Redefining Property Rights with Specific Reference to Social Ownership in Successor States of Former Yugoslavia: Did it Matter for Economic Efficiency?

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Redefining Property Rights with Specific Reference to Social Ownership in Successor States of Former Yugoslavia: Did it Matter for Economic Efficiency?

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Abstract

> "The agents of a prince regard the wealth of their master as inexhaustible; are careless at what price they buy; are careless at what price they sell; are careless at what expense they transport his goods from one place to another. Those agents frequently live with the profusion of princes, and sometimes too, in spite of that profusion, and by a proper method of making up their accounts, acquire the fortunes of princes."
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> **Adam Smith (1776), *The Wealth of Nations,* Book V, Chapter II, Part I.**

High economic growth rates after World War II characterized both socialism and capitalism. There have been impressive results in the former socialist block, Western Europe, USA, and Japan. Apart from these models based on private (capitalist) and state (socialist) ownership, the fastest economic growth in the world for some time was recorded in former Yugoslavia under social ownership with no specific owner having full ownership rights. The issue of property rights despite being subject to comparative analysis, did not matter much.

After social ownership was privatized, the effects were not only as they were expected to be, but the countries like those that emerged from former Yugoslavia have yet to cope and strive for greater efficiency than before. This paper looks at the redefinition or privatization of social ownership in successor states of former Yugoslavia, and identifies the causes of smaller effects than expected of this redefinition.

Introduction

The onset of the transition process in former Yugoslavia coincided with the economic and political disorganization in Central and Eastern Europe (CEE) and the former Soviet Union. The development, speed and success of transformations and privatization depended on initial conditions, policies implemented, and the external environment (Pejovich, 1993; Ellman, 1994). In most cases these factors were interdependent and played a crucial role in the outcomes of transition and privatization in short to medium term. For example, the initial conditions of the Yugoslav transition path to a market economy were characterized by dramatic events and interethnic conflicts that led to the dissolution of the Federation, with political and economic consequences for the republics that became independent states.

Political disorganization and distorted environment have always been an obstacle to transition and privatization. Policy makers tended to favor the worst scenario during transition rather than continue *status quo* of socialist economy. This then had adverse effects in the restructuring process as a result of dramatic economic decline (Roland, 1994). While this refers to the early transition period, it should be reminded that privatization has promised more than actually achieved even in a stable country when it was implemented for the first time – the United Kingdom. The conclusion which Florio (2004) draw from a thorough investigation of the British experience from 1979 to 1997 is that privatization has had smaller effects on overall economic performance and efficiency than the theory of property rights had established. Moreover, the British privatization being the first most important case in history was not a success as its proponents and policy makers were roaring. It was a selective success for the firms that came more efficient from their better position on the eve of privatization, and a failure in terms of social welfare.[1]

The British and Western privatization, however, should be distinguished from CEE for two crucial reasons: first, the West privatized Publicly-owned Enterprises (POEs) as opposed to privatization of commercial enterprises in CEE; and second, privatization of POEs in Western countries may be referred to a reform within existing system, whereas in CEE and former Yugoslavia in particular, it was part of the bigger changes not only within the economy, but the society in general.

To come out with an assessment on the impact of privatization in successor states of former Yugoslavia, the paper begins with a brief review of different types of property and their associated incentives with respect to efficiency. Section two outlines the reasons that led to privatization of public and state property. Similarly, the necessity of privatizing social property and the methods of privatization implemented in successor states of former Yugoslavia are discussed in section three. The section continues with an assessment of the impact of privatization methods on corporate governance and restructuring. Section four summarizes a number of causes leading to smaller privatization results than expected by grouping them as internal and external factors in separate subsections. Section five provides a summary and draws conclusions.

[1] "In some ways, this rift [the welfare impact of privatization] has distanced the United Kingdom from the social model of its European partners. No government in the European Union would have considered acceptable a doubling of the percentage of people living in conditions of poverty in less than two decades…..Britain's economic system is now closer to the U.S. form of capitalism than to the European pattern, without the benefits of American technological leadership, entrepreneurialism, and international hegemony." (Florio, 2004, p.363).

1. Different types of property as incentive to economic efficiency

In broader terms, property as Waldron (1991) maintained, can be understood as a set or system of rules regulating the right to, and control of, material resources. In this way, the term property right is used in economics to denote the essence of the property. Every society has an institution or a body to enforce these rights and that is the state. The enforcement is made depending on political system of a country and the economic system it wanted to establish. Thus capitalist democracy enforced the right to private property as a foundation of market economy. Centralist socialism enforced the right to state property and planned economy. The self-management socialist regime as the institution responsible for enforcing the right to social property defined the means of production as socially-owned.[2] That is, the society as a whole was supposed to be the owner of social assets (thus, social ownership). As such, social ownership had both similarities and differences with state and private ownership.

Social property and social ownership is a relatively new category of property rights and their analysis is relatively new as well. Since it was introduced in former Yugoslavia in the early 1950s, no significant attention was paid to its analysis until Furubotn and Pejovich (1970) who believed that one could not present a satisfactory theory of the Yugoslav firm without an explicit reference to its property right structure. This was due to some of the specific features of this type of property rights, in particular: (i) enterprises were not allowed to own assets; and (ii) selling and buying of the firm's assets only amounted to a transfer of the right to use but not the right to alienate or destroy those assets.

A vast theoretical literature has evolved on comparative performance of different property rights. Coase's (1937) article laid the basic foundations of allocation and use of property by the firm (its owner or management) and by someone else outside the firm such as the state. Interactions between allocation and use involve a relationship between

[2] When Yugoslav ideologists introduced self-management they did not know exactly how the system would operate since there was no theory about it. But even during its operation, the Yugoslav economists have not developed any theory, nor did they make any notable contribution to it. Self-management attracted the attention of Western economists who where the first attempting to create a theory of a Labor-managed Firm (LMF) or the Workers' Management, as the Yugoslav Socially-owned Enterprises (SOEs) were identified. The first article was published by Ward (1958), and then during the 1970s the interest grew among some economists from CEE such as Vanek (1970, 1977) and Estrin (1983). Horvat (1982) and to some extent Bajt (1988) were few exceptions among Yugoslav economists to have contributed to the theory of Workers' Management.

master and servant or principal and agent of property. The principal (the state or society) may engage the agent (in former Yugoslavia they were the workers) to perform some actions on behalf of the principal, including full decision making authority delegated to the agent (Jensen and Meckling, 1976).

The central point of the theory of property rights is that the firm's performance depends on objective function and incentives. State, social and private ownership are different in this respect. Private ownership has incentives to reduce costs and reap more market-based benefits compared to state ownership (Shleifer, 1998). Enterprise profit is allocated by its owners; private owners allocate their profit according to their wishes, state authorities allocate the profit of state enterprises, and the decision of the working collective or members of the company allocated the profit of Socially-owned Enterprises (SOEs).

Since the pioneering article by Ward (1958), the analysis of the behavior of an SOE has been based on comparing its performance with that of a capitalist firm. Ward who coined the term 'Illyrian firm', considered it a less independent form of capitalist firm, and as such with the failures that makes it less efficient. Ward demonstrated that the SOEs would perform less efficiently than capitalist firms because, among other reasons, their response to a price increase (or decrease) is the opposite of the capitalist firm's response. He also showed that in these firms investment pattern will be distorted in comparison with capitalist firms due to incentives of the working collective to maximize individual incomes. Such assumptions about the behavior of SOEs were based on competitive self-management for which Vanek (1970) created the most noteworthy general theory. Assuming perfect competition and the behavior of the system as a whole, Vanek along the line of Ward argued that a Labor-managed Economy (LME) will respond to aggregate demand by the change in prices rather the change in output and/or employment.

As noted by Alchian and Demsetz (1973), it is more important for the society that economic choices *what, how* and *for whom,* are preceded by techniques, rules or customs which resolve the inefficiencies that arise from the use of scarce resources, i.e. define property rights clearly. In self-management socialism, ownership rights were politically imposed and the residual rights were used by the central authority to monitor managers. Jensen and Meckling (1979) viewed as an adverse outcome the manager's limited incentive to monitor and condemn workers in case of abuse or theft because s/he is elected by the workers who can dismiss him/her. This ambiguous role and actions by the Yugoslav principal (central authority) and agent (management of SOEs) was the underlying reason for some of the inefficiencies of social ownership. In the system of Workers' Management which in its largest part seems to have been operating as a black box, the workers officially were declared and in fact they felt to be the true rulers of SOEs but hardly were; the role of the state and its agents was always significant (Lydall, 1984). In theory, the Yugoslav workers were the agents of the state, though in practice the state played a double role (as principal and agent). Having in mind the labyrinth in which self-management operated, the Yugoslav economy could not be fully and competitive LME, which various authors used as an example to establish standard theories.

Because of unclear property rights, resource allocation under social ownership was considered suboptimal. Regardless the theory, self-management in aggregate terms fared much well than capitalism and centralist socialism. At the beginning of its introduction it was lucky to enjoy a significant aid from Western countries.[3] Any economic system with such a support would have recorded obvious results. But the fact that the fastest economic growth in the world in absolute terms continued for more than a decade after the aid was received, indicates that there were other determinants. Above all, the workers motivation for work through self-management and the enthusiasm of the Yugoslav communists expressed by the slogan 'we' and 'they' intimating a comparison of their socialist version with all Eastern block, were the factors of significant impact. Table below summarizes the results of self-management from 1953 to 1965, the period which can be considered as its golden age.

[3] Western aid included capital transfers from the USA, Britain and France amounting to $425.8 million delivered from 1951 to 1954 (Dyker, 1990:24, *op. cit*).

Table 1.1: Annual rates of growth in different economic systems (from 1953 to 1965)

Indicators / Systems	Self-management socialism	Centralist (state) socialism[a)]	Capitalism[b)]
Output	11.8 (10.3)[c)]	8.7 (5.9)[d)]	7.1 (3.7)[f)]
Capital	7.5 (7.8)[c)]	8.1 (10.0)[d)]	6.3 (3.2)[f)]
Labor	6.7 (4.4)[c)]	4.1 (4.8)[d)]	2.5 (1.5)[f)]
Combined factor productivity	4.7 (4.4)[c)]	3.0 (-1.0)[d)]	3.3 (1.5)[f)]
Basic welfare differences	+5.0	+4.5	-7.0
Gini coefficient	0.25	0.21-0.26[e)]	0.40

a) State socialist countries: Bulgaria, Hungary, Poland, Romania, and Czechoslovakia;
b) Capitalist countries: Greece, Ireland, Norway, and Spain;
c) From 1954 to 1967; d) From 1940 to 1954, excluding the war years 1941 to 1945;
e) Bulgaria and Poland; f) From 1911 to 1940, excluding the war years 1914 to 1918.
Source: Horvat, B. (1982), *The Political Economy of Socialism: A Marxist Social Theory,* Martin Robertson, Oxford, pp. 203-205, tables 7, 8, and 9, *op. cit*.

The Yugoslav self-management was more efficient in terms of output, labor, and combined factor productivity than capitalist and centrally planned economies during the same as well as different comparative periods. Centrally planned socialism was able to mobilize more capital but at a lower level of combined factor productivity or efficiency. Capitalism achieved efficiency but left other resources, especially labor, at the lowest level of use. It was so because in capitalism capital hires labor while in socialism (centralist or self-managed) the other way around applied. High growth rates in former Yugoslavia continued even after 1965, so for a period of more than two decades (from 1952 to 1973) their annual average in percent terms was: 10.6 for output, 5.3 for labor, and 9.1 for capital (Estrin, 1983).

The greatest achievement of self-management socialism was that it had quickly transformed former Yugoslavia from an obsolete and largely agricultural country to an industrialized and more developed economy and society compared to other socialist countries. However, the system through the defects in operation became vulnerable to a number of failures. When Estrin and Bartlett (1982) used a large empirical literature to identify the effects of enterprise self-management on Yugoslav economy, they showed that the efficiency had isolated the general impact of regional underdevelopment, market imperfections, and government regulation, though the growth performance appeared impressive by international comparisons.

2. Justifying the transformation of different types of property into private property

It is widely accepted that the firm's efficiency depends on, or is subject to, a number of factors and the way they are structured within property rights. This gives rise to different objectives, constraints and incentives. Theoretical wisdom maintains that private enterprises pursue profit maximization and have strong incentives to reduce costs. On these grounds private property is judged to be more efficient over public and state property. State and public enterprises are regarded as less efficient for a number of reasons, including among others: i) political interference in enterprise affairs to pursue other objectives that politicians wants; ii) involvement of trade unions to lobby for higher wages for the workers; iii) employment of a greater number of employees than the firm actually may need; iv) lower quality of management and innovation due to limitations by the principal and absence of bankruptcy threat; v) less product differentiation and consumer oriented (Martin and Parker, 1997).

Following theoretical foundations that private ownership does matter in terms of efficiency, a consensus that privatization will improve efficiency was generally supported. It was this expectation that gave rise to large scale privatization of POEs in the United Kingdom. The British privatization program might have appeared as inevitable to respond against ongoing decline in efficiency of public corporations, though Galal *et al.* (1994) argue that it was not a carefully planned and controlled program.

The necessity for privatization in CEE arose from similar reasons like in Britain. There were objections against centralist economy and state enterprises but privatization was not considered as long as former Soviet Union was able to crush the 1956 Hungarian revolution and the 1968 Prague Spring in former Czechoslovakia, which probably could have led to an alternative way of socialism such as self-management, or in a more radical scenario, pave the way for privatization of state ownership. Transition and privatization eventually became inevitable by the end of 1980s or immediately once former Soviet Union withdrew defeated from the war in Afghanistan and was powerless to stop revolutions in its satellite states in CEE which broke simultaneously. It was impossible to maintain state ownership once the communist parties or the principals that monitored enterprises collapsed and pluralist political parties emerged. Thereon the privatization process in CEE preceded by a disorganization of the system that imposed the need for reallocation of resources into property rights required by the market economy. For Blanchard (1997), this disorganization is the initial phase of transition that continues with reallocation of resources, and that reallocation involves restructuring and reorganization. Then the relation between property rights clearly defined and incentives becomes obvious. Roland (2000) reminded that different ownership *per se* has not played any important role in economic performance from the perspective of general equilibrium theory, but its role became central in economics once the theory of incomplete contracts was introduced, which in turn saw its relevance during privatization in transition economies in terms of control rights and residual rights.

3. The necessity of redefining social ownership in former Yugoslavia and her successor states

Since its introduction in the early 1950s, the self-management system remained essentially unchanged till the initiation of market economy reforms in the late 1980s, although it underwent four important changes.[4] The 1974 reform of *contractual socialism* resulted in an increase in the proportion of enterprise revenues being under the influence and control of state players. SOEs were under constant pressure by the authorities to employ more workers (Madžar, 1986). Under diminished autonomy of the workers, outside players by using their influence through residual rights violated the main principle of self-management 'earning according to work' by redistribution of revenues from better performing to under performing enterprises (Vodopivec, 1993). The implication of that redistribution as Freisner and Rosenman (2002) would show later was that whenever the government policies aimed at increasing the wealth of the society they could result in diminishing the enterprise efficiency over time.

[4] The main institutional changes and phases of the development of Yugoslav self-management were: (i) the period of centrally planned economy (1945-52) that was similar to the Soviet model of socialism; (ii) the introduction of self-management (1952-65), where the process of decision-making was gradually decentralized; (iii) the period of self-managed market socialism (1965-1974) when market mechanisms were utilized in as many areas as possible, focusing on the activities of the SOEs operating in the market; and (iv) the system of 'free associated labor' (1974-1988), or 'contractual socialism' (Estrin and Petrin, 1991).

The residual rights of the state or government bodies over social ownership should also be seen from another point. They can serve as a reason for the government to interfere in the firm's affairs, by which the firm's efficiency is limited because the government may pursue different objectives referred to earlier in this paper. These problems are expected to disappear if of social ownership is transformed into private ownership, and LME moves to a full market economy. Any market economy requires the establishment of unambiguously defined, and most importantly, transferable property rights. However, the process of re-defining social ownership will be followed by claims from agents associated with SOEs (especially managers and workers), whose stake is not known. The workers believed that they have run SOEs, financed the investment expenditure, contributed to development and growth and thus had acquired ownership claims to the assets. On the other hand, when SOEs were not able to pay the minimum incomes of the workers or other claims on their income, they had to either merge with other profitable enterprises which would cover their losses, or accept the intervention by the state or the founding organization who would replace the existing management and restore the firm's financial position (usually by subsidizing it). The state assisted SOEs by subsidies or rescued them from bankruptcy by writing off their debts, or SOEs in former Yugoslavia enjoyed soft budget constraints like state enterprises in CEE. This formed the basis of ownership claims by the state or the funding organization.

During the 1980s the Yugoslav economy was in deep crisis facing hyperinflation, trade deficit, foreign debt, unemployment and inefficiencies at micro level. The policies aiming at reforming self-management were no longer producing effects as they were introduced as a reaction to correct the previous failures rather than moving towards any planned necessary reform before the crisis appeared (Prašnikar and Prašnikar, 1986). They seemed unlikely to produce substantial changes without changing the property rights regime. It was decided to do so by the end of 1988 when the Federal Executive Council of former Yugoslavia brought in the reform to privatize social ownership and make transition towards a full market economy. Privatization of SOEs was facilitated through the Law on Social Capital (Official Gazette of the Socialist Federal Republic of Yugoslavia No. 84/89 and 46/90), known as the Marković Law, named after Ante Marković, the last president of Federal Executive Council of former Yugoslavia. Very favorable terms were provided to employees to buy internal shares; a discount of 30%, which was enhanced by another 1% for each year of employment – thus the overall discount could be as high as 70% of the nominal value of shares. Each employee could buy shares at a nominal value up to 3 times his/her annual personal incomes. The shares were to be paid for within 10 years once the company was registered under a different ownership form. The implementation of this privatization program was short lived as in 1991 interethnic conflicts began to give the final stroke to political and economic organization of former Yugoslavia and privatization of social ownership remained a challenge for newly established successor states.

3.1 Methods of privatization largely similar

Each newly independent republic of former Yugoslavia adopted their own privatization laws and established the relevant institutions – privatization agencies to carry out the process. The successor states, in general, opted for the sale of enterprise assets to insiders on very favorable terms as the main method of privatization, a pattern that, with modification was inherited from the Marković Law. Croatia was the first republic to pass its own privatization law while it was still part of the Yugoslav Federation, i.e. when the law on privatization already existed. Present and former employees were entitled to buy shares at a basic discount of 20% plus 1% for each year of employment, to be paid in installments over 5 years (later the deadline was extended to 20 years). In the 1991 Serbian Privatization Law the initial discount to employees was 20% plus 1% for each year of employment, so the overall discount could not exceed 60% of the total value of shares. Employees were required to fully pay the shares for a period of 5 years. In Montenegro, favorable terms and conditions to insiders were exactly the same in the Marković Law (basic discount of 30% plus 1% per each year of employment, the overall discount could not be higher than 70% of the appraised value of shares, repayment period of 10 years).

Slovenia passed the law on privatization after independence, in November 1992 respectively. Provisions of the Slovenian Law allocated social ownership to workers and society through the privatization scheme involving employees, the transfer of shares to the three funds, and citizens: 40% of the enterprises' shares were to be transferred and allocated to the following three government funds: (i) 20% to the Development Fund; (ii) 10% to the Pension Fund; and (iii) 10% to the Restitution Fund. 20% of shares were allocated to insiders (current and former employees and their relatives) in exchange for ownership certificates or vouchers; 20% was left at the discretion of the company to be sold to current employees, former employees and retired workers, and the remaining 20% was allocated for mass privatization program (MPP) or free distribution of shares to Slovenian citizens in exchange for ownership certificates. A discount of 50% with a repayment period of 5 years applied to shares allocated to insiders.

Despite becoming independent, Macedonia continued privatization that started on the basis of the Marković Law until 1993 when it enacted its own law on privatization. The Macedonian concept of privatization was based on a number of methods. Social capital was allocated in the following way: (i) 30% to employees as internal shares, involving a discount of 30% plus 1% for each year of employment, with a repayment period of 5 years; (ii) 15% of shares were transferred to the Pension Fund; and (iii) 55% of shares were to be sold to domestic and foreign buyers under equal conditions, using a variety of methods.

Privatization of the renationalized social ownership proceeded under separate programs in the two entities of Bosnia and Herzegovina (BiH), and relied on a decentralized approach. In the Federation of BiH this was regulated with the approval of the Law on Privatization of Enterprises in December 1997. In Republika Srpska the Law on Privatization of State Capital in Enterprises was passed in June 1998. Both programs envisaged mass privatization by distribution of ownership certificates to the citizens over 18 years of age in the Federation, and vouchers to all citizens in Republika Srpska.[5] The citizens could use the certificates or vouchers to buy shares in companies to be sold via public offerings, tenders and negotiations.

The last federal unit of former Yugoslavia and the last country in CEE to pass its own law on privatization and embark on the process was Kosova. Despite the delay, the emerging transition, in particular the privatization of SOEs did not follow the pattern observed in other Yugoslav successor states, probably because Kosova became a specifically shaped problem. The methods of privatization as determined in the

[5] Large enterprises in Republika Srpska were required to transfer 10% of the state share capital to the Pension and Disabled Persons Fund, and 5% to Insurance Fund (Article 26 of the Law No. 24/98 of Republika Srpska).

regulation passed in June 2002 included: the establishment of subsidiary companies of SOEs (spin-offs) and, voluntary liquidation. The employees are entitled to 20% of the proceeds from the sale of SOEs as a compensation for the loss of their self-management rights after privatization. A summary of all first privatization laws discussed so far in this section is provided in appendix to this paper.

To sum up this section, the characteristics of social ownership related the priority of appropriation to those who were in charge of managing the SOEs. Uvalić (1997) identified the appropriation of those rights or privatization of social ownership synonymously with *converting self-management rights into property rights,* whereas the managing role of workers has been described by Medjad (2002) *as a source of customary ownership rights.* There were exceptions or restrictions to these ownership rights to the workers anyway, e.g. privatization through MPP and direct sales either as primary or secondary method.

3.2 Implementation of the privatization process: progress, pitfalls and setbacks

Economists generally thought that the privatization of social ownership and the building of a market economy in former Yugoslavia would probably be easier than the privatization of state ownership in centrally planned economies. The Yugoslav system of market socialism was understood as something closer to a market economy and, as Tajnikar (2000) put it, 'already market oriented'. Presumably, the longer experience with market-based elements was seen as an advantage in establishing a full market economy (Uvalić, 1992). As will be seen later, the privatization of social ownership came to be a more difficult task and required much time and effort. The blame has been laid mainly on the specific features of social ownership that distinguished it from state ownership. Legally, social ownership lacked precise definition under self-management and this only generated confusion about the meaning of property rights (Lavinge, 1999).

Privatization under the Marković Law had started in almost every federal unit but was halted by the outbreak of civil wars and disintegration of the country. At the beginning of transition, privatization was autonomous and decentralized (conducted from the bottom). In Slovenia, around 400 SOEs embarked on autonomous privatization by selling shares to insiders (Korže, 1992). Once the Slovenian Law on Privatization was adopted, the process initiated under the Marković Law was stopped and ownership transactions were re-examined. A similar process started by some SOEs in Croatia was not recognized and they were required to be privatized by the Croatian law only. The very short deadline for submitting applications for ownership transformation (14 months) indicated *apriori* that all enterprises would not complete the process in time. Only few SOEs were assigned for ownership transformation and most of the 3,619 SOEs remained in the state portfolio. Almost half of them were owned by Croatian Privatization Fund (CPF), creating a large state sector as a substitute for the social sector (Čučković, 1996). Privatization continued in phases that could not achieve anticipated objectives. After a decade of transition, privatization in Croatia remained incomplete. The year 2000 marked the beginning of the fourth phase with much remaining to be done. Among the reasons for slower privatization, was the fact that the CPF did not have sufficient operational and professional capacities for the most important sectors of the economy, namely shipbuilding and tourism (Čučković, 1995; Ostović, 1996). Privatization in Croatia in 2005 was still an ongoing process as the CPF continued to hold shares in hundreds of companies.

Even though the Macedonian Law was enacted in 1993, it took 20 months to see the first SOE privatized under its provisions. That was due to the delays in building institutional capacities, in particular appointing the directors of the Agency for Privatization. Until then, over 400 enterprises (1/3 of total number of SOEs scheduled for privatization) had been transformed under the Marković Law (EBRD, 1995). Differently from Slovenia and Croatia, those transformations and privatizations were recognized. The rest of privatization under the Macedonian Law proceeded very slowly, and the fear that this will have adverse effects on enterprise performance and asset stripping, forced the government to make SOEs subject to compulsory privatization under a centralized process. Faster privatization was hindered by the economic sanctions of the United Nations against Serbia on one hand and the Greek embargo against Macedonia on the other, or the two most important trade partners of Macedonia (Muhić, 1996). The process was formally completed in 2002.

The autonomous privatization that began under the Marković Law proceeded on a larger scale in Serbia than elsewhere in former Yugoslavia. Privatization was further advanced by the Serbian Law of 1991 so that by 1994 the process was completed in 1,785 or in over 53% of total number of enterprises to be privatized. However, 1994 was the year where Serbia saw the biggest retreat in privatization. Reviewing the process by the Agency for Privatization resulted in the abolishment of privatization in 1,556 or 87% of total number of privatized enterprises (Lazić and Sekelj, 1997). Revaluation because of hyperinflation of 1993 had not only blocked the process but led to the direct state control in enterprises where privatization was abolished and those to be privatized.[6]

Until 1994 when the Montenegrin Law was amended, very little progress had been made. By the end of 1995, only 10 enterprises had been fully privatized to insiders (ISSP, 2000). This insignificant number was the reason why Montenegro did not stop the process in 1994 as in Serbia. Obviously, such a slow progress left Montenegro with the alternative of MPP, which had been used in Slovenia and Croatia to speed up ownership transformation and privatization. Although it was announced in 1996, MPP did not start until 2001.

Privatization in BiH from the end of 1989 until 1991 had resulted in 585 SOEs being transformed by distribution and selling of a proportion of shares to employees, but none of them was fully privatized (Stojanov, 2002). On that year, the newly elected authorities decided to review and halt the process with the reason that the companies were being sold cheaply. The halt followed re-nationalization of social ownership during the war (from 1992 to 1995) but the share capital paid by employees under the Marković Law was recognized and did not become subject to re-privatization since then (Bojičić-Dželilović *et al.,* 2004). In Kosova, a dozen of SOEs in the Gjakova region that sold internal shares in the early 1990s remained with unclear ownership status as their shares paid for have not been recognized to the present day. Privatization of the rest of SOEs started in July 2003 under international administration, was halted in October of the same year and resumed after one year. The Kosova Trust Agency or the institution in charge to carry out the privatization planned to complete the process by mid-2005, though until the moment of writing or mid-2006 it has privatized only half of over 500 SOEs, and that with enormous difficulties and controversies. Privatization in Kosova has proved to be the biggest challenge among CEE countries for the following reasons:

[6] During the 1993 hyperinflation in Serbia and Montenegro (the second highest in the world history) employees were highly motivated to buy enterprises very cheaply. By mid 1994 they were able to buy 43% of total appraised value of social capital. After revaluation, the employees' money paid for shareholding of 43% of social capital came down to just 3% to 5% (Filipović and Hadzić, 2005).

the undefined political status; ii) consequences of emergency measures introduced by Serbia in Kosova's SOEs during the 1990s and Serbia's attempts to legalize ownership claims made during that time; iii) problems with records of property rights; iv) too many stakeholders involved in managing the process (international administration, Kosova's institutions, and Serbia); v) limited management capacities and non-transparency (Mulaj, 2005).

3.3 The impact of privatization methods on corporate governance and restructuring

After the difficulties referred to earlier regarding implementation, the completion of the privatization process did not mean the end of challenges. Privatization is not a formal transfer of property rights; it implies a change in enterprise behavior and incentives, management, and restructuring. Privatized enterprises needed to adopt their activity according to market conditions, something which they could not do within a night given their long operation under different conditions. Adapting to free market conditions depended on corporate governance or how the companies are managed and restructured after privatization.

Corporate governance is determined by methods used in privatization. In companies where the sale of shares on favorable terms to insiders was used was the main method of privatization, ownership became dispersed among many individual shareholders in Employee-owned Firms (EOFs) with adverse implications on corporate governance. These group companies, now in private ownership, have their leadership largely similar to the past, or a continuation of pre-privatization period. The central decision-making organ under the previous system of self-management – the Workers' Council – has been replaced by the Shareholders' Assembly, now resting on many individual shareholders with the right of vote. A slight difference is the presence of managerial shareholders whose shares account for a little more than those of the average or lower position employees, derived from more allocation of shares based on the managers' higher level of salaries.

Dispersed ownership was also an obstacle to restructuring of the companies. Insiders lacked capital to invest while they were no longer enjoying subsidies after privatization. But restructuring is forced by the market conditions in which EOFs had to survive. Consequently, EOFs underwent defensive restructuring through downsizing of enterprise activities such as, reducing costs by closing down unprofitable activities, job cuts, and getting rid of outdated and nonproductive technology, to the extent that enabled them to compete in the short run (Grosfeld and Roland, 1996). In the longer run they faced even more pressure from competition for greater efficiency, mainly from investor-owned companies. The need for greater enterprise restructuring and better corporate governance induces EOFs to sell their shares internally from workers to managers, and externally to the outside investors in the secondary privatization. Such a process happened in Slovenia with the aim to make dispersed ownership that resulted from privatization and MPP more concentrated. Simoneti, *et al*. (2001) who analyzed the changes and shifts in ownership concentration after secondary privatization in 426 companies found that concentration occurred mainly from workers to managers but at a low level, having no major impact on enterprise performance.

Corporate governance became a much worse problem for SOEs privatized through MPP, especially in BiH, and Montenegro. Too many citizens had no knowledge about the companies in which they became shareholders. In BiH the process neither contributed to economic recovery of the country nor attracted foreign investors as hoped. As many companies ended up in the hands of management and employees and the portfolio of Privatization Investment Funds (PIFs), dispersed ownership caused problems in corporate governance and the lack of fresh capital neglected restructuring (EBRD, 2003).

Due to priority given to methods of privatization that favored insiders and population, foreign investors were left with little room to participate. In cases when they participated in privatization of SOEs wholly or partially, corporate governance and enterprise performance was better than in those privatized differently. For example, foreign participation brought positive changes in corporate governance by filling the gap of well-trained managers and incorporating better organization practices (Čengić, 2001). The need for fresh capital was felt during privatization in Serbia and that was why the new law on privatization passed in 2001, and amended in 2003 envisaged cash sales as the primary method intending to attract strategic investors.

One would question if non-privatization could have been a better choice than privatization to insiders or to whatever owners that followed deterioration in enterprise performance? The answer is that non-privatization could have had higher costs and this has proven in many empirical studies across CEE comparing the performance of firms privatized through different methods and those non-privatized. The overwhelming majority of those studies found greater efficiency in privatized enterprises than non-privatized ones in terms of corporate governance, restructuring, productivity and incomes. This remark was addressed by Uvalić (2001) to the delayed privatization in Serbia, that had SOEs been transformed into EOFs, the results could not have been worse.[7]

4. Causes of smaller effects of privatization

When the use of resources by a certain owner or under a given system of rules of managing property rights appears inefficient, Coase (1960) stood for incentives of transferring these rights to someone who will make a better use of them, i.e. achieve greater efficiency. One of the main requirements for that efficiency is to clearly define property rights and make them fully transferable, so competition would lead to efficient resource allocation. Sometimes it may be so and sometimes it may not. Even in competition circumstances reallocation of resources may be inefficient due to asymmetric information. It is difficult to anticipate a better use of resources if there is insufficient information about their past and current qualities and shortcomings. This is something that featured social ownership during privatization and its aftermath.

The limited privatization at the Federal level associated with the monetary stabilization began to produce some positive results which Marković himself had not expected, but he soon realized that the further success above all required the stability in political domain (Bennet, 1995). It was the political crisis and national question that led to disintegration of Yugoslavia, the consequences of which lengthened the transition to a market economy and made the completion of the privatization process more difficult. But not everything depended on external factors: there were plenty shortcomings within institutions that carried out the process.

[7] Of course, SOEs in better position had greater chances of being privatized earlier and this may question post-privatization better performance. However, time does matter in privatization; when it is well-founded that it must happen, delays and/or alternatives may raise the costs, therefore should not be preferred to privatization.

4.1 External causes: the impact of disintegration of former Yugoslavia and thereafter

There is no doubt that the major factor that undermined prospects and results of privatization in successor states of former Yugoslavia (except Slovenia), is the breakup of the Federation that began in 1991 with the independence of northern republics – Slovenia and Croatia. Disintegration continued with the separation of Macedonia, the war in BiH (1992 to 1995) and, finally, the war in Kosova (1999), resulting in a complete disintegration of the Yugoslav market into republics and regions. These should be remembered as the initial conditions that deteriorated since the early 1990s, for which Prašnikar and Pregl (1991) warned and maintained that this transition depended on the resolution of the national question and democratic environment which would permit a successful implementation of the reform program.

The initial conditions in Croatia – the most developed republic after Slovenia, deteriorated severely with the outbreak of war which left a significant adverse impact on the economy in general. Damages were equal to three times the annual GDP of Croatia (Buljan, 2001). The disadvantageous circumstances became even worse as Croatia redirected considerable and increasing proportion of its diminished resources to defense at the time it was establishing state institutions.[8]

The civil war in BiH stopped the process at the beginning, which then did not resume until the end of 1997. MPP in BiH did not attract the broad participation of citizens. Ethnic controlled areas prevented minorities to participate in the process and use vouchers through PIFs. The low public confidence in the process, a high level of corruption among the main players, and the lack of interest by foreigners, were some of the characteristics of voucher privatization in BiH (Prašnikar *et al.* 2001).

Regarding drastic economic decline during transition and privatization in CEE, Stiglitz (2002) blamed exposure to, or imposition of globalization and liberalization. Without attempting to look at *pro et contra* arguments about this notice, it is worth to emphasize that the opposite has caused the same in former Yugoslavia – isolation, that constrained and slowed down the progress of privatization. The very slow progress in Serbia and Montenegro during the 1990s was caused by: i) the United Nations'

[8] At the height of war, the country with some 4 million inhabitants (excluding Serbs against whom it was fighting) had an army of 150,000 soldiers. In 1995 the share of military expenditure to GDP reached 9.4% (Bićanić, 2002).

sanctions; ii) the lack of foreign capital; iii) the sharp decline in economic activity; iv) poor experience and constraints to implement and control privatization; iv) the low level of information and non-transparent procedures (Vukotić, 2001). Despite that the war ended in 1995, Croatia was still a semi-isolated country by the end of the decade and that affected privatization progress and limited the chances of foreign investors to get involved in the process.

Under the impact of external factors on successor states such as the bloody collapse of former Yugoslavia, economic decline would have happened even without privatization. But what has impacted privatization as a process and enterprise performance afterwards, was the collapse of business networks and clusters not only with foreign countries, but also among the Yugoslav successor states. Such a disruption between federal units that became independent states was more costly for enterprises than say, republics of former Soviet Union, because, Yugoslav SOEs were organized on the system of associated labor and had their supply network and subsidiaries spread across federal units. Let alone war impact, privatization required reorganization and in peaceful time many of previous clusters could not be re-established as some enterprises in other successor states have gone bankrupt and/or reallocated resources dictated by the market forces.

4.2 Internal environment: behavior of institutions and enterprises

It is obvious that managers and employees were the biggest beneficiaries of privatization where the sale of shares to insiders at favorable terms and conditions was used. However, the schemes of allocation of social ownership presented in section 3.1 and summarized in appendix, often resulted in different ownership proportions after privatization. In Slovenia employees ended up with the same ownership share of 40% as allocated (Simoneti and Gregorić, 2004). In Macedonia they got a much better deal than in Croatia and ended up with a majority ownership stakes in slightly higher proportion of total number of SOEs than in Slovenia.

Privatization after re-nationalization in Croatia was criticized for unfairness. Favoring narrower interests of the well-connected government officials and politicians of the ruling party that remained in power for nearly 10 years, led to social ownership ending up largely in politicians and state funds as shareholders. The political capitalism in Croatia that emerged from this type of privatization became a cause of public dissatisfaction (Županov, 1997).[9] Bičanić (2002) described this resulting group of political shareholders as crony capitalism. Something similar has happened in Serbia. After abolishing autonomous privatization the newly appointed directors of SOEs embarked on running enterprises fraudulently (Palairet, 2001). State officials became rich through corruption and economic crimes within nights at the expense of workers and the population (Karadjis, 2004). The public had suspicions that many of privatized SOEs through direct sale from 2001 onwards, ended in the hands of those who were believed to have earned their money during the 1990s through corruption and fraud (Maksimović, 2003). High level of corruption and politicization was the result of privatization in BiH, too.

Inefficiencies and inexperience of institutions and policy makers to carry out privatization in a consistent way undermined the results significantly. The decision-makers were able to make plans, thought they had the needed capacities and expertise to complete the process as planned, but did not pay attention to, if it goes wrong, then what should be undertaken? This rather has happened in a somehow *ad hoc* response to the problems that delayed completion of the process and made it more costly. It is actually happening in Kosova despite a good opportunity to learn very useful lessons.

[9] A public opinion poll in 1998 assessing the level of satisfaction with the privatization results showed that around 46.8% of the public were completely dissatisfied, 21.6% partially dissatisfied, 13.3% could not assess the results, 16.9% partially satisfied, and only 1.4% completely satisfied (Čučković, 1999).

5. Summary and conclusions

In self-management socialism, two crucial aspects lacked sufficient and careful attention: i) social ownership and social property; and ii) the operation and behavior of SOEs in reality. Depending on the extent of their insights being blurry, they had implications in ownership claims against SOEs by various players. We summarize this by maintaining that, although things appear to work good but inside have got some defects not properly observed and dealt with in time, then when it comes to the problems accumulated, attempts to further reform the system (as former Yugoslavia did in mid 1980s) are likely to be without perspective. That is why the final role of the state in this respect – to organize privatization and make property rights clearly defined, came also to be an uneasy challenge. The longer experience with market-based elements being perceived as an advantage in establishing a full market economy, did not prove that the privatization of social ownership was easier than state ownership. The blame for this difficulty has been laid mainly on the specific features of social ownership and the problem of resolving the national question. Thus the prospects of privatization in former Yugoslavia soon withered away with the emergence of political crisis, the outbreak of the civil war and the disintegration of the country.

The experience of privatization involves similarities as well as differences depending on approaches, methods used, and the circumstances in which the process evolved. The fact that the main method in the first privatization laws of successor states remained the sale of enterprise assets to insiders at favorable terms, indicates that the Marković Law left a significant impact which lasted long after the disintegration of former Yugoslavia, including some consequences of unfinished privatizations and their dilemma. But there were deviations from that course in many cases, e.g., when social ownership was renationalized before privatization (in Croatia, Serbia, and BiH), some SOEs were privatized through other methods (in Macedonia), or when a part was distributed to the population (MPP in Slovenia, Montenegro, and BiH). Privatization after re-nationalization in Croatia and Serbia generated a winners group made up of people well-connected to the government or the party in power. In both countries, privatization was associated with corruption. Although autonomous privatization had many shortcomings, its rescinding in Serbia was a worse option than continuing with it. This experience shows that in the course of transition the quicker privatization is carried out the better, provided that the speed is cautious about the problems in corporate governance that may arise later.

Privatization was undertaken to improve enterprise efficiency but fell far short of this aim. No doubt that there has always been a gap between the goals proclaimed and results achieved in privatization elsewhere. It does not mean that the plans were not good or they were overambitious. The main reason was the limited institutional capacities and management skills necessary to carry out the process. None of the countries had any experience of privatization and when it ran into difficulties, there was no experience or a ready diagnosis to deal with the problem effectively. Instead, other models were embarked on to cope with the problem and complete the process. This, indeed, accelerated and brought the process to an end though it left a number of implications behind.

When we compare the management of SOEs in the past and after their privatization to employees or EOFs, we may conclude that it is similar at large. But in self-management, employees were not the only one managing SOEs; they had the support and influence of other players outside who acted as a sort of umbrella for employees. After privatization, the role of those players disappeared and employees being accustomed with that umbrella for a long time, found it difficult to do everything on their own. In cases when they came in joint ownership with other shareholders such as those who used to exercise their role in managing SOEs, there were difficulties because, in spite of being together again, their relations changed and different objectives emerged. Far more unsatisfactory performance came about when ownership was distributed to society (i.e. citizens) through MPP resulting in diffused ownership that weakened the mechanisms of corporate governance and prospects for restructuring. Foreign investment to support enterprise restructuring and improve corporate governance was smaller than expected. Two main factors may explain this: i) the overall political and economic environment; and ii) the large domination of insiders in the privatized companies which discouraged the participation of foreigners.

To sum up, the privatization of social ownership in successor states of former Yugoslavia faced many challenges. Political and institutional environment, in particular the disintegration of former Yugoslav market and the collapse of business networks had a significant impact. Difficulties of each successor state to manage and carry out privatization reflected in unsatisfactory results. Smaller effects of privatization arose also from insufficient transparency during the process. One explanation with respect to the theory of unclear and/or shared ownership rights like in social ownership vis-à-vis its privatization, is that they are likely to produce results under incentive compatibility linked to some ideals of higher levels of broader interests enforced by an apparatus, than individual or group interests within the firms under better piecemeal incentives for some at the expense of some others. To answer the basic question in this paper, did privatization of social ownership matter for economic efficiency, the answer is: not in the short to medium term. This by no means implies was then privatization necessary? Privatization was a must, but the way how it was implemented and managed undermined greater results. This now leads to another question: which ownership does matter more in terms of overall economic efficiency? From historical perspective that depends on how well ownership fits in the economic system and broader environment such as political and institutional stability.

Appendix I: Privatization in successor states of former Yugoslavia: methods, progress, and post-privatization results

	Slovenia	**Croatia**	**Macedonia**	**Serbia**	**Montenegro**	**Bosnia and Herzegovina**	**Kosova**
Total number of SOEs slated for privatization	2,500[a)]	3,619[b)]	1,216[c)]	3,486[d)]	354[e)]	2,591[f)]	558 [g)]
Year and the month the first privatization law was passed	November 1992	April 1991	June 1993	August 1993	January 1992	December 1997 and June 1998	June 2002
Approaches to privatization	Decentralized	Highly centralized	Decentralized	Centralized	Decentralized	Highly decentralized	Highly centralized
Primary method of privatization	Employee buy-outs	Employee buy-outs	Employee buy-outs	Employee buy-outs	Employee buy-outs	MPP	Direct sales (spin-off)
Secondary method of privatization	MPP	MPP	Direct sales	None	MPP	Direct sales	Liquidation
Transfers to the funds	40%[h)]	30%[i)]	15%[j)]	40%[k)]	Up to 60%[l)]	15% (RS)[m)]	None
Discount for insiders	50%[h)]	20%[i)]	30-50%[j)]	20%[k)]	30%[l)]	None	None
Additional discount per each year of employment	None	1%[i)]	1%[j)]	1%[k)]	1%[l)]	None	None
Maximum discount to insiders	50%[h)]	60%[i)]	70%-90%[j)]	60%[k)]	70%[l)]	None	20%[o)]
Repayment period	5 years[h)]	5 years (20 years in the second phase)[i)]	5 years[j)]	5 years[k)]	10 years[l)]	None	None
Limits on sales of internal shares per employee (DM)	None	20,000[i)]	25,000[j)]	20,000-30,000[k)]	18,000[l)]	None	None
Progress with large scale privatization during the 1990s	Significant	Moderate	Moderate	Significant until 1994, retreat and no progress until 2002	Very slow	Very slow or no progress	No progress Slow since 2002
Corporate governance	Moderate	Weak	Poor	Very poor	Very poor	Very poor	n/a
Enterprise restructuring	Moderate	Little	Little	Very little	Very little	Very little or no restructuring	n/a
Private sector share to GDP (2002)[n)]	65%	60%	60%	45%	n/a	45%	n/a
Privatization revenues as a share of GDP (in 2002)[n)]	4.9%	15.8%	n/a	n/a	n/a	2.9%	n/a

Sources:

a) EBRD (1994); b) Čučković (1996); c) Privatization Agency of Macedonia (2002a); d) Lazić and Sekelj (1997); e) Bojović and Vlahović, 2002;
f) Privatization Agency of the Federation of BiH and of Republika Srpska (2003); g) Statistical Yearbook of Yugoslavia (1990)
h) Official Gazette of the Republic of Slovenia, No. 55/92, Articles 22, 23, and 25; i)Official Gazette of the Republic of Croatia, No. 84/92, Articles 25 and 31;
j) Official Gazette of the Republic of Macedonia, No. 38/93, Articles 26 and 28; k) Official Gazette of the Republic of Serbia, No. 48/91, Articles 16 and 17;
l) Official Gazette of the Republic of Montenegro, No. 2/92, Articles 7, 8, 9 and 11; m) Official Gazette of the Republika Srpska No. 24/98, Article 26;
n) EBRD (2002);
o) Not a discount but the share of proceeds from the sale of SOEs going to workers according to provisions of the Regulation No. 2002/2 on the establishment of the Kosova Trust Agency on 13 June 2002 by the Special Representative of the Secretary General (Michael Steiner) was the first serious step in this process. The Regulation was amended on 22 April 2005 by Regulation No. 2005/18;

and author's own compilation.

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