INSTITUTE FOR

WORLD ECONOMICS

HUNGARIAN ACADEMY OF SCIENCES

WorkingPapers

No. 135 June 2003

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THE TRANSITION TO A MARKET ECONOMY IN THE SUCCESSOR STATES OF FORMER YUGOSLAVIA DIFFERENCES OF NORTH AND SOUTH

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SUMMARY

The paper places in a broad historical perspective the transition to a market economy in the successor countries of former Yugoslavia.

Part 1 describes historical factors and the international environment. Ethnically, the Yugoslav Federation of the socialist period was a country composed mainly of South Slavs, but from the historical and cultural points of view, it bridged Central Europe (Slovenia and Croatia) and the Balkans (FR Yugoslavia and other republics). The disintegration process was also influenced by the international environment, as the Yalta system and the Cold War ended at the turn of the 1990s and the EC pursued further integration. The menace of the Soviet Union, a factor serving to unite nations in the former Yugoslavia into a single country, was lifted. The reason why the Yugoslav Federation disintegrated and atrocious national conflicts broke out can be traced to the collapse of the 1974 Constitution, which had turned Yugoslavia into a federation tinged with confederative elements – a weak federal government supported by a strong centralized party. So long as the League of Yugoslav Communists (LYC) retained its prestige, the regime was safe, but once this was lost, the regime could not survive and the inter-republican threshold became ever higher. Thus disintegration of the economy had already begun in the 1970s. The Yugoslav economy began to stagnate at the beginning of the 1980s and became mired in the mid-1980s. The loss of party prestige culminated in January 1990 in a split into republican constituents. Between April and December 1990, free, multi-party elections took place in each republic, where goals had become disparate. Croatia faced a serious ethnicity problem. Bosnia-Herzegovina contained Muslims, Serbs and Croats living in a symbiotic relationship. It became clear that these countries could not secede from the Yugoslav Federation without bloodshed. Slovenia's rush to independence led to a tragic disintegration of Yugoslavia. The faint chance and sincere effort to avoid civil war in Bosnia-Herzegovina eventually failed. National conflicts were precipitated by internal collapse and worsened by international actions that accelerated the process from without.

Part 2 examines the process of transition to a market economy in each successor country. *Slovenia*, the most homogeneous of any constituent republic or province, suffered relatively little damage in the independence conflict as it undertook its 'double transition, from a socialist to a market economy and from a regional economy to a national economy.' Nor was its transition-induced recession very deep. More serious were the costs incurred through secession and independence. The main cause of the recession was a drastic reduction in trade with other former Yugoslav republics, which was offset by increasing exports to West Europe. Slovenia, in fact, was successful in entering the EU markets. With privatization, there was a heated controversy between advocates of gradual, decentralized, commercial privatization on the one hand and mass, centralized, distributive privatization on the other. The privatization legislation of 1992 was a compromise encompassing features of both, including privatization by free distribution of ownership certificates to all citizens. For the time being, this small country's strategy in finding appropriate areas for specialization has been successful. Furthermore, events in the outside world – the end of the Cold War, globalization and regionalism – have gone in Slovenia's favour. Western countries responded warmly to *Croatia* on its independence, but were gradually repelled by Presi-

dent Franjo Tudjman's overtly nationalistic course. The political dominance of the Croatian Democratic Union (HDZ) was unshaken until the early 2000, as opposition parties remained weak. Tudjman's political style was rather authoritarian. In the course of privatization, small and medium-sized companies were purchased by employees and management using preferential credits, while large companies, which were nationalized first, came under the management of confidants of the ruling party, which produced a small number of government-approved tycoons concentrating huge wealth in their hands. This approach led to deadlock at the end of the 1990s. Increasing public dissatisfaction led to an opposition victory in the general elections of January 2000 and a new coalition government centred on social democratic parties, embarking on economic restructuring and efforts to join the EU. The *Federal Republic of Yugoslavia* (Serbia and Montenegro) experienced two wars and two post-war recoveries within a decade. The civil war in Bosnia-Herzegovina from April 1992 to November 1995 resulting in UN sanctions being imposed on the Federation. Then came the Kosovo war. The economy of the FR Yugoslavia was damaged by the wars, sanctions and international isolation, producing a crisis in which the public had little option but to support the undemocratic Milosevic government through thick and thin. Privatization in the first half of the 1990s was frustrated by astronomical inflation. The Titoite notion of 'social ownership' meant that officially the state had not owned the means of production in the socialist period. Paradoxically, therefore, the change of system turned the state into the biggest owner after the system change, with members of the ruling party being appointed to managerial positions. The budget constraint in state and socially owned firms remained soft. The main borrowers from the banks remained their owners. The collapse of the Milosevic regime in October 2000 left the economy in a parlous state. New privatization legislation was adopted in May 2001 and a start was made to privatization, much later than in the other post-socialist, transition countries of Central and Eastern Europe. There was a crucial shortage of capital and an urgent need for FDI, especially by strategic investors. The transition to a market economy in *Bosnia-Herzegovina* and in *Macedonia* is still at an initial stage. Like Serbia and Montenegro, they need to develop regional cooperation with other Balkan countries, with the hope of joining the EU in the distant future.

The international community has extended less assistance to the Balkans than to Central and Eastern Europe. Attention and aid for economic reconstruction and stabilization need to be greatly increased to bring lasting peace to the region.

INTRODUCTION*

An underlying cause of the national conflicts that split former Yugoslavia was the economic crisis that surfaced in the 1980s and continued for more than ten years. Economic performance differed in northern and southern republics, although they all still operated under the system of socialist self-management. The break-up of the Federation produced five independent countries: Slovenia, Croatia, Bosnia-Herzegovina, a new Federal Republic of Yugoslavia (composed of Serbia and Montenegro) and Macedonia.

Transition to a market, or more precisely capitalist economy became inevitable after the collapse of the socialist system. However, the decentralized, self-managed model of socialism differed strongly from the Soviet type, so that the transition in the countries of former Yugoslavia could be said to be from an incomplete to a fully-fledged market economy.

Most people in Western Europe and the United States show bias when they view the problems of former Yugoslavia. Eastern Europe is very far from Japan and the cultural and economic ties have been weak. In this respect, Japanese researchers such as the author are handicapped, but on the other hand, they find it easier remain objective. This paper takes an approach that combines economic history with international relations.

It is important when analysing economic performances in the North and the South to consider three groups of factors: (i) the historical factors, including differences in initial conditions, *i.e.* the underlying society, the maturity of civil society, the development level of the pre-socialist market economy *etc.* (ii) the international environment, and iii) the orientation of the political elite.

Table 1
The successor states

	Area (km²)	Population (million)	Currency	Per capita GDP (USD)
Slovenia	20,251	2.0	Tolar	10,109
Croatia	56,538	4.54	Kuna	4,406
Bosnia-Herzegovina	51,129	3.2	Conv. mark	1,027
FR Yugoslavia	102,173	9.54		940
Serbia	88,361	8.98	Dinar	
Montenegro	13,812	0.56	DEM (Euro)	
Macedonia	25,713	2.03	Denar	1,702

Source: WIIW (2001).

The paper begins with a brief discussion of historical factors and the international environment. Then the reasons for the disintegration of Yugoslavia and the outbreak of atrocious ethnic conflicts are discussed. Comparisons are made between the northern and southern republics, especially Slovenia, Croatia and the new Yugoslavia, Bosnia-Herzegovina, and Macedonia being omitted because the transition to a market economy has hardly begun there. Finally, the prospects for the region are considered.

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1) Historical factors and the international environment

1.1. Historical factors

Examining movements in Eastern Europe after the collapse of the socialist regimes underscores again the importance of history. The Eastern European countries other than the Soviet successor states, which experienced a succession of political changes ('democratization') and aimed at a transition to a market economy and capitalism, can be classified broadly into the Central and Eastern European countries and the South-East European countries of the Balkans. The former belong to an area culturally influenced by Catholicism and have strong historical, cultural and economic ties with Germany and Austria. They returned to Central Europe, as it were, as soon as the Cold War ended. In the Balkans, on the other hand, civil society was underdeveloped and the area had been culturally dominated by Greek Orthodoxy.[1] There was still a noticeable legacy from centuries of rule by the Ottoman Empire.

When the author visited Budapest in May 1991, László Láng, director of the Research Centre of Central Europe, explained that Central European countries has a 'common experience'. Central Europe is very cohesive and coincides with the extent of the former Austro-Hungarian Monarchy. Again, there are historical reasons for this. What today constitute Southern Poland, Bohemia, Hungary, Slovenia and Croatia all reached their period of modernization while they formed a part of the Austro-Hungarian dominions. This meant they were affected by European or international trends in transportation, cultural achievements and level of technology. They share a historical experience of coexistence within the same empire. Even today, an industrial map of Eastern Europe shows clear concentration from South Poland through Moravia, Bohemia, Western Hungary and down to West Croatia and Slovenia. The line is still visible 85 years after the Austro-Hungarian Monarchy collapsed (Koyama 1992, p. 85).

Láng added that the difference between the Central Europe and the Balkans is historically ascribed to the difference between Catholic and Byzantine influences. Central Europe also differs from other regions politically, in that the churches were less closely connected with state power. On the contrary, the church in Byzantine Europe was always entangled with the states. Although civil society did not develop in Central Europe, there was a chance for it to happen. The difference in church-state relations is the main reason behind the distinction between Central Europe and the Balkans. The political processes of the western and southern parts of Eastern Europe remain different to this day (*Ibid.*, p. 84).

Lang's view should be considered when studying the processes of the transition to market economies in Eastern Europe.[2] Teruji Suzuki, a specialist of comparative law, attaches importance to whether countries inherited the system of Roman law, through the study of jurisprudence in medieval universities in Central Europe.[3] Roman law supported right of

[1] On civil society, see Bibic and Graziano (1994). In Japan, theoretical research on civil society is represented by Hirata (1968).

[2] Rule by the Austro-Hungarian (Habsburg) Monarchy had positive as well as negative aspects. A series of reforms, including the educational system, was carried out in the reign of Maria Theresa (1741–80). The spirit of reform was continued by her son Joseph II, who carried out abolition of serfdom and torture, promulgation of religious toleration, and promotion of industrial development. When Joze Mencinger, a prominent Slovenian economist, was asked by the author for the reason for his country's economic success in an interview (April 1, 1997), he referred unexpectedly to Maria Theresa's education reforms.

[3] For detail on Roman law, see Stein (1999). The author is also indebted to Christopher Beermann, associate professor at the Niigata University Faculty

ownership, so that it was the foundation for the subsequent development of market economies. Roman law was not inherited by countries imbued with Orthodox Christianity – Russia and the Balkans, where the concept of ownership never became so deep-rooted (Suzuki 1998). Of course, this cannot be determined quantitatively, but it seems to have effected a relative delay in the development of a market economy in pre-socialist Balkan countries.

Ethnically, the Yugoslav population consisted mainly of South Slavs, but historically and culturally, it straddled Central Europe and the Balkans. The Slovenes and Croats who seceded from the Austro-Hungarian Empire in 1918 formed a joint state with the Serbs. This became the first Yugoslavia, which later suffered chronic national conflicts, and became after World War II the second, socialist Yugoslavia under Josip Brod Tito.

1.2. Changes in the international environment

The expulsion of Yugoslavia from Cominform in June 1948 amounted to expulsion from the Soviet bloc. The Soviet Union and other Eastern European countries imposed an embargo and even threatened Yugoslavia militarily. Communists in Yugoslavia became sceptical about the Soviet type of socialism and began to grope towards a socialist road of their own.

Thereafter, relations with the West gradually improved, and in 1949, the United States began to extend economic and military assistance to Yugoslavia. 'The continued independence of Yugoslavia,' President Truman argued, was 'of great importance to the security of the United States' (Hoffman and Neal 1962, p. 148). Such US assistance continued until 1955, when rapprochement with the Soviet Union ensued. In 1958, however, the Soviet Union criticized the new programme of the LYC, which included references to the danger of war through confrontation between either the American or the Soviet bloc. Although the relationship with the Soviet Union later improved, Yugoslavia never returned to the Soviet fold and continued to view the Soviet Union almost as a 'potential enemy', citing the 1948 expulsion, the Hungarian Revolution of 1956, the suppression of reform in Czechoslovakia in 1968, and so on. Diplomatically, Yugoslavia remained neutral between East and West and secured attention as the one socialist country in the non-aligned movement. The West continued to support Yugoslavia, because of the delicate position it occupied in world politics.

Some 45 years after World War II, which had been a unifying experience for the main national groups of Yugoslavia as they fought to liberate their country, the international environment drastically changed. Gorbachev, the promoter of perestroika in the Soviet Union, practically abandoned the principle of limited sovereignty in 1988. Thereafter, the socialist regimes of Eastern Europe collapsed one after the other in 1989–90. Since the Yalta system no longer applied and the Cold War had ended, so had the menace of the Soviet Union, a factor that had united the nations of Yugoslavia into a single country. Also behind them was the fear of German and Italian expansionism, which was traditionally menaced the Slovene nation. The European Community, meanwhile, was pursuing further integration. 'The end of the Cold War made the previous deep political, ideological and military gap along Slovenia's Western and Northern borders with Italy and Austria politically obsolete and economically harmful. The Slovenes were the most exposed and sensitive within the former Yugoslavia to the demonstration effect of the West's growing affluence, its economic liberalism and political democracy' (Bebler 1997, p. 138).

of Law for recommending this book and for his own explanations.

2) COLLAPSE OF THE REGIME BASED ON THE 1974 CONSTITUTION AND THE OUTBREAK OF NATIONAL CONFLICTS

One of Tito's achievements had been to integrate the nations of Yugoslavia into a federal state of 'fraternity and unity', in a region where they had traditionally battled with each other. In every national census of that period, more than a million citizens declared their national affiliation to be 'Yugoslav'. The word 'Yugoslav' did not mean citizen of Yugoslavia but defined a national group reflecting 'a dream of communists, who tried to create Yugoslavs who would rise above the national groups' (Iwata 1983, p. 280). Unfortunately, Tito failed to spread 'Yugoslav' consciousness further than that.

Despite aid from the developed to the less developed republics, through a Fund for Accelerated Development at federal level, the economic differences between North and South widened. For example, the difference between Slovenia and Kosovo in per capita GNP was 3.2:1 in 1947, but 6.9:1 in 1978 (Ramet 1984, p. 183).

As for relations between the federation and the constituent republics, one postwar option, supported by the northern two republics, was to encourage republic-level development, another was to have a powerful federal government, which the less developed southern republics preferred, along with resource redistribution through the federal government. With hindsight, there might have been a third option: a powerful federal government in a capital located neither in Belgrade nor Zagreb, for instance in Bosnia-Herzegovina, which had hitherto managed to transcend the problems of national coexistence. No such option was discussed. After the centralist Vice President Aleksandar Rankovic fell from power in the mid-1960s, the LYC leadership went for decentralization and de-etatization.

State control weakened and market forces increased after the economic reforms of 1965. Graduate professionals and 'technocrats' played increasingly important roles. However, market-economic ills such as inflation, income differences between enterprises and rising unemployment became evident. By the late 1960s, a younger generation was criticizing the government and party leadership for emasculating self-management and for tolerating detrimental effects of market economics. The main concern in the 1950s had been to struggle against state bureaucrats and empower of self-managed enterprises, but in the late 1960s and early 1970s it became a struggle against technocracy.

The LYC pushed through amendments to the country's constitution in 1971. Designed to appease the developed republics, these were systematized as the 1974 constitution, which loosened the Yugoslav federation. Republics and autonomous provinces gained prime sovereignty and all powers except those explicitly granted to the federation, *i.e.* foreign policy, defence, measures to ensure a unitary Yugoslav market, common monetary and foreign-trade policies, and the principles of the political system and ethnic and individual rights. There was to be a collective head of state with nine members – one from each republic and province, plus the party president. Vojvodina and Kosovo, as autonomous provinces within Serbia, had fewer delegates to the Federal Assembly than the republics, but they enjoyed the same *de facto* position, with a veto over federal decision-making. The Socialist Federal Republic of Yugoslavia had become tinged with confederation.[4] Meanwhile the regime pursued economic democracy, eliminating technocracy and extending self-management to workplaces smaller than 'enterprises'. The market mechanism was not foresworn, but

[4] For the emergence of the regime under the 1974 constitution, see Rusinow (1977), pp. 284–5.

a 'contractual' mechanism became emphasized instead. In addition, the regime pursued democratization and 'de-professionalizing of politics, extending political participation by drawing large workers and other citizens into a delegate system. Nonetheless, the communists of Yugoslavia still sought to realize their goals within the framework of a one-party system.

Although Yugoslavia was unique in decentralizing and de-etatizing in this way, it still shared with the Soviet model a rejection of the multi-party system. While the constitution was being prepared, a Croatian national movement arose in 1971, which Tito eventually suppressed, although his desires to centralize again met with resistance from local leaders reluctant to concede the powers obtained in the 1965 reform and subsequent constitutional amendments. Although he was not able to reverse the decentralization of the state, Tito concentrated on re-centralizing the party. One Slovenian political scientist has called the result a 'centralist federation' (Fink-Hafner 1995), but in the present author's view, Yugoslavia at that time had a weak federal government supported by a strong centralist party. In short, the regime instituted by the 1974 constitution supposedly aimed at Utopian economic democracy, but in fact was sustained by the LYC, whose mobilization of the masses had been the force binding decentralized, self-managed socialism into a country. As long as the party retained its prestige, the regime was safe, but once it lost it, the regime was doomed.

The self-managed enterprises had considerable power, so that an albeit incomplete mechanism of market coordination functioned. Full development of a market economy, however, would require a multi-party system to reflect the diverse interests in society, as Milovan Djilas (later purged and imprisoned) had posited back in 1954. Again with hindsight, one way in which disintegration of the Federation might have been avoided would have been to have democratic parties straddling the republics and provinces, which Tito's somewhat Bolshevik view of socialism precluded.

Table 2
Proportion of goods made and services performed within the same republic or province, %

	1970	1972	1974	1976	1978
Slovenia	57.8	59.2	63.3	64.5	66.3
Croatia	62.8	63.7	64.4	68.8	70.4
Bosnia-Herzegovina	63.2	65.2	68.9	67.3	69.1
Montenegro	48.7	53.2	55.5	62.7	64.5
Macedonia	66.5	66.6	68.3	63.4	65.2
Serbia proper	60.0	60.7	62.5	65.2	67.0
Vojvodina	50.0	53.6	56.2	62.6	64.4
Kosovo	56.6	62.2	55.8	62.6	64.4
Yugoslavia (average proportions)	59.6	61.3	63.4	65.7	67.5

Source: Pavlovic and Stojanovic (1984), p. 290.

Table 3
Proportions of goods and services procured from and delivered to other Yugoslav republics or provinces, %

	Outside procurement		Outside delivery	
	1970	1978	1970	1978
Slovenia	23.9	21.3	42.2	35.5
Croatia	27.4	20.3	37.2	28.9
Bosnia-Herzegovina	36.9	27.1	36.8	30.5
Montenegro	61.8	45.3	51.3	32.2
Macedonia	36.2	30.2	35.5	35.4
Serbia proper	32.6	26.1	40.4	30.8
Vojvodina	30.8	27.5	50.6	34.7
Kosovo	53.7	47.6	43.4	37.1
Yugoslavia (average proportions)	38.0	31.0	40.0	32.0

Source: Ibid., p. 291.

Although the need for a unified Yugoslav market was always stressed officially, the markets in each territory were tending to close off in the 1970s. In Montenegro, for example, the proportion of goods and services sold within the republic rose from 48.7 per cent in 1970 to 64.5 per cent in 1970 (*Table 2*), while the proportion of commodities procured outside the republic decreased from 51.3 to 32.2 per cent (*Table 3*). The inter-territorial thresholds were becoming higher, which ran against the historical trend. Some economists went so far as to see in this the emergence of eight national economies within Yugoslavia.

These fragmenting tendencies were further promoted by 1977 legislation on foreign-currency dealings and external credits, obliging each republic and province to draw up a balance sheet of international payments and to fulfil export and foreign-earnings targets. In a seemingly contradictory tendency, the territorial units were becoming linked directly to the world economy. There were many 'cases in which the same or similar goods were being exported as another republic was importing from abroad, *i.e.* inter-republican trade was being conducting through third countries' (Korosic 1989, p. 72). The Yugoslav economy had already begun to fragment in the 1970s.

Yugoslavia enjoyed a relatively high rate of economic growth until the late 1970s. While this continued, the country's national groups coexisted happily. This rapid economic development in the 1970s was based on loose economic controls inherent in the system of self-management, which led to a sharp increase in the stock of foreign debt. At the beginning of the 1980s, the Yugoslav economy began to stagnate, and by the mid-1980s, it was mired in a crisis, to which the LYC failed to produce effective solutions.[5] The LCY, as the force binding the territories and nations into a country, gradually lost prestige. Conflicts of interest between republics began to be reflected within the LYC itself.

Economic factors were of prime import in Yugoslavia, as Ken'ichi Ohno discerningly argued: 'Where plural ethnic groups subjectively feel they share positive benefits or negative damages, the "ethnic boundaries" of their groups gradually fade, fusion proceeds and national conflicts do not occur. This is especially evident where two groups experience disproportionate benefits from cooperation (synergistic effects). Conversely, where plural ethnic groups struggle for shares of a finite pie, feelings of hostility are generated and "ethnic boundaries" actualized. Thereupon they fall into a self-inducing process whereby own-group consciousness and extra-group hatreds are fortified by tension that is heightened in turn by the consciously asymmetric perceptions ("we" as good and peaceful, "they" as evil and militant, *etc.*). In this case, national conflicts escalate at accelerating speed' (Ohno 1996, p. 256).

What triggered the conflicts among the republics was the Kosovo problem. After the suppression of revolts in 1981, the discontent of the Albanian community in Yugoslavia turned inwards. There was mounting violence towards local Slav minorities and plundering, and scores of thousands of members of the Slav minorities fled from the province in subsequent years. Many people in Serbia proper became incensed by the inability of the Serbian authorities to protect their brethren in Kosovo, although the province was part of the republic. Slobodan Milosevic came to the fore in the League of Communists of Serbia advocating outright Serbian nationalism, securing the post of party president in Serbia in 1987. The next year, on his initiative, Serbia amended its constitution to reduce the powers of the autonomous provinces. In July 1990, the Republic of Serbia dissolved the Kosovo Assembly and imposed direct rule. Meanwhile Croatia and Slovenia were becoming increasingly critical of Milosevic's political style and the increase in Serbia's weight within the federation.

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[5] To summarize, Yugoslavia had been pursuing heavy and chemicals-led industrialization in the 1970s. At enterprise level, empowered workers tended to distribute much of the gross income as personal incomes (wages) and communal consumption, so that relatively little was accumulated. Nevertheless, the investment-hungry enterprises continued to borrow from domestic and foreign banks, exploiting defects in the financial system and loose practices at financial institutions designed to serve self-managed enterprises, which themselves established banks. Local politicians exerted strong influence on bank appointments and management. As the bank debts of self-managed enterprises mounted, local politicians had an interest in continued development of the regional economy. Thus banks effectively became managed by their big debtors. Meanwhile changes in the credit system in 1972 had made it easy for enterprises to borrow abroad. Yugoslavia's stock of external debt rose from USD4 billion in 1970 to USD20 billion in the early 1980s. For more detail, see Koyama (1995 and 1996).

According to *Table 4*, based on a survey in spring of 1989, the most positive attitude toward political pluralism was shown by Slovene communists. On the subject of 'striving for a multi-party system', for example, 36 per cent of Slovene communists responded positively, which was far more than the 19 per cent of Croatian communists. With 'recognizing the existence and activity of new alliances', 44 per cent of Slovenian communists responded positively, followed by 24 per cent of Kosovo communists, who were embroiled in a very serious ethnic problem. 'LYC members in Slovenia strove for the most radical change' (Fink-Hafner 1991, p. 11), while communists in Montenegro and Serbia were generally conservative.

Table 4
Attitudes to a political pluralism among LYC members in republics and provinces, % in support

	Support for a multi-party system	Recognition of the existence and activity of new alliances	Support for access for new alliances to the mass media
Montenegro	6	9	12
Serbia	9	8	10
Vojvodina	10	12	14
Bosnia-Herzegovina	12	14	18
Macedonia	14	14	16
Kosovo	16	24	24
Croatia	19	19	24
Slovenia	36	44	46

Source: Siber, I. (1989): *Komunisti Jugoslavije o drustvenoj reformi.* Belgrade: IC Komunist, p. 29. Quoted by Fink-Hafner (1991), p. 11.

The LYC finally split in January 1990 and free, multi-party elections ensued in each republic in April–December that year. Slovenia's April elections brought in a non-communist government, but the new president was the 'Social Democrat-Communist' Milan Kucan. In Croatia, the new president was the avid Croatian nationalist Franjo Tudjman, with a non-communist government. By contrast, the elections in Serbia in December 1990 were won by the Socialist Party of Serbia, which had been created by a merger of the League of Communists of Serbia with its popular-front organization. In Montenegro, the League of Communists of Montenegro won. In both cases, the communists took a nationalistic line and gained support from many workers uneasy about their jobs. A non-communist government was formed in Macedonia. In Bosnia-Herzegovina, its symbiotic communities of Muslims, Serbs and Croats voted in a coalition government of dominant parties from each, reflecting the delicate national balance.

In this way, the goals of the republics became disparate. Were tragic nationality conflicts inevitable? In this author's view, as the effort to foster 'Yugoslav' consciousness and maintain the federation had turned out to be unsuccessful in 1991, the second best choice was to remodel the federation into a confederation. Otherwise the disintegration of the federation was inevitable, but there would still remain a possibility of a peaceful, longer process of separation based on negotiations. If the international community had been prepared to intervene in the inter-republican disputes, it should have supported the process of remodelling or of peaceful negotiated separation. Instead, the international community coped with the Yugoslav question in a blundering way.

At the time, the international community did not want the Yugoslav federation to break up and the West supported its continuation until the first half of 1991. The foreign ministers' meeting of the Commission on Security and Cooperation in Europe (CSCE), held on June 19, 1991, confirmed its support for the unity of the Yugoslav Federation. US Secretary of the State James Baker visited Belgrade on June 21 and announced that the US would never approve any unilateral secession.

However, Slovenia made a forcible move towards independence, successfully targeting its neighbour and former ruler Austria for support. To general surprise, Alois Mock, the Austrian foreign minister used the technique of including his Slovenian counterpart, Dimitrij Rupel, in the Austrian CSCE delegation.

Iwata (1999, p. 158) quotes a sentence from a book by an American ambassador to the Vatican, which had not been seriously involved in politics since the mid-19th century: 'By the middle of 1991, the Vatican moved into unprecedented action to become a leader of the process of diplomatic recognition.' According to Gianni de Mikelis, a former Italian foreign minister, Jeffrey D. Sachs, the Harvard economist, went to Ljubljana and told the Slovene government that 'in order to join Europe they would need to liberate themselves from the yoke of Belgrade' (Iwata 1994, p. 126). Support from Italy was unclear, but remarks by Mikelis suggest that some Italians were involved in the preparatory operations. He suggested the convening of a brains trust of specialists in which 'some Austrians and some Italians participated and prepared a scenario on how to contrive a collision, so as to create a climate of world public opinion favourable to Slovenia' (*Ibid.*, p. 129).

Slovenia and Croatia declared independence on June 25, 1991, with Slovenia, in particular, promptly translating it into action and establishing its own border controls. In response, Federal Prime Minister Ante Markovic (incidentally a Croat) issued a statement, in which he 'rejected Slovenia's independence and ordered Defence Minister Kadijevic to send in units of the Federal Army and defend the checkpoint on the border with Austria' (Nakamura 1994, p. 32). This put the federal army in a state of war with the Slovene defence forces, in an operation that failed 'because of skilful Slovene tactics towards the media, which made world opinion critical of the Federal Army' (*Ibid.*) After mediation by three EU foreign ministers (of Luxembourg, Netherlands and Italy) and repeated cease-fires and renewals of fighting, Slovenia and Croatia suspended their declarations of independence for three months. When the suspension expired in September 1991, the focuses of the fighting to the Slavonia region of north-east Croatia and Slovenia was tacitly allowed by Milosevic to assert its independence, which hastened the tragic disintegration of the Yugoslav federation (Glenny 1996).[6]

Croatia, unlike Slovenia in the northernmost part of Yugoslavia and was bordered by Western European countries, faced serious ethnic problems. The Serbs of Croatia counteracted discrimination and harassment by the new government by declaring an 'Autonomous District of Krajina', within which the local Croats then became an intimidated minority. It soon became obvious that Croatia could not secede from Yugoslavia without bloodshed.

Ethnic animosities had been exacerbated fifty years earlier, when Hitler's Germany supported the Croatian fascist Ustasa movement in World War II, so that Germany in 1991 should certainly have taken a more prudent position on the Yugoslav crisis. Instead, Germany took the initiative within the EU in recognizing Slovenia and Croatia and rejecting the caution shown by France and other countries. As a Japanese daily paper commented, 'Foreign Minister Hans-Dietrich Genscher, who thought that the reunification of Germany was a result of "the right of national self-determination", insisted that Germany's special task was to support such a "right of national self-determination" for other countries too' (*Asahi Shimbun*, January 11, 1992). Applying this principle to multinational Yugoslavia was simplistic, but on December 23, 1991, Germany had gone ahead and recognized not only Slovenia, but also Croatia as independent states.

The Badinter Arbitration Committee, established alongside the EC peace conference for Yugoslavia and composed of presidents of constitutional courts from five EC countries, received representations from all Yugoslav republics except Serbia and Montenegro, calling for recognition of their independence. On January 11, 1992, the Badinter Committee advised that Slovenia

[6] Hiroyuki Iwata has also questioned Slovenia's responsibility: 'The hostile nationalism of the Croats and Serbs was rampant… but the fuse would not have blown unless an electric current had been sent from Austria and Germany ' (Iwata 1994, p. 90).

and Macedonia satisfied the requirements for immediate recognition. Croatia, however, could not be recognized immediately because the Croatian government needed to show more consideration for its ethnic minorities, for whose protection there should be constitutional safeguards. In the event, the EC Council decided not to recognize Macedonia, but to recognize both Slovenia and Croatia, feeling obliged to follow Germany's lead rather than jeopardize EC unity. On January 15, 1992, other EC countries did likewise.

The largest of the three communities in Bosnia-Herzegovina were the Muslims ('Bosnians') with 43.7 per cent, followed by the Serbs (33 per cent) and the Croats (17.3 per cent). The three nations lived in mixed communities, not segregated ones for the most part. The periods of peaceful coexistence had been much longer than those of disputes, giving rise to a regional consciousness ('Mi smo bosanci'). The Japanese observer Professor Hiroshi Iwata (1999) notes that the Serb and Muslim leaders came close to an agreement to avoid civil war in July 1991[7]. Similar views have been expressed by the journalist Misha Glenny: 'The decision by the European Community to recognize Slovenia and Croatia pushed Bosnia into the abyss. Once this had happened, the Bosnian government had only three roads along which it could travel and each led to war. It could have stayed in the rump Yugoslavia and been ruled over by Milosevic and Serbia. It could have accepted the territorial division of Bosnia between Serbia and Croatia, as suggested by Tudjman and Milosevic. Or it could have applied for recognition as an independent state. The Croats and Moslems considered the first solution unacceptable; the Moslems and Yugoslavs, the second; and the Serbs, the third. This enforced choice could not have been presented at a worst time – Serbia and Croatia had been radicalized by the trauma of a war which neither side had yet won and neither side lost' (Glenny 1996, pp. 143–4). Elsewhere he adds, 'The death sentence for Bosnia-Herzegovina was passed in the middle of December 1991 when Germany announced that it would recognize Slovenia and Croatia unconditionally on 15 January 1992. So distressed was Alija Izetbegovic by this news that he travelled to Bonn in a vain effort to persuade Kohl and Genscher not to go ahead with the move. Izetbegovic understood full well that recognition would strip Bosnia of the constitutional protection it still enjoyed from the territorial claims of the two regional *imperia*, Serbia and Croatia' (*Ibid.*, p. 163).[8]

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[7] The efforts by the Muslim politician Adil Zulfikarpasic are described in Chapters 5 and 6 of Iwata (1999). Although a traditional Muslim aristocrat, he had joined the Communist Party of Yugoslavia and fought with Tito's partisans, but gone into exile in Italy in 1946. He eventually became a millionaire and Bosnian politician based in Zurich, returning to to Bosnia-Herzegovina and establishing a new party, the Muslim Bosnian Organization (MBO), after the collapse of the communist regime.. This party dominated by intellectuals won little support and gained only three seats in the general elections of November 1990, as opposed to 86 seats for the Muslim nationalist Party of Democratic Action (SDA) headed by Alija Izetbegovic. The Slovenian conflict of June 1991 alarmed many Bosnians, who feared a repetition of the ethnic murders of World War II. The Zulfikarpasic initiative received endorsement from Izetbegovic on July 12, 1991. (The phrase 'Belgrade Initiative' used in the Western media was mistaken.) On July 13, Zulfikarpasic and Filipovic (vice-president of the MBO and a member of Parliament) sat down with Radovan Karazdjic and Momcilo Krajsnik (chairman of the Republican Parliament) on the Serb side. It was agreed that the Muslims would accept coexistence with the Serbs in a confederative Yugoslavia, while the Serbs would postpone establishing a 'Regija' (Serb territory). With Izetbegovic's consent, Zulfikarpasic met Milosevic on July 14 in Belgrade and obtained his endorsement. The draft agreement needed only the signature of Izetbegovic, who was visiting the United States. Wide reports of the draft agreement caused immediate relief of the tensions between the two communities. Joint rallies were held in Trebinje, in southern Herzegovina, and Zbornik, in eastern Bosnia. The agreement was then unexpectedly rejected by the SDA. According to Iwata, Milovan Djilas considered that the Izetbegovic faction, counting on support from the Islamic world and US favour, thought it could gain hegemony over the Serbs and Croats of Bosnia-Herzegovina. Zulfikarpasic, on the other hand, underestimated the political power of those whose priority was dissolution of Yugoslavia, rather than problems of war or peace (*Ibid.*, p. 230).

[8] 'Bosnia could only have been saved if a political party spanning the three communities had emerged as the most powerful after the collapse of communist

The government of Bosnia was compelled to choose the third course. On December 20, 1991, its foreign minister requested recognition from the EC, which in turn requested that Bosnian leadership to conduct a plebiscite as a precondition for recognition. On February 29, 1992, the Bosnian leadership took a plebiscite on independence despite a Serb boycott and then declared independence on the grounds that 60 per cent of the eligible voters had supported it. The EC, pressed by Germany, recognized Bosnia and Herzegovina as an independent state on April 6.

Contrary to Western expectations, armed groups from each national community, led by extreme nationalists, began to fight for ground. The biggest victims were the Muslims and world opinion was roused by news of Serbian death camps and systemic rape of Muslim women. However, similar deeds occurred to some extent in Muslim and Croat-ruled territory as well. Although the conflict between the national groups was an intricate one, Western countries set out to examine who was right and who was wrong. The United States, in particular, was eager to solve the problem by finding and attacking villains. In the early stages, Croatia won a propaganda victory over Serbia.[9] The United States and Western Europe tended to judge matters in Central Europe and the Balkans by Western European standards. Croatia, with its Catholic culture, was found more congenial than Serbia, and the implications of Tudjman's extreme nationalism were ignored, while Serbia was made the villain. This approach by the Western countries made resolving the national conflicts more difficult. In short, the conflicts were caused by an internal collapse, worsened by international actions that had the effect of acceleration the process. The way the international community misunderstood the conflicts in Yugoslavia is evocatively demonstrated by the Dutch political scientist Koen Koch. According to his report, delivered at a conference on Yugoslavia held in the Hague in November 1991, the conflict was not federalism versus confederation, democracy versus communism, or pluralism versus nationalism. Western Europe saw the conflict as one with Slovenia and Croatia on one side, aiming at a market economy and democracy, and Serbia on the other, trying to keep up the old command economy. In fact, the Croatian government was as authoritarian as the Serbian. It is also misleading to define the Yugoslav conflict as basically an ethnic conflict, a battle between Serbs and Croats imbued with hatred centuries old. What was witnessed in fact was a power struggle between old and new political elites, using nationalistic rhetoric to boost their own positions of power and privilege, regardless of the interests of those they claimed to be fighting for. Both in Serbia and Croatia, government-controlled media revived memories of World War II atrocities and disseminated ethnic stereotypes and prejudices. This media war and the ensuing conflict curdled populations into their constituent ethnic groups. Serbs and Croats alike were manipulated by their nationalist leaders, who benefited personally from exacerbating the conflict, whereas the population was harmed directly. Nationalism, Koch argued, had to be replaced by a pluralism that accepts unique cultures, religions and languages. Only when the nationalist leadership was replaced by representatives of the democratic opposition, would the conflict end (Koch 1992, pp. 191–201).

power. The poverty of the pluralist system based on the three national parties was demonstrated by the structures which it spawned' (Glenny 1996, p. 148). By the end of 1991, the disintegration of the Yugoslav Federation had become an undisputed fact, with fierce civil warfare in Croatia. Movements for separation and independence appeared in both Bosnia-Herzegovina and Macedonia, which broke up the tripartite coalition in the former.

[9] Serbia's propaganda defeat is discussed in Yamasaki (1993). The author points out that the one international TV relay station in Yugoslavia was located in Zagreb, so that Serbia was cut off from sending out television news during the first three months of the war, by which time international opinion was firmly anti-Serb (p. 59).

3) Slovenia's development strategy and transition to a market economy

3.1. Development strategy

Slovenia, a country with an area of 20,251 sq. km and with population of less than 2 million, is ethnically the most homogenous of the former republics and provinces of Yugoslavia (90.1 per cent Slovene). Damage in the 'independence war' of 1991 was relatively minor.

In mid-1993, the government commissioned a long-term economic-development strategy from the Institute for Macroeconomic Analysis and Development, which produced a detailed report in April 1995, entitled 'Strategy for Economic Development: Approaching Europe, Growth, Competitiveness and Integration'. The main goals were (i) faster economic growth and catching up, (ii) higher competitiveness, (iii) inclusion in the European integration framework, and (iv) permanent sustainment of economic growth from the ecological, social and ethnic standpoints.[10]

An informative account of the basis for the strategy can be found in Svetlicic (1997). It was noted first that fundamental technological changes – the information revolution and related changes – had made small countries more viable; the external environment was enhancing the effects of smallness. This denied the argument that globalization and the economies of scale and scope mitigated against them. The viability of a small country in the globalized economy depends much on its ability to adapt swiftly to the changing external environment (*Ibid.*, p. 3). On the one hand, the weaknesses of small countries such as Slovenia include a weak position in international relations, due to the scarce power and natural resources, and inadequate labour and local factor conditions. This is coupled with an inability to realize economies of scale due to a small domestic market, limited finance and R and D capacities, *etc.* On the other hand, small countries achieve social (cultural and religious) cohesion more easily. They have better implemented policies and a more stable system, escape costly international responsibilities, adjust more radically and speedily, and are better placed for specialization; computerization and telecommunications which are relatively more powerful weapons for small firms and countries than for large ones. He stressed despite their weaknesses and threats, small countries have strengths and opportunities that surpass them. A small domestic market is immaterial. The key is access to world markets. Small countries like Slovenia need not have a full set of industries. Instead, they should find areas and niches of appropriate specialization and thoroughly internationalize their activities.

3.2. Economic performance: costs and benefits of secession and independence

Slovenia experienced a 'double transition, from a socialist to a market economy and from a regional economy to a national economy' (Mencinger 1996, p. 417). It had the advantages of an early start in making its market-oriented reforms within Yugoslavia (the first in the mid-1960s), maintained some advantages of its own, and gained a better position than other former socialist countries in implementing economic reforms, adapting to 'European values' and adhering to sound economic policies. However, the early 1990s saw a

[10] The strategy' is introduced briefly by Nakamura (1995) and Majcen (1999).

recession in Slovenia, as elsewhere in the post-socialist region. This 'transformational recession' has been explained by the Hungarian economist János Kornai as concomitant on the transition from a supply-constrained to a demand-constrained economy (Kornai 1995, p. 175). In the case of Slovenia, the recession was comparatively less serious, because the coordination of the economy had for many years been decentralized, and the impacts of insufficient demand had already prevailed over those of supply shortages in the 1980s, while most exports were directed towards Western Europe.

More serious were the costs caused by secession and independence (Mencinger 1996, pp. 416–17). The Slovene economy was badly hit by the secession itself, and even more so, by the subsequent political and economic developments in the remnants of the Yugoslav Federation. The 'supply shock' added considerably to inflationary pressures in the first months after independence. Slovenia also suffered damage because of hostile action against business units in other republics, as the cross-ownership pattern was asymmetric. In 1990, there were 2710 Slovene-owned business units and 62 companies in other republics, but only 690 units and 9 companies in Slovenia owned by interests in other republics. Links with the rest of the world were also hindered by unresolved responsibilities for Yugoslav foreign debt and foreign-currency reserves, non-financial assets, 2500 bilateral and multi-lateral agreements on export quotas, transport licenses, *etc.* (Mencinger 1997, p. 209). What struck hardest was near complete loss of the Yugoslav market of 23 million people. According to Mencinger's estimates (*Ibid.*, p. 210), Slovenia lost 74.1 per cent of its 'normal' exports to Yugoslavia, 18.8 per cent of its 'normal' exports proper, and 45.2 per cent of its 'normal' total exports. As a result, GDP declined in 1991 and 1992 by 8.9 and 5.5 per cent respectively. The unemployment rate rose from 2.6 per cent in 1989 to 7.3 per cent in 1991 and 9.1 per cent in 1993. The worst affected groups were young job-seekers and the unskilled – the 1993 unemployment rate for the 15–24 age group was 24.2 per cent (Svetlik 1997, p. 218).

Table 5
Slovenia's macroeconomic indicators
(1990–2000)

	1990	1992	1993	1994	1995	1996	1997	1998	1999	2000
Real economy (% changes)										
GDP	-4.7	-5.5	2.8	5.3	4.1	3.5	4.6	3.8	4.9	5.1
Industry	-10.5	-13.2	-2.8	6.4	2.0	1.0	1.0	3.7	-0.5	n.a.
Agriculture	1.6	-6.7	-4.2	4.2	1.6	1.1	-2.9	3.1	2.3	n.a.
GDP p. c. (USD mn)	8706	6280	6370	7231	9418	9439	9103	9793	10020	n.a.
Unemployment (annual average %)	4.7	8.3	9.1	9.1	7.4	7.3	7.1	7.6	7.4	n.a.
Consumer prices (% over previous year)	550	207.3	32.9	21.0	13.5	9.9	8.4	8.0	6.1	8.6
Government balance/GDP (%)	-0.3	0.3	0.6	-0.2	-0.3	-0.2	-1.7	-1.4	-0.9	-1.0
Interest rates (%)										
Deposit rate	n.a.	48.3	30.2	27.9	20.8	11.2	13.9	7.0	9.6	n.a.
Lending rate	n.a.	72.2	42.6	38.5	28.0	18.3	20.3	12.3	15.2	n.a.
External performance (USD mn)										
Goods exports	4120	6683	6083	6832	8350	8353	8408	9091	8623	9054
Goods imports	4730	5892	6237	7168	9303	9178	9184	9880	9868	10016
Trade balance	-610	791	-154	-336	-953	-825	-766	-789	-1245	-962
Current account	530	926	192	574	-100	31	12	-147	-783	-491
Current account /GDP (%)	n.a.	7.4	1.5	4.0	-0.5	0.2	0.1	-0.8	-3.9	-2.6
FDI net USD mn	0	113	111	131	183	188	340	250	144	50
Debt servicing/exports of goods & services (%)	n.a.	4.9	5.0	4.9	6.8	8.8	8.8	13.5	8.0	n.a.

Source: EBRD (2000), p. 213; data for 1990: EBRD (1997), p. 235.

Slovene companies strove to divert their exports to Western Europe. In 1992, total exports increased by 33 per cent and total imports by 28 per cent, but results in 1993 were far less impressive: exports down 9 per cent and imports up 5.9 per cent. The drastic decline in total exports was caused mainly by the collapse of trade with former Yugoslavia, which plunged by 37 per cent (from USD1508 million to USD963 million). Particularly important in this difficult period was the relative openness of the German market (Mencinger 1997, pp. 211–14). The EU share of Slovenia's total exports rose from 60.9 per cent in 1992 to 67.2 per cent in 1995, while its import share rose from 59.6 per cent to 68.9 per cent in the same period. The driving force behind Slovenian exports to the EU were manufactures redirected from former Yugoslav markets: footwear, chemicals, textile, metalworking and paper. In the second quarter of 1993, the economy bottomed out, so that GDP increased by 2.5 per cent over the year and has been growing since (World Bank 1999b, p. 49).

Despite the pessimistic forecasts, the Slovene economy seems to be competitive. When the present author visited the country in 1997, economists gave several explanations. (i) Slovenian companies were striving to modernize under the pressure from market. (ii), Slovenia had inherited the entire EC export quotas for former Yugoslavia. (iii) A division of labour similar to the one between South-East Asia and Japan was developing with Germany and Austria. For example, Slovene companies produced components (such as car seats for BMW), and other companies were making and exporting textiles under foreign brand names.

Four years after secession and independence, 'The benefits of secession appear to prevail over its costs. Namely, while the costs of re-orientating trade from protected to competitive markets were significant, the secession intensified economic restructuring, produced sound economic policy, and permitted the construction of a "normal" economic system' (Mencinger 1997, p. 213).

3.3. Restructuring and privatization

Preparations for privatization had begun at the end of the Yugoslav period. The amendment to the 1974 Constitution in November 1988 and related laws allowed gradual transformation of socially owned companies into mixed ones. Discount-price 'internal shares' enabled employee buy-outs. In 1990, responsibility for privatization was shifted to the republics. The first draft programme for privatization in Slovakia was announced in November 1990.

There was heated controversy between advocates of two approaches. One was styled gradual, decentralized, commercial privatization, by which firms themselves initiated the process and the government role was confined to regulation and monitoring. 'Gradual' meant that the initial privatization (by selling or issuing shares) might be full or partial. 'Commercial' ruled out any free distribution of shares by right, although citizens of Slovenia would be entitled to discounts on share purchases up to a ceiling and there would be additional discounts for employees of the unit being privatized. This approach was championed by Joze Mencinger, in whose view there were merits and lessons for future management in the experience of self-management under socialism.

The second group proposed mass, centralized, distributive privatization. This approach was represented by Jeffrey Sachs, an economist noted for his eradication of vicious inflation in South America and plans for shock therapy drawn up for the governments of Poland and Russia. In his view, the political, social, and economic legacy had to be eradicated. 'Centralized' meant there was a big role for government in privatization, and 'mass' that enterprises were to be immediately converted into joint-stock companies by free distribution of shares to the public.

The second privatization bill of November 1991 was voted down, but the Act on the Transformation of Social Ownership was finally passed in November 1992. This was a compromise between the strategies: the decentralized, gradual approach of the first and the predominantly distributive, voucher privatization of the second (Mencinger 1996, pp. 418–19).

Stiblar (1993, p. 185) summarizes the privatization legislation as follows. (i) It regulates the conversion of enterprises in social ownership into firms with known, private owners, while delineating the roles of the Privatization Agency, the Reimbursement Fund and the Pension Fund. (ii) Certain entities are excluded: public enterprises, banks, insurance companies, cooperatives, enterprises in bankruptcy procedure. (iii) Social capital is defined in the law as the difference between the assets and liabilities of social enterprises, plus permanent investments and stocks in their possession. The value of social capital is established by drawing up an 'opening balance', by methods prescribed by the Privatization Agency and Social Accounting Service. It is not a book value, because it is usually far from the real value. (iv) The rights of previous private (individual and corporate) owners and their heirs are also prescribed. The denationalization act called for restitution of private property rights in kind (if possible) or value (shares) to those stripped of ownership by the nationalization proceedings of the post-war socialist regime. (v) All agricultural land and forest in social ownership are transferred to the Fund for Agricultural Land from the day of enactment. Companies using and managing land may continue to do so until an authorized body decides on denationalization (restitution) or concession.

In 1993, vouchers known as ownership certificates were distributed free to all Slovenian citizens. Unlike the vouchers in Russia, these had different face values (between SIT 200,000 – DEM 2500 – and SIT 400,000) depending on the citizen's age. The total face value of the certificates distributed came to 40 per cent of the book value of social capital on December 31, 1992. The certificates were not transferable, but could be used to purchase shares in privatized companies (internal distributions, buyouts and public issues) or investment funds (World Bank 1999b, p. 88). The conversion process affected almost 1500 socially owned firms between 1993 and 1997. By November 1998, 1369 private joint-stock companies were registered as operating. The report by the World Bank saw the strong self-management tradition in Slovenia as an obstacle to privatization. Most companies were controlled by insiders. More than 90 per cent of firms chose to transfer ownership through internal distribution/buyout. In terms of capital value, however, 26 per cent of the total was held by insiders, 29 per cent by the state and 31 by institutions. Most insider buyouts took place in labour-intensive small and medium-sized firms. In 67 per cent of the approved programmes, employees acquired more than half the company, but these companies accounted for only 16 per cent of national capital value. The shares in more capital-intensive firms were offered to the public for cash or certificates, subject to approval of the floatation by the Slovenian Security and Exchange Commission. Only 12 per cent of companies used public sale as their preferred privatization method, but these accounted for almost 30 per cent of the total social capital. Slovenian citizens were given pre-emptive rights in these issues, so that sales to foreign investors were limited (*Ibid.*, p. 89). A noteworthy role was still being played by the state. For example, agricultural lands and forest previously used by socially-owned firms were nationalized, as were public utilities and three large banks and steelworks, which had been bailed out. The public services in which the state retained its participation included power generation and distribution, transportation, telecommunications and postal services, water distribution and other municipal services, and urban and environmental infrastructure (*Ibid.*, p. 90). By 1996, the private sector accounted for about 40 per cent of GDP, which was well below the proportions of over 60 per cent found in other Central European transition countries. Even in 1999, the private sector was thought to be generating only 50–55 per cent of GDP and employing about 50 per cent of the labour force.

3.4. Restructuring the financial system

Slovenia had inherited a defective banking system from former Yugoslavia, where especially under the 1974 Constitution, banks gained a character of subordination to the self-managed enterprises, which had founded them in many cases.[11] After the independence of Slovenia, the financial system including banks was essentially restructured. According to the report of the World Bank (1999b), Slovenia's banking sector faced four major problems at the time of independence. (i) Some 30–40 per cent of bank loans were non-performing. (ii) There was practically no competition in the sector. (iii) The regulatory and supervisory regime was lagging behind international standards. (iv) Banks had lost assets in other parts of former Yugoslavia (see Section 3.2). Nevertheless, Slovene banks retained liabilities, especially towards the London Club creditors.

The authorities headed off the most pressing bad-debt problem by nationalizing three major banks and establishing a Bank Rehabilitation Agency. The process began by writing off current bank losses against capital and replacing non-performing assets with BRA-issued bonds to a total of DM 1.9 billion, which was equivalent to just under 10 per cent of Slovenia's 1993 GDP. The swap removed two-thirds of the bad assets held by banks. The World Bank report found it paradoxical that public ownership in the banking sector had significantly increased during Slovenia's transition to a market economy and pointed to other problems such as weak competition and high operating costs. The rehabilitation as such had been successful and improved the sector's financial position significantly, but it was expected that the restructuring would have to continue (*Ibid.*, pp. 65–68).

3.5. Recent tendencies

Having grown continually since 1993, the Slovenian economy exceeded its 1990 output level in 1996. In 1999, per capita GDP equalled an exchange-rate USD10,109 equivalent to USD15,550 at purchasing-power parity (WIIW 2001, p. 56). Equivalent figures for the Czech Republic were USD5305 and USD13,080 respectively (*Ibid.*, p. 42), so that Slovenia was by then the richest of the transition countries.

Furthermore, it has been an economy with both inward and outward flows of FDI. According to Jaklic (2001), the first Slovenian OFDI occurred in 1951. Parallel with the disintegration of former Yugoslavia, many Slovenian companies became foreign direct investors overnight. Exports were complemented by more rapid expansion of outward FDI, especially in the second half of the 1990s. The stock of outward FDI reached USD621 million at the end of 1999, which was equivalent to 23 per cent of the inward FDI increment in that year.

Table 6
Slovenia's outward stock and flows of FDI
(USD million)

	1993	1994	1995	1996	1997	1998	1999
Outward FDI stock	280.6	354.0	489.9	478.4	452.4	599.6	621
Net outward FDI flows	1.3	- 2.9	5.1	6.3	35.6	1.7	37.5
Outward FDI stock/GDP (%)	1.5	2	2.5	2.7	2.5	2.3	3.2

Source: Jaklic (2001), p. 387.

Slovenia was already highly dependent on foreign trade, but secession and independence increased this. Exports and imports of goods and non-factor services account jointly for over 100 per cent of GDP.

[11] See note 6.

For example, the share of exports of goods and services in GDP in 1997 was 57.1 per cent, and that of imports 58.3 per cent. Slovenia's small open economy is therefore vulnerable to external economic fluctuations (World Bank 1999b, p. 5). Slovenia, like other Central East European (CEE) countries, is due to join the EU in 2004. Slovenia has still many problems in the field of agriculture, social welfare, *etc.*, associated with the structural adjustment required by the process of EU harmonization.

4) TRANSITION IN CROATIA

The transition in Croatia coincided with a hard-fought independence war. The initially warm Western welcome for Croatia's independence rapidly cooled politically in response to President Franko Tudjman's overtly nationalistic course. In 1991–5, financial assistance from the EU was limited to aid for humanitarian purposes.[12] Towards the end of the 1990s, the Tudjman regime encountered increasing public dissatisfaction and lost the general elections in January 2000. A new Social Democrat-led coalition embarked on economic restructuring and efforts to promote EU membership.

4.1. The Croatian economy after independence

Independence was obtained at no small cost. War between the Croatian and Yugoslav Federal armies began, but the conflict moved mainly to Bosnia-Herzegovina and Croatia became calm again. However, a third of its territory came under Serbian military rule and remained so until July 1995. Manufacturing was severely hit by the war, with about a third of capacity damaged (Fujimura, 1996, p. 77). GDP was 39 per cent lower in 1993 than in 1990. The annual rate of inflation exceeded 1100 per cent in 1993 (*Table 7*).

The first stage of a two-stage stabilization programme was introduced in October 1993, when the central bank tightened monetary policy and liberalized the foreign-exchange market, while the government upped utility prices to eliminate subsidies and placed controls on public-sector wages. Within a year, inflation had calmed and central-bank started to increase. The dinar was replaced by a new currency, the kuna, in May 1994. The second-stage structural reforms were intended to produce long-term economic stability, through fiscal reform, acceleration of privatization, restructuring of loss-making public-sector enterprises, restructuring of the banking system, and development of the financial system (Jovancevic, 1999, pp. 240–41).

Croatia's foreign-trade volume before independence had amounted to 100 per cent of its GDP (Samardzija 1997, p. 107). Exports in 1990, including trade with other Yugoslav republics and trade in material services, was put at USD13.7 billion or about two-thirds of GDP. This was more than halved to USD5.7 billion in 1993, following the downturn in the economy, a sharp fall in revenue from services, and the loss of two neighbouring markets (*Ibid.*, p. 35). Thereafter came rapid recovery, beginning in 1994. However, wages began to soar, increasing by almost 40 per cent in

[12] Continual discrimination and harassment of Croatian Serbs culminated in a clearance of the Krajina district by the Croatian army in August 1995 and resettlement there of Bosnian Croats, in contravention of the Dayton Agreement of November 1995. Under US pressure, the World Bank cancelled a USD30 million loan for bolstering Croatia's banking system and the IMF also postponed a loan. Negotiations for the country to join the World Trade Organization were suspended, under pressure from the United States and the EU, and its negotiations towards a cooperation agreement with the latter, which began in June 1995, were suspended in August. Although Croatia had been officially included in June 1995 among the recipients under the PHARE programme, that too was suspended in August.

1995, presumably due to earlier administrative suppression. A consequent surge in domestic demand brought a 44 per cent increase in imports without real progress in terms of GDP (*Ibid.*, p. 104). Exports in 1995 covered only 62 per cent of imports, as opposed to 93.7 per cent in 1973 and 86.3 per cent in 1988 (Statisticki Godisnjak Jugoslavije 1989, pp. 325 and 418).

place for exports in 1985 went to Italy (23.7 per cent), followed by Germany (21.5 per cent), Slovenia (13.1 per cent), Bosnia-Herzegovina (8.3 per cent), Austria (4.3 per cent), Russia (3.3 per cent), France (2.4 per cent), Liberia (2.3), the United States (1.8 per cent) and the Netherlands (1.7 per cent). In the same year, the first place in Croatia's imports went to Germany (20.1

Table 7
Croatia's macroeconomic indicators
(1992–2000)

	1990	1992	1993	1994	1995	1996	1997	1998	1999	2000
Real economy (% changes)										
GDP	-6.7	-11.7	-8.0	5.9	6.8	6.0	6.5	2.5	-0.9	3.7
Industry	-11.7	-14.6	-6.0	-2.6	0.3	3.1	6.8	3.7	-1.4	n.a.
Agriculture	-2.9	-13.5	4.5	-0.3	0.7	1.3	4.0	10.2	n.a	n.a.
GDP p. c. (USD mn)	5106	2291	2349	3137	4029	4422	4396	4806	4456	4227
Unemployment (annual average, %)	9.3	13.2	14.8	14.5	14.5	10.0*	9.9	11.4	13.6	n.a.
Consumer prices (% over previous year)	610	666	1518	97.6	2.0	3.5	3.6	5.7	4.2	6.5
Government balance/GDP (%)	n.a.	-3.9	-0.8	1.2	-1.4	-1.0	-1.4	-0.4	-6.2	-6.7
Interest rates (%)										
Deposit rate	n.a.	435	27.4	5.0	6.1	4.2	4.4	4.1	4.3	n.a.
Lending rate	n.a.	2333	59.0	15.4	22.3	18.5	14.1	16.1	16.1	n.a.
External performance (USD mn)										
Goods exports	4020	3127	3904	4260	4633	4546	4210	4605	4372	4590
Goods imports	5190	3430	4646	5432	7900	8236	9435	8773	7674	7904
Trade balance	-1170	-303	-742	-1172	-3267	-3690	-5224	-4169	-3302	-3313
Current account	1050	326	606	826	-1451	-1148	-2343	-1550	-1537	-798
Current account /GDP (%)	n.a.	3.2	5.6	5.7	-7.7	-5.8	-11.6	-7.1	-7.6	-4.1
FDI, net (USD mn)	n.a.	n.a.	120.3	117.3	120.8	515.9	550.7	1013	1635	1125.8
Debt servicing/exports of goods & services (%)	n.a.	8.8	9.7	8.9	9.6	8.9	10.0	13.1	14.4	n.a.

Source: EBRD (2000), p. 153; Data for 1990: EBRD (1997), p. 220. Note: *This sharp fall in unemployment, strange at a time when demobilized soldiers were appearing on the labour market, points to a change in methodology. Jovancevic (1999, p. 246) puts the jobless rate at 16.4 per cent in 1996, 17.5 per cent in 1997, 17.6 per cent in 1998 and 19.0 per cent in 1999.

The partner structure of foreign trade shifted steadily towards Western Europe (Samardzija 1997, pp. 106–9). In 1992, the EU took 52.45 per cent of Croatia's exports, former Yugoslavia 31.97 per cent, and CEE and ex-Soviet countries 5.79 per cent. By 1995, the EU share had increased to 58 per cent, while former Yugoslavia's was 23 per cent and the CEE and ex-Soviet group 9 per cent. With imports, the EU supplied 46.79 per cent in 1992, former Yugoslavia 23.24 per cent, and the CEE and ex-Soviet countries 13.58 per cent, as opposed to 62.16, 11.31 and 9.31 respectively in 1995. A breakdown by countries shows that first

per cent), followed by Italy (18.2 per cent), Slovenia (10.7 per cent), Austria (7.7 per cent), the UK (6.1 per cent), the United States (2.7 per cent), Libya (2.5 per cent), France (2.5 per cent), the Netherlands (2.3 per cent) and Switzerland (2.2 per cent).

Nowadays, implementation of the second stage is criticized (Croatian Chamber of Economy 2000, p. 2). The violent inflation was rapidly controlled in 1993–4 and in this regard, the stabilization programme was a success, as Ivan Teodorovic (2001, pp. 276–7) concedes. However, he criticizes the second stage because an 'economic policy that allowed for increasing domestic consumption and rising foreign debt in hand with a softening of the budget constraint had to end up with a softening of the entire fiscal system. Thus, a slowing down and in some aspects the reversal of the reform process had threefold effects: stagnant growth rates, increasing unemployment and social differentiation.'

4.2. Economic restructuring and 'state-dominated' privatization

The privatization legislation of April 1991 defined permissible procedures and a general framework. Two supplementary pieces of legislation permitted direct state involvement in any sector. The main characteristics of privatization strategy in Croatia were (i) nationalization of social capital, of which the state became owner of 80 per cent. (ii) The government had a prominent role and extensive discretionary powers in the privatization of re-nationalized firms. (iii) Instead of an Eastern European-style voucher scheme, there was a system of discounts on share purchases, with priority for employees. (iv) The privation was 'revenue-oriented' (Bicanic 1993, p. 426). A plainer explanation was given by Kalogjera (1993, p. 63), who described it as one of basic privatization objectives to obtain funds necessary to repay public debt and assist financing recovery.

Criticism of the power privatization gave to the state came from two senior Croatian economists. Noting that former Yugoslavia's shift from a command economy towards a market economy had begun in Croatia in 1950–52, where 60 per cent of prices had been liberalized over eight years, Branko Horvat (1999) called the 1990s privatization a backward transition. Similarly, Dragomir Vojnic (1999, p. 17), in a keynote speech at an international conference in 1999, said his country had 'only exploited market tradition to a certain degree' and 'the process of circulation and concentration of capital did not develop on the basis of entrepreneurship and entrepreneurial capability, but on the basis of political fitness'.

On the political side, the Tudjman regime and the Croatian Democratic Union (HDZ) held power from 1990 to 2000, thanks to a constituency system that had given the HDZ 65 per cent of the parliamentary seats with 48 per cent of the poll. The main opposition party was different in each election (communists in 1990, liberals in 1992, and yet another party in 1996). This, ironically, gave the political system a kind of stability.[13] According to Puhovski (1999, p. 20), 'All the really important decisions are made in some kind of court around President Tudjman, officially called the National Defence and Security Council.'

4.3. The privatization process

The Privatization Agency and the Development Fund set up in 1991 inherited the legal framework of the Yugoslav Federation. The role of the Privatization Agency was to check the submitted plans and supervise and monitor the privatization process. The proceeds went to the Development Fund. The Privatization Agency had the power to install managers in loss-making enterprises. The Development Fund was free of direct accountability and its portfolio of shares in almost all companies made it the biggest owner of assets and a market maker on the nascent stock exchange. For firms it owned, it appointed managers and could initiate privatization when and how it saw fit. The two organizations merged as the Croatian Fund for Privatization in January 1993 (Bicanic 1993, pp. 422–8).

Privatization itself involved three rounds of share sales and allocations to development and pension funds. The first round was a discount sale of shares to employees, the second a full-price sale, again to employees, and the third a non-

[13] Author's interview with Ivan Grdesic, Faculty of Political Science, Zagreb, July 9, 1997.

discounted sale to the public. Shares in the first two rounds could be purchased in instalments over periods of up to five years. The biggest discounts went to employees buying into firms that employed them, awarded on transactions up to a ceiling of DEM 20,000 per individual, contingent on mode of payment and years of service. Shares sold in the first round could not exceed 50 per cent of the total estimated assets of the company (*Ibid.*, p. 433).

Managerial buyouts were apparently preferred in the actual privatization, but Bicanic has pointed to problems in this regard, referring to 'the frequency and form of bending the rules and breaking the law'. The most frequent dodges were 'manager loans', 'manager's insurance schemes', and 'ghost buyers on one side and undervalued assets on the other' (*Ibid.*, p. 435). The preferential loans to managers received from banks (whose managers were established business partners or even friends) were for up to DEM 10,000. Banks might accept as collateral the shares themselves, overvalued real estate, or frozen 'foreign-currency savings deposits' (*Ibid.*, p. 435; Kalogjera 1993, p. 81). Sometimes the company involved would pay high insurance premiums on its managers' behalf, which they then cashed in at a discount to finance their share purchases. In other cases, workers would be paid to act as ghost buyers of shares at large discounts and sell on to managers. Managerial buyouts were common. However, legislation facilitated undervaluing and incorrectly valuing assets – for example, location was not considered or book value used in spite of inflation. Managers were not the only ones breaking and bending the rules. The Privatization Agency was often accused of using privatization legislation for non-economic (mostly political) goals. Noted examples mentioned by Bicanic (1993, p. 436) were replacement of managers with party faithful in Istria, attempts to influence the media by putting independent dailies and weeklies into receivership, and preventing employee buyouts to ensure that the state retained majority control.

4.4. Privatization stalemate

Privatization in Croatia came to a standstill in 1997. According to research by a Hungarian research organization Kopint-Datorg (*ET* 6: 3, pp. 176–7), the deficiency was that privatization had not been extended to the banking sector, energy industry, public utilities or arms industry. The most widespread method was sale of half the share capital to employees at a discounted price. Most unprivatized equity was handled by the Privatization Fund. Other holdings were controlled by the pension funds, while 5 per cent was being used for compensation. Small and medium-sized companies were purchased by employees and management using preferential credits. The large companies, which were nationalized first, came under the management of cronies of the ruling party. According to Kalogjera, 'Every privatization sale is carried out [in a way] favourable to a ruling party.'[14] In Croatia's case, where Tudjman and the HDZ were firmly in power from April 1990 to January 2000, the evil is evident.

It was officially declared in 1997 that 50 per cent of all firms had been privatized, but Kalogjera was sceptical. In fact, he argued, 80 per cent were in the hands of the state or under state control. Zakosek (1996, p. 93) reported that about 560,000 shareholders (12 per cent of Croatia's population) in various companies, including employees and managers, had emerged out of the privatization process. The limiting features were (a) ineffective capital markets, (b) negligible foreign investments, (c) lack of domestic capital, and (d) the fact that the main privatization transactions were still handled by the state, not the stock market. Vojnic (1999, pp. 17–20) saw hundreds of thousands of small shareholders plundered, despite the formal rights given by the law, because of their restricted ability to pay for

[14] Author's interview with Drazen Kalogjera, Zagreb, July 10, 1997.

their shares. Wealth was being concentrated into the hands of a small number of tycoons supported by the ruling structures. The deviancy involved a broad range from mass small crime, bribery and corruption, up to organized crime permeating various levels of the economy and society. Vojnic used expressions like 'maffiocracy', 'savage capitalism' and 'primitive accumulation' in his criticism of privatization practice in Croatia, adding that a previously relatively developed middle class, the foundation of civil society, had almost disappeared. He drew parallels with the situation in Russia, and blamed the deviancy on World Bank and IMF advisers and their concept of 'Washington Consensus'.

4.5. Reorganizing the banking system

According to Jovancevic (1999, p. 241), the break-up of the Yugoslav monetary system technically made the Croatian banks insolvent. Large amount of banks claims on the National Bank of Yugoslavia became impossible to collect and private foreign-currency deposits have been frozen since 1991. Numerous companies found themselves in serious difficulties, unable to repay their debts to banks. The government therefore recapitalized a number of major companies by issuing treasury 'big bonds' as a debt-repaying instrument.

The real increase in fixed assets from domestic sources was very small in the 1990s, for several reasons. (i) Except in 1995–7, the deposit rate has been lower than the inflation rate (*Table 7*), so that the marginal propensity to save has been small. (ii) High exchange rates have not encouraged industry to export, so that the volume of production has remained low relative to the size of domestic market, with high fixed costs per unit of production. The profits on domestic manufacturing and services have been low, so that corporate savings have also remained low. (iii) The limited domestic funds have made capital (*i.e.* interest rates) expensive. For instance, the lending rate in 1995 was 22.3 per cent against an annual inflation rate of only 6.1 per cent. This may also have pointed to inefficiency in the banking system. (iv) Capital markets have functioned sluggishly, making it hard for firms to finance investment through equity and impeding modernization of production (*Ibid.*, pp. 255–6).

This meant that the Croatian economy badly needed foreign direct investment, but the inflow was small until the mid-1990s (*Table 7*), due to Croatian distaste for it and the government's poor foreign relations (Croatian Chamber of Economy 2000, p. 2). Croatia and the FR Yugoslavia eventually accorded each other diplomatic recognition in April 1996, which was much welcomed internationally (Samardzija 1997, p. 24). In early 1997, Croatia received its first credit rating from three major agencies, indicating the arrival of peace and reconstruction and the end of a period of extreme political risk (Jovancevic 1999, p. 242).

Table 8
Banks according to type of ownership

Banks	1990	1994	1995	1996	1997	1998
State-owned	21	19	15	15	9	9
Private	5	32	39	43	51	51
Total banks	26	51	54	58	60	60

Source: Jovancevic (1999), p. 242.

Rehabilitation of Croatia's banks was facilitated by participation from foreign banks. The process started in 1996 with four large banks (Slavonska, Splitska, Rijecka and Privredna banka). Hitherto, the banking system had remained concentrated, with a small number controlling a relatively large proportion of total assets and revenues. The existing banks were privatized and new private banks were established (*Table 8*). Whereas only one bank had entered the Croatian market before 1996, six foreign banks opened branches or subsidiaries between late 1996 and 1997, which helped to intensify competition. By 1998, the majority of the banks (85 per cent, with 70.2 per cent of the total banking assets) were predominantly privately owned. The other nine banks (with 29.8 per cent of the total assets) were wholly or state owned (*Ibid.*, pp. 241–3). The intensified competition sent some banks out of business, including four in 1998 (Dubrovacka, Zupanska, Glumina and Gradska), which held huge amounts of bad debt (*Ibid.*, p. 257).

4.6. The Croatian economy in the second half of the 1990s

The economy started to recover in 1994, recording growth rates of about 6 per cent in 1995–7. The best performance was shown by construction, which was closely related to reconstruction of war damage. However, the Croatian economy had not recovered its 1990 level even by 1998, when it recorded negative growth in the second half of the year.

The shortage of domestic funds and the difficulties for companies in obtaining bank loans have been mentioned already. So has the very small amount of FDI up to 1995 – a per capita figure much smaller than the ones for other CEE countries. Capital investment in manufacturing and services has also been low in the final years of the federation, so that technologies in Croatia had become obsolete. Having been the world's third biggest ship-builder, producing mainly for the world market, the state-owned shipyards were allowed to stagnate and lose their international competitiveness after independence. Croatia is now only the thirteenth largest shipbuilder in the world (Horvat 1999, p. 55; *BCE*, May 2000, p. 30).

On January 1, 1998, sales tax was replaced by a value-added tax. The annual report of the Ministry of Finance denied this had any negative impact on economic growth, since it had reduced the tax rate from 26.5 to 22 per cent while successfully drawing much of the informal economy into the tax net and so increasing overall tax revenue. Instead, the annual report mentioned the financial crisis in East Asia, saying that negative perceptions of investors and increased sensibility to risk in the second half of 1997 had curbed FDI in transition countries (Republic of Croatia, Ministry of Finance 1999, pp. 9–14). GDP fell by 0.8 per cent in the fourth quarter of 1998, according to the report because of worsening credit availability on domestic and foreign markets, high costs of capital, difficulties in collecting outstanding debts, decreased growth rates in domestic demand, and a levelling of tourist consumption (*Ibid.*, p. 11). This explanation may cover the short-term changes, but the underlying cause was loss of development impetus, due to structural problems such as decreased competitiveness, delay in restructuring enterprises and the banking sector, and swelling public expenditure. Employment fell by 3.2 per cent in the first quarter of 1999 and the unemployment rate jumped from 18.6 per cent in December 1998 to 19.6 per cent in March 1999. The recession also worsened the position of the central budget. Having registered a surplus in the previous year, the budget showed a deficit to 1837 million kuna in the first quarter of 1999. To prevent further deterioration, the government approved a restrictive package in May 1999, clipping 3.5 billion kuna off public spending. Meanwhile a spate of banking failures meant that large sums had to be spent on topping up the deposit insurance fund and reducing the deficit of the welfare funds. Monetary policy also had to be tightened (*ET* Vol. 8, No. 2, pp. 129–30).

Both exports and imports declined in 1999. Exports were down to USD4.27 billion (5.8 per cent less than in 1998). Imports amounted to USD7.77 billion (*i.e.* 7.2 per cent less than in 1998). Although the trade deficit decreased slightly (USD345 million), it was still USD3.49 billion. The weak trade performance was ascribed to the absence of a preferential trading agreement with the EU, the customs border that came into effect with Bosnia-Herzegovina, and the slow start to the structural modernization of industry (*ET* Vol. 9, No.1, p. 39).

For a long time, Croatia's large deficits in goods trading had been offset by the surplus in services and remittances from workers abroad. These were both affected badly by the events in the Balkans. By the autumn of 1998, tensions between Yugoslavia and Nato were rising over Kosovo, and between March and June the following year, Nato made air attacks on Yugoslavia. Although Croatia was not in the war zone, the attacks involved overflying by Nato planes from bases in Italy and the Adriatic, which discouraged tourists from visiting the Adriatic coast and halved revenue from tourism. This and a fall in transportation led to a drastic worsening of the services balance. Accumulated external debt doubled in four years from USD3699 million in 1994 to USD8489 million in 1999 (Republic of Croatia, Ministry of Finance 1999, p. 97). By September 1999, debt had reached USD9.3 billion, of which USD1.7 billion was due for repayment by 2000 (Hrvatski 1999, p. 5).

There was also a mounting problem with debts between firms. According to data from the Institution for Payment Transactions, this amounted to 23.3 billion kuna in June 1999, which was 7.3 per cent higher than in the previous month. The total in August 1999 was almost 62 per cent or 8.9 billion kuna more than in late 1998 (*Ibid.*, p. 7).

Consolidated state spending rose from 40.5 per cent of GDP in 1994, to 47.9 per cent in 1998, when it was expected to rise to 49.1 per cent. Adding in local authorities to government spending and non-budget funds, total public spending came to 70 per cent of GDP (Croatian Chamber of Economy 2000, p. 9). The biggest share of central-government budgetary expenditure in 1997 went to defence (20.32 per cent), followed by social security and welfare affairs and services (18.76 per cent), public-order and safety affairs (12.12 per cent), education (11.78 per cent), and transport and communications (9.98 per cent). The biggest item in the 1999 budget was social security and welfare affairs and services (23.07 per cent), followed by defence (12.88 per cent), education (12.56 per cent), transport and communications (11.65 per cent), and public-order and safety affairs (9.73 per cent). Spending on defence and public order decreased, but their shares in the state budget remained high. Of the non-budget funds, the most important were pensions and health. Deficits in the non-budget funds were covered by transfers from the central budget, of which 50.8 per cent went to the pension fund in 1998 and 13.9 per cent to the health fund (Republic of Croatia, Ministry of Finance 1999, pp. 47–8). By March 1999, the number of retired was nearly one million out of a population of 4.6 million, so that the ration of active to retired was 1.6:1 in 1999, as opposed to 3.2: 1 in 1990 (*Ibid.*, p. 19). In this respect, the working programme of the new government criticized problems such as a lack of discipline in payment of pension and health contributions, recognition of claims regardless of financial conditions, and very uneven rights (Government of the Republic of Croatia 2000, p. 4). Budget expenditure had to be trimmed before a stand-by credit agreement could be reached with the IMF. Reforms of the pension and health systems became inevitable as transfers from the central budget could not be maintained. Similarly, an agreement had to be reached with social partners on limiting wage and price increases. As a result of all this, Croatian economy came to a standstill towards the end of the 1990s (*ET* Vol. 9, No.1, pp. 39–40).

4.7. Political changes

The economic difficulties showed that Tudjman's methods had failed. The public had become dissatisfied with the way Tudjman's adherents had amassed wealth while many people became impoverished. As a regional journal reported early in 1999, 'Opinion polls credit [Tudjman's] ruling party—the badly divided Croatian Democratic Union (HDZ) – with a dismal 20 per cent level of support. Worse, the man himself has dropped from the second most respected person in the country in January last year, to a pathetic 35th place now'

(*BCE*, February 1999). Few foreign statesmen chose to attend Tudjman's funeral in December 1999. The HDZ won only 40 of the 151 seats in Parliament (24.38 per cent of the vote) in the general elections of January 3, 2000. A centre-left union of the Social Democratic Party and the Social Liberal Party won 71 seats (40.84 per cent of the vote), and a centre-right union 24 seats, which decided to support a coalition government from outside. The three main candidates in the presidential election on January 24, 2000 were former Foreign Minister Mate Granic (HDZ), Drazen Budisa of the centre–left union and Stjepan Mesic of the centre-right union, a one-time president of former Yugoslavia, who won with 56.21 per cent of the vote in a run-off poll on February 7.[15]

The new prime minister was Ivica Racan, last leader of League of Communists of Croatia and leader of the Social Democratic Party. His programme, based on the public commitments of the coalition groups, was one of change aimed at building a civil society and a democratic, market-oriented state integrated into the EU. One of the main tasks was to change the political system by reducing the powers of the president and strengthening the role of Parliament and the government. Other tasks were the promotion of dialogue and tolerance, establishing an independent judiciary and the rule of law; turning Croatian Television into a public, independent, responsible medium, *etc.* The new government set out to take Croatia into the WTO and CEFTA and gain associate membership of the EU (Government of the Republic of Croatia 2000).

Prime Minister Racan called on the leaders of state enterprises and institutions to resign, so as to wind up Tudjman's economic estate (*ET* Vol. 9, No.1, p. 38). The new government broke with the nationalistic course of its predecessor. This was exemplified by a cooperative position towards the International Tribunal in the Hague on war criminals in the former Yugoslavia. Leaders of the West welcomed the new government and tried to put a rapid end to the country's international isolation.[16] In June 2000, Nato invited Croatia to participate in its Partnership for Peace. Meanwhile there were negotiations with the IMF about a new loan. In July 2000, Croatia was admitted to the WTO. Relations with the EU improved and an Agreement on Stabilization and Association was reached in October 2001.

4.8. Challenges for Croatia

Economic restructuring had been inconsistent under the Tudjman regime. The government that took office in 2000 faced tasks that included first of all painful public-spending cuts (*e.g.* reductions in government employees and their remuneration, cuts in subsidies, and reform of the pension and health systems, *etc.*) Also urgent were promoting exports, attracting FDI, restructuring business and banks, improving the capital market, accelerating privatization and opening it to foreign investors, supporting agriculture, cutting unemployment, introducing minimum social protection, and so on. Moreover, there were 46,000 displaced persons and 140,000 refugees from Serbia, Montenegro and Bosnia-Herzegovina to take care of (Government of the Republic of Croatia 2000; Croatian Chamber of Economy 2000).

According to Borozan and Barkovic (2002), 2650 companies had been involved in privatization in the first decade (1991–9). In 1991, the Privatization Fund managed a state-owned portfolio worth 86 billion kuna, of which assets worth 3.8 billion kuna remained unprivatized in 1999. Many privatized businesses were

[15] *To'o Fairu* No.521–2, pp. 4–5, *Niigata Nippoh* February 9, 2000, and other Japanese newspaper reports.

[16] *BCE* (June 2000, p. 43) reported, 'Mr Racan has handed over sensitive documents to the International Criminal Tribunal on war crimes in former Yugoslavia, despite threats from war veterans to disrupt the all-important tourist season. He has also invited to UN officials to Croatia to investigate mass graves, prompting criticism from war veterans.'

privatized businesses were ruined under the management of Croatian 'tycoons', who returned the shares to the Privatization Fund in that year, dramatically increasing its portfolio again. By September 2001, it held stock in 1203 firms with a combined share capital of 63.6 billion kuna, in which the state holding was 25.5 billion kuna. Most of the portfolio was unattractive to investors due to high indebtedness of companies, insolvency, technical obsolescence, and inappropriate manpower structures. Only about 100 companies in industry, insurance and tourism proved attractive enough to obtain FDI.

FDI, having remained low in the first half of 1990s, began to increase in 1996, reaching USD1.6 billion in 1999 (*Table 7*), when 35 per cent of Croatian Telecom was sold to Deutsche Telekom for USD850 million (followed in 2001 by another 16 per cent for USD422 million). Also in 1999, 66 per cent of Privredna Banka Zagreb was sold to Banca Comerciale Italiana. The cumulative FDI over the 1993–2001 period was USD66.4 billion, with Austria as the biggest investor (27.23 per cent), followed by Germany (25.81 per cent), the United States (18.17 per cent), Luxembourg (5.59 per cent) and the Netherlands (3.63 per cent). As for the sectoral structure, the biggest draws were telecommunications (29.37 per cent), banking (17.26), pharmaceuticals (15.41), cement (5.05), petroleum and gas (3.11), hotels and catering (2.66), commerce (1.67), bricks, roof tiles, *etc.* (1.53) and brewing (1.35). FDI in manufacturing (except pharmaceuticals) has been small and in tourism unexpectedly so. These will have to attract more foreign capital. Borozan and Barkovic (2002) note that 'blue-field' (sea-related) investment is the most profitable, but has been officially neglected and ignored so far.

To attract more FDI and activate business, it is indispensable to improve the investment climate. The communications technology and transport infrastructure need improving. There are still administrative barriers to flows of FDI. Foreign business people often encounter lengthy procedures, such as application for entry visas and work permits of foreign managers and workers, company registration and other procedures for founding a business, business-location problems such as land acquisition, construction permits, usage permit for utility services, *etc.* These are often perceived as 'administrative harassment' (*Ibid.* 2002). Here the more active attitude of Hungary towards FDI could be instructive.

Croatia aspires to join the EU by 2007, but progress seems uneven. Like other candidates, Croatia will have to introduce the acquis communautaire, revise its domestic legal system and harmonize its economy, which is a time and energy-consuming process. Bartlett (2002) points out that late entrants may be at a disadvantage compared with CEE and Baltic countries due to accede in 2004. Latecomers may face higher non-tariff barriers, restricted access to European labour markets, and fiercer competition from new members. EU supports are valuable to Croatia, but the amounts received have been modest. In connection with the Stability Pact of South Eastern Europe, the EU offers the CARDS programme to replace PHARE for the Western Balkans, including Croatia, with political rather than economic aims. It complements EBRD and World Bank support, and is geared towards fields such as democratization, return of refugees, fights against organized crime, and security of borders (*Ibid.*, p. 11). Although Croatia has the Adriatic coast, as a superlative tourist attraction, it would find it very difficult to adopt Norway's approach to the EU.[17] It will therefore continue for many years with its efforts to satisfy the conditions for the EU membership.

[17] Intent on keeping its earnings from North Sea oil to itself, Norway has found non-member association with the EU a satisfactory arrangement. Iceland takes the same position for fear of adverse effects on its fishing revenues from the EU Common Fishery Policy (Bartlett 2002, p. 14).

5) Collapse and a difficult rebirth in the new Yugoslav economy

The Federal Republic of Yugoslavia has experienced two wars and two post-war recoveries in a decade. The civil war in Bosnia-Herzegovina, which broke out in April 1992 and ended with the Dayton Accord in November 1995, led to economic sanctions being imposed on Yugoslavia from May 1992 till November 1995. The two events caused losses of USD50–60 billion and repairing this vast economic damage – or just returning to 1990 levels – is expected to take at least 10 to 15 years' (*Business Europe* September/October 1996, pp. 7–8).

Inflation on the astronomical scale of the late 1980s recurred. The monthly rate peaked in January 1994 at 310 million per cent. This was triggered by excessive public consumption due (i) to 700,000 refugees in Serbia and Montenegro and aid given to Serbs in Croatia and Bosnia (ii) a bloated, bureaucratic Federal administration inherited from former Yugoslavia, (iii) military expenditure equalling 10 per cent of social product (iv) high pension costs, and v) budgetary support to loss-making sectors (Mitrovic-Israel, 1997, pp. 470–71).

Economic activity sharply declined. The year-on growth rate of social product (a category similar to GDP) was –8.4 per cent in 1990, –11.2 per cent in 1991, –26.1 per cent in 1992 and –30.3 per cent in 1993. A drastic fall in the supply of goods led to widespread shortages, which contributed further to price increases. Hyperinflation was also stoked by mechanisms of the grey money supply peculiar to Yugoslavia. As the new Yugoslav Federation inherited a decentralized central-banking system, there was more than one decision-making entity. Monetary policy became unclear and its implementation ill-coordinated, which led to excessive money-supply levels (*Ibid.*, p. 472). The fall in output was mainly due to the UN sanctions, but also to the hyperinflation – industrial output stabilized after it ended, which was well before sanctions were lifted. The decline in output was accompanied by a decline in living standards. Per capita GDP in 1993 was half what it had been in 1991.

The hyperinflation was curbed by the implementation of the Avramovic Programme (Programme of Reconstruction of the Monetary System and the Strategy of Economic Recovery of Yugoslavia), which amounted to two-phase shock therapy. The first phase was similar to the shock therapy implemented by Ante Markovic government on January 1, 1990, which the second phase included elements of drastic reform.

Phase 1, which started on January 24, 1994, was intended mainly to halt inflation and stimulate output. It included introduced a new dinar pegged at parity with the German mark (DEM), convertible for firms and individuals, and with the money supply backed by foreign-exchange reserves. This monetary system was based on the so-called currency-board system. Implementation apparently halted the hyperinflation stopped almost overnight (Mitrovic-Israel 1997, pp. 477–8).

The currency-board system could be maintained for only six months. Before long, financial discipline loosened and the emission of currency based on borrowing from the central bank was resumed. Prices began to rise again (the inflation rate in 1995 was 120 per cent), and the gap between official and black-market exchange rates on official market and black market has expanded. The dinar was devalued in November 1995 to an official exchange rate of YUD 3.3 to DEM 1.

Phase 2 included correlating primary currency emission with foreign exchange reserves. Interest rates were to reflect market demand and the limited supply of currency. State monopolies in foreign trade and industry were ended and privatization begun. With few exceptions; quotas on exports and imports were removed and tariffs

Table 9
Macroeconomic indicators for FR Yugoslavia
(1990–2000)

	1990	1994	1995	1996	1997	1998	1999	2000
Real economy (% changes)								
GDP	-7.9	4.3	6.1	5.8	7.4	2.5	-21.9	7.0
Industry	-12.3	2.1	3.8	8.0	9.5	3.6	-23.1	11.2
Utilization of industrial capacity (%)*	n.a.	36.2	37.6	40.3	44.2	n.a.	n.a.	n.a.
Agriculture	-7.0	n.a.	4.1	n.a.	7.3	-3.2	-0.9	-19.7
GDP p. c. (USD at exchange rate)	2696	n.a.	1449	n.a.	1712	1742	1424	940
Personal consumption/GDP (%)*	n.a.	64	67	73	n.a.	n.a.	n.a.	n.a.
Govt consumption/GDP (%)*	n.a.	21	21	22	n.a.	n.a.	n.a.	n.a
Fixed investment/GDP (%)	n.a.	13	12	12	n.a.	n.a.	n.a.	n.a.
Unemployment (%)	20.3	23.1	24.7	25.8	25.5	25.4	25.5	26.8
Consumer prices (% of previous year)	579.7	n.a.	57.7	n.a.	21.6	29.9	44.9	85.6
Government balance/GDP (%)	n.a.	n.a.	n.a.	n.a.	-7.0	-6.1	n.a.	n.a.
Money and credit (% change)								
M2*	n.a..	n.a.	42.6	75.3	61.6	n.a.	n.a.	n.a.
Dinar credits of banking system*	n.a.	n.a.	68.4	100.6	44.8	n.a.	n.a.	n.a.
Discount rate (% p. a.)	n.a.	n.a.	90.2	n.a.	33.7	33.7	26.3	26.3
External performance (USD mn)								
Goods exports*	n.a.	1481.8	1531.1	1842.0	2368.0	n.a.	n.a.	n.a.
Goods imports*	n.a.	1898.1	2666.3	4102.0	4799.0	n.a.	n.a.	n.a.
Trade balance*	n.a.	-416.3	-1135.2	-2261.0	-2431.0	n.a.	n.a.	n.a.
Current-account balance	-512	-288.3	-968.2	-1318.4	-1800.0	-1180	-1341	-1298
Current balance/GDP (%)	1.8	2.4	7.6	8.8	12.1	6.4	8.9	n.a.
FDI net (USD mn)	n.a.	n.a.	n.a.	n.a.	740	113	112	25
Gross external debt (USD mn)	n.a.	n.a.	9000	n.a.	10500	11500	12500	11500

Sources: Data marked * from CESMECON (1997), p. 8; others from WIIW (2001), pp. .60–61 and 448. Note: As WIIW (2001) shows data only for 1990, 1995, 1997, 1998, 1999 and 2000, corresponding columns for 1994 and 1996 contain data from CESMECON (1997). With foreign trade, where data from CESMECON (1997) and data from WIIW (2001) disagree, data from CESMECON (1997) are adopted, but supplemented with data from WIIW (2001).

reduced. These radical reforms proposed by Dragoslav Abramovic, then governor of the National Bank of Yugoslavia, met with considerable resistance from much of the existing industrial and political power structure (*Ibid.*, p. 479). He had already clashed with the government over his unwillingness to ease monetary policy, his advocacy of speedy, unconditional Yugoslav membership of the IMF and the World Bank, and his support for privatization. Eventually, he was dismissed from his post by the Federal Parliament on May 15, 1996 and implementation of Phase 2 was neglected.

5.1. Frustrated privatization

The process of privatization has been very slow, with the equity, in most cases, being sold at preferential prices to employees and managers of the company concerned. About 2034 registered socially owned firms (45 per cent of the total) were sold off in 1990–94. More than half a million employees – 75 per cent of those employed in such enterprises – subscribed and were allocated shares. The privatization affected. 44 per cent of the total socially owned capital. Thereafter, an additional 42 per cent of socially owned capital was privatized, including mainly public infrastructure and utilities (energy, communications, transport, *etc.*)

Although this may give the impression that privatization was rapid in Serbia, there was a strange occurrence connected with the hyperinflation. In 1994, new, retrospective legislation stipulated that the amounts paid for privatized assets had to be reassessed. This has meant that only 3 per cent of all capital was recognized as privatized. A higher percentage could be retained only after paying substantial additional sums of money. The result was an almost complete suspension of privatization. The structure of capital ownership then became state 42 per cent, social 45 per cent and private 3 per cent in Serbia, while in Montenegro it was 86, social 0 and private 14 per cent respectively (Kovacevic 1997, p. 246). While the idea of 'social ownership' had been that the state was no longer the official owner of the means of production in Yugoslavia in the socialist period, the state paradoxically became the biggest owner after the change of system. The budget constraint remained 'soft' in state and socially owned enterprises alike.

5.2. Inconsistent reform of the banking system

Although the banks were converted into joint-stock companies under the banking reform of 1989, they were not privatized.

The 44 banks in the new Yugoslavia founded before 1989 are known as the 'old' banks and the 67 founded since 1989 are called the 'new' banks. The ownership structure of the latter varies. Some are entirely private while others employ both socially owned and private capital, both domestic and foreign. Although 'new' banks account for less than 20 per cent of the sector's assets, they make 80 per cent of the profits. 'Old' banks account for over 80 per cent of the total balance of the banking sector, especially the 'big six', with a total share of about 60 per cent (Pitic 1999, pp. 341–2). A situation in which 'debtors of a bank are actually its owners' persists in the 'old ' banks, whose owners are not motivated to maximize profits. Instead, enterprises buy shares in a bank to ensure that the bank offers it credit. Instead of initiating insolvency proceedings against enterprises known to have no prospects, banks were forced to keep them artificially alive for social and political reasons (*Ibid.*, pp. 343–4). It is said that bad loans constituted about 60 per cent of the social product in 1997 (Labus 1997, p. 38).

At the beginning of 1991, the government froze the population's foreign-currency deposits ('old foreign-currency savings deposits') and failed to settle for them. At the beginning of 1997, the total liabilities of the state to the public were DEM 6.4 billion (Vukotic 1997, p. 8). This exacerbated the credibility crisis in the banking system.

5.3. A delay in reforms

UN sanctions were lifted immediately after the Dayton Accord in November 1995 and foreign trade officially resumed. GDP increased by 5.8 per cent in 1996 and 7.4 per cent in 1997. Although the performance was apparently not so bad, the Yugoslav economy had serious structural problems. Through the national conflicts and UN embargo, the new Yugoslav economy maintained several features and defects of Titoite self-managed socialism.

The Yugoslav economy had low international competitiveness. Its exports in 1997 were less than a half its imports and the trade deficit of USD2.4 billion corresponded to 16 per cent of GDP. The price for covering such a huge deficit was excessively high interest rates, which in turn hiked up the exchange rate, stimulating further imports and restraining exports. High interest rates made it difficult for domestic companies to obtain credit. The share of investment was only 11 per cent of GDP.

As a continual increase in profits was not to be expected, companies laid off workers instead of increasing employment. During the period 1989–97, the number of employed decreased from 2.9 million to 2.33 million. (In the social sector it fell from 2.73 million to 2 million, while in the private sector, it rose from 58,000 to 320,000.) The number of unemployed in 1997 was 816,000 and the unemployment rate 26 per cent, with an additional 800,000 or so hidden unemployed. Unlike the number of employed, the number of dependants increased (1.24 million pensioners and 700,000 refugees). The absence of a serious banking reform can be explained by the lack of will to carry it out (Sevic and Zamberlin 1999, p. 366).

In 1997, the share of the state budget and its deficit accounted for 47.7 per cent and 5.6 per cent of GDP respectively. The state budget was suffering from a chronic deficit due to the numerous loss-making enterprises and a decrease in the number of employed. The government decided not to pay the wages of certain members of the public sector and to delay paying pensions (MacWilliams 1997, p. 382). To cope with the budget deficit, the government was always tempted to print money and sell off state property by the piece. A typical example was Serbia Telecom, partially privatized at the end of June 1997 to an Italian company (29 per cent) and a Greek company (20 per cent). Most of the proceeds were utilized to pay back wages and pensions. A new law on ownership transformation was adopted in Serbia in July 1997 and came into effect in November.

5.4. Difficult rebirth

Reconstruction of the Yugoslav economy calls for radical economic reform, according to foreign observers and many people inside the country. The biggest problem lies with domestic politics. Slobodan Milosevic managed to remain leader so long, despite repeated failures and heavy criticism, because (i) the opposition was fragmented, (ii) the government and ruling parties controlled the mass media, (iii) Milosevic's nationalistic line had popular appeal, especially in the countryside. Milosevic's coalition of post-communists and extreme right-wingers was also kept in place by the distribution of managerial appointments. The ostensible 'privatization' left the state as the biggest owner of the means of production, which was the source of the ruling parties' power.

A programme of radical economic reforms was announced in February 1997 by a group of 17 economists (G17) who sought a new, democratic government in Serbia and the Federation, describing the Milosevic regime as 'socialist totalitarianism' supported by an alliance of politics, public enterprises and organized crime (Vukotic 1998). At an international symposium entitled 'Roles of Trade Unions in the Privatization Process', held in Belgrade in June 1998, a trade-union leader explained, 'It is paradoxical that an international symposium with such a subject is being organized by trade unions. Usually trade unions are the biggest victims in privatization. Trade unions in Yugoslavia do not shrink from privatization as a means of resolving the present situation.' With the banking system, G17 advocated overcoming the credibility crisis the G17 advocated solving the problem of government's foreign-currency debts to the public, establishing independence of the central bank, returning to international financial markets, and introducing foreign capital. However, FR Yugoslavia did not succeed in getting full financial assistance during the Milosevic period, because membership of the IMF was not obtained. In mid-1998 the United States and the EU decided to ban investment in FR Yugoslavia, a freeze on the bank accounts of Yugoslavs abroad, and a ban on landings by Yugoslav civil aircraft while the country's approach to the Kosovo problem remained unsatisfactory.

Devaluation from YUD 3.3 to YUD 6.0 to the German mark in April 1998 did not increase Yugoslav exports or improve the trade balance due to the high dependence of Yugoslav producers on imported raw materials and capital goods. The growth rate of social product in 1998 was 2.6 per cent. Recession ensued in the latter half of 1998 and industrial production in January 1999 was down by 9.6 per cent from the same period of the previous year. According to a questionnaire survey of firms (*Economska Politika*, Broj 2441, February 1, 1999, p. 8), the main constraints on production were shortages of credit (41.8 per cent), imported materials (20 per cent) and demand (17.1 per cent), coupled with low prices (13.9 per cent). By the spring of 1999, the Yugoslav economy was at a standstill.

5.5. Kosovo and the Nato bombardment

The groups aiming for democratic rebirth in the Yugoslav Federation were prevented from ousting the Milosevic administration by divisions among themselves. Milosevic, meanwhile, failed to find a peaceful solution in Kosovo, where armed clashes between the local Albanian 'Kosovo Liberation Army' and Serbian security corps were taking place and many Albanians becoming refugees. Mediation by the United States and others went badly.

The Yugoslav rejection of a final proposal for peace provided the occasion for Nato to begin aerial bombardment of the country on March 24, 1999.[18] The US and West European forces intervened militarily in Kosovo to stop ethnic cleansing by Serbia, but it is difficult to say that their purpose was achieved. In fact, military intervention brought a surge of Albanian refugees, while the bombardment caused heavy civilian casualties elsewhere in the FR Yugoslavia. For the time being, the perceived international aggression tended to reinforce Milosevic's political power. Damage on the Yugoslav side was estimated at about USD30 billion, with more than 600,000 lost jobs and 2.5 million citizens losing sources of earnings. Unemployment is said to have reached 50 per cent. Thousands industrial, commercial and public facilities were destroyed or damaged. The 23 oil refineries hit caused serious pollution. Transportation and communication facilities destroyed or severely damaged included 61 bridges, railways, roads and airports. GDP decreased by 22 per cent in 1999.

The first conference of donor countries on the reconstruction of Kosovo was held on July 28, 1999 in Brussels and a meeting on cooperation for stabilization in South-Eastern Europe on July 29–30 in Sarajevo. The Milosevic administration was not admitted, although delegations from surrounding countries were. No assistance other than humanitarian aid was permitted for the FR Yugoslavia, which had suffered the worst damage.

5.6. Collapse of the Milosevic Regime

Milosevic was defeated by Vojslav Kostunica, a candidate of the Democratic Union of opposition groups at a presidential election in late September 2000. Milosevic tried to retain power, but was dislodged early in October by a surge of public protests. Kostunica's provisional government rapidly restored membership of the United Nations (November 2000), IMF (December 2000), the EBRD (December 2000) and the World Bank (May 2001). In December 2000 the government began to negotiate three successive financial agreements with the IMF to support its stabilization and market policies. The international community took a charitable view and a donor conference in December 2000 decided on emergency aid to prevent a humanitarian disaster over the winter.

[18] Just before the deadline at Rambouillet, the US made an additional proposal – Appendix B (1999) of the Final Draft of the Peace Agreement – requesting that Nato armed forces be given strong extraterritorial rights and freedom to deploy not only in Kosovo, but throughout the Federation. This was unacceptable to Yugoslavia at all.

The new government that took office in January inherited an inflation rate of 120 per cent; a non-existent foreign-exchange market, a sick banking sector, a huge government budget deficit, sizeable arrears of debt and a wide trade gap. The foreign debt since 1992 had reached USD12.2 billion (equivalent to 145 per cent of GDP). Unemployment was running at 27.3 per cent. Industry was using obsolete equipment. Shortages included electric power, pharmaceuticals, oil and gas, fertilizers, and foods (sugar, cooking oil, wheat, *etc.*) (Yugoslavia 2002). It was impossible for FR Yugoslavia to reconstruct its economy without international support. A donor conference sponsored by the World Bank and the European Commission was held in Brussels on June 29, 2001, to which the government of Serbia submitted a detailed 'Reform Agenda'. This contained 36 priority programmes and projects, focusing on three main areas: (i) establishing the rule of law, (ii) renewing the economy, and (iii) combating poverty and offering social protection to vulnerable groups.

5.7. Privatization by trial and error

The privatization begun in the first half of 1990 had failed to bring positive change in the economy. A further round after the Dayton Agreement, under the 1997 Act on Ownership Transformation, strongly favoured granting shares to employees, with up to 60 per cent of the equity being reserved for them free of charge. Almost 1000 companies adopted this form of privatization, and most were quickly privatized between October 2000 to February 2001, following unification of the official and unofficial exchange rates. However, the government gained very little revenue from the sales and there was negligible inflow of badly needed capital from abroad. The new government suspended the legislation to limit further losses and review the process (Ministry for International Economic Relations of Serbia 2001).

The corporate sector was in a parlous state, affected also by a decade of economic sanctions and by the Nato bombardment. There had been a 60 per cent fall in output between 1990 to 2000 and a dramatic increase in the debts of state-owned enterprises to domestic and international creditors. Much of this related to 28 large industrial concerns (*Ibid.*). A new law on privatization adopted in May 2001 was followed by the establishment of an Agency for Privatization in June. Although the FR Yugoslavia made a very late start with privatization, compared with other transition countries, it was 'better late than never'.[19]

All state-owned enterprises are to be privatized by 2005. In 2001, three cement works were sold, and in the first half of 2002, an additional 15 big factories were privatized. By the end of 2002, 44 large companies, including the Zastava car factory, were being privatized. There are two procedures: tender privatization and auction privatization. All large enterprises, the number of which does not exceed 150, will be subject to tender privatization by the Privatization Agency. The more than 7000 small and medium-sized firms will be privatized by auction carried out by the enterprise itself with state assistance (Yugoslavia 2002).

5.8. Grounds for anxiety

Outside observers still see grounds for anxiety in the countries that make up former Yugoslavia. The Republic of Montenegro, headed by President Djukanovic, intensified its moves toward independence in the closing years of the Milosevic period, including use of the DEM as legal tender. This received Western encouragement designed to hasten the overthrow of Milosevic. Now

[19] This remark was made by Branislav Soskic, president of the Association of Economics in Serbia, in the keynote speech at an academic conference on privatization at the Faculty of Economics, University of Belgrade in early April 1997.

that the Milosevic regime has collapsed, the West no longer hopes for the emergence of a further small, independent country, but the momentum has continued. In March 2002, Serbia and Montenegro agreed to dissolve the Yugoslav Federation in favour of a 'state union' of Serbia and Montenegro, which came into effect on February 2003. Full independence for Montenegro may still be imminent.

Meanwhile the conflict deepened between Federal President Vojslav Kostunica, a moderate nationalist, and the late prime minister of Serbia, Zoran Djindjic, who was oriented toward the West, with Kostunica's party withdrawing from the Democratic Union. The election for president of Serbia took place in October 2002, with Kostunica as a candidate, since the Serbian president became more powerful after the formation of the state union. He gained more votes than his main opponent, Deputy Federal Prime Minister Miroljub Labus, but the poll of less than 50 per cent meant the election was invalid. Labus did not stand in the repeat election in December, when Kostunica won 58 per cent of the vote against an extreme-right nationalist, but the election was again invalid due to a 45 per cent poll. The voter apathy reflected dissatisfaction at the miserable economic conditions and disgust at the struggle for power between the two big-name politicians who led the political change in 2000. It is noteworthy that an ultra-nationalist like We should pay attention to the fact that an ultra nationalist (Vojislav Seselj) won 36 per cent of the votes. In Montenegro, a presidential election in December 2002 was likewise invalid because of a low poll.

The assassination of Serbian Prime Minister Zoran Djindjic on March 12, 2003 was followed immediately by a state of emergency. It is reported that the perpetrators were members of the security police under the Milosevic regime, discontented with Djindjic's policies in general, particularly the crackdown on black-marketeering. Djindjic was succeeded by his deputy prime minister (and deputy leader of the Democratic Party), Zoran Zivkovic, who declared that his government would pursue Djindjic's policies. To improve the investment climate and reconstruct the economy, there has been an appeal to the Yugoslav people to restrain themselves from parochial nationalism and secure political stability.

6) PROSPECTS

Although for Slovenia, 'the cost of reorientating trade from protected to competitive markets were significant' (Mencinger 1997, p. 213), it has so far succeeded in entering EU markets. For the time being, the small country's strategy for finding appropriate specialization areas has been successful and world events such as the end of the Cold War, globalization and regionalism are running in its favour. Slovenia had advantages compared with other transition countries. As part of former Yugoslavia, it developed an albeit imperfect decentralized market economy during the socialist period. The decentralized coordination mechanism Slovenia inherited seems to have facilitated the transition to a successful market economy. Slovenia also experienced a long period of self-management. The World Bank (1996a and 1996b) points to this as a negative tradition, but the author agrees with Mencinger that there must be advantages in such experience helpful for Slovenia's future economic development. Slovene workers have the kind of strong sense of enterprise allegiance found in Japan, as do managers. Managers in the highly centralized planned economies were simply administrators, but in Slovenia, they acted executives, gaining experience and know-how about the market economy. Slovenia has to solve many problems to do with the structural adjustment and harmonization to the EU, but it is to be hoped that its strengths as a small country will mean that social cohesion and adaptability come more easily.

Despite initial Western countries goodwill at the time of independence, Croatia's economic performance has not been good. It suffered severe damage in its independence war. More seriously still, the policies of the Tudjman government failed. A change of government eventually came in January 2000, followed by the election of a new president to replace the deceased Tudjman. The new government came out against the extreme nationalism of its predecessor and announced democratic reforms. This will improve relations with Western countries and generate active assistance that will help Croatia to make use of its geopolitical advantage. Its economy should soon develop and the transition to a market economy proceed smoothly. If it finds its niche in world markets, it will also be able to make use of the 'strengths of small country' to attain rapid economic development.

FR Yugoslavia does not have such strengths. Its economy was damaged successively by the break-up of former Yugoslavia, the national conflicts, the UN sanctions, and the Nato bombardment. It was unable to utilize its experiences of a decentralized market economy under self-managed socialism. This has been a 'lost decade' for FR Yugoslavia. However, the essential cause of the economic crisis was the delay in reforms. Serbia and Montenegro now have to take drastic action to accelerate privatization, deregulate small and medium-sized enterprises, reform the financial system, encourage FDI, *etc.* The success of these reforms will require active support from the international community that was withheld from the Milosevic administration. At last, Serbia and Montenegro may succeed in overcoming their international isolation, since the collapse of the Milosevic regime in October 2000. The new leadership inherited economic misery and countless intractable problems. To improve the investment climate, Serbia and Montenegro will indeed have to refrain from parochial nationalism and secure political stability.

Bosnia-Herzegovina has yet to recover from its civil war. Hostile feelings between communities remain. It is indispensable for the Office of the High Commissioner (OHR) and the Stabilization Force in Bosnia and Herzegovina (SFOR) to stay for the time being. Promoting reconciliation and nation-building is a matter of the highest priority. International assistance is indispensable at this stage in economic recovery. Thereafter the emphasis will have to shift from humanitarian to commercial assistance and a market-oriented economy, including the privatization process.

After independence, Macedonia was negatively affected by the civil war in the former Yugoslav Federation, UN sanctions, its conflict with Greece, the Nato bombardment of Serbia, and so on. When the Kosovo war ended in June 1999, Macedonia at last had the peaceful environment needed for economic development. For the time being, international assistance is necessary for recovery and reconstruction of its economy. It is also necessary to educate young people to adapt to a market economy. The 'strengths of a small country' can be expected to outweigh its weaknesses soon. Macedonia, along with Serbia and Montenegro, needs to develop regional cooperation in the Balkans, in the hope of joining the EU eventually.

Until recently, the international community has extended less assistance to the Balkans than to the CEE countries. A great deal more assistance for economic reconstruction and stabilization in the former will be needed to ensure lasting peace.[20]

[20] Tsuneo Morita, previously of Nomura Research Institute Budapest and now president of Tateyama Magyar Laboratorium Ltd, is quoted by Morita (2000, pp. 196–7) as saying, 'The gap between countries… with [market-economy] experience and those without such experience is bigger than estimated. If the process of systemic transformation in Central Europe takes 20–30 years, it would be reasonable to view it as a historical project taking 40, 50 or more years in the Balkans, and over a century in former Soviet countries… It will be a sustained historical process.'

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