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Privatization in Serbia: The Second Run

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Table of Contents

Summary
Acknowledgments
List of Tables and Figures

1. Introduction
2. Privatization Models
3. Privatization in Serbia before June 29, 2001
4. The Privatization Law of June 29, 2001
5. The Reality of Privatization in Serbia after June 29, 2001

Appendix
Cited Literature

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List of Tables

1. Advantages and disadvantages of models of privatization
2. Result of privatization in Serbia prior to 2001
3. Models of privatization according to the June 29 law
4. Industrial production in Serbia in 2001/2
5. Inflation in Serbia in 2001/2
6. Average monthly wages in YU dinars and US dollars 2001/2
7. Nominal and real increase of monthly wages in 2001/2
8. Unemployment rate in 2001/2
9. Enterprises ready to be privatized in May 2002
10. Tender and auction sales: the cumulative results so far
11. Result of tender sales so far

Figure

1. Institutional structure of the privatization policy

1. Introduction

Privatization in Serbia has been given a second chance. This time, the government has made it clear that it means it. It has set up a ministry for privatization; invited international experts to assist in drafting the law on privatization; opted for the case-by-case approach and sale model; started restructuring big enterprises before selling them off; and engaged in a serious advertising campaign to make privatization acceptable to the Serbian public.

There are several broad aspects of a privatization policy. The most important one is the selection of the best model by which to privatize; that is, the method of sale or transfer. The second is the development of financial market institutions enabling the trading of shares created by privatization (share funds, investment funds, stock market, commission to regulate securities exchange etc.). The third is the transparency and the fairness of the process. This paper attempts to assess the coherence of the newly developed Serbian privatization model, and how well and how fairly it is being applied.

Change was certainly needed. It will be argued in section 3 that the management-employee buyout model that was deployed in the 1991 and 1997 laws on privatization was actually an attempt to stall privatization in Serbia and allow the political elite tied to the Socialist party of Serbia and JUL, to grab assets without putting them to the right or productive use.

2. Privatization Models

The first post-Milosevic Serbian government embraced the sale model for privatization. Before explaining this model and its advantages and disadvantages, a definition of privatization is in order. John Nellis defines privatization as 'a transfer of ownership such that a majority of the shares or equity in enterprises passes from state or public ownership into private hands' (Nellis 1998: 13). Cheryl Gray says that 'the task [of privatization] is not only to change ownership but to create good corporate governance and to further the development of legal norms and supporting institutions neede d in full-fledged market economies' (Gray 1996: 1). On these definitions, the major task of privatization is to create real private owners. The existence of real owners is essential to ensure the final aim—namely, a good corporate governance that will make the firms and the economy work. But corporate governance, especially in post-socialist states, is partly dependant on techniques or models of privatization. Gray argues that good corporate governance

> 'depends to a large extent on the technique used to privatize and the distribution of ownership that results. Different types of private owners […] all bring different mixtures of both goals and capabilities to the firm they own. […] Creating formal ownership is necessary but not sufficient; creating effective corporate governance is the more complete task' (ibid. 3).

There are several ways to privatize. In transition economies the best are:

a) restitution;

b) sale model;
c) management-employee buyouts;
d) mass privatization.

Although the list contains or implies four separate approaches, there are basically two models that dominate the current privatization policy in East-Central Europe. If restitution (i.e., the handing back of assets to pre-socialist owners) is separated out as a special case, there remains sale and mass privatization. Privatization through sales implies direct sale of enterprises to so-called strategic investors, often foreign investors. It was most successfully used in advanced OECD countries such as the UK and middle-income mixed economies such as Chile. In the East Central European economies, Hungary and Estonia have successfully used this approach. Strategic investors tend to be those already in the business, meaning that they have a specialized knowledge of the firm they are interested in buying, its real or potential markets, and its competitors. The assumption is that such investors will be interested in continuing the production, not in shutting down the firm as soon as they buy it.

When considered within the context of East Central Europe, the major disadvantage of this model is that it works best where the market environment is well-established. Since in new democracies market institutions are far from developed, investors tend to be wary and sales tend to be slow. What is more, in infant and undeveloped markets—and especially in a country such as Serbia that is depleted by four wars it was involved in waging during the 90s—there can be found a limited amount of capital. The problem is, therefore, who will invest.

The current assessment is that, in transition countries, privatization through sale is the best way to privatize. This is forcefully argued in two papers written by Djankov and Murrell (2000; 2002). The papers show that the move from state to private ownership did result in greater amount of restructuring, but it also showed that the countries that deployed any type of mass privatization score more poorly than the countries that deployed direct sale method regarding the restructuring of the enterprises. However, wherever sale approach was embraced (except for East Germany), it was combined with other approaches. It is important to mention two other models and their advantages, because the prescriptive part will refer to these in order to overcome the difficulties of the current strategy.

The second key variant of mass privatization is management-employee buyout (MEBO). It implies a giveaway or a sale, often at steeply discounted prices, of all or part of the company to the people who work inside the company, be they managers or employees (Gray 1996: 14). This is why this approach is dubbed 'insider' model. Insider model, as the dominant one, was tried in Croatia, Georgia, Russia, Slovenia, Romania, Ukraine, Armenia, Uzbekistan, Albania, and Yugoslavia prior to 2001. This model is always a popular one, enables fast and easy implementation. It is more equitable bur rather inefficient (ibid. 14-15). However, in all mentioned countries, bar Slovenia, where it was applied as the dominant model, it failed in creating real owners. *Transition Report* published by the European bank for reconstruction and development in 1999 ranks these countries at the bottom of the list of most successful privatization policies. This suggests that insider model can be said to be, at best, a good substitution if the main model becomes too slow. This is why it came as a

supplement to sale model in Hungary in 1993 in order to speed up privatization process.

Voucher privatization is a model that differs from both sale and manager-employee buyouts. It sees all citizens (not only workers) as equally entitled to the shares of firms. Gray writes that

> 'Vouchers are given or sold at very low prices to domestic citizens, thereby eliminating the shortage of domestic capital, which is the core problem with the sale approach. […] If well-designed, voucher privatization can overcome many of the problems with the various sales approaches, most notably the perceived unfairness, the shortage of domestic capital, and the difficulty of placing monetary values on state assets' (ibid. 20).

The problem with this type of privatization is that it, like the MEBO, does not resolve the problem of 'real' owners and corporate governance.

Table 1 shows the advantages and disadvantages of each model.

			Objective		
	Better corporate governance	Speed and feasibility	Better access to capital and skills	More government revenue	Greater fairness
Method					
Sale	+	-	+	+	-
MEBO	-	+	-	-	-
Voucher	?	+	?	-	+
Spontaneous	?	?	-	-	-

Table 1 (Source: *World Development Report 1996*, p. 52)

Privatization is always a matter of politics, not simply economics. Economists may be able to design the best privatization model from the point of view of stimulating efficiency, but which model will be picked out for a certain context will depend on the views and power of the various stakeholders involved. At the end, it is always up to politicians to decide. Mass privatization is initially more popular politically than conventional sales techniques because it implies a greater inclusion of the population. In countries where those inside the firm had very little influence over what to do with state property, like in Germany or the Czech Republic, the government could opt for a top-down privatization. In countries where workers or managers had more influence, like in Russia or Poland, this was unfeasible. Likewise, the selection of models largely depends what kind of problem a specific country is faced with. The Czech Republic did not have any foreign debt when the Berlin Wall fell. It was not in acute need of resources for debt repayment, so it could afford a mass privatization program that gave away the assets. Countries such as Hungary, that had a very large and pressing foreign debt, had to sell the assets to raise money to pay it off.

As it stands, the sale model opens up the possibility for establishing concentrated ownership. When ownership is concentrated, firms tend to restructure faster and perform better. Concentrated ownership enables the so-called deep restructuring of firms which is the development of new production lines, identification of the new markets, and implementation of new management techniques and business strategies. Only deep restructuring can create new jobs. In contrast, types of mass privatization (voucher or MEBO) usually result in dispersed ownership. In this approach, most firms start off being owned mainly by both insiders and some outsiders but without strong dominant shareholder. Dispersed ownership can have a negative impact on corporate governance, because it leads to the so-called defensive or reactive restructuring, meaning downsizing in production, workforce and capacity associated with the loss of market (*Transition Report 1999*, p. 165). As mentioned, there is now a considerable empirical evidence showing that various types mass privatization has not led to strong restructuring and recovery (Djankov and Murrell 2000; 2002).

Effective corporate governance exists when owners are motivated to use resources efficiently. In addition, owners must be equipped with capabilities to monitor what managers do and make them to act in firm's best interest (*World Development Report 1996*, p. 52).

One cannot dispute that privatization contributes in most cases to efficiency gains, but for it to be overall success it must do more than address efficiency issues. In the Czech Republic and Russia privatization was fast, but private ownership without appropriate governance rules and safeguards was created. The safest conclusion is perhaps that privatization must be neither too fast, nor too slow. Where it was too fast (as in Russia), it quickly created a mass private owners but the owners were not real, that is, competent to run the firms productively. Where it was too slow, (as in Bulgaria, Romania, and the Ukraine in the early 1990s, and Belarus up to today), it resulted in almost no privatization at all (Gray 1996: 7).

3. Privatization in Serbia before June 29, 2001

First efforts at privatization in Yugoslavia began in 1990, but quickly arrived on a bumpy road. The Federal government led by Ante Markovic passed in 1988 Law on Enteprises, then in 1989 Act on financial Operations and Laws on Social Capital. The laws enabled firms's reoragnization, their insolvency and brankruptcy. It also permited Emplyee Assenblies of the firms to sell the wished amount of enterprise's capital. The shares of the enterprise were sold at a 30% discount a rate to the present and former employees of the company. For each year of the employment the workers were given 1% discount up to a maximum of 70% of the nominal value of the shares (Uvalic 2001: 2) The hopes in the successful beginning of privatization, just like the hopes in economic reforms in general, were squashed by the conservative Milosevic government and the political conflict that was speeding up in the beginning of 1990 when the first multiparty elections were held in all six republics. The breakup of the country was inevitable and with it the breakdown of the announced economic reform in SFR Yugoslavia.

The Federal laws from 1989 continued to have some effects during the fisrt half of the 1990s. The federal privatization law was followed by a law regulating privatization in Serbia. In 1991, the Serbian parliament adopted the Law on conditions and procedures to transform collective property into other forms of property (*Sluzbeni glasnik Republike Srbije*, no. 48/91, 75/91, 48/94, 51/94). This law permitted only the transformation of so-called collective property (*drustvena svojina*), forbidding the transformation of state-owned property. The transformation did not cover public or collective enterprises that were owned by the state or local authorities. Privatization was not mandatory.

Between 1989 and 1994 some 60% of Serbian firms were privatized. But since it was an insider privatization, it did not do anything to change the corporate governance within the firms. Firms essentially continued to behave the same, accummulating arrears, receiving direct subsidies and soft credits. 'Banks often preferred to write loans off rather than put firms into bakruptcy; there was little inventive to foreclose on loans, since bankruptcy and liquidation procedures were heavily weigted in favor of the indebtor' (OECD 2002: 57). On top of all this, there came the 1990 Serbian constitutution that mandated the equality of all types of ownership.

Due to huge inflation that culminated in December 1993, and the failure to re-value the assets to account for this inflation, the privatization carried out between 1990-1993 resulted in the sale of firms for unreasonably low prices. This is why in 1994 the Serbian parliament, in a move pushed for by the Democratic party, annuled the results of privatization by amending the 1991 Privatization law. As early as 1994, the Agency for privatization revised most of the deals made between 1991-1993, and reversed the results of the 1991 privatization law. The reevaluation was so-called *ex post* revaluation of the share which were privatizated prior to 1993. It meant that all the shares which were extremely cheap in the inflatory 1993, suddenly became very expensive. This forced most of the shareholders to give up on the subscribed shares due to their high price (Uvalic 2001: 2). As a result, less than 10% remained privately owned.

During 1995, when Dragoslav Avramovic was the governor of the Yugoslav national bank, there was debate whether privatization should be made obligatory. In 1996, the Federal parliament passes a new privatization law that delineates a framework for the two republics, stating that privatization must remain voluntary. This was followed by a second Law on Property transformation adopted by the Serbian parliament in 1997 (*Sluzbeni Glasnik RS* , no. 32/97). The 1997 law saw insiders (workers and pensioners who were or are employed by firms) as the only eligible beneficiaries of privatization. It gave away up to 60% of the total share with no strings attached. One problem was, however, that not too many employed got the full 60% because the law attached the percentage of the shares to the years spent in the firm (articles 11-12). The usual outcome was that workers and the director got about 20-30%, whereas the rest was transferred to a share fund managed by the state. In practice, the share fund managers took no interest in governing the firm at all, whereas the workers were under the threat of the director of the firm to vote the way he suggested. The proportion of the shares given out to the employees was not high enough, and the menagers could happily retain the control in the privatized companies. This also created the phenomenon known as 'tunneling', although in much smaller extent than in the Czech Republic.

As a result, the restructuring of corporate governance under the 1997 law never occurred. This Serbian version of a MEBO simply did not motivate management and workers to restructure. If restructuring implies downsizing, as it does, workers owning shares are rarely interested in restructuring the enterprise. In addition, the most damaging limitation was that, due to the insider character of the privatization, foreign investors were not allowed to buy shares. Moreover, privatization was not obligatory; insiders could initiate the process if they wished but they were not required to do so.

One novelty of the 1997 law was that, although preferring MEBO model, it did foresee special tender procedure for 75 enterprises that were seen as potentially lucrative. The 49% of the shares of the Serbian Telecom were sold by this law, altough the government had to amend the Law on Foreign Investment, for this Law saw the Telekom as a strategic company that cannot be sold to foreign investors.

Once again, and not surprisingly, the results were less than hoped for, and the implementation of the 1997 law was terminated in February 2001 when the Serbian parliament amended the law (*Sluzbeni Glasnik RS*, no. 10/01), and paused the process

for six months, the time-limit within which a new law on privatization was intended to be passed.

At the beginning of 1997, a modest share of collective capital had been privatized, whereas state ownership remained untouched. In total, under the 1997 law on privatization, only 10% of the capital was privatized by the end of 2000. The share of this 10% in the GDP was around 2%.

Results of privatization in Serbia prior to 2001.

	Number of enterprises
Started privatization	428
Finished in first round	284
Finished in second round	246
Privatized	18

Table 2 (Source: Report from the Direction for the Assessment of Capital.)

[But see Table 25 from OECD, p. 104, from Uvalic 2001]

Only smaller firms were privatized under the 1997 law. The sum of the emitted shares was estimated at 12 billion dinars (€200 million). The only big enterprise that was privatized was Telekom Srbija, in which 49% of shares were sold to the Greece STET and the Italian OTI. All in all, privatization policy prior to 2001 was flawed in that: a) it did not really make privatization possible; b) the few enterprises that went through the process did not become more efficient; and c) it was not just and fair (Mijatovic 2000: 7).

The insider method that was dominant in all three laws had basically neither effect on the Serbian enteprise sector nor at the Serbian economy in general. The insider privatization 'has mainly resulted in widespread ownership by insider who today, given enormous losses of alarge part of the economy, most frequently own worthless shares in highly undercapitalised enterprises' (Uvalic 2001: 6) Besides, state owned enteprises become more and more to be seen as a source of political power due to the very close ties between economics and politics. It was estimated that leading politicians were directors of about 30 largest companies. A political party, called JUL headed by Milosevic's wife Mira Markovic, started to gather such people. One of the most important goals of any future privatization policy that had to break with the past was to destroy this economic-political link.

4. The Privatization Law of June 29, 2001

The new privatization law, enacted on June 29, 2001, gave up on the insider model and the practice permitted by the previous law. Privatization was made obligatory, and the state was given a greater role in ensuring the certainty of the process. As will be seen, foreign ownership was encouraged, and the governement decided to let the firms that started privatization under the 1997 law finish the process.

The Serbian parliament adopted an extensive set of laws and measures to regulate the privatization process.

- The privatization law (June 29, 2001; *Sluzbeni glasnik Republike Srbije (SG RS)*; no. 38/01);
- The privatization agency law (June 29, 2001; *SG RS,* no. 38/01);
- The share fund law (June 29, 2001; *SG RS,* no. 38/01);
- The ordinance concerning tender sale of capital and assets (July 17, 2001; *SG RS*, no. 45/01);
- The ordinance concerning auction sale of capital and assets (July 17, 2001; *SG RS*, no. 45/01) (amended on August 2, 2002; *SG RS*, no. 45/02);
- The ordinance concerning the methodology for assessment of value of capital and assets (July 17, 2001; *SG RS*, no. 45/01) (amended on August 2, 2002; *SG RS*, no. 45/02);
- The rulebook concerning the content and methods for running the privatization register (August 29, 2001; *SG RS* no. 52/01);
- The rulebook concerning the content and methods for running the temporary register (August 29, 2001; *SG RS* no. 2/01);
- The rulebook concerning the level of cost of privatization before the Agency for privatization incurred by enterprises and other legal persons (September 28, 2001; *SG RS* no. 57/01);
- The rulebook concerning the prospectus form (July 19, 2001; *SG RS* no. 44/01).
- The law on amanding the privatization law (February 28, 2003; *SG RS* no. 18/03)

The Law on Privatization of June 29, 2001 tries from the very beginning to avoid the trap of the past. Articles 1 and 3 set forth that both collective and state-owned property must be transformed. Article 2 lays out four basic principles of privatization:

a) creating conditions for development of economy and social stability;
b) transparency of the process;
c) flexibility;
d) letting the market form the prices of firms.

It can be seen that that privatization is not the goal in itself, but that the objective is rather to create the basic institutions of a market economy. The Law aims at making the privatization process transparent, meaning that the public has the right to be timely informed what firms are up for privatization, who buys them, and if the procedures for privatization were carried out according to the law. Finally, point d) insists that firms be sold under prices formed by the markets, not determined by the administration.

These are the major institutions to implement the privatization policy are: The ministry for privatization, the privatization agency, the share fund, and the contemporary register (which is supposed in time to turn into a regular privatization register). The agency forms commissions that handle specific tender and auction sales.

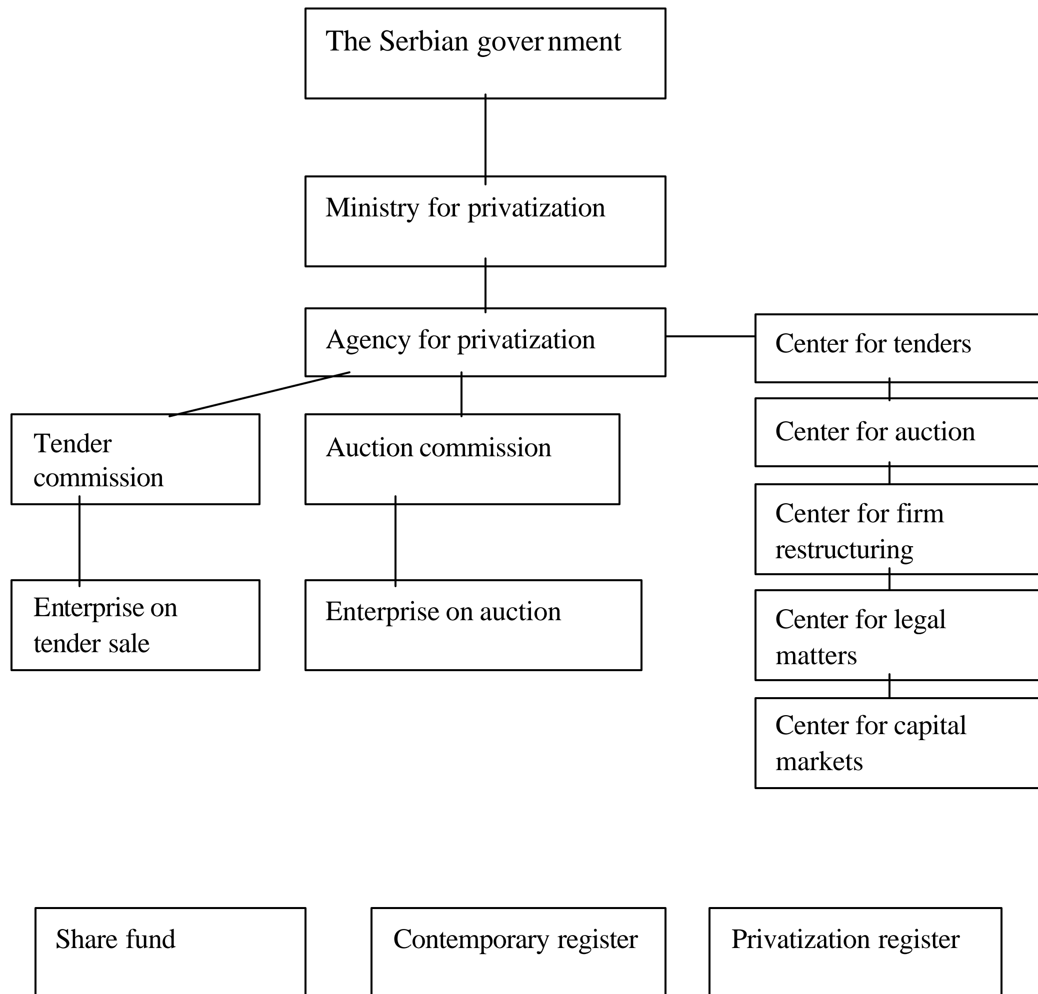

Figure 1. Institutional structure of the privatization policy.

Article 9 postulates two models of privatization: sale of capital and transfer of capital with no compensation (Table 3). Sale can be divided into two types, public tenders and public auctions, whereas assets can be transferred to workers and citizens.

Models of privatization according to the June 29 Law.

1. Sale of capital	2. Transfer of capital with no compensation
Methods of sale	Methods of transfer
1) Public tender	1) Transfer of shares to employees
2) Public auction	2) Transfer of shares to citizens

Table 3

The general features of sale approach is already explained in section 3. The new law, which adopts a sale model, gives priority to outsiders to buy firms. The goal is not just to sell firms, but to sell them to so-called strategic partners who will continue to produce, and not strip the assets or shut the firm down soon after they move in. Strategic partners are expected to bring skills and money to the firm, to deploy resources more rationally, insist and establish profit-based orientation of the firm, thereby creating environment for a market economy to thrive, which in turn will lead to the opening of new working places.

Four key aspects for tender sale are:

a) offered price;
b) social program;
c) the level of new investments in the firm;
d) environmental program.

The government decided to pursue manifold goals with the privatiation policy. Hence, price is not the only criteria by which firms are sold. Neither is this the most relevant criterion. Level of investments and social program also play role in determining the final decision.

Auction sales are carried out at the designated places where firms are sold by public bidding. Auctions (articles 34-40) differs from tender sale in having only one specified condition as to who can buy the firm. Whereas in tender sale there are several conditions that determine who is the buyer, the sole condition that determines the outcome of the auction is the price—whoever bids the highest price takes away what is up for sale. As opposed to a tender where the Agency organizes and carries out the whole process, an auction is only organized by the Agency, and the implementation is handled by a commission set up by the Agency.

Although article 12 stipulates that buyers in auctions can be subjects from the inside but also from the outside of the company, the very same article makes it clear that Yugoslav citizens can buy capital or assets only after submitting proofs on not having obligations that stem from the Extra profit law (*Sluzbeni Glasnik RS*; June 22, 2001; no. 36/01). The key motivation for this proviso was political. It was supposed to block the people who benefited from close ties with Milosevic from turning their illegally

obtained wealth into legitimate private property by laundering their assets on public auctions.

Articles 42-45 state that up to 30% of the assets of each firm may be transferred to workers, ex-workers (pensioners), and citizens. The worker obtains up to €200 in shares for each working year. The total eligible years of service is 35, which makes all in all €7,000 worth of shares free of charge.

The two models of privatization prescribed by the June 29 law are by no means equal in weight. The sale model dominates the transfer model. Sale is the model the government prefers, meaning that the bulk of shares in enterprises must be sold. It is postulated that up to 70% of the capital must be sold on either tender or auction, whereas the remaining 30% will be transferred to employees or citizens but only upon the completion of the sale of the 70% (articles 42-54). More importantly, although the Law is not explicit on this, the government made it clear that tender will be employed for big and strategic firms, whose number most likely does not exceed 200. Smaller and medium-size enterprises, whose number is estimated at about 7,000, are planned to be sold in public auctions.

The tender process is of crucial importance for Serbian privatization, for the biggest, large value firms, employing the majority of the workforce will be sold by this method. Tenders are organized and carried out by the Agency for privatization. The procedure covers: preparation for sale, public advertising, accepting the bids, assessment of the bids, closing contracts, and other things (Art. 27). The Agency is in charge of tender and auction procedure, but article 29 says that the minister of privatization forms a commission in charge of overseeing the tender procedure. The commission has three members that are appointed by the government, one member from the local community, and one member from the firm itself. For every tender sale the government and the Agency form a separate tender commission. The bidder must pay a deposit in order to be eligible to bid (art 30). The minister for privatization sets the sum of the deposit.

The Law also specifies how the revenues from privatization will be distributed. 75% goes directly to the Serbian budget, 5% to the restutution fund, 10% to the pension fund and another 10% to the infrastructure fund (Art. 61).

The privatization agency law sets out the tasks of the agency. The Agency is the key body 'that promotes, initiates, carries out and controls the privatization process according to the law' (art. 1). Being in charge of implementation, the Agency is the body that indicates the separation between privatization policy and its implementation. This implies analysis of the financial situation, presentation and advertising of the firms to be privatized, decisions by which consulting and legal advising firms are hired, and so on. The main resources for the funding and working of Agency are provided by the state budget and incomes from privatization transactions (art. 5). The Agency also specifies the method by which the firm will be privatized. It organizes the tender and auction procedure and, in the case of tender sale, suggests to the tender commission which offer is the best one (art. 9), but it the tender commission that takes the final decision whom the firm is sold. The Agency is also in charge of informing the public about the nature and progress of privatization.

‘The Agency is separated from the ministry by a Chinese Wall,’ as the minister of privatization likes to say. This is important because it indicates that, at least formally, the possibility for corruption is lessened. The Agency has even a separate bank account, meaning that, unlike the ministry, it is fully financed from sales revenues. The Agency is divided up in five centers: center for tenders, center for auctions, center for restructuring, center for legal matters, and center for capital markets.

The share fund is another important body in the institutional structure of privatization policy. Its activities are defined by articles 67-74 of the privatization law and by the Share fund law. The major activity of the fund is to manage and sell the shares that remained undistributed by the privatization process set by the previous law. The 1997 stated that the shares of a firm may be given away in two rounds. The firms that carried out the first round of privatization under the 1997 law do not go into the second round, but transfer all remaining shares to the share fund. Also, all the shares that were not distributed in the second round are transferred to the fund. The share fund either sells the shares that are transferred to it, or it registers them with the privatization register. The share fund is obliged to sell these shares only upon the request of the Agency for privatization but this sale has to be based on market value of the shares and conducted on stock market. The fund is obliged to abide by the principle of indiscriminacy and publicity, providing access to all interested parties of all relevant information. The fund has to sell off all shares in its portfolio within six years from the date of the law. The shares can be sold on public auction but also on the stock market via brokers (art. 9 of the Share fund law).

The government and the Agency also decided to restructure certain enterprises it self before the sale. There are 44 enterprises in thius group that encompass some 150-200,000 workers. The criteria to get into this group are that the firm must be large, has significant debt, and regionally important.

5. The Reality of Privatization in Serbia

More than one year after the privatization law has come into force and the process began, privatization in Serbia has not started to yield the results it was supposed to. Of course, the process is still young, private property is still not prevalent; there is little evidence of any substantial restructuring in corporate governance or of the better performance of privatized companies; and growth is still not picking up. An alleged disadvantage of privatization by direct sale is that it is slow, whereas various types of mass privatization can be done faster. Moreover, there have been a number of different views as to when to start privatization, or whether privatization is needed at all in the first years of transition. One approach emphasizes the need for cautious but immediate privatization. A countering approach, espoused by Joseph Stiglitz (1999), stresses that macroeconomic stabilization accompanied by market-supporting institutions have to be attained and secured first. Privatization should take place after these institutions are functioning in some minimal manner.

Be that as it may, the Serbian government decided to start privatization program parallely with building necessary institutions for its implementation. On the other

hand, the macroeconomic situation in the beginning of 2001 was relatively favorable for starting privatization. Macroeconomic stabilization was quickly achieved, meaning that the fundamental requirements for a successful privatization had already existed before it started off in July 2001. Some steps aiming at macroeconomic stabilization were carried out already by the end of 2000, but the real stabilization began after the new Serbian government was voted in on January 25, 2001. The Serbian government was not able to increase industrial production in 2001, but production did not drop, meaning that annual production growth loss in 2001 was 0%. In 2002, however, industrial production growth rate was 1.7%.

Industrial production; month-to-month in per centages

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2001	-7.4	2.1	11.6	-3.3	-0.8	1.8	-9.7	4.0	5.7	10.4	-2.8	-1.0
2002	-15.8	3.8	12.7	-2.6	-3.5	-0.6	-2.8	-2.3	6.5			-4.5

Table 4. (Source: G17 Economic Review)

Before the election of September 24, 2000, the average annual rate of inflation was 112%. Inflation was down already by the end of 2000. Average inflation in 2001 was 40.7%. Althought the projected inflation rate for 2002 is 20%, in the end of 2002, it was 14.8%.

Inflation. Month-to-month per cent changes

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2001	3.2	3.3	0.9	9.3	1.9	3.9	2.4	2.7	1.4	2.6	1.6	
2002	0.6	1.0	0.8	0.9	0.4	0.5	4.1	0.4	0.9			0.8

Table 5. (Source: G17 Economic Review)

Average wages have also risen very quickly. But the rise was more nominal than real. In October 2000, the average wage was around $40. Already at the end of 2001, it was $122.5. The increase of real average wages in 2002 was 30.2%, and average nominal wage in December 2002 was $169.

Average monthly wages in YU dinars and US dollars

2001	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
YuD	3821	4087	4262	4531	4497	5530	6268	6800	6900	7408	7729	8456
USD	55.3	59.2	61.8	65.6	65.1	80.1	90.8	98.5	100	107.3	112.0	122.5
2002	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
YuD	7435	7924	8204	8793		8993	9342					11555
USD	107.7	114.8	118.8	127.4		130.3	135.3					169

Table 6. (Source: G17 Economic Review.)

Nominal and real increase of monthly wages. (Month-to-month)

		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2001	Nom.	n/a	n/a	n/a	n/a	n/a	n/a	13.35	8.5	1.5	7.4	4.3	9.4
2001	Real	n/a	n/a	n/a	n/a	n/a	n/a	11.3	5.4	-0.3	4.3	3.6	9.1
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2002	Nom.	-12.1	6.6	3.5	6.5	-1.2	4.2	3.9	6.4				12.3
2002	Real	-11.6	5.3	2.4	5.9	-1.4	3.7	-0.4	6.3				12.5

Table 7. (Source: G17 Economic Review)

The most troublesome macroeconomic indicator in Serbia is the high rate of unemployment. It was practically stable in 2001, but in December 2002, it reached 30.7%.

Unemployment rate (as per cent of labor force)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2001	26.2	26.6	26.8	26.8	26.7	26.7	27.0	27.2	27.0	27.1	27.2	27.3
2002	27.7	27.9	27.7	27.9	27.9	28.4	28.9	30.1				30.7

Table 8. (Source: G17 Economic Review.)

This run of figures was presented here for two reasons. First, it is important to show in what kind of macroeconomic environment privatization process in Serbia takes place. The economic situation is relatively stabile, although not particularly cheerful. Second, the figures indicate if privatization has started to affect the restructuring of the Serbian enterprises, which is the final objective of any privatization policy. As may be seen from the figures, this argument still cannot be made. With a high rate of unemployment, low average salaries, and zero or tiny industrial growth more than one year after the privatization process was kicked off, it can be claimed that the privatization policy of the Serbian government did not yield the results it was supposed to.

This can be attributed to both objective obstacles and policy flaws. The first step in laying a good foundation for privatization is to impose financial discipline ("hard budget constraints") and ensure competition. Serbian firms were accustomed to using so-called soft credits, usually doled out by the Development fund administered by the Serbian government and financed from the Serbian budget. Soft credits were easy to get, but it was almost easier not to repay or to return them under silly conditions. This allowed many socialist enterprises to survive throughout the 90s, but this is also what allowed them to avoid restructuring and privatization under the 1997 privatization law. In 2001, the Serbian government abolished the institution of soft credit, which forced some firms to go out of business. But it retained the policy of forgiving the debts or paying interest rates on time of medium-size firms, and covering the losses of large infrastructural and energy enterprises such as electricity or railway systems that still gobble up huge amounts of the Serbian budget. So far, the government did not tackle the structure of these big infrastructural enterprises. The Serbian electric company is, for example, overstaffed with about 67,000 people employed, which is approximately twice the number of the employed it should have. It is especially worrisome that along with the increase in the price of electricity, business losses of this company are also increasing. For instance, in 2000, the KwH of electric energy cost $0.85 cents, and the total loss for 2000 was $121 million. In 2001, the price rose to $1.41 c per KwH, whereas the loss was $202 million. In July 2002, the price went up to $3 c, but the projected loss rose to $377 million. The government still has no general plan what to do with the biggest public enterprises.

Since the major problem that any reform government faces are the so-called socialist giants—which are the large loss-makers, are incapable of paying debts, and are severely overstaffed—the government has engaged in targeted top-down programs to restructure some enterprises prior to their privatization. Since it is expected that no

investor will buy a firm that calls for immediate massive lay offs, the government took on this dirty but essential job. The process works as follows: the privatization agency analyzes firms in its portfolio and decides whether the firm has first to be restructured or goes directly to tender or auction. If restructuring is necessary, the government comes up with a special program for each firm. The general idea of restructuring is to make enterprises lean and clean for sale not to pump more investment money into losing proportions.

The Agency for privatization defined three critical criteria for assessing whether a company can be included in the program: a) organizational structure; b) large number of employees; c) heavy indebtedness. Applying these criteria, the Agency divided companies in three groups. The first consists of six companies whose poor condition might cause dangerous social problems. The second consists of 20 companies that could be restructured in relatively short time. The third group is made up by a dozen companies that are perhaps most difficult to restructure. In August 2002, 26 big enterprises was in the process of restructuring, and by the end of the year, a total of 44 firms are expected to be in the process.

It must be stressed that this kind of restructuring of firms has to be done sooner or later. Most of the firms have already been downsized but still look rather unattractive for the potential investors. In spring 2002, after the first round of restructuring of the Zastava factory has been done, the government could not sell Zastava even for $1. This means that the very same firms will need another round of restructuring, which will additionally burden the government that hardly survived the costs of first round restructuring.

The Serbian government, especially the ministry for privatization, was rather sanguine about the start of privatization process. It began by advertising privatization to foreign donors, and restructuring enterprises for sale. However, the result of the first year of privatization was far from cheerful. The government spent considerable energy on arranging the documentation and procedures for privatization but it did not succeed in actually privatizing much. The number of firms awaiting privatization (Table 9) vastly exceeded the number of firms that were privatized.

Enterprises ready to be privatized in May 2002.

	Firms ready for privatization	Number of employees	Book value on Dec. 31, 2000 in € 000
Total	285	96,522	603,787
Tenders	63	53,492	343,301
Auctions	222	43,030	260,485

Table 9. (Source: *Privatization in Serbia*, no. 4, May 2002, p. 5.)

At the time of finishing this draft (October 2002) five firms (out of 200) had been privatized by tender, and 39 (out of 7,000) by auction sales. Table 10 shows the total of the privatized firms, whereas Tables 11 shows the details for each tender sale.

Tender and auction sales: Total result by mid-March 2003.

	Number of	Number of	Revenues from sales in

	enterprises	employees	million €
Auctions	385		97
Tender	12		210
Total	397		307

Table 10.

Discouraged by the slow rate of the auction sales, the Serbian government on July 3, 2002 announced it would ease the conditions for auction sale. The changes took place in the form of two ordinances of August 1, 2002. (Ordinance concerning amendments of Ordinance concerning the sale of capital on public auction, *SG RS*, no. 45/02; Ordinance concerning amendments of the Ordinance concerning the methodology for assessment of value of capital and assets, *SG RS* no. 45/02). The major change regarded the method for assessing the value of the company. The ordinance introduced a corrected book value for assessing the value of the firm. The reason for this was that the initial prices on auction sales turned out to be too high. Take for example 'Ribotex.' At the first attempt to sale, the initial value was €1½ million set by the Agency. The auction failed to attract bidders. When the corrected book value method was applied, the initial price was set at €200,000, and at the end of auction, it was sold for €491,000. Too high initial price are a common problem in privatization programs around the world, especially in transition countries. Reasonable initial prices are essential for auction sales to succeed.

There were also some changes regarding bidding and price. The so-called English auction (also called 'open outcry' or ascending bid) remained to be the only type of auction, while the Dutch auction is abandoned. The bidding now starts from 80% of the estimated price, and goes higher. The government also announced it would form a special fund with €100-150 million from which potential domestic buyers can borrow the money to bid on auction. All this, the government expected, would speed up the process of auction sales, that from July 21, 2002 were supposed to be taking place on a weekly basis.

* * *

One of the most painful task with a privatization policy is whether it brings about the required changes in corporate governance. Privatization was mainly used as a method to retain political control, not to enhance enteprises' performace. One could say that political reasons have prevalently determined the fate of the Serbian enterprises. Yet, one could also say that these political reasons had a concrete form that enabled this political control. Problems of corporate governance was mainly due to the fact that social property and accompanied features were still present with in the Serbian economy. Owners could neitehr sell the property nor appropriate procedeeds from sales. 'Property rights remained ambiguous, non-individual, divided among theree collective agents—employed workers, the enterprise, and the state.' (Uvalic 2001: 10). Moreover, the insider model in Serbia showed only disadvantages of the MEBO. Although there are countries where MEBO worked fine (Slovenia), in the Serbian context it was a disaster. Wherever it could create specific problems, it did. Workers tend to pay high salaries at the expense of new investments and did not care for restructuring, which confirms that MEBO is not compatible with rational economic behaviour in Serbian context.

Changes in corporate governance did not occur prior to 2001 for several reasos. Social property was still here with the ambigous effects on corporate governance. 'Fifty years of self-menagements and socialism have left such deep traces that decision-making practices and working habits seem to have changed little' (Uvalic 2001: 15). b) There is no clear link between owensrship form and mechanism of corporate governance. This is supposed to be changed by the new privatization policy. This is perhaps the most important novelty of the new privatization policy. According to it, the insider model is abandoned and the government tends now to concertrate ownership as much as it can by giving 70% to single owner.

One of the most problematic points in the Serbian government's privatization policy is related to the understanding of what the goal of privatization policy is. This is essentially related to why the government picked out the model it did. A model is selected because it helps achieve broader policy objectives. Consider the examples of the Czech Republic or Hungary. One of the reasons why the Klaus government opted for the voucher model was Klaus's ambition to win the next parliamentary elections. Vouchers are distributed to everyone, and their distribution is, at the outset, usually very popular politically. The economic upshot of a voucher privatization may be inefficient (as it turned out to be in the Czech Republic), but it is unmistakably fair.

On the other hand, Hungary resorted to a sale model, just like Serbia. The rationale for this decision was to fill in the budget and to attract good owners. As opposed to the Czech Republic which in the time of the fall of the Berlin Wall did not have the problem with foreign debt, Hungary's foreign debt was huge. Privatization was partially meant to solve the Hungarian problem of retiring foreign debt. The Hungarian case is instructive for the Serbian case since the reasons that are driving the privatization policy in both cases are the same: Revenues from priva tization are meant to be used up for paying off foreign debts, or to fill in the budget.

Servicing the foreign debt needs not be the sole objective of a privatization policy. Government can have some other objective to achieve with privatization policy. For example, the objective of the government can be to ensure allocative efficiency of resources. As said in section 2, one of the general objectives of privatization is to ensure that ownership gets into the hands of real owners. If the new owners are real, they will make the best out of it, thereby increasing production. The third goal might be related to stabilization. The money could be used to fill in the gaps in the budget, which makes printing of money an unnecessary activity. Privatization may serve manifold purposes, but it is essential that the government ranks in priority the objectives it intends to accomplish with the privatization policy. The problem with the Serbian government is that it tries to simultaneously accomplish manifold objectives with a single privatization policy. The government uses privatization policy to ensure allocative efficiency of resources, but also to take care of laid off workers, and fill in the gaps in the budget, which is meant to help it win political points.

That the Serbian government does try to accomplish manifold goals with one policy can be seen from the example of the first tender sale. When the government sold the cement factory Novi Popovac, it was sold to the Swiss Holcim that offered $52.5 million, although the Greece Titan offered $67.9. The tender commission justified its

decision by referring to another relevant criteria for tender sale — namely, the level of new investments. Holcim offered $83.9 million of investment, whereas Titan offered only $26.6 million.

In order to calculate the total offer, the government applies the method of weighting. Suppose that the formula implies that the cash is valued at 100% and investment promises at 66% (social program is not factored in). A very simplified calculation in the case of the Novi Popovac could have looked like this:

> Holcim: 52.2 cash + 83.9 investments (x 66% = 55.4) = 107.9 total
> Titan: 67.9 cash + 26.6 investments (x 66% = 17.6) = 85.5 total

Appendix

Tender sales by mid-March 2003

Name of factory	Line of business	Name of strategic partner	Final price in mil. $	Percent of capital privatized	Obliged to invest in mil. $	Sale closed on
Beocin	Cement production	Lafarge, France	50.9	70%	32.3	1/29/01
Kosijeric	Cement production	Titan, Greece	35.5	70%	29.6	1/30/01
Novi Popovac	Cement production	Holcim, Switzerland	52.5	70%	83.9	1/30/01
Seval, Sevojno	Aluminium processing	Impol, Slovenia	7.5	70%	14.5	8/27/02
Merima, Krusevac	Household consumables	Henkel, Germany	14.4	70%	43.1	8/28/02
TOTAL			160		203	

Table 11

Auction sales by mid-March 2003.

Name and site of firm	No of employ ed	Line of business	Price (in $000)	Price (in 000 YuD)	Buyer	Date of sale
Autoservis, Priboj	43	Maintenance and repairment of cars		2,352		
Elgrakop Plc, Ljig	63	Colours production		14,625		
Ornament, Subotica	47	Façade making		5,796		
Diork, Kragujevac	363	Clothes making		13,610		
Golubac, Arilje	76	Hotel menagement		29,019		
Loznica, Loznica	9	Fruits and vegetables		190		
Montaža, Beograd	521	Construction		34,864		
Zlatibor, Cajetina	132	Production of milk, meat, and eggs		66,640		
Neimar, Valjevo	22	Construction materials		316		
Zorka-boje, Šabac	177	Chemical industry		232,530		
Hladnjaca, Ljubovija	51	Fruits and veget ables deep freezing		18,048		
Palisad, Cajetina	164	Retail and wholesale		47,769		
Kijevo, Beograd	78	Stone exploitation		55,048		
Grada, Beograd	16	Trade		11,562		
Metalservis, Smederevo	31	Trade		2,952		
Remont, Becej	80	Maintenance of motor vehicles		7,636		
Standard, Novi Sad	92	Bags		29,024		
Granit, Ljubovija	65	Stonebreaking		50,336		

Milivoj Lazin, B. Arandelovo	65	Agriculture products		41,373		
Metalac, Kladovo	11	Making of metal construction		6,322		
Riboteks, Ljubovija	16	Fishpooling		18,681		
Iverak, Valjevo	56	Metal hardware		10,368		
Jugoremedija, Zrenjanin				960,000	AD Jaka 80 Radovis, Macedonia	9/10/02
IGM Ruma, Ruma	2138	Pharmaceutical raw materials		66,918	Zivorad Pantic	9/10/02
AD Macvapromet, Sabac	53	Refregenerating and processing of fruit and vegatables		2,240	DOO Viktorija 3.S	9/10/02
Laminat, Bajina Basta	82	Laminat and paperboards		7,298	Borivoje Skoric	9/10/02
DP Progres	332	Production of furniture and wood processing		17,060	MPS Marketing Tim	9/10/02
DP Buducnost, Sremski Karlovci	57	Clothes manufacturing		3,325	DOO Pansped	9/10/02
Dimnicar, Kula	14	Chimney services		176	Gordana Koprivica	9/27/02
Progres, Bela Crkva	48	Wholesale		1,365	Radivoje Stojicic	9/27/02
Instalacije, Novi Sad	26	Construction installations		1,179	Radoslav Djuricic	9/27/02
Dekor, Sabac	128	Construction, final works		52,000	Milisav Teodorovic	5/10/02
Nebojsa Jerkovic, Sabac	63	Furniture		4,000	Zoran Filipovic	5/10/02
Proteinka, Sabac	57	Lived stock feeds		21,238	Dejan Tufegdzic	5/10/02
Podunavlje, Golubac	29	Wholesale and retail trade		7,210	Borisav Jovanovic	5/10/02
Ozren, Pozarevac	32	Wholesale and retail trade		3,000	Nebojsa Zivanovic	5/10/02
Standard, Leskovac	105	Finalization works in construction		16,500	Metodije Jovanovic	5/10/02
Metal, Obrenovac	32	Finalization works in construction		422	Milisav Kasratovic	5/10/02
Mesar, Uzice	70	Fresh meat		4,560	Srbija-Mond	5/10/02
Knjigovodstveni Centar, Sombor	12	Accounting services		25.374	Jovan Brkic	5/10/02
TOTAL				622,000		

Table 11.

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