

Crisis in Slovenia: Roots, effects, prospects

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Abstract

The author examines the last 20 years of Slovenian economic history. He argues that export-led economic model based on depreciated domestic currency and capital controls enabled stabilization and convergence with developed EU economies until 2004. The period of debt-led growth characterized by instability and recurrent recession after 2008 is explained by dissolution of the earlier economic model after Slovenia's accession to EU. A brief comparison is then made that reveals a striking resemblance with the case of Portugal which joined ERM about a decade earlier. From this it is inferred that the crisis is structural and that no simple return to earlier economic models could secure further convergence.

Keywords: Slovenia, economy, crisis, economic development.

1. Introduction

This paper is composed of three parts. First two sections deal with two distinctive periods of Slovenia's recent economic history. The first focuses on the period of export-led growth in the 1990s and early 2000s, the second on the period of debt-led growth, characteristic of the years just before and during the present Great Recession. The third section compares the Slovenian economy with those of other EU member-states. Based on that it tries to identify three possible strategies to overcome the present setback.

2. The period of export-led growth¹ (1993–2003)

This period can be divided (Kračun, 2008) into two sub-periods, the period of stabilization (1993–1997) and the period of stable growth or convergence with core EU member-states (1998–2004). This subdivision is justified by the fact that Slovenia regained its pre-transition GDP in 1997. The period of stabilization began in 1993 with the end of so-called ‘transition depression’, i.e. the sharp slump after the collapse of socialist Yugoslavia. After 1993 the economy witnessed sustained economic growth and reduction of unemployment and inflation. The period of stabilization was also a period in which most of the institutional reforms, such as privatization, were carried out.

A few words should be said about the starting point of transition. Firstly, Slovenian economy was open, exporting to other Yugoslav republics and Western markets. The balance of payments constraint was a crucial factor in economic management: maintaining a surplus of exports over imports in relation to other republics and foreign countries was an important goal of the economic policy. Secondly, it was able to achieve, right until the late 1980s, full employment with rates of registered unemployment below 1.8% (Woodward, 1995: 829-54).

In the late 1980s and early 1990s the pillars of the model were shaken. Trade liberalization and exchange rate stabilization came simultaneously with the break-up of Yugoslavia and disappearance of its common market. This triggered a massive wave of bankruptcies with a huge loss of jobs.² Nonperforming loans piled up in the banks’ balance sheets. Inflation was still soaring (240.6% and 92.0% in 1991 and 1992, respectively, cf. Table 1).

Those factors were to become the central challenge of the period of stabilization. Two of them proved to be decisive. First of all, exporting sectors successfully reoriented to Western markets as witnessed by a current account surplus (6.3 % as a proportion to GDP) in 1992 and surpluses in the subsequent years of stabilization. Of course, this was not only the result of growing exports, but also of diminishing imports. Secondly, international competitiveness was not

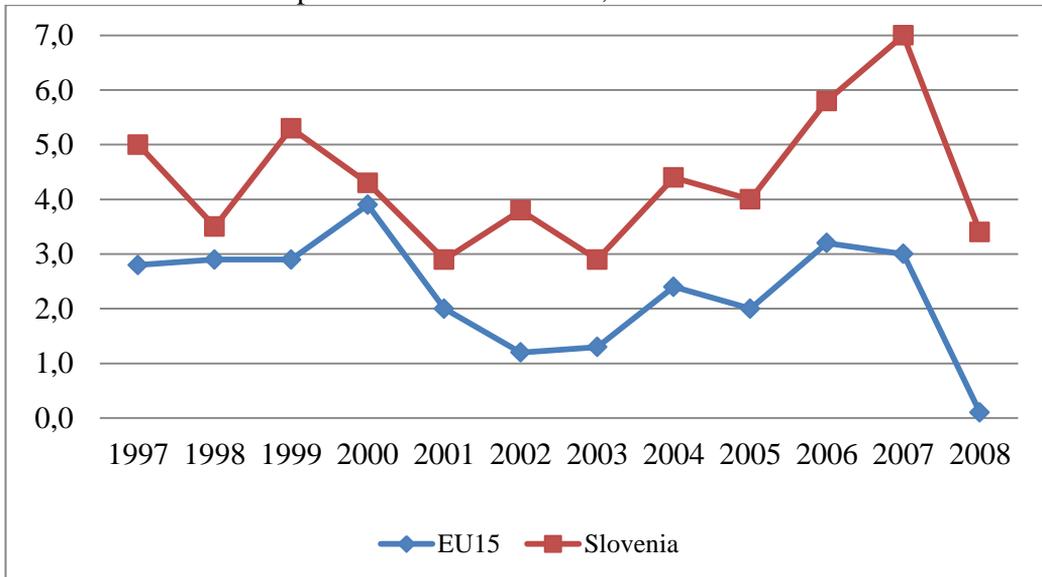
¹ This term has been used by Stockhammer (2012) who distinguishes debt-led growth model in countries with high current account deficit and high household indebtedness (USA, UK) from export-led model in countries with current account surplus and low household indebtedness (such as Germany, Japan and China) as two alternatives in face of diminishing wage-led demand. As Stockhammer (2012: 13) points out, Central European countries do not exactly fit into this model. The same goes for Slovenia. In the first period, characterized as export-led, Slovenia did not always have current account surpluses (cf. Table 1). Thus, the depreciated domestic currency and investment based on domestic accumulation rather than international capital flows must also be stressed as crucial elements of the model.

² In 1987, 867,797 persons in paid employment were registered, but only 665,568 in 1993. The number of registered unemployed persons grew from 15,184 in 1987 to 129,087 in 1993 (*Statistical Yearbook*, 1994: 190).

obtained at the expense of the living standard - at least of those still employed. After a sharp decline in real wages in 1991 and 1992 (-22.3% and -1.4%, respectively), average yearly growth of the real wage in 1993-1997 was 5.9% (Kračun, 2008: Table 2). There are some indications that the rise of wages was crucial in securing the growth of output because it offset the fall in external demand caused by European recession (Kračun, 2008: 13-4). Liberalization of prices brought down inflation considerably (cf. Table 1), but prices of non-tradables and wage rises still pushed export prices up. Instead of an exchange rate anchor that would have made price competitiveness dependent on “internal” devaluation (i.e. cuts in wages and taxes), a free-floating exchange rate was implemented. “External” depreciation was therefore used to offset the rise in domestic prices. The instruments used by the Bank of Slovenia to prevent appreciation of the currency also acted as checks on the movement of capital. Both were vital elements of the growth pattern prevailing until 2004.

Economic performance between 1993 and 2004 presented in Table 1 and Figure 1 can be interpreted as a continuation of the favorable trends in the period of stabilization. The latter can be said to have ended in 1997 when Slovenia regained pre-transition GDP, in fact much sooner than other transition economies (Buchen, 2007).

Figure 1
Comparison of Growth Rates, EU15/Slovenia



Source: Eurostat.

Let us briefly consider other aspects of transition, such as privatization, wellbeing of citizens and effects on the class structure of the society. These features are important because privatization established a specific ratio of equity to debt capital, which affected the conduct of the corporate sector before the crisis, thus affecting its manifestations.

There were four major privatization processes: (i) transformation of ownership of enterprises, (ii) bailing out of the banking sector; (iii) restitution of assets nationalized after WWII ('denationalization') and (iv) privatization of socially owned housing.

(i) Much like in other Central and Eastern European (CEE) countries, socially owned firms ('social capital') were privatized by free distribution of vouchers. Thus, no fresh capital has been invested into corporate sector as would have happened, if the firms had to be bought-out with actual money. A rather specific ownership structure was established. Medium and smaller (labor-intensive) enterprises came under the control of their management and (retired) workers (and their families). The largest share of the 'social' capital, however, was obtained by private investment funds managed by holding companies, which 'bought' the shares with certificate vouchers invested by citizens. However, the control of investment funds was soon centralized in the hands of their managers rather than 'shareholders', and the most of the equity was centralized in few of the existing 24 holding companies. Another large owner was the state. First of all, at least 40 % of social capital in a given firm was transferred to state funds. Their capital gains were to be used to co-finance restitution of nationalized property (Restitution fund) or old-age pensions (Capital fund). Unprofitable firms were transferred to the Development fund to be restructured and later privatized. All in all, the ownership structure was dispersed, the share of public and household ownership high, as was the ownership of financial companies. The share of foreign-owned equity was rather low (Mencinger, 2006). However, centralization began very soon as reflected by diminishing number of shareholders in privatized companies. Households, preferring consumption, especially tended to sell their assets.

(ii) The banking sector was nationalized rather than privatized. This paradox was the result of socialist institutional setting and the crisis of the "real economy". Banks under the socialist regime were cooperatives controlled by the companies that founded them (Woodward, 1995: 185). Thus, they were privatized automatically with the owning firms. However, nonperforming loans made many banks insolvent. They had to be bailed out. This was achieved by nationalization of the two largest banks and the transfer of bad assets to the state agency acting as a 'bad bank'. Together with the Slovenian part of ex-Yugoslav debt, these costs were the main source of public debt. Though (foreign) private banks entered the

market, state-owned banks remained dominant. This still differentiates Slovenia from other CEE countries.

iii) Restitution of assets (land, real-estate, equity) had considerable effects on asset inequality of population, but only marginal on the economy. Out of DM 2.8 bln. of property privatized this way, only about 13% were equity.

iv) Remarkably, privatization of socially owned housing also affected the economy. Yugoslav self-managing firms were namely responsible for providing housing to their workers either by provisioning credit for private builders or by financing the construction of socially owned housing. Firms owned 68% of the rental housing. In 1991, they were obliged to sell them to their existing tenants at discount prices. It is believed that about 100.000 apartments were privatized this way. However, the money was not paid to the firms, but to the state budget. The main effect on corporate sector was the reduction of firms' assets (capital). Much like 'denationalization', this process induced an arbitrary appropriation of social wealth to people, occupying socially owned housing in main urban areas. On the other hand, it completely excluded foreign nationals who were not eligible to own real estate although they used to have the same "dwelling rights" as Slovene nationals. This redistribution also favored urban to rural areas where private construction prevailed over social.

Privatization and establishment of capitalist property and production relations destroyed the egalitarian socialist class structure. But, unlike other CEE economies, which developed into 'liberal market economies' (like UK), Slovenian economy resembled 'coordinated market economies' (such as Austria and Scandinavian countries), as argued by Feldmann (2006) and Buchen (2007). It was characterized by strong trade unions, high job protection and welfare spending plus a large public sector. The results were high rates of employment and record low Gini coefficient (0.22 in 2001), indicating robust social cohesion.

The recent class structure of Slovenian society is poorly studied. The transition established capitalist and managerial ruling classes as opposed to proper wage-laboring class and – after years of full employment – a persistent reserve army of labor. It stimulated the growth of non-agrarian small enterprises (mostly in the service sector), the economic basis of traditional petty bourgeoisie. Contrary to what one might expect, the modern petty bourgeoisie (public sector and welfare state employees and [semi]professionals) endured and grew both in numbers and influence.

Table 1
Socioeconomic performance in the 1st period (1993–2003)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
<i>GDP growth (% p.a.)</i>	2.8	5.3	7.4	3.6	5.0	3.5	5.3	4.3	2.9	3.8	2.9
<i>(relative to EU15 average)</i>	3.8	2.8	5.7	1.8	2.2	0.6	2.4	0.4	0.9	2.6	1.6
<i>Unemployment rate (%)</i>	9.1	9.0	7.4	6.9	6.9	7.4	7.3	6.7	6.2	6.3	6.7
<i>(relative to EU27 average)</i>								-2.1	-2.4	-2.6	-2.4
<i>Current account balance (% of GDP)</i>	1.5	4.0	-0.3	0.2	0.3	-0.6	-3.2	-2.7	0.2	1.0	-0.8
<i>Net external debt (% of GDP)</i>									-1.4	-2.6	-1.7
<i>Inflation rate (% p.a.)</i>	22.8	19.5	9.0	9.0	8.8	6.5	8.0	8.9	8.6	7.5	5.7
<i>General government balance (% of GDP)</i>	0.3	-0.2	0.0	0.3	-1.1	-0.6	-2.2	-3.7	-4.0	-2.4	-2.7
<i>General government debt (% of GDP)</i>			18.6	21.9	22.4	23.1	24.1	26.3	26.6	27.8	27.2
<i>Gini coefficient</i>									0.22	0.22	0.22

Source: Eurostat, except for general government debt (AMECO) and inflation before 1997 (Kračun, 2008). Quarterly figures (Q4) are used for net external debt. Figures in lines 2 and 4 are calculated as a difference between the figures for Slovenia and respective EU average. Data on Germany are used as a proxy for EU15 for years 1993–5.

3. The period of debt-led growth and the crisis (2004–13)

The shift in the growth model was not instantaneous. It was, however, dramatic. The growth based on domestic accumulation, controlled flows of capital (credit) and floating exchange rate (leading to external devaluation) was abandoned in the process of accession to the EU and especially EMU. Indeed, it was monetary policy that proved to be decisive. Exchange rate was fixed to Euro when Slovenia entered ERM II in July 2004, putting an end to capital controls, reducing inflation below 3% and long-term interest rates to 5.2%. Surely, all the remaining protectionist measures (such as tariffs) were abolished with the integration into the common market, but their effects were secondary to those of monetary policy.

It has to be emphasized that the old model was not abandoned because of its possible inefficiency. Its performance have not deteriorated. The new model was not chosen after a rational consideration of alternatives. On the contrary, the move was entirely ideological and pragmatic: accession to the EU (and EMU) was the central objective of the ruling classes never to be questioned. And since the Maastricht criteria and rules of the EMU were incompatible with autonomous monetary policy, the latter had to be abandoned.

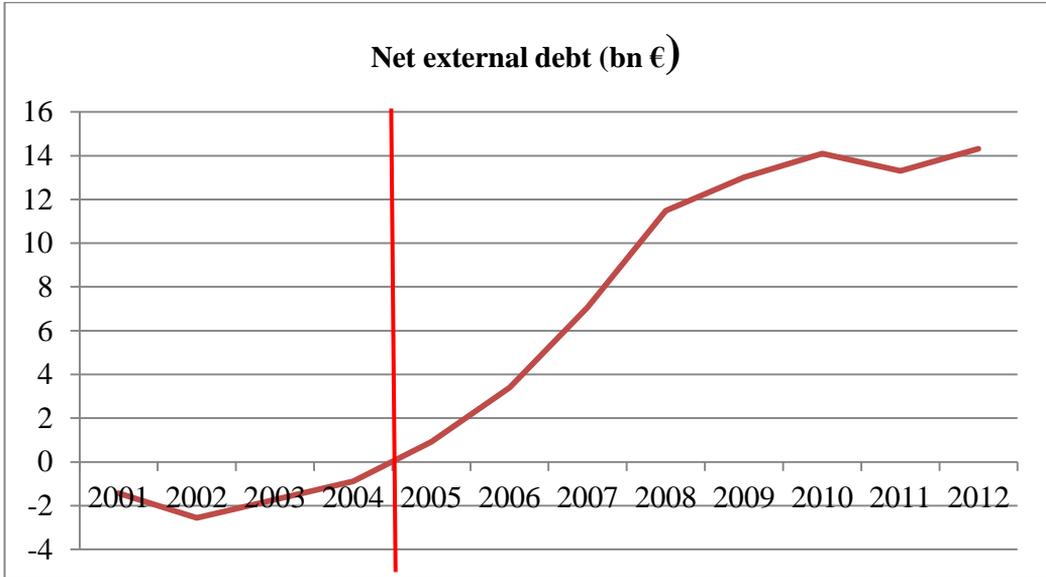
This second period should also be divided into two sub-periods: the period of destabilization (2004-2008) and the period of crisis (2009-2013).

3.1. The period of destabilization

The period of destabilization can be characterized as a period of credit-fueled overheating of the economy. Two indicators are the most telling, the growth of private debt and net external debt (Figure 2).

In 2007, the year when Slovenia entered the Eurozone, the growth of credit to corporate sector reached a stunning 29.8%, whereas the average growth in 2001-2004 was about 13%. Net external debt also exhibited dramatic trends. In August 2005, Slovenia still had a positive position (i.e. it was a net creditor to the rest of the world), while at the end of 2008, the net debt reached €11.5 bln. Foreign credit was taken on by the domestic banks, acting as a mediator between foreign capital markets and domestic corporate sector (Mencinger, 2011).

Figure 2
Debt accumulation in Slovenia after 2004



Source: Bank of Slovenia.

However, it is not only the rapid growth and the amount of indebtedness that is important, but also its structure. The specificity of the Slovenian case is the extremely high share of credits to corporations (rather than households) in total credits, which amounted to 54% vs. 26.3 % in EU17 (Mencinger, 2011). Indebtedness of the corporate sector was enhanced in the period of destabilization. Debt-to-equity ratio reached 144% in 2010 (vs. 111% in EU17).

This ‘addiction’ with credit could be reflecting the lack of equity capital partly linked to privatization. However, before turning to that issue, one must examine the overall performance of the economy (cf. Table 2). Foreign credit fuelled investment: in 2007, gross capital formation grew by 19.3% and gross fixed capital formation by 13.3%. Credit expansion also fueled aggregate demand (11.8% increase in 2007). GDP grew by 7% in 2007, the highest rate since 1995). In comparison, the average growth in the ‘convergence period’ was 3.8% (cf. Table 1).

The growth in the period of destabilization was, however, short-lived and ‘unsustainable’. This is confirmed by three indicators:

(i) Current account deficit grew because exports lagged behind imports (in 2008, the index of imports was 185, index of exports 175, 2003: 100) and because of larger outflow of dividends and interest payments. (ii) Inflation rose as well, reaching 5.5% in 2008 (highest since 2003). Unit labor costs increased (reached

110.3 in 2008, while in Germany they decreased to 99.4, 2005: 100), whereas productivity was lagging behind (growth between 2004 and 2008 was 18.9% in Slovenia and 35.6% in EU27).

(iii) Inflation of asset prices (i.e., relating to fictitious capital) was even more stunning. The value of financial assets increased enormously: Ljubljana stock exchange index (SBI 20) inflated to 12242 points in 2007 (vs. 4935 in 2004, about 2.5 times higher), as did the real-estate prices.³

Before turning to financial destabilization, it is necessary to comment on the trends presented above. By 2008, the previous model of growth constrained by the balance of payments and led by domestic accumulation has all but vanished. The new model was eroding price competitiveness in a manner that resembles Portugal's boom when it was entering the EMU (Blanchard, 2007). Like in Portugal, the positive side of the 'boom' was that it brought down unemployment, though, as in the case of Portugal, not for long.

As we examine in the last section, Portugal's boom ended in a slump, much like the Slovenian. However, Slovenia's boom was ended by the global 'Great Recession'. Local developments were interrupted before reaching their 'natural' conclusion. The burden of erroneous credit-fueled overinvestment was nevertheless enormous. That is why it is instructive to take a closer look of debt-accumulation mechanism and of consequent investment. Empirical studies of all Slovenian firms with more than 100 employees are available (Bole *et al.*, 2011; 2012a, 2012b). Their findings could be summarized as follows:

1) 'In all analyzed countries, except for Slovenia, the high increases in debt before 2009 and drops following were only limited to a small share (around 10–25%) of firms.' (Bole *et al.*, 2012a)

2) 'In Slovenia, median firms increased core investments in the climax of the boom period by almost 50 percent (!) of balance sheet sum in just one year. By investing so fiercely, Slovenian median enterprises surpassed the top median enterprises in other European countries [...] by more than 40 percentage points of the balance sheet sum!' (ibid.)

3) 'Although investments in core business activities were by far the most important drivers of the increasing financial debt of firms throughout the observed period,⁴ firm's indebtedness was also strongly influenced by long term financial

³ In 2003–7, prices of non-residential buildings went up by 65%, the prices of apartments and land were up by 80% and the prices of houses almost by 100% (GURS, 2007: 10).

⁴ Of course, growth was differentiated across economic activities. In 2007, value-added grew by 16.8% in constructions and 14.3% in financial services. The story of transport industry, traditionally important because of countries' geographic position, is very telling. Total fleet capacity has more than doubled (index 230) between 2006Q2 and 2008Q2. Moreover, as the prices of real-estate grew,

(portfolio) investments. However, the effects of the investments in real estate assets were much smaller, but not negligible.’ (Bole *et al.*, 2012b).

How can one interpret these facts? First of all, it was not stock market bubble nor, indeed, the real-estate bubble that were essential, but rather erroneous overinvestment in core activities. This trap of cheap money and potentially gainful investment was present in all Europe. But investment in core activities was the dominant way of spending money in Slovenia and, unlike in other European countries, it was fairly equally distributed among the firms, rather than being concentrated in specific clusters. Some authors claim that this ‘clearly demonstrates an absence of any macroeconomic brakes as a crucial failure of macroeconomic policy in the boom years 2007-2008’ (Bole *et al.*, 2012a). It is a fact that no anti-cyclical measures were implemented by the Bank of Slovenia (like raising capital requirements) and that the government acted pro-cyclically. It increased the amount of cash and credit in the economy by repaying its debt to domestic investors, mostly banks, ahead of time (operation was financed by issuing long-term Euro bonds). It issued warranties for new external borrowing by the state-owned highway building company (DARS). It lowered payroll taxes and raised government spending. In short, government measures made money cheaper and investments (potentially) more gainful.

The mistakes of the Slovenian government and the specific conditions in Slovenia made the trap of cheap money worse. The concept of ‘financial accelerator’ was suggested to measure the effect of those country specific factors. The point is rather simple: when the price of assets is rising, the potential profitability of investments rises as well. Alongside with it grows the borrowing potential of firms, because rising value of their assets gives them more potential collateral. Financial accelerator in Slovenia was the highest among the European countries studied (Bole *et al.*, 2012a).

One last observation has to be made. Centralization of ownership of some ‘semi-privatized’ firms was making progress throughout this period, especially in the form of manager LBOs (leveraged buy-outs) and centralizations of capital through acquisitions of other firms. As a rule, the shares of the target company were used as collateral to acquire loans. In such cases financial accelerator is associated with earlier privatization that created a rather dispersed ownership of many corporations. Another, though less clear-cut correlation is to the method of privatization. As already mentioned, the strong ‘pull’ for credit might be explained by the lack of equity capital in privatized firms, which were bought with ‘pieces of paper’ and stripped of their real-estate assets by the privatization of socially owned

transportation firms started investing in it as well, which is unusual for their activity and indicates speculation (Pahor *et al.*, 2011: 167).

housing. This absence of ‘patient capital’ is now used by some, for instance ex-governor of the Bank of Slovenia, as an argument for further privatization, i.e. selling of firms to foreign companies rather than maintaining state or domestic private ownership. We will return to this in the concluding section.

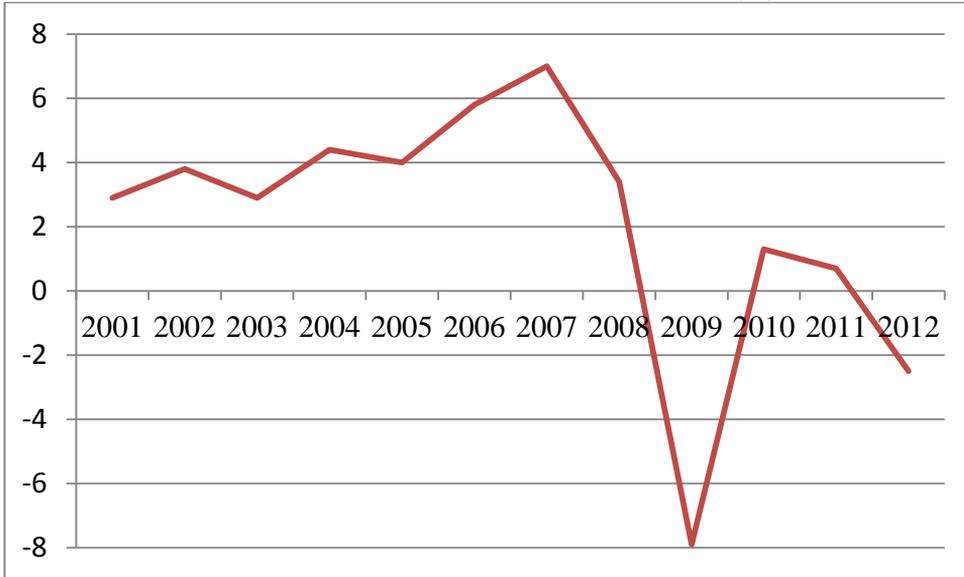
Slovenia did not escape the ‘iron law’ of business cycles. What happened could be appropriately termed the ‘Minsky moment’. Stability and good prospects of future capital returns drove investment, credit and speculation up to a point when external demand collapsed and asset prices plummeted.⁵ The cash flow generated by core business activity and assets was insufficient to repay or refinance the debt and often to maintain the core activity as well.

3.2. The crisis (2009-13)

The crisis in Slovenia is a W-shaped crisis with two major slumps, one in 2009 and the other in 2012. The crisis started in the export (especially manufacturing) sector. It affected non-tradeables such as constructions and real-estate by 2010. By that time, the banking sector was adversely affected and the ‘credit crunch’ began. The combined effect of economic and banking sector crisis was the rise of the amount of nonperforming loans. This required massive state interventions in 2011, 2012 and 2013. With negative (2009, 2012) or insignificant (2010, 2011) GDP growth plus stagnating or diminishing (2011 and on) state revenues, this put a great strain on public finance. Demanded yields on government bonds sometimes surpassed 7%. Austerity measures were adopted which cut government spending, but these also negatively affected growth which turned negative again in 2012 after two years of weak recovery. In short, the crisis of ‘real economy’ developed into a crisis of the banking sector, which further evolved into a crisis of public finance (sovereign debt and government deficit). Let us briefly examine this chain of events.

⁵ Real-estate market contracted. Prices of houses dropped by 25%, prices of apartments by 17% between the peak of 2007/2008 and 1st half of 2013. (GURS, 2013)

Figure 3
GDP Growth in Slovenia, 2001-2012 (%)



Source: Eurostat.

3.2.1. The crisis of the 'real economy'

The downturn came in the last quarter of 2008 with a sharp decline of exports and, consequently, domestic demand. In 2009, GDP dropped by 7.9%, exports by 16.1% and industrial output by 16.7%. The unemployment was continuously rising. Initially, certain 'Keynesian' measures were implemented. The minimum wage was raised, subsidies were used to save jobs, private corporate debt was guaranteed by the state. There were liquidity injections to state-owned banks in the form of small-size recapitalizations and large government deposits. Together with the rise of external demand this brought about a short but incomplete recovery (GDP reached €36.15 bln. in 2011 compared to €37.24 bln. in 2008). The exporting sector seemed to have fared better than the rest of the economy. Already in 2011, exports surpassed the pre-crisis high (€20.7 bln. compared to €19.7 bln. in 2008). Credit growth resumed although at a much slower pace than before (though faster than in the EU17), until July 2010 (when the growth rate reached 2%), then slowed down and turned negative in February 2011. In July 2010 credits to corporations amounted to €21.3 bln. (vs. €19.4 bln. at the end of 2008), but then they shrank to €18.6 bln. in January 2013.

The reasons for 'credit crunch' remain highly debated. It seems that both push and pull factors should be taken into account:

(i) Firms were highly leveraged and their assets were devalued quickly; thus, they were unable to service their debt, let alone to take on new loans. This was especially true in case of construction firms, notorious financial holdings and large firms in the process of LBO. The construction sector began collapsing at the end of 2009, and has been declining at a rate of 12% and 13.9% in 2010 and 2011, respectively (in terms of number of hours worked). The value of construction put in place fell from a record high €4.7 bln. in 2008 to €2.6 bln. in 2011. Literally, all large construction firms went bankrupt in 2010 or 2011. The number of persons regularly employed in the sector fell from 87,947 in 2008 to 59,792 in 2012.

(ii) Stricter capital requirements (Basel III) were imposed by the Bank of Slovenia in 2010, a year before than in other EU17 countries. In both cases, banks reacted by cutting loans. Credit growth stopped in the next quarter after implementation and then turned negative (Bole, 2012). This happened both in Slovenia and EU17, but in Slovenia it happened a year earlier. Credit to enterprises grew only 0.07% in 2010 and turned negative next year. Some observers claim that this was the main trigger of the new slump. In the absence of fresh capital, the banks reacted with contraction ('bank strike'). Thus, the debt of otherwise viable companies could not be reprogrammed.

The overall result was a huge loss of jobs. Depending on the measurement (labor force survey or register data), there are now between 70,000 and 86,000 less employed persons than in the peak year of 2008.⁶ Unemployment rate is currently 9.6% (4.4% in 2008).

3.2.2. The banking crisis and the crisis of public finance

The credit crunch and bank strikes triggered massive growth of nonperforming loans of the banking sector rendering the reprogramming/repayment of debts impossible for many firms in distress. The growth of nonperforming loans and capital requirements of the banking sector demanded government action. As a first step, government secured the liquidity of banks by borrowing money on international financial markets and placing it into banks in the form of deposits. Then, rather modest recapitalizations of two largest (state owned) banks followed in 2010 and 2012. Capital adequacy of the whole banking sector has remained stable (11.7% in 2008 and 11.9% in 2012), but at a cost of shrinking of total assets from in €51.6 bln. in 2009 (146% of GDP) to €46.13 bln.

⁶ According to Statistical Office of the Republic of Slovenia data bases, approximately 990,000 people were in paid employment in Slovenia (labor force survey) or around 880,000 in regular employment in 2008. Not all of those people became unemployed; some of them were retired. Still, there were 66,262 registered unemployed persons in Slovenia in 2008, whereas there were, at the moment of writing, almost 130,000 registered 'job-seekers'.

(130% of GDP) in March 2013. The process continues. Loans-to-deposits ratio (LTD) was reduced to from 162% in 2008 to 126% in 2012, which is still above EU17 average (109%).

Despite this, the amount of nonperforming loans has been rising constantly to reach € 7 bln. in September 2008 (14% of portfolio).⁷ The distribution of nonperforming assets is disproportional.⁸ State owned banks have the largest share of bad assets (the largest bank, NLB, supposedly over 30% of its portfolio). The three largest banks have estimated €4.9 bln. of bad assets (24.61% of all assets). Their average capital adequacy ratio is now 11.6%. The government decided to deal with this problem by creating a “bad bank”. It was formally established in the beginning of 2013, but no assets were transferred until December after EC and ECB instructed stress tests and asset quality examinations have been carried out. As a result, € 3.46 bln. of government funds (cash and bonds) have been pumped into the banks by recapitalization. €4 bln. worth of bad assets have been transferred to the “bad bank” for the exchange of €1.7 bln. worth of state guaranteed bonds.

3.2.3. The crisis of public finance and welfare state

Such large expenditures have obviously affected public finance, especially in a time when state revenues stagnated and began slightly declining (by 2011). Government deficit increased from 0% in 2007 to 6.3% of GDP in 2009. Public debt burden rose from a modest 22% in 2008 to 38.7% in 2010 and 47.1% in 2011. Austerity measures helped to curb the deficit to 3.8% in 2012, but it didn't prevent the debt burden rising to 54.4% of GDP in 2008. This was still well below the EU17 average (90.8%) but its refinancing began to create problems. Following the turmoil in the Eurozone, the yields on Slovenia's 10-year bonds began rising in the autumn of 2011 with required yields exceeding 7% in November 2011 and again in January and August 2012 putting the country effectively out of the international financial markets for a time. However, financing of deficit was not jeopardized as government continued to issue treasury bills and later also long-term dollar bonds (Autumn 2012, Summer 2013 and the early 2014) plus a 3-year Eurobond in the Autumn of 2013), but yields remained high. Currently, interest payments on sovereign debt amount to 2.2% of GDP (1.1% in 2008, but 2.4% of GDP in 2001),

⁷ Official data of the Bank of Slovenia (2013c: 43). However, in the assessment in the common report of the Bank of Slovenia and ECB on recent stress tests the figure is much higher, i.e. above €9 bln. or 27% of all assets (Bank of Slovenia, 2013b: 110).

⁸ It is also disproportional in terms of the debtors. The sectors with the highest share of non-performing loans are construction and financial intermediation (Bank of Slovenia, Financial Stability Review, May 2013, 30, Table 3.6)

but they will necessarily grow with the maturing of the newly taken debt, which is to reach 70% of GDP (and possibly more) in 2013.

If compared to Greece or Portugal, austerity measures were rather mild due to the fierce struggle of the trade unions and general unrest that triggered the collapse of the Janša government at the beginning of 2013. Public sector employment was actually rising up to June 2012 and massive layoffs were altogether avoided even after explicit reduction of jobs began in July 2012.⁹ Public sector wages were growing until June 2012 when wage cuts were implemented. Private sector wages have tended to rise moderately.¹⁰

At the moment, prospects are grim. According to the latest estimates, GDP growth rate has dropped to 1.1% in 2013 and the growth, if any, in 2014 will remain weak. The debt burden will probably exceed 75% of GDP. The only positive element is the growing current account surplus (probably around 7% of GDP in 2013) and weak but stable growth of exports. However, the recovery will be a jobless one, because the level of employment will probably decline for two more years.

What can be said of the last 10 years of economic development in Slovenia? It is obvious that the 1993–2003 growth model has dissolved. Its only remnant is the current account surplus. Certain features of the “coordinated market economy” have endured, such as high employment in the public sector, relatively high income equality and still relatively modest poverty rate. However, two strong factors of inequality are gaining strength. Firstly the developments in the labor market, not only because of unemployment, but because of segmentation between fulltime regular employment with its safety nets and protection and growing precarious employment with overrepresentation of women, migrants and youth. Secondly, because the quality of social services is (in comparison to developed countries) declining, especially in health care. This means less factual equality when it comes to health service and also that the modern petty bourgeoisie’s (public employees’) position is threatened by privatization tendencies coming from within and outside the public sector. Social cohesion is under threat, no doubt, and the outcome will depend on what happens in the economy.

⁹ New employment in the public sector has been limited and a number of older public employees were retired.

¹⁰ Higher salaries were cut disproportionately more than lower.

Table 2
Socioeconomic performance in the 2nd period (2004–2013)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
<i>GDP growth (% p.a.)</i>	4.4	4.0	5.8	7.0	3.4	-7.9	1.3	0.7	-2.5	-2.7*
<i>(relative to EU15 average)</i>	1.8	1.8	2.4	3.8	3.0	-3.4	-0.7	-1.0	-2.1	-2.7*
<i>Unemployment rate (%)</i>	6.3	6.5	6.0	4.9	4.4	5.9	7.3	8.2	8.9	
<i>Current account balance (% of GDP)</i>	-2.6	-1.7	-1.8	-4.2	-5.4	-0.5	-0.1	0.4	3.3	6.8*
<i>Net external debt (% of GDP)</i>	-0.9	0.9	3.4	7.1	11.5	13.0	14.1	13.3	14.3	
<i>General government balance (% of GDP)</i>	-2.3	-1.5	-1.4	0.0	-1.9	-6.3	-5.9	-6.3	-3.8	-5.7
<i>Government debt (% of GDP)</i>	27.3	26.7	26.4	23.1	22.0	35.2	38.7	47.1	54.4	63.1
<i>Inflation (% p.a.)</i>	3.7	2.5	2.5	3.8	5.5	0.9	2.1	2.1	2.8	
<i>Gini coefficient</i>		.238	.237	.232	.234	.227	.238	.238	.237	
<i>Poverty risk (% of population)</i>		18.5	17.1	17.1	18.5	17.1	18.3	19.3	19.6	
<i>(relative to EU27 average)</i>		-7.2	-8.2	-5.2	-6.1	-5.4	-5.0	-4.2	-5.2	

Source: Eurostat, except for the general government debt (AMECO). Quarterly figures (Q4) are used for net external debt. Figures in Lines 2 and 11 are calculated as a difference between the figures for Slovenia and respective EU average.

* Estimations.

4. The structural nature of the crisis and its possible outcomes

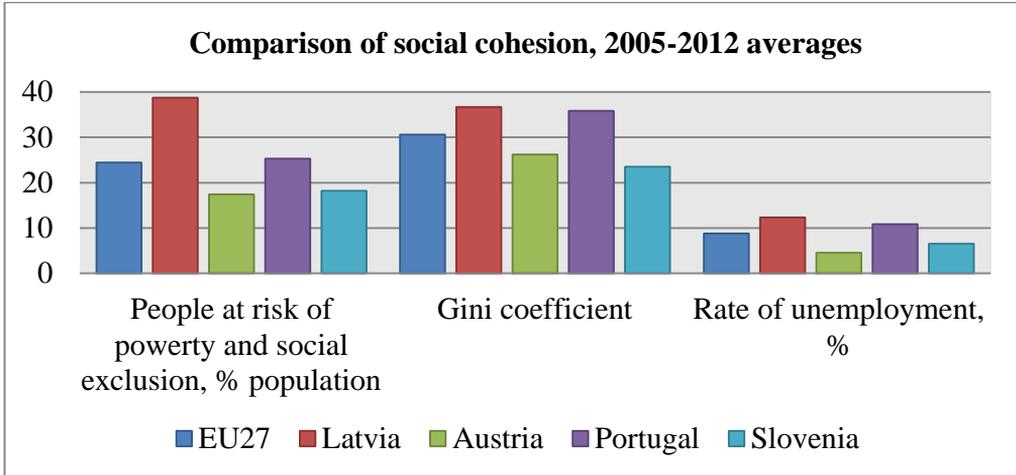
In this section, the Slovenian case will be brought into a wider European context, and some predictions will be made regarding the future development.

The Slovenian socioeconomic model can be summed up in a short formula: An East European country with South European level of economic development and Scandinavian type of social cohesion:

(i) In terms of GDP per capita in PPP it has outstripped Portugal already in 2001 and Greece in 2011 and it has been closing the gap in relation to Spain and Cyprus.

(ii) In terms of Gini coefficient and employment rate, Slovenia fits into the Scandinavian model; it has the lowest Gini coefficient in EU and the highest employment rate of all East and South European countries except Cyprus (Mencinger, 2013: 27). It has the highest Human Development Index of all East and South European countries, etc. (cf. Fig. 1).

Figure 4
Social cohesion in some EU member-states



Source: Eurostat.

This outcome is the result of Slovenia's favorable position at the beginning of the transition to capitalism and by the fact that its development was to a certain point endogenous, i.e. supported by following factors:

(a) Autonomous monetary policy until 2004, i.e. free floating rather than fixed exchange rate (ending up with depreciation rather than appreciation of domestic currency), relatively high inflation and controlled capital flows.

(b) Local, often state ownership prevailing over foreign ownership dominant in East European countries especially in the banking sector. East European model based on FDIs witnessed several weaknesses not inherent to early 'Slovenian model'. Mencinger (2009: 9; 2013: 16) calculated that in the period of 1993–2008, East European countries achieved an annual average growth rate of 4%, coupled with 12% unemployment and 6% current account deficit as a proportion to GDP, plus substantial budget deficits. Slovenia fared much better with an average growth rate of 4.5%, a current account deficit / GDP ratio of 1.0%, an unemployment rate of 6.75% and a small budget deficit (around 1.5% of GDP).

Can the history of European integration give us a clue about future developments? Senjur (2007; 2012) argues that EU can be divided in three developmental groups:

a) High-income countries (HIC's) in the center with GDP per capita in PPP above average (average 117%, EU25: 100, 2002) and innovation-based growth.

b) Middle-income countries (MIC's) of the Southern periphery with GDP per capita greater than 75% threshold (on average 80%) and growth based on increasing efficiency.

c) Low-income countries (LIC) of the Eastern periphery with GDP per capita below 75% threshold (on average 45%) with growth based on the expansion of production factors.

Senjur (2007) points out that group-membership remains very stable. Only some small countries¹¹ have shifted up during the last 50 years. One was Ireland. Between 1991 and 2003 it gained 70 percentage points in GDP per capita (50 in terms of PPP, EU15:100,) and transformed itself from an MIC to HIC. The other was Slovenia, which transformed itself from a LIC to MIC by gaining 21 percentage points (12 in terms of PPP, EU15:100) in the same period.

The point is that the gap cannot be eliminated with methods of growth characteristic of the existing level of development. A change is needed and it can be achieved in two ways: either by some endogenous innovation or with a bypass. Ireland made an exogenously-driven bypass by relying on US investments that brought in monopolized advanced technology and knowledge that could not have been acquired by any other way. Slovenia's more modest break was endogenous, it consisted of implementing and upgrading of technologies/knowledge used by the MIC's. In the rest of this paper I will address two questions that follow from this premise:

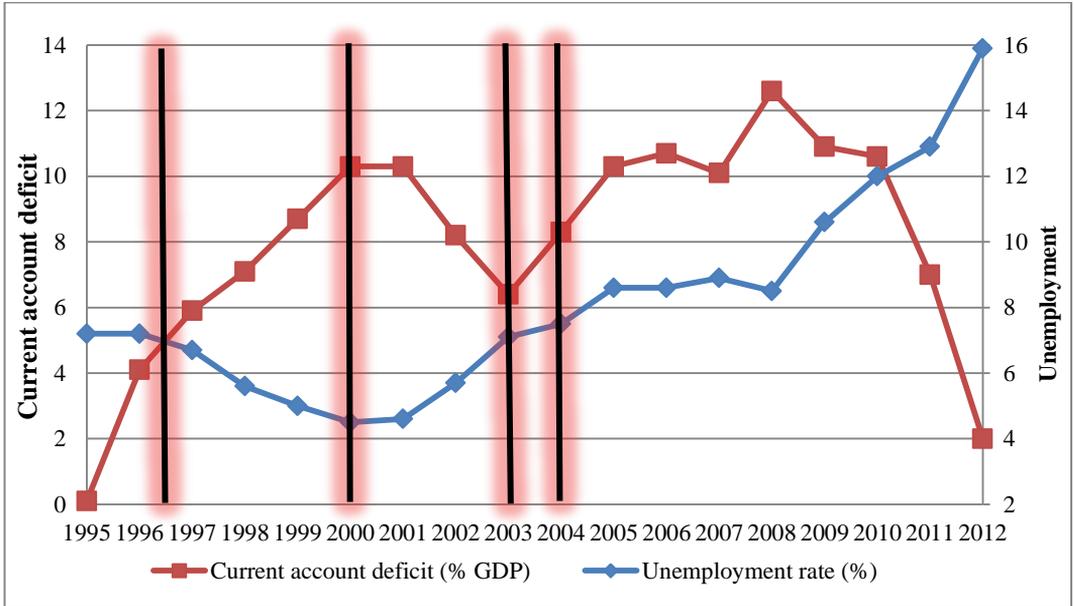
- (i) Given the crisis, can a country like Slovenia preserve its position?
- (ii) Could it eliminate the gap separating it from developed economies?

To answer the first question, let us look at the case of Portugal. Slovenia's boom-bust cycle in 2004-2013 closely resembles that of Portugal in 1995-2006 (Blanchard, 2007). Portugal joined the ERM II and later EMU. Interest rates declined, investment and consumption boomed. No anti-cyclical measures were implemented to halt overheating. Unemployment fell, but wages rose faster than productivity, which meant growing unit labor costs. Price competitiveness fell and current account deficit rose from 0 in 1995 to about 10% in 2000 (Figure 5).¹² This is remarkably similar to Slovenia in 2004-2008 (Figure 6). And so was the slump. Growth rates diminished and turned negative in 2003 followed by years of near stagnation. It should be recalled that this occurred even before the Great Recession, in times of global and European boom.

¹¹ With a population of less than 10 million.

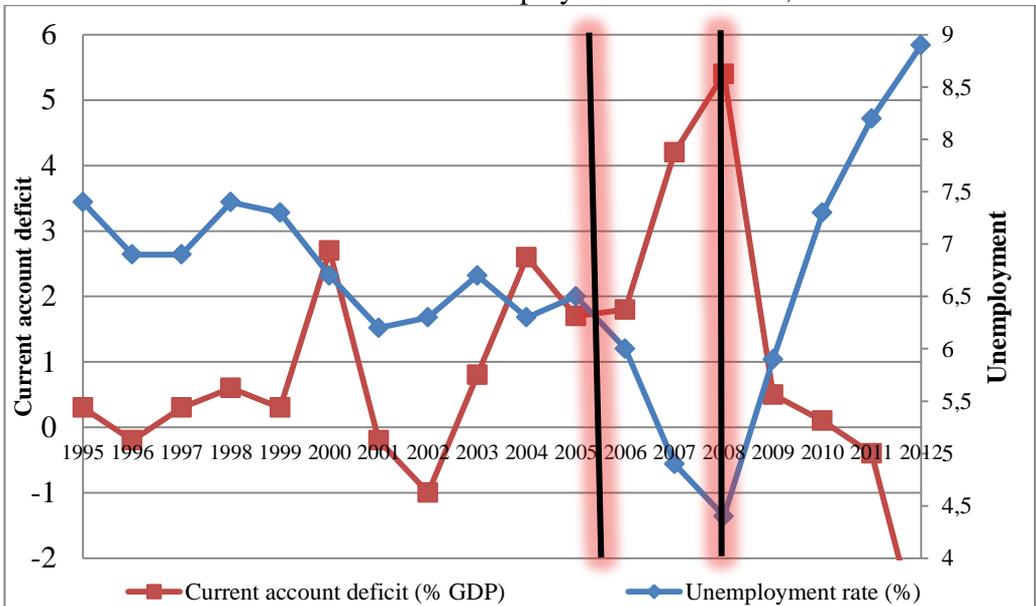
¹² According to Blanchard, rising current account deficit should be attributed to falling price competitiveness. In case of Slovenia, at least, the mechanism (inverse movements of current account deficit [accumulating] and unemployment [diminishing] in Figures 6) was more complex. Export growth did not slow down much after 2004, so the amounting current account deficit should be attributed to investment in imported capital goods. Thus, it was credit-based investment fuelling both current account deficit and employment. This is not to say that diminishing price competitiveness did not affect exports, but only that it was not the main cause of the current account deficit.

Figure 5
Current account deficit and unemployment in Portugal, 1995-2012



Source: Eurostat.

Figure 6
Current account deficit and unemployment in Slovenia, 1995-2012

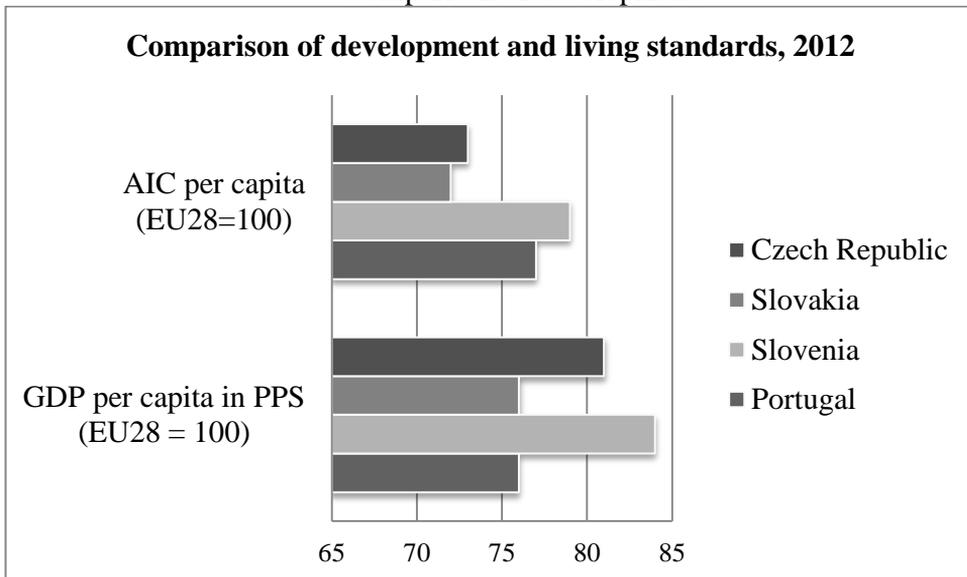


Source: Eurostat.

According to Blanchard, a country facing such trends had little option but to, deliberately or spontaneously, improve its price competitiveness by reducing wages and improving productivity. He termed this process ‘competitive disinflation’. In the context of our discussion of developmental groupings in the EU, it is interesting to note that Blanchard was very optimistic about the prospects of Portugal catching up with developed Western countries in terms of GDP. He argued that Portugal should not try to advance in high-technology, but rather continue competing with East European and Asian industries by increasing efficiency. He advised that its competitive advantages should be used, for instance, to develop ‘Florida model tourism’: get the Westerners to come to retire in Portugal. This would reduce current account deficit (because of remittances) and stimulate demand for sophisticated services (like health care).

I am not sure how serious Blanchard was about this, but the actual performance of Portugal was one of losing its relative and absolute position in relation to other MIC’s and even LIC’s rather than catching up with HIC’s. Portugal is clinging on to the group of countries with GDP per capita in PPS 15–25 % below EU27 average, and was actually outstripped by two EEC’s, the Czech Republic and Slovakia a couple of years ago (Eurostat, 2013).

Figure 7
Comparison of development



Source: Eurostat.

This brings us to the question of eliminating the gap. I will address it in terms of development strategies currently debated in Slovenia.

(a) Neoliberal economists suggest that Slovenia should opt for ‘competitive disinflation’ in order to raise its price competitiveness by cutting taxes, lowering minimum wage and public expenses. What they propose is some sort of bypass strategy based on privatization of all major state controlled companies and the banking sector.¹³ The opponents of this view (Mencinger, 2009; 2013) rightly point to the lessons from Eastern Europe that relied heavily on FDIs. First of all, dependence on FDIs is correlated to large current account deficits because the outflow of profits and dividends eventually outweighs the inflow of new investment, especially in times of crisis and with industry moving further east. Secondly, investment in Eastern Europe was mostly not ‘greenfield’ investment that would bring technological progress, as witnessed by the low scorings of those countries in terms of R&D and innovation.¹⁴ Thirdly, those countries have not made any breakthrough in development, with possible exception of the Czech Republic and Slovakia. My argument is that the effects of reliance on FDIs for development have been different in EECs and Ireland. *In Ireland the effect was a bypass that eliminated the gap, in the East it was limited convergence with persistent gap.* I think that implementation of austerity (reduction of factor costs by lowering wages and taxes) and reliance on FDIs will bring nothing but stagnation to the MICs such as Portugal, let alone Slovenia, which enjoys none of Portugal’s competitive advantages and prestige (as a former colonial power). In terms of social cohesion this will bring larger inequality of the living standards and opportunities.

(b) Keynesian economists maintain that Slovenia should return to the earlier model. They urge government to stop privatization and to use state controlled banks and funds as a basis for industrial policy that would support technological development, a rise of productivity and efficiency. However, they seem to forget that Slovenia’s success was linked to autonomous monetary policy that offset the asymmetrical shocks. Today, Slovenia has an appreciated currency it does not control, there is a *de facto* fiscal union in the EU that constraints its fiscal policy and strongly discriminates against state ownership. In other words, the EU is hostile to endogenous developmental projects.

¹³ According to Bank of Slovenia’s report Slovenia has the highest share of banking sector under government ownership, 44%. This share is 15% in Germany, 27% in Portugal and, quite surprisingly, 34% in Slovakia (Bank of Slovenia, 2013b: 9).

¹⁴ ‘Indeed, by the number of patent applications per million of inhabitants, CEE countries are comparable to the Third World countries’ (Mencinger, 2013: 23). Slovenia scores much better, but still much below the EU27 average. In terms of gross expenditures on R&D as a proportion to GDP, its performance is nearer to the EU average.

(c) The third option is the one most desired, but also the one less likely to occur. The working people could take the initiative in order to achieve employees' control of the enterprises and citizen's control of accumulation and investment. This would serve three goals:¹⁵

(i) Companies would be run in the interest of their employees. In microeconomic terms, this means that they would be driven by maximization of employees' income, rather than profit rate.

(ii) Accumulation would be based on considerations of efficient use of capital and future investment, i.e. the rate of profit would be planned and unequal. Investment would take account of externalities.

(iii) The final aim of the system would be the satisfaction of actual needs and equality of opportunity, rather than just GDP growth or profit accumulation.

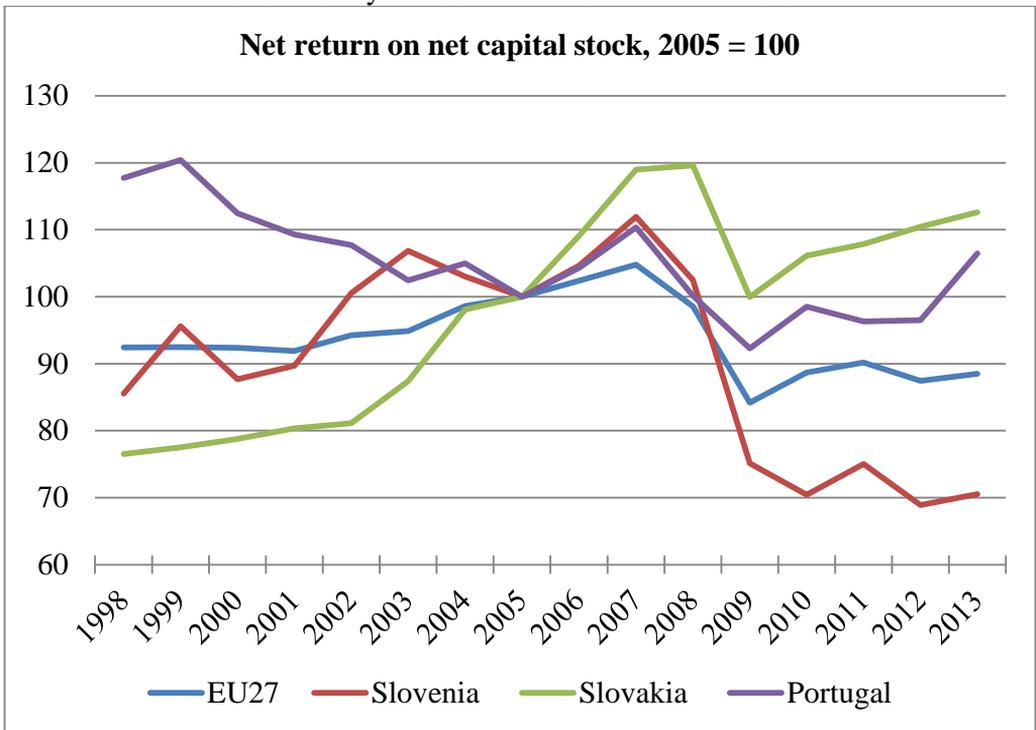
It seems that this option is a synthesis of both a bypass and endogenous development. It is endogenous because it mobilizes the initiative, knowledge and resources of the local population rather than importing them. But it is also a bypass. No one could expect that a country like US would transfer its knowhow to countries that, unlike Ireland, don't share its cultural and demographic heritage and geostrategic interests. No external bypass is possible, in my opinion. But this, socialist alternative would change the coordinates of the socioeconomic system. It would make the whole categorization based on GDP irrelevant. Its performance would be measured by and consciously steered towards the wellbeing of all its population.

This would be a true bypass and the one that is really needed. This point could be illustrated with the following argument. In a capitalist economy, profitability is the ultimate criterion of investment, because the great majority of enterprises are profit-making organizations. Since 'capitalists' are the only owners of capital and profitability the only criterion of investment, no one is going to invest in activities that don't bring profit, regardless of its other positive effects. As shown by the Figure 8, profitability in Slovenia has declined considerably. Moreover, as Figures 9 and 10 show, profitability of Slovenian or Portuguese companies is comparably low. This is consistent with the growth model that was not based on cheap labor. But, with such trends, 'greenfield investment' in Slovenia or Portugal is irrational. In this context, Blanchard is right and this is another difference between Slovenia and Ireland and another indication that the effects of FDI-led growth in Slovenia would be like the ones in EEC countries, not like in Ireland. Foreign investors would take over existing companies in service

¹⁵ These points refer to economic model put forward in Lipovec (1970) as a synthesis and further development of economic models of USSR and SFR Yugoslavia. A direct political expression can be found in Manifesto (2013).

and financial sectors. They would raise profitability by lowering wages and cutting employment (and pressing the government to lower taxes and provide subsidies) and by creating monopolies in order to profit from ‘unequal exchange’ with other sectors. The result would be stagnation in terms of employment, development and living standards. This is precisely why investment should be socialized. Who will invest in firms that bring quality jobs, regional development, etc., but little profit, if not banks and funds controlled by the people who will benefit from it?

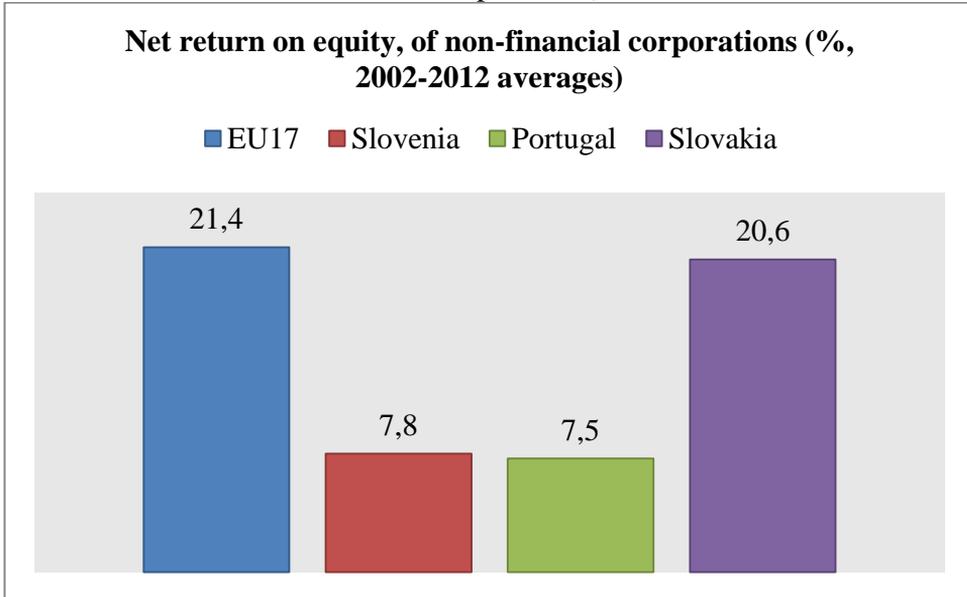
Figure 8
Profitability trends in some EU member-states



Source: AMECO.

Figure 9

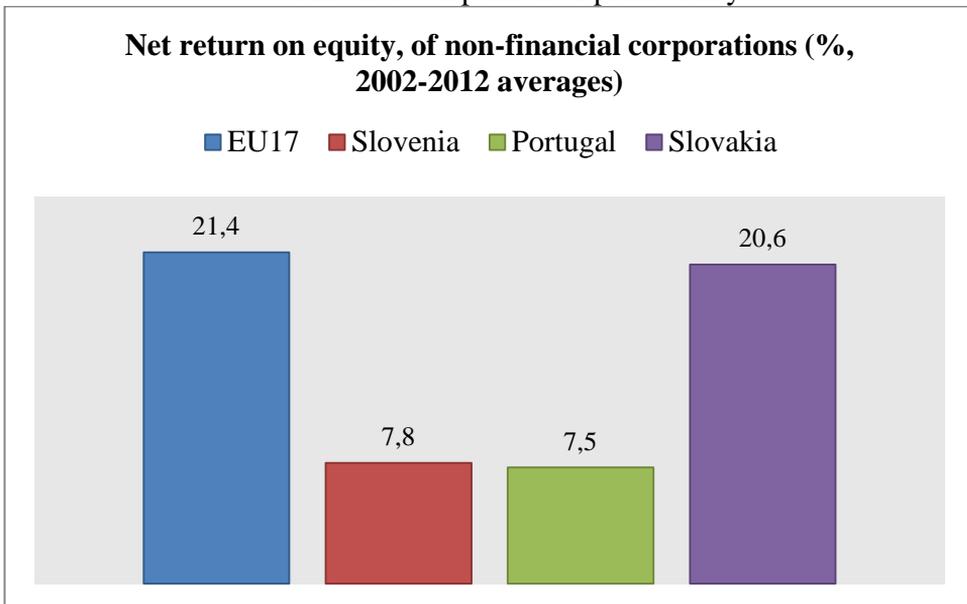
Comparison of profitability (gross return on equity, before taxes, of non-financial corporations)



Source: Eurostat.

Figure 10

Another comparison of profitability



Source: Eurostat.

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Özet

Slovenya’da kriz: Nedenleri, etkileri ve geleceği

Bu yazıda Slovenya iktisadi tarihinin son yirmi yılı incelenmektedir. Yazarın görüşüne göre, düşük değerli ulusal paraya ve sermaye hareketlerinin kontrolüne dayanan ihracat-itişli model, 2004 yılına kadar hem Slovenya ekonomisini istikrarlandırmış, hem de gelişmiş AB ekonomilerine yakınsamaya katkıda bulunmuştur. İstikrarsızlıkla karakterize edilen borç-itişli büyüme süreci ve 2008’den sonra tekrar ortaya çıkan ekonomik durgunluk, daha önceki modelin Slovenya’nın AB’ye katılmasından sonra çözülmesi ile açıklanmaktadır. Yazının daha sonraki bölümünde Slovenya, Avrupa Döviz Kuru Mekanizması’na (ERM) yaklaşık bir on yıl önce katılmış olan Portekiz’le karşılaştırılmakta ve iki örnek olay arasındaki çarpıcı benzerlik sergilenmektedir. Söz konusu karşılaştırmadan çıkarsanan şeyler, (i) krizin yapısal nitelikler taşıdığı ve (ii) salt geçmişteki ekonomik modellere dönerek AB’nin gelişmiş ülkelerine yakınsamanın daha ileriye götürülemeyeceğidir.

Anahtar kelimeler: Slovenya, ekonomi, kriz, ekonomik gelişme.