

Yugoslavia: Economic, Political and Human Experiment

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Figure 1

YUGOSLAVIA

Formal Name: Socialist Federal Republic of Yugoslavia

Capital: Belgrade

Total Area: 255,892 square kilometres

Agricultural Area: 142,000 square kilometres

Forest Area: 93,000 square kilometres

Population (30. 06. 1988): 23,556,000

National Currency: Dinar

Ethnic Groups: Serbs, Croats, Muslims, Slovenes, and Macedonians (all South Slavs, constituting together over four fifths of total population); Hungarians, Albanians and Italians are the principal minority groups

Languages: Serbo-Croatian, Slovenian and Macedonian; Hungarian, Albanian and Italian are the main national minority languages

1. Introduction

The former Yugoslavia's geopolitical location between the East and the West put her in the middle of a political power game. Organized neither as a communist nor as a capitalist country, Yugoslavia served as a mediator (a kind of arbitrage zone) between the two blocks for decades. The foreign policy of nonalignment was appreciated both in the West and in the East and allowed Yugoslavia to maintain good political and economic relations with both sides.

Up to the early 1970's, Yugoslavia was considered to be a success story with one of the highest rates of economic growth in the world, and also with highly developed social, health and educational systems. Unfortunately, years of economic and political "reforming" resulted in the total destruction of the country. A process of decentralization in all spheres of activity started to threaten the country's future prospects. The self governing socialism that was relatively developed on the microlevel did not have its reflection on the macrolevel -- the level of the global society. Economic chaos resulting from decades long process of "experimenting" was getting larger political and ethnical dimensions.

Located in the Balkan region of southeastern Europe, on the historical boundary between the "crescent and the cross," Yugoslavia was exposed to different influences throughout its history. Probably the easiest way to describe Yugoslavia is to use the words of its greatest novelists of all

times, Ivo Andric: "...a bridge that is the crossing place from West to East , and vice-versa..."¹

These words describe certain features relevant to the area that only few years ago was called Yugoslavia, where the bridge is a symbol of the shifting influence of different European, as well as Asian cultures.

From its birth, Yugoslavia has been one of the most interesting and diverse countries in Europe. The South Slav peoples who came together in 1918 to form the Kingdom of Serbs, Croats and Slovenes² had each had centuries-long history of rule by competing eastern and western powers. Since the collapse of the Roman Empire these peoples had never lived together under the same authority. The creation of the Kingdom of Serbs, Croats and Slovenes was the final step in their struggle for independent and united country. As part of a huge European empire for many centuries, Slovenia, Croatia and Vojvodina had developed economically and culturally much faster than their neighbours, Serbia proper, Bosnia and Macedonia, which shared the fate of the Ottoman Empire for more than four centuries. Only Montenegro managed to avoid the destiny of other South Slavs and stay independent until the creation of Yugoslavia.

After 360 years of Turkish rule, Serbia was the first among South Slav countries to gain her independence in 1878. Slovenia was under German rule since A.D. 700, and under Austria since the Middle Ages. Vojvodina came under Hungarian control in A.D. 900. Croatia managed to stay

¹Andric, I. (1962) *The Bridge on the Drina*, Knopf, New York, p. 274.

²In 1929 the name was changed into Yugoslavia, meaning the land of the South Slavs.

independent until 1102 when it was also absorbed by Hungary. Power game players in Bosnia switched their places in 1878 when Turkish rulers were succeeded by Austrian dictators³. In the aftermath of the First World War, only Serbia and Montenegro (which included most of present-day Macedonia and Kosovo) were independent countries with developed state apparatus which allowed Serbia to take a dominating position with respect to other South Slavs, who joined the Kingdom in 1918.

Nature has given Yugoslavia a rich variety of natural resources: good hydroelectric potential, coal sources, oil and gas reserves, a wide range of ferrous and non-ferrous ores⁴ (e.g. copper, zinc, chrome, bauxite, antimony and mercury), and a very fertile agricultural area. However, between the two world wars, the greater part of the population lived in extreme poverty, particularly in the eastern regions. Agriculture was the most important sector employing the majority of people: 80 percent of the population depended upon agriculture and only 60 percent of all agricultural land was being used. Industry was underdeveloped compared with available domestic resources. In 1938, industry accounted for only 20.3 percent of the national income. Equally serious was the royal government's failure to stimulate the growth of manufacturing, which encouraged exploitation of raw materials for industries abroad. In these first two decades of Yugoslavia's existence the country was faced with serious problems: industry was underdeveloped, agriculture was bankrupt, acute

³Hamilton, I. (1968) *Yugoslavia: Patterns of Economic Activity*, G. Bell and Sons Ltd, London, pp. 9 - 22.

⁴The exploitation of these resources has been hampered by problems of accessibility, and in some cases by the low grade of the ore.

overpopulation was present, and social amenities lagged far behind other European countries⁵.

The historical drama on the "bridge" between West and East helps explain three major problems with which postwar Yugoslavia had to deal. First, Yugoslavia was an underdeveloped country with respect to its reserves of energy, mineral and agricultural resources. Second, it was a land of contrasts: cultural, political, economic and ethnic. Third, the nature of the factors that had affected the character of economic activities before the Second World War varied in time and place, which resulted in certain maladjustments in Yugoslavia's economic development. Economic backwardness was reflected in an underdeveloped nature of the economy in relation to both the resources available and the needs of the population.

During the Second World War, Yugoslavia suffered more human and material damage than any other nation in Europe, not including Poland and countries of the former Soviet Union. Direct war damage to buildings and functional installations amounted to \$9,000 million. More than two thirds of agricultural machinery and over half the livestock that had existed on farms before 1941 were destroyed during the War. Two factories in five were completely ruined, and miles of railway tracks and roads were lost.⁶ In 1945, the economic base level, particularly in the most devastated

⁵Bombelles, J. (1968) *Economic Development of Communist Yugoslavia 1947-1964*, The Hoover Institution on War, Revolution and Peace, Stanford University, Stanford, p. 7.
"...In 1939 mortality rates averaged 14.9 per thousand... Only 50.1 percent of the children of school age attended elementary schools, while 44.6 percent of the population was illiterate."

⁶Hamilton, I. (1968) *Yugoslavia: Patterns of Economic Activity*, G.. Bell and Sons Ltd, London, pp. 12 - 33.

areas of Croatia, Serbia and Bosnia was far below what it had been in 1939.

The aim of this paper is to examine and assess critically external and internal factors that played a major role in Yugoslavia's economic development from 1945-1992. In what follows, I will discuss Yugoslavia's development path in the light of the specific problems that the country was facing. In parts two and three, we will see Yugoslavia's transformation into the first, and until this day, the only market socialist economy. Part four will cover the country's economic development during the 1980's, paying special attention to the rising problems of inflation and balance of payments deficit. The role that international financial institutions (primarily the IMF and the World Bank) have played in Yugoslavia's economic transformation will also be discussed in this section. By the end of 1980's the economic situation in the country was worse than ever before. In December 1989, the new government headed by Prime Minister Ante Markovic introduced very restrictive anti-inflation programmes, as an attempt to combat rising economic and ethnic problems and keep the country in one piece. These last years of Yugoslavia's existence will be described in part five. To conclude, I will emphasize, in my opinion, the most important factors that brought the country to its end.

2. Economic Development 1945 - 1965

2.1 The First Five Year Plan

In 1945, Yugoslavia was reorganized as a federation of six socialist republics and two autonomous provinces. The Communist Party of Yugoslavia, a strongly centralized organization,

gained complete control over the country. By the end of 1945, the government managed 89 percent of the entire industry. According to the constitution of 1946, all mineral wealth, power resources, means of communication and all foreign trade were placed under state control.⁷ A major land reform programme was instituted; the government promulgated an agricultural reform that limited the size of private holdings to 35 hectares per farmer. Soon after, a central planning agency was established and the First Five Year Plan (1947-1951) was drafted. The government rapidly adopted the "Soviet economic model".⁸

The first plan was based on the assistance from the Cominform bloc (Communist Information Bureau).⁹ The main objective of the Plan was to transform the technologically backward, mostly agrarian economy into an industrialized nation in five years, raising the economic and social levels of the country's less developed republics. Specific targets were to increase national income by 93 percent, total production by 128 percent, and the value of industrial production by 394 percent.¹⁰ An enormous emphasis was given to capital formation in basic industries (raw materials processing, energy, metals). The start was promising with high rates of investment in all economic

⁷Bombelles, J. (1968) *Economic Development of Communist Yugoslavia 1947-1964*, The Hoover Institution on War, Revolution and Peace, Stanford University, Stanford, pp. 9 - 26.

⁸Yugoslavia became the second country after the Soviet Union to establish a command economy.

⁹The assistance, in terms of credit, was coming mainly from the Soviet Union. However, other members of the Communist Information Bureau were involved as Yugoslavia's trading partners.

¹⁰Bombelles, J. (1968) *Economic Development of Communist Yugoslavia 1947-1964*, The Hoover Institution on War, Revolution and Peace, Stanford University, Stanford, p. 15

sectors. The rate of total national investment reached 27.3 percent in 1951 and continued to grow in the years to come. Yet, there were serious weaknesses. Too many new industrial projects were started and depended upon imported capital equipment, and the costs of many projects increased beyond original projections. Also, planning process required more people working on production plans, and the number of administrative personnel in enterprises expanded greatly. In addition, agriculture still produced less than it had in 1930's.

The Soviet Union, as the most powerful and influential country in the Eastern Block, tolerated little opposition and independence. Also, it became clear that the original Soviet economic model was not exactly "a worker's paradise." In June 1948, President Tito and Yugoslavia took a separate line from the Soviet Union on several issues, including some economic ones,¹¹ and Yugoslavia was expelled from the Communist Information Bureau. Yugoslav Communists and Tito were accused of "not showing enough commitment to the class struggle."¹² However, it is difficult to imagine that this would be the sufficient reason for a country to be excommunicated. The problem was that Yugoslav leadership insisted on equal treatment of all the member countries of the Cominform bloc. In addition, Tito's idea about a Balkan federation involving Yugoslavia, Bulgaria, Albania, and possibly Romania was not welcomed in the Soviet Union. Namely, Stalin

¹¹Lamers, E. (1976) *Joint Ventures Between Yugoslav and Foreign Enterprises*, Tilburg University Press, Tilburg, p. 43.

"It was argued that far from being truly socialist, state ownership was state capitalism under which the workers would still be exploited - not by private owners but by the state bureaucracy."

¹²Dyker, D. (1990) *Yugoslavia: Socialism, Development and Debt*, Routledge, New York, p.17

thought that this would put Yugoslavia into a dominant position with respect to other Balkan countries, which represented a threat to the Soviet domination in the "socialist world." The communist countries instituted a boycott, cancelling treaties, trade agreements and loans: trade between Yugoslavia and COMECON¹³ member countries dropped dramatically (Table 1). Yugoslavia had to turn to the West -- especially to Germany -- to replace the goods originally ordered from socialist countries. However, the impact of the boycott on the economy was severe, causing a decline in the gross national product and making the first plan obsolete.

Table 1. Percentage of Yugoslav Exports and Imports with COMECON, 1948-56

	1948	1949	1950	1951	1952	1953	1954	1955	1956
Export	51.6	14	0	0	0	0	2.3	8.7	20
Import	48.4	14.3	0	0	0	0	11.6	8.9	21.5

Source: Singleton, F., Carter, B. (1982) *The Economy of Yugoslavia*, St. Martin's Press, New York, p. 115.

Having rejected the concept of the state as the decision-making authority in the economic process, Yugoslavia began building a new and unique economic order based on workers' self-management. Its first step was workers' participation in the management of firms.¹⁴ The state continued to be the legal owner of enterprise capital, but management by the elected worker's

¹³The Council for Mutual Economic Assistance (COMECON) was founded in Moscow in 1949.

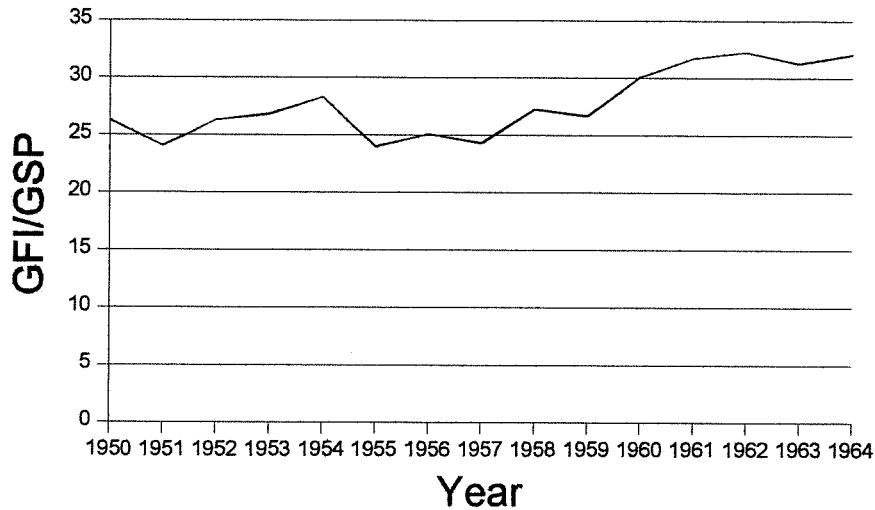
¹⁴"Law on the Management of Economic Organizations by Working Collectives" was promulgated on July 5, 1950.

representatives replaced the former management by higher level bureaucrats. The centralized approach to economic activity was partially substituted by market mechanisms. Namely, each enterprise was more or less free to determine what it would produce, where it would buy its inputs, how much it would import or export, what prices it would charge, and what salaries it would pay. The incomes of both workers and management now largely depended on the earnings of their enterprise and it was in their interest to cut costs, improve the quality of their products, increase sales and try to manage capital assets more efficiently. Still, even after the reforms, the central government continued to maintain rather tight control over basic macroeconomic decisions. It was the League of Communists that indirectly controlled almost all spheres of Yugoslavia's life through different government and quasi-government bodies. Enterprises were subjected to a variety of taxes and contributions for specific purposes. Also, annual federal plans and government decrees determined the proportion of investment funds that enterprises, communes, and republics could spend in each annual plan period. Other than wage determination and conditions of work which were largely under the control of worker representatives, enterprise directors were there to make important decisions covering the business policy of their enterprises, and they were still appointed directly by government.

However, these were the years of remarkable growth of the Yugoslav economy. The ratio of gross fixed investment to national income was remarkably high throughout the 1950's, and was over 30 percent in the early 1960's (Figure 2). Dyker puts this into perspective comparing Yugoslavia's gross investment ratio with the gross investment ratios in some western developed countries: the gross investment ratio in post-war Britain was rarely above 20 percent, while in West

Germany it averaged just over 25 percent in the same period.¹⁵

Figure 2. Ratio of gross fixed investment to gross social product



Source: Dyker, D. (1990) *Yugoslavia: Socialism, Development and Debt*, Routledge, New York, p. 44.

2.2 The Second and Third Five Year Plan

By 1956, a relatively broad industrial basis was achieved. Liberalised agricultural policies and increased fertiliser supplies stimulated some progress in agriculture. The achieved percentage of growth of agricultural production was much higher than its targeted level. With the high level of investment in industry, infrastructure and human capital, Yugoslavia was able to fulfil the Second

¹⁵Dyker, D. (1990) *Yugoslavia: Socialism, Development and Debt*, Routledge, New York, p. 42.

Five Year Plan (1957-61), a year ahead of schedule. In 1960 Yugoslavia achieved the average annual growth rate of 13 percent. Agricultural production expanded by 10.5 percent per annum, permitting food export, industrial output increased by 14.2 percent per annum, building by 16.2 and transport by 13.3 percent per annum. Yugoslavia became an exporter of its industrial manufactures, capital goods and expertise.¹⁶

Despite these improvements, the balance of payments gap widened to \$150 million (\$US) annually. This partially resulted from the creation of the European Economic Community, with Yugoslavia losing some Western European markets. In addition, overinvestment in some sectors, including public buildings, was accompanied by underinvestment in those industries based on the utilisation of resources which would have given Yugoslavia a comparative advantage on world markets. When Yugoslavia's current account deficit in 1960 reached \$250 million; the "red light" alarmed the international donors -- that year the US Congress decided that no more economic aid should be given to Yugoslavia.¹⁷

In a first attempt to restore the situation, a series of economic reforms were rapidly introduced along with a very ambitious Third Five Year Plan (1961-65) with the intent to increase the influence of market forces. The 1961 reforms were "approved" by the IMF under the condition

¹⁶ Cecez, M. (1987) *Privredni Sistem I Privredni Razvoj Jugoslavije*, Svjetlost, Sarajevo, p. 43-67.

¹⁷ *Ibid.*, pp. 225-234.

that Yugoslavia liberalize her trading regime and payments systems.¹⁸ However, failing to achieve any of its ambitious targets at the end of the first year, the Third Five Year Plan was abandoned.

Yugoslavia was not spared the problems that other developing countries were facing: inflation, rising unemployment, balance of payments deficit and rising government expenditures due to a rapid increase of subsidies for basic consumer goods and services. To deal with these problems, Yugoslavia had to turn to various sources of outside help. Being subject to rationing on credit markets due to the high country risk, Yugoslavia turned to international financial institutions, primarily the International Monetary Fund and the World Bank. The cost of the credit was in this case less reflected in the interest rate, but rather in the conditionalities attached.

In order to accommodate the IMF and other foreign investor's requirements, Yugoslav politicians developed a new ideology based on the idea of market socialism. Following the IMF's directions, the foreign trade policy was partially liberalized. A "coefficient system" was replaced by import duties and export subsidies, with an average level much lower than the old coefficients. Still, almost 75 percent of imports were subject to direct control through a licensing system. In an attempt to stimulate exports and reduce imports, the dinar was devalued in 1961 from 300 to 750 dinars to the dollar. As a consequence, domestic prices were brought into line with world market prices. However, the involvement of international financial institutions in determining the country's economic policy at this stage was still rather marginal. It was in the late 1970's that Yugoslavia

¹⁸Carson, R. L. (1990) *Comparative Economic Systems*, M. E. Sharpe Inc., New York, p. 414.

came under their control undertaking structural adjustment programmes that showed limited or no success.

3. Market Socialism

3.1 The Reforms of 1965

The year of 1965 can be considered as the beginning of the second phase in Yugoslavia's development. A series of economic reforms were introduced with an intent to "integrate the Yugoslav economy with the world market and begin steps to full convertibility of the dinar."¹⁹ That year the dinar was devalued again at a rate of 1,250 dinars to the dollar (30%); import duties were cut by half and the abolition of export subsidies was predicted. The reforms were "encouraged" by the IMF, resulting in a stand-by credit of \$80 million.²⁰

This devaluation was followed by a reform in the price system. The prices of 20 percent of industrial goods were free to vary along with market fluctuations. Shortly after that, the authorities, worried about inflationary pressures, imposed a general price freeze for key raw materials. Three months later, when the price freeze was removed, the prices increased by an average 30 percent with the highest increase in food, electricity, transportation and rents. Since wage increases were not fully

¹⁹McFarlane, B. (1988) *Yugoslavia: Politics, Economics and Society*, Printer Publishers Ltd, London, p. 122

²⁰Dyker, D. (1990) *Yugoslavia: Socialism, Development and Debt*, Routledge, New York, pp. 63-79.

compensated by price increases, the most important goal of the 1965 reforms -- to increase the share of personal consumption in total domestic demand, and to shift resources from the public to the enterprise sector and from investment to consumption -- was not fulfilled.

Along with the price system reforms, tax and banking systems were radically changed in order to make banks and enterprises more responsible for the use of investment funds. The Law on Banking and Credit established nine investment banks specializing in long-term lending and deposits. "Social investment funds" that were the main source of fixed investment financing were replaced by investment banks. Also, commercial banks were no longer to be established by and restricted to certain localities, but rather to be founded by groups of enterprises and government units which contributed initial capital subscriptions. The founders of banks would provide primary guidance to the credit and loan policy of the banks, which would bring them closer to the needs of their clients. Banks were expected to become independent, self-managed enterprises able to compete with each other.

As a result of the 1966-67 credit restrictions, the liquidity of enterprises was drastically reduced. Investments in both "non-productive" and "productive" activities followed the downward trend and did not show any signs of improvement until the end of 1967, when credit restrictions were relaxed and certain rules fixing the allocation of financial resources of banks and enterprises were abolished.²¹ The balance of payment on goods and services deteriorated from 41 million in

²¹"Non-productive" investment meaning investment in housing, government administration, public services, and "productive" investment meaning investment in "producing"

1966 to 109 million in 1968, which was due to the slow progress of exports and the liberalization of imports.²³ The effects of import liberalization were negative with respect to the output of some hard-industry, low-productivity sectors like steel and iron production and machine-building.

According to the Yugoslav authorities, one of the main goals of these reforms was to make the dinar fully convertible: "...convertibility will be achieved the day when Yugoslavia can remove all controls on the free exchange of the dinar."²⁴ Unfortunately, this didn't happen for more than two decades, and when it happened, it didn't reflect the real state of the economy.

Although the rate of economic growth continued to be relatively high, the reforms did produce problems that certainly deserve to be mentioned. Import liberalization imposed stronger competition from foreign products, giving an incentive to enterprises to eliminate excess labour and increase productivity. Consequently, employment fell quite sharply in 1966. Price liberalization and devaluation of the dinar that aimed to change price structures and stimulate exports put much stronger pressure on the general level of prices than it was expected, proving that one should proceed with caution when it comes to price liberalization.

The unique nature of the Yugoslav economic system and its rapid institutional changes

sectors whose output is included in social product.

²³ The degree of liberalization of imports was increased from 20% in 1966 to 45% in 1967. For details see OECD (1969) *Economic Survey: Yugoslavia*, Paris, p. 12.

²⁴ Singleton, F., Carter, B. (1982) *The Economy of Yugoslavia*, St. Martin's Press, New York, p. 143.

played an important role in the creation of economic policy. Due to the lack of an active and effective fiscal policy, monetary policy became a major tool in controlling an increase in the money supply. Prior to the major economic reforms in 1965-66, bank credit was primarily regulated by quantitative controls with interest rates as the main tool. However, interest rates were restricted by federal law and always lagged far behind the rate of inflation, creating credit demand much higher than credit supply. Given this ineffective interest rates policy, the link between monetary and real variables was more direct, making changes in credit conditions more important with respect to prices.

3.2 Institutional Changes and the Crisis of the 1970's

The Constitutional Amendments in 1971, the new Constitution in 1974, and the Law on Associated Labour in 1976 laid down the foundations of the new economic and political system of market socialism. Principles were set up for further enterprise reorganization. With an introduction of more decentralized, self-managed basic organizations of associated labour, individual workers were allowed to have "greater voice in the affairs that immediately affect them."²⁵ However, this excessive decentralization produced a potential threat to enterprise efficiency and the decision-making process. In addition, these reforms resulted in a transfer of policymaking power from the federation to the individual republics and autonomous provinces. The process of decentralisation touched on the issues of the role of the central government undermining the all-Yugoslav approach to economic development. Furthermore, "republicanization" seemed to paralyze the federal

²⁵Ibid., p. 153.

government since the consensus between the republics on some very important questions was almost impossible to reach: "...federal bodies were partially dismantled and formally reconstituted as instruments of the republics, composed of their own representatives on a parity basis."²⁶ As we will see later on, this transfer of political power from the federal to the republican level was one of the most important factors responsible for the revival of some old, never properly resolved political and ethnic questions.

Contrary to the first post-war decades when Yugoslavia's economy was characterised by constantly high economic growth, in the early 1970's it experienced a "stop-go" pattern.²⁷ The situation changed from year to year. The beginning of "a cycle" was characterized by an expansion of exports and an increase in the export/import growth ratio. Once, the growth had reached a certain point, the growth of imports would start to rise much faster than exports, reducing the ratio to its critical point. As a result the balance of payments deficit would show, which, together with the rate of inflation that was increasing faster than the rate of growth, became one of the constraints to Yugoslavia's future growth. However, compared to other middle-income Mediterranean countries Yugoslavia still performed quite well.²⁸

²⁶Tyson, L. D. (1980) *The Yugoslav Economic System and Its Performance in the 1970's*, Institute of International Studies, University of California, Berkeley, p. 13

²⁷World Bank (1983) *Yugoslavia: Adjustment Policies and Development Perspectives*, Washington, D.C., p. 5.

²⁸Tyson, L. D. (1980) *The Yugoslav Economic System and Its Performance in the 1970's*, Institute of International Studies, University of California, Berkeley, pp. 3 - 4.

With the balance of payments crisis in 1970-71, Yugoslavia experienced a sharp decline in the export/import ratio from about 85 percent in 1965 to 56 percent in 1971.²⁹ The dinar was devalued twice and adjustments in both exports and imports were introduced. Dinar devaluation, together with imported inflation, contributed to the acceleration of inflation in 1970-71. Imports of industrial materials and capital goods increased noticeably. On the other hand, a small fall in exports was registered. As a result, the trade deficit more than doubled. However, since the government borrowings were used to finance this deficit, the balance sheet failed to show this increase: current account surplus of \$419 million was registered in 1972. In 1973 the Yugoslav economy experienced relatively slow growth of output and rapid inflation. Measures undertaken to reduce inflationary pressures weakened domestic demand and suppressed real growth. Real GNP growth in this period was less than the 1971-75 plan forecast.

In 1972, the banking system went through further reforms. Measures were undertaken to increase the influence of enterprises in the banks' operations and to increase the responsibility of the founders for bank's obligations.³⁰ If there had been reasonably developed money markets, the Yugoslav banking system would have been very similar to the banking systems of western market economies. However, the lack of open market activities and inter-bank lending made commercial banks too dependent on the Central Bank and decreased capital mobility. Due to this and the

²⁹World Bank (1983) *Yugoslavia: Adjustment policies and Development Perspectives*, Washington, D.C., p. 3.

³⁰ However, founders had the privilege to withdraw completely their capital and transfer it to other banks.

existing selective credit policy, monetary control effectiveness was highly limited.

Obviously, the Yugoslav monetary system did not function as well as it was supposed to. The fact that there were no functioning capital (money) markets and that real interest rates were rather low (even negative), resulted in a chronic excess demand for money and credit at the enterprise level. Since foreign borrowing was strictly controlled, this excess demand could not be satisfied outside the domestic banking system. In addition, the absence of tradeable financial assets hindered the banks with surplus liquidity to channel it to the banks with insufficient resources. Strong ties between business banks and enterprises and the high degree of engagement of the central banking system in selective direct credits to business banks had considerable weight in the determination of the volume and pattern of credit expansion.

The employment situation also worsened in the 1970's. The share of active agricultural population in the total labour force in that period dropped to 40 percent. However, the absorptive capacity of the socialised sector and small private business was not sufficient to prevent a rise in the total number of registered job-seekers from 92 thousand in 1955 to as much as 739 thousand in 1977.³¹ Unsustainable "over-employment" in the socialised sector resulted in 1965 economic reforms with an intention to reduce waste of resources and increase labour productivity. The number of workers that found employment in this sector was drastically lowered to only 182 thousand

³¹OECD (1978) *Economic Survey: Yugoslavia*, Paris, p. 29.

compared to 744 thousand in 1955-60 and 680 thousand in the 1960-65 period.³² At this point a large number of Yugoslav workers tried their luck abroad: mostly in Germany and Austria. The major part of emigrant workers came from the agricultural sector: the loss of skilled workers was relatively small.

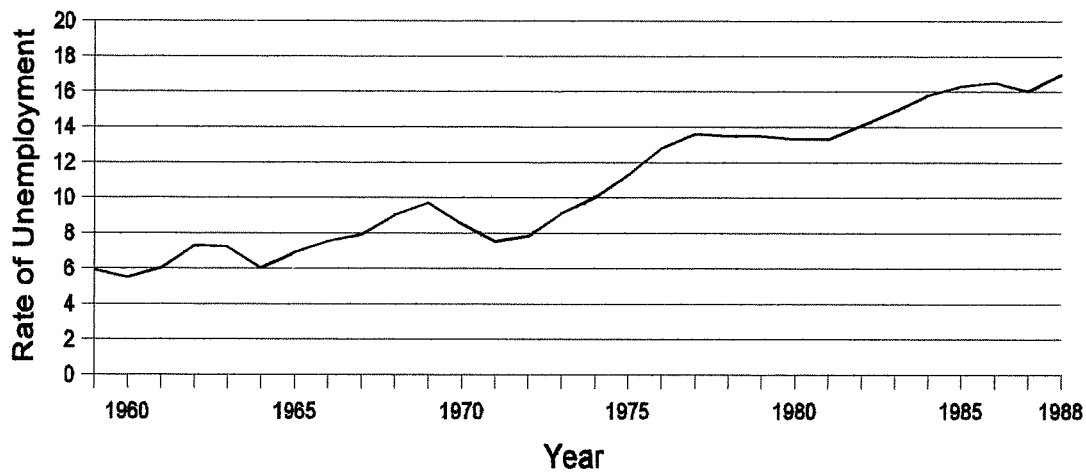
This massive labour outflow was welcomed by the Yugoslav authorities. The Yugoslav economy benefited from the remarkably high savings ratio of emigrant workers and remittances. Approximately 710 thousand Yugoslav workers found work abroad from 1965 to 1970. However, the changes in labour market conditions of the "host countries" and an introduction of restrictive laws on the employment of foreign labour reduced the number of Yugoslav workers who found employment abroad: 150 thousand of these workers returned to Yugoslavia in 1975-77. Combined with an accelerating labour outflow from agriculture, the army of returning workers from abroad resulted in a rising general level of unemployment. Contrary to the rule of "full employment" in socialist countries, Yugoslavia was faced with persistent and rising unemployment and was never able to resolve this question (Figure 3).

The weak investment activity and unsatisfactory investment structure were exhibited during this period, with relative growth rates of "productive" investment being much lower than the planned rates, and the growth rates of "non-productive" investment exceeding the planned target. These low levels of investment growth were mainly the result of the stabilisation measures introduced by the

³²Ibid.

end of 1972 and at the beginning of 1973. In spite of the weak domestic demand, prices continued to rise rapidly. An increase of price indices of all goods was 17 percent in 1972 and 20 percent in 1973.

**Figure 3. Unemployment trends,
1959 - 1988**



Source: Woodward, S. L. (1995) *Socialist Unemployment: The Political Economy of Yugoslavia, 1945-1990*, Princeton University Press, New Jersey, p. 193.

The 1976-80 plan concentrated on external adjustments through a combination of export promotion and import substitution (Table 2). Under the plan, all the energy sectors were to be developed at a faster pace in order to lessen Yugoslavia's vulnerability to "external shocks" and to correct domestic productive structural imbalance. This was supposed to be achieved through an investment effort directed toward priority sectors: electrical energy, coal extraction, oil and gas

extraction, machinery and shipbuilding, agroindustry, transportation and tourism. The slump in world trade constituted the most important threat to the growth targets in 1975. Due in part to EEC restrictions, agricultural exports stayed rather low.³³ Also, the export of raw materials experienced a decline in absolute terms. Beside the unfavourable conditions in major markets abroad, competitive factors and a changing structure of exports also played an important role in Yugoslavia's unsatisfactory export performance (Table 3). The table shows the widening of the trade gap with the convertible area; the share of exports to OECD countries declined from 56 to 36 percent, and to EEC from 39 to 23 percent. The share of exports to centrally planned economies showed a corresponding rise. In 1975, as a result of these changes in the terms of trade as well as of different rates of development of trade with various regions, Yugoslavia had a trade deficit of 3,590 with 6,145 of imports and 2,555 of exports.

Table 2. External Sector Targets of the 1976-80 Plan

	Actual (1971-75)	Plan (1976-80)
Gross Material Product	5.9	7
Exports	8.4	8
Imports	8.8	4.5
Fixed Capital Formation	7.1	8

Source: World Bank (1983) *Yugoslavia: Adjustment Policies and Development Perspectives*, Washington, D.C., p. 14.

³³Yugoslavia had a well developed meat industry: 90 percent of fresh meat and live animals exports went to the Common Market.

Table 3. Foreign Trade by Regions

	1970	1971	1972	1973	1974	1975	1976
Exports total (millions)	1678.9	1814.4	2237.2	2852.6	3805.1	4072.3	4878
OECD (share)	55.9	53.1	56.8	55.7	46.6	35.7	41.8
EEC (share)	39	35.7	36.1	35.7	27.4	22.8	27.2
East Europe (share)	32.5	36.9	36.1	34	41.6	47.3	41.8
Other (share)	11.5	10	7.1	10.3	11.9	17.1	16.4

Source: OECD (1975) *Economic Survey: Yugoslavia*, Paris, p.13

The policy measures, designed to ease the foreign exchange crisis of 1974-75, resulted in the lowest output growth in Yugoslavia's post-war history (Table 4). As a result of these measures, a small current account surplus was achieved. The current account surplus (financed mainly by government borrowings) was considered a success, since the balance of payments stabilization was the primary policy objective of the 1970-75 period. However, one must not forget that the overall performance of the economy was below the targeted level, and therefore, must be careful in evaluating these results.

The revival of activities abroad (especially in OECD countries) improved the performance of exports in 1976. Even so, the share of OECD countries in total Yugoslav exports was still below the pre-recession 1972-73 period. Imports from major convertible currency areas fell, but an increase was realised with Eastern European countries as well as with oil-producing African and Middle East countries. This was an impetus for more expansive growth strategy through 1977-78. However in 1978, exports slackened significantly, which, combined with an increase in imports

caused, again, a large current account deficit and an increase in inflation. Furthermore, the existing problems were accelerated by unexpectedly high agricultural imports, an earthquake in Montenegro affecting tourism receipts, and the second oil shock. As a result, the current account deficit rose to \$3.7 billion.

Table 4. Main Indicators of the 1976-80 Period

	1976	1977	1978	1979	1980
Gross Material Product	3.9	8	6.8	7	2.2
Industrial Production	4	9.4	8.7	8.3	4.4
Agricultural Output	7	5	-6	6	-2
Exports	10.7	-4.4	-0.2	12.6	7.7
Imports	-4.4	12.2	0.6	18.5	-11.1
Retail Prices	9.4	13.3	13.4	21.9	29.9
Balance of Payments	165	-1582	-1256	-3661	-2291

Source: Ibid., p.14.

Note: With the exception of the balance of payments that is given in absolute terms, all the figures in the table represent growth rates.

Once again, the IMF entered the scene. A stabilization programme was instituted and the dinar was devalued by 30 percent against the US dollar. The current account developments and Structural Adjustment Loans directly impacted on the capital account. An actual debt increase was \$9.8 billion, instead of the planned \$6 billion. As a result, gross interest payments increased from

\$0.4 billion in 1976 to \$3 billion in 1980.³⁴

Throughout the 1970's, the Yugoslav economy was subject to a series of external and internal disturbances. The World Bank "Country Study" provides information on trends in external competitiveness based on a comparison of export unit value indices in dollars and a comparison of wholesale price-deflated or real effective exchange rate movements.³⁵ The data show relative stability in the price deflated effective exchange rates -- which is not unexpected, since the National Bank of Yugoslavia strictly followed the IMF's "devaluation strategy" trying to bring the level of domestic prices into line with world market prices. This part of the programme was evaluated by the World Bank as successful. However, the wage increase that normally follows the dollarization of prices, was evaluated as: "... a significant loss of competitiveness..," in terms of higher labour costs.

Despite all the problems, average growth performance during the 1960's was quite good. Except for agriculture, average annual growth was generally high throughout the period. Yugoslavia entered 1970's as relatively stable country in an intermediate stage of development. Still, the transition from an administrative to a socialist market economy was bound to create problems. Macroeconomic reforms (or, better to call them "experiments") instituted in late 1970's and early 1980's weakened the Yugoslav economy. In addition, Tito's death in 1980 widely opened the door

³⁴World Bank (1983) *Yugoslavia: Adjustment Policies and Development Perspectives*, Washington, D.C., p.16.

³⁵Ibid., p. 86.

to social and ethnic divisions. Growing decentralization in all spheres of the country's activity became the main barrier to further development of the federal system, resulting in political divisions between the Federal government and the governments of the Republics and Autonomous Provinces. In 1974 Ross Johnson wrote: *"...Looking to the future, the political shape of Yugoslavia will be influenced by several key factors. Much will depend on economic performance... The question for the future is whether the process of national affirmation will continue to postulate a Yugoslav community of nations or whether it will degenerate into exclusivist nationalism promoting national hatred of other Yugoslavs."*³⁶ Indeed, Yugoslavia's economic crisis of the late 1970's and 1980's aggravated further regional economic-political conflicts with explicit national consequences.

4. Stabilization Policies of the 1980's

4.1 Regional Development Problems

With a particularly rapid expansion of investment, Yugoslavia succeeded in maintaining relatively high growth rates throughout the 1960's and the 1970's. The continued application of development-oriented policies raised average living standards, although considerable differences in the level of economic development existed between the regions. Namely, rising regional disparities were observed in several economic indicators of regional development: income per capita, income per worker, output and employment. Although the post-war growth experienced by

³⁶Johnson, R. (1974), "Yugoslavia in the Twilight of Tito", *The Washington Papers*, vol. 2, The Centre for Strategic and International Studies, Georgetown University, Washington, D.C., p. 54.

some less developed regions was quite significant, the gap between these and the more developed regions was constantly increasing (Table 5).

Table 5: Regional Inequality in Yugoslavia (coefficients of variation)

	1964	1974	1984
Income per capita	0.45	0.54	0.54
Income per worker	0.16	0.1	0.16
Industrial output	0.76	0.74	0.72
Industrial employment	0.74	0.7	0.53
Output per worker	0.13	0.16	0.17

Source: Zarkovic-Bookman, M. (1991) *The Political Economy of Discontinuous Development: Regional Disparities and Inter-regional Conflict*, Praeger Publishers, Westport, Connecticut, p. 133.

As we can see, the lowest regional disparity occurred in income per worker and industrial productivity. The highest disparities were experienced in industrial output, indicating high concentration of industrial output by region. Therefore, a faster rate of economic development of the less developed regions, compared to the rest of the country, was one of the most important goals of Yugoslavia's postwar economic policy. The 1981-85 plan increased emphasis placed on domestic joint ventures, encouraging more explicit inter-regional economic linkages and unified domestic markets for goods and services. Unfortunately, the joint venture policy did not show too much success in the previous period. Nevertheless, 1981 results offered some hope: approximately 130 - 140 joint venture investment agreements were concluded in 1981 for a total value of about 50 billion

dinars. The majority of these joint venture investments were centred on the potential for increasing the production of energy and raw materials in less developed regions. As such, these projects were mainly based on capital-intensive technologies with very high costs per job created.

The problem of regional inequalities can most easily be seen in the case of the Autonomous Province of Kosovo. Although Kosovo shared the overall growth of the Yugoslav economy in the postwar period, its economic and social development lagged far behind the other less developed regions. The rest of the Yugoslav community made special efforts to bring this Province into the development level of other republics and province. The 1981-85 plan assigned 43 percent of the Federal Fund as well as 42 percent of all budgetary transfers to Kosovo.³⁷ The transfer of funds to Kosovo was supposed to give the Province the chance to restructure its economy in favour of more labour-intensive activities. As we shall see later, the problem of regional inequalities would take large proportions both because of the extent of these inequalities and because of existing national conflicts among regions. The Federal fund and budgetary transfers to less developed regions would become one of the major issues discussed by the secessionist republics: the "burden" of financing less developed regions was emphasized especially by Slovenia and Croatia.

4.2 Involvement of the IMF and the World Bank

The major external event in the early 1980's was hardening in the attitude of international capital markets toward lending in eastern Europe. Balance of payments difficulties and restricted

³⁷ World Bank (1983) *Yugoslavia: Adjustment Policies and Development Perspectives*, Washington, D. C., pp. 233 - 283.

access to foreign finance forced Yugoslavia to seek help from the IMF and the World Bank. At the beginning of 1981 the IMF approved a three-year credit of \$2.2 billion to Yugoslavia. After providing Yugoslavia with its financial support, the IMF secured a central role at a macro-economic level due to the conditionalities attached to its credit facilities. The scheduled disbursement of credit was conditional upon progress towards meeting specified targets. In addition, the disbursement of the World Bank funds as well as the policies of other creditors were also largely dependent on the Yugoslav agreement with the IMF. Therefore, the Yugoslav government, faced with very difficult economic problems, "decided" to follow the IMF's prescribed stabilization programs: restrictive monetary and fiscal policies, a cut in public expenditures, the reduction in the share of investment in fixed assets, and the introduction of more active policy of exchange and interest rates.

Like many developing countries, Yugoslavia was adversely affected by the crisis that struck the world economy during the 1970's. The Yugoslav response to the economic difficulties of the 1970's was the 1981-85 Federal Social Plan. The first half of the 1980 was characterized by a sharp acceleration in the domestic inflation rate (56 percent per year), accompanied by unsatisfactory export performance. As a result of these developments, in the second half of the 1981, the Commission of Federal Social Council on Problems of Economic Stabilization was established. Shortly after, the stabilization programme was announced. The Council's approach to curtailing inflation relied on restrictive monetary policy, stressing the importance of price, interest and exchange rate policies. According to the anti-inflation program, relative prices were to be brought into the level with the world prices. The exchange rate policy acknowledged the need for regulated depreciation of the dinar. The program recognized that there was high probability of accelerating

inflationary pressures, but regarded this as an acceptable price for realistic exchange rates. The main aim of the interest rate policy was to eliminate the problem of negative interest rates and to bring the mechanism of interest rates back to normal.

If we go back to the measures undertaken in the 1970's and compare them with these "new" measures introduced in the 1980's we can easily detect the IMF's "standard" policies of liberalization and stabilization. In both cases the first step was depreciation of the dinar done with an intention to "bring relative prices into the level with the world prices," and ensure more stable exchange rate policy. In addition, this was supposed to stimulate exports by making them cheaper to the foreign customers, and to hinder imports by making them more expensive to the domestic buyer. Given the importance of industry in Yugoslavia's trade, the industrial sector was to bear the burden of adjustment. According to the plan, Yugoslavia was to increase the competitive efficiency of manufactured goods in international markets, and to increase the rate of utilization of investments. The share of investment for priority activities: energy, ferrous metallurgy, nonferrous metallurgy, basic chemicals, and machinery and equipment industry, in total investment was planned to increase from 53 percent realized in 1976-80 period to 63 percent during the 1981-85 period.³⁸ It is important to stress at this point that there existed a large number of unfinished projects initiated in 1976-80 period. 43 percent of the planned investment in priority industries were intended for the completion of these ongoing projects. With respect to the agricultural sector, the 1981-85 plan was relatively optimistic and characterized by ambitious production targets. Namely, Yugoslavia was to become

³⁸Ibid., pp. 130 - 131.

self-sufficient in wheat, sugar and edible oil production by 1985. The individual agricultural sector was to bear the major burden of planned increases in yields and marketed output.

Given these elements of the 1981-85 plan, it is not difficult to establish close relationship between the plan and the conditionalities set by the IMF in return for the credit approved in 1981. However, the credit that Yugoslavia received from the IMF was barely enough to cover the current account deficit for 1980. With a steady fall in levels of real personal income since 1979, with imports of materials being cut back and stocks falling to a dangerously low level, with an increasing inflation and the fact that the economy was already suffering from serious external liquidity problems, it became obvious that Yugoslavia would not be able to meet its international commitments without large-scale, new credits. Therefore, in October 1981 the governor of the National Bank of Yugoslavia went to London to discuss a loan of \$400 million with the London Club. By the end of 1982 another loan for \$200 million was launched by private banks. The same year Yugoslavia received a visit from Tom Clausen, president of the World Bank, who promised financial support for restructuring policies in terms of \$300 - 350 million of new credits annually over the period of five years.

In April 1983, a large rescheduling package was announced, involving 15 countries and 583 creditor banks, with the following main elements:

- "(1) The refinancing of \$2.8 -3.2 billion of long, medium and short term liabilities owed to financial institutions or national governments;
- (2) A consortium loan of \$ 600 million to the National Bank of Yugoslavia;

- (3) A \$500 million bridging loan from the Bank for International Settlements, repayable by the end of 1983;
- (4) A structural adjustment loan and further project loans from the World Bank totalling \$400 million; and
- (5) New bilateral public loans totalling \$1.2 billion, \$600 million to be disbursed in 1983 and the rest during 1984 - 1985."³⁹

The 1982 - 1984 period was characterized by intensive economic policy efforts to restructure the economy in response to the balance of payments crisis. A large number of steps were taken in 1982 to ease the external constraint. However, the measures undertaken did not prove to have the expected results. In May 1982 new rules were laid down for the allocation of foreign exchange to give priority to debt-servicing payments. The policy of continuous adjustments to the exchange rate policy was recommended by the IMF, and accepted by Yugoslav authorities. The major goal of the policy was to promote exports to the convertible currency countries and to help a further shift in resources to the external sector. Starting in October 1982, the dinar was devalued by 17 percent. By May 1983, the effective depreciation of dinar undertaken in several steps amounted to 40 percent.

The policy of continuous devaluation resulted in an acceleration of inflation. It became highly uncertain whether Yugoslavia had sufficient potential for additional exports to the convertible area that would justify the size of the real devaluation conveyed. Indeed, due to an

³⁹ Dyker, D. (1990) *Yugoslavia: Socialism, Development and Debt*, Routledge, New York, p. 124.

underestimated effect of the real effective depreciation of the dinar and associated price increases,⁴⁰ inflationary pressures were much stronger than has been expected. Threatened by the inflation that could get out of control, Yugoslav authorities imposed a price freeze in January 1984. For the first five months of 1984, the increase in retail prices fell to 6 percent (compared to 60 percent in 1983), excluding certain increases in administered prices. However, price controls led to a rigid price structure and a low elasticity of demand with respect to the prices of imported goods on which Yugoslavia was highly dependent (for example, petrochemical products). This had negative effects on exchange rate policy, preventing it from fully affecting imports and domestic demand, and making a drastic change of the exchange rate necessary in order to achieve the same results.

Figure 4 shows the main economic indicators for 1975 - 1989 period of structural adjustment in Yugoslavia. Some positive results were accomplished. The balance of payments on current account was back in surplus by 1983, and by 1986 totalled nearly \$1 billion. During this period imports were relatively stabilized, but exports did not see much of improvement until 1987. Furthermore, export volumes to the developing group of countries (mostly machinery and equipment exports) slackened dramatically.⁴¹ Obviously, the current account surplus was due to inflows of new loans in 1982 and a large rescheduling package in 1983.⁴² The country's exchange rate policy, in

⁴⁰ OECD (1984) *Economic survey: Yugoslavia*, Paris, p. 13.

"...By the end of 1983 consumer price increases reached 60 percent, compared with 44 percent from the previous peak."

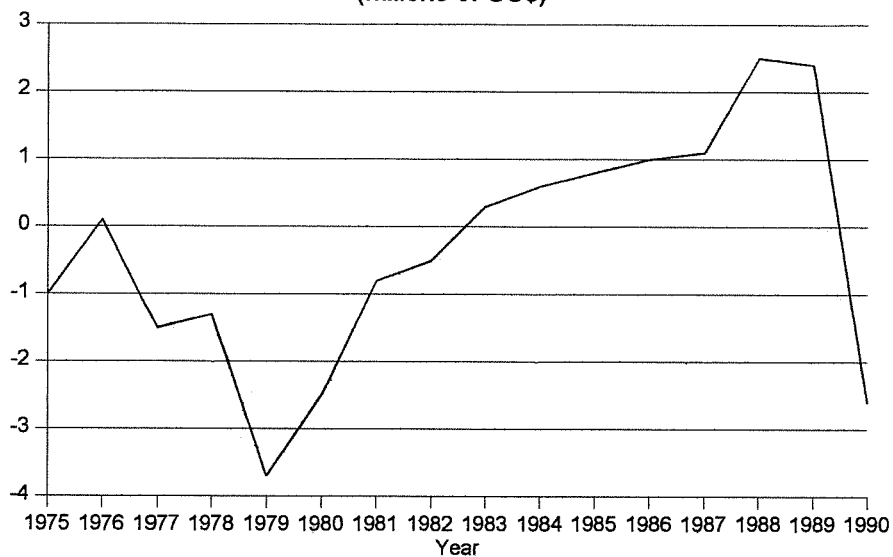
⁴¹ *Ibid.*, p. 31.

⁴² The level of external debt increased from \$15.2 billion in 1979 to \$22 billion in 1987.

Figure 4.

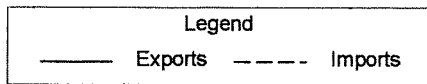
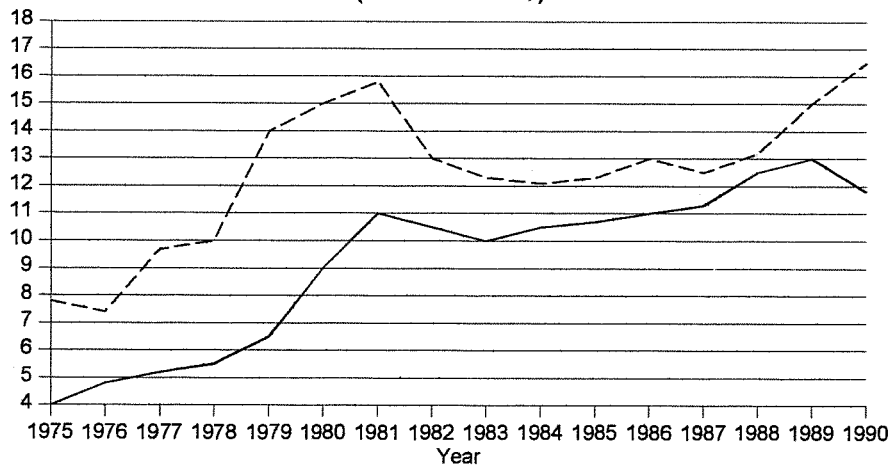
Current Account, 1975 - 89

(Millions of US\$)



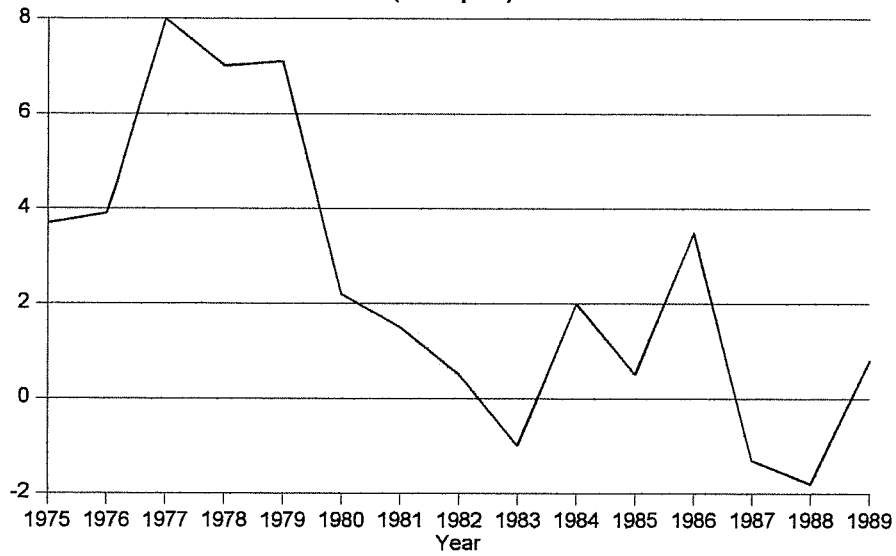
Exports and Imports, 1975 - 89

(Millions of US\$)



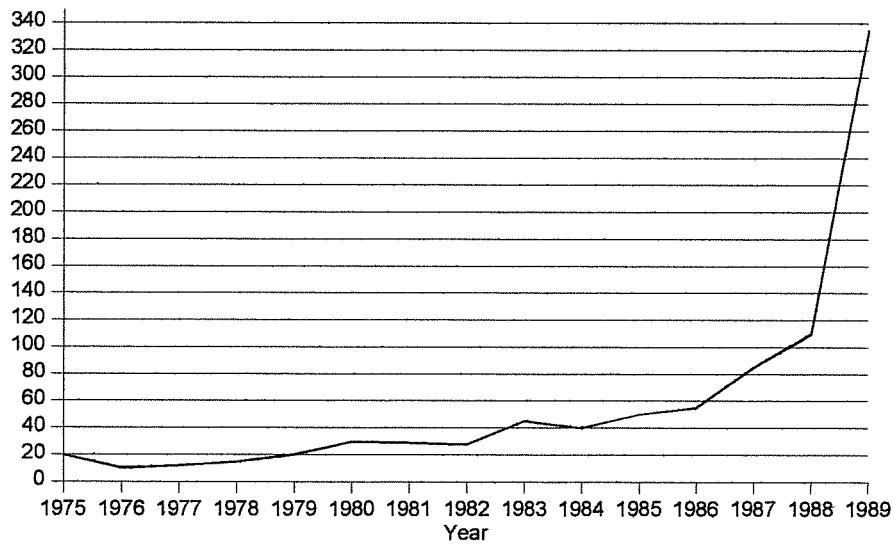
Real GSP Growth, 1975 - 89

(in % p.a.)



Inflation rate, 1975 - 89

(CPI)



Source: World Bank (1990) *Yugoslavia: Financial Sector Adjustment Loan*, Washington, D.C., p.2

general, could be described as a race by the authorities to keep the rate of devaluation ahead of the rate of inflation. Black-markets all over the country were blooming -- black-market rates for the dinar against the US dollar were 50 - 100 percent higher than the official rates. The intensification of direct control over imports and exports promotion policy resulted in an aggregate deficit in key consumer goods, including petrol, sugar, detergent, cooking oil and coffee.⁴³ Shortages of imported raw materials hit hard the production and resulted in the fall of the real GSP (gross social product). Decline was also exhibited in the productivity level. During the 1980-88 period, productivity in industry declined at an average annual rate of 0.5 percent. In fact, seven of the ten sectors saw negative productivity growth rates.⁴⁴ However, efforts to stimulate output growth were not directed equally to all sectors; they were conducted on a selective basis paying more attention to the following four sectors: industry, catering, construction, and transportation. Output growth in catering sector was very important because it covered the Yugoslav tourist industry, which provided an access to foreign exchange.

The performance of the industrial sector exhibited serious problems in the 1980's. Industrial performance deteriorated significantly with output growth falling from 3 percent per annum in the first half of the decade to 0 percent in 1987 and 1988. Unsatisfactory performance of the industrial sector resulted in part from the combination of distorted relative prices and controlled resources.

⁴³ Dyker, D. (1990) *Yugoslavia: Socialism, Development and Debt*, Routledge, New York, p. 131.

⁴⁴ Gapinski, J. (1993) *The Economic Structure and Failure of Yugoslavia*, Praeger Publishers, Westport, Connecticut, pp. 118 - 119.

Deep recession induced by the liquidity crisis of the 1982 -1983 and the IMF's "liberalization" policy transformed the current account deficit into accelerating inflation. Measures introduced in the 1980's were based on a large-scale devaluation strategy: in less than a year (from October 1982 to May 1983) total effective depreciation of dinar undertaken in several steps amounted to 40 percent. This was done in order to stimulate exports and hinder imports. However, given that the Yugoslav economy was largely dependent on imported raw materials, it was not surprising that the industrial performance deteriorated dramatically. As a result of this "devaluation" technique, nominal interest rates increased, putting credit out of reach for the majority of enterprises. Industry was virtually left without sources of financial help and means for financing the production. Thus, even if export terms had been favourable, Yugoslav enterprises were not able to produce enough to export.

As we can see, macroeconomic imbalances were constantly deteriorating despite government efforts to bring the country back on the right track. Five years of high but fluctuating increases in prices had negative impact on both consumer demand and public consumption. Relaxation of price controls and the shift of policy emphasis in late 1984 from demand restriction to a revival of growth resulted in even more inflationary climate. Namely, in January 1985 prices of more that 85 percent of goods and services were fully liberalized -- as a result, the inflation rate went out of control.

4.3 The Reforms of 1985

In order to reverse unsatisfactory trends, fundamental reforms were introduced in June and July of 1985. The main goals of these reforms were:

"(1) To stop all "non-economic" investment and to reduce the growth of government

consumption by decreasing taxes;

- (2) Price increases covering about 40 percent of industrial producer goods were deferred for 120 days -- this measure was equivalent to a partial four-month price freeze;
- (3) Directives were issued to enforce the laws on the distribution of enterprise income and to raise the share of capital accumulation, thereby encouraging a deceleration in the growth of average earnings during the remainder of 1986;
- (4) The dinar was devalued in effective terms by 14.4 percent in June 1986 in order to improve Yugoslavia's competitive position by 10 percent;
- (5) Exporters to the convertible currency countries would receive a higher level of tax-drawbacks than the rest of the exporting sector; and
- (6) Banks were asked to give priority credit to export industries, agriculture and to tourism for the direct promotion of exports and for financing imports of materials to be processed for re-exporting.⁴⁵

To help put these measures into effect, a new Banking Law was adopted in 1985. The main aim of the law was to increase financial discipline. Namely, strict rules limited banks' lending to loss-making enterprises or to those who had not settled previous obligations. However, banks were still owned and directed by enterprises. Therefore, the allocation of funds was still highly dependent on the controlling power of enterprises rather than on sound economic criteria.

By the end of 1987, the economic situation was no better than it had been in the early 1980's.

⁴⁵ OECD (1987-88) *Economic Survey: Yugoslavia*, Paris, p. 21.

In May 1988, in an attempt to break the cycle of stagflation, the Yugoslav authorities, supported by the IMF stand-by arrangement and agreements with the commercial and official creditors, announced the so-called "May Anti-inflation Program."⁴⁶ The program was based on further restrictive fiscal, monetary and income policy measures, with large-scale import and foreign exchange liberalisation. The increase in wages was fixed at 122 percent for 1988, which was slightly below projected price increase. With an introduction of the market liberalisation policy, wage ceilings were lifted in 1989. The projected reduction of the aggregate rate of inflation was 95 percent during 1988 and 60 percent in 1989. By November 1988 the prices of industrial products were fully liberalized, and at the end of 1989 all indirect regimes of price control were abolished. All these measures, coupled with 25 percent devaluation of the dinar, resulted in a wave of hyperinflation.⁴⁷ However, this is not surprising when we know that the large-scale devaluations that do disrupt the entire price system (the price system will follow the devaluation trends) go hand in hand with inflation.⁴⁸

⁴⁶ Chossudovsky, M. (1995) *Dismantling the Economy of Former Yugoslavia*, Paper presented at: The Other Face of the European Project, Alternative Forum to the European Summit, Madrid, p. 2.

⁴⁷ OECD (1989-90) *Economic Survey: Yugoslavia*, Paris, pp. 12 - 16.

⁴⁸ This "dollarization of prices" affects people in sense that they lose confidence in their currency so they start saving in hard, foreign currency, sometimes even using foreign currency as unit of account.

5. The Disintegration of Yugoslavia

After almost three decades of rapid and diversified growth, Yugoslavia's economic performance in the 1980's was rather discouraging. Almost a decade long, continuing crisis had enormous effects on the population's standards of living. Real wages in Yugoslavia in 1987 were 37 percent less than in 1978.⁴⁹ The overall percentage of people estimated to live below the official poverty line was at 17.5 percent in 1978, 21.5 percent in 1984, and 24.8 percent in 1987. Just to compare, in 1984 only 1 percent of Japan's population lived below the poverty line; and in the 1960's Yugoslavia had growth rates higher than Japan.⁵⁰ Furthermore, poverty was not anymore predominantly rural as it was at the end of the 1970's: gradual impoverishment of existing urban labour made it an urban phenomenon.

Unsatisfactory economic performance and deteriorating standards of living accompanied the further decentralization of the federal system and gave wings to regional economic competition and fuelled the development of nationalist ideology. Given the large differences in regional levels of development, economy became an ethnic issue, creating a link between nationalism and economics. With continuing large falls in output and private consumption, rising unemployment and high rates of inflation, the country was faced with increasing social and political turmoil and the future contours of Yugoslavia's political system became highly uncertain. Any attempt to cure

⁴⁹ Milanovic, B. (1990) *Poverty in Poland, Hungary, and Yugoslavia in the years of Crisis, 1978 - 1987*, World Bank, Washington, D. C., p. 7.

⁵⁰ *Ibid.*, p. 11.

these problems was bound to fail because no political agreement between the Yugoslav republics and autonomous provinces could be reached: federal constitutional system allowed each of the six republics and two autonomous provinces to veto any decision of the Federal Parliament. The principal reasons for this inefficiency of the federal system lay in the 1974 constitutional reform that transferred political power to the republics and autonomous provinces.

5.1 The Reforms of 1989-90

In the face of these developments, the government of Branko Mikulic resigned in late 1988. A new government headed by Prime Minister Ante Markovic assumed office on March 16, 1989 under the condition that the government would not be supervised by representatives of republics and provinces and there would be no interference by political bodies in government activities. Economic reforms were immediately introduced aiming at the transition of Yugoslav economy to a western-type market economy. The first part of these reforms, focusing on stabilization, began on December 19, 1989 with the new anti-inflation program comprising the following measures:

- (1) a new currency unit was introduced with one new dinar equalling 10,000 old dinars;
- (2) the dinar was made convertible and pegged to the Deutschemark (DM) at an exchange rate of 1 DM to 7 dinars;
- (3) wages were frozen for six months at their level from December 15th; and
- (4) prices of 25 percent of industrial goods were frozen as of January 1st, and a price stop was decreed for rents and other housing charges.⁵¹

⁵¹ OECD (1989-90) *Economic Survey: Yugoslavia*, Paris, pp. 12 - 16; see also World Bank (1990) *Yugoslavia: Financial Sector Adjustment Loan*, Washington, D. C., pp. 10 - 13.

The major goal was to decrease the inflation rate that just in 1989 jumped from 2,700 to 10,000 percent.⁵² Another goal was to decrease the unemployment rate that was in 1989 around 14 percent. However, resolving the unemployment problem meant a conflict with efforts to bankrupt inefficient enterprises.

Obviously, the new government was determined strictly to follow the IMF and the World Bank policy "proposals." Given the fact that in 1986 Yugoslavia abandoned its stand-by arrangement with the IMF,⁵³ which worsened its relationship with the international financial community, we can easily imagine the difficulty of the situation in which the Prime Minister Ante Markovic had found himself after assuming the office in March 1989. Contrary to previous stabilization policies based primarily on the exchange rate adjustments, the new government decided to fix the exchange rate of the dinar against the Deutschmark, hoping that this measure will impose strong anti-inflationary discipline and have strong psychological impact. Namely, previous devaluations had negative effects on the Yugoslav people's confidence in their national currency and banking system. Because of that, many domestic transactions were carried out in Deutschmarks rather than in dinars. By restoring the people's confidence, the federal government hoped to attract more bank deposits and considerable amounts of convertible currency that would increase the level of the foreign exchange reserves.

⁵² Zarkovic-Bookman, M. (1994) *Economic Decline and Nationalism in the Balkans*, St. Martin's Press, New York, p. 96.

⁵³ Dyker, D. (1990) *Yugoslavia: Socialism, Development and Debt*, Routledge, New York, p. 158.

Despite all the problems that new government was facing, the assessment of the reforms in mid-1990 was quite positive. The stabilization programme showed good results in terms of declining the monthly rate of inflation from 60 percent in December 1989 to almost 0 percent in the second quarter of 1990. As Zivko Pregl, the Deputy Prime Minister of Yugoslavia stated:

*"... There was little money in the market, so that even without a freeze on incomes, enterprises would have had a very slim chance of raising it. Also because money was scarce, the market demand was restricted, and frozen producer prices could not be increased. By putting a freeze on some categories in enterprises, we created psychological security; enterprises would not have to expect cost shocks on personal incomes and some key material inputs, such as imports, energy, and transport. This caused the enterprises to refrain from exerting pressures for increases in their output prices. In fact, in February, March, April, and May of 1990, many enterprises reduced their prices."*⁵⁴

Indeed, after more than a decade long constant problem with inflation, zero monthly inflation sounded almost like a dream. Unfortunately, the dream was just too good to be true. Within the period of five months, with an introduction of tight credit policy, liberalization of imports, and a new Banking Law and a Law on Enterprises with more severe bankruptcy rules, 350 enterprises became bankrupt affecting 210,000 workers. Some 15 - 20 percent of the labour force was not paid during this period in order to allow enterprises to meet their obligations and avoid bankruptcy.

⁵⁴ Pregl, Z. (1992) "Political and Economic Reforms," in *Yugoslavia in the Age of Democracy: Essays on Economic and Political Reforms*, Macesich, G. (eds), St. Martin's Press, New York, pp. 55 - 61.

5.1.1 Financial Sector Restructuring

Since the 1970's the Yugoslav banking system had a three-tier structure including:

- 147 Basic (commercial) banks which were funded, owned and directed almost exclusively by enterprises;
- 9 Associated Banks which handled foreign exchange and large borrowing operations; and
- more than 200 Internal Banks organized within enterprises to conduct their payment, lending and credit transactions.⁵⁵

According to the World Bank analysis, the system was evaluated to have serious shortcomings, especially in the area of credit allocation and pricing decisions. Therefore, the three-tier banking structure became the main objective of the banking system reforms. The reform was initiated by

1989 Laws on NBY, banking and bank rehabilitation emphasising following measures:

- Banks must become profit-oriented, independent business entities;
- Equity investment in banks must be opened to different parties: individuals, foreign investors, etc; and
- Dismantling of the three-tier banking structure.

These measures were highly recommended by the World Bank constituting the conditions of the second tranche of financial sector adjustment loan. A new accounting framework was developed by Coopers & Lybrand Deloitte -- it also had to be approved by the World Bank before reaching the Yugoslav authorities. The 1989 Law on Rehabilitation, Bankruptcy, and Liquidation of Banks hit hard all the banks, whose potential losses were exceeding 50 percent of their capital. As of June 30,

⁵⁵ World Bank (1990) *Yugoslavia: Financial Sector Adjustment Loan*, Washington, D. C., p. 5.

1990, only 78 banks successfully came out of the process of restructuring and were granted licences by the NBY. The banks that were illiquid at that time or banks for which "emergency across-the-board restructuring program" did not yield the desired results were to be covered by the case-by-case program in a longer period of time.⁵⁶

5.1.2 Industrial Sector Restructuring

Another aspect of 1989 reforms was the restructuring of the enterprise sector. The principles of social ownership of capital and of worker self-management were emphasised as the major problems generated by Yugoslav social and economic system. Therefore, the program for enterprise transformation and restructuring placed emphasis on the recapitalization and reprivatization of socially owned enterprises. The idea was to allow workers *"to purchase internal shares in the enterprise up to three times their net personal earnings, at share prices discounted in proportion to their years of service... With the sale of internal shares, the enterprises were to be transformed from socially-owned to mixed ownership... In the second instance, the internal shares could then be sold on the market, at which time a separate valuation of the enterprise would be required, to ensure that the sales of social capital and assets took place at appropriate prices."*⁵⁷ The Law initiated the great debate among Yugoslav economists. The question was: What are the appropriate prices for socially-owned enterprises? Unfortunately, Yugoslavia stopped existing before anyone was able to answer this question.

⁵⁶ Ibid., p 15.

⁵⁷ World Bank (1991) *Yugoslavia: Industrial restructuring Study*, Washington, D. C., pp. 23 - 24.

The 1989 Financial Operation Act established the so-called "exit mechanism" for enterprises who were insolvent for 30 days running, or for 30 days within a 45 day period -- giving them a "chance" of arriving at a settlement with their creditors. Otherwise, bankruptcy procedures should be initiated. For 1989, the World Bank estimated that, out of the total of 7,713 enterprises, 2,170 were loss-making. For the period Jan-Sept 1990, the number of loss-making enterprises increased to 2,435, with the number of employees equal to 1,345,290. The heaviest impact of the exit mechanism was on smaller enterprises -- larger firms somehow were able to avoid liquidation. Table 6 clearly shows a dramatic increase in the number of bankruptcies and liquidation during 1990 compared to 1989, especially among small enterprises.

Suffering from serious problems for years, the Yugoslav industrial sector was devastated by the effects of industrial restructuring program. Liberalization of trade regime and convertibility of the dinar led to a boom in the import of consumer goods. Competitive pressures of price and import liberalization on domestic enterprises were larger than ever. In the situation where domestic producers were unable to compete with cheaper and more attractive imported goods, a large number of enterprises were simply wiped out from the market, leaving more than half million of people without work, and thereby without means of support (Table 6).

Constantly deteriorating economic conditions resulting in falling standards of living and waves of strikes exposed the frightening reality: the uncertainty of Yugoslavia's tomorrow. The Prime Minister Ante Markovic was accused from almost all Yugoslav nationalities for exercising favouritism among republics. As a result, unilateral actions were undertaken by some republics and

the federal system was unable to fight their obstinate actions. Markovic's economic reform was more and more hindered with relations among the country's various ethnic groups. Disagreements

Table 6. Bankruptcies and Liquidations

	Bankruptcies			
	1989		1990 (Jan-Sept)	
Size of firm by no. of workers	No. of firms	No. of workers	No. of firms	No. of workers
less than 200	119	7800	451	20100
from 200 to 500	61	19000	181	61500
from 500 to 1000	20	13300	105	73100
more than 1000	22	48200	130	367400
Total	222	88400	867	522100
	Liquidations			
	No. of firms	No. of workers	No. of firms	No. of workers
Size of firm by no. of workers				
less than 200	24	600	15	700
from 200 to 500	2	500	7	2300
from 500 to 1000	—	—	—	—
more than 1000	—	—	—	—
Total	26	1100	22	3000

Source: World Bank (1991) *Yugoslavia: Industrial Restructuring Study*, Washington, D. C., p. 34.

regarding the economic reform were quickly reflected in the political arena, giving the wings to the raising nationalism. Namely, Slovenia and then Croatia maintained that their hard-earned money

had been wasted and inefficiently used in the less developed regions. The less developed regions: Kosovo, Macedonia and Montenegro complained that the transfer of funds from more developed to less developed regions, instead of eliminating economic disparities, had actually generated uneven development. Furthermore, the federal government was accused by Serbian authorities of deliberately pursuing policies aimed at impoverishing Serbia. Relying on nationalist agitation to divert attention from economic and social problems, republic leaders challenged the federal system, and unfortunately were highly successful in disintegrating the country.

5.2 The Fall of Yugoslavia and the Prospects of the Successor States

The formal secession of Slovenia and Croatia in October 1991 marked the end of the Socialist Federal Republic of Yugoslavia. Macedonia left the federation in April 1992, followed by Bosnia-Herzegovina in August of the same year. Serbia and Montenegro formed the new Federal Republic of Yugoslavia. The former Yugoslav republics, Slovenia, Croatia, Macedonia and Bosnia and Herzegovina, all undertook separate loan negotiations with the Bretton Woods institutions. The new Federal Republic of Yugoslavia followed somewhat different path. In 1992 sanctions were imposed on the new Yugoslavia for its involvement in the Bosnian war. They included the following measures: all trade was to cease; all foreign assets of the country were to be frozen; air traffic was to be suspended; monitoring ships were to inspect cargo passing into the Adriatic Sea and the Danube River; and the restriction of truck and train passage to a few border points. Moreover, the new Yugoslavia suffered from a lack of international recognition, contrary to other new-born states. The effects of the sanctions on the new Yugoslav economy were devastating. The most serious aspect of the sanctions was its effect on prices: in May 1993 inflation was at 205 percent monthly

and 84 million percent annually. Few months later (in August 1993), the situation became dramatic: monthly inflation jumped to 1,880 percent and the annual rate could not be expressed in words -- it was 363,000,000,000,000,000 percent. In addition, per capita national income dropped from \$3,000 to \$300, industrial output fell by 40 percent and half of the labour force lost their jobs -- it was estimated that 97 percent of the population was living at the poverty level.⁵⁸ It is difficult to say whether this economic disaster was due only to the sanctions or it was also associated with the reforms undertaken in the former Yugoslavia before its breakdown. In any case, considering the long-lasting effects of 1992-93 economic disaster, future prospects of the new Yugoslavia do not seem very promising.

With respect to the prospects of other successor states, one can only hope that the IMF and the World Bank projects will be more successful this time -- although this is hard to believe, considering the similarities between the programs implemented in the former Yugoslavia and those undertaken by the successor states. The worst situation is in Bosnia and Herzegovina, which suffered enormous human and material damage during the four-years long civil war. In addition, the peace agreement signed on December 14, 1995, in Paris still does not provide more hope into peaceful future -- a fragile peace can end any day. A financial assistance necessary for Bosnia's economic "recovery" is estimated to a minimum of \$5.1 billion over the 1996-98. Unfortunately, much of the financial support that Bosnia will be getting is tied to servicing its external debt. It was estimated that under the best possible scenario Bosnia would need 7 - 9 years to recover to the pre-war level

⁵⁸ Zarkovic-Bookman, M. (1994) *Economic Decline and Nationalism in the Balkans*, St. Martin's Press, New York, pp. 114 - 118.

of GDP. Let just hope that these projections are really attainable.

To break this circle of pessimistic expectations, I must mention Slovenia: the most developed former Yugoslav republic. Thanks to the superior competitiveness of Slovenia's economy compared to all other former Yugoslav republics, it seems that Slovenia stands better chances of surviving the Balkan crisis. The richest post communist state, with a GDP per capita over \$6,000 has good chances of soon becoming a full member of the European Union.

6. Concluding Remarks

Since Yugoslavia's historic split with Stalin in 1948, the country had followed its own development path maintaining an independent international position called "nonalignment." The socialist market economy based on extensive indicative planning and the participation of employees in management enjoyed international popularity for quite some time. Up to early 1970's, Yugoslavia was a success story with one of the highest rates of economic growth in the world and highly developed social, health and educational systems.

One would expect that a country like Yugoslavia -- the country with three religions, four languages, two alphabets, six nations and even more national minorities, six federal states and seven neighbours, the Balkan country that was the meeting place of three large world cultures for centuries -- would have a rather "exciting" history. However, it is difficult to conceive that Yugoslavia's

history had to be so short. Years of worker self-management, public ownership that "no one was responsible for", overinvestments in unprofitable projects and mismanagement of profitable ones, and overdependence on foreign funding filled the glass almost to the top. Obviously, Yugoslavia's economic development followed a path that was too capital and energy intensive, given its resource endowments. As a result, a dual economy was developed: there were large-scale, capital-intensive but also the least efficient firms with high access to loans on one side, and small, labour-intensive enterprises with low access to investment credit, on the other side. Mismanagement and low capital utilization were inevitable consequences of Yugoslav approach to economic development. However, it would be quite wrong to attribute Yugoslavia's breakdown only to Yugoslav authorities and their economic policy-making. It would be also quite wrong to suggest that the IMF and the World Bank conditionalities had no impact whatsoever on Yugoslavia's economic situation. Indeed, changes were highly desirable; but, were the measures implemented in Yugoslavia the right ones!?

The IMF conditionality packages and the World Bank projects largely failed to have the expected impact on the Yugoslav economy. Maybe, if these projects were created so to take into consideration very specific characteristics of the Yugoslav system, the results would have been better than they were. My impression is that a more realistic program should have included certain elements of state intervention that would provide more consistent economic policy and much tougher approach to financial and monetary discipline. In any case, we can only speculate on what approach would have given better results, and whether it was possible at all, considering the violent and destructive history of Yugoslav peoples, to save the country and keep it in one piece. Maybe, the former Yugoslav nations have better prospects now than they had within Yugoslavia?!

To conclude I would, once again, like to use the words of Ivo Andric: "...*The Bridge stood there as it was condemned, but still in one piece and untouched, between the two belligerent worlds...It looked like the white, old bridge which survived through centuries with no traces and scars will -- under new tzar-- stay the same and resist the changes to come.*"⁵⁹ Indeed, many expected the bridge to survive, but it didn't. Will someone build it again? That remains to be seen.

⁵⁹Andric, I. (1962) *The Bridge on the Drina*, Knopf, New York, p. 179.

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