Jelena Žarković Rakić*
Gorana Krstić**
Nermin Oruč***
Will Bartlett****

INCOME INEQUALITY IN TRANSITION ECONOMIES: A COMPARATIVE ANALYSIS OF CROATIA, SERBIA AND SLOVENIA

ABSTRACT: *This paper investigates the relationship between income inequality and different welfare state trajectories that three countries of the former Yugoslavia "south of the Alps" have taken over the three decades since the breakup of the country in 1990. It is remarkable that three countries emerging from a common (socialist) system have experienced diametrically opposing outcomes regarding inequality. Slovenia has one of the lowest levels of income inequality in Europe, Croatia an average level of inequality, and Serbia one of* the highest levels. The paper first examines the extent and nature of income inequality in the three countries before examining the determining causes of inequality, rooted in the evaluation of labour markets, education systems, and tax-benefit systems. It concludes that the divergent transition paths have created the different inequality outcomes observed in the three countries.*

KEY WORDS: *Income inequality, Welfare state, Labour market, Education systems, Social protection*

JEL CLASSIFICATION: D31, D63, I24, J51, P52

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*   University of Belgrade, Faculty of Economics, Serbia, jelena.zarkovic@ekof.bg.ac.rs
**   University of Belgrade, Faculty of Economics, Serbia, gorana.krstic@ekof.bg.ac.rs
***   Centre for Development Evaluation and Social Science Research, B&H, noruc@credi.ba
**** London School of Economics and Political Science, UK, will.bartlett@ekof.bg.ac.rs

INTRODUCTION

This paper investigates the relationship between income inequality and different welfare state trajectories that three countries of the former Yugoslavia "south of the Alps" have chosen over the three decades since the breakup of the country in 1990. These successor states are Slovenia, with one of the lowest levels of income inequality in Europe, Croatia with an average level of inequality, and Serbia with one of the highest levels. This paper examines the key factors that have produced inequalities in these three countries, each of which emerged as independent states almost thirty years ago from the same institutional base in a single country, Yugoslavia. We analyse how subsequent country-specific transition reforms have influenced the diverging levels of income inequality in these three countries. The reforms we investigate are in the policy areas of the labour market, education system, and tax and benefit policies.

When these three countries were Yugoslav republics they shared a generous and inclusive welfare system based on the principles of solidarity and equality. The welfare state was based on a universal public education system and Bismarkian social health insurance and pension provision, combined with in-kind benefits provided by enterprises in which employment rights were protected. Social assistance was provided through a range of family benefits, while the universal health and education systems provided comprehensive services that were mainly free at the point of delivery (Bartlett 2013). In 1976 Yugoslavia had a relatively low level of disposable income inequality with a Gini coefficient of 0.21 for the distribution of net personal income in the social sector (i.e., state enterprises), indicating a very low level of inequality derived from this income source (Flakierski 1989). The inequality in net personal income within the constituent republics of the former Yugoslav federation reflected the overall level of inequality in the country, at 0.23 for Croatia, 0.22 for Serbia, and 0.24 for Slovenia (World Bank online data, various years pre-1990). Despite the similarity in income inequality in the republics, divergence in levels of economic development and income per capita was wide and persistent, and was likely a major factor in the eventual break-up of the federation (Yarashevich and Karneyeva 2013). Another factor was the deep economic crisis that affected the country in the

1980s, which led to a fall in income levels and an increase in the poverty rate.[1] Nevertheless, throughout this period income inequality within the republics remained stable, reflecting the shared reduction in income across the population (Milanović 1991).

After the dissolution of Yugoslavia the welfare regimes of these three countries evolved in different directions, largely influenced by the varied experience of war and conflict, the different privatisation strategies implemented by their ruling elites, and the pace of their EU accession. Slovenia largely escaped the ravages of war in the 1990s and managed a process of gradual transition, preserving many of the previous egalitarian features of the Yugoslav system (Kraft, et al. 1994). It developed a coordinated market economy with strong institutions of wage bargaining between capital and labour, which underpinned its relatively low level of income inequality (Feldmann 2014).

Croatia was embroiled in a devastating armed conflict in the first half of the 1990s. In contrast to Slovenia, Croatia followed a path of rapid transition to capitalism in the early 1990s, privatising much of its industrial sector even while the war of Yugoslav succession was being waged in its territory. However, due to the low income level and the population's inability to purchase all the industrial assets, a form of mixed economy emerged in which the state retained a minority stake in many companies. This close involvement of the state in the economy led to the emergence of a system of political capitalism, in which political parties maintained a close involvement with the business sector (Bartlett 2018). The leaders of industry were closely networked with the ruling party in a system of 'crony capitalism' (Ivanković 2017), which inhibited the emergence of a dynamic entrepreneurial economy and led to a long period of stagnation and post-crisis recession after 2008. This type of mixed economy led to an inequality that is similar to the EU average.

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[1]   The poverty rate rose from 12.8% in 1983 to 25.7% in 1985, stabilising at that rate thereafter. "The descent into poverty for the already established urban population was, among other things, associated with the inability to procure replacements for worn out consumer durables. Televisions, washing machines, and other consumer durables suddenly became too expensive for an ordinary household. Increased rents and electricity bills sharply compressed the affordable standard of living below the accustomed level. This reversed the standard of living to a level that households might have had some 20 years earlier." (Milanović 1991:197)

Although Serbia was involved in the wars of Yugoslav succession in the early 1990s, it initially avoided armed conflict in its territory. However, UN sanctions in the 1990s and intense NATO bombing during the Kosovo war in 1999 severely damaged its economy. A legacy of the sanctions regime was the emergence of a form of political economy in which patronage networks cornered strong positions in the economy (Andreas 2005; Gould and Sickner 2008), leading to a system of state capture that has become prevalent throughout the Western Balkan region (Keil 2018). After 2000 a rapid privatisation policy was implemented in which unscrupulous buyers engaged in asset stripping and tunnelling purchased assets at low prices (Vujačić and Petrović Vujačić 2016). The best businesses were sold off, while the least productive firms and bankrupt enterprises remained on the books of the privatisation agency. This placed the huge burden of financing these loss-making enterprises on the state, while also providing a fertile breeding ground for the practice of clientelism and creating a large group of outsiders employed on low wages in the extensive informal economy (Cvejić 2016). Serbia became a 'candidate' for EU membership in 2013, the same year that Croatia became a member state (Uvalić 2010).

These different experiences led to different versions of capitalism in the three countries, and correspondingly different experiences of inequality.

INEQUALITY IN THREE COUNTRIES

Inequality in transition economies is generally thought to increase in the early stages of transition as resources shift from the state sector to the emerging private sector and the wage gap is widened by deregulation and liberalisation, reflecting the operation of market forces. This process is thought to come to an end as transition is completed, when wages eventually reflect the marginal products of workers' characteristics (education, age etc.) and competition restrains further wage disparity.

This process is reflected in the three countries studied in this paper. In Slovenia, Stanovnik and Verbič (2014) show that income disparity increased after independence up to 1993, but stabilised thereafter. They argue that this can be attributed to the introduction of a minimum wage, as well as effective tripartite wage bargaining managed through an Economic and Social Council. Wage inequality even decreased after 2005, partly due to income tax reform in 2005 and differentiated tax allowances in 2008.

In Croatia, early measures of inequality after independence based on the Household Budget Survey showed an increase in the Gini coefficient of income per household member from 0.276 in 1988 to 0.298 in 2002 (Nestić 2005). Taking a longer perspective, and using a variety of data sources, Hoffman et al. (2012) demonstrated that the Gini coefficient for wage inequality increased from 0.237 in the socialist period (from 1973 to 1988) to 0.277 during the early period of transition and conflict (1989–1995), and further to 0.308 during the later period of transition to a capitalist economy (from 1996 to 2008), finishing the latter period at 0.333 in 2008 just prior to the onset of the global economic crisis, which affected Croatia badly. The authors propose that this increase in wage inequality is consistent with increased returns to skills, and thus reflected an efficiently operating market economy (Hoffman et al. 2012: 216). The increase in market inequality in Croatia is shown to be greater than comparable measures in Slovenia, while the redistributive effort was lower (Čok et al. 2013).

Inequality in Serbia increased throughout the 1990s, even more than in Croatia. Krstić (2016) shows that the Gini coefficient reached 0.387 in 2013. She argues that this was due to the low work intensity of household members and the high proportion of people working in part-time, temporary, and self-employment arrangements, mostly in the informal sector. Kecmanovic (2012) calculates men's wage inequality as 0.315 in 2005, driven by changes in wage premiums. This represents a slight fall following the introduction of a minimum wage in 2000 by the new democratic government. As shown in more detail below, with the exception of pensions, direct taxes and social benefits have had a relatively low redistributive effect in Serbia due to the low coverage of social transfers, particularly monetary social assistance and child benefits, and the Serbian income tax system's very low level of progressivity.

Measures of inequality can now be compared based on the EU Survey of Income and Living Conditions (SILC) for Slovenia, Croatia, and Serbia. The SILC provides data on the inequality of market income (i.e. income before taxes and transfers) and inequality of equivalised disposable income (i.e. income after taxes and transfers) in the three countries on a comparable basis. As can be seen from Figure 1, in 2018 Serbia had the third-highest inequality of equivalised disposable income in Europe and Slovenia had the second lowest, while Croatia's inequality level was close to the EU average. Market inequality in Serbia was 22 Gini points

higher than in Slovenia, while in Croatia it was 8.9 points higher. After redistribution through the tax and benefit systems the level of inequality was much reduced in all countries, although the relative position of these three countries remained the same. The gap between the three countries was somewhat reduced by the redistributive effect of taxes and benefits, but remains large.

Figure 1: Gini coefficient of equivalised disposable income and redistributive effects of social transfers, 2018
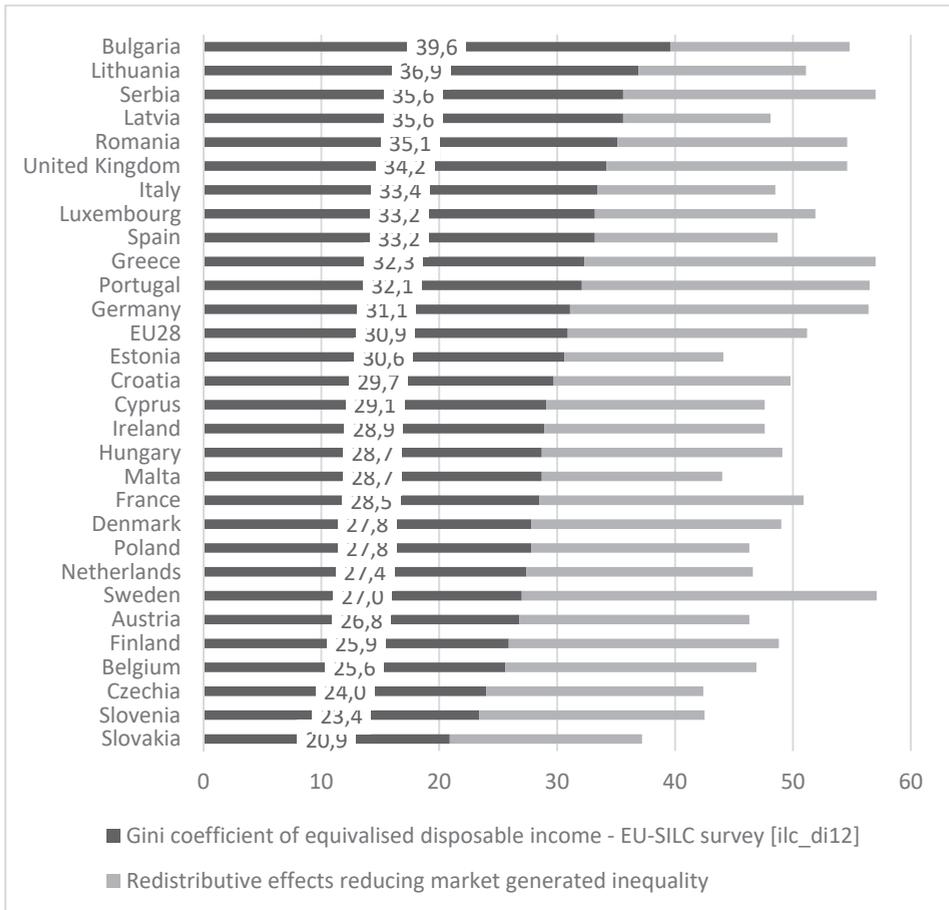
Source: Eurostat online data variable code [ilc_d12]. Note: the sum of the Gini for equivalised disposable income and redistributive effects is the market-generated Gini coefficient for total equivalised income.

The effect of redistributive policies in the three countries can be measured by the gap between market income inequality and disposable income inequality. In Serbia the inequality in equivalised disposable income was 24.2 Gini points below its total market income inequality, which indicates a significant redistributive effort. By comparison, the reduction in Gini points due to redistributive effects was lower in Croatia at 18.9 and in Slovenia at 19.4. Overall, despite a considerable reduction in Gini inequality through the redistributive power of the tax benefit system in Serbia, the initial market inequality in Serbia was so high that the redistribution effect was insufficient to influence the country's overall relative position. After redistribution the inequality of disposable income in Serbia was 14.5 Gini points higher than in Slovenia, while in Croatia it was 6.7 points higher (see Figure 2). Thus, even after redistribution, disposable income inequality was still extremely high in Serbia, in fact the third highest in Europe, while disposable income inequality in Slovenia was the second lowest in Europe.

Data from the SILC surveys for 2016 reveal that wages constitute the largest part of total gross income in each country, ranging from 59% in Serbia to 68% in Slovenia. Income from self-employment accounts for between 9% of total income in Croatia and 5% in Slovenia. Public pensions are the second-largest income source in each country, being largest in Serbia at 20% of gross income, just 14% in Slovenia, and 19% in Croatia. Social transfers other than pensions range from 8% in Croatia to 11% in Serbia. Correspondingly, the share of taxes and social security contributions is highest in Serbia and lowest in Croatia.

Krstić (2019) explores which sources of income (wages, self-employment income, pensions, taxes and benefits) have been the most important in contributing to income inequality in the three countries, using SILC survey micro-data. She applies the factor source decomposition approach developed by Lerman and Zityhaki (1985). Not surprisingly, considering their large contribution to total income, gross wages make the largest contribution to inequality. The second largest source contributing to overall inequality is income from self-employment in Croatia, pensions in Serbia, and income from capital in Slovenia. Pensions reduce inequality in each country, the largest impact being in Serbia. However, the contribution of social transfers other than pensions differs between the three countries: while they reduce inequality in Slovenia and Croatia (although on a small scale in Croatia), in Serbia social transfers favour the poor more than any

other income source, but nevertheless the amounts are higher for higher-income households in absolute terms (Krstić 2019). Finally, taxes and social contributions reduce inequality in all three countries, with the largest effect in Slovenia. In conclusion, Slovenia's lower disposable income inequality compared to Serbia (and Croatia) can mainly be explained by the more equal market-determined income distribution in Slovenia, combined with a higher redistributive capacity of taxes and social transfers. Overall, the Slovenian tax system is more progressive than in Croatia or Serbia, and social transfers are better targeted at the poor.

In the rest of this paper we delve deeper into the causes of wage inequality by exploring the role of labour market institutions in the next section and education systems in the following section, in each of the three countries. We also identify key differences in each country's social welfare system in order to better understand the causes of the different impacts of redistributive policies related to social transfers and pensions in each of the three countries.

LABOUR MARKETS

Since wage disparity makes the largest contribution to income inequality in the three countries, we explore the ways in which differences in labour market institutions contribute to the dispersion of wages. In each of the three countries the labour markets have performed poorly in recent years as a spillover effect of the eurozone crisis (a direct effect in Slovenia, which has adopted the euro as its currency), leading to high levels of youth unemployment. On the whole, Slovenia has the best labour market performance, with overall higher activity rates and employment rate and lower unemployment rates than in Croatia and Serbia. In 2018 the unemployment rate in Slovenia was 5.1%, compared to 8.2% in Croatia and 12.9% in Serbia (see Table 1 below). The proportion of workers in precarious employment has also been fairly stable in Slovenia but has increased in Croatia and Serbia over the last decade, reaching the highest levels in Serbia in 2017 (see Figure 2). As indicated in the previous section, wage inequality, determined by labour market institutions, is the predominant effect on income inequality, as also found in previous studies of transition economies (Milanović 1999, 2003; Mitra and Yemtsov 2006).

Figure 2: Precarious employment (% total employment)
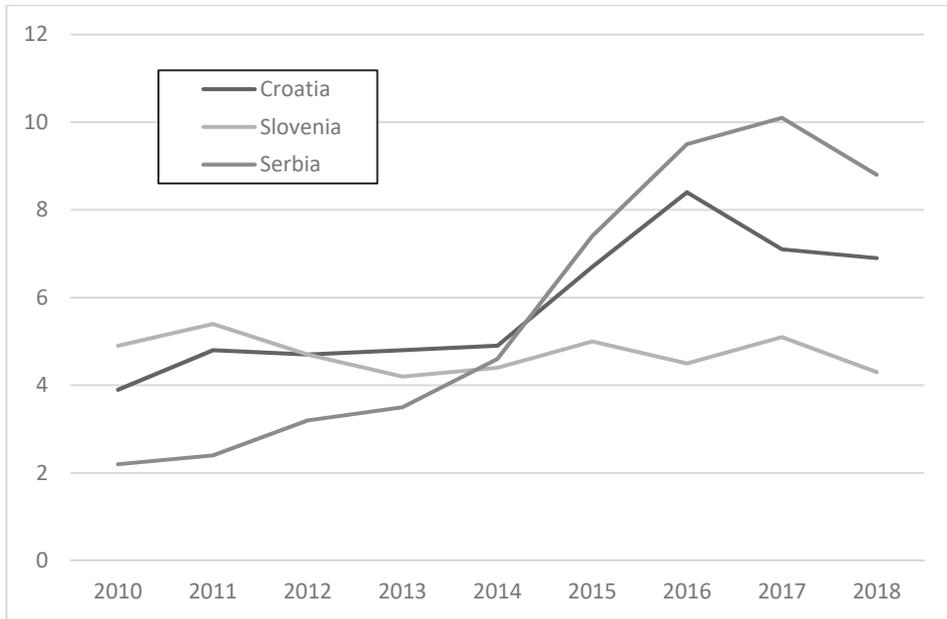
Labour market institutions such as wage bargaining systems have a large role to play in determining wage inequality. However, the effect of wage bargaining systems on the dispersion of wages is ambiguous as it depends on the number of workers who are covered by collective agreements. Wage-setting institutions that normally reduce wage disparity by reducing the 'skills premium' may have different effects when the labour market is segmented. Union power and coordinated wage bargaining might reduce wage disparity for workers covered by trade union agreements (insiders), while increasing downward wage flexibility for workers who are not covered by such agreements (outsiders, or those in the informal sector).

The Slovenian labour market has been governed by an effective wage bargaining system through the tripartite social bargaining mechanism (Feldmann 2014). The tripartite institutions were established at a national level in 1994, early in the transition process (Bembič 2018). Consequently, collective bargaining coverage

is highest in Slovenia, reaching 71% of the labour force in 2016.[2] By contrast, only 47% of employees in Croatia are covered by collective bargaining agreements. In Serbia collective bargaining coverage was 55% in 2010 but more recent data is unavailable: it is likely that it has fallen, mimicking the situation in Croatia. Almost all employees in the public sector are covered by collective bargaining, whereas in the private sector it is non-existent (European Commission 2017). Since about 30% of employees work in the public sector in Serbia it is likely that this reflects the proportion of employees covered by collective bargaining agreements.

Overall, Slovenian trade unions are more functional and more likely to obtain the desired outcomes, and as such are more powerful than those in the other two countries. Union density is higher in Slovenia than in Croatia and Serbia. According to the 2020 European Working Conditions Survey, 59.2% of employee respondents in Slovenia reported having a trade union representing them in the workplace, compared to just 45.2% in Croatia and 41.4% in Serbia.[3] Although the public sector trade unions in Croatia are relatively strong, in the private sector they are weak.

Given these patterns of the labour market institutions, the wage inequality outcomes have been predictable, with a less equal wage distribution in Serbia and Croatia than in Slovenia. Serbia has a particularly weak labour market. Using SILC survey data, Krstić (2016) finds that employees' income inequality in Serbia is related to the quantity and quality of employment, given that almost 50% of those in the lowest income quintile live in households with very low work intensity. Self-employed and part-time workers are most exposed to poverty risk, while many of the self-employed are informal workers who are outside the social protection system, earning one-fifth less than formal workers (Krstić & Sanfey 2011). Many part-time workers are employed in the informal sector, partly because part-time employees in the formal sector face very high marginal tax rates

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[2]   Data drawn from ILO online database: https://ilostat.ilo.org/data/

[3]   See European Foundation for the Improvement of Living and Working Conditions (EUROFOUND) European Working Conditions Survey 2020, online data: https://www.eurofound.europa.eu/data/european-working-conditions-survey

due to the low progressivity of the Serbian tax system. By contrast, Slovenia has a progressive personal income tax system.

Policy has also contributed to differences in wage inequality between the three countries. Slovenia has made great strides towards introducing a policy of flexicurity in the labour market (Lissowska 2017). Labour market reforms have proceeded slowly in Croatia (Matković 2017). Labour market institutions in Serbia have proved hard to reform due to the limited role of social partners, weak administrative capacity, and an absence of policy coordination. However, recent Serbian labour market reforms agreed under an IMF Stand-by Arrangement have encouraged greater labour market flexibility and have neglected the flexicurity arrangements prevalent in Slovenia. Consequently, they have had significant adverse consequences for income equality.

EDUCATION SYSTEMS

Besides labour market institutions, education systems also play an important role in determining market inequality. Education provides skills that are valued on the labour market as skills premia, and in competitive labour markets skill dispersion should be reflected in wage dispersion. Education systems are the fundamental means of skills development, although on-the-job learning is also important. Unequal access to educational opportunities is therefore an important determinant of the supply patterns of skilled labour and wage inequality. When the demand for high skills or high educational qualifications increases faster than the supply an increased pay level is expected for such skills, and equivalently for lower skill levels.

Reflecting this process, after the onset of transition the general level of pay for higher skilled workers in Slovenia increased as market forces gained more traction in the labour market than had been the case under the former socialist system (Orazem and Vodopivec 1995). However, over time the Slovenian educational system generated a greater supply of skilled workers and these skill premia began to fall, leading to less pronounced pay disparity (Bartolj et al. 2013). Reforms introduced in 1999 introduced new vocational programmes and a flexible vocational education system, which underpinned an increased and adaptable supply of skilled workers. This has been reflected in improved educational outcomes. The average PISA test score in Slovenia was 495 in 2018,

compared to 479 in Croatia and 439 in Serbia. Similar differences were recorded in relation to maths and science scores.[4] At the tertiary level, Slovenia rapidly expanded its supply of higher education graduates so that by 2018 some 36.3% of the population aged 25–54 had a higher education degree, compared to just 27.9% in Croatia and 25.7% in Serbia.[5] Moreover, the general collective agreements in Slovenia specified minimum and maximum pay levels for workers with different skill levels, differentiated according to sectoral agreements (Adams et al. 2017). This further muted the extent of market-determined wage inequalities in the labour market.

By contrast, Croatia and Serbia failed to introduce equivalent educational reforms and their vocational education systems have been unable to respond effectively to the large structural changes that have followed the transition process (Teodorović et al. 2016). School leavers in these countries face a challenging transition to the labour market. Kurelić and Rodin (2012) have shown that higher educational reforms have had little success in Croatia. As can be seen in Table 1, labour market indicators are more favourable for those with higher education in all three countries, progressively improving across educational levels. Particularly notable are the high activity and employment rates for tertiary-level graduates in Slovenia, and the correspondingly low unemployment rate (in 2018 just 3.7% for those with tertiary education, compared to 11.0% in Serbia). In Croatia, activity and unemployment rates are particularly unfavourable for those with only primary-level education or less. In Serbia the unemployment rate does not follow the same gradient of improvement with education level as in the other two countries. An upper secondary education graduate in Serbia has the same chance of being unemployed as a school leaver with only primary education or less. This indicates the weakness of the educational system in Serbia in comparison with the other two countries, reflecting as much as anything the role of upper secondary-level vocational education, which in Serbia is particularly weak in providing skills that support access to the labour market (Bartlett et al. 2014).

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[4]   The PISA 2018 maths scores for Slovenia, Croatia, and Serbia were 509, 464, and 448 respectively, while for science the scores were 507, 472, and 440.

[5]   Eurostat online data variable [edat_lfs_9904].

Table 1: Labour market indicators by educational level in 2018, 20–64 year olds (%)

	Activity rate			Employment rate			Unemployment rate		
	Croatia	Serbia	Slovenia	Croatia	Serbia	Slovenia	Croatia	Serbia	Slovenia
ISCED 0-2 (primary or less)	42.4	58.2	56.0	37.2	50.1	50.8	12.1	13.9	9.2
ISCED 3-4 (upper secondary)	71.3	71.3	78.0	65.1	61.6	73.7	8.6	13.6	5.5
ISECD 5-8 (tertiary)	86.8	87.4	91.3	81.5	77.8	88.0	6.1	11.0	3.7
All ISCED 2011 levels	71.0	72.5	79.5	65.2	63.1	75.4	8.2	12.9	5.1

Source: *Labour Force Surveys, Eurostat online data*

Moreover, access to educational opportunities differs across countries. In transition economies, inequality in access to education, training, and employment typically leads to young people being socially excluded (Kogan and Unt 2005). Secondary schools in the Yugoslav successor states continue to select students on the basis of ability as measured in performance tests at primary school, which leads to the allocation of the brightest students to grammar schools (known as gymnasia), the best vocational schools, and the most popular courses. While apparently offering equal opportunity to all students, those from disadvantaged backgrounds are more likely to fail such selection processes and to be directed toward schools with lower entry criteria. Consequently, children of middle-class parents are more likely to enter gymnasia, while children of working-class parents are more likely to enter VET schools, which tend to be less well-resourced, leading to poorer quality education for these groups (Bartlett et al. 2014).

Figure 3: Coefficient of variation in 2018 PISA test scores of 15 year olds in reading, maths, and science
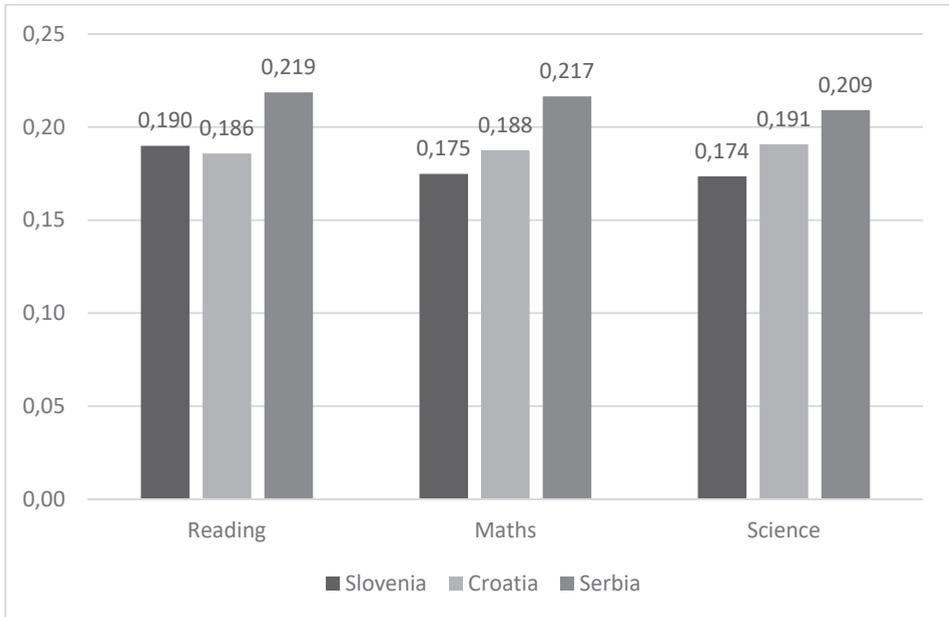
Such inequality in educational outcomes is more evident in Serbia than in Slovenia, with Croatia occupying an intermediate position. Figure 3 compares the coefficient of variation in PISA 2018 scores in the three countries and demonstrates that Serbia has the highest variation in maths and science test scores, while Slovenia has the lowest variation in all three subjects. This suggests that skill-related income dispersion may be related to the pattern of educational inequality, which may in turn be related to inequality in access to educational opportunities. Social differentiation may occur at entry into secondary school, which may then lead to intergenerational transmission of inequality. This process has been evidenced in Croatia, where students who attend VET schools are predominantly from low-income families with a low level of parental education, low motivation, and low learning outcomes (Matković, et al. 2013). Also, in Croatia at the tertiary level the children with a more privileged family background have a greater chance of attending university (Doolan et al. 2018). The social reproduction of inequality is also evidenced in Serbia by the high proportion of children attending vocational schools whose parents also attended such schools

(Bartlett et al. 2014). These socio-economic differences in family background play out in the PISA 2018 test scores. For example, whilst in Serbia 51.4% of low performers in reading (defined as achieving level 2 or below) come from the bottom quarter of households by economic, social, and cultural status, only 28.9% of low performers in reading in Croatia and 26.2% in Slovenia come from low socio-economic status households.[6] Additionally, 56.8% of students in Serbia with a low socio-economic profile attend schools whose principals consider that their school's capacity to provide instruction is hindered by inadequate or poor physical infrastructure, compared to 47.0% in Croatia and just 27.8% in Slovenia.[7] Thus, access to adequate educational opportunities is far more dependent on socio-economic class in Serbia than in Slovenia, with Croatia in an intermediate position, reflecting the market income distribution ranking of the three countries. This suggests that educational opportunity has a profound influence on inequality in the three countries.

SOCIAL PROTECTION SYSTEMS

Education and labour market distortions go a long way towards explaining the difference in the distribution of market wages in the three countries. However, this market distribution is subject to policy measures that redistribute income through tax and the benefit system. For example, Čok et al. (2013) find that Croatia has a higher level of post-tax income inequality than Slovenia due to the combination of higher pre-tax income inequality and a less redistributive tax and benefit system. Therefore, in this section we trace the different approaches to redistributive policies in the three countries.

Reforms to tax and benefit systems in Slovenia and Croatia have embraced a progressive personal income tax code, whereas income tax reforms in Serbia introduced a flat tax system (Žarković Rakic 2015; Arandarenko and Vukojević 2008). Slovenia introduced a very progressive personal income tax (PIT) system, similar to those in European Union countries, with five tax brackets, marginal tax rates of between 16% and 50%, and several tax allowances. The system was in place until 2004, when discussion emerged both in expert circles and the wider public concerning the necessity to simplify the tax code. With the start of the

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[6]   See OECD PISA 2018 Results Volume II, Table II.B1.2.6, OECD 2019
[7]   See OECD PISA 2018 Results Volume II, Table II.B1.5.22, OECD 2019

economic crisis in 2008, PIT reforms decreased the tax burden of low-income individuals (Čok et al. 2011). Croatia has rejected flat tax proposals and retained a progressive personal income tax with several tax brackets, with corresponding tax rates of 15%, 25%, and 35%. By contrast, in Serbia the personal income tax system introduced in 2001 was based on a 10% flat tax, which lacks both vertical and horizontal progressivity since the tax paid depends more on the type of income than on the size of income (CLDS 2003). A mandatory minimum social security contribution base is set at 40% of the average gross wage, so someone working part-time at the minimum wage could pay contributions on an income threshold higher than actually earned.

The three countries have evolved very different pension systems. The most radical pension reforms were introduced in Croatia, as recommended by the World Bank (Bartlett and Xhumari 2007). Under these reforms, a compulsory privately funded pension pillar was introduced. However, the pension reform did not succeed in eliminating the fiscal deficit, which had been one of its purposes (Šonje 2011). Serbia and Slovenia both rejected World Bank recommendations to introduce a compulsory private pillar into their pension schemes (Orenstein 2008). Both countries retained the Bismarkian state-managed system with contributions related to wage and salary levels. In Serbia, reforms introduced in 2003 replaced defined benefit pensions with a points-based system related to years of service indexed by prices (the least generous form of indexation), with a low minimum pension, supplemented by voluntary private pensions. Pensions have led to substantial reductions in market-determined inequality in Serbia (Djindjić 2014). The existence of the minimum pension, although extremely low at just 25% of the average wage, is the main reason why the Serbian pension system has a larger redistributive effect than the other two systems. In Slovenia the generous defined benefit public pensions indexed by wages have been complemented by a means-tested safety-net state pension of last resort (Guardiancich 2010). In Croatia the public pension pillar is indexed by a mix of prices and wages and there is no minimum pension.

In Slovenia, social assistance benefits have been gradually increased since 2001 (Kump et al. 2011). Child benefit coverage is extensive and the benefit near universal, as 86% of children receive it. Coverage has been gradually increased and the benefit design changed in order to direct it more at lower income groups.

In Serbia, spending on social assistance benefits has fallen from 1% of GDP in the early 2000s to 0.6% of GDP in 2017, far below the EU average of 1.3%. In Croatia social assistance benefits amount to 1.5% of GDP (Žarković Rakic et al. 2017). Spending on poverty-reducing cash transfers is relatively low in Serbia compared to Croatia and Slovenia (Žarković Rakic et al. 2017), with consequent implications for its tax and benefit systems' capacity to reduce income inequality. Krstić (2016) shows that social transfers have reduced inequality in Serbia as measured by the Gini coefficient to a greater extent than taxes, but by far less than similar transfers in most EU countries.

CONCLUSIONS

In this paper we have shown that income inequality increased following the transition to a market economy in the 1990s and 2000s in three of the successor states of former Yugoslavia. Yet in Slovenia, where the reforms were more gradual, the increase in inequality was more moderate than in Croatia and Serbia. In Slovenia the labour market institutions were more consensual and have been described as instituting a coordinated market economy. Strong social partners, including trade unions, and a culture of dialogue and consensual policymaking contributed to a philosophy of gradualism in the transition process and to the preservation of a range of social rights in Slovenia. In recent years, precarious forms of employment have become more prevalent in Croatia and Serbia than in Slovenia. The process of EU accession and Slovenia's early EU membership also supported the harmonisation of social and labour legislation with the EU acquis communautaire.

Education and skills are a strong predictor of wages in all three countries. According to SILC 2016 data, returns to tertiary education are higher in Slovenia than in Croatia and Serbia. However, the education system in Slovenia supports greater equality of access to students from lower socio-economic groups than in the other two countries, while the education systems in Croatia and Serbia have lagged behind Slovenia in reforms. This is reflected in the variance in PISA test scores, which is mainly lower in Slovenia than in Croatia and Serbia. Moreover, higher education has become more widely dispersed throughout the Slovenian population than in the other two countries. All this has contributed to a lower level of wage inequality in Slovenia than in the other two countries.

The process of europeanisation also improved the quality of policy debates among social policy actors in Croatia, while in Serbia the social inclusion paradigm came later, with little impact on welfare reforms. The tax and benefit regimes introduced in Slovenia have been relatively egalitarian and progressive, while in Serbia these redistributive mechanisms have been regressive for a long time and have failed to have a substantial impact on inequality. While the pension scheme in Serbia has a large redistributive effect, on its own this is insufficient to tackle the serious problem of inequality in that country.

It is remarkable that three countries that emerged from a common economic system have experienced such divergent experiences in the evolution of their labour markets and systems of education, tax, and social protection, with diametrically opposing outcomes for inequality. The relatively low level of inequality in Slovenia can ultimately be traced back to the relatively gradual approach to transition and the country having been fortunate in avoiding the same degree of disruption due to war and UN sanctions as suffered by the other two countries. Moreover, Slovenia preserved a consensual approach to wage bargaining with a successful model of tripartite social partnership. In Croatia, on the other hand, a rapid process of transition under wartime conditions led to the transfer of large portions of industrial assets to tycoon owners who typically stripped their enterprises of productive assets, rather than engaging in productive entrepreneurship to improve competitiveness. Alongside an unreformed education system, this has led to poor labour market outcomes, although the effect on inequality has been muted, leading Croatia to replicate the average level of inequality in Europe. In Serbia, weak labour markets, an unreformed education system, and the capture of the economy by politically connected actors has led to a form of political capitalism in which the income inequality that has emerged is one of the highest in Europe. Although the unreformed state pension scheme has had a large redistributive impact, this has not been enough to counter the relatively high inequality levels generated by market forces.

In conclusion, the combined evolution of labour market institutions, education systems, and tax and benefit systems has created divergent paths of inequality in three countries that emerged thirty years ago from a common socio-economic system, demonstrating the importance of policy reform over initial conditions in generating economic outcomes from the transition process.

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