

Political Economy of Enterprise Restructuring in Serbia

Boris Begović

Center for liberal-democratic Studies

boris.begovic@clds.org.yu

and

Marko Paunović

Center for liberal-democratic Studies

boris.begovic@clds.org.yu

CLDS Working paper #0108, July 2005

Abstract

The aim of this paper is to explore, from the political economy perspective, public policy towards enterprise restructuring in Serbia in the post-Milosevic period, including incentives to decision-makers for such a policy, its achievements, and dynamics. Also, it empirically tests the conventional wisdom in Serbia that economic issues, such as employment and real wages, are dominant factors for voters in deciding whether to vote for pro-reform or anti-reform political parties. Conventional models of voting behavior that stress economic variables find strong support in both theoretical and empirical literature. By regressing election results from 150 municipalities on various economic, social and demographic variables, we distinguish whether and to what extent enterprise restructuring and, more broadly, economic transition, influences voting behavior in Serbia. We find that economic variables are mostly statistically insignificant, but that employment in failed companies did influence voting behavior in 2000 and 2007. However, increased support for antireform parties over the same period can not be explained by enterprise restructuring. We offer potential explanations for these observations.

Key words: enterprise restructuring, political economy, voting decisions, econometric models, political parties

JEL Classification: P26, P31

Acknowledgments

The authors would like to thank Edward Christie, Bruce McQueen and Zorica Mladenović for very useful comments and suggestions. Supported by GDN Regional Research Competition grant. The standard disclaimer applies.

1. Introduction and literature overview

Since the democratic changes in October 2000, starting with the ousting of Slobodan Milosevic from office and with the election of a new, democratic and reform-oriented government, which took office in January 2001, economic issues started to dominate the political agenda and debates in Serbia. Phrases such as restructuring, investment climate, privatization and liberalization entered the political arena. Although politicians soon realized that some of these expressions were popular with voters while others were not, it was and still is widely believed that increased living standards, inflow of foreign investments, low inflation and higher real salaries would strengthen democratic political forces and help them in dealing with the remains of the Milosevic regime and in breaking with his political legacy. However, it is also widely thought that closing the loss-making socially owned enterprises (SOEs) and the associated job losses would lead to a punishment of the incumbent government by the electorate. This widely held perception led democratic governments since 2000 to deal with enterprise restructuring very carefully. As a result, only some of these companies were privatized or liquidated. The others are still in an indeterminate state.

This thinking of politicians and other opinion makers has been strongly supported by public opinion polls, where most respondents stressed that economic issues, such as unemployment and living standards, were the issues that they most care about. However at the December 2003 and January 2007 parliamentary elections there were huge and sustained increases in support for the main anti-reform political parties, the Serbian Radical Party (SRS) and the Socialist Party of Serbia (SPS). This occurred in spite of the overwhelming increase in living standards and suggested that what voters declare to be important in opinion polls and how they vote are two very different things. Also, more recent public opinion polls show that in spite of the improved macroeconomic environment and dramatically improved living standards since 2000, SRS was by far the most popular political party in Serbia with ratings of about 35-40% in mid-2006. It is worth mentioning that SRS is basically the only political party that has not adjusted its rhetoric since the 1990s and is the only party which still promotes and insists on purely political issues, with only limited elements of social issues based on leftist/egalitarian populism. Also, public opinion polls show that SRS is perceived as lacking the capacity to reform the economy even by their own voters/supporters.

We believe that this represents a sort of a puzzle – people say that their main concern is the economy, but the number of votes that the “old regime” gets is increasing, even though the economic situation is improving.

The described public policy that preserves and subsidizes inefficient SOEs is strongly supported by the both theoretical and empirical literature in the field of political economy of transition. One approach, brought forward by Shleifer and Vishny (1994), argues that self-interested politicians intervene in the conduct of SOEs in order to pursue goals that are not aligned with enterprise efficiency. In particular, politicians are interested in

maintaining excess levels of employment to please their constituency. Privatization depoliticizes enterprises: when managers receive cash-flow and control rights over assets, it becomes more costly for politicians to influence the conduct of firms, their leverage to intervene decreases, and the management of firms can make more efficient decisions.

Although the models of Shleifer and Vishny (1994) and Bennesen (2000) provide some predictions about the process of privatization, they do not uncover the motives of a government to privatize. Given that the government loses its ability to influence firms' conduct as a consequence of privatization, why should privatizations ever happen—except for exogenous reasons? Debande and Friebel (2004) develop a model in which they give a positive theory of privatization in a framework similar to the one of Shleifer and Vishny (2004). They argue that the government may be interested in making firms more efficient because of the following mechanism: privatization provides managers with stronger incentives to exert effort; more managerial effort may help to create or to maintain jobs that otherwise would be destroyed, without requiring inefficient government intervention. Put differently, privatization, via increased managerial efficiency, may be a cheaper way to maintain or to create employment than the subsidization of loss-making SOEs.

This is similar thinking to another type of approach, whose goal is to find the optimal rates of job creation and job destruction in transition, e.g. Aghion and Blanchard (1994), Fidrmuc (1999), Roland (2002). The basic thinking is that job creation and job destruction are normal consequences of transition from planned to market economy. If job destruction in large-scale SOEs is not compensated (or not compensated quickly enough) by job creation in the emerging privately-owned sector of the economy, it may lead to excessive unemployment, resulting in strong opposition to future reforms. At times, incumbent governments may be aware of this sequence of events and may tend to slow down job destruction in order to stay in office.

On the other hand, too little enterprise restructuring, i.e. too little job destruction, because of continued extension of subsidies and/or application of soft budget constraints to the SOEs, ultimately undermines private sector development and job creation due to the higher tax burden and/or distorted wages on the labor market induced by the SOEs. Lack of job creation will decrease the number of winners and may on balance decrease the popularity of the incumbent government as well. Accordingly there are, at least in theory, some political incentives that can drive reform efforts either way.

However all of these approaches are based on one implicit assumption: that constituencies vote only or predominantly based on the economic situation and on their economic self-interest as they perceive it. We will test whether it is justified to use this assumption in Serbia, whose transition, due to the 1990s wars, has been rather specific.

A theoretical reason for doubting the importance of economic variables would be to assume rational ignorance and/or bounded rationality. A rather uneducated population, a low circulation of newspapers and a rather short democratic tradition/practice could

explain why voters are not very well informed and why they may be unaware of the costs and benefits of voting for one political party or another. That way they can over- or underestimate the effects of their vote. We will control for these effects by controlling for the effect of the education level on voting patterns. Prima facie, the rational ignorance and/or bounded rationality hypothesis only predicts that uninformed voters will occasionally vote wrongly, not that they are necessarily systematically biased in one direction – toward SRS, for example, or any other anti-reform political party. However rational ignorance could still influence the outcome of elections in a systematic way if one additionally includes an assumption about the asymmetric complexity of political programs. Indeed, pro-reform political parties often have more sophisticated programs – ones that include difficult and not so clear-cut issues such as EU integration, trade liberalization or restructuring of the economy. In this case rational ignorance and/or bounded rationality could lead to a bias in voting patterns, as voting for pro-reform parties requires more information and more understanding of sophisticated political and economic concepts.

Another explanation could be a wider one – that the economy is not really the key issue. Of course, professional politicians might try to make economy the issue of the day, but they don't always succeed. Glaeser and Ward (2006) argue that cultural politics in USA is not unusual: "The true aberration was the mid-twentieth century era of economic politics."

With the exception of Milanovic (2004), empirical studies of the link between economic variables and voting patterns have not been produced for the case of Serbia in an econometrically rigorous manner. Our conclusions could provide insights into what really matters/doesn't matter for voters in Serbia. Furthermore, our results can be compared to the results of empirical research from other transition countries (e.g. Symposium on Job destruction, job creation and voting in post-communist societies, *European Journal of Political Economy*, 2006) and the factors that explain the differences between Serbia and other transition countries could be explored. So far the consensus among researchers is that economic variables have only a marginal influence on voter behavior in Serbia. Milanovic (2004) demonstrated that the 2003 parliamentary election results (voting in favor of non-reform political parties, predominantly SRS) were determined, on the municipality level, by the share of refugees and internally displaced persons, the share of ethnic minorities and the education level of the constituency. Nonetheless, this research deals only with the 2003 election results, not the change in the election results over the 2000-2007 period and the change in the role of both economic and non-economic explanatory variables.

If this hypothesis is empirically verified – i.e. that the economy doesn't really matter – the somewhat discouraging policy conclusion would be that a growing economy, higher living standards and a greater inflow of FDI will not help the pro-reform (democratic) political forces in Serbia. On the other hand, it would also mean that a faster pace of enterprise restructuring, privatization and liberalization will not hurt popularity ratings of democratic parties and endanger their pro-reform policies. Such an outcome would therefore be relevant for policy implementation, as government, although taking care of its political ratings (popularity), would have a signal that it can be involved in more radical, swifter

and fast-implemented enterprise restructuring and that this can be directly communicated to its constituency. Such a result would not be relevant in terms of policy content, but it would be relevant in terms of policy implementation and communication.

The rest of our paper is structured as follows. Part two consists of a brief overview of the enterprise restructuring process in the post-2000 period and of its main political implications. Part three discusses the hypotheses we want to test and presents the data that we use. Parts four and five present our empirical analysis and results. Part six concludes.

2. Restructuring of the Real Sector in Serbia

Serbia is widely perceived as a latecomer to the transition process. The suspension and then the annulment of transition during the 1990s made Serbia inherit almost all the negative mechanisms of the operation of the economy from the previous period, with the addition of new ones: domination of inefficient social ownership; discrimination against the private sector; domination of politics over the economy; transformation of companies into social care centers, lack of financial discipline (soft budgetary constraint); abuse of the police and judicial systems, leading to widespread criminalization of the society and corruption; reducing the market to the goods market, while the markets of money, foreign currency, capital and labor were semi-legal, with mostly administrative prices.

At the beginning of transition in Serbia, in late 2000 and in early 2001, the real sector in the Serbian economy comprised of, for all practical purposes, five groups of enterprises:

1. Completely new private companies, established through private investment after 1989, when private business was legally allowed.
2. Companies which were partially privatized under the privatization model in application as of early 1997, until end-2000.
3. Socially and state-owned companies which do not need pre-privatization restructuring.
4. Socially and state-owned companies which need pre-privatization restructuring, i.e. which cannot be privatized without such restructuring.
5. State-owned public enterprises.

With the exception of the companies in group 1, all other companies in the domestic real sector constitute the legacy of socialism in the Serbian economy, with all their minor or major weaknesses already in evidence long before the political crisis that broke out in 1991. The weaknesses of these companies were simply intensified in the course of the 1990s, with changes in the region, i.e. the new catalysts which came from the break-up of the country, international sanctions and the international isolation of the Serbian economy, extraordinary political circumstances and an institutional vacuum that was caused by the implosion of the institutions of communism, which was not followed by the building of the institutions of a market economy. The consequences of these developments for many

companies in the real sector were numerous: inferior and outdated technology, poor production programs, uncompetitive products, a lack of good incentives for employees and low economic efficiency. In line with the above, the situation of the Serbian real sector in early 2001, at the beginning of transition, was such that its larger share was not competitive at the international level.

A key strategic decision related to this issue was adopted in early 2001: in all the cases mentioned, except for the specific case of public enterprises, restructuring should be carried out by a private owner of those companies. That decision was based on the assessment that a private owner can do the job of restructuring far better than the state, hence a conclusion was drawn that post-privatization restructuring would be economically more efficient than pre-privatization restructuring. In that sense, a precondition for efficient restructuring of the real sector was its privatization.

The model of privatization which was chosen was based on the sale of the majority socially or state-owned equity stake (at least 70 percent of shares) in the real sector companies. One of the main motives for the application of such a privatization model was to establish concentrated ownership, i.e. to create a private owner of the company's capital, who has efficient incentives and mechanisms to carry out its restructuring, embodied first and foremost in his undisputed majority stake in ownership.

One of the major problems in the post-2000 period was (and still is) related to a large number of large socially and state-owned companies which could not be privatized through sale, given that nobody was interested in buying them on sight. The reasons for this lack of interest were essentially twofold. Firstly, an absence of any business prospects of such companies, which are in a large number of cases conglomerates, i.e. engaged in many different activities, without being specialized in an area where they would have a competitive edge. Furthermore, these companies very often were mistaken ("failed") investments from the very start – they were constructed on the basis of investment decisions taken by persons who did not have to bear the consequences of these decisions. In some such conglomerates there are however certain plants, i.e. parts of the enterprise, which have some kind of business prospects. Consequently, the fragmentation of such companies should be carried out and those units which have some business prospects should be established as separate companies. Other units without any future in business should be candidates for bankruptcy and liquidation, in order to privatize their assets, primarily fixed assets, instead of their equity. Of course, in such a division it is necessary, in collaboration with creditors, to allocate the liabilities of the company to the units which are formed by its partition.

The second problem was the accumulated debts of companies, i.e. their obligations which in many cases were higher than their assets, so that such companies had negative equity. Consequently, it was necessary to resolve the issue of their debts before launching privatization. It turned out that the largest part of liabilities of these companies (in some cases more than 80 percent) was debt to the state - direct debt, such as tax and contribution

arrears, or indirect, such as unpaid utility bills to public enterprises (power, gas, water, etc.). Still, the bulk of the liabilities of these companies to the government is a consequence of foreign loans for which creditors were issued sovereign (government) guarantees, which have not been repaid.

The two problems mentioned above created a need for pre-privatization restructuring of these companies, in order to make their privatization possible to begin with. The envisaged restructuring implied organizational changes (mostly fragmentation) and resolution of company liabilities. It was supposed to be just a light pre-privatization restructuring which is followed by privatization through tender or auction, i.e. by the sale of equity of that company, or its parts, to a new private owner. Therefore, as early as 2001 a group was formed of 69 companies with around 155,000 employees (those who formally had a work place).¹

The above described restructuring, provided that a solution is found for the liabilities of the company, may also be called a substitute for bankruptcy, i.e. liquidation of a company through bankruptcy. One should not completely disregard the possibility that one of the motives for introducing such restructuring lies in the awareness of the shortcomings of the then legal arrangements related to bankruptcy at that time, in particular extremely long duration of bankruptcy proceedings, weaknesses in its implementation and uncertainty with respect to the adoption and implementation of new bankruptcy legislation (which proved to be reasonable, considering that the new bankruptcy legislation, although passed by the Parliament, has not been implemented until 2006).

However, in the first seven years of transition almost nothing came out of the said restructuring and subsequent privatization of these companies. The question may be asked why there are such delays in the restructuring and privatization of this group of companies.

It is obvious that two main technical problems have arisen in relation to the implementation of thus designed restructuring. The first one is the problem of identification, separation and verification of claims by different creditors on these companies, taking into account that their arrears are years or even decades old. The second problem is a relatively complex and often absurd organizational structure of these companies. This problem is augmented by the engagement of foreign advisors, which in certain cases was mandatory, where big multilateral donors provided grants. Foreign

¹ The number of such companies varies. So far, since 2001 only several such companies have been privatized, which decreased the initial number of companies under restructuring. Contrary to that, companies which were not initially slated for restructuring, and whose privatization failed after two attempts (nobody offered the initial price), are included into the group for restructuring, as it has been assessed that further attempts at their privatization will not be successful. Hence, the total number of companies slated for restructuring was around 80 at the beginning of 2006. Moreover, this number of companies should be increased by more than 200 smaller subsidiaries. These companies are in a way hostages of large companies, bearing in mind that the future of subsidiaries, whatever it may be, is linked to the fate of large companies which need to be restructured.

consultants, unused to such organizational arrangements, were wasting time searching for the sense where there is no sense, nor has ever been.

However, the key reason for the absence of activity in the field of restructuring of this group of companies lies in the lack of political will to implement it. Overstaffing in those companies is the main reason behind that lack of will. Namely, the restructuring of these companies would inevitably lead to lay-offs of a sizeable number of those presently employed - whether directly, in the course of pre-privatization restructuring, or indirectly, after privatization, as part of efforts by a new owner to restructure his own company and enhance its economic efficiency.

In that respect it was perceived that the restructuring of these companies, i.e. lay-offs of redundant workers, can have negative political consequences – significant falls in political popularity of those taking these decisions and those implementing such restructuring. Therefore, there is a direct incentive to politicians to maintain the inherited redundancies, namely in the case under consideration here, not to carry out pre-privatization restructuring. General managers, i.e. employees' representatives in those companies, being aware of the mentioned incentives related to political popularity, are in a position to blackmail politicians, mostly by demanding a constant flow of, and an increase in, subsidies to such companies, i.e. suspension of any restructuring of such companies.

In this manner a political equilibrium was established in the form of balanced subsidies to non-restructured and non-privatized companies, maintenance of redundant workers in them and political support which those employees and their families lend to the politicians who are not carrying out restructuring. This finding is in full compliance with the findings of the model of relations between politicians and firms (Shleifer and Vishny, 1994). In the equilibrium, explicit subsidies are paid to loss-makers (budget item subsidies to non-financial organizations) and soft budget constraints are made possible. Namely, in addition to direct subsidies, non-payment of utility bills to public enterprises is tolerated, and as for other creditors, the efficiency of collecting claims from socially and state-owned companies in Serbia is proverbially low.

An indirect confirmation of the thesis that this political equilibrium was established relatively early on, which was not conducive to the real sector restructuring, is a relatively low level of efforts invested in institution building, i.e. in creating institutions and building administrative capacities necessary to carry out pre-privatization restructuring. Namely, in setting up the Privatization Agency which is, among other things, in charge of the real sector restructuring, far more attention was paid to the building of the Tender and Auction Centers than of the Restructuring Center.

It is obvious that, in principle, such a political equilibrium was established in Serbia, namely a vicious circle in which there are no incentives to any of the parties to begin the restructuring of the real sector. However, a question is raised as to the extent to which some of the perceptions underlying the decision-making process are based on reality. On

the one hand, the first transition government lasted almost three years, longer than in nearly any East European transition country. Still, it is questionable how justified it would be to link this political result primarily to the non-implementation of real sector restructuring. Furthermore, the fall of the first Serbian reformist government in 2003 certainly was not a consequence of the restructuring of the real sector, since no such restructuring ever happened. Finally, a question may be asked as to the degree to which real sector restructuring influences the popularity rating of the government today. Namely, employees in these companies indubitably belong to the losers from transition, so it can be assumed that this part of the electorate turned against the government, that is against reform policies, a long time ago, and that they have long been voting for opposition political parties, in particular those which are clearly not reform-oriented.

As a result, Serbia's political equilibrium is based on political support resulting from increased subsidies, versus political support resulting from cuts in taxes collected for financing these subsidies. Seven years after the beginning of transition, political popularity as a result of increases in subsidies is still far greater than political popularity won on the basis of cuts in the tax burden on taxpayers. In present-day Serbia, the number of those who are mindful of their own tax burden is still relatively small. The number of those who live on subsidies, that is, on transfers, is considerably larger. With a rise in wealth, i.e. at an increased level of steady income, the number will also increase of those who define their preferences in politics on the basis of tax burdens, among other things, which political competitors are offering to them. Such a change should bring about the establishment of a new political equilibrium in which there will be no incentives for supporting inefficiencies in the real sector. Support to such change could come from a tax reform which would increase the share of direct taxes in total tax revenue at the expense of indirect taxes. Namely, a tax burden based on direct taxes is much easier to comprehend for voters and a larger number of voters would then see the connection between increased subsidies and their own increased tax burden.

3. Hypotheses and Data

There are several hypotheses that will be tested.

The first one is that the 2000 election results were affected by people working in the failed socially-owned companies, namely that they tended to vote for Radicals or Socialists. We believe that this group of people is very risk-averse, and that they perceived regime change as potentially disastrous for their employment status and living standards.

The second hypothesis is linked to the importance of other economic variables. The conventional wisdom is that growth in living standards and in average salaries and improvements in employment prospects should decrease support for antireform parties. However, since at the national level increases in living standards have been followed by

decreases in support for the incumbent government, we believe that the conventional wisdom may be wrong.

The third group of hypotheses is linked to the importance of mainly demographic variables in explaining voting patterns (at the municipal level), notably the share of ethnically Serbian population, the share of elderly people, and the share of refugees (i.e. mostly ethnically Serbian refugees from other parts of the former Yugoslavia), since some previous research indicated that these variables are instrumental in explaining the voting patterns in Serbia.

The fourth hypothesis to be tested is whether the restructuring process has actually decreased the support for antireform parties. The explanation would be that people who were working in these companies and lost their jobs have switched from reform to antireform parties. It seems that most politicians in Serbia are afraid to push for faster restructuring as they believe that that would undermine their support. This does not necessarily contradict the first hypothesis, as it is focused on those employees who initially voted for the reform parties.

Our data set consists of the following data at the municipality level (150 municipalities in Serbia; the cities of Belgrade, Novi Sad, Niš and Kragujevac are each considered to be single municipalities): the share in total municipality population of people working in socially-owned companies undergoing restructuring processes in 2001 and 2006; the relative change in the share of people working in these companies; the average nominal wage in December 2000 and December 2006; the relative change in salary over the 2000-2006 period; the share in total municipality population of employed people in 2000 and 2006; the relative change in employment over the 2000-2006 period; the percentage in total municipality population of refugees and internally displaced persons; the share in total municipality population of people receiving social assistance (as a proxy for poverty rate for which data do not exist at the municipal level); the illiteracy rate, measured on a 1-5 scale (a proxy for education level); the share in total municipal population of residents of Serbian ethnicity; the share of population older than 65 years; and GDP per capita in 2004. In addition, we have collected the data on municipality votes for Radical and Socialist parties at the 2000 and 2007 elections.

The main link that we are seeking to test is the link between the share of employees of restructuring companies and voting results. All of the other variables are therefore be treated as control variables. However, more broadly, we want to test the predictive strength of other economic variables and see whether and how they influence the election results.

Most of the data are official statistical data. However, the data on the employment in companies undergoing restructuring is collected from the financial statements submitted by the companies to the National Bank of Serbia. We have identified more than 200 companies in this group and collected employment data for the 2001-2006 period. The employment data has then been summed by municipalities. The registry of all of these

companies does not exist. Namely, there is a list of around 70 major companies, but all of their subsidiaries had to be identified manually. We believe that we have identified more than 80% of these companies.

4. Empirical analysis

Elections in 2000

We start by looking at the December 2000 election. It is widely perceived that these elections were somewhat specific since they were held 3 months after the ousting of Milosevic from power. However it seems that a very high percentage of variation can still be explained with a relatively small number of variables.

The initial specification included all the variables described in section 3: share of people working in restructuring companies in 2001, share of refugees, share of people receiving social assistance, GDP per capita in 2004, average salary, percentage of Serbs. It turned out that neither the percentage of Serbs, nor average salary and GDP per capita are statistically significant, hence these were excluded from the model. Our final specification and its results is shown in Table 1.

TABLE 1.				
Retained variables	Coefficients		t	Sig.
	B	Std. Error		
(Constant)	-0.202	0.026	-7.874	0.000
Share of old people (above 65 yrs)	0.866	0.144	6.028	0.000
Share of refugees and internally displaced persons in total population	1.234	0.075	16.44	0.000
Share of people receiving social assistance (material support to families)	2.523	0.356	7.095	0.000
Education	0.02	0.006	3.351	0.001
Share of people working in companies undergoing restructuring process in 2001	0.006	0.002	2.516	0.013
Method: OLS				
Number of Observations: 150		R-squared: 0.95		

As shown in Table 1, all the variables retained are statistically significant and with the expected sign. The following factors lead to more votes for antireform parties – older population, higher share of refugees, higher share of people receiving social assistance, higher illiteracy rate. Maybe the most interesting finding is that people who were at that time working in the companies that were going to be selected for restructuring also voted for antireform parties. It seems that this can be explained by their higher risk aversion.

Namely, they probably understood that their companies were not viable and that the victory of a reform-oriented government would mean job losses due to restructuring or liquidation through bankruptcy.

4.2. Elections in 2007

The second regression covers the January 2007 election results. The initial specification included nominal salary, relative change in salaries in 2000-2007 period, share of refugees, share of people receiving social assistance, share of Serbs, change in employment, illiteracy rate, share of old people, GDP per capita, employment in companies undergoing restructuring and relative change in employment in these companies in 2000-2007 period.

Our final specification and its results is shown in Table 2. The R-squared is 0.97.

Retained variables	Coefficients		t	Sig.
	B	Std. Error		
1 (Constant)	-0.18	0.037	-4.837	0.000
Share of old people (above 65 yrs)	0.745	0.208	3.586	0.000
Share of refugees and internally displaced persons in total population	1.967	0.109	18.018	0.000
Share of people receiving social assistance (material support to families)	3.215	0.516	6.229	0.000
Education	0.018	0.009	2.082	0.039
Change in employment in companies undergoing restructuring process in 2001-2007 period	0.065	0.23	2.013	0.046
Method: OLS				
Number of Observations: 150		R-squared: 0.97		

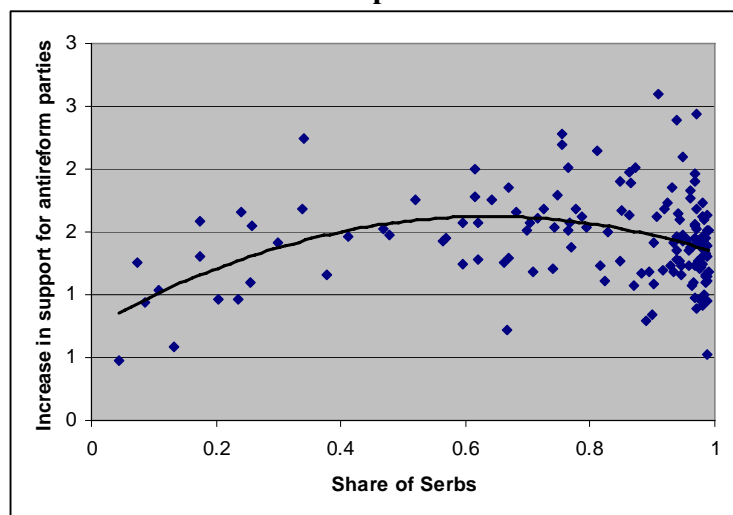
As Table 2 demonstrates, the coefficients of the retained variables are all statistically significant and the signs are as expected. However the share of employment in companies in restructuring is not statistically significant, but the change in the employment is. Therefore, the municipalities where restructuring processes were proceeding at a faster pace tended to vote less for antireform parties, which is as expected taking into account the regression results for the 2000 election. It is the size of the workforce in these firms that is a crucial factor of voting for antireform parties, precisely due to the mechanism already explained in the 2000 model. Furthermore, it is important to notice that none of the other economic variables is statistically significant, i.e. they are not the factors of voting behavior of Serbian constituency.

4.3. Changes over the 2000-2007 period

The third regression we performed looks at the relative changes in votes for antireform parties over the 2000-2007 period.

The initial specification included relative changes in salary, change in restructuring employment, illiteracy rate, share of people receiving social assistance, nominal salary in 2007, change in employment, share of Serbs, GDP per capita, share of refugees and share of Serbs squared, as we had reasons to believe that the link between share of Serbs and votes for antireform parties was not linear (Graph 1).

Graph 1.



The final specification was as shown in Table 3, with an R-squared of 0.51. Restructuring (either level or change) is found to be statistically insignificant. Some of the other variables are significant, but some of the signs are completely unexpected.

TABLE 3.

Retained variables	Coefficients		t	Sig.
	B	Std. Error		
1 (Constant)	1.057	0.182	5.805	0.000
Share of Serbs in total population, squared	-1.558	0.374	-4.17	0.000
Share of Serbs in total population	2.361	0.457	5.163	0.000
Share of old people (above 65 yrs)	-3.287	0.554	-5.936	0.000
Education	-0.74	0.025	-2.935	0.004
GDP per capita in 2004	1.34E-03	0.000	2.409	0.017
Change in employment in companies undergoing restructuring process in 2001-2007 period	0.272	0.095	2.874	0.005

Method: OLS

Number of Observations: 150

R-squared: 0.51

5. Regional Effects

Serbia is a relatively small country, however we have reasons to suspect that different regions, for cultural and other (potentially media) reasons tend to vote differently, even controlling for ethnic composition, education and other demographic, social and economic factors. Therefore, we have extended each of the final specifications with the introduction of dummy variables for each of the Serbian broader regions.

The effects with the corresponding sign of the parameter are given in the following table:

	2000 elections	2007 elections	2007/2000 ratio
Vojvodina	Negative	Negative	Not significant
East Serbia	Not significant	Positive	Positive
Western and Central Serbia	Positive	Not significant	Negative
South Serbia	Not significant	Negative	Not significant

First of all, it is clear that residents of Vojvodina tended to vote less for Radicals, controlling for all the listed social, demographic and economic variables. The explanation to this finding would probably be that residents of Vojvodina perceive themselves as having a “higher culture” than the rest of Serbia, mainly due to the non-Ottoman heritage.

The second finding is that, for some unidentified reason, citizens of Eastern Serbia are voting more while citizens of Western and Central Serbia are voting less for the antireform parties than they used to prior to 2000. One obvious explanation for Western and Central Serbia is the rise of the New Serbia party during this period, which was, for the purposes of this research, classified as reformist. Namely, the president of this party is a former mayor of Cacak, a town in Western Serbia, and his stronghold is in that region of the country. Therefore, it seems reasonable to expect that he managed to attract former socialist and radical voters.

South Serbia seems very interesting. One of the possible explanations is the proximity of Kosovo and the possibility that citizens of this region were afraid of the Socialist/Radical rhetoric regarding the Kosovo issue.

Therefore, we have created a new dummy variable, “Proximity to Kosovo”, where we included some of the municipalities close to the border with Kosovo. These municipalities include some from Southern Serbia, but also some from Western and Central Serbia.

We find that proximity to Kosovo is negatively correlated with both the share of Radical and Socialist vote in 2007 and in 2007/2000 ratio, in spite of controlling for all the other variables.

6. Discussion and conclusions

Analyses of both the 2000 and 2007 elections results demonstrate that economic variables (GDP, salaries, and employment) are still not important when citizens of Serbia decide whom to vote for.

However the analysis of the 2000 elections shows that people who were employed in the companies that were going to undergo restructuring were even then fully aware that their companies were not viable and that any reform-minded government would tend to reduce employment in those companies by restructuring or liquidation. Therefore, they responded by voting for anti-reform political parties in 2000. The explanation probably lies in the extreme risk-aversion among this group of voters. Although the reforms could in the long run prove to be useful even to this group of voters, it seems that they favored a situation in which they had a job, no matter how poorly paid, insecure and unsustainable it was.

The analysis of the 2007 election results leads to similar results. Other economic variables, besides the pace of restructuring, are statistically insignificant, including the level of employment in restructuring companies. However, the pace of restructuring (measured by the change in employment in these companies) is statistically significant and of the expected sign. Strong positive correlation (0.723) between the level of employment in these companies and the change of employment (slower change and higher level of employment) could be an indicator that politicians tended to restructure more quickly in the municipalities where the share of that employment was relatively low. Clearly this was considered a less politically risky type of operation than in municipalities with substantial shares of total employment in firms under restructuring.

The most interesting results (and probably the most difficult to interpret) come from the third regression model, the one aimed at explaining the relative differences in votes for anti-reform parties between the 2000 and 2007 elections. As already mentioned, employment in companies in the restructuring process is statistically insignificant, meaning that the observed increase in support for antireform parties from 2000 to 2007 had nothing to do with enterprise restructuring.

In addition, the constant is highly statistically significant. Taking into account that we are trying to explain the relative change, the presence of a statistically significant constant means that some other unidentified factors are at work in all of the municipalities, namely that some national issue is probably the cause, since the strongest non-reform political party, SRS, has an image of a party that protects “the national interest”. The crucial factor that may have been omitted from the regression is the evolution of the debate about the final status of Kosovo, as the issue was not important (not on the agenda at all) in 2000 but

highly important in 2007. Although there may be no reason to assume that this factor will have stronger effects in some municipalities and weaker in the others, we have nevertheless tried to capture this difference by looking at the proximity of the municipality to the Kosovo border. We found a statistically significant negative relation between living in a Kosovo-bordering municipality and the share of votes for non-reform (and nationalistic) parties. This finding can probably be interpreted by fear of another war.

We have also tested the statistical significance of belonging to four broad regions of Serbia. We found that, controlling for all other factors, regions in Serbia do play an important role, but we were unable to fully explain the reasons for these differences.

We also uncovered a quadratic relation between the share of Serbs and votes for antireform (basically nationalistic) parties. This suggests that there is some local maximum of antireform voters (at about 65-70% share of Serbs in the total population). The reduction in the votes that antireform parties get when the Serbian share of population is higher might mean that in those municipalities ethnic Serbs tend to feel secure and nationalistic issues are therefore not at the top of the agenda. Conversely, a smaller share of Serbs means that the majority of the local constituency is made up of national minorities who have few incentives to vote for Serbian nationalist parties anyway. In short, the smallest increase of votes for non-reform political parties is found in municipalities which are the least ethnically mixed.

Secondly, the signs of the coefficients of the “demographic” variables are mostly unexpected (negative), which means that older populations and less educated electorates have tended to switch from antireform to pro-reform parties. Taking into account that average pensions have increased in real terms, as well as the fact that pension arrears have been cleared, this result could still make sense. Also, since most elderly people tended to vote for antireform parties in 2000 (regression 1), a cynical view would be that their support could only go down as their numbers naturally dwindle. The other negative sign of the parameter, linked to the education level, is more difficult to explain as it means that the municipalities with lower average education levels also tended to switch from anti-reform to pro-reform parties. A potential explanation could be that people in those municipalities have strong feelings towards the government and authority and therefore tend to vote for whoever is in power.

The impact of the last two variables is challenging to explain, since both GDP *per capita* and change in employment are positively correlated to votes for anti-reform parties, and these two are the only economic variables whose estimated parameters are significant. One potential explanation could be that the Serbian constituency overall does not have sufficient reform stamina, i.e. that there is a phenomenon of reform fatigue which has already surfaced. Hence, seven years into the transition, as living standards have increased, voters have had enough and are moving towards non-reform political parties that will stop or at least decelerate the reform process.

We also wanted to test the importance of the so-called “exit option”, i.e. the fact that many of the people who lost their jobs were maybe able to either switch to agriculture or to retire. However the lack of appropriate data prevented us from investigating this issue.

Our main finding is that the conventional wisdom regarding enterprise restructuring in Serbia is wrong: enterprise restructuring does not decrease the political popularity of reform-oriented incumbent government. On the contrary, lack of restructuring and keeping employment in these firms proved to be a breeding ground for political support for antireform parties. The main reason is that labor employed in these firms have no illusions about the sustainability of these firms (and of their jobs in these firms), so that their rational expectation is that reform-oriented parties will make them unemployed. Taking into account the high level of risk-aversion of that group of voters, its obvious choice is to vote for antireform political parties.

As a consequence, incumbent political parties can push forward enterprise restructuring without a significant political risk. Their employees already vote for non-reform political parties.

7. Bibliography

1. Aghion, P and Blanchard, O.-J. (1994): On the Speed of Transition in Central and Eastern Europe. *NBER Macroeconomics Annual* 9, 283-320
2. Caplan, B. (2001) Libertarianism Against Economism: How Economists Misunderstand Voters, and Why Libertarians Should Care, *Independent Review, Volume 5*
3. Debande O., & Friebe G. (2004) A Positive Theory of “Give-Away” Privatization, *International Journal of Industrial Organization*
4. De Loecker J. and Konings J. (2006) Job reallocation and productivity growth in a post-socialist economy: Evidence from Slovenian manufacturing, *European Journal of Political Economy*, Vol. 22
5. Desai, R. and Olofsgård, A. (2006) The political advantage of soft budget constraints, *European Journal of Political Economy*, Vol. 22
6. Djankov, S. & Murell, P. (2002): Enterprise Restructuring in Transition: A Quantitative Survey, *Journal of Economic Literature*, Vol. 40, pp. 739-792
7. Doyle O. & Fidrmuc J. (2006) Who favors enlargement?: Determinants of support for EU membership in the candidate countries' referenda, *European Journal of Political Economy*, Vol. 22
8. Estrin, S. & Rosevar, A. (1999): Enterprise Performance and Ownership: The Case of Ukraine, *European Economic Review*, Vol. 43, pp. 1125-1136
9. Fidrmuc, J. (1999): Unemployment and the dynamics of political support for economic reforms, *Journal of Policy Reforms* Vol. 9, 139-156
10. Frazier, M. (2006) State-sector shrinkage and workforce reduction in China, *European Journal of Political Economy*, Vol. 22
11. Frye, T. (2006) Ownership, voting, and job creation in Russia, *European Journal of Political Economy*, Vol. 22
12. Glaeser, E. & Ward, B., (2006) Myths and Realities of American Political Geography, Harvard Institute of Economic Research, *Discussion Paper 2100*
13. Ickes, B. and Ofer, G (2006) The political economy of structural change in Russia, *European Journal of Political Economy*, Vol. 22
14. Kornai, J. (2006): The Great Transformation of Central Eastern Europe – Success and Disappointment, *Economics of Transition*, Volume 14,
15. Mach, B. & Jackson, J. (2006): Employment change, attitude evolution and voting during Poland's transition: Longitudinal evidence, *European Journal of Political Economy*, Vol. 22
16. Milanovic B. (2004): Who voted for Radicals?, *Prizma*
17. Roland, G. (2002): *Politics, Markets and Firms: Transition and Economics*, Cambridge, Mass.: MIT Press
18. Shleifer, A. & Vishny, R. (1994): Politicians and Firms, *Quarterly Journal of Economics*, Vol. 109, pp. 995-1025.
19. Smeets, V. & Warzynski F. (2006) Job creation, job destruction and voting behavior in Poland, *European Journal of Political Economy*, Vol. 22
20. Smith, K. *et al.* (1999): Privatization Incidence, Ownership Forms and Firm Performance: Evidence from Slovenia, *Journal of Comparative Economics*, Vol. 25, pp. 158-179.

21. Tichit, A. (2006) The optimal speed of transition revisited, *European Journal of Political Economy*, Vol. 22,