DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR SLOVENIA

As approved by the Board of Directors on 7 November 2006.

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ABBREVIATIONS

BAS	Business Advisory Services Programme
CEB	Central Europe & Baltics
CEI	Central European Initiative
EC	European Commission
EIA	Environmental impact assessment
EIB	European Investment Bank
ERM2	EU's Exchange Rate Mechanism
ESA	European System of Accounts
ESCO	Energy Service Company
ETS	Emissions Trading System
EU	European Union
EU's CAP	The Common Agricultural Policy of the EU
EUR	Euro
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GEF	Global Environment Facility
GMOs	Genetically Modified Organisms
IAS	International Accounting Standards
IAIS	International Association of Insurance Supervisors
IFC	International Financial Corporation
IFI	International Financial Institution
ILO	International Labour Organisation
IMF	International Monetary Fund
IOSCO	International Organisation of Securities Commissions
IPO	Initial Public Offering
IPPC	Integrated Pollution and Prevention Control
ISPA	Instrument for Structural Policies for Pre-Accession
JSC	Joint Stock Companies
MBO	Management Buy-Out
MEI	Municipal Environmental and Infrastructure sectors
MP	Member of the Parliament
MSMEs	Micro, Small and Medium Enterprises
NATO	North Atlantic Treaty Organisation
NBFI	Non Bank Financial Institutions
NLB	Nova Ljubljanska Banka
OECD	Organisation for Economic Cooperation and Development
PCB	Polychlorinated Biphenyls
PPP	Public- Private Partnership
PSP	Private Sector Participation
SMEs	Small and Medium Enterprises
SPA	Special Protection Areas
TAM	Turnaround Management Programme
USD	United States Dollar
VAT	Value Added Tax
WB	World Bank

EXECUTIVE SUMMARY

The Republic of Slovenia is committed to and applying the principles of multiparty democracy, pluralism and market economics and therefore continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank. Having just celebrated its 15th year as an independent state, the country is about to take a further step forward with the adoption of the Euro in January 2007. The Government has, however, identified significant challenges for the country over the coming years, particularly in improving competitiveness and economic growth, reforming public administration, and enhancing labour market flexibility.

Slovenia is an advanced transition country, with the highest GDP per capita among the Bank's countries of operations. The country has recorded solid growth with low inflation and will be the first CEB country to adopt the euro in January 2007. However, the transition is not yet complete and a number of key challenges remain, particularly in large-scale privatization and institutional reform.

Resistance to the sale of profitable government-owned companies has acted as a particular drag on restructuring. The government still owns large shares in companies in sectors such as banking and insurance, telecommunications, and aluminium and steel. Overall, despite ambitious objectives, there has been slow and piecemeal implementation of the reforms.

There has been some progress in improving the business environment, such as the setting up of single access points for entrepreneurs in July 2005, which resulted in a significant decrease of the time and cost of registering as an individual private entrepreneur. The service is expected to be extended to the registration of limited liability companies and general partnerships in 2007. However, the business environment still faces a number of other obstacles.

Slovenia can access a wide range of sources of financing, including international financial markets thanks to its economic success and stability. However, specialised financial instruments, like long term structured finance, equity and quasi-equity offer yet unexploited alternatives to support the private corporate sector, especially SMEs. The very low funding costs of local banks are making it difficult, however, for the EBRD to offer attractive terms for its SME or municipal credit lines.

Since the last country strategy was approved, the Bank activities in Slovenia have remained limited due to the ready availability of debt financing from the banking sector and to the pace of reforms. The Bank has signed projects in the amount of EUR 56.0 million and EUR 28.2 million in years 2004 and 2005, respectively. All of the projects signed in 2004 and 2005 were either SME credit lines to banks and leasing companies or allocations from regional venture capital funds. The Bank's contribution to the transition process has thus remained minimal overall, particularly in light of the Government's decision to maintain majority ownership in NLB.

Looking forward and taking into account the remaining transition challenges and the principle of additionality, the Bank's activities in Slovenia will be very selective and based on the following operational objectives:

- **Enterprise Sector** – Provide equity and structured debt for local companies to fund their growth, in particular in the context of cross border expansion. Support foreign direct investment by medium-sized companies with higher risk products not offered by the private sector, particularly in regions of higher unemployment facing specific transition challenges. The Bank will also stand ready to support viable privatisation structures of the remaining state enterprises.

- **Financial Sector** – The Bank will offer capital market products to companies and financial institutions such as bonds and asset backed securities. The Bank will work on innovative products and support equity funds for Slovene corporate sector investments in the region. If there is a need, the Bank will also support the privatisation, consolidation, re-structuring and, where appropriate, the integration of banking and insurance sectors to better serve the needs of the economy.

- **Infrastructure and Environment** – The Bank will strive to facilitate private sector involvement in infrastructure development.

The Bank will continue to ensure that all EBRD operations in Slovenia meet sound banking principles, have transition impact, are additional, comply with the Bank's Environmental Procedures and incorporate, where appropriate, Environmental Action Plans.

1. THE BANK'S PORTFOLIO

1.1 Overview of Activities to Date

The Bank's cumulative commitments in Slovenia amount to EUR 597 million supporting EUR 1.8 billion in total project value; 83 per cent of the commitments were in the private sector and 29 per cent were equity investments; 26 per cent of commitments were sovereign but all such projects were in the early years of the Bank's operations in Slovenia. The bulk of commitments were to financial institutions (48 per cent) with the rest evenly distributed to energy, general industry, infrastructure and specialised industry.

The current portfolio is EUR 266 million or about 2 per cent of total Bank portfolio. It has decreased slightly from EUR 293 million at the end of March 2004. Undrawn commitments amounted to 18 per cent of the total. Impaired assets stood at EUR 3.9 million leaving the risk rating of the portfolio at 3.98, one of the strongest in the Bank. Private/state as well as private/non-sovereign state ratio reached 93 per cent and equity share 24 per cent. The largest active portfolio of 65 per cent related to financial institutions, followed by industrial sector with 23 per cent and infrastructure with 12 per cent. During the 2004/2005 period, the Bank signed 12 new projects with total value of EUR 84.2 million, of which 5 were regional venture fund allocations to Slovenia with the rest credit lines to local banks.

1.2 Implementation of Previous Country Strategy

- **Financial sector** – The Bank was successful in providing credit lines for local banks and leasing companies and fully committing the very effective GEF facility. Various allocations of regional venture funds did not translate into actual investments in Slovene companies. No further privatisation in banking or insurance has taken place. One equity investment in a non-banking sector local company is under preparation.

- **Enterprise sector** – No projects were signed but an investment by Droga Kolinska in its Serbian subsidiary Štark was approved by the Board on 16 October and signing is scheduled for November. Two other projects are under preparation with Slovene companies investing in the region. No privatisation or re-structuring projects have so far materialized.

- **Infrastructure sector** – No activity in this sector as the Government has not yet allowed meaningful private sector involvement in infrastructure.

- **Policy dialogue** – Continued efforts with the Government on the privatisation issues where Slovenia is lagging behind in areas like banking, insurance, telecommunications, heavy industry and energy sector. The Government has now adopted privatisation plans in the banking and telecom sectors and the process should be completed within the next three years.

1.3 Transition Impact of the Bank's Portfolio and Lessons Learned

1.3.1 The Financial Sector

Banking

After the removal of capital restrictions in early 1999, the Bank provided a loan to the country's largest bank, Nova Ljubljanska banka (NLB), and supported credit lines to SKB Banka and Banka Koper, the second and the fourth largest banks in the country. ***A lesson learned*** from the Nova Ljubljanska banka project is that a lengthy policy dialogue may be required at senior levels of Government to overcome local political objections to the privatisation of entities that are regarded as having strategic importance (PEX04-230). ***Another lesson learned*** from the SKB Banka credit line is that supporting a financial institution which appears to have the highest likelihood to succeed, selectively at early stage of transition does carry a strong demonstration effect on other FIs in the country (PE97-077). Later, another key contribution of the Bank has been the support in 2002 of the partial privatisation of NLB. Sector wide, however, the privatisation is not yet complete, with state-owned banks still having a significant asset share.

NBFI

In the last five years, the Bank has had two TC projects with the insurance regulator related to the introduction of a web based insurance regulatory reporting system. Insurance regulation and supervision in Slovenia is now generally used as a model for other countries.

Private Equity Funds. The Bank has been present in the country's private equity sector during the period 2000-05 through the Slovenia Development Capital Fund and the Slovenia Horizonte Fund. The overall return of the first fund has been good. However the investment strategies of the fund and the implementation by the fund managers were hardly value-adding. The performance of the second fund has been mixed, with many of its investments still unrealised. The country is still to develop local private equity manager class and investors committed to local private equity investments.

SMEs

Under the EU/EBRD Framework Facility for SMEs, credit lines were extended during the last five years to Banka Koper and Nova Kreditna banka Maribor. All these investments were supported by TC for institution building. Although Banka Koper benefited from a follow-on loan, the two banks are among the least successful participating Slovenian banks in the framework in terms of number of loans disbursed, average loan amount, and subsidy utilisation. Under the leasing arm of the Facility, credit lines were extended to Raiffeisen Leasing and SKB Leasing. SKB only started participating in the framework at the end of 2004. Raiffeisen has participated since January 2003, but SME leasing does not seem to be a key business area for the company.

Overall, a *moderate* to *significant* transition impact has been achieved in the *Financial* Sector.

1.3.2 The Enterprise Sector

Industry

The Bank has contributed to the privatisation and restructuring of several manufacturing companies, such as Yulon, a yarn producer which was sold to a strategic investor in 1995, and Sarrio, a paper mill which was successfully restructured in 1994. In addition, the Bank contributed to the development and restructuring of local companies Merkur and Alpina through capital increases. While corporate governance was improved and better financial and operational management put in place, the Bank has had limited influence on the restructuring of these companies. ***A lesson learned*** from the Alpina project is that post-privatisation equity investment is risky without solid strategic sponsor support or strong owner coalitions. The Bank should therefore consider if structuring with debt, or debt with partial equity features, could be a workable alternative (PE01-187). Only two projects were done by the Bank in Slovenia in the past 5 years, mainly aimed at supporting the modernisation and restructuring of companies through the involvement of foreign investors. The first one (Yulon) was completed with a delay of several years. The company's failure on its contractual obligations revealed sub-standard corporate governance and business conduct. The second project (Lafarge Slovenia) delivered the expected transition impact in terms of efficiency, environmental, health and safety standards and business conduct. The enterprise sector would still benefit from further restructuring and withdrawal of the state through an accelerated privatisation process.

Telecommunications

In the 1990s the Bank developed a number of TC projects which resulted in the introduction of a new organisational structure, management information system, and a new accounting system based on IAS. In 2001, the Bank assisted Mobitel GSM in rolling out an additional network. ***A lesson learned*** from the project is that state controlled entities may favour protection of their market share at all costs with substantial investments even at the expense of cashflow and lower profitability. Privately owned companies instead are driven to maximise profits within the boundaries of the license agreement (PEX03-197). The Bank also made an equity investment in a local software company supporting development of new services, but the investment was not successful. Slovenia, along with the Czech Republic, is the only new EU member state that has not yet privatised the fixed line operator though the privatisation process has now started (see Section 2.2.2). One of the mobile operators is also state-owned and its decisions are not fully based on commercial principles. There is an independent regulator, but tariff rebalancing remains to be fully completed.

Overall, a *moderate* transition impact has been achieved in the *Enterprise* Sector.

1.3.3 Infrastructure

Power

The Bank encouraged sector reform through a project rehabilitating a hydro generating plant on the Drava River. Transition impact in this project came through commercialisation, in particular the introduction of accounting systems and audited accounts. ***A lesson learned*** from the project is that the political interest of getting important contracts assigned to local manufacturing companies is extremely high. When implementing sophisticated procurement procedures in the early stages of transition, it is very important for the Bank to actively monitor the procurement process (PE00-169).

MEI

A corporate loan was approved in 1998 for the design and operation of a waste water treatment plant for the municipality of Maribor, which is built under a BOT concession contract. The Bank has had substantial impact, providing assistance for the preparation and international competitive tendering of the concession. The project was the first international tender at the municipal level for a BOT concession in the region, and the first BOT project for a wastewater treatment plant. However, the scope for replication by other municipalities has been limited, as the Maribor structure is not suitable for smaller municipalities that dominate in Slovenia.

The Bank's other involvement in the MEI sector was through a loan to Slovenski plinovodi to build and operate retail gas distribution networks in five municipalities. The project has had an important demonstration effect as it has transferred to the private sector via concessions, an activity that has historically been in the domain of the public sector. The project has been replicated in many municipalities around Slovenia and the Bank now sets standards for the concessions in this segment.

Transport

The Bank participated in three projects in the 1990s: Slovenske železnice, the Motorway Company in the Republic of Slovenia (DARS) project, and the National Road Administration project. The first investment, in Slovenske železnice, was well implemented and backed a relatively modest restructuring programme adopted by the Slovenian railways, which has experienced uneven progress. ***A lesson learned*** from the project is that the creation of profit and cost centres is not enough to convert a public enterprise into a company operating on commercial terms, and often provision of TC funds might be required for improving effectiveness of an organisation (PE98-101). The road investments were not designed with major institutional reform components. However, they have allowed the Bank to establish a policy dialogue on institutional reforms. No new projects were approved in the transport sector in Slovenia during 2000-05. The private sector participation is now in place for construction and maintenance of roads. The road sector finance has been reformed.

Overall, a *moderate* transition impact has been achieved in the *Infrastructure* Sector.

1.3.4 Overall assessment and rating

The Bank has been an active participant in the transition progress and continued to innovate to suit the emerging transition needs. However, outside of Banking and MEI, the Bank projects had limited demonstration effect at sector level. The overall transition impact of the Bank has been *moderate*.

1.4 Risk rating, mobilisation and portfolio ratio

The Slovene portfolio risk rating is presently 3.98, an improvement from 4.25 in 2004.

Overall mobilisation ratio (total project cost/EBRD financing) is 3.03, slightly decreased since the time of the previous strategy. There have been no commercial co-financings since 2001 due to the availability of debt financing from local commercial banks. Slovenia still remains at the bottom of the FDI receiver list in Central Europe and actually had an outflow of direct investment in 2005.

The sovereign/non-sovereign and private/state ratios are both 93 per cent, since all state projects included a sovereign guarantee. There are EUR 22 million still outstanding under loans to the state-owned road operator.

2. OPERATIONAL ENVIRONMENT

For the next two years covered by this Strategy, the Bank is projected to be active in Slovenia in accordance with the operational principles of transition impact, sound banking and additionality.

This Strategy will be implemented in accordance with the strategic outline for the years 2006 – 2010 agreed upon in Capital Resources Review 3 with respect to graduation.

2.1 The General Reform Environment

2.1.1 Political Environment

The Republic of Slovenia is committed to and applying the principles of multiparty democracy, pluralism and market economics and therefore continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank.

The last parliamentary elections, which were held on 3 October 2004, saw the centre-right Slovenian Democratic Party (SDS) of Janez Janša winning over the centre-left Liberal Democracy of Slovenia (LDS) of former Prime Minister Anton Rop, thus breaking the Liberals' 12-year-long hold on power. After their victory, Prime Minister Janša formed a coalition with his party's close ally, New Slovenia (NSi), as well as the populist Slovene People's Party (SLS) and the Democratic Party of Slovene Pensioners (DeSUS). However, the new government holds only a narrow majority in the 90-seat parliament. Following their electoral defeat, the LDS elected a new leader in October 2005, Jelko Kacin, a former defence consultant and deputy defence minister in the country's first post-communist government. More recently the party suffered additional setbacks following the resignation of a number of senior LDS members, notably President Drnovšek, dissatisfied with the party's lack of direction. The LDS has not offered any major challenge to the incumbent government since losing the last parliamentary elections. Local elections took place on 22 October 2006. The ruling Slovenian Democratic Party (SDS) won most seats in city councils, but managed to win only 14 mayors in the first round. Zoran Janković, an independent candidate and former CEO of Mercator, Slovenia's leading retailer, became the new mayor of Ljubljana with 63 percent of votes, well ahead of the governing coalition's choice, former Central Bank governor France Arhar, who received 20.8 percent of the votes.

This year the government set out a much-needed comprehensive national development strategy that stressed the necessity of implementing market-friendly policies that would simplify the tax code and improve the country's competitiveness in accordance with the goals set by the Lisbon agenda. This *Strategy for Slovenia's Development* outlines development goals until 2013 and includes broad issues within the economic, political, social, cultural, economic, and legal spheres.

Slovenia became a member of the EU on 1 May 2004, following a non-binding nationwide referendum held in March 2003, which passed with 90 per cent of the voters in favour of membership. A second referendum, on NATO membership, also took place on the same day, and passed with 66 per cent of the votes. Slovenia joined NATO on 29 March 2004. The country continues to play an active foreign policy role in the region of former Yugoslavia. Slovenia will be the first new EU member state to take up the EU rotating presidency in the first semester of 2008. The decision found overwhelming consensus among all domestic political parties thanks to the increased political weight and overall exposure that Slovenia would gain in Europe through the Presidency. The country's confidence was also boosted in May 2006 by the European Commission's recommendation, in agreement with the European Central Bank, that Slovenia be allowed to adopt the euro as planned on 1 January 2007. Slovenia has been the first new EU member country to have met all Maastricht criteria for macroeconomic convergence. The introduction of the euro will eliminate exchange rate risk between Slovenia's and its largest trading partner, the rest of the EU, while at the same time providing a step to reduce overall capital inflow barriers. The entry into the Schengen area, entailing the abolition of border posts on Slovenia's borders with Italy, Austria and Hungary and stricter border controls on the border with Croatia, originally scheduled for October 2007, has been delayed due to problems with the EU central information system but an EU Council decision is expected in December regarding Slovenia's date of entry.

2.1.2 Legal reform

Slovenia has made significant reforms in the legal system it inherited from the former Yugoslavia, leading to major improvements in the country's economic environment and allowing for European Union (EU) accession in 2004. The success of the country towards the establishment of a market-oriented economy and stable democratic institutions has been coupled with significant progress in the legislative alignment to the *acquis communautaire*. The legislative framework is now very nearly harmonised with that of the EU, with a number of key restrictions having been removed in the last two years.

A general assessment of commercial laws reveals that Slovenia has developed a legal system comparable to that of other advanced transition countries of Central and Eastern Europe. The results of the various EBRD legal assessment projects (detailed in Annex 11 – Assessment of Slovenia's Commercial Laws) suggest that there have been improvements in the country's effort to comply with international standards and principles in the main areas of commercial law. However, there are still remaining areas which could benefit from further developments, such as general concession law or insolvency law. A new law on Public Private Partnership passed first reading in Parliament in September 2006. Furthermore, the implementation of the legislations and regulations which are in place continues to pose a challenge, such as in the case of the incumbent telecoms operator Telekom Slovenije, which remains majority state-owned and dominant across most elements of the telecom market, five years after the market was formally liberalised.

2.2 Progress in Transition and the Economy's Response

2.2.1 Macroeconomic conditions for Bank operations

Real GDP grew by 4 per cent in 2005, compared with 4.4 per cent in 2004. Preliminary figures for the first half of 2006 suggest a year-end rate above this level (year-on-year growth is estimated at 5.1 per cent in the first and at 4.9 per cent in the second quarter of 2006). The main drivers of growth were exports, investment and domestic consumption. Private consumption increased by 3.4 per cent in 2005, compared with a 2.2 per cent rise in public consumption. Continued strong growth and employment creation are feasible over the medium term, but will require improved competitiveness through implementation of the government's ambitious new reform programme, *Strategy for Slovenia's Development*, adopted in November 2005. Concrete measures designed to achieve the Strategy's goals are presented in the Framework of Economic and Social Reforms for Increasing Welfare in Slovenia. The first year after launching the reform saw the introduction of comprehensive changes to the tax system and the labour market that will stimulate people to accept work and enterprises to raise employment and invest in development.

Macroeconomic policy has been generally prudent over the strategy period. A significant landmark was the announcement of the European Commission, in its latest convergence report published in May 2006, that Slovenia is the first of the new accession countries in ERM II to satisfy the Maastricht criteria for euro adoption. The EU finance ministers formally confirmed Slovenia's entry into the European Monetary Union in July 2006. The rate at which the tolar will be converted into the euro was fixed in June 2006 at SIT 239.64 per one euro and the euro will become the official currency in January 2007. Inflation has been kept at low levels (2.3 per cent at the end of 2005) and prospects for inflation over the next two years are good, although with the output gap almost closed, risks for demand-led inflationary pressures have increased, requiring a tighter fiscal stance than envisaged in the 2-year rolling budget (in the absence of monetary policy). The Government will remain committed to counter-inflationary macroeconomic policies in order to reduce the risk of a decline in the competitiveness of Slovenia's tradable sector and to avoid otherwise potentially higher price rises relative to Slovenia's main trading partners.

The government successfully reduced the deficit from 2.3 per cent of GDP in 2004 to 1.4 per cent of GDP in 2005 (ESA95 methodology). In 2006, the general government deficit is expected to be 1.6 per cent of GDP. On the one hand, the tax burden is among the highest in the new EU member states and is a disincentive to job creation. The government proposed a comprehensive tax reform in August 2006 to address this issue, reducing the number of income tax brackets from five to three (16, 27 and 41 per cent, respectively, thereby also reducing income tax progressivity) and curbing corporate income tax by two percentage points in 2007 and then gradually reducing it to 20 per cent by 2010, while the capital income is already taxed at a flat rate of 20 per cent. The reform also plans to gradually eliminate payroll tax by 2009. On the other hand, there are no concrete plans yet to reform the expenditure side of the budget as well (there were speculations about the increase in the rate of value added tax in 2008), and the European Commission has warned Slovenia that it is among the six most vulnerable countries to face problems with public finance sustainability due to its ageing population. Moreover, Slovenia must implement further changes to the pension system, or face significant growth in spending on pensions. The public debt is currently relatively low, amounting to 28.8 per cent of GDP at the end of 2005, but that could change in the medium term if changes are not implemented.

Despite weak growth in the eurozone in 2005, Slovenia's exports of goods and services grew by about 10.3 per cent in real terms, compared to import growth of 6.8 per cent, and the current account ended the year 2005 with a deficit of 2.0 per cent of GDP – an improvement from a deficit of 2.7 per cent of GDP in euro terms. Foreign direct investment inflows exhibited a small net outflow in 2005; in 2006 a small net inflow may be realized by the end of the year. External debt rose to 70.8 per cent of GDP in euro terms by the end of 2005, mostly due to increased bank borrowing from abroad. However, solid economic activity is expected to allow private sector obligations to be met.

2.2.2 Transition Success and Transition Challenges

Slovenia is an advanced transition country, with the highest GDP per capita among the Bank's countries of operations. However, the transition is not yet complete and a number of key challenges remain, particularly privatization and institutional reform. There has been little progress made since the previous strategy, such as the full harmonisation of the *acquis communautaire* in the area of company law, and the implementation of the portability of mobile and fixed numbers.

In recognition of the challenges ahead, the government adopted a comprehensive economic reform programme in November 2005. The programme is designed to address the themes of competitiveness and economic growth, research and innovation, public administration reform and labour market flexibility. The programme is quite ambitious and includes an action plan for all of the sub-areas, with majority of deadlines for preparing more specific programmes in Fall 2006. It remains extremely important to make sure the general consensus on the need to go through with the economic reform is achieved, even if the public is not fond of the changes awaiting them with respect to social welfare.

Resistance to the sale of profitable government-owned companies has acted as a particular drag on restructuring. The government still owns large shares in companies in sectors such as banking and insurance, telecommunications, and aluminium and steel. Overall, despite ambitious objectives, there has been slow and piecemeal implementation of the reforms. The new economic reform programme identifies exit of the state from the ownership of companies and financial institutions as well as reducing the role of two quasi-state funds, state-run Pension Fund Management (KAD) and state-run Restitution Fund (SOD), in corporate governance of the companies in their portfolio as one of its priorities within the goal of increasing institutional competitiveness and efficiency of the state. However, the action plan for 2005 and 2006 is not very specific with regard to this issue.

There has been some progress recently with the successful sale by the Government of a 5 per cent stake in Telekom Slovenije (TS) on the Ljubljana Stock Exchange. This is part of a phased privatisation plan that is expected to see a 39 per cent stake in the company sold to a strategic investor over the next 3 years. The Government intends to retain a 25 per cent plus one share stake in TS. In addition, a tender for a 55 per cent stake in the Slovene Steel Holding (SIJ) was issued in September. Once again, the Government intends to retain a 25 per cent plus one share stake in SIJ. Finally, Parliament recently approved the sale of a 49 per cent stake in NKBM, the second largest local bank. It is not clear, however, when the sale process will be initiated.

The time and cost of registering as an individual private entrepreneur have decreased significantly since July 2005, when single access points were set up for entrepreneurs (e-VEM portal and VEM offices). Everything can now be done in one place, at any time of the day (e-VEM only), is free of charge and takes about one hour. In the period from July 2005 to June 2006, the number of registrations increased by 14.3 per cent. The service is expected to be extended to the registration of limited liability companies and general partnerships in 2007, which should significantly reduce the obstacles to setting up a business.

With regard to specific sectors, transition challenges remain large in the energy efficiency and power sectors, especially concerning the level of competition. The latter needs to be improved in most other sectors as well, with the possible exceptions of agribusiness and natural resources. The legal framework represents only a small transition challenge in most sectors, whereas corporate governance needs to improve in all of them with the exception of property and tourism sectors; the challenge is negligible there. This indicates that law enforcement needs to improve.

Please refer to the snapshot table in Annex 6 for more specific individual sector-by-sector ratings and to the Structural Change Indicator Table in Annex 7 for cross-country comparative data for the EU-8 region.

2.3 Access to Capital and Investment Requirements

Domestic credit

Banks remain the most important segment of the financial market, accounting for 62 per cent of it. Bank loans remain the single largest source of financing for the Slovene economy. Increased demand from companies and households for loans has resulted in fiercer competition among banks and relatively low interest rates. However, even though competition forces them to offer favourable terms for their loans, banks still need to better evaluate credit risk. Total domestic credit (about 80 per cent of which were bank loans) represented almost 71 per cent of GDP at the end of 2005, with enterprises accounting for 60.7 per cent, households 21.8 per cent and the state for about 17.5 per cent. During 2005, corporate loans grew nominally by 22 per cent, with companies borrowing mainly in foreign currency due to favourable foreign interest rates. Lending to households reached a 26.6 per cent growth by the end of 2005, with housing loans accounting for 60 percent of the net rise. SMEs are increasingly well served for debt financing but would still benefit from better access to equity. Companies still finance themselves predominantly with bank loans or closed recapitalisations and private placement of securities.

Possible reasons for poor equity financing can be found in the general lack of public offerings (see below), fear of pressure on cost reduction and profit from the new owners, fear of the loss of control (the latter two can be inferred from the published interviews with CEOs), public access to the share registry (which has already been converted into access only for investors) which supposedly facilitated the grey market for share trading. In addition, minority shareholder rights, although relatively good on paper, are less than perfect in practice.

Capital markets

The capital market is still very small, with the total market capitalisation of all shares traded 5.9 per cent lower in December 2005 compared to December 2004, and representing 23.5 per cent of GDP (excluding investment funds). The capital market is also very illiquid, with an annual turnover representing about 9 per cent of market capitalisation in 2005. There had been no public offerings since 2000 until the 2 October sale by the Government of a 5 per cent stake in Telekom Slovenije (TS). With a free float of 25 per cent of its market capitalisation of about EUR 1.9 billion, TS became the second largest issue on the Ljubljana market. It is hoped this important listing will improve liquidity on the local market in years to come.

Foreign direct investment

FDI levels remain very low especially when compared with other countries of operations. Net FDI inflows were USD 281.1 million in 2004. In 2005, there was a net outflow of USD 88.3 million, and a net inflow of USD 74 million is projected by the IMF for 2006, although in the first half of 2006 there was an estimated net outflow of USD 55.1 million.

European Union members are prevalent among investing countries with Austria as the largest investor since 1995. At the end of 2004, the stock of direct investment by Austria accounted for 28 per cent of the total. Other EU member states accounted for

46 per cent of total FDI at the end of 2004, so overall the EU accounted for 74 per cent of total FDI.

Outward FDI by Slovenian companies has grown since 1994 (the first year for which the figures are available). The largest holdings of outward FDI by Slovenian companies at the end of 2004 were in Croatia, 30 per cent of the total. Serbia and Montenegro were in the second place with 13 per cent of the total, followed by the Netherlands with 11 per cent. More than half of outward FDI at the end of 2004, 57 per cent, went to the ex-Yugoslav countries, which indicates Slovenia could play an important role in the region's development.

2.4 Environmental Issues

There are no significant environmental issues to highlight. A fuller review of environmental issues is found in Annex 9.

3. STRATEGIC ORIENTATIONS

3.1 Bank's Priorities for Strategy Period

Key Short Term Operational Priorities

- **Enterprise Sector** – Provide equity and structured debt for local companies to fund their growth, in particular in the context of cross border expansion. Support foreign direct investment by medium-sized companies with higher risk products not offered by the private sector, particularly in regions of higher unemployment facing specific transition challenges. The Bank will also stand ready to support viable privatisation structures of the remaining state enterprises.

- **Financial Sector** – The Bank will also support the privatisation, consolidation, re-structuring and, where appropriate, the integration of banking and insurance sectors to better serve the needs of the economy. The Bank will offer capital market products to companies and financial institutions such as bonds and asset backed securities. The Bank will work on innovative products and support equity funds for Slovene corporate sector investments in the region.

- **Infrastructure and Environment** – The Bank will strive to facilitate private sector involvement in infrastructure development.

- **Policy Dialogue.** The Bank will focus on assisting the Government's privatisation and reform programme. The Bank will also examine with the Government possible use of EU funds to support energy efficiency and renewable credit lines to local banks. The Bank will also support the so far limited Government efforts to facilitate private financing of infrastructure.

3.2 Sectoral Challenges and Bank Objectives

3.2.1 The Enterprise Sector

Transition Goals

- Support the sustained regional expansion of the Slovene corporate sector.
- Completion of privatisation of large enterprises in key sectors.
- Development of high value added activities by supporting FDI and SMEs and company re-structuring with a view to addressing regional imbalances.
- Need to provide better tailored financial instruments to optimise the balance sheet of companies and support their growth.

Operational Priorities

- Provide equity and structured debt for local companies to fund their growth, in particular in the context of cross border expansion.
- Develop a Growth Capital Facility designed to facilitate small co-investments alongside venture capital investors or in the context of MBOs.
- Support foreign direct investment by medium-sized companies with higher risk products not offered by the private sector, particularly in regions of higher unemployment facing specific transition challenges.
- The Bank will also stand ready to support viable privatisation structures of the remaining state enterprises.

3.2.2 The Financial Sector

Transition Goals

- Support the increased efficiency in financial intermediation through consolidation and privatisation.
- Broaden the accessibility of the local corporate sector, in particular SMEs and small municipalities to equity, quasi equity and structured finance.

Operational Priorities

- The Bank will also support the privatisation, consolidation, re-structuring and, where appropriate, the integration of banking and insurance sectors to better serve the needs of the economy.
- The Bank will offer capital market products to companies and financial institutions such as bonds and asset backed securities.
- The Bank will work on innovative products and support equity funds for Slovene corporate sector investments in the region.

3.2.3 Infrastructure and Energy

Transition Goals

- Completion of the re-structuring of the Slovene railways.
- Full integration of the power transmission to the international grid.
- Defuse growing demand-supply imbalances in power sector.
- Privatisation and regional expansion of the incumbent fixed line telecom operator.

Operational Priorities

- Facilitate private sector involvement in infrastructure development. In particular, seek to support an eventual privatisation of the rail freight operations of the Slovene railways.
- Seek to develop an energy efficiency and renewable energy programme in support of investments by companies and residential owners of flats and housing associations. Such an initiative would require support from the Government, probably through the allocation of EU structural funds.
- Provide equity and long-term debt financing to Slovene companies planning to invest in developing power generation projects in South East Europe and the Balkans.

4. CO-OPERATION WITH OTHER IFIs

European Union (EU)

Slovenia has a reasonable record of drawing available EU funds. Co-operation with the EU will be further explored once the National Strategic Reference Framework is finalised and the operational priorities of the Structural Funds and Cohesion Funds have been decided. Co-operation under other EU programs, such as the Competitiveness and Innovation Programme, could also become relevant.

International Monetary Fund (IMF)

The IMF has no ongoing programme in Slovenia. In its most recent Article IV Report, they recognise the immediate prospects as largely favourable, but note that structural obstacles (slow privatisation, labour market rigidities and regulatory constraints) need to be reduced in order to achieve long-term growth, which is also threatened by an inflexible budget and one of the fastest aging populations in Europe.

World Bank (WB) and International Finance Corporation (IFC)

The World Bank has not engaged in new projects since 2000, while Slovenia graduated to the status of a donor in March 2004. After being absent from the market since 2000, in September 2006 the IFC provided a very favourably priced EUR 40 million loan to Mercator, the leading Slovene food retailer.

European Investment Bank (EIB)

Since 1990 the EIB has signed around EUR 1.9 billion worth of projects in Slovenia and is a significant player in infrastructure financing, with loans to DARS for motorway construction representing 50 per cent of its portfolio. EIB is the biggest lender to Telekom Slovenije, Mobitel, HSE (the main power generator) and Slovenske železnice in addition to DARS. EIB has also financed the rehabilitation of the Zirovski vrh uranium mine and an energy efficiency/waste water facility with the Eko Sklad (environmental fund). In addition, it provided loans to NLB, BACA, Hypo Alpe-Adria Bank and Banka Koper in co-operation with the EC for SME and municipality credit lines. Co-operation with the EBRD could be possible in deals taking different risk tranches, with the EBRD possibly taking a higher risk.

ANNEX 1: COMMITTED PROJECTS PER YEAR

(in EUR million as of 30 September 2006)

Op ID	Op Name	Regional/Direct	Signing Date	Total Project Value	EBRD Finance	Debt	Equity	Operation Stage
327	Drava River Hydro Power Project	Direct	25/04/93	107.2	65.1	65.1	0.0	Completed
932	Eurovision - RTV Slovenia	Direct	19/08/93	0.8	0.8	0.8	0.0	Completed
1993				**108.0**	**65.9**	**65.9**	**0.0**	
121	SKB Banka d.d. (credit line)	Direct	18/02/94	25.0	25.0	25.0	0.0	Completed
349	Slovenske Zeleznice p o	Direct	12/04/94	130.6	42.8	42.8	0.0	Repaying
1847	Company for Motorway (DARS)	Direct	13/05/94	50.1	25.2	25.2	0.0	Repaying
339	National Road Administration	Direct	10/06/94	44.0	21.5	21.5	0.0	Repaying
637	Aquasava	Direct	16/06/94	12.7	4.7	4.7	0.0	Completed
118	Horizonte Fund Slovenia	Direct	01/07/94	9.2	3.0	0.0	3.0	Repaying
1741	SKB Banka (Equity Investment)	Direct	14/12/94	31.0	14.9	0.0	14.9	Completed
803	Sarrio Slovenia - Debt	Direct	20/12/94	24.8	10.0	10.0	0.0	Completed
2075	Sarrio Slovenia - Equity	Direct	20/12/94	10.4	2.7	0.0	2.7	Completed
1994				**337.9**	**149.8**	**129.1**	**20.6**	
1254	Slovenia Development Capital Fund	Direct	16/01/95	18.8	4.2	0.0	4.2	Completed
2596	SRP - Slovenia SRP - Eurofin	Direct	11/05/95	0.5	0.5	0.0	0.5	Completed
2597	SRP - Slovenia SRP - Druzba	Direct	12/05/95	3.6	3.6	0.0	3.6	Completed
1059	Slovenski Plinovodi	Direct	25/07/95	7.9	2.3	2.3	0.0	Completed
1953	Yulon	Direct	16/11/95	52.8	12.3	12.3	0.0	Completed
1995				**83.7**	**22.9**	**14.6**	**8.3**	
3576	Yulon 2	Direct	18/12/96	10.2	5.1	5.1	0.0	Completed
3130	Mercator	Direct	19/12/96	54.9	3.8	3.8	0.0	Completed
1996				**65.1**	**8.9**	**8.9**	**0.0**	
4397	Aquasava 2 d.o.o.	Direct	20/10/97	11.5	5.5	5.5	0.0	Completed
4640	Merkur	Direct	20/10/97	48.7	12.0	0.0	12.0	Completed
1997				**60.3**	**17.5**	**5.5**	**12.0**	
4366	Alpina	Direct	22/12/98	5.9	5.9	4.1	1.8	Completed
1998				**5.9**	**5.9**	**4.1**	**1.8**	
362	Maribor Waste Water Concession	Direct	15/04/99	47.4	14.8	14.8	0.0	Repaying
4442	Info. and Comm. Tech & Industrial Electronic Fund Ltd.	Regional fund investment	02/06/99	8.2	1.9	0.0	1.9	Disbursing
5049	AIG New Europe Fund	Regional fund investment	29/06/99	13.0	2.3	0.0	2.3	Repaying
7368	Slovenia FI FW - Ljubljanska Banka (sub loan)	Direct	06/08/99	25.0	15.0	15.0	0.0	Completed
8027	Slovenia FI FW - SKB Banka Housing Loan	Direct	27/08/99	10.0	10.0	10.0	0.0	Repaying
9144	Regional/Private Equity Fund Facility - Trigranit	Regional fund investment	07/12/99	3.6	0.7	0.0	0.7	Completed
1999				**107.2**	**44.7**	**39.8**	**4.9**	
10652	Yulon Expansion	Direct	21/07/00	20.2	9.5	9.5	0.0	Repaying
7880	EU/EBRD Phase I - Nova Kreditna Banka Maribor	Direct	20/09/00	5.0	5.0	5.0	0.0	Repaying
11303	EU/EBRD Phase I - Banka Koper	Direct	15/11/00	5.0	5.0	5.0	0.0	Completed
2000				**30.2**	**19.5**	**19.5**	**0.0**	
13120	EU/EBRD Phase I - Euroventures Danube BV	Regional fund investment	26/02/01	2.8	0.6	0.0	0.6	Disbursing
17580	Hermes Softlab	Direct	13/06/01	9.0	3.0	0.0	3.0	Disbursing
13199	Raiffeisen EU Enlargement Fund	Regional fund investment	02/07/01	3.7	1.9	0.0	1.9	Repaying
22303	Mobitel GSM	Direct	13/12/01	185.0	25.0	25.0	0.0	Completed
17767	Regional Europolis Portfolio	Regional fund investment	14/12/01	75.0	26.3	10.9	15.3	Repaying
2001				**275.5**	**56.7**	**35.9**	**20.8**	
24756	Nova Ljubljanska Banka - Privatisation	Direct	09/07/02	562.4	63.7	0.0	63.7	Repaying
29432	EU/EBRD Phase II - Banka Koper II	Direct	03/12/02	5.0	5.0	5.0	0.0	Repaying
27587	Heitman Central Europe Property Partners Fund II	Regional fund investment	09/12/02	3.6	1.1	0.0	1.1	Repaying
2002				**571.1**	**69.8**	**5.0**	**64.9**	
30225	EU/EBRD Extension 4 - Raiffeisen Leasing Slovenia	Direct	15/01/03	7.0	7.0	7.0	0.0	Disbursing
34392	Volksbank FW - Volksbank Slovenia Sub-debt	Direct	09/09/03	10.0	10.0	10.0	0.0	Disbursing
33512	Volksbank - GEF (Global Environmental Facility)	Direct	02/12/03	12.0	12.0	12.0	0.0	Repaying
30156	Lafarge Slovenia	Direct	22/12/03	66.0	20.0	0.0	20.0	Disbursing
2003				**95.0**	**49.0**	**29.0**	**20.0**	
29168	Accession Fund	Regional fund investment	24/02/04	60.0	15.0	0.0	15.0	Disbursing
33613	GEF Facility - Bank Austria Creditanstalt Slovenia	Direct	17/05/04	14.0	14.0	14.0	0.0	Repaying
33206	NLB-GEF (Global Environmental Facility)	Direct	08/09/04	12.0	12.0	12.0	0.0	Disbursing
34865	EU/EBRD Extension 5 - SKB Leasing	Direct	15/09/04	10.0	10.0	10.0	0.0	Disbursing
35156	Probanka - GEF (Global Environmental Facility)	Direct	24/12/04	7.0	7.0	7.0	0.0	Disbursing
2004				**103.0**	**58.0**	**43.0**	**15.0**	
36167	Emerging Europe Convergence Fund II	Regional fund investment	24/08/05	3.6	3.6	0.0	3.6	Repaying
35562	EU/EBRD Extension 5 - HVB Leasing	Direct	20/10/05	5.0	5.0	5.0	0.0	Disbursing
35987	Argus Capital Partners II	Regional fund investment	07/12/05	0.3	0.3	0.0	0.3	Disbursing
34894	Southeast Europe Equity Fund II	Regional fund investment	15/12/05	2.0	2.0	0.0	2.0	Disbursing
36404	EU/EBRD Ext. 5 Rural Facility - SKB Leasing	Direct	21/12/05	7.0	7.0	7.0	0.0	Disbursing
36496	EU/EBRD Extension 5 - Volksbank Ljudska Slovenia	Direct	22/12/05	7.0	7.0	7.0	0.0	Disbursing
36617	SG AM Eastern Europe L.P.	Regional fund investment	22/12/05	5.9	3.3	0.0	3.3	Repaying
2005				**30.8**	**28.2**	**19.0**	**9.2**	
SLOVENIA TOTAL				**1,873.7**	**596.8**	**419.3**	**177.5**	

ANNEX 2: NET CUMULATIVE BUSINESS BY INDUSTRY
(In EUR million - as of 30 September 2006))

Sector Business Group (SIC)	Sector Team (SIC)	No. of Projects	Total Project Value	EBRD Finance	Debt	Equity	% Share of Commitments
Energy	Natural Resources	1.0	8	2	2	0	0%
	Power and Energy	1.0	107	65	65	0	10%
Sub-total Energy		**2.0**	**115**	**67**	**67**	**0**	**10%**
Financial Institutions	Bank Equity	2.0	593	79	0	79	22%
	Bank Lending	2.9	137	127	127	0	19%
	Equity Funds	2.9	60	22	0	22	3%
	Non Bank Financial Institutions	0.3	29	29	29	0	4%
Sub-total Financial Institutions		**8.1**	**819**	**256**	**156**	**100**	**48%**
General Industry	General Industry	10.6	322	95	55	40	14%
Sub-total General Industry		**10.6**	**322**	**95**	**55**	**40**	**14%**
Infrastructure	Municipal & Env Inf	1.0	47	15	15	0	2%
	Transport	3.0	225	89	89	0	14%
Sub-total Infrastructure		**4.0**	**272**	**104**	**104**	**0**	**16%**
Specialised Industries	Property and Tourism	0.5	142	43	11	32	7%
	Telecoms Informatics & Media	1.4	203	31	26	5	5%
Sub-total Specialised Industries		**1.9**	**345**	**74**	**37**	**37**	**11%**
SLOVENIA TOTAL		**26.6**	**1,874**	**597**	**419**	**177**	**100%**

ANNEX 3: SELECTED ECONOMIC INDICATORS

Slovenia

	2000	2001	2002	2003	2004	2005	2006
						Estimate	*Projection*
Output and expenditure				*(Percentage change in real terms)*			
GDP	4.1	2.7	3.5	2.7	4.4	4.0	4.7
Private consumption	0.7	2.3	1.3	3.5	2.6	3.4	na
Public consumption	2.6	3.9	3.2	1.6	3.4	2.2	na
Gross fixed capital formation	1.8	0.4	0.9	7.1	7.9	1.5	na
Exports of goods and services	13.2	6.3	6.7	3.1	12.5	10.5	na
Imports of goods and services	7.3	3.0	4.8	6.7	13.4	7.0	na
Industrial gross output	6.3	3.1	2.5	1.4	2.3	3.4	na
Agricultural gross output[1]	0.6	-4.0	13.2	-15.7	16.9	-5.1	na
Employment[2]				*(Percentage change)*			
Labour force (end-year)	1.4	1.0	-3.2	3.2	2.6	2.4	na
Employment (end-year)	2.6	0.6	-2.6	2.9	2.9	1.7	na
				(In per cent of labour force)			
Unemployment (end-year)	6.6	7.0	6.5	6.7	6.5	7.2	na
Prices and wages				*(Percentage change)*			
Consumer prices (annual average)	8.9	8.4	7.5	5.6	3.6	2.5	2.7
Consumer prices (end-year)	8.9	7.0	7.2	4.6	3.2	2.3	3.0
Producer prices (annual average)	7.6	9.0	5.2	2.6	4.3	2.7	na
Producer prices (end-year)	9.2	7.5	3.7	2.1	4.9	1.8	na
Gross average monthly earnings in economy (annual average)[3]	10.6	11.9	9.8	7.5	4.4	4.9	na
Government sector[4]				*(In per cent of GDP)*			
General government balance	-3.9	-4.3	-2.5	-2.8	-2.3	-1.4	-1.6
General government expenditure	48.1	49.0	48.0	48.1	47.5	47.2	na
General government debt	27.1	28.2	29.7	29.1	29.4	28.8	na
Monetary sector				*(Percentage change)*			
Broad money (M2, end-year)[5]	17.1	29.9	11.0	6.2	8.0	8.3	na
Domestic credit (end-year)	16.7	16.9	14.1	14.4	24.1	20.1	na
				(In per cent of GDP)			
Broad money (M2, end-year)	46.1	53.7	53.4	52.3	52.3	53.7	na
Interest and exchange rates				*(In per cent per annum, end-year)*			
Discount rate	8.2	7.8	7.3	5.0	3.3	3.8	na
Interbank market rate (average)	7.0	6.9	4.9	5.6	4.4	3.7	na
Deposit rate (31-90 days)	10.0	9.8	8.2	6.0	3.8	3.2	na
Lending rate (short-term consumer loans)	13.6	13.5	12.3	10.4	8.6	7.7	na
				(Tolars per US dollar)			
Exchange rate (end-year)	227.4	250.9	221.1	189.4	176.2	202.4	na
Exchange rate (annual average)	222.7	242.7	240.2	207.1	192.4	192.7	na
External sector				*(In millions of EUR)*			
Current account	-583	38	247	-196	-720	-547	-693
Trade balance	-1,227	-684	-265	-543	-1,009	-1,026	-1,113
Merchandise exports	11,626	12,632	13,521	13,882	15,715	17,809	20,463
Merchandise imports	12,364	12,781	13,166	13,885	16,037	17,979	20,658
Foreign direct investment, net	77	251	1,556	-151	224	-58	na
Gross reserves, excluding gold (end-year)	3,436	4,908	6,702	6,798	6,464	6,824	na
External debt stock	9,490	10,403	11,484	13,259	15,271	19,566	na
				(In months of imports of goods and services)			
Gross reserves, excluding gold (end-year)[6]	3.3	4.7	6.1	5.9	4.8	4.6	na
				(In per cent of exports of goods and services)			
Debt service	9.6	14.6	14.6	16.6	16.9	16.6	na
Memorandum items				*(Denominations as indicated)*			
Population (end-year, million)	2.0	2.0	2.0	2.0	2.0	2.0	na
GDP (in billions of tolars)	4,300	4,800	5,355	5,814	6,272	6,620	7,055
GDP per capita (in US dollar)	9,704	9,995	11,174	14,105	16,382	17,263	na
Share of industry in GDP (in per cent)	30.0	30.1	29.6	29.8	29.3	28.2	na
Share of agriculture in GDP (in per cent)	3.2	3.0	3.2	2.6	2.7	2.5	na
Current account/GDP (in per cent)[7]	-2.8	0.2	1.0	-0.8	-2.7	-2.0	-2.4
External debt - reserves (in EUR million)	4,786	3,890	3,642	5,556	7,787	10,732	na
External debt/GDP (in per cent)[8]	45.3	47.1	48.5	53.3	58.2	70.8	na
External debt/exports of goods and services (in per cent)[9]	81.6	82.4	84.9	95.5	97.2	109.9	na

1 Agricultural value-added.
2 Data based on labour force surveys.
3 Data for enterprises employing three or more persons until 2004. From 2005 onwards, data for legal persons with 1 or 2 employees in the private sector also taken into account.
4 General government includes central government, municipalities and extra-budgetary funds. Data calculated according to Eurostat methodology (ESA95) from 2000.
5 According to the harmonised ECB definition.
6 Ratio calculated in EUR.
7 Ratio calculated in EUR.
8 Ratio calculated in EUR.
9 Ratio calculated in EUR.

ANNEX 4: ASSESSMENT OF EBRD TRANSITION IMPACT BY SECTOR

Sector	*Impact*	*Comment*
Agribusiness	None	The Bank has had no involvement.
Banking	Significant	The key contribution of the Bank has been the support in 2002 to the partial privatisation of Nova Ljubljanska banka, the largest banking group in the country. This tackled key transition challenges in the country, including support to credit allocation on commercial terms, and the building of skills in the sector through the presence of foreign institutions. Other projects included credit lines to SMEs (see MSME section) and a number of credit lines which introduced financial institutions to financial products for environmental projects.
Energy efficiency	None	No new projects during the review period.
Industrial sector	Minimal	Only two projects were done by the Bank in Slovenia in the past 5 years, mainly aimed at supporting the modernisation and restructuring of companies through the involvement of foreign investors. The first one (Yulon, rated satisfactory/low) partly achieved the assigned transition impact inasmuch as the project (introduction of state-of-the-art technology through a capital expenditure programme by a foreign investor) was completed with a delay of several years and only partly due to the company's failure on its contractual obligations, indicating sub-standard corporate governance and business conduct standards. The second project delivered the expected transition impact (efficiency, environmental, health and safety standards and standards of business conduct).
MSME	Minimal	Under the EU/EBRD Framework Facility for SMEs, credit lines were extended to Banka Koper and Nova Kreditna Banka Maribor, resulting in around 400 loans. All these investments were supported by TC for institution building. Although Banka Koper benefited from a follow-on loan, the two banks are among the least successful participating banks in the framework in terms of number of loans disbursed, average loan amount, and subsidy utilisation. Under the leasing arm of the Facility, credit lines were extended to Raiffeisen Leasing and SKB Leasing, resulting in 435 leases. SKB only started participating in the framework at the end of 2004. Raiffeisen has participated since January 2003, but SME leasing does not seem to be a key business area for the company.
MEI	None	No new projects during the review period.
Natural resources	None	No new projects during the review period.

Sector	*Impact*	*Comment*
Non-bank financial institutions	Minimal	The Bank has had two TC projects with the insurance regulator related to the introduction of a web based insurance regulatory reporting system. Insurance regulation and supervision in Slovenia is now generally used as a model for other countries. The Bank is also actively involved in policy dialogue with the Government over ways to reform the state dominated insurance sector. The Bank has also extended finance to two leasing companies under the EU SME framework (see the MSME section).
Power	None	No new projects during the review period.
Private equity funds	Minimal	The Bank has been present in the country's private equity sector through the Slovenia Development Capital Fund and the Slovenia Horizonte Fund. The Slovenia Development Capital Fund made 11 investments all of which have been realised through a mixture of trade sales, management buy-outs and secondary sales (with only one write-off). The overall return of the fund has been good. However the investment strategies of the fund and the implementation by the fund managers were hardly value-adding and the returns are generally incidental to the run-up of the stock market in conjunction with the accession. No (private equity) skills transfer has been achieved through this fund and it has not resulted in an expansion of the investment activities through follow-on funds. The performance of the Horizonte Fund has been more mixed, but many of its investments are still unrealised.
Property and tourism	None	The Bank has had no involvement although Slovenia is a target country of regional property funds (Heitman Central Europe Property Fund II, Europolis II and Accession Fund).
Telecom, Inforamatics and Media	Minimal	In 2001, the Bank assisted Mobitel GSM in rolling out an additional GSM network. The Bank also made an equity investment in a local software company supporting development of new services, but the investment was not successful. In the 1990s the Bank provided technical assistance to support early stages of sector development and reform.
Transport	None	No new projects during the review period.

Source: Transition Impact Retrospective 2 (CS/FO/05-17, 20 September 2005).

ANNEX 5: ASSESSMENT OF TRANSITION CHALLENGES

(Source: Annex 6 (Assessment of Transition Challenges) comes from the Assessment of Transition Challenges document (CS/FO/05-10, 27 April 2005 Annex 1 (Country-by-country ratings and rationale synopsis)

SLOVENIA	Structure	Institutions	Conduct	Comments
Agribusiness	*Small*	*Small*	*Small*	Poorly functioning land market. Slow progress with privatisation of remaining state-owned farms. Agroprocessors still need to improve efficiency and standards. Improvements to distribution and traceability are necessary. Credit to the sector is limited.
Banking	*Medium*	*Small*	*Small*	Regulatory framework in place though with a restricted secured transactions law. Number of banks is stable and a minority is foreign-owned. Privatisation is not yet complete, with state-owned banks still having a significant asset share. Domestic credit to the private sector (as % of GDP) is low. Need for closer supervision.
Energy Efficiency	*Large*	*Medium*	*Medium*	The sectoral regulator needs to be strengthened further. The energy services market is still rather inactive, despite the presence of several ESCOs. Slovenia has ratified the Kyoto Protocol and is part of the EU Emissions Trading Scheme.
General Industry	*Medium*	*Small*	*Medium*	State regulation of the private sector remains significant. Rigid labour market regulation needs to be addressed. The enterprise sector would also benefit from further restructuring and withdrawal of the state through accelerated privatisation process.
MEI	*Medium*	*Medium*	*Small*	Control over local infrastructure rests with the municipalities, many of which are too small to finance or implement new projects. Water supply is operated by municipally-owned companies, but public private partnerships for a few specific projects have been developed. Tariffs are mostly cost reflective.
MSMEs	*Medium*	*Small*	*Medium*	Starting a business carries medium costs. However, recently one-stop shops for company registration have been introduced. A private credit bureau is in place. Collateral and bankruptcy legislation are supportive of MSME lending. The cost of registering collateral is low.
Natural Resources	*Small*	*Small*	*Small*	The oil distribution market is dominated by Slovene private companies. The only wholesale gas supplier is Geoplin, a company which is owned by the state for reportedly 40 per cent of its equity and a large quarter by Petrol, the remainder being held by other investors including Ruhrgas of Germany. The state is keen to increase its share and negotiations are ongoing. The coal-mining company Velenje is 100% state-owned.
NBFIs	*Medium*	*Small*	*Medium*	Securities and insurance markets legislation and regulation almost fully meet IOSCO / IAIS standards but some further improvements are necessary. Capital markets are reasonably developed. The insurance market is dominated by a state-owned company. There are thriving leasing and consumer finance markets.
Power	*Large*	*Medium*	*Small*	The power sector has been unbundled, but there is still very little private sector participation. There is an independent regulator, but tariffs are still subject to state interference. The State is against privatisation.
Private Equity Funds	*Medium*	*Medium*	*Medium*	Slovenia has reasonable reporting and creditors' right protection standards and has a potential for further involvement by private equity funds. The country is still to develop local private equity manager class and investors committed to local private equity investments. The development of private equity is also hampered by availability of finance from other sources.
Property + Tourism	*Medium*	*Small*	*Negligible*	Full tradability of land except foreigners. The real estate sector is developing fast, including new types property as well as financing instruments. There is some government interference in the sector.
Telecoms	*Medium*	*Small*	*Small*	Slovenia, along with the Czech Republic, is the only EU new member state that has not yet privatised the fixed line operator. One of the mobile is also state-owned and its decisions are not fully based on commercial principles. There is an independent regulator, but tariff rebalancing remains to be fully completed.
Transport	*Medium*	*Medium*	*Medium*	In railways, operating and policy setting functions have been separated and core railway businesses have been unbundled while ancillary services have been divested. In roads, private sector participation is in place for construction and maintenance. Road sector finance has been reformed.

ANNEX 6: STRUCTURAL CHANGE INDICATORS IN THE EU-8 REGION

	Czech Rep.	Estonia	Hungary	Latvia	Lithuania	Poland	Slov. Rep.	Slovenia
Enterprises (2005)								
Privatisation revenues (cumulative, in per cent of GDP)	25.1	na	34.2	5.4	13.7	13.9	35.1	4.9
Private sector share in GDP (in per cent)	80.0	80.0	80.0	70.0	75.0	75.0	80.0	65.0
Private sector share in employment (in per cent)	70.0	75.6	79.4	76.0	na	71.0	75.0	na
Budgetary subsidies and current transfers (in per cent of GDP)	9.4	1.5	2.3	4.5	0.8	na	1.3	20.3
Share of industry in total employment (in per cent)	28.9	26.0	32.4	na	20.1	21.2	28.8	30.7
Change in labour productivity in industry (in per cent)	5.7	13.7	6.8	na	4.9	7.8	2.7	2.1
Investment/GDP (in per cent)	26.5	30.3	20.3	34.2	25.0	20.2	28.4	26.0
EBRD index of small-scale privatisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of large-scale privatisation	4.0	4.0	4.0	3.7	4.0	3.3	4.0	3.0
EBRD index of enterprise reform	3.3	3.7	3.7	3.0	3.0	3.7	3.7	3.0
Markets and trade (2005)								
Share of administered prices in CPI (in per cent)	10.9	26.7	15.4	14.3	18.2	1.2	21.9	16.7
Number of goods with administered prices in EBRD-15 basket	1.0	2.0	2.0	2.0	1.0	1.0	2.0	1.0
Share of trade with non-transition countries (in per cent)	na	72.3	80.2	54.5	54.2	75.9	na	74.6
Share of trade in GDP (in per cent)	124.4	124.5	117.3	85.8	101.5	64.2	140.1	108.7
Tariff revenues (in per cent of imports)	0.2	na	0.1	0.3	0.4	0.4	0.1	0.3
EBRD index of price liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.0
EBRD index of forex and trade liberalisation	4.3	4.3	4.3	4.3	4.3	4.3	4.3	4.3
EBRD index of competition policy	3.0	3.3	3.3	3.0	3.3	3.0	3.3	2.7
Financial sector (2005)								
Number of banks (foreign-owned)	36 (27)	13 (10)	38 (27)	23 (10)	12 (6)	61 (50)	23 (16)	25 (9)
Asset share of state-owned banks (in per cent)	2.5	0.0	7.0	4.3	0.0	21.5	1.1	12.0
Asset share of foreign-owned banks (in per cent)	84.4	99.4	82.6	57.9	91.7	74.2	97.3	22.6
Non-performing loans (in per cent of total loans)	4.0	0.2	3.1	0.7	0.7	12.9	5.5	6.4
Domestic credit to private sector (in per cent of GDP)	16.8	58.9	51.1	67.4	34.0	23.1	26.8	56.4
Domestic credit to households (in per cent of GDP)	13.9	28.1	15.7	27.2	12.0	12.6	13.0	14.5
Of which mortgage lending (in per cent of GDP)	7.9	23.3	11.6	19.6	9.0	5.1	3.6	3.6
Stock market capitalisation (in per cent of GDP)	31.9	25.3	31.9	16.8	31.8	31.3	9.5	23.5
Stock trading volume (in per cent of market capitalisation)	118.6	51.1	78.0	4.6	10.1	36.3	1.6	9.0
Eurobond issuance (in per cent of GDP)	1.1	2.5	6.1	0.0	3.0	4.0	0.0	0.0
EBRD index of banking sector reform	4.0	4.0	4.0	3.7	3.7	3.7	3.7	3.3
EBRD index of reform of non-bank financial institutions	3.7	3.3	4.0	3.0	3.0	3.7	2.7	2.7
Infrastructure (2005)								
Fixed-line (mobile) penetration rate (per 100 inhabitants)	31.5 (115.2)	33.3 (108.8)	33.2 (92.3)	31.7 (81.1)	23.4 (127.1)	30.6 (75.7)	22.2 (84.1)	41.5 (89.4)
Internet penetration rate (per 10,000 inhabitants)	376.8	476.4	479.2	258.7	274.3	70.5	227.3	269.7
Railway labour productivity (1989=100)	81.3	359.7	154.0	118.6	77.1	98.8	64.8	155.4
Residential electricity tariffs (in USc kWh)	11.4	9.2	14.7	8.1	10.2	12.1	14.9	13.1
Average collection rate, electricity (in per cent) [2]	100	na	na	na	na	na	na	90
GDP per unit of energy use (PPP in US dollars per kgoe)	na	na	na	na	na	na	na	na
EBRD index of infrastructure reform	3.3	3.3	3.7	3.0	2.7	3.3	3.0	3.0
Electric power	3.3	3.0	4.0	3.3	3.3	3.3	4.0	3.0
Railways	3.0	4.3	3.3	3.3	2.3	4.0	3.0	3.0
Roads	3.0	2.3	3.7	2.3	2.3	3.0	2.3	3.0
Telecommunications	4.3	4.0	4.0	3.0	3.3	4.0	3.7	3.0
Water and waste water	4.0	4.0	4.0	3.3	3.3	3.3	3.0	3.3

ANNEX 7: POLITICAL AND SOCIAL ASSESSMENT

Domestic Politics

The Republic of Slovenia is committed to and applying the principles of multiparty democracy, pluralism and market economics and therefore continues to meet the conditions specified in Article 1 of the Agreement Establishing the Bank.

Slovenia became independent on 25 June 1991 after a nationwide referendum held in December 1990, which passed with 88.2 per cent of the votes on a 93.2 per cent turnout.

The current constitution provides for the respect of human rights and fundamental freedoms, the principles of the rule of law and social state, and the principle of the division of powers into legislative, executive and judicial branches. Enacted in 1991, the constitution established Slovenia as a parliamentary democracy with a President elected by direct universal suffrage for a five-year term, a Prime Minister nominated by the President and elected by the National Assembly, and a Cabinet appointed by the Prime Minister and approved by the National Assembly. The National Assembly (Državni zbor) is formed by 90 deputies elected for a four-year term, 88 of which are elected representatives of the parliamentary parties, plus one representative each from the Italian and Hungarian national communities. The National Council (Državni svet) is composed by 40 elected representatives of employers and other professional associations. This is mainly an advisory body elected for a five-year term, with limited legislative powers.

The last parliamentary elections, which were held on 3 October 2004, saw the centre-right Slovenian Democratic Party (SDS) of Janez Janša winning over the centre-left Liberal Democracy of Slovenia (LDS) of former Prime Minister Anton Rop, thus breaking the Liberals' 12-year-long hold on power. After their victory, Prime Minister Janša formed a coalition with his party's close ally, New Slovenia (NSi), as well as the populist Slovene People's Party (SLS) and the Democratic Party of Slovene Pensioners (DeSUS). However, the new government holds only a narrow majority in the 90-seat parliament. Following their electoral defeat, the LDS elected a new leader in October 2005, Jelko Kacin, a former defence consultant and deputy defence minister in the country's first post-communist government. More recently the party suffered additional setbacks following the resignation of a number of senior LDS members, notably President Drnovšek, dissatisfied with the party's lack of direction. The LDS has not offered any major challenge to the incumbent government since losing the last parliamentary elections. Voting took place on 22 October 2006 for the elections of mayors and municipal councillors in 210 municipalities. The ruling Slovenian Democratic Party (SDS) won most seats in city councils, but managed to win only 14 mayors in the first round. Zoran Janković, an independent candidate and former CEO of Mercator, Slovenia's leading retailer, became the new mayor of Ljubljana with 63 percent of votes, well ahead of the governing coalition's choice, former Central Bank governor France Arhar, who received 20.8 percent of the votes. Janković has been closely associated with former President and reformed communist Milan Kučan, and has been simultaneously very critical of Janša's government.

The next parliamentary elections will take place in autumn 2008.

In 2005-2006 the government developed a comprehensive national development strategy that stressed the necessity of implementing market-friendly policies that would simplify the tax code and improve the country's competitiveness in accordance with the goals set by the Lisbon agenda. In this respect, the Government recently adopted a bill on public-private partnerships in order to speed up investment in public projects. This bill obligates all contracting parties to examine the feasibility of public-private partnership for projects above a certain value. The Government also adopted guidelines for the privatisation of companies in the energy sector, which should de facto guarantee the presence of at least two energy providers in the country, capable of competing at national and regional level.

As regards the situation of the media, there has been growing concern about recent changes in the legislation, in particular for the norms regulating the allocation of state aid, which could possibly allow the Government to exercise more control over both print and broadcast media, and the introduction of stricter regulations for the right to respond, according to which any party has the right to rectify what it consider being unfair or otherwise inadequate reporting. These latest changes could make journalists more vulnerable to pressures from the political establishment. There is also an obligation to submit statements of editorial policies to governmental bodies, which could directly threaten the independence and plurality of the media.

International Relations

Slovenia became a member of the EU on 1 May 2004, following a non-binding nationwide referendum held in March 2003, which passed with 90 per cent of the voters in favour of membership. Slovenia joined NATO on 29 March 2004 following a nationwide referendum, held in March 2003, which passed with 66 per cent of the votes.

Slovenia is also member of a number of international organisations and financial institutions, among which the Organisation for Security and Co-operation in Europe (since 1992. In 2005 Slovenia held the one-year Chairmanship of the OSCE), the United Nations (1992), World Health Organisation (1992), United Nations Children's Fund (1992), International Monetary Fund (1993), World Trade Organisation (1995).

In May 2006 the European Commission, in agreement with the European Central Bank, recommended that Slovenia be allowed to adopt the euro as planned on 1 January 2007. Slovenia has been the first new EU member country to have met all Maastricht criteria for macroeconomic convergence. The introduction of the euro will eliminate exchange rate risk between Slovenia's and its largest trading partner, the rest of the EU, while at the same time providing a step to reduce overall capital inflow barriers. In addition to this, Slovenia was scheduled to enter the Schengen area in October 2007, following a positive assessment by the EU based on police cooperation, data protection and security of the maritime border. This will be delayed due to problems with the EU central information system but an EU Council decision is expected in December regarding Slovenia's date of entry in the Schengen area. Slovenia will also be the first EU new member state to take up the EU rotating presidency in the first semester of 2008. The decision found overwhelming consensus among all domestic political parties thanks to the increased political weight and overall exposure that Slovenia would gain in Europe through the Presidency. Preparations are underway, with a number of governmental departments and agencies now working on the following policy areas: revision of the Constitution for the European Union; enlargement; external policies, including the European Neighbourhood Policy (ENP); infrastructure development, also through EU co-financing; energy, including energy security, efficiency and renewables; Lisbon strategy; cohesion policy (mid term review); Common Agricultural Policy (CAP 2008 review). These issues have been identified by the Government as being the areas where Slovenia can bring the best contribution and experience. The country continues to play an active foreign policy role in the region of former Yugoslavia, in particular to support EU enlargement in the Western Balkans.

Slovenia supports Croatia's application to the EU, but relations between the two countries are complicated by a number of low level issues.. Some of the contentious issues stemming from the post-Yugoslav succession include property rights, bank accounts, land borders, and the use and funding of the nuclear power plant at Krsko. The most sensitive remains the dispute over the maritime borders of the Piran Bay, especially following Slovenia's unilateral declaration of an exclusive fishery zone in the whole Bay in January this year.

Social Issues

Demographics and Minority Groups: Slovenia has a population of approximately 2 million, of which 83.1 per cent (according to a 2002 census) are Slovenes. There are also two national minority communities of Italians and Hungarians. They are considered indigenous minorities, and their rights are protected under the Constitution. These include the right to the free use of national symbols, preservation of their identity and the founding of their own organisations, the development of economic, cultural and scientific research activities and activities in the sphere of public media and publishing. The Constitution also guarantees them the right to upbringing and education in their own language.

Other ethnic groups include Croats, Serbs, Bosnians (Muslims), Yugoslavs, Macedonians, Montenegrins, Albanians as well as the Roma. Those are not considered autochthonous minorities and subsequently many rights are not granted to them. Moreover, when Slovenia became independent in 1992, it deleted the names of approximately 30,000 residents of non-Slovenian ancestry (mainly Serbs, ethnic Croats and ethnic Bosnian Muslims, ethnic Albanian Kosovars and ethnic Roma) from the civil registries. This action was amply criticised as an administrative genocide and it is now referred to as the issue of the *Izbrisani* (erased residents), which remains sensitive as a possible violation of human rights.

According to the 2002 census, there were 3,246 Roma. The Constitution provides that "the status and special rights of Roma communities living in Slovenia shall be such as are determined by statute". Parliament has still not enacted laws to establish such rights for the Romany community. A study funded by the European Community estimated that 40 percent of Roma in the country are autochthonous. Many Roma continue to live in settlements, apart from other communities, which lack basic utilities such as electricity, running water, sanitation, and access to transportation. Roma representatives have reported that some local authorities have developed segregated substandard housing facilities to which Roma communities were forcibly relocated. Roma representatives also reported that Roma children often attend segregated classes and are selected by authorities in disproportional numbers to attend classes for students with special needs.

Muslims comprise 2.4 percent of the population, according to the 2002 census. While there are no governmental restrictions on the Muslim community's freedom of worship, services commonly are held in private homes under cramped conditions.

Access to Social Infrastructure: The Government provides compulsory, free, and universal primary school education for children through grade 9 (ages 14 and 15) and up to 4 additional years of free, voluntary secondary school education. Ministry of Education statistics showed an attendance rate of nearly 100 percent of school age children, with most children completing secondary school. The Government provides universal health care for all citizens, including children.

Human Rights: A number of domestic and international independent human rights groups generally operate without government restriction, investigating and publishing their findings on human rights cases. Government officials are generally cooperative and responsive to their views. An Ombudsman for Human Rights operates independently of government or party control, interference or influence.

Slovenia faces a modest trafficking problem. Slovenia is taking action to limit the use of its territory as a point of transit and, to a lesser extent, a source and destination country for the trafficking in persons for the purpose of sexual exploitation. There is a co-ordinated approach by government and non-governmental organisations working together on these issues and an inter-ministerial working group has been set up. Slovenia is a signatory to all international agreements relevant to these issues and has transposed them into national legislation. On June 17 2004, the Penal Code was amended to specifically criminalize trafficking in persons. Slovenian judicial and law enforcement sources deal with 10-15 such cases a year.

Labour Issues: Slovenia is an ILO member state and has ratified all eight ILO core conventions.[1] The law allows unions to conduct their activities without interference, and the Government protects this right in practice. The law provides for the right to bargain collectively, and it is freely practiced. The law prohibits forced or compulsory labour, including by children; however, there have been reports that such practices occur in relation to trafficking. The Ministry of Labour is responsible for monitoring labour practices and has inspection authority; police are responsible for investigating any violation of the law.

Although both men and women experience the same average period of unemployment, women frequently hold lower paying jobs. On average, women's earnings are 90 percent of those of men. The Government's Office of Equal Opportunities promotes non-discrimination between women and men.

[1] ILO Application of International Labour Standards List .

ANNEX 8: ENVIRONMENT

Slovenia signed the EU membership agreement on 16 April 2003 in Athens and subsequently Slovenia became a member of European Union on 1 May 2004. This included a great environmental challenge for a young country and its sustainable development.

During the period 1998-2003 when Slovenia carried out the negotiation with EU, Slovenia fundamentally changed and harmonised its legal framework for environmental protection to comply with the EU legal requirements. Law on Environmental Protection was approved by the Slovenian Parliament in June 1993. Environmental *Acquis Communautaire* required for Slovenia joining EU was approved by the Slovenian Government in March 1998. National Programme for Environmental Protection was passed by the Parliament in September 1999, followed by approval for operational programmes in the main areas of environment such as air protection, wastewater management and waste management. A new National Programme for Environmental Protection for the period 2005-2012 has been prepared and it was approved by Slovenian Parliament in November 2005. However, Slovenia still needs to comply with EU requirements relating to the list of projects for which EIA is required.

In the area of environmental investment planning, the Slovenian National Programme for Environmental Protection of 1999 envisaged investments to establish the national waste management systems which will be financed by public sector in an amount of approximately SIT 60 billion (approximately EUR 250 million). This amount will be used for financing waste management facilities in a period of 4-8 years, including thermal waste treatment facilities. Additional financing in an amount of SIT 28 billion (approximately EUR 116 million) is envisaged as private sector financing. Following its joining to the EU, Slovenian' Ministry for Environmental Protection and Spatial Planning has established a Slovenian Cohesion Fund Office to identify and prepare priority environmental investment projects in the three priority areas: (i) collection and wastewater treatment; (ii) drinking water supply; and (iii) waste management. EU's Cohesion Fund has approved 7 priority investment projects in 2006:

- Wastewater collection and treatment in the area of the River Sava catchment area, including the towns of Litija, Zagorje, Trbovlje, Hrastnik;
- Groundwater protection of the area of Ptujsko Polje;
- Hydraulic improvement of wastewater collection system of the City of Ljubljana;
- Dolenjska II phase regional waste management centre;
- Water source Mrzlek protection and water supply for the Trnovsko-Banjska area of Goriška Brda;
- Water protection and supply to Bela Krajina;
- Wastewater collection and treatment for the area of Savinja.

The Cohesion Fund's grant to Slovenia for these projects amounts to approximately EUR 75 million. The total projects value is evaluated to be approximately EUR 147 million. The difference in cost of the projects will be covered by other financial sources, primarily relying on funding from the Ecological Research Fund of Republic of Slovenia.

According to the Slovenian Operational Programme for Waste Management for the period up to the end of 2008, public sector financing in this field will be divided among the state budget (8.5 per cent), municipality budgets (20 per cent), fees for waste disposal (43 per cent), foreign investments (20 per cent) and loans by Ecological Research Fund of Republic of Slovenia (8.5 per cent). To be able to fully finance these projects, the Slovenian authorities have defined more important financial sources in the following order: loans of multilateral financial institutions such as EBRD and EIA, EU grants, public financing of infrastructure projects, private capital offered by equipment providers as well as investments provided by GEF for financing of pollution reduction.

EBRD's environmental approach to Slovenia takes into account that the Slovenian government identifies specific environmental investment needs and has considered EBRD as an important financial source. Given the advanced economic stage and well-placed environmental planning, the Bank will continue to support Slovenia's initiatives in environmental investment in such areas as the water and waste management sector.

Based on the Slovenia's well advanced EU's status and the overall economic development in recent years, IBRD has ceased financing projects in Slovenia. However, EIB is a strong partner to Slovenia and currently is financing Slovenia's Highway in the amount of EUR 300 million and Hydropower Investment in the amount of EUR 130 million.

ANNEX 9: TAM/BAS ACTIVITIES

TAM has been active in Slovenia since 1998 and BAS since 2001. A total of 65 TAM Projects and a total of 203 BAS projects were carried out in the country. TAM/BAS operations in the country were completed in 2005. 80 per cent of BAS projects have been rated as 'Highly Satisfactory' and overall productivity of BAS beneficiaries has been increased by 16 per cent on average.

SME activities

The SME sector in Slovenia has been strengthened through the activities of TAM/BAS Programmes, designed to assist the development and growth of SMEs in the Bank's countries of operations, enabling them to adapt to free market economy and assist companies to be more competitive on domestic and international markets. Areas of particular focus are management skills, market positioning, information systems, quality certification, technical and environmental upgrades.

Environment sector activities

TAM/BAS adapts its services to help with issues directly affecting the environment. In Slovenia, BAS has contributed to the environmental initiative programme of the EBRD and Global Environment Facility (GEF) to reduce water pollution in the Danube River Basin.

Expert advisory services were provided to individual companies to address the lack of technical resources and information to undertake effective pollution reduction measures, to develop pollution reduction projects requiring investment, and to evaluate if a resulting investment project proposal is appropriate for the size of the company, economically sustainable, and/or in conformity with the requirements of Best Available Techniques ("BAT") not entailing excessive cost. Using the basic principles of the BAS model, local (or foreign) experts were engaged to conduct various pre-investment activities, e.g. process optimisation and wastewater minimisation, feasibility studies to ensure cost-effectiveness in the selection of the most appropriate technology, introduction of various environmental standards (like ISO 14000, EMAS), etc.
In addition to providing technical assistance to the beneficiaries, TAM/BAS was directly involved in all stages of the project, from preliminary demand assessments to marketing and information dissemination.

Replication of this Facility is currently being prepared by Environmental Department and TAM/BAS for 5 countries in the region and covering industrial energy efficiency and use of small scale renewables.

ANNEX 10: ASSESSMENT OF SLOVENIA'S COMMERCIAL LAWS

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of such laws (also referred to as "effectiveness"). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for Slovenia, accompanied by critical comments of the Bank's legal experts who have conducted the assessments.

Capital Markets

The primary legislation governing the Slovenian capital markets include the Securities Market Act, the Investment Funds and Management Companies Act, and the Takeover Act. The Securities Market Act entered into force on 28 July 1999 and was most recently amended in November 2004. The Investment Funds and Management Companies Act entered into force on 2 January 2003 and was last amended in April 2004. The Takeover Act came into force in 1997 and was amended in 1999.

Established in 1994, the Securities Market Agency ("SMA") is the securities market regulator in Slovenia. It is an independent agency financed by market participant fees. The SMA is in charge of licensing new issues of securities, the supervision of the activities of the Ljubljana Stock Exchange ("LJSE"), the Central Securities Clearing Corporation, custodians, securities brokers and investment service providers, investment funds, mutual pension funds and asset management companies. It is also in charge of enforcing stock exchange disclosure requirements and insider trading laws. The LJSE was officially established on 26 November 1989.[2]

According to the EBRD Securities Markets Legislation Assessment conducted in 2004, the country was found to be in "high compliance" with the Objectives and Principles of Securities Regulation published by the IOSCO. The assessment was updated in 2005 and the results confirmed the 2004 scoring. In particular, the 2005 update evidenced an overall evolution towards more regulatory requirements, including closer scrutiny of the fitness and propriety of key individuals employed, heavier fines, qualifications and experience of individuals, conflicts of interest section, new grounds for refusal of a license, and required disclosure concerning the market intermediary to be provided. The update also revealed significant improvements in the clearance and settlement section. In particular, the SMA now has the power to license clearing and settlement organisations and to approve the changes to their rules and procedures. Finally, trades between direct market participants must now be confirmed as soon as possible after trade execution and settled within two days (T+2).

[2] Trading at the Ljubljana stock exchange dates back to the period between 1924 and 1942. During the Second World War the trading on the old exchange was suspended, and after the war also officially banned by a decree.

Concessions

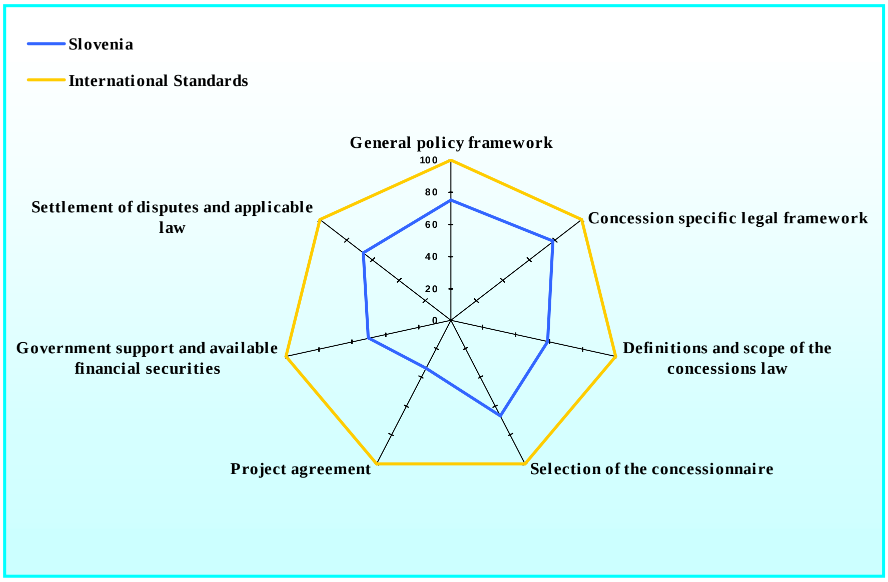
Slovenia is one of few EBRD countries of operations that does not have a single general framework law regulating concessions. Instead, a number of general and sector specific laws contain rules governing concessions. However, a new Law on Public Private Partnership passed first reading in Parliament in September 2006. Once approved the new law may change the existing situation.

The Government has created a policy and institutional framework for improving the legal environment and promoting private sector participation ("PSP") in the country (*e.g.* the establishment of the "Investments, Public Procurement and Concessions Department" within the Ministry of Finance).

The 1993 Public Trading Services Act contains core provisions on concessions (*e.g.*, dealing with the concessionaire, concession enactment, procedure, concession agreement, dispute settlement, termination). However, these provisions need to be enhanced as the scope of the law is unclear, procedure is only vaguely described, the arbitration options are not regulated, and the law provides for discretionary powers of the contracting authority for termination. The Local Government Act dated 1993 sets out a framework that permits municipal entities to award concessions for the performance of public services, but does not describe the conditions under which such concessions will be granted. In addition, numerous sector-specific acts regulate the granting of concessions in specific sectors (*e.g.* Railway Transport Act of 1999, Maritime Code of 2001, Aviation Act of 2001, Public Highways Act of 1997, Energy Act of 1999, Water Act of 2001, Mining Act of 1999, laws regulating education, health care and social care).

It is worth pointing out that various concession-related arrangements or quasi concessions exist in practice in Slovenia.

Quality of concession legislation –Slovenia (2005)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment 2005

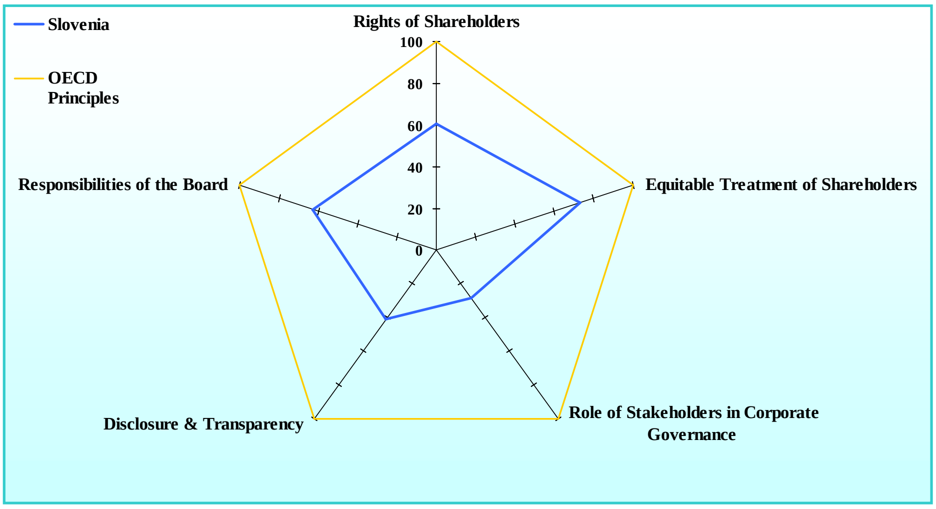
According to the EBRD Concessions Sector Assessment, Slovenian laws were rated as largely conforming with internationally accepted principles of concessions laws. However, while Slovenia has a favourable environment for granting and implementing concessions, the absence of a general concession/PSP law limits the development of PSP in the country. In particular, as illustrated by the graph above, the current laws are insufficient regarding the regulation of the project agreement, government support, financial securities and settlement of disputes.

Corporate Governance

The Companies Act is the principal law dealing with corporate governance in Slovenia. It was enacted in 1993 and amended several times, most recently in May 2006. Worth noting also is the Corporate Governance Code adopted on 18 March 2004 by the Managers' Association of Slovenia, the Association of Supervisory Boards' Members and the LJSE.

According to the 2004 results of the EBRD's Corporate Governance Sector Assessment, Slovenian corporate governance related laws (i.e., "law on the books", not how the relevant legislation is being implemented) were assessed as in "medium compliance" when compared to the OECD Principles of Corporate Governance. The major weaknesses were identified in the "disclosure and transparency" and in the "role of stakeholders" sections. A new EBRD assessment is planned to be undertaken in the course of 2006.

Quality of corporate governance legislation – Slovenia (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles.

Source: EBRD Corporate Governance Sector Assessment, 2004 assessment.

In 2005, the EBRD launched a survey for testing the effectiveness of corporate governance (how the law works in practice). Two case studies dealing with related-party transactions in a listed and unlisted company scenarios were designed. The case studies investigated the position of a minority shareholder seeking to access corporate information in order to understand if a related-party transaction was indeed entered into by the company and on how it was possible to obtain compensation in case damage was suffered. Effectiveness of legislation was then measured according to four principal variables: institutional environment, enforceability, complexity and speed. The survey revealed a relatively effective corporate governance framework in Slovenia.

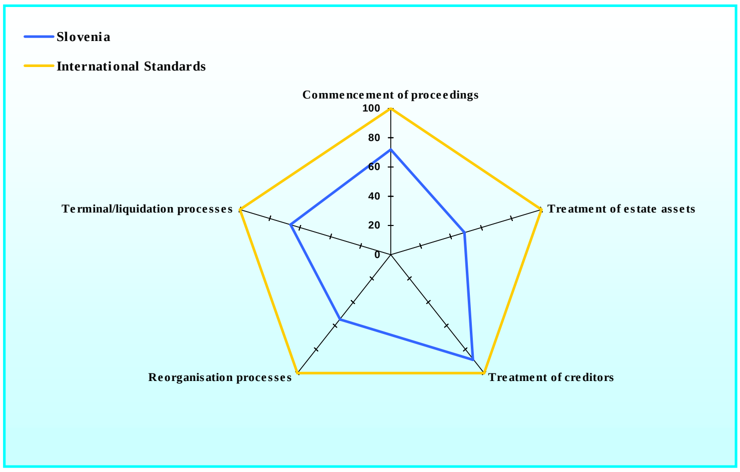
Minority shareholders have different legal actions available to obtain disclosure and redress, which are considered relatively simple and easy to enforce. The only cause for some concern is the time needed to reach an executive judgement as the procedure might last more than two years.

The institutional environment is also considered generally sound: company books are considered reliable and statutory auditors fairly independent. Courts and the market regulator are deemed impartial in their decisions although their competence may sometimes be questionable. Case law is generally available and largely used by courts and judges, which helps to improve the clarity of the proceedings. The only negative notes are the competence and experience of the prosecutor in corporate cases and the legal framework on related party transactions, which should be both improved.

Insolvency

Bankruptcy and insolvency are governed by the "Law on Compulsory Settlement, Bankruptcy and Liquidation (as amended, 1999) of the Republic of Slovenia (the "Insolvency Law"). As noted in the EBRD's 2004 Insolvency Sector Assessment, the Insolvency Law is missing many of the elements generally recognised in international insolvency standards and best practices as being critical to a well-functioning insolvency legal regime. The graph below, from the 2004 Assessment, shows the level of compliance of the Insolvency Law with these international standards in the five core areas most relevant to the sector. The law was given an overall rating of 'Low' in the Assessment.

Quality of insolvency legislation –Slovenia (2004)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the international standards such as the World Bank's Principles and guidelines for Effective Insolvency and Creditor Rights Systems, the UNCITRAL Working Group on "Legislative Guidelines for Insolvency Law", and others. The fuller the 'web', the more closely insolvency laws of the country approximate these standards.
Source: EBRD Insolvency Sector Assessment Project, 2004.

The insolvency system as a whole scored somewhat better results in the EBRD Legal Indicator Survey conducted in 2004. Whereas the Assessment measured the extensiveness of the legislation, the Survey measured the effectiveness of the system. The survey gave the system relatively high marks for efficiency, speed and transparency/predictability in terms of both creditor and debtor initiated processes.

The results of the Survey, taken with the results of the Assessment seem to indicate that the system has developed a level of functionality despite the flawed Insolvency Law.

The Insolvency Law applies to both individuals and corporate entities as well as to state-owned enterprises. The law is unclear, however, on what financial conditions are necessary to constitute insolvency and what evidence is required to prove these financial conditions and demonstrate that the debtor is insolvent.

Although this law notionally provides for reorganisation of troubled companies through a process called “compulsory settlement”, this process is largely unstructured and unlikely to be particularly useful. The compulsory settlement process does not prevent, for example, critical suppliers (such at telephone and utility companies) from cutting off supply to ransom old debts, does not permit priority reorganisation financing, does not provide for supervision of the implementation of any reorganisation plan that is approved and does not limit in any way “insider creditors” (such as shareholders and officers of the debtor) from voting on the reorganisation.

On the liquidation side, the Insolvency Law contains many elements of a sound law, such as designating a specialist bankruptcy court to hear bankruptcy matters and imposing interim protective measures when insolvencies are commenced, but is still in need of reform. Of particular concern are the provisions dealing with reviewable transactions (i.e., reviewing and reversing suspicious transactions that occurred on the eve of the debtor’s insolvency), which are woefully inadequate and were recently deemed unconstitutional by the Constitutional Court. This will make it difficult for any insolvency administrator to pursue fraudulent transactions and increase the pool of assets available for distribution in the estate. Similarly, there is no positive obligation upon officers and directors of the debtor company to deliver assets of the debtor to the insolvency administrator, thus making the administrator’s job both more difficult and more expensive.

Creditors, both secured and unsecured, are not entitled to direct notice of insolvency proceedings and therefore run the risk of having their claims disallowed or ignored if they do not become aware of the appropriate time periods for filing such claims. Finally, the Insolvency Law does not provide for the final resolution and wind-up of the insolvent estate in cases where there are not sufficient assets to pay for a liquidation. While this position may be a result of budgetary constraints and an unwillingness of the state to bear the costs of liquidating insolvent companies, it runs counter to international standards and best practices which strongly support the final wind-up and resolution of all estates.

Secured Transactions

Despite its advanced economic development, Slovenia has proved reluctant to fully embrace reform to its legal framework in order to allow for sophisticated commercial transactions to be properly secured.

The new provisions allow for the creation and enforcement of possessory and non-possessory pledges on movables. The pledge gives the right to the creditor to have its secured debt satisfied from the realisation of the pledged assets in priority over other creditors on the proceeds from such assets. The Law on Property also governs mortgages (*hipoteka*), which need to be registered with the relevant land registry (*Zemljiška knjiga*).

The non-possessory pledge allows the pledgor to remain in possession of the pledged assets (though he cannot freely dispose of them). The pledge must be entered into by execution of a notarial deed whereby the debtor gives its consent to direct enforceability. The aim is to make the enforcement more effective as it is possible to go directly to the execution procedure and dispense with the litigation procedure, which has proved in the past to be a serious issue in Slovenia (see chart below). The exact amount of the debt (principal and the interest rate) and maturity must be specified in the notarial deed. The pledge agreement may provide that in case of default the pledged assets would be sold in an out-of-court public auction (such provision is presumed in commercial agreements). The out-of-court auction can be carried out by the creditor upon the prior written notice to the debtor at least 8 days before the auction.

The pledge is now, and this is an important difference against previous regimes, recorded: in July 2004, the AJPES (*Agencija republike Slovenija za javnopravne evidence in storitve*) began to manage the Register of Non-Possessory Pledges and Seized Movable Property. Each non-possessory pledge has to be entered into the AJPES register and the notary has to make a filing in the register on the same day the pledge was created. The data contained in this register is public, accessible to everyone requiring the information on certain business entities to ascertain that movable assets owned by these business entities are not already pledged. The information is available on the AJPES website and at AJPES branch offices (http://www.ajpes.si).

Although the new system has brought some improvements, it still includes a number of shortcomings, or what seem unnecessary limitations, regarding in particular the form of security agreements, taking security over inventory and claims, and enforcement procedures.

Telecommunications

The communications sector in Slovenia is currently regulated by Agencija za pošto in elektronske komunikacije Republike Slovenije (APEK) and governed by the Law on Electronic Communications of 2004 (the "2004 Law"). APEK was established as an independent institution in 2002 and its status and capacity was enhanced by the 2004 law, passed to move Slovenia in line with European Union (EU) requirements for the sector. Policymaking remains the responsibility of the Ministry of Economy. While the 2004 Law aligns the legal framework for telecoms in Slovenia with the relevant EU *acquis*, further recent legislative amendments were necessary to bolster APEK's independence in the face of infringement proceedings from the European Commission (EC).

While the market in Slovenia was formally liberalised in January 2001, the regulator's has been criticised for an apparent failure to take the necessary steps to implement the regulatory framework and encourage competition. This has resulted in the incumbent former monopoly operator, Telekom Slovenije (TS), remaining overwhelmingly dominant in the marketplace. While there has been some competitive impact in the international market, efforts to inject competition into the local market with local loop unbundling measures have yet to produce meaningful results. Whilst carrier selection and carrier pre-selection are also available, operator take up of these services has been slow because of difficulties encountered in negotiating interconnection with TS.

TS remains majority state owned. While there has been partial privatisation of a minority stake of TS being held by a number of predominantly domestic investors, progress in implementing further privatisation has been slow. While there have been recent announcements by government in this respect, firm plans for implementation has yet to materialise

Although Slovenia was one of the first new EU member states to formally liberalise its telecoms markets, five years on incumbent TS remains dominant across most elements of the telecom market. There have been strong criticisms from many quarters, including the EC, about the lack of appropriate and timely regulatory intervention. Although APEK formally has the power to intervene on its own initiative, it has been repeatedly criticised by alternative operators and by the EC for not utilising its powers, for lacking resources and experience, and for having failed to fulfil its role in opening up the market and establishing competition. Going forward, the authorities face significant challenges to ensure the genuinely liberalised sector envisaged in both national policy and the EU communications framework is achieved. While the legislative base is largely consistent with the EU communications framework, implementation and appropriate regulatory intervention remains wanting in a number of significant areas. Areas of note are interconnection, cost-oriented tariffing and local loop unbundling. It is imperative that APEK take active and immediate steps to address deficiencies in these areas and curb TS dominance in the market place, ensuring that all necessary regulatory mechanisms are fully implemented. The government must provide APEK with all necessary support and resources to ensure full implementation of all outstanding provisions.