

## **BELATED ECONOMIC TRANSITION AND THE COMPETITIVENESS OF SERBIAN ECONOMY\***

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**Abstract.** *Previous adverse flows and results of economic transition in Serbia are the main reason for unsatisfactory state of the economy and its competitiveness. This paper analyzes both the key problems of economic transition and the achieved level of competitiveness of Serbian economy, and recommendations are formulated for future economic policy. Special emphasis is placed on institutional reforms and the need to implement policies that encourage competition.*

**Key Words:** *economic transition, competition, economy, state, institutions, market.*

### INTRODUCTION

Economic transition in Serbia is very late compared to the most successful countries in transition, and in relation to the surrounding countries. Serbia entered the transition process while it was part of former Yugoslavia, that is, at the same time as the other European post-socialist countries. However, its transition flows were not directed towards a defined goal. The trajectory of transition was long and with frequent interruptions, while the transition algorithm was inadequate. The political changes in 2000 discontinued the galloping collapse and also created the preconditions for a new beginning of transition, but with a delay of one decade. However, even after these events, transition did not gain the strength of a shock wave. Among the countries in transition, Serbia found itself at the very end and is regarded as a country of belated transition.

Incomplete economic transition and its so far adverse results are the main reasons for extremely low competitiveness of the Serbian economy. According to the Global Com-

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petitiveness Index of the World Economic Forum for 2011, Serbia occupies the position 95 among 142 countries, which is a step forward compared to 2010, when it was in the 96<sup>th</sup> place [2, p. 294]. But despite this movement forward, Serbia is still rated very low in terms of competitiveness, indicating the unsatisfactory state of the economy. In the conditions of institutional incompleteness, structural inconsistencies and uncompleted economic transition, the situation can not be repaired by spontaneous operations of the market. The aim of this paper is to highlight the need to accelerate transition reforms in those segments without which other reforms would not be effective. Institutional reforms and implementation of policies that promote competitiveness are certainly priority tasks.

### 1. THE OUTCOMES OF ECONOMIC TRANSITION

Serbia is now one of the least developed post-socialist economies. The main cause of its position is, beyond any doubt, the long-lasting and wrongly conducted economic transition. Despite the fact that the Serbian economy was and still is a suitable place for the transition reforms, in practice they have not yielded results as they were neither carried out in a desirable manner, nor accompanied by any local strategy and, moreover, they were also conducted without taking into account the economically logical sequence of their individual phases.

Today, more than ten years from the new start of the transition, economic indicators of Serbia are highly unfavorable:

1. GDP is about 70% of the 1989 level;
2. The unemployment rate is extremely high, exceeding 20%;
3. Foreign debt is about 80% of the GDP;
4. Trade balance deficit in 2010 amounted to about five billion euros, while the balance of payments was also negative over one billion euros;
5. Real salaries are lower in comparison to the distant year of 1971;
6. Annual inflation rate is 8.7% [3, p. 37].

After the political changes of 2000, a rapid and successful transition was expected to a democratic society and market economy, which was supposed to create conditions for a fast economic recovery and a corresponding increase in the standard of living, since the citizens of Serbia were drastically impoverished during the last decade of the previous century. But, instead of defining a national program and transition algorithm, which would be adapted to the socio-economic genotype and to the new, impaired starting position, the creators of transition opted for the "Washington Consensus". Instead of building an adequate institutional infrastructure suitable for the market economy, establishing the rule of law and fostering competition, the focus was on macroeconomic stabilization, liberalization and privatization, as the main principles of the "Washington Consensus".

Macroeconomic stabilization is mostly reduced to a stable exchange rate of the dinar, or more precisely, to the policy of overvalued dinar, which discourages exports. In a situation like this, import becomes attractive as compared to unprofitable export, which leads to increased foreign trade deficit and "choking" of domestic production. Inflation control is the ultimate achievement of the model of "strong currency in a weak economy", which has been applied in Serbia from 2001. The essential drawback of this model is insufficient growth, and it is not much effective in terms of price stability, too. [3, p. 8].

A radical liberalization, which was conducted immediately after 2000, has created additional problems for the domestic production, since non-tariff restrictions were abolished and the import tariff rate was reduced to single digits. Thus, the domestic economy has been exposed to tough competition, although even the World Trade Organization, which promotes world trade liberalism, is recommending a gradual reduction of tariff protection, especially in cases of economies such as the economy of Serbia.

Macroeconomic stabilization and liberalization, as they were carried out in Serbia, led to a "choking" of domestic production and to the value reduction of domestic enterprises which, under the conditions of mass privatization, have been taken over by new owners at very low prices. Such orientation of the creators of transition has exerted substantial influence on the basic economic indicators of Serbia, which are regarded as highly unfavorable.

An important feature of economic transition in Serbia reflects in a very marked decline in economic activity, which was the most pronounced in 1993, when GDP was only about 40% of the 1989 level. The recovery has been slow, so in 2010 Serbia reached only 70% of the pre-transition level of GDP, while the most advanced transition countries and other countries in our close environment have long ago exceeded that level (Hungary 138%, Slovenia 156%, Croatia 111%, Romania 128%, Bulgaria 114%). Inflation rates, which indicate the level of macroeconomic stability, are significantly lower in neighboring countries as compared to Serbia. Thus, while in 2010 the annual inflation was 12% in Serbia, in Hungary it was 4.5%, in Slovenia 1.8%, in Croatia 2.5%, in Romania 5.3%, and in Bulgaria 2.8%. Such economic growth is more than modest, if we bear in mind the low statistical starting point in the nineties after a large decline of GDP, the foreign exchange inflow generated by privatization and new borrowings after the lifting of economic sanctions and normalization of relations with the world. In addition, a special problem is the very structure of GDP, in the growth of which trade, transport and financial intermediation participate with about 80%. Due to their nature, the mentioned sectors can not be generators of growth, and therefore can not ensure its longevity and sustainability.

It is well known that the negative consequences of transition in the short term are: inflation, slowing down of economic growth, decline in production (total and especially industrial) and increased unemployment and social insecurity. However, after the transformational recession and restructuring of ownership and business, the industrial sector gets stabilized and the number of industrial workers even increases. The situation in Serbian economy is characterized by a very slow recovery of the industry, while its performances represent a limiting factor in the export of industrial products. Taking into account that the growth of industrial sector in post-socialist economies of the Eastern and Central Europe has significantly affected their GDP growth and competitiveness improvement, reindustrialization of Serbia is imposed as a high-priority objective.

The competitiveness of Serbian economy is of a relatively low level. This results in insufficient involvement in the world trade and inadequate share in the EU market. Primary products and reproduction materials are dominant in the trade with EU countries. Serbia is also evidently lagging behind other countries operating in the EU market, both in terms of quality and in terms of competitiveness, due to outdated equipment and technology.

What discriminates Serbia against other countries in transition? Above all, it is a decisive influence of geopolitical factors on the implementation of transition. Due to the impacts of a series of unfavorable circumstances (disintegration of the SFRY, civil and ethnic war, isolation, sanctions, NATO bombing campaign), the transition that started in

1990 was first blocked, and then it proceeded at a slower pace in a closed economy with hyperinflation. An entire decade of decline is probably unprecedented in history: there is hardly any society that has experienced such a thorough regression in only ten years of time. During that period, Serbian economy faced almost everything: the autarkic status, naturalization of economic life, criminalization, all kinds of shortages and insolvencies - to put it briefly, it was a crisis which had little in common with periodic crises of market economies which, in Schumpeter's interpretation, produce the conditions for new impetus by creative destruction [8, p. 172]. The progress of transition in these conditions led to different pathologies, the consequences of which are obvious, reflecting in a slowed-down privatization, the unsatisfactory quality of institutions, inadequate efficiency of privatized enterprises, insufficient investment in the new sector on which, as showed by J. Vinecki in the example of Poland, the success of transition is largely dependent, etc. [4, p. 515].

The achieved economic transition results indicate that Serbia has not yet introduced active market economy that would be capable of withstanding the pressure of competition and the effects of market laws. Measured by the indicators of the European Bank for Reconstruction and Development, it is a bit more than halfway to achieving the reforms that are considered to guide it to a system similar to the modern market-oriented economy.

## 2. COMPETITIVE CAPACITY OF SERBIAN ECONOMY AND KEY PROBLEMS OF ECONOMIC TRANSITION

The competitiveness of Serbian economy is of a relatively low level. Comparing the three basic components of the Growth Competitiveness Index (the macroeconomic environment sub-index, the public institutions sub-index and the technology sub-index), the conclusion may be drawn that Serbia has significantly aggravated its microeconomic competitiveness related to all the three components. Its export is mainly composed of raw materials and primary products, which indicates the position of Serbia in the international division of labor.

The low competitiveness of Serbian economy is conditioned to a significant extent by the belated transition, isolation and absence from the world market over many years, long-term disinvestment and significant technological lagging behind developed economies. There is expressed price non-competitiveness, since the low costs are accompanied by low labor productivity, while non-concreteness in terms of product quality is even more pronounced.

In the previous period, Serbia was achieving technological development primarily through the acquisition of foreign technologies and less through the development and use of its own ones. A considerable technological potential, thus formed in Serbia, was built into the equipment of certain sectors of the economy, but it has not been significantly effectuated. The main reason for the uncompetitiveness of Serbian economy was the system that did not generate the necessary motivation of economic entities to rapidly develop and effectively use technologies and to modernize the economy and the public sector on these grounds. After two decades of disinvestment, Serbian economy has non-competitive prices and uncompetitive technological contents in many sectors, due to outdated machines, devices and equipment and obsolete knowledge and information. The lack of investment and physical and human capital caused a significant decline in economic and technological competitiveness of the economy [6, p. 25].

Non-competitiveness of domestic products and services in the world market is also evident in the level of the import coverage by the export of more or less intensive products. Domestic products do not have competitive technological contents, modern functions, or the required quality, which led to a small export of these products and low revenues from the export of technology. This shows that, in terms of technology, Serbia falls behind the developed countries and is largely dependent on foreign trade, with a negative balance of technological payments. The unfavorable ratio of revenues to expenditures for technologies indicates that the prevailing technologies are those of foreign origin that have not been upgraded by much in order to increase exports of technology and achieve significant revenues on that basis.

Low competitiveness of Serbian economy is also the result of the belated transition, and within it, unsuccessful privatization, which was carried out without a strong policy of competition, as well as of the inadequate quality of institutions. The insufficiency of institutions caused inadequate transparency of business operations and distortion of the activities of financial markets, capital markets and the like.

By passing the Law on Privatization in 2001, Serbia re-started the process of economic transition. However, other necessary laws were not enacted then, while some of them have not been made even to this day. Thus, for example, the law on restitution has not yet been enacted. Without this law, potential investors cannot be assured that privatization is really wanted and that property rights will be guaranteed. In addition, if you want to build a market economy with dominant private property, then you first need to return or otherwise compensate expropriated private property to the owners. The Company Law was enacted in 2004, while the Liquidation and Bankruptcy Law was passed as late as in 2005. Apart from these laws, creation of a favorable environment for privatization requires adoption of many others, but their effective enforcement and rule of law are far more significant. This requirement was not met either, so there were negative implications both to the privatization itself and to the growth and development of the private sector. Considering the experiences of countries in transition, it can be seen that the countries in which the new private sector was not expanding already at the start of transition, had no success in the privatization of old state enterprises as well. The best confirmations of this are the positive experience of Poland and the negative experience of Russia. In Poland, the growth of new private sector was stimulated at the very beginning of transition and hence the transition was successful. This did not happen in Russia, and therefore it had many problems with privatization and economic recovery [4, p. 510].

Upon the approval of the Law on Privatization in 2001, expectations that privatization will be successful proved very quickly to be unrealistic. Thus, for example, the chosen privatization model was based solely on the method of selling. To privatize an enterprise, one would need to buy 70% of its socially-owned capital. If there are no takers interested in the purchase, the enterprise can not be privatized. Expected demand by reputable foreign companies failed, due to non-transparent practices and procedures and to inefficient and unreliable institutions. The well-known cases of this are the attempt of the French company "Dannone" to purchase the mineral water "Knjaz Milos" and the Swedish company "Ikea", which has been trying for several years to implement an investment project in Serbia. The first company was expelled from the domestic market, while the other did not want to realize its investments in a nontransparent manner [3, p. 38].

The results of privatization are modest and discouraging. Specifically, 1805 enterprises were privatized (107 by tenders and 1708 through auctions), 1336 companies were sold against installment plans, while privatization contracts were terminated in 435 enterprises. Revenues from privatization are also modest, amounting to 2.3 billion euros. [7, p. 199]. Poor results of the privatization have been caused by non-transparency of prescribed actions and procedures, which facilitated the rise of corruption, although the model of sales belongs to the processes by which it can be avoided. In the enterprises where privatization lasted for several years, a spontaneous privatization took place, which is but a synonym for corruption.

Since the obligation to carry out investment and social programs was imposed to the buyer, most of the privatized enterprises were bought not by the investors who had offered the highest price, but by those who had promised better investment and social programs. The absurdity of the investment programs is reflected not only in that they are very rarely implemented, but also that it is economically unjustified to impose such an obligation to the new owner. Every investor knows very well when and how much to invest and it is, therefore, senseless that this obligation be imposed by the state. The social program is also unnecessary because it should be the responsibility of the state. If this is combined with the fact that foreign investors have shown little interest in the purchase of socially-owned enterprises in Serbia, and that there was no real competition in doing so, a slow and unsuccessful privatization appears as a logical consequence.

The evident weakness of the privatization process in Serbia is reflected in the fact that part of the privatized enterprises did not get the right owners who would pursue restructuring and economic recovery of the enterprise. Enterprises were, in fact, purchased for the reasons of speculation, for obtaining business premises at low cost or for getting a lot of government land free of charge.

Continued privatization will be complicated by the fact that the companies remaining for privatization are unsuccessful in business operations and, therefore, not attractive for sale. This is the case of two hundred socially-owned enterprises where the agreements on privatization were abrogated or where disputes over property rights have not yet been resolved.

It is generally known that in the transition countries old institutions and rules of conduct are being replaced by the new ones. If the Serbian economy is viewed in this context, it may be stated that a satisfactory institutional quality has not yet been achieved. In contrast to the successful transition economies that have achieved transformational efficiency, while their institutions are successfully transformed and adapted to the requirements of the functioning market economy, the situation in Serbia is different. Namely, the creation of a virtual institutional configuration of economy is the cause of considerable concern. Mass opportunistic behavior and corruption have been recorded. The point is that markets and related institutions formally exist, but they do not function the same way as in developed societies. They are unregulated, monopolized, permeated by gray economy and criminal activities [5, p. 390].

It is noticeable that competition has not yet come to life, and also a sort of institutional vacuum can be observed that contributes to the maintenance of a non-market system with little developmental capacity. A distorted competition is not limited only to the public sector, but includes the transformed enterprises as well. Poor development of competitive market structures, that is, an inadequate policy to encourage competition, caused that any

significant effect of the transition changes, i.e. an increase of the competitiveness of local enterprises aimed at their inclusion in the global market, could not be felt.

Moreover, there are also estimates that the competition in Serbian economy has been reduced to primitive market structures and that there are various market substitutes and mutant pseudo-marketing structures, which can not guarantee any greater economic efficiency. There are many forms of quasi-institutionalization of market relations, reflecting in paternalism, monopolism, annuity-oriented behavior, and so on. It is even considered that there are nomenclature-lobbying groups which tend to create "supra-institutes" and to monopolize further flows of institutional building by their extensive network of connections.

Thus perceived, our economy is clearly on the economically inefficient path of institutional evolution. This path is mainly the result of a wrong institutional policy model. Taking relevant policies from the developed market economies was the dominant strategy of Serbian transition. Formal regulations concerning property, contracts, organizational forms of doing business, bankruptcy and liquidation procedures and social policy were adopted and completed relatively quickly. However, it has not become a generator of economic growth in the domestic circumstances and, therefore, social benefits failed to take place. Discrepancy between the enacted laws and the actual behavior of economic protagonists is also reflected in dealing less with productive and more with annuity-oriented transactions. Therefore, the transition policy creators should treat the existing informal institutional structure with full respect. Of particular importance is to recognize the rigidities that it produces in the transition process, but also to create those institutional arrangements through which their benefits will be fully exploited. [7, p. 198].

After all, since the transition is a regulated process, the role of the state has to be proportional to the progress in transition. Nevertheless, in the case of Serbia, the organization and functioning of the state in transition is a permanently neglected topic. Depoliticization and redefinition of its role are of particular importance. It must be strong and authoritative to ensure functioning of institutions, primarily of the free market, because, despite the existence of the Anti-Monopoly Law and Antimonopoly Commission, there are many abuses of monopolistic and dominant position and visible distortion of free competition. Relatively high monopolization of the domestic market prevents effective implementation of economic transition and significantly reduces competitiveness of the economy. In complying with European standards in the field of competition protection, Serbia has adopted regulations needed to implement the Competition Law, but the results in this area are still missing. That is why the state should turn to providing services that are of importance for the market functioning, such as the effect of law, infrastructure, security of property rights, transparency of tax regulatory structures, as well as macroeconomic stability.

Finally, it seems that it is necessary to spotlight the existence of some operational measures by which the state can influence the evolution of existing institutions and the creation of a market mentality of economic protagonists. In this respect, permanent activities aimed at a better and more complete protection of property rights, creation of an environment that would be stimulating for entrepreneurship and alleviation of conditions for the emergence of new, especially small and medium-size enterprises may be of great importance.

## CONCLUSION

Defining priorities in the transition strategy, in order to increase the competitiveness of Serbian economy, should be the main task of transition policy makers. The reforms undertaken in the economy were not conducted in a manner that takes into account the economically logical sequence of its major phases and, therefore, their effective outcomes failed to take place. Even though the increase in competitiveness takes time and considerable investment, economic policy focus on increasing the competitiveness of the domestic market and consistent competition policy, together with further institutional reforms and improving the quality of institutions, can have a positive impact on the improvement of competitiveness, expansion of exports and achievement of higher economic growth rates. These are, at the same time, the essential prerequisites for a successful process of transition and for the accession of Serbia to the European Union.

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## ZAKASNELA EKONOMSKA TRANZICIJA I KONKURENTNOST PRIVREDE SRBIJE

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*Dosadašnji nepovoljni tokovi i rezultati ekonomske tranzicije u Srbiji osnovni su razlog nezadovoljavajućeg stanja u privredi i njene konkurentnosti. U radu se analiziraju kako ključni problemi ekonomske tranzicije, tako i dostignuti nivo konkurentnosti privrede Srbije i formulišu preporuke za buduću ekonomsku politiku. Posebno se insistira na institucionalnim reformama i na potrebi implementacije politika koje podstiču konkurenciju.*

Ključne reči: ekonomska tranzicija, konkurentnost, privreda, država, institucije, tržište.