

Introductory remarks

The Development Report analyses the economic, social and environmental dimensions of Slovenia's development in order to evaluate progress on determinants of the welfare of the population. In previous years the Report also monitored the fulfilment of the strategic guidelines for Slovenia's development in these areas. At a time when a new strategy for Slovenia's development is being drafted, this year's Report shows the baseline situation and the development challenges of the country, not only in terms of ensuring macroeconomic stability and the long-term sustainability of economic, social and environmental development, but also in terms of meeting the country's international commitments (e.g. within the Europe 2020 strategy, the Stability and Growth Pact and the mechanism for detecting excessive imbalances).

The Development Report analysis is based on selected indicators of development and focuses attention on areas that represent a particular development challenge for Slovenia. The findings rely on official data released by domestic and foreign institutions until 31 March 2017. This year's Report therefore presents a review of trends up to 2016, i.e. up to the last year for which data are available. In areas where no relevant indicators exist owing to a lack of data, we have also consulted other sources, particularly analyses by national and international institutions and reports on the implementation of sectoral strategies and programmes. In the analyses conducted, Slovenia is mainly compared with other EU Member States. Where we did not have data for the entire EU, the average of those EU Member States for which data were available was used. Slovenia is also occasionally compared with OECD countries, usually with the average of the 21 EU Member States that are also OECD members. The terms "European average" or "EU average" refer to the EU-28 group, while the term "new Member States" means the EU-13 countries that joined the EU in the enlargements after 2004 (or the EU-12 without Croatia).

The Development Report is divided into two parts. The findings of the analysis are summarised in the main body of the Report, which is then followed by a detailed report on progress by individual indicators for Slovenia's development. The subject matter is divided into four sections: macroeconomic framework; competitiveness factors; demographic trends and the welfare state; and environmental, regional and spatial development.

Summary

Following the setback during the crisis, Slovenia has been making progress in terms of economic development and the welfare of its population in recent years; it has also reduced pressures on the environment. The Development Report analyses the economic, social and environmental dimensions of Slovenia's development in order to measure its progress on determinants of the welfare of the population. The relatively rapid economic growth in the previous decade was followed by a sharp GDP fall during the crisis, which gravely disrupted economic stability and negatively affected welfare. Since 2014 the economic picture has been improving, and Slovenia is again catching up with economically more advanced countries. The recovery has led to an overall improvement in the material situation of the population, while quality of life is also being favourably affected by the relatively good access to a large part of public services. Despite the rising economic activity, the movements of key environmental indicators have remained favourable in the last few years. However, owing to the significant fall in GDP during the crisis, Slovenia still lags significantly more behind the EU average than before the crisis in terms of economic development and the living standard of its population.

Economic activity has strengthened, but faster convergence with more developed countries is impeded by low productivity growth. In 2016 GDP rose for the third consecutive year and came close to the level recorded before the crisis. Economic growth in this period has been significantly affected not only by rising foreign demand but also by measures and reforms in the domestic environment that have improved export competitiveness and the investment climate. In addition to banking system stabilisation, the financial and ownership restructuring of the corporate sector, and labour market reform, the improvement has also been the result of adjustments of the corporate sector, particularly deleveraging and improvement in cost competitiveness. The consequently higher profitability, coupled with better access to sources of finance, has led to a rebound in corporate investment. Productivity growth, an increasingly critical factor for further convergence with economically more advanced countries, particularly in view of demographic change, nevertheless remains noticeably below the pre-crisis average. To boost productivity growth, Slovenia will have to improve particularly those structural factors that have a long-term impact on productivity.

Long-term drivers of productivity growth, which are related to the strengthening of human capital, have been gradually improving, but innovation activity remains low. The level of educational attainment of Slovenia's population has improved notably in recent years; the structure of enrolment by field of education has started to change towards a better match with labour market needs, and this could gradually reduce the existing mismatches between workforce supply and demand. However, given the falling supply of working-age people as a result of demographic change, it will nevertheless become increasingly difficult to ensure an appropriate size and structure of, in particular, the workforce with higher education. This is also important from the perspective of innovation activity of enterprises, which remains low. The business sector has otherwise significantly increased R&D investment since the beginning of the crisis, but the collaboration between businesses and the research sector is modest. Furthermore, the still small share of people with tertiary-level education in the business sector is slowing enterprises' response in implementing new technologies and digitalisation. The share of high-growth enterprises has stagnated at an exceptionally low level for several years. R&D investment of the public sector has also been cut for several years, which is another cause for concern, as it makes it more difficult for research institutions to keep up with new knowledge development.

Slovenia has restored the stability of public finances and the banking system in the last few years; the corporate sector has become less dependent on bank sources of finance. The general government deficit had declined to 1.8% of GDP by 2016. General government debt as a share of GDP also dropped considerably for the first time in seven years, which was also due to the nominal decline of debt. Positive developments were attributable not only to favourable macroeconomic conditions but also to measures to contain expenditure growth and increase revenue. However, long-term fiscal sustainability remains a challenge, given the temporary nature of some measures from previous years and demographic change, which increases upward pressure on general government expenditure. After repairing banks' balance sheets, Slovenia also restored the stability of the banking system. Bank performance improved and in 2016 the decline in bank lending slowed. After relying primarily on domestic bank financing before the crisis, enterprises have diversified funding sources in recent years, but the level of non-banking financial sector development nevertheless remains low.

The material situation of the population is also improving amid the improvement in economic conditions; in the years to come, the quality of life will increasingly depend not only on the

strengthening of the economy's growth potential, but also on Slovenia's ability to adjust to demographic change. As a result of growth in employment and earnings, household disposable income has risen for the third consecutive year. The risk of social exclusion, which otherwise remained lower than in the EU even during the crisis, has started to decrease. Income inequalities have remained low, but the segmentation of the labour market is still high, which is a problem that mainly affects the young generation. Thanks to the extensive network of public institutions and predominantly public financing, accessibility of public services is still relatively high by international standards, but it is decreasing. The quality of life in this regard will be increasingly affected primarily by social protection systems not having been adjusted to demographic trends. Regarding the pension system, the key issue is ensuring a decent level of pensions, while a decline in the accessibility of health services is indicated by rising waiting times. Moreover, the affordability of long-term care services is deteriorating and the system of care at home remains poorly developed. All of this increases pressure on the fiscal sustainability of social protection systems. Amid an efficient adjustment to demographic change, a further improvement in quality of life will also depend on Slovenia's ability to increase its economic potential to ensure further growth in household income and the provision of funding for long-term care, health-care and education systems.

Slovenia has made progress in terms of reducing the environmental burden over the last few years, but a more sustainable improvement will be required, particularly in view of faster economic growth. Greenhouse gas emissions and energy consumption have declined. Both have also fallen per unit of GDP but remained higher than the EU average. The significant negative impact of increasing road transport is particularly problematic and the absence of measures to effectively address this issue is of concern. Despite the improvement, Slovenia also lags behind the EU in terms of the consumption of raw materials per unit of GDP. More efficient raw material and energy consumption would not only help reduce the environmental burden but also increase the competitiveness of the economy. As a result of favourable natural assets, the shares of renewable energy sources and organically farmed areas are larger than the EU average, but nevertheless still below the targets. The quantity of municipal waste generated per person is also smaller than the EU average, despite an increase in the last few years, and its management has also improved significantly. However, for a transition towards a green economy, which will help increase the competitiveness of the economy and the welfare of the population without degrading the environment, Slovenia will nevertheless have to pursue more sustainable production and consumption patterns.

Institutional competitiveness, which shows how efficiently the government supports and promotes development, is still low. In the last few years Slovenia has made progress in improving government efficiency, for example in terms of reducing the administrative burden and improving insolvency legislation; it has also increased the efficiency of its judiciary. However, a comprehensive reform and modernisation of public administration have yet to be carried out. The efficiency of the government in decision-making and the execution of key development decisions also remain low. Some countries have made bigger and faster steps towards changing regulations and cutting unnecessary red tape in recent years, which has reduced the relative competitiveness of the business environment in Slovenia. This is also indicated by international indicators of the competitiveness of the government and its institutions, which point to the poor functioning of public institutions, inefficient government spending and the high burden of government regulation. People also have little trust in government institutions.

For Slovenia to achieve sustainable and balanced development, which will be reflected in higher welfare of the population, priority measures should be focused on:

- **Raising productivity by efficient use of technological progress and know-how.** For this to be achieved, it is necessary to (i) improve the efficiency of the innovation system by measures to increase the collaboration between the public research sector and enterprises, taking into account all types of innovation and the specific features of innovation in small enterprises; (ii) provide an encouraging and predictable business environment, in particular by ensuring a stable access to sources of funding, a more effective siting of buildings and activities in the landscape and removal of administrative barriers; (iii) ensure a sufficient size of appropriately educated workforce by making the educational system more responsive to changes in the labour market, by lifelong learning and by incentives for attracting in-demand labour force to Slovenia; and (iv) improve state asset management.
- **A comprehensive adjustment to the changing demographic structure of the population:** (i) labour market and migration policy: increasing the participation of young and older people; creating conditions for immigration of labour force and reducing emigration (particularly of people with higher education); (ii) social protection systems: implementing reforms that will ensure social and income security of people and access to medical services and long-term care; (iii) education and training: promoting lifelong learning and continuous on-the-job training and intergenerational knowledge transfer; (iv) promoting adjustment of work processes and better age management in the workplace; (v) encouraging

healthy lifestyle habits; and (vi) adjusting housing conditions and the transport network with the support of ICT and technological solutions.

- ***Ensuring a faster transition towards a green economy by moving towards more sustainable production and consumption patterns.*** It is essential to: (i) promote sustainable and efficient exploitation of natural resources, which will also contribute to productivity growth; (ii) accelerate research and innovations that also benefit the environment; (iii) improve sustainable mobility and increase the competitiveness of rail transport; and (iv) improve the cooperation between sectoral policy areas to align their measures.
- ***Increase the efficiency of the government and its institutions to support and promote development*** by (i) reforming and modernising public administration (more efficient organisation and digitalisation); (ii) increasing the accountability, expertise and transparency of government bodies; and (iii) restructuring general government revenue and expenditure towards greater emphasis on development and efficiency.