

ALLOCATIVE EFFICIENCY AND PRODUCTIVITY IN SLOVENIA

Summary

Slovenia's GDP per capita is approximately one fifth lower than the EU average, the gap being mainly due to lower productivity. By enhancing productivity and with policies ensuring a more equal distribution of income, Slovenia could improve the standard of living and welfare of its population. Productivity as a driver of material welfare will gain importance in the future due to the expected contraction of the working-age population (as a consequence of demographic change). While Slovenia had been closing the gap behind the most productive economies in the previous decade, the slower productivity growth following the crisis no longer suffices for a faster convergence to the average level in the EU. Enhancing productivity is a challenge for all sectors. Manufacturing industries have in fact reduced their gap with the EU the most since the crisis; but the progress made by services, knowledge-based services in particular, has been more modest. The subdued productivity growth during and after the crisis has been attributable not only to cyclical but also to structural factors, which are indicated particularly by a significant fall in the contribution of total factor productivity to labour productivity growth.

An improvement in total factor productivity could be significantly enhanced by a more efficient allocation of production factors. The results of empirical analysis show that total productivity could increase considerably were production factors (labour and capital) allocated more efficiently. The extent of the improvement would be comparable with the results for countries similar to Slovenia in terms of development. The efficiency of the allocation of production factors in Slovenia deteriorated further after 2005 and began improving only after 2013. The lower efficiency or a worsening of efficiency in the period before and during the crisis was typical particularly for service activities, which may also be related to the lower level of internationalisation, a lack of competition and higher regulatory barriers to the efficient functioning of companies in this sector.

The main barriers to productivity in Slovenia are the institutional framework and knowledge-related factors. The factors affecting productivity are divided into factors within businesses and those in the external environment. The latter refer to the conditions of allocation or the efficiency of distribution of production factors among companies. Slovenia has made significant shifts in this area in the last two decades, but the improvements were insufficient to be able to keep pace with the adjustments made by its main trading partners. The barriers in the area of knowledge are related to the insufficient ability of companies to keep pace with technological progress. They are a consequence of the education system not being sufficiently adjusted to labour market needs, and the lack of willingness among managers to tackle the challenges and introduce modern technologies.

Economic policy can directly affect productivity, particularly via factors in the business environment, while its effect on factors within businesses is indirect and occurs with a longer lag. Long-term structural measures can contribute the most to the elimination of factors that impede the optimal allocation of production factors. Given the deficiencies identified, the priority measures of Slovenian economic policy in terms of productivity enhancement should be focused on knowledge, innovation and the institutional framework. These are the key areas that can help increase productivity over the longer term. The current conditions of stable economic growth support the introduction of structural changes in these areas¹, as appropriate policy measures could turn the cyclically boosted kick-start of the economy into structural long-term based growth.

¹ See also the analysis *Assessing the Effects of Some Structural Measures in Slovenia* (IMAD, 2016).