YUGOSLAV ECONOMIC POLICY
IN THE POST-WAR PERIOD:
PROBLEMS, IDEAS,
INSTITUTIONAL DEVELOPMENTS

BRANKO HORVAT

SEPARAT 123
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Yugoslav Economic Policy in the Post-War Period: Problems, Ideas, Institutional Developments

By Branko Horvat

Introduction

Yugoslavia has been described as one country with two alphabets, three religions, four languages, five nations and six federal states called republics. One might add that the country has a population of twenty million and that it lies in the heart of the Balkans, with all that this connotes historically. For centuries the Balkans have been a meeting place of three world cultures and three powerful religions: the Catholic West, the Greek Orthodox East and the Moslem South. In terms of contemporary economic organization we may refer to the capitalist West, the centrally planned East and the undeveloped South. All these influences have been felt. A rather turbulent life was to be expected in a country so located and having these characteristics. The present generation of Yugoslavs has experienced all three known modern economic systems: capitalism before the war, centrally planned economy after the war and self-government socialism in more recent years. The last-mentioned system is their own innovation and so far the only one of its kind in existence. The same generation has also experienced all four modern political regimes: bourgeois democracy (in the form of a constitutional monarchy and multi-party system) before the war, fascism during the war, one-party state immediately after the war, and self-government democracy which is now in the process of being developed. It has also lived through a partisan national liberation war and a revolution. After the war a centralized kingdom was replaced by a federal republic, and in two decades the country had three constitutions. Finally, the same generation has experienced three different economic epochs: a pre-industrial stage before the war, rapid industrialization in the two decades after the war and the recently begun stage of a modern industrial economy approaching the Western European level. Before the war, 77 percent of the population were peasants and 40 percent were illiterate. A few economic indicators will suffice to indicate the economic development that has taken place since then: (see table 1)

Illiterates still constitute close to one fifth of the adult population, but at the same time with 11 university and college students per 1000 of population the country has moved close to the very top of the world list.

Such a tremendous pace of change virtually destroyed all traditions, but it also created a new one, a tradition of no tradi-
tion, a tradition of change. In line with the 1958 Program of the League of Communists—the heir of the Yugoslav Communist Party—ends with the words:

Nothing that has been created must be so sacred for us that it cannot be surpassed and cede its place to what is still more progressive, more free, more human.

In such circumstances economic discussion displayed certain unusual features which make formal presentation somewhat difficult. Until about 1960 most of the discussion was either not put on paper, or at least not published. Further, professional articles made practically no use of references. There was a feeling of a complete break with the past, and so there was nothing to be referred to. In the same period professional literature was almost completely descriptive. That was due partly to the fact that the first university departments in economics were established only after the war. It is said that 90 percent of all scientists who have ever lived, live to-day as far as Yugoslav economists are concerned. This percentage is virtually 100.

The second reason for the lack of analytical literature is to be found in the fact that there was hardly any time left for analysis. Economists were busy changing organization, institutions, and policies and keeping themselves informed about all these changes. Unless one had the inclinations of an economic historian, it did not make much sense to engage in a long-term research project. Before the book came off the press, the system had already been changed. Thus for quite some time professional economists were just describing what was happening. Description always precedes analysis.

Finally, until recently attention was mainly focused on what Yugoslav economists call the "economic system." Economic policy in the traditional sense—the use of a set of instruments to achieve desired results in a given framework—hardly existed. Problems encountered were generally solved by changing the institutional framework itself. For a long time, and to a certain extent even today, economic policy consisted of an endless series of reorganizations. The search for an appropriate economic system was the main preoccupation of economic policy.

After 1960 economic organization began to assume a more permanent shape and economic discussion began to take a more familiar form. Since then use has been made of references in articles, ties with the past and with the rest of the world have been established, economic debates have become frequent and lively, professional competence has increased, and a specifically Yugoslav theory of economic policy is now beginning to emerge.

I. Three Economic Reforms

Centrally Planned Economy

Institutional Development: Of all European countries occupied by the fascist invaders, Yugoslavia was the only one to liberate herself by her own forces. The National—Liberation War coincided with a genuine Social Revolution. This meant two things: an unbelievably high morale, the readiness to assault heavens—as a poet said—and also a hardly imaginable degree of devastation of the country. About 1.7 million people were killed in the battles, in concentration camps, by penal expeditions and by domestic quislings. One in every nine inhabitants disappeared in this way. Almost two fifths of the manufacturing industry was destroyed or seriously damaged. About three and a half out of fifteen million people were left without shelter. The loss of national wealth amounted to 17 percent of the total war damage suffered by eighteen countries represented at the Paris Reparations Conference in 1945 (Informativni priročnik, 1948, pp. 27—29).

Apart from all this, the financial system of the country was in a chaotic state; divided and occupied by various aggressive neighbors, the country was left with seven kinds of currencies (German marks, Italian lireas, Hungarian pengő, Bulgarian levas, Albanian francs, Serbian dinars and Croatian kunas).

The first task of the new government was to repair war damages as fast as possible and to organize the economy on what were considered to be socialist principles. For this purpose all available human and material resources were centralized, and with enormous efforts and great enthusiasm by 1947 the prewar output was achieved. The program of socialist reconstruction was carried out by means of legislative and political activities.

Yugoslavia was a peasant country. Peasants participated in the National Liberation War en mass. Agrarian reform, initiated already after the First World War, had never been fully implemented because of the opposition of the ruling classes. No wonder that one of the first moves of the new state was to undertake a radical agrarian reform. The land was to be given to those who tilled it. In less than three months after the end of the war a law was passed that took away the arable land in excess of 87 acres from farmers, in excess of 12 acres from nonfarmers. Big landowners lost their land without compensation. The land that was acquired in this way was distributed among poor peasants, who received about one half of the total land, to cooperatives and state farms (Dobrinčić et al., 1951, pp. 53—54).

The next crucial move, undertaken in 1946, was nationalization of private capital. It was nationalization in industry, mining, transport, banking and wholesale trade establishments. In 1948 nationalization was extended to retail trade and catering and in 1958 to houses with more than three apartments. About one half of the Yugoslav economy, outside agriculture, had been owned by foreign capital. Of the remainder, a sizable part had been owned by the Royal government which possessed coal and iron ore, mines, forests and the largest agricultural estates; enjoyed a monopoly in retail trade of tobacco, salt, matches and kerosene; and was the largest wholesale trader, transporter, importer and exporter, banker, building entrepreneur and real estate owner (Bitanić, 1962a, p. 78). Since a number of private businessmen collaborated with the fascist invader and quisling governments, their property was confiscated. Those who took part in the

### Table 1

<table>
<thead>
<tr>
<th>Production per capita:</th>
<th>Before the war</th>
<th>1968</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Yugoslavia</td>
<td>Western Europe*</td>
</tr>
<tr>
<td>Electric energy, KWH</td>
<td>80</td>
<td>500—1300</td>
</tr>
<tr>
<td>Crude steel, kg.</td>
<td>17</td>
<td>150—300</td>
</tr>
<tr>
<td>Cement, kg.</td>
<td>60</td>
<td>100—190</td>
</tr>
<tr>
<td>Cotton yarn, kg.</td>
<td>1.3</td>
<td>5—11</td>
</tr>
<tr>
<td>Energy kg.</td>
<td>180</td>
<td>2100—6300</td>
</tr>
<tr>
<td>Fertilizers, kg.</td>
<td>3</td>
<td>20—65</td>
</tr>
<tr>
<td>Sugar, kg.</td>
<td>5</td>
<td>24—47</td>
</tr>
<tr>
<td>Stocks per 1000 of population:</td>
<td>9</td>
<td>110—200</td>
</tr>
<tr>
<td>Automobiles</td>
<td>1</td>
<td>17—50</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Resistance—and Communist Party members did that as a matter of course—very often gave away their property without asking for compensation. And, as was already noted, many business establishments were destroyed or damaged. In such circumstances complete nationalization was politically possible, was relatively easy to carry out and did not represent an excessive financial burden.

The next move was to introduce planning by a law in June, 1946. Plans were prepared by the Federal Planning Commission, responsible directly to the Federal Government.

Everything was now ready for the new Constitution which was adopted in 1946, and in which Article 15 read: "In order to protect the essential interests of the people, increase national welfare and make proper use of all economic potentials, the state directs economic life and development through a general economic plan relying on the state and cooperative sector and exercising general control over the private sector in the economy." This paragraph may be considered as both the definition and the inauguration of a specific socio-economic system, later to be known as administrative socialism or statism.

The year 1947 brought the First Five Year Plan which was to lay the foundation for the future industrialized and developed Yugoslavia. The Plan was extremely ambitious—national income was to be doubled as compared with the pre-war level—but in the first eighteen months it was quite successfully carried out. It appeared as though the period of violent revolutionary upheavals was over with the country set on a well-defined and predictable course of economic and social development.

However, for Yugoslavia, history had always had some surprise in store. This time the surprise was more than unexpected: it was a complete shock. In the first half of 1948 Stalin accused Yugoslav Party leaders of revisionism and anti-sovietism. Yugoslavs rejected the accusation, and soon afterwards the Cominform countries launched a full scale political and economic attack. The Yugoslav Communist Party was excommunicated from the "family of brotherly parties." Various treaties were abrogated unilaterally, development loans cancelled, trade with Yugoslavia amounting to about one half of her total foreign trade reduced to virtually nothing by the middle of 1949, and a complete economic boycott established.

The first reaction on the Yugoslav side was a somewhat naive but understandable attempt to prove that Stalin and others must have been misinformed, that no one questioned orthodoxy in organizing a socialist economy, that state ownership and central planning were keystones of the system. Motivated by consideration of this sort, in January 1949 the Central Committee of the Party decided to accelerate the collectivization of agriculture. Already in an income tax law, passed in August 1948, it was stated that "the rate of taxation should be such as to foster peasants’ work cooperatives by means of lower taxes." A law on cooperatives, passed in June 1949, provided a legal framework for various types of cooperatives. Individual peasants were free not to join cooperatives if they chose. But by political propaganda and various administrative and financial devices, the authorities exerted strong pressure on them to join, and they did so in great numbers. Meanwhile the organization of the economy was modeled after the Soviet pattern. The state budget absorbed the greater part of national income. The state apparatus was running the economy directly by means of ministries and directorates. By 1950 organizational development reached the stage at which the Yugoslav economy could be considered as a model of an administratively run or centrally planned economy (Mišić, 1951, pp. 126-70). This was also the climax. Already in 1950 a new development set in. The following year a complete overhaul of the economic system was in full swing. And by the end of 1951, the centrally planned economy belonged to history.

Discussion: The ideas and theories that served as guidelines in organizing the Yugoslav economy immediately after the war are to be sought in pre-war discussions among Yugoslav Marxists. They followed the well-known orthodox viewpoint according to which socialism meant state ownership cum central planning. Immediately after the war there was so much to do that little time was left for leisurely reflections. Besides, everything seemed pretty clear, both theoretically and practically. One could rely on Marxist literature and on the experience of the Soviet Union, the first socialist country. What mattered most in those days was fast economic growth. And the Soviet Union showed how to achieve it.

But copying the Soviet blueprint did not produce quite the results expected. Furthermore, the savage attack of the Cominform countries forced people to reconsider their ideological positions quite thoroughly. And so preconditions were created for the emergence of a Yugoslav version of socialism.

Economic discussion before 1952 was dominated by two themes: planning for fast growth and the search for an authentic socialism. Since the former theme will be dealt with in the chapter on planning, we shall focus attention here on the latter.

The older theory maintained that in socialism there would be no market and no prices. After the Revolution, Yugoslavia was going through a period of transition between capitalism and socialism. In this period commodity relationships were still necessary because of the existence of private ownership and because labor was still heterogeneous (Kidrić, 1949).

Boris Kidrić— a statesman 1 who was to dominate the economic thinking of the country until his premature death in 1952—maintained that only state ownership was truly socialist (1950a, p. 8), that "the state sector was the highest form of our social ownership..." (1950a, p. 8). The same opinion is still held by most economists in the Soviet sphere of influence. In Yugoslavia it did not survive beyond 1950. Consistent with the above reasoning was the extolling of the significance of state planning. R. Uvalić (1948, p. 20), Kidrić (1949, pp. 42), S. Kräigger (1950, p. 12) and others repeated the familiar thesis of Soviet economists about planning as a fundamental law of socialist economics. A few years later this theory was to be described as a voluntarist fallacy.

Rereading of Marx and Engels showed the possibility of great confusion in interpretation. Marx and Engels wrote seldom and very little about socialism. What they wrote amounted to two groups of statements: one dealing with the organizational form of a socialist economy, the other with the essential social characteristics of a socialist system. Marx and Engels maintained that commodity relations and the market would disappear along with private ownership; there would be comprehensive planning: production and distribution would be organized without the mediating role of money. For many decades it seemed obvious that comprehensive planning meant central planning exercised by the government, and that the absence of private ownership meant state ownership. In 1950 it was discovered that Marx had never drawn

1 He soon became the President of the Economic Council of the Government and the Chairman of the Federal Planning Commission. He was also a member of the top Party leadership.
the last conclusion. In fact, and here they argued about essential characteristics of socialism, Marx and Engels denounced the state, argued that it would wither away in a classless society, talked about the self-government of producers, and asserted that "... a worker is free only when he becomes the owner of his means of production." Marx's insistence on the freedom of the individual was discovered in a statement, which was later entered into the Party program, and which reads: "The old bourgeois society with its classes and class antagonism is being replaced by an association in which development of every individual is a precondition for the free development of all" (Horvat, 1969a, pp. 105-17).

Far from being truly socialist, state ownership turned out to be a remnant of capitalism, characteristic of backward countries that are building socialism, and likely to generate dangerous bureaucratic deviations (Dobrinčić et al., 1951, pp. 10-18). In 1959 Kidrič wrote: "State socialism represents ... only the first and the shortest step of Socialist Revolution ... Persisting in state (bureaucratic) socialism ... unavoidably leads to an increase and strengthening of privileged bureaucracy as a social parasite, to a suppression ... of socialist democracy and to a general degeneration of the system into ... state capitalism ... The building of socialism categorically requires the development of socialist democracy and a bold transformation of state socialism into a free association of 'direct producers'" (Kidrič, 1959b, pp. 5-6).

Very soon a similar position was accepted by practically all Yugoslav social scientists. M. Novak wrote that to keep state ownership would mean "... not the abolition of the proletarian but the transformation of all people into proletarians, not the abolition of capital but its general rule in which a specific exploitation is being and necessarily will be developed." (Novak, 1955, p. 92). Approaching the problem from a different point of view, N. Pašić came to the conclusion: "In the past state intervention in the economy was erroneously identified with socialism. If this criterion was applied to the last several decades, it would bring into socialist ranks all eminent capitalist politicians of recent times, from Baldwin and Roosevelt to Hitler and de Gaulle" (Pašić, 1957, p. 11). A. Dragičević wrote: "Nationalization of means of production and planning are preconditions of socialism, but only preconditions and nothing more. In order to achieve 'fully developed' socialism, many more additional factors are required, in the first instance a socialist development of political relations and of economic structure of the society" (1957, p. 218). Similarly, F. Kovač and D. Miljević observed that "state ownership and state management by themselves lead to small or no change in the position of the producer in the production process and in his right to participate in the management of the economy ... In the countries in which socialist Revolution was victorious, the state, instead of becoming an organ of the working people, may and does become an organ of the state and party apparatus, which rules on behalf of the working people" (1958, p. 13). R. Mitic observed that "state socialism in the USSR through bureaucratic socialism develops into state capitalism ..." (1951, p. 21). These statements are not quite so novel as they might sound: Already half a century ago Z. Fabri, in connection with a book by Lenin, wrote: "If the state becomes an owner, we shall have state capitalism and not socialism ... Under state-ownership all proletarians would become workers hired by the state instead of by private capitalists. The state would be an exploiter and that means that an entire crowd of higher and lower managers and an entire bureaucracy with all its hierarchical strata would create a new ruling and exploiting class. It looks as if something similar has already been happening in Russia ..." (Stanovčić and Stojanović, 1966, p. 164).

Lately there has been a tendency to replace "state capitalism" by an emotionally more neutral term "etatism" (Stanovčić and Stojanović, 1966, pp. 328-36; Petuljić, 1967). The most radical in this respect is S. Stojanović, a philosopher by profession: "The term etatism denotes a system based on state ownership of means of production and state management of production and other social activities. The state apparatus represents a new ruling class. As a collective owner of means of production it employs and exploits labor. The personal share of the members of the ruling class in the distribution of the surplus value is proportional to their position in the state hierarchy ..." (1967, p. 35).

If the state is an institution alien to socialism, who is to organize the economic process? Clearly, the only available alternative is that this task be undertaken by producers themselves. Centralization as the principle of organization is to be replaced by decentralization, whereby managed economy by a self-government of workers. In the middle of 1959 a law was passed by which workers' councils were created. The draft of the law was introduced to the Federal Assembly in a speech by President Tito who said: "The slogan, the factories to the workers, the land to the peasants, is not any abstract propaganda slogan, but one which has deep meaning: It contains in itself the whole program of socialist relations in production and also in regard to social property and the rights and obligations of the workers, and therefore it can be and must be realized in practice, if we really desire to build socialism" quoted according to (Bilandžić, 1967, p. 69). By 1952 the new economic system was already in operation.

### Decentralization

#### Institutional Development

The preparation for the New Economic System—as it was called—started with the Law on Management of Government Business Enterprises and Economic Associations by Workers' Collectives enacted in July 1950, and ended with the Constitutional Law on Principles of the Social and Political System of Yugoslavia, accepted by the Federal Assembly in 1953. The New Economic System (NES) became operational in 1952. It was transitional in character and lasted until 1960. During these eight years the country achieved the highest rate of growth in the world: per capita gross national product expanded at the rate of 8.5 percent per annum, agricultural output at the rate of 9 percent, industrial output at the rate of 13.4 percent (Horvat, 1963; Popov, 1968, pp. 363-64).

The law postulated that workers' collectives conduct all activities of their respective enterprises through their managing organs, Workers' Councils and Managing Boards. The Workers' Council was to be elected by all employees of an enterprise in a secret ballot. J. A. Schumpeter once remarked: "Wild socialisations—a term that has acquired official standing— attempts are made by workers of each plant to supersede the management and to take matters into their own hands. These are the nightmare of every responsible socialist" (1959, p. 226). Such a nightmare now made legal and obligatory by an act of the Belgrade National Assembly. "The principle of workers' self-management"—explains E. Kardelj, a social scientist and one of the most active political leaders—"is the starting point of every socialist politics. ... Revolution that fails to open the door to such a development inevitably must ... stagnate in state capitalist forms and in a bureaucratic despotism" (Kardelj et al., 1956, p. 17).
In 1951 the government was busy dismantling the central planning apparatus with its ministries, directorates and administratively fixed prices. The last directorates disappeared in 1952. On December 30, 1951, a Law on Planned Management of the National Economy was passed. It replaced detailed central planning of production by planning of so-called basic proportions such as the rate of accumulation and the distribution of investment.

The enterprises could be set up even by a group of citizens. The director was to be appointed on a competitive basis by a joint commission of the Workers' Council and the local government. Unsuc cessful enterprises could go bankrupt.

Once the idea of an all-embracing administrative state control was abandoned, it was useless to insist on collectivization in agriculture, even more so because of the poor economic results. 2. Vidačković gives the following explanation: "...the massive participation of peasants in the armed phase of the Revolution and in setting up the revolutionary political power contributed to the failure of statist-bureaucratic socialization of agriculture, since the social-politically active peasantry did not submissively accept the administrative methods of collectivization" (1965, p. 12).

In 1953 the Law on Reorganization of the Peasants' Work Cooperatives made it easy for peasants to leave cooperatives and most of them used this opportunity. Those who remained were often poor peasants and that meant that the remaining cooperatives would not be viable. In order to prevent this from happening and also to curb income polarization in the villages, two months later the government carried out a new agrarian reform which reduced the land maximum to 25 acres. Since before the war nearly nine tenths of all peasant farms were smaller than 25 acres anyway, the new reform did not meet with much opposition. But the harmful effects of former policy were not wiped out. In Yugoslavia there was a long tradition of agricultural cooperatives. Forced collectivization did a great deal to discredit cooperatives. Later the general agricultural cooperatives, which were administratively established and given a monopoly in village trade, also contributed to the encouragement of a genuine cooperative movement.

After all these changes the six-year-old Statist constitution became grossly inappropriate, while the time was not yet ripe for a brand new constitution. The problem was solved by a Constitutional Law, passed in 1953. Its article four States: "Social ownership of means of production, the self-government of producers in the economy and the self-government of working people in the Commune, City and District represent the basis of the social and political system of the country. . . ."

As a consequence of the self-government principle, another very important innovation found its place in the Constitutional Law. It became known as the principle of the fusion of the political and economic sovereignty of the working people. The principle was implemented by creating the Council of Producers as a new house in the Assembly. The Council was composed of representatives of collectives of business enterprises.

In the following years the government was engaged primarily in perfecting the monetary and fiscal systems. Interest rates were applied and there was some experimentation with investment auctions. Commercial banks were added to the hitherto all embracing National Bank. Reserve requirements were introduced. Local governments acquired financial autonomy.

The First Five-Year Plan (1947–1951) was extended for a year, but never really completed. The period 1952–1956 was left with only annual plans. After NES was well established, the Second Five-Year Plan covering the period 1957–1961 was launched. It was carried out in less than four years.

**Discussion:** While the preceding period was mostly characterized by discussion of what was to be socialism, the theoretical approach becomes more positive now. The discussion started by an exchange of opinions on the so-called Transition Period and ended with an analysis of what was to be known as self-government or associational socialism.

Marx wrote that the revolutionary transformation of a capitalist into a communist society could not be carried out at once. Between the two socio-economic systems there must be a short transitional period, and the state of this period would be organized as a Dictatorship of the Proletariat. Marx's analysis looked plausible and in fact proved to be a good anticipation of what happened in Yugoslavia in the first two decades after the war (Horvat, 1969a, ch. 11). Around 1952, and intermittently later, the main issue of the debate was whether socialism (considered to be the first of the two stages of a communist society) is to be included in or excluded from the Transition Period (Horvat, 1951; Novak, 1952 and 1955; Perović, 1953; Sirotković, 1951; Kiorac, 1951). The debate was highly scholastic, and yet the issue was of enormous practical importance. If Dictatorship of the Proletariat is interpreted as a form of political regime, and not as the class content of the govern-

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**Table 2**

<table>
<thead>
<tr>
<th>Index of output</th>
<th>Number of work cooperatives</th>
</tr>
</thead>
<tbody>
<tr>
<td>1930–1939</td>
<td>100</td>
</tr>
<tr>
<td>1948</td>
<td>103</td>
</tr>
<tr>
<td>1949</td>
<td>103</td>
</tr>
<tr>
<td>1950</td>
<td>75</td>
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<tr>
<td>1951</td>
<td>106</td>
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<tr>
<td>1952</td>
<td>75</td>
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<tr>
<td>1954</td>
<td>94</td>
</tr>
<tr>
<td>1955</td>
<td>116</td>
</tr>
<tr>
<td>1956</td>
<td>97</td>
</tr>
<tr>
<td>1957</td>
<td>140</td>
</tr>
<tr>
<td>1964</td>
<td>170</td>
</tr>
</tbody>
</table>

In the period under consideration economists began to study intensively writings in the economics of socialism, particularly those of Western authors. This literature had hitherto been virtually unknown. T. Makšinovit (1958), F. Cerne (1960) and B. Horvat (1964) produced extensive critical accounts of earlier economic literature. Cerne attempted to provide an acceptable definition of socialism. In his view, socialism is characterized by the following three elements: (1) Equal rights of members of the community as producers. This implies social ownership. Element (1) is a precondition for (2) equal rights in terms of income distribution. This in turn implies distribution according to work. Both (1) and (2) are indispensable for the realization of (3) equal rights in political life. As citizens members of the community must enjoy political—Cerne talks of socialist—democracy (1960, p. 281). It appears that socialism is essentially a philosophy of egalitarianism. Cerne’s definition, although never explicitly quoted—references are not popular in Yugoslavia—may be considered as commanding wide agreement among economists and other social scientists.

On a less abstract level, in an important article in 1953, Uvalić described the main intentions of NES (1954). In the administrative period output was expanded regardless of cost. Now fast growth was to be maintained but cost considerations had to play an important role in the determination of the structure of output. The law of value, i.e. the market, was to take care of that. But the operation of the law of value must be restricted in two important respects: income distribution and capital formation must be controlled. Otherwise, Uvalić warned, exploitation and market anarchy will reappear. These ideas were to dominate economic policy in the next decade. But clumsy bureaucratic and often incompetent controls of income distribution and capital formation were to become more and more irksome and irritating.

The relation between market and planning has become a recurrent theme in economic discussion. Usually market and planning are visualized as two different mechanisms. In the opinion of Cerne the planning mechanism is to be used for long-run and general decisions, while short-run and partial decisions may be left to the market mechanism (1960, p. 11). A similar position was taken by J. Lavrač (1958). B. Jelči explores in more detail institutional arrangements necessary to harmonize the market and planning. He argues that unbalanced growth sometimes requires interventions even outside the general framework provided by the plan (1958).

By the end of the period (1958) under consideration, NES got its first theoretical rationalization in a book by the present author (Horvat, 1964). Since the socioeconomic system is conceived as an association of business, political, etc., associations, I suggested that it be called Associationist Socialism. I pointed out that the old alleged incompatibility of market and planning was nothing more than an ideological fallacy. The market is just one and that a very efficient—device of social planning. The integration of market and planning, social ownership and business autonomy of enterprises, produces a system with interesting new practical as well as theoretical features. First reactions towards this book were negative (Dragičević, Stampar & Horvat, 1962; 1963). Insisting on consumer sovereignty was considered to represent the (negative) influence of Western welfare economics. Insisting on rigorous technical analysis was considered devoid of social content and so anti-Marxian. Insisting on market economy was considered to reflect the influence of Western theory of free competition. The analysis of price formation, in which interest and rent played a certain well-defined role, was said to represent a bourgeois theory.

A similar critique was voiced by some socialist economists abroad. E. Mandel maintained that “there is a definite incompatibility between socialism—or, put otherwise, a classless society and a high degree of social equality and economic efficiency” (1957). This is so because commodity production inevitably generates social inequality and produces waste of economic resources. The reader was not told why this should be inevitable.

In this debate B. Ward came perhaps nearest to the truth. As to the method of analysis she says: “In value theory Horvat manages to produce more or less Marxist results from more or less neoclassical assumptions” (1967, p. 519). As to the substance of the theory she concludes: “Naturally enough this regime is essentially socialist; not surprisingly, it bears a more than casual resemblance to Yugoslavia. What is surprising is that it carries a more than expected measure of plausibility.”
(1967, p. 509). Most of the ideas developed in this 1958 book have now been absorbed and seem self-evident. The latest reform is based on the market mechanism and the welfare of individuals as the main guiding principles.

**Self-government Socialism**

**Institutional Development**: The last phase in Yugoslav post-war socio-economic development was prepared by a series of political, economic, and constitutional reforms in the period 1958–1963. This turbulent period was inaugurated by the new Program of the League of Communists in 1958. Here socialism is defined as: "... the social system based on socialized means of production in which social production is managed by associated direct producers, in which income is distributed according to the principle to each according to his work and in which, under the rule of the working class, itself being changed as a class, all social relations are gradually liberated from class antagonisms and all elements of exploitation of man by man" (Pravda 2a, 1958, p. 133).

Thus the Yugoslav variant of socialism appears to imply social ownership, self-management in the economy, the absence of non-labor income and of exploitation. The term "working class," as explained a few years later by Kardelj, was to mean "all working people who are participating in the social process of labor and in socialist economic relations" (Kardelj, 1962, p. 1531).

By 1960 the second Five-Year Plan was successfully completed. The economy was booming, self-management in enterprises was already well established and the Program paved the way to an accelerated pace of changes. The new Five-Year Plan was prepared. The Society felt ready for a new important step forward. In 1961 three radical reforms were carried out. In order to increase the efficiency of the market organization and to improve the quality of goods produced, the hitherto virtually closed economy was to be made more susceptible to, the influences of the world market. To achieve that, the system of multiple exchange rates was replaced by a customs tariff, the dinar was devalued, foreign trade was liberalized to a certain extent and the country became an associated member of GATT. Since developments in the field of money and banking were lagging behind the general institutional changes, an overhaul of the entire financial organization was undertaken. And finally, it seemed inappropriate for trade unions to continue to supervise wage levels and wage differentials in self-managed enterprises. And so this control was discontinued. Since then in this field, market competition has gone further than in any other modern economy. These three reforms inaugurated in 1961 the beginning of the third distinct phase of economic development.

By that time the country was institutionally ready for the new constitution which was promulgated in 1963. Explaining the aims of the constitution, Kardelj, one of its chief architects, said that it was "not only the constitution of the state but also a specific social charter which will provide the material basis, political framework and encouragement for the further internal development of the system of socialist self-government and directive democracy" (1962, p. 1533). Self-management was extended to cover not only business but also non-profit organizations. It was generalized as a principle of self-government to be applied in all spheres of economic, social, and political life. In order to achieve this, the Constitution invented a new institution: the work organization (radna organizacija). Whenever people associate in order to work for a living, they create a work organization and represent a work union (radna zajednica) which enjoys basic self-government rights constitutionally guaranteed. Work organizations include enterprises and other business establishments as well as educational, cultural, medical, social insurance and other public service establishments. As a consequence the "fusion principle" of the 1953 Constitutional Law was extended to cover all work unions, and the Assembly got three houses of work unions: for the economy, for education and culture and for health and social welfare.

The three reforms of 1961 were poorly prepared, partly inconsistent and badly implemented. As one might have expected, the sensitive market economy reacted violently. Everything went wrong: in one year the rate of growth of industrial output was reduced to one half of its 1960 level, imports soared, exports stagnated, wages went far ahead of productivity. The reformers, accustomed to a tardy half-institutional economy, were taken by surprise. Planners increased targets for 1962 in order to catch up with the Five-Year Plan goals—and were, of course, deeply disappointed. The recession was deepened. It became clear that the Plan would have to be abandoned. Administrators and political bodies were deeply disturbed. Conservative politicians and economists were busy explaining the failure of the market system and demanded that central planning be reintroduced.

Heavy pumping of money into the economy helped to generate recovery in the second half of 1962. In the next year the economy was back to its normal path of fast growth. The upswing continued into 1964 ending in a boom with heavy inflation and a great balance of payments deficit. The new recession brought a new reform. Throughout 1964 assemblies were busy discussing the principles of the new reform (Savezna Skupština, 1964). In the beginning of 1965 the government administration was set to work. By May, technical preparations were completed and in July the Federal Assembly enacted the package of laws inaugurating the reform (Savezna Skupština, 1965). Significantly enough, the solution of economic troubles was sought in further decentralization, perfection of self-government autonomy, development of a more competitive market and an integration into the world economy.

What followed appeared to be a second, more radical and more consistent, edition of the 1961 reform. The reform started as an economic one, but very soon produced important social and political consequences. Multicentric planning could not help but produce a pluralistic society. Reform was in its essence a new stage of the revolution; so asserted V. Bakaric, president of the Croatian League of Communists (1967, p. 231). Self-government autonomy became firmly rooted in the Socialist Establishment.

**Discussion**: The reform of 1961—called also NES (1)—marked the beginning of a real academic discussion of economic matters. Up to that time institutional changes had been too fast, and economists too few, so rigorous analysis and discussion had been replaced by descriptions.

The discussion started with an exchange between Uvalic and Bicanic. Uvalic reiterated his views that income distribution and capital formation could not be left to regulation by the market. So far, distribution according to work had encountered serious difficulties. The capital market, as a device for capital formation and allocation, was unacceptable because it would lead to group ownership. Social profitability and individual profitability were two different things. The individual interest of a collective was inferior and had to defer to the social interest (Uvalic, 1962). Bicanic objected that Uvalic did not distinguish clearly between what is commonly called the economic system, and the plan. The economic system (general
The government was alarmed and asked a group of academic economists associated with a research institute to find out what had happened. This move was precedent in the governmental attitude towards managing economic affairs. In a few months the group produced a report, popularly called The Yellow Book (Horvat, 1962a).

The findings of the Yellow Book may be summarized as follows. Inefficient planning resulted in economic instability. The structure of supply failed to match the structure of demand, there was a downward shift in long-run export trends, there was a serious lack of skilled labor force. The inherently unstable economy was exposed to the simultaneous shocks of the three poorly prepared and badly implemented partial reforms cited above. The insistence on financial discipline created a serious shortage of money with strong deflationary effects. The abolition of income control led to wild increases of wages unrelated to productivity increases. The liberalization of foreign trade emphasized the fundamental importance of economic research as a basis for economic policy and the stability of the legal and policy framework as a precondition for efficient operations of enterprises in a market setting.

In the meantime, another research institute produced an analysis of the defects of the economic system. The report became known as The White Book and it criticized deficient planning, an imperfect market, arbitrariness in income distribution and inconsistencies in investment decisions (Dabčević et al., 1962). Both documents were discussed in a meeting jointly organized by the Association of Economists and the Federal Planning Bureau in Zagreb in January 1963 (Savjetovanje, 1963). The former planning officials and a certain number of economists with a more centralist orientation criticized the two documents. They questioned the possibility of efficient investment and a high rate of growth in a decentralized setting. They thought that the market necessarily led to a destruction of the socialist principle of income distribution. Some of them pointed out that the classical conflict between the essentially social character of production and atomized decision-making lay at the bottom of all economic difficulties (Savjetovanje, 1963, p. 192).

However, the majority of economists agreed on the necessity of further decentralization and the perfection of self-government autonomy. Since the Zagreb debate the basic principles of the development of the economic system have never been seriously questioned among Yugoslav economists.

The well known saying about doctors—"the operation was successful but the patient died—might have been applied to discussions among Yugoslav economists: the causes of economic troubles had been well explained, but the reform was dead. It soon became clear that the entire experiment had to be repeated. And so it was, in 1965. The situation was rather complicated. "The casual observer is often puzzled," commented R. Bićanić. "Only a few years ago Yugoslavia was presented as an example of a country with one of the highest growth rates in the world, now the foremost aim of economic policy is to reduce investment. For more than a decade the socialist economy struggled against bureaucratic command; now an administrative price freeze has had to be introduced. It was the first country in the world to initiate workers management in business enterprises and to abolish the wage system; now there is discussion about whether this means too much or too little democracy. . . . National problems were said to have been solved; now the country is pregnant with increased tensions among the constituent nations, tensions newly created and socialist in origin. Efforts to find solutions to these problems are now concentrated into two words: The Reform.'" (Bićanić, 1966, pp. 633-34). Bićanić and Dzeba (Dzeba and Belaćić, 1967) followed the following aims of the reform:

1. The immediate purpose was to combat an increasing pace of inflation; to remove the chronic deficit in the balance of payments; to reduce all sorts of subsidies (for exports, unprofitable production, etc.) drastically in order to avoid the necessity of central administrative interventions; to correct price disparities in order to establish more efficient market relations and eliminate administrative controls. These were preconditions for some longer-term measures of structural change in the economy such as: revision of growth and investment policies; putting the productivity of the economy on an internationally competitive level; liberalization of domestic and international trade and elimination of the balance of payments deficit; convertibility of the currency in order to open the economy and expose it to the stimulating influences of the world market. In its broader social aspects, the reform was expected to impart a de-politicization of economic decisions; double the share of enterprises in the control of national income, reducing thereby the economic power of the state; to link the level of living to that of productivity; to increase the rationality of economic decision-making. Bićanić concludes that the fundamental aim was in fact "to build a model of a socialist system for a developed country, one which will be able to stand the competition of other developed countries without the constant tutelage of government machinery" (1966, p. 643). He and Horvat (Dobrišić et al., 1951) pointed out that this model is ‘very different from the mixed economy of the “welfare state”.

The aim described was to be achieved by a process which Bićanić called the four
For them, developments were alarming. For some, the evidence was politically much better prepared than the one in 1961, but not so economically. Economically it was based on a rather naive idea of the viability of the laissez-faire principle. Monetary policy appeared to be practically the only available device of economic policy. In order to stabilize prices, the government applied a credit squeeze. It worked, but it also produced deflation with unemployment and stagnation. From the beginning of 1965 to the middle of 1967 the annual rate of growth of industrial output dropped from twelve percent to minus one percent. Negative growth rates had not been known since 1952. The government thought that this was unavoidable, and that the reform "in its strategic aspects" proceeded as planned. Some economists and many businessmen were alarmed. For them, developments were catastrophic and certain to produce another failure. Soon economists were to discover the existence of business cycles. Since cycles had not been known to the government—it was held as self-evident that cycles could not exist in a socialist economy—the government proceeded to frame economic policy as if the cycles did not exist. The results of such an economic policy could not be encouraging.

The discovery of cycles proceeded in stages. The successive retardations of growth, described already in the fallow year, indicated that the Yugoslav economy might have been subject to cyclical fluctuations. The research undertaken in the Institute of Economic Studies confirmed the hypothesis. (This will be discussed more fully in Chapter 5.) In the spring of 1967, in Ljubljana the Association of Economists held a meeting dedicated to problems of stabilization (Savjetovanje, 1966). Four papers dealt explicitly with business cycles. The research institute mentioned ventured to make a forecast of the lower turning point (1967), boom (1969) and recession (1970) of the current cycle which proved to be correct up to the time these lines were written (second half of 1969).

A couple of months after the Ljubljana meeting a public debate took place. It was focused on the theme: "Economic Science and the Economy" (Insttitut, 1968a). Seven economists participated. A. Bajt raised the question of the responsibility for the reform and criticized the naive view that investment generated inflation. Z. Bašiščević evaluated the contention that there was a conflict between politicians and economists. Z. Mrkvič observed the foreign trade equilibrium. Horvat pointed out a number of mistakes contained in currently popular economic reasoning (and, consequently, in economic policy), and in a separate article, which caused a newspaper explosion of discontent, calculated the losses due to cyclical instability. The output lost appeared to amount to about forty percent of the social product. The three remaining economists supported the official view that everything was more or less all right.

In February 1968 the Institute of Economic Studies organized an all-Yugoslav conference on the current economic situation. The study prepared for this occasion (Institute 1968b) described the cyclical mechanism operating in the Yugoslav economy and made a coherent proposal for an anti-cyclical policy. This was an important step forward. The proposal insisted on a combination of monetary and fiscal policies (the latter was virtually non-existent at that time); on a combination of prices and income controls; and on the importance of the interrelations between aggregate demand and investment.

By the end of the same year another feature of the unsuccessful 1961 reform was revealed: two research institutes were officially asked to assess the implementation of the reform. There was, however, an interesting difference: this demand did not come from the government but from the Central Committee of the League of Communists. Two reports were prepared: the findings were more or less the same. I quote from the report that was published (Insttitut, 1969). This report found that in spite of a strong deflationary policy, prices were no more stable than they were before the reform; that the Five-Year Plan was not likely to be fulfilled; that the administrative control of prices was extended over a greater percentage of output than before the reform; that the liberalization trends in foreign trade were checked and reversed; that the balance of payments deficit was expanding; that the rate of saving was decreasing; that the losses and indebtedness of firms were increasing; that the rise in labor productivity was slightly retarded; and that unemployment was increasing beyond anything known in the country in the past two decades. Elaborating its early prognosis in more detail, the Institute predicted an acceleration of growth in the first half of 1969 (to a rate some sixty percent higher than the one forecast by the Federal Planning Bureau), an inflationary pressure in the second half and the downturn of the cycle and the beginning of a new recession by the end of 1969 or in the first half of 1970. The first two forecasts proved to be correct; the last had still the status of forecast at the time; these lines were written. A few months later V. Ražnikovšč undertook to analyze the unpublished papers prepared by the administration as a basis for the reform. Ražnikovšč came to the conclusion that none of the important goals had been achieved in a satisfactory way (1969/70, p. 47).

Once again the ominous question was posed: What had happened? A careful analysis of developments seems to suggest the following answer. Economic growth and institutional changes were too rapid for the government apparatus and other organs of economic policy to be able to cope with efficiently. Almost overnight a backward Balkan country reached a European standard of economic development, and an administrative economy was transformed into a market economy. At the same time responsible authorities often lacked the necessary understanding of how a modern market economy operated. If to all that we add the pioneering in the system of self-government—nonexistent anywhere else in the world—it becomes clear that the complexities of the socio-economic environment have increased enormously and that it will take some time before the organizational framework is adapted, the necessary knowledge is accumulated and the new social system begins to operate smoothly (Insttitut, 1968a, 1969; Horvat, 1968a).

II. Planning

Four Five-Year Plans

The rationale for central planning was explained in Chapter 1. By 1947 the machinery for central planning was completed. Hierarchically organized planning commissions on various levels—federal, state, district and city—were entrusted with comprehensive planning in their respective territories. The operational planning and implementation was carried out by ministries and then down the line by general and chief directorates, and planning sections in the enterprises. Annual plans were broken down into quarterly, monthly and ten-day plans. In 1949 about 13,000 groups of commodities were planned (Čulic, 1948, p. 15). In the same year the state budget comprised two thirds of the national income (Kličić, 1960, p. 453). Every enterprise had to send to the su
prior authorities 600-800 different reports per year. The annual economic plan weighed some 3,300 pounds (Bićanić, 1957, p. 65). Supplies and customers were assigned to every enterprise in advance. Since these administrative allocations were not quite perfect, the enterprises were asked "to find their ways." The planning authorities would provide them more money then they wanted and would ask them to spend it. As prices were fixed, spending money meant finding raw materials and investment goods necessary for the fulfilment of the plan. In a market economy one endeavors to save money, in the centrally planned economy one is at great pains to spend it; in the former selling is the most difficult task, in the latter buying is the greatest worry of businessmen.

The economy was run as one single mammoth enterprise. That required establishing a system of continuous control of operations of all enterprises. In 1948 Kidrić voiced complaints against those who considered that there was no need for daily reporting and who were satisfied with ten-day reporting (Kidrić, 1960, p. 468).

A number of years later J. Stanovnik, now Secretary of the U. N. Economic Commission for Europe, at a lecture delivered to Swedish economists in Stockholm, was asked what sort of devices were used to implement plans in Yugoslavia. He answered: "Telephones!"

The first Five-Year Plan covered the period from 1947 through 1951. It proclaimed four main goals:

(1) to overcome economic and technological backwardness;
(2) to strengthen the economic and military power of the country;
(3) to strengthen and develop the socialist sector of the economy;
(4) to increase the general welfare of the population.

Consumption was taken care of, but it was last in the order of priorities. The goals enumerated were to be achieved by an explosive increase of output; compared with the pre-war level, national income was to increase 1.9 times, agricultural output 1.5 times, industrial output 4.9 times. However, due to poor statistics, the pre-war level must have been greatly underestimated and the three targets were achieved only by 1954, 1959 and 1961 respectively.

At first the implementation of the plan proceeded in a satisfactory way, though not as well as was generally believed. In 1949 the economic blockade of the Cominform countries forced Yugoslavia to search for trading outlets for about one half of her exports and to secure the same proportion of imports from other sources. Although substantial foreign aid was secured two years later, this sudden reorientation of foreign trade had stifling effects on growth. The next blow came from nature; in 1960 a severe drought reduced agricultural output by one third. Collectivization also helped to aggravate agricultural problems. The radical economic reorganization in 1951 could only complicate matters. Industrial output fell by four percent in 1951, and by one more percent in 1952. The plan was extended for a year, but that was already pointless, and the report on its fulfilment of the First Five-Year Plan was never published.

And yet, if not a full success, the Plan was far from being a failure. It generated output substantially above the pre-war level, it raised the share of gross investment in fixed assets to 33 percent of gross national product (material product definition; close to 30 percent on the SNA definition) and created entire new industries.

In 1952 rigid central planning was replaced by "planning by global proportions." These proportions were: minimum use of output capacity and the corresponding wage fund, profits as a percentage of the wage bill (a device for wage planning), basic capital formation, taxes and allocation of budgetary resources (Vučković, 1952, p. 31). In this way, the central plan was expected to regulate general economic activity without administrative orders, by influencing the rate of growth and the proportion between investment and consumption, and by effecting structural changes in the economy (Jelić, 1961). The old Planning Commission—which acted as a superministry controlling the activities of all economic ministries and was in charge of the overall implementation of the plan (Djordjević, 1965)—was replaced by the Federal Planning Bureau, an expert institution with no administrative powers. Republics, districts (later communes) and enterprises would produce their plans independently. State planning became social planning which meant wide consultations among all interested parties, inclusion of non-profit institutions and independence of enterprise plans.

The next three years were used to complete the key investment projects of the Five-Year Plan in annual installments. In the discussion about the 1955 Plan the new mood was already apparent; agriculture looked neglected, investment too large and one-sided (Popović, 1964, pp. 147, 150). By the end of that year M. Popović could say in the Federal Assembly that one period of economic development was completed (1964, p. 160). The year 1956 was used to prepare the Second Five-Year Plan for the period 1957-1961. In this plan increase of consumption already ranked third among the five main goals (Lovrenović, 1963, p. 220). Growth of investment was somewhat retarded and its structure radically changed. The share of industrial investment was substantially reduced in order to double the share of agriculture and increase the shares of transport and trade (Popović, 1964, p. 211). Within manufacturing, consumer goods industries were to expand faster. So-called non-productive investment in social overhead capital was also accelerated. All these changes proved beneficial and the plan was carried out in four years. The planning system seemed to be well adapted to the needs of the economy and worked satisfactorily. This system was described by J. Sirotković (1961), S. Dabčević (1963), and Jelić (1962).

The first plan distorted the structure of the economy by emphasizing capital formation in heavy industries. The second one undertook to make corrections but went to the other extreme by overexpanding consumer goods industries. Thus, the third plan was left with the task of redressing the balance again by accelerating investment in power generation, metallurgy and intermediate goods industries. These fluctuations in investment induced Šćepanić and R. Stojanović to invent a theory of investment cycles inherent in a socialist economy with an uneven pace of technological progress (1960). Z. Baletić and R. Stojanović criticized this theory as unacceptable since mistakes in planning are attributable to ignorance and not necessarily to socialism, and that technological progress is rather innocent in this respect.

The Third Five-Year Plan for the period

<table>
<thead>
<tr>
<th>Indices</th>
<th>1948</th>
<th>1949</th>
<th>1950</th>
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<tbody>
<tr>
<td>Federal Planning Commission</td>
<td>367</td>
<td>116.6</td>
<td>106.3</td>
</tr>
<tr>
<td>Federal Statistical Office (later ministries)</td>
<td>100</td>
<td>111</td>
<td>103</td>
</tr>
</tbody>
</table>
1961 through 1965 endeavored to accelerate the growth of output even further. Personal consumption ranked second among the goals (Lovrenović, 1965, p. 221). The Plan was hardly launched when the country found itself in the middle of a recession, the reasons for which were explained in the previous chapter. The Plan was doomed to fail. In order to avoid unpleasant discussions, the Federal Assembly decided to replace it by a seven-year plan covering the period 1964–1970. For that purpose the Assembly passed a Resolution in which the basic political and economic goals of the new plan were defined as follows (Yugoslav Survey, 1964):

1. steady rise of the level of living, in the first place of personal consumption, and higher share of personal incomes in national income;
2. catching up with international standards of productive efficiency and labor productivity;
3. expansion of external trade through more intensive inclusion of Yugoslavia in the international division of labor;
4. accelerated development of underdeveloped areas;
5. further development of socialist society by strengthening the role of direct producers and working organizations in the management of productive forces.

A comparison of these goals with those of the First Five-Year Plan shows very clearly the distance that separates social planning from state planning. The welfare of individuals is moved from the end to the beginning of the priority list. Behind this change one finds the philosophy which holds that economic welfare is both the purpose and the most powerful incentive for production. An autarchical orientation is replaced by openness towards the world market and international influences. The measure of the perfection of a socialist economy is no more to be found in increasing the share of the state in the national capital but in the development of self-government. Yet, the First Plan and the Resolution had one thing in common: neither of them was implemented.

The Resolution in fact foreshadowed the Reform of 1965. The changes in economic institutions were so radical that it became necessary to prepare a new Five-Year Plan for the period 1966-1970. The Plan incorporated the goals of the Resolution. It envisaged a somewhat lower rate of growth of GNP (7.5–8.5 percent per year), a relatively modest expansion of manufacturing (9–10 percent), but a high rate of productivity increase (6–7 percent a year). Current analysis of the Federal Planning Bureau indicates that these targets are not likely to be achieved (Medenica, 1968).

**Growth and Cycles**

In order to be able to evaluate successes and failures in planning—and in economic policy in general—one has to have a look at some data. The following table summarizes the developments in terms of rates of growth of the most important statistical aggregates.

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<tbody>
<tr>
<td>Gross National Product</td>
<td>2.3(^*)</td>
<td>9.8(^*)</td>
<td>6.8(^*)</td>
</tr>
<tr>
<td>Industrial output</td>
<td>12(^*)</td>
<td>13.4</td>
<td>7.9</td>
</tr>
<tr>
<td>Agricultural output</td>
<td>-3.1(^*)</td>
<td>8.9</td>
<td>2.1</td>
</tr>
<tr>
<td>Export of Commodities</td>
<td>-3.1(^*)</td>
<td>11.7</td>
<td>7.0</td>
</tr>
<tr>
<td>Import of Commodities</td>
<td>3.0(^*)</td>
<td>9.7</td>
<td>7.0</td>
</tr>
<tr>
<td>Employment(^*)</td>
<td>8.3(^*)</td>
<td>6.9</td>
<td>2.4</td>
</tr>
</tbody>
</table>

* 1946-1952
  * 1953-1960
  * 1960-1967
  * Persons employed outside private agriculture

Sources: Statistical Yearbooks.

In the central planning period collectivization caused stagnation in agriculture and the economic boycott of the Cominform countries caused stagnation in exports. As a result total output grew slowly. In the second period the unfettered economy was in full swing in all spheres with an acceleration of growth in the second half of the period. Foreign trade expanded faster than output and exports faster than imports. In the third period agricultural output caught up with domestic demand, while the European export markets became increasingly difficult to penetrate. The slowly expanding market for agricultural products reduced the rate of growth of agricultural output. Increased economic instability increased the rate of growth of manufacturing. As a result, the overall pace of expansion was reduced. In all these developments institutional factors, described before, played an important role. If one wants to judge the performance of the economy on the basis of a somewhat longer period, the period 1952–1968 appears to be the appropriate one. In these sixteen years, total output expanded three and one half times, manufacturing five times, agriculture two and a half times, foreign trade in commodities four times and employment outside private agriculture three times.

Since Yugoslavia has been so far the only country that has lived through three different economic systems—capitalist, fascist and self-government—in a relatively short period of time, it may be possible to evaluate the comparative efficiency of the three systems. Something of the kind was attempted by T. Marschak. He reduced the dimensions of the problem by studying the comparative efficiency of the centralized and decentralized frameworks. Marschak’s results were not conclusive. He felt that the lessons which the current designer of new economic systems could draw from the Yugoslav experience were “staggeringly obscure” (1968, p. 586). Later research was undertaken in the Institute of Economic Studies (IES) (Horvat, 1969b). Efficiency was measured in terms of the rate of growth of output attributable to technical progress, defined as the residual after the contributions of labor and capital have been accounted for. The results are summarized in Table 4.

The periodization in the table is not ideal and is determined by the availability of data. Yet the results of the analysis are extremely suggestive. In the following section it was stated that the investment program of the First Five-Year Plan was completed by 1953. Statistical testing in the IES study showed that the Yugoslav economy operated on the basis of two completely different production functions, one applying to the period 1947–1955 and the other afterwards. The former had a negative residual, the latter a positive and a very large one. The table seems to suggest that central planning expanded output and employment fast, and capital formation even faster, as compared with the private capitalist pre-war economy. But it also reduced overall efficiency. Self-government...
accelerated the growth of output and technical progress beyond anything known before while preserving fast employment expansion.

As might have been noticed already, the growth was fast but not at all smooth. At first the possibility of regular cyclical development was rejected by some economists. Yet in another IES study business cycles with periods of about four years were established (Horvat, 1970). These cycles, that manifest themselves as fluctuations in the rates of growth (see Figure 1), have interesting features not found elsewhere. Thus inventories are accumulated in the downswings and decumulated in the upswings; the accelerator is not operative; prices tend to vary inversely with the cycle etc. The upper turning points seem to be generated by divergent changes in import and export elasticities that end in an explosion of the balance of payments deficit. The lower turning points are somewhat more difficult to explain. Bajt believes that consumer demand in a certain extent autonomous and helps to generate an acceleration of output growth (1999b).

If the beginnings of the cycles are measured from inflection points in the downswings of the rates of growth these points correspond to peaks of deviations from an exponential trend of absolute magnitude), they appear to coincide with major economic reforms. Thus, the five cycles that have occurred so far describe in an interesting manner the history of post-war economic policy (Roman numerals indicate quarters):

5. Economic Reform, I/1965-

Cyclical institutional development seems also to be a novel feature of business cycles.

Development Policy and Methods of Planning

Development Policy and Functions of Social Plans: The philosophy of development, generally accepted by Yugoslav economists and the Government until about 1956, is well described by Cobeljic, then the deputy director of the Federal Planning Bureau (1959a). Cobeljic maintains that rapid industrialization is the chief method of generating development. Industrialization creates additional urban employment, which alleviates latent un-

Note: The rates of growth due to increased efficiency are calculated on the basis of the absolute growth of GNP. The data refer to manufacturing, mining, power generation, construction and credit.

<table>
<thead>
<tr>
<th></th>
<th>1932</th>
<th>1950</th>
<th>1960</th>
<th>1965</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capitalism</td>
<td>2.28</td>
<td>3.28</td>
<td>5.91</td>
<td>10.31</td>
</tr>
<tr>
<td>Elistation</td>
<td>4.07</td>
<td>4.76</td>
<td>9.99</td>
<td></td>
</tr>
<tr>
<td>Self-government</td>
<td>10.31</td>
<td>4.44</td>
<td>7.84</td>
<td>4.44</td>
</tr>
</tbody>
</table>

Note: The war years 1914-1918 and 1941-1945 are excluded. The data refer to manufacturing, mining, power generation, construction and credit.
employment in agriculture. The growth of the urban labor force generates additional demand for agricultural products and so stimulates the development of agriculture. Physical control of foreign trade, in order to prevent the import of non-essential goods and to secure imports of capital goods, and the more rapid growth of consumer goods industries (so-called Department II) helps to accelerate industrial growth which in turn generates development impulses throughout the economy. Imports are paid for by exports of raw materials and agricultural products. The necessary saving is secured by a proper price policy. Prices in predominantly private agriculture are kept low and in consumer goods industries are inflated by means of high turnover taxes.

The policy described was not only advocated but was also consistently implemented. In the period 1950-1956 investment in industry (manufacturing, mining and power generation) absorbed 51 percent of all investment. The share of industry in national income rose from 21 percent in 1939 to 40 percent in 1956. Four fifths of industrial investment were channelled into heavy industry and power generation. The share of saving in national income increased four times as compared with the pre-war level (Čobadžić, 1959a, pp. 178, 366).

The planning system in 1947-1952 was consistent with such a development policy. The main characteristics of this system, as described by Jelić, another deputy director of the FPB, were as follows: a/ strict centralization of decisions about priorities, timing and structural changes; b/ physical allocation of resources as a basic method of planning; c/ financial elements play a secondary role and serve to achieve balances in value terms; d/ targets represent directives; e/ production is planned by commodities and capital formation is planned in terms of individual investment projects; f/ prices are administratively fixed; g/ the elements of which a plan is composed are also instruments in its implementation (Jelić, 1962, pp. 102-105).

After the engine of growth had been set into motion in the way described and the economy organized along socialist lines, there was a possibility of and a need for a different approach. Jelić referred to Rostow's take-off theory and to Bičanić's threshold of growth theory (Bičanić, 1962b) and insisted on decentralized initiative as a further vehicle of growth. Self-government implied that the function of planning be separated from the function of operational management. Jelić pointed out that social plans should determine at least three global proportions—the basic division of national income, the structure of investment and the relations with foreign countries—if they were to be efficient devices for implementation of social preferences (Jelić, 1962, p. 144).

The same three global proportions were accepted as basic by D. Bjelogić, director of the Planning Bureau of Serbia. He added, however, a fourth one: the relative growth of the less developed states and regions (1965, p. 119). Bjelogić presented his paper to a conference on social planning held in Belgrade in 1965, where Čobadžić and K. Mihailović spoke in favor of introducing more directives into planning, while M. Samardžija and M. Koršič maintained that even the planning of the share of accumulation and the structure of investment meant a violation of self-government. This discussion, which covered a wide spectrum of opinions from semi-central planning to an almost completely laissez-faire approach, has been characteristic of the Yugoslav economic profession since the enactment of the new Constitution in 1963. The trend has been towards the laissez-faire extreme. In 1960 the Federal government controlled 48 percent of business investment directly through its General Investment Fund, and in addition, that 14 percent indirectly, through tied loans (Jelić, 1962, p. 158). In 1969, the Party Congress recommended that so-called state capital be eliminated and in the future the federal government is not supposed to retain any direct control over investment resources. A satisfactory solution has not as yet been found, and work on the new Law on Social Planning, which began in 1963, has not yet been completed (Savezna Skupština, 1966a).

The advocates of the new approach to planning, Siroković (1966), the former director of the Planning Bureau of Croatia, and R. Stajner (Savezna, 1966a), the present director general of the Federal Planning Bureau, M. Mesarić (1967) and others argue that the professional function of planning should be supplemented by an emphasized social function, that annual plans should be abandoned and replaced by parliamentary resolutions (which has been practiced since 1963), and that medium-term plans should be continually revised and extended every two to three years. Bičanić describes the desirable system of planning as polycentric planning. This presumes the existence of one planning mechanism consisting of many autonomous plans interlinked in a specific, competitive system (Bičanić, 1963b, 1967). These ideas have been more or less accepted, but in parliamentary debates criticisms have been voiced that it was not at all clear how the plans were to be implemented (Savezna Skupština, 1966a, p. 91). In practice the implementation of plans has left much to be desired and the law on Social Planning is still to be produced.

The functions of social planning in the present Yugoslav setting have been described by the IES (Jugoslovenski Institut, 1968, p. 20), and similarly by Mesarić (1969), as follows: (1) A plan is, first of all, a forecasting device. (2) As such it provides economic subjects with necessary information for their autonomous decision-making. This, together with institutionalized consultations, makes the plan an instrument of coordination of economic decisions. (3) After relevant social preferences have been determined by an essentially political process, the application of modern tools of economic policy makes the plan an instrument for programming economic development. (4) Once the social plan has been adopted by the Parliament, it becomes a directive for the Government. Point (4) is the only administrative or compulsory aspect of social planning.

Institutional Framework: The precondition for efficient social planning is an adequate analysis of the functioning of an institutional framework. A general idea of how the system works or is supposed to work may be obtained from a description by Horvat (1969a).

The Yugoslav economic system consists of autonomous, self-governing, work organizations and individual producers in the market and non-market sectors of government machinery. The task of the latter is to use non-administrative means in coordinating the activities of market and non-market agents and to organize public administration in certain fields of common interest (judiciary, defense, foreign affairs, etc.).

The functioning of this economic system is based on the assumptions that the self-governing collectives are materially interested in maximizing their incomes and that the Government and Parliament are able to create an economic environment in which autonomous decision-makers be...
have in accordance with general social interests. Both assumptions seem to have been proved correct by the modern theory of economic policy and by experience in well-organized market economies. Between the "Center" (Parliament) and the "Periphery" (Work Organizations) four types of gravitational forces are active in keeping the system in equilibrium and the economic agents on the predictable trajectories of social interest.

These forces are information—consultation ties, market ties, economic policy ties (instruments of economic policy and legislation) and administrative ties. The last mentioned are exceptional as far as economic agents are concerned and apply to various organs of the Center such as ministries, the National Bank, certain bureaus, and the like. I should add that there is also a fifth type of ties—political ties—which closes the whole structure connecting the work organizations with the Parliament and with flows of commands (arrows) oriented from the Periphery towards the Center. In order to keep this section short, I shall not analyze these ties (this is why they are omitted from Figure 2). It is, however, important to realize that the Parliament is organized in a rather unorthodox fashion. Apart from the traditional Political House, whose members are more or less professional politicians, elected by all citizens, there are three additional houses, dealing with three different social-economic groups of problems (economic, health and welfare, education and culture). The members of these three "Houses of Work Unions" are not professionals; they keep their usual jobs and are elected by the "producers" in these three specific fields.

Let us now have a look at the market half of our economic cosmos. The activities of enterprises and individual producers are coordinated by the market in the first place. The market is, however, a very rough and unreliable mechanism requiring constant adjustments. These adjustments are achieved through general regulative measures and the instruments of economic policy of the Government. The financial flows, intended to achieve a desirable allocation of resources, are regulated by the National Bank within the framework of the Social Plan. There are two additional types of specific financial interventions: in the field of foreign trade (credits and exchange risks insurance) and in investment (insuring proper structure and regional allocation of capital formation). These three purposes are served by three federal funds: for export credits, for underdeveloped regions and for investment.

Market equilibrium is being worked upon by three institutions. Two of them—the Directorates for food and industrial products reserves—intervene whenever supply and demand do not match. The former Directorate also administers agricultural support prices. The third institution, the Price Control Bureau, is now a somewhat alien element in the system. I expect that in the near future this governmental bureau will evolve into a Price and Wage Arbitrator, an institution in which all relevant interests would be represented and all decisions made jointly. At the moment more than 40 percent of industrial prices are controlled. Statistical and Planning Bureaus have only informative—consultative functions in this system.

A rather peculiar arrangement of the Yugoslav system is to be found in what I call a quasi-market. The activities of schools, hospitals, museums, and other non-market work organizations cannot be coordinated by the market directly as is done in the case of enterprises. In a socialist society sick persons should be healed, talented youths educated, regardless of whether and how much they can afford to
pay. On the other hand, the traditional budgetary financing of non-market activities has led to bureaucratic practices incompatible with a self-government system. The solution of this dilemma was sought in an interpolation of a special self-government mechanism between the government and the non-market working organizations. This mechanism is called interest unions. The unions obtain their financial resources on the basis of parliamentoary decisions and then buy the services of non-market producers on behalf of the society. The non-market producers compete for available resources by offering their services on differential conditions. In this way, there emerges a special type of market—a quasi-market—which makes it possible for the relations between the non-market sector and the society to be economically conditioned, for the collectives in the non-market sector to preserve their autonomy, and at the same time for relations within the fields of education, culture and social welfare to be based on the principle of "distribution according to needs," which is one of the preconditions of a socialist society. It is clear that the enterprises can also intervene in the non-market sector—either by buying services directly or by creating special foundations—and that is why in Figure 2 market and non-market sectors are also directly connected by market ties.

Apart from economic relations between official bodies and economic agents there are relations between federal and state and local authorities, between the latter two and the work organizations and among all of them. I must, however, refrain from describing all these relations, although they are extremely important for the functioning of the system as a whole.

Other Issues: One of the recurring issues of the planning controversies is the problem of optimum investment and saving. Impressed by the unpleasant contraction of personal consumption during the Five-Year Plan, Čoležić maintained that a certain minimum rate of growth of consumption represents the upper limit for the growth of output (1959a, p. 188). Similarly, Stojanović argued that reduction of consumption growth below a certain limit reduces the growth of labor productivity and that this functional relation determines the optimum rate of investment (1960). Bajić also agreed that the optimum rate of investment is determined by the rate of consumption that maximizes the productivity of labor (1958), but this is not necessarily the socially desirable rate of investment. The purpose of production is to increase economic welfare, and a maximization of welfare through time can be ascertained only by a discounting procedure (Bajić, 1963). Horvat argued that pure time discounting is inconsistent because an individual will regret his present impatience at some later date, and utility discounting is impractical since it cannot be ascertained empirically. The other often suggested theoretical solution—social determination of the terminal stock of capital—is irrelevant, since no sensible planner ever insisted on carrying out a long-term plan. One constructs, say, twenty-year plans in order to take into account all relevant consequences of the decisions that are taken now; with every new element of information in time the plan is revised and the planning horizon is pushed forward. The alternative approach suggested can be described as follows. Since every economy has a definite and very strictly limited capacity to absorb investment (in Yugoslavia the limit is around 35 percent of GNP, SNA definition), maximum growth is achieved when the marginal efficiency of investment is reduced to zero. If a lag of several months for achieving a certain level of consumption is an acceptable price for maximizing consumption within one's lifetime, then the maximum rate of productive investment is identical to the optimum rate of saving. Thus maximization of the rate of growth appears to be a proper target for socialist planning. The trouble with the First Five-Year plan was not a low level of consumption but an appropriately high level of investment. Pushed into the region of negative marginal efficiency, investment depressed output. A large part of such a stagnating output (up to 20 percent of national income) was used for defense. On both counts potential consumption was seriously reduced (Horvat, 1958, 1965).

Sophistication in economic analysis and planning methods has advanced considerably since the telephone age described by Stanovnik. Yet, both are still far from being impressive. Interindustry analysis has been adapted for planning purposes (Sekulic, 1968; Horvat, 1969d). Interindustry analysis was used in calculating the new exchange rate and the price levels in the last reform. Simple econometric models are now regularly used in the early stages of the preparation of a plan (Nikolić, 1964; Horvat, 1968b). An integrated system of social accounts, specially adapted for planning needs, has been produced recently (Horvat, 1968b; 1969a). For the rest, planners rely on adequate statistics, old-fashioned balancing and hunches. A satisfactory methodology of planning is yet to be written.

III. Labor-Managed Enterprise

Self-management is undoubtedly the most characteristic of Yugoslav institutions. Further developed into social self-government, it is the pivotal institution of the Yugoslav socioeconomic system. Moreover, Yugoslav social scientists are quite unanimous in believing that without self-government socialism is impossible (Fiumengo, 1965). Thus the fate of socialism depends on the feasibility and efficiency of self-government. In this section we will be concerned only with self-government as applied to business firms, which is usually denoted as self-management.

Self-management is not a Yugoslav invention. The development of this institution can be followed from the beginning of the last century (Horvat, 1969a, ch. 5). Every social revolution from the Paris Commune onwards attempted to implement the idea of self-management. In the very beginning of the revolution in Yugoslavia, in 1914, workers were assuming control over factories in various places (Tauté, 1963, p. 30). With the establishment of central planning, the idea of self-management suffered a setback. However, already in 1949 it was revived; by the end of that year workers' councils were created as advisory bodies in 215 major enterprises and in June 1950 the law passed that inaugurated the era of self-management.

For more than a decade the basic organizational principles of self-management remained unchanged. All workers and employees of a firm constitute the work collective (radni kolektiv). The collective elects a workers' council (radni odbor) as its executive organ; the council has 15 to 120 members elected originally for one year and recently for a two-year period. The council is a policy making body and meets at intervals of one to two months. The council elects a managing board (upravni odbor) as its executive organ; the board has 3 to 11 members, three quarters of whom must be production workers. The director is the chief executive and is an ex officio member of the managing board. As soon as it was established, self-management met with criticism and skepticism. Both came mostly from abroad. It was said that self-management would erode discipline and that workers would distribute all profits in wages, thus reducing the...
growth potential of the economy. In 1955 Ward suggested that workers had no real choice in the election of the council and that actions reportedly taken by the councils might represent rubber stamping (Ward, 1957; Horvat and Radkovic, 1959).

In evaluation of these criticisms one may point out that, regarding labor discipline, the International Labor Organization regulations has curtailed the former powers of the supervisory staffs, it would not appear to have impaired their authority... It has undoubtedly strengthened the position of the collective vis-a-vis the management, but it does not appear to have undermined labor discipline (International, 1962, p. 203).

As to the growth potentials, the rate of accumulation remained high with a chronic tendency towards overinvestment and with a high rate of growth. Elections are supervised by courts, and all candidates approved by the majority of the workers are included in the voting list. The safeguards against the creation of a managerial class are the workers' majority in the managing board and the provision that members of self-managing bodies may be elected only twice in succession.

The real difficulties were encountered elsewhere. The original organizational scheme proved to be too rigid, and had to be revised extensively in all its three components. It soon became evident that the director's position was not quite compatible with the new arrangement, and directors came to be "one of the most attacked and criticized professions in the country" (Novak, 1967, p. 137). In the midst period the director was a civil servant and a government official within the enterprise. He was in charge of all affairs in the enterprise and responsible exclusively to the superior government agency. In the self-management system the director became an executive officer of the self-management bodies, while at the same time continuing to represent the so-called public interest in the enterprise. This hybrid position has been a constant source of conflicts. At first the director was appointed by government bodies. In 1952 the power of appointment of directors was vested in the commune. In 1953 public competition for the director's office was introduced and in the selection committee the representatives of the commune retained a two-thirds majority. In 1958 workers' councils achieved parity with communal authorities on the joint committee authorized to appoint and dismiss directors of the enterprises. The present state of affairs is that the director is appointed by the workers' council from candidates approved by the selection committee on the basis of public competition. He is subject to re-election every four years, but may also be dismissed by the workers' council. Since the appointment of the director does not depend exclusively on the will of the collective as is the case with all other executives—he has been considered a representative of "alien" interests in the firm. There have been constant attempts to reduce his power, which have made his position ambivalent and reduced his operational efficiency. On the other hand, as G. Leman remarks, the director is expected to play the triple role of a local politician, a manager and an executive (1969, p. 28). In the context of what has just been said, the managing board was supposed to exercise control over the work of the director and the administration. Involved in problems of technical management and composed of non-professionals, the managing board often proved to be either a nuisance or ineffective. For professional management the director had to rely on the college of executive heads (kolegiji), which was his advisory body and subordinated to him. Thus two fundamentally different organizational setups were mechanically fused into one system. The director's office provided a link between them, i.e., between the self-management organs and the traditional administrative hierarchy.

Finally, in any somewhat larger firm one single workers' council was not sufficient if there was to be real self-management. In 1956 workers' councils on the plant and lower levels were created apart from the central workers' council. Even this was not sufficient, because hierarchical relations between workers' councils at various levels were not compatible with the spirit of self-management. The self-management relation in its pure form is polyarchic and not democratic—explains D. Gorup ić—"the democratic relationship represents a domination of the majority over the minority... The polyarchic character of the self-management relationship is revealed in equal rights of members of a certain community" (Gorup ić, 1969, p. 16).

In 1959 an interesting new development began with the creation of so called economic units (ekonomisko jedinica). The enterprises were subdivided into smaller units with a score or several scores of workers. Since a year earlier the enterprises had become more or less autonomous in the internal division of income, it was thought that a strong incentive could be built into the system if economic units recorded their results, took care of the quality of output, use and maintenance of machinery, and themselves distributed their incomes according to certain efficiency criteria. In an interesting study Leman, a German student of Yugoslav self-management, argues that economic units resulted from endeavoring to eliminate dividing lines between these fields of activities: policy making, managing and executive work (1967, pp. 28-39). Soon, economic units began to practice collective decision making on all sorts of matters. It became advisable to enlarge economic units so as to comprise individual stages of the technological process or separate services. Economic units were transformed into work units (radne jedinice). The hierarchical self-management relations within the enterprise called for a revision. Important self-management rights (distribution of income, employment and dismissals, assignment to jobs) were transferred to work units. Direct decision making at meetings of all members of the work unit became the fundamental form of management. In this way the work unit provided a link between the primary group and social organization. It was both a well defined techno-economic unit, meeting the requirements of efficient formal coordination, and the basic cell of workers' self-government (Zupanov, 1962).

Work units, several workers' councils and managing boards, many commissions and committees—all this made the formal organization of a labor-managed enterprise rather complicated and inefficient. In order to make such a formal system work, it had to be simplified in practice and this was done in various informal ways. That in turn meant further limitations on competent professional management and a further reduction of efficiency. Workers' management is passing through an efficiency crisis caused by the need for a radical transformation of inherited organizational structures. After all, workers' management meant a fundamentally new principle in running enterprises and it would have been surprising if that did not require painful adaptations and deep changes in social relations. I must add, however, that the conclusions in this paragraph, though based on widely held beliefs, cannot be substantiated in a more rigorous way because no adequate empirical research has been undertaken so far.
Although the crisis has not yet been overcome, matters have begun to be gradually sorted out. A constitutional amendment passed in 1969, made it possible for enterprises to drop managing boards and to experiment with various organizational schemes. Trade unions, authorities and workers have come to realize that certain developments were based on erroneous beliefs concerning various management functions in a labor-managed enterprise. Perhaps the clearest analysis of the mistakes made came from a sociologist, J. Županov (1967a). Županov distinguishes self-management (samoupravljanje), management (upravljanje) and executive work (prakvođenje). The last mentioned is a partial activity intended to carry out a decision made within a policy framework. The integration of all decisions into a consistent framework is the task of management. But management means only technical co-ordination, while coordination of various interests, making basic policy decisions, is a task of self-management. Self-management means social integration, the formulation of common goals, which is a precondition for efficient operational work of the management. The confusion between management and self-management generated tendencies to transfer more and more of formal coordination to bodies whose task was social integration. As a consequence, satisfactory social integration was not achieved, while non-professional management meant lower efficiency (Biljančić, 1969). S. Bolić has reminded me that this inherently complex problem was complicated even further by a rather naive ideology contained in legislation and political propaganda and advocating direct participation in administrative work as an indispensable safeguard of the interests of workers.

How are the problems encountered to be solved?

Gorupić (1967) and the IES (Institut, 1968a) saw the solution in a fusion of professional competence and self-management. The enterprise may be considered an association of work units. The professional managers of the work units should no longer be appointed, as in the traditional set-up, but be elected by their associates. In this way they would represent the interests of their primary groups, while at the same time being also professionally competent. Managers so elected would make up a managing board which would be both an executive organ of the workers' council and a professional management body. Decisions would be made collectively. Since most of the decisions affecting the daily lives of workers would be made and implemented within economic units and by themselves, executive work would become more and more purely organizational and lose its order-giving character (Novak, 1967, p. 118). Businessmen proved susceptible to this approach (Jillet, 1969).

As one might have expected in a country like Yugoslavia, as soon as these ideas had been clearly formulated the practical experimentation began, and the Constitution was promptly amended.

Before closing this section let me note another interesting phenomenon: the development of the so-called autonomous law. Enterprises appear as law-creating bodies. Their self-management organs pass charters and rules governing the organization of work, the composition and responsibility of self-management and other organs, the distribution of income, and the conduct of business. The autonomous law-creating power emanates directly from the Constitution, the rules and regulations are legally binding on all persons to whom they are addressed within an enterprise and disputes are settled by the enterprise organs, except in some specific cases. In this way "a continual narrowing of the area of state law and corresponding broadening of the area of so called autonomous law characterizes the entire process of regulation of social relations in Yugoslavia" (Kocančević, 1969, p. 1).

Enterprise

The introduction of self-management in 1950 implied the dissolution of the centrally planned, administratively run economy. The enterprise was to become independent and autonomous. Individual enterprises needed some guidance and co-ordination. Therefore so called Higher Business Associations (viša pravoderna udruga) were set up in order to replace former state directorates and to preserve continuity in the organization of the economy. The governing councils of these new bodies were composed of representatives of workers' councils of the constituent enterprises. But Higher Business Associations tended to operate along the same administrative lines as former directorates and were therefore dissolved in 1952. A period of laissez faire ideology followed. Isolated enterprises were expected to engage in free competition on the market. Attempts to form larger business units and multiplant firms were frowned upon as contrary to genuine self-management and as signs of going back to a disguised state control. In spite of the fact that the system worked well because a special sort of administrative coordination was still effective. The chief coordinator was the Bank implementing the targets of the Plan. The Bank operates a specially designed bookkeeping for every enterprise, distributed the incoming money to various accounts (for wages, taxes, and various enterprise funds) and determined the amount of the necessary working capital which was to be provided on a credit basis, etc. (Vucković, 1952, pp. 11–2). Although the control was monetary, the value proportions were derived from physical targets.

After 1952 the process of decentralization was not arrested at the level of the enterprise, but went below it. It has already been mentioned that in 1956 the formation of plant workers' councils began and in 1959 the first economic units appeared. The internal cohesion of the enterprise was reduced and it looked as if it was broken up into its component parts. At the same time various monetary and non-monetary administrative controls were gradually being removed. In 1954 the enterprise assumed control of its fixed capital. Fixed assets could be bought and sold without asking for permission. Investment auctions were tried out. In 1958 the enterprise gained control over the internal distribution of income and two years later the trade union control of wages was removed. The stage was set up for a genuine market economy.

As soon as all preconditions for classical free competition of numerous small enterprises were met, it became clear that such an economy would not work very efficiently in the second half of the twentieth century. Since the state refrained more and more from coordinating economic activities, some other agency or agencies had to replace it in that function. That is why the process of integration was initiated. Working collectives themselves had to assume economic coordination in a state that was withering away. The circle of organizational development seemed closed. The process was started by a fully integrated state managed economy, passed through a period of radical decentralization and is now moving towards another stage of full integration in the form of a labor-managed economy.

The forms of integration are various. The simplest one is an agreement for business cooperation intended, for instance, to achieve specialization of the production programs of two or more enterprises. Next comes contractual techno-economic cooperation resulting in joint production, sales or procurement of raw materials. If
Mergers and various forms of business cooperation may mean monopoly. That is why a sort of anti-monopoly legislation appeared as well. It is explicitly forbidden to limit free competition in production or sales to any enterprise outside the business group concerned, and government inspectors are expected to take care that there is no sharing of the market or concurrence about prices. No serious research about possible monopoly practices has been undertaken as yet, and so there is no possibility of presenting an evaluation here. But it must be borne in mind that the Yugoslav economy will behave differently from other market economies. Workers' management implies a spontaneous public supervision of business conduct and so classical forms of collusion, characteristic of private monopolies, are hardly to be expected, J. Dirlam (U.S. Congress, 1968, p. 3854) finds that the degree of output concentration is higher in Yugoslavia than in the United States; J Drutler (1964) establishes the non-existence of correlation between profits and output concentration and similarly H. Wachtel (1969) finds no correlation between wages and output concentration. In spite of a considerable number of mergers in the period 1959–1963, the degree of concentration actually decreased (Miljević, 1963).

A new enterprise may be founded by an already existing enterprise, by a government agency or by a group of citizens. The founder appoints the director and finances the construction. Once completed, the enterprise is handed over to the work collective which elects management bodies. As long as all obligations are met, neither the founder nor the government have any say about the operations of the enterprise. Enterprises are also to merge or to break in parts. If a work unit wants to leave the mother enterprise, and the central workers' council opposes that, a mixed arbitration board composed of representatives of the enterprise and of the communal authorities is set up. In all these cases it is, of course, implied that mutual financial obligations will be settled.

Since the capital of an enterprise is socially owned, the fundamental obligation of the enterprise is to keep capital intact. If it fails to do so for more than a year, if it runs losses or fails to pay out wages higher than the legal minimum for more than a year, the enterprise is declared bankrupt or the founder undertakes to improve its business record. In the latter case self-management is suspended and replaced by Compulsory Management (prihodna uprava), a form of receivership administered by officials chosen by the commune (Miljević, 1963). Bankruptcies are rather rare because the commune is obliged to find new employment for workers and so prefers to help the enterprise as long as possible.

If integration processes are to proceed efficiently, the organizational forms must be extremely flexible. Thus since 1967 it became legally possible for two or more enterprises to invest in another enterprise and then share in profits. Similar arrangements were adopted in joint ventures with foreign capital (Friedmann and Mates, 1968; Sukiasović and Vujčić, 1968). In an open economy, like the Yugoslav one, foreign capital is welcome provided it does not limit workers' self-management. Therefore direct investment is impossible, but joint ventures are encouraged. The basic motivation for a Yugoslav firm to enter into close business cooperation with a foreign partner is to be found in the desire to secure access to the knowhow and the sales organization of the foreign firm. In this way the Yugoslav firm tries to achieve international standards in technological efficiency and to expand its market.

Theoretical analysis of the behavior of the Yugoslav firm has only begun. Oddly—or understandably—enough, a pioneer work was done by a foreigner, B. Ward of the University of California at Berkeley. In his 1958 paper on the "Illyrian" firm (1958), Ward argues that rational behavior will require maximization of income per worker. In the Marshallian short-run, one product, one factor case this leads to some queer consequences: an increase in wages leaves output and employment unchanged, an increase in fixed costs raises output and employment, and an increase of product price reduces output and employment. In a similar analysis eight years later, Domar showed that by generalizing the production function to include several products and several factors and by introducing the demand curve for labor the results are changed and begin to resemble the traditional conclusions about the behavior of the firm (Domar, 1966). Proceeding along similar lines D. Dubravčić comes to the conclusion that in a labor-managed firm there will be a strong tendency to use capital intensive technology (1967). The empirical evidence does not give unequivocal support to this conclusion. While on the one hand there is a chronic hunger for capital and enterprises use every opportunity to invest, Yugoslav enterprises are also full of redundant workers. Instead of postulating what should be rational, the present author observes the actual practice of Yugoslav enterprises which is the advance for the current year, and at least once a year make corrections (positive or negative) depending on the income earned. If this behavioral rule is used in the analysis, the results are again the same as in the traditional theory of the firm (Dubravčić, 1968). The last in this controversy, Dubravčić points out that comparative analysis is really not legitimate because it is assumed that a capitalist firm maximizes an absolute magnitude (profit) while a socialist firm is expected to maximize a relative magnitude (income per worker). Dubravčić suggests a symmetrical treatment on the basis of the entrepreneurial input, which is capital in the capitalist case and labor in the socialist case. If a capitalist firm maximizes the rate of profit (profit per unit of capital) it will behave in ex-
The ownership controversy

In Marxist sociology ownership relations are the basic determinants of social relations and of the socio-economic system. The class that owns — i.e., has an economic control over — the means of production, rules the society. For a long time, and in most instances even today, it has been maintained that private property generates capitalism and state property socialism. In fact, the percentage of national capital owned by the state has been taken as the most reliable measure of the degree of socialism achieved. It follows that a socialist economic policy must be oriented towards an overall economic control by the state and must be hostile towards private initiative. As already noted, the above described view was generally accepted in Yugoslavia until 1950, and since then it has been thoroughly revised. It is now pointed out that there are at least three reasons why the dogma of the identities between private ownership and capitalism, and state ownership, is false: the artisans of medieval towns were private owners but not capitalists; in ancient Oriental kingdoms state ownership was frequent and yet that had nothing to do with socialism; in fascist countries the state extensively controlled social and economic life while these countries were obviously capitalist (Horvat, 1964a, ch. IV). Yugoslav scientists are now quite unanimous in believing that state ownership may be a useful device to initiate socialist reconstruction, but is otherwise as alien to socialism as is private ownership. The present position is well summed up by J. Djordjević (1966, pp. 81, 79): "State ownership of means of production creates a monopoly of economic and political power and makes possible the uniformity of economic and political power under the control of a social group personifying the state." Thus, "... the essence of classical (class) ownership is not changed... As the holder of the title to property, it (the state) disposes with the producers' labor and its results, on the basis of which surplus labor is appropriated by groups which have their own interests in keeping their commanding functions and thus retaining their power and social status and prestige." If state ownership fails to promote socialism, is there a feasible alternative? The Yugoslav answer is: social ownership. But the answer to the next question — What precisely is social ownership? — is not so easy and simple. The legal experts agree that social ownership implies self-government, that it is a new social category, that, if it is a legal concept, it does not imply an unlimited right over things characteristic of the classical concept of property, and that it includes property elements of both quasi-property and other writers maintain that social property is a legal, economic or sociological concept or is non-definable in these terms because it relates to quasi-property. And if it is a legal concept, it may be applied in various ways. By applying the calculus of combinations we can easily determine the number of possible theories. It seems that available possibilities have been sufficiently exploited since M. Tomošević (1965) was able to describe these different theories.

The legalistic controversy was somewhat less interesting than the one among economists and sociologists that followed.

*Territorial political unit such as a commune, a district, an autonomous province, a republic and the federation.*
Bajt drew attention to the fact that the legal owner and economic owner may be two different persons. The former holds legal title, the latter derives the actual benefit from the use of a thing (Bajt, 1966b). In this sense, ownership implies the non-existence of exploitation which in turn implies the distribution of income according to work performed. If a person or a group of persons are earning non-labor income, they are exploiting others, and in so far as this happens social property is transformed into private property. Thus self-management per se is not a sufficient condition for the existence of social property.

The institution of property already undergoes gradual disintegration under capitalism. Shareholders are legal owners but management exerts real economic control. That is why I prefer to replace the traditional concept of property by a more fundamental concept of economic control (Horvat, 1969, Ch. 15). The latter always means "control over labor and its products" which is Marx's definition of capital as a social relation (Marx, 1953, p. 167). In this respect legal titles are irrelevant. If artisans or peasants possess no monopoly power—which in an orderly market system is likely to be the case—then they represent no alien elements in a socialist society. And there can be little doubt that they practice self-management. Horvat and Bajt came to the conclusion that individual initiative is not only compatible with but is an integral part of a socialist system. In fact the process of production can be organized individually or collectively and that is why Bajt talks about two forms of social ownership: individual and collective.

Agreement about the matters mentioned so far is quite universal by now. Differences in views appear when intermediate cases are considered. Yugoslav law makes it possible for artisans and inn keepers to employ 3-5 workers. V. Rašković (1967a, pp. 106-107) and many others consider this to be a form of exploitation, a remnant of the old society, something alien to the system but which has to be tolerated at the present level of development. In support of this view Rašković argues that the employer would not hire workers if this were not profitable for him. It may, however, be argued in reply that a worker, by choosing an individual employer instead of a firm, reveals that he finds such employment more profitable for himself. Such a line of reasoning leads clearly to an impasse. To resolve the question whether workers may be hired by individual employers, and if so how many of them, a sociological argument has been advanced as a criterion. As long as an individual employer works himself in the same way as his employees and has not become an entrepreneur merely organizing the work of others, employees may be considered as (often younger) associates in the work process, direct personal relations of a primary group are preserved and the alienation phenomena of wage labor relations are not present.

Discussion of the scope and role of individual work was invited by political bodies and very soon decisions were made following more or less the ideas expounded above. Individually organized production became a constituent part of a socialist economy.

IV. Market and Prices

Price Policy

Price Policy represents an incessant series of attempts to control the famous series of value (supply and demand relations). Its history is instructive since it provides an insight into the working of various institutional arrangements.

Administration of Prices: Immediately after the war, with the economy almost totally destroyed, there was an extreme scarcity of all goods. The prime purpose of economic policy was to prevent profiteering and to generate output by any means available. This was the period of "profitability at all costs" (Rudušić, 1968, p. 143).

Prices were determined on the free market only for a few luxury products. Mostly prices were set on the basis of actual costs incurred and could vary from one producer to the other. The Price Offices would examine each case and make the relevant decisions (normiranje cijena). This was not a very efficient procedure. Since actual cost was taken as given, there was no incentive to economize on inputs. Wages were fixed, and products could always be sold. In order to minimize risk, producers tended to inflate the costs in their price proposals and in order to keep prices down the Price Offices tended to apply linear reductions to proposed prices. The authorities and the businessmen began to play at hide-and-seek, which is so characteristic for an administratively controlled economy.

The launching of the First Five-Year Plan in 1947 required a system of uniform prices ( jedinstvene cijene). Uniform prices were determined by the planning authorities and were expected to be rigidly stable. The aim was to provide a link between the physical and the value part of the plan, to have a control over the implementation of plans and to avoid the administrative costs of changing prices frequently. Prices were formed by adding an average rate of profit to average cost for a product. The less efficient producers had planned losses, the more efficient ones extra-profits; in the case of public utilities the loss was absorbed by the budget. Through the establishment of the system of uniform prices, the law of value was considered to be subject to an efficient social control (Križić, 1948, p. 143).

It soon became evident that uniform prices did not equilibrate supply and demand. There was chronic excess demand. Private producers (peasants and artisans) held a large share of the market and their incomes could not be easily controlled. Most consumer goods were rationed and sold at the existing uniform prices, but available quantities of consumer goods were not sufficient to satisfy the needs of the entire population at the lower uniform prices. By the end of 1947 the first quantities of consumer goods were supplied to the free market at higher uniform prices (više jedinstvene cijene). These prices were derived from the existing uniform prices by applying multiplying factors varying from 2 (for potato and beans) to 6 (for garments). The resulting trading profit was absorbed by the budget. In 1948 about 45 percent of all consumer goods were supplied at higher uniform prices (Šefcer, 1956, p. 376). In this way, it was hoped, excess money incomes would be absorbed.

In agriculture a system of compulsory deliveries (obavezni otkup) was applied. Peasants were obliged to sell most of their products to the state at prescribed low prices. For the money they obtained they could not buy all those industrial products they wanted. Thus they tried to reduce deliveries and substitute their own consumption for money incomes. The government reacted by creating a market for industrial goods at higher uniform prices. Peasants reciprocated by evading compulsory deliveries and supplying more goods to the free peasant market, the only section of the market where the prices were equilibrating supply and demand. These prices tended to rise fast and so the government decided to substitute a carrot for the stick: in 1948 the government introduced linked prices (vezane cijene). Agricultural
prices were linked with industrial prices in such a way as to establish the pre-war parity. Peasants sold their products to the government at lower prices and in return obtained coupons which enabled them to buy industrial products at prices that were about 16 percent lower than commercial prices (Dobrinčić et al., 1951, p. 141).

Local markets were less rigidly controlled. After 1949 local enterprises could in principle sell their products at commercial (higher uniform) prices. Trading establishments that were supplied by two establishments that were supplied by two single price. And so sliding prices (klizave cene) were invented. The selling price slides in a span determined by the lowest and the highest supply price. These prices were approved by the local authorities.

Development of the Market: The strategy of the 1951/1952 price reform can be summarized as follows: (a) a sufficiently large increase of prices to absorb all excess money incomes; (b) a sufficiently large increase of retail prices of manufactured consumer goods relative to agricultural prices to generate the capital accumulation necessary for fast growth; (c) a smaller increase in producer goods prices to stimulate investment and the expansion of compartment I (producer goods industries). The first two goals were achieved with remarkable success. As a result, industrial producer prices were kept stable over a period as long as a decade. The third strategy proved to be deficient and generated a lot of trouble.

While the general index of industrial producer prices was declining for almost three years, prices of certain raw materials (ferrous and nonferrous metallurgy, building materials, wood products were rising.

That is why in 1954 ceiling prices were set by the government for a number of raw materials, and in the next year the list of controlled intermediate goods was further extended. In 1955 industrial producers prices rose by five percent, which led to the creation of the Federal Price Office in the same year. Since then a system of administrative control of prices has been gradually developed. The essential features of this control are as follows:

1. The government sets fixed prices for electrical power, cigarettes, transportation rates, sugar, oil, salt and some other commodities.

2. The government sets ceiling prices for metallurgical products, coal, petroleum and some other goods.

These two categories of prices are changed at infrequent intervals. But when they are changed, the change is rather drastic.

3. Control on the basis of prior price registration is the most frequent kind of control. It was introduced in 1958. Producers intending to raise prices are obliged to notify the Federal Price Bureau thirty days beforehand. If within this period the FPH does not veto the price increase, it can be effected. The principal criteria for placing a product under control are: (a) its importance for the standard of living or for production costs of other products; (b) scarcity on the market and (c) the monopoly position of the producer (Vuković, 1968).

4. Control of trade margins is implemented by republics for wholesalers and by local authorities for retailers.

5. Price freeze. This instrument was used only on two occasions, in 1952 and in 1965, during two price reforms.

6. Agricultural prices are placed under a special regime. Guaranteed prices are applied to staple food products. This means that the Federal Food Reserve Board is obliged to purchase all quantities of the products offered for sale and to pay guaranteed prices. For milk and industrial crops minimum prices apply. This means that if these products are bought at least the minimum prices have to be paid for them. An industrial crop is normally not grown unless the producer has a prior contract with the buyer. Prices used in such cases are agreed upon prices.

Industrial prices have been mostly heavily controlled. In the last decade this control was exercised over the following percentages of the value of industrial output (Radulović, 1968, p. 282; Drutter, 1968, p. 113; Institut, 1969, p. 6):

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<tr>
<td></td>
<td>31.2</td>
<td>67.0</td>
<td>60.0</td>
<td>53</td>
<td>46</td>
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The time series of prices, given in Table 6 may give an idea of how efficient the price policy and price control were.

After 1961 the administrative control of prices was increased and so was the inflationary pressure. What in fact happened?

The most frequent form of price control—prior price registration—could not be adequately applied to new products. By making small changes in the design of a product an enterprise would transform it into a new product and so could evade price control. In 1964 almost twenty five thousand new products were launched. Low and rigidly controlled prices of raw materials made their production unprofitable and so depressed output; in agriculture prices were particularly depressed. That is why in 1964 prices were raised administratively in agriculture, the food processing industry, energy generation and nonferrous metallurgy. Next, differential taxation, a system of premiums and subsidies, and administrative interventions in foreign trade tended to preserve and even increase price disparities (Petrović, 1966). As

<table>
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<tr>
<th>Year</th>
<th>1954</th>
<th>1955</th>
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<tr>
<td>1954</td>
<td>100</td>
<td>128</td>
<td>123</td>
<td>245</td>
<td>327</td>
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<tr>
<td>1955</td>
<td>100</td>
<td>109</td>
<td>94</td>
<td>70</td>
<td>77</td>
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a consequence individual enterprises conducted their business under highly unequal conditions. Producers whose prices or wages were lagging behind were trying to catch up with their neighbors. The Federal Price Bureau received 12,800 requests for price increases in 1961 and 69,000 requests in 1964 (Drutter, 1968, p. 107). But the most important reason for the break in price trends in 1961 lies elsewhere. Until 1961 personal incomes were quite efficiently controlled by fiscal and nonfiscal means (Trade Unions). That is why prices were quite stable (except in agriculture, and administrative controls relatively few (Institut, 1968b, pp. 37-41).

In 1961 income controls were abolished, very soon a cost-push inflation occurred and, despite increasing administrative control, prices went up. A few years later the Institute of Economic Studies suggested that the Federal Price Bureau relax administrative price control and focus its attention on income control (Institut, 1969, p. 41). The suggestion was not followed and instead monetary policy was used as the chief anti-inflationary weapon. By 1965 the economy was ripe for another radical price reform. In March prices were frozen and a tax reform carried out. Various subsidies were drastically reduced and the tax burden of enterprises alleviated. In the next few months a new price structure was prepared. In July the dinar was devalued; new prices were introduced and frozen. Relative prices of certain raw materials, intermediate goods (electric power, petroleum, ferrous and nonferrous ores and metals, chemicals, timber products and agricultural products) and transportation services were substantially increased. World prices (as registered in exports or imports) were taken as a basis for the new price structure. This was to make possible a rapid integration of the Yugoslav economy into the world economy. World prices were corrected upwards or downwards by taking into account capital accumulation needs of various industries and other specific purposes. A new customs tariff was to iron out these differences.

The price stabilization proceeded rather slowly, as can be seen from Table 6. The lifting of price controls went even slower. In 1968 prices looked stabilized, but almost one half of industrial prices were still under control. Disparities between controlled and uncontrolled prices began to emerge. The output of certain industries tended to become depressed. In 1969 prices began to rise again. The experience of 1964 seems to have been repeated. The reform of 1965 eliminated the worst price disparities, but subsequent price controls created new ones. The price game seems far from being successfully completed.

There has been a lively discussion about the appropriate pricing system for a labor managed economy. This discussion hardly touched the classical controversy on marginal cost versus full cost pricing. Since marginal cost pricing requires government intervention, the lack of interest in this procedure among Yugoslav economists is understandable. On a more theoretical level it was pointed out that allocational efficiency—as represented by marginal cost pricing—is inferior to growth efficiency—as represented by full cost pricing which makes possible the business autonomy of an enterprise (Horvat, 1964, Ch. 2).

The price debate was centered around the problem of how the price is to be formed. It started in 1950 when Kidrič opted for the "value price" (1950b). In his last writing in 1952 the late Kidrič described the value price as the one consisting of costs of production (including wages) and accumulation (gross profits) calculated as proportional to wages. These prices were actually tried out in 1953 and 1954. Kidrič compared the rate of accumulation principle with the traditional average rate of profit principle (profit proportional to capital invested is characteristic of Marx's price of production) and came to the conclusion that only the former was appropriate for a labor managed economy. In his view the average rate of profit principle "represents a contradiction to socialist planned management of the economy," and leads to "a kind of cooperative capitalism" (Kidrič, 1952 pp. 42, 46). A decade later M. Todorović—who was to become the secretary of the League of Communists—came to the opposite conclusion. He maintained that in a system of commodity production, including its socialist variety, in which fixed capital is used, prices must take the form of prices of production. Since capital is socially owned and production is planned, the use of prices of production cannot lead to the same consequences as in a laissez faire framework of liberal capitalism. (Todorović, 1965, pp. 60, 65, 78).

Strange as it may sound, there is no basic disagreement between Kidrič and Todorović. The difference between their views primarily reflects the difference in the degree of economic sophistication.

<table>
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<tr>
<th>TABLE 6—CHANGES IN PRICE LEVELS IN PERCENTAGES PER YEAR</th>
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<tbody>
<tr>
<td>Producer prices in manufacturing and mining</td>
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<tr>
<td>Agricultural producer prices</td>
</tr>
<tr>
<td>Retail prices (including services)</td>
</tr>
</tbody>
</table>

The lack of material incentives was compensated for by moral incentives such as public praise, the trophy—flag, the title of shock worker or of innovator. In the post—revolutionary atmosphere these incentives were very powerful.

After several years the lack of material incentives became a serious obstacle to efficient production. Due to post—war scarcities and to an egalitarian ideology, by 1953 the salaries of office employees in industry had been reduced by one third and of civil servants by one half relative to workers' wages and compared with the prewar levels (Berković, 1969, p. 81). Non-wage income "fringe" benefits was higher than wage income. Since 1952 both trends have been reversed. Trade Unions advocated higher skill differentials. Economists (Bajt, 1956) urged an increase in the share of discretionary income (income after taxes and contributions left to free disposal of an enterprise) in order to increase productivity. Wachtel finds that interskill differentials increased until 1961 and then began to fall. The average income span between the highest and the lowest paid job is now 1:4 (Berković, 1969, p. 82). M. Janković estimates that wage income increased to 65 percent of total workers' income in 1956 and to 73 percent of total income in 1967 (1968, p. 159). The idea was to leave to the market the job of determining the appropriate income differentials and to stimulate efficieny by increasing the discretionary part of workers' disposable income. Since 1952 it has been the task of workers' councils to determine wage differentials and work incentives. The distribution of income between the enterprise and the community was settled in a very simple way. On the basis of the social plan, the expected income of the enterprise and the corresponding wage bill were determined. The difference between gross income (depreciation excluded) and wages was called accumulation and funds (AF). The ratio between AF and wages was called the rate of accumulation and funds. This rate was applied to actual gross income earned in order to derive wages. It was mentioned in section 10 that the AF rate was considered an appropriate socialist substitute for the rate of profit, and that this is theoretical justification; whatever the merit of that argument, the practical effects were good. The AF rate helped to bridge the institutional gap between complete administrative control and a relative autonomy of the enterprise. It also induced workers to economize on labor. In 1953 employment in manufacturing and mining increased by 5 percent, and labor productivity by 6.2 percent. In 1954, when the AF system was abandoned, employment increased by 13 percent and labor productivity slightly fell.

The AF rates were, of course, not uniform. The 1952 plan envisaged a rate of 19 for agriculture and another of 582 for manufacturing and mining. This difference reflected the already described goals of price policy: industrial prices were inflated in order to facilitate the collection of investment resources. However, even within manufacturing different industries had widely different rates. In industries where high rates there was no incentive to reduce costs. Since the rates could not be established very precisely, some collectives began to earn high wages. The government reacted by introducing a tax on the surplus wage fund (the difference between the standardized and the achieved wage bill). Since the standardized wage bill was the product of an average wage rate and the number of employed, the enterprise increased employment—often fictitiously—of less skilled workers in order to reduce the tax basis. The government reacted by differentiating taxation according to skill categories. Enterprises countered by artificially changing the skill structure, declaring their workers to have higher skill.

The AF rates were a not very refined instrument of economic policy. They were introduced in the belief that they could be standardized for all enterprises within an industry group. Soon, however, individual rates had to be prescribed for each particular enterprise. This implied direct administrative interventions which were at variance with the basic intentions of the new system. In 1954 the AF system was replaced by a system called "accounting wages," which lasted for the next three years.

Yugoslav economists had been complaining for some time that in their economic calculus enterprises do not consider capital services as a cost item (Lipovec, 1954, p. 142). That was a natural result of the fact that capital was given to enterprises free of charge. This practice was discontinued in 1954 when a capital tax of 6 percent was introduced. This tax was considered as a price for the socially owned enterprises. This tax was levied on enterprise funds and remaining capital. Apart from that, the enterprise was obliged to pay normal interest rates on credits granted by the bank. Also the profit and turnover taxes were introduced, the latter becoming the chief instrument of accumulation. In this way instruments of economic policy became more varied and more flexible.

The new system implied a division of the wage fund into two components: accounting wages and wages out of profit. Accounting wages were derived by applying prescribed wage rates to skill categories taking into account actual working time. Again, skills were fictitiously increased. Working time as a basis of accounting led to a disregard of work norms. The next year "wage schedules" (tarifni pravilnik) were introduced. Wage rates were determined by the social plan. Wage schedules of individual enterprises represented a kind of collective agreement between the enterprise and the Trade Union and local government (Tomić, 1968, p. 11). Differential efficiency was accounted for, and a part of profit was used as a premium for improvements of quality, reduction of costs etc. Since profit was taxed at 50 percent, enterprises tried to reduce profit by increasing wage rates and reducing norms. The government commissions for wages were unable to prevent this from happening.

In 1957 the First Congress of Workers' Councils was held. The Congress asked that the autonomy of the enterprise be widened. This primarily implied greater independence in income distribution. The division of income into wages and profit was considered inappropriate and reminiscent of wage—labor relations. In order to meet these demands, in 1958 the income distribution system was changed and a compromise reached. The wage schedules remained and were still subject to approval of local authorities and trade unions. The enterprises income was treated as one single whole and was distributed by workers' councils into wages and contributions to various funds. The difference between income and accounting wages (called minimum personal income) was progressively taxed. The wages in excess of the basic pay were also progressively taxed (Pejović, 1966, pp. 98—99).

Progressive taxation was very much resisted. And so was the outside tutelage as far as wage differentials were concerned. In 1961 both were abolished. Workers' councils became completely independent in determining wage rates and distributing income. Progressive taxation was replaced by a flat 15 percent levied on income. In 1965 even this tax was abolished.

Changes in wages policy implied drastic changes in relative factor shares. If we divide value added into gross wages (wages and taxes levied on wages) and gross
rentals (depreciation, interest, net profit and taxes levied on capital), the percentage share of the latter in manufacturing and mining varied as follows (Horvat, 1969b, p. 41):

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>1952</td>
<td>10%</td>
</tr>
<tr>
<td>1953</td>
<td>12%</td>
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<tr>
<td>1954</td>
<td>17%</td>
</tr>
<tr>
<td>1955</td>
<td>19%</td>
</tr>
<tr>
<td>1956</td>
<td>21%</td>
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<tr>
<td>1957</td>
<td>21%</td>
</tr>
<tr>
<td>1958</td>
<td>25%</td>
</tr>
<tr>
<td>1959</td>
<td>27%</td>
</tr>
<tr>
<td>1960</td>
<td>28%</td>
</tr>
<tr>
<td>1961</td>
<td>30%</td>
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<tr>
<td>1962</td>
<td>32%</td>
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<tr>
<td>1963</td>
<td>34%</td>
</tr>
<tr>
<td>1964</td>
<td>36%</td>
</tr>
<tr>
<td>1965</td>
<td>38%</td>
</tr>
</tbody>
</table>

While wage systems with wage schedules and progressive taxation were applied, real wages lagged behind productivity increases and producer prices were stable. From 1958 on real wages began to increase faster than labor productivity, and the discrepancy between the two series widened particularly in the cyclical trough in 1961/62 and after 1964 (Popov, 1968, p. 627). The peculiar movements of prices that followed were considered in the section on Price Policy. Another peculiarity was established by Wachtel; inter-industry wage differentials continued to increase, and interindustry wage structure appeared as a function of average productivity which explained 80 percent of the variance (Wachtel, 1969, pp. 151, 173).

Popov found a high correlation between the rate of growth of industrial output and the productivity of labor (r = 0.66) (Popov, 1968, p. 622). If all these bits of information are put together, the following interpretation begins to emerge.

Trade Unions announced the principle: wages should increase proportionally to productivity. The principle was widely accepted, and it is a sound principle when applied to the economy as a whole. If applied to individual enterprises, it generates great trouble. In a rapidly growing economy various industries expand at widely different rates (petroleum industry at 19.3 percent, tobacco industry at 5.1 percent per annum in the period 1952-1966). Thus rates of growth of labor productivity are bound to differ very much (11.7 percent and 1.2 percent respectively).

Thus wages must differ and differentials must increase in time (money wage rates increased 12.8 times in the petroleum industry and 8.3 times in the tobacco industry in 1952-1966) (Popov, 1968, p. 630).

Kovač found that in 1966 wage rates for the same category of skill in the highest paid and the lowest paid industry group were related as 2:1 (1968, pp. 130-33). All this is, of course, in flagrant contradiction to the principle of distribution according to work. That is why Bajt remarked that the principle of remuneration according to productivity actually denied the principle of remuneration according to work performed (1967b, p. 363). Deviations of productivity income from labor income have been analyzed by the present author. They represent (after deductions for other facto costs) a form of rent which I call the rent of technological progress (Horvat, 1969b). The faster the rate of growth, the more important this rent becomes.

Rašković (1967b, p. 230) and others suggested that the principle of distribution according to work be replaced by a more appropriate principle "according to the result of work." It is not the process of work as such but its results that have to be rewarded. Rašković noted that grossly imperfect markets in Yugoslavia meant exploitation of one group of collectives by another, more privileged, group (1967b, p. 219).

The meaning of the principle, "according to the results of work," has been stressed by Šefer in a rather curious fashion. Šefer notes that in developed capitalist countries free-market wage determination has been replaced more and more by a policy of "equal pay for equal work." He feels that such a policy is inapplicable in Yugoslavia because workers bear business risks, i.e., they share in both profits and losses. Work cannot be remunerated automatically; it has to be socially recognized, which happens at the market where the exchange determines the result of work. The principle "equal pay for equal work" could be implemented only in a system of state ownership and state management of the economy (Šefer, 1968b, pp. 74-75). Thus Šefer, Korač and a certain number of others in fact argue that the principle, considered Marxian, can be implemented in a capitalist and statist setting, but not in a self-government system. The falsities of this laissez faire reasoning are obvious: market imperfections provides no criteria for the social recognition of somebody's work; the redistributive effects of market imperfections can be eliminated also by means other than the statist one.

Other Issues: On income differentials due to technological and other rents, differentials due to variable entrepreneurial abilities of various working collectives are superimposed. Šefer quotes data for Belgrade enterprises in 1967 when the same jobs in various enterprises were paid rates as different as 1:3 or 1:4 (1968a, p. 434). It is clear that such extreme differences generate enormous inflationary pressure.

There is also an additional consequence. Capital intensive enterprises are able to improve their personal income positions by distributing a part of profit in wages. That is why wage rates are positively correlated with capital intensity. Yet, if profits tend to be reduced, enterprises become more and more dependent on outside sources for financing their investment. This generates new difficulties which we will consider in the section on Banking and Monetary Policy.

Apart from technological rent, the classical forms of rent were both discussed in the literature and applied in practice (Hašarić, 1950, Horvat, 1953). Agricultural rent is absorbed, in principle, through taxation according to cadastral revenue. Mining rent represented a separate item of income of mines and crude oil producers for several years. However, it was determined in a rather arbitrary way and gen-
erated regional differences. Consequently, it was resented by the enterprises and was eventually abolished. All urban land belonged to communes and urban land use is used to finance communal investment.

J. Dirlam, an American student of Yugoslav economic affairs, points out that the Yugoslav system can be viewed as one in which labor employs capital, instead of a system in which capital employs labor as is the case under capitalism. The social ownership of capital requires a somewhat different approach to capital charges in the labor-managed enterprise as compared with its capitalist counterpart. The floor and not the ceiling is set for depreciation rates. Profits need not be taxed and instead payroll taxes are suggested (Institut, 1968b). A tax on capital is primarily an instrument for allocating resources and not necessarily a device for collecting revenue for the government. The revenue from capital taxation has been used by the government to finance major investment projects and also to finance the Fund for underdeveloped regions. Resistance against these redistributive activities of the Federal Government has been growing, and recently a political decision has been made to abolish the capital tax. Many economists disagree with this decision. Some argue that the abolition of capital tax, which represents the price for the use of social capital, will initiate a transformation of social ownership into collective ownership. D. Gorupić and J. Perišić argue that the price of a product should contain an element of capital growth (1968, pp. 12, 13). Lavrāc maintains that the accumulation–protecting interest rate may be differentiated according to industries and regions (1968). S. Popović suggests that the compensation for the use of social capital will probably be a bulk of development resources. After all factors of production, except labor, are paid their shares, the remaining net income is to be distributed among workers. Additional accumulation can be derived only from this private income, which means that workers remain owners of that part of capital (S. Popović, 1968). Similar is the position of Černe who maintains that the participation of workers with their own means in the development of the enterprise—which implies receiving adequate interest or dividends—would stimulate rational behavior of workers and management bodies (1967a, p. 21). On the other hand, Samardžija argues that this is both economically irrelevant and socially dangerous. Contemporary shareholders participate in the profits of their corporations with only small percentages that accrue to dividends. And attempts to make workers co-owners must end in the establishment of a separate group of owners of means of production within the society (Samardžija, 1968, pp. 145, 303).

We have thus reached the point at which the general principles of an adequate distribution policy may be discussed. There seems to be considerable agreement on two issues. (1) As great a part of income generated as possible should remain under the direct control of the working collective. (2) Only labor income should be distributed in wages. These two principles imply a sharp division of income into two components: labor income appropriated by individual workers and income belonging to the society but remaining under the control of the working collective and used exclusively for investment purposes. In order to be able to divide net income into labor and nonlabor parts, we need a theory of factors of production. In this respect Bajt follows the traditional approach and defines factors of production as sources of productive services. He enumerates five such sources: labor, entrepreneurship, invention, land and capital (1967b, p. 351). The first three generate labor income, although normally a small proportion of income from inventions is appropriated by inventors. This theory leads Bajt into difficulties when he has to explain monopoly income. He then argues that in a market economy monopoly participates in income; monopoly does not add to output but only adds to income of all factors (1967b, p. 357).

In order to avoid the shortcomings of the traditional theory, the present author defines factors of production as types of forces that influence the generation of output. Factors have to be priced in such a way as to lead to an optimal allocation of resources. The latter means achieving maximum output from given resources or minimum input of resources for a given output. There are four factors: labor, entrepreneurship, capital and monopoly. The first two generate labor income (wages and profit), the latter two generate nonlabor income (interest and rent). Creative work and organizational work as well as routine work generate labor income. The income due to the activities of the work collective as a whole represents entrepreneurial income. Capital services are priced in the usual way and have already been discussed. A few more words need to be said about the price of monopoly. Rent is the price of monopoly in the sense that it represents the surplus over the minimum supply price of resources. Land rent appears in three forms described by Marx (differential rent I and II and absolute rent), then there is mining rent and a somewhat special urban rent. The rent of technological progress—due to the fact that certain industries expand faster and enjoy economies of scale effects, or participate more in general technological advance, or both—has already been described. Bajt adds the rent from market monopoly, which he describes as a situation when the selling prices are above normal and the buying prices are below normal (Bajt, 1962, p. 93). After land, natural resources, technology and market monopolies are accounted for, the remaining part is a monopoly in the narrower sense. Except for the last, the prices of the other monopoly factors may be in principle determined either by the market mechanism (land and mines) or by economic analysis (technology and market). As far as the latter is concerned, progressive taxation may in practice prove a more efficient procedure. If taxes are designed in such a way as to be considered as just, they will not affect the supply of resources and this is how in fact we defined rent (Horvat, 1964, ch. 5, 4, 6).

Actual business practice and legislative measures do not quite follow the principles discussed above. The productivity-wage practice leads to an appropriation of a considerable part of non-labor income. The same consequences follow from the facts that mining rent is included in undifferentiated income and that there is no progressive taxation. In 1968 a new law on the distribution of income in the enterprises included income from capital invested in other enterprises in the undifferentiated income of the collective-investor. P. Jurićvić promptly called that a rather dubious theoretical solution (1969, p. 50). In general, the distribution of income according to the work performed is still a goal to be reached.

**Foreign Trade Policy**

**Background:** The pre-war trade struct...
tured was rather simple. Food and other agricultural products represented about one half of total Yugoslav exports. One fifth of exports consisted of wood and almost an additional fifth of non-ferrous ores and metals (Dobrinčić et al., 1951, p. 488; Fabinc et al., 1968, p. 144). Thus close to ninety percent of export earnings were provided by these three sectors producing raw materials and semi-manufactured goods. Immediately after the war the development strategy consisted in (1) expanding the exploitation of natural resources in these three sectors and (2) in using the export proceeds to finance imports of equipment and other producer goods. It was also expected that (3) the Soviet Union would provide great help in speeding up economic development. The second part of the program was carried out successfully, since the share of consumer goods in imports was reduced from 22 percent before the war to only 11 percent in the period 1947-1951 (Kovacević, 1959, p. 59). The first and the third parts encountered unexpected difficulties.

Due to a decline of per capita agricultural production and rapid industrialization, agricultural export surpluses were reduced and so was the total volume of exports. It soon became fashionable to explore the question whether Yugoslavia was not becoming a permanent net importer of agricultural products (Srdar, 1933). The nationalization of foreign property imposed a new burden on the balance of payments. On the other hand, reparations for war damages were to a large extent left unpaid, in particular by Western Germany and Hungary. Immediately after the war about 75 percent of foreign trade was conducted with the Soviet Union and her East European allies. In 1947-1948 the trade shares with these countries were stabilized around 50 percent in exports and 42 percent in imports. In the middle of 1948 the ominous Resolution of the Cominform meant the end of good relations. By 1949 the Soviet group reduced the trade to one-third and in 1950 it was cancelled altogether. The Soviet Union and her allies applied a total boycott to all relations with Yugoslavia.

Thus the country was cut off from the East completely. It was separated from the West as well, as it did not enjoy the facilities mutually provided by western countries to each other. It was not included in the Marshall Plan; it remained outside GATT. In short it was isolated in a hostile world. The five-year industrialization plan—imbued with so many hopes—had only been initiated, when suddenly the contracts were broken, and supplies of equipment and materials ceased to arrive. Trade was declining:

### Table 8

<table>
<thead>
<tr>
<th>Year</th>
<th>Exports</th>
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<tr>
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<td>1955</td>
<td>122</td>
<td>142</td>
</tr>
<tr>
<td>1956</td>
<td>328</td>
<td>311</td>
</tr>
</tbody>
</table>

**Sources:** Jugoslovia 1945-1964, p. 77; SGJ—1959, p. 121.

Foreign exchange reserves dropped from 53 percent of the value of imports in 1957 to 12 percent in 1948 and 4 percent in 1952 (Mrkvić, 1963, p. 186). Exports decreased and food consumption was declining. Defense expenditures amounted to twenty percent of national income. Two severe droughts, on in 1959 and the other in 1952, proved unexpected allies of the Cominform and reduced agricultural output to 25 percent below the pre-war average. The situation looked hopeless. That is why Stalin expected surrender.

Yet this nation was not accustomed to surrender; it was more at home in fighting back. And it did so, for the first two years struggling practically alone. Investment plans were changed, trade was channeled towards the West, even the economic system was changed. From 1951 on, foreign economic aid began to flow, mostly from the United States. It consisted primarily of food, raw materials and military supplies. The aid amounted to 7.8 percent of total imports in 1951, and over the next decade it was gradually reduced to zero.

The crisis was soon overcome and the economy entered a period of unprecedented growth. The effects of the heavy capital investment of the First Five-Year Plan began to materialize in rapid expansion of industrial output. The new agricultural policy soon generated phenomenal growth of agricultural output. Exports were catching up with imports. In 1954 the first trade contacts were established with the East European countries. After the conciliatory visit of Premier Khrushchev to Belgrade in 1955, normal trade relations were established and so a precious outlet for increasing exports was found (Obradović, 1962, p. 40).

In the decade that followed, exports increased 3.3 times, i.e., at a rate twice as high as in the world as a whole. These developments were too good to last long. In 1957 the Common Market was born in Rome. Two years later EFTA was created in Stockholm. Practically all West European countries became members of the one or the other trading group. East European countries belonged to COMECON, created in 1949, but it was just operating since 1954. Yugoslavia found herself isolated again. At first it did not matter too much. But gradually intrazonal trade in all three areas began to increase rapidly and to depress trade with third parties. This was true in particular for the Common Market, the most important trading partner of Yugoslavia. Common Market countries account for 30 percent of Yugoslav exports, 38 percent of imports and two-thirds of financial transactions. What makes this trade so vulnerable is the fact that between one third and half of Yugoslav exports to Common Market countries consists of agricultural products. Regular and variable import tariffs in the Common Market amount on the average to 50 percent of the Yugoslav export prices, for beef even to 60-70 percent, which clearly cannot encourage exports. Variable protection rates, when first announced to GATT, were said to be an exceptional instrument, the customs tariff remaining the basic one. In fact, however, variable rates amount to 2.5 times the regular tariff, they are changed daily, weekly or quarterly and represent a permanent instrument of total protection (Ziberna, 1969; Mitić, 1969).

Yugoslavia reacted to the new situation by trying to increase her trade with the developing countries. This attempt met with a limited success. Imports from developing countries increased to a maximum of 14.1 percent of Yugoslav imports in 1964 and there has been a permanent balance of payments surplus with these countries (Pelicon, 1968). Next, close relations were established with GATT. At first an observer, Yugoslavia became an associated member of GATT in 1959 when she also enacted the Customs Law. In 1961 a temporary customs tariff was produced and next year Yugoslavia became a temporary member of GATT. In 1963 a new, permanent customs tariff was enacted, and a year later full membership was granted by GATT.

COMECON was also approached. Its members absorb almost one third of Yugoslav trade. In 1964 Yugoslavia be-
came an observer in COMECON. With the Common Market special agreements are negotiated.

India and the United Arab Republic account for one third of Yugoslavia's trade with developing countries. In 1966 the heads of the three countries initiated a scheme which became known as Tripartite Co-operation. The agreement, ratified in 1968, comprised 500 products to which preferential rates of 50 percent became applicable, and envisaged also industrial co-operation. It was also suggested—this time by economists and not by politicians (Bilandzić, 1967, p. 30)—that a Danubian trading area be formed. If that had proved possible, it was hoped that the area could have been extended North and South. The occupation of Czechoslovakia rendered that idea utopian for the time being.

Attempts to develop economic relations with as many countries as possible and the foreign policy of an uncommitted nation enabled Yugoslavia to establish trade with 120 countries. Trade is not only geographically dispersed; it is also diversified in terms of products exchanged. As a result a theory of "capillary trade" emerged. V. Pertot argues that small quantities reduce marketing difficulties, and S. Obradović adds that highly diversified trade reduces risks of business fluctuations. Empirical research lends some support to this hypothesis. P. Mišajlović finds that the concentrated pre-war export was very much dependent on external business fluctuations, while no such dependence appears to exist after the war (Mišajlović and Tano- vić, 1959, p. 77). Capillary trade also has its drawbacks. Obradović points out that it increases marketing costs and quotes approvingly Šiačić, who maintains that export concentration is a precondition for a permanent export position on the world market (Obradović, 1962).

Fast growth after 1955 led to profound structural changes. The share of exports of commodities and services in social product increased from about 13 to about 20 percent. The Yugoslav share in world trade doubled, but being still less than one percent, provides a justification for the capillary theory. The share of those three traditional natural resource sectors in exports has been reduced from 90 to 50 percent (Fabinc et al., 1968a, p. 144). Raw materials and manufactured goods changed their places in the structure of exports (Guzina, 1950:6 in 1939 to 13:50 in 1968).

The once self-sufficient peasant economy is now only a matter of historical interest. It has been replaced by a relatively open industrialized economy participating actively in development of the world market.

Prologue: Rigid central planning in the period 1945–1951 implied a state monopoly in foreign trade. The domestic market was completely cut off from the outside world. The rate of exchange was just an accounting device without economic meaning. Export and import trade were conducted at prescribed domestic prices. The Fund for Price Equalization, created in 1946, compensated exporters for the differences between the domestic and export prices. Each transaction implied a separate foreign exchange rate. That was consistent with the principle of profitability at all cost applied in the home market. Exporters were obliged to surrender their foreign exchange proceeds to the National Bank. Foreign trade enterprises acted as agents for the Ministry of Foreign Trade and were obliged to implement import and export plans. Plans were defined in physical terms and so traders were not interested in prices and other trading conditions. The system was simple and consistent, but not very efficient. Yet, in the turbulent post-war years it did the job it was designed for.

The most important event in those years was the Cominform economic boycott. At that time details about operations of mixed Soviet–Yugoslav companies became publicly known and stirred great indignation. A certain number of these companies were created with a proclaimed aim of helping to develop the country. Capital was invested in even shares; profit was divided evenly, the Russians appointed their own people as general managers, insisted on preferential treatment and objected to Yugoslav financial control. All this reminded people too much of their pre-war experience with foreign capital and mixed companies were gradually liquidated. But the problem was more complex than that; economic relations among socialist countries were at stake.

In an interesting 1949 article M. Popović then a member of the government and now the President of the Federal Assembly, explained the position that had been taken (1949). If a less developed and more developed country meet in the world market, they will exchange commodities with different labor contents. The more productive country will get back more labor than it gives away. This implies exploitation. Further, if in mixed companies profit is divided according to capital invested, a principle of distribution alien to socialism is introduced and as a result exploitation appears in yet another form. According to socialist principles—said Popović—the entire surplus value, i.e., the entire profit obtained by the society after it had sold the commodity in the world market, belongs to the proletariat which has created that value . . . (1949, p. 108).

To such theories, and not quite unexpectedly, Russian negotiators reacted rather iconoclastically: "Torgovlja–torgovlja, a drusha–drusha" (trade is trade and friendship is friendship). But for Yugoslavia, then a year or two after the Revolution, socialism meant immensely more than trade; to put the two on an equal footing was profoundly shocking. Economic relations among socialist countries were seen as similar to the relations of the various regions within one country. Developed socialist countries had an obligation to grant aid to the less developed ones in order to speed up their growth and enable them to reach the same level of development in the shortest possible time (Obradović, 1962, p. 39; M. Popović, 1949, p. 70).

These were not abstract ideas; they were applied in relation to Albania. Yugoslav and Albanian partisans fought together during the war and relations between the two countries were very close. As a more developed country, Yugoslavia sent experts and material supplies to Albania. Tariffs were abolished and monetary units were given the same nominal value. Attempts to design a single system of prices failed because productivity differences between the two countries were too great. But they then continued to trade at their internal prices which meant that Albania exported at Albanian prices and imported at Yugoslav prices (the latter were somewhat lower than the Albanian on average). In this substitution of world market prices by respective domestic prices Popović saw the elimination of the exploitation characteristic of the world market mechanism (M. Popović, 1949, p. 128). In fact, however, this conclusion does not necessarily follow. To find out whether and how much Albania gained, one would have to calculate the entire trade in Albanian, Yugoslav and world prices and compare the value aggregates. And in order to make exchange equivalent in labor terms one would have to apply input–output analysis. Another policy measure had much more obvious implications. Albania was granted interest-free loans for an unspecified length of time. This was an early anticipation of the now familiar aid programs for underdeveloped countries.

Bulgaria was another country with which
Yugoslavia expected to eliminate tariffs and possibly even form a confederation. Yugoslavia waived Bulgarian reparations obligations for war damages, and after the Pled agreement in 1947, hopes went high in both countries. A few months later Stalin launched his attack, and soon all achievements were forfeited, all hopes buried. Fermer friends became enemies.

The Cominform economic boycott and the need to finance the Five-Year Plan compelled Yugoslavia to establish contacts with the world capital market. Ideological reasons and unpleasant experience with Western capital before the war and with Soviet capital afterwards made joint stock companies and mixed companies an undesirable form of import of foreign capital. Loans remained the only available alternative. But loans may also affect the economic and political independence of the country unfavorably. In order to prevent this from happening, V. Guzina suggested, in a paper representing the common opinion of the time, that foreign trade be conducted according to the economic plan, and a specified volume and structure of exports be secured (1959, p. 71). Guzina also held that autarchy was both impossible and undesirable, and favored development of an open but controlled socialist economy. These ideas were characteristic of foreign trade policy in the next decade.

Three Steps Towards Free Trade

By the middle of 1951 the new economic thinking reached the sector of foreign trade. As usual, market experimentation began with agricultural products. Exporters of certain agricultural commodities were allowed to sell their foreign exchange proceeds at a price which was obtained by multiplying the official rate by the factor 7. This foreshadowed the new official rate determined on January 1, 1952 at 18 = 309 din (the old rate was 18 = 50 din). Exporters were granted a retention quota of 50 percent with which they could finance imports of their own choice and sell imported commodities at free prices.

The transition from complete state-monopoly to a system of free trade was not a simple affair. Various alternatives were discussed. In an important article early in 1952, D. Avramovic, then a staff member of the Bank, argued that a fixed exchange rate and, in particular, its exclusive use, cannot be practiced in a socialist economy. In order to secure the minimum volume and the necessary structure of exports and imports consistent with production and investment targets, the fixed exchange rate should be replaced by either physical allocation of goods or a system of multiple exchange rates. The latter is more consistent with a socialist market economy. Since foreign prices constantly fluctuate and since a full employment high rate of growth economy needs stability, there was a need to be an Equalization Fund to absorb violent fluctuations. Thus, not only is there a need for multiple exchange rates, but these rates should also fluctuate. The capitalist principle of a fixed exchange rate and business fluctuations must be replaced by a socialist principle of multiple fluctuating exchange rates (Avramovic, 1952).

Most of these ideas were soon tried out. In July of the same year the system of 17 price equalization coefficients was set in operation. Coefficients, applied to export prices calculated at the official exchange rate, ranged from 0.8 (for exports of agricultural products) to 4.0. Low coefficients were applied to imports of equipment and raw materials in order to keep their prices low.

A high degree of liberalization was envisaged in foreign trade, but in comparison to the liberalization of the home market, the liberalization of the foreign trade system proved to be a much tougher job. First of all—and again is contrast to the home market—the price of foreign exchange was too low. Already in 1951 the actual average export exchange rate was 354 dinars for one dollar, and in 1952 it increased to 585 dinars which was almost twice as much as the official rate. The average import exchange rate was lagging behind (especially 440-500 dinars). Cheap imports exerted pressure on the balance of payments. The foreign exchange reserve of 4 percent of imports made economic interventions impossible. No wonder that the newly created foreign exchange market, DOM (Foreign Exchange Accounting Place), did not work. At first, exporters were obliged to sell only 55 percent of their foreign exchange to the Bank; the remaining 45 percent, representing their retention quota, could be used for imports of their own choice or sold to importers at the DOM. Already in October the retention quota was lowered to 20 percent, and that meant the death sentence for DOM. In the next year DOM rates soared to a level 6.8 times higher than the official rate. Average actual exchange rates went up as well.

In 1954 a series of desperate attempts was made to save the system. The accounting exchange rate was increased to 632 dinars for a dollar. Coefficients were revised and applied to DOM rates, and not to the official rate. A steep tax on the gains at the DOM. A number of other complicated procedures were applied. DOM rates were brought close to the new accounting rate, which the authorities aimed for. Yet importers of raw materials could not compete any more at DOM for foreign exchange and so separate sales were organized for them. This reduced the amount of available free foreign exchange to something like one percent of the domestic. The retention quota was reduced to only one percent. Price of foreign exchange soared and by 1960 reached a level 12.3 times as high as the official rate. The National Bank replaced exporters as the only seller of foreign exchange (Mikulina, 1963, pp. 301-315).

The first free trade attempt failed because the initial price for foreign exchange was set too low, initial reserves were too small, the share of the free market in foreign exchange supply was too small and disparity between home and foreign price too great. It would have been rather difficult to find elsewhere in the world such relative prices, remarked V. Meichisher, as existed in Yugoslavia in 1955: one type writer ribbon (2,800 dinas) equals a pair of shoes equals two yards of wooden fabric equals one third of an average employee's salary equals two-day full board in a first class hotel in a tourist resort equals 15 haircut equals the monthly rent of a five room apartment (Miushner, 1956, p. 193). At that time three different foreign exchange regimes coexisted: the official rate, the regular and the separate DOM rates. Meichisher suggested that the number of coefficients be gradually reduced to only two, one for industrial and one for agricultural products. In 1957 M. Firovich calculated deviations of actual exchange rates of various product groups from the average actual rate of 18 = 779 dinas. It turned out that industrial exports and food, equipment and invisible imports were subsidized at rates between 21 and 35 percent, that there were export taxes between 16 and 21 percent for agricultural, wood and invisible exports and a protection rate of 105 percent for consumer goods imports (Firovich, 1957).

By 1960 it had become clear that the foreign trade system needed a thorough revision. D. Ochovin evaluated the situation in three points. Enterprises were stimulated to press for an increase in coefficients, not to compete in the world market. Coefficients had ceased to be passive equalization instruments and were in fact transformed into active devices for increasing price disparities. Profitability calculations were made practically impossible
Mrkušić noted that in an economy where exports are price elastic and imports are not, there will be a constant tendency for export exchange rates to move away from the import ones. That required physical restrictions (Mrkušić, 1965, p. 297). Both did happen. Higher export exchange rates were bound to produce inflationary pressure—via the money supply—as Avramović had already warned (1952, p. 24).

The recession that started in 1960 made things worse and stimulated the authorities to undertake a reform in 1961. This time an ample supply of foreign exchange was secured by foreign loans. But the other two mistakes of the 1952 reform were committed again: the new accounting rate was set too low (750 dinars for one dollar); the actual export rate in 1960 was 981 din and in 1961 went up to 1021 din (O. Konv, 1966) and price disparities were corrected in only a few cases.

The situation was worsened by the fact that about one half of Yugoslav foreign trade was oriented towards clearing currency countries, most of it towards COMECON. Both import and export flows with the COMECON countries are much more unstable than with the convertible market (Mušar, 1968). Both import and export prices on the COMECON market are higher than on the world market. Besides, it is easy to export to this market but difficult to import from it and vice versa for the convertible currency market. As there was one single exchange rate for both markets, the consequences should be obvious. Importers were oriented towards convertible currency countries, exporters towards clearing currency markets. The balance of payments deficit with the former increased rapidly, while there was an unabsorbed surplus on the trading account with the latter. A boom in 1964 produced unbearable pressure on the balance of payments. In the same year the cycle was reversed. The recession helped to induce the authorities to undertake another reform in 1965.

In the same year the cycle was reversed. About one quarter of imports was liberalized and retention quotas remained in most cases at 7 percent. For the rest there was a complicated system of inducements and restrictions; in order to achieve a proper regional distribution of trade, a category of imports from the convertible area was made conditional upon the purchase of a specified amount of clearing currency (Savea, 1966). Export premiums and tax subsidies were abolished. Tight money policy was used to keep prices stable; reduce internal demand and compel enterprises to export.

Once again the new regime failed to produce the results expected. After an initial burst of exports and a contraction of imports which in 1965 produced a small balance of payments surplus, imports began to expand faster than exports. Internal demand was checked, but so were exports. A balance of payments deficit reappeared and was increasing. Unpleasant clearing currency surpluses were cumulated. Import restrictions were multiplied. Export inducements were reintroduced. Differential exchange rates were back. The dinar was stable on the tourist market—dinar notes could be bought at rates close to the official one at all foreign exchanges—but a quiet devaluation was proceeding under the surface. None of the objectives quoted by Anakloski was achieved.

The ways in which the free trade reforms were carried out did not indicate an impressive professional competence. But in this respect Yugoslavia is not unique in the present world. The most popular method of policy making seems to be the method of trial and error. It has its drawbacks but, if applied with sufficient persistance, it also produces useful results.

The new foreign trade regime became operational in 1967. About one quarter of imports was liberalized and retention quotas remained in most cases at 7 percent. For the rest there was a complicated system of inducements and restrictions; in order to achieve a proper regional distribution of trade, a category of imports from the convertible area was made conditional upon the purchase of a specified amount of clearing currency (Savea, 1966). Export premiums and tax subsidies were abolished. Tight money policy was used to keep prices stable; reduce internal demand and compel enterprises to export.

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So far I have been examining deficiencies. Let me now briefly evaluate the results. Since 1952 the span between extreme actual (resulting from actual revenues of exporters and actual payments of importers) exchange rates has been considerably narrowed. Actual exchange rates have become considerably more stable. The positive difference between the actual export and the actual import exchange rates of 303 din. in 1955 was transformed into a negative difference of 109 din in 1967. Government interventions in foreign trade operations have been reduced in every respect. About one fifth to one fourth of imports is firmly and completely liberalized either directly or via retention quotas and other arrangements. The tourist dinar is a stable and convertible currency. The stage is set for the last—if there is such a thing in economics—assault on free trade and convertibility.

The What-to-do-Next Controversy

The misfortunes of the third reform were not entirely unexpected. Mrkušić, A. Čičin-Šain and other economists evaluated various government objectives as unattainable given the policy pursued.
Soon a lively discussion developed focusing on three themes: protection, the nature of exchange rates, and convertibility.

1. Fabine argued that every protection policy ought to be associated with a development program. Developing countries encounter serious bottlenecks in output capacities and shortages in material and financial means. Therefore, unlike developed countries whose protection policy aims at changing the structure of prices and incomes, developing countries must have a protection policy oriented towards changes in the structure of production. The main objective of a tariff policy is to protect national production by introducing a desirable differentiation of internal prices as compared with prices on the world market. There are, however, three important tasks which a tariff policy cannot perform. It cannot regulate the volume of imports, it cannot achieve the desirable structure of imports and it cannot regulate a regional distribution of trade (Fabine, 1963, 1968b). One has to find other devices to do these jobs.

Evidently, administrative interventions of the government are one possible alternative. It is, however, not acceptable as a dominant alternative in the Yugoslav setting. Next, a proper exchange rate system could do at least part of the job. This system could be based on a single rate, or on multiple rates, and the rate or rates could be pegged or be fluctuating. Out of these elements four main combinations and a number of variations may be formed. On the one hand there will be a single pegged rate on the other fluctuating multiple rates.

In the debate the Institute of Foreign Trade noticed an inconsistency in the traditional approach. The policy of a single rate usually imposes the elimination of multiple rates on the export side, while on the import side they are retained in the form of a customs tariff. In fact, however, the economic justification for multiple rates is the same for both components of foreign trade (Institut, 1964, p. 73). Mirkuišć and O. Kovač of the IES suggested that the pegged rate be made flexible by the application of exchange rate ingredients such as tax reductions, and preferential transportation rates like, but they find direct export subsidies unacceptable, presumably because they fear a proliferation of arbitrary government interventions (Bilandić, 1967, p. 34). As far as the import side is concerned, Fabine noted that fixed customs rates do not prevent their flexible application (by an appropriate definition of the customs value or by introducing price clauses) (Fabine, 1963, p. 38). Other devices—such as a customs registration tax—are available as well. Thus even if the single fixed exchange rate is chosen as a basis for the system, the prevailing expert opinion favors making it flexible in both senses: it ought to be changeable in time and differentiable with respect to the fixed standard. The justification for this approach had already been provided by Avramović in the cited paper of 1952: a planned economy cannot tolerate that outside economic conditions and fluctuations be automatically transmitted to the internal market. This was now reiterated by U. Duščin, who advocated not only flexible, but also fluctuating rates (Duščin, 1968, p. 593). Mirkuišć pointed out that if one wanted to keep the balance of payments in equilibrium either the exchange rate or, internal prices will have to be continually adjusted. Since internal stability is obviously the first priority, the flexibility of the external value of money follows as a natural consequence (Mirkuišć, 1967).

The government chose to base its policy on the pegged rate. This decision now came under attack. A pegged rate implied government interventions, which were intended. Fluctuating rates involved risks of instability, which the government was not willing to assume. Ćičin–Saín thought that these risks could not be so great, that fluctuating rates required much smaller reserves and much less stringent conditions in terms of financial discipline, organization of the market etc. (Ćičin–Saín, 1968a). A few years earlier, G. Matesich, an American economist of Yugoslav origin, also argued in favor of fluctuating rates. He believed that “such a system would serve to integrate the country’s economy more effectively with the world’s economy by quickly indicating to planners when mistakes in the planning have been made. The correction of mistakes would not have to depend on intermittent changes in rigid official exchange rates” (Matesich, 1964, p. 202).

On the other hand Mirkuišć argued that fluctuating exchange rates would generate speculation and would be destabilizing. He cited the Canadian twelve-year experimentation with fluctuating rates which he claimed ended with trade restrictions for about one half of imports (Mirkuišć, 1969). Ćičin–Saín suggested that speculation could be avoided if enterprises were obliged to sell foreign exchange as soon as it was earned. Capital movements would clearly require separate control.

Fluctuating exchange rates implied the existence of a foreign exchange market. The government feared that this might mean repeating the failures of the DOM. On the other hand enterprises and business chambers were pressing for higher retention quotas. The prevailing export opinion seemed to be in favor of the market, even if not for all currencies. Since the country ran a chronic surplus on its trading account with the clearing area as a whole and with most individual clearing currency countries, it seemed advisable to start market operations with these currencies (Bilandić, 1967, p. 34).

That would mean fluctuating rates for about one half of the foreign exchange proceeds. The next phase might be trading in convertible currencies, and finally a proclamation of the external convertibility of the dinar.

Ćičin–Saín examined the pros and cons of partial and full convertibility via external convertibility, i.e., by satisfying Article VIII of the IMF agreement, or via internal liberalization. In favor of the former, he advanced the following three reasons: (1) the dinar might become a reserve currency, which would mean an interest-free credit for Yugoslav imports; (2) clearing countries might find it advisable to liquidate their clearing deficits in order to accumulate convertible dinar balances and (3) the financial prestige of Yugoslav would increase. He felt, however, that these reasons were not particularly convincing. Even if fully convertible, the dinar would probably not be held as a reserve currency in any substantial amount, and in so far as clearing deficits were structural, they would not be remedied by financial devices. On the other hand, external convertibility would require substantial reserves and is the more difficult to achieve the higher the degree of internal liberalization (Ćičin–Saín, 1967, 1968a). Liberalization would result in lower inventories—inventories are notoriously high in the Yugoslav economy—which would mean a considerable saving in foreign exchange and in working capital.

Later in the debate professional opinion swung in the direction of external convertibility. Mirkuišć argued that in fact Yugoslavia maintained external convertibility with the convertible currency countries. If Yugoslav traders pay foreign exporters in their own currency, this is the same as if they paid in an externally convertible dinar. The official proclamation of external convertibility would lead
to greater financial discipline, greater influence of the world market on internal costs of production and also to some foreign exchange economizing because foreign exporters would not insist on converting dinar balances immediately into their own currency (Mkusić, in press). The Economic Institute in Zagreb pointed out that external convertibility would facilitate multilateralization of trade with the COMECON countries (Fabinić et al., 1968a, p. 191).

As already noted, Yugoslavia belongs to neither of the trade areas in Europe and is politically uncommitted. As a result she encountered considerable difficulties in trade with her neighbors. However, why not transform this position of weakness into a position of strength? A country which went through underdevelopment, central planning and market organization and which is economically and politically uncommitted might perhaps become a desirable economic meeting place for three different worlds. If so, external convertibility is certainly one of the preconditions for making the mediating role of the Yugoslav market attractive for her partners from the West, the East and the Underdeveloped South (Cićinić-Sain, 1968a, p. 82).

V. Money, Banking and Public Finance

Banking and Monetary Policy

There has been a lot of experimentation in the Yugoslav economy. This is true for the monetary field more than any other. Banking can be organized in a centralized or decentralized fashion. Decentralization can be (1) regional, (2) functional or (3) both. Centralization can be (1) absolute or (2) partial. Thus there are five possible organizational solutions. All of them have been tried out at one time or another.

Banking for a Centrally Planned Economy: According to the Institute of Finance, in the socialist economy of 1949 money was a tool used by the state authorities to distribute social product in proportion to the labor of each working-man, to establish economic ties among enterprises and to exercise control over their activities. Money was also a means of accumulation and an instrument of control over plan fulfillment (Finansinski, 1949, p. 63). The banking system was expected to provide money which had such properties.

From pre-war times Yugoslavia inherited a certain number of private and state banks. The former were eliminated by 1947 and the latter were reorganized. The National Bank was a descendent of the Serbian National Bank created in 1883. The former State Mortgage Bank—the heir of a state bank set up in Serbia in 1862 (Uprava fondova)—continued to operate as the State Investment Bank. The Agricultural Bank of 1929 continued to operate in the same field. There was also a Handicraft Bank and, in view of ambitious industrialization programs, it appeared advisable to set up a separate Industrial Bank.

The war had not yet been ended when a process of creating regional banks began: six republics—six regional banks.

For a country aiming at central planning, all these banks did not represent a very purposeful arrangement. In September 1946 a consolidation of the banking system began. All existing banks were merged into the National Bank, entrusted with short-term transactions, and the State Investment Bank, which was to deal with investments and foreign loans. Apart from dealing with short-term credit, the National Bank issued currency, performed general banking and agency services for the government and served as a clearing house for the entire economy. In 1948 the two-bank system seemed overly centralized. Since local enterprises and agricultural co-operatives played special roles at that time, 89 Communal Banks and 6 regional State Banks for Lending to Agricultural Co-operatives were formed. Communal banks were universal banks (they were for servicing local budgets, extending short and long-term credits, collecting savings, controlling bank fulfillments of local enterprises). Banks charged a one percent interest rate which was in fact a commission charge for their services. It was not deemed appropriate for a socialist system to charge interest as a price for capital.

Since it is much easier to control financial transactions conducted via bank accounts than those made in cash, already in 1945 all enterprises and other non-private transactors were obliged to have drawing accounts with the bank. Soon about ten percent of payments were conducted without using cash. This was one of the lasting results of the early period of banking development. Payments through bank balances developed into a unique internal payment system, channelled through local offices of the National Bank. It embraced all banks, post offices, enterprises, government funds and a considerable part of the private sector and connected all money streams of the economy into a single consistent system (Vučković, 1963, p. 366).

In many respects the early Yugoslav monetary system was a replica of the Soviet model. This is particularly true for the three instruments of monetary control: credit planning, cash distribution and the automatic collection of invoices.

Credit planning was the only instrument to survive the administrative phase. Until 1950 credit planning simply meant summoning up the credit needs of individual enterprises. This was done by planning authorities. The bank was supposed to implement such plans in a routine way. Later, credit plans were transformed into credit balances, which meant that needs were balanced with means. Banks were made responsible for drawing up credit balances (Vučković, 1956, p. 172). The planned amount of credit for individual enterprises was obtained by dividing the output target into an individual capital—turnover coefficient and then subtracting the enterprise’s working capital (Vučković, 1963, p. 366).

The main purpose of cash distribution plans was to control receipts (mainly in retail trade, catering and passenger transport) and expenditures (primarily for wages and payments to peasants) made in cash (Stevanović, 1954, pp. 145–46). The cash plan was made for territorial units and for separate money streams and so provided useful information about receipts and expenditures of the population and about various channels in which the money was circulating in the economy. But it was a rather rigid instrument with not much use outside central planning and was therefore abandoned in 1951.

In order to enhance financial discipline, enterprises were forbidden to grant trade credits to each other. The automatic collection of invoices served the same purpose. The bank would automatically credit the seller’s account when goods were shipped and then charge the buyer’s account. In this way no mutual crediting could be practiced. Payrolls were carried out smoothly. If there was no money in the buyer’s account, credit was automatically extended. This, of course, meant that credits would expand beyond the limits set by the credit plan. At first, such matters did not worry planners too much; physical targets and not money flows were important. Other consequences were more disquieting. The total volume of credits depended more on debtors than on banks. The necessary discipline was jeopardized. Sellers did not care about the solvency of their buyers, and also tended
not to pay sufficient attention to delivery terms, assortment and quality of goods. Buyers did not mind accumulating excessive inventories. After a while careless buyers had to be put on "black lists," their drawing accounts were blocked and in many cases they were brought before the courts. The automatic payments mechanism broke down and was in 1951 replaced by free contracts among the trading partners (Vučković, 1957, p. 21).

**Learning by Doing:** What sort of banking system was appropriate for a self-management economy? Centralized or Decentralized? There was a lively discussion on that issue. E. Neuberger surveyed the principal arguments advanced in favor of the one or the other alternative (1959a). Whatever the merits of these arguments might have been per se, the government decided to play safe. No one lng system was appropriate for a self-managed enterprises. The automatic payments function would stop any irregular payments, which was particularly important for payments related to wages; the Bank checked the fulfillment of tax and other obligations of an enterprise towards the state. The system was later simplified, the number of separate accounts was gradually reduced and the Bank began to rely more on quarterly accounting statements by the enterprises. A standard accounting scheme, obligatory for all enterprises, made this task a routine matter. In 1959 the social accounting with its drawing accounts system for the entire economy and turned into an independent social service. The work was computerized and the service became very efficient. A little later it was discovered that the Social Accounting Service's monopoly on the payments traffic was not an obstacle to enterprises keeping their financial resources with the banks of their own choice. Today every non-private income earner has a drawing account with the Social Accounting Service, and pays commission charges, and at the same time has a deposit account with one of the banks, and receives interest on deposits.

The proper procedure to be used in extending short-term credits was one of the important problems the all-embracing National Bank had to solve. In those days of romantic beliefs in the possibilities of inventing simple problem-solving devices such as the Rate of Accumulation and Funds—that would eliminate the arbitrariness of a bureaucratic apparatus, the Bank hired a couple of mathematicians and asked them to invent appropriate formulae for credit extension. A booklet with several dozens of such formulae was published in 1952 (Miljanic et al., 1956). They were based on turnover coefficients of credits and ratios of sales to costs. Since parameters to be used in formulae could be calculated only as some sort of averages, it was soon discovered that some enterprises got some more credits than they needed, while others badly lacked the money to keep production going. Formulae were abandoned and in 1953 the amount of credit extended was related to the maximum quarterly credit used by the enterprise in the previous year. This favored last-year debtors and penalized good entrepreneurs and had to be abandoned. But the idea of some automatic credit evaluating mechanism was not abandoned.

In 1954 the Bank experimented with credit auctions. Vučković explained that credit auctions were to be kind of socialist credit market where the supply and the demand of money would meet and determine the general conditions for credit extension (1957, p. 38). The Bank expected that less profitable enterprises would refrain from asking for credit because they would not be able to bear high interest rates. Enterprises were prepared to offer the highest interest rates up to 17 percent—because they considered credit the only available solution. The Bank then set the marginal interest rate at 7.5 percent. But this was a negation of the whole idea of auctions. Soon credit was extended automatically to every enterprise that had satisfied the formal conditions of an auction. Since all automatic devices provide insufficient, in 1955 the Bank fell back on the traditional banking practice of an individual evaluation of every credit request.

By 1954 two facts were established: (1) the NES worked well as a whole but (2) the centralized bank left much to be desired. As soon as that had become clear, regional and functional decentralization were initiated. One of the main justifications for decentralization was the socio-economic incongruity between self-management in the commodity market and state monopoly in the financial market. Vučković quoted approvingly the governor of the National Bank, who declared that in a decentralized banking system the credit function would be subject to the control of social self-government instead of bureaucratic management (Vučković, 1957, p. 86). Communal banks with all their diverse activities were re-established. The banks were obliged to keep reserves with the National Bank of up to 30 percent of demand deposits and 100 percent of investment funds. In the next three years three specialized federal banks were added: a foreign trade bank, an investment bank and an agricultural bank. The National Bank was relieved of investment and some other banking operations. Each bank was a member of a network of some automatic credit extending short-term credits was one of the important problems the all-embracing National Bank had to solve. In those days of romantic beliefs in the possibilities of inventing simple problem-solving devices such as the Rate of Accumulation and Funds—that would eliminate the arbitrariness of a bureaucratic apparatus, the Bank hired a couple of mathematicians and asked them to invent appropriate formulae for credit extension. A booklet with several dozens of such formulae was published in 1952 (Miljanic et al., 1956). They were based on turnover coefficients of credits and ratios of sales to costs. Since parameters to be used in formulae could be calculated only as some sort of averages, it was soon discovered that some enterprises got some more credits than they needed, while others badly lacked the money to keep production going. Formulae were abandoned and in 1953 the amount of credit extended was related to the maximum quarterly credit used by the enterprise in the previous year. This favored last-year debtors and penalized good entrepreneurs and had to be abandoned. But the idea of some automatic credit evaluating mechanism was not abandoned.

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The federal government often interfered with the banking system by creating an institutional system in the financial sphere. The National Bank offices were inefficient, unimaginative, engaged in distributing the planned increase in credits and executing the decisions of the head office. Communal banks fell under the complete control of local authorities which often made it impossible to conduct a sound business policy of profitable and safe investments. The federal government often interfered with the banking business by immaterializing certain kinds of deposits or by running a deficit inconsistent with the social plan. In order to overcome the deficiencies a series of reforms was undertaken. As a result of the 1952 period, reforms were carried out in two-year intervals starting with 1961.

In 1961 communal banks became basic and universal credit institutions. In order to eliminate the monopolistic influence of political authorities, a two-thirds majority of members of the banks' managing boards were nominated by workers' councils of the enterprises located in the territory of the bank. Next, eight regional banks reappeared. They were to serve as mediators between communal banks — which were required to keep a 5 percent reserve with respective regional banks — and the National Bank. That was a rather unfortunate arrangement, since it caused the disintegration of the national credit market into six regional markets with different business conditions etc (Miljanic, 1964, p. 53). This mistake was rectified four years later.

In 1952 an interesting new institution was created. It was called Joint Reserve Funds of the Enterprizes. D. Dimitrijevic describes Joint Reserves as a semi-financial intermediary. Joint Reserves — created at communal and republican levels — grant credits to enterprises which have losses, are not competitive, have an unsound financial position and are not eligible for regular bank credit (Dimitrijevic, 1968a, p. 19).

For more than a decade Yugoslav banking practice, and monetary theory, maintained a fundamental difference between fixed capital and working capital financing. This made sense in a centrally planned economy, but led to mistaken policies in a market setting. It was now realised that working capital was not homogeneous: it consisted of a constant part, which could and should be financed as fixed capital, and a fluctuating part which was a proper object of short-term credits. In 1961 enterprises consolidated the fixed capital and working capital funds into one single business fund. Thus, all liquid assets could be used both for current payments and for capital formation. In order to increase the financial independence of enterprises, they were encouraged to finance the constant part of the working capital out of their own funds and to rely on bank credit for the fluctuating part only. But that was not enough for a full-fledged credit policy.

Policy makers had to solve the following problem: design a flexible credit policy with a minimum of administrative allocations when there is no proper money and capital market. They decided to use so-called qualitative control, which implied regulating the demand for credit. The new system lasted for four years and produced some good results. Enterprises knew in advance what conditions they must fulfill in order to obtain credit from the bank. Commercial banks were sure to get credits from the National Bank if they fulfilled the prescribed conditions. But the system was also deficient in many ways. B. Mijovic, a director in the National Bank, pointed out that qualitative control (conditions, purpose, duration and kinds of credits) could not quite achieve all the aims of quantitative regulation of the Yugoslav economy, this is a valid statement.

New money ought to be used to finance primarily the circulation of commodities. Thus credit is given on the basis of some evidence, invoice or bill of exchange, that a commodity has been sold by a producer or bought by a merchant. Credit cannot be given for sales to final buyers (government, investors, consumers). As exceptions to the rule and on the basis of individual evaluation by the bank, credits can also be given for seasonal stocks and for stocks due to some circumstances beyond the enterprise's control. In particular, credit for stocks, far from being an exception almost reached the level of credits for commodity circulation (Miljanic, 1964, p. 72). Apart from this first category of credits, which creates some kind of neutral money, credits can also play an active role in supporting production. Such are credits for specific ventures, primarily for exports, agricultural production and for building apartments for sale. Miljanic also noticed one difficulty with his system. Business operations require that an enterprise always have at its disposal a certain amount of money pure and simple. This money is a part of constant working capital, but, being money, should not be financed out of income. On the other hand, if it is financed by credits, they are clearly not short-term ones. Miljanic feels that revolving credits might do the job (1964, p. 88).

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of banks: investment banks financing fixed and constant working capital, commercial banks extending short-term credit, and savings banks dealing with consumer credit. Table 9 summarizes the latest organizational changes (Basaraba, 1967, p. 78).

Organizational changes reflected very definite policy changes. (1) Federal, Republican and communal banks disappeared. All banks can in principle conduct their transactions over the entire territory of the country. This deterritorialization policy came as a response to frequent complaints against parochialism and unsound political pressures of local and republican authorities. (2) The market orientation of banks resulted in a concentration process that reduced the total number of banks by one half in only three years. By the end of 1968 the number of banks was further reduced to 74. This number ought to be compared with 206 in 1967. But the most important was (3), the change in the setting up and running of the banks. Here at last, a solution consistent with the organization of the rest of economy was found.

Banks are now established by enterprises and socio-political communities (federal, republican, local) as equal partners. In order to be independent business establishments, banks have their own capital, called the credit fund. The founders invest their capital in the credit fund of the bank and become shareholders. At least 25 founders are required for any bank so as to preserve the essential service function of the bank. The bank is managed by enterprises and socio-political communities in proportion to the amount of their capital invested in the credit fund. Shareholders are entitled to dividends depending on business success. These dividends cannot be distributed in wages, but can only be used for capital formation. In order to prevent monopolization, no single shareholder can have more than ten percent of the total number of votes in a bank's assembly regardless of the amount of capital invested.

Also no enterprise or socio-political community can be refused the right to invest in a bank and take part in its management. The Assembly of a bank consists of investors and representatives of the bank's personnel. It appoints the Executive Committee, the director and his deputy. The Executive Committee implements the bank's general business policy. The Credit Committee deals with individual requests for credit except in some special cases. In order to ensure an objective and expert business evaluation of requests, the Credit Committee is composed of the bank's own experts. The employees of a bank have their own self-management bodies which deal with the distribution of personal income, use of various funds, personnel matters and the like and, through representatives on the Executive Committee and in the Assembly, participate in the management of the bank.

After a network of commercial banks had been established, the National Bank discontinued its direct business contacts with enterprises and became a centralized bank in the traditional sense. In its function of regulating the money supply, in 1961 the National Bank had the following weapons at its disposal (Golijanis, 1967, pp. 95-104).

2. Sales of foreign exchange.
3. Fixing of terms for extension of short-term credit by communal banks.
4. Legally required reserves held by commercial (later by commercial) banks with the National Bank. The upper limit was set at 35 percent of liquid deposits.
5. Limits for interest rates (in practice 3-12 percent).
6. Restriction of the use of certain kinds of deposits. This instrument was often and indiscriminately used, which greatly angered the owners of funds. L. Perišić points out that in the period 1954-1962 between 24 and 45 percent of total deposits were blocked in this way (1967).
7. Special credits extended by the National Bank to other banks. These credits were used to finance about one half of all short-term credits extended by commercial banks to their clients.
8. Consumer credit policy.

Compared with traditional banking, some items appear superfluous, but one important item is missing: there is no place for an open market policy since there are, so far, no treasury bills. Instrument 7 is a substitute for that. By special credits new money is created and the liquidity of commercial banks ensured. If a bank wants to reduce excessive liquidity, in order to avoid paying passive interest, it can do so by repaying its credit to the National Bank.

As already mentioned, the 1967 reform replaced credit demand control by credit supply control, and so the functions of the National Bank had to be adjusted accordingly. Instruments 3 and 6 were abandoned and the existing amount of special credits was frozen and could not be increased. Several new instruments were added:

10. Rediscount credit, which is used as an instrument of both global and selective control. It amounts to about 12 percent of all commercial credits. In order to qualify for getting this type of credit a commercial bank must fulfill two conditions:
   (a) its total indebtedness with the National Bank cannot be greater than its demand deposits; (b) at least one half of its short-term credits must consist of credits with repayment periods shorter than three months. Condition (b) is a special type of liquidity reserve requirement designed for the Yugoslav environment where there is enormous pressure to use short-term sources for investment loans.
11. Discount rate.
12. Quantitative restriction of credit as an exceptional measure.

This is an impressive array of weapons which, if inappropriately used, can cause considerable damage. In the section on monetary policy we will see how this can happen.

In 1967 a daily market was set up within the Association of Banks as a particular kind of stock exchange for supply and demand of short-term capital. Banska in need can obtain credit for a period not exceeding 15 days (Basaraba, 1967, p. 81).

At the time these lines were written, the Federal Parliament passed a package of financial laws providing, among other things, that shares in a bank's capital can be sold to the business public, but not to socio-political communities and to banks themselves. These two events may be con-

<table>
<thead>
<tr>
<th>Type of Bank</th>
<th>November 1964</th>
<th>June 1967</th>
</tr>
</thead>
<tbody>
<tr>
<td>Communal banks</td>
<td>206</td>
<td>61</td>
</tr>
<tr>
<td>Republican investment banks</td>
<td>8</td>
<td>39</td>
</tr>
<tr>
<td>Specialized federal banks</td>
<td>3</td>
<td>11</td>
</tr>
<tr>
<td>Total</td>
<td>217</td>
<td>111</td>
</tr>
</tbody>
</table>

Table 9—Banks in Yugoslavia

November 1964 | June 1967
---|---
 Communal banks | 206 | 61 |
 Republican investment banks | 8 | 39 |
 Specialized federal banks | 3 | 11 |
 Total | 217 | 111 |

Neuberger examines the role of central banking under three types of economic systems, the Yugoslav system before 1967 being one of them (1958).
sidered as proper beginnings of a stock exchange development—of the Yugoslav variety, of course.

Let me close this section with a note on monetary planning. On the basis of reliable and up-to-date information provided by the Social Accounting Service, a sophisticated system of flow-of-funds accounts was designed. Since 1967 this system has also been used for annual and monthly monetary planning, thus replacing the old-fashioned credit balances. Its author, Dimitrijević, gave a technical description of the methods used in his 1968b article.

**Investment Financing:** The amount of professional literature on investment financing varies in inverse proportion to the number of complaints against the state of affairs in this field. It is difficult to figure out why this is so. Perhaps it is because investment financing is in a sense a border-line case: neither monetary theorists nor fiscal policy experts nor predominantly physical planners feel competent to deal with it. In any case investment financing has become one of the weakest links in economic policy for a long time, and yet no serious study of its problems has been undertaken so far. Thus I will confine the exposition to a description of actual development.

Capital formation may be financed by fiscal means, i.e. out of taxation, or out of enterprises’ own funds, by bank loans or by means of securities of various kinds. This is roughly the order in which the various kinds of investment financing have been tried out in Yugoslavia.

Early in 1945 the government created the Fund for Reconstruction whose resources consisted of confiscated war profits10 and of proceeds from sales of goods supplied by UNRRA. Very soon loans given by the Fund were written off and capital formation was financed in the budgetary fashion typical of a centrally planned economy. Investment resources were allocated by the plan and given to enterprises from the budget free of charge. Enterprises could not sell capital goods; they could only transfer them to other enterprises after having obtained permission to do so. Since the state was the only owner of capital and prices did not matter much anyway, this arrangement was consistent with the rest of the system.

The crucial year of 1952 inaugurated important changes. The Federal budget as a source of investment finance was replaced by the Fund for Basic Capital Development. Investment resources were still allocated without repayment obligations, but the creation of the Fund led to a division of the budget into two separate parts: one was related to administrative expenses and the other consisted of various investment and interventionist funds. This was to become a permanent feature of the Yugoslav budget.

In 1952 the federal government concentrated just about all investment resources in its Fund. That served the purpose of gaining time for the preparation of a more thoroughgoing reform. Already the next year Funds for Croiting Investment Activities were formed. Enterprises established their own investment funds financed out of profits that the plan was left to them. Both measures led to considerable decentralization of capital formation financing. The system assumed its more permanent shape in 1954 when Social Investment Funds (SIF) were created at all levels, federal, republic, district and communal. Since then, until the latest reforms, Social Investment Funds were granting loans to business enterprises, while capital formation in the non-business sector (schools, hospitals, government offices, etc.) continued to be financed out of the government budget. The creation of SIF—which tended to multiply as time went by—had an interesting behavioral consequence. Since all levels of the government were under constant heavy pressure to invest, and funds were separated from the budget, their resources tended to be inflated beyond anything envisaged by the Social Plan. In the period 1955–1960 the volume of investment surpassed the target established by the Social Plan by 39 percent (Vasić, 1963, p. 213).

The reform of 1954 introduced two other important innovations. One consisted of the transfer of capital assets to enterprises. For the privilege of using social capital, they had to pay an interest rate of 0 percent, which was in 1965 lowered to 4 percent. Interest had to be paid on capital used regardless of the source of its finance. The proceeds from this interest as well as the repayments of the loans granted represented real resources of the General Investment Fund operated by the federal government. The interest rate on social capital was differentiated according to the aims of price policy and according to the capital intensity of particular industry groups. It ranged from 0.1 percent for agriculture to 1 percent for electric power generation and coal production, to 2 percent for transportation, to 6 percent for ferrous metallurgy and 9 percent for most other industries. In this way the interest burden, as a percentage of net product, was more evenly distributed among various industry groups. The average rate of interest amounted in 1961 and 1966 to 2.8 and 1.3 percent respectively in terms of capital and to 3.8 and 2.4 percent respectively in terms of net products (Trkija, 1968, p. 23).

The second innovation is related to investment auctions. There are four types of investment allocation decisions: (1) the level of total investment, (2) the allocation of investment funds among sectors of the economy, (3) the allocation among firms within a sector, and (4) the allocation among technological variants within a firm (Neuberger, 1959b, p. 93). In theory one could, of course, improve this scheme in various ways. One could apply price discrimination in order to siphon out all non-labor income contained in the difference between the offered and paid interest rates, one could replace point offers by schedule offers. In practice the experiment did not achieve great success. It was soon discovered that the two price criteria—the interest rate and the repayment period—were insufficient. Thus other criteria were added: the percentage share of participation with own resources (differentiated according to industries and ranging from zero for electric power to 80 percent in manufacturing), the shortest period of construction, the lowest cost per unit of output, and regional effects (Vučković, 1963, p. 372; Hauković, 1967b, p.
220. The main defects of auctions appeared to be the following ones. It takes time and it is very costly to prepare an application for credit. Auctions are held at widely spaced points of time which may not correspond with the enterprise's need for investment funds. As in the case of credit auctions, enterprises were ready to offer high rates of interest just to secure the loan. They did not worry too much about future repayments because the tradition of free social capital was still very much alive and because it looked obvious that a plant or any size cannot be closed down "just because the loan cannot be repaid." Thus the authorities in charge of SIF had to examine every case very thoroughly as they would have had to do even without auctions: According to Neuberger's estimates, at most one-third of all investments at any time were allocated through auctions. In such circumstances auctions gradually degenerated into an old-fashioned administrative distribution of investment from government funds. Auctions failed. The criteria used for investment allocations from SIF had never been very transparent—another reason for the lack of analytical literature—and had always been greatly influenced by political considerations. As a result "political factories" appeared. All important investment projects were somehow multiplied six times, one for each republic. Besides, Social Investment Funds absorbed two-thirds of total investment resources, and owing to participation requirements, controlled directly an even larger share of total investment. Insufficiency and bureaucratic control were not quite compatible with the self-management aspirations of the economy. Enterprises pressed for an increase in their share in investment finance. The data on actual development in characteristic years are given in Table 10.

A considerable share of investment money in the SIF was obtained through taxation. When in 1962 these "contributions to Social Investment Funds" were raised by 50 percent (Veksanović, 1966) there was a general outcry against the "expropriation." It was requested that "state capital" be done away with. Two years later the contributions to SIF were abolished, and the funds transferred to bank credit funds. That is why bank investment loans increased so sharply in 1965. The starting principle of the reform of 1965 was: to leave at the disposal of enterprises a larger share of their savings and consequently to restrict the role of socio-political communities in investment decisions (Jovanović, 1965, p. 3222). The pendulum was pushed a little too far in the decentralization direction because it was requested that even large capital intensive projects (power generation, communications) also be financed out of capital concentrated in banks.

The role of the Federation in investment was reduced to the operation of the Fund for Undeveloped Regions that would distribute annually on to undevoloped regions close to two percent of national income as investment funds. Republican and communal funds also diminished considerably. But the share of enterprises, with the exception of short-lived post-reform increase, remained stagnant. As Table 10 shows, what actually happened was that the Federation and the banks simply changed places in investment financing.

In a situation of chronic excess demand for investment resources, banks could easily assume a dominant role. The sum of the regular and penalty rates of interest could be as high as 18 percent. The first recession—which in fact followed the reform—was bound to reduce the investment funds of enterprises and make enterprises more dependent on banks. D. Vojnič points out that in 1968 the repayments of bank loans amounted to 111 percent of net profits of enterprises (1969, p. 89). With almost one-half of investment resources under their control, banks established themselves as a dominant force in the investment market. What should be done to safeguard the independence of enterprises? The answer is by no means clear. The present discussion has concentrated on possible improvements of the capital market. In 1963 government bonds became negotiable and in 1968 the first enterprise bonds appeared. In 1969 bank shares were invented and the present author has suggested that participating debentures be introduced (1967b). The securities market could supply at least part of the capital outside the banks' control. Pooling resources and joint ventures are encouraged. After the Social Investment Funds had been abolished, interest on social capital became a mere capital tax that flowed into the government budget. A political decision was taken to abolish this capital tax as soon as possible. It is now being suggested that this interest—amounting to about one-eighth of business investment—be given to enterprises as resources earmarked for investment (i.e., it would be treated similarly to depreciation funds). It will not be surprising if in a little while another reform in this field is carried out. After a money market has been to a certain extent adequately organized, its twin, the capital market, can surely not lag behind for very long.

Anti-Inflationary or (Anti-) Anticyclical Monetary Policy: In a centrally planned economy market disequilibria result in physical shortages; in a market economy they are reflected in inflation. The age-old discussion about the real causes of inflation was resurrected among Yugoslav economists, in particular after 1961. Monetary theorists, not unexpectedly, tended to see the source of all troubles in an uncontrolled expansion of money supply. M. Cirović argued that the increased commodity prices represented the way in which the economy adapted itself to an excessive expansion of credit and money supply (1964, p. 183). Similarly M. Vučković believed that inflation was essentially a product of excess demand. Since new money brings along new demand unaccompanied by supply, a market disequilibrium arises and generates increases in prices. The excessive expansion of short-term credits is a consequence of the following deplorable practices: short-term credit is used (irregularly of course) for long-term investments, for non-salable stocks, to cover losses, to finance budget deficits and to finance taxes at all levels of government (Vučković, 1967, pp. 128-29). The last mentioned practice is probably also one of the Yugoslav inventions in the field.

**Table 10—The Composition of Investment in Fixed Capital by Source of Finance, Excluding Private Investment**

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<tbody>
<tr>
<td>Federation</td>
<td>99</td>
<td>98</td>
<td>98</td>
<td>87</td>
<td>74</td>
<td>64</td>
<td>52</td>
<td>41</td>
<td>33</td>
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<td>25</td>
<td>20</td>
<td>16</td>
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<td>15</td>
<td>15</td>
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<tr>
<td>Kingdoms</td>
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<td>50</td>
<td>46</td>
<td>43</td>
<td>40</td>
<td>37</td>
<td>32</td>
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<td>17</td>
<td>14</td>
<td>14</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>Communities and Districts</td>
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<td>7</td>
<td>1</td>
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<tr>
<td>Week Organizations</td>
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<td>2</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>5</td>
<td>7</td>
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<td>20</td>
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<td>26</td>
<td>28</td>
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<tr>
<td>Non-Business</td>
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<td>Banks</td>
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</table>

Owing to a fairly completely budgetary decentralization, local governments are very keen on squeezing out of “their” enterprises every possible dinar. In the early days of the NES they could do so by tailoring taxes so as to leave the coffers of the enterprises empty. This phenomenon had been described by Miljanic and Vučković already in 1956 (Miljanic, 1956; Vučković, 1956). Thus in 1954 in one single year, communes managed to increase their budgetary revenues by 98 percent (Vučković, 1956, p. 173). In order to comply with these patriotic requests, enterprises would have to increase prices or ask for credits or both. Credits were readily granted because paying taxes on time had always been considered a first priority. After the budget system had been somewhat more efficiently designed, the arbitrariness in taxation was reduced, but whenever in need communes would simply delay payments for goods and services they bought. In this respect republics and the federation have also been guilty until this very day. It is not surprising, therefore, that the business community does not trust their governments too much and tries to get rid of any “bureaucratic” control.

Now, though it is true that credit was excessive and money supply inconsistent with stable prices, it does not necessarily follow that prices were the consequence and credit the cause in the inflationary process. The hypothesis was tested in the IES and it turned out that there was either no correlation between credit and prices or there was a slight negative correlation: higher credit=lower prices. This paradox will become understandable in a moment.

Prices are predominantly determined by changes in wages, and so inflation is most of the time a cost push inflation. As already mentioned in the section on Price Policy, wages appear to be a function of capital intensity, technological rent and institutional monopoly (banks, insurance companies). Wage increases in privileged work-organizations initiate wage increases throughout the economy, and whenever prices cannot bear a cost increase, they are revised upwards. Bajt adds that the high degree of price control increases the pressure of excess demand on the free section of the market, which then generates price increases, and that inefficient investment planning produces an inadequate structure of output which in a semi-closed economy makes it difficult to match demand (Bajt, 1967a; Bogoev, 1967).

Business cycles complicate matters even further. Prices are formed in Yugoslavia in a rather peculiar way. Depreciation and interest on social capital represent fixed elements. Wages, as everywhere, are inflexible downwards. For reasons explained in the next chapter, all taxes are tied up with wages and vary proportionally to wages. Since tax payments enjoy high priority it may happen—and did happen—that the total amount of taxes collected increases in the trough of a depression. Finally, repayments of loans represent an additional fixed element. Thus, as soon as there is a slight retaliation of production, the enterprise finds it impossible to cover costs and has to run losses—or increase prices.

In a downswing a labor-managed enterprise will not dismiss workers. Thus production will be continued and inventories accumulated. Inventory accumulation is financed out of profits and credits. When these two sources are exhausted, involuntary trade credits and price increases will replace them. As far as inflationary pressure is concerned, we may expect price increases in the downswings and stable prices in the upswings. Figure 1 confirms such an expectation.

The analysis just sketched—a result of research of the IES—was unknown at the time monetary reforms were designed and implemented. The traditional view that inflation means “too much money chasing too few goods” gained wide acceptance. All one had to do, so it was thought, was to curtail the supply of money and the economy would be stabilized. Stabilization was envisaged exclusively as price stabilization. In the program of the 1965 reform employment targets were not even mentioned. Foreign exchange reform, membership in GATT and co-operation with the IMF were interpreted as an international obligation to keep the dinar stable at all costs—a task which even a Tory government would nowadays be reluctant to undertake, but which was cheerfully attempted in an economy innocently unaware of what it might mean. Tight money policy was to be the only device for achieving price stability. There were some doubts about the wisdom of such a policy, but critics were frowned upon and the policy was implemented. That proved to be fatal. Since prices vary inversely to the cycle, an anti-inflationary monetary policy meant an anti-anticyclical policy, a policy of continuous and direct destabilization.

The vices and virtues of monetary policy in the last eight years have been analyzed by Holjevac (1967b) and Perišin (1969), recently appointed Governor of the National Bank. I will mainly draw on their work and on the research conducted in the IES in the text that follows.

In 1960 the cycle reached the upper turning point (see Fig. 1). That passed unnoticed, but price increases were noticed. The analytical device used in such situations consisted of a comparison of “commodity funds” (social product in real terms) and “purchasing funds” (personal and government consumption and investment in money terms) which good and up-to-date statistics made possible. The differences between the two were interpreted as excessive money supply. In 1960 the difference was considerable and called for monetary restrictions. In addition, in 1961, during the recession, a monetary re-
and so was the monetary policy. In the second half of 1964 and the beginning of 1965 reserve requirements were raised up to the legal limit of 35 percent, enterprises were forced to use savings for increases in working capital, investment banks had to use one quarter of their loans for working capital financing, consumer credits were reduced. All this, together with the upheavals caused by the price reform, reduced aggregate demand and output growth from about 15 percent in 1964 to about 4 percent by the end of 1965. Since the tax reform left the Federal government without money, it had to resort to substantial deficit financing, which once again upset monetary planning. But the downturn was arrested for a period of four quarters, and all symptoms normally present at an upwards reversal of the cycle became apparent. However, this time the National Bank had formidable monetary weapons at its disposal and it decided to use them to combat "excessive" liquidity.

For some reason, not explained in the documents, the National Bank established the rule that liquidity reserves of commercial banks held as balances with the National Bank should amount to no more than 6 percent of monetary demand deposits (Perlins, 1969, p. 515). These reserves ran around 10 percent under the second half of 1966. As "purchasing funds" were appreciably higher than "commodity funds"—which is reflected in price increases—it looked obvious that there was too much money in the economy. The National Bank reduced its special credits to commercial banks and put an absolute limit on their operations. Consumer credits were further reduced. In 1967 exports were retarded, and so it was decided to depress internal demand even more in order to achieve an export drive. As one might have expected, this did not help exports—in fact their rate of growth was soon reduced below zero in spite of selective export credits—but liquidity reserves were brought down to 5 percent, even lower than planned.

As a result of this anti-inflationary policy output growth was reduced to minus two percent, which had not happened since the Cominomays. The present author is the same as the mistaken monetary policy at eleven percent of percent of gross national product. Perlins found that gross savings had been reduced from 43 percent of GNP in 1964 to 30 percent in 1967 (1969, p. 517). Unemployment was increasing fast. But price stability was not achieved (see Table 6).

The new system of regulating the money supply proved to be very efficient in reducing money supply to any desired level. This conclusion follows from the foregoing description of its practical operation but can also be illustrated by a series of indices. If we compute ratios of money supply per 100 dinars of transactions, expressed as a sum of gross national product and the output of intermediate goods, we get the following data (Perlins, 1968, p. 63):

<table>
<thead>
<tr>
<th>Year</th>
<th>M2</th>
<th>M1</th>
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<tbody>
<tr>
<td>1957</td>
<td>15.3</td>
<td>9.1</td>
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<tr>
<td>1958</td>
<td>12.3</td>
<td>9.4</td>
</tr>
<tr>
<td>1959</td>
<td>14.1</td>
<td>11.3</td>
</tr>
<tr>
<td>1960</td>
<td>15.6</td>
<td>11.4</td>
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<tr>
<td>1961</td>
<td>15.3</td>
<td>11.3</td>
</tr>
<tr>
<td>1962</td>
<td>18.7</td>
<td>13.1</td>
</tr>
</tbody>
</table>

In the three years after 1964 the relative money supply was reduced to 62 percent of its original level. One might be tempted to think that this simply meant increasing the transactions velocity of money. But that is not so; the lack of banking credits was compensated for by involuntary trade credits. The latter amounted to 60 percent of short-term bank credits in 1964, to 138 percent in 1967 and surpassed bank credits almost two times by the middle of 1969. One other fact is worth noting. Figure 1 shows that boom periods of business cycles occurred in 1960 and 1963 and recession periods in 1961 and 1967. A glance at Table 11 suffices to see the extent to which monetary policy was cyclically synchronized; there was an abundant money supply in the boom and tight money policy in the recession. Consequently monetary policy has been an important destabilizing factor preventing the economy from exploiting its growing potentials.

The second half of 1967 brought the revival and the acceleration of growth continued through 1968 into 1969. Taxes were stabilised for a while, inventories reduced, exports soared in 1969 and monetary policy had a relatively easy job to support these favorable trends. It remains to be seen whether monetary authorities—and monetary theorists—have learned the lesson and whether they will be able to avoid making the same mistakes once the trends are reversed.

Public Finance and Fiscal Policy

Budget for a Centrally Planned Economy: In the first two years after the war the new state tried to make the best of the inherited financial system. Taxation was improved in two ways. Before the war a sales tax levied on consumer goods was a major source of government budgetary revenue. That represented a great burden for poor sections of the population. Next, income tax progression was mild (up to 32 percent) and there were several separate income taxes for various sources of income. Thus people with several sources of income—i.e. the richer ones—could easily evade paying high taxes. It was only natural that the new revolutionary government would make the necessary corrections. The sales tax was reduced from 62.8 percent of government budgetary revenues in 1939/1940 to 46.8 percent in 1946, and separate income taxes were replaced by a single one applied to the entire personal income at increased rates (Finansiski, 1949, p. 25). However, uneven taxation reappeared, soon and even in 1969 B. Jelcic complained that the differential tax burden for the same personal income of different taxpayers meant the negation of principles proclaimed and guaranteed by law (1969, p. 159).

When in 1947 central planning was inaugurated, the financial system of the country had to be changed radically. In the old system the government budget, used to finance the work of public administration and some social services, that corresponded to the administrative character of the old state. The new socialist state—as described by the Institute of Finance (Finansiski, 1949, p. 15)—acts as an organizer of the entire economy. The targets are annually elaborated in the economic plan and the budget ought to reflect them financially. Each planning organ has its own budget, which is a constituent part of the overall budget. The sum of all financial plans of all ministries, i.e. of all industries, represents an annex to the budget. Thus the budget becomes the financial plan of the entire economy (Finansiski, 1959, p. 11; Matejic, 1958, p. 170). The budget amounted to 44–43 percent of national income (Poric 1964, p. 120). About one half of budgetary revenues was spent on investments.

R. Radovanovic describes four principles on which such a budget was based. (1) Centralization of all revenues at the disposal of a political-territorial unit (municipality, district, county, province, republic, federation) in the budget of its government. (2) Financing from the budget of all social activities. As far as business firms are concerned, only net revenues are entered into the budget. (3) Concentration of the budgets of all political-territorial units in the Federal budget to ensure central direction in carrying out the most important tasks. This is the famous principle of budgetary monism. (4) As a result of
(3) funds are allocated among various bodies in accordance with their recognized needs and irrespective of their budgetary potentials. Lower bodies are obliged to implement general policy and higher bodies are expected to provide the necessary resources. This had at least one negative consequence. Lower organs were not stimulated to economize with their funds. Instead of trying to expand production in their territories, they were busy in budget expenditures and exerting pressure on higher bodies to find necessary resources (Radovanović, 1962, p. 1112).

Taxes in such a system are just a technical means for channeling gross profits into the budget (Tišma, 1964, p. 29). The price of a product consists of cost of production, profit and the turnover tax. Profit is generally a small item and is mostly left to the enterprise. If individual planned profit is higher than the average one, there is extra-profit, half of which has to be paid into the budget of the higher administrative organ. A planned loss is covered from the higher budget. If achieved profit is higher than planned, half of the difference is left to the enterprise as an incentive. Turnover tax is just a balancing item in an administratively set price. Since it is charged on all commodities and is paid as soon as a commodity is shipped, it is also used as an indicator of how the implementation of the plan is proceeding.

In order to accommodate productivity changes in such a rigid price structure the "increase in the fall of production" was explicitly planned as a separate item. This decrease is partly paid into the budget and so a rather unusual new type of tax was created. Finally, various types of prices, discussed in the section on administratively set prices generated so-called commercial profit, which was mostly absorbed by the budget.

In 1949 the four items enumerated were (in billions of dinars): turnover tax 66.6, share of profits 4.6, decrease in cost of production 3.8 and share of commercial profits 13.1 (Tišma, 1964, p. 96). Turnover tax represented, of course, the bulk of budgetary revenues.

The major proportion of budget revenues came from the business sector. Taxes paid by the population were steadily decreasing in importance, from 22.4 percent of all revenues in 1946 to 9.7 percent in 1952. As a consequence taxation of the population was governed by extra-fiscal considerations. In 1950 the tax on income earned in the state sector was abolished. (It was to be reintroduced only in 1969.) This did not matter much, since wage and salary differentials were greatly reduced and income distribution was extremely egalitarian. But income taxes were retained for the private sector and the progression was rather stiff. For peasants the tax rates went up to 70 percent in 1947 and up to 90 percent in 1948, as compared with the flat rate of 3 percent for the members of peasant work cooperatives (cooperatives organized similarly to state farms) (Finiński, 1949, p. 34). This tax policy was inspired by the idea of the class struggle and was aimed at inducing peasants to join cooperatives.

The policy of stiff taxation of peasants and artisans was continued also later and for the same reasons. In agriculture it was discontinued after the second agrarian reform in 1953, which reduced the maximum size of agricultural estates to 25 acres and so eliminated any possibility of capitalist development. In 1954 taxation on the basis of cadastral income was introduced, and rates were lowered. Both proved to be stimulating. It is interesting to note that Radovanović described the tax on cadastral revenue as an instrument designed to replace compulsory deliveries while melting sure that a minimum output will be produced (Hanžeković, 1967a, p. 91). There was no possibility of capitalist development in handicrafts either, because artisans could employ at most five workers. However, public opinion held that there was something wrong about private business. Tax rates were substantially reduced only in 1963 (Hanžeković, 1967b, p. 33). The policy of containment continued until the ownership discussions in 1967 analyzed in the section on Ownership Controversy. In the meantime the number of artisan shops was substantially reduced, which caused economic difficulties.

**Taxation Experiments:** After the French Revolution in 1789—remarked J. Lovčević, the Constituent Assembly abandoned taxes in favor of contributions. After the Yugoslav Revolution a law on taxes passed in 1946 declared that a tax was "a contribution... given to the state for economic development, cultural advancement, and for the maintenance of the state apparatus" (Milatović, 1967, p. 34). In spite of all its protests of public finance experts, the term stuck. From 1952 enterprises have been paying autocontribution (turnover tax representing an exception) and individuals pay contributions somehow emanated from social property, taxes from private property. Since the 1965 tax reform contributions have become synonyms for direct taxes or taxes levied on labor income and the term tax is used to denote various forms of turnover tax or property tax. The terminological confusion did not matter very much. But lack of professional competence in designing an appropriate taxation system did matter. In the period 1952-1965 the tax system was changed five times with obvious consequences as far as the efficiency of conducting business was concerned.

In 1952-1953 the system of AF rates—whose rationale was discussed in the section on Distribution Policy—predetermined the taxation system. Out of accumula­tion and funds obtained by the application of a rate, prescribed by the social plan, to the net product of an enterprise, the social contribution was paid to the budget. It contained social insurance payments, proportional to the wage bill and was paid at the flat rate of 45 percent. Wage bills above the standard prescribed were taxed at steeply increasing rates. A tax on extra profits was envisaged by law, but never applied due to technical difficulties (Tišma, 1964, p. 97). Turnover tax was greatly reduced, and amounted to 9-14 percent of budgetary revenues (Jelić, 1967b, p. 14). Its task was to absorb enterprise profits and to influence price formation (Radovanović, 1953, p. 62).

The system of AF rates helped to eliminate administrative ties between enterprises and planning authorities, but it was soon degenerated into an administrative determination of AF rates for each individual enterprise. It had to be replaced by a system working more in a market fashion. It was not clear how to design such a system. It seemed advisable to make use of the experience of traditional market economies. Instead of net product, profit was the base of taxation for the next four years (1954-1957). Wages became part of costs of production. Profit was taxed at a flat 50 percent rate. The other half of gross profit was used for contributions to SIF's for supplements to basic wages, for enterprise funds and for some other purposes. Wages from profits were linked with contributions to local budgets which amounted to same sort of progressive payroll taxation. A tax on monopoly profit was envisaged but never applied because it proved...
impossible to establish which part of the income resulted exclusively from the work of the collective. The share of the enterprise (wages and undistributed profits) gradually increased to one third of net product generated (net product included turnover tax) (Tisma, 1964, p. 99).

In this period two interesting new taxes were introduced. Mines, hydroelectric power stations and some other firms were to pay rent. Artisans and peasants were obliged to pay tax on hired labor. The latter tax was insignificant in quantitative terms, because only one-eighth of the artisans and almost no one among peasants hired labor, but served as a reminder that hiring labor meant exploitation.

Wages as part of production were deemed inappropriate for a self-management system. Thus the new system, inaugurated in 1958, was based on the distribution of total enterprise income. That was a switch from profit to net product, reduced for turnover tax and some other items. There was also a terminological change: wages and salaries were replaced by personal income. With many changes the system lasted until 1964.

The main tax, surpassed only after 1961 by the turnover tax, was the contribution from income. The rates were progressive up to 80 percent. Tax progression was in 1961 replaced by a flat rate of 15 percent and a surtax of 25 percent. In the meantime another development took place. It appeared reasonable to link collective consumption and public services to the level of personal incomes earned in any particular territory. For this purpose contributions to budgets were made out of the wage bill. In 1958 these contributions were progressive; in 1959 a flat rate of 11 percent was charged; the rate was increased to 15 percent in 1963. In 1964 some tax rates were reduced, and mining taxes and contributions to SIF abolished. The abolition of progressive rates led to a reintroduction of the progressive personal income tax (Tisma, 1964, p. 207). This indicated that the economic functions of the payroll tax and personal income tax, as discussed below, had been confused. The share of the enterprise in its net product increased to about one half.

In order to increase this share still further, the last reform of 1965 abolished all contributions from enterprise income. The share in net product jumped to about two-thirds. Since then enterprise taxation has rested exclusively on payroll taxes. If we count social insurance contributions, labor has been made about 60 percent more expensive than necessary. This has serious consequences. Before 1960 taxation created capital saving inducements (Pejovich, 1964): in a labor surplus economy that was rational. Since 1964 taxes have stimulated labor saving practices. Enterprises did in fact react to tax incentives and soon, and thousands of workers became redundant. Further, flat rates introduced an awkward rigidity and tended to intensify cycles. Finally, the abolition of progressive payroll taxation after 1958 and the lifting of wages control in 1961 meant that two important checks on inflationary pressures were eliminated. We have already discussed the consequences.

Taxation experiments have clearly not been completed. Is there anything one could say about how an appropriate taxation system ought to be designed? On various occasions the IES has made suggestions in this regard, and they may be summed up as follows. The equalization of personal income distribution can be achieved by the familiar progressive personal income tax. There is no need to tax profits, even less to tax them progressively, since capital is socially owned. But there is a need to tax payrolls and to tax them progressively. In order to do this wages ought to be standardized by applying accounting wages for certain categories of skill. (The skill rating should, of course, not be left to enterprises themselves, just as school diplomas are not issued by pupils themselves.) When faced with the alternative of either losing a greater part of the "excess wage fund" through taxes or using that money for development purposes the working collective will often opt for the latter. This will check wage increases in the most profitable enterprises—which have continually been generating wage pushes—and expand their investment, increasing the supply of their products relative to demand and lowering prices. Labor should be made as cheap as possible (for the enterprise, of course, not for the workers) in order to stimulate labor intensive production. If some taxes still prove necessary, they may be levied on the enterprise income at a flat rate. Such "contributions from income" may be considered a self-management counterpart to the familiar value-added tax.

While direct taxes have received little attention in professional economic literature, turnover tax has been extensively discussed. And with good reason. It survived through all tax reforms as one of the principal taxes. Since 1954 the share of turnover tax in total budget revenues has oscillated between 29 and 43 percent (Hanžeković, 1967a, p. 28). By 1964 six kinds of turnover tax were in operation (Lazarcif, 1965). Producers' turnover tax was inherited from the days of central planning. It was levied on some 250 products at rates varying between 2 and 81 percent; it was contained in producers' prices, represented a part of enterprises' gross receipts and was collected at the time the invoice was issued. It was easily and quickly collected, even before bills were paid, and was liked by the government. It was also used as an instrument of price policy. In order to provide independent sources for communal budgets, in 1956 a communal sales tax was introduced. In 1961 owing to the abolition of progression in enterprise income taxation the government ran short of money and introduced the one percent general turnover tax. This was a multiple-stage tax and was intended to reduce the number of middlemen between producers and final consumers: however, apparently no effect of this kind was achieved (Hanžeković, 1967b, p. 47). There was then also purchase tax on specific products, service sales tax and duty on real estate and other transfers.

Producers' turnover tax has been severely criticized. Both the government and the enterprises tended to abuse it as a price formation device. In twelve years its tariff was changed almost one hundred times (Jelčić, 1967, p. 4). Its handling required a large amount of working capital on the part of the enterprise. It tended to distort prices, and so did the multiple stage general turnover tax. In the case of exports, tax deductions had to be computed and made. For all these reasons the two kinds of turnover tax were abolished and in 1965 replaced by a sales tax levied on consumer goods in retail trade, added to retail prices, charged directly to buyers and collected when the commodity was sold. But a retail trade sales tax cannot be changed often and cannot be differentiated for many products. Thus it is used as a price formation instrument and is rather limited. It is now primarily a device for collecting budget revenue.

Budget for a Self-Government Economy: A budget is more consistent with a centrally planned economy the more all-embracing it is. Ideally all financial transactions of the economy are to be regulated by the budget. It is the other way round in a self-government economy. Here the budget ought to be restricted to as small a section of the economy as possible in order not to interfere with the economic activi-
ties of work collectives. Ideally the budget should cover only the activities of various state agencies. In this respect the 1952 reform initiated three important developments. They were related to the organization of the non-market sector of the economy, to the creation of various social funds and to the decentralization of budgetary revenues and expenditures.

The Yugoslav tradition had made a sharp division between enterprises (poduzece) and institutions (ustanove). The former were business establishments, the latter were financed from the budget and roughly corresponded to non-profit institutions in the USA and elsewhere. Since the latter depended on the budget, i.e. on the government administration, for their revenues, it was clear that self-management had little chance of developing. Thus institutions that performed public services and could be financed partly or wholly by selling their services were separated in a special group of "institutions with independent finance." Gradually it became evident that there were two fundamentally different types of public services: the one (government administration, judiciary, police, defense) rendering various administrative services to society, the other (education, science, medical care, etc.) increasing the welfare of the members of society. It seemed appropriate to finance the latter from the budget ("public expenditure") and to organize them in a more or less traditional fashion, but the latter ("collective consumption") required a different approach.

M. Hanžeković suggested that taxes be used to finance the former and contributions the latter (Hanžeković, 1967a, p. 17). Next, while there was to be a free market for the short-run operations of enterprises, it appeared advisable to retain substantial central control in the field of capital formation. But capital financing was to be on a credit basis and budgetary financing implied grants without repayments. Thus investment resources were to be separated from the budget and concentrated in investment loan funds. The budget continued to finance investment projects in the nonmarket sector (schools, hospitals, etc.).

In 1952 social insurance had also been separated from the budget. This decision was motivated by the fact that social insurance could be efficiently operated as an independent social service under a social self-government regime. The latter meant that the governing bodies were composed of representatives of various social interests (physicians, social workers, citizens, government representatives). Very soon there was a proliferation of various funds for housing, for advancement of agriculture and forestry, for roads, for cultural activities, for education etc. Many of these funds had their independent management bodies and obtained their resources from special contributions or from budgets. Hanžeković suggested the following three-fold classification (1967a, p. 13): (1) funds for capital formation (SIF) or for financing public services; (2) funds for financing without repayment obligation or for granting credit; (3) with social self-government bodies or without. Different trends have appeared in further developments. Loanable funds were mostly transferred to the banks. Funds without independent management bodies are used as often temporary instruments of budgetary financing for special purposes. The third category, permanent funds with independent social government, represents an innovation.

The social-insurance fund set an example. A decade later the example was followed by education. At first, T. Konevski remarked, that was just a transmission mechanism in budgetary financing (1968, p. 165). But in 1967 Education Unions were formed to operate the funds. Assemblies at communal and republican levels vote money to be allocated to education funds. Education Unions—self-government bodies composed of representatives of schools, outstanding figures in cultural life, government agencies—distribute the money by negotiating the services to be rendered by various educational establishments. In 1969 Research Unions were formed. They operate funds for research work created in 1960. Unions are shown in the quasi-market sector of Figure 2.

Hanžeković points out that in 1965 funds absorbed 8.8 percent and institutions 14.2 percent of national income, which had to be compared with total budgetary expenditures that amounted to 20.1 percent of national income (1967a, p. 14). Institutions obtain about one third of their income from selling their services to direct buyers (to the market), 59-60 percent of their revenues come from various funds (quasi-market) and only one-tenth derives from budgetary subsidies. Such a structure of revenues enabled the non-market (not non-profit, because they do make profits) institutions to gain a considerable amount of independence. Also, they established closer contacts with the buyers of their services and with the rest of the economy. Is there, one might ask, any economic activity in which an Archaeology Department of a University, a museum or an art gallery can engage? Yes, there is, though perhaps not directly. Tourist agencies and hotels may be, and in fact are, interested in financing the development of an archeological site, a local museum or an art gallery. Sometimes these are rather roundabout ways for achieving certain goals, but if they eliminate government control and increase independences, the price may not be too high. Yet there are other costs involved. Konevski points out some of them (1968, pp. 128-65). To administer a fund an administrative apparatus has to be set up. Unlike business enterprises in the market, a school or a hospital is in an inferior position when it negotiates contracts with the funds. Commercialism may and does have detrimental effects in such fields as culture, education, science or medical care. The consumer may be, and often is, victimized. Since it is too early to evaluate the working of the system, one can only invoke the wisdom of the ancient Greeks concerning the organization of human affairs: right proportions, no extremes.

The creation of funds and the establishment of self-financed institutions represent two aspects of decentralization. As a consequence the share of budgetary revenues in national income was reduced from one-third in 1952 to one-fifth in 1967. The third aspect of decentralization was related to the division of revenues among budgets of various socio-political units. The federation was gradually transferring its responsibilities for various social services to republics and communes. As a result the share of federal expenditures in total budgetary expenditures dropped from 74 percent in 1952 to 53 percent in 1968. The trends have been reversed as compared with what has happened elsewhere. The division of budget revenues among various budgets is a somewhat complicated technical problem. No less than five laws in the period 1952-1965 tried to solve it and with only limited success. In theory there are two possibilities: a separation of revenues, and joint revenues. Both have...
been tried out at one time or another.

After 1952 the budget monism of a centrally planned economy was replaced by a budget pluralism better suited to a self-government economy. The former budgetary system was based on participation in joint revenues, the higher governmental bodies determining the conditions of participation. If lower budgetary units were to be made more independent in the development of revenue sources in their own territories, a system based on a separation of revenue sources seemed more appropriate. Thus sources of revenue were allocated to budgets at various levels. Only the federation was entitled to introduce new taxes, but, if introduced, taxes had to be immediately allocated to specific budgets or funds. In principle every unit was to cover expenditures from its own revenues. This principle was not fully implemented, but there was a great change as compared with the former practice. In two characteristic years republics and communes obtained their revenues in the following ways (Radovanović, 1956a, p. 445):

<table>
<thead>
<tr>
<th>Year</th>
<th>Own revenues</th>
<th>Participation in joint revenues</th>
<th>Federal subsidies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td>53.7%</td>
<td>31.3%</td>
<td>1.0%</td>
</tr>
<tr>
<td>1954</td>
<td>52.5%</td>
<td>18.9%</td>
<td>5.0%</td>
</tr>
</tbody>
</table>

With many changes this system lasted for nine years (1952-1960). Its main shortcomings, as described by Radovanović (1956, p. 115) and K. Bogoev (1964, pp. 189-190) were two. Sources allocated to lower units were not sufficient to meet the recognized needs. Deficits were substantial and were covered by sharing in revenues and by subsidies. These were discussed every year anew, which made lower units very dependent on higher authorities. Next, the lack of objective allocation criteria generated a bargaining process. For both reasons the system failed to provide a satisfactory and incentives.

In the period 1960-1964 the budgetary system was again based on participation. Separate sources were allocated only to the federation (they covered 90 percent of its revenues) and to communes (about 20 percent of their revenues). Republics and provinces had no separate sources. The participation of all units was determined by federal and republican laws. The higher units could not arbitrarily select more favorable sources for themselves. In order to eliminate another source of arbitrariness, participation rates were not differentiated according to sources as before, but instead one single participation rate was applied to all sources of revenue. Participation rates were increased for less developed units, and if this was not sufficient, subsidies were granted. Increased shares and subsidies were to be determined on the basis of the funds needed for carrying out "mandatory tasks and services." However, since objective criteria were not established, the familiar arbitrariness crept into the process. In 1960 only 9 percent, and in the following year only 3.6 percent of all communes were able to cover their needs in the regular way (Bogoev, 1964, p. 205). About one-half of all communes had to rely on both increased participation shares and subsidies. What was intended to be a corrective device turned out to be the main instrument for balancing budgets of lower units.

The 1965 tax reform introduced the separation principle once again. The sources were allocated as follows: Taxes on personal income and sales taxes may be introduced by all socio-political communities. Apart from that, taxes on property (and some other taxes) belonged to communes, estate duties to republics and customs duties to the federation. Communes and republics are empowered to decide independently what kinds of revenue to introduce for their territories and to fix the tax rates. There are two safeguards. The federal government can fix temporarily the limits for the tax rates set by republics and communes. Communes and republics are legally obliged to cooperate with one another in fixing the level of their revenues in order to achieve equal treatment. Republics and provinces are entitled to federal subsidies provided their per capita revenue is below the Yugoslav average and they have exhausted all possibilities for collecting revenue through taxation of personal income, in conformity with the economic potential of their population (Turčinović, 1968). This time the criterion for subsidies has been defined somewhat more precisely. But it has also been criticized. Hankovich argues that approximately equal budgetary revenue per capita cannot be an appropriate criterion. Instead appropriately defined necessary and justified expenditure should provide basis for allocations. (1967a, p. 7). In fact this seems to be the problem of the Yugoslav budget system. Yugoslav territories are extremely unevenly developed. Per capita income in the Republic of Slovenia is 5.4 times higher than in the Autonomous Province of Kosovo. Communal budgetary revenues are, of course, even more unequal: in 1965 the most developed commune in Slovenia obtained per capita revenue almost 16 times higher than the least developed commune in Kosovo. Such extreme differences inevitably ruined all schemes in which allocation criteria were not precisely defined. Konevski complains that in the new system more than one-half of communes in Serbia have to rely on subsidies, which is inconsistent with the philosophy of self-government (1968, p. 116).

In 1968 the government asked a research institute to study the problem. A group under the chairmanship of P. Sicheri prepared a voluminous report (Sicherl et al., 1968), Sicheri finds that although differences between the developed and the underdeveloped regions in per capita income are extreme, differences in nonagricultural income per worker are small. He used a special statistical method developed by his colleague B. Ivanović (1964) to establish that the distance between developed and underdeveloped regions is appreciably greater in the economic sphere than in the sphere of social services and living standard. In a later article Sicheri argues that it is easier to reduce the distance in the latter sphere (in terms of flows of services) than in per capita national income (1969). As a basis for subsidy computations, Sicheri takes accounting budgetary revenue which he defines as revenue obtained by applying the average Yugoslav tax rates to actual tax sources in the region. The dilemma of whether policy should be based on the equalization of needs or of revenues is resolved in favor of revenues, on the ground that it is difficult to determine needs in an objective way and that to do so is also inconsistent with the philosophy of decentralization decision making. There follows a long and involved discussion of the most appropriate method of determining standard revenue. The difference between the standard and the accounting revenue is to be covered by federal subsidy. Sicheri's Report has been discussed in government and parliamentary committees but has not produced practical results as yet.

Communal Economy: In daily life every man appears in a double capacity: as a producer and as a citizen. Thus direct democracy will also have two aspects: one relating to the work place, the other to the territory where citizens live. As members of working collectives, people engage in self-management. As inhabitants of towns and villages, they manage their affairs by establishing local self-government. The territorial association that corresponds
to the collective at the work place is the commune.

There has been a strong tradition in local government in Yugoslavia since the days of the National Liberation War. People's Liberation Committees, as local government bodies, worked with great independence, initiative and resourcefulness to supply the partisan army and organize daily life in the liberated territories. It is hardly a matter of chance that the first People's Committees and the first Committee of Workers' management appeared simultaneously in the fall of 1941 in the mining town Krupanj. People's Committees continued to exist after the war, but then as components of a rigidly centralized system. The system was based on the principle of democratic centralism, which meant that higher bodies could aggregate decisions of People's Committees. This practice was radically changed in the late 1950s. The principle of democratic centralism was replaced by the principle of legality control (Dordevic, 1957, p. 24). District People's Committees became organs of self-government and Communal People's Committees organs of local government. District Committees had assemblies with two houses: one composed of political representatives, the other of representatives of producers. The next crucial step was taken three years later. The 1955 law on local self-government proclaimed that the Commune was "the basic political-territorial organization of self-government by the working people and the basic socio-economic community of the population on their territory." The Constitution of 1963 changed the phrasing slightly to make the commune "the basic socio-political community." The development of the communal system has been greatly influenced by the historical example set in 1871 by the Paris Commune, "that finally discovered political form in which emancipation of labor can be carried out" (Marx). It is useful to notice, as D. Milivojevic points out, that the commune has not been conceived as just a form of otherwise familiar local government. It is a community of those living, working and producing, satisfying their basic needs, and realizing their civil and self-governing rights in a particular territory (1965, p. 8). For a while districts retained certain coordinating functions and then gradually withered away.

Since the commune is a territorial association, one of the first problems to be solved was to determine the size of the territory. The problem was solved by practical experimentation over the period of a decade. Consistent with central planning was a hierarchy of governmental levels. There were three levels below the level of republic: county (oblast), district (kotar) and local committee (mjesni narodni odbor). In 1951 counties disappeared. The orientation towards a market economy made excessive administrative fragmentation—there were more than 7,000 local committees—unnecessary and so in 1952 the number of local committees was halved and committees were replaced by communes. In order to bring local government closer to citizens, in 1955 the commune was made the basic self-government unit. Since, however, the commune was expected to exercise a wide variety of functions, its territory had to be increased. Table 13 depicts the process of territorial transformation. Each new law on territorial changes, remarked E. Pusic, was announced as the last and the definite one (1968, p. 245).

Table 13—Number of Territorial Units of Local Government

<table>
<thead>
<tr>
<th>Year</th>
<th>Local committees/communities</th>
<th>Communes</th>
<th>Districts</th>
</tr>
</thead>
<tbody>
<tr>
<td>1948</td>
<td>7,067</td>
<td>627</td>
<td>408*</td>
</tr>
<tr>
<td>1952</td>
<td>3,082</td>
<td>251</td>
<td>197</td>
</tr>
<tr>
<td>1955</td>
<td>1,479</td>
<td>147</td>
<td>114</td>
</tr>
<tr>
<td>1957</td>
<td>591</td>
<td>107</td>
<td>107</td>
</tr>
</tbody>
</table>

* 1965.


The 1955 law was preceded by extensive discussions about the functions of the commune. In a paper presented at the annual meeting of Serbian economists in 1954 J. Djavbo maintained, and those present agreed, that a labor managed enterprise had no incentive to embark upon substantial capital formation. In his opinion large investment would imply creating a new enterprise which would be equally labor managed and so could not be dominated. For this reason Djavbo argued that the commune was "the natural investor in our circumstances" (1954, p. 192). As Table 10 shows, communes indeed became large investors. In 1964, when a maximum was reached, 25 percent of all investment in fixed capital was financed by communes (and districts). Since 1959 communes have been entitled to initiate the setting up of all kinds of enterprises, to bring about mergers or carry out liquidations (Bogov, 1964, p. 129). However, the last economic communities. These were to be self-governing communities of citizens in rural and urban localities concerned with all activities connected with the satisfaction of the needs of citizens and their families. J. Duric describes three functions of a local community: it is (a) a form of self-government including traditional political activities, (b) a unit of town planning and (c) an organization taking care of some social services, public utilities, etc. (1965). Pasic is rather skeptical about local communities contributing in any important way to self-government. In his view their activities are too restricted to be particularly attractive to the citizens and in a modern urban setting territorial close­ness per se generates no specially active social ties (1968, p. 243). There are 27,086 localities in Yugoslavia, and by 1965 statutes of communes provided for the creation of 4,908 local communities (7.7 per­cent of communes did not establish local communities at that time). The organizational circle seems to have been closed: communes have replaced districts and local communities have replaced local committees. But considerable social experience has been accumulated in the process. Apart from exercising the functions of traditional local government, which include local politics, public utilities, education, social welfare, etc., a commune is also responsible for other aspects of local life. D. Miljkovic explains this in detail. The commune is expected to harmonize individual and social interests. It is responsible for social property, either under its own control or "belonging" to enterprises. It takes care of economic development and cultural advancement. It coordinates all economic, social and political activities on its territory, prepares a social plan and makes it possible for citizens to participate in the process of social decision-making (Miljkovic, 1961; J-split, 1969). But commu­nal self-government is a contradictory institution, remarked Djordjevic, as it carries with it forces of unification and disintegration both forces will soon make themselves felt.

The 1955 law was preceded by extensive discussions about the functions of the commune. In a paper presented at the annual meeting of Serbian economists in 1954 J. Djavbo maintained, and those present agreed, that a labor managed enterprise had no incentive to embark upon substantial capital formation. In his opinion large investment would imply creating a new enterprise which would be equally labor managed and so could not be dominated. For this reason Djavbo argued that the commune was "the natural investor in our circumstances" (1954, p. 192). As Table 10 shows, communes indeed became large investors. In 1964, when a maximum was reached, 25 percent of all investment in fixed capital was financed by communes (and districts). Since 1959 communes have been entitled to initiate the setting up of all kinds of enterprises, to bring about mergers or carry out liquidations (Bogov, 1964, p. 129). However, the last economic
reform put an almost exclusive reliance on enterprises as far as capital formation was concerned, and by 1968 the communal share in investments dwindled to four percent. But this left other economic functions of the commune intact. In cases of failure of an enterprise, the commune shares a good deal of the financial responsibility involved. The commune also gives guarantees for credits and loans granted by the banks to enterprises located on its territory.

For people accustomed to central planning, i.e. to administrative methods in running an economy, it was difficult to imagine a really free market. They were determined to get rid of governmental controls. It seemed obvious that the best way to achieve that was to replace it by communal control. The self-governing commune would tell enterprises what to do and how to behave. In 1954 and 1955 communes were empowered to determine the needs of enterprises and to distribute their profits after federal taxation. Since they were entitled to determine their shares in profits and sales and since they were independent in budget expenditures, communal shares reached the upper limit remains to be seen.

Fiscal Policy: I add this section for the sake of completeness. But it might as well have been omitted. Strange as it may sound, taxation is a fiscal policy in Yugoslavia. In fact, this is quite consistent with the belief in the absence—or with the ignorance of the presence—of business cycles.

Fiscal policy can affect aggregate demand via the revenue or the expenditure side of the budget. The revenue side, taxation, has been recognized as a legitimate tool of fiscal policy in theory and is sometimes used in practice. Producers' turnover tax has been occasionally used to affect the general level of prices in order to absorb excessive purchasing power. Otherwise numerous tax changes have been made in order to affect individual prices or to increase the discretionary power of enterprises over their incomes and have not been intended to affect aggregate demand. To a certain extent selective turnover tax reductions have occasionally had price stabilization effects.

The federal government occasionally ran a substantial deficit in recession years, as for instance in 1962 and 1965. But that was purely accidental, a consequence of the combined effects of tax reforms and the lack of revenues. Textbooks on public finance, written invariably by people with training in law, keep on reminding students of the time-honored principle of sound finance: the balanced budget. And since governments on all levels were not too scrupulous in their spending practices, insisting on balancing the budget was quite justified. Bogoev points out that the budget has always been balanced when presented to the Federal Assembly for acceptance and that only in implementation would deficits appear. Deficits have amounted to 10-15 percent of the federal budget and up to 5 percent of republican and communal budgets, but have been much larger for extrabudgetary expenditures (investment, social insurance) (Bogoev, 1966, p. 189).

<table>
<thead>
<tr>
<th>TABLE 14.—BUDGET EXPENDITURES IN 1966</th>
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<tbody>
<tr>
<td>Total expenditure</td>
</tr>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>Education</td>
</tr>
<tr>
<td>Science and culture</td>
</tr>
<tr>
<td>Social welfare and medical care</td>
</tr>
<tr>
<td>Public utilities</td>
</tr>
<tr>
<td>Public administration</td>
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<tr>
<td>National defense</td>
</tr>
<tr>
<td>Infrastructure Investment</td>
</tr>
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The first public debate about fiscal policy took place in 1967. At an economic conference in Ljubljana, Bogoev (1967), Hanseković (1967b) and Jelic discussed the absence of fiscal policy in Yugoslavia and made various suggestions. Bogoev quotes the Resolution of the Federal Assembly on Economic Policy in 1967 which stated that there was excess demand and that not only had all budgets to be balanced but also reserves had to be accumulated. As our Figure 1 shows, Yugoslavia experienced an unusual depression in 1967. Bogoev also points out that proportional tax rates levied on payrolls have cycle-intensifying effects and that the small amount of transfer expenditures (unemployment compensation, debt repayment subsidies) limits the possibilities of an effective anticyclical policy. In the post-war period the federal government raised three internal loans (for the First Fire Year Plan, to counteract the effects of the Cominform economic boycott and to finance the rebuilding of Skopje, destroyed by an earthquake). The sole purpose of these loans was to transform a part of personal consumption into investment. Bogoev believes that the rigidity of the existing fiscal pluralism may be softened and an effective anticyclical use made of appropriately designed federal budgetary subsidies to other budgets.

B. Šeskić is the only other economist who has made written contributions related to fiscal policy (1967a). Šeskić was primarily interested in the expansionary effects of public works. In his view the most appropriate objects of increased public financing are: housing and communal construction, road construction, land reclamation and irrigation projects, and power generation projects. Such investment projects are desirable also because of their very low import content, as was pointed out by the IES. Šeskić added that they were also very labor intensive, which is of great importance for a labor surplus economy (1967a).

VI. Self-Government, Markis and Socialism

Limitations of space preclude discussion of two important lines of economic policy, agricultural policy and regional development policy. But there is one permanent theme of Yugoslav social science discussion which cannot be neglected: the interrelationship between socialism, self-government and market. Recent discussions of this problem will be surveyed in this concluding chapter.

I have already discussed the familiar contention that socialism and markets ("commodity production") are incompatible. It was the basis of P. Sweezy's criticism of Yugoslav economic policy as a "gradual transition from socialism to capitalism" (1964). Sweezy argues that the market restricts socialist relations and transforms social ownership into a sort of collective ownership. Material incentives and market orientation necessarily generate a profit-seeking mentality. The evaluation of social usefulness by profit is characteristic of a capitalist system. Gadgetry and acquisitiveness replace socialist values. This sort of criticism is fairly common.

J. Djordjević argues in reply that the undesirable social phenomena are the result of industrial civilization and not only the consequence of the market. The abolition of the market means a return to Stalinism and state property. Self-government implies free disposal of earned income and, more generally, business autonomy which, in turn, implies markets. If this is not understood, the alternative is an old one: the eschatological idea of state rule and the re-education of man. "Man would be placed under the tutelage of the state (or party, or some other mechanism) to be prepared and educated, so that one day he may become an adult socialist subject" (1965, p. 90).

Yugoslav economists are quite unanimous in believing that the market ought to be maximally exploited as a device of economic organization. Philosophers, however, have their doubts. M. Marković, a leading philosopher actively interested in economic affairs, believes that initial forms of workers' self-management cannot be achieved without material incentives which imply market competition. However, if exclusive reliance on money relations became a permanent feature of the society, self-management might gradually degenerate into a sort of capitalist cooperative. If the results of work were permanently evaluated in terms of income, and if the desire to earn as much money as possible became a permanent and basic interest of a worker, this would produce a personality type not basically different from the type produced by a capitalist society (1965, p. 70).

Referring to Marx, some of my philosopher colleagues declared that socialist commodity production was a contradiction in terms. In Marx's sense commodity production implies market relations which result in commodity fetishism and various alienation phenomena. I tried to clarify matters in the following way. The familiar statement that commodity production generates capitalism ought to be reversed. Commodity production existed in slavery, feudalism, and capitalism as well as in capitalism. It clearly did not determine all these socio-economic systems; on the contrary, it was determined by some more fundamental social relationships and was shaped by respective social systems. Thus, for instance, capitalism resulted from private ownership, Stalinism from state ownership. Since there are so many types of commodity production, it need not be surprising if we also find socialist commodity production. The elimination of private ownership does not necessarily produce socialism, although it may restrict the role of the market considerably. If private ownership is replaced by state ownership, capitalism is replaced by statism and commodity fetishism by office fetishism. In both cases relations among people are reified, social inequality preserved, class exploitation continued, essentially human existence made impossible. In socialism social ownership makes social capital equally accessible to anybody while the authoritarianism of a privately managed or a state managed firm is replaced by self-management. In this context the market and planning are not goals but means. If a working collective is to be really autonomous in economic decision-making, the market is indispensable. But planning contradicts the business autonomy of an enterprise and so the choice is between planning and the market—says a time-honored fallacy. In fact social planning, far from restricting, enlarges the autonomy of enterprises for at least three reasons: (1) it reduces uncertainty which is the basic restriction on free decision-making; (2) it establishes the rate of growth, the market expands and so the number of available alternatives increases; (3) it equates business conditions and so makes the success of a producer less dependent on external conditions which he cannot control and which are economically and socially irrational (Horvat, 1968b).

The nature of the relationship between the market and the plan is a frequently discussed subject. Plan and market have been traditionally contrasted as two separate mechanisms. But some economists try to develop a monistic approach. Bakarić argues that there can be no contrasting, that the law of value reigns supreme and that planning is just one, although the most important, element in it (1963, p. 52). This statement seems to be the reverse of what I said in the preceding paragraph and in the section on decentralization, but the contradiction is more apparent than real. What Bakarić tries to do is to combat the...
voluntarism of étatist planning and to show that there is an objectively given framework within which planners are obliged to move. Malešević understands this statement to mean too much laissez-faire to his taste. He criticizes the inconsistencies of the officially proclaimed economic policy and warns that an insufficiently controlled market causes damage to individuals (negation of distribution according to work), and to enterprises (different business conditions in various industries) optimal production). All this tends to generate an ideology which maintains that socialism is not economically superior to organized capitalism, that inequality and exploitation are products of human nature organized capitalism, that inequality and exploitation are products of human nature.

D. Malešević sees the shortcomings of self-management, as it exists today in Yugoslavia, primarily in the fact that it is confined to the enterprise. Investment resources are not allocated rationally; in the present situation self-management and planning contradict each other, the socialist distribution principle is negated and there is a tendency for group ownership to arise. As a result a laissez-faire approach is excelled. Malešević suggests that the self-management structure be completed upwards. He believes that the integration processes, which was discussed in the section on enterprise, are neither fast enough nor quite appropriate. Malešević means for an integral system of self-management in which co-ordinating self-management bodies would be created on the level of industries and also regionally. Membership in such associations would be obligatory (1964).

Malešević's system resembles the system of Higher Business Associations which existed in the two-year transitional period 1951-1952. A few years after self-management became operative, the present author suggested a somewhat different approach. A careful study of the economics of the oil industry showed that there was very little to be gained by competition and a lot to be achieved by a co-ordinated policy based on independent and competent research. I suggested that industries possessing similar characteristics establish common but independent economic-technological research institutes. The institutes would prepare alternatives for major policy decisions. The most acceptable alternative, perhaps modified in the process, would be chosen by the representatives of enterprises through some sort of self-management mechanism. The industrial research institutes would also serve as development planning institutions and as such would cooperate with territorial planning bureaux (Horvat, 1962c, ch. 24).

Self-management in enterprises is just one element in an integral system of social self-government. Pušić points out that such a system has three basic components: territorial (various levels of government); functional (enterprises and institutions, i.e., work organizations); and social (cultural, religious and other associations of individuals). Pušić is mostly concerned with the first component. He is thus the first among Yugoslav authors to study systematically the problem of the withering away of the state—generally considered utopian outside Yugoslavia. The state will wither away when government over individuals is replaced by the management of things. Engels took this famous phrase over from Saint-Simon. The latter, as well as other writers of his time, maintained that public administration was exclusively an instrument of power but that it was otherwise unimportant for the life of a nation. Marx and Engels argued with the first part of the statement, but regarded public administration as very important. Later an important duality appeared: public administration was no longer exclusively an instrument of power, but was also entrusted with various socially necessary activities: education, medical care, social welfare etc., basically differ from defense, police and judiciary. The monopoly of physical power might occasionally be useful if it is not at all necessary when social services are concerned. In socialism public administration without state political power becomes the question of the day. In other words, systematic planning and co-ordination of social services does not presuppose any longer the existence of a commanding center such as is political power (Pušić, 1968). The interest unions and the quasi—market, discussed in the section on institutional framework, represent an attempt to move in this direction.

Self-government is not a purely economic phenomenon. While economists are naturally enough, primarily interested in economic aspects, other social scientists explore additional dimensions. Lj. Tadić, the political scientist, points out that Yugoslav self-government socialism is mostly confined to the economic sphere. It has been developed on the micro level without a corresponding reflection on the macro level, that of the global society (Simpozij, 1969, p. 55). S. Stejovanović, the philosopher, maintains that without faster political democratization it is impossible to create self-government on higher levels of social organization (Simpozij, 1969, p. 34). R. Supek, the sociologist, explains that political pluralism does not mean a multi-party system which can also be bureaucratized. In a self-government setting political pluralism means direct control of various centers of power. How this is to be achieved is an open problem. Supek expects a certain duality of power to develop at first, a combination of classical representative democracy and self-government.

Evidently, self-government is not a closed and complete system. Many questions are still open, many problems unresolved. The Yugoslav social laboratory is bound to be active for some time to come.

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