 2003 (EU-25=100) (SLO: 75.7, EU-15: 107.2)* ❖ Relative price level, 2002 (EU-25=100) (SLO: 75.3, EU-15: 103.7)*
DETERIORATION (COMPARED TO PREVIOUS YEAR)	<ul style="list-style-type: none"> ❖ Business investment, 2001 (SLO: 23.8% GDP, EU-25: 18.0% GDP, EU-15: 17.9%) ❖ Employment rate, 2003 (SLO: 62.6%, EU-25: 62.9%, EU-15: 64.4%) ❖ Long-term unemployment rate, 2003 (SLO: 3.4%, EU-25: 4%, EU-15: 3.3%) 	<ul style="list-style-type: none"> ❖ Gross domestic expenditures on R&D, 2002 (SLO: 1.54% GDP, EU-25**: 1.93% GDP, EU-15: 1.99% GDP) ❖ Employment rate of older workers, 2003 (SLO: 23.5%, EU-25: 40.2%, EU-15: 41.7%)

Source: Eurostat, New Cronos database.

Note: * The relative price level and labour productivity in PPS were calculated by the IMAD from Eurostat data.

** 2001 figure

II.B. COMPETITION IN THE GOODS AND SERVICES MARKETS

II.B.1. OPENING NEW MARKETS TO COMPETITION AND CONTINUING ECONOMIC INTEGRATION

The Slovenian economy is much more intensively integrated into global economic trends through trade flows, rather than through flows of foreign direct investments (FDI). The 56.5 percentage share of exports and the equal share of imports of goods and services in GDP in 2003² show that the Slovenian economy is relatively well integrated in the global economy and that Slovenia's markets are open to foreign competition. In 2001, the non-weighted average MFN custom rate in Slovenia was 10.8%, compared to only 4.7%³ in the EU. Upon its accession to the EU, Slovenia adopted the common custom rate of the EU. This means that the Slovenian market was further liberalised for imports from countries, which had had no free trade agreements with Slovenia. A simultaneous development was the increase of trade barriers for some markets or products, which enjoyed a favourable regime before Slovenia's accession to the EU.

In 2001 (EUR 412 million) and 2002 (EUR 1,750 million), Slovenia registered record inflows of foreign direct investments (FDI). In the past two years such inflows were not repeated and they indeed dropped to the low level of before 2001. In 2003, inflows amounted to EUR 299 million, and in the first half of 2004 to EUR 84 million. The high inflows of 2001 and 2002 were above all the result of several major acquisitions, while there were no such acquisitions in 2003 and 2004. The 'Greenfield' FDI continued to remain modest. At the end of 2003, the share of FDI in GDP was 20.6%, compared to 16.9% in 2002. In 2002, foreign-owned companies accounted for 17.1% of total assets, 13.4% of total employed, 21.5% of total sales, and 35.9% of the total exports of Slovenia's corporate sector.

² Statistical Office of Slovenia

³ WTO figures. It should be noted that in the EU nearly half the imports are governed by the MFN custom rate, whilst prior to accession around 85% of imports were covered by preferential agreements, that is no custom duties were paid. The weighted average custom rate was below 2%.

On the other hand, a sustained increasing trend of direct investment by Slovenian companies abroad has been recorded. In the 1999-2002 period Slovenia's outward FDI assets increased from EUR 625 million to EUR 1,849 million (from 3.1% GDP to 7.5% GDP). FDI outflows increased from EUR 161 million in 2001 to EUR 414 million in 2003 and reached EUR 133 million in the first half of 2004. Most of these investments went to the successor countries of the former Yugoslavia.

The legal framework for the free flow of goods and services

Slovenia has adjusted its legislation to the EU legal order in the field of free movement of goods and services. Together with Lithuania, Slovenia has the smallest transposition deficit among the new EU member states regarding the implementation of internal market directives⁴. Until May 2004 Slovenia had not transposed 87 of the total 1528 directives, which amounts to a 5.7 % transposition deficit. On the basis of the Lisbon Strategy, the EU adopted more than 70 directives that should facilitate better harmonisation and a joint legislative framework aimed at strengthening the internal market, competitiveness and potential for economic growth. By the end of August 2004, 50 directives should be transposed to national legislation, of which Slovenia will manage to transpose 37 entirely and 8 partly. The transposition rate of the Lisbon directives into the national legal order amounts to 74%, which puts Slovenia among the countries with the best results.

The horizontal administrative infrastructure for the free movement of goods⁵ has been put in place⁶ and is working. Adequate coordination and efficient operation of market surveillance bodies have been provided, taking into account proportionality, the implementation of early warnings, and exchange of information about dangerous products.

In the field of free movement of services, the internal review of legislation harmonisation with Articles 43 and 49 of TEC was finished by the end of 2003. Based on established incompatibilities, adequate adjustments of legislative instruments and regulatory decrees were made. Permanent monitoring of the harmonisation level with the EU legislation was also put in place.

Slovenia had previously signed (preferential) free trade agreements with 33 countries⁷. It had to denounce these agreements due to the stipulations of the Treaty of Accession to the EU. On the day of accession to the EU, Slovenia took over the EU common commercial policy, including all trade agreements with third countries that the EU had concluded prior to that date. The most important of these were stabilisation accession agreements with Croatia and FYR Macedonia, the European agreements with Romania and Bulgaria, the Euro-Mediterranean Agreement etc⁸.

The termination of free-trade agreements that Slovenia had with successor countries from former Yugoslavia (Croatia, FYR Macedonia, Bosnia and Herzegovina) most considerably influenced the volume of Slovenia's foreign trade exchange. The negative influence was partly alleviated by taking over the stabilisation accession agreements that the EU concluded with Croatia and FYR Macedonia. The effect of termination of these agreements on economic

⁴ Internal Market Scoreboard no. 13, July 2004.

⁵ Slovenian Standardisation Institute, Slovenian Accreditation, Metrology Institute of RS etc.

⁶ On January 1, 2004, the Slovenian Institute for Standardisation (SIST) became full member of the European organisations for standardisation CEN and CENELEC, whereas the Slovenian Accreditation (SA) signed an agreement with the European Accreditation on mutual recognition of accreditations for calibration laboratories and test laboratories (EA MLA).

⁷ (i) accession agreement with EU (15 countries); (ii) with EFTA countries (4 countries); (iii) CEFTA (with Bulgaria, the Czech Republic, Croatia, Hungary, Poland, Romania, and Slovakia); (iv) with other countries (Estonia, Latvia, Lithuania, Israel, Turkey, FYR Macedonia, and Bosnia and Herzegovina).

⁸ Slovenia is currently taking an active part in negotiations for trade agreements with the Mercosur countries, the Gulf countries, Albania, and other countries, that are on behalf of the EU led by the European Commission.

growth has been estimated⁹ at about –0.1 of a percentage point. However, Slovenia at the same time benefited from the adoption of the EU common customs tariff, free mutual trade with sensitive products in the EU, the abolition of border controls and formalities, which lowered the cost of trade. Therefore the net effect on trade growth, is estimated to have been positive.

Technical barriers to trade

Regarding technical harmonisation in the harmonised area of free movement of goods, Slovenia has managed to transpose the majority of directives into the Slovenian legal order¹⁰, whereas regulations and decisions have become directly applicable upon Slovenia's accession to the EU. Barriers to trade in the internal market are being addressed at two levels within the EU, i.e. by further harmonisation and by applying the principle of mutual recognition.

Slovenia has regulated mutual recognition and the validity of documents on conformity, and conformity markings in the harmonised area by the Technical Requirements for Products and Conformity Assessment Act. In order to regulate the non-harmonised part (Articles 28 – 30 of TEC), this Act has been amended by the introduction of the mutual recognition clause (MRC) aimed at the elimination of technical barriers to trade in the area.

To prevent the erecting of new barriers to trade, it is of utmost importance to introduce the notification procedure according to Directive 98/34/ES, which was entirely transposed into the Slovenian legal order by the Regulation on the Notification Procedures for Standards, Technical Regulation and Conformity Procedures¹¹. By becoming a full member of the EU Slovenia entirely adopted the implementation of the notification procedure, which binds the competent national bodies to inform all the participants in the notification procedure about their programme of preparing standards and technical regulations, and stipulates the obligatory suspension period.

Standardisation remains an important tool in the process of technical harmonisation and will gain even further importance by the implementation of a new General Product Safety Directive. More than 99% of Slovenian standards are currently based on the work done within European or international standardisation organisations. Representatives of the Slovenian Institute for Standardisation have been taking an active part in the process.

On 1 May 2004, the national SOLVIT Centre¹² began operations. It is part of a system of national centres from EU member states. The system is based on direct mutual cooperation between public administrations and SOLVIT national centres, which should facilitate a faster elimination of barriers to free movement in the internal market.

Barriers to cross-border investment

Since Slovenia lags behind in the area of foreign investments, the measures to promote foreign investment in Slovenia focused on three key areas: (i) better supply and accessibility of industrial land, (ii) financial incentives for investments, and (iii) institutional measures to promote foreign direct investment and marketing of Slovenia as an FDI location.

⁹ Damjan, Jazbec, Majcen, Polanec, Masten: Ocena makro in mikroekonomskih učinkov vstopa Slovenije v EU (Estimate of Macro and Micro Effects of the Accession of Slovenia to EU), GZS, May 2003.

¹⁰ Internal Market Scoreboard No. 13, July 2004.

¹¹ The Regulation is entirely based on the EU directive on information procedure in the field of technical standards and technical regulation (98/34/EU as amended by 98/48/ES).

¹² SOLVIT is an electronic system for informal solving of internal market cross-border problems that are caused when public administration bodies apply EU law in an incorrect manner.

The development of industrial zones has been determined as one of the priorities of the Government in the Single Programming Document. In order to improve the situation in 2004, the first call for tenders was held for funding from structural funds for renewal, modernisation and construction of public and municipal utility infrastructure in business zones.

The implementation of an internationally comparable system of non-reimbursable financial incentives for foreign investment continued within the Programme of Measures to Promote Entrepreneurship and Competitiveness 2002-2006. The financial funds for that purpose doubled in comparison to 2003.

The institutional arrangements in the field improved with the adoption of the Act on Attracting Foreign Direct Investments and Facilitation of Company Internationalisation in July 2004. The Act introduces an internationally comparable institutional basis for efficient promotion of direct foreign investment in Slovenia and for promoting the internationalisation of Slovenian enterprises; it defines activities for the promotion of direct foreign investment and the internationalisation of enterprises and determines the agencies responsible for the implementation of the above activities. The Act gives the legal basis that is needed to put in place an efficient infrastructure for a public agency and the network of the agency's branch offices abroad that will strive to achieve the goals. The Act also provides a legal basis for the distribution of state assistance to direct foreign investors.

Public procurement

The efficiency of public procurement procedures significantly influences the efficiency of the public sector. In 2003, public procurement in Slovenia totalled SIT 423 billion (EUR 1.81 billion) or around 30% of the national budget expenditure, or 7% of the GDP. On the public procurement market 315,600 public contracts were awarded in 2003, of which 9,448 were high-value and 306,155¹³ were low-value contracts. There are still relatively few foreign tenderers or candidates (1.52%¹⁴ of the total procurement value) although with Slovenia's membership of the EU its public procurement market is becoming more interesting for tenderers from the member states. The trends in procedures¹⁵ from 2001 and 2002 continued in 2003 with the open and restricted procedure as the most commonly used, and the negotiated procedure¹⁶ being residual.

Public procurement in Slovenia is regulated by the Public Procurement Act and the Act on the Review of Public Procurement Procedures¹⁷. The Public Procurement Act was amended in January 2004 in order to be fully harmonised with the EU directives concerning public procurement. Since May 2004, the Rules on Standard Forms for all types of notices, which

¹³ The Republic of Slovenia Budget Implementation Act for 2003 and 2004 defines the national threshold for awarding public contracts for goods and services at SIT 10 million (EUR 42,790) and for construction at SIT 20 million (EUR 85,580) – VAT excluded.

¹⁴ Out of the total value of public contracts, around 1.52% were awarded to foreign tenderers (of which around 1.37% were from the EU and around 0.15% were not from the EU). The Slovenian public procurement market is not the only one that is still relatively difficult for foreign tenderers to access. This is true also for all other Member State markets where the movement of goods and service in public procurement still does not exceed 10%.

¹⁵ Out of the total number (349) of review claims with respect to the award procedures considered by the National Review Commission in 2003, 139 were resolved to the satisfaction of claimants (nearly 40%): in 41 cases the entire award procedure was annulled, in 54 cases the contracting authority's decision on selection was annulled, and in 44 cases the award procedure was partially annulled.

¹⁶ The open and restricted procedures best guarantee compliance with all the fundamental principles of public procurement. The legislative conditions for the application of the negotiated procedure are extremely restrictive.

¹⁷ The Act on the Review of Public Procurement Procedures governs, inter alia, legal protection of tenderers and the public interests in public contract award procedures. The Public Procurement Act stipulates, inter alia, the compulsory action of contracting authorities and tenderers in the award of public contracts for goods, services and construction (ie. classical contracts) and the compulsory action of contracting authorities and tenderers in the award of public contracts for goods, services and construction in the water, energy, transport and telecommunications sectors (ie. infrastructure contracts).

must be advertised by contracting authorities under the Public Procurement Act¹⁸ have been applied.

The introduction of mandatory electronic public procurement¹⁹ will make the award of public contracts even more transparent and will also enhance competition on the domestic market in public contracts, which, considering the lack of flexibility in domestic supply, in turn implies the potential reduction of prices, economies of scale and, subsequently, the more cost-effective use of public funds.

II.B.2. COMPETITION POLICY, REGULATORY FRAMEWORK AND NETWORK INDUSTRIES

The Slovenian economy is one of the most open economies amongst the new member states of the EU (high level of trade integration), and the trends of the prices of market products and services therefore reflect a condition of relatively efficient competition in these sectors. In spite of the economy's openness, there are still options available to further improve efficient competition in Slovenia, notably in the financial sector, in the network industries and in terms of infrastructure.

Analyses of the degree of market concentration in retail trade show a degree of concentration that is low on average, and which is, among other things, the result of the sector's openness to foreign competition²⁰. The electrical energy market's openness is 64%, with five distribution companies operating in this market; the gas market's openness is 50%²¹. The analysis of the financial sector indicates a medium high concentration as the five biggest banks had a 67.4% share, measured by income from banking operations. The concentration is due to the gradual approach to privatisation in the banking sector and the integration of Slovenia's financial market.

Important measures aimed at increasing efficient competition – besides enhancing the economy's openness (by stimulating FDI and further privatisation) – are including more efficient legislation, public administration and public network services, better market regulation and the elimination of barriers to competition entering or exiting in the market.

Competition policy

From the legislation point of view the field of competition protection has been substantially aligned with the EC legislation, while national legislation has been updated with the enforcement of Council Regulation 1/2003. The Competition Protection Office is officially determined as a functionally independent authority tasked with adequate powers to exercise control over restrictive agreements, abuses of dominant position and mergers. The decisions of the Office are final; the Administrative Court assures the possibility of legal protection for undertakings treated in the procedure. Functionally, the Office has all the potential for autonomous investigative activities and adopting of final decisions. For the time being, the misdemeanour judge is responsible for imposing fines on the basis of a written proposal of the Office, but with the enforcement of the new Misdemeanour Act, the Office is also taking over

¹⁸ The contents of the forms prescribed by these Rules are identical for public contract notices, which must be advertised in the Official Gazette of the Republic of Slovenia, and for those which, due to their value, must be advertised in the Official Journal of the European Communities.

¹⁹ The 2004 amendment to the Public Procurement Act prescribes the use of electronic notices and invitations to tender. For the purposes of setting up a single information portal for electronic notices concerning public procurement a 12-month transition period applies.

²⁰ Mrkaić, Pezdir: *Ovire za konkurenco v slovenskem gospodarstvu in ukrepi za odprav.* ICK, September 2004

²¹ European Commission, 3rd benchmarking report on the implementation of the internal electricity and gas market, March 2004.

the responsibility of sanctioning. Due to its additional responsibilities, the Office shall strengthen its administrative capacity²².

The major part of procedural activities is still dedicated to the judgements of mergers. In 2003, out of 63 adopted decisions of the Office, 54 were in the field of mergers. The structure of judgements is gradually being modified. A stronger emphasis shall be placed on judgements of more demanding infringements of anti-trust legislation, such as cartel agreements and abuses of dominant position.

Besides the Competition Protection Office (responsible for the implementation of general competition rules), regulatory authorities have officially determined responsibilities for the introduction and promotion of competition in the field of network sectors, as mentioned in the chapter on public utilities and other network industries.

State Aids

After a substantial reduction during previous years the volume of state aids in Slovenia in 2003 has slightly increased in comparison to 2002 (as % of GDP: 2002 - 1.44%, 2003 - 1.52%; in EUR per employee: 2002 – EUR 432.4, 2003 – EUR 479.8). Compared to the EU²³, Slovenia demonstrates a higher level of state aids measured in terms of GDP share (SLO: 0.88%; EU-15: 0.56%), but a lower level of state aids per capita (SLO: EUR 108; EU-15: EUR 132).

In 2003 the distribution of state aids also underwent considerable changes. The part of state aid for agriculture and fisheries strongly decreased (2003: 46.8%; 2002: 59.8%), whereas state aid shares to the transport sector, cultural sector and energy sector expanded. The part of state aids directed to horizontal objectives experienced the highest growth (2003: 32.9%; 2002: 24.9%), despite being harmonised with the Lisbon commitment to re-directing aid from sectoral towards horizontal objectives of common interest, including cohesion objectives. State aids granted on the basis of regional criteria are still rather limited (2003: 3.7%; 2002: 3.6%).

Upon Slovenia's accession to the EU the European Commission has become the exclusive control authority for the granting state aids. A special department at the Ministry of Finance is in charge of ensuring that state aids at the national level are granted in compliance with the *acquis communautaire*, performing also an advisory role for state aid grantors, administering a central database, reporting and instructing the participants in the aid granting procedure. In the present year the sixth Survey on state aid was issued (covering the period from 2001 till 2003 and including the local level data) and the fourth Inventory²⁴ of state aid, covering data on aid granted through the last three years, was prepared.

Utilities and other network industries

Telecommunications

The new fundamental legal Act on Electronic Communications, adopted in April 2004, liberalised the telecommunications domain in accordance with the EU legislation. There are

²² The provision of adequate administrative and financial resources, aiming to efficient performance of the Competition Protection Office, remains one of the main priorities of the Office. In September 2004, there were 18 employees in the Office, who are constantly upgrading their expertise knowledge. Due to the additional responsibilities of the Office on the basis of modernisation of competition rules and responsibility of sanctioning, the Office shall need for optimal functioning at least 37 employees.

²³ The EU – Slovenia state aid comparison is not including the aid to railways.

²⁴ The State Aid Inventory comprises data on state aid schemes, legal basis, instruments and granted amounts of state aid. It indicates the financing procedure of individual measures over years and through this the dynamics of spending funds.

no exclusive and special rights awarded to any subject on the market²⁵ and entry onto the market is now simplified, which is very important for new entrants on the fully liberalised telecommunications market. A variety of mechanisms for market-relations-balancing have been introduced and the independent regulatory Agency now has extended competences to protect competition and to cooperate with the Competition Protection Office of the Republic of Slovenia and with the EU regulatory bodies.

Competition exists in all market segments of the telecommunications market, with the exception of fixed telephony for national calls. Apart from the monopoly operator, a further two operators have acquired licences to provide these services but they have not yet entered the market. After the Act on Electronic Communications entered into force, five more companies applied to provide fixed public telephony services; however, they also have not yet started to operate.

Providers of voice services over the Internet protocol (VoIP; 22 operators) and international transmission networks operators, providing international calls (11 operators) became significant competitors to Telekom Slovenije. In the mobile telecommunications service market there are currently 3 operators²⁶. Two of the operators have the status of operators with significant market strength. A comparison of market shares (in terms of joint revenues) with the previous period shows that the market share of the largest operator has decreased by 2 percentage points to 76 %.

Narrowband access to the Internet is widespread in Slovenia (45 lines per 100 inhabitants). There are 10 operators on the market – of which none holds the majority share (new entrants together account for 56 % of the market). The number of broadband connections is growing, including ADSL, cable networks and other technologies (3 lines per 100 inhabitants). The largest provider (SiOL) controls 66 % of the market. The number of lines using ADSL technology doubled during 2003 and is still growing, while the market share of the competitors surged to 8.4 % in 2004.

The Post and Electronic Communications Agency is an independent regulatory body playing the role of supervisor of postal and telecommunications services. It adopts secondary legislation as well as operational regulations based on sector laws and accepts notifications from entrants onto the post and telecommunications market.

In 2002, the Agency introduced a programme for the gradual balancing of prices on the telecommunications market. Regarding the connection of fixed and mobile networks it supported the implementation of two additional interconnection levels by adding single transit and local level to the double transit and the implementation of three price levels for network interconnection. This was followed by a significant price reduction in 2003. Currently, the prices stand somewhat below EU average. The Agency also played a role in the price reduction in fixed to mobile network calls and the substantial lowering of user costs for Internet access.

A licence for the provision of third generation mobile telecommunications (UMTS) was awarded to Mobitel in 2001 on the basis of a public tender. The Agency is preparing a new call for tender for two more licences in order to secure the necessary market competition in this field.

The State still holds a 62.53 % share in Telekom Slovenije (its daughter companies are Mobitel and SiOL), which is the largest telecommunications operator on the Slovenian

²⁵ The procedures providing better competition and imposing certain obligations to the operators with significant market power are elaborated in detail.

²⁶ 1 for NMT, 2 for GSM, 3 for DCS and 1 for UMTS.

market. The privatisation of the dominant operator has not yet commenced, due to unfavourable market conditions, which are preventing the sale of the company at a reasonable price. Different models of privatisation are being considered for implementation in 2005.

Postal services

The penetration level of the postal network in Slovenia is similar to the average European level, both by geographical and demographical criteria. For the present, there are approximately 20 postal service providers along with the major service provider Pošta Slovenije d.o.o.²⁷ (the only provider of universal postal services).

Postal activities in Slovenia have been formally and actually harmonised with European directives. The Postal Services Act adopted in 2002 and amended in May 2004 abolished the monopoly in the field of postal services and liberalised the postal market by removing all legal obstacles for the entry of competitors. The Post and Electronic Communication Agency supervises the deregulation of postal services in conformance with the law and its duties.

Public environmental protection services, water supply

Compulsory national public environmental protection services are services for the management of radioactive waste, incineration of municipal waste, management of animal waste, collection, recycling or disposal of certain other types of waste, performing of measurements, examination and treatment of combustion plants, chimneys and ventilators, monitoring of hydrological, erosion, geological, seismological and other geophysical occurrences and monitoring of the state of environment. In the following years some of the listed public services will participate in establishment of the effective operation control system for small and medium combustion plants (especially those on fossil fuels), which Slovenia needs to establish by 2007. In the field of waste management, concessions for some other special waste management systems will be given. Providers of public services for the management of waste tyres will be joined by the providers of public services for the management of end-of-life vehicles, waste electrical and electronic equipment and also hazardous waste, especially those in households, chosen by the providers of the municipal public service for the management of municipal waste.

The providers of national public environmental protection services are the concessionaires. These companies are under control of the Board as well as the Inspectorate, and they are known for their co-operation with companies from other EU states with similar respective powers. A project for the establishment of constant electronic connection between the Ministry and the providers of national public environmental protection services is in progress, aiming to make supervision of the performance of their services more accessible to the civil service, which will certainly contribute to the introduction of measures of higher economic as well as environmental efficiency.

The current state in the field of municipal public environmental protection services in regard to drinking water, management of municipal waste and discharge and treatment of wastewater still needs improvement. Many of these public services, which were performed by an average of 62 providers in the last year, are questionable.²⁸ Most of them are organised similar to public enterprises, the ownership of which is fully municipally owned or they are service units run by local authorities. The rest are companies, which are either 100% owned by private capital or which have mixed ownership. Through supervising cost efficiency and directing municipalities into joint investment and enhancing the area of the provider of the

²⁷ Pošta Slovenije is in 100 % state ownership and was in 2002 transformed from a public utility to a public company.

²⁸ In comparison to other similar public services systems in this field in EU, the effective company for providing municipal public environmental protection service should supply at least 100,000 inhabitants.

public services, we wish to establish conditions for increased efficiency and higher expertise of providers, since the demands to be fulfilled grow higher with each year. Apart from the performance of local public services, most of the providers in Slovenia perform other (profitable) activities, which frequently mean inadequate transparency over the performance of public services. Rules on the pricing practices of the compulsory municipal public environmental protection services are in preparation, aiming to resolve these issues with a precise division of market and public activities costs.

In the area of the performance of municipal public environmental protection services, operational programmes will be devised by the end of 2004, aiming to provide work conditions, which will comply with requirements regarding the municipal waste disposal and discharge of municipal waste water in the priority areas.

Electrical energy

The holding company of the Slovenian power plants Holding Slovenske elektrarne²⁹ is the largest domestic producer of electricity with around half of national production, followed by the nuclear power plant Krško with around 40% of electricity production – the rest is produced by two-system thermal power plants and several smaller qualified producers. Qualified production³⁰ and other preferred dispatching³¹ production accounted for 11.2% of the total national electricity production in 2003.

In May 2004, amendments to the Energy Act were passed, providing the opening of the market for all non-household customers on 1 July 2004. The number of eligible customers, reaching around 8,000 before that date, rose significantly afterwards. Before 1 July 2004, eligible customers' total consumption reached almost 68% of the total national consumption in Slovenia, but this percentage has increased to around 75%, this also being the percentage of the market opening. In Slovenia, there is one transmission system operator (TSO, already legally unbundled) and five regional distribution system operator (DSO, account unbundled³²).

In 2003, eligible customers were able to de facto change their suppliers. Four Slovenian production companies³³ participated in the wholesale market, and a portion of the customers bought their energy abroad, mostly in Austria where the prices are a bit lower; but the limited transmission capacities in Austria mean limited net transmission capacity. 24% of Slovenian consumption was imported. The allocation of the cross border capacity is divided evenly between Slovenian and neighbouring transmission system operators. In 2003, following a tendering procedure, 16 eligible customers and 5 electricity producers got access to the cross border transmission capacities, and afterwards some were also allocated interruptible capacities. The Slovenian part of the capacities was divided according to published rules, following the pro-rata method. This method will be used until 1 July 2007, according to the changed dates for application in Slovenia of certain provisions of the Regulation 1228/2003. The method allows mainly the larger consumers (to import) or producers (to export) to be allocated capacities.

The retail market saw mainly five local distribution companies, comparable in size (from 37% to 10% of market share), providing for reasonable competition. Around 10% of distribution customers switched suppliers and prices for eligible customers slightly dropped.

²⁹ Since summer 2001, large hydro powerplants and two thermal powerplants are united in the holding company.

³⁰ From renewables, waste and powerplants with higher-than-average efficiency.

³¹ Co-generation and thermal power plant, taking advantage because of the use of domestic fuel up to 15% of primary energy.

³² Legal unbundling has to be performed by 1 July 2007.

³³ 58%, 32%, 6% and 4% of Slovenian production

Electricity was also traded in the organised market, within Borzen. In 2003, the traded quantities of electricity in the daily market increased by 45% compared to 2002 and represented 3.1% of national consumption. Due to a drought in the summers, electricity prices on average increased by over 50%³⁴, whereas the prices for eligible customers have dropped somewhat.

The setting of prices for tariff consumers, made by the government, is carried out in accordance with the Plan for raising the regulated prices in 2004 and 2005, a part of the government's anti-inflation policy. On 1 July 2003, the Slovenian price for electricity for a typical household consumer with about 3500 KWh of annual consumption not including tax was about 15% lower than the average price for EU-15, and based on the data from the Ministry of the Environment, Spatial Planning and Energy the domestic prices for eligible industrial consumers have dropped in the last year, but are still lagging behind the European average prices for household consumption.

Natural gas

With the adoption of amendments to the Energy Act in April 2004, Slovenia has duly transposed the requirements contained in the Directive on the internal natural gas market into its national law. Based on the amendments to the Energy Act, there is now the required legal and functional separation of the activity of the natural gas transmission network operator from other commercial activities. Access to the network is no longer negotiated; it is regulated. The methodologies for the determination and accounting of tariffs in transmission and distribution have to be established by the Public Agency of the Republic of Slovenia for Energy (national regulator) by November, in agreement with the Government, on the basis of which system operators of the transmission and distribution networks will calculate the tariffs which will then be approved by the regulator. As of 1 July 2004, all non-household consumers have become eligible consumers, while households will become eligible consumers as of 1 July 2007.

The situation in the natural gas supply has not changed since January 2003 despite a 50% openness of the market. There is still only one supplier for major industrial consumers and distributions; as of 1 January 2005, this supplier will no longer perform the tasks of the transmission system operator. Apart from this, there are long-term contracts for natural gas supply until 2007 that the majority of consumers have concluded with this supplier. Since Slovenia is expected to increase natural gas consumption by around 70% (chiefly due to new gas-fired power generating plants) by 2015 in accordance with the national energy programme, there exists a possibility of new suppliers (primarily for new consumers). In accordance with these plans, the system operator will develop the network so as to enable access to the planned new consumers.

Transport Policy

In July 2004, the government adopted a Resolution on the Transport Policy of the Republic of Slovenia, which identifies activities imperative to eliminate discrepancies in the development of the transport system in Slovenia to date, and also lays down the time schedule in which these discrepancies must be eliminated.

Rail Transport

Since Slovenia joined the EU, the entire freight rail transport, including combined transport, has operated as a commercial activity, while passenger transport has remained a public

³⁴ Increased prices were the result of increased demand for energy needed for cooling, and the combination of draught and low hydro powerplants production meant that the missing electricity was produced in the more expensive thermal powerplants.

service obligation. Access to public railway infrastructure has been liberalised, in alignment with the EU rules. Licences to operate rail transport, issued in the EU, are recognised in Slovenia.

The public company Slovenske železnice (Slovenian Railways – SŽ), having been transformed into the Holding Slovenske železnice, is still the only transport company in Slovenia. Three subsidiary companies, designated by statute, have been registered: for passenger transport, freight transport, and a subsidiary for the operation and maintenance of public railway infrastructure. With the adoption of the Act Governing the Reorganisation of the Slovenske železnice Holding, which enabled the increase of the company's capital, refinancing and restructuring of loans and ensured financial funds for the reorganisation of personnel, the financial situation of the company has improved. The Railway Directorate has been transformed into the Public Agency for Rail Transport, which has been assigned the task of managing public railway infrastructure. The Agency has thereby assumed the functions of an infrastructure manager, in compliance with European legislation.

The adoption of the second package assures its implementation in the coming two-year period, and predicts the direction of operations in the future. Extension of the liberalisation of access to the entire railway network, establishment of the European Railway Agency and of a regulatory body in all member states, as well as all the other requirements from this package will require modifications of national legislation in the area of railways.

Road Transport

Road freight transport is geared to the market. In Slovenia, the majority of goods are transported by road. Thus in 2001, 65 million tons of goods were transported by road, while 15 million tons by rail. In compliance with transport policy, a decrease in the volume of goods transported by road is expected by 2010, accompanied by an increase in the volume transported by other modes of transport. With Slovenia's entry into the EU, Slovenian haulers operate on the single European market in a more competitive manner and without the numerous barriers and restrictions they faced in the past³⁵.

In public passenger transport, the cancellation of interurban and suburban services has stopped, in part also due to subsidies for regular passenger transport; nevertheless, the number of transported passengers continues to decrease. In 2004, a Decree on the concession granted for the operation of the public service obligation of public regular passenger services in internal road transport was adopted; and concession contracts with transport operators have already been signed for a period until 2008. These transport operators will be receiving, until the end of 2004, a supplement of SIT 50 (EUR 0.2 per each kilometre travelled, which represents a doubling of the previous subsidy); as from January 2005, the level of the supplement will depend on the difference between expenses incurred and revenues generated in individual services, calculated for each kilometre travelled. Slovenia has thus shifted from a system of subsidies provided to public passenger transport to a system of operating and co-financing a public service obligation for the operation of this transport. In the future and in compliance with the transport policy in 2004 and 2005, a public transport passenger act will be adopted, governing in a unified manner the entire area of passenger transport in various modes of transport.

Maritime Transport and Air Transport

In 2003, the Port of Koper company transhipped over 11 million tons of goods in the area of the freight port of Koper. More than a third of the total volume of goods was transhipped for Slovenia's market; the rest of the goods were in transit. In compliance with the provisions of

³⁵ Permits and other authorisations, prohibition of cabotage, etc...

the Maritime Code, the first concession contract for the operation, management, development and regular maintenance of port infrastructure will be concluded with the above company. In recent years, the volume of freight and passenger port transport has been increasing³⁶; the increase of capacity will be further enhanced through relevant links onto road and railway infrastructure.

In 2004, a public company, Kontrola zračnega prometa Slovenije, d. o. o. was established, providing air traffic services, air information services and an air telecommunications service, as a compulsory, national public service obligation. Regulatory tasks are thus separated from the operation of public services.

II.C. THE BUSINESS ENVIRONMENT

To create a corporate-friendly business environment the following factors are of key significance: incentives for entrepreneurship, reduction of administrative barriers, adequate tax legislation and reforms to improve the efficiency of the institutional regulatory framework and public administration.

The institutional framework in Slovenia is improving, though not at a steady pace. An improvement was recorded in 2003 by international research, the IMD World Competitiveness Report 2004³⁷, indicating increased values for three aggregate competitiveness indexes: performance of the economy, government efficiency, and infrastructure, whilst the value of the fourth aggregate index – corporate efficiency – dropped. The World Economic Forum Global Competitiveness Report 2003-2004 shows a slightly higher aggregate growth capacity index (GCI) for Slovenia, even though the country is ranked lower than in previous years – 31st; the public institutions which determine the business environment recorded a lower value and dropped to rank 35. The business competitiveness index (BCI) ranks relatively low, 30th, and as part of this index the quality of the national business environment dropped to rank 34.

Fostering entrepreneurship and reducing administrative barriers

In 2004, Slovenia continued to implement Programme of Measures to Promote Entrepreneurship and Competitiveness 2002-2006. This year the following two laws on the promotion of entrepreneurship and small and medium-sized enterprises were adopted: the Act on the Support Environment for Entrepreneurship, and the Act on Revisions and Amendments to the Small Business Act. The building of the VEM system (one-stop-shop system) also continued.

The Entrepreneurship Environment Support Act is an important step forward in establishing an entrepreneur-friendly environment. By stipulating public authorisations for services and connections among institutions, the new Act provides for strengthening of the service network that supports entrepreneurs in the entire area of Slovenia. This will increase the transparency and efficiency of state investments in the field of promoting entrepreneurship.

One of the instruments for the promotion of entrepreneurship is strengthening the role of the Public Fund for Development of the Small Business Sector, which with the existing funds of SIT 10 billion in the period 1996 – 2002, on average annually supported about 200 projects in an amount close to SIT 7 billion and thus provided for over 500 new jobs. By developing new services, guarantees, starting capital and risk capital for enterprises, the financial potential of the Fund will increase in the future in synergy with other financial institutions (banks,

³⁶ From 1995 until 2003, on the average 40,000 passengers yearly travelled by public maritime passenger transport, although maritime passenger transport is operated only during the relevant season. The setting-up of a modern passenger terminal has been foreseen in Koper.

³⁷ IMAD: Economic Mirror, volume 3/2004, p. 3.

international financial institutions, funds). According to the Single Programming Document, structural policy funding is earmarked also for co-financing instruments (guarantees and premiums) for promoting investments into small and medium-size enterprises that are carried out by the Public Fund for Development of the Small Business Sector.

The Act stipulates the establishment of a system putting in place the institutions of innovative environment, technological parks, incubators and technological centres. The state has been supporting such activities in the past through public tenders and incentives for promoting joint development projects³⁸. By defining such institutions, the new Act provides for a better transparency of public spending for that purpose, since it sets apart the services for development and knowledge transfer for groups of enterprises as a public function, and the implementation of development projects for enterprises as a state assistance.

The Act also provides the basis for the use of funding from the structural funds. The funds of the European Regional Development Fund (ERDF, ERDS) are designed to complement the existing funding of the Government in the field for projects such as better connections and faster transfer of knowledge to the business sector, the development of new financial instruments (guarantee schemes) and the provision of better access to services for SMEs (VEM, the voucher system). The Act complements the legal framework for the implementation of the planned measures by a legal definition of the programme basis (the procedure for preparing and adopting the Programme of Measures for the Promotion of Entrepreneurship), and by providing a legal basis for the establishment of implementation infrastructure needed for an efficient use of structural funds. The latter is also an important EPD goal designed to prepare for the following financial period of 2007-2012, since adequate implementation institutions will be one of the key conditions for obtaining and spending an amount of funding that is expected to be larger than the current one.

The Act on Revisions and Amendments of the Small Business Act has liberalised the small business sector in those areas that guarantee equal conditions to the small business on the common European market. The new Act stipulates that the craftsman's license may be granted to anybody who has at least finished higher vocational education in the appropriate programme and has at least three years of experience. There are no more qualification conditions for engaging in similar crafts. Furthermore the Act outlines the basis for determining the membership fee and an indicative structure of the Chamber's bodies. The latter should contribute to a more representative presentation of the small business sector. Currently, regulatory decrees are being drafted, aimed also at the elimination of unnecessary administrative barriers.

The VEM system (one-stop-shop system) has three elements – the info point, the support point and the registration point. The first two elements have already been put in place. The info point is designed to exchange business information through the Slovenian business internet portal and the small business promotion network. The support point is designed for the implementation of the subsidised advisory system, the so-called 'voucher' advising³⁹. The registration point in the VEM project has started to be implemented and will make it possible to register an enterprise in just one state institution. The VEM project will enable the registration of an enterprise to be carried out within 14 days.

³⁸ In 2003 the state supported three technology parks, two incubators, 28 technological centres, 11 clusters, 4 technological networks.

³⁹ The basic services in the programme are general and specialised entrepreneurial advising. The access to the programme of voucher advising is granted through the Small Business Development Centre in cooperation with the network of selected local and regional business centres. The funding for the instrument of subsidised advising (voucher for operating small and medium-sized enterprises) has been earmarked in the Single Programming Document from the structural policy funds.

The efficiency of public administration

In the last year, the operations of public administration were oriented towards the implementation of systemic legislation⁴⁰ and of the Slovenian public sector development strategy until 2005. The basic problem has been related to the introduction of new public management principles into administrative organisational culture and to the acceptance of new features brought to the employees by the new legislation, which is why a large emphasis has been placed on employee training and on human resources management. In individual parts of public administration, the organisational structure and work organisation have not yet been adapted to business processes. The Act on the Public Sector Salary System is not yet entirely in operation, as the key provisions of the act are linked to negotiations with social partners, which are intensely under way. Furthermore, the implementation of the Civil Servants Act has shown some weaknesses in practice, which is why modifications of the act are envisaged. In the future, the government plans to define more clearly the status of public institutions and public enterprises, as the acts to regulate this field at the normative level are still in preparation phase, and to include the public in the adoption of regulations to a greater extent.

Progress has been made in the field of human resources management (systematic monitoring of working and professional qualities and work assessment as the conditions for promotion) and in the provision of formal conditions for higher efficiency of administrative procedures and better accessibility of administrative services to the users. With the entry into force of the amendment to the Act on General Administrative Procedure, electronic transactions with customers are being introduced and procedures are being simplified as a result of the removal of administrative barriers. At the local level of operation of administrative bodies, performance and efficiency measuring has been initiated, with the key criteria being customer satisfaction, satisfaction of employees and the ratio between the solved administrative matters and operation costs. Delays in administrative matters at the local level have mostly been eliminated.

In accordance with the Act on Access to Information of Public Nature, the persons authorised to access such information have been determined and catalogues of information of public nature have been drawn up, which guarantees better transparency of public administration transactions.

The above mentioned is in line with the measures to remove administrative barriers in 2004, adopted by the government on the basis of the study by the public administration reform project group, which include simplification, unification and uniformity of procedures, as well as larger possibility of choice and better openness and transparency with regard to the functioning of administration.

Tax policy

In terms of the share of collected taxes in GDP, the Slovenian tax system is competitive with those of the EU Member States, since in 2002 the share of collected taxes in GDP totalled 39.8% in Slovenia compared to 40.4%⁴¹ in EU-25. The objective of the tax reform carried out this year is the restructuring of direct taxes by reducing the tax burden of labour⁴² and

⁴⁰ State Administration Act, Civil Servants Act, Inspection Control Act, Act on Public Sector Salary System, Public Agencies Act

⁴¹ According to data received from Eurostat and calculations made by the Ministry of Finance.

⁴² According to the calculations of the Ministry of Finance, in 2003, taxes and contributions per one employed unmarried worker without children whose only source is a salary amounting to 67% of the average salary of a worker in the processing industry, amounted to 39.8% of total salary costs, which is by 2.6 percentage points more than the average in the EU-15 (37.2%) for the same year.

increasing the effective tax rate for corporate income tax so as to prevent the total tax burden from growing.

In the field of taxes, the year 2004 saw the completion of tax reforms required for Slovenia's entry into the EU and the final harmonisation with the *acquis communautaire*. A new system of charging VAT for transactions among EU member states and the adjustment of the excise duty system have been introduced. On 1 May 2004, excise duty on coal and coke was introduced in order to bring Slovenia's legislation into line with the new Energy Products Directive, while from 2007 excise duty will also be introduced on electricity. In compliance with the adopted legal frameworks⁴³, the level of excise duties on cigarettes is gradually growing. By adjusting excise duty levels for mineral oil and gas, the Government has, in the course of 2004, alleviated the adverse effects of the rise in oil prices on inflation and economic growth.

In the field of indirect taxes, the second half of 2004 leading into 2005 will see the continuation of adjustments (increase) of excise duties in compliance with the commitments undertaken during the pre-accession negotiations, and of the transposition into the national legal order of new solutions in European regulations.

In 2004, the government continued to complete the system of environmental charges. An environmental pollution tax was introduced in relation to old car scrapping; moreover, amendments to the existing regulations governing individual environmental charges⁴⁴ were adopted. Owing to Slovenia's entry into the EU, regulations have also been adjusted (environmental charges, motor vehicle tax) thereby introducing new ways of charging duties required for the functioning of the EU internal market.

In September 2004, the personal income tax threshold was raised by an amendment to the Payroll Tax Act, thereby disburdening both employers and labour costs chiefly in labour-intensive industries where salaries are the lowest. Before the amendment, the general taxable minimum accounted for 49% of the average salary, and has now risen to the level representing 62% of the average salary⁴⁵.

The year 2004 saw the implementation of direct tax reform through the adoption of the Personal Income Tax Act and the Corporate Income Tax Act. The new Personal Income Tax Act provides an alleviation of burden for taxpayers, in particular those in lower tax categories, and the equalisation of burdens in individual types of income. It will take effect in 2005 and the resulting budget revenue will therefore be lower by around 10%. The adoption of the new Corporate Income Tax Act has brought Slovenia's tax system into line with the EU requirements in the field of tax treatment of dividends, company restructuring, interest and royalties; it has also removed tax barriers for the operation of entities in the internal market. The reform of corporate income taxation will ensure a more consistent adjustment of a taxpayer's burden to its economic strength and thus prevent the escape of taxable base abroad. The aim is to ensure the neutrality of the tax system in the light of the organisational form taken by the legal entities, and the competitiveness of their operation in the market. The tax rate – 25% – remains unchanged. At the same time the tax on total assets of banks was abolished.

In 2005, a new real estate tax act will be adopted, entering into force in 2006. The mass real estate evaluation act and the establishment of a better-quality land cadastre and a new cadastre

⁴³ On 1 January 2004, it reached 57% of the retail price of the best-selling cigarettes in Slovenia's market and as from 1 July 2004, excise duty may not be lower than EUR 50 for 1000 cigarettes of the best-selling price category. Excise duty will continue to increase once a year (1 July) in order to reach, by 1 January 2008, the minimum excise duty specified in European regulations.

⁴⁴ Excise duties on mineral oils and gas will continue to remain one of the instruments to curb inflation. In the area of imposing environmental charges, the Government will continue the established policy of completing the system of environmental charges.

⁴⁵ The taxable minimum has been raised from SIT 130,000 (EUR 542) to SIT 165,000 (EUR 688).

of buildings will provide a basis for the introduction of the above tax. Through the imposition of the real estate tax, compensation for the use of building plots and property tax of natural persons will be abolished. The existing system will be replaced with a uniform system of real estate evaluation and tax liability assessment at the national level. No significant change in the tax burden of individual real estate is expected. The financial effect of changes will, therefore, depend chiefly on the completeness and quality of data in real estate cadastres.

II.D. INVESTMENT IN A KNOWLEDGE-BASED SOCIETY

A knowledge-based society is determined by a range of interconnected factors. These factors are above all the generation and transfer of knowledge to all segments of the economy and society (investment in research and technological development, the information society, and education). Progress has been made in all these fields, but an active and coordinated policy is still required, aimed in particular at establishing an institutional framework and introducing new instruments and mechanisms, which will allow all fields to operate at a high level of quality.

Research, technological development and innovations

In 2002, expenditure for research and technological development (R&D) in Slovenia amounted to 1.53% of GDP (EU 2001: 1.93%). Although investment in R&D in Slovenia is at a lower level than the European average, it is nevertheless the highest among the new member states and it surpasses investment in some old member states. In the structure of funding R&D in 2002 the business sector contributed the largest level with 60%. The structure of researchers (in FTE) according to the sectors of employment in Slovenia compared to the EU average shows a lower level of researchers in the business sector (2002: 34.9%) compared to the higher percentage in governmental and the higher education research sectors (2002: government – 32.2%, higher education – 29.4%). Slovenia is also behind the European average in the number of researchers (in FTE) per 1000 active population (2002 SLO: 4.7; 2001 EU-15: 5.7). Nevertheless, the Slovenian R&D community is efficiently participating in the European research area (in the 6th Framework Programme in 2003 it reached the most successful countries) and it similarly successfully participates in the COST Programme and the industrial research programme EUREKA.

In accordance with the Act on research and technological development from the year 2002, by the end of 2003 and at the beginning of 2004 two public agencies were established, namely the Agency for research activities and the Agency for technological development. On the basis of the same law the Council for science and technology was also established, chaired by the President of the Government, and based on a partnership between the business and public sectors it has already adopted some operative decisions concerning the priorities of future research funding. In 2004 the preparation of the new National research and development programme was further elaborated, which, among other things, will determine the policy and priority orientations of research and technological development in Slovenia in the next 5-year period.

In 2004 an Act on taxes on income of legal entities was adopted, entitling companies to a reduction of taxes amounting to 10% of the invested amount in equipment and an additional reduction of taxes amounting to 10% of the invested amount in equipment for research and technological development. This law also introduces also tax relief for the employment of Ph.D.s in companies, with a decrease in taxes amounting to 30% of salaries of newly-employed Ph.D.s for the first 12 months of their employment.

A novelty in the cooperation between industry and the research community was the decision adopted in 2004 to finance (within the European structural regional fund) the establishment of

8 to 9 centres of excellence in priority areas, intended to connect institutions of knowledge and the leading industrial subjects, and a programme of financing the purchase of research and laboratory equipment in public research institutions. There is also a new programme of targeted research projects in the area of defence and security, adopted at the beginning of 2004.

In 2003, measures were adopted to increase the investment of public funding for R&D, which particularly increased the investment of public funding in applied research and targeted research projects. The mentioned measures also included an increase of public funding for the creation of a stimulating environment for investment in R&D by the private sector, for the stronger connection of the public research sphere with the private sector and for the transfer of knowledge from public research organisations into industry.

Information society

Internet penetration saw continued growth last year, with 47% of the population using the internet by the end of 2003 (EU-15: 50%); 40% of users access the internet daily and another 40% weekly. 64% of households possess a personal computer, and internet access amongst households tripled during the last four years to reach 45% of households by the end of 2003. Narrowband access still prevails, as 55% of internet users still use dial-up modem access. The trend is clearly towards broadband, 20% of households are already connected to broadband access lines. Regardless of the relatively satisfactory coverage of the Slovenian territory, the digital divide will need to be continuously addressed and this applies to all aspects of the divide: regional, educational, social and economic. A set of measures has been prepared for this purpose within the economic and social cohesion programmes⁴⁶ and structural funds⁴⁷. More than 10% of the available structural funds have been allocated for information society projects in the 2004-2006 period.

While Internet access in schools is almost complete, Slovenia lags behind the EU average regarding the ratio of pupils per computer. In 2003, 18 pupils had access to one computer (EU-15: 10). At the same time, Slovenian teachers are far behind the EU average with regard to ICT integration in the teaching process⁴⁸ and the level of the teachers' special didactic skills, as well as the motivation of principals.

Access to the Public Sector Information Act was adopted in 2003, improving the interoperability and the access of public services in a substantial way. In introducing e-government services, Slovenia is only 0.9 of a percentage point below the EU-15 average (69%). The G2C (Government to Citizen) services in Slovenia stand 7.2 percentage points above the EU average, while G2B (Government to Businesses) is 9.1 points lower. The Government therefore launched an ambitious inter-ministerial programme of VEM system (One-Stop-Shops) and offered 157 electronic services to enterprises through the Government Centre for Informatics. Since this year, revenue taxes can be paid via the Internet by means of digital certificates.

Education and training

Following the systematic strengthening of the involvement of the younger population and adults in secondary and post-secondary education and training (including the increasing range of lifelong activities) the educational attainment of the population is being improved.

⁴⁶ Phare Economic and Social Cohesion Programs ESC: Improving digital literacy of unemployed, Life Long Learning and One-Stop-Shops.

⁴⁷ Information society activities are eligible as a horizontal priority in European Regional Development Fund (ERDF), European Social Fund (ESF) and European Agriculture Guidance and Guarantee Fund (EAGGF). In addition, vertical measures for broad band penetration (ERDF) and Life long learning (ESF) have been prepared.

⁴⁸ Data on computer usage in hours weekly in primary schools - SLO: 1.1 hours, EU-15 3.6 hours

The average year of successfully completed schooling of the active population has increased (also in industry and services with high added value) as well as the share of the younger generation with completed secondary school education. Educational attainment could be additionally increased (62.7% of the generation in 2002) by the intensified involvement of the younger population in tertiary education with a reduction of the drop-out rate and a shortening of the duration of tertiary education. In terms of the share of adults with tertiary education, Slovenia still lags behind the EU, and the gap has even increased.

Slovenia has developed some national schemes and measures in order to improve the education and training system. In the field of employment policy, the activities support the measures implemented by EU employment policy. Within this framework, two laws were adopted in 2004: the Act on changes of the law in higher education and the Act on post-secondary education. Both acts should contribute to the creation of the stimulative formal basis for intensification of the activities, which Slovenia is implementing within the framework of the Bologna and Brugge-Copenhagen process in tertiary education and training.

Measures that support national policies in the field of education and training are: (i) teacher training; (ii) modernisation and development of education and training programmes supply, (iii) further extension of local/regional centres of lifelong learning aimed at strengthening access to education and training; (iv) vocational guidance and counselling of youth and adults, especially women with uncompleted schooling; (v) the extension of the model of quality assurance system on the principle of self-evaluation, with special emphasis on adult education and vocational education and training.

Basic efforts in the field of education and training are therefore aimed at the intensified implementation of lifelong learning as the basic European instrument for ensuring the quality of education, educational attainment and increasing the employability of people and their chance of staying employed.

II. E. CAPITAL MARKET AND FINANCIAL SERVICES

The reform of the financial sector in the area of regulation and the harmonisation of the legal system with EU directives is proceeding well. In terms of the basic indicators of the level of development in the financial system⁴⁹, Slovenia has made progress since last year's report. As the key financial intermediaries, banks in recent years have made an intensive effort to develop a range of new services in addition to their traditional banking services. The consolidation process is still underway in the banking sector. In the last two years in particular there have been structural changes in the pattern of consumer saving, with a sharp rise in the number of mutual funds and the assets held by them. As part of the restructuring of the securities market, last year saw the conversion of the privatisation funds into ordinary public limited companies, while the small size of the market and the resulting poor level of competition is hindering faster development. Having joined the EU, Slovenia has now been included in the process of creating an integrated financial market in the EU, in line with the guidelines of the Lisbon Strategy and the Financial Services Action Plan.

Development of regulations and legislation for financial markets and financial institutions

There were more laws and amendments adopted in 2004 in the area of financial markets, financial institutions and oversight of these that entail further harmonisation with the *acquis*

⁴⁹ In 2003 banks' total assets (including savings banks and savings and loan undertakings) were equivalent to 89.5% of GDP, while insurance premiums were equivalent to 5.0% of GDP (compared with 4.8% in 2002) and market capitalisation was 23.4% of GDP (23.2% in 2002)

communautaire.⁵⁰ In March 2004 the National Assembly adopted the Act Amending the Payment Transactions Act with the aim of harmonising completely with the directive on cross-border credit transfers and the directive on settlement finality in payment and securities settlement systems. April 2004 saw the adoption of the Act Amending the Insurance Act, whose main aim was to harmonise the insurance sector with the EU directives adopted after 2000,⁵¹ and the Act Amending the Investment Funds and Management Companies Act, which entails final harmonisation with the directive on collective investment undertakings, which governs management companies and the simplified prospectus. The second act abolished the restrictions on investment funds' holdings in securities issued by persons outside EEA countries, and introduced the institution of custody, regulating the delegation of custodian services, which allowed for the clearing and settlement of transactions concluded in such securities via other clearing and settlement systems, and not merely restricted activities of this type via the single national system. This arrangement has promoted integration with the financial markets of the EU.

July 2004 saw the adoption of the Act Amending the Securities Market Act, expanding the powers and responsibilities of the Securities Market Agency in the prevention of insider trading and the measures it can take. This law has transposed the provisions of the EU directives on misuse of the market, including the ban on insider trading and the ban on market manipulation. The handling of insider trading insofar as it concerns other EU member states has been simplified, greater transparency has been ensured, and a regime of mutual and cross-border cooperation by Slovenian regulatory authorities has been established in the prevention, detection and sanctioning of misuse of the market and in the supervision of the capital market. The law also expanded the range of services that stockbroking companies are allowed to provide, from the acceptance of orders for buying and selling investment funds' investment coupons to the forwarding of such orders to management companies. The previous activity of trading is now placed among trading services, which are the subject of licensing and thus form the basis for the recognition of this licence throughout the EU and the provision of these services by domestic stockbroking companies and banks merely on the basis of notification throughout the EU. The restriction on trading securities issued by companies based in Slovenia, on the securities market in Slovenia only, was also abolished.

Amendments to the Act Regulating the First Pension Fund of the Republic of Slovenia and the Conversion of Privatisation Funds have also been adopted, allowing the manager of a pension fund to act more efficiently and with less hindrance to the benefit of the fund members, while a Legal Successors of Privatisation Funds Act is under preparation.

Amendments to the Securities Market Act will be drawn up in the last quarter of 2004 to transpose into the Slovenian legal system the provisions of the prospectus directive and certain provisions of the directive on the transparency of the operations of issuers of securities traded on the organised market. In 2005 preparations will begin for a new Securities Market Act to transpose the provisions of the directive on financial instruments markets (ISD2) and the remaining provisions of the directive on the transparency of the operations of issuers of securities traded on the organised market into the Slovenian legal system (the directive is yet to be adopted). Transposing the ISD2 directive will abolish the concentration rule and will introduce multilateral trading facilities, which will increase competition for organised securities markets. This directive will also give investment firms (stockbroking companies and banks) the same right as to organised markets to choose the system via which they could

⁵⁰ The basic laws governing this field are the Banking Act, the Insurance Act, the Securities Market Act and the Investment Funds and Management Companies Act, which are in accordance with the *acquis communautaire* for financial services as it applied when they were being drawn up

⁵¹ The directives on life insurance (consolidated), which also contains provisions from the directive on the required capital adequacy for insurance undertakings conducting life insurance transactions, the directive on the capital adequacy of insurance undertakings in non-life insurance, the directive on the bankruptcy and liquidation of insurance undertakings and the directive on insurance mediation and brokerage

settle concluded securities transactions, which will contribute to increasing the effectiveness of various securities markets and settlement systems, strengthening competition and removing the obstacles that still exist. The upcoming prospectus directive will entail the mutual recognition of the prospectuses of securities issuers from different member-states, thus abolishing national restrictions on companies' access to other capital markets for financing purposes. The Government is to discuss the Act Amending the Securities Market Act and submit it to the National Assembly for reading in the first half of 2005.

Also under preparation are a financial conglomerates bill, which entails the transposition of the EU directive on the supplementary supervision of credit institutions, insurance undertakings and investment firms in a financial conglomerate, and a mortgage banking bill, which is needed to resolve legal and systemic questions connected with mortgage banking and to improve the effectiveness of financing for house-building in Slovenia. The latter is aimed at developing mortgage banking and, within this context, the issue of mortgage bonds in Slovenia.

Restructuring of the financial sector

Banks remain the most important financial intermediaries on the Slovenian market. At the end of 2003 banks accounted for 81% of the total assets of all financial institutions on the Slovenian financial market (insurers and reinsurance companies, stockbroking companies, mutual funds, investment companies, privatisation funds, mutual pension funds and pension companies are included in addition to banks).

Slovenia's banking sector is stable and performing well, despite foreign competition and the falling trend in both lending and deposit interest rates, particularly in 2003, which is also confirmed by the indicators for the banking sector.⁵² In recent years, alongside traditional banking services, banks have been intensively developing investment banking services, different forms of saving, banking insurance services, e-banking and telephone banking. In line with this the structure of banks' revenues is changing, with the proportion of non-interest revenues rising – which is one of the indications that Slovenia's banking system is converging with the international system. Financial services for SMEs and venture capital services are still lacking in development.

The total assets of the entire banking sector amounted to SIT 5,123 billion (EUR 21,643 million) at the end of 2003, equivalent to 89.5% of GDP. There was no change in the number of banks on the Slovenian market in 2003 (there were 20 banks on the market), and there were no major changes in market concentration, with the largest bank retaining its share of 34% of banks' total assets.

The structural changes in consumer saving as a result of falling bank interest rates and the rise in prices on the Ljubljana Stock Exchange resulted in a rise in the influx of money into mutual funds, which reached 55% of the net influx into tolar and foreign currency savings at banks (excluding sight deposits, compared to 32.5% in 2002), with the assets value of mutual funds rising by 67%. Banks and other financial intermediaries responded to the changing habits of consumers by establishing new funds, with their number rising by two in 2003 and seven more funds starting up in the first half of 2004.

With the privatisation of the largest bank (NLB) and the sale of a 34% interest to Belgian bank KBC, a 5% interest to the EBRD and a 0.3% interest to institutional investors (9% of the shares were offered to them), a stable ownership structure was attained with one-third

⁵² The total assets of the banking sector as a proportion of GDP have been rising for a number of years, while operating expenses as a proportion of average assets have been falling, reaching 2.7% in the first half of the year. The interest rate margin as a proportion of interest-bearing assets has also fallen, and in the first half of the year was 0.2 of a percentage point lower than in the same period last year at 2.7%, while the proportion of uncollectable assets remains at a low level

belonging to the state, one-third to the key investor and one-third to portfolio investors. In the case of the second-largest bank (NKBM), the Government opted for consolidation with its interest in Poštna banka Slovenije. The proposed link-up should contribute to consolidation in the banking sector in Slovenia, as the two affiliated banks will control a market share (in terms of total assets) of 13.4% (NKBM 11.4% and PBS 2%). The synergy of the banks' link-up will be seen in lower operating expenses, a rationalisation in the backroom departments and information technology, the elimination of duplicated bank counters, and faster, higher-quality and better-targeted client service.

The Government issued two rulings on the basis of the Ownership Transformation of Insurance Companies Act in 2003, namely the ruling on the coordination of capital ratios at Zavarovalnica Triglav and the ruling determining equity capital holdings in the unregistered capital of Zavarovalnica Triglav and the eligible beneficiaries of such holdings, which began the process of privatising the largest Slovenian insurer.

The total assets of insurance and reinsurance companies on the Slovenian market amounted to SIT 588 billion (EUR 2,487 million) at the end of 2003, equivalent to 10.3% of GDP. In the insurance sector the largest insurer controls a sizeable proportion of the market, its share in 2003 being 42.6% as measured by gross earned premiums. In line with the development of the insurance sector, insurers are achieving the most rapid growth in earned life insurance premiums, which as a proportion of total premiums are still behind those in wealthier European countries (20% in Slovenia). In terms of premiums earned from property insurance the Slovenian insurance sector is above the EU average (3.3% of GDP in the EU-15 in 2002, 4.0% in Slovenia in 2003). Life insurance and pension insurance, hitherto lacking in development, are showing considerable growth. Life insurance accounts for the majority of the growth in gross insurance premiums as a proportion of GDP. Gross insurance premiums in Slovenia were equivalent to 4.7% of GDP in 2001, 5.0% in 2002 and 5.1% in 2003. In the EU-15 the figure was 9.1% in 2001, while the average for the ten new members was 3.5% of GDP.

The market capitalisation of shares on the Ljubljana Stock Exchange (excluding investment funds) reached SIT 1,340 billion (23.4% of GDP or EUR 5,660 million) by the end of 2003. There were four fewer shares listed on the exchange at the end of 2003 than at the beginning, while the number of shares on the OTC market rose by one share issue. A major development on the Ljubljana Stock Exchange in 2003 was the conversion of the privatisation funds into ordinary public limited companies. The conversion of the privatisation funds resulted in 14 additional ordinary share companies on the OTC market at the Ljubljana Stock Exchange. A major obstacle on the securities market, one that makes domestic businesses uncompetitive in this area, is the small size of the national securities market and the low profile of Slovenian financial intermediaries in the EU, and thus also the high unit cost owing to a lack of economies of scale.

In March 2004 the Government approved a new version of the Consumer Credits Act, aimed at better protection for borrowers. The new version places restrictions on a number of exemptions to which the law has not thus far applied, and expands the powers and responsibilities of the Office for Consumer Protection in issuing licences for consumer lending. One of the bill's proposals is a maximum effective interest rate, and another new feature is that those convicted of fraud or usury will no longer be able to obtain a licence for lending. The bill also redefines the concept of consumer mortgage agreements, makes a notarial protocol a requirement and gives the notary's obligations, as well as gives a detailed definition of the net credit value. February 2004 saw the adoption of the Protection of Apartment and House Buyers Act, which envisages custody accounts and custodian services by banks on the basis of contracts concluded between a custodian notary, a custodian bank

and the housing seller as a possibility for protecting buyers against the risks involved in purchasing real estate.

III. ENVIRONMENTAL SUSTAINABILITY

A new Environmental Protection Act was adopted this year regulating the protection of human existence with the inseparably linked natural environment and general conditions of the use of natural resources. The most important innovations of the new act are the introduction of strategic environmental assessment, the environmental protection licence for the operation of installations, the strengthening of public participation and rights of access to environmental information, and the systematic improvement of the economic instruments of environmental protection with the aim of putting into practice the ‘polluter pays principle’.

On the basis of the Environmental Protection Act several specific regulations are already in force, setting forth the emission and immission limit values and other specific rules, environmental impact assessment, monitoring of the state of the environment and environmental pressures, environmental taxes and other issues. The Government has recently adopted the new National Environmental Action Programme for the period until 2008. The general aim of the programme is the general improvement of the state of the environment and the quality of life and protection of natural resources.

In accordance with the provisions of the new Environmental Protection Act, the ‘polluter pays principle’ is one of the major principles of the environmental protection policy. It includes the obligation that the polluter must pay the entire costs of the legal measures adopted to reduce pollution as well as the measures for risk management, use of natural resources and sanitation of environmental pollution. Implementing the polluter pays principle has in the last few years become a very important source of finance for the environmental protection policy. Until today, the following economic instruments have been introduced in Slovenian environmental protection policy: waste water tax, water abstraction charges, CO₂ tax, landfill tax, tax on used end-of-life vehicles, tax on lubricants. The revenues from environmental taxes amounted to SIT 41 billion (EUR 175 million) in 2003 which represented 1.4% of total tax revenues and 0.6 % GDP⁵³.

Intensified actions to implement the scheme for emission trading started already in 2004. In September, the Slovenian Government adopted the National allocation plan for the period 2005-2007. On the basis of this document, the Ministry of the Environment will allocate allowances free of charge to operators of installations⁵⁴ where activities causing green house gas emissions are carried out until the end of 2004.

In 2003, the Ministry of the Environment, Spatial Planning and Energy prepared an Action Plan for Reducing Greenhouse Gas Emissions; on the basis of the recalculated greenhouse gas (GHG) emission inventories for previous years, the Action Plan was corrected accordingly in 2004. It was estimated that the implementation of the relevant EU legal acts, whose aim is to reduce GHG emissions, will suffice to reach the goal of reducing emissions by 8%. Currently, a number of measures for emission reductions are being implemented, e.g. a CO₂ tax, the promotion of efficient energy use and the use of renewable energy sources, energy labelling of house appliances, thermal insulation characteristics of building materials, waste management, power and natural gas trading, informing consumers on CO₂ emissions from motor vehicles, promotion of bio-fuels, excise duties on fossil fuels and power.

⁵³ IMAD: 2004 Spring Report and EIPF: 2003 Economic Trends

⁵⁴ These are operators who are obliged to obtain permission for the emission of GHGs in order to operate these devices, in compliance with the provisions of the new Environment Protection Act.

The National Energy Programme has been adopted this year. Long-term strategic policies also include reduction in energy intensity⁵⁵ (2.3% yearly) which was achieved in 2003. The main measures to increase energy efficiency are: introduction of an energy tax, tax on CO₂ emissions, financial incentives for environment-friendly production⁵⁶, dissemination of information and awareness-raising for energy consumers, energy advisory network, promotion of performance of energy services (contract-based energy saving or energy supply, demand side management) and support for research, development and demonstration projects.

IV. ECONOMIC AND SOCIAL COHESION

The issue of economic and social cohesion is specific in the case of Slovenia. As a region Slovenia reached 77% of the EU-25 level of economic growth, measured in GDP per capita (PPP), according to the latest Eurostat estimates for 2003, which shows a positive trend from the point of view of economic cohesion. The same applies to the unemployment rate (ILO methodology) which was 6.5% in 2003 and was lower than the EU average. Despite the relatively low variation coefficient in regional GDP⁵⁷, which according to IMAD reached 24.9% in 2002, the differences in development between the most developed part of the country (the Central Slovenia region) and the least developed part (the Pomurje region) amounted to a ratio of 1:2.05.

The promotion of a balanced regional development policy, which was established in 1999 and provides a solid basis for the promotion of endogenous development potential in the regions, especially by producing regional development plans and the establishment of regional development agencies as basic institutional structures, which provide links between the economic and social environment in the regions, is faced with a lack of legislative framework, which would accelerate the decentralisation, or at least a de-concentration of administration framework. This hinders the quality development of regional centres which, especially in the remote regions, do not have a critical mass for faster development.

The proposed system solutions are aimed at forming regional development councils as a form of private-public partnership, thus established on both the NUTS 2 and NUTS 3 levels. Within the active regional policy in 2003, SIT 9.5 billion (EUR 40.6 million) was earmarked for regional incentives for regions lagging most in development, increasing by almost half compared to the year before. Within the framework of horizontal policies of individual sectors there was also SIT 63.1 billion (EUR 270 million) of regional incentives earmarked for the implementation of regional development plans in 2003, which also increased by 7.4% compared with 2002.

The approval of the Single Programming Document 2004-2006 means further support for achieving economic and social cohesion amongst the Slovenian regions and an opportunity for balanced regional development, which will be realised through a spatial targeting approach, enabling increased welfare in the less developed, mainly peripheral regions. Realisation of all three SPD priorities – promotion of the productive sector and competitiveness, knowledge, human resource development and employment, and restructuring of agriculture, forestry and fisheries – is being implemented according to the subsidiarity principle, which emphasises the improvement of the competitive capabilities of Slovenian regions (on the NUTS 3 level) on the basis of concentrated allocation of funds of individual measures into the regions which lag the most in development.

⁵⁵ Energy intensity of Slovenia's industry decreased considerably in 1995-2002; however, not enough, in particular in the last two years of the above period (in 2001 it even slightly increased). This was the consequence of replacing hydroelectric power failure with bigger primary consumption of coal and nuclear energy, and expansion of energy-intensive industry.

⁵⁶ Subsidies, loans under favourable conditions, exemptions or tax relief.

⁵⁷ Variation coefficient is defined as a quotient between the standard deviation and the average, corrected according to the size of the regions.

As far as social cohesion is concerned, indicators adopted in Laeken show positive trends. The poverty risk rate for 2002, measured on the basis of income in cash and in kind, dropped compared to 2001 from 10.6 to 9.9 and is below the EU average. Disparity of income distribution by quintile classes ratio remained on the same level as the year before, and dropped slightly as measured by the Gini coefficient. The government adopted the National Social Inclusion Action Plan for the 2004-2006 period, determining further strategy and concrete measures for implementing social inclusion policy, based especially on accelerating employment inclusion and reducing dependence on social transfers, improving accessibility of education, housing and social services as well as providing assistance to the most vulnerable groups.

V. CONCLUSION

In 2004, the Government of the Republic of Slovenia continued its economic reforms whose common goal is the country's efficient integration into the EU in the sense of achieving nominal and real convergence and the Lisbon objectives. The most important measures were taken in the field of the quality of public finance (increasing the share of state subsidies for horizontal objectives, a major increase of budget funds allocated to science and technological development, accelerating economic activity, education, an active employment policy, and infrastructure), strengthening instruments which stimulate entrepreneurship, stimulating direct foreign investments (increased funds for non-repayable incentives, improved availability of infrastructure and building land in business zones), and taxation (adopted tax reform which reduces the tax burden of labour and introduces incentives for investment in R&D).

In June 2004, the Government adopted the draft Development Strategy of Slovenia for the first decade of its membership in the EU, launching a broad public debate on the strategy, which will be concluded by the end of year. The elaboration of the strategy was based on a comprehensive evaluation of the country's development achievements and weaknesses.⁵⁸ In the transition period, Slovenia managed to significantly reduce its economic gap with the EU. High and stable economic growth was achieved without major macro-economic imbalances. Growth has slowed down in the past three years, mainly due to unfavourable global economic conditions, but also because of the relatively slow restructuring of the economy. Analyses show that the slow restructuring of the economy has affected Slovenia's export competitiveness and consequently its ability to continue to achieve above-average economic growth (real convergence), while it was at the same time the main factor which kept inflation at a relatively high level (nominal convergence). Slovenia has managed to preserve a relatively favourable level of social development and numerous indicators show that it is at the average level of the EU-15. The level of social protection is increasing and the poverty risk level falling, whilst income inequality shows no increase. Life expectancy is increasing and the infant mortality rate decreasing. Weaknesses to be mentioned are the education level which is still too low, and inadequately targeted social transfers. The trend of growing regional differences, recorded during most of the transition period, has slowed down significantly in the past two years. A relatively high level of environmental development has been achieved, reflected in the relatively high share of renewable energy sources, the introduction of environment-friendly methods in agriculture and in the relatively low, though increasing, share of road freight transport. Energy intensity fell over the last decade, although the pace of reduction is slowing down; the unfavourable growth rates of the principal emission-intensive industries and intensive agriculture are reasons for concern

Slovenia's basic developmental objective is to exceed the average level of economic development in the enlarged EU within the next decade. This will enable the country to preserve and improve its level of social security, accelerate the development of all regions and

⁵⁸ See more in the Development Report 2004, IMAD. The report was submitted as an appendix to the national Report on Structural Reforms 2004.



improve the environment. This will result in a higher quality of living and integral human development. The draft strategy⁵⁹ outlines five key development programmes which are of essential significance for achieving the objectives: (i) more efficient use of knowledge for economic development and quality jobs; (ii) a competitive business environment and a more efficient and cheaper public administration; (iii) integral human development and quality of living; (iv) more harmonious regional and environmental development; (v) asserting Slovenia in the world. After a public debate, which shall endeavour to achieve a wide consensus on development goals and required changes, the Government will adopt the final text with precisely defined goals, measures, and the responsible institutions.

⁵⁹ A translation of the draft strategy was submitted as an appendix to the Report on Structural Reforms.

SUPPLEMENT

FOLLOW UP ON THE RECOMMENDATIONS SET OUT IN THE BROAD ECONOMIC POLICY GUIDELINES

For the first time, the updates of the 2004 BEPGs include country-specific guidelines for the ten new member states. This supplement presents a brief survey of the measures adopted by Slovenia last year in response to the recommendations.

The BEPGs for Slovenia included the following concrete recommendations:

- a) lower inflation in a sustainable way;
- b) increase employment rates, especially for older workers;
- c) improve conditions for sustained productivity growth; and
- d) promote the development of effective competition in all segments of the economy, notably in network industries.

Ad. a) Lower inflation in a sustainable way

The key objective of Slovenia's economic policy is to reduce inflation to a level that would ensure meeting of the Maastricht criteria and the adoption of the euro in 2007. In June 2004, an important intermediate goal was achieved, i.e. earliest possible entry to ERM-II. The gradual reduction of inflation, which started in 2001 and improved in 2003, is continuing in 2004. The growth of consumer prices fell to 4.6% at the end of 2003 (from 7.2% at the end of 2002), and was 3.3% in September 2004. The reduction was the result of the coordinated and restrictive economic policies of the Government and the Bank of Slovenia, which will continue in the following years. The Bank of Slovenia stabilised the exchange rate of the tolar after the entry to ERM-II, thus eliminating its considerable effect on prices. The Government continued to implement restrictive policies in the field of administered prices (in accordance with the plan for raising administered prices in 2004 in 2005, their total growth should not exceed the growth of market determined prices), and eased their direct and secondary impact on inflation through counter-cyclical adjustment of excise duties on liquid fuels. The adopted Social Agreement ensures that future wage growth will not cause additional inflationary pressures on the demand side. In the field of social transfers, the Government shifted their adjustment from past inflation to expected inflation, and in wages policy the expected inflation is only one of the elements taken into account in wage negotiations (besides the achieved productivity growth and inflation in the Euro zone). Indexation was completely abolished in financial contracts.

To preserve the sustained growth of administered prices, i.e. their long-term sustainability, the continuation of structural reforms in public services, financial markets and the labour market will be of key significance. Liberalisation in the field of public services is under way and so is the forming of effective regulation. The objective of these reforms is to create competition in sectors where it is not yet sufficiently present, especially in the field of distribution and sales of petroleum products (liquid fuels for transport and heating), basic utility services and, in part, also in the telecommunications and electrical energy sectors.

Ad. b) Increase employment rates, especially for older workers

- review the tax and benefit systems
- foster active ageing, notably by including the older population in life-long learning programmes
- stimulate temporary employment

The employment rate in Slovenia continues to stagnate and slightly lags behind the average of the EU-15, but it is higher than in the group of new member-states (with the exception of

Cyprus). The lower employment rate in the group of older workers is still affected by the early retirement schemes of the early 1990s. The average retirement age has been increasing for several years as a result of the pension reform, but it is still below the EU average.

As part of its active employment policy, Slovenia has introduced several measures to improve conditions in the labour market. Nearly all of these new measures are aimed at stimulating employment and creating new jobs through subsidies and tax incentives and even though they are linked exclusively to the employment of unemployed persons, they are aimed at employers. Furthermore, most of the funds (70%) are allocated to employment measures in regions with above-average unemployment rates. As of 2004, three special measures have been implemented to achieve higher activation and additional incentives for employment in target groups; these are aimed at employers and as such at boosting their labour demand. These three measures are: (i) promoting new employment for long-term unemployed persons, recipients of welfare allowances – a lump-sum subsidy; (ii) exemption of social contributions for employers who employ unemployed persons aged over 55; (iii) exemption of payroll tax and refunding of contributions to employers who employ unemployed persons with a university education. As part of the tax reform, the modified income tax brackets and the higher threshold for payroll taxes lowered the tax burden of the lowest income group, and this will also contribute to their employability.

Ad. c) Improve conditions for sustained productivity growth;

- reduce administrative barriers
- promote investment in R&D
- improve the quality of the tertiary education system

The 2004 data indicate higher productivity growth after the slowdown of last year. In spite of the fluctuations in recent years, the gap between Slovenia and average productivity in the EU continues to narrow, and it will be further reduced by faster restructuring of the corporate sector towards activities with higher value added.

Slovenia is aware that a favourable business environment requires a corporate-friendly administration and a reduction of administrative barriers. In the past year, two important acts were adopted with the view of promoting entrepreneurship and small and medium size enterprises; in addition, the VEM system (One-stop-shop) was further developed. The 2003 and 2004 budgets included an increase of public funds for R&D activities and the priority was on investment in applied and target research. Two public agencies were established in the field of research activities and technological development and the preparation of a new National Research and Development Programme continues. The programme will, amongst other things, define the policy and priorities of research and development activities in Slovenia in the next five-year period. In accordance with the Bologna Declaration, the modernisation and development of education programmes is continuing, including the post-graduate level.

Ad. d) Promote the development of effective competition in all segments of the economy, notably in network industries.

- strengthen the administrative capacity the Competition Protection Office
- ease the entry of new competitors in network industries
- facilitate the purchase of lands for industrial use

Liberalisation and privatisation are under way in the telecommunications and postal services, the electrical energy sector, transportation and other public services. The established independent regulators (agencies) are already operative, but they have encountered initial difficulties and their operations are still not sufficiently effective.



The legislation governing network industries was harmonised with European legislation in the past year and, with some exceptions, entry to the market is free. Regarding the implementation of the internal market directives, Slovenia (and Lithuania) have the lowest transposition deficit of the new member states. The Competition Protection Office which monitors the protection of competition regarding restrictive agreements, abuse of a dominant position and corporate concentrations, was given new authorities last year, and its administrative capacity is being enhanced. Competition exists in all segments of the telecommunications market, except for domestic calls in fixed telephony, where the institutional monopoly was abolished, but no competition has yet been established in practice. The deregulation of the electrical energy market separated the activities of production, transmission, distribution and supply, thus providing for competition in the industry market. Railway transport was transformed and the Slovenian Railways, a public company, was privatised. Slovenia's full membership in the EU also opened the market for foreign carriers. In order to increase the availability of building land for industrial use, Slovenia held a first tender for subsidies from the structural funds of the EU for the renovation, modernisation and development of public and utility infrastructure in business zones.