ABSTRACT: Serbia has a rather unique environment for the privatization of its state-owned firms. On the one hand, unlike many transition economies, it had experience with mixed forms of ownership prior to the 1990s. On the other hand, its isolation and policy stagnation in the 1990s left it somewhat behind the other transition economies in terms of privatization. Thus, Serbia now has the opportunity to learn from the experiences of other transition economies. This article examines what those lessons should be and how they should be applied to Serbian circumstances. In the light of this analysis, Serbian privatization policies are critically evaluated, and a prognosis for future developments is proffered.

Economic Reforms and Privatization

During the past few decades, Yugoslavia was developing a market-oriented, centrally planned economy. More often than not, economic agents made decisions independently, and the habits and behavior of the citizens were market oriented. At the beginning of the 1990s, steps were taken toward accelerating market-oriented reforms of the system, including privatization, which Yugoslavia

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had begun before any other country in transition. However, as a consequence of noneconomic factors—the disintegration of the single market of the former Yugoslavia and the actions of the international community, including sanctions against Yugoslavia, gross domestic product was more than halved, and manufacturing and distribution were disrupted. At the same time, structural reforms ceased.1

After hyperinflation in 1992 and 1993, which was the second highest in world economic history, the program of stabilization and economic recovery was launched at the beginning of 1994. It was successful in halting inflation and increasing gross domestic product, industrial output, and external trade for a few years. However, market-oriented reforms were not continued, and, consequently, stabilization and growth were not sustained. Moreover, FR Yugoslavia was severely damaged during the bombing campaign in March–June 1999. Ultimately, at the end of the 1990s, Yugoslavia—a pioneer in transformation toward a market-oriented economy—was ranked in the third group of economies in transition in terms of achievement in reforms.

After years of crisis, the political changes that occurred in October last year brightened the economic as well as the overall forecast for the future. FR Yugoslavia returned very quickly to the international community and to international organizations. The return to international financial institutions such as the International Monetary Fund (IMF) and the World Bank (WB) and the lifting of sanctions against Yugoslavia were particularly important steps. Under these new circumstances, one can see that the goals of a development strategy are as follows:

(1) the process of transition toward a marked-oriented economy, which includes privatization as a priority;
(2) structural adjustment, which means that the role of services, small and medium-sized enterprises, and the private sector in the economy must increase their share of gross domestic product. This also includes the restructuring of enterprises and rehabilitation of the banking sector;
(3) an outward-oriented strategy, with an aim to increase the
total volume of foreign trade, and especially to encourage foreign investment inflows.

The Privatization Process During the 1990s

It must be emphasized that the private sector was already strong in some limited areas prior to the 1990s. First, agricultural resources, unlike in other ex-communist countries but like Poland, were more than 90 percent operated by private farmers. Due to the small size of each family farm, the agricultural production of those private farmers was not market-oriented in that the majority of marketed agricultural production originated from socially owned farms called “combinats.” Second, during the last decade of legal reforms, private small business (small and medium-sized enterprises [SMEs] and sole proprietorships) became strong. Although this sector’s share in gross domestic product is not yet large (around one-third including agriculture), the number of SMEs has grown fivefold compared to the beginning of the 1990s.

It is important to bear in mind that, for decades, the Yugoslav economy developed very specific so-called social ownership.² There were two possible ways to privatize socially owned companies: (a) indirectly—first by turning social ownership into state ownership, transferring shares after corporatization to state-owned funds, as in Croatia or Montenegro, and then privatizing the companies; (b) directly—by distributing or selling shares after corporatization. From the beginning Serbia used the direct method of privatization.

The privatization process started in the early 1990s and went through three phases, with little progress. The first phase of privatization was based on the federal law “On Social Capital.”³ The model was based on worker and manager buyouts, with relatively high discounts for share acquisition. Among the former republics of SFR Yugoslavia, the process was most rapid in Serbia, where around 2,000 enterprises started ownership transformation. In 1992 and 1993, due to hyperinflation, employees and employers were
highly motivated to buy shares. As a result, 43 percent of the total capital of Serbian firms had been transformed by mid-1994.

The second phase was actually a step backward as all transformation procedures were reexamined and recalculated. In an attempt to get all the gains of hyperinflation, the government introduced a revaluation of the already transformed social capital. As a result, the first phase of privatization was practically annulled. After revaluation, which was realized by the Government Agency for Capital Valuation, the share of private shareholders’ capital to total capital was pushed down from 43 percent to 3–5 percent. With the legal framework no longer operational, privatization was halted, while, at the same time, enterprises and employees anticipated a more favorable legal framework for privatization. On the other hand, foreign investors were unable to invest due to sanctions against Yugoslavia.

International conditions for privatization were relaxed after the Dayton agreement and the lifting of sanctions in 1996 and 1997. In an attempt to secure privatization, a ministry for economic and ownership transformation was established and the Ownership Transformation Act was introduced. For the first time, free share transfer of up to 70 percent of total capital of firms was possible and available not only to former and current employees but also to other citizens, including civil servants, pensioners, and farmers. Privatization was based on the free will of enterprises, and all employees were to make decisions, as in the first phase of privatization under the Federal Law on Social Capital. Economic experts identified voluntary privatization as the main shortcoming of a rapid transition process.

All enterprises were separated into three groups: (a) state-owned, public companies, which for the first time became candidates for privatization. These included enterprises at the republic level: PTT (Post and Telecommunications), JAT (Yugoslav Airlines), JZ (railways), EPS (electricity generation, transmission and distribution), and NIS (oil industry). There were also more than 500 companies at the local community level; (b) big socially owned enterprises—
the government chose seventy-five enterprises for the special list of those of strategic importance for the whole economy, both profitable and nonprofitable firms; and (c) small and medium-sized socially owned enterprises. All in all, there were more than 4,000 candidates.

There were three possible privatization models: (a) selling shares, which included the so-called first round, in which shares would be transferred to employees and other citizens free of charge, and the second round, in which shares would be sold to employees and other citizens at a discount, but at no discount to other investors; (b) the increasing capital model, which was stimulative, as money from privatization would not be transferred to state funds but remain within the enterprise, and discounts would be given to employees and citizens together with the right to get free shares; and (c) the debt equity swap model, with possible discounts of up to 20 percent of the total debt.

Polls at the beginning of 1998 indicated high interest for privatization among both those persons who were responsible within enterprises and citizens. Different institutions predicted that more than 80 percent of estimated enterprises would go private, the majority of them in a one-year period. However, realization of the law did not yield those results. The reasons were twofold. The law had serious obstacles, such as the voluntary decision to enter into privatization, which opened the door for those who opposed privatization. International conditions for foreign investment by that time had become worse, as foreign investment in FR Yugoslavia was forbidden.

For more than three years, until February 2001, only 800 enterprises had made the decision to become shareholding companies and started to transfer and sell shares (Table 1). That is about 20 percent of the total number of state and socially owned enterprises that were candidates for privatization. The total capital of privatized enterprises reached 6.5 billion DEM, with the total number of employees in those enterprises at 216,000. These figures demonstrate that the results were modest and especially unsatisfactory from
the standpoint of the need for fast structural adjustment in the Serbian economy and the restructuring of companies. It is important to bear in mind that all those enterprises are efficient, but small and medium in size. This means that only one state-owned enterprise, Telecom, was privatized, with capital from the Italian STET and Greek telecommunications company OTE forming 49 percent of the total capital, during the short period in 1997 when this was possible. On the municipal level, one state-owned company was privatized as well, the sport and cultural center Pinki–Zemun. Not one enterprise from the special government list started privatization, although respectable international companies expressed strong interest in some of them, for instance, cement plants, pharmaceutical companies, food producers, breweries, and so forth.

The pace of the process was slow with oscillations, as Figure 1 shows, because circumstances as well as the approach of the gov-

Table 1

Enterprises Entering the Privatization Process in Serbia as of February 2001

<table>
<thead>
<tr>
<th>Number of enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Applying for verification of capital valuation:</td>
</tr>
<tr>
<td>Decision completed</td>
</tr>
<tr>
<td>Procedure under way</td>
</tr>
<tr>
<td>Completed without decision</td>
</tr>
<tr>
<td>Round 1—enterprises entering the process:</td>
</tr>
<tr>
<td>Prospectus published</td>
</tr>
<tr>
<td>Awaiting publication of prospectus</td>
</tr>
<tr>
<td>Transformation abandoned</td>
</tr>
<tr>
<td>Round 2—enterprises entering the process:</td>
</tr>
<tr>
<td>Prospectus published</td>
</tr>
<tr>
<td>Awaiting publication of prospectus</td>
</tr>
<tr>
<td>Number of employees in 795 enterprises</td>
</tr>
<tr>
<td>Total capital evaluated in 795 enterprises (DEM)</td>
</tr>
</tbody>
</table>

ernment toward privatization changed. During 1998, only 180 enterprises entered the process of ownership transformation, the same number as as in 1999. The process was very slow during 2000, but by the end of the year several hundred companies had decided to start privatization in a hurry.

The first reason for such behavior was the devaluation of the dinar in December. Before that employees were not motivated to get free shares, as the value of shares in hard currency was calculated on the basis of the official exchange rate, which was a few times less than the value calculated on the basis of the black market exchange rate. The second reason for the rapid pace was related to the signals that the new law would be very restrictive for employees. During February, the Ministry for Privatization stopped all privatization procedures until the new law was enacted.

**Time to Rethink Transition and Privatization**

The political changes that occurred after October 5, 2000, created more room for maneuver in the reform process and brightened expectations. FR Yugoslavia (FRY) returned quickly to the international community, to the United Nations, and to international financial institutions, most important, the IMF and the WB. Sanctions toward the FRY were lifted and the European Union (EU) again introduced preferential treatment for commodities imported from FRY. Industrial production, construction, and both internal
and international trade are now increasing. Those encouraging signs point to good economic forecasts for the future, which is important for the next reform steps.

Favorable conditions are very important if the government wants to complete privatization. Specifically, the foreign channel is now open for foreign investment inflow. Furthermore, an increase in economic activity provides better job opportunities for employees who will lose their jobs due to privatization. The dilemma related to privatization now is whether to continue in the same direction or to change the approach? Unfortunately, after ten years transition experience in Central and Eastern Europe, this question is not easy to answer. It is even more difficult than before as transition steps and paths are under consideration. This is not exclusively a dilemma for Serbia either. To arrive at an answer, it is necessary to examine privatization in the broader context of complex market-oriented reforms.

**Rethinking Transition**

Experience in the ten-year long transition provides enough evidence to envisage results from the standpoint of the sequence and content of reforming steps. The discussion of these questions escalated two years ago within international financial institutions, particularly the World Bank and International Monetary Fund (Fischer and Sahay 2000: 4–5). It was partially related to the problems of the Asian financial crisis and the fine-tuning of financial policy in the global context, but it was mainly related to the mixed and inconclusive economic results of transition countries, particularly of Russia. Russia’s mostly negative results and experience are particularly important in that reform there was based on the prescriptions of international financial institutions (Nellis 1999: 2–3).

The discussion opened three crucial questions. The first question is related to the pace of transformation toward the market economy, including privatization. From the beginning of the transition project, the dominant approach was that speedy and radical
reforms were necessary. The arguments in favor of shock therapy were: (a) reforms cannot be realized step by step, but all at the same time, and (b) reforms have to be realized immediately, to prevent old attitudes from stopping them. In reply to criticisms of this approach based on the unsatisfactory results, those who advocated shock therapy, such as J. Sachs, D. Lipton, and J. Kornai, argued that the shock was not strong enough or that reforms were not being realized aggressively enough and that this was the reason for the bad results. In other words, market reforms were planned well, but realized in the wrong direction. On the other side are those who defended the gradualist approach (Stiglitz 1999; Nellis 1999), who argued that shock therapy was wrong, and that the reasons for failure were much deeper, the main reason being a misunderstanding of the operating of a market economy. According to those authors, shock therapy inevitably led to negative consequences for the economy in transition, particularly social consequences. Citizens and employees were not ready to pay such a price and started to oppose further reforms. So the balanced approach has to take into account several important issues such as: (a) the stage of development of a market-oriented legal framework and institutions; (b) the time necessary to (re)build market conditions and for economic agents to adapt to the new environment; (c) the consensus of different social groups such as employers, employees, pensioners, unemployed persons, and so forth; and (d) external conditions and support.

The second question is directly related to privatization: What is the most appropriate privatization model? Although in all transition economies a combination of models was used, one of them was dominant, but with differing levels of importance during various phases of privatization. From the beginning of the 1990s, the usual advice was to open the door for private initiative through privatization and for the more efficient use of resources. However, the oversight was that, in a market economy, ownership and control are separated. In this sense, the voucher model, which was advocated as a speedy and equitable method of privatization, could
be seen as inefficient. The worker buyout model, as an insider model of privatization, was attacked from the beginning, first, because it led to self-management control, which is not efficient in the use of resources; second, it closed the door to foreign investors; and third, the process of privatization with the worker buyout model is time consuming. Discussions within international financial institutions saw this model as more appropriate than the others. The main argument in favor of the model was that the social costs related to privatization are not too high and may be acceptable to all citizens. This argument again emphasized the need for a social consensus (Stiglitz 1999: 13–15; Nellis 1999: 4).

The third crucial question for transition, particularly privatization, is related to so-called big privatization, that is, the privatization of large enterprises. It is important to define the sequence of restructuring in large enterprises, as their capital and number of employees are economically significant. Usually, one can argue that it is better to privatize them first, and then to restructure. The budget is too tight to use scarce capital to restructure enterprises, and, more important, the investor who is ready to buy is capable of choosing a better strategy for restructuring. However, so-called big privatization became the most difficult question, as it is closely related to other policy measures, particularly social policy and the regulation of enterprise liquidation. The government must beware of a possible domino effect, that is, the possibility that too many enterprises and banks may go bankrupt.

**Rethinking Transition in Serbia**

Three crucial questions regarding the transition mentioned above, partly related to privatization, have to be analyzed within the Serbian legal framework and practice. The transformation of the Serbian economy during the past decade was very slow with steps backward and forward. While this was partly due to difficult international circumstances, the main reason was the government’s changing approach toward transition, which incorporated both
encouraging and discouraging phases. From this standpoint, at the beginning of 2001, there is a need for a faster transformation toward the market economy. This is particularly important for the process of structural adjustment and restructuring of existing enterprises. The main shortcoming of the contemporary situation is a lack of any clear transition strategy. The new government did not prepare an overall strategy for transition nor cope with partial reforms, causing issues like fiscal reform and privatization to lack a clear perspective as to what would be the next steps. Although preparing the transformation strategy could consume a lot of time, the experience with fiscal reform and the law on privatization indicated that, without a clear vision, any partial reform steps could be difficult and even more time consuming. Moreover, the planning and realization of reform steps separately, without overall coordination, will not lead to a positive final outcome.

First, the gradualist approach to transition stressed the importance of the development of a market institution and laws. For successful privatization, it is necessary to build institutions responsible for different aspects of the process. Slow ownership transformation during the past three years occurred partly because several institutions were either not established or not in operation. Among these, no central register for securities was established. Instead, a database for privatization, that is, a database of enterprises and shareholders, was created within the Agency for Capital Valuation, which operates within the Ministry for Privatization, but with very limited human and technical resources. This created a serious bottleneck for rapid privatization because the control procedure took longer than necessary. To overcome this problem, it was necessary to establish the central register as soon as possible and to transfer data from the existing database within the Agency. Another important institution, which was established by law but did not begin operating, was the Republic Shareholding Fund. It was to be responsible for taking care of shares that were transferred by law to the Pensioner-Insurance Fund, and also responsible for the remainder of shares that were not sold during the privatization
Those shares, for instance, could be sold on the stock exchange and thus be used for rehabilitation of the Pension-Insurance Fund. An important role of the Republic Shareholding Fund could also be to establish funds for restitution to persons whose property was expropriated or nationalized in the previous period. In addition, it is important to establish several other institutions, including an agency for encouraging foreign investment, a development bank, and the like.

Several laws have to be enacted in an attempt to complete the institutional and legal infrastructure for privatization. First, there must be a Law on Investment Funds because FR Yugoslavia has no regulatory rules in this field, although the draft law has been prepared for several years. This law is particularly important if the government wants to broaden the possibilities for attracting foreign investment. Second, the Law on (trading with) Securities has to be amended to make more room for the development of the financial market and to regulate it in the right direction. This is partly the process of harmonization of the legal framework for a market-oriented system with European Union Regulations. Third, the former Privatization Law (Ownership Transformation Act), besides its other shortcomings, created barriers to the secondary trading of shares. Specifically, there is a five-year limit on the sale of shares that employees and other citizens get for free. There are restrictive articles related to the preemptive rights of those who already have shares as well. Both clauses have to be replaced by new regulations with the aim of increasing trade in securities.

Second, the discussion between the gradualists and those who advocate shock therapy raised the question of the dominant privatization model. On the basis of the Hungarian and Polish experiences, it was argued that selling enterprises or the majority of their shares to strategic partners is the most efficient model of privatization. However, gradualists instead advocated the insider model, as it is socially better accepted. The Serbian experience is important to this discussion, because the former privatization law was based on the worker buyout model while the dominant model in
the new law will favor of strategic partners. The insider model from the previous law was advocated as being appropriate to the Yugoslav past, specifically, social ownership and a legacy of self-management. On the contrary, the new law will give strategic partners the chance to get more than one-half of the total capital of companies that are to be privatized. While this change in the legal framework will encourage the foreign investor, it could be dangerous if foreign investment inflow remains modest.

The third question of transition is related to the sequence of steps in so-called big privatization. Usually, the advice to the government responsible for the process of transition has been that it is efficient to privatize first and then to restructure large firms. The environment for big privatization in Serbia in the past ten years has been irregular because of sanctions. So, one can argue that, under those circumstances, the government had no choice but to start partial restructuring of large enterprises as a chance for some large, unprofitable firms to survive. The new law on privatization is in favor of strategic partners, which means that foreign investors are now expected to start restructuring after privatization. So, under regular conditions the standard sequence of steps in big privatization could be realized.

The New Law on Privatization

Privatization is among the most important issues of transition and will influence the final result of reforms. The dilemma—whether to continue with the same model or to implement a different one—is not easy, and the several months’ time that the Ministry for Privatization spent preparing the draft law was unexpected because there were signals that it would be an easy and quick task. The draft is now ready and some of its crucial new points can be commented on and some additional questions addressed: the different approach to different categories of companies, the plan for privatization, compulsory privatization, whether the main channel of the process will be based on foreign investment, and, conse-
quently, a smaller portion of shares offered to employees and other citizens.

So-called big privatization must be realized and treated separately from small privatization. It is a time consuming process, and the experience of transition countries has demonstrated that a five- to ten-year period is needed to complete it. Big privatization has to be realized case by case, preferably with foreign investors as strategic partners. Government support in the restructuring process of large companies is desirable. The former Serbian privatization law stipulated a case-by-case approach with an important role for the government in leading the process. Thus, it can be argued that the barrier to rapid big privatization was not the law, but the unfavorable circumstances. The government was free to fix the portion of capital that would be offered to the strategic partners. The draft Law on Privatization predicts the same approach. As was the case earlier, the candidates for big privatization are state-owned enterprises and large socially owned firms. The important news is that the public tender method will be used to choose strategic partners for all large enterprises. Lifting the sanctions made way for this method, which was not possible earlier because public tender could not be used and foreign partners from the EU and other developed countries could not apply for privatization. The Agency for Privatization within the Ministry would be the institution responsible for managing the procedure of privatization of those large enterprises. It should be emphasized that this could be a purely administrative approach, which does not exclude the possibility of corruption. The appropriate solution may be that the Ministry for Privatization, instead of the Agency, should engage some strategic advisers in the form of consulting companies.

The introduction of compulsory privatization is the most positive recent development. A majority of Yugoslav economists have pointed out that the former law’s main obstacle to rapid privatization was the free will of employees to make the decision to privatize small and medium-sized enterprises. Practice has proved this prediction right. The draft law stated that all small and medium-sized
enterprises had to initiate and complete the procedure within a period of four years. Although one can argue that this period is arbitrarily/artificially defined rather than based on a specific estimation, it can be considered appropriate in that the term of office of the government is also four years. In addition, those enterprises are pushed to enter privatization as soon as possible because, over time, the portion of shares that can be transferred to employees free of charge decreases. If the enterprise does not start privatization within the four-year period the draft law states that social capital will became state-owned and the government will manage privatization.

The plan of privatization that will be adapted yearly is prescribed in the draft law for the first time. The reasons for such a plan can be transparency, control, and how public the process is. The plan will be linked to the fiscal year because income from privatization would be transferred to the republic budget and used to cover budget deficits, that is, transition costs, as in other transitional countries. It would be based on a prediction of the income from the privatization of state-owned and large socially owned companies.

Foreign investment inflow through strategic partnership for Serbian firms is not only desirable but also necessary. Both employers and employees are interested in foreign partners, including those bringing know-how, technology, standards, resources for firm restructuring, and, finally, an increase in the operational efficiency. However, one can argue that the interest of foreign partners is probably overestimated. The noneconomic risk of investment in Yugoslavia is very high, and even showing an increasing tendency, because of political problems in the south of Serbia between Serbia and Montenegro related to the federal concept and problems within FRY Macedonia. So, the period during which the process of privatization could take place with investments from foreign strategic partners would be longer than is desirable. The balance between the two channels of privatization, foreign partners’ and employees’ (managers’) buyout, existed in the former law, but disappeared in the draft law. One can predict a high likelihood that, after four years, the government will con-
clude that the foreign investment interest in privatization is too weak. Thus, the law would be changed to introduce a voucher method with the aim of speeding up the process.

A very important issue related to those mentioned above is that the draft law gives fewer rights to employees and citizens than before. The Ownership Transformation Act gave the majority of citizens who have ever worked in socially owned and state-owned firms, including those employed in institutions, the opportunity to become owners of shares free of charge of up to 70 percent of the total capital of small and medium-sized enterprises. It is important to bear in mind that this reflects the legacy of several decades of self-management. The law was enacted on the basis of the consensus of important interest groups: employees, trade unions, employers, and pensioners. In contrast, the draft of the new law is not based on such a consensus, and this could be dangerous for the final results of the reforms. After the ten-year economic crisis, Serbian citizens are tired and probably not ready to accept new sacrifices such as losing their personal rights.

Other Issues in Related Areas

While privatization is very important, it is only part of the process of transition to an open, market economy. In the economic, legal, and institutional infrastructure of Serbia there are several aspects that require restructuring and reform, not only to facilitate privatization but also as part of the general transition process.

The banking system is going to need reform, both technically and from the standpoint of corporate control. Two sharply separate groups of banks exist now in FR Yugoslavia (Serbia):7 (a) old, large state-owned banks whose capital and volume of operations account for three-fourths of the total banking sector, but who have ruined capital, huge foreign debts, and debts toward citizens based on the frozen foreign saving deposits of citizens; (b) new, privately owned small banks, whose tight resources offer no chance of sustaining an economic recovery. Reform of the banking system is a very complex process that requires time, large financial resources,
and foreign support. This reform should have three lines of closely coordinated activities: first, the rehabilitation of state-owned banks, not all, but those that can survive and operate in an international setting; second, the development and increase of the capital of private banks through mergers and strategic partnerships with foreign banks; and third, it is necessary to make room for respectable foreign banks to enter the Yugoslav financial market.

One of the important lessons learned from transition countries is proof of Kornai’s prediction that for reforms to be successful, the most important thing is the spontaneous development of a new private sector (Fischer and Sahay 2000: 6). Privatization of already existing companies is very sensitive from a political point of view and essentially important for the introduction of hard budget constraints at the level of economic agents. However, it is not useful to waste time and energy in an attempt to prepare a perfect legal framework for fast privatization. It is more important to coordinate support for small and medium-sized enterprises in private hands. The rapid increase in the number of such firms in the first half of the 1990s later stagnated, pointing to the huge potential and energy of entrepreneurs. It is clear that foreign investors would rather establish a new entity alone or together with domestic partners than be faced with ruined machinery and the overemployment of existing enterprises. At the same time, new private firms and self-employment would be the rational way to solve the problems of those who will lose their jobs. Thus, the government must encourage this process.

Notes


2. Officially, social ownership has been defined as that belonging to the whole society—to everyone and to no one personally. In practice, however, when an enterprise was profitable, profits were distributed to employees through wages, that is, collective-type ownership, and when an enterprise was unprofitable, it asked the government for help, that is, state-type ownership).
6. According to the Ownership Transformation Act, in the first year, the holder can sell only 10 percent of shares that have already been transferred to him/her, in the second and third years 20 percent per year, and, finally, in the fourth and fifth years, 25 percent per year.
7. The banking system is a federal responsibility.

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