The Western Balkans

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William Bartlett
The London School of Economics and Political Science

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Will Bartlett

University of Bristol

1. INTRODUCTION: THE POLITICAL BACKGROUND

The break-up of Yugoslavia in 1991 following proclamations of independence by the republics of Slovenia, Croatia, Macedonia, and in 1992 of Bosnia and Herzegovina established several new states in the region. It was followed by a decade of conflict. Wars broke out in Croatia in 1991, in Bosnia and Herzegovina from 1992 to 1995, in Serbia and Kosovo 1999, and serious insurgency occurred in Macedonia in 2001. Albania, already well established as an independent state, did not escape a violent civil conflict following the collapse of a number of pyramid savings banks in 1997. The turbulence in the region calmed down following the intervention of international institutions, including armed intervention by NATO in the Kosovo conflict, and active diplomatic intervention by the EU in resolving the Macedonian conflict in 2001.

Croatia, Macedonia and Albania are unitary states, and have achieved a degree of stability. However, two less stable federal states have been established. The Federal Republic of Yugoslavia, established in April 1992, changed its name to Serbia and Montenegro in 2003. Within it, the province of Kosovo was placed under United Nations administration (UNMIK) following the end of the Kosovo war. In 2002 a provisional government of Kosovo was elected to which some less strategic state powers were delegated. In practice, Montenegro has many features of an independent state, with autonomy to design its own institutions of economic management and social welfare and, like Kosovo, has adopted the euro as legal tender. Montenegro is due to hold an independence referendum in 2006, and discussions on the final status of Kosovo have begun. Whatever the outcome, the uncertainty over the political constitution of the state union of Serbia and Montenegro has provided weak incentives for the development of a coherent set of complementary institutions.

The other federal state, Bosnia and Herzegovina (BiH), is composed of two 'entities', the Republika Srpska (RS) and the Federation of Bosnia and Herzegovina (FBiH), and the autonomous District of Brčko. Following the Dayton Agreement in 1995, the United Nations appointed a High Representative to oversee the implementation of the peace agreement. The Office of the High Representative (OHR) has wide powers to intervene in the political and economic affairs (Chandler 1999). Since most economic policy making powers are in any case decentralised to the level of the two entities, and within FBiH further decentralised to ten canton governments, the powers of the central government to formulate economic policy and to design the institutions of a new market economy are extremely limited.

In the 1990s those South East European states that were least affected by the wars and conflicts in the Balkans, namely Slovenia, Romania and Bulgaria, became early candidates for EU membership. Slovenia achieved EU membership in 2004, while Romania and Bulgaria have signed Treaties of Accession and are due to become EU members in 2007 or 2008. The European Commission has designated the remaining Balkan states the 'Western Balkans', with a 'perspective for eventual EU membership. Thus far, Croatia and Macedonia are the leaders in this process having signed Stabilization and Association Agreements (SAAs) in 2001[1]. Croatia became an official candidate for EU membership in 2004 and Macedonia in 2005. Albania has been negotiating for a SAA for several years while Serbia and Montenegro and BiH are at the start of their SAA negotiations. Kosovo is waiting for a resolution of its status before joining in even that process while taking early steps through the implementation of a European Partnership.

One important condition for EU entry is the creation of a functioning market economy. But as recent research has shown, there are a wide variety of different forms of capitalist market economies. Key dimensions of the discussion of the 'diversity of modern capitalism' have been identified by Amable (2003) who identifies five key dimensions which distinguish capitalist systems: institutional configurations of product markets, labour markets, systems of finance and

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[1] The Macedonian SAA came into force in 2004, the Croatian SAA in 2005.

corporate governance, the welfare system and the education system. Different combinations of these give rise to different models of capitalism within which institutional complementarity enables coherent and distinct models to evolve over time. However, this process of institutional evolution has not been available to the transition countries, which have had to adopt institutions on a more or less experimental basis borrowing ideas and examples from other more advanced capitalist countries. The Western Balkan countries have additionally relied heavily on international assistance and aid donations in the aftermath of the devastation of the various armed conflicts that beset the region in the 1990s. This assistance has very often come on highly conditional terms and has involved the transplantation of policies and institutional solutions from elsewhere. The institutional mix that has emerged has typically been based on policy transfer from a variety of sources and on uncoordinated policy advice. This has resulted in a rather exotic mixture of economic and social reforms, and the institutional configurations that have emerged have often been neither complementary nor compatible. The emergent forms of capitalism therefore do not fall neatly into the boxes identified in the varieties of capitalism literature. Moreover the important role of informal as opposed to the formal institutions that are the focus of the theory presents a further difficulty for classification.

In the rest of this chapter I attempt to identify some of the main directions of institutional change in the region since the collapse of Yugoslavia and the overthrow of the communist system in Albania. I follow the five dimensional typology of formal institutions established by Amable, and in the final section present some necessarily imperfect and preliminary conclusions about the types of capitalism that seem to be emerging from this period of rapid change.

2. Finance and Corporate Governance

Privatization legislation was introduced early after independence in Croatia in 1991, and in Macedonia in 1993[2]. While implementation was rapid in Croatia, the process did not take off in Macedonia until 1995. In BiH, as a consequence of the armed conflict, privatization legalization was not passed until 1999. Initial attempts at privatization in Serbia had been reversed in the mid 1990s and new

[2] For an overview of privatization in the Yugoslav successor states in the first half of the 1990s see Uvalić (1997).

privatization legislation was not introduced in Serbia until 2001 after the overthrow of the Milošević regime. Privatization has been most delayed in Kosovo where privatization administered by the UN through the Kosovo Trust Agency only began in 2003. The principle difference between these successive waves of privatization was the important role of insider privatization to employees and managers in the Croatian and Macedonian and Albanian cases, the use of voucher privatization in Bosnia and Herzegovina and the adoption of direct sales through auctions and tenders in the Serbian case. Paralleling these developments, financial deepening took place relatively early in Croatia, where bank credit to the private sector increased as a share of GDP from about 1994 (Cottarelli et al., 2003). Financial deepening did not begin in BiH until 2001 and in Serbia and Montenegro until 2002, and was not noticeable in either Albania or Macedonia at the time of the Cottarelli et al. study.

The Croatian privatization law envisaged the compulsory privatization of all enterprises and the elimination of social ownership[3]. Privatization transferred ownership to a new class of politically well-connected individuals many of whom were returned expatriates or local businessmen with close links to the governing party, or even members of it. Other beneficiaries included enterprise managers who were able to acquire shares with loans offered by state owned banks to individuals favoured by the ruling party, the HDZ (Petričić, 2000: 207-8). Such loans would typically be repaid from company profits, or through mortgaging company assets. Shares acquired by managers through such management buy-outs were often sold on the basis of under-valued assets. Employees also benefited from the discounted sale of shares, but many sold them to managers at the first opportunity or simply ceded them to the managers in return for preserving their jobs. With a few exceptions, the new ‘tycoons’ stripped the assets of many Croatian industries rather than reinvesting for long-run growth. By 1998 these excesses led to a full-blown banking crisis and the collapse of some important regional banks. The economy entered into a recession in 1999, unemployment reached unprecedented levels (Bartlett, 2003). Within a few years

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[3] Social ownership was the unique form of Yugoslav property, equivalent to state ownership in other socialist countires. Socially owned enterprises were formally under the supervisory control of workers’ councils under the Yugoslav system of workers’ self-management.

the Croatian banking sector had been largely taken over by foreign banks, mainly from Italy and Austria. Nevertheless some of the privatized enterprises survived and became large and successful companies that have subsequently driven the growth of the Croatian economy.

In Macedonia the privatization programme was carried out quickly and was largely completed by the end of 1997, by which time over one thousand enterprises had been fully privatised and only 234 remained in the privatization process. The main methods of privatization adopted were management and employee buy-outs, with management buy-outs being the most prevalent in terms of both employment and the value of equity involved. Managers were required to put up only ten percent of the purchase price with the remainder to be paid in instalments over ten years. Typically, the most profitable, or potentially profitable, enterprises were sold to managers at substantial discounts, often on the basis of severely undervalued asset valuations. Weaker and smaller enterprises were sold to employees often at more inflated valuations of assets. In a number of cases managements acquired further shares from employees by dubious methods, or appropriated the voting rights of the employee share holdings, consolidating majority holdings to the management group. By the end of 2003, some 1,678 companies had been privatised. Of these, 393 companies, with assets of just €77 million had been privatised through an employee buy-out, and 234 companies with assets worth €705 million had been privatised by management buy-out. The disparity in value of the two sets of companies indicates that one way or another the managers had acquired by far the most valuable part of the privatised company base. The rest of the companies were privatised through other methods. Just 155 companies with capital assets of € 25 million were sold to foreign owners. Thus insider privatization has been the predominant form of ownership transformation in Macedonia.

In Bosnia and Herzegovina about two thousand socially owned and state owned enterprises, worth an officially estimated $10 billion, were included in the privatization process. The approach adopted in FBiH was based on mass voucher privatization, avoiding the direct sales to insider workers and managers that had characterized privatization in Croatia and Macedonia. Vouchers were awarded to all citizens who were over eighteen years old in December 1997, and who had been citizens of the socialist republic of Bosnia-Herzegovina in March 1991. Only 65 percent of any purchase of assets or shares could be made with vouchers, the remaining amount had to be paid for with cash. This was intended to raise revenue for the government, but it effectively excluded many people with limited means. The first phase of privatization involved the sale of small enterprises and flats, mostly owned by the municipalities. The sale of larger enterprises took place after a number of Privatization Investment Funds had been established which were the main buyers. Individuals could participate in the purchase of large enterprises by investing their vouchers in the Investment Funds. However, in the absence of effective financial institutions many individuals sold their vouchers on the open market to raise much needed cash (Donias, 2002). In the fractured Bosnian state privatization inevitably took on an ethnic dimension, with vouchers being accumulated in the hands of wealthy individuals based in the different ethnic communities. While many smaller enterprises have been privatized, larger enterprises have remained in state ownership especially in RS.

In Serbia the initial privatization process ground to a halt after the imposition of United Nations sanctions in 1992. Some public utilities were nationalized and many other enterprises were converted into so-called "mixed ownership" in which the state had effective control. Previously privatised enterprises were brought back into state ownership through a revaluation of capital assets (Lazic and Sekelj 1997). The state-owned banks often had a dominant shareholding, and controlled many firms that were formally privatised. The other major shareholders were often managers who had bought large shareholdings at heavily discounted prices. A new privatization programme initiated in 2001 was designed, with the assistance of the World Bank, to make a radical break with the past, basing the process on cash sales through public tenders and auctions. (IMF 2002: 35). Privatization proceeded rapidly in the first two years with most small and medium sized enterprises sold off mostly through auction, but since 2003 the process has slowed down following the assassination of prime minister Djindjić in 2003, an event which revealed the strong hold of organised crime in the country (Vasić, 2005). The new government elected in December 2003 adopted a more populist approach, returning to the policy of protecting large state-owned industries (Begović 2005).

In Albania small-scale privatization had been largely completed by the end of 1994. An Enterprise Restructuring Agency, established in 1993 with assistance from the World Bank to restructure the largest enterprises before their privatization was responsible for the thirty-two largest enterprises in Albania. By

1996, when the agency was closed, the restructuring programme had reduced the workforce from 50,000 to less than 7,000 and ten of the thirty-two enterprises had been privatized (Vaughan Whitehead 1999: 157). In 1995 a voucher scheme was introduced to complete the privatization of the large state owned enterprises. However this was unsuccessful and the large enterprises sector was privatised through direct sales gradually over the following years. Although privatisation was pushed through rapidly, there was no parallel development of a properly regulated financial system. In its place a set of 'pyramid' schemes emerged in Albania in the early 1990s. These attracted savings because the population did not trust the state-owned banks. Many individuals and families had placed their life savings in the schemes, which offered unrealistically high rates of return. The pyramid schemes also provided opportunities for recycling profits earned from smuggling petrol and other goods into FRY during the period of the UN Sanctions. Several pyramid schemes collapsed in January 1997, and the naïve depositors lost hundreds of millions of dollars. Violent protests against the closures soon turned into serious riots and in several towns. In the south of the country protestors set fire to government buildings. In March the prime minister resigned a State of Emergency was declared. But rather than quelling the riots the use of armed police and military units sparked a widespread uprising against the government. Factories and shops were looted and weapons were seized from military arsenals. Armed gangs took over several towns in the south of the country, and rebel committees were established. In the face of the revolt the army and police authority disintegrated and the country slid into anarchy. The government was overwhelmed and forced to resign. An interim government appealed for international assistance and eventually Italy took the leading role in an international force that entered Albania to restore order.

Table 1. Privatization and Ownership in the Western Balkans

	Large scale privatization	Small scale privatization	Governance and enterprise restructuring	Private sector share GDP	Ratio Bank Credit to GDP 2002
Albania	3	4	2	75%	4.9%
Bosnia and Herzegovina	3-	3	2	50%	21.9%
Croatia	3+	4+	3	60%	45.6%
Macedonia	3+	4	2+	65%	17.1%
Serbia and Montenegro	3-	3+	2+	50%	14.7%

Source: EBRD (2005) Transition Report 2005 (London: European Bank for Reconstruction and Development) and Cottarelli et al. (2003).

Data from the EBRD Transition Report provide a summary picture of the outcome of the privatization process in the Western Balkans. The privatization process has been most advanced in Croatia and Macedonia, although there are still significant sectors in state ownership, such as the large shipyards in Croatia. The share of private ownership is highest in Albania, indicating the collapse of state involvement in the economy, although corporate governance arrangements are relatively weak. The effects of the delayed privatization process in Bosnia and Herzegovina and in Serbia are reflected in the relatively low indicators for large-scale privatization and the low share of the private sector in the economy.

3. PRODUCT MARKETS AND BARRIERS TO ENTRY

As noted above the privatization process in the Western Balkans has been relatively slow in Serbia and Montenegro and in BiH. In these two cases the state has maintained a close involvement in the economy (in the case of BiH at entity level). Political parties have been able to control the economy to their advantage by retaining control over the enterprise sector and controlling appointments to top managerial positions. In the former cases the retention of political power was focused on the connection between political parties and state owned enterprises, combined with a disinclination to foster the growth of the private sector. In Croatia and Macedonia, insider privatization involved transfers of ownership to politically favoured individuals. Governments gained political advantage through fast privatization to insiders. These different approaches impacted on the policies towards the entry of new private firms, being less accommodating in the case of Serbia and Montenegro and BiH than in the case of Croatia and Macedonia. In Albania, following the pyramid bank collapse of 1997, economic policy became more liberal, guided by the strong influence of the IMF and the World Bank, which supported the economic recovery. These trends are reflected in the data on the entry of SMEs presented in table 2, which shows the greater difficulty of registering a company and the lower density of SMEs in Serbia and Montenegro and in BiH, compared to the other three countries[4].

Table 2. Entry of SMEs (2003)

	Number of days to register a company (2002)	Number of days to register a company (2005)	Number of procedures to register a company (2002)	Number of procedures to register a company (2005)	SMEs per thousand inhabitants (2002)
Albania	62	41	11	11	18.2
Bosnia and Herzegovina	74	54	12	12	7.9
Croatia	50	49	13	12	14.3

[4] Bartlett and Bukvič (2003) present evidence of higher barriers to SME growth in BiH compared to Macedonia, while Broadman et al. (2004) discuss entry barriers for SMEs in all South East European countries.

<table>
<tr><td>Macedonia</td><td>48</td><td>48</td><td>7</td><td>13</td><td>16.4</td></tr>
<tr><td>Montenegro</td><td>4</td><td rowspan="2">15</td><td>4</td><td rowspan="2">10</td><td rowspan="2">8.5</td></tr>
<tr><td>Serbia</td><td>71</td><td>16</td></tr>
</table>

Source: OECD (2003) South East Europe Region Enterprise Policy Performance: a Regional Perspective (Paris: Organisation for Economic Co-operation and Development). Data for 2005 are taken from the World Bank Doing Business Database [www.worldbank.org].

The reduction of barriers to entry and growth of SMEs has been a main focus of policy towards the improvement of competitiveness of the Western Balkan states and to the creation of a more favourable 'investment climate'. In Bosnia and Herzegovina, the High Representative formed a so-called 'Bulldozer Commission' in 2003 to sweep away restrictive legislation which was to some degree effective and led to a reduction in the number of days needed to register a company from 74 in 2002 to 54 in 2005. In Serbia recent reforms have led to a significant fall in the number of days needed to register a company and propelled the country to the top of the league of the World Bank's best performers in 2005. Nevertheless, the effect of restrictive regulations over the years has been to push much economic activity into the informal economy. Levels of informal economy activity have been high in Serbia and Montenegro and in Bosnia and Herzegovina, also due to the effects of UN sanctions which generated a strong black market and criminal economy in Serbia (Andreas 2005). The war in BiH had similar effects (Andreas 2004). The informal economy appears to be especially evident also in Albania where a recent report estimates the non-agricultural informal economic activity at around one quarter of GDP (OECD 2004).

4. Labour Markets

In former Yugoslavia the system of worker self-management provided a high degree of job security to employed workers, while the decentralized relations between enterprises and absence of central planning led to open unemployment (Bartlett 1991). Although employee participation within enterprises has been abolished in all the successor states, institutions of social dialogue between employers, trade unions and governments have been established in all the Western Balkan countries at national level. These institutions are however, generally weak and ineffective (Djurić 2003). The exception is Croatia where an Economic and Social Council (ESC) was established in 1993 and operates through 18 regional branches. It is a tripartite body on which each of the social partners has six seats and consults government on labour legislation. Elsewhere the institutions of social dialogue are only weakly developed. In BiH there is no ESC at state level because the trade unions are divided on ethnic lines. Two ESCs operate at entity level. The RS ESC was established in 1997 but meetings are infrequent and the RS government has little interest in the process of social dialogue while the FBiH ESC was established only in 2002. ESCs were established in Macedonia (1996), Serbia (2001) and Montenegro (2001) and Kosovo (2001) but the social partners are relatively weak in those countries. In Albania the National Council of Labour was established in 1997 as the main tripartite body. It consults the Ministry of Labour and Social Affairs on issues of social policy and labour policy but in practice meets infrequently.

Unemployment has continued to be a major problem in the Western Balkans. In 2003, registered unemployment rates ranged from lows of between 15%-16% in Albania and 19% in Croatia to highs of 44% in Bosnia-Herzegovina, 45% in Macedonia, and as high as 53% in Kosovo. Labour Force Survey measures of unemployment where available are lower than registered unemployment but still high.

Table 3. Unemployment data 2003

	Registered unemployment rate (%)	Proportion of total who are long term unemployed (% of total)	Proportion of total unemployed below 25 years (% of total)	Labour Force Survey unemployment rate (%)
Albania	15.0	92.6	7.7	15.2
Bosnia and Herzegovina	44.0	n/a	n/a	n/a
Croatia	18.7	59.6	35.8	14.3
Macedonia	45.3	87.0*	58.4.^	36.7

Serbia and Montenegro	28.0	75.6^	46.5^	15.2

*Source: CEB (2005). Note: * 2001, ^ 2002*

The countries in the region inherited a set of employment laws that offer relatively high levels of protection to incumbent workers (Arandarenko 2004). High dismissal costs have created labour markets with low rates of labour force turnover, simultaneously boosting the informal economy. Young people have found it difficult to obtain employment in the formal sector and increasing rates of youth unemployment. Workers who lost their jobs through restructuring have found it hard to return to employment, and consequently the rate of long-term unemployment is high in most countries. Part of the explanation can be found in the degree of rigidity in labour market institutions and the extent of employment protection. Arandarenko (2004) identified Croatia as the country with the most restrictive employment legislation and the most inflexible labour markets in the region. A World Bank report noted a reduction of employment protection in Macedonia during the 1990s, which however remained relatively high in relation to other transition countries (World Bank 2003: 40). Another explanation in the Yugoslav successor states that have adopted Bismarkian health insurance systems is the incentive to register as unemployed merely to ensure payment of health insurance contributions by the Employment Bureau.

Employment policy reforms have been adopted in several countries away from passive measures to active labour market policies. In both Croatia and Serbia new Employment Laws were introduced in 2003 designed to improve the flexibility of the labour market, and in Kosovo a new Employment Law was enacted in 2004. The Croatian reforms led to a reduction in the level of employment protection, which brought the country into line with the average restrictiveness of old EU member states such as France (Šošić 2005). Less is known about the effects of legislation in Serbia but anecdotal evidence points towards weak effects, and continuing rigidities in the labour market. National Employment Action Plans (NEAPs), inspired by the European Employment Strategy, provide a framework for active labour market policy measures. They are being developed in Croatia, Macedonia and Serbia with the assistance of the CARDS programme and other donor organizations.

5. SYSTEMS OF SOCIAL PROTECTION

At the beginning of the 1990s new legislation was introduced to reform the social welfare systems. In Albania a Law on Social Assistance and Welfare was passed in 1993 that established a market-oriented and means-tested system of social assistance, administered by a new institution known as the State Social Services. In September 2004 a new draft Law on Social Assistance and Welfare, prepared with support from the World Bank, was discussed in the Albanian parliament. It aims to develop community-based social services involving NGOs and other civil society organizations in the provision of social services.

Social services and welfare benefits were well developed in former Yugoslavia and administered through local Centres for Social Welfare, responsible to government ministries. These continue to exist in all the Yugoslav successor states, with the responsibility to assess needs, distribute social assistance payments and provide social welfare services. Average social assistance payments are extremely low, highlighting the importance of active labour market measures that would provide income-earning opportunities for the poorest groups. In some countries badly affected by the conflicts of the last decade the issue of the social welfare of war veterans and war victims and their families has been contentious. In FBiH, in RS and in Croatia war veterans' and their families are entitled to more favourable levels of social assistance benefits than other citizens. Attempts to reduce the privileges of this social group led to protests in RS, while in Croatia their political support played some role in the electoral victory of the HDZ in Croatia in 2003. In RS a specialised department of the Ministry of Veterans' Affairs provides them with privileged access to social services that are not available through the municipal CSWs.

Pension systems

Due to the large number of pensioners, pensions form a central element of the social protection systems in the Western Balkans. However, pension systems are under severe strain due to low employment rates and a poor record in contribution collections and the dependency ratio, the ratio between pensioners and employees, is unfavourable since early retirement had been widely used to facilitate enterprise restructuring. Relatively high contribution rates have lead to widespread avoidance by businesses and stimulated the growth of the grey economy. The countries of former Yugoslavia inherited an income-related pay-as-you-go system with relatively high replacement rates and pension expenditures absorb high proportions of GDP in Montenegro (17%), Croatia (13.5%), Serbia (12%), and Macedonia (9%). Pensions are lower in Albania where pension expenditures amount to just 5% of GDP. Nevertheless, pensions are low in relation to subsistence needs in all the Balkan countries, with average pensions of just €100 per month in FBiH, €90 in Serbia and Montenegro, €50in Albania, and €40 in Kosovo. In RS pensions even the limited pension entitlements are often not fully paid.

The World Bank has been influential in driving forward pension reforms in the region, and several countries have embarked upon pension reform programmes. Pension and Disability Insurance Laws were introduced in Croatia in 1998, in Macedonia in 2000, in Serbia and Montenegro in 2003, while in BiH the reform effort has focused on harmonization of the provisions of the pay-as-you go system between the two entities. In Kosovo an entirely new pension system has been introduced following the 1999 war.

The Croatian pension reform laws introduced a three-pillar pension model. The first pillar maintains a reformed compulsory pay-as-you-go system with an extended retirement age. The second pillar, introduced in 2002, is based upon individual compulsory contributions to private pension funds. The third pillar envisages voluntary top-up contributions but has not yet been implemented. The Macedonian pension reform, which began in September 2004, introduced a three-pillar pension system similar to the Croatian model. The privately managed and fully funded second pillar will be compulsory for new entrants to the labour market, and is to be implemented in 2006. In Kosovo a three-pillar pension system has also been introduced under the guidance of World Bank and USAID assistance. The publicly managed first pillar provides a flat rate pension of €40 to all citizens aged over 65. This was introduced because contribution records of many Kosovar workers had been lost during the 1999 conflict. The second pillar consists of a privately managed and fully funded pension system based upon a 5% contribution by employees on gross wages. It is administered by the Kosovo Pensions Savings Trust, which, extraordinarily, has placed the scheme members' individual savings accounts entirely outside the country in a mutual investment fund managed by ABN-Ambro in Belgium. The third pillar consists of a small number of occupational schemes, of which there are just six in operation.

In contrast to these multi-pillar pension reforms, the Serbian government has resisted introducing multi-pillar pension reforms and is focusing instead on the reform of the compulsory pay-as-you-go system by raising the retirement age, changing the pension formula, changing the pension indexation, and reviewing the level of the minimum pension. In Montenegro a new pension law envisages the eventual introduction of a three-pillar pension system, pending the strengthening of the pension system administration (half of potential contributors evade payment). In BiH the reform of even the first pillar pension system is hampered by inefficiencies in the public pension funds at entity level, which are unable to pursue unpaid contributions effectively. A recent agreement between the two entities to harmonize the pension systems and to recognize acquired rights across entities, but it appears that this agreement is not being implemented. In Albania a social insurance based pay-as-you go pension system was introduced in 1993. It consists of a compulsory part, a voluntary part and a supplementary part, all administered by the State Insurance Institute. Pensions are income-related, with a minimum pension to support the incomes of the poorest pensioners, which is 75% of the minimum wage. There are no plans to introduce multi-pillar reforms.

Health

In all the emergent states of former Yugoslavia health care services are financed through compulsory health insurance contributions paid in proportion to wages and salaries, and collected by National Health Insurance Funds, which are the successors of the old Republican Health Insurance Funds. Although compulsory national health insurance systems are supposed cover the whole population, in practice the system has broken down in BiH where 37% of the population of FBiH and 15% of the population of RS are uncovered. This situation has come about due to the extensive spread of the informal, grey economy and the failure of employers even in the formal economy to pay health contributions. In Albania, although a compulsory health insurance system exists, the services covered are limited to polyclinics and some drugs. A new Health Care Insurance Law presented to parliament in 2004 envisages extending coverage to hospital health care services. Most health services are provided through a tax-funded public health care service covering the whole population.

Health expenditures are highest in Croatia where health care costs amount to almost 9% of GDP, close to the EU average. Health expenditures in FBiH are low and facilities are often duplicated at canton level, while administrative expenses are high due to the existence of ten separate cantonal health insurance funds. Unequal access to health care services resulting from the lack of cross financing between cantons has led to significant spatial inequality in health care provision. Health expenditure from public sources is lowest in Albania where it amounts to just 2.9% of GDP although supplemented by almost equivalent private expenditures and patients are often required to make significant informal private contributions to access public health care facilities in the form of side payments to doctors and other health workers.

Table 4. Health and Education Expenditures as % GDP

	Total Expenditure on Health (% GDP) in 2000	Total Expenditure on Education (% GDP) in 2000	Public expenditure on health (% GDP) 2003	Public expenditure on education (% GDP) 2003
Albania	3.4%	2.7%	2.1%	2.9%
Bosnia and Herzegovina	4.5%	6.3%	n/a	5.8%
Croatia	8.6%	5.1%	7.2%	4.2%
Macedonia	6.0%	4.1%	n/a	n/a
Serbia	5.6%	4.4%	5.6%	3.5%
Montenegro			7.3%	5.9%
EU average	8.7%	n/a	n/a	n/a

Source: UNECE Statistical Yearbook (2005) and ILO (2005).

6. EDUCATION

In the former Yugoslav states, the share of education in GDP has remained around 4%, low by international standards (the EU average is 5%), while in Albania the share of public education expenditure in GDP was just 2.9% in 2003 (see table 4). This is supplemented by private resources as parents make additional informal contributions or send their children for additional lessons in the private sector. Schools in the main cities are overcrowded. In FBiH although education expenditure is relatively high, the multiplication of administration in the various levels of government and facilities are duplicated within cantons. There are different curricula for the three ethnic groups, and children from the ethnic groups are often taught in different classrooms in the same school. In Serbia and Montenegro the school system has suffered from a chronic lack of investment. In Kosovo the education system has had to be rebuilt both physically and academically in the aftermath of a decade of exclusion of the Albanian minority from the school system and following the destructive impact of war. In addition, a high rate of illiteracy among girls reflects the widespread phenomenon of early school drop out especially in traditional rural villages, which represents a challenge to policy makers concerned with issues of gender equality and social inclusion. In Croatia, due to the higher level of GDP the education system is better funded than in other countries, although problems remain in relation to damaged school buildings in the war affected areas. The most pressing problem in Croatia is the low pay of teachers, which in relation to other sectors in the economy has led to demoralization among teaching staff. For Vocational Education and Training (VET) systems most countries of the region have been given assistance by the EU CARDS programme, which has been involved in VET reform projects in Albania, Croatia, Macedonia, Serbia, Montenegro, and Kosovo. These VET reform projects have been directed essentially at the secondary school system. This assistance has reflected a Continental European approach to VET education. They have rarely addressed the pressing problem of retraining the unemployed and redundant workers that have been left stranded in mid-life by the widespread deindustrialization and loss of career expectations that have affected thousands of adult workers.

7. CONCLUSION

Four of the five countries of the Western Balkans began their transition towards a capitalist economy from similar if not identical initial conditions as members of the same federal state. The institutions of self-managed market socialism in former Yugoslavia were the most liberal market-oriented institutions of the socialist world. The fifth, Albania, started its transition from a diametrically opposed position as one of the most centralised command economies. As indicated in the introduction, the circumstances of transition and post-conflict reconstruction have necessitated a chaotic mix of institutional borrowings from experiences in other countries. The institutional configurations that have emerged have seldom been based on strong institutional complementarities. However, in the light of the analysis provided by Amable and other analysts of the varieties of capitalism approach, it is possible to broadly discern three types of capitalist economies seem to be emerging in the Western Balkans.

The first group of countries are the early reformers, which comprise Croatia and Macedonia. These countries both privatised relatively early during the 1990s through predominantly insider privatization. Government policy has been pro-market and efforts have been made to reduce the barriers to SME entry and growth, especially in Croatia. Consequently the density of SMEs in the population is relatively high. Both countries have relatively high employment protection, although this is reducing following labour market reforms, and social dialogue is active although weak. On the social side, both have adopted market-based three-pillar pension schemes, Bismarkian health insurance, and spend relatively high proportions of GDP on health, but less on education. Overall, while the picture is mixed, it seems reasonable to conclude that these two countries are evolving towards a classic Continental European model of capitalism. This is likely to become more emphasised as they move increasingly closer towards the goal of EU entry (both are candidate states). The position of Macedonia in this group is however tenuous. The mix of institutions is unstable and ambiguous, and given the significant presence of organised crime (Mappes-Niediek, 2004), the country could potentially gravitate towards the third group described below.

The second group comprise Albania and Kosovo. Albania made rapid early progress with small-scale privatization and although privatization stalled temporarily in the late 1990s, it now has the highest share of private activity in GDP of all Western Balkan states. Kosovo began transition with a state sector that was highly inefficient and under Serbian domination. The underground economy established by the Albanian population in the 1990s was essentially in the private sector. Both economies are highly reliant on the private sector, and Albania has the highest density of SMEs in the population of all Western Balkan countries. The informal economy is prevalent, and there is a medium level of barriers to SME entry. Unemployment rates are relatively low in Albania partly due to mass emigration, while unemployment in Kosovo is extremely high due to the greater difficulty of exit. Social protection is based on a residual model with means testing and the pension system if pay-as you go, but income related. In Kosovo pensions are flat rate with a compulsory second private pillar. The share of public expenditure on health and education is low and individuals are expected to make private contributions to pay for both services either formally or informally. Overall, despite a number of anomalous institutional features, this pair of countries corresponds broadly to the image of a liberal market economy, or at least they appear to be moving in that direction. However, the low level of financial intermediation, and the correspondingly high degree of informalisation based upon cash-economy principles, combined with ineffective public administration and high scope for the operation of organised crime suggest that this liberalism is quite unlike that in the more developed market economies. The strong reliance on informal rather than formal institutions to ensure contract compliance (Xheneti, 2006) suggests that, if not a uniquely 'Balkan' form of liberal capitalism at least it corresponds to the more unregulated forms of transitional economic systems discussed elsewhere in this book.

The third group are the late reformers, comprising Serbia and Montenegro (although Montenegro has more recently adopted some more liberal market features) together with Bosnia and Herzegovina (especially RS). This pair of countries had the slowest start to privatization, and consequently has the lowest share of private activity in the economy. At the same time the informal economy is a significant factor, including black economy and criminal activities. Their density of SMEs in the population is relatively low, and there are many obstacles to new firm entry, although this has improved in Serbia and Montenegro in recent years. Employment protection in the formal sector is strong, yet social dialogue is poorly developed. Both have resisted World Bank sponsored pension reforms, although pension and social transfers are low and inefficient. Health and education services are poorly funded, and in BiH also inefficiently provided. This pair of countries has many similarities to the Mediterranean model identified by

Amable, but due to the additional prevalence of black market activities and stalled reforms could perhaps qualify as a *sui generis* Balkan model of capitalism.

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