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Innovation and Spatial Dynamics**

Privatization in Serbia - Success or Failure? Observing the Progress and the Macroeconomic Effects of a Delayed Privatization Process

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Abstract: The fall of the Berlin Wall in 1990 signified a new era in European history. Most of the former socialist countries started a process of transition from centrally planned to the market economy already in 1990. Many studies have been undertaken with the aim of analyzing the effects of privatization and transition in former Soviet countries, but there is significantly less literature about privatization progress in former Yugoslav countries. Therefore, the purpose of this study is to fill in the gap in the existing literature by focusing on exploring the progress and effects of the privatization process in Serbia. This study will provide the reader with an insight into the progress and effects of privatization process in Serbia. It will also give a further understand about the reasons behind the delay of reforms and how that affected the success of Serbia's privatization in the last ten years. Finally, the study will also throw light on the present situation and what reforms need to be more emphasized in the future.

Key words: privatization effects, delayed transition, progress, Serbia

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CIS	The Commonwealth of Independent States
EBRD	European Bank for Reconstruction and Development
EU	European Union
EUR	Euro
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
IMF	International Monetary Fund
NATO	North Atlantic Treaty Organization
SAA	Stabilization & Association Agreement
SBC	Soft Budget Constraints
SEE	South East European Countries
SFRY	Socialist Federal Republic of Yugoslavia
SOE	State Owned Enterprise
UN	United Nations
WWII	The Second World War

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1. INTRODUCTION

The fall of the Berlin Wall in 1990 signified a new era in European history. Two big socialist State Unions- the Soviet Union and the Socialist Federal Republic of Yugoslavia (SFRY) disintegrated into smaller independent countries. Most of the countries started a process of transition from centrally planned to the market economy already in 1990. The process of transition is very complex and includes many different aspects that need to be taken into concern when designing a transition strategy. Market reforms require changes in economic structure, political arrangement, institutional framework etc. Since many countries were included in this process there was a big debate about choosing the “right” transition strategies. One of the most important aspects of transition is privatization of state owned companies (SOEs).

Many studies have been undertaken with the aim of analyzing the effects of privatization and transition in former Soviet countries, but there is significantly less literature about privatization progress in former Yugoslav countries. Therefore, the purpose of this study is to fill in the gap in the existing literature by focusing on exploring the progress and effects of the privatization process in Serbia. The Serbian case is unique in a way that the whole transition, hence the privatization process, was delayed due to unfortunate events during 1990s. Held back by war and sanctions, the economy started recovering in 2000 when market reforms officially began and when the old political regime was abolished. That is why Serbia is often called “a transitional latecomer”. The outset of Serbia’s transition and privatization process happened when the other former socialist countries had already ten years of reforms behind them.

With regard to the theoretical framework and the diverse literature used this study is aiming to answer following questions: *“What were the main macroeconomic effects of the privatization in Serbia during the first ten years of the privatization process? How do the observed effects of privatization in Serbia comply with the expectations about efficiency gains indicated by the theoretical framework?”*

In order to answer these questions a variety of secondary data will be used. First of all, the study will provide the overview of Serbia’s transition and privatization progress in comparison with Croatia and Slovenia. This will be followed by an analysis of the macroeconomic situation of Serbia in order to grasp effects of privatization. Consequently, the study will present outcomes of the privatization process up to year 2011.

This study will provide the reader with an insight into the progress and effects of privatization process in Serbia. It will also give a further understand about the reasons behind the delay of reforms and how that affected the success of Serbia’s privatization in the last ten years. Finally, the study will also throw light on the present situation and what reforms need to be more emphasized in the future.

The paper is structured as follows. Next section will present the theoretical background for the relevant topic. It is divided into four sub-sections and each represents one of the arguments. Section after will provide an overview of the relevant literature. Subsequent part demonstrates the data and methodology used. It is followed by section about empirical research. This section is divided in three different sub-sections. Finally, the last section is devoted to concluding remarks.

2. WHY DO COUNTRIES PRIVATIZE? THEORETICAL BACKGROUND

There is an ongoing debate among scholars if private ownership is more efficient than state ownership. During the decades after World War II many developing and East European countries established a system of central planning and nationalized their industries. SOEs were formed as an important part of such systems. In order to understand the underlying logic behind nationalizing enterprises it is important to note the SOEs were very often formed to make sure that political control of production exists and that there is better provision of public goods (Estrin et al, 2009). There was also a belief that state intervention will be able to correct market failures and therefore sustain economic development. SOEs were also seen as a good way of maintaining high employment rates since governments were guaranteeing full employment and equitable income distribution (Estrin et al, 2009).

Already in the 1980s it was noticed that the performance of state enterprises was disappointing. These enterprises were not profitable and inefficiently large. From that time many economists as well as international organizations such as World Bank and IMF started arguing for privatization as a best way for countries to establish clear property rights and market driven economy. The main reason why scholars are arguing for private over state enterprises is that many studies discovered that private enterprises are more efficient. To put it in other words, state enterprises do not contribute to the efficient allocation of resources and do not follow demand-supply forces in an economy. There are four main arguments that theoretically support efficiency problem and will be presented in the sub-sections below.

2.1. Incentives Problem

Maggison states that it is easier to understand the incentives of managers on top of a private enterprise since they will try to manage a private firm with the aim of maximizing the owners' wealth (Meggison, 2005). This further means that the management has incentives to make decisions that maximize profits and increase efficiency. These decisions could be, for example, to invest in research and development, new products, various improvements, etc. In short, this refers to investing in anything that is estimated to bring higher profits and minimized costs. In addition, Schleifer argues that incentives to innovate,

reduce costs and improve quality are the main contributors for the “dynamic vitality” of free enterprises (Shleifer, 1998). In addition, these incentives are one of the explanations why capitalism is economically superior to socialism (Shleifer, 1998). Incentives of private firms’ managers become even more emphasized in the case where firms are not protected from competition (Meggison, 2005). There is a higher motivation for improvements and better performance when competition is sharper and when firms cannot count on government protection.

In contrast, managers of state enterprises have weaker incentives. Since they are employed in a state enterprise they cannot benefit directly from increased profits. At the same time, if they decide to reduce cost of production they will have to bear the majority of the costs such as dissatisfied suppliers and workers. Therefore, even if they are aware that the enterprise is not very efficient they will choose not to pursue with the potential improvements or innovating new product. These incentives get even weaker in a situation where the enterprise has a monopoly position in the economy as a provider of a crucial services or products (for example state-owned oil company or telecommunication enterprise). If the enterprise with monopoly position faces difficulties due to inefficient production, managers could count on state support, since these enterprises are very important for the country. In the case of monopoly it would also be harder to see the inefficiency of the enterprise. Additionally, with the absence of competition, consumers will have no other choice, hence the market pressure for improvements will not be sufficient to give incentives for change in efficiency.

Dixit describes one more important reason for weaker incentives of managers of state firms. He argues that managers’ lack of motivation for efficiency improvements is influenced by reporting to multiple masters (Dixit, 1997). For example, in the American political framework managers of SOEs are answerable to several different constituencies such as Congress, federal agencies and possibly state and local government bodies (Dixit, 1997). All mentioned constituencies have different objectives. Hence, while managers of private firms try to satisfy mainly shareholders, managers of state firm have variety of different interests to fulfil.

2.2 Monitoring Problem

Even if the state tried to increase the profits problem of corporate governance could hamper the performance of the enterprises. Since state enterprises have a dispersed type of ownership, i.e. they are owned by the state and hence by citizens, there are no incentives to monitor the decision and business strategies of SOE’s managers. Given that the ownership is spread among numerous persons, none of them has enough incentives to properly observe the actions of managers. One of the reasons is that cost of the monitoring will fall on the back on the person/entity that takes such action and the potential gains from successful monitoring is supposed to be shared with the public. The first scholar who advocated the

idea that state enterprises are inefficient because of the poor incentives of dispersed owners was Alchian (Meggison, 2005). There is also a low pay off for the potential efforts and resources put in monitoring. For example, if the political party is acting in harmony with society's best interests the cost of monitoring SOE's managers would probably be very high, whereas in return the electoral pay off of such actions will be quite low (Meggison, 2005). Moreover, state enterprises in most of the cases are not allowed to go bankrupt and citizens cannot sell them, so there is no punishment for inefficiency that managers should be afraid of (Vickers and Yarrow, 1991).

Vickers and Yarrow also point out that managers of state firms are protected from effective monitoring with asymmetric information (Vickers and Yarrow, 1991). SOE managers are the ones who have all the relevant information about business strategies and costs, so in case the state decides to monitor the actions, the manager will have a negotiating advantage. He could operate with the available information in his best interest. On the other hand, private owners could put constraints on managers' discretionary behaviour through high-powered incentives for managers or through the operation of the market for corporate control (Estrin et al, 2009). To sum up, lack of proper monitoring of SOE managers together with lack of external constraints allowed managers to fulfil their own goals.

2.3. Inefficiency due to Soft Budget Constraints (SBC)

As it was noted in the previous sub-section, managers of state firms are very seldom penalized for the sluggish performance of the enterprise. It was also mentioned that the state will rarely let SOE go bankrupt or shut them down. However, the question is what happens in a case when there is not enough capital to keep up with production? It was most often the case that government was providing necessary resources despite being aware that these enterprises are not efficient and profitable. This action is usually referred to as "soft budget constraints".

The concept of soft budget constraints was initially formed by Kornai who was the first to notice this phenomenon when analyzing the Hungarian economy in 1970s. This was the time a socialist economy was experimenting with the introduction of market reforms (Kornai et al, 2003). Even though SOEs were formed with the aim of obtaining profit, the state did not permit collapse of those enterprises which were reporting only losses. Substantial subsidies were made every time these enterprises needed resources in order to bail them out. Managers recognized that they could always count on government support, even after constant losses and this affected their business decisions and incentives. The soft budget syndrome is usually linked with transition economies and privatization processes, but some economists showed that it could be also applied to other countries. Sheshinski and Lopez-Calva estimated a model which showed that public ownership inevitably leads to soft budget constraints (Meggison, 2005). Their study demonstrated state financial intervention to failing enterprises whenever the political costs of allowing a state enterprise

to go bankrupt outweighed the political cost of subsidization (Meggison, 2005). When trying to impose hard budget constraints the government would rather make efforts to restructure SOEs than liquidate them. Consequently, large state enterprises are too politically important for the government to let them fail. In turn, SOEs are protected from the harsher discipline by the weaknesses they have.

It was also argued in the literature that hardening budget constraints will not lead to restructuring since there will be a lack of the entrepreneurial incentives associated with outside investor (Estrin et al, 2009). This claim is linked with the idea of incomplete contracts. Incomplete contracts refer to tendency of state managers to make a routine decision while managers of private firms would rather turn to innovating and stimulating entrepreneurship (Estrin et al, 2009). Taking all the characteristics of the soft budget constraints into concern, it is not surprising that one of the prior reforms suggested by the international organizations was hardening of the budget constraints, preferably through privatization as a way of breaking bonds between the state and enterprises. EU made hardening of budget constraints one of the preconditions for potential member countries (Bruker et al, 2005).

2.4. Governments Tend to Misuse SOEs

Three theories presented above show what are potential causes for inefficiencies of state enterprises when assuming that government is acting in people's best interest. However, if one assumes that government's actions are driven with some other, non-economic objectives, the argument against state ownership becomes stronger. As Dixit describes state enterprises and government agencies must operate in the framework of politics (Dixit, 1997). As SOEs are controlled not by markets but political authorities, there is a lot of space for rent seeking¹ actions. It would not be possible to write about state enterprises and privatization without mentioning the role of the politics since they are inseparable. Schleifer and Vishny argue that one of the reasons for the low efficiency of the state enterprises are political pressures that authorities pose on SOE's managers (Schleifer and Vishny, 1994). In their study, they demonstrated that in cases when managers are controlling state enterprises politicians are using subsidies and bribes to make managers fulfil political goals (Schleifer and Vishny, 1994). They also show that SOEs will be inefficient even in the situation of fully competitive markets, mainly as a result of pursuing non-economic objectives. Those objectives are maintaining excess employment, building factories in politically (but not economically) desirable locations and pricing outputs at below market clearing prices (Meggison, 2005). Boycko, Scheifer and Vishny support this argument by claiming that the links between enterprises and politics should be severed. Consequently, this would lead to restructuring and increase of efficiency. Because of this reason, they

¹ Rent seeking presents actions with the aim of gaining economic benefits by manipulating or accessing political and institutional arrangements.

believe that privatization combined with effective stabilization policy is one of the ways for achieving the goal of depoliticising firms (Boycko et al, 1996).

3. PREVIOUS RESEARCH

Ever since the transitional changes started after the fall of the Berlin Wall they have been driving a lot of attention. There is an extensive literature on various transition aspects in, for example Russia, Czech Republic, Poland and many other countries. Since the issue of this paper is to observe the effects of privatization in Serbia, only papers exploring different aspects of privatization will be presented. In order to build a wider picture of the privatization process and get the feeling about potential outcomes the first sub-section will present some of the seminal papers about privatization in transitional countries. Due to peculiarities of Serbia's transition the next sub-section will give the notion about the research on Serbia's transition process. The final sub-section presents what kinds of studies have been done so far about privatization process in Serbia.

3.1. Previous Research on Privatization

One of the main issues many authors were interested in is about the link between methods of privatization and growth of a country. For example, Bennett, Estrin and Urga (2007) by using a cross-country panel model have investigated how different methods of privatization affected growth in transitional countries. They found that only voucher privatization was associated with faster growth, while neither private sector growth nor capital market development made significant contributions (Bennett et al. 2007). Gouret explored what methods were dominant in transition countries and, additionally, what macroeconomic influence they had. He discovered there were improvements in economic performance in countries when the main methods were gradual sales (Gouret, 2007). In addition, Stiglitz (2003) criticizes the "shock therapy"² approach suggested to all transition countries in 1990s by IMF and the World Bank. He argues that Poland and China succeeded in establishing economic growth due to gradual reforms the authorities chose in these countries (Stiglitz, 2003, p.181). Bennet, Estrin and Maw (2005) tried to investigate why countries in many cases chose mass privatization as the primary method of privatization. Their study revealed that mass privatization has been rational not only in a political sense but also in an economic, since it was estimated that the method of mass privatization was revenue-maximizing (Bennet et al., 2005).

Another big group of studies was focused on relations between effects of privatization and ownership structure in transition countries. For instance, Estrin, Hanousek, Kočenda and

² "Shock therapy" approach refers to sudden and radical changes that occur when a country is in transition from a central-planned to a market economy. Shock therapy reforms include price liberalization, massive privatization of state-owned enterprises and trade liberalization.

Svejnar (2009) made an extensive study about effects of privatization and ownership. The study was undertaken in order to summarize what had been learned so far and what new conclusion can be derived. They discovered that the privatization effects are mainly positive in Central Europe, but smaller in quantitative term when companies were sold to foreign owners (Estrin et al, 2009). The effects are also bigger in the later transition period (Estrin et al, 2009). In the Commonwealth of Independent States (CIS)³ privatization to domestic owners had a negative or insignificant effects, while to foreign owners the effect was positive or insignificant (Estrin et al, 2009). Bennett and Maw (2003) explored how partial state ownership affects firms' performance. They concluded that in the two-firm differentiated-product oligopoly model they used a partial state ownership could be effective. However, it depends on the competition in the product market and the weights in the welfare function (Bennett and Maw, 2003). Djankov and Claessens (2000) performed their study on 6000 privatized and state-owned enterprises in seven different East European countries. The results showed that the privatization effects are stronger in later periods than in the beginning of privatization. In addition, enterprises that were privatized in two years had the same level of labour productivity as state-owned enterprises, while those privatized for three or more years outperformed state-owned firms (Djankov and Claessens, 2000). Frydman, Gray, Hessel and Rapaczynski (1999) analyzed performance of privatized enterprises in several transitional countries and discovered that ownership type affects the performance of enterprises in a different way. Privatization to an outsider demonstrated more positive effects on enterprises' performance than privatization to an insider owner (Frydman et al, 1999). Zinnes, Eilat and Sachs (2001) investigated if the change of ownership structure is sufficient to improve economic performance. The research revealed that privatization would give certain gains in case when privatization is "deep", meaning that systematic institutional reforms have also been carried out. The authors concluded that while ownership matters, institutions matter just as much (Zinnes et al, 2001). Moshiri and Abdou (2010) came to similar conclusions. When exploring the effects of ownership structure, they realized that privatization per se does not have positive influence on economic growth. On the other hand, when accompanied with regulations the impact on economic growth was significant and positive (Moshiri and Abdou, 2010).

Some authors chose to focus on a number of different aspects of privatization. For instance, Bjornskov and Potrafke (2010) analyzed what was the influence of government ideology on privatization in transitional countries of Central and Eastern Europe. The study discovered the tendency of market-oriented governments to promote small-scale industries rather than large-scale ones (Bjornskov and Potrafke, 2010). On the outset of the transition in 1990s leftist governments were advocating public ownership, but the affinity decreased in the later years from mid 1990s to 2007 (Bjornskov and Potrafke, 2010). Banerjee and Munger

³ The Commonwealth of Independent States (CIS) is an association of former Soviet countries that was formed after the break of Soviet Union in December 1991. Current member states are Azerbaijan, Armenia, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Uzbekistan and Ukraine.

came to the conclusion that political benefits are the main explanations behind the timing, pace and intensity of privatization (Banerjee and Munger, 2004). In addition, the results demonstrated that countries that adopted policies earlier were the ones that started implementation later (Banerjee and Munger, 2004). Crivelli (2012) focused on financial aspect of privatization. His study was about links between privatization and the fiscal decentralization reforms. The main findings of the study showed that privatization alone will not significantly contribute to establishment of fiscal discipline to local governments (Crivelli, 2012). However, privatization coupled with reforms in the banking sector (which restrain access to soft financing) showed to be successful at hardening the budget constraints of local governments (Crivelli, 2012).

3.2. Previous Research on Transition in Serbia

The transition of countries to a market economy is a very complex process and can be observed from different aspects. The changes occur not only in the structure of the economy, but also in political arrangements, social values, population mindset etc. Therefore, there is variety of topics explored in the ongoing transition process in Serbia. For example, Bajec and Jakopin explored what are the challenges of industrial development in transition in Serbia (Bajec and Jakopin, 2009). Taking into concern that transition in Serbia started later than in other South East European countries (SEE) it is not a surprise that these authors claimed that after 8 years of transition Serbia is somewhere half way through with this process. In addition, it was stated that Serbia is lagging behind EU countries more and more. They report that Serbia still did not catch up with the lag that was created in 1990s. While it reduced the gap with other SEE countries, at the end of 2008 GDP in real terms was 15% lower than in 1990 (Bajec and Jakopin, 2009). The authors claim that in the beginning of the transition, industry in Serbia was two decades old and even after 8 years of transition the industry is still playing the most important role in exports of the country (Bajec and Jakopin, 2009). The main problems as they see them are obsolete technology, low level of investment, high production costs and presence of incompatibility with the EU standards (Bajec and Jakopin, 2009). The authors concluded with the claim that the main challenge government is facing is how to transform the industrial structure and bring it closer to European standards without reducing employment (Bajec and Jakopin, 2009).

Simon (2010) chose to observe transition progress from a different angle. He explored what were the growth mechanisms in three transitional countries- Serbia, Hungary and Russia. He motivates the choice of countries by stating that all three of the countries have tried to introduce the market reforms already in 1960s, but failed to raise efficiency mainly because they were too limited to affect incentives (Simon, 2010). When countries decide to take the road of transition to market economy it is expected that these reforms will foster long-term economic development. In the case of Serbia he named the process “triple transition”

claiming that Serbia is undertaking economic reforms, political changes and state- and nation-building (Simon, 2010). The author used mathematical models in order to investigate what were the main contributing factors to economic growth in transition countries. With the aim of splitting economic growth into its fundamental factors he applied the endogenous development model whose parameters could be relevant for any country of the world (Simon, 2010). He found that in Serbia labour had the most important role in macroeconomic growth while in two other countries it was the mobile technical progress (Simon, 2010). This finding is not unexpected since it was discovered that in Serbia a considerable part of the workforce was transferred to manufacturing which was the most important part of the industry.

Another factor that was studied in relation to economic growth of transition countries is the level of inflation. One of the important questions in macroeconomics is how inflation affects economic growth. A majority of studies showed that inflation has actually a negative influence on economic growth of a country. The inflation that occurred in the Serbia in 1990s was one of the highest in the world. When the transition started in 2000 it was more or less under control. In his paper Murić (2010) investigated what was the influence of inflation on economic growth in Serbia during first few transition years. The finding was in accordance with the majority of studies undertaken on this topic; inflation had a negative influence on Serbian industrial production. To be more specific, he estimated that a rise of 1% in inflation is associated with a 0.23% decline in industrial production (Murić, 2010).

Transition countries are also very often dependent of foreign capital. In case of lack of financial resources they rely heavily on foreign direct investments. In order to attract FDI countries need to convince investors that the business climate is suitable for investments. Therefore, a group of Serbian authors, including Obradović, Fedajev and Nikolić, undertaken research about business environment in the Balkan countries. Furthermore, they also explored what would be the main factors for attracting FDI and ranked the countries according to preferences of investors (Obradović et al, 2012). Since the business environment is a complex concept, the authors used multi-criteria methods in order to compare the alternatives and rank the countries. They constructed a few different scenarios and analyzed the countries in each of them. Their estimation showed that Serbia would be in the last three places in all the scenarios together with Albania and Bosnia and Herzegovina. The authors concluded that the reforms Serbia has undertaken so far were not sufficient and that there is still a long way to go in order to have a favourable business environment (Obradović et al, 2012). There reforms would include a compound set of reforms such as economic, institutional, structural etc.

Another way for a transition country to solve the problem with lack of capital is to borrow financial resources from international institutions. The increase of external debt was one of the main causes of the economic growth in Serbia over the past few years (Hrustić, 2011). Hence, the increase of trade deficit started burdening Serbian economy. Hasiba Hrustić

analyzed how borrowing from international organizations actually influence Serbian economy. On one hand she found that external debt was growing faster than GDP (Hrustić, 2011). This is not surprising taking into concern that Serbian economy had scarcity of resources and low level of lending in the beginning of transition. On the other hand, loans from international institutions encouraged reforms for economic stabilization and further adjustments according to EU standards (Hrustić, 2011). She concluded that straightening links with the international organizations could contribute to economic growth and further development in Serbia.

One more author dealing with the issue of business environment in Serbia is Vesna Paraušić (2007). She tried to explore what contributes to the low level of competitiveness of Serbian enterprises. Business environment was assessed as unfavourable in both macro and micro terms. The author sees ineffective institutions and insufficient infrastructure as fundamental problems of the Serbian economy (Paraušić, 2007). She points out that both institutional and infrastructural changes should be made a priority in transitional reforms. These changes would show that the government is ready to cut the links with the previous political arrangement while at the same time making Serbia more appealing for investments (Paraušić, 2007).

Some of the authors decided to explore different aspects of transition in Serbia. For example, Kecmanović (2012) devoted her research to the wage inequalities during the transition process. Socialist economies are usually thought to have compressed wage inequality since the ideology is based on "equality". Compared to other socialist countries, for instance Soviet Union, the income distribution was more dispersed in Yugoslavia due to large regional differences in economic development (Kecmanović, 2012). Using the Lemieux decomposition methodology and five annual Labour Force Surveys the author tried to investigate changes in the distribution of earnings in the first few years of transition, between 2001 and 2005 (Kecmanović, 2012). She found that the main causes of changes in wage inequality are wage premiums. The contribution of alteration in composition of the labour force is very small (Kecmanović, 2012). When the effect of private sector growth is concerned the study revealed that change in the size of private sector combined with wage premiums account for an average of 25% of the changes in inequality for the observed period (Kecmanović, 2012). The author concluded that falling inequality together with growth of real incomes can be interpreted as positive indicators of recovery from 1990s. She also points out that some effects such as low participation in the labour force are hard to grasp, but could also influence wage inequality.

One more way to explore characteristic of labour market is to investigate how much influence labour had in transition countries. Miroslav Stanojević (2003) made a study about workers' power in transition economies comparing Serbia and Slovenia. He claims that the main reason for different transitional paths of Serbia and Slovenia lies in the different reactions of political elites to the workers' strike movements (Stanojević, 2003). Stanojević

argues that authorities in both countries had two possible choices, either to undertake gradual market reform combined with strong respect for workers' interests; or refusal of market reforms and pacification of the labour force (Stanojević, 2003). The author argues that Serbian political elite intentionally chose the second choice while in Slovenia the case was opposite and resulted in workers' inclusion in transition. He concluded that the main reason for Slovenia having one of the most successful transitions and Serbia an abortive one is the difference in reactions to strong labour movements (Stanojević, 2003). Prevailed nationalism contributed to delaying of transitional reforms.

3.3. Previous Research on Privatization in Serbia

As was noted before, Serbia started its transition process later than other South East European countries, officially in 2000, but reforms actually started a year later, in 2001. When taken into concern that it has been only slightly more than a decade it is reasonable that there are not many studies dealing with the topic. This is particularly true in the case of privatization. One of the first attempts to observe early effect of privatization was made by Milena Jovičić (2005). To be more specific, she investigated what effects privatization had on labour market in Serbia. As it was discovered in the previous studies on privatization different levels of unemployment came as a result of different policies regarding public firms (Jovičić, 2005). Depending on the rigidity of budget constraint the authorities had two main choices, to cut the wages or to reduce employment. Ex-Soviet countries were more prone to cutting wages while Central and East European countries had proclivity for reducing employment. She found that, as in many transition countries, privatization was coupled with a rise in unemployment in the first four years of privatization. One also needs to bear in mind that the Serbian case was unique in a way that unemployment problems in the beginning of 1990s were worsening with the influx of refugees. The author concluded that a rise of the private sector in the observed period was not sufficient to alleviate consequences of redundancy in the public sector. In addition, she pointed out that privatization and economic restructuring did not have favourable effects in the first few years and that there was a need to put more emphasis on job-creating policies (Jovičić, 2005).

Another study trying to grasp early effects of privatization in Serbia was undertaken by Cerović and Mitrović in 2007. The aim of their research was to investigate the effects of the new privatization plan adopted in 2001. Various privatization indicators were taken into concern in attempt to capture early privatization outcomes. These indicators include revenues from privatization, changes in structure of enterprises by ownership status, number of privatized firms, etc. (Cerović and Mitrović, 2007). They discovered that the new plan from 2001 has changed the ownership structure of enterprises. But, it was also noted that privatization and forming of new firms did not have equal impact in all sectors, the biggest impact was present in trade and processing-industries regarding private ownership

growth (Cerović and Mitrović, 2007). In addition, the authors found out that revenues and number of transactions started slowing down after 2003.

On the other hand, a study by group of Serbian authors led by Mirko Cvetković reported rather positive preliminary results of privatization. They claimed that during the observed time, from 2001 till 2007, Serbian government accomplished an “impressive progress” even though there were many constraints, such as political instability and unique social ownership (Cvetković et al, 2008). It was assessed that the variety of methods employed by the Privatization Agency (tenders, auctions, bankruptcy and pre-sale restructuring) were suitable and gave good results. It was specially stressed that there was a thorough preparation for each of the units that were supposed to be privatized, while the sales were always competitive and transparent (Cvetković et al, 2008). They argue that all the actions were guided with the aim of establishing change in corporate governance and at the same time increasing productivity in Serbian enterprises making them more attractive for investors.

One of the later studies that came up with different conclusions was performed by Sonja Bunčić (2012). She explored privatization models in the countries of ex-Yugoslavia and tried to find out why some countries experienced more and others less successful process of privatization. Despite some differences among the countries all of them started the transition with similar social legacy- social ownership and worker self-management, but achieved different results (Bunčić, 2012). As one of the main problems the author pointed out tendencies of authorities for trying to keep the old arrangements even after the transition started. Further on, these actions were putting pressure on choice of privatization models (Bunčić, 2012). She concluded that the main contributors to the Serbian sluggish privatization performance were the misuse of social ownership specifics, weak public institutions and corruption (Bunčić, 2012).

The latest study about the results of privatization was published by Vujačić and Vujačić in 2011. The authors expressed the surprise for the fact that there is such a scarcity of studies exploring the results of privatization taking into concern it has been going on for a decade. Their study was the first one that tried to investigate the scope, type, results and institutional failures of privatization with emphasis on the period between 2001 and 2011 (Vujačić and Vujačić, 2011). Taking into concern that the estimation of privatization failure is around one in four, the authors decided to further explore what are the weaknesses of the legal and economic aspects of the current privatization model (Vujačić and Vujačić, 2011). In addition, monitoring and implementations flaws were analyzed. The authors discovered that one quarter of unsuccessful privatizations was caused by new owners not being able to keep the level of activity of the enterprises or not keeping the continuity of business (Vujačić and Vujačić, 2011). When it comes to auctions, most of the unsuccessful privatization occurred due to the failures of buyers to meet required payments. The authors concluded that the results presented are not satisfactory and require further in-depth analysis.

So far there has been only one extensive survey with the attempt to address the question how privatization has affected enterprises and workers. It was the initiative of Socijalno-Ekonomski Savet za Ekonomska Pitanja (Social-Economic Council for Economic Issues). They constructed three different questionnaires, for workers and majority owners in privatized enterprises and Privatization Agency, in order to see how this process looks from different perspectives. All three sizes (small, medium and big) of enterprises were included in the survey. Out of total of 1266 privatized enterprises in 2011 they randomly selected 417, which accounted for 32.9% (Socijalno-Ekonomski Savet za Ekonomska Pitanja, 2011). They managed to collect answers from 146 enterprises (some did not answer while other either had been erased from the register or some were in bankruptcy). The results of the survey showed that the level of employment was reduced by 45,10 % in the privatized enterprises that continued to operate. This is in accordance with some of the estimations that in the first ten years of privatization 74,41 % of people employed in the public sector lost their job (Socijalno-Ekonomski Savet za Ekonomska Pitanja, 2011). When it comes to salary levels, the authors call for caution when projecting the results on the whole economy. In many of the cases, when there was significant lay-off, management decided to increase salaries of people who remained in the companies. In other words, there was not general increase of wages, just transferring resources from fired to the ones who remained employed. The survey discovered that economic effects were not as expected. Exports showed a slight increase and the capacities of production were on lower level than in 1990s. An interesting outcome was that every fourth investor invested more than he was obliged to and every fifth did not invest anything after the purchase (Socijalno-Ekonomski Savet za Ekonomska Pitanja, 2011).

4. DATA AND THE METHODOLOGY

This study is explorative in its nature with a quantitative character. By collecting available data on transition and privatization process the aim is to grasp the early effects that privatization process had in Serbia. Due to short time spans earlier studies on privatization effects were using either panel data with several countries or cross-section analysis if they managed to collect data from certain number of enterprises. Since the aim of this paper is to explore the progress of privatization in Serbia and the time span is a bit more than a decade the method used was deriving different inferences from the available data. Therefore, secondary data was collected from international organizations and Serbian official databases and the analysis was undertaken with use of descriptive statistics. The empirical part is divided in three parts, starting from broader picture of Serbia's transition and privatization, proceeding to macroeconomic overview and finally to privatization outcomes.

As mentioned several times before, secondary data was used. In order to explore how successfully Serbia was fighting corruption during privatization process corruption indices were used. They were obtained from Transparency International, an organization that fights for transparency and suppression of corruption. The evaluation of countries' score was from 1 to 10 (where 1 is higher rate of corruption and 10 stands for no corruption) until 2012, when they changed the scale from 1 to 100, but retained the same method. The first part of the empirical analysis is based on transition and privatization indicators constructed by EBRD (European Bank for Reconstruction and Development). There was a comparison between Serbia, Croatia and Slovenia in development of six different indicators. These indicators are: price liberalization, trade and forex system, competition policy, large scale privatization, small scale privatization and governance and enterprise restructuring. The EBRD uses special methodology in forming these indicators. In short, the lowest level is 1 and the highest is 4+. More detailed explanations about each of the indices are available in the Appendix.

The second part of the empirical analysis refers to macroeconomic situation in the country that is linked to privatization process. Since it was argued that privatization could encourage economic growth of a country GDP series were used in order to analyze if that was the case in Serbia. The time span chosen was from 1990 till 2012. These series were obtained from Ministry of Finance in Serbia and it also needs to be pointed out that the value in 2012 is a projection of Ministry of Finance and Economy and Statistical Bureau of Serbia. In addition, FDI flows were used to check the levels of foreign investments during the privatization period. Since green-field investments have been rare in Serbia, the majority of the investments coming into Serbia were a result from privatization. The source for this data was the National Bank of Serbia. Another macroeconomic indicator used was level of employment. To be more specific, two different figures were used. One figure demonstrates the total numbers of persons employed in Serbia obtained from Ministry of Finance and Economy in Serbia. The second figure depicts the trends in level of employment in enterprises that were subject to privatization. This data was derived from a conference held by Economic Institute of Serbia, from a paper by Ivan Nikolić. The last macroeconomic indicator used in this subsection was Gini coefficient. Gini coefficient is one of the ways to analyze the inequality distribution in a country. Previous experiences of former Soviet transition countries showed that in the majority of cases inequality during privatization rises.

The last part of the empirical analyses deals with the outcomes of the privatization process in Serbia. The data used are from a study made by Vujačić and Vujačić (2011). These are so far the only available data about the number of privatized firms, rate of success, book value, purchase price and social expenditures in Serbia. The authors made a personal request for the data and obtained the data directly from the Privatization Agency. The data used are not available for wider public in the website of the Agency, so this study relies on the data from the paper by Vujačić and Vujačić (2011).

5. HISTORICAL REFORMS IN SERBIA

5.1. Historical Background in Brief

From the period after WWII until 1991 Serbia was a part of Socialist Federal Republic of Yugoslavia with five other countries Slovenia, Croatia, Bosnia and Herzegovina, Montenegro and Macedonia. Yugoslavia was under the governance of a communist supporter Josip Broz known as Tito. Up to 1991 Serbia was also the largest of six countries. Already in 1950s the system of central planning was progressively transformed into the unique social and economic system identified as workers' self-management with somewhat fuzzy property rights (Vujačić and Vujačić, 2011). It was argued in the literature that this system relied more on market forces than in most other centrally planned economies (Kecmanović, 2011). For example, incomes of employees were to some extent connected to enterprise performance and there was a bigger divergence in wage levels (Kecmanović, 2011). It also needs to be noted that workers' self management gave empowerment to workers and made them feel they own the company. This is one of the main differences compared to other transition countries. At the same time this was an advantage since it brought Serbia closer to a market economy, but also a disadvantage since it was one of the largest constraints later when privatization started. Tito's death in 1980 was a break point when disagreements between countries started rising. His successor was Slobodan Milošević who encouraged Serbian nationalism and heated an already tensed relationship between countries. Once seen as a late developing, rapidly industrializing country (Palairat, 2001) Serbia started slowing down in 1980s expressing economic decline. Some assess this decline as a consequence of incompletely removed state-bureaucratic controls over economy (Simon, 2010). In 1989 a new wave of market reforms started under Prime Minister Ante Marković. This package of reforms included privatization as well and presents the first attempt to introduce change in ownership structure and defining property rights. The reforms prioritized the establishment of a legal structure that could further support the creation of property rights. Besides not having the support from president Milošević the reforms were doomed to failure when Yugoslavian breakdown occurred.

5.1.1. The War, Sanctions and the Demise of Yugoslav Federation (1991-1999)

The year 1991 represents the period when countries started declaring independence and when the Bosnian war started. In May 1992 UN Security Council imposed the sanctions on Serbia. These sanctions referred to all trade, international financial transactions and all scientific, cultural and sport exchanges (Babić and Jokić, 2010). In Figure 8, which shows annual percentage of GDP growth in Serbia, it can be observed how hard Serbia was hit with UN sanctions. GDP decline goes as far as -30%. The economy started recovering around 1995 slightly before the Dayton Peace Agreement. Signing the Dayton Peace Agreement in 1995 meant the end of Bosnian war. This was followed by official suspension of UN sanctions already in 1996. Figure 8 also demonstrates how the economy of Serbia was

recovering in this period. Next in the line of unfortunate events was the Kosovo conflict that started in 1999 by NATO air strikes on Serbia. The air attack lasted from March till June 1999. In order to understand why Serbia started privatization much later than other countries it was necessary to mention these events which were the main contributors.

When it comes to the progress of the privatization process in this period a few important things need to be mentioned. Serbian economy in 1990s was dominated by inefficient social and public ownership (Simon, 2010). The lack of control and discipline led to a rapid spread of corruption which harmed the probity of the privatization process. Despite the turmoil in 1991 Serbia adopted a Law on Conditions and Procedures to Transform Collective Property into other Forms of Property (Vujačić and Vujačić, 2011). The privatization was mainly insider privatization and according to the law, 80% of ownership was about to be private and 20% social (Vujačić and Vujačić, 2011). The capital was evaluated in the end of each year. However, the hyperinflation made capital undervalued and the whole process was a big giveaway. New phase of privatization started in 1997 when the legislation was altered again, allowing workers to buy up to 60% of capital (Bunčić, 2012). This lasted until the end of the Milošević regime.

5.2. Political and Legal Reforms after 2000

The year 2000 is especially important since it marks the end of the Milošević regime, hence the end of the socialist political arrangement. Breaking with the socialist regime represents moving forward to a democratic political system and a market economy. The event, in Serbia known as the 5th October Revolution, signifies the beginning of the market reforms initiated by Zoran Đinđić the Prime Minister and a member of Democratic Party. He was the first politician who made efforts towards integration of Serbia to EU. His reforms were focused on macroeconomic stabilization of the country and establishing institutional and legal framework harmonized with advanced EU countries. In fact, the new government was making significant efforts which were rewarded with Serbia becoming a potential candidate country in 2000. With the help of IMF Serbia's state budget became more transparent. The economic recovery and progress of reforms were interrupted in 2003 when Đinđić was assassinated. His successor Zoran Živković was more focused on harmonization issues with Montenegro and to a certain extent neglected initiated liberalization reforms. The turnover happened in 2004 when Vojislav Koštunica's government came to power and continued reforms towards EU accession (Simon, 2010). Frequent change of the ruling party resulted in loosening of fiscal discipline. Repeated elections encouraged authorities to increase wages in the public sector. Separation from Montenegro happened in 2006 and since that time Serbia is an independent country that does not belong to any State Union. In 2008 Serbia signed a Stabilization and Association Agreement (SAA) with the EU. Consequently, Serbia applied for EU membership in 2009 and in 2012 it gained full candidate status.

It was important to mention the EU accession progress since it is essential for the process of Serbia's transition. As in the case of former Soviet transition countries, membership in EU

stimulates establishment of institutional framework which supports market reforms and makes state action more transparent. This is also important for the privatization process. In the situation where law enforcement is loose and property rights are not well defined and protected, the privatization process leaves lots of space for corruption and rent seeking. Table 1 presents Serbia's ranks with the regards to corruption perception index. The observed period starts with the year 2003 because that is the first time that Serbia and Montenegro was included in the analysis by Transparency International. It needs to be clarified that years from 2003 to 2005 are showing ranks for Serbia and Montenegro and after 2006 only for Serbia. The range is between 1 and 10 and the higher score country gets, the less corruption there is. In 2012 the system was changed and the range was 1-100, but its principle is similar. Looking at the table one could notice that Serbia and Montenegro started with a low rank (106) and a very low score (2.3). Over the time Serbia showed an improvement with corruption fighting, but still stayed within the group of the countries with score closer to 1. In 2012 Serbia's progress was assigned score 39, which would be equal to 3.9 in the old scoring system. Even though Serbia demonstrated a modest advancement over time, in 2012 there were only 5 European countries ranked lower – Greece, Albania, Belarus, Russia and Ukraine (Transparency International, 2013).

Table 1: Corruption Perception Index, 2003-2012

	Rank	Score
2012	80	39 ⁴
2011	86	3.3
2010	78	3.5
2009	83	3.5
2008	85	3.4
2007	79	3.4
2006	90	3.0
2005*	97	2.8
2004*	97	2.7
2003*	106	2.3

**Ranks for Serbia and Montenegro*

Source: Transparency International, 2013

When it comes to privatization, there was a breakthrough in 2001 when a new law was introduced- The Privatization Law. The new model of privatization that emerged after the new law was passed was based on the belief that privatization is an opportunity for a break with both the past system of self-management and the model of insider employee privatization (Vujačić and Vujačić, 2011). Up to 2001, insiders had a leading role in the privatization process which new ruling party observed as a barrier to establishment of

⁴ In 2012 a new scoring system was introduced, ranging from 1 to 100. Up to that time the range was from 1 to 10.

improved corporate governance. The new privatization model was based on two main types of sales- *tenders and auctions*. It is not surprising that a sales approach was chosen since economy needed resources to start recovering. Revenues from privatization were supposed to be distributed 75% to state budget (for budget recovery, social programs etc.), 5% to the Restitution Fund, 10% to the Pension Fund and 10 % to the Infrastructure Fund (Vujačić and Vujačić, 2011).

Large enterprises were supposed to go on tenders in order to attract foreign investors while small and medium sized enterprises were offered through auctions. Since tenders were for large enterprises (and these enterprises were among better performing ones) there was an emphasis on social and environmental programs in the sales process. The government wanted to make sure that new owners will either keep the majority of employees and in that way avoid mass unemployment or compensate employees in the case of job loss. When it comes to auctions, efforts were made in gaining more transparency of the privatization process and decreasing the level of insider ownership in small and medium companies.

The new law stopped the second distribution of shares in companies that started their privatization process in the period before 2001. The shares that were not distributed were transferred to the Share Fund which was supposed to sell the shares on the stock market or by auction on the request of the Privatization Agency (Vujačić and Vujačić, 2011). The Privatization Agency was formed in 2001 to monitor the process of privatization. In order to be unbiased and transparent the Agency was separated from the Ministry of Economy and given independence.

6. EMPIRICAL RESEARCH ON THE PRIVATIZATION EFFECTS

6.1. Privatization and Transition Progress- Comparison between Serbia, Croatia and Slovenia

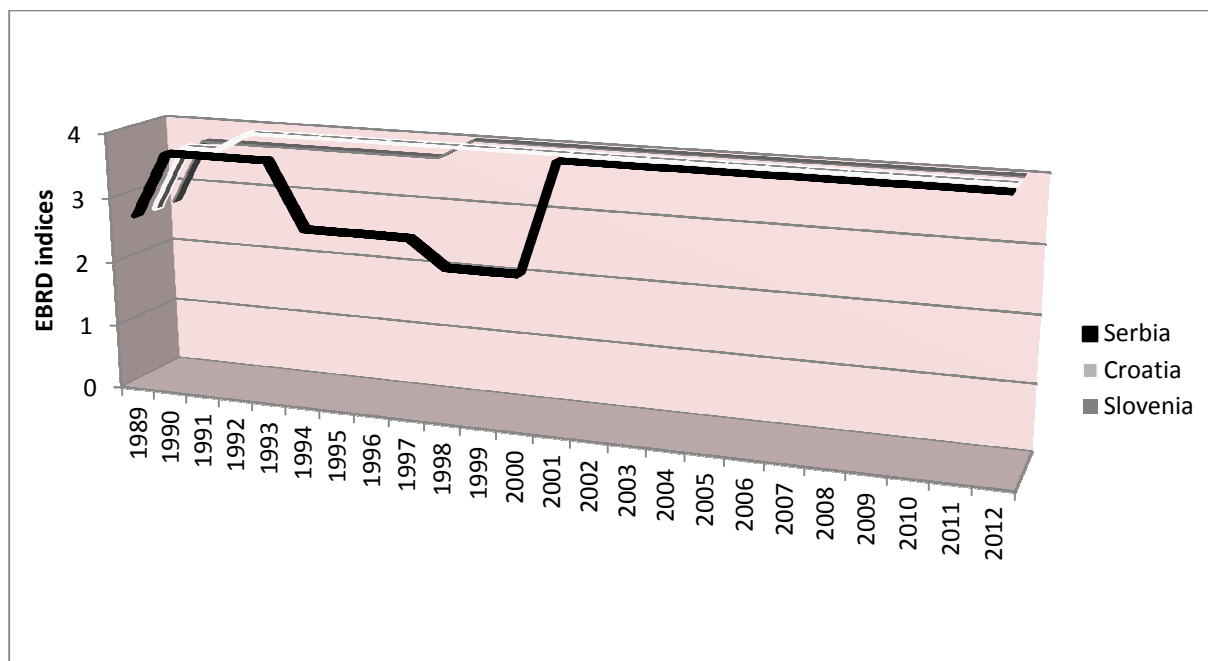
In the first part of the empirical research there will be a comparison of Serbia's privatization process with the progress of Slovenia and Croatia. These countries were chosen for the comparison because they are the most successful in terms of economic growth and transition of all former Yugoslav countries. Slovenia managed to enter European Union in 2003 and it is expected that Croatia will enter in July 2013. As it was mentioned in one of the previous sections, within Republic of Yugoslavia Serbia was performing better than all the rest of the countries. However, the situation started changing in 1980s and since then Serbia was catching up after these two countries. This sub-section should shed light to the transition and privatization progress in these three countries and at the same time help realizing at what stage of the reforms countries are. Since this is the first time that EBRD indicators are used in the investigation about Serbia's privatization, the analysis would also contribute to making a more comprehensive picture about how much has been done so far and what should be additionally improved in the future.

In this sub-section EBRD transition indicators will be used for the analysis of the transition, hence privatization progress. The indices have range from 1 to 4+ depending on the progress of the country (1 is lowest level and 4+ is highest). Detailed methodology about the EBRD indices is available in the Appendix. The observed period is from 1989 till 2012. The reason why 1989 was taken as the beginning of the period is that the first attempt to undertake market oriented reforms occurred in the year 1989.

6.1.1. Transition progress

Figure 1 depicts the development of price liberalization in Serbia, Croatia and Slovenia for the period from 1989 till 2012. Looking at the figure it could be argued that Ante Marković's market reforms in 1989 actually had progress in price liberalization⁵. All three of the countries show an upward trend already in 1989. The starting point was index 2.7, which refers to reforms in price administration.

Figure 1: Price Liberalization, 1989-2012



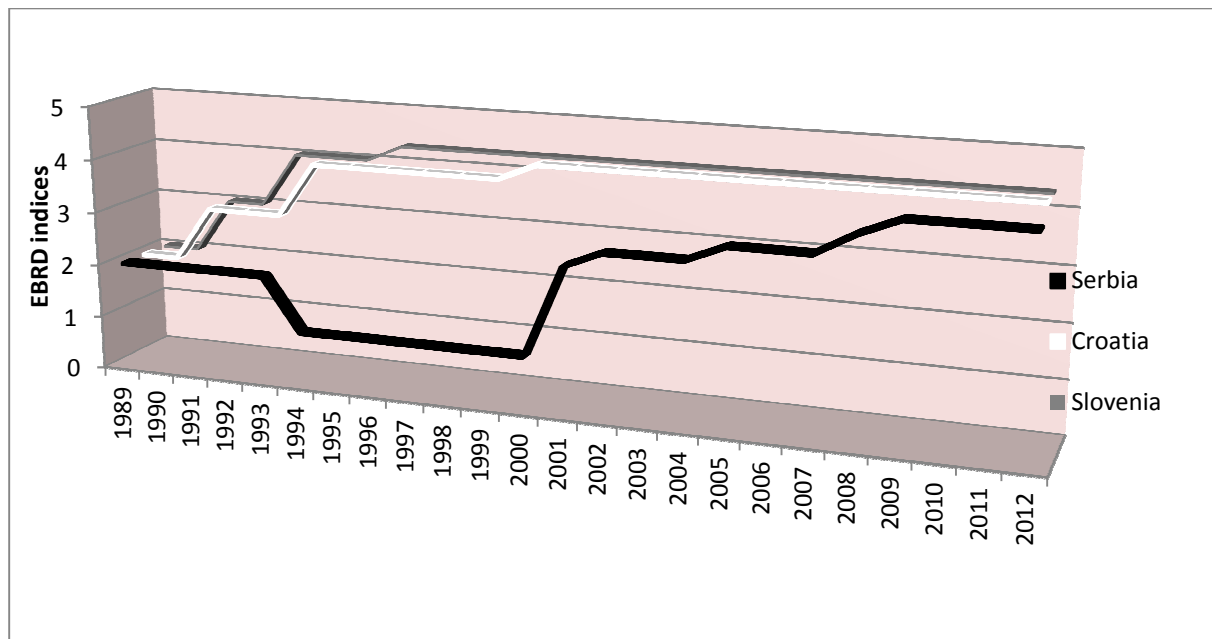
Source: Author's calculations based on the data obtained from EBRD, 2013

All three of the countries show an upward trend already in 1989. The starting point was index 2.7, which refers to reforms in price administration. Already in 1990 all the countries jumped to level 3.7. To be more specific, level 3.7 means that countries have undertaken significant price administration reforms, but there is still presence of state procurement at non-market prices (ERBD, 2013). However, while Croatia and Slovenia continued the trend of success, Serbia took different path. Affected severely by hyperinflation and UN sanctions Serbia had a downfall in liberalization of prices. It started recovering around 2000 and

⁵ Price liberalization was one of the priorities of the reform package in 1989.

rapidly reached the level of two other countries. Since then the countries were at the same level in price liberalization- level 4. This is quite a success in the case of Serbia, concerning that it managed to recover fast and catch up with the two other countries. This high level means that EBRD estimated that these countries made a complete price reforms and there is only a small number of prices remained administered by the state.

Figure 2: Trade and Forex System, 1989-2012



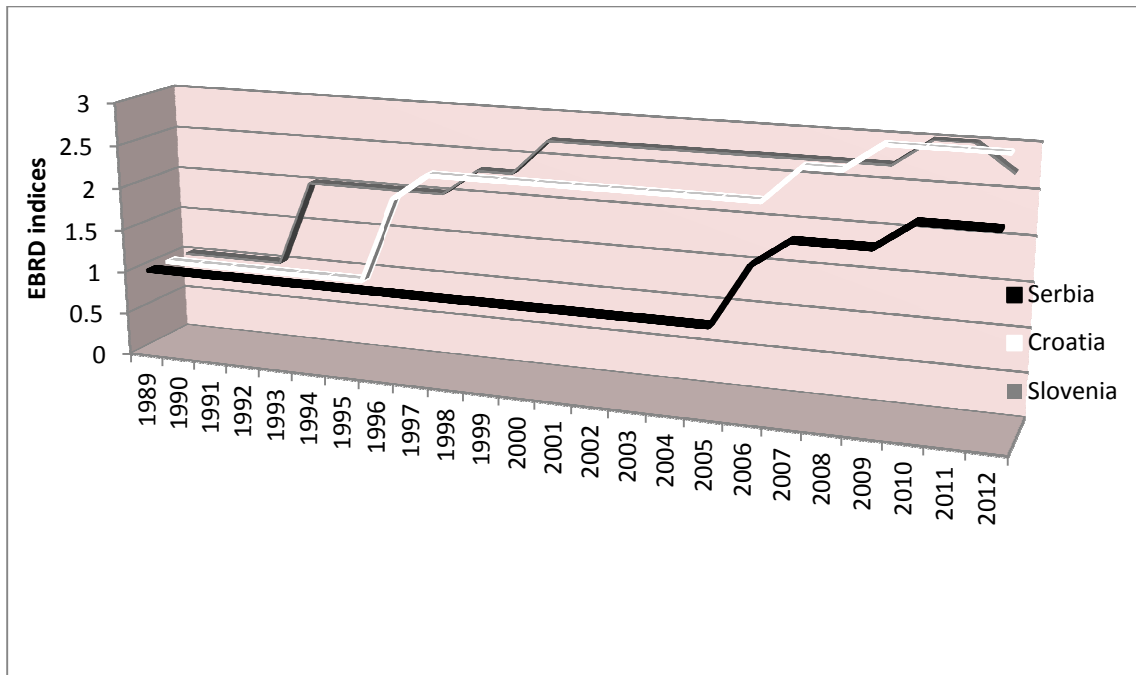
Source: Author’s calculations based on the data obtained from EBRD, 2013

Figure 2 represents trends in trade liberalization and exchange rate system. In the year 1989 all three countries were at level 2 in EBRD assessments. This further implies that all three of the countries had some liberalization of exports and imports, but the foreign exchange system was not fully transparent (EBRD, 2013). Slovenia and Croatia managed to start rising their level of openness and liberalization already in 1991. They followed a very similar pattern, but Croatia was lagging behind until 2000 when they established the same level. It is not a surprise that Serbia had a decline taking into concern that UN sanctions were applied to all means of trade. It started recovering and rising above the initial level after 2000. In 12 years time Serbia reached a level very close to two other countries. Specifically, the level in 2012 was 4 meaning that there was a removal of all administrative restrictions on import and exports together with full current account convertibility (EBRD, 2013).

Next figure (Figure 3) illustrates how much effort has been put in reforming the competition policy. What is striking from the figure is the fact that all three of the countries had a very low start. The level of their competition policy was evaluated as level 1 by EBRD. To be more specific, this level indicates that neither one of the countries had a competition legislation and institutions. Slovenia was the first country to start rising its levels of competition policy and was soon followed by Croatia. By the end of the observed period they were

approximately at the same level- around 3. This further means that both of the countries made efforts to reduce restriction to market entries and to increase level of competitiveness of the environment. Serbia was on a different road, it was stuck on the same level up to 2006. In last 6 years it managed to reduce some of the restrictions, but still not enough to get evaluation higher than 2.

Figure 3: Competition Policy, 1989-2012



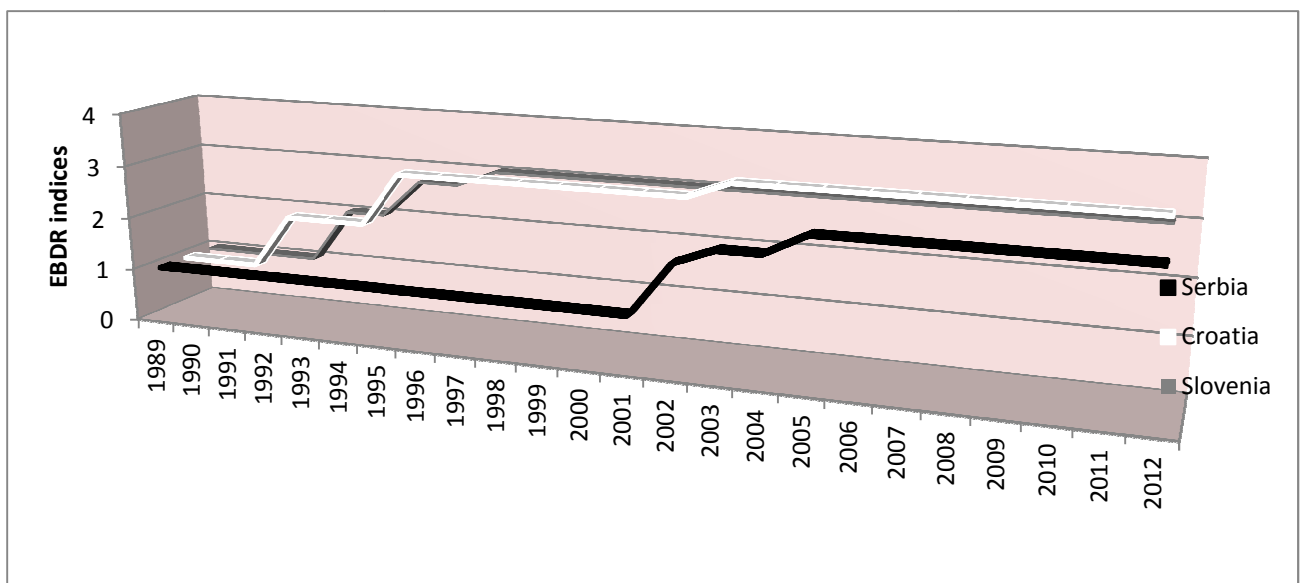
Source: Author’s calculations based on the data obtained from EBRD, 2013

6.1.2. Privatization progress

Figure 4 depicts trends in large scale privatization in Serbia, Croatia and Slovenia. Large scale privatization refers to privatization of large and medium enterprises in all three countries. As can be noticed all three countries started from the same low level in 1989. EBRD assigned index 1 to all countries, which means that there was little private ownership at the time. The figure shows that Croatia and Slovenia started privatizing large and medium SOEs soon after they claimed independence. Highly affected with the Bosnian war and UN sanctions, Serbia retained the same level up to 2000. The situation started changing between 2000 and 2001 when the trend in large scale privatization started growing upwards. Even though Serbia demonstrated improvement in large scale privatization, it still has not been able to reach levels of Croatia and Slovenia. In 2012 both Croatia and Slovenia are around level 3, which refers to having more than 25% of large-scale enterprise assets in private hands or in the process of being privatized (EBRD, 2013). At the same time, EBRD assessed Serbia’s progress with 2.7, which shows that some of the sales are completed and that there is a scheme for further sales.

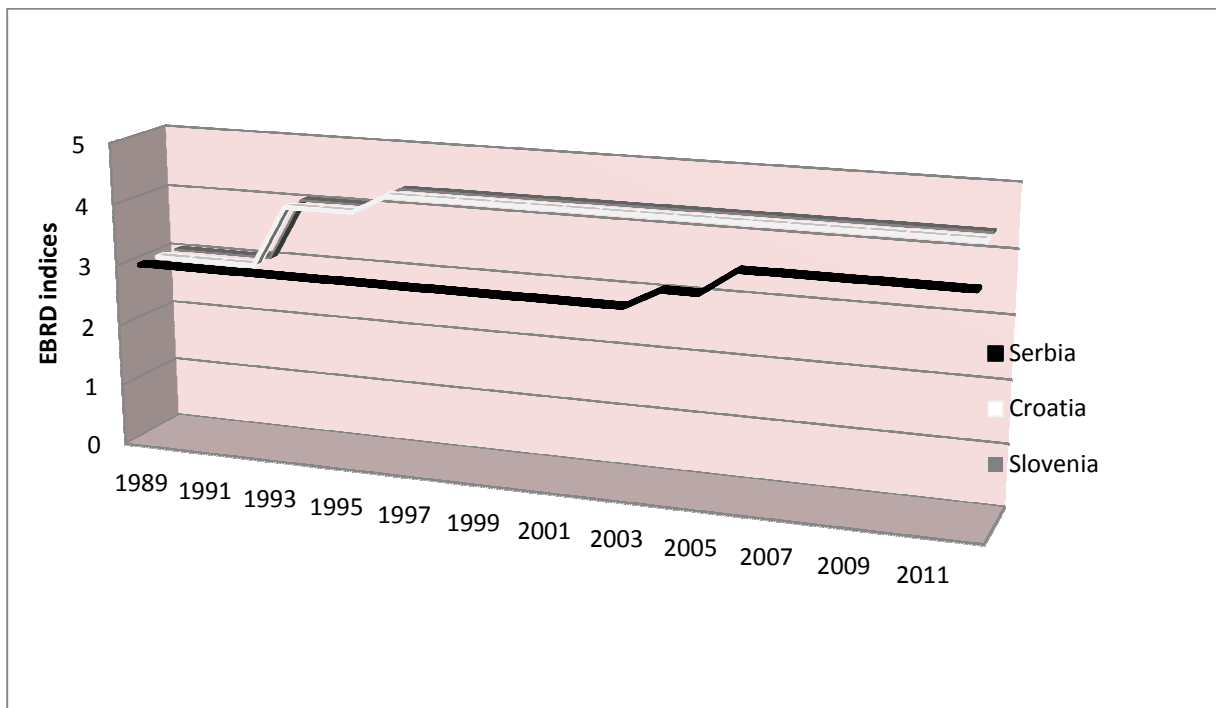
Trends of small scale privatization in Serbia, Croatia and Slovenia are presented in Figure 5. Just like in large scale privatization, all three countries had the same starting level in 1989. However, it needs to be noted that in the case of small scale privatization the level in 1989 was higher than level for large scale privatization. EBRD evaluated the situation in the beginning of the period as index 3, which shows that all three countries had a wide-ranging programme that was ready for implementation (EBRD, 2013). In a few years time Croatia and Slovenia managed to reach a level of 4.3 and to maintain it till the end of the observed period. A level higher than 4 means that these two countries came very close to standards of a typical advanced economy (EBRD, 2013). Additionally, such a high level demonstrated that is no or small state ownership of small enterprises. In the case of Serbia, there was not much progress. As was said before, Serbia started with the index 3 in the beginning of the observed period and ended up with 3.7 in 2012. Like in the case of large scale privatization, the outset of Serbia's small scale privatization was delayed, it started around 2002. Serbia still did not manage to catch up with the levels in Croatia and Slovenia until the end of observed period.

Figure 4: Large Scale Privatization, 1989-2012



Source: Author's calculations based on the data obtained from EBRD, 2013

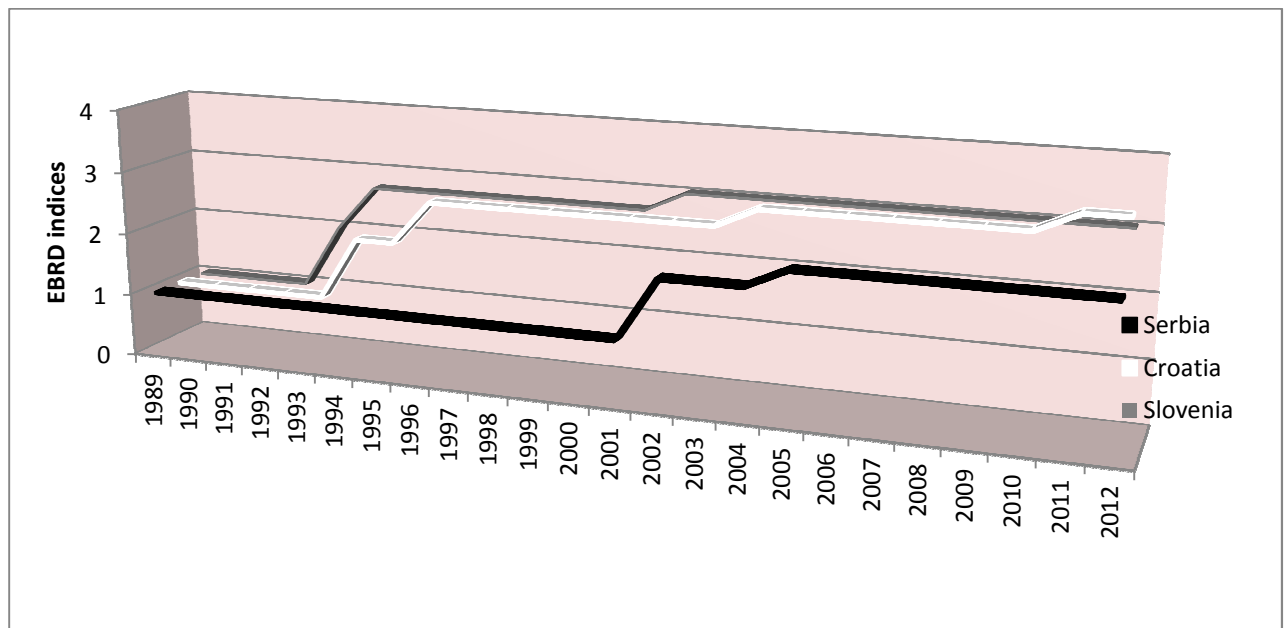
Figure 5: Small Scale Privatization, 1989-2012



Source: Author's calculations based on the data obtained from EBRD, 2013

Figure 6 illustrates how the trends in governance and enterprise restructuring look like in the three chosen countries. This is an important indicator since it shows how much of advancement a country made in hardening the budget constraints and in corporate governance. The figure points out that, as in both examples above, EBRD assigned the same level to all three countries. Serbia, Croatia and Slovenia have EBRD index 1 till approximately 1992. The lowest index in the case of governance and enterprise restructuring means that soft budget constraints were present in all three former Yugoslav republics. To be more specific, this means that financial discipline was loose and that SOEs were subsidized by the state despite their performance. Over the period, Croatia and Slovenia succeeded to climb up to index 3 following approximately the same pattern. Index 3 was allocated to countries that accomplished hardening the budget constraints while at the same time promoting corporate governance (EBRD, 2013). On the other hand, Serbia was less successful. Again, due to unfortunate historical events in the 1990s, the outset of reforms was delayed. The level Serbia reached in 2012 was evaluated as index 2.3, which further means that credit and subsidy policies were slightly tightened, but not enough action with the aim of strengthening competition and corporate governance (EBRD, 2013).

Figure 6: Governance and Enterprise Restructuring, 1989-2012

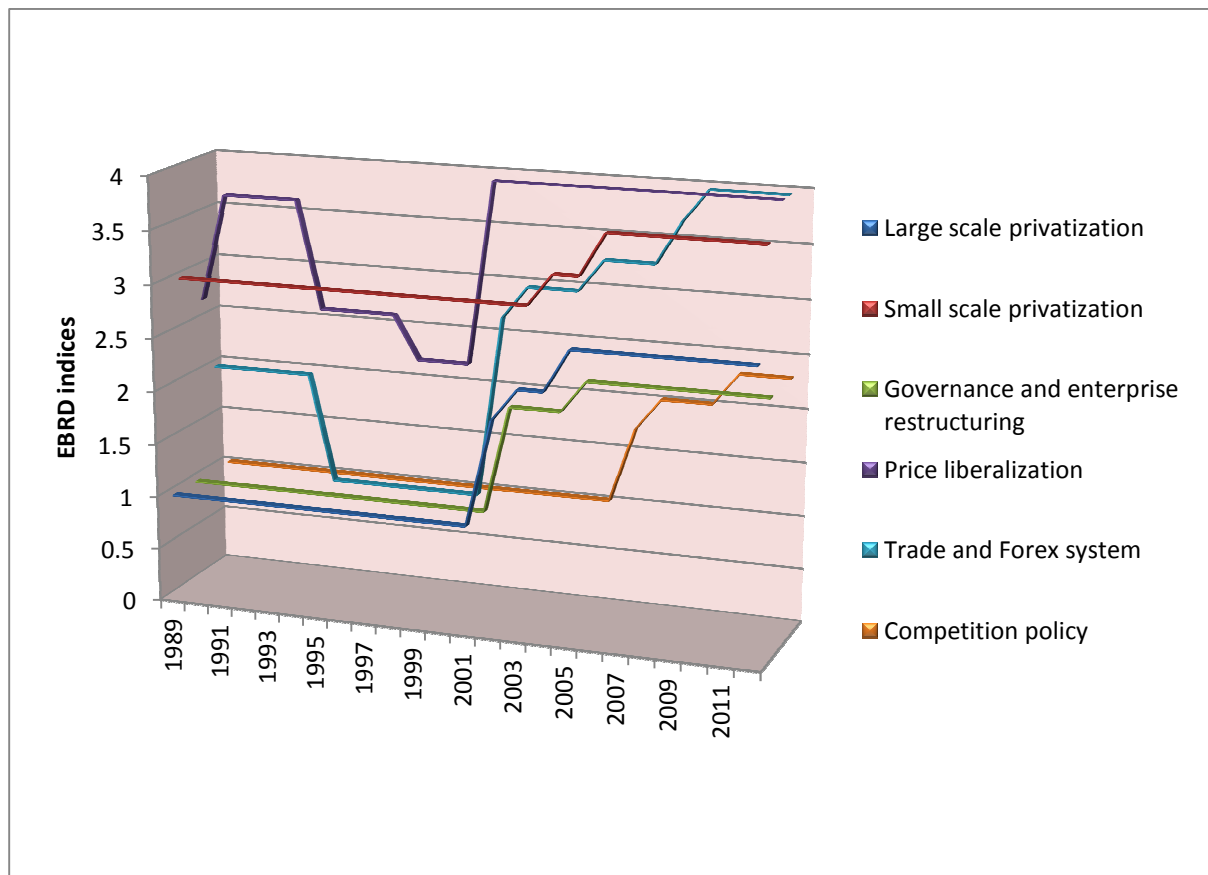


Source: Author's calculations based on the data obtained from EBRD, 2013

The final figure in this subsection presents the picture of all six previously analyzed transition indicators. So far there was comparison for each one of the indicators for Serbia, Croatia and Slovenia. But, Figure 7 was made in order to observe the situation only for Serbia. One could conclude that all events from the 1990s affected price liberalization and trade the most since these two indicators were the only two that showed a decline while the others were in stagnation. The indicators show that Serbia started recovering later than other countries, after 2000. After that period all of the indicators recorded an upward trend. Competition policy is the indicator which lagged the most behind the other indicators and still is in lower levels. This infers that Serbia is not sufficiently stimulating competition between the firms. In addition, as some of the authors pointed out (Obradović et al, 2012; Paraušić, 2007), it could be implied that the business environment is not attractive enough for foreign investors. According to EBRD, Serbia scored the best in price liberalization and trade and forex system. These are important indicators for Serbian transition since both show bigger involvement in international trade and harmonization with market prices, Participation in international trade is especially important for a transition country such as Serbia in order to encourage economic growth and recovery. Governance and enterprises restructuring together with large scale privatization still did not reach satisfactory levels indicating that more efforts are needed in these fields. According to the theory about soft budget constraints, hardening the budget will not automatically lead to restructuring of enterprises (Estrin, et al, 2009). Since the indicator for governance and enterprise restructuring evaluated budget hardening, corporate governance and enterprise restructuring it could be concluded that there was some advancements in hardening the budget constraints, while entrepreneurial activities of new owners were not stimulated

enough to result in successful enterprise restructuring and improved corporate governance. Small scale privatization had the highest starting point, but did not grow significantly till the end of the observed period. Due to a modest increase in this indicator it could be assumed that government was not putting much emphasis on the privatization of the small firms. This questions the government ideology in Serbia, since some of the authors showed that market-oriented governments show tendency of promoting small-scale industries rather than large-scale ones (for example, Bjornskov and Potrafke, 2010).

Figure 7: All Six Transition Indicators for Serbia, 1989-2012



Source: Author’s calculations based on the data obtained from EBRD, 2013

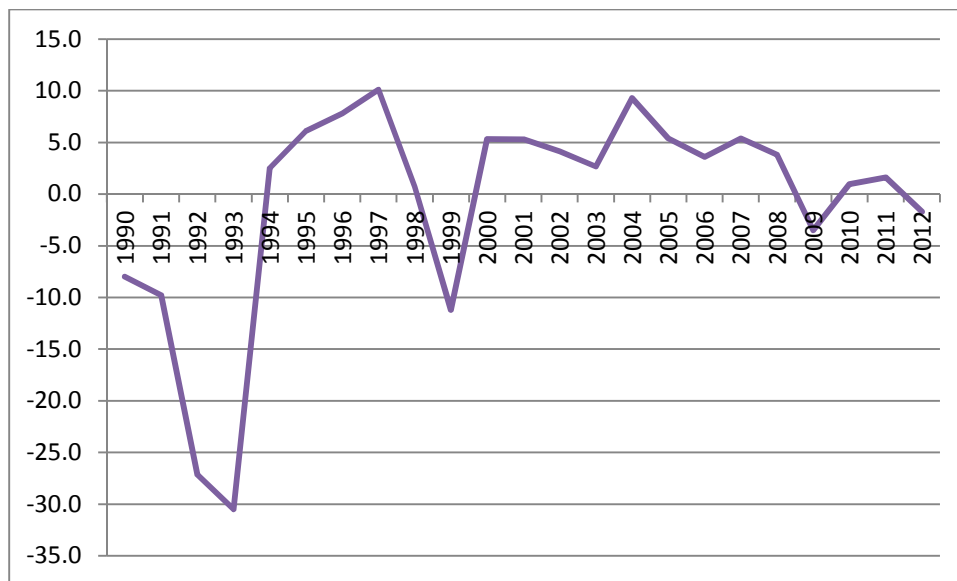
6.2. Overview of Macroeconomic Trends in Serbia

This subsection will present some macroeconomic trends in Serbia. According to the theoretical background it could be expected that privatization, hence rise of private sector will lead to a better allocation of resources, increased foreign investment and consequently to encourage economic growth of a country. However, sometimes, for example in case of gradual reforms, these effects could come with a delay. In the further analysis the emphasis will be on the period when privatization officially started, after year 2000.

Figure 8 presents the trend in GDP growth in Serbia from 1990-2012. The reason why GDP series include a longer time span is to show how hard the economy was hit with the unfortunate events in 1990s. One could notice that during year 2000 real economy started

recovering slowly. Even though the rates of growth were modest, they were the signs that after a hard decade the economy was back on track again. The situation was relatively stable with a small decline in 2003. The highest peak was in 2004 when GDP growth reached 9.3%. Since then the economic growth is in constant decline. After a decade of recovery GDP showed a negative rate of growth in 2009. This was a consequence of global economic crisis and the authorities are still claiming that the economy has not recovered yet. One could also see in the graph that since 2009 rates of growth are very small. The projection of Ministry of Finance and Economy was that GDP growth was again negative in 2012. Although the process of privatization has been going on for more than a decade, it seems that the real economy is not getting enough push to establish more sustainable growth. It could be argued that economy still has not recovered from all the misfortunes when the next crises occurred in 2008 and left consequences. One could also notice that being influenced by a global crisis is a sigh that a country is involved in trade with other countries. This is especially important for a small transitional country such is Serbia. Centrally planned economies were not very involved in the international trade since governments imposed many constraints on the exchange with other countries. Therefore, showing the response at the global crises could signal the trade and market liberalization.

Figure 8: GDP Growth in Serbia (% annual), 1990-2012



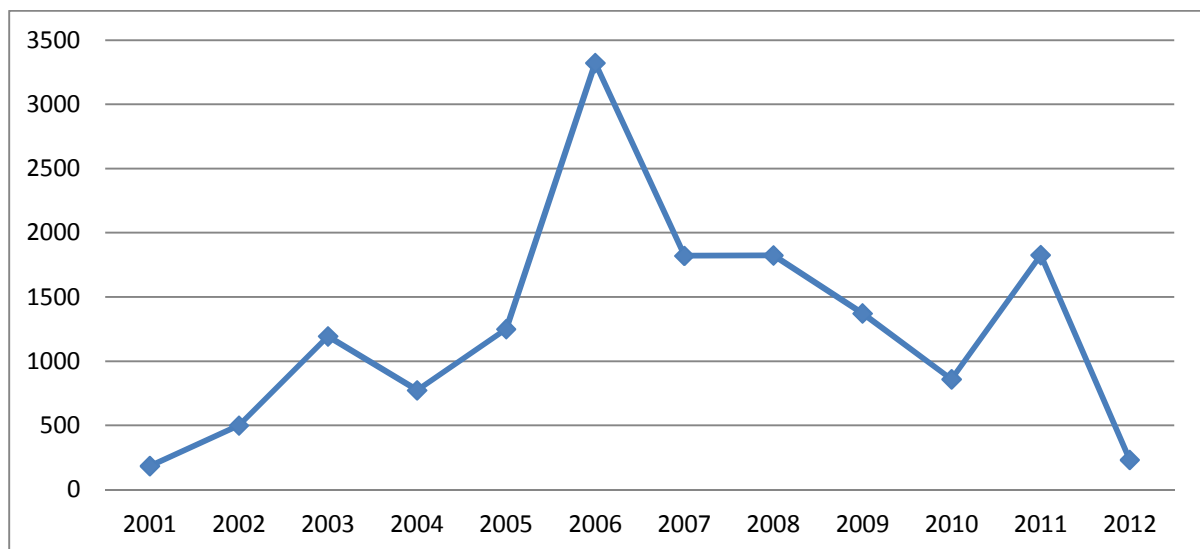
Source: Ministry of Finance and Economy in Serbia, 2013

In addition to GDP growth the next figure presents FDI flows in Serbia. For a transition country with an ongoing privatization process inflows of FDI are very important from many reasons. Foreign investors bring financial sources, modern technology, know-how, knowledge transfers and other factors that are important for recovery and further development of a country. This macroeconomic indicator is more directly linked with the process of privatization, since the government was intending to attract foreign investors, especially for the sales of large enterprises. Additionally, there were not many green-field

investments in Serbia, so FDI flows were mainly consequences of the privatization process. As it can be observed from the graph, there was a steady increase of FDI since the beginning of privatization until 2003. In 2003 the political situation was a bit unstable again and it resulted in less quantity of enterprises sold in 2004. When the situation stabilized the level of FDI was rising again. Year 2006 represents an outlier since the level of investment that year was almost like the sum of all investments until that year. The reason for such a high level of investment was the privatization of Mobtel, a state-owned telecom operator company that was purchased by Telenor. Mobtel was sold for 1.919 million and that is one of the biggest investments in the overall privatization process. Currently, this privatization is under investigation together with 23 more privatizations because European Parliament evaluated it as dubious (Politika online, 2013). As it could be expected, after 2008 the level of investment was declining again, potentially as a consequence of crisis. In 2011, JAT airways, a state owned airline company, started its privatization process and this transaction is projected as a rise of FDI in 2011. In 2012 the level of FDI came back to the level in the beginning of the privatization process.

The analysis of FDI trends are in accordance with the predictions by Obradović et al (2012) that Serbia is still not see as favourable business environment. The reforms that have been undertaken so far were not sufficient to make Serbia attractive for foreign capital. The fact that FDI levels came back close to initial values after a decade of privatization is rather worrying. On one hand it could be a consequence of the global crises that resulted in overall decrease in investment. On the other hand it could be a support for Paraušić's claims that Serbia's business environment is still unfavourable in both macro and micro terms (Paraušić, 2007).

Figure 9: FDI in Serbia (in mil EUR), 2001-2012



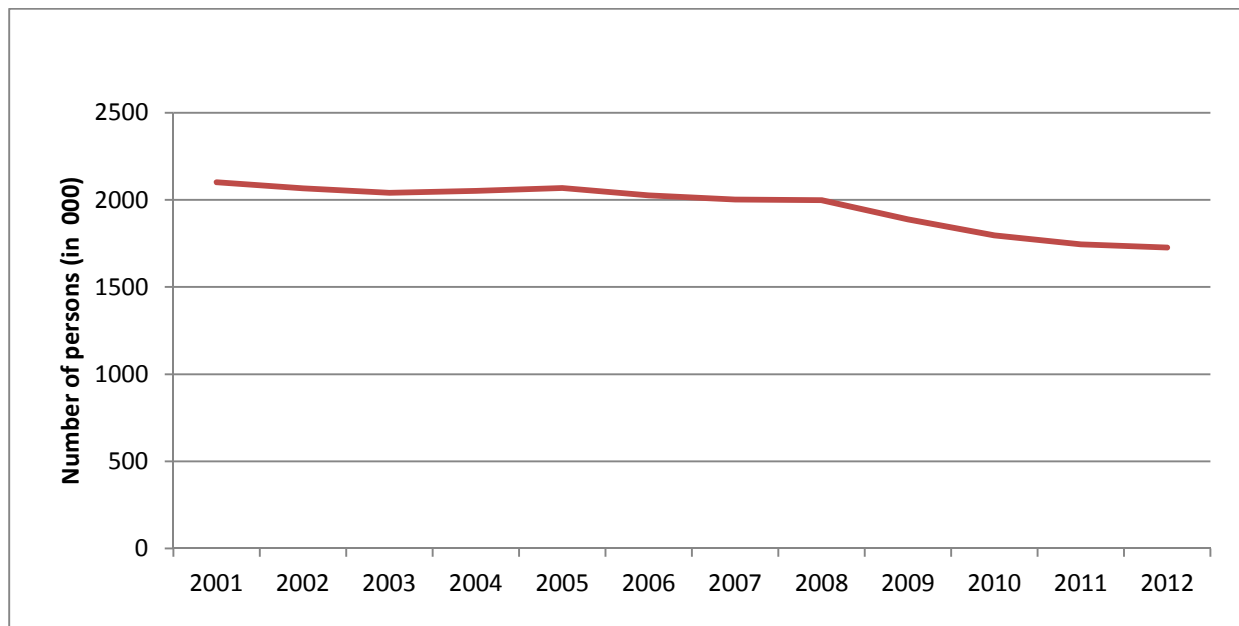
Source: National Bank of Serbia, 2013

Another very important macroeconomic indicator closely linked with the privatization process is the level of employment in a country. Since state-enterprises were very often overstaffed lay-offs were an inevitable part of the process of privatization. It is very hard to privatize and at the same time maintain the same or a similar level of employment. One way of determining how successful privatization was in a country is observing how much the level of employment decreased. Next two figures are included with the aim of analyzing the trend of employment in Serbia during the privatization process. Figure 10 depicts the total number of persons employed (it is expressed in thousands) and figure 11 shows the trend in the number of persons employed in enterprises that were subject to privatization (including enterprises with both successful and unsuccessful privatization process). If one starts analyzing the broader picture, i.e. the level of total employment in Serbia, one could notice that there was only a slight decrease in employment until 2007. This would be a positive sign since the majority of enterprises entered the privatization process by 2007. After 2007 there was a bigger decline. Speaking in numbers the situation would look like this, in the last decade the number of persons employed decreased from 2.1 million in 2001 to 1.7 million in 2012. The total reduction was about 20%.

However, the situation seems different when only firms that were subject to privatization are observed. There was a steep fall in levels of employment from 2002 till 2012. In the beginning of the period the number of employees in these firms was 0.68 million. By the end of the period, the number drastically decreased to 0.27 million. This further means that the number of employees in firms that were subject to privatization decreased for 0.41 million, which is more than 60%. If we divide the number of positions lost with years, the estimation is that 41000 working places were lost on yearly basis. These numbers demonstrate a harsher situation than could be noticed in the levels of total employment. In order to understand the seriousness of the situation it needs to be explained how a typical working life looked in socialist Serbia. When persons finished a high school or university they were guaranteed a job in a SOE and usually they stayed in the same position/company until their retirement without further education or specialization. When privatization started, new owners of overstaffed companies were dismissing old employees. People who became unemployed, for example a decade before their retirement, were not attractive workforce since they had poor qualifications and no diversity in their career. With foreign firms which penetrated the country it was getting harder to find another job. It could be speculated that probably the majority of people laid off did not manage to find another job, at least not in regular market. In these situations, people usually turn to the black market, working somewhere without being registered and without social and pension insurance.

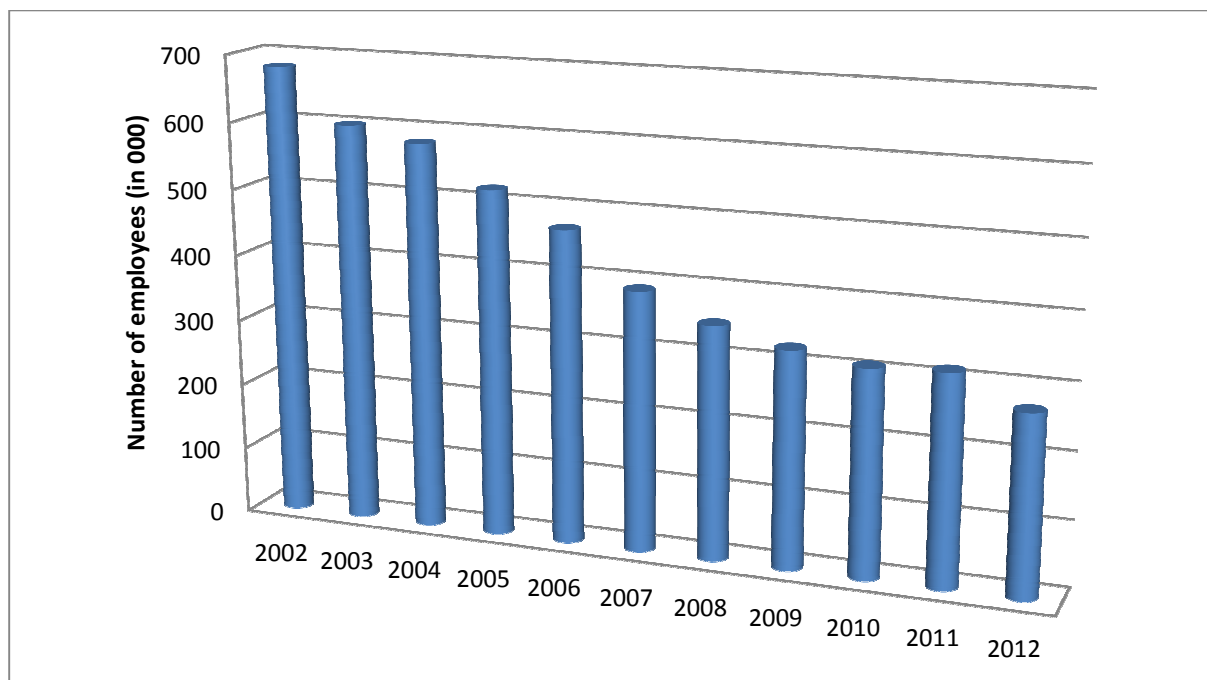
Figures presented actually show that Serbia did not manage to meet the challenge of carrying out the privatization process and at the same time retain similar employment levels. Previously it was mentioned that depending on the budget constraints governments had two choices either to cut the wages or to reduce employment (Jovičić, 2005).

Figure 10: Total Number of Persons Employed in Serbia (in 000), 2001-2012



Source: Ministry of Finance and Economy in Serbia, 2013

Figure 11: Number of Employees in Firms that were Subject to Privatization (in 000), 2002-2012



Source: Nikolić, 2013

The trends for employment levels Serbia show that the second option was more in favour during the privatization process. A study conducted by Jovičić showed that in the first four

year of privatization the unemployment level was rising and that in the future there should be more emphasis on the job-creating policies (Jovičić, 2005). Having a longer time span, this study demonstrates that the declining trends in employment have not changed until 2012. In addition, this further implies that there was not much emphasis on the job-creating policies by government. It could also be speculated that development of private sector was not sufficient to make up for significant layoffs in the state sector.

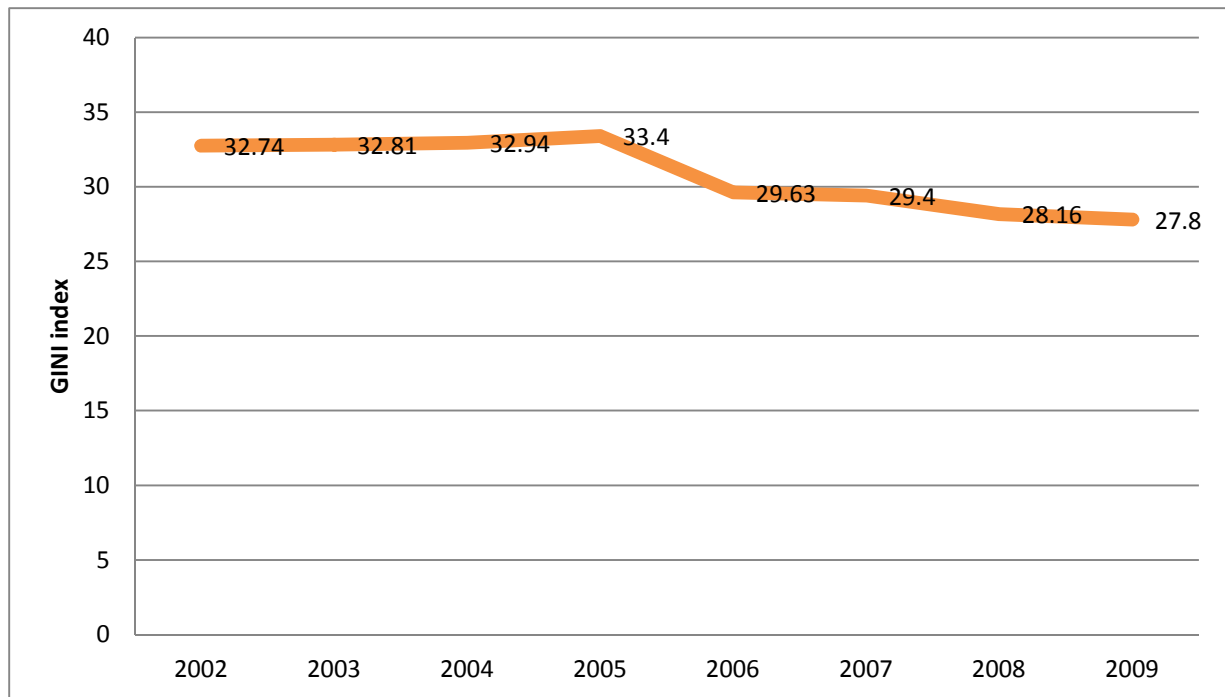
In a transition country where GDP growth does not display significant growth and where the level of employment is decreasing it could be expected that changes also occurred in poverty distribution. One of the most common ways to analyze poverty trends is by using Gini coefficient. The Gini coefficient “measures to what extent the distribution of income or consumption expenditure deviates from a perfectly equal distribution “(World Bank, 2013). The range can be from 1 to 10 or from 1 to 100. But the principle is the same, 0 stands for perfect equality and 100 (or 10) for perfect inequality. This further implies that countries should be closer to the lower threshold.

Since the socialist countries were based on the idea of equality there is a general rule that the central planned economies distributed income more equally than the market economies (Kolodko, 1999). Therefore, when the process of transition, hence privatization, started almost all of the countries recorded the increase in inequality. In the case of Serbia, the only data available are for the time span from 2002 until 2009. It is not possible to know what the exact levels of Gini coefficient were for the period before in order to compare. However, it was estimated that in the late 1980s the Gini coefficient for socialist economies averaged 23 or 24, while for the developed West European countries was 6 points higher (Kolodko, 1999). One needs to bear in mind that due to the self-workers management and regional differences Yugoslavia had a bigger divergence in income distribution than other socialist countries.

As it can be seen in the Figure 12 in year 2002 the Gini coefficient for Serbia was 32.47. Since the privatization process already began it could be assumed with justification that the Gini index probably increased compared to previous years. The Gini index for Slovenia was 29.2 and for Croatia 31.1 for the same year (World Bank, 2013). One could notice that Gini index for Serbia was not much higher than in the neighbouring countries with more successful transition. It is interesting to point out that in Poland, which usually seen as a country with one of the most successful transitions (Stiglitz, 2003, p. 181), the Gini coefficient in 2002 was 34.1 (World Bank, 2013). By year 2005 the Gini coefficient was constantly rising, which is not surprising since the period coincides with the beginning of privatization and market reforms. The peak was in 2005 with a Gini coefficient of 33.4, and since then is in constant decline. This trend could be interpreted as a good sign since poverty is not rising despite recession and slowdown after the crises in 2008. It was argued in the literature that it is easier to address issues of inequality when a country is growing than when it is in recession (Kolodko, 1999). In the case of expansion the country needs to

decide how to distribute income that is growing. On the other hand, in the recession the question is how to distribute the loss of income (Kolodko, 1999). These facts explain why it is important that Serbia managed to decrease inequality in times when economy was in recession. The Gini trends displayed here support the findings of Kecmanović (2012) who discovered that despite the bigger income dispersion the inequality levels in Serbia were falling.

Figure 12: Gini Coefficient in Serbia, 2002-2009



Source: World Bank, 2013

6.3. Outcomes of Privatization in Serbia

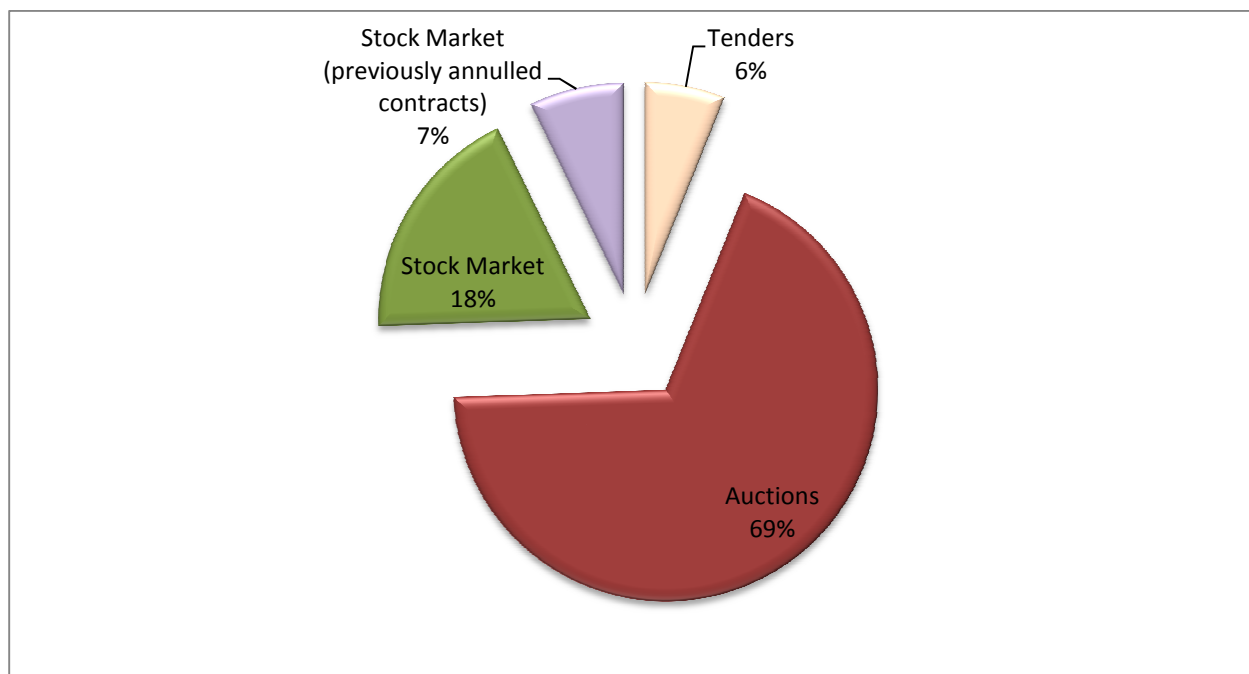
After making a wider picture about the transition and privatization progress, from now on the analysis will be focused on the privatization outcomes in Serbia. Tables 2 and 3 present the sum of privatization process up to 2011. Table 2 includes the total of enterprises offered in the observed period, book value (B) and purchase price (P) of companies and also the ratio between purchase price and book value (P/B). Table 3 presents investment in social programs. So far, these data are the only data about privatization process provided by authorities in Serbia.

Table 2: Privatization Results from 2002 till 2011

Sum 2002-2011	Sum offered	% of success	Book value (B) in 000 EUR	Purchase price (P) in 000 EUR	P/B
Tenders	218	41%	926.425	1.098.969	1.19
Auctions	2460	64%	978.206	882.160	0.90
Stock Market	660	85%	512.159	526.308	1.03
Stock Market (previously annulled contracts)	259	66%	92.873	100.280	1.08
Stock market⁶ (previously privatized)	1051	84%	73.605	50.364	0.68
Total	3.597	66%	2.583.258	2.658.081	1.03

Source: Vujačić and Vujačić, 2011

Figure 13: Shares of privatization types, 2002-2011

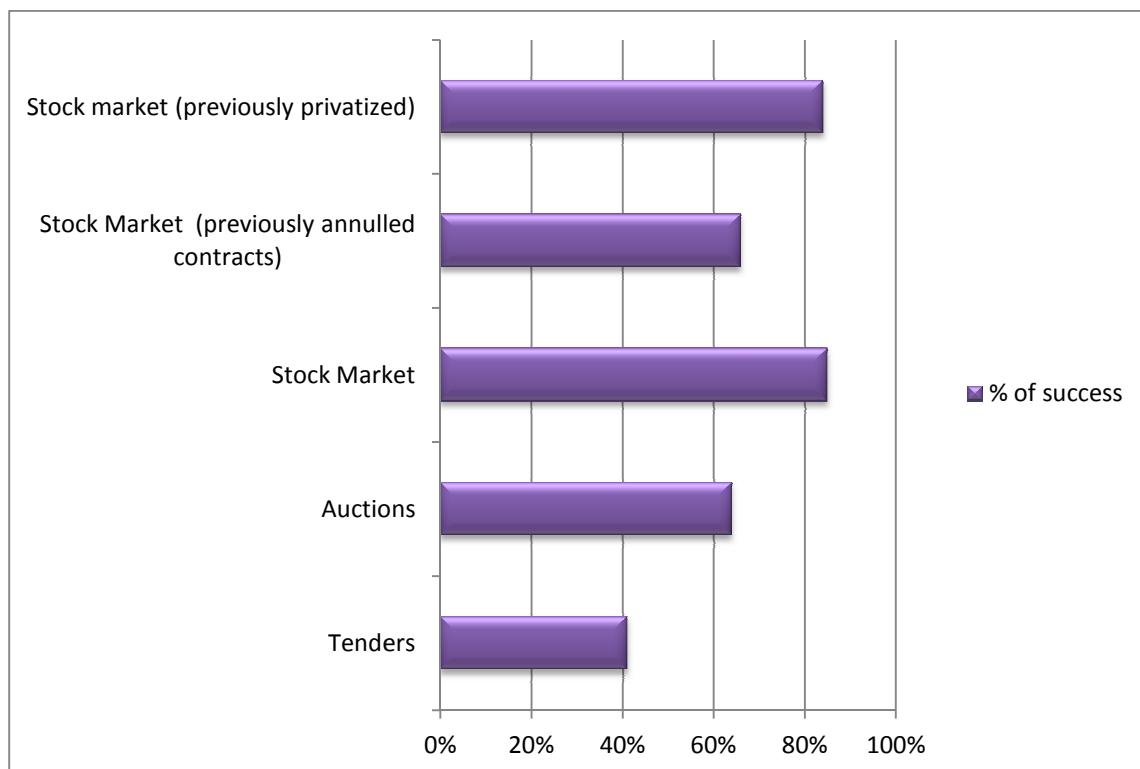


Source: Author's calculations based on the data obtained from Vujačić and Vujačić, 2011

⁶ Not included in total of number of offered enterprises since enterprises are already part of auctions and tenders. On the other hand, book and purchase value is included in the total sum since that represents the value obtained on the stock market.

As was mentioned before, the main ways of sales were tenders and auction. Figure 13 clearly demonstrates the shares of privatization types in the whole process. It could be noticed that the least number of companies was offered through tenders- 218 enterprises or 6% of the total number. Since tenders were only for large SOEs this number is not unexpected. The prices reached in tenders were 19% higher than the book value (P/B ratio 1.19). Tendere had the smallest rate of success compared with other means of privatization (Figure 14). Again, this could also be due to selling only large enterprises in tenders. It is harder to find an investor for more expensive and larger firms. Since the companies sold in tenders were well performing large state enterprises, foreign experts were engaged in the process of evaluating the enterprises. These companies were very important to the country and efforts were made in making the process fair and transparent.

Figure 14: Percentage of Success of Different Privatization Methods



Source: Author's calculations based on the data obtained from Vujačić and Vujačić, 2011

When it comes to auctions, the situation was different. Enterprises included in the process were small and medium sized and their number was higher. To be more specific, in the period from 2002 to 2011 there were 2460 enterprises offered through auctions. It represents 69% of the total number in the observed period (Figure 13). The P/B ratio shows that purchase price was actually lower than the book value. The explanation for such a trend lies in the way purchase prices were formed in the case of auctions. In the beginning of the privatization process the Dutch auction was used. To be more specific, the starting price was the highest and evaluated by consultants. During the auction, the price is decreasing and

the process is done when a bidder expresses willingness to buy an enterprise. In August 2002 the methodology was changed to English auction and the starting price was corrected book value (Vujačić and Vujačić, 2011). English auction is an ascending bidding and in Serbian case the starting price was 80% of determined value (Vujačić and Vujačić, 2011). It was argued that corrected book value actually gave advantage to the insiders of the company, since they were the only in the possession of firms' real value. This could explain why in the case of auctions enterprises were sold under the book value. The rate of success was 64% (Figure 14) which is higher than in tenders, but still not high enough to consider auction as successful way of privatization.

When it comes to selling through stock market, the biggest rate of success had enterprises that already were in the process of privatization before the new law was passed. The results are quite surprising when it comes to price evaluation of previously privatized enterprises. As can be seen from the table the number of enterprises included in this category is 1051, but estimated book price for all enterprises is a bit more than 73 million euro. In addition, the purchase price was 68% of book value (P/B ratio 0.68). Vujačić and Vujačić (2011) were hesitant to go deeper in the analysis of this data but they agreed that these numbers require further research and explanations.

However, it could be speculated that price manipulation was the main reason for such low values. This assumption leads us back to the theoretical framework and the monitoring problem in state enterprises. These enterprises entered the process of privatization under a different political regime when property rights were not clearly defined and when the system of workers self management was still valid. Especially during 1990s monitoring of SOE's performance and managers in charge was not the priority. The insiders could have and were using the advantages possessing asymmetric information. Delayed transition, sanctions and high inflation rates encouraged the emergence of gray and black economy allowing individuals to get wealthy in a short period of time. These wealthy individuals made political connections which helped them to take part in the privatization process and make most of it for personal benefits. In the state companies workers still had stakes in ownership structure. The majority shareholders could have used their advantage of possessing asymmetric information and possibly devaluated the value of the company on purpose. Small shareholders not being familiar with the true value of the company could have sold their shares for small amounts of money to individuals who had interest in getting the full ownership. In addition, hyperinflation during 1990s could also contribute to devaluating the prices of property. However, it needs to be pointed out that these are only speculations and these data leave space for some further, more detailed research.

Table 3: Social Program Expenditures in Different Privatization Methods, 2002-2011

Sum 2002-2011	Social Program (S) in 000 EUR	S/B
Tenders	276.689	0.30
Tenders- annulled	2.042	0.00
Auctions		
Stock Market	0	
Stock Market (previously annulled contracts)	0	
Stock market (previously privatized)	0	
Total	276.689	0.11

Source: Vujačić and Vujačić, 2011

Data for the social expenditures are very scarce and nothing much could be inferred from it. The only amount of social spending reported is for tenders. It was noted in one of the previous subsections that the biggest emphasis on social programs was put in tender sales (Vujačić and Vujačić, 2011). This is simply because large enterprises were often overstaffed and in order to prevent or alleviate the consequences of layoffs the government was making these social programs a part of the contracts. In the case of auction it cannot be concluded that there were no expenditures since it is not stated if there were investments or not. One could settle for arguing that the expenditures were probably the biggest and most important in large enterprises that were sold through tenders.

7. CONCLUDING REMARKS

Empirical evidence revealed that Serbia made certain efforts in catching up with other countries during the last decade. All six EBRD indicators used showed that Serbia had at least 8 to 10 year lag in transitional reforms with regard to progress of Slovenia and Croatia. However, in 2012 Serbia managed to either be on equal levels with Slovenia and Croatia or at least close. Serbia obtained the best results in price liberalization and trade and forex system. Privatization of small enterprises was also evaluated as a success. But, when it

comes to the rest of the indicators (large scale privatization, enterprise restructuring and competition policy) Serbia still has a long way to go to improve its performance.

When the focus is switched only to the macroeconomic situation in Serbia, the picture looks less optimistic. GDP series show that the economy never really recovered from all the shocks Serbia went through in the last 20 years. A transition economy should have higher GDP growth rates in order to demonstrate that it is actually developing. One of the reasons for lower growth rates is that the economy does not have enough resources to encourage higher growth rates. Additionally, the FDI levels in Serbia are not very high (with a few exceptions) meaning that Serbia is still not attractive enough for foreign investors to engage in purchasing state enterprises. The image of the current situation looks even darker when levels of employment are analyzed. It seems that privatization led to severe layoffs resulting in more than 60% reduction in employment in enterprises that were subject to privatization. However, the good side is that there was no big increase in inequality for that period. Inequality was rising in the beginning of privatization process which could have been expected, but since 2005 it is in constant decline even in the period of crises.

When privatization results are summed up for the years from 2002 till 2011, it could be concluded that the rate of success was the biggest in the situations when the value of enterprises was undervalued. This occurred mainly in the case of enterprises that commenced the privatization process within the old law regulation and socialist regime signifying that insider information was playing a significant role. After the new law was passed this situation was improved and in the majority of cases SOEs were sold for price higher than the book value. Social programs were emphasized the most in tender sales while for the rest we cannot claim anything with certainty due to the lack of data.

The question is what could be further inferred from this analysis and the case of Serbia. Using the theoretical framework supporting privatizing SOEs as the starting point the expectations are that privatized companies would prove to be more efficient. So far, Serbia's economy is not indicating the rise of private sector that encourages economic growth and recovery. What could have gone wrong?

The first argument of theoretical foundation was that managers of private firms have better incentives for making entrepreneurial decisions for maximizing profits. However, retaining the old social regime until year 2000 resulted in unjust privatization of SOEs that entered the process in 1990s. Enterprises were undervalued which led to a big giveaway process. This further directs us to another theoretical argument- the problem of asymmetric information. Firms privatized in the old regime were sold to insiders who possessed valuable information and took advantage of them during the process. Consequently, we could conclude that these enterprises are not contributing to a better allocation of resources and bigger efficiency because they might have been used for actions such as money laundering of the wealth acquired during 1990s. Such argument is in accordance with the study by Banerjee and Munger (2004) which revealed that the timing, pace and intensity of the

privatization process depend on the political benefits. In addition, Boycko et al. (1996) pointed out that the links between enterprises and politics need to be severed in order to have positive effects.

When taking into concern experiences of other countries and extensive literature presented in this paper another question is about the existence of an “ideal” model of privatization. In the beginning of the 1990s international organizations such as IMF and MMF believed that sudden and radical changes would drive growth in transition countries (Stiglitz, 2003). When “shock therapy” started showing drawbacks some of the countries switched to the gradual approach. Stiglitz argues that a gradual approach to transition and privatization is a better choice of reforms (Stiglitz, 2003). In support, Gouret (2007) discovered that gradual sales in privatization contributed to a better economic performance. Serbia chose the gradual approach, but even after a decade the positive effects on growth are still lacking. One could argue that a gradual approach could also be problematic in a sense that it is a way of postponing the process. On the other hand, it could be the case that the positive effects will come with a certain time lag. A study by Estrin et al. (2009) demonstrated that effects in Central Europe are bigger in the later privatization period. This could also happen in Serbia considering that the whole process of transition and privatization was delayed.

What this paper argues for in the case of Serbia is that the success of the privatization process and of privatized firms will depend on the existence of a political and institutional structure which supports market reforms. The main reason why Serbia is displaying such a sluggish performance seems to be that the links with politics were maintained for too long. Without appropriate law enforcement and well defined property rights the whole privatization process leaves space for corruption and money laundering. This argument supports studies that showed that privatization gives positive effects only when it is coupled with regulations and institutional reforms (for example, Sachs et al, 2001; Moshiri and Abdou, 2010). For the privatization success there needs to be a political regime which supports market reforms and suppresses both corruption and rent seeking.

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APPENDIX

Official EBRD methodology and explanations for each of the indicators are presented below. The methodology was downloaded from http://www.ebrd.com/pages/research/economics/data/macro/ti_methodology.shtml.

Overall transition indicators

- Large-scale privatisation

1 Little private ownership.

2 Comprehensive scheme almost ready for implementation; some sales completed.

3 More than 25 per cent of large-scale enterprise assets in private hands or in the process of being privatised (with the process having reached a stage at which the state has effectively ceded its ownership rights), but possibly with major unresolved issues regarding corporate governance.

4 More than 50 per cent of state-owned enterprise and farm assets in private ownership and significant progress with corporate governance of these enterprises.

4+ Standards and performance typical of advanced industrial economies: more than 75 per cent of enterprise assets in private ownership with effective corporate governance.

- Small-scale privatisation

1 Little progress.

2 Substantial share privatised.

3 Comprehensive programme almost ready for implementation.

4 Complete privatisation of small companies with tradable ownership rights.

4+ Standards and performance typical of advanced industrial economies: no state ownership of small enterprises; effective tradability of land.

- Governance and enterprise restructuring

1 Soft budget constraints (lax credit and subsidy policies weakening financial discipline at the enterprise level); few other reforms to promote corporate governance.

2 Moderately tight credit and subsidy policy, but weak enforcement of bankruptcy legislation and little action taken to strengthen competition and corporate governance.

3 Significant and sustained actions to harden budget constraints and to promote corporate governance effectively (for example, privatisation combined with tight credit and subsidy policies and/or enforcement of bankruptcy legislation).

4 Substantial improvement in corporate governance and significant new investment at the enterprise level, including minority holdings by financial investors.

4+ Standards and performance typical of advanced industrial economies: effective corporate control exercised through domestic financial institutions and markets, fostering market-driven restructuring.

- Price liberalisation

1 Most prices formally controlled by the government.

2 Some lifting of price administration; state procurement at non-market prices for the majority of product categories.

3 Significant progress on price liberalisation, but state procurement at non-market prices remains substantial.

4 Comprehensive price liberalisation; state procurement at non-market prices largely phased out; only a small number of administered prices remain.

4+ Standards and performance typical of advanced industrial economies: complete price liberalisation with no price control outside housing, transport and natural monopolies.

- Trade and foreign exchange system

1 Widespread import and/or export controls or very limited legitimate access to foreign exchange.

2 Some liberalisation of import and/or export controls; almost full current account convertibility in principle, but with a foreign exchange regime that is not fully transparent (possibly with multiple exchange rates).

3 Removal of almost all quantitative and administrative import and export restrictions; almost full current account convertibility.

4 Removal of all quantitative and administrative import and export restrictions (apart from agriculture) and all significant export tariffs; insignificant direct involvement in exports and imports by ministries and state-owned trading companies; no major non-uniformity of

customs duties for non-agricultural goods and services; full and current account convertibility.

4+ Standards and performance norms of advanced industrial economies: removal of most tariff barriers; membership in WTO.

- Competition policy

1 No competition legislation and institutions.

2 Competition policy legislation and institutions set up; some reduction of entry restrictions or enforcement action on dominant firms.

3 Some enforcement actions to reduce abuse of market power and to promote a competitive environment, including break-ups of dominant conglomerates; substantial reduction of entry restrictions.

4 Significant enforcement actions to reduce abuse of market power and to promote a competitive environment.

4+ Standards and performance typical of advanced industrial economies: effective enforcement of competition policy; unrestricted entry to most markets.