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SLOVENIA: Analysis of economic developments in 1999 and prospects for 2000 and 2001

2000 SPRING REPORT

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ANALYSIS OF ECONOMIC DEVELOPMENTS IN 1999 AND PROSPECTS FOR 2000 AND 2001

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SLOVENIA: Analysis of economic developments in 1999 and
prospects for 2000 and 2001
2000 SPRING REPORT

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Table of contents

List of tables

List of graphs

List of boxes

FOREWORD

The 2000 Spring Report provides an estimate of the economic developments and factors of growth underlying the Slovenian economy in 1999 and examines prospects for 2000 and 2001. The Report comprises six sections. An introduction and a short summary (Chapters 1 and 2), providing an overview of the current economic trends, future developments and traps of development, is followed by an overview of developments in the international environment (Chapter 3) which are having a strong impact on the economic situation in Slovenia due to the openness of its economy, and by a report on institutional changes (Chapter 4). A detailed survey and analysis of developments in different areas in 1999 and the first months of 2000 are presented together with short-term development projections for 2000 and 2001 in Chapter 5. Chapter 6 provides a look at other factors of development and presents other indicators measuring welfare and development. The next chapter presents the main guidelines and dilemmas of economic policy for the next two years.

For several years, the Spring Report has been prepared by the Institute of Macroeconomic Analysis and Development in the English and Slovenian languages. The Government uses it as one of its sources in preparing economic policy measures and drafting the state budget.

The Report has been prepared on the basis of data provided by information services (mainly the Statistical Office of the Republic of Slovenia (SORS), the Bank of Slovenia (BS), the Agency for Payments (AP)), expert estimates of other domestic and foreign institutes and international institutions. The SORS published the total system of national accounts for 1999 as early as in May. Based on that information, the Institute prepared new national account estimates for Slovenia for 2000 and 2001 in May.

The 2000 Spring Report has been prepared by: Maja Bednaš (editor, head of the project, summary, international environment), Alenka Kajzer (co-editor, summary, employment policy), Branka Tavčar (national accounts), Tanja Česen (investment, construction, SME), Pavle Gmeiner (technological restructuring, competitiveness of nations), Matjaž Hanžek and Marta Gregorčič (human development and value orientation), Slavica Jurančič (international competitiveness), Maja Kersnik Bergant and Peter Beltram (the individual - the agent of development and social integration), Rotija Kmet (production structure of gross domestic product), Jasna Kondža and Dušan Kidrič (public finance), Mateja Kovač (agriculture), Mojca Koprivnikar Šušteršič (hotels and restaurants, trade), Saša Kovačič (incomes policy), Tomaž Kraigher (employment and unemployment), Jože Markič (export-import flows and the balance of payments), Ana Murn (state aid), Judita Novak (performance of companies, institutions and legal persons), Janja Pečar (regional development), Jure Povšnar (electricity, gas and water supply, mining, transport and communications), Bojan Radej (the environment), Matija Rojec (foreign direct investment, enterprise sector restructuring), Ana Sečnik (manufacturing), Metka Stare (computer services and telecommunication), Duška Šavorn Radovan (structural policy), Ana Tršelič (private consumption), Janez Šušteršič (introduction), Boštjan Vasle (monetary policy, inflation), Luka Vesnaver (financial intermediation, household and company borrowings and savings), Ivanka Zakotnik (national accounts). Technical support (charts, statistical appendix, processing of statistical data from balance sheets and profit and loss accounts): Bibijana Cirman-Naglič, Marjeta Žigman, Vlado Mostnar, Dragica Kovač, Tina Kopitar.

Acronyms in the text have the following meanings: **AP** Agency of the Republic of Slovenia for Payments, **BS** Bank of Slovenia, **ELES** Electro Slovenia, **IER** Institute for Economic Research, **IMAD** Institute of Macroeconomic Analysis and Development, **MF** Ministry of Finance, **SORS** Statistical Office of the Republic of Slovenia, **Ur.l. RS** Uradni list Republike Slovenije (Official Journal of the Republic of Slovenia)

The Report is based on data available up to and including 2 June 2000.

1. INTRODUCTION

This year's general economic situation, as reflected by the main macroeconomic indicators, will be very much like last year's. Strong economic growth is set to continue (4%). This will be favourable to further employment growth (0.9%), while the current account deficit (3% of gross domestic product) and the general account deficit (1% of gross domestic product) are not expected to narrow. The average level of prices will be higher than last year (around 7.6% compared to 6.1%). The results may be similar to last year's, but they have been shaped by entirely different economic processes.

The main **lever of last year's economic growth** was strong domestic demand, within which capital formation rose the most. Private consumption rose at an above-average rate compared to previous years, despite wages rising below labour productivity growth. In the first half of the year, consumption was mainly driven by expectations arising from the introduction of VAT and remained at relatively high levels in the following period. Consumption was supported by a steep rise in loans, whereby companies borrowed abroad more than before. Information on domestic consumption trends is the most scarce of all gross domestic product components during the year, which is why the gross domestic product assessment based on quarterly gross domestic product by kind of activity has been substantially corrected upwards. Figures from financial statements helped to create a favourable picture of last year: company profits increased more than three times compared to 1998. Such positive financial results were very likely also the result of a stronger role of owners in company management.

This year, domestic consumption growth is expected to fall to levels typical of previous years. Given the economic upturn in Slovenia's major trading partners, foreign demand will again be the driving force behind economic growth. Owing to changes in the levers of economic activity and the consumption structure, the **reasons for the external imbalance** are changing as well. The strengthening of economic growth in the EU and a gradual pick-up in the economies of Croatia and Russia, together with a moderate real depreciation of the tolar, should contribute to a stronger real rise in exports than in imports. Unlike in 1999, there will be no one-off impacts this year such as a leap in consumption due to the introduction of VAT or a fall in tourism receipts due to the political situation in former Yugoslavia. Imports of consumer goods fell in the first quarter of this year against the same period last year and the first figures and forecasts on the results in tourism are optimistic. The main reason for the current account deficit staying at the same level will be a deterioration in the terms of trade – expensive oil, raw materials and intermediate goods – which are beyond Slovenia's power. In such a context, the debate on structural reasons for the deficit and the possible measures for eliminating them is futile, at least in the short term. What raises concern is the fact that the deficit continues to be financed mainly by borrowing abroad and the deficit's possible impact on the stability of the exchange rate. A long-term solution remains the introduction of high technology and more competitive production processes.

The rapid rise in prices early this year was largely the result of one-off and external factors. The direct impact of VAT in mid-1999 was almost entirely exhausted within the three-month period after its introduction. However, soon afterwards the inflation rate was pushed up by high world oil prices. They raised production costs directly through petroleum product prices and indirectly through prices of other imported inputs. Further evidence pointing to the predominance of cost factors causing inflation is an accelerated rise in producer prices, a fall in imports of consumer goods early this year (pointing to a slowdown in consumption), and above all the core inflation, according to which the non-administered prices are as yet not rising substantially.

Weighing up between the external and internal, or between the cost and demand factors behind inflation, is crucial in the formulation of a policy aimed at its reduction. In order to reduce inflation that is driven by the cost pressure of world prices, economic policy should try to hamper expectations of higher inflation and check the inflationary overheated consumption. Indexation mechanisms have a key role in this respect. Nominal depreciation of the tolar is moving largely in line with the relative inflation. This translates world price rises into domestic production costs and could give rise to persistent expectations of higher inflation in the long run. In terms of export competitiveness, the exchange rate movements are of relatively minor importance this year because of strong foreign demand. Expectations are also shaped by tolar indexation clauses, which are slightly above the monthly inflation rate this year due to the calculation method. The adjustment of wages and pensions will already take place in the middle of the year because of a quicker rise in prices than expected. The increased nominal labour costs and stronger domestic consumption, together with real depreciation of the tolar, could create an inflationary spiral in the second half of the year, which would stimulate a rapid internally-driven rise in non-administered prices. The highly restrictive monetary policy led by the Bank of Slovenia since the last quarter of 1999 has had some effect on the rise in domestic interest rates through the low growth of monetary aggregates. Monetary policy cannot influence the cost factors behind inflation, but it can shape expectations and hinder the transfer of inflationary pressures to the demand side by increasing the attractiveness of saving and raising the cost of loans. According to IMAD's forecasts, the monthly price rises in the second half of the year will drop to the levels seen before the introduction of VAT assuming that monetary policy remains restrictive, world oil prices fall as expected, administered prices rise moderately and that the level of competitiveness is sufficient in all sectors of the economy.

This year's higher inflation is creating pressure to increase general government expenditure through the adjustment of wages and pensions. Considering the fact that, due to strong economic activity, the general government revenue relative to gross domestic product is expected to fall despite its nominal increase, and that sustaining a relatively low general government deficit will become even more important than usual owing to inflationary pressures and rises in interest rates, it will be most appropriate to deal with the situation at hand by reallocating funds within the planned volume of general government expenditure.

A gradual slowdown in domestic consumption, the restrictive monetary policy as well as the expected deceleration of economic activity in the major trading partners will gradually lead to a slowdown in domestic economic activity. Next year's real economic growth is therefore projected to be slightly weaker (4.5%), the average increase in prices substantially lower (4.9%) and employment at about the same level (0.7%). The nominal current account deficit (2.8% of gross domestic product) and the general government deficit (1% of gross domestic product) are forecast to stay roughly at this year's levels. The forecast is based on the assumption of a gradual slowdown of the current strong economic growth. The emergence of an inflationary spiral in the domestic market, causing a rise in production costs, could lead to a faster and stronger fall. Economic activity could also be hindered through stricter lending conditions in foreign and domestic monetary markets, which would result in higher financing costs, poorer liquidity and a rapid drop in demand. A possible hard landing of the overheated US economy would have a strong negative impact on all European economies.

A key element in sustaining high economic growth rates, a further reduction of inflation and a gradual narrowing of the deficit in the balance of payments in the medium term is and remains the completion of creating a competitive market economy. Central issues are the reform of public administration with a new role of the state – complementing traditional economic policy measures by structural and development policy and offering support to entrepreneurship – the creation of a stimulating environment for domestic and foreign investment, the building of a more flexible labour market and investment in human resources, the stimulation of technological development and increasing competitiveness in financial and infrastructural sectors. All of this is part of the commitments Slovenia has taken on in the process of approaching the EU.

2. SUMMARY

2.1. SLOVENIA IN 1999 – Positive macroeconomic results, external balance undermined

Economic developments in 1999 were significantly shaped by changes in economic conditions in the country – tax reform, enforcement of the Europe Agreement, other systemic changes – and a slowdown in economic growth in Slovenia's major trading partners. Economic growth in Slovenia was stronger than expected or forecast only a few months ago. Inflationary movements were relatively favourable despite the pressure from VAT introduced in July and the rising petroleum product prices in the second half of the year. Developments in the labour market were positive as well: employment increased and unemployment fell. Wage growth was stronger than in 1999, but still below the rate of labour productivity growth. Company performance improved: profits rose and losses fell. The general government deficit was lower than projected. On the other hand, Slovenia ran a deficit in the current account of the balance of payments for the first time last year. As foreign direct and portfolio investment inflows were modest, the deficit was mainly financed by borrowing abroad. Foreign exchange reserves dropped. Household borrowing with banks increased and the share of gross savings in gross domestic product fell owing to a steep rise in government and private consumption. The increased demand for loans and the current method of fixing interest rates (by raising the tolar indexation clause) halted the fall in interest rates.

Slovenia's real gross domestic product rose by 4.9% in 1999 and thereby exceeded the average annual growth rate of 4% seen over the last six years. **Gross domestic product per capita** was USD 10,078, significantly higher than in other transition economies.

Domestic demand was the main lever of **economic growth in 1999**, while exports of goods and services rose by a modest 1.8% in real terms. Going up by 16.1% in real terms, capital formation was the strongest component of domestic demand. The other two components, government and private consumption, rose at a rate higher than real gross domestic product growth (up 5.7% and 5.4%, respectively, in real terms). Uncertainties before due to the introduction of VAT stimulated private consumption in particular. The most dynamic activity last year was construction, going up by 14.4% in real terms, while high growth in value added was also seen in distributive trades (up 6.5%), and real estate, renting and business services (up 5.2%). Value added in manufacturing rose by

3.9%. Broken down by quarters, economic activity leapt in the second quarter (7.4% year-on-year) and rose at a slower but still robust rate in the second half of the year.

Foreign demand decelerated as a result of a slowdown in merchandise export growth and a real fall in exports of services. Exports of goods slowed down because of the dampened economic growth in the EU, particularly in the first half of the year, and a drop in the purchasing power of the Croatian and Russian markets. Economic growth in the EU averaged 2.3% last year, according to the European Commission (2.9% in 1998). Countries recording a significant slowdown last year were Germany, Austria and France, all of them being Slovenia's major export markets, while relatively modest economic growth continued in Italy. Recession tendencies continued in Croatia, where real gross domestic product fell by 0.3%. The drop in the service balance was mainly caused by a lower surplus in receipts from travel (increased imports and decreased exports).

Imports of goods increased by 7.5% in real terms. The main reasons underlying such growth were the accelerated rise in imports before the introduction of VAT, high imports in the second half of the year, except in July, because of the rising world oil and commodity prices, and a gradual price increase in Slovenia's import markets. The trade deficit (balance of payments statistics) totalled USD 1,156.7 million, USD 381.8 million more than in 1998. The surplus in receipts from services totalling USD 365.6 million was way below expectations (USD 148.1 million lower than in 1998). The relatively strong economic growth in Slovenia in 1999[1] was therefore achieved at the expense of a significant undermining of the external balance. The **current account deficit** totalled USD 581.4 million, or 2.9% of gross domestic product.

Factors leading to the deficit in the balance of payments were of an external and internal character. The main external factors were: (i) the recession in Croatia and the economic crisis in Russia; (ii) the slowdown in economic activity in the EU; (iii) the poor tourism season caused by the war in the Balkans and the diminishing shuttle trade caused by lower cross-border price differences; and (iv) the worsening of the terms of trade in the second half of the year (rising oil and commodity prices). The main internal causes of the balance of payments disequilibrium were: (i) strong imports caused by spending before the introduction of VAT; (ii) the persistence of a trend of deteriorating cost-to-export price ratio in comparison to the major trading partners (CEFTA, EU), which was related to both weak internationalisation of Slovenian companies

[1] Stronger economic growth was only seen in 1995 when the economy rose by 5.3%.

and the modest investment in technological development over the last few years; (iii) strong investment activity, which accelerated the imports of investment goods and caused a lower surplus from services: Slovenia became a net importer of construction services while maintaining the same level of exports of construction services; and (iv) a rapid rise in services imports driven by requirements of the economy as well as by changes in private consumption habits. Some of those reasons have a long-term character.

After rising modestly in the first half of the year, when consumer prices climbed by 2.7%, inflation accelerated in the period following the introduction of VAT. It rose at a rate of 3.4% in the first three months after the introduction of VAT. Expectations of the impact of VAT on prices, reflected in increased consumption before its introduction, turned out to be exaggerated. In the second half of the year, the annual inflation rate was significantly pushed up by the rising world oil and commodity prices.[2] The year-end inflation rate climbed to 8% (6.5% in 1998). The favourable trends in the first half of the year helped the average annual inflation rate to climb by only 6.1%, a rate lower than in 1998 (7.9%).

After the fall or stagnation in employment in previous years, some **positive developments** were seen in the **labour market** last year. The number of people in employment increased by 1.8%. Even if the number of people participating in public works programmes – previously recorded as unemployed, now as employed – are excluded, the number of persons in employment rose by 1.1%. Employment increased mainly in the services sector (up 5.1%), while it continued to fall in industry (down 1.6%). The Active Employment Policy and deletions from unemployment registers led to a drop in the registered unemployment rate to 13% in December. The average annual rate was 13.6% (14.5% in 1998). Unemployment measured by the labour force survey also fell in comparison to 1998: the unemployment rate by ILO standards was 7.6%. The fall in the number of persons in employment established by the labour force survey suggests that the levels of informal employment and the shadow economy shrank. The difference between the registered and surveyed unemployment rates remained wide (7.6% and 13.6%, respectively). Despite the falling unemployment, the problem of structural unemployment persisted.

The agreed incomes policy and a specific adjustment mechanism raising wages in line with VAT-driven price rises led to a 3.3% real rise in the gross wage per employee. Wages in the private sector, up 3.2% in real terms, were mainly pushed up by profit-related payments in the last two months of the year, when

[2] The rising oil prices directly added 1.4 percentage points to the 8%-rise in consumer prices.

they leapt 13.8% in real terms. Wages in the public sector, up 3.7% in real terms, rose to a large extent because of the adjustment mechanism correcting wages in line with price rises (adjustments at the beginning and in the middle of the year), because of wage supplements to basic wages agreed upon in collective agreements, promotions and new employment at higher levels of the pay scale. At the macroeconomic level, the lagging of wages behind labour productivity growth continued in 1999 from the previous two years.

Excess demand for foreign currency stemming from the current account deficit and the introduction of foreign currency accounts for domestic legal entities, as well as a stronger US dollar in international money markets led to real depreciation of the tolar against the basket of currencies (0.7% on the basis of consumer prices and 3% on the basis of producer prices). Despite the improvement in price competitiveness, the cost competitiveness of Slovenia's manufacturing edged down on average last year. Even though the tolar depreciated and labour costs continued to rise moderately, labour productivity growth was too weak to lead to a fall in unit labour costs measured in the basket of currencies.

The consolidated general government revenue climbed by 7.2% in real terms and amounted to 43.7% of gross domestic product. The rise was significantly due to revenues from sales taxes in the first half of the year, revenues from sales taxes collected in the second half of the year but charged on sales made earlier, and the above-average revenues from value-added tax upon the tax system change. Total general government expenditure climbed by 6.8% in real terms and amounted to 44.3% of gross domestic product. The general government deficit came to 0.6% of gross domestic product, being narrower than in 1998 (0.8% of gross domestic product). The fall in the deficit was accompanied by the increase in both general government revenue and expenditure relative to gross domestic product.

Parallel to taking on the *acquis* and building up a new institutional framework, Slovenia led intensive negotiations for membership in the EU. Before the end of the year, Slovenia had submitted all 29 negotiating positions to the European Commission. Slovenia's economic results and **progress made in building the institutional framework** last year were positively assessed by the International Monetary Fund and the European Commission. Those assessments say that Slovenia has a functioning market economy, a relatively stable macroeconomic environment, the highest level of living standards, and the highest assessment of the safety of investment among countries in transition or candidate-countries for the EU (excluding Cyprus). The accelerated implementation of structural reforms, considered too slow and insufficiently effective in previous years, was assessed as a step forward. Areas that were pointed out were changes following the implementation of the Europe Agreement, the introduction of VAT, the passing of a new Foreign Exchange Act, the easing of barriers to financial flows, the passing of a number of other acts, and pension reform in particular. The Progress Report for 1999 issued by the European Commission in October last year was significantly more favourable than in 1998. The Commission positively assessed the stepping up of the harmonisation of legislation, particularly in the area of the internal market (regulations on standards and certificates, the free movement of capital, banking, personal data protection, company law, value-added tax, and anti-trust rules). A positive assessment was also given for the implementation of short-term priorities and obligations from the accession partnership, for considerable progress made in veterinary medicine, justice and home affairs, regional development, environmental protection, employment and social affairs. The shortcomings pointed out by the International Monetary Fund were an insufficiently flexible labour market, the under-developed banking and financial sectors, and uncertainties concerning further company and bank privatisation. The European Commission negatively assessed progress in the reform of public administration and the judiciary. It was particularly critical about the alignment of legislation regulating public procurement, intellectual and industrial property, insurance sector, and state aid. However, some important measures have been undertaken in these areas this year.

Similar shortcomings have been pointed out by the International Institute for Management and Development (IMD) in its assessment of Slovenia's competitiveness made in 1999. Slovenia was ranked 40th among 47 countries, with above-average rankings achieved in the factors of People, Domestic Economy and Infrastructure, a slightly lower ranking in Management and Science and Technology, while below-average scores were achieved in Internationalisation, Government and Finance. Slovenia won praise on account of its high potential for development due to entrepreneurship, know-how and technology, the IMD nevertheless pointed out the obstacles and setbacks in improving competitiveness, particularly in areas of state administration, economic policy implementation, and financial market development.

Last year's macroeconomic results were positive, although achieved in an environment of an undermined external balance. But what gives rise to concern is the slow pace of financial sector restructuring and public administration reform as well as labour market inflexibility. Slovenia's banking and insurance sectors will be increasingly more exposed to foreign competition and yet the banking sector's performance is on average not improving and the privatisation of the two state-owned banks with an almost 40% market share is being postponed.

Despite the passing of the Ownership Transformation of Insurance Companies Act, the privatisation of insurance companies was temporarily stopped because of ambiguity concerning the estimated share of social capital. This, coupled with delays in the privatisation of infrastructural companies, the persistent low profitability of many Slovenian companies, the lack of information on company performance and business plans, and the image of a closed financial market in Slovenia created over the past few years is reflected in the shallowness of the capital market. It will be impossible to change the role of the state without the reform of public administration. But neither public administration nor labour market reform will yield positive results immediately. There are currently a number of programmes under the employment policy aimed at increasing flexibility of the labour market. That flexibility will by no means be improved by long debates about the employment act or many of the proposed solutions concerning employment relations.

Slovenia already achieved the pre-independence and pre-transition level of economic development a few years ago. The economic, social and environmental aspects of development are closely linked, but growth and the level of gross domestic product principally measure economic performance. Correcting this shortcoming has been attempted by devising new concepts and measures of development. The concept of **human development** stresses the importance of simultaneous development in economic and social fields, the reduction of poverty and inequality, the preservation of the environment, and the active participation of people. The concept of **sustainable development** says that the welfare of current generations must be exclusively based on the conservation of welfare resources (those produced and non-produced), the exploitation of natural resources limited by the regeneration capacity of those resources, and on investment in the welfare of future generations. The Human Development Index, which complements economic indicators of development with indicators on health and education, shows that Slovenia made progress in the 1990s. In 1997, Slovenia was ranked 28th among 174 countries according to the Human Development Index and it climbed in comparison to 1992 in all components of the index. A comparison of inequalities in income distribution (the Gini coefficient) between 1993 and 1998 reveals a slight drop in inequality. The Genuine Savings Index, a measure of development in terms of sustainability, shows that Slovenia did not put under threat the welfare of future generations with its economic activity. However, the country developed neither to the detriment nor to the benefit of future generations. Slovenia should formulate a development pattern that would be acceptable for current generations (economic growth) and would benefit future generations more than so far (low environmental degradation and accumulation of welfare resources produced).

2.2. PROSPECTS FOR 2000 AND 2001 – Relatively strong economic growth continues, the impact of international environment strengthens

Economic developments in 2000 and 2001 will be significantly influenced by the international environment. A pick-up in economic activity in Slovenia's most important trading partners will boost production in manufacturing through strong real export growth. Having revived in the second half of 1999, economic growth in the EU is forecast to accelerate this and next year (3.4% or 3% real growth), according to the European Commission, particularly in Germany and Italy, where the strongest growth is expected. Economic growth forecasts for CEFTA countries, Russia, Croatia and other countries of former Yugoslavia are equally optimistic. Slovenia's trade with former Yugoslav countries is increasing both in terms of traditional exchange and sophisticated forms of international co-operation (outward foreign direct investment in particular). This year's economic developments will also be shaped by the rising oil prices and a strong US dollar. Even though exports will rise more strongly than imports, the current account deficit will remain relatively large owing to the fall in the terms of trade. Inflationary pressures will, unlike in previous years, be more of an external character (oil prices and the strong dollar). The pressure from oil prices is not expected to increase in 2001, according to foreign analysts, and the US dollar is likely to weaken gradually. This will reduce pressure on domestic prices and improve the terms of trade.

With exports of goods and services rising strongly in 2000 – a real increase of 7.1% is expected – **foreign demand** will again be the main lever of economic growth this year. Domestic demand is forecast to decelerate from last year's 6.2% to 4.8% in real terms mainly because of subdued private and government consumption. Both are projected to rise at a rate below gross domestic product growth (2.9% or 3% real rise). Investment activity should continue to be dynamic – we estimate a real rise of 9% in investment in fixed assets – and concentrated on the construction of infrastructure. Gross domestic product growth, based on the assessment of current trends, will continue to be strong and will record a rate of around 4¾% this year, slightly below last year's rate. In 2001, investment consumption will retain a strong pace (up 9% in real terms), while private and government consumption are expected to be subdued as in this year (3% and 3.3% real rises). Economic growth is likely to slow down slightly to around 4.5% owing to a weak rise in export markets.

Manufacturing, driven by a rise in export orders, is expected to be **one of the most dynamic activities** in 2000 (a 5.3%-rise in value added), construction should continue to grow strongly as well as a result of infrastructural works. Services will rise slightly less than last year (up 4.1%) mainly because of a slowdown in distributive trades, but the rise will be maintained by transport driven by increased industrial production and exports. Business services, incorporating the dynamic sector of information technology, should rise more strongly than other services, which will help improve the quality of services in the domestic economy and the ongoing positive shifts in trade in services. In 2001, value added in the services sector is expected to accelerate slightly (up 4.5%), which will result in a larger share of services in gross domestic product, also because manufacturing and construction are likely to decelerate to some degree.

This and next year, gross savings will continue to have a smaller share in gross domestic product than gross fixed capital formation. The **dynamic investment activity** will thus still be **financed** by foreign savings, i.e. inflows from abroad. Part of the current account deficit remains, as with last year, a development deficit (given that investment funds are allocated efficiently), which could in fact improve the impact of investment and contribute to raising the level of technological development and competitiveness. However, even if investment funds are allocated efficiently, we can only expect a long-term effect on competitiveness and exports as the main investment activity in Slovenia is infrastructural investment. The persistence of the deficit at 3% of gross domestic product this year and at 2.8% next year calls even more urgently for the opening up of the Slovenian economy to foreign direct and portfolio investment. Covering the deficit only by borrowing abroad could undermine its sustainability as early as next year. The problem is aggravated by flows in the financial account of the balance of payments: trends seen early this year suggest that this year's foreign direct and portfolio investment outflows might even exceed inflows (excluding Eurobonds).

In addition to measures adopted this and last year, and the government's scheme for attracting foreign investment, the investment clime, both for foreign and local investors, could be improved by drawing up and implementing a government programme to lift administrative barriers to investment. The key problems in reducing those barriers are very likely to emerge in relation to land and labour legislation, as shown by the report of the Word Bank's Foreign Investment Advisory Service.

The **current account deficit** is not expected to narrow this year despite real exports rising more than imports (up 7.1% and 6%, respectively) for three main reasons: (i) the terms of trade will deteriorate by 1.2 percentage points: export prices will fall more strongly than import prices principally because of high world oil prices, a strong US dollar and a rise in producer prices in supplying countries; (ii) imports of investment and intermediate goods will continue to accelerate, which is in line with the pick-up in industrial production and strong investment activity; and (iii) the surplus from services will remain at last year's level (in US dollars) despite stronger net inflows from tourism and transport. The latter is in part the result of a strong US dollar but more of structural and long-term nature: imports of services with high value added rise with a higher level of economic development. The terms of trade are expected to improve by around 0.5 of a percentage point in 2001, but the current account deficit relative to gross domestic product is not likely to narrow substantially (2.8% of gross domestic product) because exports will decelerate slightly (to 5.9%) following a slowdown in export market growth.

Improvement in the **price and cost competitiveness** of Slovenia's manufacturing seen in the first quarter of this year as a result of real depreciation of the tolar (mainly due to a strong US dollar) and labour productivity growth (mainly due to increased output in manufacturing) is estimated to continue until the end of the year, albeit at a lower rate. Relative unit labour costs in the basket of currencies will fall by 1.3% in 2000. The slower improvement in cost competitiveness will largely be due to weaker labour productivity growth (around 5.5% year-on-year). The tolar is expected to depreciate 1% in real terms against the basket of currencies on the basis of relative consumer prices, assuming that the US dollar loses some strength in the second half of the year.

This year's **inflationary movements** are to a large extent shaped by external factors such as the rising petroleum product and commodity prices in world markets and the rising inflation (consumer and producer prices) in the EU. They are indirectly pushing up domestic producer and consumer prices through expensive imports. Because of the calculation effect of the introduction of VAT in mid-1999 on inflation this year, it would be very unlikely for the inflation rate to drop below last year's level (6.1%). This is practically impossible after the 3.7%-rise in consumer prices over the first five months of this year. Assuming that there will be no additional pressure from world petroleum product prices before the end of the year, the exchange rate and wage growth nor any rise in excise duties, the average annual inflation rate is forecast to come in at around 7.6% this year. Given the expected slowdown in world petroleum product prices in the second half of this and next year, the external inflationary pressure will be substantially weaker. This could, coupled with a restrictive monetary policy and subdued wage growth, result in a drop of the average inflation rate below 5%.

2

As prices rose quickly early this year, the adjustment of basic wages by price rises will happen earlier, i.e. in the middle of the year, as laid down in the Minimum Wage, Wage Adjustment Mechanism and Holiday Allowance Act for 1999-2001. This will **raise wages** more in the public than in the private sector. Taking into account wage fluctuations that depend on the number of working hours and the expected acceleration at the end of the year, the average gross wage per employee in the private sector is estimated to rise by 2.5% in real terms in 2000. Wages in the public sector are forecast to rise by 2.5% in real terms, part of which will be due to regular promotions, wage supplements in education, the payment of the first part of the wage supplement in public administration and a 1%-increase of the basic wages in December planned in the collective agreement for the non-commercial sector. The average gross wage is thus estimated to rise by 2.5% in real terms, a rate below labour productivity growth. The lagging of wage growth behind labour productivity should be maintained next year, when the average gross wage is to rise by around 2.3% in real terms (around 2% in the private and around 3% in the public sector).

The slow wage growth, active employment policy and relatively strong economic growth will create conditions for the positive trends in the **labour market** to continue this and next year. The number of employees in full-time equivalent is estimated to rise by around 0.9% this year and by 0.7% in 2001. The ongoing fall in registered unemployment is expected to continue, albeit at a slower rate, because of the persistent structural unemployment, a stronger influx of first-time job-seekers, and fewer deletions from the unemployment registers. Crucial factors in increasing employment and reducing unemployment in the years to come will include effective implementation of a comprehensive employment policy that takes into account the local situation as well as follows employment guidelines in the EU. Over the last two years, the EU's employment policy has been successful in stepping up employment in its Member States.

Total general government expenditure is forecast to rise by 3.4% in real terms this year, a rate below real gross domestic product growth. The state budget adopted in January 2000 plans expenditures of SIT 1,060 billion. Owing to prices moving up more quickly than projected while drawing up the budget, there will be strong pressure to increase expenditure on wages and pensions. Total general government revenue is expected to rise by 2.5%, a rate below expenditure growth. Keeping the general government deficit within sustainable limits next year (up to 1% of gross domestic product) will require a **reform of**

direct taxes, a larger structural share of taxes on consumption and capital, and higher general government revenue without raising tax rates.

Table 1: Selected macroeconomic indicators in 1996-2001

	1996	1997	1998	1999	2000 estimate	2001 estimate
GROSS DOMESTIC PRODUCT - real growth in %	3.5	4.6	3.8	4.9	4 3/4	4.5
Trade balance in USD million	-881.7	-771.6	-774.9	-1,156.7	-1,210.0	-1,185.0
as % of GDP	-4.7	-4.2	-4.0	-5.8	-6.0	-5.5
Current account balance in USD million	39.0	36.6	-3.8	-581.4	-605.0	-615.0
as % of GDP	0.2	0.2	0.0	-2.9	-3.0	-2.8
Employment based on national accounts method, %	-0.9	-0.5	0.0	0.9	0.9	0.7
Unemployment rate by ILO, %	7.3	7.4	7.9	7.6	7.3	7.2
Gross wage per employee (% real rise)	5.1	2.4	1.6	3.3	2.5	2.3
Inflation (annual average)[1], in %	9.7	9.1	7.9	6.1	7.6	4.9
Effective exchange rate - real terms[2], in %	-2.9	0.7	4.0	-0.7	-1.0	-0.1
CONSOLIDATED GENERAL GOVERNMENT REVENUE AND EXPENDITURE BY GFS - IMF METHOD						
General government revenue as % of GDP	42.7	42.0	43.0	43.7	42.8	42.1
General government expenditure as % of GDP	42.4	43.2	43.8	44.3	43.8	43.1
Surplus/deficit as % of GDP	0.3	-1.2	-0.8	-0.6	-1.0	-1.0

Sources: SORS, Bank of Slovenia, Ministry of Finance, estimates made by IMAD.
Notes: [1]retail prices as a measure of inflation until 1988, since 1998 consumer prices. 2) a rise in value means appreciation of the tolar and vice versa; measured by relative consumer prices.

2

3. INTERNATIONAL ENVIRONMENT – More favourable global economic trends and growth in export markets

3

After a slowdown in **global economic growth** in 1998 and at the beginning of 1999, this being the consequence of the Asian, Russian and Brazilian crises, economic activity in the second half of 1999 started to improve, as expected (especially in the markets that were most affected by financial crises). Economic revival was, on average, more pronounced than had been anticipated by international institutions in autumn 1999. Thus the International Monetary Fund (IMF) estimated, in spring 2000 (IMF, April 2000), that last year's global economic growth was 3.3% or 0.4 of a percentage point higher than predicted in October 1999. In its Spring 2000 Forecasts the European Commission similarly assessed last year's global economic growth, in which its autumn estimate was corrected by 0.3 of a percentage point (EC, 2000). Among the factors which mostly boosted last year's economic growth were: the booming USA economy which, against expectations, continued at an unabated rate, the more rapid recovery of South-east Asian economies, Brazil and most other Latin-American economies, the faster revival of economic growth in the European Union (EU) in the second half of the year and the favourable influence of increased oil prices on economic growth in oil exporting countries (especially Russia and the OPEC countries).

Favourable economic trends in the second half of 1999 and the continuation of dynamic economic growth in the USA in the first months of 2000 considerably improved the outlooks for global economic growth in 2000. According to IMF estimates, this year's economic growth rate will reach 4.2% (exceeding autumn predictions by 0.8 of a percentage point), whilst the European Commission's estimate was somewhat lower (4%), but it also increased its October assessment by 0.4 of a percentage point. The strongest revival of economic activity in 2000, compared to 1999, is forecast for the EU, the EU candidate countries, Latin-American countries, Indonesia and other South-eastern Asian economies. Somewhat lower growth rates among large countries, compared to 1999, is expected in India and China, who recorded high gross domestic product growth rates (6.8% and 7.1% respectively last year; estimates for 2000: 6.3% and 7% respectively; IMF, 2000), and in Russia (3.2% in 1999 and 1.5% in 2000; IMF, 2000) where growth in 1999 was primarily stimulated by rising oil prices.

World economic growth in 2001 is forecast to reach about 3.9% (IMF, 2000; EC, 2000) which is somewhat slower compared to 2000, primarily because of the slowdown in economic growth in the USA, Canada, India, China, and EU, while gross domestic product in other parts of the world will continue to grow. As estimated by the IMF and the European Commission, a slightly higher growth will be recorded in 2001 when compared to 2000 in Central and Eastern European countries in transition, Russia, Japan, the ASEAN members, as well as countries in South and Central America and Africa. Nevertheless, analysts from both of these institutions are drawing attention to the fact that global economic growth in 2001 will largely depend on how quickly the overheated American economy cools down (see Box 1). The following economic growth estimates are based (unless otherwise stated), on the assumption that the American economy will gradually cool down and that global economic growth in 2000 and 2001 will be 4.2% and 3.9% respectively.

Table 2: Economic growth, volume of world trade and movements in prices of oil and raw materials (real growth in %)

	1998	1999	2000	2001
World output	2.5	3.3	4.2	3.9
World trade volume	4.2	4.6	7.9	7.2
World oil price	-32.1	38.7	35.1	-19.2
World commodity prices*	-14.7	-6.9	4.9	3.2

Note: *average, based on world commodity export weights.
Source: IMF, 2000

In line with dynamic economic growth in 2000 and 2001 the **volume of international trade**, which has for the last ten years been rising approximately twice as fast as global economic activity, will also increase. Given a further decline in oil prices, following the agreements made in March and in June 2000 between the OPEC countries on increasing oil output, **oil prices**, which rose on average by 38.7% in the global market last year (averaging USD 18.14), will this year increase on average by 35.1%. Thus, the average price of oil would reach USD 24.5, as estimated by the IMF. It is also expected that in 2001 oil prices will fall even further, so that its average price will be close to that recorded in 1999, i.e. USD 19.8. The IMF also predicted that the price of **raw materials** in 2000 would, on average, climb by 4.9% (in relative terms the prices of metals will grow faster) and by 3.2% in 2001. As regards **exchange rate fluctuations,** the IMF and the European Commission forecast that the USD/EUR ratio in 2000 and 2001 would remain the same as recorded in the middle of January 2000 (around 1.02). Taking into account inter-currency ratios in April and early May, this can only be achieved given a substantial strengthening of the Euro against the US dollar by the end of 2000 (in mid May 2000 the USD/EUR exchange rate was approximately 0.90).

Box 1: The scenario of the American economy's "hard landing"

As estimated by the International Monetary Fund (IMF) and the European Commission the slowdown in America's economy is inevitable, although it is difficult to say when and to what extent it will occur. Thus, the IMF envisioned **two scenarios** for USA economic trends in 2000 and 2001, which will characteristically impact on global economic growth in these two years. According to both scenarios the levelling off of economic growth in the USA will primarily be influenced by restrictive monetary and fiscal policies aimed at decreasing inflation and curbing domestic consumption. The above-mentioned 3.9% global economic growth in 2001 is based on the scenario of the presently more probable "soft landing" of the USA economy, which foresees a gradual slowdown in America's economic growth in 2001 (by 1.4 percentage points less than in 2000). The "hard landing" scenario, on the other hand forecast further "overheating", i.e. faster growth of both the American and other global economies in 2000 (4.4% and 4.7% respectively; IMF, 2000), followed in 2001 by a rapidly decreasing confidence in the US dollar, an outflow of foreign capital from the USA and a pronounced downward trend in economic growth, owing to intolerable external imbalances and exchange rates misalignments. In such a case, gross domestic product growth in the USA in 2001 would be merely 1%, while global economic growth 3%. Despite warnings about very high stock market valuations particularly in the new economy and the consequences of their plummeting, influential American economists keep emphasising that the possible plunge in asset prices will not be the principal reason for the slowdown of American economic growth, as the impact of the 1987 stock exchange collapse on economic trends in the "real economy" was also negligible. Experience in the first months of 2000 show that sharp fluctuations of asset prices on American stock exchanges cannot alone weaken the confidence in the US dollar, which in April and May reached all-time-highs, compared to the Euro (possibly the consequence of the lack of confidence in the European currency). Judging by the response of the American and European monetary authorities to economic developments in late 1999 and early 2000 as well as by a reduction in the general government deficit in the USA and the EU (which gives the necessary room for manoeuvring to increase consumption in case of a substantial slowdown in economic growth) IMF experts believe that a "soft landing" is more likely, although no sooner than in 2001.

In 1999, gross domestic product growth in the **United States of America** exceeded 4% for the fourth consecutive year. The IMF assessed it to be 4.2%, which is 0.5 of a percentage point above its autumn forecast. It was primarily driven by strong domestic consumption (especially private). Economic conditions in 1999 and in the first months of 2000 witnessed dynamic growth (in the first quarter the annualised gross domestic product growth was 5%), and the continued strengthening of the US dollar on international money markets. This year's favourable developments and the unshaken confidence of investors, consumers and producers in further economic growth in the first quarter of 2000 raised USA economic growth assessments for 2000 from 2.6% to 4.4% (IMF, 2000). In 2001 this growth is expected to slow down, mainly as a result of continued restrictive monetary and fiscal policies and reach approximately 3% (the “soft landing” scenario).

According to the latest assessment made by the European Commission, economic growth in the **European Union (EU)** in 1999 was 2.3%, which exceeded the estimate from October 1999 by 0.2 of a percentage point. This higher assessment was caused by faster growth in the last quarter of 1999, which was mainly triggered by a much stronger export demand. After a downward trend in the first half of the year, industrial production started to ease upwards in June 1999 and grew until the end of the year owing to larger export orders. The European Commission forecasts that in 2000 economic growth in the EU will substantially improve and it is estimated to reach between 3.2% (IMF, 2000), and 3.4% (EC, 2000) thus exceeding the autumn assessments by 0.5 and 0.4 of a percentage point respectively. This year foreign demand will take over the role as the main driving force behind economic growth, whilst investment consumption is also expected to strengthen when compared to 1999. Average inflation in 1999 was 1.2% and this year it will increase to 1.8%, primarily due to higher prices at the end of 1999 and the beginning of 2000, but will still be below the limit of price stability (2%) as determined by the European Central Bank. A similar growth in prices is also anticipated for 2001 when it will be mainly stimulated by the expected slight relaxation of monetary policy. In 2001 average economic growth in the EU will slow down somewhat as a result of slower economic growth in the USA and will thus reach the expected 3% (EC, 2000; IMF, 2000). In the case of a “hard landing” of the American economy and insufficient or delayed responses by the European Central Bank’s in terms of monetary policy, economic growth in the EU in 2001 would, on average, be lower by about 1 percentage point (around 2%), although in such a case it is more probable that the EU Member States will decide on more expansive fiscal policies. Taking into account the significantly smaller general government deficit in 1999 (it averaged 0.6% of gross domestic product in the EU) and probably also in 2000 (0.4% of gross domestic product), more expansive fiscal policies in the EU would not cause notable macroeconomic imbalances.

Following a substantial slowdown in **German economic growth** in 1999, this year it is expected to range between 2.8 and 2.9% primarily thanks to heavy investment in equipment and fast-growing exports (7.9% or 9.3%; EC, 2000). Growth in imports will also be relatively high (7.3%, EC, 2000), with the purchasing of investment goods abroad expected to increase most rapidly, whilst private consumption in 2000 is estimated to rise relatively slowly (2.2%; EC, 2000). The European Commission predicts that in 2001, economic growth in Germany will remain at its 2000 level, whilst according to IMF experts it will

Table 3: Economic growth, inflation and growth in imports of Slovenia's major trading partners (in %)

	Real GDP growth			Inflation			Real growth in imports of goods and services		
	1999	2000	2001	1999	2000	2001	1999	2000	2001
EU	2.3	3.4	3.1	1.2	1.8	1.7	6.1	7.7	7.1
Germany	1.5	2.9	2.9	0.6	1.6	1.6	7.1	7.3	7.6
Italy	1.4	2.7	2.7	1.7	2.1	1.9	3.4	7.5	7.6
Croatia*	-0.3	1.0	2.0	4.4	4.0	4.0	-3.9	5.0	2.0
Austria	2.3	3.2	3.0	0.5	1.3	1.0	5.8	8.4	7.2
France	2.8	3.7	3.2	0.6	1.1	1.2	3.8	7.3	5.9
Bosnia and Herzegovina*	8.0	9.0	6.0	5.0	3.0	3.0			
USA*	4.2	4.4	3.0	2.2	2.5	2.5	12.7	9.0	5.5
Poland*	4.1	4.5	5.0	7.3	7.0	5.0	-4.8	5.0	5.5

Notes: *real growth in the imports of goods, **estimates are less reliable owing to insufficient statistical data and mostly relate to the Federation of Bosnia and Herzegovina.
Sources: GDP: European Commission, IMF; Croatia and Poland - WIIW, BIH - EIU; inflation: European Commission, WIIW, EIU; growth in imports of goods and services: European Commission; growth in imports of goods (Croatia, the USA, Poland): European Commission, WIIW.

edge up by 0.4 of a percentage point. In 2001 the influence of private consumption on the economic growth is expected to increase, whereas that of exports and investment consumption is expected to drop in relative terms, but the two will remain the most dynamic growth components.

The **Italian** economy witnessed relatively low economic growth in 1999, primarily due to reduced export demand by Asian and Eastern European markets and more moderate domestic consumption (the restriction on general government expenditure, fluctuations in the domestic consumers confidence). In the second half of the year export growth caused a significant upsurge in economic activity. Favourable developments continue in 2000 when economic growth is forecast to reach around 2.7% (IMF, 2000; EC, 2000) or 0.4 of a percentage point more than expected last autumn. In 2000, gross domestic product growth will be influenced not only by exports but also by stronger investment activity, which is anticipated to further strengthen in 2001. A similar pace of economic growth is expected to continue in 2001 (2.7%, EC, 2000 or 2.8%; IMF, 2000).

In **Austria**, economic growth was 2.3% last year. Compared to 1998 (2.9%) its pace has slowed down mainly due to a more modest growth in exports and investment, whilst domestic consumption growth in 1999 was slightly higher (due to the impact of lower taxes). In 2000 export and investment demand are expected to rocket (by 5.1% and 9%, respectively; EC, 2000) being the main boosters of improved economic growth, which is estimated to be 3.1% (IMF, 2000) and 3.2% (EC, 2000). The European Commission estimates that in

2001 economic growth will rise by somewhat less (3%), while the IMF predicts an even more pronounced rise (3.3%).

Even though economic growth in **France** was slightly lower in 1999 (2.8%) than in 1998 (3.2%), it was nevertheless still well above the European average. Principally it was encouraged by notable investment demand and in the second half of the year also by revived exports combined with more pronounced private consumption. The upward trend in private consumption and exports is expected to continue in 2000. It is assessed that growth in investment consumption will slow down somewhat although it will still significantly influence gross domestic product growth. It is estimated that the latter will increase by 3.5% (IMF, 2000) or 3.7% (EC, 2000), which is respectively more by 0.5 and 0.8 of a percentage point than predicted last autumn. In 2001, economic growth is forecast to stabilise and reach about 3.2% (IMF, 2000; EC, 2000)

The **Croatian** economy underwent a recession in 1999 (gross domestic product dropped in real terms by 0.3%; CBS, 2000), resulting on the one hand from increased company and bank liquidity, and on the other from slower economic growth in the EU and the crisis in the Balkans, the latter primarily affecting tourism and transport. The economy recovered in the last quarter of 1999, while value added in industry had already started rising in the second quarter (1.2% real growth in 1999). Economic growth estimates for 2000 are more optimistic and range between 1% (WIIW, 2000) and 2.8% (Miljenović, 2000) mainly based on an expected better tourist season and an increase in exports of goods, which should bring about further growth in industrial production and investment in equipment. Economic growth is expected to be further stimulated by foreign capital inflows in the framework of the continued privatisation process, above all that of the financial sector. In 2001 economic growth is estimated to be about 2% (WIIW, 2000). Success in resolving accumulated structural problems in the country (an unequilibrated pension system, the imprudent use of privatisation proceeds, the banking sector crisis and high unemployment rates) will also significantly impact economic performance in 2000 and 2001.

Economic growth in the **CEFTA countries (excluding Slovenia)** in 1999 averaged some 2%, which is up by 0.4 of a percentage point compared to autumn forecasts. Higher economic growth estimates for 1999 were influenced by more favourable global factors, especially in the second half of 1999. Among these were primarily, the faster recovery of the EU economies, more favourable economic trends in Russia and more active investment and trading activities in Bulgaria and Romania, which took place in the framework of the stabilisation and rebuilding of South-Eastern Europe. Quarterly data show that economic growth in all CEFTA countries improved in the second half of 1999 and upward trends are also expected to continue in 2000 (with the exception of Slovakia where its restrictive economic policy will hinder faster economic recovery). This year's gross domestic product growth in the CEFTA countries will thus average between 3% (WIIW, 2000) or 3.6% (EC, 2000; IMF, 2000), which is approximately the same as estimated last autumn. Similarly to 1999, the highest growth rates in 2000 will be posted by Poland, Hungary and Bulgaria, whilst the recession in the Czech Republic and Romania is also expected to stop. In 2001, average economic growth in the CEFTA countries is predicted to further improve and range between 3.6% WIIW, 2000) and 4.3% (IMF, 2000; EC, 2000). The economic growth, compared to 2000, will strengthen most in Romania, Slovakia and the Czech Republic, while Poland and Hungary are likely to experience the highest growth rates.

Table 4: Economic growth, inflation and external imbalances in the CEFTA countries (in %)

	Real GDP growth			Inflation			Current account balance, as % of GDP		
	1999	2000	2001	1999	2000	2001	1999	2000	2001
Bulgaria	2.5	4.2	4.5	0.3	3.0	3.0	-4.6	np	np
Czech Rep.	-0.6	1.6	2.6	2.1	3.5	3.5	-1.5	-2.4	-2.6
Hungary	4.1	4.6	4.9	10.0	8.3	6.5	-4.2	-4.0	-3.8
Poland	4.1	4.9	5.3	7.3	7.0	5.0	-7.6	-8.1	-7.7
Romania	-3.7	0.2	2.6	45.8	40.0	35.0	-4.2	-5.0	-5.3
Slovakia	1.6	1.4	3.1	10.5	13.0	10.0	-5.4	-4.1	-2.5

Note: *average of estimates by WIIW, IMF and the European Commission.
Source: WIIW, IMF, EC

In 1999, economy in **Bosnia and Herzegovina,** which is becoming an increasingly important export and investment market for Slovenia, recorded an 8% growth rate (EU, 2000; IMF, 2000). This represents a significant levelling off after high growth rates in the first years of post-war rebuilding (in the 1995-1998 period Bosnia recorded an average annual growth rate of almost 25%). In the past few years, the enormous balance of payments current account deficit in Bosnia (about 23% of gross domestic product in 1999), resulting from extensive imports (post-war building) and extremely modest export capacities, was chiefly financed from donations and favourable long-term loans. In the following years, somewhat larger foreign capital inflows are expected in the framework of the privatisation process in which Slovenian investors are actively involved. According to the IMF's optimistic scenario, economic growth in 2000 and 2001 will annually reach some 14% (IMF, 2000), while the EIU assess it to be 9% in 2000 and about 6% in 2001 (EIU, 2000). Taking into account the pending structural reforms, the increased liabilities of external debt servicing as well as stricter conditions imposed by the IMF and other lenders, the latter assessments are more plausible.

Despite the proximity of war in the Balkans, it is estimated that **Macedonia's** economic growth was 2.7% in 1999, which was first and foremost a result of increased sales to non-residents, received foreign humanitarian aid and a 5% growth in agricultural production. It was assessed that the volume of industrial production dropped by 2.5% (WIIW, 2000). In 2000, economic growth was estimated to be 3% and in 2001, 5% (WIIW, 2000), primarily based on expected higher foreign capital inflows and increased exports to Kosovo. Economic growth is unlikely to be faster, regardless of anticipated higher investment in Macedonia, as a result of major structural problems (the restructuring of large loss makers, unemployment, the probable rise in the budgetary deficit).

In the following years economic growth in Macedonia and Bosnia and Herzegovina will above all depend on political stability in the wider region of South Europe and the implementation of the **Stability Pact for South-Eastern Europe**, in which Slovenia participates as an active donor. Besides the countries that emerged from the former Yugoslavia (Slovenia excluded), Bulgaria, Romania and Albania also receive such aid. In the following years activities in the framework of the Working Table on Economic Reconstruction and Development of the Stability Pact will be primarily aimed towards two priorities: regional development with the emphasis on infrastructure, and the establishment of national institutions and business environment. With the situation in the Balkans calming down and the international community becoming more active in stabilising the situation in this region, greater possibilities will also open for foreign direct investment, in which Slovenia, being one of the best connoisseurs of the region, can play an important role, not only as the investor, but also as the advisor to other foreign investors.

4. INSTITUTIONAL FRAMEWORK – Accession to the EU helping to build the institutional framework

Accession to the EU and negotiations for membership have accelerated the building-up of the institutional framework, the creation of new regulatory mechanisms, and the changing of the role of the state. In 1999 and early 2000, several acts were passed that are to bring profound, and yet gradual, changes in certain areas. The entering into force of the Europe Agreement in February 1999 has been another significant initiator of change.

The introduction of value-added tax and excise duties in mid-1999, and the passing of the Pension and Disability Insurance Act at the end of the year brought to a conclusion two key structural reforms that had been prepared for several years. In the fiscal area, the system of direct taxes will have to be changed. Solutions put forward by the Public Finances Act, the Accountancy Act and the Public Procurement Act will undoubtedly improve the efficiency, transparency, responsibility and control over the use of public finances. The Public Finances Act prescribes that the budget be drawn on the basis of multi-year planning, which will allow the financing of long-term development plans and defining of developmental priorities.

The new Pension and Disability Insurance Act came into force on 1 January 2000. Changes concerning the terms and conditions of retirement and the level of pensions will be introduced gradually. In addition to compulsory pension insurance based on solidarity and the pay-as-you-go system, the Law introduces supplementary voluntary pension insurance (in specific cases also compulsory supplementary insurance). As supplementary insurance is capital funded, the reform will gradually re-shape the domestic capital market.

Significant changes have been introduced in regulating the financial sector. Three systemic acts have been passed (the Banking Act, the Securities Act and the Insurance Act), as well as the Foreign Exchange Act, the Dematerialised Securities Act the Ownership Transformation of Insurance Companies Act. Implementation of the latter has been temporarily stopped owing to a constitutional dispute. With the entering into force of the Europe Agreement, the Bank of Slovenia has eased restrictions on the foreign capital inflow (abolition of the need for deposits on loans raised abroad, a gradual reduction of the premium charged for the keeping of a custody account for foreign portfolio investment, a new definition of portfolio and foreign direct investment).

An important step has been taken in the field of public utilities reform by passing the new Energy Act (for details see Box 5). Significant institutional changes are also being carried out in agriculture (the passing of the Agriculture Act, the setting-up of the Agency for Agricultural Markets and Rural Development, and Chamber of Agriculture and Forestry) and regional development (Promotion of Balanced Regional Development Act, Structural Policy Council). In the area of competition, the State Aid Control Act prescribes the setting-up of a Commission for State Aid Control responsible for *ex ante* and *ex post* control over state aid instruments.

Key areas for increasing the competitiveness of the Slovenian economy where regulative changes are being prepared are the labour market and public administration (as regards the former, discussions about a new labour law are under way). The poor assessment of Slovenia's administration in international comparisons points to the urgency of increasing state efficiency (see Chapter 4.1).

4.1. COMPETITIVENESS OF NATIONS – Low assessment of state efficiency calls for a ždifferent' state

A national economy is as efficient as its companies. On the other hand, the competitiveness of companies is significantly influenced by the organisation of the state. The state's competitiveness depends on how it adapts its rules and institutions to economic transactions, while taking modern technology into account. The International Institute for Management and Development (IMD) assesses, in co-operation with its partner institutes, synthesised national competitiveness, attractiveness and aggressiveness, on the basis of 288 quantitative and qualitative criteria. Among 47 countries, Slovenia was assessed for the first time in 1999.

Based on the assessment of competitiveness in all eight groups (see Table 5), Slovenia was ranked 40th, with below-average rankings achieved in Finance, Internationalisation and Government, and poor rankings also in Science and Technology, and People. The IMD's methodology covers the issues of state administration and economic policy in the Government group, consisting of 48 indicators divided into six sub-groups.[3] A closer look at these indicators and

[3] National Debt, Government Expenditure, Fiscal Policy, State Efficiency, State Intervention, and Legal Security.

Table 5: IMD's competitiveness rankings of 46 (47) countries in 1997-99

	Domestic economy			Internatio-nalisation			Govern-ment			Finance			Infra-structure			Manage-ment			Science, technology			People			Synthesi-sed rank		
Year	97	98	99	97	98	99	97	98	99	97	98	99	97	98	99	97	98	99	97	98	99	97	98	99	97	98	99
Denmark	18	14	10	9	12	12	23	20	22	4	4	5	5	5	9	5	8	11	23	14	9	3	2	2	**8**	**8**	**8**
Finland	23	20	4	13	11	11	15	15	10	13	8	8	3	3	2	8	5	3	6	6	6	1	3	1	**4**	**5**	**3**
Netherlands	16	13	7	6	6	6	22	17	18	2	2	3	12	8	7	4	3	2	12	11	8	10	9	12	**6**	**4**	**5**
Austria	27	37	14	18	25	22	26	32	24	21	20	20	14	12	11	21	25	22	19	22	21	9	12	8	**20**	**22**	**19**
Ireland	5	6	2	12	7	8	12	6	5	20	15	16	22	23	23	12	10	7	7	8	11	20	19	21	**15**	**11**	**11**
Spain	33	31	24	14	18	14	21	23	13	22	21	14	21	25	22	28	28	23	27	30	26	26	27	22	**25**	**27**	**23**
Portugal	40	35	21	15	13	19	30	29	25	27	22	21	35	32	27	43	39	34	43	38	38	32	31	25	**32**	**29**	**28**
SLOVENIA			**34**			**46**			**47**			**44**			**29**			**38**			**36**			**28**			**40**
Czech Rep.	36	43	44	24	29	35	41	40	42	35	36	42	29	27	32	42	42	45	44	37	41	24	28	34	**35**	**38**	**41**
Greece	38	33	25	33	35	32	40	43	36	33	34	31	37	37	35	32	36	31	34	33	31	30	29	30	**37**	**36**	**31**
Poland	39	41	37	44	43	45	45	46	44	45	43	37	36	36	38	44	43	44	42	44	43	35	41	38	**43**	**45**	**44**
Hungary	44	42	17	21	26	17	39	26	26	38	30	28	23	20	26	40	35	30	28	27	27	29	30	26	**36**	**28**	**26**

Source of data: The World Competitiveness Yearbook, IMD, Lausanne 1998, 1999.

their correlation reveals to what extent the government and state administration have been successful in conducting economic policy, particularly as regards the building-up of an institutional framework that enables companies to make full use of their competitive advantage. Slovenia was put in a low 47th place in the Government group, principally owing to State Efficiency[4], a sub-group consisting of nine indicators (0.945), followed by State Intervention (0.860), Legal Security (0.819), and Fiscal Policy (0.802). These high levels of correlation support the following principles of effective competition in the international environment: (i) state intervention should be minimal and restricted to creating the conditions for enterprises to compete; (ii) the government should plan the type of macroeconomic and social conditions that minimise external risks for the economy; and (iii) the government's economic policy should be flexible in order to be able to respond to changes in the international environment.

Slovenia's State Efficiency has been compared within a group of twelve reference countries (see Table 6). Recording an average score of 3.10, Slovenia ranks at the bottom of the sample, 16% worse off than the Czech Republic placed in the second worst place. The low assessment can be partially attributed to the structure of executives chosen in the sample: companies managed by the Slovenian

[4] This assumption is supported by the correlation matrix showing the žbehaviour' 13 reference countries (for details see SEM 8/99:8).

Development Corporation were also included.[5] It should nevertheless be pointed out that Slovenian managers exhibited a high level of responsibility in improving competitiveness by giving a high score of 6.64 (11th place out of 47 countries), which points to a high level of the sense of responsibility compared to Hungary (42nd place) or Austria (9th place).

Table 6: State efficiency indicators in 1999

Country	1		2		3		4		5		6		7		8		9		Average 1-9	
	A	B	A	B	A	B	A	B	A	B	A	B	A	B	A	B	A	B	A	B
Finland	7.26	1	8.53	1	7.45	1	7.94	1	7.42	1	7.55	1	7.52	1	7.03	1	9.52	2	7.80	1
The Netherlands	7.09	4	7.65	3	6.61	4	7.00	4	6.98	4	6.07	5	6.91	4	4.98	4	9.23	3	6.95	3
Denmark	5.74	7	7.84	2	6.26	6	6.57	6	4.96	10	6.49	4	6.18	6	5.87	2	9.01	6	6.52	5
Ireland	7.16	3	7.34	4	7.07	2	7.88	2	6.99	3	6.57	3	7.13	2	5.16	3	9.10	4	7.16	2
Austria	5.69	8	7.00	5	6.03	7	5.87	8	6.08	6	5.82	6	5.79	8	3.14	7	9.54	1	6.11	7
Belgium	4.85	11	5.66	8	5.06	11	5.54	9	5.36	8	5.00	8	4.27	10	2.74	8	7.67	9	5.13	9
Spain	7.23	2	6.46	6	6.66	3	7.83	3	7.03	2	6.80	2	7.09	3	4.17	5	8.90	7	6.91	4
Hungary	6.33	5	6.29	7	6.37	5	6.98	5	6.24	5	5.55	7	6.45	5	3.88	6	8.41	8	6.28	6
Portugal	5.86	6	4.37	11	5.19	10	6.17	7	5.63	7	4.85	9	6.03	7	2.51	9	9.05	5	5.52	8
Greece	5.23	9	5.19	9	5.34	9	5.39	10	5.26	9	4.09	10	4.89	9	1.97	12	7.63	10	5.00	10
Slovenia	**3.22**	**13**	**3.97**	**12**	**4.15**	**12**	**2.10**	**13**	**2.13**	**13**	**2.36**	**13**	**2.57**	**13**	**1.71**	**13**	**5.71**	**11**	**3.10**	**13**
Czech Rep.	4.07	12	3.21	13	4.11	13	4.21	12	3.75	11	2.64	12	3.54	12	2.36	10	5.36	12	3.69	12
Poland	5.20	10	5.18	10	5.42	8	4.37	11	3.60	12	3.53	11	4.77	11	2.09	11	4.64	13	4.31	11

1 - government economic policies adapting to changes in the economic environment (the highest score: 10.0)
2 - legal framework supporting country's competitiveness
3 - legislative activity of the parliament meeting the competitive requirements of the economy
4 - consensus about policy directions inside the cabinet
5 - government's transparency concerning policy intentions
6 - effective implementation of government decisions
7 - the political system adapting to economic challenges
8 - bureaucracy hindering business development
9 - the risk of political instability

Source of data: The World Competitiveness Yearbook 1999, IMD, Lausanne 1999.
Notes: A - assessment, B - ranking.

A detailed analysis of Slovenia's state efficiency – taking into account the remaining five sub-groups that make up the Government group in comparison to other countries in 1999 – reveals that the quality of state governance in the economic, social and administrative areas is above all determined by state

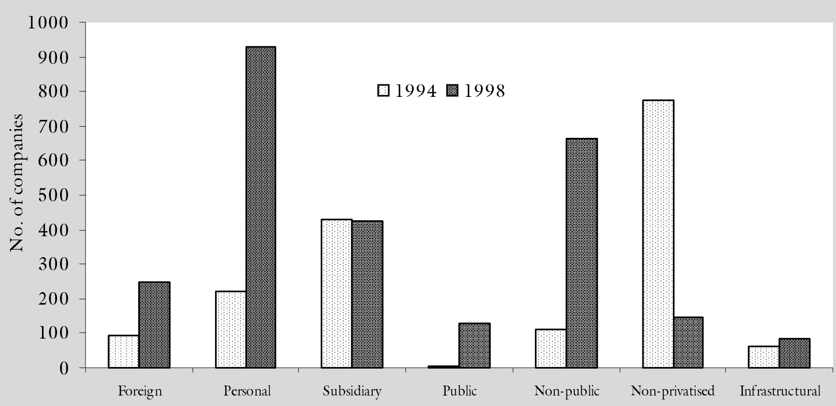
[5] The European Bank for Reconstruction and Development also published an assessment of the quality of governance in countries in transition (EBRD, 1999). The results are similar to those of the IMD, even though the method was different and simpler. Companies in 20 countries in transition assessed obstacles to their business ranging from 0 (major obstacles) to 3 (no obstacles) in four areas: micro-economic governance, macro-economic governance, physical infrastructure, and law and order. Slovenia was ranked 2nd with the governance index totalling 1.95, below Hungary (1.98). It was rated lower in the groups of physical infrastructure and law and order, and reached about the same level as Hungary in macro-economic governance. Slovenia was ranked the highest in micro-economic governance.

efficiency. This, of course, concerns not only the taking on of the *acquis* (in public administration as well) but also its implementation. In order to be placed higher in the Government group, i.e. to improve the assessment of state administration and economic policy, it is necessary to achieve a higher ranking in all nine state efficiency indicators. The underlying goal of improving state efficiency is to (i) adapt the rules of the game and institutions to the needs of companies in the market; and (ii) regulate economic activities in compliance with EU rules. This calls for the rapid reform of the state administration.

4.2. ENTERPRISE SECTOR RESTRUCTURING – Privatised companies must accelerate their entry into offensive restructuring; the state must strengthen its role in development

Restructuring of the corporate sector is a key factor in ensuring continuing strong growth of the Slovenian economy. A more or less normal capitalist ownership structure was gradually created in the enterprise sector in Slovenia the 1994-98 period. However, the restructuring process remains unfinished owing to the slow privatisation of certain sectors of the economy (companies owned by the Slovenian Development Corporation, Slovenian Steelworks, etc).

Graph 1: Changes in ownership structure of Slovenia's enterprise sector, 1994-1998

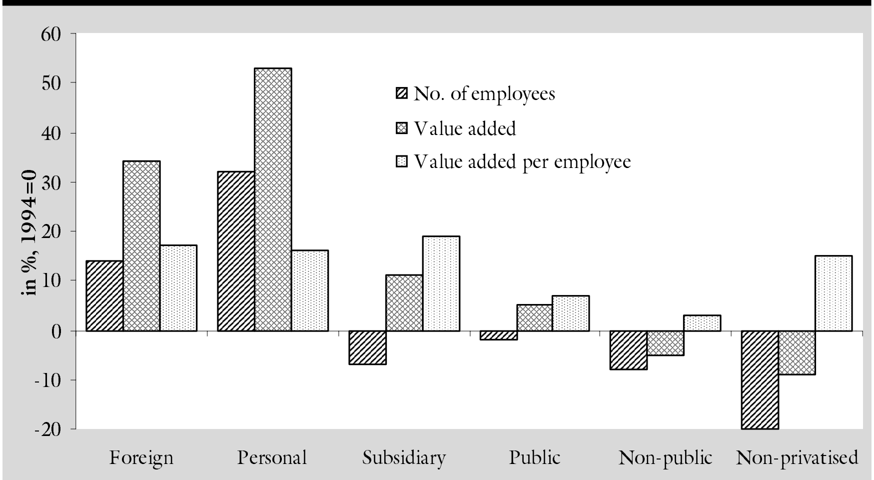


Sources of data: Rojec, Simoneti, Rems, author's calculations based on AP's data.

The analysis of the performance of the Slovenian non-financial corporate sector in 1994-98 (Simoneti, Rojec, Rems, 2000) shows that the pattern and intensity of the restructuring process, and consequently performance, differ significantly between ownership categories of companies. Some companies have moved out of defensive restructuring where companies rationalise production, reduce capacities and employment, discontinue non-profitable programmes in order to adapt to changes in the market and other conditions within their capacities. They have entered the offensive restructuring phase whereby companies look for new opportunities and markets by investing and introducing new programmes, by increasing capacities and employment.

Analysis of the performance of different ownership categories of companies shows that there are three groups of companies in Slovenia: (i) companies with concentrated ownership; (ii) companies with dispersed ownership; and (iii) non-privatised companies. Companies with concentrated ownership show superior performance and have a high and constantly rising return on equity compared to other companies. They grow faster thanks to investment and rising employment. Differences between companies with concentrated ownership and other companies are widening in terms of return on equity, value added per employee, the level of value added and the number of employees. Companies with dispersed ownership are improving their performance, however, the improvement is slow and is the result of defensive restructuring rather than investment, employment and expansion. Non-privatised companies are staying

Graph 2: Net operating profit per equity by ownership categories



Sources of data: Rojec, Simoneti, Rems, author's calculations based on AP's data.

in the red even though operating losses are falling and the operating cash flow is recording a positive trend. These companies have also increased their value added per employee, which is the result of employment falling more strongly than value added.

Dominant processes in changing the ownership structure of the Slovenian enterprise sector[6] in this period were: (i) a strong increase in the number and significance of personal, public, non-public and foreign companies, and a rapid drop in the number and significance of non-privatised companies; (ii) a stagnation in the number and significance of subsidiary companies, which suggests that the popularity of this category was closely linked to privatisation; and (iii) strong capital intensity of infrastructural companies, which recorded strong growth in assets throughout the period financed mainly by ownership capital (investments of the state).

The reason for the rise in the number non-public enterprises lies in the fact that privatisation resulted in a dispersed ownership structure in the majority of companies (a large number of small owners). Public companies with an approval to sell shares to the general public form a minor group, however, these companies are relatively large and have high capital share and high sales. Foreign companies

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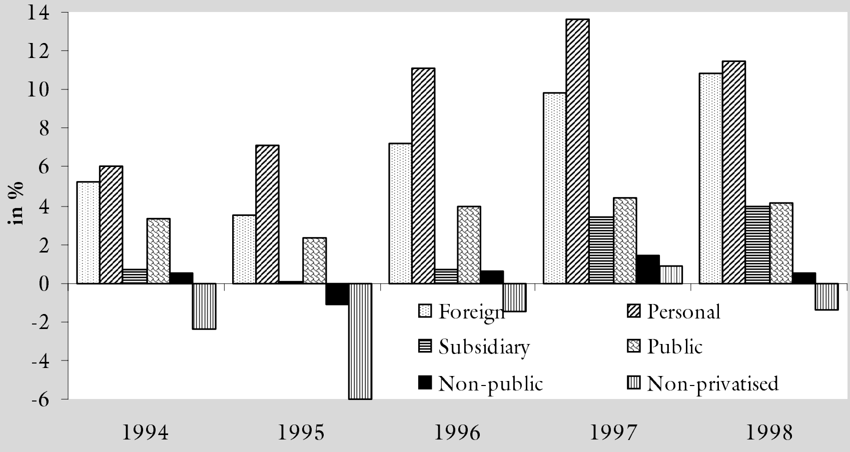
[6] The analysis covered companies that meet these criteria: (i) the average number of employees is 10 or more; (ii) total asset value SIT 90 million or more; (iii) sales equal to or exceeding SIT million. There were 1,695 companies that did not meet these criteria in 1994 and 2,626 in 1998.

The criterion according to which companies were divided into ownership categories was the type of owners with the largest share in a company. Companies were divided into:
- *foreign companies:* where a majority stake is held by a foreign owner;
- *personal companies:* where domestic natural persons hold a majority stake in a company (each more than 10%);
- *subsidiary companies:* where domestic legal persons (each more than 10%) hold a majority stake in a company;
- *public companies:* where approval has been obtained from the Securities Market Agency to offer shares to the general public;
- *non-public companies:* where minor owners do not have a majority stake, mostly domestic legal and natural persons, their shares cannot be bought by the general public;
- *non-privatised companies:* socially- or state-owned entities that do not carry out infrastructural activities;
- *infrastructural companies:* where the state is the owner and the companies carry out infrastructural activities, i.e. coal extraction, electricity production and distribution, postal services, etc.

also form a relatively small but fast-growing group in terms of number and significance.

In the five-year period, companies covered in the analysis[7] reduced the number of employees (-5.1%), moderately increased their assets and value added (2.9% and 6.2%, respectively), boosted sales (12.3%) and exports (18.6%), and recorded surging operating profits (92.7%). Companies seem to be in a gradual transition from the defensive to offensive restructuring phases, and operating profits are becoming an important criterion in establishing performance. A detailed analysis shows that there are significant differences in trends between ownership categories, which is why these conclusions need to be looked at in relative terms: (i) positive trends were mainly due to rapid growth of foreign and personal companies, categories with relatively weak importance in terms of number; (ii) the number of employees only rose in foreign and personal companies; and (iii) operating profits recorded the strongest growth at the aggregate level in the observed period, however, there were wide differences between categories of companies. The strongest growth was seen in subsidiary companies, followed by foreign and personal companies, while public and non-

Graph 3: Net operating profit per equity by ownership categories



Sources of data: Rojec, Simoneti, Rems, author's calculations based on AP's data.

[7] These figures cover 1,200 companies that met the criteria mentioned above each year in the observed period (number of employees, asset value, sales value). The analysis does not cover infrastructural companies as their terms of operation are defined by the state rather than market forces.

public companies lagged behind substantially. Non-privatised companies consistently recorded a loss throughout the observed period, except in 1997.

On the one hand, there are foreign and personal companies with concentrated ownership that have undertaken offensive restructuring and are expanding, and non-public companies with dispersed ownership structure, while on the other there are non-privatised companies still deeply into defensive restructuring. The latter attempt to improve performance by rationalising operations and reducing capacity and employment. Subsidiary and public companies are in between: they are expanding their capacities, but are reducing employment at the same time.

In the given period, each ownership category increased value added per employee, but differences between categories were wide. It was non-privatised, public and non-public companies that exhibited the weakest growth. Foreign and personal companies increased value added per employee by raising value added, assets and employment, i.e. by expanding their activity or offensive restructuring, while other companies achieved the same result by reducing the number of employees. A rise in fixed assets in foreign and personal, as well as subsidiary companies, and a fall in fixed assets in other categories also shed some light on the differences in the levels of restructuring between companies.

In general, the Slovenian enterprise sector is still not in an offensive restructuring phase because total growth is mainly driven by foreign and personal companies, while companies that have been privatised, public and non-public companies, as well as subsidiary companies representing almost three-quarters of the Slovenian enterprise sector, record low growth rates and are to a large extent still in the defensive restructuring phase.

Different performance indicators[8] show an improvement in performance on average over the 1994-98 period. However, the average hides a number of characteristics pointing to the too slow restructuring of Slovenia's non-financial corporate sector. If foreign and personal companies are not taken into account, that is companies recording the most favourable trends in performance and owned by strategic owners with clear goals and assets to realise these goals, at least as regards foreign companies, the initial impression of a gradual improvement in performance is seriously tainted. Restructuring is slowest in

[8] The following indicators were used: net operating profit per equity and sales, net operating cash flow per equity and sales, and value added per employee. For a detailed treatment of these indicators see Simoneti, Rojec, Rems, 2000.

those categories where it should be the most vigorous, i.e. in public and non-public companies, companies having undergone privatisation, and in non-privatised companies. Within the group of companies undergoing privatisation, public companies owned by a majority of external owners recorded the best results. However, these owners have neither the possibilities nor the motivation (dispersed ownership, unclear role of para-state funds and investment companies) or assets to step up the restructuring process in the companies they own. The situation is even worse in non-public companies, which suffer stagnation, and in non-privatised companies, which show signs of improvement, but still record operating losses. The stagnation of non-public companies raises doubt as to whether internal owners have the ability, motivation and assets to carry out restructuring, while the poor performance of non-privatised companies casts doubt on the rationale of whether the state should insist on rescuing these companies at any cost. These trends have resulted in a further widening of differences in performance between foreign and personal companies on the one hand and companies undergoing privatisation on the other. This is very discouraging for the whole Slovenian enterprise sector; we want companies that have undergone the privatisation process and represent the lion's share of the Slovenian enterprise sector to gradually catch up with foreign and personal companies, which are a model of how a company should operate. It seems that Slovenia has still not created conditions for the prompt restructuring of companies that have gone through the privatisation process.

While restructuring the enterprise sector, the state followed an active policy of microeconomic intervention in the economy. In the early post-independence period, the state's intervention was aimed at preventing the collapse of large enterprises and the resulting social unrest, while later on it gradually introduced intervention aimed at promoting development. The policy used different instruments and institutions. In the field of public finances, the state allocated 2.93% of gross domestic product in 1992 through subsidies as the main instrument of state aid (according to public finance statistics). From 1992 to 1996, subsidies were gradually reduced (1.35% of gross domestic product in 1996), while since 1996 they again saw a rising trend, amounting to 1.73 % of gross domestic product in 1999. The state also used other intervention mechanisms within public finances, such as tax exemption and relief, soft loans, guarantees, etc. It also used indirect intervention instruments through various state and municipality funds. The total volume of state aid was only assessed last year: according to EU methodology, state aid climbed to 3.5% of gross domestic product, substantially above the annual average of 1.2% of gross domestic product in the EU in 1995-97.

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Box 2: Economic functions of the state and the WTO, OECD and EU rules

Even though global economic trends reflect a tendency towards the globalisation of production, free competition between economic agents, and the liberalisation of world trade, the state continues to perform a number of important economic functions. The state sets up the legal framework for the efficient functioning of a market economy, provides a stable macroeconomic environment by buffering economic fluctuations in order to prevent unemployment, stagnation of the economy and price rises. The state also performs purely microeconomic functions. First, distribution, which aims at evenly distributing productive resources among regions and sectors, and second, reallocation whereby the state maintains the existing economic structure. Over the last few years, advanced states, in particular, have also performed a development function in order to improve the quality of the labour force, raise the level of accumulation and investment, promote technological development and entrepreneurship, and boost economic growth in consequence.

As a result of the strong inclination towards minimising state interference in the economy, the world associations (WTO, OECD, EU) have developed a system of rules defining those areas where state intervention is allowed, concerning in particular the microeconomic environment. On the one hand, this should prevent negative impacts on the world economy and competition and, on the other, accentuate the development function aimed at strengthening technological development, environmental protection, and raising the quality of the labour force. Each member-state must adhere to these rules, meaning that Slovenia, by becoming member of the WTO, is obliged to follow its rules, and will have to do the same in the process of accession to the EU.

By signing the Europe Agreement and passing the State Aid Control Act, Slovenia will be obliged to follow EU rules in conducting the system of state aid in 2001. Derogations relate to the restructuring of the textiles, footwear and steel industries, and have been harmonised with the European Commission. In 1999, Slovenia set up an inventory of state aid and made the first survey on the volume, aims and instruments of state aid. In 2000, the second survey will be prepared and a system of *ex ante* control gradually introduced. Slovenia's current state aid policy will change after 2000 by assuming a developmental rather than allocative role (rescue and rehabilitation of loss-making companies). This is the underlying principle of EU rules on state aid reflected also in the current average structure of aid in EU Member States.

The intensity of the process of enterprise sector restructuring is a key factor that determines the capacity of Slovenia's economy to cope with competitive pressure and market forces in the single EU market. It is therefore urgent to strengthen the competitiveness of Slovenian small- and medium-sized enterprises, which represent an important segment of the national economy[9] as they will be exposed to stiff competition upon accession to the EU. The contribution of small- and medium-sized enterprises to economic development is substantial and largely the result of their inclination towards research and development and specialisation. Furthermore, they have a major role in promoting regional development, particularly in regions that are underdeveloped and have high unemployment rates. Owing to specific problems – difficulty in obtaining capital for investment and the payment of taxes and contributions – small- and medium-sized enterprises require a policy that will create an environment conducive to their development. In terms of state aid, the promotion of small- and medium-sized enterprises converges industrial and competition policies, as state aid interventions in that area do not distort competition in the market due to its small scale and dispersion.

The main act regulating the allocation of state aid to small- and medium-sized enterprises is the Small Business Development Act, and the main strategic document is the Strategy of Developing the Small Business Sector in Slovenia, still going through parliament (Poročevalec, 34/96). However, criteria that define small- and medium-sized enterprises in the two documents are not the same as in the EU, and the objectives of state aid do not comply with EU rules.[10] At national and local levels, state aid to small- and medium-sized enterprises is given by a number of institutions, which reduces transparency and control. This is why a new classification of state intervention instruments by company size should be made and harmonised with the EU's rules. In 1997, state aid to small- and medium-sized enterprises accounted for 15.95% of all aid given to manufacturing and other services; in 1998 the share climbed to 24.35%. Aid to small- and medium-sized enterprises was mainly given for investment, but also

[9] In the EU, small and medium-sized enterprises (up to 200 employees) employ over 60% of all workers and companies with less than 100 employees represent 99.3% of all companies. Slovenia's definition of a small company is not harmonised with the EU. The Companies Act defines small enterprises as those employing up to 50 people, and medium-sized those with up to 250 workers. Small and medium-sized enterprises accounted for 37% of the total revenue and 33.5% of the total net profit of companies in 1999, according to figures by the Agency for Payments.

[10] EU rules on state aid for small and medium-sized enterprises dating from 1996 were made on the basis of the White Paper called Growth, Competitiveness and Employment, saying that those companies are a factor of dynamic development and social stability. The basic rules on state aid are focused on: (i) investment in tangible fixed assets (land, buildings, equipment); (ii) investment in intangible fixed assets, mainly related to technology transfer; (iii) counselling services, training and knowledge dissemination. The rules are valid for all areas, except for those with special sectoral rules (steel industry, shipbuilding, car industry, synthetic fibres industry, coal mining, agriculture, fisheries, and transport).

for counselling services, training, research and development. The prevailing state aid instruments were grants, guarantees, soft loans, loans to loss-making companies, grants/subsidies on interest rates, tax relief, and guarantees.

The **significance of small companies** in a modern economy is growing. This is a crucial sector for boosting the competitiveness of the whole economy as competitiveness is the stiffest in this sector. In developed economies where the segment of large enterprises is dominated by oligopolies and monopolies, market mechanisms principally operate in the segment of small companies. They complement economic activities of large enterprises, make the economy adaptable and flexible, and generate the most new ideas. The existence of small companies is therefore crucial for the normal functioning of a market economy and one of the factors of its performance. In the EU, medium-sized enterprises employ 19% of all workers on average and generate 17% of all revenues. They are concentrated in manufacturing, particularly in textiles, rubber, paper and machinery industries, and also active in services, particularly information technology. In the EU, small companies employ 23% of all workers and account for 17% of revenues. They principally operate in the leather, fur, metal, and wood industries. Small companies employ one out of three employees in wholesale trade, and one out of four in the printing and publishing industry. Micro-companies account for 33% of all employees and generate 18% of revenues in the EU. They account for 10% of all employment (self-employment) and represent 4% of revenues of companies with no employees. The segment of micro-companies includes self-employed persons doing contracting work in construction, or small family companies operating in the services sector, such as retail trade, catering, real estate, financial intermediation, and other personal services.

Financial indicators from the profit and loss accounts suggest a slightly different size structure in Slovenia than in the EU. The significance of micro-, small- and medium-sized enterprises in the economic structure is shown through their economic power rather than number (many companies have no employees). Micro-, small- and medium-sized enterprises generated 57% of total revenue in Slovenia, 49% of value added, and accounted for 53% of all employment in 1998. Medium-sized enterprises generated one-quarter of total value added, while economic growth was below the average. Micro and small companies generated one-third of revenue, one-quarter of value added and jobs. Small companies are the most dynamic sector with 8.3% economic growth, positive business results and strong employment growth (10%). Micro companies recorded average economic growth and a stagnant number of employees. Micro, small- and medium-sized enterprises are a very dynamic and flexible sector of the economy; it is however also the most vulnerable. Their business results are below the average: they accounted for 57% of total net profits and up to 75% of total net losses.

The small business sector should be included in the sector of micro-, small- and medium-sized enterprises. In December 1998, there were 87,568 self-employed persons (36,429 farmers, 45,409 individual private entrepreneurs, 5,730 own-account workers, e.g. artists, lawyers, etc), operating in the small business sector and employing 60,827 people, 4.6% more than in the previous year. This sector employed 25% of all workers in the enterprise sector. Financial figures on private entrepreneurs are available with a two-year delay and are still unavailable for 1998. In 1997, private entrepreneurs reported SIT 652 billion of revenues (about 9.1% of revenues of all commercial companies), and generated SIT 244 billion of value added (11.1% of all value added).

Micro-, small- and medium-sized enterprises are fundamental to competitiveness and job creation. Slovenia's export potential principally lies in this sector, which could, like in the EU, employ a larger number of people. The analysis of economic trends in small- and medium-sized enterprises reveals above-average growth with the highest profitability and return on equity, while the revenue-to-expenses ratio, efficiency and productivity are lower. This sector has a weaker capital capacity than large enterprises, short-term liabilities mainly rise on account of a rapid rise in financial liabilities. This leads to high financing expenses, which dampens business results, reduces profits and thus hinders development. Large enterprises record a capital value twice as high as liabilities, as shown by their balance sheets, while the situation in small companies is reverse. The balance sheet structure of private entrepreneurs is more favourable: capital was three times higher than short-term and long-term liabilities.

4.3. TECHNOLOGICAL RESTRUCTURING – Promoting technological development urgently needed to improve competitiveness

Technological restructuring is the main force pushing value added per employee further up, and a co-creator of the global competitiveness. The level of technological complexity of products[11] increased from 4.2 in 1994 to 5.9 in

[11] There are 15 grades of technological complexity: grade one includes tasks that require no qualifications, grade fifteen includes technologically the most advanced tasks.

1997, according to the available data. Assuming from the rise in imports of modern equipment, the level has continued to increase since 1997. In spite of this, Slovenia remains low in terms of technological complexity, sells its products in low price ranges, and has therefore limited opportunities for expanding exports, particularly in markets of advanced economies. Part of the reason lies in the elimination of R&D departments in companies or their limited innovation capacity. According to a survey (IER, 1997), companies would have to employ 800 people as research staff and invest around SIT 60 billion in development per year in order to catch up with the EU countries. In its analysis of research and technological systems, the European Commission has established that Slovenia's total investment in R&D was relatively high in 1999, but there are too few technological applications and too little co-operation between companies, institutes and universities. An environment favourable to science and technology should therefore be created and the government's priorities in the field of research and development clearly defined, for competitiveness cannot be improved without a commitment to technological development.

The role of science and technology in Slovenia can be further elucidated by an international comparison. We have taken those indicators from the IMD system of indicators that most clearly show the impact of science and technology on national competitiveness (see Table 7). There is a strong correlation between the sub-groups of indicators within Science and Technology and global competitiveness (Gmeiner, 1999).

Among 47 countries, Slovenia was ranked 36th in the Science and Technology group of indicators in 1999, while among 13 reference countries it was ranked last. In the latter group of countries, Finland came first; in terms of global competitiveness, it was put in a high 3rd place among 47 countries. Around 20% of Finland's exports were high technology products or services (about 6% in Slovenia). It allocates 4.6% of the state budget for research and development (2.5% in Slovenia). Since 1990, the country increased the total research and development expenditure relative to gross domestic product by 50%, so that the total share (state and corporate sector) exceeded 3% of gross domestic product (around 1.5% in Slovenia). Finland has managed to bring the knowledge of universities and institutes closer to the development needs of companies. Slovenia was put in a low 46th place in this respect, with other areas, such as experienced engineers, support to the application of technology and promoting technical education with young people being equally critical. What raises concern is Slovenia's drop in Science and Technology, falling from 36th to 40th place in 2000 despite its improvement in the global competitiveness (from 40th to 35th place).

Table 7: Slovenia and reference countries in the Science and Technology group by IMD method, 1999[12]

	1		2		3		4		5		6 = 1 to 5		7	
	A	B	A	B	A	B	A	B	A	B	A	B	A	B
1 Finland	7	1	7	1	1	1	11	3	19	5	6/6	1	3	1
2 Denmark	8	2	15	2	5	3	8	1	16	4	9/14	3	8	3
3 Austria	19	5	22	5	25	6	18	6	23	6	21/22	6	19	5
4 Netherlands	10	3	20	3	4	2	17	5	8	2	8/11	2	5	2
5 Belgium	14	4	23	6	20	5	12	4	10	3	18/16	5	22	6
6 Ireland	23	7	25	8	13	4	10	2	3	1	11/8	4	11	4
7 Spain	25	8	24	7	28	9	29	9	29	7	26/30	7	23	7
8 Greece	38	13	37	11	27	8	28	8	33	8	31/33	9	31	10
9 Portugal	35	12	42	13	32	10	37	12	35	9	38/38	11	28	9
10 Czech Rep.	27	9	34	9	45	13	33	10	47	13	41/37	12	41	12
11 Hungary	33	11	21	4	26	7	20	7	43	11	27/27	8	26	8
12 Poland	30	10	35	10	44	12	36	11	46	12	43/44	13	44	13
13 SLOVENIA	22	6	38	12	43	11	44	13	37	10	36/-	10	40	11

Notes: 1 - R&D expenditures, (5 indicators), 2 - R&D personnel (6), 3 - technology management (5), 4 - scientific environment (5), 5 - intellectual property (5), 6 - total 1-5 (26), 7 - global competitiveness (288), A - ranked among 47 countries, B - ranked among reference countries of Slovenia; the first figure in column 6 refers to 1999 and the second to 1998.
Source of data: World Competitiveness Yearbook, *International Institute for Management and Development - IMD, Lausanne, 1999.

Slovenia's priority in the field of research and technological development is co-operation with the EU. An agreement on co-operation up until 2002 has been made, and negotiations in the chapter on Science and Technology have been temporarily concluded. In the period before accession to the EU, Slovenia's industry will have to get ready to face strong competition in the single market by increasing the level of its technological development. Slovenia will thus be able to make full use of its comparative advantage in the People group of IMD's indicators, where Slovenia is placed the highest out of the eight national competitiveness aggregates.

The Act Regulating the Forms of Support for Business Companies to Develop New Technologies and to Establish and Manage their Development Units Between 2000 and 2003 has been passed. In order to implement the Act, a Programme of Promoting Technological Development will have to be adopted as well. The Programme, devised by eight ministries and the Slovenian Development Corporation, is divided into 6 programmes and 26 direct or indirect measures to raise technological development: (i) incentives to companies

[12] For a detailed analysis of 26 indicators see Pavle Gmeiner's research on Slovenia's position in an international comparison of competitiveness focusing on technological development (Gmeiner, 1999).

for the development and introduction of new products and technologies; (ii) incentives to companies for the setting-up and running of their own development departments; (iii) promotion of co-operation between companies and the building of common infrastructure; (iv) promotion of innovation in regions; (v) development of human resources; (vi) other measures having a direct impact on technological development. Those incentives, which are harmonised with EU rules on state aid, could increase value added in companies actively engaged in development to over SIT 6 million per employee, the number of patents by one-quarter, and the number of experts in companies by 800 in the period up to 2003, according to estimates of the Ministry of Science and Technology.

5. ANALYSIS OF CURRENT ECONOMIC TRENDS AND SHORT-TERM PROJECTIONS

5.1. GROSS DOMESTIC PRODUCT – Growth in 1999 higher than expected

According to the first SORS estimates, gross domestic product rose by 4.9% in real terms in 1999. Economic growth substantially exceeded the levels planned in autumn (from 3.5 to 4%) as well as preliminary estimates made by the SORS (4%). The first SORS estimates, show that in 1999 gross domestic product in current prices amounted to SIT 3.254 billion.

In 1999, gross domestic product grew fastest in the second quarter (a 7.4%-rise in real terms in the second quarter following a 3%-increase in the first quarter - at the annual level), whilst in the third quarter it slowed down to 4.1% at the annual level and started to improve again towards the end of the year (5% higher in real terms in the last quarter compared to the same period in 1998). Last year's movements in economic activity were significantly affected by the introduction of VAT on 1 July. This was reflected in the exceptional real growth of value added in the sectors of trade and construction in the second quarter (up by 26.2% in construction and 18.2% in trade and repair of motor vehicles, compared to the same period in 1998), which was related to the higher spending in the months prior to the change in the tax system. On the other hand, economic activity, primarily that of manufacturing, which has a relatively high share in total value added (23.8% in 1999), was also affected by the slower economic growth of Slovenia's main foreign trading partners in the first half of 1999.

5.1.1 PRODUCTION STRUCTURE OF GROSS DOMESTIC PRODUCT – Dynamic growth in manufacturing and continuing favourable trends in construction in 2000 and 2001

In 1999, the highest rise in value added was recorded in construction (14.4%) and wholesale and retail trade and repair of motor vehicles (6.5%) as well as in real-estate and business activities (5.2%). For the first time since 1996, the services sector (from G to O) experienced higher real growth in value added (4.4%) than in industry (C, D and E; 3.3%), whilst compared to industry and construction together (up by 4.9%), its pace was slower. Last year, employment increased mainly in the services sector (up by 3.3% according to national accounts statistics) and in construction (2.4%), whilst once again it decreased in industry and agriculture (by 1.5% and 10.3%, respectively). In 1999, the service sector's share in value added and total employment further improved, nevertheless, in the second half of the nineties, this upward trend slowed down as a consequence of the already achieved development level on one hand and the stronger interdependence between the service and industrial production sectors on the other. This period (1995-99) was characterised by different paces of growth in individual service activities, which was affected by a series of factors. In view of modern global development tendencies (the service and information society, the Internet, the new economy) and dynamic changes in information and communications technology, the trends in computer and telecommunication services are the most important (for details see Box 6).

It is estimated that stable economic growth will continue **in 2000** (4 ¾ per cent). With more favourable economic growth of the main trading partners (see Chapter 3), the pace of growth in value added in manufacturing, which slowed down in 1999, is expected to accelerate (to 5.3%). A substantial increase in real terms is also envisaged in construction (15.0%), having the strongest multiplier effect (indirect and direct) on production of all sectors in the national economy[13]. Thus, value added in industry and construction together is expected to increase by 6.3% in real terms (by 4.7% in industry), whilst growth in service activities will be slightly slower (down to 4.1%), compared to the relatively higher growth in 1999. **In 2001**, we expect services to slightly improve again (around 4.5%) and industry to stabilise at 4%, resulting in an increase in gross domestic product of approximately 4.5% in real terms.

The sector of **agriculture, hunting and forestry** still remains significant for the Slovenian economy and even more emphasis is put on its environmental, spatial and social functions. The share of value added of this sector in total value added is gradually declining (from 4.3% in 1997 to 3.7 % in 1999), nevertheless it remains relatively high, particularly compared to the EU countries. In 1999, the value added of this sector increased by 2.3% in real terms.

5

The SORS' data on production volumes in 1999 show that the harvest of cereals was poor, as wheat production was 31% lower than in 1998, when it was exceptionally abundant. The harvest of both corn for grains and for ensilage

[13] In the past, the total construction multiplier by sector (showing the volume of production in all sectors of the national economy which is directly and indirectly required for satisfying a unit of demand for construction services) stood at 2.18.

Table 8: Value added by sectors and gross domestic product

	Structure in %, current prices				Real growth rates in %, 1995 prices			
	1998	1999	2000 estmate	2001 estimate	1998	1999	2000 estimate	2001 estimate
A Agriculture, forestry, hunting	3.6	3.2	3.1	3.0	3.1	2.3	2.0	2.0
B Fishing	0.0	0.0	0.0	0.0	-4.4	-7.5	5.0	2.0
C Mining	1.1	1.0	0.9	0.9	0.1	-0.7	-1.0	-0.5
D Manufacturing	24.1	23.8	23.6	23.4	4.6	4.0	5.3	4.5
E Electricity, gas and water supply	3.0	2.6	2.5	2.4	0.9	-2.5	1.0	1.0
F Construction	4.9	5.3	5.7	6.0	4.6	14.4	15.0	10.0
G Wholesale, retail trade, certain repair	10.0	10.0	10.0	10.0	2.8	6.5	4.0	5.0
H Hotels and restaurants	2.6	2.6	2.6	2.6	0.9	1.5	4.0	5.0
I Transport, storage, communications	7.2	7.0	7.0	7.0	5.2	3.2	4.0	4.5
J Financial intermediation	3.7	3.7	3.7	3.7	3.7	2.8	3.5	4.5
K Real estate, renting and business services	10.3	10.5	10.5	10.6	2.4	5.2	5.0	4.5
L Public administration and defence	5.0	5.0	4.9	4.8	3.5	4.0	3.0	3.5
M Education	4.8	4.9	4.9	4.9	3.1	3.5	4.5	4.0
N Health services and social work	4.6	4.7	4.6	4.6	1.7	4.2	3.5	4.0
O Other community and personal services	3.1	3.1	3.1	3.1	5.8	4.8	5.0	5.0
FISIM	-2.0	-2.1	-2.1	-2.0	2.9	0.3	1.5	1.5
1. VALUE ADDED (A ... O + FISIM) in basic prices	85.8	85.3	85.1	85.1	3.6	4.6	4.9	4.7
2. Corrections (taxes on products and services - subsidies)	14.2	14.7	14.9	14.9	5.0	6.3	3.7	3.5
3. GROSS DOMESTIC PRODUCT (3 = 1+2)	100.0	100.0	100.0	100.0	3.8	4.9	4 $^{3}/_{4}$	4.5

Source: SORS; estimate: IMAD.

was poorer by 8% and 9% than in 1998. The harvest of early fruit was bountiful (owing to severe frost in 1998, any comparison would be unreasonable), but not that of late-season fruit and grapes. The harvest of fruit produced in plantation orchards was down by 14% while that of grapes from vineyards was down by 20% compared to 1998. Similarly to previous years, 1999 saw further growth in sugar beet production (up by 23%), as more agricultural land was under sugar beet, due to its market appeal.

At the end of 1999, the total number of cattle in animal husbandry, which is the main branch of agriculture, increased by 4% over the end of 1998. The number of sheep has increased in previous years, whereas in 1999 it remained at the 1998 level. There were 6% fewer pigs whilst the production of fresh pork and beef went up by 23% and 2% respectively. Statistically recorded total sales of agricultural products levelled off in 1999, despite higher value added in the sector. The inference that may be drawn is that relatively developed direct producers' sales in food markets are even further increasing, also via tourism farms, which are gaining ever more ground.

In 1999, the value of Slovenia's trade in agricultural products and foodstuffs with other countries, expressed in USD terms, was lower in 1999 than in previous years mostly owing to the substantially stronger US currency. Total imports decreased more than total exports, therefore, the usually low export-to-import ratio of agricultural products and foodstuffs once again slightly improved (up by 44.8% in 1997, 47.8% in 1998 and 49.1% in 1999). Since the agricultural part of the agreement with the CEFTA countries entered into force at the beginning of 2000, thereby removing trade barriers between Slovenia and other CEFTA members, it may be expected that the share of trade with these countries will further increase. However, data on trade in agricultural products and foodstuffs in 2000 is still not available. Trade in agricultural products between Slovenia and EU countries will also be liberalised in July 2000, but not entirely, as the most sensitive products will remain subject to customs quotas.

Box 3: Structural and Institutional Changes in Agriculture

In 2000, Slovenia will start implementing the **Agricultural Policy Reform,** as the adopted budget is sufficient to start carrying out measures in line with the EU's requirements. The set targets take into account economic, social and environmental principles: the transition from market and pricing policies to a structural policy; compensation for higher production costs arising from unfavourable natural conditions; the struggle against the discontinuation of farming and the depopulation of remote rural areas; the protection and preservation of the man-made landscape; and the integral development of rural areas. The Decree on the introduction of financial intervention for the preservation and development of agriculture and food production and the Decree on the integral development of rural areas and village restoration for 2000 define in detail the aims and conditions for the allocation of budgetary resources. For the first time this year, they will be allocated via the **Agency for Agricultural Markets and Rural Development** which still has to be accredited by the EU by the end of September. In the pre-accession period, the Agency will take on all tasks concerning pre-accession assistance and later the Common Agricultural Policy of the EU as well. In terms of institutions, one novelty of great importance for Slovenian agriculture is the **Chamber of Agriculture and Forestry**, founded in 1999, which will give a new dimension to the professional and advisory services available in agriculture and forestry. It will represent the interests of farmers, land-owners, agriculture and forestry co-operatives and agricultural enterprises. The **Agriculture Act** regulates a comprehensive system of planning agricultural and rural development. It defines the goals of agricultural policy, agriculture and rural development planning, measures for agricultural policy, the quality and labelling of agricultural products and foodstuffs, their trading, public utilities, databases, procedures and bodies involved in the implementation of the Act, research and training, as well as inspection.

According to estimates of the Agricultural Extension Service, the favourable weather conditions last autumn enabled sowing to be carried out at an optimal time, with plants germinating and surviving winter well. The SORS' data from the beginning of 2000 show that growth in the number of gestating animals was as follows: there were 9% more heifers than in the same period last year (cattle breeding is the main branch of Slovenian agriculture), whilst pig numbers were down by 5%. This data also shows that in the first quarter of 2000 the purchase of agricultural products equalled in real terms that recorded in the same period last year. **Real growth in value added in the sectors of agriculture, hunting and forestry** is expected to continue in **2000** and **2001** and will thus **reach approximately 2%** in both years.

In 1999, value added in **mining** dropped in real terms by 0.7% and employment, according to national accounts statistics, went down by 72%. Commercial companies created 81% of value added in this sector with 85% of this value added being created in coal mining, particularly in the production of brown coal and lignite. In 1999, extraction of brown coal decreased by 8.4% i.e. from 828,000 tonnes in 1998 to 758,000 in 1999, whilst that of lignite fell by 6.4% i.e. from 4,064,000 tonnes in 1998 to 3,804,000 in 1999. The bulk of domestic coal was intended for the production of electricity. As many as 426 tonnes of brown coal were planned to be imported in 1999, which should cover a good third of the total quantity required in Slovenia. Last year, the net loss of mining companies increased more than threefold over the 1998 figure, amounting to SIT 4.615 million, of which SIT 3.227 million was recorded in coal mining alone. Losses in the branch of uranium and thorium extraction fell slightly, nevertheless, they still reached SIT 1.492 million. In 1999, net profit from the extraction of other non-fuels mining was three times below the 1998 level, only slightly exceeding SIT 100 million.

The energy balance of the Republic of Slovenia for 2000 is still being drafted and it is expected that Slovenia's coal extraction in 2000 will be approximately at the 1999 level. Pursuant to the **draft law on the gradual closing of the Trbovlje-Hrastnik mine and the development restructuring of the region, mines are planned to be closed in the 2000-2012 period**, whilst until 2008 coal will continue to be extracted to cover the needs of the Trbovlje thermal power plant. In the first phase (from 2000 to 2004), total expenses arising from the mine closure are expected to total almost SIT 16 billion (SIT 891 million of which will occur in 2000). Pursuant to the draft law, brown coal output is planned to drop by 2.4% or 18,000 tonnes in 2000 and an additional 4.1% or 30,000 tonnes in 2001. In view of this fact, it is estimated that **value added** in mining will, **in 2000, decrease in real terms by around 1%, and in 2001** it is expected to drop by slightly less (**below 1%**).

In **manufacturing**, which is the most export-oriented sector of the Slovenian economy[14] and thus the most dependent on developments in global markets, real growth in value added also slowed down in 1999 (from 6.6% in 1997 to 4.0% in 1999) along with the slower economic growth of Slovenia's major trading partners. In 1999, employment decreased by more than in 1998 (according to national accounts statistics, down by 1.3% in 1999 compared to 0.6% in 1998). The effect of the weaker economic growth in the largest Slovenian export markets was mainly visible in the first half of the year, while in the second half domestic production became stronger due to an economic upturn in foreign markets. In the first six months of 1999, value added in manufacturing rose by 3.1% in real terms over the same period in 1998, while in the second half it went up by 4.7% (by 5.6% in the last quarter). Similar trends were also recorded in the volume of production where, in early 1999, the slower production activity, already characteristic of the last months in 1998, continued. This trend turned around in February and strengthened rapidly towards the end of the year, so that the volume of production in December 1999 was up to 9.1% higher than in December 1998. Owing to the poor results recorded in the first half of the year, the average annual volume of production stagnated.

The effect of unfavourable economic trends on manufacturing was evidenced by growth in the volume of production of predominantly export-oriented companies[15], which rose by 0.3% in 1999 (other producers increased by 0.4%), whereas in 1998 their volume of production grew by almost 5 percentage points more than that reported by other producers. Such results correspond to the data on the exports of manufactured goods, which increased by 4.1% in real terms in 1999 and 8.4% in 1998. Last year's slower economic activity abroad affected, among export-oriented companies, mostly those in traditional branches with low value added per employee and those still overstaffed, despite downsizing[16]. In 1999, these subsectors recorded the most pronounced decrease in the volume of production in total manufacturing compared to 1998 (down by 21.2% in the

[14] Nine out of fourteen manufacturing subsectors account for more than half of their total operating income earned abroad.

[15] Manufacturing subsectors, which according to statistical data from balance sheets and profit and loss accounts, create more than half of their operating income in foreign markets (manufacture of textiles and textile products, manufacture of leather and leather products, wood processing and manufacture of wood products, manufacture of chemicals, chemical products and man-made fibres, production of rubber and plastic materials, production of metals and fabricated metal products, production of machinery and equipment, manufacture of electrical and optical equipment and manufacture of transport equipment).

[16] In 1999, the number of employees involved in the production of leather and leather products fell by 11.6%, whilst in the production of leather, leather products and fur products it dropped by 3.7%.

production of leather and leather products; 7.0% in the manufacture of textiles and textile products; 4.7% in wood-processing and wood product manufacturing. In 1999, among export-oriented companies, the largest increase was seen in the volume of production of electrical and optical equipment (by 5.0%) and metals and metal products (by 4.0%). These are also the subsectors which recorded the highest increases in manufacturing activity[17].

In 1999, the net financial results of manufacturing companies, accounting for almost 90% of total value added in activities classified under D, were positive for the third consecutive year and substantially better than in 1998. Net profits were higher by SIT 31.4 billion over 1998, amounting to SIT 60.1 billion. The net loss for the year decreased by 12.8% and net profit for the year increased by 31%, both in nominal terms. Last year, mainly export-oriented companies on average earned a good three-fifths of their operating revenues in foreign markets. Thus, these companies generated more than four-fifths of the total income from the export of manufactured goods and services and contributed as much as seven-tenths to value added in manufacturing. At the same time, they accounted for slightly more than two-thirds of net profit and three-quarters of net loss in manufacturing. In 1999, the share of net loss posted by mainly export-oriented manufacturing companies as part of the total net loss in manufacturing rose by 5.2 structural points on 1998 (in 1998, it decreased by 8.3 structural points over 1997). The share of net profits of mainly export-oriented companies in total net profit of manufacturing was on the rise (up by slightly less than one structural point in 1999 and by 3.5 structural points in 1998).

The volume of production continued to rise at the beginning of 2000. In the first four months, the volume of production increased by almost 8% over the same period last year, primarily in the group of mainly export-oriented companies (up by 10.5%), in line with the economic revival in Slovenia's main export markets, which in turn is stimulating the domestic economy thanks to increased exports. In the first quarter of 2000, the export of manufactured goods increased by 12.7% in real terms over the same period in 1998 (up by 3.4% in the first quarter of 1999). Favourable conditions in manufacturing are reflected in lower final product stocks, which have been on the decrease this year (down by 6.7% per production unit in the first four months at the annual level). From January to March, labour productivity in manufacturing was 12.1% higher than in the same period last year (up by 11.5% in the first four months), which substantially exceeded real wage growth in manufacturing in the same period (2.3%). Labour

[17] Higher growth was also recorded in the production of coke, oil derivatives and nuclear fuel, which is primarily the consequence of the decline in production in 1998.

productivity growth resulted from the increased volume of production and the lower number of employees.

The findings of a survey on business trends in manufacturing conducted in May showed that the confidence indicator deteriorated in May. This was more a consequence of modest production expectations for the following three to four months (usual seasonal slow down in production activity) than of total orders (domestic and foreign) placed.

As the abovementioned favourable trends from late 1999 continued into early 2000, and taking into account the higher growth in exports of goods in 2000

Box 4: Restructuring of the Footwear, Textiles and Steel Industries

The Slovenian **footwear industry** has large-scale production in a few large companies, operating in a market segment typically served by small companies. Compared to the EU, it is substantially less productive, as minor EU footwear manufacturers are intensively forming clusters on the one hand and are transferring cost-intensive production phases to the countries of Eastern Europe and the Far East on the other. They themselves focus on key production and on the final phases of completion. In the Slovenian footwear industry, manufacturing a pair of shoes requires almost twice as much time as in competitive companies in the EU. Nearly 9% of the net loss in 1999 recorded by manufacturing was accounted for by the footwear industry.

A strong regional concentration of companies is characteristic of the Slovenian **textiles and clothing industries**. With increasing competition (due to oversized production capacities and imports of lower quality products), possibilities in the domestic market are limited which is why the textiles and clothing industries are very export-oriented. Value added per employee in these industries is substantially lower than in the relevant EU industries (around three times lower).

Due to the much needed restructuring of both branches and a commitment made in the negotiating positions in December 1999, the Government of the Republic of Slovenia adopted the **Programme of Adapting to the EU Internal Market Conditions in the 2000-2003 Period** involving both industries. For similar reasons, in March 2000 the Government adopted the Programme of Steel Industry Restructuring, envisaging financial and business restructuring as well as the privatisation of core companies, selling off of non-core companies and liquidating or initiating bankruptcy procedures for the inactive companies of the Slovenske Železarne (Slovenian Steelworks). This should enhance companies' marketing capacities, their technological modernisation and human resources development.

This year the **Programme of Strengthening the Competitive Position Slovenian Manufacturing Industries (including the proposed horizontal measures)** was adopted for the entire industry. These measures should increase investments in intangible assets (stimulate research and development, development cores and training), competitiveness on domestic and foreign markets (technological modernisation, ecological development of production) and encourage inter-company co-operation (improve existing institutional support, assistance to joint development projects).

value added in manufacturing is estimated to increase in real terms by 5.3% in 2000 and by 4.5% in 2001.

In 1999, **electricity, gas and water supply** recorded a real 2.5%-decrease in value added and a 1.1%-decline in employment (according to national accounts statistics). The SORS' data showed that the volume of electricity supply[18] fell by 4.1%. In 1999, the output of public power plants dropped by 3.9% (calculation by ELES). The production of hydroelectric power plants, however, increased by 8.7%, while the nuclear power plant and thermal power plants produced 6.3% and 10.2% less electricity, respectively. The share of hydroelectric plants in total electricity output increased to 28.9% (the respective figure in 1998 was 25.6%). In 1999, electricity consumption rose by only 0.7%. Due to less excess energy, as a result of lower total output, net exports of electricity decreased by 28.5% to 1,371 GWh, which accounted for 11.6% of total domestic production of electricity[19]. The energy balance of the Republic of Slovenia for 1999 envisaged a downturn in the consumption of natural gas by 5.4% and a rise in the district heat consumption by 2.5% (actual data are not yet available).

In 1999 the net loss of companies supplying electricity, gas and water supply services (accounting for 87% of total value added in this sector) decreased in nominal terms by one-third to SIT 12,444 million. A major part of this loss was incurred by the subsector of electricity production and distribution. Last year, the net loss incurred by the sector of collection, purification and distribution of water, almost doubled and reached SIT 914 million.

According to the draft energy balance of the Republic of Slovenia **for 2000**, total electricity production in Slovenia will rise by 1.1%, with somewhat higher growth in the output of standard thermal power plants and the nuclear power plant. This year, the nuclear power plant's installed power will slightly increase thanks to the replacement of its steam generators, whilst at the beginning of July two new gas turbine units at the Brestanica thermal power plant are planned to be integrated into the network. As the option of the ecological recovery of the Trbovlje II thermal power plant was voted against at the referendum and was consequently abolished, the plant is planned to continue providing its present power level up until 2008. It is estimated that **in 2000, value added** in electricity, gas and water supply will **increase by 1% in real terms, while similar** growth is also anticipated for **next year**.

[18] Weighted electricity production of different types of power plants.
[19] Total output produced by the Krško Nuclear Power Plant included.

Box 5: This year **the Energy Act,**

in force as of the middle of October 1999, will still not directly influence electricity production in Slovenia. Foreign suppliers will be able to compete with Slovenian suppliers from 1 January 2003 onwards (the Government may set an earlier date provided that the conditions for market opening are met), while the electricity market for Slovenian suppliers will be open 18 months after enforcement of the Act (i.e., a good year and a half before opening). Apart from delaying the entrance of foreign competition, the new law also protects Slovenian suppliers by offering them assistance in recovering stranded investments (unprofitable in the given market conditions). Consumers (over 41 kW of installed consumption power) and distributors will be able to freely choose between electricity suppliers, while the organiser of the market will have the possibility to prioritise qualified producers (co-generation of electricity and heat, production of electricity from renewable resources, etc.) and producers using domestic fuel (up to 15% of primary energy required for the production of electricity in Slovenia). The Act stipulates the adoption of relevant implementing regulations by April 2000, which is a prerequisite for its implementation. The majority of this legislation is in the pipeline (with short delays). It consists of decrees prescribing the methods of public utilities' operations (electricity transmission, transmission grid management, organising the electricity market and electricity distribution), decisions on appointing the managers of transmission and distribution networks and the decision on establishing the Energy Agency and appointing its acting director. Organising an electricity market involves the establishment of an electricity exchange market. A company that will be given the concession to run an electricity exchange market will be founded by a public company providing electricity transmission services over the entire Slovenian territory (Elektro-Slovenija). The newly established public utility will be financed from payments for services. The electricity price for consumers will be composed of two parts: the price formed in the electricity exchange market and the distribution price. The Agency's main activities will be: energy distribution pricing, granting licences, arbitrage, etc. They will be financed from the budget. Pursuant to the new Act, the existing public distribution companies (Elektro Ljubljana, Elektro Maribor, Elektro Celje, Elektro Gorenjska, Elektro Primorska) will perform three separate activities in the framework of the energy sector: electricity distribution, supply of electricity to tariff users (who are not consumers) and distribution network management (the Government may grant the latter to other concessionaires when the existing concessions expire).

Last year, dynamic economic activity in **construction** (14.4% real growth in value added) was accompanied by a 2.4%-rise in employment (estimated on the basis of national accounts statistics). As many as 34,132 persons were employed in companies (2.7% more than in 1998) or 62% of the total. The well-developed sector of sole proprietors employed 20,967 persons, which is an increase of 6.4%. Last year, prices in construction went up by 5.3% (December-on-December) and by 1.5% in the first three months of 2000. The lively trends in construction were also reflected in statistical data derived from the balance sheets and profit and loss accounts of construction companies in 1999. Total income of SIT 494 billion, generated by 2,483 companies, grew in nominal terms by as much as 30.9%, whilst value added totalling SIT 124 billion was higher by 24.1% in nominal terms. SIT 12 billion of net profit earned in construction was 56.4% higher in nominal terms, whereas the net loss of SIT 6 billion shows a decrease by 8.1%. In 1999, following the net loss in 1998, the construction sector once again achieved a net profit.

The dynamic construction activity continuing since 1998 is also demonstrated by statistical indicators. Last year the Slovenian construction industry completed **construction works** worth SIT 265 billion, representing a rise of 35.2% in nominal terms over 1998. The peak of construction activity was recorded in the second quarter of 1999, which was influenced by anticipated price increases following the introduction of VAT. Available statistical data on the value of construction works performed abroad cover only nine months of 1999. In this period, their value reached SIT 8.2 billion and was nominally 50% lower than in 1998. Additional information on construction may be obtained from industry statistical data for 1999, according to which the production of concrete and cement products went up by 20.8%, production of tiles and bricks by 17.8%, production of wall and floor ceramic tiles by 8.2% while the production of structural metal products rose by 7.1%.

At the beginning of 2000, the positive trends in construction continued. In the first quarter, construction companies completed construction works worth SIT 49 billion, a nominal increase of 13.2% compared to the same period last year. The highest dynamics were recorded in housing construction, which rose by 33.2%, and in road construction, whose value increased by 22.5%. Financial statistics in the first quarter of 2000 point to dynamic construction activity, with income in the construction sector amounting to SIT 118 billion or 30.3% in nominal terms more than in the same period last year. At the end of 1999, as many as 1,585 of dwellings were still under construction, thus five times exceeding the number of those completed in 1999. Last year 6,661 building permits were issued in Slovenia.

As a rule, the first quarter of the year is characterised by subdued construction activity, whilst the peak of the construction season usually follows in the later months. The typically seasonal character of the construction business makes it difficult to accurately predict growth at the beginning of the year. Nevertheless, based on the abovementioned indicators, it may be forecast that lively economic growth in construction will continue and that **value added will rise by 15% in 2000 and by 10% in 2001.**

In 1999, value added in the sectors of **wholesale and retail trade and motor vehicles repair** rose by 6.5%. The higher growth compared to 1998 (2.8%), primarily resulted from increased consumption before the introduction of VAT, which was reflected in real annual growth of as much as 18.2% in value added in the sectors of wholesale and retail trade and motor vehicles repair in the second quarter. According to national accounts statistics, employment was higher by 1.7% (2.1% drop in 1998). In 1999, the number of persons in employment in wholesale and retail trade and motor vehicles repair went up by 3.4%, the highest growth (7.9%) having been recorded in intermediation and wholesale (motor vehicles excluded). Last year, **retail sales** (income and tax on goods and services or VAT) amounted to SIT 1,798 billion, which meant a 5.3% real increase on 1998. In real terms, the highest growth (13.0%) was recorded in the sale of motor vehicles and automotive fuels, of which the sale of motor vehicles, with 52.5% higher sales in 1999 was more successful. On the other hand, trade sales in food, beverages and tobacco decreased by 5.4% in real terms. Last year, **wholesale** sales totalled SIT 1,858 billion, having increased by as much as 23.6% in real terms over 1998. Real growth in the volume of sales was recorded in all sectors, the highest in retail and trade in motor vehicles and fuels (up by 49.0%), of which the highest rises were recorded in sales of motor vehicles (up by 62.3%).

The largest share of value added in the trade sector (85.9% in 1999) is created by commercial companies, which last year nominally increased their net profit by up to 62.2% (to SIT 37,028 million). Value added generated by commercial companies totalled SIT 312,782 million and was in nominal terms 9.5% higher than in 1998.

5

The exceptional increase in consumption, which last year characterised the period immediately preceding the tax reform in 1999, will not recur this year, therefore growth in value added in trade is expected to slow down in 2000. On the other hand, in 2000 as well as 2001, value added in trade will still be stimulated by the planned opening of numerous shops and trading centres in Slovenia. At the beginning of the year, positive trends were recorded in employment (in the first two months the number of persons in employment in trade rose by 5.0% over the same period in 1999). Based on these facts, **real growth of value added** in wholesale and retail trade and motor vehicles repairs is forecast to reach **4% in 2000 and 5% in 2001.**

In 1999, value added in **hotels and restaurants** grew by 1.5% in real terms (up by 0.9% in 1998). Employment, according to national accounts statistics, increased by 5.2% (in 1998 by 2.0%) and the number of persons in employment rose by 7.0% (in 1998 lower by 2.0%). Trends in the sector of hotels and restaurants primarily depend on developments in tourism, where favourable movements in the first quarter of 1999 were followed by a drop in the number of foreign tourists and overnight stays in the second quarter, due to the crisis in Kosovo. The situation did not essentially improve even when the conditions in the Balkans stabilised, which points to other reasons for the slack tourist season. **In 1999**, the number of tourists in Slovenia fell by 2.7% compared to 1998, with foreign tourists decreasing in number by 9.5% and domestic tourists increasing by 5.2%. Out of the total number of tourists approximately 50% were foreigners (i.e. 50.5%; the respective number in 1998 being 54.3%), accounting only for 45.3% of total overnight stays (48.6% in 1998). According to destination type, the highest share of overnight stays was recorded in health (31.2%) and seaside resorts (28.9%).

Foreign exchange receipts from tourism decreased in real terms by 7.2% in 1999 compared to 1998 and amounted to USD 1,005 million. In this period, remittances to tourist companies, the only item under receipts from tourism classified directly under hotels and restaurants, rose by 18.5% in real terms. Preliminary data for the first three months of **2000** show that 9.4% more tourists spent their holidays in Slovenia than in the same period last year. The number of domestic and foreign tourists increased by 7.9% and 11.2%, respectively. Overnight stays of guests from the neighbouring countries of Croatia, Italy, Austria and Hungary, accounting for 61.2% of total overnight stays of foreign guests, went up by 16.3%. Judging from the initial results, funds allocated for the development of ski centres have started to yield a return. Assuming that the summer season will also be more successful than in 1999, the targeted 5% increase in the overnight stays of foreign tourists compared to 1998 (i.e. 3.2 million) is plausible. For good summer season results, certain conditions have to be fulfilled: the recognition of Slovenia has to improve, hotel rates should reflect the quality of services offered; infrastructure and accommodation facilities should be renovated during the peak summer season; conference tourism, one of the most profitable sectors, should be better exploited; a wide range of entertainment, recreation and relaxation activities should be available throughout the year and not only during the high tourist season.

Taking into account the anticipated increase in the number of tourists and overnight stays, better performance may also be expected in the sector of hotels and restaurants. They already transpire from the increase in the number of persons in employment in hotels and restaurants reported for the first two months of this year (up by 5.2% over the same period in 1999). It is anticipated that **value added** in this sector will **increase by 4.0% in real terms in 2000** and, given an improved recognition of Slovenia, even better results are expected **in 2001.** Thus, value added is predicted to grow **by about 5.0%** in real terms.

In 1999, the **transport, storage and communications sector** recorded 3.2%-growth in real terms in value added and a 3.1%-increase in employment, according to national accounts statistics. The structure of value added created by companies in this sector was as follows: post and telecommunications 38%, land transport 32%, supporting and auxiliary transport activities and travel agencies 26%, to mention only the major ones. According to the SORS' data, the volume of practically all passenger and freight land transport related activities decreased in 1999 over 1998[20]. The volume of land freight transport, measured in tonne-kilometres, fell by 3.4%, whilst the volume of transport via railways dropped by 2.6%. In the total cargo handling of all types of transport the volume of handled cargo decreased by 8.3% (in port transport it fell by 0.4%). Passenger land transport[21] measured in passenger-kilometres dropped by 8.0%, transport via railways by 2.9% and urban passenger land transport by 1.8%. However, all other activities in the sector of transport, storage and communications recorded a high growth rate. Sea freight transport, measured in tonne-miles, increased by 13.0%, and air passenger transport (measured by the number of passengers) went up by 14.1%. Air transport recorded an increase of 15.3% in passenger-kilometres. The postal service processed 17.2% more mail. Supporting and auxiliary transport activities[22], travel agencies and telecommunications were also very successful in 1999. At the end of last year in Slovenia, 750,000 telephone connections were made via the fixed telephone network (40 per 100 inhabitants) and approximately 550,000 via the mobile telephone network. Stationary

Box 6: National Telecommunications Development Programme

The National Telecommunications Development Programme was adopted at the end of February 2000. Up until 2015, it envisages 1.55 million subscribers in stationary telephony (over 75 subscribers per 100 inhabitants) and 1.45 million in mobile telephony. This national programme also plans the demonopolisation and partial privatisation of telecommunications. The first stage of privatisation is planned to be completed in 2000, meaning that the Government will sell off part of its 74%-stake in Telekom Slovenija, but will keep at least 51% (thus preserving its majority holding). It will also look for an appropriate strategic partner, whose technological and marketing knowledge facilitates further rapid development of telecommunications in Slovenia. The second stage is to be implemented after 2003, on the basis of experience gained in the first stage.

[20] Private hauliers and freight transport for company's needs excluded.
[21] Private transport by taxi, bus or passenger vehicles excluded
[22] Forwarding services and other transport logistics

telephony growth levelled off at about 8% per year at the end of the nineties, while mobile telephony has increased by more than 100% annually in recent years. According to the most recent data, the number of Internet connections exceeds 120,000.

The performance of commercial companies in transport, storage and telecommunications (accounting for 77% of total value added in the sector) deteriorated in 1999. Net profit amounted to a good SIT 22 billion, decreasing by approximately 14% in nominal terms over 1998. The lower volume of land transport was reflected in lower figures: after reaching SIT 4,180 million in 1998, net profit dropped to a mere SIT 713 million in 1999. SIT 22 billion of total net profit was actually generated by just two activities: supporting and auxiliary transport activities (almost 50%) and travel agencies, post and telecommunications activity (around 47%).

Given the fact that the share of international transport in total freight land transport is substantial (around 77%), the anticipated increase in foreign trade in 2000 and 2001 will have a beneficial effect on land transport growth, which is estimated to show positive growth in 2000. According to forecasts, land transport will be stimulated by anticipated manufacturing output growth. The volume of land transport will markedly increase, particularly in transport via railways, where growth of a few percent is expected in passenger and freight transport. If other activities manage to maintain the same high rapid pace as was recorded in 1999, **value added** in transport, storage and communications **would increase to at least 4 % in real terms in 2000, and do even better in 2001 (growth of about 4.5%).**

In 1999, value added in the sector of **financial intermediation** increased in real terms by 2.8%, which is below the respective figure for 1998 (3.7%). Those poorer results primarily reflected trends in the banking sector, with value added accounting for more than two-thirds of the sector of financial intermediation. Already in 1998, net interest income, being by far the most important item on banks' profit and loss accounts, grew slower, while in 1999 it dropped by 2.9% in real terms. Moreover, last year's operating expenses recorded a 4.5% real increase. In 1999, banks posted a 3.9% real rise in fees and commissions (payment transactions, administrative services, lending) and an increase of over 30% in net financial operations. However, this did not compensate for the abovementioned negative trends.

Less favourable trends in the banking sector in 1999 were confirmed by data on the movements in the number of persons in employment working in financial

Box 7: Computer and Telecommunications Services

In addition to information technology production, computer and telecommunications services are crucial for Slovenia's dynamic development. Many information technology producers, which are part of the manufacturing sector, are increasingly orienting towards providing supporting services for the buyers of their equipment, so that the actual value of computer services provided is substantially higher than shown by the data on performance posted by the computer services segment.

Computer services are classified under the category Real Estate, Renting and Business Activities (K) in which they are the most dynamic segment. In the period 1995-1999, companies providing computer services more than doubled their share in total value added (from 0.44% to 1.12%) and in employment (from 0.37% to 0.75%). The determining factor in the growth of computer services was stronger demand due to the computerisation and upgrading of information technology in companies, public utilities and public administration. Value added per employee in computer services, which in the 1995-99 period recorded the most rapid growth among activities under K, was already 48% above total commercial companies average in 1999. From 1995 to 1999, the number of employees in companies providing computer services almost doubled (to 3,495). The number of computer companies is also surging (733 in 1999 or 72% more than in 1995), which demonstrates that competition in the computer services market is ever stiffer. Further rapid growth in companies providing computer services could be hindered by a lack of professionals. **The export-orientation** of companies providing computer services is relatively weak. Nevertheless, the gap between them and the total commercial companies' average has substantially diminished in the past few years. Given the trend of strategic mergers and acquisitions in computer companies and their improved international competitiveness, it is reasonable to expect the share of export in total sales to rise in following years. Return on assets (net profit/assets) in computer services is growing. Last year, it reached almost 7%, which was substantially above the total commercial companies' average.

Companies providing postal and telecommunications services also recorded an above-average return on assets in 1999 (3.1%). Due to a relatively high share in total value added (above 4%), and a relatively low share in total employment (2%), value added per employee in these companies was twice the total of commercial companies average, despite a stagnation in the 1995-1999 period. The latter could have resulted from a lack of competition, which hampered efforts to improve efficiency. The abolition of the monopoly at the end of 2000 will further boost growth in basic telecommunications services, provided no other administrative barriers are introduced.

In view of global trends, it is reasonable to expect that mergers and acquisitions among companies providing computer and communication services will gain ground in Slovenia as well. This will be primarily related to the expansion of e-commerce, which will lead to higher demand for integrated computer and telecommunications services. Despite the good prospects of computer and telecommunications services, the Government should use appropriate mechanisms and measures in order to ensure conditions that will additionally stimulate their development and the introduction of new services and technologies related to Slovenia's integration in the information society (further training and retraining, venture capital funds, incubators).

intermediation, which increased by 9.0%. The highest employment growth (90.0%) was recorded in ancillary financial services (security brokerage and fund management, pension funds, etc.) and in the insurance sector (7.8%). However, the number of persons in employment in the banking sector, representing the bulk of financial intermediation by number of employees, decreased by 0.5%.

In 2000 and 2001, positive trends are expected in financial intermediation, which will further improve value added in this sector. Due to the process of liberalisation of financial and capital as well as the entry of foreign competition, the banking sector is expected to further consolidate and streamline. This year banks, will also start directly processing inter-company payment transactions. Moreover, the implementation of pension reform will bring about growth in the volume of insurance companies' business. With continuing positive economic trends in insurance and pension funding and its ancillary activities combined with the recovery of the banking sector, it is estimated that **value added** in financial intermediation will, in 2000 and 2001, **increase** slightly more than in 1999: **by 3.5% in 2000 and 4.5% in 2001 in real terms.**

5.1.2 EXPENDITURE STRUCTURE OF GROSS DOMESTIC PRODUCT – Foreign demand again the key factor of economic growth; dynamic growth in investment continues

With its small and open economy, Slovenia is very sensitive to the external economic environment. In previous years, the share of exported goods and services in gross domestic product was about 57% (in the EU-15 this share fluctuates by around one-third). Due to last year's poor growth in foreign demand and stronger influence of domestic demand, this share decreased substantially in 1999 to only 52.7% of gross domestic product (3.9 percentage points less than in 1998), which is the lowest level recorded since Slovenia's independence. Due to its smallness, openness and export orientation, Slovenian economic growth in 2000 will be largely influenced by economic developments in the international environment. Given the fact that Slovenia's exports are primarily oriented to the EU markets, economic trends in the EU-15 will play the key role in its domestic economic movements (see Chapter 3). In 2000 and 2001, favourable international trends will increase the impact of foreign demand on Slovenian economic growth. Taking into account current economic trends in the international and domestic environments and expected favourable global development, particularly in the EU countries, which are Slovenia's main trading partners, the first spring national accounts estimate for Slovenia has been made, showing that the country could reach a 4 ¾ percent rate of economic growth this year, while in 2001 the respective percentage is estimated to be 4.5%.

In 1997 and 1998, foreign demand was the main driving force behind economic growth until 1999 when it weakened, due to slower growth in Slovenia's major export markets, while domestic demand became the main growth factor. Last year, total domestic demand increased by 6.2% in real terms, which is 1.3 percentage points above the rise in gross domestic product. It was primarily triggered by higher spending before the introduction of VAT and excise duties, as well as by very dynamic investment activity. In 1999, real growth in all basic aggregates of domestic consumption (private, government and investment consumption) exceeded real growth in gross domestic product. In 1999, the strongest real growth was recorded in gross fixed capital formation (16.1%), the highest recorded since 1995 (16.8%). Therefore, the development of the individual components of domestic demand was favourable in 1999, as real growth in investments substantially exceeded final domestic consumption expenditure (5.4%). In 1998, the pace of gross fixed capital formation was dictated by investment in equipment (18.1% real growth), while 1999 witnessed the most dynamic growth in investment in buildings and construction works (25.1% real growth). The share of gross fixed capital formation in gross domestic product in 1999 rose by 2.3 percentage points to 26.9%. In 1999, total government expenditure (individual and collective) increased by 5.7% in real terms (up by 5.9% in 1998) and household expenditure by 5.4%. The share of final domestic consumption expenditure (individual and collective) in gross domestic product grew by 0.2 of a percentage point in 1999, primarily due to 0.2 of a percentage point bigger share of government expenditure in gross domestic product (to 20.6%). Thus ended the period of continuous decline in

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Table 9: Growth in aggregate demand components

	Real growth rates in percent					
	1996	1997	1998	1999	2000 estimate	2001 estimate
Total aggregate demand	3.6	6.2	5.0	5.3	5.2	4.9
of which:						
Foreign demand (exports)	3.3	11.3	7.2	1.8	7.1	5.9
Domestic demand (a+b+c)	3.7	5.0	4.4	6.2	4.8	4.7
a) intermediate consumption	3.4	4.6	3.6	4.6	4.9	4.7
b) final consumption	2.7	3.6	3.7	5.4	2.9	3.0
of which:						
- private expenditure	2.4	3.3	2.9	5.3	2.9	3.0
- government expenditure	3.6	4.3	5.9	5.7	3.0	3.3
c) gross fixed capital formation	9.2	11.3	11.1	16.1	9.0	9.0

Source: SORS, National Accounts estimates: IMAD.

the share of final consumption in gross domestic product, which had lasted since 1995.

In 1999, household expenditure increased by 5.4% in real terms, thus exceeding the growth of gross domestic product for the first time since 1995. The most important factor which affected private consumption in 1999 was the introduction of VAT. The expectations prior to implementation of VAT led to concentrated purchases of durable consumer goods which, in ordinary circumstances, would have been distributed over several years[23]. In 1999, the disposable income of households increased in real terms by 5.4%, while additional funds were raised by bank loans and through leasing of durable consumer goods.

This and next year's domestic demand growth will be more correlated with gross domestic product growth and is expected to reach 4.8% and 4.7%, respectively. Gross fixed capital formation will increase by as much as three times more than final consumption, so that the **share of gross fixed capital formation of gross domestic product will continue to grow.** In 2000 and 2001, gross fixed capital formation is expected to rise annually by 9.0% in real terms, with its share in gross domestic product anticipated to grow by approximately 1 percentage point per year. Following the upsurge in 1999, private consumption is forecast to level off in 2000 and 2001. The higher interest rates, which had already started to increase in the second half of 1999, will probably encourage people to set aside part of their disposable income as savings. Moreover, higher growth in consumption in 2000 will be limited by higher indebtedness and the increased burden of servicing the loans taken out in 1999. The share of private consumption in gross domestic product will drop from 55.4% in 1999 to 54.8% in 2000 and to 54.2% in 2001. An increase in

Table 10: Gross domestic product by expenditure

	Structure in %, current prices					
	1996	1997	1998	1999	2000 estimate	2001 estimate
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0
External balance of goods and services (exports-imports)	-1.0	-1.2	-1.5	-4.0	-4.1	-3.9
Domestic consumption total	101.0	101.2	101.5	104.0	104.1	103.9
- Private final consumption	57.3	56.5	55.6	55.4	54.8	54.2
- Government final consumption	20.2	20.5	20.4	20.6	20.3	20.0
- Gross fixed capital formation	22.6	23.5	24.6	26.9	28.0	28.7
- Changes in inventories and valuables	0.9	0.7	1.0	1.1	1.1	1.0

Source: SORS; estimate: IMAD.

[23] Data on retail sales (see Chapter 6.1) and growth in retail loans in the second quarter of 1999 (see Chapter 6.7) reflected a substantial increase in expenditure in this period.

government final consumption expenditure in 2000 is expected to be slower than in 1999 (3.0% in 2000; 5.7% in 1999), in line with the adopted state budget for the year 2000.

Foreign demand, which was relatively poor in 1999 (1.8%-rise in real terms), owing to slower economic growth in the EU countries and a decline in purchasing power in Croatia and Russia, is expected to grow substantially (7.1%) this year, according to favourable forecasts of economic growth in Slovenia's main trading partners. It will again assume the role of the main driving force behind economic growth. Foreign demand will continue to grow relatively quickly in 2001, however less than in 2000 (5.9%) due to slower growth in export markets.
Given the high growth in imports of goods and services in 1999 (7.3%) and substantially slower real growth in exports (1.8%), the share of the deficit in goods and services trade in gross domestic product[24] considerably increased last year (to 4.0%; 1.5% in 1998). Despite more favourable conditions in the international environment and stronger foreign demand, the deficit will probably remain at approximately the 1999 level, primarily owing to deteriorated terms of trade (higher oil prices, the stronger US dollar). In 2001, the pace of exports will be slightly slower than that of imports[25], which is primarily the consequence of on-going investment activity combined with slightly decreasing export demand. Consequently, the share of the deficit in goods and services trade in gross domestic product is expected to be just below 4% in 2001, despite the anticipated weaker US dollar and lower oil prices.

Owing to positive total factor income and current transfers, gross national disposable income in 1999 exceeded gross domestic product by 1.1 percentage points. In 2000 and 2001, the positive income and current transfer balance is expected to stay at the same level. The share of gross savings in gross domestic product decreased from 25.5% in 1998 to 25.1% in 1999, due not only to lower net primary income from the rest of the world (also by 0.2 of a percentage point) but also higher final consumption expenditure (by 0.2 of a percentage point). The level of savings in 1999 was insufficient to cover domestic investment, therefore the deficit in the current account of the balance of payments increased. Given a substantially slower growth rate in final domestic consumption expenditure in 2000 (2.9%; 5.4% in 1999), the share of gross savings in gross domestic product is expected to rise by 1 percentage point (by 0.7 of a percentage point due to lower private consumption expenditure and by 0.3 of a percentage

[24] Since 1995 final domestic consumption expenditure exceeded GDP

[25] Real growth in exports will be lower by 1.2 percentage points (5.9%), whilst real growth in imports by 0.5 of a percentage point (5.5%).

point owing to a decline in government consumption expenditure). The achieved level of national savings (26.1% of gross domestic product) will also be insufficient for funding domestic investment this year, the current account of the balance of payments deficit will amount to 3% of gross domestic product (for details see Chapter 5.3.2.2).

5.1.3 COST STRUCTURE OF GROSS DOMESTIC PRODUCT – The share of labour costs in gross domestic product continues to fall

In 1999, the downward trend in the share of total labour costs in gross domestic product (recorded since 1994) continued at an abated pace. Because of the lagging of the nominal growth in total wages and other labour costs behind nominal growth in gross domestic product, the share of total labour costs (compensation of employees) in gross domestic product was further reduced by 0.4 of a percentage point to 51.9% in 1999. With the somewhat slower growth in wages in 2000 and 2001, positive developments in the cost structure are expected to continue. The share of compensation of employees in gross domestic product is thus anticipated to drop to 51.6% in 2000 and 51% in 2001. The change in the taxation of goods and services in 1999 led to 0.7 of a percentage point rise in the share of taxes on production and imports in the primary income structure of gross domestic product (to 18.3%). Therefore, with an unchanged share of subsidies on production in gross domestic product (2.2%), the shares of both compensation of employees and gross operating surplus decreased by 0.4 of a percentage point (to 51.9% and 32.0%, respectively).

Table 11: Cost structure of gross domestic product

	Structure in %, current prices					
	1996	1997	1998	1999	2000 estimate	2001 estimate
1. COMPENSATION OF EMPLOYEES	54.8	53.6	52.3	51.9	51.6	51.0
2. TAXES ON PRODUCTION AND IMPORTS	17.4	17.0	17.6	18.3	18.4	18.3
2a. taxes on products	13.4	13.3	14.3	15.0	15.3	15.4
2b. import duties and taxes	3.0	2.0	1.4	1.2	1.0	0.9
2c. other taxes on production	1.0	1.7	1.9	2.1	2.0	2.0
3. SUBSIDIES	2.1	2.1	2.2	2.2	2.2	2.1
4. GROSS OPERATING SURPLUS AND GROSS MIXED INCOME (4=5+6)	29.9	31.5	32.4	32.0	32.2	32.7
5. Consumption of fixed capital	18.1	18.0	17.9	17.4	17.3	17.3
6. Net operating surplus	11.7	13.5	14.5	14.6	14.9	15.4
7. Gross domestic product (7 = 1+2-3+4)	100.0	100.0	100.0	100.0	100.0	100.0

Source: SORS; IMAD estimates.

The increased share of taxes on goods and services[26] in 1999, accounting for 15% of gross domestic product (14.3% in 1998), is also related to the reduced tax evasion following the introduction of VAT. Thanks to the system of double control, VAT enables more efficient collection (90-95%) than sales tax due to the higher volume of registered transactions. This year, the share of taxes on goods and services will reach 15.3% of gross domestic product. With customs tariffs and import duties having been reduced, their share in gross domestic product dropped to 1.2% in 1999 (1.4% in 1998). Owing to further liberalisation of cross-border trade in the framework of the Europe Agreement made between Slovenia and the EU and other free-trade agreements, further reductions of customs tariffs and import duties will continue in 2000.

The share of gross operating surplus, i.e. income of equity owners and production managers from the primary distribution of gross domestic product, decreased to 32.0% in 1999 (32.4% in 1998). This fall is exclusively due to the lower share of consumption of fixed capital, while the share of net operating surplus rose by 0.3 of a percentage point (1999's business results of companies were the best in the last six years; for details see Chapter 5.9.1).

5.2 INTERNATIONAL ECONOMIC RELATIONS

5.2.1 INTERNATIONAL COMPETITIVENESS – Rising cost and price competitiveness to subside towards the end of 2000

While the price and cost competitiveness of the total Slovenian economy improved in 1999, the position of Slovenian manufacturers in international markets deteriorated. A three-year long continuing rise in relative unit labour costs, coupled with the worse price/cost ratio of the Slovenian manufacturing industry compared to major trading partners, particularly in exports of goods, resulted in a drop in Slovenia's market shares on international markets in 1999.

In 1999, the tolar depreciated against the basket of seven currencies (the German mark, the Austrian schilling, the Italian lira, the French franc, the US dollar, the GB pound and the Swiss franc) as a result of excess demand for foreign exchange

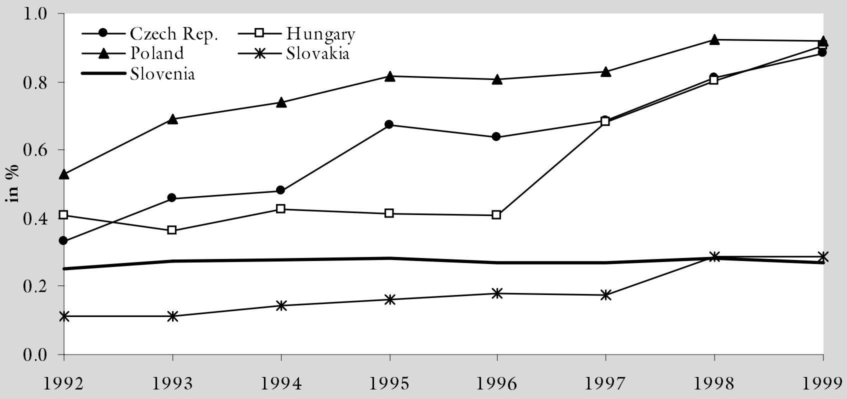
[26] According to national accounts methodology (ESA 95) taxes on goods and services are all taxes payable per unit of product or performed services in production or sales. These taxes include the set of sales taxes or VAT, special duties or excises, taxes on real estate transactions, tax on motor vehicles, tax on special gaming and special taxes (air pollution, gambling machine, local, overnight stays and some utility taxes).

arising from the current account deficit and the introduction of foreign currency accounts for legal entities (1 September 1999) on one hand, and due to strengthening of the US dollar on international foreign exchange markets on the other. The effective exchange rate of the tolar was on average lower by 5.5% in nominal terms in 1999 and by 0.7% in real terms (measured by relative CPI) or by 3% (measured by PPI). The most pronounced fall in the value of the tolar was seen between January and July 1999 (in real terms by 4.2% or 5.8%), which was halted in July by the intervention of the Bank of Slovenia. In the following months until November the tolar appreciated, in part due to higher monthly price growth resulting from the introduction of VAT. While the tolar depreciated against the US dollar by up to 5.3% or 8.6% in real terms in 1999, it on average even slightly strengthened (by around 0.5%) against some major EU currencies (the German mark, the Austrian schilling and the French franc) when measured by relative consumer prices, but if measured by relative producer prices it dropped (between 1.3% and 2%). On the basis of relative inflation, the price competitiveness of Slovenian goods was lower than on average in 1998 when compared to Croatia as well (real tolar appreciation against the Croatian kuna was 3.6%), whilst in comparison with the CEFTA-4 countries (the Czech Republic, Hungary, Poland and Slovakia) it remained at practically the same level as in 1998.

After stagnating for two years, the **cost competitiveness of the Slovenian economy improved again in 1999**, according to the available data, due to stronger relative labour productivity growth. With relative unit labour costs falling by a close to 1%, the share of labour costs in gross domestic product dropped in Slovenia in comparison to its main trading partners (by 0.7%), which slightly improved the relative profitability of the Slovenian economy.

While competitiveness of the Slovenian economy improved, **the position of Slovenian manufacturing in the international environment became more difficult in 1999.** Relative unit labour costs of Slovenian manufacturing (measured in the basket of currencies) rose by 1.1% which, in conjunction with a drop in the relative export prices of goods (estimated at 4.5%), resulted in lower profitability of Slovenian exports compared to its major trading partners. The deteriorated cost competitiveness of Slovenian manufacturing in 1999 was the result of modest labour productivity growth owing to stagnant production volumes. The 1.8% labour productivity growth in manufacturing was entirely the consequence of reduced employment (1.7%). Although the trend of slower growth in compensation of employees continued in 1999 (growth dropped from 3.4% in 1998 to 2.8%), its real growth compared to labour productivity was one percentage point higher. Therefore, manufacturing's unit labour costs increased by 1.4% in 1999. Similarly, cost competitiveness decreased in comparison with the EU average and this was somewhat more pronounced compared to the CEFTA-4 countries (2.3%).

Graph 4: Market shares in EU member states



Source of data: SORS, WIIW, OECD, calculations IMAD.

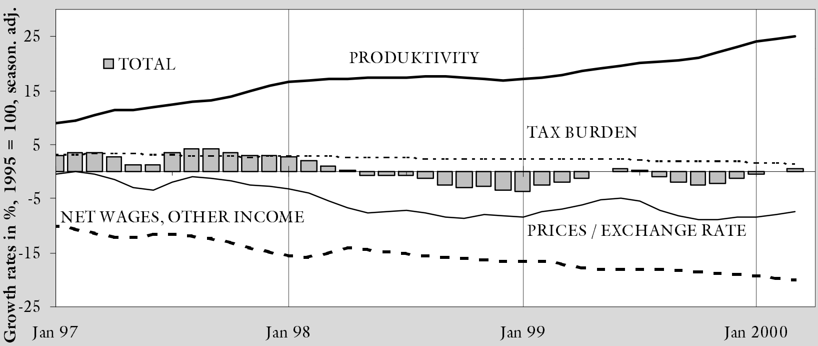
Slovenia's market share in international markets fell from 0.236% in 1998 to 0.214% in 1999. The share of goods exported from Slovenia in the imports of the EU Member States decreased from 0.284% to 0.269%. Slovenia's market share dropped most significantly in France, after it had temporarily surged in 1998 due to car exports; the respective fall was somewhat weaker in the Italian market, while it increased in Germany. Slovenian market share in Croatia shrank as well (from 9.722% to 8.628%). Thanks to increased market shares in the Czech Republic and Poland, the share of goods exported from Slovenia in the imports of CEFTA-4 countries rose from 0.476% to 0.492%. In the same period export performance of the CEFTA-4 countries in the EU markets was relatively higher than that of Slovenia, due to their better cost competitiveness, since their market shares grew from 2.822% to 2.995%.

At the beginning of 2000 the price and cost competitiveness of Slovenian manufacturing improved. Under the influence of excess demand for foreign exchange on the foreign exchange market (DEM 311 million, data for corporate and exchange-office market for the first four months) and the significant strengthening of the US dollar in international foreign exchange markets, the nominal and real depreciation of the tolar against the basket of currencies continued at the beginning of 2000. In April the tolar was 3.9% weaker than in

December 1999 in nominal terms and 1.7% in real terms (measured by relative CPI) or by 2.9% (measured by relative PPI). In the first four months nominal depreciation of the tolar was 7.6%, whilst real depreciation was 1.7% or 5.2% in annual terms (measured as above).

The cost competitiveness of Slovenian manufacturing improved in the first quarter of 2000 owing to the exchange rate as well as increased labour productivity, resulting from productivity growth in spite of a slightly higher number of employees. While the upward trend in labour productivity gradually subsided, the pressure of real compensation per employee on the international competitiveness of Slovenian manufacturing mounted in the first quarter of 2000 mostly due to an accelerated rise in other remuneration as well as higher tax burden. Therefore, the downward trend of unit labour costs, which started in October 1999, gradually slowed down in 2000. Compared to last December unit labour costs dropped by 1.6% in March 2000. Cost competitiveness improved more strongly in annual terms (in the first quarter of 2000, unit labour costs were 6.2% lower than last year), mainly due to high labour productivity growth (up by 9.8% year-on-year). The high growth of labour productivity was partly the result of a low benchmark. Real compensation per employee rose by 3% year-on-year in the first quarter of 2000 (of which net wages increased by 2.2%, other remuneration by 6.3% and personal income tax, contributions and payroll tax by 2.9%).

Graph 5: Competitiveness components



Sources of data: SORS, AP, BS, calculations IMAD. Note; Growth indicates an increase in competitiveness.

Bearing in mind that labour productivity growth is estimated to stabilise at approximately 5.5% year-on-year by the end of 2000, the **cost competitiveness of Slovenian manufacturing** will improve moderately on average **in 2000**, as suggested by figures for the first quarter. If the tolar depreciates against the basket of currencies (nominally by 6.4%, or by 1% in real terms based on CPI), as anticipated, and if real compensation per employee reaches the forecast 2.8% (the same as in 1999), this year's relative unit labour costs will fall by 1.3%.

5.2.2 BALANCE OF PAYMENTS AND EXTERNAL DEBT

5.2.2.1 EXPORT-IMPORT FLOWS AND BALANCE OF PAYMENTS – Despite dynamic export growth in 2000 and 2001 there is little possibility to decrease the deficit on the balance of payments current account

In 1999 movements in export-import and other balance of payments flows were marked by changed domestic and international economic conditions, especially increased domestic private and investment consumption, but also slower economic growth in the major trading partners, the strengthening of the US dollar on international money markets and the increasing prices of oil, petroleum products and raw materials mostly in the second half of the year. Last year, the volume of trade in goods and services expressed in current US dollars, decreased by around USD 640 million, principally as the consequence of the stronger US dollar against other currencies in which most of Slovenia's trade in goods and services is carried out. In real terms, imports and exports increased in 1999, although significantly less than in 1998 (especially exports). This notable slowdown in the real growth of total exports and imports of goods in 1999 (1.8%) compared to 1998 (7.2%) was influenced by less favourable economic trends in our major export markets (slower growth in the EU, recession in Croatia and reduced purchasing power in Russia). In 1999 exports of goods rose by 2.4% and export of services declined by 1.2%, both in real terms (the main reason being less income from tourism because of the proximity of the Kosovo war). Total imports of goods and services, stimulated mainly by intense investment activity, larger private demand prior to the introduction of VAT and faster growth in imports of construction and other services, increased much more rapidly than exports (by 7.3% in real terms, namely, goods by 7.5% and services by 5.9%), although slower than in 1998 (10.4%). The fact that imports grew quicker than exports and that the terms of trade deteriorated boosted the trade deficit, which amounted to USD 1,156.7 million (USD 774.9 million in 1998).

While the surplus on the balance of services (together with surpluses in the balance of income and current transfers) in previous years was sufficient to cover the trade deficit, it was primarily the reduced services surplus (USD 365.6 million in 1999 and USD 513.7 million in 1998) and the increased goods deficit in 1999 that resulted in a deficit on the balance of payments current account amounting to USD 581.4 million[27], which is significantly more than in 1998 (USD 3.8 million). Thus, last year's deficit on the balance of payments current account reached 2.9% of gross domestic product, which means that the upper limit of low macroeconomic vulnerability, as defined by the European Bank for Reconstruction and Development (EBRD, 1999) was exceeded. It needs to be mentioned that a similar nominal deficit on the balance of payments current account would already have been formed in 1998, had the terms of trade in international market not improved.

The deficit on the balance of payments current account was chiefly financed through increased borrowing from abroad since the net inflow from foreign direct and portfolio investment (with the exception of euro-bonds issued in March 1999 in the amount of USD 438.2 million) was significantly lower in 1999 than in 1998. In 1999, capital-and financial account of the balance of payments showed increased liabilities to other countries i.e. the inflow of foreign capital amounting to USD 537.3 million (in 1998 net capital exports amounted to USD 167 million). In the same year, the financial inflows from abroad were principally influenced by higher bank and company borrowings and issues of government bonds, whilst financial outflows mainly consisted of granted corporate loans and net outflows of foreign cash exported by population. In 1999 the net financial flow from abroad accounted for 2.2% of gross domestic product and did not entirely cover the deficit on the balance of payments current account (2.9% of gross domestic product). Therefore, foreign exchange reserves dropped in 1999 (in December 1999 they were by SIT 678 million lower than in December 1998, of which about three quarters due to exchange rate differentials; for more specific details see Chapter 5.2.2.2)

The Slovenian economy is traditionally very open as its foreign trade coefficient the 1995-1999 period (total trade in goods and services compared to gross

[27] Compared to 1998 net labour and investment income was lower in 1999 (less net labour income and more net investment expenses – repatriation of profits, payment of interest on securities owned by foreigners), whilst only a slight increase was recorded in net current transfers.

domestic product) was approximately 1.14. Therefore, external conditions[28] to a great extent determine through balance of payments movements all economic trends and the country's economic performance. From the point of view of export markets growth, external factors will have a more favourable impact on balance of payments movements in 2000 than they did in 1999, for according to international institutions economic growth in Slovenia's major trading partners will strengthen in 2000 (for more specific details see Chapter 3). The expected faster growth of our major trading partners will accelerate the growth of Slovenian export markets, which are forecast to reach an 8% real growth in 2000. Under the assumption that the US dollar strengthens against the basket of currencies of Slovenia's major trading partners by 5.4% on average (by 6.7% against DEM), foreign trade prices expressed in US dollars will drop in 2000. This decrease will be more pronounced in export prices (index 97.3) than in import prices (index 98.5), primarily due to high oil prices and to higher producer prices in countries exporting to Slovenia. Should such developments really take place, **the terms of trade in the Slovenian economy in 2000 will deteriorate by about 1.2 percentage point**.

In the first quarter of 2000 compared to the same period of 1999, exports of goods increased by 12.8% in real terms, while imports of goods were in real terms higher by 9.8%. A more rapid real growth in goods trade compared to last year's respective period (in the first quarter of 1999 compared to the first quarter of 1998 exports and imports of goods rose in real terms by 4.1% and by 4.4% respectively) resulted from a recovered European and global economy in 2000 and partly from the revival of trade with the countries of the former Yugoslavia and Russia. Increased export demand boosted domestic industrial production (for more specific details see Chapter 5.1), and consequently stimulated faster growth in the imports of intermediate goods, i.e. raw materials, semi-finished goods and oil (in the first three months by 16.3% in real terms compared to the respective period last year). Further growth in domestic investment activity in the first quarter was accompanied by the dynamic imports of investment goods (up by 9.8% in real terms), whereas imports of consumer goods, on the other hand, were lower (by 3.9% in real terms) due to a slight tolar depreciation against the basket of currencies in the first quarter (5.4% in real terms, measured in terms of producer prices). Despite the fact that in this period imports grew faster than exports in real terms, deteriorated terms of

[28] Demand movements in export markets; changed prices of oil, other raw materials, and producers' domicile prices, which generate import prices growth; foreign interest rate fluctuations; the intensity of the "push" factors of capital flows, determined by economic development in emitting economies (Fernandez and Montiel, 1996)

trade caused trade deficit expressed in USD to rise by USD 96.4 million compared to the respective 1999 period, thus totalling USD 317.5 million. Besides lower net income (by USD 35 million) and current transfers (by USD 7.7 million) increased trade deficit was the main reason for a greater deficit on the balance of payments current account, since the surplus in services (USD 111.9 million) remained at approximately the same level as in the first quarter of 1999. The deficit on the balance of payments current account in the first three months of 2000 thus amounted to USD 175.4 million, which is by USD 142.7 million more than in the respective period last year.

Faster growth in export markets (from 4.9% in 1999 to 8% in 2000) will trigger a quicker real increase in exports of goods in 2000, which is expected to rise up to 7.8%, as indicated by the quarterly data on export movements and the extremely high export expectations of Slovenian manufacturers. A more dynamic export growth will also be stimulated by the revived trade of goods with the former Yugoslavia South-Eastern Europe and Russia, as well as by Slovenia's greater integration in globalisation flows. In view of the fact that, the import boom in 1999, was a one-time phenomenon preceding the introduction of VAT, in 2000 a somewhat lower real growth in imports of goods (6.5%) is expected. Improved domestic industrial activity (imports of intermediate goods) and continued lively investment activity, including expected economic restructuring (imports of investment goods) will remain the main boost to imports, which are still rather dynamic. Since the negative influence of deteriorated terms of trade in 2000 will be relatively greater than the positive influence of export market growth, the trade deficit expressed in current USD will increase this year, namely, by some USD 54 million, and total USD 1,210 million. As regards the end-use structure of imports in 2000 the deficit is estimated to maintain or even strengthen "development" aspects (imports of investment goods).

In 2000, exports of services are foreseen to increase by 3.8% in real terms. Real income from tourism is forecast to increase by 1% in 2000 (in 1999 it dropped by 7.5% in real terms), primarily thanks to an expected good tourist season and an increased number of foreign tourists. Transport services exports, which depend on the volume of the exports of goods, are also predicted to show real growth. The real rise in the imports of services should be 3.2%; higher levels of economic development will especially increase imports of other services (communication, finance, computer, IT and insurance), which require more know-how, a skilled workforce and contains a higher value added. This year's surplus in service trade will thus account for USD 385 million, enough to cover 31.8% of the trade deficit, which is approximately as much as in 1999.

In 2000 the factor income balance will when compared to 1999 drop somewhat more (from USD 90 million to USD 65 million) depending on the increase in interest rates abroad, Slovenian debt-servicing obligations in 2000 (USD 1 billion according to long-term debt repayment plan, of which USD 261 million in interest; BS, 2000), and the larger than expected payments abroad of investment income. Assuming that Slovenia will get pre-accession assistance from the PHARE, ISPA and SAPARD programmes as expected, positive unrequited transfers are already foreseen to slightly increase. On the basis of estimated balance of goods and services, the income balance and current transfers, the **balance of payments current account in 2000 is predicted to record a deficit of USD 605 million or about 3% of the gross domestic product**.

In 2001 a relatively favourable influence of variables in the domestic and international environment on balance of payments movements will continue, although European economies will grow slightly slower when compared to 2000. Reduced imports by major trading partners will slow down the real growth in Slovenian exports by 0.6 percentage point (to 7.4%). According to this estimate exports of goods would rise by 6.6% and imports of goods by 5.8% both in real terms. Exports of services are assessed to increase by 2.7% and imports of services by 3.9% in real terms (imports of services will rise faster in line with the general upward demand for services resulting from a higher level of economic development). It is estimated that with the expected slightly higher unrequited transfers net inflows the **current account balance** will stabilise at approximately the same level as in 2000 (USD 615 million) **accounting for about 2.8% of gross domestic product**.

5.2.2.2 EXTERNAL DEBT – The main source of international borrowing is in government bonds and long-term loans of the private sector, raised through commercial banks

At the end of 1999, Slovenia's external debt was USD 5,491 million or USD 532 million more than at the end of 1998 and almost three times more than in 1991. In 1991 Slovenia assumed part of the former Yugoslavia's debt in the amount of USD 1.765 million, which could be attributed to specific final beneficiaries (allocated debt). In the same year additional loans were raised abroad, predominantly by the private sector, although these were small in volume until 1994. External debt rose significantly in 1995 (USD 712 million) and in 1996 (USD 1.04 billion) when the Government assumed its share of the non-allocated debt of the former Yugoslavia to commercial banks. Following a relatively small increase in 1997 (USD 166 million), external debt grew significantly once again in 1998 (by USD 783 million), primarily owing to higher government borrowing, which raised cheaper finance to partially repay more expensive loans, raised in the previous years. The increasing deficit on the balance of payments current account and less strict credit terms abroad also impacted external debt growth in 1999, which nominally was not as fast as in the previous year, primarily due to a stronger US dollar. Taking into account borrowing mostly in the Euro Area, this contributed to slower external debt growth expressed in US dollars (negative exchange rate differentials totalled USD 634 million).

Table 12: Slovenia's external debt in the 1991-1999 period (in millions of USD)

	1991	1992	1993	1994	1995	1996	1997	1998	1999	31.03. 2000
TOTAL DEBT	1,866	1,741	1,873	2,258	2,970	4,010	4,176	4,959	5,491	5,924
Long-term debt	1,765	1,659	1,744	2,172	2,916	3,960	4,041	4,849	5,374	5,801
- Public and publicly-guaranteed	1,357	1,203	1,206	1,331	1,437	2,025	2,067	2,370	2,542	2,917
- Private not guaranteed	408	456	538	841	1,479	1,935	1,974	2,479	2,832	2,884
Use of IMF credit	-	-	12	7	4	1	-	-	-	-
Short-term debt	101	82	117	79	50	49	135	110	117	123

Source: The Bulletin of the Bank of Slovenia

After 1991, foreign credit became increasingly available to both Slovenia and its economic entities. The private sector had already started borrowing from private sources abroad in 1991 and 1992, while the government was given this possibility in 1993, when Slovenia became a member of all the major international financial institutions. This improved the confidence of institutional and private lenders and normalised credit relations between Slovenia and other countries.
Since the share of short-term debt in total external debt was below 7% at all times and after 1993 even below 4%, it is above all sensible to analyse in detail the structure of long-term debt both from the spoint of view of the borrowers and lenders. The share of public and publicly-guaranteed debt in the 1991-1999 period fell significantly (from 77% to below 50%), primarily due to faster growth in private non-guaranteed debt. Two thirds of the increase in Slovenia's external debt from 1991 are the result of additional private borrowing and only one third due to credit raised by public entities and that backed by state guarantees. The actual share of private debt is even larger, since the state also issued a guarantee for the allocated part of debt, which is in fact private, because the borrowers have been identified and they duly service their obligations.

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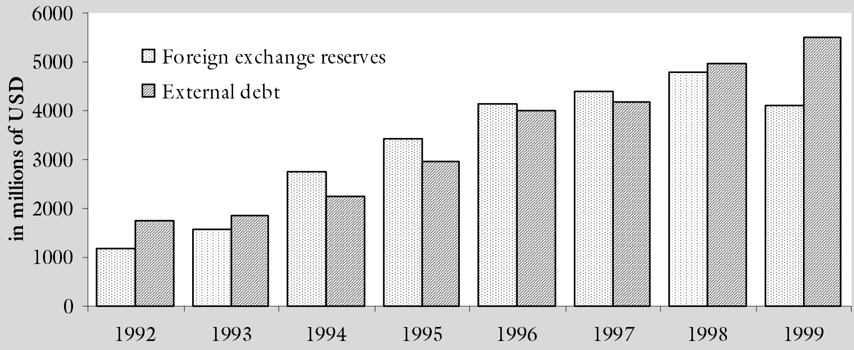
Foreign commercial banks were the most important **source of private external debt** throughout the period (their share exceeding 60% at all times). Among the primary reasons for higher private external debt were more favourable credit terms abroad, the improved rating of Slovenia on international financial markets and the willingness of foreign commercial banks to grant loans to Slovenian entities, lagging growth in exchange rates behind domestic inflation, and the insufficient long-term credit potential of domestic banks. In order to curb external private borrowing, the Bank of Slovenia introduced in February 1995 a 40% deposit of each drawn tranche of loans, granted for the period up to five years. This measure, however, failed to substantially reduce external borrowing by the private sector (banks and companies were able to raise loans with repayment periods exceeding five years without difficulties). Debt increase was slowed down only by extending the repayment periods of loans, for which deposits were not necessary, from five to seven years (July 1996). The volume of newly granted loans in 1997 was thus for the first time after 1991 lower than in precedent year. In 1999, the volume of newly granted loans reached the last-nine-years' peak (USD 2,261 million), due to more favourable credit terms abroad and to the fact that from February 1999[29] no deposit was required for loans raised abroad.

Throughout the period from 1994 to 1998 total foreign exchange reserves exceeded or approximately equalled external debt. But in 1999 the foreign exchange reserves to external debt ratio dropped substantially (from 96.4% at

Graph 6: Comparison of foreighn exchange reserves and external debt in the 1991 - 1999 period



Source of data: BofS.

[29] Upon the implementation of the Europe Agreement between Slovenia and the EU the Bank of Slovenia, pursuant to the provisions therein, reduced the rate of deposit required for loans raised abroad to 0%, thus freezing (and not abolishing) the measure itself.

the end of 1998 to 74.7% at the end of 1999), while external debt increased by USD 532 million, and foreign exchange reserves dropped for the first time by USD 678 million last year (approximately three quarters of the reduction were accounted by exchange rate differentials resulting from the soaring US dollar on international money markets and did not arise from funding of the deficit in the current account of the balance of payments). In the first three months of 2000, external debt growth continued, as it increased by USD 433 million, principally because of state borrowing (in March the state issued euro-bonds in the amount of USD 380 million), and reached USD 5,924 million at the end of March. In the same period total foreign exchange reserves increased by USD 154 million despite the strengthening of the US dollar (total foreign exchange reserves of the Bank of Slovenia by USD 125 million and those of commercial banks by USD 29 million), so that at the end of March they amounted to USD 4,257 million. The foreign exchange reserves to debt ratio was 71.9% at the end of March.

With the exception of 1999, private borrowing abroad without state guarantees exceeded government borrowing in all the previous years. State borrowing was somewhat stronger primarily in 1998 and 1999 (issuing euro-bonds and raising loans), mostly due to early repayments of more expensive loans and the covering of the general government deficit. More repayments of public and publicly-guaranteed debt in 1998 raised the debt servicing ratio (the ratio between annual debt repayment and foreign exchange income from exports of goods and services) from 8.5% in 1997 to 13.2% in 1998. The debt service ratio in 1999 once again dropped to 7.7%, which is still much below the critical level of 30%, as determined by the World Bank (Defrančeski, 2000). Together with some other debt indicators[30], the debt service ratio shows the ability of the country to regularly service its debt where Slovenia ranks between those countries with a relatively low debt burden. Should the expected current deficit on the balance of payments in 2000 and 2001 be maintained at approximately USD 600 million, the pressures to increase Slovenia's external debt will continue in both years, unless there is a major rise in foreign direct and portfolio investment. Greater borrowing and consequently higher debt-servicing obligations would deteriorate debt indicators but these however would still remain below critical value. Furthermore, a comparison with the CEFTA countries (Štiblar, 2000) shows

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[30] EDT/XGS – ratio between total external debt and foreign exchange income from exports of goods and services (critical level is 275%; Slovenia in 1999: 49.9%); EDT/GDP - ratio between total external debt and GDP (critical level is 50%; Slovenia in 1999: 27.4%); INT/XGS – ratio between annual value of paid interest and foreign exchange income from exports of goods and services (critical level is 20%; Slovenia in 1999: 2.2%)

that in 1999 Slovenia's relative debt (share of debt in gross domestic product) and debt burden (debt servicing ratio) place it amongst the less indebted countries.

5.2.3 FOREIGN DIRECT INVESTMENT – Changed approach to foreign investment does not give immediate results

At the end of 1998 the foreign direct investment (FDI) stock in Slovenia totalled USD 2,907.3 million, which is USD 610.3 million more than at the end of 1997. This figure includes USD 160.5 million of foreign capital in companies indirectly owned by foreign investors (indirect affiliation: a company with foreign capital fully or partially owns another Slovenian company). In the same year FDI inflow amounted to USD 165 million, this discrepancy resulted from several reasons, the most important being: (i) balances include several elements which are not recorded in FDI flows (crediting transactions between foreign parent companies and their subsidiaries in Slovenia, investment in kind etc.); (ii) appreciation of the tolar against the dollar in 1998; (iii) reclassification of certain portfolio investments into foreign direct investments.

Despite a significant increase in 1998 (see Table 13), a downward trend was noticed in FDI inflows after 1997. After record FDI inflows in 1997 totalling USD 320 million their amount almost halved in 1998, and then again fell by 50% in 1999 in respect to the previous year. Taking into account the USD 83.4 million of FDI inflows in 1999, FDI in Slovenia last year stood at about USD 3 billion. These data imply two major conclusions: (i) modest FDI inflows show that foreign investors are still avoiding Slovenia and that liberalising measures taken by the Government in 1999 were insufficient to attract FDI, since the number of new foreign investors is still negligible; (ii) the growth in existing FDI which exceeded FDI inflows, on the other hand shows that present foreign investors intensified and increased their activities in Slovenia and proves their positive attitude to Slovenia as a location for investment.

The initial balance of payments data for 2000 indicate a further decrease in FDI inflows, as in the first two months of the year no more than USD 2.2 million of inflows were recorded compared to USD 23.9 million in the respective period of 1999, which was in itself an extremely bad year. Developments in the first two months of 2000, when FDI outflows from Slovenia (2.9 USD million) exceeded FDI inflows to Slovenia (USD 2.2 million of inflow), are likely to continue throughout 2000. It will be no surprise if in 2000 Slovenia becomes a net foreign direct investor abroad. This can be explained by two facts: (i) FDI

Table 13: Flows, balance and changes in the balance of inward FDI[1] in Slovenia in the 1993-1998 period

	1993	1994	1995	1996	1997	1998
VALUES, in millions of USD						
Total value as at the end of the year[2]	954.3	1,325.6	1,758.6	2,069.4	2,297.0	2,907.3
(of which FDI via indirect affiliation)[3]	n/a	(n.p.)	(n.p.)	(91.9)	(116.4)	(160.5)
Equity and reinvested profits	709.7	966.7	1,202.2	1,349.1	1,665.6	2,166.4
Liabilities to foreign investors	346.6	476.5	694.3	893.3	811.0	845.1
Claims on foreign investors	102.2	117.6	137.9	173.0	179.6	104.2
Net liabilities to foreign investors	244.4	358.9	556.4	720.3	631.4	740.9
Changes of stock of FDI - total value[2]	n/a	371.3	433.0	310.8	227.6	610.3
Equity and reinvested profits	n/a	257.0	235.5	146.9	316.5	500.8
Net liabilities to foreign investors	n/a	114.5	197.5	163.9	-88.9	109.5
Annual inflow	112.6	128.1	176.0	185.5	320.8	165.4
Total value as at the end of the year[2]	n.p.	38.9	32.7	17.7	11.0	26.6
Annual inflow	1.4	13.8	37.4	5.4	72.9	-48.4

Source: Bank of Slovenia.
Notes: [1]Companies in which foreign investors have a capital share of 10% or more;
[2]Total value = equity + liabilities to foreign investors - claims on foreign investor;
[3]Indirect affiliation: is a company (co)owned by companies with foreign participation in Slovenia, taking into account the limit of at least 10% capital share.

inflows cannot substantially exceed those of 1999 (if at all), despite certain positive shifts in public and political opinion combined with the attitude and attempts of the Government, since it is too late for any radical changes in 2000. "Surprises" in the form of a major foreign acquisition are also unlikely, since they take time; (ii) highly increased interest in foreign investment abroad has lately been present among Slovenian companies, especially for the countries of the former Yugoslavia. It seems that Slovenian companies realised the urgency of internationalising their business. Last year's FDI outflows in the amount of USD 43.8 million were by far the highest so far (in 1998 - USD 11 million and in 1997 - USD 25.5 million). The growing number of planned and realised FDI abroad and a much stronger demand for the backing of the Slovene Export Corporation show that FDI outflows will significantly increase this year, especially those to the former Yugoslavia and countries in transition.

The existing analyses reveal several obstacles to FDI inflows to Slovenia. Irrespective of the fact that Slovenia is a small market, which will always be a major obstacle for greenfield FDI – although it will diminish once Slovenia becomes a full member of the EU – there are five other major obstacles to FDI inflows to Slovenia: (i) administrative obstacles are quite significant; the unfinished transition reflected in incomplete corporate legal framework, and discrimination favouring certain company categories, which increases the cost of companies' establishing and operating; (ii) problems in providing business premises and land for business purposes, especially for industry; (iii) many privatised companies have not yet started comprehensive restructuring, which would encourage them to seek foreign strategic partners (particularly true of industries with economies of scale); (iv) ambiguous signals about the Slovenian attitude to FDI, since in individual cases its negative stance often prevails over its general statements in support of FDI and; (v) until recently its FDI policy was extremely passive, and institutionally inadequately organised, while incentive schemes were inappropriate in comparison with other countries in the region.

In 1999, Slovenia took several measures, which improved the investment climate, namely: (i) the adoption of the Foreign Exchange Act, which fully implements the principle of national treatment, (ii) the narrowing of the definition of foreign portfolio investment, so that custody accounts are required for foreign investors with less than a 10% share in a company (previously 50%), (iii) ratification of the Europe Agreement including a series of measures regarding FDI liberalisation, (iv) the more active role of the Trade and Investment Promotion Office, which in 1999 started implementing certain promotional activities (increasing the accessibility of industrial land, more free-of-charge services to foreign investors provided by the Trade and Investment Promotion Office and improving the image of Slovenia as location for FDI).

Further declining of FDI inflows in 1999 and 2000 indicate that the above measures are insufficient. There is growing awareness that a significant FDI increase in Slovenia will not take place unless: (i) the process of state property privatisation is widely opened to foreign investors and the process itself accelerated; (ii) a more active policy in promoting new FDI, which would have to be further strengthened upon Slovenia's accession to the EU; (iii) the government and administration show all-out commitment to boosting FDI and entrepreneurship in general.

5

Two steps in the right direction were made at the beginning of 2000. The first is the Slovenian Government's Programme for the Promotion of FDI in 2000, adopted in January 2000, and the second the analysis of administrative barriers to investors in Slovenia, ordered by the Government of the Republic of Slovenia from FIAS (Foreign Investment Advisory Service) of the World Bank. The main objective of the Government's Programme for the Promotion of FDI in 2000 is to increase the annual net FDI inflows from the present 1% of gross domestic product (annual average over the last few years, while in 1999 this share was below 1.0%) to 3% of gross domestic product in the next four years. The programme aimed to improve Slovenia's competitiveness as a location for FDI, consists of the following measures: (i) a simplification of administrative

Box 8: The importance of foreign-owned companies for the Slovenian corporate sector

Despite unfavourable trends, the importance of FDI for the functioning of the Slovenian non-financial corporate sector is gradually growing. At the end of 1998, foreign-owned companies (with at least 10% foreign participation) represented a mere 4.3% of the sector, but at the same time accounted for 11.1% of total capital, 11.7% of total assets and 8.8% of all employees in the Slovenian corporate sector. With this capital, assets and employees they generated 15.9% of total net sales, as much as 19.0% of total operating profit, 12.3% of total operating loss and 14.0% of total investment outlays. Foreign-owned companies were most successful in exports, exporting as much as 27.6% of the Slovenian non-financial corporate sector's total. In the 1994-1998 period the share of foreign-owned companies in Slovenian corporate sector rose significantly – mainly in exports (by 11.8 percentage points), investment outlays (by 10.3 percentage points), sales (by 7.5 percentage points), capital (by 10.1 percentage points), assets (by 8.3 percentage points) and the number of employees (by 5.3 percentage points). Exports and sales are obviously those areas where foreign-owned companies perform better than domestic ones.

procedures; (ii) an improved accessibility of building sites for those investing in new projects, especially in industrial production; (iii) adjusting the existing system of economic incentives so as to also make them accessible to foreign investors and comparable to incentives aimed at attracting FDI in other competitive countries. The policy of promoting FDI, as set out by the Programme, will mostly focus on greenfield investment and on increasing the capacities of existing foreign-owned companies already operating in Slovenia. At the same time, it will support those projects involving foreign strategic capital, which will positively affect the development of participating domestic companies (this primarily concerns state-owned domestic companies). The programme is also opening up the privatisation of state-owned companies to foreign investors (strategic and institutional), especially in the area of infrastructure, companies owned by the Development Corporation of Slovenia and other state-owned industrial companies (Slovenian Steelworks). Moreover, the programme supports a more active participation of foreign investors in the privatisation of financial and other service sectors, which nevertheless still remains to be defined in more detail.

The report by FIAS Slovenia – Administrative Barriers to Investment- can influence future FDI inflows to Slovenia at least as much as the programme for their promotion. Foreign investors coming to Slovenia face a series of administrative barriers which seriously diminish their willingness to carry out their projects. Since in most other countries administrative barriers are minor, foreign investors get the impression that only in Slovenia are such obstacles put only in their way. But this of course is not true, as domestic economic entities also encounter the same administrative barriers. Thus, their removal would not only have a positive impact on foreign investors but also on the entire Slovenian corporate sector. The most serious problems foreign investors come across are: acquiring land for investment purposes, obtaining various building and work permits for foreigners, and recruiting and laying off of staff. Foreign investment is especially seriously hindered because these processes are time-consuming and uncertain. The FIAS report gives several recommendations on how to remove these administrative barriers.

FDI policy development in Slovenia in 1999 and 2000 undoubtedly shows a positive shift in Slovenia's official attitude towards FDI, while its results depend on the government's actual commitment to carry out the programme, especially the part related to privatisation of the remaining state-owned companies. The programme clearly advocates higher foreign participation in the privatisation of state-owned companies, including financial institutions and public utilities. However, nothing yet has been decided, despite the fact that the programme recommends the intensive participation of foreign investors. First and foremost this is a political question far too important to be decided solely by a programme for the promotion of FDI.

The implementation of FIAS recommendations on removing administrative barriers to foreign investors in Slovenia is even more far reaching considering the improvement of Slovenia's position as an investment location. For the time being this is of course only a proposal made by a foreign advisory service, which still has a long and uncertain way ahead of it before it becomes a government programme for removing the administrative barriers to foreign investments in Slovenia. The FIAS report extends far beyond the question of FDI and is of great importance for the entire Slovenian corporate sector, since it reveals the main obstacles faced by both foreign and domestic investors in Slovenia. There is no doubt that the Slovenian government will adopt several recommendations made by FIAS, although it is very unlikely that they will be implemented in the short run, especially since major administrative barriers in Slovenia primarily concern land and labour relations –the areas with far-reaching economic, social and political implications.

Besides the improved climate for FDI in Slovenia and the much greater willingness of the government and local authorities to take measures more favourable for foreign investors, Slovenia urgently needs to carry out some successful FDI projects in order to improve its rating in the eyes of foreign investors. This would be an adequate demonstration for foreign investors. The finalisation of state property privatisation opens the possibilities for FDI but this should be very transparent, since any other attempt would mean a step backward.

5.3 INVESTMENTS – Dynamic investment activity to continue in the future

Lively investment activity is the most important generator of high economic growth in Slovenia. In 1999, gross fixed capital formation increased by SIT 978 billion nominally or 16.1% in real terms (compared to 11.1% in 1998), whilst its share in gross domestic product reached 26.9%. Countries in transition have different levels of investment activity, such as, 31% in the Czech Republic and 39% in Slovakia, whereas in Poland and Hungary investment shares in gross domestic product are 21% and 16% respectively. In EU Member States investments rose last year by 4.9% on average, accounting for 21% of gross domestic product. Of the EU members the most marked growth in investments was recorded in Ireland (12.5%), whilst among other advanced economies investment activity was most intense in the USA with 8.4% real growth.

The technical structure of gross fixed capital formation (according to national accounts) shows that last year 97% of investments was in tangible and 3% in intangible fixed assets. Of the former 54% represented investments in building and construction works and 46% in producers' durable goods (machinery and equipment). SIT 514 billion was invested in building and construction works, which is in real terms 25% more than in 1998. Investments in machinery and equipment totalled SIT 408 billion or in real terms 8.6% above the 1998 figure, of which purchases of personal cars improved by 12.5% in real terms and investments in other equipment and machinery (accounting for 77% of total investments in equipment and machinery) grew by 10.5% in real terms.

In Slovenia last year the pace of investment activity differed in each quarter. Lively investment activity rose steeply in the second quarter, stabilised in the third and once more experienced an upward trend in the fourth. The most accelerated pace was recorded in construction activity, which increased by as much as 33.3% in real terms according to IMAD estimates (for more specific details see chapter 5.1). Imports of equipment surged in the second quarter (increased by 60% compared to the respective period the year before), which represented 77% of the annual growth, whilst in the remaining three quarters growth was moderate (3.9% on average). In 1999, the imports of equipment exceeded the 1998 figure by 17.3% in real terms. In the first six months production of investment goods was on the rise, whereas in the second half of the year it levelled off, so that in the whole 1999 production exceeded that of 1998 by 1.3%.

According to the data supplied by the Agency for Payments of the RS[31] , legal entities invested SIT 424 billion last year or nominally 21.1% more than in 1998. Lively investment activity characterised all sectors with the exception of public service. The most intense investment activity, however, was recorded in business services, the energy sector, health and other services. Business services, which experienced a real growth of 57%, were the largest investor (Motorway Company of the Republic of Slovenia) accounting for one fourth of total investment outlays. According to the volume of investment outlays, investments in public service came second, even though outlays were lower by a quarter in real terms compared to 1998. Next came investments in transport and communications, which improved by 8% in real terms. These were followed by manufacturing, representing one sixth of total investments, which remained at the 1998 level, whilst investments in wholesale and retail rose by 13% in real terms.

Investments in economic infrastructure (according to data provided by the Agency for Payments of the RS), which also cover investments in transport infrastructure and the energy sector, were worth SIT 171 billion, exceeding the 1998 figure by 16% in real terms. Investments in transport infrastructure, amounting to SIT 143 billion, accounted for a good third of total outlays, of which SIT 97 billion went on the construction of roads and highways or twice as much in real terms as in 1998. A high 35% growth in investments was recorded in post and telecommunications (SIT 34 billion), 22% (SIT 3 billion) growth was recorded in investments in harbour transport, whilst investments in railway transport , in the amount of SIT 9 billion decreased by 14% in real terms. Last year the public service invested SIT 56 billion or 25% less in real terms than in 1998. Investment activity in education was also poor (SIT 3 billion), staying at the

[31] According to the methodology of the Agency for Payments of the RS, investment outlays include expenses covered from corporate accounts for acquiring tangible fixed assets (land, buildings, forests, production and other equipment), expenses for intangible long term assets (patents, licences, trademarks, concessions, etc.) and investment outlays financed by bank loans. The Agency's data also covers purchases of new and second hand fixed assets and is not in line with the methodology of national accounts, according to which only purchases of new fixed assets count as investments. Despite this incongruence between the two methodologies, the advantage of the indicator is its availability on a monthly basis.

same level as in 1998, whilst investments in health, totalling SIT 10 billion, doubled in real terms. Total investments in economic infrastructure and public sector activities amounted to SIT 243 billion last year, meaning that together they grew by 4% in real terms and represented 57% of total outlays. In other words, 43% of total investment outlays were posted by the business sector. However, it has to be taken into account that the data supplied by the Agency for Payments of the RS excludes investments in imported equipment which, judging by quarterly assessment of gross domestic product by expenditure (according to IMAD methodology) accounted for 32% of total investments.

General government revenue and the expenditure balance of the Ministry of Finance for 1999 show investment outlays of consolidated total general government finance in the amount of SIT 109 billion or 3% of gross domestic product, of which state budget investments totalling SIT 56 billion, increased by 10% in real terms and those under municipal budgets surged by 46% (SIT 52 billion). Of total government investment SIT 54 billion went on newly constructed buildings and adaptations, SIT 21 billion on replacement investment, SIT 15 billion for purchasing equipment and SIT 7 billion for studies and projects. Besides capital expenditure, SIT 59 billion or 1.6% of gross domestic product from the budget were for capital transfers, which exceeded the 1998 figure by 21%. The largest transfer of SIT 35 billion (12% more in real terms than the year before), went to public enterprises, whilst public institutions and public utilities received SIT 14 billion or 73% more than in 1998. Capital transfers to municipalities dropped by 37% in real terms. In 1999 the central government and municipalities invested SIT 168 billion or 4.6% of gross domestic product.

1999's investment momentum has continued into 2000. In the January-March period investment outlays were lower in real terms compared to the respective period last year, however, the value of construction works rose by 13%, and imports of equipment by 9.8% and production of investment goods increased by 3%. Investment outlays in economic and public infrastructure went up by as much as 32%. The fastest growth in investments is in railway and air transport, as regards transport infrastructure; in electricity and gas supply as regards energy sector; and in state budget investments. The state budget of the Republic of Slovenia for 2000 (municipalities excluded) allocated SIT 69 billion for investment outlays (nominally 14.3% more than in 1999) and SIT 56 billion for capital transfers (exceeding the 1999 figure by 5.2% in nominal terms). The above investment activity indicators, taking into account planned investments by the companies involved in economic infrastructure (electricity and gas supply, telecommunications, railway and port transport) point to a **continuation of**

this investment momentum, not only in 2000 but also in 2001 (9% real growth).

5.4 INFLATION – Inflationary trends in 2000 stimulated primarily by external factors

In 1999 inflationary movements were more moderate than expected. In the first six months of the year a declining inflationary trend persisted. In the period between January and June the prices of consumer goods increased by 2.7% and in May and June inflation was 4.3% at the annual level. The changed system of taxation for products and services introduced in July brought about a faster growth in prices, especially in the first three months following the change, whilst in the second half of the year the higher prices of energy products on international markets had a significant impact on inflation. At the annual level, inflation started growing again in July and reached 8% at the end of the year, thus exceeding the 1998 figure by 1.5 percentage points. Despite higher annual growth towards the end of the year, average inflation in 1999 (6.1%) lagged behind the inflation posted for 1998[32] (7.9%) as well as those forecast for last spring (6.8%) and autumn (6.2%). This was mainly due to favourable inflationary trends in the first six months of the year and a less than anticipated impact of the changed taxation system. Retail prices and industrial producer prices rose on average by 6.6% and 2.1% respectively at the annual level.

The key factor influencing inflation in 1999 was the introduction of VAT. This resulted in an aggregate increase in price level and a change in relative prices. Actual price growth, due to the reformed taxation on products and services, the effect of which was evident in the third quarter of 1999, was lower than expected. The reasons for this are the moderate inflationary expectations of economic entities and the restrictive monetary and pricing policy. Another important factor which primarily pushed up inflation in the second half of last year, was the increase in oil and other commodity prices on global markets (from the end of December 1998 until the end of December 1999, the price of Brent oil shot up by 138%). The growth in petroleum product prices alone, which are included in the consumer price basket, contributed 1.4 percentage points to 8% inflation in the December 1998-December 1999 period.

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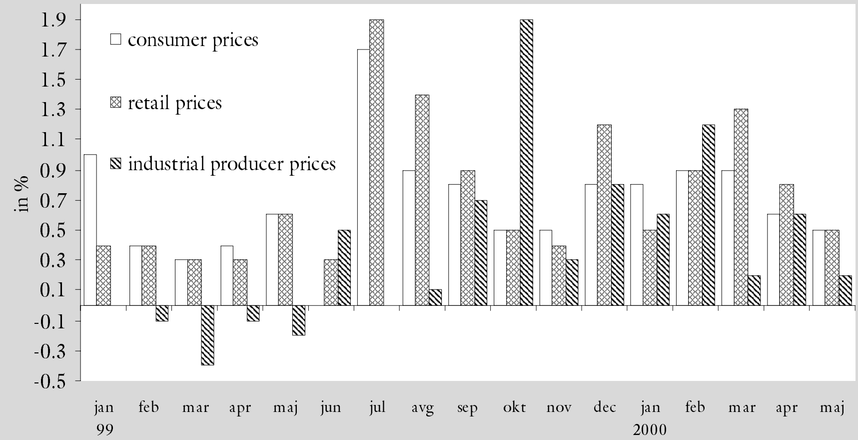
[32] The downward trend in the average growth rate has persisted since 1992.

Graph 7: Monthly price growth



Source of data: SORS.

Amongst individual product groups included in the CPI, 1999 saw the largest, 14.3%, increase in the average prices of medical and pharmaceutical products. This product group prices were also the most volatile (the standard deviation of monthly prices was 2.1). The increase and fluctuation in prices resulted mostly from the fact that in 1998 the government liberalised the prices of medical products, so that, by our estimates, the growth and changes over the next 12 months will approach the average total index. The prices of products in the group encompassing rents, fuel, and energy, experienced a 13.6% increase in 1999, the majority of that in the second half of the year (83.9% of total increase). The rate of growth of prices in the abovementioned group was primarily influenced by an increase in the prices of oil and other commodities. Last year, the prices of utility services rose on average by 12.3%, largely due to the inter-municipal price harmonisation of these services. The prices of postal and telephony services remained unchanged until December, when the government approved their increase. As a result of considerably higher phone rates, the prices of products and services in the communication group went up by 11.9% on average last year. Products and services in the transport sector grew on average by 10.6%, primarily due to higher fuel prices. This was followed by price increases in clothing and footwear group (8.0%), education (7.7%), food and non-alcoholic beverages (7.1%), recreation and culture (6.0%), housing equipment (5.2%), alcoholic beverages and tobacco (3.1%), hotels, restaurants and other services (3.0%).

In the first four months of 2000 prices rose by 3.2% compared to December 1999, which is 1.1 percentage points more than in the same period of 1998. Higher growth in the first four months of the year compared to the same period last year was influenced primarily by persistently increasing prices of energy products on international markets. Higher oil prices contributed 0.85 of a percentage point to inflation when measured over these four months. At the annual level, inflation reached 9.2% at the end of April or 1.2 percentage points more than in December last year. Price growth was characterised mostly by the seasonal price increases of food products and beverages as well as that of utility services (especially in January). Compared to the increases in inflation in February and March 1999 (0.4% and 0.3% respectively) the inflation was higher in the respective period of 2000 (0.9% in both cases), which was mostly the result of higher prices of energy, heating fuels and transport. Price growth slowed down in April (inflation was 0.6%). As was the case in other months, inflation in April was primarily driven by costlier petrol and other heating fuels as well as by the above average growth in prices of products and services related to health care.

Box 9: Core Inflation

In the last decade the price of oil was declining, which was followed by a reversal of that trend in 1999, and the highest price since 1990 was recorded at the beginning of March 2000. The increased oil price, which is of an external character for Slovenia, had a crucial impact on internal prices. Therefore, it is sensible to estimate **core inflation**, i.e. price growth, which excludes changes in prices of oil and other energy products, which are dependent on oil prices. From December 1998 until December 1999 core inflation rose by 5.4%, which is 2.6 percentage points below inflation expressed in terms of CPI. The average inflation (excluding the rise in prices of energy products) was 4.6% or 1.5 percentage points less than the average inflation measured by CPI. In the first four months of 2000, core inflation was 2.4%, or 0.8 percentage points below CPI. According to our estimates the gap between core inflation and CPI-measured inflation will widen by the end of the year in absolute terms, primarilly on account of the lagged effects of the higher prices of energy products and commodities, whilst in relative terms it will experience a decrease.

In the first quarter of 2000**, the prices of goods** grew faster than the **prices of services**; in April they increased by 9.5% and 8.9% respectively on the annual basis. The higher growth of prices of goods, compared to the average consumer price growth, was caused by higher oil prices and, consequently, other commodity prices. In April, the ratio between the prices of goods and services reversed, meaning that the latter increased more than the former. Compared to December 1999 services were costlier by 3.6% and goods by 3.1%. Taking into account that the services are for the most part non-tradable and competition in this sector is less fierce, prices of services are again expected to increase faster than the prices of goods

In the first seven months of 1999 the share of directly administered prices in the CPI stabilised at approximately 14% of total products and services in the consumer price basket, after the prices of medicinal and pharmaceutical products, fuel oil, diesel, basic foodstuffs (bread, milk, sugar and meat) and compulsory automobile insurance had been liberalised in 1998. The changed weighting of the CPI in January 2000[33] even further reduced the share of directly administered prices in the CPI, bringing it down to 13.7% in January 2000. The most important groups of prices still controlled by the government at the beginning of 2000 were those of petroleum products, electric energy and utilities, transport and telecommunication services. At the end of March 2000, the government in agreement with oil companies adopted a model for determining the price of automotive petrol, according to which the prices are adjusted to the world oil price. Pursuant to the new methodology, since April retail prices of petrol have been formed on the basis of the oil price on the global market, fluctuations in the US dollar exchange rate and the agreed retail margin. This will gradually reduce the price disparity between the world oil price and petrol prices in Slovenia, which grew significantly, especially in the second half of 1999 and in early 2000, due to the delayed adjustment of domestic prices to the world price movements.[34]

The government will continue with gradual liberalisation of administered prices of products and services, using adequately established competition in the underlying markets as its primarily criterion and thus abolish the remaining price disparities (postal services and telecommunications).

In 1999 administered prices increased faster than consumer prices. In the period between December 1998 and December 1999 administered prices rose by

[33] Regular change of goods and services sample and weighting coefficient included in the CPI reflects changes in consumption structure.

[34] The retail price of petrol is formed as a sum of the average two-weak price of petrol on commodity exchanges (converted in tolars per liter) and a gross margin. The minimum base gross margin is 6 and the maximum 11 tolars. A change in petrol price on the commodity exchange of +/-1.5 tolars represents the threshold for retail price adjustment (VAT excluded), meaning that the margin is actually limited to a range between 4.5 and 12.5 tolars. Because petrol price growth was curbed in 1999 and in the first quarter of 2000, the retail price of petrol in Slovenia will remain unchanged (will not decrease), despite more favourable conditions on international markets, as long as price disparity is not eliminated and the maximum gross margin is achieved (which would then equal the lowest in the EU).

10.4%, contributing 1.5 percentage points or 18.3% to inflation, which was 8%. The average controlled prices increased by 6.3% in 1999. In the first quarter of 2000 the disparity between growth in administered prices and the CPI widened further. During this period administered prices increased by 4.9%, whilst inflation reached 2.6%. Thus, administered prices contributed 0.7 percentage points or 25.4% to inflation in the first quarter. Over 93% of total increase in inflation in the first three months of the year was a consequence of higher fuels prices. Fuels prices, which on average increased by 6.8% in the first quarter, due to a rise in the world oil prices, contributed 11.6% to the 2.6% inflation. From January to March an increase of 14.1% was recorded in utility services, which contributed 12.0% to quarterly inflation, representing the major trigger of administered price growth in the first quarter of the year. Taking into consideration estimates by oil market analysts, claiming that oil prices on the international market peaked in March this year, and given the fact that in the second half of the year these prices are not expected to rise substantially compared to the first few months, their impact on the inflation in Slovenia is anticipated to diminish. Against this background, growth of administered prices is expected to slow down in the following months and level with consumer prices growth at the end of the year.

Producer prices of manufactured goods increased by 3.9% in 1999. In the first half of the year they declined by 0.3%, whilst in the second they rose by 3.9%. Their average annual growth rate was 2.1%. Dynamics of the producer prices growth was determined by the growth of energy products and commodity prices and was similar to that of the CPI, only that increases in industrial producer prices lagged behind by approximately three months. **Producer** prices rose mostly in the last quarter of 1999 (by 3.0% in total), whilst higher growth rates also persisted in January and February 2000 (0.6% and 1.2% respectively). In March and April, however, this rise subsided, largely due to the weaker impact of energy product prices, whereas the above-average increase in intermediate goods prices continued. Compared to December 1999 producer prices of manufactured goods increased by 2.6% in April, their year-on-year rise was 6.8%. By the end of 2000, a gradual slowdown is expected in the growth of producer prices of manufactured goods, owing mostly to an easing of external pressures.

Agricultural product prices were by 0.4% lower in 1999 than the year before. Due to a gradual loosening of the price protection of agricultural products and foodstuffs, further price declines can be expected in the future. However, the implementation of agricultural policy reform (see chapter 5.1), should partly offset a drop in income for producers, breeders and manufacturers.

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Assuming that in the second half of 2000 prices of oil and petroleum products on the international market do not increase or, rather, that they begin to fall, and presupposing that the dollar does not get any stronger, consumer price growth will slow down in the summer as a result of favourable seasonal effects. In the last quarter of 2000, monthly inflation rates would rise once again, largely due to seasonal price increases. Higher monthly inflation rates towards the end of 2000 will partly arise from the delayed effects of relatively high inflation rates in Slovenia's major trading partners at the beginning of the year. The described price growth movements will, in combination with restrictive monetary and incomes policies, help decrease the annual inflation rate in the second half of the year. Due to the higher monthly inflation rates at the beginning of the year, annual inflation will, by the end of the year, admittedly exceed our autumn forecast for 2000 (about 4%), but will nevertheless still be at least 2 percentage points below annual inflation at the end of 1999 (8%).

The introduction of VAT in mid 1999 caused higher average inflation rates in the first six months of 2000, partly owing to the method of calculation. Because of the "calculation effect" of VAT, average inflation in 2000 could, in any case, hardly be lower than the year before, and on the account of the high price growth recorded in the first few months it will exceed last year's figure as well as that forecast in autumn report. It is estimated to reach approximately 7.6%. In 2001 the downward trend in inflation is predicted to continue, given the ongoing restrictive monetary and incomes policies in combination with a neutral fiscal policy. At the end of next year inflation is expected to reach about 5% on a year-on-year basis, whereas the average inflation rate will equal 4.9%.

5.5 EMPLOYMENT AND UNEMPLOYMENT – Severe structural unemployment problems, despite growth in employment and an active employment policy

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In 1999, following a downward trend and stagnation over several years, **employment turned upwards**. From 1987 the number of persons in employment was sharply decreasing until 1997 when it levelled off. This stagnation continued until 1998 and then it rose by 1.8%. This increase in 1999 is only partly a consequence of administrative changes in the scooping of employment[35] . If the

[35] Since January 1999 and pursuant to the amended Employment and Unemployment Insurance Act, which was adopted in October (Ur.l. RS, 69/98), persons participating in public works are also regarded as being employed, whilst before they were statistically classified as unemployed.

monthly average of 5,454 persons participating in public works, who were registered as unemployed in 1998, were deducted from the number of employed in 1999, the comparable annual growth in the number of employed would still be 2%, whilst that in total persons in employment would be 1.1%. The number of employees in enterprises and organisations was on the rise throughout the year, with the exception of seasonal drops in August and the winter months. The number of those employed by individual entrepreneurs is still increasing, with seasonal breaks in the winter months; whilst the number of self-employed fluctuates, mostly due to changing estimates of the number of farmers, based on the quarterly labour force surveys. The number of individual entrepreneurs continued to fall slowly. According to monthly statistical data, the total number of employed rose by 2.8% in 1999 (those in companies and organisations by 2.6%, and those employed by individual private entrepreneurs by 5.3%), whilst the number of self-employed dropped by 5.6%. The number of farmers decreased by more than 10%, whereas that of individual entrepreneurs and own-account workers by approximately 1.5%.

The data gathered by the labour force survey showed that fluctuations in the number of persons in employment differed slightly from movements in persons in employment according to monthly published data, as they do not take into account unpaid family members and informal employment. The survey revealed that in 1999 the number of persons in employment was, on average, 1.7% below that in 1998 and that it was already falling in 1998. Judging from these data, the **grey economy is on the decline,** meaning that employers' monthly reports showed that the growth in employment was also due to a diminishing in informal employment. According to the same survey not only did the number of unpaid family workers decline in 1999, but that of employees did as well.

In 1999, the **restructuring of employment** continued**, triggering a growth in the service sector**. The number of employed in agriculture decreased by as much as 8.8% compared to 1998, whilst that of persons employed in industry continued falling even more than in 1998,. The number of employed declined in almost all manufacturing activities, except in the production of basic metals and metal products, wood and wood products as well as rubber and plastic products. The sharpest fall was recorded in the production of leather and leather products as well as the manufacture of paper and paper products. Employment

[36] All entities registered as institutions, bodies and organisations are legal persons. By legal organisational form, they include institutions, state bodies, government and government agencies, ministries, courts, trade unions, local communities, various associations, funds, etc. At the end of 1999 there were 1,752 institutions registered in Slovenia, most of them in education (52.8%).

substantially grew in the construction and the service sectors. The highest annual increase was observed in health services and social care, primarily due to the regular employment of over 2,000 persons participating in social care public works. A marked growth in employment was also recorded in the sectors of financial intermediation, other community, social and personal service activities as well as other business services. In the service sector in 1999, employment in education and public administration rose the least. The labour force survey showed a similar trend in employment restructuring; nevertheless, the share of those working in agriculture is substantially higher (about 10%), as this figure also includes unpaid family workers, mainly involved in agriculture.

Table 14: Structure and trends in the number of employed persons by activity, according to monthly reports

		Structure (in %)		Annual growth (in %)	
		1998	1999	1998	1999
	TOTAL	**100.0**	**100.0**	**0.2**	**1.8**
A	Agriculture, forestry, hunting	6.7	6.0	2.2	-8.8
B	Fishing	0.0	0.0	-4.3	-1.8
C	Mining and quarrying	1.0	0.9	-1.7	-5.6
D	Manufacturing	31.9	30.9	-1.0	-1.6
E	Electricity, gas and water supply	1.6	1.5	-2.4	0.6
F	Construction	7.1	7.3	0.4	4.1
G	Wholesale & retail; repair motor vehicles	12.2	12.4	-1.7	3.4
H	Hotels and restaurants	3.5	3.7	-2.0	7.0
I	Transport, storage and communication	6.0	6.2	1.8	4.8
J	Financial intermediation	2.3	2.5	9.7	9.0
K	Real estate, renting and business services	5.6	5.9	1.6	6.3
L	Public administration; compulsory social security	5.6	5.6	-1.6	2.7
M	Education	6.9	6.9	1.2	1.6
N	Health and social work	6.4	6.9	3.8	9.5
O	Other community, social and personal service activities	3.0	3.2	2.8	8.1
P	Private households	0.1	0.1	6.8	7.2
A+B	**Agriculture**	**6.7**	**6.0**	**2.2**	**-8.8**
C:F	**Industry and construction**	**41.6**	**40.6**	**-0.8**	**-0.6**
C:E	**- Industry**	**34.5**	**33.3**	**-1.0**	**-1.6**
G:P	**Services**	**51.7**	**53.4**	**0.8**	**5.1**

Source: SORS, IMAD calculations

According to estimates **the number of employed in terms of full-time equivalent increased by 0.9%** last year, whilst global labour productivity, which has already been growing since 1993, rose by approximately 4%. Positive trends have also continued this year. It was estimated that 1999's employment rate growth (0.9% in terms of full-time equivalent) could also be maintained at the same level in 2000, given an equal or slightly slower upward trend in global productivity. With economic growth at 4.5% in 2001, efforts to maintain a rapid growth in productivity could again somewhat slow down the increase in employment, which is forecast to reach 0.7%.

In 1999 **the number of those registered as unemployed** fell by 12,300 persons (the most since 1994), whilst the average annual registered unemployment rate dropped to 13.6%, which is the lowest percentage recorded since 1992. The decline in the number of unemployed in 1999 also includes persons participating in public work programmes (around 10,000 in total who since 1 January, 1999 have no longer been treated as unemployed whilst participating in the public works scheme) as well as those involved in regular education programmes who are no longer counted as unemployed. Without treating those participating in public works as employed, the average number of those registered as unemployed in 1999 would have been around 124,400 (instead of 119,000) and the unemployment rate 14.2% (instead of 13.6%).

By including those participating in public works, 62,350 persons found work last year or 12.4% more than in 1998. If we exclude them, the respective figures are 52,200 or 5.8% less than in 1998. Among those categorised as participating in public works there were substantially more persons active in various subsidised types of employment (on-the-job training, refunding of contributions to employers, self-employment promotion etc.) than in 1998 (see Chapter 7.4). Therefore, what primarily increased was the employment of those who were previously unemployed, which is supported by the government through its employment policy, whilst the employment of unemployed without government assistance was lower than in 1998. Inflows into unemployment also exceeded the 1998 figure – inflows due to lay-offs were 4.7% higher, to a certain extent possibly due to the fact that after participating in public works some persons were again jobless, and an increase in first-time job seekers of 5.5%.

Despite the expansion of active employment policy programmes and deletions from the unemployment register, which were even higher in 1999 than in 1998, **structural unemployment problems** have not diminished in scale. The share of long-term unemployed remains at about 63.3%, that of unskilled unemployed at around 47.5%, that of the unemployed over 40 already exceeded 50% and the share of unemployed older than 50 years was above 25%. The major causes of job losses are still terminations of fixed-term employment contracts (47%) (but their number in 1999 compared to 1998 decreased by 2.3%), followed by mutual consent to terminate employment (13.7%) and permanent redundancies (11.3%). Moreover, more than 70% of job vacancies were for fix-term contracts.

In 1999, the number of registered job vacancies increased by 4.1%, reflecting the typical seasonal fluctuations. Even though the ratio between the unemployed and job vacancies in terms of the level of qualifications slightly improved, the problem of employing the unskilled unemployed or those with inadequate education persists. The number of registered unemployed with vocational or secondary schooling per job vacancy requiring such a level of education decreased from 9.9 in 1998 to 8.8 in 1999. The number of unskilled unemployed per job vacancy where an unskilled or semiskilled workforce is required dropped from 15.3 to 14.4 and that of unemployed with a college or university education per respective job vacancy declined from 3.1 to 2.6. In total, thanks to an increase in job vacancies and decrease in unemployment in 1999, the number of unemployed per job vacancy was 9.6 (10.6 in 1998).

The aggregate registered unemployment rate has been on the decline since December 1998, however, the **difference between the unemployment rate of women and that of men** increased until October 1999 and has decreased slightly over the past few months. The unemployment rate of men dropped faster and in April 1999 it was already below 13% (12.4% on average in 1999, 11.6% in March 2000), whilst the unemployment rate of women remained high (15% on average in 1999, 13.8% in March 2000). The share of women amongst unemployed has stagnated at 50%. Also according to labour force surveys, the unemployment rate of women continues to be higher than that of men, and in 1999 the difference between the two even increased. The survey-estimated unemployment rate of men dropped from 7.7% in 1998 to 7.3% in 1999, whilst that of women declined from 8.1% in 1998 to a mere 7.9% in 1999.

In 1999, the average **survey unemployment rate** was 7.6% (7.9% in 1998). Ratios between survey and registered unemployment remain more or less unchanged. Around 20% of survey-estimated unemployed persons were not registered, whilst the remainder represented approximately half of the registered-unemployed total. In the other half of the registered unemployed, the share of persons classified according to the labour force survey as not participating in the labour force was on the rise and the share of registered unemployed, classified as labour force, was on the decline (merely 12% of registered unemployed total in 1999).

In view of the trends in the first four months this year, it is estimated that in 2000 inflows to unemployment due to job losses will be slightly above those in 1999, whilst employment of the unemployed will be somewhat lower. The influx of first-time job seekers will also be a bit higher than last year. Deletions from the unemployment register, which were considerably more numerous this spring than in the same period last year, will substantially reduce the annual average, nevertheless, it is estimated that they will not stay at such a high level throughout the year. For 2000 somewhat fewer deletions are forecast compared to the year before and the average number of registered unemployed is expected to drop to about 109,000 and the unemployment rate to 12.4%. In 2001, given a continuing upward trend in formal participation rate – which is primarily due to a slowly increasing retirement age and outflow from employment of the generation which experienced massive early retirements ten years ago – combined with a fairly slower growth in employment, the average number of registered unemployed will decrease to around 106,000 and unemployment rate to 11.9%.

5.6. HOUSEHOLD AND COMPANY BORROWINGS AND SAVINGS – Bank lending activity is stabilising this year, household savings on the rise

At the end of 1999, total outstanding loans were 13.6% higher in real terms than in December 1998 (real growth in 1998 was 18.7%). The most pronounced increase (by 34.1%) was recorded in loans to households and the government, which grew by 24.2% in 1998, while loans to corporate clients remained at the same level as at the end of 1998 in real terms when they recorded a real annual growth of 6.4%. By the close of December 1999, loans to corporate clients represented 53.1% of total loans, down by 7.1 structural points over December 1998. The main reasons why domestic banks granted less corporate loans were more favourable credit terms given to companies by foreign lenders as well as reduced lending potential of domestic banks. Poor liquidity was not the primary reason for the reduced lending potential of domestic commercial banks (their assets were tied up in large quantities of central bank's tolar bills at the beginning of 1999), but above all the inadequate maturity structure of bank deposits (less long-term deposits). **Increased consumption which** occurred before the introduction of VAT and was primarily financed by bank loans was **the main reason for the significant growth in the volume of household loans in 1999**. In an attempt to absorb the shock of the introduction of VAT, state borrowing also rose in the third quarter of 1999. By shifting loans from the business to other sectors the so-called information capital, which domestic banks have in comparison with other domestic and foreign financial intermediaries, started to diminish (Bole, Bančni Vestnik, April 2000). In terms of maturity, long-term loans increased by 13.7% in real terms in 1999 (21.1% in 1998), and short-term loans grew by 13.4% (15.2% in 1998). As at the end of December

1999 the share of long-term loans as part of total loans grew to 61.1% (in December 1998 the respective figure was 61.0%).

At the beginning of 2000, corporate lending as well as household and government lending was modest. At the end of March 2000, total loans were 1.3% in real terms above the December 1999 level (real growth in loans in the first quarter of 1999 was 1.8%), but at the same time the share of corporate loans continued to decline and was lower by 0.4 of a percentage point than at the close of December 1999. In terms of maturity, short-term loans rose slower (0.7% real growth) than long-term loans (1.7% real growth) in the first quarter of the year.

In 1999 household borrowing increased by more than one quarter. The ratio between retail loans by commercial banks and registered monthly personal income (this includes net wages and salaries, other receipts from employment and transfer receipts), which has been gradually rising since 1995, recorded a very quick growth especially in the first half of 1999, since retail loans by commercial banks in this period were on average two and a half times higher than the average registered monthly personal income. In the second half of 1999 and in the first two months of 2000 further retail borrowing levelled off, although the ratio to average income was very high at the end of February, principally due to the maturity structure of raised loans (long-term loans prevailed) and a moderate growth in personal income in January and February 2000.

Table 15: Ratio between loans and registered monthly personal income in the 1995-1999 period

Period	Average retail loans by commercial banks (in billions of SIT)	Registered monthly personal income (in billions of SIT), average	Loans / income
1995	123.9	88.9	1.39
1996	192.9	106.4	1.81
1997	224.6	119.8	1.87
1998	272.7	131.8	2.07
1999	390.2	148.8	2.62
2000 (feb)	443.0	148.0	2.93

Source: Bulletin of the Bank of Slovenia, IMAD calculations

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In the first five months of 1999 **average real interest rates** (above the tolar indexation clause) **on short-term and long-term corporate loans** dropped, which means that in May average real interest rates on short-term corporate loans were 5.3% p.a., or 0.6 percentage points less than in December 1998, whereas those on long-term loans to the business sector were 6.8% p.a., or 0.4 percentage point below the level recorded in December 1998. Due to the anticipated VAT and low interest rates the demand for loans (especially retail) increased in the period preceding the introduction. Because of rapidly growing lending and liquidity problems in the money market, the downward trend in interest rates stopped, followed by a slight increase between June and September. After this interest rates stabilised at the end of 1999, thanks to improved liquidity in the money market and the weaker lending activity of banks. In December 1999, the real interest rate was 6.1% on short-term and 8.0% on long-term loans. As opposed to interest rates on corporate loans **interest rates on retail loans** did not change much in 1999. Interest rates on short-term retail loans were 4.1% in December 1999, which is the same as in December 1998, while those on long-term retail loans dropped from 6.0% to 5.7% in 1999.

In the first quarter of 2000 real interest rates on **short-term corporate loans increased**. This rise from 6.1% to 6.3% in March was the first after six months meaning that they were 1.1 percentage points higher than in the respective 1999 period. The reasons for this were restrictive monetary policy of the Bank of Slovenia and foreign exchange transactions, which reduced the supply of tolar (demonetisation). Banks tried to compensate for decreasing tolar deposits by cashing in central bank bills, but in this way they started to drain their secondary liquidity (tolar bank bills). Further monetary policy restrictions are reflected in the fact that the central bank has started to intervene on the market through the asset side of its balance sheet. So far, the Bank of Slovenia had to intervene on the liabilities side of its balance sheet by issuing central bank bills in order to withdraw money from circulation, while from now on additional liquidity is being ensured primarily through lending, which pushes up the price of the tolar liabilities of banks. Real interest rates on long-term corporate loans have remained unchanged since September 1999 standing at 8% in March 2000. Also in March, interest rates on short- and long-term retail loans (4.1% and 5.7% respectively) were at the same level as at the close of 1999.

In 1999, household savings in banks increased by 7.0% in real terms, i.e. 7.3 percentage points **less than in 1998**. Lower growth is primarily due to tolar savings, which were reduced in the first half of the year as a consequence of increased retail consumption prior to the introduction of VAT and lower interest rates above the tolar indexation clause. Interest rates dropped after the inter-bank agreement on maximum deposit interest rates expired in February 1999. Upon the expiry of the agreement, the Bank Association of Slovenia recommended maximum bank deposit interest rates, which were nevertheless lower than those previously set by the inter-bank agreement. In June and August the Bank Association of Slovenia twice amended this recommendation with the purpose of increasing deposit interest rates. Therefore, these did slightly increase which, together with a rise in the tolar indexation clause resulting from higher inflation, had a positive impact on tolar savings growth (above all long-term). Increased tolar household savings were also partly influenced by household savings in the framework of a national housing savings scheme, which was introduced on 1 July 1999. That year, tolar savings in banks thus grew in real terms by 7.5%, while in 1998 24.8% real growth was recorded. Foreign-exchange savings, which rose by 1.7% in the first half of 1999 (short- and long-term), increased even more in the second half of the year owing to growing exchange rates, so that at the end of the year retail foreign-currency deposits were 6.4% higher than at the end of 1998 (when the respective figure was 5.3%).

Due to further growth in exchange rates **the upward trend in the volume of foreign exchange savings continued in the first quarter of 2000**. The share of long-term foreign exchange savings as part of total savings rose (by 1 percentage point compared to December 1999), which could have been the consequence of improved confidence in foreign currencies. In the first three months of 2000 **the volume of short-term tolar savings also increased as well** (4.6% growth), whereas the volume of long-term tolar savings decreased (down by 4.3%). In March, the share of long-term tolar deposits fell to 17%, which is 1.7 percentage points less than last December. Part of the reason for this lies in the transfer of long-term savings to short-term deposits in the amount of SIT 9 billion (approximately 10% of total long-term tolar retail savings) resulting from the changed methodology applied by the Bank of Slovenia in calculating obligatory reserves. Owing to quickly growing exchange rates at the beginning of the year (foreign-currency clauses exceeding tolar indexation) deposits were to some extent converted into foreign exchange savings.

5.7 FINANCIAL PERFORMANCE OF NON-FINANCIAL COMPANIES, BANKS, SAVINGS BANKS AND INSURANCE COMPANIES

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5.7.1 FINANCIAL PERFORMANCE OF COMPANIES, INSTITUTIONS AND OTHER LEGAL PERSONS – In 1999 companies recorded their best performance of the last six years

At the end of 1999 there were 145,602 entities listed in the Business Register, of which 121,909 were commercial entities (56,473 legal persons and 65,436 natural persons) and 23,693 institutions, bodies and organisations[36]. Compared to the end of 1998 their number increased by 5,450 or 3.9%. The most significant rise was recorded in the number of commercial entities, up by 3,835 (natural persons by 2,289 and legal persons by 1,546), while the number of institutions, bodies and organisations increased by 1,615. The majority of commercial entities were registered in wholesale and retail trade and certain repair, (28.3%), manufacturing (18.5%) and in real estate, renting and business activities (16.1%). In terms of legal organisational form, the most legal persons were classified as limited liability companies (86.3%). In addition to the Central Bank, the Business Register included another 31 banks, 108 savings banks and other financial organisations, 45 investment companies, 2 stock exchanges, 19 stockbrokers companies and 12 insurance companies. By kind of ownership, the number of private legal persons was the highest (93.4%). By kind of capital, domestic capital was recorded in the most legal persons (91.3%).

The analysis of 1999's business results covered 37,553 commercial companies[37], which were employing a total workforce of 463,481. The number of companies, which was increasing throughout the entire 1995-1998 period, dropped by 32 in 1999 (primarily in wholesale and retail trade and certain repair, by 734). Their number of employees, which decreased by 25,508 in the 1995-1999 period, grew again in 1999 by 4,387, principally in construction (by 3,413) and in real estate, renting and business activities (by 1.828). Over the whole period the number of companies was the largest in wholesale and retail trade and certain repair, whilst most staff were employed in manufacturing.

In 1999, companies recorded their best performance of the last six years[38]. After they had posted a net difference between net profit and net loss in the amount of SIT 36,536 million for the first time in 1998, the net difference almost tripled in 1999 totalling SIT 119,520 million. In all previous years, the net difference between net profit and net loss was negative and was the highest in 1996 (SIT 60,417 million) and the lowest in 1997 (SIT 3,868 million).

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[37] According to the National Statistical Research Programme (Ur.l. RS, 70/97) companies submit to the Agency for Payments statistical data from their balance sheets and profit and loss accounts for statistical research purposes. The basis for the analyses of companies' performance in the 1995-1999 period was statistical data from the balance sheets and profit and loss accounts of those companies which submitted their financial statements in specially designed unified forms to the Agency for Payments by February 28 for the previous calendar year. The data of companies under bankruptcy proceedings and liquidation are not included, as well as those of banks, insurance companies, authorised investment companies and certain funds.

[38] Since 1994 companies have kept accounting records in accordance with the Companies Act and with the Slovenian Accounting Standards, so the data are comparable.

Statistical data from profit and loss statements of commercial companies show which type of companies' activities generated a profit/loss. In 1999, companies recorded a positive difference between operating revenues and operating expenses in the amount of SIT 97,727 million or 47.3% more than in 1998. The difference between financial revenues and financial expenses was negative (SIT -40,115 million), nevertheless this was only half of that recorded in 1998. This is why in 1999 there was a positive difference between the loss and profit from the regular operation in the amount of SIT 57,612 million for the first time since 1994. In 1999 the difference between extraordinary revenues and extraordinary expenses (which has always been positive) was considerably bigger than in all of the previous years - SIT 93,247 million in total. In 1999, the difference between total revenues and total expenses, amounting to SIT 150,859 million was therefore positive, and almost one and a half times as much as reported for 1998. Better results in all types of operations thus contributed to the high growth in the net difference between net profit and net loss, which totalled SIT 119,520 million after deducting SIT 31,339 million of tax.

Table 16: Net profit or loss of companies

	In SIT million					As % of revenue				
	1995	1996	1997	1998	1999	1995	1996	1997	1998	1999
NET PROFIT / LOSS										
- from operation	-15,673	-8,463	50,517	66,321	97,727	-0.3	-0.1	0.8	0.9	1.2
- from financing	-54,150	-81,676	-102099	-79,456	-40,115	-1.1	-1.4	-1.6	-1.1	-0.5
- extraordinary	59,892	48,003	69443	74,097	93,247	1.2	0.8	1.1	1.0	1.2
- TOTAL	-9,931	-42,136	17,861	60,962	150859	-0.2	-0.7	0.3	0.9	1.9
Taxes on profit	15,006	18,281	21,729	24,426	31,339	0.3	0.3	0.3	0.3	0.4
NET DIFFERENCE BETWEEN NET PROFIT AND NET LOSS	-24,937	-60,417	-3,868	36,536	119,520	-0.5	-1.1	-0.1	0.5	1.5

Source: AP - statistical data from profit and loss accounts of commercial companies for 1995, 1996, 1997, 1998 and 1999

A net profit for the 1999 **financial year** was posted by 23,382 or 62.3% of all companies and amounted to SIT 258,786 million or 23.7% more than the previous year. The highest number of such companies was in retail and wholesale trade and certain repair. The largest share was generated by manufacturing (40.6%), especially by the sub-sectors of food, beverages and tobacco and chemicals and man-made fibres (5.8% each) as well as the sub-sectors of basic metals and metal products, rubber and plastic products, electrical and optical equipment and machinery and equipment (4% each). **A net loss for the year** was recorded by 11,305 or 30.1% of all companies. Again the highest number of those companies was in wholesale and retail trade and certain repair (41.3%). The loss amounted to SIT 139,266 million, 19.4% less than in 1998. As before, the largest share in this total loss was incurred by the manufacturing sector (32.3%), most of it by the sub-sectors of transport equipment (4.9%), textiles and textile products (4.6%) and basic metals and metal products (4%).

In 1999 companies in 8 activities recorded **a positive net difference between net profit and net loss**. In 4 of them, the positive net difference increased compared to 1998, most significantly in manufacturing, where a good half of the total net difference was earned. Compared to the previous year, a positive net difference between net profit and net loss also rose in wholesale and retail

Table 17: Net profit or loss for the year of commercial companies by sector (SIT million)

		NET PROFIT FOR THE YEAR				NET LOSS FOR THE YEAR				NET DIFFERENCE BETWEEN NET PROFIT AND NET LOSS			
		1996	1997	1998	1999	1996	1997	1998	1999	1996	1997	1998	1999
	Sector												
A	Agriculture, hunting, forestry	1348	1904	1660	1422	2711	2014	1540	2112	-1363	-110	120	-690
B	Fishing	13	17	21	34	27	70	5	89	-14	-53	16	-55
C	Mining and quarrying	314	345	660	610	5428	3474	2097	5225	-5114	-3129	-1437	-4615
D	Manufacturing	41742	67251	80196	105064	87462	65198	51508	44920	-45720	2053	28688	60144
E	Electricity, gas and water supply	2231	2184	2640	3541	21830	24522	21233	15985	-19599	-22338	-18593	-12444
F	Construction	4891	8228	7504	11775	5430	4803	7822	6173	-539	3425	-318	5602
G	Wholesale, retail, certain repair	34172	44958	51337	57220	21405	22922	28508	20192	12767	22036	22829	37028
H	Hotels and restaurants	1667	3094	2688	2528	4735	3788	5680	4417	-3068	-694	-2992	-1889
I	Transport, storage and communications	11624	20026	28381	27309	8482	8913	2882	5303	3142	11113	25499	22006
J	Financial intermediation	6650	2042	3511	10308	1294	8903	12068	2931	5356	-6861	-8557	7377
K	Real estate, renting, business activities	13619	21708	24845	32155	18868	29744	35201	26431	-5249	-8036	-10356	5724
L	Public administration and defence, comp. Soc. sec.	87	0	1	22	118	160	73	160	-31	-160	-72	-138
M	Education	134	256	308	500	146	562	212	318	-12	-306	96	182
N	Health care and social work	1301	2016	2411	2876	1414	2690	1923	1426	-113	-674	488	1450
O	Other community and personal services	1971	3229	3106	3422	2831	3363	1981	3584	-860	-134	1125	-162
	COMPANIES TOTAL	121764	177258	209269	258786	182181	181126	172733	139266	-60417	-3868	36536	119520

Source: AP - statistical data from profit and loss accounts of commercial companies for 1996, 1997, 1998 and 1999 trade and certain repair, health services and social work and education. On the other hand it decreased in transport, storage and communications. In 1999 a positive net difference between net profit and net loss was also reported by three activities which posted a negative net difference in 1998 (construction, financial intermediation and real estate, renting and business activities). A negative net difference between net profit and net loss was incurred by 7 activities: agriculture, hunting and forestry; fishing, other community and personal services (a positive net difference was seen in 1998), electricity, gas and water supply, hotels and restaurants, mining and quarrying, public administration, defence and compulsory social security (where a negative difference was substantially higher than in 1998). Like in 1998, electricity, gas and water supply recorded the highest negative difference between net profit and net loss in 1999, although it was by 33.1% lower than in 1998.

According to the Companies Act, companies are classified into **small, medium-sized and large** enterprises following the criteria which, apart from the number of employees, includes total revenues and average total assets as recorded in the annual financial statements for the previous year. The largest in number are small companies. In 1999 there were 91.9% of small, 5.7% of medium-sized and 2.4% of large enterprises. Compared to 1998 the number of small companies fell by 682, whilst the number of medium-sized and large enterprises increased by 568 and 82 respectively. Also in 1999, the most important share of total business results was that of large enterprises (63% in total revenues and 70% in total assets), followed by medium-sized enterprises (18.8% in total revenues and 15.4% in total value of assets) and small companies (18.2% share in total revenues and 14.6% share in total assets). In 1999 all three types of companies generated a positive difference between net profit and net loss. The highest positive net difference was disclosed by large enterprises (SIT 79,548 million) which accounted for as much as 66.5% of total positive difference between net profit and net loss in all companies; medium-sized enterprises represented 21.0% (SIT 25,074 million) and small companies 12.5% (SIT 14,899 million) of the total.

At the 1999 year-end companies recorded a total of SIT 9,364,613 million of assets/liabilities and capital in **balance sheet totals**. Compared to the statistical data from the balance sheet as at 31 December, 1998, the bottom line figure recorded a growth of 6.6% in real terms. During this period the structure of assets, liabilities and capital did not change considerably. On the assets side, the share of fixed assets fell from 65.2% to 64.3% (mostly because of a fall in the share of land and buildings), while the share of current assets rose accordingly (mostly because of higher short-term operating receivables). On the liabilities and capital side structure, the shares of long- and short-term liabilities grew (from 15.8 to 16.5% or from 28.4% to 28.9% respectively). The share of capital dropped from 51.6% to 50.5% despite good business results in 1999, primarily due to less subscribed capital (from 26.1% down to 23.1%).

According to data from records kept by Agency for Payments, **solvency** of companies significantly deteriorated in 1999. The average monthly number of legal persons whose company accounts were frozen for over 5 days per month in 1999 was 9,312, which is 775 or 9.1% more than in 1998. Their average monthly outstanding debt amounted to SIT 97,002 million, or 10.8% above the 1998 figure. In 1999 the number of employees in these companies dropped from 57,281 to 41,555, i.e. by 27.4%. Data on initiated bankruptcy and liquidation court proceedings also show that insolvency of companies increased in 1999. According to data published in the Uradni list (Official Journal of the Republic of Slovenia) a total of 233 bankruptcy and liquidation proceedings were initiated in courts last year, which is 29.4% more than in 1998.

Institutions and other legal persons[39] compiled their year-end accounts pursuant to the former Accountancy Act[40] for the last time in 1999. The Agency for Payments received 1,654 financial statements for 1999 from legal persons employing a total of 105,049 staff. Most of them came from the sectors of education (902), health care and social work (267), other community and personal services (254) and real estate, renting, and business activities (121). In the 1996–99 period the total number of legal persons increased by 258, mainly in the sectors of other community and personal services (by 69) as well as in real estate, renting, business activities (by 59). At the same time, the number of employees working in these sectors also grew (by 10,350), primarily in the sectors of public administration, defence and compulsory social security (by 4,007). Throughout the entire period the majority of staff were employed in the sectors of education (46.5% of all employees in 1999), health care and social

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[39] The above data from financial statements of institutions and other legal persons comprise data on: (i) institutions (pursuant to the Institutes Act these are organisations established for the purpose of education and training, science, culture, sports, health services, social care, child wellfare, disabled persons wellfare, social security and other not-for-profit activities); (ii) certain legal persons which performed economic activity although they were not organised as commercial companies or public utilities; (iii) legal persons which performed public activities. However, they do not comprise data from financial statements of state and local community budgets, central and local governmental bodies, legal persons which used the accounting plan for communities of interest, associations and other organisations the operations of which are governed by other regulations.

[40] Since 1 January, 2000 accounting records must be kept pursuant to the new Accountancy Act, published in the Ur.l. RS, 23/99.

work (36.4% of the 1999 total) and other community and personal services (6.3% of the 1999 total).

Table 18: Number of legal persons, number of employees, accumulation and loss in institutions and other legal persons

	1995	1996	1997	1998	1999
Number of legal persons	1,373	1,396	1,543	1,593	1,654
Number of employees	93,576	94,699	103,244	102,950	105,049
Accumulation (in millions of SIT)	2,787	2,853	5,321	4,886	5,464
Loss for the year (in millions of SIT)	3,127	2,507	2,002	1,378	2,227
Net accumulation/loss (in millions of SIT)	-340	346	3,319	3,508	3,237

Source: Agency for Payments - Financial statements of institutions and other legal persons for 1995, 1996, 1997, 1998 and 1999.

Like in commercial companies, it can be established at which level institutions and other legal persons generated a profit or a loss by classifying revenues and expenses into those from operation, financing and extraordinary activities. The difference between revenues and expenses from operation (accounting for the largest share of total revenues or expenses) was negative in the entire 1995-99 period. The difference between revenues and expenses from financing was positive throughout the years as was that between extraordinary revenues and expenses, with the exception of 1997. In the entire abovementioned period profit arising from financing and extraordinary activities always covered all losses from the principal activity, meaning that total revenues recorded throughout these years exceeded total expenses and the positive difference between them increased from SIT 251 million in 1995 to SIT 4,140 million in 1999.

According to the former Accountancy Act, **the year-end business results of institutions and other legal persons can be classified as either accumulation or loss**. The difference between these two was negative only in 1995, totalling SIT 340 million, whilst in the remaining years it was positive, with the highest amount recorded in 1998 (SIT 3,508 million). In 1999 the respective figure was SIT 3,237 million.

Box 10: In 1999, **value added created by commercial companies, institutions and other legal persons**

amounted to SIT 2,186,984 million or 11.6% more than in 1998. In the 1996-1999 period, it increased by 44.5%, whilst total value added per employee rose from SIT 2.7 million in 1996 to SIT 3.9 million in 1999. In the same period, value added generated by companies grew by 42%. In 1999, value added in companies totalled SIT 1,814,969 million or 11.8% more than in 1998, with slightly less than half of it accounted for by manufacturing. In the 1996-1999 period, value added per employee in all companies continued rising from SIT 2,713,000 in 1996 to SIT 3,916,000 in 1999, with the highest figure recorded in financial intermediation, amounting to SIT 6,945,000 in 1999. In the same period value added posted by institutions and other legal persons increased by 51%, which last year totalled SIT 372,015 million. Value added per employee in institutions and other persons entities grew from SIT 2,596,000 in 1996 to SIT 3,541,000 in 1999.

5.7.2 FINANCIAL PERFORMANCE OF BANKS AND SAVINGS BANKS – In 1999, average business results slightly below 1998

At the end of 1999, twenty-five banks **were present** in **the Slovenian banking system,** of which four were subsidiaries and one a branch of foreign banks (pursuant to the new Banking Act, adopted in February 1999, the Bank of Slovenia approved the establishment of the first branch in Slovenia in June 1999). Moreover, nine representative offices of foreign banks were in business as at 12 December, 1999, which was two more than at the close of 1998. The number of savings banks remained unchanged (six at the end of 1999), whilst the number of savings co-operatives decreased by two and totalled 68. As in the previous years, banks held the major share of the market (97.9%) when measured in terms of the balance sheet total, whilst savings co-operatives and savings banks accounted for 1.7% and 0.4% of the market share, respectively.

By the close of December 1999, the **balance sheet total** of Slovenian banks amounted to SIT 2,674 billion, according to unaudited data, and **increased by 5.3% in real terms** over 1998. Since 1994 the market shares of the largest banks remained relatively unchanged. By the end of December, the market share of the three largest Slovenian banks measured in terms of the balance sheet total accounted for 51.1% of total assets of the banking sector (51.7% in December 1998), whilst the market share of the seven largest banks in the same period was 73.7% (73.1% in December 1998).

The share of loans to the non-banking sector in the average **bank asset structure** increased last year, representing 48.9% of all assets (44.2% in 1998), with corporate clients accounting for the largest share of these placements. In the first half of the year, prior to the introduction of VAT, loans to retail clients substantially increased (primarily long-term), whilst in the second half loans to corporate clients grew faster. In 1999, the share of securities in bank assets declined on average from 33.5% to 28.5%. The main reason for this considerable drop was a smaller volume of tolar central bank bills held by banks. Thus, banks' secondary liquidity decreased from 15.5% of the balance sheet total at the end of 1998 to 14% of the same at the end of 1999.

The most important item amongst **bank liabilities** was non-banking sector deposits, with household deposits accounting for the majority (55.6% of non-banking sector deposits or 38.6% of total bank liabilities at the close of 1999). The share of deposits of the non-banking sector in the average structure of liabilities slightly declined (from 70% at the end of 1998 to 69.3% at the end of 1999), primarily due to slower growth in household deposits and a real drop in the deposits of corporate clients, governmental bodies and non-residents. Because of this, banks increased their borrowings from the central bank and, due to better credit terms abroad and their improved credit activities, they significantly increased the volume of loans taken with foreign banks (by 25.5% in real terms). Thus, in 1999, the share of liabilities (domestic and foreign) in the banking sector grew from 9.2% to 10.6%. The share of capital in the average structure of liabilities was the same as in 1998 (10.2%), whilst in 1999, the share of liabilities arising from issued securities decreased by 0.5 percentage point, to 1.9% at the close of December.

In 1999, the **total** pre-tax **profits** of commercial banks amounted to SIT 20.1 billion, according to unaudited data (SIT 25.9 billion in 1998), of which SIT 25.3 billion arose from revaluation income (SIT 23.5 billion in 1998). The main reason for the slightly lower profits in 1999 lay in the loss posted by one of the large banks at the end of the year.

Net interest income decreased over 1998, dropping in real terms by 2.9%, whilst at the same time banks posted a 3.2% increase in real terms in net fees and commissions (mostly from domestic payment transactions, administrative services rendered and credit transactions). In 1999 net profit from financial operations rose by one third in real terms on 1998, thanks to higher securities income (banks' equity investment, paid-out dividends) and income from foreign-exchange dealing. As a result of additional provisions formed by of one of the large banks at the end of 1999, the **return on assets,** which fluctuated during the year between 1.1% and 1.3% p.a., dropped to 0.8% (1.2% in 1998). The same was true of the **return on equity,** equalling 7.8% p.a. in 1999 (11.2% in 1998), whilst during the year it ranged between 10.6% and 14.3% p.a.

By the close of December 1999, **the balance sheet total** of all six savings banks amounted to SIT 11 billion according to unaudited data. In 1998 the balance sheet total of all savings banks increased in real terms, whilst in 1999 the total assets of two of them declined. Thus last year, real growth in the balance sheet total of savings banks was 7.4%, which was close to the respective growth posted by commercial banks (5.3%).

Savings banks' total pre-tax **profits** were higher in 1999 **than in 1998**, amounting to SIT 181.5 million (SIT 40.1 million in 1998), and after-tax profit totalled SIT 141 million. Better performance was a consequence of less additional provisioning, a slower rise in labour costs and a slowdown in the growth of operating expenses.

5.7.3. INSURANCE COMPANIES – The share of life assurance on the rise

In December 1999, there were 15 insurance companies in the Slovenian insurance sector (12 of them involved in insurance and 3 in reinsurance). Twelve out of the 15 insurance companies were in domestic ownership, whilst in three of them foreigners held a majority stake.

This high concentration is a characteristic of the Slovenian insurance sector. Measured in terms of market share held by individual insurance companies in basic types of insurance (property and health insurance, life assurance), the share of the largest insurance company increased to 44.2% last year (43.6% in 1998), whilst the total share held by the three largest insurance companies was 67.5%, meaning that it remained at approximately the 1998 level (67.7%). In the past two years, the insurance sector underwent further consolidation and three insurance groups were formed. The process of raising additional capital, which started in the insurance sector back in 1995, also continued in 1999, so that last year six recapitalisations were carried out, totalling SIT 3.8 billion. Four insurance companies were recapitalised and one of them raised additional capital on three occasions.

In 1999, insurance and reinsurance companies earned SIT 169.3 billion in gross premiums, which is 11% more than in 1998, whilst the share of life assurance was rising rapidly as part of the earned premiums' total. Assets of insurance and reinsurance companies recorded high annual growth rates, from 30% in 1997, to 27% in 1998 and 16% in the middle of 1999. In the structure of insurance sector assets, bank deposits and government securities were predominant.

At the beginning of the year, major changes occurred in legislation, as in January the Transformation of Insurance Company Ownership Act was passed, and at the beginning of March the new Insurance Act was enforced. The Transformation of Insurance Company Ownership Act stipulates the method for establishing the share of social capital in an insurance company and redefines its ownership structure. The Insurance Act defined a legal basis for the opening of the market to foreign competition (establishment of branches and representative offices of foreign insurance companies as well as foreign insurance brokerage companies or intermediation companies), the granting of national treatment to foreign entities when acquiring holdings in insurance companies in Slovenia, the separation of life assurance from non-life insurance, the harmonisation of rules governing prudential control as well as safe and prudent management of insurance companies with EU directives. The latest act redefined the legal status of the insurance supervisory authority and gave it broader competence. The implementation of the Transformation of Insurance Company Ownership Act was temporarily withheld, because a constitutional dispute had been initiated.

5.8 DEVELOPMENTS IN THE SECURITIES MARKET – Slacking the Slovenian capital market

Developments on the Ljubljana Stock Exchange in 1999 marked were most significantly by changes in regulations, activities related to the so-called privatisation gap and the ownership consolidation of Slovenian companies, which is still underway. On the other hand only a slight influence was exerted by what is known as basic factors, such as company performance and macroeconomic drivers. Primarily, it has to be taken into account that, on the Ljubljana Stock Exchange, the performance fluctuations of shares in mature companies from developed industries are significantly less pronounced than those of young companies from expanding industries. It was mainly the consolidation activities (take-overs) of some issuers that brought a certain dynamic to the securities market in 1999 and in early 2000.

Among the most important laws, which took effect in 1999 directly or indirectly regulating the Slovenian capital market, are the Foreign Exchange Act, the Act on the First Pension Fund of the Republic of Slovenia, the Restructuring of Authorised Investment Companies and the Dematerialised Securities Act. The latter boosted the number of share quotations of privatised companies, while the Securities Market Act primarily aligned the legislation regulating Slovenian securities market with EU directives. The Act on the First Pension Fund of the Republic of Slovenia and the Restructuring of Authorised Investment Companies primarily influenced trends in share prices of authorised investment companies and resulted in the issue of pension coupons of the first pension fund, which was floated on the Ljubljana Stock Exchange on 1 October, 1999. The new Foreign Exchange Act and the pertaining secondary legislation consequently passed by the Bank of Slovenia, which eliminated the majority of restrictions on Slovenian residents investing in foreign securities affected the developments on the Ljubljana Stock Exchange most substantially. At that time the Bank of Slovenia also relaxed the custody accounts regime for foreign portfolio investment. The time period which foreign investors were obliged to keep Slovenian securities or pay a special premium if they sold them, was shortened from four years to one, whilst the premium itself was reduced from the previous 10.38% to 2.02% per year. This softer regime failed to encourage foreign investors' activity on the Slovenian capital market, which has been on the decline ever since mid 1998.

In 1999 and in early 2000, developments on foreign capital markets had practically no influence on the movements on the Slovenian stock exchange. Share prices on the Slovenian capital market tend to follow price movements on the developed capital markets much less than share prices on the three largest Central European stock exchanges. This is primarily due to its closeness and smallness. However, in 1999 the Ljubljana Stock Exchange for the first time acted as an extremely isolated island. In the period in question, the correlation between monthly yields of the SBI index and that of the CESI, DAX (Germany) and Eurotop 100 (Europe), on which the SBI index is most dependent, was even negative. The comparison reveals that the correlation between the yields of the CESI and DAX in this period was 0.51, which is normal and expected.

From late 1998 until the end of March 2000 market capitalisation of long-term securities (shares, including those of authorised investment companies, bonds and pension coupons) on the Ljubljana Stock Exchange rose by as much as 45.3% reaching SIT 1,031.9 billion. Thus at the end of March 2000, market capitalisation of shares accounted for around 30% of the estimated Slovenian gross domestic product (25% excluding the shares of authorised investment companies). Nominally, the highest increase was recorded in the market capitalisation of shares (by SIT 148.1 billion), and, in relative terms, market capitalisation of bonds (up by 71.7% growth) and authorised investment companies (up by 76.2%). The percentage of shares in total market capitalisation of long-term securities on the Ljubljana Stock Exchange thus fell from 68% at the end of 1998 to 62% at the end of March 2000.

Table 19: Market capitalisation of long-term securities on the Ljubljana Stock Exchange (in millions of SIT)

Day	Shares	Bonds	Authorised investment companies	Total
31.12.96	124,990.4	52,192.0	0.0	177,182.4
31.12.97	315,944.6	83,399.9	0.0	399,344.5
31.12.98	483,037.3	145,108.4	82,106.0	710,251.7
31.12.99	566,461.5	221,058.6	125,358.7	912,878.8
31.03.00	631,125.7	249,220.0	151,601.4	1,031,947.1

Source: Ljubljana Stock Exchange

From late 1998 until the end of March 2000 the number of long-term securities issues grew from 173 to 255. The upsurge in the number of shares of privatised companies on the organised market was a strong incentive for the implementation of the Dematerialised Securities Act. As many as 69 privatised companies' shares were listed on the organised market and towards the end of this period they amounted to 172 in total. In 1999 the shares of all authorised investment companies which relinquished the principle of participating in the organised market until the privatisation gap has been filled were also quoted on the primary market.

Table 20: Turnover by groups of securities on the Ljubljana Stock Exchange (in millions of SIT)

Period	Shares	Bonds	Authorised investment companies	Short-term securities	Pension coupons	Total
1996	67,081.3	13,082.0	0.0	6,701.6	0.0	80,163.3
1997	87,555.1	11,525.5	0.0	9,215.6	0.0	99,080.6
1998	133,757.3	22,070.2	10,035.7	7,511.7	0.0	165,863.2
1999	168,422.5	35,298.5	53,801.9	6,446.2	1,701.4	265,670.5
1 Jan. - 31 March, 2000	36,786.2	18,400.7	13,576.4	1,150.8	621.9	70,536.0

Source: Ljubljana Stock Exchange

In 1999 the Ljubljana Stock Exchange registered a record **turnover**, which grew by 60.2% compared to 1998, whereas the number of deals rose by as much as 90.8% over the previous year. In the first quarter of 2000 market liquidity was similar. Despite a considerably greater turnover, the relative liquidity of shares measured by turnover ratio (the ratio between turnover value and average market capitalisation) in 1999 reached its lowest level since 1992 (0.32; Kleindienst, 2000)[41]. The turnover ratio of bonds at 0.18 was even lower. Nevertheless, it must be taken into account that the debt instruments market (also short-term) on the Ljubljana Stock Exchange showed poor liquidity from the very beginning. Of all long-term financial instruments only those particularly typical of transition, such as shares of authorised investment companies and pension coupons (turnover ratio of authorised investment companies shares reached 0.52) showed satisfactory liquidity in the above-mentioned period.

Three basic factors contributed to the falling share liquidity on the Ljubljana Stock Exchange last year: (i) reduced sales of shares obtained through privatisation i.e. less ownership consolidation in privatised companies; (ii) some liquid funds which otherwise would have been used for purchasing shares were instead invested in authorised investment companies; (iii) less activity on the part of foreign investors.[42] On the basis of the above it can be ascertained that the development and activities of domestic capital market participants in the recent years simply failed to keep up with the pace of the growing securities market in terms of market capitalisation. All-time low fluctuations of share prices on the Ljubljana Stock Exchange (measured by standard deviation of SBI

Table 21: Number of deals by security type on the Ljubljana Stock Exchange (in millions of SIT)

Period	Shares	Bonds	Authorised investment companies	Short-term securities	Pension coupons	Total
1996	106,591	6,858	0	17,804	0	113,449
1997	131,417	4,567	0	4,371	0	135,984
1998	142,691	4,843	86,766	3,304	0	234,300
1999	131,848	5,933	294,433	1,973	12,850	447,037
1 Jan. - 31 March, 2000	34,921	1,622	87,891	53	6,771	131,258

Source: Ljubljana Stock Exchange

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41 In typical developed and emerging capital markets in periods of normal trading this indicator is between 0.5 and 0.8. Among Central European capital markets the highest relative liquidity in 1999 was recorded in the Hungarian market (0.96).

42 According to Klirinško depotna druba (Central Securities Clearing Corporation of Slovenia known as KDD) the share of turnover created by foreign investors in total turnover on the Ljubljana Stock Exchange from the end of 1997 until the end of March 2000 dropped from 13.2% to 1.7% of the annual level and the percentage of foreigners in market capitalisation of shares decreased from 8.9% to 7.2%.

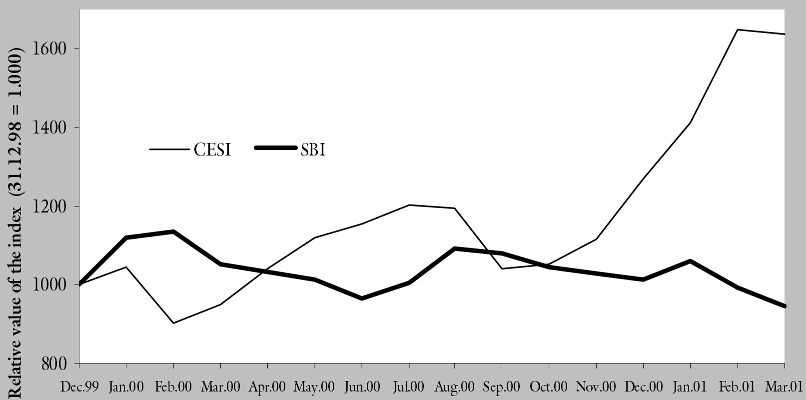
index weekly yields; Kleindienst, 2000) also point to the fact that the Slovenian capital market is on the decline.

In the following years the role of the Slovenian capital market will be influenced by both international factors (especially mergers between stock exchanges and capital markets) and factors arising from changes in the domestic system. It is realistic to expect that with the continuation of privatisation some more issues of equity securities will be floated by major issuers, after which market growth resulting from new issues will slow down. So far the organised capital market in Slovenia has functioned almost exclusively as a lever to consolidate privatisation shareholders' ownership (secondary market), while the primary capital market was preciously small, since real (»non-privatisation«) issues of equity securities were practically non-existent. An adequate range of securities, improved liquidity and openness of the market, realistically priced stocks and a more dynamic market (Kleindienst, 2000) will be of crucial importance for the development of the primary capital market in Slovenia, which is inseparable from the movements and conditions on the secondary market. The pension reform, which is expected to create the basic or anchor demand for securities, boosts the optimism regarding further development of the Slovenian capital market. However, it will only be possible to assess what influence pension reform has exerted after pension funds offer their products and the mapping out of their investment policies is drafted out in more detail. In the case of an optimistic scenario, the Slovenian capital market would in few years be able to provide a new developmental impetus, with possibilities especially in raising capital by Slovenian SMEs, which after further opening and integration of the European capital market will still have many difficulties in obtaining the necessary equity finance.

Box 11: Share yields on the Ljubljana Stock Exchange (resulting from the changed market share prices)

in 1999 and in the first quarter of 2000 were poor. Admittedly, from the end of 1998 until the end of March 2000 the SBI index increased by 1.7%, but on the other hand it dropped by 5.3% when measured in Euros. The stagnation of share prices on the Ljubljana Stock Exchange coincided with a boom on all other Central European capital markets (with the exception of Slovakia) as well as in most other parts of the world. From the end of 1998 the lag in Slovenian companies' share prices growth behind other Central European countries was also influenced by different share price movements during the Russian crisis in 1998. In 1998 the decline in Ljubljana Stock Exchange stock prices was significantly less pronounced than in other Central European markets, which is why in 1999 there was no room for any of the considerable price growth which occurred in other Central European markets. A comparison of the SBI and CESI indices trends showed that the gap between these was at its widest between the end of October 1999 and at the end of February 2000 (Kleindienst, 2000).

Graph 8: Slovenian stock exchange index (the SBI index) and the central european index CESI (relative values in EUR)



Source of data: Ljubljana Stock Exchange

In the discussed period authorised investment companies' shares yielded higher returns. In the period from the end of 1998 until the end of March 2000 the PIX index (authorised investment companies share index) rose by 27.3%. Authorised investment companies' share prices soared after the adoption of the First Pension Fund Act, which, amongst others, defined the state's obligations arising from the so called privatisation gap. The PIX index grew the most immediately after a ban on authorised investment companies' shares trading (from 4 August, 1999 until 20 October, 1999) was lifted when it rose by 60%, only to decrease by 21.6% by the end of March 2000.

6. FACTORS OF DEVELOPMENT

The quality of how we measure economic development and welfare growth is constantly improving. Initially designed to measure economic growth, gross domestic product has also become a measure of development. This was not problematic as long as welfare, the deficit of which was due to material deprivation, could be increased by stepping up economic activity. However, it has become evident that a measure of development should incorporate other welfare components such as social and environmental aspects, in addition to economic progress. The regional dimension of development has become equally important in some countries.

6.1. HUMAN DEVELOPMENT AND VALUE ORIENTATION - The human development index is rising

The 1999 Human Development Report put Slovenia in 28th place among the 174 countries for which the human development index (HDI) has been calculated. Slovenia's index and its ranking have been improving gradually since 1992. As the concept of human development and the HDI are based on the assumption of a close connection and interdependence between the economic and social aspects of development, the HDI gives an overall picture of social development.[43] The relatively quick rise in the HDI over the last few years was largely due to gross domestic product growth and an increase in the gross enrolment ratio, while the contribution of life expectancy, the most important indicator of people's general welfare, was weaker. People's welfare depends not only on the average level of living standards but also on the distribution of goods between regions and social groups (men/women, rich/poor). The 1999 Human Development Report (IMAD 1999) presented the regional HDI for the first time. The index has revealed substantial development gaps between regions in Slovenia, particularly the lagging behind of the eastern part of the country.

Indices showing gender inequalities have also been devised in order to provide an in-depth look at social development. The gender-related development index (GDI) puts Slovenia in 26th place. The almost equal values of the HDI and GDI (a difference of two places) indicate that the gap between genders in Slovenia is

[43] The HDI incorporates three components: health (life expectancy), education (a combination of literacy and gross enrolment ratio), and living standards (gross domestic product at purchasing power parities).

narrow compared to other countries. However, this is not the case in the gender empowerment measure (GEM) since Slovenia is ranked 42^{nd}. The GEM measures the participation of women in public life.

Table 22: Human development indices for Slovenia

	1992	1994	1995	1997	% change, 1992 - 97
Life expectancy at birth	0.806	0.820	0.830	0.830	+ 0.026 (3.2%)
Global ranking	**36**	**35**	**35**	**34**	
Gross enrolment ratio	0.767	0.769	0.791	0.820	+ 0.053 (6.9%)
Global ranking	**29**	**28**	**21**	**21**	
Education	0.916	0.916	0.924	0.930	+ 0.014 (1.5%)
Global ranking	**20**	**21**	**18**	**20**	
GDP per capita at purchasing power parities (USD)	0.748	0.796	0.810	0.825	+ 0.077 (10.3%)
Global ranking	**35**	**32**	**34**	**33**	
HDI	0.823	0.843	0.852	0.864	+ 0.041 (5,0%)
Global ranking	**30**	**30**	**28**	**28**	

Source: 1999 Human Development Report, IMAD.

Measures of inequality and poverty are frequently based only on income and material distribution. Welfare and human development, however, do not depend solely on the material standing of an individual. The poverty index (HPI-2[44]) devised within the context of human development addresses poverty in a more complex way. This index puts Slovenia relatively low down in the poverty rankings.

Human development is a process of enlarging the capabilities and conditions for people's choices. The three essential factors required for achieving this are a long and healthy life, knowledge and information, and access to the resources needed for a decent standard of living. This is related to a number of other areas such as human rights, collective welfare, equality, sustainable development, etc. Economic growth is by all means essential for human development, at least in terms of reducing material poverty and preventing social exclusion, it is, however, not in itself sufficient. The eradication of social exclusion and the creation of a society of co-operation based on post-materialistic rather than materialistic value orientations is only possible through economic and social integration and by reducing gaps between social groups.

[44] The human poverty index HPI-2 shows deficit in four main areas: health, education, material standards and social exclusion.

Economic development does lead to certain changes in the system of generally accepted social values and beliefs. These, in turn, generate changes in the economic, social and political systems. This is why values have such an important role in the development of society. Depending on the prevailing value patterns within societies (or differences between societies), one can distinguish, according to Inglehart, materialistic and post-materialistic value orientations. The materialistic value orientation sees the development of society merely as economic efficiency, while other development goals concerning the quality of life and the individual's rights are regarded as less important. Materialism is closely linked with a low level of the culture of democracy[45] and strong individualisation that excludes co-operation in decision-making. The post-materialistic value orientation gives preference to the quality of life, environmental protection, democracy, minority protection and civil initiative over economic efficiency. According to the Slovenian Public Opinion Poll (1991-1998), Slovenians displayed a materialistic value orientation in 1992. However, since 1995 changes have been noticed pointing to a shift favouring the post-materialistic orientation. A number of indicators nevertheless show that this is going to be a long process (the low level of the culture of democracy in particular).

Extroversion at both social and individual levels depends strongly on political democracy and a market economy. The creation of a democratic political system and moves toward a market economy in countries in transition has not been accompanied by the process of opening up internally and externally. The founding of a nation-state frequently creates a low level of democratic culture, particularly xenophobia and ethnocentrism. Even though Slovenia is one of the most homogeneous states in terms of nationality structure, with Slovenia-centrism prevailing over Euro-centrism, there is a tendency to embrace Western standards and to become part of Western European integrations. Slovenians see the state's full sovereignty as a guarantee of maintaining and improving economic and social welfare (Public Opinion Poll 1985-95).

Signs showing introversion at individual and social levels are low trust, great importance attached to the family, a low level of democratic culture, strong identification with the state, etc. The low level of democratic culture is reflected in a low level of trust in inter-personal contacts – Slovenians were ranked 40th in 1992 and the last in 1995 – and a low level of trust in institutions. Low trust

[45] The culture of democracy depends on the levels of trust in inter-personal contacts, satisfaction with life, ethnocentrism and extremism, political participation, and income differentials (Inglehart, 1997).

reduces social capital,[46] which then narrows the space for formulating development strategies. Satisfaction with life is low as well; it has improved slightly over the last six years but remains well below the world average.

6.2. THE ENVIRONMENT AND ECONOMIC PROGRESS - Slovenia shows a pre-sustainable patter

Economic growth without development is gradually threatened by its side-effects: social disequilibrium and degradation of the environment. The solution for such problem, characteristic for the transition from a medium-developed to a highly-developed economy and welfare, is provided by the **sustainable development paradigm**, promoting a new standard of society according to which the enrichment of current generations should not affect the welfare of the future ones. At the same time, the paradigm does not prevent the enrichment of the former as long as it does not cause any harm to the latter, that is to say as long as the growth of our welfare derives from: (i) the maintaining (saving) of welfare resources, both produced and non-produced; (ii) increased exploitation of natural resources, limited by the rate of their regeneration (increment, natural absorption of pollutants etc.); and (iii) investments into the welfare of future generations.

The concept of sustainable development has so far evolved from an idea to a reference and an **imperative**: it is covered by the Preamble to the Amsterdam Treaty as one of the EU's frameworks for action, providing that environmental protection and sustainable development should be included in all Community principles. Sustainable development is promoted by the international organisations of which Slovenia is a member: the World Bank, the UNO, the UNDP, the IUCN, etc. (Seljak, 1999). The institutional framework for the promotion of sustainable development is being set up throughout the world (UN Commission on Sustainable Development and its regional branches) as well as in Slovenia. The central institution for the promotion of sustainable development is the Sustainable Development Council headed by the Prime Minister. Slovenia prepares regular five-year reports on sustainable development. Moreover, partial criteria and indicators of sustainable development are being adopted within the environmental protection information system.

[46] Social capital is a system of values, norms and social relations incorporated into the social structure. This makes it possible for people to act in a co-ordinated way in order to achieve the set goals.

There is no universally accepted criterion of sustainable development. One has been adopted by the World Bank with the **genuine savings index** (GSI; 1999, p. 174-6), defined as the difference between the annual increment and the loss of gross domestic product due to (un)sustainable exploitation of two alternative welfare resources: (i) produced resources – savings and training expenses, and (ii) non-produced resources – degradation of the environment resulting from the exploitation of raw materials, the tree felling and CO_2 emissions. The result – an annual increase in the welfare of future generations – is the share of savings in gross domestic product resulting from the difference between exploitation costs (negative savings) and welfare resources improvement (as % of gross domestic product). The costs of welfare resources exploitation are calculated by summing up the amortisation of fixed capital and the additional degradation of the environment, whereas the future generations' welfare resources improvement is calculated on the basis of annual training expenses and the reduction of environmental degradation (as % of gross domestic product).

According to the **soft definition** of sustainable development (Atkinson et al., 1997), welfare resources are interchangeable: as far as future generations are concerned, it should be guaranteed that the final effect of today's actions, losses and increases of gross domestic product due to (un)sustainability, will not be detrimental to them - the GSI should be positive and as high as possible.

According to this index, Slovenia's current economic activities (1997 and 2000) do not threaten the welfare of future generations; the welfare resources it creates exceed those that it degrades – the difference in 1997 was 13.8% of gross domestic product[47]. Yet this cannot be a reason for satisfaction since an international comparison shows that Slovenia's GSI is one of the lowest. Slovenia's position slightly improves if we focus only on GSI deduction items. According to such a partial index, Slovenia (with environmental degradation equal to 0.4% of gross domestic product due to high CO_2 emissions) ranks in the middle of the list of countries, together with Portugal and Ireland, which is only slightly under the EU15 average.

Would the **future generations be satisfied** with the current economic choices if the above development patterns stayed unchanged for a long time? Hungary and the Czech Republic recorded a sustainable welfare increment in produced resources together with degradation of the environment in 1997 which were

[47] Estimates suggest that in 2000, due to the increase of gross savings on one hand and the damage caused by CO_2 emissions on the other, the value of the index should rise by 1.1 percentage points.

Table 23: Level of sustainable development achieved – estimate using

As % of GDP, 1997	ACCUMULATION OF PRODUCED WELFARE RESOURCES				DEGRADATION OF NON-PRODUCED WELFARE RESOURCES				TOTAL[1]
	Gross domestic savings	Consum. of fixed capital	Net domestic savings	Training expenses	Exploitation of the environment: Mineral. raw material	Exploitation of the environment: Energ. raw material	Wood	Environ. pollution: CO_2 emissions	
	1	2	3=1-2	4	5	6	7	8	9=3+4-(5 to 8)
Ireland	33.1	9.2	23.9	5.1	0.0	0.1	0.0	0.3	28.7
Hungary	26.9	8.0	18.9	5.2	0.4	0.1	0.0	0.7	23.0
Portugal[3]	18.5	5.2	14.0	5.0	0.0	0.1	0.0	0.3	18.4
Austria	23.5	12.9	10.5	4.9	0.1	0.0	0.0	0.1	15.2
Czech Rep.	28.4	17.2	11.2	5.3	0.4	0.0	0.0	1.3	14.8
Finland	24.6	16.7	7.9	7.2	0.0	0.0	0.0	0.2	14.8
Spain	21.4	11.4	10.0	4.8	0.0	0.1	0.0	0.2	14.5
EU15	22.1	12.5	9.5	4.7	0.1	0.0	0.0	0.2	14.0
Italy	22.3	12.4	9.9	4.2	0.1	0.0	0.0	0.2	13.9
Slovenia, 1997[2]	24.3	16.1	8.2	6.0	0.0	0.0	0.0	0.4	13.8
Germany	22.4	13.2	9.2	4.4	0.1	0.0	0.0	0.2	13.4
Poland	18.1	8.9	9.3	5.7	0.6	0.3	0.0	1.7	12.5
USA	16.0	10.7	5.3	5.8	0.7	0.0	0.0	0.4	9.9

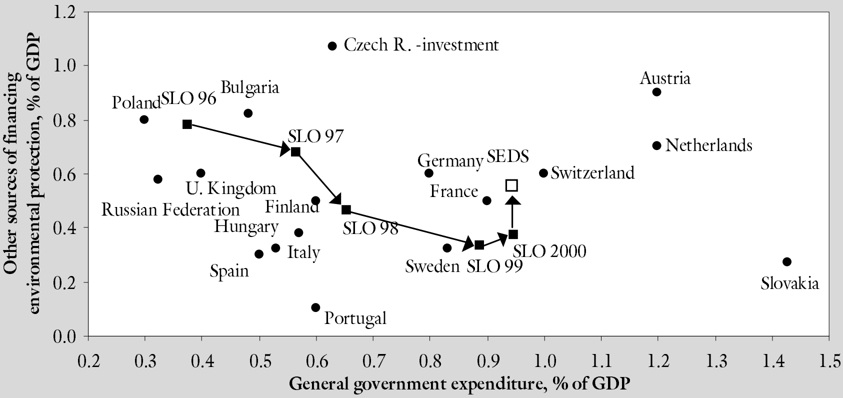
Sources of data: World Bank. March 1999. World Development Indicators 1999, pp. 174-6; Strmšnik et al., 2000; Human Development Report 1998, p. 29.
Notes: [1]Difference +/- 0.1% due to round up; [2]Data from domestic sources. Projections IMAD and estimates (for the growth of national aggregates, the medium value between Scenario+ and Scenario- is adopted; the value of CO_2 is calculated from the CO_2 emissions projections in 2000); [3]OECD, 1999

both above the average; compared to the current generations in these two countries, the future ones will not be worse off as far as welfare availability is concerned, but they will have fewer possibilities of choosing the origin of welfare since the environment will then be far more degraded than it is today. Poland and the USA recorded a counter-effect in the same year: a moderate increase of welfare deriving from produced resources and high environmental degradation – they are examples of development to the detriment of future generations because the current ones "create" their material welfare with an utilisation rate which is too low for future generations. Ireland, Finland and Austria record a similar, relatively high, increment in both welfare resources presenting a development pattern which is acceptable to both current generations (economic growth) and future ones (low environmental degradation and accumulation of produced resources of welfare).

Slovenia and Germany recorded relatively low increases in both welfare resources in 1997. Slovenia shows a **pre-sustainable development pattern.** Compared to other countries, Slovenia's development is not to the detriment of future generations, yet nor is it in favour of them. Such circumstances lead to the temptation to achieve economic progress on the account of the environment since there is, supposedly, a substantial welfare reserve for current generations in the (non-) degradation of the environment, which thanks to a "good position" should not excessively "disturb" the future ones. Approaching the end of transition towards a market economy and strengthening its development impulses, Slovenia needs a new development paradigm, and the opportunities of development offered by the sustainable development paradigm should then be taken into account.

The most important state instrument to integrate environmental and economic aspects into the sustainable development paradigm is the **budget**. Therefore, such integration should be observed by means of a register of environmental protection expenditure (Radej, 2000), with budgetary financial flows resulting from environmental protection as one of its main elements. After all, it already is (see Statistical annex) considered very important among the environmental protection registers (IMAD, SORS, MESP; 1997), and increasing environmental protection expenditure was one of the development policies of the Strategy for Economic Development of 1995, which provides that environmental protection should gradually receive more funds causing expenditure to reach around 1.5 % of gross domestic product by 2000 (Potočnik et al., 1995, p. 100). It is estimated that this year expenditure on environmental protection (according to the working plan) will reach only 1.32% of gross domestic product or SIT 52.4 billion (in

Graph 9: National environmental expenditure (the latest available data, % of GDP)



Sources of data: Poročevalec Državnega zbora (Reporter of the National Assembly), No. 17/95, 42/97, 54, 64/98, 36,74,84/99; Rapid Reports SORS No. 129/1997; 44/1998; 93/ 1999, for 1998 – SORS, a working version; Ur.l. 26/94, 40/95, 5/96, 443-9/00; Eurostat. 1997, 1999. Spring Report 1999, IMAD; Working Paper 3/1999.

1999: 1.22%, in 2001: 1.25%). This is small, considering the objectives and the National Environmental Action Plan according to which in the forthcoming 10–15 years 1.44% of gross domestic product on average should be invested in the implementation of priorities every year. Environmental protection expenditure, including current expenditure (amounting to around 0.6% of gross domestic product in 1998), will thus have to exceed 2% of gross domestic product. In this way, Slovenia would come close to the highest level of expenditure among the countries in transition (see diagram).

6.3. THE INDIVIDUAL – THE AGENT OF DEVELOPMENT AND SOCIAL INTEGRATION - The financial status of households in 1998 better than in 1992

Social policy and its related programmes and services provide for the equality and social protection of the citizens; equality in the sense of equal access to public services (schooling, health care, dwellings etc.) and social protection guaranteed through the (re)distribution of goods and services. According to estimates from 1997, Slovenia allocated for social protection[48] 24.0% of gross domestic product, approximately the same as Luxembourg (24.8%), Greece (23.6%) and Portugal (22.5%), whereas the share allocated within the European Union amounted on average to 28.2% of gross domestic product (Statistics in Focus, 2/2000).

The main objective of social policy is the social integration of the individual – the agent of development. The programmes to combat poverty and social exclusion are becoming increasingly important within the social policy programmes because they operate in the sense of reintegrating individuals living on the margins of society. Poverty and social exclusion, meaning both material and social deprivation (15.4% of the Slovenian population was exposed to a high risk of social exclusion in 1998), is becoming the central issue most frequently tackled by social policy. The Slovenian Government adopted the National Programme for the Eradication of Poverty and Social Exclusion in February 2000, with which Slovenia, as a signatory to the European Social Charter, joins the efforts of the European and international community. The

[48] Estimates by IMAD, according to Eurostat methodology - ESSPROS - European System of Social Protection Statistics; social protection expenditure includes all forms of assistance to households or individuals and the related administrative costs with regard to: sickness, invalidity, old age, death of a family supporter, child and family care, unemployment, housing and other forms of social exclusion.

Programme establishes that poverty and social exclusion can only be successfully combated by associating all the ministries which might contribute to the reduction of poverty, and by including this goal among the priorities of governmental policy. The main part of the Programme is dedicated to employment; therefore, all other policies should comply with this objective.

According to the analysis of the ministries participating in preparation of the Programme, the following tasks are essential to alleviate and prevent poverty and social exclusion: (i) providing employment for a great number of people which will guarantee their social protection; (ii) reducing educational drop-outs and increasing the number of properly skilled people; (iii) increasing the availability of social and non-profit dwellings and introducing rent subsidies for people who cannot afford to pay their rent; and (iv) raising the level of social security benefits for people unable to provide for their survival. The first three are long-term tasks, whereas the last one – raising the level of social security benefits for the most deprived people – is already being implemented thanks to the drafting of the act amending the Social Protection Act. The social security benefit will rise to the levels of a newly calculated minimum wage, sufficient for satisfying the minimum living needs of an adult person (Stanovnik, Stropnik, 1999). Such benefit (formerly called social assistance and currently called social welfare allowance) will rise from the existing level of SIT 24,464 to SIT 32,582 (in January 1999 prices).

The alleviation of poverty and social exclusion is an important part of the National Social Protection Programme by 2005 with the following objectives: improving the quality of life, providing active forms of social protection, developing an expert social network, as well as supporting and developing a common system of solving the social crisis in all sectors (public, private and voluntary).

The latest data provided by the SORS show that the poverty level in 1996 was 14.9%. This means that around 95,000 households lived below the poverty line defined as 50% of the average equivalent household income. According to data from the Household Budget Survey in 1998, the distribution of household income as the indicator of inequality shows that households in the two bottom income deciles disposed of only 8.2% of all household incomes, whereas the households in the upper two income deciles disposed of a share of household income that was four times bigger (33.4%). The ratio between receipts from employment and social benefits is getting worse. In the household income structure of 1998 (same source), receipts from employment amounted to 62.4% (69.8% in 1993), whereas social benefits, mostly pensions, amounted to 37.1% (24.8% in 1993). Gini's coefficient as the measure of inequality in income allocation among households slightly improved between 1993 and 1998 from 0.28 to 0.25. In 1999, there were 119,000 registered unemployed people in Slovenia, which hypothetically means that three times more people lived in uncertain conditions and were threatened by poverty.[49]

The above indicators affect the quality of life of the people, their well-being and state of health, as shown by the data provided by the SORS (Household Budget Survey in 1998) where 37.4% of households replied that their monthly income was hardly enough (12.3% of them had serious difficulties), and the public opinion data (Public Opinion Poll 99/2) where 36.9% of respondents said they had frequent periods of total exhaustion and tiredness, 10.7% of them said they were often unhappy and depressed, while 16.4% said they were constantly stressed and nervous. They estimated the financial situation of their households compared to the previous year's as: better - 21.2%, the same - 48.6%, or worse - 29.5%. If we compare the 1998 replies with those obtained in 1992, we see that the financial situation of households improved; in 1998, the number of households whose income was totally or mostly sufficient for living increased by 11.5 percentage points, whereas the number of those whose income was not sufficient for living fell by 7.3 percentage points.

Like values, the level of social equality and a certain material and social standard, **education also affirms and defines the individual as the agent of development**. The extent of the public education system for young people in Slovenia has already reached its upper limits. Further growth will not be possible owing to smaller future generations of students (last year there were 30,000 nineteen-year-old possible freshmen, 25,000 fifteen-year-old possible secondary school students, and only around 20,000 seven-year-old children) and an almost totally attained upper limit of proceeding from one educational level to another. Following compulsory primary school, almost every child enrols in one of the secondary school programmes; and almost every secondary school leaver enrols in a two- or four-year course at university. Among 17,470 secondary school leavers in 1999, 80% enrolled for the first time in the first year of university. Among the generation from 19 to 23, there were 28.8% regular students in the year 1998/99 and 20.7% two years before that; there were in total (together with extraordinary students) 33.4% students in the year 1998/99, 28.4% two years before that and 35.9% in the year 99/2000. Thus, the education system may improve but will not be able to expand substantially.

[49] According to the latest SORS data, the average Slovenian family has 3.02 members.

The directions of improvement of the educational system are as follows: (i) reducing drop-outs at all education levels; (ii) increasing the interest in the dual system of vocational education and in vocational technical education; (iii) increasing the share of secondary school leavers; (iv) levelling out the conditions of schooling and studies; (v) increasing competition among the providers of the programmes; and (vi) reducing the gap between the preference for sociological studies and natural sciences-technical studies. The above measures are based on the following facts.

Around 10% of pupils do not finish the eighth year of primary school (not even in 10 years). At the secondary school level, the drop-out rate is even more accentuated[50] - around 13% of a generation does not finish any secondary education programme, and around 30% of students have to take the same year again at least once. The drop-out rate at university is substantial, too. The average age of graduate university students in 1999 was 26.2 years; it took them on average 6.4 years to finish their studies. There were 28,625 children in the generation of 1974. 10,140 of them enrolled in university at the age of 19 (or 18), and 1,788 successfully concluded their studies by the age of 24 (or 23). A comparison between the children born in 1974 and those born in 1979 shows that three indicators improved: the number of students in four-year secondary school programmes increased (from 13,283 to 14,150) together with the number of students in the first year of university (regular students from 9,320 to 10,690 and extraordinary students from 820 to 1,583), and the number of pupils or students leaving school fell (from 2,200 to 1,700 at the age of 15 between primary and secondary school, and from 9,000 to 6,500 at the age of 19 before university), the drop-out rate is therefore lower.

In the levelling out of the conditions of schooling and studies, scholarships are very important in order to improve social or geographical possibilities. They are granted to some 28% of university students and 38% of secondary school students (the number of these scholarships is diminishing). The far most common are the state and Zois scholarships (for talented students); the share of scholarships granted by institutions or companies is very low and amounts to a mere 13%. In the 1999/2000 school year, banks introduced study loans which should play

[50] Achievements of the generation enrolled in 1993 (26,700 pupils): 1,080 enrolled in vocational training courses (4% of all high school students in 1993), half of them finished their studies on time, 32% finished no secondary school; 8,826 enrolled in secondary vocational schools (33% of the total), 62.6% finished on time, 16.6% did not finish at all; 10,405 enrolled in secondary technical and professional programmes (39%), 70% finished on time, the drop-out was 11.9%; 6,425 pupils enrolled in grammar schools (24%), 80.2% finished on time, the drop-out was 6.5%. (Source: MES)

the main role in scholarship policy in the future.[51] Furthermore, the residential halls for students are very important as well, yet their capacities are far too limited: there are 45 residential halls for secondary school students (occupied by 10,075 students) and 18 residential halls for university students with 8,305 residents. The share of part-time students (excluding graduates) amounted to 32.3% in 1999/2000 (only 21.3% in 1995/96). Many of them enrolled after finishing secondary school because they did not meet the conditions for regular studies.[52] By enrolling and paying for their studies they escape the likely scenario of unemployment. Most of them choose economic, business, organisational or administration study programmes (more than 60%), since the schools performing such programmes have quickly adapted to demand and accept students (and their school tuition fees) despite their insufficient capacities. Given the fact that part-time students have a status equal to regular students, the main difference between them is often only the substantial payment for a service that is, as a rule, worse than that provided for regular students.

The possibility of educational programmes within the public network being carried out by private persons and institutions might, as a consequence of increased competition, improve the quality of education (which will be even more accentuated once the capacities exceed the demand), widen the horizon by introducing different pedagogic approaches, and represent a challenge for the corporate sector.[53] Private grammar schools are extremely appreciated;[54] moreover, the number of students of independent higher education institutions is increasing (there are almost 4,000 students this year). At the higher educational level, the interest in sociology and business-management studies is unusually big (around 67% of all students). In 1999, most students graduated in sociology and business studies (39%, the EU average is 25%), only 2% graduated in natural sciences (EU 9%), and 5% in humanities and arts (EU 12%).

There are significant reserves in the education of adults, both regarding the improvement of their educational structure (among the employees of firms, companies and organisations, the share of people with a two- or four-year university degree between the end of 1997 and the end of 1998 rose from 17.5% to 18.5%, and the share of people without a secondary school qualification

[51] In the Budget for 2000, SIT 305 million is planned for reimbursing the interest rate on study loans.
[52] Only half of students in the first year is employed (60% in the second, 82% in the third, 73% in the fourth).
[53] Providing knowledge outside the public network (courses) has long been a profitable activity.
[54] The most appreciated are the diocesan grammar schools which might be, however, disputed as far as legally provided equal accessibility is concerned.

fell from 55.5% to a still high 54.5%.), the refreshment of their knowledge and the so-called lifelong learning (according to SORS' data for 1998 adults were enrolled in the following educational programmes: 82,000 in training programmes, 207,000 in programmes of upgrading and 10,000 in education towards a formal degree according to verified programmes). In order to increase unemployed persons' possibilities of returning to work, the programme of adult education (Programme 5000) is very positive and useful.

6.4. REGIONAL DEVELOPMENT - A new approach to regional development

A regional development policy reform was introduced in Slovenia in 1999, bringing significant institutional and substantive changes. Factors that called for the reform were poor efficiency and inability to meet the goals set by regional policy, insufficient use of local development initiatives, absence of the regional dimension in sectoral programmes and poor co-ordination of sectoral policies, as well as globalisation and Slovenia's accession to the EU, the latter of which mainly involves harmonising Slovenia's legislation with the community *acquis*.

One of the main steps taken in the field of regional development in 1999 was the passing of the Balanced Regional Development Act, which laid the foundations for the implementation of regional structural policy in Slovenia. According to the Act, Slovenia's regional policy will be implemented comprehensively, while concentrating on certain priority areas to which the state will direct its assistance: (i) regions with limited development potential, and (ii) areas with special development problems defined in the implementing regulation. One of the main novelties of the Act is the introduction of regional development programmes, which will be a pre-condition for obtaining the state's financial aid. Every region wanting to get funds for development will thus have to make a regional development plan.

The Act has introduced new institutions that will be responsible for implementing regional structural policy. At the national level, the Regional Development Agency has been established, the government will set up a Council for Structural Policy, while the role of the Fund for Regional Development and Preservation of Rural Settlement will be strengthened. At the regional level, regional policy implementation will be taken over by regional development agencies. The Act requires the passing of the Strategy for Regional Development of Slovenia up to mid-2000, a document on which regional structural policy will be based. Full enforcement of the Act will require some additional implementing regulations, which are being drawn up and will be passed soon.

Important steps towards harmonisation of Slovenia's legislation with the community *acquis* have been taken in the field of statistics by introducing new methods that are indirectly related to regional policy. The new Standard Classification of Territorial Units (SCTU[55]) complies with the NUTS classification used in EU Member States. This territorial division is compulsory in the EU and serves as a basis for pursuing regional policy. After joining the EU, Slovenia expects to become part of all existing programmes of structural and cohesion policies that are principally implemented at NUTS 2 and NUTS 3 levels.

Achieving 66% of the EU's average gross domestic product per capita at purchasing power parities[56] (estimated figure for 1995-97), in 1999 Slovenia stood at the level of development equal to the least developed Member States, i.e. Greece. In 1998, Slovenia recorded 68% of the EU average. At the NUTS 2 level, where Slovenia is divided into the Ljubljana Urban Region and the Rest of Slovenia, the gap is different. The Ljubljana Urban Region is estimated to have achieved 87% of the EU average, while the Rest of Slovenia only 59%. A comparison with the neighbouring regions of EU Member States at NUTS 2 level shows that the Ljubljana Urban Region is only slightly less developed than southern Austria, with K‹rnten recording 89% and Steiermark 90% of the average level of development in the EU. The lagging behind the eastern parts of northern Italy is stronger, with Friuli-Venezia Giulia exceeding the EU average by 27%.

When compared to EU candidate-countries – Bulgaria, Czech Republic, Estonia, Hungary, Lithuania, Latvia, Poland, Romania and Slovak Republic – Slovenia is the most developed in terms of gross domestic product per capita at purchasing power parities. The same goes for the majority of Slovenian regions in comparison to those of candidate countries at the NUTS 2 level.

[55] The SCTU introduces major changes at SCTU 2 or NUTS 2 levels: there will be two units – the Ljubljana Urban Region and the Rest of Slovenia. There were minor changes at SCTU 3 level, the current division of statistical regions. The Central Slovenia overlaps with the Ljubljana Urban Region at SCTU 2 level and is smaller than the former Central Slovenia as six municipalities have been excluded. They have become part of the former Dolenjska, which has been renamed the South-east Slovenia. Other regions are identical with the current statistical regions.

[56] Last year, the SORS published figures on GDP per capita of 12 statistical regions (before the introduction of SCTU) for 1996. Data for 1995-97 are estimates made by Eurostat on the basis of the SORS' data for 1996. After the division into SCTU, estimates by IMAD.

Regional disparities at the NUTS 2 level are considerably narrower in Slovenia than in other candidate-countries. The gap between the Ljubljana Urban Region and the Rest of Slovenia was estimated at 1.5:1 in 1995-97, while the gap between the most and the least developed region in other candidate-countries was between 2:1 and 3:1.

Table 24: Selected data by Standard Classification of Territorial Units at SCTU 2 and SCTU 3 levels

	Population, total and % share 30 June 1999		Registered unemployment rate, % 1999	Labour force participation, % 1999	Employment rate, % 1998	Income tax base per capita (index; SLO=100)
SCTU 2						
Ljubljana Urban Region	485,698	24.5	10.1	65.0	58.4	123.0
Rest of Slovenia	1,499,859	75.5	14.7	62.6	53.4	92.6
SCTU 3						
Central Slovenia	485,698	24.5	10.1	65.0	58.4	123.0
Littoral-Karst	103,298	5.2	10.1	61.1	54.9	116.3
Gorenjska	196,436	9.9	11.9	62.0	54.6	99.1
Goriška	119,998	6.0	7.7	61.1	56.4	112.7
Savinjska	256,562	12.9	15.3	63.8	54.0	89.1
South-eastern Slovenia	137,925	6.9	11.7	64.9	57.3	92.6
Pomurska	125,037	6.3	18.2	64.1	52.5	74.7
Notranjska-Karst	50,470	2.5	12.2	64.2	56.4	100.4
Podravska	319,468	16.1	20.6	61.7	49.0	84.5
Koroška	74,012	3.7	11.7	60.7	53.6	86.4
Posavska	70,100	3.5	14.9	63.6	54.2	86.6
Zasavska	46,553	2.3	17.5	61.9	51.1	93.1
Slovenia	1,985,557	100.0	13.6	63.2	54.6	100.0

Sources: SORS, Tax Administration, calculations by IMAD.

Wider regional disparities within Slovenia can be found at lower territorial levels: at the level of statistical regions and at the level of municipalities, where they are even bigger. Narrower disparities would have been expected considering the small size of the country. Differences are the smallest in income tax base per capita, an indicator of the economic power of the population. The income tax base is the highest in Central Slovenia, exceeding Slovenia's average by 23% in 1998. The ratio of the highest to the lowest value of the indicator (Central Slovenia to Pomurska) was 1.6:1 in 1998 and has not changed for several years. Regional disparities are wider in terms of the registered unemployment rate. Even though the total number of the unemployed fell in Slovenia in 1999, the gap between regions with the lowest and the highest unemployment rates remains wide and is increasing; the ratio rose from 1:2.4 in 1997 to 1:2.7 in 1999). As many as five regions have above-average registered unemployment rates (Podravska, Pomurska, Zasavska, Savinjska and Posavska), of which the

Podravska region stood out with its unemployment rate of 20.6% in 1999. This is estimated[57] to be the only region in Slovenia exceeding the EU average.

What is even more problematic is the structure of unemployment, which is not changing or is even deteriorating. A large share of unemployed with low qualifications is typical of all regions with high registered unemployment rates. The largest share of those unemployed is in South-eastern Slovenia (58.7%) and in Pomurska (55.9%). The latter is further characterised by the above-average share of young unemployed, representing almost one-third of all job-seekers in the region. A share of young unemployed high above the average is recorded in Goriška, whose registered unemployment rate is otherwise the lowest in Slovenia. A large number of young job-seekers is also found in the Savinjska, Zasavska, Notranjska-Karst, Koroška and Posavska regions. The share of unemployed aged over 40 is increasing in all statistical regions. Gorenjska is leading with 57.5%, where over 30% of all unemployed are over 50 years of age. The unemployed aged over 40 represent more than half of the unemployed also in the Central Slovenia, South-eastern Slovenia and the Littoral-Karst regions. The share of unemployed women is also rising in most regions, with the largest shares being recorded in the Littoral-Karst region (56%), Zasavska, Gorenjska and Notranjska-Karst regions.

Financial performance of companies improved in the majority of statistical regions from 1998 to 1999. Central Slovenia or the Ljubljana Urban Region, economically the strongest region in Slovenia, recorded the best results. With 42% of all companies and close to one-third of all employees, it generated almost one-half of the total net profit in Slovenia. Companies in the Podravska region substantially improved their financial results: after recording a loss for several years running, they concluded the 1999 financial year with a profit. Companies recorded a loss only in the Posavska and Zasavska regions: net losses in Posavska fell last year compared to 1998, while in Zasavska they surged. This region accounted for more than one-half of the total net loss in 1999 and only 5.6% in 1998. Value added[58] per employee, an indicator of labour productivity, was the highest in Central Slovenia or the Ljubljana Urban Region last year, exceeding the Slovenian average by almost one-fifth. Above-average value added per employee was also seen in the Littoral-Karst, Goriška and South-eastern Slovenia regions. The latter is the most export-oriented region – more than 50% of revenue is generated

[57] No regional unemployment rates by ILO standards (survey) are available. On the basis of the registered unemployment rate and the survey unemployment rate, the IMAD has assessed the level of unemployment by ILO in regions. This is, in fact, a harmonised unemployment rate.
[58] Taken from financial statements, IMAD methodology.

by exports – and has gradually improved its position relative to other regions in terms of labour productivity.

Regional disparities do exist in Slovenia, as demonstrated by various indicators. The adopted regional policy aims to reduce these disparities and provide conditions for balanced development throughout Slovenia. In order to do this, Slovenia has increased funding for regional development over the last few years, the Fund for Regional Development and Preservation of Rural Settlement and its investment policy attempt to bring together different sectoral policies and channel investment into the most problematic areas. Last year, the Fund was responsible for the financial part of the invitation of the Ministry of Economic Relations and Development for projects aimed at promoting development of areas threatened by depopulation. Last year, SIT 8.3 million was earmarked for regional development through the Fund, more than the total of the last three years. Adding SIT 2 million from the Ministry of Economic Relations and Development, Slovenia earmarked around 0.28% of gross domestic product for regional development in 1999, more than in 1991 (0.23%), when funding for regional development started to shrink. In 1999, the majority of aid was given for the development of agriculture, with substantial amounts also given to the corporate sector, infrastructure and active employment policy.

7

7. MAIN ORIENTATIONS OF ECONOMIC POLICY

Intensification of macroeconomic stability and gradual integration into the common making of the economic policy of the European Union are gradually reducing the relative importance of traditional national macroeconomic policies, which primarily influence production stability, the level of employment, the level of prices and the exchange rate. Processes such as globalisation, informatisation and the creation of a post-materialist value system (see Chapter 6.1) are making certain social agents (economic associations, employees' organisations, non-governmental organisations (NGOs) and, generally, civil society) increasingly equal partners to the state in shaping measures to encourage economic development and prosperity. Partnership co-operation between economic and social agents presupposes the existence of a basic consensus on development orientations in addition to efficient co-ordination among the pillars of individual state policies. In accordance with these processes, and if compared with macroeconomic policies, ground is being gained by development policies (such as competition policy, industrial policy, technological policy, regional policy, environmental policy, human resources development policy, etc.) which have an impact on the structure of production, productivity, innovative ability and investment, a country's and its economic entities' international competitiveness, transaction and information expenses as well as on the overall quality of development.

Slovenia is only just now gradually setting up a proper system of the regulating and stimulating the economy which will be based on a modern understanding of the changed role of the state in the economy, and which will go beyond the rigidity of mere macroeconomic policies. In addition, it will not involve any return to ad hoc direct state intervention, but instead bring about the intensification of development potential (technological know-how, competitive ability, savings and investment). This process is being further stimulated by the adoption of the *acquis communuataire*. Some changes have been introduced to the state aids policy (see Chapter 4.2), the policy on domestic and foreign investment stimulation (see Chapter 5.2.3), the policy of encouraging technological development (see Chapter 4.3) and the policy of balanced regional development (see Chapter 6.4). The first steps towards comprehensive reforms of the public administration and the government's efficiency - both of which are among the principle hurdles to achieving a significant degree of competitiveness abroad (see Chapter 4.1) - have been taken by reforming the state budget drafting procedures and by an attempt to clearly state budgetary priorities (see Chapter 7.1).

Apart from restructuring the way the state functions, the structural or development policy should also focus on: (i) accelerated restructuring of the corporate sector (facilitating the entry of new companies, ownership consolidation and corporate governance, strategic partnership links among companies, rapid rehabilitation or elimination of companies operating at a loss); (ii) the creation of conditions favourable to increasing domestic investment and direct foreign investment; (iii) bank and insurance companies' consolidation and privatisation; and (iv) the completion of liberalisation, regulation and privatisation of the sector of public utilities. These changes could lead to a gradual improvement in the competitive ability of the Slovenian economy in the existing manufacturing industries, but chiefly in new, technologically more advanced branches of industry. The main role here should be played by technological development, which is being encouraged by the government in several different ways (for instance technological centres are being set up, while support for technological development in small- and medium-sized companies, support for innovation and enterprise, and financing fundamental research are being provided) on the basis of the principle of a partnership which highlights the synergetic interweaving of companies' strategies and industrial policy. However, while one stresses the role of technology, one should not forget the role of modern manufacturing and information services, which are also constituent elements of the production process and a notable source of its efficiency, that is to say competitiveness.

7.1. FISCAL POLICY

A number of significant changes were made in the area of public finance in 1999. The introduction of the value-added tax and excise duties in July completed the second stage of the tax reform, which gave Slovenia an EU-compatible tax system. Pension reform, which will reduce pressure to increase public expenditure at least for a few years, was instituted by the endorsement of the new Pension and Disability Insurance Act. The system of public finance management was also changed last year. The Accountancy Act was adopted too. That law regulates bookkeeping and the preparation of annual reports for the budget and the recipients of budget funds as well as legal entities subject to public or private law whose bookkeeping is not governed by other laws. September saw the adoption of the Public Finance Act, which regulates the composition, preparation and implementation of the state and municipal budgets, the management of state and municipalities' assets as well as their borrowing, indemnities, debt management, accountancy, and budgetary control.

This year, the Public Funds Act was passed. This law sets down the rules applicable to the management and use of assets which were earmarked for a public fund to secure a certain public interest. In order to secure the economic, effective and transparent use of public finance and competition between bidders, the newly passed Public Procurement Act defines tendering procedures.

7.1.1 PUBLIC FINANCE IN 1999 – The reform of indirect taxes implemented

General Government Revenue - Changes to the system of indirect taxes were carried out in the middle of last year. While in the first half of the year general government revenue was calculated and paid in under fiscal legislation and the tax system dating from 1998, the second half of the year saw the system of sales taxes being replaced by the value-added tax and excise duties. Moreover, the laws which regulate tax liabilities and the payment of tax on real estate sales, tax on insurance sales and tax on gambling - activities that are tax-exempted in VAT system - were also adopted. The Tax on Motor Vehicles Act imposed taxes on sales of new and second-hand motor vehicles. The Constitutional Court ruled that a special tax on the total assets of banks and savings banks does not in fact breach the Constitution. The tax rate in this case increased from 2% to 3%.

The growth in general government revenue in 1999 was fuelled significantly by revenues from sales taxes, VAT and excise duties which, due to the changes to the fiscal system, were exceptional that year. Uncertainty and expectation which marked the months prior to the introduction of VAT brought about pressure to consume more, which resulted in a major inflow of sales taxes. After 1 July, sales taxes continued to be collected on invoiced sales made before the introduction of VAT. Accounting for 14.9% of gross domestic product , revenues from sales taxes, VAT and excise duties went up by 16.5% in real terms from the sales taxes revenues in 1998.

Revenues from social security contributions were 3.5% higher in real terms than in 1998. The overall real increase in personal income tax revenues was 2.3%. The lower real growth in all revenues from personal income tax was caused by income tax refunds based on the 1998 accounts and by the real-term lagging of several subcategories of personal income tax. The payroll tax remained a source of tax revenue in 1999, and increased by 15.3% in real terms from 1998 due to the progressive nominal taxation scheme. The reduction of customs duties rates resulted in a 9%-drop in real terms in the revenues from customs and import duties. Corporate income tax revenues remained at approximately the same level in 1999 as in 1998 in real terms. General government revenue, consolidated in line with the new methodology, increased by 7.2% in real terms to 43.7% of gross domestic product, a rise of 0.7 of a percentage point from 1998.

General government expenditure - State budget expenditure totalled SIT 963 billion, a real increase of 6.9% from 1998 and 26.5% of gross domestic product. As to the structure of state budget expenditure, the sharpest increase in 1999 was recorded in interest payments abroad (35.9% in real terms), subsidies (22% in real terms), capital expenditure (10.3% in real terms) and capital transfers (21.3% in real terms). Substantial growth in real terms was also recorded in the state administration's purchases of goods and services (13.2% in real terms). Wages, contributions and other personnel allowances went up 5% in real terms. Transfers to individuals and households from the state budget rose by 3.4% in real terms in 1999. Transfers from the state budget to the Pension and Disability Insurance Institute increased by 5.6% in real terms from 1998, thus accounting for 15.5% of central government expenditure, or 4.1% of gross domestic product.

Increasing by 7.8% in real terms in 1999, **local government expenditure** totalled 5.1% of gross domestic product, a marginal rise of 0.1 of a percentage point from 1998.

Expenditure on **pension and disability insurance** increased by 6.4% in real terms in 1999. 13.4% of gross domestic product was used in 1999 to implement the Pension and Disability Insurance Act, excluding health insurance contributions for the retired, which is 0.1 of a percentage point more than in 1998. Taking into account the legislation on the threshold of wage rises, pensions were adjusted according to average wage movements in Slovenia in 1999. May saw an adjustment that secures the minimum ratio between the average wage and the average old-age pension for the full pension contributions period, as stipulated by law. The number of beneficiaries increased by 0.9%. As agreed, a higher recreation allowance for the retired was paid.

Expenditure on **compulsory health insurance** in 1999 exceeded the 1998 figure by 3.6% in real terms, thereby amounting to around 6.5% of gross domestic product, a slight drop of 0.1 of a percentage point from a year earlier. The range of entitlements arising from compulsory health insurance in 1999 was nearly the same as in 1998. However, the availability of heath-care services seemed somewhat restricted. Early 1998 saw a number of measures taken to curb expenditure arising from compulsory health insurance which chiefly centred on bridling expenditure on medicines, limiting sick leave and streamlining the implementation of health programmes. These activities were also carried on in 1999. The structure of expenditure arising from compulsory health insurance shows that expenditure on services related to compulsory health insurance rose by 4.9% in real terms. In addition, expenditure on wages and contributions of health service employees increased by 5.2% in real terms, whilst expenditure on material expenses went up 4.6% in real terms. With the money spent on medicines and orthopaedic instruments increasing by 4% in real terms from 1998, sickness benefits decreased by 5.4% in real terms.

Consolidated general government expenditure rose by 6.8% in real terms in 1999 from 1998. It totalled 44.3% of gross domestic product, up by 0.5 of a percentage point from a year earlier.

7.1.2. PUBLIC FINANCE IN 2000 – Pressure to increase wage and pension expenditure due to rapid price rises

No major systemic changes to the fiscal system are expected to be introduced this year after the reform of indirect taxes was instituted in 1999. Nevertheless, the volume of general government revenue will be influenced by the measures taken at the beginning of 2000. January saw the adoption of the Act on the Manner of Settlement of Overdue Taxes and Fees which stimulates the payment of overdue liabilities by offering easy payment conditions, namely instalment payments or discounts for immediate payment. The endorsement of the Act on Exceptional Reduction of Tax Liability implemented a deal finalised in the agreement on wages policy for 1999-2001 which says that those in the lowest income brackets are not liable to pay personal income tax. The new Administrative Fees Act took effect in February 2000. Changes to the administrative fees rates will result in an increase in general government revenue. Social security contributions rate will remain unchanged compared to last year. In 2000, no changes to the payroll tax are envisaged. Revenues arising from customs and import duties will keep falling due to decreases in tax rates resulting from trade agreements.

General Government Revenue - The estimates of general government revenue based on new parameters anticipate only a moderate nominal increase, yet a decrease in its share in gross domestic product. A restrictive incomes policy regulates the growth of the direct taxes base (chiefly wages). Revenues arising from taxes on sales of services and goods are also rising at a slower pace than gross domestic product.

It has been estimated that revenues from VAT and excise duties will make up around 14.3% of gross domestic product this year, up 0.8 of a percentage point when compared to the 1998 sales tax revenues. Given that wage rises are lagging behind productivity growth, general government revenues from wages will only grow moderately in 2000. According to another estimate, revenues from social security contributions are to rise by around 3.6% in real terms. The implementation of the Act on the Manner of Settlement of Overdue Taxes and Fees has hardly borne any fruit as yet.

The anticipated rise in both wages and the number of wage earners will increase income tax revenues by 3.2% in real terms compared to 1999 which, however, will be lessened due to implementation of the Act on Exceptional Reduction of Tax Liability. As a result of the nominal progressive taxation scheme, payroll tax has been estimated to increase by 6.5% in real terms. This estimate however does not take into account the fact that the lower limit of taxing wages could be changed. Customs and import duties revenues are expected to fall by an additional 17 percent in real terms, despite increasing imports only reaching around 1% of gross domestic product.

Consolidated general government revenue has been estimated to rise by 2.5% in real terms in 2000, thereby totalling 42.8% of gross domestic product, down by 0.9 of a percentage point from 1999.

General Government Expenditure - The state budget for 2000, which was passed in January, anticipates central government expenditure of SIT 1060 billion, which is a rise of 10% in nominal and 2.3% and real terms from 1999. The central government expenditure has been estimated to account for 25.8% of the estimated gross domestic product, a fall of 0.7 of a percentage point from 1999. The sharpest increase is expected in expenditure on interest payments abroad (34% in nominal terms) and capital expenditure (30.6% in nominal terms). A substantial rise of 18.5 percent in nominal terms is expected in the state administration's purchases of goods and services this year. Also this year, expenditure on subsidies has slowed down in comparison to the same period last year, but is expected to increase, albeit by only 7 percent in nominal terms after the state budget has been endorsed. The state budget anticipates only a slight rise in transfers from the budget to the Pension and Disability Insurance Institute, which will not be enough to fill the pension budget's coffers.

Local government expenditure has been estimated to increase by 4.2% in real terms in 2000. Similar to last year, its share in gross domestic product has been estimated at 5.1%.

It is anticipated that **expenditure for compulsory health insurance** will amount to around 6.4% of gross domestic product in 2000, a drop of 0.1 of a percentage point from a year earlier. While approximately the same range of entitlements arising from compulsory health insurance will be ensured this year compared to last year, the availability of health-care services to beneficiaries seems to be more limited due to the streamlining of implementation of health-care programmes.

The new **Pension and Disability Insurance Act** entered into force at the beginning of 2000. It has been estimated that the payment of pension and disability benefits under the new law, excluding health insurance contributions for the retired, will take 13.2% of gross domestic product, which is 0.2 of a percentage point less than in 1999. On the basis of a new system of pension valorisation, pensions will be adjusted to movements in Slovenia's average wages. The number of beneficiaries is expected to rise by nearly one percent this year as well.

This year's rise in **consolidated general government expenditure** has been estimated at 3.4% in real terms when measured against 1999. The expenditure is expected to total 43.8% of gross domestic product, down by 0.5 of a percentage point from last year.

While fluctuating on a yearly basis, general government expenditure generally totals around 43.5% of gross domestic product (44.3% of gross domestic product in 1999, 43.2% of gross domestic product in 1997). It is basically determined by the volume of funds spent on wages, social transfers and public services which is unlikely to change in the future despite the fact that reforms have been carried out. Moreover, pressure to increase expenditure for several other purposes can be expected because of some other planned structural changes.

7.1.3 PUBLIC FINANCE IN 2001 – Restructuring of expenditure in line with development priorities is urgent

Forecasts of the general government revenue growth rate for 2001 show it lagging behind the gross domestic product growth rate provided that the fiscal instrument remains unchanged. General government revenue is expected to fall to 42.1% of gross domestic product.

The reform of direct taxes will be the next stage in the overall tax reform. Changes will focus on the revenues from corporate income tax and on the tax on real estate. The planned change to the personal income tax system, set to relieve pressure on lower income brackets, will bring out the social element of the tax system. In addition, reforming the corporate income tax will guarantee that the taxation of each corporate taxpayer is proportional to their economic power. Some generously granted tax relief will be abolished. In order to enhance the volume of taxes collected, the Tax Administration will have to ensure more consistent calculation and collection of taxes and contributions. Simultaneously, revenues arising from the management of financial assets of the state should be increased.

Given that social security contributions will not suffice to fund all entitlements arising from both pension and disability insurance, and compulsory health insurance, there will be a huge pressure to increase transfers from the state budget to cover the deficit in pension and disability insurance in addition to the pressure to increase compulsory health care contribution rates.

In insisting on a moderate size of the general government deficit, in 2001 it will be impossible to avoid taking measures to reduce and redistribute expenditure from the state budget in all areas. The state budget will have secured funds for implementation of the state's legal obligations that will need restructuring in line with the planned reforms of the public administration.

Gradually, the new Pension and Disability Insurance Act will bring about a slight slowdown in the rate of expenditure. The present level of public health security should be preserved as one of the goals of compulsory health insurance; due to economising measures dictated by limited funds, and given approximately the same extent of rights, the availability of health services is set to decrease. Additional funds will be secured through an expansion of the system of voluntary health insurance and an increase in direct payments.

7.1.4 GENERAL GOVERNMENT DEFICIT – To be kept within sustainable limits

Once general government revenue and expenditure were consolidated in harmony with the IMF's methodology, the general government account was balanced in the period from 1994 to 1996. As a result, by exerting no pressure on interest rates or the exchange rate through external borrowing, the balanced general government finance played a positive role in stabilising the economy.

Table 25: Consolidated General Government Revenue and Expenditure Based on GFS-IMF Methodology (as % of GDP)

	1992	1993	1994	1995	1996	1997	1998	1999	2000 estimate	2001 estimate
General Government Revenue	43.3	44.7	43.4	43.1	42.7	42.0	43.0	43.7	42.8	42.1
General Government Expenditure	42.1	43.8	43.4	43.1	42.4	43.2	43.8	44.3	43.8	43.1
Surplus/Deficit	1.2	0.9	0.0	0.0	0.3	-1.2	-0.8	-0.6	-1.0	-1.0

Source: Ministry of Finance, calculations by IMAD

The equilibrium in public finance was disturbed in 1997, the year when revenues suffered from the consequences of a reduction in social security contributions and a fall in customs and import duty revenues which had not been compensated for by new tax sources. Simultaneously, general government expenditure came under additional pressure, mainly due to an increase in wages expenditure, which resulted from the growth in wages and employment in the public sector and a rise in pension and disability expenses as well as in other social transfers emerging from the existing social security systems.

Despite the economic policy measures designed to take the pressure off general government expenditure, and regardless of attempts to secure the most stable financial sources possible, 1997 saw the general government deficit come in at 1.2% of gross domestic product.

While the shares of general government revenues and expenditure in gross domestic product increased in both 1998 and 1999, the general government deficit decreased to only amount to 0.6% of gross domestic product in 1999.

Public finance is however to face a tougher situation in 2000. An inflation rate higher than planned will result in additional pressure on general government expenditure when drafting the state budget; especially wages and pension expenditure will be under heavy pressure. With very moderate growth in general government revenue, the general government deficit, as recorded by the consolidated general government account, has been estimated to total around 1% of the estimated gross domestic product in 2000. The drafters of the public finance policy should not increase the general government deficit in spite of the more difficult conditions, yet this will only be feasible if general government expenditure is planned very carefully and restrictively, and if general government revenue is increased. The latter should be designed so as to follow the tempo of general government expenditure, whilst the structure of financial sources should further change to increase revenues from direct taxes. General government expenditure cannot be altered substantially in the short run, but what can and should be done is to check the possibility of increasing revenue not through higher tax rates, but through more effective tax collection.

7.1.5. PROGRAMME STRUCTURE OF GENERAL GOVERNMENT EXPENDITURE – No major changes in the past five years

Public finance is intended for the funding of the state's public functions. The programme structure of public finance can be used to show the purposes and programmes of the state in addition to its functional structure. On the basis of a Swedish model of budgetary expenditure management, the Slovenian Ministry of Finance prepared a review of budget expenditure which shows the functional and programme structures from 1994 to 2000 (MF, 2000a).

This period has been strongly marked by a rise in the share of transfers required in making up the shortfall in financing pension and disability insurance. No pronounced characteristics have been recorded in other segments of budgetary expenditure.

Relatively minor changes in the programme structure of public expenditure[59] emerge from the equal treatment of the entire public finance (including the

[59] The Ministry of Finance divided the state budget expenditure into 23 function and programme fields. Here we find a scheme of the programme structure of public spending (including expenditure on compulsory pension insurance and compulsory health insurance as well as local government expenditure) which involves all 23 function and programme areas united in eight groups: **The State and Local Self-Government** - Political System, Economic and Fiscal Administration, Foreign Policy and International Help, Common Administrative Services

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integration and consolidation of expenditure arising from compulsory pension and health insurance as well as all functions performed by municipalities within their local self-government programmes). Major changes to the volume and structure of funds allocated for individual purposes are impossible to carry out in a short period of time. Yet, the relative significance of transfers to the economy (agriculture excluded) should start being reduced this year and thereafter, but at the same time the share intended for social security and social cohesion should be preserved.

The programme approach would enable more transparent decision-making about the use of public funds. Even prior to instituting the programme approach, the following areas were prioritised by the government within the 2000 state budget: technological development, active employment policy, agriculture, and regional development. These priorities originate in the Preliminary National Development Programme for the Period 2000-2002, which was given the green light by the government in November 1999. The programme sets down development priorities in six fields: (i) production capacity of the corporate sector; (ii) economic infrastructure; (iii) human resources development; (iv) restructuring of agriculture and rural development; (v) environmental protection; and (vi) regional development.

Moreover, the need to adjust Slovenia to the situation and trends in the world economy will call for higher expenditure to develop the labour market and expenditure which intensifies creativity and the transfer of knowledge, thereby improving the human and social capital, by which normal integration into regional and world institutions would become possible.

Accordingly, these strategic reflections, upon which general government expenditure may depend, cannot bring about any significant potential for reducing its share in gross domestic product. Consequently, it is more important that the

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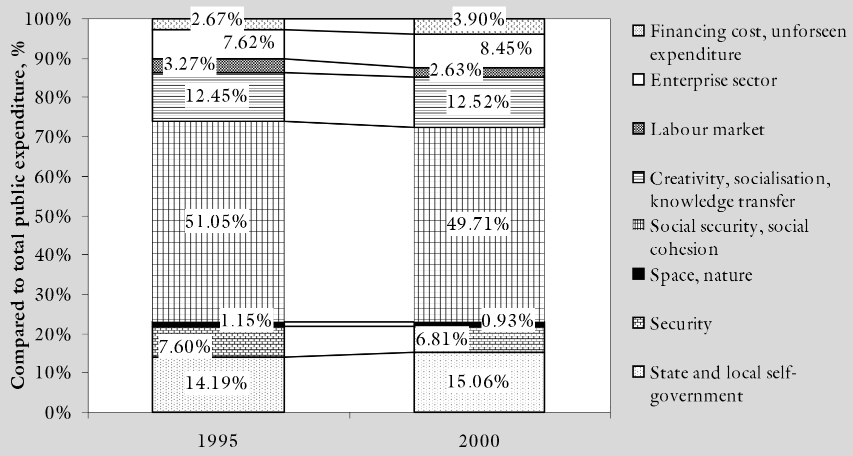
and General Public Services, Local Self-Government; **Security** - Defence and Emergency Measures, Internal Affairs and Security, Judiciary; **Economy** - Agriculture, Forestry and Fisheries, Extraction and Distribution of Energy Raw Materials, Transportation, Transport Infrastructure and Communications, Economic Affairs; **Space, Nature** - Environmental Protection and the Protection of Natural Heritage, Spacial Planning; **Social Security, Social Cohesion** - Health Security, Social Security, Pension Security; **Labour Market** - Labour Market and Working Conditions; **Creativity, Socialisation and Transfer of Knowledge -** Science and Technological Development, Education, Culture, Sports and NGOs; **Financing Cost and Unforeseen Expenditure** - Public Debt Servicing, Intervention Programmes and Commitments.

tax capacity is preserved and possibly increased through maintaining the correct tax policy and tax system.

Graph 10: Public expenditure by purpose or programme



Source of data: MF, calculations by IMAD.

7.1.6 CENTRAL GOVERNMENT DEBT - It totalled 24.6% of gross domestic product in 1999

The **central government debt** increased by SIT 122 billion in nominal terms in 1999, due to borrowing to fund the budget deficit (SIT 19.7 billion), debt servicing (SIT 64.1 billion), and borrowing for special purposes. At the end of the year, it reached SIT 893.3 billion or 24.6% of gross domestic product, a rise of 0.8 of a percentage point over the end of 1998.

Table 26: Amounts Outstanding and Changes in Central Government Debt of the Republic of Slovenia in 1999

In SIT billion

	Amount Outstanding 31.12.1998	Disbur-sement	Repayment	Net Disbursement	Revaluation, Exchange Rate Change	Changes in Debt	Amount Outstanding 31.12.1999 Stock
DEBT	771.3	202.3	146.1	56.2	65.8	122.0	893.3
I. Internal Debt	475.5	121.9	128.7	-6.8	29.8	23.0	498.5
II. External Debt	295.8	80.5	17.5	63.0	36.0	99.0	394.8

Source: Ministry of Finance, Almanac of Public Debt Management Department

The Republic of Slovenia **borrowed** using both long-term and short-term financial instruments in 1999. The most important long-term instrument of external borrowing was a ten-year Eurobond in the value of 400 million euros and, on the domestic market, a four-year bond of the Republic of Slovenia (RS 14) in the value of SIT 6.3 billion. In addition, the Treasury kept issuing the bonds of the Republic of Slovenia of the 04, 13 and 15 series F. The Treasury also continued with its regular monthly auctions of three-month treasury bills and six-month treasury bills (the first issue in October 1999, the second in December 1999; since the beginning of the year the Treasury has been issuing them bi-monthly). The maximum amount of short-term borrowing is specified in the Republic of Slovenia Budget Implementation Act, which defines an annual borrowing limit, but the actual amount also depends on the ratio between the long-term and short-term debts as well as the market situation. Last year's three-month treasury bill issues range between SIT 2.5 to 4 billion, while the figure for six-month treasury bills stood at SIT 1.9 billion.

Box 12: Main Principles of State Borrowing

The amount of new borrowing and its dynamics are based on an analysis of estimated monthly cash flow and an assessment of the situation in the financial markets. The main principle that applies to borrowing is the harmonisation of the lowest costs of borrowing as possible with an acceptable level of risk in financing the budget. Bearing in mind these facts, the Ministry of Finance prepared a schedule of long-term securities issues with 3-, 5- and 10-year maturity dates in the domestic market. A larger number of floatings with smaller amounts issued would enhance their transparency in terms of the time perspective. In addition, potential investors are acquainted in advance with issues of certain securities, which partly automatises the replacement of bonds, especially when the bondholders are very dispersed, and also spreads pressure on the market. Systematisation of issues and the expansion in the volume of securities issued aim at boosting the array of investors from non-banking institutions, thus increasing the depth and liquidity of the domestic market. The development of the government securities market offers investors an opportunity to choose between safe securities of various maturity dates, while the Republic of Slovenia gets the opportunity to reduce risks involved in refinancing its debt.

Under the Republic of Slovenia Budget Implementation Act for 2000, total borrowings in this year are limited to SIT 150 billion. The most important instrument of external borrowing this year has been the ten-year Eurobond in the value of 400 million euros. The decision to issue another euro-denominated eurobond has been made on the basis of various reasons, namely lower exchange rate risk exposure, a lower margin in comparison to the margin on U.S. dollardenominated bonds, the fact that Slovenia exports most of its goods to the European Union, to improve the image of the Republic of Slovenia among investors in the EU market, and to expand the circle of investors. The Republic of Slovenia's long-term borrowings in the domestic market totalled SIT 17.2 billion by the end of April 2000. In addition, it continued to issue three-month and six-month treasury bills. The Treasury intends to begin with regular auctions of treasury notes in the second half of this year in an attempt to expand the range of short-term borrowing instruments.

On the basis of the borrowing already carried out in 2000, as well as the estimated borrowing requirements up until the end of this year, the central government debt is expected to increase by SIT 107.2 billion, so as to reach **SIT 1,000.5 billion** at the end of 2000, or **24.4% of the estimated gross domestic product**.

Table 27: Projected Movements in the Central Government Debt

in SIT billion

	2000	2001
Borrowing requirements	163.6	219.6
Interest Payments[1]	61.2	64.0
Principal Repayments[1]	118.1	174.4
Central Government Debt	1,000.5	1,100.2
Debt as a Share of GDP (%)	24.4	24.5

Note: [1]new borrowing in 2000 and 2001 is taken into account
Source: Ministry of Finance

The projections of the borrowing requirements and the amount of central government debt outstanding for 2001 have been made on the basis of an analysis of monetary flows of the state budget as well as on the basis of Guidelines for Slovenia's Development in 2001. Over the past few years, the budget deficit has been the main contributor to growth in the central government debt. The following is a comparison of the estimated primary balance with the computed stabilisation balance, which shows what the primary budget surplus or deficit would be if the ratio between the central government debt and gross domestic product were not to increase. The assumption that the budget deficit would amount to around 1% of gross domestic product is essential in forecasting the stabilisation primary balance surplus for 2000 and 2001. In 2001, the calculated stabilisation primary surplus amounts to 0.48% of gross domestic product. Given that the actual budget surplus is expected to exceed the stabilisation surplus in 2001, the share of central government debt in gross domestic product is expected to decline (by 0.7 of a percentage point), and is expected to remain on this level in 2001 as well. Assuming that macroeconomic projections are satisfied, the central government debt would remain sustainable.

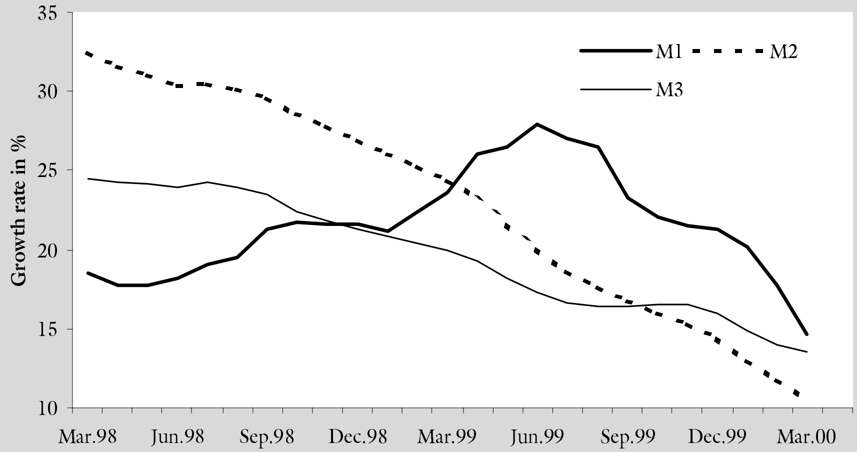
Increased volatility in exchange rates and the possibility of the continuation of such movements could significantly influence the development of the central government debt. However, the analysis of how sensitive debt is to exchange rate changes has shown that even if the budget deficit were to gradually drop to 0.9% of gross domestic product in 2001, the central government debt would remain sustainable even if the Slovenian tolar depreciated by 1% more than expected in 2000.

7.2 MONETARY POLICY – Intermediate monetary policy target in 2000: money aggregate M3 to range between 12% and 18%

The main objective of monetary policy of bringing inflation down to the level comparable to that in EU Member States, as defined by the Bank of Slovenia upon its founding, did not change last year, nor has it this year. The intermediate target in 1999 was to keep the growth of broad money aggregate M3 between 16% and 24%, whereby the Bank of Slovenia intervened on the foreign exchange market within confines of the M3 growth target and thus ensured that the exchange rate was as stable as possible. In the foreign exchange market, the Bank of Slovenia intervened by temporarily and finally selling foreign exchange. In addition, the Bank of Slovenia issued foreign exchange bills, set the foreign exchange minimum and signalised the foreign exchange rates. **The intermediate target of monetary policy** stays unchanged **in 2000**. The Bank of Slovenia has only changed its quantification and set **the target range of broad money aggregate M3 between 12% and 18%**.

In 1999, broad money aggregate M3 grew by 16% (in 1998 by 21.2%), which was at the lower boundary of the target range. The main channel of issuing M3 was the banking sector's lending to domestic clients, supply of M3 through foreign net assets in 1999 was slightly reduced due to the balance of payments outflows. Narrow money aggregate M1 grew by 21.3% (21.6% in 1998), while money aggregate M2 grew by 14.4% (27% in 1998). The structural changes in the growth of money aggregates resulted from increased demand for liquid assets in the first half of the year, changes in the currency and maturity structures of savings, as well as from the introduction of the foreign currency accounts for legal entities in September. Despite the contraction of money aggregates M3 and M2 until June 1999, narrow money aggregate M1 increased. In the last quarter of 1999 the average growth rate of money aggregate M1 started to decrease (due to lower demand for tolars), but money aggregate M3 increased (due to the introduction of foreign currency accounts for legal entities). The first four months of this year show that money aggregate M3 is still moving around the lower boundary of the target range.

Graph 11: Movements of money aggregates (year- on- year)



Source of data: BS.

In order to reach its goals for 1999 the Bank of Slovenia used **different instruments of monetary and exchange rate policies**. The most important instrument of monetary policy in 1999, measured by average daily amount outstanding, was Bank of Slovenia's tolar bills**,** although the average daily amount outstanding in 1999 fell compared to last year by approximately one-quarter. The Bank of Slovenia offered similar selection of bills as in the previous year, the only exceptions being the termination of bills with warrants and 270-day bills. In addition, the Bank of Slovenia increased temporary purchase of tolar bills, which compared to all instruments used in 1999, reached the highest average daily amount outstanding during the year. Interest rates on tolar-denominated bills were set according to the movement of inflation, whereas the interest rates on foreign-currency bills were determined to reflect the interest rates in the euro market. Among the instruments of monetary policy in 1999, loans acquired more importance than in the previous year. The largest share of all loans represented liquidity loans (approximately half of them being drawn on the basis of pledge of tolar bills), followed by lombard loans. Due to the change in maturity structure of bank deposits, the amount of mandatory reserves at the Bank of Slovenia grew by 13.4%, although the rate of mandatory reserves remained unchanged.

In 1999, the Bank of Slovenia's discount and lombard interest rates, the interest rate on banks' reserves and regular short-term loans remained unchanged, whereas the interest rate on liquidity loans for different maturity periods and the repo interest rate were changed several times. The interest rate of an overnight liquidity loan decreased from 10.5% in January to 7.5% in June, and remained unchanged until the end of the year. The interest rate for five-day liquidity loans also declined in March, from 9.4% to 8.5%. The repo rate was the most volatile, from 7.9% in January, it increased to 11.6% by April and thus reached its maximum, to gradually decline to 7.9% by August, and remained at around 8% until the end of the year.

The average nominal **interest rate on the interbank money market** declined last year (from 7.5% in 1998 to 6.9% in 1999), but fluctuated considerably during the year. In December 1999 it reached 6.9%, which was 1.3 percentage points higher than in December 1998. Last year, two explicit rises were recorded, one in April and one in May (to 7.9% and to 8.1%, respectively), when bank liquidity deteriorated. In the last quarter of 1999, it declined again, due to improved bank liquidity, and reached 6.7% in October.

In the first months of 2000 there were no major changes in monetary policy objectives. The Bank of Slovenia continued to conduct its restrictive monetary policy. It gradually raised the foreign exchange minimum, which is to be achieved by the licensed banks. The last change was made in May, when it was raised by 1.5% compared to the previous month, and by 10.2% compared to December last year.

The repo interest rate was gradually raised to 8.9% in April where it stayed until the first half of May. All other Bank of Slovenia's interest rates remained unchanged in the first four months of 2000. In May, the Bank of Slovenia raised the discount and lombard interest rates by one percentage point, to 9.0% and 10.0%, respectively, as a response to the rise of the inflation rate and inflationary expectations in the first months of the year. Due to the Bank of Slovenia's interest rate increase and changed conditions in the financial market, other interest rates also increased. The interbank interest rate increased in the first four months due to deterioration in banks' tolar liquidity and higher inflation rates (from 6.9% in December last year) and stabilised in the first part of May at 8.3%. On average, the interest rates on bills of the Bank of Slovenia also increased. The Bank of Slovenia abolished the possibility of companies taking out foreign exchange bills and is thereby continuing its efforts to settle corporate finances.

Until the end of 2000, as well as in 2001, the main objectives of the Bank of Slovenia's monetary policy will remain unchanged. Due to current macroeconomic conditions, it is expected that the Bank of Slovenia will not alter its intermediate targets nor the selection of implemented instruments. However, it is anticipated that the Bank of Slovenia would change its policy orientation towards more restrictive policy if **inflationary pressures, arising mainly from the domestic environment, pertained.**

7.3. INCOMES POLICY - Growth in wages lags behind productivity growth

In 1999 the social partners reached an agreement on incomes policy for a two-year period (up to the middle of 2001), which incorporates the basic incomes policy guideline of wage growth lagging behind labour productivity growth.

The wage adjustment mechanism in the Act on Minimum Wage, Wage Adjustment Mechanism and Holiday Allowance for 1999-2001 has not changed compared to the previous Act, meaning that, as a rule, wages are adjusted in January by 85% of the previous year's rise in consumer prices. 1999 was an exceptional year since, due to the introduction of VAT, an additional adjustment by 85% of the price rise in the first half of the year was made, i.e. 2.3%, and added to August's wages. Should prices reach a 6.8%-rise (excluding the price rise due to VAT), the "safety valve" of an early adjustment will be triggered. The method of calculating the price rise excluding the impact of the introduction of VAT was determined in the Act on Minimum Wage, Wage Adjustment Mechanism and Holiday Allowance for 1999-2001. The "safety valve" (early adjustment) was not used last year, since consumer prices rose only by 5.7% in December 1999 compared to December 1998.

In 1999, the gross wage per employee in Slovenia rose by 9.6% in nominal terms and by 3.3% in real terms. It was below the labour productivity growth (around 4%) by more than half of a percentage point.

The dynamics of growth in the average gross wage per employee in the **private sector**[59] was similar to previous years': moderate growth in the first ten months,

[59] The movement of wages in the private sector takes into account the wages of the first eleven classification activities (from A to K): Agriculture, Hunting, Forestry; Fishing; Mining; Manufacturing; Electricity, Water and Gas Supply; Construction; Wholesale, Retail, Certain

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mainly depending on the amount of working hours, followed by a high rise at the end of the year, based on profit-related payments. The real gross wage rose by 0.8% (by 0.7% in 1998 and 0.8% in 1997) in the first ten months (from January to October), and by 13.8% (in 1998 by 9% and by only 5% in 1997) in the last two months. During the year, the effect of the wage adjustment mechanism was insignificant: for example, wages in August nominally rose by 1.1%, which is far off the coefficient of possible growth according to the law (2.3%). According to the law, the basic wage defined in the collective agreement must be adjusted to consumer price rises, yet the actual basic wages in the private sector were higher than those defined in collective agreements and therefore adjustments in line with the price rise was not necessary. In 1999, the gross wage per employee in the private sector rose by 3.2% in real terms compared to the previous year, and in industry and construction by 3.1%.

The movement of wages in the **public sector**[60] depends heavily on the adjustment mechanism. Wages in the public sector are set on the basis of the basic wages defined in the collective agreement for the non-commercial sector. The rise of wages in this sector is affected by regular and extraordinary promotions in accordance with the Act on Wage Ratios in Public Institutions, Government Bodies and Local Community Bodies, and wage supplements resulting from working conditions and defined in the branch collective agreements. Public sector also includes the activity of personal and public services (O) since one-third of its employees belong in the public sector. Nevertheless, the movement of wages in this sector has the characteristics of the private sector. Due to a small number of employees, the movement of wages in this sector does not affect the movement of wages in the entire public sector.

In the last few years, the basic wages defined in the collective agreement for the non-commercial sector fell in real terms, the only exception was 1999, when they rose by 0.8% in real terms. As a consequence, without the system of wage supplements defined in the collective agreements wages in the public sector would hardly achieve positive growth in real terms. Unfortunately, these supplements were agreed upon partly and non-systematically and depended mainly on the negotiating power of the branch trade unions. At the beginning of 1999, the supplements for university teachers and researchers were raised. The

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Repair; Hotels and Restaurants; Transport, Storage, Communications; Financial Intermediation; Real Estate, Renting, Business services.

52 The movement of wages in the public sector takes into account the wages of the last four classification activities (from L to O): Public Administration, Defence and Social Security; Education; Health and Social Care; Public, Joint and Personal Services.

amendment to the collective agreement for education signed in 1998 was implemented in November 1999; accordingly the first quarter of the wage supplement was paid, meaning a 2%-rise of wages in education. In addition, the wage supplements defined in amendments to the collective agreement for health and social security and to the collective agreement for health care were paid, generating an 8%-rise in wages. Public administration also recorded a rise of wages due to supplements introduced by the Customs Service Act and the Tax Administration Act, and partially because of promotions and new employment. Since public administration records an insignificant rise of wages, it is difficult to attract qualified employees unless they are offered higher titles and by offering extraordinary promotions to the existing employed. In 1999, the gross wage per employee in the public sector rose by 3.7% in real terms, by 4.2% in public administration, by 3.3% in education and by 5% in health and social security.

Pursuant to the Minimum Wage, Wage Adjustment Mechanism and Holiday Allowance Act for 1999-2001, the wage adjustment mechanism in 2000 is to be triggered when prices rise by 4% compared to December 1999. If the price rise exceeds 5%, the rise above 5% has to be considered entirely when adjusting wages. As prices rose faster than estimated early this year, the early adjustment of wages will take place in the middle of the year.

Due to high wages at the end of last year, the **private sector** recorded a considerable nominal fall in the gross wage per employee in January (by 11.6%). In February, wages nominally remained at almost the same level as in January, but rose by 2.6% in March (because of the longer working month). If there is a continuation of the moderate rise of wages and an accelerated rise at the end of the year, **the gross wage per employee in the private sector is estimated to rise by 2.5% in real terms in 2000.**

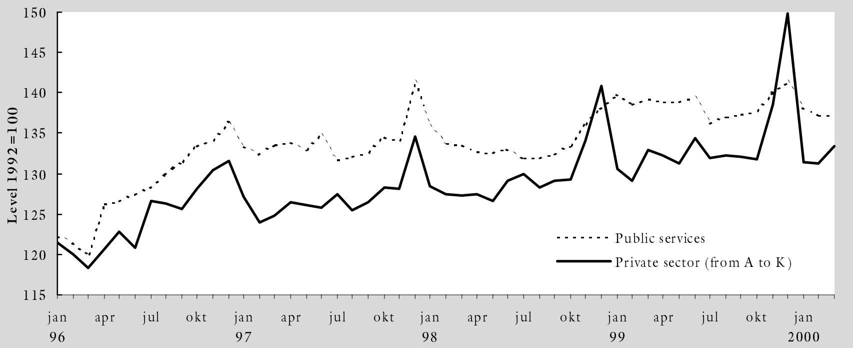
The **public sector** also recorded a fall in the average gross wage per employee in January, but only by 1.4%. In January, the regular adjustment by 85% of the consumer price rise of the second half of 1999 also took place, but the effects of the introduction of VAT were excluded. In January, only the health and social security sector saw a nominal fall in wages. There was a slight nominal wage rise in February and March, mainly due to a wage rise in education (the second quarter of the supplement agreed upon in the collective agreement was paid). The estimate of wages in the public sector in 2000 takes into account the actual movements in the first three months and the movements of wages in accordance with the law, the amendments to collective agreements and other regulations: (i) the anticipated rise of wages because of regular promotions (promotions take place every three years in all branches of the public sector according to the Act on Wage Ratios in Public Institutions, Government Bodies and Local Community Bodies); (ii) an early adjustment to the price rise in the middle of the year because the "safety valve" will be triggered; (iii) the payment of the second part of the wage supplement in education; and (iv) the wage rise in public administration in May by one-third of the wage supplement, as stipulated by the decree adopted in April. The decree provides for a rise in wages of employees in state institutions and local communities by a rise that was already carried out for the rest of the employees of the public sector by amendments to collective agreements; and (v) a wage rise of 1% in the public sector in December in accordance with the Annex to the collective agreement for the non-commercial sector. The above increases will lead to an estimated 2.5% real rise in the gross wage per employee in 2000. A stronger real rise in wages in the public sector in 2000 was expected last year, but the anticipated stronger rise in consumer prices will partly eliminate those increases.

In 2000 the gross wage per employee is expected to rise by 2.5%, which is more than one percentage point below the anticipated 3.8% labour productivity growth.

In 2001 the gross wage per employee is expected to rise by 2.3% in real terms and is to lag behind the estimated 3.8% labour productivity growth by one-and-a-half percentage points. The gross wage per employee is to rise in the private sector by around 2% in real terms and in the public sector by around 3%. The estimate for the public sector includes the rise in wage supplements, one in January and one in December 2001 (each resulting in a wage rise of 3.5%) adopted in accordance with the amendments to the collective agreement for education. In accordance with the decree adopted this year, wages in public administration will rise in January by the second third of the supplement and in July by the last third (each time by 2.3%). No other rises in supplement in other parts of the public sector have been considered. A new payment system is not likely to be adopted in 2001, therefore its effects are not considered in the estimation of wage movements in the public sector.

The **minimum wage**, determined by the Minimum Wage, Wage Adjustment Mechanism and Holiday Allowance Act for 1999-2001, is adjusted in the same way as wages, and additionally adjusted once a year by the real rise in gross domestic product for the previous year. The minimum wage is raised by the level of economic growth in the previous year until it reaches 58% of the average gross wage per employee set in the collective agreement for manufacturing. In the previous years, it reached as high as 53% of the average gross wage in manufacturing. Compared to EU countries which also have the institution of the minimum wage regulated at the state level either by law or a collective agreement (Belgium, Greece, Finland, France, Luxembourg, Netherlands, Portugal, Spain), the only country having a minimum wage higher than 53% of the average gross wage in manufacturing is Portugal. Up to now, the statistical data have shown a positive effect on containing wage dispersion. Interdecile ratio which indicates the relation between 10% of employees having the highest wages and 10% of employees having the lowest wages, remains around 3.4% (according to wage distribution data from September 1999).

Graph 12: Real gross wage per employee



Source of data: SORS, calculations IMAD. Note: index of real gross wage per employee (1992=100), deflated by consumer price index (December 1998=100).

After the stabilisation in 1998, **work-related allowances and other remuneration** rose considerably last year, by 11.5% nominally and 5% in real terms. **Payments based on contracts for work and author's fees** recorded lower growth compared to the previous year; they rose nominally by 2.6% and fell by 3.3% in real terms. The above payments reached 43% of the total wage bill in 1999 (in 1998 the share was 42.9%), but this year an accelerated rise has been recorded. Therefore, according to movements in the first three months, the above payments are anticipated to rise relative to the wage bill in 2000.

7.4. EMPLOYMENT POLICY – EU's employment policy guidelines followed, implementation of the programme poses a challenge

At the end of November 1999, the Government adopted the Strategic Goals of Labour Market Development up to 2006, the employment policies and its implementation programmes and the National Employment Action Plan for 2000 and 2001. These documents present a more active and broader approach towards employment policy in order to establish strong co-operation among individual ministries, institutions and social partners as well as a wide range of measures that might create incentives and do away with obstacles to employment. For this purpose, the Government and social partners established a group for monitoring and implementing the National Employment Action Plan for 2000 in 2001[61]. The proposed measures and programmes are based on the analysis of the situation in the labour market and the existing experience in employment policy as well as on priorities highlighted in the joint assessment on employment and labour market prepared last year by the Ministry of Labour, Family and Social Affairs together with the European Commission. The guidelines of EU employment policy for 1998 and 1999, establishing a four-pillar EU employment policy, were also taken into account.

The strategic goals of labour market development up until 2006, agreed upon both by the social partners and the Parliament, are as follows: to raise the educational level of employees; to reduce frictional unemployment, as well as structural and regional mismatch, and moonlighting; to provide active programmes for all young unemployed persons who in six months of unemployment have not found a new job; to increase the employment rate which should on average grow at more than 1% a year; and to reduce the unemployment rate by 2006 to approximately 6% according to the ILO criteria or to approximately 9% according to register sources. The attainment of these goals is important for the economic and social development of Slovenia in the coming years.

Last year's positive trends in the labour market were due to changes in the statistical coverage of unemployed persons performing public services or participating in regular training programmes, the lively economic activity, and the more active employment policy in the last two years. The policy changed from a passive to an active one thanks to the amendments to the Employment

[61] It includes 9 ministries and 4 representatives of the social partners.

and Unemployment Insurance Act adopted in October 1998. Last year, the number of compensation beneficiaries, reaching its second peak in the nineties at the beginning of 1998, dropped. The amended Law modified the conditions for entitlement to unemployment benefit and unemployment assistance, and strengthened the supervision over the work and job-seeking of the unemployed. Refusal of employment or of inclusion in the active programme, non-appearance at the request of the Employment Service or illegal work in fact means the end of entitlement to unemployment benefit or unemployment assistance.[62] Given the fact that the period of entitlement to unemployment assistance has been prolonged, the number of beneficiaries and the average duration of entitlement to assistance has increased. The total number of beneficiaries of unemployment benefit and assistance was, however, lower: the average number of beneficiaries shrank in 1999 by 10.1% compared to 1998, and compensation and assistance was granted to 31% of unemployed persons in 1999 (32.6% in 1998).

In the last two years, more than 60,000 unemployed persons a year have taken part in the active programmes. In 1998 and 1999, the number increased in particular with regard to persons participating in education and training programmes and the number of those performing public works. The Programme 5000, including training programmes for the unemployed at different levels of difficulty and intended to raise their level of qualifications, in the 1998/1999 year comprised 7,932 unemployed persons; by 31 August 1999, 62.4% of them had successfully terminated their studies, 20.1% had found employment during the course of the training programme or within six months of its termination. The number of people performing public works in the last two years exceeds 10,000. Moreover, the number of people performing public works who found regular employment after the termination of the programme increased from 17% in 1998 to 25% in 1999.

The National Employment Action Plan for 2000 and 2001 divides the measures and programmes into four basic pillars: I – improving employability, II – promotion of entrepreneurship, III – encouraging adaptability of businesses and employees, and IV – strengthening equal opportunities policies for men and women. Under the first pillar, programmes will focus on the prevention of further increases in unemployment, particularly among young people. By changing the system of vocational training, the rate of drop-outs from schools will be reduced (see Chapter 6.1), and there will be more incentives for adult

[54] For the above reasons, in 1999 the Employment Service of Slovenia stopped paying unemployment benefit to 258 unemployed persons and unemployment assistance to a further 132.

education. Despite the active employment policy, the problem of long-term unemployment has not been significantly reduced in the last two years (see Chapter 5.5). Under the second pillar, the programme of eliminating administrative barriers to the development of small- and medium-sized enterprises and the programmes for the stimulation of corporate culture among different target populations are very important. The activities under the third pillar will be directed towards modernisation of the organisation of work and stimulation of investment in the development of human resources. The programmes under the fourth pillar will provide equal opportunities for men and women and facilitate the co-ordination of professional and family life, and reduce and prevent social exclusion. Special programmes for disabled persons are planned as well.

Table 28: Number of people included in active employment programmes and the number of unemployment benefit and assistance beneficiaries

Number of persons included in active programmes	1996	1997	1998	1999
Training programmes (preparation for employment)	18,167	15,017	29,227	30,889[1]
Co-financing of internship	2,230	64	-	-
Co-financing of new jobs	-	-	987	848
Lump-sum unemployment benefit payments	881	562	17	19
Self-employment (income from self-employment)	2,310	1,590	1,630	1,643
Public works - total number Average monthly no. of people performing pub. works	4,728 2,655	5,354 2,826	10,641 4,654	10,296 5,450
Training of disabled people	1,453	1,088	1,182	957
Co-financing of jobs for the disabled	99	115	57	35
Medical care	1,965	2,382	2,742	3,284
Subsidies to sheltered workshops	3,530	4,036	4,895	5,424
Co-financing of redundancy programmes:				
- Project 11	-	6,618	10,299	2,275
- retraining	2,086	1,596	1,127	
Refunding of contributions to employers according to Art. 48.a	1,596	1,178	1,172	6,223
Refunding of contributions to employers according to Conditions for Refunding Act	799	667	717	-
Labour funds	-	-	1,473	1,057
Surpluses in state enterprises	-	-	-	360
Rehabilitation and restructuring of enterprises	-	-	-	145
TOTAL PARTICIPANTS IN ACTIVE PROGRAMMES	39,844	40,267	66,166	63,455
Number of unemployment benefit beneficiaries (end of year)	33,715	37,152	36,082	31,227
Number of unemployment assistance beneficiaries (end of year)	4,112	3,734	2,818	3,283
Number of unemployment benefit and assistance beneficiaries compared to average number of unemployed persons	30.3	32.6	32.6	31.0

Note: [1]The number includes new participants to the preparation for employment programmes in 1998, the members of job-search clubs and participants in the Programme 5000 in the 1998/1999 school year.
Source: Employment Service of Slovenia, 1999 annual report.

In addition to the existing active employment programmes, which could also have been divided into a four-pillar employment policy in the past few years, the National Employment Action Plan provides several new programmes. These often require co-operation among ministries and the active involvement of the social partners at the national and local levels. The National Employment Action Plan for 2000 and 2001 provides several programmes, measures and activities which could contribute to positive trends in the labour market in the coming years. Some of them were adopted this year and will be gradually implemented. Implementation of the entire programme will clearly pose a great challenge to the Government, local communities and social partners. It will also increase the amount of work of the Employment Service, which continues to be one of the most important implementing organisations of the action plan. In order to attain the goals and increase the efficiency of employment programmes for the unemployed, it will be necessary to offer consultations to each unemployed person. Only in this way will the unemployed be directed towards programmes that most efficiently contribute to the realisation of a person's own employment plan. Moreover, successful implementation of the programme also depends on the establishment and providing of conditions for the work of other implementing organisations.