OECD Economic Surveys

Slovenia

May 2015

OVERVIEW

BETTER POLICIES FOR BETTER LIVES

Executive Summary

- ☐ Main findings
- ☐ Key recommendations

Main Findings

After independence in 1991, Slovenia experienced impressive growth and today compares well internationally on well-being indicators. Nevertheless, the 2008 crisis revealed important weaknesses in the growth model. Prior to the crisis, easy access to credit and mispricing of risk led to an unsustainable investment boom. Rigid product and labour markets in conjunction with widespread state involvement in the economy hindered adjustment. Yet, Slovenia maintained the lowest degree of income inequality, despite deep and protracted drop in GDP. In response to the crisis important reforms have been implemented, including fiscal consolidation, pension reform, labour market reform, restructuring and recapitalisation of banks, and initiation of privatisation procedures. The reform drive has raised the credibility of Slovenia in the financial markets and boosted confidence. Together with rising competitiveness it supported a return to economic growth in 2014.

Strengthening the banking and corporate sectors Excessive credit growth, poor risk assessment and lax lending standards in the run up to the 2008 crisis led to unsustainable debt build-up in (largely state-owned) banks and in the corporate sector. A weak framework for the governance of state-owned banks and weak supervision contributed to poor credit standards, excessive risk taking and misallocation of credit. The authorities and banks were slow in recognising and tackling the problem. So far, major state-owned banks have been recapitalised, and part of their non-performing loans (NPLs) have been transferred to the Bank Asset Management Company. However, banks are still importantly exposed to credit risk as well as profitability risk, due to relatively high NPL ratios. The corporate sector remains highly indebted, but indebtedness is heavily concentrated in certain companies. Viable firms have access to financing abroad and increasingly rely on retained profits. Lengthy insolvency procedures still impede needed restructuring, although important reform was implemented in 2013.

Stabilising debt and tackling pressures from population ageing Public debt has risen rapidly from 22% of GDP in 2008 to over 80% of GDP in 2014. Despite a growth surprise on the upside, the fiscal deficit in 2014 was bigger than planned, partly due to one-offs. The government goal is nevertheless to reduce the deficit below 3% in 2015. Consolidation has relied too much on one-off measures instead of structural efforts, making longer-term expenditure control challenging. Moreover, the fiscal framework has no credible mechanism to reach medium-term objectives. The rapid rise in age-related public expenditure from pensions, health care and long-term care is further complicating future consolidation. Slovenia is aging faster than many other OECD countries. Recent pension reform has improved sustainability, but further steps are needed. Although somewhat improving, the health care system is in urgent need of reform, and the government is undertaking a thorough review of health expenditures. Long-term care lacks a stable source of funding and relies too much on high-cost institutional care.

Boosting jobs and growth Prevalence of long-term unemployment is high and unemployment among the young has increased steeply. The relatively high minimum wage compared to average wage and a high tax burden on labour reduces employment opportunities. Slovenia spends relatively little on active labour market programmes, which are not well-targeted to the long-term unemployed and the low-skilled. Public ownership and control of enterprises is widespread in Slovenia, and the profitability of state-owned enterprises is low. Corporate governance and management practices in the state-owned sector have been weak, and have deterred foreign direct investment.

Key recommendations

Continuing with structural reform

- Focus fiscal consolidation on structural measures to increase cost efficiency in education, public administration and local government.
- Enhance the leading role of the Bank Asset Management Company to ensure swift restructuring of companies and effective liquidation of assets.
- Continue privatising state-owned enterprises and do not hold controlling interests in firms operating in competitive markets.

Strengthening the banking and corporate sectors

- For the most important firms to be restructured, ensure that all assets in a company group are transferred to the Bank Asset Management Company.
- Bank Asset Management Company should maintain its independence and ability to attract highly professional staff, while adhering to the highest standards of corporate governance and transparency.
- Monitor the implementation of the new insolvency regulation and improve institutional capacity by training judges and insolvency administrators. Make out-of-court restructuring faster and more attractive.

Stabilising debt and tackling pressures from population ageing

- Adopt a fiscal rule with a credible and transparent expenditure rule, and ensure that an independent and effective fiscal council is charged with assessing adherence.
- Increase the statutory and minimum pension ages and link them explicitly to life expectancy. Calculate pension rights over lifetime contributions.
- Thoroughly reform the health sector to improve efficiency, including of organizational and governance structures and public procurement.

Boosting jobs and growth

- Increase resources for active labour market policies and better target assistance to the long-term unemployed and the low-skilled, based on evaluation of individual programmes.
- Introduce the ‘silence is consent’ rule for issuing licences required to open up a business and make obtaining construction permits and registering property faster.
- Implement the government's unified innovation policy and monitor its progress. Improve collaborative links between major stakeholders of innovation policy.

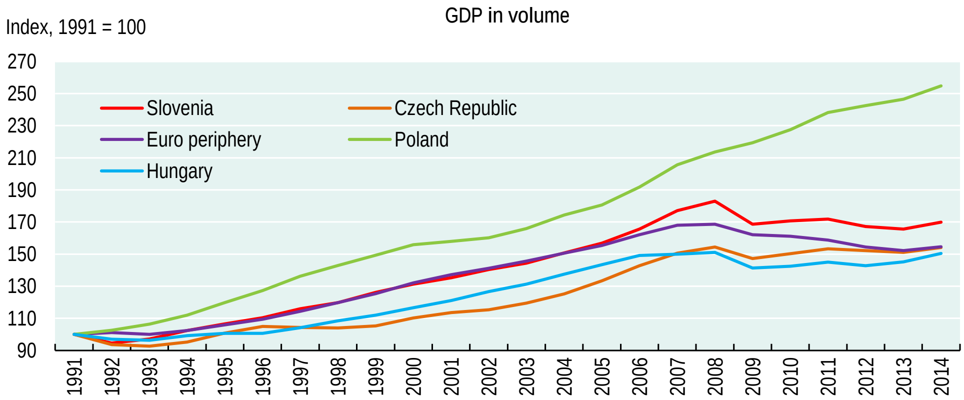
Assessment and recommendations

- Macroeconomic outlook
- Restoring the financial sector and corporate deleveraging
- Ensuring sustainable public finances
- The economic consequences of population ageing
- Raising living standards and long-term growth

The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in theWest Bank under the terms of international law.

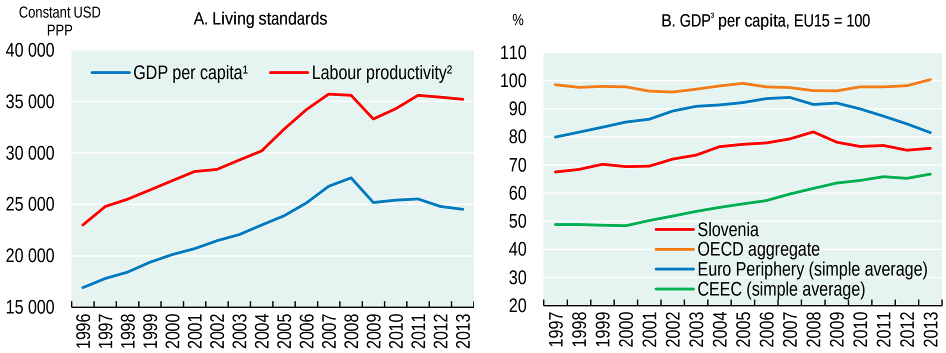
After independence upon the break-up of Yugoslavia in 1991, Slovenia experienced robust growth (Figure 1) and incomes rose steadily towards the EU average (Figure 2). The catch-up was facilitated by a relatively skilled labour force and modern industrial base, for instance in pharmaceuticals and household appliances. Production was reoriented to new markets in Europe, while Slovenia remained a competitive provider of goods and capital to the countries in the Balkans. Significant structural including trade reform and financial liberalisation, paved the way to European Union (EU) accession in 2004 and euro adoption in 2007. Growth was relatively widely shared (Figure 3), which has helped to boost well-being (Figure 4). Slovenia currently exceeds the OECD average in education, social connections, civic engagement and security.

Figure 1. **Growth was strong after independence**



Source: OECD Economic outlook 96 database.

Figure 2. **Rapid catch-up stalled after the crisis**



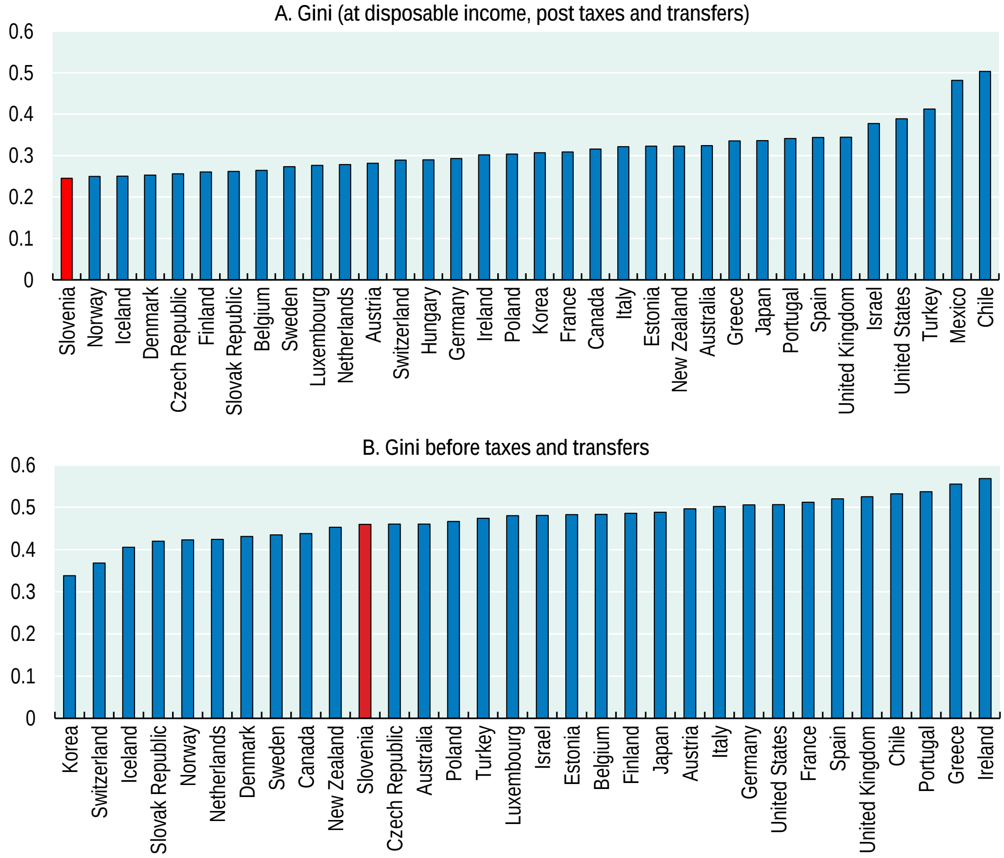
Note: CEECs include Poland, Hungary, Slovak Republic and Czech Republic; Euro Periphery includes Spain, Portugal, Greece and Ireland.

1. GDP in USD constant prices, constant PPP (base year 2005).
2. Labour Productivity measured as GDP per thousand hours.
3. GDP in million USD, current prices, current PPP per thousand persons/thousand hours worked.

Source: OECD Level of GDP per capita and productivity database.

Figure 3. **Income inequality is low**

Income inequality[1] - 2011 or latest data available



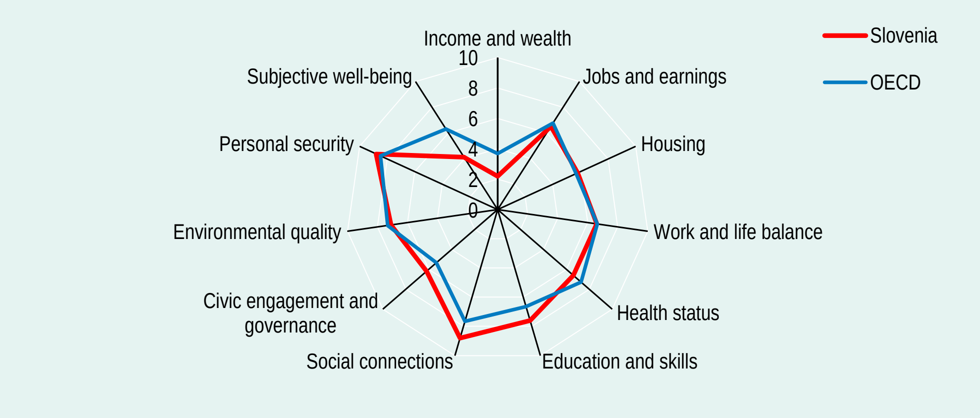
1. The Gini coefficient has a range from zero (everybody has identical incomes) to 1 (all income goes to only one person). Increasing values of the Gini coefficient thus indicate higher inequality in the distribution of income. Market income includes incomes from wages and salaries, self-employment income and cash property income together with occupational and private pensions. Disposable income is obtained by subtracting income tax and employees' social security contributions from gross income and adding transfers. Both income measures are adjusted to reflect differences in household needs depending on the number of persons in the household.

Source: OECD Income Distribution and Poverty database.

In spite of this impressive economic performance, the 2008 crisis exposed important weaknesses and imbalances. In the run up to the crisis, easy and cheap wholesale credit raised by banks abroad, overly optimistic growth expectations and mispriced risk taking led to an unsustainable investment boom in construction and much of the corporate sector. In addition, the optimism facilitated highly leveraged management buyouts. The resulting high indebtedness made corporates and banks vulnerable to changes in market conditions. Adjustment was also complicated by rigidities in labour and product markets and weak corporate governance, including in the extensive state-owned sector. The subsequent drop in output was one of the largest in the OECD . Recovery has been slow and difficult as the authorities initially reacted hesitantly and with delay in dealing with the causes of the crisis. The persistent weakness of the banking sector, overleveraged corporate sector, and a rapid rise in the public debt call for more action to restore sustainable growth.

Figure 4. **Well-being outcomes: Better Life Index**

From 0 (worse) to 10 (best), 2014[1]



1. Each well-being dimension is measured by one to four indicators from the OECD Better Life Index set. Normalised indicators are averaged with equal weights. Indicators are normalised to range between 10 (best) and 0 (worst) according to the following formula: (indicator value - minimum value) / (maximum value - minimum value) x 10.

Source: OECD Better Life Index, www.oecdbetterlifeindex.org.

Some important structural reforms have been implemented in recent years (Table 1). A pension reform increased statutory and minimum retirement ages, and increased incentives for continued work of older people, making the pension system more sustainable. A labour market reform enhanced flexibility and reduced duality between permanent and fixed term contracts, and subjected student work to pension and healthcare contributions. The business environment benefitted from simpler rules on opening a business and reduced administrative burdens. Parliament approved a list of 15 companies to be privatised and the government committed to privatise state-owned banks. Changes to the fiscal framework are expected to limit public expenditure growth in the future, lowering public debt and freeing resources for more growth-enhancing spending. The weakened banking system was recapitalised and part of non-performing assets were transferred to the newly established Bank Asset Management Company (BAMC). Bank supervision is being strengthened. Meanwhile, insolvency procedures were reformed to speed up restructuring of companies.

These reforms will - if fully implemented - have a positive impact on growth. The labour market reforms, changes to the product market regulation and effects of pension reform on employment should boost GDP by 1% in five years and 2% in ten years compared to the baseline projection (Table 2). This translates to about 0.2 percentage point faster GDP growth per year. The effect on GDP comes through improved productivity and higher employment and assumes full and swift implementation. However such estimates should be thought of as a broad guide to the expected impact of reforms rather than precise estimates. Delays, or less than full implementation, would reduce the gains.

Table 1. **Reforms approved and being implemented**

Area	Reform (fully implemented or on-going*)	Approved	Brief description
Reforms quantified			
Pensions	Pensions	Jan-13	Pension reform increased the statutory and minimum retirement ages and increased the number of years on which pensions are based. It increased penalties for early retirement and increased rewards for continued work.
Labour	Labour market reform	Apr-13	Increase of labour market flexibility and reduction in segmentation (shorter notice periods, reduction in severance payments for permanent employees, severance payments for temporary contracts, simplification of administrative procedures related to hiring and firing).
Business environment	Regulatory procedures and administrative burden	Since 2008	Processes to open a business were simplified, single contact points for getting information on all notifications and licenses were introduced, administrative burdens on start-ups and sole proprietors were simplified.
	Privatisations*	2013	Parliament approved a list of 15 companies to be privatised. By early 2015 four companies were privatised and seven are in the process. The government committed to privatise state-owned banks.
	Reforms via EU commitment*	Since 2014	EU commitment on Single Telecom Market. EU commitment in the energy sector. EU commitment in transport.
Reforms not quantified			
Fiscal	Fighting tax evasion*	July-13, Jan-15	Increased oversight and the mandatory use of cash register software; recently measures to increase transparency in cash transactions.
	Fiscal framework*	May-13	Adoption of the fiscal rule in the Constitution that requires a balanced budget over the medium term. Implementing law is still pending.
Labour	Student work	Feb-15	Healthcare and pension contributions for student work have been introduced and a minimum hourly gross wage rate was set. Students will accumulate years of pensionable service from their work.
Business environment	Governance of SOEs*	Apr-14	Slovenian Sovereign Holding (SSH) was established and made operational. The role of the SSH is to manage and dispose of the state-owned assets (SOEs).
	Insolvency procedures	June-13, Dec-13	To facilitate early restructuring of viable companies and speed up liquidations of unviable ones.
Banking	Measures for stabilisation of banks	Dec-12	In December 2012 the parliament adopted amendments to the Banking Act entrusting Bank of Slovenia with additional resolution powers, and the Act Defining the Measures of the Republic of Slovenia to Strengthen Bank Stability that, among others, established conditions for setting up a Bank Asset Management Company (BAMC). BAMC has the power to seek a quick resolution of impaired assets. Many bad assets from state-owned banks were transferred to BAMC.
	Enhancing bank supervision*	2014	The National Assembly passed a law establishing a bank resolution fund, to be financed by banks and managed by the central bank, to become operational in 2015. Macroprudential institutional framework for macroprudential oversight of the financial system was established by the Bank of Slovenia.

This survey will point out that to enhance growth a reform drive needs to persist:

- Decisive action is needed to strengthen the banking and corporate sectors.
- Further fiscal consolidation is needed to put the rising debt on a downward path, particularly in view of looming pressures on expenditures from population ageing.
- Structural reforms in product and labour markets, including privatisation of state owned assets, will help create more and better jobs, boost foreign direct investment (FDI) and increase innovation.

Table 2. **The impact of recent structural reforms on GDP over 5 and 10 years**

	GDP	Via Employment growth	Via Productivity growth
Impact on GDP growth over the horizon of 5 years (in %)			
Product Market Reform	0.7		0.7
Labour Market Reform			
Employment Protection Legislation	0.2		0.2
Pension reform	0.1	0.1	
Total	1.0	0.1	0.9
Impact on GDP growth over the horizon of 10 years (in %)			
Product Market Reform	1.3		1.3
Labour Market Reform			
Employment Protection Legislation	0.3		0.3
Pension reform	0.4	0.4	
Total	2.0	0.4	1.6

1. OECD estimates for the impact of product market reform include changes to the product market regulation (PMR) as captured by the change in the OECD PMR indicator between 2008-2013, announced privatisations and reforms via EU commitments. The 2008-2013 change in the PMR is assumed to start having an effect on growth two years before other reforms.
2. Impact on the labour market reform is assessed via the effect of the change in the employment protection legislation (EPL) on growth. Effect of the pension reform is based on a judgement and assesses the effect on employment via increased incentives for older people to stay in the labour market.

Source: OECD calculations.

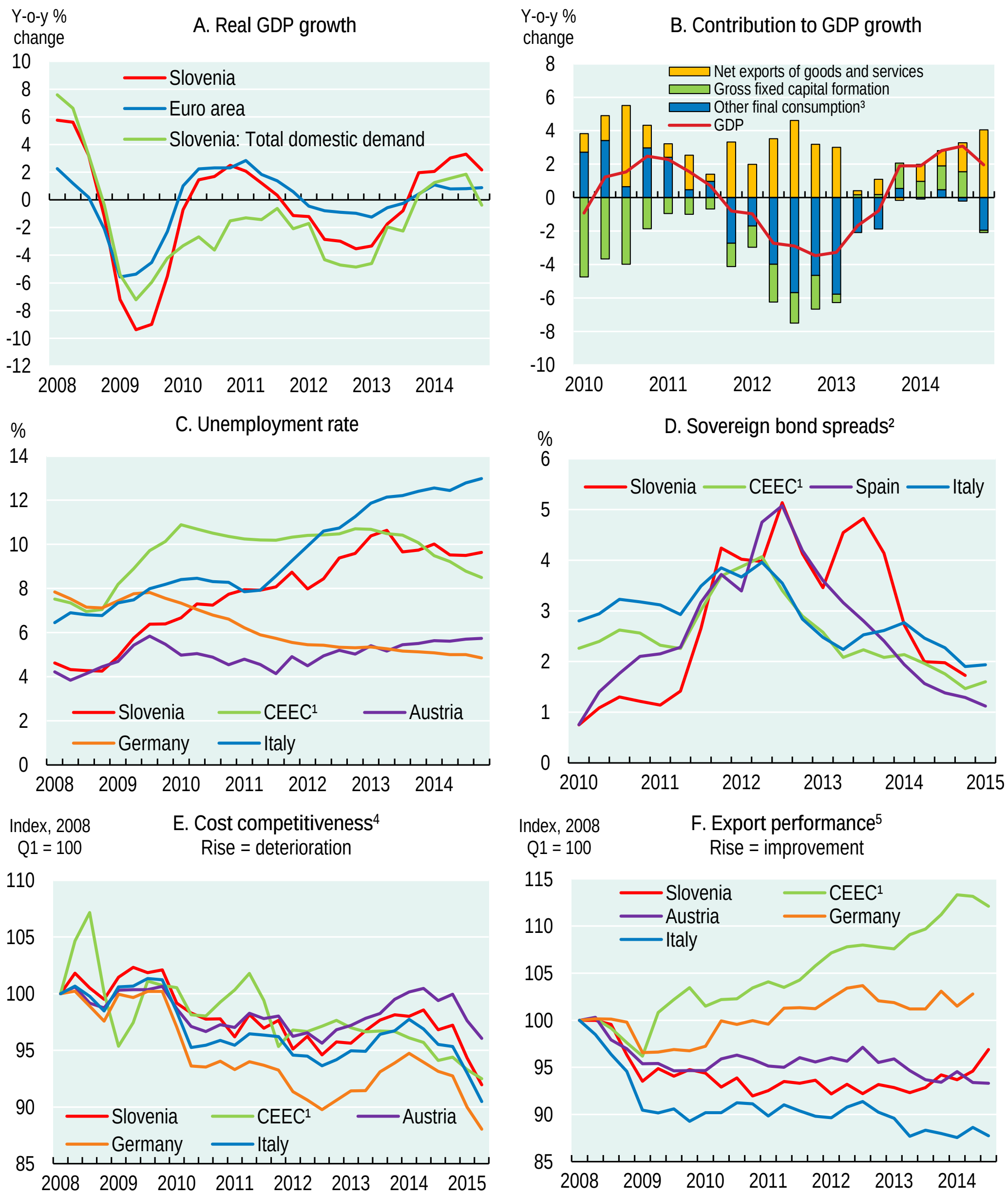
Macroeconomic outlook

Economic recovery remains fragile

After two years of recession, economic growth returned to Slovenia in 2014, driven by net exports and domestic demand (Figure 5, panels A, B). Investment was boosted by local infrastructure projects co-financed with EU funds that have to be used before the expiry of the financial perspective by end-2015. Private consumption benefitted from improvements in consumer confidence and job creation in industrial and construction activity. However, the recovery is fragile. Corporate investment remains low as companies are deleveraging, and banks' capacity to lend is constrained by still elevated non-performing loans.

Unemployment has slightly declined from its peak of 11% reached in late 2013 (Figure 5, panel C), but it remains high and more than half of the unemployed have been out of work for one year or more. Youth unemployment increased steeply and stood at about 20% in 2014. Due to the large slack in the economy, inflation has been low, and recent declines in the price of oil and other commodities have pushed inflation even lower. Slovenia's cost competitiveness and export market performance deteriorated and still lag behind some peers. Recently, however, competitiveness started to improve markedly and Slovenia has gained market shares (Figure 5, panels E, F). The tradable part of the economy, and manufacturing in particular, has made considerable unit labour cost (ULC) adjustments since 2010. And while in previous years cost competitiveness improved mainly owing to the adjustments in employment and earnings, in 2014 improvements have been mostly due to rises in value added (IMAD, 2014a).

Figure 5. **Key macroeconomic developments**



1. Unweighted average of Central and Eastern European Countries (Czech Republic, Hungary, Poland and Slovak Republic).
2. Ten-year government bond yields relative to the German rate.
3. Other final consumption include household, government and no-profit expenditure in final consumption, changes in inventories and acquisitions less disposals of valuables.
4. Real effective exchange rate based on unit labour costs for the total economy.
5. Ratio between export volumes and export markets for total goods and services.

Source: OECD Economic outlook 96 database.

Growth is likely to remain weak going forward (Table 3). Rising export growth is projected to be the main driver of growth, as global trade recovers and competitiveness improves further. Restructuring in the banking and corporate sectors, corporate deleveraging and weak credit will hold back private investment. Continued fiscal consolidation and a slow improvement in the labour market are projected to limit consumption growth. Private domestic demand will gain momentum, but only in 2016. Unemployment will decline slowly and inflation will remain low due to continued slack in the economy.

Table 3. **Macroeconomic indicators and projections**

	2010	2011	2012	2013	2014	2015	2016
GDP	1.2	0.6	-2.6	-1.0	2.6	1.8	1.9
Private consumption	1.0	-0.1	-3.0	-3.9	0.3	0.3	1.3
Government consumption	0.1	-1.3	-1.5	-1.1	-0.5	-0.3	-0.2
Gross fixed capital formation	-13.7	-4.6	-8.9	1.9	4.8	2.3	-0.4
Housing	-20.4	-12.4	-7.3	-8.8	-4.4	-1.6	1.9
Final domestic demand	-2.8	-1.4	-3.9	-2.1	1.1	0.6	0.6
Stockbuilding[1]	1.9	0.6	-1.8	0.1	-0.2	-0.1	0.0
Total domestic demand	-0.9	-0.8	-5.7	-2.1	0.8	0.5	0.6
Exports of goods and services	10.1	7.0	0.3	2.6	6.3	5.2	5.5
Imports of goods and services	6.6	5.0	-3.9	1.4	4.1	3.1	4.4
Net exports[1]	2.1	1.4	2.9	1.0	1.9	1.9	1.4
Other indicators (growth rates, unless specified)							
Potential GDP	0.6	0.2	0.2	0.3	1.0	1.3	1.6
Output gap[2]	-1.5	-1.1	-4.0	-5.2	-3.7	-3.2	-2.9
Employment	-1.5	-3.1	-1.3	-1.9	1.2	0.5	0.4
Unemployment rate	7.2	8.2	8.8	10.1	9.7	9.4	9.1
GDP deflator	-1.1	1.2	0.3	1.4	0.4	0.8	-0.5
Consumer price index	2.1	2.1	2.8	1.9	0.4	-0.4	0.7
Core consumer prices	-0.4	-0.4	0.7	0.9	0.7	0.6	1.0
Household saving ratio, net[3]	6.2	5.8	3.5	6.8	5.3	6.4	5.7
Trade balance[4]	1.6	2.0	4.4	6.0	8.1	10.5	11.1
Current account balance[4]	-0.1	0.2	2.7	5.6	5.9	7.9	7.8
General government financial balance[4]	-5.6	-6.6	-4.0	-14.9	-4.9	-2.9	-2.4
Underlying government primary balance[2]	-4.4	-4.0	-1.6	-0.6	-1.0	0.2	1.4
Gross government debt (Maastricht)[4]	38.2	46.5	53.7	70.3	80.9	83.2	85.2
General government net debt[4]	-0.4	2.1	7.9	18.9	23.2	25.5	27.5
Three-month money market rate, average	0.8	1.4	0.6	0.2	0.2	0.0	0.0
Ten-year government bond yield, average	3.8	5.0	5.8	5.8	3.3	1.2	1.1

1. Contribution to changes in real GDP.
2. As a percentage of potential GDP.
3. As a percentage of household disposable income.
4. As a percentage of GDP.

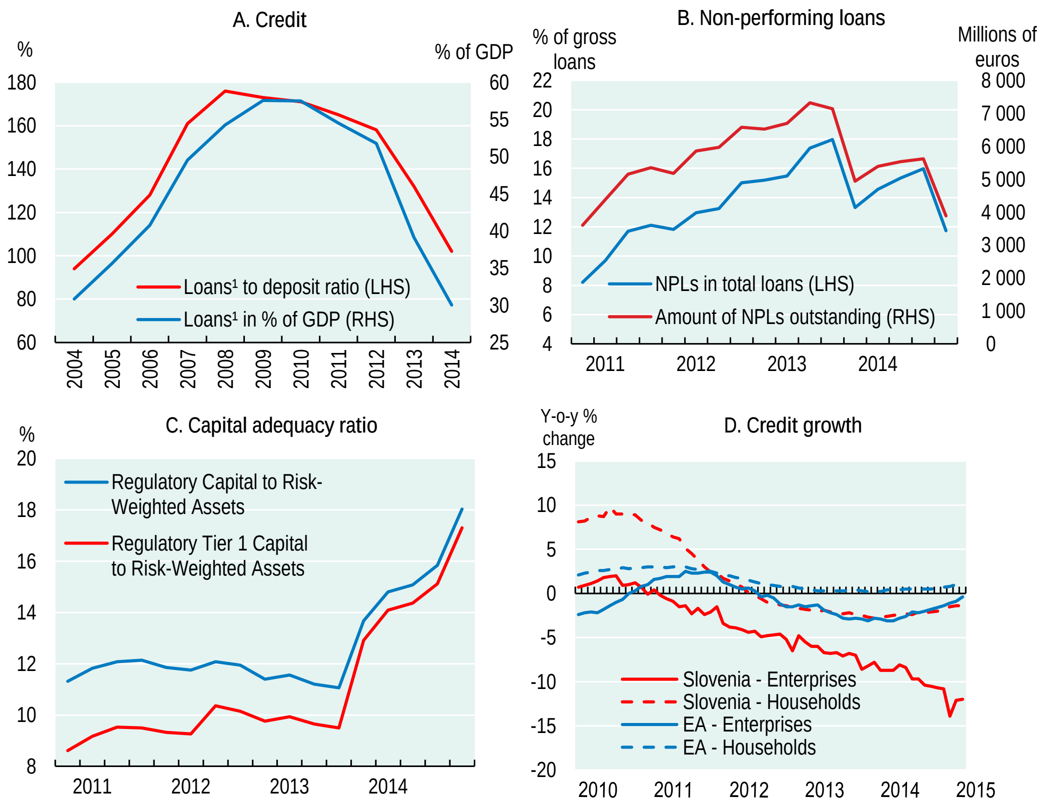
Source: OECD Economic Outlook: Statistics and Projections (database), April 2015.

The risks are more balanced than in the past, but there are still certain important risks on the downside. Lack of progress in corporate restructuring, consolidation in the banking sector, and privatisation can hold back investment and reduce access to finance. Fiscal slippage can also worsen markets' perception of Slovenia. Corporate financial and operational restructuring could raise unemployment in the short run, weighing on growth. The pace of export growth will depend largely on the growth of Slovenia's trading partners, and a possibility of a euro area slowdown therefore poses a downside risk. Having said that, euro depreciation and quantitative easing by the European central bank (ECB) could have more positive impact on European trading partners than expected, boosting exports further. Euro depreciation also opens opportunities to expand trade to new markets. Lower commodity prices will have a positive effect on terms of trade and profits of exporting firms and will boost import demand from Slovenia's trading partners. Further declines in oil prices, however, could also bring more persistent deflation, increasing the real value of financial debt and deterring investment and hiring.

Restoring the financial sector and corporate deleveraging

The banking sector was hit hard by the boom-bust credit cycle. The loan-to-deposit ratio (Figure 6, panel A), and the credit-to-GDP ratio more than doubled from 2003 to 2011. Loans were mainly directed to the corporate sector, whereas household indebtedness remained low. The big drop in economic activity led to a high proportion of non-performing loans (NPLs), (Figure 6, panel B), mostly in the large state-controlled banks. The deterioration in asset quality left Slovenian banks poorly capitalized and ill-equipped to extend further credit to the private sector (Figure 6, panels C and D), holding back investment and consumption.

Figure 6. **The banking sector was hit hard by the boom-bust credit cycle, but restructuring efforts have resulted in improvements**



1. Outstanding amount at the end of the period.

Source: ECB Statistical Data Warehouse, for Panels A and D; and IMF Financial Soundness Indicator database, for Panels B and C.

The banking sector had to be restructured and recapitalised. Comprehensive stress tests and the Asset Quality Review (AQR) of 8 banks in December 2013 showed a large shortfall in capital under the adverse scenario (Bank of Slovenia, 2013). Two small private loss making banks (4.5% of total assets, (IMF, 2014)) that had been under a supervised wind-down were recapitalised, and other small banks were asked to raise private capital, and if they were unsuccessful the state promised to provide funds. The three largest state-owned banks (NLB, NKBM and Abanka) have been recapitalised, while the shareholders and holders of subordinated debt have been wiped out. Since December 2013, the state has provided close to EUR 4 billion of capital to banks in total (11% of GDP).

To reinforce the banking sector further, the authorities committed that in the medium term they were going to fully privatise two banks (NKBM and Abanka), and reduce the state's share in the largest (NLB) to 25 % plus one share. The NKBM bank was expected to be sold in the first quarter of 2015 but there are delays. The process should be finalised as soon as possible.

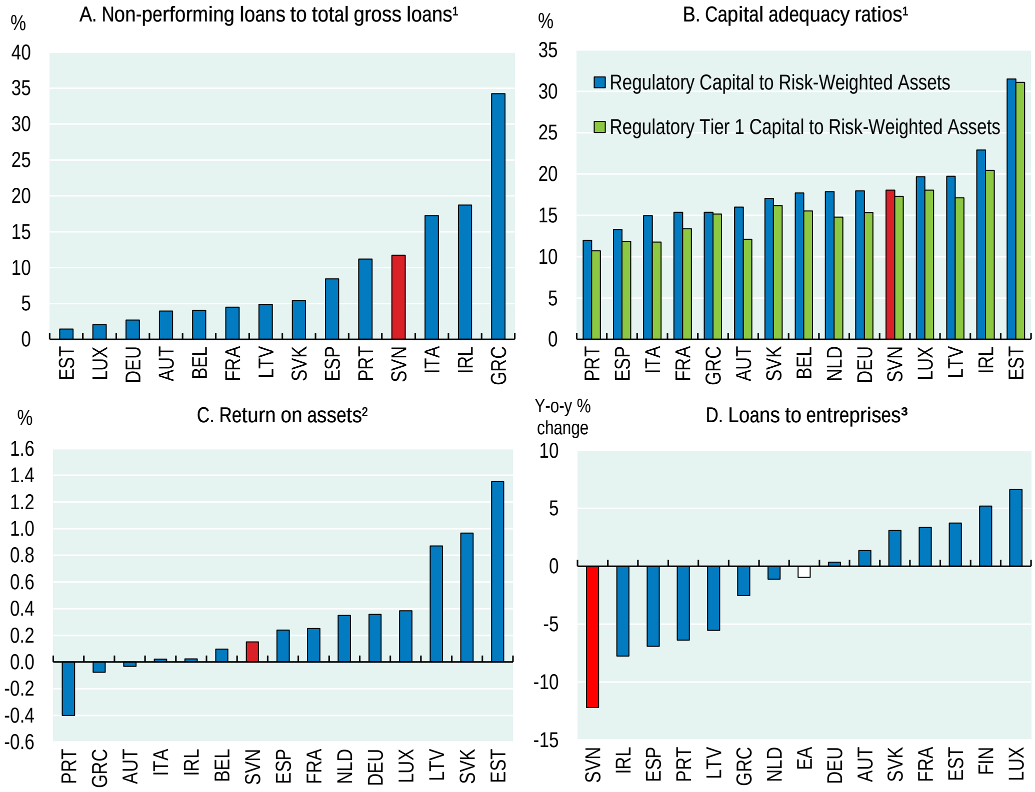
The transfer of bad assets of the banks to the state-owned Bank Asset Management Company (BAMC) was also facing delays (BAMC, 2014). BAMC was established in 2013 to have a key role in managing, liquidating and restructuring of bad assets, with the principal goal to recover the highest possible value for the transferred assets. The physical transfer of the loan files to the BAMC from NLB and NKBM was completed in 2014 while the Abanka transfer was finalised in the first half of 2015. In total, the three large state-owned banks and another small bank have transferred EUR 4.86 billion in assets to the BAMC, at the transfer value of EUR 1.56 billion, or with a 68% average haircut. Only about half of corporate NPLs have been transferred to the BAMC (IMF, 2015a), so there is room for further transfers. Foreign NPLs – consisting of lending to companies and subsidiaries of domestic banks in the Balkans – have not been transferred to the BAMC and constitute close to one quarter of total remaining NPLs (European Commission, 2015a).

Restructuring has stabilised the banking sector, but there are still weaknesses. The level of non-performing loans remains elevated (Figure 7, panel A) and capital ratios are not high compared to banks in other euro area countries (Figure 7, panel B). The level of provisioning however is higher than before and NPLs pose a lower risk to the solvency of banks (European Commission, 2015a). The results of the ECB's Comprehensive Assessment of European banks' balance sheets, announced in October 2014 showed a small capital shortfall (less than 0.2% of GDP) under the adverse scenario for NLB and NKBM. The two banks, however, will not require additional public recapitalisation, as they will be able to cover the capital shortfalls from retained earnings (ECB, 2014). Yet, profitability of banks remains low and credit activity to the corporate sector is still declining (Figure 7, panels C and D).

Enhancing the role of BAMC in dealing with bad assets

The BAMC has the legal instruments and power to seek a quick resolution of impaired assets, either by restructuring the company (when it holds more than 50% of claims) or by liquidating it. Bankruptcy procedures with BAMC involvement are to be concluded within six months. The BAMC can acquire additional assets from other banks to facilitate corporate restructuring, but has to purchase them at market prices. The BAMC can issue of up to EUR 4 billion of government-guaranteed bonds in total (about 11% of GDP) to acquire assets. The life-span of the BAMC is set to five years (until the end of 2017) after which the remaining assets are to be transferred to the Slovenia Sovereign Holding (SSH) (BAMC, 2014; IMF, 2014).

Figure 7. **The banking sector remains weak and credit activity is subdued**



1. 2014 Q4 or latest data available.
2. Average return on assets in the four quarters of 2014, except for France and Germany whose data refers to 2013.
3. Average of annual growth rates between November 2014 and February 2015. Loans adjusted for sales and securitisation of all types of maturity.

Source: IMF Financial Soundness Indicator database, for Panels A, B and C; and ECB Statistical Data Warehouse, for Panel D.

Many countries have used asset management companies (AMCs) to deal with bad assets, as for example Finland, Mexico, Spain, Sweden and the USA, but results have been mixed (Klingebiel, 2000; Laeven and Valencia, 2008). The advantages include economies of scale in consolidating scarce skills and resources within one agency, and the fact that AMCs can have enhanced bargaining power versus debtors by concentrating assets and collateral in one place. However, the transfer from originating banks means some loss of institutional knowledge about borrowers (Klingebiel, 2000; Woo, 2000). In practice, AMCs have been more successful in selling off assets of unviable bankrupt institutions than in corporate restructurings. It has also been easier to sell real estate than other assets. When AMCs only had a small fraction of the banking system on their balance sheets, it was easier to maintain independence from political pressures (Klingebiel 2000).

About two thirds of the BAMC's current exposures are in default, where BAMC is to acquire the collateral - real estate but also equity and company assets - and sell it to the private sector. The other exposure is corporates that have a viable core activity but need to be financially and operationally restructured (European Commission, 2014a). Past experience shows that corporate restructuring can be challenging, and the situation in Slovenia is exacerbated by the presence of numerous complex, inter-connected group loans with several bilateral contracts and conflicting interests (Bank of Slovenia, 2014a). Transferring all assets in a company group to BAMC will give it a majority position vis-à-vis other creditors. BAMC in coordination with the authorities should decide strategically which are the most urgent and important cases in the economy to be restructured, and ensure that additional exposures are transferred to the BAMC. This will also alleviate the problem of NPLs on banks' balance sheets. But action needs to be taken swiftly. Past experience shows that ambiguity on what additional assets may eventually be transferred to the AMCs limit banks' incentives to engage in corporate restructuring of assets remaining on their balance sheets (Klingebiel, 2000).

Independence and professionalism are also important for BAMC's success (Klingebiel, 2000). Restructuring companies requires specialised expertise which is highly valued on the market. BAMC therefore needs to have freedom to set its own remuneration policy to attract adequate talent. In addition, extending the life-span of the BAMC would reduce pressure for fire sales and enhance independence of the BAMC. The authorities are planning to change legislation in order to extend the life of BAMC to 2022 from current 2017, which is a step in the right direction. Successful AMCs in the past have relied on a detailed set of directives and guidelines to staff and contractors that cover a wide range of operations, including asset management and disposition, contract policies, bidding procedures and marketing. This minimized the possibility of fraud, made policy and cost evaluation more transparent, and hence expedited the resolution process (Klingebiel, 2000). The Slovenian Corruption Prevention Commission (CPC) and the Court of Audit in their reports voiced concerns about conflict of interest, significant corruption risks and irregularities in BAMC with respect to hiring of external consultancies, remuneration policies, internal processes and corporate governance. BAMC has taken measures to strengthen its own governance in 2014 by adopting strategic guidelines and a business strategy for asset management.

Effective restructuring and disposal of assets also requires sound financial institutions and other available markets, where the AMCs can find potential buyers for the assets. Deep and liquid capital markets also help in this regard. Slovenia lacks fresh equity, and BAMC is unable to lend money to companies, while banks are weak and unwilling to extend credit. In fact, the authorities are planning to change the law to enable BAMC to lend to companies, which will facilitate restructuring. In addition, more openness to privatisation and foreign investors could bring more fresh capital. Swift restructuring of the banking sector and resumption of credit activity is equally important. BAMC can use tools at its disposal to encourage banks to lend afresh to viable restructured companies, for example, by putting up their collateral for fresh loans or assigning super-seniority status.

Improving bank supervision and business practices of banks

The weak framework for the governance of state-owned banks contributed to poor credit standards, excessive risk taking and misallocation of credit before the crisis (OECD, 2013a). The Slovenian Corruption Prevention Commission reports (CPC, 2013) that corrupt practices in allocation of credit had been wide spread in the state-dominated banking system. The planned bank privatisations are welcome in this regard as they are expected to improve corporate governance. However, the plan to retain a blocking minority shareholding should be dropped as it opens the door to political interference.

The Asset Quality Review (AQR) from December 2013 identified several weaknesses in the banks' risk management systems (European Commission, 2014b). The data integrity validation highlighted deficiencies in IT systems and paper records, with significant gaps in several loan files. Most banks did not assign rating classes in line with the regulations issued by Bank of Slovenia and in many instances the collateral valuations were out of date. BAMC (2014) likewise notes that credit files received from the banks were in many cases incomplete and of poor quality. The risk management in banks should be of higher standard and bank supervisors should more closely follow that regulations and guidance are properly followed by the banks.

The ECB Single Supervisory Mechanism, in place from November 2014, will bring unified supervisory methodologies and standards at the Eurosystem level. New legislation was adopted in March 2015 in line with EU directives, to introduce capital shock absorbers, enhanced risk management and bank governance requirements, and improved transparency of bank operations through additional disclosure and assessment of systemic risks. Furthermore, a bank resolution fund has been established, to be financed by banks and managed by the central bank. To foster higher standards of the risk management and non-performing exposures management in banks, the Bank of Slovenia has introduced number of measures, such as additional reporting of banks and requirements for individual plans for non-performing exposure management. As the absence of credit information sharing between banks is likely to have contributed to poor risk outcomes (OECD, 2013a), the upgrading of the Central Credit Registry (Bank of Slovenia, 2014a) is welcome.

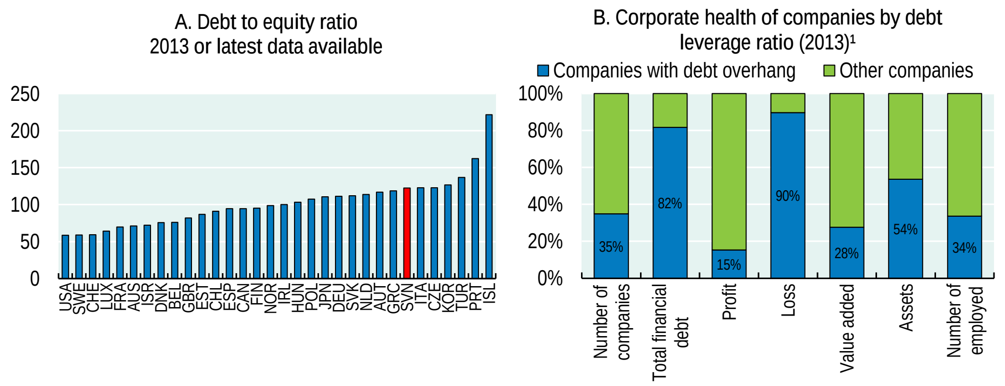
An improved insolvency framework will speed up corporate restructuring

Indebtedness of corporates remains high (Figure 8, panel A), despite debt reduction since 2009 (Figure 9, panel A). The debt is fairly concentrated (Bank of Slovenia, 2014c; European Commission, 2014b; IMAD 2014b; Damijan, 2014). Only one-third of all companies have a debt overhang - financial debt exceeding EBITDA by a factor of five – but they account for around 80% of total financial debt (Figure 8, panel B). State-owned and state-controlled enterprises are also highly leveraged and continue to be at risk of default (European Commission, 2015a). Despite the concentration of debt overhang, evidence shows that deleveraging is having significant negative effects on overall economic activity and investment (IMAD, 2014c). Moreover, compared to other vulnerable countries the economic distress is not only concentrated in real estate and construction, but widely spread across sectors, with many service sectors also affected (European Commission, 2014b). Profitability is low, due to high interest burden, and the bank funding costs of Slovenian corporates remain elevated (Figure 9, panel B), but many viable companies have been able to tap alternative sources of funding at lower cost.

The European Commission (2014b) found that between 2007 and 2012 Slovenia's expenditures on state aid to the real economy more than tripled, to 1.3% of GDP. Yet, many of the companies that received aid still ended up in financial difficulties. Given the fiscal pressures, it is important to shift from state aid to an effective framework for swift liquidation of unviable companies and effective restructuring of viable ones. The authorities are already replacing subsidies by low cost loans to companies. Furthermore, in an important step, in January 2015, the government appointed a task force for corporate restructuring and deleveraging, comprising government and central bank officials, tasked with monitoring and coordinating restructuring and deleveraging of companies, and proposing measures to make the processes more effective. Better coordination and communication among the major stakeholders will facilitate the process, so this is a welcome step.

Resolving insolvency in Slovenia is very time consuming and recovery rates are low. According to the World Bank Doing Business Survey 2015, it takes an average of 2 years to complete a standard bankruptcy procedure (involving a main secured creditor and several unsecured ones). In Slovenia, investors recover only about 50% of assets, while other countries (Finland, Japan and Norway) achieve recovery rates above 90%. Such high rates are achieved by rapid bankruptcy procedures that last 5 to 11 months. In addition, in Slovenia insolvency procedures are often initiated too late, usually when it is already impossible to save the enterprise

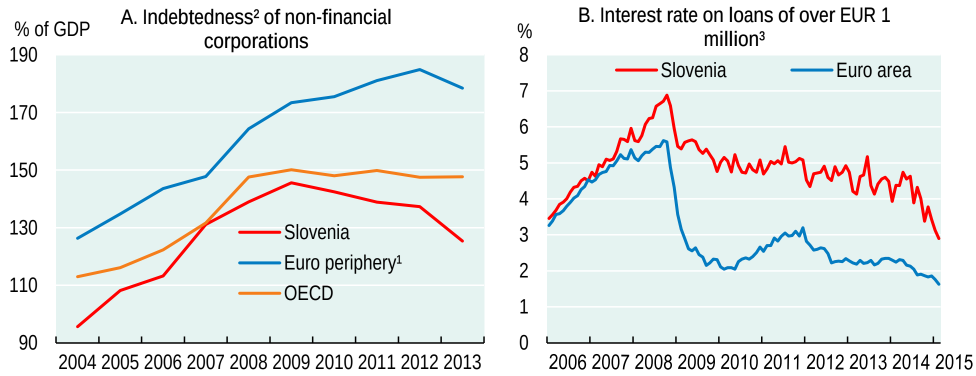
Figure 8. **The debt overhang is concentrated in a few companies**



1. Companies with debt overhang are those with negative EBIDTA (earnings before interest, tax, depreciation and amortisation) and those with debt leverage ratio (financial debt over EBITDA) larger than 5.

Source: OECD, Financial indicators database, for Panel A; and Calculations by IMAD, based on raw micro level data (firm-by-firm) from AJPES, for Panel B.

Figure 9. **Deleveraging has been under way, while corporates still face elevated funding costs**



1. The euro periphery is composed of Greece, Portugal, Spain and Ireland.
2. Debt is defined as all liabilities that require payment or payments of interest or principal by the debtor to the creditor at a date or dates in the future. It comprises of all debt instruments except for shares, equity and financial derivatives.
3. Interest rate on loans to non-financial corporations of amount over 1 million euros.

Source: OECD Financial Indicators database, for Panel A; and ECB Statistical Data Warehouse, for Panel B.

In 2013 the parliament passed important reforms to facilitate early restructuring of viable companies. The framework provides for preventive restructuring of large and medium-sized companies that are viable, but that could become insolvent within a year. The framework also gives more powers to creditors and smaller creditors now enjoy better protection. The absolute priority rule now ensures that if equity is zero, equity will be eliminated, preventing existing owners from blocking the restructuring process. The amendments also improved corporate restructuring features such as debt-for-equity swaps and corporate spin-offs to facilitate viable firms continuing as a going concern (IMF, 2014). The overall procedure of court-mandated debt restructuring has been streamlined by broadening the scope of companies eligible for a "simplified procedure".

Reforms have significantly improved the corporate insolvency regime, which, if properly implemented, can facilitate the rehabilitation of viable firms (IMF, 2014). During 2013–14, about 30 compulsory settlements were completed per year, simplified compulsory settlements increased from 10 in 2013 to 90 in 2014. Furthermore, in 2014, 8 pre-insolvency restructuring proceedings were concluded for the first time. Nevertheless, corporate bankruptcy procedures remain widespread, amounting to close to 1 000 per year in 2013–14, twice as many as in 2012 (IMF, 2015a). The effectiveness of the reform should be closely monitored and evaluated based on appropriate indicators, such as recovery rates in all types of insolvency procedures (European Commission, 2014c). Indeed, Slovenia has already started evaluating the reform (European Commission, 2015a). Institutional capacity could also be improved further to promote successful implementation. The number of judges specialised in commercial law is low. The number of insolvency administrators is insufficient and many lack relevant knowledge in the areas of accounting and finance. Furthermore, there is lack of meaningful cooperation between judges and insolvency administrators (IMF, 2015a and 2015b).

Slovenia could achieve speedy and cost effective debt settlement through better use of voluntary out-of-court restructuring, as recently introduced in Portugal and Spain. *2013 Economic Survey of Slovenia* reports that although allowed under the Slovenian insolvency law, out-of-court restructuring is not explicitly regulated and average time of such restructuring is high in international comparison. Additional incentives could be introduced to promote the use of out-of-court restructuring. Sufficient debt hair-cuts should be permitted for such procedures and tax and social security should be equalised with other liabilities.

Recommendations on restructuring and deleveraging the banking sector and the corporate sector

Key recommendations

- Enhance the leading role of the Bank Asset Management Company to ensure swift restructuring of companies and effective liquidation of assets.
- For the most important firms to be restructured, ensure that all assets in a company group are transferred to the Bank Asset Management Company.
- Bank Asset Management Company should maintain its independence and ability to attract highly professional staff, while adhering to the highest standards of corporate governance and transparency.
- Monitor the implementation of the new insolvency regulation and improve institutional capacity by training judges and insolvency administrators. Make out-of-court restructuring faster and more attractive.

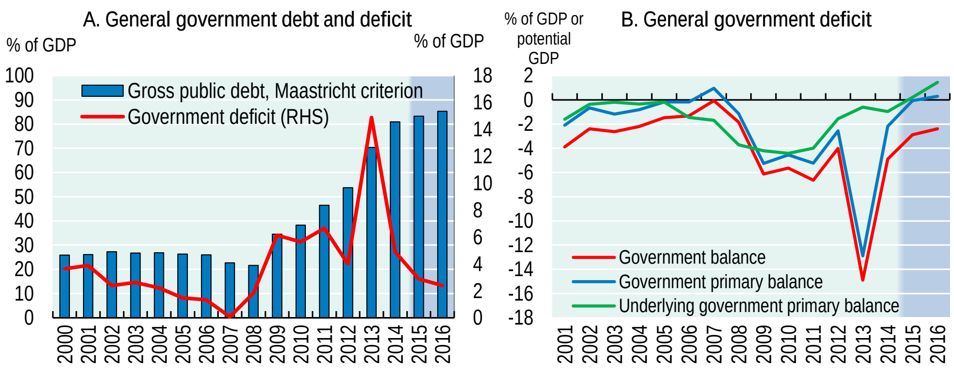
Other recommendations

- Privatise state-owned banks as planned, without retaining blocking minority shareholdings.
- In the context of the single supervisory mechanism framework, the bank supervisor should more closely monitor banks' adherence to regulations and guidance, and encourage banks to improve their risk management.

Ensuring sustainable public finances

The costs of the banking crisis, persistent deficits and the drop in output have strained public finances and led to a rapid rise in public debt from 22% of GDP in 2008 to over 80% of GDP in 2014 (Figure 10). Together with a period of high uncertainty about capital needs of the banking sector and political difficulties, this pushed sovereign yields close to 7% during 2013. Subsequent bank rescue and fiscal measures, coupled with lower risk perception in the euro area, brought the sovereign yield to below 2% (Figure 5, panel D), and the government has substantially prefinanced its 2015 and 2016 fiscal needs.

Figure 10. **The government pursues fiscal consolidation but public debt keeps rising**



Note: Data for years 2014-2016 represent OECD projections. The big shift in 2013 includes the cost of bank recapitalisation.

Source: OECD Economic outlook 96 database.

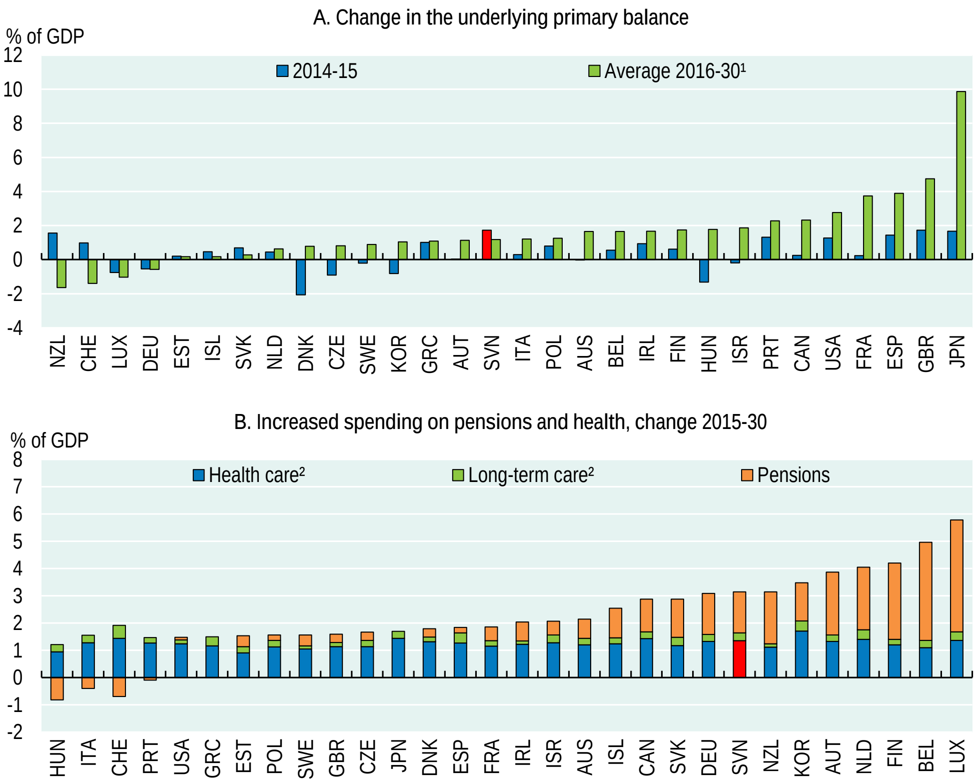
To contain the debt build-up the government has pursued fiscal consolidation since 2010. The measures have included cuts in public investment, consumption and subsidies, reduction in the public-sector wage bill, and a temporary freeze of pension indexation. The government also increased VAT and excise duties on alcohol, tobacco and fuel. The personal income tax was adjusted with elimination of the automatic indexation of tax brackets and tax allowances. The fight against the grey economy and tax evasion was stepped-up. Between end-2010 and end-2014 the fiscal effort in terms of the underlying government primary balance amounted on average to over 1 percentage points of GDP per year. In line with its commitments under the EU Excessive Deficit Procedure, the government aims to bring the deficit to below 3% of GDP by end-2015. The plan is to reach a roughly balanced budget by the end of 2019.

The path has not been easy. The deficit at the end of 2014 at 4.9% of GDP was larger than planned despite better than forecast economic growth. The expenditures were higher due to higher spending on subsidies to some public expenditures and increased absorption of EU funds (IMF, 2015a). At the same time, the newly adopted real estate tax was repealed by the Constitutional Court, lowering revenue. The government aims to lower the headline deficit to 2.9% of GDP in 2015 by further cutting the public wage bill, more efficient public procurement and changes to the system of financing of municipalities. On the other hand, it plans a 30% year-on-year increase in investment spending to support growth. On the revenue side the government plans to raise taxes on financial services and insurance, to reverse the abolition of the bank balance sheet tax, increase CO_2 and energy efficiency levies, and gain savings from a further simplification of tax collection procedures.

Simulations by the OECD show that to stabilise public debt at 60% by 2030 Slovenia needs to consolidate on average 0.9 percentage points of GDP per year beyond 2015 (the difference between the projected underlying primary balance in 2015 and the average underlying primary balance to 2030), Figure 11, panel A. This, however is made challenging by a projected rise in age-related public expenditure by about 3.1 percentage points of GDP over the years 2015-2030 (OECD, 2014a), Figure 11, panel B. Despite the recent pension reform, the public expenditure on pensions is expected to increase by 6 percentage points of GDP between 2015 and 2050 (OECD, 2014b). This comes on top of already high levels of public expenditure in terms of GDP and the steeply rising trend in recent years (Figure 12).

With public debt high and prospect of it rising further, it is appropriate that the government aims at fiscal consolidation. Given the still weak economic recovery and the impact of automatic stabilisers, the chosen pace - not too abrupt - correctly balances consolidation and growth concerns. However, the government should set out more clearly a credible medium-term consolidation plan, and the quality of the measures should be improved. Policy decisions have relied too heavily on temporary measures instead of structural efforts to rein in public expenditure growth.

Figure 11. **Structural primary surpluses will be needed to stabilise debt while age-related expenditures will exert additional pressure**



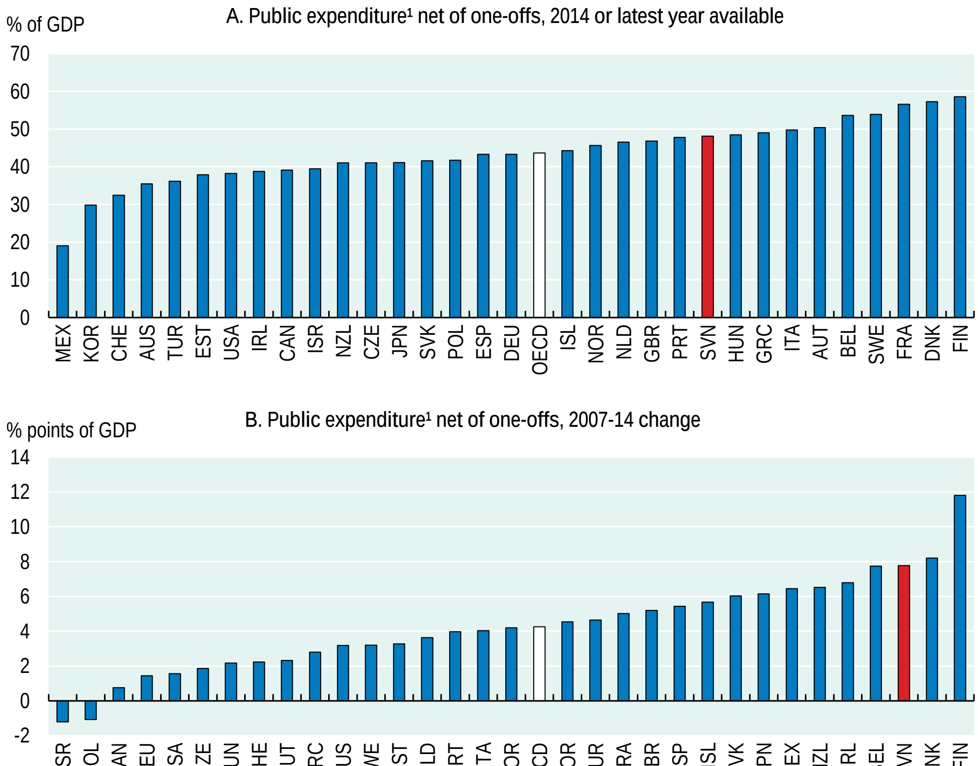
1. The average measure of consolidation is the difference between the underlying primary balance in 2015 and the average underlying primary balance between 2016 and 2030, except for those countries for which the debt target is only achieved after 2030, in which case the average is calculated up until the year that debt target is achieved.
2. Based on "Cost-containment scenario", (Oliveira Martins and de la Maisonneuve, 2014). Where projections are not available over the period 2015-30, linear interpolation has been applied.

Source: OECD calculations based on Economic Outlook no 96 projections.

Structural reform of public expenditure is key to reducing public debt

Restructuring welfare spending and better targeting social transfers - family, unemployment and disability - could go a long way in tackling the budget deficit and improving fiscal sustainability. Inactivity and unemployment traps are high in Slovenia. The combined effects of unemployment benefits, social assistance and other transfers, together with taxes, act as disincentives for the unemployed or the inactive to return to work (OECD, 2013a; Table 4). Reform could boost work incentives if, at low income levels, benefits could be withdrawn at a lower rate than the after-tax increase in earnings, to allow a more generous net increase in income. Furthermore, the progressivity of cash transfers is relatively low (Joumard et al., 2012; OECD, 2014c). With the 2012 reform, the eligibility of high-income earners for cash transfers was reduced, by taking into account all income and also property of individuals and families. Better means testing could further reduce the share of high-income earners eligible for support and boost fiscal savings.

Figure 12. **Public expenditure is high and rising**



1. Total general government expenditure corrected for exceptional net capital transfers and payments and other exceptional transfers.

Source: OECD Economic outlook 96 database.

Increasing efficiency of expenditures in education, public administration and local government can also increase sustainability of public finances (Hribernik and Kierzenkowski, 2013). In education, increasing pupil-teacher ratios and class sizes in primary and lower secondary education would lower cost and ensure a more effective use of staff. Employing better qualified teachers, with good working conditions, is more important for student performance than the number of teachers (Sutherland and Price, 2007; Hattie, 2009; OECD, 2009). The allocation of tertiary education services could also be better targeted, as it is currently very regressive, largely benefiting households at the top of the income distribution (OECD, 2013a). The number of municipalities in Slovenia has grown over the last 20 years, in contrast to pattern observed in most other OECD countries. Many municipalities are too small to provide public services efficiently and municipal mergers and financial incentives for inter-municipal co-operation should be a policy priority (OECD, 2011a). The revenue formula is more generous to smaller and less dense municipalities, and local revenues rely heavily on income tax. Hence, many small municipalities can survive as "bedroom communities" with revenue based on economic activities outside the local area. Changes to local finances could further reduce the incentives for fragmentation (OECD, 2011a).

Table 4. **Inactivity traps and unemployment traps are high in international comparison**

Average effective tax rate when moving from unemployment/inactivity into work, per cent, 2012

	Wage level (% of average worker)	Inactivity trap[1]			Unemployment trap[2]		
		Slovenia	other CEEC	OECD average	Slovenia	other CEEC	OECD average
One-earner married couple	67	65	55	63	88	62	70
	100	63	46	54	76	57	65
	150	56	43	48	65	51	59
Lone parent with two children	67	71	43	56	84	66	69
	100	63	48	55	78	68	68
	150	64	44	51	69	58	62
One-earner married couple with two children	67	81	57	66	88	59	69
	100	64	50	60	75	55	67
	150	65	46	54	66	50	61
Two-earner married couple with two children	67	45	35	35	93	68	70
	100	49	34	36	80	63	66
	150	48	33	37	68	55	60

Note: Participation tax rates measure the extent to which taxes and benefits reduce the financial gain of moving into work.

1 . Average effective tax rate when moving from inactivity into work for selected family types and earnings levels. The estimates here relate to the situation of a person who is not entitled to unemployment benefits (e.g. because the entitlements have expired). Instead, social assistance and other means-tested benefits are assumed to be available subject to relevant income conditions.

2. Average effective tax rate for a transition into full-time work for persons receiving unemployment benefits at the initial level, for selected family types and earnings levels (same in new job as in previous).

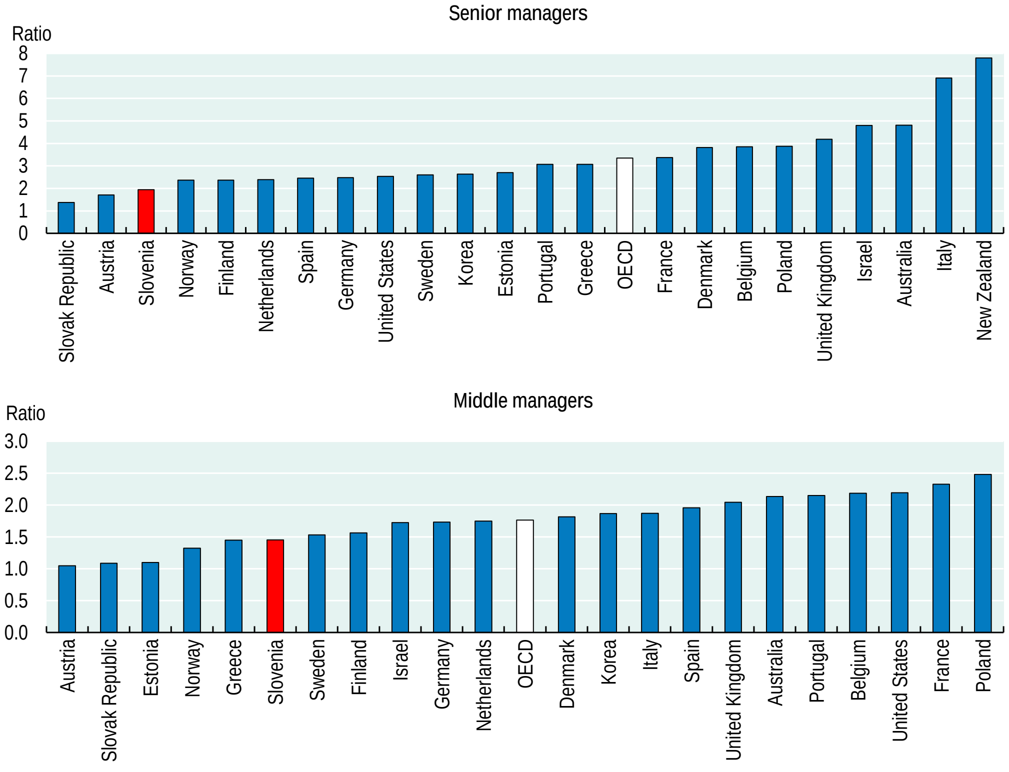
Source: OECD, Tax-Benefit Models.

There is also scope for improved efficiency in the public administration. Certain administrative units could be merged and the proliferation of agencies should be resisted. There is a lack of strategy in reducing public sector employment and the wage bill. Wage cuts were applied across the board, including in performance related pay. Yet, public sector salaries (Figure 13) and motivation of workers are already comparatively low. The authorities should reinstate performance-related pay as soon as possible, while strengthening performance assessment systems. Non-monetary incentives, such as training and options for a better work-life balance, could be used too. Furthermore, when cutting staff, reductions should be focused on inefficient programmes, and avoid aggravating shortages of certain skills and competences (OECD 2013b, 2012a and 2012b).

Weaknesses in the fiscal framework contributed to poor control over expenditure growth. The fiscal council set up in 2009 and the fiscal rule of 2010 have not effectively controlled spending. After some delays, the government in December 2014 adopted legislation to implement a Constitutional fiscal rule that requires a balanced budget over the medium term, but it still needs to be passed in parliament with a two-thirds majority. As spending growth has been hard to contain, Slovenia should adopt a credible and transparent expenditure rule (for example, a multi-year nominal expenditure ceiling) with well-defined escape clauses. Expenditure rules target the part of budget that the government controls most directly and tend to be less uncertain compared to cyclically-adjusted deficit rules, raising transparency and accountability. Successful examples - Denmark, Finland, the Netherlands and Sweden - show that expenditure rules can be effectively combined with a cyclically adjusted budget balance rules (Ayuso-i-Casals, 2012). Together with medium-term budgetary objectives based on a structural budget within the Stability and Growth Pact, the expenditure rule could provide a good basis for medium-term fiscal framework. Finally, the fiscal council should be charged with assessing both adherence to the rules and the rationale for the use of escape provisions (OECD, 2013a).

Figure 13. **Salaries in the public sector are low**

Average annual compensation of central government officials relative to compensation of tertiary-educated workers

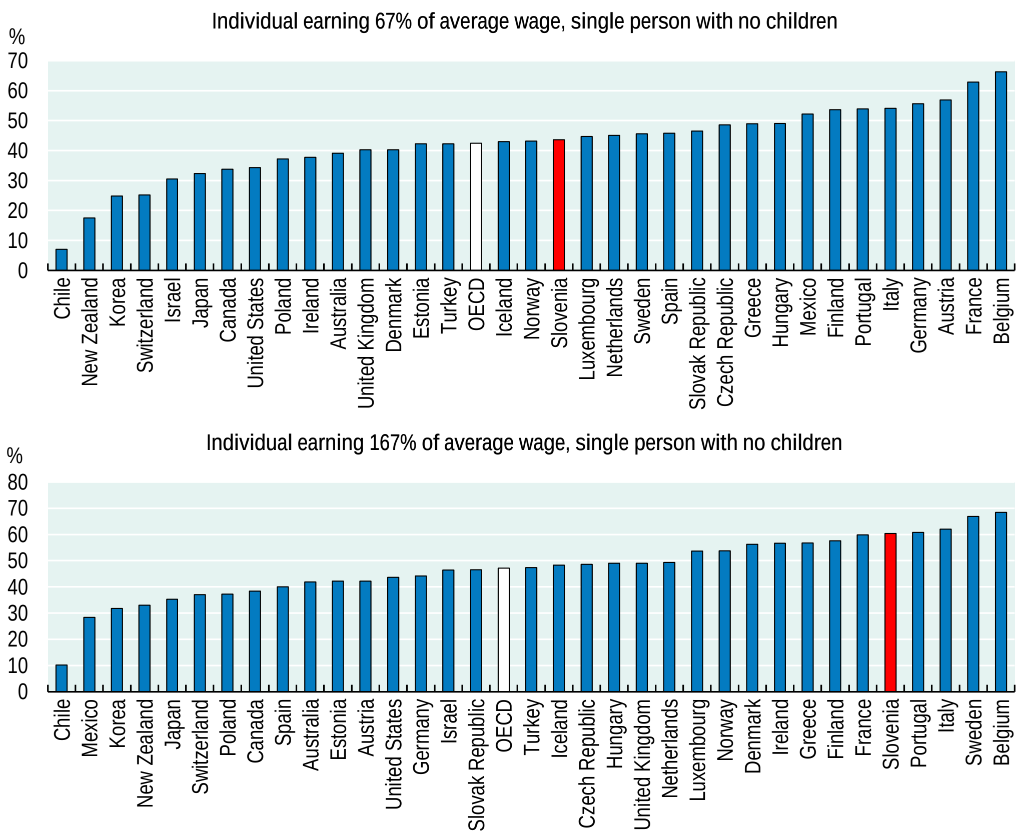


Source: Government at a Glance, 2013

Tax mix to better support growth

Taxes on labour are relatively high in Slovenia as a result of high social security contributions and progressive personal income tax, especially at the high end of the wage distribution (Figure 14). After introducing the additional 50% tax bracket for those earning more than 5 times the average wage, the marginal tax wedge for top earners stands at 66% (OECD, 2014d). This can have large costs in terms of work incentives, deter hiring and investment in skills, while bringing very little in terms of additional government revenue (OECD, 2011b; Guner et al., 2014). Better labour market outcomes could be achieved by reducing the top marginal personal income tax rate.

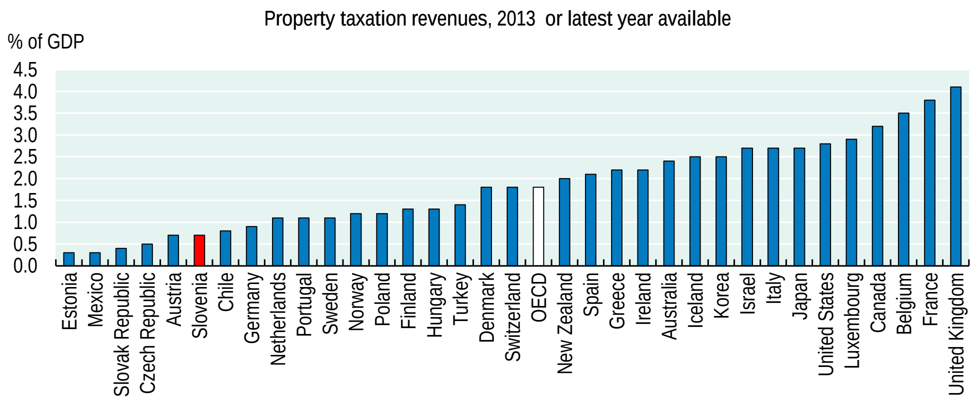
Figure 14. **Marginal tax wedge is high - % of total earnings, 2013**



Source: Public Sector, Taxation and Market Regulation database.

Revenues from taxes on property were only 0.7% of GDP in 2013, one third of the OECD average (Figure 15). Recurrent taxation of real estate is a key element of a tax system that supports inclusive and sustainable growth. This form of taxation has been found to have relatively limited negative effects on economic growth (Arnold et al., 2011). In fact, Slovenia enacted a Real Estate Tax Law in 2014, but this law was repealed by the Constitutional Court. Slovenian government plans to prepare an alternative property tax reform with the same policy objectives while satisfying legal requirements, which is a positive step.

Figure 15. **There is room to raise property taxes**



Source: Public Sector, Taxation and Market Regulation database.

Recommendations on fiscal sustainability

Key recommendations

- Focus fiscal consolidation on structural measures to increase cost efficiency in education, public administration and local government.
- Adopt a fiscal rule with a credible and transparent expenditure rule and ensure that an independent and effective fiscal council is charged with assessing adherence.

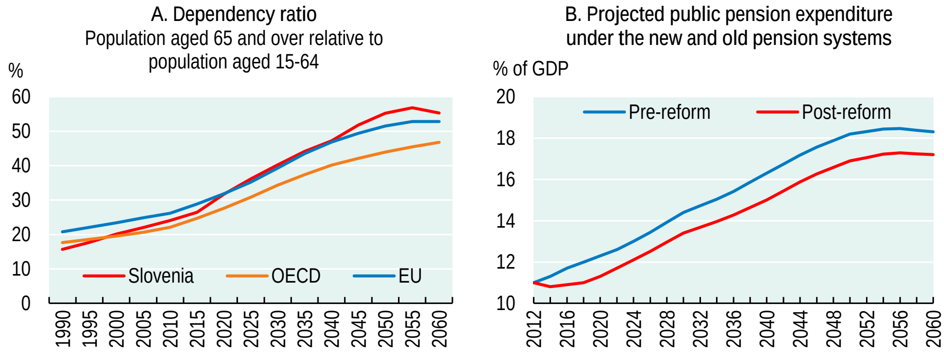
Other recommendations

- Restructure the combined effects of unemployment benefits, social assistance and taxes so that, at low income levels, benefits would be withdrawn at a lower rate than the after-tax increase in earnings, in order to increase work incentives for the unemployed and inactive persons.
- Reduce top tax rates on labour income. Better target family benefits and strengthen means testing of education-related benefits.
- Avoid across the board cuts in reducing the public sector wage bill. Reinstate the performance pay provisions and use non-monetary incentives for public sector workers. When cutting employment, reductions should avoid aggravating shortages of certain skills and competences.
- Increase recurrent taxes on real estate.

The economic consequences of population ageing

Slovenia is aging faster than many other OECD countries. The share of the elderly (aged 65 and above) is projected to increase from 17% in 2013 to 29% in 2060 (European Commission, 2014d), doubling the old-age dependency ratio (Figure 16, panel A). Policy makers will need to contain ageing-related outlays and pursue efficiency-enhancing reforms of social support systems and labour markets.

Figure 16. **Old-age dependency ratio and projected public pension expenditure**



Source: UN, World Population Prospects: The 2012 Revision for Panel A; and Majcen et al., 2012 for Panel B.

The pension system is not sustainable despite recent reforms

The new pension legislation, implemented in January 2013, strengthens the link between contributions paid and pensions received and equalises the statutory retirement age for men and women; for both it will be gradually raised to 65 years by 2020. Pensions are no longer fully indexed to gross salaries, but 60% to the increase in the average gross wage and 40% to inflation. The new measures have helped to slow the inflow of new applicants into the pension system, increase the average retirement age, and raise the share of retirees that have completed the full duration of the statutory working life (MDDSZ, 2014). These achievements, however, have to be seen in the context of a strong inflow into the pension system and related expenditure increases just before 2013 in anticipation of the reforms. In any case, the undertaken policy changes will only temporarily ease the spending pressure (Majcen et al., 2012), Figure 16, panel B. In more recent analysis, the European Commission's Ageing Working Group projects a less pronounced increase of pension expenditure in the long term (European Commission, 2015b), but confirms the near-term need for additional measures to contain expenditure growth.

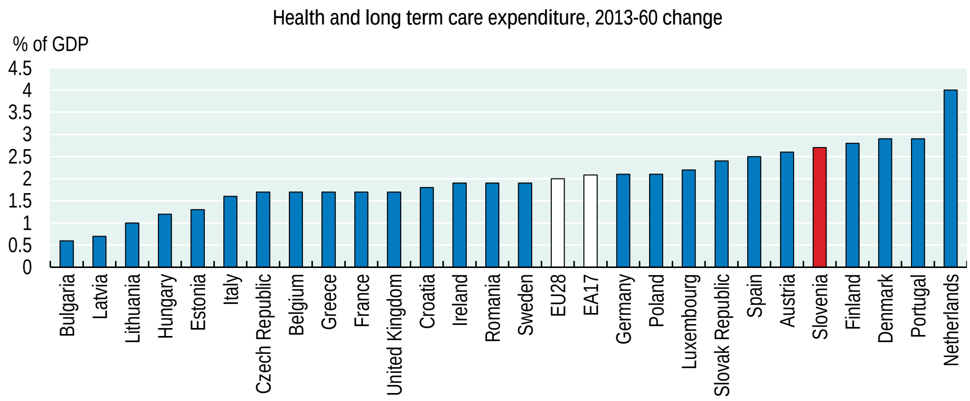
To ensure sustainability after 2020 and to take account of longer life expectancy, the effective retirement age will have to be further increased by adjusting upwards the minimum and statutory retirement ages. Also, there is a need to further tighten eligibility for early retirement and raise the minimum contribution period required to obtain a full pension. Indeed, about half of OECD countries have elements in their mandatory retirement-income provision that provide an automatic link between pensions and a change in life expectancy (OECD, 2011c).

The 2013 pension reform increased the number of years on which pensions are based from the best 18 to the best 24. However, the reform stopped short of adopting a system based on lifetime contributions, which would further increase sustainability of the system. Further, placing an even greater weight on prices in the indexation of pensions will make it possible to maintain the purchasing power of pensioners, while avoiding that labour productivity gains translate into higher pension expenditures. Countries such as France, Japan, Spain, the United Kingdom and the United States, take only price inflation into account when indexing pensions. One of the key challenges in this context is to balance fiscal sustainability and adequacy of pensions.

Expenditures on health and long-term care will grow strongly

Public outlays on health and long-term care in Slovenia are in line with the OECD average, but higher than in many countries with a similar level of GDP per capita. However, they are expected to grow strongly over the next 50 years as the population ages and life expectancy increases, as in many other countries. Under the European Commission's reference scenario, the total increase in health and long-term care expenditures would amount to 2.7 percentage points of GDP by 2060 (European Commission, 2015b, Figure 17).

Figure 17. **A big rise in health and long term care expenditures is projected in the future**



Source: European Commission 2015 Ageing Report.

Although somewhat improving, the health care system is in urgent need of reform, and the government is undertaking a thorough review of health expenditures. Rising costs and the economic downturn following the global financial crisis have resulted in the emergence of severe financial constraints. Some of the cost drivers are endemic to the system. Despite recent growth in the number of general practitioners, their share among all doctors is still low and the allocation of resources is skewed to more costly specialist care. A third of overall healthcare spending is on inpatient care, and more could be done to further develop ambulatory care (OECD, 2013a). The Commission for the Prevention of Corruption reports that the public procurement in the public health system is inefficient and susceptible to conflicts of interest. Slovenian health providers pay significantly higher prices for equipment and materials in comparison to their EU counterparts (CPC, 2014). In this context, the Insurance Institute of Slovenia has undertaken several cost-cutting initiatives, and the Ministry of Health has started to centralise the procedures for purchasing of drugs and pharmaceutical products. Finally, the government is undertaking a comprehensive review of health expenditure, scheduled for the first half of 2015. The findings of the review will serve as inputs into a comprehensive health sector reform, expected to be launched towards the end of 2015.

The health insurance system in Slovenia has a number of redistribution elements. There is no upper contribution threshold for the compulsory health insurance, so that high income employees pay much more into the insurance pool than would be actuarially needed to cover their health risks. Pensioners face a lower contribution rate than employees and despite higher contributions from the self-employed since the beginning of 2014, they contribute less than comparable wage earners. Moreover, the voluntary complementary insurance consists of a flat fee, which represents a heavy burden on low income individuals. Hence, contribution rates of different groups within society might need to be reviewed in order to reduce or avoid distortions in the system.

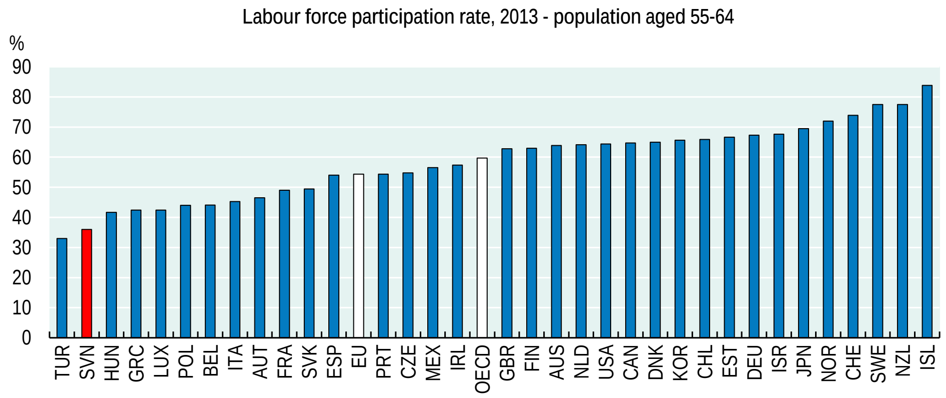
Another element in need of reform is voluntary complementary health insurance. It currently covers the full remaining part of the costs of most treatments that are not fully reimbursed by the compulsory health insurance. Hence, neither medical practitioners nor patients have an incentive to ensure that the treatments and drugs prescribed are effective and necessary. In this context, the authorities should reform the system to limit insurance cover to a basket of proven and effective drugs and services and let patients pay for any additional treatments they desire out-of-pocket or through private insurance.

The health care reform will also provide an occasion to put the financing and delivery of long-term care services on a more solid basis. Up to now, long-term care has been provided by the general health system and paid for out of resources from compulsory health insurance, pension insurance, and general tax revenues. Similarly, the regulations governing the sector are spread across several social security laws, and the oversight of long-term care activities is split between the Ministry of Labour and the Ministry of Health. A unifying framework is therefore missing. A dedicated source of funding for long-term care would be welcome to better monitor and control the expanding costs due to ageing. Moreover, long-term care is currently oriented too much towards costly institutional care. A move towards home care would generate savings, and at the same time would improve the quality of life of those under care. The government has already taken measures to further develop home care, and these should be extended and accelerated, and complemented by efforts to promote prevention and healthy ageing.

Increasing the labour market participation of older workers

Another challenge for policy makers is to raise the low labour force participation rate of workers aged 55-64 (Figure 18). The 2013 pension reform increases the statutory and minimum retirement ages and provides benefits in the form of higher pension pay-outs for continued work beyond the normal retirement age and penalties for early retirement. Yet, employers are often reluctant to hire or retain older workers. Besides being more expensive due to seniority-related pay structures, they are frequently considered as having low technological skills, being slow in processing information, and lacking openness to new ideas (European Commission, 2012a). Targeted training programmes and life-long learning could help older workers adapt to new tasks and technologies, and facilitate the migration of workers from arduous jobs to less exacting work after a certain age. Programs that encourage employers to make working conditions more accommodating for older workers open the door for longer working lives. Respective initiatives in other OECD countries include the sustainable employability programme in the Netherlands and the Centre for Senior Policy in Norway.

Figure 18. **The labour force participation rate of older workers is low**



Source*:* OECD Short-term labour market statistics database.

Recommendations to deal with the consequences of population ageing

Key recommendations

- Increase the statutory and minimum pension ages and link them explicitly to life expectancy. Calculate pension rights over lifetime contributions.
- Thoroughly reform the health sector to improve efficiency, including of organizational and governance structures and public procurement.

Other recommendations

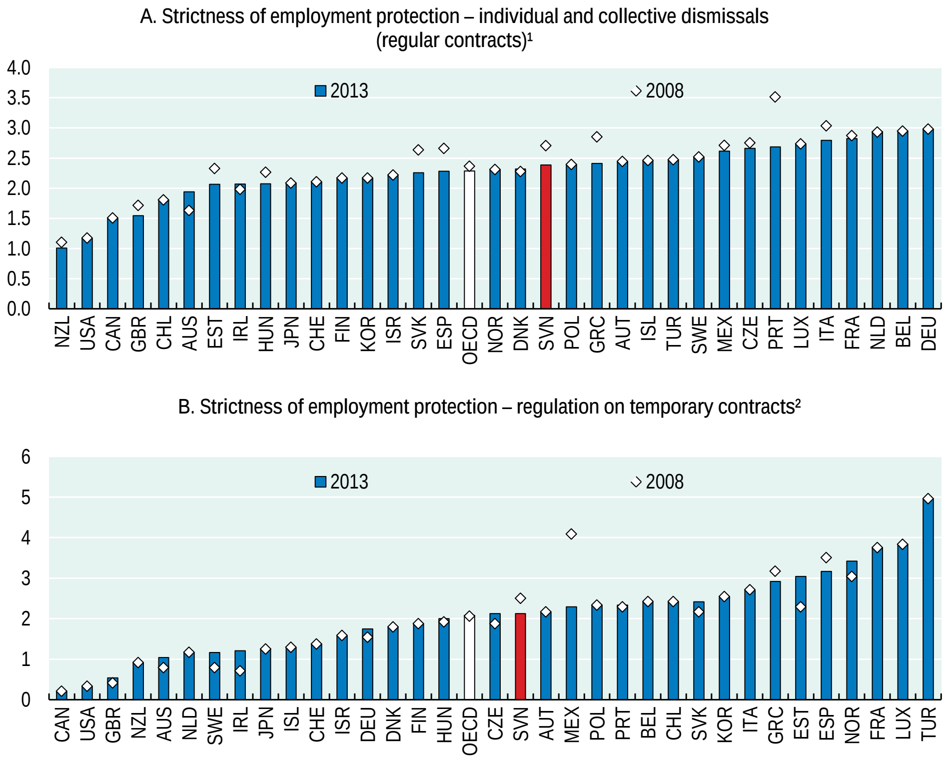
- Increase the weight of inflation, as opposed to wages, in the pension indexation rule.
- Equalize the contribution rates of different population groups to the compulsory health insurance and move coverage for health-critical services from the voluntary complementary insurance to the compulsory insurance system.
- Ensure transparent and sufficient funding for long-term care, based on contributions from the working-age population and pensioners.
- Develop home care by creating a level playing field with institutional care in the accessibility to health services, and by giving patients more freedom to organise their own care.
- Help older workers adapt to new tasks and technologies through life-long learning and targeted training programmes, and facilitate shifts of workers from strenuous jobs to less extorting work after a certain age.

Raising living standards and long-term growth by improving the business environment

Labour market policies for more jobs

The labour market has been reformed in recent years. The 2013 labour market reform reduced employment protection and reduced labour market duality between permanent and fixed-term contracts (Figure 19). The reform increased flexibility by simplifying hiring and firing, and lowered costs of permanent contracts. For fixed-term contracts it introduced redundancy payments and limited duration to two years. Bank of Slovenia (2014b) survey shows that only 14% of companies reported a change in their human resources policy due to the new legislation. Duality, however, may have indeed decreased as the share of permanent contracts among all new contracts is increasing (IMAD, 2014d). Another reform, from February 2015, phased out the preferential treatment of student work. This was another major factor behind labour market duality in Slovenia. The reform introduced healthcare and pension contributions for student work and a minimum hourly gross wage rate, increasing the cost of student work, but keeping its flexibility. Both reforms were important steps in the right direction.

Figure 19. **Employment protection was reduced in 2013**

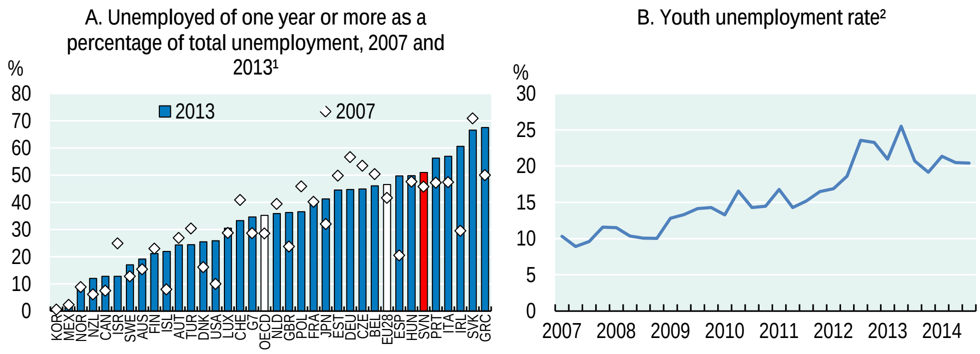


1. The OECD indicator of employment protection legislation (EPL) for regular employment measures the procedures and costs involved in dismissing individual regular employees. The indicator runs from 0 to 6, representing the least to most restrictive EPL.
2. The OECD indicator of regulation on temporary contract (EPT) measures the restrictions on the use of temporary employment by firms, with respect to the type of work for which these contracts are allowed and their duration.

Source: OECD Employment Protection Database, 2013 update.

More than 50% of the unemployed in Slovenia have been out of work for a year or more and youth unemployment has increased steeply, to about 20% in 2014 (Figure 20). Only 0.3% of GDP was spent on active labour market programmes (ALMPs) in 2012, half the amount spent on average across the OECD (Figure 21). The resources currently devoted to training and job search services should therefore be increased to enhance placement prospects for the unemployed upon comprehensive evaluation of existing programmes. To maximise the effect, given restricted fiscal space, active labour market programmes should also be better targeted on the long-term unemployed and the low-skilled. Currently, less than half of the unemployed participate in ALMPs. All unemployed should therefore be encouraged to participate in job counselling and activation programmes, by increasing awareness and specifically targeting those groups that do not participate.

Figure 20. **Long-term unemployment is high and youth unemployment has risen**



1. Countries are shown in ascending order of the incidence of long-term unemployment in 2013. Data are not seasonally adjusted but smoothed using three-quarter moving averages. OECD is the weighted average of 33 OECD countries excluding Chile.
2. Data are seasonally adjusted and refer to the unemployment rate of individuals aged 15-24.

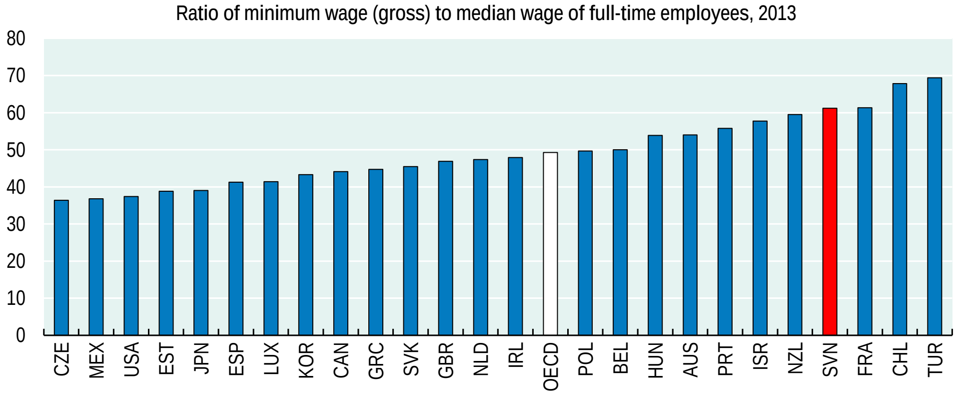
Source: OECD calculations based on quarterly national labour force surveys, for Panel A; and OECD Short-Term Labour Market Statistics database, for Panel B.

Figure 21. **Slovenia spends less on active labour market programmes than most other countries**

Source: OECD Social Expenditure database.

The high minimum wage relative to the median wage (Figure 22) potentially reduces employment prospects of low-skilled workers. The Law on Minimum Wage stipulates that minimum wage should be increased by at least the inflation rate each year, but cites other benchmarks for adjustment, such as wage trends, economic growth and employment trends. Evidence shows that earned income tax credits, rather than minimum wage increases, have been successful in supporting the incomes and employment of lower-income families in the USA (Eissa and Hoynes, 2006; Clemens and Wither, 2014). Going forward, minimum wage growth should be moderated, with a view to restoring the link to productivity and boosting employment opportunities. Incomes of low-skilled workers can be better protected through social transfers and tax measures that incentivise employment.

Figure 22. **Slovenia is one of the countries with the highest minimum wage relative to the median**



Source: OECD Minimum Wage database.

Recommendations on the labour market

Key recommendations

- Increase resources for active labour market policies and better target assistance to the long-term unemployed and the low-skilled, based on evaluation of individual programmes.

Other recommendations

- Moderate growth in the minimum wage, with a view to restoring the link to productivity and gradually increasing the gap between the minimum and median wage.

Making product market regulation less restrictive

Slovenia's overall regulatory framework is among the most restrictive in the OECD, as indicated by the OECD product market regulation (PMR) indicator (Figure 23, panel A). Slovenia's PMR score has improved since 2008, but remains worse than in most Central and Eastern European countries (CEEC) and euro area countries. This underperformance stems largely from the pervasive state involvement in the economy, but there is also room to reduce the complexity of regulatory procedures and administrative burdens on start-ups (Figure 23, panel B).

There has been improvement in some areas. The number of regulated professions has decreased from 323 to 242 (European Commission, 2015a) and the number of days required to open up a business was shortened. According to the PMR survey, Slovenia has set up single contact points for information on opening up a business, but these do not issue or accept all notifications and licenses, and are not sufficiently established at the local level. Furthermore, Slovenia could introduce the 'silence is consent' rule for issuing licences required to open up a business, as they have been successfully implemented in Portugal and the Slovak Republic. Dealing with construction permits and registering property still takes a lot of time. According to the Doing Business Survey (World Bank, 2015) it takes 109.5 days in Slovenia to register a property compared to one day in Portugal and New Zealand. Obtaining construction permits in Slovenia takes 212.5 days, more than three times the time in Finland or Denmark.

Slovenia should also further ease regulation of such professional services such as accounting, legal, engineering and architecture services (Figure 23, panel C). Regulation of professional services is strict in many European countries, although successful examples like Sweden, Denmark, Finland, Norway and Switzerland show that reduced regulation can increase competition and the quality of professional services. Education requirements to enter a profession are excessively high in Slovenia. According to the PMR survey, in the four professions, a university degree, in many cases another specialised degree, and a compulsory practice lasting up to 5 years are required to become a full member of the profession. Each profession also requires compulsory membership in a chamber of the profession.

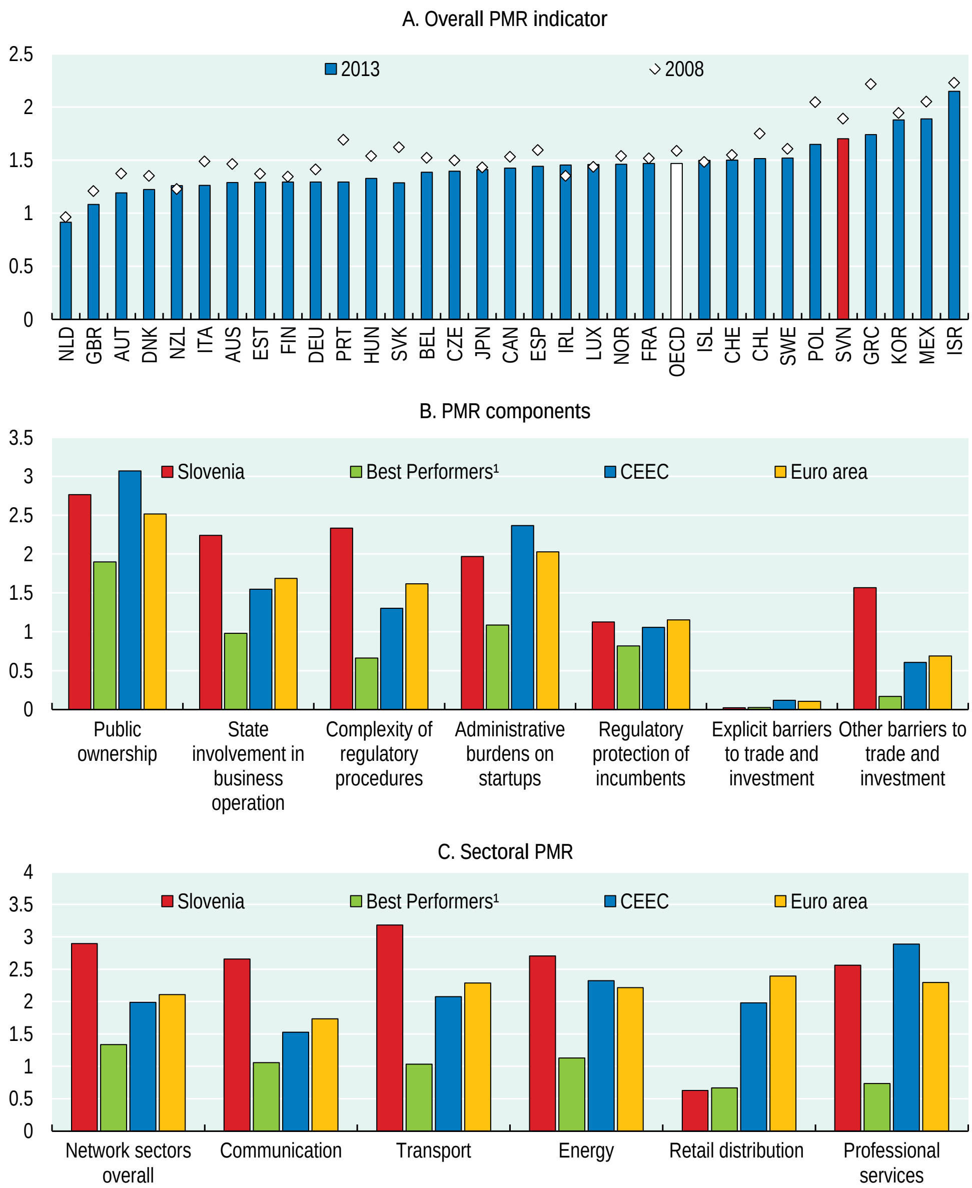
Rationalising public ownership

Public ownership and control of enterprises is widespread (Figure 23, panel B) and enterprises owned (or indirectly controlled) by the state are most dominant in network industries, but are also common in banking, insurance and even manufacturing. Rojec (2014) estimates that enterprises directly or indirectly owned by the state (higher than 50% equity share) account for 18% of the corporate sector's total assets and 23% of total equity. The profitability and productivity of state-owned enterprises (SOEs) is lower than of privately and foreign-owned companies operating in same sectors (Rojec, 2014; European Commission, 2015a and 2014b). SOEs also pose risks to public finances via potential recapitalisation needs and as receivers of a major share of state guarantees (Georgieva and Riquelme, 2013). In 2013, the parliament approved a list of 15 SOEs to be privatised, including one state-owned bank and a major telecom provider. By early 2015 five companies had been privatised and six are in the process. The government should continue with privatisations.

For the SOEs that remain under state ownership, it is important to set up a solid asset management framework to enhance performance. In April 2014, the new Slovenian Sovereign Holding (SSH) became fully operational and its capacity to manage and dispose of state-owned assets was strengthened (OECD, 2014d). The role of the SSH is to consolidate and manage all state assets under one structure, and to execute privatisation of some of these assets. Among the important next steps will be the appointment of professional and independent SSH board members. The remaining SOEs must be held to high standards of disclosure and transparency (OECD, 2014d). When setting up its own corporate governance framework for SOEs the SSH should closely follow the OECD Guidelines on Corporate Governance of SOEs (OECD, 2005).

Another priority is to develop an asset management strategy. According to the SSH law, assets are to be classified into three types: strategic, important and portfolio assets. The minimum share in strategic assets is 50% plus one vote, in important assets 25% plus one vote, while the SSH is permitted to freely dispose of portfolio assets. The government has yet to agree on an asset management strategy, which will eventually have to be confirmed by the parliament. It is critical that the strategy provide a rigorous rationale for why assets should be owned by the state at all, rather than privatised. SOEs that are in direct competition with the private sector deserve especially strict scrutiny in this regard (OECD, 2011d).

Figure 23. **Product market regulation is overly strict**



Note: The numerical PMR indicators represent the stringency of regulatory policy in specific areas on a scale of 0 to 6 with a higher number indicating a policy stance that is deemed less conducive to competition. In each case, it characterises the stance of regulation as it stood in early 2013 and does not reflect the reforms implemented since then.

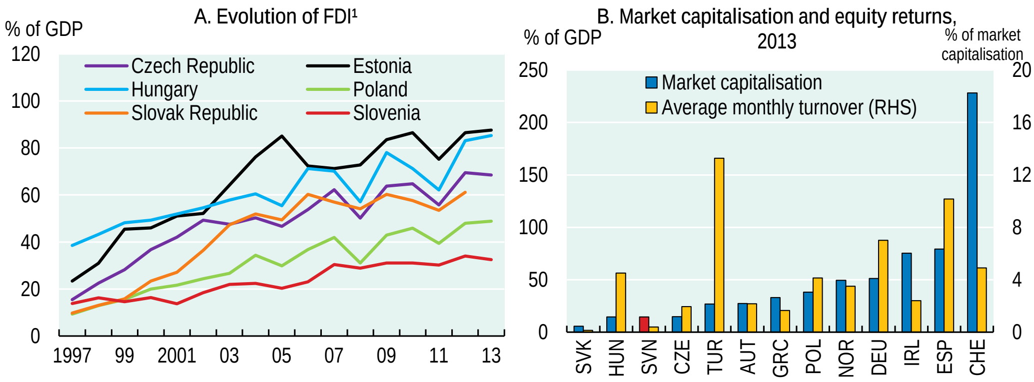
1. The simple average of the five countries with the lowest values of each indicator is shown.

Source: OECD PMR indicators database.

Less public ownership and deeper capital markets would attract more FDI

A large body of empirical evidence shows that FDI is good for growth and productivity and that companies with FDI perform better when compared to domestically owned ones (Simoneti et al., 2002; Bijsterbosch and Kolasa, 2009; Damijan, Rojec, Majcen and Knell, 2013; Dall'Orso and Sila, 2015). In the last 15 years the growth of inward FDI stock has been much slower in Slovenia than in other new EU members (Figure 24). Inward stock of FDI is just above 30% of GDP, less than half the share in Estonia, Hungary or the Czech Republic. The reason for such low FDI, despite the efforts of government to create a friendly regulatory and tax environment, lies in pervasive state ownership and political unwillingness to undertake privatisations. At a time when the deleveraging process in the corporate sector is dragging down investment and activity, Slovenia has the opportunity to open up more to FDI to bring in needed fresh capital.

Figure 24. **FDI has remained low**



1. Inward position at year end.

Source: OECD FDI series of BOP and IIP aggregates database for panel A; and Federation of European Securities Exchanges for Panel B.

Recommendations on product market regulation and business environment

Key recommendations

- Continue privatising state-owned enterprises and do not hold controlling interests in firms operating in competitive markets.
- Introduce the 'silence is consent' rule for issuing licences required to open up a business and make obtaining construction permits and registering property faster.

Other recommendations

- Prepare an asset management strategy for assets in public ownership and strengthen the corporate governance of SOEs by appointing professional board members.
- Reduce entry barriers in professional services (accounting, legal, engineering and architecture).

Boosting innovation and R&D

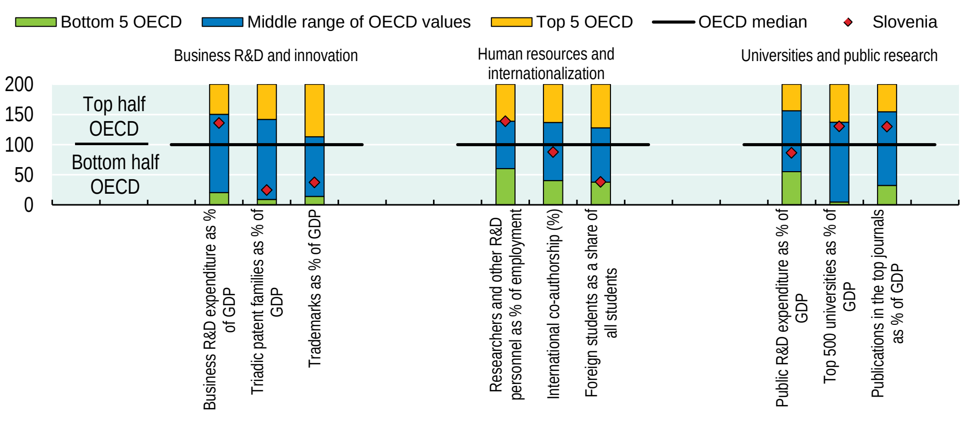
In terms of expenditure and human resources in science and technology Slovenia performs above the OECD average, but there is a low number of innovative firms, patents and trademarks (Figure 25). As argued in the *2011 Economic Survey of*

Slovenia, the disappointing innovation outcomes can be linked to the lack of entrepreneurial dynamism, general barriers to doing business and the overly complex national innovation policy. The Research and Innovation Strategy of Slovenia 2011-20 (RISS) and the National Higher Education Programme 2011-20 (NHEP) propose measures towards a unifying innovation policy (OECD, 2014e). The lack of planning, implementation and coordination in national innovation policy nevertheless hold back innovation. The current public research system is marked by administrative dispersion and rivalry among various stakeholders, and a consequent overlapping of innovation efforts. Frequent changes in policy measures and instruments have rendered new policy initiatives less credible. The collaborative links between major stakeholders of innovation policy must therefore be upgraded and streamlined (OECD, 2011d and 2012d).

In recent years the public R&D system and associated business support centres were made more responsive to the R&D demands of the business community. The authorities introduced a research voucher system, grants, tax incentives and various instruments to facilitate financing. Centres of excellence, competence centres and development centres that stimulate collaboration of public research with the business sector were also established (OECD, 2012c, 2012d). Public research has delivered some impressive results in terms of scientific output (Figure 25). Nevertheless, to facilitate further improvements, the governance of public research should be reformed so that universities and public research organisations are given more autonomy, while their accountability and performance should also be enhanced. International co-operation should be promoted further by expanding university programmes in foreign languages, opening up research programmes to foreign participation and opening the academic labour market internationally (OECD, 2012c, 2012d).

Figure 25. **Slovenia does well in terms of inputs into innovation process, but innovative activity is low**

Comparative performance of national science and innovation systems, 2014



Note: Normalised index of performance relative to the median values in the OECD area (Index median = 100)

Source: based on OECD Science, Technology and Industry Outlook 2014 and OECD, Main Science and Technology Indicators (MSTI) Database, June 2014; USPTO Bulk Downloads: Trademark Application Text hosted by Reed Technology Information Services, OHIM Community Trademark Database CTM Download, JPO Annual Reports 2001-2013 and Graham, S., G. Hancock, A. Marco A. and Myers (2013), "The USPTO Trademark Case Files Dataset: Descriptions, Lessons, and Insights", SSRN Working Paper, http://ssrn.com/abstract=2188621; Elsevier B.V. (2014), Elsevier Research Intelligence (Scopus – Elsevier); OECD Education database; and Academic Ranking of World Universities (ARWU) (2013), "Shanghai ranking", www.shanghairanking.com.

Recommendations on innovation and R&D

Key recommendation

- Implement the government's unified innovation policy and monitor its progress. Improve collaborative links between major stakeholders of innovation policy.

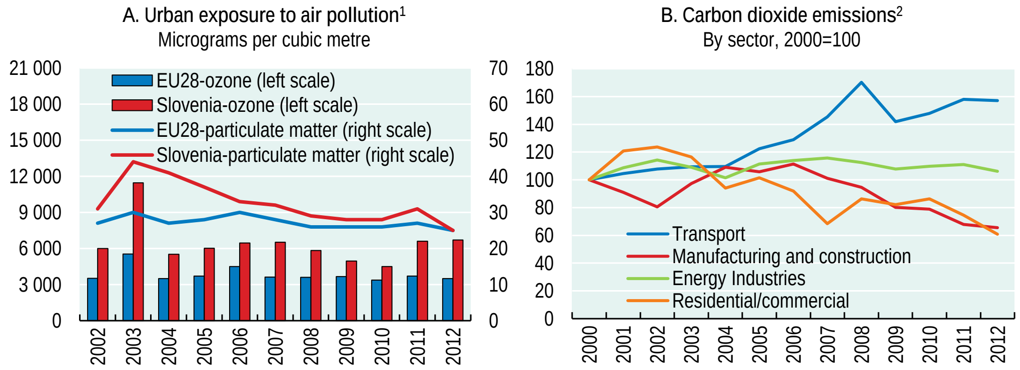
Other recommendation

- Facilitate reform in universities and public research organisations, enhancing their autonomy, leadership and accountability. Further promote international co-operation.

Greening the economy

Transport sector is the most important contributor to air pollution, as measured by carbon dioxide emissions. Due to major investment in road construction in recent years, the transport system is locked into a highly carbon-intensive pattern, made worse by a high rate of international transit road traffic (OECD, 2014d). Together with wood-burning stoves for heating, this transportation pattern contributed to the emergence of air pollution hot-spots in some urban centres (Figure 26, panel A) and steep increases in carbon dioxide emissions (Figure 26, panel B). The share of emissions from road transport is much higher than its share in passengers and freight transport, and there is therefore potential to reduce emissions by improving and extending the railway system. The government plans to increase investments in railways using public private partnerships, but there are delays due to the slow design of projects and lengthy procedures to obtain various permits (OECD, 2012e).

Figure 26. **Air pollution indicators**



1. Population weighted data. For ozone (O3) this covers the yearly sum of maximum daily 8-hour mean ozone concentrations above a threshold; for particulate matter (PM10), it covers annual mean concentrations at background stations in agglomerations.
2. Excludes international marine and aviation bunkers; sectorial approach.

Source: CO2 Emissions from Fuel Combustion OECD database. Emissions of greenhouse gases and air pollutants Eurostat database.

Revenues from environmental taxes amounted to 3.9% of GDP in 2013, one of the highest ratios among OECD countries (OECD Environment Database), which partly reflects high fuel consumption associated with transit traffic (OECD, 2013c). However, effective tax rates vary across different forms of energy. Tax rates on transport fuel are significantly higher than those on heating and process use and on electricity; and those on diesel are about 20% below those on gasoline in terms of carbon dioxide (CO_2) emissions (OECD, 2013c; Ministry of Finance). The differential between diesel and gasoline has been reduced recently due to reduced differential in excise duties on the two fuels. In addition, effective from January 2015, there was an increase in tax rate on CO_2 emissions by 20% per each kg of CO_2 for all energy products. Slovenia could improve the environmental effectiveness of these taxes by linking them further to emissions. It should also remove exemptions in the case of commercial use of diesel fuel and increase taxes on heavy fuel oil and gas oil used for heating.

Recommendations on the environment

- Upgrade the railway system and improve efficiency of railways, especially in the freight sector.
- Further align effective tax rates on different forms of energy to reflect environmental damage.

Bibliography

Arnold, J., B. Brys, C. Heady, Å. Johansson, C. Schwellnus and L. Vartia (2011), “Tax Policy for Economic Recovery and Growth”, *The Economic Journal*, Vol. 121, No. 550.

Ayuso-i-Casals, J. (2012), National Expenditure Rules: Why, How and When, European Economy, Economic Papers 473, December 2012.

Bijsterbosch, M. and M. Kolasa (2009), “FDI and Productivity Convergence in Central and Eastern Europe: An Industry-Level Investigation”, Working Paper Series, No. 992, European Central Bank, Frankfurt am Main.

BAMC (2014), Annual Report 2013, Bank Assets Management Company.

Bank of Slovenia (2014a), Policy Strategy Paper for Slovenia, Ljubljana, 17 July 2014.

Bank of Slovenia (2014b), Macroeconomic Developments and Projections, October.

Bank of Slovenia (2014c), Financial Stability Review, May 2014.

Bank of Slovenia (2013), Report on comprehensive review of the banking system and associated measures. Press Release, 12 December 2013.

CPC (2014), Annual Report 2013, Commission for the Prevention of Corruption (in Slovenian).

CPC (2013), State of Corruption in Slovenia, 2013, Commission for the Prevention of Corruption (in Slovenian), https://www.kpk-rs.si/upload/t_datoteke/Ocena_stanja_korupcije_v_RS.pdf

Clemens, J and M Wither (2014), “The Minimum Wage and the Great Recession: Evidence of Effects on the Employment and Income Trajectories of Low-Skilled Workers”, National Bureau of Economic Research, Working Paper 20724.

Dall’Orso, J. and Sila, U. (2015), “Trends in productivity and Sources of productivity growth in Slovenia”, *OECD Economics Department Working Papers*, OECD Publishing, forthcoming.

Damijan, J.P. (2014), “Corporate financial soundness and its impact on firm performance: Implications for corporate debt restructuring in Slovenia”, European Bank for Reconstruction and Development, Working paper No. 168.

Damijan, J.P., M. Rojec, B. Majcen and M. Knell (2013), “Impact of firm heterogeneity on direct and spillover effects of FDI: Micro-evidence from ten transition countries” Journal of Comparative Economics, Vol 41 (3), Pages 895-922.

ECB (2014), Aggregate report on the comprehensive assessment, October 2014.

Eissa, N and H W Hoynes (2006), "Behavioral Responses to Taxes: Lessons from the EITC and Labour Supply", in *Tax Policy and the Economy*, Volume 20:73–110.

European Commission (2015a), Commission staff working document: Country Report Slovenia 2015. Brussels, 26.5.2015.

European Commission (2015b), The 2015 Ageing Report. Economic and Budgetary Projections for the EU28 Member States (2013-2060).

European Commission (2014a), Slovenia: Review of progress on policy measures relevant for the correction of macroeconomic imbalances, November 2014.

European Commission (2014b), Macroeconomic Imbalances, Slovenia 2014. Occasional Papers 187, March 2014.

European Commission (2014c), Commission staff working document: Assessment of the 2014 national reform programme and stability programme for Slovenia.

European Commission (2014d), The 2015 Ageing Report. Underlying Assumptions and Projection Methodologies, European Economy, No. 8.

European Commission (2012), "Active Ageing", Special Eurobarometer 378.

Georgieva, S. and Riquelme, D. M. (2013) "Slovenia: State-Owned and State-Controlled Enterprises", ECFIN Country Focus, Volume 10, issue 3.

Guner, N., Lopez-Daneri, M. and Ventura, G. (2014), "Heterogeneity and Government Revenues: Higher Taxes at the Top?", IZA Discussion Paper No. 8335, July 2014.

Hattie, J. (2009), Visile Learning; A synthesis of over 800 meta-analyses relating to achievement, Routledge, London.

Hribernik, M. and Kierzenkowski, R. (2013), "Assessing the Efficiency of Welfare Spending in Slovenia with Data Envelopment Analysis", *OECD Economics Department Working Papers*, No. 1058.

IMAD (2014a), Slovenian economic mirror, December 2014, no. 12, Vol. XX.

IMAD (2014b), Autumn forecast of economic trends 2014.

IMAD (2014c), Indebtedness and deleveraging of Slovenian firms, Economic Issues 2014.

IMAD (2014d), Economic Issues 2014, August, Institute of Macroeconomic Analysis and Development, Ljubljana.

IMF (2015a), Republic of Slovenia: 2014 Article IV consultation, IMF Country Report No. 15/41, February 2015.

IMF (2015b), Legal and institutional challenges in corporate insolvency. Republic of Slovenia: Selected Issues, IMF Country Report No. 15/42, February 2015.

IMF (2014), Republic of Slovenia: 2013 Article IV consultation, IMF Country Report No. 14/11.

Joumard, I., M. Pisu and D. Bloch (2012), "Less Income Inequality and More Growth – Are They Compatible? Part 3. Income Redistribution via Taxes and Transfers Across OECD Countries", OECD Economics Department Working Papers, No. 926, OECD Publishing.

Klingebiel, D. (2000) "The Use of Asset Management Companies in the Resolution of Banking Crises", *World Bank Policy Research Working Papers*, No. 2284, World Bank.

Laeven, L. and Valencia, F. (2008), Systemic banking crises: A new database. IMF Working Paper No. 08/224.

Majcen B, M. Čok, J. Sambt, T. Turk, N. Stropnik, G. Dekkers, V. Prevolnik Rupel, V. Lavrac, N. Kump, M. Ogorevc (2012), "Izgradnja kombiniranega mikrosimulacijskega modela in modela generacijskih računov, Inštitut za ekonomska raziskovanja," Ljubljana.

MDDSZ (2014), "Učinki Pokojninske Reforme in Nadaljnji Koraki," Ministry of Labour, Family, Social Affairs and Equal Opportunities, Ljubljana.

OECD (2014a), "Growth Prospects and Fiscal Requirements Over the Long Term", in OECD, *OECD Economic Outlook, Volume 2014 Issue 1*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/eco_outlook-v2014-1-44-en.

OECD (2014b), *OECD Pensions Outlook 2014*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264222687-en.

OECD (2014c), "The crisis and its aftermath: A stress test for societies and for social policies", in OECD, *Society at a Glance 2014: OECD Social Indicators*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/soc_glance-2014-5-en

OECD (2014d), *Slovenia: Reforms for a Strong and Sustainable Recovery*, Better Policies, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264215894-en

OECD (2014e), *OECD Science, Technology and Industry Outlook 2014*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/sti_outlook-2014-en.

OECD (2013a), *OECD Economic Surveys: Slovenia 2013*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/eco_surveys-svn-2013-en

OECD (2013b), *Government at a Glance 2013*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/gov_glance-2013-en.

OECD (2013c), *Taxing Energy Use: A Graphical Analysis*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264183933-en.

OECD (2012a), *Slovenia: Towards a Strategic and Efficient State*, OECD Public Governance Reviews, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264173262-en

OECD (2012b), *The Public Sector Salary System in Slovenia*, OECD Public Governance Reviews, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264167551-en.

OECD (2012c), *OECD Science, Technology and Industry Outlook 2012*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/sti_outlook-2012-en

OECD (2012d), *OECD Reviews of Innovation Policy: Slovenia 2012*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264167407-en

OECD (2012e), *OECD Environmental Performance Reviews: Slovenia 2012*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264169265-en

OECD (2011a), *OECD Territorial Reviews: Slovenia 2011*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264120587-en

OECD (2011b), *Taxation and Employment*, OECD Tax Policy Studies, No. 21, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264120808-en.

OECD (2011c), *Pensions at a Glance 2011: Retirement-income Systems in OECD and G20 Countries*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/pension_glance-2011-en

OECD (2011d), *OECD Economic Surveys: Slovenia 2011*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/eco_surveys-svn-2011-en

OECD (2009), *Creating Effective Teaching and Learning Environments: First Results from TALIS*, TALIS, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264068780-en

OECD (2005), "OECD Guidelines on Corporate Governance of State-owned Enterprises", in OECD, *Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries*, OECD Publishing, Paris. DOI: http://dx.doi.org/10.1787/9789264009431-10-en

Oliveira Martins, J. and de la Maisonneuve, C. (2014), "The Future of Health and Long-Term Care Spending", OECD Journal: Economic Studies, OECD Publishing.

Rojec, M., (2014) "A snapshot of the main ownership features of the Slovenian corporate sector, IB Revija 1/2014.

Simoneti, M., M. Rojec and M. Rems (2002), "Ownership Structure and Post-Privatisation Performance and Restructuring of the Slovenian Non-Financial Corporate Sector", Journal of East-West Business, Vol. 7, No. 2, Routledge.

Sutherland, D. and R. Price (2007), "Linkages Between Performance and Institutions in the Primary and Secondary Education Sector", OECD Economics Department Working Papers, No. 558.

Woo, D. (2000), Two Approaches to Resolving Nonperforming Assets During Financial Crises, IMF Working Paper No. 00/33.

World Bank (2015), Doing Business Survey 2015.

Thematic Chapters

Chapter 1

Raising competitiveness and long-term growth of the Slovenian economy

The rapid growth after independence stopped in 2008 as the global crisis exposed important structural weaknesses. Large state involvement and rigid labour and product markets lowered productivity. Weak corporate governance and easy credit before the crisis led to high indebtedness and overinvestment. Slovenia was slow to deal with the underlying structural problems. Gradually, important reforms have been implemented which raised credibility of Slovenia in the financial markets and boosted confidence. But economic recovery has been sluggish, many people are unemployed and living standards still remain below the pre-crisis levels. Cost competitiveness and export market performance deteriorated, and there have been marked improvements only recently. Better corporate governance and management practices in the state owned sector and privatisations can attract FDI and raise efficiency. Low innovative activity could be boosted by more FDI, stronger framework for entrepreneurial activity and better start-up support. Relatively high minimum wage is potentially reducing employment opportunities of low-skilled workers. Limiting the minimum wage growth, and lowering the high tax wedge on labour income could boost employment. Efficiency should be raised in early and tertiary education to enhance skills. Despite generous public support, overall students' performance could be improved and there are marked differences between students from different socioeconomic backgrounds.

Chapter 2

The economic consequences of an ageing population in Slovenia

Slovenia's population is set to age rapidly in the coming decades. This demographic trend will increasingly put pressure on already fragile public finances as age related expenditure is projected to rise by 3 percentage points of GDP by the year 2030. Ensuring debt sustainability and generational equity requires reforms of social support systems and necessitates adjustments in labour markets. Policy makers will thus need to act more strongly than in the past to rein in ageing related outlays, pursue efficiency-enhancing restructurings of health and long-term care systems, and adopt measures to strengthen labour force participation. In particular, further increases in the relatively low pension age in line with the rise in life expectancy would reduce pension costs and the burden on the active population. Better utilisation of medical resources and coordinated purchasing of medical supplies would curb health care expenditure, while a dedicated funding mechanism for long-term care would enhance the sustainability of the system. Moreover, removing incentives for early retirement in combination with active labour market policies would increase the labour force participation rates of older workers from its currently very low levels.

Chapter 3

Restoring the financial sector and corporate deleveraging

Excessive credit growth, poor risk assessment and lax lending standards in the run up to the 2008 global crisis led to unsustainable debt build-up in banks and related corporates. A weak framework for the governance of largely state-owned banks is likely to have contributed to the misallocation of credit. Furthermore, there were weaknesses in the banks' risk management systems and banks often didn't properly adhere to regulations and guidance given by the supervisor. Following the results of the stress tests and the Asset Quality Review, in December 2013, the major state-owned banks were recapitalised at a cost of around 11% of GDP, and part of their non-performing loans (NPLs) transferred to the Bank Asset Management Company (BAMC). Banks nevertheless remain weak, with still high NPLs, and corporations are highly leveraged. For successful restructuring and liquidation of assets, BAMC needs to act independently, transparently, with corporate governance of highest standards. Privatisation can improve corporate governance and closer supervision can ensure better compliance by banks. Insolvency legislation was thoroughly reformed in 2013 and should be implemented effectively to help return the healthy parts of the economy to invest and grow again.

This Survey is published on the responsibility of the Economic and Development Review Committee of the OECD, which is charged with the examination of the economic situation of member countries.

The economic situation and policies of Slovenia were reviewed by the Committee on the 1st April 2015. 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 the 15th April 2015.

The Secretariat's draft report was prepared for the Committee by Urban Sila, Natasa Jemec and Peter Walkenhorst, under the supervision of Piritta Sorsa. Statistical research assistance was provided by Hermes Morgavi with general administrative assistance provided by Anthony Bolton and Mikel Inarritu. The authors would like to thank Alvaro Pereira, Robert Ford and Jeanne Dall'Orso for their contributions at different stages.

The previous Survey of Slovenia was issued in April 2013.

Further information

- For further information regarding this overview, please contact:
  - Piritta Sorsa, e-mail: piritta.sorsa@oecd.org
    tel.: +33 1 45 24 82 99
  - Urban Sila, e-mail: Urban.Sila@oecd.org
    tel.: +33 1 45 24 76 25
  - See also: www.oecd.org/eco/surveys/economic-survey-slovenia.htm

How to obtain this book

- This survey can be purchased from our online bookshop: *www.oecd.org/bookshop.*
- OECD publications and statistical databases are also available via our online library: *www.oecdilibrary.org.*

Related reading

- **OECD Economic Surveys**: *OECD Economic Surveys* review the economies of member countries and, from time to time, selected non-members. Approximately 18 Surveys are published each year. They are available individually or by subscription. For more information, consult the Periodicals section of the OECD online Bookshop at *www.oecd.org/bookshop.*
- **OECD Economic Outlook**: More information about this publication can be found on the OECD's website at *www.oecd.org/eco/Economic_Outlook.*
- **Economic Policy Reforms: Going for Growth**: More information about this publication can be found on the OECD's website at *www.oecd.org/economics/goingforgrowth*.
- **Additional Information**: More information about the work of the OECD Economics Department, including information about other publications, data products and Working Papers available for downloading, can be found on the Department's website at *www.oecd.org/eco*
- **Economics Department Working Papers**: *www.oecd.org/eco/workingpapers*
- **OECD work on Slovenia**: *www.oecd.org/Slovenia/*