Serbia: Economically catching up, politically lagging behind1
Milica Uvalic
University of Perugia
Prepared for the 16th AISSEC Conference
Parma, June 21-23, 2007

1. Introduction

After the break-up of the Yugoslav federation in 1991, there has been a substantial divergence in the transition paths of its successor states. The present paper considers the case of Serbia, the largest of the newly created countries, where until fairly recently the transition to market economy has been substantially delayed. In what follows, the most important political events of the 1990s will be recalled and their impact on macroeconomic performance and economic reforms in Serbia during the first decade of transition (section 2). The more recent economic reforms implemented by the post-Milosevic governments after October 2000 are then discussed (section 3). Taking into account the overall results of transition, an assessment is made of the present systemic features of the Serbian economy (section 4). A few concluding remarks are given at the end (section 5). Although the focus is on Serbia, the analysis also refers to the Federal Republic (FR) of Yugoslavia, and after 2003 to Serbia and Montenegro, the country Serbia belonged to until June 2006.2 Kosovo, although in June 2007 still officially part of Serbia, is explicitly excluded from the analysis.3

2. Delayed transition during the 1990s

The transition to market economy and multiparty democracy in SFR Yugoslavia, including Serbia, also started in 1989.4 In December 1989 the federal government implemented a bold macroeconomic stabilization program and launched the first privatization law, while the first multiparty elections were held in all republics soon after, in Serbia in December 1990. The transition was, however, interrupted by the severe political crisis and the break-up of the country in June 1991.

---

1 This paper draws heavily on an earlier paper Uvalic (2007), forthcoming in Estrin, Kolodko and Uvalic (eds), (2007).
3 According to the UN Security Council Resolution 1244 adopted in mid-1999, Kosovo officially remained part of Serbia, but has since then effectively been governed by the United Nations Mission in Kosovo (UNMIK). All statistical data after 1999 on FR Yugoslavia/Serbia therefore do not include Kosovo.
4 It could be argued that transition to market economy in Serbia/SFR Yugoslavia started much earlier, but two fundamental changes marked a radical break with the previous economic and political system in 1989-90: privatization launched in December 1989, and the first free multiparty elections held soon after in all Yugoslav republics.
Thereafter, a number of essentially political events have had very negative implications for most of its successor states, including Serbia. The disintegration of the Yugoslav federation was accompanied by the break-up of its economic and monetary union, loss of markets and of a common currency, four military conflicts in which Serbia/FR Yugoslavia has been directly or indirectly involved, nationalistic policies which gave priority to political over economic objectives, high costs of maintaining almost one million refugees from Bosnia and Croatia, and substantial delays in political reforms which postponed effective democratization and the establishment of a functional state. On the international front, severe political and economic sanctions were imposed against FR Yugoslavia during most of the 1990s, culminating in the 11-weeks NATO bombardments in 1999. International sanctions interrupted not only normal trade flows and foreign direct investment (FDI), but also bank transfers, access to international financial markets, membership in international organizations, general inflow of information and free travel abroad, since airports were closed and visas introduced even by neighboring countries. Most of these events have had destabilizing effects for the whole Southeast European (SEE) region, but the implications for the Serbian economy have been particularly devastating. These events have also directly influenced the slow process of economic transition and integration of Serbia with the European Union (EU).

Following the disintegration of SFR Yugoslavia in June 1991, in just a few years the economy of the new FR Yugoslavia virtually collapsed (Uvalic, 2001a). By the end of 1993, GDP had fallen to just 43 per cent of its 1989 level. Expansionary monetary and fiscal policies necessary to finance the war in 1992-93 led to one of the highest and longest hyperinflations ever recorded in world history - by the end of December 1993, an average annual rate of 116.5 trillion per cent. The 1994 stabilization program of central bank governor Dragoslav Avramovic was very successful in halting hyperinflation (average inflation in 1994 was down to 3.3 per cent), introducing a convertible dinar, and reversing the trend of declining output, but these positive results were short-lived, essentially due to lack of systemic change. In the second half of the 1990s, despite economic recovery inflation again became double-digit, exports stagnated contributing to a rising current account deficit, and the black market exchange rate in 1997-98 remained six times the official rate. After the conflict in Kosovo in 1999, GDP declined by 18 per cent, industrial production by 21 per cent, and exports by as much as 50 per cent. Over the whole 1990-99 period, foreign direct investment (FDI) amounted to just US$ 1 billion, almost entirely due to the only important privatization deal, the 1997 partial privatization of Serbian Telecom.

Throughout the 1990s, very little progress has been achieved in reforming the economic system. There were attempts to re-launch some important reforms, such as privatization (see below), but there were also serious policy reversals in other areas and the return to practices long abandoned in SFR Yugoslavia. These included frequent price freezes, extreme protectionism in foreign trade (very high tariffs in combination with a complicated system of import quotas, licenses and various types of permits), foreign exchange rationing and the use of multiple exchange rates, applied on a discretionary, non-transparent and ad hoc basis, frequently in order to favor primarily the political and economic elite. During the years of sanctions,

---

employment security was even strengthened through a law explicitly prohibiting layoffs, thus postponing enterprise restructuring.

Regarding the enterprise sector, contrary to all other successor states of SFR Yugoslavia (including Montenegro within FR Yugoslavia), where ‘social property’ was first re-nationalized in an attempt to clarify property rights and thus facilitate privatization, in its new 1992 Constitution Serbia maintained ‘social property’ as one of the four property forms (alongside private, mixed, and cooperative property). Despite two new privatization laws and abundant related legislation (1991, 1994, 1996, 1997), since privatization was to be initiated voluntarily, by decision of the enterprise’s General Assembly, the larger part of enterprises (and of the economy) remained under the ambiguous ‘social property’ regime. There was no radical break with workers’ self-management, since ‘social property’ also implied the partial maintenance of workers’ management rights. Only a small number of firms in ‘social property’ (the most important ones) were re-nationalized and also excluded from privatization, in order to ensure government control over the strategically most important enterprises. These state-owned firms which under self-management were run relatively independently by workers and managers, came under the supervision and direct control of government ministries. Instead of abandoning state paternalism, there was a step backwards towards governance mechanisms abandoned more than half a century ago (Cerovic, 2000). Not surprisingly, by 2000 the contribution of the private sector to GDP was still less than 40 per cent. Only small-scale privatization had been partially implemented, mainly resulting in widespread ownership by insiders who frequently owned worthless shares (though there have been cases of successful insider-owned firms). Instead of breaking up large enterprises, economic power further concentrated in a handful of state-protected firms, for which soft budget constraints have been maintained through various direct and indirect privileges.

A decade of political and economic instability and very selective application of transition has had far-reaching social consequences. Along with falling incomes and living standards, there was notable social differentiation with adverse effects on the distribution of income and wealth. Absolute poverty roughly doubled during the 1990s. Social protection and health services rapidly deteriorated. The banking system was abused of for political purposes, in 1992 through the freezing of citizens’ foreign currency bank accounts, and later through fraudulent financial pyramid schemes which deprived many Serbian citizens of their life-long savings (see Dinkic, 1995). Laws were arbitrarily implemented (if at all), with different criteria applied for the different segments of the economy, substantially weakening the rule of law. International sanctions created incentives for smuggling, illegal activities, organized crime and ‘war profiteering’ (Babic, 1999). New phenomena appeared in Serbia which could be characterized as elements of ‘wild’ capitalism (Uvalic, 2002). Parallel to the mass impoverishment of the larger part of the population, a new oligarchy was born recruited among directors of big factories and the closest political collaborators of President Milosevic. The political system was deeply corrupted and

---

6 SFR Yugoslavia’s 1974 Constitution defined social property explicitly as no-one’s property, as property of the whole society. Enterprises were granted the right to use socially-owned resources, but not full property rights (Uvalic, 1992, pp. 60-1).

7 The problem of citizens’ foreign exchange savings frozen in 1992 has been addressed only after the 2000 political changes: a part was paid back to citizens in cash, whereas another part was converted into government bonds.
manipulated. The new oligarchs’ strong influence over state institutions entailed significant benefits: they were in charge of the rules of the game throughout the 1990s, including foreign trade transactions which under sanctions secured enormous profits, and had used their position and various illegal and semi-legal channels to transfer capital to new private firms or personal bank accounts abroad. Many years of international isolation have contributed to the strength of the political elite, which has had a decade to entrench itself, forge new alliances (also with the underworld) and adapt to the post-1989 order (Kekic, 2000). Under sanctions, smuggling had also become the main source of earnings for many citizens, contributing to the flourishing of the informal economy. Various forms of criminality became common in everyday life, including robbery, kidnapping, murders and false suicides, of which the responsible have never been found. During the most difficult times when it was impossible to get a normal bank credit, the ‘new rich’ entrepreneurs were offering loans at weekly interest rates which were multiple the normal ones. A dramatic social differentiation of the Serbian society took place: a rapid decline in real incomes of the larger part of the population, parallel with the enrichment of a new and tiny social elite.

The severe economic and social problems that accumulated during the 1990s were frequently presented by the Serbian government as proof that the transition had prevalently negative effects, in this way also serving to justify the choice of a ‘gradualist’ strategy. In reality, vested interests of the political and economic elite prevented more radical economic and political reforms. The economic system for the most had changed little, or had regressed with respect to the model of market socialism that existed before 1989. The political system, though formally a multi-party democracy, was dominated by the Socialist Party of Serbia (SPS), or rather by its President Slobodan Milosevic and his closest collaborators.\(^8\)

3. Post-2000 reforms

A radical change in the course of transition in Serbia came after the October 2000 political changes which marked the end of the Milosevic regime. Over the last six years, the new policies have produced impressive results in many areas, though more limited progress in others.\(^9\)

One of the most urgent tasks of the Serbian/Yugoslav government in late 2000 was macroeconomic stabilization, given that price liberalization, necessary in order to eliminate major price distortions, initially also led to a high average inflation rate - of over 90 per cent in 2001. Substantial disinflation was achieved thereafter, by 2004 to a one-digit figure (see Table 1). Although average inflation in 2005 again jumped to 17 per cent (mainly due to higher oil and electricity prices and wage increases), in 2006 it is expected to decline to 12.7 per cent and further to 8 per cent in 2007. Tight monetary policy has contributed to a strong real appreciation of the dinar (2001-03) followed by exchange rate stability, and more recently again real

---

\(^8\) As observed by the BBC correspondent, ‘In almost all respects, the state in Serbia was synonymous with Milosevic’s Socialist Party of Serbia, which in turn had offered the old bureaucracy and its dependants a new lease of life in rather ill-fitting democratic clothing’ (Glenny, 1991, p. 40).

appreciation, introduction of current account convertibility and an impressive increase in foreign exchange reserves (US$ 11.7 billion by end-2006).

Serbia recorded relatively high public deficits in 2001-03, but thereafter achieved a balanced budget or even surpluses, in 2006 estimated at 2.7% of GDP (Table 1). Radical fiscal reforms have included a major simplification of the tax system, the passage to gross wages for social contribution purposes, the introduction of value-added-tax, and measures to fight the informal economy (such as fines for the non-issuing of bills). Nevertheless, the structure and level of public expenditure has not changed much, in 2005 representing 43 per cent of GDP, but this is a problem common to other SEE countries (Croatia and Bosnia and Herzegovina have even higher public expenditure).

Growth performance has been impressive throughout most of the 2000-6 period (see Table 1). The real GDP growth rate was 4-5 per cent in 2000-02, it slowed down to 2.4 per cent in 2003, but was 9 per cent in 2004, 6 per cent in 2005-06, and is likely to stay around high (over 6 per cent) also in 2007. The strong economic recovery, however, has been largely insufficient to compensate for the very substantial fall in output during the 1990s. Although most other SEE countries are in a similar situation (by 2004, only Albania had attained its 1989 GDP level), Serbia is by far in the worst situation, having by mid-2005 reached at most around 60 per cent of its 1989 real GDP. In 2005, Serbia had a GDP per capita of US$ 3250 (at market exchange rates), therefore higher than Albania, Bosnia and Herzegovina, and Macedonia; or at Purchasing Power Parity (PPP) of US$ 6540, somewhat higher only of Albania (Economist Intelligence Unit (EIU), December 2006; see Figure 8.1). Serbia’s present GDP per capita corresponds to about 30 per cent of the EU-25 average.

Recent strong economic recovery has not yet brought employment growth, on the contrary. Over 2001-05, the unemployment rate (based on labor force survey) has continued increasing, from 13.3 per cent to 21.8 per cent, the long-term unemployment rate has also increased from 9.0 per cent to 17.3 per cent, parallel with a decline in the employment rate from 59.7 per cent to 51 per cent respectively (Commission, 2006a). Though these high unemployment rates overestimate the effective number of jobless workers since many are still active in the informal economy, unemployment is a key economic problem and is likely to worsen with further enterprise restructuring and privatization. Recent government measures have been largely unsuccessful in reversing these trends.

Serbia’s external sector is also characterized by serious imbalances. The trade deficit has reached historical records, 25 per cent of GDP in 2004, though slightly declining thereafter (to 22 per cent in 2006). Serbia’s exports have remained stagnant during the 1990s, but have roughly doubled in 2001-05, particularly to the EU facilitated by EU trade preferences granted in late 2000. However, the exports structure has not changed substantially, concentrated mainly in agricultural and low processed manufacturing products. The sluggish export performance is mainly due to the structural weaknesses of the economy, the limited restructuring and modernization of key industries which missed a whole decade of technological progress (though the strong real appreciation of the dinar has also hampered export growth). In 2002, exports were still dominated by state and socially owned enterprises, accounting for 45 per cent of total exports (World Bank, 2004, p. 55).

---

10 On exchange rate regimes in the western Balkan countries see Daviddi and Uvalic (2006).
Serbia’s current account deficit is also at critical levels and among the highest in the SEE region, despite recent improvements (from 17 per cent of GDP in 2003 it has been reduced to 10.4 per cent in 2006; see Table1.). Substantial financial assistance from international donors during 2000-06 (more than €2.5 billion only through the EU CARDS program) as well as workers remittances (10-12 per cent of GDP during 2001-03) have contributed to limiting the deficit. A large part of Serbia’s external debt to the Paris and London Club of creditors and Russia11 has been favorably written off, permitting the reduction of external debt to US$ 15 billion by 2005 and of the debt/GDP ratio from 167 per cent in 2000 to 64 per cent in 2005 (EBRD, 2006, p. 173).

Foreign Direct Investment (FDI) has been steadily increasing particularly after 2003 (see below). By end-2005, FDI stock in Serbia amounted to US$ 5.9 billion (24.4 per cent of GDP), but corresponding to just 1.5 per cent of total FDI stock in all 28 transition countries (EIU, September 2006). Record FDI inflows will be achieved in 2006, of around US$ 4 billion (EIU, December 2006). As elsewhere, the largest part of FDI has been secured through a few successful privatization deals in specific sectors (tobacco, base metals, and more recently banking and telecommunications).

In addition to improved macroeconomic performance, substantial progress has been achieved in transition-related institutional reforms. Looking at EBRD transition indicators in late 2000, the only areas where some economic reforms had been implemented in Serbia were small-scale privatization and price liberalization (see Table 2.). Just a year later, the EBRD evaluated Serbia and Montenegro as ‘the fastest reformer’ among all 27 transition economies. Thereafter, many economic reforms have been carried forward successfully.

Privatization has progressed according to a new 2001 law, based on cash-based sales at tenders and auctions, which fundamentally changed the strategy away from the insiders’ model used in the 1990s towards commercial sales. During the first four years of its application, some 1500 firms were privatized (out of 3000 envisaged for privatization) and small-scale privatization has been almost completed, though large-scale privatization has been delayed. The private sector share of GDP increased from less than 40 to 55 per cent during 2000-06, but fundamental problems remain in the enterprise sector. FDI has gone into a few best companies (by October 2004, only 39 firms were sold at tenders), whereas in many privatized firms the change of ownership has left many problems unresolved, including poor corporate governance and lack of restructuring. In the still non-privatized part of the economy, there are more than a thousand socially-owned firms that have not found potential buyers (end-2006); some of these are heavily indebted loss-making firms, that since 2001 have been waiting for a new bankruptcy law, adopted only in 2006. In addition, over 70 socially-owned enterprises have been selected for a special restructuring program, but its implementation has also been delayed without justification. The strategically most important firms nationalized in the early 1990s, representing 35 per cent of Serbia’s capital, have started being privatized only in 2006-07 - such as the oil and gas company NIS or the Bor mining and smelting complex.12 These are among the

---

11 Only in 2004 around US$2.5 billion of foreign debt was written off, as a result of deals with the London Club, the Paris Club and Russia.
12 A detailed account of privatization results in Serbia is found in Cerovic (ed) (2006).
reasons why Serbia in 2006 still had a low 2+ EBRD score in governance and enterprise restructuring.

A lot of progress has been achieved in both price and foreign trade liberalization. By 2005 the average tariff rate has been reduced to around 7 per cent, the tariff structure has been greatly simplified, and trade liberalization has been implemented within the SEE region. By contrast, very limited results have been achieved in competition policy (the EBRD score being the lowest of all, 2-). Only in September 2005 did a new competition law come into effect, while in May 2006 the Commission for protection of competition became operational. De-monopolization of the Serbian economy has been delayed, as many domestic state and socially-owned enterprises continue to be sheltered from competition from abroad through non-tariff barriers, or face soft-budget constraints and are often in a better position than private firms regarding access to bank credit or tax relief. Budget subsidies to large loss-making firms have remained among the highest in the SEE region, around 3.7 per cent of GDP; in 2003, according to a World Bank survey, some 12 per cent of Serbian firms perceived no competition on the local market (World Bank, 2004, p. 34).

As to financial reforms, a number of loss-making banks were closed at an early stage, including four of the largest banks representing 55 per cent of total assets of the banking sector. Though privatization of the banking sector was initially delayed, it speeded up after 2004 and by mid-2006, 18 foreign banks were operating in Serbia, foreign ownership already accounted for 77 per cent of banking assets, while the remaining assets were in the hands of 19 domestic banks, 12 of which were state-owned (Commission, 2006a; Zdrale, 2006). Despite increasing competition, the net interest spread, though declining, has remained high: 11 per cent in 2005, substantially higher than the SEE average of 7 per cent or the Central East European (CEE) average of 4 per cent (Commission, 2006a). Currency substitution is also relatively high, as foreign currency deposits account for around 70 per cent of total deposits. Due to delays in privatization, the capital market remains underdeveloped, dominated by state bonds on frozen foreign currency deposits. Although in mid-2006, some 100 Serbian firms were quoted on the Belgrade stock exchange, traded annual stock amounted to only about € 500 million. Regarding non-financial institutions, the National Bank of Serbia has recently withdrew licenses of insurance companies not satisfying required standards.

The business environment has also substantially improved. According to the World Bank Doing Business Survey, Serbia and Montenegro was the top reformer in 2004, having been evaluated favorably in 8 of the 10 indicators (such as capital and time needed to start a new business, resolve commercial disputes, or labor legislation). In the 2006 Doing Business Survey, Serbia improved its relative position further in five of the ten indicators and ranked 1st among all six western Balkan countries, 13th among the 28 European and Central Asian countries (ahead of some

---

13 FR Yugoslavia has signed free trade agreements (FTA) with seven SEE countries, as envisaged by the Stability Pact's June 2001 Memorandum of Understanding on Trade Liberalization and Facilitation. These FTAs are in the process of being transformed into one agreement under the framework of the Central European Free Trade Agreement (CEFTA).

14 Société Générale, Raiffeisen Bank, HVB Bank, Hypo Alpe-Adria Bank, Banca Intesa, ProCredit Bank, Alpha Bank, National Bank of Greece, to mention just a few.
of the EU new member states such as Poland), and 68th in the aggregate ranking of 175 countries, having been upgraded from the 95th position it occupied in 2005.

Overall, impressive results have been achieved in most areas. Nevertheless, in mid-2006, with a 55 per cent contribution of the private sector to GDP, Serbia was still lagging behind the large majority of transition economies (all except five).15 The ‘politically correct’ model of privatization was chosen in 2001 based on commercial sales, as suggested also by World Bank experts, justified by arguments of economic efficiency, rather than social justice which has guided previous privatizations (see Uvalic, 2004). It would have been wiser to have adopted a multi-track privatization strategy; as anticipated in 2001 (Uvalic, 2001b), many socially-owned enterprises have not found potential buyers and are likely to survive well beyond the set deadlines. These enterprises should have been closed during the initial phase or, as a socially more acceptable solution, could have been given freely to workers, in line with the long tradition of self-management. Even if this would have led to a number of insider-owned firms, this could have been, also in Serbia, a highly pragmatic means of effecting initial privatization. As in many other transition economies, employee ownership would most probably have been a transitory form of organization, eventually leading to a shift in ownership from insiders to outsiders (Nuti, 1997, p. 179).

There are also other complementary areas of reform which could have facilitated faster progress in the real sector of the economy had they been implemented earlier, such as bankruptcy legislation, the general hardening of budget constraints, breaking up monopolistic structures, promoting competition, more substantial support of new private firms, radical reforms of the judiciary as to ensure the rule of law, better governance mechanisms and protection of property rights – in line with the ’New Washington Consensus’ (Kolodko and Nuti, 1997). These conditions on their own could have delivered many of the advantages expected of privatization (Uvalic and Nuti, 2004, p. 13).

4. Systemic features of the Serbian economy

Given the overall results of market-oriented economic reforms implemented so far, how different is Serbia today with respect to other countries in transition? The more radical economic reforms implemented in Serbia over the last six years have permitted its transformation, among transition countries, from a laggard to a frontrunner. In many areas of reform Serbia has caught up the other countries, and has even surpassed some SEE (and many CIS) countries (see Table 2). Thus today there are no longer large differences between the results achieved in Serbia and other SEE (even some CEE) countries, particularly regarding price liberalization, the trade and foreign exchange system, small-scale privatization, or the business environment. In other fields progress has been much slower - enterprise governance and restructuring, development of securities markets and non-bank financial institutions, competition policy - but these are areas where fundamental changes have been much slower in other transition economies as well.

Despite major similarities to other transition countries, Serbia still retains certain specific features which explain why its post-2000 transition has been quite

15 Among all 28 transition economies, in mid-2006 there were only five countries where the private sector share of GDP was lower or equal to that of Serbia: Belarus, Bosnia and Herzegovina, Tajikistan, Turkmenistan and Uzbekistan.
unique, much more complex than initially anticipated. It has been proposed (Uvalic, 2007) that this is due to essentially two groups of factors: its different socialist legacy, and the turbulent 1990s.

Socialist legacy: Has anything remained of Serbia’s 1989 specific economic features (see Uvalic, 1991)? The main advantage of a shorter reform agenda, thanks to reforms undertaken in the past, has mainly been lost, due to many reversals in economic policies during the 1990s away from a market economy. There is one advantage, latent during many years of isolation and sanctions, that has recently forcefully re-emerged, however: the rich experience accumulated during several decades of intense contacts with the West – of enterprises, commercial banks, government institutions, individuals – is today proving valuable for re-establishing relations worldwide at all levels.

As to the disadvantages, one of the elements of the old economic system that has robustly survived these 17 years of transition in Serbia is ‘social property’. The same systemic feature that was a burden in 1991 – ill-defined property rights – has remained a burden today. Under socialism ‘social property’ could have been considered an advantage of Serbia/former Yugoslavia with respect to other socialist countries where enterprises were in state property, but after 1989 it has clearly become a disadvantage, since in many cases it has slowed down enterprise privatization and restructuring.

Another disadvantage that characterized SFR Yugoslavia with respect to other CEE countries in 1989 was resistance to change, due to a higher degree of popular support of the existing regime. This disadvantage today may still be more present in Serbia than in many other transition countries, but for different reasons than those in 1989 (see below).

Legacy of the 1990s: The transition in Serbia has proved to be rather complex not only because of the survival of pre-1989 economic features and the postponement of radical change for a whole decade, but because of the numerous problems which emerged after 1991. The 1990s was not simply a lost decade from the standpoint of transition (see Begovic and Mijatovic, 2005); it was a decade of particularly unfavorable overall conditions associated with wars, isolation, non-democratic regime, hyperinflation and reversals in economic reform, which have left profound traces on all segments of Serbia’s society. The general conditions for re-launching transition in Serbia in late 2000 were consequently far worse than those in 1989 when the transition first started. More precisely, Serbia in late 2000 did not start its new phase of political and economic transformation from scratch, but with a heavy burden of the 1990s. The retrograde political and economic system set up in 1991 and a decade of political and economic mismanagement have left many negative consequences, some of which are felt still today – in the behavior of the still non-privatized enterprises, in the criminal and semi-criminal networks that made up much of the Serbian economy in the 1990s and have proved very difficult to fully dismantle, in the highly non-transparent and still non-reformed public administration, in the insufficiently modernized judiciary, in workers’ mentality and their non-acceptance that the days of self-management are over, in the use of traditional communist methods and often highly non-democratic political culture, in citizens’ mistrust of the government and of the transition.

Though features of continuity with the old regime are not an exclusivity of Serbia – also in other post-communist countries discontinuities with the old regime have frequently been more apparent than real (Kekic, 2000) – in Serbia the element of continuity has probably been even stronger. Because of substantial delays in
radical economic and political reforms and the very negative heritage of the last 17 years, these elements of continuity are proving more difficult to eradicate.

This is closely related to the previously mentioned issue of resistance to change, which in Serbia today is present not simply because, as in many other countries, the losers from transition are still numerous. The reasons behind resistance to change in Serbia are much more complex. They include nostalgia - not only for the pre-1989 days, when the standard of living was apparently higher, employment more secure, pensions were paid regularly, travel abroad did not require burdensome visas and the country was respected worldwide - but also for some features of the 1990s system, such as the possibility to earn an extra income in the informal economy which was still tolerated, or subsidies prices of electricity, bread and milk. Resistance to change derives from the unfulfilled expectations associated with false promises of nationalism, continuous manipulations of facts by the pre-2000 government and the state-controlled television (if not all media), populist policies which for years have intentionally postponed the necessary adjustments, making today’s costs of transition in Serbia particularly high.

Serbia’s apparent ambivalence and slowness in embracing change is also a result of another key difference between Serbia and CEE countries with respect to the underlying drivers of transition and associated attitudes to the West. In the early 1990s, the geopolitical and national interests in CEE coincided with those of political and economic transition, since anti-Russian and pro-European sentiment strongly facilitated the post-1989 changes. By contrast, in Serbia the international geopolitical changes ran counter to its national interests (in particular, the negative impact of the break-up of the country for Serb minorities outside Serbia), and Western policy (which culminated in NATO's bombing in 1999) has been seen by many in Serbia as fundamentally hostile to Serb interests (Kekic, 2000).

Serbian citizens have lived a whole decade in international isolation, under sanctions and the veil of false promises of the Milosevic regime, in a world of unrealistic and irrational expectations. These are some of the factors which explain why a third of the voters in Serbia in January 2007 were still not ready to accept the new direction of change taken in late 2000, towards a capitalist market economy and full integration with the rest of Europe.

Taking into account the changing nature of the Serbian economy and its institutions, today we find the coexistence of ingredients of at least four different economic systems:

- Traditional socialism (soft-budget constraints, subsidies to loss-making firms, monopolistic practices);
- Self-managed market socialism (‘social property’ of enterprises, protection of workers rights);
- ‘Wild’ capitalism (inefficient judiciary, gaps in market regulation, insecure property rights, corruption); and
- Hyper-liberal capitalism (fast trade liberalization, substantial downsizing of the welfare state, balanced budget).

While these same elements were there in 2001 (Uvalic, 2002), what has changed in the meantime is their relative weight, as the capitalist components have gained importance. There is no doubt that today the dominant paradigm in Serbia is the liberal capitalist model. The remnants of the previous economic systems – the pre-1989 market socialist and the post-1989 socialist-capitalist system - are in the
process of being emarginated, although perhaps not as quickly as desired or expected, for all the reasons discussed earlier.

5. Concluding remarks

Although transition to market economy and multiparty democracy in Serbia has proved to be rather complex and in many ways unique, Serbia is more and more resembling other transition countries. Today it is an open market economy with dominant private ownership, it has liberalized its trade with the EU and with its neighbors, it has reformed many of its institutions, its financial sector is dominated by foreign-owned banks and there is an emerging stock exchange. Serbia is also the fastest growing economy in the SEE region, it has reached substantial macroeconomic stabilization, it has a stable (or slightly appreciating) internally convertible domestic currency, it has accumulated substantial foreign exchange reserves greatly minimizing the risk of external insolvency, privatization opportunities are still abound and FDI has been on the upward trend.

What is most important, the radical turn towards a fully-fledged market economy taken in late 2000 can now be considered irreversible. Economic transformation has reached a critical mass which precludes serious policy reversals, since eventual political changes could influence the speed of transition, but not its generally positive direction. There are still numerous challenges, the most important being further increasing competitiveness on world markets through further privatization and more substantial enterprise restructuring and modernization, but the economic prospects today have greatly improved with respect to only five years ago.

The more difficult challenges lie in the political domain. Although Serbia today has the status of a ‘potential EU candidate’, in May 2006 negotiations on a Stabilization and Association Agreement with the EU were interrupted due to the non-compliance with political criteria (essentially, the non-delivery of general Mladic). It is only recently, following the formation of the new democratic government in mid-May 2007, that there were signs that negotiations with the EU could resume soon. Considering that the very process of negotiations with the EU has recently been, also in Serbia, a very powerful engine of institutional change towards EU standards, Serbia should not be left without this important incentive for long. The other even more difficult issue is to find an acceptable solution for the status of Kosovo, which has been postponed for over seven years and is unlikely to be definitely resolved without further complicating the history and geography of the Balkans. It is to be hoped that the new Serbian government will be able to forcefully and coherently implement a pro-reform and pro-Europe agenda, so that the remaining political problems can also be resolved. This would allow Serbia to benefit from more permanent political stability, which would also clearly facilitate further progress in remaining economic reforms and economic integration with the EU.

---

16 On February 2, 2007, an ambiguous ‘blueprint for a deal’ was laid out by the UN envoy for Kosovo Martti Ahtisaari without any mention of independence. The final status of Kosovo will have to be decided in a new UN Security Council Resolution, initially announced for March but thereafter postponed, in part due to the opposition of Russia.
Table 1 Serbia – Main macroeconomic indicators, 1999-06

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation (average, %)</td>
<td>37.1</td>
<td>60.4</td>
<td>91.1</td>
<td>21.2</td>
<td>11.3</td>
<td>9.5</td>
<td>17.2</td>
<td>12.7</td>
</tr>
<tr>
<td>Government balance (% of GDP)</td>
<td>Na</td>
<td>-1.0</td>
<td>-4.9</td>
<td>-8.3</td>
<td>-3.4</td>
<td>0.0</td>
<td>0.9</td>
<td>2.7</td>
</tr>
<tr>
<td>Real GDP growth (%)</td>
<td>-18.0</td>
<td>5.2</td>
<td>5.1</td>
<td>4.5</td>
<td>2.4</td>
<td>9.3</td>
<td>6.3</td>
<td>5.8</td>
</tr>
<tr>
<td>Unemployment rate (% of labor force)</td>
<td>14.5</td>
<td>13.3</td>
<td>13.3</td>
<td>14.5</td>
<td>16.0</td>
<td>19.5</td>
<td>21.8</td>
<td>Na</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>-4.4</td>
<td>-5.1</td>
<td>-5.0</td>
<td>-17.5</td>
<td>-16.4</td>
<td>-14.8</td>
<td>-10.0</td>
<td>-10.4</td>
</tr>
<tr>
<td>FDI inflows (mln US$)</td>
<td>112</td>
<td>25</td>
<td>165</td>
<td>475</td>
<td>1360</td>
<td>966</td>
<td>1550</td>
<td>4000</td>
</tr>
</tbody>
</table>

Sources: EBRD (2006), except for: unemployment (Commission of the EU, 2006a); the 2006 inflation, GDP growth rate, and current account balance (Serbian Statistical Office, December 2006); and FDI (Economist Intelligence Unit, December 2006).
<table>
<thead>
<tr>
<th></th>
<th>Enterprises</th>
<th>Markets and trade</th>
<th>Financial institutions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Private sector share of GDP (in%) mid-year</td>
<td>Large-scale privatization</td>
<td>Small-scale privatization</td>
</tr>
<tr>
<td><strong>Serbia</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>40</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>2001</td>
<td>40</td>
<td>1</td>
<td>3</td>
</tr>
<tr>
<td>2002</td>
<td>45</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>2003</td>
<td>45</td>
<td>2+</td>
<td>3</td>
</tr>
<tr>
<td>2004</td>
<td>50</td>
<td>2+</td>
<td>3+</td>
</tr>
<tr>
<td>2005</td>
<td>55</td>
<td>3-</td>
<td>3+</td>
</tr>
<tr>
<td>2006</td>
<td>55</td>
<td>3-</td>
<td>4-</td>
</tr>
<tr>
<td><strong>SEE 2006</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Albania</td>
<td>75</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>B&amp;H</td>
<td>55</td>
<td>3-</td>
<td>3</td>
</tr>
<tr>
<td>Croatia</td>
<td>60</td>
<td>3+</td>
<td>4+</td>
</tr>
<tr>
<td>Macedonia</td>
<td>65</td>
<td>3+</td>
<td>4</td>
</tr>
<tr>
<td>Montenegro</td>
<td>65</td>
<td>3+</td>
<td>3</td>
</tr>
<tr>
<td>Serbia</td>
<td>55</td>
<td>3-</td>
<td>4-</td>
</tr>
</tbody>
</table>

*Source: EBRD, Transition report 2006.*
Figure 1. GDP per head in Southeast Europe, 2005 (in US dollars)

Source: Economic Intelligence Unit, December 2006, p. 4.
References


Commission of the European Communities (2006b) 'The Western Balkans in transition', European Economy Enlargement Papers, no. 30, December.


Economic Intelligence Unit (EIU) Country Forecast - Economies in transition - Eastern Europe and the former Soviet Union - Regional Overview (London: EIU), various issues.


European Bank for Reconstruction and Development (EBRD) Transition report (London: EBRD), various issues.


