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ENDOGENOUS AND EXOGENOUS FACTORS OF FAILURE OF THE PROCESS OF TRANSITION IN THE WESTERN BALKANS

Summary: *In this paper, we analyze the concepts, results and practices of realization of economic reforms or the transition process with the aim of pointing out to the limitations of this process in the Western Balkans. In this regard, we examined the processes, the specific theses and the conclusions drawn from extensive analyzes by the relevant sources. The obtained results will answer the research question "Whether the transition process in the Western Balkans could go differently, ie to achieve the results that the public of the countries of the former communism expected?". We have shown that the transition process in the Western Balkans is far from the end. In line with the the present circumstances, the course of transition could not go differently, i.e achieve the expected results. In this regard, we are offering solutions that will turn the economy of Bosnia and Herzegovina towards market-based real competitiveness, true-to-business entrepreneurship and social sensitivity.*

Keywords: *privatization, transition, capital market*

JEL Classification: *P26, P31*

INTRODUCTION

The Fall of the Berlin Wall in 1989 presents a beginning of a new, post-communist time, i.e. a time of transformation or transition for the countries in Central, Eastern and Southeastern Europe. The process of transition is marked by the change and/or creation of institutions and private enterprises; the changing role of the state which leads to creation of fundamentally different institutions of the Government and the promotion of private businesses, markets and independent financial institutions (Falke 2002). In accordance with it, *transformational economy* or *transitional economy* is an economy which undergoes a shift from a centrally planned economy to a market economy (Feige, 1994). The process, along with the growing gap among the society classes and the loss of the so-called *middle class*, has proved to be more difficult and less predictable than the citizens of the former socialist countries had expected. Therefore, the criticism of the transition is based on the fact of significant increase of poverty and degradation, mostly of the middle class (Cifrić 1996, 137).
The idea of *the Western Balkans* has been entered into the official records of the European Union (EU) since 1997 after the EU Council of Ministers founded a special regional commission for this area. Having that in mind, the EU strategy towards the countries of the former Yugoslavia – minus Slovenia plus Albania – has been expressed by the idea of *the Western Balkans* The expression *developing market* implies the countries characterised by turbulences in institutions, the low level of corporative management and economic progress as opposed to more developed countries. Hoskisson and associates mark all the countries of the Western Balkans as the countries in transition (Hoskisson et al. 2000, 249-267). In its 2000 report the International Monetary Fund (IMF) singles out thirty countries as being *transitional*

economies (IMF 2017) including all the countries of this area. Besides, in 2000 the World Bank defined Bosnia and Herzegovina and Federal Republic of Yugoslavia (later Serbia and Montenegro) as transitional economies (Mitra and Selowski, 2002). Therefore, all the countries of the Western Balkans are still undergoing the process of transition.

The beginning of the transition in the nineties of the last century was marked by severe instability, i.e. high inflation and recession. The sharpest decline in the Gross Domestic Product (GDP) occurred between 1992 and 1996. What is more, at the end of 1994 GDP was only about forty percent of the 1989 GDP. It was not until 1996 that the countries in the region started stabilising slowly, and it was the beginning of the 21st century that brought the countries in the region only a mild economic growth. After the war tensions in politics were pacified and the process of transition renewed at the end of the last century and the beginning of this century, the Western Balkans countries reach a relatively high level of economic growth. In the period prior to 2008 the Western Balkans countries finally reach high growth rates, from their perspective, with the average growth of GDP of about 5.7 percent (Penev 2012, 18). The global financial crisis of 2008 and the 2011 Euro area crisis also reflect on the developing countries. The growth rates lose their stability and unemployment rises. Related to that, according to the IMF data, the total of GDP and GDP *per capita* in the countries in transition have not significantly risen for the last twenty-five years. According to the size of these indicators, the countries in transition are ranked lower than the countries which were member states of the EU (EU 15 member states) before the 2004 enlargement of the EU (IMF 2017). As an illustration, only a handful of countries in transition have a GDP per head higher than the half of the amount of the German GDP. In this group only Slovenia has GDP per head higher that in Greece, the weakest EU15 member state. For example, this indicator is USD 18,950 in Greece, 23,280 in Slovenia, 12,860 in Croatia, 5,600 in Serbia, and 4,540 in Bosnia and Herzegovina (IMF, 2017). According to the European Bank for Reconstruction and Development (EBRD) data, at the end of 2012 only six countries in transition (Latvia, Estonia, Lithuania, Poland, the Czech Republic and Slovakia) achieved a GDP higher than the one in 1989. Other countries scored approximately the same or even lower GDP (EBRD 2013).

1. THE INHERITED STRUCTURE OF ECONOMY, COMMUNISM AND POLITICAL INFLUENCE

When analysing the reasons why the process of transition in economy in most countries failed to bring results that the general public expected Haramija and Njavro (Haramija and Njavro 2016) isolate a couple of elements: the inherited poor structure of economy, i.e. a strong influence that the politics has on economy along with the institutional inheritance of communism. There is poorly executed privatisation which is both the consequence of these factors, and the cause for further problems; then there is inconsistent, inadequate and generalized support from the international organisations and institutions, nondeveloping character of foreign investments and, finally, the mentality characterised by resisting to changes which complicates and slows down transition.

The communist system survived in this area thanks to its authoritative qualities and also to its widespread social rights. A secure workplace and regularly paid social security used to compensate for the lack of political rights and low standard of living (Zrinščak 2003, 139). Namely, an average citizen used to have an almost secure workplace with minimal but certain income. As a consequence, there was a high employment, i.e. a hidden unemployment in all of the branches of economics (Njavro 1993).

The main criteria of choosing in communist countries is *moral and political fitness* while the level of expertise comes second. Therefore, the process of management is based on political and social fitness, rather than on expertise. In accordance with that, companies are not able to react to changes quickly which results in companies' inefficiency (Županov 1989).

In the late 1980s the budget deficit was covered up by printing money (IMF, 2014). As a result, inflation grew unstoppably, reaching 640 percent in Poland and 2,700 percent in Yugoslavia in 1989. The beginning of the transition process and the attempt to get accustomed to market regulations has unveiled all the errors and omissions of the communist system. In fact, *political capitalism* has gradually been developing through *economic reforms* in socialist countries (Županov 1989, 62). What differs this system from the *entrepreneurial capitalism* which characterises developed markets is the fact that this system is not based on entrepreneurship but on legal and semi-legal privileges. Endogenous factors inside a country, i.e. the problems which economy is facing in political capitalism are inadequate institutions of the economic system, inadequate economic measures, political influence to economic activities with political deceptiveness, the managerial skills from socialism etc. On the other hand, entrepreneurial capitalism is marked by private ownership, there is a proportionally lesser part of GDP getting redistributed via state channels, there is an integrated and competitive market, the state creates and monitors the system of regulations in the market which treats all participants in the market equally and fairly and the activities in economy are led by expert managers, authorised legal representatives of shareholders and individual entrepreneurs. So, economy demands flexibility, of both workplace and education, and while hiring there is much emphasis on competence and capability. Also, in terms of qualifications and capability, jobs in private sector are paid higher than those in state service. Science and technology play a key role in economy, and without them there are no new technologies and innovative products. Comparison of the two systems makes it clear that both types of capitalism are present in countries in transition, with prevalence of political capitalism. Thus, the transition in these countries is nowhere near the end yet because political elites, i.e. the parties in the authority do not want to give up the communist legacy reflected in the way politics influences economy.

Institutional legacy of the communism is reflected in a large, undisciplined and ineffective administration, a bureaucratic approach of the institutions and corruption. So, a workplace in the state administration was a source of safety and influence (Haramija and Njavro, 2016). ‘A bureaucratised and restrictive authority has opened the door to corruption and bribery of public services because most citizens seem to believe that it is the only way to get things done’ (Dimitrova-Grajzl and Simon 2010, 206). In spite of that, in communism citizens used to perceive the state and the state apparatus as a burden of the state and it was not amoral to avoid or bypass its regulations. Accordingly, citizens did not trust the institutions. Nikodem and Črpić (Nikodem and Črpić 2016) point to distrust issues people have towards all the relevant institutions of the society, finding the causes both in the former regime and in the immature sense that institutions are expected to solve almost all the problems. Even a glance at the agencies for statistics of the West Balkans countries confirms the prolongation of such practice, i.e. the increase in number of employees in the budget funded areas of administration, public authorities, education and art. On the other hand, there is an obvious decrease in number of employees in the processing industry. Besides, relevant researches also show a high level of corruption in the new EU member states as opposed to the *old* ones as a consequence of the communist regime. Also, when observing the trust in institutions researches, countries in transition are always at the bottom of such lists (Bjørnskov, 2007). Also, in small and open economies, such as contries in Western Balkans, monetary policy abilities are limited by many constraints (Benazić and Rami 2016, 1039).

2. PRIVATISATION IMPLEMENTATION

Facing a difficult economic situation, all the countries in Eastern and Central Europe started a process of privatisation in the late 1980s. The best known models are: public offering – the sale of equity shares in the stock market; asset sale – usually via auction; voucher privatisation – distribution of vouchers that represent a share in the ownership of a company they are invested in, most often for free or at a very low price; *privatisation from below* – the start of the new private enterprises in former socialist countries and the management buyout or employee buyout – a distribution of equity shares to employees or the company's management for free or at a very low price.

Ante Marković started privatisation in the Socialist Federative Republic of Yugoslavia (SFRY) in 1989. For the purpose of privatisation public companies were recapitalized and discount to their shares was granted (Mijatović 2005, 180). It was believed that the so-called partial capitalisation would improve the management and the control in the privatised enterprises. To paint a picture, Mijatović (Mijatović 2005, 180) divides privatisation in three periods: up to 1997, from 1997 to 2001 and after 2001. Despite the fact that ambient in Serbia has become intensively dynamic and increasingly unpredictable and, correspondingly, managing a company has become more demanding (Dmitrović-Šaponja and Suljović 2017, 1830) he claims that the results of the privatisation in Serbia are disappointing.

In post-communist countries privatisation was enacted on an underlying tendency to perform privatisation as quickly as possible because "*the state is a bad manager*". It was expected that, through the privatisation of the state-owned enterprises, the countries would be able to finance their public needs. Given the fact that the privatisation failed to bring the expected income and the expected impetus, countries in transition were forced to finance the state needs with the further borrowing. In that way the public debt increased.

Trying to leap over transition in two jumps as it was an abyss, most communist countries fell straight into a deep regression abyss returning up to twenty years in the past (Kecmanović 2017, 3). On the other hand, former communist parties are surprisingly quickly transformed in fierce supporters on the Washington consensus. The term *Washington consensus* was coined in 1990 aiming to summarise the principles behind the politics of the Latin America countries (Katić, 2009, 62). The making of these principles was initiated by the US Ministry of Finance, the World Bank and the IMF. With regard to Washington being the seat of these institutions, the term *coined itself*. Williamson (1990) presents recommendations in great detail, and Katić (2009 63) summarises them into: fiscal deficit, priorities of public consumption, tax reform, liberalisation of interest rate, foreign exchange rate, trade policy, markets and foreign direct investment, privatisation of state property and protection of private property.

A great deal of authors points out that even prior to 1989 (and reforms by Marković) many directors in the region abused the control they had over economic enterprises in order to turn them into private property. They did that by diverting money into privately-owned enterprises and selling the state-owned enterprises' assets. The possession of favoured information and political protection, along with connections with security services proved very helpful as well as the fact that such directors *made the first move* (Pakulski et al. 1996; Dale 2014).

2.1. Voucher privatisation as a dominant model of privatisation

Voucher privatisation is based on citizens being freely given vouchers which they can use to buy the equity shares of a company. The citizens were not given the same share, but depending on their age, time spend in military service, in a war, in working years etc. The aim of voucher privatisation is to privatize as many business enterprises as possible as quickly as possible. It was believed that privatisation by voucher distribution overcomes the difficulties that arise in other privatisation models as a result of appraisal. In a time when income decreased and business enterprises did not make any profit, these actions could have been cheaply bought by anyone with the access to bank loans and other sources of finance, including foreign sources. Those who could have in any way reach financial means to buy vouchers have gained 'ownership rights' over the resources and accumulated enormous wealth.

The Western Balkans privatisation is characterized by a phenomenon of employee loyalty, or so-called employee shareholding. This model is presented by buying shares at a price significantly lower than the market price or by giving shares to company management or employees free of charge. In the region of the Western Balkans it was seen as the least traumatic way of economy transformation because the control and management would be in the hands of the employees i.e. owners in that business enterprise. However, much like in other former communist countries, the key administrative, economic and political relations were in the hands of the former socialist directors – thus making them the main actors of privatisation (Čengić, 2000). Although the privatisation model assumed everyone would be equal, it soon became crystal clear that the real economic and managerial power was turning managing directors into the only real privatisation partners to the new political elite and foreign investors (Njavro 1993). Just to clarify things, Romania and Slovakia have only partially adopted this model.

The process of transition in the Western Balkans countries took off from the heritage of the self-management socialism, in an environment where legal and economic systems were outdated, containing many stipulations and practices which were incompatible with the legal system of market economy. In spite of that, workers resist giving up the surveillance and control to foreign investors which makes it easy for the current directors to take over an enterprise. At the beginning of the privatisation process the 'regulatory reform in the Western Balkans was initiated by the need for the comprehensive transformation of socialist legal systems into market economy legal systems, and characterized by deregulation and intensive creation of new legislation. Yet, privatisation process and its results vary from country to country. In Slovenia privatisation was implemented much more carefully and a lot fewer enterprises were privatised in total. Soon after leaving Yugoslavia, its privatisation comes to a halt. The Government of Slovenia adopted a new law two years later.

3. INADEQUATE AID AND THE CHARACTER OF FOREIGN INVESTMENTS

Unlike the after-war reconstruction in Europe after the World War II, the former communist countries started transition in different circumstances. The recovery of Western Europe after the World War II was given impetus by a massive and sudden growth of global economy and also by the Marshall Plan. In the beginning of the 1990s neither the US nor European economies had such impetus. Besides, the moment the USSR ceased to exist the USA lost geopolitical interest in such a plan. Therefore, the big countries did not have the will to re-enact such a plan. While the most of the Marshall Plan was about some sort of financial aid, in the case of post-communist Europe the financial aid in the beginning of the nineties was only about ten per cent. The aid to transition countries was mostly advisory and expert support. Such aid is provided by international organisations which give needed loans such as the World Bank and the IMF, or EU organisations such as the European Bank for Reconstruction and Development (EBRD), the European Central Bank (ECB) and the European Investment Bank (EIB). It was precisely these named organisations that initiated the development of such a legal system which, in their understanding, was necessary for the successful development of economy. Multitude of international organisations and donors gave their contribution to the making of that sort of environment by providing financial and technical aid. Still, the expectations that the financial aid would be like the one given to Western Europe after the World War II were an illusion. Haramija and Njavro note that the World Bank and the IMF consultants approach to developing countries with a strategy that has two main elements: *stabilization programs* and *structural measures*. Stabilization programs are aimed to liberalization of all the costs and foreign trade, and to restrictive fiscal and incomes policy in order to reduce the role of the state. Structural measures involve *privatisation, reform of banks and the cuts in the industrial policy and social assistance* (Lavigne 1995, 118). No doubt strategies like these carry a certain pressure because providing of the wanted loans is conditioned with the realization of measures and recommendations relating to privatisation (Dale 2014, 88). It was considered that the result of stabilization and structural measures should be exportation-actuated growth, since the fact that they are at the brink of Europe should provide competitive advantage. It was expected that as the public sector decreases the newly-formed privately-owned companies would take over a part of the jobs and employees in the market. However, as a result of obsolete technologies, poor product quality and loose distribution and marketing networks, only a small numbers of manufacturers from countries in transition managed to break into foreign markets, and the demands from the EU markets and the Northern America markets made the transition even more difficult.

There are officials but also consultants, mostly from developed countries in the EU, Great Britain and the Northern America, which emerge to represent international organizations that implement the planned programs. Lavigne (Lavigne 1995) makes an observation that the hiring services of these consultants make up for the most of the funds which a country is given.

While making comments on the course of transition in a country, international organisations and the EU organisations emphasise to which degree the recommendations and the reforms they are asking for have been implemented. Typically, the same actions are demanded without taking into consideration the differences between countries, their standards and specificities. The IMF and the EBRD distinguish the next steps as being the most important in the process of transition: privatisation, restructuring of the public administration and public companies, tendency to form prices in free market, supporting of free trade exchange, stimulation of competitiveness and reforms of banks and infrastructure. For example, in a 1996 report the recommendation of the World Bank was that the focus of the Bosnia and Herzegovina authorities should be the establishment of a legal, regulatory and institutional framework that would allow free market and the flow of goods and services (World Bank 1996). Metaphorically speaking, such recommendations are as effective as trying to put the same model of shoes on feet of different sizes. Accordingly, the IMF and the World Bank can be seen as oversize public consumption rehabilitation clinics, with the emphasis on the fact that the instruments and the therapy applied – are uniform, obsolete and no longer in use. Congruently, the effect of generalized IMF and World Bank plans has proven to be destimulating to the countries where they are applied. The most common reaction of international organisations, despite the fact that transition does not bear the expected progress was – not carrying out the recommended reforms. Frustration and nonunderstanding keep growing having in mind that some countries that obviously refused recommended reforms (like Slovenia) have acquired the highest living standard among the countries in transition.

Many transitional countries have seen almost complete banking sector transfer into the ownership of foreign, mostly Western European, banks. For example, the percentage of total banking assets in the hands of foreign banks by countries in the end of 2010 was the following: Slovakia 99 percent, Estonia 98 percent, Croatia 94 percent, Lithuania 90 percent, Bulgaria 85 percent, the Czech Republic 85 percent, Poland 75 percent, Serbia 75 percent, Hungary 65 percent, Latvia 65 percent (Mitra et al., 2009, 50). Foreign investments are idealised in many transitional countries under the impression that they are vital for the progress of the society or state. However, as a consequence of a number of reasons, the standard of citizens and the cash flow of direct foreign investment are often out of proportion. To illustrate that, in the end of 2003 the value of foreign investment in relation to the GDP was extremely high in Hungary (58 percent) and the Czech Republic (50 percent), but relatively low in Poland (about 27 percent) and Slovenia (16 percent). According to the Eurostat data (Eurostat 2017) Slovenia, which has the highest salaries among the transitional countries (EUR 1,051) also has the greatest number of locally-owned businesses. The Czech Republic, Croatia, Slovakia and Hungary with greater share of foreign investment all have lower salaries (EUR 870, 800, 722 and 657, respectively). To illustrate that, Albania has EUR 347, Serbia EUR 361, Bosnia and Herzegovina EUR 439, Romania EUR 517. Therefore, there is no big correlation between the foreign investment total and the prosperity of people in the countries that are given these investments.

4. VULNERABILITY OF BOSNIA AND HERZEGOVINA

As in all Western Balkan countries as well as in Bosnia and Herzegovina, non-economic factors in the region play the most important role in determining the value of trade between countries (Trivić and Klimczak 2015, 57). The economic instability results from "frequent reforms, where the economic growth and the social impact of changes were completely ignored, low rates of domestic and foreign investment, foreign trade deficit and low rates of GDP" (Duvnjak 2018, 198).

There is a line of social and economic questions which are not yet answered and whose improvement implies complicated and demanding solutions (Amidžić et al. 2016, 57). Also, many buyers of the public companies saw the privatisation as an opportunity to gain certain asset without any entrepreneurial activities and/or creation of new value. As a result of such measures, a great deal of former public companies was closed after a lengthy insolvency proceeding. In the case of better luck, such companies still exist but their market value is significantly lower than it was a couple of years ago. As a result, a high percentage of working age people lost their jobs and new workplaces were never opened (Šokčević and Dugalić, 2007). To illustrate that, since the establishing capital market the market value of privatised shareholder capital in Birač, Republika Srpska oil sector, Hidrogradnja, Zenica steel plant, Krivaja, Polihem, Soko, Bosnaplod and Kladušnica has been reduced for more than BAM three billion.

The capital market in the country has gone through stages from establishment of the both stock exchange markets to the rise and fall and awakening again (Kumalić, 2013, 70) through the increased value of debt securities, but in the terms of market material and the number of market instruments it is still undeveloped and inactive. Moreover, the banking sector is at a medium level or development with basic aggregates in it (Serdar 2015, 127). In spite of that fact, in spite of all the limitations, institutional investors can create a security portfolio in local stock markets which would provide them with the wanted yield with only a little exposure to the market risk (Grujić 2017, 437). That sort of interest from institutional investors, along with the stability of domestic currency and foreign exchange rate (Adams and Hartsfield 2010, 314-320), can represent a desired feature of a financial market. However, it is precisely the fixed foreign exchange rate that can create an illusion. In 1999 Bosnia and Herzegovina adopted a system of *currency board*. To tell the truth, this move has given results in the field of country's inflation reduction representing a significant contribution to the regulation of the finance sector. Currency board implies constantly fixed exchange rate, foreign-exchange reserve in a stable currency at a level sufficient to cover the amount of money (in paper and coins) and unlimited internal convertibility, i.e. the ability to convert domestic money into the currency of the reserve (and vice-versa) at a fixed rate. In this regard the binding of the BAM to the EUR has been an *anchor keeping the Bosnia and Herzegovina vessel from unnecessary wandering across the stormy seas of transition*. Debt crisis situations and the experience of transitional countries in the last twenty years or so point to the fact that the entry of foreign capital with borrowing from foreign markets can lead a country to big problems. For example, even though the fixing of exchange rate is rather unpopular, it still presents a certain security to the system. Abandoning of the fixed exchange rate in Bosnia and Herzegovina would lead to depreciation of the BAM in relation to stronger currencies. As a consequence, the debts expressed in dollars or euros would rise in relation to the GDP.

Tanzi (2010) reminds that the transformation of the market economy is not complete until operating fiscal institutions and reasonable and accessible expenditure programs, including the basic social welfare networks for the unemployed, sick and aging people are established. These expenditure programs should be financed from public revenues which are generated – through taxing – without overburdening the private sector. With that in mind, keeping the public debt within *acceptable limits* according to the Maastricht criteria, in order to maintain social, financial and fiscal stability, along with irrational borrowing is a safe way to collapse the system.

CONCLUSION

As this paper demonstrates, the transition in the Western Balkans is still far from being over because political elites did not give up the communist legacy reflected in the way politics influences economy. It was not enough to simply follow the guidelines of international organisations, i.e. to change the laws, and suggest and adopt an array of new laws; instead, it was necessary to create an efficient bribery- and corruption – proof apparatus. Given the presented circumstances, the course of transition could not have gone any other way in the terms of attaining objectives that the general public of the former communist countries had expected.

Facing the effects of transition was mostly reflected in identification and interpretation of problems without providing solutions. Therefore, it is vital to make the population financially and entrepreneurially *literate* so the next generations of politicians and entrepreneurs can catch up with the globalisation demands. Insufficient knowledge on these factors makes the Western aid inadequate, and the nondeveloping character of foreign investments only makes the situation in the transitional country more difficult. With all that said, the IMF, the World Bank and the EBRD keep ignoring the differences in the local traditions, culture and mentality. The same reforms are being insisted upon without taking differences, standards and specificities of each and every country into consideration. Therefore, the effect of generalized plans has proven to be destimulating for the countries where they are applied.

The most common reaction of international organisations at the poor transition results, despite the fact that transition does not bear the expected progress was *not carrying out the recommended reforms*. Frustration and nonunderstanding keep growing having in mind that some countries that obviously refused recommended reforms, like Slovenia, have acquired the highest living standard among the countries in transition.

This paper demonstrates that while the transition plans were created, not enough attention was paid to the inherited poor structure of economy and mentality which, as a consequence, lead to poor results of privatisation implementation. Congruently, the appraisal should take two courses of action. The first course should be evaluation whether after privatisation the company has fallen into the hands of the owners which have the knowledge, will and capability to develop it. The second course should be to demand the answer to the question whether the state has gained the adequate equivalent value and secured the paying of income tax as a result of privatisation.

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