Report No. 1615a-YU

Yugoslavia: Self-Management Socialism and the Challenges of Development
(In Six Volumes)

Volume I

Part I: An Economic System in Evolution

March 21, 1978

Europe, Middle East and North Africa Region

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CURRENCY EQUIVALENTS

Before January 23, 1971

1 US dollar = 12.5 dinars
1 Dinar = 8 US cents

From January 23, 1971 to December 22, 1971

1 US dollar = 15.0 dinars
1 Dinar = 6.67 US cents

From December 22, 1971 to July 12, 1973

1 US dollar = 17.0 dinars
1 Dinar = 5.89 US cents

Since July 12, 1973

The Dinar has been floating.

The rate of December 31, 1977 was

1 US dollar = 18.445 dinars
1 Dinar = 5.42 US cents
YUGOSLAVIA: SELF-MANAGEMENT SOCIALISM AND THE CHALLENGES OF DEVELOPMENT

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### COUNTRY DATA - Yugoslavia

#### AREA
- 255,804 sq. km.
- Rate of Growth: 0.9% (1961 to 1971)

#### POPULATION CHARACTERISTICS (1976)
- Crude Birth Rate (per 1,000) 18.1
- Crude Death Rate (per 1,000) 8.5
- Infant Mortality (per 1,000 live births) 37.1

#### INCOME DISTRIBUTION (1971)
- % of national income, lowest quintile 6.1
- % of national income, highest quintile 39.2

#### ACCESS TO PIPED WATER (1976)
- Occupied dwellings with piped water (38.5%)

#### NUTRITION (1974-76)
- Calorie intake (% of requirements) 137
- Per capita protein intake 98 grams

#### CROSS NATIONAL PRODUCT IN 1975
- GDP at Market Prices
- Gross Domestic Investment
- Gross National Savings
- Net Exports
- Cereal Imports

#### OUTPUT, LABOR FORCE AND PRODUCTIVITY IN 1975
- GDP at Factor Cost
- Labor Force
- Value Added Per Worker

#### GOVERNMENT FINANCE, consolidated, 1974
- Total
- Federal
- Republican
- Communal

#### MONEY, CREDIT AND PRICES
- Money Supply
- Money Supply as % of GDP
- Bank Credit (annual changes) Total
- Enterprises
- Government and other Social Sector
- Households
- Price Indices (1974=100)

---

1/ The Per Capita GDP estimate is at 1976 market prices, calculated by the same conversion technique as the 1977 World Atlas. All other conversions to dollars in this Table are at the current exchange rate prevailing during the period covered.

2/ Manufacturing, mining and construction.

3/ Total active resident labor force, excluding unemployed.

4/ Including subsidies.

5/ Money, demand deposits and float.

6/ Short- and long-term credits.
### BALANCE OF PAYMENTS AND EXTERNAL ASSISTANCE AND DEBT

#### Annual Data at Current Prices

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<td>Public Debt &amp; Disbursed</td>
<td>1,618.0</td>
<td>1,816.1</td>
<td>1,976.5</td>
<td>2,797.9</td>
<td>3,255.2</td>
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<td>Interests on Public Debt</td>
<td>63.2</td>
<td>97.1</td>
<td>101.2</td>
<td>130.8</td>
<td>130.8</td>
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<td>Repayments on Public Debt</td>
<td>146.5</td>
<td>205.0</td>
<td>282.3</td>
<td>329.0</td>
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<td>Total Public Debt Service</td>
<td>217.5</td>
<td>302.1</td>
<td>363.5</td>
<td>429.8</td>
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<td>Other Debt Service</td>
<td>638.2</td>
<td>744.6</td>
<td>827.7</td>
<td>989.7</td>
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<td>Total Debt Service</td>
<td>855.7</td>
<td>1,046.5</td>
<td>1,260.2</td>
<td>1,419.3</td>
<td>1,419.3</td>
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#### Summary of Balance of Payments

- **Exports (incl. N.F.)**: 3,424, 4,343, 5,696, 6,307, 7,259
- **Imports (incl. N.F.)**: 2,105, 2,735, 3,222, 3,320, 3,446
- **Resource Balance (F.o.b.)**: -106, -171, -1,257, -1,435, -1,505
- **Interest**: -185, -222, -385, -337, -350
- **Workers' Remittances**: 986, 1,301, 1,531, 1,575, 1,758
- **Other factor services net**: -17, 20, 93, 62, 40
- **Current Transfers (net)**: -86, -99, -14, -16, -35
- **Balance on Current Account**: 615, 444, -1,184, -1,032, 725

#### Summary of External Assistance

- **W.A.T. Loans**: 993, 1,170, 1,434, 1,850, 2,700
- **Disbursements**: 972, 696, 810, 930, 967
- **Net Disbursements**: 375, 464, 632, 720, 790
- **Capital Transactions net**: -117, -212, -139, -68, -133
- **Use of Reserves**: -185, -463, -628, -810, -917

#### Balance of Payments

- **Merchandise Trade**
  - **Exports**: Capital Goods 516, 489, 616, 420, 605
  - **Imports**: Capital Goods 362, 409, 677, 600, 761
  - **Missing Metals & Materials**: 372, 335, 556, 438, 427
  - **Agricultural Products (incl. food)**: 430, 473, 639, 488, 660
  - **Other**: 487, 421, 485, 454, 2,093
- **Total Merchandise Exports (f.o.b.)**: 2,727, 2,831, 3,500, 3,097, 3,767

- **Merchandise Trade Prices**
  - **Export Price Index**: 1974 = 100
  - **Import Price Index**: 1974 = 100
  - **Terms of Trade Index**: 1974 = 100
  - **Export Volume Index**: 1974 = 100

#### External Debt

- **End of 1971 to Mid-1977**
  - **US$1.00 = Dollars 17.00**
  - **St. 1.0 = US$0.05982**

#### Exchange Rate

- **US$1.00 = Dollars 18.465**
- **St. 1.0 = US$0.05972**

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1. Includes direct foreign investment.
2. Includes errors and omissions, short-term loans, net export credits, IMF account, National Bank and Commercial Bank Credits.
3. Figures on debt service do not correspond with balance of payments figures due to differences in coverage.
4. Includes workers' remittances.

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Europe, Middle East and North Africa Region
March 17, 1978
PREFACE

This report was prepared by an economic mission that visited Yugoslavia in October and November 1976. The mission consisted of the following: Messrs. M. Schrenk (chief), C. Ardalan (general economist), B. Blazic-Metzner (general economist), C. Chittle (foreign trade consultant), Mrs. N. El Tatawy (development economist), Miss K. Jordan (input-output specialist) and Mr. Y. Kubo (input-output specialist).
YUGOSLAVIA: SELF-MANAGEMENT SOCIALISM AND THE CHALLENGES OF DEVELOPMENT

PART I--AN ECONOMIC SYSTEM IN EVOLUTION

I. THE 1974 CONSTITUTION: ANTECEDENTS AND IMPLICATIONS

The Historical Setting

1.1 The territories which came together to form Yugoslavia after the First World War comprise seven distinct political, legal, and administrative regions. Serbia and Montenegro were independent countries at the time of the outbreak of the First World War. The remaining five regions had all formed part of the Austro-Hungarian empire--Slovenia and Dalmatia in the Austrian half, Croatia-Slavonia and Vojvodina in the Hungarian half, and the province of Bosnia-Herzegovina under the common Austro-Hungarian central hierarchy. Superimposed on these divisions, and only partially explained by them, was an extraordinary diversity and lack of cohesion among ethnic, linguistic, religious, cultural, and historical factors, together with wide disparities in social and economic development. The differences gave rise to complex problems, which were intensified during the interwar period by the internal policies of successive governments. The failure to recognize and deal effectively with the problem of multiple nationalities and to ensure a more even national distribution of political power and influence greatly weakened the internal cohesion of Yugoslavia during this particular time.

1.2 From an economic point of view, the main effect of the Second World War was the appalling casualties and physical damage which it caused. Politically, the Communist Party of Yugoslavia emerged in full control of the whole country. The rise to power of a genuinely Yugoslav party made a new and more constructive approach to the nationalities' problem possible. Under the constitution formally adopted in 1946, Yugoslavia became a federal state with six constituent republics. 1/

1.3 Despite a liberal-minded approach to the nationalities problem, the Yugoslav regime of the early postwar years was highly centralized and authoritarian. The 1946 Constitution provided for state direction of economic life and economic development by means of a comprehensive economic

Note: Paragraphs 1.1, 1.2, and 1.3 of this report are taken, almost entirely, from the World Bank's Country Economic Report, Yugoslavia: Development with Decentralization (Baltimore: Johns Hopkins University Press, 1975).

1/ A later constitutional amendment created two separate administrative regions within the Republic of Serbia. These are the two autonomous provinces of Vojvodina and Kosovo. The term "republic," as it is used in this study, should be understood to include all of the present eight regions: Croatia, Slovenia, Bosnia-Herzegovina, Montenegro, Macedonia, and Serbia Proper, as well as Vojvodina and Kosovo.
plan. The first postwar plan covered the five years from 1946 through 1951. In the first two years of the plan, output increased impressively, and the investment ratio rose to more than 30 percent. However, after mid-1948, the break with the Soviet Union and the other Cominform countries prevented fulfillment of the plan.

1.4 In 1950, Yugoslavia embarked on a unique path of development: it attempted to establish a new economic order based on a system of workers’ self-management characterized by social ownership and control of the means of production. 1/ The motivation underlying this decision was complex. Workers’ self-management was perceived as an embodiment of the spirit of the socialist state envisioned by Marxist philosophy -- a state in which workers would receive according to their labor and there would no longer be any alienation based on a separation of workers from the ownership of the means of production. 2/ In addition, workers’ self-management provided decision makers with an ingenious way of dealing with the pluralistic character of Yugoslav society; differing interests can be voiced, respected, and harmonized. Thus, in one respect the system of economic management is moving toward creating an environment in which the decision-making process can best reflect the objective of providing workers with the maximum control over their workplaces and ultimately over the economy itself. In another respect, through a parallel process of devolving decision making from the Federal government to the Republics and Communes, the system is moving towards an ever-increasing accommodation of the diverse needs and aspirations of the various nationalities that Yugoslavia comprises.

1.5 Yugoslavia’s development in the postwar period is the history of how these complex factors have shaped the country’s ability to attain its basic objectives and to cope with its inherited economic problems. Yugoslavia has had an almost unique predilection toward innovating and testing novel organizational and systemic relations. Its innovative zeal has been characterized by a commendable blend of pragmatism and flexibility and an almost uncanny irreverence for institutions and policies that have failed to meet expectations. Few dictums, apart from Yugoslavia’s commitment to Marxist thought on the social ownership of property, appear to have been inviolable, and few have

1/ Not all productive enterprise in Yugoslavia is socially owned. Although the social sector includes virtually all nonagricultural activities, about 90 percent of the agricultural sector consists of small, individually owned farms. In 1975, the agricultural sector accounted for about 39 percent of the active resident labor force and 15 percent of value added to Yugoslavia’s GNP.

2/ The Yugoslav interpretation of self-management reaches beyond the concept of "workers’ participation," which would imply some sharing of power by workers with nonworkers - management or the state. Self-management in Yugoslavia signifies direct democracy in a dual sense; decision-making power is assigned and restricted to individuals directly affected by decisions, and these individuals exercise their power directly, without the intervention of intermediaries.
withstood the march of time. Although these changes were deliberate responses to diverse—and not always mutually compatible—social, economic, and political issues, an underlying economic rationale is discernible throughout the period. An appreciation of this rationale is crucial to understanding the evolution of the system. The analysis that follows stresses the continuity of the institutional changes that have occurred; they represent an evolutionary process rather than a set of unrelated responses. The process of change has been dialectic in nature: institutional changes have impinged on the performance of the economy, which in turn has prompted further institutional changes. It is this process that is the most interesting feature of contemporary Yugoslav development.

Economic Overview 1954-74

1.6 Yugoslavia's economic objectives have included the traditional ones: rapid growth, transformation of a preponderantly agrarian economy into a modern diversified one, achievement of a high degree of income equality, and increasing integration into the world economy. During the postwar period as a whole, Yugoslavia has been remarkably successful in achieving these economic objectives. Until 1954, the performance of the economy was severely constrained by the structural readjustments that the break with the Cominform in 1948 required. After 1954, however, the economy developed rapidly.

1.7 Between 1954 and 1974, growth in Yugoslavia's real gross material product (GMP) averaged 7.2 percent a year. 1/ Rapid economic growth and a low and declining population growth rate, which averaged 1.1 percent a year during this period, resulted in per capita income reaching US$1,480 by 1975—a significant gain. 2/ Throughout the period, the economy succeeded in mobilizing a large share of domestic resources for investment. Domestic savings rates averaged about 30 percent of gross domestic product in earlier years—a considerable sacrifice in consumption. In turn, however, this sacrifice permitted the rapid growth of GMP, which facilitated large gains in personal incomes throughout the period; in fact, real personal incomes in the modern social sector rose by an average of 5.8 percent a year.

1.8 The growth of real incomes was accompanied by significant structural changes in the economy. Employment in the modern social sector increased 3.7 percent a year between 1954 and 1974, absorbing large transfers of labor from the low-productivity, private sector in which small, traditional, individually owned farms predominate. As a result, the share of the labor force employed in the private agricultural sector declined from 66 percent to 33 percent between 1953 and 1975. Paralleling this trend, the share of value added

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1/ GMP includes a market price value added of those sectors which produce goods plus the value added by the activities contributing to the production and distribution of these goods and thereby increasing their value—transport and trade. It does not include other services which are directly rendered to individuals—housing, social services, and government.

attributable to the traditional private agricultural sector declined from 40 percent in 1953 to 19 percent in 1975. As the importance of the private sector declined, a highly diversified industrial structure developed.

1.9 These domestic changes were achieved in an environment of growing integration into the world economy. Although from time to time the economy faced balance of payments difficulties which constrained its growth, its export performance was impressive. Between 1954 and 1974, exports in constant prices increased by 8.5 percent a year. By 1974, exports and imports were equal, respectively, to 20 percent and 27 percent of GNP—a high level of foreign trade for a country of Yugoslavia's size and income. This growing integration into the international economy, in addition to providing additional resources for growth, acted as a spur to efficiency and competitiveness and resulted in significant improvements in the quality of goods and services Yugoslavia produces.

1.10 Although the overall performance of Yugoslavia's economy in the post-war era has been impressive, its performance in a number of areas has appeared to deteriorate in recent years, particularly after the 1965 reforms. This is shown by the macro-economic indicators summarized in Table 1.
### Table 1: Growth Rates of Specified Macro-Economic Indicators, 1954–74 (Percent)

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<tr>
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<tr>
<td>Gross Material Product /1</td>
<td>8.4</td>
<td>6.4</td>
<td>7.2</td>
</tr>
<tr>
<td></td>
<td>(.004)</td>
<td>(.002)</td>
<td>(.002)</td>
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<tr>
<td>Gross Industrial Output</td>
<td>12.2</td>
<td>7.7</td>
<td>9.5</td>
</tr>
<tr>
<td></td>
<td>(.002)</td>
<td>(.004)</td>
<td>(.003)</td>
</tr>
<tr>
<td>Industrial Employment</td>
<td>6.6</td>
<td>3.3</td>
<td>4.3</td>
</tr>
<tr>
<td></td>
<td>(.002)</td>
<td>(.004)</td>
<td>(.002)</td>
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<tr>
<td>Industrial Labor Productivity</td>
<td>5.2</td>
<td>4.3</td>
<td>5.0</td>
</tr>
<tr>
<td>Social Sector Employment</td>
<td>5.9</td>
<td>2.9</td>
<td>3.7</td>
</tr>
<tr>
<td></td>
<td>(.003)</td>
<td>(.003)</td>
<td>(.002)</td>
</tr>
<tr>
<td>Real Social Sector Personal Incomes</td>
<td>5.9</td>
<td>4.2</td>
<td>5.8</td>
</tr>
<tr>
<td></td>
<td>(.004)</td>
<td>(.005)</td>
<td>(.002)</td>
</tr>
<tr>
<td>Inflation /2</td>
<td>2.1</td>
<td>10.4</td>
<td>5.9</td>
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<tr>
<td></td>
<td>(.004)</td>
<td>(.01)</td>
<td>(.005)</td>
</tr>
<tr>
<td>Commodity Exports</td>
<td>11.7</td>
<td>5.6</td>
<td>8.5</td>
</tr>
<tr>
<td></td>
<td>(.005)</td>
<td>(.005)</td>
<td>(.004)</td>
</tr>
<tr>
<td>Commodity Imports</td>
<td>10.5</td>
<td>9.9</td>
<td>9.5</td>
</tr>
<tr>
<td></td>
<td>(.008)</td>
<td>(.006)</td>
<td>(.003)</td>
</tr>
<tr>
<td>Fixed Assets /1</td>
<td>9.2</td>
<td>8.2</td>
<td>8.7</td>
</tr>
<tr>
<td></td>
<td>(.001)</td>
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**Note:** Growth rates are based on least square estimates, and figures in brackets are standard errors of estimates. All estimated growth rates are significant at the 99 percent confidence level. Sub-period growth rates are statistically different at the 95 percent confidence level for all indicators.

/1 In constant 1966 prices.

/2 Producer prices.

**Source:** Statistical Yearbook of Yugoslavia, 1977.

Clearly, there were significant declines in the growth rates of output, employment, personal incomes, and commodity exports. Imports continued to grow rapidly, however, so there was a sharp rise in the deficit on the trade account. The rate of inflation, which had been moderate prior to 1965, also tended to rise rapidly. In addition, investment tended to call forth smaller increments of output.

Some of these developments were an inevitable consequence of changes in external conditions; others were due to changes after 1965 in the relative weights given to various economic objectives. For example, in part the decline in the rate of growth of output and employment reflected one of the objectives...
of the 1965 reforms— to distribute a greater portion of income to consumption. Similarly, the growing importance of remittances from Yugoslavs working abroad allowed the trade account to deteriorate to the extent that it did during the 1965-74 period. The deterioration in many of the macro-economic indicators, however, conceals the considerable improvements that were realized during this period in the quality and price of domestic goods and services. This was a consequence of the increased competition that followed liberalization of the foreign trade regime in 1965. In some instances, these improvements may not have been directly reflected in the growth of output. Further, measuring changes in benefits is elusive, because it is difficult to compare incomes under a system of multiple exchange rates with those that emerge when a more realistic, unified exchange rate is adopted.

1.12 The performance of the economy after 1965 not only reflected the results of new policy priorities, it also reflected increasing difficulty in attaining these objectives. Although many factors—both internal and external—contributed to these difficulties, the particular system of economic management that prevailed during this period was the root cause of many of these problems. The "economic model" of the period after 1965 had a number of weaknesses. Mainly, these stemmed from trying to reconcile two divergent objectives: developing an effective system of workers' self-management, and retaining macro-economic instruments adequate to manage the short- and long-term development of the economy. This conflict was accentuated by a policy of relying on a market mechanism which was fraught with imperfections. The way the economy was managed offers some insight into its lagging performance and into the reasons for the institutional changes that began in the early 1970s.

Economic Management 1950-65

1.13 Yugoslavia has passed through three constitutions since 1946. These have not represented new departures, rather they have been part of an evolutionary process guided by the overriding goal of self-management and tempered by the need to reconcile the pursuit of greater worker autonomy with the development of adequate policy instruments for economic management.

1.14 Self-management was initiated in 1950 and codified in the "Law on the Management of Government Enterprises and Economic Association by Workers' Collectives." Its purpose was to ensure that workers achieved growing influence in the day-to-day operation of their work places. Use of the conventional macro-economic policy instruments, such as planning, price and incomes policies, and fiscal and monetary policies, remained firmly in the hands of the State. The respective spheres of competence of the State and of workers in economic affairs was, at least in practice, well defined. In Yugoslav eyes, however, this clarity was achieved only by depriving workers' self-management of much of its substance. Giving workers more real autonomy in managing their own affairs could not readily be reconciled with continuing to give the State direct control in the spheres of resource mobilization and allocation.

1.15 As a response to this perceived shortcoming, the second phase in the evolution of the system was initiated in the early 1960s. This appeared
to be a logical attempt to give practical substance to the principle of workers' self-management by reducing the control State agencies had over enterprise decision making. The Constitution of 1963 set the stage, and the "economic reforms" of 1965 (in fact, a series of economic measures taken between 1964 and 1967) provided a new framework for decision making. These measures instituted two parallel and closely linked processes: "de-etatization," which reduced the role of the state and "decentralization," which devolved decision making from higher to lower level State agencies. These processes involved, among other things, abandoning central allocation of investment funds in favor of a self-managed banking sector that would have considerable competence and autonomy in allocating investable resources, reducing planning of "global balances" (macroaggregates) to a largely "indicative" rather than binding mechanism, I/ devolving of the fiscal system, and greatly increasing the role of the market. The operation of the market was to be enhanced by realigning prices, abandoning multiple exchange rates, and generally liberalizing foreign trade. Previously, the workers had the right to manage their affairs within their own enterprises, subject to the influence of the State in determining the role of these enterprises within the economy; under the 1965 reforms, workers were to manage their affairs independent of the State and subject principally to the impersonal forces of the marketplace.

Economic Performance 1965-75

1.16 The "economic model" that emerged with the 1965 reforms was soon to reveal two important shortcomings. One was that the reforms significantly weakened macro-economic management by reducing the number of macro-economic policy instruments. In the process of de-etatization, some of the State's policy instruments were effectively dismantled—notably, in areas of fiscal policy, resource allocation, and compulsory plan coordination and implementation; in addition, policy making was regionalized. There was no attempt to introduce alternate mechanisms for coordinating diverse economic objectives, and too few instruments of economic policy were left to pursue these objectives effectively. The policy instruments, such as those for incomes and price policies, that were still intact were perceived as implicitly running counter to the spirit of self-management, and consequently they were pursued half-heartedly and erratically. In effect, attempts to strengthen self-management at the micro level had greatly reduced the scope for the short-term management of the economy and for the pursuit of longer term objectives.

1.17 The second shortcoming of the 1965 reforms arose from the greatly expanded role of the market. Under the new system, prices were realigned, and many were freed; investment decisions were left to enterprises and their confreres, the banks; imports were liberalized, and exchange rates were adjusted. Greater reliance on the market had many benefits, but the market

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1/ Plans during the period were drawn up by the Federal Republican Planning Institutes and formed the basis of investment decisions and background for policy measures by government authorities. They were, however, "indicative" in the sense that they did not impose any legal or mandatory obligations for social sector enterprises.
alone was not sufficient as a coordinating mechanism. The Yugoslav institutional framework created a number of serious distortions which hampered the effective operation of the market. The mobility of investable funds was limited and, in practice, highly regionalized; the influence of enterprises in pre-empting funds for investment was disparate; and the financial accountability of enterprises was scant. Other distortions were created because some prices were freed and others were still administratively determined. There was growing concern about negative social and political trends at the enterprise level; these included monopolistic practices and control by the managerial elite rather than by the workers. Even if the market had been allowed to operate efficiently, relying solely on the market would have been difficult for an economy at Yugoslavia's level of development; market prices can be misleading in an economy undergoing rapid structural changes calling for a medium-term perspective and development strategy.

1.18 Many of the negative economic trends of the period following 1965 can be ascribed to these weaknesses in macro-economic policymaking and in market performance. The adverse impact of the reforms is particularly evident in the ways inflation, the balance of payments, and resource allocation were affected; the impact on employment and regionalization is less clear-cut.

(i) Inflation

1.19 After the mid-1960s, the Yugoslav economy was subjected to considerable inflationary pressure. In part, this was because of difficulties in reconciling the demands on resources for investment and for consumption; partly, it was because of the built-in inflationary bias of the system. Until the early 1960s, prices had been fairly tightly controlled by the State, so there was a high degree of price stability. With the liberalization of prices, however, economic growth increasingly was accompanied by high and rising rates of inflation.

1.20 Before 1973, at least, the causes of inflation were principally domestic. The reforms of 1965 had sought to shift the distribution of income toward consumption, but the lack of any mechanism to balance conflicting claims on resources resulted in significant upward pressures on prices. The inflationary bias built into the economic system added to these pressures. The response of wages to labor market conditions was much stronger in the upward than in the downward direction, and prices in many sectors of production were set on the basis of cost (cost mark-up pricing) rather than demand conditions. Thus, the nominal wage increases that resulted from inflationary expectations, from attempts to maintain wage differentials among enterprises and sectors, from labor market conditions, and from productivity increases were quickly translated into price pressures.

1.21 With the liberalization of prices, particularly after 1965, the inflationary bias of the economy manifested itself in the form of large price increases. Attempts to dampen these price movements met with only limited success; too many policy instruments had been withdrawn, and those that remained were weakened by market imperfections. The use of fiscal policy for demand management was now extremely cumbersome, and the government was reluctant to rely on mandatory price and incomes policies. Monetary
policy became the principal, and often the only, policy instrument available, but it had significant shortcomings. The use of monetary policy to accomplish other objectives, notably the use of selective credit policy to influence resource allocation, weakened its anti-inflationary impact. This was particularly evident in the difficulties encountered in neutralizing the effect of changes in Yugoslavia's international liquidity on its domestic money supply. In addition, institutional factors often frustrated changes in monetary policy. Enterprises could dampen the effect of restricting the money supply by building up credits among themselves. This practice was aggravated and sustained because enterprises were rarely forced into liquidation; thus, their financial accountability was limited.

(ii) Balance of Payments

Yugoslavia's balance of payments was influenced by three factors during this period: a growing dependence on imports, a lagging export growth rate, and an increasing reliance on workers' remittances from abroad to finance the widening trade gap. Greater dependence on imports was partly a natural outcome of the liberalization of trade and partly a policy response to the increased foreign exchange that workers' remittances made available. The dependence on imports was concentrated in intermediate and capital goods. As a result, restricting imports in times of balance of payments difficulty directly affected the country's growth rate by reducing industrial production and investment rather than consumption. Given the inadequacy in short-term economic management, which might have alleviated the need for restricting imports, continuous growth was interrupted by a series of stop-go policies. In retrospect, a longer term trade strategy was needed.

Commodity exports grew considerably more slowly in the period after 1965. This was largely due to the export commodity mix in combination with the export market mix; the emphasis was on products and on markets that had relatively low trade growth, and there was little attempt to reorient the export mix. Workers' remittances, the principal source of increased foreign exchange earnings, were vulnerable to external factors over which domestic policy had only limited control, and thus they were a precarious base for Yugoslavia's balance of payments.

(iii) Resource Mobilization and Allocation

The decentralization of decision making, as well as the intended income redistribution in favor of personal incomes, resulted in a change in the pattern of saving and some decline of the domestic saving rate (24-25 percent) as compared to previously very high levels. Although the large inflow of workers' remittances sustained the national saving rate at about 28 percent, the market for investable funds during this period was characterized by excessive demand as compared to available resources. Many factors contributed to this: enterprises had little reason to fear risk-taking, because bankruptcy was rarely enforced; interest rates were low; the cost of labor was high; 1/ a major objective of enterprises was to maximize the productivity of labor; and social infrastructure development made large demands on investable resources.

1/ Added to wage cost is that of enterprise social services contributions on behalf of workers.
1.25 Excess demand, in itself, would not have led to misallocation and inefficiency if an appropriate mechanism had been available for rationing investable funds. When the State investment funds were abandoned in 1965, \(^1\) and an essentially indicative planning framework was adopted, coordination of competing investment demands was left to the market. The market had its limitations, however. The banks, which often had been founded by the large enterprises in a republic, were strongly influenced by their founders, so the capital markets tended to be regional, rather than national, in scope. Many different criteria were used to choose projects for funding, making a rational choice among alternatives impossible. Ad hoc intervention by the State and enterprises often led to compromises that were not necessarily based on the economic merits of projects.

1.26 Even if the market had operated efficiently, however—if current market prices had reflected relative scarcities and if these prices had been allowed to prevail—it is questionable whether the market is an appropriate mechanism for allocating resources in a developing country undergoing major structural changes. A longer term perspective, reflecting longer run objectives and constraints, is necessary. The Yugoslav planning mechanism, had it provided such a vision, could have done little to implement it.

1.27 As a result of shortcomings in resource allocation, there was a tendency in the post-1965 period toward duplication and excess capacity. The incremental capital-output ratio tended to rise, \(^2\) and there was a shift to a more capital-intensive growth path; neither of these effects was desirable or intended.

(iv) Employment

1.28 The performance of the Yugoslav economy in generating modern social sector employment has been mixed. After 1965, employment in the social sector grew less rapidly than before, but this does not appear to have been due to a deterioration in the employment-generating capacity of the economy. Between 1965 and 1967, there was a once-and-for-all decline in employment as enterprises attempted to rationalize production and to increase labor productivity. After 1968, the decline in employment growth mirrored the decline in the economy’s overall growth rate. In fact, employment-output elasticities before 1965 and after 1968 were quite similar. Capital-labor ratios did rise after 1965, but this was a consequence of rising incremental capital-output ratios.

1.29 Employment has always been one of the most pressing problems facing Yugoslavia. Although the reforms of 1965 did not directly impede solutions to this problem, neither did they contribute to a solution. One of the effects of the reforms was the large transfer of labor out of the traditional agricultural sectors induced by the increasing income disparities between those

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\(^1\) With the exception of the Federal Fund for the Accelerated Development of the Lesser Developed Republics and the Autonomous Province of Kosovo, which was created subsequent to the 1965 reforms.

\(^2\) The increase in output at the margin due to an increase in fixed assets at the margin.
employed in the social sector and those in the private agricultural sectors. 1/ Interregional migration tended to be limited, however, and this resulted in vastly different labor market conditions among the various Yugoslav republics.

1.30 Conditions for external migration were considerably liberalized in 1965, and migration abroad became virtually as important as the social sector in absorbing labor. It particularly benefitted the more developed republics and, as a rule, the more skilled workers. In many instances, it accentuated existing disparities. Although external migration brought significant gains, the social costs became increasingly apparent as more workers left, and, with the recent changes in the attitude of host countries, it became evident that external migration could not be sustained as a vent for surplus labor.

1.31 Incentives were lacking to develop alternate forms of modern employment within the private agricultural sector or new forms of modern sector employment, such as small-scale, labor-intensive activities in the private or social sector. This placed the burden of job creation on established social sector enterprises. Thus, by the early 1970s, despite large annual transfers of labor from the private agricultural sector to the social sector and abroad, the rate of open unemployment began to increase appreciably, which reflected significant disequilibria in the labor market. 2/ The market, by itself, could not be expected to cope with the employment problem, and it became imperative to enunciate and implement a comprehensive employment strategy.

(v) Regional Policy

1.32 In contrast to areas in which emphasis had been placed on deetatization, the 1965 reforms established for the first time a federal agency specifically for transferring funds to the lesser developed republics. Regional disparities in incomes were, and continue to be, one of Yugoslavia's key economic problems, but establishing this federal fund has been important in stemming, and recently slightly reducing these disparities. The success of this coordinated approach has been less than complete, however.

1.33 The Federal Fund for the Accelerated Development of the Lesser Developed Republics transfers financial resources to lesser developed regions by providing low-interest, long-term credits. This, along with uniform social sector wages, has encouraged relatively capital-intensive development. The most abundant resource in the lesser developed republics--labor--has been left underutilized. Furthermore, the purely financial transfer of resources, though a necessary condition for development, has not proven to be a sufficient condition. There has been only a relatively modest transfer of technical and managerial know-how--a crucial ingredient for development--

1/ These disparities increased sharply immediately after the reforms, but they were gradually redressed.

2/ Labor market, in this study, is used as a shorthand for labor supply and demand. It is not used to denote an actual marketplace where labor is actually transacted, which would run counter to the basic philosophical premises of the Yugoslav system.
to the less developed republics. As a result, industrial growth, though rapid, has been concentrated in a limited number of large enterprises, and often it has been highly capital intensive, its income effects have been fairly limited, and its economic benefits localized.

(vi) External Events of 1973-74

1.34 The diverse problems that persisted in the wake of the 1965 reforms were sharpened by events of 1973 and 1974. Fuelled by external inflation, domestic producer prices rose by 30 percent in 1974 as compared to 13 percent in 1973. Rising oil prices and the ensuing recession in Europe adversely affected Yugoslavia's balance of payments. The 1973 current account surplus of US$464 million shifted to a record deficit of nearly US$1.2 billion. The employment situation, already unfavorable, was exacerbated by returning migrants; between 1974 and 1975, some 150 thousand workers returned—a figure 30 percent higher than the natural increase in the labor force during the period. The new conditions surrounding employment of Yugoslav workers abroad have also had significant adverse effects on the growth prospects of workers' remittances. It would require significant structural changes in the economy in order to adjust to the increased burden of petroleum imports and to the uncertain future of workers' remittances.

The 1974 Constitution and its Economic Implications

1.35 In the early 1970s, the growing awareness of the need to find more effective solutions to Yugoslavia's problems led to further evolution of the system of economic management. The constitutional amendments of 1971, the first important steps in this direction, were followed in 1974 by a new Constitution which encompassed these changes, introduced others, and paved the way for major revisions in the system of economic management. 1/ Although the motivations and consequences of this Constitution extend beyond strictly economic factors, there is much to suggest that the changes were, in fact, a response to current economic problems.

(i) Macro-economic Management

1.36 The most important consequence of the Constitution is to extend the principle of workers' self-management to macro-economic decision making by introducing various workers' self-managed macro-economic instruments. This reflects a realization that ad hoc intervention in the economy had been less successful than anticipated and that a consistent framework for macroeconomic management must be agreed upon if short-term economic stability is to be ensured and longer-term aspirations fulfilled. The interesting and novel feature of the Constitution is that it achieves this objective without transgressing the rights of workers to self-management; rather, it makes self-management an integral part of the new instruments of economic policy. These

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1/ It is important to bear in mind that many of the new instruments and institutions codified in the 1974 Constitution were introduced with the constitutional amendments of 1971. The 1974 Constitution is significant in that it consolidates these earlier changes and provides a comprehensive and consistent vision of the new economic system.
new instruments consist of a new planning mechanism—self-management planning—which will affect principally the allocation of resources, and the use of contractual agreements—Social Compacts and Self-Management Agreements—to govern such diverse areas as prices, incomes, and employment.

1.37 Self-management planning involves the participation of all economic decision makers—nongovernment as well as government. Under this system, each group prepares its own plan based on a predetermined and standardized set of indicators that describe current conditions and future expectations. The process of coordinating these diverse plans involves a series of successive adjustments, or compromises, among the various plan makers. This "iterative process" is based on mandatory free exchange of information among all participants. The law on planning distinguishes at an early stage in the planning exercise between those activities that are identified as priority sectors, and all other activities. In the case of priority activities, consistency of plans by a prescribed date is mandatory, and the plan that is agreed upon must be codified in legally binding agreements among affected parties; if a deadlock should occur, government agencies can impose a temporary injunction and issue temporary instructions. In the case of nonpriority sectors, plan consistency is encouraged but not mandatory.

1.38 The unique feature of the planning mechanism is that once broad consistency among individual plans has been attained, participants are expected, or even required, to enter into publically negotiated, legally binding contractual arrangements—Social Compacts and Self-Management Agreements. These agreements involve the participation of all parties affected, and they are valid only for the signatories, but they can be contested by any party who feels his interests have been violated. The Agreements will cover the quantities of goods to be produced and transacted, prices, the origin and use of investable resources, and all other facets of the relationship between the parties. The plan period is five years, with supplemental annual plans ensuring that the process is continually monitored and adjusted.

1.39 These Social Compacts and Self-Management Agreements are not new; what is new is that they are recognized explicitly and will, in addition to their role in planning be widely used as an instrument of economic policy. The Social Compact is designed to promulgate broad policies in such diverse areas as prices, income and employment. Economic organizations, State agencies, and trade unions participate in the formulation of a Social Compact, and, once it is signed, for all practical purposes it has the force of law. The Self-Management Agreement is a much more specific agreement than the Social Compact. It is akin to a civil contract among a limited number of economic organizations. The Self-Management Agreement is intended to determine specific obligations of the parties to ensure the fulfillment of the more general objectives agreed upon in the Social Compacts, and it includes compensation clauses for noncompliance or violation. Social Compacts are particularly useful in the areas of stabilization and employment policies.

1.40 The process of negotiation and compromise that underlie these instruments could prove to be extremely cumbersome and time consuming, and it could result in deadlocks. Foreseeing this, the Constitution has provided three countermeasures: (i) to expedite decision making, a stepwise system
of delegates representing successively larger and larger groups of workers or specific interest groups has been instituted; (ii) in case of a deadlock and for matters of vital national interest, the government can take emergency measures until an agreement is reached; and (iii) the Constitution has assured strong cohesive elements through the operation of the Socialist Alliance, the trade unions, and--above all else--the League of Communists (LCY). These are not new organizations, but they have been considerably strengthened. The LCY, as "the organized force of Socialist Consciousness," is likely to play a decisive role in encouraging various negotiating parties to reach agreement among themselves; and act as an arbitrator where this fails. The LCY embraces the principle of "democratic centralism," obliging all its members to act in accordance with any resolution the LCY adopts, and it includes the politically most active segment of the population. Therefore, any position taken by the LCY strongly affects decisions at all economic and political levels.

(ii) Micro-economic Decision Making

1.41 The economic implications of the Constitution extend beyond its impact on macro-economic management into a second area that is less immediately apparent, but no less important. This area encompasses a whole set of measures that potentially improve the effectiveness of the market as a mechanism for coordination and decision making. Although the "1965 model" was frustrated by a number of important shortcomings in the way the market operated, the recent changes do not see a reduced role for the market per se. The new contractual arrangements are not intended to supercede the market; in fact, contracts are expected to be formulated on the basis of market signals. The Constitution attempts to make the market mechanism operate better mainly by increasing the checks and balances on the actions of decision makers. There is a new emphasis on ensuring greater accountability in the operation of enterprises and increased competition among them. This emphasis is evident in a number of areas such as the atomization of the industrial structure into small, autonomous operating units called Basic Organizations of Associated Labor (BOALs), with new forms of inter-enterprise financing and new accounting regulations governing the calculation of enterprise income and the settlement of inter-enterprise debts.

1.42 BOALs were created to be the building blocks which together form large enterprises. A BOAL is the smallest operating unit which produces a marketed or marketable output. In principle, BOALs are free to join each other, and they have the right to separate, subject to the conditions agreed upon at the time of association. Stringent regulations governing the calculation of income and settlement of outstanding debts impose considerable discipline on BOALs. Transfer prices among BOALs are to be made explicit, and BOALs retain the rights to distribute their incomes between personal incomes and accumulation, to allocate investable resources, and to retain claims over funds invested outside the BOAL. BOALs are expected to provide funds to each other, not only on the basis of fixed interest, but also through a newly instituted form of limited joint venture. Participants in this type of relationship decide on the use of funds and the sharing of income and risk.
1.43 The intent under the new Constitution to increase scope for development of the individual sector is evident in the new legal provisions for setting up cooperatives and mixed social-individual sector entities called Contractual Organizations of Associated Labor (COALs). A COAL is basically an "enterprise" in which a private individual contributes 10 percent or more of the initial capital. If there is more than one person involved, each individual's contribution must be at least 10 percent. The founders of the COAL work in the COAL but earn, in addition to their wages, income based on their share of the paid-in capital. The details of the arrangement are negotiated with the workers and spelled out in a Self-Management Agreement. One of the basic ideas of the COAL is that, over time, the founder should be paid back his initial capital. This has the effect of transforming the COAL into a social sector enterprise proper.

1.44 In addition to these new institutional forms, the Constitution has introduced the "Communities of Interest," an organization designed to bring both producers and consumers together to deal with transactions that, by their nature, cannot be handled efficiently through the market mechanism; these transactions will include many involving goods with public good characteristics, various types of social services, and nontraded goods.

(iii) Economic Implications

1.45 It would be premature at present to judge the ultimate impact of these constitutional changes on the economic performance of Yugoslavia. A number of the more salient features of the recent changes on various policy questions are already discernible, however, and these can serve to highlight at least the potential impact of some of the recent measures.

1.46 Resource Allocation. The most radical changes are evident in the mechanism for allocating resources. The most significant innovations are the introduction of self-management planning, a procedure for coordinating individual plans, and legal instruments which represent a binding agreement among all parties to abide by the ultimate, coordinated plan. The process by which plans are simultaneously coordinated and agreement is reached resembles in important respects an attempt to simulate the operation of forward markets, in which commodities are traded on the basis of future prices and forward deliveries. Furthermore, by specifying the origins and uses of investable resources, the planning mechanism provides an alternative to the impersonal capital market, which has always been difficult to reconcile with Marxist thinking. The Yugoslav mechanism provides, as do central planning models, prior coordination of resource allocation; this facilitates structural change and reduces market uncertainty. Yet, unlike central planning, it is not imposed, but participative; it is based on an exhaustive exchange of information, so in principle it should reflect the revealed preferences of individuals and ensure a strong commitment to plan implementation.

1.47 The planning process leaves a number of issues unresolved, however. The iterative process of coordinating individual plans is excessively time consuming, and it also makes cumbersome the process of adjusting the plan to
new conditions. Above all, there is considerable ambiguity surrounding the procedures enterprises will use to achieve agreement on production targets. Conceptually, the use of cost-benefit analysis based on appropriate scarcity prices could act as an objective arbitrator among conflicting demands; in practice, however, there is little to indicate that such techniques have been widely used. In short, although the planning methodology offers a novel and challenging framework for improving the efficiency of resource allocation, a number of important practical issues will need to be resolved if its full potential is to be realized. Refinement of project evaluation techniques would also positively contribute to improving resource allocation at the micro-economic level.

1.48 In addition to providing a new framework for coordinating decision making, the Constitution has introduced a number of measures that can improve and strengthen market forces and, ultimately, resource allocation. The most notable of these is an attempt to reform the industrial structure by vesting the decision-making function of enterprises in their constituents—the BOALs. The large size of Yugoslav enterprises, compared to international standards, and their high propensity to grow, presents a dilemma in the application of workers’ self-management. First, for self-management to be a meaningful concept, it has to apply to relatively small collectives within which individuals of fairly homogeneous views and interests can communicate easily. Second, the large size of enterprises counteracts the effectiveness of the market mechanism. Large enterprises may have easier access than small ones to investable resources; they may more easily engage in collusive behavior and exclude a growing number of transactions from the market place. The BOALs represent the means by which the new Constitution and the Law on Associated Labor seek to resolve this dilemma, by atomizing the economy’s enterprises into small decision making units.

1.49 By greatly increasing the number of independent and separately accountable entities, the roles of the market and of competitive forces potentially have been much expanded. At the same time, the transparency of transactions and the lending among BOALs are expected to reduce opportunities for monopolistic behavior and the accrual of pure economic rent. Furthermore, the ability of BOALs to enter into joint ventures, sharing risk and income, in the long run could result in a de facto "market" for investable resources that would more closely reflect opportunity costs of investable funds. To overcome the diseconomies of scale that are likely to occur with such an atomization of the economy, the Constitution recognizes a number of alternative forms of integration. Enterprises consisting now of a number of BOALs linked through a contractual relationship are expected to remain the most important economic organization. The autonomy of BOALs is safeguarded, however, by the right of BOALs to join or separate and by the requirement that all major enterprise decisions be approved by all constituent BOALs. Analogous to the association of BOALs in enterprises, enterprises are also expected to "integrate" horizontally or vertically. The emphasis is expected to be on vertical integration based on interindustry linkages between enterprises. It is hoped that the atomistic units which form the foundation of the economy can be brought together on the basis of economic principles, such as vertical linkages and economies of scale, in order to create a more efficient economic structure than one based on historical factors.
Two additional features of the Constitution also have implications for resource allocation. The creation of the COAL addresses some of the handicaps the individual sector has faced; it is designed to provide greater parity in the opportunities available to that sector. The new Self-management Community of Interest, by acting as a forum for consumers and producers to confront one another, is expected to provide more objective assessments of the revealed preference of consumers and of the costs of producers. In effect, the Communities of Interest substitute both for the self-regulating mechanism of the market and for the regulating or administering agencies of the State.

Prices and Incomes. The new Constitution, through the institution of Social Compacts on prices and incomes is likely to ease the task of stabilizing the economy by reducing the burden on monetary policy. A Social Compact on prices which reflects a political consensus against inflation can act as an instrument helping to curb the inflationary spiral. A Social Compact on incomes can ensure that the growth of personal incomes is in line with growth in productivity and provide a mechanism for regulating the distribution of resources between personal incomes and capital accumulation. Social Compacts are only one of a number of features of the new Constitution that are likely to strengthen the operation of monetary policy. In general, the need for selective credit policies will be reduced, and greater enterprise accountability will prevent uncontrolled build-up of involuntary credits.

Employment. Social Compacts and Self-Management Agreements have also helped Yugoslavia to adopt a broad employment strategy. Social Compacts have been regulating such diverse areas as growth of social sector employment, development of small-scale industry, and encouragement of growth in the individual sector. The object of these compacts with regard to employment is to ensure (i) conscious regulation of the growth of employment opportunities in the social sector and of the labor-intensive activities that are being developed as agricultural alternatives, and (ii) an explicit recognition of the potential trade-off between maximizing growth in worker productivity and growth in employment.

Regional Policy. Regional policy has not been directly changed by the new Constitution. The Federal Fund and the budget, through a process of financial transfers, remain the basic instruments for accelerating the development of the lesser developed republics. In contrast to the past, however, under the new planning system Social Compacts provide a way of supplementing pure financial transfers with other policies. These may include joint ventures involving enterprises in developed republics and those in lesser developed republics, relocation of industry and/or labor, and special measures to encourage specific types of industrial growth such as labor-intensive activities. The new framework offers considerable potential for innovative policies, though at present it is difficult to assess how far these will be realized.

Foreign Trade. The new Constitution has introduced significant changes in the field of foreign trade, but, again, the effect of the changes is difficult to interpret. The new law contains two major innovations: a
new principle for allocating foreign exchange, and new institutions for making these allocations and for monitoring balance of payments developments. 1/ Previously, foreign exchange was allocated according to a system of retention quotas which were linked to an enterprise's ability to earn foreign exchange and according to the depreciation allowances on the enterprise's equipment. The allocative procedure was biased against enterprises that provided the inputs for commodities that were exported, because the retention quotas applied only to the direct exporters. To harmonize foreign exchange requirements with the new Constitution's philosophy that workers should have greater influence over questions that affect their interests, the new law abolishes the old retention quotas system and substitutes contractual agreements among enterprises on how to share the pool of foreign exchange. The guiding principle of these agreements is that foreign exchange resources should be shared on the basis of each enterprise's contribution towards earning foreign exchange. In effect, the scheme amounts to distributing foreign exchange on the basis of value added by an enterprise, either directly to exports or indirectly by providing inputs to the exports of other enterprises. This scheme may provide an equitable means of distribution, but it fails to distribute foreign exchange to enterprises on the basis of their need for foreign exchange and on the basis of the most productive use of foreign exchange. Enterprises are permitted to share their foreign exchange, but no secondary market for foreign exchange is foreseen. Consequently, under conditions of scarcity, the procedures adopted may not in themselves, lead to an efficient distribution of foreign exchange resources.

1.55 Linked to the new procedure for distributing foreign exchange is the establishment of Communities of Interest for Economic Relations Abroad. These Communities will be established in each republic and they will include all users and earners of foreign exchange. The basic function of these Communities is to determine the distribution of foreign exchange among republics, and subsequently its distribution within republics -- that is, among enterprises. Annual balance of payments projections, by republic, with targeted surpluses and deficits will form the basis for distributing foreign exchange among republics and also the basis for extending rights for republics to borrow and lend foreign exchange among themselves. Distribution within republics is decided subsequently through a process of negotiation among enterprises. The precise mechanism for operating this scheme is unclear, as is its relationship to the principle of allocation according to contribution.

1.56 It is hoped that the Communities of Interest, acting as forums for distributing foreign exchange, will induce enterprises to be more conscious of the foreign exchange implications of their activities and thus foster a better distribution of foreign exchange. In addition, the process of annual balance of payments forecasting and the linkage of borrowing rights to forecasted foreign exchange requirements are expected to provide greater control over the balance of payments. In particular, it is hoped that a more coordinated and planned approach towards foreign borrowing will develop. Clearly,

1/ Most of these changes are embodied in the Law on Foreign Exchange Operations and Credit Relations with Abroad (March 1977).
there will be much to learn when the system is actually put into operation; the precise mechanism that will be used to determine interenterprise allocations of foreign exchange has not yet evolved, and the practical implication of involving the republics in balance of payments decisions remains to be seen.
II. MEDIUM-TERM PROSPECTS: THE FIVE-YEAR PLAN, 1976-80

2.1 The growing integration of Yugoslavia into the world economy has inevitably exposed the country to the fortunes of Yugoslavia's principal trading partners. The stop-go policies of the past decade reflect the growing interdependency between the country's domestic growth objectives and the constraints imposed by the balance of payments. This growing vulnerability has been precipitated by two factors: the growing importance of foreign trade in the economy and a number of structural changes that have characterized the evolution of the balance of payments in recent years. The most important of these structural changes have been the growing orientation of trade towards market economies, particularly those in Western Europe; the increasing reliance on workers' remittances as a principal source of additional foreign exchange; and the prominence of intermediate and capital goods in Yugoslavia's imports.

2.2 Unlike its imports, Yugoslavia's export structure is diversified both in terms of commodity composition and market orientation, and this has been an important factor in moderating, and at times shielding the economy from, the influence of external events. This can be clearly seen, for example, in the way Yugoslavia has been able to shift the direction of its trade between its Western European partners on one hand and Eastern European partners on the other. Despite this built-in flexibility, the Yugoslav economy over the years has become increasingly more vulnerable to external events.

Recent Developments

2.3 Table 1 compares for recent years certain elements in Yugoslavia's balance of payments situation and in its economy. The link between its balance of payments situation and the overall growth rate of its economy can be clearly seen. For years prior to 1972, Yugoslavia's current account deficit had increased, and international reserves were low and declining; at the same time, GNP growth rates were relatively high. In 1972 and 1973, the current account deficit was reversed, but there was a perceptible decline in the growth rate of the economy. In 1974, the combined effects of rapid economic growth in Yugoslavia at a time when the Western industrialized nations were going through a recessionary period and of the four-fold increase in oil prices led to a dramatic return of the current account deficit, which continued through 1975. The adoption of strong controls led to deceleration in the growth rate of the economy and, in 1976, to a somewhat unexpected surplus in the current account. This surplus, however, was achieved by depleting stocks of imported commodities and by restricting economic expansion to what is, by Yugoslav standards, a very modest rate. It is to be expected that the current account deficit will recur as the economy's momentum is restored and as stocks are replenished.
### Table 1: SELECTED BALANCE OF PAYMENTS AND GROWTH DEVELOPMENTS, 1970-76
(Millions of US dollars unless otherwise noted)

<table>
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<tbody>
<tr>
<td></td>
<td>Change in:</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Trade deficit</td>
<td>-1195</td>
<td>-1439</td>
<td>-990</td>
<td>-1658</td>
<td>-3737</td>
<td>-3625</td>
<td>-2489</td>
</tr>
<tr>
<td></td>
<td>Workers' remittances</td>
<td>440</td>
<td>652</td>
<td>889</td>
<td>1301</td>
<td>1511</td>
<td>1575</td>
<td>1728</td>
</tr>
<tr>
<td></td>
<td>Current account deficit</td>
<td>-340</td>
<td>-358</td>
<td>418</td>
<td>464</td>
<td>-1184</td>
<td>-1032</td>
<td>150</td>
</tr>
<tr>
<td></td>
<td>Official reserves as percentage of imports</td>
<td>4</td>
<td>6</td>
<td>19</td>
<td>26</td>
<td>14</td>
<td>10</td>
<td>24</td>
</tr>
<tr>
<td></td>
<td>Real GNP growth (percent)</td>
<td>6</td>
<td>8</td>
<td>4</td>
<td>5</td>
<td>9</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>Change in producer prices (percent)</td>
<td>9</td>
<td>15</td>
<td>11</td>
<td>13</td>
<td>29</td>
<td>22</td>
<td>6</td>
</tr>
</tbody>
</table>


2.4 The external events of 1973 and 1974 obviously had a sudden and significant impact on Yugoslavia's current economic situation. Their importance extends beyond their short-term cyclical impact on the economy, however; they have also had a significant impact on Yugoslavia's medium-term outlook. The legacy of the events of 1973 and 1974 are most apparent in two areas. The first, and the most obvious, is the balance of payments. The sharp increase in the price of oil has permanently boosted the country's import bill by US$600 million; this was an addition of nearly 8 percent to commodity imports in 1974. More importantly, the external recession that followed sharply reversed prospects for migration by Yugoslav workers, and this has inhibited the growth of an important source of foreign exchange—workers' remittances. Between 1970 and 1973, workers' remittances grew by nearly 44 percent a year, accounting for 22 percent of Yugoslavia's total current foreign exchange earnings in 1973. In contrast, merchandise exports grew by 19 percent during this period. Between 1973 and 1976, workers' remittances grew by only 10 percent, a decline that is even more significant if the higher international rate of inflation in the period after 1973 is taken into consideration. The growth rate in merchandise exports did not change. This slackening rate of foreign exchange earning, along with the oil-inflated import bill, has made the balance of payments a potentially more binding constraint on economic growth, a factor that has significant implications for Yugoslavia's medium-term development prospects.

2.5 The second area that will be affected by the decline in external migration is employment. Table 2 summarizes the employment status and sectoral structure of the labor force in recent years. Between 1969 and 1973, the number of workers absorbed by external migration increased by more than 500 thousand, nearly twice the national increase in the labor force and almost
equal to the increase in social sector employment during the period. Hence, external migration was a key factor allowing the low-productivity, private agricultural labor force to decline rapidly in size. After 1973, however, the situation was dramatically reversed. External migration virtually ceased and large numbers of workers returned to Yugoslavia. For the first time since the mid-1960s, the resident labor force began to increase. The net reflux of workers between 1973 and 1975 equaled the natural increase in the labor force. This put considerable pressure on the social sector to create additional employment opportunities, but despite a rapid growth in social sector employment, there were sharp declines in migration out of the agricultural sector and perceptible increases in open unemployment.

Table 2: EMPLOYMENT BY MAJOR SECTOR, 1969, 1973, and 1975
(Thousands)

<table>
<thead>
<tr>
<th>Employment Status and Sector</th>
<th>1969</th>
<th>1973</th>
<th>1975</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actively employed</td>
<td>8,579</td>
<td>8,801</td>
<td>8,823</td>
</tr>
<tr>
<td>Residents</td>
<td>8,007</td>
<td>7,701</td>
<td>7,923</td>
</tr>
<tr>
<td>Social sector</td>
<td>3,622</td>
<td>4,222</td>
<td>4,667</td>
</tr>
<tr>
<td>Private agriculture</td>
<td>4,095</td>
<td>3,145</td>
<td>2,897</td>
</tr>
<tr>
<td>Other private employment</td>
<td>290</td>
<td>334</td>
<td>359</td>
</tr>
<tr>
<td>Temporary migrants working abroad</td>
<td>572</td>
<td>1,100</td>
<td>900</td>
</tr>
<tr>
<td>Unemployed</td>
<td>198</td>
<td>229</td>
<td>324</td>
</tr>
<tr>
<td>Total labor force</td>
<td>8,777</td>
<td>9,030</td>
<td>9,147</td>
</tr>
</tbody>
</table>

Sources: Statistical Yearbook of Yugoslavia and World Bank Estimates.

2.6 The present study is concerned with analyzing Yugoslavia's medium-term prospects, taking into consideration the implications of the 1973/74 events. In addition, a portion of the study will focus on the long-range problem of regional disparities in Yugoslavia. Although this issue was not directly affected by the recent events, it does represent one of the critical and, at the same time, least tractable issues facing Yugoslavia.

The Balance of Payments and Economic Growth

2.7 Yugoslavia's potential for maintaining a rapid rate of economic growth hinges on the country's ability to mobilize significant external resources. But the country faces a sharply higher import bill, a problem compounded by a perceived erosion of the economy's long-term foreign exchange earning capacity. The Yugoslavs could have responded to these conditions in one of two ways or a combination of both. First, they could have initiated policies, such as an export promotion drive, designed to increase the country's foreign exchange earning capacity in order to compensate for the deteriorating prospects for workers' remittances. Second, they could have attempted to
reduce their future foreign exchange requirements by lessening the country’s dependency on imports; that is, by import substitution policies.1/

2.8 The present Five-Year Plan opted primarily for the import substitution approach. This is apparent in the Plan’s overall export and import targets. The growth rate of exports, though somewhat higher than the historical rate, is nevertheless broadly consistent with past experience; the growth rate of imports is considerably below the historical rate. The projected 4.5 percent growth rate in imports, coupled with a 7.0 percent growth in GNP, would imply an import elasticity of 0.64 percent—about one-third below the historic level. Such a sharp reduction in import elasticity would imply a considerable degree of import substitution. Because 90 percent of Yugoslavia’s imports consist of intermediate and capital goods, any significant amount of import substitution would require considerable restructuring of the economy. The analysis in this study confirms that the industries given priority in the Five-Year Plan are those in which output has tended to lag mainly as a result of growing import dependency. The Plan’s strategy, then, is to develop import substitutes in those sectors that were most directly affected by growing import dependency since 1965.

2.9 The economic justification for the specific strategy chosen by the Yugoslavs cannot be readily assessed. Such an assessment would require detailed project data on the various investments proposed and an evaluation of Yugoslavia’s comparative advantage in these areas. In particular, it would be necessary to compare the cost of saving foreign exchange by developing import substitutes with that of earning additional foreign exchange by promoting exports. This is beyond the scope of this study, and such an assessment has not been undertaken.

2.10 On strictly a priori grounds, however, the strategy underlying the plan cannot be faulted. It is true that insofar as the priority sectors tend to be amongst the more capital-intensive the plan’s emphasis may jeopardize the attainment of the country’s employment objective. On the other hand, while there is no direct evidence to suggest that the slower growth of domestic intermediate and capital goods industries since 1965 was due to inappropriate pricing policies, there is evidence that commercial policy discriminated against many of these industries. Tariffs during the period favored finished goods, providing them high effective rates of protection. In contrast, there were low nominal and effective tariffs on raw and intermediate goods. This is likely to have contributed to the shift in the pattern of resource allocation away from sectors producing raw and intermediate goods and toward those producing consumer goods. Emphasis on import substitution, as opposed to export promotion, is a more prudent strategy given the uncertainties surrounding the future prospects of the world economy. Analysis indicates that

1/ Import dependency is measured by the ratio of imports to gross output.
Yugoslav exports in recent years have been concentrated in markets and products that have been relatively slow growing. Although Yugoslavia has a very diversified export structure, its products are subject to intense competition under present fairly weak market conditions. Import substitution offers a more certain path to external economic balance and one that makes the domestic economy less vulnerable to future externally induced oscillations.

2.11 This study's assessment of the new Five-Year Plan takes a somewhat different, if more modest, tack. Because detailed sector or industry data were not available, the analysis is conducted at an aggregative level using a two-alternative macroeconomic models. The analysis attempts to determine: (1) the internal consistency of the Plan, (2) the extent and plausibility of the import substitution assumption implicit in the plan, and (3) the implications for the overall objective of the plan if the implied degree of import substitution were not realized.

(i) Internal Consistency and Structural Change

2.12 The present study uses a static input-output model, which also was the basis of the Yugoslav planning exercise, to analyze the overall internal consistency of the plan. The estimates derived by the model indicate that, based on the gross output targets, the Five-Year Plan appears to overestimate the growth of aggregate final demand. In other words, if inter-industry relations are taken into consideration, the targeted growth in output and imports will not be sufficient to achieve the targeted growth of consumption, investment, and exports. The target growth rate for at least one of the components of final demand will have to be sacrificed. This would imply, for example, that consumption would grow less than is expected, if the investment, export, and import rates are maintained; conversely, the level of imports must be higher than expected, if the other targets are to be achieved. Assuming the adjustment factor would be imports, the implicit growth rate of imports would be 6.0 percent rather than the 4.5 percent rate the Plan calls for.

2.13 The input-output model of the economy was used similarly to assess the extent and character of import substitution implicit in the Plan. Based on historic trends, an independent estimate of sectoral and industry final demand was made using the Plan-estimated aggregate growth of consumption and investment. This estimated vector of final demand was then contrasted with the Plan vector of gross outputs. Imports were treated as a residual in order to ensure consistency between the estimated final demand vector and the Plan vector of gross outputs. By deriving imports residually in this fashion, the Plan's implicit sectoral and industrial shifts in import ratios can be analyzed. The results confirm that the Plan implies a significant sectoral restructuring of imports. The share of the output of priority sectors in their respective domestic markets will have to increase considerably during this period. At the same time, the growth in nonpriority activities, preponderantly consumer goods industries is considerably below the projected growth of consumption. Consequently, there will be a greater dependency on imported consumer goods, if the present patterns of demand are to be sustained.
2.14 What emerges from the analysis is a significant restructuring of imports, with import dependency increasing in some sectors and sharply declining in others. The decline in some industries is particularly noticeable; in chemicals, for example, import dependency would be reduced 60-70 percent and in ferrous metallurgy, 40-50 percent compared with a decline of about 20 percent in other priority sector import ratios. 1/ Although determining the feasibility of such declines in import ratios would require a detailed project-by-project analysis, which cannot be undertaken here, such large reductions do raise a number of questions. The new system of planning based on forward contracting may provide an effective vehicle for ensuring that increased domestic production is, in fact, used to substitute for imports. Even with this assurance, however, the costs of such a significant reduction of imports may be high for several reasons:

1. Providing domestic intermediate goods of a quality and specification comparable to those imported may be physically impossible in the short run and difficult in the medium run, particularly in view of the wide array of intermediate goods that would be involved.

2. In certain sectors, import substitution may be difficult in the short run because of existing contractual or licensing arrangements between domestic and foreign companies.

3. The fall in import ratios implied by this analysis represents the net substitution of domestic production for imports; if the indirect import content of domestic production is taken into consideration, a considerably greater amount of gross import substitution must take place.

4. The trade gap projected by this study's input-output model is somewhat higher than the Plan specifies for 1980. Using the Plan target growth rates for consumption, investment, and exports and deriving imports residually, the estimate of import requirements is about 10 percent higher than the Plan specifies. Thus, the actual import reduction foreseen in the Plan must be even larger than these figures indicate. This lower rate of import growth does not appear to be consistent with the overall Plan targets; it could only be realized by reducing other components of domestic final demand.

(ii) Domestic and Foreign Exchange Requirements

2.15 The static input-output model, though useful as a consistency check on some of the overall Plan targets, provides little insight into a number of the more important issues involved in the growth process. The analysis, by its nature, serves only to compare the characteristics of an economy at two points in time. Although it does provide a basis for judging the consistency

1/ These changes in export dependency are shown by industry in Table 5, Chapter VII of Part III.
of the system between those specific points in time, it does not provide a means of determining whether the economy can attain the level and structure of output projected for the terminal year. Specifically, the input-output model does not provide a means of assessing whether the Plan targets can be financed from either domestic or foreign resources.

2.16 A two-gap model was used to analyze the domestic and foreign financing implications of the Plan, as well as the links between the two sources. The model was first used to simulate the evolution of the economy, using assumptions close to those used in the Plan (see Table 3). Then, by adjusting certain Plan assumptions—notably, those concerning the import elasticity and the overall growth rate—the Plan scenario is contrasted with alternate possibilities.

2.17 Plan Scenario. Though the growth prospects for workers' remittances play a crucial role in the overall development of Yugoslavia's balance of payments, the Plan does not provide an estimate of their likely level. The number of Yugoslav workers employed abroad has been, and is likely to remain, severely curtailed. Since 1974, large numbers of workers have returned to Yugoslavia; although the rate of their return is expected to subside, the trend is expected to continue. The effect on workers' remittances is complex and difficult to assess. The rise in incomes in host countries will offset to some extent the reduced number of workers abroad, and in addition, returning workers are likely to repatriate the reportedly large savings they now hold in host countries. The hypothesis used in this study is that, on balance, these offsetting effects are likely to cancel each other out so that remittances will remain constant in nominal terms. Since 1973, there has been a tendency for remittances to decline in real terms; thus, a constant nominal level for the Plan period seems a reasonable working assumption.

2.18 The simulations revealed a number of interesting results. The first was based on the Plan's macroeconomic parameters, which are summarized in Table 3. This simulation indicated that the foreign exchange requirements to finance the Plan would be considerable. The assumption regarding workers' remittances, combined with assumed growth in commodity and non-factor service exports of 8.0 percent, produces an overall growth requirement in foreign exchange earnings of 6.0 percent between 1976 and 1980. The trade gap and the current account deficit will rise throughout the period, calling for a significant inflow of foreign exchange on the capital account. Even allowing for the likely inflow of foreign exchange through suppliers' credits and credits from official sources, there will still be a gap that would have to be filled through financial credits obtained in the international capital markets. These are by their nature less certain and more volatile than other sources, particularly in the wake of the heavy borrowing by developing countries in the international capital markets in recent years. Assuming, however, that it will be possible to borrow the additional capital required, the economy's debt service ratio should not increase significantly. This is mainly because export earnings are projected to rise rapidly, particularly so if the effects of the expected rate of international inflation during the period are taken into account.

1/ A similar model was used in World Bank, Yugoslavia, Development with Decentralization (Baltimore: John Hopkins University Press, 1975).
Furthermore, the financing requirements for financial credits, net of annual repayment of principle, will not be that large. Thus, on balance, the external financing of the Plan is likely to be feasible.

Table 3: PLAN ASSUMPTIONS
(Percentages unless otherwise noted)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real Growth Rates</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gross Domestic Product (GDP)</td>
<td>6.6</td>
<td>7.0</td>
<td>7.2</td>
</tr>
<tr>
<td>Investment</td>
<td>5.3</td>
<td>7.2</td>
<td>8.4</td>
</tr>
<tr>
<td>Consumption</td>
<td>4.9</td>
<td>6.4</td>
<td>6.3</td>
</tr>
<tr>
<td>Imports /1</td>
<td>5.2</td>
<td>4.5</td>
<td>7.2</td>
</tr>
<tr>
<td>Exports /1</td>
<td>4.8</td>
<td>7.8</td>
<td>8.6</td>
</tr>
<tr>
<td><strong>Value of</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incremental capital-output ratio</td>
<td>4.2</td>
<td>4.2</td>
<td>4.2</td>
</tr>
<tr>
<td>Import Elasticity /2</td>
<td>1.0</td>
<td>0.6</td>
<td>1.0</td>
</tr>
<tr>
<td>Marginal Saving Rate</td>
<td>24.0</td>
<td>21.0</td>
<td>34.0</td>
</tr>
<tr>
<td>Investment/GDP</td>
<td>29.8</td>
<td>29.2</td>
<td>30.6</td>
</tr>
<tr>
<td>Domestic Saving/GDP</td>
<td>24.0</td>
<td>24.9</td>
<td>27.6</td>
</tr>
<tr>
<td>National Saving/GDP</td>
<td>27.6</td>
<td>27.1</td>
<td>28.4</td>
</tr>
</tbody>
</table>

/1 Includes goods and nonfactor services.
/2 Based on three-year averages.

Source: Federal Institute of Planning and World Bank estimates.

2.19 The availability of domestic resources also is not expected to constrain the growth targets of the Plan. Historically, the incremental capital-output ratio, though volatile, has averaged around 4.0. Even allowing for a somewhat more capital-intensive development under the current Plan, the incremental capital-output ratio is not expected to exceed 4.2. The new institutional changes, by avoiding duplication and waste due to inadequate plan preparation and coordination, are likely to have a positive effect on the efficiency of resource allocation. A growth trend of gross domestic product (GDP) of 7.0 percent, using an incremental capital-output of 4.2, would call for an investment share of about 29.5 percent of GDP. 1/ One of the consequences of the investment boom of 1974 was to increase the share of total investment in GDP to 30.2 percent in 1975, compared to an average of 29.8 percent for the period 1971 to 1975. Thus, the investment requirements of the Plan period

\[ ICOR = \frac{\Delta K}{\Delta Y} = \frac{I}{Yo} = \frac{I}{Yo} \frac{Y_t - Y_0}{Yo} = (\text{Investment Share}) \times (\text{inverse of growth of GDP}). \]

Where: ICOR = incremental capital-output ratio
K = capital stock
Y\text{\textsuperscript{i}} = GDP in period i
I\text{\textsuperscript{i}} = investment
would not call for any change in the present investment ratio. The average savings rates required during the Plan period to sustain the investment rate would be 24 to 25 percent for domestic savings and 26 to 27 percent for national savings; both are in line with recent experience and appear to be attainable.

2.20 Although, the external and domestic financing requirements of the Plan appear to be attainable, the Plan is based on what appears to be a rather optimistic assumption about the economy's ability to reduce its import requirements during the Plan period. The structural changes in the economy that would be required in order to achieve this goal are quite large. A reduction in import dependency as drastic as the Plan foresees appears difficult to achieve within a Five-Year Period without sacrifices in the overall growth and efficiency of the economy. Because of these reservations about the Plan's import assumption, additional simulations were undertaken in order to analyze the consequences of adjusting the economy's import requirements upwards.

2.21 Alternate Scenarios. This set of simulations concentrates on the import elasticity parameter. It is still assumed that over the period as a whole Yugoslavia will be able to reduce its import dependency, albeit at a somewhat slower pace than the Plan envisions. The import elasticity initially used in these scenarios is 0.85, which is still considerably below Yugoslavia's best past performance and is very low by international standards. It is assumed that import elasticity increases to 1.0 after 1980; this elasticity is in line with its historical value. Table 4 summarizes key elements in the balance of payments using this revised import elasticity and alternate growth assumptions.

Table 4: BALANCE OF PAYMENTS RESULTS--ALTERNATE SCENARIOS
(Millions of US dollars)

<table>
<thead>
<tr>
<th>Item</th>
<th>1980</th>
<th>1985</th>
</tr>
</thead>
<tbody>
<tr>
<td>Resource gap</td>
<td>A</td>
<td>B</td>
</tr>
<tr>
<td>Balance on current account</td>
<td>-2,470</td>
<td>-2,940</td>
</tr>
<tr>
<td>Total medium- and long-term disbursements on capital account</td>
<td>-1,260</td>
<td>-1,780</td>
</tr>
<tr>
<td>Financial credits</td>
<td>3,410</td>
<td>3,750</td>
</tr>
<tr>
<td>Debt service ratio</td>
<td>960</td>
<td>1,550</td>
</tr>
<tr>
<td></td>
<td>16.3</td>
<td>17.3</td>
</tr>
</tbody>
</table>


2.22 The first of these scenarios (A) adjusts the growth rate of the economy downward to 5.5 percent for the period 1976 to 1980. If all other assumptions remain unchanged, the balance of payments situation in 1980 would be fairly close to that of the Plan scenario. However, in contrast to the Plan scenario, the balance of payments situation improves considerably in the ensuing plan period (1980 to 1985) due to the somewhat lower growth rate of
6.0 percent during this period (import elasticity of 1.0) as compared to the Plan's long-term growth target of 7.0 percent. If the average growth rate of the economy is increased to 6.0 percent for the period 1976 to 1980 (Scenario B), the balance of payments situation deteriorates rapidly in both periods, and a sharp rise in external financing is required.

2.23 In short, if the Plan assumption about the economy's reduced import dependency is changed and a higher and more plausible level of imports is assumed, the overall growth rate must be reduced if the external financing requirements of the economy are not to exceed the external borrowing parameters established by the Yugoslavs in their Plan. An average growth rate of around 5.5 percent for the period 1976 to 1980, rising to 6.0 percent in the 1980s, would appear to be the upper limit achievable within this external borrowing parameter. The somewhat lower growth rate during the next decade seems quite plausible, and perhaps even acceptable, while the economy adjusts to the poor growth prospects for workers' remittances and the higher oil import bill. The difference between the Plan's growth target and these projections is fairly modest, and the economy would continue to grow at a very respectable 5 to 6 percent a year.

Labor Force and Employment Prospects

2.24 Providing adequate employment opportunities has been, and remains, one of the principle issues facing the Yugoslav economy. Despite the rapid diminution of the agricultural labor force over the past decade, one-third of the active labor force continues to work in the agricultural sector. The extent of underemployment in the agricultural sector cannot be accurately assessed, but it is clear that a large portion of the agricultural labor force is engaged in low-productivity activities and that the average income in this sector is less than half the average in the social sector. In addition to the problem of underemployment, there has been a tendency for registered unemployment to rise rapidly in recent years. With external migration no longer providing a vent for surplus labor but rather contributing to the supply of workers to be absorbed, a crucial question in Yugoslavia will be the extent to which the social sector can generate sufficient employment opportunities.

(1) Labor Supply

2.25 Yugoslavia's total population growth rate is expected to decline gradually between 1976 and 1980, although there will still be considerable differences among republic's in population growth. The projected labor force growth rate is slightly lower than the population growth rate between 1976 and 1980, but it falls quite dramatically in the 1980 to 1985 period. This sharp decline principally reflects the growing proportion of the population that is expected in the marginal age groups, which have lower activity rates. The regional differences in the growth of the labor force are even more pronounced than in population growth; labor force growth rates vary from 3.3 percent a year in Kosovo to -0.2 percent in Serbia between 1975 and 1980, and from 3.4 to -0.6 percent, respectively, for the 1980 to 1985 period. Hence, inter-regional differences will be sharpened and labor surplus regions will have the fastest natural rate of increase in the labor force.
2.26 In addition to the natural increase in the labor force, the Plan foresees two additional sources of demand for employment: a return of 250 thousand migrant workers, and a targeted reduction in registered unemployment of 136 thousand. If these two factors are added to the demographic increase and if it is assumed that returning migrants go back to their regions of origin and that the reduction in unemployment in each republic is proportional to its present share in total unemployment, the increase required in social sector employment is considerably greater. Table 5 brings together these elements and compares the projected growth rates of job seekers with the actual growth rate of employment experienced during the last plan period. The figures indicate that opportunities for a continued decline in the agricultural labor force are likely to be limited in all the lesser developed republics, particularly in Kosovo and Bosnia-Herzegovina. In all republics other than Kosovo, there are some prospects for reducing the agricultural labor force, but in Kosovo it is likely to continue to grow, even with fairly optimistic assumptions about the growth in social sector employment and interrepublic migration.

Table 5: ABSORPTION OF RETURNING MIGRANT WORKERS AND REDUCED UNEMPLOYMENT, 1976-80

<table>
<thead>
<tr>
<th>Region</th>
<th>Actual growth in social sector employment 1971-1975 (percent)</th>
<th>Job seekers 1976-80 (thousands)</th>
<th>Required annual growth rate in social sector employment (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Return- Reduced Un- Reduced Un- Demo-</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>ing migrants employed migrants employed graphic Total</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less developed regions:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bosnia-Herzegovina</td>
<td>5.5</td>
<td>54</td>
<td>1.5 0.6 2.8 4.9</td>
</tr>
<tr>
<td>Montenegro</td>
<td>5.3</td>
<td>3</td>
<td>0.6 0.8 2.6 4.0</td>
</tr>
<tr>
<td>Macedonia</td>
<td>5.3</td>
<td>21</td>
<td>1.2 1.3 2.6 5.1</td>
</tr>
<tr>
<td>Kosovo</td>
<td>6.7</td>
<td>9</td>
<td>1.3 1.4 6.7 9.4</td>
</tr>
<tr>
<td>Developed regions:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Croatia</td>
<td>3.7</td>
<td>82</td>
<td>1.4 0.3 0.8 2.5</td>
</tr>
<tr>
<td>Slovenia</td>
<td>4.4</td>
<td>19</td>
<td>0.6 0.1 0.3 1.0</td>
</tr>
<tr>
<td>Serbia Proper</td>
<td>4.0</td>
<td>43</td>
<td>0.7 0.7 -0.2 1.2</td>
</tr>
<tr>
<td>Vojvodina</td>
<td>3.5</td>
<td>19</td>
<td>0.8 0.6 1.0 2.4</td>
</tr>
<tr>
<td>Total</td>
<td>4.4</td>
<td>250</td>
<td>1.1 0.6 1.2 2.9</td>
</tr>
</tbody>
</table>

(ii) The Employment Outlook

2.27 The Plan foresees a growth in employment of 3.5 percent over the 1976 to 1980 period. Comparing the experience during the past decade and allowing for the more rapid growth in output that is expected during the Plan, a growth rate of 3.5 percent appears to be somewhat on the low side. Using sectoral employment-output elasticities and allowing for the shift in the structure of production during the period, growth of 4.4 percent in employment might be expected if the Plan’s target GDP growth rates are achieved. Two points should be noted, however. First, the capital cost per job created during the Plan period is expected to rise quite sharply; for example, the direct capital-labor ratios within the priority branches of industry are twice the industry average. Second, if the Plan is revised downward by cutting back the nonpriority sectors, the impact on employment could be quite sharp, because the nonpriority sectors are considerably more labor-intensive than the priority sectors. Because a lower growth rate than the Plan foresees may be necessary if the degree of import substitution in the Plan cannot be achieved, a 3.5 percent growth in employment would appear to be reasonable.

2.28 Although the social sector employment growth rate appears to be attainable, the planned growth rate of private nonagricultural employment appears somewhat optimistic. A growth of employment of 5.1 percent during the 1980 to 1985 period would imply an employment-output elasticity of approximately 1.0, which is considerably higher than the historical rate. An increase in the growth rate of private non-agricultural employment is likely to occur as a result of the new institutional arrangements and the growing reflux of migrant workers. In the past two years, however, the returning migrants have already saturated work opportunities in a number of sectors, notably catering and road haulage. The new institutional arrangements should encourage private investment in new productive sectors, although the novelty of many of these arrangements is likely to mitigate against any sudden and large increase in employment in these sectors.

2.29 Table 6 brings together the various elements of the labor supply and demand. The labor supply indicates the number of additional job seekers that would have to be provided with work in order to attain the objectives made explicit in the Plan. Labor absorption indicates the number of additional jobs expected to be available based on the Plan assumption about growth in social sector employment and a somewhat lower (4.0 percent) growth assumption for the private nonagricultural sector. The difference between the labor supply and the job supply indicates that some reduction of the agricultural labor force would be possible. The projected 2.0 percent annual decline in the agricultural labor force would be considerably below the 6.0 decline experienced between 1970 and 1975, however. At this lesser rate, income differentials between the two sectors, though diminishing, would do so only marginally. For the whole period, a growth rate of social sector employment in excess of 2.4 percent would result in an excess demand for labor and ease a gradual reduction in the agricultural labor force; a growth rate below 2.4 percent would result either in an increase in agricultural employment or an increase in open unemployment.
Table 6: LABOR FORCE BALANCES 1976-80
(Thousands of workers unless otherwise noted)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total labor supply</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labor force</td>
<td>9,147</td>
<td>9,424</td>
<td>277</td>
</tr>
<tr>
<td>Migrants</td>
<td>780</td>
<td>530</td>
<td>250</td>
</tr>
<tr>
<td>Unemployment</td>
<td>540</td>
<td>400</td>
<td>140</td>
</tr>
<tr>
<td><strong>Total labor absorption</strong></td>
<td></td>
<td></td>
<td>954</td>
</tr>
<tr>
<td>Social sector</td>
<td>4,667</td>
<td>5,543</td>
<td>876</td>
</tr>
<tr>
<td>Private non-agriculture</td>
<td>359</td>
<td>438</td>
<td>78</td>
</tr>
<tr>
<td><strong>Excess labor demand</strong></td>
<td></td>
<td></td>
<td>287</td>
</tr>
<tr>
<td>Reduction in agricultural labor force (annual percentage)</td>
<td></td>
<td></td>
<td>2.0</td>
</tr>
</tbody>
</table>


Reducing Regional Disparities

2.30 Regional disparities are likely to persist in Yugoslavia for the coming decade. Increasingly, they are articulated among Yugoslavs and reflected in official documents. The Long-Term Development Plan lists reducing these differences as a national priority, and the Five-Year Plan for 1976-80 has as one of its explicit objectives a higher than the national average rate of growth in the less developed regions. It also recognizes that addressing the problem would require a more comprehensive approach than is presently being taken.

2.31 Previous regional policies supported the less developed republics by transferring to them large amounts of financial resources. In addition, the less developed republics, themselves, were dedicated to their own economic and social development. These policies produced structural change through industrial growth and established physical and social infrastructure. As a result, they achieved significant progress in terms of GMP growth and social welfare. In spite of this impressive progress and an overall income distribution pattern which is favorable by international comparison, major regional disparities persist; the most developed region, Slovenia, has a per capita GMP that is six times that of the least developed region, Kosovo. 1/ These differences

1/ This reflects the extreme of the regional income disparities indicators, however. The per capita income differential derived from the household survey data gives a ratio of 3.5:1 for Slovenia and Kosovo, respectively.
largely arise from the fact that, compared to developed regions, the less developed regions have: (1) higher population growth rates and a larger labor force absorption problem as a result of previous population dynamics; (2) a higher incidence of intraregional disparities, because a large proportion of the population is dependent upon private agriculture, which lags significantly behind the social sector in average productivity and personal incomes; (3) greater concentrations of industry in branches with higher capital-output and capital-labor ratios and lower profitability; and (4) more institutional weaknesses—shortages of managerial skills and technical knowhow—and infrastructure deficiencies.

(i) Prospects for Interregional Migration

2.32 The past population dynamics in the less developed republics have resulted in a labor force absorption problem of major dimensions; conversely, labor shortages are being experienced in some developed republics. This inequality in labor force availability, as well as the opportunities for employment abroad which existed in the past decade, has led to some inter-regional migration; for example, one-fourth Slovenia's present labor force is non-Slovene. The long-term plan for Yugoslavia stresses the need for family planning in some parts of the country, as well as the need to step up internal migration. Nevertheless, prospects for large-scale inter-regional migration—significantly above previous levels—and the pursuit of a more vigorous migration policy are still likely to be limited. In the shorter run, the constraint will be set by the pressures in the developed republics to provide employment for their own surplus agricultural labor force and their temporary migrant workers returning from abroad. In the longer term, there are a number of limitations on interregional migration, including: (1) sensitive nationalities balances, which are an important feature of the socio-political heritage of Yugoslavia, (2) in cases of non-permanent migration, the personal and social hardships connected with temporary separation of families; (3) in cases of permanent migration, the additional material and social costs of settling workers and their families in new localities; and most significantly, (4) the most mobile workers in the less developed republics are likely to be the young and the better educated and trained, whose migration could lead to a major drain of human resources that merely intensifies the institutional weaknesses of the less developed regions. Because of these limitations, supplementing the transfer of financial resources with transfers of technical knowhow is crucial to redressing regional disparities.

(ii) Policies to Redress Regional Differences

2.33 New legislation provides for a somewhat larger flow of financial resources from developed to less developed republics through the two federal mechanisms—The Federal Fund for the Accelerated Development of the Less Developed Republics and Kosovo, and budgetary grants. The Federal Fund mechanism is financed by obligatory loans from social sector enterprises, amounting to almost 2 percent of their CMP. The Fund provides concessionary loans—with a grant element of about 40 to 50 percent—to lesser developed republics to supplement their investment potential in economic activities.
Grants from the federal budget, amounting to another 1 percent of GMP, contribute significantly to republic and communal budgets to support social services in the poorer areas.

2.34 These transfers entail considerable benefits to less developed republics and sacrifices to developed ones. Resources from the Federal Fund would for the present Plan period account for about 20 percent of total economic investment in less developed regions—about 75 percent for Kosovo—and together with budgetary grants, amount to about 10 percent of their GMP. The developed republics contribute—on a gross basis—about 3 percent of their GMP to these transfers; this is an even larger sacrifice—about 10 percent—of their economic investment potential, which represents future GMP foregone.

2.35 Financial transfers are of crucial importance, but as the sole means for enhancing the development of less developed economies, they have limitations. Yugoslavia recognizes that the growing complexity of the lesser developed economies requires technical and managerial knowhow as well as financial support. A new Federal Fund provision allows for one-fifth of required contributions by social sector enterprises to be transferred to the lesser developed republics in the form of joint ventures. This is an important, though still limited, attempt to share technical and managerial expertise among the republics. The Social Compacts and Self-Management Agreement provisions of the 1974 Constitution and the new system laws have a similar orientation. These agreements emphasize (1) the vertical and horizontal integration of production units (BOALs or enterprises), both inter- and intraregionally, especially for national priority sectors, and (2) various forms of joint venture arrangements based on risk and income sharing among enterprises.

2.36 The effects of these measures, though expected to be positive, are difficult to assess for the present Plan period. Transferring technical and managerial knowhow is invariably more difficult and time consuming than transferring financial resources. Furthermore, the more capital-intensive priority activities, such as energy and basic metallurgy, are located in the less developed republics; efforts to realize growth targets in these areas could act to reinforce the existing unfavorable industrial structure and to dilute somewhat the less developed republics' own efforts to diversify.

(iii) Issues for the Eighties

2.37 Historically, Yugoslavia has inherited much diversity, and its regional disparities, are a complex problem that requires a comprehensive approach for its resolution. Three important, though increasingly interrelated, challenges in the field of regional development are likely to remain with Yugoslavia in the eighties: reducing regional income disparities generating productive employment and reorienting regional industrial structure.

2.38 The Reduction of Income Disparities. Although the Five-Year Plan envisages a higher GMP growth rate for the less developed regions than the national average, if the higher rate of population growth is sustained in those regions, it would dilute the impact, the growth differential might have on per capita incomes (see Table 7). Thus the reduction of the average
interregional income disparity may be: from 69 to 72 percent of the national average for Bosnia-Herzegovina, Montenegro, and Macedonia and only from 33 to 34 percent for Kosovo. With existing transfer mechanisms, this modest improvement is still feasible even if the overall GMP growth rate is somewhat lower than planned and is more nearly that which this analysis indicates. Maintaining sufficiently high overall and regional growth rates is, nonetheless, crucial if the necessarily widening absolute income differential is to be made more bearable for lesser developed regions and if the sacrifices the resource transfers entail are to be made more palatable for the developed regions. The rapid growth of social sector employment and the policies for intraregional development are necessary to improve, or at least prevent any deterioration of, the intra-sectoral/intra-regional income inequalities that exist in all regions of Yugoslavia, but with higher incidence in the less developed republics. The continuing extension and improvement of the coverage of social security and social services for the rural population should also act to improve the social welfare of these people.

2.39 Kosovo constitutes a special case among the less developed regions and receives special attention under the national plan. The provisions for Kosovo, like those affecting all less developed regions, are centered on transferring a larger-than-proportionate volume of domestic financial resources and providing preferential access to foreign borrowing and certain imports. Because institutional weaknesses in Kosovo are very pronounced, however, a special package of technical, managerial, and infrastructure policies and provisions should be designed in order to increase the likelihood that this expected large inflow of financial resources will be used efficiently.

Table 7: REGIONAL GROWTH TARGETS: FIVE-YEAR PLAN 1976-80

<table>
<thead>
<tr>
<th>Region</th>
<th>1975 Population Growth Rate</th>
<th>1975 GMP per capita (percent of Yugoslav average)</th>
<th>1976-80 GMP per capita (percent of Yugoslav average)</th>
<th>1980 GMP per capita (percent of Yugoslav average)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less developed regions</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bosnia-Herzegovina</td>
<td>1.3</td>
<td>69</td>
<td>8.2</td>
<td>64</td>
</tr>
<tr>
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<td>8.3</td>
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<td>69</td>
<td>8.0</td>
<td>71</td>
</tr>
<tr>
<td>Kosovo</td>
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<td>33</td>
<td>9.5</td>
<td>34</td>
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<tr>
<td>Developed regions</td>
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<tr>
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<td>124</td>
<td>6.5</td>
<td>124</td>
</tr>
<tr>
<td>Slovenia</td>
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<td>201</td>
<td>6.1</td>
<td>195</td>
</tr>
<tr>
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<td>92</td>
<td>7.0</td>
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<tr>
<td>Yugoslavia</td>
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<td>100</td>
<td>6.9</td>
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</table>

Creating Productive Employment Opportunities: Yugoslavia’s overall employment outlook discussed earlier is no indication of the rate at which employment opportunities will develop in the various republics. Detailed sectoral output projections are not available for all republics, so the effects of the structural shifts in the economy cannot be readily ascertained for each republic. For indicative purposes, however, regional growth rates in social sector production are presented in Table 8, and, from these, growth in employment is estimated on the assumption that employment-output elasticities are 50 percent higher in the less developed republics than in developed republics. The employment figures are then compared with the growth of social sector employment that would be necessary to satisfy the Plan objectives of reducing unemployment and of providing adequate employment opportunities for returning migrants and for the natural increase in the labor force.

Table 8: EMPLOYMENT GROWTH BY REPUBLIC, 1976-80

<table>
<thead>
<tr>
<th>Region</th>
<th>Growth, 1976-80</th>
<th>Employment requirement /2</th>
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</thead>
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<tr>
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<td>8.9</td>
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<td>n.a.</td>
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<tr>
<td>Vojvodina</td>
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<td>n.a.</td>
</tr>
</tbody>
</table>

n.a. = not available.

/1 Based on the assumptions that the overall employment elasticity with respect to growth in social sector value added is 0.6, and the elasticity for less developed Republics is 0.8, one third higher than for the developed Republics.

/2 Social sector employment growth necessary to absorb returning migrants and natural increase in labor force, ensure target decline in unemployment.


1/ This assumption is based on historical relationships. An analysis of these relationships may be found in Chapter V of Part III of this study.
It is apparent that the Plan's relatively high growth assumptions would allow some reduction in the agricultural labor force in most less developed republics. The only exception is Kosovo, which cannot be expected -- even under optimistic assumptions -- to absorb the increments to its labor force even if the Plan growth targets are achieved. In the case of other republics also, the employment situation may be somewhat less favorable than the table might imply. One reason is that the overall growth rate for the economy and the rates for the republics appear to be somewhat optimistic, given the planned investment outlays. Another reason is that a relatively high share of industries in the less developed republics have low labor-output ratios. The Plan's emphasis on basic industries is likely to affect adversely the employment generating capacity of these republics. Taking these factors into account, the opportunities for migration out of the agricultural sector, with the exception of Slovenia and Serbia, are likely to be fairly limited.

2.41 The Reorientation of Industrial Production Structures. In addition to the ongoing rural-to-urban shift of population and agricultural-to-industrial shift of production, the long-term development of the less developed republics and the reduction in regional disparities may well hinge upon realizing a more nearly optimal pattern of regional industrial specialization. For a variety of reasons, the present regional industrial specialization patterns contradict comparative advantage in terms of relative endowment with the various resources. The efforts of less developed regions to diversify their industrial production have also created a considerable degree of duplication and excess capacity. A more efficient use of national resources would call for corrective measures that would shift the industrial structure in developed regions towards more capital- and skill-intensive industries, leaving the more labor-intensive activities for location in the less developed regions. This fundamental adjustment of the interregional division of labor, painful and complex as it might be, would be in the long-term interest of all republics. Because of the hardships and adjustment costs to certain enterprises and regions, particularly in the context of the decentralized decision making that self-management implies, the process is not likely to proceed at any adequate pace on a voluntary basis. In some cases, structural adjustment may involve transferring an established enterprise from one republic to another or even shutting it down; in other cases, it may require reaching an interregional agreement on the location of new facilities. Because all regions would realize long-term benefits from restructuring industrial patterns, there may be a need for setting up a compensation mechanism at the federal or republic level to smooth out the adjustment costs for individual enterprises. Given the ingenuity of the Yugoslav system in terms of pragmatic adaptation to the needs and concerns of the society and of national cohesion, a serious search for a solution is timely.

Summary

2.42 The medium-term prospects of Yugoslavia inevitably are difficult to assess, given the significant changes that have recently occurred in the system of economic management. One of the principle objectives of these changes has been to strengthen the overall macroeconomic management of the economy. The
new planning system provides a novel mechanism for coordinating decision making in the allocation of resources. Similarly, the use of Social Compacts in other policy areas will induce various interest groups to consider economic issues in a broader perspective and to appreciate the tradeoffs involved in coordinating diverse objectives. The management instruments that have been adopted have many positive features and bear considerable promise. It is significant that in these changes the Yugoslavs have correctly diagnosed the shortfalls of their previous system of economic management and have adopted a set of measures consistent with meeting these deficiencies. Although other policy measures (of varying degrees of compatibility with Yugoslavia's noneconomic objectives) could be envisaged, the current measures nevertheless do provide a tenable and workable response to acknowledged problems. The application of these instruments is also likely to raise a number of important practical questions that will need to be resolved. Yugoslavia in the past has exhibited considerable flexibility and pragmatism, a feature that is likely to continue and a factor that should serve as a warning against an excessively rigid interpretation of current changes. There will undoubtedly be further changes as the new policy instruments are elaborated upon or--where necessary--modified, but on balance the economic implications of the 1974 Constitution are likely to be positive.