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PRIVATIZATION AND MARKET REFORMS IN SLOVENIA*

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Three and a half years after gaining its independence from former Yugoslavia, the Slovene economy has finally reached two important turning-points: it has reversed the decline in real output per person that persisted since the late 1980s, and it has begun to implement its unique privatization law. The purpose of this paper is to explain these events and analyze what they mean for the country's future.

Slovenia and Yugoslavia

Slovenia led former Yugoslavia in both economic performance criteria and impetus for market reform. During the last phases of self-management, Slovenia had enjoyed the lowest unemployment of all Europe and seven times the personal income of people in Kosovo. At the time of Tito's death in 1980, their living standards allowed Slovenes to consider themselves western Europeans.

Slovene economists had played crucial roles in developing the federation's movements towards market allocations of resources in the 1950s and market pricing in the 1960s. Their political representatives then demanded further market changes in 1990 which, along with calls for multi-party elections, finally split the League of Communists and led to the first democratic republic elections later that year.

The dissolution of Yugoslavia, which Slovene actions helped precipitate, had however negative economic consequences for the Slovene economy. In the euphoria of sovereignty, many Slovenes wishfully believed that they could maintain their exports to the rest of Yugoslavia after becoming independent. In 1990, about 60% of their exports had gone to the rest of the federation. By 1994 this had fallen to 15%.[1] Though the war in Croatia and

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* Revised version of paper read at the AAASS Convention, Philadelphia PA, November 1994.

[1] "Slovenia: Special country report," *Financial Times* 30 Mar 1993: 36-39.

Bosnia clearly contributed to this decline, this trend would have existed even in peace.

While part of Yugoslavia, Slovene producers had long subsidized their exports to the west by their generous profits from sales to the rest of the country. Yugoslav tariffs and quotas protected Slovene manufactured goods from foreign competition. Shortages of hard currency in the other republics also gave Slovene products favored status. All this was lost once the republic became a separate country. Though Slovene goods were of high quality compared to those of the rest of Yugoslavia, their prices were also high compared to foreign alternatives.

Some Slovene leaders were also naive about the amount of foreign capital their new country would attract. Even though the country had only 2 million people, they expected western firms to invest as heavily as they do in Luxemburg.[2] Unfortunately for Slovenia, Luxemburg was not the appropriate analogy as it is part of Europe's largest market while Slovenia's market is smaller than that of most American cities. While Slovenia has received the second highest foreign investment among former socialist states on a per capita basis, this amount has proven insufficient as foundation for enterprise privatization.

The loss of the Yugoslav market caused the real Slovene Gross Domestic Product [GDP] per person to drop 9% in 1991 and 6% in 1992. The Slovene GDP then grew 1.3% in 1993 to about $6,366.[3]

The total drop in the level of economic activity mirrors that experienced in other former socialist states, but in the Slovene case its cause was more complex. Slovene producers in most sectors had already adapted to market conditions and did not depend on government planning or subsidies. In the late 1980s many had restructured themselves and were clearly more prepared for the real market than their counterparts in the rest of Eastern Europe. Their shock after independence, however, was the immediate need to replace their Yugoslav business with new foreign sales. This was difficult to do quickly and often was achieved by selling at or

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2 Robert Mulej, "Ameriški capital? Forget it," *Gospodarski vestnik* 19 Jul 1990: 19.

3 *Recent Economic Trends 1993* (Ministry of Planning, Republic of Slovenia, 1994), and *Banka Slovenije. Monthly Bulletin* (Ljubljana) Jan. 1995.

below variable costs. At the same time, the post-communist government of Slovenia continued the earlier Yugosalv trend of reducing trade barriers, and domestic producers suddenly faced vigorous import competition.

Finally, the continuation of the war in Bosnia and Croatia has postponed the final distribution of Yugoslav assets and debts among the former republics; these issues had not been resolved when Slovenia left the federation unilaterally in 1991.

Slovene Economic Performance

The loss of the Yugoslav market also had a dramatic impact on employment. After experiencing unemployment levels below 2% during the 1980s, Slovenia now (late 1994) faces 14.2% unemployment. The liberalization of the economy has opened numerous opportunities for self employment, which grew 27% (excluding agriculture) compared to 1993. Nevertheless, total employment declined 2.7% over the same period.[4]

Employment is expected to increase in the future in response to economic growth. Industrial production has expanded 7.3% in 1994 and retail trade grew 11% during this same period. Tourist nights increased 6.6% and both imports and exports grew about 6% since 1993. The ratio of exports to imports in 1994 was 94%.[5]

The government's greatest success has been the introduction of the new currency, the Tolar, in late 1991. After initial inflation problems that year, the Tolar has been incredibly stable, maintaining its value at about 77-80 to the Deutschmark and about 120-125 to the US Dollar. Slovene exporters complain that the government has not allowed the Tolar to depreciate against these currencies equal to inflation rates.[6]

The government has used tight money policy to support the Tolar and reduce inflation. Inflation for the year 1991 was 117% but by 1993 it fell to 22% and in 1994 it was 19% (measured by producer prices) and 21% (by consumer prices). The monetary policy and illiquidity of the banks, however, have caused interest rates to remain unnaturally high. Producers pay 12-18% above inflation for credit, levels too expensive for many, especially small firms trying to survive their first year.

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4 *Recent Economic Trends 1993.*

5 Ibid.

6 Interview with Kleindienst (for interviews, see Appendix).

Government spending and taxation remain a cause of the current inflation. In 1992 its revenue constituted 47% of GDP and expenditures 46.8%. In 1994 expenditures grew to 48.8% of GDP and revenue 47.7%.[7] The costs of maintaining the independent government have been higher than expected. In 1993 Slovene total taxes on labor were thought to be the highest in west Europe, approximately 110%. In 1994 some of these social taxes have been transferred to a new personal income tax system.[8]

Slovene Privatization Plans

Since 1990 Slovenia debated four privatization plans, before finally passing its unique legislation in November, 1992. The self-management system of the communist period, which had contributed to the world's third fastest economic growth between 1950 and 1979, posed special challenges for privatization. First, the Yugoslav and therefore the Slovene constitution said that society, not the state, owned the means of production. The government, therefore, could not sell what it did not own. Secondly, the experience of making decisions inside their enterprises caused Slovene workers to believe that they were responsible for the success of their companies. Consequently, they thought they should not have to purchase what they had built. Thirdly, though Slovene citizens were wealthy by Yugoslav standards, few had enough capital to purchase or own former state emterprises. Finally, though the League of Communists was discredited, an egalitarian ethos persisted in society.

In mid-1990 the Federal government passed a privatization law known after the Prime Minister, Ante Marković. Workers were allowed to buy stock in socially-owned companies at discounts of 2% for each year of work experience up to 60%. The amount purchased by this discount was limited to three times the average wage in the firm. Book value was to be used as the basis for stock purchases. Stock not thus sold would be transferred to Republic Development Funds which would sell the remaining shares.

In Slovenia criticism of the Marković plan came from all sides. Given the rampant inflation of the 1980s, economists

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7 *Banka Slovenije. Monthly Bulletin* .

8 Anton Rop, "Case Study: Privatization in Slovenia: General Framework for Privatization in Slovenia," CEEPN Academy, Ljubljana, 30 Jan. - 3 Feb. 1995.

questioned the use of book value for stock purchase. Workers had little interest going into debt to buy what they believed belonged to them. Finally, the DEMOS coalition, led by Christian Democratic Prime Minister Peterle, declared in September of that year that all Federal laws were superseded by Slovene statutes.

In October 1990, a Slovene privatization proposal by Vice-Prime Minister Jože Mencinger and Director of the Privatization Agency Marko Simoneti, two leading economists, was presented to the Parliament. Their goal was to create a decentralized process in which companies, employees, managers, and creditors would be the primary actors and government only the monitor. They rejected stock distribution plans which, they thought, would fail to produce the active owners needed to insure the efficient operation of the enterprises. They wanted to limit the role of the state and preserve the positive labor-management relations and decentralized decision-making of the former system.

This plan would have enabled each firm to select one of seven options for privatization. Among them was internal privatization in which workers and managers could purchase the shares. Employees would have had discounts up to 30% of the adjusted book value of their firms. Amounts purchased by discounts were limited to 20,000 Deutschmarks.

The Agency for Privatization, however, could require thorough market valuations. To support this effort, Director Simoneti developed an extensive training program for Slovene economists, so that the country would not have to depend on expensive western valuation experts.

This proposal never passed. Conversatives in DEMOS attacked employee ownership as a continuation of communism. Workers had little or no idle cash for down-payments. Others criticized the discount system, saying it would benefit the few with high income and wealth at the expense of the majority. Former owners of property taken by the government after WW II also intervened, demanding full return of "their" property and even claimed entitlement to lost profits during the 45 years of communism.

Finally, Mencinger resigned as Vice-Prime Minister and shortly before the mini-war with Yugoslavia his successor proposed a new model in June, 1991. This version followed the ideas of Professor Sachs (who had argued against the Mencinger-Simoneti proposal). After employees and managers received 10% of a

firm's shares (less than the 15% workers were to be given in a similar plan in Poland), the rest would be allocated freely to investment funds, banks, and pension funds. Citizens would receive shares of these funds, which in turn would control the companies. No valuation of firms would be necessary. Speed of the transformation was the goal.

Following independence from Yugoslavia, enterprise managers led the attack on the plan. They clearly feared losing their positions but more importantly they argued against losing the cooperation with labor which had developed in Slovene firms under self-management. The trade unions rejected the role of fund investment managers in company decisions and the loss of employee voice in decisions.

After ten months of debating this stock distribution scheme, the DEMOS coalition fell apart. Its internal political differences transcended the goals which had initially unified the seven parties (multi-party democracy and succession from Yugoslavia). In April, 1992, Dr. Janez Drnovšek, the Slovene who had led the Yugoslav Federal collective Presidency in 1989-90, was asked to form a new government. In June he proposed a compromise privatization plan.

Drnovšek's privatization proposal was a blend of distribution and paid approaches. Following five months of political argument, the plan was finally approved in November 1992, just weeks before the Parliamantary elections in early December which were won by Drnovšek's Liberal Democratic Party. See FIGURE I: after the first 60% of shares are distributed freely, each company selects one of the four methods to sell the final 40% of its shares.

Figure 1: SLOVENE PRIVATIZATION LAW

Each Socially owned firm distributes its stock:

20%	free distribution inside the firm
20%	free distribution through investment funds
10%	free distribution to pension funds
10%	free distribution to compensation fund
40%	paid privatization (onwnership packet) by:
	A. Manager-Employee Buy-out
	B. Public Tender
	C. Public Auction
	D. Public Offering of Shares

Employees must approve the enterprise plan. Thorough market valuations are required by the Agency which also must approve the plan. The sale of a company's assets through liquidation (by the Development Fund) is the last resort for firms whose prospects for profitability are exceptionally poor.

For the internal buy-out by workers and managers, at least one-third of the employees are required to participate. They first use their certificates to obtain the shares distributed freely inside their firm. These shares become internal shares, voted by the employees but not for sale to outsiders. Of the final 40%, one-fifth must be purchased in cash but firms can use profits from the previous 2 years for this purpose. Employees and managers receive a 50% discount (from the formal company valuation approved by the Agency) on these shares. Shares not purchased for cash are transferred to the Development Fund which provides credit for the remaining shares over four years. Each year employees can use enterprise profits above a 2% (real) return on investment for share purchases. This incentive was aimed at encouraging firms to moderate their wage increases in favor of profits.[9]

Citizens participate by trading investment certificates they receive for shares in three ways: 1) internally from their own firms, 2) from newly created independent invesment funds, and 3) on the stock market. These certificates, which are publicly recorded, are not transferable but they can be inherited. The actual shares are given to the citizens two years after the certificates are traded to minimize short-term speculation. The value of citizen certificates depends on age, from about $800 for those under 18 to about $3,200 for people over 48.[10]

The Privatization Investment Funds are regulated by a law passed in January 1994. These funds are completely autonomous from the state. The law allows them to take a majority position (up to 100%) in a company, invest up to 20% of its funds in real estate, and have a maximum of 20% of its investment in one firm. By the end of 1994, 40 funds, controlled by 23 management companies, were certified by the government.

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9 Rop, "Case study."

10 Anton Rop, "U Sloveniju Privatizacija je bolja nego u Hrvatskoj: tu nema Malverzacija," *Globus,* 24 Jul. 1994: 49-51.

By 31 December 1994 90% of Slovene socially-owned firms had submitted privatization plans to the Agency. In more than 80% of companies whose plans are already approved by the Agency, internal owners will jointly have 60% ownership, and in 85% of them internal owners will have at least 50% ownership. However, the 15% of firms in which external owners will control more than 50% of the stock represent almost 50% of the value of social capital. As expected, internal ownership will prevail more in small and medium size firms, and the larger, more capital intensive firms will need external ownership.[11]

Most of the final shares in the 40% ownership packet not purchased internally are being sold to the public or to the Privatization Investment Funds through the stock market. The options of auction or public tender are being used primarily for foreign sales.

The development of the Compensation Fund remains at an early stage. It is not clear whether its goal of establishing secure property titles will be achieved to the extent expected by foreign investors. Foreign investors also reveal concern over the prohibition against foreigners owning real estate. At this point they can only obtain long-term leases. Claims by former owners, however, will not now interfere with the domestic privatization process.

Discussion and Analysis

The Slovene privatization plan is a compromise between free stock distribution and selling models. This compromise represents the type of political maturity required for public acceptance of a privatization plan. It is also the type of adaptation an ideal model must undergo when being applied to specific economic and social conditions. The Slovenes are building their unique market system. Furthermore, the details of the compromise attempts to preserve two positive characteristics of the former system: decentralized decision making and labor-management cooperation.

The emphasis on internal buy-outs fits several conditions in Slovenia. Enterprise managers wanted to preserve the commitment and loyalty to the firm the former system had developed in their employees. This was especially important during the transition period when most firms had to find new clients to replace their

[11] Rop, "Case study."

customers in former Yugoslavia.[12] Slovenia did not have immediate access to a an alternative source of enterprise managers.[13] Slovene leaders realized that they could not depend on foreign buyers for their firms.[14]

Secondly, the Drnovšek government acknowledges that privatization alone will not solve all economic problems. Accordingly, Slovenia has passed a bank rehabilitation act and restructured three banks, prepared a plan for the restructuring of large industrial enterprises with substantial losses, begun a project of revamping public enterprises, and developed new social policies appropriate for a market economy. Included are programs for income maintenance and training for workers who lose their jobs in the old companies.

The effort to restructure large industrial companies is limited to those which have no potential buyers in their current form. Most potential foreign investors refuse to buy a firm in which hundreds or thousands of people would have to be fired.[15] In some cases they are the major employer in their district. Immediate liquidation is not considered a realistic option.

Without an end to the conflict in former Yugoslavia, prospects for further Slovene economic growth are limited. The social, political and military instability among Slovenia's neighbors discourages foreign interests from investing in her firms. Secondly, the recent export success cannot continue indefinitely. In 1993, exports grew to $5.9 billion, up 6.2% from 1992 and this was almost 60% of Slovenia's GDP. Also, the aggressive policy of the conservative government in Italy towards Slovenia had added new uncertainty in the eyes of western companies considering doing business there. Fortunately, Italy has dropped its objections to Slovenia's application for Associate status in the European Union.

Nevertheless, the current Slovene expansion in the absence of the former Yugoslav market is encouraging. In fact, growth of real GDP in 1994 was 5%. Whenever the conflict in Croatia and Bosnia ends, Slovene firms will reap the benefits of expanded business. Industrial firms will feed the rebuilding process there and in Serbia, where the embargo has hurt Slovene exports. Slovene food

[12] Interviews with Kleindienst, Rupnik, and Goste.
[13] Rop, "Case study."
[14] Interviews with Drnovšek, Simoneti, and Mencinger.
[15] Interviews with Jacobs and Maselli.

producers will also enjoy greater sales as tourism there and at home returns to its pre-war levels.

Finally, the Drnovšek privatization process seems to meet two crucial tests: domestically it is viewed as being basically fair and mostly free from corruption or manipulation. This is necessary to weather the entended period of unemployment and dashed economic expectations which has followed the separation from Yugoslavia and the establishment of the new political order. The fairness, openness and flexibility of the privatization process may enable Slovenia to enjoy the stability it needs in the near term to realize the full benefits of a private market economy in the long term.

Internationally, this social and economic stability has made Slovenia more attractive for foreign investment. In fact, it is now viewed very favorably by surveys that rate the total climate for new business ventures.

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POVZETEK

PRIVATIZACIJA IN TRŽNE REFORME V SLOVENIJI

Štiri leta po izstopu iz Jugoslavije je Slovenija pričela uresničevati svoj edinstveni zakon o privatizaciji in z njim mnoge prednosti resničnega tržnega gospodarstva. Da bi pojasnil uspešnost slovenskega ekonomskega razvoja in njegove možnosti za bodočnost, se pisec članka ustavlja predvsem pri slovenskem odhajanju iz samoupravljalnega sistems, pri njegovem izgubljanju jugoslovanskega trga, in zlasti še ob razpravljanju o razvojnih možnostih slovenskega gospodarstva v bodočnosti. V razmišljanju se še posebno dotika vprašanj privatnolastninske zakonodaje, ki bo slovenskim organom upravljanja in delavcem podjetij omogočila postati večinski lastnik v več kot 80 odstotkov svojih podjetij. V razpravi se pisec članka ustavlja predvsem pri svojih izkušnjah, ki si jih je pridobil kot svetovalec slovenske privatizacijske agencije in kot svetovalec več slovenskih podjetij; njegov namen namreč je obrazložiti, kako legalne spremembe lahko vplivajo na managerje podejetij in kako managerji sami gledajo nanje.