

POLITICAL MACROECONOMY: THE CASE OF SERBIA

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JEL Classification: P 16, P 26, P 27, E 62

Original Scientific Papers

Primljeno / Received: May 17, 2013

Prihvaćeno / Accepted: October 23, 2013

Abstract

In political macroeconomics, it is known that the economic policy instruments can be used for political purposes – artificial improvement of economic indicators in order to win the elections. The political instability in Serbia, reflected in frequent elections, as well as in the disparity in economic aims of the key political parties leading to the increasing political uncertainty in both the pre-election and post-election periods, weakening both monetary and fiscal stance of serbian government, faced with low level of living stanrard og serbian citizens – voters.

The neo-liberal Washington consensus has persistently insisted on liberalization, de-regularization, shock therapy, and monetary rigidity guided by the logic of that being the only way for macro-economic stabilization: there is no alternative, and the confirmed devostating consequences of such monetarist stabilization and anti-Keynesian non-development policy have not caused its theorists and practitioners to waver.

Key words: *political macroeconomics, competitiveness, institutions.*

1. INTRODUCTION

The great economic crisis, which started in 2009, in the post-socialist countries, has shown that the transition strategy cannot be based on weakening the state and expecting that flexible and efficient market economy will be established automatically. What is needed is credibility, reputation and commitment of main economic actors. In the post-socialist environment, there is no automatism for establishing market institutions. Therefore, the only efficient strategy is the incrementalist one, which recognizes the existent institutions and upgrades them realistically.

2. POLITICAL MACROECONOMY

Last quarter of the XX century marks the emergence of a new economic discipline - Political Macroeconomy (PM) - which relies on achievements in macro-

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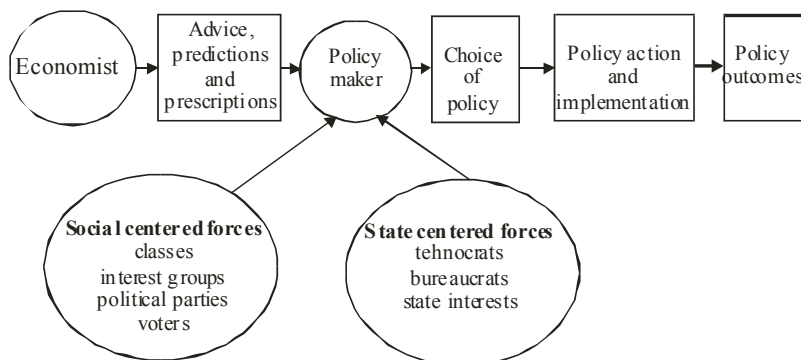
economics, theory of choice and game theory. PM deals with the following issues (Snowdon and Vane (2005), p. 518):

- relationship between politics and economics in the framework of political business cycles, inflation, unemployment, stabilisation policy;
- relationship between dictatorship, democracy, inequality and economic growth;
- economic instability and conflicts;
- integration in world economy and strength of economy.

Classical model of relationship between politics and economics entails the analysis of formulation, enacting and consequences of economic policy for policy makers. PM analyses decisive influence of social and state factors – interest lobbies and groups – upon policymakers which surpass the role of economists. State. According PM, is in the very center, exposed to the influences of economics and politics. The state of economy decisively influences voters and their behaviour, and policy makers are aiming at re-election, while those in opposition strive to win and come to power. Politicians are driven with following motives:

- a) *ideological-partisan* – their focal group is only their party membership, or
- b) *opportunistic* – their focal group are all voters.

Grafikon



Source: Snowdon and Vane (2005), p. 520.

Two approaches – opportunistic and ideological (partisan) marked the development of NPM since mid 70-ties years of XX century.

Assumptions about politicians are:

- Non-Partisan opportunistic politicians;
- Partisan ideological politicians.

Assumptions about voters and economic agents are:

- Non-rational behavior, non-rational expectations;
- Rational behavior, rational expectations.

Table 1: Models of political macroeconomics.

Assumptions about politicians	Assumptions about voters and economic agents	
	Non-rational behavior, non-rational expectations	Rational behaviour, rational expectations
Non-Partisan opportunistic politicians	V. Nordhaus (1975): "The Political Business Cycle", <i>Review of Economic Studies</i>	K. Rogof (1988): "Comment on Macroeconomics and Politics", <i>NBER Macroeconomics Annual</i>
Partisan ideological politicians	D. Hibs (1977): "Political Parties and Macroeconomic Policy", <i>American Political Science Review</i>	A. Alesina (1987): "Macroeconomic Policy in a Two-Party System as a Repeated Game", <i>Quarterly Journal of Economics</i>

Source: Snowdon and Vane (2005), p. 526.

Table 2: Politico-economic models – assumptions and predictions

Politico-economic models	Main assumptions	Predictions
1. Adaptive opportunistic business cycle theory (Nordhaus, 1975)	Expectations-augmented Phillips curve. Politicians only care about re-election. Agents are myopic and have non-rational expectations	Governments, both left and right, behave the same. Output will increase and inflation fall before an election. Inflation accelerates as the election approaches.
2. Adaptive partisan model (Hibbs, 1977)	Exploitable Phillips curve trade-off. Policy-makers and voters are ideological and non-rational.	Governments of different ideological persuasions will have different macroeconomic objectives with respect to inflation and unemployment. Government of the right will tend to have persistently higher unemployment and less inflation than government of the left.

3. Rational opportunistic model (Rogoff and Sibert, 1988)	Short-run Phillips curve trade-off. Agents have rational expectations, but imperfect information. Voters elect the party they expect to perform best.	All government behave the same. Monetary growth and fiscal expansions before elections.
4. Rational partisan model (Alesina, 1987)	Short-run Phillips curve trade-off. Agents have rational expectations, but election outcome uncertain. Left-of-centre parties have strong aversion to unemployment relative to inflation. Right-of-centre parties have strong aversion to inflation relative to unemployment.	Left-of-centre governments produce an inflation bias compared to right-to-centre governments. Output is above (below) the natural rate at the beginning of a left-(right-) of centre government.

Source: Snowdon and Vane (2005), p. 547.

3. CREDIBILITY AND REPUTATION OF MACROECONOMIC ACTORS

Basic PM model – rational voters and partisan-ideological government emerged in the matrix:

- voters with adaptive-naive or rational expectations, and
- opportunistic government focused towards all voters, or partisan-ideological government focus only toward party membership

Introduction of government was of crucial importance, as government must take care about big actors – stakeholders – voters, political competitors, external political and economic competitors. Government behaviours becomes strategic, and game theory becomes essential for explanation of politico-economic outcomes (Carlin, W. and D. Soskice, 2006). PM model encompasses:

- individual actors possess rational expectations in the environment of income and price rigidities;
- business cycles are consequence of changes of aggregate demand;
- aggregate demand influence level of output and employment, as nominal rigidities obstruct fast changes of incomes and prices;
- aggregate demand fluctuations obstruct attaining of equilibrium employment,
- supply shocks influence equilibrium employment, while institutional and political differences between countries are important factor of level of employment.

Leading proponent of PM – D. Acemoglu explains different destinies of national economies and lack of warranted and secured economic growth with two

dominant paradigms – geographical and institutional. The geographical paradigm explains economic growth by dominant factors of geography, climate, ecology, while the institutional paradigm considers institutions as essential factors in promoting investment in human, physical capital, technology and knowledge. Good institutions possess three attributes:

- they establish property rights in the society;
- they limit all elites whose goal is rent seeking;
- they ensure equal opportunities for all individuals in a society in the field of employment, social security and human rights.

Where such good institutions are absent there is no economic and social prosperity (Acemoglu, D., 2003). Acemoglu and Robinson (2006) conclude:

- warranted democratic progress does not exist;
- monocausal explanations of democracy are not fruitful;
- factors of establishment and consolidation of democracy are different,
- there exist fundamental conflict between elites and public: public is prodemocratic, elites are nondemocratic;
- democracy depends upon conflict between public and elites: when benefit from democracy is greater than cost of keeping nondemocracy transition to democracy occurs;
- social outcomes are uncertain, and depends upon many factors, nondemocracy can transform to democracy and vice versa.

Triangle of following factor determines economic origins of democracy (Acemoglu and Robinson, 2006):

- economic incentives determines political behaviour, individual act rationally according to game theory;
- conflicts have key role, as different social groups have their separate interests about possible social outcomes;
- political institutions have central role in the process of solving conflicts, as they define future distribution of *de iure* political power.

Relationship between elites and public can be summarized in following manner:

- If repression is too expensive, elites will promise political concessions and income redistribution;
- if threat of change of regimes diminishes elites will abandon previous announcement concerning democratisation and thus they will reduce its credibility,
- if this practice is frequently repeated public will not believe promises and will insist upon change of political institutions;

- key problems is: political actors can not be bounded with fulfillment of promises unless they reduce their political power,
- democracy is thus credible as it presupposes change of political institutions in the interest of majority.

Democracy is more probable under the following conditions (Acemoglu, D. and J. Robinson, 2006, p. 27):

- when critical mass of social unrest exists in the society which cannot be reduced or neutralized with limited concessions;
- when costs of establishing democratic society for elite are less than costs of repression.

OECD countries in whole period since 1840. were democratic. According to Polity score first wave of democratisation occurred after First World War, and second after Second World War.

Freedom house and Polity score document main thesis that wealthier countries are more democratic, and that there is strong correlation between level of income and democratisation: wealthier countries (USA, Canada, Australia) are more democratic, while poorer countries (sub-Saharan Africa, South America, Central America) are less democratic. Higher inequality is strongly connected with lower level of democracy: countries with higher inequality and higher Gini coefficient are less democratic.

4. ECONOMIC REFORMS IN SERBIAN AND DEMOCRATIZATION PROCESSES

EBRD determines progress in transition based on nine indicators: Large scale privatisation (LP), Small scale privatisation (SP), Enterprise restructuring (ER), Price liberalisation (PL), Trade & Forex system (TFS), Competition Policy (CP), Banking reform & interest rate liberalization (BRIRL), Securities markets & non-bank financial institutions (SMNBF), Overall infrastructure reform (OIR). According to the EBRD methodology, minimal value of an individual indicator equals 1, which corresponds to the sum of 9 points for a total of indicators taken. When the sum equals 9 points, there is no progress in transition.³

³ Jakšić, M., Prašćević, A., **Politics and Economic Performances: the Case of Serbia**, EBES international conference, Istanbul 2010. Jakšić, M., Prašćević, A., **Politička makroekonomija**, Ekonomski fakultet, Univerzitet u Beogradu, Beograd, 2010.

Table 3: Transition indicators for Serbia – achieved progress in transition⁴

Year	LP	SP	ER	PL	TFS	CP	BRJRL	SMNBFI	OIR	Total indicator values sum	Percentage of achieved reforms (%)
2000	1	3	1	2,33	1	1	1	1	2	13,33	14,45
2001	1	3	1	4	2,67	1	1	1	2	16,67	25,59
2002	2	3	2	4	3	1	2,33	1,67	2	21	40,04
2003	2,33	3	2	4	3	1	2,33	2	2	21,66	42,24
2004	2,33	3,33	2	4	3	1	2,33	2	2	21,99	43,34
2005	2,67	3,33	2,33	4	3,33	1	2,67	2	2	23,33	47,81
2006	2,67	3,67	2,33	4	3,33	1,67	2,67	2	2	24,34	51,18
2007	2,67	3,67	2,33	4	3,33	2	2,67	2	2	24,67	52,28
2008	2,67	3,67	2,33	4	3,67	2	3	2	2,33	25,67	55,62
2009	2,67	3,67	2,33	4	4	2	3	2	2,33	26	56,72

Source: EBRD.

Freedom house for Serbia since 2010. PR - Political rights and CL - Civil liberties are estimated 2 (Scale one to seven), and overall Serbia is evaluated as free.⁵

Table 4: The Global Competitiveness Index 2012–2013 rankings and 2011–2012 comparisons.

Country/Economy	Rank/144	Score (1-7)	Rank among GCI 2011–2012 sample	GCI 2011–2012 rank
Serbia	95	3,87	94	95

Source: The Global Competitiveness Report 2012–2013-13, 2012 World Economic Forum.

⁴ Total scale of progress in transition according to the EBRD transition indicators goes from 9 points (0% achieved reforms) to 38.97 points (100% achieved reforms).

⁵ Political Rights and Civil Liberties are measured on a one-to-seven scale, with one representing the highest degree of Freedom and seven the lowest. Freedom in the World Country Ratings, 2012. ed.

Among the countries of former Yugoslavia Slovenia is 56/57, Montenegro 72/60, Macedonia, FYR 79/79, Croatia 80/76, Bosnia and Herzegovina 87/100. According to World Economic forum The Global Competitiveness Report 2012–2013-13 Serbia is classified as efficiency driven economy (33 countries within that group), but according to innovation and sophistication factor its rank is worse – 124, overall score 2,96. As next table shows worst results concerning requirements are in the field of institutions.

Table 5: The Global Competitiveness Index 2012–2013: Basic requirements.⁶

Basic requirements		1. institutions		2. Infrastructure		3. Macroeconomic environment		4. Health and primary education	
Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score
95	4,15	130	3,16	77	3,78	115	3,91	66	5,53

Concerning efficiency pillars situations is as follows:

Table 6: The Global Competitiveness Index 2012–2013: Efficiency enhancers⁷

Efficiency enhancers		5. higher education and training		6. goods market efficiency		7. Labor market efficiency		8. financial market development		9. Technological readiness		10. Market size	
Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score
88	3,83	85	3,97	136	3,57	100	4,04	100	3,68	58	4,10	67	3,64

⁶ The Global Competitiveness Index 2012–2013: Basic requirements (cont'd.) p. 17.

⁷ The Global Competitiveness Index 2012–2013: Basic requirements (cont'd.) p. 19.

In subcategory *Efficiency enhancers* best rang is due to Technological readiness (58) and worst for good market efficiency (136). Possible explanation for best rank is traditionally developed health and education system (rank 66 in previous table), and still low level of competition and high level of market concentration.

Concerning innovation and sophistication factors Serbia rank is 124, score 2,96, worse for business sophistication (rank 132, score 3,11) and better for innovation (rank 111, score 2,81).

Table 7: Good governance and Serbian institutions, 2008-2012

Indicator	2008		2009		2010		2011		2012	
	Rank	Score	Rank	Score	Rank	Score	Rank	Score	Rank	Score
Property rights	108	3.6	111	3.4	122	3.2	126	3.1	130	3.1
Intellectual property protection	105	2.8	101	2.8	111	2.6	107	2.7	116	2.8
Judicial independence	106	3.0	110	2.8	124	2.5	128	2.4	129	2.4
Burden of government regulation	132	1.9	129	2.2	131	2.2	134	2.3	136	2.4
Transparency of government policymaking	82	3.9	86	4.0	97	4.0	102	3.9	111	3.8
Organized crime	97	4.5	109	4.2	111	4.3	107	4.3	118	4.1

Source: The Global Competitiveness Report, 2008-2012, eds.

5. ROLE OF INSTITUTIONS

Transition process in Serbia in view of institutional economy is at the focus of this paper. The term transition (lat. Transpire - to pass) has been used by M. Dobb in his analysis of the transition from feudalism to capitalism (Discussion on the transition from feudalism to capitalism). In modern literature, transition means applying economic theory and practice with the aim of transforming former social-

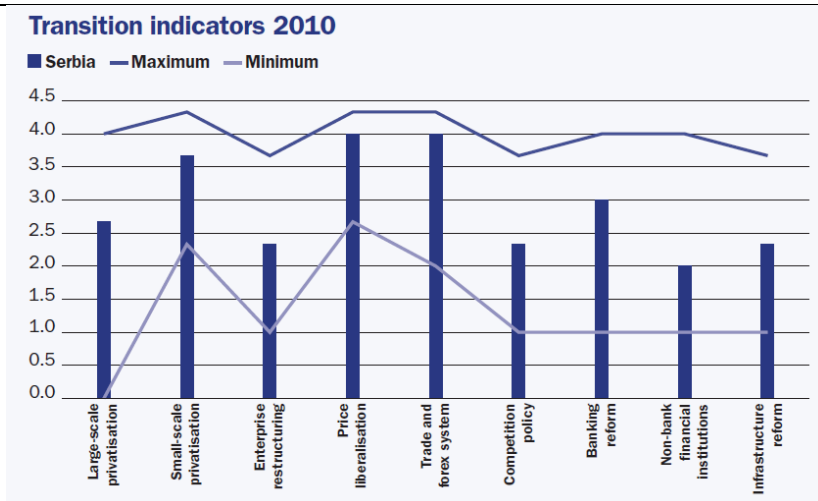
ist economies into market economies. O. Blanchard defines transition as passing from an economy in which state owned firms dominate to an economy with the dominant private sector (Blanchard, O.).

The „import“ of institutions of developed market economies is at the essence of these processes. It is not an utopian social engineering process that builds society according to fictitious model that might never be realized, but it is rather an imitative social engineering process that builds society according to real model (Stefanovic, Z.)

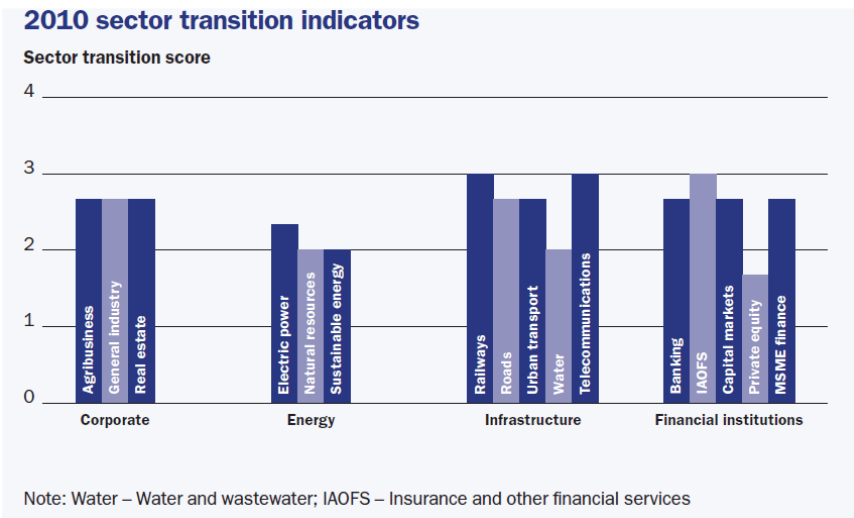
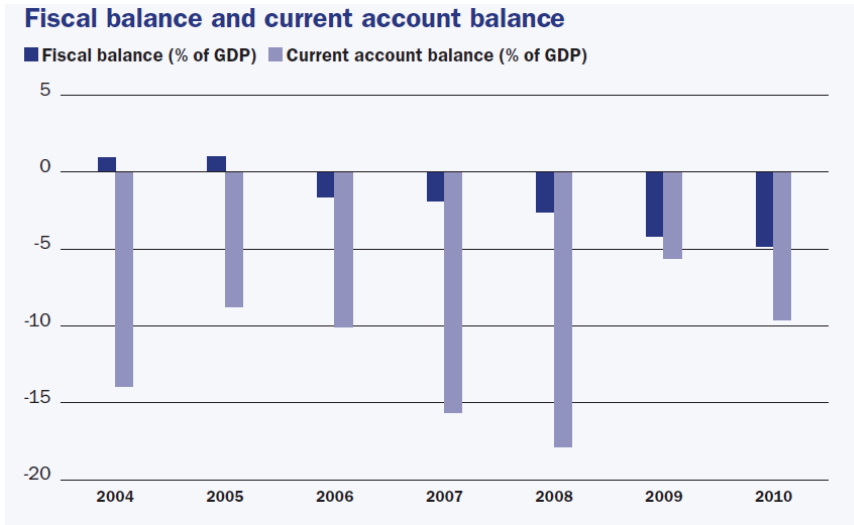
It is argued that the transition economy is both 1. market economy and 2. capitalist in nature: „the road to free economy comprises main and accessory roads. The question is what kind of capitalism they lead to, at what pace, at what costs, and who are the winners and losers in the process.“

Emphasizing the diversity of capitalisms being established, H. Alavi wrote about peripheral capitalism, and J. Taylor about the problem of homocentric capitalism – of different effects in different environments. J. Kornai argues that: „in each country historians view some unique characteristics of their systems that have emerged only there as result of unique and unrepeatable factor constellation. According to the geographical criterion, distinction is made between capitalisms in different parts of the world: in the USA characterized by a high degree of individualism and limited role of the state; Scandinavian as welfare capitalism with its extensive income redistribution; Japanese capitalism with strong state intervention and intertwining of bank and large industrial capital“ (Kornai, J.)

Grafikon



Source: EBRD, Transition Report 2010, Serbia –Transition assesment, p. 140.



Source: EBRD, *Transition Report 2010, Serbia – Transition assesment*, p. 141.

Both negative fiscal and current account balance confirm the thesis that populist, or leftist government will follow more restrictive monetary and fiscal policy in Serbia, in contradiction to expectations of voters. Even if expectations of voters are rational, there is no strong partisan ideological policy, so problem of reputation, credibility and commitment is of primary importance on the level of public support to reforms in Serbia. This contributes to frequent political elections without deeper reform of institutions and establishment of good governance.

Table 8. Indicators of quality of institutions and rule of law (-2 worst, + 2 best)

Country	Quality of law regulative	Rule of law	Control of corruption
Czech republic	1.24	0.95	0.31
Croatia	0.56	0.19	0.05
Hungary	1.05	0.78	0.33
Serbia	-0.02	-0.39	-0.21
OECD	1.44	1.50	1.61

Source: Kaufmann, Kraay, **Mastruzzi indicators**, according to B. Urosevic et. al.

Peripheral capitalism in Serbia characterizes: a) emerging from the sphere of trade; b) dominant role of trade and banking capital, c) deformed and crumbled production process. This is drawn upon the role of state in the transition process: of the three potential roles – the „invisible hand of state” (well organized, uncorrupted, dominance of law), the „assisting hand” of state (bureaucratic differentiated support to some and sanctioning of others, corrupted) and the „grabbing hand” of state (bureaucracy and political parties lead solely by their own interests). (Jaksic, ANP)

The evolutionary-Keynesian perspective focuses on institutional factors in the effort to find explanation of development cycles and macroeconomic problems of stabilization, rejecting stylized facts on balanced and smooth self-balanced market mechanism. Every system, true also for market-capitalist system, is slowly adapting and changing in response to the environment producing greater or smaller disturbances.

There exists a *path-dependance* – dependence on trends established in the past, in both stimulating and limiting sense: development has to coincide with given circumstances and mechanical transplanting of models cannot bring effect on a long-term basis: macroeconomic results of an economy intertwine with its institutional heritage and when this is recognised to a certain degree it may contribute as stimulating and not limiting factor. Such development path, dependent on „what was before”- histeresis – shows that insurmountable predetermined factors and limitations do not exist, as we could be lead to believe from the practice of mechanical transplantation of stabilization models proclaimed and strongly advised by the International Monetary Fund – IMF. These „universal” mechanically implemented models in different environment, conditions and circumstances have

always been designed by definition to be successful in their stabilization dimension, but unsuccessful in developmental sense, as it has never been in their focus. (Stiglitz and Serra)

The institutional model, in comparison to neo-liberal, is far more complex as it comprises: a) institutions as structural variables, and b) political and social power distribution. Market economy functioning in this complex network is not less flexible because of the fact.

Capitalist economy in the twentieth century does not prove the existence of self-balancing automatism that brings an economy back to steady state after periodic and temporary exogenous shock. The changes from good to bad times, and vice versa, are viewed by endogenous factors of heritage – histeresis – intertwining of macro-economic performance and environment, as the present developments depend on the past. The solution could be found by referring to the model of mixed economy with institutions limiting the infinitely free market game that might still exist only in textbooks. Political change of institutions eliminate these limitations: in the society that satisfies human needs it is necessary to set the path for future development. Famous historian F. Brodel concludes: „Capitalism is a force that is moving, but a force that does not know where it is going to”.

6. CONCLUSION

Stability and growth are, beyond doubt, the most important indicators of the performances of an economy, and in the underdeveloped countries, they are even more important because there is no growth there or it is negligible. It is a historic irony that the IMF, created under intellectual auspice of John Maynard Keynes, has abandoned the policy of growth and employment in favour of monetary stability. Nevertheless, there are certain developments, because nowadays the IMF also stresses the importance of institutions, the rule of law, good conduct, and the importance of institutional heritage both as the enticing and the limiting factors.

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