

Vladan Ivanovic¹, Duro Duric², Goran Nikolic³
**PRIVATIZATION PROCESS IN SERBIA:
GENESIS AND POLITICAL ECONOMY CONTEXT**

The aim of this paper is to analyze the political economy context and the key developments of the privatization in Serbia. It presents the institutional history of the privatization process during the last 20 years. The analysis focuses on the political economy aspects of privatization. The conclusions on the privatization process in the last two decades could be mainly summarized as disappointing as for the economic performance. These kinds of results are mostly the consequence of the effect of different political factors.

Keywords: transition in Serbia; privatization; government policy; political economy; institutional history of privatization.

Владан Іванович, Джуро Джурич, Горан Ніколич
**ПРИВАТИЗАЦІЙНИЙ ПРОЦЕС У СЕРБІЇ:
ЕВОЛЮЦІЯ ТА ПОЛІТИКО-ЕКОНОМІЧНИЙ КОНТЕКСТ**

У статті проаналізовано політико-економічний контекст та ключові моменти розвитку приватизаційного процесу у Сербії. Представлено інституційну історію приватизації за останні 20 років. Аналіз зосереджено на політико-економічних аспектах процесу приватизації у Сербії. В цілому, підсумки приватизаційних процесів у Сербії за два останні десятиліття важко назвати економічно успішними. Невтішні результати приватизації у Сербії – результат впливу, в першу чергу, низки політичних факторів.

Ключові слова: перехід Сербії до ринкових відносин; приватизація; державна політика; політекономія; інституційна історія приватизації.

Рис. 1. Літ. 36.

Владан Іванович, Джуро Джурич, Горан Ніколич
**ПРИВАТИЗАЦИОННЫЙ ПРОЦЕСС В СЕРБИИ:
ЭВОЛЮЦИЯ И ПОЛИТИКО-ЭКОНОМИЧЕСКИЙ КОНТЕКСТ**

В статье проанализированы политико-экономический контекст и ключевые моменты развития приватизационного процесса в Сербии. Представлена институциональная история приватизации за последние 20 лет. Анализ сфокусирован на политико-экономических аспектах процесса приватизации в Сербии. В целом, итоги приватизационных процессов в Сербии за два десятилетия нельзя назвать экономически успешными. Неутешительные результаты приватизации в Сербии – результат влияния, в первую очередь, ряда политических факторов.

Ключевые слова: переход к рыночным отношениям в Сербии; приватизация; государственная политика; политэкономия; институциональная история приватизации.

Introduction

"Today's society is facing completely new existential conditions which we do not have any experience with" (Eucken, 1952). This is de Sismondi's thesis from the beginning of the industrial revolution that we could fully apply to the situation in which former socialist economies found themselves during the beginning of the last decade of the twentieth century. For Serbia, that period was the beginning of the first decade of the third millennium.

¹ Faculty of Economics, University of Kragujevac, Serbia.

² Institute of Economic Sciences, Belgrade, Serbia.

³ Institute for European Studies, Belgrade, Serbia.

A number of specificities of global institutional character, together with a very complex economic, social and political environment, and the strong effect of uncertainty that accompanied every aspect of transition, are some of the external factors which have strongly influenced the two decades of efforts in trying to establish market economies that are, in the historical context, the most effective and the most adaptable model of economic activities organization. The central feature of this process is the transfer of state and social property rights to various patterns of private ownership. Of course, privatization is not only a reflection of internal needs of transition economies, but it was often a condition for getting a greater support from international financial institutions (Stiglitz, 2008).

Although it can be said that the cradle of privatization is Great Britain (Robinson, 2003), the most significant changes in this area happened in former communist countries of Central and Eastern Europe. In particular, privatization was an institutional change of incremental character in developed economies, while it had systemic character in transition economies. The lack of developed commodity markets, the absence of dispersed business relationships, the lack of capital markets, the limited development of credit markets, a relative economic autarchy, and poor integration into the international financial system, all together caused the privatization in transition economies to be associated with a number of risks, which made its ultimate success uncertain and its end result limited. Regardless the initial similarity of the general institutional environment, the results achieved by countries differ significantly. This outcome can be explained by the fact that failures of a state during transition varied among different states in the same way market failures vary among different markets (Ramamurti, 1999). Although the transfer of ownership per se has an effect on financial, corporate and all other aspects of business, it's first of all a business result, and this is especially apparent for privatized enterprises, significantly influenced by the complex matrix of economic and political factors.

Even though it is possible to judge the reasons for privatization on the basis of normative and positive analysis, it is still necessary to point out that 4 explicit aims of privatization programs can be identified in transition countries. Namely, privatization should result in increased allocative and productive efficiency, improving the financial situation of the public sector as well as liberating resources for other purposes in the public sector – this most frequently refers to social policy (Sheshinski, Lopez-Calva, 2003). Finally, it is necessary to point out, especially if one takes into account the decades of experience in the operation of state-owned enterprises, that the main purpose of privatization is not simply to change ownership, but to hand it over to a truly better owner (Kornai, 1990).

This paper explores the specific features of privatization in Serbia in the period from 2002 to 2009. The paper is structured as follows: a brief institutional history of the privatization process in Serbia is presented in the second part of the paper; specific results achieved in the field of privatization are highlighted and analyzed in the third part, and the fourth part deals with the analysis of political economy context in which privatization in Serbia took place, as well as the analysis of the main directions of influence of political factors on the efficiency of privatization. The last part presents the basic conclusions and evaluation of the privatization process hitherto.

Institutional history of privatization in Serbia

With regard to the privatization process in Serbia, we can identify the two completely different stages in terms of the circumstances in which it was conducted, in terms of the objectives that the creators of economic policy had in mind for the privatization process, as well as in terms of the results achieved.

The main characteristic of the privatization process in Serbia is its lagging behind other transition processes in Central and Eastern Europe. The causes of this refer mostly to political characteristics and the political ideology before 2000, the political and legal features of the Yugoslavia breakup, 4 military conflict in which Serbia was directly or indirectly involved, as well as various international sanctions during the 1990s (Uvalic, 2001). Furthermore, key institutional aspects at the national level, especially a large increase in corruption and a devastated "rule of law", contributed to the creation of business environment which exerted permanent adverse influence on the economic performance of both private and state enterprises.

The first institutional framework for privatization was the Federal Law on Social Capital passed back in the age of SFR Yugoslavia in 1989, and supplemented by the Amendments in 1990. This bill encouraged the insider privatization or the so-called "spontaneous privatization" (Li et al., 2005), considering there were a lot of privileges for the current and former employees. However, as disintegration tendencies grew in the mid of 1991, Serbia adopted the Law on Transforming Social into Other Forms of Property, which kept the basic idea of the preferential status of insider privatization (Uvalic, 1992). During the following 3 years, until January 1994, Serbia was exposed to inflationary tendencies of gigantic proportions – Serbian hyperinflation was the second strongest, and the second longest in the world history (Dem et al., 2001). In such circumstances, employees were able to acquire shares in the company very cheaply. 70% of all social enterprises started privatization during these 3 years. Moreover, 80% of the capital was in the hands of private owners (Zec et al., 1994).

However, because hyperinflation significantly decreased the capital value for new owners, most of whom were employees, had to pay, all firms that have previously been privatized had to get into the revaluation process on the basis of Capital Revaluation Law, 1994. This process reverted the privatization to its beginning, because many people who had acquired some property under hyperinflation, and these were almost exclusively employees, were unable to pay the revalued amount. The end result was that 97% of the previously privatized capital returned to the social form, with only 3% retained by private owners (Bolcic, 2003). The final result of the revaluation practically meant going back to the beginning of the privatization process.

Solutions that followed the new Law on Ownership Transformation in 1997 presupposed 3 types of privatization: autonomous privatization, privatization according to a special program and privatization with the consent of a founder. This law was only nominally focused on speeding up the privatization process, while in reality it was so burdensome, that it largely prevented or slowed down the privatization. The focal point of this privatization program was the autonomous privatization, which gave many preferential conditions to insiders and thus represented continuity with previous legal solutions to a large degree. Another important feature of the Law of 1997 was the principle called "voluntary privatization", which meant that the extent and the time of privatization depended solely on management and employees of a

company, which slowed down the process even more. In summary, it can be said that various legal solutions in the period from 1989 to 2001 were primarily focused on maintaining the status quo and that they never aimed at the construction of a modern market economy, considering the absence of reforms in other areas, such as monetary, tax, and even political ones. On the contrary, privatization was the instrument of political positioning. This fact is most directly evident on the example of the privatization of "Telekom Serbia". The company was sold to Greek and Italian partners for 1.8 bln DM, which enabled a rapid influx of financial resources used for financing pensions and salaries, and which, in turn, raised government popularity in the short term (Begovic, 2000).

In conclusion, it can be said that poor legal decisions directed to insider privatization, and the lack of reforms in key areas of economic and political systems prerequisite for a successful privatization, such as the weak rule of law, high level of corruption, irresponsible monetary and fiscal policies, and isolation from foreign countries, caused very limited results during the first decade of transition. Given the experience and the results during this time, it would be most appropriate to mark it as a transition without transformation. The final result of the privatization in the 90s was that more than 60% of GDP was still being created through the system of social and state enterprises.

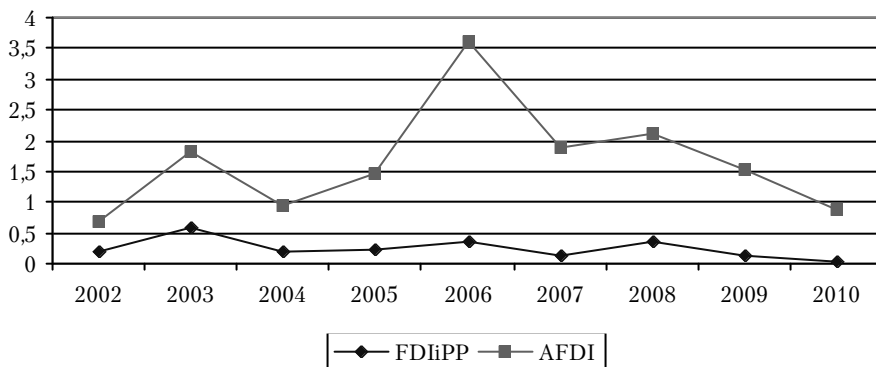
While the most important challenges of the first decade of the XXI century for most Eastern and Central European countries were linked to the process of European integration and their joining the EU (Csefalvay, 2001), in 2000 Serbia finally embarked on building a free and open market economy, in which privatization was an integral central part of transition efforts. The failures of privatization programs based on insider privatization during the 90's and the poor performance of those privatized at this time in this way, confirm in a severe way, among other things, the so-called "Berle-Means" hypothesis, i.e. that dispersed ownership is a significant explanation of an ineffective corporate governance.

Considering the bad experience and the results achieved on the basis of the institutional arrangements in the 1990s, the new Law on Privatization, adopted in 2001, envisioned direct sales as the primary method of ownership transformation. This type of transformation represents the most efficient method of ownership if the advantages and disadvantages of other alternative methods are taken into account (Brada, 1996). There were two methods of operational sales of companies – tenders and auctions. In addition, this process was strongly influenced by the new political elite's perception of political nature of the whole process. Above all, it could be seen in the fact that privatization was the critical point of the reforms that could make the whole process irreversible. Furthermore, due to the catastrophic state of public finance, direct selling of companies should have contributed to their considerable consolidation (Vujacic, Petrovic-Vujacic, 2011). This was to be accomplished in two ways. On the one hand, the elimination of soft budget constraints would have reduced the budget expenditures. On the other hand, the influx of financial resources from the sales was supposed to contribute to the budget revenues. Regarding the first aspect, the result was limited (state-owned enterprises subsidies replaced continuously growing subsidies to state-owned enterprises), while the impact on revenues was weak and short-term.

Some macroeconomic evidence on privatization results after 2000

If we analyze the main business indicators of privatized enterprises, it is obvious that there was a significant improvement in economic performance. This primarily refers to the indicators of productivity and profitability, and partly to exports. The increase in revenues in the period from 2002 to 2010 was 69%, and reached the total value of 3.5 bln euros. In the area of profitability, privatized companies made the profit of 200 mln euros in 2010, unlike the losses of 2002, which amounted to 102 mln euros. At the same time, SOEs that were not privatized were continuously at a loss, whereas productivity i.e. revenue per employee in privatized companies increased 3.4 times.

However, taking into account the volume of FDI which was directly realized through privatization in the period from 2002 to 2010, the results were disappointing in the real sector. In fact, only during the first two years some funds were earned in the form of foreign direct investment through privatization process (FDI & PP) – 182 mln in 2002 and 589 mln euros in 2003, while those numbers were disappointing during the rest of this period. Throughout the period, FDI and PP (1.018 bln euros) represented only 7.89% of the aggregate foreign direct investment (AFDI – 12.918 bln). FDI, PP and AFDI movements are presented on Figure 1.



Source: Privatization Agency of Serbia.

Figure 1. The relationship between aggregate FDI and FDI realized through privatization process

Discussing FDI and privatization, it is necessary to stress another important fact. Namely, it is often pointed out that enterprises in transition economies that are privatized by foreign companies show extraordinary performance in comparison to those privatized by domestic capital (Estrin et al., 2009). The latter is probably being the case in Serbia. However, it is especially important to emphasize that terminated contracts of privatization consist of more than 99% of domestic legal and natural persons, and the remaining 1% are almost exclusively foreigners of Serbian origin and Serbian companies whose owners have Serbian citizenship. In other words, although the presence of foreign companies was limited in the privatization process, they were far more responsible in assuming management of new enterprises.

Another major macroeconomic aspect refers to the impact on employment. Basic conclusion, when it comes to Serbian experience after 2000, is that there has been a huge reduction in employment in privatized companies. The annual loss of jobs was on average 45 ths in the period from 2002 to 2011. The number of employ-

ees at these enterprises decreased by 410,000, i.e. the number of employees in privatized enterprises was reduced on average by more than 60% (Nikolic, 2012). However, this could only partially be a criticism aimed at the privatization process, since much of it can be interpreted as a problem of excessive employment that had burdened the operation of SOEs, but also as a problem of inadequate staffing structures in these companies. In this sense, Serbia is no exception since all former communist economies faced the problem of excessive employment at state enterprises (Goering, Sarangi, 2012). For example, it is considered that around 3 mln jobs that were under the control of "Treuhandanstalt", were lost in Eastern Germany (Bruckner, 1997). In addition, companies were often inefficiently big in the system of central planning (Hanousek et al., 2009), so unemployment was partly created as a result of restructuring. Data for Serbia also contradict some of the conclusions of other studies on transition economies that show a relatively modest impact of privatization on unemployment (Estrin et al., 2009). It seems that Serbia's experience confirms the frequently pointed out rule which says that it is difficult to achieve other welfare economic objectives through privatization (Bruckner, 1997).

Political economy context of privatization process in Serbia

The analysis of political factors assumes an inevitable place in the analysis of privatization in the transition context (Bortolotti, 2005). Outside this political economy context, privatization and its achievements can hardly be understood (Chong, Lopez-de-Silanes, 2005). Serbia is no exception in this sense.

In the case of Serbia, it is necessary to point out that the governments after 2000 used a strategy of revenues maximizing. The companies that had the best economic performance and certain market perspective had the priority in being sold (Cerovic, Dragutinovic-Mitrovic, 2007). There were several complementary explanations for such behavior of an executive. On the one hand, privatization should not be seen only as market-driven phenomenon, but also as a process strongly influenced by the state of public finance in a country (Bortolotti, 2005). In addition, part of the explanation for this type of privatization dynamics arises from the fact that these companies are likely to function effectively even after privatization, which will provide support for further privatization and absorb subsequent political costs of privatization of worse companies more easily (Rodrik, 2006). However, the inflow of substantial financial resources by selling the most profitable companies may seem discouraging for further reform efforts taken by government. On the other hand, this is also a limiting factor for the success of privatization process in its later stages, as late-comers are worse-off companies which have even less chance of survival or of finding adequate owners at the consolidated market.

The role of political leadership, in the sense of energetic and effective implementation of the reforms, should not be ignored, as it was confirmed by the experiences of Mexico, Peru and Argentina (Ramamurti, 1999). Moreover, the profile of the companies that enter the privatization process may vary depending on political leadership, as it was the case of Poland, so the companies privatized during the Walensa period showed some considerable differences from those privatized during that of Kwasniewski (De Fraja, Roberts, 2009). In Serbia, however, there are no considerable comparable differences because there is an almost complete convergence of the political elite when it comes to strategy and policy of privatization.

One of the conclusions of hitherto studies on privatization is that it takes place faster in presidential systems rather than in the systems of consensus/proportional democracy (Bortolotti, 2005). This seems to be the case for most of transition economies, whereas Serbian privatization was additionally prolonged by the existence of inefficient political system before 2000. In addition, the governments of Serbia consisted of a large number of coalition partners in the period after 2000, which, due to the existence of a large number of political actors with veto power, slowed down the whole process even more. The slow dynamics of privatization process is often emphasized in Serbian literature as the important characteristic confirming the fact that privatization was unsuccessful. However, it is important to say that the problem is not so much to do with the slow dynamics of enterprises privatizing, but more with the dynamics and the development of complementary institutions, such as a market-supporting legal framework. This aspect is especially obvious if we look at the EBRD transition indicators.

Finally, perhaps the most important disadvantage, which is especially noticeable in the case of failed privatizations that make up 23.23% of the totally realized privatization programs where the majority of buyers were natural persons (91.81%), came from the legislative process and was strongly influenced by political factors. Namely, giving preference to natural persons (in terms of them being able to pay the privatized company in installments over the period of 6 years) over legal persons (obliged to pay all at once) when purchasing companies, created prerequisites for a strong influence of corruption, cronyism and rent-seeking behavior. Moreover, the behavior mechanism of owners in the majority of failed privatizations consisted of the following: new owners of a company used the privatized company as collateral to get a loan; then they would produce a large amount of cash and buy a new firm in the process of privatization, again as a natural person. After that, they would end the contract of the purchase of the first company with the Privatization Agency, not paying the second installment. They would use the other company to raise a loan that would pay the price for the company that had previously been privatized (Vujacic, Petrovic-Vujacic, 2011). The final result of privatization in these cases was severe asset-stripping.

Conclusion

During the period prior to 2000, the times of the so-called "transition without transformation," the politically motivated maintaining of the status quo, i.e. the power structure called "ancien regime" (state socialism), was the primary target in the area of designed and implemented process of privatization. The main objective was maintaining the political and economic control of the society (Lazic, Sekelj, 1997). Although that privatization had its positive sides in the period after 2000, particularly in the area of influence on the changes in corporate governance and the (limited) inflow of capital and know-how (Cvetkovic et al., 2008), the whole process, as well as other spheres of public policy, were characterized by a significant presence of state failures. Although the disadvantages of the privatization processes in other transition economies were available ex ante, Serbia still did not manage to bypass them in its own transformation. Moreover, it is difficult to draw a clear "Maginot line" in their identification, it seems that the ones from the political sphere predominantly shaped the unsatisfactory results of privatization. It may also seem that the words of Anne

Krueger completely describe the reform efforts in Serbia: "Meant Well, Tried Little, Failed Much" (Rodrik, 2006). Finally, it is argued that the countries that have not gone through the privatization have had the best experience with it. It does not seem surprising that the country in question is Switzerland.

References:

- Analiza efekata privatizacije u Srbiji, Agencija za privatozaciju, Republika Srbija.
- Begovic, B.* (2000). Telekomunikacije: privatizacija na srpski nacin, Republika, No. 232.
- Bolcic, S.* (2003). Blocked Transition and Post-Socialist Transformation: Serbia in the Nineties, William Davidson Institute Working Paper No. 626.
- Bortolotti, B.* (2005). Political institutions and privatization policy. *Journal for Institutional Comparisons*, 3(1): 12–18.
- Brada, C.J.* (1996). Privatization is transition or is it? *Journal of Economic Perspective*, 10(2): 67–86.
- Brucker, H.* (1997). Privatization in Eastern Germany: A Neo-Institutional Analysis, Frank Cass & CO. Ltd, Germany.
- Cass, A.R.* (1988). Privatization: Politics, law and theory. *Marquette Law Review*, 71: 450–523.
- Cerovic, B., Dragutinovic-Mitrovic, R.* (2007). Privatization effects: some evidence from Serbia. *Transition Studies Review*, 14(3): 469–487.
- Chong, A., Lopez-de-Silanes, F.* (2005). The truth about privatization in Latin America, in: A. Chong and F. Lopez-de-Silanes (Eds.) *Privatization in Latin America: Myths and Reality*, World Bank Publications, pp. 1–65.
- Csefalvay, Z.* (2001). Economic transformation: from central planning to market economy, in: N. J. Smelser and P. B. Baltes (Eds.) *International Encyclopedia of the Social and Behavioral Sciences*, pp. 4141–4146.
- Cvetkovic, M., Pankov, A., Popovic, A.* (2008). Balkan latecomer: the case of Serbian privatization, in: V.I. Lieberman and J. D. Kopf (Eds.) *Privatization in Transition Economies: The Ongoing Story*, pp. 221–260.
- De Fraja, G., Roberts, B.M.* (2009). Privatization in Poland – what was government trying to achieve. *Economics of Transition*, 17(3): 531–557.
- Dem, A., Mihailovici, G., Gao, H.* (2001). Inflation and Hyperinflation in 20th Century: Causes and Patterns, Columbia University – School of International and Public Affairs.
- Doh, P.J.* (2000). Entrepreneurial privatization strategies: order of entry and local partner collaboration as sources of competitive advantage. *The Academy of Management Review*, 25(3): 551–571.
- Estrin, S., Hanousek, J., Kocenda, E., Svejnar, J.* (2009). The effects of privatization and ownership in transition economies. *Journal of Economic Literature*, 47(3): 699–728.
- Eucken, R.W.* (1952). *Grundsätze der Wirtschaftspolitik*, J.C.B. Mohr (Paul Siebeck), Tübingen.
- Goering, E.G., Sarangi, S.* (2012). Durable goods produced by state owned enterprises. *Economic Modeling*, 29(3): 893–899.
- Gouret, F.* (2007). Privatization and output behavior during the transition: methods matter! *Journal of Comparative Economics*, 35: 3–34.
- Hanousek, J., Kocenda, E., Svejnar, J.* (2009). Divestitures, privatization and corporate performance in emerging markets. *Economics of Transition*, 17(1): 43–73.
- Kornai, J.* (1990). *The Road to a Free Economy, Shifting from a Socialist System: The Example of Hungary*, W. W. Norton and Company, New York, USA.
- Lazic, M., Sekelj, L.* (1997). Privatization in Yugoslavia (Serbia and Montenegro). *Europe-Asia Studies*, 49(6): 1057–1070.
- Li, S., Ouyang, M., Zhou, D.* (2005). Modeling privatization as a firm strategy in transition economies. *Journal of Business Research*, 58: 37–44.
- Nikolic, I.* (2012). Privatizacija u Srbiji – Između Euforije i Razocarenja, Savetovanje Naucnog društva ekonomista Srbije.
- Pesic, V.* (2007). State Capture and Widespread Corruption in Serbia, CEPS Working Document No. 262.
- Ramamurti, R.* (1999). Way haven't developing countries privatized deeply and faster? *World Development*, 27(1): 137–155.
- Robinson, C.* (2003). Privatization: analyzing the benefits, in: D. Parker and D. Saal (Eds.) *International Handbook on Privatization*, Edward Elgar Publishing Limited, pp. 41–59.

- Rodrik, D.* (2006). Goodbye Washington Consensus, hello Washington Consensus? A review of World Bank's economic growth in 1990s: learning from decade of reform. *Journal of Economic Literature*, 44: 973–987.
- Roland, G.* (1994). On the speed and sequencing of privatization and restructuring. *Economic Journal*, 104: 1158–1168.
- Sheshinski, E., Lopez-Calva, L.F.* (2003). Privatization and its benefits: theory and evidence. *CESifo Economic Studies*, 49(3): 429–459.
- Станчић, В. и З. Грубишић* (2011). Повезаност политичких и економских реформи у процесу транзиције – искуство транзиционих земаља, са посебним освртом на Србију. *Политичка Ревија*, 10(3): 241–258.
- Stiglitz, J.* (2008). Foreword, in: G. Roland (Ed.) *Privatization: Successes and Failures*, Columbia University Press, pp. 1–19.
- Uvalic, M.* (1992). *Investment and Property Rights in Yugoslavia – The Long Transition to a Market Economy*, Cambridge University Press, Cambridge, UK.
- Uvalic, M.* (2001). Privatization and corporate governance in Serbia (FR Yugoslavia). *CESifo Economic Studies*, 49(3): 429–459.
- Vickers, J., Yarrow, G.* (1991). Economic perspective on privatization. *The Journal of Economic Perspectives*, 5(2): 111–132.
- Vujacic, I., Petrovic-Vujacic, J.* (2011). Privatization in Serbia: results and failures, *Economic Annals*, 56(191): 89–105.
- Zec, M., Mijatovic, B., Djuricin, D., Savic, N. (eds.)* (1994). *Privatizacija – Nuznost ili sloboda izbora*, Beograd, Jugoslovenska knjiga i Ekonomski Institut.

Стаття надійшла до редакції 02.04.2013.