

The Carl Beck Papers
in Russian and East European Studies

No. 707

The Yugoslav Economy

Systemic Changes, 1945-1986

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July 1989

ISSN 0889275X

The Carl Beck Papers:

Editors: William Chase, Bob Donnorummo, Ronald H. Linden

Assistant Editor: Rosemary Anderson

Design and Layout: Robert Supansic

Submissions to *The Carl Beck Papers* are welcome. Manuscripts must be in English, double-spaced throughout, and less than 100 pages in length. Acceptance is based on anonymous review. Mail submissions to : Editor, *The Carl Beck Papers*, Center for Russian and East European Studies, 4G21 Forbes Quadrangle, University of Pittsburgh, Pittsburgh, PA 15260.

In the theory of economic systems, the Yugoslav economy serves as the one example of the self-managed, participatory, labor-managed, socialist market economy. Benjamin Ward's "Illyrian firm" (Ward, 1958), Evsey Domar's "producers' cooperative" (Domar, 1966), Jaroslav Vanek's "labor-managed market economy" (Vanek, 1970) and Branko Horvat's "realistic model" (Horvat, 1972) have all been directly or indirectly inspired by the particularities of the Yugoslav institutional setting. This setting has, however, not been very stable. Thus, Yugoslav post-war systemic development is often divided into distinct systemic periods. Four periods will be distinguished here:

1. Administrative Socialism or the period of Soviet-type economic system (1945-1952);
2. Administrative Market Socialism (1953-1962), sometimes referred to as the period of decentralization; which gradually led to
3. Market Socialism (1963-1973);
4. Contractual Socialism (1974 to the present), also referred to as the period of income relations.

The periodization is normative, with four post-war constitutions (in 1946, 1953, 1963, and 1974) forming the basis; the starting years of the periods are the years in which new constitutions were passed. Such periodization, based on constitutional rules for the functioning of the economy, is open to criticism. First, it creates the notion of abrupt changes, which did not occur. Second, some far-reaching institutional changes preceded the constitutional changes, but others were established only after the new constitution was adopted. Third, the gaps among the ideologies represented by the specific constitutions, the actual normative setting, and reality have always been wide. Fourth, some economic policy changes have had greater impact on the actual economic development than systemic changes. The 1965 economic reform which was dominated by a macroeconomic policy change (Bajt, 1984; Burkett, 1983) has even

been considered the turning point between the "more successful" and the "less successful" period of the labor management (Horvat, 1971; Sapir, 1980). The same is true for 1980, when the change of economic policy forced by indebtedness caused a similar turning point in all measurable performance indicators. The periodization is, however, closely related to the normative allocation of decision-making within the economy.

In "administrative socialism" (1945-1952) the answers to basic economic questions were to be given by planners. In other words, valuation, organization of production, income distribution, and savings-investments decisions were to be centrally directed.

After 1952, Yugoslavia started to move away, step by step, from centralized economic planning by reducing administrative constraints and by giving enterprises a more independent role in decision-making. While the birth of the new system can be attributed to the Law on Management of Government Business Enterprises and Higher Economic Associations by Workers' Collectives, enacted in 1950, its basic legal and political features were explicitly defined in the Constitution Act of 1953. It is this system which, according to the theory on economic systems, often serves as the one example of a socialist market economy or of a socialist self-managed economy. Up to the early sixties, self-management was rather limited even in a normative setting. In short, in the 1953-1962 period two of the basic economic decisions, namely decisions on income distribution and the savings/investment decision, remained under strict government control, while the question of what to produce was to be decided upon by consumers, and independent enterprises were free to decide how to organize production and how to combine productive factors.

Although many systemic changes occurred during the sixties, two reforms, in 1961 and in 1965, can nevertheless be distinguished. Due to these reforms, the mechanism of economic control was reduced, the autonomy of economic units increased, and a phase referred to as "market socialism" was initiated. With the abolition of wage controls and with increased decentralization of investment, the remaining two basic economic

decisions, i.e., on income distribution and capital allocation were, at least formally, transferred to independent enterprises.

By the early seventies, important institutional changes were introduced. They started with the constitutional amendments in 1970, which were to be the blueprint for the so-called associated labor concept of the self-managed economy. Although they did not formally question the proclaimed basic elements of the socialist market system, the changes were so far-reaching that the market character of the Yugoslav economy has become questionable. To a considerable extent, the associated labor concept rejected two components of the market economy: the market as the basic allocative mechanism; and macroeconomic policy and indicative planning as means of indirect regulation of economic activities. In the 1970s these were replaced to the greatest extent possible by mechanisms of social contracts, self-management agreements, and wide-ranging social planning. In short, the problem of who is to answer basic economic questions became blurred.

The normative periodization raises the question of what were the reasons for systemic changes. If the rather mystical "development of productive forces" is not accepted, the question is reduced to a simpler one, namely whether the reasons (and the goals) of the systemic changes were inspired predominantly by economic or political considerations. Although it is not easy to answer this question, it seems that the political factors prevailed in the abandonment of the Soviet-type, centrally-planned system in the early fifties and in the adoption of the associated labor concept in the early seventies, while the reforms in the early and mid-sixties were prompted predominantly by economic considerations.

The motives for changes in the early fifties have not yet been fully explained. According to "official beliefs," the change can be explained by the predispositions of Yugoslav political leaders long before the break with the Soviet Union. This can hardly be proved by developments before or after the break. A favorable conjunction of events and circumstances, i.e., that the war of liberation was in large part of independent effort and

that the Soviet model was voluntarily adopted, enabled rapid rejection of the Soviet model. But there is no evidence that the workers' self-management was "in the air before it was officially introduced by the government" (Gurvitch, 1966). The organization of the economy, the overwhelming nationalization of practically every economic activity, including typical non-capitalist forms of production, and by far the strongest pressure for forced collectivization of agriculture after the break with the Soviet Union indicate the opposite. Bad economic results, the difficulties encountered after the break, and the need to adapt to the new environment were no doubt important. Nevertheless, the ideological and political, rather than economic, issues were decisive in the search for new forms of socialism, organization and planning different from those of the Soviet Union. The opinion that something had to be invented quickly appears to be close to the truth, and can be confirmed by the writings of Yugoslav political leaders at that time.

According to Boris Kidric, one of the architects of the economic system in both the first and second period, state ownership was the highest form of the ownership of the means of production and planning was the fundamental law of socialist development (Kidric, 1949, 1950a). However, in less than one year state ownership was altered to being only the first and the shortest step of the socialist revolution, and the building of socialism required the transformation of state socialism into a free association of direct producers (Kidric, 1950b). Very soon, similar statements were repeated by practically all Yugoslav social scientists. The ability of Yugoslav politicians and social scientists to reread and to reinterpret Marx according to daily needs was established for the first, but not the last, time.

The actual motives for the changes in the seventies, officially undertaken to enforce the basic elements of the system of self-managed socialist economy, can be grouped into economic, social and political categories. Among these categories, economic development after the 1965 reform was the most important. Enforcement of the market, combined with the

restrictive macroeconomic policy measures adopted after the 1965 economic reform, produced predictable though not anticipated results. The growth of the economy slowed considerably. Social and political consequences of rapidly increasing unemployment resulting from both the long-run development on the supply side and the short-run slack in the demand for labor could only be alleviated by the massive exodus of workers abroad. The cost push inflationary pressures emerging from the increased freedom of enterprises in the distribution of income resulted in inflation. The balance of trade worsened and Yugoslavia's share of world exports started to decline, though balance of payments deficits were offset by the remittances of workers abroad and flourishing tourism. The economic aims of the reform were not realized, and economic reform was more and more considered a failure, signaling an end of the "Yugoslav economic miracle" (Sapir, 1980).

Rather poor economic performance was accompanied by even less desirable developments in the social and political domain. Social property defined as property of "each and all", meaning the free access of each and all to the existing means of production, "degenerated" into group property (Bajt, 1980). The inequalities among individuals and among regions increased, causing social and political tensions among republics. Furthermore, the concentration of economic power in the hands of managerial elite-technocrats (though predominantly members of the Party) not only endangered the workers' control in the enterprises, but threatened to deprive the Party bureaucracy of political control. The last mentioned point is also very important for the changes of both the economic and the political system. Institutional changes emerged as inevitable if the system, and particularly the political power of the LCY (The League of Communists of Yugoslavia) and its actual control of social, political, and economic development, was to be saved. The market proved socially and politically less neutral than assumed in both the Langean theory of decentralized socialism or in the theory of labor-managed socialism.

"Contractual" Socialism, 1974-1986

The Normative Setting

The new economic system was shaped by Edvard Kardelj, who dominated Yugoslavia's economic and political thinking for more than twenty years. Again, there were no difficulties finding the roots and explanations in Marx's teaching, and again, the Yugoslav social scientists were practically unanimous in praising the reforms. Rare doubts were pushed aside. The system was legalized by the Constitution of 1974 and the Associated Labor Act in 1976. In the following years every single part of the economic system was gradually affected, and entirely new and awkward terminology was introduced. Only the most important institutions can be sketched here: the new organizational forms; the so-called income relations and pooling of labor and resources; the institutions of free exchange of labor; and the system of social planning.

The Basic Organization of Associated Labor (BOAL) was introduced as the basic organizational unit. According to the Constitution and Associated Labor Act, workers realize their socio-economic and self-management rights in the BOALs. The relationships among workers within and among BOALs, within Working Organizations (WO, enterprises) and within Composed Organizations of Associated Labor (COAL) are formulated by the Self-Management Agreements (SMAs). Maximization of income was proclaimed to be the basic objective function of BOALs, WOs, and COALs. This "resolved" the debate of what is the appropriate objective function for a worker-managed economy which was started by Ward's "natural and rational" rule (Ward, 1958) more to the satisfaction of most foreign scholars in the field (Domar, 1966; Vanek, 1970; Sapir, 1980) than Yugoslavs (Horvat, 1972; Dubravcic, 1970).

To assure that social property and self-management promoted cooperation rather than competition required a new instrument which was

to replace contracts in a market economy. These were SMAs; multilateral contractual agreements which were to replace the intermediation by planning agencies or price signals. They have been combined with the system of Social Contracts (SC), another major institutional innovation. SCs are agreements among socio-political communities (governments at different levels) or between them and other agents in the economy, including chambers of commerce, trade unions, and Self-Managed Associations of Interest (SMAIs), which state policy objectives in areas such as planning, income distribution, etc.

Vertical and horizontal "pooling of labor and resources" has been seen as one of the cornerstones of the system: first, as a replacement of short-run market relations; second, for channeling investment resources to their most profitable uses; and third, as a way in which other policy objectives could be achieved. The SMAs for channeling investment resources were to exceed a purely indicative role and were designed to replace capital markets in resolving problems of capital mobility and resource allocation. It was hoped that they could overcome the low mobility of capital and encourage the distribution of investible resources between surplus and deficit enterprises without mediation of banking institutions which had become ideologically suspect.

The concept of Free Exchange of Labor (FEL) is an innovation in social finance which deals with collective needs which cannot be met through market mechanisms. Two basic categories of social needs are distinguished; general and collective needs. The former, being in the interest of the entire community, are funded predominantly through taxes. FEL as related to collective needs is meant to replace the role of the state by direct relations between the producers of services and the specific social groups which are the users of services. The funding of collective needs is to be ensured predominantly through self-imposed contributions. The SMAIs are the organizational forms linking the interests of those who use the services with those who produce them.

Disappointments with the market revived confidence in planning. This revival, however, required a reconciliation of planning with the proclaimed premises of the economic system. As directive or indicative planning could not be adapted to the new system, a new concept of social planning was invented which differed considerably from both directive and indicative planning. Its basic characteristics can be summarized as follows. Planning involves all relevant organizations, requires their active participation, and carries legal obligations. It consists of microeconomic planning of economic units (BOALs, WOs, COALs), and macroeconomic planning by socio-political communities. There is an obligatory exchange of information by all economic units. The coordinated plans are codified into legally binding agreements – SMAs and SCs. All affected parties are to be consulted and their agreement secured before codification. The basic plan is the midterm five year plan with annual assessments and revisions. The planning process is continual and is simultaneously carried out by all planning agents.

The Norms and the Reality

Although a divergence between practice and legal doctrine has been the rule rather than the exception in Yugoslavia, the breakdown of the system introduced by institutional reforms in the seventies can hardly be questioned. It suffices to consider the legislation which elaborated the institutions and functioning of the system. The laws regulating the behavior of economic units in the distribution of income, price formation, and foreign trade regulations, which were introduced after 1976, are only a few of those which have been explicitly or implicitly abolished and replaced by new laws or administrative measures soon after their appearances. Other laws, for example the law on planning or the law on "compulsory pooling of labor and resources" of commercial with manufacturing enterprises, have remained irrelevant for the actual functioning of the economy.

defenders of a self-management socialism that the system's blueprints had become unusable and the results were unwelcomed. This became particularly apparent after 1979 when net inflow of foreign capital ceased. Thus 1979 can be considered the apex of "contractual socialism." However, contrary to the situation in 1950 when "administrative socialism" was quickly abolished, the abandonment of the "contractual socialism" has been rather slow, at least on the ideological level. On the other hand, more and more government interventions have been required to replace a number of suspended or irrelevant "rules of the game."

The situation developed into the most severe crisis of the Yugoslav economic and political system, which prompted a new reform. It started in 1982 with the Long Run Stabilization Program (*Savezni drustveni savet*, 1984) which consists of seventeen documents (over 1,000 pages) dealing with inflation, unemployment, foreign economic relations, infrastructure, agriculture, transport, energy, "small scale" industry, regional development, social policy, changes of the economic and legal system, etc. It was produced by groups of economists led and supervised by politicians. While the Program is highly inconsistent in its approaches to economic problems, and one can find that it contains influences of all schools of economic thought, from extreme monetarism to orthodox Keynesian, often nicely cloaked in Marxian terminology, its main orientation is nevertheless clear; a reintroduction of the market and a reduction of a number of institutions introduced in the seventies.

The enormous conceptual differences between the Long Run Stabilization Program, which tried to revive "market socialism" and the Associated Labor Act, the cornerstone of "contractual socialism," have not deterred politicians and some social scientists from applauding both at the same time. The Program remained the single proclaimed answer to the crisis in most of the speeches at Party and trade union congresses in 1986. This, however, does not mean that all politically relevant social groups have in fact accepted the premises of the Program, or that its parts have been readily introduced into the economic system. On the contrary, the

Program was followed with the systemic stalemate which can be easily illustrated.

Another document, *The Critical Analysis of the Functioning of the Political System of Socialist Self-management (Savezni drustveni savet, 1985)* which appeared at the end of 1985, has even been considered an alternative to the Program by most economists. The Analysis, although stressing the need for radical changes and formally appealing to the Program, reopened debate on the majority of the economic questions dealt with in the Program. More importantly, its basic idea is that there is no need for changes in the basic premises of the economic system. What should be changed, according to the Analysis, is individual behavior. Thus, the breakdown of the system and the catastrophic economic results were viewed as being caused by the inappropriate behavior of economic units and not by deficiencies of the blueprints.

Changes in the economic system were nevertheless occurring. Again, two quite different directions can be distinguished. Some systemic laws reintroduced the "rules of the game" which restored "market socialism," while others strengthened the transition to "administrative socialism." The price control law of 1984 and the law on the banking system of 1985 can be considered examples of the first direction. The 1984 price control law abolished the Self-Managed Associations for Prices and the criteria for price formation, and restored the principle of free price formation on the enterprise level without negotiations within the SMAs, and, in effect, government price controls. (Less than two years later, the government proposed a new law, which reintroduced the criteria for price formation and increased administrative controls.) The 1985 law on the banking system reestablished banks as independent economic units.

On the other hand, the new laws regulating foreign economic relations (1986) and the regulation of income distribution strengthened the transition to tighter administrative control. The foreign trade system of 1977 (the actual operation of which was aided by the "gray" markets for foreign currency cloaked in the appropriate self-managed terminology) was

replaced by the administrative system in 1986. The questionable right to foreign currency by those who "created" it and the theoretically unacceptable principle by which imports were required to equal exports on all levels, were replaced by a principle of socially (administratively) determined "import needs". Also the new law on planning, while simplifying the planning system to some extent, retained most characteristics of social planning, and regained some of those of directive planning. Furthermore, the short run plans for 1986 and 1987 (resolutions) reinforced direct control in those fields where such control existed previously (prices, imports), extended it to new fields (inventory formation), and questioned some of the cornerstones of the program such as the "real positive interest rate" and the "real" exchange rate.

The variety of ideas concerning the way out of the crisis, which has been generally recognized as economic, social, political, and moral, has been particularly wide in academic debates. A number of solutions have been suggested and most of the taboo topics have been reopened (Horvat, 1985; Jerovsek *et al.*, 1985). These include, to name a few, recognition of labor and capital markets as indispensable segments of the market economy, changes in the self-management principles (Goldstein, 1985), questioning the concept of social property and its replacement by collective property (Bajt, 1986), and restoration of a mixed economy (Popovic, 1984). Although published, most of the ideas have been rejected, or what proved to be more politically effective, ignored.

The Long Run Stabilization Program, which can be considered the reform proposal of the eighties, shares some of the general characteristics of economic reforms in other socialist countries. It tries to increase economic efficiency by introducing or restoring the tools of capitalist market economies, while at the same time retaining the basis of the economic (social property of the means of production) and political (the Party's political monopoly and the principle of democratic centralism) systems. The Program also shared the fate of economic reforms in other socialist countries; with the same ideological obstacles and fear of an un-

acceptable weakening of the Party's political monopoly being the final and the most decisive arguments for determining the actual extent of the reforms and their duration.

Unresolved systemic dilemmas will no doubt be the most important determinant of Yugoslavia's economic, social, and political future. One should, however, not overlook the performance and the state of the economy and their effects on future developments.

Economic Performance and Recent Developments

Economic Systems and Their Performance

The vast majority of efforts to analyze the performance of the socialist self-managed economy have been directed to microeconomic issues. Microeconomic performance has been judged predominantly by deductive analysis comparing worker-managed firm behavior to that of the capitalist firm, under different assumptions about objective functions, production functions, institutional constraints on labor and capital supply, and environmental conditions. The macroeconomics of the labor-managed economy have been much less analyzed, though both theoretical and empirical studies of macroeconomic performance exist (Tyson, 1980; Estrin and Bartlett, 1982; Burkett, 1983; Bajt, 1986; Mencinger, 1986).

The two most prominent scholars in the field of labor-managed economy, Vanek and Horvat, have stressed the theoretical macroeconomic advantages of a workers'-managed economy. Vanek's conclusions about the performance of the self-managed economy are extremely favorable.

Comparatively – leaving aside the Soviet-type model as a basically inefficient one (except perhaps when it comes to income distribution) – there is every reason to believe that the participatory economy is, all other things considered, superior to,

the western capitalist economy. In the sphere of how well it allocates resources in production, it has both advantages and disadvantages compared to western market alternative. It has a definite advantage in generating full employment, long-run price stability, and growth. (Vanek, 1981, 38).

Horvat arrived at similarly favorable macroeconomic implications. He states that high rates of growth are assured by a higher propensity to invest due to reduced risk and uncertainty, full employment by virtue of the reluctance of workers to dismiss fellow workers, and control of inflation by the absence of the fundamental employee-employer conflict (Horvat, 1972).

In an empirical analysis for the 1971-1977 period, the three testable macroeconomic characteristics proposed by Vanek and Horvat were confronted with the Yugoslav reality (Mencinger, 1979). Only one of the three macroeconomic implications, generation of full employment, was confirmed. The other two theoretical advantages, promotion of growth and long-run price stability, were not confirmed. On the other hand, support for strong economic performance of the Yugoslav economy was provided by earlier empirical studies (Balassa and Bertrand, 1970). The performance has often been described as impressive before 1965, and the declines after 1965 were attributed to the changes in external conditions, to the changes in the relative weights given to various economic objectives, to the increasing difficulties in attaining these objectives, and only partly to the system which weakened macroeconomic policy-making (World Bank, 1979). It is beyond the scope of this paper to adequately analyze the performance of the Yugoslav economic system and to compare it to the performance of other systems, both capitalist and socialist. The knotty point of such an analysis is to disentangle systemic from other factors such as changes in external conditions, government regulations, interregional disparities, and macroeconomic policy measures which affect economic performance in different countries or in different periods. The results, which follow, should therefore be considered indicative.

Performance indicators for the periods are summarized in Table 1 (i.e., indicators of growth, capital formation, standard of living, employment, price stability, efficiency of productive factors, employment balance, and external balance). A subperiod, 1980-1986, is added to the period 1974-1986.

The growth rates depicted in Table 1 appear satisfactory when compared to those of developed market economies. Comparisons with similar countries, however, suggest that Yugoslav growth performance was not exceptional except for agricultural production in the period 1953-1962, which was predominantly a result of the fact that the previously catastrophic policy of forced collectivization had been abandoned. The very good industrial performance in the 1953-62 period is somewhat deceptive. This rapid growth is at least partly due to huge investments into industries with high capital/output ratios and long gestation periods, which were started before 1953 but which added to growth afterwards.

The comparison of Yugoslav growth figures from the two most recent periods with the figures of a comparable group of countries (middle income oil importers) indicates that they are in the same general range. For both periods the average rates of GNP growth in Yugoslavia were slightly lower than for the group (7.0% for 1963-1973 and 5.6% for the 1974-1980 period); industrial production growth was slightly higher in Yugoslavia in the first period (8.6% compared to 8.2% for the group) but lagged behind in the second (3.8% compared to 5.4%). Growth of agricultural production lagged in both periods (3.1% compared to 3.4% and 2.7% compared to 3.1%) (World Bank, 1985).

The figures on the share of investments in GNP, however, suggest that the cost of growth in Yugoslavia was very high and, indirectly, that Yugoslavia, despite all institutional changes, retained the Soviet pattern of development. According to the figures of the World Development Report, the investment share in GNP in middle income oil importers was 22.0% in 1965, 24.9% in 1973, and 26.6% in 1980. The same source reports the Yugoslav figures as 30.2% for the 1965-1972 period, 33.1% for

Table 1. Main Performance Indicators of the Yugoslav Economy, 1946-1986

[Average annual rates of growth in percentages]

Indicator	1946-52 ¹	1953-62	1963-73	1974-86	1980-86
GNP	2.3	8.2	6.5	3.5	0.8
Industry	12.9	12.2	8.6	5.4	3.0
Agriculture	-3.1	9.2	3.1	2.3	0.3
Employment	8.3	6.3	2.4	3.6	2.4
Exports (US\$)	-3.1	12.0	14.0	11.3	6.5
Imports (US\$)	3.6	10.1	16.6	10.3	-2.0
Investments		11.5	5.3	0.7	-8.0
Consumption		6.5	6.4	2.2	-1.0
Prices		3.6	13.0	33.3	48.7

[Ratios in percentages, except where noted]

	1953-62	1963-73	1974-84	1980-84
Unemployment rate	5.01	7.58	13.29	14.24
Export/import ratio	64.44	69.44	63.96	74.81
Labor/output ratio ²	3.87	2.42	1.86	1.86
Capital/output ratio ³	2.28	2.23	2.64	2.82
Investment/GDP rate	41.99	33.87	35.21	28.60

1. Horvat, 1971.

2. Number of workers per million dinars (1972 prices).

3. Value of capital per unit of output.

Source: Statistical Yearbook, various years.

the 1973-1978 period, and 36.5% for the 1979-1983 period. These figures confirm estimates that the growth of GNP per unit of investments in the 1960-1980 period was only 62% of the growth per unit of investments in comparable market economies of southern Europe (Bajt, 1984).

Changes in the efficiency, which are shown by the movements of the capital/output and labor/output ratios on Table 1, indicate that systemic changes have affected the efficiency of the Yugoslav economy.

In the period of "administrative socialism," economic growth was achieved by enormous input increases; both capital/output and labor/output ratios increased rapidly. When rigid planning was abolished and the sovereignty of planners was replaced by that of consumers and independent producers, the economy became more efficient. In the period 1953-1962, both capital/output and labor/output ratios decreased rapidly. In the third period capital/output ratio started to grow again, while labor/output ratio slowly decreased. Changes in the distribution mechanism, which made relatively abundant labor expensive (the majority of taxes and contributions were levied on wages) and scarce capital a free good (with real negative interest rates), appear to be important for such a development. The situation worsened considerably in the period of "contractual socialism"; capital/output ratio started to increase rapidly, labor/output ratio stagnated and even began to increase after 1980.

Economic Systems and Structural Developments

While the reforms affected economic performance, it is less clear what impact they had on the economic structure. This could be ascertained by comparing the pattern of structural change in Yugoslavia to the pattern of structural change in other countries, both market and centrally planned. However, that would be beyond the scope of this paper. To get a superficial indication of the likely effects which the reforms might have had on the economic structure and to avoid the problems of relative price differences in comparisons of production structures, sectoral distribution of

nonagricultural employment in 1980 in Yugoslavia is compared to sectoral distributions of employment in market and centrally planned economies.

Table 2 indicates that sectoral distribution of nonagricultural employment is to a greater extent determined by general socialist/capitalist division than by stage of development. Yugoslavia has some distinct features. Trade, catering, banking and insurance employ more workers than the same sector in centrally planned economies, while the share of manufacturing and mining resemble the workers in the trend established in these type economies. Despite incessant systemic changes, the Yugoslav nonagricultural employment pattern remained closer to those of centrally planned economies than to those of market economies, except for the relatively high share in trade and catering.

To gauge the explanatory role of systemic changes on the sectoral distribution of employment, a regression was fitted with the shares of employment in manufacturing and mining, and construction and transportation (sectors 1 and 2 in Table 2) in total nonagricultural employment being the dependent variable, sL and the per capita GNP (data from Pryor, 1985, 68) and a dummy variable D for economic system (D equals 0 for a capitalist and 1 for a socialist country), being the independent variables. Data for 1980 for twenty-two European countries listed in Table 2 (Yugoslavia excluded) produce the following equation:

$$sL = 58.79 - 0.1816 * GNP/cap + 14.90 * D \quad R^2 = 0.86$$

$$(16.9) \quad (-3.46) \quad (7.47) \quad SE = 3.61$$

The share of labor force in the "material" sectors is, expectedly, inversely related to the per capita GNP and there is a significant difference between the two systems. According to the equation, the share of employment in the "material" sectors is, at the same level of development, higher by 15 units in the socialist countries. The estimated figures for Yugoslavia would be 69.0% if Yugoslavia followed socialist planned type of development, and 54.2% if it followed capitalist market type of

Table 2. International Comparison of the Sectoral Distribution of Employment

[in percentages]

Country	Manufacturing, Mining	Construction, Transportation	Trade, Catering, Banking, Insurance	Other Services	(1) + (2)	(3) + (4)
	(1)	(2)	(3)	(4)		
Austria	35.0	17.0	23.7	24.3	52.0	48.0
Belgium	27.9	15.6	26.4	30.1	43.5	56.5
Denmark	24.0	16.7	22.3	37.2	40.7	59.3
Finland	31.0	16.3	22.8	30.0	47.3	52.7
France	29.3	16.4	25.6	28.2	45.7	54.3
Ireland	29.2	18.4	24.4	28.0	47.6	52.4
Italy	32.4	18.2	24.7	24.8	50.6	49.4
Netherlands	23.7	17.9	27.4	31.0	41.6	58.4
Norway	24.0	18.1	25.0	32.9	42.1	57.9
Portugal	37.2	18.4	19.0	25.1	55.6	44.4
Spain	33.7	18.5	29.6	19.2	52.2	47.8
Switzerland	35.7	13.3	29.8	21.2	49.0	51.0
Sweden	26.3	14.2	21.1	38.4	40.5	59.5
Great Britain	32.1	13.5	24.6	29.8	45.6	54.4
Germany (BDR)	39.6	14.3	21.6	24.7	53.9	46.1
Average	30.7	16.5	24.5	28.3	47.2	51.8
Yugoslavia	42.6	19.8	17.7	19.9	62.4	37.6
Bulgaria	44.8	20.8	11.0	23.4	65.6	34.4
Czechoslovakia	44.1	19.4	12.7	23.7	63.5	36.5
Hungary	43.2	20.4	12.2	23.9	63.6	36.4
Germany (DDR)	47.1	16.4	11.5	25.0	63.5	36.5
Poland	43.2	21.8	12.2	22.8	65.0	35.0
Rumania	50.4	21.1	8.8	19.8	71.5	28.5
Average	45.5	20.0	11.4	23.1	65.5	34.5

Source: Yearbook of Labor Statistics, ILO Geneva, 1981.

development. The actual figure of 62.4% places Yugoslavia almost precisely in the middle between the two systems, which might be considered an indication that economic reforms have had some impact on structural development.

The State of the Economy in the Eighties

Stagflation and External Balance

Macroeconomic performance in the period of "contractual socialism" is characterized by a pre- and post- 1980 division which differentiates between a more and a less successful subperiod. In the first subperiod performance indicators reflecting "internal balance" are satisfactory, while developments in the "external balance" are unfavorable. The second subperiod differs considerably; it is characterized by deterioration in internal balance accompanied by improvements in external balance. The macroeconomic performance of the Yugoslav economy in the seventies and early eighties was apparently dominated by the developments in the external sector. The movements in the balance of payments indicate that the success before 1980 was fictitious. The yearly inflows of foreign capital were greater than the increases of the gross domestic product. Thus, the Yugoslav economy was doomed to stagnate for a decade if there were no net foreign capital inflows. When the possibility of development based on foreign accumulation faded and when the accumulated debts required an enormous outflow of capital for debt servicing, the fictitious success dissolved as well.

The interdependence between domestic economic performance and external balance is strong. The attempts of economic policy to restore external balance in 1972 and in 1975-1976 were followed by deterioration of the situation at home and quickly abandoned. Only after 1979, when the

indebtedness became excessive, did economic policy finally shift towards restoration of external balance. The "price" for achieving external equilibrium was high. It consisted of stagnation, unemployment, inflation, and increased interregional disparities. The annual growth of GNP decreased from 6.1% in the period 1971-1979 to only 0.9% in the period 1980-1985. The unemployment rate reached 15.4% at the end of 1985. The average inflation rate increased from 20% in the 1971-1979 period, to 40% in the 1980-1984 period, to 90% in the 1985-1987 period, and to 250% in 1988, with spiraling inflationary tendencies. Real wages decreased to two thirds of their 1979 level and interregional differences increased.

Unemployment

The economic, social and political implications of the unemployment figures in Yugoslavia differ from the implications of comparative figures for a developed industrial country in many respects. The characteristics of labor supply and demand in Yugoslavia make unemployment basically a long-term and regional problem. Labor supply is determined by the developing nature of the country with its relatively high birth rates, high percentage of agricultural population and specific ownership structure, i.e., predominantly socialist ownership in the nonagricultural sector and predominantly private in the agricultural sector. Rapid industrialization, the spread of technological progress in agriculture, differentials in real wages, and economic policy inspired by ideological prejudices, caused a quick one-way flow of labor from the agricultural to the nonagricultural sector. Agriculture became the most important source of labor for the nonagricultural sector, and a buffer against the negative social and political effects of unemployment. On the other hand, demand for labor was determined by the long-term scarcity of capital which implies a complementary rather than substitutional relation between labor and capital. This was amplified by underpriced capital which favored capital intensive projects in a country with scarce capital and abundant labor. Ideological

Table 3. Regional Development in Yugoslavia

	Yugo- slavia	Bosnia/ Herce- govinia	Monte- negro	Croatia	Mace- donia	Slovenia	Serbian Republic	Serbia Proper	Kosovo	Vojvo- dina
	Rates									
Labor participation rate (1984)	.277	.227	.248	.327	.245	.423	.252	.276	.120	.295
Net participation rate (1984)	.417	.365	.405	.527	.411	.690	.405	.427	.232	.460
Unemployment rate (1984)	.153	.228	.232	.075	.262	.018	.193	.169	.491	.154
	Indexes									
GDP per capita (1955)	100	83	77	122	68	175	86	91	43	94
GDP per capita (1983)	100	69	77	125	65	197	91	99	28	120
GDP per employee (1955)	100	87	87	102	100	129	89	85	106	95
GDP per employee (1983)	100	88	88	100	82	126	99	98	70	110
	Average Growth Rates									
GDP 1956-1983	5.7	5.3	5.9	5.3	5.9	6.0	6.0	5.9	5.7	6.2
Population 1956-1983	0.9	1.2	1.1	0.5	1.4	0.8	1.0	0.8	2.4	0.5
	Ratios									
Capital/output (1983)	2.85	3.44	4.35	2.85	2.85	2.70	2.56	2.44	4.00	2.83
Marginal capital/output (1971-1983)	6.36	7.09	9.52	6.80	6.99	5.62	5.92	5.46	11.00	5.98

Source: Statistical Yearbook.

ferences in productivity between modern nonagricultural and backward agricultural sectors; differences in productivity within sectors; and systemic factors.

Disparate population growth rates diluted the benefits to be gained from nearly parallel GNP growth rates. They also widened the gap between the less and the more developed regions of the country. While birth rates, fertility rates and natural growth rates in the more developed regions, and in several of the less developed areas as well, stabilized around 1970, the population of Kosovo continued to grow at an extremely rapid pace. Kosovo's 5.4% fertility rate (1975) caused its population to more than double in one generation. Thus, even if Kosovo's fertility rate were to be sharply reduced, the working age population would continue to expand unabated for several decades.

The disparity between the productivity of the more modern non-agricultural and traditional private agricultural sectors within the same region is enormous. Thus, the differences in labor force participation rates, which indicate the relative size of the modern sector, point to the second main source of regional disparities. The differences in productivity within the modern socialist sector, as indicated by the differences in the average and marginal capital/output ratios are the third.

Due to cultural differences and other factors such as housing, the low mobility of labor from the South to the North cannot be expected to change. The transfer of capital and related technology from the North to the South could substitute for low labor mobility. However, large voluntary transfers cannot be anticipated, partly due to low absorptive capacities and partly due to the legal enforcement of social property, which does not protect the investors from losing both capital invested and control over the established enterprises.

Any sizable reduction of regional disparities will therefore be slow and expensive. A gradual reduction of disparities might be accompanied by an extended period of rising unemployment (Katz, 1985) and increased political tensions aggravated by increased nationalism. Massive transfers

of resources will, on the other hand, continue to be necessary if socially and politically acceptable disparities are to be attained. This appears to be feasible only by administrative action directing the movement of resources from the North to the South.

Prospects for the Future

The prospects of the Yugoslav economy for the nineties do not appear encouraging. External balance in the eighties was achieved only by allowing internal imbalance. The possibilities for economic recovery and development are therefore limited. The transformation of an economy which has obtained such a large proportion of its disposable product (up to 10%) from abroad, into an economy with sufficient productive capacity to offset reduced imports and to generate the capital required by debt servicing, can only be accomplished in the long term. The fact that it took half a decade to stabilize the current account is indicative of the difficulties involved. Changes will be hindered by the existing economic structure which makes export expansion difficult, and by the existing economic system, which, as demonstrated in 1986, is unable to take advantage of favorable external conditions.

The adaptation to external balance has seriously reduced the share of investment relative to GNP. This means not only a slower growth of productive capacities and employment, but also a slower introduction of technological changes. Minimal growth rates and the prevention of a worsening of its economic position within Europe (including Western and Eastern countries) appear to be the most Yugoslavia can hope to attain in the second half of the eighties and first half of nineties without a massive inflow of foreign capital. Also, the social implications of slow growth can result in counter-reform, and administrative solutions might be favored for at least two reasons. First, the reintroduction of the market would increase social differences among individuals and regions to unacceptable

dimensions. Secondly, the energy and social patience of the population have been stretched thin during the years of continuous economic crisis. The state of the economy and its social implications will no doubt be important obstacles to economic recovery which can only be attained by effective economic reform. But, is such a reform feasible?

In the past Yugoslav economic reforms were enacted within the existing political system and rather easily adapted to the leadership's ideology. They differed from the reforms in other socialist countries of Eastern Europe: their impact was greater; their scope was not limited by external powers; and they were not related to changes in political leadership. The reforms in Yugoslavia and other East European countries have, however, remained "half-hearted efforts to implement policies promoting free market exchange of goods and services" (Katz, 1987). They have in particular failed to diffuse political and economic power, as counter-reforms have been enacted when market forces became too destructive for the political monopoly of the Party and its Marxist ideology. The persistence of the present overwhelming crisis indicates that if a new reform is to be effective, it will require the abandonment of the Party's political monopoly and its Marxist ideology. Yugoslavia has reached the point where any economic reforms unaccompanied by political reforms can only increase the inconsistency between the economic system and the political system. The ability to reread and to reinterpret Marx, which has been the predominant characteristic of past reforms, does not suffice anymore.

It has often been argued that theoretically self-management and public ownership are compatible with Pareto efficiency and that the political system is irrelevant for the efficiency of the economy. Accordingly, the efficiency of the Yugoslav economy might be raised by economic reforms that left the political system and the bases of the economic system (self-management and public ownership) intact. In reality, the economic system is inseparable from political considerations and dominant ideology which determine not only the bases of the economic system but also economic policy. Moreover, because the "leading subjective force" and

the "determined ways of development" are superfluous in a market-based economy, the commitments of the Party to the concept of market economy have remained "half-hearted." Secondly, social property, if not administratively protected, would tend to "degenerate" into two empirically more efficient forms: ideologically suspect collective property and ideologically unacceptable private property.

While continuous economic crisis and growing ethnic and social tensions require changes, Yugoslavia appears for the first time unable to move to meet these serious challenges. The number of commission, meetings, resolutions and words devoted first to "open questions and serious difficulties," then to "economic crisis," and finally to "overwhelming economic, political and moral crisis" have grown rapidly. Yet the stalemate has continued. Federalism, the decentralization of political power and its concentration at the local and republican levels, as well as the fact that the Yugoslav League of Communists plays a less dominant centralizing role than before, when combined with the presence of more diversified values and interests than in other communist parties in Eastern Europe, causes analysis and forecasting to be a very risky enterprise. This complexity can be both advantageous and disadvantageous for radical reform. While federalism, decentralization, the relative weakness of the Party, and the diversity in values ease the steps toward market economy, they can also prevent forceful action aimed at solving Yugoslavia's problems. This impasse is already much in evidence in the course of on-going constitutional debate.

Acknowledgement

The author owes thanks to unnamed referees and to Arnold Katz of the University of Pittsburgh for their comments and suggestions, and to the latter also for making the paper readable. Without his help and encouragement, this work could never have been written. The paper was in large part composed during the author's stay at the University of Pittsburgh, which was financed by the Fulbright Commission.

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