

Economic Reconstruction of Serbia and Montenegro and Stabilization of South Eastern Europe¹

Yoji Koyama

I. Introduction

The state union “Serbia and Montenegro” has experienced two wars during a decade (the war at the time of the breakup of the former Yugoslav Federation, and Kosovo war in 1999) and two recoveries. The country suffered from international isolation during the Milosevic era. The country finally escaped from its international isolation after the collapse of the Milosevic regime in autumn in 2000. The Stabilization and Association process, initiated by the EU in 1999, gives West Balkan countries a prospect of EU accession (See Koyama, 2005).

The country has been recovering with support from the international community. However, its recovery is sluggish, and the real GDP growth rate is 5.2% in 2000, 5.3% in 2001, 3.8% in 2002 and 2.0% in 2003 (WIIW, 2004, p. 54). As of 2003 its GDP was a little bit over 50% of the level of in 1989. According to the latest information, Albania’s per capita GDP on purchasing power parity basis in 2001 is US\$ 3,781. The corresponding figure of Serbia and Montenegro in 2001 is about US\$ 3,112². Therefore, stagnating Serbia and Montenegro has been surpassed by Albania, which can be no longer referred to as “the poorest country in Europe”. Rather Serbia and Montenegro is in economic plight Owing to the restrictive monetary policy inflation rate has been substantially reduced from well above 100% to single-digit levels during the same period. However, unemployment rate has risen from 26.5% to 31.9% during the same period. The country has been suffering chronic deficit in the current payment balance. The total exports cover only one thirds of the total import in 2003. To make matters worse, the ratio of the deficit to GDP increased from –3.9% to –11.7% during the same period (WIIW, 2004, pp. 54-55). Such a chronic and huge deficit in trade balance reflects structural fragility of the economy. FDI inflow in Serbia and Montenegro began to increase in 2001, but the amount is still modest (See Koyama, 2005).

The former Yugoslavia, Serbia and Montenegro in particular, has been as it were

an epicenter of the turmoil in South Eastern Europe. Therefore, its economic reconstruction is necessary not only for the well-being of people in the country but also for stabilization of South Eastern Europe (SEE). In this paper I would like to clarify serious problems which Serbia and Montenegro has been facing and consider the way for rebirth.

II. A Delay in Reform

A problem SEE countries have in common is a bigger size of informal sector. Gligorov, et al (2003) explains several surveys on the informal sector in transitional economies. It is sure that the size of informal sector in Serbia and Montenegro is well above 30%. It is noteworthy in this connection that Welfens (2001) shows a very sharp insight into the shadow economy. The military itself will become part of the shadow economy as overcoming the Western embargo requires considering illegal sources for stocking up on the weapon arsenals (Welfens, 2001, p.137)

Economic reforms have been delayed. It was clear at around 1990 that self-managed socialist economy has collapsed. Therefore, it was necessary to make transition to a capitalist market economy. The Milosevic administration was aware of this point. At least until the Milosevic's fall, however, the economy has maintained specific features of the self-managed socialism together with its defects, although there is justification due to the successive ethnicity conflicts and the UN embargo.

During the Milosevic era privatization was implemented by trial and error. Since the state was not an owner of means of production in the self-managed socialism it was necessary first of all to transform the social ownership into the state ownership in the process of privatization. The privatization, which began in the first half of the 1990s, failed to realize any positive change in economy. Due to the hyperinflation during 1992-1994, paradoxically the state became the biggest owner after the system change. Supporters of the ruling party were appointed to directors of many companies. "Soft budget constraint" remained dominant in state and social enterprises.

Although banks were transformed into joint-stock companies by the banking system reform in 1989, they were not privatized. In FR Yugoslavia banks which were founded before 1989 are called 'old' banks, while banks which were founded after 1989 are called 'new' banks. Some of the new banks are entirely private while in others there are both socially-owned and private capital, both domestic and foreign. 'Old' banks accounted for more than 80% of the total balance of the banking sector, and especially

'big six' among 'old' banks accounted for about 60% in the second half of the 1990s. A situation in which "debtors of a bank were actually its owners" was perceived among 'old' banks as before. Profit maximization was not the owner's motivation. Instead, enterprises bought the share of a bank so as to be extended credit from this bank. Instead of initiating the bankruptcy proceedings against the enterprises which were known as having no prospects, banks were forced to keep them artificially alive for social and political reasons (Pitic, 1999, pp.343-344). Such a situation in the banking sector is also a negative legacy of the self-managed socialism.

Under the provision of the Law on Ownership Transformation of 1997 a further round began. The process strongly favoured the granting of shares to employees, with up to 60% of shares reserved for employees for free. Almost 1,000 companies adopted this form of privatization, and most of them were quickly privatized in a short period from October 2000 to February 2001 following the unification of the official and unofficial exchange rates. However, this brought very limited gain to the Government from the sale of its equity. The new Government suspended the autonomous article of the 1997 to limit further losses and review the privatization process.

III. New Round of Privatization

A new law on privatization was adopted in May 2001. Indeed, compared with other transition countries, Serbia and Montenegro made a very delayed start in privatization. It was said that all enterprises should be privatized by 2005. Privatization is implemented in three ways: i) tender privatization; ii) competition privatization; iii) auction privatization. All large enterprises, the number of which does not exceed 1500, will be privatized by tender privatization carried out by the Agency for Privatization. All small and medium-sized enterprises, the number of which is more than 7,000, will be privatized through auctions. In this case auction is highly decentralized on an enterprise. Each enterprise organized and carried out the auction. The State Commission for auction just assists the auction (Yugoslavia, 2002).

Ekonomaska Politika, a bi-weekly journal, published at the end of March 2004 carried a feature article on the results which were achieved so far by privatization. Let us confirm the achievement of privatization by summarizing the article.

A new wave of privatization began on the basis of the new law on privatization of 2001. The main model is sale. The first transformation of ownership on the basis of the law was implemented on January 30, 2002. As a result of open tender three cement

firms in Beocin, Novi Popofac and Koseljac obtained foreign strategic partners. The first auction was implemented on April 3, 2002. The first firm which was sold by this method is 'Automobile Service Priboj'. Out of 1,425 firms which were to be sold, the number of firms which have been sold by February 19, 2004 is 1,117, and its success rate is 78%. The revenue from the privatization of these firms exceeds € 1.3 billion. It is reported that the revenue was used for various fiscal necessities, restructuring of big-scale social system, guarantee of liquid capital and social protection of employees who have lost their jobs in the process of the restructuring of firms. The investment program which is related to the privatized firms exceeds € 750 million, and it is to be implemented in the next period. The social program exceeds € 250 million, and it is related to the firms which were privatized through tender. It is reported that the social program is respected where it is obligatory and that owners escape from the program where it is not obligatory. Nearly 150 thousand workers are working at the privatized firms.

The article summarizes as follows: First, tender privatization was implemented relatively carefully, and consequently good firms were sold and their sale prices exceeded their book prices. Similarly, the criteria for selection were relatively strict, and strategic investors (buyers) hoped more investment and also their investment exceeded the book prices at these firms.

Second, in the case of auction, better performing and worse performing firms are mixed, and the accomplished sale prices are only about 80% of their book prices. It means that in the case of smaller firms the privatization of both good firms and bad firms were implemented generally. They are afraid that this might give a negative message to the outside that firms would be sold at very cheap prices simply to pour as much fund as possible to budget

Third, firms which account for 8.4% of the total book prices were sold on the capital market, and their revenues account for 11.3% of the total. This is a case in which the shares of firms, which entered the privatization process according to the previous law, were traded on the capital market this time in connection with the government's policy. It is proved that individual firms, which have been entirely privatized or partly privatized, are now very successful and draw foreign strategic investors' attention. The best example of this case is Apatinska Brewer which became a partner of 'Interbr', a Belgium Concern.

Fourth, as for the revenue from the privatization, the biggest share was realized through tender (61.6%), followed by auction (27.1%) and capital market (11.3%).

Table 1 General View of Firms Which have been sold by February 19, 2004

(Unit: Euro 1,000)

| | Firms for sale | Sold firms | Success Rate | Number of Employees | Book prices | Sold prices | Amount of investment | Social program |
|----------------|----------------|------------|--------------|---------------------|-------------|-------------|----------------------|----------------|
| Tender | 67 | 35 | 52 | 34,402 | 590,098 | 809,966 | 656,697 | 270,441 |
| Auction | 1,060 | 913 | 86 | 80,325 | 442,586 | 355,500 | 92,582 | |
| Capital market | 298 | 169 | 57 | 34,977 | 94,475 | 149,380 | 5,902 | |
| Total | 1,425 | 1,117 | 78 | 149,704 | 1,127,159 | 1,314,840 | 755,181 | 270,441 |

Source: Ekonomska Politika, Broj 2710, str.21.

The privatization has made a remarkable progress in 2003 when 814 firms were sold and the revenue was € about 944 million. The privatization in 2003 includes the following big trades:

- Privatization of 'Tabaco Industry' in Nis. Philip Morris which acquired this firm expended for the privatization € 518 million, of which € 387 was used for acquiring 70% of the total capital and the rest was used for an investment program, a basic social program and an additional social program and support to the local autonomy.
- Privatization of 'Beopetrol' in Belgrade. Lukoil acquired this with € 117 million. Lukoil paid Euro 70 million in 2003 and is to pay the rest for two years.
- Privatization of 'Tabaco Industry' in Vranje. A tabaco company of the US and Britain (BAT), which acquired this, spent € 87 million, of which € 50 million was spent to acquire 67.81% of the total capital of this company, and the rest was spent through investment program and social program as well as support of local autonomy.

The pace of the privatization has slowed down in 2004. By the early 2004 (by the day of survey, February 19, 2004) 43 companies were sold and € 31.3 million was earned. € 47.7 million was appropriated for investment and € 500 thousand for social program. In fact, however, the prices of these companies were beaten because the book price of these companies was € 67.7 million in total. Only a small part was sold out of the companies for sale. It means that attractive objects for investment from viewpoint of foreign companies have already been sold and less attractive objects have remained, that fewer people are interested in them, and that it became more difficult to find buyers. In addition, political disorder had influence on a delay in privatization.

The third annual report of the Stabilization and Association process of the EU says that reforms that attract more greenfield FDI will become increasingly important in

order to assure the country's external sustainability (EU, 2004). There are encouraging factors. For example, Serbia and Montenegro gained an agreement with Paris Club in 2001, which wrote off 66% of the outstanding debts. Similarly the country gained an agreement with London Club in July 2004, which wrote off 62% of the total debts (US\$ 2.7 billion), ie. US\$ 1.6 billion. These reduced a part of heavy burden from Serbia and Montenegro and enabled the normalization of its access to international capital markets (*EP*, Broj 2725, 12. jul. 2004)

IV. Political Situation

A cause of worry is political instability. The Republic of Montenegro, headed by President Djukanovic (Now Prime Minister of the Montenegrin Government), intensified its orientation of toward independence in closing years of the Milosevic period. The use of Deutsche Mark (now Euro) as a legal tender is its expression. In order to overthrow the Milosevic regime, the West actively assisted Montenegro. Now that the Milosevic regime has collapsed at last in October 2000, the West no longer hopes further emergence of a small independent country in South Eastern Europe. However, once Montenegro's orientation toward independence gained momentum, it would not stop.

In March 2002, Serbia and Montenegro basically agreed about the dissolution of the Federal Republic of Yugoslavia and the formation of the state union Serbia and Montenegro. This state union started on February 4, 2003. The government at the state union level is very weak. The Constitutional Charter assigns only 5 Ministerial posts: Foreign Affairs, Defense, International Economic Relations, Internal Economic Relations, and Human Rights and Minorities' Rights to the state union level's government, which has insufficient financial support.

In both Republics there have been political disorder. Here I will explain the situation in Serbia. In 2001-2002 the conflict deepened between President of the Federation Vojislav Kostunica, a moderate nationalist, and Prime Minister of the Republic of Serbia Zoran Djindjic, who was oriented toward the West. The US requested the Serbian Government to arrest Milosevic and deliver him to the ICTY as a condition for economic assistance. When at last Prime Minister Djindjic put into practice the request at the end of March 2002 the confrontation between the two big-name politicians became crucial. Democratic Party of Serbia led by Kostunica left from the Democratic Union (DOS). Thus DOS, which has been composed of 18

political parties and groups and supported the Kostunica Administration, has split. The election of the President of Serbia was held in October 2002. Kostunica ran for this election because the President of Republic of Serbia would have more power after the formation of the state union. The Presidential election was substantially contested between Kostunica and Vice Prime Minister of Serbia Miroljub Labus, who was a leader of G17 and got support from Democratic Party. Although Kostunica got more votes than Labus, the election failed because the voting rate was less than 50%. The Presidential election was held again in December 2002, but it again failed.

Serbian Prime Minister Djindjic was assassinated on March 12, 2003. Third Annual Report of the Stabilization and Association process says that the tragic assassination of Serbian Prime Minister Djindjic in 2003 was the most serious indication of the heavy legacy of the past and the continuing threat from elements linked with the former regime and that the civilian control over military should be extended to defense industry (EU, 2004). The fact that Presidential elections failed twice due to low voting rates reflects dissatisfaction of people who have been in miserable economic situation for a long time and felt disgusted with politician's struggle for power. The third Presidential election held in November 2003 failed too due to a low voting rate. Meanwhile Chairman of the Republican Parliament served as acting President. At the end of December 2003 the election of Serbian Parliament was held one year earlier than usual. Since the procedure of the election of Serbian Parliament includes a stipulation of the so-called 5% article, minor parties tried to cooperate with one another or join up with bigger parties and submitted a list of candidates.

Here I will briefly explain the political orientation of main political parties in Serbia: Serbian Radical Party is a right wing nationalistic party, and it cooperated with Serbian Socialist Party during the Milosevic era. Mr. Seselj, its leader, served as Vice Prime Minister at that time. In the same way as Milosevic he is now in a prison in the Hague as a war criminal; Democratic Party of Serbia, with Kostunica as its leader, takes a position of moderate nationalism; Democratic Party is oriented toward the West and active in cooperation with the EU and the NATO. The late Mr. Djindjic was its leader. The present leader is Boris Tadic; G17 plus started its activity with a group of 17 economists, who criticized Milosevic's policies and announced the counterproposal in the late Milosevic era, and it became a political party (G17 plus) in autumn 2003. The leader is Miroljub Labus (Professor of Finance at the Law Faculty of the University of Belgrade), who served as Vice Prime Minister of Djindjic Government; Serbian Movement of Renewal is a nationalistic party with strong inclinations for revival. Vuk Draskovic, its leader, held up extreme ideas such as abolishment of Albanian as an

official language and instruction in Albanian in the territory of Serbia at the first free election in 1990; Serbian Socialist Party is a party which has descended from the League of Communists of Serbia. It merged with its united front and became a socio-democratic party in 1990. Since at the same time the party held up Serbian nationalism it gained support from a majority of people for a certain period of time. Milosevic, who is in a prison in the Hague, still serves as the leader of the party. From the prison he as well as Seselj sent messages by magnetic tapes to their own parties, participating in this election; In addition, Archbishop of the Serbian Orthodox Church made a speech in support for Serbian Movement of Renewal, intervening in the election (Milosevic, 2003).

The number of the total seats of the Parliament is 250. The voting rate of the General Election in December 2003 was 58.8%. The result of the election was as follows: The leading party is Serbian Radical Party with 83 seats (the rate of votes obtained is 28%), followed by Democratic Party of Serbia with 53 seats (18%), Democratic Party with 37 seats (13%), G17 plus with 34 seats (12%), Union of Serbia Movement of Renewal with New Serbia with 22 seats (8%), Serbian Socialist Party with 22 seats (8%), etc. No single party won a majority of the total seats.

Since the beginning of 2004 a problem how to organize coalition became a focus of the politics. Since Serbian Radical Party could not find a partner for coalition, a coalition with Democratic Party of Serbia as a center was pursued. Finally a minority government with Democratic Party of Serbia, G17 plus and Serbian Movement of Renewal with New Serbia (The total number of their seats was 124, and it was two seats less than the majority.) was formed with Serbian Socialist Party's support from the outside the Cabinet. Thus a new Cabinet with Kostunica as Prime Minister started on March 2, 2004. Democratic Party became an opposition party (Shiba, 2004, p. 290; Milosevic, 2003).

The election law was revised by the Serbian Parliament, abolishing an article which required voting rate of minimum 50%. The Presidential election was held on June 13, 2004 on the basis of the new election law. The election was substantially contested between Nikolic, a candidate from Serbian Radical Party, and Tadic, a candidate from Democratic Party. As many parties made a united effort to prevent Serbian Radical Party from victory Mr. Tadic won the election. The distance between the Government and Democratic Party has seemingly become narrowed, but Democratic Party did not join the Cabinet. In this way, a strange twist phenomenon has emerged in which Democratic Party is opposition toward the Government while the Presidential post is in hands of Democratic Party. In local elections held in late September 2004 Serbian

Radical Party as well as Democratic Party made a leap forward. In the face of the second ballot held in October a special meeting of Prime Minister Kostunica (Democratic Party of Serbia) with President Tadic (Democratic Party) was held on cooperation in the election. In order to press forward with reforms it would be necessary that the both parties should cooperate with each other more closely forgetting everything that has happened between them.

The feasibility study by the EU commission for starting negotiation on Stabilization and Association Agreement (SAA) was postponed due to the above mentioned reorganization of the state. Institutionally there are differences in many fields between the two Republics. For example, each Republic has different currency and custom system, which has been an obstacle for the start of negotiation on SAA. Montenegro adopted VAT in April 2003 while Serbia has not adopted it yet.

It was decided that referendum would be held in May 2006 in Montenegro and that the Republic would be able to become independent if more than 55% of the total votes would support it. Many observers expect that the Republic will become an independent country. The Kosovo problem remains unsolved. A direct talk between the Serbian government and the Kosovo government began recently. It is mostly likely that Kosovo will become independent in the near future. Cooperation with the ICTY has been insufficient. It is reported that Mr. Karadjic and General Muradjic, indictees of the ICTY, have been harbored by their supporters and that there are supporters even among the military. This results in a delay in start of its negotiation with the EU on Stabilization and Association Agreement

VI. Experiences in East Asian countries

Postwar Japan's experience seems to be suggestive. Japan has lost its overseas territory, which entailed the repatriation of many people. In addition to atomic bombs dropped over Hiroshima and Nagasaki, most of big cities were devastated by incendiary bombs. A quarter of the national wealth was reduced to ashes. Most of workers who worked at major munitions factories were fired as soon as the war ended. A large crowd of demobilized soldiers and people repatriated from overseas appeared on the labor market. There was a big scale of unemployment. There were so many people who had no house to live in, etc. Although very poor, people were liberated from the militaristic suppression, and they made desperate efforts for their subsistence like economic animals. Japan concentrated its energies on its economic recovery and development

with its military burden being relatively small. There is an episode: Mr. Hayato Ikeda, who served as Prime Minister in the first half of the 1960s, advocated and promoted the income doubling plan. He always talked about economic problems. After receiving Mr. Ikeda's visit French President at that time General Charles De Gaulle derided him as a salesman of transistor radio. However, owing to the line giving priority to the economy, Japan has been able to keep its military expenditure at about 1% of GDP and succeed in attaining the high economic growth.

South Korea's experience seems to be also suggestive. The Korean Peninsula was divided into two countries by the Korean War. The land was totally devastated. People made desperate efforts for their subsistence also like economic animals. Around 1960 South Korea was lagging behind North Korea in terms of economic power. South Korea introduced capitals and technology from the USA and Japan. South Korea experienced its high economic growth 10 years later than that in Japan. In 1996 its per capita GDP exceeded US\$ 10,000, and the country was admitted to the OECD, which is regarded as a club of developed countries. Next year South Korea experienced the financial crisis, but it was overcome in a short period of time by people who were united with feelings of national crisis. South Korean people's experiences teach us the importance of people's feelings of crisis.

I am afraid that I might make an insulting remark, but I would like to say that people in Serbia and Montenegro, especially people in Serbia should start from the fact that the country was defeated. In my opinion, the situation in Serbia is quite similar to that in Japan immediately after World War II. Differences consist in the following points: Firstly, in the case of Japan there was an absolute authority such as General Headquarter of the Allied Forces (Occupation Army), and therefore public order was maintained to certain extent while Serbia lacks it. Secondly, there is of course a difference in time. The main energy resources were coal and petroleum at the time immediately after World War II. At present the main energy resources are petroleum and atomic energy, and moreover advanced information-communication technology, which did not exist immediately after World War II, is now widespread. Other than these points there are many points in common. Their territories have been decreased. Both countries were severely damaged by wars. Japan had unemployment on a massive scale, and similarly Serbia has the same problem now, etc. In our time, however, the size of a country's territory has nothing to do with its national power, which is supported by its international competitiveness. The most important is ability to create things whether those are hard (material) or soft (immaterial). It is necessary for Serbian people to break off parochial nationalism and dedicate themselves to reconstruction and development of

the economy as Japanese people and Korean people did before.

VI. Conclusion

As we have seen Serbia and Montenegro has been in a very difficult situation. Finally I would like to conclude by mentioning challenges for its rebirth.

- In order to recover and reconstruct its economy it is necessary to secure first of all its political stability. The two Republics Serbian and Montenegro struck out for their own ways. It is highly probable that Montenegro would become independent. The both Republics should endeavor to secure political stability within each Republic. Especially, Serbia has a kind of twist phenomenon, but in order to press forward with reforms it would be necessary that both Democratic Party and Democratic Party of Serbia should cooperate with each other more closely forgetting everything that has happened between them.
- Its more close cooperation with the international community, the EU in particular, is required. Its more active cooperation with the ICTY is also required.
- Evil practices inherited from the period of self-managed socialism (banks controlled by debtors, soft budget constraint, etc.) must be completely overcome. A change in people's style of living is necessary (This is a recommendation to become a kind of 'economic animal').
- In order to actively attract FDI, it is necessary to improve the investment climate. The experiences in Central and East European countries would be suggestive.
- It is necessary to strongly accelerate privatization.
- As the privatization process necessarily entails mass unemployment, it is necessary to take active measures for promoting small and medium sized-enterprises in order to increase employment opportunity and activate the economy.

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² For the data on per capita GDP on purchasing power parity basis in 2001, see Koyama (2005).

Economic Reconstruction of Serbia and Montenegro and Stabilization of South Eastern Europe

セルビア・モンテネグロの経済再建と南東欧の安定化

セルビア・モンテネグロは10年間に二度の戦争を経験した。ミロシェヴィチ時代は国際的に孤立した。この国は2000年秋にミロシェヴィチ体制が崩壊してようやく国際的孤立から抜け出すことができた。この国の経済は悲惨な状況にある。その経済は構造的に弱体である。慢性的に巨額の貿易赤字を抱えている。その輸出総額は輸入総額の3分の1しかカバーできない。この国がいわば南東欧の動乱の震源地であったので、経済を再建することは、国民の幸せのためのだけでなく、南東欧の安定化のために必要である。

2001年5月に新しい民営化法が採択された。他の移行経済諸国と比べると、この国は民営化に向けて非常に遅いスタートを切った。2003年に民営化は外国資本の参加を得て、大きく前進したが、2004年に入ると、ペース・ダウンした。

不安材料は、この国が政治的に不安定だということである。セルビアとモンテネグロ両共和国の関係がぎくしゃくしてだけでなく、それぞれの共和国内でも不安定である。セルビアでは、セルビア民主党を中心とする連立政権に対して、民主党は野党の立場をとっているが、大統領職は民主党が握っているという一種のねじれ現象が見られる。未解決のコソボ問題、ICTY（旧ユーゴ国際戦争犯罪法廷）への不十分な協力、という問題も存在する。

この国の現状はある面では、第2次大戦直線後の日本の状況に似ている。この点では、戦後の日本の経験、朝鮮戦争後ならびに1997年の金融危機以後の韓国の経験も有益な教訓を提供している。国民は偏狭な民族主義は捨てて、モノ作りに邁進すべきである。

この国は非常に困難な状況にあるが、とくに重要な課題は以下の点である。

- 1) 多分、モンテネグロは2006年5月の国民投票を経て、独立することになる。それぞれの国内において政治的安定性を確保することが必要である。セルビアでは、改革を進めるためには、民主党とセルビア民主党の協力が必要である。
- 2) 国際社会、とくにEUとの協力、ICTYへのより積極的な協力も必要である。
- 3) 自主管理社会主義時代から受け継がれた悪弊（債務者によって管理される銀行、ソフトな予算制約、等）は絶対に克服する必要がある。
- 4) FDIを積極的に誘引するために、投資環境を改善する必要がある。その際、中東欧諸国の経験が参考となる。
- 5) 停滞した民営化を再度加速する必要がある。
- 6) 民営化過程は大量失業の発生を伴う。雇用機会を拡大するために、そして経済を活性化するためにも、中小企業の育成措置を積極的に講ずる必要がある。