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OECD

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The economy of the Federal Republic of Yugoslavia (FRY) was devastated during the 1990s. Economic reform since the end of 2000 has marked a sea change in policy that has already had a number of positive effects. Difficult decisions have been taken to implement some structural reforms, and the economy has been substantially liberalised and stabilised. Inevitably there are risks to the hitherto positive macroeconomic developments, especially in Montenegro that has relied heavily on foreign aid. Export-led growth may suffer from the economic slowdown in Europe, the FRY's largest market. At the same time, the economy needs to attract inflows of capital. Hence the government needs to keep up the pressure of reform in order to reshape the domestic competitive environment. It takes time for structural reforms to become effective and new institutions to take root. In due course reforms will benefit domestic firms and industry, simultaneously providing fertile ground for the foreign investment that is needed both to support the balance of payments and to help seed a wider domestic recovery.

A decade of economic decline…

The 1990s was a decade of economic decline in Yugoslavia. Having started the period well integrated with the world economy and with a higher standard of living than in other transition economies, the country ended the decade in disarray. Income per head was one of the lowest in Europe, and poverty had only fallen back a little after its dramatic increase during the hyperinflation of 1993-94. War in the Balkans was the main culprit; international economic sanctions had starved the economy of capital, prompted the country to default on its foreign debt and distorted production. The banking sector was illiquid and bankrupt; state and socially owned enterprises were moribund. Informal "grey" activity replaced some of that lost in the formal economy, but this provided the opportunity for corruption and organised crime to grow.

…brought to an end by a radical programme of economic reform

In 2000, a change of government at the federal level, and then in Serbia, marked a turning point; Montenegro had embarked on its own programme of reform somewhat earlier. The Federal Republic of Yugoslavia's (FRY) economy is dominated by Serbia, which accounts for more than 90 per cent of output and in practice the two economies are managed separately. The new government in Serbia adopted an ambitious programme of economic reform, committing itself to reversing the trends of the previous decade and integrating the economy with the European Union. Forthright action staved off a potential humanitarian and economic tragedy. In less than two years trade and prices have been liberalised; new fiscal and monetary policies have substantially reduced inflationary pressure, stabilised the exchange rate and improved expectations. Relations with international creditors have been largely normalised, and banking sector reform was strongly advanced through the improvement of prudential regulation and the bold closure of the four largest commercial banks on grounds of insolvency. Comprehensive privatisation legislation marked a break with dubious schemes of the past in welcoming foreign investment to participate in a process designed to be transparent.

A firm policy foundation based on a programme of structural change …

The FRY has laid a foundation for economic growth. It also has an ongoing programme of reforms, designed in conjunction with international economic institutions, to deliver the structural changes needed to sustain growth into the future. But significant challenges remain in putting the FRY onto a path of sustainable growth. While restructuring its Paris Club debt has brought some respite, the budget remains fragile. It will have to bear the inevitable costs associated with enterprise restructuring, notably through spending to maintain a social safety net, while at the same time the burden of taxation needs to be reduced to encourage entrepreneurship and attract foreign investment. In the energy sector, the government needs move beyond emergency rehabilitation by establishing a policy framework and progressively separating its policy function from regulatory enforcement and the operation of state-owned companies. On the external side, debt servicing is projected to increase at the same time as flows of foreign aid are expected to fall, and import growth is likely to continue. In essence, these difficult policy problems can be resolved if the economy quickly moves into a period of export-led growth and is able to attract significant flows of foreign direct investment. Montenegro finds itself in a particularly acute position of running significant "twin deficits" in the budget and current account, largely financed out of foreign aid. As levels of aid are expected to decline sharply in the near future, Montenegro is likely to be faced with a major macroeconomic adjustment.

…though the prospects for near term growth remain uncertain

Following the end of the war in Kosovo the economy rebounded, growing by some six per cent per year in 2000 and 2001. Growth in 2001 benefited from a good harvest, but is likely to be somewhat lower in 2002 and 2003 as the response of output and exports to the changes in economic policy has been slow and complicated. Growing wages and household incomes have stimulated increased consumption, but this has largely been met by a rapid growth in imports. Recovery in domestic industry is anaemic. Overall, industry in the FRY seems to have suffered a mild "transitional recession" as the sector adjusts to lower subsidies, newly restricted access to credit and greater competition from imports.

Higher consumption has drawn in imports

Higher debt service is only one factor influencing the balance of payments. During 2000-01 reported imports increased by 47 per cent, mostly in consumption goods. Combined with weak export growth, this has led to a growing current account deficit. While not unexpected at this stage of transition, this underlines how important it will be for the FRY to attract foreign direct investment to support the capital account in the balance of payments. The same is true in Montenegro, where there are serious additional concerns. There, a single subsidised aluminium plant accounts for more than half of exports. Also, since the euro is the official currency, Montenegro only has the option to depreciate the real exchange rate through a difficult process of disinflation.

Inflation has been substantially reduced

In Serbia, monetary policy has made a major break with the past. The National Bank of Yugoslavia (NBY) has all but given up its previously primary role of making loans and giving guarantees. Instead it has successfully used the exchange rate as a monetary anchor to bring down inflation. Since January 2001 the dinar has been held at about 60 to the euro (previously 30 to the deutschmark). Inflation had fallen to 17 per cent (year on year) in the middle of 2002. Indeed, core inflation is about one-third of this rate, as the government has been increasing administratively controlled prices. All the while, the NBY has been accumulating foreign reserves, which had reached EUR 2.1 billion in August 2002 (more than 5 months of imports). A significant part of this rise is due to increased demand for dinars by domestic residents. Taking this into account, monetary policy was contractionary in 2001 and the first half of 2002. The NBY has not actively used interest rates as a policy tool, and so interest rates have fallen with inflation, though they remain comparatively high. In contrast, having adopted the euro as its currency, Montenegro has little scope to operate an independent monetary policy.

Introducing more exchange rate flexibility could help manage expectations in the future

The NBY's exchange rate anchor has successfully stabilised expectations and restored demand for the dinar. Indeed the NBY has regularly had to intervene to prevent the dinar from appreciating. However, given that inflation in the FRY is significantly higher than in the euro zone, the NBY's policy of nominal exchange rate stability has resulted in substantial real exchange rate appreciation since October 2000. Taken in conjunction with the deteriorating current account, this has lead to suggestions that the FRY should devalue the currency in an effort to restore its external price competitiveness. However, this approach assumes both that the NBY would be able to influence the real exchange rate in the short run without destabilising the demand for money, and that the FRY's poor export performance is a matter of price competitiveness. Neither is necessarily the case. A more effective alternative might be to use monetary policy to reduce inflationary pressure by developing more effective techniques to sterilise exchange market intervention and reduce excess bank liquidity. However, continuing to defend a nominal anchor over a long period can actually contribute to greater future destabilisation at the time when pressures for a downward adjustment begin to mount. Recent international experience suggests that it is extremely difficult for the financial sector to recover from such a shift. Introducing some degree of exchange-rate flexibility designed to sustain money demand could, in the short term, slow down disinflation. However, in the medium run it could help the FRY avoid a destabilising shift in expectations in the wake of external pressure on the exchange rate. Such a move is best made from a position of strength, where there is confidence in the central bank and foreign exchange reserves are high. In addition, a policy consistent with mild nominal depreciation could help the real sector in adjusting to economic shocks.

The budget has been consolidated, but government needs to address the structure of expenditure

As with monetary policy, fiscal policy in Serbia has made a marked break with the past. While the republican budget was close to balance in the past, it was in practice financed by building up expenditure arrears, by allowing large deficits to build up off-budget, and through the quasi-fiscal activity of the NBY in granting soft loans to the banking system and directly to enterprises. The government has eliminated or merged numerous extra-budgetary funds into a single consolidated budget controlled by the ministry of finance. Both Serbia and Montenegro are implementing treasury systems to improve accountability for expenditure and to track budget execution. The FRY will need a comprehensive reform to bring the size of government more in line with the current capacity of its economy. This is badly needed to manage Serbia's primary expenditure, which is high in relation to the state of its economy: it is similar to that of more developed transition countries where GDP per capita is more than double that of the FRY. Given the demand for social expenditures arising as a consequence of reform, both Serbian and Montenegrin governments should look for a structural reduction of expenditure in other areas. State expenditure on the military and police establishment, and the civil service, are notably higher than in other countries.

There are some significant fiscal challenges

Social funds, particularly the pension fund, represent an important fiscal strain in the FRY. In Serbia, the government took some palliative measures in January 2002 in raising the retirement age and changing the way pension payments are indexed. Similar measures are planned in Montenegro. But these do not represent a comprehensive solution to a fundamental imbalance that is likely to deteriorate as the population ages. Another domestic challenge relates to growth in the total civil service wage bill. Numbers have not fallen, and attempts to impose a wage freeze have been unsuccessful: real wage growth is estimated to be above 20 per cent in some parts of the administration. A third challenge is interest payments. Increased foreign debt servicing will become a significant fiscal burden. The FRY has normalised its relations with official creditors, negotiating an agreement with the Paris Club that granted a generous level of debt forgiveness. Nonetheless, the FRY remains a heavily-indebted country, and initial grace periods expire at the time that foreign assistance is expected to decline. By the middle of the decade, foreign debt servicing is expected to amount to more than USD 1 billion annually.

Taxes on labour income should be reduced

Serbia undertook a major tax reform in March 2001. Despite lower nominal rates, for instance of payroll taxes, revenues went up as tax bases were broadened and the government began to tighten channels of tax avoidance, for instance by widening the tax base for payroll taxes to include benefits-in-kind. It remains the case that much activity, especially in small and medium-sized enterprises, evades tax altogether, while the actual burden on registered business has probably been increased. To avoid reducing the stimulus to entrepreneurship and blunting the incentive for business to migrate from the grey sector to the formal economy, the government needs to bring down the burden on business by continuing to reduce tax and contribution rates on labour income.

Government should meet its commitments as they fall due

Despite the government's desire to encourage businesses and individuals to pay their tax, it does not always respect its own obligations. Although the government is committed to avoid an increase in its aggregate payment arrears, it could send a strong signal about the importance of economic obligations by tightening its commitment to meet all current payments as they fall due. In the longer run it will be necessary to bring down these arrears, which still amount to some 6 per cent of GDP.

Enterprises are struggling in the face of reduced profits and lower liquidity

The FRY's enterprise sector is under pressure. Smaller firms have found their profit margins being squeezed as cost pressures mount and competition, notably from imports, has increased. One cost pressure is increased payroll taxes, though there has been little pressure for higher wages to date. Larger firms have experienced the same difficulties, but have in addition experienced a dramatic loss of liquidity and persistent pressure for wage increases, notably in the public sector. This should be stemmed by the adoption of more decentralised wage bargaining. It has become harder to cover losses through access to new credit or by increasing arrears to suppliers. Implicit subsidies, for instance through cheap energy, have been reduced. This particular trend will continue, as artificially low energy prices doubly impaired economic adjustment. On the one hand low prices deprived the energy sector of resources needed for maintenance and investment, and on the other they stimulated demand, for instance for relatively inefficient electrical domestic heating.

As yet there is a lack of dynamism amongst small enterprises, which face a period of difficult trading

While falling profitability and increased competition might not suit individual entrepreneurs, they are a healthy sign of market competition. There are regional differences and signs of revival among micro-enterprises, but overall there is a worrying lack of dynamism in the small enterprise sector. Among FRY businesses, small is not synonymous with new. Most enterprises in an OECD survey were well established. Some 60 per cent dated from before 1992, and half of the rest were at least five years old. There is continuing stagnation, or even decline, in the overall number of SMEs even though the FRY already has low employment and output in the SME sector compared with OECD countries. The environment for small enterprises may well continue to deteriorate in the near future. In Serbia, the government has a strategy to reduce the size of the grey economy while simultaneously improving the operating conditions for legitimate firms. This suggests a difficult period for the small business sector as existing sources of profit are likely to dry up before (necessarily slower) improvements in the business environment take hold. The sector is also likely to suffer as privatisation and government action gradually cut through a web of fraudulent contacts and contracts between SMEs and larger state or socially owned enterprises. On a more positive note, the results of the OECD survey suggest that small businesses are not subject to the same degree of harassment by state authorities as in some other transition countries. Nor did it seem that Yugoslav entrepreneurs felt it important to cultivate relationships with state or local authorities.

Government needs to reduce the burden of regulation

The governments in Serbia and Montenegro have begun to address this lack of dynamism by creating agencies to monitor and support SMEs. While more information is badly needed, policy would do well to assist entrepreneurs by reducing the burdens placed on them by the state rather than by designing special privileges to support the sector. In practice access to privileges is particularly susceptible to corruption and fraud, and risks strengthening the power of already entrenched incumbents at the expense of the new firms that ought to be the primary target of policy. The government would do better to promote mechanisms that allow firms to enforce contracts quickly and cheaply, and to take care that predatory behaviour by existing firms does not extinguish the prospects for new entrants. In Serbia, company registration should become easier and cheaper.

Decisive bank restructuring is a strong basis for financial sector development

Along with their peers in other countries, small businesses in the FRY complain about the lack of access to credit. This is unexceptional; indeed credit to the smallest businesses has risen over the last year as a result of foreign involvement in this activity. As already noted, the lack of access to credit is a more significant problem for larger enterprises, which were most affected by the NBY's decisive action to close and liquidate the four largest commercial banks. These institutions were comprehensively bankrupt, and the NBY took the decision to close them rather than to attempt rehabilitation. This action sent an admirably strong signal about how the NBY intends to supervise the financial sector. Along with increasing involvement of foreign banks, this has helped gradually to restore confidence. For the time being, the financial sector remains small. Financial intermediation is very low (the share of active bank assets is only some 25 per cent of GDP), and all banks still have high rates of loan arrears and default, justifying their cautious attitude to new lending. This is partly a temporary state of affairs while banks develop the skills needed to make good credit decisions, but it has some negative repercussions. For instance, enterprises find it difficult to secure short-term credit for trade, which hampers the development of exports. The lack of laws and effective enforcement of collateral pledged against loan default is a significant barrier to new lending. New rules on leasing would be another way in which the government could ease access to capital, as would ensuring that secured creditors receive prompt and predictable treatment during enterprise bankruptcy proceedings.

Privatisation in Serbia is gathering pace after a slow start …

Experience of privatisation during the 1990s left the population with a cynical view of the governments' motives in undertaking yet another programme. Serbia and Montenegro have sought to overcome this scepticism in different ways. In Serbia, the government has stressed the need to conduct privatisation openly, and for payment of cash. The process is designed to produce dominant new owners, including foreigners, though employees and the state pension fund receive a residual portion of shares once a majority sale has taken place. The desire for transparency led the government to establish a cumbersome valuation and sale procedure, which relied on the existence of accurate asset valuations and projections of future operations. By mid-August 2002 only 15 enterprises had been sold. The government announced changes in July 2002 designed to accelerate privatisation. The targets for the remainder of 2002 and into 2003 are ambitious, though this rightly reflects the view that state- and socially-owned enterprises must be subjected to credible financial discipline as quickly as possible. This will release money in the budget for other areas, such as education or social spending, and would allow individual assets to be recycled into other, more productive, uses. In considering growing pressure for restitution, the government will have to weigh the costs of inevitable delay in privatisation resulting from in-kind restitution against what might be the cash costs of compensating individuals who are able to demonstrate a rightful claim over privatised assets.

… and in Montenegro the state still dominates the economy

Montenegro has chosen a different route to Serbia. After a popular mass privatisation programme and earlier sales, an estimated 45 per cent of industry remains in government hands, of which some is held in state social funds. A significant part of the government's holding is in a single giant aluminium company that dominates both Montenegro's exports and electricity consumption.

Effective bankruptcy and liquidation need to accompany privatisation

By the end of the 1990s, Yugoslav enterprise had become characterised by a very close relationship between business and politics, fostered by the international sanctions on Yugoslavia for much of the decade. Privatisation is one of the elements of reform in the business sector needed to break this link. Transparency in the privatisation process is of paramount importance: Serbia's programme acknowledges this. Yet in both Serbia and Montenegro the tender process aggregates different, in some cases vague, criteria, which lays the process open to accusations of manipulation. The most effective inoculation both against corruption, and accusations of corruption, would be to publish not only the tender criteria and the winning bid, but all bids. Ultimately, privatisation can only be a success if it is part of a portfolio of policies that give rise to a dynamic, competitive, entrepreneurial environment. The persistent survival of loss-making enterprises is inconsistent with this objective; in this sense the issue of speed is important. It is not clear how the government, either in Serbia or in Montenegro, intends to deal with state or socially-owned enterprises for which it cannot find a buyer. It will be vital that businesses face clear, and clearly enforced, rules on bankruptcy and liquidation whoever is their owner. In due course the government will also have to pay more attention to rules on effective competition. This notably requires setting the regulatory framework for natural monopolies.

Foreign direct investment depends on the domestic environment …

Privatisation is one means of attracting foreign direct investment (FDI), though this has generally been overestimated as a source of fresh capital in transition economies. This is likely also to be the case in Yugoslavia. Privatisation sales to foreigners serve an additional purpose, injecting knowledge, skills and, often, access to overseas markets. Foreigners often prefer making greenfield investments, and are strongly influenced by the local business environment. Greater economic liberalisation seems to promote greater flows of FDI; this is turn seems to be associated with higher levels of employment and output in smaller businesses. Hence both FDI and the health of the SME sector are indicators of progress with economic reform. Offering tax advantages is likely to be both expensive in terms of revenue forgone and in direct costs on the budget, and of doubtful value in attracting investment. Rather, policies that are good for the domestic business environment are also good for attracting foreign direct investment.

… and is needed to underpin macroeconomic sustainability…

In essence, inflows of FDI and export growth are an integral part of the projection that underpins the macroeconomic framework. Yugoslavia liberalised its trade early on in the reform process, though it retains the power to set export quotas to ensure an adequate supply of food on the domestic market. Liberalisation was an important step, though it predictably resulted in a widening trade deficit as imports, especially of energy and consumption goods, grew rapidly. Increased debt servicing will shortly add to the widening current account deficit. Initially, renewed confidence in the dinar has sustained the capital account in the balance of payments, though this represents a one-off adjustment that cannot provide ongoing support. FDI is a more durable source, particularly since flows of foreign aid to the region are expected to diminish over the next few years whilst strong import demand is likely to persist.

…in conjunction with export growth

Yugoslavia's industry and trade suffered dramatically during the 1990s. Trade was disrupted both by war and sanctions while its structure had been influenced by policies that placed greater weight on the potential to earn foreign currency than on economic efficiency. In addition, as its capital stock deteriorated during the 1990s, Yugoslavia tended towards labour-intensive, low-skilled and commodity production and retained a rather unspecialised export structure compared to others. This is a concern for future export growth in a world where firms increasingly compete in quality and variety, often of more complex intermediate products. Offering the right quality at the right time is at least as important as offering the cheapest price. A skilled educated workforce is an advantage as firms compete for niches, becoming ever more specialised. Yugoslavia, however, fell back on exports of primary materials and traditional industries such as textiles, where price competition is fierce. Whilst the country may at first need to exploit comparatively low labour costs to bolster the balance of payments, future export potential is best served by policies that enable exports to move back up the production quality ladder, notably those that attract expertise and access to foreign production and sales networks.

Trade promotion should be handled carefully

It is difficult to devise policies on trade promotion that work. It is often impossible to collect the information needed to design policy properly, and there are always costs attached to public intervention. For instance in Yugoslavia's context it would be important to ensure that trade promotion policy did not simply benefit incumbent firms at the expense of potential new firms. The most immediate barriers to trade are at physical borders, and in fulfilling bureaucratic requirements. Poor transport infrastructure is also a hindrance. Government could help promote exports by achieving more fluid borders. Policies on mutual recognition of paperwork with other countries in the region, better physical facilities, as well as linked information systems and more professional border staff would all help. The one area in which government could help directly is by establishing centres where exporters could easily get help in fulfilling the bureaucratic requirements of the EU, the FRY's most important market. It would help accession negotiations to the WTO if Serbia and Montenegro could negotiate a single, rather than two, sets of tariffs. An export credit agency established in October 2002 may help alleviate another constraint.

In conclusion

Both Serbia and Montenegro have moved decisively to embrace far-reaching economic reforms that seem irreversible. Both republics have passed an impressive amount of legislation. They now face the challenge of implementation, on which necessary future reform depends. In the autumn of 2002 further reform sat in the shadow of constitutional uncertainty, both over the future nature of the federation between Serbia and Montenegro and over the relationship between the federal and republican governments. Resolving this uncertainty is fundamental to providing a stable legal framework. This should in turn enable the FRY to adopt the recommendations made in this Assessment and to continue its progress towards economic transition and smooth integration with Europe.

I. ANATOMY OF ECONOMIC DECLINE

At the time of the last OECD Economic Survey in 1990, what is now the Federal Republic of Yugoslavia (FRY) appeared poised to occupy a position in the vanguard of economic transition in Europe.[1] In comparison to the other European transition countries at the time, Yugoslavia boasted more developed market institutions, greater integration into the world economy, more foreign direct investment, and a higher standard of living. While the 1980s proved a difficult period for output, incomes, and inflation, the government showed a renewed determination toward the end of the decade to stabilise and liberalise the economy, and launched a privatisation programme.[2]

Unfortunately, these plans fell victim to increasing political conflict, setting the stage in Serbia and Montenegro for a Balkan 'lost decade' of decline, disintegration, war, sanctions, embargoes, and unsustainable economic policies. In the period from 1990 to 1999, recorded GDP in the FRY (Serbia and Montenegro) fell by more than 50 per cent (Figure 1). The FRY's estimated standard of living is now one of the lowest in Europe, and a substantial share of the population has slipped into poverty. Unemployment has remained in double-digit levels (Table 1). Persistent macroeconomic instability, including full-blown hyperinflation in 1993, induced a flight both from the national currency (the dinar) and dinar-denominated assets that lasted throughout the decade. As the 1990s progressed, central government played an ever greater role in directing economic activity in the official sector, whilst a growing informal (grey) economy fed on mounting economic distortions. The commercial banking and payments systems were co-opted for quasi-fiscal purposes and to administer state support in priority areas. A myopic administrative allocation of resources was reflected in mounting enterprise, bank, and budgetary arrears. In sharp contrast to the other former socialist countries in Europe, the FRY ended the 1990s with substantially weaker market institutions than it had possessed a decade earlier. A larger share of the formal sector of the economy came to depend on explicit or implicit state subsidies, while the informal sector developed sophisticated means of circumventing laws and regulations. Use of the commercial banks and energy companies to administer implicit subsidies, left these sectors particularly devastated by the end of the 1990s.

(Figure 1. Industrial output and gross material product, 1990-2001)

(Table 1. Basic economic indicators)

Following hyperinflation and the introduction of international economic sanctions in 1992, the government stopped servicing its foreign debt in 1993. Foreign currency bank deposits, which represented a large share of domestic savings, had already been frozen in late 1990. Isolated from world financial markets, and faced with a highly sceptical population, the government nevertheless succeeded in restoring at least some degree of economic stability in the mid-1990s following a decision to peg the dinar to the deutschmark. Output slowly began to recover, but expansionist macroeconomic policies soon fuelled new inflationary pressures and motivated increasing financial repression of the foreign exchange market. After falling to very low levels in 1994, retail price inflation (December on December) accelerated again (Figure 2). The sale of Serbian Telecom yielded USD 700 million to the Serbian budget in 1997 and another USD 300 million in 1998, giving the economy temporary relief from inflationary finance. During this period, foreign trade received a boost after sanctions were lifted in 1996 and Autonomous Trade

Preferences were extended by the EU at the end of 1996. The dollar value of FRY foreign trade grew by 42 per cent between 1996 and 1998. But inflation again began to accelerate again towards the end of 1998.

(Figure 2. Retail price inflation, 1995-2001)

The Kosovo war of 1999 brought this interlude to an end, sending the FRY's recorded GDP into a tailspin: it fell by an estimated 18 per cent. This figure may exaggerate the actual decline in output, as a vigorous grey economy exploited the conditions created by the international embargo and other market distortions of the time. Nevertheless, there can be no question that 1999 represented a culmination of the disastrous political and economic developments throughout the decade. In addition to pervasive disruption and a highly negative effect on economic activity, the Kosovo war resulted in significant damage to roads, bridges, the railway and power stations. Internally-displaced persons (IDPs) from Kosovo added to an estimated 600 000 refugees already in the FRY, adding additional stress to social assistance programs.[3]

There are important differences within the FRY

For all practical purposes, Serbia and Montenegro have become two separate economies in recent years, with entirely different currencies, central banks, macroeconomic policies, budgets, and foreign trade regimes. The same is true of Kosovo (see below). Montenegro adopted the deutschmark (euro) as a parallel currency in 1999, making it the only currency from November 2000. The Central Bank of Montenegro currently functions entirely independently of the National Bank of Yugoslavia (NBY), including in its regulation of Montenegrin commercial banks. Hence, the NBY has *de facto* become the central bank for Serbia. The Montenegrin budget has received no federal transfers and made no contributions to the federal budget since June 1998. An agreement of 2002 sets out conditions for the preservation of at least a formal political union for the next three years, although the precise conditions of this union, and future arrangements, remain to be clarified (Box 1).

Important regional differences have always existed within Serbia (OECD, 1992). The relatively developed northern region of Vojvodina borders on Hungary, Croatia, and Romania, and its ethnic mix reflects this proximity. Vojvodina is particularly rich in agriculture, has strong traditions in small and medium-sized business, and faces a relatively lower burden from large loss-making industrial enterprises. The average wage in Vojvodina in 2001 exceeded that in Central Serbia by 23 per cent. As a relatively wealthy region, Vojvodina has been pursuing a campaign of greater economic independence and fiscal autonomy. As discussed in Chapter II, an agreement in 2001 has granted somewhat greater fiscal autonomy to this region. Although there was a tendency towards increasing fiscal centralisation during the 1990s, the former-Yugoslavia (SFRY) had traditionally been quite decentralised with respect to taxation and state finances.

Box 1. **A new federal structure for the FRY**

By the end of 1991 the Federal Republic of Yugoslavia (FRY) had been reduced to a federation between Serbia and Montenegro after Slovenia, Croatia, Macedonia (now known as the Former Yugoslav Republic of Macedonia), and Bosnia and Herzegovina had unilaterally declared independence from the federation. A new federal constitution was adopted in April 1992, "founded on .… the equality of its member republics." Notwithstanding this constitutional protection against the domination of Serbia, which accounts for over 90 per cent of both GDP and population in the federation, a strong separatist movement remained in Montenegro. This movement strengthened at the time of international sanctions, during which Montenegro continued to receive international aid and technical assistance. The Montenegrin government, elected in 1998, subsequently promised a referendum on independence. This referendum was expected to take place in 2001 but was then delayed, until parliamentary elections in 2002, and subsequently postponed further. The uncertainty surrounding the future of the federation continues to hinder the external relations of the FRY, including progress toward eventual EU accession.

Box 1. **A new federal structure for the FRY (contd.)**

In an effort to resolve this uncertainty, the EU brokered negotiations to preserve a federal country. In March 2002, representatives of the federal government, Serbia and Montenegro signed an agreement (the "Belgrade Agreement") witnessed by the EU's High Representative for Common Foreign and Security Policy. This agreement formally acknowledged the political and economic *status quo*, but committed the two republics to remain bound together in a "state union" for at least three years. During this time, the agreement proposed that the economic systems of the two republics would become harmonised as they began to integrate with the EU. The two republics also committed themselves to preserve the free movement of goods, services, capital and people. At the same time, they recognised the mutual right to maintain separate customs services, trade policies, and currencies. The agreement also allowed for shared representation at international institutions.

The agreement was duly ratified by the Serbian, Montenegrin and federal parliaments by the end of May 2002. These bodies then delegated representatives to a constitutional commission tasked to produce a draft constitutional charter by June 2002. Once the charter is agreed, the Federal Republic of Yugoslavia would cease to exist, its official name becoming Serbia and Montenegro. At the end of the process, the constitutional charter would have become the "state union's" constitution. The agreement obliges the republics' parliaments to amend their respective constitutions in line with the constitutional charter by the end of 2002. The charter and these other plans have all been delayed in the context of political complications. At the end of October 2002 a draft charter had not yet been agreed.

Assertion of the two republics' independence in economic affairs sits uneasily with the functions of the new federal tier, which include international and internal economic relations (along with defence, foreign affairs and minorities' protection). Indeed, in April 2002, there was already some discord over the trade policy memorandum that was sent to the WTO to start the FRY's accession process. In any case, the EU is expected to help the republics' economies converge, and to monitor progress towards achieving this aim. It is also expected to arbitrate disputes that relate to economic matters in the context of its 'stabilisation and association process'.[1]

1. According to the Belgrade Agreement, Serbia and Montenegro have the right to raise questions with the EU regarding "the functioning of the common market and the harmonisation of trade and customs policy".

A break with the past

The year 2001 hopefully marks a turning point for the FRY. The new governments of the FRY and republic of Serbia have strongly committed to reversing the trends of the previous decade by achieving a rapid transition to an open market economy, normalising relations with international financial markets, attracting foreign direct investment, and moving rapidly toward full economic integration with the EU (Box 2). Since 1998, the government of Montenegro has independently pursued reforms that embody the same general goals. In 2001, the FRY and Serbian governments developed comprehensive and highly ambitious economic programmes in conjunction with the International Monetary Fund, World Bank and European Commission. The governments have already taken a number of the planned measures. In Serbia, the programme includes action to liberalise Serbian markets substantially, fundamental changes in the conduct of macroeconomic policy, and an array of structural reforms.[4] Continuing uncertainty about the future of the federation remains a negative factor, though the March 2002 agreement between Serbia and Montenegro appears to be a step forward. It contains a commitment by both republics to simultaneous harmonisation of their economic policies with requirements in the European Union.

This reorientation in economic policy has already had a number of positive outcomes. New fiscal and monetary policy has succeeded in substantially reducing inflationary pressure, stabilising the exchange rate and improving expectations. Normalisation of relations with foreign creditors is well under way. A restructuring agreement reached with the Paris Club in December 2001 rescheduled most of the FRY's foreign debt (see below). Similar agreements are expected with other major foreign creditors. The solvency and capitalisation of the banking system was significantly enhanced in January 2002 after the bankruptcy and closure of the four largest insolvent Serbian banks, accompanied by improvements in prudential regulations, refinancing policies, and supervision. The Serbian privatisation process began on a high note with the sale of three cement plants to foreign investors in January 2002 for USD 139 million (see Chapter IV).[5]

Given the difficult starting point, however, radical economic and political transformation in the FRY promises to be a considerable challenge for many years to come. The initial response of output and exports to liberalisation and the new policy mix has been slow and complicated. Many enterprises in the FRY were subjected to a major shock as commercial credit became expensive and suddenly scarce, subsidies were curtailed, foreign competition increased and the government began to crack down on widely used channels of tax evasion. Under these conditions, the recovery of industrial output and investment following the Kosovo war in 2000 essentially came to a halt in 2001, with only about half of the 1999 decline erased. Although wages, incomes, and retail trade continued to grow in 2001, this was primarily due to the effects of good weather and market reforms in agriculture, a larger share of imported goods in consumption (partly due to humanitarian aid), and a widening trade deficit. Despite the success in realising debt restructuring agreements with foreign creditors, foreign debt servicing will constitute a major fiscal burden, and risk, in the medium term. The success of the current programme will hinge on achieving strong rates of growth in output, exports, and investment, as well as on the maintenance of responsible macroeconomic policies. This, in turn, necessitates the creation of a competitive environment within South East Europe to attract foreign investment and expand exports, such as envisaged in the ministerial declaration on investment signed by the federal, Serbian and Montenegrin governments in July 2002.[6]

Although accounting for less than 10 per cent of the FRY's GDP, the republic of Montenegro nevertheless attracted a substantial share of official aid to the FRY in 2000 and 2001. This largely reflects the strategic importance afforded to Montenegro during the Kosovo war as well as the real need to deliver humanitarian assistance. Foreign aid can help defray the inevitable costs of economic transition, though Montenegro's exceptional aid inflows may carry a curse as well as a blessing since it has allowed the republic to sustain large twin deficits in the balance of payments and republican budget. Since levels of aid are expected to decline substantially in the foreseeable future, Montenegro will then be faced with major macroeconomic adjustment to the extent that past aid has been used to finance unsustainable current expenditure at the cost of delaying necessary labour, social and pension reform.

Recent economic performance

The FRY economy has been undergoing a difficult dual process of recovery from the Kosovo war of 1999 and adjustment to major changes in economic policies and laws. The most important successes have been in macroeconomic stabilisation and the normalisation of relations with foreign creditors, in addition to drafting and starting implementation of an ambitious economic programme (Box 2). On the other hand, the still largely depressed state of the real sector, and high degree of future uncertainty for output, exports, income and money demand, speak for significant future risks.

Box 2. **The Economic Programmes of the FRY, Serbia and Montenegro**

In 2001, the FRY embarked on an ambitious programme for macroeconomic policy, liberalisation, and structural reform. This programme was drafted in conjunction with the International Monetary Fund, the World Bank, and other international organisations, and has been elaborated in a series of published "Memoranda of Economic and Financial Policies" and other documents.[1]

Box 2. **The Economic Programmes of the FRY, Serbia and Montenegro (contd)**

Recent reform initiatives in the FRY can be divided into four categories. A first set of measures targets the rapid liberalisation and foreign trade. This includes the liberalisation of most prices, a schedule for increasing energy prices to cost-recovery levels, the removal of most quantitative restrictions on foreign trade (with the remainder to go by 2004), and the rationalisation of import tariffs. A second set of measures seeks to establish effective institutions of macroeconomic policy: consolidation of fiscal and quasi-fiscal financial flows into single federal, republican and local budgets; rationalisation of the tax system; creation of a treasury and modern payment systems; and removal of the central bank and state bodies (other than finance ministries) from fiscal and quasi-fiscal activities. A third group of measures, associated closely with the IMF Stand-By Arrangement (and subsequent Extended Structural Adjustment Facility), concerns the conduct of macroeconomic policy: stabilisation of prices and the exchange rate; reduction or elimination of budgetary arrears; strict wage policies; and restoration of relations with international creditors. A final set of measures is devoted to a host of structural issues, most notably privatisation, the labour market, competition policy, bank restructuring, pension and social policy reform, public administration, and the judicial system. In the FRY, and especially in Serbia, 2001 witnessed a substantial number of changes in economic policy, institutions, and laws. A calendar of the more important FRY, Serbian, and Montenegrin reform measures can be found in Annex I.1.

Although formally a part of the overall FRY reform programme, Montenegro has pursued reforms independently since 1998. It introduced the deutschmark (euro) as the currency in an effort to enforce fiscal discipline by denying the government access to easy borrowing from the central bank. In conjunction with this reform, the republic has fundamentally reformed the budget process and restructured the banking sector in partnership with a number of international and aid organisations. There are continuing plans that aim to restore the pension fund to solvency, consolidate extra-budgetary funds into the general government budget, eliminate remaining subsidies and resume foreign debt payments. The government intends to reduce substantially the level of informal economic activity. Montenegro has also completed a mass voucher privatisation programme that supplemented tender sales and auctions.

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1. The Memoranda can be found as appendices to the various IMF performance reviews of the Stand-By Agreement in 2001 and 2002, all of which can be accessed on the IMF website: http://www.imf.org/. In 2001, the Serbian government produced an Economic Recovery and Transition Programme in conjunction with the World Bank, elaborated in Government of the Republic of Serbia (2001).

Aggregate statistics show economic output recovering at a similar pace in 2000 and 2001 after a sharp decline in 1999: gross material product (GMP) grew by an estimated 6 per cent during both years.[7] However, the breakdown of this growth by sector reveals two distinct periods in this recovery: the year 2000 and the post-reform period of 2001 and 2002. With the exception of agriculture, which suffered from very poor weather, 2000 witnessed a substantial and broadly based rebound throughout the economy. Aggregate industrial production grew by 11 per cent, thereby reaching 85 per cent of its recorded level in 1998. However, output in 2001 followed nearly the opposite trend (Figure 3). Agriculture recovered from the poor weather in 2000, but aggregate industrial output remained flat. Falls in most sectors of light and heavy industry were offset by continued growth in the production of plastics, fibres, and other materials. This industrial slowdown continued into the first half of 2002, with industrial output actually declining by an estimated 1.4 per cent relative to the corresponding period of 2001. Industrial output in the first nine months of 2002 was a little higher (1.1 per cent) than during the same period in 2001.

(Figure 3. Gross material product, industrial output and agricultural output, 1998-2001)

Thus, the real sector of the FRY economy appears to be emerging from something akin to a mild transitional recession starting in 2001, though it is not yet clear that this establishes a sustainable trend (see Chapter II). It is possible that Yugoslavia has managed to escape a "transition recession" associated with the end of socialist economic management as the economy benefited from a rebound in activity following the catastrophic declines of the 1990s. Another other possibility is that Yugoslavia yet has a classic transition recession ahead of it.

Employment has followed a similar trend to output. After remaining at roughly 2.5 million from the beginning of the decade, aggregate employment in the FRY began to fall in 1999 and on into 2002 (Figure 4). In contrast to many other transition countries, registered unemployment is much higher than unemployment measured through labour market surveys carried out according to an ILO definition. Registered unemployment has remained above 25 per cent of the active labour force, though survey figures have been only about half this rate.[8] The difference evidently owes much to the presence of generous benefits, particularly for health, that accrue to the registered unemployed. A large number of workers who are informally employed register themselves as formally unemployed. The recent economic slowdown is associated with marginal reductions in employment on all three of these measures. Recorded employment edged downwards, and both registered and survey unemployment have shown marginal increases, respectively reaching 27 per cent and 12.2 per cent by late 2001.

(Figure 4. Employment and unemployment)

By adopting an exchange rate anchor, the National Bank of Yugoslavia (NBY) succeeded in substantially reducing inflation and stabilising expectations about prices and the exchange rate (Figure 5). After liberalising the foreign exchange market and unifying the exchange rate, the dinar has remained at close to 30 to the deutschmark (later 60 to the euro) since October 2000, with the NBY resisting some pressure for nominal appreciation. Montenegro employed a more extreme solution by adopting the deutschmark as a parallel currency in November 1999, and as its sole official currency a year later. In this context, retail price inflation (December on December) in the FRY declined from 114 per cent in 2000 to 39 per cent in 2001 (against a target of 40 per cent). Inflation has continued to decline rapidly in 2002, registering 9.2 per cent for the first nine months of the year. Annual inflation in 2002 will be below the official target of 20 per cent. This strong downward dynamic in inflation since the second half of 2000 is clearly visible in Figure 5. Despite its downward trend, the persistence of rather high inflation at the stable exchange rate has derived from three main factors: administrative increases in a number of (repressed) controlled prices, demand pressure associated with purchases of dinars reflected in the balance of payments, and wage growth (see Chapter II).

(Figure 5. Inflation, 1999-2002)

Serbia, and particularly Montenegro, have been incurring twin deficits in the republican budget and current account. To some degree, these deficits are the counterpart to inflows of official aid since 2001. Together in 2000 and 2001, Serbia received the equivalent of almost USD 1 billion in official aid, while Montenegro attracted in the region of USD 270 million between January 1998 and March 2002. Before 2001, explicit and implicit government spending in the FRY took many different forms, including numerous off-budget funds, loan guarantees, directed credits, and bank refinancing on soft terms. All of this off-budget fiscal and quasi-fiscal activity has not yet been quantified, so comparison of budgetary expenditures and deficits with the past are difficult. Before 2001, the official Serbian republican and federal budgets were close to balance on a cash basis, though this balance was achieved by building up expenditure arrears. The primary source of quasi-fiscal expansion was the NBY.

The 1.4 per cent deficit (in GDP) of the consolidated Serbian budget in 2001 was significantly smaller than that originally targeted in the IMF Stand-By Arrangement (6 per cent) (Figure 6).[9] This was largely due to inflation and tax collection exceeding expectations and, especially, lower access than expected to external sources of deficit finance. The planned Serbian deficit in 2002 (6 per cent) is considerably higher than that realised in 2001, in part because it includes debt servicing payments, while external support has again been significantly lower than projected. Whilst the Montenegrin government has incurred rather more substantial budget deficits in the past, it plans a deficit of some 5 per cent in 2002.

(Figure 6. Consolidated budget on Serbian territory and the Montenegrin budget, 2001)

Following war and foreign trade liberalisation, the current accounts of both Serbia and Montenegro have weakened on the back of expanding trade deficits (Table 2). Import growth has (un)comfortably exceeded rising exports. During 2001, Serbian imports grew by an estimated 30 per cent, while export growth was only 10 per cent, increasing the trade deficit to more than USD 2.5 billion and the current account deficit to USD 624 million (5 per cent of GDP). In this context, recorded imports in Serbia reached their pre-war (1998) levels in 2001, while exports remain almost USD 1 billion lower.[10] Rapid, although somewhat slower, Serbian import growth in the first half of 2002 (12 per cent) continued to widen the trade deficit. Montenegro, on the other hand, experienced a strong fall in both imports and exports in the first half of 2002 according to federal statistics.[11] Despite the widening deficit, capital account inflows (and strengthening local demand for dinars) have so far more than compensated for the negative current account. The NBY accumulated almost EUR 1.5 billion of gross foreign reserves between January 2001 and May 2002.

(Table 2. Foreign trade, 1990-2001)

Strong import growth in Serbia, though not in Montenegro, reflects not only a more liberal trade regime and inflows of official aid, but also a recovery in real wages and incomes since 1999 and a real appreciation of the dinar. It appears that roughly 60 per cent of additional Serbian imports in 2001 were of consumer goods (see Chapter V). Imports have thus accounted for an increasing share of retail trade, which grew by an estimated 16 per cent in real terms in 2001, 11 per cent higher than its 1998 level. According to official estimates, average real wages in the FRY grew by 13 per cent in 2001, and now also exceed their 1998 levels (Figure 7).[12] The recovery in aggregate demand and consumption has been slightly slower, due to the modestly declining employment discussed above.[13] Yet there is a notable contrast between rising domestic demand and retail trade, and the stagnation in most areas of domestic production, including consumer industries.

(Figure 7. Average real wage rate and retail trade)

Despite growing wages in 2000-2001, average incomes in the FRY remain low compared with the surrounding region. In 2000 the World Bank estimated that poverty in the FRY was twice as high as in 1990. It also notes that many households are clustered around the poverty line, so that small changes in income have a significant impact on poverty rates. Anecdotal evidence suggests that informal networks and *ad hoc* initiatives, rather than state benefits, shoulder much of the burden in alleviating poverty. In particular, households rely on support from informal employment, household agricultural plots, and accumulating payment arrears for utilities. The problems of poverty and grey activity are particularly acute in Kosovo, which formally remains part of Serbia although the lack of available data and slow progress in economic reform led to Kosovo being excluded from this Assessment. A summary of the situation in the territory is given in Box 3.

A significant share of the FRY fiscal budgets and foreign assistance has been directed at repairing the infrastructure damaged during the Kosovo war. The electrical power sector has been a particularly critical target, as a combination of low capacity and high demand at repressed prices has led to chronic shortages. Rolling blackouts have taken their toll on the economy and population. Aid has helped to finance repairs to damaged power stations, and to meet losses in the electricity sector generated by artificially low prices and problems with payment discipline. Of EUR 2.8 billion in foreign aid commitments to Serbia during 2000-04, 26 per cent has been earmarked to the energy sector. By

March 2002, repairs to existing installed capacity had lifted generation by 27 per cent during the winter of 2001-02 compared with a year earlier. Nevertheless, power shortages have continued to plague the FRY in 2002. The current initiative to increase energy prices to cost-recovery levels and improve regulation is a difficult, yet critical part of the FRY government reform programmes (chapter II).

The FRY achieved a primary objective in 2001 by normalising its relations with international creditors. Of foremost importance was the debt restructuring agreement reached with the Paris Club in November 2001, which wrote-off 66 per cent of outstanding debt (in present value terms).[14] Arrears to the IMF, World Bank, and many other international creditors have been consolidated and rescheduled in the context of new loan agreements. Negotiations continue with remaining foreign creditors to restructure outstanding debt to the London Club, an estimated USD 2.3 billion. Nevertheless, even under the terms agreed (and those expected to be agreed), servicing its foreign debt will become a significant burden on the FRY in the medium term (see Chapter II).

Box 3. **Kosovo**

Following intervention by NATO military forces during 1999, at the request of the United Nations the Yugoslav region of Kosovo and Metohija is no longer administered by the Serbian authorities in Belgrade. Under UN Security Council Resolution 1244 the UN Mission in Kosovo (UNMIK), headed by the UN Secretary General's Special Representative (SGSR), took over the civilian administration. It had a mandate, amongst others, to conduct border monitoring, and support reconstruction of the economy and key infrastructure. This interim administration is without prejudice to "the principles of sovereignty and territorial integrity of the FRY and other countries in the region"; Kosovo remains inside the FRY's international boundary.

In practice, the presence of UNMIK and the absence of further debate about what Kosovo's final legal status might be, have left the territory in a constitutional limbo that aversely affects economic management. For instance, it is unclear to what extent Kosovo's foreign debts,[1] formally the liability of the sovereign government in Belgrade, will have to be serviced locally; nor whether UNMIK has the power to alter tariffs or dispose of state-owned land. This legal uncertainty seems certain to act as a barrier to foreign investment though other factors, notably the lack of basic physical security or a functioning legal system, are likely to act as greater disincentives.

Kosovo's economy is in poor condition, though recorded statistics ignore the prodigious amount of economic activity that takes place in the grey economy. Population growth outstripped the economy during the 1980s and 1990s, and per capita income fell. Indeed by 2000 more than half the population was living in poverty, with some 12 per cent living in extreme poverty (World Bank, 2001b). Although economic activity is heavily concentrated in agriculture, there has been migration off the land to the cities as the service sector, and especially construction, has grown rapidly. This has put ever greater pressure on dilapidated civil infrastructure. This has been particularly apparent in the energy sector, which has been unable to meet demand despite concentrated efforts to rehabilitate capacity in electricity generation and distribution. It is also the case that Kosovo lost a certain amount of human capital with the emigration of ethnic Serbs during and after the 1999 war.

Macroeconomic policy is very constrained. Kosovo has adopted the euro as its official currency, so there is effectively no monetary policy. On the fiscal side, the economy is heavily reliant on private and public transfers. Expatriate Kosovars have traditionally made very significant remittances from abroad. In 2001 these amounted to some EUR 400 million (25 per cent of GDP). The IMF has calculated that consumption is as much as 146 per cent of GDP. Following the war, Kosovo has also been cut off from Serbia, its largest market. Revenue collection within Kosovo has increased. This is mainly due to the introduction of a VAT in July 2001, and application of excises on all manner of goods in addition to the typical list of alcohol, petrol and tobacco.[2] In 2001 Kosovo ran a fiscal surplus (2.4 per cent of GDP), even before grants, though excluding capital reconstruction expenditure, which is fully financed by official aid. However, the government is not yet providing even adequate basic services in health and education.

Box 3. **Kosovo (contd)**

UNMIK has promoted the creation of new institutions in Kosovo, though it will take time for these to bed in, and there are already strains over where the boundaries lie between the authority of UNMIK and local institutions. This process is taking place whilst the polity remains divided and fragile, and violence lies barely beneath the surface. Against this background structural policy has made some advances, but has become a casualty of political paralysis. Regulations requiring firms to register have met with some success: more than 20 000 small enterprises registered during 2001 (International Crisis Group, 2001). However, allowing small firms a dispensation from keeping proper records undermines much of the benefit. For the time being privatisation has stalled. As well as a debate over the legality of sales now, and questions of annulling privatisations during the 1990s, the principle of selling state assets is not generally accepted. Another concern is over whether, or how, to share privatisation revenues with the government in Serbia. There is nevertheless a lot of private sector activity: agricultural land is 90 per cent privately owned (though not the food processing industry), and according to some estimates more than half of GDP was privately generated, even in 1995.

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1. These are estimated to be some USD 1.4 billion, of which USD 440 million is to the Paris Club.
2. UNMIK levies excises on soft drinks, video recorders, satellite dishes, televisions and telephones.

II. MACROECONOMIC PERFORMANCE AND POLICY

The federal, Serbian, and Montenegrin governments have moved quickly to place economic policy on a sound footing. They have opened the economy, restructured the banking sector, and adopted legislation in many areas aimed at integration with the European Union, though these laws may not fully meet the requirements of the *acquis*. The distortions and inefficiencies of the past imply the existence of potential capacity that can be harnessed to reverse the severe decline of the past decade, and to provide a basis for sustainable growth. Nevertheless, the rapid pace of change and the severity of inherited problems complicate this transition. The real sector of the economy has had to adjust to a sudden drop in liquidity, fewer subsidies, a crackdown on tax avoidance, and greater foreign competition. Whilst an important degree of stabilisation and fiscal consolidation has been achieved in recent years, maintaining fundamental macroeconomic balances will depend increasingly on achieving a strong economic revival. The speed of this revival will, in turn, depend on fostering a robustly competitive environment for business and investment in the region. Given the significant number of firms with poor governance or questionable economic viability, a difficult process of restructuring still lies ahead (see chapter IV). This process can be greatly facilitated by the development of a dynamic and flexible legal private sector that was largely suppressed in the FRY during the last decade.

A raft of new legislation affecting most areas of the economy has accompanied the government's reform initiative. The very volume of new legislation will strain Yugoslavia's administrative capacity to implement the changes that have been set in train. Already the system of justice is proving to be a bottleneck, with the courts struggling to absorb new legislation and the volume of new cases. Similar strain is likely to affect the administrative capacity of government: ministries have to draft bylaws and other regulations called for in primary legislation. Furthermore, supervision by parliament and other bodies, such as new independent "councils", will have to keep pace with a rather fluid regulatory environment.

Sustainability of the current macroeconomic policy framework faces a number of challenges. In the medium term, the level of foreign aid is likely to decline at precisely the time that scheduled foreign debt servicing will mount. Social policy reform will most likely demand increasing attention and up-front resources. As discussed further in this chapter, effective macroeconomic policy will have to walk a number of tightropes. Notably, greater exchange rate flexibility may need to be introduced in Serbia, but in a manner that does not destabilise expectations. Commercial banks require opportunities to re-establish commercial lending, but must be prevented from developing irresponsible or excessively risky portfolios. The costs of restructuring and debt service place demands on the budget, but firms' tax liabilities must be maintained low and stable enough to make the FRY competitive with its neighbours. Successful resolution of these difficult problems and trade-offs would be much easier against a background of rapid economic growth and investment.

This Chapter examines recent performance of the FRY economy, giving attention to questions of economic growth, the balance of payments, the macroeconomic policy framework, and commercial banking. A rapidly changing environment and policy mix, together with remaining weaknesses in basic data, complicate an assessment of the current economic situation in the country. Nevertheless, some fundamental problems and trends can be identified. Given the substantial amount of attention devoted to macroeconomic policy in a number of other recent reports on the FRY economy, this Assessment places particular stress on the performance of FRY firms and the barriers to, and prospects for, growth.[15]

Economic growth: problems and prospects

As indicated in Chapter I, economic decline in the 1990s reduced recorded GMP (gross material product) per capita in the FRY by more than half. This decline was associated with changes in the structure of output (Table 3). The share of manufacturing and mining fell from half of GMP in 1989 to less than one-third of GMP by 1998. Agricultural production has been more stable, consistent with an increase in the share of agriculture (together with forestry and hunting) from 15 per cent to 22 per cent of GMP over the same period. The economy has also become more oriented toward trade and services.

(Table 3. Shares of gross material product by sector)

Domestic industry began a rapid recovery in 2000. It grew by an estimated 11 per cent, regaining half the calamitous 23 per cent fall in 1999. Industrial growth was quite broadly based, though with some concentration in textiles, metals, mineral products, chemicals, and plastics (Table 4). GMP grew much slower during 2000 than industry due to poor weather and a disastrous harvest. Agricultural output fell by 13 per cent. However, the industrial recovery that was underway in 2000 all but came to a halt in 2001, and this slowdown continued into 2002, with industrial output down by an estimated 1.4 per cent for the first half of the year relative to the same period in 2001. The third quarter showed an improvement. During the first nine months of 2002 industrial output still declined in Montenegro (-2.7 per cent), but increased slightly in Serbia (1.3 per cent).[16]

(Table 4. Industrial output: 1998-2001)

In contrast to 2000, recorded GMP growth of 6.2 per cent in 2001 can be attributed almost entirely to a recovery in agriculture. However, though the positive trend of 2000 in industry, construction, and transport came to an end in Serbia, it continued to underpin recovery in Montenegro. Altogether, industrial output levelled off at only 86 per cent of its 1998 level. Within major industrial sectors, only the production of chemical, rubber, and plastic products continued to exhibit the same strong upward trend as in 2000. Many sectors that showed strong signs of recovery in 2000 moved into decline in 2001, including mining, food products and tobacco, textiles, leather and footwear, metals, machinery and equipment. After significant growth in 2000, construction and freight transport also registered strong declines of 13 and 20 per cent, respectively. The relatively poor performance of domestic industry is particularly striking in light of the continued growth of incomes, consumption, imports, and retail trade in 2001. Although industrial exports outpaced growth of output in 2001 and early 2002, this performance appears modest relative to the past (see Chapter V).

The puzzle of weak recovery

The weak recovery of output and exports is a puzzle that deserves some attention. Since the end of 2000 the FRY has benefited from an absence of war and the lifting of embargoes and sanctions. The recent period has also witnessed trade and price liberalisation, stabilisation, rising real incomes and substantial inflows of international support. At first glance, this would appear to create quite favourable conditions for a rapid recovery. But there are a number of causes that potentially account for the sluggish performance of domestic industry. Changes in macroeconomic policy have also reduced the availability of subsidies to some firms and organisations, and arrested the accumulation of arrears. A virtual collapse of the banking sector and domestic financial markets has severely restricted access to liquidity for many FRY firms. Foreign trade liberalisation, growth in domestic labour and energy costs, and a steady real appreciation of the dinar since 2000 have exposed FRY firms to increasing foreign competition.[17] A common perception is that new laws and regulations may have also increased the overall (both formal and informal) burden of government on many businesses. The capital stock, including basic infrastructure, is depleted following years of war and low investment. The Kosovo war created new borders, with a corresponding growth in bureaucracy and costs for the movement of individuals and goods. Finally, the accuracy of official statistics in documenting recent trends can be questioned. Official statistics appear to be biased towards activity in larger firms, many of which depended on soft credits and other subsidies, while activity in parts of the service and SME sectors is poorly monitored.

It is important to assess the relative weight of all these factors in explaining the recorded slowdown in growth before considering future prospects in the FRY economy. To what extent is the current sluggishness of economic growth a statistical artefact, a process of short-term adjustment, or a consequence of deeper structural deficiencies that only time or changes in economic policy can overcome? While the accuracy of official statistics may leave much to be desired, evidence presented below and in Chapter III nevertheless suggests that the recession is not limited to relatively well-monitored large state or socially-owned firms. On balance, smaller firms also appear to face difficult, possibly growing, problems, although these look to be qualitatively different from those faced by larger firms. Overall, given recent measures to reduce grey economic activity, official growth statistics could either over- or understate changes in economic activity.

Some recent reports on the FRY economy emphasise the deterioration of the capital stock during the previous decade both as an explanation of the low level of output and as a major constraint on growth.[18] Indeed, during the 1990s investment was persistently too low to replenish the existing capital stock, which had an enormously detrimental effect on capacity over the decade. In addition to the low volume and questionable efficiency of fixed capital investment during the 1990s, the war of 1999 caused some damage to the capital infrastructure of the country, particularly in water transport, bridges, railway and electrical power. While the absolute magnitude of this damage is difficult to measure, it seems somewhat unlikely that it is a primary explanation for why the rapid industrial recovery of 2000 came to a halt in 2001. Infrastructure and capital stock were in even worse condition during 2000 than 2001, as investment and foreign aid must have improved the situation, at least marginally. For example, whilst rolling electrical blackouts surely impeded production in 2001, they were even more common during 2000.

It has been harder, and more expensive, for FRY firms to access Kosovo markets since the war in 1999. This will have affected output and trade to some degree. Nevertheless, this effect is also almost certainly of secondary importance in explaining the current slowdown. Firstly, rough estimates suggest that Serbian trade with Kosovo before the war amounted to no more than USD 250 million (significantly less than 5 per cent of total trade).[19] Secondly, the restoration of severed trade links after the war should have been more advanced in 2001 than in 2000. In any case, the volume of trade is too small for this effect to have had a strong impact on aggregate Serbian output.

The impact of reform on enterprises in Serbia

The effect of some of the other factors mentioned above is at least partly visible in the financial balance sheets of Serbian firms, which account for the vast majority of economic activity in FRY industry.[20] The Serbian Bureau of Clearing and Payments, known by its local acronym ZOP,[21] maintains a database of all (recorded) transactions in Serbia, as well as all regular enterprise financial returns.[22] We have selected balance sheet indicators for 2000 and 2001 relating to the economy as a whole, as well as for four individual sectors: industry and mining, construction, agriculture, and trade (mainly retail trade). The separate information on industry and mining facilitates the identification of factors behind the industrial slowdown. Construction serves as an imperfect proxy for investment activity. Finally, agriculture and trade have specific characteristics, and were apparently areas of economic growth in 2001. In addition, we have given separate consideration to small businesses (see also Chapter III). This serves to illustrate how problems in the small business sector differ qualitatively from those of larger firms.

Despite the comprehensive coverage of ZOP data, it is far from complete. In particular, a substantial number of transactions in the FRY economy avoid the ZOP network through the use of cash or barter. Keeping at least some share of transactions in the grey economy not only helps evade taxes, but also avoids the significant fees (since reduced) that ZOP levies on all transactions. Nevertheless, most legitimate FRY firms, particularly outside of small agriculture and trade, would appear to channel the majority of their transactions through ZOP. However, numerous small farmers and traders do operate entirely outside the ZOP network, and hence the data on these sectors should be treated with caution.

Table 5 presents a few basic indicators of performance in 2000 and 2001 for Serbian firms. For the economy as a whole, all sectors under consideration showed a real decline in sales in 2001. Whilst growth in recorded output volume is not necessarily inconsistent with a decline in the real value of sales, one suspects that results for agriculture and trade in 2001 would be positive if they included transactions outside the ZOP network. Construction experienced a particularly difficult year in 2001, due in part to much lower government spending in this area. With the exception of trade in 2000, firms reported aggregate net losses and operating losses in both 2000 and 2001. Dramatic net losses in industry in 2000 are partly due to revaluation of long-term (frozen) foreign currency denominated debts (see below) following strong depreciation of the dinar. Operating profit, consisting of sales revenue minus production costs, offers a better picture of the state of Serbian industry than does net profit. After correcting for differences in depreciation between 2000 and 2001,[23] operating results for the economy as a whole are similar in the two years. Industry and agriculture showed marginal improvement, construction and trade some deterioration.

(Table 5. Selected balance sheet indicators of Serbian firms, 2000-01)

Small businesses account for the majority of activity in the trade sector. In contrast to larger firms, small businesses appear to have experienced a measurable decline in operating profitability in 2001 relative to 2000. This is consistent with the evidence gathered in the business survey summarised in Chapter III. Two leading factors behind the decline in operating profits for small businesses are higher wage costs and declining margins from the resale of purchased goods. Given survey evidence that wage rates have not increased significantly over the period in question, higher wage costs in the ZOP data most likely reflect a new regulation in 2001 that reclassified non-wage benefits as wages (see below). Declining profit margins on intermediate sales activities probably reflect greater competition on domestic markets, including that from imported goods. Nevertheless, average efficiency in smaller firms remains much higher than in larger firms (Table 6). While accounting for 29 per cent of sales recorded by ZOP, small firms were, on average, only responsible for 10 per cent of all operating losses in 2001, and only 2.5 per cent of net losses.

(Table 6. Share of aggregate sales and losses in small firms)

The ratio of labour costs to net wages in the FRY reveals a relatively heavy burden of taxation on labour (Table 5). Combined social security contributions and taxes for the employer and employee are roughly equal to the net wage paid to the worker. As discussed below, tax reform in Serbia has emphasised a shift from direct labour taxes to indirect (sales and excise) taxes. Measures to reduce the burden of labour taxes have had some impact: labour costs fell from about 130 per cent of net wages in 2000 to 100 per cent in 2001.[24] The "tax wedge" fell from 51.3 per cent in 2000 to 46.5 per cent in 2001, still higher than the OECD average.[25] Nevertheless, many firms, especially small businesses, complain that the actual burden of labour taxation may have actually have grown for three reasons. Firstly, new regulations reclassified non-monetary labour compensation as wages for the purposes of calculating firms' tax liability. As indicated above, this is a likely reason for the significant reported increase in small firms' unit wage costs in 2002. Secondly, though greater monitoring and higher fines, the government has been reducing the widespread practice of evading labour taxes either by hiring workers informally or understating compensation. Lastly, the government appears to have shown less tolerance towards chronic accumulation of arrears in payment of taxes and social security contributions.

Table 7 presents measures related to liquidity and its evolution in Serbian firms during 2000 and 2001. The so-called quick ratio is a commonly employed measure of short-run solvency. It represents the ratio of current liquid assets (current assets less stocks) to current liabilities. A ratio of 1.00 or more shows that firms can meet their current liabilities out of their current liquid assets. There is no optimal value for the quick ratio, which depends on the structure of finance and the sectoral mix of industry. However, given the current conditions in Serbia one would expect a value for the ratio to exceed 1.00 by some margin.[26] FRY firms appear considerably less liquid than this standard, with smaller firms slightly more liquid than larger ones, although there is no marked change between 2000 and 2001.

(Table 7. Measures of liquidity for Serbian firms, 2000-01)

The evidence in Table 7 clearly suggests a severe tightening of the liquidity constraint for larger firms, particularly in industry. Industrial firms formerly financed their operations with short-term credit amounting to the equivalent of 31 per cent of sales, and utilised average payment delays of the equivalent of 36 days. In 2001 these had fallen to 15 per cent and 24 days. There was a predictable expansion of inter-enterprise loans among these firms in response to this liquidity crunch, but it did not fully compensate. The sharp fall in short-term credit and current payables was concentrated in large firms, strongly suggesting that most of this former credit might have been "soft" finance for operational losses. The situation for small firms, outside agriculture, is quite different. These firms have always operated with very low average levels of credit, and the availability of credit did anyway not decline in 2001. In fact, international support for small business during 2001 may have contributed to the slight increase in credit to small businesses (as a share of sales) during the year.

Although it is difficult to identify the various subsidies paid to FRY enterprises, Table 8 presents some measures related to this area. The first line shows the receipt of direct subsidies and grants to FRY enterprises. Direct subsidies and grants, measured as a share of all sales, did not change much in 2001, although the aggregate figures in Table 8 most likely disguises important changes in the allocation of these resources. Discretionary fiscal support was curtailed (see below), while a number of foreign-backed grants in 2001 focused specifically on supporting the energy sector and rebuilding infrastructure. Cheap energy, especially electricity, constitutes another important form of subsidy for manufacturing firms. The table shows that unit energy costs increased measurably in 2001 relative to 2000, particularly for large industrial firms, indicating a decline in average energy subsidies. As discussed below, however, energy prices have remained repressed, and payment discipline is often still difficult to enforce. Tax arrears represent still another implicit form of subsidy in the FRY, and since a Decree in June 2002 tax arrears are fully written-off in enterprises that are privatised. In addition to a substantial subsidy from tax arrears that are never paid in full, a number of businesses have complained bitterly that arrears on taxes and social contributions can be tolerated on a selective firm-by-firm basis, thus casting a shadow over the environment for fair competition. ZOP data apparently does not record the majority of tax arrears in Serbia, particularly those associated with social contributions, as this gross amount is known to be much larger than the numbers given in Table 8. However, the amount of tax arrears that are recorded by ZOP did not change much as a share of sales between 2000 and 2001. Wage arrears to employees also remained fairly constant as a share of sales in 2001.

(Table 8. Measures of subsidies to Serbian firms)

In sum, several factors can be identified as contributing to the disappointingly sluggish economic recovery in the FRY. They appear to have affected larger and smaller firms differently. Larger firms, particularly those in industry, have faced a severe liquidity crunch. Unprofitable firms are finding it harder to raise external finance to cover their losses, either through credits or arrears. Firms that relied heavily on short-term credit for working capital have been forced to make rapid adjustments. Smaller firms did not on average experience much change in access to credit, though there has been some increase in (internationally-funded) micro-credit lending. Instead they faced what appears to be a profit squeeze from higher input costs and, possibly, fiercer competition, including that from imports (see Chapter V). This profit squeeze most probably also affected many larger firms. It is possible that the rather small decline in aggregate operating losses for larger firms in 2001 is a combination of two factors acting in opposite directions: a large fall in losses from firms that can no longer finance loss-making activity, and a significant increase in losses in other firms for the same reasons as found in smaller businesses.

To what degree might these problems reflect only the strains of short-run adjustment, as opposed to longer-term structural barriers to growth? To one degree or another, both difficulties are present. While restructuring of the banking sector and restoration of credit markets promises to be a gradual process in coming years, the development of institutions to support short-term credits for working capital and exports might emerge relatively rapidly. This would particularly be the case where government took measures to protect the rights of commercial creditors, notably for secured loans. Many firms that received an initial shock from lower liquidity are most likely making short-term adjustments to the new realities that may support a revival of activity in the near future. Difficulties in the overall competitiveness (low profitability) of FRY firms, and a possible deterioration of the business climate for small enterprises, are causes for more immediate concern. There are no quick and simple solutions for the significant number of non-viable industrial firms in the FRY economy. The speed of restructuring depends both on the development of effective institutions of bankruptcy and a dynamic new private sector. The latter should play a critical role in re-employing labour and capital more efficiently, and in attracting direct foreign investment

Concerns about the competitiveness of FRY firms relate partly to the steady real appreciation of the exchange rate. Montenegrin inflation exceeds that in the euro zone by a considerable margin. In Serbia, the dinar appreciated by about 35 per cent in real terms during 2001 and 2002 (Figure 8). The real value of the dinar had already reached its pre-war value (December 1998) in mid-2001, and is now approaching its level in December 1996. Labour costs and imports have also rebounded to pre-war levels, but exports remain roughly one third lower. Although balance of payments pressures for appreciation may be beginning to subside, the necessity of further administrative price rises for energy and transport presages further real appreciation (see below). Given the limited scope to affect the real exchange rate constructively through monetary policy in the FRY's current context, the business environment may require a boost in other forms, such as lower taxes, and a strong effort to enforce fair competition and to attract foreign investment.[27]

(Figure 8. The real exchange rate)

The energy sector

The energy sector has been a source of serious instability in the FRY economy over recent years. Resolution of these problems is an essential step towards attaining sustainable growth. During the 1990s the energy sector was a vital part of the economy, and still provides half of all tax revenue. Due to its size and geographical location, a stable and efficient energy sector in the FRY is needed for the development of regional energy interconnection and trade. Problems in the energy sector reflect the cumulative effect of polices that channelled mass subsidies to firms, and the population, through cheap energy. This stimulated excessive and wasteful consumption, whilst at the same time depriving the energy sector of capital to develop its capacity to meet growing demand. Electrical power has been a particularly acute problem in both Serbia and Montenegro, which have in recent years experienced frequent disruptions in power supply and rolling blackouts. Although it possesses potentially advantageous power infrastructure, including a good share of relatively cheap hydroelectric capacity, the FRY has nevertheless turned from being an electricity exporter to the region at the outset of the 1990s to being strongly dependency on energy imports (Figure 9). Net imports reached a high of 8 per cent of electricity consumption in Serbia in 2001. Montenegro relies even more heavily on imports, which have reached one third of all electricity supplied in the republic.

(Figure 9. Net imports of electricity to Serbia)

Real average electricity prices fell by 59 per cent between 1997 and 2000 in Serbia, as tariff increases lagged far behind inflation (Figure 10). The price per kWh fell to the equivalent of US cents 0.9 in 2000, five times lower than the unit cost estimated by World Bank and other international experts.[28] Effective electricity prices were even lower due to widespread non-payments and non-equivalent barter arrangements. Despite some improvement in payment discipline, the Serbian electricity company, Elektroprivreda Srbije (EPS), still did not receive payment for as much as 34 per cent of all electricity supplied in the first four months of 2002. During this time, however, EPS did succeed in reducing the share of barter in receipts to 5.5 per cent, down from 34 per cent in 2000 and 24 per cent in 2001.[29] Electricity prices were finally increased to an average of US cents 1.6/kWh in 2001 and US cents 3.2 in July 2002. They are scheduled to follow a stepwise upward adjustment, reaching US cents 4.0 cents in 2003 and US cents 4.5 in 2004. The adoption of new electricity tariffs has helped stabilise EPS's income as well as promoting energy efficiency.

(Figure 10. Average electricity prices in Serbia, 1996-2001)

Cheap electricity has doubly damaged the FRY economy. On the one hand, the electrical power sector has been deprived of resources needed to maintain capacity and make investments. On the other hand, cheap energy has motivated an unfortunate shift towards relatively costly and inefficient electrical heating systems.[30] Despite a recorded fall in output and incomes of more than 50 per cent during the 1990s, per capita electricity consumption increased by an alarming 44 per cent. Most of the increase in demand has come from electrical heating by households as electrical energy became relatively cheap compared to other fuels such as natural gas, district heat and even wood. While industrial electricity consumption fell during the 1990s, the share of household consumption in all electricity use increased from 36 per cent to 55 per cent.[31] At the same time the efficiency of electricity generation itself declined as EPS inputs of coal, water, consumables and workforce per kWh increased.

In Montenegro, the single giant aluminium firm, Kombinat Aluminijuma Podgorica (KAP), consumes an estimated 45 per cent of all electricity in the republic. Throughout the 1990s, this plant accumulated huge electricity debts that were continually restructured. In April 2002, average electricity prices reached US cents 3.0/kWh, although KAP continued to receive a special subsidised price of US cents 2.0/kWh.[32] As indicated above, Montenegro has continued to import a much higher share of electricity than Serbia. The lowest import price paid by the Montenegrin electricity company (EPR) is more than US cents 3.0/kWh, and on average import prices range between US cents 4.0 and 5.0/kWh. This is somewhat less than the US cents 2.0/kWh paid by its biggest customer, KAP. Thus, despite the somewhat higher prices for electricity paid in Montenegro than in Serbia by consumers other than KAP, the EPR has continued to shoulder huge losses in the manner of its Serbian counterpart.[33] In fact, electricity shortages and blackouts have been even more serious in Montenegro than in Serbia. As in Serbia, payment discipline has been a problem. EPR only managed to obtain payment for 79 per cent of electricity supplied in 2001, 30 per cent of which was in barter.[34]

The coal, oil, gas and district heating sectors have also been problematic in recent years. The Serbian coal industry has been required to supply thermoelectric plants with coal (lignite) at below cost, with corresponding losses financed largely through soft loans. Serbian oil refineries' equipment is obsolete, and suffered significant damage during the Kosovo war. For natural gas, Serbia relies on imports from the Russian Federation. Intermediaries within the country have been obliged to supply this gas domestically at below cost, leading to the accumulation of losses and payment arrears that have been a source of the strained economic relations with Russia and the Russian gas monopoly, Gazprom. The government has made progress in these relations in recent years, and has performed better in making current payments for energy. Nevertheless, tensions persist under the constant threat that Gazprom will restrict supply. The Serbian government has launched price adjustments for natural gas and district heating in an effort to reduce the use of electrical heating systems by providing alternative sources of energy.

The causes of the energy crisis in the FRY are rooted in unsustainable and highly inefficient policies, with further complications arising from damage to infrastructure during the Kosovo war. This crisis therefore has a straightforward, although politically difficult, solution, involving a combination of a new energy policy and the selective reconstruction of damaged infrastructure. It is expected that domestic energy consumption will remain below its pre-war level as industry recovers only slowly and households respond to higher energy prices by reducing their demand. Foreign aid and Serbian budgetary resources have been channelled toward repairs in the electrical power sector, and several damaged power plants had their capacities restored or increased in 2001. In October 2002, a 600 MW plant, representing some 10 per cent of domestic electricity production, was brought back into service having been completely refurbished.

The Serbian and Montenegrin governments have shown a resolve to implement painful but necessary real increases in energy tariffs in a stepwise manner (Chapter I). The special case of KAP in Montenegro remains politically difficult. Given the dominance of this firm in the Montenegrin economy, however, this problem will need to be confronted sooner or later. Other institutional reforms in the energy sector have been planned along with foreign support. This includes the creation of an independent regulatory body, and a reorganisation that will break apart the electricity monopoly, introducing competition into generation and supply. However, the FRY has not yet established energy policy guidelines, nor relevant institutions, raising concerns that both reforms and the energy sector will fragment. The International Energy Agency (IEA) recently stated that the "rehabilitation process appears to be too focused on large electricity supply and transport projects whereas the objectives at the government and power companies (EPS and EPR) levels have not yet been set. Furthermore, the cost-effectiveness of large rehabilitation projects cannot be verified as up-dated electricity demand forecasts and least cost plans have not yet been developed".[35]

During the 1990s central European countries have reformed their energy sectors by adopting new energy policies, developing new institutions, enforcing the regulatory framework and restructuring energy companies. The FRY will have to do similarly in order to achieve a more efficient energy sector, which is still at the first stage of reform. The authorities should put in place a new energy policy, including a forecast of demand and measures to improve energy efficiency and environmental performance. They should reinforce the capacity of government to co-ordinate and implement market reforms, and strengthen corporate governance in the energy sector, notably in ensuring an arms-length relationship between the government and state-owned companies. In due course, the government should progressively seek to separate the development of energy policy, regulatory enforcement and the energy companies. The introduction of competition into the sector is realistic medium term goal, which can take place once the sector has been stabilised and rationalised.

Agriculture

Whilst the energy sector has been a source of instability in the economy, in Serbia agriculture has played a vital role as a safety buffer. It is much less significant in Montenegro, though agriculture has always been central to the FRY economy. In 2000 the country had 5.4 million hectares of utilised agricultural area (UAA), similar to that in Bulgaria and Hungary, though dwarfed by the 14.8 million hectares in neighbouring Romania. As indicated above, agricultural output remained relatively stable during the years of decline, bringing its share in GDP to 28 per cent by 2001. While registered employment fell in the economy as a whole, agriculture increased its share of employment by 2 per cent (600 000 people) between October 2000 and October 2001. As well as constituting a growing share of GDP, the agricultural sector has played an important part in sustaining the population during the 1990s and to the present day, notably through subsistence production and the distribution of food through informal networks.

The average size of agricultural holdings in the FRY is quite small by EU standards. Average FRY farms comprise 3.4 hectares (Ha), as compared with an EU average of some 18½ Ha. Only three EU countries have average farm sizes below 10 Ha.[36] This difference persists for the largest farms. Even amongst farms larger than 10 Ha, average size is only 15 Ha. This distribution is partly a consequence of ownership. As in Poland, agricultural land in Yugoslavia was never collectivised and has remained almost exclusively in private hands: private holdings accounted for 85 per cent of the utilised agricultural area in 2000, and a similar share in output.

Agriculture suffered less than industry during the 1990s, notably due to increased subsistence farming. However, agricultural productivity fell as the trade embargo limited access to agricultural inputs, especially oil, fertilisers, seeds, tractors and machinery. The FRY started the decade as a net food exporter, but a steady deterioration led to a net trade deficit on food in 2001 of USD 166 million. This deficit emerged as agricultural exports fell by more than 50 per cent during the decade, at least partly due to protective policies that placed export quotas on some agricultural products, notably wheat.[37] Yields in production of grains and vegetables also suffered from a lack of fertilisers during the period of trade disruption. Consumption of mineral fertilisers in 2000 was less than one-third of its level a decade earlier. Overall, between 1997 and 2001 yields in wheat, cereals, maize and vegetables all fell steadily. Nevertheless, in 1997 FRY was still a relatively efficient Balkan producer in terms of yield, even if it could not match FYR Macedonia's efficiency in production of vegetables. Yields of wheat and cereals met or exceeded levels in Poland and Romania, though, again, fell a long way short in vegetables. The yield gap between FRY and Hungary widened between 1997 and 2000, though this points to some productivity 'headroom' that could be recovered if the sector is able to invest and restructure.

The balance of payments

Most of the macroeconomic trends discussed in this Assessment are reflected in the FRY balance of payments. A positive evolution in the balance of payments position of Serbia and Montenegro will be critical to the success of the current economic programme. Table 9 summarises some of the main items in the FRY balance of payments between 1997 and 2001. Montenegro is fully included in this balance only until the end of 1999; from then on the balance of payments includes only trade data in respect of Montenegro. More recent developments in that republic, based on limited data, are discussed below. This section summarises general trends in the balance of payments, foreign trade is examined in more detail in Chapter V.

(Table 9. The FRY balance of payments, 1997-2002)

Statistical inconsistencies complicate the comparison of more recent years with the past. Firstly, recent initiatives to reduce widespread smuggling, particularly of oil and tobacco products, imply that a higher share of imports is probably recorded now than previously. Thus, imports in earlier years are probably understated compared with current figures. Secondly, in the past a large share of inflows into the country avoided the banking system and went unrecorded, thus making older figures on transfers and other inflows suspect for comparative purposes. According to official figures, current transfers, mostly remittances, grew from USD 310 million in 1997 to USD 1.2 billion in 2001, though this almost certainly reflects underreporting of the inflows for 1997 as opposed to a genuine surge in remittances**.** Since both inflows and outflows went unrecorded, interpretation of the overall current account position in relation to previous years is rather ambiguous.

Nevertheless, it does appear that import growth comfortably outstripped growth in exports over 2000-01. During this two-year period, reported imports increased by an estimated 47 per cent. Overall macroeconomic trends in the country, notably recession in domestic production at a time of increasing demand and retail trade, suggest that much of this recorded growth in imports was not simply due to better reporting. During this same period, exports grew by 19 per cent, but in 2001 were still one-third below their pre-war levels. The resulting increase of over USD 1 billion in the recorded trade deficit in 2001, relative to the pre-war year of 1998, was compensated in the current account by an equivalent increase in recorded inflows from official grants (USD 563 million) and remittances. Particularly given the probable bias in the data from 1997-1998, current account figures suggest that the overall volume of foreign trade was significantly higher in 1998 than in 2001.

Although data for the first six months of 2002 show a marginal decline in the dollar value of Serbian exports (relative to the same period of the previous year), preliminary figures for the subsequent months show that export performance has improved (Table 9). Preliminary figures show that exports in the first nine months of the year were 15 per cent higher than during the same period in 2001. At 21 per cent, imports for the first nine months also continued to grow strongly, thereby further widening the trade deficit.

The current account deficit in 1997-1998 was financed by inflows of foreign direct investment, almost entirely due to the USD 1 billion sale of Serbian Telecom. In contrast, the strong capital account in 2001 is due to higher demand for dinars, and growth in foreign currency accounts in domestic banks. Inflows from these two sources alone amounted to an estimated USD 632 million in 2001, 56 per cent of which was due to currency conversion. Credits and foreign direct investment accounted for another USD 300 million. Given the source of foreign currency inflows, the National Bank of Yugoslavia and FRY commercial banks succeeded in accumulating USD 637 million in reserves during the year. Capital flows during early 2002 were stronger than a year earlier, partly due to temporarily advantageous conditions for converting cash deutschmarks into euro-denominated bank balances, boosting the deposit base of commercial banks by almost EUR 700 million during the first six months of 2002. The demand for dinars continued to increase during the first half of 2002, adding to an inflow of USD 167 million FDI following the first tender privatisation (in the cement industry).[38]

The rapid expansion of dinar demand reflected greater confidence in the currency, but is likely to stabilise in the near future. The invisibles balance should also weaken steadily, as the burden of foreign debt servicing increases while inflows of foreign aid declines. For these reasons, export growth and attracting foreign direct investment will become increasingly important in maintaining Serbia's balance of payments position.

Montenegro now publishes a separate balance of payments (Table 10). According to this new information, Montenegro's trade deficit widened sharply from USD 298 million in 2000 to USD 375 million in 2001, equivalent to about 29 per cent of GDP. The balance of payments position in Montenegro has been supported by relatively high inflows of official aid (Chapter I). As this foreign aid declines, Montenegro will also be faced with the need to increase exports or attract significantly higher levels of FDI.[39] Relative to Serbia, the Montenegrin balance of payments presents some additional concerns. Since Montenegro has adopted the euro as its currency, any necessary real exchange rate depreciation would have to occur through an economically and politically difficult process of disinflation.

Secondly, the giant aluminium plant Kombinat Aluminijuma Podgorica (KAP) dominates Montenegrin exports.[40] International financial consultants disagree about the firms long term viability.

(Table 10. Montenegro balance of payments, 2000-02)

Monetary policy

The conduct of monetary policy in the FRY since 2001 represents a radical break with the past. Prior to 2000, the distinction between fiscal and monetary policy was quite murky. The NBY essentially pursued fiscal objectives through loan polices and guarantees to select banks, firms and organisations. While the explicit state budget remained close to balance, a large share of implicit government expenditures were realised though the expansion of credit in this way, a process that eventually led to macroeconomic imbalances, strong inflationary pressures, and the decapitalisation of the banking sector. Since 2001, the NBY has all but dropped this quasi-fiscal function, concentrating instead on containing inflation, maintaining exchange rate stability and improving the regulation of commercial banking. Directed credits have apparently been discontinued. Given the weakness of financial markets and the banking sector, however, the scope for monetary policy has been quite limited. This is particularly the case in Montenegro since the adoption of the euro as its domestic currency. For that reason, almost all of this section is devoted to Serbia.

Officially the exchange rate is a managed float, used by the NBY to anchor monetary policy in Serbia. The value of the dinar has remained very stable at close to 60 dinars to the euro (earlier 30 dinars to the deutschmark) from November 2000 to the middle of 2002.[41] Monetary activity of the NBY in 2001 and 2002 has mainly comprised interventions on the currency market to ensure exchange rate stability. Due to the restored demand for dinars, and inflows from abroad, purchases by the authorities of foreign exchange at the *de facto* fixed exchange rate accounted for roughly half the EUR 634 million accumulation in the NBY's gross foreign reserves during 2001. The rest of the increase derives from official aid and the release of previously frozen assets to the NBY, as well as an IMF stand-by loan. Gross reserves more than doubled during 2001, amounting to EUR 1.3 billion by the end of the year (Figure 11), and EUR 2.1 billion at the end of August 2002. The NBY sterilised only a small part of these purchases through sales of its securities, thereby allowing the money supply to increase along with demand for dinars (Figure 12).[42] Money supply (M1) increased by an estimated 97 per cent in 2001. It continued to grow quickly in early 2002, increasing by another 72 per cent in the first nine months of the year. Real M1 rebounded in 2001 following the sharp fall in previous years, growing by an estimated 58 per cent, and another 56 per cent in the first three quarters of 2002 Even after this substantial real growth, the level of monetisation in Serbia remains quite low. At the end of 2001, M1 still only stood at 8 per cent of Serbian GDP.

(Figure 11. Gross foreign reserves of the NBY)

(Figure 12. Money supply)

Refinancing policies have been quite conservative, particularly since the closure of the four largest insolvent banks in early 2002. Even before the closure of these banks, net claims of the NBY on the Serbian banking sector fell by an estimated 64 per cent in 2001, and amounted to only 0.1 per cent of GDP on Serbian territory. Bank refinancing remained extremely limited in 2002. Credit to government has also been subject to a ceiling of 2 per cent of GDP in accordance with the IMF agreement. Consequently, after taking into account additional currency issued to satisfy the demand for dinars at the given exchange rate, monetary policy has been contractionary in 2001 and 2002. The NBY's outstanding claims on the domestic economy fell by 46 per cent in real terms during 2001.

A contraction in commercial credit, combined with growing commercial bank deposits at the NBY, have helped to moderate the inflationary potential of monetary expansion. An end to liberal refinancing policies and enforcement of prudential regulations (under the threat of closure), have together fundamentally altered the orientation of remaining Serbian commercial banks. These have increased their liquidity and reserves (see below); reserve requirements for commercial banks (both for dinar and foreign currencies) were unified and set at 20 per cent in 2002. While this requirement is quite high by international standards, it has not come close to binding on many banks. Due to a perceived lack of relatively low-risk investment opportunities in the domestic economy, Serbian commercial banks increased their deposits with the NBY by 60 per cent in real terms in 2001. On 31 December 2001, aggregate bank deposits with the NBY amounted to nearly twice the prudential requirement, the equivalent of 32 per cent of M1 (Figure 13). By the end of 2001, Serbian banks also had foreign exchange cash reserves held in foreign banks equivalent to EUR 520 million, or 55 per cent of M1.

(Figure 13. Required and actual deposits of Serbian banks with the NBY)

In this environment, despite the growth in money supply, the FRY authorities succeeded in reducing retail price inflation (December on December) on Serbian territory from 112 per cent in 2000 to 42 per cent in 2001, and to 16 per cent (September on September) by the autumn of 2002. As emphasised above, given the stability of the exchange rate this implied a considerable real appreciation of the currency. An important part of inflation in Serbia is associated with price liberalisation and increases in prices that remain administratively fixed, particularly those for energy. Excluding administratively controlled prices on energy, medicaments, utilities, transport and postal services, inflation in the FRY is officially estimated to be as low as 16.5 per cent (December on December) in 2001, rather less than half the rate of retail price inflation.

Interest rates in Serbia have fallen along with inflationary expectations, but remain comparatively high (Figure 14). By early 2002, rates on short-term loans for exporters fell to less than 1 per cent a month. However, average rates for most other short-term credits remained over 2 per cent a month in mid-2002. At the unchanging exchange rate this is effectively a euro interest rate, and remains excessive for many enterprises. Margins between commercial loan and household deposits rates have narrowed, but remained close to 0.6 per cent per month in the middle of 2002. The discount rate of the NBY has become only something of an indicative indicator, as discount refinancing has become extremely rare and selective.

(Figure 14. Monthly interest rates)

Despite the major liberalisation and unification of the exchange rate at the end of 2000, the foreign exchange market remained subject to regulations that forced commercial banks to pass on foreign exchange purchased from individuals to the NBY. However, from May 2002 Serbia liberalised current account transactions, accepting the responsibilities of current account convertibility (IMF Article VIII). Investments abroad and other capital outflows remain restricted, although limits on cash that individuals can take out of the country were increased from EUR 500 to EUR 2 000. Along with current account convertibility, the NBY has introduced a regulation forbidding the use of euros or other foreign currency for domestic payments, a measure aimed to strengthen the transactions demand for dinars.

The scope for monetary policy in Montenegro is somewhat limited. The main function of the Central Bank of Montenegro (CBM) is to create and sustain sound banking and an efficient payments system. There is no national currency and the Central Bank of Montenegro cannot issue credit, either to the government or the commercial banks. Its only tool of monetary policy is the reserve requirement on the banking sector. This requirement was initially set at 80 per cent for sight deposits, though by October 2002 this had fallen to 60 per cent. The CBM expects the requirement to fall further during 2003. Until June 2002 statutory reserves at the CBM were not remunerated. However, from 1 July 2002, the CBM pays annual interest of 1 per cent on 40 per cent of deposited reserves. Banks may also place 10 per cent of their statutory reserves as treasury bills. Whilst reserve requirements are high by international standards, banks may use up to half this reserve to manage their intra-day liquidity needs.

The influence of exchange rate policy

Exchange rate policy has become a central point of debate in monetary policy discussions in Serbia. Maintaining a stable exchange rate as an anchor for monetary policy has proven an effective measure for stabilising expectations and restoring demand for the national currency (Figure 15). Nevertheless, after a decade of high and unstable inflation and financial collapse, money demand remains potentially volatile. Partly for this reason, the NBY has defended an implicit fixed exchange rate since November 2000. As indicated above, the maintenance of this exchange rate has actually necessitated large net purchases of foreign currency to forestall nominal appreciation of the dinar.

(Figure 15. Nominal exchange rate, 2000-02)

The substantial real appreciation of the dinar since October 2000 through inflation has caused concern in some circles, and has raised the question of a possible adjustment to the exchange rate. Appreciation of the real exchange rate erodes the competitiveness of FRY firms, which is worrisome in the medium term for an economy with a substantial trade deficit, historically low exports, and a growing share of imports in domestic trade and consumption. In addition, as pressures for real appreciation cannot be expected to keep up indefinitely, continuing to defend a given rate for a long period of time could actually contribute to a greater future destabilisation at the time when pressure for a downward adjustment begins to mount.

On the subject of competitiveness, the primary question is to what degree the NBY could, or should, use instruments of monetary policy to stem the real appreciation of the exchange rate. Particularly in the context of depressed financial markets and potentially unstable money demand, the NBY has been understandably cautious in this regard. In such an environment, the ability of the NBY to have a substantial constructive impact on the real exchange rate is most likely highly limited. Pressures for real appreciation have come from the balance of payments and, to some degree, the repressed state of administered prices in energy, transport, and utilities. A deliberate attempt to control the real exchange rate through a more active exchange rate policy might achieve its goal only at a high cost, namely through destabilising the demand for dinars. This could then lead to high, and potentially volatile, inflation. As opposed to an active exchange rate policy, the development of effective policies to sterilise currency market interventions and mop up excess bank liquidity may be a more effective monetary policy approach to reducing inflationary pressures for any given exchange rate path.

In contrast, the issue of avoiding a possible future destabilisation of expectations does relate directly to exchange rate policy. For this reason, the NBY should consider strategies that would increase short-term flexibility in the nominal exchange rate in a way that would not adversely affect money demand. Such an adjustment in the near future, even if it contributes to slightly higher inflation and nominal interest rates, could have net benefits for monetary policy in the medium term. It would be advantageous for the NBY to make such a policy shift from a position of strength, before the market perceived that reserves were becoming depleted and pressures was building for an adjustment. As indicated by recent international experience of exchange rate crises, once expectations become destabilised due to perceived external pressure on the exchange rate, it can be exceedingly difficult to restore stability to financial markets. To the degree that wages and some other prices lack flexibility downwards, in nominal terms, a policy consistent with mild nominal depreciation could additionally benefit the real sector in adjusting to economic shocks. Such a policy is not possible in Montenegro due to the absence of a domestic currency, implying that adjustment to negative balance of payment shocks would need to occur through wage and price disinflation.

Government budgets and fiscal policy

Serbia and Montenegro operate entirely separate budgets and fiscal policies. The discussion below relates mainly to Serbia, for which more information is readily available, though a short section on Montenegro is included at the end. In addition to the discussion in Chapter I of this Assessment, a partial presentation of some basic figures and problems in Montenegrin budgetary and fiscal policy can be found in IMF (2002a and 2002b).

As with monetary policy, the conduct of Serbian fiscal policy since 2001 marks a qualitative break with the past. A lack of data for the period before 2001 makes a comprehensive assessment of the budgetary picture in Serbia difficult. On paper, the federal and Serbian republican budgets were close to balance before 2001. The governments did not engage in active deficit finance from domestic sources in the mid-1990s, and typically met revenue shortfalls through the accumulation of expenditure arrears. In addition, large implicit (quasi-fiscal) deficits were run off-budget. As discussed above, the NBY played a major role in granting direct soft loans to enterprises, refinancing commercial banks that were also making such loans, and providing support to various ministries and other funds for off-budget expenditures. In addition, individual ministries and other state organisations directly controlled numerous extra-budgetary funds, the exact magnitude of which is unknown.

Financial control over the economy was previously exercised through the state run Bureau for Clearing and Payments (ZOP), which ran the country’s only clearing system. Large deposits held in ZOP accounts (a necessity for payments) were also used to support government finances. Given chronic payment arrears, political intervention often determined which firms were actually paid and how quickly, as well as which firms could build up arrears without having their accounts blocked. In Serbia ZOP was also a direct source of revenue for the government: all ZOP transactions carried a fee, and payment delays induced by ZOP bore no interest. The fee was lowered in 2002, from more than 1 per cent to 0.6 per cent of each transaction’s value.

The economic programme developed in co-operation with the IMF and World Bank has concentrated on consolidating former fiscal and quasi-fiscal accounts into an explicit consolidated budget controlled by the Ministry of Finance. This includes halting quasi-fiscal activities by the NBY, eliminating or consolidating numerous extra-budgetary funds into the general state budget, and developing financial reporting and financial accountability. Programmes are underway in both Serbia and Montenegro to phase out the ZOP network and develop treasury systems. This programme is particularly advanced in Montenegro, where ZOP’s monopoly of payments was broken in 2001 and a treasury system became partially operational. In Serbia, the government intends to close ZOP by the end of 2002; in Montenegro the same point should be reached by mid-2003.

The consolidation of state revenues and expenditures in 2001 facilitates a rough comparison of state budget revenue and expenditure in the FRY with other countries in the region (Figure 16). Along with most other countries of the former Yugoslavia, the FRY has a rather large government.[43] Despite widespread tax evasion and the low reported profitability of FRY firms, Serbia manages to collect sizeable tax revenues: consolidated state revenue is about 40 per cent of GDP. The aggregate picture on the expenditure side flatters Serbia since it did not service its foreign debt in 2001. Indeed, Serbia’s primary expenditure was close to that of more developed transition countries (Poland, Hungary, the Czech Republic), where GDP per capita is double to triple that of the FRY, and substantially higher than in Romania, Bulgaria, the Slovak Republic, and Albania.

(Figure 16. Revenues and expenditures in the FRY and selected countries)

Given the severe fiscal challenges that lie ahead (see below), the FRY will most likely require a comprehensive reform that brings the size of government more in line with current capacity and the condition of the Serbian and Montenegrin economies. By 2006, foreign debt servicing should absorb another 4-5 per cent of Serbian GDP in state expenditures whilst other commitments should mount. These include compensation for frozen foreign currency deposits and reduction of pension arrears. On the other hand, enhancing the competitiveness of Serbian firms requires the government to develop and maintain a relatively low tax burden. Unfortunately, such a fiscal reform can probably not avoid cutting expenditure on social benefits, though some of these remain high relative to other countries in the region. Given the high welfare and political costs from reducing such benefits at a time of considerable social distress, the Serbian and Montenegrin governments might be well advised to seize opportunities to cut other areas of expenditure. State expenditures on the military and police establishment, and the civil service, are notably high in the FRY compared with other countries of the region. Serbian state spending on the military from explicitly recognised sources comprises at least four per cent of GDP, a figure that is more than twice the EU average.[44]

The federal budget, equivalent to about 7 per cent of GDP, has essentially belonged to the territory of Serbia since 2001, as Montenegro has made no contributions to this budget since June 1998.[45] Hence, Table 11 shows flows of expenditures and revenues to, from, and within the general government budget on the territory of Serbia for the year 2001. This includes the federal budget, the Serbian republican budget, and extra-budgetary funds for pensions, health, and unemployment. Most federal expenditure is devoted to the military. Local budgets are relatively insignificant, accounting for only about 4 per cent of GDP in 2001. This should change in the future, however, at least in the case of the provincial budget of Vojvodina (see below). The Serbian republican budget and aggregated extra-budgetary funds each accounted for about 17 per cent of GDP in 2001. Table 11 reveals that the three extra-budgetary funds, particularly those for pensions and health, are the primary source of budgetary imbalance in Serbia. If it were not for transfers to these funds, the republican budget would have generated a surplus of more than 2 per cent of GDP in 2001. Instead, the consolidated Serbian (federal plus republican plus local) budget experienced a deficit estimated at 1.5 per cent of GDP.[46]

(Table 11. The general government budget on Serbian territory)

The 1.5 per cent fiscal deficit in 2001 was much lower than the 6 per cent originally anticipated by the Serbian government and in the IMF Stand-by Arrangement. During the year, tax revenues to the republican government came in at 6 per cent over budget, due both to higher inflation and better tax collection than expected following the 2001 tax reforms (Box 4). Whilst revenue over-performed, Serbia also reduced budgeted expenditure as projected levels of foreign assistance for deficit finance were not disbursed. Despite higher inflation, nominal expenditures on government procurement and social protection were reduced by roughly 15 per cent in nominal terms from their budgeted levels in 2001. On the other hand, subsidies to the economy and transfers were increased beyond their budgeted values (Table 12).

(Table 12. The Serbian republican budget, 2001-02)

The planned budget for 2002 embodies some major changes from that of 2001 (Table 12). Projected increases in foreign assistance and privatisation revenues were expected to finance a substantially wider republican deficit (4.2 per cent of GDP). Whilst two-thirds of the republican deficit in 2001 (1.2 per cent of GDP) was covered by the NBY, financing in 2002 was planned mostly to come from foreign sources (2.3 per cent of GDP) and privatisation receipts (1.4 per cent), in addition to borrowing of 0.6 per cent of GDP from the NBY. A higher deficit, and a projected increase in republican revenues by

2 per cent of GDP, support a significant increase in public expenditure, equivalent to 5 per cent of Serbian GDP. The 2002 budget prescribes significantly higher expenditures to foreign debt servicing, capital (infrastructure) investments, transfers, and government procurement. Some government officials have expressed the hope that this increase in expenditures would serve as a fiscal stimulus to bring the economy out of recession.

Implementation of the 2002 Serbian republican budget became strained in the first four months of the year as both growth and inflation were lower than expected. Tax revenues amounted to less than 30 per cent of the planned budget, while expenditures were held to 28 per cent of the year's total. This position had mostly unwound by the half-year mark, with revenue, expenditure and the overall balance running at 46 per cent of the budget for the year.

Box 4. Serbian tax reform

The Serbian and Montenegrin governments have made reform of their tax systems a primary objective. The overall goals of reform have been neutrality, efficiency, and simplicity, and alleviation of the particular burden of labour taxation in the FRY. The tax systems prior to reform were a confusing mass of taxes, tax rates, and exemptions. Special bilateral tax privileges, such as the tolerance of arrears, were commonly granted to certain priority firms. Tax evasion was widespread.

Serbia embarked on a major tax reform in March 2001. This reform unified the sales tax, a major source of revenue in Serbia, to a flat rate of 20 per cent, although some exemptions were maintained for basic food products. Both Serbia, and Montenegro have announced their intention to implement a value added tax as soon as their bureaucracies are capable of administering it properly. Excises were expressed in dinars per unit and indexed to inflation. The 2001 reform also eliminated a number of exemptions for the corporate income tax. The payroll tax base was expanded to include various types of benefits-in-kind, which previously represented a primary means of tax avoidance, while rates were somewhat reduced. A tax on financial transactions consolidated two taxes previously levied on all payments, and under new rules in 2002, a large number of transactions have become exempt from this tax altogether. In a politically contentious move, a one off tax on "extra-profits" was introduced in an attempt to capture those profits made in the past through favouritism of the previous government. So far, about EUR 60 million have apparently been collected in this manner. Another set of administrative measures attempts to reduce widespread tax evasion and smuggling.

The initial results of the Serbian tax reform appear to be positive. Tax revenues to the consolidated state budget on Serbian Territory increased by more than 2 per cent of GDP in 2001 relative to 2000, exceeding government expectations. The ZOP data analysed above are consistent with a fall in payroll tax deductions from about 130 to 100 per cent of the net wage.[1] The IMF highlights alleviation of the high burden of labour taxes, compensated by higher indirect taxation, as an important accomplishment of the tax reform.[2] Nevertheless, it should be noted that the opinions of Serbian entrepreneurs given in Chapter III express dissatisfaction with the changes. This may be due to the higher share of labour compensation now being defined as wages, and so subject to taxation, which appears in the financial accounts examined above as a sharp increase in recorded wage costs for small businesses.

A package of new tax measures was published in September 2002. The main reform is to reduce corporation tax to 14 per cent, and to grant a 10 year tax holiday in cases where more than YUD 600 million (EUR 10 million) are invested and more than 100 people are additionally employed. Furthermore, certain items were exempted from sales tax. These included cooking oil, fat, sugar and rent on additional business premises. Capital gains tax has been abolished.

1. These percentages were calculated directly from ZOP enterprise data, and include sundry employer labour costs as well as employer payroll tax and social security contributions. The Serbian ministry of finance puts the wedge at, respectively, 105 and 75 per cent.
2. IMF (2002*a*), pp. 7-8.

Fiscal decentralisation has become a major topic of discussion and reform in Serbia. Although local and regional budgets have been relatively insignificant in recent years, accounting for only 4 per cent of general Serbian budgetary expenditures in 2001, they have been much more important historically. The 1990s witnessed a strong fiscal centralisation. In the current period, pressures for fiscal decentralisation have again resurfaced. As could be expected, the relatively rich northern region of Vojvodina has led the campaign for greater fiscal independence. This resulted in the approval of special measures in 2001 that granted Vojvodina more fiscal autonomy. These changes allow Vojvodina to collect revenues for various administrative taxes and fees on services. It may also engage in capital transactions (*i.e.* borrow) and receive direct donations. In addition, Vojvodina receives a small share of revenue from the Serbian sales and income taxes. Significant regional disparities in the FRY, and pressures from richer regions to keep a larger share of their tax revenue, could become an increasing source of tension in the conduct of fiscal and social policies in Serbia.

Fiscal challenges ahead

Serbia faces some formidable challenges in fiscal policy and budgetary execution. A primary concern is servicing the foreign debt, the burden of which will grow substantially in the medium term at the same time as official aid is expected to decline. Against this background, the IMF and World Bank have studied the question of Serbia's fiscal sustainability.[47] Following the restructuring agreement with the Paris Club and other negotiations, the FRY's total sovereign foreign debt stood at USD 10.5 billion (90 per cent of GDP) at the end of May 2002 (Table 13). If, as expected, similar agreements are reached with the London Club and some other creditors in the near future, total foreign debt should fall to below USD 9 billion. The IMF study outlines a sustainable fiscal path that has outstanding foreign debt rising to USD 10 billion in 2004, then declining to USD 9 billion by the end of the decade. Under this scenario, annual debt servicing will climb to almost USD 1 billion in 2004 and 2005, subsequently reaching a maximum of USD 1.6 billion, before declining to USD 1.3 billion in 2010 (Table 14).

(Table 13. External debt of the FRY)

(Table 14. IMF study scenario for medium-term external sustainability, 2002-10)

Given the assumptions underlying this scenario for growth in GDP, the evolution of the balance of payments, and the achievement of restructuring agreements with remaining creditors, the IMF study projects an increase in foreign debt service to more than 17 per cent of government expenditure in the latter half of the decade. This implies a substantial fiscal adjustment. Furthermore, the assumptions underlying this scenario appear quite optimistic. The US dollar value of GDP is projected to grow by an average of 8 per cent throughout the decade, whilst annual growth in exports is projected to reach 15 per cent during 2002-2005, gradually slowing to 10 per cent thereafter. Under these conditions, the trade and current account deficits shrink despite additional annual outflows of roughly USD 1.5 billion due to foreign debt service. The level of debt is projected to remain at a peak of 67 per cent of GDP until 2004, from when it declines to 38 per cent in 2010. Direct foreign investment is also assumed to grow rapidly, becoming a primary source of balance of payments support. Additional external borrowing is therefore expected to be rather small, and net borrowing turns strongly negative in the second half of the decade. This scenario thus presumes a relatively rapid take-off into strong export-led growth and high inflows of FDI.

Sensitivity analysis with respect to export growth and foreign direct investment in the IMF report indicate the possibility of serious liquidity problems in the event of slower growth and lower foreign investment.[48] Available evidence on the state of the Serbian economy presented in this Assessment raises the possibility of significant on-going restructuring and slower growth in the near future. The assumed average annual 8 per cent growth in the dollar value of GDP until 2010 is partly based on expectations of continued real currency appreciation. However, given the dinar had already strengthened beyond pre-crisis levels by mid-2002, it is unclear how much additional appreciation would be consistent with the presumed acceleration of export growth. However, if FDI inflows are higher than expected this might stimulate higher growth than in the baseline projection. Nevertheless, the foreign debt position underlies a number of questions that continue to surround the future evolution of the fiscal situation in the FRY and Serbia.

As indicated above, the social extra-budgetary funds, particularly the pension fund, represent a primary source of fiscal strain in the FRY. In December 2001, the Serbian government introduced some limited measures to constrain the size and growth of pension benefits. The retirement age was increased from 55 to 58 for women and from 60 to 63 for men, and retirement is no longer mandatory. Pension indexation was changed from a 100 per cent wage-based scale to a 50:50 basket of wages and retail prices. The latter measure is based on a hope of a continued recovery in real wages, which could increase contributions faster than benefits. These partial measures do not yet represent a comprehensive solution to the fundamental problem of imbalance, which may become more severe in the medium term due to an ageing population. The Serbian government has been working, together with international support, to streamline social benefits and better target support. Nevertheless, the problems of poverty and a lack of information dictate that progress in this area can only be gradual. Thus, an imbalance in the social extra-budgetary funds should continue to present difficulties for budgetary management over the medium term.

As emphasised above, before 2001 the accumulation of arrears served as the primary instrument in achieving state budget balance. Moreover, budgetary arrears were only one expression of an economic environment in which payment discipline was poor and, at best, selectively enforced. As part of its reform agenda, the current government has committed itself to improving payment discipline. Measures to enforce a higher share of cash payments in the energy sector have been discussed above. Progress is also visible in the budgetary sphere. Indeed, the current agreement with the IMF explicitly prohibits an increase in budgetary arrears payable. According to Ministry of Finance data, this condition appears to have been met. Although arrears from the Serbian republican budget and extra-budgetary funds accumulated somewhat in the second half of 2001, they declined in early 2002 to levels below those during the previous year. Nevertheless, the problem of state budgetary arrears remains a serious obstacle to establishing much-needed discipline in state finance and the economy more widely. Despite a marginal decline, arrears from budgets and extra-budgetary funds at 31 March 2002 remained the equivalent of 6 per cent of GDP, or 15 per cent of total expenditure.[49] The problem of budgetary arrears remains particularly serious in the execution of the extra-budgetary social funds (Table 15). By meeting its own financial obligations, the government would send an important signal to the economy about the emphasis it places on financial discipline and the rule of law in the economic sphere.

(Table 15. Payable arrears of Serbian state budgets and funds)

Wage policies are an important element in Serbia’s fiscal programme. The government has made a commitment to prevent real wage growth in the state sector of the economy. In addition, it has planned to reduce the state administration.[50] In the first half 2001, the Serbian government attempted to implement a temporary freeze on nominal wages in many parts of the state and budgetary sectors, and limit subsequent wage growth to 10 per cent during the year. As indicated in Chapter I, these regulations do not appear to have succeeded in preventing rather rapid wage growth in the economy. During 2001, real wages grew by an estimated 13 per cent, while in some areas of state administration such as social security, education, and health care, official estimates of real wage growth are above 20 per cent.

Box 5. Labour market regulations

A central institution of the former Socialist Federal Republic of Yugoslavia was the so-called "worker-managed firm". While the Yugoslavian firm in practice involved relatively little outright worker control, a number of institutions did exist that guaranteed security of employment and other rights for employees. Mandatory collective bargaining between trade unions and employers' associations was necessary for a number of important decisions. This agreement also commonly denied individuals or smaller firms the right to engage in their own independent wage bargaining. A number of other conditions hindered flexibility in hiring and dismissing workers. The continued existence of inherited rigidities in the labour market is problematic at a time of major structural transformation, which necessitates a significant adjustment in wages and the re-employment of labour in new and more efficient enterprises.

A new Serbian Labour Law of December 2001 sought to address some of these problems. The law proposed three significant changes to labour legislation: it increased the scope for employers to dismiss employees; it introduced rules on how to structure a redundancy programme, and it specifically recognised the role of short term and temporary work. Employers now have the right to dismiss employees for "non-performance", or as a result of "technical, economic or organisational change". Most importantly, firms with fewer than 50 employees were exempted from the burden to transfer redundant workers to another part of the firm. The law placed an obligation on the firm to produce a redundancy programme, after consultation with trade unions. The programme specifies whether workers will be transferred, placed on short time working, or whether they will benefit from retraining. The law reduced the ceiling on redundancy pay to a maximum of 5 months wages. Though this new ceiling is comparable to the situation in many EU countries, it is more burdensome than in most transition countries.

Whilst this labour reform constituted a significant improvement to labour market rules, a number of problems may still require further attention. The new law entrenches the role of a separate labour inspectorate, which can have a positive role in enforcing labour law and health & safety at work. Further legislative changes may be necessary to ensure that labour law does not place an excessive burden on firms, with attendant opportunities for corruption. The new labour law also leaves in place the collective bargaining framework whereby all workers in a workplace are covered by the collective bargain whether or not they belong to a trade union. In addition, a trade union representing only 15 per cent of the workforce has the right to agree to a collective bargain.[1] This measure may inhibit the mechanism by which workers can price themselves into registered employment by lowering their wage demands. Along with building effective bankruptcy institutions and removing entry barriers to new firms, the reform of labour regulations remains an area of potential benefit for promoting much needed flexibility in FRY markets.

1. The trades union may represent even fewer employees in a given workplace where union membership covers at least 10 per cent of those employed in a sector or activity.

Montenegro

Montenegro introduced significant legislative changes in 2001, including the adoption of an organic budget law. Fiscal policy had previously lacked transparency and accountability, relying on a system of cash rationing. A modern treasury became operational in January 2002. Furthermore, there has been some progress in eliminating extra-budgetary deficits. A new law on municipal finance was approved by the government for submission to parliament. This redefines sources of revenue, as well as introducing limits on borrowing and issuing guarantees. However, it will take time for the new fiscal system to become fully operational: ZOP will continue to exist until the middle of 2003, and the CBM has temporarily taken over some ZOP functions (clearing takes place at the CBM, payments authorisation in the ministry of finance). In reforming the payments system the government has to take care that the functions carried out by ZOP are reflected in the new arrangements. In aggregate, these reforms represent an underlying change in the budget mechanism and decision-making, leading to some institutional tension between the ministry of finance and the central bank.

There is some evidence that the budget deficit in 2001 is somewhat lower than in the past (less than 5 per cent of GDP). However, these results are for the primary fiscal balance excluding putative contributions to the federal tier. More importantly, the need to service government debt represents a considerable risk to the fiscal account into the medium term. After seven months of 2002, it seems that the government will struggle to meet its target for the fiscal deficit over the year as a whole (Table 16). A tentative start is being made on fiscal pressure from future pension expenditure: measures to increase the retirement age and change indexing of pensions were sent to the Parliament at the end of 2002.

(Table 16. The Montenegrin republican budget, 2002)

Commercial banking

Credit and financial markets in the FRY were brought to the verge of collapse in 1999. Since then, Serbia and Montenegro have both embarked on comprehensive restructuring programmes designed to re-establish commercial banking in the country on an entirely new institutional basis. The banking crisis had several causes. The government had used the banking sector extensively for quasi-fiscal purposes, thereby burdening the balance sheets of FRY banks with soft credits directed at priority sectors of the economy. These assets were matched on the liabilities side with liberal refinancing from the NBY, and resources attracted from abroad that carried a sovereign guarantee. As with enterprises, government control over the banking sector was realised partly through the state monopoly over the payments system (ZOP). Given the distorted incentives facing commercial banks, this control may have actually been fortunate in limiting the granting of corrupt loans to private affiliates. This problem played a major role in the 1996 banking crisis in neighbouring Bulgaria, for example.[51]

Given the large share of deposits, borrowing and lending denominated in foreign currency, hyperinflation in 1993 had a devastating impact on the banking sector. Most enterprises could no longer service their foreign currency debts and, consequently, banks could not honour their obligations. In addition, dinar loans and deposits were all but eliminated. The government took the radical measure at that time to freeze foreign currency deposits in commercial banks. Most of these deposits remain frozen today, although the Serbian government has recently taken measures to begin compensating depositors. The freezing of deposits, together with the financial pyramid schemes that flourished due to lax financial market regulation, took a psychological toll on FRY households and other depositors. Even now, the majority of savings in the FRY are held in foreign cash outside the banking system. Estimates of the amount of foreign cash held by the population are inevitably imperfect. Nevertheless, the recent conversion of cash deutschmarks to euros through the NBY reportedly reached a volume of EUR 4 billion during the end of 2001 and early 2002. This can be compared to dinar money supply (M2) of EUR 1.1 billion at 31 December 2001, and broad money (dinar assets plus foreign currency bank accounts) of roughly EUR 2 billion.

The FRY government issued sovereign guarantees during a rescheduling of commercial bank and sovereign debt that took place in the late 1980s. Hence, the subsequent default of the government on these obligations included a technical default of the banks themselves. Therefore, pending the successful restructuring of this debt, access to international capital markets for FRY banks is severely limited. This even includes the acceptance of guarantees for short-term export credits.

By the end of the 1990s, the banking sectors in Serbia and Montenegro were in a virtual state of collapse, with highly negative capital and assets dominated by non-performing loans, and were severely mistrusted by the population. Financial transactions typically avoided the banks, favouring 'suitcases' of cash or various types of mutual offsets. In Serbia, the majority of negative capital and losses were concentrated in the four largest banks, which in 2001 still accounted for 60 per cent of all assets, and

67 per cent of outstanding commercial credit, to the non-financial sector. But most of these assets were frozen in long-term foreign currency loans that represented the counterpart to borrowing by the government (through guarantees) on international capital markets. The share of these four banks in short-term credit fell to below 30 per cent by the end of 2001. In September 2001, after a comprehensive audit that involved the USAID and other international experts, the NBY estimated the negative capital of these banks to be the equivalent of EUR 5 billion.[52]

Decisive bank restructuring

Lacking the resources needed to recapitalise the banking sector, the NBY and government took the bold step in early 2002 of closing the four largest banks.[53] In the previous six months they had already closed 19 other banks. Drawing on support from the Serbian budget, roughly USD 20 million was granted to employees of these banks as severance pay whilst the Serbian government bought USD 30 million worth of claims by local net creditors.

Those commercial banks operating in Serbia can be divided into roughly three categories. The most difficult group is those state or socially-owned banks that were founded before 1989, well before the hyperinflation 1993. Like the four largest bankrupt banks, these banks remain burdened with frozen assets and liabilities in the form of long-term foreign currency loans and deposits. In January 2002, the NBY estimated that 67 per cent of the aggregate assets and liabilities held in these banks was frozen. Due to these large holdings of frozen non-interest bearing assets, several banks were put under the supervision of a special unit in the NBY. The NBY then elaborated a plan during 2002 to restructure these banks. The plan is to convert state claims (related to the Paris and London Club) on the banks, corresponding to the frozen foreign currency deposits, into shares. This would put most of the banks explicitly into majority state ownership. A debt workout programme is then planned, with the short-term goal of writing off and (partly) separating bad debts of these banks owed by enterprises that could potentially be privatised to a strategic buyer. The banks themselves may then be privatised or shut down (see also Chapter IV). In August 2002 the NBY executed this debt equity swap in 14 commercial banks, and is currently working on the subsequent programme.[54]

Even for newer banks not saddled with frozen loans, the current state of commercial banking remains difficult. Prudential regulations are understandably strict. While some regulations have been tightened, particularly for provisioning, the most important difference with the past is in enforcement. For the first time, banks that do not meet regulatory requirements face license revocation, bankruptcy, and liquidation. In addition to the four largest banks and 19 others closed in 2001, the NBY induced the merger of a further 17. By the end of the year there were only 49 banks operating in Serbia.[55] Other banks have been given strict deadlines to comply with prudential norms.

Eight majority-owned foreign banks currently operate in Serbia, five of which received licenses in 2001. Foreign banks have become increasingly important to banking operations, accounting for an estimated 16 per cent of Serbian bank capital, and 13 per cent of assets, at 31 December 2001 (excluding the four large insolvent banks). If older banks with frozen assets are excluded, these numbers are considerably higher: 23 per cent and 38 per cent of capital and assets, respectively.[56] These foreign-owned banks have played a particularly important role in restoring confidence in the banking system, and have gathered the lion's share of new deposits in the economy (Figure 17). At 31 December 2001, banks with foreign capital accounted for a reported 69 per cent of all non-frozen deposits in Serbia.[57]

(Figure 17. Real dinar and foreign exchange deposits in Serbian commercial banks).

Table 17 summarises some balance sheet indicators for 31 December 2000 and 2001 for all banks, other than the four largest, operating in Serbia. For the end of 2001 a distinction is made between the newer banks, and older banks that were founded before 1989 and have balance sheets dominated by frozen assets and liabilities. By the end of 2001, total assets in active Serbian banks (again excluding the four large liquidated banks) fell to only 41 per cent of GDP. The share of non-frozen assets is even smaller: 25 per cent. Hence, the banking sector has become exceedingly small in terms of financial intermediation. The share of short-term (new) credit in the assets of older banks is only 13 per cent, while deposits account for only 17 per cent of liabilities.

(Table 17. Serbian commercial banks: selected balance sheet indicators)

Most of the present, and the future, of the Serbian banking sector lies in the hands of the newer banks. These banks are considerably more active as intermediaries than are their older peers, relying on deposits for the majority of attracted resources, and allocating 43 per cent of assets in short-term credits. However, the share of all short-term credit from Serbian banks to the non-financial sector amounts to only 7 per cent of GDP, quite low compared with most other transition countries. It is also particularly striking in comparison with past levels in the FRY. New long-term credit is exceedingly scarce.

The banking sector is currently very liquid. As much as 36 per cent of all assets in new banks, and a similar percentage of non-frozen assets in older banks, is held in cash equivalents or deposits at the NBY. These are mostly held as deposits at foreign banks. A glance at the credit portfolios of these banks, however, reveals that a cautious attitude towards expanding loans appears justified. A substantial 23 per cent of short-term loans were reported as being in arrears at 31 December 2001, with the share of reported overdue loans actually higher in the newer banks. Despite this problem, the counterpart to high liquidity is that the capital adequacy ratios of most operating banks is sufficient, indeed far exceeding the prudential norm of 8 per cent. Whilst the banking sector as a whole, even without the four large banks, continued to generate net losses in 2001, these aggregate losses were concentrated in older banks currently under the administration of bank rehabilitation authorities.[58] On aggregate, newer banks showed a slight net profit in 2001.

While the active banking sector in Serbia and the FRY remains quite small, it is beginning to re-emerge operating under fundamentally new principles and institutions. However, the high share of arrears in short-term lending speaks for the serious difficulties that remain in credit markets. At least part of the problem may be related to human capital. FRY banks are still building the skills needed to make effective and responsible credit allocation decisions in a difficult environment. But legal protection of creditors also appears to have been inadequate. This perception has motivated the approval of a new bankruptcy law for banks in 2002 that somewhat strengthened the rights of creditors in pursuing their claims. It will understandably take time for bank capital, assets, trust and institutions able to allocate credit efficiently to grow in the FRY. The most severe current liquidity constraints in the economy might be alleviated relatively quickly through an expansion of short-term credit, particularly for export operations. Measures to support lending against collateral and the strong protection of creditors rights would play an important part in facilitating this process.

Montenegro

The banking sector in Montenegro has suffered from many of the same problems as in Serbia. Since 2001, the Montenegrin authorities have undertaken a comprehensive programme of bank restructuring and regulation. The largest commercial bank in Montenegro was put under the direct control of the Central Bank of Montenegro, with its activities highly restricted pending a decision on restructuring. Two other problem Montenegrin banks were closed in 2001-02. With international assistance, Montenegro has passed a package of new laws and regulations aimed at providing the foundation for a new banking system. Supervision is carried out according to the internationally accepted Basle criteria. This seems to have had some impact on confidence. In October 2002 there were 10 banks licensed in Montenegro, of which two were new and three were in majority foreign ownership. Private savings have increased since euro conversion: banking deposits, at EUR 14.3 million, were some five times higher at the end of September 2002 than at the end of December 2001.

III. SMALL BUSINESS AND ENTREPRENEURSHIP: RESULTS FROM A BUSINESS SURVEY

New small private businesses have played an instrumental part in economic transition throughout Central and Eastern Europe. Economic restructuring has principally involved a shift of labour, capital, and other resources from large enterprises, commonly loss-making and poorly-governed, to areas of higher efficiency and competitiveness. Small private businesses have been central to this process. These businesses operate under hard budget constraints; they are obliged to meet the demands of rapidly changing market conditions, or fail. A number of studies emphasise the vital importance of small business activity in relatively successful transition economies.[59] Small and medium sized enterprises (SMEs) remain vital to the performance of relatively developed market economies, accounting for close to 50 per cent of all employment in most OECD countries.[60] Considering the severe problems of competitiveness, profitability, and management in large state and socially-owned enterprises in the FRY, economic revival in Serbia and Montenegro will depend on the performance of new private business.

In addition to their overall importance for growth in transition economies, the state of SMEs offers an effective barometer of how market institutions are developing in areas such as entry, exit, fair competition, contract enforcement, the rule of law and financial intermediation. Emerging market economies with relatively developed institutions in these areas will typically foster a dynamic and growing small business sector. Conversely, problems encountered by small businesses in these areas can offer valuable signals to the government for the prioritisation of economic policies and reforms.

The existing SME sector in the FRY

While the FRY stands to profit from small business development in much the same manner as other Eastern European economies, the point of departure in Serbia and Montenegro is somewhat different from other transition countries. Markets and small private businesses were never abolished, and there is hence a relatively strong, continuous tradition in private entrepreneurial activity. At the outset of transition in most former Soviet block countries, most small private businesses were new firms, even if a number of them were spun off from older entities. In contrast, a significant number of small businesses now operating in the FRY have histories dating back to the 1980s; in the FRY small is not synonymous with new. There was a large increase in the number of registered enterprises in the early 1990s following a change in legislation, though a large proportion never became active. Although the resilience of small firms helped sustain economic activity during a difficult decade in the 1990s, this feature may hold back a revival. Evidence points to a disturbing lack of dynamism in the FRY's small business sector. In Serbia, official data show a continuing stagnation, or even decline, in the number of SMEs, while a recent official study acknowledges negligible levels of firm creation and little evolution of small businesses into medium sized firms.[61] Employment in the smallest firms seems to have increased slightly in 2001 from the trough it had reached in 2000. Anecdotal evidence also suggests that there are some areas in the FRY which have a stronger entrepreneurial tradition, and where local authorities are more supportive of SME activity.

Still another important, complicating factor concerns the relation of small businesses to both the informal economy and the state or socially-owned sector. Most transition countries have large informal sectors that largely consist of 'underground' SME activity. They also have, to a greater or lesser extent, encountered problems with schemes that 'privatise' income, subsidies, or assets out of the state sector through fraudulent contracts, or contacts, between large and small firms (see also Chapter IV). The nature of economic policymaking in the FRY during the 1990s suggests that these kinds of problems may have become endemic in Serbia and Montenegro. Policies included wholesale subsidisation of the state and social sectors, repressive regulation of legitimate markets, and toleration of a large informal sector that operated in violation of these regulations. Under these conditions, the activities of many (registered or unregistered) small firms naturally gravitated toward the underground economy, including schemes for siphoning resources and subsidies away from the official sector.

The current FRY government has a dual strategy. It intends to reduce the size of the underground economy and curtail subsidies to the state and social sectors, whilst simultaneously improving conditions for the operation of legitimate private businesses. However, this strategy may impose a difficult economic transition for the FRY small business sector as former sources of profit dry up before (slower) improvements in the formal business environment take effect. Currently, even the profits of many registered small businesses most likely depend on the evasion of high existing payroll taxes and social security contributions. Perhaps this partly explains the paradox of why economic liberalisation following the change of government in January 2001 does not appear to have induced an immediate response in growth and profits in the SME sector. Neither output nor employment in the FRY small business sector has improved. Furthermore, whilst official statistics do not cover a large part of this sector, neither does indirect evidence suggest that there has been any offsetting expansion of SME activity in the grey economy (see below).

Official data on the state of the small business sector are quite limited. The main source is the Bureau for Clearing and Payments (ZOP), which monitors the official accounts of all registered firms; the primary limitation of this data is that a significant share of SME transactions in the economy are not recorded in these accounts. In fact, a good number of small businesses do not have ZOP accounts at all. As discussed in Chapter II, for activity that is recorded ZOP data suggest growing difficulties in the small business sector in 2001 as costs rose and profit margins fell. This apparent trend is supported by survey data presented below. The ZOP accounts also show the SME sector incurring both operating and net losses in recent years. This mainly seems due to two factors. Firstly, there is a natural incentive to hide profits from ZOP in order to avoid or evade taxes. Secondly, the SME sector defined by ZOP includes a number of loss-making socially-owned entities. Taking only private firms, the sector is at least marginally profitable, in contrast to the substantial aggregate losses reported in the state and social sectors.[62] Official data indicate that small firms are, on average, much more efficient than larger firms (see Chapter II).

Given the prime importance of the small business sector, the Serbian and Montenegrin governments are rightly taking steps to transform this sector into a legitimate, dynamic, market-oriented part of the economy, operating under hard budget constraints. Closer statistical and other monitoring of small businesses may reveal areas where policies need adjustment in order to achieve the overall goal. A number of recent surveys have highlighted the main obstacles to business in the FRY SME sector.[63] They include corruption, harassment by state inspection and other agencies, and a costly and prolonged process of registration for new businesses. This is at least part of the explanation why small businesses in the FRY currently account for a significantly lower share of employment and output than in the East European transition countries. Official statistics, showing relatively low employment and output in the SME sector together with stagnation in the numbers of small businesses, resemble those of Russia and Ukraine (Figure 18).

(Figure 18. Self-employment and small business employment in selected countries)

OECD survey of 404 small enterprises in the FRY

In order to understand the perceptions of small entrepreneurs about recent changes in their environment and remaining obstacles to their success, the OECD Economics Department carried out a business survey of 404 firms in four different regions of the FRY. This sample included firms in the relatively prosperous and economically dynamic northern region of Vojvodina (103), the city of

Belgrade (98), several cities in Southern Serbia (102), and the city of Podgorica in Montenegro (101). A complete breakdown of responses by region and sector, and methodological details, can be found in Annex III.1 and Annex table A.2.

The survey focused on genuinely small businesses, those in the sample had an average of 11 full-time employees. Entrepreneurs (directors of small firms) were asked questions about difficulties in starting up and operating small businesses, and how this has changed over the last two years. Some questions refer to the specific experience of the firm in question, others to perceptions about changes in the overall climate in their respective geographical areas. The questionnaire corresponds closely to another business survey carried out by the OECD Economics Department in four regions of the Russian Federation in 2001. In a few cases, this provides an interesting comparison, as Russia is another country in which the environment for small businesses is acknowledged to be difficult and official numbers show stagnation. A particularly serious problem in Russia is the harassment of entrepreneurs by (corrupt) state officials and administrations (OECD, 2002a).

The results of the survey are rather mixed. The majority of entrepreneurs do feel relatively confident about their own financial stability and prospects for the future. Whilst they note the importance of strong informal personal ties with customers and suppliers, they do not consider informal contact with national or local state officials to be particularly important. Although a handful of entrepreneurs noted harassment by various state authorities, particularly the tax administration, this problem is much less serious than in Russia. On the other hand, the survey confirms what appears to be a low degree of dynamism in the small business sector, as well as a perceived deterioration in the overall SME environment. Small businesses face declining profit margins and barriers to investing in their firms. They are very critical of changes in tax legislation, and do not believe the courts offer an effective way for them to enforce their contracts.

Results of the survey

Despite the use of random sampling, nearly all the firms surveyed had been operating for at least five years. In Serbia, as many as 41 per cent of firms in the sample dated from before 1991, though the proportion in Montenegro was lower (28 per cent). Furthermore, even for those firms founded after 1991, 46 per cent of directors had been in post for at least five years. The mean period of service for all of the directors interviewed was 7.6 years (Table 18). The significant difference between Serbia and Montenegro probably owes much to the fact that the sample from the latter republic has a relatively high share of firms in trade and services (65 per cent) as opposed to a high concentration of manufacturing firms in Serbia (56 per cent). This sample reflects the greater concentration of small manufacturing firms in Serbia. For the entire sample, the share of pre-1991 firms was higher in manufacturing (45 per cent) than in trade and services (30 per cent). In sum, this sample supports the impression that very few legitimate small businesses are currently being created in the FRY.

(Table 18. Basic characteristics of firms in the sample)

Whilst the average number of full-time employees in the sampled firms was just under 11, there were differences between sectors, for instance the average in manufacturing firms was a little higher (13). In addition to their full-time staff, firms reported an average of 1.5 part time employees. Anecdotal evidence suggests that this number probably refers only to legitimate (registered) part time employees. The practice of hiring part time employees informally to evade sizeable payroll taxes remains widespread, and the actual number of part-time employees is probably higher. A strong majority of directors characterised the financial condition of their firm as “stable”, as opposed to “unstable” or “critical” (Table 19).

(Table 19. Directors' characterisation of firms' financial condition)

A first set of questions asked entrepreneurs to provide an ordinal ranking of the three most difficult problems they confronted in starting-up and operating their own firm. Given the virtual absence of new start-ups in the sample, the responses on starting businesses are of limited value. However, the responses concerning firms' operations were more revealing (Table 20). Altogether, entrepreneurs top concerns were: lack of consumer purchasing power; access to working capital or credit; and rising cost of inputs. Fierce competition, high national taxes, and insufficient investment capital merited less frequent, but nevertheless significant, responses. The answers exhibit a fair degree of uniformity across regions. The Montenegrin group perhaps gives a little more emphasis to lack of consumer purchasing power, although this again seems a consequence of the high number of firms in trade in the Montenegrin sample. Those firms in trade generally placed great weight on this factor (35 per cent *vs.* 25 per cent in the whole sample).

(Table 20. Most significant operating difficulties faced by small firms)

The emphasis on insufficient consumer purchasing power, lack of working capital or credit, high taxes, and fierce competition in Table 20 could be considered a positive result. When asked, small businesses the world over, OECD countries included, stress similar problems. For the FRY, reported pressure from the rising cost of inputs is consistent with narrowing profit margins in the small business sector, something that is supported both by ZOP data analysed in Chapter II and more direct questions in the survey (see below).

The survey went on to ask entrepreneurs to rate various day-to-day business activities as "difficult", "not so difficult" or "rather easy". As could be expected, entrepreneurs stressed the overall difficulty of access to bank credit (Table 21). However, the regional breakdown in responses to this question is somewhat curious. In the relatively developed regions of Belgrade and Vojvodina, where commercial banking is concentrated, over 70 per cent of those surveyed indicated that access to bank credit was difficult, while only 3 per cent claimed that it was easy. This contrasts with responses from firms in the relatively poor and underdeveloped area of Central Serbia. Here only 39 per cent listed access to bank credit as difficult, while 23 per cent claimed that it was easy. Similarly, in Montenegro only 40 per cent chose "difficult" and 11 per cent choose "easy." Once again, the greater concentration of Montenegrin businesses in trade could explain this result. In the current economic situation, it seems reasonable that banks would be more willing to finance rapid trade operations than provide working capital to manufacturing firms. This is supported by the higher overall share of firms in manufacturing citing access to credit as difficult (62 per cent) relative to trade (43 per cent). The result for Central Serbia is more curious, and raises questions about the relative access to credit that might be clarified through further study. Where there is little bank credit, small enterprises in other countries commonly rely on their friends or associates for financial support. In the FRY, SMEs claim that obtaining financial support in this way is even more difficult than raising bank credit (Table 21).

(Table 21. Difficulties faced by small firms in day-to-day operations)

A very consistent finding was that firms have little difficulty in finding or engaging suitably qualified staff. Neither did they believe it is difficult to dismiss employees. Once again, Montenegro was an exception, where 57 per cent of firms find it difficult to reduce their workforce. It is not clear whether this is the result of already stiff regulation, or whether it is the result of other, perhaps cultural, factors. In addition to this regional difference, it seems that the very smallest firms (1 or 2 employees) find dismissal difficult. This is probably not the result of legal difficulties so much as the managerial challenge of dismissing staff in such an intimate environment or the loss of accumulated knowledge that would inevitably follow where you dismiss half the workforce. It is also the case that firms in Vojvodina found it harder to attract suitably qualified staff than firms in other regions. Nevertheless, further evidence that firms do not find themselves constrained by labour market legislation is that 90 per cent of them have maintained or increased employment in the last two years. Notwithstanding official data that show rapidly rising average wages, firms did not report that they were under pressure from increased wage demands.

The difficulties reported by entrepreneurs in expanding operations or purchasing new equipment are most likely related to low liquidity and profitability. While Russian small businesses averred to problems in regional protectionism as a barrier to expanding into other territories, most FRY firms believe it would be just as easy (or difficult) to open a firm in another region as in their own.[64] The responses in Table 21 confirm the perception that obtaining various licenses and certificates can be a difficult task for entrepreneurs. This point is underlined in OECD-EBRD (forthcoming), which shows that entrepreneurs consider both the procedures for registering new companies and obtaining licenses and certificates to be overly bureaucratic, complex, time-consuming and costly. A significantly larger number of entrepreneurs rated this activity as more difficult in Belgrade (48 per cent) and Central Serbia (52 per cent), than in Vojvodina (35 per cent) and Montenegro (27 per cent). Responses to the question on protection from extortion are also interesting, particularly in Belgrade where 23 per cent of respondents refused even to answer the question. Of those who did answer in Belgrade, 41 per cent claimed that such protection is difficult, and only 6 per cent rated it easy. Entrepreneurs in Vojvodina also stressed this problem, while businesses in Central Serbia and Montenegro were divided. It should be noted that this question does not by itself measure the level of criminal activity. A well-developed protection racket might actually make the purchase of protection easier.

Whilst some studies have stressed the problem of harassment by various state bodies of small businesses in the FRY, this is not borne out by the survey responses (Table 22).[65] Entrepreneurs were asked which, if any, official state bodies have been particularly obstructive to their operations over the past year. Only the tax administration attracted a significant number of responses. Given the strong tradition of tax evasion in the FRY, and recent measures to increase tax collection, the responses seem an entirely plausible reflection of a desirable policy shift. The prevailing attitude of entrepreneurs seems to be that the tax system is too unstable as a result of frequent changes in rates and types of tax affecting small businesses. This has a knock-on effect in terms of ability to plan investment decisions, and an increased burden in terms of compliance costs. For purposes of comparison, the average responses of 304 Russian entrepreneurs to the same question in the regions of Tula, Udmurtiia, and Irkutsk are also given in Table 22. Clearly, this problem is altogether a different scale in Russia than in the FRY.

(Table 22. Burden of harassment on small firms by state agencies)

Another set of questions focused on the difficulties of enforcing explicit or implicit contracts. Responses revealed the weight small firms place on long-term friendly working relationships with suppliers and customers. While the importance of a written contract was mentioned by a significant number of entrepreneurs (42 per cent), a strong majority (68 per cent) believed that a contract is not usually sufficient to obtain payments due to the firm (Table 23). This is consistent with the apparent scepticism amongst entrepreneurs over using the courts to resolve conflicts with customers or suppliers. Only 14 per cent of those businesses sampled indicated that they used the commercial court to resolve contractual conflicts. Likewise, there was scepticism over using the courts to handle infractions by regulatory authorities. More entrepreneurs indicated that they would anyway comply with a regulatory body exceeding its legal authority than would go to court. On a more positive note, a strong majority of firms did not believe it was important to cultivate a special relationship with various state bodies and administrations.

(Table 23. Use of formal contracts by small firms in collecting debts)

During the survey, entrepreneurs were asked to offer their general impressions on the overall environment for small business activity in their cities, and how this environment has changed in recent years (Table 24). A significantly greater number of businesses in every region surveyed indicated a perception of a deterioration of the overall climate than noted an improvement. Specifically, they perceived deteriorating profit margins, demand, investment opportunities, and the overall business environment. On balance, entrepreneurs seem rather pessimistic about developments in the judicial system as well. The only area in which they responded positively, overwhelmingly so, was in respect of relations with employees. This seems due to changes that have eroded the bargaining positions and strength of employees and the labour unions vis-à-vis employers (see Box 5). Small firms in Montenegro weakly indicated that there were growing possibilities to compete with existing firms; Serbian entrepreneurs were evenly divided on this question.

(Table 24. Perceived changes in the business environment over the last two years)

Falling profit margins in small businesses are consistent with the financial data analysed in Chapter II. This factor is particularly noticeable in trade, where only 12 per cent of entrepreneurs indicated an improvement and 52 per cent noted a deterioration. Despite the apparent growth in retail trade in the economy as a whole in 2001 and early 2002, most entrepreneurs do not perceive any strengthening of consumer demand. This suggests growing competition from imports (see Chapter V). Given a scarcity of bank finance, almost all investment must be financed out of retained earnings, thereby linking declines in profit margins and retained earnings to lower investment opportunities. The availability of external finance for SMEs may have improved in Belgrade and Montenegro, at least marginally, which might be associated with foreign-backed programmes that support SME lending. On questions about firms' relationship with various state authorities, the licensing process, and criminal activity, responses in all regions indicate an absence of change.

Reponses by entrepreneurs on the state of their own particular firm were, on balance, more positive than their perceptions about the climate for small businesses as a whole. As reported above, the majority of firms considered themselves financially stable. They did note a fall in their own sales and profitability but, somewhat ironically, emphasised their growing competitiveness. Responses for "level of production" and "employment" were also marginally positive. The majority of businesses in the survey believe they operate in an environment of "fierce competition". However, they also plan to increase turnover in the immediate future, particularly in Montenegro.

Programmes and policies

The evidence presented here and elsewhere in the Assessment offers a mixed assessment of small business development in the FRY. On the one hand, existing small businesses seem rather confident of their financial stability and plan to increase turnover in the future. On the other hand, entrepreneurs perceive a deterioration in a number of important elements in the economic and institutional environment for small businesses, including profitability, investment opportunities, and tax conditions. Most disturbing is that the sector appears stagnant, with relatively little entry of new firms or exit of old ones. A dynamic small business sector exhibits sizeable rates of entry and failure in a competitive environment, hard budget constraints and rapidly changing market conditions. The legitimate small business sector in the FRY remains quite small by international standards, and the slow pace of private firm creation should be a major cause for concern.

The patterns observed in the FRY's SME sector reflect an on-going transition in the sector itself. It has had to shift away from dependence on the subsidised state and social sectors, the exploitation of policy-induced market distortions and a high degree of informal activity, towards legitimate operation in an open market economy. Although it is natural that this transition will complicate SME development in the short term, it is vital that policy reforms facilitate the sector's transition. This means alleviating some of the administrative burdens of operating a legitimate small business in the FRY, creating opportunities for the entry of new firms, and defending possibilities for fair competition.

Both Serbia and Montenegro have developed strategies for monitoring and promoting small business development. With foreign assistance, Montenegro created an Agency for the Development of Small and Medium-Sized Enterprises. This agency has been monitoring the Montenegrin small business community, developing proposals for reform and programmes for SME development. Its policy priorities are to promote entrepreneurship by making it easier for Montenegrins to start businesses, and to encourage them to do so by explaining the benefits of self-employment. The Agency also seeks to promote business skills, reduce the grey economy and lessen the burden of government regulation and taxation. An important initiative in Montenegro simplified the registration procedure for new firms, and reduced its cost. From June 2002, company registration costs EUR 1 and takes four days. The procedure previously took at least 15 days, and cost EUR 5 000. Montenegrin entrepreneurs offered somewhat more positive responses in the survey than their Serbian counterparts on perceived changes in the SME environment during the last two years, including the availability of external finance. The longer history and higher levels of foreign support for SME development in Montenegro may go some way to explaining this result. The Montenegrin Agency for Development of SMEs has encouraged the government to guarantee SME borrowing, though this type of intervention carries both a risk to the budget and entails distortions that arise in choosing which SMEs will benefit.

The Serbian government has also devoted much recent attention to the small business sector. A new Agency for Development of SMEs and Entrepreneurship was established in November 2001, answerable to the Ministry of Economy and Privatisation. The Agency is establishing a network of regional offices that provide information and training to SMEs, and is responsible for implementing the ministry's strategy for SMEs. The Agency has three basic operational goals: to invigorate economic development in the regions; directly spur entrepreneurship through business incubators and programmes of education; and finally to propose legal and regulatory changes that would improve the operating environment for SMEs.

As a contribution to the Agency's work, in June 2002 the Committee for Development and Foreign Economic Relations of the Serbian National Assembly endorsed a comprehensive Strategy for SMEs in Serbia.[66] This programme acknowledges the prime importance of the small business sector for successful economic transition in Serbia, and proposes a series of measures to facilitate its development. This programme is informed by a survey identifying the various formal and informal costs of operating a small business in Serbia.[67] The Programme of Entrepreneurship proposes several categories of government measures for improving the SME environment, including tax exemptions for new businesses, new laws to simplify registration and licensing procedures, state procurement contracts for small businesses, limits on state inspections, the creation of training programmes, special credits and investment funds for SMEs, and the development of 'business incubators'. As of mid- 2002, however, many questions remain concerning the details and sources of funding for these activities.

Given the limited resources available to the Serbian and Montenegrin governments, effective policymaking requires prioritisation. For this purpose, it is useful to remember that entrepreneurs, by their very nature, tend to be independent people who are themselves able to identify profitable opportunities for business. Small business development stands to profit most from measures that can improve the overall business climate for entry, exit, market relations, and effective competition. Given the dormant state of financial markets in the FRY, proposals for extra state assistance through privileged credits, tax exemptions, and procurement contracts have an understandable political appeal. But these types of programme are also commonly susceptible to fraud and corruption. Moreover, special treatment granted only to certain SMEs could undermine the objective to create fair conditions for firm entry and competition. The privatisation process will also influence how quickly competition develops (see Chapter IV). The very low observed rate of firm creation speaks for considerable caution in approving any programme that grants special privileges only to selected incumbents. While the SME sectors in Serbia and Montenegro might indeed benefit from the development of institutions for micro-finance lending, it remains the case that SMEs throughout the world operate successfully under considerable liquidity constraints, using retained earnings as their primary source of finance.

Given that they expect to operate under conditions of a hard budget constraint, effective competition and weak financial markets, SMEs will have only limited recourse to outside finance for some time to come. Nevertheless, the speed with which the credit market in the FRY revives also depends significantly on economic policy. Since virtually all lending to SMEs is backed by collateral, legislation to facilitate the use of collateral can be particularly important. Commercial banks and SMEs need conditions under which collateral can be easily and costlessly seized in the event of default on a secured loan.

Leasing has proven an effective tool for supporting the activities of small businesses in many countries, and legislation in this area could also be a priority target in the FRY. The government can affect the market for leasing directly, since the leasing market is very sensitive to tax treatment and the protection of the rights of the lessor to recover assets when the lessee defaults on payments. Increasing use of leases would be one way in which Yugoslav business could rebuild its assets without having to finance their full price. It would help relax the constraint represented by the availability of credit, accelerating the recovery of investment and production. From the government's point of view, it would additionally be one way to attract foreign investment and capital. Providing that the ruling legislation allows recovery of the asset, it substantially reduces the risks to the lessor of operating in what would otherwise be considered a volatile and difficult environment in which to do business.

The results of the OECD survey, as well as other sources of information, suggest that low existing level of dynamism in the (legitimate) small business sector, and corresponding low rate of new firm creation, should be a primary target for economic research and policy in the SME sphere. Future studies should focus on this question in particular, and clarify the existing problems. The simplification of registration procedures may be one critical measure in this area. In the recent OECD business survey, FRY entrepreneurs complained much more of registration procedures than their Russian counterparts. The possible predatory behaviour of incumbent firms toward new entrants in the FRY should also be investigated in detail for various specific markets. Competition law can help with these problems. However, the competition authority lacks political and public support, and does not have the necessary powers or resources to undertake pro-competition initiatives.

IV. THE ENTERPRISE SECTOR AND PRIVATISATION

Privatisation in Yugoslavia predates the ambitious programme announced by the new democratic government in June 2001. Earnest efforts at privatisation began at the end of the 1980s, and sporadically re-emerged during the 1990s as the government sought to raise revenue, increase efficiency or transfer assets to further its political objectives.

Yugoslavia's system of worker-managed socialism had bequeathed an enterprise sector very different from those typically found in other socialist economies. Firms operated in a market environment, setting prices and making investment decisions. However this outwardly competitive environment was commonly undermined by government intervention in the banking sector, setting the cost of credit and directing credits to favoured enterprises. Enterprises also faced very different incentives to those in a market environment: firm exit was rare, and surplus resources were rather used to increase wages than be reallocated or invested (see OECD (1991) and Annex IV.1). Another Yugoslav peculiarity was that, unlike in systems of central planning, the central government refrained from intervening directly in businesses. To a certain extent, weaker central authority allowed local governments to play a much more important role, notably in the six separate republics that made up the Socialist Federal Republic of Yugoslavia (SFRY). In any case, competition did not extend to firm mergers or take-overs and, crucially, to forcing the closure of loss making firms. These structural factors had macroeconomic consequences, most notably through the upward pressure on public expenditure (see Chapter II). The need to subsidise loss-making enterprises was a direct source of pressure on the budget; another was public investment in new firms needed to absorb the growing labour force.

The nature of the enterprise sector and the experience with privatisation in the 1980s and 1990s influenced the design of privatisation that began in 2001, and will affect its ultimate outcome. Not least, this legacy has raised questions over legitimacy, arising from the difference between legislation at federal and republican levels. The drawn-out experience with privatisation has also induced a cynical view amongst the population of the government's motives in undertaking yet another programme.

Backwards steps: the experience of the 1990s

The last OECD Economic Survey of Yugoslavia drew attention to the deteriorating financial position of the enterprise sector through the 1980s (OECD, 1990). Reforms passed after 1984 had little effect in stemming losses and strengthening financial discipline, and rates of return remained very low despite access to credit at negative real rates of interest. The government passed an Enterprise Law in 1988, followed in 1989 by an Act on Financial Operations and a Law on Social Capital. Together these three pieces of legislation provided a mechanism to address the problem of insolvent firms by introducing rules on bankruptcy and allowing firms to restructure using private capital. They facilitated firm re-organisation, as a prelude to restructuring and privatisation, by suppressing semi-independent sub-units,[68] and specifically allowed wholly private enterprises as well as 'mixed' private and socially-owned enterprises. The most important innovation was the change that allowed an enterprise's Employee Assembly to sell some, or all, of the enterprise's capital. Together this package of laws became known as the Markovic Laws.

These legislative changes left open one important question. Although firms could become mixed, in the sense of having both private and social capital, the new rules did not specify how this would affect the hitherto dominant role of the Employee Assembly. This ambiguity acted as a considerable discouragement to domestic and foreign investors. Foreign direct investment remained at very low levels throughout the 1990s, despite legislation from 1988 that had accorded foreign firms "national treatment" (Figure 19).[69]

(Figure 19. Foreign direct investment inflows, 1996-2001)

This legislation was passed by the Yugoslav federal parliament, and subsequently inherited by the five subsidiary republics. It worked on the basis that firms could not be compulsorily sold. The underlying tactic was therefore to make it attractive to managers and employees to opt for privatisation by allocating them shares.[70] In fact, the reforms had been undermined soon after they were enacted. The Serbian constitution of 1990 reiterated the equality of all ownership rights, including social ownership. This constitutional equality ruled out forcing privatisation on socially-owned enterprises, reinforcing the Yugoslav federal constitution that forbade compulsory privatisation. The shibboleth of voluntary privatisation was once again strengthened after it became entrenched in the new federal constitution of April 1992. This constitutional position dogged further attempts at enterprise sector reform throughout the decade, and remained in place until the adoption of a new Law on Privatisation in 2001. The Achilles heel of the Markovic process was that it failed to address the question of social ownership.

Initial privatisation in Serbia, 1990-94

Between 1989 and 1994 some 60 per cent of Serbian firms completed Markovic privatisation, after which they were on average 80 per cent privately-owned. However, sales to insiders and fundamental uncertainties over the relationship between owners and the Employee Assembly, meant that privatisation did little to change the behaviour of enterprises, much less place them under a 'hard budget constraint'. As a result, the overall condition of the enterprise sector did not improve. As real interest rates turned positive during this period (removing one source of indirect subsidy to enterprises), firms began to accumulate arrears and continued to receive direct subsidies and soft credits. Banks often preferred to write loans off rather than put firms into bankruptcy; there was little incentive to foreclose on loans, since bankruptcy and liquidation procedures were heavily weighted in favour of the debtor. These influences dominated any marginal impact on efficiency that changes in ownership may have promoted.

Even the tentative efforts at privatisation in Serbia represented by the Markovic process were soon to be undone. Hyperinflation took hold in Yugoslavia at the beginning of 1993 and did not abate until January 1994. In the aftermath, the nominal amounts owed by those who had purchased shares under the privatisation programme had become vanishingly small. Privatisation had effectively transferred social assets to insiders for free. The government's response was to annul the privatisation process through an amendment to the Privatisation Law in 1994 that clawed back previously privatised capital.[71] Once this procedure was complete, less than 10 percent of capital remained privately owned. The legacy of this reversal can be seen in the 2001 privatisation programme, in which sales are for immediate delivery of cash.

During this period a new trend emerged in the enterprise sector: nationalisation. This policy ran counter to the Yugoslav system of economic management that had prevailed since the late 1950s, but the government began to turn socially-owned enterprises into state-owned enterprises. This was the product of two distinct influences. Firstly, some argued that the strategy of decentralising enterprise management was undermining socialism. In addition, by 1993 the federal state had ceased to exist in all but name. Hence the need to maintain decentralised management in the enterprise sector, in order to sustain a political equilibrium between the republics, had also evaporated. If these were legitimate motivations, a second altogether more pernicious influence was that of corruption. State-owned companies were a ready source of political patronage. This was exploited directly by highly placed politicians, but also indirectly in the sense that they needed tighter control over key sectors in the economy to bolster their political position. An estimated 40 per cent of social capital was transferred into state ownership during the early 1990s, covering mainly utilities and transport but also including some television, radio and print media.

Experience in Serbia: 1995-97

There was a wide debate during 1995 on whether privatisation should be mandatory or whether it should continue to be voluntary. The issue had resurfaced due to an obligation under the new constitution to replace, or affirm, all federal legislation in place at the time it had been passed in 1992. A reform proposal co-ordinated by the central bank was made in May 1996 (Avramovic and Uvalic, 1996), but in the end the government dashed expectations of reform. It opted to affirm existing legislation: the 1996 federal Law on Privatisation endorsed existing policy that privatisation should be voluntary. The only innovation was explicit recognition that the republics should develop their own privatisation programmes within the loose framework laid down in federal law.

Serbia passed its own Privatisation Law in 1997. Much as in the Markovic process, firms could opt into a privatisation programme which offered shares to existing employees at a generous discount and on generous terms.[72] The proceeds from privatisation were earmarked to various funds (the pension, employment and development funds), though up to 60 per cent of the shares could be distributed free of charge. This renewed attempt at privatisation therefore amounted to little more than a reprise of the Markovic process, though for the first time the 1997 legislation introduced special treatment for "strategic enterprises". The government took over responsibility for privatising the (potentially lucrative) 75 enterprises that fell into this category. The most controversial privatisation under this law was that of Serbian Telecom in 1997, for which the government had to alter the Law on Foreign Investment to remove telecommunications from a list of strategic industries in which foreign investment was prohibited.

In fact few companies opted to privatise under the 1997 legislation (Table 25), though by 2001 the various privatisation initiatives had, when taken together, resulted in a significant number of companies in 'mixed' (social/private) ownership. This mixed group did not include the larger companies. This was because the ceiling on share distribution to "insiders" was expressed in nominal terms. The ceiling did not prevent insiders from gaining a dominant share of enterprises with modest total assets, but the *proportion* of assets passed to employees in larger enterprises was simply too small to persuade these groups to cede control. Managers had too many opportunities to 'tunnel' assets and profits out of the state and socially-owned enterprises in which they worked to make privatisation an attractive option (see Chapter III). Although the Serbian private sector at the end of 1998 contributed more than one-third of gross social product, state and socially-owned enterprises dominated employment and ownership of assets (Table 26).

(Table 25. Privatisation in Serbia, 1997-2000)

(Table 26. Profile of Serbian enterprise by ownership, December 1998)

Slow progress in Montenegro led to determined change

The experience in Montenegro was somewhat different, although the outcome was much the same. The issue of social ownership had been confronted head on in the 1992 Act on Property and Management Transformation. This law required socially-owned enterprises to incorporate, that is to become public limited liability companies and issue shares representing ownership. The result was mass incorporation during the middle of the decade (Table 27) These newly issued shares were not sold, but rather were distributed to existing employees. This contrasts with the Markovic process: in Montenegro all enterprises became companies, and some shares were distributed free to the workforce.[73] At the end of the process, the state owned 60 per cent or more of formerly socially-owned enterprises, through various state funds (for pensions, employment and development) (Vukotic, 2001). There was no more 'social capital' or confusion about the ownership of firms. However, as in Serbia, continued state ownership did little to change enterprise behaviour or encourage firms to behave more efficiently.

(Table 27. Enterprise transformation in Montenegro, 1990-99)

Montenegro used the latitude granted it in the 1996 federal law to pass its own Privatisation Law in 1996. This law set out how state funds would offer their accumulated shares in enterprises for sale to the public. In the three years following this privatisation law, the funds sold majority shares in 96 enterprises: a controlling share in 86 companies (of which two were by tender, the rest by auction), and a managing share in 12 companies.[74] Nevertheless, by the time this process concluded in 1999, still more than two-thirds of enterprise capital remained in state hands, and some 22 per cent of capital was held by employees (Table 28). The incentives on managers, notably through access to subsidies and easy credit, had not changed, and enterprise performance had not improved. As in Serbia, the process favoured insiders (employees and management), and sold shares at discounts and with long payment periods. In addition, the process was criticised for lacking transparency, and for decision-making being too dispersed amongst different parts of government, notably the three state funds. There was a generalised failure to co-ordinate the process, but also in enforcing those agreements that had been reached. Where privatisation contracts had been made, employees sometimes simply refused to co-operate, or sought to add obligations/benefits to the agreed contract. There was little respect for formal property rights.

(Table 28. Ownership of Montenegrin firms, December 1999)

A radical change in strategy took place against the background of increasing pressure from foreign donors of aid and technical assistance to make progress. In response to criticisms, and to prevent the ossification that had occurred in Serbian privatisation, the government of Montenegro established a Privatisation Council in September 1998. This body took control of the process, putting a stop to 'spontaneous privatisation' and promising immediate progress. The result was the 1999 amendment to the Privatisation Law. The amendment's guiding principles were swift, transparent privatisation. Companies were obliged to prepare a privatisation plan, specifying a timetable, which was made public. The government established a central share registry so that share ownership could be reliably bought and sold, and company ownership established. Most importantly, despite the misgivings of foreign advisers, the amendment marked a wholehearted shift in favour of mass voucher privatisation (MVP).

A legacy of suspicion

At the end of 1998, the private sector still accounted for less than 15 per cent of Serbian employment, and held about 6 per cent of business assets.[75] One year later, the situation was not much different in Montenegro despite protestations that the processes were entirely different. But in both republics there had been little change in ownership and still less in managerial behaviour over the enterprise sector as a whole.

By the end of the 1990s Yugoslav business had become characterised by a very close relationship between business and politics, fostered by the imposition of international sanctions on Yugoslavia for much of the decade. Rules and behaviour governing conflicts of interest had been replaced by the doctrine of looking after one's own interest. Defence of the public interest had given way to flourishing corruption and the confluence of political and business affairs. In Serbia, leading political figures were directors of the 30 largest enterprises. In this environment the public regarded the political motivation for further privatisation with some suspicion. This legacy was a strong influence on the design of Serbian privatisation that began in 2001. Montenegro sought to address weaknesses in its privatisation programme somewhat earlier through the legal changes it had introduced in 1999, but by the end of the decade these had not led to effective progress. The public doubted the legitimacy of the process.[76]

Breaking with the past: a fresh round of privatisation

As well as drawing on experience in other transition economies, the Serbian privatisation programme clearly addresses the concerns arising from the legacy of Yugoslavia's 'lost decade'. The privatisation process is mandatory; this more than anything else distinguishes the 2001 programme from its predecessors in the 1990s. It aims to pass socially and state-owned assets to a new dominant owner in a transparent and predictable process grounded in the rule of law (Box 6). One consequence of this approach is that the government has chosen to let those enterprises that had started privatisation under Serbia's 1997 law, complete the process. Retrospectively annulling these privatisations would have further undermined public confidence in the legal process and called into question the government's intention itself to respect the law. Foreign ownership is encouraged, as the government has acknowledged that foreign investors bring management expertise and technical know-how as well as financial resources (see below).

Serbia's programme encompasses all state and socially-owned enterprises, though the government has undertaken to restructure certain enterprises, or enterprise groups ('systems') before selling those pieces that are judged salvageable. Of an estimated 50 systems, the government expects nearly all will be restructured. The Ministry of Economy and Privatisation makes the decision about which systems will qualify for restructuring, in consultation with the Privatisation Agency. Broadly, the criteria are that the system should be large (together they cover some 150 000 to 200 000 employees), have a significant debt burden and, lastly, be regionally important. A summary of the systems likely to qualify is given in Table 29.

(Table 29. 'Systems' likely to qualify for pre-privatisation restructuring)

Box 6. Serbia's privatisation programme

The Serbian privatisation programme was launched in June 2001. It is based on three laws and three decrees that define the process and give the authorities the powers they need to execute the sale of socially-owned and state enterprises. The three laws are the Law on Privatisation; Law on the Privatisation Agency and Law on the Share Fund. The ancillary decrees are on the Sale of Capital and Property by Public Tender; the Sale of Capital and Property by Public Auction, and on the Methodology for Valuation of Capital and Property. Together these lay out a strict timetable for each phase of the privatisation process. The process has been designed, and legislation drafted, in close association with the World Bank.

The legislation requires all enterprises to value themselves, and to prepare a timetable for privatisation. A decision to begin the process can be made by the enterprise, by the demand of a potential buyer, or by the Ministry of Economy and Privatisation. The law specifies that the privatisation of socially-owned enterprises must be completed within four years: *i.e.* by June 2005. Most enterprises are to be sold by auction, though some 300 of the larger enterprises will be sold by public tender. Those that cannot be sold by the end of the period and are bankrupt, will be liquidated. The decision about which enterprises to select for tender privatisation rests with the Ministry, after discussion with the Privatisation Agency. Indeed, the Ministry retains overall responsible for privatisation, whilst the Privatisation Agency executes the process at arm's length from government. The authorities expect that some 2 000 enterprises will be privatised by auction, with a slightly higher number likely to end in liquidation. The government's intention is that all enterprises should be privatised by direct sale to a majority owner.

Box 6. **Serbia's privatisation programme (contd)**

The 2001 privatisation legislation has sought above all else to make the process transparent. Enterprises privatisation plans and valuations are public documents; the auctions and tenders take place in public and must be widely announced (including in the London *Financial Times*); there is to be no further negotiation with the winning bidders once the winner has been declared (other than on the nature of guarantees offered in support of the bid); in the case of tenders, the criteria used to assess the bids will be announced in advance, on a case-by-case basis. Each privatisation is supervised by a commission, and foreign advisers are used in constructing the tender and assessing the bids. The legislation also specifies how the proceeds from privatisation are to be distributed. Of the total, minus success fees paid to advisors, 75 per cent passes to the Serbian budget, 5 per cent is set aside in a fund to meet restitution claims, 10 per cent is paid each to the pension fund and an infrastructure fund, of which half is controlled by the regional tier and half by the local municipality.[1] Once the sale is complete, up to 30 per cent of the shares (the proportion falls the longer it takes the firm to begin privatisation) is distributed free to employees, and citizens in the case of tender privatisations.

If any shares are left unsold, they are passed to a new Share Fund. This fund is intended only to hold shares until they can be sold. Its founding legislation insists that it will have sold all the shares transferred to it within six years: *i.e*. by June 2007.

Tenders

In consultation with the government, the Privatisation Agency sets the criteria for assessing the tender bids in advance of the call to tender. The tender commission consists of five members: three representatives of the government of Serbia, one of the local authority where the enterprise is located and one representative of the enterprise. The commission decides whether to accept or reject the winning bid proposed by the Privatisation Agency. Existing workers qualify for a free distribution up to 15 per cent of the enterprise's capital.

Auctions

The auction takes place at the Belgrade Stock Exchange providing that there is at least one qualified bidder.[2] The auction is an English auction, beginning at the lower end of the approved enterprise valuation. If there are no bidders, then the auction immediately begins again as a Dutch auction, beginning at the upper end of the approved enterprise valuation. Existing workers qualify for a free distribution up to 30 per cent of the enterprise's capital.

Valuation

Enterprises are all obliged to produce a book value, and capital valuation according to two methods: discounted cash flow (DCF) and liquidation value. The discount rate used in the DCF is set to the return on a riskless asset + Yugoslavia country risk + entity specific risk of between 5 and 25 per cent. No enterprise may be sold for less than the deposit required of participants in tenders or auctions, though the Ministry of Economy and Privatisation sets this deposit without explicit reference to the enterprise valuation.

1. The relative shares of the Serbian and other budgets are being revised, with the aim to increase the part going to local authorities. This change was expected to take effect during the last quarter of 2002.
2. From September 2002, other suitable public places may hold auctions. Auctions may also take place outside Belgrade, in Novi Sad, Nis and Kraljevo.

Privatisation results: Serbia

At the end of September 2002 only 33 enterprises had been sold (5 by tender, 28 by auction) for a total of about EUR 170 million (Table 30). The government has set itself the ambitious target of auctioning 1 000 enterprises by the end of 2002. The slow start calls into question the government's strategy of offering the best enterprises first in order to generate a momentum in the process that would then carry over to the less attractive firms.

(Table 30. Serbian privatisation, January - September 2002)

A different approach to that used for enterprises has been used in the banking sector. The National Bank of Yugoslavia (NBY) has used the authority as banking regulator that it failed to exercise with any vigour during the 1990s (Chapter II). The NBY has adopted a policy of direct intervention to address the problems of liquidity and solvency in the medium-sized banks. Unlike the larger banks, it did not take-over the banks on grounds of insolvency but instead took control using debt-equity swaps. This was possible since many of these banks had issued debt under sovereign guarantee, on which they defaulted during the 1990s, passing liability onto the government (though this was subsequently relieved in an agreement with the Paris Club in December 2001). These liabilities are being converted into equity. In this way the NBY took a majority stake in 14 commercial banks in August 2002, arguing that this would enable it to clean the banks up and quickly sell them to a strategic investor.

There is one further channel by which the Serbian government is transferring assets into private ownership. The state share fund has accumulated holdings in some 800 companies, in which it is often the largest shareholder. The holdings are generally between 10 and 40 per cent. Since April 2002 the Share Fund has auctioned holdings in 21 companies on the Belgrade stock exchange. Shares with a book value of USD 42.4 million were sold for USD 65.8 million. The government expects Share Fund sales to be an important source of revenue over the near future.

Privatisation results: Montenegro

Mass voucher privatisation (MVP) covered only 40 per cent of the shares in the 190 companies included in the programme.[77] Other methods, notably tender sales, have been more important for Montenegro's privatisation process (Table 31). Taking into account previous share distributions, individuals directly own some 30 per cent of industry, plus a further 15 per cent through privatisation investment funds (PIFs) in which they invested their vouchers. The largest fund represents about two-thirds of this holding, with the balance being divided between another five funds.[78] However, not all companies were included in the MVP. Indeed with voucher privatisation now complete, an estimated 45 per cent of industry (including the 17 largest companies) is not in private hands. Given that the state pension fund holds another 11 per cent and that the 30 per cent held by individuals is widely dispersed, this potentially leaves the state with considerable influence over developments in the industrial sector. This is particularly so since rules on protection of minority shareholders and competition regulation have not yet been developed. The government still aims to sell its direct holdings by tender.

(Table 31. Privatisation in Montenegro up to July 2002)

Shares are traded on one of Montenegro's two stock exchanges. Though shares in companies sold during the MVP had been tradable since March, secondary trading of shares only took off in May 2002.[79] However, the increase in trading volumes was largely not in MVP company shares, and only five companies accounted for 80 per cent of trading.[80] The privatisation funds are not yet active traders, having taken some time to meet regulatory requirements in respect of registering their shareholders on a central database. It remains the case that relatively few of the companies offering their shares on the exchange are able to sell them, and that it is too early yet to examine what impact privatisation has had on corporate governance and firm performance.

The, perhaps surprising, outcome of MVP has been that individuals mainly invested their vouchers in traditional sectors: steel, agriculture, electricity and the railway. This may implicitly involve a calculation about moral hazard; namely that the government will not let these, nominally private, companies fail.

Privatisation design in the FRY

The issue of speed

Privatisation in Serbia is portrayed as an issue of economic efficiency rather than one of social justice. At the same time, a main concern is to stem the need for subsidies, allowing the government instead to channel resources to areas such as education and the social safety net, both objects of equity not efficiency. It is not possible to consider policy in these two areas separately. Faster privatisation will help reduce subsidies more quickly, and the presence of adequate social safety nets encourages faster privatisation. Delaying privatisation will put off the moment at which assets are used more effectively by the firms that currently hold them, or recycled into better uses in others' hands. Indeed slow privatisation can provide an excuse for enterprise managers to stop selling assets on the grounds that they want to maximise the cash value of the firm in privatisation, although individual assets may have a higher economic value outside the firm. Notwithstanding this imperative, putting in place sound institutions to execute the privatisation process inevitably takes some time.

In line with this thinking, the government has continually stressed the need for speed in its privatisation programme. Although the government has been at pains to point out strict timetables, its four-year time limit is not as absolute as has been portrayed. The law specifies that privatisation of socially-owned enterprises must be completed within the time limit. The law says nothing about state-owned companies. Hence, following the wave of nationalisations in the 1990s, those companies now in state hands are not subject to this time bar. The authorities declare that they have an internal objective to complete privatisation of those state-owned companies that are to pass into private ownership within six years. But this intention has no legal force, and at the same time Serbia might wish to retain some of these assets permanently in state hands. For the time being the government plans only to look to the EU as a model, though the wide variety of experience amongst EU countries leaves open the possible future scope of the public enterprise sector.

The evidence from other transition economies on whether this matters for future enterprise performance is mixed. Indeed there is some evidence that firms privatised later in the process are at an advantage; they become seasoned by surviving in a difficult environment, though this presumes that the authority of the state and the rule of law are sufficiently strong to prevent managers asset-stripping the firms in the interim period before privatisation in what is euphemistically known as "spontaneous privatisation". Whilst privatisation is no magic bullet with respect to enterprise performance, slow privatisation is most likely to have a significant negative impact on the government's fiscal balance and could hinder the reform effort more widely (Kornai, 2001).

The relationship between privatisation and the budget

The government has set aside resources in the budget to pay the redundancy costs of 60 000 workers in 2002. Similar amounts are envisaged for 2003. This is one constraint on how quickly restructuring of those enterprises held back from immediate sale can proceed. There is also inevitable pressure on the budget from payments under social programmes that are less directly under government control. For instance, the budget has to cover health insurance contributions for the registered unemployed.

Constraints imposed by international financial institutions prohibit the government from financing budget expenditure out of increased arrears. This leaves the authorities having to make an invidious judgement about the relative costs of preventing enterprises from collapsing by failing to enforce their current and historical obligations to the government or state-owned companies (such as the electricity company), and forcing (at least parts of) them into bankruptcy or liquidation. The former would deprive the government of some current revenues but save the immediate costs of increasing unemployment, the latter might help preserve scarce resources but would crystallise costs associated with higher unemployment. In addition, rising unemployment would most likely in itself present political difficulties for the government. Of course, privatisation revenues themselves are a source of financing, but experience in other countries suggests that they are usually extensively overestimated.

The choice between direct sales and mass privatisation

The Serbian approach avoids reliance on secondary markets as a mechanism for dominant owners to emerge. This should not prevent some effort being put into developing adequate institutions of corporate governance, particularly regarding the protection of minority shareholder rights, transparency and disclosure. The objective of privatisation is to concentrate ownership amongst outsider owners, unconnected with the enterprise. This choice reflects the experience in, notably East Germany, Estonia and Hungary. These countries moved decisively to sell their enterprises to outsiders, mainly foreigners, in contrast with transition economies such as both Slovenia and the Czech Republic. An alternative model is a more gradual development of a domestic entrepreneurial culture in Poland in what became known as privatisation through liquidation. Though in Poland’s case, privatisation of the state sector has proceeded quite slowly and the state still plays an important part in the economy. The chosen strategy was to reinforce creditor rights as a way to strengthen corporate governance and ultimately improve enterprise management and performance.[81]

Whilst the process aims to transfer assets to a dominant new owner, as in previous privatisation programmes the Serbian government has provided incentives to existing and retired workers to give up social ownership. This free distribution of shares can be seen either as a payment in support of social equity, or as a regrettable necessity to facilitate the privatisation process (Carlin and Landesmann, 1997). Within this constraint, the process minimises the risk of disruption. The free distribution of shares will take place only after the sale of a majority stake; once there is a new majority owner a minority share is distributed free of charge to the existing workforce.[82]

The government has rightly emphasised its desire to attract foreign investors: a new law on foreign investment was passed in January 2002 guaranteeing foreign companies and individuals “national treatment” including the right to buy land. Although the evidence on the role of private ownership *per se* is somewhat mixed, there is stronger evidence to support the positive role played by foreign participation in privatisation. Foreign partners not only bring fresh capital. They can bring managerial and technical expertise but also, crucially, access to international sales and production networks. Foreign direct investment is patient capital, not susceptible to the sudden reverses that can affect more fickle portfolio flows. But it takes more than the existence of a privatisation programme to stimulate inflows of FDI. The supply of FDI is sensitive to the nature of the business environment. Indeed inflows of FDI and greater economic liberalisation tend to go hand in hand (Selowsky and Martin, 1998). Hence, it is possible to see flows of FDI as an indicator of the economic environment, that will of course also determine whether domestic SMEs are able to establish themselves and grow (World Bank, 2002). Low levels of *per capita* FDI are associated with low levels of employment in SMEs (see Chapter III).

Enterprise valuation

For those enterprises that immediately enter into privatisation by tender or auction, the valuation method for determining the minimum sales price (discounted future cash flow), places enormous weight on projected net cash revenues over the next 3-5 years. Over such a short time horizon, and given the low starting point, this should lead to modest sales prices. Advisers engaged by the government have an incentive to make sure that enterprises are sold since they will then gain a success fee: their remuneration has been weighted towards success fees rather than retainers. This reinforces the likelihood that enterprises will be offered at realistic prices. Nevertheless, the valuation method is rather cumbersome, and presumes the existence of accurate individual asset and financial valuations. In July 2002 the government made changes to the privatisation process that diminished the importance of enterprise valuation (see below).

Notwithstanding the precise methods set down to value enterprises, partly motivated by the desire to prevent corrupt sales at undervalue, sales prices are determined by demand. Serbia's relatively high labour costs, in euro terms, count against it when fighting to attract foreign direct investment to its privatisation programme. As does the shaky condition of financial statistics, which still mostly fail to meet International Accounting Standards. Neither is Serbia by itself a large market, and investors may reckon that it could yet take some time for regional trade to overcome the barriers, both formal and psychological, that are the inheritance of the Milosevic era (see Chapter V).

Voucher privatisation in Montenegro

In contrast to Serbia, Montenegro was much less influenced by the experience in other transition countries. Instead, a different set of domestic constraints played a much greater role in shaping privatisation. Notably this lead to the choice to distribute assets free of charge to the whole population in order to overcome its suspicions that the programme was biased towards a political class in which there was a generalised lack of confidence. The need to sell privatisation on these grounds was held to exceed the potential disadvantage of entrenching poor managers during MVP.

The newly established Privatisation Council had begun its work by passing the 1999 amendment to the Privatisation Law. In addition to technical changes, the amendment made provisions that privatisation revenues should be set aside to be used for development projects, rather than be swallowed by the gaping Montenegrin budget deficit. Its work culminated in the 2001 Privatisation Plan, mandated by the 1999 amendment. This Plan set out the timetable for mass voucher privatisation. The Privatisation Council also set in train a large public information campaign to persuade citizens to take up their free vouchers to use in the MVP. This played an important part in achieving the eventual take-up rate in excess of 90 per cent.

Legitimacy, delay and discretion

Whilst the adoption of mandatory privatisation in Serbia is a welcome departure from previous programmes, the legal position remains that the government cannot sell socially-owned assets. Hence the programme formally requires an enterprise's Employee Assembly to approve the privatisation plan. There is an incentive for them to do so: the number of shares distributed free to employees diminishes over time. However, it remains uncertain how the government can respond if Employee Assemblies refuse to adopt these plans in line with the new legislation. Notwithstanding the legal uncertainty, the Privatisation Agency has the power to impose privatisation on an enterprise without the assent of the Employee Assembly, though this power has not yet been tested in the courts.[83] The most obvious alternative route is for the government to enforce its obligations against the enterprise (the government forgives all debts outstanding to it from enterprises that are privatised). This would include tax and social security payments, but also debts to state-owned energy companies. The authorities do have considerable choice over how far and how fast to enforce hard budget constraints on socially-owned enterprises. However, in those situations where a socially-owned enterprise is successful and has no need for overt or covert support from the state, it seems the government has no mechanism to enforce its corporatisation or privatisation. In this case, the enterprise would not be a drain on the budget, and would contribute positively to the economy. It may be, therefore, that socially-owned enterprises will continue to be a quirk of the Yugoslav economy for some time to come.

Irrespective of whether some socially-owned enterprises do persist, addressing recalcitrance is likely to delay the process. Furthermore, the aim that privatisation be transparent adds to the inevitable tension between executing the process quickly and ensuring that it takes place properly. The authorities are doing what they can to reduce this pressure. They handed down a ruling in early 2002 obliging enterprises to begin immediately preparing financial data, so as to ensure that this, often painstaking, exercise does not hold up the process once the company has embarked on privatisation. Unlike in Montenegro, the government has side-stepped the potential delays that would have ensued from allowing a process of restitution by declaring that property included in the privatisation programme will be compensated financially (after the event, if necessary). But this issue may yet return (see below).

Furthermore, the notion of a quick, clean privatisation in Serbia is muddied by the existence of significant enterprise sector debts to bankrupt commercial banks. The relationship between enterprises and the commercial banks is of the utmost importance. The government decision to integrate policy towards the banking and enterprise sectors led to a Memorandum of Understanding between the Bank Restructuring Agency (BRA) and the Privatisation Agency. This short memorandum requires the two agencies to co-operate, and sets out two operational agreements. Firstly, the BRA will accept a part of the privatisation sales proceeds in settlement of the debts of enterprises sold by auction. The BRA's share will be equal to the proportion of bank debts in the enterprise's total liabilities. Secondly, the BRA agreed to request the competent authorities *not* to enforce their claims against 'major enterprises' until at least July 2003. By implication, such enterprises are all subject to tender privatisation. The Memorandum does not go on to specify how much the BRA will eventually recover.

The government has repeatedly stressed its wish to have an open, objective, privatisation process. The auction process clearly meets this aim, as does the tendering procedure outlined in the legislation. Whatever the good intentions, it remains the case that the *ad hoc* determination of criteria on which tender bids are submitted opens the door to accusations of potential manipulation. Any system requiring aggregation of multiple criteria demands the application of some discretion. A tender determined only on price does not suffer this drawback, though it does similarly suffer from the need to frame a rule for qualification to take part in the tender. But given the government's wish to apply different criteria on a case-by-case basis, the obligation to publish all information surrounding the tender, including the losing bids, is the most effective possible immunisation against potential charges of dishonesty.

The same goes for Montenegro. Discrimination between tender bids will not however be only on price. The authorities would like to attract strategic long term partners to Montenegro, and believe they need to discretion to single out bidders who they believe meet multiple criteria including image, business plan (investment), projected employment and tender price. The first criterion, "image", is especially vague. Its presence could be used by opponents of privatisation to block any further progress, and its very vagueness leaves it open to exploitation by those with dishonourable intentions.

The privatisation process is still being established

Privatisation can mark a decisive shift in an economy towards greater efficiency delivered by private enterprise. Yet this will only succeed if it accompanied by other policies that roll back the dully pervasive impact of state regulation typical of socialist economies and, more importantly, if it stimulates a culture of risk-taking and entrepreneurship. If privatisation merely represents more money to carry on as before it will actively damage the chances of new business to enter the market and develop (see

Chapter III). It will also only provide short-term relief for the budget, since a call for renewed subsidies will inevitably emerge.

Releasing entrepreneurial energy means breaking the identity between politics and business (Box 7). Privatisation in Yugoslavia has been carefully designed with this in mind, though it is inevitable that domestic investors in privatisation will face scrutiny over the source of their wealth or financing. It seems that Serbia has wholeheartedly embraced the need to stimulate capital inflows from abroad, and therefore that the country will gain faster access to not just to financial capital, but also managerial and technical skills. The large continuing influence of the state in Montenegrin industry calls into question how much privatisation there will lead to a change in managerial behaviour, and through improved efficiency to an increase in the rate of growth. In Serbia's case, the policy of targeting the best firms for early privatisation will not necessarily make it any easier to deal with the hard cases that remain. In the meantime, the government has sought to improve corporate governance by giving the Privatisation Agency the power to appoint directors and by increasing minority protection, notably through establishing a public share registry. Indeed both republics have not yet addressed the need to overhaul administration in bankruptcy and liquidation procedures in order to strengthen creditors' rights.

Box 7. The fight against corruption

In 2000 the FRY ranked next to bottom out the 90 countries covered in Transparency International's Corruption Perceptions Index. Since then the Serbian government has taken a number of measures to improve the situation. The most visible was the introduction of an Extra Profits Tax levied retrospectively on individuals with suspicious accumulations of wealth. This sent a strong signal that the authorities were not prepared to leave alone those who had become wealthy on the basis of corrupt relationships during the 1990s. Since then combined teams of police and prosecutors have been formed in 26 municipalities, and during the first half of 2002 special telephone numbers established by the government generated calls by whistleblowers that have led to 128 arrests.

The centrepiece of the government's effort is the creation of the Council for the Fight Against Corruption in December 2001. The Council has made a number of recommendations on the basis of which action plans were submitted to the government in September 2002. Specifically these envisage the need for new laws to regulate the financing of political parties and conflicts of interest amongst public servants, the creation of a code of conduct for civil servants, and finally the adoption of a national strategy on corruption.

Transparency International did not rank the FRY in 2001 for lack of suitable survey data. However, the country's ranking and index score are expected to rise as the new measures take effect.

The absence of exit mechanisms may yet undermine privatisation strategy in Yugoslavia. Newly restructured and solvent banks will not increase their lending if they cannot protect their asset, however much the enterprise sector is starved of credit. This requires rules on collateral and a predictable, secure, way to recover loans that fall into default.[84] The absence of effective liquidation has two further consequences. The governments will have to bear the fiscal burden of keeping open existing bankrupt enterprises longer than it would otherwise have to. A second point concerns the emerging business sector. In Poland, privatisation by liquidation was an effective way of recycling stranded assets into productive use. This played a part in encouraging the emergence of new firms. There is therefore a considerable cost in choosing to focus only on rapid privatisation of the better enterprises and to push off, most likely for some years, the more difficult decisions on enterprises that cannot survive. Whilst there is undoubtedly a need to get the process started, progress needs to be balanced to avoid subverting the whole process and undermining the benefits that privatisation is intended to bring.

Unlike rules on bankruptcy, the absence of competition regulation is less serious at this stage. As the economy and banking sector slowly recover, and a capital market takes root, firms will have little option by rely on retained profits to finance investment. There is a strong argument that too fierce competition at an early stage may deprive firms of this source of financing, hobbling future growth in the economy (Carlin *et al*, 2001). Nevertheless, the emergence of dominant monopolies, especially if they are associated with organised crime, would become difficult to dismantle.

Adapting Serbia's privatisation strategy

The Ministry of Economy and Privatisation's strategy was different to that adopted by the NBY. The NBY used its power as a regulator effectively to nationalise banks prior to their subsequent sale. However, the difference between the two policies narrowed following a Decree Law in May 2002, which allowed the Ministry of Finance to undertake the same debt-equity swaps in the enterprise sector as those used by the NBY in the banking sector. This evolution of policy may herald an acceleration in the restructuring and sale of the largest state and socially-owned enterprises that is now expected to begin early in 2003.

July 2002 announcement on privatisation

The Serbian government has continued to show considerable commitment to its privatisation programme, placing great emphasis on the speed with which state- and socially-owned assets are transferred to the private sector. By the middle of 2002 the government rightly decided to accelerate the privatisation programme, and resolved to put in place measures to address what it had identified as shortcomings in its original design. It remains determined to pass any additional measures needed to conclude the programme within the time limits it has previously set itself.

It made some announcements in July 2002 that sought to simplify the privatisation process and stimulate participation in order to generate some momentum in a process that had ground to a halt. These affected the procedure for privatisation auctions, though not for tenders. The use of Dutch auctions (where the English auction failed to reach the reserve price) was abolished, and the minimum price was lowered to 20 per cent of the upper valuation.[85] The deposit required of auction participants was lowered to less than the reserve price. Most importantly, the government announced changes to the valuation method in August 2002, that considerably simplified the procedure. Auction results in September and October 2002 suggest these measures are having the intended effect.

Restitution is a growing source of discomfort

Despite the Serbian government's commitment to compensate owners, rather than restitute property that has been privatised, the issue of restitution is not resolved. As the privatisation process gathers pace it seems inevitable that more claimants will come forward. There is a real risk that this can lead to paralysis, not least in the judicial system. Proving or disproving claims to property is a complex and time-consuming business. There is also the political risk that failure to restitute property proves to be increasingly unpopular; particularly if compensation turns out to be low or paid out only slowly. Public dissatisfaction could damage the privatisation process, but not as much as halting the process to allow claims to be processed *ex ante*.

Successful privatisation depends on improving the business environment

Perhaps an overarching risk is that privatisation should not be seen as an end in itself. It forms one part of economic transition by which the balance of economic assets and control are shifted away from the public to the private sector. Hence, privatisation can only be a success to the extent that it is accompanied by other policies that give rise to a dynamic, competitive, entrepreneurial environment. This notably includes policies that enable new firms to enter the business sector (see Chapter III), and a regulatory framework that enhances corporate governance. Ultimately, successful economic transition results from building a set of mutually reinforcing policy reforms (OECD, 2000).

An important question mark over the emerging business environment concerns the role of the state share funds and what to do with enterprises for which there is no buyer. The Serbian share fund has been set up with a sunset clause and is prohibited from exercising its management rights. But, however obliquely, the state will be left with a significant holding and potential influence in the enterprise sector. The Serbian authorities insist that they will liquidate all enterprises which the Privatisation Agency cannot privatise. But beyond announcing that they ultimately expect to liquidate perhaps 2 000 enterprises, they have not elaborated who will carry this out; or how; or over what time period. There is a similar issue in Montenegro over the shares held by its social funds, and the large remaining share in industry held directly by the government. For the time being, this lack of detail may undermine the credibility of their announced intention.

In conclusion, the challenges the government faces in disposing of the stock of state and socially-owned business assets may be less important than stimulating the environment for enterprise creation and supporting entrepreneurship. The market-oriented reforms that would lead to success in these areas would simultaneously prompt greater inflows of FDI. Foreign investors respond to the nature of the domestic business environment rather than individual enterprises offered for sale in a privatisation programme. Naturally, greater inflows of FDI supported by ongoing policy reforms could stimulate a virtuous circle of enterprise restructuring and growth leading to higher FDI. Unlike Montenegro, the legal framework for privatisation is not yet completely resolved in Serbia. Despite the legal certainty, enterprise sales in Montenegro, for instance by tender, suggest that implementation of privatisation is being varied in both republics as they increase their practical experience of the process.

V. TRADE AND COMPETITIVENESS

For its size, Yugoslavia trades relatively little

During the early 1980s the share of trade in Yugoslavia's GDP rose sharply. However, despite a depreciation of the dinar in 1983, disappointing export performance led to the emergence of large current account deficits. This acted to constrain imports, and by the middle of the decade the share of trade was roughly the same as it had been ten years earlier. In 1990, Serbia's share of trade and exports in GDP (58 and 26 per cent respectively) were nearly the same as those of Czechoslovakia, which was then only about to embark on its economic transition. This comparison treats Serbian trade with the other republics of former-Yugoslavia as external trade.[86] Since then, trading relations of the FRY and its near neighbours have developed in dramatically different ways. The FRY suffered war and sanctions (see below). In contrast, by 1998 the share of trade in the GDP of the Czech and Slovak republics and Hungary exceeded 100 per cent, and export shares were between 50 and 60 per cent. The share of trade in FRY's GDP in 2001 was 86 per cent, and the export share stood at a little over 30 per cent. This was more in line with Bulgaria, whose shares were 90 and 40 per cent, respectively.

It is difficult to know whether these substantial difference in the importance of trade to the economies of FRY and its neighbours are overstated. It is certain that statistics on recorded trade are more than usually unreliable. War, UN sanctions and porous borders will all have undermined the reliability of trade statistics. As well as trade that simply went unrecorded, some exports and imports will have been recorded in neighbouring countries. For example, a significant amount of trade between Serbia and Republika Srpska in Bosnia & Herzegovina went unrecorded; some Yugoslav trade was disguised as FYR Macedonia's exports or imports. Nevertheless, recorded trade does provide at least a basis for assessing the changing patterns of Yugoslav trade, and drawing some conclusions about its future growth.

Previous trade distortions have left their mark

FRY trading patterns since 2000 still bear the imprint of previous distortions. These fall into two categories. The first is the system of economic management applied in the former-Yugoslavia; the second is the reaction to the disintegration of Yugoslavia.

Prior to 2002 the lack of an internationally convertible currency was a strong incentive to trade with fellow republics that shared the same money. Since an agreement in 1973, trade between Yugoslavia and CMEA countries was expressed, and bilateral balances were to be cleared, in convertible currencies. By itself, the existence of a common currency encouraged trade between republics in spite of the system of economic decentralisation. In 1987, more than half of republics' exports were to other Yugoslav republics; for Serbia it was a little less (43 per cent), for Montenegro a little more (59 per cent). Inter-republican trade was sometimes the consequence of central influence over investment decisions. In some cases this led to investment in processing capacity that drew feedstock from another republic. But the onset of war left some production capacity stranded, contributing to a fall in trade.

The need to earn foreign exchange was a further influence on the structure of exports in the SFRY. From the beginning of the 1980s, Yugoslavia became severely constrained by its balance of payments. The lack of an internationally convertible currency led the authorities to stimulate and subsidise industries that could earn hard currency revenues by exporting, irrespective of whether this was economically efficient. This type of foreign exchange-earning investment can still be seen in FRY's aluminium, vehicle and pharmaceutical industries. Overall, this did not prevent Yugoslavia losing market share in OECD countries. Trade was anyway still concentrated in labour or resource-intensive products, with particularly labour-intensive products coming under greater competitive pressure from non-OECD countries, notably in South East Asia.

Where war ravaged the half of trade that took place within Yugoslavia, international sanctions decimated the rest. The UN introduced sanctions on Yugoslavia in May 1992. These were considerably strengthened in April 1993 and not lifted until October 1996, although they had been suspended in October 1994 as part of the process that led to the Dayton Peace Agreement in November 1995. The UN did not re-impose sanctions during the Kosovo conflict, though it did impose a ban in March 1998 on trade in armaments and military equipment with FRY that was lifted in September 2001. In contrast, in late 1997 the EU did remove autonomous trade preference it had granted the FRY only a year earlier. This mattered. Most of the FRY's genuinely external trade was with the EU (Figure 20).

(Figure 20. Yugoslav trade, 1992)

It is difficult to understate the collapse in Yugoslavia's trade during the 1990s. It started the decade trading at a similar level to other countries about to start economic transition; ten years later trade had barely recovered to this modest level.

The new government liberalised trade quickly

During the latter part of the 1990s the Yugoslav authorities had operated a rather complex system of trade protection. Official tariffs were not the main barrier: the average tariff was 13 per cent. However, the effective rate actually paid by importers was probably rather higher since border controls allowed for considerable discretion. Customs officials were able to determine the value of imports to be taxed. Anecdotal evidence suggests these powers were widely used and, irrespective of whether officials were corrupted, this once again increased the effective tariff burden. But there were compensating distortions. The tariff rate was applied to goods valued at the official exchange rate, typically 10 per cent above the market rate though at times much higher than this. This amounted to an import subsidy. In addition Yugoslavia operated a system of quantitative trade controls, though it is not clear how much this will have affected trade flows. Control of import quotas was undoubtedly lucrative. Lack of access to trade finance and the balance of payments were a more formidable restraint to import trade.

One of the current government's first actions on coming to office was to liberalise trade. A trade regime was introduced by the Foreign Trade Law and Customs and Tariff Law in May 2001. The latter reduced the number of tariffs to only six (between 1 and 30 per cent), and the average tariff from 14.3 to 9.4 per cent. The average tariff weighted by 2000 import data is a little lower, at 8.09 per cent. The top tariff rate is levied on luxury consumer goods, and "for the purpose of protecting domestic production". More than half of all imports suffer customs duties at 1 or 5 per cent; some 27 per cent of imports suffer duty at 10 per cent or more. The customs categories Food & Beverages and Weapons suffer the highest average duty rates. Non-tariff barriers were much reduced, but some trade is still subject to quotas or permits, notably for some agricultural products (export quotas), and understandably for weapons (permits). Specifically, the government can introduce export quotas to ensure adequate supply of goods on the domestic market. These quotas are set for one year, before 30 November of the preceding year. In 2002 export quotas existed for live bovines, leather, sugar, soya beans, sunflower seeds, wheat and wheat flour.[87]

Imports, and exports of some products, have risen…

As in other transition countries, the immediate impact of trade liberalisation has been on imports. In neighbouring Hungary, annual import growth following trade liberalisation was above 30 per cent; in

Bulgaria it was above 70 per cent. Both countries had high levels of external debt, as does Yugoslavia. In Yugoslavia's case import growth has notably been of energy and consumption goods. The effect of strong import growth can be seen in the deteriorating trade balance (see Chapter II). Imports measured in US dollars had grown back during 2001 to the level they reached in 1998. Imports of consumption goods grew at more than twice the rate of equipment of intermediate goods. This has affected the performance of domestic firms (see Chapter III). In contrast, exports in 2001 were still one-third below their 1998 level.

Disaggregated to the 4-digit level, the three categories of imports that grew most in 2001 were oil, gas and electricity. Unsurprisingly, imports from Russia jumped in concert. Even here the distortions of the 1990s make themselves felt: the fourth category was humanitarian aid. There was also strong import growth in fertilisers and cotton, both raw material inputs to Yugoslav production. But the most striking feature of import growth in 2001 was the increase in imports of consumption goods. OECD estimates suggest that 60 per cent of import growth was in consumables (Figure 21). The proportion amongst products with the strongest level of import growth was even higher. Imported consumer goods have in turn played an important part in facilitating growth in retail sales. Growth in imports of consumer goods represents some 40 per cent of the growth in retail sales during 2001. Imports of capital machinery needed for investment that could promote future export growth are noticeable by their absence. Overall, imports remain constrained by the balance of payments. Some imports, notably humanitarian aid, are self-financing; for the rest, availability of financing is the main constraint.

(Figure 21. Weight of consumption in import growth, 2001)

Compared with OECD countries, Yugoslav trade in the late 1980s was not concentrated in the sense that exports were spread over a relatively large number of categories. This is still the case. However, though widely spread in terms of products, export growth has been concentrated in labour-intensive and/or low-skill, production (Astrov, 2002). These are agricultural products, extractive industries (aluminium, copper, iron & steel, wood), footwear and leather, and textiles. Of the 50 4-digit categories with the highest export growth in 2001, 10 were textile products. To the extent there has been an export revival it has been in these basic, low-skill, industries. Of total export growth in the top 50 categories, nearly 80 per cent fell into these basic industries. An exception to this has been the export of weapons and ammunition to both Balkan and EU candidate countries.

At the same time, the share of exports to the EU rose to 43 per cent in 2001 from the 39 per cent to which it had fallen in 1998. The countervailing fall in export share was to South East Europe, notably FYR Macedonia but also in other EU candidate countries. It seems likely that this is a statistical artefact, reflecting diversion of recorded trade, on paper if not in practice, that took place during the Kosovo conflict. Exports to the EU have risen since the beginning of 2001, but the rate of increase was rather modest, and flattened out towards the end of 2001 and into 2002. Import growth has been somewhat higher and, on average, more sustained (Figure 22).

(Figure 22. External trade with the EU, 2001-02)

Montenegro adopted a separate trade regime

Montenegro introduced its own tariff regime and customs administration in June 2000. Hence it took over the power to set customs duties from the federal government. However, whilst the new rules lowered tariffs, they were to be levied on the deutschmark value of imports. Previously, duties had been charged on dinar values calculated using Yugoslavia's overvalued exchange rate. Tariffs of between 0 and 5 per cent applied to more than 90 per cent of imports. Remaining imports, of "luxury and protected goods", faced tariffs of between 10 and 15 per cent. Despite these initial reforms, customs administration remains somewhat complex, with importers having to comply with various procedures and having to meet fees and licensing requirements. There is anecdotal evidence that many goods on which a 1 per cent transit tax is paid at the border, never pass out of the country (ISSP, 2002).

Trade with Serbia remains problematic. The continuing failure to provide an adequate payments clearing system between Serbia and Montenegro leaves exporters and importers having to meet high financial transactions charges. There are also complications over where traded goods become liable for sales tax. There was previously a clear incentive for companies not to trade directly, but to divert trade through a third country. This incentive is strengthened for imports to Montenegro, since goods of Serbian origin entering Montenegro from a third country are subject to a zero per cent tariff. Despite this uncertainty in trade policy, officially-recorded Montenegrin imports have risen strongly, and the trade balance has deteriorated (Chapter II). By October 2002 the situation had improved, with the only remaining barrier to direct trade between Serbia and Montenegro being the need to clear payment through a correspondent bank in a third country.

… but overall export growth has been disappointing

Structural factors underlie the disappointing recovery in exports, notably the accretion of distortions that took place during the 1990s. Firms were no longer able to produce products for export. The disintegration of Yugoslavia, and the hyperinflation that occurred at the same time, led to considerable dislocation in production as output fell. One specific problem was the war breaking links in the supply chain between republics. Furthermore, enterprises were not generally bankrupted or closed down so, whilst they were still active on paper, in practice many scaled back or halted production. Hence it became difficult to obtain reliable supplies on the domestic market, and sanctions (along with lack of foreign currency) prevented firms from importing the materials they needed. During this period the capital stock deteriorated through lack of investment, and this deficit could not subsequently be made up through trade policy measures. Exports became ‘capital constrained’.

There is a further structural weakness that follows from the system of economic management practised in the SFRY. Decentralisation promoted a certain tendency to self-sufficiency in the republics. This in turn led to a surprisingly unconcentrated export structure, which has persisted (OECD 1998, Jovicic *et al*, 2001). Whilst this may not have been a significant bar to greater trade in the 1970s and 1980s, in the intervening decade the global trend has been towards greater specialisation and growth in intra-industry trade (OECD, 2002b). Modern manufacturing places increased emphasis on the role of intermediate products. Firms search for components at the quality they need for the cheapest price. This is a consequence of manufacturing changing away from straightforward mass production towards mass customisation of a basic product shell. Firms compete through offering variety and accelerating product cycles. This has led to growing trade within firms, and between firms in the same industry as production of these components becomes more specialised. Indeed this trend is likely to lower the price elasticity of intermediate goods: although price matters, being able to produce the right quality at the right time could matter more.

Countries that wish to benefit from this change have to become more specialised; but Yugoslavia has moved in the opposite direction (Box 8). Intra-industry trade fell sharply after 1991, recovered from 1997 but fell again in the aftermath of the Kosovo conflict. It barely recovered during 2001 as exports picked up (Table 32). This underlines how Yugoslavia has fallen back on exports of primary materials and traditional industries. The contrast with some of its neighbours, both inside and outside the EU is revealing. Yugoslavia’s degree of intra-industry trade is higher than that of neighbouring FYR Macedonia and a little lower than in Croatia, countries that share Yugoslavia’s economic background. It is very much lower than in Hungary and Austria. Rising exports of manufactures are consistent with greater intra-industry trade and, as can be seen in Yugoslavia's case, the converse is also true.

Box 8. International competitiveness and trade specialisation

The notion of competitiveness in trade somewhat loses its meaning when applied to countries rather than firms or products (Krugman, 1994). Although it is ultimately firms that specialise, it is nevertheless possible to think of trade specialisation from the perspective either of countries or firms. The technique used to examine this issue is to measure the degree of *inter*-industry and *intra*-industry trade. This analysis is based on disaggregated data of trade flows, showing exports and imports separately by industry category.

There is a high level of inter-industry trade where, for each industry, there are either high exports and low imports, or *vice versa*. For instance, this is the case where a country's production and exports are concentrated in a small number of particular industries, which likewise largely satisfy domestic demand out of domestic production. Consumption needs from other industries are fulfilled through imports. This is typically the case where countries largely produce commodity items by exploiting natural resources. Hence, a high level of country specialisation suggests a high degree of inter-industry trade.

This contrasts with a situation where there is a high degree of intra-industry trade. Here each industry simultaneously has a high level of both imports and exports. This is the situation where firms become highly specialised, contributing one piece to a production chain that is spread internationally. The partly finished product is imported, the firm adds its part of the process and exports its output to the next link in the chain. The same firm-level specialisation occurs when firms exploit a niche within an industry. They export their product worldwide, but firms in the home country find themselves importing other niche products within the same industry from abroad. The industry simultaneously exports and imports: a high level of intra-industry trade. It is characterised by a high degree of product specialisation in individual firms, representing a greater opportunity to add value to the production process.

Inevitably, countries mix inter- and intra-industry trade. But growing intra-industry trade is the hallmark of a world where production networks and supply chains span the globe. This can present problems for firms trying to specialise: it is often difficult for an individual producer to penetrate these networked industries, needed to facilitate market access. One approach is to seek FDI or other forms of partnership with foreign companies, and hence these network effects are important for improving competitiveness. In practice this type of trade offers the most scope to increase exports. A failure by firms to specialise and offer products of the right quality to enter into international networks, and hence extend the degree of intra-industry trade, is likely to limit future export growth.

Whilst this analysis can help understand countries' trading patterns, it is important to note that the chosen level of disaggregation affects the results. As an ever finer industry definition is used, so the likelihood of exports and imports falling within the same category falls, eroding the measure of intra-industry trade.

(Table 32. FRY index of intra-industry trade, 1991-2001)

Weakness of intra-industry trade is partly a consequence of existing trade rules, particularly in less sophisticated industries. In particular, it reflects the requirement for evidence that a country is genuinely processing goods that it exports (by changing their industrial classification), not simply acting as a conduit for goods from elsewhere to markets where it has preferential access. For instance, this is the case with textile exports to the EU. The EU requires that textiles products imported from Yugoslavia must have changed their tariff heading, as evidence of value-added processing, if the products did not originate in Yugoslavia itself. In practice this means Yugoslav textile producers have to use relatively expensive cloth imported from the EU rather than from cheaper sources elsewhere in the world. This policy diminishes the degree to which Yugoslavia can exploit its lower costs of labour. The policy also encourages outward processing trade (OPT). This is an arrangement where an EU producer supplies material and designs to a Yugoslav enterprise, which assembles the finished product and delivers back to the EU producer. This trade has been particularly important for textile production, but also in the footwear industry. Both OPT and reliance on inter-industry trade could discourage Yugoslavia from investing in skills and production capacity better suited to intra-industry trade that will be needed to generate export growth over the medium term.

Exports may yet drive recovery

Yugoslavia has to become competitive if it is to generate the exports that can sustain durable growth. Whilst the widening trade deficit in 2000-2001 is expected, future export growth will have to close the gap if the domestic Yugoslav economy is to retain access to vital imports of capital equipment and intermediate goods. Export growth is also needed to ensure that Yugoslavia's can continue to service its external debt. Despite the generous level of debt write-off under the Paris Club agreement in November 2001, Yugoslavia remains a heavily-indebted country. National competitiveness has traditionally been associated with a narrow macroeconomic interpretation that focuses on the movement in the real exchange rate. However, this variable has been very volatile during the past decade, a period of macroeconomic instability (Chapter II). Moreover, the real exchange rate cannot capture developments in particular industries. Ultimately it is individual firms and industries that are competitive, not the national economy. Therefore, the following section uses an indicator of *revealed* comparative advantage (RCA), which tends to be more stable with respect to short run macroeconomic changes.

The RCA is calculated as the difference between export and import shares. It is important to note that a negative RCA does not imply that a country will have difficulty exporting goods in that category; rather it identifies areas structurally giving rise to trade deficits that have to be made up with surpluses in other areas. Whilst the indicator points to areas of structural deficit/surplus, it does not reveal a cause. Indeed trade distortions such as high tariffs or non-tariff barriers affect trade flows, and so influence the RCA. But this is the indicator's strength. It reflects trade outcomes with the state of the world as it is. This can guide governments in making policy choices. However, policy changes that would affect trade outcomes will in some instances only be available to a national government alone; in other situations they may only be made in the context of multilateral agreement.

Yugoslavia's specialisation

An analysis of RCA reinforces the conclusion that Yugoslavia has relied on exports of agricultural products, extractive industries and basic manufacturing. Amongst the top-twenty 4-digit export categories (that account for nearly two-thirds of total exports), only pharmaceuticals, shipbuilding, aircraft and ceramics require a capability in more sophisticated manufacturing. The remaining categories confirm the importance of agriculture, textiles, wood/furniture and iron, steel & aluminium (Table 33). Shipbuilding in the FRY is to supply Danube river traffic, and would benefit from a resumption of significant river transport once the waterway has again become permanently navigable.

In contrast to the product categories that comprise revealed comparative advantage, revealed comparative disadvantages are concentrated in more complex manufactures (machinery, electrical apparatus, vehicles, chemicals), and raw material inputs such as fuels, fertilisers, animal feed and cotton.

(Table 33. Revealed comparative advantage (RCA))

Changes in the RCA between 1991 and 2001 underline the way in which Yugoslavia's pattern of trade changed for the worse during the during the 1990s (Table 34). Aluminium, wood, textiles and vegetables are all amongst the 10 categories with the largest positive change in RCA. The surprising appearance in this list of cotton and aircraft is explained by import compression. These did not turn into dynamic Yugoslav exports, but rather imports dried up due to sanctions and lack of creditworthiness, boosting the RCA. Amongst the 10 largest reductions in RCA are clothing and cereals. This is evidence of how Yugoslavia lost markets during this period that will be difficult to win back. Within manufacturing, there has been a striking increase over 1993-2000 in the RCA of basic labour-intensive products, as the RCA of sophisticated products has fallen. The strength of exports in labour-intensive low-skill products is also a reflection of the low need for investment capital in these sectors. Yugoslavia has predictably economised in the use of its scarcest resource.

(Table 34. Changes in revealed comparative advantage, 1991-2001)

Prospects for trade with the EU and in regional markets

It is Yugoslavia's misfortune to have comparative advantage in textiles and agriculture, two product areas that suffer widespread protection and discrimination in international trade. In September 2001 the EU unilaterally reduced its tariff barriers to products from South East European countries, including Yugoslavia. This offer is asymmetric: it is not conditional on similar tariff reductions in the countries of South East Europe. Nevertheless, some tariff barriers remain, notably in sensitive sectors, such as textiles and fruit & vegetables, in which the RCA suggests these countries have potential for export growth. Tariff reductions by themselves are also no guarantee of export growth. Evidence from similar reductions made previously by the EU suggest that non-tariff barriers to exports remain in place. An important example is the need to comply with complex certification of origin in order to benefit from the tariff reductions (Brenton and Manchin, 2002). Another example is the need to demonstrate compliance with veterinary and sanitary standards.

Notwithstanding the practical difficulties of increasing exports to the EU, there seems to be very significant potential for greater trade between Yugoslavia and its giant neighbour. One study finds that current trade between FRY and Austria/Italy/Germany is only half of the predicted level. If FRY were to become an associated or full member of the EU, current trade could quadruple. Interestingly, it seems as though FRY could gain access to many of potential increase in trade without becoming an associate or full member of the EU (Christie, 2002). Poor transport infrastructure and long border delays are a very considerable barrier to trade. Given the number of borders that goods must cross to reach the EU from most Balkan countries, this is a major cause of delay. The need to negotiate a multiplicity of customs regimes introduces a degree of uncertainty. Finally, border controls offer the opportunity for corruption to flourish. The return to investment in improving border controls, and to achieving better integration between customs administration in the various countries, would be large.

There are risks associated with increasing EU trade. Perhaps the most important is that the countries of South East Europe will concentrate on competing with each other for EU trade based on similar geographical advantages and endowments. This would inhibit greater specialisation and product differentiation that would become a source of long term sustainable growth, instead becoming locked into exploiting depletable or natural resources, and relatively cheap labour. The countries need to attain the trading weight that will allow them to develop the product niches that propagate further specialisation. This outcome is more probable if the countries can stimulate trade amongst themselves.

The experience in some other transition economies, notably Hungary, has been that there is a limited period after transition starts in which countries can exploit their low cost labour, but quickly move production up the quality ladder. The point is that transition economies typically have low quality-adjusted labour cost, rather than just low labour cost *per se*. The human capital embodied in its workforce should quickly increase productivity once allied with fresh physical capital. As in other transition economies, access to markets and lack of skills in management and marketing may inhibit domestically-generated export growth. This only serves to emphasise the need for foreign direct investment. But market access and marketing can be rapidly grafted onto a relatively skilled workforce. This provides FRY with an opportunity, though it is limited. Human skills depreciate, and eventually disappear.

Regional trade liberalisation

The FRY government has actively pursued policies of trade liberalisation. It signed a Memorandum of Understanding on Trade Liberalisation and Facilitation in June 2001. This Memorandum commits the countries of South East Europe to complete a network of free trade agreements amongst themselves by the end of 2002. FRY already had an agreement with FYR Macedonia dating from 1996. It signed new agreements with Bosnia and Herzegovina in February 2002, and with Hungary in March 2002. Agreements with Albania and Slovenia were initialled in September 2002; those with Bulgaria, Croatia, Moldova and Romania are under negotiation. In addition, negotiations with Belarus are under way, while those with Turkey are expected to start. These agreements are in line with WTO commitments, and are compatible with the countries' various agreements with the EU. The FRY also signed a free trade agreement with Russia in 1999.

Serbia and Montenegro have filed a joint brief to begin accession negotiations with the WTO. A working group established to consider the documents has not yet met, though the WTO has requested a number of clarifications of Yugoslavia's submission. The FRY government considers membership of the WTO as one of its leading priorities, and sees the accession procedure as part of the process by which the FRY will become integrated in international trade. To this end, the government has an explicit target to liberalise trade (see above) and lift remaining restrictions on capital flows. The existence of divergent tariffs within the federal state is bound to complicate negotiations. In July 2002 the two republics agreed to finance a joint economic authority that will seek to harmonise economic legislation with that of the European Union. At the same time they agreed to harmonise their excise duties by the end of 2003, and customs tariffs by the end of 2005.

In the longer term, the FRY's export sector needs investment to overcome its current inability to meet what is demanded on international markets. This is partly a question of entrepreneurship, which is dealt with more fully in Chapter III. The government's privatisation programme is a conscious effort to stimulate exactly this kind of investment in order to overcome the 'capital constraint' under which the export sector has operated (see Chapter IV). The sector will have to become more diversified, deepening regional and intra-industry trade that will give it the chance to integrate with international supply chains. In the short run, exports would respond quickly to quicker transport times to the EU market. More fluid borders are vital in achieving this. There is a physical aspect in terms of better road and rail infrastructure, but also an administrative and bureaucratic side. Customs officials need the training and equipment to enable them to operate efficiently and fairly; exporters need help in fulfilling the bureaucratic requirements entailed in trading with the EU. Technical assistance in EU form-filling delivered close to the exporter would in all likelihood be more valuable than a rhetorical tariff reduction of which exporters may be unable to take advantage. And the Balkan countries can help themselves by integrating their border controls and customs systems.

Export promotion

Whilst arguments can be made to justify government intervention to support exporting industries financially, it is in practice difficult or impossible to collect the information to design these policies properly. There is also the usual risk that public intervention may not offer a net benefit, and that once established, it may be difficult to redirect or terminate. As a result, there is a growing consensus amongst economists that trade promotion is unlikely to succeed (OECD, 2001). However, there are other strategies that government can pursue to encourage exports and trade.

The most obvious difference government can make is to reduce its own tariffs and administrative barriers to trade, for instance through improving transit delays at its borders. FRY has taken significant steps to reduce its tariffs, though further progress in negotiations with the WTO and EU may depend on how quickly Serbia and Montenegro can co-ordinate their rates. More could clearly be done on improving customs administration, and in negotiating agreements on mutual recognition of inspections and documentation with neighbouring countries. Where administration is inevitably complex, such as in trade with the EU, the government could invest in local facilities to help exporters and potential exporters over the administrative hurdles through the provision of translation and officials with the necessary procedural expertise. Investment in physical transport infrastructure could also but help. More indirectly, a stable macroeconomic environment encourages foreign trade and investment. And one in which there is a transparent, quick and predictable legal process to resolve contractual disputes. This would in turn encourage growth in the availability of trade finance, and facilitate greater trade (see discussion in Chapters II and III).

NOTES

1 . The OECD Economic Survey of Yugoslavia published in 1990 covered the Socialist Federal Republic of Yugoslavia (SFRY), though it included regional breakdowns that allow comparison with what has become the Federal Republic of Yugoslavia (FRY).

2. On this subject, see OECD (1990)

3. This is the estimate of the Serbian government in Government of the Serbian Republic (2001), pp. 5.

4. The main areas for structural change are privatisation, taxation, commercial bank regulation, pension reform, competition policy, health care, bankruptcy, the judiciary, and corporate governance.

5. The three plants were: Kosjeric, Beocin and Novi Popovac.

6. The ministerial declaration on regional investment forms a part of the Investment Compact, a programme of the Stability Pact for South East Europe.

7. Gross material product is the aggregate measure of domestic economy activity calculated by the FRY Federal Statistical Office (FSO (2001), page 113). This measure is an underestimate of gross domestic product as it does not include a number of activities in the service sector. It also makes no account for the large grey economy. For this reason, if the grey economy has shrunk, growth in gross material product may actually overestimate economic growth in the country since 1999. Some FRY institutes and the IMF have attempted to estimate GDP on the basis of existing information, but the reliability of these estimates remains highly questionable. The IMF reports figures of 5.0 and 5.5 for GDP growth according to their measurement in 2000 and 2001, respectively (IMF, 2002b).

8. The ILO definition of employment adds those workers who have informal jobs, but does not subtract those workers formally employed who are not paid or do not work.

9. As only Serbia made contributions in 2001, the federal budget is also consolidated with the Serbian republican and local budgets to form a "consolidated budget on Serbian territory." As described in Chapter II, the federal budget actually generated a small surplus in 2001.

10. It is widely believed that a larger share of imports went unrecorded before 2001, indicating that actual growth in imports may be somewhat exaggerated in official statistics.

11. By contrast, recent Montenegrin balance of payments data show that exports increased strongly during the first half of 2002 (see Table 10).

12. Measures increase in net real wages. See Chapter II for an explanation of methodological changes in calculating official wage statistics.

13. Changes in aggregate household incomes and expenditures in 2001 and 2002 are difficult to measure directly due to important methodological breaks in the relevant statistical time series. Comparing May 2002 with July 2001 according to what is claimed as a consistent methodology, indicates that real household incomes grew by 9.3 per cent during that period. This is considerably slower than growth in reported wage rates.

14. The agreement allowed for a 51 per cent write-off upon signature of a 3 year Extended Structural Adjustment Facility (ESAF) with the IMF, and a further 15 per cent on successful completion of the ESAF.

15. For a comprehensive survey of macroeconomic policy issues, see IMF (2002a, 2002b).

16. Output and trade statistics in Montenegro exhibit a very high degree of volatility. This can partly be associated with the fact that a very large share of output and trade in the republic depends on a single aluminium firm, Kombinat Aluminijuma Podgorica (KAP), which continues to have access to heavily subsidised electricity.

17. Montenegro has employed the deutschmark, and later the euro, as its currency. Real exchange rate appreciation in Montenegro through inflation has been very similar to that in Serbia in 2002.

18. This has been highlighted in the memoranda of the FRY government contained in IMF (2002a); see also pp. 4 in IMF (2002a).

19. It is difficult to know what FRY's exports are to Kosovo, not least since exports have been diverted through Montenegro and FYR Macedonia. Montenegro has only separately recorded exports to Kosovo since April 2001. UNMIK reports some imports to Kosovo, though its Figure of USD 0.5 million from Serbia seems low. An indirect estimate of trade with Kosovo can be made by taking the share of Kosovo's GDP that was traded with Serbia (Serbian territory) before the conflict, assuming that Serbia picked up half the trade that was previously with Croatia and Slovenia, and applying that share (38 per cent) to Kosovo's reported GDP in 1998.

20. Montenegro accounts for less than 10 per cent of GMP in the FRY. Industrial output in Montenegro is also dominated by the single giant aluminium plant, Kombinat Aluminijuma Podgorica (KAP).

21. Zavod za obracun i placanja.

22. Enterprises have to make a half-year return in June and a full return at the end of December, comprising balance sheet and profit & loss account.

23. In the ZOP accounts, the operating profit figures for 2000 are higher than those shown in Table 2.3. Under conditions of rapid inflation, depreciation allowances declined to quite low levels in real terms in 2000, but were subsequently adjusted upwards for 2001. In the interest of comparability, we have done a rough correction to compensate for this fact, postulating that the ratio of actual depreciation to sales in 2000 should have been similar to 2001. Depreciation costs for 2000 were therefore adjusted upward to the point where their share exactly equals that for 2001.

24. These percentages were calculated directly from ZOP enterprise data, and include sundry employer labour costs as well as employer payroll tax and social security contributions. The Serbian ministry of finance puts the wedge at, respectively, 105 and 75 per cent.

25. The simple average tax wedge in OECD countries was 43.0 per cent in 2001. Rates in Member countries ranged from 20.5 (Korea) to 76.5 (Hungary). The wedge in Yugoslavia is higher than in Poland or the Slovak Republic, though lower than in the Czech Republic or Hungary.

26. By way of comparison, the quick ratio for quoted firms in Germany was 1.25 towards the end of 2001.

27. In September 2002 the Serbian government announced its intention to adopt new tax incentives to attract investment, including a tax holiday and a reduction in corporation tax to 14 per cent.

28. This estimate is reported in World Bank (2001a), p.2.

29. Data provided by EPS.

30. Electrical heaters are less than 10 per cent efficient from generation to consumption, compared with over 90 per cent for a residential gas boiler.

31. Figures in this paragraph are from the Serbian Ministry of Energy.

32 . The Montenegrin government believes that a part of the price difference is justified by lower losses on the higher voltage transmission lines used to supply KAP.

33 . The Montenegrin government expects the electricity price to KAP to increase at the end of 2002.

34. The information for this paragraph was obtained directly from Montenegro Electroprivieda (EPR).

35. IEA-UNDP Workshop on New Energy Policies in Southeast Europe, Serbia, October 2002 (http://www.iea.org/about/nmccee.htm).

36. The smallest EU farms are in Greece, Italy and Portugal, with average sizes of 4.5 Ha, 6.4 ha and 9.0 Ha.

37. The export quote on wheat will be eliminated from December 2002.

38. Preliminary figures for FDI during the first three quarters of 2002 show a net inflow of EUR 300m.

39. The timely disclosure of basic macroeconomic information to international organisations and potential investors might be at least one step forward toward the attraction of greater FDI.

40. Estimate of the Institute of Strategic Studies and Prognoses reported in Monet, ISSP (2002).

41. The shift from the deutschmark peg (30 dinars) to the euro (60 dinars) did in fact imply a nominal depreciation of more than 2 per cent.

42. The outstanding stock of NBY bills increased by an estimated YUD 1.8 billion in 2001, which amounts to only about 6 per cent of the expansion of M1 during the same period.

43 . Montenegro is an exception in Figure 2.8, since a significant share of its budget has been financed from foreign grants.

44. For comparative purposes, figures from EU and other countries on military spending can be found in International Institute for Strategic Studies (2000). Recent estimates of military spending in Serbia vary. One study placed military spending at over 6.2 per cent of GDP. The official 2002 federal budget proposes spending on the military that would be the equivalent to 4.6 per cent of GDP.

45. Although Montenegro ceased making a contribution to the federal budget, it continued to pay local costs (eg food, accommodation, electricity) of the Yugoslav army (JA). The federal authorities had previously stopped transferring a part of federal customs revenue and contributions to the Montenegrin pension fund.

46. In Table 11, the sum of gross transfers to extra-budgetary funds in 2001 (5.2 per cent of GDP) is greater than transfers from the republican and federal budgets (3.9 per cent of GDP) due to transfers from the three extra-budgetary funds to each other (1.3 per cent).

47. See IMF (2002a), pp.11-12, 39. The World Bank conducted a fiscal sustainability analysis as part of an overall Public Expenditure Review in 2002, although the results had not been released at the time of preparation of this Assessment.

48. The IMF report conducts two types of sensitivity analysis, one in which exports are only 60 per cent of the baseline projection and another where FDI is only half of that expected. Additional borrowing is assumed to fill the gap.

49. 2001 budgetary and extra-budgetary expenditure out of Serbian republican funds.

50. Government of the Republic of Serbia (2001), pp. 7.

51. See OECD (1997a), OECD (1999).

52. Data provided by the NBY.

53. The NBY decision took account of the fact that these institutions also had negative cash flow.

54. The state took a majority stake in 10 banks (Kontinental Banka, Jubanka, Privredna Banka Pancevo, Vojvodjanska Banka, Kredi Banka, Panonska Banka, Niska Banka, Novosadska Banka, Borska Banka and Pirotska Banka), and became a co-owner of a further four (Agrobanka, Kapital Banka, Cacanska Banka and Komercijalna Banka).

55. Data provided by the NBY.

56. From data presented in National Bank of Yugoslavia (2002).

57. IMF (2002b), pp. 23.

58. National Bank of Yugoslavia (2002).

59. On this point, see in particular Blanchard (1997), Johnson, Kaufman, and Shleifer (1997), and World Bank (2002).

60. For the importance of SMEs for growth in the US economy, for example, see Foster *et al* (1998).

61. Committee for Development and Foreign Economic Relations (2002), pp. 11, 23.

62. Committee for Development and Foreign Economic Relations (2002).

63. See for example OECD-EBRD (forthcoming), a review conducted as part of the Stability Pact for South East Europe's Investment Compact.

64. This is in contrast to the case of the Russian Federation, where more than half of entrepreneurs questioned indicated particular difficulties with expanding activities to different regions.

65. See for example G17 Institute (2002).

66. Committee for Development and Foreign Economic Relations (2002).

67. G17 Institute (2002).

68. These sub-units were called BOALs: Basic Organisations of Associated Labour.

69. "National treatment" did not extend to allowing foreigners to own land.

70. In Serbia's case, employees in firms opting to privatise received shares on very favourable terms, linked to length of service. Long-serving employees could buy shares, valued at accounting book value, at up to a 70 per cent discount paying over 10 years (Uvalic, 2001). However, the new owners had to accept the firm's liabilities and obligations along with its assets. The favourable terms in the original legislation were somewhat modified by the 1991 Serbian Privatisation Law, but the underlying approach did not change.

71. Motivated, doubtless, by political expediency, an analogous situation that arose over at the same time over houses and flats sold to their occupants, was left to stand.

72. Enterprises deemed to be operating "in the public interest" had to seek prior approval for privatisation from the government (either republican or federal).

73. In Montenegro 10 per cent of the shares were distributed free of charge to employees, with another 30 per cent available under various conditions including long service. The state became the formal owner of the remaining shares.

74. A 'managing share' allowed management to buy 35 per cent of a firm's shares for payment over 5-7 years, but with the guarantee to exercise 51 per cent of the voting rights over this period (Vukotic, 2001).

75. The private sector was defined as self employment + enterprises in majority private ownership.

76. See, for example G17 Institute (2000).

77. An initial 40 per cent had been distributed to employees, and a further 20 per cent was transferred to the state pension fund.

78. Of these six PIFs, five (including the largest) are Slovenian owned.

79. Prior to voucher privatisation the dominant majority of shares traded in Montenegro were in short term securities. Trading volumes had anyway collapsed after 1998; a small revival in 2001 was due mainly to bank recapitalisation, during which banks issued new equity.

80. The five firms are: Juzni Jadran, Stevanoviac trgovina, Jasikovac, Obnova-Premis and Telecom Crne Gora.

81. For experience in other transition economies see for example OECD (1995), OECD (1997b), OECD (1997c), OECD (1998) and OECD (2000).

82. Retired workers will benefit indirectly, from the 10 per cent of the proceeds that the law specifies will be paid into the pension fund.

83. Amendment to the Enterprise Law, July 2002.

84. Bankruptcy is a federal responsibility; new rules await resolution of the terms under which Serbia and Montenegro will enter into a "state union".

85. In an English auction the bids increase in value; a sale is agreed where the last bid exceeds a minimum ("reserve") pric.e. In a Dutch auction, the auctioneer reduces the offer price in steps, and the first bidder is declared the winner.

86. Formally, former-Yugoslavia was the Socialist Federal Republic of Yugoslavia (SFRY).

87. The export quota on wheat and wheat flour was abolished from 1 September 2002.

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TABLES

Table 1. **Basic economic indicators**

	1995	1996	1997	1998	1999	2000	2001
Real GMP growth	6.1	5.9	7.4	2.5	-21.9	6.4	6.2
Retail price inflation (Dec./Dec.)	120	59	10	44	54	114	39
Exchange rate (USD per YUD)		5.3	6.8	11.3	23.5	55.2	66.4
Registered unemployment (Per cent of the labour force)	24.6	25.7	24.5	25.1	26.1	26.5	27.5
Export of goods (USD million)	1531	2018	2677	2858	1498	1723	1903
Import of goods (USD million)	2666	4119	4826	4849	3296	3711	4837
Current account (USD million)			-1279	-660	-715	-339	-624
Per cent of GDP			-8.8	-5.3	-9.3	-4.9	-5.4
Budget balance (Per cent of GDP)							
Serbia							-1.4
Montenegro							-2.2
NBY gross foreign reserves (EUR million, end of period)				279	292	564	1300

Source : Federal Statistical Office and OECD calculations.

Table 2. **Foreign trade, 1990-2001**

USD million

		1990	1991	1992	1996	1997	1998	1999	2000	2001
Exports of goods		**5816**	**4704**	**2539**	**2018**	**2677**	**2858**	**1498**	**1723**	**1903**
of which:	Montenegro	259	158	94	97	140	129	123	161	232
	Serbia	5453	4506	2354	1918	2531	2723	1369	1558	1671
Imports of goods		**7460**	**5548**	**3859**	**4119**	**4826**	**4849**	**3296**	**3711**	**4837**
of which:	Montenegro	221	190	154	259	301	335	358	355	507
	Serbia	7044	5212	3412	3826	4503	4475	2881	3330	4330
Trade balance		**-1644**	**-844**	**-1320**	**-2101**	**-2149**	**-1991**	**-1798**	**-1988**	**-2934**
of which:	Montenegro	38	-32	-60	-162	-161	-206	-235	-194	-275
	Serbia	-1591	-706	-1058	-1908	-1972	-1752	-1512	-1772	-2659
Trade balance (per cent of GDP)					**-15**	**-15**	**-16**	**-23**	**-29**	**-25**
of which:	Montenegro				-20	-19	-28	-39	-29	-29
	Serbia				-14	-14	-15	-21	-28	-25

Source : Federal Statistical Office, National Bank of Yugoslavia and OECD calculations.

Table 3. **Shares of gross material product by sector**

Per cent

	1989[1]	1994	1998	1999[1]	2000[1]
Gross material product (YUD million)	160 529[2]	20 750	127 189	163 467	348 887
Total	100.0	100.0	100.0	100.0	100.0
Agriculture, hunting, forestry and fishing	16.6	21.7	19.9	22.7	23.3
Industry and mining	47.5	37.6	32.7	32.5	34.9
Electricity, gas and water supply	3.5[3]	2.5	4.3	3.9	2.3
Construction	6.1	8.5	6.9	6.2	6.2
Wholesale and retail trade, repair	12.6	16.5	18.4	18.5	17.2
Transport, storage and communications	6.2	8.9	13.0	11.3	10.3
Other	7.7	4.3	4.7	5.0	5.8

1. Data excludes Kosovo and Metohija.
2. Value in old dinars before currency reform.
3. Electricity and water only.

Source: Federal Statistical Office.

Table 4. **Industrial output, 1998-2001**

	Share of GMP, 1999	Index, 1998 =100			
	Per cent	1998	1999	2000	2001
Industry	**36.3**	**100**	**77**	**86**	**86**
Mining and quarrying	**2.6**	**100**	**81**	**88**	**77**
Energy-producing materials	1.7	100	86	93	84
Non energy-producing materials	0.9	100	74	81	67
Manufacturing	**29.9**	**100**	**71**	**81**	**82**
Food products, beverages and tobacco	8.9	100	96	98	95
Textiles and textile products	2.3	100	69	85	86
Leather and leather products, footwear	0.6	100	65	71	70
Wood and products of wood	0.6	100	86	100	81
Paper, publishing and printing	2.4	100	73	83	83
Coke and refined petroleum products	0.0	100	45	47	79
Chemical products and fibres	2.8	100	52	58	66
Rubber and plastic products	1.3	100	73	85	97
Other mineral products	2.0	100	74	93	97
Metals and metal products	2.4	100	58	78	73
Other machinery and equipment	1.7	100	65	75	72
Electrical and optical equipment	1.6	100	83	83	76
Transport equipment	1.4	100	62	83	72
Manufacturing n.e.c.	1.7	100	75	89	96
Electricity, gas and water supply	**3.9**	**100**	**94**	**95**	**96**

Source: Federal Statistical Office, Monthly Review and Statistical Yearbook of Yugoslavia, 2001.

Table 5. **Selected balance sheet indicators of Serbian firms, 2000-01**

	Growth in sales[1]	Share of exports in sales		Share of operating profit in sales[2]		Share of net profit in sales[2]		Labour costs / net wages	
	2001/2000	2000	2001	2000	2001	2000	2001	2000	2001
All firms									
Entire economy	-5.2	4.5	9.8	-9.4	-9.3	-39.4	-5.5	2.3	2.0
of which									
Industry and mining	-1.6	5.6	13.6	-9.1	-8.8	-58.1	-7.0	2.3	2.0
Construction	-28.9	2.3	4.8	-4.3	-8.2	-6.3	-3.9	2.2	2.0
Agriculture	-4.4	1.6	3.0	-15.3	-13.1	-6.2	-11.7	2.3	2.0
Trade	-5.7	2.7	3.9	0.2	-1.8	-4.7	-0.4	2.4	2.1
Small enterprises									
Entire economy	-3.8	1.9	4.1	-1.6	-3.3	-4.5	-0.5	2.4	2.1
of which									
Industry and mining	-9.3	2.3	6.5	0.8	-2.6	-5.4	-0.7	2.3	2.0
Construction	-21.7	1.0	1.5	-2.8	-7.0	-2.6	-0.03	2.3	2.0
Agriculture	-2.4	0.7	2.4	-6.7	-6.5	-3.2	-1.6	2.3	2.0
Trade	1.7	2.0	3.3	0.9	-0.1	-4.1	0.1	2.5	2.1

1. Deflated by average Serbian retail price inflation.
2. Due to a major difference in depreciation charged in 2000 and 2001, depreciation in 2000 is adjusted to be the same share of sales as in 2001.

Source: Serbian Bureau of Payments (ZOP) and OECD calculations.

Table 6. **Share of aggregate sales and losses in small firms**

	Share of small firms in sales		Share of small firms in operating losses		Share of small firms in net losses	
	2000	2001	2000	2001	2000	2001
Entire economy	28.7	29.1	5.0	10.3	2.9	2.5
of which						
Industry and mining	13.0	12.0	0.0	3.6	0.9	1.3
Construction	36.8	40.6	23.9	34.7	13.4	0.3
Agriculture	33.2	33.9	14.6	16.9	17.7	4.5
Trade	51.1	55.1	..	4.0	46.8	0.0

Source: Serbian Bureau of Payments (ZOP) and OECD calculations.

Table 7. **Measures of liquidity for Serbian firms, 2000-01**

	Quick ratio		Share of trade payables in sales		Share of short-term credit in sales		Share of cash in sales		Share of inter-enterprise loans in sales	
	2000	2001	2000	2001	2000	2001	2000	2001	2000	2001
All firms										
Entire economy	0.56	0.58	108.2	78.0	20.9	11.2	4.3	3.8	0.9	1.9
of which										
Industry and mining	0.45	0.49	132.4	90.8	31.3	15.0	3.7	3.1	1.1	3.3
Construction	0.79	0.73	86.1	88.2	7.4	9.5	4.3	5.7	0.6	0.4
Agriculture	0.56	0.55	59.4	53.5	6.6	5.5	1.7	1.5	0.0	0.0
Trade	0.73	0.70	75.8	57.5	3.5	2.9	2.8	2.9	0.1	0.2
Small enterprises										
Entire economy	0.63	0.62	47.2	46.6	2.2	2.6	2.6	3.2	0.1	0.1
of which										
Industry and mining	0.58	0.56	48.6	50.2	2.2	2.6	2.5	2.8	0.2	0.1
Construction	0.79	0.59	46.8	53.4	1.9	2.4	2.6	4.4	0.2	0.1
Agriculture	0.63	0.66	47.9	48.8	6.6	5.5	1.4	1.4	0.1	0.0
Trade	0.64	0.65	43.7	41.9	1.6	2.0	2.3	3.1	0.1	0.2

Source: Serbian Bureau of Payments (ZOP) and OECD calculations.

Table 8. **Measures of subsidies to Serbian firms**

	Share of direct subsidies and grants in sales		Share of energy costs in sales		Share of tax arrears in sales		Share of wage arrears in sales	
	2000	2001	2000	2001	2000	2001	2000	2001
All firms								
Entire economy	2.2	1.8	6.9	8.4	4.4	4.1	1.1	1.1
of which								
Industry and mining	0.8	0.7	11.4	13.5	5.8	5.2	1.9	1.8
Construction	0.2	0.3	4.0	5.3	3.8	4.8	1.8	2.6
Agriculture	1.4	1.6	4.9	5.4	5.3	5.1	1.9	2.0
Trade	0.1	0.1	0.7	0.9	1.9	1.7	0.6	0.6
Small enterprises								
Entire economy	0.5	0.5	1.4	1.9	2.3	2.1	1.1	1.1
of which								
Industry and mining	0.2	0.2	1.7	2.3	2.7	2.8	1.4	1.7
Construction	0.2	0.3	1.9	2.6	2.5	2.8	1.6	1.9
Agriculture	0.7	0.7	2.1	2.3	2.9	2.7	1.5	1.4
Trade	0.1	0.0	0.6	0.8	0.1	0.0	0.6	0.6
Memorandum								
Transport (all firms)	15.6	13.6						

Source: Serbian Bureau of Payments (ZOP) and OECD calculations.

Table 9. **The FRY balance of payments, 1997-2002**

USD million

	1997	1998	1999	2000	2001	Jan-Jun 2001	Jan-Jun 2002
Current account balance	**-1279**	**-660**	**-715**	**-339**	**-624**	**-620**	**-839**
Balance of goods and services	**-1614**	**-1323**	**-1391**	**-1457**	**-2398**	**-1403**	**-1613**
Exports f.o.b	3574	3947	2147	2547	2762	1274	1269
Imports c.i.f	-5188	-5270	-3538	-4004	-5160	-2677	-2882
Trade balance	-2070	-1816	-1619	-1788	-2834	-1568	-1694
Exports	2756	3033	1676	1923	2003	953	965
Imports	-4826	-4849	-3295	-3711	-4837	-2521	-2659
Services, net	456	493	228	331	436	165	81
Receipts	818	914	471	624	759	321	304
Expenditures	-362	-421	-243	-293	-323	-156	-223
Net factor income	**25**	**8**	**8**	**-1**	**-26**	**-16**	**-28**
Official grants	**0**	**0**	**0**	**271**	**563**	**282**	**192**
Current transfers	**310**	**655**	**668**	**848**	**1237**	**517**	**610**
Capital account balance	**1162**	**181**	**117**	**363**	**960**	**381**	**1065**
Foreign direct investment	740	113	112	50	165	53	180
Medium and long term credits	128	50	29	245	127	126	334
Repayment of principal on medium & long term loans	-74	-25	-17	-11	-33	-6	-16
Short term credits and deposits, net	229	-35	-37	30	75	39	91
Other capital flows, net	139	78	30	49	626	169	476
Advanced payments and deposits	105	47	17	40	-14	14	-135
Investment abroad	34	31	13	9	8	1	0
New foreign exchange savings deposits	0	0	0	0	276	0	311
Foreign exchange purchases	0	0	0	0	356	154	300
Errors and omissions	**99**	**364**	**487**	**203**	**301**	**436**	**657**
Overall balance	**-18**	**-115**	**-111**	**227**	**637**	**197**	**883**
Financing	**18**	**115**	**111**	**-227**	**-637**	**-197**	**-883**
Central Bank, net	-23	70	29	-227	-363	-192	-651
Commercial banks	41	45	82	0	-274	-5	-232

Source: National Bank of Yugoslavia.

Table 10. **Montenegro balance of payments, 2000-02**

USD million

	2000	2001	Jan-Jun 2001	Jan-Jun 2002
Current account balance	**-68.5**	**-60.7**	**-170.0**	**-110.1**
Balance of goods and services	**-208.8**	**-269.4**	**-219.0**	**-153.8**
Exports f.o.b	160.9	293.9	99.3	127.5
Imports c.i.f	458.5	669.0	332.1	301.1
Trade balance	-297.6	-375.1	-232.7	-173.6
Exports	130.1	152.7	35.4	44.6
Imports	41.3	47.0	21.7	24.8
Services, net	88.8	105.7	13.7	19.8
Receipts	34.1	77.6	28.6	54.1
Expenditures	1.0	2.2	16.2	19.6
Net factor income	**33.1**	**75.4**	**12.4**	**34.4**
Official grants	**115.0**	**142.6**	**39.5**	**13.8**
Current transfers	**-7.4**	**-9.4**	**-3.0**	**-4.6**
Capital account balance	**..**	**31.8**	**1.7**	**14.7**
Foreign direct investment	..	5.3	1.8	8.7
Portfolio investment	..	2.7	-0.1	-0.4
Foreign capital grants	7.4	24.6	..	..
Medium and long term credits	..		0.5	2.1
Repayment of principal on medium & long term loans	..	..	-3.1	-3.2
Net investment abroad	..	-0.8	2.6	7.5
Errors and omissions	**..**	**6.8**	**172.2**	**102.0**
Overall balance	**..**	**-22.1**	**3.9**	**6.6**
Financing	**..**	**22.1**	**-3.9**	**-6.6**
Central bank reserves	..	22.1	-3.9	-6.6

Source: Central Bank of Montenegro.

Table 11. **The general government budget on Serbian territory**

Per cent of GDP

	2001
Federal Budget	
Revenues	6.9
Expenditures	6.7
of which: transfers to Extra-budgetary Funds	0.2
Balance	0.2
Republican Budget	
Revenues	17.1
of which: tax revenues	16.0
Expenditures	18.6
of which: transfers to Extra-budgetary Funds	3.7
of which: transfers to local budgets	0.1
Balance	-1.5
Local Budgets	
Revenues	4.4
of which: own revenues	4.3
of which: transfers from republic	0.1
Expenditures	4.4
Balance	0.0
Pension Funds	
Revenues	11.1
of which: own revenues	7.5
of which: transfers	3.5
Expenditures	11.1
Balance	-0.1
Employment Fund	
Revenues	0.6
of which: own revenues	0.4
of which: transfers	0.2
Expenditures	0.6
Balance	0.0
Health Fund	
Revenues	5.6
of which: own revenues	4.4
of which: transfers	1.2
Expenditures	5.5
Balance	0.1
General Government[1]	
Revenues (net of transfers)	38.7
Expenditures (net of transfers)	40.0
Balance	-1.3
Memorandum	
Serbian GDP (millions of dinars)	712 379

1. The figure for general government excludes transfers between funds.

Source: Serbian Ministry of Finance.

Table 12. **The Serbian republican budget, 2001-02**

	As a share of Serbian GDP			Jan-Jun 2002 as a share of the revised budget for the year
	2001	2002 budget	2002 revised budget	
Revenues				
Total revenue	**17.1**	**19.1**	**18.8**	**46.3**
Current revenue	**17.1**	**19.1**	**18.8**	**46.3**
Tax revenue	**16.0**	**18.1**	**18.8**	**46.3**
Personal income tax	4.4	4.7	4.8	45.8
Corporate income tax	0.5	0.5	0.5	53.3
Turnover (retail sales) tax	5.3	7.2	6.6	44.5
Excises	3.4	4.1	3.9	42.6
Tax on property	0.0	..	..	
Tax on financial transactions	1.4	0.9	1.3	52.5
Tax on extraprofits	0.2	..	..	
Other taxes	0.8	0.7	1.7	43.5
Nontax revenue	**1.1**	**1.0**	..	
Capital revenue	**0.0**	..	..	
Expenditures				
Total expenditure and net lending	**18.6**	**23.2**	**23.0**	
Total expenditure	**17.9**	**23.2**	**23.0**	**46.3**
Current expenditure	**17.3**	**21.9**	**21.4**	**47.6**
Expenditure on goods and services	**6.2**	**6.9**	**6.1**	**49.0**
Wages and salaries	3.8	4.0	3.5	53.0
Employer contribution	0.8	0.8	0.7	47.0
Other purchases of goods and services	1.6	2.1	1.9	42.2
Interest payment	**0.1**	**2.3**	**1.0**	**22.8**
Interest payment on domestic debt	0.1	0.7	0.2	49.5
Interest payment on foreign debt	0.0	1.6	0.8	16.2
Subsidies	**3.1**	**3.1**	**3.7**	**65.5**
Transportation	1.4	..	..	
Agriculture, forestry, hunting and fishery	0.8	..	..	
Mining, mineral wealth, heating and energy	0.5	..	..	
Tourism	0.0	..	..	
Financial sector	0.3	..	..	
Other sectors	0.2	..	..	
Transfers to the state government or funds	**3.8**	**5.9**	**6.8**	**44.8**
Social protection	**2.2**	**2.6**	**2.7**	**49.0**
Grants to NGOs	**0.2**	**0.0**	**0.0**	**57.4**
Repayment of public debt	**0.6**	..	..	
Repayment of old foreign currency savings	0.5	..	..	
Servicing of government bonds	0.1	..	..	
Other current expenditure	**1.1**	**1.0**	**1.1**	**14.4**
Capital expenditure	**0.6**	**1.3**	**1.5**	**27.8**
Net lending	**0.7**	**0.0**	**0.0**	
Balance	**-1.5**	**-4.1**	**-4.2**	**46.1**
Financing	**1.5**	**4.1**	**4.2**	**44.1**
of which:				
Domestic Sources	**1.1**	**1.7**	**1.9**	
Net borrowing	**1.1**	**0.6**	**0.6**	**82.8**
From the NBY	1.2	0.6	0.6	82.8
From commerical banks	0.0	..	..	
Other	0.0	..	..	
Privatisation receipts	**0.0**	**1.1**	**1.4**	**35.6**
Foreign Sources	**0.4**	**2.4**	**2.3**	**39.3**
Loans	..	1.4	1.4	36.0
Grants	0.4	1.0	0.8	44.8
Memorandum:				
Serbian GDP (millions of dinars)	712 379	946 486	946 486	

Source: Serbian Ministry of Finance.

Table 13. **External debt of the FRY**

Estimate at 31 May 2002, USD million

	Outstanding debt (principal)	Interest arrears	Late interest	Total
Total debt	**8970.2**	**1088.5**	**471.3**	**10529.9**
Total debt in convertible currency	**8811.3**	**1062.4**	**471.3**	**10345.1**
Medium and long-term debt	**7749.7**	**1062.4**	**471.3**	**9283.4**
Multilateral institutions	3017.3	57.8	49.3	3124.5
IMF	471.9			471.9
IBRD[1]	1953.2			1953.2
IDA	71.4			71.4
EUROFIMA	141.7			141.7
IFC	81.8	57.8	49.3	188.9
EIB	52.8			52.8
European Community	210.7			210.7
EUROFOND-CEB	30.1			30.1
EBRD	3.7			3.7
Governments - Total Paris Club	2496.9			2496.9
Paris Club[2]	2454.9			2454.9
Credits concluded after 20 December 2000	42.0			42.0
Other governments[3]	257.4	11.2		268.6
China	219.9	11.2		231.1
Libya	37.5			37.5
Commercial Banks (London Club)[4]	1353.2	870.9	141.2	2365.3
Other creditors[5]	624.8	122.5	280.8	1028.1
Short-term debt	**1061.7**			**1061.7**
China	100.0			100.0
Governments - Paris Club	33.2			33.2
Others	425.1			425.1
Trade credits on oil & gas imports	503.4			503.4
Debt in non-convertible currency	**158.8**	**26.0**		**184.9**

1. Consolidated debt as of 31 December 2001 (principal+currency pool+regular interest+late interest).
2. On the consolidated debt as of 31 July 2001 (principal+regular interest+late interest) amounting to 4241,97 million USD, interest was calculated applying the rate of 5% for the period of moratorium, amounting to 138,88 million USD. The debt reduction terms under Agreement with the Paris Club Creditors were then applied to this amount.
3. Regular and late interest calculated in accordance with terms of original agreements.
4. Excluded debt purchased by National Bank of Yugoslavia and other Yugoslav legal entities.
5. Includes credit for USD 5,5 million by principal. Creditor under this loan is not the International Investment Bank, Moscow any more, but PFHC Establishment, Liechtenstein.

Source: National Bank of Yugoslavia.

Table 14. **IMF study scenario for medium-term external sustainability, 2002-10**

USD million

	2002	2003	2004	2005	2006	2007	2008	2009	2010
Export growth (USD terms, per cent)[1]	12.3	16.4	16.4	15.0	13.0	11.0	10.3	10.3	9.5
Import growth (USD terms, per cent)	15.1	9.9	8.3	8.1	7.0	6.4	6.3	6.3	6.3
Current account balance, before grants	-1646	-1722	-1623	-1449	-1363	-1282	-1176	-1039	-914
External debt[2]	8598	9397	10130	9706	9840	9780	9472	9036	8908
External debt service[3]	343	467	719	852	1107	1315	1512	1630	1308
External debt service (Per cent of government revenue)[3]	6.2	7.9	11.3	12.5	15.0	16.6	17.8	18.0	13.5

1. Reported exports only.
2. Incorporates the phased 66 percent debt reduction offered by the Paris Club, with comparable action provided by other official bilateral and commercial creditors.
3. Besides the phased 66 percent debt reduction offerd by the Paris Club, assumes a 60 percent capitalization of moratorium interest for the 2002-2005 period (as per the Paris Club agreement). Debt service projections for other official bilateral and commercial creditors are based on the assumption of comparable treatment.

Source: IMF(2002*b*).

Table 15. **Payable arrears of Serbian state budgets and funds**

Shares of annual expenditure in 2001

	August 2001	October 2001	December 2001	March 2002	June 2002	June 2002 share of GDP
All budgetary arrears	15.3	16.7	18.6	14.7	14.2	5.7
Serbian consolidated republican budget	8.5	9.4	9.4	5.4	4.6	1.1
All extrabudgetary funds	24.3	26.5	30.8	27.2	27.1	4.7
Pension fund	24.5	27.6	35.0	29.0	27.9	3.1
Health fund	21.1	22.1	20.9	20.4	22.7	1.3
Employment fund	52.9	48.3	44.7	58.5	54.8	0.3

Source: Serbian Ministry of Finance.

Table 16. **The Montenegrin republican budget, 2002**

EUR million

		Jan-Jul 2002 as a share of the budget for the year
Revenues		
Total revenue and grants	***298.8***	***46.5***
Total revenue	**269.7**	**47.1**
Current revenue	**269.7**	**47.1**
Tax revenue	**208.6**	**55.4**
Personal income tax	67.9	45.3
Corporate income tax	8.0	94.9
Turnover (retail sales) tax	61.9	52.3
Excises	33.7	81.2
Tax on property	4.1	54.8
Customs tariffs	18.2	33.5
Customs transit fees	14.7	62.2
Nontax revenue	**61.1**	**18.5**
Administrative fees	3.2	71.5
Natural resource use fees	3.7	29.4
Revenue from work of authorities (line 733)	41.8	2.1
Other revenue	12.4	57.6
Capital revenue	**0.0**	
Grants	**29.1**	**41.5**
Expenditures		
Total expenditure and net lending	***342.9***	***53.8***
Total expenditure	**319.5**	**53.5**
Current expenditure	**302.8**	**54.2**
Expenditure on goods and services	**191.7**	**54.0**
Wages and salaries	80.1	64.9
Benefits-in-kind	13.3	37.8
Employer contribution	41.3	41.1
Other purchases of goods and services	57.0	51.8
Interest payment	**23.6**	**32.5**
Interest payment to residents	0.6	89.3
Interest payment to non-residents	23.0	31.1
Subsidies		**33.5**
Public companies	25.9	33.4
Other companies	0.1	49.4
Transfers to the state government or funds	**9.4**	**46.8**
Social protection	**33.8**	**47.5**
Grants to NGOs	**1.7**	**49.9**
Repayment of public debt	**14.8**	**150.4**
Foreign loans	0.0	
Domestic loans	14.8	150.4
Other current expenditure	**1.8**	**41.6**
Capital expenditure	**16.8**	**40.9**
Expenditure reserve	**11.9**	**50.8**
Net lending	**11.5**	**64.7**
Balance	**-44.2**	**103.0**
Financing	**44.1**	30.7
Domestic Sources	**44.1**	**54.4**
Net borrowing from commercial banks	20.1	54.4
Privatisation receipts	24.0	10.9
Foreign Sources	**0.0**	
Loans	0.0	
Grants	0.0	

Source: Montenegrin Ministry of Finance.

Table 17. **Serbian commercial banks: selected balance sheet indicators**

	All banks[1]		Newer banks	Older banks	All banks,[1] Per cent of GDP	Share of new banks in total banking sector
	31 Dec 00	31 Dec 01	31 Dec 01	31 Dec 01	31 Dec 01	31 Dec 01
Assets (YUD million)	248 957	291 460	93 324	198 136	40.9	32.0
of which (per cent)						
Cash and cash equivalent	12.3	13.5	24.5	8.4	5.5	57.9
Deposits with NBY + short term securities refinanced	5.0	6.9	11.6	4.7	2.8	54.0
Short term credits	13.8	22.8	43.0	13.4	9.3	60.2
of which to NFS		17.0			6.9	
Short-term securities		3.0	5.8	1.7	1.2	61.3
Long-term securities		2.8	0.0	4.1	1.1	0.1
Other assets and non-operating assets	8.4	4.7	4.8	4.7	1.9	32.4
Claims on FRY for Foreign Exchange savings deposits	36.8	22.9	0.0	33.7	9.4	0.0
Long term loans and investments	17.9	16.8	2.6	23.5	6.9	4.9
Equity investments	1.7	1.8	2.7	1.3	0.7	49.0
Fixed assets	4.1	4.7	5.0	4.5	1.9	34.4
Total	100.0	100.0	100.0	100.0		
Off balance sheet items (% of assets)		30.4	12.1	39.1	12.5	
Liabilities (YUD million)	248 957	291 460	93 324	198 136	40.9	32.0
of which (per cent)						
Demand deposits	15.9	24.9	42.5	16.6	10.2	54.6
Liabilities to NBY	0.3	0.2	0.1	0.3	0.1	8.1
Short term deposits		7.1	11.1	5.2	2.9	50.0
Long term deposits		0.3	0.3	0.3	0.1	37.6
Short term loans	1.6	1.3	1.3	1.3	0.5	32.7
Long term loans	18.5	14.0	0.3	20.5	5.7	0.7
Short term securities		1.0	2.5	0.2	0.4	84.4
Long term securities		0.4	0.0	0.6	0.2	0.3
Other	6.2	2.7	4.1	2.0	1.1	48.4
Liabilities for Foreign Exchange savings deposits	37.1	24.0	0.0	35.3	9.8	0.0
Long term provisions	2.8	8.3	3.8	10.4	3.4	14.7
Capital	17.6	15.8	34.0	7.3	6.5	68.7
Total	100.0	100.0	100.0	100		
Selected indicators						
Capital adequacy	23.0	21.9	40.6	10.3		
Share of overdue (classified) loans in short-term credit		23.1	26.1	17.0		
Share of classified assets in all assets	8.3					
Pecuniary Capital (prudential norm, EUR million)	467.9					
Net profits (YUD million)		-10 524	181	-10 704		

1. Excluding the four largest banks that were closed in early 2002.

Source: National Bank of Yugoslavia, 2002 and OECD calculations.

Table 18. **Basic characteristics of firms in the sample**

	Total		Belgrade	Vojvodina	Central Serbia	Montenegro
	Number	Per cent	Per cent			
Republic						
Serbia	303	75				
Montenegro	101	25				
Year established						
1991 and before	186	46				
after 1991	218	54				
Principal activity						
Manufacturing	206	51	64	46	60	34
Trade	81	20	12	15	17	37
Services	77	19	13	25	11	28
Construction	24	6	6	8	10	2
Transport	4	1	..	5	1	..
Research & development	4	1	4	..	..	..
Other	4	1	..	2	2	..
Employment						
Full time employees (number)	10.9					
Part time employees (number)	1.5					
Mean service length of director (years)	7.6					

Source: 2002 OECD Survey of 404 firms in the FRY.

Table 19. **Directors' characterisation of firms' financial condition**

	Total		Belgrade	Vojvodina	Central Serbia	Montenegro
	Number	Per cent	Per cent			
Stable	271	67	58	67	68	74
Unstable	97	24	32	25	19	20
Critical	36	9	10	8	14	6

Source: 2002 OECD Survey of 404 firms in the FRY.

Table 20. **Most significant operating difficulties faced by small firms**

	First named		Overall	
	Number	Per cent	Number	Per cent
Insufficient customer purchasing power	101	25	238	59
Increasing cost of other inputs	57	14	133	33
Insufficient working capital	57	14	117	29
Insufficient credit	44	11	129	32
Insufficient capital for investment	20	5	97	24
Fierce competition	20	5	105	26
High national taxes	20	5	97	24
Increasing wages	16	4	32	8
Other	16	4	24	6
Inability to find suitably skilled employees	12	3	32	8
Changing legislation & regulations	12	3	44	11
Unreliable supply of inputs	8	2	32	8
Obsolete technology	8	2	44	11
High local taxes	8	2	40	10
Conflict with owners of the firm	0	0	0	0
Harassment by state or local authorities	0	0	4	1

Source: 2002 OECD Survey of 404 firms in the FRY.

Table 21. **Difficulties faced by small firms in day-to-day operations**

Per cent

	Difficult	Not so difficult	Quite easy	No response
Open a bank account	3	37	60	..
Obtain bank credit	55	35	10	..
Obtain financial support from business partners, other enterprises or private individuals	64	29	6	..
Hire employees	32	42	26	..
Dismiss employees	32	37	31	..
Find suitably skilled and qualified employees	37	45	18	..
Purchase new equipment	76	19	4	..
To expand	66	30	3	..
Purchase timely business advice	34	55	10	..
Obtain licenses/certificates	40	51	8	..
To lobby the authorities	69	21	3	7
Protect the business from extortion	30	43	18	9
Memorandum items				
Obtain bank credit				
Belgrade	83	15	2	..
Vojvodina	61	35	4	..
Central Serbia	39	38	23	..
Montenegro	40	50	11	..
Obtain licenses/certificates				
Belgrade	48	44	8	..
Vojvodina	35	54	11	..
Central Serbia	52	47	1	..
Montenegro	27	59	14	..

Source: 2002 OECD Survey of 404 firms in the FRY.

Table 22. **Burden of harassment on small firms by state agencies**

	FRY		Russia
	Number	Per cent	Per cent[1]
None	190	47	19
Tax	121	30	22
Other	32	8	23
Local authority	20	5	5
State authority	20	5	2
Fire	8	2	16
Health & sanitation	4	1	13
ZOP	4	1	n/a

1. Average response.

Source: 2002 OECD Survey of 404 firms in the FRY and OECD (2002a).

Table 23. **Use of formal contracts by small firms in collecting debts**

	Number	Per cent
Always	32	8
Usually	97	24
Sometimes	125	31
Hardly ever	97	24
Not at all	53	13

Source: 2002 OECD Survey of 404 firms in the FRY.

Table 24. **Perceived changes in the business environment over the last two years**

	Improved	Unchanged	Deteriorated	Balance of improvement
	Per cent			Difference
For SMEs as a whole				
Profit margins	17	22	54	-37
Overall environment	23	22	39	-16
Demand for goods and services	27	23	43	-16
Investment opportunities	23	25	40	-17
Possibility to compete with existing firms	25	45	19	6
Relationship with employees	23	72	3	20
In your firm				
Profitability	20	35	45	-25
Sales	29	32	38	-9
Level of production	31	34	21	10
Average wages	31	49	21	10
Number of employees	25	64	11	14
Competitiveness	41	39	20	21

Source: 2002 OECD Survey of 404 firms in the FRY.

Table 25. **Privatisation in Serbia, 1997-2000**

Number of enterprises

Ineligible firms	1750
Eligible firms	7000
Capital valuation completed	2218
Phase I started	412
Phase II started	202

Source: Uvalic (2001).

Table 26. **Profile of Serbian enterprises by ownership, December 1998**

Per cent

	Number	Employees	Assets	Turnover	Share in GSP
Wholly non-private ownership	12.0	49.6	57.8	34.8	33.1
Social	11.6	48.2	55.0	33.9	31.4
State	0.4	1.4	2.8	0.9	1.8
Co-operative	3.1	1.6	1.0	1.7	1.0
Mixed	8.8	34.1	35.1	28.3	28.2
Private	76.0	14.6	6.2	35.2	37.7

Source: Uvalic (2001).

Table 27. **Enterprise transformation in Montenegro, 1990-99**

Number and capital (EUR million)

	Number	Capital	Per cent
Years			
1990-94	18	299	
1995	123	939	
1996	64	729	
1997	51	546	
1998	40	105	
1999	51	18	
Total capital incorporated	**347**	**2635**	**56.6**
Remaining capital		2021	43.4
Total enterprise capital		**4655**	**100.0**

Source: Vukotic (2001).

Table 28. **Ownership of Montenegrin firms, December 1999**

Per cent

State ownership	68.5
State	8.9
Development Fund	35.3
Employment Fund	6.1
Pension Fund	18.3
Banks	1.9
Employees	22.4
Other	7.2

Source: Vukotic (2001).

Table 29. **'Systems' qualifying for pre-privatisation restructuring**

	Number
Sector	
Metals	14
Chemicals	8
Textiles	6
Food & food processing	4
Machinery and equipment	3
Automotive	3
Rubber	2
Electrical machinery	2
Non-metals	2
Tools	2
Leather	1
Paper	1
Construction	1
	49
Geographical area	
Central Serbia	28
Belgrade	12
Vojvodina	9
	49

Source: Serbian Privatisation Agency.

Table 30. **Serbian privatisation, January-September 2002**

USD million

Company	Sale method	Month	Book value	Sale price	Investment commitments
Kosjeric	Tender	January	31.2	35.5	29.7
Beocin	Tender	January	7.2	50.9	32.3
Novi Popovac	Tender	January	15.5	52.5	85.5
Merima	Tender	September	12.0	14.4	43.3
Seval	Tender	October	11.0	6.5	14.6
Tender sub-total			**76.9**	**159.8**	**205.4**
2 companies	Auction	April	0.3	0.3	0.1
4 companies	Auction	May	3.3	2.1	0.5
8 companies	Auction	July	6.1	5.5	2.3
5 companies	Auction	August	2.3	2.2	0.2
9 companies	Auction	September	3.3	1.6	0.5
Auction sub-total			**15.3**	**11.7**	**3.6**
Total			**92.2**	**171.5**	**208.5**

Source: Serbian Privatisation Agency.

Table 31. **Privatisation in Montenegro up to July 2002**

EUR million

	Estimated value of capital	Per cent
Mass voucher privatisation	318.8	13
Sale by tender	1347.2	54
Batch sale	490.6	19
Auction	17.6	1
Other	322.6	13
Total privatised	**2496.9**	**100**
Still to be privatised	2208.3	

Table 32. **FRY index of intra-industry trade[1], 1991-2001**

Year	
1991	59
1996	52
1997	54
1998	51
1999	50
2000	49
2001	50

1. Grubel-Lloyd index corrected for aggregate trade imbalance.

Source: CEPII, CHELEM database and OECD.

Table 33. **Revealed comparative advantage (RCA)**

Products	1991	1998	2000	2001	Export share 2001	Cumul.
76 Aluminium and Articles Thereof	1.89	2.56	7.50	7.68	8.88	8.88
62 Articles of Apparel and Clothing Accessories, Not Knitted or Crocheted	8.60	5.39	4.72	6.13	7.11	15.99
44 Wood and Articles of Wood; Wood Charcoal	1.03	11.94	4.08	4.17	5.70	21.69
74 Copper and Articles Thereof	5.30	5.53	5.15	3.80	4.13	25.82
40 Rubber and Articles Thereof	1.64	2.03	2.21	3.73	5.03	30.85
08 Edible Fruit and Nuts; Peel of Citrus Fruits or Melons	1.12	1.25	4.00	3.22	4.62	35.47
64 Footwear, Gaiters and The Like; Parts of Such Articles	2.40	0.77	1.89	2.49	3.89	39.37
72 Iron and Steel	2.58	5.53	3.12	2.30	4.64	44.00
07 Edible Vegetables and Certain Roots and Tubers	0.58	0.91	0.98	1.58	2.04	46.04
61 Articles of Apparel and Clothing Accessories, Knitted or Crocheted	1.53	1.08	1.53	1.57	2.01	48.05
17 Sugars and Sugar Confectionery	1.59	-0.18	-0.12	1.30	2.18	50.23
69 Ceramic Products	0.61	0.48	1.79	1.19	1.60	51.83
73 Articles of Iron or Steel	1.40	0.33	1.36	1.03	2.75	54.58
89 Ships, Boats and Floating Structures	0.52	0.53	0.54	0.84	0.99	55.57
30 Pharmaceutical Products	0.91	1.25	1.38	0.83	2.15	57.71
63 Other Made Up Textile Articles; Sets; Worn Clothing and Worn Textile Articles; Rags	-0.02	-0.05	0.13	0.82	0.98	58.70
15 Animal or Vegetable Fats and Oils and Their Cleavage Products; Prepared Edible Fats; Animal or Vegetable Waxes	-0.12	0.60	0.81	0.79	0.97	59.67
94 Furniture; Bedding, Mattresses, Stuffed Furnishings; Lamps and Lighting Fittings, n.e.s.	1.37	2.84	1.07	0.72	1.72	61.39
19 Preparations of Cereals, Flour, Starch or Milk; Pastrycooks' Products	-0.03	0.11	0.90	0.70	0.94	62.33
88 Aircraft, Spacecraft, and Parts Thereof	-0.12	0.08	-0.16	0.69	1.65	63.98

Products	1991	1996	2002	2001	Import share 2001	Cumul.
27 Mineral Fuels, Mineral Oils and Products of Their Distillation; Bituminous Substances; Mineral Waxes	-14.09	-13.07	-19.84	-18.06	20.70	20.70
84 Nuclear Reactors, Boilers, Machinery and Mechanical Appliances; Parts Thereof	-3.02	-6.21	-4.02	-5.65	10.20	30.89
52 Cotton	-7.22	-5.35	-5.47	-5.07	5.34	36.23
87 Vehicles Other Than Railway or Tramway Rolling-Stock, and Parts and Accessories Thereof	-0.32	-2.13	-5.79	-3.22	5.23	41.46
29 Organic Chemicals	-1.81	-0.53	-2.02	-1.56	2.02	43.48
31 Fertilizers	0.21	-0.15	-0.73	-1.43	1.55	45.03
85 Electrical Machinery and Equipment and Parts Thereof; Sound & TV Recorders and Reproducers	-0.62	-2.49	-0.46	-1.34	4.69	49.72
38 Miscellaneous Chemical Products	-0.89	-0.73	-1.15	-1.30	1.73	51.45
24 Tobacco and Manufactured Tobacco Substitutes	0.75	0.38	-0.78	-1.27	1.44	52.89
48 Paper and Paperboard; Articles of Paper Pulp, Paper or Paperboard	-1.53	-2.78	-1.42	-1.23	2.63	55.52
22 Beverages, Spirits and Vinegar	-0.10	0.05	0.28	-1.10	1.83	57.35
90 Optical, Photographic, Cinematographic, Measuring, Checking, Precision, Medical Instruments and Apparatus	-1.79	-2.16	-0.73	-1.02	1.63	58.98
09 Coffee, Tea, Mate and Spices	-1.23	-1.42	-1.89	-0.88	1.06	60.03
28 Inorganic Chemicals: Organic or Inorganic Compounds of Precious Metals, of Rare-Earth Metals, of Radioactive Elements or of Isotopes	-0.75	-0.62	-1.17	-0.80	1.18	61.21
25 Salt; Sulphur; Earths and Stone; Plastering Material, Lime and Cement	-0.84	-0.83	-0.92	-0.67	0.89	62.10
33 Essential Oils and Resinoids; Perfumery, Cosmetic or Toilet Preparations	-0.16	-0.60	-0.41	-0.66	0.86	62.96
32 Tanning or Dyeing Extracts; Tannins; Dyes, Pigments; Paints and Varnishes; Putty and Other Mastics; Inks	-0.78	-0.93	-0.70	-0.62	0.96	63.92
23 Residues and Waste From The Food Industries; Prepared Animal Fodder	-0.26	-1.14	0.07	-0.62	0.98	64.90
34 Soaps, Organic Surface-Active Agents, Washing Preparations, Lubricating Preparations, Artificial Waxes, Prepared Waxes, Shoe Polish, Candles, Dental Wax	-0.45	-0.66	-0.41	-0.58	0.81	65.71
55 Man-Made Staple Fibres	1.10	-0.31	-0.19	-0.50	0.60	66.31

Source: Federal Statistical Office and OECD.

Table 34. **Changes in revealed comparative advantage, 1991-2001**

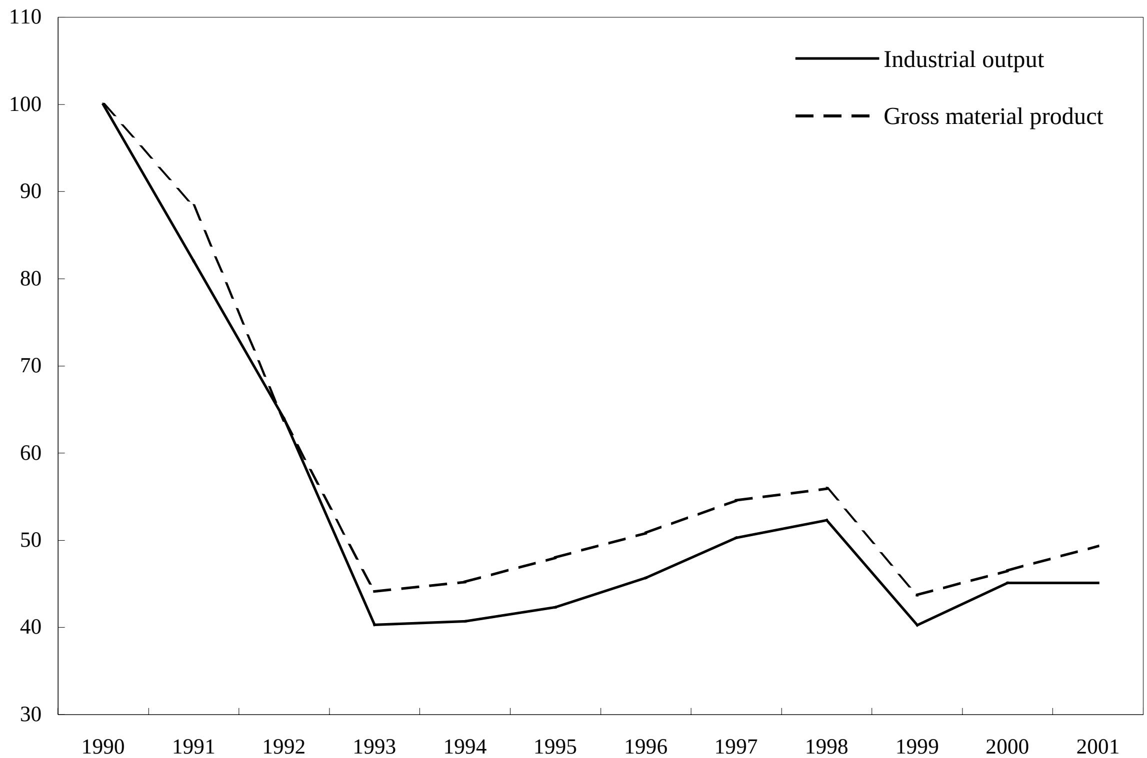
Code	Title	RCA 2001	RCA 1991	Difference
10 largest positive changes				
76	Aluminium And Articles Thereof	7.68	1.89	5.79
44	Wood And Articles Of Wood; Wood Charcoal	4.17	1.03	3.13
52	Cotton	-5.07	-7.22	2.15
08	Edible Fruit And Nuts; Peel Of Citrus Fruits Or Melons	3.22	1.12	2.10
40	Rubber And Articles Thereof	3.73	1.64	2.09
41	Hides And Skins (Other Than Furskins) And Leather	0.60	-0.72	1.32
07	Edible Vegetables And Certain Roots And Tubers	1.58	0.58	1.00
15	Animal Or Vegetable Fats And Oils And Their Cleavage Products; Prepared Edible Fats; Animal Or Vegetable Waxes	0.79	-0.12	0.92
63	Other Made Up Textile Articles; Sets; Worn Clothing And Worn Textile Articles; Rags	0.82	-0.02	0.84
88	Aircraft, Spacecraft, And Parts Thereof	0.69	-0.12	0.81
10 largest negative changes				
22	Beverages, Spirits And Vinegar	-1.10	-0.10	-1.00
74	Copper And Articles Thereof	3.80	5.30	-1.50
55	Man-Made Staple Fibres	-0.50	1.10	-1.60
31	Fertilizers	-1.43	0.21	-1.64
10	Cereals	-0.16	1.81	-1.97
24	Tobacco And Manufactured Tobacco Substitutes	-1.27	0.75	-2.02
62	Articles Of Apparel And Clothing Accessories, Not Knitted Or Crocheted	6.13	8.60	-2.47
84	Nuclear Reactors, Boilers, Machinery And Mechanical Appliances; Parts Thereof	-5.65	-3.02	-2.64
87	Vehicles Other Than Railway Or Tramway Rolling-Stock, And Parts And Accessories Thereof	-3.22	-0.32	-2.90
27	Mineral Fuels, Mineral Oils And Products Of Their Distillation; Bituminous Substances; Mineral Waxes	-18.06	-14.09	-3.96

Source: Federal Statistical Office and OECD.

FIGURES

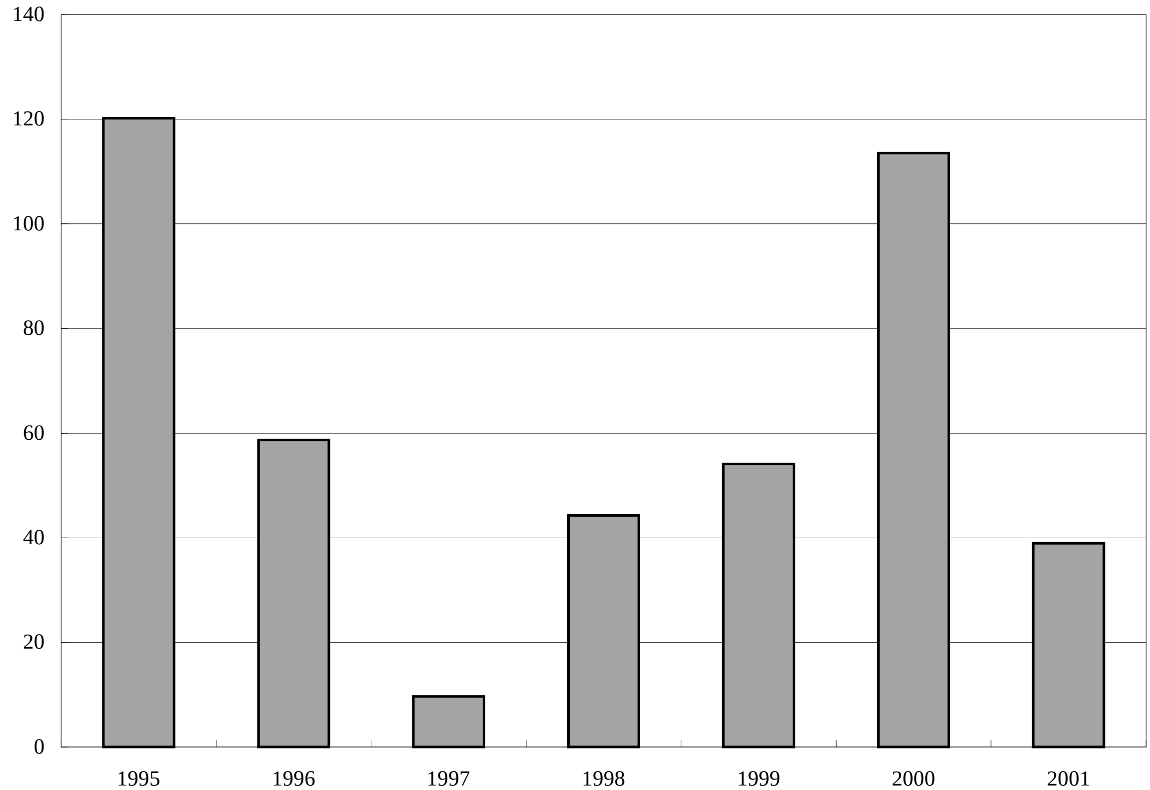
Figure 1. **Industrial output and gross material product, 1990-2001**

Index, 1990 = 100



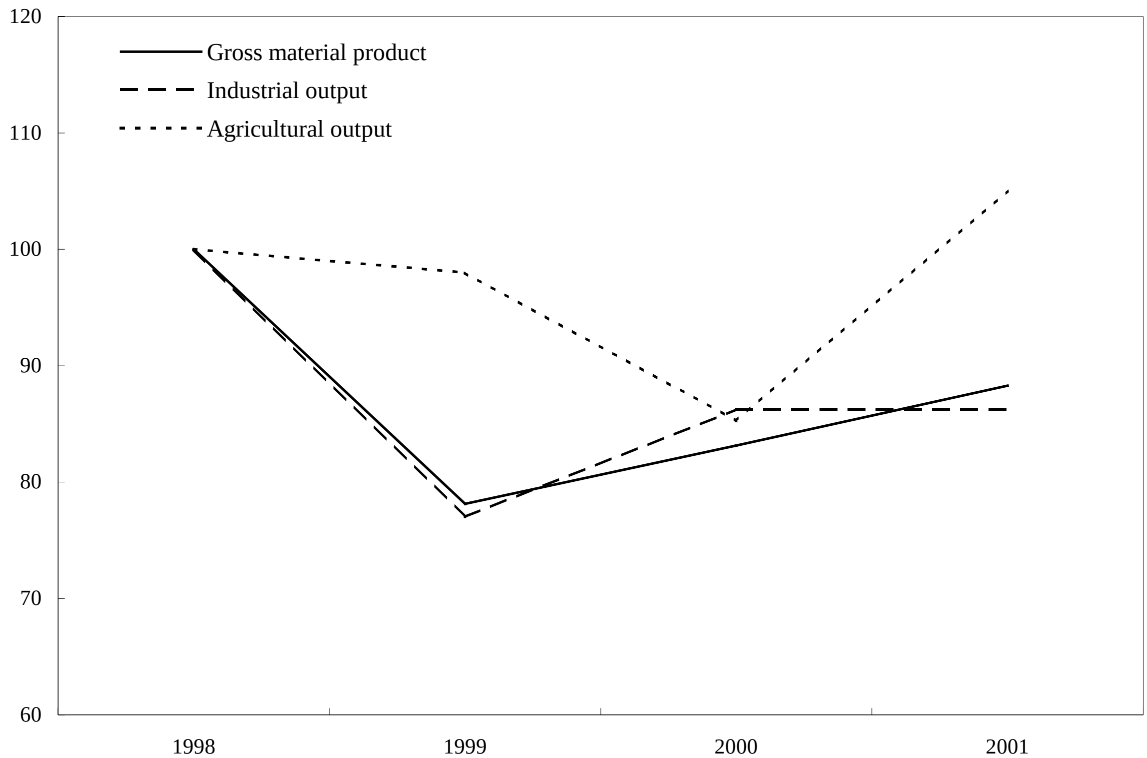
Source: Federal Statistical Office, *Statistical Yearbook of Yugoslavia, 2001* and *Monthly Review of Economic Statistics*.

Figure 2. **Retail price inflation, 1995-2001**
December on December, per cent



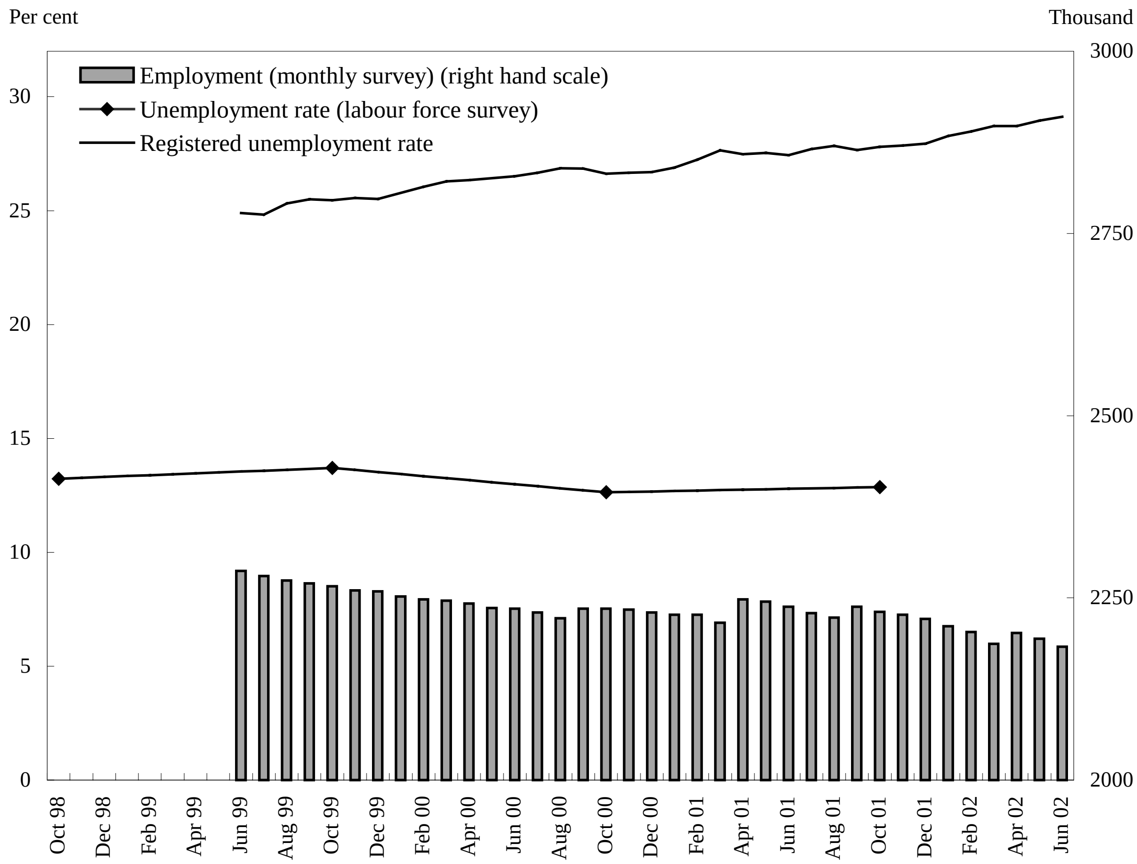
Source : Federal Statistical Office.

Figure 3. **Gross material product, industrial output and agricultural output, 1998-2001**
Index, 1998 = 100



Source: Federal Statistical Office, *Statistical Yearbook of Yugoslavia, 2001* and *Monthly Review of Economic Statistics*.

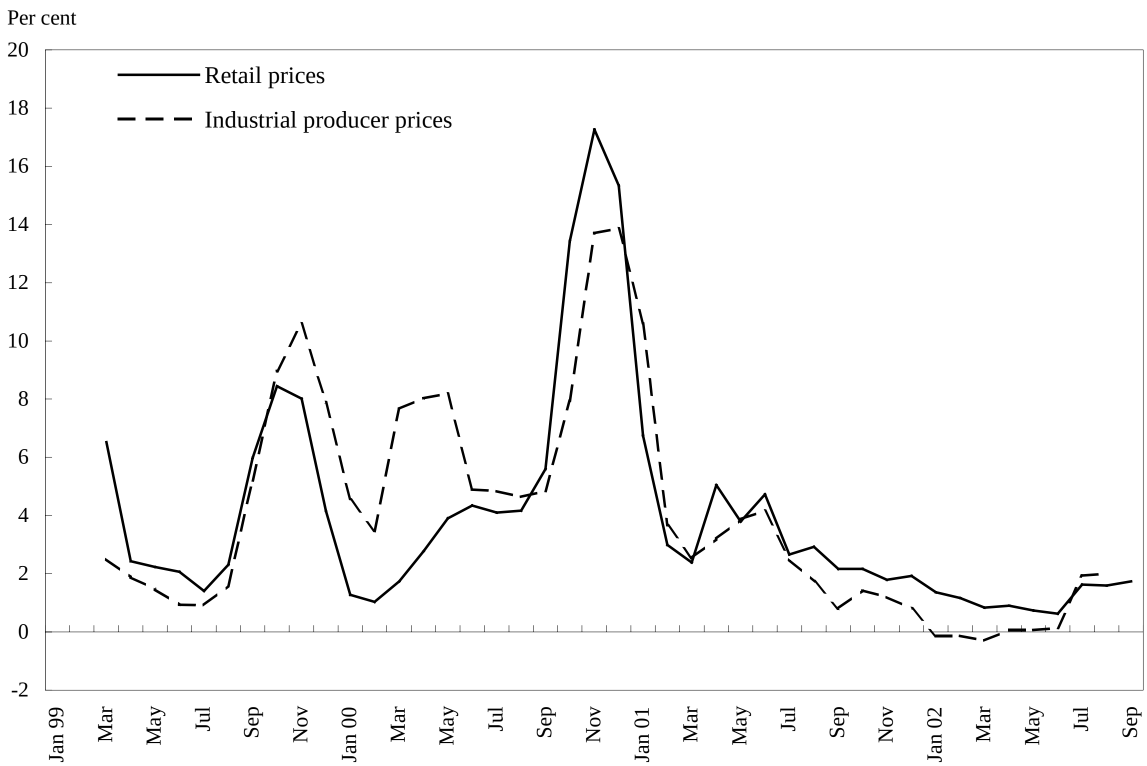
Figure 4. **Employment and unemployment**



Source : Federal Statistical Office and OECD calculations.

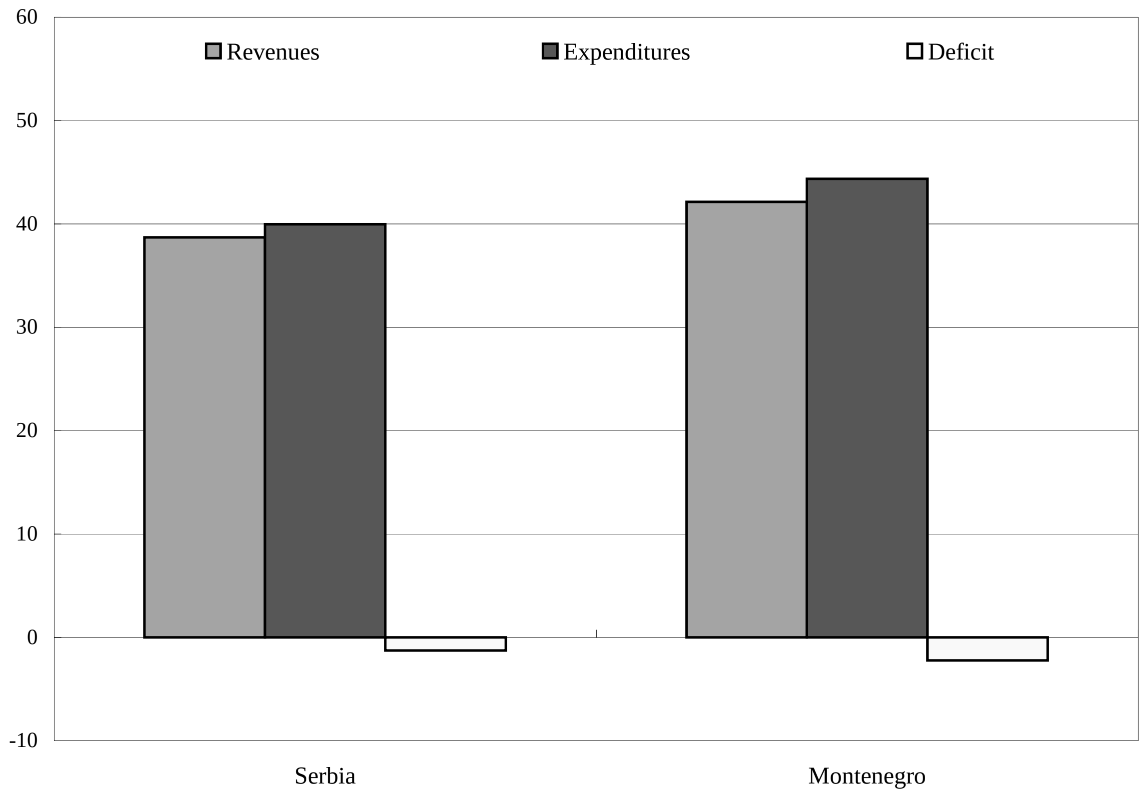
Figure 5. **Inflation, 1999-2002**

Monthly rates, 3-month moving average



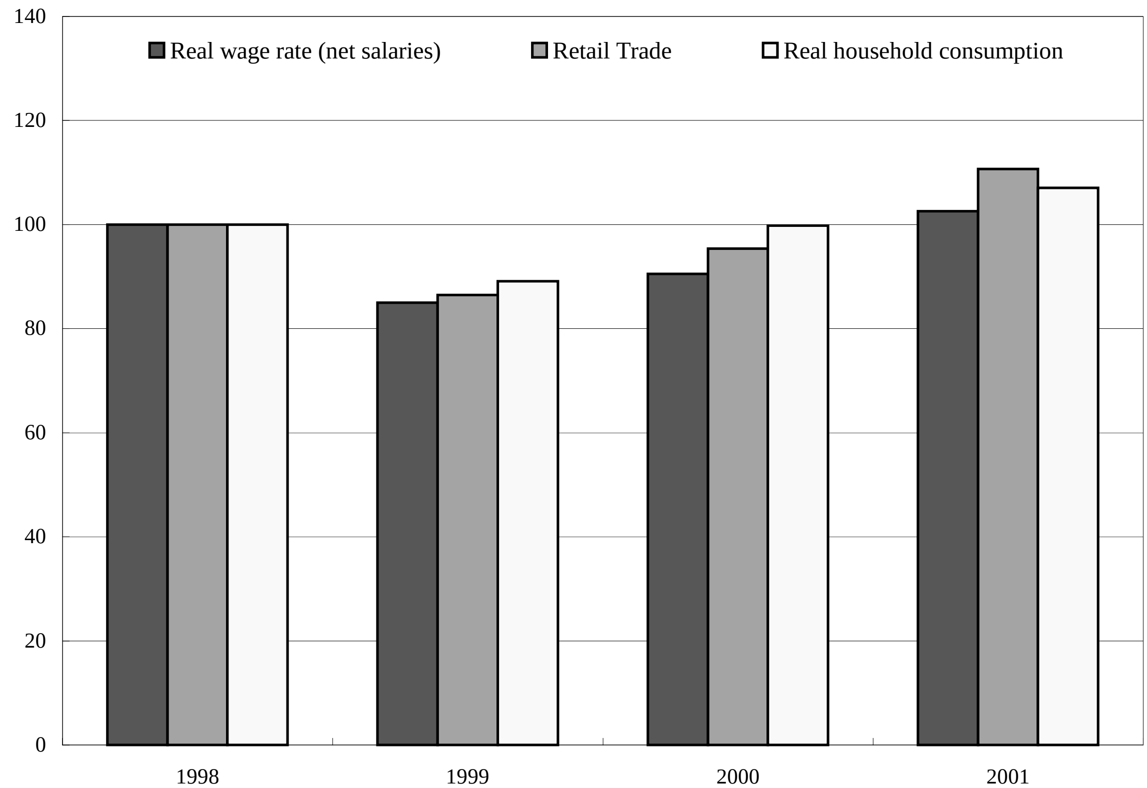
Source : Federal Statistical Office.

Figure 6. **Consolidated budget on Serbian territory and the Montenegrin budget[1], 2001**
Per cent of GDP



1. Data for Montenegro are unofficial.
Source : Serbian Ministry of Finance and IMF (2002b), A56.

Figure 7. **Average real wage rate and retail trade**
Index, 1998 = 100



Source : Federal Statistical Office and OECD calculations.

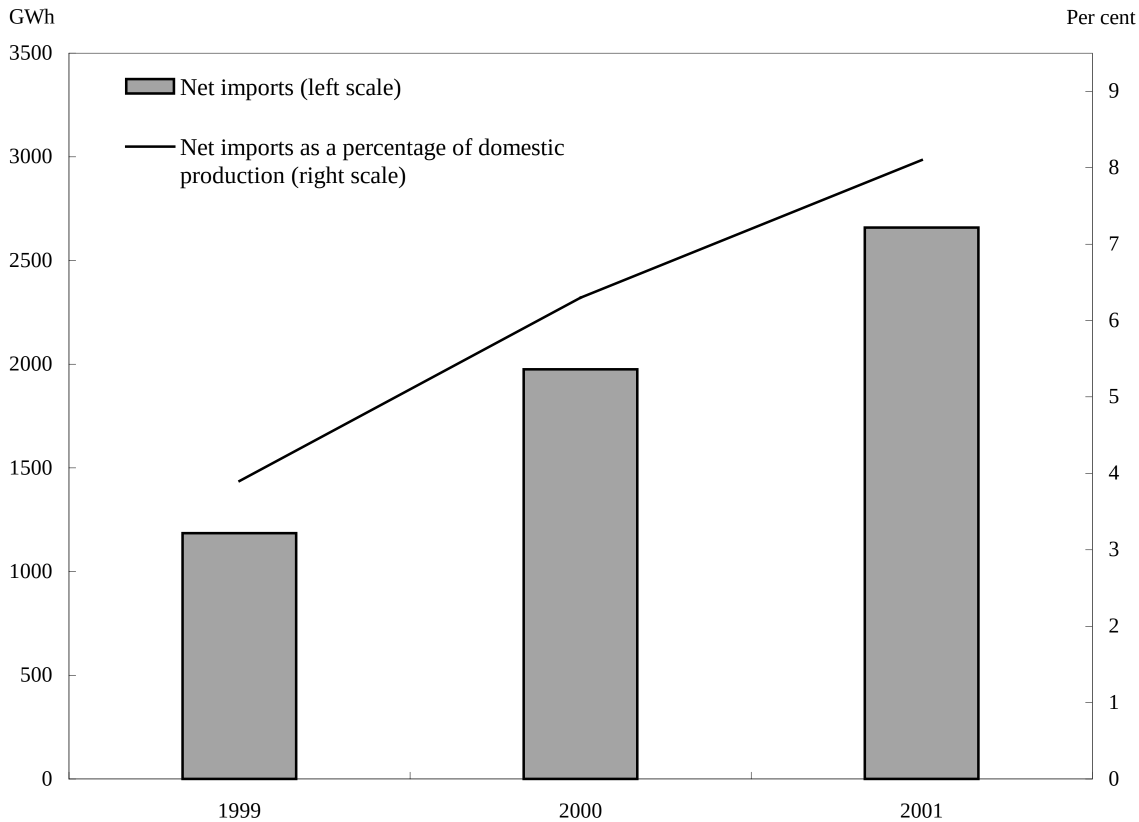
Figure 8. **The real exchange rate**

EUR per YUD, January 1999 = 100

Note: Informal exchange rate used before November 2000.

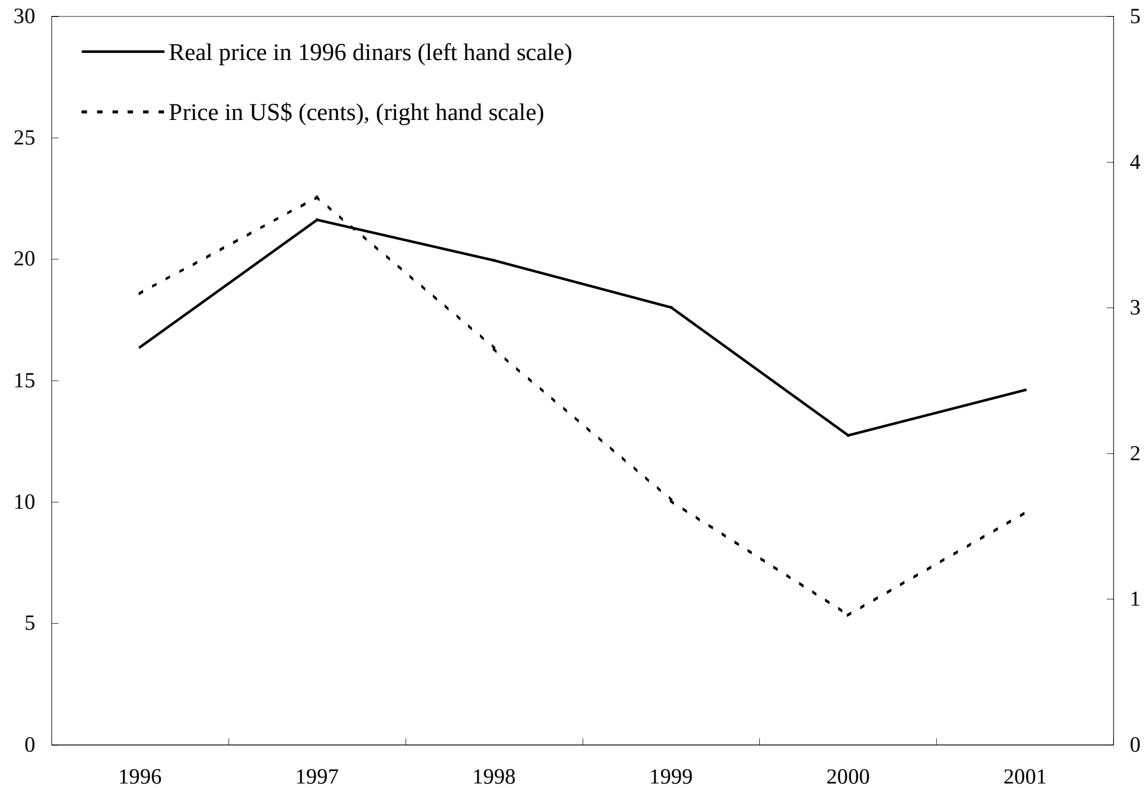
Source : National bank of Yugoslavia and OECD calculations.

Figure 9. **Net imports of electricity to Serbia**



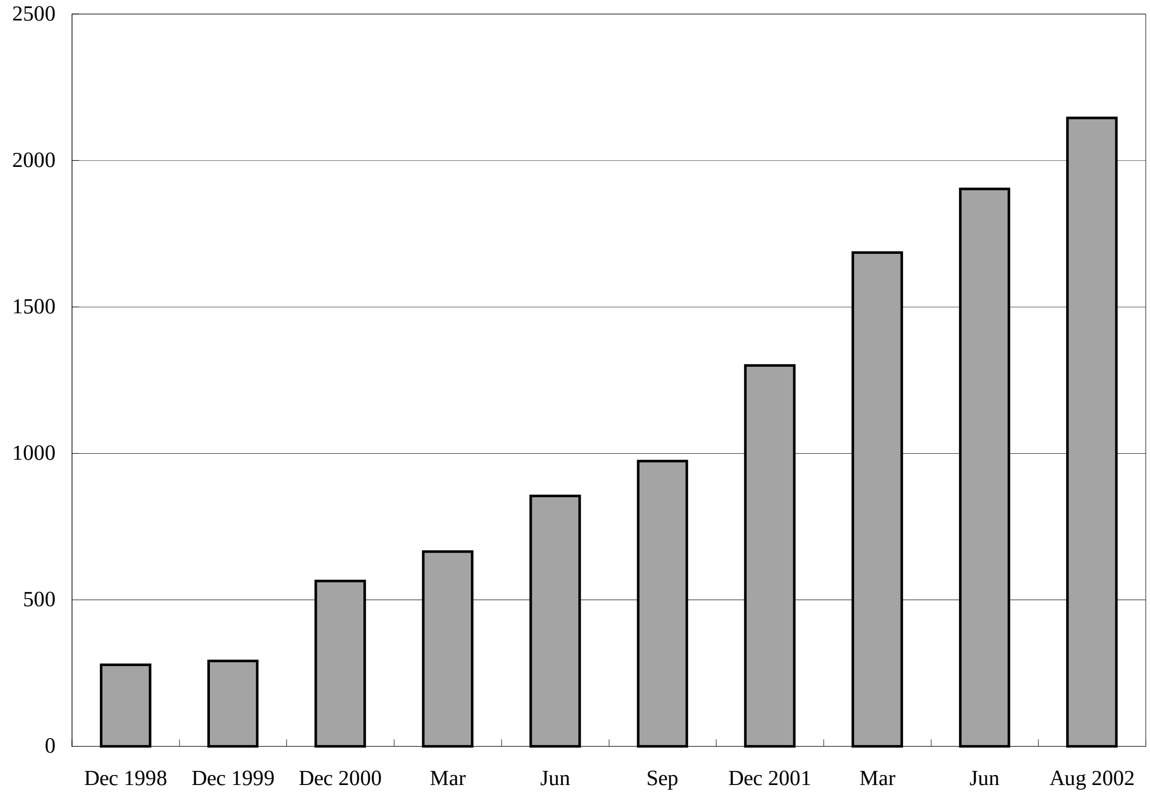
Source : Elektroprivreda Srbije (EPS).

Figure 10. **Average electricity prices in Serbia, 1996-2001**
Price per KWh



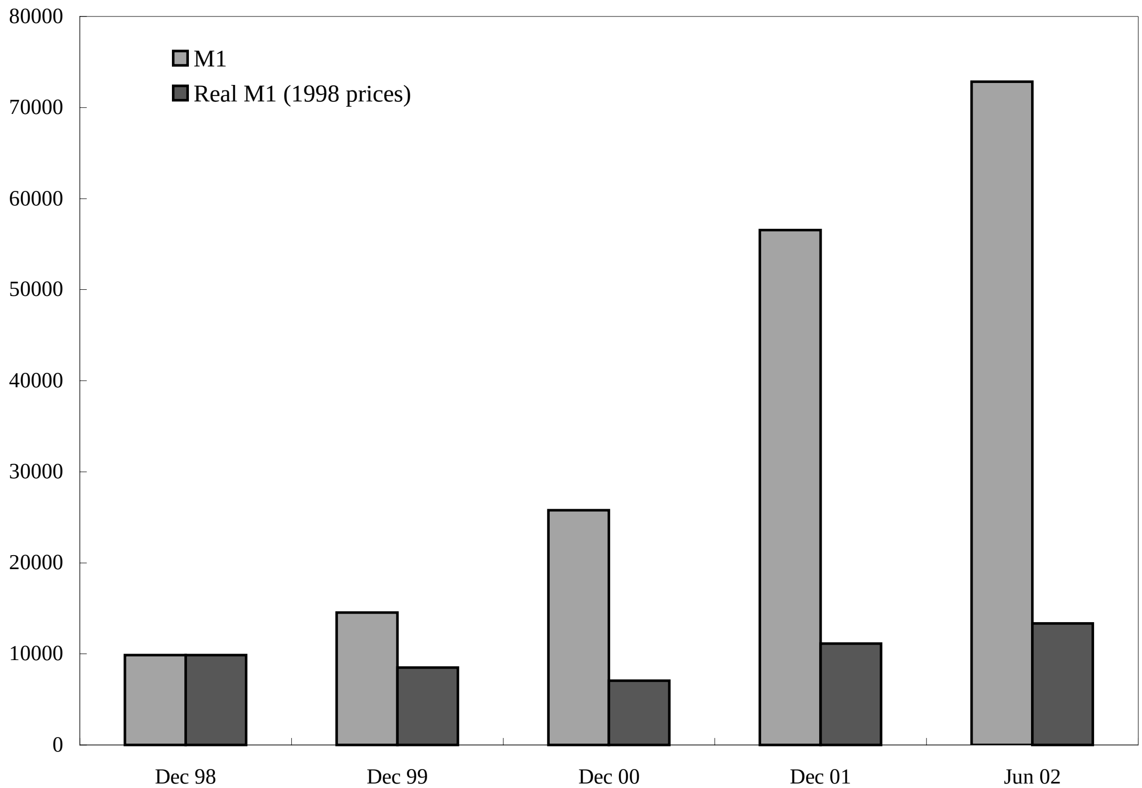
Source : Elektroprivreda Srbije (EPS).

Figure 11. **Gross foreign reserves of the NBY**
EUR million



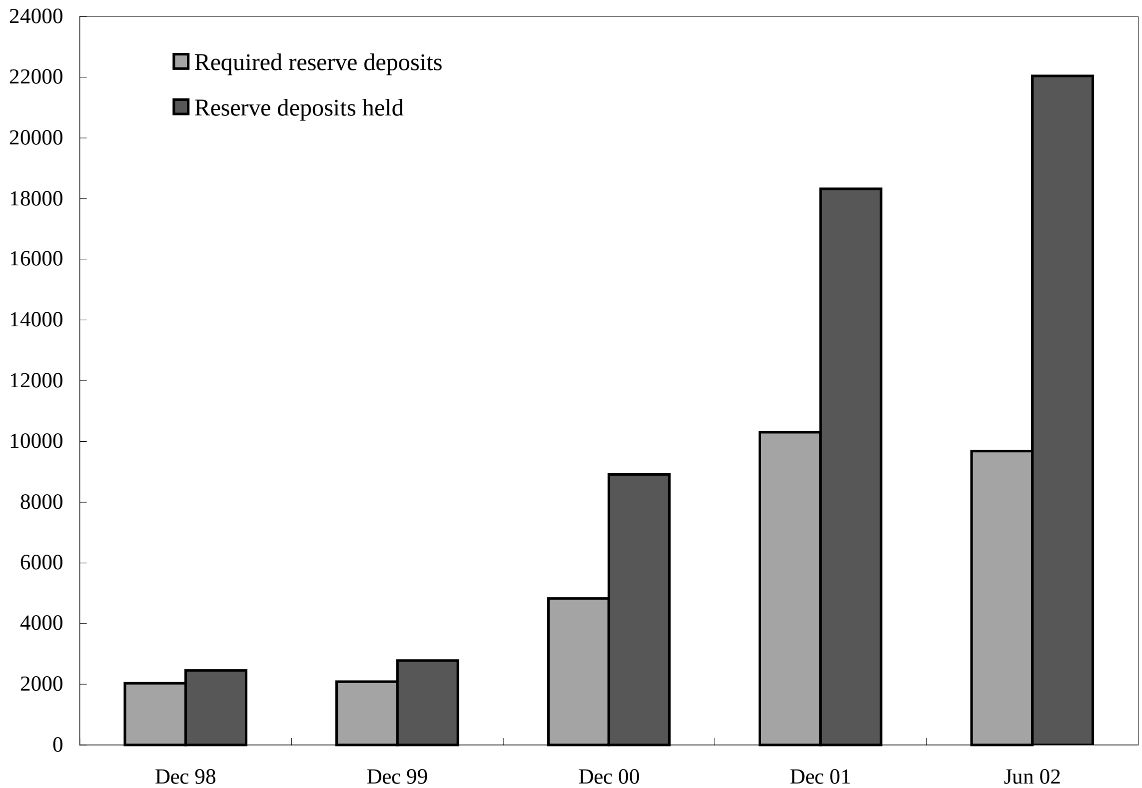
Source: National Bank of Yugoslavia.

Figure 12. **Money supply**
YUD millions, end of period



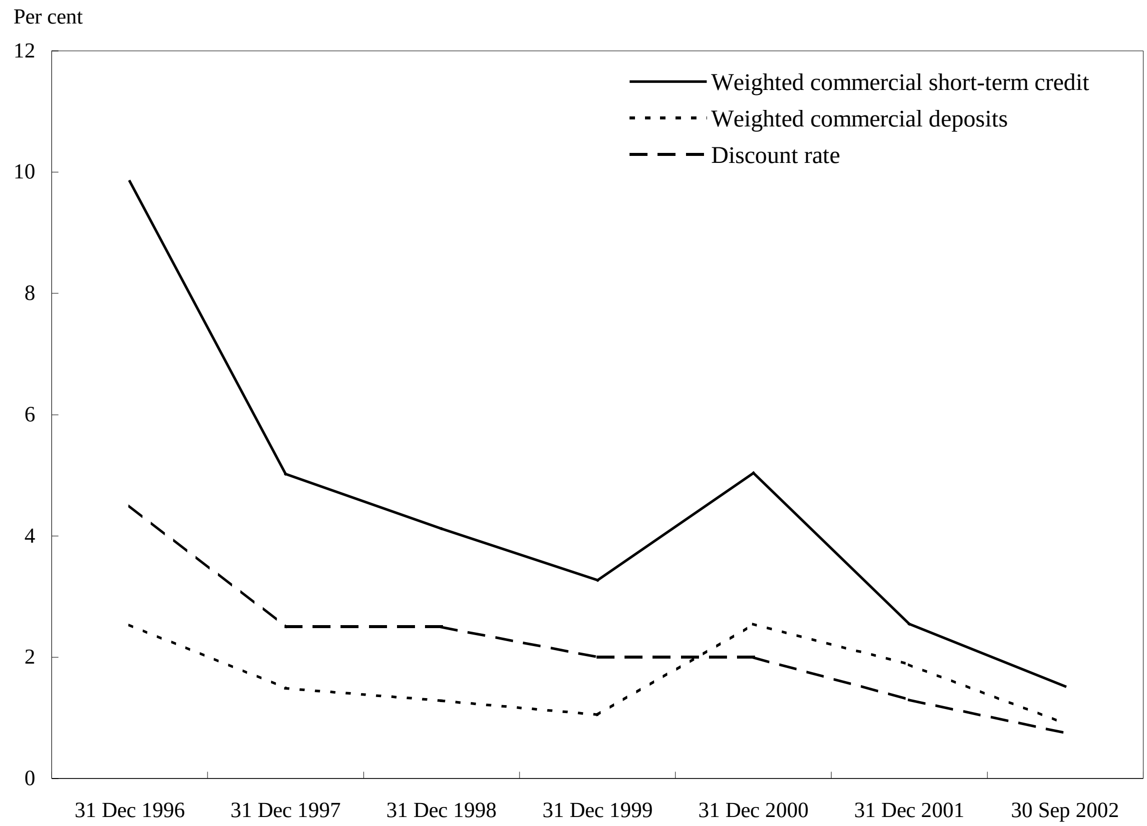
Source: National Bank of Yugoslavia and OECD calculations.

Figure 13. **Required and actual deposits of Serbian banks with the NBY**
YUD millions, end of period



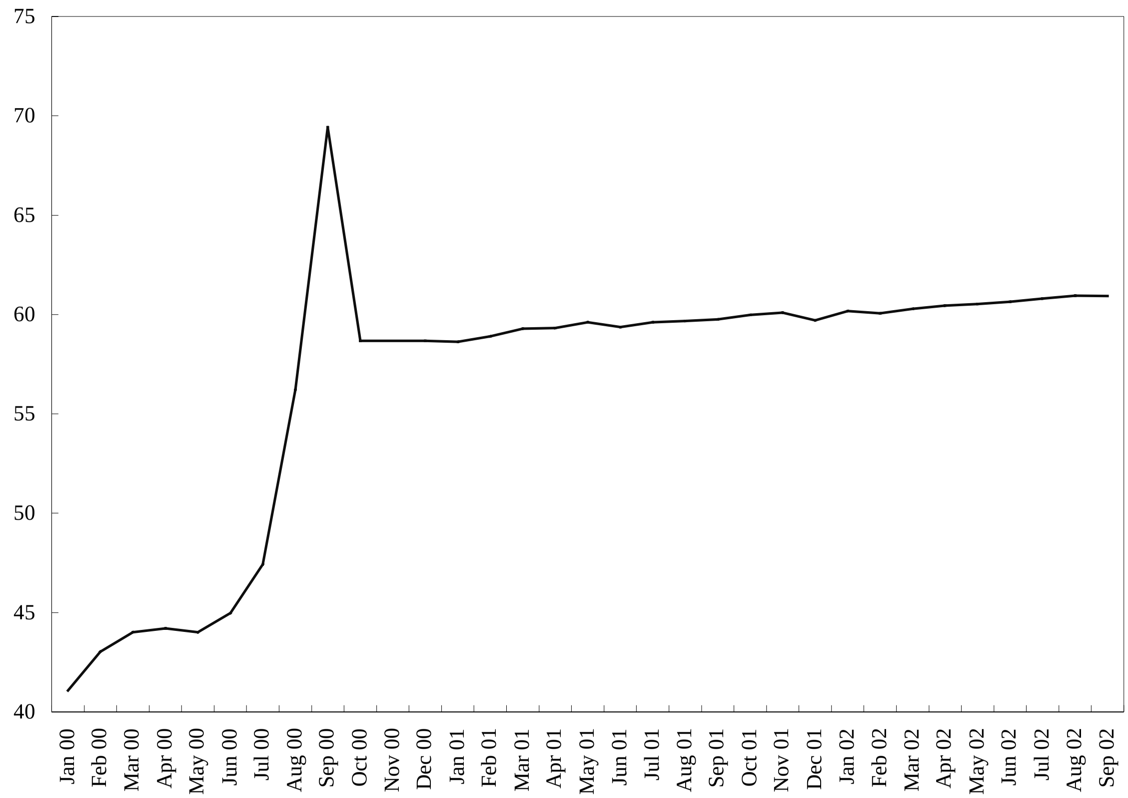
Source: National Bank of Yugoslavia.

Figure 14. **Monthly interest rates**



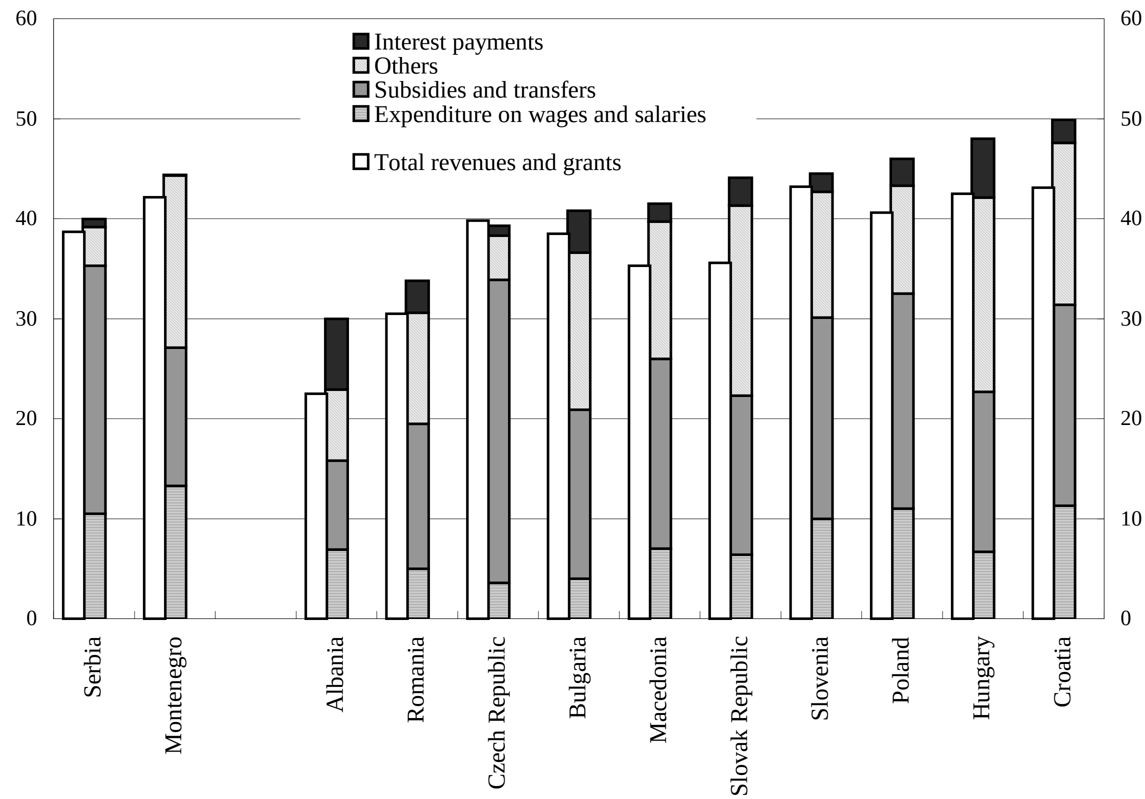
Source : National Bank of Yugoslavia.

Figure 15. **Nominal exchange rate, 2000-02**
YUD per EUR



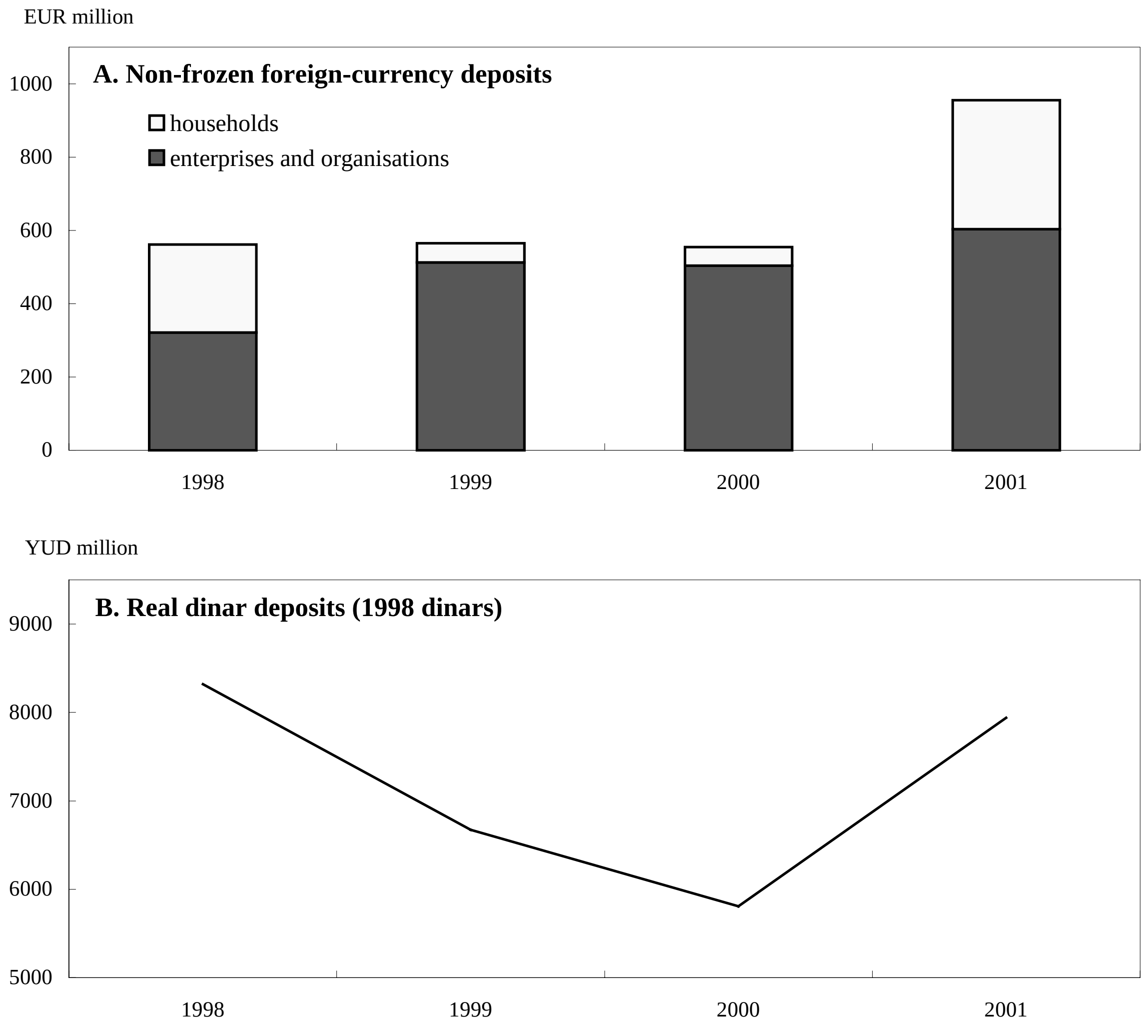
Note: Informal exchange rate used before November 2000.
Source : National bank of Yugoslavia.

Figure 16. **Revenues and expenditures in the FRY and selected countries**
2001, per cent of GDP



Source : IMF, OECD and WIIW.

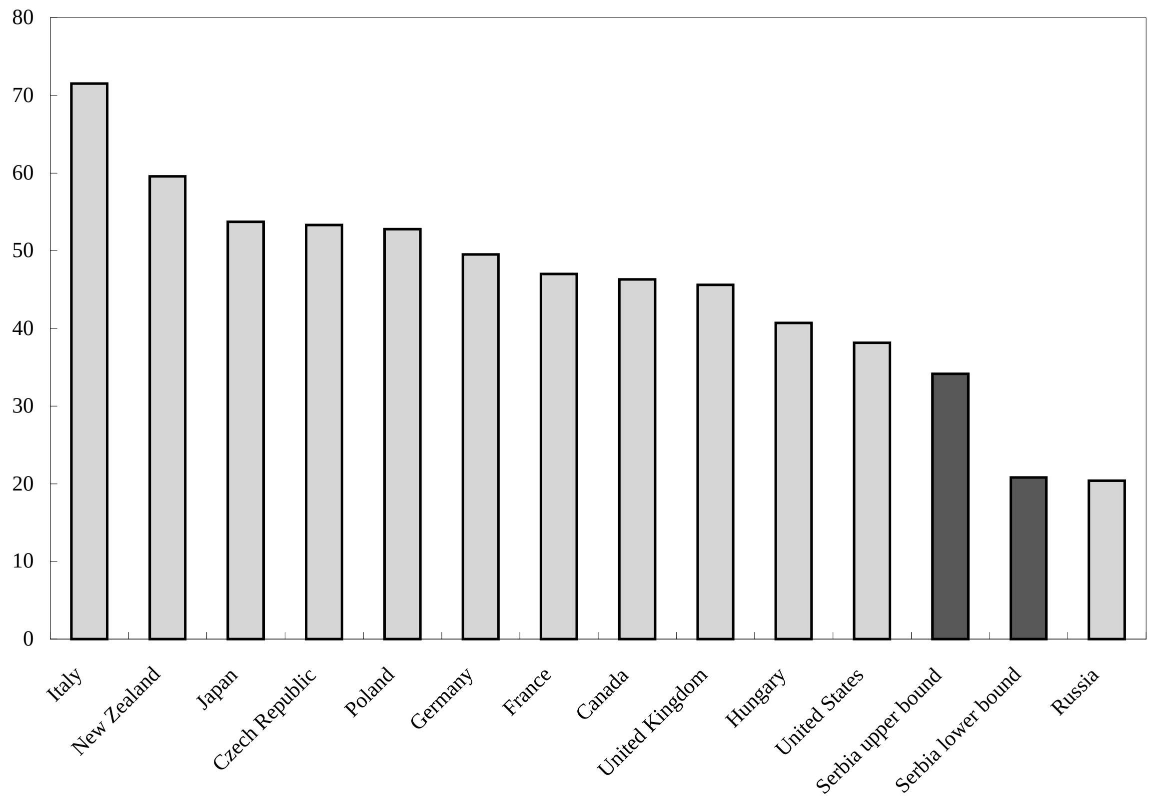
Figure 17. **Real dinar and foreign exchange deposits in Serbian commercial banks**
31 December



Source: National Bank of Yugoslavia and OECD calculations.

Figure 18. **Self-employment and small businesses employment in selected countries**

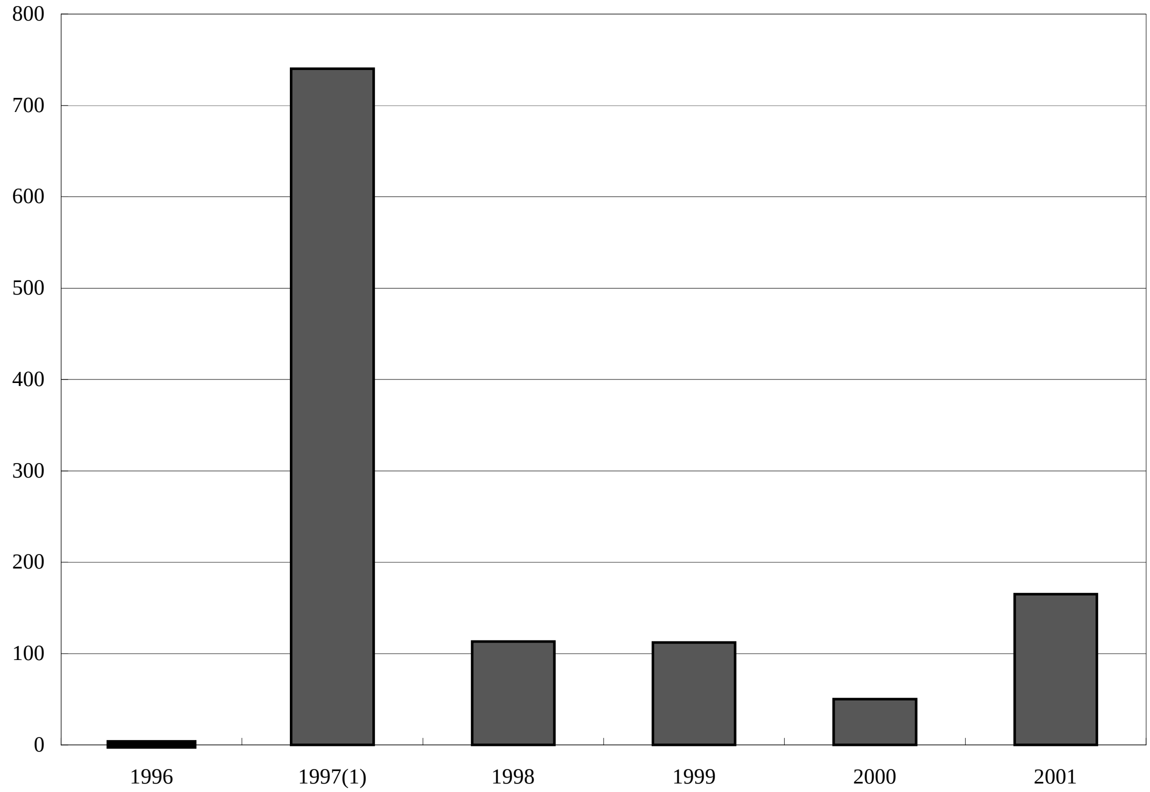
Per cent of employment



Note: Small enterprise figures for OECD member countries includes self-employment and employment in enterprises with less than 100 workers. For Russia the data refers to self-employment and total employment in registered small enterprises. The Russian definition of a small enterprise is an enterprise with up to 100 employees in industry, construction or transport, and up to 50 employees in most other sectors. The number for FRY comprises employment in small enterprises and self-employment. In order to facilitate a comparison with other countries, the chart shows the FRY share both for small enterprises (up to 50 employees) and small and medium enterprises (up to 250 employees).

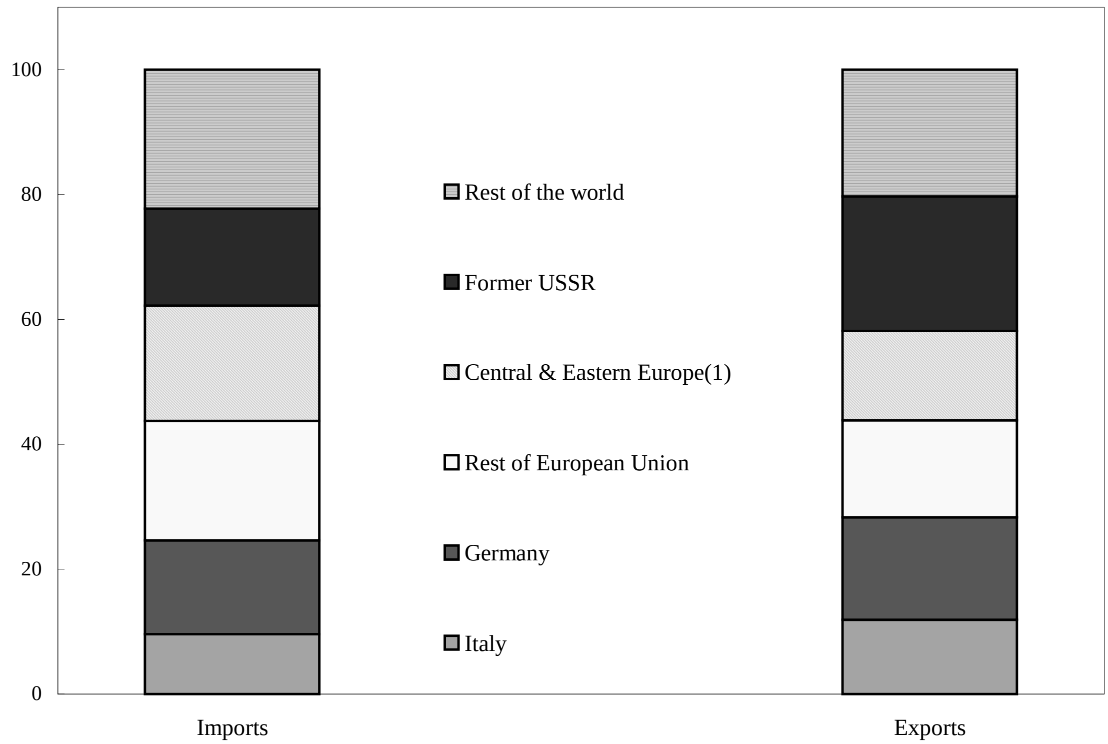
Source: 2002 OECD Survey of 404 firms in the FRY, Goskomstat and OECD.

Figure 19. **Foreign direct investment inflows, 1996-2001**
USD million



1. Includes sale of Serbian Telecom.
Source : National Bank of Yugoslavia.

Figure 20. **Yugoslav trade[1], 1992**
Per cent



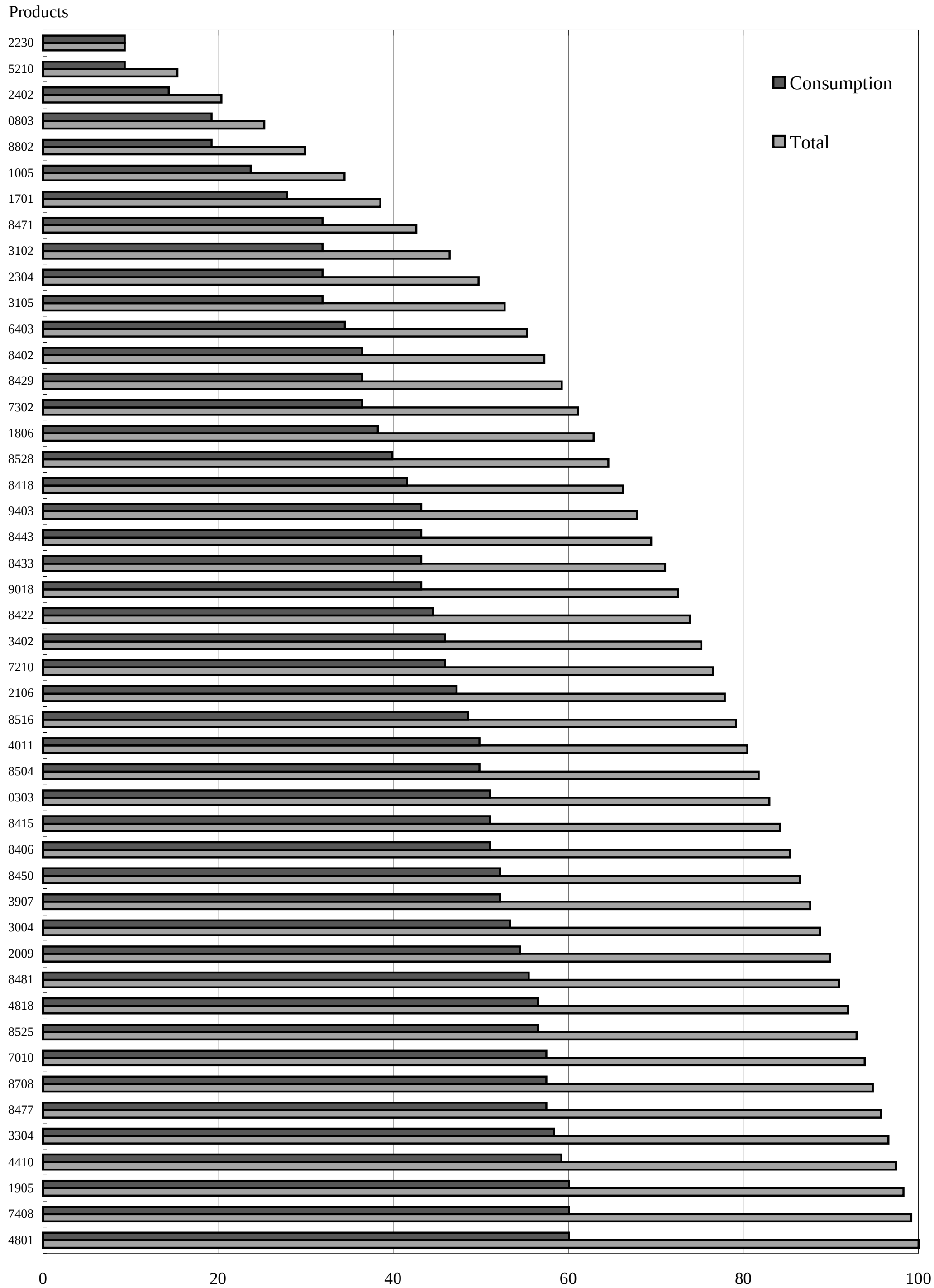
Note: Data are for the Socialist Federal Republic of Yugoslavia (SFRY).

1. Albania, Romania, Bulgaria, Poland, Hungary, Czechoslovakia.

Source: Federal Statistical Office.

Figure 21. **Weight of consumption in import growth, 2001**[1]

Per cent

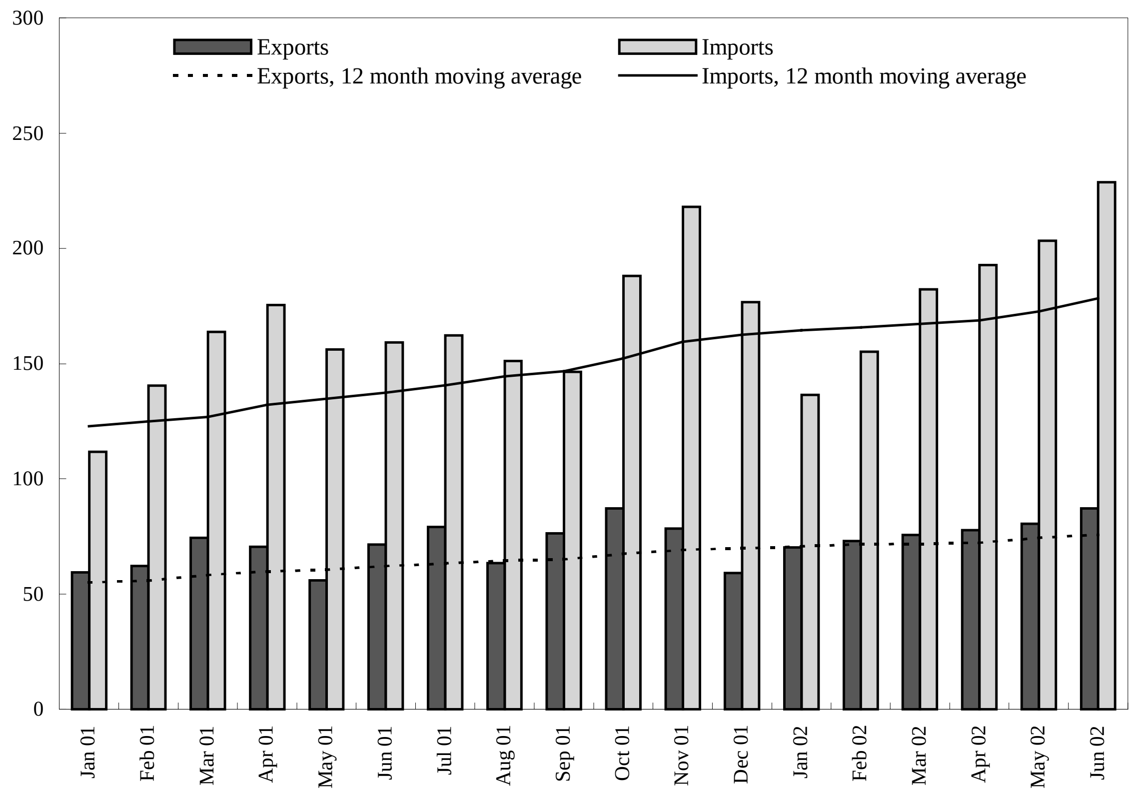


1. Cumulative distribution of top-50 increases in imports during 2001 (4-digit categories).

Note: Serbia's imports were ranked using the 4-digit HS level, highest increase in US dollar value (2001 less 2000) first. The top 50 4-digit categories (covering 54 per cent of the increase of imports during 2001) were classified either as being consumption goods, or not. The cumulative share in the top-50 total (by descending US$ import increase in 2001) was then plotted, both for consumption goods and all goods. See Annex table A.3. for a key to the product codes.

Source : Federal Statistical Office and OECD.

Figure 22. **External trade with the European Union, 2001-02**[1]
USD million



1. Based on records of European Union countries. Greece and Netherlands are excluded.
Source : OECD, *Monthly Statistics of International Trade* .

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ANNEXES

Annex tables

ANNEX I.1. YUGOSLAVIA: A SELECTED CHRONOLOGY

1989	December	Start of Markovic reforms; dinar pegged to deutschmark
1990	Spring	Privatisation law adopted
	Late autumn	Partial freeze on foreign currency savings
1991	January	Milosevic expropriates foreign currency reserves through ZOP
	Spring	Slovenia stops transferring tax revenues to the federal budget
	June	First Yugoslav war begins in Slovenia
	Mid summer	Second Yugoslav war begins in Croatia
	December	War with Croatia ends (Vance agreement) Slovenia and Croatia conditionally recognised as independent states by the EC
1992	April	Third Yugoslav war starts in Bosnia
	May	Economic sanctions introduced by the United Nations
1993	Mid-year	Major new banks collapse
1994	January	Hyperinflation peaks
		Fixed exchange rate introduced
1995	July-August	Croatia takes control of Krajina; military activity spills over into Bosnia
	December	Dayton peace accords signed
1996	Winter	Most sanctions on Yugoslavia removed (“outer wall of sanctions” remains) Autonomous preferences extended by the EU
	May	NBY governor Avramovic (architect of the 1994 stabilisation) removed
	December	Large demonstrations erupt in Serbia, lasting 88 days

1997	Spring	49 per cent of Serbian Telecom sold for USD 1 billion
	Mid-year	Parliamentary elections in Montenegro
	October	Privatisation law introduced (Serbia)
	End of year	EU fails to renew autonomous trade preferences
1998	January	USA and EU tighten “outer wall of sanctions”
	Early spring	Violence erupts in Kosovo
	Mid-year	Milo Djukanovic wins the presidential elections in Montenegro
	December	Privatisation Council established (Montenegro) Deutschmark introduced as the second legal tender in Montenegro
1999	March	Fourth Yugoslav war begins in Kosovo
	June	End of Kosovo war; territory placed under UN administration
	July	Stability Pact for South East Europe launched in Sarajevo
	November	Deutschmark adopted as sole legal tender (Montenegro)
2000	October	Vojislav Kostunica accedes to Yugoslav presidency
	October	Most price controls relaxed (Serbia)
	November	Montenegro introduces the deutschmark as its currency
	December	Exchange rate unified and dinar anchored to the deutschmark (Serbia) Foreign Trade Law amended
2001	January	UN sanctions lifted
	February	Djindjic government takes office in Serbia
	March	EU liberalises access to its markets
	May	Non-tariff barriers largely abandoned; new tariff structure introduced
	June	Privatisation Law (Serbia) IMF Stand-by Arrangement approved
	July	Electricity prices increased (Serbia) ZOP monopoly on transactions abolished (Montenegro)
	September	Montenegro Stock Exchange (NEX) opens
	December	Agreement on debt reduction with the Paris Club

2002	January	Privatisation by tender of 3 cement plants (Serbia) Closure of largest 4 commercial banks (Serbia) Interim pension reform (Serbia)
	March	Agreement with EU on the FRY's future constitutional arrangements
	May	IMF Extended Arrangement approved Current account convertibility (IMF Article VIII) announced
	June	Electricity prices increased again Vojvodina granted limited autonomy Share trading accelerates on Montenegro stock exchange Dinar declared sole legal tender in Serbia
	July	Announcement of changes to privatisation programme (Serbia) Ministerial declaration on regional investment (part of Stability Pact Investment Compact)
	August	NBY exercises debt-equity swap to take over 14 commercial banks

ANNEX III.1: OECD ECONOMICS DEPARTMENT SURVEY OF 404 SMALL ENTERPRISES IN THE FRY

The OECD survey was carried out in May 2002 using a one-stage stratified sample. The first step was to take a random sample of active registered private enterprises from the Uniform Register of Enterprises. The total sample of 404 firms was drawn equally from Belgrade, Vojvodina, Central Serbia and Montenegro. The survey technique was face-to-face interviews. The sample was also stratified according economic activity, sampling enterprises in manufacturing, construction, commerce and services.

The sample population was small firms registered with the Commercial Court that had opened a giro account in the Clearing and Payment Service (ZOP) and filed the requisite returns. Firms are defined as 'small' if they satisfy two of three criteria, namely having less than 50 employees, with assets or turnover less than a specified nominal ceiling that is revised annually. Of 270,000 registered firms some 100,000 have accounts at ZOP, and of these some 76,000 (28 per cent of registered firms) filed the requisite annual return for 2001. Of these, about 45,000 are small enterprises, of which some 40,000 (a little over 90 per cent) are in the private sector. In the FRY these active small private enterprises, only 15 per cent of total registered enterprises, are overwhelmingly (55 per cent) engaged in trade.

There were a number of practical difficulties in carrying out the survey. The most severe problem was locating small private enterprises. Many of them are registered at one address, whilst they actually carry on their business at another address (without reporting the change of address in the register). A second problem was that the activity description in the Register was often inaccurate, notably with enterprises registered in manufacturing or services in practice carrying on trade.

The full results of the survey are reported in Annex table A.2.

ANNEX IV.1 YUGOSLAV ENTERPRISE

Yugoslavia developed a style of economic management that was distinct both from central planning practised in most communist states and market socialism that began to emerge from the 1970s, notably in Hungary and China. From the early 1950s Yugoslavia adopted *worker managed socialism*. The essential difference from economic management in other communist states was that the Yugoslav system was based on decentralised market mechanisms. Banks ran on a commercial basis and the government ran a conventional budget into which firms had to pay taxes. There was even a bankruptcy procedure. However, there was little private ownership in industry or trade. But Yugoslavia's distinctiveness was apparent in the high degree of private activity in agriculture, housing (especially rural housing) and services, notably tourism.

The most important feature of the system was that it acknowledged individual firms were better placed than a central planner to make decisions about output and pricing. It left it to firms to assess and take business risks, including investment. By the mid-1970s, central planning had been reduced to a system of loose 'indicative planning', where the centre only collected information on enterprises' intended output. Yugoslavia's system had two main characteristics: social ownership and self-management.

Social ownership

Enterprises were socially-owned. The state did not own and could not sell socially-owned enterprises. Socially-owned enterprises were also constitutionally forbidden to sell themselves. All decisions were made by the Employee Assembly, consisting of all current employees. The employees were in a practical sense the owners, since they were entitled to take residual income as wages. The state did impose some limits on this right, indirectly by placing legal restrictions on how residual income was derived (for instance, the firm was obliged to pay taxes and interest), and directly by capping growth in nominal wages.

Self-management

The Employee Assembly appointed the firm's management, and all employees had a contract with the firm. The state did reserve the right to intervene and replace a firm's management in defence of the "social interest", for instance when a firm was declared bankrupt, but in practice this power was only selectively exercised. Direct central control over self-managed firms was weak.

The combination of social ownership and self-management had a number of consequences. Employees had an obvious incentive to maximise residual income and minimise the number of workers amongst whom this residual had to be shared. Critics quickly noted that this would lead to lower output and employment than in similar firms in market economies (Ward, 1958). The consequences for investment are ambiguous. There is pressure to under-invest (the Furbotn-Pejovic effect) as employees seek to maximise the residual available for distribution as wages, particularly employees closer to retirement who by their age and position would have a stronger voice at the Employee Assembly. There was a parallel impact on inflation, as this behaviour put upward pressure on enterprise wage costs. The resistance of self-managed firms to increasing employment had a further consequence. In order to absorb the growing labour force, the government had to found an increasing number of enterprises. This took its toll on efficiency as firms were not allowed to fail and the costs of co-ordination grew.

However, the potential for income growth increases with available capacity. The outcome in Yugoslavia tended towards ever greater investment as the authorities gradually subverted the market mechanisms by cutting the cost of credit enabling firms to borrow, often at negative real interest rates. A related development had frequently been the creation of 'in-house' banks that freely financed enterprises in their wider 'system'.

Table A.1. **Kosovo basic economic indicators, 2001**

	EUR million	Per cent of GDP
Population (million)	1.9	
GDP per capita (USD)	899	
National accounts		
GDP	1946	100
Private consumption	2000	103
Public consumption	355	18
Public investment	726	37
Exports	239	12
Imports	1726	89
Balance of payments		
Trade balance	-1446	-74
Unrequited transfers	1247	64
Current account balance	- 86	-4
Budget		
Consolidated revenue	463	24
Current expenditure	416	21
Capital expenditure	712	37
Fiscal balance	- 665	-34
Grant financing	761	39
Banking sector		
Total assets	502	26
Cash and CFA deposits	254	
Net loans	24	
Customer deposits	478	

Source: Demekas *et al* (2002).

Table A.2. **OECD survey of 404 small enterprises in the FRY**

General information about the firm

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Q1. Where is your firm located (city)?														
	Per cent													
Beograd	24	100	..	..	..	29	21	31	15	19	22	28	23	23
Niš	18	..	..	71	..	18	18	21	19	11	15	18	18	19
Novi Sad	21	..	81	..	..	22	20	17	19	28	16	16	25	23
Subotica	2	..	10	..	..	4	2	3	..	3	..	1	2	6
Kraljevo	2	..	..	10	..	2	3	2	..	5	..	..	1	7
Čačak	2	..	..	10	..	5	1	4	1	..	1	3	3	2
Kruševac	2	..	..	10	..	1	3	2	1	4	1	3	3	2
Pančevo	2	..	10	..	..	1	3	2	..	4	4	2	1	3
Podgorica	25	..	..	..	100	18	29	17	46	25	39	28	24	15
Q1. Where is your firm located (republic)?														
	Per cent													
Serbia	75	n.a				82	71	83	54	75	61	72	76	85
Montenegro	25	n.a				18	29	17	46	25	39	28	24	15
Q2. When was your firm founded?														
	Per cent													
1991 and before	38	46	41	38	27	n.a		45	33	29	25	34	41	46
After 1991	62	54	59	62	73	n.a		55	67	71	75	66	59	54
Q3. What is the principal activity of your firm?														
	Per cent													
Manufacturing	51	64	46	60	34	60	45	100	..	..	37	44	51	64
Construction	6	6	8	10	2	6	7	..	..	22	4	3	6	11
Commerce	20	12	15	17	37	18	22	..	100	..	21	27	24	10
Transport	1	..	5	1	..	..	2	..	..	5	1	..	3	2
Services	19	13	25	11	28	14	22	..	..	66	36	25	13	10
Research & development	1	4	..	..	..	1	1	..	..	3	..	2	1	1
Other	1	..	2	2	..	1	1	..	..	3	..	..	2	2

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

General information about the firm

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Q5a How many people are employed in your firm - full-time?														
Mean	10.9	9.4	12.8	13.6	7.8	12.7	9.8	12.8	7.4	9.9	1.7	3.9	7.9	24.6
Q5b How many people are employed in your firm - part-time?														
Mean	1.5	2.8	1.2	1.7	0.6	1.7	1.5	1.6	0.4	2.2	1.0	0.6	1.8	2.5
Q6. How long have you been a director of the firm?														
	Per cent													
1-2 years	17	17	16	13	24	5	25	16	22	16	27	23	9	13
3-5 years	20	10	23	17	28	4	29	14	26	25	21	22	18	18
> 5 years	63	72	61	71	49	91	46	70	52	59	52	54	73	70
	Years													
Mean	7.6	8.2	7.8	7.9	6.4	11.1	5.5	8.2	6.7	7.2	6.6	7.0	8.1	8.3
Q7. What did you do immediately before becoming a director in this firm?														
	Per cent													
Manager of another private firm	14	13	15	17	11	10	16	13	10	18	16	9	14	17
Non-managerial employee of another private firm	9	11	8	10	7	7	10	10	6	9	9	11	10	6
Employee in a socially-owned/mixed/state firm	54	54	50	60	51	58	51	54	68	45	49	53	53	58
Self-employed	10	11	14	3	13	11	10	9	5	15	13	10	10	8
Other	2	1	4	3	1	3	2	2	1	3	1	2	4	2
First employment	6	6	3	4	10	5	6	6	6	4	6	9	6	2
Retired	0	..	1	..	..	..	0	0	..	..	1	..	..	..
Employed in a non-managerial position in the same firm	1	..	2	1	1	1	1	0	1	2	..	1	2	1
Manager in a socially-owned/mixed/state firm	1	1	2	..	1	1	1	2	..	..	1	1	..	2
Worked abroad	1	1	2	1	..	1	1	1	..	1	..	1	..	2
No response	2	1	..	2	5	1	2	1	2	3	1	2	..	4

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Local business climate

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Q8. In your view, how has the environment for small businesses changed in your city during the last two years?														
	Per cent													
Improved	23	24	21	27	18	24	22	24	15	25	19	22	21	27
Unchanged	22	23	19	23	22	21	22	23	21	20	24	23	21	20
Deteriorated	39	42	42	41	32	43	37	38	42	40	40	40	42	36
Hard to say	16	10	17	9	29	12	19	15	22	14	16	16	17	17
Q9. How would you characterise the change in the following aspects of the environment for small businesses in your city during the last two years?														
	Per cent													
Demand for goods and services														
Improved	27	26	31	23	31	27	27	29	17	32	30	22	28	30
Unchanged	23	23	22	30	17	24	23	28	16	20	25	23	19	26
Deteriorated	43	45	40	43	43	43	42	38	62	38	37	47	45	40
Hard to say	7	6	7	4	10	5	8	6	5	9	7	8	8	4
Profit margins														
Improved	17	12	19	17	21	19	16	20	9	19	22	14	11	22
Unchanged	22	23	21	20	22	20	22	22	19	23	21	22	22	22
Deteriorated	54	61	53	59	45	54	55	52	64	52	52	59	59	47
Hard to say	7	3	6	5	13	7	6	6	9	7	4	5	7	9
Investment opportunities														
Improved	23	28	23	21	22	27	21	29	19	16	18	20	19	33
Unchanged	25	16	28	24	34	22	27	23	25	31	36	26	20	24
Deteriorated	40	45	37	50	27	41	39	40	35	42	34	40	49	35
Hard to say	12	11	12	6	18	10	13	7	22	12	12	15	13	8
Availability of external (domestic or foreign) finance														
Improved	28	32	28	23	29	25	29	28	36	22	24	22	33	30
Unchanged	33	35	33	27	39	39	30	33	30	37	37	31	27	38
Deteriorated	24	19	22	35	18	20	26	24	22	24	24	28	26	18
Hard to say	15	14	17	15	15	16	14	15	12	17	15	18	14	14
Possibility to compete with existing firms														
Improved	25	24	28	16	30	22	26	27	23	21	21	27	25	24
Unchanged	45	44	36	49	50	49	42	43	51	44	52	36	40	53
Deteriorated	19	23	20	23	8	17	20	18	15	22	19	22	23	11
Hard to say	12	8	16	13	12	12	12	12	11	13	7	15	13	12

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Local business climate

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Relationship with employees														
Improved	23	24	14	24	29	19	25	24	19	22	27	22	19	24
Unchanged	72	73	83	72	61	75	71	71	75	73	66	78	70	73
Deteriorated	3	2	3	3	5	5	2	3	4	3	4	1	7	2
Hard to say	2	..	1	2	5	1	2	1	2	3	3	..	4	2
Relationship with tax authorities														
Improved	14	16	13	17	9	14	13	15	19	8	9	14	14	16
Unchanged	62	64	64	50	68	61	62	57	64	68	63	62	60	62
Deteriorated	19	15	17	31	12	18	20	23	11	18	21	22	15	19
Hard to say	6	4	6	2	11	7	5	5	6	7	7	3	11	3
Relationship with the local authority														
Improved	14	21	14	18	5	20	11	16	11	14	12	13	13	18
Unchanged	62	65	60	52	72	59	64	59	72	62	66	63	60	62
Deteriorated	13	7	16	18	13	14	13	15	12	11	10	16	13	13
Hard to say	10	6	11	13	10	7	12	10	5	13	12	8	15	7
Relationship with state authority / regulators														
Improved	13	16	18	15	3	19	10	15	11	11	10	10	13	18
Unchanged	62	62	55	54	78	58	65	58	72	64	61	67	63	58
Deteriorated	11	9	12	13	11	12	10	14	7	9	16	12	7	10
Hard to say	13	12	15	19	8	11	15	14	10	15	12	10	18	14
Relationship with agencies supporting small business														
Improved	11	12	10	16	8	10	12	16	6	8	7	8	10	18
Unchanged	44	41	42	33	58	48	41	41	48	44	46	41	41	46
Deteriorated	9	5	10	17	5	10	9	10	6	9	10	10	9	7
Hard to say	36	42	39	34	29	32	38	33	40	39	36	41	40	29
Ease of obtaining official licenses														
Improved	18	18	24	15	13	20	16	17	20	18	15	18	16	20
Unchanged	49	47	50	41	58	51	48	52	46	47	51	39	53	55
Deteriorated	20	22	14	29	14	16	22	20	19	21	21	24	21	14
Hard to say	13	12	12	15	15	13	14	12	16	14	13	19	10	10
Tax legislation														
Improved	17	17	23	18	9	26	11	19	17	14	9	11	19	25
Unchanged	41	37	42	32	54	39	43	37	42	49	43	42	42	39
Deteriorated	30	39	28	41	14	28	32	36	23	26	39	34	28	25
Hard to say	11	7	7	9	23	7	14	9	17	11	9	13	11	11

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Local business climate

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Protection from criminal activity														
Improved	16	8	15	22	20	13	18	14	26	14	16	16	8	22
Unchanged	50	60	52	39	48	53	48	52	53	44	48	45	56	50
Deteriorated	16	20	14	15	16	19	14	18	6	19	22	18	15	12
Hard to say	18	11	19	25	17	15	20	17	15	23	13	22	21	15
Efficiency of the judicial system														
Improved	9	11	9	12	6	8	10	10	9	8	9	7	8	13
Unchanged	53	53	50	51	58	55	52	54	58	48	54	49	58	52
Deteriorated	17	17	17	18	16	18	16	17	14	20	21	17	17	15
Hard to say	21	18	24	20	20	19	22	20	20	23	16	27	17	20

Q10. In your view, how has the burden on small businesses changed in the last two years with respect to the following:

Per cent

	Total	Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Taxes														
Increased	65	62	56	73	67	64	65	64	64	65	75	69	56	62
Unchanged	22	20	29	16	24	20	24	20	21	26	16	22	28	21
Decreased	8	12	12	8	2	11	7	12	9	3	1	5	11	13
Hard to say	5	5	3	4	7	5	5	3	6	6	7	3	4	5
Social contributions														
Increased	55	55	49	61	54	51	57	59	56	47	57	54	55	54
Unchanged	25	22	19	21	37	24	25	22	20	33	25	28	24	22
Decreased	17	20	30	15	2	22	14	18	17	15	10	16	16	22
Hard to say	4	2	2	4	7	3	4	1	7	5	7	3	5	2
License & other fees														
Increased	51	44	38	71	53	49	53	52	46	55	66	50	47	49
Unchanged	32	37	35	19	38	31	32	31	35	31	27	36	30	32
Decreased	8	12	13	7	2	10	7	10	6	8	1	6	9	14
Hard to say	8	7	15	4	7	9	8	7	14	6	6	8	14	6
Number of licenses/permissions/certificates														
Increased	32	27	21	41	38	26	35	30	32	35	39	39	22	29
Unchanged	45	47	47	40	48	47	44	43	37	54	49	39	45	50
Decreased	12	14	17	14	2	16	10	16	11	5	4	11	10	18
Hard to say	11	12	15	5	13	11	11	11	20	6	7	11	23	4

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Operating difficulties faced by small businesses

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Employment regulations														
Increased	24	23	25	35	11	25	23	30	14	19	25	22	20	27
Unchanged	48	46	47	40	58	46	49	44	44	56	54	53	46	42
Decreased	7	15	6	7	2	7	8	9	7	5	3	6	10	9
Hard to say	21	15	22	18	29	22	21	17	35	19	18	19	24	22
Health & safety regulations														
Increased	30	27	35	44	15	34	28	36	22	26	30	30	30	30
Unchanged	53	58	49	38	68	48	57	49	57	58	60	52	50	54
Decreased	4	7	3	6	1	5	4	4	5	3	3	4	5	4
Hard to say	12	8	14	12	16	13	12	11	16	12	7	14	15	12
Environmental regulations														
Increased	24	14	33	29	20	22	25	28	23	18	30	23	17	28
Unchanged	50	60	38	45	58	53	49	49	57	47	58	44	55	48
Decreased	2	6	2	..	1	3	2	1	6	2	1	3	3	1
Hard to say	23	19	27	25	21	22	24	21	14	33	10	29	25	23

Q11a. Which was the most significant difficulty in starting-up your firm?

Per cent

	Total	Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Costs of registration (payments)	13	8	11	16	18	14	13	14	15	11	19	16	13	8
Registration procedure (time and complexity)	25	24	28	27	22	25	25	27	23	24	25	28	25	24
Funding start-up costs and working capital	30	31	34	21	36	29	31	29	35	30	30	33	31	27
Opening a bank account	0	..	..	1	..	..	0	0	..	..	..	1	..	..
Finding suitable premises	4	8	1	3	5	2	6	3	5	5	4	3	3	6
Obtaining necessary licenses	11	12	12	12	8	12	10	9	10	15	10	8	13	13
Attracting suitable managers	1	..	1	3	2	1	2	2	1	1	..	1	2	2
Attracting suitable employees	2	3	3	1	2	1	3	1	4	3	..	3	1	4
Finding suppliers	2	4	1	4	..	2	2	3	2	1	..	3	2	3
Establishing relations with potential customers	5	5	6	4	4	6	4	6	2	4	7	3	5	5
Establishing relations with local authorities	1	..	1	1	1	1	0	1	..	1	..	..	1	2

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Operating difficulties faced by small businesses

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Extortion by criminal groups	0	..	..	1	..	..	0	..	1	..	..	..	..	1
Other	0	..	..	1	..	1	..	..	1	..	..	1	..	..
No response	4	4	3	6	3	5	3	5	..	5	3	3	4	6

Q11b. Which were the three most significant difficulties in starting-up your firm?

Per cent

	Total	Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Costs of registration (payments)	21	14	21	28	20	24	20	23	23	16	25	27	20	14
Registration procedure (time and complexity)	52	43	59	63	42	53	51	54	46	53	52	59	48	48
Funding start-up costs and working capital	55	54	57	53	56	58	53	51	59	59	67	56	52	50
Opening a bank account	2	3	4	2	1	1	3	3	2	2	3	1	3	3
Finding suitable premises	24	29	18	19	30	18	27	23	30	20	22	22	23	27
Obtaining necessary licenses	40	41	36	33	49	37	41	39	41	41	42	41	34	41
Attracting suitable managers	8	2	4	15	13	7	9	10	9	6	1	4	14	12
Attracting suitable employees	16	13	21	15	16	15	17	18	15	15	12	16	17	19
Finding suppliers	16	15	15	14	20	16	16	14	25	14	18	18	15	14
Establishing relations with potential customers	27	30	30	24	27	22	31	27	30	27	27	23	35	26
Establishing relations with local authorities	11	8	12	9	14	12	10	8	10	15	6	9	11	14
Extortion by criminal groups	2	3	3	1	1	3	2	2	1	3	3	2	1	2
Other	1	2	2	1	1	2	1	2	1	1	..	1	2	2
No response	11	17	7	13	7	15	8	13	2	13	9	8	11	14

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Operating difficulties faced by small businesses

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Q12a. Which is the most significant difficulty in operating your firm?														
	Per cent													
Increasing wages	4	1	10	4	2	7	3	4	5	4	1	5	5	4
Increasing cost of other inputs	14	14	21	11	10	17	12	13	16	15	10	18	11	14
Unreliable supply of inputs	2	5	4	1		1	3	1	1	5		3	4	2
Insufficient working capital	14	14	18	15	10	16	13	13	19	14	21	15	16	10
Insufficient capital for investment	5	7	4	2	7	5	5	7	2	3	3	4	5	6
Insufficient credit	11	14	5	17	8	9	12	15	6	7	7	9	11	14
Obsolete technology	2	3	1	2	2	3	2	3	1	1	4	1	2	2
Inability to find suitably skilled employees	3	2	3	4	3	3	3	3	4	3	1	3	3	3
Insufficient customer purchasing power	25	23	17	20	40	21	27	20	35	28	28	28	18	26
Fierce competition	5	3	7	7	4	5	5	6	2	6	4	5	7	4
Changing legislation & regulations	3	3	2	2	4	3	3	2	1	5	3	..	4	4
Conflict with owners of the firm	0	1	..	..	..	1	..	0	..	..	..	..	..	1
High local taxes	2	..	1	8	1	3	2	2	..	4	3	3	3	2
High national taxes	5	3	2	6	8	3	6	5	6	3	7	4	5	3
Other	4	5	5	3	2	4	4	5	1	3	4	2	4	5
Q12b. Which are the three most significant difficulties in operating your firm?														
	Per cent													
Increasing wages	8	2	17	9	6	10	8	7	11	8	3	9	8	10
Increasing cost of other inputs	33	26	42	33	33	35	32	33	37	31	25	43	25	35
Unreliable supply of inputs	8	12	9	7	4	7	9	9	4	9	7	9	7	7
Insufficient working capital	29	27	35	29	25	31	28	28	28	31	42	29	26	24
Insufficient capital for investment	24	31	29	14	21	26	22	28	15	22	24	21	29	22
Insufficient credit	32	36	32	39	20	35	30	40	20	25	27	25	34	38
Obsolete technology	11	12	7	19	6	11	11	13	11	7	12	10	11	10
Inability to find suitably skilled employees	8	6	8	6	11	7	8	6	9	9	4	9	10	6
Insufficient customer purchasing power	59	57	56	53	70	52	63	50	75	64	72	53	57	59

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Operating difficulties faced by small businesses

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
	Per cent													
Fierce competition	26	21	26	20	37	22	28	22	32	29	25	22	30	26
Changing legislation & regulations	11	14	5	13	14	12	11	11	12	12	6	11	9	16
Conflict with owners of the firm	0	1	..	..	1	1	0	1	..	..	..	..	1	1
High local taxes	10	7	8	18	6	13	8	10	6	11	9	11	13	6
High national taxes	24	20	16	27	34	25	24	23	28	24	27	27	24	21
Harassment by state or local authorities	1	2	1	..	1	1	1	1	1	..	..	..	2	2
Other	6	11	6	4	4	6	6	9	2	4	7	5	5	7

Q13. How difficult is it currently for your firm to undertake the following?

	Per cent													
Open a bank account														
Difficult	3	6	4	2	1	2	4	4	2	3	6	1	5	2
Not so difficult	37	29	44	22	53	38	36	39	35	36	42	39	33	35
Quite easy	60	65	52	76	46	60	60	58	63	62	52	60	61	62
Obtain bank credit														
Difficult	55	83	61	39	40	57	55	62	43	52	61	53	57	54
Not so difficult	35	15	35	38	50	34	35	29	43	38	30	35	35	36
Quite easy	10	2	4	23	11	9	10	8	14	10	9	12	7	10
Obtain financial support from business partners, other enterprises or private individuals														
Difficult	64	72	76	60	50	65	64	66	58	66	67	68	64	60
Not so difficult	29	23	19	31	43	27	30	28	35	28	25	26	30	34
Quite easy	6	4	5	9	8	7	6	6	7	6	7	6	6	6
Hire employees														
Difficult	32	31	28	35	33	31	32	30	43	27	48	29	29	27
Not so difficult	42	41	47	36	45	38	45	40	37	48	34	45	45	42
Quite easy	26	29	25	28	23	31	24	30	20	25	18	26	26	31
Dismiss employees														
Difficult	32	20	28	22	57	27	35	28	43	31	43	28	31	30
Not so difficult	37	44	49	29	26	32	40	38	30	40	33	41	36	35
Quite easy	31	36	23	49	17	41	25	34	27	29	24	30	32	35

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Operating difficulties faced by small businesses

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Purchase new equipment														
Difficult	76	76	82	76	72	74	78	80	69	75	79	77	79	73
Not so difficult	19	22	17	20	18	22	18	16	27	19	16	16	18	25
Quite easy	4	2	1	4	10	5	4	4	4	5	4	7	3	2
Find suitably skilled and qualified employees														
Difficult	37	40	47	35	27	37	37	40	30	37	33	37	39	38
Not so difficult	45	37	43	49	50	44	45	45	46	44	49	41	46	46
Quite easy	18	23	11	16	23	19	18	15	25	19	18	22	16	16
Purchase timely business advice														
Difficult	34	35	40	37	25	35	34	40	23	32	30	33	42	32
Not so difficult	55	49	52	60	60	52	57	52	69	52	55	59	48	58
Quite easy	10	16	8	3	15	13	9	8	7	16	15	9	10	10
Obtain licenses/certificates														
Difficult	40	48	35	52	27	40	41	43	32	41	40	38	48	37
Not so difficult	51	44	54	47	59	47	54	49	60	48	48	52	47	56
Quite easy	8	8	11	1	14	13	6	7	7	11	12	10	5	7
To expand														
Difficult	66	71	67	68	58	66	66	66	68	65	70	65	69	63
Not so difficult	30	26	30	31	35	29	31	30	30	32	27	30	28	34
Quite easy	3	3	3	1	7	5	2	4	2	3	3	5	3	2
To lobby the authorities														
Difficult	69	67	65	66	79	62	74	67	72	71	70	72	71	65
Not so difficult	21	18	26	26	11	25	18	22	17	19	16	20	21	23
Quite easy	3	1	1	5	6	6	2	3	5	2	3	3	4	2
No response	7	13	8	3	4	7	7	7	6	8	10	4	4	10
Protect the business from extortion														
Difficult	30	41	36	21	22	25	33	33	20	31	30	29	29	30
Not so difficult	43	30	46	49	49	43	43	42	49	42	43	40	44	46
Quite easy	18	6	14	25	27	23	15	16	23	18	19	22	19	13
No response	9	23	5	6	3	9	9	10	7	9	7	9	8	10

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Operating difficulties faced by small businesses

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Q14. Which of the following have been particularly obstructive to your firm's operations?														
	Per cent													
Health & sanitation	1	..	4	1	..	1	2	2	1	..	1	..	1	2
Fire	2	2	6	1	..	2	2	3	1	2	..	3	1	4
Tax	30	39	26	37	19	33	28	33	27	28	25	31	33	30
ZOP	1	2	3	..	1	3	1	1	4	1	..	3	1	2
Local authority	5	3	8	2	6	5	4	3	4	8	3	3	5	6
State authority	5	7	8	..	4	5	5	4	4	6	4	5	5	4
Other	8	8	5	13	8	9	8	10	2	9	9	5	8	11
None	47	39	41	46	62	42	50	44	57	46	57	50	45	41
Q15. Which actions do you take if you believe regulatory bodies are exceeding their legal authority?														
	Per cent													
Complain to the local authority	5	3	2	7	8	5	5	6	2	4	4	3	5	6
Complain to a state authority	4	7	1	5	5	3	5	4	4	5	1	6	3	6
Complain to the employers' federation/ chamber of commerce	3	1	5	1	5	3	3	2	5	3	..	..	4	6
Go to court	12	13	12	15	8	14	10	14	5	13	9	10	15	13
Try to negotiate a compromise	54	48	62	56	50	54	55	52	68	49	57	49	54	58
Comply anyway	17	19	13	17	18	16	17	17	14	18	21	25	16	7
Other	0	..	1	..	1	1	0	0	..	1	..	..	..	2
No response	4	8	5	..	5	5	4	3	2	8	7	6	3	2
Q16. How much competition does your firm face?														
	Per cent													
None	2	3	2	2	2	3	2	3	1	2		3	2	2
Little	4	5	1	4	7	7	2	4	4	4	6	3	7	2
Moderate	26	21	25	38	18	29	24	27	25	24	28	24	23	28
Fierce	63	65	67	49	69	58	66	60	67	64	58	64	63	64
Hard to say	5	5	5	7	4	4	6	5	4	7	7	5	5	4

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Operating difficulties faced by small businesses

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Q17. Who are your firm's main competitors?														
	Per cent													
Similar local private firm(s)	49	43	52	52	48	41	54	47	51	50	54	54	47	42
Local medium/large firm(s)	15	23	11	9	17	15	15	11	19	19	18	17	13	13
Other Yugoslav firms	15	7	16	23	14	20	12	18	14	11	9	10	19	19
Foreign firms	4	7	5	4	2	5	4	5	4	3	4	3	5	6
Other (specify)	9	13	10	3	9	8	9	10	5	9	9	7	8	10
There is no competition	3	3	3	3	2	4	2	3	..	3	3	3	2	2
Hard to say	6	3	4	7	9	7	5	6	9	3	3	5	6	7
Q18. On average, how difficult would it be for you to start another business in a different city/region compared with your firm's city/region?														
	Per cent													
Considerably more difficult	28	23	30	38	19	27	28	28	20	32	39	28	26	22
Somewhat more difficult	19	11	17	23	24	14	22	17	28	16	13	19	24	18
Similar	18	30	22	12	9	20	17	20	11	19	15	22	15	19
Easier	3	7	2	1	2	2	4	4	1	2	3	3	1	4
Hard to say	32	29	28	26	47	37	29	30	40	31	30	28	34	37
Q19. The level of wages in your firm is fixed in:														
	Per cent													
Dinars	66	85	87	91	..	75	60	76	47	62	57	66	68	69
€ (EUR)	32	13	7	8	100	24	37	23	51	34	43	34	29	26
Other (DEM)	2	2	6	1	..	1	3	1	2	4	..	..	3	5
Q20. If the dinar falls against the €(DM), would you expect the dinar prices of goods you purchase from Yugoslav companies during the subsequent 2 months to:														
	Per cent													
Increase proportionately	53	48	52	78	35	49	56	56	58	47	55	61	47	50
Increase less than proportionately	4	7	3	3	2	5	3	4	4	3	..	4	6	3
Increase more than proportionately	15	23	26	6	4	21	11	15	7	19	6	16	16	18
Not change	3	1	8	1	3	4	3	1	4	6	6	2	4	2
Hard to say	25	20	11	12	56	22	27	24	27	25	33	17	27	26

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Business relationships

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Q21. In your view, which three of the following are the most helpful in collecting payments due to your firm?														
	Per cent													
Having a formal contract	42	34	36	45	51	41	42	41	47	38	49	39	32	47
Having a good working relationship	48	43	40	48	59	45	49	46	54	45	51	50	44	46
Having a strong friendly relationship	50	46	45	45	62	46	51	44	60	51	54	48	53	46
The option to call on official authorities	10	17	11	6	5	10	10	11	5	11	12	8	10	10
The option to call on informal enforcement	2	5		3	2	1	3	2	4	2	1	3	4	2
There are no effective ways to collect debt	36	20	44	47	31	36	35	37	30	38	24	34	40	41
Q22. To what extent can you rely on formal contracts to obtain payments due to your firm?														
	Per cent													
Always	8	10	4	10	8	9	7	9	6	7	4	11	4	10
Usually	24	17	22	21	35	25	23	23	20	27	25	20	20	30
Sometimes	31	22	36	25	39	29	31	29	41	27	42	28	26	30
Hardly ever	24	35	24	28	10	22	25	22	22	29	12	28	33	21
Not at all	13	15	14	16	9	14	13	16	11	10	16	13	17	10
Q23. Which of the following do you usually use to resolve conflicts with your customers and suppliers:														
	Per cent													
Face-to-face negotiation	75	62	75	76	86	68	79	70	90	74	87	74	79	66
Appeal to state or local authorities	2	3	2	1	1	3	1	2	..	2	1	2	4	..
Commercial court	14	18	16	16	8	19	12	17	6	15	10	13	9	22
Arbitration or other courts	3	5	3	4	..	5	2	3	1	3	..	4	2	4
Other third party mediation	2	3	3	..	3	1	3	2	..	3	..	3	1	4
No response	4	8	2	3	2	5	3	5	2	3	1	4	4	4

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Business relationships

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Q24. How would you characterize the business relationships with your customers and suppliers?														
	Per cent													
Predominantly reliable/predictable	62	64	63	55	64	62	61	61	69	58	58	59	61	66
Mixed	34	29	34	36	36	31	35	34	30	36	37	34	34	31
Predominantly unreliable/unpredictable	3	5	3	6	..	5	2	4	1	4	3	5	3	2
No response	1	2	..	3	..	1	1	1	..	2	1	2	1	1
Q25. With which groups do you believe it is most important for your firm to form a close long-term business relationship?														
	Per cent													
Suppliers	69	65	77	73	59	69	68	73	68	61	60	69	71	71
Customers	93	95	96	88	91	90	94	92	94	93	94	91	91	95
Banks	45	42	51	51	36	47	44	49	41	42	36	42	50	49
Local authority	4	5	5	3	2	5	3	3	1	7	1	2	6	5
State authorities	5	11	4	1	5	5	6	8	..	3	1	6	7	5
Tax authorities	6	5	10	7	1	5	6	6	1	8	4	8	3	6
Other regulatory authorities	2	2	3	2	1	3	2	2	..	3	1	1	3	2
Other	1	..	3	..	..	1	0	..	..	3	..	..	..	2
Q26. How difficult is it to establish a working relationship with the following institutions?														
	Per cent													
Banks														
Difficult	25	28	30	17	28	29	23	29	20	24	33	20	26	26
Not so difficult	46	49	46	37	53	44	47	46	44	47	45	45	49	46
Quite easy	28	23	24	46	19	26	29	25	36	29	22	35	25	27
Local authorities														
Difficult	43	47	42	28	55	40	45	44	44	41	52	43	36	43
Not so difficult	48	43	51	57	42	50	47	48	49	48	39	47	56	49
Quite easy	9	10	7	15	3	10	8	8	6	11	9	10	7	8
State authorities														
Difficult	54	62	50	44	61	50	57	55	59	50	55	50	54	58
Not so difficult	40	30	47	45	37	41	39	39	38	42	40	41	42	37
Quite easy	6	8	4	11	2	9	4	7	2	8	4	9	4	6
Tax authorities														
Difficult	50	54	32	57	58	43	55	51	59	43	51	52	54	46
Not so difficult	40	34	58	30	36	44	37	41	31	43	39	36	41	42
Quite easy	10	12	10	13	6	13	8	8	10	14	10	12	5	12

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Business relationships

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Public prosecutors office														
Difficult	50	58	32	43	67	42	55	50	59	44	54	49	51	48
Not so difficult	38	30	49	46	27	46	33	41	27	39	37	39	38	38
Quite easy	4	1	3	8	4	3	4	3	1	7	3	5	..	6
No response	8	11	17	3	2	8	8	5	12	10	6	7	11	8
Other regulatory authorities														
Difficult	40	49	27	33	50	36	42	42	47	31	42	41	40	38
Not so difficult	48	39	56	52	43	52	45	48	38	53	48	49	50	44
Quite easy	5	5	4	9	4	6	5	5	2	8	4	6	2	8
No response	7	7	13	6	3	7	8	5	12	8	6	4	8	10
Licensing/certification authorities														
Difficult	42	43	28	49	47	42	41	47	42	32	46	35	46	42
Not so difficult	44	44	53	37	40	41	45	41	40	50	39	47	44	43
Quite easy	8	4	10	6	11	8	7	4	11	11	9	11	4	6
No response	7	9	9	8	3	9	6	7	7	7	6	7	6	9

Q27. Which one of the following best characterizes the current financial condition of your firm?

Per cent

	Total	Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Stable	67	58	67	68	74	62	70	65	68	69	52	70	65	74
Unstable	24	32	25	19	20	29	21	26	23	20	37	20	23	21
Critical	9	10	8	14	6	9	10	9	9	10	10	10	13	6

Q28. How have the following main indicators of activity changed during the last two years in your firm?

Per cent

	Total	Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Level of production														
Improved	31	32	30	37	25	33	29	44	9	23	21	21	36	42
Unchanged	34	28	40	33	37	35	34	29	38	41	43	40	29	29
Deteriorated	21	28	17	25	15	24	20	26	15	17	24	21	21	21
No response	13	13	13	4	24	8	16	..	38	19	12	19	14	9
Sales														
Improved	29	33	29	29	26	29	29	37	17	25	24	19	30	41
Unchanged	32	24	31	36	35	32	31	26	41	36	33	36	29	29
Deteriorated	38	41	40	34	37	38	38	37	42	36	39	45	40	30
No response	1	2	..	..	3	1	2	0	..	3	4	..	1	1

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Business relationships

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Profitability														
Improved	20	16	16	22	28	17	22	23	12	21	21	14	18	28
Unchanged	35	31	41	32	36	37	34	35	36	35	36	38	31	34
Deteriorated	45	53	44	46	37	46	44	42	52	44	43	48	51	38
Average wages														
Improved	31	32	32	32	27	29	31	36	19	31	24	25	30	40
Unchanged	49	45	48	46	56	48	49	44	65	46	54	50	50	44
Deteriorated	21	23	20	22	17	23	19	20	16	24	22	25	20	16
Number of employees														
Improved	25	22	19	29	28	19	28	27	21	24	7	16	25	42
Unchanged	64	64	64	62	65	60	66	61	69	64	76	72	67	47
Deteriorated	11	13	17	9	7	21	6	12	10	12	16	12	8	10
Competitiveness														
Improved	41	38	32	34	58	30	47	40	43	40	42	38	33	48
Unchanged	39	43	41	42	31	44	36	39	37	41	43	41	40	34
Deteriorated	20	19	27	24	11	26	17	21	20	19	15	21	27	18

Q29. During 2002 do you plan to:

Per cent

	Total	Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Increase turnover significantly														
No	15	24	12	16	9	14	16	15	16	14	15	16	15	14
Yes	69	68	77	62	69	70	69	72	62	69	72	66	68	72
Undecided	16	7	12	23	22	16	16	13	22	16	13	18	18	14
Increase output significantly														
No	20	21	22	20	18	22	20	18	32	16	21	22	21	18
Yes	53	62	55	53	43	60	49	72	16	46	48	45	51	66
Undecided	17	5	14	25	24	12	20	9	25	25	21	19	19	11
No response	10	11	9	3	16	7	12	0	27	14	10	14	9	6
Radically change the product line														
No	58	66	74	44	50	63	56	62	52	57	54	58	70	53
Yes	16	14	11	25	12	15	16	24	5	8	16	10	13	22
Undecided	16	8	7	28	21	16	16	14	15	21	21	16	9	18
No response	10	11	9	2	18	7	12	0	28	14	9	16	8	6
Acquire other firm(s)														
No	79	84	83	72	77	78	79	76	78	85	84	83	82	70
Yes	8	8	8	8	8	6	9	8	10	7	7	7	7	10
Undecided	13	8	9	21	15	16	12	16	12	8	9	10	10	20

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Business relationships

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Establish subsidiaries or branches														
No	67	65	68	67	68	67	67	64	74	68	73	76	65	58
Yes	19	26	26	9	14	17	20	20	12	21	13	12	22	25
Undecided	14	9	6	25	18	16	14	17	14	11	13	12	14	18
Break-up the firm														
No	92	96	94	91	87	92	92	94	88	92	90	93	95	90
Yes	2	..	2	5	..	2	2	2	1	1	3	1	..	3
Undecided	6	4	4	4	13	6	6	4	11	7	7	6	5	6
Merge with another enterprise														
No	89	89	90	92	84	91	88	89	90	88	84	91	86	92
Yes	3	5	2	..	4	1	4	3	2	3	6	3	2	2
Undecided	8	6	8	8	12	8	9	8	7	9	10	7	11	6
Liquidate the firm														
No	94	94	98	92	91	95	93	95	91	93	91	92	96	95
Yes	2	2	..	4	1	2	2	2	2	1	3	2	3	..
Undecided	4	4	2	4	8	3	5	3	6	6	6	6	1	5
Sell the firm														
No	92	92	95	92	90	92	92	94	90	92	94	91	94	92
Yes	2	3	2	4	..	3	2	2	4	2	3	3	3	1
Undecided	5	5	3	4	10	5	6	4	6	7	3	7	3	7
Q30. Are you confident that your firm will survive over the next:														
	Per cent													
3 months	2	1	1	4	3	1	3	2	2	2	7	3	1	..
6 months	2	4	1	1	1	3	1	3	..	..	1	3	1	2
12 months	5	11	1	3	4	3	6	4	2	7	4	5	6	3
24 months	2	3	1	1	4	3	2	3	1	2	1	3	3	1
36 months	2	2	2	5	1	2	3	3	1	3	3	5	1	1
> 36 months	69	57	75	74	71	73	67	70	72	67	60	59	70	83
Hard to say	17	21	19	13	16	16	18	14	21	20	22	22	18	10

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Business relationships

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125

Q31. Are there sufficient suppliers in your city/region of the following services to small business?

Per cent

	Total	Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Financial/credit (banks)														
Enough	41	27	27	64	46	39	42	39	54	36	40	41	40	42
Not enough	38	56	36	26	35	39	37	41	31	38	31	37	38	43
Practically none	9	10	18	2	7	11	8	11	6	8	10	6	11	10
Hard to say	12	7	18	8	13	10	12	9	9	18	18	16	11	5
Leasing contracts														
Enough	10	10	6	3	23	10	11	10	12	9	15	9	15	6
Not enough	31	36	31	35	22	29	32	35	28	26	31	28	32	32
Practically none	33	35	39	24	35	37	31	31	30	38	33	35	27	35
Hard to say	26	19	24	38	21	24	27	24	30	26	21	28	26	26
Legal advice on registering firms														
Enough	55	46	51	56	67	59	53	50	59	61	61	54	50	57
Not enough	24	29	25	25	16	24	24	27	20	20	22	22	23	27
Practically none	9	13	11	7	5	6	11	10	9	7	9	12	9	6
Hard to say	12	12	13	12	12	12	12	12	12	12	7	12	18	10
Other legal advice														
Enough	56	52	49	54	69	58	55	53	59	59	64	50	53	59
Not enough	25	26	30	29	16	22	27	26	20	27	24	28	24	25
Practically none	8	12	10	6	4	10	7	10	10	3	7	10	7	6
Hard to say	11	10	12	11	11	10	12	11	11	10	4	12	16	10
Advice on producing official certificates for goods/services etc														
Enough	30	36	21	25	41	32	29	27	41	30	37	33	26	28
Not enough	33	38	33	38	23	33	33	38	25	30	34	23	34	40
Practically none	15	13	20	17	10	17	14	17	10	15	9	18	17	14
Hard to say	22	13	25	21	27	18	24	18	25	25	19	26	23	18

Table A.2. **OECD survey of 404 small enterprises in the FRY (continued)**

Business relationships

	Total	Stratum				Founded		Principal sector			Number of employees			
		Belgrade	Vojvodina	Central Serbia	Montenegro	1991 and before	Since 1991	Manufacturing	Commerce	Other	1 or 2	3-5	6-10	>10
Number	404	98	103	102	101	153	251	205	81	118	67	116	96	125
Business consulting														
Enough	21	28	17	9	31	25	18	19	26	20	30	22	17	18
Not enough	34	38	30	40	30	33	35	36	41	28	31	31	39	36
Practically none	25	17	34	35	14	26	25	28	15	28	22	23	24	30
Hard to say	20	17	19	16	26	16	22	18	19	24	16	24	21	16
Auditing														
Enough	77	83	76	80	71	78	77	74	83	80	84	78	74	77
Not enough	11	11	12	10	13	9	13	14	10	8	10	13	11	10
Practically none	4	2	5	6	4	5	4	5	2	3	3	5	4	4
Hard to say	7	4	8	4	12	8	6	6	5	9	3	4	10	9
Book-keeping														
Enough	89	93	92	86	83	87	90	87	89	91	97	88	88	86
Not enough	6	5	6	9	6	6	7	8	5	4	3	7	5	9
Practically none	1	1	1	2	1	2	1	1	..	2	..	2	1	2
Hard to say	4	1	1	3	10	5	3	3	6	3	..	3	6	4
Advice on protecting intellectual property														
Enough	22	33	17	12	26	29	18	21	23	21	30	19	21	21
Not enough	26	30	24	22	28	22	28	26	30	23	27	29	24	23
Practically none	29	13	36	46	19	26	30	33	17	29	21	26	28	36
Hard to say	24	24	22	21	28	23	24	20	30	27	22	26	27	20
Internet service providers														
Enough	63	81	64	42	66	59	65	65	68	57	67	62	69	58
Not enough	20	16	24	25	14	24	18	19	15	26	21	19	15	25
Practically none	6	1	5	15	3	6	6	8	6	3	4	8	5	6
Hard to say	11	2	7	18	17	11	11	9	11	14	7	11	11	12
IT software and databases														
Enough	49	58	48	28	61	45	51	47	58	45	58	51	46	44
Not enough	28	34	36	28	16	32	26	26	23	36	27	28	28	30
Practically none	8	4	7	18	3	9	7	11	7	3	4	7	7	11
Hard to say	15	4	10	25	20	14	16	15	11	17	10	14	19	15

Table A.3. **Description of HS 4-digit codes**

HS 4-digit	Description
2230	Alcohol
5210	Woven Fabrics Of Cotton, Containing 50 % To 85 % Cotton By Weight, Mixed Principally Or Solely With Man-Made Fibres And Weighing =<200 G Per M2
2402	Cigars, Cheroots, Cigarillos And Cigarettes Of Tobacco Or Of Tobacco Substitutes
0803	Bananas, Incl. Plantains, Fresh Or Dried
8802	Powered Aircraft -E.G. Helicopters And Aeroplanes-; Spacecraft -Incl. Satellites- And Spacecraft Launch Vehicles
1005	Maize Or Corn
1701	Cane Or Beet Sugar And Chemically Pure Sucrose, In Solid Form
8471	Automatic Data Processing Machines And Units Thereof; Magnetic Or Optical Readers, Machines For Transcribing Data Onto Data Media In Coded Form And Machines For Processing Such Data N.E.S.
3102	Mineral Or Chemical Nitrogenous Fertilizers (Excl. Those In Pellet Or Similar Forms, Or In Packages With A Gross Weight Of =<10 Kg)
2304	Oil-Cake And Other Solid Residues, Whether Or Not Ground Or In The Form Of Pellets, Resulting From The Extraction Of Soya-Bean Oil
3105	Mineral Or Chemical Fertilizers Containing Two Or Three Of The Fertilizing Elements Nitrogen, Phosphorus And Potassium; Other Fertilizers (Excl. Pure Animal Or Vegetable Fertilizers Or Mineral Or Chemical Nitrogenous, Phosphatic Or Potassic Fertilizers)
6403	Footwear With Outer Soles Of Rubber, Plastics, Leather Or Composition Leather And Uppers Of Leather (Excl. Orthopaedic Footwear, Skating Boots With Ice Or Roller Skates Attached, And Toy Footwear)
8402	Steam Or Other Vapour Generating Boilers (Excl. Central Heating Hot Water Boilers Capable Also Of Producting Low Pressure Steam); Super-Heated Water Boilers
8429	Self-Propelled Bulldozers, Angledozers, Graders, Levellers, Scrapers, Mechanical Shovels, Excavators, Shovel Loaders, Tamping Machines And Road Rollers
7302	Railway Or Tramway Track Construction Material Of Iron Or Steel, The Following : Rails, Check-Rails And Rack Rails, SwitchBlades, Crossing Frogs, Point Rods And Other Crossing Pieces, Sleepers Cross-Ties, Fish-Plates, Chairs, Chair Wedges, Sole Plate
1806	Chocolate And Other Food Preparations Containing Cocoa
8528	Television Receivers -Incl. Video Monitors And Video Projectors-, Whether Or Not Combined, In The Same Housing, With Radio-Broadcast Receivers Or Sound Or Video Recording Or Reproducing Apparatus
8418	Refrigerators, Freezers And Other Refrigerating Or Freezing Equipment, Electric Or Other; Heat Pumps (Excl. Air Conditioning Machines Of Heading No 8415)
9403	Furniture And Parts Thereof N.E.S. (Excl. Seats And Medical, Surgical, Dental Or Veterinary Furniture)
8443	Printing Machinery (Excl. Hectograph Or Stencil Duplicating Machines, Addressing Machines And Other Office Printing Machines Of Heading Nos 8469 To 8472); Machines For Uses Ancillary To Printing, For The Feeding, Carriage Or Further Processing
8433	Harvesting Or Threshing Machinery, Including Straw Or Fodder Balers; Grass Or Hay Mowers; Machines For Cleaning, Sorting Or Grading Eggs, Fruit Or Other Agricultural Produce (Other Than Machines For Cleaning, Sorting Or Grading Seed
9018	Instruments And Appliances Used In Medical, Surgical, Dental Or Veterinary Sciences, Incl. Scintigraphic Apparatus, Other Electro-Medical Apparatus And Sight-Testing Instruments N.E.S.
8422	Dish-Washing Machines; Machinery For Cleaning Or Drying Bottles Or Other Containers; Machinery For Filling, Closing, Sealing, Capsuling Or Labelling Bottles, Cans, Boxes, Bags Or Other Containers; Other Packing Or Wrapping Machinery
3402	Organic Surface-Active Agents (Excl. Soaps); Surface-Active Preparations, Washing Preparations, Incl. Auxiliary Washing Preparations, And Cleaning Preparations, Whether Or Not Containing Soap (Excl. Those Of Heading 3401)
7210	Flat-Rolled Products Of Iron Or Non-Alloy Steel, Of A Width >=600 Mm, Hot-Rolled Or Cold-Rolled Cold-Reduced, Clad, Plated Or Coated
2106	Food Preparations N.E.S.

Table A.3. **Description of HS 4-digit codes (continued)**

HS 4-digit	Description
8516	Electric Instantaneous Or Storage Water Heaters And Immersion Heaters; Electric Space Heating Apparatus And The Like; Electro-Thermic Hair-Dressing Apparatus, E.G. Hair Dryers, Hair Curlers And Curling Tong Heaters, And Hand Dryers
4011	New Pneumatic Tyres, Of Rubber
8504	Electrical Transformers, Static Converters, E.G. Rectifiers, And Inductors
0303	Frozen Fish (Excl. Fish Fillets And Other Fish Meat Of Heading 0304)
8415	Air Conditioning Machines Comprising A Motor-Driven Fan And Elements For Changing The Temperature And Humidity, Including Those Machines In Which The Humidity Cannot Be Separately Regulated
8406	Steam Turbines And Other Vapour Turbines
8450	Household Or Laundry-Type Washing Machines, Including Machines Which Both Wash And Dry
3907	Polyacetate, Other Polyethers And Epoxide Resins, In Primary Forms; Polycarbonates, Alkyd Resins, Polyallyl Esters And Other Polyesters, In Primary Forms
3004	Medicaments Consisting Of Mixed Or Unmixed Products For Therapeutic Or Prophylactic Uses, In Measured Doses Or Put Up For Retail Sale (Excl. Goods Of Headings 3002, 3005 Or 3006)
2009	Fruit Juices, Incl. Grape Must, And Vegetable Juices, Unfermented, Not Containing Added Spirit, Whether Or Not Containing Added Sugar Or Other Sweetening Matter
8481	Taps, Cocks, Valves And Similar Appliances For Pipes, Boiler Shells, Tanks, Vats Or The Like, Incl. Pressure-Reducing Valves And Thermostatically Controlled Valves
4818	Toilet Tissue, Handkerchiefs, Make-Up Removal Tissues, Towels, Tablecloths, Serviettes, Nappies, Sanitary Towels And Tampons, Bed Sheets And Similar Articles For Household Or Medical Use, Personal Hygiene Or Sanitary Products, Clothing And Clothing Access
8525	Transmission Apparatus For Radio-Telephony, Radio-Telegraphy, Radio-Broadcasting Or Television, Whether Or Not Incorporating Reception Apparatus Of Sound Recording Or Reproducing Apparatus; Television Cameras
7010	Carboys, Bottles, Flasks, Jars, Pots, Phials, Ampoules And Other Containers, Of Glass, Of A Kind Used For The Conveyance Or Packing Of Goods, Preserving Jars, Stoppers, Lids And Other Closures, Of Glass (Excl. Glass Envelopes And Containers...)
8708	Parts And Accessories For Tractors, Motor Vehicles For The Transport Of Ten Or More Persons, Motor Cars And Other MotorVehicles Principally Designed For The Transport Of Persons, Motor Vehicles For The Transport Of Goods And Special Purpose Motor Vehicles
8477	Machinery For Working Rubber Or Plastics Or For The Manufacture Of Products From These Materials, Not Specified Or Included Elsewhere In This Chapter
3304	Beauty Or Make-Up Preparations And Skin Care Preparations, Incl. Sunscreen Or Sun Tan Preparations (Excl. Medicaments);Manicure Or Pedicure Preparations
4410	Particle Board And Similar Board Of Wood Or Other Ligneous Materials, Whether Or Not Agglomerated With Resins Or Other Organic Bonding Agents
1905	Bread, Pastry, Cakes, Biscuits And Other Bakers' Wares, Whether Or Not Containing Cocoa; Communion Wafers, Empty Cachets Of A Kind Suitable For Pharmaceutical Use, Sealing Wafers, Rice Paper And Similar Products
7408	Copper Wire (Excl. Surgical Sutures, Stranded Wire, Cables, Plaited Bands And The Like And Other Articles Of Heading 7413, Electrically Insulated Wires And Strings For Musical Instruments)
4801	Newsprint, In Rolls Or Sheets As Specified In Note 7a Or 7b To Chapter 48

Table A.4. **Detailed structure of exports, 2001**

	Products	Export share	Memorandum items: Import share	Memorandum items: RCA
76	Aluminium And Articles Thereof	8.88	1.19	7.68
62	Articles Of Apparel And Clothing Accessories, Not Knitted Or Crocheted	7.11	0.99	6.13
44	Wood And Articles Of Wood; Wood Charcoal	5.70	1.53	4.17
40	Rubber And Articles Thereof	5.03	1.30	3.73
39	Plastics And Plastic Products	4.71	4.23	0.47
72	Iron And Steel	4.64	2.33	2.30
08	Edible Fruit And Nuts; Peel Of Citrus Fruits Or Melons	4.62	1.40	3.22
84	Nuclear Reactors, Boilers, Machinery And Mechanical Appliances; Parts Thereof	4.54	10.20	-5.65
74	Copper And Articles Thereof	4.13	0.34	3.80
64	Footwear, Gaiters And The Like; Parts Of Such Articles	3.89	1.40	2.49
85	Electrical Machinery And Equipment And Parts Thereof; Sound Recorders And Reproducers, Television Image And Sound Recorders And Reproducers, And Parts And Accessories Of Such Articles	3.34	4.69	-1.34
73	Articles Of Iron Or Steel	2.75	1.72	1.03
27	Mineral Fuels, Mineral Oils And Products Of Their Distillation; Bituminous Substances; Mineral Waxes	2.64	20.70	-18.06
17	Sugars And Sugar Confectionery	2.18	0.88	1.30
30	Pharmaceutical Products	2.15	1.31	0.83
07	Edible Vegetables And Certain Roots And Tubers	2.04	0.45	1.58
61	Articles Of Apparel And Clothing Accessories, Knitted Or Crocheted	2.01	0.44	1.57
87	Vehicles Other Than Railway Or Tramway Rolling-Stock, And Parts And Accessories Thereof	2.00	5.23	-3.22
94	Furniture; Medical And Surgical Furniture; Bedding, Mattresses, Mattress Supports, Cushions And Similar Stuffed Furnishings; Lamps And Lighting Fittings, Not Elsewhere Specified; Illuminated Signs, Illuminated Name-Plates And The Like; Prefabricated Build	1.72	1.00	0.72
88	Aircraft, Spacecraft, And Parts Thereof	1.65	0.97	0.69
Total		**75.74**	**62.30**	

Source: Federal Statistical Office and OECD.

Table A.5. **Detailed structure of imports, 2001**

	Products	Import share	Memorandum items: Export share	Memorandum items: RCA
27	Mineral Fuels, Mineral Oils And Products Of Their Distillation; Bituminous Substances; Mineral Waxes	20.70	2.64	-18.06
84	Nuclear Reactors, Boilers, Machinery And Mechanical Appliances; Parts Thereof	10.20	4.54	-5.65
52	Cotton	5.34	0.27	-5.07
87	Vehicles Other Than Railway Or Tramway Rolling-Stock, And Parts And Accessories Thereof	5.23	2.00	-3.22
85	Electrical Machinery And Equipment And Parts Thereof; Sound Recorders And Reproducers, Television Image And Sound Recorders And Reproducers, And Parts And Accessories Of Such Articles	4.69	3.34	-1.34
39	Plastics And Plastic Products	4.23	4.71	0.47
48	Paper And Paperboard; Articles Of Paper Pulp, Paper Or Paperboard	2.63	1.40	-1.23
72	Iron And Steel	2.33	4.64	2.30
29	Organic Chemicals	2.02	0.47	-1.56
22	Beverages, Spirits And Vinegar	1.83	0.73	-1.10
38	Miscellaneous Chemical Products	1.73	0.43	-1.30
73	Articles Of Iron Or Steel	1.72	2.75	1.03
90	Optical, Photographic, Cinematographic, Measuring, Checking, Precision, Medical Or Surgical Instruments And Apparatus; Parts And Accessories Thereof	1.63	0.60	-1.02
31	Fertilizers	1.55	0.11	-1.43
44	Wood And Articles Of Wood; Wood Charcoal	1.53	5.70	4.17
24	Tobacco And Manufactured Tobacco Substitutes	1.44	0.18	-1.27
08	Edible Fruit And Nuts; Peel Of Citrus Fruits Or Melons	1.40	4.62	3.22
64	Footwear, Gaiters And The Like; Parts Of Such Articles	1.40	3.89	2.49
30	Pharmaceutical Products	1.31	2.15	0.83
40	Rubber And Articles Thereof	1.30	5.03	3.73
Total		**74.21**	**50.21**	

Source: Federal Statistical Office and OECD.