Serbia’s Transition Challenges for policy-makers

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Background

- Transition in Eastern Europe (EE): fall of Berlin Wall (November 1989) →
  - Replacement of one-party system by multiparty democracy
  - Market as main mechanism for allocation of resources + private property

- Last 25 years: radical changes of political and economic system in Eastern Europe
Background

**Serbia: a specific case**

- A laggard, delayed radical economic reforms until late 2000 (end of Milosevic regime)
- Serbia → many statehood changes (25 years):
  - *SFR Yugoslavia* (1945-91), one of its 6 republics
  - *State Union of Serbia and Montenegro* (2003-6)
  - *Republic of Serbia* (June 2006), after separation from Montenegro
- Lost its southern province, when Kosovo proclaimed independence (Feb. 2008)
Background

**Serbia’s transition**: complex, in many ways unique

- Why did Serbia end up lagging so much behind?

**Causes of delays**

- Internal (break-up of Yugoslav federation, non-democratic regime, military conflicts ...)
- External (international sanctions, NATO bombing, hesitant or wrong policies of the EU) → measures that were often ineffective, contributing to even greater delays in Serbia’s transition

- **Political instability** → very profound and long-term economic consequences
Issues

- Focus
  - Economic transition, but within a political & historical context

- Time horizon: 1989 – today
  - Necessary to include the 1990s, since events during first decade of transition had a fundamental impact

- Different perspectives:
  - Insider/outsider
  - Academic/policy-maker (Vice-Minister, 2000-01)
Issues

1. *First decade of transition*
   - Starting conditions (1989)
   - Performance during 1990s

2. *Economic policies after 2000*
   - Achievements
   - Failures

3. *Integration with the European Union*

4. *Current challenges*
1. First decade: 1990s

- **Transition in Serbia** also started in 1989 (part of former Yugoslavia)
  - First radical economic reforms – last Yugoslav government (1988-90)
  - First multiparty elections in Dec. 1990 (Milosevic President)

- Proclamation of political independence of Slovenia and Croatia (June 1991) → break-up of Yugoslavia
- Serbia & Montenegro → FR Yugoslavia (1992)
Serbia’s starting conditions (early 1990s)

- **Advantages** (inherited from Yugoslavia)
  - External relations: a non-aligned country, not a member of the Soviet bloc, EC trade preferences since 1971 → trade primarily with the West
  - Serbia: biggest and most populous Yugoslav republic, major weight regarding most economic indicators, though not the most developed

- **Disadvantages**: Ongoing political crisis → break-up
...1990s

Early 1990s: years of extreme instability

- **Political**: Break-up, military conflicts, international sanctions, non-membership in international organizations... (IMF, WB)

- **Severe economic consequences**
  - Wars → expansionary monetary and fiscal policies led to one of record hyperinflations in world history → early 1993: 116.5 trillion %
  - Extreme decline in GDP: 80% over 1990-93 (FRY)
  - Rapid currency depreciation, de-industrialization, shortages
  - Market-related reforms suspended/reversed: price freezes, prohibition of lay-offs, re-nationalization of strategic firms
Hyperinflation in FRY (1992-93)

2d highest (Hungary 1st, 1945), today 3d (Zimbabwe, 2008) + 2d longest (24 m.) after Russia’s in 1920s
Exchange rate policies (1992-94):
Divergence of black market/official rate
... 1990s

January 1994? New Central Bank governor Avramovic

- **Avramovic’s Stabilization Program**
  - Radical monetary reform: currency board (fixed exchange rate backed by foreign reserves, denomination of dinar)
  - Eliminated hyperinflation overnight, but results short-lived
  - Mid-1994: Relaxation of tight monetary policy, no fiscal reforms, lack of radical reforms

- **Avramovic’s other initiatives** (May 1996):
  - Status of FRY in IMF (Avramovic: Chief negotiator)
  - New privatization law (political consensus) ... rejected
Events of the 1990s → Profound social consequences

- Income redistribution in favor of the state/political and economic elite:
  - Inflation tax
  - Financial pyramid schemes (private banks) → loss of most citizens savings (long term consequences)

- Increasing poverty & social differentiation, corruption, flourishing of illegal activities (war profiteers)
Dayton Peace Accords (Dec. 1995): end of war in Bosnia and Herzegovina, hopes for better times

- **Serbia**: continuity of previous policies, rather than radical changes

- International sanctions against FRY lifted, but “outer wall” of sanctions remained (Milosevic in power)

- **Economic consequences**: Serbian firms’ foreign accounts abroad frozen, unregulated status in international organizations, political risk (no FDI)

- Sluggish macroeconomic performance, slow economic reforms (1997 privatization law)
... 1990s

Rising social and political unrest

- **Massive demonstrations** against regime (winter 1996-97) due to non-recognition of victory of Democratic Party (elections)
- **Kosovo**: progressive worsening of political situation, conflicts between Kosovo Liberation Army & Serbia’s military forces
- New international sanctions against FRY in May 1998, reinforced in 1999, no agreement with Milosevic...
- **NATO bombing** of FRY (24 March 1999) for 11 weeks, to prevent ethnic cleansing (not authorized by the UN)
- **Economic consequences** → destruction of factories, infrastructure, drop of GDP by 19%, of exports by 50%...
2. Economic policies after 2000

**October 2000:** Democratic federal government (Kostunica) + Serbia (Jan. 2001), but many difficult issues on agenda

- **FRY’s status** in main international organizations, diplomatic relations with Western Cs, neighbours

- **Serbia and Montenegro’s** complex relations
  - Federal government: unnatural coalition between Democratic Opposition of Serbia & Montenegro’s SNP
  - Montenegro: Djukanovic’s strive for independence (since 1997), mistrust in federal government
  - Different views on reform of federation, cooperation with Hague Tribunal (war criminals)
  - One country, but two economic & monetary systems (Montenegro: DM/€; Serbia: Dinar)
Economic policies after 2000

- **Political conditionality** of international organizations
  - Key issue: cooperation with Hague Tribunal
  - Yet no political consensus on delivery of Milosevic → transferred to the Hague only in June 2001, the night before the Donors Conference for FRY!

- **Aid dependency**
  - Arrival of financial aid: conditional on political issues
  - Along with aid, also technical assistance → transition strategy in line with “Washington consensus”

- **Public administration**: conditions extremely unsatisfactory
Economic policies after 2000

Political changes → new course in economic policies

- **Economic achievements** (2001-08)
  - *Macroeconomic stabilization:* declining inflation...
  - *Strong growth* (2001-8), annual average over 5%
  - *FDI inflows* (stock $20 billion), US$ 2,900/cap.

- **Institutional reforms** → towards the “ideal” model of market economy: liberalization of prices and of foreign trade, privatization of firms and banks...
Strong growth, declining inflation
Foreign Direct Investment (net inflows), 2001-08

- CEE & Baltics
- CIS
- Western Balkans
- Bulgaria & Romania
- Serbia

Million US $
# EBRD transition indicators, 2012

**Scores:** 1 (no reforms) to 4+ (market economy)

## Two critical areas

<table>
<thead>
<tr>
<th>Country</th>
<th>Private sector share in GDP</th>
<th>Enterprises</th>
<th>Markets &amp; Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Large-scale privatization</td>
<td>Small scale</td>
<td>Price liberalization</td>
</tr>
<tr>
<td></td>
<td>governance &amp; firm restructuring</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Albania</td>
<td>75</td>
<td>4-</td>
<td>4</td>
</tr>
<tr>
<td>B&amp;H</td>
<td>60</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Croatia</td>
<td>70</td>
<td>3+</td>
<td>4+</td>
</tr>
<tr>
<td>Macedonia</td>
<td>70</td>
<td>3+</td>
<td>4</td>
</tr>
<tr>
<td>Montenegro</td>
<td>65</td>
<td>3+</td>
<td>4-</td>
</tr>
<tr>
<td>Serbia</td>
<td>60</td>
<td>3-</td>
<td>4-</td>
</tr>
</tbody>
</table>
Economic policies after 2000

Policy failures

- **Labour market**
  - No new employment, rising unemployment, widespread informal sector (21%–30% of GDP)

- **Increasing external imbalances**
  - Rising trade and current account deficits

- **Slow economic recovery**
  - Despite strong growth, by 2008 real GDP at only 72% of 1989 level (2013: 70%) \(\rightarrow\) *most unfavourable position among all Balkan countries!*

- Catching-up/convergence not easy after multiple recessions (early 1990s, 1999)
“Jobless” growth

By 2013: Unemployment up to 24%
Increasing external imbalances
Real GDP growth in Balkan countries
1990-2013 (1989=100), Serbia: 70% of 1989 GDP
GDP per capita in PPS, 2013 (EU28=100)

- Luxemb.: 264
- Austria: 129
- Sweden: 127
- Netherl.: 127
- Ireland: 126
- Denmark: 125
- Germany: 124
- Belgium: 119
- Finland: 112
- France: 108
- UK: 106
- EU-28: 100
- Italy: 98
- Spain: 95
- Malta: 87
- Cyprus: 86
- Slovenia: 83
- Czech Rep.: 80
- Slovakia: 76
- Portugal: 75
- Greece: 75
- Lithuania: 74
- Estonia: 72
- Poland: 68
- Hungary: 67
- Latvia: 67
- Croatia: 61
- Romania: 54
- Bulgaria: 47
- Montenegro: 42
- Serbia: 36
- FYROM: 35
- Albania: 30
- BiH: 29
Economic policies after 2000

**Reasons for policy failures?** Structural weaknesses in real sector of economy

- **Privatization:** slow implementation of 2001 law
  - Mid-2009: 23% of total number of firms planned for privatization still not privatized
  - 25% of broken contracts (non-respect of obligations...)
  - Privatization proceeds not used for investment

- **Foreign direct investment:** Over-optimistic expectations
  - Mainly privatization-related
  - 2/3 in services (banking, telecommunications, real estate, trade) → in non-tradable goods!
  - Many industrial firms not modernized or restructured
Structure of FDI (2004-10)
Total $19.5 billion → 73% in services

<table>
<thead>
<tr>
<th>Industry</th>
<th>Investment Value (USD million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial Intermediation</td>
<td>5,789.7</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>3,906.8</td>
</tr>
<tr>
<td>Real estate, renting</td>
<td>2,974.0</td>
</tr>
<tr>
<td>Transport, storage and communication</td>
<td>2,796.6</td>
</tr>
<tr>
<td>Wholesale, Retail, Repairs</td>
<td>2,431.8</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>586.5</td>
</tr>
<tr>
<td>Construction</td>
<td>408.1</td>
</tr>
<tr>
<td>Other Utility, Social and Personal Services</td>
<td>183.1</td>
</tr>
<tr>
<td>Agriculture</td>
<td>155.1</td>
</tr>
<tr>
<td>Public Administration and Social Insurance</td>
<td>100.7</td>
</tr>
<tr>
<td>Hotels and restaurants</td>
<td>100.3</td>
</tr>
<tr>
<td>Electricity, Gas and Water</td>
<td>24.1</td>
</tr>
<tr>
<td>Fishing</td>
<td>7.1</td>
</tr>
<tr>
<td>Education</td>
<td>2.6</td>
</tr>
<tr>
<td>Health and social work</td>
<td>0.5</td>
</tr>
</tbody>
</table>

Source: National Bank of Serbia
Economic policies after 2000

- **Postponed restructuring of state sector**
  - 550 state-owned strategic firms, their restructuring started only after 2006, not many privatized:
    - Oil company *NIS* → Russian *Gazprom*
    - Car producer *Zastava* → *FIAT*
    - Airline *JAT* → *Etihad Airways* (Abu Dhabi)

- **Other microeconomic reforms delayed**
  - *Business environment* (red tape)
  - *Competition policy*: new law adopted only in 2005, anti-trust Commission set up late (2006) and ineffective
  - *Government subsidies* to loss-making firms
  - *Corporate governance* mechanisms not in place
Doing Business Indicators
(World Bank, 189 countries)
2014: Serbia ranked 91st (deterioration)
Doing Business Indicators
Serbia (2013): sub-indicators very different
Economic policies after 2000

Consequences of policy failures

- **Slow growth of the private sector**
  - 2009: Private sector only 60% of Serbian GDP (one of 6 lowest shares in Eastern Europe)!

- **Inadequate capacity restructuring**
  - Structural changes → expansion of primarily services
  - Strong deindustrialization (1990s, 2000s) → manufacturing value added: 16% of GDP (2012)

→ Share of *tradable goods sectors declined from 41% of GDP in 2000 to 24.6% in 2007!*
Slow growth of private sector

Employment: from 49% to 74%
GDP: from 40% to 60%
Strong deindustrialization: Serbia/Balkans

Manufacturing value added: 16% of GDP (2012)
3. Serbia’s integration with the European Union

**EU Stabilization and Association Process** (new policy for Balkans) → Renewal of relations with FRY (Nov. 2000)

- **Political integration**: process slow, burdened by many problems
- **EU conditionality**: more stringent → conditions more numerous and procedures longer for Balkans than for the Central East European countries
- **Specific political problems**
  - Serbia – Montenegro relations
  - Insufficient collaboration with the Hague Tribunal
  - Status of Kosovo (after 1999 under UNMIK)
Serbia’s integration with EU

Progress: primarily after 2008

- **Stabilization and Association Agreement** finally signed in April 2008
- Serbia applied for “candidate” status, became an EU candidate in March 2012

- **April 2013**: Serbia – Kosovo agreement (mediation of Brussels) → gradual normalization of relations, pending issues discussed

- **21 January 2014**: Beginning of EU accession negotiations, but no chapter opened yet... progress slow

- **Serbia – 29th member of EU in 2020?**
Serbia’s integration with EU

Political process slow, but other positive results

- **EU financial assistance:** over € 3 billion through specific programs (CARDS, IPA, IPA II)

- **Legal harmonization:** adoption of laws in conformity with EU *acquis communautaire*

- **Visa regime:** finally lifted (Dec. 2009), after almost 20 years!
Serbia’s relations with the EU

- **Increasing economic integration**
  - *Trade* → EU is Serbia’s main trading partner
  - *FDI*: 75% from EU
  - *Banking & financial integration*: most Serbian banks sold to EU banks (75% foreign owned)

- **Global crisis** (late 2008): revealed many problems!

- **Serbia-EU integration** → A *double-edged sword*:
  - During prosperous times (2001-08), helped economic growth, but in times of crisis → high vulnerability to external shocks!
4. Current challenges

- **Global economic crisis:** severe impact on Serbia (after late 2008) → 3 recessions in last six years:
  - 2009: -3.5%
  - 2012: -1.5%
  - 2014: -0.5%
  - 2015: negative growth expected

- **Growth model** of the 2000s no longer viable
  - Growth based on consumption, increase in imports (rather than export-led)
  - Strong credit boom, increasing current account deficits financed by foreign capital (foreign aid, FDI, loans, remittances) → inflows sharply reduced after 2008
Real GDP growth in Balkans
2004-8 (average) & 2009 - 2014
Current challenges

Government policies

- **Stimulus programs** (2009 - 10) → helped recovery, but rise in public debt (65% of GDP), public deficit: over 6% (2014)
- **More flexible exchange rate** → real depreciation of Dinar
  - Export growth → reduced trade (current account) deficit
  - But increase in external debt (€): over 85% of GDP (2012)

External support

- **IMF SBA** (US$ 4 billion) + new Agreement (March 2015)
- **IMF/EBRD “Vienna initiative”:** Informal agreement with foreign banks not to withdraw capital from region (repeated recently – “Vienna II” – but much less successful)

- **Key issues:** How can Serbia become more competitive on world markets? *How can Serbia raise its future growth rate?*
Global Competitiveness Index

Serbia: among 148 countries ranked 101st

Rank/148 Cs, 2013-14

- Switzerland: 1
- Germany: 4
- USA: 5
- Montenegro: 67
- Macedonia: 73
- Croatia: 75
- Bosnia & H: 87
- Albania: 95
- Serbia: 101
Exports of goods and services/GDP ratios
2013 → Serbia/Balkans less integrated than CEE
Current challenges

New SBA with IMF (2015) → gradual fiscal consolidation (cuts in public wages, pensions, employment; structural reforms ...)

- How to compensate the recessionary effects of these measures?
- Through more public investment, to stimulate economic growth!
- Investment in infrastructure → roads, railways, energy

- Fiscal Council of Serbian government: calculations of fiscal multipliers: increase in public investment spending would have a very strong multiplier effect on growth
- Resources provided through loans of EIB, EBRD, WB (€3,7 bn)
- Projects are also ready!
- Problem? Low efficiency in implementing investment projects → institutional weaknesses!
Current challenges

Longer-term policies

- Serbia cannot count much on quick return of FDI, must rely more on own resources (and policies)!
- **Industrial policy**: more targeted policies, to promote investment in key sectors (export-oriented firms), diversification of industrial base, innovation ...
- **R&D policy**: increase investment in human capital
- **Employment policy**: wage employment in private sector

→ **Better functioning of government institutions** to facilitate investment, enforce laws, collect taxes, fight corruption ...

- Unless government institutions are strengthened, results of economic reforms will remain partial
Institutions?

**EIU Democracy Index (2012)**

- Red: Hybrid regimes
- Blue: Flawed democracies
- Green: Full democracy
Current challenges

Problems in the political domain

- What after **Kosovo**’s declaration of independence?
  - Kosovo not recognized by Serbia, but also by 45% of UN members (Russia, India, China) & 5 EU MS (Cyprus, Greece, Romania, Slovakia and Spain)
  - EU enlargements → require unanimity (?)
- No country renounces voluntarily to a part of its territory, yet Kosovo is today *de facto* independent
- Serbia should consistently implement its pro-EU agenda and look primarily towards the future

*These tensions will be greatly reduced once all Balkan countries enter the EU ...*
Conclusions

Serbian case

- *Adverse political conditions* → very negative long-term economic consequences
  - Blocked reforms for a whole decade → catching up very difficult
  - Importance of political consensus

- *Lessons not learned* from the more advanced countries, similar mistakes repeated in Serbia → importance of timely microeconomic reforms
SERBIA'S TRANSITION
Towards a Better Future
Milica Uvalić

Miša Uvalić
TRANZICIJA U SRBIJI
KA BOLJOJ BUDUČnosti
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