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Introduction

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INTRODUCTION

At the beginning of its transition from a socialist to a market economy in the early 1990s, Slovenia was hailed a success story, and for good reason. During the first few years of the transition, between 1991 and 1995, Slovenia went further than any other Eastern European¹ nation in terms of economic reform, achieving political independence and economic sovereignty. Despite civil war and a loss of major markets, Slovenia successfully stabilized its economy, introduced its own stable, convertible currency (the tolar), and carried out some fundamental economic reforms achieving positive growth, a budget surplus, and low external debt. With this, Slovenia fulfilled the first two components of the ambitious macroeconomic program for the economic independence and restructuring of the country as passed by the Slovenian Parliament in 1992. The program included five elements: 1) monetary independence, 2) macroeconomic stabilization, 3) financial restructuring of loss-making enterprises, 4) restructuring of commercial banks, and 5) privatization.

Reforms fell short, however, in the other three components, all of which were essential to transforming Slovenia into a modern market economy with strong private ownership. The weaknesses of the socialist legacy of public ownership held the economy back: notably, an inefficient banking system; a dearth of private equity; and large-scale losses and debt in state-owned companies and public banks. Sadly, the past two decades have seen very little advancement in the privatization and restructuring of state enterprises and banks. The reason for slow progress reflects, as correctly pointed out by some of the articles in this volume, a strong ideological bias against foreign capital, competition, and private investment.

Nevertheless, the success of Slovenia's initial economic reforms and the country's subsequent accession to the European Union in May 2004 brought about some economic miracles. Today Slovenia enjoys a much higher standard of living, aligned—to some degree

and in some respects—with European standards, with well-constructed infrastructure, new highways, and cities that are in much better shape than before.

Regrettably, however, some important economic reforms stalled and remain at an impasse. Although Slovenia was the first transition country² to join the Eurozone—a feat accomplished in January 2007—the country has benefited remarkably little from foreign investment and the common market for capital. Only its export-oriented sector enjoys foreign investment and access to international capital markets. The country has only recently begun to address some of the tough issues concerning its outdated pension system. Labor laws remain inflexible, have a bias against youth, and impede job creation. Competition rules and the current corporate legal framework actively stifle competition, repel private investors—especially foreign investors, and foster poor governance under the aegis of accounting and information systems that lack transparency. Tax legislation continues to be inefficient and biased against new market entrants. Bankruptcy laws are stacked significantly in favor of the owners of failed companies versus legitimate creditors. The state is encumbered by an oversized and highly politicized bureaucracy. Moreover, certain members of the political elite have exploited public companies and state-owned banks, using the banks to finance privatizations through leverage, and without equity.

Given all of the above, Slovenia was poorly prepared to face the global financial crisis that started in 2008. The ensuing downturn in the country's economic activity has been second only to that of Greece, within the euro area. Unemployment has been and remains high. Enterprises that were “privatized” through “political” loans from state banks (without equity investment) went bankrupt and could no longer service their excessive debt. The banks and the government subsequently lost access to global financial markets, forcing the

¹Economies under the sphere of influence of the former Soviet Union.

²Countries that transitioned from command economies with state property to market economies with private property following the collapse of the communist regimes in Eastern Europe.

government to adjust its finances in an effort to roll over the stock of debt, pay for a moderate deficit, and recapitalize the state banks unable to recover loans from well-connected—and apparently impervious—individuals. In sum, Slovenia's financial problems were not caused by the global financial crisis *per se*. The crisis served to expose the fundamental mismanagement of the economy. Slovenia's financial woes came as a direct consequence of the country's corrupt "privatization" model and the inefficient management of state enterprises—specifically state-owned banks.

Slovenia's previous two governments—Alenka Bratušek's Positive Slovenia (2013–14) and Janez Janša's Slovenian Democratic Party (2012–13)—each remained in power for only about a year because of political infighting. As I write, in September 2014, a new government is being formed. The new administration faces the daunting task of implementing critical structural reforms the country has been resisting for 20 years. Their first step will be to restructure companies formerly "privatized" using state bank leverage, raising their productivity through an injection of new capital by new investors. Next, they will need to create flexible labor laws capable of generating new jobs, improve the business regulatory environment, and establish a climate conducive to investment. This, in turn, will induce a flow of capital into new business, creating employment and spurring the privatization of non-strategic, state-owned companies (breweries, etc.). Next, they will need to correct fiscal imbalances, reduce external debt, and work to clean up and sell state banks to new, private owners capable of instilling a commercial, market-driven corporate culture. Finally, they will have to introduce additional reforms in both the state pen-

sion and the healthcare systems.

These immensely challenging undertakings will require a firm political commitment by the new government if it is to break through the usual gridlock and gain the consensus needed to define priorities and implement necessary reforms. What is certain is that with its well-educated, hard working population, its diversified, export-oriented industry and services, its strategically advantageous European location, and its glorious, pristine landscape that is perfect for tourism, Slovenia possesses all the conditions required to regain its momentum and become an exemplary success story. Whether the future government can achieve these goals and restore the country to full prosperity, however, remains to be seen.

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The articles in this volume were authored by the Martindale Student Associates from the Martindale Center for the Study of Private Enterprise at Lehigh University. I had the pleasure of meeting these diligent students and answering their questions during their research trip to Slovenia in May 2013. Their articles offer thoughtful analysis, an accurate diagnostic, and a host of valuable insights, perspectives, and recommendations regarding the economic and social complexities, challenges, and opportunities of this country in transition. I consider this volume to be necessary reading for students, for advisers of the Slovenian government, and for future public officials, including government ministers.

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