ISS DEN HAAG
8 3501 00092 1061

Institute of
Social Studies

ISS

Yugoslavia's Economic Crisis: the Price of Overexpansion

Willem Burger

ers ISS Occasional Papers 100 ISS O

Yugoslavia's Economic Crisis: the Price of Overexpansion

Willem Burger

October 1984
Institute of Social Studies

The views expressed in this publication are those of the author and not necessarily those of the Institute of Social Studies.

ISBN 90-6490-014-0

Printed in The Netherlands

1. INTRODUCTION[1]

Yugoslavia is one of the rapidly industrialising countries which has had a record of very high rates of economic growth over the past decades and which is now balancing on the brink of bankruptcy. That its grave financial problems have not attracted as much international attention as those of, for instance, Poland, Brazil or Mexico may perhaps be explained by the marginal position that Yugoslavia occupies between East and West, both geographically and politically. A further explanation may be that so far, the crisis has not given rise to major domestic political upheavals. Moreover, the economy is relatively small, the population of Yugoslavia being only some 22 million.

The unique design of the Yugoslav economy, however, makes it an exceptionally interesting case for analysing the causes of the crisis. On the one hand the bulk of Yugoslav production capacities is socialised, while on the other the coordination of economic activities is largely based on market competition between workers'-self-managed enterprises, small private firms and self-employed producers. There is no other socialist economy in which enterprises and banks have had as much autonomy as they have been given in Yugoslavia since the economic reforms of the mid-1960s. Worker-controlled enterprises have been able to decide on investments, plan their production, borrow from banks and determine - at least in principle - their wage rates and sales prices.

However, this does not mean that the economy has become entirely liberalised. In order to counter chronic inflationary tendencies, state agencies have continued to subsidise prices of certain basic commodities, and most of the time they have also applied general ceilings on price and wage increases. In the course of the 1970s market competition was moderated through a system of 'self-management agreements' (on commodity prices, transactions etc.) between enterprises, and through 'social compacts' (on wage rates, social-security schemes etc.). The latter are co-signed by enterprises, trade unions and the commune, republic or federal governments. These social compacts also determine the contributions which the workers make from their incomes to finance social and economic infrastructural facilities and services.[2]

Because the autonomy of the market sector has been constitutionally guaranteed, planning can only be 'indicative'. Yearly 'resolutions', medium- (i.e. five-year) and long-term plans specify investment priorities, targets for productive employment etc. These resolutions are based on the plans made by enterprises and the various branches and sectors of the economy. The enterprises can deviate from these plans, and in fact they have done so on a large scale, despite a growing number of disincentives such as credit squeezes on low-priority investments.[3]

International trade also has been greatly liberalised by the economic reforms of the mid-1960s. This was done to force Yugoslav firms to compete with foreign producers on the local and international markets. As a result the economic role of the state has become quite comparable to that of the governments in Western capitalist welfare states. The one major exceptional aspect of the Yugoslav economy is that the income earned in the socialised sector (which comprises the autonomous work collectives that produce using socialised capital) is far greater than that in the private sector (which comprises the self-employed citizens and private enterprises with a maximum of five salaried workers and produces using private capital). This is clearly shown by the statistics presented in Table 1.

Table 1. *The Percentage of Gross Income Earned in the Various Industries in the Socialised Sector in Yugoslavia, 1980*

Industry	%
Mining, processing industries and manufacturing	100
Trade and banking	99
Traffic and communications	93
Tourism and catering	86
Construction	84
Crafts	48
Agriculture, fisheries and forestry	24
All industries taken together	87

Source: Statistički Godišnjak Jugoslavije, 1981 (Savezni zavod za Statistiku SFRJ, Beograd).

Such a politico-economic structure leads one to expect that Yugoslavia would be in a favourable position to avoid the inefficiencies of economic centralism, with its virtually inevitable bureaucratic rigidities. These rigidities mar rational economic behaviour at all levels, right down to and including the individual enterprise. At the same time one would expect such a structure to also prevent the economic wastage which characterises capitalist industrial development, with its inherent antagonisms and contradictions, anarchy of the market and periodic crises.

Such was, indeed, the expectation - if not conviction - expressed in official and unofficial statements made by Yugoslav social scientists, planners and politicians during the 1960s and early 1970s. At that time the growth rate of the Yugoslav economy ranked among the highest in the world, and the real consumption of the Yugoslav people (excluding the social services, which were also rapidly expanding) almost doubled, while unemployment remained low.

The fact that during this time, the number of Yugoslav workers employed abroad - mostly in Western Europe - rose to around one million (some 11 per cent of the economically active population in 1975) was not generally viewed as a negative development. Their wage remittances to Yugoslavia constituted a very substantial and very welcome inflow of hard currency. This rose from an annual equivalent of US$1.1 billion in 1972 to that of US$2.1 billion in 1977. Together with the earnings in foreign currency from tourism, which rose from an annual equivalent of US$0.5 billion in 1972 to that of US$0.9 billion in 1977, these remittances helped the country rather successfully to maintain a balance in international payments until 1976, despite persistently high foreign-trade deficits.[4]

2. GROWING IMBALANCES AND THE FIRST SIGNS OF CRISIS

The euphoria that surrounded Yugoslavia's impressive post-reform industrial expansion, which was fostered by Keynesian economic insights just as it was in the West, gradually faded when commodity markets showed ever-increasing imbalances in the mid-1970s. In several branches (for example the automobile industry) unsold stocks and overcapacities became an increasingly heavy financial burden on enterprises. Unemployment steadily grew, albeit largely because there were fewer employment opportunities for Yugoslav workers abroad.

At first official optimism persisted, however. Thus far measures calling for 'economic stabilisation' (one of the main slogans of the decade) had indeed been effective in keeping inflation down to 12-15 per cent, which was a significant improvement over earlier inflation rates of around 20 per cent. Now that the symptoms of recession were making themselves felt, the ceilings on wage and price increases and measures to prevent collective expenditures from expanding faster than real economic growth were combined with new stimuli for the industrial sector. In the years from 1976 to 1979 banks were encouraged to give fresh credit to enterprises with liquidity problems (in order to accelerate sales of stocks at frozen prices, among other things), while new investments were stimulated by relaxing credit restrictions ensuing from the priorities set in the current five-year plan. In 1979 nominal interest rates on medium- and long-term loans to enterprises - which, at 9 per cent, were already far below the inflation rate - were brought down further to levels between 6.5 and 6.9 per cent.[5] In the meantime investments in economic infrastructure by the federal government and the governments of the republics and communes continued to rise not only in absolute terms but also in proportion to GNP (see Table 2).

Through these measures the investment rate in Yugoslavia, which was still high, was boosted even further. Apparently this was believed to be the best strategy to solve simultaneously the problems of rising unemployment, illiquidity and inflation. An even more modernised industrial sector was thought to be able to increase efficiency and reduce production costs. This was expected to increase sales on the domestic and foreign markets, and so to give the economy a fresh impulse.[6]

The confidence in this strategy proved to be unrealistic, and the Yugoslav version of supply-side economics had dramatic consequences. These were as follows:

- Yugoslavia's foreign-trade deficit tripled between 1975 and 1979 to more than US$7 billion.
- Inflation (measured on the basis of the cost of living) more than doubled during 1979-80, until it reached a peak of 45-50 per cent *per annum* in the early months of 1981.[7]
- Total employment continued to increase by 3-4 per cent *per annum* at first, and then by 1-2 per cent, but the number of people seeking employment grew much faster (5-6 per cent *per annum*) and rose to close to 900,000 (or about 10 per cent of the economically active population) in 1982.[8]
- The volume of industrial production grew from 1977 to 1979 in accordance with the planned objectives, expanding by about 8-9 per cent *per annum*, but after that it fell sharply.

Table 2 gives an overview of the recent trends in the economy shown by some important social and economic indicators.

The deplorable financial position of the country forced the federal government to take severe austerity measures. During 1980, 1981 and 1982 net real incomes in the socialised sector were allowed to drop by an average of 16 per cent, and those of workers and personnel employed in government

Table 2. *Some Important Statistical and Financial Indicators of Yugoslavia's Socio-economic Development, 1966-82*

Indicator	*1966-75*	*1976*	*1977*	*1978*	*1979*	*1980*	*1981*	*1982*
% net real-income growth of average worker (in the socialised sector)	5.3**	4.5	3.3	5.3	-0.1	-7.5	-5.0	-1.0
% inflation (based on the cost of living)	22.4**	11.6	15.0	14.3	20.4	30.3	41*	32*
Total employment (in mlns) excl. the self-employed	3.6→4.8	4.9	5.1	5.4	5.6	5.8	5.9	6.0
Persons seeking employment (av. x 1,000)	268→540	665	717	738	775	789	833	888
Unemployed receiving social allowances (av. x 1,000)	81→145	177	161	167	181	248	287	317
% of growth in volume of industrial production	7.1**	3.2	9.9	8.4	7.7	4.6	3.9	0.1
Gross fixed investments as % of GNP								
a. productive enterprises	21.7	24.7	26.7	28.9	27.4	29.4	26.3	29.8*
b. socio-economic infrastructure (excl. private housing)	4.8	5.7	5.8	6.5	6.7	6.3	5.1	
Value of exports (in mlns US$)	2,167**	4,878	5,256	5,668	6,794	8,976	10,233	10,238
Foreign balance of trade (in mlns US$)	-1,463**	-2,489	-4,380	-4,317	-7,225	-6,087	-4,828	-2,693
Balance of payments (in mlns US$)	-375**	+165	-1,582	-1,256	-3,661	-2,291	-750	+1,200
US$/Yugoslav dinar parity (av.)	12.5→18.0	18.2	18.4	18.6	19.1	29.3	37,8	48.0

* These figures are approximations.

** These figures are annual averages.

Sources: The figures for 1976-80 are compiled from *SGJ, 1974-81*. The figures for 1981-82 are compiled from *INDEKS Mesečne Pregled Privredne Statistike...* (see footnote 9).

administration and collective services dropped by more than 20 per cent. This helped to decrease inflation to about 32 per cent in 1982.[9] Imports of consumer goods and of raw materials to produce these were curtailed, and this caused sharply felt shortages of gasoline, coffee, sugar, vegetable oils, soaps and synthetic detergents, among other things. Exports of domestically produced commodities were forced to increase, so that some of them were soon in short supply on the local markets. The main instrument was a series of drastic devaluations of the dinar: by the end of 1982 the dinar's US$ parity was 30 per cent of what it was in 1978.

These measures have considerably eased Yugoslavia's monetary predicament: the foreign-trade deficit was reduced to the level of the early 1970s, and in 1982, for the first time in six years, the international balance of payments became positive (see Table 2).

These quick achievements are remarkable, but the country and its people are paying a high price for them. What causes concern, more than anything else, is the stagnation in industrial growth which has developed even though the rate of fixed investments has remained very high.

3. THE STAKES ARE HIGH, BUT WHERE SHOULD THE BLAME BE PUT?

The political, ideological and scholarly debate in Yugoslavia about the numerous problems arising from rapid industrial growth, from technological progress and innovation and from the transformation of the labour force during the process of change from predominantly rural to urban employment, has always been quite intense. This has been the case especially since the liberalisation in the early 1960s, and the subsequent efforts towards liberalisation through institutional reforms based on quite radical constitutional alterations. These reforms were intended to establish more effective workers' control over the entire economy (including the planning process, the banking system and the public and social-service sectors).[10] They were expected to have a stabilising effect on the economy, but inflation, serious money-supply problems (with spells of embarrassing illiquidity in entire economic sectors) and chronically high foreign-trade deficits continued to plague planners and decision-makers at all levels.

Nevertheless official documents time and again restated an unshakable confidence in the self-managed, decentralised economy and its capacity to learn from experience and ultimately to succeed in creating a harmonious, prosperous and modern socialist nation.[11] In other words the ideological and political stakes in making steady progress in that direction were - and still are - high. It is therefore not surprising that in the past few years, the grave disequilibrium in economic relations within the country, as well as with its foreign business partners, gave an unusually urgent, and at times even desperate, quality to the public discussion about Yugoslavia's economic prospects.

In that discussion the factors which were most frequently emphasised as being responsible for Yugoslavia's present situation are the following:

External factors

1. *The world economic recession.* - This came at the critical period for Yugoslavia, when the country had to reap the fruits of its high investments in export-oriented industrial and agro-industrial capacities. The gradual stagnation in the growth of revenues from exports to EEC countries and the United States, which was partly due to tariff restrictions, was especially sharply felt. The recession also resulted in the repatriation of some 330,000 migrant workers between 1973 and 1982, mainly from Western Europe. This caused a decrease in foreign-currency remittances on the one hand; on the other hand an urgent need arose to create new jobs at a much faster pace than was originally foreseen as necessary.
2. *The oil-price increases in 1973 and 1979.* - These made Yugoslavia's import bill for oil, oil products and natural gas rise to more than US$3 billion in 1980. This figure was 23.3 per cent of total imports, whereas it had been a mere 5.5 per cent in 1972.[12]
3. *The rises in interest rates on foreign debts.* - Because of these, Yugoslavia became burdened with an additional annual bill of an estimated US$0.4-0.5 billion in 1980, 1981 and 1982.[13]

Internal factors

1. *Economic losses due to human failings.* - These included poor management of enterprises, a lack of motivation and of commitment to elementary principles of efficiency among the workers etc. Some critics pointed out the lack - or inadequacy - of economic sanctions that in other economies effectively limit mismanagement and inefficiency.[14]
2. *Costly mistakes made in an over-complicated planning mechanism.* - Bureaucracy and technocracy have also been seen as damaging to the development of self-management relations within and between enterprises, and especially between enterprises and banks.[15]

3. *Certain monopolistic and oligopolistic tendencies in the economy.* - Large firms and industrial conglomerates sometimes gained undue influence on investment planning and credit policies at the level of the republics and communes. From the early 1970s onwards the banks in particular were almost constantly attacked by the press and the political fora for not being able to sufficiently resist pressures from those 'member-founders' which were well established, powerful and credit-hungry. The negative consequences of this were widely felt: credit for smaller, local firms and for new economic initiatives became increasingly scarce.[16]
4. *Certain state interventions in the price mechanism.* - Some price controls were too sudden and drastic and had disastrous effects on returns on investments in certain production lines and even entire industrial sectors. (The interventions intended to control the prices of steel and other raw materials are examples of this.) However, it was sometimes argued that quite the reverse was the case, i.e. that in order to ensure economic stabilisation the state had to exert much stricter controls on prices, including those set among enterprises on the basis of self-management agreements.
5. *'Political investments'*, to use the term common among the Yugoslavs themselves. - This term refers to investments made more on the basis of political considerations than on economic ones.[17] Such investments were most often ascribed to rivalries between republics, as each republic wanted its own steelworks, car factory, petro-chemical complex, rail-connected seaport, etc. This rivalry paralleled what was and is happening all over the world: each major town or provincial capital wants its own ultra-modern hospital, stadium, concert hall, theatre or other kind of centre. Obviously in a federation of republics such as Yugoslavia, it is not easy to effectively counter such tendencies without evoking historically based suspicions of an attitude of superiority - if not outright discrimination - on the part of larger, richer and more developed regions. Such discrimination had prevented less prominent regions from playing any significant role in pre-war Yugoslavia.

   However, there were also cases where the economic wisdom of costly investment projects was questioned even within a particular republic, but these projects were realised nevertheless due to pressure from locally influential circles. Some of these projects turned out to be grave mistakes and had to be abandoned, since no further financial resources could be made available to rescue them.[18]

There can be no doubt whatsoever that these phenomena have contributed, to a greater or lesser extent, to Yugoslavia's present problems. However they do not, in my opinion, *explain* the crisis. As far as the *external* economic constraints are concerned, these pose equally serious problems to other rapidly industrialising countries with open economies. Some of these economies have suffered from destabilisation, albeit not as acute as that of Yugoslavia today. In that respect it is highly relevant to note that even a decade before the world economic recession in the late 1970s, Yugoslavia had the highest inflation rate of all rapidly industrialising nations except Israel and some Latin American countries.[19]

As far as the alleged *internal* causes of Yugoslavia's economic problems are concerned, in my view they must be considered as falling within the normal range of the imperfections and inefficiencies inherent in any politico-economic system.

The prime symptom of destabilisation, which is accelerating inflation, by definition points to growing overspending. Economies may be able to put up with that, as in fact the Yugoslav economy did until the mid-1970s, as long as the overspending is mainly on the *consumption* side. If consumer demand is too high a wage-price spiral evolves, and this merely reflects self-defeating social pressure to push consumption beyond the level that the economy can bear. When, under such circumstances, the investment rate is *not* too high, productivity grows quickly, while capacity is fully used, so that there is little or no unemployment. In such situations profits are, typically, satisfactory; cash flows are positive and stocks minimal.

In Yugoslavia, however, the characteristics which the situation acquired were precisely the reverse. Real net consumer spending, which ever since 1971 had lagged slightly behind the growth of productivity, stagnated and even decreased when inflation rose to around 40 per cent in 1980. The rate of capacity use declined in several branches of industry, and the overall growth in productivity fell sharply, as was explained above. The increase in stocks on unsold goods rendered many enterprises dangerously illiquid.[20]

This combination of characteristics indicates that at least one important cause of overspending, if not the main one, must be sought in the realm of production. The following considerations support this view.

1. It cannot be convincingly argued that Yugoslav enterprises are exceptionally inefficient in using their production equipment (once installed), labour power, energy and other inputs.

2. The share in gross national income of investments in public goods and in infrastructural facilities is high, when compared to international levels, but it is not high when compared to the Yugoslav rate of industrial expansion and transformation. (The volume of gross investments in fixed assets in the productive sector is a good indicator of the latter rate.)[21]
3. The share in GNP of investments in fixed assets in the productive sector was one of the highest in the world for a period of more than twenty years. This share was matched only by Japan.[22]
4. Over the years from 1976 to 1979, when there was a marked fall in investments in Japan, as in other industrial nations, the Yugoslav rate of capital formation in economic enterprises rose to (post-war) record levels, averaging 25.6 per cent of its gross material product. Thereafter destabilisation symptoms assumed alarming proportions.[23]

These points provide ample empirical evidence to conclude that the main cause of overspending is indeed in the sphere of accumulation and amortisation of capital goods in the productive sector. Such overspending necessitates proportionally high complementary investments in the public sector, i.e. investments for ancillary services and infrastructure. Furthermore it provides a satisfactory explanation for the emergence of overcapacities in most sectors of the economy and for Yugoslavia's growing inability to finance a sufficiently large share of its investments from domestic savings.[24]

The latter development became Yugoslavia's 'Achilles heel' in the given circumstances. Foreign-exchange deficits accumulated so fast that the country is now facing severe problems in meeting its international financial obligations. Yugoslavia's total hard-currency debt reached a figure close to US$20 billion in 1981, while it was a mere US$1.2 billion in 1965. In 1980 the country's foreign-debt servicing (i.e. repayments of principal and interest) required an amount equal to about 45 per cent of the current foreign earnings.[25] Only new foreign credit - from the IMF, among other sources - could keep the burden of this servicing within manageable limits.

Overinvestments in the Yugoslav economy *might* be ascribed to the cumulative effects of numerous incidental cases of irrational investments resulting from a variety of mistakes, incompetences, inappropriate regionalist influences and the like. Rather than doing this, however, it appears more promising to consider, in the next section, whether factors can be identified that caused *systematic* distortions of decisions on economic investments, whenever and wherever they were being taken.

4. INSTITUTIONALISED UNDERPRICING OF INVESTMENTS: A MAJOR DESTABILISING FORCE

A striking aspect of the Yugoslav economic system has, since the economic reforms of the mid-1960s, been that the interest rates at which banks extended credit to firms for financing investments have consistently been low. Despite inflation rates fluctuating between 12 and 20 per cent throughout the 1970s and climbing to around 40 per cent in 1980 and 1981, medium- and long-term loans could be contracted at nominal interest rates of 8-9 per cent on the average. In 1979 and 1980 these rates even fell to less than 7 per cent. Authoritative sources, some of which are mentioned below, have repeatedly pointed out this anomaly.

Branko Horvat, perhaps Yugoslavia's most reputed economist both nationally and internationally, was one of the first to make such observations. As early as the late 1960s he emphasised that excessively low real interest rates had a destabilising effect in the absence of balancing mechanisms which could create a capital market that would function properly.[26] More recently this has become a key point in analyses of economic developments in Yugoslavia, as the following four examples show.

1. Jaroslav Vanek, an economist of Czech origin who is well known from his theoretical work on the economics of the self-managed firm, has over the years become a specialist on Yugoslavia's socialist market economy. In an article first published in 1973 he wrote that 'the subjectively low cost of capital is bound to produce, for those who have capital [i.e. existing firms] unnaturally high capital-labour ratios.' He went on to say that where equality of personal incomes is promoted through regulations which force enterprises with higher incomes to accumulate more, '[this] will lead [in those enterprises] to ever higher and more capital intensive accumulations, and thus in a never ending cumulative process, the rich enterprises will grow richer, the poor ones and the unemployed will be left behind'.[27]

   What Vanek sketched is a highly unstable industrialisation process in which Yugoslav policy-makers were forced to choose either to accept slow growth with rapidly rising unemployment or to opt for a grossly overcapitalised, fast-growing but no less inefficient economy at the price of high inflation. After Vanek wrote this in 1973, actual developments unfortunately proved his prediction to be very correct. The statistics also show that a choice was made for growth with high inflation.

To enhance efficiency in the use of capital through improved distribution of investment funds, Vanek proposed a flat *real* interest rate on investment credit and savings deposits of 12-15 per cent. He developed strong arguments to demonstrate that this would enable stable industrial growth with full employment at a much more modest volume of investments (which would yield savings on capital). Apart from that, such an interest rate would create incomparably better conditions for effective workers' self-management at the enterprise level.[28]

2. The report prepared in 1975 by a World Bank mission to Yugoslavia described the distorting influences of the structure of negative or low interest rates as follows:

   (i) it fuels excessive investment demand, making control of inflation more difficult;
   (ii) it encourages waste of capital in all its uses . . . in utilising existing capacities and in choosing replacement rates;
   (iii) it affects adversely the quantity and quality of financial savings and investments . . . ;
   (iv) by implicitly relying on nonprice rationing of credit, it creates scope for arbitrary intervention by political bodies in enterprise credit allocations.[29]

3. The OECD's *Economic Survey: Yugoslavia*, published in May 1981, discussed the issue of what it called 'the low and inflexible real interest rate policy' in a similar vein. It concluded that 'it has encouraged an excessive level of stock building and fixed investment'.[30] Earlier in the report it is stated that 'The sizeable negative real rates are an important inducement to borrow and undermine both the short-run stabilisation objectives and the long run aim of promoting more efficient investment and growth.'[31]
4. In the same year Kosta Mihailović published a remarkable book entitled *Ekonomska stvarnost Jugoslavije* [The Economic Reality of Yugoslavia].[32] The author has for many years been acknowledged as a prominent authority on regional development, but this book deals mainly with long-term overall economic development in Yugoslavia and the causes of the present crisis. It was intended for a wider public and was quite successful in reaching it: the second edition, published in 1982, sold as quickly as the first one. Mihailović's work will be discussed extensively here not only because it presents a recent review of Yugoslavia's economic problems by a highly competent economist from the country itself, but especially because it is, in my opinion, a work of great analytical quality that goes right to the heart of the matter.

   The thrust of Mihailović's argument is directed at the nature and speed of the accumulation and turn-over of productive capital, this being 'the key question in the development of any economy'. The poor functioning of the financial market is considered 'the major weakness of the Yugoslav monetary system'.[33] However, it connects the issue of overly capital-intensive development (or, to translate Milhailović's own words, 'the maximisation of income per [employed] worker as the basic motive for economising enterprises, which boosts the individual, and not the aggregate productivity of the labour force') not only to the severe underpricing of investment credit (to less than 30 per cent of its real value[34]), but also to '[the] bias . . . created by secondary income distribution, which has linked the contributions for collective and general consumption [i.e. taxes for infrastructural expenditures - W.B.] to the [use of the] labour force, as a consequence of which the latter has become unwarrantedly expensive'.[35] The institutionally determined distortion of factor costs - i.e. making the scarce factor (capital) cheap and the abundantly available factor (labour) expensive - has been 'the prime cause of the high proportion of investments in the national product, the low efficiency of investments and the rapid growth in [the number of] unemployed citizens'.[36]

Milhailović traces these grave symptoms of destabilisation in the Yugoslav economy, which 'fosters wastage in the entire society',[37] to an ideologically inspired faith in, if not obsession with, rapid development on the basis of the capital intensification of production. What has happened is that through exorbitant social costs and, eventually, a decrease in aggregate income through rising unemployment, the economy was pushed over the brink into crisis.

Milhailović concludes that a revision of the country's fiscal and monetary policy is necessary in order that the economic costs of using the basic means of production will, by and large, be reflected in their prices. Thus he advocates a drastic increase in the interest rate on investment credit, to a level higher than the inflation rate(!), and a fiscal reform which lowers taxes and levies on wage payments, combined with the re-introduction of a rental levy on the use of socially owned 'basic means' (i.e. capital assets).[38] A monetary and fiscal reform along these lines is not merely one of several instruments to achieve economic stabilisation: it is *the* decisive one and has a very broad impact on economic relations.[39]

Mihailović presents his proposals as an attempt to achieve a workable synthesis between the market economy and the planned economy, while avoiding the weaknesses and dangers of both. He writes:

> It is, probably, the most important aim of the proposed complex of measures that they induce economic subjects to behave as the social optimum requires . . . . They will not diminish the regulatory role of the market in economic relations. On the contrary, the market will be left to regulate those relationships which it is able to regulate.[40]

It evidently is Mihailovic's purpose to provide the economic actors with the right signals to guide their entrepreneurial efforts.[41]

However, the implications go far beyond the creation of superior economic steering mechanisms in the technical sense and reach into the realm of ideological objectives. Mihailović, like Vanek, is well aware of that. On the last page of his book he states that the reforms which would achieve a 'liberation from the tutelage of territorial political centres' are not only 'a condition for greater efficiency in the economy, but also for further development of self-management relations [in society]'.[42]

This approach is very much in line with official Yugoslav ideology, which has always emphasised 'de-étatisation' as a major objective and consequence of workers' self-management of the economy and society.[43] It has, moreover, not only been Marxian thought which provided good 'objective' reasons to argue that there is a link between economic progress and human liberation. It is true not only in Yugoslavia but also in many other countries that few forces are a greater obstacle to effective democratic and self-management relations than economic inefficiencies. These inefficiencies result in and are caused by a high and/or rising unemployment rate, coupled with low and/or declining real incomes of employed workers and of the population as a whole.

5. CONCLUSION: A LESSON FOR INDUSTRIAL CAPITALISM?

The Yugoslav and foreign analysts who have looked for 'systemic', as opposed to so-called 'accidental', causes of the present crisis in the Yugoslav economy have undoubtedly proved to be on the right track. They have identified powerful distorting forces that are built into the Yugoslav legal and institutional framework and that determine the conditions under which the Yugoslav market operates.

Surely certain external circumstances of an accidental nature have had a share in destabilising the Yugoslav economy. Examples of these are the oil-price increases in 1973 and 1979 and the negative effects of the world economic recession on exports to Western Europe and the Americas in particular. Even if allowance is made for these circumstances, however, an explanation is still needed for why they have put the Yugoslav economy so much more out of balance than other market economies.

This paper is not the appropriate place for trying to establish whether the markets for capital, labour and commodities in Yugoslavia were liberalised too much or too little from the viewpoint of maximising the benefits of their intrinsic self-regulatory and stabilising potential. It is not the *degree* of institutional control over - or interference with - market processes that seems a very promising issue for evaluation. Indeed in all industrial market economies, governments constantly interfere with markets through their monetary and fiscal system, trade regulations and agreements and their policies for wage and price setting. In so doing they co-determine the direction and outcome of the economic process. This in no way contradicts the principle of market competition among autonomous (private or collective) economic enterprises: there are no games without rules, and a 'free for all' is not a game.

Bad rules, however, spoil any game. That is a matter of the *direction* in which various institutionally and politically determined regulations move or guide markets, and that direction can be established with much more certainty than the *degree* of the impact.

In this perspective the rather extreme case of economic disequilibrium in Yugoslavia gains an interesting dimension which gives it a far more general relevance. This is because Yugoslavia's monetary policies, primarily aimed at giving enterprises easy access to cheap credit (extended by banks operating along lines very similar to those of commercial banks anywhere else in the world), do not differ essentially from those prevalent in capitalist market economies. Its fiscal system, which finances 80-90 per cent of the collective expenditures through levies on wages, personal incomes and consumer's purchases, also does not differ essentially. The approach in the field of income policies has been the same, basically Keynesian, strategy as was followed by the capitalist economies during the economic boom. Under that strategy net wages - i.e. wages less taxes and social premiums - were allowed to rise at the same pace as the overall growth of the gross material product. This meant that, as in other rapidly growing industrial countries, almost the entire fiscal burden on personal incomes and consumer expenditures was passed on to the wage bill of enterprises, with the result that the rise in the price of labour became way out of proportion.

That the Yugoslav institutional policy is fundamentally identical to that of the capitalist economies is, of course, not a coincidence. The very successful and rapid industrial growth in the West during the 1950s and 1960s was taken as a model, both theoretically and practically, for Yugoslavia's capital-intensive course of development. In fact for more than ten years after the mid-1960s the Yugoslav economy achieved even greater capital accumulation and growth in real consumer's income than most other industrial nations - albeit with more quickly rising public (mostly foreign) debts and inflation.

There are indeed many indications that Yugoslavia's economic policy-makers simply 'overdid' it in their strategy of capital-intensity-biased stimulation, and that they overheated the system to such a degree that the costs began to outweigh the benefits. The economy came to operate with growing wastage of its physical and human resources.

The question now arises of what was - and still is - happening to *international* industrial capitalism at this time? In recent years it too has proven ever more clearly to be inherently prone to crisis. This has cruelly smashed the optimistic expectations to the contrary, which had developed during the decades of economic boom. It is true that the phase of almost uninterrupted expansion in industrial capitalism after the Second World War lasted about twice as long as Yugoslavia's prosperity under a similar economic strategy, but twenty-five years of relatively stable economic growth cannot by any stretch of the historical imagination be a reason to label it 'long lived'! The symptoms of economic destabilisation in Western industrial capitalism may not - as yet - be as acute as they are in Yugoslavia, but qualitatively they are not different: the common symptoms are dwindling profits and/or growing losses in the market sector, high and increasing unemployment rates and stagnating growth in productivity and in demand. Other symptoms depend on the style of crisis management chosen by the polity: one sees either rapidly growing public deficits and inflation, with no decline in the gross national product or only a slow one, or drastic cuts in public expenditures causing the downward production trend to accelerate.

Western analysts of Yugoslavia's economic problems have for many years been very keen on revealing the institutionally determined distortion of relative factor costs, but now it seems that it would be wise for them to turn their attention to that same phenomenon in their own capitalist market economies. This is perhaps not so much because of low interest rates on investment credits, even though one should keep in mind that the much-discussed sharp rise in real interest rates to 5-7 per cent or more is a very recent development. Before 1978 and throughout the build-up of the crisis, real interest rates of 0-3 per cent were quite normal among the industrial nations in the West.

There is, however, every good reason to take a critical look at the Western capitalist fiscal systems which are currently applied, as they have grown over time. In all Western industrial countries without exception, the tax burden weighs heavily on labour (i.e. personal incomes and consumption), while investments in capital assets are subsidised through public funding or are fiscally stimulated in other ways. It is a fact that 55-60 per cent of the gross national income, and in some countries even more, is channelled through the public sector. At the same time a large share of the public expenditures are intended to directly support, or are a direct consequence of, the investment and transformation process in the market sector. These conditions make it evident beyond any doubt how strongly such a one-sided linkage of taxes and premiums to the employment of labour, rather than to capital, favours the latter at the expense of the former.

In this connection it is interesting to note a short comment in the conclusions to the World Bank's 1975 report on Yugoslavia: 'the distortive effects of a large body of proportional taxes on personal incomes has been recognised'.[44] Nevertheless this second source of the upward price distortion of labour as compared to capital (i.e. investments), which is probably of no less economic significance than low or even negative interest rates on investment credit, is hardly ever mentioned in analyses of the causes of unbalanced capital formation, inflation and unemployment in Yugoslavia (and in other rapidly developing nations). One reason why this is so is now perhaps clear. The fiscal systems in the leading industrial countries in Europe and North America are in that respect equally if not more sharply biased than the Yugoslav system.

There may be another factor explaining why that bias has thus far been given so little attention in the debate on structural imbalances in Western industrial development. Logically speaking a correction would require that the capital stock of enterprises in the market sector would be taxed in one way or the other. Alternatively one might consider taxing additions to that capital stock in the form of new investments. Even if the vast majority of economists were not so dogmatic as to reject such a line of thought offhandedly, considering it a dangerous heresy to be erased from the slate of policy options as quickly as possible, in all likeliness it represents a departure from current thinking that is too sharp to be seriously considered. Taking such a measure would indeed entail a major break with widely acclaimed policies seeking to achieve the ideal of rapid technological and economic progress.

Given the ever more serious and apparently insoluble economic problems in the West, the part of the world which used to serve as a model for successful economic expansion, perhaps the suitable time has now come for a more sober interpretation of the history of Western capitalism in the colonial and neo-colonial periods. As a consequence greater willingness may develop to consider major deviations from standard capitalist economic thought and practice.[45] More credit should go to those who, like Kosta Mihailović, have the courage to challenge conventional ideas about economic development regardless of how strong the support for them still is among liberal, Keynesian or socialist colleagues.

Indeed it is not ideological differerences, as they are commonly understood, that seem to be decisive at the present moment, nor questions of economic orthodoxy or heresy for that matter. It is first of all necessary to (re)gain a more firm theoretical footing, now that experience has shown so many economic beliefs and convictions to be little more than myths, some of which have had quite disastrous consequences. Rather than abandoning existing economic theory - a solution for which some defeatists might argue - (re)gaining that theoretical footing means relinking theory to some of its almost forgotten roots. Coming back to the central theme of this analysis, in any market theory the notion of 'the right price' is very classic and very orthodox. In this perspective the 'unorthodox' idea of correcting the price of using capital by taxing capital investments to the extent that they increase the costs for the (public sector of the) economy can hardly be called heretical. Why are all the external costs of production added to the price of employing labour and none of them to the use of capital? Even worse, why is the use of capital subsidised with funds raised by additional taxes on labour?

The latter practice is not consistent with elementary economic logic. Possibly this is because it was inspired by an unfaltering faith in technological progress at all costs, which dates from the nineteenth century. Moreover, we may have hit here upon an issue which should help in identifying a criterion for distinguishing between 'capital-ist' and 'labour-ist' (i.e. socialist) thinking that nowadays has become more relevant historically than some conventional criteria.

Whatever the case may be, the question of the manner in which the external costs of production in the market sector are fiscally attached to factor employment cannot be separated from the question - which theoretically is equally neglected and equally fundamental - of the 'right' speed and direction of technical progress. The key phenomenon which links the two is, of course, the substitution of capital (and non-human energy) for labour. In spite of the general consensus among economists that trade cycles and economic crises are caused by private and public overinvestments during economic booms, the entire institutional framework of industrial market economies - capitalist and socialist alike - continues to be set on stimulating physical investments in productive activities at all stages of the trade cycle. Bearing in mind that, as was mentioned above, in the wake of any rapid process of industrial growth and development comes the need for massive investments in infrastructural facilities, it should not be surprising that each major industrial boom ends in a crisis, and that the symptoms of the crisis are aggravated rather than alleviated by further general investment stimuli.

The conclusion of this analysis seems to imply that Yugoslavia, with its serious problems in industrial development, should be held up as a kind of mirror to other industrial countries struggling with economic destabilisation and recession. It indicates that policies designed to moderate the volume of investments in economic enterprises and the rate at which new production techniques are adopted are likely to achieve a better allocation and fuller use of economic resources. They would definitely improve the rate of return on productive investments and increase the income disposable for collective expenditures and consumption of the population.

Contrary to what is commonly believed, such policies would not arrest technical progress, nor would they even slow it down. There are several reasons for this.

1. The frontiers of technological innovation could be pushed forward as fast if not faster than before. The main difference would be that each new technique would diffuse more slowly through the industrial branches where it could be profitably used, while each unit of modern equipment installed would be kept in operation for a longer period on the average. High initial interest or taxes paid on the newest equipment would moderate its competitive margin over older vintages of production equipment, so that the latter would remain profitably operable during a longer part of their technical lifetime.
2. The direction in which technical advancements would move would change somewhat. The emphasis would shift from the substitution of labour (even though that would continue) to other forms of rationalisation, in particular savings on capital, energy and other inputs.
3. The growth and adaptation of social and economic infrastructure could be

attuned to a lower aggregate need for such adaptation arising in the productive sector. This would create scope for a relative decrease in public expenditures.

Economic Steering after Keynes: a Brief Final Note

Since governments are by far the strongest single financial as well as socio-economic steering force in a society, they can contribute a great deal to realising a more balanced and cost-saving course of economic development, whether it be in Yugoslavia or in any other socialist or capitalist market economy. They can, however, only do this as long as they take full cognizance of the 'objective' constraints of the economy and society they control. Moreover, if built-in institutional mechanisms (of which policy-makers may not be fully aware) put heavy politico-economic pressure on constantly stimulating certain dynamic factors of progress exclusively, and in so doing implicitly discourage other equally important ones, even drastic stabilisation measures applied on a year-to-year basis are likely to fail, unless they begin by correcting the more fundamental institutional imbalances.

It has often been said in recent years that the world desperately needs a 'new Keynes' or, to put it in less personal terms, a new set of ideas or a new economic theory that can help governments to overcome the current international crisis. I believe that the material presented in this paper provides some clues as to what such a theory should be concerned with first of all: i.e. with the institutional and particularly fiscal and monetary checks and balances in the economic process. This time it is not merely a matter of maintaining the aggregate volume of demand at the required 'full-employment level' (as was Keynes' central concern), but of the proper regulation, such that it functions as a major balancing device, of the volume and nature of capital investments in new production equipment. This appears to be the additional instrument that is needed to curb the structural tendency to overexpand, which typifies so many modern industrial economies under classical Keynesian economic regimes. This tendency causes them to overcharge the social, environmental and economic 'carrying capacity' of the society.

NOTES

1. This study was undertaken as part of the ongoing research programme at the Institute of Social Studies, The Hague, in which 'Basic Needs, Employment and Technology' is one of the themes.

2. See the authorised text of the law entitled *Zakon o udruženom radu* [Law on Associated Labour] (Edition Vjesnik, Zagreb, 1976), chapters VI and VII.

3. See W. Burger, G. Kester and G. den Ouden, *Self-management and Investment Control in Yugoslavia* (Institute of Social Studies, The Hague, 1976, Research Report Series No. 2), chapter III.

4. The statistical data referred to in this section are taken from the annual publications entitled *Statistički Godišnjak Jugoslavije* [Statistical Yearbook of Yugoslavia] (Savezni zavod za statistiku SFRJ [Federal Bureau of Statistics of the Socialist Federal Republic of Yugoslavia], Beograd), for the years from 1970 to 1981, hereafter referred to as *SGJ*.

5. OECD, *Economic Surveys: Yugoslavia* (Paris, OECD, May 1981), p. 37.

6. See e.g. the article by P. Krasulja and S. Čonkić entitled 'Industrial Development 1961-1977', in *Yugoslav Survey* 1979 (2) (Yugoslovenska Stvarnost, Belgrade), p. 146; and the front-page editorial in the Yugoslav daily *Vjesnik*, 9 April 1975, which discusses the 1976-80 plan.

7. OECD, *Economic Surveys: Yugoslavia* (Paris, OECD, July 1982), pp. 16-17.

8. Between 1973 and 1978 net remigration of migrant workers, which was 60,000 *per annum* on the average, roughly equalled the annual increase in registered unemployment. However, in the three subsequent years (i.e. 1979-81) remigration dropped to below 10,000 *per annum* on the average, which was less than half of the increase in unemployment (see OECD, *Economic Surveys: Yugoslavia* [July 1982], pp. 15 and 60).

9. See *INDEKS Mesečne Pregled Privredne Statistike. SFR Jugoslavije* 1983 (1) (Savezni zavod za statistiku SFRJ, Beograd).

10. See Burger *et al. Self-management and Investment Control in Yugoslavia*, chapters II and III.

11. See, for example, the official Yugoslav publication in English entitled *The Social Plan of Yugoslavia for 1981-1985* (Yugoslovenska Stvarnost, Belgrade, 1981), pp. 3-10.

12. OECD, *Economic Surveys: Yugoslavia* (May 1981), p. 58.

13. Based on figures presented in Dragutin Marsenić, 'Basic Characteristics of Yugoslavia's Foreign Trade and Balance of Payments', *Yugoslav Survey* 1982 (2): 79.

14. See, for example, the report prepared in 1975 by a mission of the World Bank, entitled *Yugoslavia: Development with Decentralisation*, V. Dubey, ed. (Baltimore, London, Johns Hopkins University Press, 1975), pp. 15 and 242.

15. See the Introduction to *The Social Plan of Yugoslavia for 1981-1985*, p. 5, footnote 11.

16. See, for example, the article by A. Budimlić, *et al.* in Vjesnik, 14 December 1972. See also *Platform*, the English translation of the preparatory document for the 10th Congress of the League of Communists of Yugoslavia (Kommunist Publishing House, Belgrade, 1973), Part 2, III/4.

17. See the weekly *NIN* (Beograd), 13 June 1982, pp. 20 and 21; and 17 October 1982, p. 15.

18. See the weeklies *Politika* (Beograd), 8 November 1982, p. 8; and *NIN*, 2 May 1983, pp. 16-19.

19. *SGJ*, *1981*, p. 754.

20. The weighted average of capacity use in all branches of industry was only 81 per cent in the years 1977, 1978 and 1979 (see *SGJ*, *1979-1981*, Tables 117/3 in all three volumes). There can be little doubt that since 1979, when the *SGJ* stopped giving the figure for this average, it must have increased considerably: industrial investments remained very high, and the growth in material production in 1980 and 1981 was minimal.

21. In the 1970s public investments in social, administrative and economic infrastructure in Yugoslavia were less than one-third of those in the commercial sector and in agriculture. This share is low in comparison to that in many other industrial countries in Western and Eastern Europe. See *United Nations Yearbook of National Accounts Statistics 1980* (United Nations, New York, 1982), Vol. I, Part 2.

22. See *United Nations Yearbook of National Accounts Statistics 1980*, Vol. II, Tables 2A and 2B, pp. 23-87.

23. See *United Nations Yearbook of National Accounts Statistics 1980*, Vol. I, Part 2, Table 6A, p. 1,646.

24. See Marsenić, 'Basic Characteristics . . .', p. 80. Over the years from 1976 to 1979 Yugoslavia's import bill for machinery, transport equipment, instruments etc. rose from the equivalent of US$2.59 billion to that of US$5.3 billion, which was an increase from 41.3 per cent to 45.1 per cent of total imports, excluding oil and other fuels (see *SGJ*, *1981*, Table 121/13, p. 313).

25. Marsenić, 'Basic Characteristics . . .' pp. 97, 80; and *SGJ*, *1981*, p. 305.

26. See, for example, Branko Horvat, 'Yugoslav Economic Policy in the Post-War Period: Problems, Ideas, Institutional Developments', *The American Economic Review*, Vol. 61, no. 3, Part II (June 1971), Supplement, pp. 140-142.

27. Jaroslav Vanek, 'The Yugoslav Economy Viewed through the Theory of Labor Management', in *The Labor-managed Economy. Essays by Jaroslav Vanek* (Cornell University, Ithaca, New York, 1977), pp. 57, 58.

28. Vanek, 'The Yugoslav Economy . . .', pp. 80ff.

29. World Bank, *Yugoslavia, Development with Decentralisation*, p. 15.

30. OECD, *Economic Surveys: Yugoslavia* (May 1981), p. 45.

31. OECD, *Economic Surveys: Yugoslavia* (May 1981), p. 38.

32. Kosta Mihailović, *Ekonomska Stvarnost Jugoslavije* [The Economic Reality of Yugoslavia] (Prosveta, Beograd, 1981). The translations of quotations from this book are my own.

33. Mihailović, *Ekonomska Stvarnost* . . . , pp. 207 and 238.

34. Mihailović, *Ekonomska Stvarnost* . . . , p. 237.

35. Mihailović, *Ekonomska Stvarnost* . . . , p. 242.

36. Mihailović, *Ekonomska Stvarnost* . . . , p. 243.

37. Mihailović, *Ekonomska Stvarnost* . . . , p. 281.

38. Such a levy had been in existence between 1954 - when control over socially owned capital assets was transferred to the enterprises that used them - and 1966. Depending on the branch of industry, enterprises paid between less than 1 per cent and 6 per cent *per annum* on their equipment, premises etc., irrespective of how they had been financed (see Horvat, 'Yugoslav Economic Policy . . .', p. 139).

39. Mihailović, *Ekonomska Stvarnost* . . . , p. 247.

40. Mihailović, *Ekonomska Stvarnost* . . . , pp. 288 and 289.

41. Mihailović, *Ekonomska Stvarnost* . . . , p. 279.

42. Mihailović, *Ekonomska Stvarnost* . . . , p. 290.

43. See e.g. chapters I-V of the preamble to *The Constitution of the Socialist Federal Republic of Yugoslavia* (Delo, Ljubljana, 1974), pp. 53-68. This is an authorised English-language version of the Yugoslav constitution.

44. World Bank, *Yugoslavia, Development with Decentralisation*, p. 16.

45. The need for new theories on capital formation and in particular on capital productivity appears most urgent. Recently valuable contributions have been made by, for example, Narindar Singh in *Towards a Holistic Social Enquiry* (New Delhi, Zakir Husain Centre for Educational Studies, 1981); Orio Giarini in *Dialogue on Wealth and Welfare. An Alternative View of World Capital Formation* (New York, Oxford etc., Pergamon Press, 1980); and Anghel Rugina in 'Toward a Third Revolution in Economic Thinking', *International Journal of Social Economics*, Vol. 10, no. 1 (1983).