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The Costs and Benefits of Slovenian Independence

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Declining trade with the rest of Yugoslavia hurts Slovenia's short-run prospects. But in the long run Slovenia may benefit from greater macroeconomic stability, freedom from subsidizing less-developed regions of Yugoslavia, and speedier integration with Western Europe.

This paper — a product of the Transition and Macro-Adjustment Division, Policy Research Department — is part of a larger effort in the department to investigate the transition of economies of Eastern Europe and the former Soviet Union. Copies of the paper are available free from the World Bank, 1818 H Street NW, Washington, DC 20433. Please contact Sabah Moussa, room N11-017, extension 39019 (April 1993, 36 pages).

One year is not enough time to draw conclusions about independent Slovenia's prospects, and it may not be easy for other countries to copy Slovenia's model. Slovenia is ethnically homogeneous, culturally and historically compatible with the West, and near (and somewhat protected from) friendly Western neighbors. And despite sharp political divisions, it has shown a political will to fight counterproductive redistribution. Still, Slovenia's experience may offer insights for other new post-Communist economies:

- Despite the obvious short-run costs of the brutal breakup of Yugoslavia's federal structure, Slovenia's medium- and long-run economic prospects are fairly good. Declining trade with the rest of Yugoslavia dims Slovenia's short-run prospects. But in the long run it may benefit from greater macroeconomic stability, freedom from subsidizing less-developed regions of Yugoslavia, and speedier integration with Western Europe.

- What has happened to Slovenia does not prove that separation necessarily improves welfare. In fact, had forces amenable to rational

debate and compromise prevailed in Yugoslavia, Slovenia's secession might have decreased welfare.

- Slovenia's experience suggests that secession from a larger entity that is wrecked by political instability may produce economic benefits. Local autonomy gives Slovenia a chance to introduce a new currency and achieve macroeconomic stability, for example. This can work only if the local political constellation is not controlled by coalitions bent on preserving the old system of redistribution and is not hampered by major political divisions that paralyze decisionmaking.

In short, secession can be beneficial if the new state is more homogeneous and functions more coherently than the old state.

- Not all newly independent states would face the costs Slovenia has faced. In the Czech-Slovak breakup, for example, political risk and refugee costs (or rather, the costs of migration) were much smaller than in Slovenia. Indeed, the Czech republic may also expect short-term costs but long-term gains.

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COSTS AND BENEFITS OF INDEPENDENCE: SLOVENIA

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Costs and Benefits of Independence: Slovenia

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1. SLOVENIA AND THE YUGOSLAV ECONOMIC SYSTEM

Below we first provide a historical background of Yugoslavia, pointing to factors perpetuating differences among regions.¹ We then discuss features of the Yugoslavia's economic system that most importantly influence the adjustment path and overall growth of Yugoslavia's successor countries. We argue that (a) more developed regions (MDRs) of Yugoslavia heavily subsidized less developed regions (LDRs), and, moreover, Slovenia was the region that was (at least in the 1980s) drained the most; (b) Yugoslavia was continually plagued by macroeconomic instability, in part because of subsidization of less-developed regions and poorly-performing enterprises, and (c) due to disintegrative tendencies within Yugoslavia, the production structure of its constituent regions was much less influenced by being a part of a larger entity than the production structure of former-Soviet republics.

1.1 Yugoslav Development Report: Perpetuation of Economic Differences Across Regions

The continual efforts to change Yugoslavia's economic system provide an excellent indicator of the gravity of Yugoslavia's many economic and political problems. After the break with Stalin in 1948, Yugoslavia gradually abandoned centralized, Soviet-type of institutions, and instituted a newly conceptualized system of self-management. From its introduction in the early 1950, the self-management system underwent frequent changes. The most significant ones were the so-called liberalization reforms of the mid-1960s, and, as a reaction to them, the negotiated planning reforms of the mid-1970s.²

Accommodating its vast ethnic, religious, and cultural differences, Yugoslavia became a federation of six republics (later, two autonomous provinces, Kosovo and Vojvodina, were created as separate administrative units within the republic of Serbia). The federation, it was thought, would resolve the burning national question, unresolved in inter-war Yugoslavia, bring

prosperity for all ethnic groups and decrease regional disparities.

As can be seen from Table 1, Yugoslavia did not succeed in diminishing, let alone eliminating, regional differences. The GNP per capita of Slovenia rose from 160% to 200% of the Yugoslav average between 1955 and 1988, while the GNP per capita of Kosovo fell from 40% to 24% in the same years. Indeed, of the less-developed regions, Kosovo, Montenegro, and Bosnia-Herzegovina all saw their GNP per capita decline relative to the Yugoslav average, with only Macedonia showing improvement.

Table 1
Basic Indicators of Yugoslavia and Its Republics

		Yugo- slavia	Bosnia- Herz- govina	Monte- negro	Croatia	Macedo- nia	Slovenia	Serbia			
								Serbia	Serbia Proper	Kosovo	Voj- vodina
Population	1953	100	16.7	2.5	23.2	7.7	8.8	41.1	26.3	4.8	10
	1989	100	18.9	2.7	19.8	8.9	8.2	41.5	24.6	8.2	8.7
Population (1) Growth Rate (2)	1988	23690	4479	639	4683	2111	1948	9830	5940	1939	2051
	1989		8.1	9	0.9	10.3	3.1		1.3	23.2	-1.6
GNP Per Capita*	1955	100	80	80	120	60	160	80	80	40	80
	1988	100	65	71	129	65	200	88	100	24	118
GNP *	1953	100	14.4	1.8	26.7	5.2	14.3	37.6	25.5	2.2	9.9
	1988	100	12.7	2	25.5	5.7	16.6	37.5	24.9	2.2	10.4
Exports *	1973	100	11.2	2	36.3	5.5	19.5	37.1	26.7	1.6	8.8
	1988	100	16.8	1.8	20.6	5.3	22.2	33.2	22.7	1.4	9.1
Imports *	1973	100	8.5	1.3	24.5	4.1	20.5	28.9	22.1	1.2	5.6
	1989	100	12.9	1.1	26.6	6	18.5	33.1	21.1	1.2	10.8
Fixed Assets *	1953	100	13.6	0.9	28.2	4.2	20.1	33	22.7	1.7	8.6
	1988	100	15.3	3.2	25.8	5.8	16.9	33	20.5	2.9	9.6
Workers*	1955	100	14.8	2.2	27.2	6	15	34.8	23	2	9.8
	1989	100	15.8	2.5	23.5	7.7	12.4	38.1	25.2	3.5	9.4
Unemployment *	1955	100	8.9	1.4	28.8	14.3	10.8	35.9	21.9	3.8	10.2
	1989	100	23.1	3.9	11.6	12.4	2.3	46.7	26.7	11.6	8.4
Unemploy. Rate	1989	11.6	16.2	19.2	6.6	17.4	2.8		10.6	28.5	11.2
Interregion Migration (3)	1989	0.25	0.5	0.43	0.17	0.12	0.18		0.19	0.26	0.24

Note: * In percentage of national average.

(1) Person.

(2) Per 1000.

(3) Persons who migrated in percentage of total population.

Source: *Statistical Yearbook of Yugoslavia*, various years

In part, the poor showing of LDR GNP per capita can be explained by rapid population growth. It is noteworthy, however, that Macedonia, which had the second highest population growth rate of all the LDR's, was nonetheless able to increase its GNP per capita relative to the Yugoslav average. This implies that population growth cannot be the only factor explaining weak LDR GNP per capita growth.

The strengths of Slovenia can be further illustrated by examining GNP and export shares. Slovenia's share of Yugoslav exports consistently exceeded its share of Yugoslav GNP, thanks to the superior competitiveness of Slovenia's economy. Furthermore, Slovenia's share of Yugoslav exports grew from 1973 to 1989, while that of all the LDR's except Bosnia fell slightly. Clearly, the gap between Slovenia and the LDR's widened over the years. This was true despite the growing share of LDR's in Yugoslavia's fixed assets, contrasted with Slovenia's decline from 20.1 to 16.9%.

1.2 Salient Features of Yugoslavia that Influence the Adjustment Path of Constituent Units

A. State Paternalism, Cross-Subsidization and Subsidization of Less-Developed Regions.

The feature of the Yugoslav system that can be singled out as the most important cause of its failure is state paternalism, that is, a monoparty political system coupled with ill-defined property rights.³ That system was characterized by massive, pervasive redistribution through a soft budget constraint, a system where profitable firms were discretionally taxed and the proceeds were used to bail out unprofitable firms.

Besides hampering work incentives and contributing to an unstable macroeconomic environment (see below), soft-budget redistribution also included significant interregional redistribution of income from more developed to less developed regions of Yugoslavia. Below

we summarize the results of the empirical study by Kraft and Vodopivec (1992) on all (8,689) Yugoslav manufacturing enterprises, for 1986.

To do justice to the redistribution in the Yugoslav economy, Kraft and Vodopivec introduced several nonstandard types of tax and subsidy imposed on firms. Besides formal taxes and formal subsidies, they considered two much less visible forms: (1) quasisubsidies and quasitaxes, defined as compulsory financial investments with large stipulated negative returns, and (2) "gains and losses on money," defined as the appropriation of financial savings based on an inflation tax.⁴ Gross taxes thus consisted of formal taxes, quasitaxes, and "losses on money," and gross subsidies consisted of formal subsidies, quasisubsidies, and "gains on money."

Kraft and Vodopivec found that formal taxes and subsidies in Yugoslavia were only the tip of the iceberg, and that redistribution of income was massive, with net subsidies in manufacturing of 18 percent of income or 15.6 percent of manufacturing GDP (table 2). For the purpose of the present paper, however, their more important findings relate to interregional redistribution. The less-developed regions (LDRs) of Yugoslavia (Bosnia and Herzegovina, Macedonia, Montenegro, and Kosovo) were the main beneficiaries of redistribution. The main source of redistribution was subsidized credits, as shown by large net money gains of LDRs manufacturers (see table 2, column 1). Aided by transfers from the "Fund for Development of Less-Developed Regions," LDRs were also able to levy much lighter taxes and quasitaxes on their enterprises than the more-developed regions (MDRs). Looking at the overall redistribution, net subsidies for LDR manufacturing amounted to a stunning 57 percent of LDR's income from manufacturing; and net subsidies for Montenegro's and Kosovo's manufacturing considerably exceeded the two regions's income from manufacturing! The enterprises of only one region,

Slovenia, were net tax-payers.

Table 2
Redistribution by Republic and Autonomous Province⁽¹⁾
(as a percentage of income)

	Formal Taxes	Formal Subsidies	Quasi-Taxes	Quasi-Subsidies	Losses On Money	Gains On Money	Net Subsidies ⁽²⁾
Yugoslavia	14	1	25	13	88	132	18
Less-developed Regions	9	1	19	12	105	177	57
Bosnia	9	1	21	11	118	178	43
Montenegro	8	1	18	15	104	236	123
Macedonia	11	0	17	13	86	135	35
Kosovo	8	0	15	15	68	220	145
More-developed Regions	16	1	27	13	83	117	5
Croatia	15	1	32	10	86	136	13
Slovenia	17	0	23	24	77	83	-11
Serbia (3)	16	1	25	9	84	125	10

(1) Income-weighted mean of firms' rates (the firms' redistributive flows as a percentage

(2) Defined as the difference between the sum of subsidy rates and the sum of tax rates.

(3) A defect in the data base made it impossible to distinguish Vojvodina from Serbia proper.

The two are listed as "Serbia" here.

Source: Kraft and Vodopivec (1992)

Even though the data allow us to determine only the recipients, not the donors of net subsidies, the data suggest that transfers from richer to poorer regions well exceeded the levels mandated by law (1.5 to 2 percent of GDP for the more developed regions). The most important source of subsidies was net money gains and such gains were financed by taxing the population at large. Even if one assumes that taxes were spread evenly across republics (ignoring direct transfers from more-developed to less-developed regions), the more-developed regions turn out to be net taxpayers (at 13 percent) and the less-developed regions net beneficiaries (at 40 percent) -- substantially above the rate that would be generated through mandated transfers.⁵

The heavy subsidy of LDRs suggests a Gerschenkronian interpretation -- the government-

mediated transfer of capital to fight backwardness (Gerschenkron 1962). The less-developed regions appear to be using fiscal policy and bank credits to promote and direct industrial development.

More-developed regions have always looked upon development transfers as a burden, so it is surprising that actual redistribution exceeded mandated levels. There are two reasons for this. First, such subsidies are the outcome of the federation yielding to the LDRs' pressures to put out the fire -- that is, to make up for both enterprises' losses and local governments' deficits. Second, Yugoslavia's development plan for LDRs has historically favored capital-intensive industries. That plan was backed with concessionary credits and direct investments by firms from MDRs in LDRs.

Yugoslav observers have noted that price distortions favored the MDR's. According to estimates by Kraft (1992b), the introduction of equilibrium goods prices would have increased enterprise revenues at the expense of wages in all regions. However, Slovenia would have received revenue equal to 2-5% of social product, while Kosovo, the region most hurt by price distortions, would have received revenue equal to 9.8 to 12.9% of social product. This implies that price distortions took back subsidies of 7.8% to 7.9% of social product for Kosovo relative to Slovenia--a rather insignificant sum compared to the 145% of social product soft-budget subsidy calculated for Kosovo in Table 2.

B. Macroeconomic Instability

State paternalism underlay macroeconomic imbalances in Yugoslavia. As discussed above, the government redistributed significant portions of GNP through (1) ad hoc interventions (taxation or subsidization) into the distribution of income at the firm level, and (2) (mis)use of

the financial system. Unprofitable firms got subsidies (such as straight subsidies, concessionary crediting, and tax waivers) that were in turn converted into components of demand. But this massive redistribution of income was typically only partly financed by fiscal revenues. Yugoslavia traditionally relied heavily on monetary expansion to finance government interventions -- with unavoidable inflationary implications.

It might seem that fiscal imbalances could not account for Yugoslavia's macroeconomic instability, because Yugoslavia always had a balanced budget. Rocha (1992) argues that the impression of a balanced public sector budget is false -- that there was a hidden but real deficit of significant proportions. This deficit consisted mainly of implicit subsidies to enterprises (1) by providing domestic credits at highly negative real interest rates, and (2) through a foreign exchange insurance scheme that allowed enterprises that take out foreign loans to shift the repayment of their debt onto the shoulders of commercial banks or the central bank, financed by the inflation tax. (See also Bole and Gaspari 1991.)

Bole and Gaspari (1991) show that other facts also contributed to inflation in Yugoslavia -- especially the inconsistent economic policy itself. Sporadic price controls in particular blocked relative price adjustments, so that exchange-rate adjustments influenced only the general level of prices without affecting the structure of production. Their very repetitiousness showed the ineffectiveness of price controls. Targeted price increases escalated when the price freeze was lifted, thus increasing inflationary expectations.

Bole and Gaspari also find that wage and monetary policy also generated significant inflation. In addition, the external imbalance that necessitated an exchange-rate adjustment contributed to inflationary pressures.

When workers can fight price increases by raising their wages, one mechanism to reduce wages (the so-called Pazos-Simonsen mechanism) is to permanently increase the rate of inflation. This points to the presence of the other, traditionally recognized character of inflation in socialist countries: cost-push inflation. But it is important to realize that inflation in Yugoslavia was not only fueled by mounting costs. Unless Yugoslavia addressed the fundamental imbalances associated with the subsidization of enterprises, it would have had no chance for permanent stabilization.

C. Regional Production Structure and Disintegrative Tendencies.

The liberalization reforms of the mid-1960s and institutional changes in the 1970s triggered the creation of regional barriers which prevented the creation of a genuine national market. This hindered interregional trade within Yugoslavia and, at the same time, pushed regions to external trading. These tendencies have produced a production structure much less geared to a Yugoslav market than the one that would have evolved either under central planning or under a genuine economic union. The newly created independent parts of former Yugoslavia thus find it is easier to reorient production to markets outside Yugoslavia.

The reforms of the mid-1960s moved Yugoslavia toward decentralization, autonomy of enterprises, and reliance on the market as means of coordination. The most significant changes involved transferring a large part of the federal government's responsibilities to republics, increasing the autonomy of enterprises in price formation and the distribution of enterprise income into personal incomes and accumulation, adjusting relative prices to world prices, transferring responsibility for resource mobilization and allocation from the state to economic

enterprises and banks, and introduction of a unified exchange rate instead of multiple ones (Schrenk et al, 1979, p. 26).

To regain a grip on the economy, the government launched a new wave of reforms in the 1970s, introducing "negotiated planning." The government indeed regained much of its former control, but it was regional and communal, rather than federal, government that took charge in the 1970s and 1980s. Governments exerted control through informal pressures for the execution of certain projects, and against the execution of others. They were driven by concerns about securing goods in short supply, or to utilize raw materials produced locally and "exported" to other regions at controlled prices. Not surprisingly, control strengthened autarkic tendencies, rounding-off the local economies.

The resulting decline of interregional trade is seen clearly in Table 3.⁶ All regions experienced decreasing share of deliveries outside the home republic in the years 1970 to 1987. The declines range from the relatively mild 3.8 percentage point decrease experienced by Macedonia to the remarkable 18.2 percentage point decrease experienced by Vojvodina. Slovenia's 6.5 percentage point decrease occurs in the middle of this period, with most of the decrease occurring between 1970 and 1974.

Table 3

**The Share of Deliveries Outside One's Republic or Province in
Total Deliveries of the Republic or Province, 1970-1987**

SR & SAP	YEAR (percent)							
	1970	1972	1974	1976	1978	1980	1983	1987
Bosnia-Herzegovina	36.8	34.8	39.1	32.7	30.6	29.1	29.6	27.5
Montenegro	51.3	46.8	44.5	37.3	32.2	34.5	34.3	33.1
Croatia	37.2	36.3	35.5	31.4	29.9	28.1	28.7	27.1
Macedonia	33.5	33.4	31.7	36.6	35.4	33.6	31.6	29.7
Slovenia	42.2	40.8	36.7	35.5	35.5	35.7	37.9	35.7
Serbia	31.2	40.5	29.4	26.3	22.6	22.5	24.6	23.6
- Serbia Proper	40.0	39.3	37.5	34.8	30.8	30.2	34.3	32.9
- Vojvodina	50.0	42.4	43.8	38.4	34.7	35.6	33.0	31.8
- Kosovo	43.4	37.8	44.2	37.4	37.1	34.4	31.0	29.8

Sources: *Federal Secretariat for Market and General Economic Affairs*, "Analysis of the Functioning of the Unified Yugoslav Market", Belgrade, Nov. 1987.

Savic, Nebojsa, "Competition on the Domestic Market", Economics Institute Belgrade, 1989

Levels of interregional migration were also low in Yugoslavia. Certain types of migration were fairly common, such as Bosnian migration to Slovenia, but the overall levels were not large. Table 4 shows migration levels as of 1989. Yugoslav migration appears to be an order of magnitude lower than that of most OECD countries.

Table 4

**Interregional Migration in Yugoslavia and Selected OECD Countries
(Persons Who Migrated in Percentage of Total Population)**

Regions (1)	
Yugoslavia (1989)	0.25
Bosnia and Herzegovina	0.50
Montenegro	0.43
Croatia	0.17
Macedonia	0.12
Slovenia	0.18
Kosovo	0.19
Vojvodina	0.26
Selected OECD countries (1987)	0.24
Australia	1.6
Canada	1.5
Finland	1.6
France	1.3
Germany	1.1
Italy	0.5
Japan	2.6
Norway	2.6
Sweden	3.9
United States	2.8

Notes: (1) Regions in Yugoslavia are RAPs; definitions in other countries vary (in Germany, for example, cities are also taken as regions).

Source: Internal material of the Statistical Office of Yugoslavia (interregional migration); OECD Employment Outlook, OECD, Paris, July 1990.

Finally, the system of foreign trade stimulated balanced foreign trade by each region, so the regions were explicitly encouraged to look at their own comparative advantage vis-a-vis the rest of the world. Specialization within Yugoslavia was de-emphasized, and the effects of decisions

on Yugoslavia's balance of payments was subordinate to the effect on individual republic's balance of payments. This added a final element to Yugoslavia's economic disintegration.

2. THE FIRST ECONOMIC EXPERIENCES OF INDEPENDENT SLOVENIA

Slovenia's exit from Yugoslavia has allowed it to manage its own economic affairs. In the first year, the record is impressive: Slovenia has successfully introduced a new currency, the tolar, brought inflation from a monthly rate of 21.5% in October 1991 to a monthly rate of 1.4% in August 1992, accumulated nearly \$1 billion of foreign reserves, and created the basic institutions and instruments for effective macroeconomic policy. It seems doubtful that such accomplishments would have been possible in a unified Yugoslavia, even without the war.

Naturally, much more remains to be done. Privatization legislation was not passed until November, 1992, impeding progress in this important area. Enterprise and financial sector restructuring remains mainly in the preparatory phase. Similarly, reforming labor legislation and labor market practices has begun, but much more can be expected.

Below we first describe the introduction of the new Slovenian currency.⁷ Then we discuss Slovenia's new macroeconomic policies and institutions, especially in the monetary sphere, that facilitated macroeconomic stabilization. The section concludes with a discussion of restructuring and future programmatic issues.

2.1 Gaining Economic Control: the Introduction of the Tolar

To assert its economic self-determination, independent Slovenia needed to gain control of fiscal and monetary policy. Fiscal control proved easier, because, like other regions in former Yugoslavia, the fiscal system and policy had been for the most part under the control of

Slovenian authorities since the constitutional reform of 1974.⁸ To gain full control, Slovenia simply stopped paying taxes to the Federal Government and took over customs.

Slovenia began its push for monetary control by (re)drafting laws regulating the financial system in the fall of 1990. These included the Bank of Slovenia law, the Banking Law, and laws regulating bank supervision, bank liquidation, deposit insurance, international credit relations and customs. With the exception of the Banking Law, the financial laws are similar in instrument design and institution set-up to the old federal Yugoslav financial laws amended on the federal level in the late 1980s.⁹ However, based on experience with the expansionary monetary policies of the Yugoslav central bank, the central bank law gave the Bank of Slovenia (BoS) full independence in conducting monetary policy. This proved crucial in implementing macroeconomic stabilization policies after October 1991.

These financial laws were passed in June 1991 together with the declaration of Slovenian independence. Their implementation was temporarily suspended due to the outbreak of the war and the subsequent Brioni Accord that froze further moves towards independence for the next three months.

The introduction of a new currency became an imperative once the NBY's monetary policy became totally subservient to Serbia's war finance needs. The main impetus for implementing currency reform was thus to prevent the republic from being sucked into the inflationary spiral of the dinar monetary zone.

The currency reform was undertaken immediately after the expiration of the Brioni Accord moratorium in October 1991. The new currency, named the tolar (SIT), was well-received by the public. Its introduction proceeded remarkably smoothly.¹⁰ Some 8.6 billion YUD,

equivalent to about \$75 per head, were exchanged. Bank deposits were automatically converted into tolar. Financial contracts were left untouched by the conversion, since Slovenian law stipulates that contracts can be written in any currency. External payments with former Yugoslav regions required some new arrangements, which were concluded in the ensuing month.

2.2 Successful Macroeconomic Stabilization

In contrast to the unsuccessful stabilization attempts of the federal Yugoslav authorities, Slovenia by and large had stabilized its economy by the fall of 1992.¹¹ Perhaps the key was the monetary policy of the Bank of Slovenia. The BoS policy, the exact opposite of NBY redistributive and expansionary monetary policies, strengthened the soundness and stability of the new currency.

Monetary policy was supported by a market-determined exchange rate policy, which resulted in the buildup of Slovenia's international reserves.¹² Only in summer 1992, with the advent of a new government, was restrictive monetary policy supported by stabilization-oriented fiscal policies as well.

Table 5 shows the main contours of the stabilization. In the sections below, we outline the impact of macro policy in more detail.

Table 5: Slovenia 1986-1992
Main Economic Indicators

	Industrial Production, Annual/Annualized Growth in %	Retail Prices Annual/Monthly Growth in %	Real Net Personal Income, Annual/Annualized Growth in %	Unemployment Rate % (1)	Balance of Payments			Monetary Survey					
					Current Account	Capital Account	Change in International Reserves	Foreign Assets	Domestic Assets	Foreign Liabilities	M1 monthly % growth	M2 monthly % growth	
					MILLIONS OF US DOLLARS			MILLIONS OF TOLARS					
1986	1.8	93.1	13.8	1.5									
1987	-1.2	130.6	-1.9	1.6									
1988	-2.6	212.3	-10.9	2.2	1,384.2	35.4	-						
1989	1.1	1,306.0	15.2	2.9	1,1061.1	25.8	-						
1990	-10.5	549.7	-25.8	4.7	558.7	123.9	-						
1991	-12.4	117.7	-11.0	8.2	210.9	-23.8	-112.1						
1991:9	-11.2	17.0	-20.4	9.0	80.2	-17.6	-0.0						
1991:10	-17.0	21.5	-24.3	9.4	-13.0	-11.5	-15.8	82,607	129,118	91,230			
1991:11	-15.8	18.7	-27.4	9.9	56.5	0.5	-29.7	91,248	138,778	96,444	-0.02	0.12	
1991:12	-18.7	15.4	-31.9	10.1	0.9	9.9	-66.8	107,985	142,158	80,985	0.16	0.17	
1992:1	-17.6	15.2	-33.2	10.5	46.4	4.3	-12.5	109,566	147,882	80,338	0.00	0.06	
1992:2	-11.8	11.0	-28.4	10.7	149.8	-1.2	-33.9	144,850	177,433	105,621	0.06	0.22	
1992:3	-11.4	11.5	-22.9	10.7	65.7	-1.5	-48.2	160,140	189,170	111,221	-0.01	0.12	
1992:4	-21.0	5.1	-22.8	10.8	59.2	12.4	40.6	169,527	194,956	112,968	0.18	0.06	
1992:5	-19.6	6.5	-11.2	10.8	15.3	21.4	64.0	176,215	193,074	112,066	-0.03	0.07	
1992:6	-14.3	5.9	-6.3	11.0	92.6	-17.9	-110.5	177,800	196,098	107,888	0.05	0.04	
1992:7	-8.7	2.0	-11.6	11.5	38.9	17.8	-145.7	189,794	202,575	108,803	0.06	0.09	
1992:8	-19.0	1.4	0.0	11.7	34.1	51.6	-92.1	207,748	207,853	110,384	0.13	0.05	
1992:9	-13.4	2.7	3.6	12.2	174.0	-15.7	-43.2	222,193	218,123	114,322	0.05	0.08	
1992:10	-9.8	3.4	10.0	12.7	149.4	28.1	-10.4	235,820	230,614	119,779	0.05	0.06	
1992:11	-6.1	2.8	-					254,139	241,950	125,167	0.03	0.04	

(1) Percent share of registered unemployed in total active population; a labour force survey carried out by the institute of Social Sciences, Ljubljana, using concepts and definitions of Eurostat, has estimated the unemployment rate in October 1991 at 7.3%

Source: Bank of Slovenia Monthly Bulletin.

A. Fiscal Reform

In early 1991, Slovenia put its public finance system on a comparable footing with the developed market economies. The system of direct taxation was revised and the number of taxes and contributions was drastically reduced. Slovenia introduced corporate profit and personal income taxes, while social security contributions paid by employers and employees were retained only for pension and disability insurance, and health and unemployment insurance.

During 1991, inflation erosion of collected revenues and arrears from enterprises hurt by the collapse of trade the rest of former Yugoslavia put revenue collection well below target. Government expenditures were also cut significantly in real terms, and government wages were frozen. Public expenditure was reduced to 43.2% of GDP in 1991, in comparison with 48.9% in 1990. Most of the reduction came from reducing Slovenia's contribution to the Yugoslav federal government budget to 0.9% of GDP in 1991 from 7.2% in 1990.

The budget deficit of 2.6% of GDP in 1991 was not alarming by international standards, and indeed quite modest compared to other Central European economies in transition. But the budget did not include provisions for enterprise and bank restructuring, and the large domestic burden denominated in foreign exchange deposits was also not properly accounted for.

The fiscal policy stance improved only in summer 1992, as the new Government attempted to address restructuring issues by earmarking funds for loss makers and cutting other current expenditures. The government also improved its cost management. This, together with the continuation of restrictive monetary policy, brought inflation in August 1992 to a monthly rate of 1.4%.

B. Restrictive Monetary Policy

The success of macroeconomic stabilization in independent Slovenia can be largely attributed to the smooth currency introduction, and restrictive monetary policy, both the efforts of the Bank of Slovenia (BoS). The continuously restrictive BoS monetary policy of the first independent year was a real change from the previous redistributive and expansionary monetary policy.

Table 5 above illustrates the tightness of monetary policy after independence. M1 actually shrank in nominal terms in the first month after independence. M2 growth was also quite moderate, as was the growth in foreign liabilities.

A crucial factor enabling restrictive policy was central bank independence, established by the law on the Bank of Slovenia. The Law mandates the BoS alone to execute monetary policy, free from political interference. Price stability and smoothly-functioning domestic and international payments are its only objectives. The most important provisions of the Slovenian law that distinguish it from the former Yugoslav law are: independence of BoS supreme bodies, the BoS relation to the Government, and enhanced indirect monetary instruments.

Independence of BoS Supreme Bodies. The Governor and the members of the Board cannot be connected with the Government or any organization controlled by the BoS. The Board consists of the Governor, Deputy Governor, three Vice-Governors and six independent experts. All are appointed for 6 years by Parliament. The Governor and six independent experts are nominated by the President, while the Governor nominates the Deputy Governor and three Vice Governors.

By contrast, the Board of the National Bank of Yugoslavia consisted of the eight governors of the regional National Banks of republics, and the Governor of the NBY. Only the Governor

of the NBY was elected on the federal level, while the other governors were elected in the regions' parliaments, and represented regional interests in the NBY. The 1974 legislation provided that the NBY Board should vote by consensus to prevent republican influence. The consensus vote was soon (in the inflationary 1980s) replaced by ordinary majority vote to accommodate the economic interests of less developed regions and Serbia, which effectively controlled the NBY apparatus.¹³

The BoS's Relation to the Government. To reduce direct financing of the government deficit, the law allows the BoS to extend only short-term loans to the government for bridging cash-flow problems. The stock of these loans cannot exceed five percent of the current budget, nor 20 percent of the total budget deficit.

As mentioned above, the former Yugoslav legislation required a balanced federal budget, and, in principle, also excluded the possibility of direct budget financing by the central bank. However, indirect budget financing through quasi-fiscal deficits was widely practiced. (Rocha, Saldanha 1992)

Enhanced Indirect Monetary Instruments. To enhance the effectiveness of monetary policy, the Law allows the BoS to employ all commonly-used monetary instruments, including a variety of open market operations that exert impact through interest rates. Although the NBY enjoyed similar provisions, it preferred direct instruments like selective credits and credit control. The BoS Law totally excludes the use of selective credits, while the use of other direct credit controls is prohibited beyond December 31, 1993. This underscores the commitment of the authorities to the use of indirect monetary control.¹⁴

C. The Market Determined Exchange Rate Policy

The objective of Slovene exchange rate policy was to reinforce macroeconomic stabilization and to promote economic integration with the West, with a final objective of making the tolar completely convertible while pegged to the DEM. The main vehicle for achieving this was a market determined tolar exchange rate. This contrasts sharply with the administration regulation of dinar exchange rates in the 1970s and 1980s.

The tolar is expected to derive its strength from strict macroeconomic policies and a healthy balance of payments.¹⁵ At the time of currency introduction, Slovenia was not a member of international organizations and was not about to receive any financial support. Since the country's level of net international reserves was low--at the end of September 1991 reserves in the banking system only amounted to \$204 million, and the BoS had literally no reserves--a floating exchange rate was introduced, with some exchange restrictions imposed to protect reserves.

The initial lack of foreign exchange compelled the BoS to introduce some exchange restrictions, including freezing of foreign exchange deposits. These were partly lifted later, as Slovenia's reserves grew. However, deposits will only be completely unfrozen after Yugoslavia's foreign exchange claims and liabilities are settled, as part of bank and enterprise ownership and restructuring reforms.

Importantly, banks cover exchange risk by extending domestic credit in foreign exchange, and not by general BoS guarantee. Such a guarantee was the main source of NBY losses in the 1980s; it came to be known as the "black hole".

2.3 Restructuring Experiences and Programmatic Issues

While Slovenia has been a pathbreaker in its rapid and successful accomplishment of currency reform and macroeconomic stabilization, it has made less progress on restructuring issues. In particular, ownership change has been glacial, financial sector restructuring has not occurred, and labor-market institutions are only beginning to be changed.

A. Privatization Policy

Slovenia has gone slowly on privatization. Whereas other ex-Communist states moved rapidly to privatize small enterprises, Slovenia decided not to privatize small enterprises separately. As a result, most of the growth of the private sector has occurred through the start-up of new enterprises. Registered commercial companies roughly tripled between 1989 and 1991. Private sector employment increased by 4%, and self-employment by 8.1% in 1991. (Pleskovic and Sachs, 1992 p. 36. See also Kraft (1993) for information on the growth of the private sector in pre-war Slovenia.)

No less than three privatization bills were considered by the Parliament of Slovenia. The two failed bills represented diverging approaches: one favored internal privatization through worker-manager buyouts, and the other favored external privatization through distribution of shares to citizens and pension funds, coupled with the establishment of mutual funds. The latter approach is similar to methods used in Czechoslovakia, Russia and Poland.

Internal privatization was denounced by Professor Jeffrey Sachs. Sachs argued that the plan unfairly benefitted existing managers, was open to speculation since accurate evaluation without functioning capital markets is impossible, and failed to fit the circumstances of large, capital intensive and expensive enterprises (Pleskovic and Sachs, 1992, p. 38)

Defenders of internal privatization argued that Slovene managers are not typical of managers in Communist countries. Many are highly capable, and quite familiar with management in a market milieu. Furthermore, Slovene workers may have taken advantage of self-management structures to achieve a degree of participation in management. Insider privatization therefore makes sense in Slovenia, they argue, as a way of utilizing workers' and managers' firm-specific knowledge and of nurturing the efficiency advantages of worker participation.

A compromise bill was finally passed in November 1992, combining internal and external approaches. The bill permits sale of the whole enterprise, employee purchase, or transfer of shares. The latter approach requires 10% of the book value of social capital to be distributed as shares to the Slovenian Pension and Invalid Fund, 10% to the Compensation Fund, 20% to authorized investment companies, 20% to employees, and 40% to the population at large.

The method of privatization is chosen by the individual company, subject to the approval of the Agency for Privatization of the Republic of Slovenia. It is hoped that this framework will prove flexible enough yet simple enough to facilitate rapid privatization in 1993.

B. Financial System Rehabilitation

Financial system rehabilitation has been recognized as a key to the transition to market economy. Functioning capital markets play a crucial role in the allocation and mobilization of resources.

The main weaknesses of the Slovenian banking system were inherited from the old Yugoslavia. One bank, the Ljubljanska Banka, enjoys a near-monopoly. Also, Slovene banks are owned by social enterprises, which have their representatives sitting on bank boards. But, at the same time, these enterprises are the bank's major debtors. The negative implications of

this kind of cross-ownership were abundantly evident in the old Yugoslavia, and have been seen for example in Chile in the early 1980's (Diaz-Alejandro, 1985).

In addition, Slovenian banks have a very high proportion of non-performing loans in their portfolios (30-40%). This is a problem that may require governmental action, whether to recapitalize the banking system or to assume the bad-loan portfolio.

Slovenia has made a start on these problems, auditing banks in 1991 and establishing a Bank Restructuring Agency in the fall of that year. In the next years, financial sector restructuring will be a key policy issue for the government.

C. Labor Market Legislation and Practices

As a part of the comprehensive economic transformation toward a market economy, the Slovenian labor market has undergone major changes in the last three years. Above all, workers can be laid off, and thus the Rubicon of job security has been crossed. Labor mobility has been enhanced also by more flexible hiring legislation. The rigid system of wage determination that prevailed under self-management has been replaced by collective bargaining.¹⁶

But the last major improvements of the functioning of the labor market occurred in February 1991, when Slovenia significantly shortened the required advance notification period for redundant workers from 24 to six months. What is more, as an independent country, Slovenia made two moves that have hurt the economy in the longer-run. In July 1991, following the June aggression and the pending loss of the Yugoslav market, parliament halted new initiations of bankruptcy procedures, and the Ministry of Labor began providing employment subsidies for those enterprises unable to meet wage payments--no doubt, a bad industrial policy.

Moreover, there has been a lack of trust and coordination between the two major institutional players in collective bargaining (the government and the trade unions), resulting in the suspension of incomes policy in February 1992. By August 1992, the total wage bill had increased 40.2% in real terms (Ministry of Planning of Slovenia), seriously threatening to fuel inflation. Establishment of a more harmonious labor-management atmosphere will be one of the most important imperatives for future governments.

3. ECONOMIC COSTS AND BENEFITS OF SEPARATION

3.1 The Costs of Separation

While Slovenia may well benefit in the long-run from its separation from Yugoslavia, in the short-run there are obvious and significant costs.¹⁷ These include: the cost of reorienting trade; growth of autarkic tendencies; the danger of "germanization"; heightened perception of political risk in Slovenia due to the war, and spillovers from war-torn republics, such as the refugee problem.

The cost of reorienting trade has already proven significant. In 1987, 35.7% of Slovenia's deliveries went to the rest of Yugoslavia. The war has temporarily disrupted this trade. In addition, ex-Yugoslav states have erected trade barriers with each other, and most have non-convertible currencies. Even Slovenia and Croatia now levy tariffs on each others' goods, making trade diversion a problem even with Slovenia's closest ally from ex-Yugoslavia. Therefore, even in the medium-term, much of Slovenia's trade with the old Yugoslavia will have to be reoriented.

The costs of reorientation go well beyond the search costs of finding new customers. Slovene producers had many advantages within the Yugoslav market: familiarity with the market,

customers' familiarity with Slovene goods, and superior productivity and quality relative to other Yugoslav producers. The international market is far more difficult to penetrate and profit margins are probably lower than on the old Yugoslav market.

In addition, the Yugoslav market provided a wider platform for Slovene producers than the Slovene market. Scale economies may be lost in the process of trade reorientation for this reason, especially if Slovene producers are not able to redirect all of their lost sales on the Yugoslav market to third markets.

These problems are somewhat alleviated by the high degree of disintegration within former Yugoslavia. As noted in section 1, Yugoslav regions tended to view their balance of trade as distinct from the Federation as a whole, and had a good deal of freedom to find their own pattern of comparative advantage.

Bole (1992) estimates that the collapse of the Yugoslav market has caused Slovene GDP to shrink by 6%. In light of the 38% fall of Slovene industrial production between June 1989 and June 1992, the collapse of the Yugoslav market appears not to have played a decisive role. Rather, it seems to be one cause of problems, alongside with hyperinflation, the demand shock involved in the stabilization attempt of 1990 and the stabilization of 1991-92, and the collapse of the CMEA market.

Slovenia's separation may also enhance other autarkic tendencies. Strategic military arguments could be made for retaining and further developing Slovenia's heavy industry base, including everything from steel to computers. For a small state like Slovenia, this would require a greater deviation from the country's current comparative advantage than for a larger entity like Yugoslavia. Furthermore, such a move would reverse recent, probably healthy trends to

restructure Slovenian heavy industry, eliminating outdated and ecologically damaging technology.

A related, longer term problem is fear of germanization. Given the small size of the Slovene economy, the impact of a few significant foreign investments could be quite large. A defensive reaction, restricting the sales of Slovene assets to foreigners, could well take hold. Such a reaction seems more likely in a small state like Slovenia than in a medium-sized entity like the old Yugoslavia. The first indications of such a reaction can be seen in the new Slovene governments' unwillingness to allow foreigners to buy land.¹⁸

In addition, Slovenia's proximity (both physical and political) to ex-Yugoslavia has resulted in its sharing much of the political risk associated by foreign investors with Yugoslavia. Slovenia has been unable to gain admission to the IMF through 1992, and its relationship to the European Community, although good, has been far slower in developing than other Central European nations'.

A further strain on the Slovenia economy is the refugee problem. While the refugee situation in Slovenia is not nearly so bad as in Croatia, an estimated 75,000 refugees (3% of Slovenia's population) arrived between July 1991 and October 1992.

A key question is whether these costs will continue to affect Slovenia over the medium to long-term. Trade reorientation costs are essentially one-time costs incurred during the transition from one trade pattern to another. The other costs have a longer duration. Trade diversion will continue as long as trade with other ex-Yugoslav republics is disrupted, and even after that if tariff or other barriers remain in place.

Political risk, too, may linger for a considerable period of time. How long will depend on the success of Slovenian diplomacy in creating a perception that Slovenia is quite different from the rest of ex-Yugoslavia. The refugee problem, in turn, cannot be solved quickly, nor will the issues of autarky and germanization be immediately settled. Hence, we may conclude that the costs of separation are felt in the short-run, but may continue to accumulate through the medium-term (probably to the end of the decade).

3.2 Benefits of Separation

The overarching benefit of separation for Slovenia has been political: exit from the chaos of ex-Yugoslavia. Following the end of the one-week war between Slovenian forces and Yugoslav People's Army in late June-early July, 1991, Slovenia has been able to separate itself from the brutality and violence of the Yugoslav war. It has also been able to keep extreme political forces (above all extreme nationalists) from gaining significant power within Slovenia, thereby facilitating the establishment of peaceful democratic processes.

In the eyes of the Slovene people, this political benefit justifies any short-run economic sacrifices. Nonetheless, a case can be made for the proposition that Slovenia will experience medium and long-term economic benefits. These fall under three headings: enhanced macroeconomic stability through Slovene sovereignty and control over monetary and fiscal policy; enhanced capital accumulation through the dismantling of the old system of redistribution and faster access to the EC and its benefits.

Enhanced macroeconomic stability is the fruit of political sovereignty. The old Yugoslavia did not possess adequate federal mechanisms for managing the macroeconomy. As noted above, the formal balance of the Federal budget hid a significant but unmeasured deficit. The difficulties

in achieving approval by all the federal units in parliament for compromises on federal allocations made fiscal policy response sluggish. Disagreements over taxation policy also made it difficult to achieve a coherent federal policy in this area.¹⁹

Similarly, federal monetary policy was hampered by the political set-up and power-balance in the NBY. With its governors chosen by Republican parliaments, the central bank lacked any substantial degree of independence. Controlled by a coalition favoring redistribution and easy money, it chose to put out the fires that started at the regional level.²⁰ For Slovenia, which practiced greater fiscal discipline than other federal units, this meant an unexpected and unwanted inflationary impulse without corresponding benefits.

It is in this context that Slovenia's assumption of fiscal and monetary independence must be understood. The introduction of the Slovenian tolar, in particular, has proved an invaluable instrument in protecting Slovenia from the hyperinflation of the dinar in late 1991 and 1992. In this sense, independent Slovenia might prove to be an optimal currency area, for it has turned out to be an area within which coherent monetary policy has been politically feasible.

The point here is that Yugoslav regions--in an ethnically heterogeneous society with large differences in economic development--functioned as distributional coalitions (Olson, 1982) thereby preventing coherent fiscal and monetary policies and turning them into a vehicle of redistribution. Efficiency was subordinated to redistribution. Hence, the potential advantages of participation in a larger entity were not realized, and separation from the larger entity provided an improvement in this area.

Another aspect of macroeconomic stability derives from Slovenia's new-found flexibility to create labor market institutions appropriate to its own circumstances. With a small economy and

a fairly ethnically homogeneous workforce, Slovenia is a candidate for all-encompassing corporatist bargaining between labor and management. Similar institutions have proved highly successful in small, open European economies like Sweden and Austria. They provide a way to keep the overall level of wage increases within the bounds necessary to ensure macroeconomic stability. Also, they facilitate achieve macroeconomic targets (e.g. for exchange rates, relative unit labor costs, and employment). (Layard, 1990)

Enhanced capital accumulation is the second benefit expected from Slovenian separation. This benefit is contingent on ending the practice of redistribution of the old regime.

Interregional subsidization was ended immediately upon separation from Yugoslavia. But cross-subsidization is more persistent. Thanks to the economic collapse engendered by the war, Slovenia has been unable to end subsidies. Reported losses in 1991 reached 31.4 billion tolar (8.7% of GDP) (Pleskovic and Sachs, 1992), with two-thirds of the losses concentrated among the largest 100 industrial enterprises. As was mentioned in section 2, wage subsidies have been employed to keep insolvent enterprises afloat.

The key question is whether independent Slovenia will be in a better position to end cross-subsidization than it would have been within Yugoslavia. The passage of privatization legislation suggests that the answer may well be yes. Slovenia's political system still must find a way to carry through bankruptcy and rehabilitate the financial system. Nonetheless, Slovenia's progress so far compares favorably with what Yugoslavia achieved in 1990, when the Markovic government's privatization and restructuring program became hopelessly mired in interregional conflict.

If the process of restructuring the financial and industrial sector is successful, capital accumulation should improve. The old pattern of subsidization effectively taxed more successful enterprises while subsidizing the less successful ones. Estimates by Vodopivec (1989) suggest that this had a negative effect on productivity. Similarly, Kraft (1992a) has found that soft-budget finance allowed loss-making enterprises to maintain their investment despite continued loss-making.

Another factor contributing to faster capital accumulation, as well as higher living standards, will be Slovenia's ability to fashion its own tariff policies. The less-developed regions of Yugoslavia stoutly resisted lowering tariff barriers. Slovenia, with its greater competitiveness, should be able to lower tariff barriers much further than Yugoslavia as a whole.

There is a danger here as well. As a small economy, Slovenia is forced to be open. Whether it can thrive in a competitive international environment remains to be seen.

A third benefit is faster access to the EC. Yugoslavia's aspirations to enter the EC have been frustrated by its inability to meet EC human rights and political democracy conditions. A major impetus for Slovenian independence was the assessment that the Milosevic leadership in Serbia was unwilling to resolve the Kosovo situation in a way satisfactory to the EC (as well as the rest of the international community).

Slovenian independence appears to have unblocked the way to Europe. Close co-operation with both EFTA and the EC have already begun, including the disbursement of funds for small-business aid and other programs in August, 1992. While the continuation of the war renders Slovenia's situation somewhat uncertain, it appears that Slovenia is on a much faster track to Europe than any of the other ex-Yugoslav republics.²¹

What will closer association with Europe mean for Slovenia? First, it will mean a stamp of approval for foreign investment in Slovenia. Second, it will mean guaranteed access to European markets. Third, membership would also allow Slovenes to work anywhere in Europe without special permission, and likewise would allow EC citizens to work in Slovenia. Fourth, should Slovenia accede to the EC, it would probably be eligible for funds from the EC's regional program (ERDF, ESF). These funds have proved a major enticement for the poorer EC members (Ireland, Portugal, Greece especially.)

Of course, it is far from inevitable that Slovenia will become a full member of the EC. Such a development is hard to foresee within the current decade. But closer association seems highly realistic, with ties growing stronger rather rapidly.

Even without membership in the EC, Slovenia has managed to greatly increase the inflow of foreign investment. Direct foreign investment roughly tripled in value between 1989 and 1990, and grew another 40% in 1991 despite the war (Ministry of Finance, 1992). Although most of these investments are small, they seem a hopeful good portent of things to come. Leading European companies now involved in Slovenia include Siemens, Renault and Henkel, and three major Austrian banks, including Creditanstalt, are represented as well.

4. CONCLUSIONS

One year is not a very long time to draw conclusions about the prospects of independent Slovenia. Perhaps matters will look quite different a few years hence. Therefore, any conclusions drawn at this early stage must be tentative.

First, despite the obvious costs Slovenia has incurred in the short-run, prospects of medium and long-run economic benefits seem fairly good. Above all, the ability to pursue

macroeconomic stability, the fruit of political independence and a separate currency, promises to pay off in the not too distant future. Membership, or at least closer relationship with the EC also appears likely, and would prove highly beneficial. The ending of old interregional redistributive practices, if coupled with the ending of cross-subsidization, and the fashioning of new institutions, especially labor market institutions, appropriate to Slovenia, hold out further benefits.

Second, Slovenia's case does not prove that any separation from a larger entity would be welfare increasing. In fact, Slovenia's separation from Yugoslavia might not have been as beneficial as it has been already had Yugoslav politics come out differently. Had forces amenable to rational debate and compromise prevailed in Yugoslavia, Slovenian secession might have been welfare decreasing.

Slovenia's experience suggests that secession from a larger entity that is wrecked by political instability may have economic benefits. If local political autonomy provides the opportunity to introduce a new currency and achieve macroeconomic stabilization, separation can become economically attractive. However, this can only work if the local political constellation is not controlled by distributive coalitions bent on preserving the old redistributive system, and is not hampered by major political divisions that paralyze decision-making. In short, secession can be beneficial if the new state is more homogeneous in its composition and coherent in its functioning than the old state was.

Not all of the costs Slovenia has faced would be felt by other newly independent states. In the Czech-Slovak breakup, for example, political risk and refugee cost (or more properly costs

due to migration) are much smaller than in the Slovene case. Indeed, the Czech Republic may face a similar situation to Slovenia's: short-term costs but potential long-term gains.

Slovenia's circumstances are fortunate. It is ethnically homogeneous, culturally and historically compatible with the West, and enjoys proximity to (and some protection from) friendly Western neighbors. Furthermore, even though political divisions have been sharp, it has shown a political will to fight counterproductive redistribution.

There may not be a Slovenian model for anyone to copy. But there is a growing body of useful experience that Slovenia has to offer other new post-Communist nations.

ENDNOTES

1. We refer to Yugoslavia's republics and autonomous provinces as "regions" for convenience.
2. For a taxonomy of the Yugoslav economic system, see Ben-Ner and Neuberger (1990).
3. See the discussion of this and an opposing view -- attributing the failure to workers' control of enterprises -- in Vodopivec (1992).
4. Yugoslavia has traditionally been plagued by inflation. Inflation rose from about 30 percent in 1980 to full hyperinflation by the end of 1989.
5. That rate would be about 5 to 6 percent (the GMP of less-developed regions was about one-third of that of the more-developed regions in 1986).
6. Burkett and Skegro (1988) detect no disintegrative tendencies. Their test, however, is seriously flawed. First, they use the pre-1976 industry classification, which lumps together the production of intermediate and final products within sectors (metals, minerals, chemicals, textiles, wood and leather). Such an aggregation prevents the detection of rounding-off tendencies within such sectors--the type of rounding-off that probably was very common. Second, interregional trade flows are measured with unacceptable imprecision. They are obtained indirectly, as the difference between the region's production and consumption, and the estimates of consumption are based on the assumption that regional consumption is proportional to the production share of the region in the Yugoslav total (on the industry level)--a very poor assumption (especially for intermediate production).
7. See Government of Slovenia (1992), Bank of Slovenia (1992) and Op de Beke (1991).
8. This puts Slovenia at a great advantage compared to the states of the former Soviet Union. Even the Czech and Slovak Republics had to revamp the whole budget process, converting subsidies and direct appropriation of enterprise revenues into the State budget, just before their separation.
9. Indeed, the organizational structure of the central banking system of former Yugoslavia provided the basic institutional set-up for the currency reform. In Yugoslavia the regional National Banks executed commonly agreed-upon monetary policy on the regions' territories. This institutional heritage gave Slovenia a big advantage over the ex-Soviet Republics.
10. The first step towards introducing a new currency was the printing of coupons in summer 1990. This was seen as an emergency measure, taken in light of the increasing danger of a new hyperinflationary cycle following the failure of the second phase of the Markovic program. It proved extremely important in facilitating a smooth currency exchange.
11. We do not mean to argue that Slovenia had achieved full stabilization. Inflation in October, 1992 rose to 3.5% per month, following substantial wage increases, and unemployment remained

near 11%. Nonetheless, these figures compare well with the near-hyperinflation in the rest of ex-Yugoslavia.

12. Reserves were also built up in the process of housing privatization, which began following the passage of the Housing Law in November 1991. (Gray and Stiblar, 1992)

13. See Cvikl (1990).

14. The effectiveness of indirect monetary instruments will be impaired as long as loss-making enterprises and banks are not restructured. Important preconditions also include the development of short-term financial and capital markets.

15. Slovenia BOP current account was in surplus throughout the 1980's, with the only exception being 1990, when the exchange rate was fixed as part of the Federal Government's anti-inflation program.

16. For a discussion of recent trends, legislation and major issues concerning the labor market, see Vodopivec and Hribar-Milic (1992).

17. Even before the civil war, these costs were so apparent that the leading Slovene economist, Aleksander Bajt, warned that the drive for independence could not be justified on economic grounds. [Bajt, 1991] Bajt's argument makes sense only if the alternative is an integrated, peaceful Yugoslavia. Lacking such an alternative, independence was simply a necessity.

18. It should be noted, however, that several other East European countries have forbidden foreign landownership as well.

19. An old, but nonetheless relevant diagnosis of Yugoslavia's institutional inability to conduct fiscal policy is found in Horvat, Hadziomerac et al (1973)

20. The same forces also undermined the ability of the federal government to conduct consistent policies in other areas, for example price controls (see above).

21. Slovene negotiators have asked both the EBRD and the IMF to grant Slovenia the minimum necessary shareholding for membership, pending resolution of the apportionment of the debts of ex-Yugoslavia. Slovene sources claim that the EBRD has accepted this offer, but the EBRD refuses comment. (Euromoney, 1992)

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