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Economic Transformation in Slovenia: From a Model Example to the Default Edge

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Abstract: The Slovenian economy appeared on the brink of bankruptcy at the end of 2013. The situation was caused by high level of classified debts in state-owned banks. This can be seen as surprising because Slovenia used to be (for a long time) considered as a (textbook) example of the gradualist transformation approach. The goal of this article is first to describe the transformation process in the country and consequently to determine causes of the economic problems that resulted in the 2013 crisis. The article concludes that the economic problems were rooted already in the specific functioning of the centrally planned system in Yugoslavia. These specifics had a direct influence on the transformation process in the country and stood behind the application of gradualism. Among the most telling features of gradualism were slow privatization, cold attitude towards foreign investment and the foremost lasting casual economic environment caused by behaviour of the state-owned banks. My conclusion is that the country's economic problems can be ascribed to gradualism and that they are a clear example of the path dependence development.

Key words: Slovenia, economic transformation, banking system, gradualism

JEL Classification: P2, N14

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Introduction

Slovenia recently (late 2013) came into the centre of economists' interest because it appeared on the brink of bankruptcy and seemed to be the next hot candidate for the Eurozone bail-out.[2] It has been able to avoid it up till now (spring 2016) but its financial system underwent a deep test and the fiscal costs were enormous. However, the state of the Slovenian economy was not always so critical. Before the world financial crisis, the country had achieved long-lasting and stable economic growth. It had been often mentioned as a successful gradualist transformation alternative to the shock therapy (for example Stiglitz, 2007). I would like to argue that Slovenian problems during the financial crises should be attributed primarily to the gradualist approach and in fact even to

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[2] Slovenia is a relatively small country with 2 million inhabitants. It ranks among developed countries with GDP per person reaching 29 650 (IMF, 2014). But (probably due to the crisis) the country still has not graduated from the EBRD.

the particular functioning and values inherited from the Yugoslav socialist economy. Slovenian development can thus be seen as an example of path dependency.

The goal of the paper is first to analyze the process of the economic transformation in Slovenia and on this basis find out causes of the financial crisis. The causes of the crisis are partly to be found already in the Yugoslav centrally-planned system. That is why the first part of this paper deals with the specifics of the economic system used in socialist Yugoslavia. Then I shortly mention the political development that created a framework for the applied economic policy. The policy itself is described in the following section. I pay special attention to privatization and to the development of the banking sector that were both in the very core of the financial crisis. Consequently, the text is heading towards its final section, where I analyze the country's particularity – gradualism. Slovenian gradualism (or country specifics) brings together historical aspects from the centrally-planned system with the economic policy applied during the transformation period. I argue that the gradualist attitude seemed to be serving the country well for a long period (good economic results) but at the same time it was undermining the long-run economic stability and became the main culprit of the financial crisis.[3]

1. Specifics in functioning of the Yugoslav economy

The unique setting of the socialistic economy in Yugoslavia built foundations that had a direct influence on the consecutive development. I discuss first of all the relationships among the republics and the centre/federation; then the overall development of the economy and finally functioning of the economy on the microeconomic level.

Yugoslavia consisted of a highly heterogeneous group of republics. Slovenia was by far the most developed and industrialized one–for example in 1990, Slovenia with its 2 million inhabitants formed only 8% of the population total in Yugoslavia but the Slovenian economy produced 20% of Yugoslav GDP and 29% of overall exports. Slovenia was the most developed country in the Eastern Bloc as well. The economic differences among the republics of Yugoslavia were equalized by fiscal transfers from the more developed to the less developed republics. Slovenia's contribution to the federal budget was 16.8% (Shortall, 1996).[4] Constitutional changes in 1974 resulted in a situation when de facto only defence, international politics and monetary matters stayed in the hands of the federal authorities. The separation went so far that each republic had even its own central bank and the control above overall money supply was generally weak

[3] I would like to point out that while working on the paper, I was confronted with troubles regarding the data. There are foremost problems with the length of the consistent data series. It is difficult to find relevant and homogenous data that would cover the whole period in all transition countries but it is an even more serious problem in a country that emerged after the disintegration of Yugoslavia. The second point is that the article is primarily targeted at analysing problems in the Slovenian economy however there are also data for other countries in several figures and tables. The main goal of this paper is not a comparison and these data should only help the reader to see the process of Slovenian economic transformation in a broader context.

[4] Cvikl, Kraft and Vodopic (1993) write that the redistribution policy was not successful and, in the long run, the differences among the republics were increasing – for example GDP per person in Slovenia increased from 160% of the Yugoslav average in 1955 to 200% in 1988 and on the contrary this indicator for Kosovo declined from 40% to just 24%.

(Barlett, 1996). At the same time, the fiscal self-management was applied, which meant that government expenditures were fragmented into hundreds of programs on the republic level.

The socialistic economic system in Yugoslavia, created after a schism with the Soviet Union, was highly specific and often labelled as market-socialism – a system set somewhere between the market and the centrally-planned systems (Estrin, 1991). It shared common features with other centrally-planned economies, like a highly limited share of private ownership, but the Yugoslav companies were generally more market orientated and the whole economy was more integrated into the western markets. The official central planning system was scrapped already in 1965. Additionally, there was always a significant level of price flexibility the inhabitants did not need to suffer from chronic shortages of consumption goods and some of the companies (e.g. ski producer Elan) were able to successfully compete on the world markets. But general economic development was highly unstable and fluctuating. Yugoslavia suffered from several waves of high inflation. Furthermore, its economic results started to worsen following the oil shocks of the 1970s (Ferfila, Phillips, 2010).

The country was heavily borrowing on international markets during the 1970s and it was hit by a debt crisis at the beginning of the 1980s. Consequently, Yugoslavia was not able to re-pay its debts. The following decade was marked by reforms and retreats. An austerity programme was approved in 1982 in reaction to debt problems. The program was partially successful in stabilizing the economy but the Mikulic government abandoned this policy and loosened restrictions already in 1984 (Barlett, 1996). Growing debt was a natural consequence and another crisis hit the country in 1987. On the other hand, the economy progressed towards the market; already in 1987, 40 % of all prices were set free and in the 1988 – 89 period the government liberalized most of the remaining prices and imports. In 1989, 87 % of imports were already liberalized (Pleskovic, Sachs, 1994). At the same time, steps towards reforms in the corporate and banking sectors were being taken as well.

At the beginning of 1990, the situation was critical and the Markovic government introduced yet another stabilization program.[5] The reform parcel consisted of short-run measures – wage freeze for half of the year, 20 % devaluation and fixing of the exchange rate, convertibility of the dinar for transactions on the current account, fiscal and monetary restrictions and tough bankruptcy law. These measures were successful in securing a temporary stabilization of the economy – inflation and foreign debt declined. But the individual republics were not willing to follow the restrictive economic policy and launched measures targeted against these reforms and even against each other.[6] When the period of wage regulation finished, price growth again accelerated. Austerity was one of the hot topics in the first free elections in the mid-1990 – politicians generally promised to abandon them. The government was no longer able to carry on imple-

[5] Gligorov (2004) mentions that contrary to other ex-socialist countries, these reforms did not take place after political changes and thus the government could not claim political legitimacy. Generally speaking, the government lacked political capital that existed in countries like Poland or Czechoslovakia.

[6] For example Serbia announced tariffs against Slovenia and Croatia in an attempt to shelter domestic industries (Barlett, 1996).

menting structural changes, bankruptcy law, nor fiscal and wage discipline. For example, Serbian government increased the volume of money in circulation and, in direct opposition to the Markovic government's policy, it also increased pensions. The total of the volume of money in circulation increased by 138 % in the first ten months of 1990 and inflation reached 122 %. The IMF suspended providing promised credits and developed countries froze their loans to Yugoslavia as well (Barlett, 1996). There was a growing lack of foreign (hard) currencies. Runs on banks appeared in the course of the year and people were withdrawing their savings (foremost in foreign currencies). Foreign exchange reserves were naturally disappearing from the coffers of the central bank as well (Mencinger, 2004). In the summer of 1990, exports sharply declined and the federal government had to devaluate the dinar from 7 to 9 against the German mark (Pleskovic, Sachs, 1994). The country suffered from a record high current account deficit and foreign debt reached USD 16 billion at the end of 1990. The division of this debt was another source of tensions among the republics. Generally, after a promising start, the Markovic reform program ended in total disarray. The government approved yet another program in July 1991 but it was short-lived because the country was already falling apart.

The overall development in the 1980s is summed up in Table 1**.** The facts mentioned above account for the poor economic performance of the country. GDP per person declined by more than 5% in the whole Yugoslavia during the decade. On the other hand, there were significant differences in the extent of this decline among the respective federal republics. Table 1 shows the straight disparity in the level of development among the individual republics as well.

Table 1: Gross Domestic Product per capita in Yugoslavia in 1980 and 1989 (in 1972 USD)

	1980	1989	Change (in %)
All Yugoslavia	17764	16820	-5.3
Slovenia	35320	33103	-6.0
Croatia	22505	21238	-5.6
Bosnia	11722	11424	-2.5
Montenegro	14034	12398	-11.7
Serbia	17453	17429	0.0
- Vojvodina	20029	20063	+0.0
- Kosovo	5013	4317	-13.9
Macedonia	11949	10891	-8.8

Source: MILLS K., "GDP in Yugoslavia: 1980-1989

The third aspect that I would like to analyse is micro-economic development, which can be seen as a cause of the overall weak economic performance. Yugoslav system was characterized by self-management socialism. This system started to come into effect already in the 1950s when it replaced state ownership in the corporate sector. The core of the system was the high independence of the companies in the decision-making process. Employees organized in workers' councils enjoyed a very high level of independence. The consequence was that companies were neither private nor state-owned but "socially owned". This made employees and management in the respective companies believe that the companies were (even though not de jure) de facto theirs (Gligorov, 2004). The system seemed to be efficient in the first years after its implementation but the companies became less and less efficient in the long run. This development was enabled by soft budget constraint. It generally meant that profitable companies were discretionally taxed and money was provided to loss-making companies via banks. Another consequence of the self-management system was a relatively low level of the private sector in the economy.[7]

To sum up the economic development in Slovenia We can consider several main aspects. To begin with, the collapse of Yugoslavia put Slovenia in a difficult position. The macroeconomic situation was highly fragile with a huge debt, hyperinflation and a high level of imbalances in the economy. On the other hand, Yugoslavia had already made several steps in the direction towards a market economy – foremost prices and imports were nearly unrestricted. The system on the microeconomic level was based on self-management with significant power in the hands of employees. At the same time, political relationships among the members of the federation were extremely tense. All of these aspects had a direct impact on the consequent political and economic development.

2. Politics in Independent Slovenia

The political development in the country consisted of two aspects – outer and inner. They were understandably overlapping but I can consider the main aspects of the development separately. I start with the outer relationships. Slovenia was one of the republics that struggled to gain more independence. In a referendum that took place in December 1990 more than 90 % of the inhabitants voted for the country´s independence. Slovenia declared its independence on 25th of June 1991. As a consequence, the Yugoslav army attacked the country. The war lasted for 10 days (amounting to 200 casualties) till the European Community mediated an armistice. Following negotiations that were not successful and the Slovenian parliament re-declared independence. The European Community acknowledge Slovenian independence on 15th of January 1992. The war inside ex-Yugoslavia continued till 1995. Slovenia was affected by disrupting ties to other markets as well as by incoming refugees.[8]

The country progressed in integrating into western structures at a considerably quicker pace than other ex-Yugoslavian republics. Slovenia became a member of the IMF in 1993, GATT in 1994, WTO in 1995, CEFTA and EFTA in 1996 and signed a free trade agreement with Croatia at the end of 1997. Slovenia accessed the EU and NATO in 2004.

The inner political development was, on the whole, significantly calmer. The first free parliamentary elections after World War II took place in April 1990. The winner became a coalition of the centre-right wing parties with nearly 55% of the votes. After the fall of the government in 1992, Janez Drnovšek became the PM. He stayed in power (with a short break) till 2002. His party generally followed a social democratic policy

[7] In 1986 only 5.7 % of the overall output was produced by the private sector (Jeffries, 2003).

[8] Just between June 1991 and October 1992, 75,000 people (3% of Slovenian population) sought asylum in the country (Cvikl, Kraft, Vodopic, 1993).

and it was forming coalition governments till 2004 when it lost power to a conservative party. The left returned to power in 2008 and stayed in power till 2011. Then economic problems contributed to the fall of the government and a series of short-lived governments were created by new political parties. We can conclude that parties following social democratic values were in power for most of the transition period.

3. Economic policy

The third section is devoted to economic policy during the transformation process up till the financial and economic crisis at the end of the 2000s. I analyze (in four subsections) the chronological development in the main steps in economic policy. I divide the period broadly to reflect the main stages that took place – independence, economic recovery, the EU accession, and the economic crisis. Consequently, two separate sections deal with privatization and the development in the banking sector. The goal is to emphasis specific aspects of the Slovenian economic development that in my view constitute the gradualist approach – it can be seen for example in the attitude towards liberalization, foreign capital, inflation or the rules on the labour market.

3.1 Economic steps towards and after independence (1990-1992)

Slovenia declared its economic sovereignty in March 1990. It progressed towards economic independence as well. One of the first steps was that the government allowed the use of non-official exchange rate among the companies and at the end of the year it started issuing its own emergency currency. It declared control over taxes and tariffs in January 1991. The government expenditures were centralized. Government deficit was a modest 2.6% of GDP in 1991. The taxes transferred to Belgrade were substituted by voluntary contribution to the federal budget. It was a relatively easy step because Slovenia had strong control over its budget since the constitutional changes of 1974. These limits on deliveries to the federal budget (the contribution declined from 7.2% GDP in 1990 to 0.9% in 1991) had an impact on the government spending share, which declined from 48.9% of GDP in 1990 to 43.2% of GDP in 1991 (Shortall, 1996). Pleskovic and Sachs (1994) write that macro stabilization was one of the goals of the stabilization program approved in the spring of 1991.[9] The others goals were a financial restructuring of the loss making companies, restructuring of banks, privatization and currency independence (see below). The authors mention that the first and the last points were politically urgent, while the others were not deemed as priorities; they were affected by the war and general postponing. The war and tensions among the ex-Yugoslavian countries affected even the relationship with the closest ally – Croatia – and the countries levied duties on mutual trade. The war highly affected foremost tourism and transport.

A new currency unit (first of all) for business accounts was constituted in April and a new currency – the tolar – was introduced in October. The main purpose was to escape hyperinflation that was spreading from ex-Yugoslavia. Serbia was blamed for abusing monetary policy for its war efforts at that time. The tolar introduction was a smooth process.

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[9] Slovenia is the only East European country that had never applied for an IMF programme, allowing successive governments more leeway in their policy making (EIU, 2009).

The tolar was introduced in the floating exchange rate regime. There was a discussion about the exchange rate regime among the economists and it lay even in the core of the discussion about gradualism and shock therapy (see the last section) but the main argument for floating was a literal lack of reserves in the coffers of the central bank (Cvikl, Kraft, Vodopic, 1993).[10] Not surprisingly, consequent restrictions on foreign currencies transactions followed – including temporary freezing of deposits. The new currency succeeded in price stabilization – (per month) inflation declined from 21.5% in October 1991 to 1.4% in August 1992. This inflation decline took place without price regulation, with an exception of a short-run wage regulation in February 1992 (Pleskovic, Sachs, 1994). The country accumulated 1 billion of foreign reserves relatively quickly by August 1992 (Cvikl, Kraft, Vodopic, 1993).[11] The exchange rate regime was changed from free floating to managed floating at the end of 1992. Already at that time the country recorded an inflow of foreign capital that the central bank sterilized – it struggled not to allow currency appreciation.

An important role in the disinflation process was obviously played by the central bank that was established in 1991 as an independent institution that was not allowed to provide credit to the government, with the exception of short-run credits for solving cash-flow problems. The main operating goal of the bank after 1992 was money base targeting (Bole, 2004).

Other reform measures were applied in 1991 as well – among others the previous socialist tax system was changed. Slovenia incorporated corporate profit and personal income taxes into its system. At the same time, the labour market became more flexible in order to increase labour force mobility. In specific, labour force dismissal was eased and a rigid system of wage determination (that worked in self-management) was replaced by collective bargaining. On the other hand, Cvikl, Kraft and Vodopic, (1993) write that after the war the bankruptcy legislation was postponed and the Ministry of Labour paid employment subsidies to enterprises that were not able to pay wages. The overall subvention amounted to 31.4 billion tolars (8.7% GDP) in 1991 – two thirds of the losses were caused by the economy’s 100 largest enterprises.

Meanwhile, the country progressed towards the opening of the domestic market for imports. Non-tariff measures were eliminated and a new tariff schedule was applied. The level of domestic market protection was generally quickly declining as we can see in Table 2.

Table 2: Share of import value (percent) 1986-96

Import regime	1986	1990	1993	1996
Free imports	3	78	97	98
Conditionally free imports	58	8	0	0
Quotas	37	12	1	0
Licenses	2	2	2	2

Source: Majcen, B., & Kaminski, B. (2004). Trade Policy in the Transition Process

[10] Ribnikar and Košak (2004) write that exchange rate reserves covered just 4 days of imports in October 1991.

[11] One of the reasons was privatization of housing because inhabitants had to use their own reserves that were denominated in foreign currencies (Mencinger, 1997).

From the point of view of macro-economic indicators in this period, the economy was on the decline (as in other countries of the Eastern Bloc) till 1992. The war and consequent tensions had without doubts an impact on economic production – it was calculated at 6% of GDP but industrial production declined by 38% between June 1989 and June 1992. It means that the disintegration of Yugoslavia was not the key reason for the economic decline (Shortall, 1996). There were other causes – hyperinflation, demand shock, stabilization programs and, above all, the transformation process. Unemployment was unlike in most of the other transforming countries relatively low and stood at 8.3% in 1992 while employment was significantly declining in this period. Inflation was relatively stabilized.

3.2 Recovery and economic growth (1993-1996)

After overcoming the transformation recession the country continued with slow but steady reforms. A foreign trade law was adopted in 1993, a bankruptcy law enacted in 1994, most prices were liberalized by June 1994 and full convertibility (free movement of capital) was introduced in 1995. It was necessary to deal with bad debts in banks (they reached 10 % of credits in 1993) and the two biggest banks became state-owned and stayed in the government's hands (Ovin, Kramberger, 2004).

Economic growth was supported by an export boom. Exports together with an inflow of capital led to an increase in foreign reserves. The tolar meanwhile appreciated in real terms. The central bank tried to depreciate it by using the managed floating regime (Mencinger, 1997). It struggled to deal with inflow of foreign capital and in consequence capital movement control was introduced in mid-1996. The bank kept applying sterilization measures as well.

Fiscal policy was exemplary in this period. The government achieved budged surplus by 1996 and it had only moderately small deficits. Fiscal policy was tougher than in other transforming countries.[12] The role of government redistribution stayed high and the share of government expenditures in GDP was even increasing till 2001 when the share reached close to 50%. Considering the development in respective sectors of Slovenian economy in the 1990s, we can recognize that the share of non-market services was increasing as well. This further confirms that the government played an important role in the economy.[13]

3.3 From the start of the European integration to the world crisis (1997 – 2007)

The association treaty with the EU was signed as late as in 1996 (for example, the Czech Republic signed the treaty already in 1993) and it came into effect as of the beginning of the following year. It had, among others, an impact on trade with the EU. The liberalization was asymmetric – the EU opened its market more quickly but Slovenia had to liberalize its market in the following years as well.

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[12] The partial cause of the growing imbalance after 1996 was the acceptance of the ex-Yugoslavia foreign debt after the agreement with the London club.

[13] Silva-Jáuregui (2004) even writes that the government sector was the main source of unhealthy growth in real wages in the given period, which exceeded both the agreed targets as well as growth in productivity. This wage growth in the government sector was consequently spreading to other parts of the economy. The situation changed only after mid-1997 when wage indexation was relaxed.

Slovenia had to tune its legal system with the European one and accept Acquis communautaire. The EU created pressure on the country to improve efficiency and rules. For example, administered prices still created 20% of the CPI basket in 1997 and restrictions on prices of bread and milk were removed only that year. Restrictions on prices of white flour, sugar and oil products even stayed in force (EBRD, 1998). There were still effective capital requirements that were applied on most of the foreign loans and credits. Slovenia was warned that postponing of the liberalization measures could have a negative impact on the accession process in 1998. The parliament consequently (in the second half of 1999) approved an amendment that ended capital movement control (Dyker, 2000). And the parliament allowed a higher volume of foreign ownership in the country as well.[14] These measures led to significant augmenting of FDI inflow into the country.

Value added tax was introduced in 1999 as well. Fiscal position was generally still healthy but the government deficit temporarily worsened in 2000 and 2001. The authors of EIU (2003) state that one of the reasons was lasting indexation of public sector wages. Regardless of this, government debt was low. Consequently, the country had to improve its fiscal balance before the accession to the Eurozone. A comprehensive tax reform was approved by the parliament in 2004 – it among others limited income tax brackets.

The central bank changed its policy as well. The overall long-run lasting goal was lowering inflation to the level of developed countries (Bank of Slovenia, 1999). But during the 1990s the bank used extensive capital control to discourage short-term portfolio inflows, relying on multiple anchors in its disinflation strategy, including money supply and nominal exchange rate (EIU, 2003).

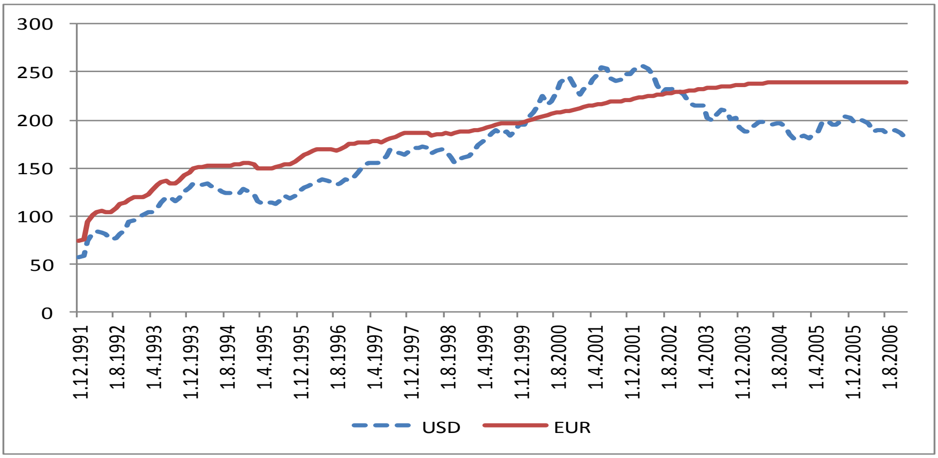
The main intermediate target was changed in 1997 from targeting of growth of M1 to targeting growth of M3 aggregate (Bank of Slovenia, 1999). At the end of 2001, authorities decided to gradually abolish the practice of interest rate indexation. Most of the remaining capital account restrictions were removed in early 2002. With free capital movement, the central bank was forced to adopt a new monetary strategy. It decided for informal inflation targeting. The long-term inflation target for 2005 was 3-4%, with intermediate targets of 5.8% by late 2002 and 4.1% by late 2003 (EIU, 2003). The bank significantly missed its first target for 2002 because inflation stood above 7% and it subsequently softened its target for 2003. Inflation in that year was approaching the target anyway – it extended to 4.6% at the end of the year. Bringing down inflation became a necessity because the country wanted to access the Eurozone at the beginning of 2007 and thus had to achieve inflation levels in accordance with the convergent criteria.

The country became a member of the EU in 2004. And in the same year, the tolar was tied in the ERM II system – the central parity (with fluctuation zone +/- 15%) was set. The exchange rate truly stabilized after a period of continuous depreciation (see Figure

[14] Some of the authors (Ferfila, Phillips) welcomed the accession process but were critical of the EU policy, which was in their view advancing "neo-liberal" economic values by supporting free movement of goods, capital and labour market mobility (Ferfila, Phillips 2010). It remains a mystery how they wanted to join the EU without joining the inner European market.

1). Slovenia became the first transforming country to enter the Eurozone at the beginning of 2007.

Figure 1: Development of the exchange rate – tolar per dollar and euro (monthly average)



Source: Bank of Slovenia, https://www.bsi.sipxweb (23. 7. 2014)

The country seemed to be a highly successful transformation case with strong uninterrupted economic growth and high living standards. But the economy suffered from drawbacks that resulted from Slovenia´s transformation strategy and its consensual approach. The critics pointed out foremost the lack of restructuring and privatization effort. For example, the authors of the EBRD Transitions reports enduringly criticized slow progress in restructuring and privatization in the previous period (EBRD, 2007). Similarly, the authors of the EIU Country profile 2009 (EIU, 2009) noted that restructuring in Slovenia had been slower than in other post-communist countries. They considered two reasons – the first was positive – many factories had been already internationally competitive at the beginning of the transformation. The other reason was the nature of Slovenian privatization, which largely left existing management in control and resulted in the management and employees gaining a substantial stake in most manufacturing plants. The authors of the EBRD Transition report 2009 wrote that enterprise sector suffered from a relatively high level of government interfering and many companies needed far-reaching restructuring to become internationally competitive (EBRD, 2010). The IMF (2011) blamed the pre-crisis high growth that led to “unfounded expectations that Slovenia could grow out of its structural problems, leading to the postponement of long-overdue reforms.” Certain mistrust of the economy and slow privatization was expressed in negative net flow of FDI in the three years preceding the crisis. Authors of the EBRD Transition report 2011 mentioned that low level of FDI had a negative impact on productivity, which was significantly lower compared to other transforming economies (EBRD, 2011).[15] External debt enlarged already before the crisis as well.

[15] Similarly, for example Damijan et al. (2008) proved that low inflow of FDI into Slovenia, mainly due to way of privatization, constrained access to international knowledge spillovers.

3.4 Economic crisis (2008-2013)

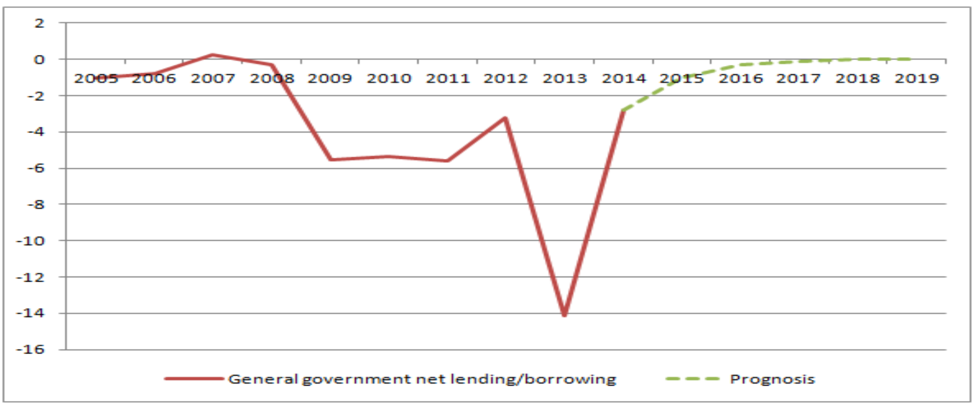
The economy started to contract at the end of 2008 and the slump continued during 2009 (it was the deepest decline in the Eurozone excluding Greece). External as well as internal factors played a role in the recession. Among the former was a decline in exports (-12%) that was a direct consequence of the world economic downturn. Among the internal ones was foremost the state of the banking sector (see the following subsection) that led to the credit squeeze. The crisis brought about bankruptcies, a decline in GDP, the abrupt end of the construction boom and growth in unemployment.

In response to the crisis, the government approved three fiscal parcels between December 2008 and July 2009 with an intention to soften the impact of the crisis on the economy (EBRD, 2009). The parcels increased infrastructure expenditures, including support for troubled companies and subsidies to employees on extended leave. These measures were worth about 1.6% of GDP and contributed to a growing fiscal deficit (see Figure 2).

Fiscal balance became a crucial problem of economic policy. The governments had to deal with not only the recession but the costs of the cleaning of the banking sector as well. The deficit reached high levels (6% of GDP) already in 2009 and high fiscal imbalances lasted for the following years. The respective governments tried to stabilize the situation and applied for ambitious fiscal consolidation programs but they were not able to improve the balance significantly. The general government debt was meanwhile quickly augmenting.

In 2010, the economy seemed to be improving and it achieved slight economic growth. The government behaved as if the crisis was over and increased minimum wage, which was already higher than in most of the EU countries, by 23% (EBRD, 2010). It seems that the country did not accept economic reality and real wages, as well as the unit labour costs, were sharply increasing till 2010. The Capital Asset Management Agency was established as a central ownership agency to manage direct national concerns in state-owned companies. But the assets were in the end transferred to the newly established Slovenian Sovereign Holding at the end of 2012.

Figure 2: General government net lending/borrowing and its prognosis (in % of GDP)



Source: IMF, World Economy Outlook Database
http://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx (August 18th 2015)

In 2011 the government tried to tackle some of the pressing problems. It planned to increase flexibility on the labour market and take first steps towards a pension reform.[16] The pension reform was considered as an element of fiscal consolidation as well. Both of the reforms were supposed to be approved in a national referendum but the public declined both of them. Consequently, the authors of the EBRD Transition report 2012 (EBRD, 2012) again evaluated the progress of structural reforms as slow. At the end of the year the economy fell into recession again.

The new coalition government approved reform plans at the beginning of 2012. These consisted of another pension reform, privatization of the banks (the government was supposed to keep minority shares) and immediate expenditures cuts. The fiscal deficit was indeed temporarily stabilized in this year but the government debt was continuously ballooning. The restructuring in the financial sector did not progress and the share of non-performing loans was increasing (see the respective subsection). External factors were not helping either – foremost Italy (as one of the main trading partners) stayed in recession.

The dissatisfaction with the political situation as well as with austerity programs created pressure on the Janša government. Among others, the country was paralysed by a general strike of public employees in January 2013. The government in the end toppled and the new government – formed by Bratušek – (finally) headed for serious reforms. A new insolvency law was approved, as well as a law that made holding a referendum more difficult. A structurally-balanced budget was incorporated into the constitution. Labour market and pension reforms were ratified as well. Labour market reforms somewhat reduced the rigidities on the market and the pension reform increased the effective retirement age. These reforms gained nearly unanimous support in the parliament. The government froze public wages and pensions too. It also selected 15 larger companies to be privatizated in the autumn of the same year. The most difficult task for the government was to stabilize the financial sector. There were several waves of speculation about the necessity to bail out the country due to a critical situation in (state-owned) banks. The government created the Bank Asset Management Company (BAMC) to absorb bad assets from banks but it was not enough to stabilize the situation. The situation was critical and the country was able to avoid a Euro-zone bail in December 2013 only out by organising an expensive bank rescue plan (see the following subsection about banks). The price of this salvage was a giant fiscal deficit (nearly 15% of GDP) in that year.

Economic development in 2014 was affected by snap elections as these interrupted reform efforts. The new government returned to reforms as of September 2014. Several large privatisations, such as Mercator, Ljubljana Airport and Letrika, were completed in 2014. Government debt overcame 80% of GDP in that year – the size doubled since 2010. The economy returned to a growing trajectory.

[16] Slovenia has one of the most rapidly ageing populations in Europe and without a reform the system is prone to become one of the most expensive in Europe in the next 30 years (EBRD, 2011).

4. Privatization

Only farming and very small-scale artisan enterprises were privately owned under the communist regime (EIU, 1997). "Social ownership" was the dominant form of ownership at that time. It meant that the employees played a crucial role in the decision-making process in the enterprises even though Simoneti, Rojec and Gregorič (2004) write that the decisions were made in reality by negotiations among workers, managers and the state. The crucial aspect for the following privatization was the belief of the employees (and the managements of companies) that they de facto owned the companies even though the situation was de jure different.

Ownership started to change already at the end of the 1980s in several different directions. A new law allowed private business activities and voluntary self-privatization of companies at the beginning of 1989. But the government carried out steps in just the opposite direction at the same time. Soós (2011) writes that the strategic enterprises – energy, a majority of the transport sector, post office, telecommunications, waterworks, communal services, mining and metallurgy, two large banks and several insurance companies were taken into state property at the beginning of the transformation process and not privatized till 2000. Moreover, Soós mentions spontaneous privatization, where management of the companies was able to acquire the property out of the companies.

But considering the size of the property the main approach had to be privatization. There were generally two ideological approaches towards privatization after the country´s independence (Mencinger, 2004). One of the approaches was based on decentralization and gradualism and supposed that the system of self-management should be used in the transformation process. The proponents of this approach argued that the companies were de facto independent and that it would be a pity not to take advantage of this advanced state. The companies were supposed to decide on their own about the privatization method. The other approach was centralized and it proposed massive and quick privatization organized by the government. This approach expected to free distribution of shares that would be fair to all inhabitants of the country. The proponents wanted to reach the western structures as soon as possible. Mencinger (2004) states that the dispute was in fact political – about the control of the economy. The decentralized approach was supported by the managers of the companies and previous political elites. On the contrary, the new government and the new political elites endorsed the centralized attitude.

The dispute between these concepts went on for two years. Its consequences were resignations of several ministers and a fall of the government.[17] The conclusion was a compromise law that was a combination of several privatization methods. The law was approved in November 1992 as The Ownership Transformation Act. In practice, the law allowed each of the companies to choose (to a certain degree) its privatization method. As many as 40% of shares were transferred to state-controlled financial funds (the Restitution/Compensation Fund (SOD), the Pension Fund (KAD), and the Development Fund) for later sale. The second possibility was that 20% of the shares were kept for

[17] Kende (1993) mentions a public survey from 1990/1 that looked at views of privatization. The survey concluded that 40% of the inhabitants supported self-management as the privatization method, 22% wanted to sell the property to the highest bid, 20% supported re-privatization and 18% did not want to privatize at all.

free distribution to employees, former employees and their relatives. The third possibility was an internal sale to employees of up to 40% shares with a 50% discount. The fourth possibility was a public sale of shares or sale of entire companies in case of bankruptcies with proceedings paid to the funds. The fifth possibility was ownership transformation by the issue of new shares in a value greater than 30% of existing equity to retire debts or finance new investment.

Buchen (2007) writes that Slovenia issued vouchers for 40% of GDP. Inhabitants received vouchers in the value of USD 1,500-3,000 (according to age, the older the people, the higher the value). They could exchange the vouchers for shares in their company, other companies or privatization investment fund (PIF). It was not allowed to sell the vouchers. The PIFs were established by the private sector as well as state-owned banks. They were limited to holding at maximum 10% of an enterprise (Soós, 2011).

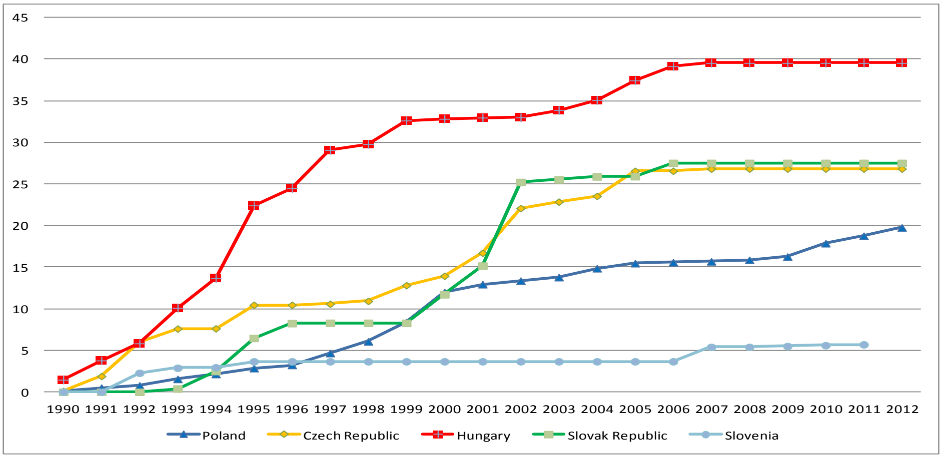
The privatization progress was generally slow. In 1991, only 4% of employees worked in the private sector and 8.1% of the labour force was self-employed (Cvikl, Kraft, Vodopic, 1993). Ferfila and Phillips (2010) notice that in 1993 the social sector still employed three quarters of the labour force and produced two thirds of output. Growth in the private sector was caused mainly by an appearance of new small companies. Only a little more than 10 % out of 400 listed companies were transferred to private hands by mid-1993. Soós (2011) sees the cause of slow privatization in the strong position of the former socialist nomenclature that was able to defend its positions and interests.

In practice, the main privatization method became internal privatization with a broad contribution of the government´s funds. Ferfila and Phillips (2010) write that 90% of socially-owned companies decided for internal buy-outs by mid-1995. This privatization method obviously did not bring new capital into the companies. The Slovenian system naturally (due to historical reasons) emphasised a high role of the trade unions, employees and workers' councils. It was demonstrated by the introduction of the co-determination model in 1993, which was similar to the German Mitbestimmung (Ferfila, Phillips, 2010). The greatest loss-making large companies stayed meanwhile in the government hands. Another characteristic feature was a general dislike for foreign capital.[18] After privatization, property consolidation was made more difficult as well – the shares could not be sold earlier than 2 years after the privatization and as of 2000, a purchase of more than 25% of the shares had to be approved by the Securities Market Agency (Dyker, 2000).

The sluggish and specific form of privatization can be seen in Figure 3. We can notice that Slovenian privatization revenues were in fact by far the lowest among the depicted countries and one of the lowest in the whole Eastern Bloc.

[18] Ferfila and Phillips (2010) mention that out of 1,500 privatization projects that the Slovenian Agency for Reconstruction and Privatization received by April 1995 only 3 embraced foreign capital.

Figure 3: Cumulated privatisation revenues as a share of GDP



Source: OECD (2014), OECD Economic Surveys: Poland 2014.

What was the result of the privatization process? Some 1,600 enterprises were privatized by the end of 1998. The ownership was crumbled among different state institutions, privatization investment funds (which remained passive owners) and foremost managers and employees with 75% of the companies under insiders' control (EIU, 2003). In 1998, the private sector still created only 50% of the country´s GDP.[19] Spruk (2012) argues that non-privatization was a consequence of the net of ex-communist nomenclature consisting of politicians as well as entrepreneurs that preferred direct influence in the companies via friendly loans. He mentions the role of corporate oligarchs from the socialist period and their media that led in his view to economic nationalism, state-led protectionism of the domestic industries, institutional barriers for FDI, cronyism and endemic corruption. There were other problems as well. Simoneti, Rojec, and Gregorič (2004) state that it lasted 8 years (till 2002) till PIFs were able to exchange vouchers for shares due to "privatization gap" which meant that PIFs had many more vouchers than property for privatization. Consequently, PIFs, that were founded to exercise active control of the companies (Buchen, 2007), were in reality very passive.

This slow method of the mostly MEBO privatization caused only minor changes in the real functioning of the companies and allowed trade unions to maintain their strong position. The attitudes towards this development diverge. Some of the authors – for example Gligorov (2004) consider such transformation of self-management companies as successful due to only few bankruptcies and high unemployment. Berend (2009) praises Slovenian privatization as well. Ferfila and Phillips (2010) criticise this way of privatization for not leading to restructuring of the companies but, at the same time, they argue that productivity was increasing and restructuring was not threatened. Spruk (2012) is, on the other hand, highly critical claiming that restructuring took place in the slowest possible way as a consequence of pressure groups interests and socialist mentality, which preserved the highly inefficient status quo. Strong trade unions prevented improvement in productivity by protecting employees in both state-owned as well as in

[19] Hungarian private sector already produced 85% of GDP at that time (EBRD, 1998).

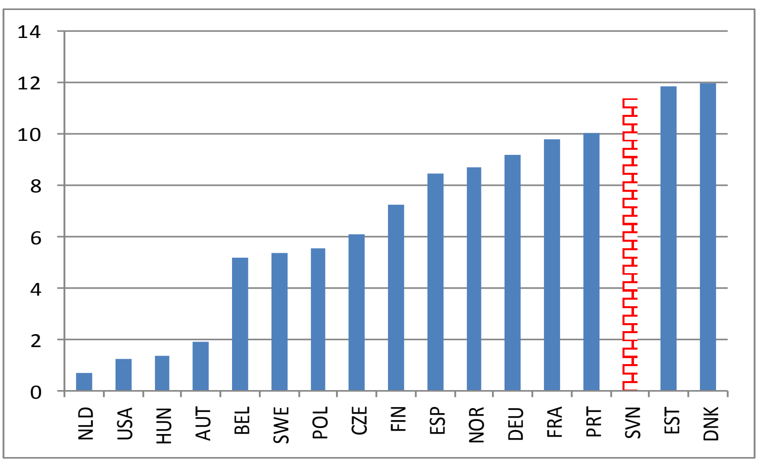
private companies against competition pressures. The situation is similarly regarded by the authors of the EIU country report (EIU, 2003) who state that slow privatization into management and employees hands slowed down the restructuring process. I would like to argue that the specifics of Slovenian privatization are one of the direct causes of the consequent financial calamity.

The authors of the EBRD Transition report 2000 (EBRD, 2000) write that the state still owned shares in 180 mainly large companies (in 80 of them the state was a majority owner) at the turn of the century. These shares were formally transferred to the Slovene Development Corporation (founded 1998) with a mandate to liquidate or restructure and privatize these companies. But there was a growing conviction that the Corporation was an extra-budgetary vehicle to provide subsidies to the enterprises (EBRD, 2001). Several bigger sales took place in 2001 and 2002 (for example 34% in the Nova Ljubljanska Banka to the Belgian KBC – see the following subsection) but many loss-making companies stayed in the state hands. Ovin and Kramberger (2004) write that the government, via quasi government funds (KAD and SOD), controlled from one fifth up to one quarter of the privatized companies at that time. The process of consolidation (especially into foreign hands) meanwhile progressed only slowly unlike, for example, in Hungary or the Czech Republic (Soós, 2011). On the other hand, Buchen (2007) writes that the number of companies where insiders were a dominant group declined from 50% in 1998 to 18% in 2002, but the author also notes that the insiders' share was still high.

In 2013, the Slovenian state still owned scores of companies that covered a broad range of activities from telecommunications, food processing to sail boat and shoe manufactures (Rousek, Steinhauser, 2013). The overall slow privatization progress can be summed up in the EBRD large scale privatization index where Slovenia was lagging behind Central European countries during the whole transition period.

The share of the government role stayed high in international comparison as well. The OECD (2013) provided information about public ownership on GDP (see Figure 4).

Figure 4: Public assets (% of GDP)



Source: OECD. OECD Economic Surveys: Slovenia 2013, 2013.

The government pledged, only in 2013 under the pressure of the crisis, to privatize 15 large enterprises. Several of them were really privatized during the following year.

The respective governments (regardless of their left or right political orientation) followed the public views towards the privatization process and generally decided to soften and slow it down with an overall intention to keep the property in Slovenian hands. They tried to avoid politically unpopular consequences of tough privatization – foremost unemployment. This attitude seemed to be successful for a long period. Unfortunately, there was a flip side to this policy, which negatively impacted the (still state-owned) banking sector as I describe in the following subsection.

5. The development of the banking sector

The banking sector appeared in the centre of the world crisis as well as Slovenian crisis after 2008. The roots are partly to be found already in the inherited ills of the banking sector from former Yugoslavia. Slovenian banks were divided and highly decentralized at that time. There were many small banks that were owned by enterprises to which they provided (cheap) credits (Shortall, 1996). Soft budget constraints created an environment characterized by a high share of classified debts and due to this, the banks needed to recapitalize in response to the political changes (Ferfila and Phillips, 2010).[20] They were audited in 1991 and the Bank Restructuring Agency was established to help them. The first banking law was approved as well and it changed the status of the banks.

The then state-owned Nova Ljubljanska Banka (NLB) enjoyed the dominant position in the banking sector. Ferfila and Phillips write that it controlled 75% of the banking actives and 80% of external transactions in 1993. It was recapitalized and downsized in 1994 but it still kept the dominant position on the market – together with another state-owned bank – the Nova Kreditna Banka Maribor (NKBM). In addition to this, there were 18 regional banks (Ferfila, Phillips, 2010). Bank rehabilitation program was ended by mid-1997 because profits were increasing and the share of non-performing loans declined to 12%. But foreign banks were not allowed to open branches in the country and no foreign bank got a licence between 1994 and 1999 (EBRD, 1998). This can be seen as a consequence of the government's mistrust in competition in the banking sector. As an even more tangible proof, we can see the government's unwillingness to privatize state-owned banks. This de facto allowed the governments to keep the banking sector under their control and created a casual environment not only for the state-owned companies but for the private ones as well. Privatization of the two biggest banks the NLB and the NKBM was approved in 1999. They controlled 40% of the market at that time. But the privatization was only partial because state pension and restitution funds were supposed to gain (each) 10% of the shares and another 20% were offered to portfolio investors (EBRD, 2000). It meant that the state kept effective control over the banks. The only real progress took place in the third biggest bank, the SKB because the Société Générale purchased nearly all the shares in May 2001. In 2002, the government sold 34% in the NLB to the Belgian KBC. And in the following year, the EBRD purchased another 5% of the bank. The share of the government and the government controlled funds declined from 83% to 44% but it was still enough to keep control over the

[20] Shortall (1996) mentions that 30-40% of debts were non-performing at that time.

bank. The KBC consequently repeatedly asked to gain its majority share in the NLB as promised in 2002 but the government did not allow it (EBRD, 2008). Spruk (2012) adds that the bank itself was against its privatization. The situation in the NKBM was similar – the government still kept 90% of the shares before the start of the financial crisis in 2007 (EBRD, 2007). Slow changes in the Slovenian banking sector can be demonstrated by the share of the foreign banks in the domestic market. Berend (2009) writes that this share in 2004 in Hungary was 83%, in the Czech Republic and Slovakia 96% and in Slovenia only 17%.

The state-owned banks played an important role in the ballooning of the credits in the country in the period before the world crisis.[21] There were several reasons for such behaviour. One of them was the general interconnection of the banks and the companies in the whole transformation process that in a way continued the policy of the soft budget constraint. The second reason can be long-run economic growth that seemed to be ever-lasting. And the third one sharp decline in real interest rates after accessing the Euro-zone.[22] The consequence was a generally high investment level especially in the construction and the housing sectors (IMF, 2014). On the flip side, the credit boom without doubts contributed to strong but unsustainable economic growth in the period. There were warning signals that the banking sector was not healthy – for example, the profitability of the overall sector was significantly lower than in the other EU countries at that time (EBRD, 2009). Furthermore, the authors of the IMF report (2014) mention that state-owned banks owned shares in several corporations, including the main supermarket chain, breweries, sparkling water plants, hotels, and newspapers, creating the potential for directed and connected lending and political interference. Another problem was that the banks were generally overly reliant on external funding and credit growth was financed by short-term credits on international markets (IMF, 2011). Regardless of these problems the Bank of Slovenia, that supervised the banking sector, stated about "the banking sector good performance" before the crises (Bank of Slovenia, 2007).

The credit boom trend was abruptly ended in 2008 when the world crisis stroke. Firstly, the banks seemed to be coping with the situation rather well. The authorities provided an unlimited guarantee for all deposits by individuals and small enterprises until the end of 2010 (EBRD, 2010). But already in 2008 it was necessary to increase banks' capital. As a consequence of the government help, the sources of the banking sector financing were shifting from external to the governmental and the ECB. The difficult situation in the banking sector and a growing share of the non-performing loans concluded in a sharp decline in lending that naturally had a negative effect on real production in the country.

Both of the biggest banks passed the EU-wide stress test in 2011 but the NLB failed to meet the capital standard and needed another capital injection (EBRD, 2011). The IMF (2011) informed that Slovenian banks were among the most thinly capitalized in the EU at that time. The government purchased most of the newly issued NLB shares but publicly-owned electricity and postal companies participated in the capital enlarging as

[21] The share of loans to GDP sharply increased from 32% in 2004 to 56% in 2008 (EUROSTAT, epp.eurostat.ec.europa.eu/ June 18th 2014).

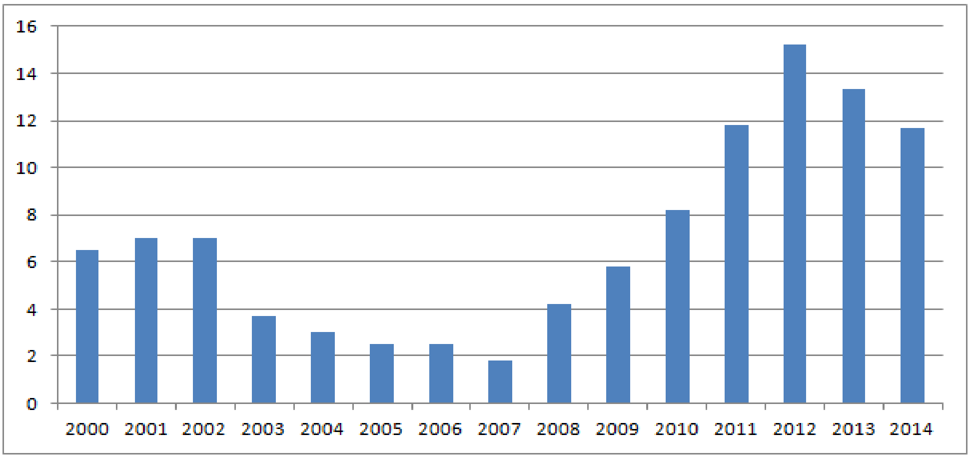
[22] Real interest rates (estimated ex-post) declined from 5.1% in 2006 to 1.6% in 2007 (World Bank, data.worldbank.org, August 20th 2015).

well. Capital was increased in the NKBM too.[23] The authors of the IMF report (2011) mention that recapitalization was able to cover the losses that appeared during the crisis but it was not sufficient to create new lending capacity. The banks were not helping economic recovery.

The three state-owned banks (NLB, NKBM and Abanka) remained under severe stress in the following year. Due to this, Slovenian banks participated in Eurosystem LTROs (Long-term refinancing operation) in December 2011 and March 2012.[24] They drew 4 billion euros – making Slovenia one of the heaviest users of LTROs relative to bank assets (IMF, 2014).

These measures partially improved the situation in the banking sector but they did not solve it. And the share of non-performing loans was steadily increasing as we can see in Figure 5. Most of the problematic credit was issued from the late 1990s through 2008.

Figure 5: Non-performing loans (in percent of total loans)



Source: *World Bank, World Development Indicators*

The government created the BAMC to deal with non-performing loans in 2013. The three state-owned banks later on transferred there about 4.6 billion euros of non-performing loans at a price of 1.6 billion (IMF, 2014).

These steps were not enough to calm down the situation and there were growing doubts about the government's ability to solve problems in the banking sector. I have mentioned that there were broad worries that the government would be forced to ask the rest of the Eurozone for a bail-out (similarly to Cyprus). The government was able to avoid the bail-out in the end but at high costs – 3.01 billion euros that were injected into the state-owned banks (IMF, 2014).[25] The consequence was a deep fiscal deficit and the

[23] The consequence was that the share of the publicly-owned entities in the NLB increased to 59% and the stake in the NKBM remained constant at 51% (IMF, 2011).

[24] In this program, the ECB offered European banks low-interest (1%) loans for an exceptionally long period of three years, accepting loans from the banks' portfolios as collateral.

[25] The size of Slovenia GDP is roughly 35 billion Euro – it means that just this program cost 8.5% of GDP.

jump in the government debt. The level of non-performing loans was very high in international comparison. The main culprits were the large state-controlled banks whose ratio of non-performing loans in 2012 was 30.16%. The small domestic banks' ratio was 23.12% and foreign 11.22% (OECD, 2013).

In 2014 the situation stabilized and the share of non-performing loans declined but it remained still high. And the contingent liabilities from government guarantees amounted 18% of GDP in 2014 (IMF, 2015). The IMF warned that weak position of borrowers raised the probability that guarantees may be called.

6. Slovenian gradualism

The term "gradualism" was mentioned several times on the previous pages. In this final section, I build on the previous parts of the text and show that gradualism (the country's specifics) was an important factor in the Slovenian transformation. I further claim that while it was responsible for its success it is also to be regarded as the main culprit of the financial problems after 2008.

There are several topics connected with gradualism that we must deal with. First of all, I begin with the definition of this transformation attitude. Secondly, I try to determine whether gradualism actually was applied in Slovenia and whether any other approach was possible. Thirdly, I sum up the specific aspects of the Slovenian development and show their impact on the economy.

6.1 Definition of gradualism

Slovenian authors (for example Ferfila, Phillips, 2010; Ovin, 2004; Šušteršič, 2004) often take pride on the applied gradualism as the optimal way of their country's economic transformation. They believe (or at minimum believed) that the concept led to better results than the shock therapy (big bang approach). However, they define it only rarely.

They are not alone and there are no clear definitions of either gradualism or the shock therapy method. This void is significantly worse with gradualism – more about problems with definitions of both of the transformation concepts for example in Mikula, Žídek (2014). I can generally conclude that the shock therapy wanted to achieve the state of the market economy as soon as possible. The typical examples were Czechoslovakia and Poland. The shock therapy in specific usually meant – prices liberalization, trade liberalization (inner convertibility and declining trade barriers), tough fiscal and monetary policies, devaluation, (possibly quick) privatization (and possibly fixed exchange rate). The other extreme is the gradual approach. Defining this transformation approach is a significantly more problematic task and for example Krkoška (1999) and Kožušník (1997) pay special attention to the fact that so far, no one has ever come up with any consistent theory of gradualism. The main idea behind the gradual approach is that the costs (decline in output, growth in unemployment and growth in the price level) of the big bang are too high and it would be possible to decrease them if the transformation speed was lower. In practice, more gradual approaches could mean slower prices liberalization, slower opening of the domestic market and a gradual privatization process.

6.2 The applied transformation concept

I describe the initial situation in Slovenia at the beginning of this paper. I would like to argue that there was in fact no need for the shock therapy in the Slovenian economy after gaining the independence because prices and trade were already liberalized.[26] Any need for radical reform is further questioned if I consider the level of openness of the economy (share of exports in GDP 50%) and the share of the developed countries in Slovenian exports –75% in 1990! (Mencinger, 2004). I can compare these indicators for example, with the situation in Czechoslovakia – exports in GDP reached something around 30% and the share of the developed countries was around 25% (Žídek, 2006). These numbers prove that Slovenian producers were integrated into the world economy and in fact able to compete on the western markets at a level that was absolutely unachievable for producers in all other centrally planned economies.[27] It is indirect evidence of a good state of the Slovenian economy at that time (together with high GDP per person). And it increases doubts about the necessity or in fact possibility of a radical reform. In 1989, Slovenia was by far the most liberalized economy in the Eastern Bloc. The starting conditions in the individual countries without a doubt determined the optimal/possible transformation path.

Slovenia was not even able to follow any radical approach because most of the prices were liberalized and trade was open. Under such conditions, what kind of radicalism should take place? At the same time, according to Slovenian authors (e.g. Ovin, Kramberger, 2004), the country followed strict monetary and fiscal policies that are again considered as another typical (necessary) feature of the shock therapy.

The question is what the Slovenian interpretation of gradualism was, in other words, how the term 'gradualism' was defined by domestic economists and authorities. I found out that Slovenian authors often mistake discussions about gradualism and shock therapy for discussions about applying different exchange rate regimes. Menciger – deputy minister at that time said: "the debate on pegging versus floating reflected two opposite approaches to the transitive in Slovenia in general: a radical and a gradual approach" (Shortall, 1996). Slovenia decided for a floating exchange rate and thus in the view of Slovenian economists followed the gradualist path. There is another problem with this attitude. The fix exchange rate obviously necessitates high stock of foreign currency reserves in the coffers of the central bank to defend the exchange rate. Slovenia had only negligible reserves when the tolar was introduced and, at the same time, there were unsolved debts after the split of Yugoslavia. It was hardly a favourable environment for applying strict exchange rate rules in the form of the fix exchange rate regime.

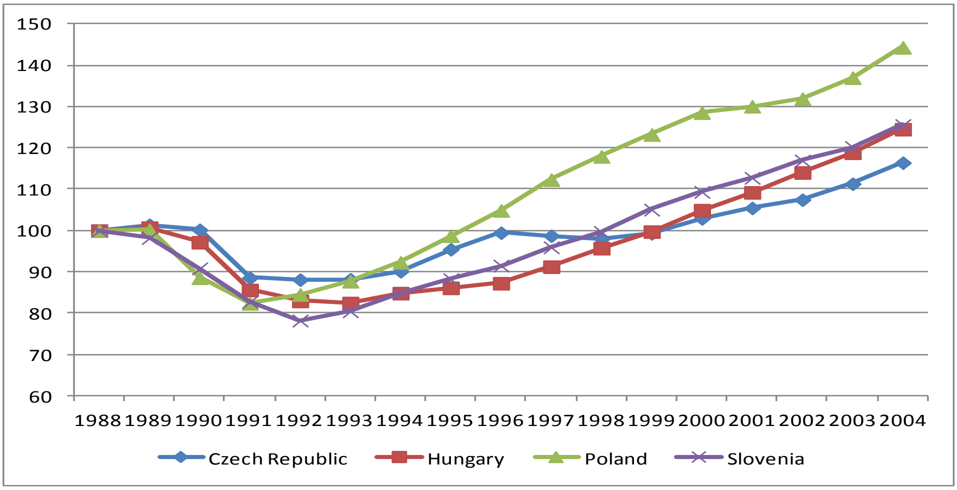
At the same time, Slovenian authors believe that gradualism helped them to avoid a sharp decline in the production at the beginning of the transformation and that the transformation decline was due to it lower (Ovin, Kramberger, 2004; Šušteršič, 2004). This claim is highly questionable as well. We can see the cumulative development of GDP in Figure 6. I compare Slovenia with the Czech Republic, Hungary and Poland – countries

[26] For example the EBRD index of price liberalization for Slovenia reached 3.7 out of 4.3 points already in 1990 (EBRD, 1998).

[27] Authors of the EIU Country profile (EIU, 2009) remark that many Slovenian factories obtained western technology through licensing agreements in the 1970s and 1980s, which enabled them to become internationally competitive.

considered as the main proponents of the shock therapy approach. And we can see that Slovenian gradualism did not lead to smaller economic decline, on the contrary the Slovenian slump was the deepest.[28]

Figure 6: Cumulative economic growth in Central Europe and Slovenia



Source: EBRD: Selected economic indicators data, http://www.ebrd.org/country/sector/econo/stats/index.htm.

I have already mentioned that majority of Slovenian authors believe/d in gradualism. But the views are not unanimous and there are several critical voices as well. Ovin and Kramberger (2004) mention that the real meaning of gradualism was a postponement of unpopular reforms hiding behind rhetoric about the social state. They notice that the former elite and management of large enterprises were against changes and were able to block them – which resulted in gradualism. An interesting view is provided by Pleskovic and Sachs who already in 1994 wrote that the feeling of relative prosperity led to postponement of the reforms (Pleskovic, Sachs, 1994). Silva-Jáuregui (2004) identifies Slovenian traditional consensus building as the cause of slow structural reforms.

6.3 Slovenian specifics and their impact

I would like to argue that the entire discussion about gradualism and the shock therapy is, in fact, unimportant and artificial. It would be in my view more appropriate to talk about the country's specifics without using unclearly defined labels (gradualism and shock therapy) that have political rather than economic connotations. On the other hand, And I believe that the previous analysis provides specifics that can be identified as characteristic of the economic transformation in Slovenia. What were these specifics? One of the key aspects was postponement of the privatization process (or more broadly unpopular reforms).[29] I should especially emphasize slow privatization of the banking

[28] Admittedly, none of these countries was affected by a war.

[29] We can note that Poland postponed its privatization in a similar way (for example Žídek, 2011) even though it is always considered as the textbook example of the shock therapy.

sector that exercised significant influence of the whole economy. The second aspect of the Slovenian development was relatively slow disinflation.[30] And the third was a reluctant attitude towards foreign investment.

The specifics created casual environment for the Slovenians and their enterprises. Slovenian authors were right to argue for a long time that their mix of initial conditions and applied economic policy achieved very good economic results with low unemployment and lasting economic growth. But I believe that there was a flip side and all three above-mentioned specific features contributed to the creation of the particular economic environment that was consequently the main culprit of the depth and length of the financial crisis. Unpleasant and unpopular structural reforms as well as privatization of large companies were postponed. State-owned banks provided loans to state-owned companies (or private companies) and in fact continued with the policy of soft budget constraint from the centrally-planned period. The true state of the banking sector was masked by economic growth but it was fully revealed with the world crisis. The crisis led to a steep increase in the classified loans. Secondly, higher inflation in the country and thus higher interest rates provoked the banks to borrow abroad. It, at the same time, created profit opportunities – borrowing with a low interest rate abroad and lending with a high interest rate at home. Both of these aspects contributed to the casual domestic environment that appeared unsustainable during the crisis. Thirdly, low FDI had a negative impact on productivity and competition level inside the country.[31]

Generally, all these aspects seem to have contributed to the relatively relaxed economic environment in which the domestic producers were to some extent protected and some of the sectors stayed un-restructuralized. Lasting economic growth was inflated by lending from the (state-owned) banks. The companies on the other hand did not lay off employees and thus kept their part of the "social contract".

Figure 7 sums up macroeconomic development. We can see that Slovenia was a really successful transforming country and its real cumulative GDP grew significantly more than the average among the EBRD transition countries after the mid-1990s. The highest difference was achieved at the beginning of the world crisis. The final numbers show that any advantage that the country ever had disappeared in the following years. It seems that the merits of the country's specific form of economic development were only temporary and they were flattened with the crisis.

Conclusions

This article presents the most important aspects of the Slovenian economic transformation from a centrally-planned economy to the financial crisis. I argue that the country's gradualist approach was responsible for both success as well as for the economic downturn. The true roots of economic problems in Slovenia lie in my view very deep and far – de facto in the functioning of the Yugoslav centrally-planned system.

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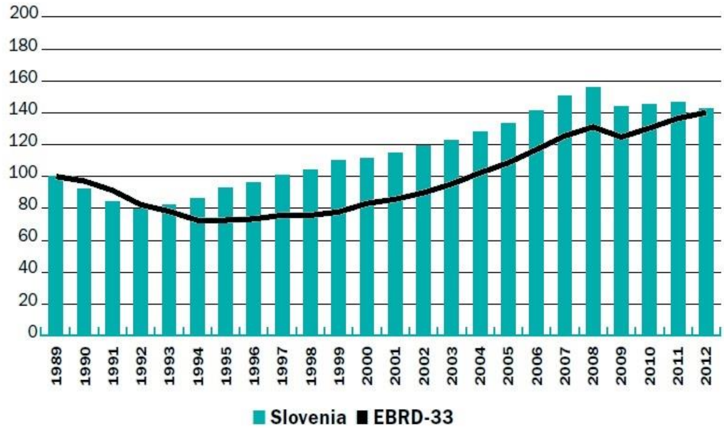
[30] In 2002, Slovenia even had the second highest inflation among transition countries after Romania.

[31] The stock of FDI in Slovenia in 2007 was only 22.7% GDP. The respective number in the Czech Republic was 59.5%, in Poland 40.1% and in Slovakia 62.2% (UNCTAD, 2015).

Figure 7: Real GDP (1989=100), Slovenia and EBRD 33 (average of all countries monitored by the report)



Source: EBRD, EBRD Transition report 2012

The specifics of the Yugoslav system – mainly self-management – became direct causes of the specific transformation path. They influenced foremost privatization. Similarly, the country did not fully get rid of the socialist habit of soft budget constraint. The (not privatized) state-owned banks were irresponsibly lending to the state as well as to private companies. At the same time, the Slovenians generally enjoyed their relatively casual economic environment. This system, in which enterprises were to a certain degree sheltered and helped by the government, was efficient till the world crisis and brought about steady growth with low unemployment. But the world crisis revealed the real state of the economy and foremost of the banking sector (primary of the state-owned banks). Classified debts became the critical economic problem. Slovenia from this point of view repeated mistakes of some of the other transforming countries – including the Czech Republic (e.g. Havel, 2004 or Simonson, 2000) – because postponing of the banking sector privatization led to irresponsible behaviour: high level of lending, accumulating of classified debts and consequently to high costs of the banking sector cleaning. In the Slovenian case, the costs were so high that the country appeared close to default.

The main culprit can be found in Slovenian gradualism (or rather in the specifics of the applied Slovenian economic policy). But it seems to be natural and to some degree unavoidable if I consider the initial conditions – self-management, the close relationship between companies and banks and high living standard. The electorate naturally wanted to keep their advantage in the(ir) companies and save their jobs. Politicians consequently pursued gradualism as a way to keep the companies functioning and prevent unemployment. It was a way that promised to avoid any radical reforms that seemed unnecessary. This became a part of the country's social contract. Public worries about rough competition were reflected in the privatization proceedings, obstacles for FDI inflow, non-privatization of the banks and general postponing of deregulation – all these became roots of the consequent problems. The Slovenian political representatives were not able or willing to deal with these problems and to take politically unpopular steps and thus harden economic environment in good times. It seems that the economy was able to avoid some of its transformation costs only to pay for them more dearly later. But the initial transformation conditions in my view determined the whole transformation process up to the bitter financial crisis.

At present (2016), the country stays rich; politicians have been able to deal with the acute problems and to avoid the threatening humiliating default. Slovenia seems to be on a good track to overcome its economic troubles.

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