

Chapter 4

Enhancing the business environment to foster productivity growth

Slovenia's rapid catch-up process owes much to a favourable business environment. The 2008 level of product market regulation (PMR) index is much lower than in the Czech Republic and Poland, while being closer to the levels noted for neighbouring countries (Austria, Hungary and Italy) or the OECD average. Keener competition since EU accession has set the stage for large numbers of small and medium-sized enterprises to be created. Foreign direct investment (FDI) inflows, though, have remained low, pointing to a sub-optimal transfer of best-practice knowledge. In key service sectors (financial services, energy and telecommunication), low contestability linked to state involvement and strong market concentration may have deterred inward FDI.

In this setting, competitive forces in state-controlled services sectors need to be spurred through economic restructuring, improved corporate governance practices and, ultimately, through further privatisation when the economy recovers. A more efficient financial service sector is particularly needed to develop sophisticated financial products for a rapidly ageing population. Furthermore, overall prospects of reduced potential output growth strengthen the call for a comprehensive innovation system to allocate resources to knowledge-intensive sectors. The quality of Slovenia's future business environment will largely depend upon the success of innovation policies, including the provision of efficient, innovation-oriented support services. The key challenge in this area is the optimisation of collaborative links connecting the research community, the business sector and the State. Evidence suggests that it is the combination of framework conditions rather than a reform in one single area that matters for long-run economic performance.

Led by strong gains in total factor productivity (TFP) and buoyant output growth, Slovenia's per capita income rose to 85% of the EU15 average in 2007. Intense pressure on resources has produced a positive output gap in 2007-08, pushing the unemployment rate below the non-accelerating inflation rate of unemployment (NAIRU) for some years (see Chapter 3). Looking ahead, real income convergence is set to slow, the remaining income gap having become small. In addition, the rapid ageing of the population will tend to curb potential output growth. In this setting, policy makers have naturally focused attention on areas with a strong potential for enhanced efficiency. One of these areas is the business environment.

This chapter outlines the range of opportunities for improving Slovenia's business environment. It identifies major areas where policy action is needed to strengthen competitive forces and to stimulate entrepreneurial dynamism. The first section describes Slovenia's changing ownership and enterprise structures. The second section deals with salient features of the current business environment, as indicated by the state of product market competition and the strength of innovative, entrepreneurial forces. The third section analyses recent initiatives to improve the business environment. Main examples of potentially anti-competitive behaviour in key service sectors are highlighted in the last section. The policy recommendations are summarised in Box 4.4 at the end of the chapter.

Changing ownership and enterprise structure

A slowly changing ownership structure

Slovenia implemented a major programme of ownership transformation in the 1990s as part of its transition into a market-oriented economy. The 1992 Ownership Transformation Act, the main legislation in this area, was aimed at ensuring a smooth transfer of ownership rights in socially owned enterprises (SFRY). These enterprises were held by the State, but run jointly by employees and management (self-managed firms). They constituted the vast majority of firms (Box 4.1).

In the early phase of ownership transformation, foreign participation was kept at bay by capital controls, a two-year freeze on share transfers for newly privatised companies and investment restrictions in the banking and insurance sector. With the advent of EU membership, however, these restrictions were progressively relaxed and phased out. Even so, FDI inflows, though picking up in 2007, have remained relatively low.

By 2004, the divestment of socially owned enterprises was largely completed. In the second phase of ownership transformation, the State was expected to gradually withdraw from the economy (filling the "privatisation gap"), except for companies of "strategic" interest where the State would retain a dominant influence. Privatisation projects included banks, energy utilities, the airport, port facilities (Adriatic seaport of Koper), railways, the Telecommunication Company and major industrial firms producing steel, aluminium, tyres and pharmaceutical products. The second privatisation phase was expected to present significant opportunities for foreign investors.

Box 4.1. **Dissolution of social ownership (1992-2004)**

The 1992 legislation provided for a decentralised approach to dissolving social ownership based on general conditions set out by the law. Ownership transformation followed a predetermined formula, allowing a large proportion of company shares to be allocated to employees and management. During the process of ownership transformation, privatisation certificates (vouchers) were issued totalling 40% of GDP. One fifth of a firm's capital had to be transferred to employees. Another portion of 40% could be sold either to employees or directly to the public. As it turned out, the majority of firms opted for the internal method allocating shares to insiders. The remaining 40% of the socially owned capital had to be transferred to three State-controlled Funds (SCFs) (OECD, 1997).

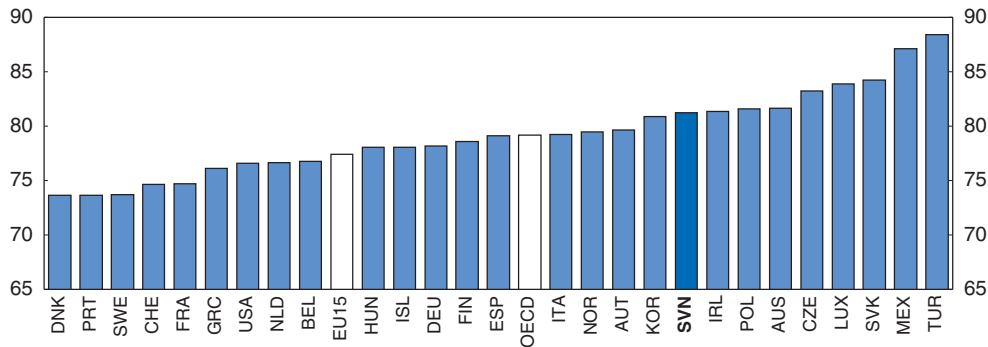
Two of these Funds, the Compensation Fund (providing compensation payments for previous owners) and the Capital Fund of Pension Insurance, received each 10% of the social capital. The third Fund, the Slovene Development Fund, received 20% of the capital, its main mandate being to restructure companies and to sell them thereafter to private investment funds (PIFs). An ownership certificate (voucher) account was opened for each citizen enabling purchases of non-transferable shares of privatised enterprises. Ownership privatisation took mainly the form of direct management-employee buy-outs, voucher-based purchases and direct sales to buyers. The emerging ownership structure was of a hybrid nature, combining buy-outs by Slovenian citizens with a transitory "nationalisation" through the three State Funds (Buchen, 2005).

State Funds have held non-controlling shares in large segments of the economy and in the decision-making process of individual enterprises. The Slovenian Development Corporation (1997), the legal successor to the Slovenian Development Fund, restructured, privatised or liquidated a large number of companies. The Slovenian Development Corporation ceased its operation in 2004 after divesting as many as 1 340 companies. The privatisation process achieved one of its main objectives, i.e. the transfer of ownership of most socially owned companies to the private sector, while preserving the social consensus over privatisation (WTO, 2002).

As it turned out, privatisation in 2004-08 proceeded more slowly than planned and, EU-accession notwithstanding, inward FDI declined sharply in terms of GDP until 2006. Major privatisations comprised the leading retail food company (Mercator; 100% privatisation in 2005), Slovenska Industrija Jekla d.d. and the second largest bank NKBM (partial privatisation with a sale of 48.1% of the bank's capital through an Initial Public Offer in December 2007). Coincidentally, two State Funds, the Capital Fund (KAD) and the Compensation or Restitution Fund (SOD), reduced their portfolio of companies from 492 in 2004 to 194 in 2008. In remaining companies, however, State participation increased over time. At 81% of the total economy, the private sector is larger than OECD average but remains smaller than in other transition economies (Figure 4.1). However, this ratio does not reflect the full scope of the state involvement in the economy as it has a direct or indirect minority blocking share in many private companies.

Privatisation coincided with a sharply reduced diffusion of popular ownership, the number of shareholders dropping to around one third of the population in 2008 from around three quarters at the end of the 1990s. At the same time, the number of publicly traded companies declined, while the concentration of ownership with management buyouts (MBO) and subsequent squeeze outs of minority shareholders accelerated. Partly financed by state-owned banks, the MBOs have been highly leveraged. In some instances, however, MBOs

Figure 4.1. **Private sector share in GDP¹**
Gross value added in current prices in per cent of total, 2007²



1. Private sector covers NACE activities A to K (from agriculture, hunting and forestry to real estate, renting and business activities).
2. 2006 for Ireland and Mexico. The OECD aggregate is an unweighted average excluding Canada, Japan and New Zealand.

Source: OECD (2009), *National Accounts of OECD countries – online database*, April and Eurostat database (2009), *Economy and Finance*, April.

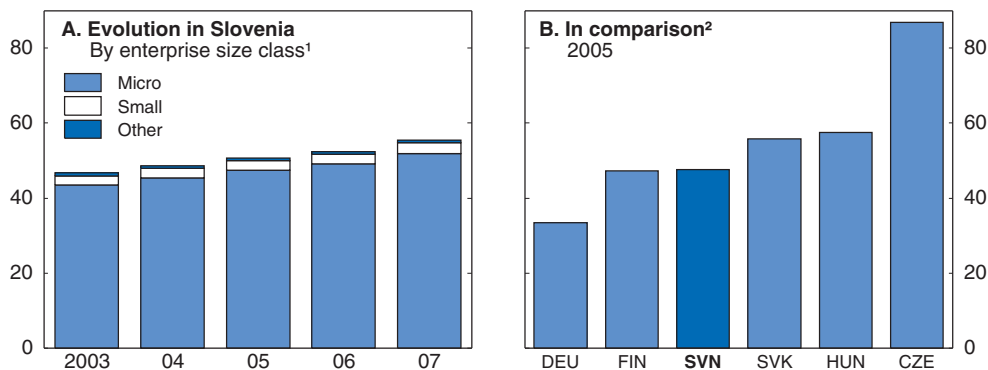
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failed to correspond to principles of good corporate governance: existing take-over regulation was circumvented through beneficial ownership being hidden under another friendly name (“parked”). This practice allowed prices to be lowered during the take-over bid.

A rapidly changing structure of the enterprise population

The process of ownership transformation and privatisation has coincided with significant changes in both enterprise density and the structure of the enterprise population. The rise in the number of firms (20% between 2003 and 2007) far exceeded population growth, raising enterprise density (number of firms per inhabitant) to levels observed in many other countries (Figure 4.2). Higher enterprise density reversed earlier trends, which had pointed to an embedded lack of entrepreneurial dynamism (OECD, 1997).

Figure 4.2. **Enterprise density**
Active enterprises in industry and services per thousand population



1. Enterprise size class by number of employees: micro – up to 9, small – 10-49, other – 50 and above.
2. Excluding public administration and management activities of holding companies; 2004 for Germany.

Source: IMAD (2006-08), *Slovenian Economic Mirror* (various issues), Institute of Macroeconomic Analysis and Development; and Eurostat database (2009), *Industry, Trade and Services*; and *Population and Social Conditions*, March.

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The sharp rise in the number of firms from 93 200 in 2003 to 112 000 in 2007 entirely stemmed from buoyant creation of small firms (10-49 persons) and micro enterprises (up to 9 persons), mainly in construction and real estate. In contrast, the number of large enterprises (250 persons and more) fell from 300 in 2003 to 274 in 2007, while the average number of persons employed by large firms increased (Table 4.1). As a result of these divergent movements, the share of small and medium-sized enterprises (SME) in the firm population edged up to 99.8%, with micro firms accounting for as much as 93.5% of the enterprise population.

Table 4.1. **Basic enterprise indicators**

	2003	2007
Number of enterprises	93 233	112 026
<i>of which: small and medium-sized enterprises (SME) (%)</i>	99.7	99.8
Size distribution of enterprises (% of total)		
Large (250 employees and more)	0.3	0.2
Medium-sized (50-249 employees)	1.2	1.2
Small (10-49 employees)	5.2	5.1
Micro (up to 10 employees)	93.3	93.5
Average operating revenue per employee (thousand EUR)		
Large firms	102	140
SMEs	90	130
Medium-sized firms	98	143
Small firms	105	148
Micro firms	73	107

Source: IMAD (2006-08), *Slovenian Economic Mirror*, various issues, Institute of Macroeconomic Analysis and Development.

Value productivity (operating revenues per employed person) increased much more strongly for each of the three SME-categories (medium-sized, small and micro firms) in the period 2003-07 than for large firms. Job creation broadly mirrored the scale of rising value productivity, being buoyant for SMEs, especially for small and micro firms, whereas overall employment in large firms declined. The trend of rising firm creation, value productivity and job growth confirms evidence gathered in other transition countries, where *ex novo* firms stand out in terms of vibrant efficiency and employment gains. In contrast, State-owned and privatised firms often display similar, lukewarm performance patterns (OECD, 1997; Scarpetta *et al.*, 2002).

Signs of qualitative comparative advantages

Historically, Slovenia's SMEs have been proficient in the domain of product design and product differentiation, enabling swift adaptations to shifting consumer demands. This faculty has traditionally enabled firms to operate in product niches, making them competitive in high-value added segments of the manufacturing sector. Movements of unit value ratios (UVRs) show indeed an improvement in the quality content of Slovenia's manufacturing goods exports in the 1994-2004 period (IMF, 2006). While the scale of quality improvement has been larger than in countries with a similar per-capita income level (*e.g.* Portugal), it has been smaller than in other new member states (Czech Republic, Estonia and Hungary). Comparing the structure of Slovenia's exports to the EU15 shows a specialisation in technology-intensive and skilled-labour intensive goods. Most of these, however, fall into the category of medium and low technology (90% as against 74% for the EU15 average).

With reduced prospects of catching up and keener technological competition, the pressure to maintain export market shares is set to rise. In this setting, continued policy efforts are required to raise the sophistication of production and have enhanced quality to open up new markets (Fabrizio *et al.*, 2007). In the past, a programme of cluster formation (2000-02) aimed at sharpening qualitative, comparative advantages by kindling co-operation and networking among local producers (geographical proximity). Based upon the bottom-up approach and the principle of learning-by-doing, the cluster programme is credited with having added to small and micro firms' vibrancy. The most innovative clusters can be found in the machine tools, electrical/optical, automotive, domestic appliances, construction and transport industries (Dermastia, 2005).

Good business environment and adequate entrepreneurial dynamism

Rising foreign trade shares but weak FDI inflows

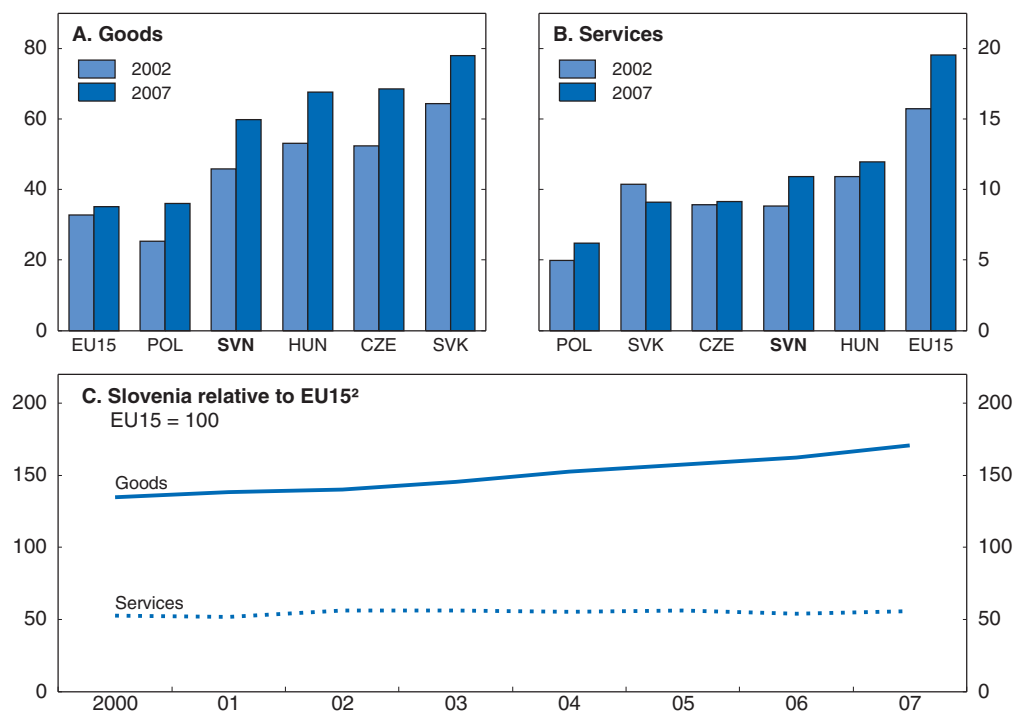
Slovenia's openness to competitive forces is manifest in large and growing foreign trade shares. International market integration (measured by the sum of the value of exports and imports as a percentage of GDP) is strong, with export and import shares being large and rising since EU accession (Figure 4.3). While the international market integration for goods is stronger than for services (a commonly observed phenomenon), the gap between the two (nearly 50 percentage points in 2007) is unusually large for a country with a relatively large per capita income. Moreover, flows of inward and outward foreign direct investment (FDI) have remained subdued in terms of GDP (Figure 4.4). International service trade and FDI thus contribute much less to competitive pressures than international goods trade. In some key service sectors, high market concentration combined with dominant State involvement have deterred inward flows of FDI (Dalsgaard, 2008).

Inward FDI (mostly from EU countries and Switzerland) doubled in 2001-03, rising to nearly 4% of GDP in 2003. It contracted subsequently, falling below 2% of GDP in 2006 (Figure 4.4), a surprising development considering EU accession and FDI increases observed in other new-member countries. The figures for 2007, when FDI inflows reached 3% of GDP, indicate a slight improvement compared to the previous years.

The number of firms with inward FDI participation is small (4.9% at the end of 2006) and largely concentrated in the export and import sectors. In terms of capital, the presence of FDI is stronger, accounting for 17% of the corporate sector's capital at the end of 2006. Firms with FDI participation record higher profits than in the corporate sector as a whole. They also pay wage premiums (13% in manufacturing), but not in the hotel and catering sectors. Nearly one half of inward FDI in 2004 has been concentrated in manufacturing, nearly one fifth in financial intermediation and another fifth in trade (wholesale and retail), transport, storage and communication.

In contrast to the weaker trend of inward FDI, outward FDI picked up since EU accession, surpassing inward FDI in terms of GDP in 2006. Stronger outward FDI largely reflected high expected rates of return on capital in the countries of the former Yugoslavia. Outward FDI is highly concentrated in a few Slovenian firms. At 2.5% in 2004, the number of Slovenian companies investing abroad was only half the corresponding number for inward FDI.

Figure 4.3. **Market integration**
In per cent of GDP¹

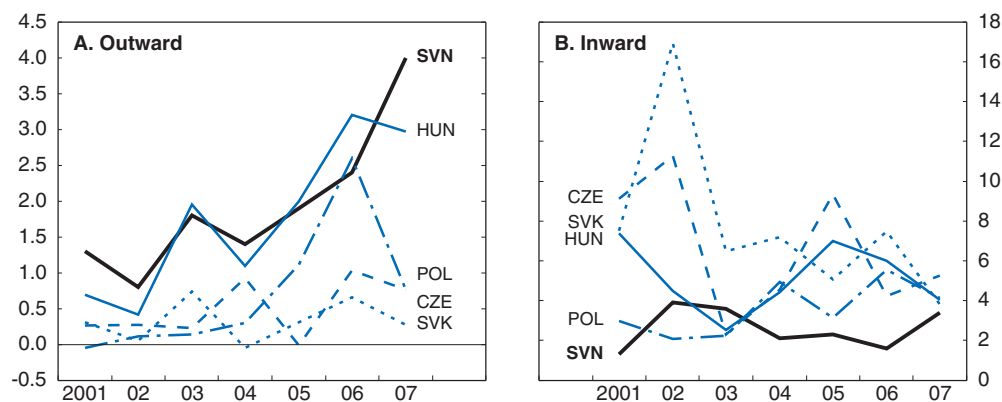


1. Measured by the average value of imports and exports in per cent of nominal gross domestic product.
2. Unweighted average.

Source: OECD (2009), *National Accounts of OECD Countries* – online database, April.

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Figure 4.4. **Foreign direct investment flows**
In per cent of GDP



Source: OECD (2009), *International Direct Investment and National Accounts of OECD countries* – online databases, April; Eurostat database (2009), *Economy and Finance*, April.

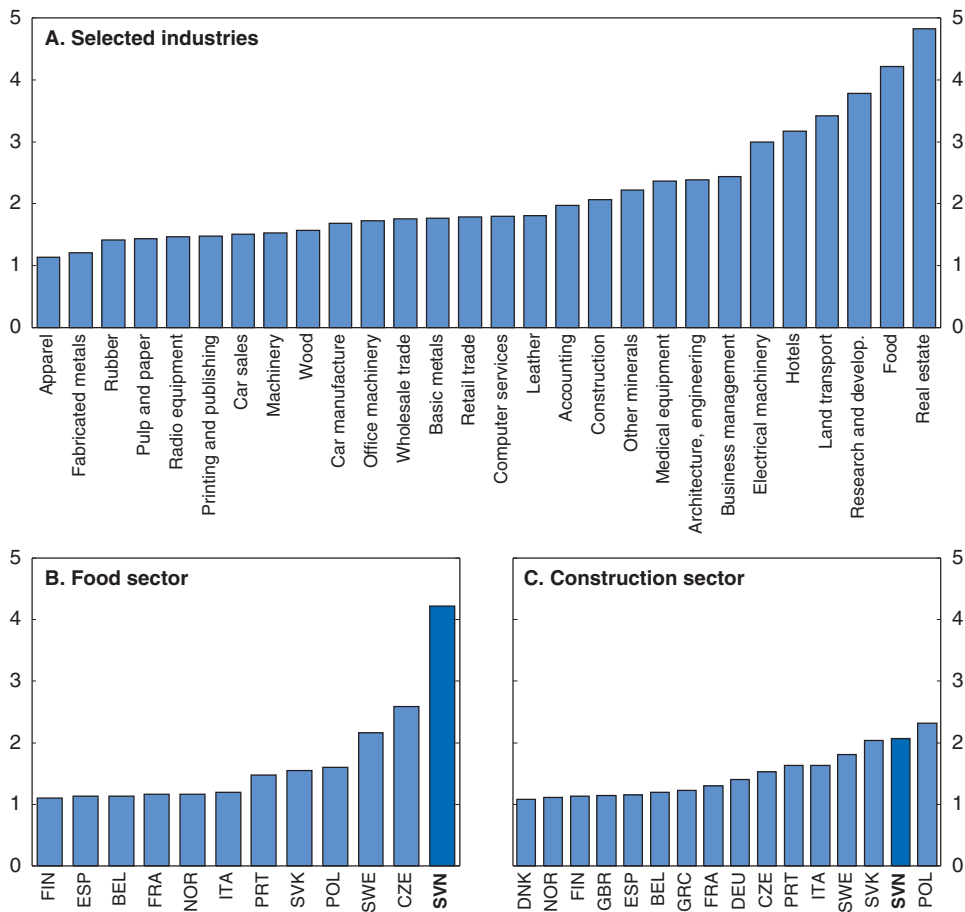
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Product market competition: room for reducing mark-ups in some sectors

On average, mark-ups in Slovenian industries do not appear particularly high in comparison with OECD countries, but the average masks large differences across sectors


(for the estimation method of the mark-ups see Annex 4.A1). The lack of competitive pressure allows for high mark-ups in a number of sectors (Figure 4.5, panel A). Mark-ups are probably the best available measure of competition and high mark-ups are an indication of weak competitive pressure stemming from *inter alia* a combination of excessive product market regulation, or the lack of regulation in case of dominant players, or the lack of competition from foreign exporters or investors.

Figure 4.5. **Estimated mark-ups**¹



1. Mark-ups are estimated using firm-level data over 1993-2005 and are expressed as a ratio over average cost.

Source: Molnar, M. (2009), "Measuring Competition in Slovenian Industries – Estimation of Mark-ups", *OECD Economics Department Working Paper*, forthcoming and Molnar, M. and N. Bottini (2008), "How Large are Competitive Pressures in Services Markets? – Estimation of Mark-ups for Selected OECD Countries", paper presented at the OECD Technical Workshop on Trade Barrier Assessment Methodology, 12 December.

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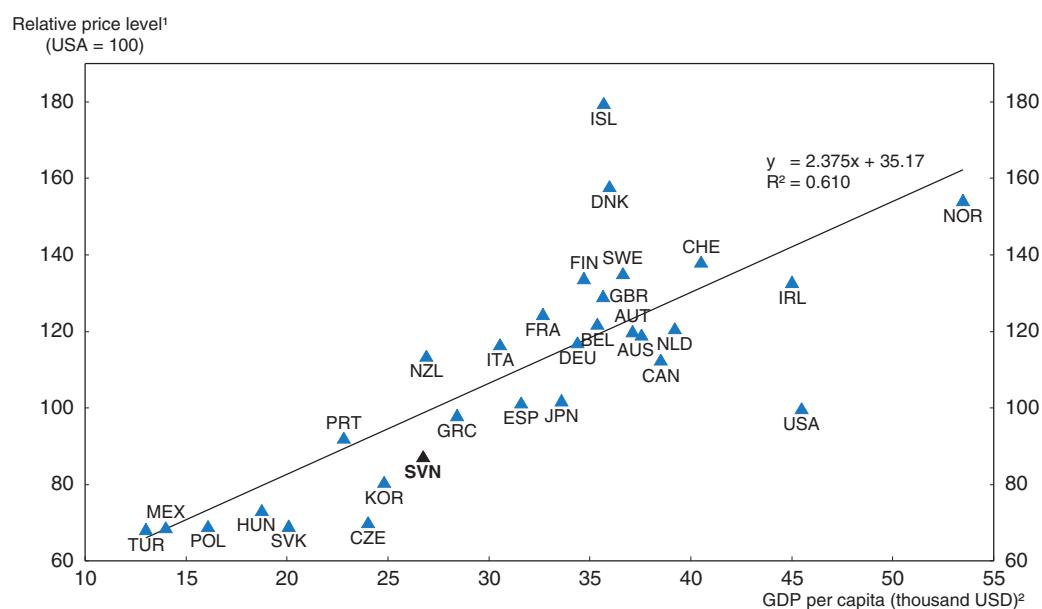
While mark-ups tend to be higher everywhere in highly-regulated and less tradable services industries, in Slovenia, high mark-ups are observed even in some manufacturing industries, in particular food and beverages. Mark-ups in this sector are substantially higher in Slovenia than in other transition economies (Figure 4.5, panel B), where mark-ups tend to be high in general. Vertical integration of retailers and food processors allows for high mark-ups that can be passed on to consumers in the form of higher prices owing to high concentration in the retail food sector (75-85% of market share by the three largest

players if including franchises) and to occasional symptoms of collusive behaviour among players. Mark-ups are also high in some tradable services industries, such as construction (Figure 4.5, panel C), which registers one of the lowest mark-ups among services in OECD countries. High concentration in the construction sector and the growth of construction output outpacing that of GDP have allowed construction firms to charge high mark-ups.

While mark-ups are the best available measure of competitive pressure, other indicators may complement the analysis of such pressures in product markets. A rather rough, but widely used method of measuring product market competition is to compare relative price and wage levels across countries and sectors (Figure 4.6). The major drawback of such comparisons, however, is that final prices may not necessarily reflect the extent of competitive pressures only but other country-specific features such as tax systems, distribution systems or input prices, and gross wages include social security contributions that differ by country as well. Nevertheless, relying on these rough indicators, relative to its per-capita income, Slovenia has a low overall price level and a relatively low level of unit labour costs (Dalsgaard, 2008).

Figure 4.6. **Relative price levels**

2007



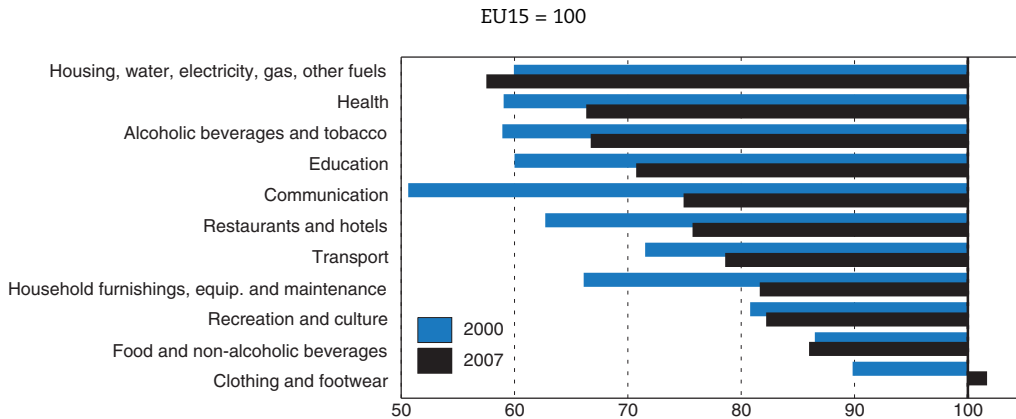
1. Purchasing power parities divided by the exchange rate.
2. At current prices and current purchasing power parities.

Source: OECD (2009), *National Accounts of OECD Countries* – online database, April.


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Looking at disaggregated price levels and taking into account Slovenia's per capita income position reveals the same pattern of no "overpricing". Compared to the EU15 average, relatively high prices are only indicated for clothing and footwear (2007) (Figure 4.7). On the other hand, Slovenia along with Spain recorded by far the strongest average annual rise in food prices in 2000-07, exceeding the corresponding increase for EU15 countries by as much as 2 percentage points. This discrepancy has raised questions about the state of competitive conditions in the retail food sector (see the third section of

Figure 4.7. Price levels by sector relative to the European Union



Source: Eurostat database (2009), *Economy and Finance*, April.

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this chapter). In contrast, relatively low prices are found for housing, water, electricity, gas and other fuels, health, alcoholic beverages and tobacco. “Underpricing” for some of these goods reflects government-regulated prices which, in turn, are fixed in tune with social and competitiveness considerations. In the energy and communications markets, state-controlled companies continue to be dominant, notwithstanding recent increases in market share for new entrants (see last section of this chapter).

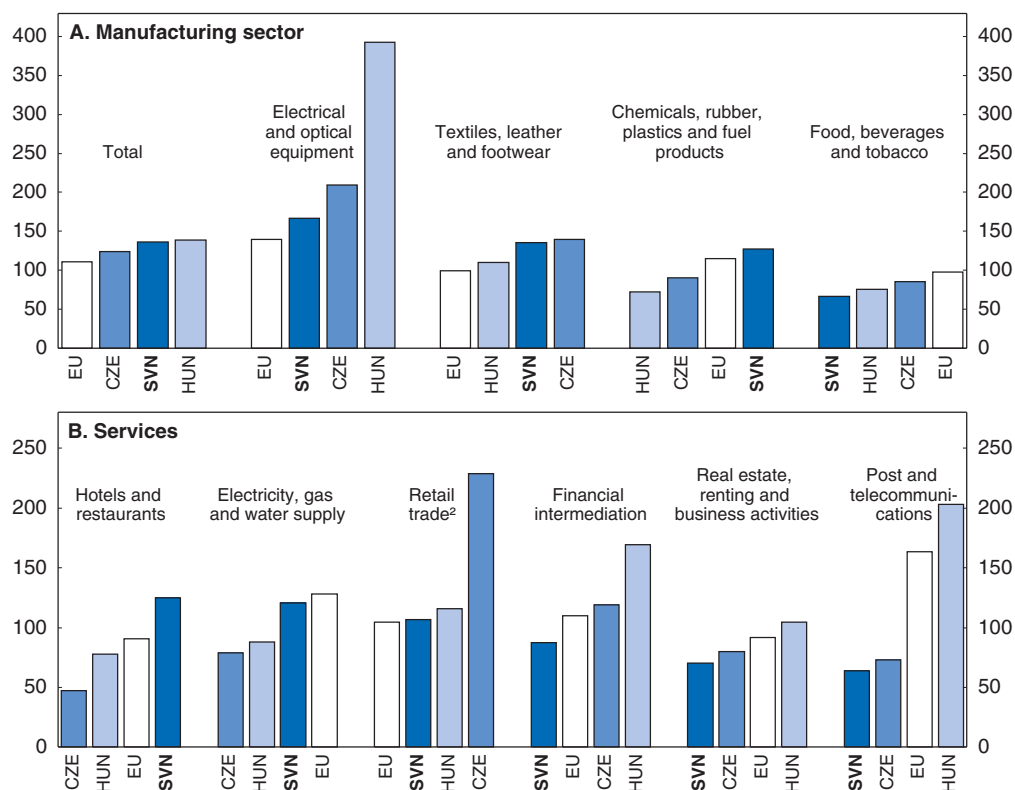
Productivity trends show Slovenia is performing well in most manufacturing sectors. This confirms the finding of resources being used efficiently in the goods sector. In contrast, efficiency developments seem to be lagging behind peers in a few service sectors, e.g. post and telecommunications, real estate and business services, and financial intermediation (Figure 4.8). In some of these sectors (telecommunications and financial services), market concentration is strong and state control pervasive (see last section).

Product market regulations are generally supportive of competition

The recently constructed OECD product market regulation indicator shows a slightly less liberal PMR stance for Slovenia than for the OECD average (Figure 4.9). Compared to other emerging market economies, however, the PMR are much more conducive to unleashing market forces (Czech Republic and Poland). Nonetheless, relative to the United States or the United Kingdom, the two countries with the lowest PMR scores, Slovenia’s PMR are much more binding. Looking at sub-indicators reveals a large excess of administrative burdens for sole proprietor firms; explicit barriers to trade and investment; and strong state involvement in business operations.

The State’s pervasive influence expresses itself through both the appointment of supervisory boards and the subsequent appointment of management in a number of leading companies. Judging by circumstantial evidence, the selection of both new board members and management appears to be frequently based on political allegiance rather than on expertise. State intervention is not confined to companies where the State has a formal majority of shares. Several leading companies are jointly (partially) owned by state-owned companies and by State Funds (KAD and SOD). Through direct and indirect ownership the State is thus able to exercise strong influence on business operations. In 2008, KAD and SOD alone owned a blocking minority (over 25%) in five of the seven

Figure 4.8. **Total factor productivity**¹
Value added based, 2005 (1995 = 100)



1. EU covers EU15 member countries for which growth accounting could be performed, namely: Austria, Belgium, Denmark, Finland, France, Germany, Italy, Netherlands, Spain and United Kingdom.

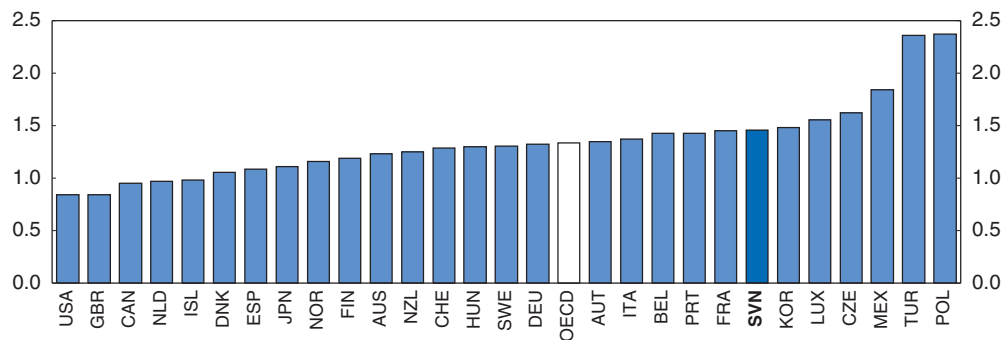
2. Excluding motor vehicles and motorcycles, and repair of household goods.

Source: EU KLEMS database, March 2008; see Timmer, M., M. O'Mahony and B. van Ark, *The EU KLEMS Growth and Productivity Accounts: An Overview*, University of Groningen and University of Birmingham, available at www.euklems.net.

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Figure 4.9. **Product market regulation indicator**

Scale of indicators 0-6, from least to most restrictive, 2008¹



1. The OECD aggregate is an unweighted average of the data available (27 countries).

Source: OECD (2009), *International Regulation database*, www.oecd.org/eco/pmr.

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largest listed companies. Being a majority owner in another of the seven largest listed firms, through direct and indirect holdings, the State effectively enjoys a blocking minority in six out of the seven largest listed firms. Over the past few years, the state power has probably been used to influence specific take-over transactions. Moreover, certain state-owned companies have been cajoled into supporting some sectors of the economy. In underperforming state-controlled companies, strategic plans therefore need to be implemented with the aim of raising productivity to levels observed in other EU countries. Competent supervisory boards, which are apt to employ professional management, should be appointed. The new government rightly created an independent Council for Accreditation (CAS), which would be in charge of appointing members of supervisory boards. The State also exercises its influence through significant public procurement each year (Box 4.2). To level the playing field for competition, the State needs to further improve procurement practices to rule out collusion among tenders.

Box 4.2. Recent changes in public procurement

In the early 2000s, total procurement of works, supplies and services were estimated at 12% of GDP (2001) (WTO, 2002). Subsequently, Slovenia's procurement policies have been progressively aligned with both EU directives and the WTO Government Agreement (GPA). While the harmonisation process was completed in 2007, each ministry is still responsible for its own procurement. Procurement costs are high and, in some instances, in excess of market levels by as much as 30%. Current public tenders still total 8-9% of GDP per year. Collusive behaviour among tenders and corruption have led the new government to consider establishing a single procurement office. OECD experience on the benefits of a single procurement office shows that procurement costs tend to be reduced. However, evidence is mixed in terms of reducing corruption and unfair competition, the results being dependent on the quality of public governance in each country.

Basic legislation governing public procurement is the Public Procurement Act of 1999-2000. Applied to central and local governments, public undertakings and utilities, the Act increased protection for bidders, unified all procedural requirements and eliminated the 10% preference for domestic bidders. The Act established an independent body, the National Review Commission (NRC) whose members are appointed by Parliament to ensure their independence.

The Act also created a central administrative authority (Public Procurement Office), which is in charge of implementing procurement rules. The Office's tasks include regular analysis of the procurement situation, cooperation with foreign institutions and notification to the National Review Commission. Together with an "electronic" form generator (standardised web applications) and additional e-administrative elements (portal receipt-and-delivery system application, e-payments, e-serving, e-signature, e-awarding of contracts and e-auction facility) these process innovations have yielded substantial procurement savings (EUR 10 million in 2007) (Republic of Slovenia, 2008a).

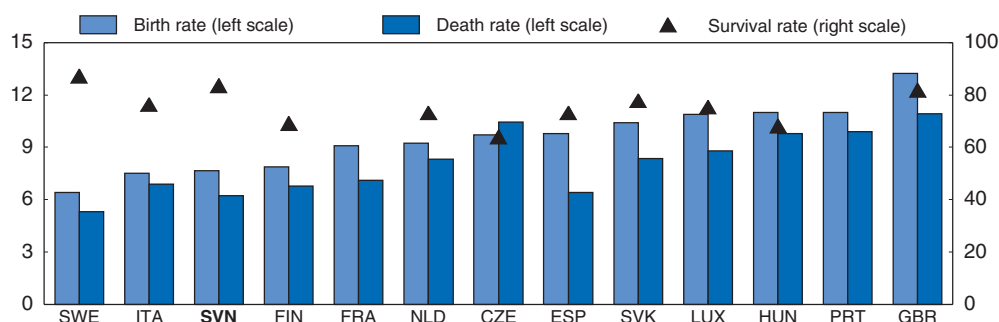
Slovenia is among the first countries to have established a single information portal, on which contracting bodies are obliged to publish all information relating to public tender. With this innovation, Slovenia meets the requirements of the Manchester Declaration, which requires contracting authorities to award at least 25% of all contracts electronically by 2010.

Some obstacles to firm creation remain

Internationally comparable data show that in 2002-05 Slovenia created and closed down fewer enterprises than in many other EU countries (Figure 4.10), whereas the survival rate (average life time) ranked among the highest in the EU area. Such a life profile may be pointing to a general lack of entrepreneurial dynamism. Indeed, in the World Bank's latest ranking of "Ease of Doing Business" covering the 12-month period to June 2008, Slovenia occupies the 54th place among 181 countries (Figure 4.11). Inside the EU, only a few countries (Czech Republic, Greece Italy and Poland) report stronger obstacles to entrepreneurial activity.

Figure 4.10. Firm creation and firm closure¹

Per cent, average 2002-05



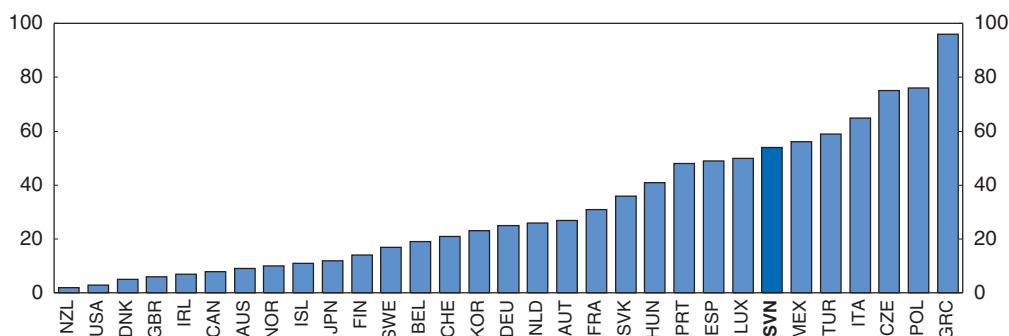
1. Industry and services excluding public administration and management activities of holding companies. The birth and death rates are enterprise births or deaths divided by the number of active enterprises. The survival rate is the number of enterprises in a year who have survived for two years divided by the number of enterprise births two years previously.

Source: Eurostat database (2009), Structural Business Statistics, May.

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Figure 4.11. Ease of doing business

Rank among 181 countries¹



1. Economies are ranked on their ease of doing business, with first place being the highest. The ease of doing business index averages the economy's percentile rankings on ten topics, made up of a variety of indicators, giving equal weight to each topic. Period covered June 2007 to June 2008.

Source: World Bank and International Finance Corporation (2008), *Doing Business 2009*, online database.

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The World Bank's ranking reveals various impediments to entrepreneurial activity, broadly confirming the information conveyed by the OECD PMR indicator. The areas where Slovenia particularly lags behind include employing workers, (158th place among 181 countries), registering property (104th place), getting credit (84th place), enforcing

contracts, trading across borders and paying taxes (78th-79th place) and dealing with construction permits (69th place). On the other hand, Slovenia performs better in closing a business and starting a business, relative to its overall standing in the World Bank's ranking. Some of these comparatively favourable results already reflect recent policy action designed to reduce the administrative burden surrounding firm creation.

Examining the sub-components of the World Bank ranking shows that strict regulations, time-consuming red tape and lack of information constitute the bulk of Slovenia's impediments to entrepreneurial activity (Table 4.2). The principal obstacles are: rigid employment rules (difficulty of hiring, rigidity of hours and difficulty of firing); long duration for registering property (391 days); lack of credit information, public registry coverage and private bureau coverage for access to finance;¹ long delays and high transaction costs for trading across borders (20 days for procedural export requirements); costly time inputs for paying numerous taxes; long delays in enforcing contracts (1 350 days); and high costs and long delays in obtaining construction permits.

Table 4.2. **Slovenia's ranking in Doing Business 2009**

Compared to 181 countries¹

Regulations	Slovenia	CEEC ²	EU15	OECD
Ease of doing business	54	57	32	31
Starting a business	41	77	53	52
Dealing with construction permits	69	97	48	52
Employing workers	158	77	100	82
Registering property	104	53	68	53
Getting credit	84	28	49	37
Paying taxes	78	124	58	65
Trading across borders	78	69	28	36
Enforcing contracts	79	56	38	36
Closing a business	38	72	21	29

1. All aggregates are unweighted averages.

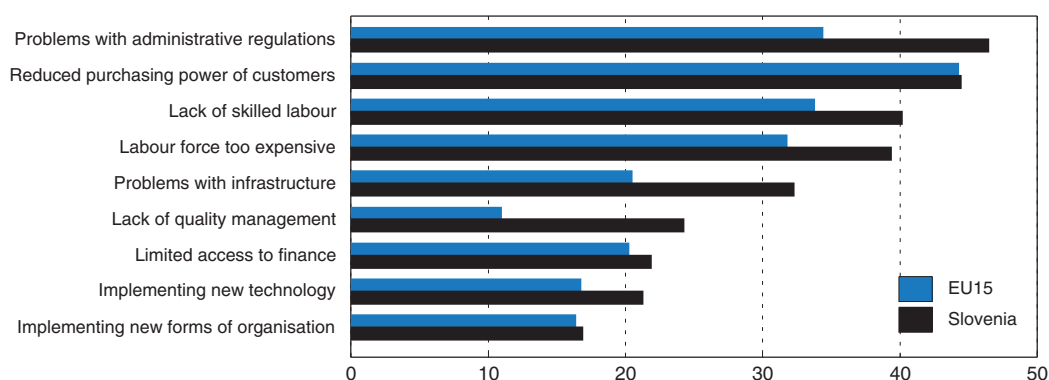
2. Central and East European countries that are OECD members: Czech Republic, Hungary, Poland and Slovak Republic.

Source: World Bank and International Finance Corporation (2008), *Doing Business 2009*, www.doingbusiness.org.

Surveys conducted by the Observatory of European SMEs in November-December 2006 (European Commission, 2007) partly confirm the World Bank's findings. The Euroflash Barometer measures the relative importance of nine barriers to entrepreneurial activity by the number of affirmative responses given by a group of SME-entrepreneurs. The intensity of a barrier is positively correlated with the share of affirmative answers. On this basis, administrative regulations were singled out as the most powerful impediment to entrepreneurial initiatives. Then, Slovenian entrepreneurs cited important hindrances in order of importance, as being skill shortages, high labour costs, limited access to finance and infrastructural problems. They also noted lack of quality management and barriers to new technologies and new forms of organisation (collective process innovations) as entrepreneurial stumbling blocks (Figure 4.12).


A third international indicator of entrepreneurial activity, the Global Entrepreneurship Monitor (GEM) shows Slovenia's early-stage entrepreneurial activity, though rising, to be low (4.8% in 2007 as against the average of 5.2% for 17 EU countries). The ratio of opportunity-to-necessity driven entrepreneurship has kept on rising (a ratio of 9 to 1 in 2007), largely reflecting a search for independence amid buoyant economic conditions.

Figure 4.12. **Obstacles to entrepreneurship**
Per cent, end 2006¹



1. Share of affirmative responses to a question asking whether the company had faced the obstacle in the last two years. All size classes of business are included.

Source: European Commission (2007), *Observatory of European SMEs: Analytical Report*, Flash Eurobarometer 196, May.

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Recent initiatives to improve the business environment

Stronger competition policy

The long-run interplay of market forces is partially conditioned by the effectiveness of competition policy. Slovenia's legal framework in this domain is rooted in Article 74 of the Constitution which prohibits practices restricting competition. The Prevention of the Restriction of Competition Act (1999), replacing the first competition law (1993), transcribed into domestic legislation EU-anti-trust rules about restricting abuse of dominant position and mergers. The law uses a 40% market share threshold as a reference for assessing market dominance. Other criteria like ease of entry are also taken into account.

Competition rules are enforced by the Competition Protection Office (CPO), a functionally independent institution with appropriate statutory powers to review restrictive arrangements and concentrations in all economic sectors. Its powers are exercised *ex post* (except for mergers). Competition issues in individual sectors are dealt with jointly with sectoral regulators, whose *ex ante* control competences provide for market regulation. Having no obligation to report to any executive or legislative body, the CPO has enjoyed some measure of independence. Moreover, the CPO's effectiveness was hindered by insufficient sanctions and inadequacy of legal provisions concerning the liability of companies to cooperate with the CPO.

The 2008 Law on the Prevention of Restrictions of Competition has rectified some of these weaknesses. The new law empowers the CPO to collect information more rapidly, to widen the scope of its investigations and to impose stiffer sanctions. The new law also simplifies the appeal process. With adoption of the 2008 law Slovenia has largely completed the process of transposing EU directives into Slovenian legislation. However, relative to the scale of actual and potential anti-competitive behaviour, the CPO is understaffed (less than 20 persons), requiring strong administrative support from the Ministry of Economy. The government should strengthen the powers of the CPO by transforming it into a truly independent agency with budgetary autonomy.

The nature of cases investigated by the CPO has changed over time. The number of decisions on concentrations has declined, while those on presumed cartel agreements and abuses of dominant position have increased (Table 4.3). Since the end of 2007, the CPO has initiated ten new proceedings regarding alleged cartel agreements and nine proceedings regarding abuse of a dominant position. In the retail trade, energy and financial services sectors, several cases of possible concentration, cartel agreement and abuse of dominant position have been opened.

Table 4.3. **Proceedings before the Competition Protection Office**

	Decisions issued	Concentrations	Abuse of a monopoly position	Restrictive agreements
2006	52	47	1	4
2007	55	50	3	2
2008	45	41	2	0

Source: Republic of Slovenia (2008), "Reform Programme for Achieving the Lisbon Strategy Goals", October; and Competition Protection Office.

Reducing administrative barriers

Under Slovenia's Development Strategy (2005), effective action has been taken to reduce obstacles to entrepreneurial activity. Responding to entrepreneurial complaints about heavy red tape (cumbersome and time-consuming administrative procedures), the government progressively eased administrative burdens in 2006-08. Under the Declaration on the Elimination of Administrative Barriers, nearly 1 000 regulations were checked in 2006, 30% of which were rejected. In 2007, the unified methodology for measuring administrative costs (SCM) was approved, paving the way for legislative measurements of regulatory impacts. A portal was also opened allowing citizens to submit proposals for the improvement of regulations electronically. In effective terms, 30 regulation-reducing measures out of a total of 34 measures planned in 2006 had been put into effect by March 2007. Subsequently, in 2007, an additional 30 measures were announced, half of which had been carried out by March 2008.

For the period 2008-09, the government announced 44 supplementary steps. The 2008-09 Programme for the Reduction of Administrative Burdens is threefold, consisting of the simplification of administrative procedures; the reduction in requirements to collect statistical data and to submit various reports; and cuts in administrative costs by 25% in the labour law domain by 2010. The government also introduced a screening process for new regulations so as to avoid a return of administrative impediments (Republic of Slovenia, 2008a).

To directly spur business start-ups, the government in 2008 created "one-stop shops" (VEM), reducing costs to establish limited liability companies. This, together with other simplified administrative procedures, has vastly improved Slovenia's ranking in the World Bank's subcategory of "Starting a business" within the overall "Doing Business" ranking. Among 181 countries, Slovenia advanced from the 124th place in *Doing Business 2008* to the 41st place in *Doing Business 2009* (World Bank, 2008). Even so, while starting a business currently requires five procedures, it takes 19 days and costs 0.11% of annual per-capita income, suggesting room for further improvement relative to good-practice economies. Labour market reforms included cuts in the cost of redundancy dismissals (shortening the notice period from 75 days to 60 days) and making the hiring of workers easier (extending

the maximum duration of fixed-term contracts) (2007 Employment Relationship Act). Administrative barriers should be lowered further by easing employment rules and facilitating property registration.

Easing access to finance

Among the nine principal obstacles to entrepreneurship listed by the Flash Eurobarometer 196 (November-December 2006; European Commission, 2007) (Figure 4.12), access to finance ranked relatively low, with only 22% of entrepreneurs identifying it as a major hindrance to business activity. On the other hand, credit information, public registry coverage and private bureau coverage are all inadequate, hampering the release of funds to firms. To lower credit transaction costs, the use of credit registry should be promoted. The state-owned Slovenian Enterprise Fund (SEF) has strengthened financial mechanisms for easing SMEs' access to finance in 2007-08. These included loan guarantees, extended guarantees, subsidies and favourable leasing conditions for start-ups of innovative enterprises, including micro firms. In 2007, the government adopted the Venture Capital Company Act, introducing tax relief for venture capital investment in high-growth SMEs. At the same time, a public venture capital company was established in 2007, using public/private partnerships as a means of buttressing new, innovative and expanding SMEs. On the current financial and economic crisis, a lack of confidence and increasing risks have restricted the flow of financial funds to firms.

Searching for a coherent innovation system

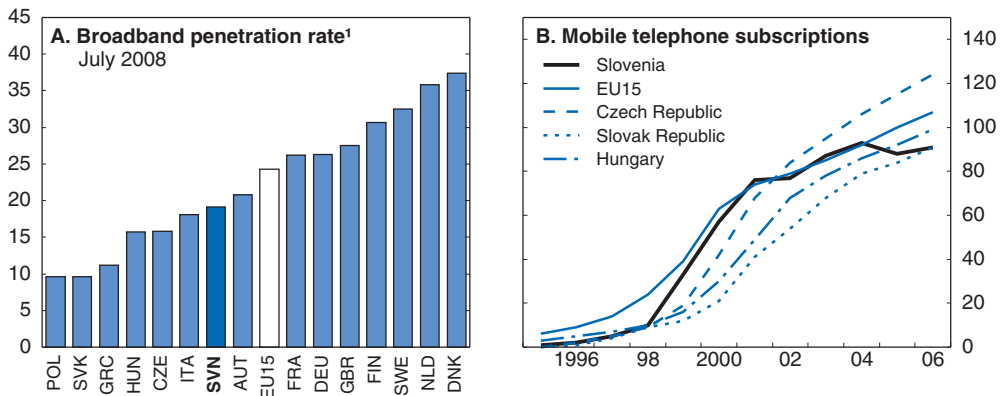
A high-wage economy among new EU member states and emerging markets, Slovenia faces growing challenges to maintain its international competitiveness. Quality upgrading and specialisation in higher value-added niche markets represent an increasingly important strategy to withstand competition from low-cost economies. In this situation, the ability to augment the quality and technological content of exports will be a key determinant of long-run growth prospects. The success of moving up on the "technology and quality ladder" largely depends upon an efficient innovation strategy, combining entrepreneurship and innovation policies.

Viewing social capital as a vital innovation asset, many OECD countries since the mid-2000s have increasingly engaged in the creation and expansion of business support units (service stations such as business incubators, innovation laboratories, business development centres and business accelerators).² Wide information and communication technology (ICT) diffusion favours the creation and expansion of these service stations. It enables network building, data collection and information exchange among support centres, enterprises and government agencies. ICT also tends to directly lower barriers to entrepreneurial activity.³ Drawing on the experience of best-practice countries, Slovenia should expand the network of public/private business support centres. Multi-purpose "hubs" need to be established, optimising links between the research community, the business sector and the government.

While the diffusion of new technology is broadly adequate...

ICT diffusion tends to vary with the stage of economic development. Slovenia's ICT record in 2007-08 has been broadly in line with its relative per-capita income position, showing only small gaps vis-à-vis the EU15 average in the areas of broadband connection and mobile telephone subscriptions (Figure 4.13). Regarding household's access to internet, Slovenia has achieved virtual parity with the EU15 average.

Figure 4.13. **Telecommunications indicators**
Per 100 inhabitants



1. Number of broadband access lines per 100 inhabitants.

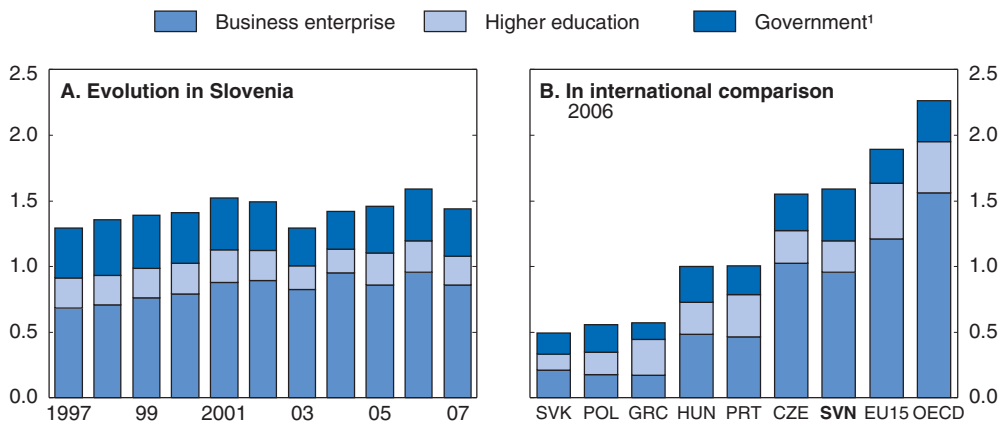
Source: Eurostat database (2009), Information Society Statistics, May.

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... the structure of R&D spending is still doubly skewed

On the research and development (R&D) side, the gap between Slovenia's spending and the average expenditure for EU15 and EU27 countries has narrowed, R&D outlays totalling 1.6% of GDP in 2006 as against 1.9 per cent of GDP for the EU15 average (Figure 4.14).

Figure 4.14. **Research and development expenditure**
In per cent of GDP



1. Includes the private non-profit sector.

Source: OECD (2008), *Main Science and Technology Indicators*, Vol. 2, December and SORS (2009), "Research and Development Activity, Slovenia, 2007 – Final data", First Release, Statistical Office of the Republic of Slovenia, February.

StatLink <http://dx.doi.org/10.1787/644876518085>

Slovenia's research and development strategy contained in the 2005 Reform Programme for the Implementation of the Lisbon Strategy has been partially put into effect in line with the National Research and Development Programme (2006-10) (NRDP, see Box 4.3). In parallel, the Programme of Measures to Promote Entrepreneurship and Competitiveness (2007-13) has lent support to innovative activity. Nonetheless, policy

initiatives lacked coherence and strong will to implement recognised by the government itself, “there is nowhere a systemic set of relevant interconnected measures brought together within a single comprehensive strategy” (Republic of Slovenia, 2008a). The efficiency of innovation policies can be enhanced by having independent institutions (domestic and foreign ones) measure existing programmes against international best-practices. Administrative dispersion should be reduced by merging innovation support programmes. Overall R&D spending should be raised, stimulating private R&D expenditure while strengthening the technology-oriented component of public R&D outlays.

Box 4.3. Initiative of innovation policy

The National Research and Development Programme 2006-10 (NRDP) also aims at rebalancing the structure of public R&D spending, raising the technology-oriented share in public R&D spending from 10% in 2007 to 45% by 2010. To reach this ambitious target, the Slovenian Technology Agency (TIA) together with the Slovenian Research Agency (ARRS) have stepped up the implementation of programmes drawn up by three ministries (Ministry of Higher Education, Science and Technology; Ministry of the Economy and Ministry of Defence) and largely financed by EU structural funds. A large portion of these structural funds are earmarked for reinvigorating innovative and research capacities. In addition, the Slovene Enterprise Fund (SPS) and the Public Agency for Entrepreneurship and Foreign Investment (PAEFI) stimulate innovative activity of SMEs.

TIA's main activities in 2008 included support for the operation of at least ten technology platforms, which will install an infrastructure for stronger and more productive links between academic institutions and the business community. In parallel, the advantage of geographical proximity has been used to help SMEs absorb new technology (“Valor” project). Together with the Ministry of the Economy, TIA has begun developing a methodology for stimulating start-ups of high-technology companies based upon R&D results. Financing, based upon public/private partnerships, is mixed, about 25% coming from EU structural funds, 20% from national and local budgets and the remainder (55%) from private sources. EU and national financial contributions for innovative projects will be allocated through public tender, including allocation of funds for FDI.

On its part, the Slovenia Research Agency (ARSS) has placed stronger emphasis upon adapting work by public-sector researchers to the needs of Slovenian industry. Increased co-financing from private companies for applied projects is expected using private funds to underpin public R&D activity. Promoting technological investments in SMEs and micro firms, the Slovene Enterprise Fund (SPS) completed the first public tender (EUR 49 million) in 2007.

With a view to finally shaping an effective national innovation system, in 2008 Slovenia created the Competitiveness Council, composed of 15 members (9 ministers and 6 members from key academic, research and business institutions) (Republic of Slovenia, 2008b). The Council's main mandate is to create and expand collaborative connections linking knowledge institutions and the business community. To this end, the Council has set highly ambitious targets:

- Raising the number of innovative firms to at least 40% of the enterprise population in 2013-15 from 27% in 2002-04.
- Increasing the number of patent applications at the European Patent Office to at least 110 applications per million inhabitants in 2013-15 from 54 applications in 2004.
- Increasing the share of high-technology exports to at least 16% in 2013-15 from 4.5% in 2006.

- And raising R&D spending to 3% of GDP by 2013 with a split of two thirds for private spending and one third for public spending.

Easing access to entrepreneurship education, training and business services

Policy action has also been taken to respond to both the perceived lack of managerial skills (the sixth most important obstacle to entrepreneurship according to the Flash Eurobarometer 196) and structurally weak, early-stage entrepreneurial activity. The Public Agency for Entrepreneurship and Foreign Investment (PAEFI) has progressively promoted the development of entrepreneurial skills through voucher-based counselling of actual and would-be entrepreneurs. In addition, new legislation (the 2007 Act Regulating a Supportive Environment and the 2008 Register of Innovative Environment) should improve the cooperation between innovation laboratories, technology parks and business incubators.

A National Centre for Innovation and Competitiveness was created in 2008 under the umbrella of PAEFI to upgrade the range of different business support services. The new centre will introduce a comprehensive information system integrating the full range of support services for entrepreneurship development (special programmes for women and young people). In the longer run, entrepreneurial activity should also benefit from the gradual phasing-in of entrepreneurship studies into the school system. In 2008, providers were chosen to implement selected pilot projects at various levels of the school system. The process of introducing entrepreneurship education in schools, universities and research institutions should be accelerated.

Improving the infrastructure

According to the Flash Eurobarometer 196, the inadequacy of the infrastructure is a powerful impediment to entrepreneurial activity. Nearly one third of surveyed entrepreneurs expressed dissatisfaction with various forms of infrastructure (transportation, energy, communications). The railway infrastructure is particularly weak, although the number of railway kilometres per inhabitant is relatively high. The maritime infrastructure (Port of Koper) needs upgrading and expansion after several years of booming international trade. Transport policy is embedded in the 2006 Sustainable Mobility Project (2007-13). The Project aims at reducing road freight and personal vehicle transport in urban areas and at integrating public passenger transport with all sub-systems at the local, national and international levels.

Some progress has been made to create an integrated public passenger transport system, including intermodal terminals. The railway infrastructure is being expanded and improved with the construction of new railway links between Jesenice/Ljubljana/Dobova and between Koper/Sezana/Hodos. In 2007, Slovenia brought railway legislation into line with EU standards, eliminating barriers to cross-border provision of services, raising operating safety and easing access to infrastructure through newly established institutions. Even so, the railway sector has not yet been opened to competition. Negotiations are currently underway, creating a public-private partnership with a foreign company, which would run both railway and maritime operations at the Koper port.

Strong market concentration in key service sectors

In a few service sectors (financial services, energy and telecommunications), high market concentration continues to co-exist with dominant state ownership. High market concentration without state control is present in the retail food sector. Anti-competitive conduct in these sectors has prompted interventions by the Competition Protection Office.

In 2008, the government appointed an inter-ministerial working group to ensure the timely implementation of the EU Service-Directive for the internal market. A draft horizontal law on services in the internal market was finalised in September 2008. With the adoption and implementation of the postal directive, the postal services in the EU will be fully liberalised. In the liberal professions sector, procedures for qualification recognition have been simplified, as applications are now filed and dealt with directly by the respective ministry.

Privatisation has slowed down, while regulatory capacities have improved

At the same time, the pace of privatisation has remained slow. For future sales, advisory groups have drawn up privatisation strategies for four major companies (Telekom, the insurance company Triglav and the two State banks NLB and NKBM). Sales of state-owned assets in 2007 included the 55.3% capital share of Slovenska industrija jekla d.d. to a strategic partner (March 2007) and the sale of a 48.1% capital share in the NKBM, the country's second largest bank. While further sales of NKBM shares are planned, the State intends to retain a 25% plus one minority blocking share. The government will also keep a controlling share in Slovenia's largest bank (NLB). Other major privatisation initiatives scheduled for 2007-08 (sales of capital shares in Triglav, the insurance company, and in Telecom) have been suspended. Looking ahead, the resumption of privatisation should be based upon a calendar of planned sales of state-owned shares along with a list of companies still owned by the State.

Capacities for protecting and promoting competition have improved with stronger powers being given to the Competition Protection Office following the new (2008) law on the Prevention of Restrictions of Competition. In the insurance and capital market sector, powers and the institutional independence of supervisory bodies (the Securities Market Agency and Insurance Supervision Agency) have been reinforced (Act Amending the Market in Financial Instruments and the Act Amending the Insurance Act). Similarly, both the autonomy and powers of surveillance and enforcement of the Post and Electronic Communications Agency have been strengthened (Act Amending the Electronic Communications Act 2006). To further increase regulatory capacities, the new government is considering merging the capital-market and insurance supervisory agencies under the umbrella of the Bank of Slovenia.

The dominant role of state-owned banks

Slovenia's financial sector is less developed than that of European countries with similar income levels. Notwithstanding strong credit growth, bank assets at 40% of the euro area average in 2005 were well below those in euro area peers. The development of the non-bank financial sector was even more behind that of euro area peers, its assets only totalling 20% of the euro area average. In 2001, the banking sector was marked by high market concentration, the three largest banks accounting for 57% of total banking assets and the top seven banks presiding over 80% of total banking assets. Slovenia's largest bank (Nova Ljubljanska Banka, NLB) had a market share of 35% followed by the Nova Kreditna Banka Maribor (NKBM) with a market share of 12%. Both banks were state-owned (WTO, 2002).

Several years later (2008) the banking sector displayed similar, oligopolistic features, the three largest banks still having a high, combined market share (48% in 2008), above corresponding ratios observed in the EU27. The largest bank does not face competition from any institution of similar scale, as its market share of about 30% is three times as high as that of the second-ranking bank. Foreign banks' market share, though rising from low levels over the past few years, has remained relatively small with a market share (measured by total

assets) of 31% in 2008. NLB still conducts about 80% of the banking sector's international transactions. Overall, the Herfindahl index for 2005 ranked the Slovenian banking sector as the 6th most concentrated one among 16 sample countries (Bems and Sorsa, 2008).

Foreign banks can establish commercial presence through wholly capitalised subsidiaries or through branches. Banks registered in the European Union can directly provide services in Slovenia. While the presence of foreign banks has been growing since 2004, the prevailing level and structure of concentration continue to make for low contestability, damping the play of competition. NLB's commanding lead over the second largest bank (NKBM) appears to confer a role of price leadership. Slovenian banks have regularly followed suit when NLB changed its interest rates. Moreover, in 2008, Slovenian banks raised fees for automatic teller machine (ATM) withdrawals simultaneously, prompting an inquiry by the Competition Protection Office into alleged collusive behaviour. Foreign banks abstained from raising such fees.

While market concentration has remained broadly unchanged, the banking sector's ownership structure has changed only slowly over time. In 2001, the French bank *Société Générale* took over the third largest bank (SKB). In 2007, 48% of the second largest bank's shares (NKBM) were sold via an initial public offering (IPO). There are plans to sell half of the remaining state-owned 52% shares of NKBM, the State retaining a blocking stake of 25% plus one share. These privatisation initiatives notwithstanding, the State continues to exercise pervasive control over the banking sector. In 2008, the State still owned 33% of the largest bank (direct control), while it indirectly controlled another 17% through state-owned investment funds and non-bank corporations.

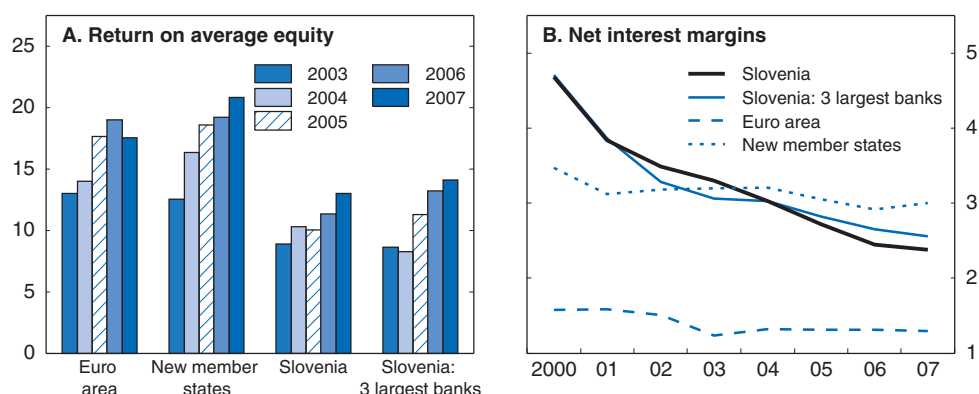
A relative lack of banking efficiency and profitability

Sustained high market concentration and dominant state control have probably contributed to Slovenia's banking sector being less efficient and profitable than banks located in both the euro area and in new member states (NMS). Although rules for loan loss provisions were eased in 2006-07, following the introduction of International Financial Reporting Standards (IFRS), the 2006-07 share of pre-tax profits in total operating income and the return on average equity (ROAE) remained far below levels seen in NMS and the euro area (Figure 4.15, panel A). Within the banking sector, state-controlled banks are found to be particularly inefficient, reflecting heavy overstaffing as well as incomplete use of ICT-based information. Currently, there is no commonly shared base of data on enterprise performance making credit risk assessment unduly costly (World Bank, 2008). Econometric evidence supports the notion of contestability and efficiency being below that of European peers (Bems and Sorsa, 2008; Holló and Nagy, 2006). Strengthening the contestability and economic performance of Slovenian banks thus holds the promise of stimulating competitive forces. The scale of both potential productivity gains and FDI inflows is correspondingly large.

While there are signs of growing competition, state-owned banks need to be rapidly restructured

Net interest margins have substantially narrowed over time, falling from 5% in 2000 to 2.2% in 2007. Since EU accession (2004), net interest margins shrank more strongly in the banking sector as a whole than for the three largest banks, a sign of enhanced competition. Even so, overall net interest margins in 2007 were still twice as high as the euro area average, exceeding this average by more than 1 percentage point (Figure 4.15, panel B). The wider interest spread points to continued low contestability, auguring further pressure on

Figure 4.15. **Return on average equity and net interest margins**
Per cent



Source: Bems, R. and P. Sorsa (2008), "Efficiency of the Slovene Banking Sector in the EU Context", *The Journal for Money and Banking* (Bančni Vestnik), Vol. 57, No. 11, November.

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banks' profitability. In the area of retail financial services, competition is set to rise with the implementation of the Directive on Payment Services and the associated full introduction of the Single Euro Payments Area schemes (SEPA). The SEPA Credit Transfer Scheme began to be introduced in January 2008. In the capital market sector, the powers and institutional independence of the Security Market Agency have been strengthened (Act Amending the Market in Financial Instruments).

A more efficient banking sector would also be able to conceive more sophisticated financial products for pension savings for a rapidly ageing population as well as to share information on insurance fraud, enterprise performance and credit conditions. Deeper EU integration and capital market development would, in addition, sharpen the competitive edge of Slovenian banks. While further privatisation could enhance efficiency gains, the government is bent on retaining controlling shares in key banks. In this setting, in both banking and elsewhere, stronger efficiency gains can be reaped through both raising the standards and independence of board members and designing a longer-term growth strategy for state-controlled enterprises along the lines advocated by the OECD Guidelines for the Corporate Governance of State-owned Enterprises. Listing banks in the stock exchange could raise management accountability as well as the transparency of operations (Bems and Schellekens, 2007).

Strong state involvement in the insurance sector

The insurance sector is governed by the 2000 Insurance Company Law and the Law on Ownership Transformation of Insurance Companies. This legislation paved the way for increased competition, foreign investment and privatisation of socially owned enterprises. Currently, there are 18 insurance companies operating in Slovenia, two of which are foreign-owned. In addition, there are three specialised institutions performing insurance functions in the public interest. There are no ownership restrictions on insurance companies, foreign companies being entitled to establish their own, locally incorporated subsidiaries or acquire 100% of a listed or unlisted insurance company.

Market concentration is particularly strong in the insurance sector, the State-controlled Triglav Insurance Company enjoying a market share of 50%. More than one third

of Triglav is owned by the Institute of Pension and Invalidity Insurance (ZPIZ) and more than one fourth by the State Restitution Fund (SOD), making the State a majority share holder. Earlier initiatives to privatise Triglav failed because of procedural complexity. The Pension Fund's share was initially planned to be sold to natural persons who held Triglav-insurance policies in 1990. State-owned shares in Triglav are scheduled to be progressively sold, the withdrawal process ending in 2014.

Triglav's market power has given rise to non-cooperative behaviour, as the company has blocked industry's attempts to create and share a common database on insurance fraud. Moreover, the European Commission has issued complaints about Triglav's discriminatory practices, differentiating insurance premiums across persons with identical characteristics. Despite rising competition from foreign insurance companies since 2004, Triglav's return on capital has remained well below EU averages. The number of insurance premiums per employee is comparatively low, pointing to overmanning.

The Ministry of Finance is responsible for the regulatory framework of insurance companies. The Insurance Supervision Agency is in charge of formulating and implementing regulations as well as issuing licenses for new companies. Since June 2000, the Insurance Supervision Agency, previously part of the Ministry of Finance, has become an independent body, reporting directly to Parliament. Its powers of supervision have been strengthened with the Act Amending the Insurance Act.

Keener competition and low prices in telecommunication services despite strong state influence

The liberalisation of the telecommunications sector started late and has been gradual. Until 2000, the development and the provision of services relied entirely upon the state-owned monopoly Telekom Slovenije (1997 Telecommunication Law). In 2001, a new Telecommunications Act was introduced to complete the deregulation of the market. The 2001 Act opened the fixed-voice telephony market to competition by unbundling the loop, i.e. the lines linking individual subscribers to the network. It liberalised both the construction of networks and the provision of basic telecommunication services.

The 2001 Telecommunications Act also established a regulator, the Telecommunications and Broadcasting Agency (the Agency), which is responsible for monitoring prices, regulating and supervising telecommunications markets, and administering interconnections. The Agency's head is appointed by the government. The Agency is also responsible for all procedures related to the entry of new operators. Its decisions need to be communicated to the European Commission. A universal service obligation is imposed upon licensed operators. The Act Amending the Electronic Communications Act (December 2006) extended the autonomy, powers of surveillance and administrative enforcement of the Agency.

The Ministry of the Economy is in charge of telecommunication policy and main regulations in the sector. The 2001 Telecommunications Act also created the Telecommunications Council, an advisory body composed of telecommunication members appointed by Parliament.

The current market structure is marked by high market concentration. Beginning 2008, Telekom Slovenije, the principal operator, still controlled about 90% of the fixed telephone market, two-thirds of the mobile telephone market and the broadband internet market. Market shares of this size are unusually high by international comparison.

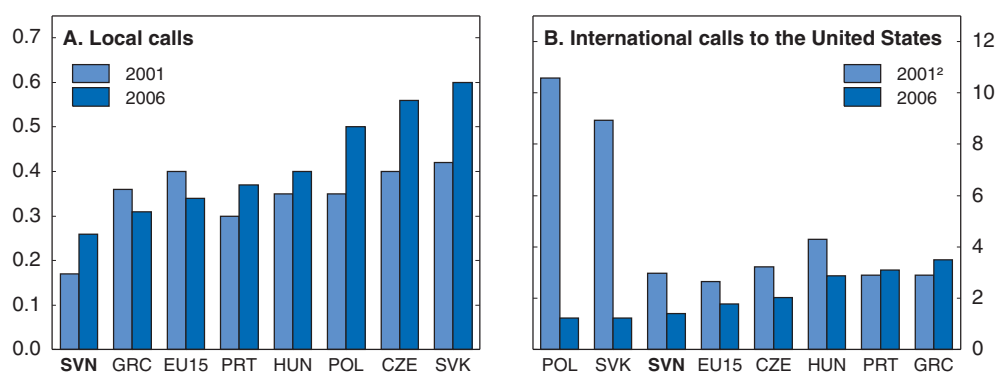
There are signs of rising competition, as evident in declining market shares for Telekom in all segments of the market. On the other hand, the privatisation process has stalled. In 2007, a public tender for the sale of 49.13% of Telekom Slovenije was issued to a strategic owner, but the selling process was suspended. Currently, the government directly owns 52.5% of Telekom Slovenije and another 21.6%, indirectly, through two state-owned Funds. The operator Mobitel is 100% owned by Telekom Slovenije.

Recent trends show continued convergence among existing networks for the transmission of sound, data and broadcasting. In 2007, a rising number of operators provided multiple play services combining fixed telephony, broadband Internet, television and mobile telephony. In the segment of fixed telephony, competition has increased with the growth in Internet provided telephony supplied by nine operators in 2007. In the mobile telephone market, the main operator's share has declined amid five new operators which started operations. Moreover, a new operator entered the market establishing infrastructure in 2007. There are also signs of increased competition among cable operators and xDSL (digital subscriber line) technology providers. New operators have become active in the domain of mobile broadband Internet access. Considering all types of the broadband access, the shares of both the principal and alternative operators have levelled off (Republic of Slovenia, 2008a).

Despite the commanding market share held by Telekom Slovenije, prices for telecommunications by type of call are relatively low. Overall, communication prices in 2007 were 25% lower than the EU15 averages (Figure 4.16). Nevertheless, Telekom has been the subject of several Competition Protection Office dominance cases in various telecom sectors, including fixed telephone (2000), wholesale broadband Internet (2004) and mobile telephone (2005). In February 2009, the CPO started proceedings against Telekom in response to the alleged abuse of the dominant position in the market of broadband and vocal services. The head of Telekom is appointed by the supervisory board for a four-year term. The powers of surveillance and enforcement of the Post and Electronic Communications Agency were strengthened in 2006 (Act Amending the Electronic Communications Act).

Figure 4.16. **Telecommunications prices**


Euro per 10 minute call¹



1. Price includes value added tax.

2. 2002 for the Czech Republic.

Source: Eurostat database (2009), Industry, Trade and Services, May.

StatLink  <http://dx.doi.org/10.1787/644888415243>

Postal services

In the postal market, there were 11 providers in 2007. The license for the provision of universal postal services, including the right of reserved service provision as the sole provider, is held by the Posta Slovenije. The provision of universal postal services implies rendering a public service and thus will be maintained, but under strict conditions of high quality of service and the access of all inhabitants to the single market (Republic of Slovenia, 2008a).

Relatively low final user prices for natural gas and electricity despite strong state presence

Following the dissolution of social capital in the 1990s, all energy distribution companies have become joint-stock companies owned by the State. Their status of a public enterprise was maintained until 2007. Companies producing and distributing electricity began to be partially privatised in 2000, with sales of a 20.5% capital share. In 2001, all energy-producing companies, with the exception of the Nuclear Power Plant Krsko, were merged to become the Slovenian Power Holding Ltd. (HSE).

After slow and partial privatisation, a second pillar of electricity production was established with the creation of Gen Energy Ltd. (2007). At the same time, market and auction instruments were introduced allocating capacities for cross-border transmission. The current market share of the main electricity provider (more than 50%) is lower than the EU27 average (60%). In the wholesale electricity market, the market share of the second production pillar (GEN-I, which is part of the group GEN Energy Ltd.) has recently increased with the transfer of long-term agreements from HSE to GEN-I.

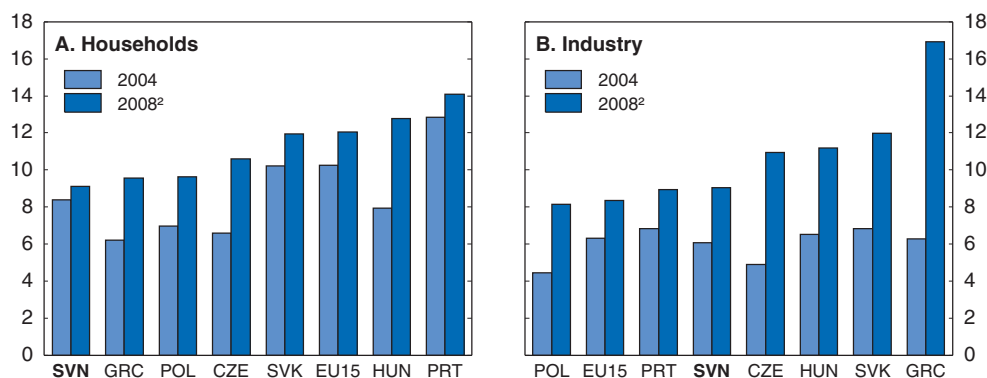
As part of the Reform Programme for Achieving Lisbon Strategy Goals (2008-10), the electricity distribution sector is due to be restructured, transferring the system to the electricity distribution operator (SODO). Following separation of sales and network activities in the electricity sector, privatisation of electricity distribution companies will resume. The government also foresees further gradual privatisation of electricity production. By establishing two “pillars” of production, the government intends to enhance competitive forces in the production sphere.

Electricity and natural gas prices to final users, regulated until 2007, are both lower than in neighbouring countries (Austria and Italy) and generally low by international comparison. The comparative price advantage *vis-à-vis* the EU15 average ranges from 10% for household natural gas to 25% for household electricity and industrial natural gas (Figure 4.17).

In 2007, prices for wholesale electricity increased more strongly than could be explained by exogenous trends. Accordingly, the Competition Protection Office sanctioned the excessive pricing power (“raising prices in concert”) and issued rulings against five electricity distributors. A decision by the Supreme Court is pending. Competition in the electricity market is also constrained by restrictions preventing distributors from directly buying electricity from the cheapest source (nuclear energy). While producers’ contractual obligations *vis-à-vis* certain buyers of electricity expired in 2008, there are too many tiers in the electricity market, with state-owned wholesale companies separating distributors from producers. Portions of electricity from different sources (hydro, coal and nuclear energy) are allocated to distributors. Action is therefore needed to allow distributors to buy electricity directly from the most cost-efficient source.

In the wholesale market for natural gas, the main provider’s market share still accounts for almost 100%. In contrast, several suppliers operate in the retail market, with

Figure 4.17. **Electricity prices**
Euro per 100 kilowatt hour¹



1. Prices charged to final consumers excluding taxes.
2. 2007 for EU15.

Source: Eurostat database (2009), *Environment and Energy*, May.

StatLink  <http://dx.doi.org/10.1787/645053772087>

none of them holding a dominant position. In 2008, the Italian company ENI entered the Slovenian market for natural gas as a new supplier of retail and wholesale natural gas. ENI sells natural gas through an enterprise which it partially owns.

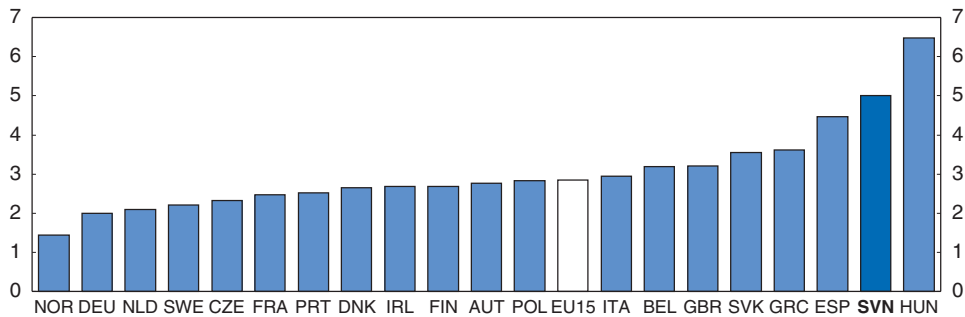
High market concentration in the retail food sector

Slovenia's retail sector is largely free from restrictions, with no limitations on evening openings, Sunday work (except for women) and no zoning limits (apart from city centres). Reflecting comparatively low wages and salaries, retail food prices are 10-15% lower than in Italy and Austria. In contrast, market concentration has traditionally been strong, with three companies (Mercator, Slovenia's leading supplier; Spar an Austrian company; and Tuš) holding 65-75% of the retail food market. Including franchising, the combined market share rises to 75-85% of the market. Following EU accession, foreign companies have entered the market (Lidl, Aldi and Hofer), building up a market share of 5-6% in the space of two years (2005-07).

Signs of rising competition notwithstanding, Slovenia's retail food prices accelerated far more strongly in 2007-08 than could be explained by the world-wide food price surge (Figure 4.18). The inordinate rise in food prices has led the Competition Protection Office to examine the possibility of collusive pricing behaviour (hidden price agreements). The CPO's investigations focus, in addition, on Slovenia's principal food supplier Mercator which holds 36-39% of the market. The issue here concerns the unification of pricing lists and effective prices (after rebates) charged by Mercator to wholesalers.


Until 2006, the Mercator Company was partially owned by the State. A 35% share was sold to two companies, one of them being the local brewery company Laško. Sales conditions (absence of tender) lacked transparency, the state's selling prices being surprisingly low. In 2008, in the middle of the financial crisis, Laško expressed its wish to sell 48% of Mercator's shares to a single foreign investor. The selling offer has met with strong resistance from Mercator's management and domestic food suppliers. Increased foreign investment in the Mercator Company is seen as putting domestic food production at risk.

Figure 4.18. **Food prices**
Harmonised index of consumer prices, average annual growth 2000-08¹



1. 2001-08 for Hungary. The EU15 aggregate is an unweighted average.

Source: Eurostat database (2009), *Economy and Finance*, May.

StatLink  <http://dx.doi.org/10.1787/645088860800>

Box 4.4. **Policy recommendations for enhancing the business environment to foster productivity growth**

Increase competition to foster productivity

- In financial services and selected network industries, reduce state control through progressive, transparent privatisation. Issue a calendar for planned privatisation initiatives along with a list of enterprises still held by the State, even if current financial conditions may warrant some delays.
- Explore ways to improve the management and governance of state companies. In underperforming state-controlled companies, implement strategic plans to raise productivity to levels observed in other EU countries. To this end, appoint competent supervisory boards which have the capacity of appointing professional management.
- In the domain of public procurement, improve the State practices to rule out collusion among tenders.
- Reinforce the independence of the Competition Protection Office by transforming it into a truly independent agency with budgetary autonomy.

Reduce barriers to entrepreneurship

- Ease employment rules and facilitate property registration.
- Widen the use of credit registry to lower credit transaction costs.
- Strengthen entrepreneurship education in schools, universities and research institutions (good practice countries include Denmark, Netherlands and Norway).
- Expand the network of public/private business support centres to foster entrepreneurial dynamism.

Increase efficiency and effectiveness of innovation policies

- Raise aggregate research and development (R&D) spending, increase its private component and strengthen the technology-oriented portion of public R&D expenditure.
- Have independent (domestic and foreign) institutions evaluate existing programmes supporting innovation against international best practice.
- Consider reducing administrative dispersion by merging business innovation support programmes.
- Improve the efficiency of multi-purpose centres (hubs) to strengthen links between the research community, the business sector and the government.

Notes

1. Credit registries, which collect and distribute credit information on borrowers, greatly expand access to credit. By sharing credit information they facilitate risk assessment and credit allocation.
2. One example is Mexico, where policy-induced collective process innovation since 2004 has acted as a main vehicle for stimulating individual product, process and market innovations (OECD, 2007).
3. In the financial sector, rising ICT diffusion enhances banks' capacity of credit assessment, augmenting the transparency of data on firm performance and credit conditions. By potentially kindling competition among financial institutions, ICT eases barriers to finance, with a consequent fall in bank lending rates for SMEs relative to benchmark interest rates (interest rate convergence) (Mittelstädt and Gerri, 2008).

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ANNEX 4.A1

Estimation of mark-ups for Slovenian industries

A departure from the standard assumptions of the neoclassical production theory allows for the assumption of monopolistic firms charging mark-ups over marginal costs.

To implement such an approach, first, the production technology is assumed to be defined by the neoclassical production function:

$$Y = AF(N,K) \quad (1)$$

where Y is output, A is multifactor productivity growth, there are two inputs: N is labour, and K is capital and $F(\cdot)$ is a homogenous function of degree λ (the degree of returns to scale). The firm and year subscripts are subtracted for the sake of simplicity. After log-differentiation* and re-arranging:

$$SR_{primal} = y - \alpha_N n - (1 - \alpha_N)k = (1 - B)a - B(y - k) \quad (2)$$

where SR_{primal} is the primal Solow residual, the lower case indicates log-differentiation, α_t is the revenue share of factor i and B is the Lerner index, which is closely related to the mark-up μ :

$$B = 1 - \frac{1}{\mu} \quad (3)$$

Estimation of equation (2) would lead to biased results as the explanatory variables are correlated with the productivity shock a . To overcome the endogeneity issues, the dual or priced-based Solow residual is derived by using the cost-function associated with the production function in equation (1).

Oliveira Martins et al. (1996) show that the equation to estimate the mark-up can also be derived from the direct definition of the mark-up over average cost:

$$SR_{dual} = \alpha_N w + (1 - \alpha_N)r - p = (1 - B)a - B(p - r) \quad (4)$$

where w is the growth rate of wages, r is of the rental price of capital and p is of output. By subtracting (4) from (2) and adding an error term, B can be estimated as Roeger (1995) showed. As the unobservable productivity term, a cancels out with this subtraction, this equation is relatively easy to estimate.

$$\frac{P}{AC} = \frac{P*Y}{(W*N + R*K)} = \frac{\mu}{\lambda} \quad (5)$$

* Through differentiation, the growth rate of output can be related to the growth rates of inputs, i.e. capital and labour.

where AC is average cost, P , W , and R are the prices of output, labour and capital, respectively, whereas λ is an index of returns to scale (i.e. average costs over marginal costs) and μ is the mark-up.

After differentiation and under the assumption of constant returns to scale ($\lambda = 1$) the equation to estimate (after adding an error term) is obtained:

$$(p + y) - \alpha_N(w + n) - (1 - \alpha_N)(r + k) = B[(p + y) - (k + r)] \quad (6)$$

where the first term in the left-hand side is nominal output, the second is wage cost multiplied by the estimated coefficient on labour α_N from the production function and the third is the rental price of capital multiplied by the estimated coefficient on capital ($1 - \alpha_N$), all in differences. The totality of the left-hand side is the Solow residual with variables measured in nominal terms. In the right hand-side, B is the Lerner index ($[\text{Price} - \text{Average Cost}] / \text{Price}$) to estimate.

Firm-level data for Slovenian firms are obtained from the Amadeus database and the OLS fixed effect estimator is employed to estimate the mark-ups. For details of estimation methods and results see Molnar and Bottini (2008), and Molnar (2009).

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Glossary

ALMP	Active labour market policies
AWG	Ageing working group
CDS	Credit default swap
CEECs	Central and East European countries
CPO	Competition Protection Office
ECB	European Central Bank
EIUA	Employment and Insurance against Unemployment Act
EMU	European Monetary Union
EPL	Employment protection legislation
ERA	Employment Relationships Act
ERM	Exchange rate mechanism
EU	European Union
EU15	EU members before enlargement in May 2004
EU27	EU members as from 2007
EUR	Euro
FDI	Foreign direct investment
GDP	Gross domestic product
HSE	Slovenian Power Holding Limited
ICT	Information and communication technology
IFRS	International financial reporting standards
IMAD	Institute for Macroeconomic Analysis and Development
IMF	International Monetary Fund
KAD	Capital Fund
MBO	Management buyouts
NAIRU	Non-accelerating inflation rate of unemployment
NDC	Notional defined contribution
NKBM	Nova Kreditna Banka Maribor
NLB	Nova Ljubljanska Banka
NMS	New member states
NPL	Non-performing loan
NRDP	National Research and Development Programme
PAEFI	Public Agency for Entrepreneurship and Foreign Investment
PDIA	Pension and Disability Insurance Act
PLYA	Project learning for young adults
PMR	Product market regulation
R&D	Research and Development
SID	Export and development bank
SME	Small and medium-sized enterprises

SOD	Compensation of Restitution Fund
TIA	Slovenian Technology Agency
TFP	Total factor productivity
USD	United States dollar
VAT	Value added tax
ZPIZ	Institute of Pension and Invalidation Insurance

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On 16 May 2007, the OECD Council decided to open discussions with Slovenia on accession to the Organisation and, on 30 November 2007, an Accession Roadmap, setting out the terms, conditions and process for accession was adopted [C(2007)104/FINAL].

In the Roadmap, the OECD Council requested a number of OECD Committees to provide it with a formal opinion. The Economic and Development Review Committee was requested to review Slovenia's overall economic policies in order to provide a formal opinion on the degree of coherence of Slovenia's policies with those of OECD member countries. In light of the formal opinions received from OECD Committees and other relevant information, the OECD Council will decide whether to invite Slovenia to become a member of the Organisation.

The present Economic Survey of Slovenia was prepared for the purposes of the accession review of Slovenia and was discussed by the Economic and Development Review Committee on 16 April 2009. The draft report was then revised in the light of the discussions and given final approval as the agreed report of the whole Committee on 6 May 2009.

The Secretariat's draft report was prepared for the Committee by Colin Forthun, Isabell Koske, Willi Leibfritz, Axel Mittelstadt and Margit Molnar under the supervision of Pierre Beynet. Research assistance was provided by Desney Erb.

The previous Survey of Slovenia was issued in May 1997. This Survey is published on the responsibility of the Secretary-General of the OECD.

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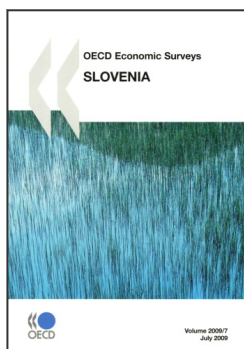


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