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POLITICAL CONSTRAINTS ON SERBIA'S ECONOMIC DEVELOPMENT

Introduction

Serbia's development and transition face both political and economic constraints stemming from the 1990's (or the Milosevic regime era) as well as, from the post -Milosevic or post -Democratic revolution era (i.e. since 2001). It should come as no surprise that the some of these major constraints overlap the time periods and that inherited problems have weighed heavily on the post -Milosevic leadership.

Let us, however, start from the beginning. In 1990, Yugoslavia with all of its political problems that were about to explode, had for its Prime Minister, Ante Markovic, a man who had just launched a market oriented reform held to be extreme by most communist parties of the six republics that made up the Yugoslav federation. Political conflict led to war and breakup, but it should be remembered that the communist parties of the republics saw market reform as a direct threat to their hold on power.

Furthermore, much of the economic arguments used to push for or justify the break-up put at their core the Marxist concept of "exploitation" of their republics by the others in spite of the fact that the Federal budget covered basically the armed forces, foreign affairs, customs and the like, i.e. the very minimum of government. It is true that some funds were transferred to the underdeveloped republics (Macedonia, Montenegro, Bosnia and Herzegovina, the autonomous province of Kosovo), but these were perceived as less of a problem (less than 2% of Gross Material Product) than relative prices of various types of goods and services produced by the republics of which some were controlled. This concept of "exploitation" continuous to haunt the various republics in regards to some of their own regions. Suffice it to say, that in spite of the Yugoslav market socialist model and non-existence of central planning there was deep ideological skepticism of the workings of the market which enabled republican elites to capitalize on, in their quest for secession.

Fear of losing political power through transition to the market economy is what characterized the then ruling political elites. When wars and armed conflicts came along -the beginning of the transition processes to a full fledged market economy were delayed for at least six to ten years in comparison with the other East European economies. In the case of Serbia, it only began in 2001. Add the cost of the armed conflict and NATO intervention and bombing, the Serbia inherited by the leaders of the democratic revolution was in worse shape as compared to others in terms of the economy, lawlessness, corruption, incapacitated and outdated institutions along with the unresolved issues that were to plague her for years to come.

The Consequences of the Milosevic regime

The major consequences of the Milosevic regime can be logically divided in to (a) the cost of disintegration of Yugoslavia, (b) the cost of the time lag in transition that led to the lack of privatization revenue and other potential foreign direct investment, (c) the cost of the war and the cost of the bombing during the NATO intervention in the Federal Republic of Yugoslavia (FRY).

The costs of disintegration are difficult to estimate and the evidence may be mixed (Uvalic, 1993). Nevertheless, interregional trade has been rising since 2000 and shows a trade gap of 60% estimated by gravity models (Trbovich 2006). The fact that CEFTA was formed with the benefits of trade in mind implicitly been suggests that the costs of the fall in trade might have been high. Other costs include the costs of establishing local currencies and local monetary authorities, costs of the loss of inter-industry trade, costs of penetrating new markets, etc. Above all, there are fixed costs of statehood that can not be avoided (armed forces, customs etc.)

In the case of the FRY, one should add the costs of sanctions imposed in 1992 and only slightly relaxed in 1995, to be completely done away with after 2000. The sanctions not only hurt the economy and added extra costs for sanction busting activities, but also, practically destroyed the growing small legal private sector, marginalized the middle class and provided favorable circumstances for the criminalization of society.

The direct cost of the damage done to Serbia by the bombing due to the NATO intervention of 1999 was estimated at 4 billion $US by a group of independent economists (Dinkic,ed.1999) . These direct costs include general and economic infrastructure and non-economic civilian sectors. In an economy estimated at 15 billion $US GDP, this represents quite a substantial sum.

However, most probably the greatest costs came in the form of delayed transition reforms and the cost of the war itself. These are not easy to separate given the non-transparent system of public finances at the time and the lack of independence of the central bank. One can, therefore, only look at some of the basic data at the end of the Milosevic regime to get a grasp of the dimensions of economic devastation.

GDP fell by approximately 50% in the decade of the 1990's with industrial production being the hardest hit falling to around 40% over the decade. (World Bank, 2001). Had average growth been at the historical levels (the Federal Republic of Yugoslavia - consisting at the time of Serbia and Montenegro would have had a cumulative positive effect of 82 billion $US. This should be corrected by the probable fall in output due to the transition process that would have taken place. Nevertheless, it is difficult to imagine that the loss in GDP would have been as high in Serbia and Montenegro.

The inflation rate reached 115% at the end of 2000, reviving fears of the return of hyperinflation that occurred as historically as one of the worlds's the highest in 1993. The external imbalances were extremely large amounting to 16.8 % of GDP. The average nominal wage was at around 50 Euros.

Inherited problems concerning the future of the Federation with Montenegro opting for independence and the future status of Kosovo loomed large. Pressure from abroad in terms of conditionality of aid based on cooperation with the Hague tribunal was another issue which was handed over to the new leadership.

A New Beginning with Old and New Constraints

The goals of the new democratic leadership could be summarized in the following way:

a. Reintegration into the international community- basically on a long-term road to integration in to Europe and Euro-Atlantic structures;
b. Replacing the Milosevic nomenklatura with qualified technocrats committed to democracy and rule of law;
c. Going to both reconstruction (due to the war) and transition to a market economy;
d. Achieving good governance over a five year period, i.e. Reforming the judiciary, eradicating corruption, enforcing contracts etc.

Looking at the record of the 2001-2008 period (the one before the onset of the world economic recession) one comes up with mixed results.

Overcoming International Political Constraints

In terms, of reintegration into the international community, the results can be viewed both positively in some areas and less than satisfactory in others. After the victory of the democratic opposition, the FRY relatively quickly reestablished diplomatic relations with the countries that it had severed them with at the outbreak of the NATO intervention in 1999. The economic sanctions were suspended; the FRY joined the Council of Europe and later the Partnership for Peace. It also, reestablished its relations with the international financial institutions (IMF, WB, EBRD, etc) and managed to renegotiate its debt to the Paris club with 66% write off. This was put into effect after completing the arrangement with the IMF over three years.

All this occurred against the background of conditionality concerning cooperation with the Hague tribunal, the coming of the independence of Montenegro (2006) and after prolonged negotiations, the unilateral declaration of independence of Kosovo (2008). These issues weighed significantly on the energy, focus and workload of the political elite, which led to turbulence in internal politics and a slowdown in the processes that lead to European integration. For example, the stagnation of negotiations on the SAA due to the refusal of Montenegro to constructively negotiate within the FRY framework until a two-track negotiation was provided by the EU, made for at least a year of delay. The refusal of the Dutch government to allow for the SAA (Stabilization and Association Agreement) to go forward until the two fugitives from justice are apprehended and brought to justice in front of the Hague tribunal in spite of agreement by all the other member states that the SAA should be ratified, is another case in point. These types of impediments put forth by member states of the

EU are hugely detrimental to the general pro-European orientation of the population and the ruling coalition.

Let it be noted that in spite of extremely difficult issues of separation of Montenegro and the secession of Kosovo, Serbia has remained on the European track throughout the period. This is an outstanding achievement in itself and should be rewarded by the EU.

Naturally, all of this should not excuse the government in more recent times (2009) for not fulfilling the National Program for Integration with the European Union (NPI) which is a part of the SAA agreement and which Serbia is obliged to implement. The slowness of implementation, a great deal of which is related to elections, long periods of coalition government formation, lies in the realm of responsibility of both the political system and political actor behavior. The other internal impediment consists of the rules of parliamentary procedure that enable the opposition to basically filibuster government proposals for long periods of time, a practice that has only recently been amended by new rules of procedure that limit the time of debate.

In spite of these problems one should note that foreign direct investment (FDI) rose to a cumulative total to 16.6 billion $US by 2008. The political determinants can be seen in FDI peaking in 2006 at 5.4 billion $US Euros, a drop to 3.5 and 2.9 with the approaching of the unilateral declaration of independence of Kosovo and as a consequence the turbulent elections of 2008 and before that in 2007 with the coalition government being formed in the last minutes of the legal deadline. (Source: National bank of Serbia, from www. siepa.gov.rs)

Finally, it should be noted that the region also has problems with EU integration and that most recently there have been signs that the situation may deteriorate. (Bardos, 2000).

The Transition Process

In terms of the transition process and macro-economic stability one can say that Serbia has also had mixed results.

GDP growth has averaged over 5% for the whole period (of 2001-2008) which is comparable to the region. These high growth rates reflect the lifting of sanctions, the opening up of the economy, foreign assistance in the first years and a low base due to the devastation of the 1990's. Specifically, the great slump of the 1990's was a substitute for the transition recession that the former centrally planned economies went through in the first years of transition.

The privatization process can be generally considered to be successful since most of them were done by auction and the larger enterprises by tender. The revenues from these sales and accompanying investment and social programs added up to close to 4 billion Euros. The privatization process went relatively smoothly, with according to the latest statements by privatization agency officials, a success rate of 75%. The success of the privatization process can be seen by the fact that employment in the private sector (including agriculture) rose from 46% to 65% in 2007, adding another 300 000 jobs to the private sector during a period in which there has been an overall loss of 750 000 jobs in the non-private sector. (Mijatovic (ed.) 2008). Privatization can, therefore, be considered to have gone relatively smoothly in spite of a few scandals.

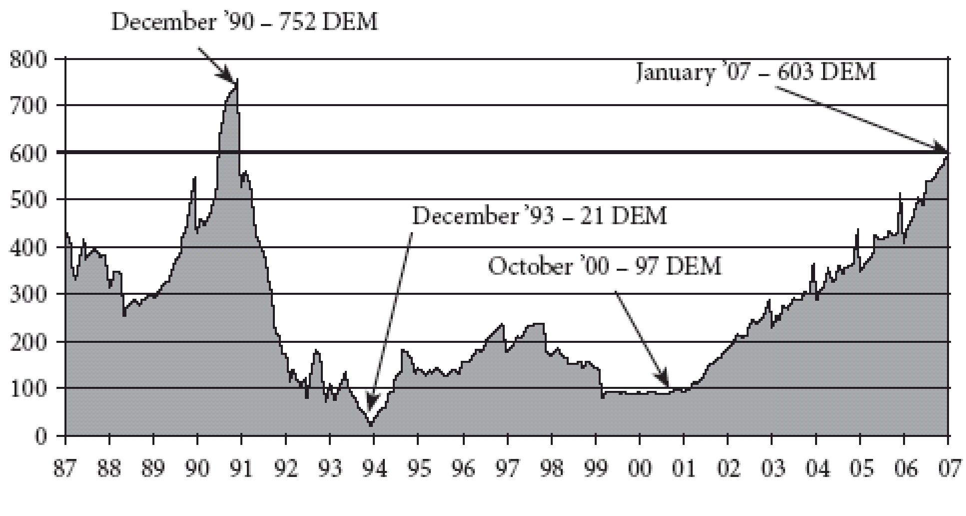
The major reservation that can be voiced concerning this process is that the model is necessarily slow, burdened with administrative procedures and obviously favors the sale of the more successful enterprises first. This has left a large number of enterprises to be privatized probably through bankruptcy procedures, the least popular and probably politically detrimental to the government.

The problem that remains is the continued existence of state-owned enterprises (around 80) that had been originally chosen for restructuring before the privatization process. Hardly anything was done in terms of restructuring of these enterprises due to various factors - the dominant one being lack of political courage because of a high level of hidden unemployment.

High growth rates of the Serbian economy over the past eight years have led to an increase in real wages. Since 2000 wages have quadrupled, with GDP per capita going from 2100 $US to 5600$US (only a part of it due to the fall in the value of the dollar).

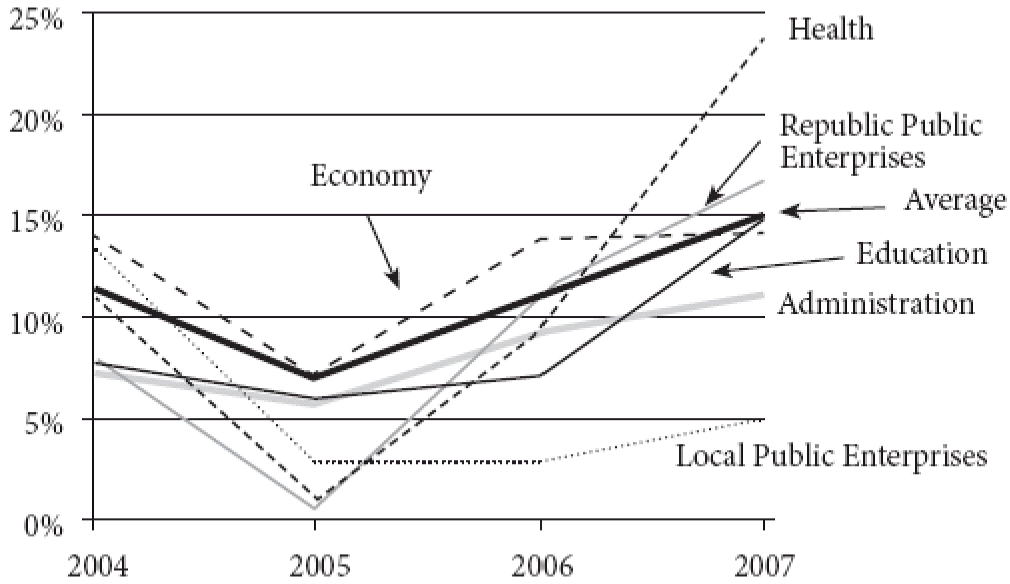
The following figure (figure1) illustrates this very well:

Wages in Serbia
1987-2007



Unfortunately, the increase was well above the growth in productivity and the most dramatic increase was directly related to the political election cycle. This link with the political cycle is most obvious in the case of the latest pre- election periods. This shows that democracy under a proportional system can create unstable coalitions with the dominant party often being into a position of giving in to pressure of the smaller parties that promote their agenda almost at any cost seeing this as a good political investment for a future election.

Growth in real wages May 2004-May 2007 (figure2)



Source Republican Statistical Office - taken form (Mijatovic (Ed), p.14)

Higher wages not supported by a rise in productivity inevitably led to higher demand that led to the maintained inflation in double digits. Furthermore, along wit the liberalization in trade it led to a high current account deficit, a fiscal deficit and an increasing external debt.

Furthermore, it should be noted that capital budget expenditure increased due to the National Investment Plan (NIP) which relied on the proceeds from privatization of the first mobile operator. With further government external borrowing on the rise and the issuance of guarantees by public companies, there was an increase in public investment and spending of about 1-2% of GDP.

The NIP which was drawn up quickly in order to disperse some of the privatization revenue was in its smaller project financing done without any transparency whatsoever, while after the formation of the coalition government and the inauguration of a new minister had a wide set of criteria to select projects. In their scope they were reminiscent of the soviet enterprise success indicators making the selection process equally non-transparent.

What is particularly disturbing is the way in which some of the main infrastructure projects were inaugurated as obvious populist vote- getting attempts. The most extreme example is the Horgos- Pozega highway which was granted as a concession and which never had a chance to be implemented under the original conditions. The whole issue is going to be settled in court.

In spite of vast improvements in the fiscal system over the past eight years, the share of government spending at the constant share of 40% of GDP is impossible to sustain and is at a level at which it was at the beginning of the transition process. The same can be said of the current account deficit as a percentage of GDP.

A combination of all these factors has made the economy vulnerable with the fiscal and current account deficits endangering further growth and development.

The following table (Table1) shows the vulnerability indicators for Serbia selected countries (as percent of GDP. arithmetical mean for the region):

	South-east Europe	**Bulgaria**		**Croatia**		**Romania**		**Serbia**	
	2006	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**
Fiscal deficit	–0.7	3.5	3.5	–3.0	–2.8	–0.5	–2.3	–1.5	–1
Current account deficit	–11.3	–15.5	–20.2	–7.8	–8.5	–10.3	–13.9	–12.4	–16.5
External debt (total)	68	78.4	87.6	89	…	42	…	61	65.1
Public debt	31	25	21.3	41	…	19	…	39.6	37.6
Reserves/short-term debt	167	135	138	100	…	125	…	717.3	729.7
Reserves/(short-term debt plus c.a. deficit)	85	76	82	74	…	64	…	219	164.3
GDP growth	6.1	6.3	6.1	4.7	5.7	7.9	6.0	5.6	7.5
Inflation	7.4	7.4	7.5	3.2	2.8	6.5	4.4	12.7	10.1

Source: IMF WP/07/236, IMF Data and Statistics for 2007, IMF CR for selected countries for 2007, National Bank of Serbia for Serbia. (Mijatovic Ed, 2008, p10)

Governance

Nevertheless, looking at the record of governance one can see improvement in all areas. This is especially true over the longer period as the Milosevic regime proved to be disastrous in terms of governance in all of its aspects.

If we take the six basic governance indicators developed by research of the World Bank (Kaufman, D et al.) It can be observed that Serbia had made progress in terms of governance quality on all fronts Table 2:

Table 2

Governance criteria	2005	2004	2003	2002	2000	1998	1996
Democracy and accountability	0.12	0.11	0.14	–0.30	–0.29	–1.05	–1.45
Political stability and absence of violence	–0.91	–0.89	–0.90	–1.03	–1.33	–2.01	–1.29
Government effectiveness	–0.31	–0.12	–0.50	–0.61	–0.80	–1.11	–0.71
Regulatory quality	–0.53	–0.52	–0.68	–0.62	–0.90	–1.90	–1.45
Rule of law	–0.81	–0.78	–0.97	–0.99	–1.14	–1.06	–1.26
Control of corruption	–0.55	–0.55	–0.55	–0.77	–1.13	–1.03	–0.98

Source: www.govindicators.org
The maximum value of the indicator for good performance is + 2.5 and the minimum value is - 2.5

One can not but observe that there has been vast improvement over the years. Still there is a lot of space for improvement in the immediate future. The basic areas that need to be addressed are certainly corruption and the rule of law which most directly affect the economy. It should also be noted that Serbia is ranked 101 in terms of enforcing contracts and 115 in registering property according to the World Bank latest Doing Business report.

Conclusion

Serbia has had a mixed record in the 2000-2008 periods. After the fall of the Milosevic regime, the new leadership inherited a devasted country in all aspects. The transition process produced overall positive results in the beginning in terms of macroeconomic stabilization, privatization and growth.

However, the political constraints inherited from the past were immense and had to affect the transition. These political issues and constraints had to do with the declaration of independence by Montenegro (2006) and the unilateral declaration of independence by Kosovo (2008). The major internal shock was, of course, the assassination of Prime Minister Zoran Djindjic in 2003 which led to a 45 period of martial law. Conditionality concerning the cooperation with the Hague Tribunal was not helpful as it slowed down the movement and momentum of reforms necessary for the future accession to the EU. The SAA talks were suspended in April 2006 and the

SAA was granted Serbia only in 2008, albeit that it would not be put into effect till "full cooperation" with the Hague tribunal was established. To this date the SAA implementation is still pending.

These external pressures also led to the fragmentation of the original coalition (too huge to last with 18 members), the most important being the dispute between the two major parties in the great opposition coalition of 2000. This then in turn led to a series of elections in the 2006 and 2008 in anticipation of the unilateral declaration of independence of Kosovo. The two major democratic parties of the original opposition managed to form a government in 2007 that lasted for a year (till 2008).

The problem of political instability in the 2000-2008 periods reflected itself in four parliamentary elections, two regular local and two regular presidential elections (with several presidential elections failing due to an originally high turnout requirement). A further complication of the political system is the existence of a popularly elected president and a prime minister elected by parliament. This is the case in all of the countries in the region and is a source of instability in itself. More often than not, there is cohabitation. If the president is from the ruling party this necessarily diminishes the authority of the prime minister creating less government effectiveness in multi-member coalitions.

In the run up to the election, the parties in power looking at short term gains enabled the expansionary fiscal policy leading to major imbalances. It was a short time before political cycles set in with basically irresponsible wage hikes that can not be sustained in the medium run. Not addressing the current account deficit and further involving the state in investment projects with most of the small ones done for political patronage and in a non-transparent way led to waste of resources and added to inflationary pressures. In spite of the fact that there was a general improvement in the quality of governance, there is a long way to go in this respect.

What is particularly disturbing is that coalitions due to the proportional system are in, the Serbian setting necessarily frail, giving disproportional leverage to the smaller partners in the coalitions. This leads to short sightedness, lack of transparency, patronage in the appointment of party officials to plum jobs and boards of directors of public enterprises. In turn this compromises the reform efforts in the eyes of the public with a danger of alienating it from politics.

These challenges need to be faced openly, squarely and without false excuses, by the political elite in power. Whether or not it is capable of doing so, remains to be seen.

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