# Introduction

Over the past forty years Yugoslavia has been trying to develop its own model of socialism based on workers' self-management, decentralization, social ownership and increasing reliance on the market. These characteristics of the Yugoslav economic system have led many scholars to consider Yugoslavia to be very different from other socialist economies, frequently ascribing, in line with the theoretical literature on the labour-managed firm, economic inefficiency of the Yugoslav economy to the specific features of its economic system.

At the same time, however, until 1989 Yugoslavia remained a socialist economy characterized by many of the systemic features (and problems) of a traditional centrally planned economy. Although in Yugoslavia some of the typical priority objectives of centrally planned economies have been abandoned – such as full employment and price stability – along with many of the traditional centralized institutions, other fundamental socialist goals have been retained, including the commitment to non-private property, planning, egalitarianism, and solidarity.

The intention of this book is to evaluate the impact of such 'dualism' – self-management and increasing use of the market on the one hand, and socialist features on the other – on the nature of the Yugoslav system, by focusing on the specific field of investment. The period examined is primarily post-1966, since it is with the reforms of the 1960s that substantial institutional changes were introduced into the economy, in particular in the field of investment.

The book is divided into three main parts. After these introductory remarks, the first part describes the institutional setting and presents the theoretical framework necessary for understanding Yugoslav investment behaviour. In chapter 1, the evolution of the Yugoslav economic system is briefly described through a discussion of the main directions of past economic reforms, economic performance and problems encountered, and the present economic crisis and the measures taken to overcome it. The three subsequent chapters discuss the theoretical framework: on the one hand, the likely impact of self-management on investment behaviour, as developed by Vanek, Furubotn, and Pejovich (chapter 2) and some extensions of the theory (chapter 3); and, on the other hand, the likely impact of systemic features of the socialist economy, following the theory of János Kornai (chapter 4).

The second part of the book provides empirical evidence on the nature of the Yugoslav system, with the aim of determining which of the two theories is more suitable to Yugoslavia. A general assessment is first given of Yugoslav investment and savings performance, both at the aggregate and enterprise level (chapter 5). The analysis proceeds with an evaluation of factors which, according to the theories discussed, are likely to have influenced investment in Yugoslavia, namely a number of market variables on the one hand, and socialist features of the Yugoslav economy on the other (chapter 6). Finally, the theories are also verified using econometric tests (chapter 7).

The last part of the book discusses pressure for more radical reforms in the field of investment incentives and property rights in Yugoslavia, both in the past and today. Chapter 8 analyses early theoretical proposals for such reforms developed by Edvard Kardelj and their practical implementation during the 1970s, pointing to the lack of change in the property regime as one of the main reasons for their failure. Chapter 9 focuses on current property reforms: it discusses proposals advanced during the property debate of the 1980s, which have paved the way for a radical change in official policies; concrete measures taken by the Yugoslav government from 1988 onwards and its privatization programme; regional problems linked to its implementation; and evidence on property restructuring in Yugoslavia. Since Yugoslavia is presently going through a process of transition from a socialist to a mixed market economy, similar to the process under way in other former socialist economies, chapter 10 discusses some specific features of the Yugoslav transition. In the concluding chapter 11, an overview of the principal conclusions is given.

# Part I

# The institutional and theoretical framework

# 1 The Yugoslav road towards market socialism

Despite retaining a communist one-party political regime until 1989, Yugoslavia was the first socialist country to attempt far-reaching economic reforms, and because of its early start and the frequency of systemic changes, it was for years considered the most reformed socialist economy. Along with significant institutional innovation, a policy emphasis on rapid growth led to continuous economic progress up until 1980, when a serious economic crisis began to develop. In order to give an overview of these developments, the evolution of the Yugoslav economic system will be presented through a short description of the main characteristics of past economic reforms, economic performance until 1980, and the present economic crisis.[1]

## Past economic reforms

Each decade in post-war Yugoslavia has brought with it a new series of institutional changes, designed to gradually transform the economy from a traditional centrally-planned one into a more market-oriented system.

For a brief period after the Second World War, the Yugoslav economy was organized along similar lines to that of the Soviet Union. The model adopted was based on centralized planning, state ownership of enterprises brought about through nationalization (except for agriculture, the largest part of which remained in the hands of private farmers), state monopoly in the most important spheres (investment, banking, foreign trade), and administrative control of most prices. The system effectively implied full control of the federal state over the economy.

Following the Tito–Stalin conflict in 1948 and the expulsion of Yugoslavia from Cominform, in the early 1950s the Soviet-type economic model was abandoned. A law of 1950 introduced workers' self-management, initially in a limited number of enterprises and sectors, giving the workforce the right to directly elect workers' councils as the main decision-making organs of the enterprise which were to decide on production plans, inputs, hiring policies, and to a limited extent, prices and income distribution. Self-management was reinforced with the replacement of centralized planning by a more flexible system based on the planning of overall targets only ('global proportions'). A single price structure was also introduced, parallel to some relaxation in price controls.

In line with these changes, in 1953 state property was replaced by 'social property' intended as property of the whole of society. This gave enterprises in the social sector not property rights, but rather the right to use socially-owned assets and to appropriate their product (at first subject to a small capital charge, and since 1971 free of charge). Expansion of the private sector, consisting mainly of agriculture and certain crafts and services, was restricted by law: the 1953 land reform reduced the limit on the size of private holdings from 35 to 10 hectares per family, while in other sectors limits were placed on the number of workers that could be employed (usually five workers other than family members).

In the early 1950s, the state monopoly of foreign trade was replaced by a more decentralized system giving more freedom to enterprises in their foreign trade operations. The banking system was also somewhat decentralized, with the setting up of sectoral banks for agriculture, investment, and foreign trade. There was also some devolution of the federal powers to republican and local governments.[2] Competences in certain fields, such as light industry, were transferred from the federal to the republican level, while local political authorities were given certain independent rights to taxation.[3] The local commune became responsible for the implementation of the social plan, supervision of enterprises, and the provision of social and other services.

The institutional changes implemented during the 1963–7 period were much more far-reaching, and it is this economic reform that has usually been considered as marking the passage to 'market socialism' in Yugoslavia. The right to self-management was extended to all sectors and types of organization; planning was further relaxed by a switch to a system of indicative planning; and the market was to become the main mechanism of resource allocation. Price liberalization was carried further, through adjustments designed to remove distortions in relative prices, although certain prices continued to be fixed administratively and a system of controls was maintained. The competences and responsibilities of republics and local governments were increased further, and after 1968 the rights of the two autonomous provinces were also strengthened. There was major innovation in the foreign trade sector, in line with the policy of directing trade primarily towards Western markets: the system of multiple exchange rates was replaced by a uniform exchange rate, and the Dinar was devalued in 1965 in order to establish a more realistic rate; some import restrictions were reduced; and in 1967 joint ventures with foreign partners were permitted.

The economic reform of the 1960s included important changes in the field of banking, investment and finance. Central banking was separated from commercial banking, and a diversified structure of decentralized all-purpose banks was set up. The investment sphere was extensively decentralized, with the intention that banks and enterprises would become the principal agents of investment decisions. In 1963, central investment funds were abolished and their resources transferred to banks, which were to become the main financial intermediary; the only federal fund was to be the Fund for the Development of Less-Developed Republics and Regions. Fiscal burdens on firms were reduced – which left a larger share of generated income at their disposal – and wage controls were substantially relaxed, giving enterprises greater control over the distribution of their income. In principle firms were able to choose their own investment projects, as well as the proportion of profits to be allocated to investment.

The economic reform of the 1960s was followed by a number of economic, social and political problems,[4] resulting in a need for further major institutional change. A new economic reform was implemented in the 1971–6 period,[5] introducing a number of innovations. In the macroeconomic field, new mechanisms of policy coordination were invented, designed to reinforce the planning instrument, to be based on self-management principles permitting the active participation of economic agents in the overall planning process. 'Social compacts', or agreements concluded at different levels between representatives of the political authorities (or 'socio-political communities', in Yugoslav terminology),[6] trade unions, enterprises and other organizations, were to be concluded on policies to be pursued in a given field, such as prices, income distribution, employment, foreign trade, and so forth. In addition, 'self-management agreements' were to regulate relations between enterprises and other organizations in different areas of mutual interest, such as terms for the foundation of enterprises and banks, joint investment projects, transactions and deliveries, and so forth. These agreements are negotiated through a process of bargaining between the parties concerned, and once concluded, their implementation is, in principle, obligatory.

The economic reform of the 1970s brought about a further devolution of powers from the federation to the republics, and to the lower-level socio-political communities. In order to take account of the different economic interests of the single regional components of the Yugoslav federation, and to promote local interests and responsibilities, the reform strengthened the rights of the single republics in many important fields, including prices, income distribution, taxation, employment, social security and welfare, and foreign trade. Other fields, such as national defence and foreign policy, remained under federal control. Monetary and exchange rate policies, while also within the competence of the federal government, were to be based on agreement between the republican governments; since such agreements relied on the principle of consensus, a veto power was effectively given to each republic.

Substantial decentralization took place, in particular in the foreign trade sector, after 1977, when self-managed communities of interest for foreign economic relations were set up at republican levels. The new system had a number of deficiencies, as it implied the fixing of import and export quotas of each republic, the administrative allocation of foreign exchange both among and within republics, and preferential access to foreign currency for final exporters. Enterprises were also allowed to retain a substantial part of their foreign currency earnings in bank accounts, which were also permitted to be kept outside of Yugoslavia.

In the microeconomic sphere, in order to facilitate self-management within enterprises, during the early 1970s firms were split up into smaller units (so-called 'basic organizations of associated labour' – BOALs), each having its own self-management organs and statutory acts. Other new forms were also introduced: organizations of associated labour (OALs), regrouping several BOALs; complex organizations of associated labour, regrouping several OALs; and contractual organizations of associated labour, financed by a combination of private resources and socially-owned capital. In the field of social services, 'self-managed communities of interest' were introduced, intended to be organizations directly linking the interests of users and providers of such services on a self-management basis.

In order to reinforce further the position of enterprises *vis-à-vis* the banking sector, and prevent the concentration of financial resources within banks – something which, in the late 1960s, was regarded as being in conflict with self-management – banks were transformed into non-profit 'service' agencies of enterprises operating under their direct control. Substantial financial innovation was also brought about through the diversification of financial instruments, both standard (such as bonds, treasury bills and promissory notes) and those adapted to the Yugoslav self-management system (different forms of pooling of labour and resources which permit direct investment by one enterprise in another, or private investment by an individual into a socially-owned enterprise).

Economic reforms were reinforced by specific features of Yugoslavia's international economic relations. It did not join the Council for Mutual Economic Assistance (CMEA) in 1949 (although it participated, after 1964, in some of its standing committees), remained full member of the International Monetary Fund (IMF) and in the 1960s, became member of the General Agreement on Tariffs and Trade (GATT) and associate member of the Organization for Economic Cooperation and Development (OECD). Yugoslavia also had a privileged relationship with the European Community, from the early 1970s through trade agreements and benefiting from the Generalized System of Preferences (GSP), and since 1980 through a Cooperation Agreement, which besides trade regulates other important fields of cooperation (such as financial loans, energy, transport and technology).

## Economic performance up to 1980

In spite of variations and some deterioration in economic performance during the post-1965 period, until the early 1980s the Yugoslav economy developed rapidly (see table 1.1). The annual rate of growth of gross material product (GMP) or 'social product' in Yugoslav terminology,[7] was over or close to 6 per cent throughout the 1953–80 period. A substantial proportion of GMP, around 30 per cent or more, was devoted to investment in fixed assets, frequently at the expense of consumption. Pursuing a strategy of rapid industrialization, the authorities gave priority to the development of industry over agriculture, and to the social sector over the private. Development-oriented policies made possible important changes in the structure of the economy, the growth of industrial employment with significant transfers of the labour force from agriculture, and a continuous increase in average living standards. The opening up of the economy to the West in 1965 led to concentration on Western markets, to a gradual integration of Yugoslavia into the world economy, and to substantial trade diversification.

Achievements in terms of economic development were also accompanied by a number of problems, in particular following the economic reform of the 1960s. Along with decentralization, liberalization and increasing reliance on the market mechanism – but without the parallel introduction of an efficient mechanism of macroeconomic regulation and control – the Yugoslav economy began to be characterized by deterioration in performance and increasing instability. After 1965, there was a notable slowdown in the growth of GMP, industrial output, employment and commodity exports, and the authorities had to cope with new problems such as inflation, unemployment, increasing disparities in regional development, and balance of payments difficulties.

Following the partial liberalization of prices in the mid-1960s, the average annual inflation rate (retail prices) increased to 10 per cent by the end of the decade, and to 20 per cent during the 1970s. Lower rates of output growth had aggravated the problem of unemployment, and the registered unemployment ratio of the total labour force rose to 6.9 per cent in 1976 and to 8.4 per cent in 1980 (OECD 1982, p. 14). In spite of the existence of a federal fund which ensured the transfer of substantial resources from the more to the less developed republics and regions, regional disparities in levels of development increased. Thus the difference in income per capita between the most developed republic, Slovenia, and the least developed region, Kosovo, increased from 5 to 1 in 1955, to 7.5 to 1 in 1988. At the same time, there was also substantial income disparity across sectors and across enterprises, even within the same sector.

Finally, the slowdown in the growth of commodity exports, together with a substantial increase in imports in the late 1960s, led to a widening trade deficit and to increasing balance of payments difficulties. While the deficit on the trade account was initially compensated for by workers' remittances from abroad and by tourism, during the 1970s the situation progressively deteriorated as invisible earnings became insufficient to balance the current account. The Yugoslav authorities did not react to the 1973–4 oil shock by lowering domestic spending, but rather, earlier growth rates of consumption were maintained or even increased; in particular, there was a rapid expansion of investment. This was made possible by more frequent recourse to borrowing on international markets, leading to a rapid increase in Yugoslavia's external debt (net of lending) – from less than $2 billion in 1970 to

Table 1.1. *Average growth rates of macroeconomic indicators in Yugoslavia, 1953–1989 (percentages)*

| | 1953–6 | 1957–60 | 1961–5 | 1966–70 | 1971–5 | 1976–80 | 1981–9 |
|---|---|---|---|---|---|---|---|
| GMP | 6.6 | 11.3 | 6.8 | 5.8 | 5.9 | 5.7 | 0.5* |
| GMP per capita | 5.2 | 10.2 | 5.7 | 5.9 | 5.1 | 4.3 | −0.2* |
| Industrial output | 12.9 | 14.1 | 10.6 | 6.1 | 8.1 | 6.7 | 2.0 |
| Social sector GMP | 5.6 | 13.7 | 9.0 | 6.1 | 6.5 | 6.2 | 0.6 |
| Private sector GMP | 8.7 | 6.1 | −0.1 | 4.6 | 3.0 | 2.3 | −0.1 |
| Employment | 6.3 | 7.6 | 4.3 | 1.0 | 4.3 | 4.0 | 1.9 |
| Real personal income per worker | 1.1 | 9.1 | 5.4 | 7.3 | 1.5 | 0.9 | −0.6 |
| Retail prices | 2.3 | 3.0 | 11.1 | 10.0 | 20.2 | 17.4 | 120.0 |
| Commodity exports | 9.4 | 14.6 | 9.7 | 5.8 | 4.9 | 1.5 | 2.4 |
| Commodity imports | 7.4 | 14.5 | 5.8 | 14.3 | 5.8 | 0.8 | −1.0 |

*1988
*Source:* Savezni zavod za statistiku (SZS), *Statistički Godišnjak Jugoslavije 1990*, Tables 102–9 and 102–10.

$14 billion in 1979 and, following the second oil shock, to $18 billion in 1980. At the same time, due to shortcomings in the system of resource allocation, certain structural imbalances began to emerge. Insufficient investment in crucial sectors, such as energy and raw materials, led to a rising dependence of the Yugoslav economy on imported inputs, whereas there was excess capacity in other sectors and the duplication of plants of suboptimal size across regions. These negative trends culminated in 1979 after the second oil shock, which brought about a record deficit on both the foreign trade and the current accounts ($7.2 billion and $3.7 billion respectively).

## The present economic crisis

The balance of payments constraint led the Yugoslav government to implement policies aimed at raising gross savings and suppressing domestic demand. Since 1981 these policies have been supported by IMF stand-by loans and credits from western governments and foreign commercial financial institutions. The initial austerity package, introduced in 1981, consisted of severe cuts in all components of domestic demand (especially imports and investment), price liberalization, restrictive monetary policies, and a more realistic exchange rate brought about through several devaluations of the Dinar.