

# **Political Economy of Enterprise Restructuring and Election Results in Serbia<sup>1</sup>**

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### **Abstract**

The general objective of the paper is to examine a specific reform policy toward real sector enterprise restructuring in Serbia after 2000 from the perspective of political economy. The specific objective of this paper is to examine the links between political support to real sector enterprise restructuring in Serbia and a government decision regarding the policy of their restructuring. There is no evidence that relative employment in the firms slated for restructuring influences the election results. Enterprise restructuring did not result in a decline in support for pro-reform parties. It was demonstrated that demographic factors have a crucial effect on the behavior of voters in Serbia.

Key words: Enterprise restructuring, political obstacles, voting behavior, demographic factors, election results

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## 1. Introduction

Transition that took place in East European countries over the last decade of the 20<sup>th</sup> century, that is, reforms of institutions and government policies aimed at creating full-fledged market economies, initiated at that time, raised the issue of political support to reform-oriented processes. More specifically, transition began with the introduction of democracy, based on a multi-party system, regularly held elections and peaceful change of government. In the described circumstances, the necessary condition for sustainable reform-oriented policies is political support from the electorate. The absence of such support gives rise to two types of political constraints. One type are *ex ante* political constraints, i.e., those constraints which prevent the initiation and implementation of a particular reform, since the lack of political support for that reform means that those who have initiated and/or implemented it, with the votes of the dissatisfied electorate, will lose the next elections. This is why a government that consists of politicians whose primary goal is to be reelected, also fails to embark upon such a reform. The second type refers to *ex post* political constraints, i.e., those constraints that are based on the discontinuation, reversal or even annulment of the implemented reforms. This clearly shows that in democracy, sustainable reform is simply not possible without political support from the electorate. Accordingly, reform as a whole and/or individual reform-oriented steps are endogenous from the standpoint of the political process, so it is inevitable to examine these steps within the conceptual framework of political economy as well.

The general objective of this paper is to examine a specific reform policy toward real sector enterprise restructuring in Serbia after 2000 from the perspective of political economy. To that end, the specific objective of this paper is to examine the correlation between political support to real sector enterprise restructuring in Serbia and a government decision regarding the policy of their restructuring. In order to achieve the said objective it is necessary to consider relevant theoretical models and examine the past empirical studies into the relationship between reform, political support to reforms and factors of that

political support, that is, opposition to reforms. This will be followed by an analysis of technical specificity of real sector restructuring in Serbia, including the inherited situation in that respect, with a description of the progress made so far in real sector enterprise restructuring in Serbia. On the basis of all those findings, basic hypotheses will be formulated, which will be empirically tested. The empirical research is, however, preceded by definition of its strategy and a description of the available data. It is possible to expect that the resolution of different econometric problems, particularly the problems of omitted variables, should result in the formulation of regression models which will cover various factors of the behavior, that is, decisions of voters in Serbia, thus obtaining comprehensive regression models that can explain results of elections in Serbia, irrespective of the primary objective of the study: the correlation between enterprise restructuring in the real sector and political support for that reform. In such a manner, as a by-product, another result is obtained: the factors of the election results in Serbia. All obtained results will be commented on in the conclusion, and guidelines for further research will also be offered.

## **2. Overview of Previous Theoretical and Empirical Papers**

The main political consequences of transition are based on the fact that reforms very rarely result in a Pareto improvement; instead, there are winners and there are losers. All this takes place against a backdrop of uncertainty, which means that individuals cannot be certain about their position at the end of a reform; rather, they only expect to emerge as either winners or losers. This is also surrounded by one more kind of uncertainty: whether, and to which extent, political parties will deliver on their election promises. In such circumstances, those who expect to emerge as losers have incentives to try, by voting for anti-reform parties, to *ex ante* block the reform, that is, to initially prevent, through their vote for anti-reform authorities, the reform from taking place. If the reform, however, has taken place, those who have lost due to that reform are trying, by voting for anti-reform parties, to stop, reverse or annul the reform by bringing them to power, thus creating *ex*

*post* political constraints on the reform.<sup>2</sup> Therefore, the question is raised of defining a reform strategy which would secure the necessary political support and make all those reform-oriented steps which make transition possible and raise economic efficiency.

Having all that in mind, it is not surprising that previous research that looked into the correlation between political support and reform emerged very early in the last decade of the 20<sup>th</sup> century, which was marked by East European transition. Way back in the early 1990s (Fernandez and Rodrik, 1991) attention was drawn to the possibility of even winners voting against pro-reform parties (of which they presume that they conduct reform which increases economic efficiency), if losers of the reform have not been individually identified *ex ante*. The conclusion was that, if a strong political constraint was involved, pro-reform authorities would have to develop and apply mechanisms to compensate losers, in order to remove the political constraint on the reform. Such compensation, irrespective of bad incentives that it creates, has its cost, of course, since public spending, that is, the burden on taxpayers, is bound to go up. Precisely such costs of securing political support and overcoming political constraints on reforms generate considerable social costs. This prompted some authors (Dewatripont and Roland, 1992) to claim that it is quite possible for a slower pace of transition to be desirable, precisely because it leads to less pressure on the fiscal sector.<sup>3</sup> Wyplosz (1993) formulated a theoretical model whose results show that *ex post* political constraints are stronger than those *ex ante*, which means that it is politically more difficult to maintain reforms, than to initiate them. The conclusion from the standpoint of policy implementation is that the very fact that losers are in a minority is not enough to secure sustainable political support for reforms, but the author concludes that the government has to engage in the redistribution of income from winners to losers, in order for transition to be politically sustainable.

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<sup>2</sup> Such behavior, admittedly just in part, is aimed at creating *ex post* political constraints. In its other part, it is aimed at *ex ante* political constraints, i.e., at preventing reform-oriented parties from conducting further reforms.

<sup>3</sup> A later, partially modified model by the same authors (Dewatripont and Roland, 1995) offers new findings supporting partial reforms, primarily from the standpoint of *ex post* political constraints, as well as new findings regarding the sequencing of the reform steps. Findings related to the desirability of partial reforms are challenged by a bit more general model (Katz and Owen, 2000).

One of the most frequently mentioned losses, which inevitably occur with transition reforms, is the reduction of employment. The pace of losing existing jobs and creating new ones is not related only to political constraints on reforms, but also to its basic mechanics. Therefore, Aghion and Blanchard (1994), precisely through the optimal pace of job losses in the inherited, state (socially) owned sector and job creation in the private sector, define the optimal pace of transition in East European countries. If job losses in the state (socially) owned sector are not matched with job creation in the private sector, high unemployment is created and then two options for conducting pro-reform policies exist for the authorities. One is large-scale and generous compensation for the laid-off (insurance against unemployment and material assistance to individuals), but something like that brings high, sometimes prohibitive costs of implementing it. The second option is to pay no compensation to losers, to the laid-off, but that increases the probability of them voting against a pro-reform government, which brings about a danger of arresting the reform. If, however, job losses in the inherited state owned sector are few, that is not positive *per se*. That is to say, the keeping of such jobs through explicit or implicit subsidies, which result in relatively high wages, creates distortion on the labor market. It means that new, privately owned firms under such conditions should pay higher wages in order to attract labor, compared to those wages that one would need to pay in a period of high unemployment. This undermines private sector growth, thus undermining the process of transition, regardless of the existence of political support from employees of the state owned companies. In those circumstances, the model by Aghion and Blanchard shows that the unemployment level can be either too high, thus undermining political support to reform, or too low, thus slowing down reform, that is, decelerating job creation in the private sector.<sup>4</sup> Hence, in theoretical terms, it is possible to define the optimal unemployment level during transition, that is, the optimal pace of transition.

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<sup>4</sup> If transition amounts to reform, i.e., the restructuring of state owned companies, then it is certain that the authors of this model have focused solely on *ex post* political constraints.

The generalization of the above model (Tichit, 2006) is based on the introduction of two new assumptions. First, jobs are lost in the private sector as well, not only in the state owned one, due to, for example, wrong business decisions of private entrepreneurs or changes in the structure of demand. Second, the sector “change”, from the standpoint of the labor force, is not necessarily made through unemployment: everybody is allowed to change their job in a state owned company for a job in a private one at any point in time. The results of this model have shown that there is multiple dynamic equilibrium. The first equilibrium is established through a rapid decrease in the number of jobs in the state-owned sector, a relatively high unemployment rate and rapid creation of new jobs in the private sector. In brief, one successful transition. Due to high unemployment, the private sector has at its disposal the labor force at a relatively low price (wages), which promotes its growth, hence employment as well. Such dynamic equilibrium characterized the countries of Central Europe. The second equilibrium is based on a slow decline in the number of positions in the state-owned sector, that is, its stagnation, a relatively low unemployment rate and very slow job creation in the private sector. Such dynamic equilibrium remains a characteristic of many of the former Soviet Union countries.

The maintenance of the employment level in the inherited, state (socially) owned sector should be looked at in light of subsidies (explicit and implicit, through soft budget constraint) which the said sector is receiving. Without those subsidies, that is, with the introduction of hard budget constraints, the state sector, due to its inherent inefficiency, cannot stay afloat in competition with the private sector. This raises the issue of motivation on the part of the authorities to keep state owned firms afloat through subsidies, signifying increased public expenditure and a higher tax burden, which has its political costs. Shleifer and Vishny (1994) have developed a model on the basis of which they have formulated a thesis that politicians (whose first and foremost interest is, as previously mentioned, to stay in power) subsidize state owned firms, in order to maintain the existing employment levels in those firms, and those whose jobs are preserved by means of subsidies will vote for the party in power so as to keep the practice of subsidizing, hence their jobs, too. Moreover, it turned out that wages in such firms, because they are subsidized, are higher than wages

which the private sector can offer. That, in turn, increases incentives to employees in the state owned firms to vote for the party in power.

The above model of politicians' behavior can be supplemented by introducing the assumption on the heterogeneity of politicians (Desai and Olofsgard, 2006). One group comprises of incompetent politicians, those who are not able to pursue reforms even if they wanted to do so, and their behavior does not differ from the behavior described in the above model. Essentially, their underlying desire is to preserve the *status quo*. Contrary to them, there are competent politicians, those who are able to design and carry out reforms. They can maintain the low unemployment rate, which they have taken over, at the end of their term in office, but in the meanwhile change the structure of employment: instead of employment in the government sector, at the end of their term in office sustainable employment in the long run in the private sector will be attained. During their term, unemployment initially goes up (loss of jobs in the government sector), only to fall afterwards (job creation in the private sector).

The previous discussions unambiguously point to the prevalent opinion that the issue of jobs creation or loss is the key to gaining/losing political support, hence to the creation of political constraints on reforms. Therefore, it is justified to ask a general question: which outcomes are possible when it comes to the employment-related vote?

There are three types of voters that appear on the labor market. One group comprises employees in state owned companies, in whose favor a comprehensive reform does not work, since they expect and/or fear that such a reform will make them unemployed. Therefore, this group of voters can be expected to always vote for anti-reform parties since they believe that such parties will stop the reform, keep the subsidies for their firms and thus preserve their job and social status. The only unknown element in this respect is the extent to which such an arrangement is sustainable, but that is not crucial for making

political choices.<sup>5</sup> In other words, voters who vote for anti-reform parties do not know whether these parties will succeed in their intention, but it is clear that they also have no incentive whatsoever to vote for pro-reform political parties.<sup>6</sup>

The second group of voters comprises employees of privately owned companies, who are advocates of reform, since they see further reform as a chance for their sector to advance and, consequently, for their position to improve. They have no incentive to vote for anti-reform political parties, since they can expect from them only deterioration of the status of private firms (a higher tax burden, exacerbated conditions for business operations, new subsidies for state owned firms, etc.), that is, deterioration of their own position irrespective of the position of private firms where they work, due to the spreading of forcible income redistribution (in order to provide compensation to the losers in transition) and an increase in their personal tax burden (personal income tax, property tax, etc.). Accordingly, a rational choice for such voters would be pro-reform parties.

The third group comprises the unemployed, irrespective of whether they lost a job in the state owned or private sector, or those who have never been employed. Still, one can presume that most of the unemployed lost their jobs during restructuring, privatization or liquidation of state owned firms. How will these voters vote? One possibility is for them to vote for pro-reform parties. As indicated by Rodrik (1995), the unemployed know very well that the only sustainable employment is in the private sector, and therefore they are advocates of reform and give political support to reform-oriented parties, in order to create conditions for the fastest possible advancement of the private sector and creation of as many jobs as possible. If this thesis were true, it would have very significant consequences for the political economy of the reform. First, there would be no *ex post*, but only *ex ante* political constraints. In other words, for reformists, the only important thing is to initiate

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<sup>5</sup> A choice between the one who may not succeed in defending his interest and the one who will do everything to undermine his interest is not a difficult choice for a voter.

<sup>6</sup> If an employee in a state owned company is not satisfied with his position, he can move to a new job in the private sector without any problems. There is no need to vote for pro-reform parties while he is still employed in the government sector and intends to stay there.



the reform, namely restructuring, privatization and liquidation of state owned firms, thus creating unemployment, and the unemployed will be at the forefront in lending political support. Second, from the standpoint of reformists, the more unemployed persons, the better. Consequently, the problem of sustainability of the political reform in fact does not exist.

Contrary to such behavior of the unemployed, it is also possible to assume that they vote for anti-reform parties. There are two basic motives for something like that. The first, those who have lost jobs hope that the new authorities will stop, reverse or even annul the reform, thus giving them jobs again. In the case of privatization, that is, liquidation of state owned firms, the probability of something like that happening is low – a firm which has been privatized will not be nationalized, let alone “brought back to life” if the enterprise was liquidated. The second motive is much more authentic – it is income redistribution, that is, compensation to those who have lost their jobs, through generous amounts of unemployment benefits, prolonged duration of unemployment insurance coverage, and all other measures of forcible income redistribution which increases the welfare of those who have lost jobs, preferably to the level which enables them to stop seeking a new job.

Obviously, the unemployed also have motives to vote for pro-reform parties, as well as against them, so the possibility should be allowed for a number of unemployed voters (including their households) to behave in one way, while other such voters behave in another way. The relative frequency of such behavior probably varies from one situation to another and it can be arrived at only empirically. Therefore, one should turn to the presentation of the most significant empirical papers dealing with that topic.

The results of eight parliamentary elections in total, in four transition countries (Poland, Hungary, the Czech Republic and Slovakia) between 1992 and 1998 were used to test the factors which influence the voting for pro-reform parties (Fidrmuc, 2000). It turned out that there is a statistically significant correlation which shows that a rise in the unemployment rate results in a fall in political support (the number of votes), while a rise

in the number of (small) entrepreneurs, that is, the strengthening of the private sector presented in such a manner, leads to a statistically significant increase in political support to pro-reform-oriented parties. It turned out, however, that the correlation between the level of wages and political support is not statistically significant, although those whose wages are going up in a reform could have been expected to be more inclined toward pro-reform-oriented parties.

Jackson *et al.* (2003) used a combination of the results recorded in parliamentary elections in three different years (1991, 1993 and 1997) and data obtained from a survey carried out among the electorate. No direct statistically significant correlation between unemployment and political support to pro-reform-oriented parties was identified, but an empirical study has unambiguously demonstrated that the strongest support came from the employees of newly established private firms, as well as from those regions where such firms generated most of the employment. An analysis of data obtained through the survey has shown that unemployed persons have lower confidence in private firms relative to state owned enterprises.

Results of the 1995 parliamentary elections in Russia were the subject of empirical research (Warner, 2001), which used the existence of numerous regions of that country and the fact that reform was pursued at a different pace and in a different manner in different regions. The main hypothesis was that in those regions where progress was made in the reform, that is, where it was faster, political support to the reform went up. This hypothesis has been empirically confirmed, with the speed of the reform being reflected in the programs for privatization and price liberalization; the basic explanation is that reform brings about improvements felt by the broadest population segments, which is the reason why political support is built. The above empirical research did not look at the impact of the existing or expected unemployment on political support, but some other factors of political support were investigated (the share of people with higher education, *per capita* outlays on alcoholic beverages, the amount of unpaid wages, etc.). Therefore, it remains

unclear what the results would have been had the data on unemployment been included in the regression model.

The empirical research into the political support for the then ruling party, that is, coalition in 2000, proceeded from the fact that precisely that coalition, which had come into power in 1997, carried out resolute pro-reform steps which introduced Bulgaria to the club of market economies (Valev, 2004). The data on political support were obtained on the basis of a survey in which one of the questions was “Will you vote for that coalition in the next election?”. The empirical research did not produce unambiguous results. The statistical significance of the correlation between political support to the ruling coalition and voters’ unemployment emerges and vanishes depending on the specification of the regression model, but it is always negative, which theoretically was rather expected. Still, the inclusion of interactive variables (unemployment and permanent residence in villages and small towns) results in a statistically significant positive correlation, which means that unemployed persons living in smaller places give political support to the ruling coalition. It appears that “Rodrik’s effect” in Bulgaria exists just in smaller towns and in villages.

As an indicator of political support and of the popularity of reform, one can use answers to the question “Do you personally feel that the creation of a market economy in your country is the right move?” (Kim and Pirttila, 2006), which was posed over the period 1990 to 1997 to respondents in 14 East European, transition countries.<sup>7</sup> The empirical research is based on the use of several methods for estimating the parameters of regression models. It turned out that political support falls with a rise in inflation and inequality in income distribution (measured by the Gini coefficient) at the time of the survey, and, in some estimations of the model, also with a rise in unemployment in the period that preceded the public opinion poll. Although, theoretically speaking, a weak correlation could be expected

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<sup>7</sup> Answers to the question “Do you expect that the financial situation of your household is going to improve or deteriorate in the next 12 months?” are used by the authors as a measure of *ex ante* political constraints, while the unemployment rate and inequality in income distribution (Gini coefficient) are measures of *ex post* political constraints. It remains unclear why inequality in income distribution is used as a measure of *ex post* political constraints. There obviously is aversion on the part of the electorate, i.e., the public, toward an increase in income distribution equality.

between unemployment and political support (due to the ambiguity of the link between these two variables), no theoretical rationale was offered in the paper for a strong (negative) correlation between political support and economic inequality. The inclusion of indicators of *ex ante* political constraints (defined on the basis of answers to the question about personal expectations) and political support showed the existence of the expected very strong negative correlation between these two variables.

The overview of the prior empirical studies shows that no unambiguous results have been obtained regarding the correlation between unemployment and political support. Such finding has not been expected. In addition to the already mentioned theoretical controversy (“Rodrik’s effect”), it is necessary to also take into account several other facts related to the behavior of voters in transition countries. First, the presented empirical papers, that is, regression models that were estimated, were based on the implicit assumption that voters vote exclusively, or at least predominantly, on the basis of the economic situation in the country which is changing commensurate with the progress in reform, that is, on the basis of their own personal economic interest, irrespective of how they may perceive it. It is obvious, however, that voters’ decisions are taken on the basis of a series of factors, where some of them have nothing to do with economic values and their changes. This does not refer solely to transition countries. For instance, examination of the behavior of the U.S. electorate and election results in different federal states (Glaeser and Ward, 2005) indicates that economic issues are no longer as dominating as they used to be between the middle and the end of the 20<sup>th</sup> century. The authors believe that the domination of economic issues in elections is only an “aberration” in relation to the questions of cultural and religious differences, that is, divisions. If economic issues in the U.S. are considered to be an “aberration”, then it is certainly acceptable that in many East European countries in transition, non-economic, that is, classical political issues can become important. This is particularly the case in those countries where disintegration of the state occurred, that is, new states were created, which in some cases was even accompanied by smaller or greater wars, territorial disputes, massive human rights violations, large number of refugees, etc.

Even on the assumption that voters' decisions are taken solely on the basis of economic values, there are serious reasons to conclude that in the taking of such decisions the rationality of voters is limited. First, the mentioned decisions are taken against the backdrop of uncertainty, both in terms of whether someone will be a loser or a winner (and, how high the loss or the gain will be), and in terms of whether the parties for which one votes (if they come to power) will deliver on their election campaign promises. The phenomenon of limited rationality on the part of voters with respect to economic values is even more pronounced in East European countries where there is no (uninterrupted) tradition of democracy and market economy institutions, and that is further intensified by a relatively low degree of information among the electorate (low circulation numbers of dailies and weeklies, etc.).

Moreover, the assumption on the limited rationality of the voter does not in itself mean that there is a bias of his/her error – it is possible to expect that the error is randomly distributed. It means that no systematic error will occur in the voting for anti-reform and pro-reform parties. However, it is difficult to accept the assumption on the random distribution of the error. This has to do with the fact that there is asymmetry of the complexity of political programs and communication with the electorate. That is to say, pro-reform political parties mostly have relatively sophisticated economic programs, which include quite difficult and not so simple issues, such as foreign trade liberalization, European integration and restructuring of various segments of the economy. All that, to be accepted, requires more information and better understanding of transition processes, that is, at least superficial knowledge of basic economic concepts. In contrast, the programs and rhetoric of anti-reform parties are easier to understand, so it is possible to conclude that the limited rationality will be more pronounced in the case of pro-reform parties.

All the above observed constraints are very significant for understanding the relationship between economic values and political support and results of elections in Serbia. Milanović (2004) conducted so far the only econometric study into the factors of election results (for the parliamentary election of December 2003) which showed that anti-reform

political parties (in this case only the Serbian Radical Party) record better results in those municipalities where the share of refugees and internally displaced persons is higher, also the share of ethnic minorities in the total population, and the lower level of education of the population measured by the number of school grades completed. It turned out that the only economic variable which has a statistically significant impact on the results of elections is *per capita* GDP, that is, the level of development of a particular municipality – the higher the development level, the fewer the voters for the SRS.

### **3. Restructuring the Real Sector in Serbia**

Serbia embarked upon transition late, in early 2001. Due to the stoppage, followed by the annulment, of the transition process during the 1990s Serbia inherited almost all negative mechanisms of the functioning of the economy in the previous period, plus some new ones were added: the prevalence of inefficient social ownership, discrimination against the private sector, domination of politics over the economy, transformation of firms into social welfare centers, the absence of hard budget constraints, abuse of police and the judiciary, which brought about overall criminalization of society and corruption, reduction of markets to the goods market, while the markets for money, foreign exchange, capital and labor were semi-legal, with administratively set prices.

At the beginning of transition, in early 2001, the real sector of the Serbian economy consisted of five groups of firms:

1. completely new private firms, established after 1989, the year when private business was allowed;
2. firms that had been partially privatized through the privatization model applied in the period from 1997 to 2000;
3. socially and state owned firms that did not need pre-privatization restructuring;
4. socially and state owned firms in need of pre-privatization restructuring, that is, which could not be privatized without such restructuring;

## 5. state owned public enterprises.

With the exception of the firms from the first group, all other firms in the domestic real sector constituted the legacy of socialism, with all big and small problems that came to the fore much before the political crisis that started in 1991. The weaknesses of these firms were just made worse during the 1990s, when political problems, such as the break-up of the country, sanctions and isolation of Serbia and implosion of the communist system, only served as a catalyst. The consequences of all this for a large number of state owned firms were manifold: inferior and obsolete technology, weak production programs, uncompetitive products, lack of incentives to employees and low economic efficiency. In line with that, the situation in the real sector in Serbia in early 2001, at the beginning of transition, was such that its largest portion was not at all competitive at the international level.

The key strategic decision related to this issue was taken as early as the beginning of 2001: in all cases, except for the specific case of public enterprises, restructuring was to fall in the competence of the private owner. Such decision was taken on the basis of an assessment that the private owner is better placed to carry out that task than the state, hence it was concluded that post-privatization restructuring was economically more efficient than pre-privatization. In that respect, privatization constituted a precondition for restructuring.

The privatization model that was chosen was based on the sale of majority stakes in firms (at least a 70% stake in publicly owned equity). One of the main motives for the implementation of such a privatization model was directed toward installing a majority private owner, who would have efficient incentives and mechanisms to carry out restructuring.

One of the main problems was related to a number of large socially and state owned firms which cannot be privatized by sale, since there is no interested buyer. There are two main reasons for this lack of interest. First, the absence of any business prospects for those

firms, which are organized as conglomerates in most of the cases, i.e., they pursue a wide range of activities and are not specialized for the field where they may have a competitive edge. Furthermore, these firms have very often been wrong (“failed”) investments from the very beginning – made on the basis of investment decisions taken by those who did not have to suffer the consequences of their decisions. In the case of some of the conglomerates, there are certain factories, that is, parts of those firms, which have some market prospects. This means that it is necessary to split such firms into parts and to turn those spin-offs that have some prospects into separate firms. Other parts should be candidates for bankruptcy and liquidation, in order to privatize their assets, mostly fixed ones, instead of their equity. Of course, in such cases it is necessary, in collaboration with creditors, to distribute the liabilities of the firms to their spun-off parts.

The second reason is accumulated debts of those firms, i.e., their arrears which are often higher than the value of assets, so that such firms have negative value of capital. This necessitates resolution to the issue of debts prior to embarking upon privatization. It turned out that an overwhelming part of these debts (in some cases exceeding 80%) refers to arrears to the government – direct debts, such as tax and social contribution arrears, or indirect, such as unpaid utility bills (electricity, gas, water and the like). Still, the bulk of the debts of these firms to the state are a consequence of foreign loans for which, in the course of the 1970s and 1980s, sovereign (state) guarantees were issued, and which the debtors (firms) did not service.<sup>8</sup>

The two mentioned problems make pre-privatization restructuring necessary, in order to be able to start with privatization. The proposed restructuring implies solely organizational changes (mostly the unbundling of the conglomerates) and resolution to the issue of firms’ debts. The idea was to have only “light” pre-privatization restructuring, followed by

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<sup>8</sup> Since a sovereign guarantee was called at one point, the government has become a debtor to foreign creditors, but also a creditor of domestic companies which have not met their financial obligations to foreign creditors. At issue here are obligations toward creditors organized in the Paris and London Clubs.



privatization either through tender, or through auction, that is, the sale of equity of these firms, or its parts, to a new, private owner.<sup>9</sup>

In early 2001, when the privatization, that is, restructuring strategy for the real sector was defined, 69 such firms with their subsidiaries were identified, employing around 155,000 people. Naturally, the number of these firms changes over time. That number goes down by the number of those firms that were successfully restructured and then privatized, as well as the number of those firms that went bankrupt. However, the number of those firms can also go up since the firms that were not successfully privatized in two attempts (tenders or auctions) are put into this group subsequently. Therefore, the number of firms under restructuring, that is, the number of employees in such firms constitutes a synthetic indicator of the pace of real sector restructuring in Serbia.

Table 1.

The number of firms under restructuring and their employment levels

Year	Number of employees	Number of firms
2001	131,658	237
2002	116,665	222
2003	98,804	218
2004	83,754	215
2005	75,768	198
2006	67,549	179

Source: National Bank of Serbia data, the Solvency Center

Note: Data refers to the situation on 31st December of the observed year.

What is obvious is the slow pace of restructuring. Five years of that process resulted in a number of firms which accounts for as much as 73% of the initial number of firms, while

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<sup>9</sup> The described restructuring, provided that a solution is found to the issue of debts, can be characterized as a substitute for the bankruptcy, i.e., liquidation of a company. The possibility should be allowed of such an arrangement being adopted precisely because of the awareness of huge problems related to the legal framework governing bankruptcy, especially with respect to the excessive length of bankruptcy proceedings, as well as the weaknesses in the implementation of the new Bankruptcy Law.

the level of employment has been reduced to 51% of the initial employment level – still higher than a half. Such pace is a consequence of, *inter alia*, two main technical problems related to the implementation of the conceived restructuring. The first problem was associated with the issue of identification, allocation and verification of claims of different creditors of these firms, bearing in mind that many of these debts are several decades old. The second problem was related to the relatively complex and often completely absurd organizational structure of these firms. The problem was only augmented by engaging foreign experts, which in certain cases was mandatory, and whose services were paid by international donors. More specifically, foreign consultants, not used to such organizational arrangements, wasted precious time looking for some sense where there was none and had never been<sup>10</sup>

However, it is possible to presume that the key reason for the lack of activities in the field of pre-privatization enterprise restructuring lies in the lack of political will to carry out that restructuring. Namely, restructuring of those firms would inevitably lead to a considerable number of lay-offs – either direct, during the pre-privatization restructuring, or indirect, after the privatization, as part of the efforts by the new owner to restructure the firm and increase its economic efficiency. Therefore, the basic assumption is that these cases involve an *ex ante* political constraint, since the authorities assumed that workers laid off from such firms would vote against pro-reform parties in the next election. It was also assumed that side events (strikes, social unrest, demonstrations, etc.) could attract anti-reform parties' other voters as well, who were not directly hit by the mentioned restructuring.

In that sense, it was perceived that the restructuring of such firms, followed by the shedding of the redundant labor, can have adverse political consequences – a sharp drop in popularity ratings of those who take and implement such decisions. Therefore, there was a clear incentive from state owned enterprises to the authorities to keep the redundant labor,

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<sup>10</sup> For more on technical problems in pre-privatization restructuring in real sector companies in Serbia see: Begović and Paunović (2006).

that is, in this case, not to carry out restructuring. General managers of these firms, who were fully aware of the mentioned incentives related to *ex ante* political constraints, were in the position to blackmail the state authorities, largely by demanding a constant flow of, sometimes even an increase in, subsidies which these firms receive. In such a manner, political equilibrium was created in the form of a certain level of subsidies to state and socially owned companies while maintaining redundant workers in them and the political support which those employees and their families lent to the politicians who were not restructuring. This finding is in full compliance with the findings of the model of relations between politicians and firms (Shleifer and Vishney, 1994).

An indirect confirmation of the thesis that these *ex ante* political constraints and a described political equilibrium were established relatively early at the very beginning of the transition process, thus practically making the restructuring of the real sector impossible, can also be found in the relatively feeble efforts invested in the building of administrative capacities necessary for the implementation of pre-privatization restructuring. Namely, in the establishment of the Privatization Agency, which was in charge of, *inter alia*, real sector restructuring, considerably more attention was devoted to the Auctions Department and Tenders Department than to the Restructuring Department.

It is obvious that such political equilibrium was struck at the very beginning of transition in Serbia in which there are no incentives for any of the players to embark upon the restructuring of the real sector. However, a question is raised as to the extent to which some of the perceptions and assessments on which this equilibrium is based, rely on facts. Namely, the first transition government in Serbia lasted for three years, longer than in any other transition country. Also, it is difficult to link the fall of the government with the (non)pursuance of real sector restructuring – the fall of the pro-reform government in 2003 certainly was not a consequence of the restructuring of the real sector, since it never took place, for all practical purposes. Finally, the question is raised of how much restructuring can actually influence the change in the popularity of the authorities, that is, loss of political support. That is to say, the employees of such companies inevitably belong to

transition losers, hence it is possible to presume that this part of the electorate has been against reform-oriented authorities anyhow, and for a long time at that – that is, they have always voted for anti-reform parties. Therefore, it is not possible to talk about loss of political support where there was no support to begin with.

It should be mentioned that political equilibrium in Serbia vis-à-vis enterprise restructuring is based more on political support arising from higher subsidies, than on the support arising from tax cuts. Seven years after the beginning of transition, political support based on an increase in subsidies seems to be higher still than the political support based on a cut in the tax burden. That is a consequence of the fact that in Serbia the number of those who are aware of their tax burden is relatively small. The number of those who live on subsidies, that is, transfers, is much higher. With an increase in wealth, that is, with an increase in income, the number of those who base their attitude toward politicians on the level of their personal tax burden will also go up. Such a change should also lead to the establishment of new political equilibrium, in which there will be no incentives for maintaining inefficiencies in the real sector. Support to such change may also come from the reform of the tax system which would lead to an increase in direct taxes, with a reduction in indirect taxes. Namely, the tax burden predominantly based on direct taxes is much more understandable to voters and, as a result, a larger number of voters would be able to see the link between high subsidies and (their) high tax burden.

#### **4. Main Hypotheses and Data**

The paper will econometrically test several main hypotheses. The first hypothesis is that those who influenced the results of the 2000 election were employees in the companies that needed pre-privatization restructuring, that is, that they voted for anti-reform parties way back in that election. We believe that this group of voters has strong aversion to risk and that they have rightly assessed that a change of government (coming into power of

pro-reform parties) could turn them into losers, primarily from the standpoint of loss of jobs and a fall in the living standards.

The second hypothesis that we shall test is that enterprise restructuring did not, in fact, lead to a fall in political support to pro-reform-oriented parties that were in power. The confirmation of this hypothesis would mean that the perception of pro-reform politicians from that resulted in *ex ante* political constraints, was wrong, as well as that there is no real basis for *ex post* political constraints. This hypothesis is not necessarily in contradiction with the first one, since it is predominantly turned to voters who had initially voted for pro-reform parties. In the opposite case, they would have been people who had lost jobs in socially owned companies, but continued to vote for pro-reform parties (“Rodrik’s hypothesis”).

The third hypothesis is associated with the importance of other economic values as factors of political support. The assumption that a rise in the standard of living (expressed in the *per capita* gross domestic product growth), average wages and employment opportunities (measured by the employment rate) reduce the support to anti-reform parties is a fairly widespread assumption. We believe, however, that non-economic factors have a decisive influence on election results in Serbia. For that reason the hypothesis is set that economic factors (apart from the pace of enterprise restructuring) are not statistically significant factors of political support. We have found reasons for such a position in the specific features associated with Serbia, that is, the prevalence of constitutional and political topics (the unresolved political issues related to the joint state with Montenegro, the status of Kosovo, cooperation with the Hague Tribunal, facing the past related to the wars in the 1990s, etc.) over the economic ones, of the kind that could rarely be found in the transition countries.

The fourth hypothesis is that the preferences of voters regarding constitutional and political topics are to a large extent embodied in demographic values (the share of ethnic minorities in the total population, the share of refugees and internally displaced persons in the total

population, the age structure of the population, etc.), so that we assume that the support to anti-reform parties grows with a rise in the share of minorities, refugees and internally displaced persons, a higher average age of the population, since the political preferences of these voters regarding constitutional and political (“national”) topics are far closer to the stands, that is, rhetoric of anti-reform parties in that respect. This hypothesis is in line with the results arrived at by Milanović (2004).

The fifth hypothesis is that the motive of some population categories (those on the dole and/or the elderly) to vote for anti-reform parties lies in the hope of those voters that these parties will keep forcible redistribution of income toward the groups concerned, that is, that they will succeed in maintaining the remnants of the socialist system of the welfare state. Of course, the voting by elderly voters for anti-reform political parties can be caused by their preferences regarding the constitutional and political issues and tight links among anti-reform parties in that regard (“patriotic parties”) or closeness with the stands, that is, rhetoric of anti-reform parties regarding forcible redistribution. In other words, the correlations described by the fourth and fifth hypotheses are in that respect, in the case of elderly voters, complementary among themselves.

The mentioned hypotheses will be tested on the basis of the results of the parliamentary elections in December 2000 and in January 2007, namely on the basis of the data at the level of 150 municipalities in Serbia (the municipalities in the territory of Serbia excluding Kosovo, with the cities of Belgrade, Novi Sad, Niš and Kragujevac being taken as single municipalities). The main dependent variable is the election result of anti-reform parties, defined as a ratio between the number of votes for anti-reform parties and the total number of registered voters in the electoral rolls. The assessment of whether a party is anti-reform is made on the basis of its program, political activities and election campaign rhetoric. In these elections, two consistently anti-reform parties were identified: the Serbian Radical Party (SRS) and the Socialist Party of Serbia (SPS).<sup>11</sup> Consequently, the variable:

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<sup>11</sup> Classification of the mentioned two parties as anti-reform is related to the period 2000-2007. Later organizational and programmatic transformations of these parties (if any) were not taken into account.

$ANTIREF_{i,j}$

represents the ratio between the number of votes for the SRS and SPS together and the total number of registered voters in the municipality and in the year  $j$ ,

$REST_{i,j}$

represents the ratio between the number of employees in companies under restructuring and the total number of registered voters in the municipality and in the year  $j$ ,

$EMPL_{i,j}$

represents the ratio between the total number of employees and the total number of registered voters in the municipality and in the year  $j$ ,

$WAGE_{i,j}$

represents the absolute amount of the average wage in dinars in the municipality and in the year  $j$ ,

$GDPPC_{i,j}$

represents the amount of *per capita* gross domestic product in the municipality and in the year  $j$ ,

$MATASS_{i,j}$

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Likewise, the assessment about the anti-reform character of these parties is related exclusively to their attitude toward economic reforms, without getting into an assessment of their attitude toward democracy or national, constitutional and political issues.

represents the ratio between the number of inhabitants on the dole (welfare support – material assistance to the family) and the total number of registered voters in the municipality and in the year  $j$ ,

$AGE_{ij}$

represents the ratio between the number of inhabitants beyond 65 years of age and the total number of registered voters in the municipality and in the year  $j$ ,

$EDUC_{ij}$

the average number of years of education of the inhabitants in the municipality and in the year  $j$ ,

$REFUG_{ij}$

represents the ratio between the number of refugees (including IDPs as well) and the total number of registered voters in the municipality and in the year  $j$ ,

$SRB_{ij}$

represents the ratio between the number of inhabitants of Serbian ethnicity and the total population in the municipality and in the year  $j$ ,

$DVOJ_i$

represents a dummy which equals 1 if the municipality  $i$  is in Vojvodina and

$DKOSMET_i$



represents a dummy which equals 1 if the municipality  $i$  borders with Kosovo or with a municipality that borders with Kosovo.

Separately estimated were regression models for the 2000 December election results and the January 2007 election results, only to separately estimate the regression model in which the dependent variable was a change in the success of anti-reform parties in those elections, namely by using the indicator:

$\Delta\text{ANTIREF}_i$

represents a quotient of the ratio between the number of votes for the SRS and SPS together and the total number of registered voters in the municipality and in 2000 and 2007.

The model specification is such that it includes all those variables which were deemed as variables that can exert influence on the election results, so the probability that an error was made of leaving out a relevant variable is low. The method of weighted least squares was used to estimate the parameters of the model. The decision to use this method, rather than the method of ordinary least squares is based on the fact that a proportionate election system is applied in Serbia, with the territory of the Republic being one constituency, so that municipalities that differ in size influence the election results with different intensities. Therefore, the weighting was performed by the size of the registered electorate of each municipality.

Furthermore, in making an econometric estimate no problem of endogeneity of independent variables is faced. That is to say, the dependent variable contains the election result at the level of the municipality and is not as such related with the election result at the level of Serbia, which is the only result that determines which pro-reform policies are to be implemented, thus influencing the number of employees in companies slated for

restructuring. Also, the election result at the level of the municipality makes no impact on the demographic values of that municipality in any manner. Consequently, the method of weighted least squares can freely be applied.

#### 4. Econometric Analysis

##### 4.1. Results of the 2000 Election

We shall begin the empirical study with an analysis of the election results of December 2000. The initial specification of the regression model includes all the variables described in the previous section. Accordingly:

$$\text{ANTIREF}_{i,2000} = a_0 + a_1 * \text{REST}_{i,2000} + a_2 * \text{EMPL}_{i,2000} + a_3 * \text{WAGE}_{i,2000} + a_4 * \text{GDPPC}_{i,2004} + a_5 * \text{MATASS}_{i,2000} + a_6 * \text{AGE}_{i,2002} + a_7 * \text{REFUG}_{i,2002} + a_8 * \text{EDUC}_{i,2002} + a_9 * \text{SERB}_{i,2002} + a_{10} * \text{SERB}^2_{i,2002} + a_{11} * \text{DVOJ}_i + a_{12} * \text{DKOSMET}_i$$

Several remarks: since no records of gross domestic product at the municipal level have been kept since 2005, the 2004 data was used for all the regressions, as it is the last year for which data is available. The source of demographic data is the 2002 census, so the demographic values, with the exception of welfare support (MATASS), refer solely to that year. The share of the Serbian population in the total population is expressed by means of the square function, on the assumption that  $a_9$  is more, and  $a_{10}$  less than zero. Namely, such values of the parameter estimates can be expected since, in the communities where the number of Serbs is low, there is no one to vote for anti-reform parties, which are at the same time the parties that care about the “national interest”. Thus, with an increase in the share of Serbs, it possible to expect an increase in the number of votes for those parties, too. Nevertheless, with the said increase, “diminishing returns” also come along, since a very high share of Serbs in the total population reduces the feeling of being under threat, hence it reduces incentives to vote for “patriotic” parties. Finally, dummies have been

included, because they present the specific features of Vojvodina and regions close to Kosovo, that is, specific features of political life in those regions.

Milanović (2004) has found a statistically significant correlation between the share of the Roma in the total population of a municipality and the election result, in that a higher share of the Roma leads to better results for anti-reform parties. A preliminary testing of the data we prepared for regression models showed that there is a very high correlation (0.913, the estimate is statistically significant at the level of at least 0.01) between the share of the Roma and our variable MATASS – the share of individuals who are receiving social assistance. Consequently, the inclusion of both these variables into the model would inevitably produce a problem of multicollinearity, so we decided to use only the variable MATASS. The main reason for such a decision lies in the possibility of explaining this correlation. Namely, a convincing theoretical explanation is that those voters who are fully dependent on the transfers based on the forcible income redistribution have no incentives to vote for pro-reform parties, since they expect that those parties could reform social assistance by eliminating it, that is, reducing the amount or the coverage of transfers. In other words, pursuant to our fifth hypothesis, those who are on the dole can be expected to vote for anti-reform parties, hoping that they will preserve the socialist system of forcible redistribution, that is, the welfare state. It is, therefore, natural that those who are on the dole vote for anti-reform parties, those parties that are not mentioning any pro-reform changes in that respect. Contrary to that, theoretically, it would be very difficult to explain why the mere fact that a person is Roma creates incentives to vote for anti-reform parties.<sup>12</sup>

Table 2.

December 2000 Election Results

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<sup>12</sup> Of course, an interesting question is the one about the origin of the high correlation between the share of the Roma and the share of people who are recipients of social assistance (material assistance to families), that is, of the direction of the causality. In other words, it is interesting to consider the issue whether and why the fact that a person is Roma increases the probability of being poor, and consequently receiving social assistance. This question, however, goes beyond the scope of this paper.

Dependent variable ANTIREF <sub>i, 2000</sub>					
	(a)	(b)	(c)	(d)	(e)
CONST	- 0.174 (-3.430) <sup>***</sup>	- 0.102 (-2.609) <sup>***</sup>	- 0.163 (-4.015) <sup>***</sup>	- 0.829 (-2.745) <sup>***</sup>	<b>- 0.985</b> <b>(-2.899)<sup>***</sup></b>
REST <sub>i, 2000</sub>	0.0578 (0.276)	0.309 (1.121)	0.006322 (0.346)		<b>-8.260</b> <b>(-2.710)<sup>***</sup></b>
EMPL <sub>i, 2000</sub>	0.0192 (0.184)	-0.0274 (-0.292)			<b>6.198</b> <b>(4.301)<sup>***</sup></b>
WAGE <sub>i, 2000</sub>	0.00977 (0.833)	-0.000505 (-0.469)			<b>0.00198</b> <b>(1.092)</b>
GDPPC <sub>i, 2004</sub>	0.00216 (1.546)	-0.0001446 (0.881)			<b>-0.000393</b> <b>(-1.940)<sup>*</sup></b>
MATASS <sub>i, 2000</sub>	4.126 (10.333) <sup>***</sup>	2.876 (8.226) <sup>***</sup>	3.999 (10.230) <sup>***</sup>	2.895 (7.883) <sup>***</sup>	
AGE <sub>i, 2002</sub>	0.720 (4.076) <sup>***</sup>	0.773 (5.422) <sup>***</sup>	0.810 (5.259) <sup>***</sup>	0.788 (5.330) <sup>***</sup>	
EDUC <sub>i, 2002</sub>	-0.00172 (-0.606)				
REFUG <sub>i, 2002</sub>	4.126 (10.333) <sup>***</sup>	1.161 (15.773) <sup>***</sup>	0.997 (12.697) <sup>***</sup>	1.155 (15.083) <sup>***</sup>	
SRB <sub>i, 2002</sub>	0.365 (2.652) <sup>***</sup>	0.373 (2.705) <sup>***</sup>	0.380 (2.384) <sup>***</sup>	0.380 (2.833) <sup>***</sup>	
SRB*SRB <sub>i, 2002</sub>	-0.287 (-2.415) <sup>***</sup>	-0.292 (-2.454) <sup>***</sup>	-0.292 (-2.284) <sup>***</sup>	-0.380 (-2.492) <sup>***</sup>	
DVOJ <sub>i</sub>	-0.0852 (-4.399) <sup>***</sup>	-0.0708 (-4.670) <sup>***</sup>	-0.0606 (-4.031) <sup>***</sup>	-0.0756 (-4.216) <sup>***</sup>	
DKOSMET <sub>i</sub>	-0.0252 (-1.718) <sup>*</sup>				
N	144	144	144	144	<b>144</b>
R <sup>2</sup>	0.997	0.977	0.997	0.953	<b>0.135</b>
F	<b>3508.78<sup>***</sup></b>	<b>355.78<sup>***</sup></b>	<b>4163.164<sup>***</sup></b>	<b>364.579<sup>***</sup></b>	<b>6.641<sup>***</sup></b>

Notes: The numbers in brackets under the parameter estimates present the statistical t-test. <sup>\*\*\*</sup> stands for the statistical significance of the estimated parameter at the level of at least 0.01, <sup>\*\*</sup> at the level of at least 0.05, and <sup>\*</sup> at the level of at least 0.10. N denotes the number of observations, R<sup>2</sup> the adjusted coefficient of determination, while F denotes the statistics of the F-test on the regression as a whole.

In the first column, model (a), there are parameter estimates of all the variables according to the original specification. It is possible to note that statistically significant parameter estimates were obtained exclusively for (not all) demographic variables, while parameter estimates for economic variables were not statistically significantly different from zero. In

order to allow for the possibility of economic variables influencing the election results, such demographic variables were left out of the regression, whose impact did not prove to be statistically significant. However not even the estimate of that model, whose results are presented in the second column, model (b), resulted in statistically significant parameter estimates of economic variables. The removal of all economic variables from the model, except for REST, would, in principle, make it possible to obtain a statistically significant parameter estimate of this variable, provided that there existed multicollinearity of some economic variable and variable REST. However, the results of the estimate of such a model, presented in the third column, model (c), show that there is no statistically significant correlation between variable REST, i.e., the share of employees in companies slated for restructuring in the electorate and the results of anti-reform parties in the election held in December 2000. The final specification of the model includes only demographic variables, namely those whose parameters have proven to be statistically significant already in the initial specification of the model.

Three main findings can be singled out. Since anti-reform parties have always had strong rhetoric concerning the welfare state, that is, forcible income redistribution toward the poor, socially vulnerable groups, such as pensioners (persons beyond 65 years of age) and persons on the dole, vote precisely for those parties. That can explain statistically significant estimates and the positive sign of variables AGE and MATASS. Anti-reform parties had a strong and loud national, that is, patriotic rhetoric and were perceived as parties protecting national interests, so those voters who keep these values high on their scale therefore vote in favor of anti-reform parties. This explains statistically significant parameter estimates of REFUG, SRB and SRB\*SRB in all the cases of the expected sign. Finally, a statistically significant estimate of the parameter with the dummy for Vojvodina municipalities shows that because of historical or some other specific features, voters from that region vote to a smaller degree for anti-reform parties.

These findings shed much light on the manner in which voters took their decisions in the 2000 election. Economic factors were of no importance; instead, the important ones were

primarily demographic. Still, for this analysis, which primarily investigates political economy of restructuring, of utmost importance is the finding that the share of employees in companies under restructuring in the total number of voters had no impact on the election results. Regardless of the model specification, estimates of this parameter are far from being statistically significant. This can be explained in several alternative ways. One possibility is that this factor simply did not have a significant influence on the voters' decision as to whom they were going to vote for; in other words, other, in particular non-economic, factors had far higher importance. The second is the assessment of employees in companies under restructuring that their jobs are unsustainable anyhow, no matter who is in power, hence it does not pay off to vote for anti-reform parties. The third possibility is that some of the voters working in companies under restructuring voted for anti-reform parties, hoping that these parties will secure the preservation of their jobs, while others voted for pro-reform parties believing that this (regardless of the loss of their jobs in the existing firm) will bring them prosperity ("Rodrik's hypothesis"), that the effects of these mechanisms had the same power, with the effect of one mechanism fully offsetting the effect of the other one. Irrespective of which of the above explanations can be accepted, it is clear that in reality there was no basis for the formation of an *ex ante* political obstacle, that is, it existed only in the perception of the politicians. The results of this analysis show that the said perception was wrong.

The estimation of model (d), which is based solely on demographic variables, shows that parameter estimates of almost all demographic variables were statistically significant, with theoretically expected signs. The variance of these variables can explain a large portion of the variance of the dependent variable ( $R^2$  is as much as 0.95). Contrary to that, the formulation and estimate of model (e), which is based exclusively on economic variables, shows that certain parameter estimates are statistically significant, while some other are not, and the variance of these variables can explain just a very small portion of the variance of the dependent variable ( $R^2$  is a mere 0.13). On the basis of this result it is obvious that economic factors did not have a crucial role in the election in 2000. An alternative explanation of this result, however, is that economic factors had the same impact on the

decisions of voters in all the regions, so they did not result in the varying of the dependent variable. Otherwise, the explanation should be reviewed in the light of the “referendum character” of the December 2000 election and the fairly clear majority choice of the voters as to what they did not want.<sup>13</sup>

#### 4.2. 2007 Election Results

The second group of regression models deals with elections held in January 2007 – the dependent variable is a result of anti-reform-oriented parties in that election. In addition to all those variables that were used as independent variables in the previous model, a time span of, practically speaking, six years, enables us to also include into the model the changes in the values of some of those variables. Therefore, this model features the change in the relative number of employees in companies under restructuring, as an indicator of the speed of real sector restructuring, as well as the change in the employment level, that is, the wage level, as indicators of the pace of economic growth, that is, the rise in the electorate’s living standards. Consequently, a new initial specification of the model reads as follows:

$$\text{ANTIREF}_{i,2007} = a_0 + a_1 * \text{REST}_{i,2006} + a_2 * \Delta \text{REST}_i + a_3 * \text{EMPL}_{i,2006} + a_4 * \Delta \text{EMPL}_i + a_5 * \text{WAGE}_i + a_6 * \Delta \text{WAGE}_{i,2006} + a_7 * \text{GDPPC}_{i,2004} + a_8 * \text{MATASS}_{i,2006} + a_9 * \text{AGE}_{i,2002} + a_{10} * \text{REFUG}_{i,2002} + a_{11} * \text{EDUC}_{i,2002} + a_{12} * \text{SERB}_{i,2002} + a_{13} * \text{SERB}^2_{i,2002} + a_{14} * \text{DVOJ}_i + a_{15} * \text{DKOSMET}_i$$

The table below presents the results of the estimate of this model, as well as of the model based on it.

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<sup>13</sup> The alternative explanation practically boils down to the following mechanism: since it is bad (in economic terms) for “all” of us, irrespective of the area where we live, we “all” vote against those who are in power, and back then those were anti-reform parties. The negative and statistically significant estimates of the constant in regression models can point to this explanation.

Table 3.

December 2007 Election Results

<b>Dependent variable ANTIREF<sub>i, 2007</sub></b>				
	(a)	(b)	(c)	(d)
CONST	- 0.232 (-2.897) <sup>***</sup>	-0.263 (-4.310) <sup>***</sup>	-0.210 (-4.614) <sup>***</sup>	<b>0.921</b> <b>(6.505)</b> <sup>***</sup>
REST <sub>i, 2006</sub>	-1.660 (-3.071) <sup>***</sup>	-1.646 (-3.102) <sup>***</sup>		<b>-9.508</b> <b>(-4.254)</b> <sup>***</sup>
ΔREST <sub>i</sub>	-1.880 (-2.534) <sup>***</sup>	-2.038 (-2.955) <sup>***</sup>		<b>-0.00246</b> <b>(-12.812)</b> <sup>***</sup>
EMPL <sub>i, 2006</sub>	0.05158 (0.367)			<b>-3.553</b> <b>(-8.554)</b> <sup>***</sup>
ΔEMPL <sub>i</sub>	-0.00371 (-0.210)			<b>-0.000218</b> <b>(-9.842)</b> <sup>***</sup>
WAGE <sub>i, 2006</sub>	-0.000150 (-1.088)			<b>0.000638</b> <b>(1.442)</b>
ΔWAGE <sub>i</sub>	0.000836 (0.459)			<b>-0.0139</b> <b>(-2.191)</b> <sup>**</sup>
GDPPC <sub>i, 2004</sub>	0.000423 (1.906) <sup>*</sup>			<b>-0.0000521</b> <b>(-0.764)</b>
MATASS <sub>i, 2006</sub>	5.760 (10.467) <sup>***</sup>	5.728 (10.804) <sup>***</sup>	5.998 (10.860) <sup>***</sup>	
AGE <sub>i, 2002</sub>	0.366 (1.457)			
EDUC <sub>i, 2002</sub>	0.00767 (0.197)			
REFUG <sub>i, 2002</sub>	1.526 (13.671) <sup>***</sup>	1.538 (14.380) <sup>***</sup>	1.508 (13.553) <sup>***</sup>	
SRB <sub>i, 2002</sub>	0.616 (3.320) <sup>***</sup>	0.609 (3.397) <sup>***</sup>	0.669 (3.459) <sup>***</sup>	
SRB*SRB <sub>i, 2002</sub>	-0.437 (-2.729) <sup>***</sup>	-0.434 (-2.789) <sup>***</sup>	-0.436 (-2.590) <sup>**</sup>	
DVOJ <sub>i</sub>	-0.104 (-3.911) <sup>***</sup>	-0.107 (-4.221) <sup>***</sup>	-0.0745 (-3.184) <sup>***</sup>	
DKOSMET <sub>i</sub>	-0.0432 (-2.002) <sup>**</sup>	-0.0349 (-1807) <sup>*</sup>		
N	144	144	144	<b>144</b>
R <sup>2</sup>	0.977	0.979	0.997	<b>0.965</b>
F	<b>3450.26</b> <sup>***</sup>	<b>4795.25</b> <sup>***</sup>	<b>9037.382</b> <sup>***</sup>	<b>569.491</b> <sup>***</sup>

Notes: The numbers in brackets under the parameter estimates present the statistical t-test. \*\*\* stands for the statistical significance of the estimated parameter at the level of at least 0.01, \*\* at the level of at least 0.05, and \* at the level of at least 0.10. N denotes the number



of observations,  $R^2$  the adjusted coefficient of determination, while F denotes the statistics of the F-test on the regression as a whole.

The initial specification of the model (the first column) includes all the variables. It turned out that, with the exception of restructuring, parameter estimates of economic values were not statistically significant, while the parameter estimates of demographic variables, except for AGE and EDUC, were statistically significantly different from zero. The removal of those variables whose parameter estimates were not statistically significant, the second column, that is, model (b), resulted in almost no difference in parameter estimates of the remaining variables, namely with the expected signs. Still, the most significant findings are related to the statistically significant parameter estimates with relative employment in companies under restructuring and change in that employment. The higher the relative employment in companies under restructuring, the fewer the people who vote for anti-reform political parties. This testifies to the expectations of those employees. They simply did not see in early 2007 any possibility for their jobs to be preserved by keeping those firms afloat with (implicit and explicit) subsidies; instead, they see their future in their restructuring, that is, job creation in the private sector. Therefore, they in fact vote for pro-reform parties. This shows that in reality there are no grounds for *ex ante* political obstacles to the restructuring of the real sector. Also very important is the finding regarding the change in relative employment in companies undergoing restructuring. The higher the fall in that employment, the lower the support to anti-reform parties, that is, the lower the probability of voters voting for those parties. In other words, accelerated enterprise restructuring (which produces a greater change, that is, a drop in employment) increases political support for reform-oriented parties. On the basis of this finding, it follows that in reality there are no *ex post* political obstacles, either. Consequently, all those policies which have insisted, since the 2007 election, on the effective deceleration of the process of enterprise restructuring in the real sector, are not based on facts, but rather on the wrong perception of political decision-makers.

The previous finding is robust to the change in the model specification, so the exclusion of all other economic variables did not result in the loss of significance, nor to the change in the sign of the parameter estimate, while the estimate itself was changed by very little. The next step of the analysis is the exclusion of all economic variables and an effort to explain election results only with demographic variables. This change did not bring about any change in relation to the statistical significance of the parameter estimates, but the value of the adjusted coefficient of determination ( $R^2$ ) went up, apparently due to the change in the number of degrees of freedom. Finally, a regression was formed in which independent variables were exclusively economic variables. Many of them have not shown statistically significant estimates of their parameters, only the adjusted coefficient of determination was still high. It is obvious that the demographic variables influence the outcomes of elections through economic ones. Had it not been so, the inclusion of the demographic variables would not have resulted in the loss of statistical significance of estimates, which actually happened in the case of model (a).

#### *4.3. Changes in Election Results in 2000-2007*

The third group of regression models is focused on the explanation of relative changes in the number of votes for anti-reform parties, over the period 2000-2007. Changes are defined as quotients, so that, for instance, the values  $\Delta\text{ANTIREF}_i$  higher than 1 denote a rise in support to anti-reform parties, while the values lower than 1 show a rise in support to reform-oriented parties. The higher the amount of  $\Delta\text{ANTIREF}_i$ , the higher the increase in support to anti-reform political parties. The specification of the initial model as such is identical to the specification of the model which explains the results of the 2007 election. Hence,

$$\Delta\text{ANTIREF}_i = a_0 + a_1*\text{REST}_{i,2006} + a_2*\Delta\text{REST}_i + a_3*\text{EMPL}_{i,2006} + a_4*\Delta\text{EMPL}_i + a_5*\text{WAGE}_i + a_6*\Delta\text{WAGE}_{i,2006} + a_7*\text{GDPPC}_{i,2004} + a_8*\text{MATASS}_{i,2006} + a_9*\text{AGE}_{i,2002} +$$

$$a_{10}*\text{REFUG}_{i,2002} + a_{11}*\text{EDUC}_{i,2002} + a_{12}*\text{SERB}_{i,2002} + a_{13}*\text{SERB}^2_{i,2002} + a_{14}*\text{DVOJ}_i + a_{15}*\text{DKOSMET}_i$$

Results of the estimate of this model, as well as of the model based on it, are presented in the table below.

Table 4.  
Change in Election Results 2000-2007

Dependent variable $\Delta\text{ANTIREF}_i$				
	(a)	(b)	(c)	(d)
CONST	0.787 (2.985)***	1.098 (5.503)***	0.630 (4.295)***	<b>1.051</b> <b>(4.641)***</b>
REST <sub><i>i, 2006</i></sub>	0.00143 (1.441)		0.570 (0.246)	
$\Delta\text{REST}_i$	-0.341 (-0.170)		0.000329 (0.165)	
EMPL <sub><i>i, 2006</i></sub>	0.488 (1.011)		1.888 (4.384)***	
$\Delta\text{EMPL}_i$	0.00004975 (1.918)*		-0.00023 (0.997)	
WAGE <sub><i>i, 2006</i></sub>	0.000125 (2.934)***	0.000156 (4.102)***	0.000179 (3.900)***	
$\Delta\text{WAGE}_i$	-0.0070 (-1.194)		-0.0059 (-0.895)	
GDPPC <sub><i>i, 2004</i></sub>	-0.000391 (-0.560)		0.000022 (0.031)	
MATASS <sub><i>i, 2006</i></sub>	-2.221 (-1.259)			<b>-2.610</b> <b>(-1.306)</b>
AGE <sub><i>i, 2002</i></sub>	-2.613 (-3.298)***	-4.056 (-5.404)***		<b>-4.583</b> <b>(-5.912)***</b>
EDUC <sub><i>i, 2002</i></sub>	0.00678 (0.547)			<b>0.0348</b> <b>(2.594)**</b>
REFUG <sub><i>i, 2002</i></sub>	0.0963 (0.270)			<b>0.0563</b> <b>(1.390)</b>
SRB <sub><i>i, 2002</i></sub>	1.535 (2.637)***	0.728 (5.064)***		<b>2.069</b> <b>(3.059)***</b>
SRB*SRB <sub><i>i, 2002</i></sub>	-1.084 (-1.557)			<b>-1.084</b> <b>(-1.842)*</b>
DVOJ <sub><i>i</i></sub>	0.210	0.186		<b>0.235</b>

DKOSMET <sub>i</sub>	(2.491) <sup>***</sup> 0.00736 (1.096)	(2.866) <sup>***</sup>		(2.652) <sup>***</sup> <b>0.12</b> (1.689) <sup>*</sup>
N	144	144	144	<b>144</b>
R	0.602	0.451	0.459	<b>0.443</b>
<b>F-test</b>	<b>39.113</b> <sup>***</sup>	<b>30.613</b> <sup>***</sup>	<b>18.613</b> <sup>***</sup>	<b>15.309</b> <sup>***</sup>

Notes: The numbers in brackets under the parameter estimates present the statistical t-test. <sup>\*\*\*</sup> stands for the statistical significance of the estimated parameter at the level of at least 0.01, <sup>\*\*</sup> at the level of at least 0.05, and <sup>\*</sup> at the level of at least 0.10. N denotes the number of observations, R<sup>2</sup> the adjusted coefficient of determination, while F denotes the statistics of the F-test on the regression as a whole.

It turns out that the importance of the problem and speed of restructuring do not in any way influence a change in the support to pro-reform-oriented parties. In other words, it turns out that there is no realistic basis either for *ex ante*, or for *ex post* political obstacles to the restructuring of the real sector in Serbia. Once again, it has turned out that those political obstacles are based on the wrong perception of decision-makers. The only economic indicator which shows a statistically significant parameter estimation is the level of wages. The higher the wages, the more the political mood shifts in favor of anti-reform parties. This finding is robust in terms of the model's specification: with the change of that specification, the statistical significance of the parameter estimation does not change. This finding is certainly counter-intuitive. A sensible hypothesis is that higher wages create greater satisfaction which can be transformed into political support to those in power, accordingly to reform-oriented parties. An explanation of this, at first sight paradoxical causality, remains a task for future research. One possible explanation of this paradox lies in the assumption that the Serbian electorate does not have enough of the "reform stamina", that is, that there is a widespread phenomenon of "reform fatigue". Consequently, after six years of transition, the living standards (measured by the level of wages) have gone up sufficiently, the voters have had enough reform and are now turning to anti-reform parties in order to stop the reform. Likewise, it is possible that, through the mentioned mechanism, voters' priorities are shifting toward those topics (national-

political) in which anti-reform parties offer the things that pro-reform ones cannot or do not want to offer.<sup>14</sup>

From among the demographic factors a change in political support is influenced by the age of the population, the share of Serbs in the electorate, and a dummy for Vojvodina. All three findings are robust in terms of the specification of the model. The areas with higher shares of elderly population segments recorded a fall in political support to anti-reform parties, which can be explained in two complementary ways. First, trust is lost that anti-reform parties could preserve the socialist system of the welfare state, that is, that they would be good in the field of effective forcible income redistribution. Second, pro-reform parties in power, through massive forcible income redistribution during the six years of their government, have gained the confidence of the elderly that they will also continue with such practice. Indirectly, this result has resolved one more dilemma: why the elderly voted for anti-reform parties in the 2000 elections. It is apparent that they did so because of the trust in those parties with respect to social protection and forcible redistribution, rather than because of the trust with respect to the protection of national interests. Had it been the opposite, that support would not have gone down during the six years pro-reform parties were in power.<sup>15</sup>

This finding is also indirectly confirmed by the fact that with an increase in the share of Serbs in the total population, the intensity of the change in support to anti-reform parties also goes up. This can be explained by a rise in the importance of national (constitutional and political) topics, so Serbian voters turned to those parties which they assessed as better protectors of that interest, and anti-reform parties enjoy such reputation. Finally,

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<sup>14</sup> The mentioned “reform fatigue” can also be explained by voter preferences regarding the quality of life, understood as a relationship between the salary earned and the invested effort. The possibility should be allowed, for the voters who get much higher wages after six years of transition are not satisfied with the quality of life, since the increase in wages is not sufficient to compensate for the greater labor effort that led to the increase in the salary.

<sup>15</sup> Account should also be taken of the fact that the structure of the pensioner electorate changed in the seven years. Some have become pensioners, some are no longer on the voters’ list. One should allow the possibility that this “change of generations” led to changes in political preferences of the pensioners, i.e., changes in their priorities.

Vojvodina turned to anti-reform parties, so the mere fact that a certain area is part of Vojvodina results in a rise in political support to those parties. There is no, at least for the time being, unambiguous theoretical explanation of his finding, apart from the already mentioned rise in the significance of the national (constitutional and political) topics that are accepted specifically in a multi-ethnic community such as Vojvodina.<sup>16</sup>

## 5. Conclusion

The first hypothesis that there is causality between the relative number of employees in firms slated for restructuring and support to anti-reform parties in the 2000 election can be dismissed, that is, the empirical study has not yielded a single result in support of this hypothesis. There are alternative explanations for such behavior, but on the basis of the results of the empirical study it was not possible to opt for any of them.

The second hypothesis that enterprise restructuring in the real sector did not actually result in a decline in support for pro-reform-oriented parties was empirically confirmed. Not only did no decline in support occur, but econometrically robust results were also obtained, which have shown that political support for reform-oriented parties went up with restructuring. In such a manner, “Rodrik’s hypothesis” that those who lost jobs in state/socially owned enterprises vote for pro-reform parties, in the case of Serbia, was confirmed. The fact which is, from the standpoint of the objectives of this paper, the most important, after all, is that the confirmation of this hypothesis means that in the reality of Serbia there are no *ex ante* or *ex post* political obstacles, but rather that they are a consequence of the wrong perception on the part of the politicians.

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<sup>16</sup> It is interesting that, in the case of all the models, the estimate of the constant is positive and statistically significant at the level of 0.01. It means that factors are operating at the national level which contribute to the increase in political support but could not be covered by the variance of the identified factors at the municipal level. Without getting into the nature of those factors in this paper, it is possible to just say that a step forward was made in the direction of higher political support to anti-reform parties at the national level which is not negligible.

As for the third hypothesis, that non-economic, that is, demographic factors have a crucial effect on the behavior of voters in Serbia, generally speaking, it is possible to accept the finding that the results of the empirical analysis offered enough elements for it to be conditionally accepted. It is obvious that the specific features associated with Serbia, that is, the domination of the constitutional and political topics over economic ones (the unresolved question of the state, related to the joint state with Montenegro, the status of Kosovo and Metohija, cooperation with the Hague Tribunal, facing the past related to the wars in the 1990s, etc.) had a strong impact on the choices made by the voters.

Results of the empirical study have confirmed the fourth hypothesis that voters' preferences with respect to the constitutional and political topics are, to a large extent, embodied in demographic quantities, since in different specifications of the regression models the variance of these variables can explain the variance of political support to anti-reform forces. In that sense, the results arrived at by Milanović (2004) have been confirmed.

Finally, the hypothesis has been confirmed that older voters (those beyond 65 years of age) vote for anti-reform parties primarily because they expect those parties to secure forcible income redistribution in favor of older people, not because of their national-political views. In time, however, the confidence of the elderly into the ability, that is, the wish of the anti-reform parties to ensure such redistribution diminishes.

The elections after January 2007 provide new material for empirical research into the results of elections in Serbia, that is, the factors influencing the political choices of the voters. This is further corroborated by the emergence of new topics, such as the declaration of independence of Kosovo, or conditionalities in the EU accession process. Furthermore, the Serbian political scene is changing, through reorganization of the existing parties, their programmatic changes, as well as through the creation of completely new parties, that is, coalitions. Still, it seems that there is one field where additional research is necessary – it is

the field of “reform fatigue”, that is, the issue of change in the quality of life in Serbia as a political factor.

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