Slovenia's Enigma and the Small Country's Development Strategy[1]

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I. Slovenia's Enigma

For a long time Slovenian nation has not had its own country. The nation had been for more than eleven hundred years, from the second half of 8th century to the end of World War I, under the rule of foreign super power such as Germany and Austria. At last in 1918, owing to the defeat of the Austria-Hungarian Empire, Slovenians were able to escape from its rule and founded a country together with Serbs and Croats. This was the first Yugoslavia, which later fell into utter confusion by nationality conflicts and allowed invasion by foreign countries such as Nazis Germany. After World War II the second (former) Yugoslavia was founded as a socialist state by Tito. After his death in 1980, however, the economic crisis gradually aggravated conflicts among Republics, finally bringing the Federation's breakup in 1991. Thus Slovenian nation has attained its independence.

It is a small country with an area of 20,251 square kilometers and with population of about 2 million. Slovenia was the richest Republic in the former Yugoslavia. Before the breakup of the Federation not a few people were skeptical about its independence on the ground that Slovenian industries, which were competitive in the Yugoslav markets, were less competitive in European markets. To be honest, I was among them.

Slovenia has experienced double transition from a socialist to a market economy and from a regional to national economy (Mencinger, 1996, p.417). In contrast to other transitional countries its transformational recession was not so serious because already during the period of the Yugoslav self-managed socialism it had a pseudo market economy in which adjustment of the economy was made in a decentralized way and therefore excessive demand (= an economy of shortage) did not exist. Rather the influence of its loss of the former Yugoslav markets was much bigger. Roughly speaking, about one-third of total Slovenian manufacturing sales in 1988

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was consumed in Slovenia, one-third was exported, one-third was sold in the other former Yugoslav Republics. Sales to the other republics of the former Yugoslavia fell from US$ 6.7 billion in 1990 to only US$ 1.5 billion in 1992 (Damjan, 2004, p.336). A drastic reduction of trade with the former Yugoslav Republics was the principal cause of the depression. Slovenian companies made desperate efforts to increase their exports to West European markets in order to substitute for plummeting exports to the former Yugoslav markets.

As for movement of the GDP, in 1992 it decreased by about 10% from 1989 level. With 1992 as its bottom, it recovered 1989 level as early as 1995 and it has been steadily growing. As of 2003 its per capita GDP equals US$ 13,897 (at exchange rate), which corresponds to US$ 19,160 as measured in purchasing power parity (WIIW, 2004, p.58). This level surpasses that of Czech Republic with corresponding figures being US$ 8,795 and US$ 16,810 respectively (Ibid., 42). The unemployment is not so high (6.7%), the inflation rate is milder (5.6%), the current account deficit is –0.4% of GDP, and the budget deficit is –1.4% of GDP (Ibid.,pp.58-59). In this way, Slovenia shows the best economic performance among the transition countries. In May 2004 Slovenia was admitted to the EU together with other Central European and Baltic countries and two small Mediterranean countries (Cyprus and Malta). Slovenia joined the ERM II in June 2004 in order to adopt EURO in the early 2007. It may be safely said that Slovenia's case is a success story.

Compared with other transition countries, especially other Central and East European countries Slovenia's way is rather unique in the following points: Firstly, in privatization of state enterprises preference was given to insiders in Slovenia while not so much preference was given to insiders in other Central and East European countries. Nevertheless, its economic performance has been better. Secondly, other transitional economies have actively attracted foreign direct investment (FDI) in order to cover their insufficient capital and absorb advanced technology and managerial know-how. In Hungary, for example, economic development has been led mainly by foreign capital. In contrast, Slovenia has not been enthusiastic in attracting FDI, and in fact it has had smaller amount of FDI inflow. Nevertheless, its economic performance has been better. This paper attempts to clarify the Slovenia's enigma

II. International Comparison of FDI inflow

Indeed, Slovenia has had smaller amount of FDI inflow. *Revue Elargissment,* which was distributed electronically bi-monthly by Regional Network of the French Ministry of Economy in the CEECs, gives us very useful information for international comparison of FDI inflow (See Table 1). The performance index is calculated as the ratio of a country's share in global FDI to

its share in global GDP. When the index is 1 it means that a country's share in the global FDI inflows equals its share in the global GDP. The bigger the FDI performance index is the more attractive the country concerned as an object of investment is. 140 countries are ranked. The first place is occupied by Ireland whose index is 5.1. No applicant country (the status is as of 2001) appears in the leading group except Malta (5th rank). Romania lags behind at the 57th rank with a weight in the FDI strictly equivalent to its weight in the world GDP. All CEE countries rank among the first 57 countries, except Slovenia. Czech Republic leads the region with an index of 2.5 (13th rank), followed by Estonia (the 16th), Bulgaria (the 24th), etc. Although Hungary attracted rather big amount of FDI in the first half of the 1990s, the country ranks unexpectedly lower in 2001 with an index 1.1 (38th rank). Slovenia's index is only 0.3 (110th rank).

Table 1 FDI inflows to CEECs in 2001, performance index and rank, and FDI share in total investment (%)

Country	FDI (billion $)	Performance Index	Rank	FDI/Capital Formation
Hungary	2.4	1.1	49	15
Poland	8.8	1.4	38	23
Czech Republic	4.9	2.5	13	35
Slovakia	1.5	1.5	35	36
Slovenia	0.4	0.3	110	4
Estonia	0.5	2.3	16	33
Latvia	0.2	1.6	32	22
Lithuania	0.4	1.5	33	18
Bulgaria	0.7	1.8	24	52
Romania	1.1	1.0	57	15
Croatia	1.4	1.7	27	28
Russia	2.5	0.3	104	7
Ukraine	0.8			10
Total Eastern Europe	27.2			18
Cyprus	0.2	0.4	102	11
Malta	0.3	4.6	5	70

Source: UNCTAD, WIR 2002, Quoted from *Revue Elargissement,* No.31.

According to Revue Elargissement, the second index, i.e., the ratio of FDI to the capital formation, measures their potential role like an engine for the catching-up. The average ratio for Eastern Europe in the very wide sense including Russia and Ukraine is 18.2%. This ratio is higher than 10% in China or Thailand. There are big differences within the region. It is highest in Bulgaria (52%). It is exceptionally low (4%) again in Slovenia. In the case of Russia it is only 7%. Seemingly it is very strange that Slovenia has the same FDI performance index as

Russia and the former ranks lower than the latter in terms of the ratio of FDI to capital formation. Is the investment climate in Slovenia as bad as Russia? No! It is much better in Slovenia.

Table 2 Rating of trustworthiness of CEE countries

	Fitch IBCA	Standard and Poors	Moody's
Slovenia	A	A	A2
Hungary	A-	A-	A3
Czech Republic	BBB+	A-	Baa1
Poland	BBB+	BBB+	Baa1
Slovakia	BB+	BB+	Ba1

Source: ITDH (2001), p.6.

According to ratings by famous rating companies in 2001, Slovenia is rated higher than Hungary. Slovenia ranks the highest among the CEE countries (See Table 2). It cannot be said that the investment climate in Slovenia is bad. This country has not adopted active preferential treatment for foreign capital in the 1990s. Rather it may be said that there has been no necessity to do so.

III. Privatization and Less Amount of FDI Inflow

1) Privatization

In Slovenia the first draft of privatization law was announced in November 1990. There was a heated controversy between two approaches over the method of privatization. The first group proposed a gradual, decentralized, and commercial privatization. This approach was represented by Joze Mencinger who served as Vice Prime Minister in charge of economic reform at that time. The second group proposed mass, centralized, distributive privatization. This approach was represented by Jeffrey Sachs, who was famous for his 'achievements' of having eradicated vicious inflation in South America and instructed the shock therapy to governments of Poland and Russia. The controversy between the two approaches resulted in a stalemate lasting for a year and a half. However, the process of the privatization was not completely stopped. In November 1992 the draft of privatization law was finally adopted. This law (Law on the Transformation of Social Ownership) was compromise encompassing features of both methods of privatization: a decentralized and gradual approach from the first, and a predominantly distributive privatization using ownership certificates (the so-called vouchers) to all citizens from the second (Mencinger, 1996, pp.418-419).

According to Stiblar, the content of the privatization law and the related laws can be

summarized as follows: First, it regulates the transformation of enterprises in social ownership into known (private) owners, as well as the role of the Agency for Privatization, the Reimbursement Fund and the Pension Fund. Second, certain legal entities are excluded from regulation with this law (public enterprises, banks, insurance companies, cooperatives, enterprises in bankruptcy procedure). Third, social capital is defined in the law as the difference between assets and liabilities of social enterprises plus permanent investments and stocks belonging to the enterprises. Its value is established by the "opening balance", for which methodology is prescribed by the Privatization Agency and Social Accounting Service. It is not a book value because this value is usually far from reality. Fourth, the rights of previous private (natural and civil persons) owners and their heirs are also prescribed. The denationalization law prescribed the restitution of private property rights in kind (if possible) or value (shares) to those who were stripped of ownership with nationalization procedure by the socialist regime after World War II. Fifth, all agricultural land and forests in social ownership are transferred to the Fund for agricultural land from the day of enactment of this law. The company may continue to use and manage agricultural land and forest until an authorized body decides on denationalization (restitution) or concession (Stiblar, 1993, p.185).

In 1993, in order to promote privatization process, an ownership certificate, a kind of voucher, was distributed to each Slovenian citizen. Unlike the voucher in Russia, the ownership certificates had different face values between SIT 200,000 (DM 2,500) and SIT 400,000 (DM 5,000) depending on the age of the citizen. The total amount of ownership certificates represented 40 percent of the book value of social capital as of December 31, 1992. The certificates were not transferable to other persons, but could be used to purchase shares of privatized companies. They were used in the internal distribution and buyouts, public sales, or were transferred to the privatization investment funds (World Bank, 1999, p.88).

In this way, the privatization in Slovenia is characteristic of its decentralized way and gradualism. Mencinger says, "Gradualism prevailed. Indeed, the reality since independence has been an even more gradual transition than the most enthusiastic gradualists had suggested, both in terms of economic policy and in terms of changes in the economic system"(Mencinger, 2004, p.79). In addition, a kind of vouchers was distributed, and at the same time the vouchers had different face value depending on the age of the citizen. Thus more preference was given to insiders who have worked at companies for longer periods.

2) FDI inflow

Slovenia has had smaller FDI inflow. The following reasons have been mentioned by Slovenian researchers: i) The country is relatively rich, its current balance has roughly been balanced, and

companies were competitive on the world market even before the transition. Therefore, it has had no urgent necessity for FDI inflow. ii) Privatization did not give advantages to foreign investors. On the contrary, the applied privatization model offered employees the chance to acquire and retain the majority of ownership of many successful companies. iii) The hesitant privatization of enterprises in the financial and public utilities sectors, where initiatives have been undertaken only recently; iv) Slow restructuring process in the privatized enterprises, which gives them little encouragement to search for strategic partners; v) Monetary consideration. The Bank of Slovenia has since independence in 1991 tried to prevent the inflow of portfolio capital. Although they were not aimed specifically at FDI, they have also tended to discourage FDI; vi) Administrative barriers, which increase the costs of a company seeking to establish itself and operate in Slovenia; vii) Slovenia's market has been considered too small, and real wages too high to attract extensive greenfield investments, while the predominance of insiders in the ownership of many successful companies has curbed acquisition (Simoneti, Rojec and Gregoric, 2004, p.236; Mencinger, 2003, p,496).

Compared with other transitional countries, for example, Czech Republic and Hungary there are much more persons who are cautious toward FDI inflow. Such a cautious attitude can be explained by the spirit of independence and self-reliance that Slovenia has firmly maintained in spite of a small country as well as relatively stronger international competitiveness which has supported the spirit. As we will see later, its international competitiveness derives from the high level of its technological potential, etc. Joze Mencinger, a representative economist in Slovenia, considers that FDI does not always enhance economic growth[2].

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[2] It is generally accepted that FDI gives positive impact on economic growth, but Mencinger (2003) suspects this point. He picked up eight EU candidates at that time - Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia – as samples and analyzed correlation between FDI and economic growth during the period 1994-2001. According to him, the assumption that FDI affects economic growth is confirmed, reverse causality, i.e., that growth attracts FDI, is rejected. Surprisingly, statistically robust negative causal relationship between FDI and growth emerged implying that FDI hampered their real convergence with EU. This result conflicts with 'taken for granted' wisdom according to which FDI enhances economic growth because it substitutes domestic savings and investment, and because it brings productivity spillover from foreign-owned to local firms. At an international conference held in Sarajevo in 2003, in his reply to the chairman's question he said that his conclusion applies to some cases and does not apply to other cases depending on countries and that we cannot make generalization.

In Slovenia there are also critical opinions about Mencinger's argument. Svetlicic, for example, criticizes his argument as follows: (i) Mencinger examines the results in the next year of investments. However, the results of investments usually appear after two or three years; (ii) It is erroneous for him to consider that government consumption has been wasted (Interview on December 6, 2004). Also Rojec criticizes Mencinger's argument as follows: (i) There was the financial crisis in Russia in 1998 during the observed period. There are always up and down in economic movement, but he did not take into account these; (ii) He discusses negative spillover. Indeed, there is such a phenomenon. For example, bankruptcy of banks and a case in which a foreign company replaces a domestic company. However, our research could not find clear evidence; (iii) We can say that in spite of a small amount of FDI inflow Slovenian economy can develop, but it is nonsense to say that if there is FDI inflow there will be negative growth (Interview on December 7, 2004). I think that we must examine this point further.

In this way the country has attracted less amount of FDI inflow. However, an exceptional year was 2002, when the Government sold its shares of Ljubljanska banka to foreign investors. 34% of the government share of the largest Slovenian bank Ljubljanska banka was sold to KBC of Belgium (€ 435 million) and EBRD (€ 64 million) and the pharmaceutical company Lek was acquired by Swiss multinational company Novartis (about $ 860 million). As a consequence the FDI inflow amounted to nearly 9% of GDP in 2002 (Lah, 2004, p.11). Joze Mencinger criticizes it as an erroneous decision[3].

Francek Drenovec at the economic analysis division of the Bank of Slovenia (central bank) told about the sale of the Ljubljanska banka's share by the government as follows: If in Western Europe 50% of the total share of the banking sector are owned by foreign capitals it would be said that the share is very big. In Slovenia foreign capitals came to own 55% of the total share of the banking sector. As a result, out of five persons at the top management two or three persons are foreigners. He added as follows: In Croatia the share of the Croatian Telecom was sold to the German Telecom. The latter is not interested in a small country. As a result, the quality of its service has decreased. The reason for the sale of the share by the Croatian Government is that it wanted to withdraw itself from management of the Croatian Telecom. It is impossible to quantify effects of privatization. In the short run a government obtains cash, but in the long run R&D divisions at enterprises will move to foreign countries, losing potential of a country's development.[4] In a newspaper article (Drenovec, 2004) he argues as follows:

> The sale of real estate to get liquid assets is a very costly exit in difficulties for the poor who are heavily indebted and have low credit rate (similar to construction of an expressway through concession). ... We must endeavor for construction and improvement of effectiveness in all the dimensions of complexity of society even if it is a so serious and long-lasting work, and we must also endeavor in order that philosophy of the government should not dwarfed to simply "creation of workplaces" and creation of a nation of dependent and subordinate workers. Stimulation of FDI is of course useful. ... However, if we accept "outsourcing" of the most central function in the system it would

[3] In his reply to my inquiry Mencinger said as follows: Slovenia implemented the rehabilitation of banks. In the West banks are in hands of domestic shareholders. The situation was similar in Slovenia too. However, the government sold about 30% of its share of a bank (Ljubljanska banka) to a Belgium bank. His argument is: "Sell what you need to sell if you need. But don't sell if you don't need to sell". A deficit in international payment was not so much at that time. There was no urgent necessity to sell. He guessed the reason for the sale of a bank's share by the government as follows: Perhaps because it seems politically fashionable. Perhaps the government thought it would meet the principle of "free mobility of capital" which IMF and the World Bank advocated. He added. After being admitted to the EU Slovenia adopted the fixed exchange regime. There is no room for the country to adopt free monetary policy and fiscal policy. Since Slovenia jointed the WTO the country is not allowed to adopt any industrial policy. What on earth remains for a country? We must possess at least banks in our own hands (Interview on December 9, 2004).

[4] Interview with Mr. Francek Drenovec on December 10, 2004.

be a very weak card of the government. In Slovenia "strategies for economic growth", which depends on attraction of FDI are unthinkable. An available complex of productive factors is already to a great extent utilized. If structural components are subtracted the unemployment rate is actually lower. ... We must not compare ourselves with Czechs and Hungarians, for example, for whom [foreign] investors easily calculate excellent profit owing to low wages (later on there remains nothing more). As for the above mentioned, we have today in Europe the best examples with Greece and Portugal. In both countries the environment is entirely open to foreign investment, but their economic growth for 10 years have hardly caught up the average European economy or have been stagnating. The problem of Slovenia (similar to Greece and Portugal) is that we have already attained a matured or saturated level of technological development and therefore appropriate solutions for further development must be searched for in other direction.

V. Secrets of Slovenia's competitiveness

Firstly, positive legacy from the self-managed socialism can be mentioned. The Yugoslav self-managed socialism had a semi (or pseudo) market economy. Managers of enterprises have accumulated experiences and knowledge on market economy. Also workers had strong feeling of belonging to their enterprises.

Secondly, workers in Slovenia are diligent. According to Stanojevic (2004), this country is a society of "work-centrism". Public opinion surveys show that Slovenians' basic values are work and family. Of course, there is a motivation to supplement insufficient incomes, but they do not mind doing weekend work. General manager of the AZ company, which became a part of the German multinational corporation system, testifies that weekend work is absolutely impossible in Germany, but "our people" are willing to do Sunday work because they feel a really strong commitment to the company (Stanojevic, 2004, p.3 and p.9).

Thirdly, on average the people's educational level is rather high, and higher level of workers' skill can be added. It can be said that this is a legacy from the Habsburg Empire. Some people ascribe the country's economic development to the educational system established during the Maria Theresia' rule[5].

Fourthy, its high technological potential should be mentioned. *Revue Elargissment* says that the numbers of patents filed, and, prior to that the R&D carried out, the spending allocated to it and the number of staff working in it, may be considered as indicators of a country's

[5] Interview with Dr. Joze Mencinger on April 1, 1997.

technological potential. In 2001 the average number of patents filed in the applicant countries is on average much lower than in the EU 15: 8 patents per million inhabitants versus 161. It is inevitable. Within the applicant countries, however, there is a big difference. Slovenia stands out in the region with 41 patents per million inhabitants, ahead of Spain (24), which is one of the EU 15. There is also a big difference between the EU 15 and the applicant countries in terms of 3 indicators: R&D expenditure in GDP, distribution between the private and public (State and higher education) sector and the number of employees. *Revue Elargessment* adds that it seems that there is a threshold of private participation at around 65%. Below, the global effectiveness of expenditure is definitively lower. And beyond, the global marginal effectiveness decreases. Those which are relatively well positioned within applicant countries are Slovenia and Czech Republic. For both countries the number of patents filed may be expected to increase steadily over the next few years (*Revue Elargessment,* No.44).

Table 3 Indicators on technological potentials

Country	Patents filed per million inhabitants in 2001	R&D expenditure (as a % in GDP, 2000)	Share of Private Companies in R&D expenditure	Employment in R&D (as a % of the active population
EU15	161	1.93	65	1.38
Germany	310	2.48	71	1.62
Greece	8	0.67	29	
France	145	2.13	64	
Ireland	86	1.21	73	
Portugal	5	0.76	23	
Finland	338	3.37	71	2.58
Spain	24	0.94	54	
Sweden	367	3.78	75	
Acceding 11 countries	8	0.78	45	0.84
Hungary	19	0.80	44	1.11
Poland	3	0.70	36	0.73
Czech Republic	11	1.33	60	0.93
Slovakia	6	0.67	66	0.86
Slovenia	41	1.52	56	1.36
Estonia	11	0.66	23	0.98
Latvia	8	0.48	40	0.69
Lithuania	2	0.60	22	0.91
Bulgaria	2	0.52	21	0.48
Romania	1	0.37	69	0.39
Cyprus	14	0.26	21	0.51

Source: Eurostat, Quoted from Revue Elargissment, No.44.

Fifthly, there is social dialogue by tripartite parties, ie., representatives of employer organizations, trade unions and the Government. The Economic Social Council (ESC) was established in September 1994 with a purpose to articulate and channel the interests of government, employers and workers and coordinate the labour market forces. Owing to this, domestic consensus can be easily established on lower level of inflation to satisfy the Maastricht criteria. This mechanism enables a moderate wage increase, thereby secures the maintenance of strong competitiveness of the industries in the country.

Sixthly, Slovenia's development strategy should be mentioned. It can be summarized as pursuit for market niche and thorough internationalization of its economic activities. According to Svetlicic (1997), Smallness of domestic markets is not important. Access to the world markets is decisively important. Small countries like Slovenia do not need to have a whole set of industries. Instead, they should find good areas appropriate to them, i.e., niches and specialize in the areas. For that purpose, they should thoroughly internationalize all kinds of activities (Koyama, 2003, p.63).

As I mentioned, Slovenia lost markets of the former Yugoslavia. Slovenian companies endeavored to increase their exports to West European markets in order to substitute for plummeting exports to the former Yugoslav markets. In 1992 exports increased by 33% and imports by 28%. At the same time, fortunately enough, Slovenia succeeded in inheriting the whole quota of exports (on textile and electric appliances) which the EC had assigned to the former Yugoslavia. As long as Slovenian companies stick to domestic markets, they cannot enjoy economy of scale and economy of scope. If a company wants to survive, it must internationalize its activities thoroughly. Companies which have succeeded in Western markets are included in Table 4.

Table 4 Highly Internationalized Companies in Slovenia

Case	Industry	Key arguments for selection
Gorenje	Electric home appliances	The biggest, oldest and most internationalized Slovenian multinational company
Prevent	Manufacturing of made-up textiles	Vertical integration in the global car industry, a true leapfrogging global, efficiency-seeker
Iskraemco	Electronics	Early internationalization starter, efficiency-seeker
Krka	Pharmaceutical	Knowledge-intensive, regional/global player in highly concentrated pharmaceutical industry
Kolektor	Manufacturing of electrical motors and generators	Inward-outward experience, global niche, intermediate product
Mercator	Trade	Regional player, first-mover advantage

Note: Lek, a pharmaceutical company, is included in the original table, but here it is omitted because the company was acquired by a foreign company.
Source: Jaklic and Svetlicic (2003), p.182.

In the case of Gorenje, for example, the company exports about 93% of its total production, 80% of which goes to the EU. It has 29 subsidiaries located in 18 countries and 6 agents. According to Daniels and Svetlicic (2001), there are a number of niches in producing intermediate products for which markets are lucrative yet too small to attract the interest of very large companies. One very good example of such a niche involves a small company from a small country, Kolector from Slovenia. This company produces commutators that have many uses in the consumer goods industry (such as in household appliances), in more sophisticated professional machines and tools and, finally and most significantly, in all types of cars (Ibid., p.225).

VI. Slovenia as a Capital-Exporting Country

1) Reentering the markets of the former Yugoslavia

As Joze P. Damjan has intensively studied the markets of the former Yugoslavia and surveyed the current exporting and investment activites of 115 of the largest Slovenian companies, here I will explain the markets on the basis of his study. During the period of the former Yugoslavia there used to be vertical supply chains across all the republics. The former Yugoslav markets (FYM) provided the Slovenian economy with a base for necessary input, such as raw materials and that are scarce in Slovenia, semi-manufactured products, and agricultural products. After processing either within Slovenia or in the local affiliates of Slovenian firms, final products were then sold on both Western and the single Yugoslav market. After the breakup of SFR Yugoslavia and the outbreak of war, however, these supply chains were interrupted, and Slovenian firms were forced to obtain the necessary inputs from the countries of CEFTA. As mentioned before, from 1992 through 1999 Slovenia's trade has reoriented to the EU (Damjan, 2004, pp.337-339).

In 1999 the trend has reversed. Now that the political situation in the individual successor countries of the former Yugoslavia began stabilizing, there are signs of economic recovery, which will stimulate demand. In addition, by that time Slovenia has established rapprochement with these countries, and Slovenia has signed free trade agreements with most of them. Slovenian firms tend to be winning back the market shares they hold before 1990 (Ibid., p.339).

The share of exports to the former Yugoslav markets remained relatively stable at about 16% from 1993 until the end of 1990s. In parallel with rapprochement with countries of the former Yugoslavia its export to these markets began to increase in 1999, and its share increases to 18% by 2002. By contrast, imports from the former Yugoslav markets stagnated in the 1990s. The consequence has been a huge and increasing trade surplus in trade with the former

Yugoslav markets. In 2002 the surplus amounted to €1.3 billion, enough to completely offset Slovenia's deficit in trade with the EU (Ibid., p.339). I think that Slovenia's advantage in the markets of the former Yugoslavia can be found in the following points: Linguistic similarity; Knowledge on local people's taste; Personal connections; and First-mover's advantage.

Of course, there are less competitive industries in Slovenia. Firms in less competitive industries place special emphasis on gaining market share in the markets of former Yugoslavia. Slovenian firms in the agriculture, food, paper, chemicals, and wood industries can on average double their export prices when exporting to the markets of former Yugoslavia compared with exporting to the EU markets (Ibid., pp.339-340).

Damjan's survey reveals that the largest Slovenian firms still prefer conventional exports over FDI as the mode of entry for all the countries of the former Yugoslavia. However, some FDI-promoted sales take place in Croatia. These firms' decisions depend on entry costs and stability of local business environment. Where entry costs are higher relative to other factor (such as the stability of the local business environment and the scale of operations), firms are more likely to penetrate these markets through FDI. Where relative entry costs are low, firms will continue to penetrate the markets through exports. The main entry barriers that Slovenian firms face in Croatia and Bosnia and Herzegovina (BiH) are high tariffs and hindered entry into local store chain, followed by transport costs. Reflecting the greater distance involved in trade with FR Yugoslavia and Macedonia, transport costs are the key trade barrier, followed by high tariffs and local store chains. In Croatia and BiH the estimated entry barriers are modest, whereas in FR Yugoslavia and Macedonia, the barriers are almost uniformly higher. In addition, the estimates of the stability of local business environments play an important role in the firms' decisions. In contrast to Croatia and BiH, FDI might be encouraged by the higher trade barriers in FR Yugoslavia and Macedonia, but the unstable economic and political climate offset the probability. Therefore, exports are the prevalent mode of market access for Slovenian firms to most of the FYM. So far, only in Croatia do Slovenian firms feel comfortable enough to set up local production establishments to serve the local market (Ibid., pp.342-344).

In case when investment entry mode was chosen, as motivation of FDI low labor cost and possible relative resource abundance has not been so important for the Slovenian firms conducting business in the FYM. Investment entry mode was chosen, first of all, as means of securing payment (due to poor financial discipline of local customers), followed by high entry costs and low labor and material cost (Ibid., pp.344-346). So far, Slovenian firms have mainly invested in representative offices and their own stores, with their chief task being to promote trade, that is, imports of goods produced by Slovenian parent firms. Only 20% of Slovenian firms investing in the region have established local production facilities. In this way, trade

promotion so far clearly dominates efficiency seeking as a motivation for Slovenian FDI in the FYM. An analysis of the investment plans of Slovenian firms up to 2004, however, reveals some change in firms' investment preferences. Trade promotion motive for FDI in the FYM has been replaced by a more distinctive efficiency-seeking motive (Ibid., p.347).

Slovenia's relative advantage in the markets of former Yugoslavia is fragile for the following reasons: Firstly, large balance of payments deficit in all of the countries of former Yugoslavia. There is a possibility to cut their imports at least in the short run; Secondly, Slovenia's FTAs with the countries of former Yugoslavia were abandoned after the EU accession in 2004; Since exporting to the markets of former Yugoslavia is less demanding in terms of product quality, any increased export orientation to these markets could potentially hinder the further restructuring of the firms involved. Slovenia's advantage in markets of former Yugoslavia will sooner or later disappear. Damjan recommends that in order to avoid unfavorable trends in the future, Slovenian firms, especially those in less competitive industries, should place more emphasis on possible relocation of their manufacturing activities through FDI to the FYM instead of specializing in exports as at present (Ibid., p.347). I think that hereafter Slovenia's outward FDI will increase more and more.

2) A Capital-Exporting Country

Before explaining Slovenia's outward FDI, I would like to confirm the situation in the inward FDI. Let us look at FDI stock by home countries as of 2003. Austria occupies the first place (23.2%), followed by Switzerland (21.8%), Germany (7.8%), France (7.5%) and Netherlands (5.4%) (WIIW, 2005, p.33). To what fields FDI stock has been distributed? Let us look at Slovenia's inward FDI stock by economic activities as of 2003. Whole sale, retail trade, repair of vehicles, etc. occupies the first place (32.0%), followed by Manufacturing (29.6%), Financial intermediation (16.2%), Real estate, renting & business activities (12.2%) and Electricity, gas and water supply (5.3%). As is shown, Manufacturing occupies only the second place, but let us look at the breakdown. Pulp, paper & prod.; publish. & printing occupies the first place (16.9%), followed by Rubber and plastic products (14.5%), Chemicals, prod. & man-made fibres (13.2%), Machinery and equipment (11.7%) and Other non-metallic mineral products (8.6%) (Ibid., p.54).

Table 5 FDI inflow and outflow US$ million

	1998	1999	2000	2001	2002	2003	2004
FDI inflow	216	107	136	370	1686	337	516
FDI outflow	-6	48	65	145	153	466	498

Source: WIIW (2005), p.18, p.24.

Table 6 Slovenia's Outward FDI Stocks and Flows in the 1990s US$ million

	1993	1994	1995	1996	1997	1998	1999
Outward FDI stock	280.6	354.0	489.9	478.4	452.4	599.6	621
Outward FDI flows	1.3	-2.9	5.1	6.3	35.6	1.7	37.5
Outward FDI stocks as a % of GDP	1.5	2	2.5	2.7	2.5	2.3	3.2

Source: Jaklic (2001), p.387.

Table 7 Stocks of Inward and Outward FDI US$ million

	1998	1999	2000	2001	2002	2003	2004
Inward FDI stock	2777	2682	2893	2605	4133	6337	7500
Outward FDI stock	636	627	768	1005	1522	2311	3000

Source: WIIW (2005), p.19, p.25.

It is noteworthy that Slovenia is a country with a relatively bigger amount of outward FDI. According to Jaklic (2001), the first Slovenian outward FDI dates back to 1951. As many Slovenia's companies had economic relations with their counterparts in Republics of the former Yugoslavia, parallel to the disintegration of the Federation, they became foreign direct investors overnight. The exports have been complemented by a more rapid expansion of outward FDI especially in the second half of 1990s. In the 1990s outward FDI remained at low level, but it began to increase in 1999 and surpassed inward FDI in 2003, and inward FDI and outward FDI are competing with each other in 2004 (See Table 5 and Table 6). During the period 1993-2004 the total stock of Slovenian outward FDI increased from US$ 280 million to US$ 3 billion (See Table 7). Although its outward FDI is still smaller than its inward FDI in terms of the stock, if we pay attention to the flow we can say that Slovenia is becoming a capital exporting country.

Let us examine the outward FDI stock more in detail. If we look at the outward FDI stock as of 2003 by economic activities we can find that a majority is occupied by Manufacturing (53.5%), followed by Wholesale, retail trade, repair of vehicles, etc. (17.2%), Real estate, renting & business activities (16.4%), Financial intermediation (6.7%), Transport,

storage and communication (4.0%), etc. If we look at the breakdown of the Manufacturing we can find that Chemicals, prod. & man-made fibres occupies the first place (34.2%), followed by Food products, beverage and tobacco (13.3%), Machinery and equipment (12.7), Textiles and textile products (9.8%) and Electrical and optical equipment (7.1%), etc. (Ibid., p.55). If we look at the outward FDI stock by host countries as of 2003 we can find that markets of the former Yugoslavia as the destination of Slovenia's outward FDI occupy 57% of its total outward FDI stocks. Croatia occupies the first place with 609.8 million (33.0%), followed by BiH (11.2%), Netherlands (7.8%), Serbia and Montenegro (5.5%). Germany (5.5%), Poland (5.3%), Macedonia (4.3%), Austria (3.5%), Russia (3.3%), Romania (1.6%) and Bulgaria (1.1%) (Ibid., p.57).

3) Challenges Slovenia is facing

Slovenia is facing the following challenges: Firstly, classic and traditional industries have declined. For example, the textile industry removed its factories to BiH and Serbia. The Johnson Controls, an American company which produces car seats, has produced headrests for car seats in Slovenia until recently, but it removed its factory to Croatia because the labor costs has become too expensive. Wood industry is in a similar situation. In the case of a steel factory in Jesenice, the government has been a major owner, but the new government intends to sell the factory. The country is urged to upgrade its industrial structure.[6]

Secondly, there is high job security, but at the same time there is a split among generations. Elderly workers are assured their jobs on the one hand, and younger generations are not assured their jobs on the other hand. Similarly there is a big cultural gap between the both. Many young people are obliged to do temporary jobs and expose themselves to a visible or invisible menace of unemployment. As a result, the birthrate tends to decline. This is a serious matter for the country's future. It is necessary for the country to find a way to assure young generations their jobs and at the same time maintain its strong international competitiveness (Stanojevic, 2004).

Thirdly, Slovenia joined ERMII in June 2004. The country plans to adopt EURO in the early 2007. There is domestic consensus on lower level of inflation to satisfy the Maastricht criteria. Slovenia is required to keep and enhance its international competitiveness while maintaining domestic consensus on ERMII.

[6] Interview with Dr. Miroslav Stanojevic on December 8, 2004.

Conclusion

In Slovenia privatization was implemented with preference given to insiders and therefore FDI inflow has been less than the other Central and East European countries. Nevertheless, its economic performance has been better. The reason for why such a unique way has been possible seems to consist in the spirit of independence and self-reliance that Slovenia has firmly maintained in spite of a small country as well as relatively stronger international competitiveness which has supported the spirit. Its international competitiveness derives from the legacy from its past and the high level of its technological potential.

Slovenian companies have pursued to find niche in world markets and specialize in them, and for that purpose they have endeavored to internationalize all kind of activities. The small country's strategy has so far been successful.

In terms of FDI performance index and the ratio of FDI to capital formation in 2001 Slovenia attracted FDI inflow at the same level as Russia or a little bit lower level than it. However, this does not mean that the investment climate in Slovenia is as bad as in Russia. Rather it means that Slovenia has a matured economy which can develop with a smaller amount of FDI inflow and exports a certain amount of capital by itself. Its export of capital has not been capital flight as most cases in Russia but substantial outward FDI, a majority of which has been directed to markets of the former Yugoslavia.

Fortunately enough, the tide of globalization has been so far running in favor of Slovenia. Hereafter, however, the country will have to face challenges by China in world markets in the context of globalization. We should pay attention to whether the small country will be able to continue its development strategy.

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