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The Puzzle of State Ownership in Slovenia[1]

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ABSTRACT

In this paper we evaluate the privatization process in Slovenia. We first present different models of privatization and compare their results by focusing on four transitional countries (Czech Republic, Hungary, Poland and Slovenia). Later on we show the drawbacks of Slovene privatization. Our analysis shows that the speed of the privatization is not the key question. More relevant is the transparency in the privatisation process. In the paper we also argue that companies which are natural monopolies or have large network effects should not be privatised.

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1. PRIVATISATION IN CENTRAL EUROPEAN COUNTRIES

1.1 Privatisation models before privatisation takes off

Paradoxically, one of the biggest economic issues facing countries today is the danger of deflation. It was a completely different story 20 or even more years ago in former socialist countries. An important characteristic of those economies was the so-called shortage economy (Kornai, 1980), meaning the supply of goods was less than the effective demand for them. The transformation from a rigid planned economy to a market economy led to an increase in efficiency. Raising economic efficiency through the privatisation of state (social) ownership was seen as its main tool.[1]

An extensive debate started that questioned whether privatisation should be fast or stretched out over a longer period of time; should it be carried out via the free distribution of companies' shares or by selling companies; should the owners of companies be internal or external; and should the proceeds from the potential sale of state-owned companies be dedicated to the current generation of the population or be distributed among many generations (intergenerational solidarity). Different models of privatisation appeared in public even before the various countries had prepared concrete plans to carry out privatisation.

We will begin our discussion by introducing two generic ideas of privatising state (social) ownership. The first idea describes privatisation by way of the even and cost-free distribution of state-owned companies' shares among all citizens (Brittan, 1988). Because the idea corresponds to the perception of a 'fair' society, it is quite popular. Another advantage of distributive privatisation is its speed. It can be carried out very rapidly.

The second idea is based on the assessment that the state (social) ownership is the result of the effort of several generations of people and so the proceeds should be distributed among a few generations. Therefore, a sovereign wealth fund needs to be established that can dispose of state-owned assets on a long-term basis. Of course, the fund does not manage the firms. If there were a possibility to manage them from a single centre, that would be done by a centrally planned institution. In order to enhance the value of their own assets, one would sell companies in a reasonable time and invest the accumulated assets somewhere abroad (so as to avoid incestuous behavior in case the proceeds were invested in domestic firms). Returns on investment would be allocated to the national budget according to the principle – more from the average returns in years (period) with a higher budget deficit and less from the average returns in years (period) with a lower budget deficit. This is also how the deficit/surplus in the pension fund that is caused by demographic trends (like the ageing of the baby boom generation) would become balanced.[2]

Among many others, the idea of the free distribution of shares was supported by World Bank economist Emanuel Hinds (hereinafter: the Hinds model). He believes that in order to stop the asset stripping which arises from inefficient corporate governance, privatisation needs to be carried out fast. Distribution of the state (social) ownership is only the first phase. In the second phase, the acquired shares should be sold to interested buyers who, based on the ownership function they obtain, become the holders of corporate governance (Hinds, 1990).

The sale of companies underlies the privatisation model prepared by the think-tank group of economists within the Blue Ribbon Commission (Blue Ribbon Commission, 1990). The buyers of companies can be domestic or foreign. Domestic individuals receive the funds needed to purchase companies from bank loans. A country then uses the proceeds from the sold companies to cover its current fiscal requirements (restructuring companies prior to selling them, providing subsidies to other companies etc.). This model again foresees rapid privatisation.

On the other hand, the Kornai model (Kornai, 1990) suggests that the private sector can be truly developed through the natural selection of 'flesh and blood' entrepreneurs. Consequently, a state is "obligated to handle the wealth it was entrusted with care until a new owner appears who can guarantee a safer and more efficient guardianship. The point now is not to hand out property,

[1] Economists mostly agreed that privatisation would have a positive effect of increasing 'productive efficiency''. However, it is not necessarily true that in each case privatisation also leads to an increase in 'allocative efficiency'. For example, it is unlikely one would find much of an allocative improvement after turning 'public' natural monopolies into 'private' ones.

[2] The above text of course describes the functioning of Norwegian Government Pension Fund – Global (hereafter GPF-Global), to which we will return later in the paper.

but rather to place it in the hands of a really better owner… Enterprises should be sold carefully and mostly on a one-by-one basis rather than freely distributed to the public" (Kornai, Ibid, p. 82).

If we compare the three models explained above with each other (of course, there are more of them, but they are not crucial for our discussion) in terms of the generic ideas presented, we can see that first model (the Hinds model) only seemingly leads to a 'fair' society in which all citizens would have resources for production. The free distribution of shares is only the middle phase in the process of finding an efficient owner and efficient corporate governance for a company. The ownership certificates individuals obtain must be transferred to a secondary market which, in addition to all of that, still needs to be established. However, it is impossible to see upfront if via takeover bids on the stock market this will actually prove to be reliable enough to ensure efficient matches between enterprises and owners (Tirole, 1990).[3] Besides that, a country engaging in mass privatisation does not obtain revenues from the sales that are made.

In the Blue Ribbon model and the Kornai model, the establishment of an efficient 'corporate governance' mechanism is more likely. However, they differ in the speed of execution of privatisation and also in who would be the biggest beneficiary of the sale of companies. While the first model (the Blue Ribbon model) advocates the sale of companies within a short period of time and using the proceeds to lower the fiscal burden of the current generation, the second (Kornai) model suggests handling the sale of medium and large companies over a longer period of time since it first has to establish the efficiency of contractual rights and ensure the protection of private rights.[4] Based on this concept, the country serves as a guardian of the state ownership. When selling companies a country needs to pursue the goal of achieving the highest long-term social benefit possible.

A case-by-case approach to selling state-owned companies includes the risk of stopping the privatisation process after having had a negative experience while selling an individual company. This could slow down the process of establishing a market economy. Lipton and Sachs (1990) suggested a compromise that would include the advantages of mass privatisation (speed) and the advantage of the case-by-case approach (corporate governance). They introduced it as follows: "A portion of shares would be given at a low price or at no charge to workers, and another portion of shares would be transferred rapidly and free of any charges to various financial intermediaries (such as mutual funds, pension funds, and commercial banks). Shares in these intermediaries will in turn be distributed or sold to households. Finally, the government would retain a portion of each enterprise's shares and would gradually sell them as a block to 'core investors' who are about to take a key role in management of an enterprise" (Lipton and Sachs, Ibid., p. 299).

1.2 A comparison of four countries

A. The Czech Republic

It is well known that mass privatisation with vouchers in the Czech Republic played an important role in the fast transformation from state-owned to privately-owned companies. While only 2 percent of all registered assets were owned by the private sector in Czechoslovakia in

[3] Tirole (1990) distinguishes between a so-called 'noisy' phase and mature phase in transition from socialist to market economy. Due to the high uncertainty, the capital market in the 'noisy' phase is unable to perform two core functions: 1) to create 'speculative' information that could help predict future company yields (value of the company) and; 2) to create strategic information to enable an evaluation of the success of a strategy and the increased value of a company.

[4] It is interesting here that we can find a similar idea much later in Knyazeva, Knyazeva and Stiglitz (2013), where they estimate the effect of privatisation in 'Old' (Western) and 'New' (Central and Eastern) European economies. If we correct the privatisation decisions in companies for endogeneity (cherry-pick effect), we can see a negative effect of privatisation on the efficiency of companies in the short term, caused by the costs of privatisation and costs of unsettled contractual and property rights.

1989, by 1995 this share had risen in the Czech Republic to 75 percent (Svejnar eds., 1995). Around 1,800 medium and large companies were privatised in two waves of mass privatisation.[5] A less known fact is that the Czech Republic was hit by a deep economic crisis in the period 1996–2000, and one of the most important reasons for that was the mass privatisation (Nellis, 2008). Vouchers which had been bought by citizens for the symbolic fee of CSK 1,000 were mostly exchanged for shares in investment funds (75 percent of all issued vouchers) which were competing for equity shares in companies. Weak regulation of the capital and financial markets enabled suspicious, often illegal transactions whose goal was to push out all previous voucher owners from the ownership of investment funds. Consequently, the price of the investment funds' shares fell and poor corporate governance of the companies occurred. Besides that, some of the biggest investment companies (which managed investment funds) were owned by banks and these banks were owned by the state. The banks and investment funds jointly 'serviced' poorly performing companies. Kornai (2000) reported that the productivity of Hungarian companies was 36 percent higher in 1998 than in 1989. In Poland, the productivity of companies was 29 percent higher, while in the Czech Republic it was barely 6 percent higher.

The crisis pointed out bad practices in the area of privatisation. "Since that time, government has addressed the deficiencies in the legislative and legal framework (particularly with regard to investment funds and capital markets), privatized completely or almost completely most of the commercial banks, and started the last remaining large privatization projects in electricity, energy, radio-television, and railways" (Nellis, Ibid., p. 102).

Since the effect of privatisation becomes dispersed in the long run, the question of the efficiency of the Czech Republic's mass privatisation is today mainly academic in nature. For our discussion, an interesting result appears in the econometric research by Gupta, Ham and Svejnar (2008), who showed that better performing firms were privatised first and that ignoring this selection leads to biased estimates of the effects of privatisation. Moreover, Hanousek, Kocenda and Svejnar (2007) found no effect of the concentration that results from the initial large-scale privatisation, but they found a positive effect of majority ownership by domestic private owners as a result of the non-transparent ownership changes that took place after privatisation. As Nellis (2008) pointed out: "One reason why direct foreign investment is so important is that the higher reputational risk of such investors may lead them to adhere to decent behavior standards, even in the absence of local regulations or enforcement capacity" (Nellis, Ibid., p. 102).

B. Hungary

During socialism, Hungary had by far the greatest experience with a market economy among former members of COMECON. With experience of 35 years of partial, radical and sectoral reforms, Hungary may serve as a good example of what is and is not possible under one-party rule from the historical perspective (Adam, 1989). However, Hungarians did not pay much attention to the privatisation of state-owned companies in the period of socialism.

The privatisation of companies was an important topic of two transition plans made in 1990 (Blue Ribbon Commission plan, Kornai plan). Both plans offered the idea that the fundamental method of privatisation is the sale of companies. However, these plans are competitive with each other, as we saw above, regarding the speed at which the sale of companies takes place.

The turning point in the debate on the speed of privatisation came overnight due to the need to sell companies because of the high budget deficit (Csaba, 1992). At the end of the 1980s, sales transactions were 'spontaneous', encouraged from the side of managers and often made in combination with foreign investors (Voszka, 1993). Privatisation became more regulated after 1991. It was usually based on tenders, which were also available to foreigners.

[5] An overview of privatisation in the Czech Republic is provided in Hanousek and Kocenda (2003).

State-owned companies had to take on the legal frame of joint-stock companies. Their shares were in the possession of the State Property Agency (SPA). At the end of 1993, the SPA had privatised around 30 percent of its own capital, half of which belonged to foreign capital (Mihalyi, 1994). The share of foreign investments in gross domestic product was almost 16 percent in September 1994, meaning it was much higher than the share in similar transition economies (Havlik et al., 1995). It was typical of Hungarian privatisation to have less of workers' ownership, less of dispersed ownership, and a lot of concentrated ownership, especially in the form of foreign ownership (Frydman et al., 1993; Earle, Kuscera and Telegdy, 2005).

Brown, Earle and Telegdy (2006) in their extensive study on the effects of the privatisation on companies' productivity in four countries (Hungary, Romania, Russia and Ukraine), during the period 1992–2002, where they also included the productivity of those companies before privatisation (Since 1985), show that for Hungarian companies: 1) privatisation has a positive effect on productivity; 2) the effect of privatisation to foreign investors is bigger than the effect of privatisation to domestic investors; 3) the effect takes place right after the privatisation occurs and becomes dispersed later and; 4) when including the period before the privatisation, an immediate effect is seen in those companies which were sold to foreigners. Unlike in Ukrainian or Russian companies, where productivity usually falls after a foreign takeover (pointing to the strategy of asset stripping), Hungarian companies experienced a positive shock of productivity after a foreign takeover. This signals to the new owners that the managers are capable of continuing their career in the company.

However, Brada (1996) warns that the SPA was often a passive owner in many companies. Not only did it enable managers to control the companies, it also led to 'spontaneous' or 'wild' privatisations by enabling low selling prices for foreigners. Brown, Earle and Telegady (2006) add that positive shocks to productivity after a takeover occurred should point to the existence of inside information on the side of transferees. Since it takes some time from the beginning to the end of a takeover, new owners and managers can determine the most suitable time of sale while trying to achieve the highest takeover premium.

C. Poland

So far we have talked about the Czech Republic and Hungary which are among those that relatively quickly privatised their state-owned enterprises. We showed that both countries selected their own leading method of privatising medium and large enterprises. However, in both countries the privatisation process did not run smoothly. But what happens if we choose a slower pace of privatisation like Poland did?

The discussion on how and if they even should privatise medium and large state-owned enterprises was fierce in Poland. For example, in 1990 there were 20 different versions of the Law on Privatisation under discussion (Nellis, 2008). There are at least two important reasons for this: 1) the number of medium and large state-owned enterprises in Poland was very high (official statistics identified more than 8,400 enterprises that created around 70–80 percent of gross domestic product) and; 2) already during socialism many companies created workers' councils, which became an important player in the negotiations with managers and associated ministries. In July 1990, the Parliament adopted a Law on Privatisation, which did not show any preference for mass privatisation or for the sale of companies. It also did not support a combination of these, as had been suggested by external consultants led by Sachs and Lipton (Lipton and Sachs, 1990). The Law determined that companies have to decide on their own if they want to be privatised and that consent from the managers and workers is needed. Companies were required to produce a plan for the sale of the company and deliver it to the Ministry for Ownership Change. It was expected that the best companies would be the most interested in privatisation.

Poland therefore chose a pragmatic approach of privatising medium and large state-owned enterprises. Pragmatism also led to the idea to create 10–20 state holding companies, which would operate purely on commercial criteria and later be eventually privatised. It can also be found in the background of the mass privatisation, which occurred with a lag of a few years, that the Polish population did not have enough funds to buy companies.

The mass privatisation programme (MPP) was adopted in April 1993. It included 512 medium and large companies, most of whose shares (60 percent) were distributed among 15 "National Investment Funds" (NIFs), 10 percent was divided between employees and 30 percent remained in the State Treasury. Any adult resident had the possibility, for a small monetary payment, to obtain a 'bearer MPP share certificate', which enabled him to invest in each of the 15 NIFs. For various reasons, the MPP did not start operating until the end of 1995.

In early 1997, only 22 percent of the pool of 8,441 medium and large state-owned enterprises in 1990 had become privately owned (Blaszcyk and Woodward eds., 1999). As shown in Figure 1, the Polish economy in the 1990s grew relatively quickly in spite of the high proportion of state-owned enterprises (Table 1). However, such enterprises had limited access to financing, especially when it came to financing their development plans. Therefore, they often operated with outdated technology and an excessive number of employees (Blaszcyk and Woodward eds., p. 44-46).

D. Slovenia

At the turn of the 1990s, the privatisation of social ownership was a topical issue in Slovenia.[6] In 1991 three proposals were being debated: 1) a decentralised, gradualist model based on worker buyouts (the Mencinger model); 2) a centralised model of mass privatisation (the Sachs model); and 3) a semi-decentralised model with the transfer of public property into preference shares of the Pension Fund (the Ribnikar model). The Mencinger model mainly seeks to encourage internal ownership.[7] The Sachs model follows the efforts of the free distribution of shares and first requires the nationalisation of companies. The Ribnikar model takes the generic formation of social ownership into account and builds on intergenerational coordination. It also aims to avoid an additional external shock which may arise due to privatisation.[8]

The 1992 Privatisation Law allocated 20 percent of a firm's shares to insiders (workers), 20 percent to the Development Fund that auctioned the shares off to investment funds, 10 percent to the National Pension Fund, and 10 percent to the Restitution Fund. In addition, in each enterprise the workers' council or board of directors (if one existed) was empowered to allocate the remaining 40 percent of company shares for sales to insiders (workers) or outsiders. Based on the decision on the allocation of this remaining 40 percent of shares, firms can be classified as being privatised to insiders (the internal method) or to outsiders (the external method).

The Law is a compromise proposal and is very similar to the Lipton and Sachs proposal (1990). The distribution of shares among employees (in exchange for ownership certificates) is followed by the transfer of shares to three state funds (pension fund, restitution fund and development fund). The remaining shares are intended to be sold as a package. At this point, the intended roles of the three state funds should be pointed out. The pension fund should provide

[6] Up until 1991 Slovenia was still part of Yugoslavia. Privatisation of social ownership was included in the different options of the future economic development (Prašnikar and Pregl, 1991).
[7] Due to the nature of self-management in firms in former Yugoslavia, it was claimed that workers were already their economic owners (Bajt, 1992).
[8] Ribnikar wrote in 2011: "Sale to foreigners and/or capital imports would generally strengthen the domestic currency and thereby reduce the competitiveness of domestic enterprises. If companies that were sold to foreigners were owned by the pension fund, that exact fund should reinvest the proceeds abroad in foreign securities. In this case selling the companies to foreigners would have no impact on the level of the exchange rate … The pension fund would have, although at this time (in 1991) nobody knew that, the true characteristics of the 'Sovereign Wealth Fund'" (p. 169).

additional funding to the pension treasury. The restitution fund should be a source of funds to cover obligations to former owners whose claims could not be returned in kind. The development fund is expected to perform the operating function in the trade of company shares for equity certificates, which would be collected from the population by investment companies. It was established already in 1991 in order to organise the restructuring of larger enterprises in difficulty. We will talk about its role in the restructuring process of large companies later on.

By the end of 1995, 1,446 social-owned companies previously managed by workers delivered their privatisation programmes to the Agency for Privatisation. By 1997, 1,381 of them had obtained a privatisation approval and an entry in the court register. Workers and employees acquired a majority stake in 802 companies (61.3 percent), although the share of these enterprises in the total capital of privatised companies was only 22.9 percent. In 150 companies (11.5 percent), which accounted for 45 percent of the total capital, the share of internal owners was less than 20 percent (Mencinger, 2006). There are varying figures available on how much public property was privatised this way because the data on the value of social capital before and after privatisation take different equity valuation methods into account (book value vs. estimated value), or have a different base for assessing social capital (namely, what should be regarded as social capital).[9] After formal privatisation of social ownership was carried out, the ownership structure was led by internal owners (approximately 40 percent), investment funds (25 percent), and state funds (22 percent), while the remaining 13 percent was sold to external owners or exchanged for privatisation voucher certificates of people who were not part of the company (Gregorič, 2003).

The share of the public sector in Slovenia's gross domestic product at the start of the new century was, however, still significant (Table 1). One reason is the Law on Ownership Transformation (1992) which excluded from privatisation enterprises that provide special public services, banks and insurance companies, enterprises which under the law as defined as co-operatives, enterprises which are transformed under forestry legislation, and firms in bankruptcy. In addition, public sector and state property were built from the former for self-management and social ownership personalised »communities of interest« which were voluntary organisations of producers and consumers of certain goods and services, notably 'public goods' such as health, education and utilities (Prašnikar and Svejnar 1988). In addition, the new state was setting up state funds for a variety of tasks. Besides the Development Fund, ten funds were established after 1991: the Housing Fund, the Technological Development Fund, the Fund for Farm Land and Forests etc. The Development Fund was, for example, established with the goal of assisting in the restructuring of the Slovenian economy during the process of privatisation. Two hundred and seventeen enterprises applied and 98 of them, accounting for 10 percent of workforce and 40 percent of losses of the Slovenian economy, were included in the programme. Gradually, the Development Fund (later transformed into the Development Corporation) evolved into a permanent institution for providing various forms of non-transparent and often politically motivated assistance to troubled companies. The Development Corporation was finally liquidated in 2002. A study of financial assets of the Republic of Slovenia indicated that two-thirds of financial assets in 1995 were the capital and founding investments of some 410 public institutions, 28 public companies, 11 national funds, two government agencies, 2 banks in the process of rehabilitation and a few other smaller institutions (Prašnikar, Čok and Oražem, 1996).

Despite these specifics, in the 1990s Slovenia achieved comparable economic growth, as shown in Figure 1. This can be attributed to 'sound macroeconomic policies' with a focus on macroeconomic stabilisation in the first phase (until 1995) and structural adjustments to miti-

[9] Jaklin (1996) shows that calculations made by the Ministry for Economic Affairs in December 1993 showed that firms in social ownership transformation employed almost 50 percent of the labour force in the business sector (231,750), had a 37.5 percent share in the total book value of the social capital and created 39.2 percent of revenues in the business sector. Mencinger (2006) claims that social ownership subject to transformation represented 68 percent of the existing capital.

gate market distortions being a priority in the second phase (Bole and Mramor, 2006), the rapid development of small, private firms (Prašnikar, 1998), and cooperation between owners, managers and employees which, especially in the case of internationally oriented Slovenian companies, led to offensive growth strategies (Prašnikar and Gregorič, 2002). Exposure to competition and the reduction of soft budget constraints most likely forced the state-owned enterprises to make some adaptations to the market. Progress can also be seen from the results of two econometric studies which address the effectiveness of companies in this period.

Prašnikar and Svejnar (2007) analysed the pre-privatisation investments and wage behaviour of Slovenian firms in the period 1991–1995, when the relevant decision-makers already knew how these firms would eventually be privatised. They concluded that investment behaviour is more consistent with the imperfect capital market (internal funds) hypothesis than with the neoclassical or accelerator models, where output demand drives investment behaviour. In addition, firms display a trade-off between investments and wages with worker-insiders sharing in firms' surplus or appropriating funds that are supposed to be used for depreciation of investments. However, when analysing the restructuring of privatised corporations during the late 1990s using labour demand and investment equations, Domadenik, Prašnikar and Svejnar (2008) discovered that the privatised firms in the period 1996–2000 behaved similarly to firms in developed economies since they displayed important features of profit maximising behaviour. The researchers found little support for the hypothesis that a firm's export orientation and important institutional features, such as insider or outsider privatisation, employee ownership and employee control, eventually affect the firm's employment and investment behaviour. Such results suggest that rapid and massive introduction of international competition into the domestic market of a country induces similar economic behaviour in companies with different structural and institutional characteristics.

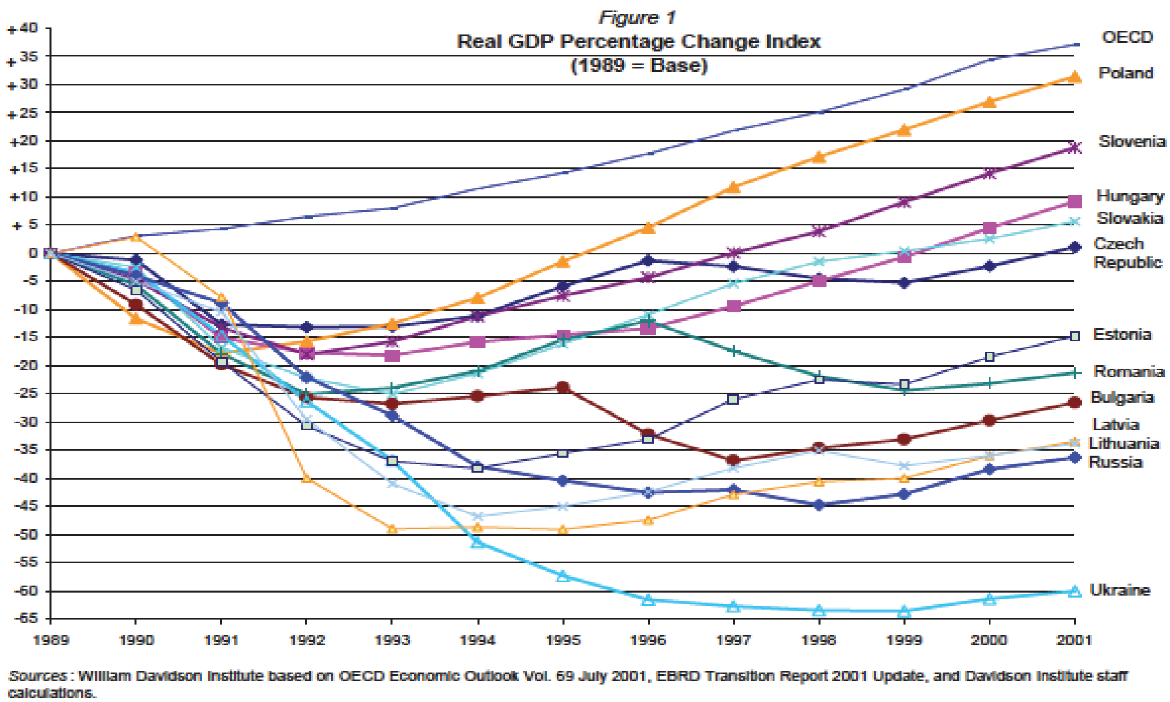
1.3 Did the transition end at the start of the 21st century?

After a decade of transition the question arises of whether the transition is over. Transition countries overcame the transition depression phase better than expected (Figure 1). Further, in most of the countries the private sector exceeded 50 percent of gross domestic product (Table 1). Gelb (1999) saw a distinction in the fact that problems and policy issues in transition countries no longer significantly differed from those in similarly developed countries. According to this concept, the transition was over. Svejnar (2002) defined the borderline as a situation in which the market replaces the central plan and countries are able to achieve growth rates that enable them to cooperate with more developed market economies without the use of protectionist measures.

For a number of countries, including Slovenia, entering the EU posed a new challenge. Although Slovenia was recognised by many as one of the better prepared candidates for entry, it separated itself from other candidates with an above-average large government sector. In the 1990s, awareness was built that many problems can be solved by a powerful state. Even some who had otherwise pushed for a competitive economy often sought help in the state (and political parties).[10] Moreover, problems with the sterilisation of foreign currency inflows in major foreign acquisitions (LEK) contributed to the view that domestic ownership is needed to achieve economic growth. Consequently, political affiliations and coalition coordination[11] already played an important role in the creation of the first wave of Supervisory Board elections in companies in which the state held a big enough stake (1996–2000). This developed even further, especially when serious plans for the accelerated privatisation of state-owned enterprises emerged (Domadenik, Prašnikar and Svejnar, 2015). Many people hoped to 'make a quick buck'. Everything was ready for it. The only thing missing was the appropriate financial source.

[10] A good example is the proposal to change privatisation investment funds (PIFs) into mutual funds. We will discuss this later.
[11] Considering the existing electoral legislation in Slovenia, a coalition government is almost a necessity.

Figure 1: Real GDP percentage change index



Source: Svejnar, 2002, p. 9.

Table 1: Share of the private sector in gross domestic product in 2000 (in percent)

Czech Republic	80
Hungary	80
Poland	70
Slovak Republic	75
Slovenia	55
Estonia	75
Latvia	65
Lithuania	70
Albania	75
Bulgaria	70
Romania	60
Kazakhstan	60
Russia	70
Ukraine	60

Source: Svejnar (2002, p. 11)

2. THE PRE-CRISIS PRIVATISATION STAMPEDO

2.1 The macroeconomic framework

The pre-crisis period in Slovenia coincided with the country entering the EU, the European Exchange Rate Mechanism 2 (ERMII), and later also the European monetary union. In the booming period of the world economy Slovenia implemented a nominal landing in ERMII. At that time, Slovenia was in a near monetary policy vacuum, with falling nominal interest rates, falling sovereign risk premium, and stable exchange rates. The fiscal policy stance was formally neutral as it ran negligible deficits. However, fiscal policy was still far too complacent for the economy, which had no control over monetary policy.[12] Although the standard market institutions of a developed economy, including the regulatory system (banking, capital market and market structure), were already set up when Slovenia entered the EU, they were not even close to enough to prevent the disastrous consequences of having such a complacent fiscal policy and applying far too lax monetary policy. The fast and complete freeing of (foreign) financial flows, which took place in order to accelerate the landing process of the real economy (mainly implemented through privatisations and acquisitions), was the cliche of the day (Bole, Prašnikar and Trobec, 2014a).

This period was also marked by the free access of banks (and other economic units) to external resources of loanable funds. They thus played, as described by Miller-Stiglitz (2010), the role of financial "deep pocket" investors. Competition among new banks entering the market and trying to carve out as the biggest market share possible[13] further fuelled the additional supply of credit.

2.2 Before the outbreak of a new wave of privatisation

A. Concentration of ownership in privatised companies

The concentration of ownership in privatised companies occurred really fast.[14] One reason for that was non-transparent trading in shares. Trading took place among big owners (investment funds, state funds), among companies and big owners, where the takeover legislation was often not respected (parking shares in certain places), and among companies and small shareholders (redemption of own shares from small shareholders, concentration of ownership in authorised companies).[15] Regulatory and supervisory authorities (the Securities Market Agency - SMA), authorities of the Ljubljana Stock Exchange, the Slovenian Competition Protection Agency (SCPA), government, and parliament) seemed to work in a confused manner and missed out on the chance to respond to the rent-seeking behaviour of different stakeholders.

The Law on Private Investment Funds from 1994 predicted that after some time Private Investment Funds (PIFs) would mainly be transformed into mutual funds. However, PIFs persistently lobbied against that solution.[16] Ten years later (in 2004), when the statutory deadline expired, the majority of PIFs transformed into joint-stock companies (financial holding companies), which were not subjected to such strict due diligence from the side of regulators as mu-

[12] See, for example, Bole (2006), and Bole and MacKellar (2009).
[13] Foreign banks were entering the market with more favourable credit terms in order to take over the market share of existing banks, with which they followed the trend of loosening credit terms (Feldin et al., 2009).
[14] In 150 of the most important large and medium-sized firms in Slovenia involved in the sample and that on average employ 500 employees, Pavlič Damijan, Gregorič and Prašnikar (2004) found that from 1998-2002 the share of insiders in an average firm decreased from 39.81 percent in 1998 to 29.75 percent in 2002. In the same period, the share of domestic firms rose from 7.80 percent to 26.79 percent. Foreigners increased their share from 3.03 percent to 6.72 percent, and PIFs from 18.72 percent to 19.17 percent. The share of state-controlled funds in an average firm decreased from 20.13 percent to 10.24 percent.
[15] Authorised companies are a form of an internal shareholders' organisation and function according to a mutual shareholders' agreement.
[16] The Act on PIFs Legal Successors, which was listed for the first time for parliamentary discussion in 2001, was accepted in relatively changed form only in 2007.

tual funds, which are listed on the stock exchange. Investors in investment funds (previous owners of privatisation certificates) also did not have any chance to influence an improvement in the transparency and efficiency of the investment funds by treating with their exit. Some PIFs took advantage of shortcomings in the legislation and inefficient control and transferred their assets abroad. Others believed a financial holding should play a role in directing the concentration of ownership in particular companies (a group of companies) and were preparing themselves for their final takeover.

Moreover, some larger mostly nonfinancial companies, which were still a subject of ownership transformation, were transformed into financial holdings. They acquired financial assets through the sale of individual parts of the company and used them to purchase other companies with the clear intention to on-sell them (Istrabenz, Sava…). Several entrepreneurs (de novo companies) began with this kind of activities as well. They started with zero or little capital and earned some money through the first transactions with securities of privatised companies, or received necessary capital from bank loans. In addition, some non-financial companies (mainly industrial ones), which justified takeovers by economies of scale and economies of scope, added to the concentration of ownership (Pahor, Ferligoj and Prašnikar, 2004).

B. The ‘consolidation’ of ownership in the banks

Let us first mention that in the past years Slovenia already performed similar operations to rescue its banking sector like it did in 2014. As a result of the rehabilitation of the banking system which began in 1993 and ended in 1997,[17] the two largest banks Nova Ljubljanska banka (NLB) and Nova Kreditna banka Maribor (NKBM) became state-owned banks.

In 2002, the government announced the privatisation of both banks through a tender, which was only partly successful. Namely, due to a public outcry against selling the banks to foreigners, the Belgian bank KBC was allowed to only acquire 34 percent of all shares in NLB. The remaining owners were the EBRD with 5 percent, other private owners with 17 percent, and the state with 44 percent of shares. At that time, the state’s share in NKBM exceeded 90 percent.

According to the agreement with KBC, there would be no changes in the ownership structure of NLB until the end of 2005. It appears that the government had tacitly promised that KBC would become the major shareholder. Negotiations between KBC and the new government started in 2004, but failed. There were three options on the negotiating table: 1) the state keeps a 25 percent share plus a golden share; 2) KBC receives the majority stake (51 percent); or 3) KBC receives a minority stake (49 percent). None of these options was accepted. That is why a year later KBC proclaimed that it would turn away from becoming a strategic investor in NLB.

Discussions on the privatisation of NKBM also lasted a long time while the ways for how to sell the bank were changing as well. In 2001, the plan was based on the idea to privatise NKBM to some foreign strategic partner. Later, in 2004, the idea emerged that the privatisation should be carried out in the form of dispersed ownership and through public sale of the bank in the domestic and foreign markets. Then again, based on the government’s plan from May 2006, privatisation of NKBM should take place in two steps. In the first step they would sell 20 percent of the shares to some key investor, who would in addition restructure the bank, 5 to 10

[17] Due to lost assets in other parts of Yugoslavia and non-performing loans, the central bank (Bank of Slovenia) placed the three largest ‘old’ banks, which accounted for more than 50 percent of assets, in a formal rehabilitation status. The pillar of the banks’ rehabilitation was the swap of their bad assets for governmental bonds. Two new banks (NLB and NKMB) were established and a third one (Poštna banka) was merged with NKMB. The assets were transferred to the new banks, while the liabilities to depositors and assets invested in former Yugoslav republics were retained by the ‘old’ banks. Under the swap, the newly established Bank Rehabilitation Agency (BRA) became the owner of the banks because the value of their capital was negative. Public debt created by the rehabilitation amounted to DEM 1.9 billion (approximately EUR 1 billion). It was only marginally recovered by the BRA, which also played a major role in the supervision and restructuring of the banks. When the BRA was resolved (1997), its ownership was transferred to the state (Štiblar and Voljč, 2004).

percent would be offered to domestic individuals, and 20 to 25 percent to institutional investors in an international tender. The sale of the rest of the share comprising up to 25 percent and one share (kept by the state) would be carried out in the second step, where the share would be offered to international investors.

C. Some outliers of privatisation

Among companies that did not fit into the previous two categories, much attention in the observed period was focused on the potential privatisation of Telekom, Luka Koper, Zavarovalnica Triglav, Hit and Aerodrom Ljubljana. None of these cases were resolved in the observed period.

In Telekom, the leading Slovenian company in the area of telecommunications, the state directly and indirectly owns a 74.14 percent share.[18] In the considered period, questions were raised as to whether the state should sell its share of ownership or not, whether the company should be sold piece by piece or together in one piece, or whether the shares should be listed on the stock exchange or not. In 2006, a few decisions were made: 1) there would be no piece-by-piece privatisation; 2) the company should list its shares on the stock exchange; and 3) state and parastatal institutions should reconcile their method for performing the share sales.
Based on the idea of the 2002 Insurance Companies Ownership Transformation Act, shares owned by the state in Triglav, the largest insurance company in Slovenia, were transferred in a trusteeship to the Slovenian Compensation Fund (SOD) and the Pension Fund Management (KAD),[19] which was supposed to sell the shares to individuals or other entities that were entitled to buy the shares in proportion to their past paid-in insurance premiums.[20] One of the initial discussions (which was later dropped) in the next period led to the notion that Triglav and NLB would join in the holding through which the Belgian KBC would have a chance to enter Triglav. In 2006, a request for the earliest possible privatisation of a 34.37 percent share was made. However, it was estimated that selling to an individual insurance policyholder would be technically difficult to implement. In 2007 the Slovenian Parliament decided that the share belongs to KAD and later to the Institute for Pension and Disability Insurance.

The government announced in 2003 that Luka Koper is a natural monopoly and hence the company would not be privatised. Moreover, a search for a strategic partner would be initiated. Luka Koper, in which the state today owns a 67.11 percent share, was only mentioned in privatisation stories at the end of the period in association with building up a logistics holding that would be established by Slovenia and Deutsche Bahn. Deutsche Bahn would enter Intereuropa and Luka Koper directly, and acquire a 75 percent share at a market price, while the state would retain the remaining shares. Slovenia would also retain the 51 percent share in Slovenian Railways. The negotiations finished quickly and the idea disappeared.

A similar story is Hit in which the state owns 40 percent of ordinary shares. Negotiations on the construction of a mega entertainment centre in Goriška together with the American corporation Harrah's Entertainment also included the potential privatisation of Hit. However, they did not bring any results.

Aerodrom Ljubljana was to be privatised under the Law on Ownership Transformation from 1992. The company was listed on the stock exchange. The shares were liquid due to the rela-

[18] At the end of 2006, the Republic of Slovenia owned 62.53 percent, SOD 4.25 percent and KAD 7.36 percent of Telekom.
[19] This also happened in the other four cases with similar arrangements.
[20] Among Triglav's biggest shareholders on 31 December 2006 there was SOD with 42.3 percent, KAD with 34.47 percent, Radenska, d.d. with 1.93 percent, Sava-Re, d.d. with 1.15 percent, Hit, d.d. with 1.12 percent, and others owning less than 1 percent. On 15 January 2015 the Institute for Pension and Disability Insurance owned 34.47 percent, SDH 28.9 percent, Hypo Alpe Adria Bank Zagreb 6.15 percent, Skandinaviska Enskilda Banken S.A. Luxembourg – FI 2.04 percent, Hrvatska Poštanska Banka, d.d. 1.35 percent, Eastern European Fund 1.47 percent, Austrian Anadi Bank AG 1.23 percent, and others owned less than a 1 percent share.

tively high returns. Moreover, state-owned companies (Luka Koper) started buying shares in it in 2006. Slovenian state-owned companies exceeded the threshold for a takeover for which they were penalised in 2012 when the Securities Market Agency (SMA) took away their voting rights (the privatisation of Aerodrom Ljubljana will be further discussed later).

2.3 The plan for withdrawing the state from the economy

The so-called 'transparent withdrawal of the state from the economy' was part of the government's programme "The Framework of Economic and Social Reforms for Increasing Welfare in Slovenia" launched at the end of 2005.[21] It was to be achieved first by transforming KAD and SOD into portfolio investors and, second, by the coordinated privatisation of the country's largest predominantly state-owned companies.

In order to make the sale of the state's ownership as transparent as possible, companies in the portfolios of KAD and SOD were divided into three groups.

The first group consists of non-public stock companies and limited liability companies. The major criterion for selling companies in this group is the maximisation of revenue from sale of the company. KAD and SOD should therefore act together, constantly estimating the profitability of the companies, and look for as many potential buyers as possible. The deadline for this kind of privatisation was set at 30 months.

Listed companies compose the second group. KAD and SOD should, while taking the shallow Slovenian capital market into account, try to independently maximise shareholder portfolio values in compliance with the stock market rules. The deadline to become a portfolio investor (their combined ownership in a company should not exceed 10 percent) rather than active investors was set at 24 months. After that period of time, KAD and SOD should manage their portfolios according to the principles of portfolio investors.

In the third group, there are companies which due to their size and importance for the national economy, are not tied to any deadline for their privatisation. Their sales should be in concurrence with the liabilities of the two funds (denationalisation claims in the case of SOD, and participation in the pension system in the case of KAD), the market situation, and the sales of other state-owned companies.

For privatising directly state-owned companies, which have a large market share of the domestic market and are considered important for the economy's functioning (Telecom, the largest insurance company, the two large banks), a so-called 26XY model of partial privatisation was proposed. According to this model, the government should in the long run retain 26 percent of the ownership while strategic investors could acquire X (0<X<74) percent of shares and financial investors Y (0<Y<74) percent of shares. X and Y would vary from case to case, depending on the need to restructure a company; the more urgent, the higher the value of X and the lower the value of Y (Mencinger, 2006).

"In 2007 and 2008, the government should also sell the companies that are predominantly and directly owned by the state. The money from each sale should go directly to the national budget. The most important among them were SIJ (the steel mills holding with book value of 174 million euro, and 80.4 percent of government share), NKBM bank (185 million euro, 90.4 percent government share), Telekom (612 million euro, 62.5 percent government share), Nafta Lendava (oil refinery, 22 million euro, 100 percent government share), Peko (shoe producing company, 16 million euro, 82.1 percent government share), Termoelektrarna Trbovlje (electricity generation by coal, 26 million euro, 80.3 percent government share), Termoelektrarna in toplarna Ljubljana (electricity generation, heating, 38 million euro, 65 percent government

[21] The package consisted of 70 measures in order to ensure higher economic growth and welfare.

share). Furthermore, some companies which are owned by state-owned companies, are to be sold as well; the proceeds of these sales would not be the revenues of the budget. The largest in this group is aluminium producing company with the book value of 92 million euro, and which is 80 owned by ELES (state-owned electricity holding)" (Mencinger, Ibid., p. 29).

2.4 Investment with a strategic delay

After entering the EU (2003), Slovenian companies started to enjoy their easier access to the EU market and hence their ambitions became stronger to achieve higher yields. Slovenian banks also benefited from the better access to foreign resources. Let us take an average company which is considering the various investment opportunities available to it. The company can devote its money to investments that would increase its 'core business'. It could also invest in takeovers where the chances of achieving the best yield occur when taking over companies in countries of former Yugoslavia. Then again, the company could invest in real estate, where the potential yields are again high.

Acquisitions of capital are financed by entrepreneurial wealth (net worth) and borrowing.[22] Even when he borrows, net worth matters because a borrower's financial position is a key determinant of his cost of external finance. Higher levels of net worth allow the external finance premium to be reduced. An anticipated rise in asset prices raises net worth more than proportionately, which stimulates investment and, in turn, raises prices even further.

However, because all businesses are doing the same thing an asset 'bubble' emerges and its collapse is an aggregate shock threatening a large-scale default. The existence of a mechanism which through a financial accelerator endogenously amplified and propagated the process of companies' debt accumulation triggered by an external fund inflow in the pre-crisis period (a positive financial accelerator), and a mechanism which prolonged the crisis via non-optimal deleveraging policies which caused high collateralisation, credit rationing, and a neglect of the cash flow performance of banking clients (a negative financial accelerator) is already well documented in Slovenia.[23]

Based on the previous discussion, one of the most favourable investment options in the observed period was the acquisition of an ownership share in privatised firms under the management of the two state funds. Concentration of ownership in privatised firms took place through the whole period after the formal privatisation was completed, partly also because of the sale of the state funds' shares. However, when investors received information that politics was encouraging the purchase of shares (chances to purchase them at a lower price) and that the banks, especially state-owned banks, are prepared to finance those kind of purchases (soft loans), they increased their interest in them. This may concern ownership in one's own company (MBO) or ownership in other companies (takeovers).

Purchases of the ownership stakes in state funds can be seen as an investment with a strategic delay in which the investor times his decision to take advantage of the information revealed by others. When enough information is available, one does not want to delay with the decision anymore. In our case, information about the positive decisions of other investors on buying shares from both state-owned funds passed around quickly. That is why the majority of investors decided on the purchase in a short period of time.[24]

[22] See Miller and Stiglitz (2010) in Krisnamurthy (2010). For earlier models of the so-called balance sheet crisis, also see Minsky (1986), Kiyotaki and Moore (1997).
[23] See Bole et al., 2012, 2014a.
[24] For a formal model of investment based on information revelation and strategic delay, see Chamley and Gale (1994).

Table 2. Equity investment sales of SOD and KAD between 2004 and 2014 without sales to the Slovenian Sovereign Fund (SDH) (formerly SOD) and PDP (Special Company for Corporate Advisors, Inc.) (sum of annual transactions, number of transactions, average transaction value and median of transactions)

	Sum of annual transactions			Number of transactions			Average transaction value		Median of transactions	
YEAR	SOD	KAD	TOTAL	SOD	KAD	TOTAL	SOD	KAD	SOD	KAD
2004	1,244,583	58,427,809	59,672,392	6	57	63	207,430	1,025,049	68,176	475,467
2005	67,641,698	114,432,952	182,074,650	31	29	60	2,181,990	3,945,964	144,723	176,278
2006	174,242,211	55,751,318	229,993,529	52	54	106	3,350,812	1,032,432	119,753	98,282
2007	229,464,142	233,834,467	463,298,609	52	48	100	4,412,772	4,871,551	871,692	1,224,937
2008	168,841,711	37,411,822	206,253,534	9	11	20	18,760,190	3,401,075	220,091	99,831
2009	112,260,524	2,253,462	114,513,986	6	5	11	18,710,087	450,692	7,627	430,154
2010	210,704	551,033	761,737	4	2	6	52,676	275,516	32,897	275,516
2011	238,787	1,165	239,952	5	3	8	47,765	388	516	157
2012	51,553,447	16,527,509	68,080,956	5	4	9	10,310,689	4,131,877	36,151	1,877,290
2013	58,546,921	-	58,546,921	2	-	2	29,273,460	-	29,273,460	-
2014	159,603,975	17,607,412	177,211,387	6	2	8	26,600,663	8,803,706	10,726,148	8,803,706

Sources: SOD and KAD internal statistics provided to the authors

Note: The data include all transactions conducted by SOD and KAD between 2004 and 2014 without sales to SDH (formerly SOD) and PDP since they are just other state institutions. Transactions where an investment is sold to the same buyer more than once in the same year were grouped. Such cases do not exist for SOD, therefore the data for SOD are the same as in Table 2. Data on sales of investments of the Republic of Slovenia in 2013 and 2014 are added to SOD. Data on bankruptcies, liquidations and exchanges conducted by SOD are not included.

The data in Table 2 show the number of transactions in a single year, the summed amount of transactions and average values (mean and median) made by each fund separately and together during the period 2004–2012. The data reveal the following: 1) the number of transactions (sales) increased significantly in 2006 (after the plan for the state's accelerated exit from the ownership in both funds was published) and in 2007 (before the crisis); 2) proceeds from the sale of both funds' ownership shares in privatised firms during the years increased, especially in 2007; 3) based on the previous years the average values of sales in both funds rose in 2007 due to a bigger number of sales at higher prices than before; 4) in 2006 and 2007 SOD increased its sales' activities more than KAD did; 5) the number of transactions in sales' values in 2008 and 2009 was reduced. In these two years, fewer transactions were made, but the value of those went up, which probably points to the fact they were arranged in advance; 6) in 2010 and 2011 the sale of KAD and SOD's ownership share based on the number and value of transactions waned; and 7) in 2013 and 2014 only a few transactions of a higher value were made.

3. THE GLOBAL CRISIS AND THE PRIVATISATION OF STATE OWNERSHIP IN SLOVENIA

3.1 Shocked by the crisis: a lack of macroprudential regulation

When the global crisis emerged, the endogenous bubble creation processes in Slovenia[25] were interrupted by exogenous shocks. Uncertainty in the international financial market triggered a credit crunch in the wholesale market for loanable funds. As a result, banks in Slovenia were only partly able to refinance their foreign credits and had to curtail the supply of credits to their clients in the domestic retail credit market. Already in 2009, the Slovenian government alleviated the liquidity squeeze facing banks (the credit crunch in the wholesale market of loanable funds) by providing guarantees to banks to enable them to access foreign markets. Ample intervention by the ECB further mitigated the liquidity squeeze of banks.

However, alleviation of the credit crunch in the wholesale loanable markets did not neutralise the credit crunch in the retail market, where several factors prolonged the retail credit crunch. First, a drastic drop in demand in foreign and domestic markets increased uncertainty about future economic development, which reduced the information capital of banks (their capability to evaluate the future solvency of their clients). To offset the reduction in information capital, banks began to increase the necessary collateral coverage of their credits and switched their credit evaluation policies from an approach based on "mark-to-market" to one based on "mark-to-risk". Banks not only started to increase the necessary credit collateral coverage, but also considerably enhanced their credit rationing which stopped not just new credits, but also considerably reduced automatic credit renewals. Second, the severe credit cut and sudden drops in demand affected sectors with longer processes of production the most, so construction was hit the worst. The glut in the real estate market caused by the free fall of collateral value and collapse of the construction industry had a significant negative effect on the real estate and stock markets. That further decreased the size (value) of firms' collateral and exacerbated their credit squeeze.

Finally, the process of increasing credit collateralisation and rationing as well as accelerated deleveraging was also facilitated by the banking regulator's supervision measures. After the first quarter of 2010, the Central Bank launched a process of accelerated implementation of stricter

[25] Slovenian firms borrowed around EUR 13 billion during the period 2004-2008, of which 60 percent (approximately EUR 8 billion) was aimed for financing the 'core' investments. The rest went for financing so-called financial investments and real-estate investments, of which around one-third represents banks' financial investments in companies abroad (especially in former Yugoslav countries), one-third was dedicated to financing investments in real-estate business, and one-third was given for financing the purchases of equity shares (Bole, Prašnikar and Trobec, 2012a).

capital requirements (Basel III) by: 1) changing (increasing) the minimum capital adequacy ratios within a very short period of several months; 2) insisting on mark-to-market valuations of banking assets, even though transactions on the capital market for most companies were negligible or even non-existent, after the collapse of the stock market to less than one-third of its pre-crisis capitalisation; 3) increasing upfront capital requirements (marginal capital requirements) for new credits; and 4) increasing second pillar capital requirements. All of these came on top of the already stricter national supervision standards (Prašnikar et al., 2014).

As bank recapitalisation was very slow, banks were unable to timely fulfil the banking regulatory requirements. Therefore, banks at first started to restructure their portfolio of assets in favour of claims against the government or in favour of clients with more collateral available because those claims 'consume' less capital. Next, they began to simply squeeze balance sheets by selling assets and cutting credits. In addition, the so-called Lahovnik's Law (2009)[26] disabled state-owned banks from further lending to 'Tycoon' companies. Since those companies were not in the right shape to return their credits, banks seized their shares which had been given to them as collateral when the companies had taken out their loans.

Empirical results from Bole et al. (2014a) show that the wrong timing, sequencing and calibration of deleveraging in Slovenia incurred high opportunity costs in the boom-bust episode (2007–2012). Procyclical interventions of the banking regulator and corresponding responses of banks resulted in a prolonged credit crunch period and spiralling financial de-intermediation. Cutting bank credits independently of company performance in the first years after the crisis erupted greatly increased the migration of firms to negative cash flow and bankruptcy status in the following years. In addition, companies increased the level of forced (intercompany) credits, especially in the services and construction sectors (due to the low level of collateral), which spread illiquidity across the whole economy. The research claims that taming deleveraging after the crisis had erupted in the first year would have decreased intercompany illiquidity almost 40 percent more efficiently than in the following years. As an alternative approach to cutting bank credits immediately after the sudden stop (independently of intercompany debt and cash flow), banks would had to have first revolved credits among firms. In doing so, intercompany credits would be reduced in companies with 'appropriate performances', e.g. a positive cash flow. Bank credits would have to be reduced afterwards.

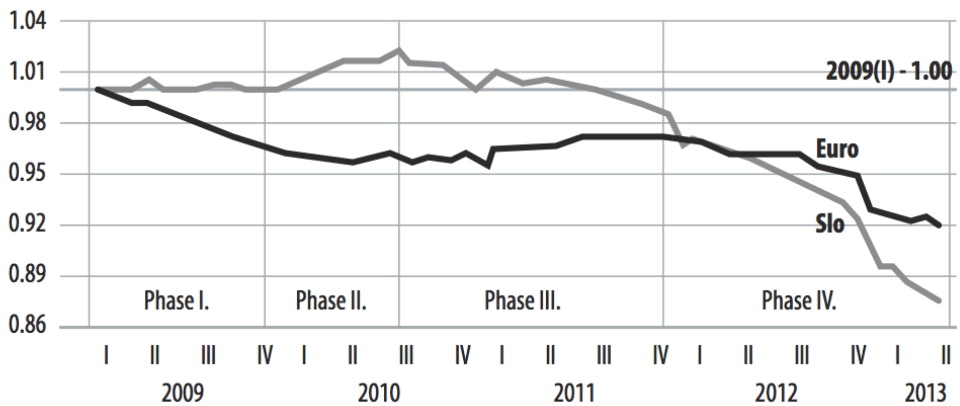
In the absence of such measures, and with the described actions of banks, Figure 2 shows the results of post-crisis credit growth in Slovenia compared to the EU. The credit crunch in the wholesale credit market and drop in real demand caused a reduction of credit in the retail market (phase one). State guarantees stopped the credit crunch already in the third quarter of 2009 – credits and activity started to grow and the liquidity of enterprises to pick up (phase two). In the 2010/6 the Bank of Slovenia in a very short period (two months) dramatically increased the regulatory requirements – 80% of capital requirements had to be in core tier one. Credits levelled off (phase three). In the second part of 2011 (after 2011/5), uncertainty driven by referendums on the sovereign bonds market and EBA requirements – 2011/9 (which pushed banks from the core EU to remove funds from the less developed part of the EU) triggered the fast falling of credits (phase four).

We currently face a situation where firms have started to accumulate their cash flow. This accumulation is the result of several issues. The first is the previously described policies of banks and the banking regulator (macroprudential regulation). Second, firms have had to deleverage with no or very uncertain support of the banks in which case those firms without any serious liquidity issues are breaking their ties with Slovenian banks and stocking up their cash or turning to foreign banks. Third, the leading bankers say that there are no good projects avail-

[26] Actually, this was not a law but a political appeal to bankers. It had a great influence on the Slovenian financial system since some important Slovenian companies were able to service their credits, but were unable to repay their debt.

able to finance and at the same time fail to mention the high interest rates and other (rationing) requirements restraining the availability of credit. The banking sector is thus effectively changing its role from a 'risk manager' to a 'risk avoider'. As a consequence, banks are focusing on risk-free or almost risk-free investments, which results in a reduction of the expected marginal efficiency of investment (MEI) and the disappearance of the information capital in banks due to the discontinued relationship with their clients. Fourth, some sectors (service, SMEs) have been completely cut off from the banking sector due to the limited availability of collateral. Lastly, banks are increasingly administratively managed, with a complicated decision tree and the dominant role of risk departments.

Figure 2. Bank credit growth in Slovenia from 2009 to 2013



Source: Bole, Mencinger, Štiblar and Volčjak, 2014b.

In times when creditors would have to actively intervene in companies, establish crisis management and try to restructure companies with debt-to-equity swaps (and wiping out existing shareholders) as was already suggested in 2011 (Bole et al., 2011),[27] the banks took on a more defensive role of draining money out of firms through high interest rates, thereby avoiding restructuring and moving directly into bankruptcy. The banks also passively waited for the solution that had already been discussed in government circles about the establishment of a bad bank (DUTB). This in principle destroyed a lot of knowledge (embodied in enterprises with still 'alive' debt transferred to the 'bad bank') as it is taking time for DUTB to become fully operative (to build corresponding information), not to mention the very limited room for manoeuvre in liquidity support. It is necessary to stress that the problems and drawbacks of the bad bank variant of restructuring banks are already known, and were also known from other countries (for example Ireland) when the bad bank procedure was being formally launched.[28] So the majority of today's problems concerning DUTB are not unexpected (slow transfers of non-performing loans to DUTB; overcapitalisation of commercial banks, inadequate instruments available to DUTB; insufficient resources of DUTB to take the lead in a syndicate of creditors when actively restructuring companies, the slow and low recovery and thus much costlier banking rehabilitation). But some are completely unnecessary although fiscally very costly. The inappropriateness of the design of the EU's state aid procedure for crisis management increased the costs of banking rehabilitation even more because it prevented the conversion to equity of claims against companies with a positive cash flow upon being transferred to DUTB. Two options (both

[27] Miller and Stiglitz (2010) proposed the so-called 'super' Chapter 11 approach to substitute the procedures on a case-by-case basis normally employed in common bankruptcy law with a similar approach on a macro scale so as to internalise the externalities caused in the event of a resale of assets and to minimise destruction of the knowledge embodied in the going-concern status of enterprises put into restructuring. Capital restructuring and asset purchasing facilities are discussed in this light. The process of capital restructuring under 'super' Chapter 11 consists of three major measures (debt-equity swap, capital injection and loan write-downs).
[28] See, for example, Landier and Ueda (2009).

bad) are possible for such claims: twice as many fiscal resources would be needed to keep a firm alive, or the knowledge embodied in the going-concern status of such enterprises would be (completely) unnecessarily destroyed.

3.2 Legal and organisational changes in governing state ownership in Slovenia

When one does not know what to do, organisational changes are often introduced. On the other side, it is true that the management of state property was far from efficient. In some cases, the Slovenian government has become the manager of state-owned property, partly even individual ministries, KAD and SOD, the D.S.U. (a limited-liability management and consultancy company), which was established to handle the property of the former Development Company in liquidation, and some others. That is why the post-crisis period became seen as the period for legal and organisational changes in managing the state-owned property, and which can be summed up as follows:

- Pension Fund Management (KAD), which was established in 1996 with the intention to generate additional resources for pension and disability insurance. In the meantime, in addition to managing the equity shares it gained through the privatisation of firms, it developed a range of other services (First pension fund of the RS, Guarantee fund PPS, Closed mutual fund for public service employees…). The Slovenian Compensation Fund (SOD), which was established through a change in status in 2000, has maintained the fundamental task of taking care of the settlement of obligations to the beneficiaries of property that was confiscated from them in the past. In order to ease the management of some companies where both funds had the majority or at least an important portion of the ownership, and where due to the crisis or long-lasting poor corporate management companies fell into difficulties which is why they insisted on taking on crisis management, on 18 May 2009 PDP (Special Company for Corporate Advisory, Inc.) was established.
- On 20 October 2010 Slovenia received an order from the OECD that it has to manage its state ownership in a centralised, transparent and above all politically independent way from the executive branch of the government, political parties and various other interest groups. As a result, the Capital Assets Management Agency of the Republic of Slovenia (AUKN) was established.
- On 3 October 2011 KAD established its subsidiary Modra zavarovalnica. KAD transferred to Modra zavarovalnica the management of the majority of its funds (Closed mutual pension fund, Capital mutual pension fund, First pension fund, Guarantee mutual pension fund). In accordance with the Act on the Transformation of KAD and SOD (dated 23 October 2010), both funds were transformed into portfolio investors, which are prohibited from investing in shares in companies with limited liability. KAD thus became a mixed-activity insurance holding company. It was also given the obligation to provide EUR 50 million each year for the pension fund at the Institute for Pension and Disability Insurance of the Republic of Slovenia (ZPIZ).
- With the introduction of the Law on the Slovenian Sovereign Fund (SDH) (on 28 November) 2012 the management of capital investments owned by the RS was transferred to SOD and AUKN was thereby abolished. SOD managed state-owned capital investments until 26 April 2014, when SDH was established by the Law. SDH took over the rights as a single shareholder of KAD. Also PDP merged with SDH when SDH took care of the repaid transfer of KAD's share to PDP. SDH is responsible for managing capital investments it itself owns, those owned by the RS, for those which are owned by KAD under legal conditions, for capital investments in ZPIZ, in the insurance company Triglav, and for capital investments owned by the D.S.U. The government of the RS is the sole shareholder of SDH. The government of the RS performs the tasks and responsibilities of the SDH assembly. The supervisory board

has five members who are named by the National Assembly of the RS based on the government's proposal. The SDH Management Board has five members. The SDH Supervisory Board names a chairman and his or her members. The Economic and Social Expert Committee has seven members who are offering consultancy to the Management Board of SDH. Members are named by trade union federations or confederations which are representative on the state level, and which are members of the Economic and Social Council, although the experts are confirmed by the SDH Management Board.

3.3 How to proceed?

Minsky's (1986) financial instability hypothesis (FIH) is an appropriate basis for explaining the creation of the asset bubbles in Slovenia. The capital surge (which took place together with interbank borrowing abroad) triggered excessive optimism among agents and euphoria over investments, which was possible to be satisfied through borrowings from banks. Minsky's displacement ('game changer') took place by both the drop in the sovereign risk premium and the decision to launch a massive sell off of state-owned firms. This was followed by companies' investments in 'core business' in which yields increased disproportionately, purchases of shares' (purchases of domestically owned and foreign owned shares in South –East Europe which contributed to the equity bubbles' inflation, and real-estate purchases which contributed to the growth of the real-estate bubble. The mania over investments in Slovenia (based on Kidleberger and Aliber)[29] was stopped by the global financial crisis. With the sudden drop in external financial flows, borrowing markets tightened and banks became reluctant to borrow. An opposite process, a decline in investor optimism (revulsion) started, which transformed speculative investors into Ponzi investors and hedge into speculative ones[30] Moreover, as already shown, the crisis in Slovenia was amplified by the lack of appropriate timing (time trajectory) of policy interventions, correct sequencing of deleveraging different kinds of debt and appropriate calibration of policy interventions in the process of deleveraging (Bole, Prašnikar and Trobec, 2014a).

After six years of crisis, a few important conclusions can be presented for our discussion:

- In 2014 Slovenia did not achieve the amount of GDP from 2008. It lost approximately 30 percent of 2008 GDP during the period 2008–2014. This was one of the greatest losses among EU countries.
- Companies whose ownership shares were sold by SOD and KAD during the period 2004–2008 belonged to the following activities: industry (SOD – 44 percent; KAD – 40 percent); services (SOD – 42 percent; KAD – 41 percent); construction (SOD – 7 percent; KAD – 13 percent); financial holding company (SOD – 2 percent; KAD – 5 percent); other (SOD – 5 percent; KAD – 2 percent). KAD and SOD were cooperating on more than 40 percent of sales. SOD conducted 6 percent and KAD 4 percent of all transactions with foreigners. On 19 January 2015, around 15 percent of firms whose shares were sold by SOD and KAD in the mentioned period were foreign owned. In a further 10 percent of firms, foreigners were the minority owners. More than 20 percent of the companies were bankrupt or in the process of liquidation. A significant proportion of firms (more than 29 percent) had already been erased from the companies register.
- For managers' buyouts of the big companies (groups of connected firms: Pivovarna Laško, Perutnina Ptuj, Sava Kranj, Merkur….), SPVs (special purpose vehicles) were used (in some cases even as mailboxes), which financed purchases of ownership shares with the help of bank loans, and the collateral for these loans was usually shares of the just bought compa-

[29] See Kindleberger and Aliber (2005).

[30] In the Minsky financial cycle entrepreneurs move from robust financial positions with minimal credit outstanding and little leverage in normal times ('hedge finance') toward 'speculative investors', generating income sufficient to cover interest payments and then 'Ponzi' investors which also borrow to pay interest.

ny. In order to avoid takeover legislation, the transferees parked the ownership shares in related firms. When the 'anti-tycoon' clause was implemented and especially state-owned banks did not want to revolve already granted loans, banks took over the ownership shares (which had been given as collateral) since the SPVs were unable to repay the loans.

- Financial holding companies established by transforming the activity of non-financial companies which were often themselves the subject of managers' buyouts (Istrabenz, 31 Sava…) often acquired the money for their activity by borrowing from many different banks. They are subject to a similar conclusion as the group of firms in section three.
- Financial holding companies established by transforming the privatisation funds, PIDs (Zvon 1, Zvon 2, NFD, …), likewise borrowed money from banks to finance investments to purchase ownership shares of firms and to purchase real estate (especially in construction). After the asset bubble burst, most of them experienced a similar story as the group of firms in sections three and four. This also applies to some financial holding companies which were newly established (de novo) with or without the help of the banks.
- State-owned banks (NLB, NKBM) were the ones most engaged in corporate lending (they were also providing finances for real-estate takeovers). This also holds for the majority of medium and small banks, including foreign-owned banks. Only SKB, owned by Societe Generale, came out of this relatively unattached. After long-lasting debate on whether the main banks should be recapitalised or not, and after unsuccessfully implemented measures that were supposed to enable autonomous rescuing of the stranded banks' investments (the guarantee scheme in 2009 was put in place too late and also included firms with C and D credit ratings), the idea of a 'bad bank' was introduced in 2012, implemented in 2013, and became operative in the following year. We discussed the problems of the bad bank in section 3.1.
- On the other side, the intensive policies of deleveraging Slovenian firms led to the actual reduction of their indebtedness. Firm debt (loans and debt securities on gross operating surplus (EBITDA) for the median company fell from 5.3-fold in 2010 (EU=3.8) to 3.5-fold in the first half of 2014 (Bole, 2014). The propulsive part of the economy (especially international Slovenian firms) succeeded in reducing their over-reliance on bank financing. However, this has now become one of the biggest problems facing Slovenian banks. In the event these firms wish to borrow money, they borrow it from banks abroad. Firms no longer trust banks, which left them without any help in hard times.[32] Instead, they are accumulating their cash flow and adapting their investment decisions and decisions on the salaries' increases in the future.

Where can we find the primary reasons for the failure of the 'Transparent exit of the state from its ownership share in companies' programme from 2005? The lack of appropriate macro-prudential regulation in times of displacement as well as in times of the revulsion phase of the Minsky cycle as evident in the Slovenian case is certainly one of the main reasons for the current situation.

As the second reason, the state's non-transparent operations when privatising firms must be emphasised. A series of criticisms can be levelled at the state's actions during the entire

[31] Through disinvestments in its own divisions of oil products (the sale of OMV), Istrabenz spread its business in the food industry (purchase of Droga, Kolinska), and the hotel industry (purchase of Hotels Palace, Postojnska Cave, the construction of Kempinski Hotels Portorož). One of Istrabenz's most important investments in 2007 and 2008 was the purchase of almost 25 percent of Petrol's shares on the stock exchange. Since Petrol's management saw such investments as a hostile takeover, as a retaliatory measure it bought SOD and KAD's share in Istrabenz and published the takeover contract. The global crisis and fall in values on the stock exchange pushed both companies into deep trouble.

[32] A similar effect is known from the firms' and banks' behaviour at the time of the Japanese crisis 15 years ago, and their consequences can still be seen today (Caballero, Hoshi and Kashyap, 2008).

period of privatisation. We already mentioned some of them in the previous sections. Below we will show four visible cases of privatisation which represent the heart of the problems we are analysing: 1) NLB; 2) NKBM; 3) Mercator; and 4) Aerodrom Ljubljana.

First, let us offer some thoughts about the privatisation of both Slovenian banks. As we showed in section 2.2, the pressures for their privatisation were present for a long time. From today's point of view, we can describe their privatisation as a catastrophe. For example, instead of letting KBC take over NLB in 2005, Slovenian taxpayers had to take on the whole burden of the bank's recapitalisation in 2014 since KBC had already previously resigned from the bank's ownership.

In NKBM only the first privatisation phase was performed. However, even here, the initial model was changed and in the end mainly dispersed individual Slovenian owners were participating. It is worth noting that in 2009 the state avoided recapitalisation of the bank by selling shares on the Warsaw Stock Exchange and 'forcing' public companies to do so. Eventually the state recapitalised the bank and all the owners lost their assets in NKBM. Both cases will be included on one side of the debate, which is characterised by extreme protection of the so-called Slovenian 'national interest'.

The sale of Mercator, PLC and Ljubljana Airport, PLC will be classified on the other side, represented by extreme advocates of privatisation. Mercator, PLC is an important networking company with significant spillover effects because a vast network of Slovenian suppliers is linked to it. Its sale was non-transparent even at an early stage, when the equity shares of both state funds were sold. The two companies (Pivovarna Laško, Istrabenz, PLC), which through political pathways acquired shares in Mercator, were stripped from the banks as they were (after acceptance of the anti-tycoon legislation) unable to settle the debts that were secured by these shares. As the sale continued, the Mercator, PLC consortium of sellers led by the state-owned NLB did not take alternative bids into account, but already in the first round gave priority to the buyer that was Mercator's competitor. In addition, the purchaser possesses a variety of agricultural production plants that are not located in Slovenia. Further, its financial position was bad even before it bought Mercator, and purchasing it only made things worse. The financial industry, which was deciding on the sale of Mercator shares, was not convinced by the warnings about the national harm that would result from the sale (Bole, Prašnikar and Trobec, 2012b). Adequate macroprudential regulation was also missing in this case.

Ljubljana Airport, PLC is the central airport in Slovenia. It can therefore be placed among companies with a natural monopoly. Tellingly, the Czech Republic, although it privatised the majority of its companies, decided not to privatise Prague Airport. In the background of this decision was the fear that a private company would take advantage of the natural monopoly, increase the prices and obtain part of the consumer surplus that would otherwise belong to the consumer. We doubt that Slovenian governmental institutions calculated the increase in deadweight loss as a result of privatisation before making the decision to sell the airport. Even worse, the state, even though it had a majority stake through state-owned companies, did not make any decisions about the sale due to the withdrawal of its voting rights by the SMA decision. Other sellers (financial institutions) exclusively pursued their own private interest when selling the airport.

Two conclusions can be made on the presented examples. First, the decision on the privatisation of firms with networking connections (and strong spillover effects), and the privatisation of companies which have the characteristics of a natural monopoly should not be left for private agents to make. Private benefits are not the same as social benefits in such cases. Second, there cannot be any successful development to see if the privatisation process is not transparent. Hence, a privatisation process should be under special social supervision. Let us look at the interesting experiences of the Norwegian Government Pension Fund Global – GPFG. It was established in 1990 with two goals: 1) the Fund is a long-term vehicle which would allow for the preservation of oil revenues through the diversification of investments into international securities; and 2) it is necessary to protect itself against the risk of the 'Dutch disease' (Chambers et al. 2013). This strategy was developed through experience. The Parliament decided that the entire portfolio of the Fund would be international due to the possibility of incestuous action if the funds were to be invested in domestic companies. In Norway there was also a discussion on whether the public should be excluded from the review of the investment managers' activities. Should only the final results be examined or should the investment strategies and their implementation also come under scrutiny? There is an interesting argument as to why the people should be involved in the Fund's operations (transparency), although on the contrary the Fund would be more efficient if it did not operate publicly. "Because it is demanded by the Norwegian people" (Chambers et al., Ibid., p. 79). The Fund is today one of the biggest and most successful sovereign funds in the world.

Let us add another point. If networking among members of Slovenian state firms' Supervisory Boards represents one of the problems, it is not necessarily true that we can avoid this by selling the companies to foreigners. Diversification is an important concept economists use when talking about lowering risk. This is also true when it comes to the geographical diversification of buyers of state-owned companies.

The reasons for the further privatisation of state property in Slovenia are not only found in the poor corporate governance of these companies. Other countries also have state-owned enterprises, but many of them do not have such big problems as Slovenia. Something could already be done if the incestuous relationship in the management of state-owned enterprises is least partially eliminated (Domadenik, Prašnikar and Svejnar, 2015). However, this in itself would not be enough. Although they are owned by the state, companies need investments to develop. The predominant method of financing investments in Slovenia so far has been financing through bank loans, for which it is possible to say that significant difficulties have been encountered.[33] Especially in the Slovenian situation it will take some time for agents to accept that bank credits cannot entirely finance the investment ambitions of individuals or social groups. [34] If state-owned enterprises were more efficient than their privately-owned counterparts, they could finance their investments through internal accumulation. However, if the majority of state-owned enterprises continue to operate in such a way as today, this is not to be expected. Further, the budget of the Republic of Slovenia in the period ahead will not be able to take care of additional borrowing to provide financial resources for national companies. So how can state-owned enterprises in Slovenia obtain funding for their development?

Should the subsequent privatisation of state-owned enterprises be fast or slow? The response to this question brings us back to the start of our discussion. East Germany after the merger often appears as a successful fast privatisation example. The Treuhand had two objectives: to privatise the firms in its charge as quickly as possible to ensure that the firms it privatised would be able to compete and survive after privatisation. The second responsibility was often passed on to the buyers by requiring them to put forward a business plan that sought to keep each state-owned enterprise in its current line of business and established employment and investment targets for the future. Between 1990 and the end of 1994, when its privatisation activities ceased, the Treuhand had disposed of 13,000 state-owned enterprises (Brada, 1996). However, the cost of privatisation was substantial. In the course of its existence, the Treuhand took in US$ 50 billion but spent US$ 243 billion on privatisation. Moreover, the overall economic situation in East Germany is today not so magnificent.

[33] This is not only a problem in Slovenia. Although corporations provide a suitable way to raise capital in an uncertain environment, they can create a negative externality if their drive for profit leads to over-indebtedness on the credit market. With this, they delegate too much risk to creditors and ultimately taxpayers. This is due to the fact that some markets do not exist (missing markets). Bank lending could be replaced, for example, by so-called Arrow securities that enable risk-sharing so that in good times the owner of a security is allowed to obtain income, but in bad times he is not.

[34] Rimske Terme is one of the last examples of missing such a notion. The company was almost entirely built on credits. Because it was unable to repay its loans, it ended up in bankruptcy and was later bought, at a considerably lower price, by a private owner.

Hungary also sold the majority of its state-owned enterprises in a short time. Critics suggest they were sold too cheaply. At the same time, we observe that the Hungarian state is buying some companies back. Poland still has quite a lot of state-owned firms and is selling them gradually (it sells more when it has major budget problems - Hagenmejer et al., 2014). We also mentioned the Czech Republic whose rapid privatisation process generated bubbles that pushed it into a financial crisis by the end of the 1990s.

The Slovenian experience with the financial crisis, to which the autonomous developments in Slovenian financial markets in relation to the intended accelerated privatisation contributed a lot, is reason enough for caution in the following privatisation processes. Exaggeration in this area would, in the circumstances of a shallow financial market and day-to-day uncertainty in the global context, lead to already known processes that would demolish the fragile economic recovery from last two years.

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