European Bank
for Reconstruction and Development

Slovenia country diagnostic

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Country diagnostics are a European Bank for Reconstruction and Development (EBRD) tool for identifying the main obstacles to entrepreneurship and private-sector development in the economies where it operates. They also help to shape the Bank's priorities and project selection in formulating new country strategies. Each diagnostic informs the EBRD's policy engagement with the authorities in that country.

Country diagnostics assess national progress and challenges in developing a sustainable market economy. Private-sector development and entrepreneurship are at the heart of the Bank's mandate, but in all of the Bank's investee economies, the private sector faces a range of problems and obstacles. The country diagnostic highlights the main challenges facing private companies and shows where each country stands vis-à-vis its peers in terms of the six key qualities of a sustainable market economy – looking at whether economies are competitive, well governed, resilient, integrated, green and inclusive – and points out the main deficiencies and gaps in each area.

The diagnostics draw on a range of methodologies and best practices in assessing how big obstacles are. Extensive use is made of in-house expertise across the EBRD, along with surveys such as the Business Environment and Enterprise Performance Survey (BEEPS) and the Life in Transition Survey (LiTS), as well as other cross-country surveys and reports by institutions such as the World Bank, the World Economic Forum and the Organisation for Economic Co-operation and Development (OECD). For some larger countries, the diagnostics also draw on specially commissioned studies looking at selected issues that are critical for private-sector development in the relevant country.

The diagnostics are led by the EBRD's Country Economics, Strategy and Policy team, drawing substantially on the expertise of sector, governance and political experts in the Policy, Strategy and Delivery (PSD) Department and consulting widely with relevant experts across the EBRD when preparing the final product. The diagnostics are shared with the EBRD's Board of Directors during the country strategy process and published during the public consultation period.

The views expressed in the diagnostic papers are those of the authors only and not those of the EBRD.

For more information, go to: https://www.ebrd.com/publications/country-diagnostics

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Executive summary

Slovenia has the highest gross domestic product (GDP) per capita of all the economies in which the EBRD operates. However, productivity growth has been subdued over the past two decades and the country's transition to a sustainable market economy remains incomplete, with significant challenges in a number of areas:

- In some instances, private-sector competitiveness has been held back by weak governance standards and a lack of business sophistication. Improvements in these areas would allow domestic businesses to become more competitive across the region, particularly in the area of business services (including information and communications technology [ICT]). Supply-side reforms should focus on further easing the cost of doing business and stepping up the level of digitalisation, while increasing the intensity of innovation and boosting added value, including in the traditionally competitive manufacturing sector.
- Activity in the local capital market remains modest. Small, innovative firms need easier access to risk capital financing in light of the underdeveloped venture capital and private equity ecosystem.
- State ownership remains significant in key sectors, at times constraining competitiveness and innovation. Competition should be fostered in key sectors such as insurance, telecoms and tourism. Further efforts are also needed to strengthen governance and minimise political interference in state-owned enterprises (SOEs).
- Widespread labour shortages need to be addressed by matching skills to the needs of employers and reforming the pension and long-term care systems to encourage longer working lives.
- Renewables have historically been neglected in Slovenia, putting the country's green transition and energy independence at a disadvantage. Recent pledges to install more solar and wind capacity, alongside the potential expansion of nuclear power, are welcome, but need to be accompanied by significant investment in the grid.

To underpin sustainable growth, economic policy needs to address all three components of growth: technology, human capital and productivity. Investment in future-proofed, sustainable technologies and sectors needs to be prioritised, while reforms are needed to unlock more allocative efficiency, including in the public sector. In the medium term, as the labour market tightens and the country's demographics worsen, more effective policies are needed to increase and improve labour supply to support continued growth.

Contents

1. Political and economic overview 5

1.1 Political economy 5

1.2 Macroeconomic overview 6

Growth performance 6

Economic structure and private-sector overview 9

2. Assessment of the market economy 11

2.1 Competitive 11

Market structures and institutions supporting competition 12

Capacity to innovate and add value 13

2.2 Well governed 17

Governance at national level 17

Corporate and SOE governance 19

2.3 Green 21

Energy supply and emissions 21

Energy consumption and efficiency 24

The environment and the circular economy 25

2.4 Inclusive 26

2.5 Resilient 29

Energy resilience 29

Financial stability 32

2.6 Integrated 35

External integration 35

Internal integration 36

1. Political and economic overview

1.1 Political economy

In the decades prior to the collapse of the former Yugoslavia and Slovenia's independence in 1991, Slovenia was part of a quasi-market socialist system, where gradual reforms had been implemented since the early 1980s. Slovenia's political system was less rigid than those of other post-socialist economies, so its economic system was more market-oriented.[1] Consequently, unlike other states in the region, where the main forces driving the collapse of socialist regimes were external, the transition in Slovenia was endogenous and gradual, making it one of the most successful in central and eastern Europe (CEE). Slovenia's early transition was threefold: (i) a shift from socialism to a market economy; (ii) a transition from a regional economy to a national one; and (iii) a switch from being part of the former Yugoslavia to being a European Union (EU) member state.[2]

Slovenia has been an EU and North Atlantic Treaty Organization (NATO) member state since 2004, an OECD member since 2010 and a user of the European single currency, the euro, since 2007. In June 2023, Slovenia was also elected as a non-permanent member of the United Nations (UN) Security Council for 2024-25. This will be an opportunity for the country to raise its international profile and promote its foreign policy priorities.

Slovenia's political culture has been shaped by dividing lines between left and right, urban and rural, and religious and non-religious. State involvement remains high, with the country – unlike its CEE peers – not undergoing a comprehensive privatisation process in the 1990s.

Slovenia held parliamentary, presidential and local elections in 2022. Following the parliamentary election of April 2022, a centre-left ruling coalition was formed, comprising the newly established environmentalist Freedom Movement (GS) of Prime Minister Robert Golob, the Social Democrats (SD) and left-wing Levica, with a comfortable majority in parliament. The election of liberal Nataša Pirc Musar as President (Slovenia's first female President) in November 2022 suggests a tranquil relationship between the two branches of executive power.

The government is well positioned to champion the green agenda, social justice and the strengthening of the rule of law. The GS-led administration has called for the full decarbonisation of the economy and energy self-sufficiency. Supported by an inflow of EU funds, Slovenia is committed to greater spending on green technology and digital policies. Support and reconstruction measures will also be a focus in this parliamentary term following severe flooding in large parts of the country in August 2023.

Slovenia's response to Russia's war of aggression on Ukraine has been closely coordinated with its Western allies. The country continues to provide defence, technical and humanitarian support to Ukraine and remains supportive of EU sanctions on Russia.

[1] See Vaupot (2019).
[2] See Mrak et al. (2004).

1.2 Macroeconomic overview

In 2023, Slovenia was the economy in central Europe and the Baltic states (CEB) that was closest to converging on EU average GDP per capita, at 91 per cent in adjusted prices. However, the economy has failed to achieve any convergence since 2008, thanks to seven years of anaemic growth after the global financial crisis and a domestic banking crisis in 2012-13. Only since 2016 has growth resumed and the economy managed to return to pre-crisis levels. The impact of the Covid-19 pandemic was mitigated by a strong fiscal response, which enabled a strong recovery. However, the fallout from the war in Ukraine translated into a sharp slowdown in growth in 2022 and 2023. Growth should recover in the coming years as financing conditions ease, consumer confidence improves and investment accelerates.

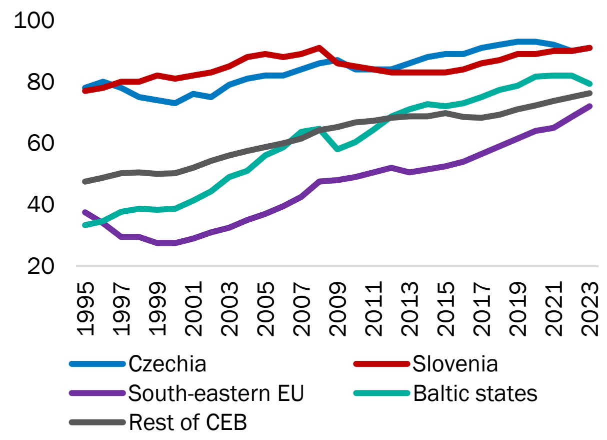
The dynamics of growth in recent years suggest that the output potential of the economy remains relatively low, amid a challenging demographic situation. In this context, the Slovenian economy would benefit greatly from structural reforms that raised its productivity levels and moved it closer to the frontier of EU innovation.

Growth performance

Slovenia boasts relatively high income and welfare levels. Among former socialist states, Slovenia arguably has the highest standard of living. In 2024, the monthly minimum wage was €1,254, the eighth highest in the EU, while in early 2024, the average gross wage was €2,320, close to the EU average.[3] Moreover, Slovenia is the EU member state with the lowest level of income inequality, as measured by the Gini coefficient.[4]

However, the country has failed to significantly increase its relative standard of living in recent decades. Its high level of welfare stems not from rapid convergence, but from a high starting point. For example, in 2005, Slovenia's median annual net income (€8,797) was more than twice that of Czechia (€4,233), with most of the EU-11[5] recording figures of less than €3,000. From this perspective, Slovenia's progress looks modest and is best reflected by the price-adjusted convergence in added value and consumption (see Chart 1). In essence, Slovenia has been stuck at 80 to 90 per cent of the EU average and has not been able to achieve full convergence.

Chart 1. Real GDP per capita at purchasing power parity (index: EU-27=100)



Source: Eurostat (2023b).

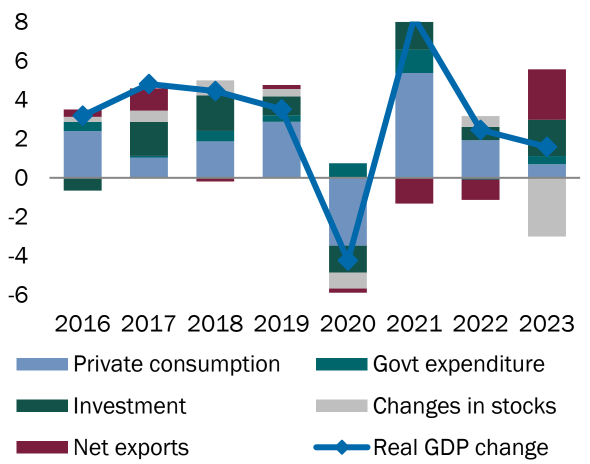
The fiscal expansion triggered by Covid-19 facilitated a strong economic rebound, but the consequences of the war in Ukraine have been severe. Prior to the Covid-19 crisis, growth had been robust, driven by a rebound in domestic demand and positive dynamics in foreign demand (see Chart 2). After a strong uptick in 2021, growth slowed significantly in 2022 owing to weakness in consumer demand and investment. Exports were unable to offset the increase in the imported energy bill, leading to a negative contribution from net exports. In 2023, GDP growth weakened again,

[3] See SURS (2023a).
[4] See Eurostat (2023a).

[5] These are the 11 EU member states in central and eastern Europe: Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, the Slovak Republic and Slovenia.

falling to 1.6 per cent, with investment and a decline in imports the main contributors to growth, while private consumption slowed further. In the first quarter of 2024, growth stayed at end-2023 levels, boosted by goods exports and government spending, but dragged down by declines in investment and service exports. The EBRD is forecasting growth of 2.3 per cent and 2.6 per cent in 2024 and 2025, respectively.

Chart 2. GDP growth and its contributors (per cent)

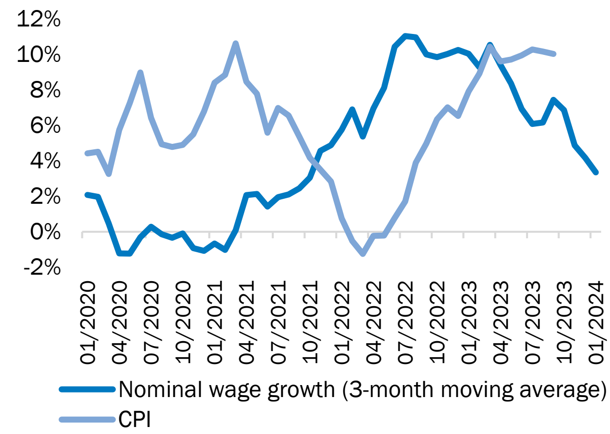


Source: SURS (2024) and authors' calculations.

The effects of the 2022 price shock have been considerable, exacerbated by a decline in nominal wages. In 2022, cyclical supply-demand factors, exacerbated by the effects of the war in Ukraine, prompted a surge in annual inflation (see Chart 3). Consumption weakened in 2022 and 2023, linked to the phasing-out of support for public-sector employees in 2020 and 2021, which translated into a deep decline in real wages in 2022. Real wage growth turned positive in 2023, but consumption has not strengthened again. Inflation dropped in 2023, but has yet to reach the European Central Bank's 2 per cent target.

The August 2023 floods inflicted significant damage on assets and infrastructure. Slovenia was hit hard by flash floods in August 2023, with damage and reconstruction costs estimated to total €9.9 billion (17 per cent of GDP). The government plans to spend €2.3 billion on reconstruction over the next five years, which should boost overall investment activity. However, implementation has been fairly slow and hampered by legislative changes, with just €360 million allocated in 2024.[6]

Chart 3. Annual inflation and nominal wage growth



Source: SURS (2023a, 2023b) and authors' calculations.

Strong nominal growth has contributed to a decline in public debt levels. Despite significant deficits having been recorded since the Covid-19 crisis, the public debt-to-GDP ratio has still declined from almost 80 per cent at end 2020 to 69 per cent at end 2023, driven by growth and high inflation.[7] Budget deficits of around 2.5 per cent of GDP in the coming years should contribute to a slight further decline in the debt-to-GDP ratio, pushing it down towards 65 per cent.

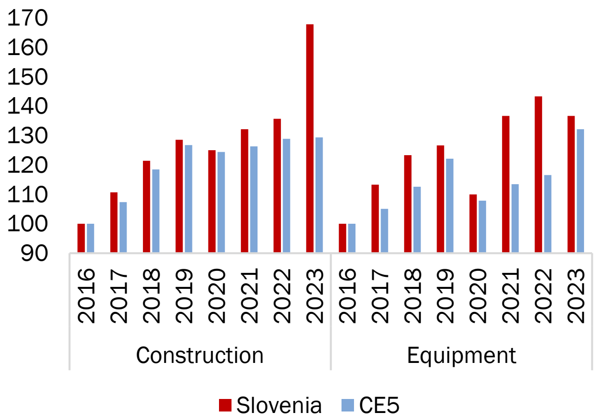
Investment has picked up in recent years after a period of weakness. Following the global financial crisis and a domestic banking crisis, Slovenia's private sector underwent a period of deleveraging, which caused a period of underinvestment. From 2017, investment started to recover, increasing from 17 per cent of GDP in 2016 (the lowest in the region) to 21 per cent of GDP in 2023. A post-Covid boom in equipment investment eased in 2023, but equipment investment levels

[6] See STA (2024).

[7] See European Commission (2024a).

remained above the average of central European peers (see Chart 4). Public investment has supported infrastructure development, particularly in the railway sector, boosting the construction sector, while 2023 estimates suggest a significant jump in engineering works, perhaps in part related to post-flood reconstruction. Nevertheless, overall construction investment is still below pre-global financial crisis levels, having hit a low point in 2016.

Chart 4. Gross fixed capital formation by asset type (index: 2016=100)

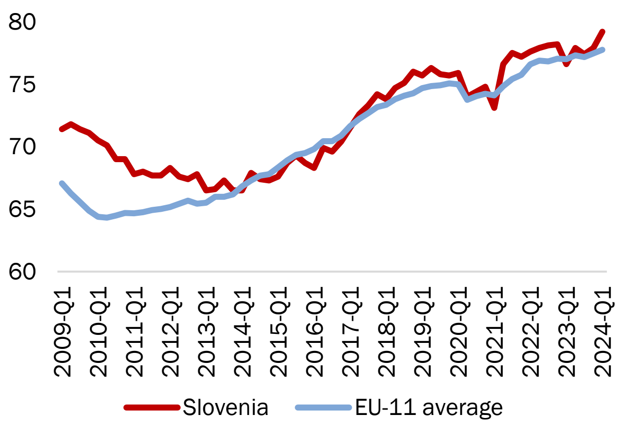


Source: AMECO (2024) and authors' calculations.
Note: CE5 comprises Croatia, Czechia, Hungary, Poland and the Slovak Republic.

The labour market has been adding jobs in recent years, contributing greatly to growth. Despite small hiccups in the last few quarters, employment rates remain relatively high compared with historical levels and EU averages (see Chart 5). Slovenia's employment levels are lower than the EU average only when it comes to less educated women and older people – thanks, among other things, to stronger incentives to retire (see Section 2.4). The flipside of this is that Slovenia's tightening labour market and growing labour shortages are reinforcing the need to do more to ensure that the country maintains an adequate labour supply.

While labour and capital inputs have strengthened, convergence in terms of productivity has disappointed. Labour productivity has fluctuated between 80 per cent and 85 per cent of the EU average over the past two decades.[8] As it has not achieved significant convergence in productivity levels, Slovenia has been caught up by its CEB peers. This is mainly due to its slowdown in capital growth, despite decent growth in capital productivity, while the post-Covid rebound has been supported by the tightening labour market and less by productivity improvements (see Chart 6). Total factor productivity (TFP) growth was also strong in the post-banking crisis period, but moderated in 2021 and 2022. Consequently, real labour productivity per hour worked increased by only 2 per cent in 2023 relative to 2019. At sector level, only construction saw a significant bump up, recording a 15 per cent increase in productivity in this period, probably driven by rising prices and stagnating wages (mostly for foreign workers).[9]

Chart 5. Employment rate (per cent)

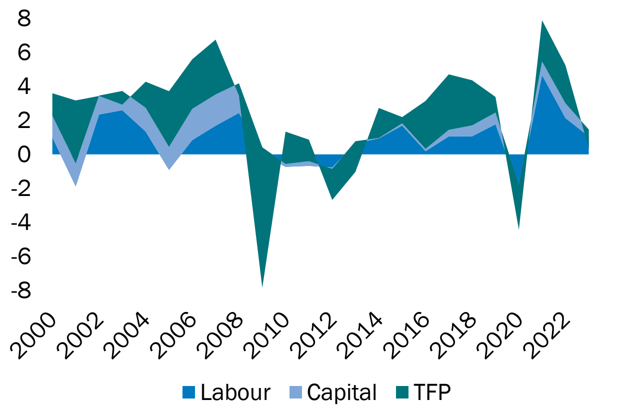


Source: Eurostat (2023m).

[8] See Eurostat (2023d).

[9] See Eurostat (2023c).

Chart 6. Contributions of growth drivers (per cent)



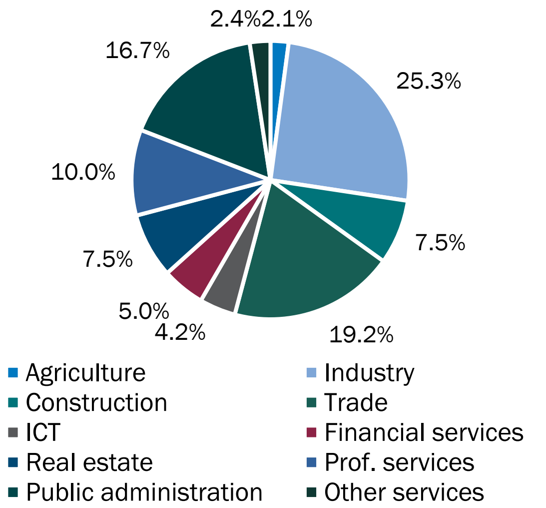
Source: The Conference Board (2023) estimates and authors' calculations.

Economic structure and private-sector overview

Slovenia's economic structure is skewed towards manufacturing. With a share of 25 per cent, industry accounts for a relatively large percentage of the economy, the second highest in the region after Czechia (see Chart 7). In contrast, the ICT sector has a relatively low share, which in 2023 stood at 4.2 per cent, lower than the EU average and far lower than some regional peers (with Bulgaria, for example, recording a figure of 7.5 per cent).

Employment in non-ICT high value-added sectors is strong. Because of its economic structure, Slovenia has the EU's third-highest level of employment in manufacturing (with that sector accounting for 20.6 per cent of total employment in 2023). It also has the highest employment in knowledge-intensive services in the CEB region and the eighth-highest in the EU.[10] At the same time, employment in ICT and business services is lower than in some other countries in the region. This reflects the significant ICT skills shortages reported by firms. In 2021, high-growth firms accounted for just 8.6 per cent of total employment in Slovenia – one of the lowest rates in the region. Nevertheless, employment by high-growth firms in industry, construction and market services was in line with the EU average.[11]

Chart 7. Sectoral breakdown of gross value added, 2023

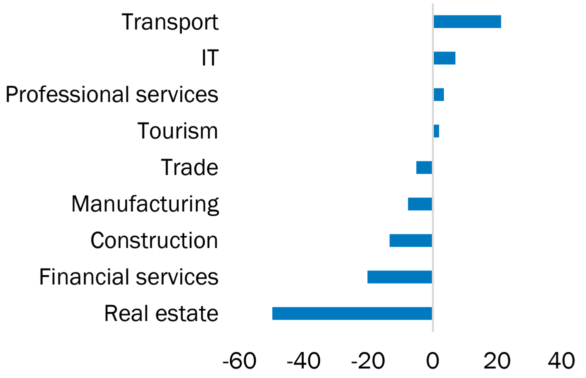


Source: Eurostat (2023e).

The wage-adjusted productivity[12] of Slovenian firms is lagging the EU-11 average in key sectors. As Chart 8 illustrates, the competitiveness of Slovenian firms was below the EU-11 average in a number of sectors in 2021 – not only in the real estate and financial services sectors, but also in more important sectors such as manufacturing and construction. This suggests that if wages are included in a comparison of sectoral productivity, Slovenian firms do not have a significant competitive advantage over regional peers. Any advantage must therefore come from being more innovative, offering more added value or providing unique products and services, as Slovenian firms cannot compete on price alone.

10 See Eurostat (2023f).
11 See Eurostat (2023g).
12 Wage-adjusted productivity is defined as value added divided by personnel costs, adjusted for the ratio of paid employees to the total number of persons employed – or, put more simply, apparent labour productivity divided by average personnel costs (expressed as a ratio in percentage terms).

Chart 8. Difference between Slovenia and EU-11 average in wage-adjusted labour productivity, by sector, 2021 (ratios)



Source: Eurostat (2023h) and authors' calculations.

Business dynamism is slightly lower than the EU average. While in industry and services, the business churn rate[13] is only marginally below the EU average, business dynamism in the ICT sector is notably lower (16.5 per cent, compared with an average of 22.5 per cent across the EU-27).[14] Slovenian enterprises also seem to be less prone to being shut down, suggesting a more stable business environment, but also more rigid insolvency procedures (see Section 2.1 for more details).

Despite limited privatisation in the early years of the transition process, foreign firms play an important role in the economy. Foreign-controlled enterprises accounted for 23.4 per cent of total employment in 2020, at the higher end within the EU and in line with other EU-11 countries. However, foreign firms' share of total value added was 27.8 per cent in that year, the lowest level in central Europe, reflecting the fact that those firms' share of total foreign direct investment (FDI) stocks was the lowest in the region (see Section 2.6 for more details).[15]

[13] This is calculated as the sum of enterprise births and deaths divided by the number of active enterprises.

[14] See Eurostat (2023g).

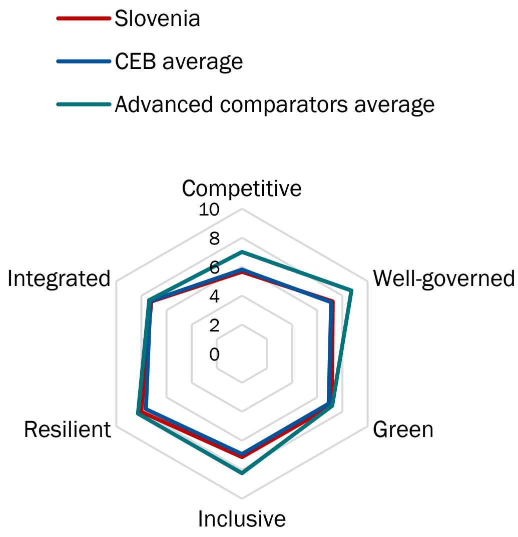
[15] See Eurostat (2023i).

2. Assessment of the market economy

In the EBRD's 2023 assessment of transition qualities (ATQs), Slovenia achieved higher scores than the regional average for central Europe and the Baltic states (CEB) on four of the six qualities that are subcomponents of the ATQs. The ATQs are composite indices of six desirable qualities of a sustainable market economy – competitive, well governed, green, inclusive, resilient and integrated. They are obtained by combining information on a large number of indicators and assessments.

Slovenia is the most resilient economy in the CEB region, but has relatively lower scores for competitive and well governed. Relative to the rest of the region, the country performs better in terms of the green and inclusive qualities (second and third, respectively), but scores slightly weaker on the scores for competitive, integrated and well governed (seventh, sixth and fifth, respectively) (see Chart 9).

Chart 9. EBRD ATQs, 2023

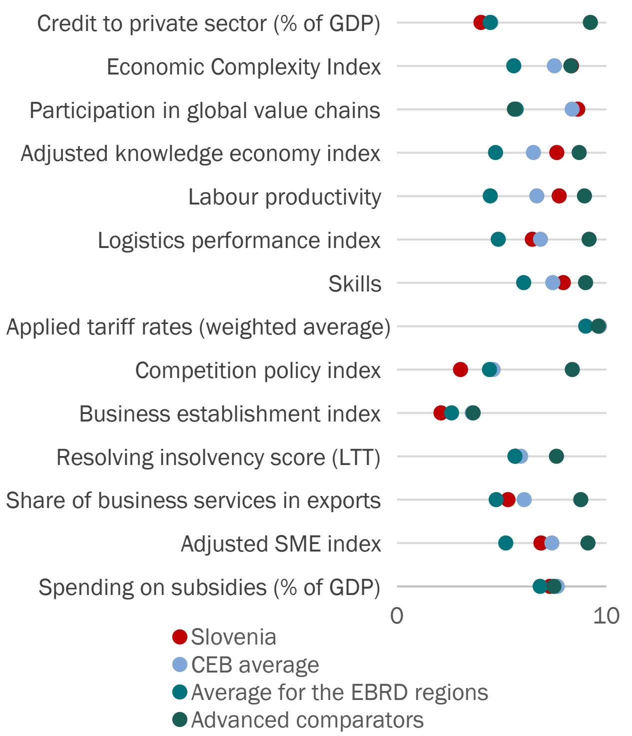


2.1 Competitive

With a score of 5.65 in 2023, Slovenia is ranked only seventh in the EBRD regions in terms of competitiveness, despite having higher income levels than regional peers. This is driven by a low average score for the market structures that should support competition, which is lower than the CEB average. The score for the set of indicators assessing the "capacity to innovate and add value" is slightly above the CEB average, but still significantly lower than in advanced comparators, with a key gap in the area of credit to the private sector – a legacy of the banking crisis.

These results, combined with other findings, suggest that Slovenia needs to address constraints on competition and prioritise investments and innovation that add significant value in order to close the gap to the EU average.

Chart 10. Indicators of competitiveness



Market structures and institutions supporting competition

Slovenia is lagging regional peers when it comes to several indicators of business dynamism. In the EBRD's assessment, the largest gaps relative to the CEB average are in competition policy, the establishment of businesses and spending on subsidies, implying a less dynamic business environment. Nevertheless, from a regulatory perspective, Slovenia's average product market regulation score (which is based on OECD indicators) was already equal to the OECD average in 2018, with the indicators that are lagging mostly pertaining to the extent of public ownership and the regulation of network services such as railways.[16] Some liberalisation of professional services could also be beneficial.[17]

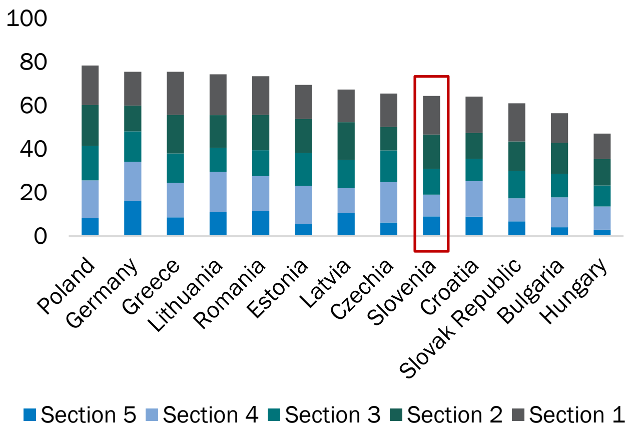
Slovenia's business environment has historically been rather limiting, but it should improve with new policy initiatives. In the BEEPS VI survey, which was conducted by the EBRD and the World Bank and covered the period from 2018 to 2020, the percentages of Slovenian firms reporting that labour regulations (16.22 per cent), tax administration (7.93 per cent), transport (6.72 per cent), access to land (3.54 per cent) and customs and trade regulations (3.11 per cent) were the biggest obstacles to business operations were all higher than the respective CEB averages.[18] In the EIB Investment Survey 2023, Slovenian firms reported that a lack of skilled staff (88 per cent), energy costs (85 per cent) and uncertainty about the future (80 per cent) were the main barriers to investment.[19] Recent reforms such as the Debureaucratisation Act (which mainly targets construction permits), the Investment Promotion Act and amendments to public procurement should help to streamline firms' engagement with the state.

[16] See OECD (2018).
[17] See European Commission (2023a).
[18] See BEEPS (2020).
[19] See European Investment Bank (2023).

Competition policy should improve with the transposition of the ECN+ Directive. Slovenia's current competition policy score, which is based on 2019 data, points to a significant gap in competition policy in Slovenia. However, following the delayed transposition of Directive 2019/1/EU in October 2022 (the ECN+ Directive), the country's new regulatory framework gives enhanced powers to the Competition Protection Agency, streamlines infringement procedures and facilitates international cooperation, which should all increase enforcement.

Insolvency proceedings could be streamlined. According to the EBRD's 2022 business reorganisation assessment, Slovenia could improve the efficiency of its insolvency proceedings. While the country is performing better than a selection of EU member states in terms of its regulatory framework (see Section 1 in Chart 11) and planning and the initial stage of restructuring (see Section 2), Slovenia is lagging its peers when it comes to Section 4 (the approval phase), sitting at the lower end relative to other economies where the EBRD invests. This mostly reflects judges' limited involvement in the review and assessment of restructuring plans and their feasibility, as judges mostly focus on formalities. Nevertheless, Slovenia is a leader in the region in terms of data transparency. The implementation of Directive 2019/1023/EU on the discharge of debt and disqualifications and on measures to improve the efficiency of restructuring and insolvency procedures should improve the overall system.

Chart 11. EBRD scores for reorganisation procedures (points)



Source: EBRD (2022).

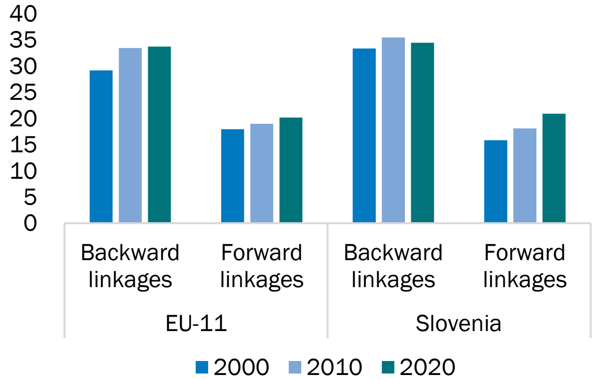
Capacity to innovate and add value

Slovenia has one of the most open and competitive export-oriented manufacturing sectors in the region. As a small, export-oriented economy, large companies have significant economic weight in Slovenia. Exports of goods and services were equivalent to 92 per cent of GDP in 2022 (with goods accounting for 73 per cent of those). That is one of the highest figures in the EU and one that has grown consistently over the last decade. Similarly, Slovenia's participation in global value chains is one of the highest in the EU (see Chart 12). Slovenia was ranked fifth in the EU in 2021 in terms of moderately and highly technology-intensive products' share of total goods exports (68 per cent).[20] This was driven mainly by exports of pharmaceutical products (28 per cent of 2022 exports) and machinery (18 per cent), as Slovenia's largest firms are in the automotive, pharmaceutical and consumer electronics sectors. Given the country's manufacturing traditions, there are also many smaller firms that are integrated into global supply chains and producing specialised, advanced products, similar to Germany's Mittelstand. Nevertheless, according to

[20] See World Bank (2023a).

the Economic Complexity Index, despite very competitive trade intensity (12th place), Slovenia performs worse in the technology (27th place) and research (53rd place) sub-indices.

Chart 12. Participation in global value chains (per cent)

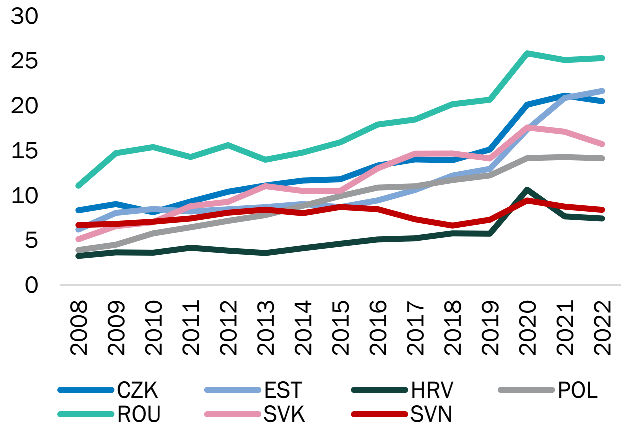


Source: OECD (2023a).

Slovenia is a top performer in terms of the presence of "hidden champions" in the economy. In a study conducted in 2018-20, Slovenia emerged as the economy with the largest number of "hidden champions"– highly competitive, export-oriented and technologically advanced firms operating in niche markets – per capita in the region.[21]

Business and IT services account for a small share of service exports, suggesting that the economy may be at a disadvantage in the digital transition. With a long tradition of manufacturing, the economy has been relatively slow in expanding its service exports, with transport and tourism accounting for two-thirds of exports. IT and other business services accounted for 28 per cent of total service exports in 2022 (or 5 per cent of GDP), and their share of service exports has not increased significantly over time, in contrast to Slovenia's peers (see Chart 13). The country's exports of ICT services are, in fact, among the lowest in the region, despite decent amounts of digitalisation at firm level (see below). The recent changes to the government's approach and the apparent prioritisation of digitalisation are a positive development in this regard. Reforms to reduce the restrictiveness of trading services may also unlock additional value.[22]

Chart 13. ICT service exports as a share of total service exports, 2022 (per cent)



Source: World Bank (2023b).

In general, the relatively small domestic market is not conducive to economies of scale. While supply-side drivers of productivity are important and are, in part, being addressed, the demand side remains a key constraint on private-sector growth. Slovenian firms' expansion in the wider region – as exemplified by recent anecdotal evidence of investment in countries such as Bulgaria outside the more familiar Western Balkans region – is therefore commendable. Spillovers from export-oriented sectors to other branches of the economy should also be encouraged.

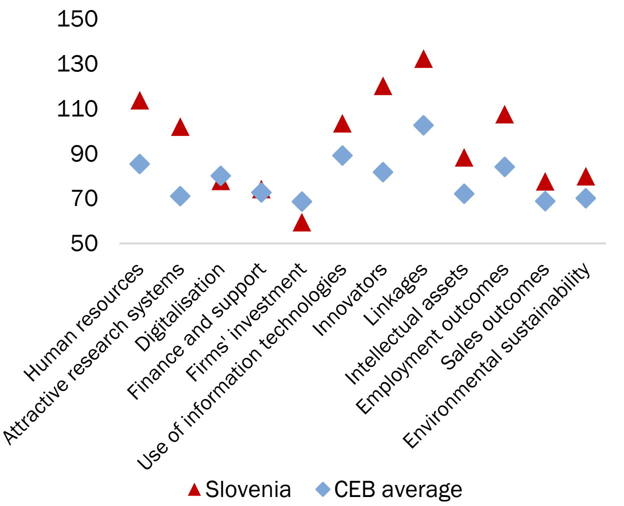
The intensity of innovation has increased in recent years, but remains slightly below the EU average. According to the European Innovation Scoreboard 2023, Slovenia is a moderate innovator, with its score equivalent to 95 per cent of the EU average.[23] In terms of research and development (R&D) expenditure per capita, Slovenia invested more than any other EU-11 country in 2021 in nominal terms, but that figure

[21] See Tabak et al. (2018).
[22] See European Commission (2023a).
[23] See European Commission (2023b).

was less than both the EU average and its own peak performance in 2013. Slovenia's Recovery and Resilience Plan (RRP) includes several reforms that could improve the country's performance in terms of innovation and R&D. The Act on Research, Development and Innovation Activities introduces performance-based funding for research organisations, simplifies the rules on researchers' mobility and removes barriers to the hiring of foreign researchers. Meanwhile, Slovenia's Council for Development will bring together policymakers and relevant research and innovation (R&I) stakeholders to create an efficient monitoring and evaluation system and inform the policymaking process.

Slovenia's innovation ecosystem displays comparative advantages, as well as significant shortcomings. As Chart 14 illustrates, Slovenia has comparative advantages when it comes to linkages between innovative firms and research, the percentage of innovating firms, and human resources. However, Slovenia is lagging the EU average and its peers in the CEB region when it comes to firms' investment in innovation, as firms report very low investment in non-R&D innovation and low availability of adequate financing. Similarly, the indicator measuring firms' investment has been on a downward trend since 2016. In terms of innovation output, firms report significantly lower incidence of business process innovations, while product innovation is in line with the EU average. Moreover, Slovenia is ranked fourth in the EU in terms of the percentage of non-innovating firms that could possibly innovate, implying some untapped potential that could be unlocked.[24]

Chart 14. Components of the European Innovation Scoreboard 2024 (EU-27=100)



Source: European Commission (2024c).

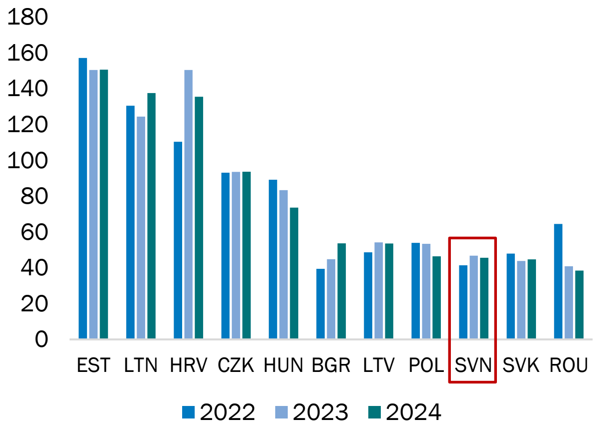
Private-sector innovation is being hindered by a lack of venture capital financing. Slovenia is at the lower end of the EU-11 group in terms of venture capital investment (see Chart 15). The new Act on Forms of Alternative Investment Funds and the country's capital market development strategy – both of which form part of the RRP – may help to tackle the low levels of venture capital in Slovenia's private sector.

The low levels of venture capital investment reflect the extremely modest private equity ecosystem. Despite a strong performance in 2021, when €428 million was invested, 2022 and 2023 saw investment fall towards the long-term average, with just €71 million and €13 million being invested in 2022 and 2023, respectively.[25] As such, Slovenia is comparable to small economies in the EU-11 or Serbia or Ukraine in terms of the depth of its venture capital and private equity ecosystem. This is a challenge when it comes to fulfilling the growth potential of Slovenian firms, especially those that face succession issues.

[24] See European Commission (2023b).

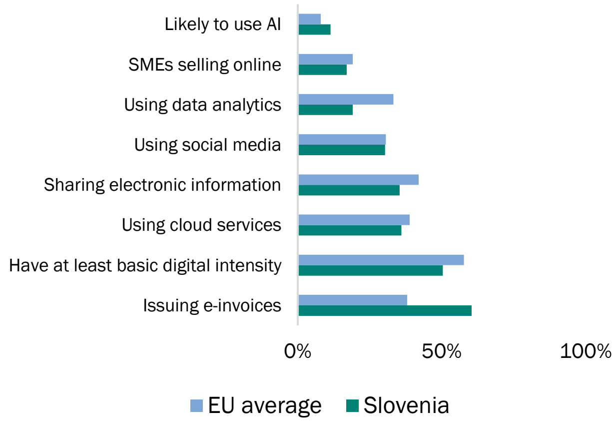
[25] See InvestEurope (2024).

Chart 15. Normalised venture capital investment scores (EU-27=100)



Source: European Commission (2024c).

Chart 16. DESI indicators of the digital transformation of SMEs, 2024



Source: European Commission (2024b).

Despite Slovenia's relatively small ICT sector, the digitalisation of Slovenian firms is on a par with the EU average. In European Commission survey data for 2023, about 50 per cent of the small and medium-sized enterprises (SMEs) surveyed reported at least a basic level of digital intensity, which was very close to the EU average (see Chart 16). Similarly, 35 per cent of firms reported electronic sharing of information, again close to the EU average, and 36 per cent were using cloud services. At the same time, the percentage of Slovenian firms that said they were likely to use artificial intelligence (AI) stood at 11.7 per cent, compared with an EU average of 8 per cent. These results suggest that digital transformation is progressing at a micro level, but Slovenia is still some way behind advanced comparators.

2.2 Well governed

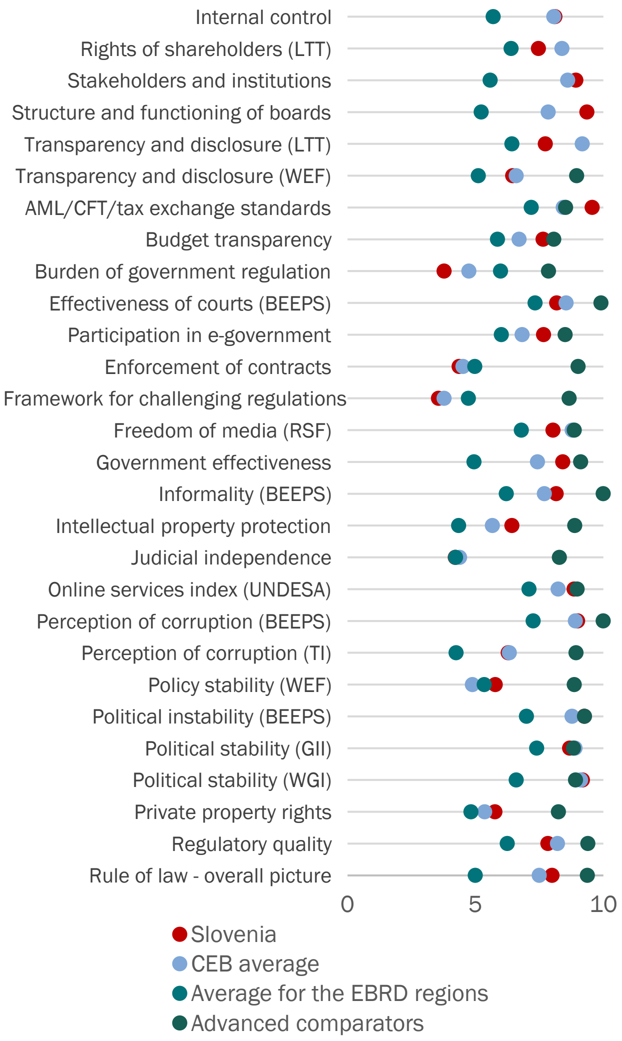
Slovenia is ranked fifth in the CEB region for governance, behind the Baltic states and Czechia. Slovenia has not caught up with advanced comparators in terms of the perceived effectiveness of the judicial system, lagging even the CEB average for most of the relevant indicators. Meanwhile, regulatory quality and the burden of government regulations are both areas where long-term improvement is required. On the plus side, e-governance and online public services are becoming more prevalent in Slovenia and have improved in recent years.

Slovenia's corporate governance framework is relatively advanced, but needs strengthening. In the state-owned enterprise sector, the government applies the most up-to-date recommendations on SOE management, but frequent state and political interference mean that robust safeguards are required to ensure efficient management.

Governance at national level

Public trust in public authorities is satisfactory, but is lower when it comes to the judiciary and control of corruption. In the spring 2023 Eurobarometer, 27 per cent of Slovenians considered the public administration to be close to citizens, compared with an EU average of 15 per cent, while 38 per cent regarded it as complex and burdensome – again better than the EU average of 48 per cent.[26] In contrast, firms and citizens in Slovenia were more negative than the EU average when it came to the rule of law: 79 per cent of firms and 83 per cent of citizens considered corruption to be widespread in society (compared with EU averages of 65 and 70 per cent respectively). However, when asked to report actual experiences of corruption, both groups reported fewer instances than the EU average.[27]

Chart 17. Indicators of governance



Slovenia's public administration is fairly centralised. Slovenia's public sector accounted for 16.7 per cent of total employment in 2019, at the lower end of the distribution for OECD members.[28] Central government accounted for 61 per cent of public-sector employment in 2020, suggesting a relatively high level of centralisation, which is understandable given the country's small size.[29] Apart from some easing of the financial and

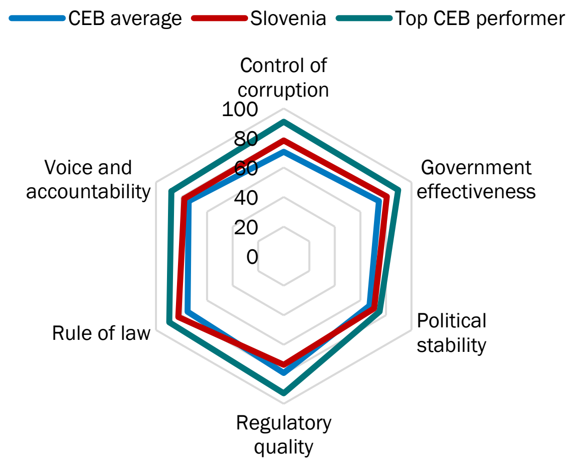
[26] See European Commission (2023d).
[27] Ibid.

[28] See OECD (2021).
[29] See European Commission (2022a).

bureaucratic burdens on local authorities as of 2020, no other major administrative reforms have been implemented in recent years. Those reforms were carried out because of the longstanding financial weakness of local government.

Government is generally effective, resulting in a good quality of policymaking, but it is yet to reach the level seen in advanced comparators. As reflected in relevant sub-indicators, Slovenia's government performance and regulatory quality are similar to the respective CEB averages (see Chart 18). In this sense, the country does not display a governance "premium" relative to its peers, despite having higher living standards. Anecdotal evidence on the time taken to adopt important reforms, such as the Long-Term Care Act, suggests a fairly slow and somewhat unpredictable process, leading to uncertain outcomes for policymaking, especially for more complex reforms. The tax framework has also been amended frequently, affecting the predictability of business.

Chart 18. Worldwide Governance Indicators, 2022



Source: World Bank (2023c).

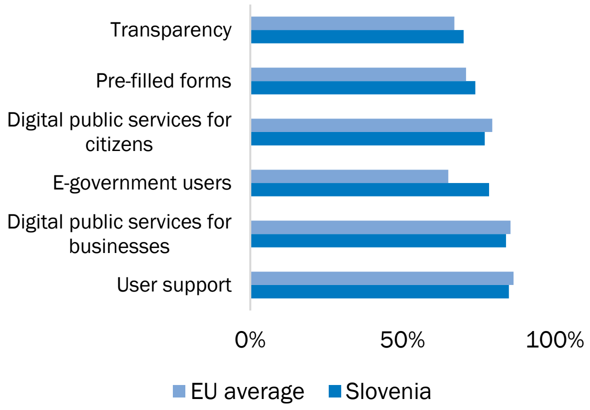
The gap to advanced comparators is larger when it comes to the judicial system. According to the *2023 EU Rule of Law Report*, the Slovenian justice system has seen some improvements in quality and efficiency, as well as addressing issues raised in previous years. However, the European Commission notes that the judicial system still needs additional safeguards to ensure the independence of the judiciary and prosecutors.[30]

Anti-corruption institutions need to be strengthened. In Transparency International's Corruption Perceptions Index 2023, Slovenia was ranked 42nd globally (out of 180 countries).[31] It is generally rare for corruption cases to be prosecuted and they tend to take too long, raising concerns. Despite some progress related to increases in the resources of relevant anti-corruption institutions, the European Commission has recommended that Slovenia remove obstacles to the investigation and prosecution of corruption cases and start implementing its new anti-corruption strategy without further delay.[32]

E-governance has been prioritised and accelerated since the Covid-19 pandemic. The need for better online services during the pandemic forced the authorities to accelerate the deployment of e-government solutions, and e-governance is now one of the main priorities in the RRP. Important bills were adopted in 2021 and 2022 covering e-identification, e-signatures and e-identity cards. Meanwhile, the digital skills of civil servants are being addressed through training. The government has established a special digital transformation unit in the Prime Minister's office, which has been driving most of these initiatives. DESI indicators suggest that Slovenia outperformed the EU average for digital public services in 2024 (see Chart 19).

[30] See European Commission (2023e).
[31] See Transparency International (2023).
[32] See European Commission (2023e).

Chart 19. DESI indicators of digital public services, 2024 (normalised scores)



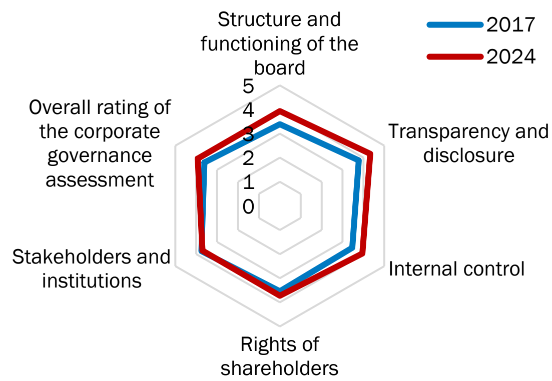
Source: European Commission (2024b).

Corporate and SOE governance

Slovenia's corporate governance framework has improved significantly in recent years. Historically, Slovenia's corporate governance practices have been deficient, indirectly caused by a lack of privatisation involving foreign investors, which often led to untransparent fights for control between domestic owners and complex ownership structures for state-owned assets. After becoming an OECD member in 2010, the country established Slovenian Sovereign Holding (SSH) in 2014 to manage state-owned assets, and its laws on SOEs were aligned with the OECD's principles in 2016. An EBRD review of Slovenia's corporate governance framework in 2017 assessed its overall level as "moderately strong", with the structure and functioning of boards and internal controls being rated "fair".[33]

A subsequent assessment of Slovenia's corporate governance framework in 2023 suggests that improvements have been made in recent years. Slovenia's corporate governance framework again achieved an overall rating of "moderately strong", with improvements in most of the main areas (see Chart 20). At a more granular level, non-financial disclosure (part of transparency and disclosure) and the quality of internal control frameworks have both improved significantly compared with 2017.

Chart 20. EBRD assessment of Slovenia's corporate governance framework



Source: Djurić and Tumanyan (2024).

However, some key elements of corporate governance still need strengthening. Areas with a rating below "moderately strong" (corresponding to a score of around 3) in 2023 included the independence of directors, the effectiveness of boards and the composition of boards, pointing to a need to enhance the roles and independence of boards in Slovenian companies.

SOEs in Slovenia account for a large share of total added value relative to the country's peers and are wider in scope. Thanks to the rather unique method of privatisation in the 1990s, the Slovenian state maintains control over strategic sectors such as energy, transport and banking. At the end of 2022, the state owned (through SSH) assets with a book value of €11.2 billion, with an average return on equity of 2.8 per cent (lower than the target of 5 per cent and the 2021 average of 6.1 per cent).[34] SSH classifies 80 per cent of its assets as "strategic". While state-owned banks have been privatised in recent years, the state has not signalled a change of heart when it

[33] See Cigna et al. (2017).

[34] SSH data.

comes to other potential listings or privatisations, irrespective of the political party in government.

SOEs' corporate governance can potentially be affected by political interference. In theory, Slovenia adopted a robust governance framework in 2019; in practice, however, experience shows that the state can interfere abruptly in the management of its assets.[35] Indeed, SSH's management often changes after an election. For example, following the parliamentary elections in April 2022, which resulted in the formation of a new government, the President of the Management Board of SSH was replaced in September 2022, and three of the four members of the Supervisory Board of SSH were replaced in November 2022. Nevertheless, SSH maintains a fairly mature, professional and transparent stance.

[35] See IMAD (2023a).

2.3 Green

Slovenia ranks second in the EBRD regions on the "green" transition quality. That strong result reflects the protection of biodiversity, the energy efficiency of the energy system and the wider economy, and the regulatory and strategic framework for climate change and the green transition. Slovenia also outperforms the CEB and EU averages when it comes to waste management.

At the same time, however, that overall score masks a lack of readiness and ambition when it comes to accelerating the green transition. Slovenia has made the smallest amount of progress in the CEB region in terms of adding renewable capacity in recent decades, while the electricity grid is not ready for additional capacity (as described in the section on resilience). Unlocking this potential against the background of the need for more energy independence must be a top priority, but there are signs that the process has started to pick up speed.

Energy supply and emissions

The Environmental Protection Act establishes Slovenia's long-term objective of achieving climate neutrality by 2050. That climate neutrality target aligns with the long-term climate strategy adopted in 2021.[36] For the period up to 2030, that long-term climate strategy is based on decisions already included in Slovenia's Development Strategy 2030, the Integrated National Energy and Climate Plan (NECP) and other sectoral documents. Table 1 summarises the sectoral emission reduction targets Slovenia is looking to achieve by 2050.

Chart 21. Green indicators

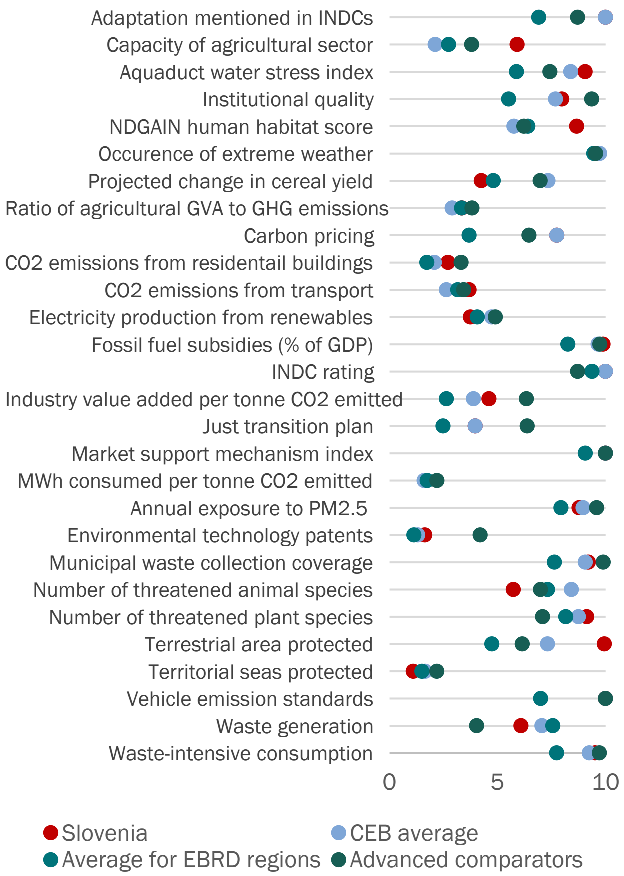


Table 1. Sectoral emission reduction targets to be achieved by 2050 (based on 2005 levels)

Sector	Target to be achieved by 2050
Transport	90-99% reduction
Energy	90-99% reduction
Industry	80-87% reduction
Agriculture	5-22% reduction
Buildings	87-96% reduction
Waste management	75-83% reduction
Total excl. LULUCF[37]	80-90% reduction
LULUCF	Min. reduction of 2.5 $MtCO_2e$
TOTAL	**Net-zero GHG emissions**

Source: UNFCCC (2021).

[36] See UNFCCC (2021).

[37] LULUCF stands for land use, land-use change and forestry.

Slovenia's updated NECP sets indicative milestones for sectoral greenhouse gas (GHG) emissions by 2030.[38] The sectoral targets that were laid down in the updated NECP drawn up in 2023 (which set more ambitious targets relative to 2020) were as follows:

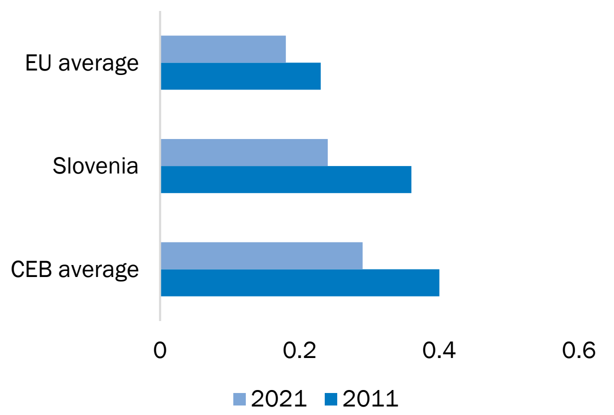
- Transport: +3 per cent
- Buildings: –74 per cent
- Agriculture: –1 per cent
- Waste management: –67 per cent
- Industry: –55 per cent[39]
- Energy: –48 per cent[40]

The updated NECP raised the target for renewables from 27 per cent of final consumption by 2030 to 30-35 per cent (which is, however, still below the required 46 per cent), including 52 per cent for electricity generation, 41 per cent for heating and cooling, and 26 per cent for transport.[41] The NECP also set energy efficiency targets for buildings, seeking to reduce their energy use by 20 per cent and reduce their GHG emissions by at least 70 per cent by 2030 relative to 2005. The NECP estimated total financing needs of €28.5 billion (equivalent to around 6 per cent of GDP per year).

Slovenia is on track to achieve the primary and final energy consumption targets set out in its NECP. However, the European Commission regarded the 2020 targets as only moderately ambitious and was not able to properly assess the 2023 update owing to the incompleteness of the report.[42]

The Slovenian economy is 33 per cent more carbon-intensive than the EU average. While Slovenia's GHG emissions intensity has halved since the 1990s, it remains above the EU average (but is lower than in most CEB countries). Relative to 2005, emissions have declined by 35 per cent in Emissions Trading System (ETS) sectors and by 13 per cent in non-ETS sectors – slightly less than the EU average. The energy sector accounts for 80 per cent of the country's total GHG emissions, followed by agriculture (10 per cent) and industrial processes and product use (7 per cent).

Chart 22. Carbon intensity per unit of GDP ($kgCO_2$/2015 US$)

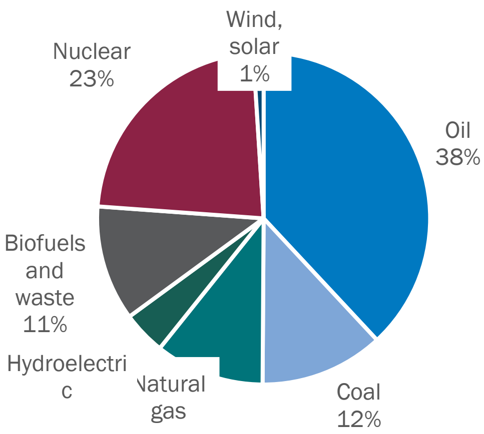


Source: IEA (2023a) and authors' calculations.

Slovenia's energy supply is heavily reliant on fossil fuels and nuclear power, with wind energy and solar power accounting for negligible shares. The energy supply mix continues to be dominated by more traditional sources (see Chart 23). In 2022, large percentages of Slovenia's electricity production came from nuclear power (41 per cent), hydroelectric power (25 per cent) and coal (24 per cent), while solar power generated only 5 per cent.

[38] See Vlada Republike Slovenije (2023).
[39] Only for the part of this sector that is not included in the EU's Emission Trading System (ETS).
[40] Only for the part of this sector that is not included in the ETS.
[41] See European Commission (2023f).
[42] Ibid.

Chart 23. Total energy supply by source, 2022



Source: IEA (2023b) and authors' calculations.

Renewables have not been scaled up so far. Between 2005 and 2021, Slovenia added the smallest amount of renewable capacity in the EU as a percentage of the total electricity mix.[43] Nevertheless, in 2023, Slovenia increased its solar capacity by almost 60 per cent to 1.105 GW – one of the largest increases in the EU.[44] The target of achieving 3.5 GW by 2030 looks realistic if the same pace is maintained over the remainder of this decade. Ramping up renewable energy capacity would increase Slovenia's energy independence and enable a full transition to a green economy.

Barriers to the deployment of renewables have yet to be fully addressed. The key barriers to such deployment include the procedures for obtaining permits, a lack of readiness at the level of the distribution grid and issues relating to storage infrastructure.[45] Moreover, Slovenia has offered only modest subsidies for renewables and associated technologies (€29 per capita, compared with an average of €163 per capita across the EU as a whole), failing to stimulate investment in renewables.[46] Slovenia's grid infrastructure will need €3.5 billion worth of investment by 2030 in order to fully integrate the pipeline of renewables. Reflecting the modest amounts of investment in renewables in recent years, green financing has failed to take off, with outstanding sustainability bonds totalling just €2.25 billion.[47]

In parallel, the authorities are considering the possibility of expanding nuclear capacity. Despite its recent pledges to increase the role of renewables in the energy supply, Slovenia is focused on pursuing a more balanced approach, with nuclear energy being the balancing cleaner resource. There are currently plans to build another unit at the Krško nuclear plant, to be completed by 2037. This is subject to a referendum in 2024, with the investment decision due to be taken in 2027 or 2028.[48] The authorities are also considering small modular reactor technology and have adopted a new spatial planning strategy running until 2050 to enable the construction of additional nuclear capacity.

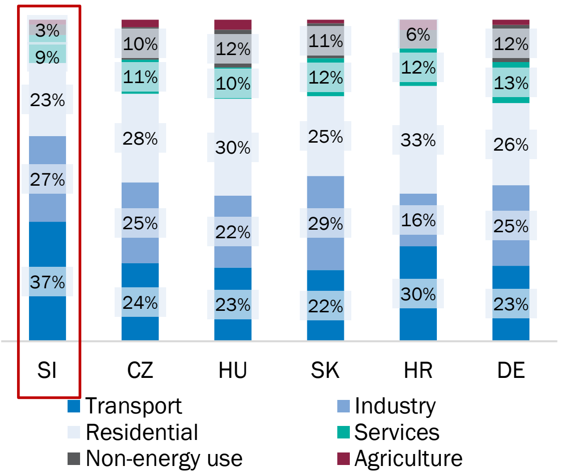
Slovenia has adopted the National Strategy for the Phasing-Out of Coal and the Restructuring of Coal Regions, in line with the Just Transition Principles.[49] Slovenia has committed to completely phasing out coal by 2033. The EU's Just Transition Fund (JTF) is supporting Slovenia's efforts to diversify the local economy, particularly in the Savinjsko-Šaleška (SAŠA) and Zasavje regions.[50] The degraded coal facilities in those regions will be repurposed and revitalised with the aim of investing in the expansion of renewable energy production. The JTF is also supporting 2,400 workers who are active in the coal sector, providing lifelong career guidance and training. JTF funding allocated to Slovenia under its investment and growth goal is set to total €113 million over 2021-27, with another €145 million having come via the European Recovery Instrument in 2021-23.[51]

[43] See IMAD (2023a).
[44] See Spasić (2024a).
[45] See European Commission (2023a).
[46] See IMAD (2023a).
[47] EBRD calculations.
[48] See Spasić (2024b).
[49] See Ministry of Infrastructure (2021).
[50] See European Commission (2022b).
[51] See European Union (2021).

Energy consumption and efficiency

The transport and industrial sectors are the main energy consumers in Slovenia. In 2021, these two sectors accounted for 64 per cent of final energy consumption (see Chart 24).

Chart 24. Breakdown of final energy consumption by sector, 2021



Source: IEA (2023c) and authors' calculations.

Slovenia's total energy intensity has fallen by almost 35 per cent since 2005, but it was still 12 per cent higher than the EU average in 2021.[52] Compared with regional peers, Slovenia had a higher energy intensity (in price-adjusted terms) than Latvia, Lithuania and Croatia, implying average performance. The most energy-intensive sector is transport, followed by the industrial and residential sectors. When energy intensity is adjusted for the climates of the respective countries, Slovenia has the fifth-highest energy intensity in the EU (19 per cent higher than the EU average), but the progress the country has made since 2000 is the third-best in the EU, with an energy saving rate of 34.3 per cent.[53] Looking at key sectors, the energy saving rate for industry is 34.7 per cent relative to 2000 – lower than in most regional peers – but the energy intensity of the sector is still slightly lower than the EU average. In contrast, Slovenia's services sector has recorded the third-largest energy saving improvement in the EU over the same period. In an energy efficiency index[54] compiled by the Odyssee-Mure project, Slovenia ranks ninth in the EU, behind Latvia and Estonia in the CEB region.[55]

Energy efficiency in manufacturing has exceeded the EU average in recent years. In 2015, energy productivity in Slovenia's manufacturing sector was around 5 per cent lower than the EU average, but progress was made in subsequent years, leaving it around 5 per cent higher than the EU average in 2021.[56] In fact, energy productivity has almost doubled since 2005 in Slovenia, while across the EU as a whole, it has increased by around 40 per cent. Consequently, the energy intensity of Slovenia's manufacturing sector was the eighth lowest in the EU in price-adjusted terms in 2021.[57]

The transport sector is a major source of energy consumption and emissions. According to Odyssee-Mure estimates, the energy saving rate of Slovenia's transport sector relative to 2000 stands at 24.6 per cent – higher than the EU average.[58] Nevertheless, Slovenia's position on regional trade routes is leading to increases in freight transport. This, combined with the intensive use of personal cars, means that there is an urgent need to reduce emissions while improving rail connectivity.

The energy efficiency of buildings has improved. According to Odyssee-Mure estimates, Slovenian households have improved their energy efficiency by 41.2 per cent since 2000 – the third-largest improvement in the EU.[59] Nevertheless, households in Slovenia still use around 12 per cent more energy than the average EU household, adjusted for climatic conditions.[60] The efficiency of

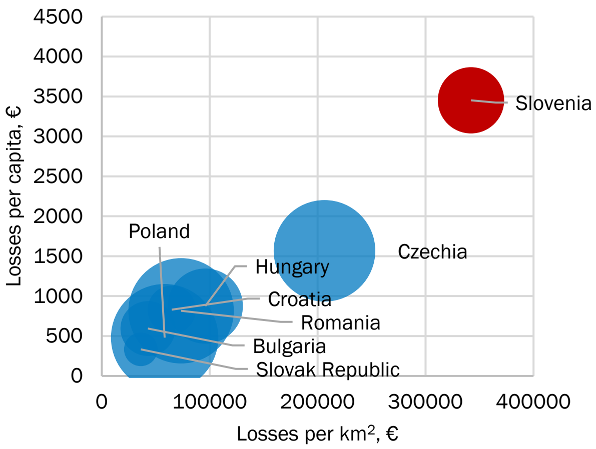
[52] See Eurostat (2023j).
[53] See Odyssee-Mure (2023a).
[54] The main components of this index are (i) the level of energy efficiency, (ii) progress on energy efficiency and (iii) energy efficiency policies.
[55] See Odyssee-Mure (2023b).
[56] See IMAD (2023a).
[57] See Odyssee-Mure (2023c).
[58] See Odyssee-Mure (2023d).
[59] See Odyssee-Mure (2023e).
[60] Ibid.

Slovenia's heating could also be improved, as it requires 20 per cent more energy per m² than the EU average, adjusted for climatic conditions.

The environment and the circular economy

The flash floods of August 2023 increased the urgency of climate adaptation measures. The economic damage caused by weather and climate-related events prior to the August 2023 flash floods totalled €3.85 billion, with Slovenia being impacted more than its peers in the CEB region in per capita terms and relative to the physical size of the country (see Chart 25). Adding the impact of the floods brings the total amount of recent damage to €13.8 billion. The state will finance the reconstruction work and climate adaptation measures using additional EU funds and a tax imposed on banks and other firms for the next five years. This highlights the importance of climate adaptation and resilience measures in Slovenia.

Chart 25. Economic damage caused by extreme weather and climate-related events, 1980-2022



Source: EEA (2023c) and authors' calculations.
Note: The size of each circle indicates total losses. The chart does not include the damages of the 2023 flash floods.

Slovenia is continuing its progress in the area of waste management. It is currently on track to meet its main recycling targets for municipal waste and packaging waste for 2025. Its recycling rate in in 2020 was 59.3 per cent, which was already in excess of the 55 per cent that it was targeting for 2025.[61] However, to account for the impact of the new calculation rules, the EEA assumes a reduction of 5 percentage points, resulting in an estimated recycling rate of 54.3 per cent – below the target for 2025. Slovenia is not at risk of failing to meet its 2035 target of sending 10 per cent or less of municipal waste to landfill (achieving a figure of 6.7 per cent in 2020). Average annual municipal waste generation per capita fluctuated over the period 2004-20, but returned to its 2004 level in 2020.[62] Overall, Slovenia averaged 511 kg per capita in 2021, below the EU average of 530 kg.

The new Environmental Protection Act, which was adopted in March 2022, introduces comprehensive regulations in the area of waste management. It includes provisions aimed at reducing the impact of resource use and improving overall resource efficiency, in line with the transition to a circular economy. Significant investment in waste and wastewater is planned as part of the country's RRP.

More progress is needed when it comes to the circular economy and decoupling economic growth from resource use. The country's circular material use rate of 11 per cent is close to the EU average of 11.7 per cent. However, like the EU as a whole, Slovenia is not on track to meet its objective of achieving a circular material use rate of 23.4 per cent by 2030.

[61] See EEA (2023a).

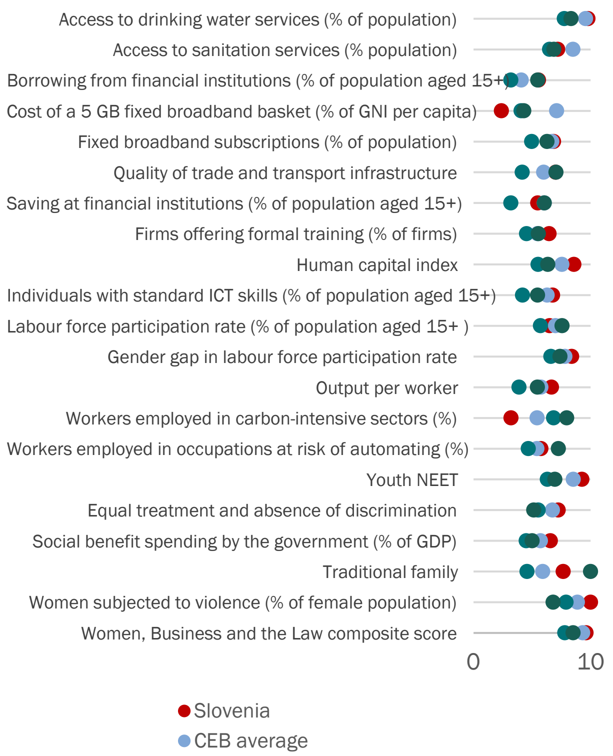
[62] See EEA (2023b).

2.4 Inclusive

Slovenia performs better than most CEB peers when it comes to inclusion, reflecting its high levels of human capital development, satisfactory access to services, and small gender and age-based inclusion gaps. Indeed, in 2023, it was ranked third in this area out of the 36 economies where the EBRD invests. While there are still some gaps when it comes to access to broadband, and a large percentage of employment is in carbon-intensive sectors, Slovenia performs well in terms of policies, norms and human capital development.

Nevertheless, some of Slovenia's most urgently needed reforms are in this area, including reforms to the pension system, long-term care and the healthcare system. These are all required in order to ease labour shortages and address long-term demographic challenges.

Chart 26. Inclusion indicators



Access to services is lower than the CEB average. While Slovenia performs better than its peers in terms of the percentage of the population that borrows from banks and the overall quality of infrastructure, it is lagging when it comes to the cost of 5G broadband, access to sanitation services and the percentage of the population that is saving with a financial institution (see Chart 26).

Meanwhile, Slovenia's policies and norms are assessed as being more progressive than the CEB average. The indicators used to measure this (the last five in Chart 26) suggest that Slovenia is performing well in terms of protecting women's rights, enabling integration and limiting overall discrimination. In fact, Slovenia is outperforming advanced comparators on almost all indicators.

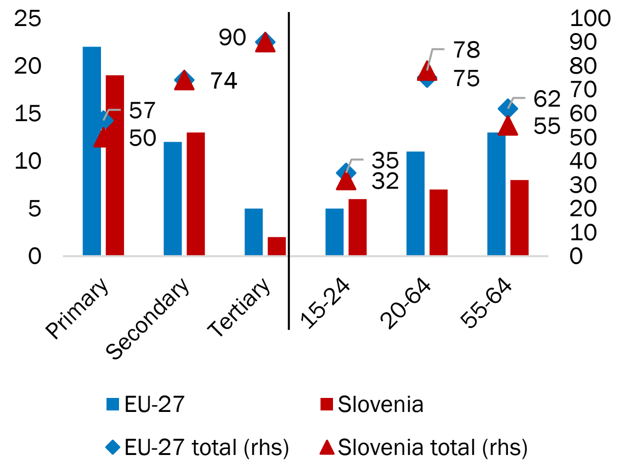
Slovenia is among the best performers in the EU in terms of income and gender inequality, partly reflecting its high levels of human capital development. In 2022, only 13.3 per cent of the population was at risk of poverty or social exclusion, the second-lowest figure in the EU (after Czechia) and far lower than the EU average of 21.6 per cent).[63] In terms of gender, women were only 1.1 percentage points more likely to be at risk of poverty than men – a smaller difference than in Czechia, where men are at considerably less risk than women. In fact, employed women were at less risk of poverty than employed men. More notable gaps were observed for people without primary education and retired persons, where the risk of poverty was closer to the EU average of around 25 per cent.[64] In 2021, Slovenia had a gender pay gap of 3.8 per cent – the third lowest in the EU and far lower than the EU average of 12.7 per cent.[65]

The labour market has tightened considerably since the Covid-19 crisis, increasing labour shortages. In Q3 2023, the employment rate in Slovenia stood at 77.3 per cent – higher than the EU average of 75.3 per cent, but lower than in most regional peers.[66] While activity rates for

[63] See Eurostat (2023k).
[64] Ibid.
[65] See Eurostat (2023l).
[66] See Eurostat (2023m).

young and older people are lower than the respective EU averages, increases in those rates would not result in all labour demand being met (see Chart 27). Indeed, labour shortages reported by firms in the manufacturing and service sectors reached record levels at the end of 2022 (see Chart 27). A cooling of economic activity in 2023 led to a marginal easing of labour shortages, with labour-market slack increasing to 6.8 per cent in Q3 2023 (albeit remaining the fourth lowest in the CEB region).[67] Nevertheless, around half of all companies in the construction sector, a third of firms in the wholesale and retail trade sector and a quarter of manufacturing firms were affected by labour shortages in that quarter.[68] Another labour-market weakness is the fact that 55.3 per cent of young people (defined as those aged 15-24) are under temporary contracts, the second-highest figure in the EU.

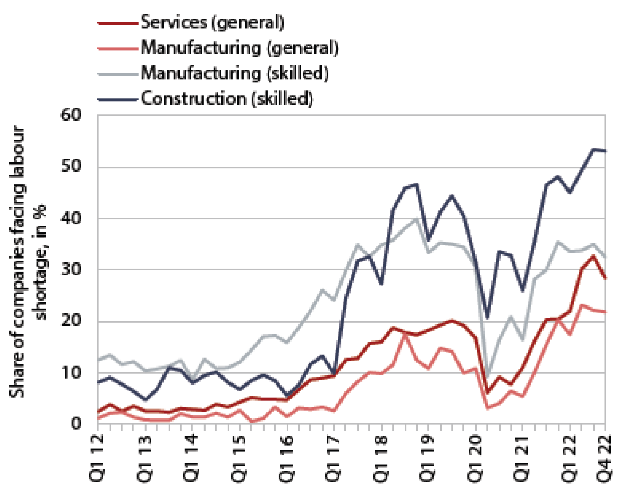
Chart 27. Employment gaps by level of education and age, 2022 (per cent)



Source: Eurostat (2023m).

To cover labour shortages, Slovenia has imported a significant number of workers. In recent years, Slovenia has managed to attract migrants from the Western Balkans countries and Asia. In 2023, foreign workers accounted for over 90 per cent of the annual increase in employment.[69] In August 2023, almost 15 per cent of all employed persons were foreign nationals, with larger shares being seen in construction, transport and services.[70]

Chart 28. Reported labour shortages

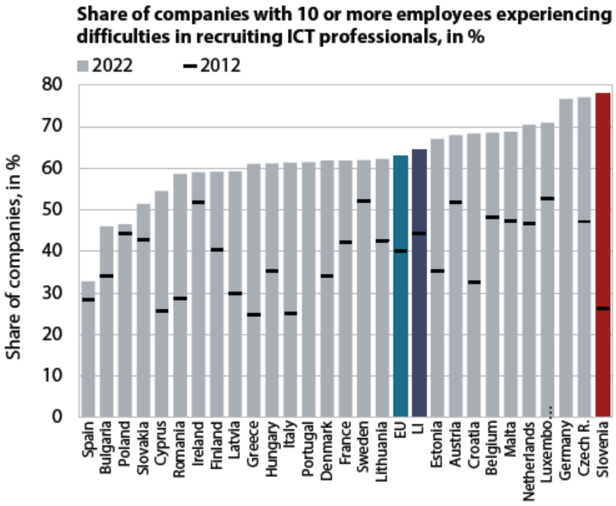


Source: IMAD (2023a).

Shortages of digital skills and ICT professionals are particularly acute. According to the DESI Index 2023, the supply of ICT professionals is in line with the EU average. However, the labour shortages reported by firms suggest that Slovenia could significantly accelerate its digital transformation if it were to increase the supply of relevant ICT skills (see Chart 29). ICT accounted for 4.5 per cent of total employment in 2022, similar to the EU average.[71] Moreover, only 1.4 per cent of female graduates were in ICT, compared with 9.4 per cent for male graduates, reflecting a gender gap that is slightly larger than the EU average.[72]

[67] See Eurostat (2023n).
[68] See IMAD (2023b).
[69] Ibid.
[70] See IMAD (2023a).
[71] See Eurostat (2023o).
[72] Ibid.

Chart 29. Shortages of ICT professionals



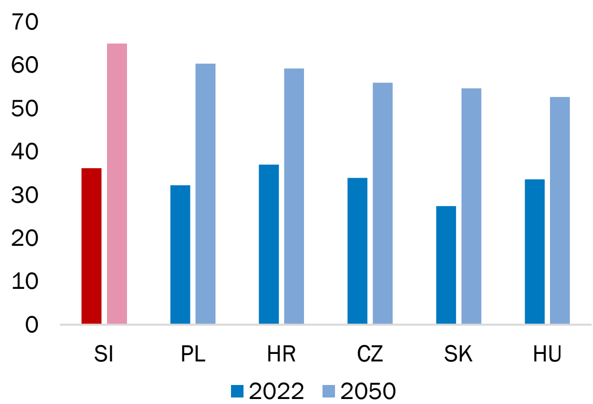
Source: IMAD (2023a).

The green transition will prove challenging for people working in carbon-intensive sectors. A relatively large share of Slovenia's total employment is in energy-intensive sectors such as coal mining, particularly in the Savinjsko-Šaleška and Zasavje regions. There are approved projects worth €258 million under the Just Transition Fund, which envisage the closure of coal power plants by 2033 and associated support for 2,400 workers in the Savinjsko-Šaleška region. The Zasavje region has also had coal-mining operations in the past and is now looking to reorient its local economy.

While Slovenia's social protection system is adequate overall, its long-term care and healthcare systems need urgent reform. In 2021, Slovenia had the highest general government expenditure on social protection in the EU-11, at 17.9 per cent of GDP.[73] Given the higher levels of inequality in old age and the projected acceleration in demographic ageing, Slovenia needs to ensure that its long-term care system will function well over the next few decades. The situation in long-term care has been deteriorating, with staff shortages in nursing homes and poorly developed home care. The need for a uniform regulatory framework has been acknowledged for more than two decades, and a new law was adopted in June 2023 after the one adopted in December 2021 failed to specify how the new system would be financed. The new bill addressed the decentralised nature of long-term care facilities and shortages of funding and staff. The system will be financed by a 1 per cent contribution from firms and employees – a measure that has been criticised by the business community.

Pension reforms are also needed amid acute demographic challenges. State spending on pensions in Slovenia will rise from 10 per cent of GDP in 2019 to 15.7 per cent by 2050, the second-highest figure in the EU.[74] This is due to the higher-than-average projected old-age dependency ratio (see Chart 30). Under current legislation, the retirement age will stay at 62 years, the second lowest among OECD members. Other necessary changes include price indexation, the linking of age of retirement to life expectancy, the simplification of pension rules, increases in the transparency of finances, and more incentives for occupational plans.

Chart 30. Old-age dependency ratios (per cent)



Source: Eurostat (2023q).

[73] See Eurostat (2023p).

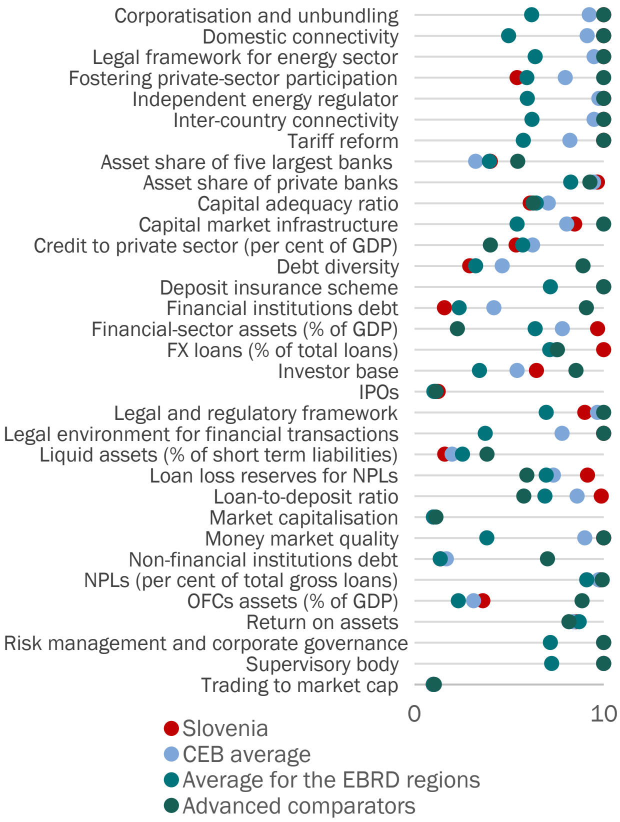
[74] See OECD (2023b).

2.5 Resilient

Slovenia was ranked first in the EBRD regions for resilience in 2023. Its high score reflects the resilience of the energy system (which is generally better than the CEB average, with the exception of private-sector participation in the energy sector). The energy crisis of 2021-22 forced stakeholders to adjust the entire energy system, enhancing energy security and independence while accelerating its readiness for the green transition. At the same time, the investment gap in infrastructure for the period to 2030 remains significant.

As for financial resilience, Slovenia's banking sector has recovered from the banking crisis and its performance is in line with the regional average, but its depth has continued to decline. Capital market activity remains very limited owing to size and liquidity constraints, which is forcing the supply and demand sides for securities to get involved in foreign markets.

Chart 31. Resilience indicators



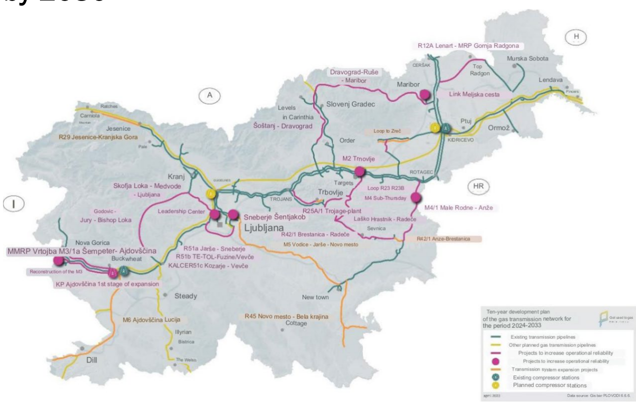
Energy resilience

Slovenia's energy resilience indicators are on a par with advanced comparators. In the EBRD's assessment, Slovenia's regulatory framework and the structure of its energy system are in line with those of advanced comparators when it comes to the unbundling of energy players, the independence of the regulator and connectivity. The only aspect that needs some improvement is private-sector participation, given Slovenia's largely nationalised energy system and the limited competition in the generation and distribution segments. All major energy producers, transmission system operators and distributors remain state-owned.

Slovenia's energy connectivity and supply are more diversified than those of most regional peers, but significant investment is needed to improve the grid. Slovenia is connected to Austria by two 400 kV transmission line systems and one 220 kV transmission line; it is connected to Italy by one 400 kV line and one 220 kV line; and three 400 kV transmission line systems, two 220 kV lines and three 110 kV lines connect Slovenia to Croatia. A 400 kV connection to Hungary was completed in June 2022. As regards gas infrastructure, Slovenia plans to significantly expand its cross-border transmission network, with key projects including additional interconnections with Croatia, Hungary and Austria (see Chart 32). In 2022, electricity losses in the transmission network were the highest in the last ten years, largely owing to increases in transit and imports, although losses in the distribution network have continued to decline.[75] About €3.5 billion of investment in the grid is needed to integrate renewables, while ELES (the transmission system operator) plans to invest about €1.6 billion by 2032 under its latest development plan.[76] The need for investment can be seen in the fact that 25 per cent of connection applications from prosumers were rejected in 2022.[77]

Despite the diversification of domestic production, Slovenia remains a net importer of electricity. In 2022, Slovenia imported almost as much electricity as it produced domestically following much weaker generation of hydroelectric power and lower coal-fired production at the Šoštanj Thermal Power Plant (TEŠ). In fact, the share of total demand covered by domestic production declined to 70 per cent that year, having averaged 86 per cent over the previous four years.[78] Although the government managed this crisis fairly well, reliance on imports will increase in the absence of more domestic capacity, bearing in mind the expected closure of coal-fired power plants.

Chart 32. Planned investment in gas infrastructure by 2030

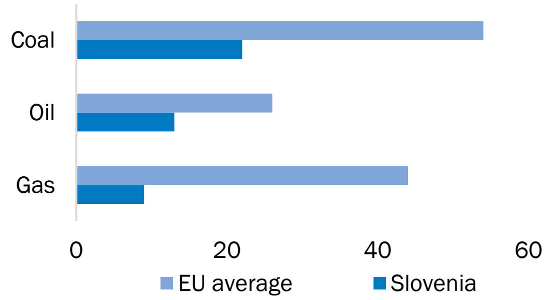


Source: European Commission (2023f).
Note: Only the green lines are in operation; the rest are either planned or under construction.

Slovenia's dependence on Russia for energy has decreased since 2022. Slovenia has historically been a net importer of energy and fully dependent on imports for coal, natural gas and oil products. While Chart 33 shows that Slovenia was dependent on Russia for around 10 per cent of its gas imports prior to the war in Ukraine, 85 per cent of its gas imports came from Austria – which, in turn, imported almost everything from Russia. Since the start of the war in Ukraine, the government has received more gas from Italy and booked more capacity at the Krk LNG terminal in Croatia. Moreover, imports from Algeria will cover a third of Slovenia's annual gas consumption until 2026 under a three-year contract signed in November 2022. The government intends to completely replace Russian gas imports by 2025.

[75] See Agencija za energijo (2023).
[76] Ibid.
[77] Ibid.
[78] Ibid.

Chart 33. Percentage of imports coming directly from Russia



Source: European Commission (2022c).

The government has intervened in the energy market to stabilise prices and limit the effect on consumption. The state has intervened heavily in energy markets through several measures (see Box 1). The combined impact of those measures meant that the annual electricity bill of an average household in 2022 was 22 per cent lower than it would otherwise have been, standing at €617 – similar to the figure for 2021 – instead of €794. The average annual gas bill was 9.7 per cent lower than it would otherwise have been, but was still 39 per cent higher than in 2021.[79] The impact of price developments can be seen in consumption patterns. Gas consumption declined by 13.7 per cent in the period from August 2022 to March 2023 – not quite achieving the EU's objective of 15 per cent. Meanwhile, electricity consumption fell by 8.2 per cent between November 2022 and March 2023 – again, below the EU's target of 10 per cent – as households and small businesses consumed more than the average for previous years (while large consumers reduced their consumption).[80] In 2022, Slovenian households had the second-lowest final electricity prices in the CEB region, after Hungary.[81] The same was true of business customers, whose final prices were only bettered in Croatia. Thus, the fact that electricity bills increased only marginally meant that there was little incentive for households to consume less and increase energy efficiency.

Box 1. Summary of policy response to energy crisis

The government adopted several support packages. The main ones were as follows:

- **February 2022** – exemption from network charges and renewable energy source and combined heat and power contribution until May 2022; reduced excise duties on electricity and heating; one-off allowance to alleviate energy poverty.
- **July 2022** – retail price cap for households and SMEs for electricity and natural gas from September 2022 to September 2023 (later extended to end 2023).
- **August 2022** – 50 per cent reduction in renewable energy source and combined heat and power contribution from September 2022 to September 2023.
- **September 2022** – Value-added tax rate reduced from 22 per cent to 9.5 per cent for all consumers of all types of energy until June 2023.
- **January 2023** – price cap for district heating until May 2023.
- **June and September 2022** – no environmental tax payable from June 2022 to August 2022 and from September 2022 to May 2023.
- **September 2022** – subsidies for firms, and state guarantees to help key energy companies to access liquidity.
- **October 2023** – retail price caps extended until end-2024 for households only, with the caps covering 90 per cent of consumption. (In fact, the gas cap, which was subsequently lowered in light of the decline in global prices, was ultimately removed in May 2024.)

Source: Agencija za energijo (2023).

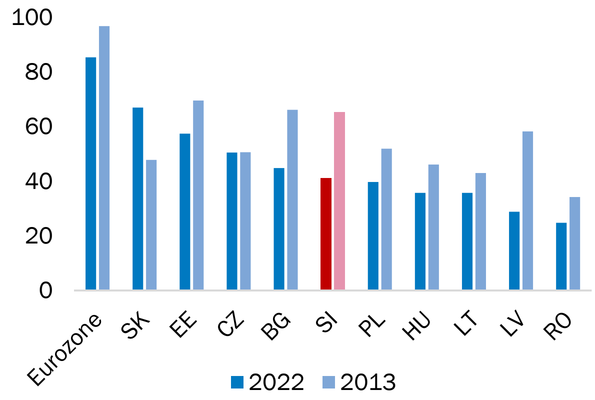
[79] Ibid.
[80] Ibid.
[81] Ibid.

Financial stability

In the EBRD's assessment, Slovenia's financial stability has improved in recent years and is slightly better than the CEB average. Slovenia's financial sector, which continues to be dominated by banks, is in much better shape than it was around 2013, when acute financial market tensions were observed. However, Slovenia's scores for capital adequacy ratios, credit to the private sector, debt diversity, financial institutions' debt and the legal and regulatory framework are lower than the respective CEB averages, reflecting the legacy of the 2013 banking crisis (see Chart 31).

The banking sector's depth has been on a downward path in recent years. Following the 2013 banking crisis, the private sector has been deleveraging, which has reduced the size of the banking sector but improved its quality. The assets of the banking sector were equivalent to 88.7 per cent of GDP at end 2022, and that figure declined further throughout 2023.[82] The average loan-to-deposit ratio has also declined sharply, falling from 141.5 per cent in Q3 2013 to 65.7 per cent in Q3 2023. Slovenia's bank credit to the private sector is now low relative to the EU average, but that is not unusual in the EU-11 (see Chart 34). In turn, asset quality has improved over the years, with non-performing loans (NPLs) declining from 6 per cent of total loans in 2018 to 1.6 per cent in October 2023. Slovenia's average Tier 1 capital ratio in 2018-22 was decent at 17 per cent, but slightly lower than the EU average and at the lower end of the CEB region, while its return on equity (ROE) was among the highest in the region, at around 11 per cent. The cost-to-income ratio has averaged 62 per cent over the past five years, suggesting that banks are less efficient than their peers in other CEB countries.[83]

Chart 34. Domestic credit to the private sector by banks (percentage of GDP)



Source: World Bank (2024) and authors' calculations.

Despite the economic slowdown, banks enjoyed a strong 2023. In 2023, banks experienced significant growth in net interest income, with the ROE exceeding 20 per cent, as deposit rates rose less than rates on loans.[84] The stock of loans to the non-banking sector was strongly affected by the rise in interest rates and declined by 1.6 per cent in the first ten months of 2023 (with a 2.5 per cent decline in loans to non-financial corporations). New deposits more than halved compared with 2022 amid weaker household savings. Slovenia is the EU member state where household deposits account for the largest percentage of bank liabilities, showing the importance of economic conditions to banks' funding structures.

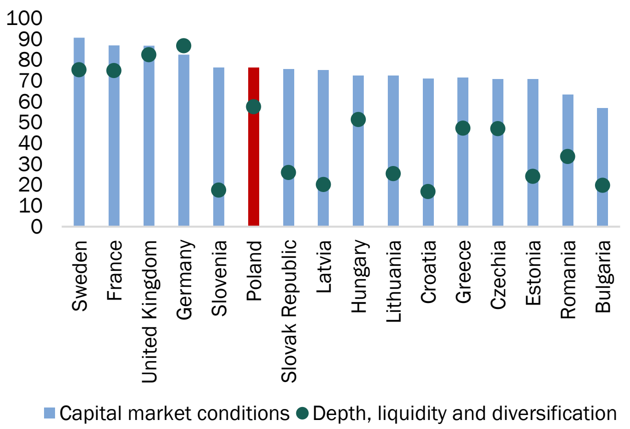
A windfall tax was imposed on financial institutions after the August 2023 floods, but profitability will be maintained. Given the strong performance of the sector and the need to fund post-flood reconstruction, the government introduced a windfall tax in September 2023, requiring financial institutions to make payments equal to 0.2 per cent of the total assets of their domestic operations for a five-year period from 2024, which will bring in around €100 million per year. While using interest income might have been preferable to total assets, the ceiling set at 30 per

[82] See Banka Slovenije (2023).
[83] See S&P Global Ratings (2023).
[84] See Bank Slovenije (2023).

cent of banks' pre-tax profits is a useful limit, as the International Monetary Fund has indicated.[85]

Slovenia's capital market features adequate enabling conditions, but market outcomes are modest, mainly owing to its small size (see Chart 35). Issuance of corporate and sovereign bonds is reasonably strong by comparison with regional peers, but the preference for international issuance is inhibiting the growth of the domestic market, which also features particularly shallow and declining secondary market liquidity. On the positive side, this reflects the strong links between the Slovenian economy and Europe's capital market. Equity markets are also underused compared with the rest of the EU, despite conducive conditions for the regional integration of capital market infrastructure and the quality of the legal and regulatory environment.

Chart 35. Financial market development index, 2022



Source: EBRD (2023).

Slovenia's legal and regulatory environment and its capital market infrastructure are both advanced. Its central bank's regulatory and supervisory framework complies with Basel III-based EU regulations, with the European Central Bank supervising the country's three largest banks. The country's delayed adoption of the Market in Financial Instruments Directive 2014 (MiFID II), for which it was fined in 2021, is its only outstanding failure to comply with EU directives on financial markets. Although several international and regional financial institutions are present in Slovenia, cross-border interest in its market has been relatively low. One of the main reasons for the limited interest is the lack of liquidity. Another factor is the fact that several listed companies have failed to appeal to international investors, as they do not communicate effectively with the international investment community. In March 2023, Slovenia published its Capital Markets Development Strategy 2023-30, focusing on digitalisation and SME involvement, the creation of additional supply in the capital market in the form of bonds, and the promotion of financial education, with the ultimate objective of attaining emerging market status. The strategy also aims to leverage distributed ledger technology to establish a unified digital platform for SME investment and provide SMEs and small investors with direct access to capital markets.

Issuance of corporate and sovereign bonds is relatively strong, but most bonds are placed outside the domestic market. While the total outstanding notional amount of corporate bonds was €2.5 billion (around 5 per cent of GDP) in December 2022, only 26 per cent of those were domestic bonds, indicating companies' preference for tapping international markets for large issuance. Issuing entities spanned a variety of sectors, reflecting Slovenia's small but diverse economy. The largest domestic issuers were NLB (the country's largest bank), Nova KBM (the recently privatised bank) and DARS (the state-owned motorway company). The overwhelming majority of sovereign bonds were also issued abroad, with a total outstanding notional amount of €38.1 billion (63 per cent of GDP) – of which approximately 69 per cent were international bonds as at April 2023. In contrast, there is a systemic lack of secondary market liquidity in the local fixed-income market, with bond turnover on

[85] See IMF (2024).

the Ljubljana Stock Exchange (LJSE) totalling just €0.11 million in 2022.

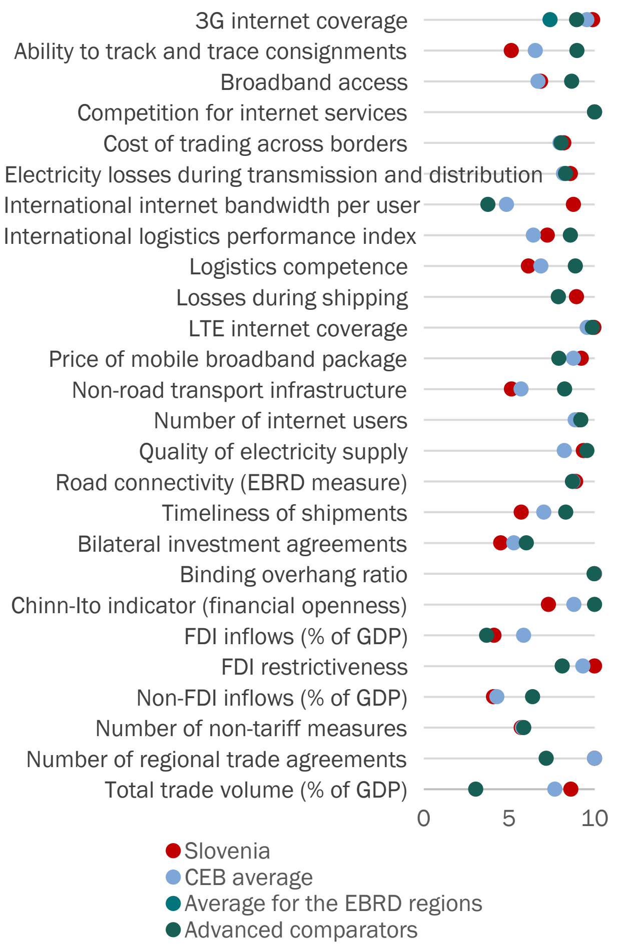
Slovenia's equity market is fairly well developed, but activity has been on a downward trajectory. In December 2022, the market capitalisation of the Slovenian equity market stood at around 13 per cent of GDP, roughly in line with regional peers but still significantly below the EU average. Since the beginning of the 2000s, when more than 200 issuers had shares listed on the LJSE, the number of issuers has declined or stagnated each year. At the end of 2019, 29 companies were listed on the LJSE; by 2022, the number had fallen to 24. Total turnover for equity instruments has improved in recent years, rising from €327 million in 2018 to €430 million in 2022, but this has mostly been limited to a few larger companies.

Slovenia's institutional investor base is fairly well developed, but also tends to invest abroad. The country's insurance sector is sizeable, but still underdeveloped, with €8.4 billion in total assets at end 2022. Fourteen insurance companies have their head offices in Slovenia, with the two largest being partially state owned and a further eight being foreign insurance companies that operate in Slovenia. At least 12 insurance companies offer some form of life insurance, with such products accounting for 27.6 per cent of total gross written premiums in 2022. In December 2021, insurance companies' investments accounted for 82 per cent of their assets, with roughly a third of their investments going to domestic issuers. Meanwhile, pension funds have grown quickly owing to the regular contributions generated by the mandatory second-pillar pension system. There are currently 12 mutual pension funds managed by three companies, with total assets worth around 2.5 per cent of GDP. In addition, five asset management companies manage 79 mutual funds or sub-funds of umbrella funds; their total assets under management stood at €3.9 billion at end 2022. However, securities issued by domestic entities account for a very small percentage of the portfolios of mutual funds – just 2.3 per cent in 2021.

2.6 Integrated

Slovenia is ranked fifth in the EBRD regions in terms of internal and external integration. For internal integration, Slovenia scores higher than the CEB average for all indicators except those measuring the performance of the logistics sector. Non-road transport infrastructure could also be improved, which is consistent with the government's desire to boost investment in rail infrastructure. More investment is also needed to upgrade digital infrastructure. As far as external integration is concerned, trade intensity is very high, but financial openness and absorption of foreign capital are weaker than in other CEB countries, largely because of Slovenia's transition model, which limited foreign capital from entering the domestic economy.

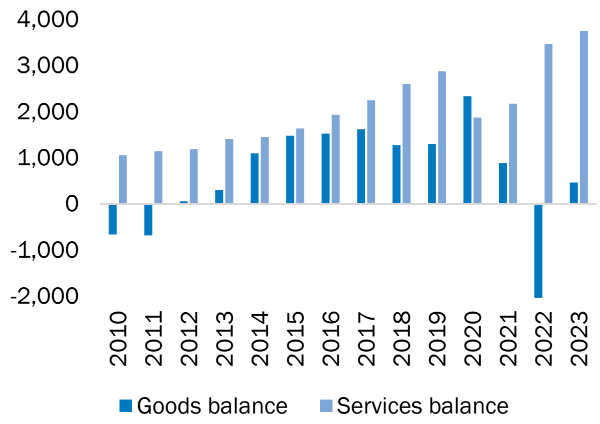
Chart 36. Integration indicators



External integration

The Slovenian economy has one of the highest degrees of trade openness of the OECD countries. In 2023, exports and imports fell to 161 per cent of GDP amid a drop in both imports and exports of goods, but that figure was surpassed by only the Slovak Republic and Hungary in the CEB region. Historically, Slovenia has enjoyed large trade surpluses thanks to its competitive manufacturing sector and its strong transport and tourism services (see Chart 37).

Chart 37. Trade balances for goods and services (€ millions)

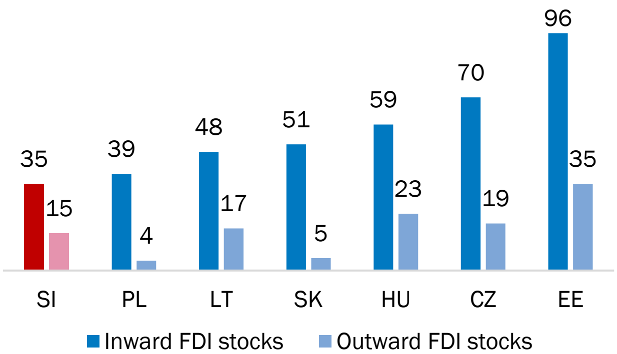


Source: SURS (2024) and authors' calculations.

Slovenia's FDI inflows have been weaker than those of regional peers in recent years. Dwindling FDI inflows in Slovenia have reduced FDI stocks to 35 per cent of GDP, way below the CEB average of around 60 per cent (see Chart 38). Reflecting the structure of the economy, FDI stocks in manufacturing are second only to Hungary in the CEB region. According to the OECD, the restrictiveness of FDI in Slovenia is the third lowest among OECD countries.

Outward FDI could be a source of additional value. As mentioned, Slovenian companies should look to increase their foothold in the region. This is supported by the fact that their outward FDI stocks stood at a respectable 15 per cent of GDP in 2022 (albeit slightly lower than those of the Baltic states, Czechia and Hungary). Still, after years of lagging the EU average, outward FDI flows totalled 1.1 per cent of GDP in 2022, higher than the EU average of 0.54 per cent.[86] Services' share of total outward FDI stocks was the lowest in the CEB region, suggesting that there is some potential for improvement.

Chart 38. FDI stocks as a percentage of GDP, 2022

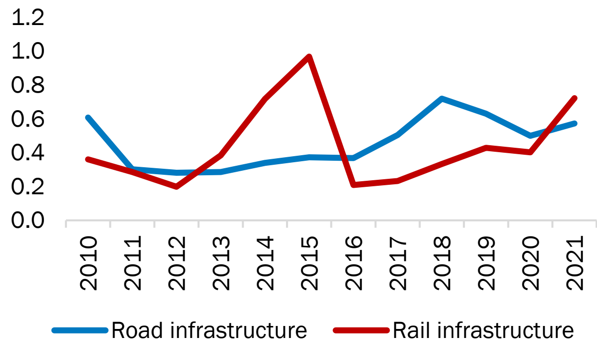


Source: OECD (2023c).

Internal integration

Slovenia's road transport infrastructure is adequate, with investment in rail infrastructure being prioritised. Slovenia was ranked 13th on the World Economic Forum Competitiveness Index for 2019 in terms of perceptions of road quality.[87] Its score for the EBRD's indicator of road connectivity is above the average for advanced comparators, pointing to an adequately developed road network. Investment in rail infrastructure has increased in recent years, reflecting the high levels of need and its priority status for public spending. After a small decline in 2022, when investment in rail infrastructure totalled €300 million, the Slovenian authorities made investment commitments of up to €470 million in 2023 (see Chart 39). Over the next few years, connectivity and service quality are expected to improve significantly in the railway sector, with major projects being financed by EU funds following some delays in the past. Meanwhile, air transport has been in decline since the collapse of Adria Airways in 2019.

Chart 39. Public investment in transport infrastructure as a percentage of GDP



Source: OECD (2023d).

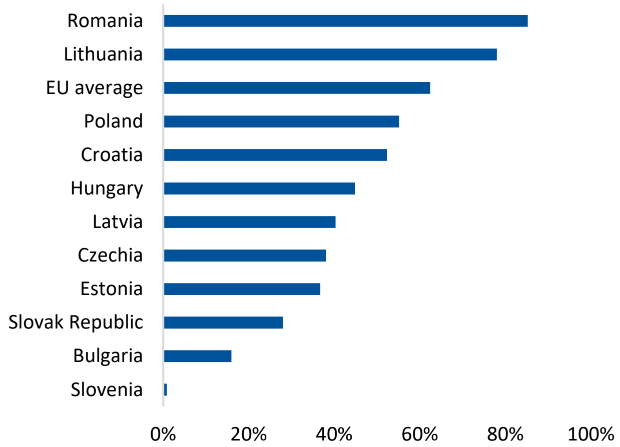
Logistics services could be improved. According to the EBRD's logistics performance index, Slovenia is one of the lowest-performing countries in the EU in terms of the quality of logistics services and associated skills, despite its key role as a link between central and south-eastern Europe. It also scores relatively poorly on the timeliness of shipments (see Chart 36).

Digital infrastructure is mostly in line with the EU average, with the exception of very high-speed broadband. As regards coverage, Slovenia has made good progress over the past decade in terms of increasing the availability of broadband, with speeds of over 100 Mbps. However, broadband with speeds of over 1 Gbps remains almost non-existent, compared with average coverage of 62 per cent in the EU in 2021 (see Chart 40). Based on available metrics, fast broadband coverage in rural areas is in line with the EU average of 67 per cent, while fibre coverage stands at 46 per cent, above most regional peers.[88] 5G coverage stood at 36 per cent in 2021, below the EU average of 66 per cent. In

[86] See OECD (2023c).
[87] See World Economic Forum (2019).
[88] See European Commission (2023c).

terms of take-up, the percentage of households with fixed-line broadband has declined in recent years, standing at 77 per cent in 2021 – below the EU average.[89] This is probably due to the stronger take-up of mobile plans.

Chart 40. High-speed broadband coverage, 2021



Source: European Commission (2022d).

[89] Ibid.

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