



DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS

**FOREIGN DIRECT INVESTMENT IN SLOVENIA
TRENDS AND PROSPECTS**

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FOREIGN DIRECT INVESTMENT IN SLOVENIA TRENDS AND PROSPECTS¹

Recent Macroeconomic performance

Slovenia is a small economy with a population of approximately 2 million. With GDP per capita of US\$9,105 in 2000, it is the most developed of the transition countries of Central and Eastern Europe. After an initial transitional recession, reflected in decreasing GDP growth rates in 1991-1992, Slovenia succeeded in considerably reducing the inflation rate in 1993 and regained economic growth the same year. GDP growth rates are expected to remain between 4-5 per cent in the near future, and the inflation rate is expected to drop from 8.9 per cent (annual average) in 2000 to 5.1 per cent in 2003. Throughout the entire transition period Slovenia has more or less sustained fiscal and external balance.

The 59.0 per cent share of exports of goods and services in GDP (in 2000) demonstrates that the country has a distinctive export-oriented economy. This is true primarily for its manufacturing sector (see Table 1 for details). Most exports are destined for EU countries. In 2000, 63.9 per cent of Slovenia's exports went to EU countries (Germany 27.2 per cent, Italy 13.6 per cent, and France 7.1 per cent), 15.6 per cent to the successor states of the former Yugoslavia (Croatia 7.9 per cent and Bosnia and Herzegovina 4.3 per cent), 11.2 per cent to transition countries of Central and Eastern Europe (Poland 2.6 per cent, Russia 2.2 per cent, etc.), and 4.6 per cent to non-European OECD member countries (the United States 3.1 per cent).²

Flows and stocks of FDI

FDI stock – foreign equity and reinvested profits plus net liabilities of foreign investment enterprises (FIEs)³ in Slovenia at the end of 2000 amounted to US\$2 808.5 million. Taking into account US\$199.8 million of FDI inflows in January-August 2001 the stock of inward FDI in Slovenia in September 2001 stood at about US\$3 billion.

Table 1. Main macroeconomic indicators of Slovenia in 1991-2003

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001 ¹	2002 ¹	2003 ¹
GDP per capita; US\$	6 331	6 275	6 366	7 205	9 431	9 480	9 163	9 878 ²	10 109	9 105	9 461	10 290	11 244
GDP real growth rate; %	-8.9	-5.5	2.8	5.3	4.1	3.5	4.6	3.8	5.2	4.6	4.4	4.2	4.5
Exports of goods and services; % of GDP	n.a.	63.1	58.5	58.9	55.3	55.6	57.4	56.8	52.4	59.0	60.2	59.8	59.6
Current account balance; % of GDP	n.a.	7.4	1.5	3.8	-0.1	0.2	0.1	-0.8	-3.9	-3.3	-1.8	-2.0	-2.0
Rate of unemployment by ILO; %	n.a.	8.3	9.1	9.1	7.4	7.3	7.4	7.9	7.6	7.0	6.7	6.5	6.2
Gross fixed capital formation; % of GDP	n.a.	18.4	18.7	19.6	21.4	22.5	23.4	24.6	27.4	26.7	26.2	26.8	27.2
General government account balance; % of GDP	2.6	0.2	0.3	-0.2	0.0	0.3	-1.2	-0.8	-0.6	-1.4	n.a.	n.a.	n.a.
Inflation rate (annual average); ³ %	117.7	201.3	32.3	19.8	12.6	9.7	9.1	7.9	6.1	8.9	8.5	6.4	5.1

Sources: (i) For 1995-2003, IMAD 2001a; (ii) for 1992-1994, IMAD 1996; (iii); for 1991, WIIW 1999.

Notes: 1) Estimate. 2) GDP per capita purchasing power in US\$ in 1998 was 14,800; 3) Retail prices as a measure of inflation until 1998, after 1998 consumer price index.

**Table 2. Flows, stock and changes of stock of inward FDI¹ in Slovenia
in 1993-2000²**

	1993	1994	1995	1996	1997	1998	1999	2000
VALUES, in millions of US\$								
Year-end stock – total	954.3	1 325.9	1 763.4	1 998.1	2 207.3	2 765.8	2 656.5	2 808.5
Equity & reinvested earnings	709.7	966.5	1 203.5	1 274.9	1 559.4	2 011.6	1 893.9	1 883.2
Net liabilities to foreign Investors	244.4	359.4	559.8	723.1	647.9	754.2	762.6	925.3
Changes of stock – total ³	n.a.	371.6	437.5	234.7	209.2	558.5	-109.3	152.0
Annual inflow – total ³	112.6	128.1	177.4	194.0	375.2	247.9	181.2	175.5
Inflows from abroad	112.6	128.1	176.0	185.5	320.8	165.4	83.4	83.4
Reinvested earnings	n.a.	n.a.	1.4	8.5	54.4	82.5	97.8	97.6
GROWTH RATES, in %								
Year-end stock – total	n.a.	38.9	33.0	13.3	10.5	25.3	-4.0	5.7
Annual inflow – total	1.4	13.7	38.5	9.4	93.4	-33.9	-26.9	0.0

Source: Bank of Slovenia.

Notes: 1) FDI whereby a foreign investor holds a 10 per cent or higher share in a company; 2) From 1996 onwards direct investments with indirectly affiliated enterprises are also included; 3) Inflows are in principle smaller than changes in stocks since international payments transactions comprise only part of the changes in stock; most notably, inflows data do not include changes in net liabilities to foreign investors. Furthermore, inflows do not include data on directly affiliated companies. From 1995 onwards data on reinvested earnings are also included in inflows and, thus, in the balance of payments; n.a. = not available.

The stock of inward FDI in Slovenia during the period 1993-2000 almost tripled, increasing from US\$954.3 million to US\$2 808.5 million,⁴ FDI inflows and stock grew rapidly up until the end of 1997. Slovenia subsequently experienced a slowdown in FDI inflows that recovered only in 2001. The first half of 2001 brought about an important positive change in FDI inflows in Slovenia; in January-August 2001 FDI inflows amounted to US\$199.8 million, compared to only US\$44.0 million in the same period of 2000. Higher inflows are predominantly due to a limited number of foreign acquisitions, two of which are most notable – the French bank Société Générale acquired a majority share in SKB Bank and the Austrian company Mobilkom acquired a majority share in the mobile phone operator Simobil.

Until the end of 2001 a continuation of higher inflows of FDI in Slovenia can be expected. FDI projects already realised or announced for 2001 indicate FDI inflows in the approximate amount of US\$500 million, by far the highest annual FDI inflow to Slovenia recorded so far. In the years to come, the same or even higher inflows of FDI can be expected. The major reason for this is the forthcoming privatisation of state property, mostly in the financial sector and public utilities. The government is strongly motivated to involve foreign investors in the forthcoming privatisation for both strategic development and fiscal reasons. The participation of foreign investors in privatisation, accompanied by the support of the investment incentives policy embodied in the government Programme for the Promotion of FDI in 2001-2004,⁵ is expected to have a positive influence on the perception of Slovenia as investment location and, consequently, on the increase of FDI inflows in general.

The increasing share of net liabilities in FDI stock indicates the growing importance of the consolidation of existing FDI versus new FDI projects. This pattern is also confirmed if FDI inflows are broken down into new inflows from abroad and reinvested earnings. The latter's share is increasingly relevant, representing approximately 54 per cent of total inflows in 1999 and 2000. It would appear that existing foreign investors in Slovenia appreciate the investment environment in the country more than potential new investors.

As far as the mode of entry of foreign investors in Slovenia is concerned, the Bank of Slovenia's data distinguishes between greenfield FDI, acquisitions, and other investments (in institutions, subsidiaries and foundations). By number, greenfield FDI is the most frequent type, accounting for 55.8 per cent of all foreign investments at the end of 1999, whereas 41.9 per cent of foreign investments have been acquisitions. In terms of equity the situation is the opposite. Acquisitions account for 68.7 per cent of all foreign equity, while greenfield FDI accounts for 31.0 per cent. Other investments are negligible. The average value of foreign equity in acquisitions is US\$1.8 million and in greenfield US\$0.6 million.

Table 3. Flows, stock and changes of stock of outward FDI¹ from Slovenia in 1993-2000; in US\$ million

	1993	1994	1995	1996	1997	1998	1999	2000
Year-end stock – total	280.6	354.0	489.9	459.5	459.4	608.3	605.0	794.0
Equity and reinvested earnings	241.7	342.4	366.2	342.9	324.7	367.8	359.6	466.2
Net claims to companies abroad	38.9	11.7	123.7	116.5	134.7	240.5	245.4	327.8
Changes of stock – total	n.a.	73.4	135.9	-30.4	-0.1	148.9	-3.3	189.0
Annual outflow ²	-1.3	2.9	5.1	-6.3	-35.6	1.7	-37.5	-66.0

Source: Bank of Slovenia;

Notes: 1) FDI whereby a foreign investor holds a 10 per cent or higher share in a company; 2) “-“ means outflow; n.a. = not available.

In 2000, Slovenia registered a record US\$66.0 million outflow of FDI. At the end of 2000 the stock of Slovenian outward FDI was US\$794 million. In the period January-August 2001, the outflows were US\$40.6 million, compared with US\$24.1 million in the same period in 2000. In 2000, the stock of Slovenian outward investment increased by US\$189 million, which was higher than the increase in inward FDI stock in the same year (US\$152 million). This increase was due more to higher equity and reinvested earnings (up by US\$106.6 million) than to increased net claims to companies abroad (up by US\$82.4 million). In fact, 2000 was the first year since 1994 that saw a considerable increase of equity and reinvested earnings. In 1994-1999, equity and reinvested earnings only grew by US\$17.2 million, while net claims to companies abroad in the same period increased by US\$233.7 million. These trends seem to indicate that in the 1994-1999 period Slovenian investors were mostly consolidating their existing investments abroad, while in 2000 and especially in 2001, there is evidence of more dynamic activity in establishing new FDI projects abroad, mostly related to the successor countries of the former Yugoslavia.

Countries of origin and destination

Investors from EU countries dominate FDI in Slovenia. At year end 2000 no less than 84.0 per cent of total inward FDI stock was accounted for by EU countries, the major investors among them being Austria (45.6 per cent of total foreign equity stock at year-end 2000), Germany and France, followed by Italy, the United Kingdom and the Netherlands. FDI from other EU countries lags behind. Of non-EU countries, only the United States, the Czech Republic, Switzerland and Croatia are significant investors. The share of EU countries in inward FDI stock in Slovenia in 1994-2000 increased significantly, i.e. from 62.0 per cent to 84.0 per cent.⁶ By far the highest increase, i.e. 23.2 percentage points, was made by Austrian investors. Slovenia's proximity to the EU and its traditionally strong economic co-operation with Austria, Germany, Italy and France, are the major reasons for the domination of investors from these countries.

Although a typical foreign investor in Slovenia is a small to medium-sized company from one of the nearby EU countries, especially Austria, FDI in Slovenia is heavily concentrated on a relatively small number of large FDI projects mostly with European multinational enterprises (MNEs). These projects determine the investing country as well as the industrial breakdown of FDI stock in Slovenia. The five largest FDI projects (out of 1,726) accounted for 23.1 per cent of total 1998 end-year stock of FDI in Slovenia, the largest ten for 35.4 per cent, the largest 15 for 45.6 per cent, while 46 FDI projects with foreign equity above US\$10 million account for 68.6 per cent.⁷ Of the latter only five are of non-EU (mostly United States) origin.⁸

Table 4. Distribution of end-year stocks (total value) of FDI in Slovenia by investing countries¹ in 1994 and 2000; US\$ million and per cent

	1994		2000		Change of share 1994-2000
	Value	Share	Value	Share	
Austria	296.9	22.4	1 279.4	45.6	+23.2
Germany	196.3	14.8	350.5	12.5	-2.3
France	154.2	11.6	299.2	10.7	-0.9
Italy	136.0	10.3	152.0	5.4	-4.9
United Kingdom	5.5	0.4	101.5	3.6	+3.2
Netherlands	11.0	0.8	82.9	3.0	+2.2
Denmark	16.9	1.3	42.4	1.5	+0.2
Luxembourg	0.2	0.0	29.6	1.1	+1.1
Sweden	0.2	0.0	13.5	0.5	+0.5
Belgium	4.9	0.4	7.1	0.3	-0.1
Ireland	-0.1	0.0	1.2	0.0	0.0
Finland	0.0	0.0	0.5	0.0	0.0
EU – Total	821.7	62.0	2 359.8	84.0	+22.0
United States	12.2	0.9	109.3	3.9	+3.0
Czech Republic	0.1	0.0	104.9	3.7	+3.7
Switzerland	62.9	4.7	102.0	3.6	-1.1
Croatia	409.8	30.9	48.0	1.7	-29.2
Liechtenstein	1.7	0.1	14.4	0.5	+0.4
Cyprus	0.3	0.0	14.4	0.5	+0.5
Other countries	17.2	1.3	55.7	2.0	-0.7
TOTAL	1 325.9	100.0	2 808.5	100.0	0.0

Source: Bank of Slovenia.

Notes: All countries with higher than US\$10 million end-2000 stock are included plus other EU countries.

Table 5. Distribution of end-year stocks (total value) of Slovenian FDI abroad by host countries¹ in 1994 and 2000; US\$ million and per cent

	1994		2000		Change of share 1994-2000
	Value	Share	Value	Share	
Austria	9.6	2.7	27.7	3.5	+0.8
Germany	30.6	8.6	70.5	8.9	+0.3
France	-0.8	-0.2	8.0	1.0	+1.2
Italy	6.2	1.8	8.2	1.0	-0.8
United Kingdom	0.4	0.1	10.4	1.3	+1.2
Denmark	0.0	0.0	8.3	1.0	+1.0
Other EU countries	-4.8	-1.4	-7.6	-1.0	+0.4
EU – Total	41.2	11.6	125.5	15.8	+4.2
Croatia	193.0	54.5	357.7	45.1	-9.4
Macedonia	15.9	4.5	66.1	8.3	+3.8
Bosnia and Herzegovina	14.8	4.2	61.9	7.8	+3.6
Yugoslavia	27.9	7.9	26.6	3.4	-4.5
Successor countries of former Yugoslavia – Total	251.6	71.1	512.3	64.5	-6.6
Czech Republic	2.4	0.7	10.4	1.3	+0.6
Poland	13.3	3.8	55.7	7.0	+3.2
Russia	4.8	1.4	15.8	2.0	+0.6
Ukraine	5.0	1.4	7.4	0.9	-0.5
Romania	0.3	0.1	5.5	0.7	+0.6
Slovakia	0.3	0.1	5.2	0.7	+0.6
Other transition countries	4.7	1.3	6.6	0.8	-0.5
Transition countries – Total	30.8	8.7	106.6	13.4	+4.7
United States	13.9	3.9	22.1	2.8	-1.1
Switzerland	11.8	3.3	8.4	1.1	-2.2
Liberia	16.6	4.7	23.7	3.0	-1.7
Iraq	0.0	0.0	9.9	1.2	+1.2
Other countries	-11.9	-3.4	-14.5	-1.8	+1.6
TOTAL	354.0	100.0	794.0	100.0	0.0

Source: Bank of Slovenia; Notes: 1) All countries with higher than US\$5 million end-2000 stock are included. Data concerning real estate owned by Slovenian households abroad (mainly real estate in Croatia) are not included. Also claims on other successor countries of the former Yugoslavia, subject of negotiations on succession, expatriate assets in these countries, and other assets transferred to the Slovenian government during the process of privatisation are not included.

While inward FDI from Austria into Slovenia is increasing (45.6 per cent of end-2000 inward FDI stock), Slovenia's outward FDI is as much concentrated on Croatia (45.1 per cent of Slovenia's end-2000 outward FDI stock). In addition to Croatia, countries that are increasingly attractive for Slovenian investors are Macedonia, Bosnia and Herzegovina, Poland, and Germany. The gradual increase in outward investment from Slovenian firms is related mostly to the activity of Slovenian firms in the successor countries of the former Yugoslavia (64.5 per cent of end-2000 outward FDI stock). Transition countries of Central and Eastern Europe and the EU are far less represented as host countries.

Slovenian firms are increasingly aware of the necessity of intensified internationalisation in which outward FDI is an important method. Successor countries of the former Yugoslavia (proximity and familiarity with the environment, previous business connections, knowledge of languages) and, to a certain extent transition countries, represent a kind of logical first step in this direction.⁹ The establishment of a regional investment fund for South-East Europe, to be initiated by the Slovenian government, seems to indicate that the government is aware of the strategic importance of Slovenian investment in the region, as well as of the problems facing investing firms.

Distribution by economic activity

With 43.1 per cent of total FDI stock at the end of 2000, manufacturing is by far the most important recipient sector of FDI in Slovenia. Within the manufacturing sector, FDI is heavily concentrated in paper and paper products, chemicals and chemical products, machinery and equipment, rubber and plastic products, and motor vehicles and trailers. Apart from the manufacturing sector, FDI is concentrated in trade, financial intermediation and other business services. Industrial distribution of FDI is to a major extent determined by a handful of large FDI projects, which as a rule emerged out of previous co-operation between foreign investors and the Slovenian companies they had invested in. Foreign investors in Slovenia have been far more attracted by individual Slovenian companies (as target companies or joint venture partners), that is, by their specific characteristics, than by individual industries as such.¹⁰

In the manufacturing industry the major investments are by the French company Renault in car manufacturing (Revoz), the Austrian paper companies Meyr Melnhof (Količevo karton) and Brigl & Bergmeister (Papirnica Vevče), PB from the Czech Republic also in paper (VIPAP Videm Krško), E.G.O. from Switzerland in electro-thermic apparatus (ETA Cerčno), and Siemens from Germany in telecommunications equipment.¹¹

In 1994-2000, there have been some interesting shifts in the relative importance of individual industries as FDI recipients (see Table 6). Most manufacturing industries either retain or increase their shares in FDI stock. The highest increase was in rubber and plastic products due to the entrance of Goodyear in car tires manufacturing. On the other hand, a decrease of shares is noticeable in motor vehicles and trailers, and in paper and paper products. Outside the manufacturing sector, shifts have been more intensive. Due to the removal of the nuclear power plant Krško (Croatian-Slovene joint venture) from the list of FIEs, FDI in electricity supply almost disappeared. On the other hand, there was a considerable increase in the share of financial intermediation and other business activities in FDI stock.

Table 6. Distribution of end-year stocks (total value) of FDI in Slovenia by industries¹ in 1994 and 2000; US\$ million and per cent

NACE industries	1994		2000		Change of share 1994-2000
	Value	Share	Value	Share	
15 Food products and beverages	15.8	1.2	38.5	1.4	+0.2
17 Textiles	8.4	0.6	12.7	0.5	-0.1
19 Leather and leather products	0.1	0.0	12.4	0.4	+0.4
21 Pulp, paper and paper products	120.0	9.1	178.7	6.4	-2.7
22 Publishing and printing	6.8	0.5	12.8	0.5	0.0
24 Chemicals and chemical products	80.5	6.1	173.2	6.2	+0.1
25 Rubber and plastic products	14.9	1.1	141.4	5.0	+3.9
26 Other non-metal mineral products	26.7	2.0	73.3	2.6	+0.6
27 Basic metals	6.8	0.5	53.2	1.9	+1.4
28 Fabricated metal products	4.6	0.3	35.3	1.3	+1.0
29 Machinery and equipment n.e.c.	82.8	6.2	144.7	5.2	-1.0
31 Electrical machinery and apparatus	21.9	1.7	57.3	2.0	+0.3
32 Radio, television and equipment	14.0	1.1	31.5	1.1	0.0
33 Medical and precision instruments	8.6	0.6	32.4	1.2	+0.6
34 Motor vehicles and trailers	142.4	10.7	131.8	4.7	-6.0
Other manufacturing industries ²	46.3	3.5	80.3	2.9	-0.6
<i>D Manufacturing – Total</i>	<i>600.6</i>	<i>45.3</i>	<i>1,209.5</i>	<i>43.1</i>	<i>-2.2</i>
40 Electricity, gas, steam & water supply	296.6	22.4	17.2	0.6	-21.8
50 Sale & repair of motor vehicles/fuel	66.7	5.0	44.8	1.6	-3.4
51 Wholesale and commission trade	90.9	6.9	261.6	9.3	+2.4
52 Retail trade and other repairs	37.9	2.9	87.9	3.1	+0.2
55 Hotels and restaurants	8.6	0.6	17.4	0.6	0.0
63 Supporting & aux. transport activities	9.5	0.7	28.4	1.0	+0.3
64 Post and telecommunications	0.0	0.0	10.3	0.4	+0.4
65 Financial intermediation	84.7	6.4	712.6	25.4	+19.0
66 Insurance, pension funds	10.7	0.8	10.7	0.4	-0.4
70 Real estate business	2.0	0.2	24.0	0.9	+0.7
74 Other business services	91.8	6.9	337.8	12.0	+5.1
92 Recreational, cultural & sport activ.	0.2	0.0	18.8	0.7	+0.7
Other activities	25.7	1.9	27.5	1.0	-0.9
TOTAL	1 325.9	100.0	2 808.5	100.0	0.0

Source: Bank of Slovenia.

Note: 1) Only industries with more than US\$10 million 2000 end year FDI stock; 2) Industries with less than 3 FDI entities are all included here. The major part relates to tobacco products.

Table 7. Distribution of end-year stocks (total value) of Slovenia's FDI abroad by industries¹ in 1994 and 2000; US\$ million and per cent

<i>NACE industries</i>	<i>1994</i>		<i>2000</i>		<i>Change of share 1994-2000</i>
	<i>Value</i>	<i>Share</i>	<i>Value</i>	<i>Share</i>	
15 Food products and beverages	30.4	8.6	63.4	8.0	-0.6
17 Textiles	-3.0	-0.8	6.0	0.8	+1.6
18 Wearing apparel, dressing fur	3.2	0.9	9.7	1.2	+0.3
19 Leather and leather products	24.8	7.0	10.6	1.3	-5.7
20 Wood & wood products, exc. furniture	11.2	3.2	9.0	1.1	-2.1
21 Pulp, paper and paper products	7.9	2.2	7.5	0.9	-1.3
22 Publishing and printing	4.1	1.1	6.0	0.8	-0.3
24 Chemicals and chemical products	43.2	12.2	121.9	15.4	+3.2
26 Other non-metal mineral products	-2.0	-0.6	19.0	2.4	+3.0
28 Fabricated metal products	8.1	2.3	47.2	5.9	+3.6
29 Machinery and equipment n.e.c.	14.3	4.0	81.2	10.2	+6.2
31 Electrical machinery and apparatus	0.7	0.2	17.9	2.3	+2.1
32 Radio, television and equipment	1.3	0.4	5.6	0.7	+0.3
33 Medical and precision instruments	6.1	1.7	10.8	1.4	-0.3
34 Motor vehicles and trailers	-13.4	-3.8	16.4	2.1	+5.9
Other manufacturing industries	10.8	3.1	0.1	0.0	-3.1
D Manufacturing – Total	147.7	41.7	431.9	54.4	+12.7
40 Electricity, gas, steam & water supply	49.7	14.0	42.3	5.3	-8.7
45 Construction	8.7	2.5	16.2	2.0	-0.5
51 Wholesale and commission trade	58.2	16.4	26.1	3.3	-13.1
52 Retail trade and other repairs	10.1	2.9	62.2	7.8	+4.9
63 Supporting & aux. transport activities	5.6	1.6	19.3	2.4	+0.8
65 Financial intermediation	41.1	11.6	94.7	11.9	+0.3
66 Insurance, pension funds	4.3	1.2	24.3	3.1	+1.9
74 Other business activities	19.7	5.6	47.0	5.9	+0.3
Other activities ²	8.9	2.5	30.0	3.8	+1.3
TOTAL	354.0	100.0	794.0	100.0	0.0

Source: Bank of Slovenia.

Note: 1) Only industries with more than US\$5 million 2000 end year FDI stock; 2) Industries with less than 3 FDI entities are all included here.

As much as 54.4 per cent of Slovenia's end-2000 outward FDI stock is accounted for by manufacturing, 12.7 percentage points more than in 1994. This indicates the increasing ability of Slovenian manufacturing enterprises to internationalise.¹² Industries that account for the largest part of Slovenia's manufacturing outward FDI are chemicals and chemical products (notably pharmaceuticals), machinery and equipment, food products and beverages, and fabricated metal products. Outside the manufacturing sector, Slovenian investors are most active in financial services, retail trade and other business activities.

Major explanatory factors behind FDI and future prospects

Motivation for investing in Slovenia and strategic pattern of FDI in Slovenia: factor cost advantages versus market seeking FDI

From the point of view of the motivation and strategic behaviour patterns of foreign investors in Slovenia it is possible to distinguish between market-seeking (horizontal FDI) and factor cost advantages-seeking (vertical FDI, such as resource-seeking, efficiency-seeking and strategic asset-seeking). The latter are motivated by differentials in factor endowments, or by different kinds of capabilities, expertise and skills, advantage of economies of scale and scope, and by differences in consumer tastes and supply capabilities. Factor cost advantages-seeking FDI consists of geographical separation of different stages of the value-added chain with forward and backward integration. On the other hand, market-seeking or horizontal FDI is motivated by market access. The orientation of sales to local markets in the case of market-seeking, and to exports in the case of factor cost advantages-seeking FDI, is one of the major distinguishing characteristics between these two types of FDI.¹³

The economic literature on foreign investors in Slovenia shows that gaining access to or enlarging their market share has traditionally been their most important motive. However, foreign investors generally list multiple objectives (growth, profitability, expansion of exports, etc.) in their ventures in Slovenia. They also ranked such important motives as the reduction of production costs and having an export base for third countries (see, for instance, Rojec 1998). Table 8 shows that access to local and other (adjacent, neighbouring) markets remain the two most important single motives. Nonetheless, the relevance of other motives such as technology and know-how, quality of labour, recognised trade marks, financial support of the Slovenian target company/joint venture partner, and securing material and parts – denoting factor cost advantages-seeking FDI – seem to prevail. Interviews with foreign investors, therefore, seem to indicate that most FDI in Slovenia is of the factor cost advantages-seeking type. As far as the role of labour is concerned, it is clear that it is not the low cost (only 1.8 per cent of interviewees quote it as a motive) but rather the quality of labour (26.9 per cent of interviewees) that motivates foreign investors in the case of Slovenia.

Table 8. Motives of foreign investors in Slovenia

<i>Motive</i>	<i>% of FIEs quoting individual motive¹</i>
Access to Slovenian market	41.5
Access to other markets	36.3
Technology and know-how	29.8
Quality of labour	26.9
Financial support	25.1
Recognised trade mark	17.0
Purchasing of material and parts	10.5
Low cost of labour	1.8
Acquisition of company in bankruptcy procedure	1.8
Other	7.0

Source: Dedek & Novak, 1998.

Notes: 1) 183 FIEs answered the question. Each respondent was allowed to quote more motives.

Case studies of FIEs give another set of information on the motivation and strategic pattern of FDI in Slovenia. Eight cases of FDI offer a variety of motivations and strategies of foreign firms when investing in Slovenia:

- a) The German company Hella acquired the motor vehicle lighting equipment manufacturer Saturnus Avtooprema in the context of Hella's recognition of the need for more rapid growth and globalisation, i.e. having a direct presence in all the major countries in which its major customers (final car assemblers) establish production. In this context Hella particularly needed a company that would be able to handle the Italian market competently. By acquiring Saturnus, the idea was to combine Hella's R&D capabilities with Saturnus' lower (labour) costs to penetrate the Italian market. Saturnus has in fact succeeded in penetrating FIAT's suppliers.
- b) Polyamide filaments and chips manufacturer Yulon was acquired by the Italian company Gruppo Bonazzi in the context of the industry's increasing concentration and globalisation that prompted Bonazzi to speed up growth as quickly as possible. Bonazzi's major motivation for buying Yulon was basically strategic, i.e. the rapid increase of its capacities by acquisition, thus improving its position in a highly oligopolised industry. Strategic motivation was combined with other reasons of a market, costs, etc. nature; in spite of labour costs not being particularly low in Slovenia, the relation between the labour costs and labour quality/productivity was considered as favourable.¹⁴
- c) The Danish company Danfoss acquired a compressors' manufacturing company Danfoss Compressors with the motive of obtaining access to relatively inexpensive skilled labour. The investment was aimed at a relatively low-cost location from which to serve a very competitive market. The investment was a relocation of part of Danfoss' manufacturing capacity in Germany. Almost all the output is exported, with the EU being the major market. Danfoss is grooming its subsidiary to assume sole responsibility for the European compressor market.

- d) The German company Bosch-Siemens took over MGA, which produces small household appliances sold under the various Bosch-Siemens brand names, because it was attracted by the lower cost of skilled labour in Slovenia and wished to consolidate existing unprofitable sites. MGA exports its entire output. MGA's competitive advantage is its workforce, which is more highly trained than in Southeast Asia (Lorentzen, Moellgaard & Rojec 1998).
- e) The acquisition of Papirnica Količevo (paper mill) by the Italian company Saffa was made in the context of Saffa's programme to strengthen its position in the international cardboard industry. By acquiring Količevo, Saffa hoped to gain control over the South European markets, to create a strategic position for future penetration into CEE markets, and to acquire production capacities that could be expanded substantially at reasonable cost.¹⁵
- f) Siemens' reasons for becoming a minority shareholder in Iskratel, which produces switching devices for telecommunication systems, were to obtain a foothold in the regional market, to acquire access to skilled labour and manufactured inputs, as well as to try to exercise control over third markets (in the then CMEA), to gain access to indigenous technology, and first mover advantages. This investment is not the relocation of an existing facility. Siemens extensively uses the services of Iskratel's engineers, who produce customised software solutions for Siemens systems.¹⁶
- g) Two of the major factors that influenced the German company Reemtsma to acquire cigarette manufacturer Tobačna Ljubljana were to strengthen Reemtsma's position in the CEE region and to increase its market share in the former Yugoslavia. The whole project was in the context of efforts to strengthen the position of European cigarette manufacturers faced with increasingly aggressive penetration by leading U.S. cigarette MNEs into the European cigarette market. The collapse of the former Yugoslav market has made Tobačna mostly an exporter of cigarettes.¹⁷
- h) Renault's major motive for investment in Revoz in 1991 was the then Yugoslav market. Lower labour costs and the availability of skilled labour were additional relevant motives. After the collapse of the Yugoslav market, Renault had to reorient to export markets. This basically changed the type of FDI from market-seeking into factor cost advantages-seeking, making the factor costs determinants of investment dominant. In spite of losing the Yugoslav market, Renault obviously assessed Revoz as being competitive enough to be fully integrated into Renault's industrial system.¹⁸

These cases suggest three basic conclusions. The first conclusion relates to the pattern of foreign investors' motivation and strategic behaviour in the case of Slovenia, which is characterised by the following: *i*) investing in Slovenia is not just an isolated operation, but is conducted in the context of foreign investors' internationalisation strategy, which they feel to be increasingly urgent; relocation/restructuring via FDI in the context of globalisation becomes a necessity and not a matter of choice; *ii*) foreign investors do not follow a single motive but, in principle, a multiple set of market-seeking, factor cost advantages-seeking and strategic motives; *iii*) cheaper labour is an important motive but the accent is always on the favourable price of skilled labour; *iv*) a good opportunity, especially the possibility of buying a company in the privatisation process, and good previous co-operation between the prospective foreign investor and a target company/local joint venture partner are important stimulators for a foreign company to decide to invest.

The cases offer three basic conclusions. The first conclusion relates to the pattern of foreign investors' motivation and strategic behaviour in the case of Slovenia which is characterised by the following (i) investing in Slovenia is not some solitary operation but is going on in the context of foreign investors' strategy of internationalisation which they feel as increasingly urgent; relocation/restructuring via FDI in the context of globalisation becomes a necessity and not a matter of choice; (ii) foreign investors do not follow a single motive but, in principle, a multiple set of market-seeking, factor cost advantages-seeking and strategic motives; (iii) cheaper labour is an important motive but the accent is always on the favourable price of skilled labour; (iv) a good opportunity, especially possibility to buy a company in the privatisation process, and good previous co-operation between the prospective foreign investor and a target company/local joint venture partner are important stimulators for a foreign company to decide to invest.

The second conclusion is that, in spite of the relevance of local (ex-Yugoslav) market as a motive, factor cost advantages-seeking FDI is predominant in Slovenia.

The third conclusion is that in the framework of factor cost advantages-seeking FDI, four kinds of FDI can be distinguished, notably among FDI such as *i*) Danfoss Compressors and MGA, which involved the relocation of existing facilities or consolidation of existing unprofitable sites; *ii*) Saturnus and Yulon with no actual relocation, but it could be supposed that, theoretically, an alternative option of domestic investment did exist;¹⁹ *iii*) Sarrio and Iskratel, which are essentially a combination of market-seeking, factor cost advantages-seeking and strategic considerations; and *iv*) Tobačna and Revoz, where, due to the collapse of the ex-Yugoslav market, the initial market-seeking motivation switched to factor cost advantages-seeking motivation.²⁰

One set of factors that co-determine the extent of export-oriented factor cost advantages-seeking FDI versus (local) market-seeking FDI relates to host country characteristics. The issue here is, to what extent Slovenia's specific characteristics as a host country stimulate factor cost advantages-seeking FDI as compared to market-seeking FDI. Four host country characteristics seem to be especially relevant for export propensity of FIEs: *i*) most of the evidence suggests that the smaller the host country market the more export-oriented are FIEs, *ii*) a higher host country development level is generally correlated with factor cost advantages-seeking rather than market-seeking FDI, *iii*) FDI projects in Central and Eastern European countries that are in a more advanced stage of transition reforms are more likely to be export-oriented and integrated into foreign parents' multinational production process, characteristic of factor cost advantages-seeking FDI, *iv*) liberalisation of FDI and trade regimes, and economic integration (free access to foreign markets) have proved to be crucial stimulators of export-oriented FDI.²¹

These host country characteristics clearly qualify Slovenia for export-oriented factor cost advantages-seeking rather than market-seeking FDI. Slovenia is a very small market; it is a relatively developed country at an advanced stage of transition reform, and has an export-oriented economy.

Actual export data of FIEs in Table 9 strongly confirm the above conclusions, i.e. the increasing importance and prevalence of export-oriented factor cost advantages-seeking FDI in the Slovenian manufacturing sector and the prevalence of market-seeking FDI in the service and public utilities sector. In 1999, FIEs in Slovenia exported 42.6 per cent of their sales. This was to a major extent due to the situation in the manufacturing sector, which was responsible for no less than 88.0 per cent of all FIEs exports. In 1999, manufacturing FIEs exported as much as 68.2 per cent of their overall sales (in 1994 62.9 per cent). The situation in non-manufacturing activities is considerably different, since on average they exported only 11.4 per cent of their sales, mostly in the field of transport and communications, trade and business services. Of the 20 manufacturing industries in Table 9, FIEs in five of these have an exports to sales ratio of more than 80 per cent (medical and precision

instruments, electrical machinery and apparatus, machinery and equipment, wearing apparel and basic metals), in another two it is higher than 75 per cent (textiles, fabricated metal products) and in three more it is higher than 70 per cent (leather, footwear and leather products, rubber and plastic products, motor vehicles). There are, therefore, at least ten manufacturing industries in Slovenia that clearly attract factor cost advantages-seeking FDI. The major two are motor vehicles and trailers, with exports to sales ratio of 74.5 per cent and a 32.8 per cent share in total FIEs exports, and machinery and equipment with an 82.8 per cent exports to sales ratio and an 11.9 per cent share in total FIEs exports. Also, in no less than 15 of the 20 manufacturing industries in Table 9, FIEs have a higher exports to sales ratio than domestic enterprises (DEs). On average, export orientation of FIEs in the Slovenian manufacturing sector is 43 per cent higher than that of DEs. This is additional confirmation of the distinctively high export orientation of FIEs in the Slovenian manufacturing sector.²²

In summary, although local and adjacent (neighbouring) markets are important motives for investing in Slovenia, consideration of specific characteristics of Slovenia as a host country, case studies of foreign investors' strategy in Slovenia, and especially the actual very high export orientation of FIEs in the manufacturing sector, all support the view that factor cost advantages-seeking FDI dominates in the manufacturing sector of Slovenia. It is exactly the opposite in the service and public utilities sector, where market-seeking motivation clearly prevails.

Wages as a determinant of FDI in Slovenia

Surveys of the motivations of foreign investors in Slovenia show, as far as labour is concerned, that it is the quality and not the low cost of labour that motivates foreign investors. This is not surprising, given that labour costs in Slovenia are by far the highest among Central and Eastern European countries in transition. In 1997, monthly labour costs in Slovenia were US\$980, compared to US\$536 in Hungary, US\$461 in the Czech Republic, US\$458 in Poland, US\$400 in the Slovak Republic, US\$158 in Romania and US\$126 in Bulgaria.²³

The finding that it is the quality rather than the cost of labour that motivates foreign investors in Slovenia is further confirmed by sectoral distribution of FDI in Slovenia, characterised by FIEs' tendency to locate in capital- rather than in labour-intensive manufacturing industries. In addition, not only do they tend to locate in capital-intensive industries, FIEs also tend to use much more capital-intensive techniques than DEs in the same manufacturing industries. In as many as 17 out of the 20 manufacturing industries listed in Table 11, FIEs have more machinery and equipment per employee than DEs. On average, manufacturing FIEs use 2.33 times more machinery and equipment per employee than DEs.

It could be expected that more capital-intensive techniques in FIEs also require the use of more skilled labour than in DEs. The data, however, do not seem to support this. If FIEs in the manufacturing sector use as much as 2.33 times more machinery and equipment per employee than DEs, they pay on average only 17 per cent higher labour costs per employee. The existing evidence suggests that a relevant part, if not most of the difference in wages, is due to the fact that for the same skills FIEs tend to pay somewhat higher wages, approximately 10 per cent more than DEs. For instance, in Tobačna Ljubljana after the acquisition, the policy has been to keep wages approximately 10 per cent above the Slovenian average (Rojec & Svetličič 1998b), in Biterm (thermostats producing company with minority share of Danish Danfoss) wages are claimed to be slightly higher as compared to other companies in the local community (Rojec & Svetličič 1998c), in Saturnus Avtooprema, the foreign parent company's policy is that wages should be approximately 10 per cent above the Slovenian average, in Yulon the level of wages is also quoted to be higher than average in Slovenia (Rojec & Stanojević 2001).

**Table 9. Export to sales ratio in FIEs and DEs by industries in per cent;
1999 income statements/balance sheets data**

<i>NACE industries</i>	<i>Exports to sales ratio (%)</i>			<i>FIEs – Distribution of exports by industries (%)</i>
	<i>FIEs</i>	<i>DEs</i>	<i>FIEs/DEs (Index)</i>	
15 Food products and beverages	17.3	13.4	129	1.0
17 Textiles	76.5	70.1	109	2.2
18 Wearing apparel, dressing fur	98.9	54.8	180	0.0
19 Leather, footwear & leather products	72.3	61.8	117	0.4
20 Wood & wood prod., exc. Furniture	37.7	51.8	73	0.3
21 Pulp, paper and paper products	68.0	52.2	130	6.6
22 Publishing and printing	48.1	6.8	706	0.7
24 Chemicals and chemical products	65.5	65.9	99	7.6
25 Rubber and plastic products	73.2	53.5	137	4.5
26 Other non-metal mineral products	44.0	39.1	112	2.6
27 Basic metals	80.8	63.6	127	3.5
28 Fabricated metal products	78.4	48.4	162	2.1
29 Machinery and equipment n.e.c.	82.8	62.7	132	11.9
31 Electrical machinery and apparatus	84.8	62.3	136	4.8
32 Radio, television and equipment	48.9	59.3	82	3.3
33 Medical and precision instruments	84.4	61.4	137	1.8
34 Motor vehicles and trailers	74.5	64.5	116	32.8
35 Other transport equipment	40.7	49.8	82	0.0
36 Furniture, manufacture n.e.c.	24.5	50.3	49	0.0
Other manufacturing industries ¹	47.8	12.1	395	2.0
<i>D Manufacturing – Total</i>	<i>68.2</i>	<i>47.6</i>	<i>143</i>	<i>88.0</i>
<i>Non-manufacturing activities</i>	<i>11.4</i>	<i>9.1</i>	<i>126</i>	<i>12.0</i>
A Agriculture, hunting, forestry	11.3	5.9	192	0.0
C Mining and quarrying	2.0	3.3	59	0.0
E Electricity, gas and water supply	6.6	1.4	475	0.0
F Construction	7.0	2.6	272	0.1
G Wholesale and retail trade, certain repair	10.4	7.5	139	8.8
H Hotels and restaurants	0.0	14.8	0	0.0
I Transport, storage, communications	28.5	28.8	99	1.3
J Financial intermediation services	0.8	0.3	258	0.0
K Real estate, renting, business services	24.9	7.4	336	1.7
M Education	0.0	3.2	0	0.0
N Health services and social work	10.7	7.5	142	0.0
O Other community and personal services	2.9	36.3	8	0.0
TOTAL	42.6	21.4	199	100.0

Source: Institute for Macroeconomic Analysis and Development; based on Bank of Slovenia and Agency for Payments data.

Notes: 1) Sum of industries with less than 3 FIEs (16 – tobacco manufactures, 30 – office machinery, 37 – recycling).

Table 10. Growth of real gross wages per employee and of labour productivity in the manufacturing sector of Slovenia in 1992-1999

<i>Year</i>	<i>Monthly gross wages per employee (in US\$)</i>	<i>Growth of real gross wages per employee¹ (chain index in %)</i>	<i>Growth of labour productivity² (chain index in %)</i>	<i>Ratio between growth of productivity and growth of wages (in %)</i>
1992	532.7	95.6	96.4	100.8
1993	551.8	108.6	107.2	98.7
1994	616.0	104.9	111.9	106.7
1995	783.6	103.2	108.4	105.0
1996	784.1	104.0	106.7	102.6
1997	744.9	103.4	104.5	101.1
1998	795.0	102.9	105.3	102.3
1999	792.8	102.8	101.8	99.0

Source: Institute for Macroeconomic Analysis and Development; based on Bank of Slovenia and Agency for Payments data.

Notes: 1) Deflated with consumer price index; 2) Volume of industrial production per employee.

It can therefore be concluded that in the Slovenian manufacturing sector FIEs tend to use much more capital-intensive production techniques than DEs, but these techniques are rather standardised and, in principle, do not require more skilled labour. FIEs and DEs use more or less equally skilled labour, but FIEs pay somewhat higher wages. FIEs are able to achieve much higher labour productivity, in terms of value added per employee, than DEs. Surveys of workers in a typical FIE indicate that the workload has increased (considerably) since the foreign investor took over the company.²⁴ . The indicator of value added per labour costs is very persuasive in this regard. With 1 SIT (Slovenian Tolar) of labour costs, manufacturing FIEs are able to produce 1.84 SIT of value added, which is 33 per cent more than DEs.²⁵ Labour issues are discussed further in Chapter 4.

Table 11. Machinery and equipment per employee and labour costs per employee in manufacturing FIEs; 1999 income statements/balance sheets data

<i>NACE industries</i>	<i>Machinery & equip. per employee</i>		<i>Labour costs per employee</i>		<i>Value added¹ per employee</i>		<i>Value added¹ Per labour costs</i>	
	<i>FIEs, mill. SIT</i>	<i>FIE/DE Index, %²</i>	<i>FIEs, mill. SIT</i>	<i>FIE/DE Index, %²</i>	<i>FIEs, mill. SIT</i>	<i>FIE/DE Index, %²</i>	<i>FIEs (Ratio)</i>	<i>FIE/DE Index %²</i>
15 Food products and beverages	4.8	126	3.6	129	4.3	105	1.17	80
17 Textiles	3.6	277	1.9	100	3.8	162	1.98	162
18 Wearing apparel, dressing fur	0.1	20	1.4	82	1.3	7.2	0.93	86
19 Leather, footwear & leather products	1.2	171	2.4	126	3.8	185	1.58	150
20 Wood & wood prod., exc. furniture	6.1	469	2.4	120	4.7	189	2.00	161
21 Pulp, paper and paper products	17.6	677	3.1	1.41	6.3	205	2.04	149
22 Publishing and printing	5.4	225	2.7	71	4.1	82	1.54	117
24 Chemicals and chemical products	7.4	224	3.2	84	7.9	113	2.47	134
25 Rubber and plastic products	2.1	42	2.5	96	3.5	85	1.44	91
26 Other non-metal mineral products	6.9	256	3.0	130	7.1	201	2.35	157
27 Basic metals	5.0	143	3.0	120	4.9	148	1.66	123
28 Fabricated metal products	2.4	104	2.4	104	3.7	116	1.51	110
29 Machinery and equipment n.e.c.	2.6	163	2.4	100	4.2	132	1.76	132
31 Electrical machinery and apparatus	2.6	153	2.8	112	4.7	135	1.68	120
32 Radio, television and equipment	1.1	85	3.6	164	5.5	198	1.53	120
33 Medical and precision instruments	1.7	155	2.1	81	3.3	99	1.58	122
34 Motor vehicles and trailers	6.6	388	2.9	138	6.0	250	2.06	184
35 Other transport equipment	2.8	311	1.9	79	2.3	96	1.20	125
36 Furniture, manufacture n.e.c.	1.9	158	1.8	90	2.5	95	1.40	106
16, 30, 37 Other manufact. industries ³	7.8	433	4.0	138	13.5	304	3.35	220
<i>D MANUFACTURING – Total</i>	4.9	233	2.8	117	5.1	153	1.84	133
<i>TOTAL – All activities</i>	4.4	148	3.0	115	5.3	146	1.78	125

Source: Institute for Macroeconomic Analysis and Development; based on Bank of Slovenia and Agency for Payments data.

Notes: 1) Value added is gross value added, calculated as difference between sales and costs of merchandise, material and services; 2) Index between indicator for FIEs and indicator for DEs; 3) Sum of industries with less than 3 FIEs (tobacco manufactures, office machinery, recycling).

What is the rationale of foreign investors in the above context? If increasing labour costs at home make certain types of production non-viable, one of the possible solutions to the problem is to relocate production abroad. By moving production facilities abroad, the company continues to utilise its existing industry specific assets, including its given production technique, but swaps the home country labour force with a cheaper one in a host country.

In a situation of a given production technique, a company would make a relocation/restructuring decision on the basis of value added to labour costs ratio criteria. The maximum amount of value added per employee that could be produced by a certain production technique is more or less fixed and, therefore, with increasing labour costs per employee at home, the value added to labour costs ratio decreases. To prevent a decrease in the value added to labour costs ratio, or more to the point, to increase it, a company would establish production capacities abroad, in a country whose labour force is able to produce the expected amount of value added per employee with a given production technique, but at lower labour costs per employee. There are therefore two basic conditions to relocate/restructure via FDI abroad; the first is the adequate quality of the labour force in the host country, meaning that it is capable of realising the expected amount of value added per employee with a given production technique, and the second is lower wages than at the existing location.

Table 12. Value added per employee, labour costs per employee and value added per labour costs in the manufacturing sector of Slovenia and major EU investing countries in Slovenia in 1998; national accounts data

	<i>Value added per employee (Euro)</i>	<i>Labour costs¹ per employee (Euro)</i>	<i>Value added per labour costs (Ratio)</i>
EU – 15	48 800	33 400	1.46
Austria	58 072	34 736	1.67
Germany	56 120	39 078	1.44
Italy	38 552	27 722	1.39
France	62 952	38 744	1.63
Slovenia	16 680	10 624	1.57
FIEs ² in Slovenia	22 565	11 784	1.92

Source: Eurostat 2000; Statistical Office of the Republic of Slovenia 1999.

Notes: 1) Remuneration in the case of EU countries and compensation of employees in the case of Slovenia; 2) Calculated by applying FIEs/All enterprises indexes from company financial statements data (Institute for Macroeconomic Analysis and Development; based on Bank of Slovenia and Agency for Payments data) to national accounts data for Slovenian manufacturing as a whole.

Table 12 clearly demonstrates that a relocation/restructuring, i.e. an investment decision, cannot be made only on the basis of labour costs per employee. Slovenia does have much lower labour costs, i.e. labour costs per employee, than any of the major EU investing countries, but it also lags behind very much in terms of productivity, i.e. quality of labour measured by value added per employee. The only possible basis for making a decision is a comparison of productivity and cost of labour in terms of value added per labour costs. *Ex ante*, and from the point of view of prospective foreign investors, this

means that, when a foreign investor makes a decision to relocate/restructure abroad, he is confident that with the given production technique he will achieve approximately the same productivity as at home but at lower labour costs.

It is not that prospective foreign investors are looking at the value added per employee data in a host country; instead they check whether the conditions that enable achieving the required level of productivity are in place. *Ex post*, successful foreign investor decisions about relocating/restructuring abroad should in fact be demonstrated by higher value added per labour costs in foreign subsidiaries than at home. The case of Slovenia seems to confirm this rationale. The value added per labour costs ratio in foreign FIEs involved in manufacturing in Slovenia is much higher than in the manufacturing sector of any of the major EU countries investing in Slovenia.²⁶

Investment opportunities and competitive advantages of Slovenia as investment location

Existing analysis of foreign investors' motivations²⁷ and of Slovenia's competitive advantage as an investment location²⁸ suggest that it is reasonable to distinguish between *i*) investment opportunities open to foreign investors that represent a direct motive, i.e. a factor causing foreign investors to begin to consider investment in Slovenia, and *ii*) natural and created factors/environment and investment climate in Slovenia in the framework of which the potential investment is realised. The latter constitutes a framework that determines to a considerable degree whether an investor will decide to take up an investment opportunity.

Investment opportunities for foreign investors in Slovenia can be classified into five groups:

- a) *Acquisitions of and joint ventures with Slovenian companies* where investment opportunities arise from:
 - High domestic purchasing power (GDP per capita higher than in any other Central and Eastern European country in transition; approximately at the level of Greece and Portugal) and growth potential of its small domestic market (4-5 per cent GDP growth rates in the last mid-term period).
 - High export propensity of Slovenian companies with relevant market shares in EU countries.
 - Strong trade and business links of Slovenian companies with other parts of the former Yugoslavia and with Central and Eastern European countries in transition.
 - High level of managerial and technical skills in companies.
 - Local industrial environment assures technological capabilities that enable speedy mastering of the technology transferred by foreign investors.
 - Transport costs are low; main investing countries are near, transport connections are good.
 - Good acquisition opportunities (of not yet privatised) Slovenian companies in the process of rehabilitation (companies in the portfolio of Slovenian Development Corporation, companies of Slovenian Ironworks etc.).

b) *Subsidiaries in Slovenia as part of the integrated international production of multinational enterprises.* Investment opportunities arise from:

- Quality of the workforce: well educated and trained, dedication to work, industrial tradition, language skills, high level of computer literacy.
- Low labour costs if compared to productivity level (high value added to labour costs ratio).
- Relatively high level of managerial and technical skills in companies.
- Central geographical position (proximity) making transport costs low (good international transport and communication linkages).
- Trade links with other countries; liberal foreign trade regime and integration in the EU and CEFTA.
- Industrial tradition and especially experience in manufacturing middle technology level products.

Opportunities for location of parts of integrated international production in Slovenia exist particularly in production requiring a higher level of workforce quality, industrial experience, middle technology level, and low transport costs.

c) *Investment in infrastructure sectors – public utilities.* Investment opportunities arise from:

- Slovenia is just about to start privatising public utilities.
- The gap between Slovenian investment needs in infrastructure facilities and available financial sources requires more intensive engagement of private capital in infrastructure investment.

d) *Slovenia as a location for regional headquarters,* as a regional rather than a local market. Investment opportunities arise from:

Its geographic location between EU countries (Slovenia is among the most advanced candidates for EU membership), CEFTA countries (Slovenia is member of CEFTA) and successor countries of the former Yugoslavia (Slovenia has free trade agreements with Croatia and Macedonia, is about to sign one with Bosnia and Herzegovina, and is eager to improve the framework for doing business with the Federal Republic of Yugoslavia, excellent knowledge of the markets and long established business links) with well developed business links with all three groups of countries.

- High level of managerial and technical skills in companies.
- High quality of living for representatives and executives of foreign investors, including high level of security.
- Good international transport and communication links.
- Political stability.

- e) *FDI in services, especially in business infrastructure.* Investment opportunities arise from:
- Fast growing economy and market with very high demand for business services.
 - Forthcoming privatisation of the financial sector.
 - Full liberalisation of capital flows, introduction of funded pension schemes, changes in the population's savings habits, and modes of investment financing in companies strongly increase the need for financial intermediation, especially via capital market.²⁹

Factors that create an attractive and friendly environment for investing in Slovenia are:

a) *Market factors* consisting of:

- Growing and open economy. In 2000 GDP growth rate was 4.2 per cent and exports to GDP ratio 59.0 per cent (IMAD 2001a).
- Economic and political stability with the highest international ratings among Central and Eastern European countries in transition. In 2000 the inflation rate was 8.9 per cent, general government deficit 1.4 per cent of GDP, current account deficit 3.3 per cent, unemployment rate 7.0 per cent; IMAD 2001a).
- Good access to markets on the West, East and South-East Europe. Slovenia has signed a Europe Agreement with the EU and is among the most qualified candidates for EU membership, is a member of CEFTA and has free trade agreements with numerous countries.

b) *Production factors* consisting of:

- Location in the heart of Europe with a maritime cargo port.
- Developed infrastructure with extensive transport grid and telecommunications network.
- Long industrial tradition coupled with ability to implement new technologies.
- Well educated, flexible and motivated work force with good command of foreign languages – model industrial relations.
- Experienced managers.
- High quality of living.

c) *Regulatory framework* consisting of:

- Intensive adoption of EU legal and system framework. By the end of 2002 Slovenia expects to be ready for EU membership.
- Liberal regime of international economic relations, characterised by WTO membership and European Agreement with the EU.

- Liberal FDI regime, based on the national treatment principle and unlimited profit and equity repatriation.

Low, 25 per cent corporate profit tax and other incentives for FDI.

Barriers to FDI

In spite of the above mentioned investment opportunities and positive aspects of the investment climate in Slovenia that resulted in rapid increases of FDI in the last decade, it seems that other transition countries of Central and Eastern Europe, notably those who are members of the OECD, have succeeded in attracting relatively higher amounts of FDI. This is not the case in terms of FDI stock per capita, where Slovenia with US\$1,411 (2000 data) is before Poland with US\$828 and Slovakia with US\$686, and does not lag much behind Hungary with US\$1,900 and the Czech Republic with US\$1,752. However, in terms of FDI stock as a share of GDP, Slovenia with 15.5 per cent (2000 data) lags behind the other four countries. The respective figure for Hungary is 43.2 per cent, for the Czech Republic 40.4 per cent, for Poland 20.1 per cent and for Slovakia 19.3 per cent.³⁰ If FDI inflows are broken down into inflows from abroad and reinvested earnings, it is obvious that low inflows in recent years were mainly due to a low number and value of new FDI projects. The increasing amount of reinvested earnings by existing foreign investors in Slovenia, on the other hand, tends to show that existing foreign investors strengthen and increase their operations in Slovenia, indicating their positive appreciation of Slovenia as an investment location.

What are the reasons for FDI inflows not being as high as in countries like Hungary and the Czech Republic? Studies undertaken by the Slovenian Institute for Macro-economic Development (IMAD), the Foreign Investment Advisory Service (FIAS), and experts at the university of Ljubljana³¹ suggest the following factors:

- Small local market.* The small size of Slovenia's domestic market is the major constraint preventing more FDI inflows.
- Monetary considerations* have for a long time been one of the major scruples of the Bank of Slovenia regarding foreign capital inflow. Under a regime of a managed floating foreign exchange rate where money came into circulation almost exclusively through foreign exchange transactions, in a situation where Slovenia was faced with the problem of a small monetary area with a positive current account balance up until the end of 1997, capital inflows represented a constant pressure on domestic currency appreciation. In these circumstances the central bank embarked on various measures to counteract exchange rate pressures, including various measures to cope with the risks associated with capital inflows.³² Although these measures have served their monetary purpose, i.e. preventing a negative impact of excessive speculative capital inflows, and although they were not directed against FDI, they have tended to discourage it.³³
- Privatisation and enterprise restructuring.* There are several aspects responsible for privatisation not having contributed enough to FDI inflows. *i)* The first was the (mass)privatisation concept in industry and trade that implicitly favoured internal (employee and management) buy-outs. Foreign acquisitions were only exceptional in privatisations dominated by distribution through the use of ownership certificates and internal buy-out at considerable discounts. *ii)* The second aspect was that the (transition) restructuring process in privatised companies was not rapid enough and did not encourage them to search for strategic foreign partners. *iii)* The third was the hesitant and

late privatisation of state ownership in the financial and public utilities sector, where more decisive moves have been initiated only recently.

- d) *Political instability due to the collapse of the former Yugoslavia* was for a long time an important constraint to attracting more FDI into Slovenia. According to various country risk assessments, political risk is no longer an inhibiting factor in the case of Slovenia. For instance, in *Euromoney's* political risk assessments, Slovenia has better rating than Poland, Hungary, the Czech Republic and Slovakia.³⁴
- e) *Unfinished transition process*. Incomplete transition increases the costs of establishing and operating a company. This is especially reflected in the so-called implementation gap, i.e. the gap between formally adopted regulation and inability to (fully) implement it. Economic and legal systems are now fast approaching EU standards, and this process is likely to be completed with integration into the EU.
- f) *Administrative barriers* to investment and company operations are a relevant constraint to more active engagement by domestic and foreign investors as they increase the costs of setting up and running a company. Although in a number of areas (like tax administration, customs procedures, industrial property rights and standardisation procedures, and to a certain extent also procedures for establishing businesses and foreign exchange transaction reporting requirement) definite or important breakthroughs have already been made, in some areas administrative procedures still remain too long and complicated. FIAS made specific recommendations to the Slovenian government on how to ease and improve administrative procedures in the field of company registration, business activity permit, acquiring land, site development, expatriate work permit and employment regulation.
- g) *Problems in acquiring industrial locations*. Access to business premises and land, especially for industry, obtaining clear title to land, acquiring the necessary permits to build and operate a factory, are often complex and time consuming. Problems also stem from the high price and low availability of land and industrial and business premises in general (FIAS 2000).
- h) *Relatively rigid and unbalanced labour legislation* that does not take sufficient account of the interests of employers, i.e. in general, the rules governing the relationship of employers and employees is biased towards employees (FIAS 2000).
- i) *Relatively rigid labour market*. Slovenia has a relatively well-educated and productive labour force, but labour costs are relatively high compared to competitive investment locations, and labour force mobility in Slovenia is relatively low (in certain regions there is a lack of certain professions which are in surplus in other regions) (FIAS 2000).
- j) *The policy of promoting FDI has long been rather passive* (insufficient funds and staff for serious FDI promotion activity). Since 2000 the government has put more effort and devoted more resources to attracting foreign investors. These activities are to be further strengthened in the future (TIPO 2001).

Determinants of future inward FDI trends in Slovenia

Apart from the elimination of the barriers to inward FDI mentioned above, two major determinants of future FDI inflows in Slovenia will be: *i*) the process of integration into the EU and *ii*) the privatisation process of the financial sector and public utilities. In this framework, of course, a number of other factors will be relevant, particularly the completion of the transition process. An adequate framework for macroeconomic and macro-organisational policies (see Dunning 1992) is extremely important in attracting the type of export-oriented FDI projects that dominate in Slovenia.

Slovenia's integration into the EU. The EU integration process is not only a strong incentive for FDI among member countries, but also for FDI from non-member to member countries. The accession of a new country into the EU is an even stronger incentive for increasing FDI flows into the accessing country. With its accession into the EU, the accessing country becomes an integral part of the internal market and adopts the internal market's common rules of the game (*acquis communautaire*) that stimulate FDI inflows from EU member countries as well as from other countries. With accession into the EU the problem of Slovenia's small local market as the most important constraint for more FDI inflows will also cease to exist.³⁵

Privatisation of the financial sector and public utilities. The dynamics and mode of privatisation in the financial sector (banks and insurance companies) and public utilities (telecommunications, airline company, energy sector etc.) will be the second most crucial factor of future FDI inflows into Slovenia. There is no doubt that foreign investors will be included in these processes. The final modalities of privatisation are, however, not yet clearly defined, except in the banking sector. In any case it is safe to conclude that privatisation will lead to considerable FDI inflows in the near future.

Completion of the transition process. Another important factor affecting future FDI inflows in the country will be the dynamics of transition reforms and reforms related to integration into the EU. The fact that Slovenia is among the forefront candidate countries for EU membership considerably reduces the perception of risk of doing business in Slovenia by potential foreign investors. This is mostly because potential foreign investors are sure of what the future economic and legal system will look like (*acquis communautaire*) and the timing of the adoption of this system is also known (National Programme for the Adoption of the *Acquis*). Adoption of an appropriate normative framework is, however, not enough; the catchword is implementation of this framework. The completion of transition thus depends to a great extent on enforcing and implementing changes, establishing an enterprise sector that will be able to viably compete on the internal market of the EU, efficient corporate governance, competition and competitiveness of public utilities, and a competitive banking sector. In short, the completion of transition means the establishment of (fully) functioning market economy institutions. For Slovenia, the process of EU accession is nothing less than an acceleration of the transition process, a guarantee that the transition process will be faster and more thorough.

Slovenia as a springboard for South-East Europe. The Stability Pact for South-East Europe and the changes that have taken place in the Federal Republic of Yugoslavia, in combination with the gradual long-term integration of the area into the European integration process have definitely demonstrated Slovenia's possibilities in the region. The affirmation of Slovenia as a springboard for doing business in the successor countries of the former Yugoslavia does therefore provide a definite possibility of increasing future FDI inflows into Slovenia. Slovenia should try to persuade foreign investors to let it handle the markets of other parts of former Yugoslavia from Slovenia (establishing of regional headquarters for successor countries of the former Yugoslavia in Slovenia). Slovenia has undeniable advantages in this regard, i.e. much lower country risk, knowledge of circumstances, language, culture, people, high reputation of Slovenian products in these countries, geographical location, etc.

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<http://www.sipo.mzt.si> (Slovenian Intellectual Property Office)

<http://www.sigov.si/ops> (Office of the Prime Minister, Negotiating Team for Accession to the European Union)

<http://www.sigov.si/mf/angl/> (Slovenian Ministry of Finance)

<http://www.sigov.si/mzz/ang/> (Slovenian Ministry of Foreign Affairs)

NOTES

1. This report is based on contributions by Matija Rojec, Matej More, Marko Simoneti, Mojmir Mrak, Andrej Svetlicic and Mirjam Mocnik, prepared for the Ministry of Economy of the Republic of Slovenia for the OECD review.
2. IMAD, 2001a.
3. i.e. companies with 10 per cent or higher foreign equity share.
4. The decrease of stock by US\$109.3 million in 1999 is predominantly due to high appreciation of the US\$ against the SIT in that year; in fact the stock measured in Euro increased by Euro 317.8 million.
5. Rojec 1998.
6. Shifts of the shares are importantly influenced by heavy reduction of the share of Croatia. This is mostly due to the fact that since 1998 the Croatian share in the Nuclear Power Plant Krško is no longer included in the FDI stock; Slovenia and Croatia still negotiates the future status of the plant.
7. Rojec, 2000a.
8. These investors are Goodyear and Kirkwood Industries from United States, Renault, Leclerc and Société Générale from France, Meyr Melnhof, Henkel, OMV, Brigl and Bergmeister, Interspar and Bank Austria from Austria, E.G.O. from Switzerland, Siemens, Reemtsma, Pfeleiderer and Porsche from Germany etc.
9. Svetličič, Rojec and Trtnik, 2000.
10. Rojec 1998.
11. Other major investments include: (Iskratel), Kirkwood Industries from the United States in commutators (Kolektor), Danfoss from Denmark in compressors for refrigerators (Danfoss Compressors) and in heating and ventilation control systems (Danfoss Trata), Bosch-Siemens from Germany in small household appliances (BSH Hišni aparati), Reemtsma from Germany and Seita from France in cigarettes (Tobačna Ljubljana), Pfeleiderer from Germany in insulation materials (Pfeleiderer Novoterm), Henkel from Austria in detergents and cosmetics (Henkel-Zlatorog) and in chemical industry (Henkel Ecolab), Goodyear from the United States in car tires (Sava Tires, Goodyear Engineered Products), Gruppo Bonazzi from Italy in synthetic fibers (Yulon) and textiles (Aguasava), Hella from Germany in car lighting equipment (Saturnus Avtooprema), Messer Griesheim from Germany in industrial gases (Messer Slovenija), Safilo Group from Italy in spectacle frames (Carrera Optyl), Bayer from Germany in pharmaceuticals (Bayer Pharma), Inexa from Sweden in steel, Johnson Controls from Germany in automotive components manufacturing (NTU Johnson Controls). In trade, major FDI projects are Interspar from Austria, Porsche from Germany and Leclerc from France; in banking there are Bank Austria Creditanstalt and Volksbank from Austria and Société Générale from France, while in telecommunications there are Mobilkom from Austria and Western Wireless from the United States.

12. Svetličič and Jaklič 2001.
13. Dunning 1993, Caves 1971, 1982.
14. Rojec and Stanojević 2001.
15. Rojec and Svetličič 1998a.
16. Lorentzen, Moellgaard and Rojec 1998.
17. Rojec and Svetličič, 1998b.
18. Rojec and Stanojević 2001.
19. In practice, there was no alternative, because FDI objectives could never be achieved by investment at home, because acquisition opportunities made the investment more rational, and simply because both projects were made in the context of internationalisation processes of parent companies.
20. Rojec and Stanojević 2001.
21. Rojec, 2000b.
22. FIEs in the Slovenian manufacturing sector are, however, not only much more export but also much more import oriented than DEs. In 1997 the share of FIEs in total manufacturing sector exports was 28.2 per cent, in imports 34.4 per cent and in trade balance surplus 16.6 per cent. In FIEs imports to sales ratio was 54.4 per cent while in DEs only 27.7 per cent. Both groups of companies, FIEs and DEs realised high surpluses in their foreign trade flows, but the relative effect on foreign trade account (measured by the surplus to exports ratio) was much higher in the case of DEs (40.5 per cent) than FIEs (20.5 per cent).
23. WIIW 1999.
24. See, for instance, the cases of Tobačna Ljubljana (Rojec and Svetličič 1998b), Sarrjo Slovenija (Rojec and Svetličič 1998a), Yulon and Saturnus Avtooprema (Rojec and Stanojević 2001).
25. On average, in all activities with 1 SIT of labour costs FIEs are able to produce SIT 1.78 of value added, which is 25 per cent more than DEs (see Table 11 for details).
26. Rojec and Stanojević 2001.
27. See for instance Dedek and Novak 1998, Rojec 1998.
28. See for instance FIAS 1998, TIPO 1999.
29. For more on the investment opportunities for foreign investors in Slovenia see especially in FIAS 1998, and TIPO 1999.
30. In Slovenia during 1993-2000, stock of FDI per capita increased from US\$479 to US\$1,411, while the share of FDI stock in GDP increased from 7.5 per cent to 15.5 per cent, Hunya and Stankovsky 2001.
31. Rojec 1998, Dedek and Novak 1998, IMAD 1999, FIAS 1998, FIAS 2000.
32. They included measures to control the credit activity of banks, such as limited transformation of foreign savings into domestic liquidity and limited transformation of bank short-term liabilities into

long-term assets. Other measures raised the costs of foreign funds. Among them, the most important were a 40 per cent non-interest bearing tolar deposit for each foreign loan with maturity of up to five (and later on seven) years that is intended for conversion, which was introduced in February 1995, and the introduction of custodian accounts to regulate the inflow of portfolio investments.

33. Mrak, Rojec and Potočnik 2001.

³⁴. According to September 2000 issue of *Euromoney* Slovenia's political risk rating was 17.43 (of maximum 25 points), that of Czech Republic 17.11, Hungary 17.06, Poland 16.56 and Slovakia 12.86.

35. Rosati 1998.