Yugoslavia: The Case of Self-Managing Market Socialism

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For many years the Yugoslav economic system appeared to offer a middle way between capitalism and Soviet central planning. The Yugoslavs' brand of market socialism placed reliance on markets to guide both domestic and international production and exchange, with the socialist element coming from the "social ownership" and workers' self-management of enterprises. The system seemed successful until the late 1970s. However, in recent years, many of the problems besetting other socialist economies like Poland and Hungary—like stagnation, international debt, enterprise inefficiency and inflation—have emerged to bring the whole experiment into question. These failures raise wider questions about the compatibility of socialist ownership and control with the market mechanism. I conclude that, while Yugoslav market socialism has not been proven inherently unfeasible, it contained serious flaws concerning the organization of the firm and the operation of the capital market. Reforms paralleling those elsewhere in Central and Eastern Europe are now on the agenda, but the situation has been complicated by ethnic rivalries which bring into question the survival of the Yugoslav state.

This paper will first describe how the Yugoslav economy has been distinguished from those of its socialist neighbors. The following sections will describe the economic record of Yugoslavia since the 1950s, and the lessons to be drawn from the long-standing Yugoslav experiment.

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The Yugoslav Transition, 1952–88: Market Socialism?

After a break with Stalin in 1948, the Yugoslavs began a form of central planning which was intended to ensure greater reliance on the domestic and world market and workers' control over the enterprise.¹ There were major reforms in 1952, 1965, 1974 and the mid-1980s, and a continuous stream of minor changes. I divide the pre-1988 reform process into two phases: the shift from central planning towards markets between 1952 and 1974, and then a move from markets towards bureaucracy and bargaining as the primary mode of resource allocation between 1974 and the mid-1980s. Ironically, despite having relied heavily on markets some 20 years earlier, the Yugoslavs by 1985 had an economic system rather similar to the decentralized planning of Poland and Hungary.

After World War II, the Yugoslavs under the victorious communist Partisan leader, Tito, introduced a planning system modelled closely on that of the Soviet Union. The changes began in 1952 with a reform package which, with its emphasis on replacing vertical command planning by direct horizontal relations between more autonomous enterprises through a regulated market, foreshadowed later developments in Central and Eastern Europe in many ways. Measures included price liberalization, a significant exposure to international trade on the basis of multiple exchange rates with tariffs (though the dinar was never freely convertible), and the gradual development of a commercial legal code, including rules pertaining to bankruptcy. In this first period of reform, however, the state still retained considerable control over the country's development by allocating investment funds centrally. The value of investment remained high, averaging 34 percent of gross material product (the Soviet bloc's gross indicator of national output) during the 1950s. It was financed by high taxation on enterprises, in excess of 60 percent of their net income (approximately value added) during the 1950s. Finally, the non-farm private sector was restricted to firms employing fewer than five workers (ten in some republics), and became concentrated in personal service activities such as restaurants and taxis.

The Yugoslav transition path was distinguished from later experiments by the role allocated to workers' self-management. The cardinal principle was that employees had to have a key role in the decision-making structures of their enterprises. Precise arrangements have varied from period to period, but the main instrument for employee influence has been the Workers' Council which, even in the late 1950s, was given the authority to appoint managers (from a predetermined selection list at that time); to fix internal pay structures; to determine recruitment procedures; and to allocate the enterprise surplus between wages and investment. Self-management appears to have given work-

¹There is extensive literature on the evolving Yugoslav system, to which I cannot hope to do justice. Interested readers are referred to Milenkovich (1971), Tyson (1980), Estrin (1983) and Lydall (1984).
ers and managers a real degree of effective autonomy and decision-making power absent in other socialist economies. The evidence suggests that the bulk of decisions were guided by management, with workers particularly involved over questions of welfare, employment and pay (Estrin, 1983; Lydall, 1984).

Yugoslav idealogues felt that workers' control could not be effective with ownership rights in either private or state hands, because the enterprise would then be expected to pursue the objectives of its owners. One might expect conflicts over growth as against income maximization, and over the share of profits to be retained for investment. Communist aversion to private ownership, even of a collective kind, led the 1952 reformers to "social ownership," effectively a form of non-ownership. Under this arrangement, workers in each enterprise are permitted to appropriate the surplus normally allocated to owners and to make accumulation decisions, but retain no individual or marketable rights over the assets.2

Pro-market reform was accelerated in 1965. The allocation of investment was decentralized from state investment funds to socially owned banks, controlled by their founders (enterprises or local government authorities). The banks' share of investment finance rose from 3 percent between 1960 and 1963 to more than 50 percent by 1970, while the state's share fell from 60 percent to 16 percent over the same period (Estrin, 1983). The emerging capital market was concentrated (the largest ten banks provided the vast majority of investment credits) and highly regulated; interest rates were determined centrally and typically held very low (Dmitrijevich and Macesich, 1973). The 1965 reforms also further increased the openness of the economy, liberalized prices and enhanced the decision-making authority of self-managed firms by reducing the share of taxes in enterprise net income to below 40 percent.

The second phase of Yugoslav reforms between 1974 and 1988 represented a deliberate move back from allocation by markets. In the new environment bargaining between enterprise management, local government officials and bankers, often through the offices of the League of Communists, became the centerpiece of resource allocation; political or bureaucratic interference in everyday economic decision-making was rife.3 The Communists felt that markets were taking the economy in a direction they did not want to go, with sharp trade cycles, unemployment and pay inequality. It was also argued that self-management was ineffective because managers were usurping decision-making authority. Thus, the 1974 reforms had two stated objectives: to provide political direction to the development process and to strengthen self-management. The latter was attained by breaking enterprises up into their constituent establishments or workshops, usually units within plants. Each of these "Basic Organiza-

2 Furubotn and Pejovich (1970) argue that such arrangements will lead enterprises to underinvest, because workers lose the principal invested from retained earnings since they have no individual claims over the enterprise assets.

3 The dates are not exact. Retrenchment probably began as early as 1971, and the authorities started to reform again as early as 1982, though the Enterprise Law which seems to be the decisive break was not until 1988.
tions of Associated Labor" (BOALs) had its own self-management apparatus and in law replaced the enterprise. Enterprises as previously constituted ceased to exist, though their structures often reemerged as combinations of legally separate BOALs voluntarily bound together by contract.

For economic coordination, the authorities convened consultative committees by industry and region to reach agreements on pay, investment shares in enterprise net income and development plans. The two main forms of agreement were Self-Management Agreements between BOALs, which were legally binding, and Social Compacts which included political authorities. In principle, the authorities intended to bring these various voluntary contracts together in a non-binding "indicative" plan, but as Ben-Ner and Neuberger (1990) point out, the agreements often proved to be incoherent in the sense that aggregate targets were not consistent with the sum of the individual targets. The main effect of this new institutional framework was to replace competition with collusion throughout the system.

The idea that policy should emerge through agreement by all interested parties was also intended to guide the federal political structure into the post-Tito era. Most policy-making authority was therefore devolved to the level of the republics and central economic action had to rely on assent from the six republics and two autonomous provinces. This devolution became effective after the death of Tito in 1980, when conflicts between the nationalistic politicians representing the relatively more liberal, western-oriented and developed republics in the north, and the Balkan national communist leaders who dominated the less developed south began to multiply. This greatly reduced the possibility of an effective policy response to the second oil shock of 1979 and the harsh economic environment that followed it. It also led to disintegration of markets by republic and region.

The Economic Record

The Yugoslav macroeconomy performed very well until the late 1970s on many counts, though problems were clearly building up from the mid-1960s. Growth was particularly impressive between 1952 and 1979, averaging around 6 percent per annum with per capita consumption rising by almost 4.5 percent. But the economy has been virtually stagnant since then. The collapse since 1979 has brought into dispute the durability of these previous successes, and the viability of the system itself.

Even in the heyday of fast growth, the economy had problems of domestic and international balance, though this may have been in part the consequence of inward capital flows. Exports grew fast, and to western as well as Soviet-bloc markets, but imports on average grew faster. Between 1953 and 1960, the balance of payments was in deficit to around 3 percent of gross material product, and in the 1960s, exports to hard currency areas were on average only 66 percent of imports from those areas. The current account deficit was
funded initially by grants from the United States, and later by invisible earnings, especially remittances from Yugoslav workers abroad, and loans. These latter rose sharply after 1974, and international debt reached $19 billion by 1979.

Growth effectively stopped once it became difficult to borrow after 1979. Though the authorities managed to reduce imports by deflating demand, the economy failed to restructure toward export-led growth; it is this failure to adjust which highlights the deficiencies of Yugoslav market socialism. The vacuum of economic coordination, with neither the market nor planners able to guide the economy, prevented any coherent response to the underlying changes in comparative advantage.

Inflation, which reached triple digits in 1987 and 1988 and then moved into four-digit hyperinflation during 1989, represents Yugoslavia's most visible economic failure in the 1980s. In contrast to other socialist economies, the Yugoslavs have had open inflation since the late 1950s, at a rate somewhat above the OECD average. However, financial discipline became especially lax in the late 1970s, largely because commercial banks were credit unions controlled by their debtors and central monetary policy was ineffective since banks and firms, via inter-enterprise credits, were able to create money themselves. As a consequence, the inherently inflationary pressure of a self-managed system, in which no agents within the enterprise have an interest in standing up against wage demands, got out of control. The problem had been present since 1965, but was exacerbated by the need for real wage falls post-1979 and the increased subsidization of enterprises to reduce the emergence of open unemployment.

Self-management and social ownership also meant that the Yugoslavs failed to create effective capital and labor markets. Despite a considerable degree of liberalization in other areas, markets were never very important in determining the allocation of capital in Yugoslavia. The authorities retained direct control until 1965, with distribution of investment funds based primarily on planners' preferences rather than rates of return. The move post-1965 to a banking system represented considerable decentralization of capital allocation decisions, but market criteria were still seldom dominant. The government kept interest rates extremely low (almost always negative in real terms) and the banks dealt with the ensuing shortage of funds by rationing, usually on the basis of political criteria or, after 1974, according to the pattern of personal contacts between enterprise managers, banks and the local authorities. There were therefore no forces to ensure that capital productivities were equalized across industries, republics or even local regions. Moreover, the misallocation of capital, charged for at far below market clearing rates, led capital rents to abound. Under self-management these rents were for the most part absorbed into labor incomes, exacerbating misallocation in the labor market.

Large wage differentials emerged in Yugoslavia after 1965 between sectors and firms, of a sort not normally found in market economies. For example, the ratio from highest to lowest of average pay between sectors increased from around 1.5:1 in the 1950s to more than 2.3:1 after the 1965 reform under
which firms got effective control over pay determination. This compares with a typical ratio in western Europe of around 1.6:1. Pay dispersion between firms within a sector was also remarkably high in the 1960s and 1970s, exceeding a ratio from top to bottom of 3:1 in more than 30 percent of sectors, as against perhaps 1.5:1 in the west (Estrin, 1983). Perhaps most strikingly, pay differentials for a given specific job in a particular city were very wide, for example 6.5:1 for bookkeepers in Belgrade in 1983 (Flakierski, 1989). To the extent that pay reflects the marginal product of labor, these differentials indicate an emerging labor market misallocation, of a form predicted by the labor-management literature in the absence of enterprise entry and exit (Estrin, 1983).

In practice, entry of new firms was very limited in the period of maximal reliance on the market mechanism, 1965–73, and nonexistent thereafter. The reason was that, since all new enterprises of any size had to be socially owned, no one had an incentive to create new firms except the political authorities, who concentrated their efforts on existing organizations. Under these conditions, labor-management theory suggests that, since wages and employment are determined by existing employees on the basis of conditions in the firm, the labor market flows which normally move labor between low- and high-value marginal product areas will be ineffective. Workers cannot bid entry into high paying self-managed firms, since their admission would lower the pay of existing employees.

Self-management itself does not appear to have acted as a brake on economic development in Yugoslavia during the 1950s and 1960s. To the contrary, the tendency to replace conflictual by cooperative relations may have been an element in the rapid rise of labor productivity over the period. The self-management system at its best relied on the distinction between enterprise policy-making, which was subject to employee influence, and the execution of that policy, which was the domain of management. The successful maintenance of this distinction allowed the workers to be implicated in market-oriented decision-making via the Worker's Council while providing a mechanism for management to ensure adequate discipline. The problem which emerged in this period was instead an excessive reliance by firms on the highly imperfect capital market for investment funds, because of the increasing claims by workers for distribution of enterprise profits. The underlying reason was the non-marketability of employees' rights to future income streams, implicit in the social ownership arrangements. This gave workers a bias against the investment of current profits to obtain future income from the enterprise; those with a short time horizon preferred to take their return now in the form of current wages.

The organizational changes in 1974, however, highlighted the question of enterprise efficiency under self-management. The problems were associated with declining labor productivity throughout the 1980s, low capital productivities and the absence of effective financial discipline on firms (Lydall, 1984, 1989). The reason was probably that breaking up enterprises into BOALs
transformed managers into mere functionaries, carrying out the orders of self-management organs which bore no personal or collective responsibility for poor choices. There was no way to penalize workers for incorrect decisions. Authorities guaranteed that incomes would not fall below a statutory minimum. In law, loss-making enterprises should have been reduced to this minimum but this ruling was rarely applied. Layoffs were virtually unknown and bankruptcies—the ultimate penalty in capitalist systems—were almost nonexistent.

In practice, the Yugoslavs subsidized loss-makers to maintain jobs. This was usually done at the local level by the commercial banks which were controlled by enterprises and local authorities. The scale of subsidies was therefore reflected more in balance sheets of the banks than the public sector deficit. Even in the 1970s, some 10 percent of the labor force was employed in loss-making firms; this profitability was calculated on the basis of low or zero capital costs, and the proportion has risen dramatically in the 1980s.

Conclusions

At first sight, the problems of the Yugoslav economy since 1979 would seem to echo the conclusion from analysts of Poland and Hungary that the mix of markets and socialist ownership is inefficient. But this ignores both the peculiarities of the Yugoslav situation—self-management, social ownership and the weakness of the federal as against the republican governments—and the considerable, if short-lived, successes of Yugoslav market socialism in the 1960s. It might reasonably be argued that the Yugoslavs abandoned an adequate reliance on the market mechanism and a proper balance between self-management and effective corporate governance before there was sufficient evidence as to the efficiency of the system. The only firm conclusion is therefore that the post-1974 arrangements, with lax competitive market pressures, poor financial discipline and weak managerial authority, were particularly poor at ensuring adjustment to changing world economic conditions and at countering inflation.

However, while the jury is still out as to the viability of market self-management, other lessons remain to be drawn from the Yugoslav experience. In their numerous reforms, the Yugoslavs never fully resolved two fundamental questions: the appropriate balance of managerial and employee prerogatives in the democratically-run firm, and the decentralized capital market institutions to be associated with self-managed enterprises. In the former area, they initially relied excessively and then leaned excessively against management; in the latter, they placed control over the capital market in the hands of enterprises and political authorities, arguably the worst solution. If self-management is ever again on the agenda, reformers in countries with more established economic institutions and market traditions might be in a better position to avoid these mistakes.
Between 1988 and 1991, the Yugoslavs embarked on reforms which implied abandoning their unique system and moving towards western-type capitalism, though economic questions have increasingly been overshadowed by ethnic tensions. Reform packages for most economies in transition have focused on macro-stabilization, price and trade liberalization and privatization and similar issues have been central in the Yugoslav debate. A draconian stabilization plan, paralleling that introduced in Poland, commenced in January 1990. It centered around currency convertibility, a wage and partial price freeze and restrictive fiscal and monetary targets, and was remarkably successful at reducing inflation from a monthly rate of 59 percent in December 1989 to virtually zero by the summer of 1990. Since then, the price index has been increasing again, though not to previous levels.

Reforms in Yugoslavia have the additional problem of deciding how to change the system of enterprise ownership and management. The state cannot straightforwardly sell what it does not legally own, and the enhancement of employee rights via self-management cannot necessarily be costlessly revoked. The Enterprise Law of 1988 allowed the emergence of legal alternatives to social ownership and abolished the system of BOALs, since then there has been an upsurge in the small scale private sector. However, few firms have as yet volunteered to privatize, and there is some conflict between federal proposals, which stress “internal privatization” (that is, sales of shares to current and previous workers and managers) and those of Slovenia and Croatia, which suggest renationalization of social property followed by assets' sales through stock markets.

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