Transcript of a conference call on Slovenia

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Ms. Zucchini: Good morning, this is Silvia Zucchini, from the Communications Department of the IMF. Good morning and good afternoon, if anyone is connected from other time zones.

We are here this morning to discuss, with Antonio Spilimbergo, the IMF mission chief for Slovenia, the main issues covered in the 2013 Article IV Consultation Report, which will be published this morning at 10:00.

You should have received the Staff Report, an IMF Survey interview with Mr. Spilimbergo, and a press release. I will now turn the microphone to Mr. Spilimbergo a few opening remarks before opening the floor for questions.

Mr. Spilimbergo, please go ahead.

Mr. Spilimbergo: Good morning, this is Antonio Spilimbergo. I am the mission chief for Slovenia up to now. This was my last mission after a long experience during a particular moment, because Slovenia was one of the countries most hit by the crisis. After Greece, it has had the second largest drop in GDP in the euro area, and when the mission took place in October 2013, there was a lot of concern about the ability of Slovenia to cope with these issues.

As you may know, on December 12th, Slovenia announced a comprehensive plan to deal with the banking problems. This took into account the results of the asset-quality review and stress test, and included quite substantive recapitalization of the banks. In particular, (inaudible) publicly (inaudible).

I said the problem was urgent, but the roots of the problem were deep-rooted in the past. And, basically, when the crisis hit, it highlighted some structural weaknesses which were present in Slovenia even before the crisis. And these weaknesses included a perverse and troublesome inter-linkage between the banking sector and the state and the corporate sector. This led to a massive over-leveraging of the corporate sector, one of the highest in Europe, which, in turn, had a very bad effect on the bank-balance sheet because of the banks. And this, in turn, became a problem for the state, given that the state owns the majority of the banking sector.

So, even though the manifestation of fiscal problems was in the banking system, the deep roots were in the corporate sector. So the main message of our 2013 Article IV report is that Slovenia was very good at taking care of the banking problems, because it accepted and implemented a very sort of independent asset quality review of the banking sector, and decided to recapitalize, as indicated by, suggested by the stress test.

However, now is the moment to solve the roots of the problem, which is the corporate sector, and the inter-linkage between the state and the corporate sector. This requires more time, it's more difficult. But our message is that unless you do this, the problem will come back in the future. It's a little bit like take antibiotics, the fever goes down immediately, but unless you keep on taking up to the end, the problems come back later on.

Questioner: I wonder whether I could ask Mr. Spilimbergo to say more about the problem being deeply rooted in the corporate sector. We know that state-owned enterprises, for example, occupy a big share of the Slovenian economy and, you know, that the government has got plans to try and deal with the sort of tangled relationships between state-owned companies and the sort of ownership structure which is often indirect through funds.

I wonder whether he could perhaps sort of expand upon what exactly is this problem in the corporate sector, how specific it is to Slovenia, what sort of measures are needed to tackle it, how far he believes the government's own measures -- including, obviously, the planned privatization measures -- how far they'd go towards tacking it.

MR. Spilimbergo: Thank you. This is a very important question, because the relationship between the corporate and the state sectors in Slovenia is very complicated.

To begin with, three observations: first, there is the usual (inaudible), which is common in other countries. The state in Slovenia still owns certain major corporations— the transportation, the airport, the airline industry, the highway, the port, the infrastructure, meaning the telecommunications. But this is common, to a lesser extent, to other countries. But in addition to this, the state also owns the three main banks. And this is probably the source of the problem. Because the governance of these three banks has been problematic, in fact. And, being a small country, the relationship between customers and bank has not always been (inaudible) relationship. And so loans, in the past, especially, tend to be extended not in a proper way.

On this, here, there is a third issue. This bank came to own many corporate corporations, not financial corporations, including breweries, supermarkets chains, newspapers, etc. And this is very incestuous, because banks are not good at managing breweries, as you can imagine. And, in particular, public banks have no expertise in managing breweries or supermarket chains. This has been a problem. Because (inaudible) bank you have, such a pervasive public presence, it will create also a bad (inaudible).

There is a fourth characteristic, which is quite peculiar. In fact, public ownership was not organized very properly. So there were many agencies that had interest in various companies. Sometimes the objectives were conflicting among each other. This creates the problem, and the lack of general direction. So, not only do you have a lot of public ownership, but you have little scrutiny, little accountability, and that there were (inaudible) with the financial sector. All this situation, in a small country where (inaudible) relationship.

All this wouldn't have been a problem if the financial crisis hadn't hit Slovenia so much in 2008 and 2009. But because on these pre-existing weaknesses, the big drop in GDP created a very complex situation.

In addition, in the period 2006-2007, at the time of entry of Slovenia in the euro, there was an additional issue to consider. There was the credit boom; credit was growing at an unsustainable way. It was financed mostly by publicly-owned banks, which were financing themselves through short-term debt in the Wall Street market. So, there was an intermediation between short-term money from abroad coming to public banks, and given to domestic entrepreneurs.

This created a system of (inaudible) banking, because you have a very cheap money. And (inaudible) bank according to criteria which were not (inaudible) business criteria.

In addition, from 2002 until 2007, Slovenia implemented some privatizations, which were done in some cases not for (inaudible) groups that (inaudible) economy, tycoons, basically, leveraged (inaudible) very disproportionally in order to buy companies, and they didn't have the money nor the ability to run these companies. That created a major problem.

Finally, at the time of, before the global financial crisis, Slovenia had also a construction boom. This was done mostly by domestic companies. And in 2008, these companies didn't find new jobs to do. So this meant major construction companies basically went bankrupt. Also, there, the problem was in part that these companies were directly linked to the state, which created a problem.

So, the problem is quite complex. What to do next? And here, give the complexity of the problem, you need a multi-pronged approach. One issue is to rethink seriously the role of the state, and what is the comparative advantage of the state, and in managing the banks.

The government has already decided that it needs to privatize the second largest bank, NKBM, and this is a really welcome step.

The second step is the government has announced is to improve the governance of publicly-owned banks. And this is important—but, for the moment, this is just a statement.

Third, they intend to establish a new agency for public ownership, which is more transparent and accountable. And this is also very important.

Fourth, they will undertake the reform of the corporate insolvency regime. Up to now, the corporate insolvency regime was not really efficient. It was mostly to cover, to protect existing owners, rather than the company. Nowadays, with a new insolvency regime which was just introduced on January 1st, there's more attention to the viability of a company. But, it will take time, because Slovenian companies are among the most in debt in Europe. And so, it will take time before they can grow out of this debt.

Questioner: I'm afraid I was cut off during the answer. So, forgive me if I'm just going over something that Mr. Spilimbergo has already said. I would like to ask about the figures given in the staff report for public debt as a percentage of GDP. How worried should one be about possible liabilities that might find themselves onto public debt, precisely because of the state entanglement in the economy?

Mr. Spilimbergo: Well, if you look at the contingent liability, which are mostly in publicly-owned enterprises, it's about 20 percent of GDP.

This is mostly linked to DARS, which is the highway company, the company which administers the highway. That has a clear revenue flow given by the payments from the tolls. I'm not really in the position to evaluate that loan, not that portion. But it's the bulk of the contingent liability.

The other contingent liabilities were on the banking sector. But now, after the asset-quality review and the stress test, a large part of it was taken care of by the large recapitalization.

We estimate that, at the end of 2014, Slovenia will have about a debt-to-GDP ratio of 78 percent, which is large. At the end of 2008, just at the beginning of the crisis, Slovenia had a debt-to-GDP ratio of 22 percent. It was one of the countries with the lowest debt-to-GDP ratio. Still, at 78, Slovenia is lower than the euro average. But what I think is worrisome is the rate of increase of this public debt.

As I said, the key issue there is to do a serious restructuring of the corporate sector and the state, because that creates perverse incentives, and can create new debt and new contingent liability. And this is the reason why we have insisted so much in our report that unless a proper corporate structure is done, the risk will persist.

Questioner: Only to clarify that the 20 percent of GDP, that is not including the banks.

Mr. Spilimbergo: The 22 percent was public debt at the end of 2008, and did not include the banks.

Questioner: No, sorry. I meant when you referred to the contingent liabilities you mentioned a figure of 20 percent of GDP. And that doesn't include the banks, because they've been dealt with.

Mr. Spilimbergo: I don't think so. In fact, it includes SID, which is a development bank. So, a large part of the 20 percent include, as I said, the DARS, their highway company, and some part also includes SID, which is the state development bank, which was not covered by the stress test.

Questioner: I would like to ask you, Mr. Spilimbergo, are you convinced that Slovenia can solve its problems alone? Are you leaving the mission on Slovenia with the conviction that the prime minister, the finance, minister, and the governor of Slovenia will solve our problems without outside help?

Mr. Spilimbergo: Thank you very much for the question. The authorities have shown repeatedly, and said repeatedly, that Slovenia can solve the problem by itself. And they act accordingly.

I must say that, both publicly and privately, the authorities have shown the determination consistent with this message, and so I feel that the most problematic moment was to find funds for the recapitalization, and this was done. So, if anything, the most acute phase of the crisis is gone.

Now, to me, it remains crucial to continue with the determination to do things, now that the acute phase of the crisis is gone, rather than falling into complacency. The authorities so far have shown determination, but risks will persist.

Ms. Zucchini: As there are no further questions, we will have a few closing comments from Mr. Spilimbergo, and then we will finish the call, just in a few minutes.

Please, Mr. Spilimbergo, you have the floor.

Mr. Spilimbergo: Thank you very much. Our report will be made public today. As people have focused a lot on urgent issues concerning Slovenia, I think it's important to take a longer view on issues pertaining to the country. There are few problems that we already discussed. One is the role of the state, which is difficult, and needs some fierce thinking during the next few months.

The second is FDI. Slovenia has been one of the countries with low FDI penetration in Europe. This is problematic for two reasons: first, because we know that FDI bring new technology, new experience from outside, and it's important to starting the process of internationalization; second, because FDI also is equity capital rather than debt. So, if a negative shock happens, you share the risk with the foreigners rather than just domestically. Among the problems of Slovenia, I think it took a lot of capital from outside, but as debt rather than equity.

Third—and, to me, this is most important issue, is that there is clear evidence—and we have this discussed in our staff report—that FDI employs disproportionately younger people. And Slovenia has large youth unemployment, and this is bad. Having FDI will help address this issue. So I gave these three reasons to explain why internationalization and FDI are important.

Second, in the long run the fiscal situation is an important factor. As I mentioned, by the end of 2014 the debt-to-GDP ratio will be almost 78 percent. This means that the fiscal accounts have progressively to produce a primary surplus to reduce the debt. And we identified in the past, that further pension reform is necessary. It's not a short-term necessity because, up to now, there is a freeze on the pension, but it's important to build up a consensus to do a second stage of reform.

So, I highlighted three issues where we think that Slovenia should focus on: completing the process of internationalization with FDIs, reducing the role of the state in the economy, and putting on paid-footing the fiscal account.

Ms. Zucchini: Thank you very much to Mr. Spilimbergo and to other participants today. Have a good day.

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