Serbian Economy – History, Transition and Present

14

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Abstract

After liberation from the Ottoman rule, Serbia was primarily focused on building its internal political system, while most of its economy relied on primary sector activities such as agriculture and mining. During the First World War, Serbia suffered enormous material damage and human victims which additionally slowed down its economic development. Serbian economy development in the period between the two world wars was the consequence of ad hoc economic policies, with no long-term plans or government guarantees that the economic well-being of wider population would improve. Immediately after the Second World War, Serbia (as part of the former Yugoslavia) became a centrally planned economy with predominantly state-owned property. However, unlike other Central and Eastern European countries, the market economy elements were, more or less successfully, introduced in Serbia within the framework of socialist economy model. After the breakup of Yugoslavia, Serbian economy transition to a complete market economy model was evolving in two phases. The 1990–2000 period was characterized by wars, international isolation of Serbia and high material and human losses. After the democratic changes in the year 2000, Serbia begins its journey of a new economic development in compliance to the standards of the European Union accession.

Keywords

Macroeconomy · Economic growth · Economic development · Economic history · Transition

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14.1 Economic Development Until the Second World War

After liberation from the Ottoman rule, the Kingdom of Serbia was not focused on economy development and efficient use of its resources, but on building of its internal political system. Immediately after gaining political independence, and also long after that, Serbian statesmen and politicians emphasized political issues, while putting economy issues aside. Most of the population was working in agriculture, thus earning the basic livelihood. More than three quarters of people worked in primary sector, dominated by agriculture and mining. Industrial production was predominantly at the level of cottage industry, and mainly in the form of milling industry, meat production, textile production and sugar industry (Srpski Centralni Komitet and Radovanovic 1918).

After the First World War, Serbia allied with other Yugoslav nations, and on December 1, 1918, the Kingdom of the Serbs, Croats and Slovenes was founded. After the Great War, the economic situation in Serbia was extremely difficult. The damage to its agriculture was enormous, while industrial production nearly ceased entirely. Rail transport was no longer functional, trade was limited to the domestic market and national banking system had collapsed (Vučo 1968). During the Great War, aside from heavy demographic losses, Serbia also lost more than half of its property, which had devastating consequences to the already underdeveloped economy. Recovery and further development of the Serbian economy were significantly slowed down and made more difficult due to the lack of capital, raw materials and qualified workforce.

In the given circumstances, during the first years following the Great War, Serbian economy based its development predominantly on high custom taxes (as protection of domestic economy) and the inflow of foreign capital. In this period, agricultural development played a major role in economic growth and development of Serbia (the demand of food was already at the extremely high level in Europe, and especially

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Western Europe). Serbia used this fact well, because more than four fifths of the population of Northern and Southern Serbia were farmers (Milenković 1998). The trend increasing demand was especially noticeable with respect to flour, grains and meat which led to a dramatic rise in the prices of agricultural products. On the other hand, concessions given to foreign partners significantly contributed to the industrial development.

Foreign capital was present the most in copper mines of the town of Bor (Eastern Serbia), metallurgy industry in Trepča where lead and zinc were produced (Kosovo and Metohija), antimony mines in Zajača (Western Serbia), etc. As the result of mining and black metallurgy development, Serbia was developing rather quickly, but other countries that used Serbia as a base for raw materials grew much more quickly in economic terms (Serbia was mostly importing finished products, while exporting raw-materials and semi-finished goods). The foreign capital was also interested in producing goods for domestic consumption, but only when they could hold a high-profits-yielding monopoly position on the market. Existence of monopolies resulted in high prices of product for end-customers (e.g. sugar, cooking oil and electrical power), which had a further negative impact on the population's living standard. Therefore, the most developed industries in the period after the First World War in Serbia were food industry (e.g. sugar, beer and chocolate), chemical industry, wood-processing and paper industry, textile industry, mineral and metal industry and air-craft production (Ikarus – the first Serbian company for production of air-planes – was founded in 1923 in the town of Novi Sad). The proportion of industry, mining and craftsmanship in gross domestic product (GDP) had risen between the two wars from 21% to 30%, while the proportion of agriculture and forestry had declined from 58% to 51% and proportion of other industries had fallen from 21% to 19% (Čobeljić and Rosić 1989).

The development of Serbian economy in the period between the two world wars was actually the consequence of the economic policy which was created ad hoc, with no long-term plans and no government guarantees that the economic well-being of wider population would improve. Undeveloped, the economy was left to the mercy of fluctuations of the world market, foreign capital interests and other forces whose sole goal was to keep the existing, regressive economy system. The economic crisis, especially in agriculture sector that occurred in Europe a few years before the First World War had shown all the weaknesses of such Serbian economy. On the eve of the Second World War, heavy social stratification was already noticeable – a small number of very rich capitalists and huge masses of poor workers and farmers.

The Second World War brought about new losses, both in human lives and material goods. In addition, the communists at the territory of Yugoslavia materialized the victory over German occupiers by changing the political system: creating of the republic and establishing a single-party system and a centrally controlled planned (command) economy. After the Second World War, being a part of a bigger country, Yugoslavia, Serbian economy grew similarly to other Eastern European countries (Neal 1967; Kovac 1995). Serbian economic development in the next several decades could be analysed through three or four differentiated periods (Crafts and Toniolo 2008):

1. The period until the beginning of 1970s (the communist "Silver Age" growth period), when Serbian economy developed rapidly due to accelerated industrialization of the Socialist Federal Republic of Yugoslavia (SFRY)
2. The period of slowdown, which finished with a collapse at the end of the 1980s
3. The period of transition to market economy (1990–2000) – the period of the initial, unsuccessful transition
4. The accelerated transition to market economy (2000 and on)

14.2 "Silver Age" – A Growth of Yugoslav Economy

Immediately after the Second World War, SFRY (Serbia) was a communist country with a centrally planned economy and predominantly state-owned property (just like all other countries in Central and East Europe). The initial enthusiasm of planned economy development had soon fizzled out (there had been a political split between SFRY and USSR in 1948). By the beginning of 1950s, SFR Yugoslavia had already began introducing the first elements of market economy by transforming the state-owned property (establishing of the workers' self-management system in its companies which was supposed to provide a significant role in decision-making to the workers).

In the next decades, there were a string of reforms with the aim to decentralize the country's economy system and to introduce a market mechanism which implied liberalization of prices and foreign trade, introduction of multi-banking system and passing legislation for joint ventures in order to attract foreign investments as much as possible. Although such built market system did have significant limitations (low share of private property, existence of "soft" budgetary limitations in companies' debt settlements and constant presence of the state in companies' business operations), the Yugoslav economy managed to achieve significant growth after the Second World War. Owing to high rates of economic growth, Serbian and Yugoslav economies had, in a relatively short period, achieved the rank of medium developed countries (Serbian GDP in 1947 was only 3% lower than in

1939, and by 1952 the average GDP growth rate was 1.9%) (Devetaković et al. 2019). The economic development of the period was based on building of heavy industry and energetics which required very high infrastructure investments.

In the 1960, the GDP per capita in Yugoslavia had reached world average (Kovač 1995; Neal 1967), although it grew more slowly and annually amounted on average to 0.6% (Kukić 2018). The period between 1952 and 1964 was especially productive, when an extremely quick economic growth was achieved, with the average annual rate in Yugoslavia of 8.3%, and in Serbia 8.7%. This was a period when employment, fixed assets and labour productivity grew rapidly due to implementation of the selected economic development strategy in Serbia and Yugoslavia during the entire post-war period. The economic policy creators believed that the population's living standard could be increased exclusively by the industrial development. The emphasis was on the production of capital and interphase goods. Special attention was dedicated to energetics, mechanical industry and basic capacities for processing of domestic raw materials. Thereby, the necessary amounts for investments were provided in prioritized industries, which were, by means of imported technologies, elevated to a higher technological level in a very short time. During the second half of the 1950, industrial investments were redirected to industrial branches and groups that were to produce final products. All this resulted in high industry growth rates and consequentially also in economic growth.

Economy continued to grow even after this period of initial economic rise and comparisons of domestic products from 1952 to 1989, which was seven times higher, testifies to that (Table 14.1). The largest contribution to the increase of gross domestic product (GDP) could be assigned to the social economic sector (industry and mining the most), whose output in the given period rose 8.5 times, and its share in total GDP was 88% (Miljković 1989).

After the Second World War, industry became the leading economic sector in Serbia (Table 14.2). Constant investment activities had created a strong production potential as the basis for development of the entire Serbian economy. On the other hand, the implemented economic policy of industrialization resulted in a significant decrease in the share of agriculture in the making of GDP (from 39% to 14%) (Miljković 1989).

Table 14.1 Gross domestic product (GDP) growth indexes of individual industries in the period 1952–1990

Year	1952 (%)	1972 (%)	1990 (%)
Total economy	100.00	100.00	100.00
Manufacturing and mining	21.70	35.10	43.60
Agriculture and fishery	30.80	16.80	15.10
Forestry	3.70	1.10	0.80
Craftsmanship	5.30	3.10	3.30
Construction	12.50	10.60	6.80
Traffic	6.80	8.60	9.60
Trade	12.20	18.80	14.50
Hospitality	4.50	3.10	2.40
Other industries	2.50	2.80	3.80

Source: Author's calculation based on data from Statistical Office of the Republic of Serbia (1953, 1972, 1991a)

Table 14.2 Participation of individual economic industries in the total domestic product of SFRJ

Industries	Growth Index 1989/1952	Average annual growth rate (%) (1952–1989)
Total economy	703	5.4%
Manufacturing and mining	1785	8.1%
Agriculture and fishery	338	3.3%
Water resources management	622	5.1%
Forestry	214	2.1%
Craftsmanship	285	2.9%
Construction	388	3.7%
Traffic	985	6.4%
Trade and hospitality	641	5.1%
Other industries	912	6.2%

Source: Author calculation based on data from Statistical Office of the Republic of Serbia (1953, 1991b)

In the period 1947–1989, industrial production grew more than 20-fold, whereby secondary sector recorded the highest rise in the share of the country's GDP. Chemical industry had the fastest growth, while production of vehicles had the slowest one. The shares of construction industry and craftsmanship in the structure of GDP sources also decreased (Miljković 1989).

At the beginning of the 1980s, tertiary sector achieved an increase in the structure of GDP from around 18% to about 32%, while this share somewhat decreased by the end of the decade (Devetaković et al. 2019). However, the primary sector branches – agriculture and forestry – had the slowest growth. The reasons were of structural and fundamental nature.

The growth of agriculture in the period after the Second World War was evolving in the setting of two forms of property – private and state-owned. A new social sector emerged as the result of agrarian reform that was supposed to harmonize agricultural sector with the socialist way of earning profits. However, in the end, more than four fifths of the total cultivable agricultural land remained privately owned, and this conditioned a specific development of this branch in SFRY (which was completely different when compared to the Central and Eastern European countries). On the one hand, the state-owned agricultural sector was also developing, and it rapidly modernized itself, made more investments and applied new technologies. On the other hand, the private sector also survived, but achieved significantly slower growth because individual owners of

agricultural lands did not have enough accumulated capital to be able to keep up with the investments in new technological solutions in agricultural production. Also, the education structure of the employees in social sector was favourable, which reflected on the emergence of differences in labour productivity, at a disadvantage to the private sector.

Although agricultural production had grown trifold in the period 1952–1989 (average annual growth was about 3.1%), it was lagging behind in comparison to other economic branches, above all industry, became noticeable in the 1970s (Kukić 2018). The main reason for this was the disparity in agricultural products' prices when compared to industrial products' prices – always to the disadvantage of the former ones. This was especially evident in the cases and industrial branches that were using agricultural products as their raw materials. Agricultural products (inputs) were paid to the farmers at very low prices, while finished industrial goods on the market were much more expensive. This especially affected the agricultural private sector. Due to this, the supply of agricultural products was decreasing over time in comparison to the demand, which created additional pressure for their import. This, in turn, increased the foreign trade deficit and impeded the foreign trade balance of the country, which was already compromised by importing of raw materials, semi-finished goods and investment goods for all other economy sectors (in the 1980s, this had significantly worsened the macroeconomic position of the country). In addition to the said price disparities, other factors had also influenced slower agricultural development. One of the more important ones was the fact that agrarian policy was non-existent in the country's economic policy framework. In other words, agriculture development policy in SFRY was either non-existent or, if it had indeed been created in some previous periods, it was not consistently executed. Also, the fragmented privately owned land properties and weak application of agrarian-technical measures disabled the agricultural producers to achieve economy of scale and decrease costs of production per unit of yield. Thereby, the private agricultural sector was becoming less and less competitive, and this further caused a slower growth in agricultural production, so the very branch became unattractive for foreign investments.

The stated changes in the Serbian economy structure had numerous economic, but also wider social consequences. They had incited significant changes in population's relocations and demographic structures. An increasing number of people migrated from rural to urban areas, and this changed the composition of active population as well as the arrangement of employed population by economy sectors (see the Chap. 12).

In the period between 1957 and 1990, out of all SFRY republics, Serbia had the largest individual share in total Yugoslavian GDP (Fig. 14.1), which was mostly constant and amounted around 38% (Miljković 1989). Unlike Serbia, the share of other republics in total Yugoslavian GDP was volatile. Croatia, as the second largest economy in ex-Yugoslavia, decreased its share in total Yugoslavian GDP from 28% to 25%, while the share of Slovenia was 17%, Bosnia and Herzegovina around 13%, Macedonia 6% and Montenegro 2% (Gregory 1973).

However, although it contributed the most to the Yugoslav GDP, Serbia was not economically speaking the most developed Yugoslav republic. Based on per capita GDP movements, it is noticeable that, in the stated period, Slovenia was, in economic terms, the leading republic of the ex-Yugoslavia (almost a 100% above Yugoslav average). At the given period, Serbian per capita GDP was 8% lower than the Yugoslav average, while Croatian was 20% above the average (Miljković 1989). Such huge differences between the regions (republics) in one country occurred under the influence of different factors: impact of informal institutions (in Slovenia, it was most compatible with capitalist system) and implementation of all reforms towards some market economy model, which was sincere in Slovenia, since Slovenians paid attention to small companies and also, when it was allowed, to private business. This was simply not

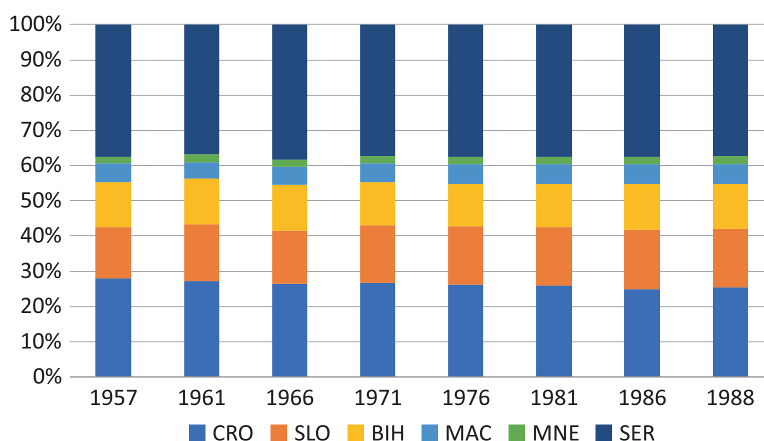

Fig. 14.1 Shares of individual republics in total Yugoslav GDP (1957–1988). (*Source:* Author's calculation based on data from Statistical Office of the Republic of Serbia 1953, 1991b)

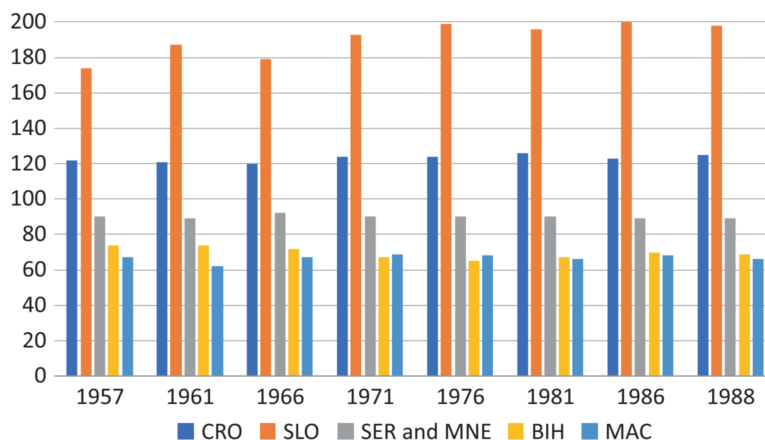

Fig. 14.2 Levels of per capita GDP achieved in individual republic in comparison to Yugoslav average (=100) (1957–1988). (*Source:* Author's calculation based on data from Statistical Office of the Republic of Serbia 1953, 1991b)

popular in other republics, so it is no wonder that the degree of Slovenia's economic development was constantly improving, while in other cases, such as Bosnia and Herzegovina and Macedonia, it was decreasing (Fig. 14.2).

Therefore, Serbia strayed further away from the most developed parts of Yugoslavia, primarily from Slovenia. On the other hand, economic differences in Serbia itself were decreasing, except in Kosovo and Metohija. Due to extremely rapid growth of population in the said autonomous province, the effect of above-average increase in GDP was neutralized, which caused this part of Serbia to lag behind both Yugoslav and Serbian averages (Kosovo and Metohija's GDP was 24% of Yugoslav average) (Miljković 1989). Central Serbia had per capita GDP equal to Yugoslav average, while the same indicator in autonomous province Vojvodina was 18% higher than that average (Miljković 1989).

During the 1960s, the economic growth of Yugoslavia was already slowing down significantly (in the period 1965–1979, the average annual economic growth rate in Yugoslavia was 5.6%, while in Serbia it was 5.6%). Although production was still rising, the quality of economic growth considerably deteriorated. The production efficacy was lowering, the rate of employment increase was slowing down due to high inflow of workforce, industrial production was not in concord with the demand, while foreign trade deficit was increasing, mostly due to increasing import of reproduction materials (oil, above all). The total foreign trade deficit of SFRY between 1970 and 1980 increased from slightly less than 10% to about 50% of GDP (Kovačević 2019).

In response to the problems it was facing in the 1970s, Yugoslav and even Serbian economy based its growth on significant foreign debts. This resulted in constant growth of the degree of the country's indebtedness abroad (Fig. 14.3).

One of the causes of the economic crisis that hit Yugoslavia at the end of 1980s was precisely the inability to take new loans and settle the debts for loans taken in the previous period. At the beginning of 1980s, Yugoslavia was one of the most indebted countries, and it remained such until its

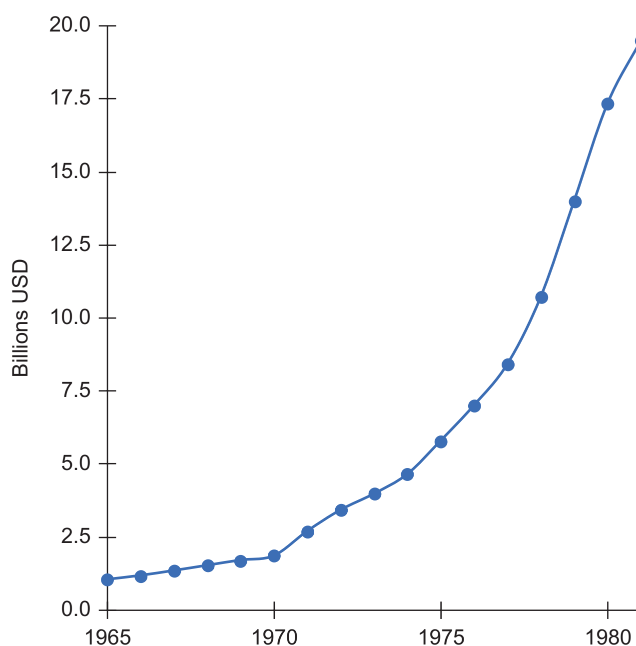

Fig. 14.3 Fluctuations of the net foreign debt of SFRY (1965–1980) (in billions USD). (*Source:* Author's calculation based on data from Čolanović 1985)

economic and political collapse. In addition, the crises that shook the entire world in the 1970s ("oil shocks" in 1973/74 and 1979/80) had the impact on Serbian economy as well. In truth, the first oil crisis did not significantly disturb Yugoslav economy, because Yugoslavia was getting cheap oil from Libya. However, problems arose during the second oil crisis, when negative effects of the rapid economic growth – founded on rapid de-agrarization of the country and extensive investments and employment growth, accompanied by a slow work productivity growth and absence of efficient use of resources and new technologies – became visible. All of this led to a decrease of Serbian economy's competitiveness and payments balance deficit, which was covered by an ever-

larger indebtedness abroad. New investments were covered by loans and reissuing of money.

In the meantime, the constitutional reforms in 1974 had brought much higher economic and political independence to the Yugoslav republics and autonomous provinces (see the Chap. 4). These provisions had, among other things, enabled individual republics and provinces within the federation to make independent loans, which quickened their development. However, the republics did not individually take on repayments of these loans. They acted as free riders, counting on the fact that someone else (that is, the federal government) will repay the debt in the name of the federation. Thus, separate monetary systems were created within the Yugoslav federation, which facilitated the decomposition of the common state at the beginning of the 1990s.

14.3 Slowdown Period – Serbian Economy in the Last Yugoslav Decade

For the last two decades of the twentieth century in SFRY, Serbia had the largest territory within it (34.5%), the largest number of inhabitants (41.5%), the largest share in Yugoslav gross domestic product, the largest share in total Yugoslav investments (38%) and in the total number of employees (38%) (Fig. 14.4) (Uvalic 2010). Also, one half of agricultural production and one third of industrial production of SFRY was happening in Serbia. Serbia was much less export-oriented than Slovenia or Croatia, but it still had the largest share in Yugoslav export and import (30% and 33%, respectively). Serbia cooperated the most with OECD countries, where it placed 57% of its export and procured 60% of its import (Kovačević 2019). On the other hand, although Serbia had the largest number of signed agreements on international cooperation in the 1980s, the total amount of foreign investments in Serbia amounted to only one third of the investments in Slovenia, that is, it was only one fifth of the total foreign investments in entire Yugoslavia.

During 1980s, Yugoslavia and Serbia experienced a drastic slowdown of economic growth. The average annual growth rate of the Yugoslav GDP was only 0.7%, whereby the growth in Serbia was 0.9% (Uvalic 2010). Since the population movement was happening at the similar rate (in Serbia, somewhat slower than the domestic product rate), per capita domestic product stayed practically unchanged.

The growth of employment and production capacities was significantly slower than in the previous periods. Work productivity and fixed assets' effectiveness, as well as investments decreased, while inflation was becoming more prominent. Unemployment was getting an ever-larger proportions. Although trade balance deficit was decreasing, this was due more to the limitation set on import than to the growth of export. Namely, in 1979, in the eve of crisis, the federal government decided to devalue dinar by about 30% in order to incite export, while it set higher prices on import as a response to the catastrophic trade deficit and enormous debts. This had a negative effect on production and, through it, also on employment, spending, investments and other macroeconomic parameters. By the end of the 1980s, per capita GDP amounted to $2520 at the official exchange rate for the entire SFRY, while by the purchasing power parity of dinar, GDP amounted to almost $5550 (Uvalic 2010).

Economically weakened in such a way, Yugoslavia faced another crisis at the end of the 1980s. In a certain way, this crisis represented the final phase of a long-term process of the production growth slowdown, but its causes were rooted in the period when Yugoslavia and Serbia had high rates of economic growth that were not based on sustainable economic foundations. Facing this new challenge, the economic policy creators in SFRY decided to dramatically change economic and social systems: to turn to market affirmation and to abandon the socialist way of doing

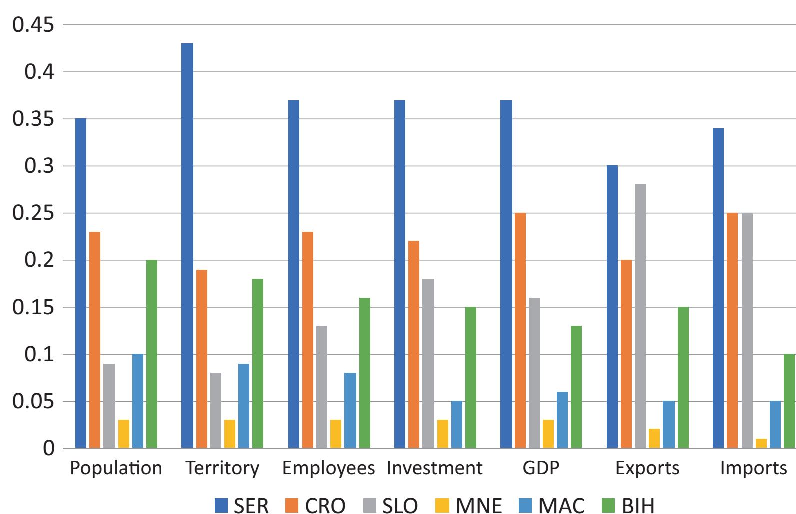

Fig. 14.4 Main economic indicators of the republics in SFRY (1991) (share in total). (*Source:* Author's calculation based on data from Statistical Office of the Republic of Serbia 1991b)

business based on state-owned property. This was practically the start of transition of the Serbian, that is, Yugoslav economy. However, in the absence of the expected results of such reforms, tensions occurred in the political relations between the republics of the federative state at the beginning of 1990s, which eventually led to their final disagreement, that is, to the breakup of Yugoslavia.

14.4 Economic Transition – Phase #1 (1991–2000)

In 1989 (globally observed), out of all other socialist countries, Serbia (within the frames of SFRY) had the most favourable conditions to shift to the market economy model; however, due to political reasons, from being in the position of the leading country, Serbia turned into a country which lags behind the most in the transition.

Transition of Serbia to a market economy model started while Serbia was still within the ex-SFRY, at the time when the process of transition was just starting in Central and Eastern Europe (CEE), in 1989. The ex-SFRY had a vast number of competitive advantages compared to the other countries in the region: specific geo-political position in the world and a very favourable position in international economic relations, the largest trade with European economic community compared to other CEE countries and a relative openness to the abroad also attracted significant amounts of foreign capital (as early as 1954, the first business agreement was concluded between Serbian car manufacturer *Zastava* and Italian car manufacturer *FIAT*). Reforms from 1988 to 1990 were especially important for Serbia's economic position, and they represented a package of measures for transition to market economy. Although implemented just before the break-up of the state, the reforms had positive and long-term effects on all the republics of the ex-SFRY.

After the dissolution of the former Yugoslavia (see Chap. 3), the Yugoslav market quickly disintegrated and almost all forms economic cooperation between the republics ceased to exist. In such circumstances, the federation's gross domestic product decreased significantly (Yugoslav GDP was 7.6% and Serbian GDP was 8.3%) (Litwack and Price 2002). Serbian economy was facing numerous problems: a strong inflationary pressure occurred which was caused by an enormous inflow of dinars into Serbia from other republics (the space where dinar was official currency was shrinking); problems occurred in collection of the unpaid debts due to cash flow interruptions; public revenues decreased due to disintegration of the common customs union; loss of the goods' vendors and cheap production factors from other republics; loss of large protected markets in other parts of the country; loss of traditional connections between business partners; trade limitations imposed by the newly formed states; decrease of the foreign investors' interests due to decreasing of the market size and extremely high political risks, etc. (Uvalic 2001). The wars that were ongoing in the immediate proximity of Serbia or at its territory (Kosovo and Metohija) additionally burdened its economy, in addition to the loss of human lives and material devastation – by 1996, approximately 560,000 refugees poured into Serbia, according to UNHCR data (Ambroso 2006). The economic situation was additionally worsened by the United Nations (UN) embargo introduced at the end of 1991, due to alleged involvement of Serbia in the civil war in Croatia. Sanctions were intensified in May of 1992, after the war had spread to Bosnia and Herzegovina. Federal Republic (FR) of Yugoslavia (with which Serbia was a continuity state as of 1992), was completely excluded from all international trade and financial flows, whereby it was prevented to import and export goods and services, to engage in payment operations abroad and to repay of loans.

After the Dayton Peace Agreement in 1995, which ended the civil war in Bosnia and Herzegovina, embargo on the FR Yugoslavia (consisted of Serbia and Montenegro 1992–2003) was partially lifted, but the so-called "outer wall" of the sanctions remained in force preventing FR Yugoslavia from becoming a member of international organizations. Also, Serbia was prevented to participate in any form of the help that the European Union provided to the countries in transition. Unfortunately, not only that the "outer wall" of sanctions was not lifted, but a new "package" of sanctions followed in May of 1998 (using the situation at the southern Serbian province, Kosovo and Metohija, as the pretext). This quite adverse socioeconomic situation worsened when the NATO conducted air strikes against the FR Yugoslavia in March 1999 (See Chap. 4).

All the stated external factors in the last decade of the twentieth century had either a direct or an indirect extremely negative impact on macroeconomic stabilization, economic recovery and systems' reforms in the country, that is, on all the processes that make up the foundation of the transition towards market economy. In the period 1990–2000, the macroeconomic performance of Serbian economy varied significantly, although the long-term trend implied a general fall in most macroeconomic indicators, especially after the war in Kosovo and Metohija. In the period 1990–1999, GDP in Serbia and Montenegro had dropped more than 50%, while at the end of 1993, domestic product dropped to the level of 43% of the GDP in 1989 (Economic Commission for Europe 2004). The country's defence at the time of war and providing assistance to the refugees was financed by means of expansive monetary and fiscal policy. Such policy created one of the biggest hyperinflations ever recorded in the economic history of the world (in 1993, the inflation reached the level of over 1800%) (Đukić 2018).

Due to macroeconomic instability and hyperinflation, domestic currency was practically abandoned, and the practice of expressing the prices mostly in Deutschmarks was introduced, while at the same time "grey economy" appeared in Serbian economy. The government had an ever-larger role in directing economic spheres in the state-owned sector, but on the other hand, debts of companies and banks were increasing, as well as the country's budgetary expenses. The largest part of the legal economic sector depended on direct or indirect government subsidiaries, while the unofficial economic sector developed elaborate mechanisms to "by-pass" laws and regulations. Business banks and energy sector were used to approve indirect subsidies, which caused major problems within the said sectors at the end of the 1990s. The living standard of the people was constantly decreasing, while their foreign currency deposits were "frozen" in the banks (OECD 2002; Uvalic 2001; Habib 2001).

Amidst all these unfavourable processes in Serbian economy, the state managed to establish a temporary economic stability in 1994 by implementing a monetary reconstruction program, prepared by a team of economists lead by Mr. Dragoslav Avramović, who was the governor of the National Bank of Yugoslavia at the time. By means of the said applied economic measures, founded on the decision to tie Serbian dinar to Deutschmark, Serbia managed to stop hyperinflation and to recover production. However, such positive effects were soon reduced due to the problems caused by the absence of system changes, which imposed limitations on further maintenance of stability. The expansive monetary policy soon brought about new inflationary pressures, while financial repression of the foreign exchange market was constantly increasing. In the next few years, inflation remained very high (in 1995 and 1996, the retail prices inflation was 40% and 60%, respectively) (Đukić 2018). The officially recorded unemployment grew from 23% (in the period 1992–1994) to 27.1% in 1998 (Đukić 2018). Somewhat more favourable trends in monetary stabilization and the undertaken economic measures reflected on the economic growth rates which were higher in Serbia in the period 1994–1997 than they were in other countries of the Southeast Europe (Litwack and Price 2002), primarily because of the low starting point. In the observed period, the foreign capital inflow was extremely small, mostly due to the country's unregulated status in international financial institutions and high political risk. The only considerably large privatization concerned the company "Telekom Srbije" in 1997 (49% of the company was sold to Greek and Italian partners), and the money earned in this transaction enabled the country to stop inflationary financing of its economy for a short period of time (Uvalic 2001). Even though embargo had been slightly loosened and there had been certain positive movement in foreign trade exchange, a great deficit was still present in current balance (in 1999, the share of current balance in GDP was 9.4%). Old foreign exchange reserves were only $300 million, while the total foreign trade debt in 1999 was $14.1 billion (Litwack and Price 2002). Therefore, at the end of 1998, the inflation started to rise once again.

The NATO Pact military operation in 1999 had the biggest negative effect on Serbian economy in this phase of transition. At the beginning of 1999, and especially in March when the NATO bombing began, the considerably weakened Serbian economy was already in recession (Habib 2001). According to the data of Federal Statistical Office of Yugoslavia, in 1999, GDP dropped by 19.3%, per capita GDP dropped by 20% and industrial production decreased by 23.1%. The biggest production fall was observed in the capital goods production, as well as in iron, steel and chemical industries, while consumer goods production was decreased only by several percent (Devetaković et al. 2019).

After the NATO bombing, SR Yugoslavia became one of the poorest countries in Europe. Per capita GDP was only $1688 (1999) – only slightly higher than in Albania, whose per capita GDP for the same year amounted to $1181, and a lot lower than in other countries of the Southeast Europe (Habib 2001). In December of 1999, the average net salary in Serbia was 95 Deutschemarks, while just a year before that it amounted to 167 Deutschemarks (G17 2000). This salary was not sufficient to cover even a half of the consumer basket. Payments of salaries and pensions were delayed for several months and they were often paid *in kind*, and for a while they were paid as coupons for electric power purchase. According to the UN estimates, in 2000, about two thirds of the SRY population lived below the poverty line which is defined as a per capita income lower than $2.4 a day (for Montenegro, the poverty line is income below $3.5 a day) (G17 2000).

Table 14.3 Estimated damage to physical infrastructure as the consequence of NATO bombing 1999

Sector	Direct damage ($ millions)
Infrastructure	**753.8**
Transport	334.4
Electric power facilities	258.0
Other infrastructure	161.4
Economic infrastructure	**2712.3**
Industrial facilities	2609.9
Agricultural infrastructure	27.3
Tourism and hospitality	42.8
Other	32.3
Non-economic civilian objects	**372.8**
Cultural and historical monuments	100.0
Public sector	71.8
Private sector (households)	201.0
TOTAL	**3838.9**

Source: Economic Commission for Europe (2004)

The damage of NATO bombing to Serbian economy was extremely high (Table 14.3). According to some estimates, the total cost amounted to $30 billion: direct cost included $4 billion of physical damage (70% of which was the damage of destroyed industrial capacities), $2.3 billion was the cost of human capital lost and $23 billion was the cost of the loss of potential GDP due to physical damage to capacities, which became evident 10 years after the war (G17 2000).

During the last decade of the twentieth century, having in mind all the circumstances under which the Serbian economy tried to transform itself, an entire set of systems that a country is based on was destroyed. The rule of law was practically dysfunctional because most of the laws were applied arbitrarily, that is, different criteria were applied to different segments of economy.

This had highly negative effects and long-term consequences, since this was precisely the way in which the power became concentrated in the hands of few state-owned companies (or private companies that were under protection of the state). These companies were operating under "soft" budgetary limitations in the form of direct and indirect privileges, such as bank loans with low interest rates, import licenses, purchase of foreign currencies at official exchange rate and tax rate decreases or complete tax exemptions. Close relationships were formed among political and economy elite that allowed overlapping of economic and political authorities. Before political change in 2000, the general managers of 30 biggest companies were at the same time the key politicians, Members of Parliament, ministers in federal and republic governments and close political associates of the ruling power of the time. Such economic and social climate gave birth to corruption. The long period (almost 10 years) under all sorts of sanctions gave the government a pretext to selectively apply laws and create privileged groups of population, whose activities could more often than not be filed under the domain of organized crime and war profiteering. The representatives of the state and the members of criminal organizations frequently cooperated very closely. In 1999, SR Yugoslavia was among ten most corrupt countries in the world and the most corrupt country in the Southeast Europe, and the share of "grey economy" in total GDP was somewhere between 35% and 50% (G17 2000). The accountability for the loss of the people's foreign currency savings (which amounted somewhere between 6.5 and 7 billion dollars) fell on the ruling structures, who had during the 1990s already elaborated the mechanisms of pouring these funds from the hands of the people to the hands of the ruling political elite: the frozen foreign currency savings in the banks of ex-Yugoslavia, issuing of the state bonds for reconstruction of Serbia whose value was completely decreased by inflation, pyramidal schemes offered by two large private or para-national banks founded in cooperation with the authorities, hyperinflation of 1992/93 that forced citizens to sell their entire foreign currency savings so they could survive. It is thought that the difficult economic situation, which reflected onto the social sphere, was one of the key reasons for the collapse of the socialist government at the parliamentary elections in the year 2000. This extreme social stratification manifested in the system that functioned exclusively in the interest of the ruling political and economic elite. This stratification reflected in a massive impoverishment of a large portion of population and fast enrichment of a small number of individuals who had the control over the economy of the entire country. Such extreme social polarization left long-term negative consequences on Serbian economy, and it turned out that eliminating or at least mitigating they represented the most difficult task of all reform programmes that were later planned, created and implemented.

14.5 Serbian Economy at the Beginning of the Twenty-First Century – Is Transition Over?

In the first years after the political changes in 2000, the transformation of Serbian economy towards market model continued. However, precisely due to the change of political environment, this was qualitatively a new phase of the transition process in Serbia. Political factors were changed, but social and economic circumstances in which transition was to continue still remained unfavourable, and overcoming them became one of the most important goals of the new creators of economic policies and economic reforms in Serbia.

At the beginning of the twenty-first century, Serbia significantly lagged behind the ex-Yugoslav republics of Slovenia and Croatia (in the year 2000, Slovenia's GDP was 293% above the average GDP for other ex-Yugoslav countries, while Croatian GDP was 81% above the value of the same indicator) (Stiperski and Lončar 2008). Still, unlike their predecessors, the new political structure in Serbia showed this time a genuine willingness and desire to stabilize the economy and transform it by an adequate macroeconomic policy and market-oriented structural reforms. In addition, in this period, the economic policy creators also had a significant help from the international community. It is important to note that, in the first years after the political changes, the relationship between the republics-members of SR Yugoslavia also changed, so in 2003 the State Union of Serbia and Montenegro was formed and it existed until 2006, when both member states proclaimed their independence. Thus, after 88 years, as the legal successor of the Yugoslav state, Serbia indirectly renewed its independence.

At the beginning of 2001, Serbia finally started the process of transitions, just like majority of other, much more

developed countries in Central and Eastern Europe. However, even with a vast knowledge regarding the process of transition to market system of profit earning that was acquired based on the 10-year experience of the countries in transition, many measures were conducted in Serbia based on a trial-and-error principle which, although applicable at a macroeconomic level, left huge negative consequences. On the other hand, a different approach to transition could not have been expected, having in mind the specific contemporary economic history of Serbia, characterized by long periods of wars in the immediate surroundings and international isolation after the break-up of the ex-Yugoslavia. All of this created the desire, and also the need to begin the key economic reforms as soon as possible and as enthusiastic as possible, sometimes even without previously well-conceived concept of their implementation. Although some huge mistakes did happen, which were made in different segments of reforms (privatization, fiscal system, etc.), the new stage of transition in Serbia represented an important step towards introducing a market-based system of profit earning and a break-up with the quasi-reforms being implemented up until that point.

The new transition strategy towards building of a market economy in Serbia was founded on four elements: establishing macroeconomic stability and external balance, inciting economic growth and creating the basis for sustainable level of supply, improvement of the population's standard of living and building of market institutions and improvement of the systems for managing the state and economy. Although "transitional recessions" (which could have been rightfully expected based on the experience of other ex-socialist countries) was successfully avoided in this phase of transition, the result was disappointing because the accelerated economic growth failed to take place. In the period from 2000 to 2007, an average annual GDP growth of 5.6% was achieved, which additionally decreased by 2009 due to the world economic crisis, and even a negative growth was observed in some years (Fig. 14.5).

During the entire period from 2001 to 2017, Serbian economy was constantly facing the challenges of inflationary shocks. Because of that the state more often than not turned to monetary and fiscal policy measures, which kept inflation under control (inflation was decreased from 40.7% in 2001 to 10.1% in 2007, and dropped to just 3% in 2017 as the result of restrictive monetary and fiscal policy).

For example, the per capita GDP increased significantly, and in 2017 it reached almost $5900 (Croatia had per capita GDP of $13,294 and Slovenia $23,597) (Devetaković et al.

Table 14.4 Real GDP Growth in Serbia, Central and East European countries (2000–2017) (in %)

	Average 2000–2009	2013	2014	2015	2016	2017
Albania	5.9	1.0	1.8	2.2	3.4	3.8
B. and H.	4.2	2.4	1.1	3.1	3.2	3.0
Bulgaria	5.0	0.9	1.3	3.6	3.9	3.6
Croatia	3.0	−0.5	−0.1	2.4	3.5	2.8
Hungary	2.4	2.1	4.2	3.4	2.2	4.0
Macedonia	3.1	2.9	3.6	3.9	2.9	0.0
Montenegro	…	3.5	1.8	3.4	2.9	4.3
Poland	3.9	1.4	3.3	3.8	3.0	4.6
Romania	4.8	3.5	3.4	3.9	4.8	6.9
Serbia	5.1	2.6	−1.8	0.8	2.8	1.9
Turkey	3.8	8.5	5.2	6.1	3.2	7.4
Slovak Rep.	4.5	1.5	2.8	3.9	3.3	3.4
Slovenia	2.9	1.1	3.0	2.3	3.1	5.0
Czech Rep.	3.4	0.5	2.7	5.3	2.5	4.3

Source: International Monetary Fund (2018)

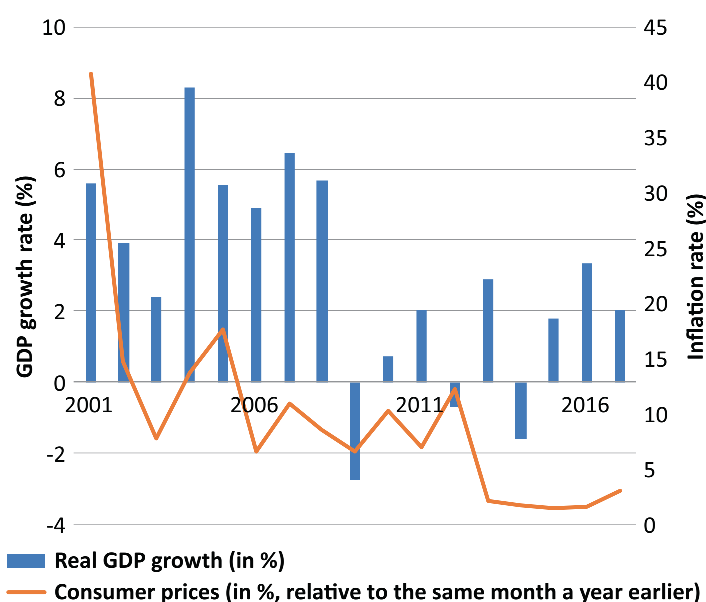

Fig. 14.5 Real GDP growth and inflation in Serbia, 2001–2017. (*Source of data:* Author's calculation based on data from Statistical Office of the Republic of Serbia 2019)

2019) (Table 14.4). Although the average real GDP growth rate in Serbia was among three best results in the region during the period 2000–2009, it was declining in the following years falling in 2017 below 2% (International Monetary Fund 2018).

The transition in Serbia also implied privatization of the entire state-owned property, whereby a rise in productivity and efficacy of companies was expected. At the same time, some state-ownership sectors required restructuring (e.g. public enterprises). The selected privatization model was characterized by a targeted quick privatization along with the use of "shock therapy", and its main characteristic was the emphasis on selling of the enterprises, that is, selling of capital to external foreign and domestic investors. Privatization income was directed to the state budget, but instead of being used to finance investment projects that would boost employment, these funds were mostly used for current spending and covering of budgetary deficits. In the period 2002–2016, 2419 public enterprises were sold (with the earned income of 2.7 billion EUR and investments worth 1.046 billion EUR) (Grgurević 2018), whereby the largest number of enterprises was sold by 2008. However, this privatization model proved to be catastrophic for Serbian economy because it was often related with selling the companies to individuals who were incapable to continue and improve their business operations or to individuals close to politicians in key state positions who were inclined to rent seeking. The enterprises were often sold to individuals who did not have any references in the given fields where the enterprises operated and who often used the purchased property as a guarantee for obtaining mortgage loans from banks. These loans were never to be repaid, which caused liquidation of these enterprises and massive discharges from employment. In addition, the buyers of these enterprises often did not fulfil their obligations towards the state, so a large number of these sales contracts were cancelled (Grgurević 2018).

Besides the real sector, the privatization process also spread into the banking sector, and in addition to all this, even a large housing fund was privatized. At the beginning of 2002, four large state-owned banks in Serbia were privatized which, despite their strong tradition and experience in the banking field at domestic and foreign markets, had huge unpaid debts of their clients and the state itself was one of the biggest such clients. After their liquidation, Serbian banking market started being dominated by foreign banks: they increased their share in total assets from 27% in 2002 to 75.5% in 2007. At the same time, the state-owned banks' share was significantly decreased (from 35.6% to 15.8%), as well as the share of domestic private banks (from 37.4% to 8.7%) (Vuković 2009).

In the period 2001–2005, the total amount of direct foreign investments in Serbia was 3.1 billion EUR. However, their structure was unfavourable: the green field investments share was extremely small and it mostly included trade and real-estate. By privatization of highly profitable enterprises (such as cement plants, tobacco industry factories, food-industry factories, metal industry plants, etc.), as well as by privatization of banks, the main part of foreign direct investments (FDIs) was created in the said period. This trend continued until the beginning of the world financial crisis, whereby the total amount of FDIs in the period 2006–2008 reached the level of almost 6.3 billion EUR (Ratkaj et al. 2020). The slowdown in economic and investment activities worldwide as the result of global economic crisis also affected the Serbian economy. In 2008, the total FDIs in Serbia were still above 2 billion EUR, primarily due to privatization of the car factory *Zastava* by the Italian company *FIAT* (Fiat Chrysler Automobiles Serbia) and also due to the strategic agreement in the energy sector between the Republic of Serbia and the Russian Federation (Russian "Gazprom" took over the Petroleum Industry of Serbia for 400 million EUR) (Ratkaj et al. 2020). Since 2009, the FDIs in Serbia were decreasing, and after the world financial crisis they dropped by about 50% (Fig. 14.6).

During the period 2010–2018, the FDIs in Serbia were highly volatile in character. The sudden leap in 2011 was the consequence of an increased inflow from the purchase of the largest Serbian retail trade chain Delta-Maxi by Belgian supermarket chain Delhaize. An extremely low inflow of foreign direct investments compared to the previous 10 years occurred in 2012, and this could be explained by political instability in the country due to presidential and regular parliamentary elections. Since 2013, FDIs started to increase, while in 2018 they reached over 3 billion EUR (in 2018, the Chinese mining company *Zijin Mining* took over 63% of shares of the Serbian cooperative company *RTB Bor* in a

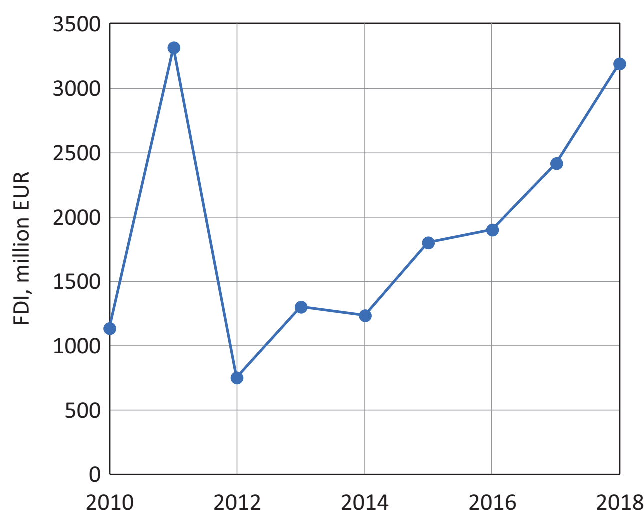

Fig. 14.6 FDIs in Serbia (2010–2018, million EUR). (*Source:* Author's calculation based on data from the National Bank of Serbia 2019)

1.126 billion EUR deal with the Serbian Government) (National Bank of Serbia 2019).

Cumulatively in the period from 2004 to 2016, the largest FDI inflows were in two sectors: financial and insurance sector (27%) and manufacturing sector (26%) within which the leaders were automotive components, food and tobacco, textiles and real-estate – combined, they accounted for more than half (54%) of total inbound FDI projects in 2018 (Barklie 2019). Significantly lower level of FDI inflows was realized by wholesale trade, retail trade, motor vehicles repair (17%), real-estate activities (11%) and transportation and storage activities (10%) (National Bank of Serbia 2019).

According to the Statistical Office of the Republic of Serbia, at the end of 2016 the share of foreign branches operating in Serbia was 3% of the total number of business entities in the Republic of Serbia. Foreign branches employed a total of 223,125 workers, or 21% of the total number of employees in Serbia (Ratkaj et al. 2020). The largest number of employees was recorded in the manufacturing sector (50.1%), wholesale and retail trade, motor vehicles repair (22.5%) and administrative and support service activities (8.8%). Foreign business entities from the EU Member States were represented with 77.2% (from Austria, Italy, Netherlands, Germany, Luxembourg, Greece, Norway, Croatia and Slovenia), from non-EU countries with 21% (e.g. China, Russia, Turkey, Montenegro and USA), while the remaining 1.8% were foreign subsidiaries from offshore financial centres (National Bank of Serbia 2019).

Unlike foreign investments, domestic public and private investments in Serbia were among the lowest in Central and Eastern European (CEE) countries. Several years back, they were around 3% of GDP, while in other CEE countries their share was 4–5% of GDP (Republika Srbija – Fiskalni savet 2015). Domestic private investments accounted for somewhat higher percentage – about 10% of GDP (around 15% of GDP in CEE countries). Unfortunately, there were no signs that the situation would improve in the future, since public investments declined by 6.7% in 2014, while private investments declined by 3–4% (Republika Srbija – Fiskalni savet 2015). With such small investments, it was impossible to achieve high rates of economic growth. According to the estimation of the Fiscal Council of Serbia, the share of total investment in GDP should have been no less than 25% in order for a sustainable growth rate of 5% to be achieved (Republika Srbija – Fiskalni savet 2015). The situation was even worse regarding the public investments: they were lower than in any other comparable country and revealed a deep oscillating character. The level of current investments of approximately 3% of the GDP was below any acceptable criterion and such level definitely did not lay foundations for growth and development of the private sector. According to some analysts, the share of public investments in the GDP for the countries at the same level of development as Serbia should have amounted to 4–5%, although this ratio should be significantly higher during the phases of faster development and construction of infrastructure (Serbia's needs) (the estimation of the Fiscal Council of the Republic of Serbia) (Republika Srbija – Fiskalni savet 2015).

In the previous two decades, Serbia achieved macroeconomic stability, conducted basic transitional reforms and also managed to complete privatization, with the exception of few enterprises. International trade and capital flows were liberalized, inflation was stabilized at a low level and fiscal deficit was eliminated. GDP, employment and salaries increased, while public debt and the percentage of uncollectable loans decreased. However, the advancement achieved by establishing of macroeconomic stability and by basic economic reforms contributed to greater visibility of the core issues of Serbian economy. Above all else, these were institutional problems that in the past remained in the background due to macroeconomic problems: a modest progress made in structural reforms and economic policy that insufficiently incites growth.

There was an increase in foreign trade deficit and, most importantly, a very slow growth of investments. In the previous 10 years, Serbia had a significantly slower economic growth when compared to the CEE countries' average, and the main reason for this was a low level of investments. Starting from 2008, the investments level in Serbia did not surpass 20% of GDP, while the CEE countries had more than 22% of investments in their total GDPs (Republika Srbija – Fiskalni savet 2015). It takes much more than fiscal consolidation for a long-term sustainable growth. The previously mentioned weakness of institutions is reflected in insufficient protection of the contracts and ownership rights, low level of administrative staff's competencies and high corruption, poor public enterprises' management and insufficient efficacy in realization of public investments. All these elements create unfavourable environment for entrepreneurship, development of small and medium firms, investing and employment. Consequently, Serbia has a very low degree of innovations, insufficient domestic private and public investments and low employment. The World Bank's Ranking List regarding the quality of state governance (measured through elements such as corruption level and the like) shows that Serbia ranks 12 out of 14 CEE countries (only North Macedonia and Albania ranked lower than Serbia) (Kaufmann and Kraay 2019). This means that Serbia is ranked near the bottom of the list with respect to quality of its institutions.

Related to the previously stated is also the fact that in the past several years there has been very little progress in restructuring of public enterprises (to which the state has, in a large part, transferred social and fiscal functions). Ineffectiveness of Serbian public enterprises is, without a doubt, illustrated by several years of delays and high costs of road construction, extremely poor railway service, occasional

problems with electricity production, low investments in public utilities infrastructure, etc. Therefore, in the following period, the highest potential for accelerating of economic growth in Serbia lies in structural and institutional reforms. When Serbia is concerned, these reforms are crucial, because the trend of its economic growth in the past 10 years was slower than the CEE countries' average. Crucial structural reforms in the following period must include restructuring of public enterprises, public administration reform and education reform. And one of the most important goals that Serbia set to itself after the year 2000 was the accession to the European Union, which would mark the end of the process of economic and institutional transition (in 2012, Serbia received the status of a candidate country and this marked the start of negotiation for accession to the EU).

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