



CENTRE FOR CO-OPERATION WITH THE ECONOMIES IN TRANSITION

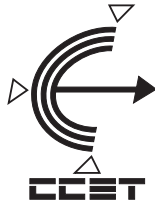
OECD ECONOMIC SURVEYS

SLOVENIA

1997

SPECIAL FEATURE

ECONOMIC
AND
FINANCIAL RESTRUCTURING



CENTRE FOR CO-OPERATION WITH THE ECONOMIES IN TRANSITION

OECD ECONOMIC SURVEYS

1996-1997

SLOVENIA

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

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BASIC STATISTICS OF THE REPUBLIC OF SLOVENIA (1995 unless noted)

THE LAND

Area (sq. km)	20 256
Agricultural land (in per cent of total area)	36

THE PEOPLE

Population (thousands, mid-year)	1 987.5	Employment (thousands)	882
Projected population growth rate, per annum (1996-2001)	0.1	Employment by sector (percentage of total)	
Life expectancy at birth: male	69.6	Agriculture	11
female	77.4	Industry (including construction)	43
Infant mortality (per thousand live-births, 1994)	5.5	Services	46
Registered unemployment (percentage of the labour force, 1996)	13.3		
Labour force survey unemployment (percentage of the labour force, mid-1996)	7.3		
Recipients of pensions (excluding disability: thousands)	358.6		

PARLIAMENT (1996 elections)

Government coalition	{	Democratic Pensioners' Party	5
		Liberal Democrats	25
		People's Party	19
		Christian Democrats	10
		Nationalist Party	4
		United List of Social Democrats	9
		Social Democrats	16
		Two seats are reserved for the Italian and Hungarian minorities	

PRODUCTION

GDP (billion tolar, current prices)	2 202
GDP per capita (US\$, purchasing power parity exchange rate)	10 521
Gross fixed capital formation (percentage of GDP)	21.2

PUBLIC FINANCE

General government budget balance (percentage of GDP)	0
General government revenues (percentage of GDP)	46.1
General government expenditures (percentage of GDP)	46.1
Public debt (end-year, percentage of GDP)	28

FOREIGN TRADE AND FINANCE

Exports of goods and services (percentage of GDP)	56
Imports of goods and services (percentage of GDP)	57
Foreign exchange reserves (mn US\$, December 1996)	4 116
Gross external debt (mn US\$, December 1996)	4 001

CURRENCY

Monetary unit:	tolar
Currency units per US\$ average of daily figures:	
Year 1996	135.4
January 1997	145.7

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This is the first OECD Economic Survey devoted to Slovenia.

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This Survey is published under the responsibility of the Secretary-General of the OECD.

Assessment and recommendations

One of the most advanced transition countries...

Slovenia, a newly independent state from June 1991, occupies a unique place among the economies in transition in Central Europe. In terms of its degree of development, the Slovene economy can in many respects be viewed as closer to Western European countries than to the other former-socialist states of Central Europe. For example, the level of GDP per capita in Slovenia (measured on an exchange rate basis) is currently two to three times that of other Central European states (including the Czech Republic, Hungary and Poland), close to that of Greece and Portugal, and one-third to one-half the level of Austria, France and Germany. The “lead” over other countries in Central Europe is substantially smaller when GDP is compared according to purchasing power parities because prices are, in many cases, also comparable with those in Western Europe.

... with long-standing openness to trade and market processes

Many of the distinctive features of Slovenia were already apparent at the time of independence from the former-Yugoslavia. It is therefore crucial to an assessment of Slovenia’s *current* performance to understand the country as it *was*, prior to independence and prior to transition to a full market economy. In this regard, two areas seem of particular importance. The first concerns the openness of the economy and the freedom of circulation of people and products across Slovenia’s borders. Slovenia was the principal trading arm of former-Yugoslavia, itself the most open economy in Central and Eastern Europe. Moreover, most of this trade was with more advanced market

economies in the West: Germany and Italy were Slovenia's main trading partners in 1990, together taking 40 per cent of exports. Second, enterprises in former-Yugoslavia were characterised by a system of self-management and social capital, the so-called 'market socialism'. This system of decentralised control, where markets were allowed to play a significant role in the allocation of resources throughout the economy, stood in contrast with the much more centralised economic management that prevailed elsewhere in Central and Eastern Europe. As a result of these two characteristics, the overall familiarity with market mechanisms was more developed in Slovenia than in other countries. Consequently, the various aspects of product competitiveness, including quality and variety, were better understood when the transition process started. This made possible a rather rapid catch-up with western standards and practices that has been taking place since the early 1990s. These aspects are visible and striking for a visitor during his or her first contacts with the Slovene economy. Nevertheless, despite this relatively favourable situation, Slovenia can rightly be viewed as an economy in transition. Market socialism, combined with the break-up of former-Yugoslavia and its aftermath, have left a legacy of difficulties at both macroeconomic and structural levels. These will be discussed below.

After the transition shock, growth resumed earlier than in other transition economies. There was a rapid trade re-orientation and the economy was stabilised

Slovenia was among the first transition countries where growth resumed. The recovery started in 1993 with GDP growth of 2.8 per cent, improved to 5.3 per cent growth in 1994 and 3.9 per cent in 1995. In 1996, GDP growth is estimated to have been around 3.5 per cent and Slovenia recovered the GDP level of the pre-transition years. Domestic demand, notably final consumption, has played a large role in recent growth, reflecting in part the large and growing share of the service sector in the economy. The importance of foreign trade becomes much more apparent when industrial output is considered. Indeed, after a deep

contraction from the late 1980s, growth of industrial output accelerated to an impressive 6.4 per cent in 1994. This was made possible by the massive trade re-orientation towards the West, especially Europe. By 1995, the geographic structure of Slovene trade had become dominated by the OECD countries, which account for roughly 80 per cent of trade turnover. Germany is the leading trade partner with 30 per cent of Slovene exports and 23 per cent of imports. This trade re-orientation accentuated the openness of the Slovene economy, where the ratio of exports plus imports of goods and services to GDP reached around 110 per cent in 1995. The current account has been roughly in balance in recent years. At the same time, and consistent with these favourable trade developments, during 1992 and 1993 macroeconomic stabilisation was particularly successful in bringing down inflation from around 300 per cent to just over 20 per cent; then, in late 1995, the inflation rate moved into single digits for the first time since 1976. A main pillar of the stabilisation programme was a prudent fiscal discipline, embodied in a roughly balanced consolidated budget since 1992. Concerning the costs of transition, structural change in the economy has led to a significant rise in unemployment. Nonetheless, when measured by ILO standards, the unemployment rate after peaking at 9.1 per cent in 1993 has declined to just over 7 per cent in 1996.

But, recently, output growth and exports have slowed down and macroeconomic policies for 1997-98 are coming under pressure

After the strong surge in 1994, industrial output was up only by 2 per cent in 1995 and the slowdown continued until the first quarter of 1996. In 1996, output was 1 per cent higher than in 1995. Moreover, total exports of goods (in current US\$ terms) were approximately the same in 1996 as in 1995, although they are estimated to have increased by around 2.5 per cent in real terms. Recent output trends may be attributable in part to a lagged effect of a significant and steady deterioration of export competitiveness due to the real exchange rate appreciation (on a

price basis) from mid-94 to mid-95 and nominal wage increases which were not fully compensated by productivity growth. The worsening economic conditions in the EU in general, and Germany in particular, are also likely to have been an important factor explaining this slowdown of industrial output. Given the concentration of trade with EU countries, Slovenia is naturally rather dependent on the economic developments of these trade partners. The slow pace of restructuring in some parts of the economy is also now starting to impinge on the sustainability of economic growth. There are also some signs that macroeconomic policies are progressively losing their impetus in the stabilisation of the economy. For example, retail price inflation increased from 8.6 per cent at end-1995 to above 10 per cent in the first half of 1996 before decreasing again to 8.8 per cent in the year to December 1996. Inflation of around 10 per cent is still far higher than in the OECD economies with which Slovenia is increasingly integrating, and is well above the range where policy-makers should be aiming. On the fiscal side, and despite the fact that the general government budget for 1996 is roughly in balance, the continuation of favourable fiscal outturns in future years will depend on a firm policy stance being implemented towards some areas of structural reform discussed below.

The outlook seems much dependent on the policies to be implemented by the new government

Sustained by improved conditions in foreign markets and competitiveness, exports are picking up again. This should help real activity to strengthen somewhat for 1997 and 1998, with a projected 3.5 to 4 per cent increase in GDP in each of these years. Improved export performance should also maintain a near-balanced position in the current account. However, little change is expected in the inflation rate as there will be upward pressures on prices from further liberalisation of controlled prices (including energy). Moreover, while the precise effect on prices of the proposed introduction of a new value-added tax is still to be

determined, it will presumably contribute to inflationary pressures. Unemployment may decline slowly, but there appear to be substantial structural elements in current unemployment – including concentration of unemployment among the low-skilled and in regions which used to be heavily industrialised. These projections assume that the new government implements a range of proposed fiscal measures and tackles some much-needed areas of spending reform. A firm fiscal position provides the appropriate conditions for the allocation of economic resources to be driven primarily by market mechanisms, so that they flow to the most productive sectors in the economy. In a small open economy like Slovenia, consistency between macro and structural areas of policy reform seems particularly crucial to maximise the chances of sustained growth.

Monetary policy has faced significant pressures from capital inflows, with some unevenness in the pace of disinflation

In the conduct of monetary policy, the Bank of Slovenia's operational emphasis is on the growth rates in the narrow money aggregates. Firm control over monetary growth was instrumental in the rapid disinflation achieved after 1991. While, correspondingly, the exchange rate is allowed to float, its level and direction have nevertheless been influenced at times by various forms of intervention by the Bank in the foreign exchange market. For example, faced with large current account surpluses from 1992 to 1994, the Bank engaged in large-scale intervention and sterilisation in order to limit the impact of these surpluses on the exchange rate and money supply. However, the high costs of these activities subsequently led to their being curtailed. The period from around early-1994 to mid-1995 was marked by general stability in the nominal exchange rate and strong appreciation in the real exchange rate, leading to a further sizeable fall in the inflation rate. With the current account moving into deficit in the second half of 1995, the tolar depreciated sharply – by around 10 per cent against the Deutschemark – in the six months to March 1996, before

stabilising again. This depreciation, along with increases in some controlled prices, contributed to the pick-up in inflation in the first half of 1996.

There is need to make the goal of low inflation more transparent and credible in order to increase confidence in the tolar

The key requirement now facing the monetary authorities is to establish in a transparent manner that low inflation is indeed their main objective, and to demonstrate that policy is clearly and consistently directed towards this goal. In general, the Bank needs to take on a higher profile in order to “lead” public opinion and expectations regarding the prospects for further disinflation, and to build confidence in the currency. Persistent uncertainty about inflation and exchange rate developments is suggested by the high level of foreign currency deposits still held at Slovene banks (a development which can be originally explained by the “memory” of the hyperinflation period). Currently, around 60 per cent of household deposits are held in this form, and these deposits have been steadily increasing.

Greater publicity for monetary policy operations and objectives would help build credibility

With financial liberalisation, including further opening of the capital account, the need for a broader set of monetary indicators relevant for reaching inflation objectives may arise. This need not imply a departure from the current regime combining money aggregate targets and a floating exchange rate. Nevertheless, given the openness of the economy, exchange rate developments are likely to play an important role in further disinflation. In recent years, lack of transparency in policy operations – including the role of the exchange rate – has at times created room for doubt about whether the Bank’s main objective has been to maintain the disinflation process or support external competitiveness. In this regard, the Bank’s operational objectives would be more transparent, if published. Such statements could include indicative scenarios or projections for factors expected to influence the inflation outlook, including changes in controlled prices. These scenarios would help to

illustrate the trade-offs involved with different economic choices (such as the implications of higher wage growth), would provide a benchmark for assessing actual monetary conditions, and hence would help financial markets and the public to understand and anticipate policy adjustments. Support is also needed from other areas of policy in winding down inflation. For example, ongoing fiscal restraint would ease the pressure on monetary conditions; de-indexation of wages and interest rates is essential; and further labour market liberalisation would give enterprises greater opportunity to take direct responsibility for maintaining and building their competitiveness.

A budget consolidation strategy is needed to handle the problem of excessive wage growth in the public sector...

As part of the stabilisation package implemented in the early 1990s, a year-to-year balanced budget approach was followed. Looking ahead, however, a more comprehensive medium-term strategy is needed to ensure stability of the macroeconomic environment. In this regard, there are two key areas of reform. The first is related to the increasing wage expenditures. Under social pressures, public sector wage policy has led to the equalisation of wage growth in the so-called economic and non-economic sectors. However, recruitment and retention requirements within overall budget ceilings should be the prime mechanism for setting wages in the public sector. In order to let resources flow to the private sector and achieve better allocative efficiency, the labour market should be allowed to establish firmer links between productivity gains and real wage growth and, in this context, sectoral differences in wage growth should be expected. An excessive focus on average public wage growth has been inducing spill-overs to the rest of the economy and creating budget pressures.

*... and to solve
the long-run
unsustainability
of the pension
system*

A second key area of macro-structural policies is the reform of the pension system. Perhaps also part of the “closeness” of Slovenia to some more advanced Western European economies, the present pension system is unsustainable. In the present system, pensions are provided almost exclusively through a state-run, pay-as-you-go system. Funding comes from social security contributions and transfers from the state budget. These resources will in the future produce a dramatic shortfall compared with the liabilities. The main factors explaining this trend are the rapid ageing of the population and the early retirement policies of the period 1991-92. The elderly dependency ratio is projected to rise from 48 per cent in 1995 to over 90 per cent by 2040. This is also substantially higher than projections for any other OECD country with the exception of Italy. As shown by the simulations presented in the Survey, an increase in the standard retirement age should be considered as part of policy reforms in this area and one of the more direct ways to address this problem. So far, the reform model which seems to be favoured by the authorities would involve a three-pillar pension system, comprising the continuation of a “slimmed-down” version of the current pay-as-you-go scheme, the introduction of compulsory personal pension accounts managed by mutual, public or other forms of funds, and voluntary additional pension savings. These lines of reform seem consistent with recommendations of the major international financial institutions and broadly comparable to reforms currently being implemented in a number of OECD countries. It is important that decisions to reform the pension system take place as soon as possible. Moreover, other policy actions are also needed to ensure the viability of the new system. Among others, an effective regulatory regime has to be put in place to ensure the financial soundness of the pension funds and to promote competition among them. The maintenance of fiscal restraint and low levels of public debt will help provide

greater room for manoeuvre as pressures of the pension system on public sector budgets increase. Finally, further progress toward low inflation and overall monetary policy credibility will encourage growth in long-term financial planning among market institutions and the public in general.

The process of rehabilitation of the banking sector seems in better shape than in most transition countries

Following several years of restructuring, the Slovene banking sector now appears to be in relatively good health compared with other countries in transition. A major rehabilitation programme began in 1993 when the two largest banks were placed under the control of the Bank Rehabilitation Agency. At the time, these banks comprised over half the domestic banking sector and around 45 per cent of their loans were non-performing. Since then, asset quality and financial performance in the sector have significantly improved: the rehabilitated banks now have under 5 per cent of loans which are non-performing, and they along with almost all other banks are currently profitable.

But increased competition and more diversified financial intermediation services are needed as part of the overall restructuring process

However, the need for further development and restructuring is still apparent. While the dominance of the two largest banks has fallen, there are also many small banks which are relatively over-capitalised, but not very efficient. Many of these small banks will probably have to be absorbed by larger banks over the next few years. Despite the large number of banks (28), the financial sector is rather shallow, with the ratios of money aggregates and bank assets to GDP being relatively low in comparison with other countries in Central Europe and with the OECD area. More sophisticated products and services, such as investment banking, are under-developed, and only around 40 per cent of bank assets are in the form of loans to enterprises and other non-financial, non-governmental entities. Moreover, competition in the market for deposits is artificially curtailed through a cartel arrangement – approved by the

anti-monopoly office and the Bank of Slovenia – which sets maximum interest rates on deposits. In addition, close links still appear to exist between some banks and enterprises that are both their owners and clients. This situation, along with state-ownership of the largest banks, raises risks of moral hazard. In most of these areas – with the exception of the deposit cartel – there is little that the government should do in a direct way to produce restructuring and the development of financial services. However, various policy measures should provide more neutral competitive conditions in the sector, and hence encourage market-based reforms. Some of these measures are included in the new Banking Act which is expected in 1997; they include the opening of the sector to branches of foreign banks, and the introduction of a deposit guarantee scheme. A further key step involves the privatisation of the two large banks under the control of the Bank Rehabilitation Agency. Based on their financial performance and condition, these banks now appear ready for privatisation. For Slovenia to receive full value for its investment in these banks, foreign bidders should be encouraged to take part in the privatisation process, a move which should also lead to more rapid growth in domestic banking services and expertise. Finally, while the deposit cartel may have led to short-term reductions in some interest rates, this arrangement is not compatible with longer-run needs to boost competition and innovation, and should be dropped. A “problem” that contributed to the perceived need for such a cartel – apparently the deposit behaviour of certain extra-budgetary funds – would be better dealt with by integrating these funds into the main fiscal monitoring and control regime.

Privatisation has been a complicated process which is near to completion

Transformation of the former “socially” owned enterprises into both private and state ownership has been a complicated and slow process which is expected to be finished some time in 1997. By the end of 1996, the share of the private sector in the economy, which has been increasing gradually, passed the 50 per cent mark of value added and employment. At the end of the current privatisation process, the breakdown of value added is expected to be around two-thirds private and one-third public.

However, the conditions for improved corporate governance may not yet be fulfilled

The privatisation of previously socially-owned enterprises does not necessarily, by the very fact of privatisation, change their incentive structure. Indeed, all that the privatisation did was to transfer the ownership rights to a diverse group of institutional investors, insiders, and small (outside) investors, with different interests and areas of expertise. For this reason, there are pending problems with institution building and corporate governance. Insiders tend to be averse to external control (both foreign and domestic), slowing the process of change in the short-run. More dynamic, market-based restructuring may nevertheless occur in the longer-term, including increased foreign investment, but will need support from other areas. For example, it is important for the proposed law on take-over and merger actions to be passed and implemented. While it is well understood that there is the need to liberalise capital and labour markets, firmer policy action in these areas is needed.

After the boom in the early years of transition, the process of enterprise creation did not gain momentum...

Given the more favourable starting conditions of Slovenia, as already mentioned, enterprise characteristics appear to be better than in other countries in Central Europe. For example, Slovenia already has a high proportion of small enterprises, which makes the enterprise structure close to the EU average. In addition, the role of very large enterprises (*i.e.* with 5 000 or more employees), generally with major

re-structuring problems, is also less significant in Slovenia. The number of “dormant” or “dead” enterprises is also under 10 per cent in Slovenia – by far the lowest among the central and eastern European countries. However, the creation and development of new enterprises is crucial for the restructuring process, and as important as the privatisation process itself. Indeed, some evidence gathered for other transition countries tends to show that, in many aspects, the performance of (still) state-owned and privatised companies tends to be comparable whereas the *ex novo* firms stand out both in terms of productivity and employment creation. In this regard, there are some signs that the pace of enterprise creation in Slovenia slowed down in recent years. A simple relation between income levels and enterprise density estimated for a group of transition countries suggests that there is scope for further enterprise creation in Slovenia. Despite a favourable economic climate and legal environment, the high level of real interest rates does not support investment and the creation of new firms. This illustrates the need for macroeconomic policy to be consistent with and reinforce structural policies.

***... and some big
loss-making
companies are
crowding-out
resources
from the new
private sector***

Concerning the degree to which hard budget constraints are ensured at the enterprise level, the evidence in aggregate is that most commercial companies are currently earning profits, but there is still a core group of large, loss-making enterprises. These are probably the main recipients of support provided by the state via some extra-budgetary funds and through subsidies from state and local budgets. While such support may find justification in the adjustment “shocks” faced by these firms and the local communities in which they operate, it is essential that assistance be of limited duration and directed at restructuring the operations of these companies, preserving the viable parts (if any) of their activities and eliminating unprofitable areas. It is striking that among the top 20 Slovene enterprises, only roughly

half are displaying significant returns to capital. This also suggests limited progress in restructuring the core of large Slovene enterprises. This transition process can be painful because many of these unstructured enterprises are also among the largest employers. However, this should not block the restructuring process itself. The risk otherwise is that these companies would be a long-term drain on public resources, and the emergence of new, potentially profitable firms would be crowded out.

Economic restructuring could be enhanced by increased participation of foreign capital

In per capita terms, Slovenia already has – by central and eastern European standards – significant foreign capital participation. Nevertheless, the involvement of foreign investors in the economy could be more important, especially because during the privatisation process there has been some hesitancy to accept foreign capital in Slovene enterprises. Available evidence on the performance of firms having foreign investment participation compared with firms having exclusively domestic capital points out a positive association between foreign capital participation and enterprise performance. Even if foreign investors would naturally have been attracted to companies which were strong to begin with, the indicators such as those relating to financial structure and asset utilisation in these enterprises suggest the sort of standards applying in more advanced economies, and which should therefore signal the direction of restructuring that should be expected of Slovene enterprises. Slovene policy-makers endorse the principle that direct state intervention in the activities of FDI units should be avoided. Nevertheless, Slovenia has to make further progress in the liberalisation of capital movements and financial sector reform in order to open the economy to foreign direct investment. This should be based on stable macroeconomic conditions and transparent regulations, notably equal treatment of foreign investors and domestic enterprises.

Industrial policy should not distort the comparative advantages of the Slovene economy, which appear to be light industries with a relatively high content of R&D and product differentiation

Analysis of trade specialisation shows that Slovenia possesses the advantages of a skilled and productive work force combined with a relatively high degree of product differentiation. These characteristics enable firms operating in product niches to be competitive in rather sophisticated segments of the manufacturing sector. Industries relying merely on cost advantages are in the medium and long-term threatened by the potentially strong competition of neighbouring transition countries, whose industries still have a substantial competitive edge in a context of rapidly increasing productivity. Therefore, the competitive advantages of Slovenia seem to be situated more in terms of quality or product differentiation than in terms of prices. Policies that would aim to restructure heavy loss-making enterprises in traditional industrial sectors would seem to be in contradiction with the structural characteristics of the Slovene economy and, in the end, could only impinge negatively on the overall restructuring process. Some suggestions to target the promotion of fast growing enterprises do not seem appropriate. Even with the aim of favouring light industries and sectors with a high degree of product differentiation, policies have to be horizontal. Only continued openness to international markets and a good diffusion of technology and information can ensure the economic restructuring which is needed in Slovenia.

The unemployment benefit system needs to be more firmly administered

The labour force and employment fell sharply in the early years of transition but (according to survey data) have generally been increasing since around 1993. Some decline was evident in 1996, however, reflecting the broader economic slowdown at least in the earlier part of last year. Encouraging trends in employment growth of recent years have included the re-orientation of employment away from industry and towards services, and the growing importance of the small business sector. Surveyed unemployment is around 7 per cent at present. Registered unemployment is

nearly double this level and is usually the policy target, although this measure includes a large number of people who are either working, or not seeking or available for work. Only around one-third of the registered unemployed receive unemployment benefits. However, there is also a large increase in the “escape rate” to employment near the point of benefit exhaustion. This suggests that there is scope for tightening the administration of benefits – for example, to ensure that recipients comply with eligibility requirements including job search, work-readiness and limits on additional income.

Wage setting should be more decentralised and indexation mechanisms should be phased out

Real wages declined between 1989 and 1992, but since then have increased rather rapidly. In 1996, real wage growth is estimated to have been 5.0 per cent, including 6.6 per cent in the non-market sector. There is also extensive indexation of wages to past inflation. Recent wage growth is well above the level agreed to in the tri-partite Social Agreement, which *inter alia* targeted real wage growth in 1996 at 2 per cent below the rise in GDP. Wage restraint and rapid productivity growth are important if Slovenia is to maintain its international competitiveness and provide owners with the resources needed for restructuring and investment. The high level of non-wage labour costs is also of concern. Overall, gross labour costs are nearly double net earnings, a situation which risks impairing employment growth and competitiveness. Recent reductions in employer social security contribution rates are therefore welcome, and ongoing spending restraint in this area, leading to further reductions in contribution rates, should be sought. Other elements of labour costs, including wages themselves and the range of allowances and bonuses currently in place, should be subject to negotiation between the parties directly affected by these bargaining processes. In this regard, current bargaining arrangements appear to comprise an awkward mix of centralised and decentralised

elements in which no party takes full responsibility for the outcomes. Further decentralisation of bargaining to the enterprise level would encourage the owners, managers and employees of each firm to take its financial performance and competitive requirements directly into account in labour negotiations. It is important for current indexation provisions to be progressively phased out from wage-setting arrangements. Such a step would support the disinflationary stance of monetary policy.

***Wrap-up:
are reforms
sufficiently active
to put Slovenia
on a convergence
path with more
advanced
economies?***

In summary, the transition process to this point has been marked by a largely successful programme of macro-economic stabilisation, coupled with substantial reform of trade relations and the banking sector and progress in enterprise restructuring. Contributing to these developments has been the relatively favourable starting point of Slovenia compared with other transition economies in terms of familiarity with market processes and external trade. The challenge now is to build on this strong base that has been established. In this respect, Slovenia can be viewed as at a threshold where policies implemented in the next two or three years will be crucial for maintaining the pace of economic transformation. Clear progress towards further lowering of inflation and containing fiscal pressure is needed, and these measures need to be integrated with the labour market, social, and financial reforms outlined above. Consistency between these macroeconomic and structural reforms provides the best prospect of ensuring sustainable improvements in external competitiveness and reductions in domestic interest rates, elements which are essential for ongoing enterprise development and overall economic growth.

I. Background and recent developments

Setting the scene

Slovenia became an independent state in June 1991, after the break-up of the former-Yugoslavia. This country of roughly 2 million inhabitants then faced the challenge of re-orientating production and trade towards international markets. However, Slovenia started the transition process in better economic shape than other transition countries and the other republics of the former-Yugoslavia. Among other European transition countries, Slovenia had the advantage of already having a market-based economy, although with restrictions on property rights and on the use of capital. In Yugoslavia, Slovenia was the wealthiest and the most western-oriented region. With only 8 per cent of the total population, Slovenia generated 18 per cent of the social product¹ and 20 per cent of Yugoslavia's total industrial output in 1990.

Regional disparities were rather large in the former-Yugoslavia. The social product per capita in Slovenia was about double the national average, and eight times that of the much less developed province of Kosovo.² This polarisation far exceeded the dispersion of regional per capita output of most OECD countries. The uneven regional development was also reflected in sharply diverging regional unemployment rates. Compared with the Yugoslav average of about 15 per cent at the end of the 1980s, Slovenia's unemployment rate stood at only 3 per cent, while that of the less developed regions (Montenegro, Bosnia and Herzegovina, Macedonia, Kosovo) was 23 per cent. Some economic and social indicators comparing Slovenia with overall Yugoslavia are shown in Table 1. In addition to the output and unemployment comparisons, also noteworthy is Slovenia's leading position with respect to education and health indicators (although the dispersion within former-Yugoslavia with respect to social measures, such as educational attainment, was generally smaller than the differences

Table 1. **Economic and social indicators before the transition**
1989 and index Yugoslavia = 100, unless otherwise indicated

	Slovenia	Yugoslavia
Real gross social product per capita	198	100
Exports as share of GDP (per cent)	22.2	17.9
Unemployment rate	3.2	14.9
Public expenditure per capita		
Education	198	100
Health	201	100
Mean years of schooling (1986)	113	100
Literacy	122	100
Higher education enrollment rate	130	100
Cars per 1 000 inhabitants	293	146

Source: Statistical Office of the Republic of Slovenia; OECD.

in economic indicators). In terms of GDP per capita comparisons (Table 2), Slovenia has had a significant lead over other central and eastern European economies and, amongst OECD countries, has been relatively close to Greece and Portugal.

Table 2. **GDP per capita**
US dollars

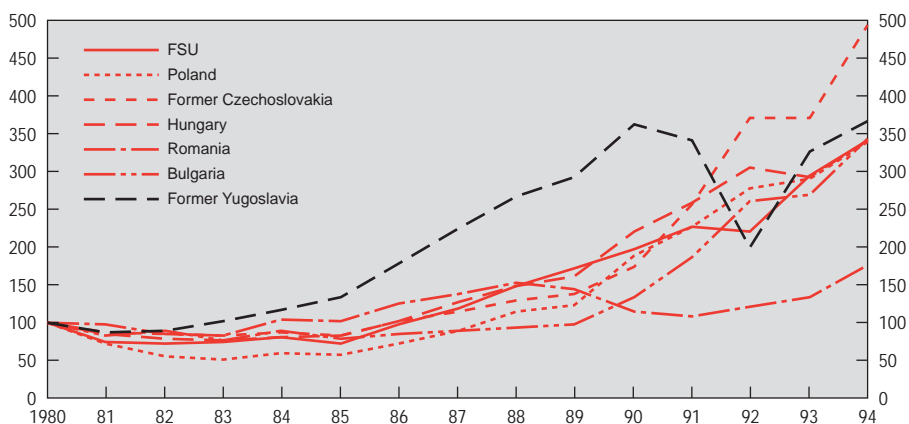
	Current exchange rate		Current PPPs	
	1991	1995	1991	1995
Slovenia	6 331	9 348	9 108	10 521
Austria	21 092	28 997	17 326	20 743
Czech Republic	2 490	4 420	8 690	9 616
Greece	8 690	10 936	9 798	12 157
Hungary	3 231	4 295	5 911	6 604
Poland	2 000	3 057	4 217	5 479
Portugal	7 735	10 060	10 135	12 440
Slovak Republic	2 046	3 248	6 746	7 379
Spain	13 582	14 272	12 745	14 205

Source: Statistical Office of the Republic of Slovenia; OECD.

An important point for the understanding of recent economic developments concerns the particularly open position of Slovenia with respect to international trade. Slovenia conducted about 30 per cent of Yugoslavia's total exports and accounted for nearly one quarter of total imports in 1990. Around two thirds of Slovene exports went to, and about 70 per cent of imports came from, the EC and EFTA countries. Trade with the former Council for Mutual Economic Assistance (CMEA) countries accounted for only 16 per cent. The largest individual trading partners were already in Western Europe – Germany (22.2 per cent of total exports) and Italy (18.8 per cent); the former Soviet Union was only in third place.

Furthermore, not only was Slovenia the most open republic in the former-Yugoslavia but also the Yugoslav economy itself was the most open economy in the central and eastern European area. For example, exports from Yugoslavia to OECD countries were growing at a much faster rate during the 1980s than in the other former socialist countries shown in Figure 1. In contrast to these countries, Yugoslavia had well-developed trade links with the European Community. Those

Figure 1. **EVOLUTION OF OECD MANUFACTURING IMPORTS FROM CEECs, 1980-94**
1980 = 100



Source: OECD.

were based notably on a very favourable trade and co-operation agreement concluded in 1980. After the break-up of Yugoslavia, Slovenia exchanged the Yugoslav agreement for an extended and revised agreement of its own that came into force in September 1993. Subsequently, an Association Agreement with the EU was signed in June 1996. Reflecting these trends, the ratio of exports plus imports of goods and services to GDP in Slovenia was around 110 per cent in 1995. One should not ignore that commuting with close Austria and Italy was also common: a source not only of revenue, but also of information and training.

Slovenia was also an important interface between the former-Yugoslavia and international markets. This position was reflected in the relatively intense trade relations between Slovenia and the other parts of the former-Yugoslavia. Before the split, Slovenia's sales to other republics accounted for about one quarter of total sales, and purchases in that region slightly exceeded one fifth of total purchases. Within Yugoslavia, Croatia ranked first among Slovenia's trading partners. In 1990, the volume of bilateral trade with this republic amounted to about half of Slovenia's total trade turnover within Yugoslavia. Concerning industrial markets, the links were even stronger as about one third of all sales were directed to other former republics. Some industrial branches were particularly dependent on the Yugoslav market, *e.g.* the footwear and chemical industries (about half of their turnover was made in the Yugoslav market), the textile industry (40 per cent), metalworking and the paper industry (one third).

This particular position meant that Slovenia suffered a large shock after the split of the former-Yugoslavia, particularly with the collapse of trade due to the war in the Balkans and the associated international sanctions. Foreign trade links Slovenia had through other Yugoslav enterprises were cut and Slovene property in other republics was confiscated. Slovenia had to start a drastic re-orientation of trade from the Yugoslav market to foreign markets. Sales to other former republics of Yugoslavia decreased from US\$6.7 billion in 1990 to US\$1.2 billion in 1995 while exports to the rest of the world increased from US\$4.1 billion to US\$7.1 billion. At the same time, effective protection rates decreased from 53 per cent in 1986 to 7 per cent in 1993.³

Nevertheless, there were some windfall gains. For example, Slovenia was a net contributor to the federal budget of the former-Yugoslavia. Independence has offered to Slovenia the opportunity to develop its own institutions and policy direction, building on an economic base which, as noted, was stronger than in the

other republics of former-Yugoslavia and indeed stronger than in any other country in Central Europe. Given Slovenia's favourable starting conditions – even taking into account that central governmental and administrative institutions had to be set up – a key issue to be addressed in this Survey is whether current policy direction and progress with restructuring are sufficient to maintain Slovenia's relatively strong position in the region.

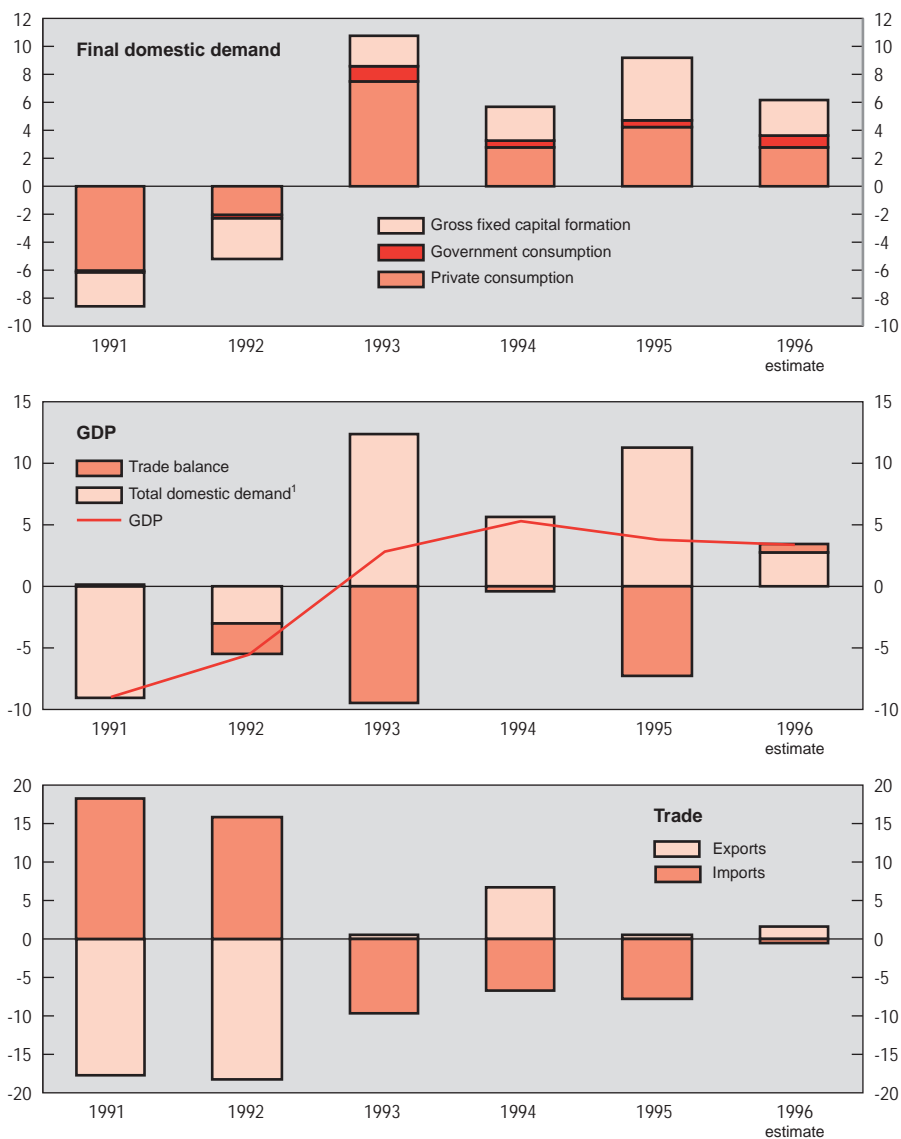
Resumption of growth and structural change

Adjustment in the real economy and re-orientation of trade

In the eighties, the Yugoslav economy was stagnating. After three years during which output was already falling, in 1990 the GDP of Slovenia (then still part of the Federal Republic) started declining substantially, and this decline continued in the first 1½ years of independence. The recession was aggravated by market losses in other former Yugoslav republics and in the CMEA countries. At the same time, the economy had to adjust to the introduction of market-oriented reforms. In the 1991-92 period, GDP fell cumulatively by 14.5 per cent. Nevertheless, after Poland, Slovenia was the second country where growth started to resume after the transition shock. The recovery began in mid-1993 with the GDP growth rate for the full year reaching 2.8 per cent. Subsequently, this improvement gained momentum, with 5.3 per cent growth in 1994 and 3.9 per cent in 1995. In 1996, Slovenia recovered the GDP level of the pre-independence years.

Overall, domestic demand appears to have contributed the most to the economic recovery (Figure 2). Nevertheless, external trade has also played a very important role: estimates of the Bank of Slovenia indicate that the elasticity of real exports with respect to total demand growth in foreign markets has been rather stable at around 1.3. The resumption of growth in 1993 was induced by an increase in domestic demand, generated by rising real revenues brought about through rapid nominal wage increases and falling inflation. In the following year, growth was sustained by expanding investment and strong export demand. In 1995, domestic demand components were again the driving force for economic growth; demand growth included rising imports of consumer durables, boosted by appreciation in the tolar. Domestic demand increased by 9 per cent in

Figure 2. **CONTRIBUTIONS TO GDP GROWTH**
As a percentage of GDP in previous year



1. Including stock variation. For 1996, data are preliminary, especially given uncertainty regarding the variation in stocks.

Source: Statistical Office of the Republic of Slovenia.

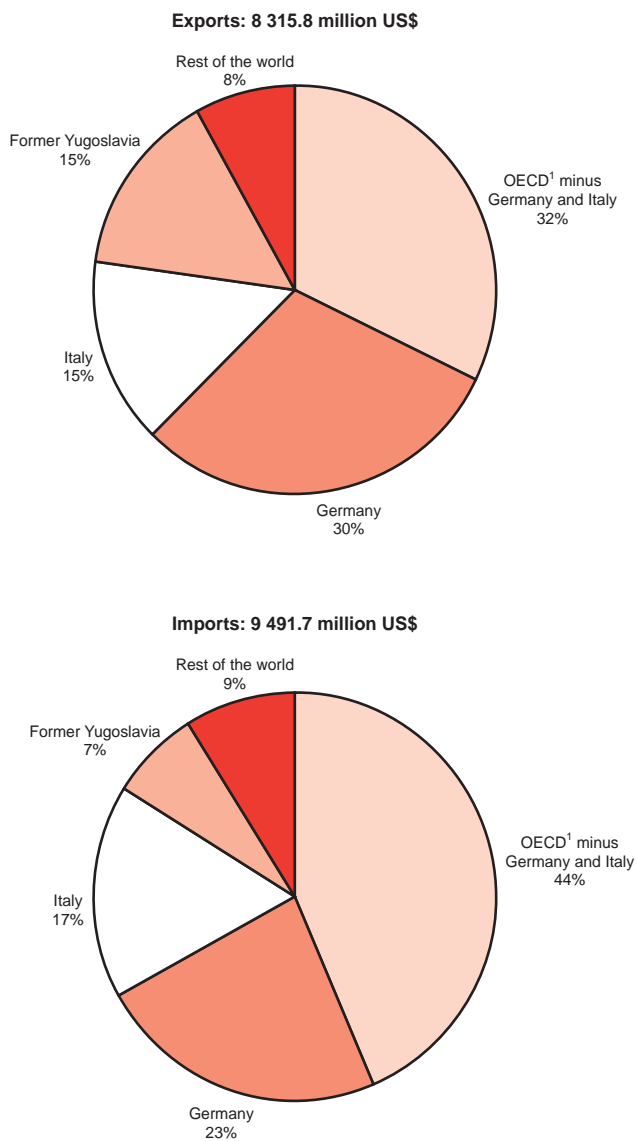
real terms in 1995, while foreign demand (which increased by 0.7 per cent) was much less influential than in the preceding year. In 1996, domestic demand again grew strongly, by an estimated 5-6 per cent, while foreign demand increased by only around 2 per cent (further details regarding GDP developments since 1992 are provided in the Statistical Annex).

In the industrial sector the adjustment process is still underway. After a prolonged contraction in the second half of the eighties, production started to revive in 1994 with an impressive 6.4 per cent growth. The pick-up in industrial activity was made possible by strong foreign demand resulting from the economic recovery in the West European markets. This effect is closely associated with a massive trade re-orientation towards the West, combined with broader improvements in the composition and quality of exports. Indeed, the geographic structure of Slovene trade is currently dominated by the OECD countries, which account for roughly 80 per cent of the trade turnover (Figure 3). In 1995, Germany was the leading trade partner with 30 per cent of Slovene exports and 23 per cent of imports. Next came Italy with 15 and 17 per cent, respectively. While the volume of industrial output in 1995 was below its 1987 level, this reflects the important restructuring that has occurred, including closures of coal mines and steel mills, and offsetting growth in the service sector.

For most of 1996, industrial output was below its level of the corresponding months of 1995. However, growth late in the year led to output in 1996 as a whole rising by 1 per cent over its 1995 level. In 1996, the production of intermediate goods was still 1.5 per cent lower than in 1995, while consumer goods' output was 1.6 per cent higher and production of capital goods was up by a strong 10.1 per cent.

In 1996, total exports of goods were roughly at the same level (in current US\$ terms) as in the previous year, and total imports of goods were 1 per cent lower. These trends are partly attributable to the downturn in economic activity in Slovenia's major trading partners in the second half of 1995 and in early-1996. The role of external factors is indicated by the elasticity noted earlier, and by broader links discussed below between foreign demand (particularly in Germany, Italy and Austria) and overall industrial production in Slovenia. However, the decline (4.1 per cent) in exports to the EU area may still reflect data problems in the measurement of processing trade,⁴ where EU countries (particularly Germany) are Slovenia's main export destinations.

Figure 3. FOREIGN TRADE BY COUNTRY, 1995



1. Total OECD Members, end 1996.

Source: Statistical Office of the Republic of Slovenia.

A strong link between exports and industrial growth

A comparison between the growth rates of dollar-denominated exports and manufacturing production in Slovenia and in other transition countries is given in Figure 4. It is striking that these two series are particularly close in the case of Slovenia. Indeed, the correlation coefficient between export growth and industrial production reaches 0.60 in Slovenia, whereas the link seems less strong for the other transition countries. The Bank of Slovenia estimates that the time lag between foreign demand and Slovene industrial production is of one to three months. Given that the EU accounted for 65 per cent of exports in 1996, economic developments in Slovenia are then highly dependent on the evolution of European industrial growth, and in particular of Slovenia's leading trading partner – Germany. This dependence can be seen in Figure 5, which suggests some effect of the cycles of industrial production in Germany on Slovenia's industry.

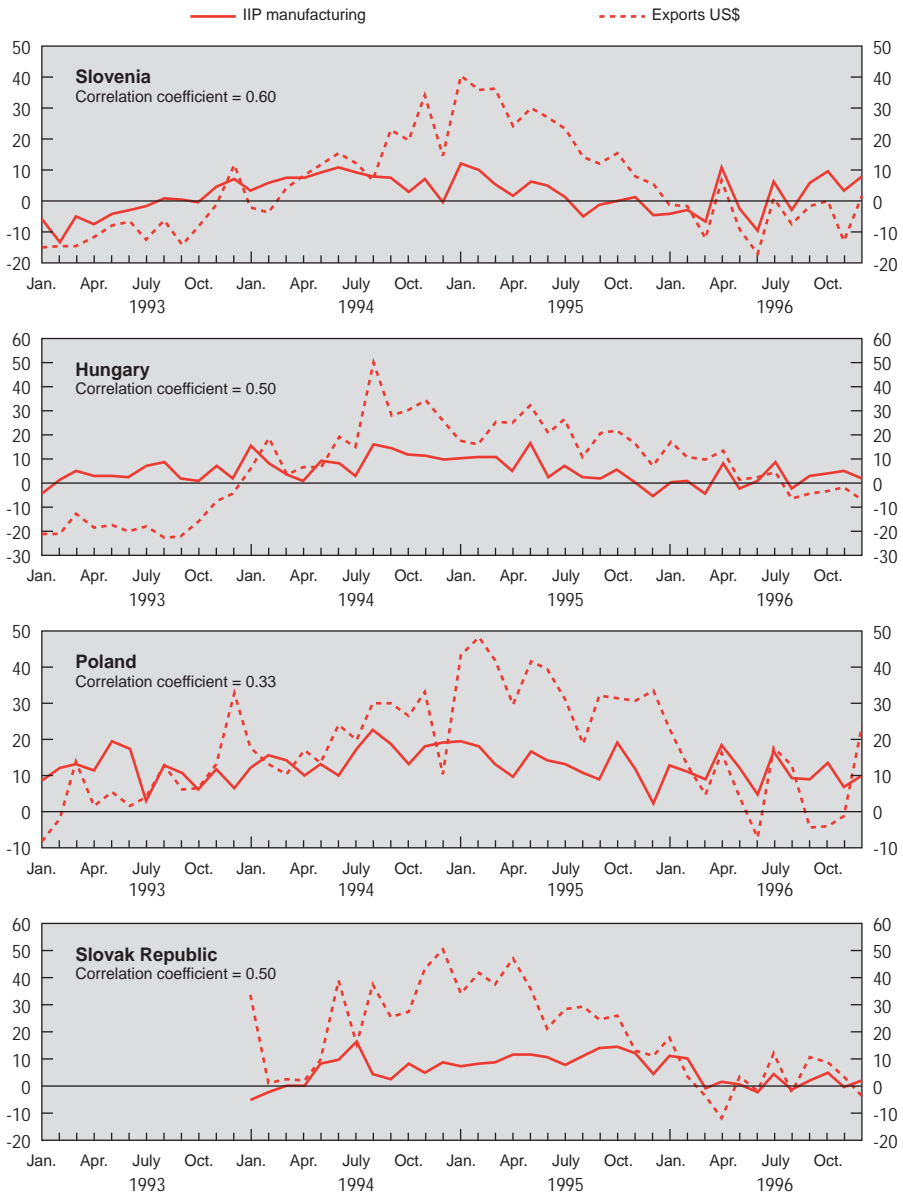
This strong geographical dependence has raised concerns, and the Slovene authorities would favour increased geographic diversification. In this regard, developing trade flows with the partners of the Central European Free Trade Agreement (CEFTA)⁵ and resuming trade with the countries of the former-Yugoslavia are viewed as possible options. In 1996, CEFTA countries accounted for 5.5 per cent of Slovene exports and 6.5 per cent of imports. The former-Yugoslav republics accounted for 17 per cent of exports and 7 per cent of imports. According to the authorities' projections, the share of exports to the former-Yugoslavia could increase to around 20 per cent by the year 2000.⁶

Export competitiveness also matters

Despite the economy's sensitivity to trade cycles, it is important to stress that recent output trends are also attributable to earlier losses in competitiveness. As can be seen from Figure 6, there was a significant deterioration of the export competitive edge between mid-1994 and mid-1995. This was due mainly to the combined effect of real exchange rate appreciation and wage increases not fully compensated by productivity growth, trends which have reversed to some extent more recently. The slow pace of restructuring in some parts of the economy may also have contributed to the output slowdown (see Chapter IV for a more detailed discussion of this point).

Figure 4. EXPORTS AND INDUSTRIAL OUTPUT GROWTH:
A COMPARISON

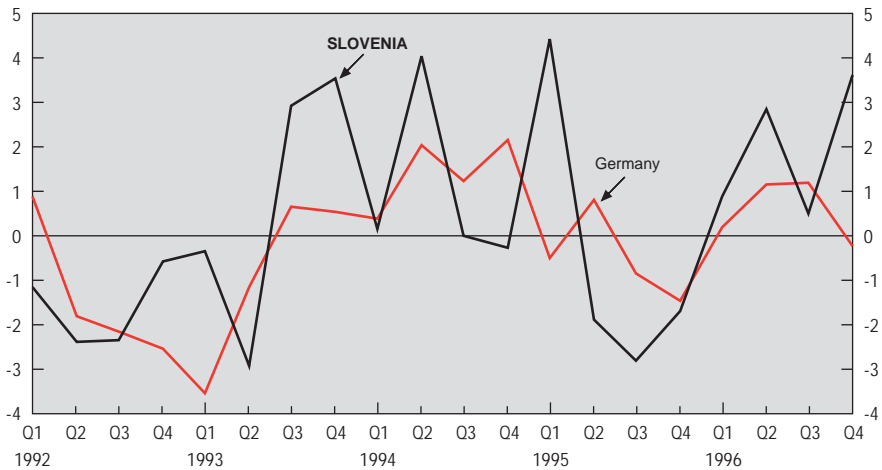
Per cent change over 12 months



Source: Statistical Office of the Republic of Slovenia, OECD.

Figure 5. **INDUSTRIAL PRODUCTION IN SLOVENIA AND GERMANY**

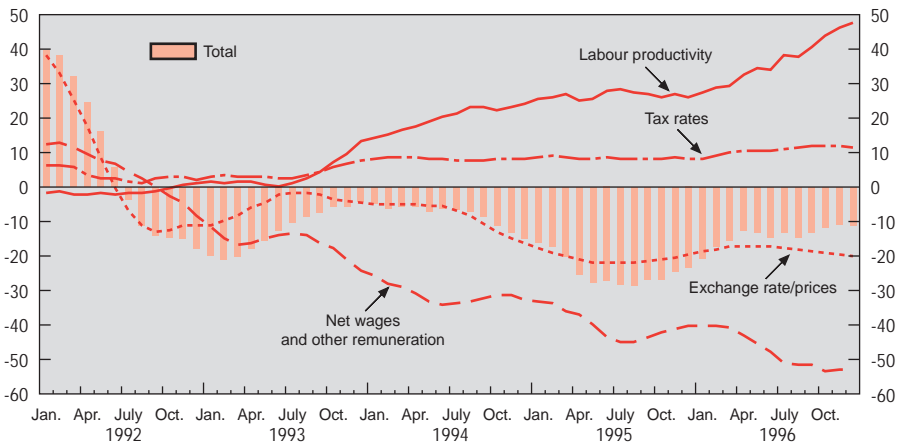
Growth in per cent, seasonally adjusted



Source: Statistical Office of the Republic of Slovenia, OECD.

Figure 6. **COMPONENTS OF EXPORT COMPETITIVENESS¹**

Growth rates in per cent, seasonally adjusted



1. Growth in the indices indicates an increase in export competitiveness.

Source: Statistical Office of the Republic of Slovenia, Bank of Slovenia, IMAD.

Structural change

Transformation of industry and services

The transformation process began earlier in Slovenia than in the other countries in transition, in part as a result of trade barriers that were erected between the former-Yugoslav republics. Transformation also started from an economic base that was already relatively more orientated to the service sector. The mining sector fell sharply in 1988, manufacturing output fell from 38 per cent of GDP in 1988 to 30 per cent in 1990, and the largest drop in industry as a whole occurred in 1989. By 1990, industry comprised 36.9 per cent of value added, and this share had fallen further to 32.1 per cent in 1995 (Table 3). The service sector share actually fell – from 52.8 to 50.3 per cent of value added – between 1990 and 1991, a consequence of the collapse of tourism when war broke out. For example, overnight stays by foreign tourists fell by nearly 60 per cent between 1990 and 1991. Since then, however, the service sector share has

Table 3. **GDP by kind of activity**

Per cent

	1990	1991	1992	1993	1994	1995	1996 estimate
Agriculture	5.0	5.2	5.2	4.5	4.7	4.3	4.4
Mining and quarrying	1.0	1.3	1.7	1.0	1.1	1.0	1.0
Manufacturing	29.9	31.0	28.4	25.9	26.0	24.4	23.8
Electricity, gas and water supply	2.5	3.7	2.0	2.4	2.5	2.4	2.3
Construction	4.3	3.7	3.8	4.1	4.2	4.4	4.6
Wholesale and retail trade, repairs	10.4	8.8	9.4	9.7	10.1	10.2	10.3
Hotels and restaurants	2.0	1.8	2.2	2.5	2.8	2.7	2.7
Transport, storage and communications	7.8	7.2	6.5	6.8	6.6	6.4	6.3
Finance services	12.2	12.2	12.5	12.8	13.0	13.9	13.9
Health and social work, education	12.1	12.2	13.6	13.7	12.1	12.5	12.4
Public administration	3.3	3.2	4.0	4.3	4.4	4.6	4.6
Value added	90.6	90.2	89.3	87.8	87.5	87.0	86.4
Corrections	9.4	9.8	10.7	12.2	12.5	13.0	13.6
GDP	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Value added	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture	5.5	5.7	5.8	5.1	5.4	5.0	5.1
Industry	36.9	39.9	35.9	33.4	33.8	32.1	31.4
Construction	4.8	4.1	4.3	4.7	4.8	5.1	5.3
Services	52.8	50.3	54.0	56.8	56.0	57.9	58.1

Source: Statistical Office of the Republic of Slovenia, IMAD.

increased (including a slow rise in tourist stays), reaching 57.9 per cent of value added in 1995. From 1990 to 1995, the agricultural sector's share in value added has remained in the range of 5 to 6 per cent.

Disaggregated data shed more light on the extent and form of restructuring that is taking place. Large-scale manufacturing industries, in many cases involving basic products, have tended to be harder hit by the adjustment process, as well as some of the more labour-intensive industries. There are also considerable differences in the rate of decline. Looking at the more recent period between 1995 and 1996, iron and steel went down by 19.2 per cent, machinery equipment by 13.5 per cent and footwear by 24.2 per cent, while smaller falls are evident in metal products (2.3 per cent) and paper and paper products (2.9 per cent). In some light industries, such as food, beverages and wooden products, output has increased, as it also has in chemicals and electrical equipment (see Statistical Annex Table A2).

After falling by 23.7 per cent in the 1990-92 period, fixed investment resumed growth in 1993, increasing by 11.9 per cent in annual terms; this upturn strengthened in the two subsequent years, with growth of 12.6 and 20.8 per cent, respectively. Overall, the share of investment in GDP increased from 18.8 per cent in 1990 to 21.2 per cent in 1995 (see Statistical Annex Table A1). According to official estimates, this share further increased to 22 per cent in 1996.

The private sector's contribution to economic activity has increased from 41 per cent of value added (and 36 per cent of employment) in 1993 to an estimated 50 per cent of value added (47 per cent of employment) in 1995, and probably approaches around 55 per cent of both measures in 1996. Although precise comparisons are difficult, these shares appear to be lower in Slovenia than in some other transition economies, mainly because the privatisation process in Slovenia began later (see Chapter IV). However, with the rate of privatisation picking up in 1995 and 1996, the private sector share has been rising and is expected to reach around two-thirds of value added when the current privatisation process is completed.

A small and protected agricultural sector

Reflecting a relatively developed economy, the share of agriculture in GDP was already low at the start of the transition process. As noted earlier, agriculture in Slovenia comprises around 5 per cent of value added (and 4 per cent of GDP),

close to the share in most OECD countries. Consequently, in this respect Slovenia faces less adjustment in this sector compared with other transition economies. Employment in agriculture, as a share of total employment, declined from 8.4 per cent in 1991 to 7.1 per cent in 1995. Most are employed on small-scale individual farms,⁷ and only about 12 per cent of farmers depend for their income exclusively on farming. Slovenia is a net importer of agricultural products and food, especially of animal feed.⁸

Nevertheless, agriculture plays an influential role in the economic, social and political processes because many Slovenes, even employed elsewhere, have close links with farm activities (*e.g.* many retain small farm holdings). In 1994, a three-year programme for the implementation of the Strategy for Agricultural Development came into effect, providing for a real increase in guaranteed agricultural producer prices and a greater share in total budget expenditures for agriculture. The 1996 state budget provided for a 20 per cent nominal increase in funds allocated to agriculture, of which one third (1.2 per cent of total budgetary expenditures) was earmarked for subsidies. The biggest part of subsidies is intended for covering production costs in mountainous regions, marketing and promotion services, interest repayments and the promotion of cattle breeding.⁹

A range of producer and consumer prices of basic food products (wheat, sugar beet, flour, bread, fresh milk and sugar) are under government control and are maintained by price supports and high tariffs.¹⁰ The level of agricultural protection in Slovenia – although high – is below that of the EU and would not create any serious problems in the case of EU membership (provided the EU does not change its agricultural policy). Various scenarios of Slovenia's adoption of the EU's Common Agricultural Policy (CAP) forecast a substantial growth in revenues and incomes of farmers. Slovenia could also make use of EU structural and regional funds for the implementation of development policies, and markets would open for competitive Slovene products.¹¹

On the other hand, Slovenia's level of agricultural protection created problems when the country became a member of CEFTA, where prices (but not necessarily protection levels) are generally lower. At the time of CEFTA accession (1 January 1996), Slovenia was granted special treatment: food and agricultural products temporarily remained part of already existing bilateral agreements with the other four CEFTA countries.

The labour market

As discussed further in Chapter VI, total employment declined by nearly 20 per cent between 1989 and 1993. Since then, registered employment has shown a further small decline of around 3 per cent (although labour force survey data show a rise of about the same proportion, and are probably better suited to picking up employment of temporary, contract, and family workers). Structural change has led to a significant rise in unemployment. Registration records show official unemployment rising rapidly from 2.9 per cent in 1989 to 8.2 per cent in 1991, peaking at 14.4 per cent in 1993 and 1994 before declining slowly to 14.0 per cent at end-1996. In contrast, the annual labour force survey measure (which follows ILO standards) shows a peak of 9.1 per cent in 1993 and a faster absolute and relative decline to 7.3 per cent in May 1996.

Real wages fell sharply during the period of high inflation prior to 1992, but have increased rather strongly since then. Overall growth in real net wages between 1992 and 1996 has been around 35 per cent. In 1996, real wages were 5.0 per cent higher than in 1995, nearly one percentage point above the rate of productivity growth and also above the rate of wage increase agreed to in the 1996 Social Agreement between the government, employers and union representatives. Growth has been particularly rapid in the non-market sector, with consequent pressures on the fiscal position. Wages are indexed to past inflation which, together with bargaining arrangements more generally, raises concerns about the ability of labour market processes to contribute to overall economic stabilisation and adjustment. These and related issues are considered in Chapter VI.

From hyperinflation to macroeconomic stabilisation

Monetary developments

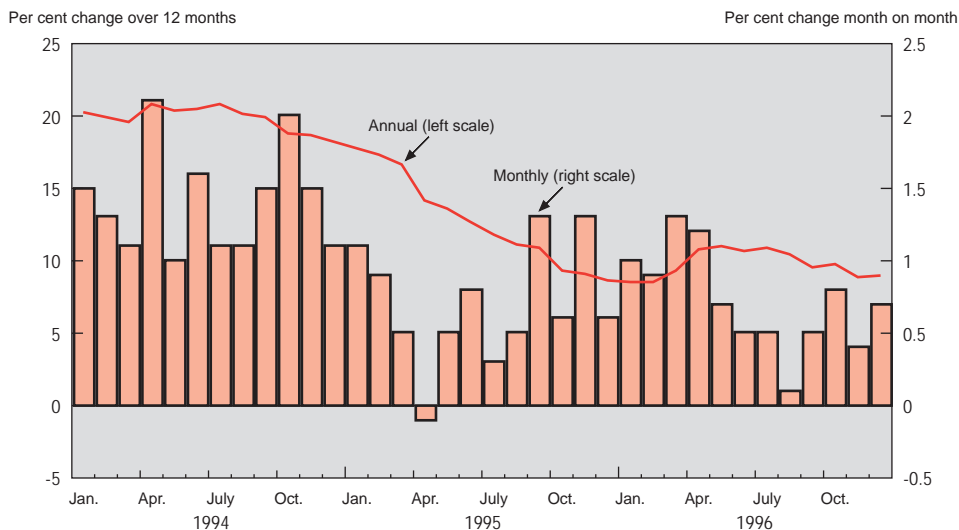
The deterioration in the economic and political environment during the last years of the former Yugoslav Federation was marked by hyperinflation in all Yugoslav republics, including Slovenia. The annualised rate of increase in consumer prices reached 13 000 per cent in the final quarter of 1989, up from 500 per cent in the first quarter (OECD, 1990). Implementation of a stabilisation programme became therefore the first order of business for newly-independent

Slovenia as a prerequisite for resumption of economic growth. The new currency, the tolar, was introduced on 8 October 1991. During 1992 and 1993, macro-economic stabilisation was particularly successful in bringing down retail price inflation from around 300 per cent to just over 20 per cent. In late 1995, the inflation rate moved into single digits for the first time since 1976.

After this remarkable achievement, disinflation policy has had some difficulties in making further progress. This is discussed in detail in Chapter II. Annual retail price inflation increased slightly from 8.6 per cent at end-1995 to 8.8 per cent at end-1996. In part, the pick-up in inflation in the first few months of 1996 (see Figure 7) resulted from increases in petrol and other controlled prices at the beginning of the year. Monthly price rises since then have been substantially lower.

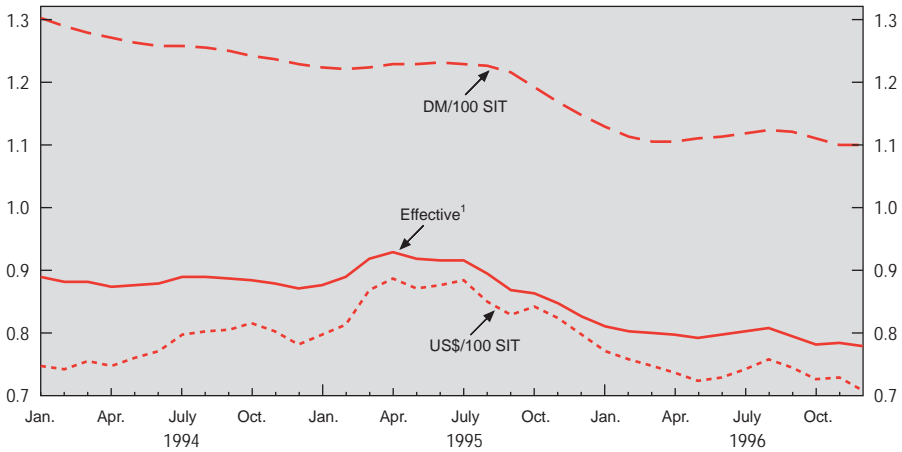
In addition, the sizeable depreciation of the tolar in the second half of 1995 and early-1996 is likely to have contributed to the increase in the inflation rate at the beginning of 1996, just as the relative stability in the currency in the preceding period helped with disinflation (Figure 8). Real interest rates have declined

Figure 7. RECENT INFLATION TRENDS



Source: Statistical Office of the Republic of Slovenia.

Figure 8. EXCHANGE RATES



1. Effective exchange rate (weighted with merchandise turnover cashflow currency basket). Growth in the index denotes growth in value of the tolar and vice versa. Index of 1993 = 1.

Source: Bank of Slovenia.

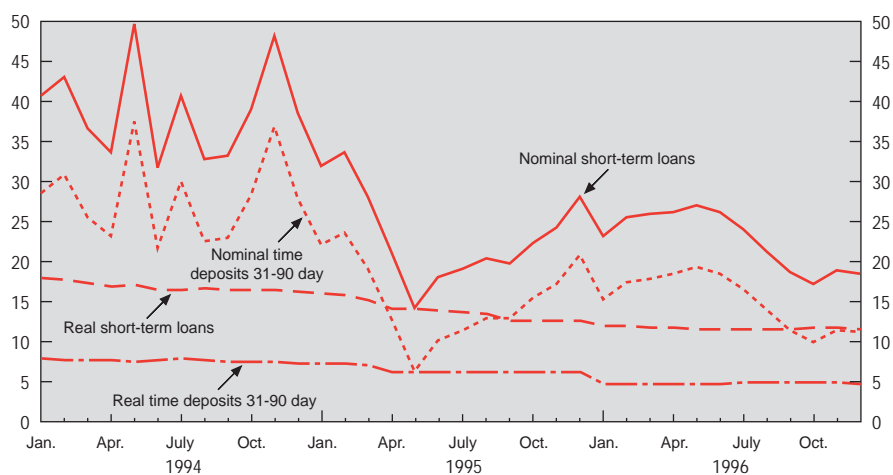
steadily in recent years, while nominal rates – indexed to recent inflation outturns – have been much more volatile (Figure 9).¹² Nominal rates fell sharply in the first half of 1995 as inflation fell and monetary conditions eased, but then rose in the following twelve months as inflation increased. In the second half of 1996, lower inflation has led to a resumption of the decline in nominal rates.

Fiscal policy

Another main pillar of the stabilisation programme has been prudent fiscal discipline, embodied in a roughly balanced consolidated budget since 1992. Depending on the years, the deficit/surplus has fluctuated between 0.3 and –0.2 per cent of GDP. In 1995, the outturn was marked by an improvement of the general government balance relative to the initial budget plan. The 1996 budget was approximately in balance. In terms of revenue collections, the effects of slower real activity in the economy have been offset by the increase in inflation. The continuation of favourable fiscal outturns in future years, however, will depend both on a firm policy stance being implemented towards reform of the

Figure 9. REAL AND NOMINAL INTEREST RATES

Per cent per annum



Source: Bank of Slovenia.

pension system, and on addressing wage pressures in the public sector (see Chapter II). Social security contribution rates have been lowered from 44.7 per cent at end-1995 to 38 per cent as of mid-1996. This has increased the deficit in the pension fund budget, which is being financed through substantial transfers from the state budget (transfers of around 2.7 per cent of GDP are expected at end-1996 and 4 per cent of GDP in 1997).

External performance and trade policy

Balance of payments

Developments in the balance of payments reflect, in particular, the growing importance of services in the current account and the accumulation of foreign reserves. Up to 1995, the current account was in surplus, with a growing trade deficit compensated by a surplus in the service balance, notably in the tourism

sector (Table 4). The income balance has been in surplus since 1994, with substantial inflows from worker remittances and overseas investment income more than offsetting interest payments on foreign debt.

Table 4. **Balance of payments**
US\$ million

	1992	1993	1994	1995	1996
Current account	926	192	540	-36	36
Trade balance	791	-154	-338	-953	-854
Exports f.o.b.	6 683	6 083	6 830	8 345	8 366
Imports f.o.b.	5 892	6 237	7 168	9 298	9 221
Services	180	376	724	725	777
Receipts	1 219	1 393	1 852	2 018	2 103
Transport	276	446	486	504	480
Travel	671	734	959	1 079	1 211
Other	273	213	407	435	413
Expenditure	1 039	1 017	1 128	1 293	1 327
Transport	439	390	418	435	404
Travel	282	305	369	413	452
Other	318	322	341	445	470
Goods and services	971	222	386	-228	-78
Exports	7 902	7 476	8 682	10 363	10 469
Imports	6 931	7 254	8 296	10 591	10 547
Factor services	-91	-51	107	147	90
Receipts	70	115	270	368	358
Labour income	0	8	153	166	168
Investment income	70	107	117	202	189
Expenditure	161	166	163	221	268
Profits from direct investment	1	16	13	13	23
Interest	160	150	150	208	245
Unrequited transfers	46	21	47	45	24
Receipts	93	154	191	205	162
Expenditure	47	133	144	160	138
Capital and financial account	-646	-202	-545	157	-35
Capital account		4	-4	-14	-4
Capital transfers		5	-3	-12	-3
Non-produced non-financial assets		-1	-1	-2	-2
Financial account	-646	-206	-541	171	-31
Direct investment	113	111	131	170	180
Foreign in Slovenia	111	112	128	176	186
Domestic abroad	2	-1	3	-6	-6
Portfolio investment	-9	3	-33	-10	783
Other long-term capital	-117	-209	3	231	-410
Assets	-158	-313	-136	-373	-378
Liabilities	41	104	139	604	-32
International reserves	-633	-111	-642	-220	-583
Statistical errors	-280	10	5	121	-1

Source: Bank of Slovenia Bulletin.

In 1996, Slovenia's trade balance was just over US\$0.85 billion in deficit (about US\$100 million lower than in 1995), while the balance on services was US\$0.78 billion in surplus. With smaller surpluses on factor services and unrequited transfers, the current account ended the year roughly in balance, as in 1995.

Even after adding its share of the former-Yugoslavia's debts,¹³ Slovenia's foreign indebtedness is low. In November 1996, gross debt stood at US\$4.1 billion (compared with US\$3 billion at end-1995), or around 22 per cent of GDP. Virtually all of this debt was long-term, and just over half (US\$2.2 billion) comprised public and publicly guaranteed debt. At the same time, foreign currency reserves of the whole banking sector totalled US\$4.3 billion (around 5 months of imports), of which US\$2.4 billion were held by the Bank of Slovenia. These totals represent increases of US\$1 billion and US\$0.7 billion respectively over their levels a year earlier.

Division of former Yugoslav assets

A question under recent political focus (but with relatively little economic impact) has been the division of the former-Yugoslav assets. In July 1996, the Bank for International Settlements (BIS) made a proposal about the division of frozen assets of the former National Bank of Yugoslavia (NBY).¹⁴ The BIS proposed distributing 8 000 shares held by the NBY to the central banks of the successor states according to a key introduced by the IMF. Slovenia would get 1310 shares and a 16.39 per cent share of the common assets of the former NBY both in gold and deposits; as a result, some US\$96 million would be assigned to Slovenia. At a meeting of central bank governors and finance ministers from Slovenia, Croatia, Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia in Washington at end-September, participants agreed on the proposed model and procedure based on the IMF key. However, the agreement was blocked by FR Yugoslavia.

Trade liberalisation

Slovenia became a member of the GATT in October 1994 and subsequently of the WTO in July 1995. Recognising the key role of international trade, the authorities have been liberalising progressively the trade regime. In 1996, the custom rates in Slovenia generally varied from "free" to 27 per cent (and higher

for some agricultural products). The weighted average tariff rate applied to most-favoured nations (MFN) stood at 10.7 per cent in 1996. The Republic of Slovenia grants MFN treatment to goods originating in almost all foreign countries. Approximately 98 per cent of imports were free from quantitative restrictions (EBRD, 1996) by the end of 1994. Moreover, the government is considering eliminating non-tariff barriers in sectors such as telecommunications and electrical equipment. Slovenia complies with IMF Article 8 (Sections 2, 3 and 4); as of September, 1995, Slovenia has recognised the obligations that arise from current account convertibility, although such convertibility had been achieved *de facto* in 1992. Free trade agreements have been signed with the EFTA and Baltic States, and with Bulgaria and FYR Macedonia; free-trade agreements will be signed with Israel and Romania in April 1997, and expert-level negotiations are taking place with Croatia. Almost 75 per cent of Slovene trade takes place on the basis of such agreements (including the Association Agreement with the EU).

Outlook

After worsening in the second half of 1995 and first quarter of 1996, economic trends improved as of the second quarter of 1996. Preliminary estimates for 1996 indicate moderate GDP growth of around 3.5 per cent. Contributing to the upturn, exports of goods picked up again during the summer of 1996. For 1997 and 1998, real activity is projected to be at or slightly above recent levels, with GDP growth in the range of 3.5 to 4 per cent (see Table 5). Contributing to a possible pick-up in activity are improved conditions in export markets, coupled with the real depreciation of the tolar that has occurred over the past year. Export performance should improve, but import growth is also expected to be stronger than in 1996. As a result, the current account deficit in 1997 may end up somewhat higher than in 1996. Little change is expected in the inflation rate, however: indexation mechanisms in labour and financial markets appear to create significant inertia in inflation, and there will also be upward pressures from further liberalisation of controlled prices (including energy). These projections do not include the effect on prices of the introduction of a new value-added tax expected in January 1998. The level and coverage of the VAT have yet to be determined.

Table 5. **Slovenia: Economic outlook**

Percentage change unless noted

	1994	1995	1996	1997	1998
Real GDP growth	5.3	3.9	3.5	3.5	4
Inflation (CPI end-year)	18.3	8.6	8.8	9	8
Unemployment (end-year) ¹	9.1	7.4	7.3	7	7
Fiscal balance (percentage of GDP)	-0.2	-0.2	0	-0.7	-1
Current account (US\$ billion)	0.5	0	0	-0.5	-0.5

1. Labour Force Survey measure.

Source: Statistical Office of the Republic of Slovenia; OECD estimates and projections.

Unemployment may decline slowly, but there appear to be substantial structural elements in current unemployment – including concentration of unemployment among the low-skilled and in regions which used to be heavily industrialised. The fiscal position is projected to be in small deficit, with revenue growth supported by the increase in real GDP and by on-going inflation (as the tax system does not appear to be fully indexed). This projection assumes, however, that the new government implements a range of proposed fiscal measures and tackles some much-needed areas of spending reform, particularly in the social security area (see Chapter II).

II. Macroeconomic management

Monetary and exchange rate policy

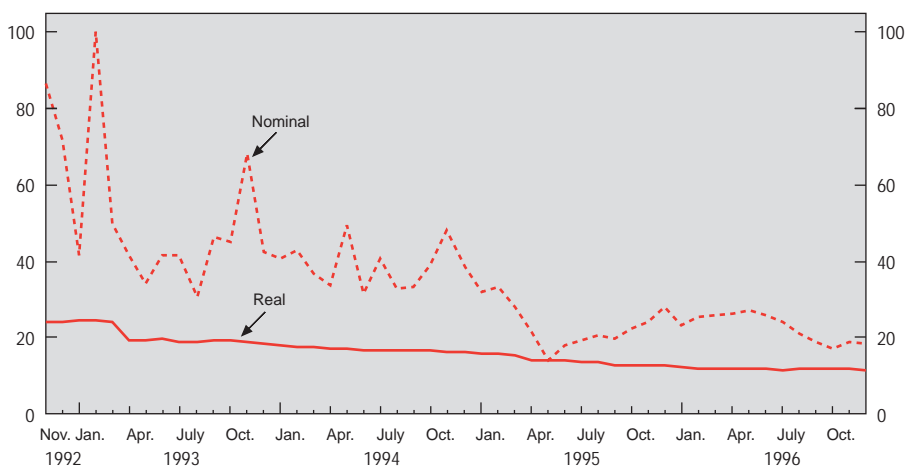
Under its establishing legislation of June 1991, the Bank of Slovenia is an independent organisation responsible directly to the Parliament, which appoints the Governor of the Bank. The Bank's primary responsibility is to maintain stability in the currency and the general liquidity of payments within Slovenia and abroad (Bank of Slovenia, 1995). The Bank has made substantial progress towards these objectives, especially when its achievements are assessed against the starting point. The challenge now facing the Bank is to "complete the job", especially in ensuring that the inflation rate moves steadily towards the levels prevailing in Western Europe.

Substantial progress so far...

The Bank of Slovenia faced a wide range of institutional and economic difficulties when the new currency, the tolar, was introduced on 8 October 1991. First, the fact that the Bank had only just been established as an independent entity meant that the monetary authorities had to tackle the organisational and operational requirements of building credibility in the currency and in the financial system more generally. Second, after experiencing very high inflation during much of the preceding decade, the public's confidence in the new currency was bound to be low. Third, at the time of independence, official foreign exchange reserves were minimal (only US\$112 million at end-1991), leaving the Slovene economy highly exposed to changes in external trade performance and financial market sentiment, and giving the Bank little scope for exchange rate management. Fourth, as described further in Chapter III, the largest banks in Slovenia carried a huge legacy of bad debts, with consequent risks for the stability of and confidence in the overall financial sector.

Figure 10. **NOMINAL AND REAL INTEREST RATES (SHORT-TERM LOANS)**

Per cent per annum



Source: Bank of Slovenia.

Against this back-drop, much has been accomplished. The Bank of Slovenia has established itself as a credible institution; and the conduct of monetary policy, along with fiscal policy, has led to favourable reactions of rating agencies and other international observers regarding the quality of Slovenia's macro-economic management.¹⁵ As discussed in Chapter I, inflation has come down sharply. Falling inflation has been accompanied by declines in nominal and real interest rates, although real rates are still high (*e.g.* nearly 12 per cent for short-term working capital loans) (Figure 10). Official foreign exchange reserves have built up rapidly (as have unofficial reserves). And, as discussed in Chapter III, the financial sector appears to be on a much more stable footing, with the two state-owned banks now ready for privatisation.

... but significant concerns and challenges remain

Looking ahead, however, several concerns arise regarding the conduct of monetary policy. In broad terms, the Bank of Slovenia faces a significant challenge in achieving further disinflation and reaching Western European inflation

levels by the end of the decade (a widely-stated objective). More specifically, there are problems with the lack of transparency in operational aspects of policy, and with still-present weakness in confidence in the domestic currency. These difficulties are to some extent understandable, given the recent introduction of the currency and the memory of hyperinflation in the final years of the former Yugoslav Federation. However, the Bank of Slovenia, supported by other arms of economic policy, needs to demonstrate clearly that it is continuing to build policy credibility and is moving steadily towards the low-inflation goal. These matters are discussed next.

Policy operations

Within its overall policy objective of stability in the currency, the Bank of Slovenia's operational targets focus on the narrow money aggregates. The Bank sets an intermediate target for M1 growth (based on growth in real money demand combined with the inflation goal in the next period), and seeks to reach this by targeting growth in the monetary base. This approach was instrumental in achieving rapid disinflation after 1991: real money aggregates fell during the high inflation at the beginning of this period, and the Bank's control of money growth thereafter led to inflation falling from double-digit rates per month to single-digit rates per year by 1995.

Less clear is whether this operating strategy is, by itself, sufficient to achieve and hold significant further falls in the inflation rate. There are general uncertainties inside (as well as outside) the OECD area about the stability of money demand functions – even in those countries that announce money growth targets. More specifically, Slovenia (as with other transition economies) faces the additional uncertainty arising from financial liberalisation, including further opening of the capital account. Hence, as discussed below, while close monitoring and control of the money aggregates may continue to play an important role in policy operations, this approach may need to be broadened to give more prominence to other indicators and instruments relevant for reaching the inflation objective.

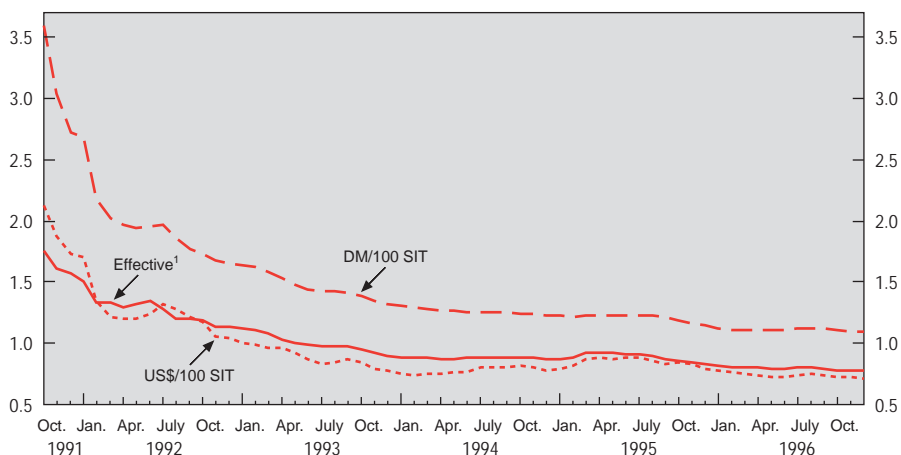
Further complicating the picture have been uneven and sometimes alternating trends in the real and nominal exchange rates for much of the past five years. Immediately after its introduction, both real and nominal exchange rates depreciated rapidly (*e.g.* the tolar fell from 32 to the DM when introduced in

October 1991 to close to 50 in January 1992). The nominal rate then stabilised in the second quarter of 1992 (Figure 11). The period since then can be roughly divided up as follows (although the exact timing of each spell depends on which specific cross rate is used):

- mid-1992 to first quarter of 1994: greater stability in the real exchange rate (with a decline in early-1993), and steady depreciation in the nominal rate;
- second quarter of 1994 to third quarter of 1995: slowing depreciation, and then some appreciation in the nominal exchange rate, and rise in the real rate;
- third quarter of 1995 to first quarter of 1996: declines in both nominal and real exchange rates;
- second quarter of 1996 to present: general stability in nominal rate, appreciation in real rate.

The developments summarised above have been influenced by the Bank's response to foreign exchange inflows faced by Slovenia over this period, coupled with sizeable variation in the level of these flows. For example, from 1992

Figure 11. **NOMINAL EXCHANGE RATES**



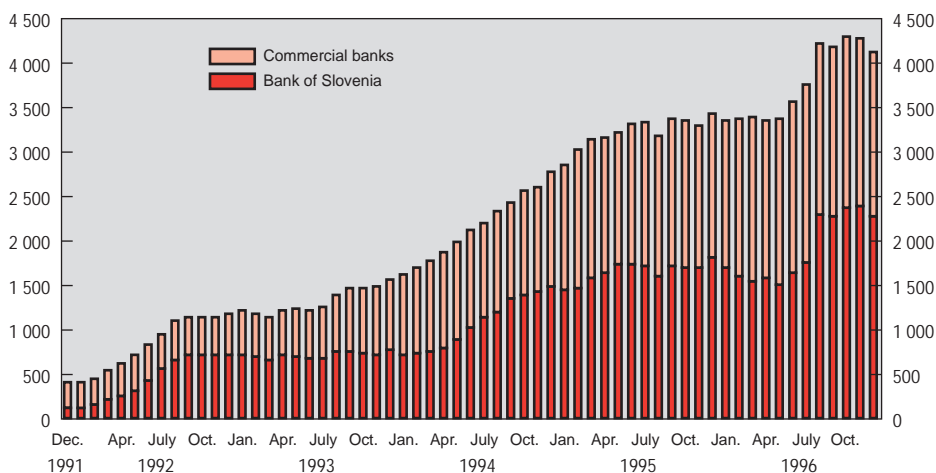
1. Effective exchange rate (weighted with merchandise turnover cashflow currency basket). Growth in the index denotes growth in value of the tolar and vice versa. Index of 1993 = 1.

Source: Bank of Slovenia.

to 1994 Slovenia faced very strong inflows arising from current account surpluses (which averaged over 4 per cent of GDP in this period), and from favourable domestic interest rate differentials over foreign rates. In response, the Bank of Slovenia engaged in a massive and costly programme of intervention and sterilisation in order to counter the exchange rate pressures of these inflows and to meet its domestic money growth target. The result of this activity was that the Bank induced a continuous decline in the nominal exchange rate and forestalled any real appreciation. At the same time, the Bank realised a large build-up in official foreign exchange reserves which (along with commercial bank reserves) increased most rapidly in 1992 and 1994 when the current account surplus was at its strongest (Figure 12). Similarly, growth in the money base in this period was driven by strong growth in the Bank's net foreign assets largely, but not completely, offset by increases in its net domestic liabilities (Table 6).

The Bank's sterilisation activity has been conducted with a large and complicated assortment of financial instruments; these are summarised in Box 1. In addition, the Bank has introduced direct restraints on commercial banks designed

Figure 12. **FOREIGN EXCHANGE RESERVES**
Millions of US\$



Source: Bank of Slovenia.

Table 6. **Balance sheet of the Bank of Slovenia**

Billion tolar

	31 Dec. 91	31 Dec. 92	31 Dec. 93	31 Dec. 94	31 March 95	30 June 95	30 Sept. 95	31 Dec. 95	31 March 96	30 June 96	30 Sept. 96	31 Dec. 96
Foreign assets	6.5	70.8	104.0	190.1	193.3	216.5	222.3	250.9	233.4	227.9	315.0	329.5
<i>of which:</i>												
Deposits	6.2	70.0	94.7	163.0	165.0	182.0	183.5	200.7	175.6	187.2	266.8	267.6
Securities	0.0	0.6	6.7	11.6	12.3	15.3	18.0	26.3	30.0	34.0	42.3	54.7
Claims on general government	8.7	8.8	18.6	15.4	15.3	15.2	15.4	14.9	15.1	15.4	15.3	15.0
Claims on domestic banks	3.8	16.3	16.0	29.9	19.5	18.2	31.8	43.1	43.4	28.2	43.2	15.7
<i>of which:</i>												
Liquidity loans	0.0	15.0	13.6	13.8	14.4	11.2	9.7	7.7	10.3	5.1	0.6	1.3
Repurchase agreements	1.0	0.0	1.5	12.6	3.9	5.6	11.3	16.8	18.6	16.0	18.4	13.6
Other loans	1.4	0.6	0.7	3.3	0.9	1.2	10.6	18.4	11.1	6.9	23.6	0.5
Other assets	0.3	2.0	1.5	4.9	3.4	4.0	4.1	3.6	2.5	2.7	4.3	4.1
Total assets	19.3	97.9	140.1	240.3	231.5	253.9	273.6	312.5	294.4	274.2	377.8	364.4
Notes issue	9.8	25.5	34.6	50.6	46.0	56.0	57.3	63.9	59.1	65.7	63.2	71.4
Deposits of banks	6.1	10.7	15.6	28.5	30.9	33.4	32.5	35.2	39.2	37.0	36.7	43.1
General government deposits	1.6	5.8	6.0	27.4	23.6	24.6	37.7	47.5	33.8	30.4	77.9	22.0
Other demand deposits	0.1	0.9	0.9	1.1	1.2	1.2	1.3	1.4	1.2	1.5	1.8	1.6
Tolar bills	0.0	2.4	2.8	12.4	26.7	13.3	12.0	6.6	9.1	3.0	12.2	16.3
Foreign currency bills	0.0	38.3	47.6	87.3	72.3	94.0	98.8	120.0	107.1	90.9	139.4	162.1
Allocation of SDRs	0.0	0.0	4.6	4.7	4.5	4.4	4.5	4.8	5.0	5.1	4.9	5.2
Capital and reserves	1.4	8.3	19.7	21.1	21.1	21.1	21.1	26.3	26.3	26.3	26.3	26.3
Other liabilities	0.4	6.0	8.3	7.0	5.3	5.8	8.3	6.7	13.8	14.5	15.3	16.3
Total liabilities	19.4	97.9	140.1	240.1	231.6	253.8	273.5	312.4	294.6	274.4	377.7	364.4

Source: Bank of Slovenia.

Box 1. Instruments of monetary policy*

The principal instruments used by the Bank of Slovenia (BoS) to reach monetary policy objectives are:

Loans to banks: These loans come in three main forms: *Lombard loans*: the last resort measure – 5-day loans offered at an interest rate one percentage point above the discount rate; *Short-term loans*: both regular monthly loans offered by the BoS (intended for banks which are most active in buying foreign exchange from enterprises), and supplementary loans, intended to neutralise the effect of transfer of the budget liquidity surplus from banks to the BoS; *Liquidity loans*: these comprise overnight loans to banks which are net debtors on the inter-bank market, loans (of 1 to 14 days) to the banks undergoing rehabilitation (see Chapter III), and last-resort liquidity loans for banks with liquidity difficulties.

Repurchase agreements: the BoS buys its foreign currency bills from banks in auction sales, under the agreement that these bills are to be repurchased by banks after one month.

Tolar bills: BoS bills issued under various maturities (from 2 to 60 days), and always available.

Twin Bills: short-term, transferable BoS securities, available to banks and via them to firms and households. These comprise a tolar and foreign currency part, are bought in tolar at a discount and redeemed half in tolar and half in DMs. The two parts can be traded separately, with the revaluation clause applying to the tolar portion.

Bills with warrants: transferable securities, bought at a discount in tolar and bearing a nominal interest rate. A warrant attached to the security acts as a hedge against higher inflation and a smaller rate of exchange rate depreciation than projected. Holder of warrants are able to buy new tolar bills or foreign currency bills at a discount, the reduction depending on the increase in actual inflation and exchange rates compared with the official projection for inflation.

Foreign currency bills: transferable securities available to banks and via them to other legal entities. These are purchased at a discount in DMs or US dollars. They are the most important securities for banks, as they can serve as collateral for Lombard, liquidity and short-term loans, are used in repurchase agreements, and bills with maturity of up to 120 days are used to satisfy requirements regarding banks' minimum foreign exchange holdings (see below).

Reserve requirements: applied to banks and savings banks against tolar deposits of up to one year. Minimum requirements at end-1996 were 12 per cent of sight and 30-day time deposits, declining progressively to 1 per cent of deposits from 6 months to one year.

(continued on next page)

(continued)

Foreign exchange minimum: reserve requirements based on the volume of banks' payments abroad (35 per cent of average payments in the last three months) and on foreign currency deposits held at banks (e.g. 100 per cent of residents' sight deposits, and 75 per cent of time deposits of up to 3 months).

Purchases and sales of foreign exchange: foreign exchange intervention of the BoS has involved purchases of foreign exchange from banks undergoing rehabilitation, in connection (e.g.) with their repayment of overnight liquidity loans. The Bank also sells foreign exchange to banks in exchange for 120-day BoS bills denominated in DMs. In 1996, two new offers of foreign exchange intervention were introduced. Purchase of foreign exchange by BoS, foreign exchange swaps and purchase of BOS foreign exchange bills (simultaneous triple offer) is a combination of existing instruments, first offered in April 1996. This instrument has been inactive since September 1996. Purchase of foreign exchange with rights is an instrument first offered in July 1996, by which BoS purchases foreign exchange from the banks participating at the auction. The auction is linked to the right of the elected banks to sell to the BoS the same amount of foreign exchange during the next six months, while maintaining the bid exchange rate in their relations with customers.

* Source: Republic of Slovenia (1996a); Bank of Slovenia Annual Reports (1994, 1995).

to decrease their willingness to convert foreign exchange into tolar. For example, 40 per cent of each foreign loan with maturity of up to seven years that is intended for conversion into tolar (rather than used directly for import purchases) has to be held in a non-interest-bearing tolar deposit.¹⁶ In March 1995, the Bank tightened reserve requirements applying to foreign currency deposits: minimum reserves of 100 per cent, in liquid foreign currency assets abroad, were to be held against household sight deposits, and 75 per cent against time deposits of up to 3 months.¹⁷

The financial market interventions of the Bank were very costly: for example, the Bank's operating surplus fell from SIT 17 billion in 1993 (1.2 per cent of GDP) to SIT 1 billion in 1994. In the first half of 1995, the Bank was in deficit due to sterilisation costs from the previous year. It was these high costs, coupled with a broader realisation by the Bank that it could not continue to "hold the tide" against inflow pressures and currency appreciation, that apparently pushed the Bank to curtail its intervention and sterilisation activities in 1995.

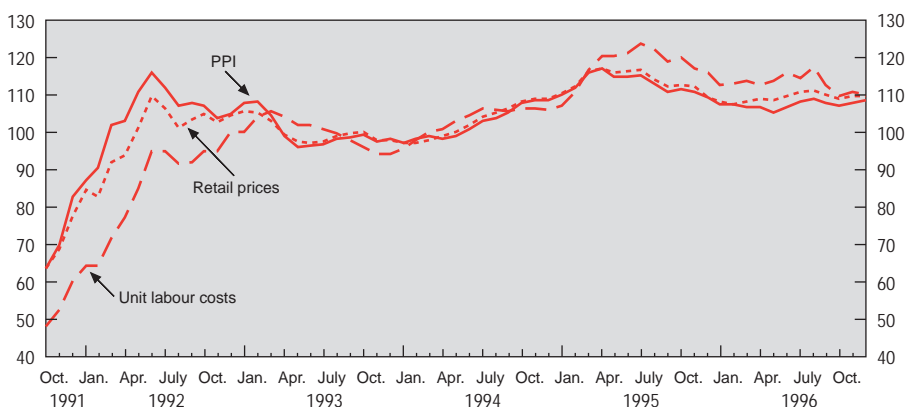
Reflecting these developments, domestic monetary conditions eased in the first half of 1995. Money base growth exceeded the Bank's target in January to August (especially earlier in this period). In April, the Bank substantially reduced its official interest rates, with the discount and Lombard rates being lowered by 6 percentage points to 10 and 11 per cent respectively. These moves were accompanied by large reductions in market rates: interbank rates fell from 19.3 per cent in January to a low of 6.4 per cent in May, and short-term nominal lending rates fell from 32 per cent to 14.2 per cent over the same period. In the foreign exchange market, the current account moved into deficit in the second quarter of 1995 which, combined with the declining attractiveness of tolar-denominated assets, reduced inflow pressures. The tolar was stable against the Deutschemark in this period, and appreciated by around 10 per cent against the US\$ and the lira. Overall, the appreciation was 4.6 per cent in nominal effective terms, contributing to a real appreciation of 15 per cent (on a unit labour cost basis).

The situation changed in the second half of 1995 and early-1996, however, when nominal and real exchange rates again declined. In nominal effective terms, the tolar depreciated by over 12 per cent between mid-1995 and February 1996, including falls of 16 per cent against the US\$ and 10 per cent against the DM. While not enormous, this depreciation contrasted with inflation of under 7 per cent (and declining) in the same period. Various factors apparently induced this change. As noted above, capital inflow pressures eased as a result of the current account moving into deficit and measures introduced by the Bank of Slovenia to restrict foreign borrowing. There was also pressure from exporters for restoration of competitiveness positions, claims backed with early evidence of economic slowdown. Lower inflation and changes in indexation provisions applying to deposits¹⁸ led to lower and more stable domestic interest rates. And (self-fulfilling) expectations of a depreciation contributed to increasingly rapid switching of households out of tolar-denominated deposits later in the year. For example, the tolar – DM rate in exchange offices (used by the public to purchase foreign currencies) “over-shot” the foreign exchange market rate by 3 to 4 per cent at some points in December 1995 and January 1996, compared with a usual margin of under 1 per cent.

Concerned by the pace of exchange rate decline, the Bank placed additional restraints on the activities of exchange offices in December 1995.¹⁹ The nominal exchange rate then stabilised in February 1996, and there was a slight nominal

appreciation (0.5 per cent in effective terms) in the following six months. Together with the pick-up in inflation, this led to real appreciation of just under 4 per cent (in terms of both retail prices and unit labour costs) between February and August. These trends reversed in September and October, when the nominal effective rate fell slightly and the real rate returned to the level that had prevailed earlier in the year (Figure 13).

Figure 13. **REAL EXCHANGE RATE DEVELOPMENTS SINCE END-91¹**
1993 = 100



1. Effective exchange rate (weighted with merchandise turnover cashflow currency basket), deflated by PPI, retail prices, unit labour costs. Growth in the index denotes growth in value of the tolar and vice versa.

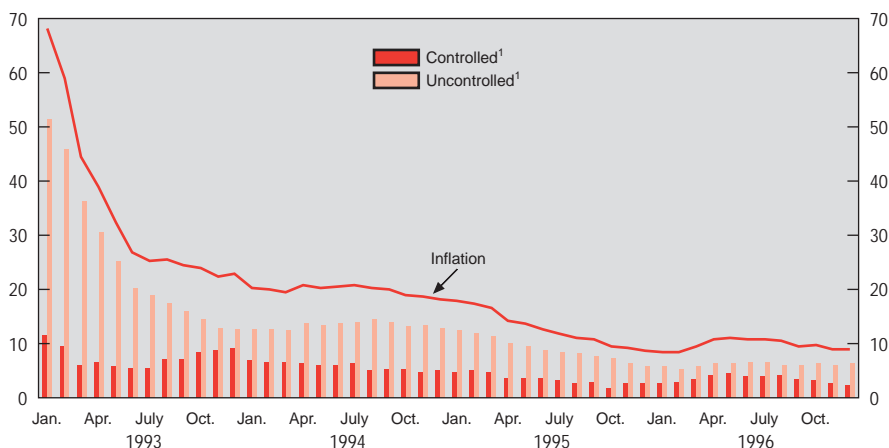
Source: Bank of Slovenia.

Implications for inflation

The exchange rate developments outlined above are reflected directly in the disinflation process. As noted above, inflation fell rapidly in 1992 – from an annual rate of around 300 per cent at the beginning of the year to under 100 per cent at year-end. Progress then slowed significantly during 1993 and 1994. Monthly retail price inflation stabilised in the range of 1 to 2 per cent over this period (averaging 1.7 per cent in 1993 and 1.4 in 1994), and the annual rate

moved down rather slowly – from 22.9 per cent at end-1993 to 18.3 per cent at end-1994. Moreover, in 1993 and 1994 there appears to have been no reduction in the core inflation of market-determined prices: *uncontrolled* prices (comprising around three quarters of all prices) contributed 12.8 percentage points to overall inflation in the year to end-1994, compared with 12.3 points to end-1993; in contrast, *controlled* prices contributed 4.9 percentage points to annual inflation in 1994 compared with 9.3 points in the previous year (Figure 14).

Figure 14. **CONTROLLED AND UNCONTROLLED PRICE INFLATION**
Per cent change over 12 months



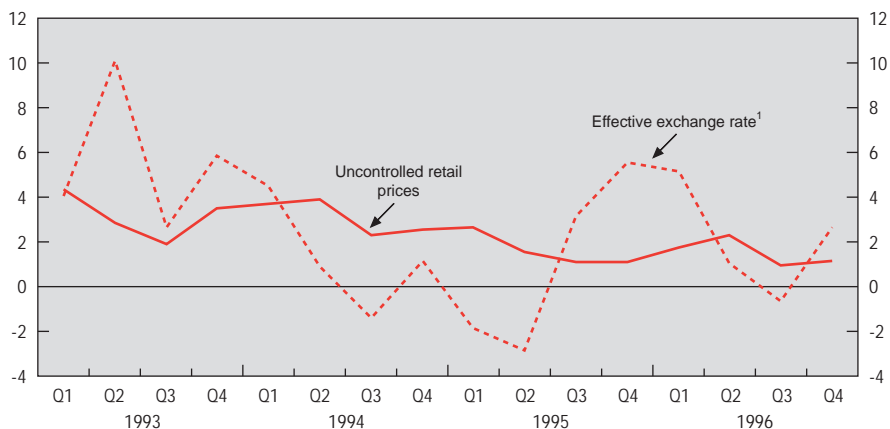
1. Bars show contributions of uncontrolled and controlled prices to total inflation.

Source: Statistical Office of the Republic of Slovenia (inflation); IMAD (controlled, uncontrolled).

Substantial further gains in inflation were not realised until early-1995, when monthly inflation moved under 1 per cent in February and remained there for all but two months during the rest of the year. By end-1995, annual inflation had moved down to 8.6 per cent; inflation in both controlled and uncontrolled prices more than halved during the year, each rising at around the same pace as overall inflation. Allowing for the lags involved – which appear to be around two quarters in this case – this fall in inflation is a direct result of the slower

depreciation and then stability in the nominal exchange rate in the mid-1994 to mid-1995 period (Figure 15). The currency depreciation since mid-1995 has probably contributed to the pause in the disinflation process in 1996, although increases in some controlled prices (such as petrol) also had an important impact in the first half of last year (as shown in Figure 14). The broader influences behind recent inflation trends are also indicated by the fact that growth in prices in the non-tradeables sector has been two to four percentage points higher than price growth in the tradeables sector in each of the last three years.

Figure 15. **INFLATION AND EXCHANGE RATE**
Quarterly growth rate in per cent



1. Effective exchange rate (weighted with merchandise turnover cashflow currency basket). A fall in the exchange rate index shown on the graph indicates an appreciation in the tolar.
Source: IMAD (uncontrolled prices); Bank of slovenia (exchange rate).

Confidence in the currency

As noted at the beginning of this chapter, the credibility of the Bank of Slovenia and of the tolar have grown from virtually a zero base to substantial levels. This progress is reflected for example in the strong growth of real

tolar-denominated bank deposits since 1991 (*cf.* Monetary Survey in Statistical Annex). Despite this progress, however, confidence in the currency still shows signs of caution and fragility. These weaknesses are most evident in two (closely related) areas: the *indexation* mechanisms and mentality that still pervade the economy; and the use of *foreign currencies* for savings and more generally as a unit of account.

Most interest rates for households and business are quoted in real terms, with a revaluation clause to adjust for recent inflation (see earlier footnote). Although the Bank of Slovenia has, since 1994, been gradually introducing and extending the use of nominal rates for monetary policy instruments, this practice appears to have developed at a slower pace in the private banking sector. Furthermore, there is extensive use of indexation in wage agreements, as described in Chapter VI. Proposals of the Bank of Slovenia (submitted when inflation fell below 10 per cent) that nominalisation of the economy be extended both within and beyond the financial sector were not accepted by the Parliament.

Foreign currency deposits at Slovene Banks currently comprise 32 per cent of M3, a proportion that has fallen by only 3 percentage points since the end of 1992. This includes around 60 per cent of household deposits which are in foreign currencies, and these deposits have been steadily rising during 1995 and 1996. Moreover, holdings of foreign exchange (whether in cash or deposits) appear to be very sensitive to prospective changes in the exchange rate – as in 1995 when the expectation of an exchange rate depreciation led to a rapid increase in foreign currency demand.

Such behaviour aimed at protecting the real value of earnings and savings is of course entirely rational, and not surprising given both the long-standing ability of citizens to hold foreign accounts and their experience of hyper-inflation conditions in recent memory. However, there are several concerns that arise in the present situation. The various “protections” from domestic price changes under current arrangements risk producing a complacency towards inflation – not just amongst individuals, but potentially also at the policy level. While much progress has been made in bringing inflation down to under 10 per cent, the current level is still far higher than in the OECD economies with which Slovenia is increasingly integrating, and is well above the range where policy-makers should be aiming. Moreover, indexation mechanisms are not fully or evenly applied across all population sectors and economic activities (for example, the fiscal position

still appears to be a net “beneficiary” of inflation). In ways that are often subtle and non-transparent, these distortions can aggravate the equity and efficiency costs of inflation (*e.g.* see Fischer, 1996 and references therein).

A further concern is that, as long as confidence in the currency is still hesitant, the Bank may be forced into a short-term policy stance focused on limiting the effects of adverse changes in public or financial market sentiment, rather than emphasising medium-term policy objectives. The most obvious example of this arises from the volatility of capital flows, which the Bank appears to view as largely beyond its control but which at times requires a substantial policy response. If the Bank is to be in a position where it can anticipate and effectively influence monetary developments over the medium term, preferably at the least cost to the real economy, stronger credibility in policy operations and objectives is essential. Some steps that may contribute to this goal are discussed next.

What needs to be done

A clearer, stronger approach is needed in three areas of monetary policy and in the broader context within which policy operates. These areas involve the specification of and commitment to firm policy objectives; greater transparency in the use of monetary policy instruments and indicators; and co-ordination with and support from other major policy areas, notably fiscal and labour market policies. Complementing these measures should be clear political backing for the Bank’s policy goals.

Policy objectives

The direction of monetary policy would be clearer if the Bank announced an explicit objective regarding low inflation and an indicative timetable for getting there. Reaching such a goal does appear already to be an important objective of the government and the monetary authorities and, as noted in Box 1, the Bank’s bills with warrants already contain an official inflation projection. Nevertheless, as implied above, it appears that policy direction is often driven by shorter-term considerations, and that the Bank is reluctant to give a higher public profile to a low-inflation goal. This hesitation apparently stems from a concern that missing a stated target could lead to a loss of policy credibility. Building credibility is certainly a key requirement. However, there are several drawbacks with the view that it is too risky or too early to announce publicly an explicit objective: without

a clear commitment to a medium-term goal, the Bank may be more vulnerable to short-term pressures; confidence in policy direction may remain guarded; and the process of building the credibility of monetary policy may thereby be excessively drawn out. On the whole, the benefits of announcing a clear goal seem to be well worth the risks that this entails.

Monetary instruments and indicators

A visible commitment by the Bank to an inflation target implies that policy operations would be seen by economic observers as consistently directed towards this goal: the expectation should be that monetary conditions would be kept sufficiently firm for the target to be reached.

There is no single policy regime which is clearly superior in this regard. For example, the Bank's monitoring and control of growth rates of the narrow money aggregates might continue to play an important role in policy operations. However, as noted above, there are concerns regarding the on-going stability and predictability of money demand, and also doubts about whether inflation can be sufficiently controlled just through money aggregate measures. Accordingly, it seems likely that the present approach would need to be supplemented by the use of a wider array of monetary indicators and instruments.

In particular, given its close links with the inflation rate, the exchange rate will inevitably continue to play a major part in the disinflation process. This need not imply a departure from the present flexible exchange rate regime: there are recent examples of successful disinflations in small open economies operating under floating rates, just as there are examples under fixed rates.²⁰ Moreover, a flexible rate can provide an important element of adjustment in the face of external shocks. Nevertheless, as in the past, the Bank may wish to influence exchange rate developments; in this regard, it could consider relying more heavily on indirect measures – especially interest rate adjustments – rather than on direct interventions. Such an approach would reduce the amount of sterilisation that is required, would be less costly for the Bank, and hence might be viewed by financial markets as more sustainable than past practices.

More generally, it might be useful for the Bank to publish routinely its operational approach and objectives, including its views on developments in key monetary indicators and instruments. Such statements could include scenarios or projections for factors expected to influence the inflation outlook, including

changes in controlled prices. There would be several potential benefits in this approach. The scenarios:

- would illustrate the *trade-offs* that are involved with respect to economic and policy choices – for example, faster growth in nominal wages would probably mean a firmer monetary stance, implying higher interest and exchange rates;
- would provide a *benchmark* against which actual monetary conditions, and the Bank's performance, could be assessed;
- and hence would provide the basis on which policy adjustments could be understood and *anticipated* by financial markets, businesses, labour organisations and the public in general.

The Bank would therefore take on a somewhat higher public profile than at present under this strategy, in explaining its assessment and expectations of monetary conditions. This greater transparency in the policy stance and rationale should help to build the Bank's credibility. In this context, expectations of a tightening or loosening in policy should tend to become self-fulfilling, rather than requiring explicit adjustments by the Bank.

Policy co-ordination and support

The real costs of disinflation will be reduced if the monetary stance is consistent with other areas of economic policy. This co-ordination needs to occur at both a macroeconomic and microeconomic level. For example, the fiscal position has generally supported monetary policy in most years since independence: general government outturns in surplus (1992, 1993) or close to balance (1995, 1996) have helped to restrain pressures on interest rates and domestic demand, and to build national savings.²¹ It is important for such consistency between the two arms of macroeconomic policy to continue, despite growing pressures on the fiscal position (see later in this chapter). Reforms in particular areas of public spending – notably the pension system and other areas of social support – can also be of assistance to monetary conditions and inflation by stimulating private savings, reducing interest rates, and hence improving investment and the supply potential of the economy.

Labour market policy is also of central importance in this context, given the close links between wage developments and inflation pressures. A firmly controlled, centralised approach may in some respects appear the most suited to

achieving aggregate wage restraint and support for disinflation. However, as suggested in Chapter VI, this system is unlikely to be in the best interests of the economy as a whole, particularly as privatisation and economic restructuring proceed. Greater capacity for relative wage adjustments – across firms, skills, regions, and other dimensions – appears essential to support the restructuring process, implying the need for greater decentralisation in wage setting. Such reforms should be accompanied by measures to progressively de-index wage adjustments from inflation outturns. In a situation where enterprises and their employees take on greater responsibility for negotiating wages and conditions, the Bank's main function would again be in the information and public relations domain – such as in pointing out the potential effects of different wage and price decisions on the real exchange rate. In this connection, it is noteworthy that, at some points over the last two years, many enterprises have expressed concerns about exchange rate trends while appearing to give less attention to recent wage developments.²²

Economic efficiency considerations dictate that there be on-going liberalisation of energy, communications, transport and other controlled prices, and steady adjustment towards market levels, even though these moves can have a direct impact on the price level. It is also important, however, that strong incentives be maintained for producers and distributors to improve their productivity, and that monopolistic elements in these activities be managed through effective regulations and restructuring (including introducing competition where possible). With such measures, pressures for persistent price increases in these areas – beyond the one-off effects of adjustment to market levels – can be reduced.

Fiscal policy

Under the self-management system prevailing in the former-Yugoslavia, public finances were mainly administered by the self-managing communities at different territorial levels. Supporting this system were a number of complex tax-subsidy redistribution schemes and a lack of significant central government control over fiscal policies. The principle of fiscal decentralisation was defended on the grounds of fiscal efficiency and fiscal discipline. The central budget was financed to a large extent from local contributions while all the budgets were required to balance every year. The monetary system was also somewhat decentralised with every republic and province having its own central bank as a part of the federal central banking system.

In 1991, Slovenia introduced an integrated central government budget and a fiscal reform (Bojnec, 1996). Despite the progress made to date, substantial vestiges of the previous system remain, however. One example is the existence of many extra-budgetary funds. Under the Yugoslav system their number was very large (over 600, including local level funds). After the creation of Slovenia as an independent state they were all abolished. However, a number of extra-budgetary entities have re-appeared, under a variety of laws and monitoring regimes (see Box 2). While their overall fiscal impact is currently small (apart from the obligatory social insurance funds), the liabilities of these organisations are likely to be viewed as backed, implicitly or explicitly, by the State. Hence, they represent an area of fiscal risk, and it is important they be brought within the overall fiscal monitoring and reporting regime. To this end, the authorities are currently preparing a general law to cover these entities, which will provide an overall regulatory regime for the organisation, auditing and supervision of their activities.

Another example of the specific Yugoslav heritage is the control of government payments and tax collection (and also all payments between legal entities) by an independent body, the *Agency for Payments*. While this Agency is widely credited with being an efficient means of tax collection and a valuable source of financial information on enterprises, the costs and centralisation of this system have been of concern. As a result, an integrated tax administration has now been established in the Ministry of Finance, and consideration is being given to setting up a more standard clearing-house arrangement between banks.

The general government in Slovenia comprises the central government, two obligatory social insurance funds (the *Health Fund* and the *Pension and Disability Fund*) and 146 local budgets. The social insurance funds are comparable in size to the state budget. For the other extra-budgetary entities noted in Box 2, their funding comes largely from the state budget, and so their financial position is to some extent reflected in the public accounts. According to the Ministry of Finance, they are currently probably in surplus in aggregate. Their aggregate revenue may be around 1.5 per cent of GDP. The consolidated general government budget has been roughly in balance since 1992: the Health and Pension Funds and local budgets have generated structural deficits that are compensated by a large surplus in the central government accounts (Table 7).

Box 2. The “galaxy” of extra-budgetary entities in Slovenia

The extra-budgetary funds and other entities have raised concerns, both because of their growing number, and because of the lack of a unified legal framework for their organisation and supervision. The fiscal impact of most of these entities is currently small (the main exceptions being the obligatory Health Fund and Pension and Disability Fund, on which the financial information is much more complete); however, given their different accounting rules, separation from the Treasury, and implicit or explicit State backing for their liabilities, these organisations risk reducing the transparency of the overall fiscal management and evaluation regime. Reflecting the range of laws and processes under which they were established, these entities take on a variety of legal forms. The authorities distinguish between two main types. The first, termed “Zavod”* by the authorities (indicated by “Z” in the list below), are either regulatory agencies or provide services on behalf of the State; they do not own their own assets, and are funded either from the State budget (if they have a regulatory role), or through their own activities (if they provide services for the State), with possibly additional resources from the State. The second type, known as Funds (indicated by “F”), own their assets and are independent from the State budget in terms of revenues and profits (*i.e.* they do not return profits to the State budget).

As noted, the obligatory social insurance funds, which have a Zavod-type structure, are fully integrated into the general government accounts. Apart from these, the next four most important funds are:

Development Fund: a joint-stock company responsible for enterprise restructuring and privatisation (see Chapter IV).

Capital Fund of Pension Insurance: a joint-stock company whose assets will be transferred to the pension fund.

Fund for Agricultural Lands and Forests: this Fund owns around half the assets of all the entities listed here.

Fund for Compensation: a joint-stock company receiving part of the former social capital for restitution purposes, (see Chapter IV).

Zavod-type agencies discussed elsewhere in the text include:

Agency for Payments.

Bank Rehabilitation Agency.

Agency for Privatisation and Restructuring.

Other entities tend to be small and targeted on specific activities:

Fund related to nuclear power (F).

Technological Development Fund (F).

Ecological Development Fund (F).

(continued on next page)

(continued)

Fund for Succession of the former Yugoslav Republic (Z).

Fund for Film production (Z).

Housing Fund (F).

Fund for the Development of SMEs (F).

Fund for non-professional cultural activities (F).

Fund for Regional Development (F).

Fund for payments of war damages (not yet operating).

Fund for Radio and Television (Z) (the National Broadcasting Company).

Agency for the Securities Market.

Agency for Insuring Bank Savings (not yet active).

Agency for handling radio-active waste (Z).

Agency for revising ownership of social capital.

* These entities appear to be roughly equivalent to the “*établissements publiques*” in France; in some anglo-saxon countries, the term “quango” (quasi-autonomous non-governmental organisations) is used as a generic term for such organisations.

Revenue and expenditure structure

Along with achieving a consolidated balanced budget, the government has been introducing significant changes in the budget structure. Tax revenues account for slightly over half of general government revenues, and it is noteworthy that their share has been increasing over time (Table 8). This is mainly due to indirect taxes, the main single component of state revenues (30 per cent). Currently, the sales/turnover tax rate varies from 5 per cent for basic consumption goods (food, books, pharmaceuticals) to 32 per cent for luxury goods (cars with over 1.8 litre engines, gold and jewellery, perfumes). In the future, the rates and/or the base of indirect taxation will probably have to increase in order to compensate for the expected decrease in social contribution rates and customs duties in the context of the European integration process.

To that end, Slovenia is planning the introduction of a value-added tax (VAT) and new excise taxes, possibly in January 1998. This tax reform would be co-ordinated by the new tax administration, covering all taxpayers, which was established in July 1996.

Table 7. **Summary of general government operations**

In billion of SIT

	1992 outturn	1993 outturn	1994 outturn	1995 <i>budget</i>	1995 outturn	1996 <i>budget</i>	1996 preliminary outturn
Central government ¹							
Revenue	217.6	319.9	421.1	519.5	520.7	576.6	612.7
Expenditure	210.9	300.7	374.0	464.0	453.0	494.3	502.2
Balance	6.8	19.2	47.1	55.5	67.7	82.3	110.6
Health fund ¹							
Revenue	80.4	105.3	120.6	140.9	139.6	163.4	169.1
Expenditure	72.3	107.3	131.9	152.8	153.2	168.1	172.9
Balance	8.1	-1.9	-11.3	-12.0	-13.6	-4.7	-3.8
Pension fund ¹							
Revenue	124.6	185.6	225.5	262.2	265.3	274.2	255.8
Expenditure	127.4	186.1	248.0	294.1	302.5	334.6	340.9
Balance	-2.8	-0.4	-22.5	-31.9	-37.3	-60.5	-85.1
Local budgets							
Revenue	40.4	62.0	80.5	71.3	81.2	87.4	100.1
Expenditure	50.3	74.1	98.0	91.8	102.4	111.3	121.2
Balance	-9.9	-12.1	-17.5	-20.5	-21.1	-23.9	-21.1
Solidarity fund							
Revenue	3.8	2.1	2.1	..	..	..	..
Expenditure	3.4	2.1	2.1	..	..	..	..
Balance	0.4	0.0	0.0	..	..	..	..
Consolidated government							
Revenue	466.8	674.8	849.8	993.9	1 006.8	1 101.5	1 137.8
(% GDP)	45.9	47.0	46.0	46.4	45.7	45.0	45.5
Expenditure	464.3	670.2	854.0	1 002.8	1 011.1	1 108.3	1 137.2
(% GDP)	45.6	46.7	46.3	46.8	45.9	45.2	45.5
Balance	2.5	4.7	-4.2	-8.9	-4.3	-6.8	0.6
(% GDP)	0.2	0.3	-0.2	-0.4	-0.2	-0.3	0.0
Privatisation							
Revenue	..	..	..	8.0	8.6	8.0	10.4
Expenditure	..	..	..	8.0	4.9	11.5	11.0
Balance	..	..	..	0.0	3.7	-3.5	-0.6
<i>Memorandum item:</i>							
GDP	1 018.0	1 435.1	1 845.8	2 141	2 202	2 450	2 500

1. Transfers between the different levels of government and the funds are netted out.

Source: Ministry of Finance, *Government Finance Accounts 1991-1996*.

Broadly speaking, social security contributions have accounted for the other half of government revenues, but their share has been decreasing (from 45 per cent in 1992 to 39 per cent in 1996). Because social contributions are a main

Table 8. Revenue structure of general government

In percentage

	1992	1993	1994	1995	1996 budget	1996 outturn estimates	1997 scenario
1. Tax revenues	46.2	46.8	52.2	52.3	53.8	54.9	58.2
<i>of which:</i>							
Corporate income tax	1.3	1.0	1.8	1.3	1.3	2.0	1.9
Personal income tax	14.7	14.5	15.1	14.5	15.1	15.0	15.6
Domestic taxes on goods and services	23.2	23.5	27.0	28.4	29.1	29.8	31.0
Custom duties	6.9	7.6	7.6	7.7	7.9	6.7	5.7
2. Social security contributions	44.7	44.5	40.8	40.2	39.3	38.9	35.3
<i>of which:</i>							
Health insurance	18.3	15.1	13.7	13.6	14.6	14.5	14.8
Pension and disability insurance	23.5	26.3	25.8	25.6	24.3	22.0	20.3
3. Non-tax revenues	9.0	8.2	6.8	6.5	6.1	7.3	6.3
4. Capital revenues	0.1	0.5	0.2	0.2	0.2	0.9	0.2
5. Revenues from privatisation	0.0	0.0	0.0	0.8	0.7	0.8	0.1
TOTAL REVENUES	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Finance, *Government Finance Accounts 1991-1996*.

component of wage costs, which have been increasing, the government has pursued a policy of reducing the social security contribution rate. From 1992 to January 1996, this rate declined from 50.35 to 42 per cent of gross wages. In July 1996, there was a further decrease in the rate for pension and disability insurance paid by employers to 8.25 per cent (from 12.85), bringing the total average rate of social contributions to 38 per cent (22.1 for the employee and 15.9 for employers). In order to compensate for the loss of revenues resulting from this measure, a selective pay-roll tax was also introduced in July 1996. However, these sources are not sufficient, by themselves, to fund current (or future) social expenditure, and additional transfers from the central government budget have been required.

On the expenditure side, two items stand out in terms both of their size and of their increasing trends (Table 9). The first concerns public sector wages, whose share in spending at both central and general government levels has increased significantly since 1992. This rise of the wage share is concomitant with a significant pressure on wage growth from the non-market sector in

Table 9. **Expenditure structure of general government**

In percentage

	1992	1993	1994	1995	1996 budget	1996 outturn estimates	1997 scenario
1. Central government	45.3	44.8	43.8	44.6	44.1	43.5	45.5
<i>of which:</i>							
Wages	12.4	13.0	11.7	15.6	16.1	16.4	16.4
Social transfers and transfers to social services	11.8	12.9	12.6	10.3	11.1	10.6	10.9
Subsidies and other transfers to business sector	6.1	4.7	3.5	3.6	2.6	2.5	2.6
Fixed assets and other capital expenditure	5.2	4.7	6.1	5.8	5.2	5.1	5.5
Defence	3.9	3.1	2.9	3.1	2.7	2.7	3.6
2. Local government	10.8	11.0	11.5	10.1	9.9	10.5	10.1
<i>of which:</i>							
Wages	2.3	2.3	2.4	1.3	1.3	1.4	1.4
Transfers to social services	4.5	4.4	4.5	4.5	4.5	4.3	3.9
Subsidies and other transfers to business sector	3.4	3.7	4.0	3.6	3.5	4.2	4.1
3. Pension fund	27.5	27.8	29.0	29.8	29.9	29.7	28.1
4. Health fund	15.7	16.0	15.4	15.1	15.0	15.1	15.1
5. Expenditure of revenues from privatisation	0.0	0.0	0.0	0.5	1.0	1.1	0.1
TOTAL EXPENDITURE	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Finance, *Government Finance Accounts 1991-1996*.

general, which may have spilled over to private sector wages. Notably, in the course of the pre-election period in 1996, strikes in the public sector (*e.g.* doctors and teachers) forced the government to agree on the principle of wage increases in 1997. These may be difficult to fulfil within the context of a balanced budget.

The obligatory Pension and Disability Fund is the second major item whose share is increasing over time. Currently, it accounts for 30 per cent of total expenditure. It is likely that the main budget pressures in the next few years will come from this fund, because the designated social contributions no longer cover its growing costs. This situation will not improve in the future, as the government is committed to reducing further the burden of social contributions on total wage costs. By its nature, however, the structural deficit of the Pension and Disability Fund can only be tackled by appropriate structural reforms (see below).

Medium-term issues

In 1997, if no additional measures are taken and all current areas of expenditure are to be covered, the general government deficit could increase to around 2 per cent of GDP. This deficit (which contrasts with the balance achieved in 1996), results primarily from the impact of increased social allowances (including pensions), and higher public sector wages. Although relatively small by international comparison, a deficit of this size would present problems for the fiscal position and is viewed as unaffordable by the Ministry of Finance; it is likely that policy orientation will continue to be directed towards a budget roughly in balance. However, in coming years, pressures on the budget are almost certain to increase unless steps are taken on pension reform and the next stage of fiscal reform. In this regard, an overall fiscal consolidation strategy could be considered.

First of all, there is scope for further reduction in the size of general government expenditures. General government expenditures represented 45.9 per cent of GDP in 1995 (Table 7). This places Slovenia below OECD European levels, but above the OECD average. An additional decrease in the revenue and expenditure shares of GDP could be envisaged, provided in part through reforms of the tax system and the obligatory social security arrangements. Although the share of subsidies in GDP has been falling, the current level of public spending goes along with a still strong presence of the government in the economy, mainly due to the slow privatisation process. This impinges on the chances of success in the private sector.

Increasing wage expenditures raise concerns about the possibility of keeping the budget deficit down in future years. Under social pressures, the government's income policy has led to the equalisation of wage growth in the market and public sectors. In order to let resources flow to the private sector and achieve better allocative efficiency, the labour market should be allowed to establish a firmer link between productivity gains and real wage growth. Therefore, a high degree of wage equality in the whole economy may be misplaced and unaffordable. Indeed, the Slovene authorities are now endeavouring to de-emphasise the practice of having explicit linkages between public and private sector wage movements.

The reform of the pension system is a key area for policy action. As the detailed analysis of the next section shows, the present pay-as-you-go pension system is unsustainable in the long-run. In addition, social contribution rates are still high. They contribute to high wage costs, adversely affect competitiveness and favour tax evasion. Further reduction in this expenditure can only be achieved in the long-run by structural reform of the pension system. This reform may be politically difficult to propose in the absence of highly visible budget deficit problems. However, in a medium-term strategy, reform of the social security system seems unavoidable (see next section).

Even with rapid progress in these areas of structural reforms, expenditure pressures from the social funds will appear in the medium term. These pressures will require an improvement in tax collection in order to ensure the source of revenues and the continuation of a balanced budget. Revenues from indirect (future VAT), profit and property taxes will have to be increased.

In connection with the VAT reform, the new tax administration will have the important task of extending the tax base in order to capture activities in the present shadow economy and reduce tax evasion. Designing an optimal VAT system is a complicated task. There is a consensus in the literature that, for a given existing VAT system, compliance is improved with a lower tax rate, fewer tax rates, more learning time and greater spending on administration (Agha and Haugton, 1996). However, the guidance provided by the literature is less clear on the start-up conditions for a new VAT system. The positive link between the size of the administration and tax compliance suggests that the new tax administration needs a critical mass to work efficiently, but it may also be difficult to decide on its optimal size before some learning takes place for the specific case of Slovenia. Until 30 June 1996, the functions of the tax office for natural persons were performed by the National Public Revenue Administration, and for legal persons by the Agency for Payments. The new uniform tax office has retained the continuity of collecting taxes and other obligatory duties, and controlling their payment. Results so far – average monthly tax collections rising by more than 10 per cent – indicate the efficiency gains of this new organisation. The Law on Taxation Procedure, which has been in use since 1 January 1997, considers all kinds of taxpayers on a more equal footing. Further scope for efficiency improvements arise from the delegation of greater powers to the tax office, particularly to tax inspectors, and the introduction of a computer-backed register of taxpayers.

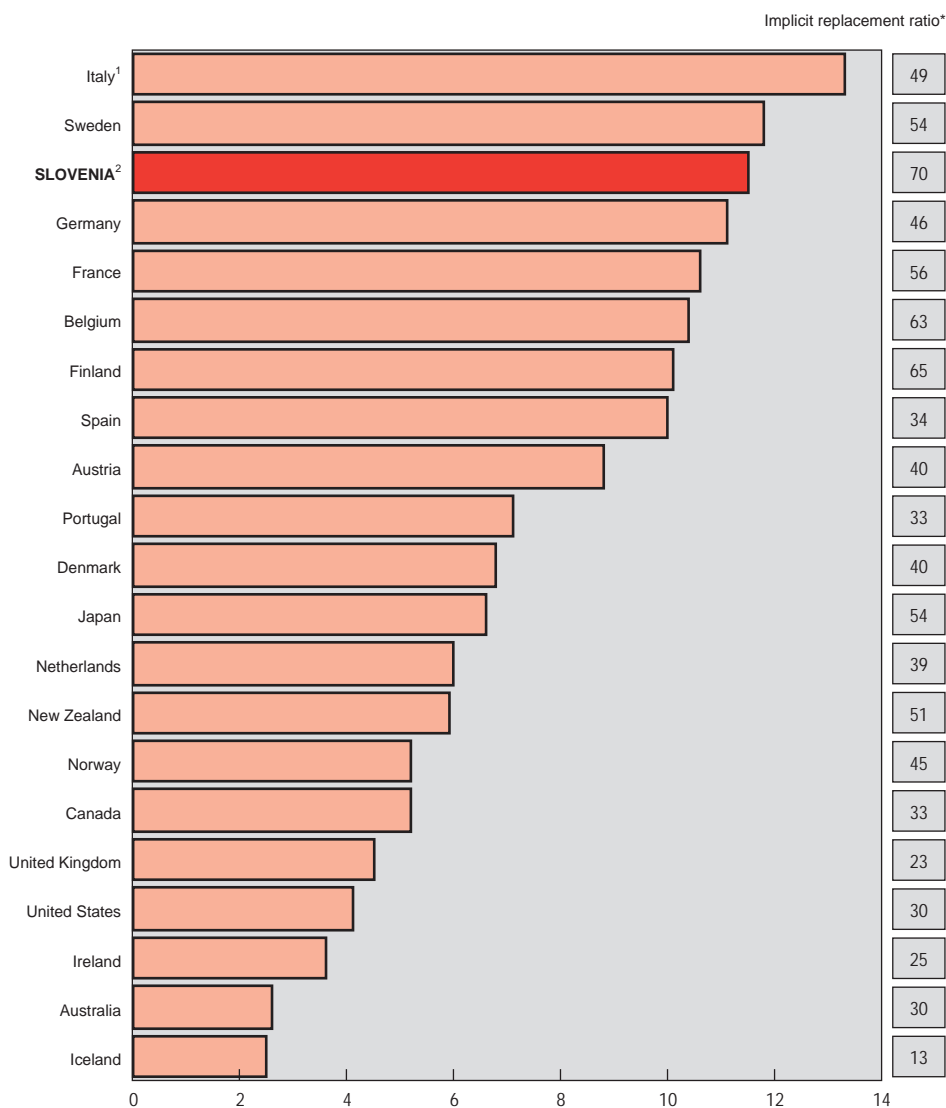
The reform of the pension system

The current pension system in Slovenia is unsustainable in the long run, and, as discussed above, represents a major source of fiscal risk for the country even in the short term. As shown in Figure 16, Slovenia currently spends a higher proportion of GDP on public old-age pensions than almost all OECD countries, virtually all of which face rising pressures from their own pension systems over the next few decades. Benefit rates, especially for those with full cover, are high by OECD standards (see below). The authorities are well aware of these difficulties: pension reform (covering disability as well as old-age pensions) is high on the list of policy priorities, with screening of reform options currently taking place.

As in other transition economies, pensions are provided almost exclusively through a state-run, pay-as-you-go system. Funding comes from social security contributions and transfers from the state budget (see above). Private pension funds appear to be in their infancy.²³ These countries, along with many in the OECD area, therefore face the challenge of meeting large, unfunded liabilities in their public pension programmes. In this regard, the scale of the funding shortfall facing Slovenia appears to be comparable with the more problematic cases in the OECD, including such countries as France, Austria, Finland, Spain and Sweden (Roseveare *et al.*, 1996). Some simple simulations can help to illustrate the extent of the problem. Projections for old-age pension liabilities are derived from a model which takes current characteristics of pension schemes (including standard retirement ages, contribution rates and benefit levels), plus legislated changes in these characteristics, and uses demographic projections for each country to build spending and revenue tracks.²⁴ While the precise results obtained from such simulations are likely to be sensitive to the particular assumptions that are used and to programme details that are not captured by the model, the results should nevertheless be broadly indicative of the trends and cross-country differences in this area.

In the ‘‘baseline’’ case illustrated in Figure 17, old-age pension expenditures rise rapidly in Slovenia over the next four decades (especially after 2015), moving from their present level of around 10 per cent of GDP to a peak of over 18 per cent in 2040. It should be noted that, as well as excluding disability pensions, these simulations do not include administrative expenditures on

Figure 16. **PUBLIC SPENDING ON OLD-AGE PENSIONS IN SLOVENIA AND IN OECD**
As percentage of GDP, 1995



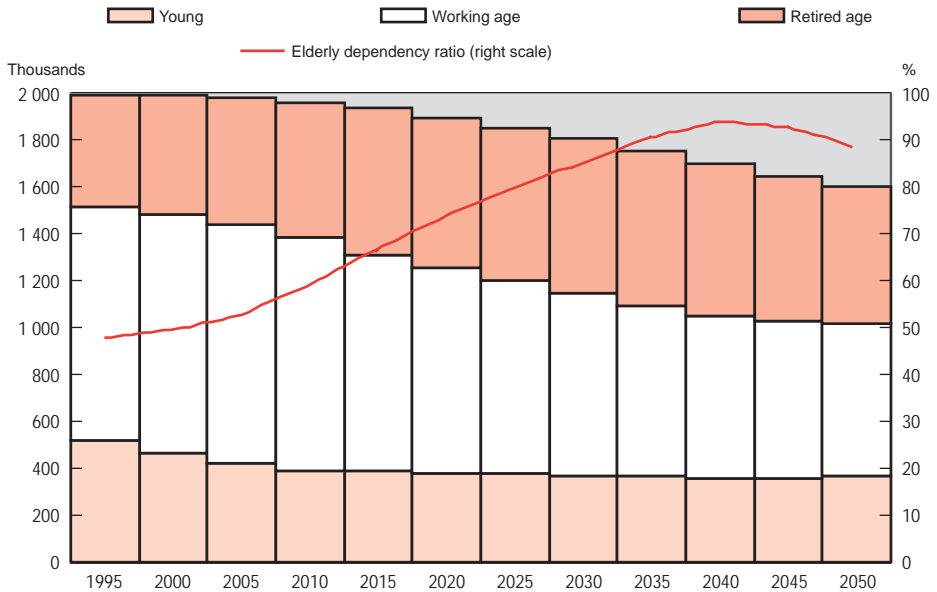
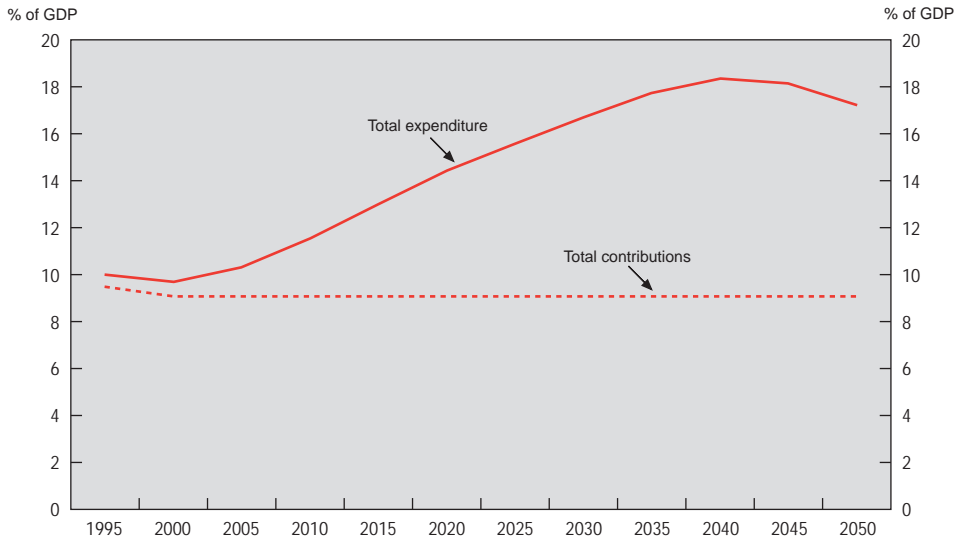
* Ratio of gross pension spending to gross wage earnings.

1. Expenditure data for Italy include disability pensions.

2. For Slovenia, the *net* replacement rate is shown (the gross rate is not available).

Source: Statistical Office of the Republic of Slovenia, OECD.

**Figure 17. OLD-AGE PENSION SYSTEM:
BASELINE SCENARIO 1995-2050**



Source: Statistical Office of the Republic of Slovenia, OECD.

pensions and some other small spending items, as these are not likely to be subject to the same demographic influences as those captured by the simulation model; these expenditures (except for disability), totalling around 1.5 per cent of GDP, are however included in the comparisons shown in Figure 16. With contributions implicitly assumed to remain stable at just over 9 per cent of GDP,²⁵ there is a rising imbalance between pension expenditures and revenues. The net present value (NPV) of the deficit to 2050 (using a discount rate of 5 per cent) is equivalent to 87 per cent of GDP (Table 10).

The elderly dependency ratio (*i.e.* the population at or above the standard retirement age, as a proportion of those of working age) is projected to rise from its present level of 48 per cent to over 90 per cent by 2040 (Figure 17, lower panel). The latter ratio is substantially higher than projections for any of the OECD countries covered in Roseveare *et al.* (1996) with the exception of Italy. The combination of several factors – affecting both eligibility and entitlements for pension benefits – contributes to these relatively unfavourable projections for Slovenia.

Eligibility

Retirement ages in Slovenia remain relatively low by OECD standards, despite recent reforms in this area. The standard retirement age for men with 40 years of insurance cover (35 years for women) is being steadily raised from 55 (50 for women), where it was in 1992, to 58 (53) as of 1998; somewhat later ages apply for those with shorter periods of insurance.²⁶ In comparison, the standard retirement ages in almost all OECD countries are now, or are being raised to, at least 65 for both men and women.²⁷

The simulation reported in Scenario 1 in Table 10 indicates the possible effects of a further increase in the retirement age (at current contribution and benefit levels). This scenario suggests that an increase in the standard retirement age (*i.e.* for full insurance cover) to 61 by 2005 for men, and by 2010 for women, would largely “solve” the longer-run pension deficit. This would imply an increase of around four years in the standard retirement age for men, and eight years for women, compared with current levels. Such results must be viewed with caution, given the limitations of the simulation model; however, they do indicate that, as in the OECD area, later retirement should be viewed as a central part of policy measures to meet future pension liabilities.

Table 10. **Old-age pension system: alternative scenarios 1995-2050**

	1995	2000	2005	2010	2015	2020	2025	2030	2035	2040	2045	2050
Baseline scenario¹												
<i>In % of GDP</i>												
Total contributions	9.5	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1
Total expenditure	10.0	9.7	10.3	11.5	13.0	14.4	15.6	16.7	17.7	18.3	18.1	17.2
Balance	-0.5	-0.6	-1.3	-2.4	-4.0	-5.4	-6.6	-7.6	-8.6	-9.3	-9.0	-8.2
<i>Net present value 1995²</i>												
NPV contribution in % of GDP	234.4											
NPV expenditure in % of GDP	321.0											
NPV balance	-86.6											
Scenario 1³												
<i>In % of GDP</i>												
Total contributions	9.5	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1
Total expenditure	10.0	8.5	7.4	7.0	7.9	8.9	9.9	10.6	11.1	11.7	12.0	11.9
Balance	-0.5	0.5	1.6	2.1	1.2	0.1	-0.8	-1.6	-2.0	-2.6	-2.9	-2.9
<i>Net present value 1995²</i>												
NPV contribution in % of GDP	253.5											
NPV expenditure in % of GDP	246.2											
NPV balance	7.3											
Pension expenditure variation from baseline	0.0	-1.1	-2.9	-4.5	-5.2	-5.5	-5.7	-6.0	-6.6	-6.7	-6.1	-5.3
Scenario 2⁴												
<i>In % of GDP</i>												
Total contributions	9.5	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1	9.1
Total expenditure	10.0	9.0	8.9	9.9	11.2	12.9	13.3	13.9	14.8	15.2	15.4	14.2
Balance	-0.5	0.1	0.1	-0.8	-2.1	-3.8	-4.2	-4.9	-5.7	-6.1	-6.4	-5.2
<i>Net present value 1995²</i>												
NPV contribution in % of GDP	234.4											
NPV expenditure in % of GDP	282.2											
NPV balance	-47.8											
Pension expenditure variation from baseline	0.0	-0.7	-1.4	-1.6	-1.9	-1.6	-2.4	-2.7	-2.9	-3.2	-2.7	-3.0

- Baseline scenario:** Employment grows with the working-age population; real GDP and real wages grow with 1.5% productivity rate and with employment; the contributions calculated using total contributions paid over total wages in 1995; the implicit replacement ratio (average benefits/average earnings) remains constant; the eligibility ratio is 75.8%; pension expenditures grow with wages; the retirement is 57 for men, and 52 for women; disability pensions are excluded.
- The net present value (NPV) refers to today's value of future receipts and payments, the calculation assumes a discount rate of 5% per year over the period 1995-2050.
- Scenario 1:** The average retirement age rises to 61 years in 2005 for men, in 2010 for women.
- Scenario 2:** Pension expenditures are indexed to price (rather than wage) growth.

Source: Statistical Office of the Republic of Slovenia; OECD.

Slovenia also made extensive use of early retirements during the restructuring process (especially between 1990 and 1992). This is reflected in patterns of labour force participation: for example, the participation rate of males aged 55 to 59 is currently 48.6 per cent (down from 50 per cent in 1990 and nearly 60 per cent in 1980), and 16.6 per cent for females (23 per cent in 1990 and 28 per cent in 1980). In contrast, participation rates in the same age range in EU countries average 69 per cent for males and 36 per cent for females. Early pensions are currently available at age 58 for men with at least 35 years of insurance, and 53 for women with at least 30 years' cover; eligibility arises if individuals lose their jobs due to enterprise failure, have a recent history of long-term unemployment, or have work-related invalidity. While taking pressure off unemployment rolls, this policy increases benefit expenses and reduces the potential contribution base of the pension system, while favouring the exit of many productive people from the workforce.

Entitlements

Comparisons of entitlement levels are not straightforward, largely because of the wide variety of insurance (and also tax) arrangements across and even within countries. Nevertheless, provisions in Slovenia appear generous in comparison with those generally found in OECD countries. The pension benefit for individuals with the full insurance cover described above is 85 per cent of the pension base, which is calculated according to average wages over the "best" ten years.²⁸ Averaged over all pensioners, the net replacement rate appears to be just over 70 per cent (comprising around 77 per cent for contribution-related old-age pensions and 54 per cent for survivors' pensions).

In comparison, standard replacement rates for those with *full* cover in OECD earnings-related schemes (as cited in Roseveare *et al.*, 1996) are often in the 40 to 60 per cent range (*e.g.* in the US, Germany, Austria, Finland, Portugal, and Sweden), although rates substantially higher and lower than these are found in some countries. The pension base tends to take into account a longer period of earnings, particularly when recent reforms are fully phased in (*e.g.* this period is due to move from 10 to 25 years in the major private sector scheme in France, and from five years to lifetime earnings in Italy). Such longer periods reduce incentives for earnings to be artificially boosted just before retirement, and reduce

the impact on final pension levels of rising returns to skills and experience over the working life (returns which, as noted in Chapter VI, have been increasing in Slovenia).

Pension benefits in Slovenia (as well as the earnings' base on which benefits are calculated) are indexed according to overall wage growth. In a large majority of OECD countries, pensions are indexed to prices rather than wages. Scenario 2 in Table 10 indicates the possible results if Slovenia moved to price indexation. The effects are substantial: the NPV of the pension deficit would be cut virtually in half, to under 50 per cent of GDP. Over the period from the present to 2050, the implicit benefit level would fall from around 70 per cent to 60 per cent of average earnings.

The calculation base for pension benefits is reduced by two percentage points (and sometimes 3 percentage points for women, depending on the contribution period) for each year of eligibility below the standard qualifying period (e.g. from 85 to 83 per cent of the pension base if the recipient is one year short of the period required for full cover). There is a further reduction of 1 per cent per year in the pension benefit in the case of early retirement (applied until the standard retirement age is reached). These appear to be well below the adjustments that would be actuarially "fair": for example, reduction rates in the range of 5 to 7 per cent per year are found under early retirement provisions in some OECD countries (including the United States, France, Belgium and Sweden). Individuals in Slovenia are also able to "purchase", on favourable financial terms, additional years of insurance (covering, for example, time spent in higher education or in the armed forces) in order to increase their level of benefits.

Directions of reform

The assessment and simulations described above suggest some of the directions of reform that should be considered to preserve a viable public pension scheme in Slovenia. As in all pension planning, the required adjustments in retirement behaviour and savings patterns will be less severe, the sooner reforms begin. In this regard, it is encouraging that the Slovene authorities are actively considering reform proposals; it is important that a robust scheme be selected and implemented without undue delay, preferably with broad-based public and political support to increase the prospect that changes are durable. Reforms are also

intended for disability pensions, an area where – as suggested by experiences in some OECD countries – there tends to be significant risks of moral hazard and spending growth.

The reform model that is favoured by the authorities would involve a three-pillar pension system:²⁹ this would comprise the continuation of a “slimmed-down” version of the current pay-as-you-go (PAYG) scheme; the introduction of a compulsory, fully-funded scheme where individuals invest in personal pension accounts managed by mutual, public, or other forms of funds; and voluntary additional pension savings, managed by private funds, for those wanting higher retirement incomes than provided under the compulsory provisions.

This reform is consistent with recommendations of the major international financial institutions regarding the optimal design of pension schemes;³⁰ and is broadly comparable to reforms currently being implemented in a number of OECD countries (including the United Kingdom, Australia, Norway and Sweden). Under these arrangements, the equity role of pensions – particularly with respect to basic income support and redistribution – would be concentrated in the compulsory PAYG scheme, but with lower overall benefit levels than under current arrangements. Other reforms (as implied above) to the present system should also be considered in order to improve its financial viability, including pushing back the retirement age and ensuring that entitlements under early retirement provisions (if available at all) are actuarially fair.

Saving for retirement benefits that are above those provided under the basic PAYG scheme could in principle be a matter of individual choice, provided future retirees were fully aware of the relatively low (and possibly declining) level of benefit they could expect to receive from the basic scheme in comparison with present arrangements. However, given the extent of reform that is required (*e.g.* in attitudes towards and responsibilities for pension provision), some degree of compulsion may be justified in order to develop long-term savings. Compulsion should nevertheless be directed towards only limited levels of provision, so that individuals still face substantial flexibility and choice regarding the level and form of retirement savings. For example, voluntary components of provision for retirement need not be viewed just in terms of savings in designated retirement funds, but in terms of overall accumulation of long-term assets: these could include financial instruments, housing, and other recognised stores of value. In

other words, beyond compulsory levels of provision of basic and income-related pension support, people should face neutral choices³¹ between a rather wide set of assets in which to store and accumulate wealth.

Finally, public policy in this area needs to play a key role in three further respects. First, an effective regulatory regime has to be put in place to ensure the financial viability of pension funds, to promote competition between funds, and to support growth in the financial sector more generally (as discussed in Chapter III). Second, the maintenance of fiscal restraint and low levels of public debt will help provide greater room for manoeuvre as pressures of the pension system on public sector budgets increase. Third, further progress toward low inflation and overall monetary policy credibility will encourage growth in long-term financial planning among market institutions and the public in general.

III. Restructuring: the banking sector³²

Background

The banking sector in Slovenia has undergone profound changes in recent years, largely as a result of the twin ‘‘shocks’’ of adjustment towards a competitive, market-orientated system, and of management of the substantial stock of bad debts that arose (or at least were revealed) during the transition process. While such shocks are common to all of the economies in transition, there were several rather unusual features of the Slovene banking sector – some of which may have assisted, and others which complicated, the adjustment process. For example:

- there was already some degree of competition and market behaviour in the system. In the early 1980s, there were 16 banks in Slovenia. However, until 1990 there was one dominant group in the banking sector, Ljubljanska Banka group (the ‘‘republic’’ bank for Slovenia), which had around 90 per cent of total Slovene bank assets. The other banks were branch offices of banks in former-Yugoslavia, and Ljubljanska Banka also had branches throughout the Federation;
- banks had a well-established international network and experience with international banking (including in the West);
- social enterprises were the founders and owners of banks. On the one hand, this has meant that as these enterprises were privatised, banks also passed directly into private ownership (although, as noted below, two major banks are currently state-owned). However, social control implied that banks’ lending behaviour was driven largely by political and ownership interests, with insider lending institutionalised;
- at the time of independence, Slovene banks lost assets elsewhere in ex-Yugoslavia but retained liabilities (including ‘‘joint and several liabilities’’ to creditors of ex-Yugoslavia). For example, banks had formerly placed almost all of their foreign currency deposits in the central bank in

Belgrade. These deposits (amounting to DM 660 million in the case of Ljubljanska Banka) have not been returned to Slovenia. A means of repaying depositors in Slovenia was settled on in 1993, but liabilities (of over DM 500 million) to depositors of Ljubljanska Banka branches in other parts of former-Yugoslavia remain.³³ When the Nova Ljubljanska Banka and Nova Kreditna Banka Maribor were formed in 1994 (see below), the latter liabilities remained at the ‘old shell’ banks, and became the subject of negotiation and succession processes with the other republics.

Bank restructuring and rehabilitation

The loss of bank assets as noted above, together with the sharp downturn in enterprise performance in the early years of transition, led to significant deterioration in banks’ loan portfolios. In 1992, 13 of the 26 banks that were then in operation (accounting for over 70 per cent of deposits) had losses, and over 30 per cent of loans were non-performing. In early-1993, the two largest banks – Ljubljanska Banka (LB) and Kreditna Banka Maribor (KBM) – were placed under a formal rehabilitation programme, and in early-1994 they were joined by the 6th ranking bank (Komericalna Banka Nova Gorica, which was later acquired by KBM). These banks comprised over 50 per cent of the Slovene banking sector in 1993, and around 45 per cent of their loans were non-performing when they were put under rehabilitation. The Bank Rehabilitation Agency (BRA), which has the principal responsibility for conducting the rehabilitation programme, was set up by government decree in October 1991.

The key step in the rehabilitation process was the exchange of non-performing assets and contingent liabilities of these banks for bonds issued by the BRA.³⁴ A total of DM 1.9 billion of bonds was issued, equivalent to just under 10 per cent of 1993 GDP. This swap removed around two-thirds of the bad assets from the three banks, so that around 15 per cent of their loans remained non-performing. Ljubljanska Banka, for example, retained direct responsibility for supervision of around 40 companies with problem loans. The decision not to completely clear the banks’ balance sheets of non-performing assets was designed to reduce the scope for moral hazard, and to ensure that the banks themselves would face on-going pressures to increase profitability and improve their financial positions.

Three important rehabilitation transactions followed this initial step. First, in July 1994, the Nova Ljubljanska Banka (NLB) and Nova Kreditna Banka Maribor (NKBM) were established. In dividing the balance sheets between the old and new banks, the old banks retained all claims and liabilities to former-Yugoslavia. Second, in November 1995 the original BRA bonds (which were 30-year DM-denominated bonds) were replaced by tolar-denominated state bonds. The latter bonds have shorter and variable maturities, bear lower interest rates, but are marketable immediately; their issuance thereby decreased profits, but eliminated serious currency and maturity mismatches in NLB's and NKBM's balance sheets. Third, an agreement was reached in Spring 1996 between Slovenia and foreign private creditors regarding debts of former-Yugoslavia. This agreement, negotiated through the London Club, helped to release Slovene banks in rehabilitation from the "joint and several liability" clause between former-Yugoslavia and foreign private creditors, and contributed to improvements in Slovenia's credit rating.

In addition to supervising the banks in rehabilitation, the BRA has been engaged in managing the bad assets that were transferred to it. Under the exchange described above, the BRA acquired claims totalling over DM 1 billion in 102 enterprises. The BRA's actions have involved a combination of loan rescheduling, debt-equity swaps, receipt of cash payments with a discount, and debt write-offs. Overall, 32 per cent of bad debts have been recovered. Through its management of bad assets, the BRA has received (as of end-1996) DM 151 million in cash, DM 139 million in shares and equity stakes, and DM 58 million has been rescheduled; DM 319 million has been written off. According to the BRA, it has recovered most small-company debt. However, the major share of bad debts arose from relatively few loans to some large enterprises, and the status of these claims is therefore dependent on broader restructuring questions and requirements facing these firms.

Current state of the banking sector

Financially strong...

Four years after the start of the rehabilitation programme, the financial position of the major Slovene banks has improved significantly. Judging by the number of banks and distribution of banking services between them, the level of

competition in the sector has also increased; however, as discussed in more detail below, there are several concerns in this regard, including a cartel agreement covering all the banks and setting maximum interest rates on deposits.

There are currently 28 banks operating in Slovenia, 14 of which have a full licence;³⁵ 12 banks have some degree of foreign capital, including four with a majority foreign share. Several indicators of the sector's performance between 1992 and 1995, and estimates for 1996, are shown in Table 11. Aggregate net income (before taxes) has turned around from a loss of over SIT 15 billion in 1992 to a surplus of SIT 13.8 billion in 1995. All but three banks were profitable in 1995, including consolidated net profits of SIT 4.7 billion at NLB and SIT 1.8 billion at NKBM (representing returns on equity of roughly 20 per cent in each case). Higher profitability has arisen through a combination of improved earnings and restraint on operating expenditures. This is particularly evident in the case of the banks undergoing rehabilitation. At NLB, for example, employee numbers have fallen from 3 400 in 1991 to under 2 500 in 1995 (although most of this decline occurred between 1991 and 1993). Of the banks incurring losses, the most significant case concerned Komercialna Banka Triglav, which ranked in 12th place according to assets. Liquidation proceedings were begun against this bank in June 1996, followed by bankruptcy proceedings (see Box 3).

Table 11. **Income statement of the banking sector, 1992-96**

In million SIT

	1992	1993	1994 ¹	1995 ¹	1996 estimate
Number of banks	30	32	33	31	28
Net interest	40 925	70 142	31 153	42 128	51 316
Net commissions	9 698	15 566	11 695	19 692	23 657
Net other income	-14 118	-14 297	13 000	19 320	-519
Operating expenses	-16 261	-22 180	-36 828	-44 689	49 560
Depreciation	-2 296	-3 267	-3 330	-6 103	5 663
Net write-offs, provisions	-33 464	-45 626	-11 018	-15 180	22 488
Net income before taxes	-15 516	338	4 672	13 800	21 710
Return on equity (%)	-15.1	0.2	2.7	7.2	12.2
Return on assets (%)	-2.5	0.0	0.4	1.0	1.3
Assets/equity	6.1	6.6	6.9	7.0	9.7

1. Before audit revisions.

Source: Republic of Slovenia (1996a); Bank of Slovenia; IMAD.

Box 3. The case of Triglav bank

The only case of banking failure since 1991 is the Triglav bank. The non-audited 1995 financial results for this bank did not indicate that major difficulties lay ahead, especially not the liquidity problems that occurred in Spring 1996. The weaker points in these results were below average rates of return on equity and assets, above average interest rates and liquidity, low costs, but credit expansion above average.* However, the audit report finished in May 1996 set additional write-offs and bad loan provisions at SIT 950 million, leading to an audited income statement showing a loss of SIT 901 million. The audited balance sheet still showed positive capital of SIT 3.2 million.

Before its troubles started, Triglav was the twelfth largest bank, with 1.8 per cent of total banking sector assets and 1 per cent (102) of sector employees. The bank was apparently over-aggressive in a policy of increasing its share of banking, offering higher than average rates for deposits which then entailed charging higher rates to borrowers. Only higher risk clients were willing and able to borrow at these high interest rates. The mis-match in Triglav's balance sheet was also significant: short-term financial resources were used for longer term credits to clients.

The auditor's report led to some depositors shifting funds to other banks. At this time, however, Triglav Bank held no Bank of Slovenia (BoS) or government debt instruments that could have been used for refinancing. As a result, the BoS had no basis for assisting the bank, and other banks were also reluctant to provide funds in these circumstances. Indeed, if the Bank of Slovenia had devised other means of refinancing Triglav, even in the absence of discountable paper, this would have set a dangerous precedent and increased moral hazard risks in the system as a whole.

Bank activity was frozen for 15 days, after which the liquidation procedure was introduced at the beginning of July 1996. During that procedure the appointed liquidation manager established that the value of Triglav bank's liabilities significantly exceeded its assets (claims), and changed the procedure into bankruptcy. But, on the initiative of major creditors (depositors) of Triglav bank, the Court of Appeals overruled the decision of the liquidation manager (hence returning Triglav to liquidation procedure), and ordered the Bank of Slovenia to start a new examination. This examination found a deficit of SIT 8.5 million between the liquidation value of the bank's assets and its liabilities (even higher than the deficit estimated earlier by the liquidation manager). As a result, the Court introduced bankruptcy proceedings over Triglav bank on 27 December 1996.

The first bank collapse in independent Slovenia triggered immediate strengthening in the Central Bank's prudential regulation: in August 1996, special requirements regarding matching of the term structure of banks' assets and liabilities were introduced; and a

(continued on next page)

(continued)

stand-by mechanism was built in for possible reaction within the banking sector in the case of similar events in the future. All banks now hold (voluntarily) some level of secondary liquidity, and so the Triglav case may have provided some useful lessons regarding prudent bank behaviour. Following the collapse, deposits started to move towards larger, established banks (including Nova Ljubljanska Banka) and the first signs of strategic alliances appeared. However, as the short-term liquidity alert calmed down very quickly and no special reasons existed for such troubles to recur, moves in the direction of further consolidation of the banking system (decreasing the number of banks) have ceased for the time being.

* Non-audited results in 1995 for Triglav Bank (with sector-wide averages in parentheses) were ROE 4.9 per cent (7 per cent); ROA 0.8 per cent (1 per cent); real active interest rate 7.5 per cent (6.1 per cent); real passive interest rate 4.1 per cent (3.6 per cent); total interest rate margin 2.9 per cent (3.3 per cent); costs/assets 2.3 per cent (3 per cent); liquid assets/total assets 10 per cent (5 per cent); loans/deposits 123 per cent (104 per cent). However, the results from the audited financial statements were ROE -23.1 per cent, ROA -3.9 per cent.

In the sector as a whole, returns on equity and assets have increased significantly since 1992. However, the return on equity – averaging 7 per cent overall in 1995³⁶ – ranged from 6 per cent on average in the small banks to 10 per cent in the large ones (with relatively high returns at NLB and NKBM as noted above) (see Annex Table). At least in the case of some smaller banks, this rate of return appears low in comparison with alternative investments, suggesting the need for consolidation and further productivity gains in the sector (see below). The combined capital of NLB and NKBM improved from DM -1.0 billion before rehabilitation began in 1993, to over DM 0.4 billion in 1995 – a result of profitable performance during the rehabilitation process, and of the lower need to build provisions against non-performing loans.

The quality of bank assets has also improved since 1993. As noted above, when NLB and NKBM entered the rehabilitation process, they retained a loan portfolio of which around 15 per cent was non-performing. In 1996, this share is under 5 per cent. In the sector as whole, the share of bad assets in total assets has declined from 7.6 per cent in 1993 to 3.9 per cent in 1995. The classification of credit exposures shown in Table 12 indicates a steady increase since 1993 in

Table 12. **Bad assets in Slovene banking sector**

In million SIT and percentage

All banks	1993	1994	1995
Bad loans	n.a.	62 350	55 789
Bad loans/total assets	n.a.	5.06	3.58
Bad assets, on and off-balance	90 018	80 723	68 949
Bad assets/total assets	7.6	5.6	3.9

Classification of credit exposures of banks			
Credit exposures grade ¹	% of total credit exposure		
A	81.1	86.1	89.4
B	6.6	5.7	4.8
C	4.7	2.5	1.9
D	3.2	2.6	2.1
E	4.3	3.1	1.8

1. Credits are categorised as follows: A = payments on time; B = payments up to 30 days overdue; C = 31 to 180 days overdue; D = 181 to 365 days overdue; E = over 1 year overdue.

Source: Republic of Slovenia (1996a).

A-grade credits and decrease in all categories of classified credits. Nevertheless, Borak (1995) notes that the slow pace of debt restructuring in the enterprise sector has limited the extent to which banks can further lower their credit risks. He also expresses concern about the quality of risk assessment techniques and expertise in the banking sector.

Slovene banks appear to be well-provisioned against non-performing loans and assets.³⁷ In the case of the banks undergoing rehabilitation, actual provisions are almost 100 per cent of those required under international standards. In addition, other measures of risk, such as net foreign currency exposure and maturity mismatches, have been reduced. In the sector more generally, banks are over-capitalised – partly as the result of high capital requirements set by the Bank of Slovenia for a full banking licence.³⁸ The average capital adequacy ratio at end-1995 was 21.7 per cent, well above the 8 per cent minimum requirement. While this situation reduces banks' profits and should in time induce some consolidation in the sector (see below), this strong capital position adds a further important margin of protection against foreign exchange risks, and against current and potential non-performing assets.

... but with some persistent structural difficulties

While its financial health has improved significantly in recent years, the Slovene banking system still faces a number of actual or potential structural difficulties – particularly in comparison with more developed OECD economies. These problems could place important limitations on the extent to which the sector can meet the needs of economic restructuring and growth. Two broad areas of concern are discussed here: these involve the depth and sophistication of the financial system; and the extent of concentration and competition, including the cartel agreement on deposit rates.

Financial sector depth and sophistication

Despite some progress during the transition so far, the financial system in Slovenia is still shallow in comparison with OECD and other Central European economies. As indicated in Table 13, the ratio of the main money aggregates to GDP is significantly lower in Slovenia than in the OECD area and elsewhere in Central Europe. Total banking sector assets are also relatively low at around 70 per cent of GDP. As of end-November, 1996, 46 per cent of overall bank assets (excluding the Bank of Slovenia) consisted of claims on domestic non-financial enterprises and individuals (well below deposits of these entities); the other sizeable shares comprised foreign assets (24 per cent of total assets), and claims on general government (21 per cent, largely central government securities

Table 13. Money aggregates as share of GDP, 1995

	M1	M2	M3
Slovenia	8.7	29.1	42.6
Austria	18.6	89.8	..
Czech Republic	36.2	83.0	..
France	23.7	..	71.3
Germany	23.6	36.4	55.5
Hungary	18.7	42.9	..
Italy	34.1	62.8	..
Poland	13.1	36.5	..
Portugal	26.3	76.2	..
Slovakia	28.6	69.0	..
Switzerland	42.9	94.5	118.0

Source: Bank of Slovenia; OECD.

issued as part of the rehabilitation process). While supporting the picture of a financially stable system, these data suggest there is scope for further provision of domestic intermediation services to support private sector growth.

The low level of monetisation in the economy is also reflected in the widespread use of foreign currencies for deposits, loans and as a general unit of account. As discussed in Chapter II, these patterns (which do not appear to be abating) complicate the task of monetary policy and suggest continuing lack of confidence in the domestic currency; as noted earlier, they have also led to increasing restrictions on banks' foreign currency operations.

More broadly, the market for domestic financial services is underdeveloped. Banks appear to restrict their activities to classical banking services, while more sophisticated products and services (such as investment banking) are just beginning to emerge. Even the foreign banks that have entered the system appear to be largely replicating these standard services rather than adding elements of innovation and sophistication. Domestic banks, including those conducting international transactions, have limited expertise and participation in foreign financial markets, and this may impede the strengthening of domestic financial services (Borak, 1995). Furthermore, banks have little opportunity or incentive to be innovative in deposit services at present as a result of direct restraint on competition in this market (see below).

The present ownership structure in the banking system may be contributing to this lack of dynamism. As noted earlier, around 40 per cent of banking sector assets are still under state control and, amongst the private banks, important links still appear to exist between banks and the enterprises that used to fully own them. Both of these situations clearly give rise to risks of moral hazard, and may also have limited the development of the sector: state-owned banks may have been required (or at least encouraged) to maintain a very cautious approach during the rehabilitation process, and private banks may also have tended to stay with traditional borrowers and services rather than diversifying their activities.

Deconcentration and competition

There has been substantial reduction in the degree of concentration of the Slovene banking sector during the transition process, especially prior to 1995; there are, however, some signs of increasing concentration over the last two years. The individual and collective shares of the seven largest banks in assets,

equity, loans and deposits are shown in Table 14. The dominant role of NLB has diminished, with its share of total assets falling to 29 per cent in September 1996. The change in NLB's share of loans and total assets since early-1994 is the main reason for the declining share over this period of these 7 banks taken together. However, NLB's share of deposits increased quite sharply (by 5 percentage points) in 1996; this appears to be a result, at least in part, of switching of deposits from the failed Triglav bank into NLB (see Box). Overall, the degree of concentration in Slovenia appears comparable with some of the more concentrated systems in Western Europe – below that of the Netherlands, close to Belgium and France, and well above Spain, the United Kingdom, Italy, and especially Germany (Stiblar, 1995).³⁹

The large number of small banks in this system has led to a widespread perception that Slovenia is “over-banked”. For example, when ranked by assets, the top 10 banks account for nearly 80 per cent of total system assets, and the smallest 10 account for under 7 per cent (see Annex Table). In such circumstances, it is difficult for many banks to achieve economies of scale and to provide intermediation services as efficiently as the larger institutions. Using indicators such as total assets/capital and total assets/employees, Stiblar (1995, 1996) finds that the “productivity” of Slovene banks is around one-third the level of developed market economies – largely because many of the smaller banks do not use capital and labour very efficiently. High capital requirements for a banking licence, as noted above, were imposed by the Bank of Slovenia partly in an attempt to induce some consolidation among the smaller banks. Instead, banks have been endeavouring to build their capital individually, leading to the present state of over-capitalisation.

In time, various types of market pressure may produce some rationalisation. The relatively high costs of doing business and low rates of return on equity should tend to make it increasingly difficult for many banks to continue attracting customers and capital participants. Further competition may arise from proposed changes in the banking law (see below) which *inter alia* would allow branches of foreign banks to begin operations in Slovenia.

As noted above, competition between banks is currently artificially restrained through a cartel agreement covering all the banks, which sets maximum interest rates on deposits. This agreement, introduced in April 1995 and renewed until March 1997, has been approved by the anti-monopoly office and is

Table 14. **Bank concentration**

Banks	31.1.94	31.12.94	31.12.95	30.9.96
TOTAL ASSETS				
Total assets in banking system (SIT billion)¹	965	1 167	1 484	1 686
Share of total (%)				
GB Kranj	5	4.7	4.4	4.4
Abanka	4	5.2	4.6	5.0
Banka Celje	8	4.4	4.7	4.8
SB Koper	7	6.4	5.5	5.7
NKB Maribor	7	11.4	11.0	11.6
SKB	9	11.6	12.0	11.8
NLB Ljubljana	40	31.4	29.0	28.6
7 biggest banks ²	79	75	71	72
EQUITY (capital)				
Capital and reserves in banking system (SIT billion)¹	100	143	177	180
Share of total (%)				
GB Kranj	11	9.8	8.5	7.8
Abanka	4	2.8	3.4	3.3
Banka Celje	8	6.6	6.2	6.1
SB Koper	8	4.9	6.2	6.1
NKB Maribor	5	7.7	7.9	8.3
SKB	13	11.9	12.4	12.8
NLB Ljubljana	7	12.6	13.0	15.0
7 biggest banks ²	55	56.3	57.6	59.4
LOANS TO NON-BANKING SECTOR				
Loans to non-banking sector in banking system (%)	100	100	100	100
GB Kranj	4	5	5	4
Abanka	3	4	4	4
Banka Celje	4	4	5	5
SB Koper	8	8	5	5
NKB Maribor	5	4	8	8
SKB	16	16	16	16
NLB Ljubljana	31	22	22	21
7 biggest banks ²	71	63	64	65
DEPOSIT OF NON-BANKING SECTOR				
Deposit money banks in banking system (%)	100	100	100	100
GB Kranj		4	4	4
Abanka	6	6	6	6
Banka Celje	5	5	5	5
SB Koper	8	7	7	6
NKB Maribor	8	8	13	12
SKB	11	13	13	11
NLB Ljubljana	28	25	23	28
7 biggest banks ²	70	68	71	73

1. The data on total assets and equity do not include the assets of the former Ljubljanska Banka (LB) and Kreditna Banka Maribor (KBM), which are still under negotiation.

2. Total assets > 50 billion SIT at 31 December 1995.

Source: Stiblar (1996).

also supported by the Bank of Slovenia (*e.g.* banks offering higher rates than those stipulated in the agreement face more restrictive reserve requirements). The perceived need for such a cartel apparently stems from an earlier period when some smaller banks bid “excessively” high prices for very large deposits, including those of off-budget state funds, leading to high deposit and hence lending rates in the system as a whole. Faced with a high interest elasticity of supply of funds from the institutional sector, and a low demand elasticity, banks competed much more actively in the deposit rather than in the loan market (Bole, 1996*b*). Moreover, the new small banks competed for deposits in order to increase lending to larger banks and brokerage houses, rather than to the real sector. The interest rate agreement was therefore seen as a way of rectifying this “imbalance” between deposit and loan-side competition. On the one hand, this agreement – which resembles interest rate restraints that, in the past, have been applied in a number of OECD economies – is credited with helping to bring down interest rates during 1995 and reducing systemic risk in the sector as a whole. It appears to be widely supported in the banking sector, albeit with some exceptions.⁴⁰ On the other hand, such an arrangement is incompatible with the broader, longer-run needs to bolster competition and innovation in the sector. Competition in the deposit market, just as in the loan market, should play a central role in driving banks to identify their areas of market advantage, and to design products tailored for particular client groups. If the original “problem” arose in part from the behaviour of certain off-budget funds, bringing all of these funds more into the mainstream of the fiscal monitoring and control regime (as suggested in Chapter II) might help to reduce distortions stemming from their treasury practices. In addition, further improvements in the “balance” of the banking sector – including further deconcentration among the large banks and consolidation among small banks – should improve the extent of effective and sustainable competition in the markets for deposits and loans.

Upcoming issues

The Slovene banking sector will face a number of important developments over the next year or so. A new Banking Act is expected to be enacted in late-1997. In part, the proposed law would provide more precise definitions than current legislation regarding such matters as the scope of banking activities

(which could be performed only by licensed banks), supervisory arrangements, and basic prudential conditions to be followed by banks. The draft law is harmonised with EU legislation, and would be an important step in bringing the banking framework in Slovenia closer to that prevailing in Western Europe.

Two other significant developments are proposed in the new Act (also as part of the harmonisation process). First, branches of foreign banks would be permitted, without direct capital requirements. Although foreign banks are allowed (and operate) at present, these banks have to meet the same requirements regarding foundation capital as apply to domestically incorporated banks. Opening up the sector to branch offices of foreign banks would help to improve the range and sophistication of services that are available, while the additional competition arising under this move would be likely to create more pressure for rationalisation among the many smaller domestic banks.

Second, the draft Act proposes the introduction of a deposit guarantee scheme, under which the deposits of a failed bank would be covered by funds accumulated within the banking sector. The State would become involved only if these pooled funds did not cover the obligatory guaranteed deposits. The main concern that arises with deposit guarantees is that they will increase risks of moral hazard in the behaviour of bank owners, managers, and clients, although these problems can be countered to some extent by careful design of risk-sharing arrangements.⁴¹ The proposed reform should, nevertheless, improve the degree of competitive neutrality in the banking system, particularly by offsetting the impact of explicit or implicit state guarantees that may be seen to lie behind large banks – either because they are state owned, or because they are simply viewed as “too big to fail”.

The other major issue facing the banking sector concerns the potential privatisation of NLB and NKBM. These banks now appear ready to move out of the rehabilitation process and into the private sector: as noted above, their recent financial performance has been strong; and they are satisfying conditions, covering a range of prudential standards, which the Bank of Slovenia set in 1995 as pre-conditions for their formally moving out of rehabilitation. There appears to be widespread acceptance⁴² of the key objectives that should guide the privatisation strategy: these are to find a strategic investor to strengthen the corporate governance in the banks; to sell the banks primarily for cash (rather than, for example, in exchange for privatisation vouchers) in order to reduce public debt; and to have a rapid and transparent privatisation process.

These goals should then shape the form of privatisation that is chosen. In particular, it is important for Slovenia to be prepared to accept significant foreign participation in these banks. In addition to the new capital this would provide, foreign strategic partners should help to accelerate the integration of more advanced financial standards and services into the Slovene banking sector. In contrast, domestic sources of capital are limited, and banking expertise is already spread over many institutions. Sales of strategic stakes to large domestic enterprises would increase concentration and indebtedness in the economy, and would risk not providing banks with the international linkages and practices that would be beneficial. In this regard, it should be noted that the draft Banking Act introduces limits on enterprise ownership of banks, designed in part to prevent “insider” lending. Broad-based public participation in the banks’ privatisation could nevertheless be achieved through a general share flotation of some remaining part of the banks’ capital – preferably, as noted, for cash rather than vouchers. In addition, some stake might be made available to institutional investors and integrated, for example, with proposals (as described in Chapter II) to introduce funded pension plans.

Finally, while this chapter has focused on the banking sector, other parts of the financial sector also face important restructuring requirements, including the securities and insurance markets. In broad terms, non-bank financial institutions are under-developed by OECD standards in terms of their services, expertise and depth. For example, turnover in the bond market is dominated by trading in government bonds, with corporate bonds so far playing only a small role. The insurance industry is under-capitalised, and life insurance premia represented under 1 per cent of GDP in 1995, compared with levels of 4 to 7 per cent in such countries as the United States, Japan, France and the United Kingdom (EBRD, 1996). Development of a wider range of financial services is essential in order to provide alternatives to direct bank financing of enterprise activities and, more broadly, to provide more sophisticated ways of handling risk.

Progress is nevertheless evident, or at least in prospect, on a number of fronts. Growth in the equities market has been quite rapid in 1995 and 1996, mainly as a result of the ownership transformation process (see Chapter IV): major developments in this area have been securities issued in exchange for ownership certificates by the investment funds that were established as part of the privatisation model; and public offers of securities, for both cash and certificates,

by companies undergoing transformation from social to private enterprises. Depth and expertise in the equities market can be expected to grow as these and further such shares become more actively traded. Trading on an over-the-counter market began in January, 1995, and futures trading started on the commodities exchange in March, 1996. As noted in Chapter II, there are also proposals to introduce a funded pension system. The authorised pension funds accompanying this scheme would provide an important means of assembling and allocating savings, once an adequate legal framework for such funds has been put in place.

Other legislative reforms, covering the securities market and foreign exchange transactions, are under consideration. In particular, there are proposals for a progressive opening of the capital account, in a manner viewed as consistent with the aims and operations of monetary policy. Such liberalisation is essential so that Slovenia can be further integrated with the international financial community and (as in the case of the banking sector) can draw on the services and expertise that this community offers. Current plans are to liberalise long-term capital flows (including inward and outward direct investment), flows connected with commercial transactions, and personal capital movements (Republic of Slovenia, 1996a). More gradual liberalisation of medium and short-term portfolio investment flows (and of some other short-term capital movements) is envisaged, given concerns about exchange rate stability and the thinness of the capital market. Restrictions would also remain on land purchases by foreign natural persons,⁴³ although with relaxation in some cases – for example, in the case of foreigners who are longer-term residents in Slovenia. In early-February 1997, the Bank of Slovenia introduced new measures to strengthen the regulation and monitoring of inflows and outflows of capital for portfolio investment purposes. Under these measures, foreign exchange flows must go through client accounts opened in banks with full banking licences (whereas many transactions had previously occurred in a less controlled manner in brokerage houses). The transactions costs associated with these flows are expected to rise, although the Bank hopes that overall cost increases will be contained by greater competition in the banking sector.

IV. Restructuring: enterprises

Enterprises of another kind

The institutional regime in the former-Yugoslavia can be described generically as a “socialist market economy”.⁴⁴ This meant that the economy was significantly decentralised, and both resource allocation and income distribution were shaped to a large extent by market forces.

The socialist character of the Yugoslav economy was preserved through the system of decentralised ownership that was called the *social ownership* structure, in contrast with the state ownership structure prevailing in other socialist countries.⁴⁵ This arrangement made firms legally responsible for their assets, liabilities and revenues, and employees the *de facto* owners of the firms – *i.e.* they were legally responsible for the management of their companies in the name of the whole Yugoslav society. There were no *de jure* owners in the self-managed firms. In some sense, ownership was not legally decentralised but economic management was. This is, of course, rather different from centralised state ownership. In this respect, it should be emphasised that Slovenia was the leading region in the former-Yugoslavia advocating this decentralised market socialism.⁴⁶

The bulk of Yugoslav enterprises was created by transforming state-owned, often previously nationalised, enterprises into socially-owned enterprises.⁴⁷ Nevertheless, the creation of new enterprises was also possible in an autonomous and spontaneous way. Therefore, the entry into a particular industry or market was not exclusively dependent on the decision of central political power (although *local* political influences were always important).⁴⁸

Enterprises reacted to price signals, because central planning was abolished in Yugoslavia and *a fortiori* in Slovenia in the early 1960s. The Yugoslav system was characterised by some markets that were cleared by market forces, some that were constrained or missing. In the latter case, goods were either rationed or

there was the so-called forced-substitution between products or services.⁴⁹ Still, for most enterprises, market prices were the dominant economic parameter, with decision-making therefore decentralised by prices rather than by quantities. Enterprises had some flexibility in setting *wages*, although within the context of broader regulations and agreements.

In principle, enterprise *management* was chosen by employees, although political approval was required – especially in the case of the larger and more important enterprises where managers were nominated by the authorities. However, some kind of a market for managers did exist in Yugoslavia and Slovenia. Enterprises were also able to take *investment decisions*; however, the concept of return on equity was absent, and investment decisions tended to be based on political considerations rather than on expected returns. Enterprises could also take credits from the commercial banks that existed in Yugoslavia and Slovenia since the mid-1960s (as noted in Chapter III, the most important banks were owned by the enterprises that were also their debtors).

An important characteristic of the social enterprises was that they were responsible for all their liabilities as if they were privately owned, but the firms themselves could not be sold. This difference was thought of as being fundamental for the identity of social ownership and for the legal justification of self-management.⁵⁰ There was also some exit from the market, as bankruptcy and liquidation procedures were recognised by Yugoslav laws, though these were rarely used. In addition, mergers, separations, and other changes in the industrial structure did happen, albeit, with almost no exception, under political interference.

Overall, social enterprises' objectives were closely related to employees' interests. Indeed, self-managed firms were supposed to maximise their residual over non-wage costs (*i.e.* the sum of wages and profits). The employees signed *contracts* with their respective enterprises that included some provisions allowing for possibility of a lay-off, although this result was rather limited. Some of the major theoretical drawbacks in the incentive structure of the self-management system, and their relevance in the case of Slovenia, are summarised in Box 4.

Obviously, the deficiencies of the self-managed firms were also related to the institutional limitations of the labour and capital markets (which, in the latter case, did not really exist). The whole system was set out in detail in the Yugoslav and the Slovene constitutions. Its main characteristics, described above, then put significant constraints on the privatisation process once it was undertaken.

Box 4. Incentive structure in self-managed enterprises

The self-managed enterprise has received a great deal of attention in the economics literature. Three main drawbacks in its incentive structure have been identified, although it is arguable to what extent these problems applied (or at least were evident) in Slovenia. The drawbacks are claimed to be the following:

- i)* Self-managed firms are reluctant to hire additional labour because the typical employee will be interested in maximising average income per worker, which will be higher the lower the number of employed. This is the so-called *Ward-effect*. This problem appears at odds with the evidence that unemployment in Slovenia was rather low, at least in comparison with the other republics of former-Yugoslavia, although in the entire region the official unemployment measures would have substantially understated the real extent of unemployment. It is notable, nevertheless, that the restructuring process has involved removing large quantities of *excess* labour from enterprises.
- ii)* Related to that is the *non-existence of a unique wage rate*. As firms maximise average income, wages across firms may differ significantly and systematically for the same level of skills or qualifications. As noted in the main text, however, regulations and collective agreements also played an important role in wage-setting in Slovenia, tending to reduce the scope for and extent of inter-firm wage differences.
- iii)* Employees would be less interested in *investing* in their own firms than in consuming their income (or investing it in private firms, to the extent that this is possible). In general, investment decisions in socially-owned firms would not be based on profitability (*i.e.* rate of return) criteria. This is the so-called *Furubotn-Pejovich effect*.^{*} While the existence of negative real interest rates may, conversely, have provided some incentive for investment, political influences appear to have played a major overall role in investment decisions.

* See Furubotn and Pejovich (1970).

The privatisation process

Given that self-managed firms were legally without owners, a key issue before privatisation was the so-called “identification of the owners”.⁵¹ In former-Yugoslavia, a series of laws was passed that had the general heading of “transformation of the social capital” and that aimed at identifying the owners of the firms, but the general feeling was that the firms were *de facto* owned by their

employees. However, this was not the legal definition of social property; therefore, legal and constitutional changes were needed in order to transform the social capital into enterprise specific capital (this is akin to the setting-up of corporations), and then to sell or distribute shares to the employees. This process was mainly undertaken by the successive Yugoslav governments in the late 1980s. However, before 1991 and under Yugoslav laws, very few Slovene firms were really transformed in this way.

After gaining independence, Slovenia started the real privatisation process. The decision was taken (after a long and heated debate)⁵² to essentially modify the former Yugoslav approach to the transformation of social capital in order to take into account the specific legacy of social ownership and to take advantage of pre-privatisation steps that had already been accomplished.

Two fundamental ideas guided the privatisation debate in Slovenia: the respect of rights and the issue of social justice. As mentioned above, there were strong feelings in the population that employees were virtually the owners of the firms in which they were employed. Therefore, accommodating these perceived property rights, Slovene privatisation proceeded to find a way to make them *de jure* rights. However, as social ownership also meant that the property belonged to the whole society, it was deemed that it would be just to let other segments of society, and not only those who were employed at the moment of privatisation, take part in the process. Accordingly, privatisation certificates were issued to all citizens of Slovenia and a number of Funds were created to take care of parts of the former social capital.

Transformation of social enterprises into either state or private enterprises

The Law on Ownership Transformation, which is the central element in the complex legislation on privatisation, was passed in 1992 and twice amended in 1993. The legislation represents a compromise between a centralised approach and autonomous privatisation: this means, in practice, that companies are allowed to select autonomously their own privatisation plan out of the several methods of privatisation provided for by law. The Agency for Privatisation and Restructuring was created by the government to supervise the process. The Law defines three main actions: nationalisation, restitution and privatisation. The agricultural land and woods used by previously socially-owned firms were nationalised.

Restitution can take the form of restitution in kind, compensation from the Slovene Restitution Fund, or equity stakes in enterprises. Restitution claims, to be filed in administrative offices in local communities, are decided on a case-by-case basis.

The main objective of rapid ownership transformation is also linked with a wide range of other transformation issues. These include audit of so-called “wild uncontrolled privatisations”; transfer of non-operating assets to local communities, other enterprises, and the State; protection of national parks; and harmonisation with international accounting standards. Public utilities were nationalised or privatised (or a combination of both) and, as discussed in Chapter II, three major banks were nationalised to avoid bankruptcy.

The Law on Ownership Transformation provided for a combination of free transfers of capital and commercial privatisation methods. The enterprises eligible for privatisation (1545, or 2800 if affiliated “daughter” firms are taken into account) could submit their privatisation plans according to the following possibilities.

- Part of the social capital (40 per cent) should be transferred (free) to public funds:
 - 10 per cent of the ordinary shares transferred to the Compensation Fund;
 - 10 per cent transferred to the Capital Fund of Pension Insurance;
 - 20 per cent transferred to the Development Fund, that would later sell this portfolio to Special Investment Funds (which had to be private) for ownership certificates.
- The rest (60 per cent) could be privatised in the following ways:
 - Internal distribution (up to 20 per cent of the shares could be distributed in exchange for ownership certificates to employees, former employees and relatives of employees; these shares cannot be transferred for two years from the date the privatisation is recorded in the court register);
 - Internal buy-out (up to 40 per cent of the shares can be sold, for cash or ownership certificates, to insiders under a special internal buy-out scheme; employees and former employees receive a 50 per cent discount on the value of the shares included in the programme);
 - Sale of the shares of the company (public offering of shares, public tender, public auction);

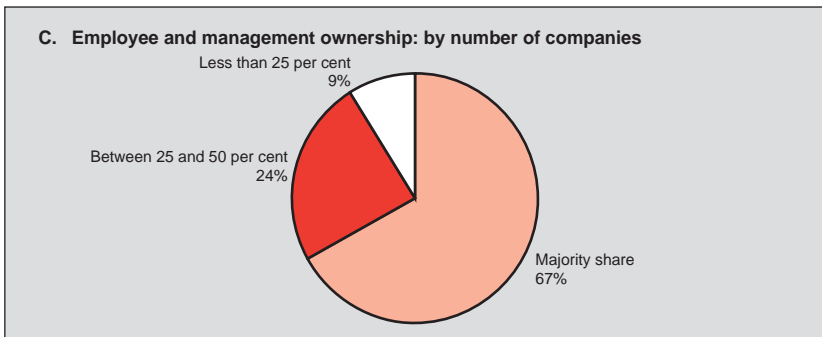
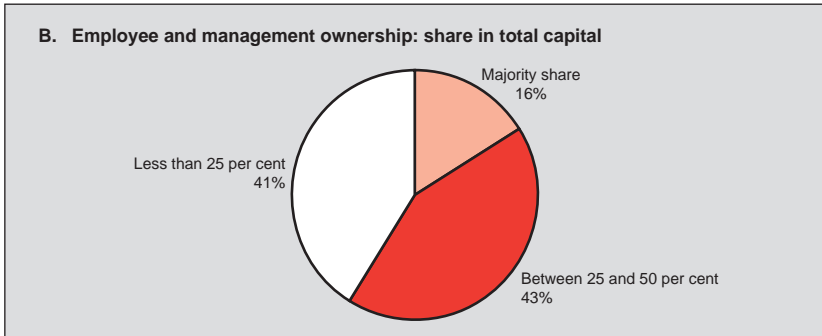
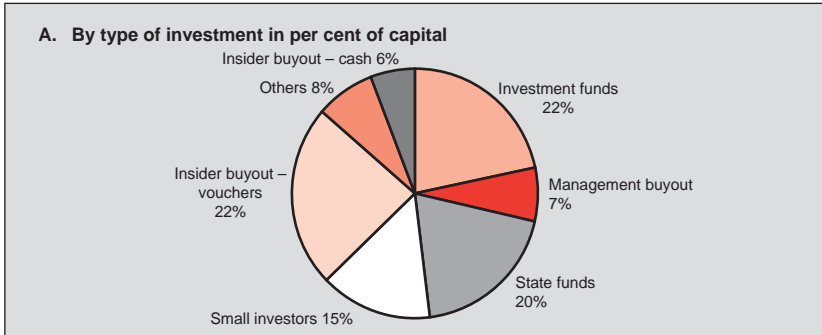
- Sale of all the assets of a company in combination with its liquidation (the Development Fund assumes all the liabilities of the company);
- Ownership transformation by raising additional private equity (only if new shares are issued for more than 10 per cent of the existing equity);
- Transfer of shares to the Development Fund.

The law applies to all the socially-owned enterprises that were transferred to state ownership (*i.e.* excluding essentially part of the utilities sector). Together with the passing of the privatisation law, all the citizens of Slovenia were given certificates that could be used to buy shares. The certificates were not otherwise transferable.⁵³

At end-1996, around 90 per cent of privatisation plans (covering 1 340 enterprises) had been approved and, of these, around 65 per cent of the firms concerned had been registered as private companies. While there is majority insider control in two thirds of the privatised companies, these represent only 16 per cent of the equity of enterprises eligible for privatisation. Large enterprises tended to be too expensive for internal buy-outs, and chose other privatisation options. For example, about eight per cent of mostly large enterprises (123 cases) have decided to offer their shares through public offerings. Small investors will own controlling share-holdings in only 1.3 per cent of large enterprises, but these comprise almost 12 per cent of total equity. The third important group of owners are institutions (the Special (private) Investment Funds, Pension Fund, Compensation Fund), which will be the largest owners in 17 per cent of enterprises (representing 34 per cent of total equity). The ownership structure in privatised enterprises as of end-1996 is shown in Figure 18, and the capital structure by method of privatisation is shown in Table 15.

Some aspects of the privatisation process have been criticised as slow. Compared with other countries in Central Europe, privatisation in Slovenia had a relatively late start, although this may be partly attributable to the unique ownership structure. The rhythm of privatisation increased in 1994 and, since the middle of 1995, has levelled off at an average of roughly 30 companies per month (Figure 19). Officials claim, however, that by adopting this somewhat cautious approach Slovenia has “avoided the mistakes” that have occurred elsewhere in Central Europe. Some areas of difficulty still remain, however. As well as the companies still waiting for second approval (signalling their registration), 140 proposals are in procedure (usually indicating some dispute

Figure 18. OWNERSHIP STRUCTURE IN SLOVENIA, 1996



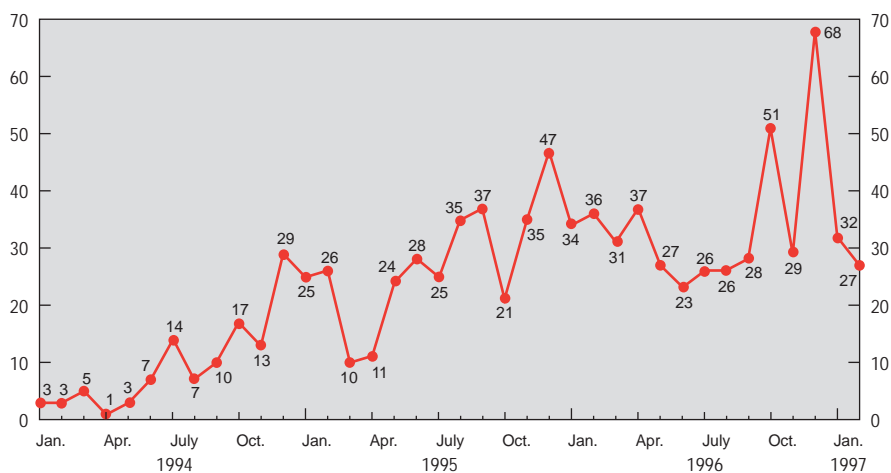
Source: Privatisation Agency.

Table 15. **Capital structure by method of privatisation, 1996**

	Capital (million SIT)	Structure (in percentage)
Transfer directly to known owners	282 763.6	30.8
Internal buyout	162 690.8	17.7
Development fund	120 789.0	13.2
Internal distribution	116 992.7	12.8
Sale of shares	85 927.5	9.4
Pension fund	60 218.6	6.6
Restititional fund	60 190.8	6.6
Transfer to development fund	17 911.8	2.0
New share issue	9 444.4	1.0
Total	916 929.2	100.0

Source: Privatisation Agency.

Figure 19. **NUMBER OF PRIVATISED COMPANIES**
January 1994-February 1997



Source: Privatisation Agency.

over asset valuations or the division of assets between the company and other claimants). In addition, the Development Fund (DF) became the owner of 98 enterprises in mid-1992 during the earlier stages of restructuring (before the Law on Ownership Transformation). These are being dealt with partly through

restructuring and selling to strategic investors, and partly by allowing “hopeless cases” to go into bankruptcy. At end-1996, the DF still owned 24 of these enterprises, but hopes to reduce this total to five by the end of 1997. The DF has acquired a further 31 companies which, one way or another, have not complied with the requirements of the ownership transformation law, and more such cases could arise before the current privatisation process is finished. In total, the DF had equity positions in around 170 companies at end-1996 (although some of these were minority stakes).

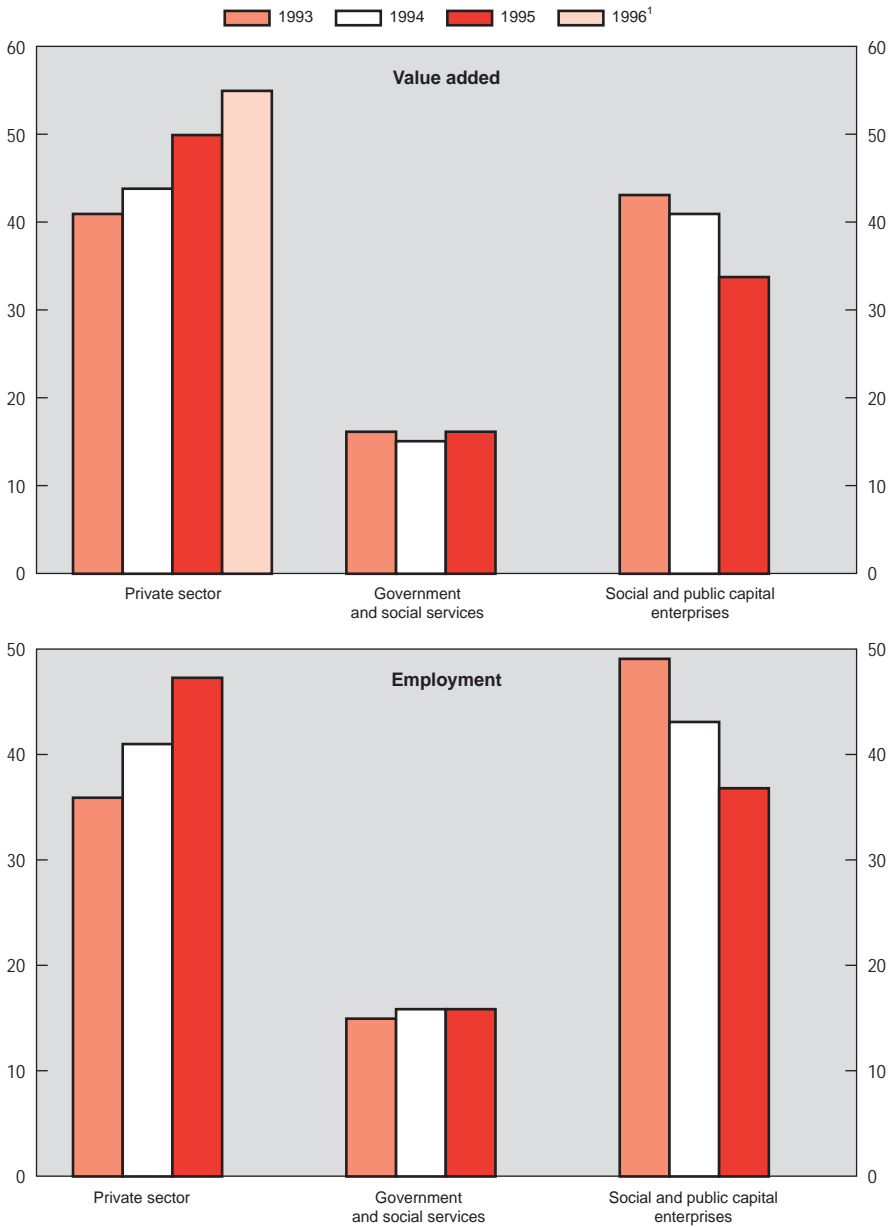
The current ownership transformation process is expected to be finished in 1997. The share of the private sector in the economy has gradually increased, reaching 50 per cent of value-added and 47 per cent of employment by the end of 1995 (Figure 20). At that point, the share of social and state-owned enterprises was 34 per cent of value-added (37 per cent of employment), while the government sector represented 16 per cent of value-added and employment. This breakdown need to be viewed cautiously, however: for example, some companies are part public, part private, with their classification therefore depending on the precise distribution of shareholdings. As noted in Chapter III, two major banks appear ready for privatisation, and there are also several state-owned enterprises, particularly in the utilities sector, that are yet to be privatised. In some of these areas – and especially if privatisation is extended to cover a wider range of social and public services – some degree of consensus-building is likely to be required in order to generate broad public support for this further privatisation.

Post-privatisation issues

The pre-privatisation developments took care of the problem of creating corporations and of some preliminary issues for the identification of the owners. The privatisation process itself concerned the transfer of property rights. After these steps, the major problems both with social ownership as well as with self-management were at least legally solved. However, after privatisation, problems arising from the increasing role of the market and its impact on performance remain.

Indeed, the ownership transformation process required by law does not necessarily mean real privatisation of the enterprise in an economic sense. In particular, the processes of recognising and responding to the full range of market incentives (including the previously-absent incentives emanating from the

Figure 20. VALUE ADDED AND EMPLOYMENT BY TYPE OF OWNERSHIP



1. For 1996, only an estimate for the share of the private sector in value added is available.
 Source: Privatisation Agency, Statistical Office of the Republic of Slovenia.

capital market), and building effective systems of corporate governance are, in many cases, just beginning. Ownership rights are currently dispersed among three distinct groups of owners with different interests and areas of expertise: a wide range of *institutional investors* (including pension, compensation and privatisation investment funds; restitution beneficiaries with large ownership stakes; banks and other creditors; state and local governments; and foreign investors); *insiders* (management and employees, plus former employees, pensioners and family members); and *small investors* (citizens participating in public offerings of shares). Even within each of these groups, interests are not homogeneous. For example, former employees are likely to have different preferences from current employees (possibly more akin to the interests of outside investors), and this would further dilute the influence of actual insiders. In a number of cases, it appears that institutional investors will play the key role in corporate governance.

Hence, while the apparent aversion of insiders to external control (both foreign and domestic) may slow the process of change in the short-term, it is not clear that these concerns will prevent more dynamic, market-based restructuring from occurring over the longer-term. Support from other reform measures will also be important. For example, the law on take-over and merger actions is yet to be passed, and then it will have to be implemented. Further liberalisation of capital and labour markets is also needed (as discussed in Chapters III and VI, respectively); for example, improving the access of firms to broader sources of financing, including that available from foreign investors, will play a key role in the adjustment process.

Some microeconomic aspects of enterprise restructuring

With the privatisation process having been completed only recently in some enterprises, and on-going in others, there is as yet little information on whether privatisation has led to changes in the pace or character of enterprise restructuring. There appears to be a widespread view, for example, that firms were hesitant to invest and pursue other reforms while their ownership structures were being clarified but that, following privatisation, many enterprises would face pressures to restructure operations and markets, take on foreign partners, and implement other changes in order to ensure their survival and progress.

However, some encouraging evidence regarding investment is provided by a Eurostat (1996) survey of enterprises in central and eastern European countries (CEECs). This suggests that investment activity is much greater in Slovene enterprises than elsewhere in the CEECs. Only around 20 per cent of enterprises in Slovenia report no investment, compared with over 50 per cent in all the other countries surveyed. Investment of over 10 per cent of turnover was reported by half the Slovene enterprises surveyed, a much higher proportion than elsewhere (for example, only around 20 per cent of enterprises in the Czech Republic, Hungary and Slovakia reported this level of investment).

This section takes a broader look at the enterprise sector, considering first the number and size distribution of Slovene enterprises, then the recent financial performance of commercial companies.⁵⁴

Number and size distribution of enterprises

At end-1995, Slovenia had a total of around 65 000 enterprises in the manufacturing and service sectors (which comprise 88 per cent of GDP). Just over half of these were commercial companies (*i.e.* registered legal entities), and the rest were small (often one-person) businesses engaged mainly in trade activities.

The Slovene enterprise sector had a different starting point and dynamics of development compared with other CEECs. Around one quarter of current Slovene enterprises were created prior to 1990, compared with around 20 per cent in Hungary and Poland and much lower proportions (often negligible) elsewhere (Eurostat, 1996). Enterprise creation in Central European countries was relatively concentrated in the 1990 to 1993 period: by end-1993, all of these countries (including Slovenia) had 70 to 75 per cent of enterprises in place. In contrast, in the Baltic and Balkan countries, a much higher proportion of current enterprises was created during 1994 and 1995.

The declining rate of enterprise creation in Slovenia is well-illustrated amongst manufacturing, mining and electricity enterprises (of which most are in manufacturing). From 1991 to 1993, around 1 200 to 1 500 enterprises per year were created in these areas, whereas this rate fell to 365 in 1994 and 238 in 1995.

The size distribution of enterprises shown in Table 16 indicates that Slovenia has a higher proportion of small enterprises and lower proportion of craftsmen (one self-employed person) than the average for CEECs. This makes

Table 16. Size distribution of enterprises and employment, 1995

In percentage

	Number of enterprises			Employment		
	Slovenia	CEECs	EU	Slovenia	CEECs	EU
0 salaried employees	50	66.2	49.7	7	14.9	9.7
1 to 49 salaried employees	48	32.4	49.2	27	34	40.1
50 or more salaried employees	2	1.4	1.1	66	51	50.2
Total	100	100	100	100	100	100

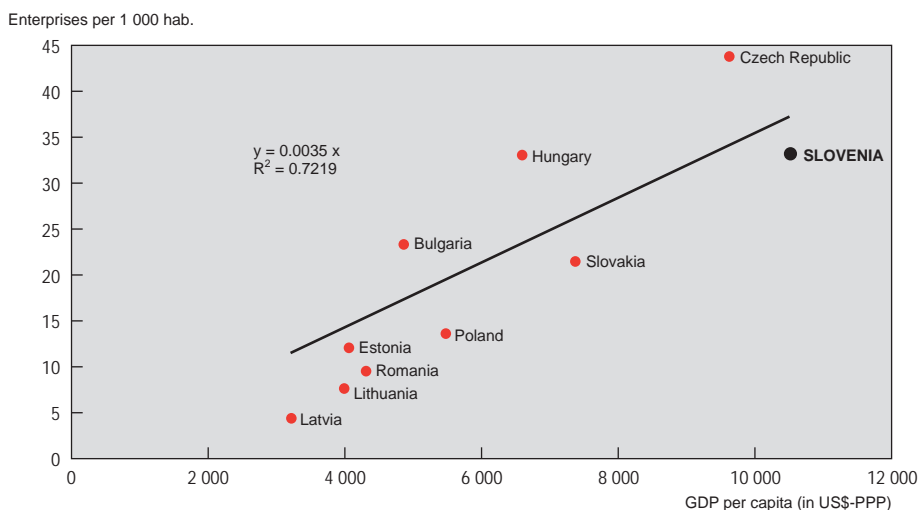
Source: Eurostat (1996).

the Slovene enterprise structure close to the EU average. In terms of employment, relatively more Slovenes work for companies with 50 or more employees than is the case in the EU or on average in the CEECs. However, this comparison may be misleading, and mainly a result of the relatively low cut-off (50 employees) that is used. For example, the share of employment in legal entities as a whole is 23 per cent in Slovenia, compared with around 30 in Poland, 40 in the Czech Republic and Slovakia, and nearly 60 per cent in Bulgaria (Eurostat, 1996). Moreover, the role of very large enterprises (*e.g.* with 5 000 or more employees), generally with major re-structuring problems, is less significant in Slovenia.

In some CEECs, after the boom of enterprise creation in the early years of transition, many of the recorded units are not active (*i.e.* they are “dormant” or “dead”). The Eurostat (1996) survey suggests that the non-active proportion is nearly 40 per cent in Bulgaria, the Czech Republic, Hungary, Romania and Slovakia, but is under 10 per cent in Slovenia – by far the lowest of all the CEECs surveyed, perhaps reflecting better procedures for recording closures.

In Figure 21, enterprise density (measured by the number of enterprises per 1 000 inhabitants) is compared with the level of economic development (as indicated by GDP per capita in purchasing power parity terms). This relationship shows, as expected, a reasonably close fit between density and GDP per capita among CEECs. Despite its relatively high enterprise density, Slovenia appears somewhat below the norm, with a “deficiency” of enterprises relative to its much higher income level, whereas the Czech Republic appears to have more than the “expected” number of enterprises.

Figure 21. **ENTERPRISE DENSITY AND GDP PER CAPITA, 1995**



N.B. Adjusted to include only active enterprises.
 Source: EUROSTAT-PECO and OECD.

While this relation between income levels and enterprise density is approximate, it suggests that there is scope for further enterprise creation in Slovenia. This point deserves some attention. As elsewhere noted in this Survey and in comparison with other CEECs, the enterprise structure in Slovenia reveals favourable characteristics, but this lead could be rapidly eroded if economic restructuring is not adequate. This aspect of enterprise creation can be as important as the privatisation process. For example, in a recent study of firms in transition economies,⁵⁵ Bilsen and Konings (1996) find that job creation occurs disproportionately in the new private sector (*i.e. ex novo* firms) compared with “traditional” firms (whether privatised or state owned), while job destruction is relatively concentrated in the traditional sector.

Financial performance

Financial indicators can provide a useful indication of the viability of the enterprise sector and requirements for further restructuring. The Agency of the Republic of Slovenia for Payments publishes detailed financial results for

commercial companies (from balance sheets and profit and loss statements submitted by 33 609 companies in 1995). Summary information from profit and loss accounts in 1994 and 1995 is provided in Table 17.

Table 17. **Profit and loss results for commercial companies**

	SIT million		Growth (in %) 1994/1995	Share in revenues (in %)	
	1994	1995		1994	1995
Revenues	4 228 543	5 000 198	18.2	100	100
Expenses	4 243 876	5 010 130	18.1	100.4	100.2
Gross loss	15 333	9 932	-35.2	0.4	0.2
Net loss (after taxes)	26 830	24 937	-7.1	0.6	0.5
<i>of which:</i>					
<i>Net profit in profitable companies</i>	85 376	112 956	32.3	2	2.3
<i>Net loss in loss-making companies</i>	112 206	137 893	22.9	2.7	2.8

Source: Agency of the Republic of Slovenia for Payments.

In aggregate, Slovene companies were slightly in loss in 1995: gross losses amounted to 0.2 per cent of revenues, and net losses were 0.5 per cent. These results were marginally better than those in 1994. Losses in 1995 occurred in just under 10 000 enterprises (*i.e.* 29 per cent of the total), with aggregate net losses of 2.8 per cent of revenues. However, this problem is concentrated among a relatively small number of large enterprises: for example, 56 companies each had net losses of over SIT 500 million (of which 24 lost over SIT 1 billion), and accounted for 44 per cent of total net losses. Moreover, losses in the manufacturing, mining and electricity sector more than fully accounted for aggregate net losses in the economy.⁵⁶

In 1995, 7 500 companies – only 22 per cent of the total – earned foreign revenues. However, the size and significance of these firms is indicated by the fact that 57 per cent of the net profit figure in Table 17 came from profits of exporting companies, while 70 per cent of total net losses also comprises losses of exporters. Tending to support arguments that many Slovene companies faced difficult trading and competitive conditions in 1995, net revenues from foreign

sales increased 14 per cent between 1994 and 1995, while revenues from domestic sales increased 21 per cent (although the general strength of domestic demand would also have contributed to these results).

Interestingly, some differences are also apparent between the profitability of small and large companies, with the former apparently earning better returns. Although 93 per cent of companies are small (up to 50 employees), they have only 22 per cent of total employees and revenues and 18 per cent of assets. However, the profitable small companies generated 31 per cent of total net profits in 1995. Conversely, large companies (over 250 employees), with 64 per cent of revenues and 68 per cent of assets, earned only 54 per cent of total net profits.

There are several indications of growth in liquidity problems among Slovene companies. The Agency for Payments reports details on the number of companies whose giro (or transaction) accounts at the Agency are blocked (presumably because of inadequate funds). Between 1994 and 1995, there was a 38 per cent increase in the average number of commercial companies whose accounts were blocked for more than 5 consecutive days in a month, and there was a 27 per cent increase in average overdue unpaid liabilities (totalling SIT 57 billion). As of end-1995, nearly 9 per cent of companies had had their accounts blocked for over one year. These difficulties are also reflected in an increase in the share of short-term liabilities in the balance sheet total, from 28 per cent at end-1994 to 30.3 per cent at end-1995.

In summary, this financial information presents an enterprise sector in which, overall, most commercial companies are currently earning profits, but where there is still a core group of large, loss-making enterprises. The latter companies are no doubt the main recipients of support provided through the Development Fund and through subsidies from state and local budget (as described in Chapter II). The provision of such support is understandable given the adjustment “shocks” faced by these firms and the local communities in which they operate. However, it is essential that assistance be of limited duration and directed at restructuring the operations of these companies, preserving the viable parts (if any) of their activities and eliminating unprofitable areas.

These conclusions are also supported by the evidence that, among the top 20 Slovene enterprises, only roughly half of the firms displayed significant returns to capital or improved significantly their position in 1995 relative to 1992 (Table 18). In the other top enterprises, the situation seems less satisfactory, as

Table 18. **Top 20 enterprises in Slovenia in 1995**

1995 ranking	Company name		Ownership January 1997	Number of employees	Revenues (thousand SIT)	Present among Top-20 in 1992	Ratio profits/capital 1992 in %	Ratio profits/capital 1995 in %
1	REVOZ	Manufacture of transport equipment	Private	2 886	113 608 864	*	Loss	3.5
2	PETROL TRGOVINA	Retail trade	Private	2 822	87 417 379	*	2.4	8.4
3	ELES	Production and distribution of electricity	Public	594	62 920 378	*	Loss	0.4
4	GORENJE	Manufacture of electrical equipment	Private	4 230	45 436 685	*	0.2	0.7
5	SLOVENSKE ELEZNICE	Railway transport	Public	9 686	42 964 076	*	Loss	0.1
6	TELEKOM SLOVENIJE	Post and telecommunications	Public	3 073	38 255 064	*	0.4	2.8
7	MERKUR TRGOVINA	Wholesale trade	Private	1 273	37 555 134	*	2.9	8.6
8	LEK	Manufacture of chemical products	Private	2 233	37 160 006	*	6.3	9.2
9	KRKA	Manufacture of chemical products	Private	2 506	32 263 422	*	1.3	8.2
10	SAVA	Manufacture of rubber and rubber products	Private	3 688	30 889 621	*	0.0	0.0
11	TOBAËNA GROSIST	Wholesale trade	Private	130	28 099 490	*	49.0	28.5
12	KOVINOTEHNA	Wholesale trade	Private	1 097	27 465 521	*	19.4	0.2
13	ELEKTRO LJUBLJANA	Production and distribution of electricity	Public	1 184	26 969 678	*	Loss	Loss
14	TERMOELEKTRARNA	Production and distribution of electricity	Public	677	24 346 353	*	Loss	Loss
15	PORSCHE INTER AUTO	Wholesale trade	Private	75	23 283 982	*	..	39.0
16	S J-ACRONI	Manufacture of basic iron and steel	Private ¹	1 750	23 119 956	*	..	0.0
17	TALUM	Manufacture of basic non-ferrous metals	Private ¹	1 098	20 374 115	*	Loss	Loss
18	NAFTA	Manufacture of refined petroleum production	Private ¹	786	19 875 586	*	0.0	9.5
19	SCT	Civil engineering and construction of water projects	Private	1 756	19 469 541	*	0.0	Loss
20	NUKLEARNA ELEKTRARNA	Production and distribution of electricity	Public	607	19 233 395	*	Loss	Loss
Total				42 151	760 708 246			
<i>Share in total of the economy in percentage</i>				5.4	16.5			

1. The State has a large share in these firms.

Source: Slovenian Business Report, 1996; Statistical Office of the Republic of Slovenia.

they continue to be loss-making or are barely profitable. This suggests that progress in re-structuring the core of large Slovene enterprises was rather limited up to now. In the future this transition process can be painful because many of these unstructured enterprises are also among the largest employers in Slovenia and therefore they could have some leverage to negotiate state financial support. It is up to the political management of the transition to take into account these aspects without blocking the restructuring process itself. The risk otherwise is that these companies would be a long-term drain on public resources, and the emergence of new, potentially profitable, firms would be crowded out.

V. Restructuring: international dimensions

Openness to foreign capital in Slovenia

Even if small, Slovenia has been able to attract foreign investment, although probably not to the full extent that is needed for restructuring. The first joint ventures in Slovenia (then still part of the former-Yugoslavia) were based on foreign investment legislation introduced in 1967 – the first in the former communist countries. After several modifications during the subsequent years, the last Yugoslav foreign investment law, adopted at the end of 1988, was substantially more liberal and provided much more leeway for the expansion of foreign investment. The law adopted in 1988, while keeping a limitation on foreign ownership of real estate, was based on the national treatment principle and allowed foreign direct investment (FDI) in the form of joint ventures and wholly owned foreign companies.

During the first years of independence foreign capital was not significant in Slovenia, in part because foreign investors were deterred by the unstable political situation in the neighbouring countries. According to the Company Register, the number of enterprises recorded as having received foreign participation increased steadily from 547 by the end of 1990 to 4 007 by the end of 1995 (see Table 19). Many of these companies are inactive, however: data from the Bank of Slovenia indicate that there were 1 348 *active* companies with FDI at end-1995, up from 1 100 in 1993. The liberalisation of the legal framework for FDI has not been accompanied by additional economic policy measures to make Slovenia more attractive to foreign investors. Instead, as shown in the case of privatisation, emphasis was put on the protection of national interests rather than on an active role of foreign investors. In addition, as discussed in Chapter III, the Bank of Slovenia – for monetary policy reasons – recently interfered with foreign portfolio inflows, resulting in additional transactions costs for foreign investors.

Table 19. Number of foreign direct investment projects

	1989	1990	1991	1992	1993	1994	1995
Flows							
Czech Republic	3 200	5 333	5 052	8 953	9 941
Hungary	5 642	4 101	4 286	4 431	3 720
Poland	..	1 216	3 151	5 214	5 157	4 570	4 349
Slovak Republic	1 600	992	2 318	2 064	1 533
Slovenia	924	499	1 154	480	403
Bulgaria	33	38	606	2 279	1 850
Romania	..	1 529	6 368	12 780	8 457	13 966	6 106
Stocks							
Czech Republic	..	467	3 667	9 000	14 052	23 005	32 946
Hungary	1 350	5 693	9 117	17 182	20 999	23 557	27 900
Poland	429	1 645	4 796	10 010	15 167	19 737	24 086
Slovak Republic	..	233	1 833	2 825	5 143	7 207	8 740
Slovenia	..	547	1 471	1970	3 124	3 604	4 007
Bulgaria	33	71	677	2 956	4 806
Romania	..	1 529	7 897	20 677	29 134	43 100	49 206

Source: WIIW, Vienna.

At first sight, the volume of FDI in Slovenia is modest compared to other transition countries (Table 20).⁵⁷ By the end of 1995 the cumulated foreign capital invested stood at US\$1 694 million, of which US\$1 643 million was FDI, and US\$51 million foreign portfolio investment.⁵⁸ This accounted for a moderate 5.5 per cent in the total FDI stock of the seven transition countries (CEEC-7) displayed in Table 20.⁵⁹ The share of FDI in GDP and in gross fixed capital formation is also relatively low. However, on a per capita basis, the picture is more favourable as Slovenia ranks second after Hungary in the CEEC-7 region.⁶⁰ The rather slow growth in investment flows recorded in 1995 (particularly in comparison with the Czech Republic, Hungary and Poland) suggests that the structural conditions for increasing foreign capital participation in Slovenia were not yet fulfilled. Notably, the participation of foreigners in the privatisation process has been modest to this point. However, as the current round of privatisation draws to a close, increased foreign participation may be expected in the on-going restructuring of enterprises (as discussed in Chapter IV).

Up to the end of 1995, the main foreign investors were Austria (27 per cent of the FDI stock), Croatia (25 per cent), Germany (15 per cent), France (10 per cent), and Italy (6 per cent).⁶¹ Germany and Austria had the largest number of

Table 20. **Total foreign direct investment**

US\$ million

	1990	1991	1992	1993	1994	1995	1996 estimates		
							Total	Per capita US\$	% GDP
Flows									
Czech Republic	..	..	..	654	869	2 562	900	87	1.7
Hungary ¹	900	1 700	1 700	2 550	1 300	4 570	1 800	176	4.1
Poland ²	..	247	900	1 479	1 342	2 511	4 000	104	3.0
Slovak Republic	..	..	..	135	185	181	150	28	0.7
Slovenia	..	..	..	..	321	368	360	181	1.9
Bulgaria	..	14	51	130	234	101	100	12	0.5
Romania	108	156	269	227	511	323	500	22	1.4
Total	1 008	2 117	2 920	5 175	4 762	10 617	7 810	80	2.4
Stocks									
Czech Republic	..	..	..	2 153	3 022	5 584	6 500	629	12.0
Hungary ¹	1 450	3 150	4 850	7 400	8 700	13 270	15 100	1 478	34.3
Poland ²	353	600	1 500	2 979	4 321	6 832	11 000	285	8.3
Slovak Republic	..	..	..	366	552	733	900	168	4.4
Slovenia	..	..	..	954	1 275	1 643	2 000	1 007	10.8
Bulgaria	..	14	65	195	429	530	650	77	3.1
Romania	108	264	533	761	1 272	1 595	2 100	93	5.8
Total	1 911	4 028	7 179	14 808	19 571	30 187	38 250	392	11.7

1. From 1996 including intercompany loans.

2. Projects with more than US\$1 million invested capital. From 1996 including reinvested profits.

Source: WIIW, Vienna; OECD; Bank of Slovenia.

(and highest equity stakes in) contractual joint ventures in Slovenia, with 81 and 66 investment projects, respectively, out of a total of 220. The US-based multinationals, which rank first and second among the most important investors in Poland and Hungary, respectively, play only a minor role in Slovenia.

Most foreign investments in Slovenia come from small and medium-size enterprises from the neighbouring EU countries. In value terms, however, FDI is concentrated in a few big projects involving European multinationals. The largest investments were done by Renault (France) in the car industry, Saffa (Italy) and Brigl and Bergmeister (Austria) in paper manufacturing, EGO (Switzerland), Siemens (Germany) and Kirkwood Industries (USA) in the electrical machinery and apparatus industry, Reemtsma (Germany) and Seita (France) in the tobacco

industry, Pflaiderer (Germany) in the production of non-metallic mineral products, and Henkel (Austria) in the production of chemical products. It is also important to note that foreign investment is often based on long-standing business relationships, and once investors come, they tend to stay.

Foreign investments are primarily directed towards the manufacturing industry, followed by electricity production (Krško), financial, technical and business services, and trade. Within the manufacturing industry, FDI is concentrated in the manufacturing of transport equipment; electrical machinery and appliances; paper and paper products; tobacco manufacturing; and to a lesser extent in industrial chemicals and chemical products. Within service sectors, foreign investment plays an important role in banking, research and development, and trade-related services.

Slovenia's future policy and strategy towards inward FDI has been formulated in the "Strategy of Slovenia's International Economic Relations"⁶² adopted by the Slovene Government on 1 August 1996. According to this document, Slovenia is expected to become more attractive to foreign investors only after the completion of the first round of privatisation. The interest of potential investors will be very likely directed only to specific industrial branches, such as paper, cement, food, beverages, pharmaceuticals, electricity, telecom equipment etc. and to selected Slovene enterprises. A substantial increase in FDI is also expected to come in the context of Slovenia's full EU membership.

In the document referred to above, the Slovene policy-makers seem to endorse the principle that direct state intervention in the activities of FDI units should be avoided. Accordingly, Slovenia's future approach and policy towards FDI will be based among others on stable macroeconomic conditions and transparent regulations, focused on Slovenia's comparative advantages and equal treatment of foreign investors and domestic enterprises.

How FDI interacts with enterprise performance

An important part of the process of economic re-structuring involves direct foreign capital participation in the Slovene economy. The interaction with foreign partners is also likely to enhance the performance of Slovene enterprises. This point was shown in a recent study by Rojec (1996), which compares the

performance of foreign investment enterprises (hereafter, FIEs) – defined as those enterprises that have at least 10 per cent of foreign equity – with domestic enterprises (DEs). Drawing from this study, some basic indicators for FIEs and DEs are shown in Table 21. In the table, FIEs are further disaggregated into those with more than 50 per cent foreign equity stake (MaFIEs) and those with a minority foreign equity stake from 10 to 50 per cent (MiFIEs).

Table 21. **Basic characteristics of domestic and foreign investment enterprises, 1994**

US\$ million¹

	Total	Domestic enterprises (DEs)	Foreign investment enterprises (FIEs)	MaFIEs ²	MiFIEs ²	FIEs in % of total
Number of enterprises	30 941	29 813	1 128	803	325	3.6
Number of employees	475 120	450 153	24 967	18 091	6 876	5.3
Equity	22 787	21 281	1 506	829	677	6.6
Assets	39 911	36 707	3 204	1 714	1 490	8.0
Net sales	30 300	27 057	3 243	2 267	976	10.7
Exports	7 768	6 284	1 484	1 169	315	19.1
Value added	6 613	6 108	505	322	183	7.6
Operating profit	808	683	125	66	59	15.5
Operating loss	912	843	69	31	38	7.6
Net operating profit/loss	-104	-160	56	35	21	

1. Original data are in tolar. For variables of stock US\$1 = 126.4576 SIT and for variables of flow US\$1 = 128.8086 SIT exchange rate was used.

2. MaFIEs: FIEs with 50% foreign equity share; MiFIEs: FIEs with 10-50% foreign equity share.

Source: Rojec (1996).

As shown, FIEs comprise only 3.6 of all enterprises (of which 2.6 per cent with a majority stake and 1 per cent with a minority stake) and account for a modest 5.3 per cent of total employment. However, these companies represent a much higher share of net sales (10.7 per cent of the total), exports (19.1 per cent, of which 15 per cent in majority foreign equity stake), and operating profits (15.6 per cent). A more detailed set of ratios enabling comparison of the relative performance of foreign investment firms is shown in Table 22. Ratios between FIEs and DEs are presented along various operating dimensions, with further comparisons between total enterprises and those in the manufacturing sector.

Table 22. **Ratio of operating indicators between foreign investment and domestic enterprises, 1994**

Per cent

	Index: ratio FIEs/DEs	
	Total	Manufacturing
Indicators of size per company		
Equity	187	252
Assets	231	278
No. of employees	146	163
Net sales	317	329
Exports	623	516
Indicators of capital intensity		
Assets per employee	157	171
Machinery/equipment and other fixed assets (except land/buildings)	338	270
Indicators of assets structure¹ as a share of assets		
Fixed assets	88	96
Tangible fixed assets	100	104
Intangible fixed assets	178	400
Machinery/equipment and other fixed assets (except land/buildings)	244	165
Current assets	124	107
Indicators related to value added		
Value added as a share of gross revenue	70	60
Costs of commercial goods, materials and services as a share of gross revenue	100	103
Labour costs as a share of net sales	58	53
Indicators of export orientation		
Exports as a share of net sales	197	132
Exports per assets	271	186
Exports per employee	426	317
Indicators of labour costs and salaries		
Labour costs per employee	126	127
Salaries per employee	122	125
Indicators of financial structure		
Subscribed capital as a share of equity	87	87
Ratio between long-term and current liabilities and equity	159	123
Equity as a share of total equity and liabilities	81	91
Equity and long-term provisions and long-term liabilities as a share of total equity and liabilities	96	97
Current liabilities as a share of total equity and liabilities	107	101
Ratio between financial revenues and financial expenses	115	136
Indicators of solvency		
Ratio between current receivables and cash and current liabilities	105	114
Ratio between net sales and long-term and current operating receivables	106	123

1. According to balance sheets, assets are composed of fixed and current assets. Fixed assets are composed of intangible fixed assets, tangible fixed assets, long-term investments and corrections of equity. Tangible fixed assets are further divided into land and buildings, and into machinery/equipment and other fixed assets.

Source: Rojec (1996).

Six areas are identified in Table 22 where FIEs differ markedly from DEs. These areas are as follows:

- *Company size*: whether compared by average equity, assets, employment, sales or exports, FIEs are distinctly larger than DEs. With all indicators except for exports, these differences are even more marked in the case of manufacturing enterprises. Although, in numerical terms, most FIEs are small and medium-size companies, FDI (by value) has been heavily concentrated in a few large projects as noted above; for example, 77 per cent of FIE assets are in the largest 17 companies with foreign participation.
- *Capital intensity*: assets per employee are 57 per cent higher for FIEs than DEs (71 per cent higher in manufacturing), and productive assets (especially machinery and equipment) are over three times as high. These differences are related to the size comparison above, and are also reflected in other indicators such as the higher labour costs and salaries per employee in FIEs (suggesting greater use of skilled labour), and lower labour costs as a share of net sales.
- *Asset structure*: the capital productivity of FIEs is increased by tying up a smaller proportion of assets in land and buildings, and having a higher proportion of machinery and equipment: one-half of FIE assets are in the latter form, compared with 20 per cent for DEs. The share of intangible fixed assets, although a small part of total assets, is also much higher in FIEs (especially in manufacturing). This may reflect the transfer of technology, skills, and so on between foreign parent companies and their Slovene partners.
- *Export orientation*: not surprisingly, the indicators of export intensity relative to sales, assets, and employees are two to four times as high for FIEs compared with DEs. Major reasons given by foreign investors for their participation in Slovene companies include a past record of successful co-operation with these enterprises, together with their export performance and established trade links (including those to former-Yugoslavia and elsewhere in Central and Eastern Europe).
- *Financial sources*: FIEs have a more “normal” financial structure than DEs, involving less use of equity finance and greater use of debt (especially long-term loans). Better access to foreign loans, using the links provided by the parent companies abroad, probably contributes to this pattern.

- *Solvency*: compared to DEs, FIEs have higher proportions of current receivables and cash to current liabilities, and a higher ratio of net sales to receivables. These solvency indicators are stronger in manufacturing enterprises, and may in part reflect links with reliable customers established through foreign parent networks (Rojec, 1996).

The above indicators are generally static, and do not show for example how much company performance changed *as a result* of FDI; foreign investors would naturally have been attracted to companies which were strong to begin with. Even in the latter case, however, these comparisons provide some insights into what may account for the generally superior performance of FIEs, and what enterprise characteristics may therefore be the most conducive to broadening foreign participation in and international linkages of Slovene companies. More generally, indicators such as those relating to financial structure and asset utilisation suggest the sort of standards applying in more advanced economies, and which should therefore signal the direction of restructuring that should be expected of Slovene enterprises.

Trade specialisation and industry restructuring

While not yet playing a big role in terms of attracting foreign capital, Slovenia plays a much greater role in the trade turnover between western and eastern Europe than could be expected by its size in terms of either population or GDP. If one takes as a reference point trade flows in 1995 between the four major European countries (France, Germany, UK and Italy) and seven economies in transition (Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia), the bilateral flows with Slovenia account for 11.2 per cent of the total. This compares with 16.8 per cent for Hungary, which has eight times the population and three times the GDP of Slovenia (Table 23).

With such a strong reliance on foreign markets, the effects of international trade on the restructuring process can then be rather critical, especially because under the Yugoslav federation many big Slovene enterprises were sized to supply a wider domestic market. After the split of the Federation, the production capacities in these enterprises could find appropriate outlets only in large export markets. The alternative was to downsize or even disappear. This trade-off is illustrated, for example, by the recent bankruptcy of one of the biggest former

Table 23. **Breakdown of the trade turnover between the CEECs and the four major EU economies**

In per cent of total trade flows between EU-4 and CEEC-7

	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia	Slovenia	Total CEEC-7
France	0.4	1.7	1.4	2.8	1.2	0.5	1.8	9.9
Germany	1.7	17.9	11.1	19.9	3.6	4.9	5.4	64.6
Italy	1.1	2.4	3.1	4.3	3.0	1.2	3.6	18.8
U.K.	0.4	1.5	1.2	2.5	0.6	0.3	0.4	6.8
(1) Total EU-4	3.5	23.6	16.8	29.5	8.5	6.9	11.2	100.0
<i>Memorandum items:</i>								
(2) Population (million)	8.44	10.33	10.26	38.54	22.71	5.35	1.98	
(3) GDP (US\$ million)	10 019	36 049	41 146	88 516	29 206	12 431	14 037	
Ratio (1)/(2)	0.4	2.3	1.6	0.8	0.4	1.3	5.6	
Ratio (1)/(3)	0.4	0.7	0.4	0.3	0.3	0.6	0.8	

Source: Eurostat-Comext database; WIIW (1995).

Slovene enterprises – the truck and military equipment producer TAM – which was not able to redirect its products to international markets and is currently under a painful restructuring process with a somewhat uncertain outcome.

In order to analyse these links, the first step is to understand how Slovenia appears in the international division of labour or, in other words, to measure its trade specialisation. To that end, the top 20 products ranked by the value of an indicator of revealed comparative advantages (RCA) are given in Table 24. This indicator was described elsewhere (OECD, 1996a).⁶³ It can be interpreted simply as a "normalised" trade balance which takes into account or corrects for the overall trade imbalance (in theory, comparative advantages should be measured in a situation of equilibrium between exports and imports). With roughly 60 per cent of total exports, these top 20 products in terms of revealed comparative advantages account for a significant portion of trade. The first stylised fact that emerges from the table is that the Slovene economy does not appear intensively specialised.⁶⁴ Indeed, for small open economies, the top value of the comparative advantage indicator is typically above 10 whereas in Slovenia its maximum value is only around 5. Furthermore, the lower intensity of sectoral specialisation implies that, by symmetry, intra-industry trade tends to be more intensive. Moreover, the products with high comparative advantage are not dominated by a single sector or industry as in the case of other similar small open economies.

Table 24. Trade structure of the Slovene economy, 1995

SITC Code	RCA ¹ in 1992	RCA ¹ in 1995	Export share ²	Cumulative share of exports ²	SITC Code	RCA ¹ in 1992	RCA ¹ in 1995	Import share ²	Cumulative share of imports ²
84					33				
Articles of apparel and clothing accessories	6.7	5.2	7.9	7.9	Petroleum, petroleum products and related materials	-6.3	-4.6	4.7	4.7
82					93				
Furniture and parts thereof	3.6	4.3	5.4	13.3	Special transactions not classified according to kind	-4.4	-2.7	2.9	7.6
77					75				
Electrical machinery, apparatus and appliances n.e.c.	4.2	4.2	9.1	22.5	Office machines, automatic data-processing equip.	-1.8	-2.2	2.4	10.0
64					72				
Paper, paperboard, paper articles, paper-pulp/board	2.4	2.6	4.7	27.2	Machinery specialised for particular industries	-1.5	-2.1	4.0	14.0
63					57				
Cork and wood manufactures, excl. furniture	2.0	2.4	3.2	30.4	Plastics in primary forms	-1.8	-1.5	2.3	16.3
54					34				
Medicinal and pharmaceutical products	1.6	2.1	3.8	34.2	Gas, natural and manufactured	-1.7	-1.3	1.3	17.6
62					25				
Rubber manufactures n.e.c.	1.7	1.5	2.4	36.6	Pulp and waste paper	-1.2	-1.2	1.7	19.3
69					78				
Manufactures of metal n.e.c.	1.6	1.0	4.4	41.0	Road vehicles incl. air cushion vehicles	3.4	-1.1	12.6	31.9
85					28				
Footwear	0.9	1.0	1.9	42.9	Metalliferous ores and metal scrap	-1.2	-1.1	1.2	33.1
35					05				
Electric current	0.0	0.8	1.0	43.9	Vegetables and fruit	-0.4	-1.0	1.7	34.8
81					04				
Prefabricated buildings, sanitary, lighting fixtures n.e.c.	1.1	0.8	1.4	45.3	Cereals and cereal preparations	-1.4	-0.9	1.1	35.8
68					51				
Non-ferrous metals	0.5	0.8	3.2	48.5	Organic chemicals	-1.7	-0.9	2.3	38.1
87					59				
Professional, scientific and controlling instruments	0.1	0.4	2.0	50.5	Chemical materials and products n.e.c.	-0.8	-0.9	1.3	39.4
66					74				
Non-metallic mineral manufactures n.e.c.	0.0	0.4	2.4	52.8	General industrial machinery and equipment and parts	-1.4	-0.8	4.5	43.9
53					67				
Dyeing, tanning and colouring materials	0.1	0.4	1.4	54.3	Iron and steel	-1.9	-0.7	4.3	48.2
61					07				
Leather, leather manuf. n.e.c. and dressed fur skins	0.6	0.4	0.8	55.1	Coffee, tea, cocoa, spices, manuf. thereof	-0.5	-0.7	0.8	49.0
65					26				
Textile yarn, fabrics, made-up art., related products	0.7	0.3	3.9	59.0	Textile fibres (except wool tops) and their wastes	-0.9	-0.7	0.7	49.7
24					23				
Cork and wood	0.5	0.3	1.0	60.0	Crude rubber (including synthetic and reclaimed)	-0.7	-0.6	0.7	50.4
02					27				
Dairy products and birds' eggs	0.3	0.2	0.5	60.5	Crude fertilizers and crude materials (excl. coal)	-0.8	-0.6	0.7	51.1
01					58				
Meat and meat preparations	0.6	0.2	1.0	61.5	Plastics in non-primary forms	-0.5	-0.5	1.1	52.2

n.e.c. : not elsewhere classified.

1. RCA : revealed comparative advantage indicator (Xi/X. - Mi/M. * 100), see text.

2. As percentage of total exports or imports in 1995.

Source: Statistical Office of the Republic of Slovenia.

Among the products with strong comparative advantage are articles of apparel, furniture, paper and wood manufactures. These light industries are characteristic of the exports of other central and eastern European countries towards European markets. Even so, Slovenia is also a net exporter of electrical machinery (9 per cent of exports), drugs and medicines (4 per cent of exports) and some sophisticated products such as precision instruments. On the import side, Slovenia appears mainly dependent on energy (petroleum), followed by office and industrial equipment. The fact that the main import item – road vehicles, accounting for 12.6 per cent of total imports in 1995 – does not emerge as a main comparative disadvantage is due to the fact that Slovenia also exports automobiles (mainly produced by the Renault plant in Revoz).

Apart from some decrease in intensity and increase in the variety of products, the 1995 trade structure has not changed substantially since 1992 (see Table 24). Therefore, while in other transition countries the trade re-orientation towards western markets tended to be dominated in the first place by the exports of intermediate goods produced in some heavy industries, in Slovenia, trade favoured a broader industrial base composed either of light industries or industries having attained a relative degree of product sophistication. This pattern probably reflects the already relatively favourable starting point of Slovenia described in Chapter I.

The specificity of Slovenia among the transition countries also emerges in other studies. Using an indicator on the degree of similarity of the trade flows between several eastern European and OECD countries, Fidrmuc, Helmenstein and Huber (1995) show that Slovenia stands out with the most (significantly) similar trade structure to those of Western European countries (see Table 25). Aiginger and Wolfmayr (1996), having analysed the qualitative competitiveness of seven countries in transition, also conclude that Slovenia has the best performance according to several indicators. For example, the trade deficit in the sectors where quality competition tends to be important is the smallest in Slovenia and, overall, these sectors account for a large share of exports (25 per cent of total exports). The sectors with structural problems, as suggested by the absence of either price or quality competitive advantages, also have a relatively small share of trade in Slovenia (10 per cent, against more than 50 per cent in some other transition countries).

Table 25. **Degree of similarity of trade flows between Eastern and Western European countries, 1994¹**

	Sweden	Finland	UK	France	Switzerland	Italy	Spain	Greece
Bulgaria	0.04	-0.01	0.13	0.16	0.06	0.62**	0.29*	0.84**
Czech Republic	0.21	0.12	0.09	0.14	0.13	0.30*	0.03	0.18
Hungary	0.10	0.09	0.25*	0.14	0.11	0.40*	0.06	0.40*
Poland	0.01	0.01	-0.02	0.03	-0.04	0.25*	0.10	0.30*
Romania	0.01	0.01	0.14	0.17	0.11	0.66**	0.17	0.75**
Russia	-0.10	-0.05	-0.07	-0.06	-0.10	-0.08	-0.06	-0.01
Slovakia	0.22	0.17	0.11	0.15	0.10	0.44**	0.02	0.30*
Slovenia	0.53**	0.38**	0.40**	0.40**	0.57**	0.72**	0.12**	0.28*

1. Pearson's correlation coefficients computed on the basis of Austrian imports for the SITC 2-digit groups.

** Significant at 1% level.

* Significant at 5% level.

Source: Fidrmuc, Helmenstein and Huber (1995).

Another indication of comparative trade structures is provided in Table 26. Despite the intense sub-contracting relations between Slovene and EU enterprises, the share of outward-processing in total trade flows is the lowest among the transition countries displayed in the table (6.3 per cent, against over 10 per cent in Central Europe and 26 per cent in Romania). This comparison suggests that Slovenia no longer has a specific advantage in this type of production and trade relation, but rather is placed in higher value-added segments in the international division of labour.

Table 26. **Share of Outward Processing Trade (OPT) in the trade turnover between the CEECs and the four major EU economies, 1995**

In per cent of total trade flows between EU-4 and CEEC-7

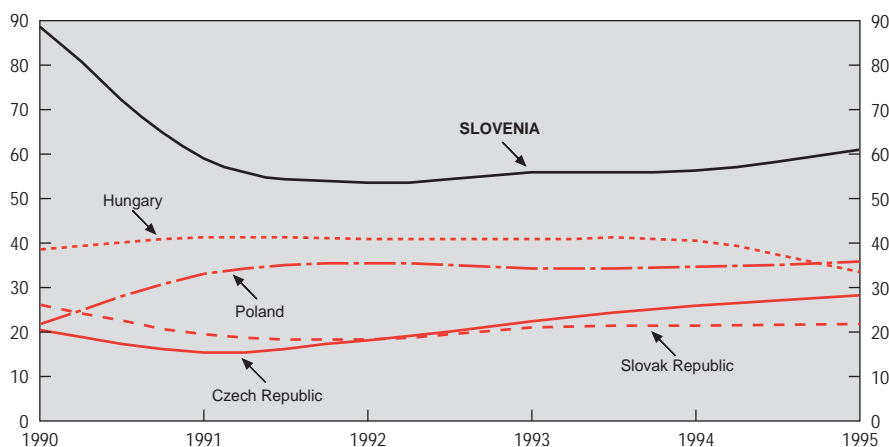
	Bulgaria	Czech Republic	Hungary	Poland	Romania	Slovakia	Slovenia
France	9.5	3.2	11.9	7.4	20.0	10.5	2.0
Germany	16.7	14.6	14.5	17.8	34.2	10.3	10.8
Italy	11.9	2.1	11.6	2.1	20.0	7.2	2.4
UK	3.7	5.1	5.2	2.1	19.4	6.0	0.8
Total EU-4	13.0	11.9	13.1	13.2	26.1	9.6	6.3

Source: Boylaud (1996)

Higher product quality compared with other countries in the region is also related to the level of labour costs. A comparison of the evolution of purchasing power parity-adjusted unit labour costs (ULC) across the four Visegrad countries and Slovenia is provided in Figure 22. Again, Slovenia stands out with the highest level of ULC, reaching roughly 60 per cent of Austrian levels by 1995. This implies that Slovenia may still have labour cost advantages compared with Western European countries, but its position in this respect *vis-à-vis* other transition countries is not favourable.

This analysis of Slovene trade specialisation enables some implications for the process of economic restructuring to be drawn. On the one hand, Slovenia possesses the advantages of a skilled and productive work force combined with a relatively high degree of product differentiation, which enables firms operating in product niches to be competitive in rather sophisticated segments of the manufacturing sector. On the other hand, industries relying merely on cost advantages are in the medium and long-term threatened by the potentially strong competition of neighbouring transition countries, whose industries still have a substantial

Figure 22. **UNIT LABOUR COSTS**
PPP-adjusted (Austria = 100)



Source: Havlik (1996).

competitive edge in a situation of rapidly increasing productivity. While Slovene products may well be price competitive in Western European markets, the specific and durable competitive advantages of Slovenia compared with other transition countries seem to be situated more in terms of quality or product differentiation than in terms of prices. This broad conclusion is corroborated by some evidence at the enterprise level. It turns out that the most successful Slovene enterprises do not seem to be the ones which exploit pure price advantages but rather the ones which are able to develop some form of technological innovation or product design. Specific examples can be found in pharmaceutical products, laser machines or pre-fabricated houses.

Consequently, as in all other countries engaged in major economic restructuring, this analysis indicates the risks with policies that would aim to restructure heavy loss-making enterprises in traditional industrial sectors. Such efforts would seem to be in contradiction with the structural characteristics of the Slovene economy and, in the end, could only impinge negatively on the overall restructuring process. The authorities are well aware of these difficulties. Policy measures in this area should focus on horizontal systems of support, as seems to be the case in a recently-published "Strategy for Increasing the Competitiveness Strategies of Slovene Industry" (Republic of Slovenia, Ministry of Economic Affairs, 1996). These measures would include the introduction of international quality and technology standards, a range of financial reforms to improve business funding and export growth, and support for research and training. Given the size of financial resources which may be implied by such a strategy, it is important that the authorities limit its possible impact on the public budget and avoid any excessive involvement of the government at the enterprise level.

VI. Labour market and wage setting

Trends in employment and unemployment

The transition process in Slovenia has included significant changes in labour market conditions, including a reduction in the labour force, decline in employment, and rise in unemployment (Table 27). The extent of these changes depends to some degree on whether data is taken from the annual labour force survey (which follows ILO standards, and is available since 1992),⁶⁵ or from registration records; these differences are of particular importance in assessing the “true” extent of unemployment in Slovenia (see below). The labour force contracted sharply in the early 1990s, mainly as a result of much larger flows of people taking up regular old-age pensions, early retirement, and disability pensions than would normally have been expected.⁶⁶ While reducing the impact that enterprise restructuring would otherwise have had on open unemployment, these withdrawals from the active population have been costly in terms of their direct impact on social expenditures, and in removing many experienced, productive people from the labour force (Vodopivec, 1996).

Total employment declined by nearly 20 per cent (177 000) between 1989 and 1993 (according to registration data). Since then, registered employment has shown a further small decline of around 3 per cent, while the labour force survey shows a rise of about the same proportion; the latter source is better suited to counting employment of temporary, contract, and family workers – areas that have grown in relative importance since the start of the transition.

The breakdown of employment in Table 27 indicates two important (and closely related) dimensions of restructuring. First, as noted earlier in connection with GDP shares, there is the overall re-orientation of economic activity away from industrial production and towards services. Second, recent employment growth has been entirely driven by the small-scale private sector – the

Table 27. **Labour force, employment and unemployment**

Thousands

	1989	1990	1991	1992	1993	1994	1995	1996
Labour Force Survey, May								
Labour force	..	..	..	969	931	936	952	943
Employed,	..	..	..	889	845	851	882	874
<i>of which:</i>								
Employed in agriculture	..	..	..	..	90	98	92	87
Employed in industry, construction	..	..	..	..	373	360	381	367
Employed in services	..	..	..	..	381	393	408	419
Self-employed and family workers	..	..	..	..	130	150	149	147
Unemployed	..	..	..	80	85	85	70	69
<i>of which: Long-term</i>					47	48	37	36
Unemployment rate (%)	..	..	..	8.3	9.1	9	7.4	7.3
Youth unemployment rate (%)	..	..	..	..	24.2	22.2	18.8	18.8
Registration data, annual average								
Employment	943	910	842	791	765	752	750	745
Employment in incorporated sector	819	782	710	657	627	605	594	582
<i>of which:</i>								
Business sector	681	648	580	527	487	462	448	433
Public services and public administration	138	134	130	130	140	143	146	149
Employment in small private sector	124	128	132	134	139	146	156	163
<i>of which:</i>								
Employees	31	32	33	33	37	41	49	54
Self-employed	37	40	43	45	47	49	52	54
Farmers	56	56	56	56	55	56	55	56
Registered unemployed	28	45	75	103	129	127	121	120
Rate of registered unemployed (%)	2.9	4.7	8.2	11.4	14.5	14.5	13.9	13.9

Source: Statistical Office of the Republic of Slovenia; IMAD; National Employment Office.

self-employed and their employees. Such trends are, of course, widespread in the OECD area (as well as in other economies in transition), and it is natural that they should also emerge in Slovenia. Conversely, as the authorities are aware, there are risks with a general policy approach that aims to preserve or restore jobs in heavy industry, particularly as such actions are likely to slow the transfer of economic resources to the more competitive, dynamic parts of the economy on which future growth will depend to a large extent.

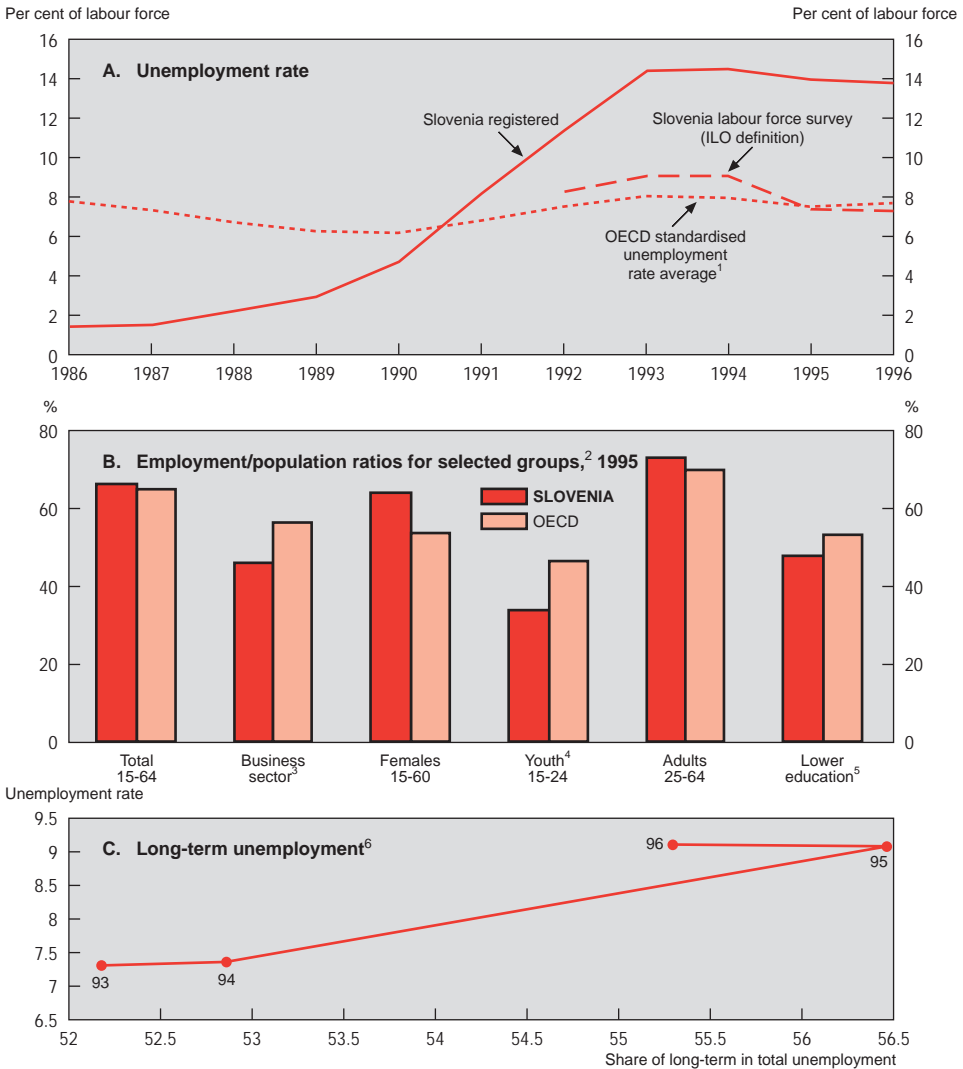
Reflecting these changing patterns of activity, the decline in total employment is more than fully accounted for by reductions in the incorporated business sector, where there was an employment decline of 29 per cent

(237 000 positions) between 1989 and 1996. Other data (not shown) on employment by activities reveal that the share of manufacturing in total employment fell from 41 per cent to 34 per cent (a loss of around 120 000 jobs) over this period. On the other hand, employment in the small private sector has increased by 31 per cent (39 000 jobs) since 1989, largely because of growth in trading activities. The sector of real estate, renting and business services increased by nearly 80 per cent between 1989 and 1995, employment rising by 20 000 and its share of total employment more than doubling (from 2.7 to 5.6 per cent). In addition, employment in public services and administration – affected by the requirements of building an independent State – has grown by 8 per cent (20 000) since 1989.

Economic restructuring has also led to a significant rise in (open) unemployment, although the amount of this rise – and, more generally, the extent to which unemployment should now be viewed as “a problem” – depends on whether one uses registration data or the labour force survey. Both measures are shown in Figure 23. The longer time series available from registration records shows official unemployment at negligible levels (under 2 per cent) before the transition.⁶⁷ Since then, it has risen: from 2.9 per cent in 1989 to 8.2 per cent in 1991, and peaking at 14.4 per cent in 1993 and 1994 (an average of 129 000 unemployed in 1993). In 1995 and 1996, registered unemployment has generally been in the range of 13 to 14 per cent, with no rising or falling trend. In contrast, the annual survey measure shows a peak of 9.1 per cent (85 000 unemployed, in 1993), and a faster absolute and relative decline to the May 1996 level of 7.3 per cent (69 000).

The wide gap between these two measures of unemployment arises mainly from differences regarding who is categorised as being in the labour force and then in employment. Estimates in OECD (1997) indicate that the registration data (for May 1996) included 32 000 individuals who would be viewed as out of the labour force by the survey definition, the majority of whom are not actively seeking or available for work. In addition, 19 000 of the registered unemployed were actually employed according to the survey definitions, most in various forms of contract, temporary, or family work. The increasing importance of informal work and short-term contracts in Slovenia (partly to avoid non-wage labour costs, including the costs of redundancy provisions) may partly account for the growing disparity between registered and surveyed unemployed.

Figure 23. KEY FEATURES OF THE LABOUR MARKET



1. Excludes Austria, the Czech Republic, Denmark, Greece, Iceland, Luxembourg, Mexico, Turkey, Hungary and Poland.
 2. Defined as the percentage of each population group that is employed. Maximum working age is 64 years, except for women in Slovenia (60 years).
 3. Business sector employment divided by working-age population.
 4. The minimum age for youth differs across OECD countries (either 14, 15, 16).
 5. Completed less than upper secondary education. OECD in 1994.
 6. Long-term unemployment is defined as individuals looking for work for one year or more.
- Source: Statistical Office of the Republic of Slovenia, OECD.

Overall, despite its well-known limitations (such as exclusion of discouraged workers), the survey measure of unemployment is internationally comparable and probably provides a more consistent and reliable basis on which to assess unemployment pressures in Slovenia. By this measure, just over one half of the total is taken up by long-term unemployment (one year or more), almost all of whom have just primary and/or vocational education; one third of the unemployed are aged under 25 (the youth unemployment rate is 19 per cent); and one third have primary school education or less (whereas this group represents under one quarter of the labour force).

Gross benefit entitlements correspond to 70 per cent of previous income in the first three months of each unemployment spell, in subsequent months falling to 60 per cent. There is an overall benefit cap, however, as a result of which net benefits (for a standard taxpayer) are at most around 80 per cent of the average net wage. Benefits, on average, are just over 60 per cent of the average net wage. Unemployment compensation is available for 3 months after 9 months' continuous work,⁶⁸ 6 months after 30 months' work, and rising eventually to 24 months after 20 years' work.⁶⁹

Given the wide range of eligibility and entitlement conditions in the OECD area, these criteria for Slovenia do not stand out as exceptional – particularly by European standards (*cf.* OECD, 1994; Martin, 1996). Unemployment benefits are not available if workers leave jobs voluntarily, and the limits on benefit duration mean that many of the long-term unemployed are no longer eligible (in December 1996, 31 per cent of the registered unemployed received unemployment insurance or assistance benefits, mainly the former).

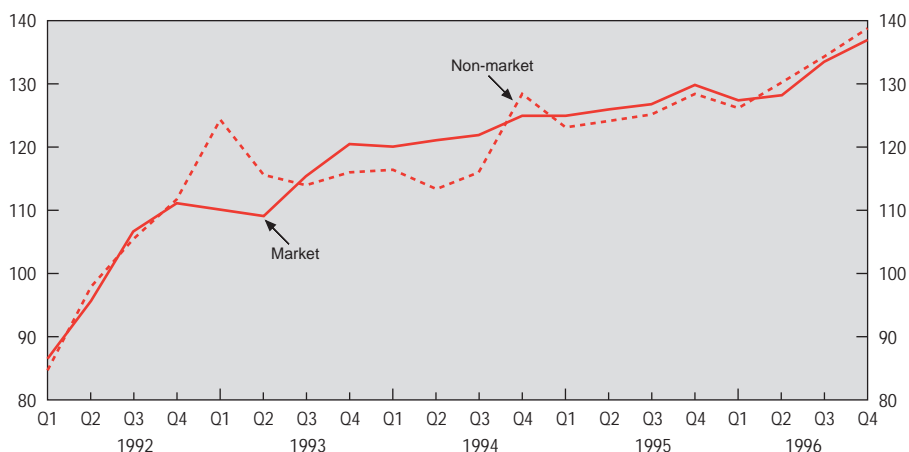
There is nevertheless scope for further changes in the Slovene unemployment benefit system with the aim of improving surveillance and work incentives; the current system may in some respects be slowing the process of labour market adjustment to unemployment and reinsertion of the unemployed.⁷⁰ In the administration of benefits, there appears to be weak monitoring and enforcement of requirements for job search, weak controls over gaining additional earnings (especially in the informal sector) while collecting benefits, and few sanctions in cases of abuse (OECD, 1997; Vodopivec, 1996). These problems are reflected in a duration of unemployment spells which corresponds very closely to the potential duration of benefits, with a dramatic increase in the “escape rate” to employment just before the point of benefit exhaustion (Vodopivec, 1996). Concerns

about the potential labour market disincentives arising under unemployment benefits led the Jobs Study (OECD, 1994) to recommend tight benefit administration, enforcement of work-testing requirements, and limits on wage-related benefits to one year, at most – recommendations which would appear to be of direct relevance to Slovenia.

Wage developments

As with employment, real gross wages fell sharply in the early years of transition and, in 1992, were around 30 per cent below their level of 1990. Since then they have increased, with particularly rapid growth (11 per cent) in 1993, especially in the non-market sector (Figure 24). Recent earnings growth has also been relatively rapid: in 1996, real wages are estimated to have increased by 5.0 per cent over their 1995 level, nearly one percentage point higher than the rate of productivity growth. This wage rise comprises an estimated 4.0 per cent growth in the market sector and 6.6 per cent growth in the non-market sector

Figure 24. **REAL NET WAGE BY SECTOR**¹
1992 = 100



1. Using retail price deflator.

Source: Statistical Office of the Republic of Slovenia, IMAD.

(IMAD, 1996b). This rate of growth is well above that agreed to in the 1996 Social Agreement (see below). The Agreement targeted real wage growth in 1996 at “2 per cent lower than the actual rise in GDP”; the objective for GDP growth was “at least 5 per cent”, whereas current estimates are that GDP grew by 3.5 per cent.

The combination of wage restraint and rapid productivity growth is essential if Slovenia is to retain and build its international competitiveness. As shown in Table 28, although earnings levels in Slovenia are still well below those in its main Western European markets, they are three or more times as high as those in other countries of Central Europe (compared according to market exchange rates,

Table 28. **Gross monthly earnings comparisons**

	At current exchange rate				At current PPPs			
	1992	1993	1994	1995	1992	1993	1994	1995
In US\$								
Slovenia	627.8	666.4	734.6	961.4	887.7	965.8	1 009.8	1 066.6
Austria	n.a.	2 542.5	2 696.3	3 190.8	n.a.	2 127.5	2 215.1	2 314.6
Bulgaria ¹	83.7	96.2	73.1	105.5	360.9	374.0	342.0	350.2
Czech Republic ²	161.3	196.3	232.0	296.4	495.7	545.0	594.0	644.7
Hungary ³	282.3	295.7	316.7	309.4	387.7	348.0	355.3	370.5
Poland	212.6	215.3	234.5	289.8	428.0	450.3	488.8	520.4
Romania ⁴	65.7	78.6	85.8	104.0	272.5	250.9	254.4	285.6
Slovak Republic ⁵	160.6	174.8	196.4	241.9	466.4	489.0	511.7	549.2
In percentage								
Slovenia	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Austria	n.a.	381.6	367.0	331.9	n.a.	220.3	219.4	217.0
Bulgaria ¹	13.3	14.4	9.9	11.0	40.7	38.7	33.9	32.8
Czech Republic ²	25.7	29.5	31.6	30.8	55.8	56.4	58.8	60.4
Hungary ³	45.0	44.4	43.1	32.2	43.7	36.0	35.2	34.7
Poland	33.9	32.3	31.9	30.1	48.2	46.6	48.4	48.8
Romania ⁴	10.5	11.8	11.7	10.8	30.7	26.0	25.2	26.8
Slovak Republic ⁵	25.6	26.2	26.7	25.2	52.5	50.6	50.7	51.5

1. Excluding private sector.

2. Manufacturing industry. 1992-94, all enterprises with 25 or more employees were surveyed; since 1995, all enterprises with 100 or more employees.

3. 1992-93, enterprises with less than 20 employees were not surveyed. From 1994, only enterprises with less than 10 employees were not surveyed.

4. Net monthly earnings, including private sector since 1994.

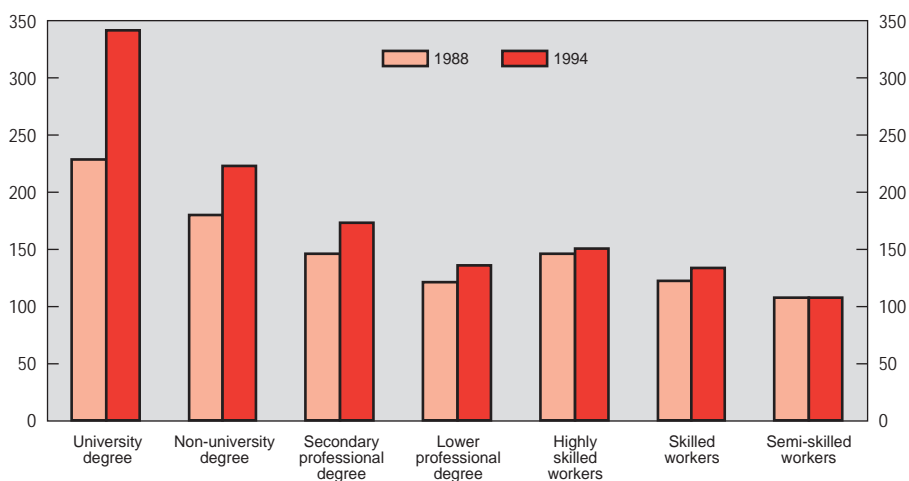
5. Data relate to employees only (*i.e.* excluding managers).

Source: Statistical Office of the Republic of Slovenia; OECD.

the difference being lower on a PPP basis). The latter countries are likely to be of increasing importance as potential export markets, as well as competitors in trade with the West. Moreover, a strong case can be made for wage growth in Slovenia to continue to be kept lower than productivity growth in order to provide owners with the resources needed for investment and other restructuring costs.

Wage dispersion – artificially compressed in the former regime – has become wider since the transition. The monetary returns to increased education and skills have risen significantly (Figure 25), a trend which should encourage greater investment in human capital development. Vodopivec (1996) notes – at least in the earlier stages of the transition – increased wage variation within labour force groups which have the same industry and human capital characteristics, and across firms in the same industry. Nevertheless, there has possibly been less variation in relative wages across the main industrial sectors than would have been expected given the differences in economic performance: for example the coefficient of variation of average earnings in the 14 main branches of activity was essentially unchanged over the period 1992 to 1995.⁷¹

Figure 25. **MONTHLY EARNINGS BY LEVEL OF EDUCATION AND SKILL**
Unskilled worker = 100



Source: Statistical Office of the Republic of Slovenia.

The preceding result suggests that indexation mechanisms – linking settlements in each sector to what is happening in other sectors as well as to inflation – may still be playing a substantial role in the evolution of relative wages. As noted in Chapter II, indexation (in both financial and labour markets) risks producing serious inertia in the disinflation process. The authorities plan to reduce the number of index-linked wage adjustments per year (from quarterly to half-yearly adjustments, and eventually to annual indexation). However, these adjustments would still be based on past inflation. A more significant commitment of wage setters to disinflation would arise if indexation was “forward-looking” – *i.e.* based on inflation projected for the period ahead. Such an approach would clearly need to be linked with measures to build the credibility of monetary policy, particularly regarding the announcement and attainment of inflation targets. Eventually, however, indexation should be dropped entirely, and all wage adjustments negotiated between the parties concerned.

There are also concerns regarding public sector wages. These are around 27 per cent higher on average than wages in the private sector, and have recently been rising more rapidly. While the difference in levels may be largely due to differences in education and skill requirements, the recent wage growth raises questions about whether wage-setting mechanisms in the public sector are sufficiently firm. Less-restrained wage growth amongst public employees is bound to produce spill-over effects into the private sector and, as discussed in Chapter II, is putting pressure on the fiscal position.

Wage determination

Wage determination in Slovenia occurs at several different levels. The base document in 1995 and 1996 has been the Social Agreement, signed by the government and representatives of employees and employers. This Agreement, which has compulsory coverage, sets out the broad conditions and expectations surrounding labour market developments, including government commitments to particular legislative measures. The main points (relating directly to earnings) from the 1996 Social Agreement include:

- real wage growth 2 per cent less than actual GDP growth;
- indexation of base salaries every quarter by 85 per cent of retail price growth in the previous quarter, rising to 100 per cent adjustment if the

price level rises more than 8.8 per cent from April on; lower indexation adjustments can be negotiated in the case of companies in financial difficulty;

- a profit-sharing provision, whereby profitable companies can pay employees a bonus of up to one extra month's salary, the total payment not to exceed 25 per cent of gross profits;
- an annual holiday bonus of SIT 102 000 (80 per cent of the average gross wage) or, if business results permit, an amount equal to one month's salary;
- a 4 percentage-point reduction in the employer's social security contribution rate in the second half of 1996 (lowering the total contribution rate from 42 to 38 per cent), partially offset by the introduction of a payroll tax (mainly affecting higher salaries);⁷²
- a minimum gross monthly wage of SIT 53 500 for the June quarter, 1996, indexed as with other salaries.

Beyond the Social Agreement, General Collective Agreements – one for the non-market sector, another for the market sector – set out specific, minimum monthly pay rates across nine education and skill categories. The agreement for the market sector provides separate scales for 24 different branches of activity. Further bargaining can occur at a more disaggregated industry level and also, in some cases, within enterprises (and/or with individual employees).

In September 1996, employers cancelled the General Collective Agreement for the Market Sector (although its pay scales remain in effect until the end of March 1997). For a new agreement, employers propose reductions in a wide range of allowances which come on top of base pay: these include payments for holiday and sick leave, travel and food allowances, supplements for shift work and other non-standard hours, and rights for particular categories of workers (such as trade union stewards and the disabled). These proposals led to industrial protests in late-1996.

This range of non-wage allowances, coupled with social security charges, has a significant impact on gross labour costs. This is illustrated in the examples shown in Table 29. Total labour costs are around 50 to 60 per cent higher than the starting gross wage (as set out in the relevant collective agreement), and nearly double the starting net wage. Labour market performance in some Western European countries suggests that high tax wedges (also taking consumption taxes

Table 29. **Structure of wage costs**
Approximate calculations for three professions in April 1996

	Secretary	Technician for metal	Engineer
<i>(In % of total labour costs per employee [11])</i>			
1 Starting-level gross wage¹	62.6	63.1	68.1
2 + Supplements on active employment (0.5% from basic wage for every active employment year)	1.6	3.2	1.7
3 – Contributions for social security paid by employee (22.10% on item 1, 2)	–14.2	–14.6	–15.4
4 + Annual vacation bonus, calculated on monthly average (to 100% of the last known statistical data on the average gross monthly wage in the economy sector: January 1996)	9.4	8.4	6.7
5 – Income tax (on item 1, 2, 4) ²	–7.8	–3.6	–10.3
6 Starting-level net wage (included annual vacation bonus, included item 1, 2, 4; excluded item 3, 5)	51.6	56.4	50.7
7 + Meal expenses reimbursement	11.3	10.1	8.0
8 + Reimbursement of travelling expenses to and from work ³	2.3	2.1	1.6
9 Complete income based on starting-level net wage (included item 6, 7, 8)	65.2	68.6	60.4
10 Contributions for social security paid by employer (19.90% on item 1, 2) ⁴	12.8	13.2	13.9
11 Total labour cost for employee – monthly average	100.0	100.0	100.0
<i>Memorandum items (in US\$):</i>			
11 Total labour cost for employee – monthly average (included item 1, 2, 4, 7, 8, 10)	728	817	1 026
12 Labour cost for employee – hourly average (excluding non-material expenses and annual vacation bonus: included item 1, 2, 10)	3.2	3.7	4.9
13 Labour cost for employee – hourly average (including non-material expenses and annual vacation bonus: item 1, 2, 7, 8, 10)	4.1	4.6	5.8
14 Total labour cost for employee – yearly average (12 × amount in item 11)	8 736	9 804	12 317
1. Valid starting-level gross wage, from General Collective agreement for the economy sector, April 1996.			
2. The calculation is based on last known statistical data of monthly average gross wage on January 1996: 119.709 SIT.			
3. Reimbursement for travelling expenses to and from work included amount 60% of the cost of public city transport for all lines, April 1996.			
4. This rate changed in July 1996 to 15.9 per cent.			
<i>Source:</i> Chamber of Economy of Slovenia.			

into account) can have detrimental effects on employment growth and unemployment, especially in situations where labour markets are inflexible (see OECD 1994). In this regard, the recent moves by the Slovene Government to lower social security contribution rates (and the prospect of further such reforms)

are to be welcomed. It is also understandable that employers should be trying to contain their labour costs by addressing the allowances provided under current arrangements.

More generally, the bargaining arrangements prevailing in Slovenia may not be optimal with respect to economic restructuring and longer-run employment growth. There is a body of literature⁷³ and empirical findings indicating that bargaining systems which are either strongly centralised or largely decentralised tend to perform better – at least regarding restraint of real wages and unemployment – than “intermediate” systems where sectoral or industrial-level agreements typically dominate (as appears to be the case in Slovenia). While it is difficult to characterise bargaining arrangements along a single dimension from centralised to decentralised, the argument is that in intermediate systems, no single group of agents takes full responsibility for the employment and other consequences of wage bargains that are struck. In Slovenia, this problem may be exacerbated by the multi-level aspects of bargaining, which may tend to produce wage drift as negotiations proceed at different levels. The Social Agreement, for example, sets out clear “statements of intent” regarding wage adjustment, but these do not appear to have been strong enough to restrain real wage growth in 1996. Moreover, as noted above, the indexation arrangements in this Agreement may tend to impart significant rigidity to relative wage adjustments.

In a transition economy such as Slovenia, it could be argued that a decentralised bargaining system (*e.g.* at the enterprise level) might be the best suited to supporting the economic restructuring and employment adjustment that is required. This could be the case particularly when the privatisation process is completed, at which point enterprises will face stronger market incentives and their ownership will be more clearly defined (in contrast, decentralisation of wage-setting while enterprises are still under social ownership may be inadvisable, given the mixed economic and non-economic motives that appear to influence wage-determination processes in this context).

Under decentralised bargaining, enterprises would take fuller responsibility for their labour costs, which, for many, will be the main component of expenditure. In planning these along with the other business decisions, employers would then be forced to assess their enterprise-specific requirements, including building productivity and competitiveness. It should be noted that the existing wage determination arrangements in Slovenia do provide some flexibility to employers.

However, this flexibility tends to be available in a codified, rigid manner (as set out in the Social Agreement), and at the margin of base sectoral agreements. Moreover, the flexible aspects of the Social Agreement are available only *after* good (or bad) performance has been demonstrated. Instead, bargaining arrangements should be designed to *contribute to* better performance.

At around 42 per cent of average earnings, the minimum wage (set in the Social Agreement) is towards the lower end of the range that prevails in OECD countries.⁷⁴ As in other countries, however, this proportion understates the relation between minimum wages (as also established in General Collective Agreements) and the earnings capacity of many of the unemployed. With the young and low-skilled disproportionately represented amongst the unemployed in Slovenia, it is important for policy makers and wage negotiators to continue taking a cautious approach to setting minimum wage levels: in particular, the equity objectives sought through such adjustments need to be balanced against concerns to avoid pricing large groups of workers out of the labour market. A lower “youth” minimum wage, as exists in a number of OECD countries, could be one way of limiting these adverse employment effects.

Notes

1. The definition of the “social product” was rather close to the concept of “net material product” used in the other former-socialist countries of Central and Eastern Europe. Roughly speaking, the social product did not include services in the definition of value added.
2. Taking the Yugoslav average of social product per capita as 100, the corresponding indices for the individual federal units in 1989 were the following: Slovenia 198, Croatia 127, Serbia proper (without provinces) 103, Serbia 91, Montenegro 73, Bosnia and Herzegovina 68, Macedonia 66 and Kosovo 25.
3. See Majcen (1995).
4. Exports and imports after subcontracting (processing) have been undervalued as a result of systematic errors in completion of the relevant customs declaration: it appears that producers have been recording net rather than gross amounts (*e.g.* value added rather than gross exports) in their declarations. Preliminary corrected data have been released, and the Statistical Office has announced that final foreign trade data will be available later in 1997.
5. Slovenia joined CEFTA in January 1996; the other countries covered by this agreement are the Czech Republic, Hungary, Poland and the Slovak Republic.
6. See *Strategy of International Economic Relations*, Republic of Slovenia (1996b).
7. The average size of a private farm in Slovenia is about 4 hectares.
8. In 1994 the gross domestic supply of agricultural products covered 84 per cent of demand, but including the imports of animal feed only 72 per cent.
9. See Spring Report of IMAD (1996).
10. OECD (1996b).
11. For further details and discussion see *Republic of Slovenia. Strategy of International Economic Relations* (1996b).
12. As discussed in Bole (1996a), however, the “real” interest rate as shown in Figure 9 is set according to explicit decisions of banks, and does not represent the opportunity costs of financial instruments. Bole’s estimates of real *ex ante* interest rates indicate that real rates are in fact more variable (and hence expected inflation less variable) than suggested in Figure 9.
13. Slovenia’s share of the directly attributable gross debt of the former-Yugoslavia was 11 per cent of the total, or US\$1.8 billion.
14. This concerns the distribution of gold assets, amounting to about US\$600 million, and the assets of three deposits denominated in Swiss Francs, US dollars and German marks, worth about US\$60 million.

15. For example, Dun and Bradstreet maintained a rating of DB3A for Slovenia in November 1996; Standard and Poor's rating is A with a stable outlook; Moody's is A3; and IBCA A-.
16. This requirement was introduced in 1995, initially for loans of up to 5 years.
17. Bank of Slovenia Annual Report, 1995.
18. In May 1995, the Bank of Slovenia abolished indexation (*i.e.* introduced nominal interest rates) on its monetary policy instruments with maturity of up to one month; for longer instruments, indexation was to be based on retail price growth in the last three months (previously, the adjustment was based on inflation over the previous month, which led to considerable volatility in interest rates). As of June 1995, commercial banks also followed this approach (Bank of Slovenia Annual Report, 1995). The indexation base was raised in February 1996 to inflation over the preceding four months, and over the previous six months, as of December 1996.
19. In December 1995, the Bank imposed a requirement that foreign exchange offices balance their sales and purchases on a weekly basis, changed to a monthly basis in January 1996.
20. For example, between the early 1980s and early 1990s, New Zealand and Australia reduced inflation from double-digit levels to low single digits while operating floating (or managed floating) exchange rate regimes, while countries participating in the European Exchange Rate Mechanism have successfully achieved and maintained low inflation under fixed exchange rates.
21. Fiscal surpluses have also been used to assist the Bank of Slovenia in intervention and sterilisation, with the liquidity surplus in the budget deposited in the Bank in either domestic or foreign currencies (see, for example, BoS Annual Report, 1995).
22. Based on discussions with a range of enterprises, plus survey information on competitiveness as reported in Economic Mirror, August-September 1996 (where 70 per cent of surveyed managers consider that the exchange rate has eroded their competitiveness).
23. The 1996 EBRD Transition Report indicates that only in the Czech Republic and Hungary are private pension funds significant and, even there, they are very small (as a share of GDP) compared with levels in the OECD area.
24. The simulation model together with results for 20 OECD countries are set out in Roseveare *et al.* (1996), which updates and extends earlier analysis in Liebfritz *et al.* (1995).
25. Contributions are a fixed share of aggregate wages which – along with GDP – increase according to total employment growth and the assumed increase in productivity.
26. For those with a minimum of 20 years' insurance, retirement ages are 63 for men, and 58 for women; and with a minimum of 15 years' insurance, the ages are 65 for men and 60 for women. The calculation base for benefits is reduced by 2 percentage points for each year of insurance acquired below the standard 40 years of coverage.
27. Of the 20 countries covered in Roseveare *et al.*, 1996, only France retains a standard retirement age of 60 for both men and women (and, in Italy, women will be able to retire at 60 (65 for men) under reforms currently being phased in).
28. Benefits are subject to a maximum of 2.6 times the average wage, and minima of 0.26 (for men) and 0.22 (for women) times the average wage.

29. The scheme outlined here is described in Starting Points for the Reform of the Pension and Disability Insurance System (Ministry of Labour, Family and Social Affairs, 1996).
30. See, for example, World Bank (1994), and EBRD (1996).
31. That is, the tax and regulatory regime should not induce people to invest in one sort of asset over another.
32. This chapter draws on a detailed background paper on the Slovene banking sector prepared by Stiblar (1996), together with additional material provided by the Slovene authorities, other references are noted in the text.
33. These depositors are mainly in Croatia and (to a lesser extent) Bosnia; liabilities in the Former Yugoslav Republic of Macedonia have been settled through the public debt of FYR of Macedonia.
34. BRA bonds were issued to cover non-performing assets and contingent liabilities, and Republic of Slovenia bonds were issued to cover the frozen foreign currency deposits (Stiblar, 1996, p. 34).
35. In addition, there are 7 savings banks and 72 savings cooperatives, playing only a small role in the overall financial market.
36. More recent audited data show returns on equity of 9.1 per cent in 1995.
37. *Cf.* Republic of Slovenia (1996a).
38. Banks currently need to have a minimum of around US\$ 32 million in capital for a full licence, well above the requirement set under EU Directive No. 89/646/EC. The new banking law due to be passed in late-1997 is expected to set a lower minimum requirement (Republic of Slovenia, 1996a).
39. Stiblar (1995) notes that the share of total deposits held by the 5 largest banks averages 53 per cent in developed economies; this share, currently around 62 per cent in Slovenia, is over 70 per cent in the Netherlands, over 60 per cent in France and Belgium, and under 20 per cent in Germany.
40. However, at least one bank has expressed concern that the term structure on deposit rates set in the agreement clashes with its objectives of attracting longer-term deposits.
41. These could include upper limits on the level of individual deposits that would be covered by insurance, possibly combined with a less-than-100 per cent guarantee for the covered portion (so that depositors retain an incentive to judge for themselves whether their deposit institutions appear sound); and risk-adjusted funding contributions by participating banks (as in the scheme recently introduced in Slovakia; *cf.* OECD, 1996a).
42. This view is based on discussions with major political parties, officials, and financial sector participants, including in the state-owned banks themselves.
43. There are no restrictions on real estate purchases by incorporated companies, whether foreign or domestically owned.
44. Although the Slovene economy started to follow a more independent macroeconomic policy even before the break-up of Yugoslavia, the institutional framework remained the same until the very end (see Mencinger, 1996a).

45. The literature on the Yugoslav self-management is vast. See, for instance. Tyson (1979), Estrin (1983), Sacks (1983) and Lydall (1984).
46. See Bajt (1988).
47. The history of socialisation is complex. For one account see Horvat (1984).
48. On that see Prasnikar (1983).
49. Kornai's term for the shortage economy.
50. On this see Bajt (1988).
51. See Mencinger (1996*b*).
52. See Bajt (1994).
53. In point of fact, they were dematerialised, *i.e.*, they were just accounting units in the bank accounts of all the citizens opened for that purpose only. The face value of the certificates as of January, 1993 was 2 000 to 6 000 DM per citizen (depending on his or her age).
54. Material for this section is drawn mainly from three sources: a survey of enterprises carried out in September/October 1995, covering Albania, Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia (*cf.* Eurostat, 1996); the annual report on results of commercial companies of the Agency of the Republic of Slovenia for Payments; and the response of the Republic of Slovenia to a wide-ranging EU questionnaire in 1996. While not exactly corresponding in every respect, these sources nevertheless appear to give a reasonably consistent picture of the current state and development of the enterprise sector.
55. The countries covered in this study were Bulgaria, Hungary, and Romania; the results cited in the text were strongest in Hungary, suggesting that they are most applicable in the more "advanced" transition economies, including Slovenia.
56. The manufacturing, mining and electricity sector had overall net losses of SIT 39 billion in 1995, compared with economy-wide net losses of SIT 25 billion.
57. See Hunya (1996) for further details and the discussion on FDI in CEECs.
58. FDI is defined as foreign investment enterprises (FIEs) with a 10 per cent or higher foreign equity share, while foreign portfolio investment is investment in FIEs with a foreign equity share of less than 10 per cent.
59. Hungary ranked first with a 43.5 per cent share, followed by Poland (22.4 per cent) and the Czech Republic (19.4 per cent).
60. CEEC-7 comprises the Czech and Slovak Republics, Hungary, Poland, Slovenia, Bulgaria and Romania.
61. The high share of Croatia stems from the Yugoslav heritage and is mainly due to Croatian participation in the nuclear power plant Kr̂ško. In the case of France, the relatively high share reflects almost exclusively Renault's engagement in the car manufacturing company Revoz.
62. For further details, see Republic of Slovenia (1996*b*).

63. The revealed comparative advantages were measured as follows:

$$R C A_i = \left(\frac{X_i}{\sum X_i} - \frac{M_i}{\sum M_i} \right) \cdot 100$$

where XI and MI are, respectively, the exports and imports for each product i . In the theoretical case of perfect specialization with two goods this indicator would give +100 (–100) for the exported (imported) product. For actual cases, the value of the indicator is much smaller, but the higher its value the higher the intensity of specialization. The value of this indicator is also related to the intensity of intra-industry trade. The higher the intensity of two-way trade, the lower the intensity of specialization. In the case where only intra-industry trade prevails, the indicator would take the value of zero for all sectors.

64. In OECD (1996a) comparable information was provided for Slovakia, Portugal and Denmark.
65. This survey is to be quarterly as of 1997.
66. It is estimated in OECD (1997) that flows into retirement in 1990 and 1991 were nearly 80 per cent higher than what would have been expected based on demographic patterns.
67. As in other countries of Central Europe, unemployment rates before the transition were artificially low as a result of constitutional guarantees of employment; Mencinger (1989) estimates that, in Slovenia, the rate of hidden unemployment in 1988 was 13.5 per cent in the social sector (cited in Vodopivec, 1996).
68. If the working period is discontinuous, the work requirement is 12 months.
69. After the expiry of unemployment insurance benefits, unemployment assistance is available for a further 6 months, although at a reduced level of around 25 per cent of the average wage.
70. A more detailed description and assessment of the unemployment benefit system can be found in OECD (1997) and Vodopivec (1996).
71. The coefficient of variation of average monthly earnings across the 14 branches was .1686 in 1992, .1672 in 1993, .1610 in 1994, and .1656 in 1995.
72. There is no payroll tax on salaries up to SIT 90 000, and the maximum rate of 10 per cent applies to salaries above SIT 750 000. The change is estimated to lower overall labour costs by 1.6 per cent in 1996.
73. See, for example, Calmfors and Driffill (1988), Calmfors (1993), and Scarpetta (1996).
74. Evidence in the OECD Jobs Study (OECD, 1994) indicates that legal minimum wages (in countries with such requirements) generally fell in the range of 35 to 60 per cent of average earnings.

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Annex I
Statistical tables

Table A1. GDP by expenditure
Billion SIT

	1990	1991	1992	1993	1994	1995
Current prices						
Final consumption	138.9	257.9	768.1	1 141.9	1 426.5	1 718.8
Private consumption	104.7	191.5	561.1	839.2	1 052.2	1 270.6
Public consumption	34.2	66.4	207.0	302.6	374.3	448.2
Gross capital formation	33.8	59.1	179.0	277.6	371.5	511.6
Gross fixed capital formation	36.9	72.0	187.5	268.8	362.2	467.8
Changes in inventories	-3.1	-12.9	-8.4	8.8	9.2	43.8
Total domestic demand	172.7	317.0	947.1	1 419.5	1 797.9	2 230.3
Exports of goods and services	178.6	291.9	642.8	843.1	1 091.3	1 203.7
Imports of goods and services	154.5	259.4	572.0	827.5	1 043.4	1 232.0
Net exports	24.1	32.4	70.8	15.6	47.9	-28.3
Gross domestic product	196.8	349.4	1 018.0	1 435.1	1 845.8	2 202.0
Constant prices of 1992						
Final consumption	865.3	792.9	768.1	855.7	889.7	941.9
Private consumption	653.9	582.3	561.1	637.7	667.2	713.9
Public consumption	211.3	210.7	207.0	218.0	222.5	227.9
Gross capital formation	220.4	185.9	179.0	217.1	242.8	314.6
Gross fixed capital formation	245.9	217.6	187.5	209.7	236.2	285.4
Changes in inventories	-25.6	-31.8	-8.4	7.4	6.7	29.2
Total domestic demand	1 085.6	978.8	947.1	1 072.8	1 132.5	1 256.5
Exports of goods and services	1 052.1	840.2	642.8	646.5	714.3	719.7
Imports of goods and services	955.8	742.2	572.0	672.4	744.1	830.2
Net exports	96.4	98.0	70.8	-25.9	-29.8	-110.5
Gross domestic product	1 182.0	1 076.8	1 018.0	1 046.9	1 102.7	1 146.0

Source: Statistical Office of the Republic of Slovenia.

Table A2. Structure of industrial output

Index 1989 = 100

	1990	1991	1992	1993	1994	1995	1996	Growth rate in %		Structure of value added 1994, in %
								1996/1990	1996/1995	
Total industry	89.5	78.4	68.1	66.1	70.4	71.8	72.5	-19.0	1.0	100.0
Capital goods	80.7	63.0	50.4	48.5	55.1	59.2	65.2	-19.3	10.1	
Intermediate goods	89.9	78.6	70.2	66.9	72.7	74.4	73.3	-18.5	-1.5	
Consumption goods	93.5	84.6	70.7	70.9	72.6	72.8	74.0	-20.9	1.6	
Production and distribution of electricity	98.6	100.8	95.6	92.2	99.4	99.1	99.9	1.3	0.8	6.2
Coal mining	87.0	80.0	85.6	78.5	73.1	72.7	70.3	-19.2	-3.3	4.4 ¹
Extraction of crude petroleum, natural gas	74.1	60.8	52.1	43.2	40.2	56.3	40.0	-46.1	-29.0	
Manufacture of refined petroleum production	111.9	122.3	121.7	121.6	81.7	111.0	85.0	-24.0	-23.4	n.a
Manufacture of basic iron and steel	87.5	58.6	60.8	55.9	66.0	66.5	53.7	-38.6	-19.2	0.8
Mining of basic non-ferrous metals	74.6	46.0	40.3	19.7	9.4					n.a
Manufacture of basic non-ferrous metals	96.4	84.3	74.6	72.9	70.2	74.7	76.1	-21.0	2.0	0.4
Smelting, alloying and refining of non-ferrous metals	104.4	92.0	94.6	92.8	96.1	106.9	107.1	2.5	0.1	0.5
Extraction of non-ferrous minerals	89.3	84.2	67.8	71.1	83.6	84.0	81.5	-8.7	-2.9	0.5
Manufacture of non-metallic minerals	94.7	82.7	77.5	74.8	80.7	82.8	80.6	-14.9	-2.7	2.8
Manufacture of metal products	85.0	77.5	65.1	62.1	64.0	60.6	59.2	-30.4	-2.3	7.4
Manufacture of machinery equipment	82.5	60.5	48.7	41.5	44.3	45.9	39.7	-51.9	-13.5	3.7
Manufacture of transport equipment	93.8	77.9	64.2	53.5	52.5	54.1	50.5	-46.1	-6.6	4.5
Shipbuilding	69.0	44.7	39.6	24.5	37.5	35.7	31.4	-54.5	-12.0	n.a
Manufacture of electrical equipment	85.8	74.6	61.0	62.3	76.7	87.0	95.8	11.7	10.1	14.0
Manufacture of basic chemicals	81.6	68.3	64.0	60.4	71.6	77.0	80.7	-1.0	4.8	2.4
Manufacture of chemical products	93.2	83.2	57.8	58.6	66.6	67.0	68.1	-26.9	1.7	10.8
Sand and stone quarrying	91.7	81.3	80.6	70.3	71.3	76.4	95.5	4.2	25.0	n.a
Manufacture of construction materials	89.0	76.5	69.4	64.5	76.7	76.4	87.8	-1.3	15.0	1.9
Manufacture of wood boards	89.7	75.3	68.0	64.4	66.0	65.7	64.7	-27.8	-1.5	1.0
Manufacture of wooden products	86.1	79.6	71.8	74.9	79.1	83.9	85.8	-0.3	2.3	5.0
Manufacture of paper and paper products	95.0	83.8	73.4	68.3	75.7	74.6	72.4	-23.8	-2.9	2.5
Manufacture of textiles	82.2	62.6	58.5	59.5	63.1	64.2	64.8	-21.2	-0.9	2.8
Manufacture of textile products	89.6	80.2	66.6	67.2	62.9	64.6	64.2	-28.4	-0.7	8.2
Manufacture of leather and fur	87.1	78.5	76.7	73.1	69.8	61.1	57.8	-33.6	-5.3	1.1

Table A2. **Structure of industrial output** (*cont.*)

Index 1989 = 100

	1990	1991	1992	1993	1994	1995	1996	Growth rate in %		Structure of value added 1994, in %
								1996/ 1990	1996/ 1995	
Manufacture of footwear	82.9	62.3	63.6	60.9	59.9	53.5	40.5	-51.1	-24.2	2.1
Manufacture of rubber and rubber products	98.7	99.8	99.5	98.8	105.1	109.8	109.4	10.8	-0.4	2.7
Manufacture of food products	100.6	96.2	78.0	76.0	79.0	80.3	83.2	-17.2	3.7	7.1
Manufacture of beverages	111.9	107.0	96.1	91.5	91.3	87.5	96.5	-13.7	10.3	3.0
Manufacture of animal feeds	102.6	99.2	86.8	76.5	76.0	79.6	79.7	-22.3	0.1	0.2
Manufacture of tobacco products	80.8	74.8	82.3	75.6	73.6	67.3	71.9	-11.0	6.9	0.7
Printing	95.5	99.2	83.5	92.0	94.1	78.5	74.6	-21.8	-4.9	2.5
Recycling	83.8	67.9	59.9	58.0	61.8	66.2	67.0	-20.0	1.3	0.4
Manufacture of miscellaneous products	70.7	55.6	60.5	70.0	67.0	66.1	68.1	-3.7	3.0	0.5

1. Including extraction of crude petroleum, natural gas.

Source: Statistical Office of the Republic of Slovenia; IMAD.

Table A3. Monetary survey

Billion tolar

	31 Dec. 91	31 Dec. 92	31 Dec. 93	31 March 94	30 June 94	30 Sept. 94	31 Dec. 94	31 March 95	30 June 95	30 Sept. 95	31 Dec. 95	31 March 96	30 June 96	30 Sept. 96	31 Dec. 96
Foreign assets															
Bank of Slovenia	6.5	70.8	104.0	104.6	137.2	156.1	190.1	193.3	216.5	222.3	250.9	233.4	227.9	315.0	329.5
Deposits money banks	112.8	203.9	188.8	218.3	221.1	282.3	291.0	286.4	284.8	301.2	301.7	345.2	370.6	363.2	365.4
Total	119.3	274.7	292.8	322.9	358.3	438.4	481.1	479.8	501.3	523.5	552.6	578.6	598.5	678.2	694.9
Domestic assets															
Claims of BS															
on central government	8.6	8.9	18.8	19.0	19.4	19.6	15.6	15.6	15.5	15.7	15.3	15.5	15.8	15.7	15.5
Claims of banks															
on general government	11.3	24.0	208.1	235.6	233.3	233.2	254.8	253.9	257.7	277.8	308.6	315.2	304.6	311.2	317.8
Claims of banks															
on enterprises	111.6	215.0	261.2	262.1	280.9	307.4	326.3	346.0	387.6	402.8	440.4	474.1	509.3	498.3	504.6
Claims of banks															
on individuals	10.4	22.0	55.2	61.5	73.1	83.4	91.6	100.0	117.5	142.3	160.5	176.5	197.9	204.6	207.2
Claims of banks															
on non-financial institutions	0.5	0.9	2.0	2.0	2.6	3.4	5.0	5.1	5.9	5.5	11.5	7.5	8.0	10.4	8.2
Total	142.5	270.8	545.3	580.2	609.3	647.0	693.3	720.6	784.2	844.1	936.4	988.8	1 035.7	1 040.2	1 053.2
Other assets	35.6	59.4	72.3	78.5	84.5	90.1	95.6	100.1	109.4	114.3	111.7	120.3	123.8	122.5	121.9
Total assets	297.4	604.9	910.5	981.6	1 052.1	1 175.5	1 270.0	1 300.4	1 394.9	1 481.9	1 600.7	1 687.7	1 758.0	1 840.8	1 870.1
Foreign liabilities															
Bank of Slovenia	0.0	0.0	-1.5	-1.5	-1.3	-1.2	-0.9	-0.8	-0.6	-0.7	-0.5	-0.5	-0.4	-0.4	-0.2
Deposit money banks	-72.7	-116.8	-139.6	-146.0	-143.2	-144.3	-159.2	-149.8	-161.9	-166.2	-186.9	-201.5	-168.9	-192.9	-198.4
Total	-72.7	-116.8	-141.2	-147.4	-144.5	-145.4	-160.1	-150.6	-162.5	-166.8	-187.4	-202.0	-169.3	-193.3	-198.6
Money supply															
Currency in circulation	-9.2	-24.2	-32.7	-30.2	-35.1	-37.6	-47.3	-42.8	-52.2	-54.0	-60.0	-55.8	-61.9	-59.5	-66.8
Demand deposits															
at banks	-29.5	-53.8	-79.4	-80.6	-89.2	-90.9	-115.9	-107.3	-124.3	-121.5	-140.0	-127.9	-138.8	-139.5	-163.3
Demand deposits at BS	-0.1	-3.4	-3.5	-4.3	-5.6	-6.8	-7.1	-7.4	-7.2	-6.6	-4.0	-3.8	-4.7	-5.1	-5.0
Total M1	-38.7	-81.5	-115.7	-115.2	-129.9	-135.3	-170.2	-157.5	-183.7	-182.2	-203.9	-187.5	-205.4	-204.0	-235.1
Tolar savings and time deposits at banks	-35.4	-104.7	-187.0	-217.1	-255.0	-277.8	-317.0	-364.2	-375.0	-396.6	-402.8	-442.0	-474.8	-472.9	-513.0
Government time deposits at BS	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-7.0	-7.8	-3.6	-4.9	-21.8	0.0

Table A3. **Monetary survey** (*cont.*)

Billion tolar

	31 Dec. 91	31 Dec. 92	31 Dec. 93	31 March 94	30 June 94	30 Sept. 94	31 Dec. 94	31 March 95	30 June 95	30 Sept. 95	31 Dec. 95	31 March 96	30 June 96	30 Sept. 96	31 Dec. 96
Total M2	-74.1	-186.1	-302.6	-332.2	-384.9	-413.2	-487.2	-521.7	-558.7	-585.8	-614.5	-633.1	-685.0	-698.8	-748.1
Foreign currency deposits at banks	-63.2	-128.2	-210.3	-225.4	-230.3	-239.9	-245.5	-252.6	-274.1	-293.1	-325.4	-352.8	-361.7	-367.6	-383.8
Total M3	-137.3	-314.3	-512.9	-557.6	-615.1	-653.1	-732.7	-774.3	-832.8	-878.9	-939.9	-985.9	-1 046.7	-1 066.4	-1 131.9
Securities															
Tolar	-2.6	-3.9	-6.8	-5.3	-5.5	-34.2	-12.6	-16.6	-18.2	-22.1	-29.3	-28.7	-24.8	-27.5	-27.4
Foreign currency	0.0	-15.4	-24.4	-22.0	-22.8	-26.8	-24.2	-17.8	-28.6	-29.5	-27.8	-28.5	-17.6	-29.5	-24.7
Total	-2.6	-19.4	-31.1	-27.3	-28.3	-61.0	-36.8	-34.3	-46.9	-51.5	-57.1	-57.2	-42.4	-57.0	-52.1
Other foreign currency liabilities to central government	-1.6	-3.2	-3.4	-6.2	-8.0	-10.2	-21.5	-17.3	-18.7	-25.4	-37.1	-27.6	-71.3	-101.8	-66.9
Other liabilities	-83.1	-151.2	-221.8	-243.0	-256.2	-305.8	-319.0	-323.8	-334.0	-359.2	-379.2	-415.0	-428.3	-422.3	-420.4
Total liabilities	-297.4	-604.9	-910.5	-981.6	-1 052.1	-1 175.5	-1 270.0	-1 300.4	-1 394.9	-1 481.9	-1 600.7	-1 687.7	-1 758.0	-1 840.8	-1 870.1
<i>Memorandum items:</i>															
Nominal exchange rates															
SIT/US\$	57.73	96.15	129.37	132.41	129.92	124.39	128.08	115.36	114.00	120.51	125.58	133.61	137.36	134.38	141.15
SIT/DM	36.77	60.83	75.68	78.20	79.48	80.08	81.43	81.76	81.34	82.36	87.12	90.45	89.92	89.31	91.06

Source: Bank of Slovenia.

Table A4. **Bank ranking by assets**

May 1996

Bank	Total assets SIT mn.	Profit in 1995 SIT mn.	ROE (%)	Increase in assets 1996/95 (%)	Share in assets of banking sector	
					Individual	Cumulative
Nova LB Ljubljana	487 248.2	4 705.0	16.9	11.4	29.3	29.5
SKB	193 583.9	1 394.8	3.4	7.6	11.7	41.3
NKB MB	184 999.5	1 922.6	14	9.8	11.2	52.5
SB Koper	91 632.9	664.6	9.1	10.8	5.6	58.0
Abanka	79 241.9	630.8	13.6	15.6	4.8	62.8
Banka Celje	73 700.4	468.8	7.2	6.2	4.5	67.3
Gorenjska banka	73 114.1	338.9	4.6	9.1	4.4	71.7
Dolenjska banka	47 038.5	262.6	6.1	18.4	2.9	74.6
LB Pomurska banka	45 906.0	412.7	3.6	8.9	2.8	77.4
Banka Austria	34 505.4	169.0	9.4	5.1	2.1	79.5
Banka Vipava	31 213.9	243.1	12	11.2	1.9	81.4
KB Triglav	29 234.4	275.3	4.9	12.6	1.8	83.1
Krekova banka	26 569.0	493.7	13.4	19.3	1.6	84.7
LB Koroska banka	23 960.0	477.4	5.2	10.6	1.5	86.2
LB Splosna banka Velenje	21 843.0	232.6	9.3	5.2	1.3	87.5
Probanka	21 451.4	278.4	6.3	19.3	1.3	88.8
SZKB	21 302.9	60.6	6.6	16.6	1.3	90.1
LB Banka Domzale	18 593.1	286.0	10.2	-0.8	1.1	91.2
SIB	18 034.5	107.5	9.8	8.8	1.1	92.3
UBK	16 161.7	52.3	5.5	16.5	1.0	93.3
LB Banka Zasavje	15 786.2	159.2	5.3	7.1	1.0	94.3
PBS	15 573.0	73.3	8.3	43.8	0.9	95.2
Banka Creditanstalt	15 008.1	-36.3		-20.7	0.9	96.1
Ljudska banka	12 293.4	-69.9	13.7	24.7	0.7	96.9
M banka	10 860.6	128	9.9	-11.3	0.7	97.5
Faktor banka	9 912.1	88.5	11.8	19.5	0.6	98.1
Hmezad banka	9 833.9	100.4	9.5	14.5	0.6	98.7
Banka Societe Generale	9 592.3	-21.3		192.1	0.6	99.3
Banka Noricum	6 495.5	-57.2	2.2	5.6	0.4	99.7
Hipotekarna banka	5 059.5	-49.2	3.8	16.9	0.3	100.0
Total	1 649 749.3	13 792.2		10.5	100.0	100.0

Source: Stiblar (1996).

Annex II

Calendar of main economic and political events

1990

December

In a referendum, Slovenes voted for a sovereign and independent State.

1991

June

On 25 June, Slovenia formally declared independence from the former Socialist Federal Republic of Yugoslavia (SFRY).

The Bank of Slovenia was formally acknowledged as an independent central bank when the Bank of Slovenia Act came into effect on 25 June.

Beginning of the ten-day conflict with the Yugoslav army.

July

Following negotiations with the Yugoslav Federation, Slovenia agreed on a three month moratorium on the independence issue (Brioni declaration) on 7 July; the Yugoslav army started to withdraw from Slovene territory.

October

Introduction of the new currency, the tolar (SIT), on 8 October. Yugoslav dinar notes and coins were withdrawn from circulation at a 1:1 ratio.

The Bank Rehabilitation Agency of the Republic of Slovenia was established.

November

A law allowing the sale of socially-owned apartments came into force (aimed in part at attracting foreign currency savings of the population held abroad or at home in order to increase foreign currency reserves).

December

Provisions of the Law on Denationalisation came into force, regulating the restitution of property which was nationalised or confiscated from former owners.

Adoption of the new Constitution on 23 December.

1992

January

The European Union recognised Slovenia officially as an independent and sovereign state.

April

Following a vote of no-confidence in its economic programme, the government heading by Prime Minister Lojze Peterle was replaced by a new coalition headed by Janez Drnovsek, leader of the Liberal Democrats and a former president of the Yugoslav Federation.

May

Slovenia became a member of the United Nations.

Representatives of Slovenia and EFTA countries signed a Declaration of Co-operation, favouring the expansion and liberalisation of trade relations.

September

The government initiated a financial and rehabilitation programme for a group of 98 enterprises (generally loss-making and insolvent) which were not subject to the stipulations of the Law on Ownership Transformation. Each enterprise had to be transformed into a commercial company and its shares transferred to the Development Fund.

November

After a long-lasting discussion about the concept of privatisation, the parliament passed the Law on Ownership Transformation. The law was subsequently amended several times.

December

On 6 December, the first parliamentary and presidential elections after gaining independence were held. Milan Kucan was elected as president. The Liberal Democratic Party was the leading vote-getter (23.5 per cent of votes cast), followed by the Slovenian Christian Democrats (14.5 per cent).

Slovenia became a member of the European Bank for Reconstruction and Development.

1993

January

The formal rehabilitation process began at the largest Slovene bank, Ljubljanska banka.

Slovenia became a member of the International Monetary Fund, and was assigned 16.39 per cent of the former SFRY quota.

A new government headed by Prime Minister Janez Drnovsek was confirmed on 25 January.

February

Slovenia became a member of the World Bank.

March

The parliament adopted a new Law on Foreign Trade Transactions.

April

Kreditna banka Maribor started its rehabilitation process.

Slovenia and the EU signed a Trade and Co-operation Agreement, to come into force on 1 September, 1993.

The Law on Protection of Competition came into force.

May

Slovenia became a member of the Council of Europe.

The Bank of Slovenia reduced the discount rate from 25 per cent to 18 per cent and the lombard rate from 26 per cent to 19 per cent.

June

Representatives of Slovenia and the Paris Club reached an agreement in principle on Slovenia's part of former Yugoslavia's unallocated debt owed to the Club. By mid-1996, final bilateral agreements were concluded with most members.

1994

January

The Bank of Slovenia increased the minimum capital requirement for banks with a full licence from DM 36.4 million to DM 60 million.

Komercialna banka Nova Gorica started the rehabilitation process.

February

The Bank of Slovenia reduced the discount rate from 18 per cent to 16 per cent and the lombard rate from 19 per cent to 17 per cent.

March

Slovenia signed the framework document on the Partnership for Peace Programme.

April

The first agreement about wage policy was signed by representatives of government, employees and employers. The tripartite Economic and Social Council was founded.

July

Ljubljanska banka (LB) and Kreditna banka Maribor (KBM) were divided into: *a)* the "old" LB and KBM, retaining all the unresolved relations with former Yugoslavia and the consequences of former Yugoslavia's debts; and *b)* the Nova Ljubljanska banka and Nova Kreditna banka Maribor, which took over the current business.

October

Slovenia joined the General Agreement on Tariffs and Trade.

1995

March

The Social Agreement for 1995 was signed by the social partners (in force to end-March, 1996).

April

The Bank of Slovenia reduced the discount rate from 16 per cent to 10 per cent and the lombard rate from 17 per cent to 11 per cent.

June

Slovenia and EFTA signed an agreement on establishing a free-trade area.
Slovenia and the EU initialled the Association Agreement.

July

Slovenia became a member of the World Trade Organisation.

September

With effect from 1 September, Slovenia declared full convertibility of the tolar, accepting the obligations of Article VIII, Section 2, 3 and 4 of the IMF agreement.

December

The Bank of Slovenia decreed that exchange offices were to balance their sales and purchases of foreign currencies on a weekly basis (later changed to monthly).

Slovenia lifted trade sanctions against the Federal Republic of Yugoslavia in accordance with the UN Security Council Resolution.

1996

January

Slovenia became a full member of CEFTA.

New customs legislation came into force, applying the combined nomenclature of the EU customs tariff to Slovenia, and reducing tariffs.

After agreement in principal on Slovenia's share in former Yugoslavia's bank debt in June 1995, creditors gave their final approval to the deal in January 1996. The Slovene parliament then adopted a law on taking over 18 per cent of former Yugoslavia's total

commercial debt arising from the 1988 New Financial Agreement (NFA). The actual amount taken over by Slovenia is USD 812 million. In exchange, the government issued bonds to creditors in June, 1996. In return, Slovenia was exempted from all liabilities under the NFA, including the joint and several liability clause.

May

The Social Agreement for 1996 was signed by the social partners; this Agreement included a reduction in the employer's social security contribution rate, and introduction of a payroll tax.

June

Slovenia and the EU signed the Association Agreement, and Slovenia applied for full EU membership.

July

Slovenia launched its debut Eurobond, totalling US\$325 million.

November

Parliamentary elections were held on 10 November; the Liberal Democrats (LDS) won 25 of the 90 seats in parliament, followed by the Slovenian People's Party (SLS) with 19 and the Social Democrats (SDS) with 16.

1997

February

A new government was confirmed by the Parliament, headed by Prime Minister Janez Drnovsek. The government comprises a coalition between the Liberal Democrats, the Slovenian People's Party, and the Democratic Party of the Pensioners of Slovenia.

*BASIC STATISTICS:
INTERNATIONAL COMPARISONS*

BASIC STATISTICS: INTERNATIONAL COMPARISONS

	Units	Reference period ¹	Australia	Austria	Belgium	Canada	Denmark	Finland	France	Germany	Greece
Population											
Total	Thousands	1994	17 840	8 031	10 124	29 251	5 206	5 088	57 960	81 407	10 430
Inhabitants per sq. km	Number	1994	2	96	332	3	121	15	106	228	79
Net average annual increase over previous 10 years	%	1994	1.4	0.6	0.3	1.6	0.2	0.4	0.5	2.9	0.5
Employment											
Total civilian employment (TCE) ²	Thousands	1994	7 680 (93)	3 737	3 724 (92)	13 292	2 508	2 015	21 781 (93)	35 894	3 790
of which: Agriculture	% of TCE	1994	5.3 (93)	7.2	2.6 (92)	4.1	5.1	8.3	5.1 (93)	3.3	20.8
Industry	% of TCE	1994	23.7 (93)	33.2	27.7 (92)	22.6	26.8	26.8	27.7 (93)	37.6	23.6
Services	% of TCE	1994	71 (93)	59.6	69.7 (92)	73.3	68.1	64.9	67.2 (93)	59.1	55.5
Gross domestic product (GDP)											
At current prices and current exchange rates	Bill. US\$	1994	331.6	198.1	227.9	544	146.7	97.2	1 328.5	1 832.3	73.1 (93)
Per capita	US\$	1994	18 588	24 670	22 515	18 598	28 181	19 106	22 944	27 826	7 051 (93)
At current prices using current PPP's ³	Bill. US\$	1994	327.9	162.3	204.2	596.7	107	82.5	1 111.8	1 601.7	118
Per capita	US\$	1994	18 382	20 210	20 166	20 401	20 546	16 208	19 201	24 325	1 450
Average annual volume growth over previous 5 years	%	1994	2.2	2.5	1.6	1.1	1.9	-1.6	1.1	2.6	1.4 (93)
Gross fixed capital formation (GFCF)											
of which: Machinery and equipment	% of GDP	1994	21.4	24.8	17.4	18.7	14.8	14.3	18.1	18.5	17.4 (93)
Residential construction	% of GDP	1993	9.8	8.7	7.8	6.2	7.2	5.90	8.10	7.5	7.8
Average annual volume growth over previous 5 years	%	1994	0.8	3.7	0.4	-0.1	-2.8	-12.9	-1	0.8	2.7 (93)
Gross saving ratio⁴											
	% of GDP	1994	16.8	25.3	22	16	17	16.6	19	21	15.5 (93)
General government											
Current expenditure on goods and services	% of GDP	1994	17.5	18.8	15	20.2	25.3	22.4	19.6	17.7	19.1 (93)
Current disbursements ⁵	% of GDP	1993	36.9	48.4	55.3	49	61.1	58.9	51.5	45.6	51.2
Current receipts	% of GDP	1993	33.5	48.6	50.1	43	58.3	52.5	46.8	45.7	40.2
Net official development assistance											
	% of GNP	1993	0.34	0.31	0.41	0.46	1.03	0.76	0.66	0.44	..
Indicators of living standards											
Private consumption per capita using current PPP's ³	US\$	1993	10 803	10 546	12 090	11 863	10 042	8 814	11 395	10 733	6 367
Passenger cars, per 1 000 inhabitants	Number	1990	430	382	387	469	311	386	413	480 ⁸	169
Telephones, per 1 000 inhabitants	Number	1991	464	432	410	586	577	544	511	420 ⁸	413
Television sets, per 1 000 inhabitants	Number	1991	480	478	451	639	536	501	407	556 ⁸	197
Doctors, per 1 000 inhabitants	Number	1993	2.2 (91)	2.3	3.7	2.2	2.8 (92)	2.6 (92)	2.8	3.2 (92)	3.8 (92)
Infant mortality per 1 000 live births	Number		6.1	6.5	8	6.8	5.4	4.4	6.5	5.8	8.5
Wages and prices (average annual increase over previous 5 years)											
Wages (earnings or rates according to availability)	%	1994	3	5.5	3.7	3.3	3.5	4.8	3.5	5.2	14.6
Consumer prices	%	1994	3	3.4	2.8	2.8	2.1	3.3	2.5	3.3	16.2
Foreign trade											
Exports of goods, fob*	Mill. US\$	1994	47 363	44 881	137 259 ⁷	165 358	41 850	29 514	235 337	422 243	8 958
As % of GDP	%	1994	14.3	22.7	60.2	30.4	28.5	30.4	17.7	23	11.5 (93)
Average annual increase over previous 5 years	%	1994	5	6.7	6.5	7.1	8.3	4.9	5.6	4.4	3.4
Imports of goods, cif*	Mill. US\$	1994	49 731	55 071	126 006 ⁷	148 297	35 932	23 091	220 508	376 566	21 111
As % of GDP	%	1994	15	27.8	55.3	27.3	24.5	23.8	16.6	20.6	30.1 (93)
Average annual increase over previous 5 years	%	1994	4	7.2	5	5.4	6.1	-1.3	3.5	6.9	5.4
Total official reserves⁶											
As ratio of average monthly imports of goods	Ratio	1994	7 730	11 523	9 505 ⁷	8 416	6 203	7 304	17 986	52 994	9 924
		1994	1.9	2.5	0.9	0.7	2.1	3.8	1	1.7	5.6

* At current prices and exchange rates.

1. Unless otherwise stated.

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3. PPPs = Purchasing Power Parities.

4. Gross saving = Gross national disposable income minus private and government consumption.

5. Current disbursements = Current expenditure on goods and services plus current transfers and payments of property income.

6. Gold included in reserves is valued at 35 SDRs per ounce. End of year.

7. Data refer to the Belgo-Luxembourg Economic Union.

8. Data refer to western Germany.

9. Refers to the public sector including public enterprises.

10. Including non-residential construction.

Sources: Population and Employment: OECD, *Labour Force Statistics*. GDP, GFCF, and General Government: OECD, *National Accounts*, Vol. I and *OECD Economic Outlook*, Historical Statistics. Indicators of living standards: Miscellaneous national publications, Wages and Prices: OECD, *Main Economic Indicators*. Foreign trade: OECD, *Monthly Foreign Trade Statistics*, series A. Total official reserves: IMF, *International Financial Statistics*.

BASIC STATISTICS: INTERNATIONAL COMPARISONS (cont'd)

	Units	Reference period ¹	Iceland	Ireland	Italy	Japan	Luxembourg	Mexico	Netherlands	New Zealand
Population										
Total	Thousands	1994	267	3 571	57 190	124 960	398	93 010	15 382	3 526
Inhabitants per sq. km	Number	1994	3	51	190	331	153	47	377	13
Net average annual increase over previous 10 years	%	1994	1.1	0.1	0	0.4	0.8	2	0.6	0.8
Employment										
Total civilian employment (TCE) ²	Thousands	1994	138	1 168 (93)	20 152 (93)	64 530	162 (91)	32 439	6 631	1 560
of which: Agriculture	% of TCE	1994	9.4	12.7 (93)	7.5 (93)	5.8	3.7 (91)	25.8	4	10.4
Industry	% of TCE	1994	26.1	27.7 (93)	33 (93)	34	31.5 (91)	22.2	23	25
Services	% of TCE	1994	65.2	59.7 (93)	59.6 (93)	60.2	64.8 (91)	52.1	73	64.6
Gross domestic product (GDP)										
At current prices and current exchange rates	Bill. US\$	1994	6.2	52	1 017.8	4 590	10.6 (92)	371.2	334.3	51.2
Per capita	US\$	1994	23 199	14 550	17 796	36 732	27 073 (92)	3 991	21 733	14 513
At current prices using current PPP's ³	Bill. US\$	1994	5.1	54.3	1 068.4	2 593.7	11.7	673.3	285.9	57.3
Per capita	US\$	1994	19 271	15 212	18 681	20 756	29 454	7 239	18 589	16 248
Average annual volume growth over previous 5 years	%	1994	0.6	4.7	1	2.1	4.1 (92)	3	2.3	2.5
Gross fixed capital formation (GFCF)										
of which: Machinery and equipment	% of GDP	1994	15.2	15.1	16.4	28.6	20.4 (93)	20.7	19.3	20
Residential construction	% of GDP	1993	3.9	6.3	7.4	11.5	..	9.4	8.6	9.3
Average annual volume growth over previous 5 years	%	1994	4.4	4.1	5.3	5.4	..	4.9	5.1	4.9
	%	1994	-4	1	-2.3	1.4	6.5 (92)	7.7	0.4	5.8
Gross saving ratio⁴										
	% of GDP	1994	16.9	19.5	18.8	31.2	60.2 (92)	15.1	24.4	20.7
General government										
Current expenditure on goods and services	% of GDP	1994	20.6	16	17.1	9.8	17.1 (92)	11.8 ⁹	14.2	14.7
Current disbursements ⁵	% of GDP	1993	34.9	..	53.2	26.9	..	..	55.4	..
Current receipts	% of GDP	1993	35.9	..	47.1	32.9	..	..	54.5	..
Net official development assistance										
	% of GNP	1993	..	0.15	0.42	0.27	0.34 (92)	..	0.88	0.22
Indicators of living standards										
Private consumption per capita using current PPP's ³	US\$	1993	11 546	7 750	11 029	11 791	15 545	4 853	10 726	9 266
Passenger cars, per 1 000 inhabitants	Number	1990	464	228	478	282	470	85	356	440
Telephones, per 1 000 inhabitants	Number	1991	527	300	400	454	511	70	477	436
Television sets, per 1 000 inhabitants	Number	1991	319	276	421	613	267	148	485	443
Doctors, per 1 000 inhabitants	Number	1993	3	1.7 (92)	1.7 (91)	1.7 (92)	2.1 (92)	1	2.5 (90)	2
Infant mortality per 1 000 live births	Number		4.8	5.9	7.3	4.5 (92)	8.5 (92)	18	6.3	7.3
Wages and prices (average annual increase over previous 5 years)										
Wages (earnings or rates according to availability)	%	1994	..	4.6	5.9	2.4	..	5.3	3.2	2.1
Consumer prices	%	1994	6.3	2.7	5.2	2	3.1	16.1	2.8	2.5
Foreign trade										
Exports of goods, fob*	Mill. US\$	1994	1 628	34 125	189 802	396 149	..	60 882	155 084	12 169
As % of GDP	%	1994	26.3	65.7	18.6	8.6	..	16.4	46.4	23.8
Average annual increase over previous 5 years	%	1994	2.7	10.5	6.2	7.6	..	21.7	7.6	6.5
Imports of goods, cif*	Mill. US\$	1994	1 464	25 812	167 690	274 916	..	79 346	139 800	11 859
As % of GDP	%	1994	23.6	49.7	16.5	6	..	21.4	41.8	23.2
Average annual increase over previous 5 years	%	1994	0.7	8.1	1.9	5.5	..	25.5	6.1	6.1
Total official reserves⁶										
As ratio of average monthly imports of goods	Ratio	1994	201	4 189	22 102	86 214	..	4 301	23 655	2 540
	Ratio	1994	1.6	1.9	1.6	3.8	..	0.7	2	2.6

* At current prices and exchange rates.

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BASIC STATISTICS: INTERNATIONAL COMPARISONS (cont'd)

	Units	Reference period ¹	Norway	Portugal	Spain	Sweden	Switzerland	Turkey	United Kingdom	United States
Population										
Total	Thousands	1994	4 337	9 900	39 150	8 781	6 994	60 573	58 375	260 651
Inhabitants per sq. km	Number	1994	13	107	78	20	169	78	238	28
Net average annual increase over previous 10 years	%	1994	0.5	-0.1	0.2	0.5	0.7	2.1	0.3	1
Employment										
Total civilian employment (TCE) ²	Thousands	1994	1970 (93)	4 372	11 760	3 926	3 772	19 664	25 044 (93)	123 060
of which: Agriculture	% of TCE	1994	5.6 (93)	11.5	9.8	3.4	4	44.8	2.2 (93)	2.9
Industry	% of TCE	1994	23.1 (93)	32.8	30.1	25	28.8	22.2	26.2 (93)	24
Services	% of TCE	1994	71.3 (93)	55.7	60.2	71.6	67.2	33	71.6 (93)	73.1
Gross domestic product (GDP)										
At current prices and current exchange rates	Bill. US\$	1994	103.4 (93)	87	482.4	196.6	257.3	130.7	1 019.5	6 649.8
Per capita	US\$	1994	23 984 (93)	8 792	12 321	22 389	36 790	2 157	17 468	25 512
At current prices using current PPP's ³	Bill. US\$	1994	95.3	122	531.7	153	167.4	319.3	1 030.2	6 649.8
Per capita	US\$	1994	21 968	12 335	13 581	17 422	23 942	5 271	17 650	25 512
Average annual volume growth over previous 5 years	%	1994	2.1 (93)	1.4	1.5	-0.3	0.5	3.6	0.8	2.1
Gross fixed capital formation (GFCF)										
of which: Machinery and equipment	% of GDP	1994	22 (93)	25.7	19.8	13.7	22.8	24.5	15	17.2
Residential construction	% of GDP	1993	..	..	5.7	5.7	7.5	10.3	7.3	7.7
Average annual volume growth over previous 5 years	%	1994	-3.93	2.7	-1.2	-7.6	-0.4	5.1	-2.1	4.6
Gross saving ratio⁴										
	% of GDP	1994	21.9 (93)	24.2	18.8	13.7	29.3	22.5	13.5	16.2
General government										
Current expenditure on goods and services	% of GDP	1994	22.1 (93)	17.2	16.9	27.3	14.1	11.7	21.6	16.4
Current disbursements ⁵	% of GDP	1993	..	..	43.7	67.3	36.7	..	42.7	35.8
Current receipts	% of GDP	1993	1.23	0.36	40.1	59	36	..	36.8	31.7
Net official development assistance										
	% of GNP	1993	9 826	7 780	8 412	9 240	13 730	3 617	10 942	16 444
Indicators of living standards										
Private consumption per capita using current PPP's ³	US\$	1993	378	260	307	418	441	29	361	568
Passenger cars, per 1 000 inhabitants	Number	1990	515	273	340	687	603	143	445	553
Telephones, per 1 000 inhabitants	Number	1991	423	187	400	468	406	175	434	814
Television sets, per 1 000 inhabitants	Number	1991	3.2 (92)	2.9	4.1	3	3	0.9	1.5 (92)	2.3 (92)
Doctors, per 1 000 inhabitants	Number	1993	5	8.7	7.6	4.8	5.6	52.6	6.6	8.5 (92)
Infant mortality per 1 000 live births	Number		4	..	7.2	5.4	..	..	6.7	2.8
Wages and prices (average annual increase over previous 5 years)										
Wages (earnings or rates according to availability)	%	1994	2.7	9	5.6	5.7	3.9	73	4.6	3.6
Consumer prices	%	1994	34 645	17 072	73 129	61 122	70 467	18 456	205 170	512 627
Foreign trade										
Exports of goods, fob*	Mill. US\$	1994	30.9 (93)	19.6	15.2	31.1	27.4	14.1	20.1	7.7
As % of GDP	%	1994	5	6.1	10.5	3.4	6.4	9.5	6.1	7.1
Average annual increase over previous 5 years	%	1994	27 345	25 967	92 182	51 730	68 126	22 976	227 026	663 256
Imports of goods, cif*	Mill. US\$	1994	23.3 (93)	29.9	19.1	26.3	26.5	17.6	22.3	10
As % of GDP	%	1994	2.9	6.6	5.2	1	3.2	37.9	2.8	7
Average annual increase over previous 5 years	%	1994	13 033	10 627	28 475	15 929	23 790	4 911	28 094	43 350
Total official reserves⁶										
	Mill. SDRs	1994	5.7	4.9	3.7	3.7	4.2	2.6	1.5	0.8

* At current prices and exchange rates.

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