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## REDEFINING PROPERTY RIGHTS WITH SPECIFIC REFERENCE TO SOCIAL OWNERSHIP IN THE SUCCESSOR STATES OF THE FORMER YUGOSLAVIA: DID IT MATTER FOR ECONOMIC EFFICIENCY?

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### **Abstract**

*High economic growth rates after World War II characterized both socialism and capitalism. There were impressive results in the former socialist block, Western Europe, USA, and Japan. Apart from these models based on private and state ownership, the fastest economic growth for some time was recorded in the former Yugoslavia under social ownership. The issue of property rights despite being subject to comparative analyses pointing to more efficiency of one versus another type of property did not matter much in those growth rates.*

*Only in mid 1980s when centralist and self-management socialism languished before making their transition to a market economy, scholars began to recognize property rights as a key to economic efficiency. Much attention was paid to how performance is affected when ownership rights are incomplete (e.g. separation of control and residual rights in social property) and/or more complete (like in private property). This article looks at the redefinition or privatization of social*

*ownership in the successor states of the former Yugoslavia, and identifies the causes of smaller effects than expected of this redefinition.*

“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.”<sup>1</sup>

### **1. Introduction**

The onset of the transition process in the former Yugoslavia coincided with the economic and political disorganization in Central and Eastern Europe (CEE) and the former Soviet Union. It is argued that its scope, speed, and success depended on initial conditions, policies implemented, and the external environment.<sup>2</sup> Having

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<sup>1</sup> Adam Smith, *An Inquiry into the Nature And Causes of the Wealth of Nations*, Book V, Chapter II, Part I. (Edinburgh, [1776]), ed. Adam Smith Institute (London, 2001), available at:

[www.adamsmith.org/smith/won-b5-c2-pt-1.htm](http://www.adamsmith.org/smith/won-b5-c2-pt-1.htm)

<sup>2</sup> See among others, Svetozar Pejovich, “Institutions, Nationalism and the Transition Process in Eastern Europe,” in *Liberalism and the Economic Order*, eds. Frankel P.

realized that the economic transition through privatization appeared as inevitable, the question was how to find methods of giving enterprises away from the state into a more efficient use in private hands. On the eve of that transformation in CEE, few managed to comprehensively assess how difficult the road ahead was going to be. The doubt expressed was that the economic reforms and reallocation of resources that were about to occur, perhaps would produce the required gains in the longer run, whereas during the process and in the short run they may hurt a majority of the citizens, which in turn could resist the reforms initiated and undermine democracy. The governments too, were to some extent aware that gains will be preceded by some inevitable pain.<sup>3</sup> That the economic reforms during the early transition incur a high social cost, has proved not to be an accident, but those

who mostly benefited in short run were the ones that initiated them. The winners were a small concentrated group who gained at the expense of the rest of the population, the losers. In the longer run, the gains appear to be more dispersed depending on the barriers of the winners' ability to block the gains of the others.<sup>4</sup>

Among many interdependent factors, initial conditions played a significant role in the outcomes of the transition reforms and privatization. For example, the initial conditions of the Yugoslav transition path 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. Such a transition during the 1990s according to Jan Svejnar was more related to turbulent political events and civil wars than economic reforms.<sup>5</sup>

Political disorganization and distorted environment has 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 on the restructuring process as a result

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Ellen, Fred Miller, and Jeffrey Paul (Cambridge: Cambridge University Press, 1993), 65-78; Michael Ellman, "Transformation, Depression, and Economics: Some Lessons," *Journal of Comparative Economics* 19 (1: 1994): 1-21; Leszek Balcerowicz, "The Interplay Between Economic and Political Transition," in *Lessons from the Economic Transition: Central and Eastern Europe in the 1990s*, ed. Salvatore Zecchini (Norwell: Kluwer Academic Publishers, 1997), 153-167.

<sup>3</sup> Such an early assessment was provided by Adam Przeworski, *Democracy and the Market. Political and Economic Reforms in Eastern Europe and Latin America* (Cambridge: Cambridge University Press, 1991), 136.

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<sup>4</sup> Joel S. Hellmann, "Winners Take All: The Politics of Partial Reform in Postcommunist Transitions," *World Politics* 50 (1998).

<sup>5</sup> Jan Svejnar, "Transition Economies: Performance and Challenges," *Journal of Economic Perspectives* 16 (1:2002): 3-28.

of dramatic economic decline.<sup>6</sup> While this refers to the early transition period, it should be remembered that privatization has promised more than actually achieved even in a stable country when it was implemented for the first time in large scale – the United Kingdom (UK).<sup>7</sup>

To come out with an assessment on the impact of privatization in the successor states of the former Yugoslavia, the article 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 ownership. Similarly, the necessity of privatizing social ownership and the methods of privatization implemented 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 sub-sections. Section five draws conclusions.

## ***2. Different types of property rights as incentives for economic efficiency***

In broader terms, property can be understood as a set or system of rules regulating the right to, and control of, material resources.<sup>8</sup> In this way, the term property rights is used in economics to denote the essence of the property. The enforcement of property rights is made depending on political system of a country and the economic system it wanted to establish through that enforcement. 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 that was unique to former Yugoslavia, defined the means

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<sup>6</sup> Gérard Roland, “The Role of Political Constraints in Transition Strategies”, *Economics of Transition* 2 (1: 1994): 27-41.

<sup>7</sup> This may not be a relevant comparison to the privatization in CEE for two reasons: first, the UK (and the West) privatized publicly-owned enterprises as opposed to privatization of commercial enterprises in CEE; and second, privatizations in the public sector in Western countries may be referred to a reform within the existing system. In spite of this, there is one important thing to remember. Privatization in the UK has had smaller effects on overall economic performance and efficiency than the theory of property rights had established. The winners in the short run were the companies that came more efficient from their better position on the eve of privatization, against a larger group of losers with unemployment peaking 11 percent in 1986. For a thorough investigation of the British privatization experience from 1979 to 1997, see Massimo Florio, *The Great Divestiture: Evaluating the Welfare Impact of the British Privatization 1979 – 1997* (Cambridge: MIT Press, 2004).

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<sup>8</sup> Jeremy Waldron, *The Right to Private Property* (Oxford: Clarendon Press, 1991), 31.

of production as socially owned.<sup>9</sup> 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

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<sup>9</sup> 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 were 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 Benjamin N. Ward, "The Firm in Illyria: Market Syndicalism," *American Economic Review* 48 (1958): 556-589. During the 1970s the interest grew among some economists from CEE such as Jaroslav Vanek, *The General Theory of Labor-Managed Market Economies* (New York: Cornell University Press, 1970); Jan Vanek, *The Economics of Workers' Management: A Yugoslav Case Study* (London: George Allen & Unwin Ltd., 1972); Jaroslav Vanek, *The Labor-Managed Economy: Essays* (New York: Cornell University Press, 1977); and Saul Estrin, *Self-management: Economic Theory and Yugoslav Practice* (Cambridge: Cambridge University Press, 1983). Branko Horvat, *The Political Economy of Socialism: A Marxist Social Theory* (Oxford: Martin Robertson, 1982) and Aleksandar Bajt, *Samoupravni Oblik Društvene Svojine* (Self-management Type of Social Ownership) (Zagreb: Globus, 1988) were few exceptions among Yugoslav economists to have contributed to the theory of Workers' Management.

differences with state and private ownership.

Social property and social ownership is a relatively new category of property rights, unique to the former Yugoslavia, and the analysis of it is relatively new as well. Since it was introduced in the early 1950s, no significant attention was paid to its analysis until the study by Eirik Furubotn and Svetozar Pejovich who believed that one could not present a satisfactory theory of the Yugoslav firm without an explicit reference to its property rights 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.<sup>10</sup> While under capitalism the market signals to producers which goods should be produced, under self-management producers determined what products consumers could buy.

A vast theoretical literature has evolved on comparative performance of different property rights. An article of 1937 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

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<sup>10</sup> Eirik Furubotn and Svetozar Pejovich, "Property Rights and the Behaviour of the Firm in a Socialist State: The Example of Yugoslavia," *Zeitschrift für Nationalökonomie* 30 (1970): 430-454.

the state.<sup>11</sup> Interactions between allocation and use involve a relationship between master and servant or principal and agent of property. The principal (the state or society) may engage the agent (in the former Yugoslavia they were the workers) to perform some actions on behalf of the principal, including full decision making authority delegated to the agent.<sup>12</sup>

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.<sup>13</sup> 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 Benjamin N. Ward in 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, citing 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 patterns will be distorted in comparison with capitalist firms due to incentives of the working collective to maximize individual incomes.<sup>14</sup> Such assumptions about the behavior of SOEs were based on competitive self-management for which Jaroslav Vanek 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.<sup>15</sup>

For a society, it is more important 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

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<sup>11</sup> Ronald H. Coase, "The Nature of the Firm," *Economica* 4 (1937): 386-405.

<sup>12</sup> Michael C. Jensen and William H. Meckling, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure," *Journal of Financial Economics* 3 (4:1976): 305-360.

<sup>13</sup> Andrei Shleifer, "State Versus Private Ownership," *Journal of Economic Perspectives* 12 (4:1988): 133-150.

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<sup>14</sup> Benjamin N. Ward, "The Firm in Illyria: Market Syndicalism", *American Economic Review* 48 (1958): 556-589.

<sup>15</sup> Jaroslav Vanek, *The General Theory of Labor-Managed Market Economies* (New York: Cornell University Press, 1970).

rights clearly.<sup>16</sup> In self-management socialism, ownership rights were politically imposed and the residual rights were used by the central authority to monitor managers. The managers' limited incentive to monitor and condemn workers in case of abuse or theft is viewed as an adverse outcome because s/he is elected by the workers who can dismiss him/her.<sup>17</sup> 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.<sup>18</sup> 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 a fully and competitive LME, which various

authors used as an example to establish standard theories.

Due to unclear property rights, resource allocation under social ownership was considered sub-optimal. Regardless the theory, self-management in aggregate terms fared better than capitalism and centralist socialism. At the beginning of its introduction it was lucky to enjoy significant aid from Western countries.<sup>19</sup> 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 1 below summarizes the results of self-management from 1953 to 1965, the period which can be considered as its golden age recording the fastest economic growth in the world.

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<sup>16</sup> Armen A. Alchian and Harold Demsetz, "The Property Rights Paradigm", *The Journal of Economic History* 33 (1: 1973): 16-27.

<sup>17</sup> Michael C. Jensen and William H. Meckling, "Rights and Production Functions: An Application to Labor-Managed Firms and Codetermination", *Journal of Business* 52 (4:1979): 469-506.

<sup>18</sup> Harold Lydall, *Yugoslav Socialism: Theory and Practice* (Oxford: Clarendon Press, 1984).

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<sup>19</sup> Western aid included capital transfers from the USA, Britain and France amounting to \$425.8 million delivered from 1951 to 1954. See David A. Dyker, *Yugoslavia: Socialism, Development and Debt* (London: Routledge, 1990).

**Table 1: Annual rates of growth in different economic systems (from 1953 to 1965)**

<b>Systems</b> <b>Indicators</b>	Self-management socialism	Centralist (state) socialism <sup>a)</sup>	Capitalism <sup>b)</sup>
Output	11.8 (10.3) <sup>c)</sup>	8.7 (5.9) <sup>d)</sup>	7.1 (3.7) <sup>f)</sup>
Capital	7.5 (7.8) <sup>c)</sup>	8.1 (10.0) <sup>d)</sup>	6.3 (3.2) <sup>f)</sup>
Labor	6.7 (4.4) <sup>c)</sup>	4.1 (4.8) <sup>d)</sup>	2.5 (1.5) <sup>f)</sup>
Combined factor productivity	4.7 (4.4) <sup>c)</sup>	3.0 (-1.0) <sup>d)</sup>	3.3 (1.5) <sup>f)</sup>
Basic welfare differences	+5.0	+4.5	-7.0
Gini coefficient	0.25	0.21-0.26 <sup>e)</sup>	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: Branko Horvat, *The Political Economy of Socialism: A Marxist Social Theory* (Oxford: Martin Robertson, 1982): 203-205, tables 7, 8, and 9, *op. cit.*

The Yugoslav self-management was more efficient with output, labor, and combined factor productivity than capitalist and centrally planned economies during the same as well as different comparative periods. One should take the sampling of selective capitalist countries for comparison with a caution. Ireland and Norway of that time (when jokes from the English lampooned the former, and from the Swedes about the latter have been more popular), were not as they are today in the rank of the most developed countries in the world.

Growth rates in self-management socialism should be also attributed to the initial low base. Nevertheless, the fact that the former Yugoslavia performed better than any other socialist country, is undisputed. Centralist socialism was able to mobilize more capital at a lower level of combined factor productivity. Capitalism had higher productivity than centralist socialism but left other resources, especially labor, at the lowest level of use. It was so in capitalism where capital hires labor while in socialism (centralist or self-managed) the opposite was true. High growth rates in the former Yugoslavia continued even after 1965, so for a period of more than two decades (from 1952 to 1973) their annual average growth in percent terms was: 10.6 for



output, 5.3 for labor, and 9.1 for capital.<sup>20</sup>

The greatest achievement of self-management socialism was that it had quickly transformed the former Yugoslavia from an obsolete and largely agricultural country to an industrialized and more developed economy and society. On the other hand, through the defects in operation, the system was vulnerable to a number of failures. When Saul Estrin and Will Bartlett 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 underdevelopment, market imperfections, and government regulation, though the growth performance appeared impressive by international comparisons.<sup>21</sup> It is worth mentioning that the development gap between federal units that made the country divided as the developed North (Slovenia, Croatia, Vojvodina) and the underdeveloped South (Bosnia and Herzegovina – BiH, Macedonia, Montenegro, and Kosovo). Serbia was at an average level of development of the federation. This division was of

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<sup>20</sup> Saul Estrin, *Self-management: Economic Theory and Yugoslav Practice* (Cambridge: Cambridge University Press, 1983).

<sup>21</sup> Saul Estrin and Will Bartlett, "The Effects of Enterprise Self-management in Yugoslavia: An Empirical Evidence" in *Participatory and Self-managed Firm*, eds. Derek C. Jones and Jan Svejnar (Massachusetts Toronto: Lexington Books, 1982): 83-107.

particular concern due to multiethnic composition of the country. The legacy of Yugoslav socialism sought as a top priority to narrow the inherited regional disparities in economic development through the establishment of the Federal Fund for Crediting Economic Development of Less Developed Regions in 1963. Regional development policy narrowed the gap in development in Montenegro and Macedonia, but not in Bosnia and Herzegovina, and Kosovo where the gap actually increased. Therefore, the figures in Table 1 on basic welfare differences begun to decline and Gini coefficient increased over the period from 1965 to 1990. As measured by incomes per capita, this gap between the most developed Slovenia and the least developed Kosovo increased from 1:4 in 1953 to 1:8 by 1990.<sup>22</sup>

In any case, for nearly four decades self-management socialism as the "third way" was the most interesting economic system in the world, from which a lot of things may be learned to generate ideas and concepts about different economic systems and their evolution. The Russian economist and Russia's former acting Prime Minister, Yegor Gaidar, upon visiting the former Yugoslavia, would later describe the system of self-management socialism and his personal experience as follows:

"And here [in Yugoslavia] I discover Marxism in its original

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<sup>22</sup> Diana Pleština, *Regional Development in Communist Yugoslavia: Successes, Failure and Consequences* (San Francisco: Westview Press, Boulder, 1992).

form...I was lucky that I happened to be where I was, because Yugoslavia was the testing ground for worker control and market socialism. As I tried to sort out the ups and downs of the economic reform, I realized how hopelessly my own knowledge of economics was.<sup>23</sup>

Former Yugoslavia initiated and was one of the three founders of the Non-Aligned Movement established in 1955 that became the third influential block in the world and remained so until the end of the Cold War. At home, the Titoist ideology sought the doctrine of *brotherhood and unity* between the nations and nationalities as a political stance of appeasement to keep the country together. In the late 1980s, this charade proved impossible and evolved into a bloody civil war.

### ***3. 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 leading to different objectives, incentives and constraints. 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 want; ii) involvement of trade unions to lobby for higher wages for the workers; iii) employment of a greater number of employees than actually may be needed; iv) lower quality of management and innovation due to limitations by the principal and absence of bankruptcy threat; and v) less product differentiation and consumer orientation.<sup>24</sup>

Following theoretical foundations that private ownership does matter for efficiency, privatization was generally supported. With this expectation, the UK embarked on a large scale privatization of public ownership. The British privatization program might have appeared as inevitable to respond to the ongoing decline in efficiency of public corporations, though it was not a carefully planned and controlled program.<sup>25</sup> Privatization in CEE arose from similar reasons as in the UK. There were objections against centralist economy and state ownership but privatization was not considered as long

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<sup>23</sup> Yegor Gaidar, *Days of Defeat and Victory* (translated by Jane Ann Miller), (Seattle: University of Washington Press, 1999), 14.

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<sup>24</sup> Stephen Martin and David Parker, *The Impact of Privatisation: Ownership and Corporate Performance in the UK* (London: Routledge, 1997), 5.

<sup>25</sup> Ahmad Galal, Leroy Jones, Pankaj Tandon and Ingo Vogelsang, *Welfare Consequences of Selling Public Enterprises: An Empirical Analysis* (published for the World Bank by Oxford University Press, 1994).

as the former Soviet Union was able to crush the 1956 Hungarian revolution and 1968 Prague Spring in former Czechoslovakia. Those events, if prevailed, could have given rise to an alternative way of socialism such as self-management, or in a more radical scenario, the privatization of state ownership. Transition and privatization eventually became inevitable by the end of 1980s, following a degeneration of communism from the inside and the decay of socialist economies in CEE.<sup>26</sup>

It was impossible to maintain state ownership once the communist parties or the principals that monitored enterprises collapsed and pluralist political parties emerged. From thereon the privatization process in CEE preceded by a disorganization of the system that imposed the need for reallocation of resources into a property rights system required by a market economy. More specifically, this was an international promoted requirement within the well-known reform package – the so-called Washington Consensus. For Olivier Blanchard, 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

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<sup>26</sup> Yegor Gaidar, *State and Evolution: Russia's Search for a Free Market* (translated by Jane Ann Miller) (Seattle: University of Washington Press, 2003), 59-62.

obvious.<sup>27</sup> Gérard Roland reminded that different ownership *per se* has not played any important role in economic performance from the perspective of general equilibrium theory. He argued that different ownership became central in economics once the theory of incomplete contracts was introduced, which saw their relevance during privatization in transition economies in terms of control rights and residual rights.<sup>28</sup>

#### ***4. The necessity of redefining social ownership in the former Yugoslavia and her successor states***

Since its introduction in the early 1950s, the self-management system remained essentially unchanged until the initiation of economic transition in the late 1980s, although it underwent four important changes.<sup>29</sup> The 1974

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<sup>27</sup> Olivier Blanchard, *The Economics of Post-Communist Transition* (Oxford: Clarendon Press, 1997).

<sup>28</sup> Gérard Roland, *Transition and Economics: Politics, Markets, and Firms* (Cambridge: MIT Press, 2000).

<sup>29</sup> 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 decentralised; (iii) the period of self-managed market socialism (1965-1974) when market mechanisms were utilised in as many areas as possible, focusing on the activities of the SOEs operating in the market; and (iv) the system of 'free associated labour' (1974-1988), or

reform of *contractual socialism* resulted in an increase in the proportion of enterprise revenues that were under the influence and control of state players. SOEs were under constant pressure by the authorities to employ more workers.<sup>30</sup> Under diminished autonomy of the workers, outside players used their influence through residual rights and violated the main principle of self-management, which is earning according to work, by redistributing revenues from better performing to under performing enterprises.<sup>31</sup> The implication of that redistribution as a later analysis would indicate, was that whenever the government policies aimed at increasing the wealth of the society they could result in diminishing the enterprise efficiency over time.<sup>32</sup>

The residual rights of the state or government bodies over social ownership should also be seen from another point of view. 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 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. The challenge is that the process of redefining social ownership will be followed by claims from agents associated with social ownership (especially workers and managers), whose stake is not known. The workers believed that they ran SOEs, financed the investment expenditure, contributed to development and growth of SOE 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). This formed the basis of ownership claims by the state or the funding organization. In cases the performance of SOEs was very poor, the state assisted them by

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'contractual socialism.' See Saul Estrin and Tea Petrin, "Patterns of Entry, Exit and Merger in Yugoslavia," in *Entry and Market Contestability: An International Comparison*, eds. Paul A. Geroski and Joachim Schwalbach (Oxford: Basil Blackwell, 1991): 204-220.

<sup>30</sup> Ljubomir R. Madžar, "The Illyrian Firm: An Alternative View", *Economic Analysis and Workers Management* 4 (20:1986): 401-410.

<sup>31</sup> Milan Vodopivec, "Determination of Earnings in Yugoslav Firms: Can it be Squared with Labor Management?", *Economic Development and Cultural Change* 41 (3:1993): 623-632.

<sup>32</sup> Daniel L. Freisner and Robert Rosenman, "A Dynamic Property Rights Theory of the Firm", *International Journal of the Economics and Business* 9 (3:2002): 311-333.

subsidies or rescued them from bankruptcy by writing off their debts, so SOEs in former Yugoslavia enjoyed soft budget constraints like state enterprises in CEE.

During the 1980s the Yugoslav economy was in deep crisis facing hyperinflation, trade deficit, foreign debt, unemployment and inefficiencies at the micro level. The policies aimed 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.<sup>33</sup> They seemed unlikely to produce substantial changes without changing the property rights regime. It was decided to do so by the end of 1989 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, 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; a discount of 30% to buy internal shares, 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.

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<sup>33</sup> Janez Prašnikar and Vesna Prašnikar, "The Yugoslav Self-managed Firm in Historical Perspective," *Economic and Industrial Democracy* 7 (1986): 167-187.

Each worker could buy shares at nominal value up to 3 times his annual personal incomes. The shares were to be paid for within 10 years once the company was registered under a different ownership form.<sup>34</sup> The implementation of this privatization program was short lived as in 1991 inter-ethnic conflicts began to give the final stroke to political and economic organization of the former Yugoslavia, and privatization of social ownership remained a challenge for newly established successor states.

#### ***4.1 Methods of privatization and implementation of the process: progress, pitfalls and setbacks***

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. Present and former employees in Croatia and Serbia were entitled to buy shares at a basic discount of 20% plus 1% for each year of employment, to be paid in installments over a period of 5 years. In Montenegro, favorable terms and

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<sup>34</sup> *Službeni List SFRJ, Zakon o Prometu i Raspolaganju Društvenim Kapitalom*, (Official Gazette of SFRJ, The Law on Circulation and Disposal of Social Capital), no. 84/89, 46/90, Beograd.

conditions to insiders were exactly the same as in the Marković Law.

Provisions of the Slovenian Law on Privatization allocated social ownership to workers and society through the privatization scheme involving: i) the transfer of 40% of the enterprises' shares to the three funds (20% to the Development Fund, 10% to the Pension Fund, 10% to the Restitution Fund); ii) 20% of shares were allocated to employees in exchange for ownership certificates or vouchers; iii) 20% was left at the discretion of the company to be sold to current employees, former employees, and retired workers at a discount of 50%; and iv) the remaining 20% was allocated for mass privatization program (MPP) or free distribution of shares to Slovenian citizens in exchange for ownership certificates.

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; (ii) 15% of shares were to be transferred to the Pension Fund; and (iii) 55% of shares were left for sale to domestic and foreign buyers under equal conditions, using a variety of sales 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. Both programs envisaged mass privatization by

distribution of ownership certificates to the citizens over 18 years of age in the Federation of BiH, and vouchers to all citizens in Republika Srpska. 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 her own law on privatization and embark on the process was Kosovo. Privatization of SOEs did not follow the pattern observed in other Yugoslav successor states, probably because privatization became a specifically shaped problem. The methods of privatization as determined by the regulation passed in June 2002 included: the establishment of subsidiary companies of SOEs (spin-offs) and, voluntary liquidation. Instead of any discount, the employees were entitled to 20% of the proceeds from the sale of SOEs. It was meant to be a compensation for the loss of their self-management rights after privatization, but strangely it could not and still cannot be included as a discount in case the employees buy the SOE. A summary with relevant details of all first privatization laws discussed so far in this section is provided in the Appendix to this paper.

To sum up the legal frameworks on privatization, the characteristics of social ownership related the priority of appropriation to those who were in charge of managing the SOEs. Milica Uvalić identified the appropriation of

those rights or privatization of social ownership synonymously with “converting self-management rights into property rights.”<sup>35</sup> The managing role of workers has been described by Karim Medjad as “a source of customary ownership rights.”<sup>36</sup> There were exceptions or restrictions to these ownership rights of employees such as, privatization through MPP and direct sales either as primary or secondary method.

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 Maks Tajnikar put it, “already

market-oriented.”<sup>37</sup> Presumably, the longer experience with market-based elements was seen as an advantage in establishing a full market economy.<sup>38</sup>

Privatization under the Marković Law had started in almost every federal unit but was halted by the outbreak of civil wars and the disintegration of the country. In Slovenia, around 400 SOEs embarked on autonomous privatization by selling shares to insiders.<sup>39</sup> 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 initiated 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) meant that 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

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<sup>35</sup> Milica Uvalić, “Privatization in the Yugoslav Successor States: Converting Self-management into Property Rights,” in *Privatization Surprises in Central and Eastern Europe*, eds. Milica Uvalić and Daniel Whitehead-Voughan (Cheltenham: Edward Elgar, 1997), 267-302.

<sup>36</sup> Karim Medjad, “Workers Control as a Source of Customary Ownership Rights: Evidence from the Privatization in Former Yugoslav Republics,” (paper presented at the Eleventh Conference of the International Association for the Economics of Participation, Catholic University of Leuven, Brussels, July 4-6, 2002), available at:

<http://ocean.st.usm.edu/~w300388/brussels/MEDJ.pdf>

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<sup>37</sup> Maks Tajnikar, “From a Labour-Managed Economy to a Market Economy: A Contribution to Economic Transformation,” *Atlantic Economic Journal* 28 (2000): 93-101.

<sup>38</sup> Milica Uvalić, *Investment and Property Rights in Yugoslavia: The Long Transition to a Market Economy* (Cambridge: Cambridge University Press, 1992).

<sup>39</sup> Uroš Korže, “Decentralized Privatization Strategy: Pitfalls and Benefits – Slovenia,” in *Privatization in Central and Eastern Europe 1991*, eds. Marko Simoneti and Andreja Böhm (Ljubljana: CEEP, 1992), 2 (140-153).

as a substitute for the social sector.<sup>40</sup> Privatization continued in phases that could not achieve anticipated objectives. After a decade of transition, privatization in Croatia remained incomplete. Among the reasons for slower privatization, was the fact that CPF did not have sufficient operational and professional capacities for the most important sectors of the economy, namely shipbuilding and tourism.<sup>41</sup> As of 2005 privatization in Croatia 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. Until the Agency for Privatization was consolidated, over 400 enterprises (1/3 of the total number of SOEs scheduled for privatization) had been transformed under the Marković Law.<sup>42</sup> Differently from

Slovenia and Croatia, those transformations and privatizations were recognized. With the remaining SOEs privatized under the new law, the process was declared 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. Just in 1994 Serbia saw the biggest retreat in privatization. Privatization was abolished in 1,556 or 87% of privatized enterprises after reviewing the process by the Agency for Privatization.<sup>43</sup> Revaluation due to hyperinflation of 1993 had blocked the process and led to the direct state control in enterprises where privatization was abolished and those to be privatized.

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.<sup>44</sup> Obviously, such a slow

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<sup>40</sup> Nevenka Čučković, "Privatization, Restructuring and Institutional Change: How Far has Croatia Gone?," in *Privatization in Post-Communist Countries*, eds. Barbara Blaszczyk and Richard Woodward (Warsaw: Center for Social and Economic Research, 1996), 1 (53-74).

<sup>41</sup> Nevenka Čučković, "The Privatisation Process and Its Consequences for the Distribution of Welfare: The Case of Croatia," *MOCT-MOST* 5 (1995): 75-90; Damir Ostović, "Privatization in Croatia" in *Privatization in Central & Eastern Europe 1995*, ed. Andreja Böhm (Ljubljana: CEEP, 1996), 6 (106-137).

<sup>42</sup> European Bank for Reconstruction and Development – EBRD, *Transition Report* 239

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1995: *Investment and Enterprise Development* (London: EBRD, 1995).

<sup>43</sup> Mladen Lazić and Laslo Sekelj, "Privatisation in Yugoslavia (Serbia and Montenegro)," *Europe-Asia Studies* 49 (6:1997), 1057-1070.

<sup>44</sup> Institute for Strategic Studies and Prognosis - ISSP, *Montenegro Economic Trends* (Podgorica: ISSP, 2000), available at:



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 under the Marković Law from the end of 1989 to 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.<sup>45</sup> The newly elected authorities soon decided to review and halt the process with the reason that the companies were being sold cheaply. The halt followed re-nationalization of social property during the war (from 1992 to 1995) but the share of capital paid by employees was recognized and did not become subject to privatization since then.<sup>46</sup> In

Kosovo, 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 yet been recognized. 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 Kosovo Trust Agency or the institution in charge to carry out the privatization planned to complete the process by mid-2005, though nearly two years after that deadline it has fully privatized only half of over 500 SOEs, and that with enormous difficulties and controversies. Privatization in Kosovo proved to be the biggest challenge among CEE countries for the following reasons: i) Kosovo's undefined political status; ii) consequences of emergency measures introduced by Serbia during the 1990s and Serbia's attempts to legalize ownership claims made during that time; iii) too many stakeholders involved in managing the process (international administration, Kosovo's institutions, and Serbia); iv) limited management capacities and non-transparency.<sup>47</sup>

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<http://www.balkannetwork.org/info/Monet11.pdf>

<sup>45</sup> Dragoljub Stojanov, "BIH Privatization and Workers Participation: the Case Study of 'Agrokomerc,' Company," (paper presented at the Eleventh Conference of the International Association for the Economics of Participation, Catholic University of Leuven, Brussels, July 4-6, 2002), available at:

<http://ocean.st.usm.edu/%7Eew300388/brussels/stoj.pdf>

<sup>46</sup> Vesna Bojičić-Dželilović, Fikret Caušević and Rajko Tomaš, "Bosnia and Herzegovina – Understanding Reform," (Global Development Network Southeast Europe and the Vienna Institute for International Economic Studies, Vienna, June 2004), available at:

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[www.wiiw.ac.at/balkan/files/GDN\\_UnderstandingReform\\_BosniaHerzegovina.pdf](http://www.wiiw.ac.at/balkan/files/GDN_UnderstandingReform_BosniaHerzegovina.pdf)

<sup>47</sup> Isa Mulaj, "Delayed Privatization in Kosovo: Causes, Consequences and Implications in the Ongoing Process," in *Path-dependent Development in the Western Balkans: The Impact of Privatization*, ed. Siniša Kušić (Peter Lang: Frankfurt, 2005): 123-163.

#### ***4.2 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, restructuring, and maybe the change in the environment. 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 the market conditions depended on corporate governance and restructuring. The type of corporate governance is largely determined by privatization methods.

In companies where the sale of shares on favorable terms to insiders was used the main method of privatization, it resulted in dispersed ownership among many individual shareholders in Employee-owned Firms (EOFs). These group companies have their management largely similar to the past or pre-privatization period. The central decision-making body under self-management – the Workers' Council – has been replaced by the Shareholders' Assembly, now resting on many individual shareholders with the right to 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 the allocation of higher value 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. Consequently, EOFs were forced to undergo defensive restructuring through downsizing of enterprise activities such as, reducing costs by closing down unprofitable activities, job cuts, and getting rid of outdated and non-productive technology, to the extent that enabled them to compete in the short run.<sup>48</sup> 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. An analysis of 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.<sup>49</sup>

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<sup>48</sup> Irene Grosfeld and Gérard Roland, "Defensive and Strategic Restructuring in Central European Enterprises," *Journal of Transforming Economies and Societies* 3 (4:1996): 21-46.

<sup>49</sup> Simoneti, Marko, Andreja Böhm, Marko Rems, Matija Rojec, Jože P. Damijan and

Corporate governance emerged as 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. Many companies in the hands of insiders, unused shares in the portfolio of privatization investment funds, dispersed ownership and the lack of fresh capital for investment neglected enterprise restructuring.<sup>50</sup>

The methods of privatization that favored insiders and the population, left little room for foreign investors to participate. In cases when they participated in privatization of SOEs wholly or partially, corporate governance and enterprise performance was better and more investment oriented. For example, foreign participation in Croatia brought positive changes in corporate governance by filling the gap of well-trained managers and incorporating better organizational practices.<sup>51</sup> 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 main privatization method intending to attract strategic investors.

The answer to the question of privatization performance should be provided in two domains: its impact on national economy and efficiency at micro level. In self-management as already discussed in Section One, aggregate performance was satisfactory despite objections against certain aspects of enterprise behavior. Soft budget constraints, merging loss-making and profitable enterprises explained that aggregate performance. At micro level, there were lazy workers supposed to have been benefiting from those working harder. Given that the workers were decision makers, they found it hard to penalize their colleagues for erosion of the working discipline which was taking place. In practice, this has questioned the theory that self-management enables better evolution of governance as a result of more liberal flow of information than in any other governance system.

After privatization the situation is reversed. Those enterprises that survived competition indeed turned more profitable for existing workers thanks to downsizing and job cuts of

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Boris Majcen, "Secondary Privatisation in Slovenia: Evolution of Ownership Structure and Company Performance Following Mass Privatisation," report no. 46 (Warsaw: Center for Social and Economic Research, 2001).

<sup>50</sup> EBRD, Transition Report 2003: Integration and Regional Cooperation (London, EBRD).

<sup>51</sup> Drago Čengić, "Corporate Governance in Croatia: Present Problems and Measures for

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Possible Evolution of Corporate Governance," (First Meeting of the South Eastern Europe Corporate Governance Roundtable, OECD, Romania, September 20-21, 2001), available at:

[www.oecd.org/dataoecd/37/22/2393207.pdf](http://www.oecd.org/dataoecd/37/22/2393207.pdf)

low productivity workers. Looking at a broader picture of privatization reveals that losses in aggregate terms have outstripped gains at micro level, thus raising the social cost as a result of increase in unemployment. This maybe attributed to the theory related to the winners concentration in a small group. One would question if non-privatization could have been a better choice than privatization to insiders that followed deterioration in enterprise performance? Non-privatization could have had higher costs and this has proven in many empirical studies across CEE. Those studies found greater efficiency in privatized enterprises through different methods than non-privatized ones in terms of corporate governance, restructuring, productivity and incomes.<sup>52</sup> This remark was addressed to the delayed privatization in Serbia, that had SOEs been transformed into EOFs, results could not have been worse.<sup>53</sup>

### ***5. Causes of smaller effects of privatization***

When the use of resources by a certain

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<sup>52</sup> Of course, SOEs in a better position had greater chances of being privatized earlier whereon this sometimes was used as an explanation for post-privatization better performance.

<sup>53</sup> Milica Uvalić, "Privatisation and Corporate Governance in Serbia (FR Yugoslavia)" (Global Development Network for Southeast Europe and the Vienna Institute for International Economic Studies, Vienna, 2001), available at: [www.wiiw.ac.at/balkan/files/Uvalic.pdf](http://www.wiiw.ac.at/balkan/files/Uvalic.pdf)

owner or under a given system of rules of managing property rights appears inefficient, Ronald H. Coase stood for incentives of transferring these rights to someone who will make a better use of them, i.e. achieve greater efficiency.<sup>54</sup> 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 such as social property in the course of 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.<sup>55</sup> But not everything depended on politics; there were also deficiencies within the institutions that carried out the process, in particular after independence of the Yugoslav successor states.

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<sup>54</sup> Ronald H. Coase, "The Problem of Social Cost," *Journal of Law and Economics* 3 (1960): 1-44.

<sup>55</sup> Christopher Bennet, *Yugoslavia's Bloody Collapse: Causes, Course and Consequences* (London: Hurst and Company, 1995).

### ***5.1 External causes: the impact of disintegration of former Yugoslavia and thereafter***

One of the major factors that undermined prospects and results of privatization in the successor states of the former Yugoslavia (except in Slovenia), is the break-up 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 Bosnia and Herzegovina (1992 to 1995) and, finally, the war in Kosovo (1999), resulting in a complete disintegration of the Yugoslav market into republics and regions. These should be remembered as part of the initial conditions.

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.<sup>56</sup> The disadvantageous circumstances became even worse as Croatia redirected considerable and increasing proportion of her diminished resources to defense at the time it was trying to establish state institutions.<sup>57</sup>

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<sup>56</sup> Radimir Buljan, “Industrial Restructuring and its Effect to the Development,” (Proceedings of the Fourth International Conference on Enterprise in Transition, Faculty of Economics, Split, Split-Hvar, May 24-26, 2001): 2386-2403.

<sup>57</sup> At the height of war, the country with some 4 million inhabitants (excluding the

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. Ethnicly controlled areas prevented minorities to participate in the process and use vouchers through privatization investment funds. The low public confidence in the process, a high level of corruption among the main players, and a lack of interest by foreigners, were some of the characteristics of voucher privatization in BiH.<sup>58</sup>

Slow progress in Serbia and Montenegro during the 1990s was caused by: i) the United Nations sanctions against it; ii) the limited market; iii) the sharp decline in economic activity; iv) poor experience and constraints to implement and control privatization; iv) the low level

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Serbs) had an army of 150,000 soldiers. In 1995 the share of military expenditure to GDP reached 9.4%. See Ivo Bićanić, “The Economic Role of the State in Southeast European Economies in Transition” (The Vienna Institute for International Economic Studies, Vienna, 2002), available at: <http://www.wiiw.ac.at/balkan/files/Bicanic.pdf>

<sup>58</sup> Janez Prašnikar, Polona Domadenik, Aleksandra Gregorič, Bostjan Jazbec, and Mojmir Mrak, “Bosnia and Herzegovina” (Country Study Report Prepared for the Global Development Network, 2001), available at:

[www.cergeei.cz/pdf/gdn/grp\\_final\\_bosnia.pdf](http://www.cergeei.cz/pdf/gdn/grp_final_bosnia.pdf)

of information and non-transparent procedures.<sup>59</sup>

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

### ***5.2 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. The schema of allocation of social ownership discussed in Section 3.1 and

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<sup>59</sup> Veselin Vukotić, "Privatization in Montenegro" (Global Development Network for Southeast Europe and the Vienna Institute for International Economic Studies, Vienna, 2001), available at: [www.wiiw.ac.at/balkan/files/Vukotic.pdf](http://www.wiiw.ac.at/balkan/files/Vukotic.pdf).

presented in the Appendix, often resulted in different ownership proportions after privatization. In Slovenia employees ended up with the same ownership share of 40% as allocated.<sup>60</sup> In Macedonia they got a much better deal than in Croatia and ended up with a majority ownership stakes in a slightly higher proportion of total number of SOEs than in Slovenia.

Privatization after re-nationalization in Croatia was criticized for unfairness. Well-connected government officials and politicians of the ruling party in power for nearly 10 years, were the main net winners.<sup>61</sup> The political capitalism in Croatia that emerged from this type of privatization caused public dissatisfaction.<sup>62</sup> The resulting group of

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<sup>60</sup> Marko Simoneti and Aleksandra Gregorić, "Managerial Ownership and Corporate Performance in Slovenian Post-Privatisation Period", *European Journal of Comparative Economics* 1, (2: 2004): 217-241.

<sup>61</sup> A public opinion poll in 1998 assessing the level of satisfaction with the privatisation results showed that around 46.8% of the respondents were completely dissatisfied, 21.6% partially dissatisfied, 13.3% could not assess the results, 16.9% partially satisfied, and only 1.4% completely satisfied. See Nevenka Čučković, "Privatisation in Central and Eastern Europe: Between Intentions and Reality" (Proceedings of the Third International Conference on 'Enterprise in Transition, Faculty of Economics, Split, May 27-29, 1999), 619-635.

<sup>62</sup> Josip Županov, "Tranzicija i politički kapitalizam (Transition and Political

political shareholders was described as “crony capitalism.”<sup>63</sup> Something similar has happened in Serbia. After abolishing autonomous privatization, the state imposed control over enterprises. The newly appointed directors of SOEs, especially of large ones, embarked on running enterprises fraudulently.<sup>64</sup> The public had suspicions that many of privatized SOEs through direct sale from 2001 onwards, ended up in the hands of those who were believed to have earned their money during the 1990s through corruption and fraud.<sup>65</sup> A high level of corruption and politicization was the result of privatization in BiH, too.

Inefficiencies and inexperience of institutions and policy makers for carrying out privatization in a consistent way undermined the results significantly. They were able to make good plans, thought they had the needed capacities to complete the process as planned, but underestimated the challenge. The response to unexpected

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Capitalism)”, *Hrvatska Gospodarska Revija* 12 (1997): 1399-1407.

<sup>63</sup> Bićanić, “The Economic Role of the State”, 9.

<sup>64</sup> Michael Palairt, “The Economic Consequences of Slobodan Milošević”, *Europe-Asia Studies* 53, 6 (2001): 903-919.

<sup>65</sup> Livija Maksimović, “Privatisation in Serbia in Conditions of Economic Stagnation” (Proceedings of the Second International Conference on From Transition to Development: Globalisation and Political Economy of Development in Transition Economies, Faculty of Economics, University of Sarajevo, Sarajevo, October 9-11, 2003), 1 (393-404).

difficulties on the road by *ad hoc* and some ambiguous choices delayed completion of the process and made it more costly. It is actually happening in Kosovo as well in spite of a good opportunity to learn very useful lessons.

## 6. 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 to which their insights were blurry, they had implications in ownership claims against SOEs by various players whose stake was not known. I summarize this by maintaining that, although things appear to work well but inside have got some defects that are 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 lack perspective. This is why the final role of the state in this respect – to organize privatization and make ownership rights clearly defined, became an uneasy challenge. The blame has been laid mainly on the specific features of social ownership that distinguished it from state ownership and the problem of resolving the national question and the democratic environment.

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 the successor states remained the sale of enterprise assets to insiders on favorable terms, indicates that the Marković Law left a significant impact which lasted long after the disintegration of former Yugoslavia. There were deviations from this course anyway, e.g. when social ownership was re-nationalized (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 of social ownership was undertaken to improve efficiency and did so for a selective group, so in aggregate terms the losses outweighed gains. No doubt that there has always been a gap between the goals proclaimed and results achieved in privatization elsewhere. It does not imply that the plans were not good or that they were overambitious. The main reason was the limited institutional capacities and management skills necessary to carry out privatization. None of the countries had any experience in 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 comparing the management of SOEs in the past and after their

privatization to employees or EOFs, it can be concluded that it is similar with slight differences. During self-management, employees were not the only ones 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 as it was disappeared and employees who were accustomed to that umbrella for a long time, found it difficult to do everything on their own. In cases when they came in joint ownership with the shareholders 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.

The answer to the basic question in this article, (*Did privatization of social ownership matter for economic efficiency?*) is a bit ambiguous. One explanation with respect to the theory of unclear and/or shared ownership rights, like in social ownership, is that they are likely to result in efficiency if an apparatus is to enforce incentive compatibility by minimizing the free riding problem. After privatization, individual or group interests within the firms under better piecemeal incentives for some at the expense of many others prevail in the short run. Was then



privatization necessary? The article showed that privatization was a must, but it took and will take time to produce greater results, perhaps longer than policy makers had anticipated. Henceforth another question arises: which type of ownership matters more in terms of overall economic efficiency? From a historical perspective it depends on how well ownership fits in the economic system and broader environment such as political and institutional stability.

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

	<b>Slovenia</b>	<b>Croatia</b>	<b>Macedonia</b>	<b>Serbia</b>	<b>Montenegro</b>	<b>BiH</b>	<b>Kosovo</b>
Total number of SOEs slated for privatization	2,500 <sup>a)</sup>	3,619 <sup>b)</sup>	1,216 <sup>c)</sup>	3,486 <sup>d)</sup>	354 <sup>e)</sup>	2,591 <sup>f)</sup>	525 <sup>e)</sup>
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% <sup>g)</sup>	30% <sup>h)</sup>	15% <sup>i)</sup>	40% <sup>j)</sup>	Up to 60% <sup>k)</sup>	15% (RS) <sup>l)</sup>	None
Discount for insiders	50% <sup>g)</sup>	20% <sup>h)</sup>	30-50% <sup>i)</sup>	20% <sup>j)</sup>	30% <sup>k)</sup>	None	None
Additional discount per each year of employment	None	1% <sup>h)</sup>	1% <sup>i)</sup>	1% <sup>j)</sup>	1% <sup>k)</sup>	None	None
Maximum discount to insiders	50% <sup>g)</sup>	60% <sup>h)</sup>	70%-90% <sup>i)</sup>	60% <sup>j)</sup>	70% <sup>k)</sup>	None	20% <sup>n)</sup>
Repayment period	5 years <sup>g)</sup>	5 years (20 years in the 2 <sup>nd</sup> phase) <sup>h)</sup>	5 years <sup>i)</sup>	5 years <sup>j)</sup>	10 years <sup>k)</sup>	None	None
Limits on sales of internal shares per employee (DM)	None	20,000 <sup>h)</sup>	25,000 <sup>i)</sup>	20,000-30,000 <sup>j)</sup>	18,000 <sup>k)</sup>	None	None
Progress with large scale privatization during the 1990s	Significant	Moderate	Moderate	fast until 1994; retreat and very slow	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 none	n/a
Private sector share to GDP (2002) <sup>m)</sup>	65%	60%	60%	45%	n/a	45%	n/a
Privatization revenues as a share of GDP (in 2002) <sup>m)</sup>	4.9%	15.8%	n/a	n/a	n/a	2.9%	n/a

**Source:**

- a) EBRD, *Transition Report 1994* (London: EBRD, 1994);
- b) Nevenka Čučković, "The Privatisation Process and Its Consequences," 76;
- c) Privatization Agency of Macedonia, <http://www.mpa.org.mk/>, accessed on 25 December 2005;
- d) Mladen Lazić and Laslo Sekelj, "Privatisation in Yugoslavia (Serbia and Montenegro)," 1063;
- e) Savezni Zavod za Statistiku, *Statistički Godišnjak Jugoslavije* (Statistical Yearbook of Yugoslavia) (Beograd: Savremena Administracija, 1990), 428;
- f) Privatization Agency of the Federation of BiH and of Republika Srpska, available at: <http://www.apf.com.ba/>, and [www.rs.privatizacija.com](http://www.rs.privatizacija.com);
- g) Official Gazette of the Republic of Slovenia, No. 55/92, Articles 22, 23, and 25;
- h) Official Gazette of the Republic of Croatia, No. 84/92, Articles 25 and 31;
- i) Official Gazette of the Republic of Macedonia, No. 38/93, Articles 26 and 28;
- j) Official Gazette of the Republic of Serbia, No. 48/91, Articles 16 and 17;
- k) Official Gazette of the Republic of Montenegro, No. 2/92, Articles 7, 8, 9 and 11;
- l) Official Gazette of the Republika Srpska No. 24/98, Article 26;
- m) EBRD, *Transition Report 2002: Agriculture and Rural Transition* (London: EBRD, 2002);
- n) 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 KTA (amended by Regulation No. 2005/18); and authors own compilation