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*Miroljub Labus**

TRANSITION AND POST-CONFLICT MACROECONOMIC POLICIES IN SERBIA

ABSTRACT: *This paper evaluates the economic performance of the three distinct policy regimes that have been adopted in Serbia since the onset of transition in 2000. The conflict period from 1991 to 1999 determined the starting point of transition and its subsequent realisation. This pre-transition shock was more severe than the shock imposed by the Great Recession in 2008. Besides these shocks, the legacy of conflict, and unresolved privatisation issues, macroeconomic policies also substantially influenced the performance of the Serbian economy.*

Three distinct policies were implemented between 2000 and 2018 with clearly different approaches: neoliberal, populist, and interventionist. This paper evaluates these policies using quarterly data on 20 macroeconomic indicators classified in 5 groups: macroeconomic stability and domestic, foreign, financial, and labour markets. Regarding the achievements of the three macroeconomic policies, the neoliberal policy is usually blamed for all the deficiencies in the economy in the period between 2000Q1 and 2006Q2. To the contrary, our data indicates that this policy performed the best. The populist policy in the next period from 2006Q3 to 2012Q2 performed the worst. Finally, the interventionist policy, starting in 2012Q3 and evaluated up to 2018Q4, has been inferior to the neoliberal policy but superior to the populist policy. The analysis suggests that apart from macroeconomic policies the starting point of transition matters for a successful economic transition.

KEY WORDS: *economic policy, neoliberalism, populism, interventionism, Serbia*

JEL CLASSIFICATION: E65, O52

* Emeritus Professor of Economics, Faculty of Law at the University of Belgrade, e-mail: miroljub.labus@belox.rs

1. INTRODUCTION

This paper presents empirical evidence of the achievement of the three macroeconomic policies in Serbia and analyses the effects of transition within their frameworks. It has been more than 19 years since the introduction of democratic changes in Serbia and the renewal of the transition process that began with the fall of the Berlin Wall in 1989. The period is long enough for an objective assessment of the different economic policies conducted in this period. Even as transition remained the enduring task, the macroeconomic framework changed, resulting in diverse outcomes.

It is possible to separate one economic policy from another, bearing in mind that they have been influenced by heritage, diverse theoretical backgrounds, and reactions to specific external shocks. The first, neoliberal policy was conducted between the fourth quarter of 2000 and the second quarter of 2006. The second, populist policy was in effect between the third quarter of 2006 and the second quarter of 2012. The third, state-interventionist policy, with a strong populist content, lasted from the third quarter of 2012 to the fourth quarter of 2018. In these periods, several governments were elected that pursued different economic policies.[1] To make our exposition simpler and easier to follow, we identify the 'First Government' with neoliberal policy, the 'Second Government' with populist policy, and the 'Third Government' with state interventionism.

Table 1 shows the key features of each of these macroeconomic policies schematically. The First Government conducted a neoliberal policy that deregulated prices and the exchange rate, liberalised foreign trade, imposed privatisation based on selling companies to strategic investors, restructured

[1] In the first period, ministerial cabinets were elected in two related states: the Federal Republic of Yugoslavia (FRY) and the Republic of Serbia. The writer of this article was Deputy Prime Minister of the Federal Government in the period 2000–2002, and Deputy Prime Minister of the Republic of Serbia's Government in the period 2004–2006, in both cases in charge of economic policy. Zoran Djindjić, Zoran Živković, and Vojislav Koštunica were Prime Ministers of Serbia, and Zoran Žižić and Dragiša Pešić were Prime Ministers of the FRY. Vojislav Koštunica and Mirko Cvetković were Prime Ministers during the second period of 2006–2012. In the third period of 2012–2018 Ivica Dačić and Aleksandar Vučić led the Serbian Government as Prime Ministers. Each government had a mandate of approximately six years, providing enough data for a statistical assessment of its achievements. See Labus (2018).

public debt, and rehabilitated the ruined banking sector. At the same time it increased public spending and implemented fiscal consolidation, with significant liberalisation of factor labour and capital markets. The difference between the inherited policies and these new policies was drastic. In the previous system there had been a dual exchange rate in which market and regulated foreign exchange prices were completely uncorrelated. Exports and imports were fully regulated by the licensing system, including fees for citizens entering and exiting the country. Regulating commodity prices below market levels created severe shortages and rationing of consumption. This system of full state regulation was replaced by macroeconomic policies based mostly on neoliberal doctrine.

Table 1: Main components of the three macroeconomic policies

Neoliberalism	Populism	Interventionism
Free floating currency.	Free floating currency.	Heavily managed floating currency.
Foreign trade liberalism.	Foreign trade liberalism.	Foreign trade liberalism.
Price deregulation.	Inflation targeting.	Constrained inflation targeting.
Resumed privatisation.	Postponed privatisation.	Postponed privatisation.
Large banks foreclosures.	Bank recapitalisation.	Bank regulation.
Public debt restructuring.	Public borrowing.	Public borrowing cum debt reversals.
Fiscal consolidation.	Fiscal expansion.	Fiscal expansion cum consolidation
Neoliberal market income policy.	Income redistribution.	Rising fiscal burden.
Neoliberal market industrial policy.	Industrial subsidies cum investors' discrimination.	Heavy industrial subsidies cum investor discrimination.
Policy rules.	Policy discretion.	Absolute policy discretion.

The Second Government initially continued with neoliberal policies, but later switched to a series of populist measures. It retained a floating exchange rate and free foreign trade, but introduced inflation targeting. Due to very high monetary policy rates, there was a sizeable speculative inflow of capital, which put pressure on the exchange rate and foreign exchange reserves due to the outflow of foreign currency through the Open Market Operations (OMO) of the National Bank of Serbia (NBS). Politics became discretionary. The government imposed redistribution of income, introduced subsidies for investment, and spent privatisation proceeds on consumption, postponed transition, increased public debt, and fiscal deficit. When the Great Recession came the government opened the door to state interventionism.[2]

The Third Government's interventionist policy initially continued with the populist policy, halting privatisation, postponing restructuring of public companies, and increasing fiscal deficit and public debt up to the point where the country was threatened with sovereign debt default. It then switched to fiscal consolidation, reduction of public administration wages and pensions, and tightening fiscal discipline. This policy increased the tax burden and continued to honour the subsidisation of foreign direct investment. The positive results of fiscal consolidation reversed the trend of public debt growth, but public sector salaries and other spending continued to grow. Allocation of foreign investment continued to be strongly influenced by the government.

Discretionary economic policy had turned into the absolute discretion of the state. 'Small' institutional changes were introduced that significantly changed the economic system. The exchange rate became a heavily managed float, where NBS interventions in the foreign exchange market, with frequent purchases and sales of foreign exchange, made the inflation rate and exchange rate the goals of the inflation-targeting system. The open market operations resulted in restrictions on the supply of debt certificates (CoD), creating a monetary system that controls both prices and quantities (repo rate and quantity of CoD).

As Table 1 shows, the populist policy shared some of the features and institutions of the neoliberal policy and continued to implement them for some time. The same applies to the relationship between the populist and interventionist policies.

[2] For the long-run effects of the Great Recession on the Serbian economy, see Uvalić et al. (2020).

However, interventionism gradually moved away from the neoliberal policy and abandoned all neoliberal market content except free foreign trade.

We measured the achievements of each macroeconomic policy based on 20 indicators divided into 5 groups for the period 2000–2018. We excluded the impact of the general trend and seasonal factors. We assessed policies based on the improvement they made on the inherited state of the economy. We did not consider the responsibilities and difficulties faced by the previous policy, nor did we take into account external shocks such as the breakup of the Federal Republic of Yugoslavia and the assassination of the Serbian Prime Minister (during the neoliberal policy, respectively), the Great Recession (during the populist policy), or floods and drought (during the interventionist policy). We also did not take into account institutional changes that cannot be statistically measured.

According to our estimates, the outcome of the first, neoliberal policy can be clearly distinguished from the results of the two other policies: the neoliberal economic policy was the most successful in recent Serbian economic history. The other two policies had very similar results until recently: 2017–2018 was a very successful economic period, which raised interventionist policy to second place. Unsurprisingly, the populistic policy performed the worst.

This article is organised as follows. The second section describes the starting point of all the post-conflict macroeconomic policies. The third section presents empirical evidence on the achievements of those policies. The fourth section ranks the performance of the policiess, and the fifth section concludes.

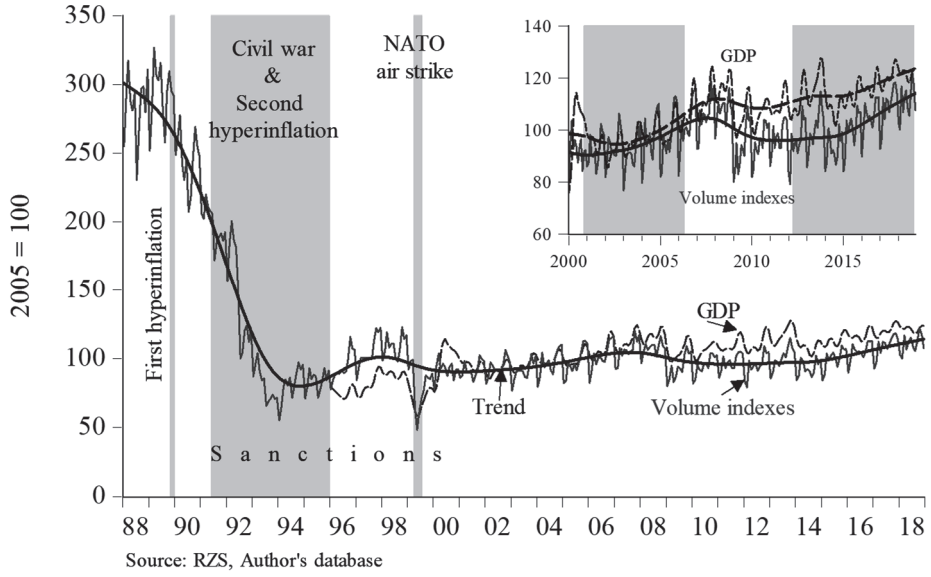
2. THE STARTING POINT

Figure 1 illustrates the starting point and history of transition in Serbia. The large graph shows the time series of industrial output and its underlying long-run trend for the period between January 1988 and December 2018. Volume indexes of industrial output are scaled to 100 points for 2005. The corresponding solid lines are coloured in blue and red. The dotted black line refers to real GDP in industry (manufacturing, mining, and electricity supply), also scaled to 100 points for 2005. These data have been published officially since the first quarter of 1996 and are not available before then; therefore we need to use volume indexes to indicate the long-term path of real GDP. The two time series have different dimensions.

GDP refers to gross value added generated in industry, while the volume indexes are quantitative measures of industrial output. Nevertheless, their cyclical pattern and trend correspond to each other pretty well. Hopefully, the path of GDP can be imagined for the entire period under consideration to give a visual impression of how deep the depression was.

The small graph in the upper right corner of Figure 1 emphasises the period of transition since the democratic changes between 2000 and 2018. We present both real GDP and output indexes in industry, as well as their short-run trends. The variability in this sub-period is greater than the long-run variability, so we nested this graph in the larger figure. The five shaded areas are of particular interest. The first refers to the first hyperinflation, which had tremendously adverse effects on the economy: the activity level dropped by 100 index points. The second shaded area corresponds to the civil war period, the breakup of Yugoslavia, and the second hyperinflation, when the activity level declined by additional 200 index points. After these adverse external shocks the economy started to recover due to a financial injection from the proceeds of privatisating the telecommunication network in 1997. However, this upturn did not last for long. The third shaded area indicates the consequences of the NATO airstrike in 1999, which cancelled all hopes of a quick recovery. The strike destroyed vital production capacity in Serbia, and industry has never fully recovered.

Figure 1: Deindustrialization and GDP [3]



The two shaded areas in the upper-right graph in Figure 2 show the short-term movements during the transition period. The first refers to the economy's development during the transition period based on neoliberal economic policies. The second relates to recovery after the Great Recession, characterised by strong government intervention. The area between these two periods reveals the impact of the Great Recession and the achievements of the populist economic policy.

Figure 1 presents a timeline of deindustrialisation, but it could also be named the destruction of Serbian industry and GDP in the last decade of the 20th century. The debacle started with hyperinflation at the end of 1989, which after a short but

[3] Data for all figures were downloaded from the web service of the RS Bureau of Statistics (RZS) https://www.stat.gov.rs/ (inflation, GDP, industry, investments, public spending, exports, imports, tradables, real wages, labour productivity, employment, unemployment), the Ministry of Finance (MF) https://www.mfin.gov.rs/ (fiscal deficit and public debt), and the National Bank of Serbia (NBS) https://www.nbs.rs/en/ indeks/index.html (exchange rate, euroisation, capital inflow, depth of financial system, bad loan provisions, and foreign exchange reserves). The problem is that these services provide monthly data from January 2004 onwards, while for the previous period they provide only annual values. To reconstruct the quarterly data for these four years we used our personal database, which we fully matched with the official annual values.

unsustainable price stabilisation turned into full-fledged hyperinflation from February 1992 to January 1994 – the second-largest hyperinflation in the world economy in the 20th century. During this period Yugoslavia disintegrated, civil war broke out, international sanctions were introduced, and in 1999 NATO bombed the country. One can hardly imagine more adverse shocks hitting an economy over such a short period of time.

These shocks are not an excuse for the failures of transition, but they clarify its starting point. Later during the transition period other external shocks would hit the Serbian economy. However, there were also internal policy shocks: one is the change from a neoliberal to a populist economic policy, and the other is the replacement of a populist economic policy with active state interventionism.

The transition in Serbia started with privatisation in 1989 in the Former Yugoslavia. The subject of privatisation was social capital, defined as an accounting counterpart to equity capital, over which the right of use was institutionally granted to self-managed establishments. The process was launched by adopting legislation transforming social property rights into insiders' equity shares, with consequent adjustments in business governance.[4] After the breakup of Yugoslavia in 1991, new legislation was adopted in Serbia, which completely undervalued equity capital under circumstances of hyperinflation. Later this legislation was amended by revalorization provisions, which virtually cancelled all previous cases of privatisation during the hyperinflation (apart from the privatisation of dwellings). Subsequently, a new model of insider privatisation was passed, under which only prime companies were attractive for privatisation. With the democratic changes the privatisation process was substantially modified. For the remaining non-privatised, socially owned businesses, a model of classical sales to strategic investors was adopted (through public auctions and public tenders). However, the privatisation proceeds were not reinvested but were

[4] The key legislation for privatisation is the following: *Law On Transformation Of Social Capital* (Official Gazette of SFRY No. 84/89 and 46/90), *Law On The Conditions And Procedure For The Conversion Of Social Property Into Other Forms Of Ownership* (Official Gazette of RS, No. 48/91), *Law On Ownership Transformation* (Official Gazette of RS No. 32/97) and *Law On Privatization* (Official Gazette of RS No. 38/01).

mostly included in the budget revenue to finance the fiscal deficit, leaving the level of productive capital unaffected.[5]

As the damage done to the physical production infrastructure had not been repaired after the civil war and NATO airstrikes, as many valuable companies were already in private hands, and as the socially owned banks were bankrupt, the scope and size of privatisation was dramatically reduced. Ignoring this fact, public expectations concerning the benefits of democratic changes and international assistance were enormous. The reality, however, was different: privatisation did not turn out to be the key driver of the Serbian transition and post-conflict development. This role had to be replaced by other unpopular government policies, which the public does not recognise. In the public perception, privatisation and neoliberal economic policy were to blame for all economic shortcomings in the post-conflict period. The public erased the civil war and its consequences from its memory.

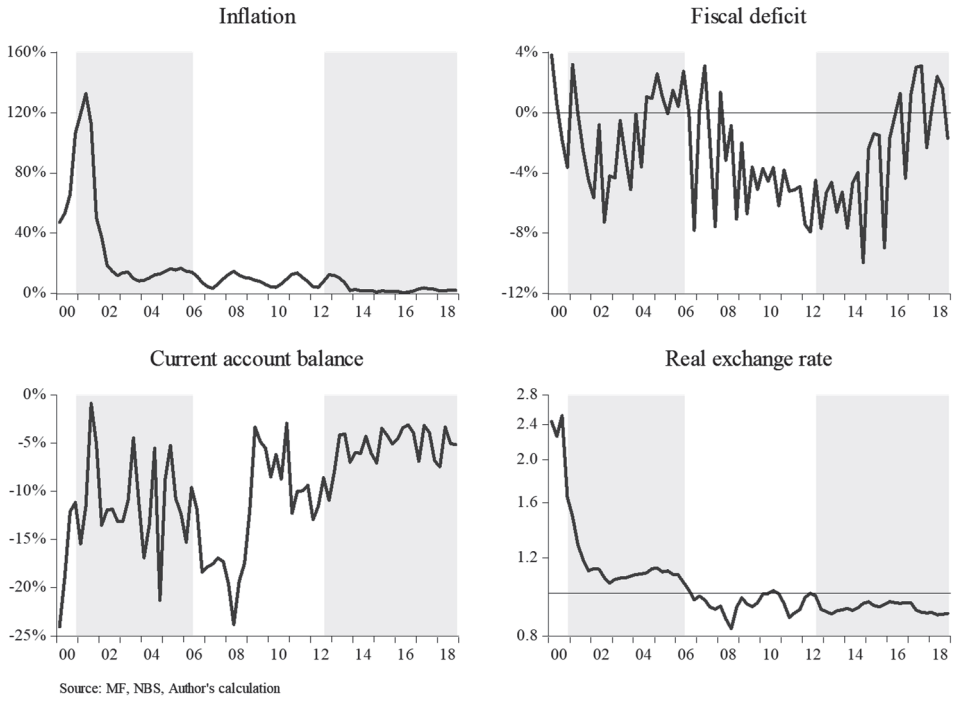
3. EMPIRICAL EVIDENCE

3.1. Macroeconomic Stability

Figure 2 shows economic policies' contribution to reducing macroeconomic imbalances based on four indicators: inflation, fiscal deficit, balance of payments, and real exchange rate. Inflation shows the imbalance in the commodity market, fiscal deficit shows the imbalance of state finances, balance of payments shows the imbalance in the external market, and real exchange rate shows the imbalance in the foreign exchange market.

[5] For further details see Uvalić (2004) and Cerović and Dragutinović Mitrović (2007).

Figure 2: Macroeconomic stability



Source: MF, NBS, Author's calculation

The neoliberal policies freed prices from administrative control and reduced inflation to a moderate level, reversed the fiscal deficit to a fiscal surplus, and restored the undervalued real exchange rate to a neutral level, but failed to reduce the payment deficit. The populist policies maintained moderate inflation, escalated payment and fiscal deficits to unsustainable levels, and overvalued the real exchange rate. The interventionist policies reduced inflation to a low level, consolidated the fiscal deficit, reduced the payment deficit to a sustainable level, and continued to overvalue the exchange rate.

Inflation. At the beginning of the transition period, inflation was very high and revealed huge imbalances in the domestic commodity market. Democratic changes took place in the third quarter of 2000 and the annual inflation rate increased to 85%. Inflation continued to grow for a year, not only due to the effect of the passing over of the previous year's prices but also because of the impact of new macroeconomic measures. During Milošević's rule, prices were controlled

and goods were rationed, creating market shortages. The supply of goods was consistently below demand. There were two options for re-establishing a macroeconomic balance: price deregulation, with the risk of further growth of already high inflation, or increasing the tax burden to subsidise prices. In the first case, the financial burden would fall on consumers, while in the second case it would fall on all taxpayers.

In line with neoliberal economic policy, the first option of price deregulation was selected. Most prices were freed from administrative controls, and the remaining prices that were still under the administrative control regime were raised to the level of market equilibrium. In 2001 the average price of railway services increased by 180%, electricity by 124%, natural gas by 103%, drugs by 80%, other public services by 70%, telephone services by 40%, and bread prices by between 50% and 80% depending on the type of bread. Meanwhile, average salaries only increased by 25%, so this economic policy was not going to be popular. In the first two quarters of 2001 the rate of inflation exceeded 100%. After that, inflation began to calm down, so that by the end of 2004 it was only 6%. However, it was slightly higher, 14%, at the end of the neoliberal period. During the period of liberalisation the inflation rate was reduced by 71%, as shown in Figure 2. In the meantime, all shortages were eliminated, and the commodity market was normalised again. Price deregulation is an unpopular economic measure, which in practice produced excellent results.

The Second Government adopted populist policies and inherited inflation of 14.0%. It managed to lower it to 5.5% by the end of its mandate in the second quarter of 2012. The interventionists took the inflation rate of 5.5% and reduced it to 2.1% by the end of the fourth quarter of 2018. After the liberalism period a monetary policy of targeted inflation was introduced, in which the main task of the National Bank of Serbia was to stabilise prices, regardless of the macroeconomic cost.[6] Under this monetary policy, one and a half billion euros were spent on defending the exchange rate and prices, and inflation was lowered by just 10%. The NBS tightened the interest rate policy (raising repo interest rates), contributed to a slowdown in economic growth, and intervened continuously in the foreign exchange market, reducing foreign exchange reserves.

6 See Šoškić (2015).

Fiscal deficit. In recent years, fiscal deficit and public debt have been at the centre of public debate, as at the end of 2014 the populist policy and its initial continuation in the period of interventionism brought Serbia to the brink of bankruptcy.[7] Neoliberal policy inherited a fiscal deficit of -1.8% of GDP but ended its mandate with a fiscal surplus of 2.7%. The movement of the fiscal deficit has been U-shaped. The largest deficit of -7.3% was achieved in the second quarter of 2002 when a three-year Stand-By Arrangement with the IMF was concluded. The result of this programme was positive. In the last eight quarters of the neoliberal policy there was a fiscal surplus, except for in one quarter.

Under the populist economic policy the fiscal surplus was turned into a fiscal deficit. This was only partly due to the Great Recession, since the negative trend was formed before the crisis. In the fourth quarter of 2006 it reached -7.8% of GDP. A similar record of 7.9% of GDP was set at the end of the populist mandate in the second quarter of 2012.

The interventionist policy continued the policy of easy public spending until it challenged fiscal sustainability. In the fourth quarter of 2014 the deficit was -10.0% of GDP, and in the fourth quarter of 2015 it was -9.0%. Therefore, a two-year Stand-By Arrangement with the IMF was concluded, supporting fiscal consolidation and eventually leading to a fiscal surplus in 2017–2018. Consequently, fiscal consolidation returned Serbia's economy to the position it had at the end of the neoliberal policy period.[8]

Balance of payments. The balance of payments shows the imbalance in the exchange of goods and services with foreign countries; i.e., in the foreign market. None of the economic policies achieved a positive balance of payments in the observed period in any quarter. This means that Serbia has a continual foreign market imbalance because it imports more goods and services than it exports.

Populist economic policies had the biggest problem with balance of payments. The largest balance of payments deficit was –23.8% in the second quarter of 2008, which was only partly due to the Great Recession. The crisis temporarily reduced

7 See also Madžar (2012).

8 See also Vujović (2018).

the deficit to –3.3% of GDP in the second quarter of 2009, but this level was unsustainable and slowly shifted to the limit of –10% of GDP.[9]

Interventionism in industrial policy had already started in the period of populist macroeconomic policy, but there were no results until a car manufacturing deal with FIAT took place, based on massive subsidies (Trifunović et al., 2009). That increased car exports and reduced the balance of payments deficit to -5%. A reduction in the price of crude oil and natural gas on the world market also contributed to a sustainable payment deficit. The current account gap was lowest in the period of pure interventionist policies, which inherited a balance of payments deficit of –12.3% of GDP and ended with a deficit of –5.1%.

The neoliberal policy did not have good results in terms of balance of payments deficit, but still managed to reduce it by 2.6 percentage points. It inherited a deficit level of -12.8% of GDP, which was decreased to -10.3% of GDP by the end of its mandate.

Real Exchange Rate. The real exchange rate is the ratio between the product of the nominal exchange rate and the price level in the eurozone on the one hand, and the price level in Serbia on the other hand. In that sense it depends on both the nominal exchange rate and relative domestic and foreign prices. We obtained the domestic price level as an implicit deflator of GDP, whose real level was normalised to the unit in 2010. We normalised foreign prices in the same way. The last thing was to normalise the nominal exchange rate to the unit value in 2010. This was done by dividing the nominal exchange rate by 103.4874, which represents the average annual RSD/EUR exchange rate calculated at the end of each month. In this sense, the long-term real exchange rate is equal to the unit. If this index value is below the unit, there is a real appreciation of the exchange rate. If the index value of the real exchange rate is above the unit it represents a real depreciation of the exchange rate. Real depreciation stimulates exports and destimulates imports. However, it also inflames inflation. Real appreciation, on the other hand, calms down inflation expectations but hurts exports.

Figure 2 shows that the neoliberal policy inherited a highly depreciated real exchange rate, but at the end of its period it had managed to stabilise it to a neutral

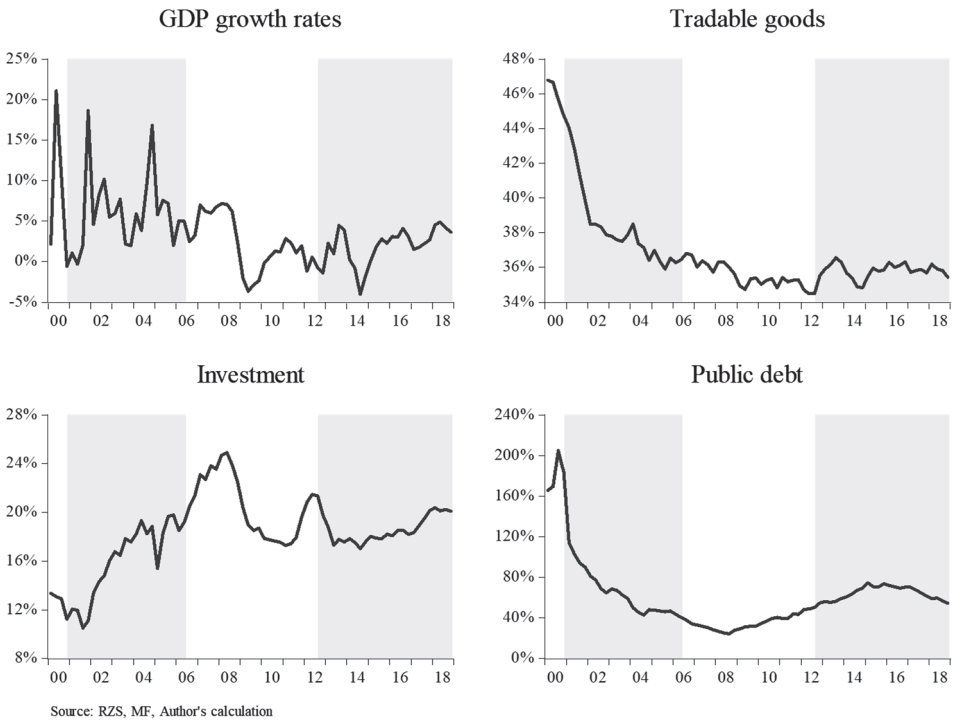
[9] See also Zildžović (2015).

level. After that, the populist and interventionist policies permanently pursued a policy of real appreciation of the exchange rate. This policy had significant support from the monetary policy of the NBS, which generally prefers an overvalued exchange rate to stabilised domestic prices.

3.2. Growth Strategy

There is a widespread belief that the Great Recession changed the economic growth strategy in Serbia. Before the recession the strategy for economic growth was based on the promotion of domestic consumption and imports, all financed by borrowing abroad. After the recession the strategy changed and began to favour exports and investment in the production of tradable goods. The facts, however, are a bit more complicated. They are shown in Figure 3.

Figure 3: Domestic market



Source: RZS, MF, Author's calculation

Growth. Growth was much faster before the Great Recession than afterwards. The average annual growth rate of seasonally adjusted GDP under the neoliberal

policy was 6.0%. It fell to 2.0% in the period of populism, while in the period of interventionism it was 1.9%. The 2017–2018 recovery significantly increased the growth rate, although many other countries had already emerged from the crisis and had begun to achieve much higher growth rates. The GDP level in the first quarter of 2008 before the Great Recession was only reached again in the first quarter of 2016. This means that the depression lasted for eight years, half of which was under populist policy and half under interventionism.

Besides, the external circumstances of the last two years in this period were far more favourable, since interest rates were historically low, the price of crude oil declined, and market prices in Europe were stable with the recovery of the eurozone and the growth of its import demand.

Tradables. Serbia has been exposed to a process of deindustrialisation since the beginning of the breakup of the former Yugoslavia, as we showed in the first part of this paper. Industry contributes significantly but not exclusively to the sector of tradable commodities. Besides most industrial output, tradable goods include goods and services from agriculture, tourism and transport, trade, and information. With the fall in the share of industry in GDP, there was also a fall in the percentage of tradable goods in GDP.

During the neoliberal policy, industrial production grew but services grew much faster, so the share of tradable goods in GDP steadily declined (from 44.7% in the third quarter of 2000 to 36.4% in the second quarter of 2006).

The trend of declining tradable goods continued during the populist policy, ending with a 34.7% share of GDP in the second quarter of 2012. This trend was partially reversed in the period of state intervention when the share of tradable goods in GDP reached 35.4% in the fourth quarter of 2018.

Investment. Neoliberalism began its mandate with a low 13% share of investment in GDP as well as a low level of real GDP generated through the investment channel. However, that changed immediately. Investment activity was significant so by the end of the mandate the share of investment in GDP had risen to almost 20%. The quarterly growth rate of investments was 3.25%, while GDP grew at a rate of 1.39%, allowing an increase in the share of investments in GDP. This trend of growth continued until the second quarter of 2008 when it reached its historical

maximum of 25.8% of GDP. Then the financial crisis suddenly halted capital inflow from the rest of the world, and the share of investment in GDP fell sharply to 18.3% in the second quarter of 2010. After that it rose to the level of 22.9% at the end of the populist period. In that period the quarterly growth rate of real GDP in investments was still positive, amounting to 1.07%. The beginning of interventionist policy in 2012 lowered the share of investment in GDP again. After that, the investment share recovered slowly so that at the end of the observation period in the fourth quarter of 2018 it was 20.1% of GDP. The quarterly growth rate of the real level of GDP for investments was negative and amounted to –0.45% for the entire period of the interventionist policy.

In the field of investment, the neoliberal policy proved to be the most effective. The populist policy was second most effective, while the interventionist policy takes third place. These results point to a far-reaching conclusion: reform and market liberalisation are more effective in attracting investment than state intervention through subsidies. After the period of neoliberalism the populist and interventionist policies pursued a policy of high subsidies for foreign direct investments, which proved to be an inferior solution. We have shown elsewhere that this policy depressed domestic investments in favour of foreign and state investments, with a more or less zero effect on the total share of investments in GDP (Labus, 2019). Moreover, the climate of weakened institutions, corruption, and a rule of law weakened through political interference in the justice system have adversely affected incentives to invest (Petrović, et al., 2019).

Public debt. All the external commercial debts of the self-managed companies were converted into public debt because the state was their guarantor. When the debts of the state are added together, at one point in 2000 public debt had reached 200% of GDP. The country was incapable of servicing its external debts. After the termination of international sanctions, restructuring the public debt was the number one issue, both for the stability of the economy and for its future growth. In the period of neoliberal policy, agreements were reached on rescheduling, including with the member states of the Paris Club of creditors and the London Club of banks to partially write-off the public debt. By the end of the second quarter of 2006 the public debt had been reduced to 40% of GDP.

The populist policy continued to reduce public debt for a while, but at the end of the second quarter of 2012 it increased to 49%. Under the interventionist policy the government kept borrowing from abroad and increased the public debt to an unsustainable 75% in the first quarter of 2015, so that the policy of borrowing had to change, or else the country would have defaulted.[10] A fiscal consolidation policy was enforced, and public debt was reduced to 55% of GDP by the end of 2018. This level was still higher than when the Third Government was elected.

3.3. The Foreign Market

We have examined the situation in the foreign market by exploring the degree of openness of the economy, euroisation of the national currency, capital inflows from abroad, and official foreign exchange reserves. The openness of the economy to the international market depends on the liberalisation of foreign trade. Liberalisation is sustainable if it is accompanied by an adequate change in the production structure and an increase in the share of tradable commodities to non-tradable goods. Euroisation is a matter of confidence in the national currency, and the level of foreign capital inflow is an indicator of the country's attractiveness for investment (direct investment and capital lending). The amount of foreign exchange reserves depends on the balance of payments and capital inflows.

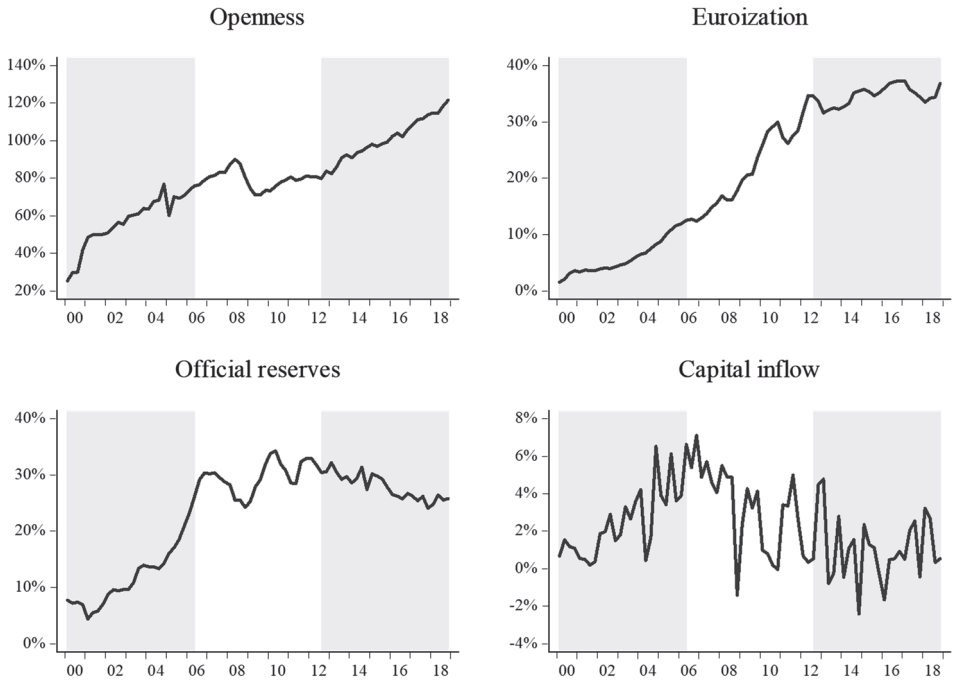
Liberalisation of foreign trade. Under the neoliberal policy the liberalisation of foreign trade was often the target of criticism. It has been claimed that after the international sanctions the Serbian economy ressembled a young industry, which the state should have protected from external competition until it was rehabilitated and became capable of fair market competition. Otherwise domestic companies would be destroyed and sold off cheaply to foreigners. Therefore, it was necessary to use quantitative restrictions and tariffs and slowly open up domestic industry to the world market.

This argument looks very attractive, with two 'small' drawbacks. First, this protectionist policy was used for years in the former Yugoslavia and never resulted in the economy matching foreign competition. There was no reason to believe that in much more difficult circumstances it would now yield different

[10] See also Andrić et al. (2016).

results. Second, after the international sanctions the domestic economy was completely bankrupt, with outdated technology and no financial capital or market connections with the world. Consumers were not ready for additional sacrifices to finance a protectionist economy, especially not when the foreign trade regime was the main generator of corruption in the country. The fixed exchange rate, set below the market level, the system of import and export licenses, and the non-transparent allocation of primary money all fuelled corruption. Moving to a flexible exchange rate, foreign exchange coverage of the dinar, and abolition of all quantitative restrictions, while at the same time lowering tariffs, eliminated corruption overnight and stabilised foreign trade. All this was supported by the unilateral trade incentives provided by the European Union, which abolished customs duties on Serbian imports, with a few exceptions related to agricultural products. Meanwhile the First Government committed itself to EU accession, which eventually led to a free trade agreement and abolition of all customs duties with the EU.

Figure 4: Foreign market



Source: RZS, NBS, Author's calculation

Bearing all this in mind, there was no alternative to liberalising foreign trade. The first graph in Figure 4 presents the openness of the Serbian economy, which we define as the ratio of exports and imports to GDP. At the beginning of the period Serbia was a relatively closed economy with a 30% level of degree of openness. Neoliberal policy rapidly raised this level to 77% of GDP. When populist and interventionist policies replaced liberalism the trend of opening the economy to the world market did not change. The Great Recession temporarily reversed the trend, but it quickly resumed and continued at the same pace. The neoliberal trade policy in Serbia has often been criticised as unfavourable for the country, but the sunsequent economic policies and governments maintained its elements.

Euroisation. Euroisation is a process that has progressed independently of the opening of the Serbian economy to the world market. Its roots are in two hyperinflations (1989 and 1992–1994), which destroyed confidence in the domestic currency. The share of the dinar has dropped continuously despite all measures aimed at strengthening its status. "Dinarisation" failed completely, irrespective of government changes and macroeconomic policy.

There are several ways to measure the level of euroisation. In this paper euroisation is defined as the ratio of foreign-currency-denominated money stock to the value of GDP. Euroisation evolved rapidly until 2016 when the NBS embarked on an active campaign of dinarisation of the monetary sector. That had minor effects and reduced euroisation only temporarily by a few index points. Its level returned to 37% of GDP at the end of the observed period.[11]

The inflow of capital. Foreign capital inflows were calculated in net terms (inflow minus outflow) and encompass four components: foreign direct investment, portfolio investments, financial derivatives, and other inflows, in which financial loans form the largest category. From the fourth quarter of 2000 to the end of 2018 around 50 billion euros entered the country: 14 billion euros under neoliberal policy, around 25 billion euros under populist policy, and 11 billion euros during the last interventionist phase. Of that amount, foreign direct investment amounted to 5 billion euros, 13 billion euros, and 12 billion euros, respectively. In the last few years there was a large outflow of capital, which was

[11] See also Bošnjak et al. (2018).

not the case before, so that foreign direct investment was higher than the total capital inflow.

Capital inflow partly depends on the state of the world financial market, and partly on the attractiveness of the country for investment (direct investment and lending). Capital inflows from privatisation depend solely on government policy, as does borrowing to finance the fiscal deficit. On the other hand, the private sector deleverages or invests depending on the attractiveness of investment and the country risk.

Foreign exchange reserves. The last indicator of the country's external position is the stock of foreign exchange reserves, which is related to the creation of primary money and the liquidity of banks and business entities. Foreign exchange reserves were meagre at the start of the observation period, but the neoliberal economic policy managed to increase them significantly. Foreign trade and exchange rate liberalisation did not pose a risk to foreign exchange reserves but, on the contrary, created an economic climate that attracted foreign capital and increased the country's foreign exchange reserves.

Under the populist policy the movement of foreign exchange reserves became cyclical. Two cycles can be seen: during the Great Recession period and later in the repeated recession in 2011. The period of interventionism changed the trend of foreign exchange reserves: they began to fall and reached a level of 24% of GDP, below the standard reached in the age of neoliberal politics.

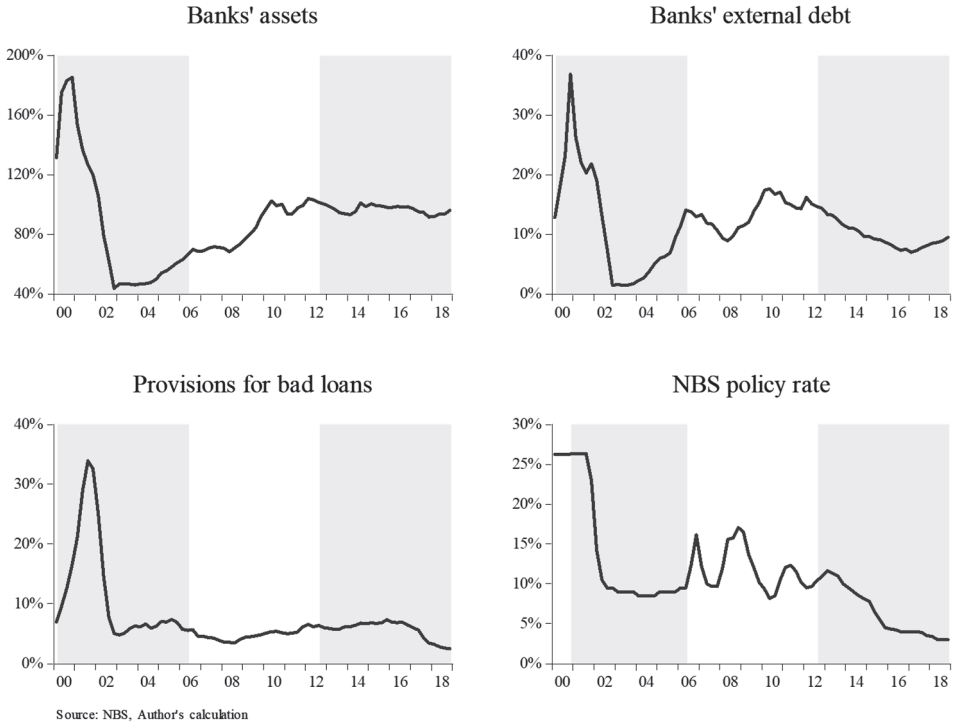
To conclude, the neoliberal economic policy was key to opening the Serbian economy to the international market, and this is a trend that can no longer be stopped. The world economy is currently in the process of renewed protectionism and a 'cold war' in which tariffs are used extensively. Serbia is not a WTO member, and bilateral agreements regulate its foreign trade relations. Irrespective of this, the crisis in world trade can negatively affect Serbia's economic growth, as it has become a small but very open economy.

3.4. Financial Market

The depth of the banking sector, the exposure of banks to external debt, the impact of bad loans, and the level of the NBS policy rate are financial market

indicators. They are shown in Figure 5. The state is heavily indebted in the domestic banking market (in dinars and foreign currencies), and its borrowing policy directly influences both interest rates and the credit potential that remains for the private sector (the crowding-out effect). The depth of the banking sector is measured by the share of banking assets in GDP. Bad loans are monitored through a series of bank reserve allocations to cover losses on bad loans. The more bad loans, the less the interest-bearing assets and the higher the banks' interest rates.

Figure 5: Financial market



Source: NBS, Author's calculation

We have already analysed the foreign exchange reserves that affect the creation of primary money. The increase in foreign currency reserves leads to a rise in money supply and, vice versa, the fall in foreign currency reserves reduces the money supply. Money supply affects the liquidity of the economy. Market interest rates largely depend on interest rates on the foreign market, but also on the monetary

policy of the NBS and the currency risk. Thus, interest rates on foreign currency loans are always lower than interest rates on dinar loans.

Depth of the banking sector. A developed banking sector is capable of financing the corporate sector and significantly supporting investment financing and investment-based economic growth. We define financial depth as the ratio of banking assets to GDP, both of which are seasonally adjusted.

The neoliberal policy inherited a formally well developed banking sector with a depth of 195% GDP, as is shown in Figure 5. However, the same figure shows huge bank losses due to non-performing loans. Practically, the five leading banks were bankrupt, and the four leading banks were declared bankrupt in the first quarter of 2002 with the dismissal of 10,000 bank employees. It was an unprecedented move, both in the country and in Eastern Europe.

Consequently, bank assets dropped dramatically. However, the credibility of the banking sector was restored, new banks quickly opened, and the banking sector as a whole recovered within a year. In the first quarter of 2002 banking assets amounted to 43% of GDP, while by the end of the mandate of the neoliberal government they had risen to 70% of GDP and the number of bank employees far exceeded the number of previously released staff. This was the cheapest and most risky banking sector reform in Eastern Europe, and probably the best reform achievement of all the economic policies.

The populist policy of the next governments continued to increase the depth of the banking sector to a level of 100% of GDP. The Great Recession only temporarily reversed this trend, with a recovery near the end of the populist policy mandate. However, the interventionist policy did not make any substantial improvements: quite the opposite, it established a slow trend of reducing the depth of the banking sector.

Banks' external debt. Foreign parent banks own most banks in Serbia. Initially the parent banks supported the credit activity of their Serbian affiliates. This was especially noticeable in the period of neoliberal policy. Populist policy could not count on this support, but banks continued to increase their foreign-based assets until 2010. After that there was a sharp deleveraging that lasted until the end of 2018. Now the external debt of banks does not exceed 10% of GDP.

Bad loans. When there are bad loans, banks need to allocate more funds from current revenue to cover potential losses. This reduces their profitability and encourages them to increase interest rates on reliable loans. Bad loans slow down credit and economic activity. In borderline cases the bankruptcy of banks (Development Bank, Universal Bank, Agro Bank, etc.) also leads to a decrease in total bank assets.

It is not surprising that under the neoliberal policy the first government inherited a high level of loss provisions, amounting to 12.9% of GDP. These provisions rose to 36% of GDP in the fourth quarter of 2001, that is, just before the closure of the four largest banks. The implementation of the banking sector rehabilitation programme reduced the share of provisions in GDP, which was 5.9% in the second quarter of 2006.

The new government that introduced the populist policy initially continued to reduce the share of bad loan provisions in GDP, but due to the adverse effects of the Great Recession they returned to the inherited level. During the time of interventionist policy the share of bad loans grew until reaching the maximum level in 2016. The NBS then decided to change its policy and stimulate the write-off of bad loans, which at the end of the observed period were no longer a significant problem for the banking sector.

NBS policy rate. After the fourth quarter of 2006, NBS monetary policy switched to targeting inflation and using the repo interest rate to manage inflationary expectations. Previously, the NBS had maintained a policy of maintaining a given level of Net Foreign Assets and used the discount rate to regulate the liquidity of banks.

In times of high inflation in 2001–2002 the reference interest rate was high, but negative in real terms. By contrast, the populist and interventionist policies pursued a policy of positive real reference interest rates. Throughout this period their average level was about 3%.

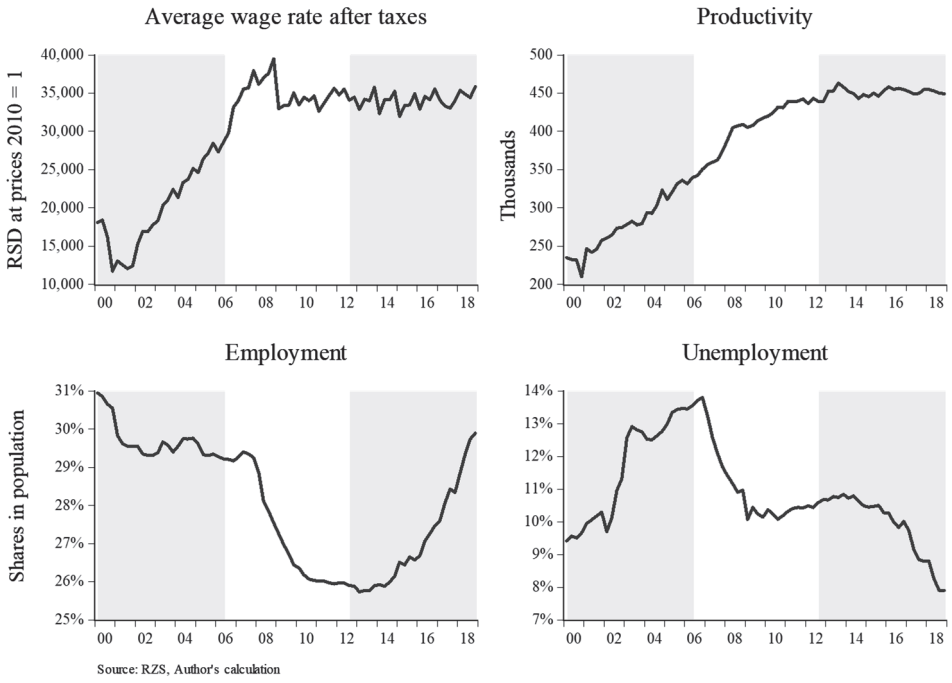
Thus, neither in the Great Recession nor during the next two recession episodes did the NBS pursue an interest rate policy that supported the recovery of the economy, but instead kept inflation at the target level at all costs. The neoliberal policy rehabilitated the banking sector with the idea that a sound banking sector

is a necessary condition for attracting and financing investment. The other two policies took on a healthy banking sector and maintained its stability standards, but used interest policy to manage inflation, not to fight the recession.

3.5. Labour Market

Real wages, labour productivity, employment, and unemployment are indicators for ranking the effect of economic policies on the labour market. In market economies, higher productivity leads to higher real wages. This principle works in the Serbian economy, where the coefficient correlation between real wage rate and productivity is 0.95.

Figure 6: Labour market



Also, higher employment means an increased supply of work, which should negatively affect the growth of real wages. That is also evident in the Serbian economy because the coefficient correlation between real wage rate and employment is –0.80. However, there is no strong statistical link between unemployment and average salary, while on the other hand the coefficient of

correlation between employment and unemployment has an unexpected positive sign, although it is a rather low 0.52.

Real wages. The level of average real wage rate (excluding taxes and contributions) was obtained by dividing the average seasonally adjusted nominal wage rate by the implicit GDP deflator, both seasonally adjusted. Thus, the real wage rate is expressed in constant 2010 prices. The graph is shown in Figure 6.

The First Government that carried out a neoliberal policy inherited an average real wage rate of 14,730 RSD.[12] In the first year of its mandate the real wage rate fell due to structural changes and deregulation of prices. However, from the next year wages and salaries started to grow and the First Government ended its mandate with an average real wage rate of 28,865 RSD (which gives an implicit quarterly growth rate of 3.0%). The next government carried out populist policies and continued to increase real wages up to the amount of 36,160 RSD, with an implicit quarterly growth rate of 0.9%. The Third Government only raised average real wages to the level of 36,270 RSD, with an implicit quarterly growth rate of 0.02%. The movement of labour productivity accompanies real wages, which is why they overgrew until the Great Recession, after which they stagnated.

Productivity. The overall labour productivity rate is the ratio of GDP to the number of employed persons. Both variables have been seasonally adjusted, and for GDP we have taken real GDP at 2010 prices. During the First Government, labour productivity grew at a quarterly growth rate of 1.67%. Under the Second Government's mandate, labour productivity grew at a slightly lower quarterly growth rate of 1.04%. However, labour productivity growth under the Third Government's mandate was negative and decreased by a quarterly growth rate of –0.06%.

Employment. Employment data was revised in 2015, and this caused controversy in professional circles (Petrović et al., 2016, Arandarenko et al., 2016).We will not go into this controversy but present the official (revised) statistical data on employment.

[12] In terms of 2010 prices.

The First Government inherited an employment rate of 2,301 million workers. During the entire mandate, employment declined due to bankruptcies and privatisations. At the end of the mandate, 2.163 million were employed under the First Government. The implicit quarterly growth rate was negative and amounted to –0.3%.

Under the Second Government the employment rate was reduced significantly due to the Great Recession. In the first quarter of 2009 less than 2 million were employed. The government completed its mandate with 1,877 million employed, giving a negative implicit quarterly growth rate of –0.6%. The Third Government reversed the declining employment trend and completed its mandate with 1,976 million workers and an implicit positive quarterly growth rate of 0.3%.

Employment improved after 2012. Serbia had taken more than a decade to deal with structural unemployment.

Unemployment. Unemployment is not the mirror of employment, as illustrated in Figure 6. Unemployment grew significantly under the mandate of the First Government. 713,000 people were registered as unemployed at the beginning of the mandate and 1,003,000 at the end. The implicit quarterly unemployment rate was 1.5%.

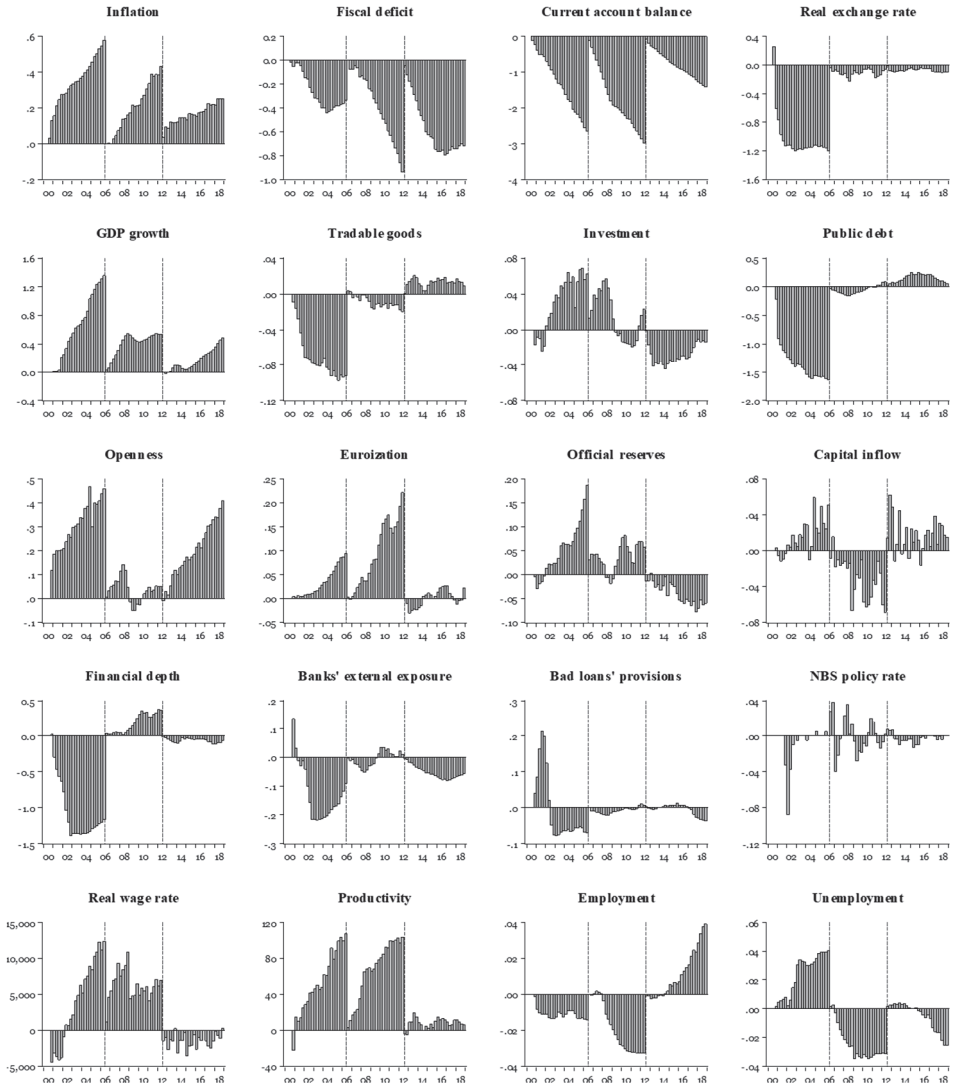
During the Second Government's mandate, unemployment dropped significantly, although employment also dropped considerably in the same period. We have no explanation for this paradox. In any case, by the end of the Second Government's mandate, unemployment had been reduced to 754,000, with an implicit quarterly growth rate of –1.2%.

During the mandate of the Third Government, unemployment fell to 646,000, which makes sense because during the period employment grew. The quarterly growth rate was –0.8%.

4. RANKING THE ECONOMIC POLICIES

We compared and ranked the three economic policies of liberalism, populism, and interventionism based on their contribution. Each indicator was treated equally. We present the policies' contributions in Figure 7.

Figure 7: The macroeconomic policies' contributions



In this approach the difference between flow and stock variables is critical. Flow variables were cumulated for each period separately. For the stock variables we first determined their marginal contributions for each quarter and then

cumulated them separately, thus obtaining the effects of each of the observed policies. Based on these effects we arrived at the ranking presented in Table 2.[13]

The average rankings are 1.65 for neoliberal policy, 2.4 for populist policy, and 1.95 for interventionist policy. The lower rank, the better. According to our estimation, neoliberal policy achieved the best results. Populist policy performed the worst. Finally, interventionist policy was inferior to neoliberal policy, but superior to populist policy.

Table 2: Ranking scores

	Liberalism	Populism	Interventionism		Liberalism	Populism	Interventionism
Macroeconomic stability				Financial market			
Inflation	3	2	1	Financial depth	3	2	1
Fiscal deficit	1	3	2	External exposure	1	3	2
Current account balance	2	3	1	Bad loans	1	3	2
Real exchange rate	1	2	3	Policy rate	3	2	1
Growth strategy				Labour market			
GDP growth	1	2	3	Real wage rate	1	2	3
Tradable goods	3	2	1	Productivity	1	2	3
Investment	1	2	3	Employment	2	3	1
Public debt	1	2	3	Unemployment	3	2	1
Foreign market							
Openness	1	3	2				
Euroization	2	3	1				
Official reserves	1	2	3				
Capital inflow	1	3	2	Average	1.65	2.4	1.95

5. CONCLUSION

The empirical evidence that we provide for Serbia in this paper shows that the starting point of transition matters as much as the proper macroeconomic policy. The conflict period from 1991 to 1999 was significant in determining that starting point. This pre-transition shock was much more severe than the shock imposed by the Great Recession in 2008. However, apart from the shocks and the delayed institutional reforms, macroeconomic policies substantially influenced the performance of the Serbian economy.

This paper outlines the long-run development in Serbia, and within it the three distinct policies. Neoliberal, populist, and interventionist policies were implemented between 2000 and 2018, with very different outcomes. This paper

[13] The scores are 1= good (first place), 2= moderate (second place), 3= poor (third place).

evaluates them using quarterly data on 20 macroeconomic indicators classified into five groups: macroeconomic stability and domestic, foreign, financial and labour markets.

Regarding the achievements of three macroeconomic policies, neoliberal policy was commonly blamed for all the economic deficiencies in the period between 2000Q1 and 2006Q2. Our data indicates quite the opposite, that this policy performed the best. The next, populist period from 2006Q3 to 2012Q2 performed the worst. Finally, interventionist policy, starting in 2012Q3 and evaluated up to 2018Q4, was inferior to neoliberal policy but superior to populist policy.

When moderating this judgement, it should be noted that external factors played an important role. External shocks hit all three policy regimes: the breakup of the Federal Republic of Yugoslavia and the assassination of the Serbian Prime Minister during the period of neoliberal policy, the Great Recession during the period of populist policy, and floods and drought during the period of interventionist policy. Future research should examine which of these had the most severe effects. This paper spreads their potential effects over twenty macroeconomic indicators, not just GDP growth. Overall, the paper shows the importance of the initial conditions that constrained policymakers' options in all three periods considered in this paper. In the future, similar constraints will apply to future governments, most notably the impact of the coronavirus pandemic, which will shape policy constraints and economic performance over the next decade.

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