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To the Graduate Council:

I am submitting herewith a dissertation written by James Larry Wolfenbarger entitled "Investment Allocations and Financing in Yugoslavia in the 1960's." I recommend that it be accepted in partial fulfillment of the requirements for the degree of Doctor of Philosophy, with a major in Economics.

George R. Feiwel, Major Professor

We have read this dissertation
and recommend its acceptance:

Accepted for the Council:

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Graduate Studies and Research

INVESTMENT ALLOCATIONS AND FINANCING IN YUGOSLAVIA IN THE 1960'S

A Dissertation

Presented for the

Doctor of Philosophy

Degree

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James Larry Wolfenbarger

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ABSTRACT

This study is an examination of the system of investment in Yugoslavia during the 1960's. The various reform measures introduced by the Yugoslav leadership during this period were analyzed in an attempt to explain the structure of investment financing and decision-making that actually emerged, and to determine the roles of the major economic units (enterprises, banks, and government) in that structure. The changes in the investment system were analyzed in order to determine their effects on the volume and pattern of investment spending. The study found that the actual organizational structure and interrelationships of the economic units in the investment process, the actual locus of investment decisions, and the effects of changes in the system on the volume and pattern of investment outlays did not fully conform to the plans of the reforms.

The focus of the study was on the post-1965 reform period. An attempt was made to determine the major reasons for the 1965 reforms. The reforms were found to have been the result of the Yugoslav leadership's response to several economic and political problems that made it almost impossible to continue centralized and directive type investment planning. In addition, there was a growing awareness on their part of the need to increase the role of the market in the investment process and to develop a greater degree of decentralized autonomy in the economy in order to achieve their basic economic objectives.

The 1965 reforms were evaluated in terms of their success in achieving the objectives set for them by the Yugoslav leadership. It was found that the reforms, although resulting in a significant decentralization of the investment process, were generally unsuccessful in implementing a structure of investment financing and decision-making necessary to further the development of self-management in the economy to the degree called for in the formal reform measures. In addition, the volume and pattern of investment spending in the initial post-reform period (1965-1969) were found to have been inconsistent with the objectives of achieving: (1) selective economic growth along lines outlined in the 1966-1970 Social Plan, and (2) greater aggregate economic stability.

In conclusion, the study found that the only major success of the reforms was the Yugoslav leadership's ability to maintain the viability of the reform movement vis-a-vis the growing economic problems and political pressures of the initial post-reform years.

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CHAPTER I

INTRODUCTION

I. SCOPE OF THE STUDY

The area of inquiry of this dissertation will be the investment process in the economy of Yugoslavia during the post-war period with emphasis on the 1960's. Changes in the organization and functions of economic units during this time period significantly altered the system of investment. The structure of investment decision-making and the methods of allocating and financing investments were noticably modified as part of an attempt to move the economy, by means of economic and constitutional reforms, toward more efficient use of resources in terms of the economic and social objectives of the planned development program. These reforms reflected a continued effort by the Yugoslav leadership to develop an economic system consistent with their objectives and increasingly based upon the organizational principle of workers' self-management. The investment process and its modifications were important elements in this reform effort.

With numerous changes being introduced during the 1960's, particularly, the much announced reforms in 1965, the exact nature of the system of investment that evolved during this period became more complex. The actual organizational structure and interrelationships of various economic units involved in the investment process, the actual locus of investment decisions, and the effects of changes in the system on the size and composition of investment outlays

apparently did not fully conform to the plans of the Yugoslav leadership. The role of the investment system under the framework of the reformed economy and specifically, the structure of investment financing and decision-making, became and remained confused to most observers of Yugoslav affairs.[1] Although some studies have been made concerning certain aspects of investment activity, there has been no attempt to explain and analyze the overall investment process and its role within the economic system.

Many specific questions have yet to be fully answered. In what ways and by whom were investment funds procured? How were investments financed? What was the role of the enterprises in the investment decision-making process? What was the nature and function of the banking system? What policy tools were used by the federal government and how did these economic levers affect investment decisions? These are but a few of many questions to which answers may, in part, provide a clearer view of the overall investment process in Yugoslavia, indicate the roles and interrelationships of economic units within this system, and reflect the nature and function of planning in the economy.

II. PURPOSE OF THE STUDY

The purpose of this dissertation is to describe and analyze the changing system of investment in Yugoslavia during the 1960's.

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[1] According to Horvat (80, p. 138), "[t]he amount of professional literature on investment financing varies in inverse proportion to the number of complaints against the state of affairs in this field" and "no serious study" of investment financing has been undertaken.

Emphasis will be placed on explaining and analyzing the decision-making structure, methods of financing investment, and the effects of changes in this decision-making structure and these methods on the size and structure of investment outlays. The focus of study will be on the investment process as it emerged after the reforms in 1965. An attempt will be made to explain the reasons for the 1965 reforms and to evaluate the success of the reform in terms of their objectives as determined by the Yugoslav leadership. The primary objective of the study is to provide a clearer understanding of the interrelated workings of the various aspects of the overall investment process and to help clearify the nature of changes in the process during the 1960's.

Specification of the organizational structure and functions of the various institutions in the investment process and analysis of the methods of allocating and financing investment will involve a survey of the banking and credit system, the planning system, pricing policies, and the income distribution system. Analysis of these elements of investment financing will help specify the role of economic units at various levels, especially the enterprise, in the investment decision-making process. In this regard, the analysis should reflect, to some degree, the nature of the economic system with respect to the role of plan and market in that system.

In a less descriptive sense, investment data will be used as supportive evidence for the analysis of the investment process and as a basis for analyzing the effect of changes in the elements of that process on the size and structure of investment outlays.

The analysis may, in part, provide answers to many questions concerning the nature and effect of the changes in the area of investment on the overall economic system and the process of development. Such a study will hopefully help fill the gaps of knowledge and understanding of the economy of Yugoslavia and specifically, those aspects concerning investment expenditures.

III. ORGANIZATION OF THE STUDY

The structure of the Yugoslav investment process as it existed in 1960 and the functions of the various economic units within that structure were the result of numerous institutional and policy changes made during the 1950's. Chapter II surveys the investment process from the centralized system of the initial post World War II period through the 1950's, during which time a decentralized system emerged.

During the 1960-1964 period new economic and constitutional reforms and policy changes were introduced which significantly altered the investment process. Chapter III reviews and analyzes these reforms and their effect on the investment process and the size and structure of investment outlays during this period. The chapter includes a survey of the economic debates during this period concerning the future direction of the Yugoslav economy, the role of the market and plan in that economy, and the need for continued investment planning and centralized control and direction intervention in the investment process. The debates that emerged and raged in increasing intensity during the 1961-1964 period and the conclusions of these debates served as the basis for the far-reaching reforms of 1965.

Chapter IV will discuss the major components of the 1965 reforms as well as other institutional and policy changes introduced during the 1966-1969 period and will analyze the impact of these changes on the investment process and the economy. In Chapter V, an attempt will be made to describe and analyze the structure of investment financing and decision-making that actually emerged during the 1965-1969 period and to discuss the actual roles of the major economic units (enterprises, banks, and government) in that structure. In addition, there will be a discussion of the effects of the reforms and policy changes on the volume and structure of investment during the period.

The conclusions of the study will be presented in Chapter VI. The purpose of this chapter is to give an overall view of the reasons for the 1965 reforms of the system of investment and to evaluate the success of the reforms in achieving the objectives set for them by the Yugoslav leadership.

CHAPTER II

THE INVESTMENT PROCESS IN POST-WAR YUGOSLAVIA, 1945-1960

I. INTRODUCTION

This chapter will present a survey of the major institutions of the Yugoslav economy from the initial post-World War II years until 1960. During this span of time two phases with distinctly different economic systems were apparent. These two phases were: (1) the period of the immediate post-war year, 1945, until 1952 that was characterized by a Soviet type command system, (2) the period 1953-1960, during which time a more decentralized system was introduced and gradually implemented and refined.

A brief survey of the economy in general and, more specifically, a description and analysis of those institutions and policies that determined and influenced the investment process, that is, investment decisions, allocations, and financing, and the effect of these institutions and policies on the size and structure of investment expenditures during each of the two phases will be presented. The purpose of this review is to provide the background necessary to discuss the nature of the investment process that existed in 1960 and to provide a basis from which the analysis of the following chapters may benefit.

II. THE COMMAND ECONOMY

After World War II the new government in Yugoslavia, faced with a need to reconstruct the war devastated economy and a desire

to organize the country along socialist principles, restructured the economy after the pattern of the Soviet command system. The essential institutions for centralized planning of economic activity and a hierarchial structure to implement the plans through direct commands were systematically organized and gradually introduced from 1945 to 1947. The Soviet model and techniques were deemed by the Yugoslav leadership to be best suited to meet the major economic goal of rapid economic growth through industrialization and the major non-economic goal of achieving socialism with a new social order by means of state power (113, p. 407). Thus, the decision was made to achieve these goals by the adoption of the familiar "Soviet blueprint" (80, p. 75).

This blueprint included the acceptance of the institutions of state ownership; central planning; administratively allocated goods and resources; state budgetary controls; collectivized agriculture; a high degree of forced saving and investment; centrally determined operating rules for enterprises concerning production, financial arrangements and prices.

The first Five-Year Plan was initialed in 1947. Under this and less aggregated annual plans the entire economic activity of Yugoslavia was spelled out and the economy run as a "single mammoth enterprise," (80, p. 88). Even more detailed and rigid quarterly plans were also introduced (113, p. 410).

Planning commissions organized on federal, republic, district, and communal levels prepared comprehensive plans for their respective territory. Operational planning and implementation were handled by government ministries and orders passed down through the hierarchial

structure from the federation to the commune and finally reaching the planning sections of the enterprises (80, p. 87). These organizational arrangements allowed the Federal Planning Commission to coordinate all economic planning in the country (140, p. 188).

The operations of each enterprise were strictly detailed by the planning system. Output volumes and mixes were set as were material inputs. Wages were set within defined ranges. Production prices were determined on the basis of planned current costs of production plus a set profit. Current production was financed by credits according to a credit plan which narrowed the scope of the production plans. Investment decisions and financing of investment projects were almost completely centralized under the planning system (113, p. 411).

Other economic institutions were introduced to help implement plans and control the investment and production efforts of enterprises. The banking system served as a fiscal agent for the federal government. Its major functions, as in the Soviet system, were to assure coordination of the budget or financial plan and the physical plans, to provide budgetary grants to finance investments, and to finance the government's foreign trade activity. Another familiar Soviet device, the turnover tax, was used to adjust prices in an effort to change supply and demand conditions in certain markets, in particular the consumer goods market, in order to clear these markets of surpluses and help avoid shortages.

Policy in the agriculture sector also followed the Soviet model. After the War an agrarian reform was initiated which gave large amounts of land to the peasantry. About one half of this land was acquired,

without compensation, from big landowners with most going to cooperatives and state farms (80, p. 73) and the rest held as small private plots.

From 1948 to 1952 attempts were made to force farm families into Soviet type collectives with compulsory deliveries and fixed prices. These efforts have been deemed a "resounding failure, economically and politically" (103, p. 168).

Under the command system, the Ministry of Foreign Trade and its agencies carried out all foreign trade transactions. The economic plans provided for separate total values of exports and imports coordinated with production and investment plans for the economy. Exports and imports were assigned to individual enterprises with agricultural products handled through centralized collection centers (113, p. 414).

Investment planning and methods of allocating and financing investments played a crucial role in the post-war command economy of Yugoslavia. In the following sections an analysis of the investment process will reveal its nature and functions as well as the role it played in the development policies of the command system.

Development Policy and Investment

Through its network of hierarchically organized planning agencies at the various levels and stages of economic activity, the command system, with its centrally determined goals and parameters, became fully operational by 1948. A major part of the central planning efforts revolved around an economic development policy that called for

rapid industrialization to generate economic growth.[1] The planning system itself was consistent with this development policy, particularly since such a system provided for "strict centralization of decisions about priorities, timing, and structural changes" (80, p. 94).

The development policy, following the Soviet strategy, relied heavily on greatly expanded investment spending with particular emphasis on heavy industries. Preference was given to investment on the assumption of the government's unlimited demand for capital and virtually unlimited "reducability" of consumption. All problems of rapid economic growth, such as production bottlenecks and shortages, were supposed solvable by increasing investment outlays (159, p. 140).

The fact that the Yugoslav leadership actually followed a policy of relatively large investment outlays is reflected by the share of total gross investment in GNP during the 1947-1952 period. This share was 28.5 percent in 1947, 31.8 percent in 1948, 33.1 percent in 1949, 32.8 percent in 1950, 30.8 percent in 1951, and 30.6 percent in 1952. The average share for the period was 31.4 percent. Productive investment[2] during the period was 23.4 percent of GNP while the share of non-productive investment was 8 percent (88, p. 2154).

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[1]The main goal of the first Five-Year Plan was "to overcome economic and technological backwardness." "[N]ational income was to increase 1.9 times, agricultural output 1.5 times, [and] industrial output 4.9 times" (80, p. 88).

[2]Productive investments are expenditures for fixed assets of work organizations excluding expenditures for fixed assets of social organizations such as schools, hospitals, and so forth, and housing. Expenditures for fixed assets of these latter organizations are called nonproductive investments.

The relatively large share of industrial investment[3] in total investment for fixed capital during the 1947-1952 period is evident from Table I. The plans to structure investment in favor of industry was apparently implemented. As indicated in Table I, the share of industrial investment in total investment grew dramatically from 34.1 percent in 1947 to 60.8 percent in 1952. Expressed as a share of total productive investment, industrial investment grew from 44.2 percent in 1947 to a significantly larger 72.8 percent in 1952 (88, p. 2160).

Other studies, although using slightly different data, reported similar results. A study in Yugoslav Survey reported that investments in industry accounted for 47.3 percent of total gross investment during the 1947-1952 period (160, p. 1761).

Another study reported an increase in industrial investment as a proportion of total gross investment from 34.7 percent in the years 1947-1949 to 49.1 percent in the years 1950-1952 (137, p. 1584). Data reported by the Organization for Economic Cooperation and Development showed the share of investments in industry and mining combined to be 56.4 percent of total gross investment in productive assets, excluding the small private sector, during the 1948-1952 period (45, p. 25.

By far the larger share of industrial investment during the period in question went to heavy industry and power production. The

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[3]The term "industry" refers to power production, mining, and all manufacturing and includes all non-agriculture primary and secondary industries.

TABLE I

TOTAL INVESTMENT[a] BY ECONOMIC SECTORS, 1947-1952

Economic Sector	Year					
	1947[b]	1948[b]	1949[b]	1950[b]	1951[b]	1952[b]
Productive Investment[c]	233	303	320	294	329	298
Industry	103	131	175	173	196	217
Agriculture	28	48	49	36	33	35
Forestry	4	12	10	4	4	3
Construction	5	11	14	12	12	7
Transportation and Communication	63	89	58	56	71	31
Trade and Catering	18	10	11	9	9	3
Crafts	2	2	3	4	4	2
Non-productive Investment[d]	79	110	140	119	93	59
Total	302	413	460	413	422	357

[a]Includes investment in social and private fixed capital, excluding working capital but including depreciation.

[b]Figures in billions of dinars at constant 1956 prices.

[c]Includes investments in fixed assets of working organizations, excluding social organizations.

[d]Includes investments in fixed assets of social organization, that is, schools, hospitals, and so forth, and housing.

Source: 88, p. 2160.

composition of total industrial investment from 1947 to 1952 is shown in Table II. A study by Rip indicated that about 80 percent of total investment in industry was absorbed by heavy industry and power production during this period (151, p. 11).

The technical structure of investment during the 1947-1952 period also reflected the direction of the development program. Outlays for all construction accounted for 61 percent of total investment while expenditures for equipment was 37 percent (88, p. 2164).

Such an expanded investment program had noticeable impact on the economy during the initial post-war period. Expanded investment spending helped stimulate economic activity. By May, 1948, industrial employment had increased 64 percent over its level in 1946 (113, p. 417). This industrial work force was supplied mainly from the agricultural sector. The composition of national income changed significantly. In 1939, industry accounted for only 26 percent of national income while agriculture accounted for 53 percent. In 1947 the share for industry and agriculture were 33 percent and 39 percent, respectively. By 1952 the share for industry had risen to 38 percent while the share for agriculture had fallen to 29 percent (88, p. 2167). Even though still highly agrarian, the Yugoslav economy was industrializing rapidly.

The growth of fixed assets, particularly productive fixed assets, under the command system was substantial. A study by Vinski, using 1946 as a base year, reported a growth index for total fixed assets of 113 in 1949 and 130 in 1953. The index for productive fixed assets in industry and mining was reported as 118 in 1949 and had risen to 144 by 1953 (184, p. 4).

TABLE II

GROSS INVESTMENT[a] IN INDUSTRY BY SECTORS,
1947-1952 COMBINED

Industrial Sector	Amount[b]	Percent
Electricity	157	16.0
Coal Mining and Processing	90	9.0
Crude Oil and Natural Gas Extraction and Processing	43	4.4
Ferrous Mining and Metallurgy	109	11.1
Non-ferrous Mining and Metallurgy	49	5.0
Metal Products Manufacturing, excluding Shipbuilding	153	15.0
Shipbuilding	32	3.3
Electrical Machinery, Apparatus, Appliances, and Supplies Manufacturing	27	2.7
Chemicals and Chemical Products Manufacturing	51	5.2
Stone Quarrying, Clay and Sand Pits, and Building Materials Industry	24	2.4
Wood Furniture and Fixtures Manufacturing	57	5.8
Paper and Paper Products Manufacturing	12	1.2
Textile Manufacturing	35	3.6
Footwear, Leather, and Leather Products Manufacturing	7	.7
Rubber Products Manufacturing	3	.3
Food and Beverage Manufacturing	40	4.1
Printing, Publishing, and Allied Industries	2	.2
Tobacco Manufacturing	4	.4
Film Industry	3	.3
Total	984	100.0

[a]Excludes private investment.

[b]Figures in billions of dinars.

Source: 88, p. 2161.

The Investment Decision

The expanded investment program of the command system and its impact on the size and structure of investment outlays and on the economy in general were the result of the decisions of a highly centralized decision making organization. As in the Soviet system, the locus of almost all investment decisions was the economic plans of the state and its agencies. This centralized framework included: (1) the general decisions concerning the rate of accumulation and basic distributive conditions, (2) the more specific decisions concerning the rate and structure of development in the economy that in turn dictated the size and composition of investments, and (3) investment decisions concerning specific projects (68, p. 113).

Although some specific investment decisions by individual enterprises were allowed under the planning system, enterprise autonomy, as in other areas, was apparently extremely limited in terms of both size and structure of investments. In addition, the limited funds retained by the enterprises for the purpose of financing investments were, it appears, strictly controlled by the central planning agencies to which the enterprises were tied in the command system.[4]

The implementation of investment decisions determined under the centralized planning structure was carried out mainly by direct commands through the various hierarchial levels in the economy under

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[4]A fuller discussion of the degree of decentralization of investment decisions appears in the following section concerning investment financing.

the supplementary guidance and control of the banking system. The banking system's strictly organized functions included the distribution of state funds for investments according to the plan and following up on the progress of specific investment projects. Coordination of all investment decisions, as well as their implementation, was assured, to a great degree, by the detailed planning process and its control devices (68, p. 114).

Investment Financing

The financing of investment under the command system of the 1947-1952 period was accomplished by a variety of methods of accumulating and distributing centralized funds earmarked for investment purposes. A review of the elements of the investment financing system indicates the highly centralized nature of the system during this period.

During the period covered by the first Five-Year Plan investments were financed mainly from Federal budget outlays without enterprise obligations to repay. Some investment expenditures were financed from the investment funds of the republics, districts, and communes that were accumulated through the taxation of enterprises. As indicated previously, enterprises had few resources available for investment purposes (88, p. 2156). The composition of investments by source of finance for the 1947-1952 period is shown in Table III. During the years 1949-1952, 72.8 percent of total investments in fixed assets were financed from the centralized funds of the Federation. The decentralized funds accounted for the remaining 27.2 percent. Of this

TABLE III

COMPOSITION OF INVESTMENT[a] BY SOURCE OF FINANCE, 1947-1952

Source of Finance	Year					
	1947[b]	1948[b]	1949[b]	1950[b]	1951[b]	1952[b]
Government Operated Funds and Budgets	100	99	99	99	98	98
Federation	72	60	66	58	50	95
Republics	23	27	20	30	41	2
Communes	5	12	13	11	7	1
Economic Organizations' Investment Funds	0	1	1	1	2	2
Total	100	100	100	100	100	100

[a]Excludes private investment.

[b]Figures in percentages based on current prices.

Source: 88, p. 2167.

share, the funds of republics accounted for 19.5 percent; the funds of districts and communes for 5.9 percent; and the enterprises the remaining 1.8 percent (66, p. 47).

The data reported clearly indicate that not all funds for investment purposes came from the centralized budget of the Federation. But this fact tends to misrepresent the actual locus of investment decisions. Although so-called decentralized funds accounted for a sizeable share of total investment outlays, the formation and use of these funds were rigidly determined and controlled by central policy makers through the planning mechanism and the central plan itself. In fact, the term "completely centralized" has been used to describe the situation during this period regarding the formation and use of investment funds (68, p. 114). Investment activities by enterprises were indirectly controlled through various deductions from their revenue in accordance with the planned income distribution scheme. In addition, the use by enterprises of their residual investment funds were strictly constrained by the plan. The degree of such constraint will become more apparent in the following review of the methods of accumulation.

The major means of investment funds accumulation during the period in question was through depreciation charges out of the gross revenue of the enterprises. Depreciation charges were but one of the major categories of gross revenue distribution which also included charges for "operating costs," "pay fund" contributions, turnover taxes, and "profit."[5] The ratios of each of these items to gross

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[5]"Operating cost" included expenditures for raw materials,

revenue were rigidly fixed by the federation (128, p. 67). Of the total depreciation deduction, 70 percent went to centralized depreciation funds while the remaining 30 percent went to the depreciation funds of the enterprises (64, p. 101). The use of these enterprise funds earmarked for depreciation were restricted, as previously indicated, by the plan (151, p. 5).

Depreciation charges were determined, after the Soviet model, on the basis of "average production cost" in the individual sectors of the economy. All enterprises producing the same good paid the same depreciation charge per unit of output. In this sense the depreciation charges were "more like tax charges" than deductions accounting for part of value used up during the production process as typically interpreted (64, p. 101). As such, they served as the major means of accumulation for funds, particularly funds of the Federation, to be used for new and replacement investment.

Under the scheme of distributing the enterprises' gross revenue, price policy was an important, though more indirect, factor affecting the absolute size of depreciation and other charges paid by the enterprises and therefore regulating the basic distribution of income

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semi-manufactured inputs, services, fuel and other materials (labor costs were excluded from operating costs). The "pay fund" contributions were the basis of workers' wages which were fixed for each occupation by the federal government. "Profit" was a residual of gross revenue and was allocated according to federal financial plans to the following uses: (1) increases in working capital, (2) fixed investment financing, (3) payments into various government budgets, and (4) payment into the enterprises' "management fund" to be used for construction of homes and cultural and social institutions for the workers as well as supplementary wage payments (128, p. 67-68).

between consumption and investment (151, p. 6). By adjusting prices, the central planners were able to raise or lower the gross revenue of individual enterprises selectively or of all enterprises in a certain sector of the economy. Since depreciation charges based on the value of each unit of output were administratively set, the central planners could adjust depreciation charges by adjusting prices. In fact, the Yugoslavs followed a policy of fixing high prices on "industrial products" during the 1947-1951 period; the indirect effect of which was to regulate the basic distribution of income between consumption and investment (151, p. 6).

Foreign expenditures in the Yugoslav economy during the post-war years was not an insignificant means of investment financing. The share of all foreign resources in total investment during the 1947-1950 period was about 13.7 percent (151, p. 10).

Results of the Command System

The economic results of following the Soviet model of industrialization, although apparently successful in the initial post-war years, had, by 1950, become disappointing. A contributing factor was the expulsion of Yugoslavia from the Cominform in 1948. By 1950 Yugoslavia had lost all of its trade and foreign investment assistance from the Cominform countries (113, p. 418). A severe drought in 1950 added to the economic woes of the country. Trade disruptions with the Cominform countries causing production bottlenecks and investments with long gestation periods helped slow output and contributed to the poor overall performance of the economy (109, pp. 70-71). These

economic woes coupled with growing political conflicts with the Soviet Union created a climate of reconsideration and review of the economic system on the part of the Yugoslav leadership.

One of the themes of economic discussions in Yugoslavia before 1952 was the search for "authentic socialism" (80, p. 75). A growing disillusionment with state ownership became apparent and the search continued for a form of economic organization more consistent with Marxian goals and means of achieving those goals. As previously noted, the goals of the Yugoslav command system, like the Soviet model, were to achieve socialism by means of state power and ownership and to achieve a new social order "for its own sake." The new emerging view was to stress social ownership and a true "withering of the state" (80, p. 80).

The Yugoslavs began to question the internal organization of the Soviet system on other grounds. The criticisms of excessive bureaucracy and centralized dominance of economic and political decisions were followed by more positive appraisals of the concept of participatory government. A new role for the plan and market was seen to include the notions of management of enterprises by workers and decentralized economic decisions (109, p. 66).

Under these economic and political conditions the stage was set for the emergence of a "purer" Yugoslav version of socialism (80, p. 75). The break from the Soviet model was begun.[6]

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[6]A more comprehensive analysis of the political, idealogical, and economic reasons for the Yugoslav break from the Soviet command model can be found in works by Milenkovitch (109) and Bombelles (16).

III. THE "NEW ECONOMIC SYSTEM"

Introduction

The enactment of the Law on Management of Government Business Enterprises and Economic Associations by Workers' Collectives in July, 1950, marked the beginning of the formal preparations for a new economic system. The law, with its revisions and additions adopted over a two year period, provided the organizational framework of the new workers' management system (16, p. 74).[7] The culmination of these preparations came with the acceptance by the Federal Assembly in 1953 of the Constitutional Law on Principles of the Social and Political System of Yugoslavia (80, p. 77).

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[7]The system of "workers' management" which defines the essential features of the Yugoslav enterprise has been briefly stated by Vanek (177, pp. xv-xvi) as follows:

> Workers associate freely to form productive or other business enterprises which they manage either directly or through representative bodies. The workers' collectivity includes professional administrators, technicians, clerical and other personnel who all enjoy equal rights within the decision-making process, each performing the tasks assigned to him in accordance with his qualifications and aptitude. New members are recruited by the collectivities when required or desired, and existing members may leave if they wish; they cannot be expelled except for a clear reason, and then only in accordance with statutory procedures.
>
> Each enterprise collectivity is fully independent in formulating its plans and policies and in the day-to-day operation of the business. It may associate with others, operate mergers, set up new enterprises or divide itself if so desired by a section of its membership. It can adopt any form of internal organization it sees fit and, more particularly, can constitute such autonomous self-governing work groups or sections as may suit its operations. It has to conform to the laws of the land but the latter must not discriminate in favour of or against any enterprise in particular.
>
> Initially the work collectivity is given such assets as are necessary for the normal operation of the firm. The initial value

Other laws, executive orders, and policy changes occurred during the transitional period 1950-1952 which clarified the revised and new institutional arrangements and which specified the responsibilities of the central planning agencies, ministries, banks, and so forth, under the new system (109, p. 82). Most important of these was the Law on Planned Management of the National Economy passed in December, 1951. Detailed central planning was replaced by planning of "basic proportions" such as the overall rate of accumulation and broad distribution of investment. Other measures were passed that led to the reduction of the "political monopoly of the state and party apparatus" (80, p. 78) and greatly increased the responsibility placed in the hands of the newly created "workers collectives."[8] These efforts reflected the desires of the Yugoslav leadership to move the country toward a form of socialism characterized by more individual freedoms and self-governing autonomy than the previous command system (80, p. 78).

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of these assets must be maintained through adequate depreciation provisions and may be subject to interest up to a maximum fixed by law. Further investments may be financed either from the collectivity's own current income or through outside loans (normally subject to interest and repayable).

The results of the firm's economic activity are disposed of freely through the market. The difference between the cost of production and the market price, if any, constitutes the firm's income which the workers' collectivity may share out among its members, directly or in the form of common services, or retain for further expansion of the business, or in the form of a reserve fund. If the firm runs into deficit and cannot secure a loan it will be wound up or reorganized and the workers' collectivity as such will cease to exist.

[8]"Workers collective" is an official Yugoslav term for the self-management body of each enterprise and includes all of the enterprises' employees and management personnel.

By late 1952 the "new economic system" (NES) was operational.[9] The basic features of the new system of "decentralized market socialism" were: (1) an economic plan, (2) the use of the market to allocate resources and production, (3) production by more autonomous enterprises, and (4) management of enterprises by the workers (109, p. 101).

The plan established basic macroeconomic proportions and "principles" of economic development (109, p. 102). "These proportions were: minimum use of output capacity and the corresponding wage fund, profits as a percentage of the wage bill (a device for wage planning), basic capital formation, taxes and allocation of budgetary resources" (80, p. 89). Decisions as to the rate of capital formation, the distribution of investment funds among economic and geographic sectors, and the size of total consumption were left to the central planners (109, p. 102). The impact of these decisions on the rate of growth and the basic allocation of output between investment and consumption allowed the central plan to influence, without detailed administrative orders concerning all aspects of the enterprises operations as under the command system, general economic activity (80, p. 89).

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[9]The NES lasted until the early 1960's. During this period the system was continuously revised as the Yugoslavs searched for a more suitable and workable social and economic structure. No attempt will be made in this study to fully analyze all the economic institutions and policies of the NES during this period. But, a brief review of the major institutions and the general scope and direction of the NES will be presented to serve as a basis for a description and analysis of the emerging investment system during this period and its effects on the size and structure of investment outlays.

In the absence of detailed central planning and administrative directives, implementation of the plan to achieve the desired objectives required the use of various economic levers not unlike those often found in market-oriented economies. The major instruments were the credit policy, fiscal policy, regulations of accounting methods of the enterprises, and certain direct controls (109, p. 102).

The main economic intentions of the Yugoslav leadership for the NEW was to inject the market into the role of determining output while maintaining a policy of rapid economic growth. In a broader sense, the Yugoslavs developed dual objectives for the NES. They continued to strive for their "vision of socialist rational development and equality" requiring rapid economic growth while stimultaneously striving to develop an organizational pattern in the economy based on workers' self-management principles (109, p. 146). The latter goal, along with the desire to inject greater efficiency into the economy, called for decentralization of economic decisions and greater enterprise autonomy. This was the basis for the decision to decentralize production decisions in the NES.[10] On the other hand, the former goal

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[10] It was not entirely clear whether the self-management organizational pattern was initially conceived by the Yugoslav leadership as an end in itself or simply a new means of striving for the economic growth objectives in light of the discontentement over Soviet techniques (109, p. 146). Bićanić (12, p. 48) reported that workers' management was first introduced as a means of encouraging fulfillment of economic plans but evolved into a "system of business management" and a "system of overall social organization" so that socialism in Yugoslavia became based on it. Whether "end" or "means," "goal" or "constraint," it became an important element in Yugoslav development policy.

was seen to call for continued rapid industrialization and economic growth which in turn were deemed to require a constraint on the degrees of decentralization in particular regarding investment decisions.[11] Thus, the continued use in the NES of a centralized investment process was due to the desire to follow a development program which was thought of as being more "dynamically efficient," that is, the achievement of higher growth rates and more rapid industrialization was more likely insured as opposed to the biases of a full market economy (109, p. 110).

The need to limit market allocations and enterprise independence under the NES was based on several factors including: (1) "a remaining skepticism" about market mechanisms, (2) "a strong belief that rational development policy required planned allocation of investment funds," and (3) "residual doubts about the 'social responsibilities' of the worker-managed enterprises" (109, p. 120). The idea that the market must be restricted with respect to capital formation through centralized controls remained a "dominant economic policy" during the 1952-1960 period (80, p. 81). Under the NES "[t]he most important restriction on the market was in the allocation of capital (109, p. 109).

Thus, even though new techniques for investment allocations were adopted, the exact degree of decentralization of investment decisions in the NEW is difficult to determine. Milenkovitch (76,

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[11]The dilemma suggested here due to the conflicting goals, one requiring (or assumed to require) economic planning and some centralized control and the other requiring little direct intervention in enterprises' economic decisions, continued to trouble the Yugoslavs throughout the years of the NES. The investment decision became the focal point of this dilemma (109, p. 146).

p. 103) concluded that the central government retained "full control and decision making power" over investment allocation. Bombelles (16, pp. 245-246) concluded that there was "no decision-making decentralization" in the NES but only more freedom allowed enterprises to carry out directives "from above." This control differed to a large extent from the control methods of the previous command system, that is, the central plan and administrative orders, and relied much more on indirect leverage of enterprises. Indirect control over investment decisions was accomplished mainly through various policies regulating the income distribution of enterprise and thereby their investment funds. This indirect control was complemented by direct decisions on investment allocations by the central government (109, p. 103). Correct interpretation of the term "full control" and more importantly, determination of the actual degree of centralized control during the years of the NES, remains in controversy. Some investigators have reported clear increases in decision making powers of enterprises in general and their expanded autonomy in decisions concerning investment outlays while others draw more guarded conclusions.[12]

Unquestionably, an important element of the NES, as reflected in previous discussions, was the area of capital formation. To the extent that investment allocation decisions and financing became

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[12]After a more detailed analysis of the methods of investment allocation, income distribution policies, and methods of financing investments in latter sections, the question over the actual degree of decentralization of decision-making power present under the NES will again be raised.

less centralized, the need for new or adapted institutions and policies was evident. A description and analysis of these various institutions and policies and their impact on the size and structure of investment outlays may help clarify the nature and role of the investment process in the NES.

Investment Financing

The system of investment financing that emerged during the years of the NES was closely tied to the framework of the planning mechanism and investment decision-making structure. Annual social plans, used to "concretize" the investment policy as outlined in the longer-term plan, provided for special investment funds. These funds included: (1) general funds for the distribution of investment resources among economic sectors, (2) special development funds, (3) agriculture funds for the improvement and promotion of cooperation between state farms and co-operative farms, (4) funds allocated for transportation uses, and (5) funds for special economic projects (130, p. 209). The administrators of investment funds were guided in their credit granting decisions by the "investment program" outlined in the annual social plans (76, p. 578).

During the period of the first Five-Year Plan under the command system, investments were, as previously noted, financed mainly from the Federal budget without repayment obligations. Enterprises had limited usuable funds at their disposal for investment purposes. In 1952, the year of transition to the NES, a fund for basic capital development was formed. Allocations from this fund were highly

centralized and, as under the budget, contained no repayment provisions. In 1953, various funds for crediting investment, with repayment obligations, were established (88, p. 2156). After 1953, a system of investment credits as a means of financing capital development was gradually introduced. In 1954, a decree on investment activity was passed that established socially (government) operated funds as the major means of financing investments. These funds included the General Investment Fund (GIF) and funds of republics and communes (88, p. 2157). In 1955, separate funds for financing housing construction and for agriculture, forestry, river basin development, road construction, and so forth, were also established (93, p. 3216). By 1957, some forty investment funds were in force at all levels of government (103, p. 123).

During 1954, methods of distributing the revenue of enterprises was also modified which resulted in an increase in the net revenue left to enterprises for financing their own investment (88, p. 2157). These investment resources of the enterprises were accumulated in "special funds" established by law.

These new financial arrangements provided three sources of funds for investment: (1) the federal investment fund (GIF), (2) the investment funds of the republics and local governments, and (3) the investment funds of the enterprises. In general, these funds were supplied by various taxes and legal income distribution payments or "contributions" levied on enterprises by all government levels,

private savings, public loans, and foreign loans and grants (103, p. 123).[13]

The investment funds system for financing investments of the NES created, in essence, a dual approach at all government levels. The newly established social investment funds provided for credit financing while non-repayable budgetary grants and special investment fund allocations for special projects continued.

The changes in the system of financing investments brought about under the NES had noticeable impact on the distribution of investment spending by source of finance during the 1953-1960 period, Table IV shows the volume and distribution of investment by source of finance for selected years during the period in question. Table V, using slightly different categories and excluding the private sector, shows the composition of investment by investor for each year during the period.

The new investment financing system led to a greater use of funds from decentralized sources as compared with the previous command system. Decentralization of investment financing with a lessening role for central government resources continue throughout the 1953-1960 period. This decentralization is evident from Table VI which shows the composition of investment in fixed assets by source of finance for three sub-periods from 1949 to 1960. Most noticeable was the increase in the use of the investment funds of enterprises. This increased use of internal financing is significant when comparing

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[13]A more in depth description and analysis of the investment funds system of the NES will appear in a later section of the study.

TABLE IV

INVESTMENT BY SOURCE OF FINANCE, 1953-1960[a]

Source of Finance	Year			
	1953[b]	1955[b]	1958[b]	1960[b]
Investment Credit Funds	2.1	1.9	2.9	4.7
Development Funds[c]	-	.1	.2	.4
Budgets	.1	.3	.3	.5
Investors' Own Resources[d]	.4	.7	1.0	1.8
Depreciation Funds[e]	.7	1.1	1.0	1.4
Private Resources[f]	.2	.3	.4	.6

[a]Based on current prices.

[b]Figures in billions of new dinars.

[c]Includes funds for the development of economic activities, exploration work, and so forth.

[d]Includes economic organizations, state organs, and institutions.

[e]Includes insurance resources for investment purposes.

[f]Includes depreciation of fixed capital in the private sector.

Source: 201, p. 801.

TABLE V

COMPOSITION OF INVESTMENT[a] BY INVESTOR, 1953-1960

Source of Finance	Year							
	1953[b]	1954[b]	1955[b]	1956[b]	1957[b]	1958[b]	1959[b]	1960[b]
Socially-operated Funds and Budgets	87	74	64	65	63	65	69	64
Federation	71	50	47	40	34	41	44	39
Republics	11	12	9	8	8	7	8	7
Communes and Districts	5	12	8	17	21	17	17	18
Economic Organizations (Enterprises)	13	26	27	29	31	30	27	31
Investment Funds	13	17	10	10	13	12	15	15
Depreciation Funds	--	9	17	19	18	18	12	16
Other Resources	--	--	9	6	6	5	4	5
Total	100	100	100	100	100	100	100	100

[a]Excludes private investment.

[b]Figures in percentages based on current prices.

Source: 88, p. 2167.

TABLE VI

PERCENTAGE COMPOSITION OF INVESTMENT
IN FIXED ASSETS BY SOURCE
OF FINANCE, 1949-1960

Source of Finance	1942-1952	1953-1956	1957-1960
Federation	72.8	46.6	38.1
Decentralized Sources	27.2	53.4	61.9
Republics	19.5	11.1	12.4
Districts and Communes	5.9	14.8	18.8
Enterprises	1.8	27.5	30.7
Total	100.0	100.0	100.0

Source: 104, p. 28.

the years 1953 and 1960. In 1953, investments financed from enterprise sources accounted for only 10.9 percent of the total. By 1960, this share had increased to 20.8 percent (133, p. 70). It should be noted that the greater use of decentralized funds during this period does not necessarily imply that a decentralization of investment decision-making also occurred.

Throughout the years of the NES foreign loans and grants, mainly from Western countries, were an important source of investment resources for the Yugoslav economy. This was particularly true during the early years of the new system, 1952-1956. The share of foreign resources in net investment during these years was: (1) 40.3 percent in 1952, (2) 52.8 percent in 1953, (3) 20.5 percent in 1954, (4) 36.9 percent in 1955, and (5) 30 percent in 1956. The average share for these years was 36.1 percent (15, p. 107). The participation of foreign resources declined relatively during the 1957-1960 period. A study by Rip has estimated the share of foreign funds in total investment for the 1956-1960 period to have been 15.7 percent (151, p. 10).

Investment Decision-Making Structure

The locus of general investment decisions in the NES concerning the rate of accumulation and basic allocations was the social plans of the Federation. The rate and structure of development and the composition of investment were present in "broad outlines" in the social plans (68, p. 113). Long-term plans (five-year plans) determined: (1) the direction of economic development, (2) the goals of "certain

fields" in some branches of the economy, and (3) the "essential lines of investment policy." Annual plans were used to dis-aggregate the long-term plans and to specify investment policy (130, p. 209). Given this general framework of decision making and the resultant basic investment funds allocations, the individual investment decisions were made by enterprises and the government (68, p. 113).

Changes made under the NES in the area of investment financing and particularly, the introduction of an investment funds system resulted in the creation of a two tier structure of investment decision-making. At the governmental level, investment decisions concerning the total volume and basic structure of investment were made by the Federation, republics, districts, and communes. Based on social utility criteria such as the rate and structure of economic development, these decisions were made under the guidance of the social plans (92, p. 249). At this level, the Federation was by far the most important decision-maker.

The investment decisions made at the governmental level were implemented and financed mainly through the use of social investment funds supplemented by the budget and specialized funds of each of the government levels. The introduction of the investment funds system at this level resulted in two important changes. One, there was a clearer separation of investment spending activity from the administrative expenditures of the state budget (13, p. 138). This became a "permanent feature" of the Yugoslav budget (80, p. 138). With the refinement of the investment funds system and the creation of the Investment Bank, decisions concerning the specific allocations

of funds among enterprises were separated from the broader sector and branch allocations decisions made by the state plan (13, p. 638).

The second major change was the decentralization of investment financing. The completion of the new financial arrangements led to an expanded role for the lower levels of government (republics, districts, and communes) in the financing process (80, p. 138). This decentralization in the financial process implied a growing role for these lower levels of government in the investment decision-making structure of the NES.

The second tier of investment decision-making was located at the enterprise level. Decisions concerning the technological variants[14] were made at this level with little or no direct centralized control. The formation of investment funds at this level also allowed the enterprises to initiate investment decisions concerning major capital projects. These latter decisions were controlled by laws and government regulations directly and indirectly influencing the size and use of the enterprise funds. This expanded role for enterprises in the NES marked another important change in contrast with the investment decision-making structure of the previous command system.

Neuberger (120, p. 214) has divided investment decisions into four basic categories or types: (1) establishment of the volume of total investment, (2) allocation of investment resources among sectors of the economy, (3) allocations among firms within each sector, and

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[14]The term "technological variants" refers to the nature of the capital project in terms of its capital and labor intensity and technical design with given techniques of production.

(4) determination of the technological variants of capital project of a firm. In Yugoslavia, during the years of the NES with its investment decisions were made by the social plans. The last decision was made, for the most part, by the enterprises. The third decision was determined by the banking system under the guidance of the social plans as reflected in the amount of social investment funds and carried out through an investment auction mechanism[15] and also by central authorities through the use of budgetary and special investment fund grants and through bank credits.

The investment decision-making structure and the investment financing system of the NES were closely intertwined. In following sections of this chapter the institutions and policies that comprised these two areas will be dealt with separately. From such analysis the nature of each separate area and the interrelationship of the two areas will be better specified.

Investment Funds System

General Investment Fund. "By far the most important source of investment credit in the period of initial decentralization was the General Investment Fund" (GIF) (76, p. 577). The funds of the GIF were directly allocated by the federal banks.[16] The banks had

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[15]The "investment auction" system of allocating investment funds will be discussed in a following section of this chapter.

[16]The federal banks were: the National Bank; Yugoslav Investment Bank; Yugoslav Agriculture Bank; and Yugoslav Foreign Trade Bank. The last three banks operated as specialized institutions for granting investment credits from the GIF (93, p. 3220).

no "self-capital" and carried out the allocations of credits from the GIF for reasons and under the directives determined and "laid down" by the Federation (93, p. 3220). The adminsitration of the GIF was solely in the hands of the Yugoslav National Bank until September, 1956, at which time these duties were absorbed by the newly established Yugsolav Investment Bank (121, p. 91).

There was a number of sources of revenue for the GIF. These sources were: (1) interest (tax) charges on the value of the fixed assets of enterprises, (2) interest on loans and credits previously extended from the GIF, (3) part of the tax collected on the income of business organizations, (4) a portion of the tax levied on "windfall profits" and ore explorations, (5) interest on the loans from other social investment funds, (6) interest on the "initial working capital" of the enterprises, (7) part of the federal income tax, (8) certain amounts from the federal "economic reserves," and (9) loans from domestic and foreign sources (154, pp. 1-2).

The general conditions for extending loans from the GIF were, as previously noted, laid down by federal regulations. Loans were granted through investment auctions and directly, under special regulations (154, p. 2).

"Investment auctions."[17] The use of "auctions" for the distribution of governmental investment funds was a novel feature of the new

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[17]The official term "investment auction" used to describe the allocation of investment funds is somewhat a misnomer. As explained in this section, it was not an auction as normally understood but was, in reality, a process by which acceptable requests for credit by the enterprises were selected to receive investment credits.

investment system of the NES. Through this device the Yugoslavs attempted to inject greater rationale and efficiency into the investment process.

The process of credit allocation through the "auction" system involved a long series of steps leading ultimately to a final investment credit grant. Initially, the bank would publish the "conditions and requirements" for the allocation of investment funds for certain purposes (130, p. 217). These public announcements included: (1) the specific purpose for which the funds would be granted, (2) the type of organization that could apply for the loan, (3) a description of the information the potential borrower must submit, (4) the criteria to be used in the selection process, (5) the proportional share of funds required of the borrower for participation in the project, (6) the maximum repayment period of the loan, (7) the date applications were due, and (8) other "special provisions" of the loan (121, p. 91).

Interested parties would then submit a "request for credit" to the bank along with certain supportive "technical and economic data" (130, p. 217). The credit request was required to contain a rate of interest offered, a period of repayment, and a statement as to the proportion of the total investment outlay to be covered by the applicants' own funds. The requests were also required to include information on the expected date of completion of the project, the profitability projected for the project, the cost of construction and the cost of production under the new project, and other supportive material. In addition, the applicants had to submit a "detailed investment program" that was to be reviewed by an "expert review commission" of the

government (121, p. 91). An outside organization had to guarantee all loan requests. The commune in which the enterprise was located was "usually the guarantor" for a loan sought by an applicant (109, p. 112).

After receiving an application for credit, the bank would first determine whether or not the applicant was "credit-worthy" under criteria specified by the State Secretary for Finances (121, p. 91). A major part of this review involved a test of solvency of the applicant. Proof of solvency was obtained through an examination of the applicants' activities, in particular, tax fulfillment and "other obligations" (130, p. 218). The bank reviewed the application to check for the inclusion of all required provisions. Then followed another review by a commission comprised of bank experts and experts from the economic sector to which the enterprise belonged or from a technical institute. This review was based on both technical and economic criteria (121, p. 92).

The final step of the "auction" proper was the decision to grant investment credit to the enterprises. Those applicants projects that were approved and that offered "the most favorable terms" were selected (121, p. 92).

The economic criteria used by the officials in the selection of investment projects for granting credit included: (1) the profitability of the project, (2) the value of the investment per unit of output, (3) the implementation time for the project, (4) the time for full credit repayment, and (5) the degree of participation (share of own funds used) in the project that was offered by the applicant (130,

pp. 220-221). The major criterion appeared to be the rate of profitability. Dynamic aspects of the proposed investment project such as the gestation period, the social effects of the project, and the effectiveness of the investment on production were not included in the selection process (66, p. 52).

The "auction" process and, in particular, the criteria used in this process for the selection of investment projects suffered from numerous weaknesses and shortcomings. Preparations of applications for credit were often time consuming and costly (66, p. 57). Usually the applicant was not qualified to "work up" an investment program and had to rely on the services of "project bureaus." Due to a shortage of these bureaus and a method of fee determination in which the bureau was paid a fixed percent of the projects total cost, there was no incentive to minimize the cost of the project (121, p. 94).

The period of time for the submission of a credit request was often too short for "fundamental studies" of the overall development program of the enterprise to be carried out as required in the application. The time period from the announcement of an auction until the deadline for the submission of applications for credit was from ten days to two months. The most frequent time period was from three to four weeks (121, p. 100).

The time factor implied by the "auction" system presented other problems. The length of time for the approval of loans varied widely with some potential investors waiting as long as two or three years for a loan approval. These situations often meant that investment programs became obsolete and funds used in preparation of credit

applications in efforts to secure loans were wastefully tied up (66, p. 54). Also, auctions were held at only certain widely spaced points in time. Often these times did not correspond to the needs for investment funds of the enterprises. In addition, the granting of credits at the same time was "likely" to create some excess demand in the investment goods market resulting in pressure on prices to rise (121, p. 100).

The announcements of investment auctions did not furnish the investors with "sufficient information" to assure their "own orientation." The productive capacity to be built in certain sectors, the size of available investment funds, and the ultimate aims of the auction were not clearly spelled out (66, p. 53). The combinations of criteria to be used in the selection process and explanations concerning how they were to be used were not made clear. There seemed to be "a certain amount" of discretion involved in decisions of investment credit granting. To the degree that such discretion was involved, there was, in essence, a return to the administrative allocations approach of the command system (121, p. 94). Concerning this point, the selection process for granting investment credit was apparently always "greatly influenced by political considerations" (80, p. 40). Territorial bias was strongly present and often these local interests prevailed in the selection process (111, p. 18). The use of these and other non-economic criteria often resulted in "political investments" without regard for allocative efficiency (154, p. 3).[18]

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[18]Indicative of the degree of politically oriented decisions was the use by some enterprises of "old party members with connections

The results of attempting to inject economic criteria into the selection process often met with failure. In particular, the use of interest rates as a criterion for granting credit was ineffective in curtailing wasteful investment spending and thus did little to increase allocative efficiency. Under conditions of limited investment funds that most often prevailed in the economy, the enterprises' goal was frequently to get investment credit at any cost. Often enterprises in the "most difficult financial situations offered highest interest rates" (159, p. 152).

Perhaps the most critical shortcoming of the auction system was the absence of certain important sectors from the auctions. Those sectors excluded included: (1) heavy industry and mining (except coal), (2) light industry (except food), (3) electrical energy, (4) oil, (5) gas, (6) railway and air transportation, and (7) all "non-productive" activities (120, p. 202). In fact, Neuberger (120, p. 192) estimated that the proportion of total net investment allocated by the auction system ranged between 10 and 35 percent and was likely closer to the lower end of the range.

These previously discussed matters raised serious questions concerning the exact workings of the investment auction system. In light of the numerous weaknesses and shortcomings of the auction process and specifically to the extent that the use and coverage of the auctions were limited, the increased efficiency of the system of

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in the Investment Bank." Their duty was to help obtain loans for the enterprise they represented through these "connections" in a manner not unlike the Russian "tolkachi" (16, p. 84).

financing investment under the NES over the administrative allocations under the command system was, it seems, substantially less in reality than was apparent in the formal arrangements and designs. In fact, it appeared that the practice of administrative grants from budgetary and social investment fund sources continued to a great extent in the NES. In addition, although separate social investment funds were set up, decisions concerning the allocations of the fund were, it seems, often centrally determined and often without substantial use of economic criteria. But, the introduction of repayable credits in the allocation process was one factor of the new financial arrangements of the NES that did imply greater rationale compared to the command system.

Special and decentralized government funds. The assets of the social investment funds at the republic, district, and communal levels were managed by the three federal specialized banks in conformity with the plans and directives of the socio-political community concerned. Sources of revenue for these decentralized funds included: (1) interest (tax) charges on fixed and working capital of enterprises, (2) interest on credits extended from the funds, (3) profit taxes on municipal organizations and enterprises, (4) land taxes, (5) other social investment funds, in particular the GIF, and (6) income tax receipts from agriculture production. The banks allocated these funds through specially regulated methods and through "auctions" as explained in the previous section (154, p. 2).

The social investment funds at all governmental levels along with the special investment funds, that is, funds for housing,

construction, and the development of certain economic and geographic areas, comprised the total of governmental funds for investment purposes. These funds and the budgets of the various governmental levels comprised the total government investment resources of the financial system of the NES. The only other source of investment resources in the overall investment funds system was the funds of the enterprises (130, p. 215).[19]

Enterprise Investment Activity

With the introduction of the self-management principle under the NES the role of the enterprise in the investment process of the economy was expanded. Specifically, the establishment of enterprise investment funds as part of the overall investment funds system created conditions for an increased role for enterprises in the investment process.

Institutional arrangements influencing and constraining the investment decisions of enterprises lay in three main areas: (1) laws governing the self-management rights of the enterprise and its director, (2) regulations concerning the acquisition, use, and disposal of capital goods by the enterprise, and (3) laws and regulations concerning the distribution of the revenue of the enterprise (62, p. 335). In essence, these three areas influenced the investment decision of enterprises in two general ways. To a degree they determined what,

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[19]An analysis of enterprise funds as part of the overall investment funds system involves a broader discussion of enterprise investment activity. This discussion appears in the following section.

when and how capital goods were to be acquired. They also affected the ability of the enterprise to invest by partially determining the volume of investment funds left for enterprise use. The following discussion attempts to specify the form of these influences and the nature of their impact on the investment decision of the enterprises in the NES.

The director (chief executive officer) of an enterprise was directly responsible to both the workers collective of the enterprise and to the local government. Under these arrangements the director was required to "formulate policy consistent with the states basic objectives and, at the same time, be able to persuade the collective concerning the wisdom of his ideas on policy" (62, pp. 335-336). In this manner the enterprise decisions on investments were clearly linked to those of the economic plans.

The Law on the Management of Fixed Capital by Enterprises passed by the Federal Assembly in December, 1953, gave "quasi-private property" rights to individual enterprises. The right to produce, buy and/or sell capital goods were subject to only two basic constraints. An enterprise was required to maintain the value of its assets. An enterprise selling an asset for less than its "book value" was required to subtract the difference from its profits and add this amount to funds earmarked for investment. In addition, the enterprise was required to pay an interest charge on the book value of its capital (62, p. 337) as part of its tax obligation to the government for the use of "social property."

Other important constraints on the investment activity of the enterprises under the new funds system were the laws and regulations concerning the distribution of enterprise gross revenue. This distribution necessarily helped determine the size of funds left with the enterprise for investment purposes and therefore critically affected, irregardless of other constraints, the investment ability of the enterprise.

During the transitional years of the NES, that is, 1952 and 1953, the distribution of income continued, as under the command system, to be administratively set based on ratios assigned by the state. During this period the role of the enterprise in the distribution decision was not increased (128, p. 68). With the enactment of the Law on Distribution of Total Revenue of Enterprises on December 24, 1953, (133, p. 30), the role of the enterprise in the income distribution process and thus in the investment process was significantly increased in accordance with the designs of the NES.

The new system of distributing the gross revenue of enterprises was based on a concept of net profit. The scheme of the new distribution system involved five major deductions from gross revenue to derive gross profits. These deductions were: (1) operating costs, (2) depreciation charges, (3) contributions to the "community" and other contributions, (4) the turnover tax, and (5) workers' gross salaries (128, pp. 68-69).

Depreciation was determined on the basis of set rates applied to the original cost or assessed value of enterprise fixed assets (64, p. 102). Depreciation rates were determined selectively for

individual groups of assets (128, p. 69). The depreciation charges flowed into a fund which remained at the enterprise level. This fund was to be used only for the "reconstruction and replacement" of current assets (134, p. 7). But, "in practice," this fund was also used for new investments (128, p. 69).

Payments required out of gross profits included: (1) a federal profits tax, (2) certain "statutory obligations," (3) additional wage salaries of the enterprise employees, (4) payments to social investment funds, (5) contributions to various governmental budgets, (6) funds left for the "free disposal" of the enterprise, and (7) residual payments to the federal budget and social investments fund (GIF) (128, p. 69). Enterprise investment funds were formed from the part of profits left for free disposal (128, p. 72).

The fact that the share of funds for free disposal and therefore the share of investment funds out of the enterprise's gross profit were apparently pre-determined seemed to reflect a degree of rigidity in the new distribution scheme not unlike that of the command system. But, greater flexibility, that is, a lessening of centralized control, was seemingly assured by two main factors. First, there was some degree of market determined prices in the NES that influenced the gross revenue of the enterprise. Second, certain payments out of gross revenue, especially workers' wages, were not rigidly set by fixed ratios which implied that gross profit was not entirely pre-determined. These factors do not indicate the lack of any influence from the governmental levels on the investment ability of the enterprise but do seem to reflect a lessening of direct, rigid, control that was

characteristic of the command system. This form of decentralization continued in later years of the NES.

In April, 1957, the Law on Distribution of Total Revenue of Commercial Enterprises was enacted which contained certain major revisions in the system of income distribution of enterprises (133, p. 30). The new system was based on a concept of net income instead of profit. Net income for an enterprise was derived by making various deductions from gross revenue. These payments out of gross revenue included: (1) operating costs, (2) depreciation on fixed assets, (3) contributions to the community and other "required" contributions, (4) the turnover tax, (5) repayment of enterprise investment loans, and (6) contributions to the "reserve fund" and certain other funds.

Net income was distributed to three major areas: (1) allocations to the social investment funds, (2) gross personal incomes, and (3) the "enterprise funds."

Distribution of the general enterprise fund included payments to a fixed capital fund, a working capital fund, a reserve fund, and a welfare fund (128, pp. 73-75). The main purpose of the working capital fund was to finance "regular expenditures' of production but, it was also used to help expand the enterprises' funds for internal expansion (133, p. 99). In later years the working capital funds and fixed capital fund were combined into a single "business fund." Contributions to the social investment funds were based on progressive rates fixed by the State. "[S]ome economic activities" were authorized to contribute an equal amount into their own investment fund (128, p. 75).

Restrictions on the use of depreciation funds of enterprises were also modified in 1957 to allow these funds to be used for repayment of investment loans. In 1959, "all restrictions regarding the use of depreciation funds were abolished" (134, p. 7).

One additional factor had some influence on the volume of investment funds left to the enterprises for their own use. Since all prices were not allowed to be determined by market forces, the price policy of the government over those prices that remained centrally controlled had an important influence on the gross revenue of some enterprises. There was some evidence that prices were used by the state to affect the volume of social investment funds through the revenue of enterprises which were an important source of revenue for these funds (159, p. 145; 134, p. 9). To the extent that prices were adjusted for this purpose they necessarily had some impact on the investment funds of the enterprises.

These then were the major institutional arrangements and policies of the NES affecting the ability of enterprises to participate in the investment process. The degree of this participation, although increased over the level of participation in the command system, was limited in terms of the volume of investment funds the enterprises could accumulate and the restrictions placed on the use of these funds. In this regard, a study by Bićanić (13, p. 637) estimated the share of enterprise income going to funds for self-financing of investments during this period to have been about 13 percent. Some lessening of control over both of these two factors during the later years of the NES seemed to increase the investment role of the enterprise in the Yugoslav economy.

Government Controls Over Investment

The NES, with its new decentralized system of allocating and financing investments through the use of investment funds, accumulated and distributed at various governmental levels and at the enterprise level, forced the state to devise certain control mechanisms to assure the proper implementation of social plans. During the period of the NES a "host of new measures" as passed intended to remove some "discrepancies in the functioning of the system" due to decentralized sources of finance and decision-making that departed from the volume and directions of investment as set forth by the social plans (88, p. 2157).

In general, planned objectives were achieved through centrally determined credit policy, fiscal policy, income distribution policy, and certain direct controls (109, p. 102). As previously discussed, the credit policy of the government relied heavily on the system of social investment funds and most importanly on the GIF to implement the planned rate and structure of the future development of the economy. This system was supplemented by a procedure for granting short-term credits intended to help maintain the desired proportions between production and consumption in general (92, p. 253). Fiscal policy, through the turnover tax and other taxes levied on the revenue of the enterprise, was used to counteract inflationary pressures in the economy and, more importantly, to achieve a desired distribution of income (109, p. 104). These fiscal measures indirectly affected not only the investment funds of the enterprise but, also the size of the social investment funds at various governmental levels (92, p. 253).

Various direct control devices were used to help insure the desired implementation of the social plans. Most noticeably, price controls were used to control the general price level and to influence the price structure of the economy. The effect of price adjustments on the investment activity of the enterprises has been previously noted. Also, direct allocations of investment funds for certain projects, subsidies, and tax rebates were often used as a means of direct intervention by the state into the investment process (109, pp. 108-109).

Problems with the investment system and its control in accordance with social plans were evident throughout the years of the NES. Due to the opposition of certain interests, both among the various levels of government and between the state and the enterprises, and conditions of insufficient investment funds, the planned objectives were often not obtained (67, p. 11). The divergence of planners' goals and decisions made by decentralized units, due to the use of the market mechanism in a system where planners' preferences were to dominate, was a major problem of the NES (120, p. 216). This problem was no greater anywhere than in the area of investment. The plan and the system of allocating and financing investment were not entirely compatible. The result was the emergence of certain differences between the social investment plans and the actual formulation of investment decisions by the enterprises. This resulted, in turn, in a climate of insecurity and uncertainty for planning by the enterprises which became a point of "greatest confusion in the area of investments" (67, p. 18). Under these conditions of uncertainty a policy by the

enterprises of investment at all cost became apparent. Actual investment outlays exceeded the planned levels during this period. From 1955 to 1960, the volume of investment in money terms averaged two percent higher than planned investment expenditures (88, p. 2157).

During the years of the NES the "Yugoslavs never adequately resolved which instruments should be used to guide the enterprises to conform to social objectives" nor "how to use the instruments without destroying the rational basis of decentralizing economic decisions and without divitalizing the concept of workers management" (109, p. 296). Methods of intervention in the allocation of investment funds were continuously introduced or modified in an effort to insure the market would operate in "harmony" with the "social interest" of the state. In reality, these methods were "nearly fatal" to the market mechanism (109, p. 110).

Decentralization Under the NES

Conclusions about the actual degree of decentralization of investment decisions under the NES and, in particular, the system of allocating and financing investment, are difficult. As designed, decisions to invest by the enterprises were to be limited under the investment funds system. Specifically, enterprises, guided by the market, were to make free decisions concerning the technological variants of given investment projects. Investment decisions concerning the total volume and basic allocations among sectors and geographic regions were to be dominated by the social plans as reflected in the social investment funds allocations, particularly,

the GIF. The auction system was the place where investment decisions of the enterprises were to be reconciled with those of the social plan. This process of reconciliation of decisions was aided by the use of various regulations and policies that determined, to a degree, the internal sources of investment of the enterprises and therefore, their appearance at the investment auction. Direct grants, subsidies, and controls were used to help insure the attainment of planned investment goals.

In reality, the restrictions on the size and use of enterprise internal funds seemed to often force their participation in the "investment auction" process (67, p. 21). During the "auction" process, the investment decisions of the enterprise was greatly overshadowed by those of the state due to the "auction" mechanism and the criteria used in the selection process. The "auction" even forced, before hand, investment programs by the enterprises with decisions on technological variants set in advance thereby reducing enterprise autonomy at that decision level (120, p. 225). In general, the "auction" process with its weaknesses and shortcomings and especially, the absence of some important sectors from the auction, resulted in "considerably less" decision-making power being given to the enterprises than the design of the credit granting system suggested (121, p. 93).

On the other hand, the social investment funds system did place greater decision-making power in the hands of lower levels of government than was true under the command system. Although subordinate

to centralized authority and constrained by social plans, these lower levels of government did, it seems, enjoy some investment decision autonomy. In general, it seems then, that a greater degree of decentralization of investment decision-making power did occur under the NES though probably much less than that degree suggested by the formal designs. Use of terms such as "full control and decision making power" (109, p. 103) when referring to the role of the state seems too extreme and not fully warranted by actual conditions in the system. In fact, the occurrence of over-investment (as compared to planned expenditures) and the constant concern by the state over the problem of co-ordination of investment decisions of the enterprises and those of the social plans indicated some degree of decentralization in the investment decision-making process of the NES. The degree of such autonomy by the enterprises may, at times, have actually exceeded that degree desired and designed by the state.

Development Policy and Investment

In the early years of the NES the development policy of Yugoslavia remained one of rapid industrialization and economic growth. Rapid industrialization, in the view of Cobeljić, the then deputy director of the Federal Planning Bureau, was deemed the chief method of continuing to generate economic development (80, p. 92). This policy was reflected in the continued large share of investment in the total output of the economy. Table VII shows the volume and share of gross investment spending relative to the GNP for each year in the 1953-1960 period.

TABLE VII

GROSS NATIONAL PRODUCT AND GROSS INVESTMENT, 1953-1960

Item	Year							
	1953[a]	1954[a]	1955[a]	1956[a]	1957[a]	1958[a]	1959[a]	1960[a]
Gross National Product	1389	1434	1617	1612	1982	2025	2373	2513
Gross Investment	400	452	454	462	539	604	690	818
Productive Investment	314	337	352	346	381	411	485	562
Non-productive Investment	86	115	102	116	158	193	205	256
Proportion of Gross Investment in Gross National Product[b]	28.8	31.5	28.0	28.7	27.2	29.8	29.1	32.9
Productive Investment[b]	22.6	23.5	21.7	21.5	19.2	20.3	20.4	22.4
Non-productive Investment[b]	6.2	8.0	6.3	7.2	8.0	9.5	8.7	10.2

[a]Figures in billions of dinars.

[b]Figures in percentages.

Source: 88, pp. 2155, 2156, 2160.

Table VIII shows the pattern of total investment by economic sector during the 1953-1960 period. The pattern of investment up to 1957 "indicates clearly enough" that development policy continued to assign a major role to industrial development at the expense of other sectors (134, p. 5). During the 1950-1956 period investment in industry absorbed 51 percent of all investment. "Four fifths of industrial investment were channeled into heavy industry and power generation" (80, p. 94).

In the period 1957-1960 investment in other sectors increased while investment in industry had a "comparable decline" (134, p. 5). The relative decline in industrial investment was offset by sizeable increases in investment in agriculture, transportation, and communication. This rather drastic shift in investment policy and the resultant changes in the structure of investment are apparent when the sub-periods 1953-1956 and 1957-1960 are compared. Such a comparison is shown in Table IX. The share of industrial investment in total gross investment declined from 44.1 percent in the 1953-1956 period to 33.2 percent in the 1957-1960 period (137, p. 1584). The relative reduction in industrial investment was carried out mainly in the basic or heavy industries while investment in manufacturing industries actually increased (134, p. 5). The distribution of gross industrial investment by sector for the two sub-periods in question is shown in Table X. Most noticeable was the increase in investment in industries producing consumer goods during the 1957-1960 period.

There appears to have been several reasons for the changing structure of investment during the 1957-1960 period. Pejovich (133,

TABLE VIII

TOTAL INVESTMENT BY ECONOMIC SECTOR, 1953-1960

Economic Sector	Year							
	1953[a]	1954[a]	1955[a]	1956[a]	1957[a]	1958[a]	1959[a]	1960[a]
Industry	207	198	203	170	164	162	192	254
Agriculture	39	48	40	56	74	97	121	112
Forestry	2	3	9	9	8	5	7	8
Construction	11	10	9	8	13	14	14	17
Transportation and Communications	40	57	67	80	94	101	112	124
Trade and Catering	11	15	19	18	22	25	31	36
Crafts	4	6	5	5	6	7	8	11
Total Productive Investment	314	337	352	346	381	411	485	562
Total Non-productive Investment	86	115	102	116	158	193	205	256
Total	400	452	454	462	539	604	690	818

[a]Figures in billions of dinars.

Source: 88, p. 2160.

TABLE IX

COMPOSITION OF INVESTMENT BY ECONOMIC SECTOR, 1953-1960

Economic Sector	Year	
	1953-1956[a]	1957-1960[a]
Industry and Mining	59.1	43.8
Agriculture	7.0	15.8
Forestry	1.8	1.5
Construction	3.2	3.6
Transportation and Communications	22.9	27.4
Trade, Catering, and Tourism	5.0	6.5
Crafts	1.0	1.4

[a]Figures in percentages.

Source: 137, p. 1584.

TABLE X

GROSS INVESTMENT[a] IN INDUSTRY BY SECTORS, 1953-1960

Industrial Sector	1953-1956		1957-1960	
	Amount[b]	Percent	Amount[b]	Percent
Electricity	189	24.6	178	23.5
Coal Mining and Processing	51	6.6	75	9.9
Crude Oil and Natural Gas Extraction and Processing	23	3.0	26	3.4
Ferrous Mining and Metallurgy	119	15.5	29	3.8
Non-metalic Mining and Processing	39	5.1	18	2.4
Metal Products Manufacturing, Except Shipbuilding	64	8.3	69	9.1
Shipbuilding	11	1.4	9	1.2
Electrical Machinery, Apparatus, Appliances, and Supplies Manufacturing	17	2.3	13	1.7
Stone Quarrying, Clay and Sand Pits, and Building Material Industry	7	.9	22	2.9
Wood Furniture and Fixtures Manufacturing	16	2.1	28	3.7
Paper and Paper Products Manufacturing	22	2.9	28	3.7
Textile Manufacturing	27	3.5	49	6.5
Footwear, Leather and Leather Products Manufacturing	3	.4	10	1.3
Rubber Products Manufacturing	2	.3	4	.5
Food and Beverage Manufacturing Industries	36	4.5	65	8.6
Printing, Publishing, and Allied Industries	5	.7	9	1.2
Tobacco Manufacturing	4	.6	8	1.0
Film Industry	-	-	1	.1
Prospecting	18	2.3	19	2.5
Other Sectors	-	-	2	.3
Total	768	100.0	759	100.0

[a]Excludes private investment.

[b]In billions of dinars.

Source: 88, p. 2161.

p. 70) has identified three major factors contributing to the shift in the pattern of investment after 1957 from industries producing capital goods to those producing consumer goods. These factors were: (1) the increased role for internal financing, (2) pressures from workers where earnings depended on the profitability of the enterprise which, in turn, depended much more on consumer preferences as reflected in the market, and (3) the monetary and fiscal policies of the federal government during that period designed to implement a new industrialization strategy. The first two factors apparently led to expanded investment outlays in consumer goods oriented industries as market forces were allowed a greater role and, simultaneously, enterprises under the new workers' management system became somewhat freer to respond to the greater demand for consumer goods. But, due to the limited expansion of the enterprises decision-making power in the area of investment, the first two factors appear to have been less important than the third in explaining the changing structure of investment. A study by Pejovski (134, p. 5) reported that, as a matter of government policy, the comparative reduction in industrial investment after 1957 was aimed at "creating essential conditions for the improvement of the general standard of living" and to create "a more harmonious economic development by means of a changed investment pattern."

According to Bićanić (12, pp. 74-78), the Yugoslav leadership followed until 1955 a policy of "global industrialization" based on the Stanlinist pattern of a rigid order of priorities in industrial development. This pattern involved the placing of emphasis for

investment in industry over other economic sectors; investment in heavy industry over light industry; investment in industries producing machinery and equipment over other heavy industry. In 1956 the policy changed to one of "accumulative industrialization" or "decentralized industrial development." There were several reasons for the change in policy. The infrastructure of the economy was already built to a substantial degree. The burden of financing investment in heavy industry from the federal budget had become increasingly greater. Defense requirements were not as crucial as in the 1947-1955 period while demands from the populace for more consumer goods was growing. The result of these pressures was the abandonment of the fixed order of priority of the 1947-1955 period.

The new industrialization strategy called for the build-up of industries which could accumulate income most quickly and could thereby provide resources (through taxation) for new industrial development while simultaneously providing goods for a higher standard of living. These industries were called "accumulative," and were mainly those producing and distributing consumer goods.

Another aim of the new policy was to correct the imbalance between the productive capacities of heavy and light industry. The new strategy encouraged investment in light industries especially, in light of the first aim, consumer goods oriented ones.

As part of the changing investment policy, there was less emphasis placed on building new capacity and an increased focus on modernizing and equipping the already present production facilities. These changes in the technical composition of investment are shown

in Table XI for the two sub-periods in question. These changes were made possible by the "fuller utilization" of basic industry capacities built in the previous periods (134, p. 6). The existence of this unused capacity may help explain the shift in policy. Construction outlays in the non-productive sector of the economy were increased during the 1957-1960 period and tended to offset the relative decline of construction spending in the productive sector.

The maintenance of high levels of total investment spending throughout the 1953-1960 period along with the changes that occurred in the pattern of investment during this period had a noticeable impact on the Yugoslav economy. In particular, there was a growth of both fixed assets and output (total and by sector). A study by Vinski (184, p. 3) on fixed asset growth in Yugoslavia reported a 75 percent increase in fixed assets (using their value when new) from 1946 to 1960 with an average annual growth rate of 4.1 percent. Using estimates of actual asset values, the study reported a growth rate of about 4.6 percent annually with an 86 percent overall increase in value. The growth of fixed assets for selected years during the 1953-1960 period by economic sector is shown in Table XII.

The level and pattern of investment spending also contributed to the growth of output during the 1953-1960 period. National income in current prices increased at an annual rate of about 10 percent during the period (102, p. 207). Industrial production increased 11-17 percent annually (151, p. 13). The growth rate of industrial output in the latter 1950's was around 13 percent. These increases in output while "productive investment" remained about 22 percent of

TABLE XI

TECHNICAL COMPOSITION OF INVESTMENT, 1953-1960

Investment Categories	Years 1953-1956[a]	1957-1960[a]
Total Investment	100	100
Construction Outlays	49	44
Equipment	42	45
Miscellaneous	9	11
Productive Investment - Total	100	100
Construction Outlays	42	32
Equipment	48	56
Miscellaneous	10	12
Industrial Investment - Total	100	100
Construction Outlays	40	30
Equipment	52	59
Miscellaneous	8	11
Agricultural Investment - Social	100	100
Construction Outlays	38	27
Equipment	32	44
Miscellaneous	30	29
Agricultural Investment - Private	100	100
Construction Outlays	26	25
Equipment	20	19
Miscellaneous	54	56
Transportation and Communication	100	100
Construction Outlays	54	40
Equipment	41	54
Miscellaneous	5	6

[a]In percentages.

Source: 88, p. 2164.

TABLE XII

FIXED ASSET GROWTH BY ECONOMIC SECTOR
FOR SELECTED YEARS, 1953-1960[a]

Economic Sector	Year[b] 1953	1956	1960
Industry and Mining	144	166	205
Agriculture and Fishing	268	347	452
Transportation and Communication	121	131	154
Construction	293	323	431
Trades and Artisanry	108	119	232
Other	145	173	142
Non-productive Fixed Asset - Total	115	122	142
Total	130	145	175

[a]Based on the new value of fixed assets.

[b]1946 = 100

Source: 184, p. 4.

the social product implied "a noticeable improvement in the efficiency of investment" (45, p. 11). Bombelles (15, p. 86) has reported a substantial lowering of the capital-output ration for all industries included in his study. He concludes that high rate of growth during the period was probable due to the completion of some productive units started in the previous period and also to the "greater availability of transportation and support facilities" (15, p. 87). As noted earlier, these structural changes were a direct part of investment policy after 1957.

Finally, the growth of industrial output and the changing role of industry in the economy, begun in the late 1950's, indicated some success by the Yugoslavs in moving toward their goal of industrialization. The share of national income contributed by industry nearly doubled from 26 percent in 1939 to 47 percent in 1960 (88, p. 2167). This industrialization was influenced in large part by the investment policy of the NES that continued to devote a large share of national income to investment while changing the pattern of that investment to avoid imbalances and to provide an expanded basis for future economic development.

IV. SUMMARY

The review in this chapter of the changes that occurred in the Yugoslav economy in general and, specifically, in the investment process from the immediate post-war years till 1960, that is, from the Soviet styled authoritarian model to the more decentralized NES, indicated the spirit and willingness of the Yugoslav's search for

their version of market socialism. Analysis of the period 1953-1960, reflected the differences of the emerging NES with the command system of the 1947-1952 period and revealed the evolutionary nature of the Yugoslav economy and, in particular, the system of investment allocation and financing.

In the economy in general, "[a]uthoritarianism was replaced by self-government as a basic principle of economic and social organization." The two economic systems have been contrasted as follows:

> . . .state ownership vs. social ownership; central planning vs. social planning; administrative allocation of goods vs. market; administrative rules vs. financial instruments; administratively fixed wages vs. free disposition of the income of the working collectives; all-embracing state budget vs. the budget of the state administration decentralized and separated from economic operations; consumption as a risidual vs. consumption as an independent factor of development; collectivization vs. business cooperation of peasants and large agricultural estates (80, p. 80).

An important part of the NES was a new framework for decision-making concerning investment including a new system for the financing of investment activity. In contrast with the command system, the institutional arrangements and policies of the NES in the investment area allowed for an expanded role and a greater degree of autonomy for both lower levels of government and enterprises in the investment decision-making process. Although the investment decisions of these lower level economic units were constrained to a large extent by various direct and indirect methods that influence the use and volume of their investment resources, their investment activity reflected a degree of decentralization greater than that of the command system.

The introduction of the investment funds system to allocate and finance investments in the NES led to certain important changes.

At the state level, the introduction of social investment funds tended to separate investment activity from budgetary expenditures. This result along with the limited use of "auctions" for allocating centralized investment resources on a credit basis helped inject a degree of rationality into the investment process that was not present in the command system. In addition, the investment funds system significantly altered the structure of investment funds sources and means of financing used in the investment process with the enterprises playing an expanded role.

The institutional and investment policy changes made in the post-war Yugoslav economy had noticeable impact on the growth of the economy. Under the NES, the growth of economic output was stepped up while the structure of investment was significantly altered. The Yugoslav economy became more industrialized.

The changes that occurred in the investment decision-making structure and system of investment financing in the NES were part of the Yugoslavs' attempt to move the economy toward a decentralized model more compatible with their concept of socialism. Although this attempt suffered from many weaknesses and shortcomings, the direction of their efforts became increasingly apparent throughout the 1950's. The sequence of events during the 1950's that defined the trend toward the ideal form "to which the Yugoslav economy is unmistakably tending" included: (1) the changing role and increased permissiveness of state plans, (2) the abolition of taxes based on wage funds that was replaced in 1954 by a system of capital goods use charges, (3) the increased freedom given enterprises in acquiring and disposing of

capital goods, (4) the introduction of "investment auctions" and the injection of profitability into the investment process, and (5) the abolishment of several constraints on enterprise income distribution (106, pp. 573-574). It was these and other efforts and this direction that required even more changes in the 1960's as the Yugoslavs' drive toward market socialism continued.

CHAPTER III

THE NEW ECONOMIC REFORM MOVEMENT

I. INTRODUCTION

In the early 1960's a new economic reform movement in Yugoslavia was begun. In 1961 certain changes were made in the economic system that were encouraged by the early completion of the 1957-1961 Plan and sparked by a growing commitment of the Yugoslav leadership to an economic system premised on an emerging ideology of self-governing socialism based, in large part, on increased autonomy of decentralized economic units and implemented under the title of workers' self-management. Throughout the early 1960's the economic system continued to "move towards the expansion of self management rights of immediate producers and the economic foundations of social self-government" (31, p. 2505). The expansion of self-management as a major organizing and motivating institution in the economy during the early 1960's was expressed in: (1) a new system of income distribution, (2) stronger direct relations between banks and enterprises with lessened governmental regulations, (3) "expanded production and foreign trade activity," (4) further development of the banking and credit system, and (5) a "gradual switch" to a system of "independent disposal" of income by working organizations, social service agencies, and other non-productive activities (31, p. 2505). Other changes in economic institutions and policies were made in response to persistent economic problems, such as inflation and large balance of payments deficits, which were

often aggravated and sometimes created by the very reforms that were intended to improve the economic system.

The economic events of the period 1961-1964 and specifically, economic crises in 1962 and 1964, generated a reappraisal and readjustment of the economic system. The reform attempts carried out during this period, which were generally vague and often ineffective, and the ensuing economic debate concerning the proper roles of the market and plan in the economy and the direction and structure of continued economic development, were starting points for more meaningful and effective economic reforms that were to be introduced in 1965.

Within the context of these economic reform efforts, the framework of the investment process that had evolved under the NES of the 1950's remained generally intact throughout the period 1961-1964. Certain changes were made, as part of the reform efforts, in an apparent attempt to make the investment system more compatible with the new directions of development of the economic system and to enhance the attainment of the objective of self-management. The more noticeable changes occurred in the area of investment financing. The investment process became a focal point of the economic analysis and debate generated by the reforms and economic problems of the period. The weaknesses and shortcomings revealed by the analysis and debate served as the groundwork for the renewed reform efforts in 1965.

The purpose of this chapter is to review the economic reform movement of the 1961-1964 period and, in particular, to analyze the changes made in the system of investment by the economic reforms and policy changes of the period and to specify the effect of these

changes on the investment decision-making and financing structures. The foundation for this discussion will be the structure of the investment process, that is, institutions and policies affecting investment of the NES that was described in Chapter II of this study. In addition, a review of the intense economic discussions and debate that emerged during the period will be presented to provide the background necessary for the analysis of the 1965 reforms in the following chapter.

II. THE 1961 REFORMS

Introduction

The "turbulent" transition period of reforms, revisions, and debates in the early 1960's was started by the Program of the League of Communist in 1958. This document implied the form of socialism the Yugoslavs were striving toward. This type of socialism included "social ownership, self-management in the economy, [and] the absence of non-labor income" (80, p. 82).

By 1960 the second Five-Year Plan for the period 1957-1961 was "declared completed." Since 1957 the economy had grown (in current prices) at an annual rate of 12 percent (109, p. 122). The "booming" economy along with the well established self-management system of organization "paved the way to an accelerated pace of changes." A new Five-Year Plan for the 1961-1965 period was prepared (80, p. 82).

In addition to the new plan a number of significant reforms were introduced in 1961 which represented "an increased emphasis on market forces" in the economy. The reforms lay in four major areas. Changes in the foreign trade area were intended to increase the

economy's productive efficiency and to improve the quality of domestically produced goods through the compeititve influence of the world market and to "bring Yugoslav prices into line with world market prices" (109, p. 123). Pavlowitch (131, p. 283) implied that another important reason for the reforms, particularly in the foreign trade area, was to secure over $275 million in grants, loans, and credits from the International Monetary Fund and from "American and West European sources" to help the economy "adjust to freer trade and convertability in foreign economic relations." To achieve these goals the following steps were taken: (1) the dinar was devalued from six hundred to seven hundred and fifty per dollar (102, p. 213), (2) a customs tariff replaced the system of multiple exchange rates (80, p. 82), (3) the country requested full membership of the General Agreement on Tariffs and Trade (G.A.T.T.) (131, p. 283), and (4) quantitative import restrictions were reduced (109, p. 123).

Changes were also carried out in the organizational structure and functions of the banking and credit system in an attempt to move the banking system, which had lagged behind other sectors of the NES in institutional reform, into line with the rest of the economy (80, p. 82). Fiscal reforms in the forms of changes in the system of enterprise income distribution and tax rate changes were a third area of reform. These fiscal changes increased the share of enterprise income left to the disposal of the workers (109, p. 123). Lastly, the control of trade unions over wage levels and differentials in the self managed enterprises was removed (80, p. 82). This control passed into the hands of the worker's councils of the enterprises (80, p. 115).

These reforms were, in general, "intended to reduce the scope of arbitrary social control and to expose the role of the market" in order to achieve greater efficiency, lower costs, and increased competitiveness in world markets for the Yugoslav economy (109, p. 123). They marked the beginning of the "third district phase" of Yugoslav economic development (80, p. 82).

Banking Reforms

The major part of the 1961 reforms involved the entire financial sector and, in particular, the organizational structure of the banking and credit system. The aim of the reforms in this area was to transform banks from mere service organizations of the various governmental agencies for the disbursement of social funds into profit-making enterprises (109, p. 123). In this regard, the methods of management, income distributions, and renumeration that existed in other economic organizations was adapted for the banks (186, p. 374).

The Law on Banks and the Law on Credit and Other Banking Activities became effective on March 1, 1961. These laws prescribed a reorganization of the entire banking structure (186, p. 370). They provided for the establishment of banks by the socio-political communities at federal, republic, and communal levels. These banks were restricted in their operations to the territory of the community that established them. The liabilities of the banks were guaranteed by this community.

Changes were also made in the area of bank management at all levels. Banks were managed by a Manager and a Board of Directors. At the federal level the General Manager of the three specialized

banks (Yugoslav Investment Bank, Yugoslav Agriculture Bank, Yugoslav Foreign Trade Bank) and the members of Boards of Directors of these banks were appointed by the Federal Executive Council. The Manager and members of the Board of Directors of republic and communal banks were appointed by the governmental authorities of their community (75, p. 245).

Although, as indicated by the bank management structure, the degree of governmental control over the banks was substantial, there was an attempt to remove some of the political influence over banks, and to expand the influence of the enterprises, especially at the command level. The new laws required that two thirds of the members of the Board of Directors of communal banks be appointed from persons recommended by the workers' councils of enterprises with head offices located in the territory of the bank. In addition, the liabilities of the communal banks were guaranteed by these enterprises as well as the local community (75, p. 245).

Under the new bank laws all business banks could grant both long-term (investment) credits and short-term credits. In practice however, two basically different groups of banks emerged: (1) banks concerned with investment credits and (2) banks concerned with short-term credit. The first group included the three specialized banks and the new republic banks that were founded under the new laws. The second group was comprised of the communal banks (93, p. 3220).

The three specialized banks continued to handle the allocation of investment funds of the central government. The six republic banks were mainly responsible for granting investment credits under

each republics' development policy, and in general, received these investment resources from deposits, credits, and grants from their republic government bodies and institutions (76, p. 568).[1] In addition, the republic banks served as mediators between the communal banks and the National Bank (80, p. 134).

The granting of credits from social investment funds of the various governmental levels by the banks continued to be carried out under conditions laid down by the governmental level controlling these assets. Although some expansion of investment capital at the banks' disposal did occur, control over the allocation of these resources was maintained through an accounting process under which the banks were required to draw up annual balance sheets projecting their investment credit plans. These plans were then submitted to the appropriate governmental body for approval (154, pp. 2-3).

A focal point of the banking reforms was the changed role of communal banks. Until the 1961 bank laws, communal banks acted as service agencies or branches for the National Bank which granted short-term credit exclusively. Although the communal banks granted consumer credit, kept savings accounts, and performed "other banking operations," they had no self-capital (93, p. 3220). Under the 1961 bank laws the short-term crediting of economic organizations was transferred entirely from the National Bank to the communal banks.

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[1] Initial resources for the republic banks came from the three specialized federal banks which transferred resources coming from republic and local funds and "some" resources from the federal fund for underdeveloped regions (165, p. 107).

The National Bank no longer served as a commercial bank but continued to perform central bank functions and acted as a bureau of the federal budget (133, p. 17).

The communal banks were authorized to accept deposits from economic organizations, communal and social bodies, and private individuals. They could grant both short-term and long-term credits subject to the "general credit regulations" of the National Bank guidelines. The communal banks continued to administer the communal investment funds (76, p. 569). The rigidity of National Bank control over credit grants by the communal banks that was implied by the institutional arrangements was somewhat more apparent than real. The operational guidelines of the National Bank were unclear. In particular, the fact that the purposes of short-term credits were not clearly spelled out often led to the communal banks use of short-term credit for investment purposes (93, p. 3219). Thus, although, as previously noted, the communal banks tended to be mainly concerned with granting short-term credits, in reality, their role in the investment process was enhanced by the condition described above.

As with the republic banks, the role of communal banks in 1961 in the granting of long-term investment credits remained small due to their small capital funds holdings and self-credit funds (93, p. 3220). But in 1962, business banks introduced time deposit accounts on a large scale for economic organizations. This led to a stronger basis for increased investment credit operations from the banks' own funds (76, p. 568). The creation of these funds provided the necessary conditions in the banking structure for a "gradual" strengthening of

the role of business banks in the direct crediting of both production and capital development of enterprises. An intensified campaign in 1963 by communal and republic banks to collect time deposits indicated their desire to increase their operations in this area (93, p. 3218).

The organizational changes and the creation and use of self-controlled funds, although limited in scope, did mark a significant break from the practices of the 1950's when banks had much less (and often no) self-controlled funds for investment credits. These reforms reflected the start of a new direction in the role of banks and the government in the investment process that continued in later years.

Enterprise Income Distribution and Fiscal Reforms

The enterprise income distribution system was modified during March, 1961. The new scheme was as follows: (1) from total revenue, charges for depreciation and expenditures for materials were subtracted, (2) from the remaining income, 6 percent interest charge on capital funds, the turnover tax, rent, and "other contributions" (taxes) were subtracted leaving gross profit, (3) a 15 percent federal tax was paid out of gross profit leaving net profits, (4) payments out of net profits went to the wage bill (including the actual amount paid to the workers, a 15 percent tax going to the budgets of the local and republic governments, a social security charge of 22 percent, and a 4 percent payment to the communal building fund), and the internal funds of the enterprise (the working capital fund, the collective consumption fund, and the reserve fund), (5) the combined total of

the working capital fund and the collective consumption fund was subject to a 20 percent tax charge going to local and republic governments' investment funds (133, p. 31). In addition, the fixed capital fund and working capital fund of the enterprise were combined into a single "enterprise fund" and regulations requiring the separation of accumulations and expenditures in these two areas were abolished (80, p. 134). These changes, especially the wage bill becoming part of profits with wage rates determined by the Workers' Councils, increased the share of enterprise earnings that the workers could freely distribute (109, p. 123) and implied an expansion of the self-financed investment ability of the enterprises.

These fiscal changes concerning the income distribution of the enterprises, along with the changes in the banking and credit system and the increased independence allowed enterprises in determining wage payments, reflected a continued effort of the Yugoslavs to increase the role of the enterprise and banks in the economic decision making process. Although most investment decisions remained centrally controlled, the reforms in 1961 did increase the autonomy of decentralized units in the investment process. Banks began to make investment credit grants out of their own funds and the enterprises experienced an expansion of funds for their free disposal. This increased ability of banks and enterprises to invest, in terms of both expanded free funds and increased autonomy in the use of these funds, was an important element of the 1961 reforms.

Economic Problems in Early 1960's

The reforms of 1961, although intended to increase the efficiency of the Yugoslav economy, were, in fact, "poorly prepared, partly inconsistent and badly implemented" (80, p. 83). The economy reacted in a manner which aggrevated old problems and created new problems.

Inflation and balance of payments problems worsened partly because of the reforms. The rise in prices was attributed to several factors. Aggregate demand grew rapidly due, in part, to an increase in personal consumption expenditures which, in turn, was due to increases in nominal incomes, employment, and consumer credit. These factors were due partly to the increased autonomy of enterprises in the distribution of their income and to the new banking system which lessened central control over credit activity, both important elements in the 1961 reforms (109, pp. 169-170). In addition, investment expenditures in current prices continued to increase. Final demand expansion during this period "was greatest in the investment sector" (144, p. 314).

On the supply side, poor harvests in 1961 and 1962 put pressure on agricultural prices. The devaluation of the dinar caused a price increase on certain imported goods in the economy (109, pp. 169-170). These inflationary pressures help depress export activity and thus contributed to a worsened trade deficit.

In addition to inflation and balance of trade difficulties, the economy experienced a decline in the growth rate of industrial production. The growth rate (in current prices) fell from 15 percent in 1960 to 7 percent in 1961 and to 4 percent in the first half of 1962 (159, p. 185).

The growing economic problems of the early 1960's led the government to make various policy changes intended to correct certain preceived deficiencies in the economy. In response to the rise in prices the volume of credit and the volume of investment spending were restricted. In addition, wage guidelines were iniated to curtail expansionary wage hikes, new import restrictions were imposed, and direct price controls were introduced (109, pp. 170-171). The increased autonomy for enterprises and banks that resulted from the 1961 reforms were apparently lessened by these stabilizing actions. The exact effect of these policy changes on the investment activity of the decentralized units in the economy remain unclear.

Helped by a large increase in the money supply, the economy began to recover during the last half of 1962. By 1963 the economy had returned to its "normal path" of rapid growth (80, p. 83).

III. FURTHER REFORM EFFORTS, 1963-1964

In 1963 and 1964 further changes were made in the Yugoslav economic system that led to a modification of the investment process. The adoption of these measures indicated, to some extent, the acceptance by the government of the economic diagnosis of those favoring greater decentralization of the economy and, in particular, the system of investment allocation and financing.

The New Constitution

During the early 1960's work was well under way on a new constitution. Adopted in 1963, the new constitution was intended to specify the functions of political, social, and economic entities.

The organizational principle of self-management was extended to cover all these areas. In particular, economic organizations were to be "primarily responsible for decisions about economic matters" (109, p. 124).

As spelled out in the constitution, the function of planning was to "reconcile relations in production and distribution." Economic organizations and various government levels were to be "independent in planning and developing the material foundation of their activity." Planning was not to mean any type of direct imposition on the part of the government (60, p. 1971).

In the area of investment the constitution provided for the formation of a federal fund for financing the economic development of underdeveloped regions (60, p. 1972). This provision assured a continued role for the central government in the investment process and thus in the development of the economy.

Some controversy arose over the principles of the new constitution and over the economic policies used to implement its principles (109, p. 124). Growing concern over the economic problems of the immediate post-1961 reform years seemed to heighten the criticism of the apparent direction of decentralization of the Yugoslav society and economy that was implicit in the new constitution. Debate over the new constitution became one of the focal points of the broad controversy that emerged concerning the role of market and plan in the Yugoslav economy.

Abolishment of the General Investment Fund

In a major move apparently intended to increase the use of "economic criteria" and decrease the use of "political criteria" in the allocation of investment funds, the General Investment Fund (GIF) was abolished at the end of 1963 (47, p. 14). The Federal Investment Capital Act provided for the transfer of most of the GIF assets to the three specialized banks. Also transferred, but not fully allocated in terms of control over their use, were certain funds earmarked for specific uses as originally planned. The banks receiving the transferred funds were "obligated to enter them into their credit funds" with the exception of resources from domestic and foreign loans. The Yugoslav Investment Bank was required to keep a separate account of capital funds received during the 1961-1963 period from the former GIF to be used as separate assets for the "promotion of development" in underdeveloped regions (154, pp. 3-4).

The distribution of the assets of the GIF among the various banks and by purpose of use is shown in Table XIII. As indicated in the table, the Federation retained control over three categories of assets of the former GIF. These three categories accounted for over 96 percent of the total assets distributed. The Federation added to these categories of assets throughout 1964 and 1965 and continued to carry out investment obligations from these funds (154, p. 5).

The apparent retention of control of the assets of the former GIF by the Federation implies that no significant change in investment decision-making power over these funds took place initially under the

TABLE XIII

DISTRIBUTION OF THE GENERAL INVESTMENT FUND ASSETS IN 1963

Purpose	Institution Receiving Assets[a]			
	Yugoslav Investment Bank	Yugoslav Foreign Trade Bank	Yugoslav Agriculture Bank	National Bank
Assets Transferred To Credit Funds[b]	14,462	1,241	3,772	381
Foreign Loans	703	--	--	--
For Financing Without Reimbursement	105	--	1	--
For Credits Converted Into Loans Without Reimbursement	17	--	--	--
For Guaranteed Investment To Be Transferred To Constituents Republic[b]	507	--	139	--
For Crediting Underdeveloped Areas[b]	638	--	--	--
Total	16,432	1,241	3,912	381

[a]Figures in millions of dinars.

[b]Federal assets centrally controlled.

Source: 154, p. 4.

new arrangements. Claims as to the de-etatization of the system of investment financing under the new designs appear to have been unfounded in reality. The apparent reason for the continued control over these funds was to assure the implementation of social plans that were prepared under the prior system and under which various federal obligations were accepted. The transitional nature of this centralized control seemed to be reflected by further measures that were later iniated. The transfer of the social funds of the GIF to the banks served mainly, it seems, as a "first step" toward more meaningful reforms in 1965, which were to significantly lessen the role of the Federation in the investment process.

The Federal Investment Capital Act left to the republics, districts, and communes the decision of whether or not the law governing the assets of the former GIF should also apply to the assets of their social investment funds (154, p. 5). In actuality, some republics followed the example and authorization of the Federation and transferred their investment funds to the banks (47, p. 14). Although the number that followed this course of action was relatively small, "their iniative stimulated others to make preparations to employ the same system with their funds (93, p. 3219).

One additional step was taken in the process of lessening the role of government in the investment process. On January 1, 1964, the contribution by the enterprises to the social investment funds of republics, districts, and communes was abolished (93, p. 3219). This action lessened the ability of the government to influence investment resources accumulation while expanding the role of the

enterprises in the accumulation process and permitting the growth of investment financing at the enterprise level.

Fiscal Reforms

Certain fiscal changes were made during the 1963-1964 period that were intended to increase the ability of enterprises to finance their capital development with their own funds. In 1963, increases in enterprise depreciation funds were authorized "to permit more self-financing investment" (106, p. 574). New depreciation rates for specific economic activities were iniated with the level ranging in accordance with the "rate of use" of the fixed asset. Depreciation charges were divided into two parts. One part accrued to fixed capital and could be used to replace old assets as well as purchase new ones. This part could also be used for working capital and other payments charged to fixed assets. The second part of the depreciation charge was to be used for expenditures not related to fixed capital (64, p. 102).

In addition to these charges, the Federation, during 1964, exempted "a number of economic sectors and groups of organizations" from the payment of income taxes (93, p. 3219). These exemptions, along with the elimination of payments by the enterprises to social investment funds and the new depreciation charges, enhanced the self-financing potential of the enterprises.

Economic Conditions and Policies in 1964

The economic recovery that began in the latter half of 1962 had become a "boom" by 1964 with "heavy inflation" and a worsening

balance of payments deficit (48, p. 16). The cost of living in October, 1964, was 15 percent above that of October, 1963. During the same period food costs rose by 22 percent and the price of fuel and electrical power by 35 percent. The rapid increases in wages that were evident after the 1961 reforms continued to occur. In August, 1964, money wages were 23 percent higher than a year earlier. In the foreign trade sector, exports rose in 1964 over their 1963 level by 13 percent while, during the same period, imports rose by 25 percent thus, worsening the balance of payments problems (102, pp. 213-214). The growth of investment demand during the first nine months of 1964 was "particularly fast" and was the "origin and principle factor of inflationary pressures" (51, p. 66).

The economic difficulties of 1964 were met with certain policy changes by the state, particularly, in the area of investment, intended to dampen inflation and having direct impact on the volume of investment activity. In an effort to slow investment spending, 20 percent of the funds available for investment credits in commercial banks were frozen. The banks were no longer given the right to grant investment credits on the basis of their total deposits. Specifically, deposits and short-term (under one year) securities were not allowed to be used for granting investment credit. The banks were also forbidden to use any part of their saving deposits to finance investments as they had previously practiced.

Other restrictive measures were also adopted to slow investment spending. The commercial banks reserve requirement was raised from 20 percent to 30 percent and accompanied by more strict credit controls.

In addition, steps were taken to prevent enterprises from using credit for purposes other than that for which the credit was originally granted (48, pp. 16-17).

As in the post-1961 reforms period, the degree of apparent confusion of economic policy, particularly concerning investment, in 1964, was striking. Throughout the early 1960's efforts were continuously being made to restructure the economy to allow a greater use of the market. Specifically in the area of investment, changes were introduced that were intended to reduce the role of the state in the investment decision-making process and in the financing of investments. Simultaneously, the economic problems that arose or worsened during the period and that were caused, in part, by the reforms lead the government to introduce certain policies that restricted the decision-making ability of the lower level units in the economy. Attempts to decentralize the economy while, at the same time, introducing restrictive monetary and fiscal policies reflected the often incompatible and self-defeating efforts of the government. The structural and organizational reforms clearly indicated a desire for greater decentralization. On the other hand, the restrictive policies adopted to help solve the economic woes of the period seemingly constrained the changing system at times to an extent that the real degree of decentralized decision-making power of the enterprises and the banks were no greater and likely often less than under the NES of the 1950's. To specify the actual degree of decentralization that occurred during the 1961-1964 period is, for these reasons, difficult.

The economic measures of the early 1960's were "neither liberal nor central" but were often the product of "political compromise." The economy of the early 1960's was neither rational decentralization nor rational centralization but "seemed to combine the worst features of each" (109, p. 167).

IV. INVESTMENT FINANCING AND DECISION-MAKING STRUCTURE

The economic reforms and the modifications of the investment system during the 1961-1964 period resulted in significant changes in the roles of the government, banks, and, to a less extent, enterprises in the investment financing process. The two most influential reforms in this regard were: (1) the reorganization of the banking system in general and specifically, the provisions allowing banks to form and use credit funds of their own and (2) the abolition of the GIF and other social investment funds of the banks, particularly the Yugoslav Investment Bank. These two measures greatly reduced the role of the Federation and other government levels in the financing of investment while expanding the role of the banks. Although changes in the system of income distribution and other fiscal changes seemed to have increased the self-financing ability of the enterprises, the actual share of investment financed from enterprise funds remained relatively unchanged.

The composition of investment by source of finance for the 1961-1964 period is shown in Table XIV. As reported in a study by Crawford (28, p. 623) the share of total investment resources provided by the banks increased from about 1 percent in 1960 to about 31 percent

TABLE XIV

COMPOSITION OF INVESTMENT BY SOURCE OF FINANCE, 1961-1964

Source of Finance	Year			
	1961[a]	1962[a]	1963[a]	1964[a]
Government	61.7	59.6	56.4	36.5
Enterprises	29.5	29.7	27.8	25.9
Banks	.9	2.9	9.1	31.4
Other	7.9	7.8	6.7	6.2

[a]Figures in percentages.

Source: 50, p. 29.

in 1964. During the same period the share of investment resources provided by the government declined from about 63 percent to about 36 percent while the share provided by enterprises declined slightly from about 31 percent to 26 percent. Most of the decrease in the role of the government came at the federal level. The share of total investment resources provided by the Federation dropped from 37 percent in 1960 to 7 percent in 1964. During the same period the share of funds provided by republics and local governments increased slightly.

The drastic reduction in the use of government funds from 1963 to 1964 (a drop of almost 20 percent of the total) and the sharp increase in the use of bank funds during the same period were due mainly to the abolition of the GIF at the end of 1963 and the transfer of its funds to the banks. However, not all of the increase in the role of the banks in investment financing can be explained by the abolishment of the GIF. Of particular importance was the increased use by banks of their own funds for granting investment credits. These credit funds, set up under the 1961 reforms and, as previously noted, expanded by an intensified campaign in 1963 by communal and republic banks to collect time deposits, became an important source of investment funds. The share of investment credits provided by the banks rose from 5.3 percent in 1962 to 20.4 percent in 1963 (93, p. 3218). Since the GIF was not abolished until the end of 1963, the significant increase in the use of bank credits during 1963 was apparently due in large part to the increased size of the banks own investment credit funds.

Of some importance is the slight reduction in the role of the enterprises in investment financing during the 1961-1964 period, particularly, since the self-financing potential of the enterprises was supposedly enhanced by the various fiscal changes made in 1961 and in the 1963-1964 period. In 1958, after the introduction of a new income distribution scheme, the share of the enterprises total income left to the enterprise was about 40 percent. During the 1961-1964 period the share of enterprise net income left to the enterprises had risen to about 46 percent (12, pp. 129-213). A possible explanation for the slight relative decline in the use of enterprise funds for investment financing purposes was the increased autonomy of enterprises in distributing their income that was allowed by the 1961 reforms. In particular, the fact that "[w]orkers' councils became completely independent in determining wage rates and distributing income" (80, p. 115) implied the possibility of rising wage payments at the expense of fixed asset expansion from enterprise funds. The actual occurence of this type of behavior seems to be reflected by the reported rapid increases in money wages throughout the 1961-1964 period and the adoption of restrictions on wage hikes in 1962 by the government in an attempt to lessen inflationary pressures.

The substantial changes that occurred in the investment financing process during the 1961-1964 period, while reflecting an apparent move toward greater decentralization, must be carefully interpreted. As previously noted, before 1964, the banks and enterprises had little self-capital from which to grant investment credits and were extremely

limited in the use of their funds by central authorities. Although the investment resources of the GIF were transferred to the banks in 1964, the use of these funds continued to be strictly controlled by the Federation through the Plan. Thus, the initial transfer of funds did not also include a corresponding transfer of decision-making power over the use of these funds.

The investment decision-making structure that existed under the NES in the 1950's remained essentially unchanged during the 1961-1964 period with only slight modification in the roles of various economic units. As implied in previous sections of this chapter, perhaps the more noticeable change was the apparent further decentralization of decision-making power with banks, enterprises, and lower levels of government allowed somewhat greater autonomy in making investment decisions.

The reorganization of the banking and credit system in 1961 resulted in a growing number of banks and an expansion of bank investment funds. Although these funds were controlled to a large extent by governmental plans, this control was located less at the central government level and more at the republic and communal levels. The increase in the influence of enterprises in bank management at the communal level and the removal of commercial bank functions from the National Bank were other indications of a lessening of centralized control over investment decisions. Thus, the increased use of bank funds for financing investment that was apparent during the 1961-1964 period did represent, to a degree, the further decentralization of investment decision-making power in the economy.

Decentralization of investment decisions was also apparent, to a degree, at the enterprise level. Modifications in the income distribution system and other fiscal reforms led to an expansion of funds for free disposal by the enterprises. The reduction in the control over the income distribution of enterprises implied a desire on the part of the state to enhance the decision-making role of the enterprises in general, including investment decisions.

These factors do seem to reflect some further decentralization of investment decision-making power during the period 1961-1964. But, the net increase in the autonomy of lower level economic units to make or influence investment decisions appears to have been slight. The fact that centralized investment planning remained in practice and major investment decisions continued to be made by central authorities indicated a desire of the state to retain substantial control over investment activity and a reluctance to allow expanded use of market forces in this area. Significant decentralization of investment decision-making power was not to occur until the 1965 economic reforms.

V. SIZE AND STRUCTURE OF INVESTMENT

Investment expenditures (in current prices) increased and the share of investment in national output remained high in the period 1961-1964. Expenditures for gross fixed capital formation rose continuously from 11.7 billion dinars in 1961 to 13.3 billion dinars in 1962, 15.8 billion dinars in 1963, and 20.4 billion dinars in 1964 (201, p. 797). The share of expenditures for fixed capital

formation in Net Material Product[2] was 37 percent in 1961, 38 percent in 1962 and 1963, and 36 percent in 1964 (203, p. 64). Outlays for fixed capital, following the trend of the late 1950's, rose 26 percent in 1960, 22 percent in 1961, and then slowed drastically to a 14 percent increase in 1962 (167, p. 1877). This decrease in the rate of growth of investment spending was due mainly to the restrictive credit and investment policies of the government during 1962. But these restrictive efforts were apparently short lived and/or ineffective. In 1963 and particularly in 1964, the economy returned to a high rate of investment spending. The increase in investment expenditures was 19 percent and 29 percent respectively for these two years (141, p. 3070). The planned development policies of the early 1960's called for continued expansion of investment spending. Investment efforts of the government were directed in a larger degree toward certain branches of the economy. These sectors included housing, communication, hydroelectric power, fertilizer and chemicals, and soil improvement. Although the development policies for these areas required increases in investment, there was little increased demand by the Federation or other government levels for investment expenditures in total (47, p. 7).

In reality, as noted previously, there was a significant expansion of investment in the early 1960's. This growing volume of investment spending, as compared to the late 1950's and given the

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[2]Net Material Product is the gross output of goods and material service less "the intermediate consumption of goods and material services, including the consumption of fixed assets" (201, p. lxi).

growing inflationary pressures of the early 1960's, has led one writer to comclude that, after the 1961 reforms, policy makers decided in favor of a high rate of economic growth as against a stable price level (6, p. 207). Such an interpretation of the economic events of the early 1960's does not appear warranted. The third Five-Year Plan adopted in 1960 for the period 1961-1965, called for an average annual total investment of 8.54 billion dinars (208, p. 472). As indicated previously, the actual level of investment spending exceeded this level in every year in the period 1961-1964. The actual average annual total investment for the period 1961-1964 was 15.3 billion dinars. In the first year of the Plan, 1961, actual investment exceeded planned investment by over 4.8 billion dinars (208, p. 473). The 1963 Federal Economic Plan called for investment in fixed capital at the same level as in 1962 (123, p. 1734) while actual fixed capital investment in 1963 was 2.5 billion dinars greater than in 1962 (a 19 percent increase) (209, p. 2277). The 1964 annual plan called for a 10 percent increase in fixed capital investment and actual investment increased by 29 percent (209, p. 2277).

The average annual share of total investment in national output called for in the thrid Five-Year Plan was 32.5 percent (208, p. 473). The actual average annual share of investment for the 1961-1964 period was 37.5 percent (172, p. 1734).

In addition, the restrictive measures adopted in 1962 and 1964 in an effort to help slow price increases through a reduction in investment spending indicated the concern of the government about

the growing inflationary pressures in the economy. The types and degrees of restrictive measures adopted seems to clearly indicate the importance placed on maintaining economic stabilization by the government.

The distribution of investment spending among economic sectors during the period 1961-1964 was, apparently, not significantly affected by the changes in the system of investment allocation and financing. There continued to be a planned emphasis on the industrial sector while more attention was focused on non-productive investments, particularly on housing construction and public utilities. The third Five-Year Plan called for "special emphasis" on those industrial branches "which constitute the modern long-term basis of an industrial development." These branches included power, iron and steel, metalurgy, chemicals, and capital equipment. Special emphasis was also placed by the Plan "on branches using Yugoslavs own agriculture and forestry resources" and on the production of building materials and non-metals (208, p. 472).

The structure of total nominal investment in fixed assets by sector is shown in Table XV. The relative distribution of fixed assets investment by sector is shown in Table XVI. The share of total social investment by economic branches for the years 1961-1964 combined were: (1) industry and mining--37 percent, (2) agriculture, fishing, and forestry--11 percent, (3) construction--2 percent, (4) transportation--13 percent, (5) trade and catering--5 percent, (6) crafts--1 percent, (7) housing and commercial activity--19 percent, (8) culture, education, science, and welfare--7 percent, and (9) administration and governmental services--5 percent (28, p. 624).

TABLE XV

SOCIAL GROSS INVESTMENT IN FIXED ASSETS BY SECTOR, 1961-1964

Sector	Year			
	1961[a]	1962[a]	1963[a]	1964[a]
Industry and Mining	409	473	532	671
Agriculture	107	119	140	171
Forestry	12	19	17	21
Construction	27	31	31	46
Transportation and Communication	169	163	165	243
Trade	52	57	81	116
Crafts	13	14	15	20
Housing and Public Utilities	169	198	314	397
Cultural and Social Activities	74	89	99	121
Government Agencies and Miscellaneous	45	68	69	77
Total	1,077	1,231	1,464	1,883

[a]Figures in billions of dinars at current prices.

Source: 86, pp. 3859-3860.

TABLE XVI

COMPOSITION OF SOCIAL GROSS INVESTMENT IN FIXED ASSETS BY SECTOR, 1961-1964

Sector	Year			
	1961[a]	1962[a]	1963[a]	1964[a]
Industry and Mining	30.0	38.8	36.3	35.6
Agriculture	9.9	9.7	9.6	9.0
Forestry	1.1	1.5	1.2	1.1
Construction	2.5	2.5	2.1	2.4
Transportation and Communication	15.7	13.2	11.3	12.9
Trade	4.8	4.6	5.5	6.2
Crafts	1.2	1.1	1.0	1.1
Housing and Public Utilities	15.7	16.1	21.4	21.1
Cultural and Social Activities	6.9	7.2	6.8	6.4
Government Agencies and Miscellaneous	4.2	5.5	4.7	4.1
Total	100.0	100.0	100.0	100.0

[a]Figures in percentages.

Source: 86, pp. 3859-3860.

Significant increases in investment spending during the period in question seemingly occurred throughout all sectors but appeared particularly rapid in the housing and public utilities sectors. This, in part, reflected the continuance of the policy of assigning less emphasis to industrial development relative to other economic sectors. The decreases in the relative share of investment going to industry during the period, which was a trend begun in 1957, continued but to a less degree. This development policy was apparently not undermined by the increased autonomy of the enterprises and banks that occurred with the further decentralization of the investment financing system and the investment decision-making process during the period.

Within the industrial sector, the structure of investment was changed somewhat during the period 1961-1964. Table XVII shows the distribution of industrial investment in fixed assets by groups of activities for the period. The average share of total industrial investment going to each activity during the 1961-1964 period was as follows: (1) fuel and power--28 percent, (2) machinery and equipment--14 percent, (3) ferrous metals--10 percent, (4) chemicals--9 percent, (5) textiles and leather--9 percent, (6) wood and paper--9 percent, (7) food and tobacco processing--6 percent, and (8) nonferrous metals--5 percent (28, p. 625). The gradually shifting of emphasis from manufacturing industries to power production and "basic" industries was apparent. The share of gross industrial investment in fixed assets accounted for by the power and raw materials sectors increased from 55.1 percent in 1962 to 60.2 percent in 1964 while the share of the manufacturing industries decreased from 45.9 percent to

TABLE XVII

SOCIAL GROSS INDUSTRIAL INVESTMENT[a] IN FIXED ASSETS BY GROUP OF ACTIVITIES, 1961-1964

Industrial Activity	Year			
	1961[b]	1962[b]	1963[b]	1964[b]
Electricity	92	84	83	132
Coal Mining and Processing	22	21	28	35
Crude Oil and Natural Gas Extraction and Processing	12	16	23	31
Ferrous Minimg and Processing	16	34	63	99
Non-ferrous Minimg and Processing	22	26	30	29
Non-metallic Mineral Mining and Processing	14	10	12	16
Manufacturing of Metal Products (excluding Shipbuilding)	34	52	57	69
Shipbuilding	3.5	3.6	5.1	5.3
Manufacturing of Electrical Machinery, Apparatus, and Supplies	9	11	15	29
Manufacturing of Chemicals and Chemical Products	43	53	50	43
Stone Quarrying, Clay and Sand Pits, and Building Materials Industry	15	16	13	14
Manufacturing of Wood Furniture and Fixtures	17	18	20	24
Manufacturing of Paper and Paper Products	17	32	34	33
Manufacturing of Textiles	38	41	39	43
Manufacturing of Footwear, Leather, and Leather Products	4.4	3.7	5.5	5.7
Manufacturing of Rubber Products	1.9	3.8	5.3	5.8
Food and Beverage Manufacturing Industries	29	26	30	30
Printing Industry	2.6	7.6	8.6	10.5
Tobacco Manufacturing	1.6	1.6	2.7	5.7
Other Industries	15	12	8	12
Total	1,007	1,231	1,464	1,883

[a]Includes investment in industry and mining.

[b]Figures in billions of dinars at current prices.

Source: 86, pp. 3859-3860.

39.8 percent during the same period of time (84, p. 40). The trend of the late 1950's of increasing the relative share of industrial investment in the manufacturing sectors was noticeably changed during the period 1961-1964. There was a renewed effort to expand basic industries. These changes in the pattern of industrial investment were, in large part, due to planned changes in the development policy and also to the investment spending of decentralized economic units which were allowed greater autonomy under the reformed investment process (84, p. 41).

The technical structure of investment remained virtually unchanged during the period 1961-1964. The composition of nominal gross fixed capital investment by type of capital good for each year in the period is shown in Table XVIII. As reflected in the table, there was a slight decrease in the share of investment for fixed capital going for the purchase of machinery and equipment and a smaller decrease in the share absorbed by construction. The share of investment in machinery and equipment decreased from 34.2 percent in 1961 to 33.3 percent in 1964 while the share of construction investment fell from 54.7 percent in 1961 to 53.7 percent in 1963 and rose again to 54.4 percent in 1964. The changes in the investment process apparently had little impact on the investment decisions in the Yugoslav economy concerning the technical structure of productive facilities.

TABLE XVIII

COMPOSITION OF GROSS FIXED CAPITAL FORMATION
BY TYPE OF CAPITAL GOOD, 1961-1964

Type of Capital Goods	Year			
	1961[a]	1962[a]	1963[a]	1964[a]
Construction	6.4	7.2	8.4	11.1
Machinery and Equipment	4.0	4.5	5.3	6.8
Other	1.2	1.6	2.1	2.5
Total	11.7	13.3	15.8	20.4

[a]Figures in billions of dinars at current prices.

Source: 201, p. 800.

VI. ECONOMIC DEBATE AND REFORM PROPOSALS

The Beginning of Economic Descussion

The 1961 reforms "marked the beginning of a real academic discussion of economic matters." Until then, the rapid institutional changes and the small number of economists had resulted in only descriptive studies with little "rigorous analysis and discussion" (80, p. 83). The discussion began with "an exchange between Uvalić and Bićanić," two Yugoslav economists. Uvalić expressed a view "that income distribution and capital formation could not be left to regulation by the market." His view was based on the difficulties of distributing income according to work and his feelings that a capital market, used for capital formation and allocation, would be "unacceptable because it would lead to group ownership" and the emergence of individual instead of social profits. Bićanić argued that this view "did not distinguish clearly" between "the economic system and the plan." He further argued that the plan was to "become an instrument of the system instead of the system being accommodated to the plan." The implied replacement for labor and capital markets by Uvalić was the central plan with planners and politicians making the basic decisions. Bićanić felt this was unacceptable and pointed out the polycentric nature of the economy (80, pp. 83-84).

A debate was organized in December, 1962, by the Association of Yugoslav Economist to deal with the draft of the new constitution. "A number of participants" argued that the draft constitution "underestimated" the role of planning. Other participants expressed a desire

to have the "planned market economy" replaced in the future by a "market planned economy." One participant, Mihajlović, argued that, "while consumer and intermediate goods markets worked well, investment goods and capital markets were notoriously imperfect and needed strict control" (80, p. 84).

As evident from the early economic discussion, the dilemma of trying to achieve the goal of rapid industrialization while at the same time attempting to build an economic system based on the organizational principle of self management became more obvious. With one goal implying central planning and control and the other implying little direct intervention from the center, differences in emphasis concerning the relative importance of these goals necessarily led to a divergence of opinions over the desired roles of the market and plan in the economic system. As the recognition of the dilemma grew the "scene was set for a new confrontation" between those "who were convinced of the ability of the market to make rational decisions, not only within the framework of fixed capacities but also to make investment decisions, and those who were not prepared to entrust the socialist economy to the anarchic market process." The question over the roles of the market and plan and, in particular, the question over the need for continued investment planning and centralized control over investment decisions became the focal point of the economic debate in the early 1960's. As the debate continued "[t]he central issue" became "the role of investment planning and the side issues were the methods of implementing the plans" (109, pp. 120-121).

Debate Over the 1961 Reform Failures

The failure of the 1961 reforms, as reflected in the severe economic recession and the growing inflationary and balance of payments problems, and the policies adopted by the government to attack these problems prompted further economic debate. In precedent setting moves concerning economic affairs, the government requested and accepted, when completed, a study of the economic problems by the Institute of Economic Studies (80, p. 84). The findings of the study, known as the Yellow Book, revealed several shortcomings in the economic system that accounted for the recession. The immediate causes of the recession were found to be a defective investment structure and "hasty application of new policies" (both the reforms and the policies adopted to correct the problems that arose) (109, p. 125). In addition, inefficient planning causing economic instability, a downward long-run export trend, and a lack of a skilled labor force necessary for continued rapid economic development were found to be present in the economy. The exposure of the "inherently unstable" economy to the simultaneous shocks of the reforms, a shortage of money, and the absolution of income controls leading to rising wages in excess of productivity tended to move the economy into a recession with rising inflation.[3] The study called for an increased use of economic research

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[3]Horvat (80, p. 142) reported that inflationary pressures in the Yugoslav economy increased during downswings in economic activity due to the peculiar way of price formation and other institutions in the economy. Price changes are mainly determined by changes in wages and inflation is "most of the time a cost push inflation." Wage increases in any sector tend to initiate wage increases throughout

as a basis for economic policy and emphasized the need for a stable legal and policy-making framework as a "precondition for efficient operations of enterprises in a market setting" that was necessitated by the liberalization of foreign trade (80, p. 84).

Other economic studies were also produced. Of particular notice was a report by a group of Zagreb economists that analyzed the defects of the economic system. The study, known as the White Book, found the major causes of the economic woes to be: (1) too much centralization of decision making, (2) poorly made decisions by central planners, (3) too little freedom of initiative for enterprises, and (4) excessive intervention in the economy by central authorities leading to "faulty functioning of the market mechanism" (109, p. 125).

In a meeting organized jointly by the Association of Yugoslav Economists and the Federal Planning Bureau in January, 1963, both the Yellow Book and White Book were discussed. The meeting involved "centralist" and "decentralizers" in sharp conflict on a variety of topics. Both studies were strongly criticized by the centralist and, in particular, they questioned the compatability of striving for "efficient investment and a high rate of growth in a decentralized

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the economy and when cost pressures became large, prices are revised upward. This pressure becomes increasingly large during downturns in economic activity when enterprises find "it impossible to cover costs" and thus raises prices. This pressure is particularly strong due to: (1) a tax system which is tied to enterprise wages which are inflexible downwards, and (2) the tendency of labor-managed enterprises to not dismiss workers in a downswing of economic activity.

setting." Concern was also expressed concerning the "destruction of the socialist principle of income distribution" implied by the market system (80, pp. 84-85). The broad underlying question over the proper relationship between the plan and the market was again raised. This question was to remain in the limelight of economic debate until the 1965 reforms (109, p. 126). At the conclusion of the meeting the "majority of economists agreed on the necessity of further decentralization and the perfection of self-government autonomy" (80, p. 85). However, this view was not to be fully accepted by the government until 1964 when it became the basis and goal for a renewed reform effort in 1965.

Further Economic Analysis, Debate, and Reform Proposals

Growing inflationary pressures, a persistent and growing balance of payments deficit, and general economic disarray in the form of price disparities and output imbalances caused by the lack of adjustment of economic organizations to the reforms and policy changes and resulting in significant inefficiencies, characterized the Yugoslav economy in 1964. These problems and the apparent failure of various regulations and control devices employed to solve the problems, which often cause greater adversities, led to an intensified search for answers to the country's economic woes. An increased realization of the irrational character of certain aspects of the economic system, individually and collectively, began to focus greater attention on the hard choices of alternatives that must be made.

This setting led economic policy makers to eventually turn to reforms as a cure to economic problems (131, p. 286). The faults

of the 1961 reforms became more apparent and efforts were intensified to repeat the experiment but only after a complete analysis based on a clear conception of the direction of the economic system and built on key elements that were deemed required to achieve the desired goals. This analysis revealed numerous weaknesses of the old system and various requirements for the new system. Two themes prevailed throughout the analysis. First, the immediate need for economic stabilization was recognized and became the short-run order of the day. Second, there was a retention of the longer-run desire to introduce structural changes in order to continue to develop the economic system toward a self-managed socialist economy.

A major weakness in the economic system was the apparent confusion and inconsistencies of economic policy in general. After the 1961 reforms, price relations that remained unadjusted and "a great number of administrative controls in price formation" created an "unequal position" for some sectors of economic activity, hindered the "consistent implementation" of the income distribution principles of the reforms, and "adversely affected the expansion of production."

These problems led to "much interference" from the Federation in the form of grants, subsidies, premiums, and so forth, and to "high taxation" of certain enterprises. These interferences, coupled with the slow down in production and foreign trade, resulted in an uncertain source of income for social services and inadequate administrative methods for their financing (149, p. 2505).

The blend of local initiative and central guidance at lower levels of the economy, which as noted previously, was required in

order to simultaneously attempt to reach the dual goals of self-management and rapid economic development, was not functioning effectively. While past economic decentralization had placed considerable control in the hands of local enterprises over investment, production plans, and wages and profits distribution, there was no assurance that this power would be used responsibly and efficiently in terms of the planned development program. In addition, there was the continuing tendency for lower level government authorities to invest in new enterprises, which were often not economical, in order to provide local jobs and prestige. In period of economic difficulty for these "political factories" pressure was placed on central authorities for help. This often led to subsidies, additional investment funds for project completions, grants, and "other aids" to prevent the collapse of weak enterprises and unemployment in local areas. In this manner the central government was "subsidizing and encouraging" waste and inefficiency in the economy (1, p. 215). Such inefficiency would, it seems, have been particularly apparent in the allocation of government investment funds to the extent that political factors had become the dominant criteria for investment decisions.

Under the policy of "selective" intervention "there was no possibility of economic calculation or any incentive for it" on the part of the enterprises. Although the market was designed to play a large role in the economy, the profitability of the enterprise "came to depend less on market variables than on its political connections that determined its access to investment credits, to scarce materials, foreign currency, and import quotas; its receipts of various subsidies

and premia such as tax rebates, privileged interest rates, and privileged import and export exchange rates; and its ability to get approval for price increases." High taxes on "successful enterprises" meant low profit maximizing incentives while enterprises with losses "had to rely on subsidies and had no incentive at all." Since personal income depended little on enterprise success, but on external factors and as such was exogenously determined, "[i]ndividual incentive was weak" (109, p. 174).

Attempts of economic planning were seemingly futile in this environment. Since economic planners were subject to pressure groups, as previously noted, the planning process became politically conditioned. Planned targets and actual results often diverged widely. In fact, "conditions were such that plans themselves tended to become a cause of market disturbances" (164, p. 5).

The confused nature of the economic system and the inability of the Yugoslavs to work out consistent economic policy was apparent. The economic policies and the resultant economic events of the period "illustrated the disasterous consequences of combining central intervention in an arbitrary manner with an ostensibly market economy" (109, p. 168).

As noted previously, industrial development was also adversely affected during the 1961-1964 period. The weaknesses of the industrial sector of the economy included: (1) an unadjusted structure of production, (2) a "fragmented character" of production, (3) excess production capacity, and (4) insufficient specialization. These problems were due mainly to the lack of a fully worked-out conception

of economic organization based on self-management and decentralized financing as well as a long term conception of industrial development (124, p. 53).

Investment System Reform Proposals

An important part of the intensified analysis of the economy and search for economic rationality and greater efficiency involved the system of investment decision-making and financing.[4] As noted previously, the investment process was the focal point of economic debate during the entire 1961-1964 period. The decision in 1963 to abolish the GIF and contribution requirements of enterprises to social investment funds clearly reflected the intention of the government to further decentralize the investment financing system and sparked a stronger interest in other aspects of the overall investment process. Certain deficiencies of the investment system became apparent which implied new directions for structural and policy changes needed in that system to improve economic efficiency.

The system of investment financing that existed in 1964 was, according to Miljković (111, p. 19), "obsolete in many respects." Changes were needed in the conditions that determined the use of investment resources which would also change the "function of the individual bearer" of the investment process. This in turn required changes in the planning system, the banking and credit mechanism,

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[4]The review in this section of the problems and reform proposals in the area of investment draws heavily on the work of Miljkovic (111). This review will serve as a basis for the analysis in the following chapter concerning the investment process of the post-1965 reforms period.

and the instruments of credit policy. Specifically, changes in the conditions of resource use could be accomplished by changing the system of distribution of production and price relations in the economy.

Certain "needs" were viewed as necessary for a more efficient investment system to become operational. First, price relations had to be correct because the "first distribution" of income was dependent on prices. Further development of "freer and more economical conditions" in the investment process required corrected price relations. Second, additional changes in the income distribution system were needed to increase the share of income retained by the enterprises. This enlarged share would contribute to the expansion of investment decision-making power at the enterprise level while reducing investment decisions made at the government levels. The enterprise would become the principle decision maker in the investment process. This in turn would expand the concern of enterprises over product and factor markets. Technological change, reconstruction and new construction of productive capacities, resource combinations, and so forth, which would increase efficiency in the economy (111, pp. 20-21).

Under these proposed changes the roles of the various levels of government would be modified. The Federation would continue to indicate, through its plans, the general trend of economic development and investment policy. Some collective resources would continue to finance certain investment projects. The role of the Federation in the investment process would be to insure the development of underdeveloped areas, to invest as needed to co-ordinate the overall

development of the economy and to bring about conditions specified in the plans. The Federation would practice direct interference with the operations of lower economic units (banks and enterprises) to an extent necessary for economic stability or for implementation of "basic material relations" that had been determined by the social plans.

The proposed role of the republics was to: (1) help develop certain "depressed" areas, (2) make investments in "large" infrastructure construction, and (3) stimulate the development of "certain economic activities." Investment activity of the communes would continue to be in the areas of transportation, housing, and social services. The source of funds for these investment operations would be the personal income tax and not taxes levied on the income of enterprises.

The banking and credit system was also to be modified. Business banks were to operate on the basis of "economic principles" and were to be fully independent of direct government intervention in their daily operations. The criteria of profitability was to be their principle guide for investment credit decisions. The investment resources of banks were to be "free" (no longer tied to socio-political units) and the banks were to become "full risk bearers." Government authorities were not to directly interfere in bank operations but were to rely on regulation through federal law and indirect control instruments (111, pp. 22-25).

Divergent Debate Positions

Two divergent positions emerged from the continued discussion over economic problems and the need for a renewed reform effort. The "conservatives" concluded that decentralization had gone too far. Authorities could no longer adequately control investment demand and other "key parameters" of economic growth and thus could not control the rate and structure of economic development (152, p. 76). They emphasized the need for a return to tighter controls over decisions concerning investment, prices, output, and profits. This position was held mainly by the middle level party bureaucrats (1, p. 216). Other "centralizers," taking a less extreme position, accepted the "existing limits of the market economy" but advocated continued central planning of investment and the use of "more sound development strategies" (109, p. 126).

The "liberals" argued that it was the retention of existing centralized controls that was at fault in the economic debacle. The controls, they admitted, worked relatively well during the 1950's at a lower stage of development but were not adequate any longer. They expressed a desire for "market socialism" that was premised on the view that the market was "a more efficient instrument for optimizing growth than central authority." Investment was viewed as the key to the problems of inflation and distorted growth but only because of the continued presence of the state in the investment process. They emphasized the need to leave investment fund accumulations and investment decisions in the hands of enterprises while limiting the role of government in the investment process to major public works and

infrastructure projects. In this regard, they stressed the need to "depoliticize the economy" in general (152, pp. 76-77). The liberal view stressed need for decentralization to be carried to its "logical conclusion," that is, making enterprises truly free. This freedom was to include both the freedom to fail and the freedom to succeed, without direct state intervention. Only in this manner, it was held, could inefficient enterprises be uncovered and eliminated while rewarding and strengthening "profitable and essential" enterprises. The liberal position was held in large part by the younger party members and some senior party leaders, including Tito (1, p. 216).

The conflict between these two groups was "very sharp" (109, p. 125). Although some issues of the debate were settled and preparations for a new economic reform were begun in 1964, the debate continued until the introduction of the new reform in July, 1965, when on balance, the liberal view clearly emerged victorious.

Economic Reform Preparations

Against this background of economic analysis and debate, formal preparations were being made for a new economic plan and a new attempt at economic reform. Throughout 1964 various governmental assemblies were at work discussing the principles of a new reform (80, p. 83).

In April, 1964, the Federal Assembly passed a resolution on guidelines for further development of the economic system (109, p. 175). The resolution called for the economic system to move "towards greater reliance on working organizations and other self-governing bodies in the implementation of social and economic development policy." In

this regard, it called for a modification of the distribution of social resources "in favor of working organizations." The Federal Executive Council was to be the prime mover of the economic system in directions indicated by the social plan. The Council was to synchronize actions on the various areas of prices, income distribution, production, foreign trade, banking and credit, and the financing of socio-political communities and public services (149, p. 2506). These measures were apparently designed to help ensure greater consistency of the various aspects of the new plan and reforms and to avoid some of the problems that occurred after the 1961 reforms.

The resolution specified "more efficient utilization of social capital" and a removal of weaknesses in this area. Along these lines, the guidelines required "[w]orking organizations in the economy and public and social services" to become "principle levers and promoters of production and its expansion." In order to meet this requirement it was deemed necessary "to enable working organizations to dispose independently of social capital proportionately to their share in its generation" and also "to be independent in shaping their investment policies" in a manner consistent with social plans and "under conditions of a unified credit system." To achieve these objectives it was deemed necessary to gradually "abolish contributions levied on the income of economic organizations and those paid into Social Investment Funds" and to "simultaneously take adequate steps to adjust price relations" in the economy. These actions would in turn require a "corresponding change in other legal provisions regulating the

distribution of gross revenue and incomes of working organizations" such as turnover taxes, interest charges on working capital and investment credits, and the foreign exchange ratios (149, pp. 2506-2507). These proposed changes were to take full account of the different business conditions of the various sectors of economic activities which had arisen due to the different conditions of investment funds procurement, inadequate credit terms, and wasted depreciation funds that were part of the old system. These "conditions" were to be examined for the "possibilities for their elimination" (149, p. 2507).

The measures described above were designed to "encourage and require" further integration in the economy of various business associations and increased mobility of resources. The measures were felt to be necessary in order to "ensure, through social plans, economic measures and adjustments in the banking and credit system, the concentration and distribution of resources and the movements of investments" in line with local interests as reflected in the social plan (149, p. 2507).

The abolition of the GIF and the transfer of its resources to commercial banks had, it was apparently felt, helped in the development of an improved system of investment finance. In order to ensure further improvements it was determined necessary to "abolish other social investment funds in their [then] present form and function." This move would in turn require adjustments in the methods of planned regulation of investment resource use if "optimal utilization in line with social plans" was to be achieved (149, p. 2507).

Further development of the banking system was deemed to require certain measures "to strengthen the independence of banks in their

business transactions" and to stimulate their interest in assuming responsibility for placing social capital earmarked for production capacity expansion and for the "mobility and activation" of investment resources. Such an objective also required, as viewed in the resolution, actions to promote further bank organization and operations and measures to regulate the banks relations with other "social bodies." In this regard, the guidelines proposed, as a necessity, the building of a system of uniform credit conditions, unified methods of guiding investments, and unified instruments of credit policy. These measures would include a reorganization of the National Bank in a way to enable it to control, by "economic measures," the overall circulation of social capital and to influence the stability and movements of economic activity (149, p. 2507).

The guidelines also called for the development of long-term price policy foundations and the adjustment of prices to the proposed new conditions in income distribution. Such price adjustments were deemed necessary in order to: (1) enable planning officials to foresee future directions of development of "interrelationships among basic categories of production and consumption" and their combined impact on price formation, (2) ensure, through "adequate income distribution," the stability of factors influencing the level and structure of aggregate demand in the economy, (3)enable adjustment, by means of credit policy, of "effective demand to the level and structure of production" and individual "categories of consumption," and (4) give more freedom to the "play of market laws" to help adjust production and consumption to each other while removing price discrepancies and other structural discrepancies in the economy (149, p. 2508).

Price adjustments were also viewed as a necessary condition for enterprises and socio-political bodies to adjust, through policy concerning their income disposal, to changes in foreign and domestic market conditions. Price adjustments were also deemed necessary to modify the economic position of certain branches in order to enable them to operate efficiently at existing price levels. Through price adjustments it was hoped that subsidies, premiums, and other intervention methods used in the then present system, as a means of planned guidance, could be reduced to "adequate levels." Price adjustments would also enable changes in the price control system by allowing the abandonment of "administrative prices, particularly ceiling or frozen prices," and would allow officials to develop "adequate criteria and objective scales for social intervention and social price control (149, pp. 2508-2509).

These changes in the system of prices, income distribution mofidications, and the independence of enterprise policy of investment and production expansion that were proposed by the resolution would also require changes in the whole "system and methodology of planning" and the form and methods of direct intervention in the economy (149, p. 2508). A changing role for the plan and the market seemed to be clearly envisioned in the resolution.

A final major proposal of the guidelines concerned the development of underdeveloped regions. In order to accelerate economic development in these areas it was felt necessary to ensure the establishment of "the Fund envisioned by the Constitution for financing the economic development of underdeveloped areas" to provide these areas with a "permanent source of income" (149, p. 2510).

The resulution proposed certain fields of study for further work on the solutions to economic problems. These fields included: (1) production expansion and investment financing, (2) the financing of socio-political communities and public services, (3) price relations and their control, (4) distribution methods concerning the income of enterprises, (5) Federation intervention in the economy, (6) banking and credit, (7) the financing of underdeveloped areas, (8) foreign trade, (9) social services, and (10) the system and methodology of planning (149, p. 2511).

The failures of the 1961 reforms and the ensuing economic recession led to the doom of the third Five-Year Plan for the period 1961-1965. The Federal Assembly decided to replace it with a seven-year plan covering the period 1964-1970 (80, p. 90). On November 25, 1964, a joint meeting of the Federal Council and Economic Council of the Federal Assembly adopted guidelines for drawing up a new social plan (150, p. 2703). This resolution reinterated the positions of the April guidelines (109, p. 175).

The basic political and economic goals of the new plan were to be: (1) a rise in the standard of living, personal consumption, and the share of personal income in national income, (2) improved production efficiency and labor productivity to approach international standards, (3) expansion of trade, (4) more rapid development of underdeveloped areas, and (5) further development of socialist principles by "strengthening the role of direct producers and working organizations in the management of productive forces" (150, p. 2703). Although never implemented, the resolution "foreshadowed the Reform of 1965."

The radical institutional changes of the new reform, that were not fully envisioned by the resolution, were to necessitate the preparation of a new plan, but one which incorporated the goals of the 1964 resolution (80, p. 90).

Throughout the continuing debate and formal preparations of a new reform attempt, the full commitment of the government to the reform effort was uncertain. Due to the divergent positions concerning the causes of economic problems and the direction the Yugoslav economy should take, the reform movement partially stagnated. The reform had to wait on a resolution of the political conflict (109, p. 168). In a meeting in December, 1964, the Eighth Congress of the League of Communists finally resolved the political issue. The Congress ruled "in favor of decentralization and the new constitutional principle of the separation of the political and economic spheres" (109, p. 175). In the Guidelines for the Future Activity of the Communists and Working People the Eighth Congress called for the "more resolute emancipation of socio-economic relations from the fetters of state intervention" and the "still fuller affirmation of the role of the direct producer and working man in the process of socially-organized production" (73, p. 218). The Congress pledged the support of Communists to the implementation of the Resolution on the basic guidelines for the further development of the economic system and the Resolution on the guidelines for the drafting of the Seven Year Plan, as passed by the Federal Assembly (73, p. 225). The decision was made; the conditions existed for continued work for economic reform.

CHAPTER IV

THE 1965 REFORMS

I. INTRODUCTION

In the beginning of 1965, the Yugoslav government agencies began work on preparing formal economic reform proposals. By May, the "technical preparations" were finished (80, p. 83). The reform proposals and all "necessary calculations" were presented to the Federal Assembly toward the end of May. This marked the beginning of a large scale public discussion on the newly proposed measures. The reform was the major topic of the second plenary meeting of the central committee of the League of Communist of Yugoslavia. Further discussions took place in meetings of the Socialist Alliance, Trade Unions, economic chambers of the federal government, Republican Assemblies, and local government bodies (97, p. 21). In June, the general framework for the economic reforms were adopted by the Central Committee thus, giving final political approval of the proposals (131, p. 303).[1] On July 24, the Federal Chamber and the Economic Chamber of the Federal Assembly jointly adopted, after a two-day debate, some thirty measures concerning economic reform (97, p. 20).

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[1] A report submitted by Todorović (174, pp. 13-15) to the Central Committee indicated the nature of the reform discussions before this body. The full text of the conclusion of the Central Committee (25, pp. 149-150) indicated their support for the reform measures.

The major economic measures adopted were: (1) fiscal reforms and a new income distribution system that were intended to lower the tax burden and expand the volume of free funds of enterprises, (2) an overhaul of the entire investment process with a reduction in the government's role in decision-making and financing, (3) a reorganization of the banking and credit system designed to lessen direct governmental intervention in bank's organization, management, and policy, (4) liberalization of foreign trade including a currency devaluation, and (5) an adjustment and "temporary" freeze of prices to allow for preparations for a new price structure under the influence of market forces (152, p. 78).

The objectives of the 1965 reforms were divided into two, not clearly defined, categories. The immediate purposes of the reforms were: (1) to lessen the rate of inflation, (2) to remove the balance of payments deficit, (3) to increase the use of idle capacity in the economy, (4) to reverse the trend toward increases in unemployment, (5) to raise the standard of living, and (6) to find a form of government action to enable the country to have a "consistent economic policy" (13, p. 634). An additional objective was to put the relations between the government and enterprises on "completely new foundations" (91, p. 91). This involved a reduction in "all sorts of subsidies" and called for a reduction of direct government intervention in enterprise operations (58, p. 85). Investments, finances, and credits were to be mainly regulated "by direct business arrangements between enterprises and the banks based exclusively on economic criteria" (91, p. 91).

In addition to these more immediate aims, the reforms had certain longer-term objectives involving basic structural changes. These longer-term aspects of the reforms included: (1) an "overhaul" of the entire price structure to correct past distortions and anomalies, (2) a revision of growth and investment policies, (3) putting productivity on an "internationally competitive level," (4) liberalizing foreign trade to remove structural causes of chronic balance of payments deficits (13, p. 634), and (5) convertability of the currency to help expose the economy to the "stimulating influences" of world markets (80, p. 85). From the long-run point of view, the major objectives of the reforms were to: (1) create "more realistic economic conditions" where prices would be market determined, (2) expose the enterpirses to "sharp competition," domestically and internationally, and (3) "increase drastically" the autonomy of economic organizations by expanding the volume and freedom of use of their own resources (59, p. 633).

A principle aim of the reforms was to modernize the economy by sliminating uneconomic investments and production by compelling enterprises to respond to demand and supply forces in the market (119, p. 29). In this regard, the goal was to "induce appropriate decisions on the part of economic organizations and not to determine them directly" (153, p. 42). This meant making enterprises really independent, abandoning restrictive economic planning by central authorities, ending subsidization of uneconomic enterprises, making prices reflect costs, and freeing foreign trade (119, p. 29).

The reforms aimed in general at depoliticizing the decision-making process of enterprises including decisions concerning current

operations and investment decisions regarding size, location, and financing. This involved a removal of the "special interest approach" by all government levels in investment decisions, enterprise personnel selection and promotion, and demands on enterprises for state funds "contributions" (13, p. 636). In essence, a major purpose of the reforms was not to develop a new scheme of continued government controls but to make possible a freeing of the economy from administrative interference (59, p. 632).

The reform measures were expected to produce improvements in the quality of management in the economy, particularly concerning investment choices, factors of production use, and foreign trade volume. The desire was "to shift the economy from extensive to intensive methods of management" (6, p. 206). In its "broader social aspects," the reforms were expected to: (1) double the share of income controlled by enterprises thereby reducing the economic power of the state, (2) link the standard of living in the country to the level of productivity, and (3) "increase the rationality of economic decision making" (80, p. 85).

The official view concerning the general direction of the reform efforts was reflected in a statement by Boris Krajger, Vice-President of the Federal Executive Council, to the Federal Assembly at the start of the debate over the reform proposals:

> We have reached a level of development at which further progress and advancement of the economy necessitates the expansion of the market as one of the fundamental determinants of economic trends (97, p. 20).

The Yugoslavs attempted to introduce "a collection of legislative

measures" enabling the market system to function with the ultimate objective being the promotion of "greater economic efficiency" (109, pp. 175-176).

A most difficult task of the reform efforts was the integration of short-term and long-term economic objectives in a manner that would lead to a "normalization of the economy" in the context of a "decentralized economy consisting of worker-managed autonomous enterprises operating on the basis of market stimuli with as little planning and administration as possible from the center" (6, p. 204). The fundamental aim according to Bićanić (13, p. 643), was

> . . . to build a model of a socialist system for a developed country, one which will be able to stand the competition of other developed countries and progress on its own merits, without the constant tutelage of government machinery.

During the latter half of 1965 attempts were made to implement the reform measures. But, it was not until 1966 that "wholehearted commitment" to reform implementation was made due to a few remaining political barriers (109, p. 175).[2] Throughout the rest of the 1965-1969 period reform implementation was carried out and new and amended measures were introduced.

In the following sections of this chapter the various elements of the 1965 economic reforms and further changes made during the

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[2]A discussion of reform resistance, the fall of Vice-President Aleksandar Rankovich, and the purge of other anti-reformist in the Party can be found in a study by Pavlowitch (131, pp. 308-312). Statements made by Tito and other Party leaders after the reform indicated their strong commitment to the new reform effort (24; 25; 199) and their desire to remove all remaining political barriers to reform implementation (19; 148).

period 1965-1969, that had an impact on the investment system, will be discussed.

II. PRICES AND PRICE FORMATION

The Role of Prices and Pricing Problems Before the 1965 Reforms

The level and movement of prices is "an essential element" in the Yugoslav economic system and determines to a "very great extent [the] economic position of economic activities, production costs and income" in the whole system (188, p. 51). In a market oriented economy "prices directly affects profits, resource allocation, rates of investment, and income distribution" (109, p. 228). In addition to these influences, there were two factors of Yugoslav prices before the 1965 reforms that implied their crucial role in the economy. One factor was the special role that price policy played in development policy and the other was a somewhat distinctive influence of prices as compared to other market oriented economies.

Before 1965, price policy was an active instrument of overall policy. Socialism in Yugoslavia was deemed to require intervention in the market but, there needed to be a minimum of direct intervention in order to assure the preservation of self-management principles. Under these conditions, price policy became a major indirect control device. The investment structure in the economy depended in large part on the profitability of industries since profits were both a source of investment funds and an incentive to invest. Profits in turn depended in part on prices of inputs and goods produced by each industry. Thus, by controlling prices it was possible to control,

to a degree, the size and structure of investment in the economy (109, p. 228). This type of governmental intervention was apparently quite large during the years before 1965. Vuković (188, p. 51) reported that "the practice of administrative interference in the economy was longest and most extensively retained in the price sector."

In contrast to most market-oriented economies, the Yugoslav economy possesses little capital and labor mobility. This is due to "substantial impediments" that are the results of certain peculiar institutional factors (109, p. 230). Concerning labor immobility, there is no Yugoslav labor market as normally understood. Enterprises do not offer "any set wage" and thus, "no such wage can be assumed in the economy as a whole." What the enterprises do offer is a share in their future income and other benefits in terms of career prospects, employment security, job training, and welfare services. Enterprises offer these job aspects to "a very real, normally local, population seeking employment" and not on an "abstract labor market." Such offers are considered by individuals not in terms of some yardstick of reward for work performed (that is, so much per hour) since none exist, but "in terms of their own conditions and preferences" in light of the total job rewards. In addition, cash, and to a greater extent, non-cash benefits are linked to seniority and "extreme differentials" may be required for an enterprise to attract workers from other enterprises. "In any case, recruitment . . . by enticing away the workforce of other firms, is widely regarded as unethical." These "tangible" aspects of employment relations results in low labor mobility. Such

immobility necessarily becomes greater during periods of economic recession (177, pp. 277-278).

Before 1965, capital mobility was extremely limited due mainly to the lack of a capital market. As noted previously, the accumulation and distribution of investment funds was carried out mainly by the government and was not guided to a great extent by market conditions (such as price) in the various economic sectors.

The existance of capital and labor immobilities meant that prices affected not only the quantities of goods produced but also personal income levels and the amounts investment in each enterprise. Where "extreme supply inelasticity" existed there would have been little output effect. Thus, prices and price movements did not result in significant changes in the allocation of capital and labor resources but, did greatly influence the structure of investment and income distribution (109, p. 230). Due to these peculiar influences of prices in the economy "price disparities were both the cause and effect of a considerable amount of administrative control in capital investment" (189, p. 3601).

By 1965, the price policy of government in previous years had led to significant price distortion (12, p. 216). Low prices prevailed in certain economic sectors and most noticeably in raw materials, agricultural products, and most services. Although partly offset by tax policies (special tax treatment for certain industries and goods), discrepancies in prices resulted in "substantial" differences in the "economic position" of certain sectors and of enterprises within sectors (189, p. 3601). Milenkovitch (109,

pp. 172-173) explained the reasons for these price disparities and their implications for the economy.

> During the late fifties and early sixties much of the economic expansion in Yugoslavia had taken place in the manufacturing sector. This was favored by direct investment allocations and by several price policies that made investment both possible and attractive. The prices of most domestic raw materials were controlled and set at quite low levels. The prices of imported materials and equipment were low as a result of the exchange rate and the low tariffs. The prices of the basic components in the cost of living such as food, rent, power, and passenger transport, were kept low, which permitted wage rates to remain low. Finally, the prices received by the producers of manufactured goods net of turnover tax were quite high. As a result, certain industries, especially the processing industries, often showed high profit margins and were able, under the Yugoslav system of self-finance, to invest and expand capacities. In addition, the existence of high profits seemed to mean that there was little pressure to reduce costs. On the other hand, when prices were kept low by price controls, enterprise income was low and subsidies were necessary for the firm to survive. Under such circumstances the meaninglessness of the prices of the inputs of capital, labor, and the materials made the selection of efficient technology impossible. Finally, plants often operated at only a fraction of capacity because of the shortages of materials or of power.

That the government recognized these pricing problems was evident from statements made by Boris Krajger, one of the designers of the reform, in his report to the Federal Assembly in July, 1965, at the opening of debate over the reform proposals (97, pp. 20-22).

> This disparity of prices has led to an unreasonable use of primary products and also to a system of distribution which necessitated the administrative transferring of resources. . . .
> We have for years been recording disproportions in the material structure of production. What I have in mind is the fact that the development of the power industry and the production of raw materials and some semi-manufactures in lagging behind the development of other industries. On the one hand this production is subsidized, while, on the other, the processing industries are growing and, owing to the low prices of raw materials and semi-manufacturers, and cheap

> labor, are making big profits and exerting pressure on imports of raw materials at an unrealistically low import value of the dinar. . . .
> Inadequate price relations in the area of investment policy also facilitates the making of wrong investment decisions. . . .
> As a result of the disparity between prices, the processing industries developed rapidly although they have no raw material basis of their own. Owing to the restrictive scope of the home markets, the inadequate policy of prices and inadequate import value of the dinar, most of the processing industry capacities are burdened by low productivity on a too diversified scale of production which is unprofitable, while many of them are technically out-dated. . . .

Thus, the need to remove the existing price disparities was a crucial element of the 1965 reform preparations. Price disparities "hampered the further development of the system of self-government." Adjusting prices and removing existing disparities were "essential preconditions for the establishment of normal conditions of business and the further development of socio-economic relationships" (189, p. 3601).

Another factor that had led to a growing concern over prices involved a dispute over the effects of the active price policy employed by the government. The dispute, which reached "crises proportions" in early 1965, was precipitated by two factors. First, intervention in the economy had reached an "all time high." Second, consensus about investment allocation goals and distribution of income goals became increasingly difficult and eventually broke down. Since price policy was a major control device affecting these two goals, a dispute of prices occurred and became "as much a dispute over the structure of investment and income" as it did over prices and pricing policies (109, p. 229).

These problems concerning prices indicated that a "freer formation of prices" and a fuller influence of market laws were needed to provide "objective scales for measuring productivity and economic efficiency," and to help implement the principle of "income distribution according to work performed" as called for in the new (1963) Constitution. These matters were the starting principles for proposed changes in the system of price formation in 1965 (188, p. 51).

Price Reforms

In March, 1965, prices were frozen in order to lessen "inflationary tendencies" of the period of reform preparation (112, p. 107). A new price structure was prepared based on world prices "as registered in exports and imports" (80, p. 112). The objective was to establish "correct" price relationships (12, p. 216) while bringing prices "nearer to those on international markets" (49, p. 8) in order to gain a foothold in these markets (12, p. 216).

The inclusion of the Yugoslav economy in the world market was viewed as "the precondition for stepping up the intensification of business" and the rationalization and modernization of the economy (97, p. 20). In addition, it was deemed crucial to create, as much as possible, "equal conditions for the formation of income" by producer categories (49, p. 8). In this regard, price adjustments for certain industries were made to take special account of capital development needs (80, p. 112).

In a broader sense, the preparation of new prices was premised on the assumptions that "price is an objective economic category"

and that markets should be the "basic regulators of prices and price relations." The reliance on markets would eliminate the need for constant government intervention and as a rule, prices should be freely formed by enterprises. This would enable enterprises to "increase their iniative," improve their production methods, and "operate more economically and efficiently" (112, p. 108).

A new price structure was introduced in July, 1965, as part of the reform measures and prices were immediately frozen.[3] The price freeze was not designed to be a permanent feature of the new price system but was to remain in force until "necessary stability of material relations in the market" had been achieved and "conditions created for allowing the movement of prices to be governed by demand and supply" (112, p. 107).

The price adjustments resulting from the new price structure had a noticeable impact on the relative economic position of certain economic sectors and enterprises within sectors. Enterprises in certain industries, particularly those in power production, extractive industries, and service industries, found their cost-revenue picture improved while others, particularly manufacturing industries, found their earnings falling. The effect of price adjustments on enterprise earnings was partly offset by a new income distribution system (42, p. 3785) which lessened the tax burden of enterprises.

Vuković (189, p. 3602) reported that the prices established by the reform "provided a more adequate basis for the distribution

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[3]A detailed account of the changes in prices by economic sector can be found in a study by Vuković (189).

of social accumulations (savings) among individual [economic] activities" and allowed "a more rational approach to production and investment" by the enterprises. In this regard, the new prices, along with other reform measures, eliminated all elements from the price structure which were not directly related to business operations of enterprises.

The new price structure created the "general economic conditions" for greater enterprise autonomy (42, p. 3783). At the same time, the "pricing problem" for the government was lessened. Price policy was no longer a major tool for plan implementation. In addition, by allowing the market to determine much more of the flow of investment, the need for an expanded investment policy was eliminated and therefore no longer had to be achieved by a price policy designed to influence investment allocations (109, p. 249).

After 1965, a movement toward less control of prices was hinted at in official statements but price controls on a large proportion of products continued. In February, 1966, price controls remained in force over 90 percent of all products (138, p. 816). The implementation of the new price structure was apparently slow.

In April, 1967, the Price Formation and Price Control Act was passed. Under this law, the new price system based on the "free formation of prices by enterprises" was more fully implemented. Prices were to continue to be subject to a "certain amount of guidence" to adjust them to development objectives and current economic policy. Direct price controls were continued to be allowed. New product prices were not controlled and became an avenue to inflated profits. The

law lifted price controls for some industrial products. After this action, about 47 percent of industrial goods were free from controls. The new law changed the role of price authorities. The Federal Price Office no longer enforced price controls but observed market trends and analyzed economic conditions that influenced price formations and price structures (188, pp. 54-57).

New Pricing Problems

The attempt to restructure prices to establish "correct" price relations while enhancing the position of Yugoslav products in world markets encountered some difficulties. The price rises envisaged by the reform and the actual changes in prices after the reform differed. This led to a divergence of the actual price structure from the planned price structure. This, in turn, meant the capital formation in individual branches of the economy differed in reality compared to the plan and "new imbalances in investment capacity were added to those inherited from the past" (12, p. 217). In addition, due to the lack of significant increases in labor and capital resources mobility, prices continued to affect the pattern of investment and income distribution (109, p. 230).

The fact that price controls remained in force in large scale after 1965 led to new price disparities between controlled and uncontrolled products as output in certain industries became depressed. The reforms "eliminated the worst disparities, but subsequent price controls created new ones" (80, p. 112).

III. THE NEW PLANNING SYSTEM

Introduction

Changes made in the system of economic planning were an important element in the 1965 reforms. Modifications in the methods and practice of planning led to a noticeably lessened role for planning in the Yugoslav economy and particularly, in the investment process. The planning reforms were the culmination of a long and intensive debate concerning the proper role of planning in an economy striving for continued economic growth and development on the one hand and, on the other, attempting to fully implement self-government as the organizational basis for all social and economic activity.

As previously discussed, during the years under the command system with its centralized management of the money, the plan served as the major instrument of economic direction by the state. In the early years of the NES a system of "social planning" was introduced while a gradual expansion of enterprise decision-making autonomy over production, development, and market relationships was carried out (163, p. 17). The "social plans" were used to project economic development "expressed through highly aggregated flows and growth rates." The plan decided the "basic proportions" for the economy including the distribution of national income and retained a certain part that was "directive in character." That part concerned the size and structure of investment. Through the use of "direct decisions," regulatory devices, and economic policies (price policy, investment funds auctions, and fiscal measures) the central government controlled

almost all the decision-making power over investment outlays (153, p. 43). In the later years of the NES direct measures of guidence as a means of plan implementation were used less and "influence" through indirect measures was employed to a greater extent (163, p. 17).

As the economy continued to grow and the attempts to expand self-government intensified, questions concerning the need for a different approach to economic planning emerged. Throughout the early 1960's and especially after the enactment of the new Constitution in 1963, discussion and debate concerning the future role of planning in the economy became widespread and covered the spectrum of opinion from "semi-control planning to an almost complete laisser faire approach."[4] As late as early 1965, economic discussion continued. In a conference in Belgrade both centralist and decentralist positions were presented (80, p. 94). With the passage of the reform legislation in July, certain changes were made in the system of planning but, the exact nature and role of economic planning remained an unsettled issue.

Planning Reforms

Under the 1965 reforms, the Federal Planning Institute became responsible for preparing "minimum range guideline plans" (the first one to cover the period 1966-1970) in order to give "policy directions" to government authorities at all levels, enterprises, and other socio-economic institutions, particularly banks (59, p. 631). These plans

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[4]Milenkovitch (109, pp. 158-166) has reviewed in some detail the nature and extent of economic discussion about planning during the early 1960's.

were to establish only "broad lines of development" including: (1) the "long-run target rates of growth," (2) "major new investment projects," and (3) "investment in social overhead" (191, p. 63).

Under the new arrangements the plan was not to be binding or enforceable in the traditional sense but, was to be only "advisory" in character (59, p. 631). According to Richard Stajner, Director-General of the Federal Institute for Economic Planning, the plan was not to present to the economy, in advance, "concepts of development, growth rates, etc.," and there was no desire to offer criteria which would be binding on the enterprises (32, pp. 48-49). The plan was to "represent a combination of conditions for economic operations and other activities" in order to direct all factors in the economy "towards rational activity, in keeping with their interest. . . ." (54, p. 10). The state was no longer to directly dispose of investment capital. The responsibility and resources for capital development was transferred to the enterprises and banks (163, p. 17). In essence, the plan took on a new character with few "centralistic and directive" elements. In principle, it left "complete decision making autonomy in the decentralized units." The "active role" and "strategic character" of the plan was limited to situations and sectors where the market could not assure balanced development. This included those sectors with special significance for continued economic development (in infrastructure, education, and so forth) and those sectors or geographic regions that were considered less developed (153, p. 44).

Bićanić (12, pp. 41-62) has explained the main characteristics of the new planning system. The new system took on a "polycentric

pattern" with the autonomy of plans at all levels of government and within enterprises assured. "Polycentric" planning provided for a matrix of interconnections between all decision-making units in the economy and operated, in principle, vertically and horizontally among all planning levels. Any planning unit (federation, commune, enterprise) could make its own plans. "[A]ll decisions are registered within the framework of a matrix" which provided for effective "social integration" of information for decision-making.

A persistent problem of the NES was the territorial limits placed on administrative units and enterprises which resulted in a sort of territorial autarky where economic linkages among enterprises were diminished. In order to overcome this problem, the new planning system placed primary emphasis on enterprise planning. These plans were to play the "main role" in the planning process. In addition, all territorial boundaries were abolished to allow greater interplay among enterprises. Enterprises were to take the initiative for planning and were given control of planning of all aspects of their operations. They became, for the most part, "free to decide what to do" and were to bear all risks of those decisions.

Another study (162, p. 95) has outlined the functions of social planning under the new reform system as follows:

> (1) A plan is, first of all, a forecasting device. (2) As such it provides economic subjects with necessary information for their autonomous decision-making. This, together with institutionalized consultations, makes the plan an instrument of coordination of economic decisions. (3) After relevant social preferences have been determined by an essentially political process, the application of modern tools of economic policy make the plan an instrument for programming economic development. (4) Once the social Plan has been adopted by the

> Parliament, it becomes a directive for the Government. Point (4) is the only administrative or compulsory aspect of social planning.

Although the 1965 reforms moved the system of planning in a decentralized direction the exact role of planning remained confused. In 1966, the Federal Assembly, adopted the Thesis on the Fundamentals of Social Planning which was intended to clear up some questions concerning planning in a self-management, market-planned economy. An attempt was made to define the relationship between the market and plan and the role of enterprise planning. The document called for accelerated social planning to support the economic development process but only in an indicative manner. The plan was not to narrow the scope of self-management (163, pp. 21-22). In essence, the document seemed to reinforce the guideline or forecasting nature of planning to serve mainly as an information source for the economy.

In the latter 1960's, the trend in planning continued, according to Horvat (80, p. 94), "towards the laisser faire extreme." This trend was perhaps most clearly reflected in the changing role of the government in the investment process. In 1969, the Party Congress recommended the removal of all direct control over investment resources still retained by the federal government. Clearly, during the 1965-1969 period, planning played a smaller and smaller role in the economy. "Increasingly, plans in Yugoslavia have taken on a character of forecasts" (191, p. 64). But as late as 1969, a satisfactory solution to the problems of planning had not been found and work on the new Law on Social Planning, began in 1963, had not been completed (80, p. 94). The exact nature and role of planning in the new economic system remained, in large part, undefined.

The Abandonment of Comprehensive and Directive Investment Planning

The central feature of the planning reforms in 1965 was the abandonment of comprehensive and directive type investment planning by the government. Members of a Federal Assembly planning committee expressed satisfaction with the authors of the 1966-1970 Plan for basing the plan on the need for enterprises and not political bodies to make investment decisions (171, p. A/16). Federal Executive Council President Ribicic called for the "full affirmation of direct producers as the chief executors of the expansion of production." He described this action as the "basic objective of our social and economic transformation" (54, p. 10).

During the earlier years of the NES centralized investment planning and control were deemed essential for assuring rapid economic growth and development. But as the economy grew and the principle of self-management became entrenched in the economic system the "great advantages" of centrally planned investment began to disappear while an "inappropriate structure" of economic development became more evident (110, p. 14).

As noted in Chapter III, the early 1960's saw the emergence of an intense economic debate concerning the proper role for the market and plan in the Yugoslav economy. This debate centered around the need for continued centralized investment planning and control. During the 1961-1964 period a "drastic reduction in investment planning" was made. But, it was not until the enactment of the 1965 reforms and the introduction of "indicative" planning that the mechanism for comprehensive centralized investment planning was fully abolished (110, p. 14).

To say that investment planning was fully abolished does not mean that economic plans after 1965 contain no investment projections or that there was no attempt by the government to influence investment activity in the economy. The crucial difference between investment planning after the 1965 reforms and before was: (1) the degree of direct government intervention in investment decisions and (2) the willingness of the government to have enterprises initiate investment plans. In this regard, the social plans after the 1965 reform reflected to a large extent the aggregated investment plans of enterprises and did not attempt to hand down all investment decisions from centralized sources. The investment decision-making structure after the 1965 reforms is described in section II of Chapter V.

There appeared to be complex economic and political reasons behind the decision to abandon centralized investment planning. In an economic sense, the planning system had seemingly become "dysfunctional" and "produced faulty decisions" (109, p. 177). The "half-hearted decentralization" of the NES was upset by the continued development of workers' management which had, by 1965, fully developed into "a system of business management" and, in a broader sense, "into a system of overall social organization, so that the whole concept of socialism had come to be based on it" (12, p. 48). But, the real power of workers' management was limited to planning current operations of the enterprises while most investment decisions remained centrally directed. It was gradually realized that "it is not possible to separate current from growth activities." Efficient management of current operations "tends to make an enterprise grow" but, this was blocked by "obstacles

set by the central planning of investment" (12, p. 50). In essence, a duality existed where enterprise autonomy and market relations (an objective of the economy) could not develop together with comprehensive and directive type plans (153, p. 43).

Another economic problem was also evident. The inequality between the functions of the dominant center and the dependent decentralized units, particularly enterprises, created tensions which were an obstacle to rational planning. This was due mainly to the arbitrary nature of decisions concerning the roles of the center and the decentralized units in the investment decision-making process (12, p. 43). As indicated in Chapter III, this situation led to a confusion of economic policy and a misunderstanding by the central planners of the nature of the entire economy.

The real need for continued investment planning was challenged. At higher levels of economic development the misallocations (in a social interest sense) that are likely to occur from using the market "may become less significant relative to the total volume of investment" (109, p. 177). To this extent, the continued need for centralized control of investment decisions to assure further development was lessened. This aspect implies that the decision to abandon comprehensive centralized investment planning may have been allowed due to the recognition of its lessened need.

Certain political factors appeared to have also played a part in the decision to abandon comprehensive investment planning. Milenkovitch (109, pp. 177-179) reported that centrally planned investment became "impossible" in Yugoslavia due to the lack of political

consensus about such planning. No consistent agreement could be reached on the overall rate of investment (the share of investment in total output) nor on the regional allocation of centrally allocated investment funds. According to Neuberger and James (122, p. 283), a "political tug of war" over investment funds developed as a result of the persistent nationality problem. Fear of Serbian domination in investment allocations led to a disallusionment by the other republics and regions concerning central planning and increased their willingness to experiment with a more autonomous, decentralized system. Milenkovitch concluded (110, p. 15) that the absence of political consensus about the objectives of planning and the exact development strategy to follow was the main reason for the decision to abandon comprehensive and directive type investment planning in 1965.

IV. INCOME DISTRIBUTION REFORMS

Reform Objectives

A major part of the overall 1965 reform effort involved changes in the system of income distribution within enterprises. In order to achieve the objective of increased use of the market in the economy, the income distribution system had to be modified to allow greater autonomy for enterprises to respond to market forces. Such a move was also in line with other reform measures that were intended to enhance the efficiency of the use of the investment resources of the economy. The critical need for modifications in the system of income distribution was recognized by the government as reflected in statements

made by Boris Krajger at the beginning of debate in the Federal Assembly over the reform proposals.

> [W]e shall have to make radical changes in the system of income distribution. I hold therefore, that, apart from changes in price relations, very important steps are the measures to eliminate duties on earned income, to shift the purchase tax [turnover tax] from the sphere of production to the sphere of consumption and to effect a series of other changes in the province of secondary distribution (97, p. 20).

The aim of the reforms was to leave the enterprises a greater share of their net income and thereby strengthen workers' self-management by leaving them more funds to distribute according to their own decisions (12, p. 213). The desire was to "increase drastically" the autonomy of enterprises (59, p. 633) by allowing them to play an expanded role in income distribution (65, p. 99).[5]

The changes in the system of income distribution were also designed to force enterprises to become more concerned about internal sources of funds, modernization of production facilities, and the establishment of "cooperation and integration" with other enterprises. These steps were viewed as prerequisites for expanding economic efficiency by solving problems of: (1) unprofitable, too diversified, and too costly production, (2) unused capacity, and (3) small-scale production

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[5]Although substantially modified during the 1960's the system of enterprise income distribution continued to be based on a concept of "net income" that had gradually evolved since 1957. This concept had grown from a desire to make the part of "social product" required to meet the needs of enterprises and their workers "independent of outside forces." The ultimate aim of a system of income distribution based on this concept was to "make workers the masters of their fate" (128, p. 81). In this regard, the changes made in the income distribution system in 1965 were complementary to the overall reform effort to expand self-management autonomy and thereby further enhance the attainment of the objective of a self-managed economy.

(97, p. 20). In essence, the changes in the system of income distribution along with other reform measures, specifically, the removal of all government subsidies and the adjustment of prices and price freezes, would pressure enterprises toward greater operating efficiency. Faced with higher costs and frozen prices many enterprises would be subjected to strong pressure to increase productivity and quality of their products. Enterprises were to be productive and prosper or fail according to their judgment (105, p. 69). With no more government intervention, inefficient firms would be forced to reorganize or close (13, p. 638).

The foreseen results of the reforms on the distribution of income was a redirection towards enterprises of a "massive" share of resources which remained, before the reform, at the disposal of government (49, p. 12). In 1964, enterprises retained about 51 percent of net social product, while the government's share was about 49 percent. After the reform, the share of the enterprises was planned to eventually grow to about 71 percent (97, p. 23). The drastic reduction in the governments' share of national income was to be allowed by a sharp decrease in government expenditures. The reforms were to greatly lessen the transfer payments of government in the form of subsidies, premiums, and so forth, and, in addition, emphasis was to be placed on greater efficiency and more rational spending in government (97, p. 23).

Reform Measures

The 1965 reforms introduced a number of changes in the type,

number, and volume of "contributions"[6] and in the scale and structure of taxes levied on the income of enterprises. Substantial changes were made in the formal income distribution scheme, that is, in income account arrangements, in the depreciation system, and in regulations concerning the use of enterprise funds. These and other changes were gradually implemented throughout the 1965-1969 period.

The number and total volume of "contributions" levied on the "gross personal incomes" account of the "net income" of enterprises were increased after 1965. This was due to the addition of new contributions and the relocation of others in the income distribution accounts scheme.[7] The new contributions included: (1) a charge for the reconstruction of the city of Skopje from the distruction of a earthquake in 1963, (2) a charge accruing to communal budget funds for financing schools, and (3) a "labor exchange contribution" accruing to communal and republic Labor Exchange Offices for financing unemployment relief and job training and retraining programs (128, p. 76).

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[6]"Contributions" is an official Yugoslav term referring to statutory and obligatory payments required by all governmental levels from the income of enterprises. A formal distinction is made between "contributions" and "taxes."

[7]In essence, the enterprises' income distribution scheme after the 1965 reforms was as follows: (1) From gross revenue; operating costs, depreciation charges, taxes and contirbutions to the community, and the turnover tax (sales tax) were deducted leaving net income. (2) Net income went for "gross personal incomes" or to the "enterprise's funds" (128, pp. 74-77). "Gross personal incomes" consisted of: (1) wage and salary payments to the enterprise's employees and (2) various obligatory contributions. The "enterprise's funds" consisted of: (1) the "reserve fund," (2) the "business fund," and (3) the "welfare fund."

This last contribution replaced the "vocational training contribution" previously levied against gross income and thus, did not represent a net increase in the number of contributions against enterprises' income.

Other contributions levied on enterprises' net income were lowered or abolished. The "contribution on personal incomes" (a payroll tax) was reduced from 17.5 percent of the wage bill (net personal incomes) to 10 percent. The "social insurance contribution" was reduced from 24 percent to 20.5 percent of the "contribution on personal incomes" (49, p. 12; 128, p. 77). In essence, the reduction in the payroll tax rate and the resultant lower total payroll tax (given net personal incomes) along with the lower rax rate for the social insurance contribution amounted to a double reduction in enterprise contributions. In addition, contributions for transportation services and for housing construction funds for local governments were abolished (49, p. 12).

Unlike the impact on enterprise contributions, the 1965 reforms greatly lessened the number and volume of "taxes" levied against enterprises' income. Most important, the turnover tax was moved from the production level to the commerce level and was no longer paid by producing enterprises (128, p. 76). The 15 percent tax on enterprises' income was abolished (80, p. 115). The rate of taxation on the capital of the enterprise ("business fund") was reduced from 6 percent to 3.5 percent (49, p. 12) and remained as the only federal tax on enterprises' income (126, p. 16). After these tax reforms enterprises paid no taxes on either their net income or profits (net

income less gross personal income charges) (12, p. 213). The reduction of the number and total volume of taxes levied against the enterprises more than offset the increased burden of contributions on the enterprises gross income. The net effect was an expansion of funds left at the disposal of the enterprises.

Another important aspect of the 1965 reforms in the area of income distribution was the expansion of the enterprises freedom of use concerning their income. The Worker's Councils were given "direct control" over the distribution of the enterprises' net income between gross personal incomes and internal enterprise funds (62, p. 337). Bićanić (12, p. 214) reported that "all restrictions" concerning this distribution were removed. In addition, no "specific allocation" to internal enterprise funds, other than the "revenue fund," was obligatory (126, p. 16). Together, these changes implied a marked expansion of enterprises autonomy in the distribution of their income.

These comments concerning the degree of enterprise autonomy in the distribution of its income may be susceptable to misinterpretation by the reader. Although there remained no direct requirement or regulation that forced enterprises to allocate a specific share of their net income to gross personal incomes or internal funds, there did remain certain legal obligatory allocations that enterprises were required to meet that affected their true autonomy in this regard. Concerning their internal funds, enterprises were required to set aside a "part" (no minimum required) of their income for debt repayment and fixed asset purchases (126, p. 17). In addition, the 1963 credit reforms required enterprises to maintain a certain amount of working

capital in their "business fund" in order for them to be deemed credit worthy. This indirect restraint was abolished in 1967 (190, p. 54). Also, the contribution charges levied on gross personal income should be considered as minimum requirements and as a constraint on enterprise autonomy. In addition, a federal statute set a minimum income (wage) for all enterprise employees and republics or communes were allowed to set additional minimum wage payments (128, p. 84).

Further Reform Efforts

With the passage of the Enterprise Depreciation Act in July, 1966, the system of depreciation was modified. Although the new law continued to require enterprises to "make good" decreases in the value of their fixed assets due to "wear and tear," obsolescence, and so forth, and to "prevent the value of these assets from being used for consumption purposes," it specified only the minimum rate of depreciation for individual groups of fixed assets. All other details concerning the methods of calculation and any additional depreciation charges were left for the enterprise to decide (64, p. 101). In general the principle features of the new depreciation system were: (1) a lower limit set by federal law, (2) an upper limit set by the enterprise, (3) a requirement that all users of social property pay depreciation charges, (4) the abolishment of a separate account for depreciation funds, and (5) the elimination of all restrictions on the use of depreciation funds by enterprises. Enterprises became "fully independent in purchasing, selling, or scrapping their fixed assets" (64, pp. 104-107).

The new depreciation law also provided for the revaluation of fixed assets effective January 1, 1967 (134, p. 13). The upward revaluation had two important effects on the income distribution of enterprises. First, there was an increase in the share of depreciation charges out of enterprises' gross income although depreciation rates were allowed to be lowered (126, p. 17; 200, p. 209). Second, enterprises were left paying about the same tax on capital even though the rate had been reduced, as noted previously, from 6 to 3.5 percent (12, p. 217). This latter effect was, in fact, anticipated in the 1965 reforms (97, p. 26).

New legislation (Basic Law on the Determination and Distribution of Income in Work Organizations and the Amendments to the Basic Enterprise Act) was passed in 1968 that altered further the system of income distribution. A principle change was the different treatment of net income. Net income was redefined as gross revenue minus operating cost and depreciation. As a result, all contributions were charged to net income. Another change involved the treatment of interest on credits, payments for other bank services, and insurance premiums. These became charges against net income instead of part of operating costs (128, p. 77). These modifications seemed, to this writer, to be mainly accounting procedure changes and did not necessarily affect the size of enterprise funds or the freedom to use these funds.

Under the new legislation, the turnover tax was completely excluded from charges against enterprises' (production and commerce) income. In essence, it became a sales tax, levied at the retail level,

and paid entirely by consumers (128, p. 76). This change implied a once and for all increase in the net income of enterprises.

A final change involved the treatment of "many losing enterprises." Under the new income distribution laws, enterprises operating at a loss were exempt from paying all statutory obligation (128, p. 77). As noted previously, the 1965 reforms called for the elimination of all special treatment for enterprises and for enterprises to respond only to market forces. The willingness of the government to live with those dictates was apparently short-lived.

Reform Results

The net effects of the changes made in the system of income distribution during the period 1965-1969, were the expansion of the share of social product retained by the enterprises and the increase in enterprises autonomy in the use of these expanded funds. The slight increases in contributions levied on enterprises' income were more than offset by the reduction in tax charges and, although some restraints still remained over the ability of enterprises to use their free funds, the constraints on enterprises use of their income were significantly less than before 1965. These changes implied a marked expansion of the enterprises self-financed investment potential.

The actual increase in the share of social product, although rising well above the share of the pre-1965 periods, fell short of that level envisaged by the 1965 reform objectives. As noted previously, the enterprises' share in social product was planned to rise to about 71 percent. The actual share was 61.9 percent in 1966, 60.8 percent in 1967, and 59.4 percent in 1968 (128, p. 82). The

trend of the initial post-1965 years was obviously contrary to that called for in the reform resolutions.

V. BANKING AND CREDIT SYSTEM REFORMS

Introduction

The 1961 economic reforms in Yugoslavia were concentrated mainly in the area of monetary and financial affairs and marked a decisive step toward the development of a banking and credit system in line with the principles of a self-management market oriented economy. Throughout the 1961-1964 period attempts were made to continue this direction of development by correcting basic deficiencies in the institutional structure and financial mechanisms of the banking and credit system. With the enactment of the Bank and Credit Law and the National Bank Law in 1965, the banking and credit system became more fully adjusted to the overall system of investment envisaged by the 1963 Constitution and the Federal Assembly resolutions on the further development of the economic system.

The "principle aim" of the new legislation was to create a mechanism that would "ensure the necessary concentration and efficient use of social capital" for the "expansion of production." In line with other reform measures, the new banking and credit laws were designed to greatly lessen the dominant role played by government in the management of social capital, that is, in making investment decisions concerning its use, and to remove governments' "decisive influence" on bank management. New principles of banking were to be adopted while others were to be abandoned, particularly the territorial

limits on banking operations. A modification in the system of short-term credits was also expected (93, p. 3215).

These objectives required numerous changes in the institutional structure and operational methods, particularly in the area of investment credits. In this regard, the 1965 banking and credit reforms directly affected the investment process in the economy. For this reason, a full discussion of these reforms is essential to an understanding of the investment process as it evolved during the 1965-1969 period.

Reorganization of the Banking System

With the passage of the new laws in 1965 the banking system underwent "substantial changes" regarding: (1) the founding, management, and functioning of banks, (2) the capital requirements of banks, (3) the status and role of banks in the economic system, and (4) the relations among enterprises, government, and banks. The new role for business banks included the management of social capital funds for investment, the granting of credit, and the carrying out of other banking operations. The banks, like other business organizations, were to be guided solely by economic criteria. Regarding their financial resources, the banks were to "earn the money" themselves and use it profitably in carrying out their operations (134, p. 19). All bank operations were to be carried out in a manner to satisfy the needs of enterprises, other working organizations, and socio-political communities. In order to perform this role effectively, banks were to be given full independence[8] in their operations (93,

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[8]The term full independence does not imply the lack of use

p. 3223; 3, p. 814). The independence of banks was a "decisive step" of the 1965 reforms toward lessening administrative controls in the area of investment and capital development (93, p. 3216).

Under the new legislation, business banks could "carry on their activities in the whole territory of Yugoslavia" (3, p. 814). This led to an increased freedom for enterprises to choose business partners and implied a more efficient use of investment funds in the economy. In addition, the abolishment of the "territorial principle" of banking was an important step in enhancing the flow of capital funds in the economy and served as a part of the needed basis for the emergence of a capital market.

The Banking and Credit Law provided for three types of business banks: (1) investment banks, (2) commercial banks, and (3) savings banks (2, p. 820). The "principle activity" of the investment banks was the granting of investment credits for fixed and working capital assets. Commercial banks "primarily" granted short-term credits but could also grant investment credits under certain prescribed conditions. Savings banks kept savings deposits and granted credits to consumers. Although the type of bank and nature of its operations were specified in a bank's charter, it could engage in operations "which in principle fell within the scope of activity of another kind of bank" (93, p. 3224).

After the 1965 legislation, two of the former federal specialized banks (Investment Bank and Agriculture Bank), the six republican banks,

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of indirect control measures by the government or the lack of regulations constraining bank operations. These controls and regulations are discussed in a following part of section V.

and the two banks of "autonomous regions" were transformed into investment banks. The Foreign Trade Bank became a commercial bank. The previous communal banks were reorganized into commercial or mixed (commercial-investment) banks. Many communal banks merged and the total number of banks decreased sharply (76, p. 580). Horvat (80, p. 136) reported a reduction in the number of banks by one-half in the first three years after the 1965 reforms.

The National Bank kept "fundamentally the same functions" as before the reforms but, the National Bank Law did spell out in more detail the exact powers and responsibilities of the central bank (76, p. 579). The National Bank's fundamental functions were: (1) to regulate, through currency issue and credit policies, the money supply in order to promote the "smooth flow of production and commerce," (2) to take measures necessary to provide for the full utilization of the economys' productive capabilities, and (3) to ensure the necessary liquidity and credit relations with foreign countries (93, p. 2333). The new law indicated that the National Bank "shall be independent in performing its tasks" (3, p. 748) and thus clearly remove direct and constant government intervention from its operations.

The Founding of Business Banks

Before the 1965 reforms, banks could be founded only by the various levels of government. Under the new arrangement, banks could be established jointly by enterprises, other working organizations, and governments as "equal" partners (93, p. 3225). The previous distinction between federal banks and commercial banks was abolished

with only the formal distinction of the charter granting procedure remaining (165, p. 108). Certain conditions had to be met in order to found a bank with the "two most important" being: (1) a definite amount of initial capital had to be secured, and (2) a certain number of founders had to provide the minimum capital (93, p. 3225). The number of founders and the minimum capital requirements were determined by the Federal Assembly (3, p. 821). The minimum number of founders was set at twenty-five for all banks while the capital requirement differed according to the kind of bank. This capital was paid into the "credit funds" of the banks to serve as initial operating resources (93, p. 3225).

The new law prescribed certain additional requirements. Investment banks founded without the Federation's participation required special legislation from the Republican Assembly of the territory in which the bank was founded (3, p. 821). The minimum capital requirement could be raised by republics above the federally determined level (93, p. 3225). In addition, a savings bank could be founded by only one government assembly (3, p. 823).

Bank Management

The management organs of the business banks were the banks' assembly, executive committee, credit committee and manager (3, p. 824). The assembly was the "supreme organ of management" of the bank (93, p. 3226) and had the authority to: (1) determine the banks' business policy, (2) determine the general conditions for granting credits and depositing resources in the bank, (3) determine the basic

distribution of bank income between the credit fund and that part left for internal distribution, (4) establish or abolish operating units of the bank, (5) determine the scope of self-management rights of the banks' workers, (6) elect members of the executive committee, and (7) appoint members to the credit committee (3, pp. 825-826).

A bank's assembly was comprised of representatives of founding organizations which had deposited resources in the bank and thus had legally obtained the right ot manage the bank (3, p. 824). The rights and responsibilities of members of the assembly were determined in accordance with the amount of capital they invested in the bank's credit fund. The founders of a bank shared in its earnings and bore the risk of its losses according to their "shareholdings." Income earned from bank operations and received by its founders could be used only for financing capital development of the founding organization and not for paying employees (93, p. 3225).

The new laws set certain limits to the management rights of bank founders. No one "shareholder" could have more than 10 percent of the votes in the bank's assembly. The workers' collective of the bank could be given votes in the assembly but they were not to exceed 10 percent of the total. The law allowed the pooling of founders votes in order to enhance their voting strength subject to the 10 percent limit (3, p. 824). Also in this regard, certificates of bank founders ("registered securities" that were issued in the amount of the capital investment of the founder) could be sold or transferred to other enterprises but <u>not</u> to other banks or government bodies (12, p. 222). This was apparently an attempt to help ensure enterprise control of banks.

The role of government in the management of banks was also limited. If two government bodies founded a bank, they could, collectively, have no more than 10 percent of the total assembly votes. If three founded a bank, the limit was 20 percent. In addition, government bodies could not found a bank alone (12, p. 221). In essence, the law indirectly required that enterprises have at least 70 percent of the bank's assembly votes (12, p. 221) and thus ensured, formally, their control over bank operations. The banks were no longer independent of enterprises (49, p. 10).[9]

The banks' other managing organs (executive committee, credit committee, and manager) were responsible "for the interpretation and implementation of business policy, decisions, conclusions, and guidelines laid down by the assembly." The executive committee worked out the details of bank policy (terms and kinds of credit, purposes for which credit could be granted, and so forth) and implemented these decisions and those made by the assembly (93, p. 3226).

The bank manager "independently" managed the bank's daily operations in conformity with the decisions, resolutions, and guidelines of the assembly and executive committee. In addition, the manager could "suspend" the execution of a decision of the executive or credit committee subject to clarification by the bank's assembly.

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[9]This was not an insignificant development. With the sharp reduction in the government's influence over investment activity and the expanded role for banks regarding investment, the new banking system, with the formal control of banks in the enterprises' hands, implied a dominant role for enterprises in the investment process. These aspects are more fully discussed in section II of Chapter V.

The credit committee of the bank was appointed from the "workers of the bank" with the bank manager serving as its chairman. Its main duty was to "decide on requests for credit" (3, pp. 826-827).

Bank Funds

The new bank laws provided for two kinds of funds for business banks. The first type of funds was similar to those of all other working organizations and included: (1) the working fund (for regular bank operations), (2) the reserve fund (for covering possible losses), and (3) the housing and social services fund (for satisfying the "common needs" of the workers). The second type of funds was those "necessary for the basic activity of the bank." These funds were the "credit fund" and the "special reserve fund" (93, p. 3227).

The credit fund was comprised mainly of initial capital resources that were invested in the bank by its founders and bank income earned in its operations (3, p. 828). There were additional sources of revenue for this fund including: (1) a "rise in the founding share" or the issuance of new shares to organizations that were not initial founders, (2) a part of the bank's annual income as determined by the banker's assembly, (3) deposits from the previous social investment funds of the various governmental levels as required by law in 1965, and (4) reinvestment of interest or dividend payments to bank shareholders as required by law (93, p. 3228).[10]

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[10]The legal requirement that bank shareholders reinvest all dividend payments in the bank's credit fund was likely due to a desire to avoid the unearned or non-work income aspect of these payments which was deemed anti-Marxian in principle.

The special reserve fund was made up from part of the bank's income alloted to the credit fund. An annual minimum of 2 percent of the "amount of credits granted by the bank as shown in the balance sheet for the year" was set as the required payment into this fund (3, p. 829). The fund had a twofold purpose: (1) to ensure the banks liquidity and (2) to cover losses from bad debts incurred from credit operations not written off against current income (93, p. 3228).

In addition to the specific sources of revenue for bank funds, as described above, banks had several other sources of income aside from that earned through credit operations. The most important of these were: (1) "time deposits," contracted for a minimum of three months, (2) "sight deposits," made by economic and governmental organizations, (3) savings deposits by the public, made to commercial and savings banks, (4) funds from bonds and "other securities" issued by the bank, (5) government resources transferred to the banks for investment purposes, (6) foreign loans, and (7) borrowings from the National Bank (76, pp. 581-582).

Bank Credit Operations

According to Jovanović, (93, p. 3222) "[t]he starting principle of the new credit and banking reform [was] to leave enterprises a larger share of the savings at their disposal, and consequently also to restrict the direct role of socio-political communities in investment decisions." Before the 1965 reforms, enterprises were often compelled, indirectly, to spend their investment resources in a way "which not always contributed to the expansion of their economic

potential" (93, p. 3222). In addition, barriers existed that blocked the flow of investment resources in the economy. As a result of the banking and credit reforms in 1965, enterprises, in addition to experiencing an expansion of funds at their free disposal and increased autonomy in the use of that capital for their own purposes, were able to invest part of their "savings" in banks and to participate in decisions regarding the use of investment capital (93, p. 3222). Under normal business conditions and having more resources at their free disposal, the financial investment by enterprises in banks tended to enhance the mobility and efficiency of investment allocations in the economy.

As noted previously in the discussion of bank management, banks became much more autonomous in all their activities, including credit operations. The bank's credit committee, under the guidance of the assembly, granted credits under general economic criteria of profitability and the bank's own policy concerning credit priorities (76, p. 583).

Under the new arrangements the practice of governmental accumulation of investment funds through taxation of enterprises' income was no longer required on a large scale. Only in certain specific cases could government bodies directly invest in the economy. But, the 1965 reforms did not eliminate all governmental control over investment credit decisions. They could continue to lay down guidelines in social plans and legislation and could require banks to extend credits for certain purposes under lower interest rates and certain "privileged" terms as long as they fully compensated the

banks (69, p. 3222). Although the banks were expected to follow the guidelines of the plans, their decisions concerning investment credits were not subject to direct administrative or legal controls (59, p. 634). In addition, long-term investment credits for certain special projects or branches, although financed from "social investment capital" concentrated in banks, could be regulated by government through special legislation requiring "definite resources" deposited in banks by enterprises and government bodies (93, p. 3222). Other governmental resources accruing from repayments of credits granted under the previous "social investment fund regime" were placed in banks for investment purposes and earmarked by the government for specific branches or projects (76, p. 582). Also, the Federal Fund for Accelerated Development of the Less Developed Republics and Regions and housing funds, previously controlled by local government, and now taken over by the banks, were funded, and credits from them controlled, by the government (76, p. 593; 134, p. 15).

As indicated previously, the National Bank, in addition to performing its normal central banking functions, was authorized to grant credits to business banks for the "activation of the productive capacity of the economy." Such credits were "much more restricted" than other credits which were intended to supply the economy with sufficient circulatory capital. These special credits could be given only under conditions deemed necessary for the removal of bottlenecks in certain sectors of the economy and to "stimulate a new line of production" or the production of a good "of special interest for export." Such conditions had to be determined by federal government bodies

and these grants had to be "specially authorized" by federal legislation (93, p. 3234).

Excluding the granting of consumer credit by savings banks, the credit operations of commercial and investment banks, provided for in the Bank and Credit Law, were of two types: (1) long-term (investment) credits and (2) short-term credits (76, p. 582). The new division of credit types was based on an attempt to link more directly the "functions of individual kinds of credit" to the "source from which they can be extended" (76, p. 583). These provisions were part of an overall attempt to shift the focus of monetary control from the demand or use side of the credit process to the supply side.

Investment credits included all credits with "the character of long-term investment outlays" (93, p. 3229) and those that the banks granted from assets derived from bank income and "long-term deposits." Under the new legal provisions, investment credits could be granted to "working and other organizations and to social-political communities" for "economic and non-economic investments" and for investments in fixed or working capital assets. Long-term credits could also, under special provisions, be granted to citizens and government bodies and to enterprises as "financial recovery credits" (3, pp. 831-832). Economic organizations could "freely choose" the bank(s) to establish credit with and were not linked formally to any bank in this respect (8, p. 4).

The sources for long-term credits were confined to: (1) the banks' credit fund and the "cash part" of other bank funds, except the reserve fund, (2) time deposits of more than one years' maturity,

(3) funds acquired from bond issues with maturities of more than one year, (4) funds obtained from loans, foreign and domestic,[11] (5) funds provided by government for investment purposes, and (6) funds especially designated by the National Bank (3, p. 832). Rational and efficient use of these funds by banks was partly ensured by legal requirements of "documentary material" from the borrowers that quantified the "financial effects" expected from the planned investment and the provided "sufficient proof" of the borrowers ability to secure the "necessary resources" to complete the intended project (93, p. 3230). Although these regulations appeared to be similar to those under the previous credit system, they apparently differed crucially in the sense that direct government intervention was not formally a significant factor in the total credit-granting process in the new system.

Short term credits retained "the same function as they had before the reform." That function was to supply the economy with "sufficient" circulating capital (93, p. 3230). The major result of the 1965 banking reform and later modifications was to more clearly specify the role of the National Bank in the area of short-term credits. In addition, the reforms aimed at preventing the use of short-term credits for financing consumption or fixed asset investment (76, p. 586).

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[11] Since 1967, banks, as well as enterprises, have been permitted to borrow directly from foreign lenders "subject to specific regulations" (76, p. 582).

Before the reforms, the banks' short-term credit activity was controlled almost entirely by "qualitative regulations" of the National Bank where it "regulated in detail the terms and purposes of all kinds of short-term credit and individual criteria for their extension." These arrangements were not consistent with the new conditions and directions created by the 1965 reforms. Steps were therefore taken in which "radical changes" were introduced in the methods of regulating short-term credits (65, p. 93). New measures called for the replacement of "qualitative" controls by "quantitative" controls. The National Bank could no longer affect the credit granting potential of an individual bank on the basis of "special subjective criteria" but, had to rely mainly on indirect means (10, p. 81). As noted previously, the new arrangements focused the emphasis of credit control on the supply side. The National Bank no longer made the distinction between the kind and purpose of credits as a condition for their extension. Instead, banks were allowed to decide on these matters constrained only by the regulation that short-term credits not be used for investment or consumption purposes. Indirect control devices such as obligatory reserve deposits, total indebtedness ceilings, and rediscount policy were introduced on a much larger scale (65, pp. 93, 100). These indirect devices together with certain "special credit" grants comprised the new control tools of the National Bank over credit supply (10, p. 81).[12]

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[12] A detailed review of the credit control instruments of the new banking credit system and a discussion of their use by the National Bank can be found in a study by Golijanin (65).

Direct Crediting of Enterprises

A major purpose of the new banking and credit system was the reallocation of "uncommitted" funds in the economy. The 1965 reforms contained provisions for the "optimum use of investment funds available" through voluntary redistribution (134, p. 17). These provisions were in line with the principle of increased autonomy for economic organizations and, in particular, their becoming the "principle agents responsible for capital development and the expansion of production." They were enabled to perform these functions under the new system not only through the banking system, as previously described, but also by "crediting their business partners without the direct intermediary of the banks" (93, p. 3231).

The Banking and Credit Law specified the allowance for direct crediting by working organization of other organizations, governments, or citizens "to promote business cooperation, or to increase production, or to promote other common economic interest"(3, p. 843). Enterprises could also combine assets for the purpose of granting credits to other organizations. There was no explicit legal constraints concerning such activity except that it be in connection with "the field of their activity" (3, p. 843). This marked a major break from previous regulations in this area. Until 1965, economic organizations could extend credit to others only "in connection with their regular business." Direct crediting in this narrow sense occurred predominantly in transactions related to the collection of revenue from the sale of goods. Direct crediting in the sales of capital goods "was very rarely practiced" (94, p. 67).

The new law restricted the source of funds for direct crediting by an enterprise to their own funds. They could use investment credits obtained from banks only if such uses were "explicitly provided for" in the credit contract with the bank. The use of short-term credits obtained from banks as a source of direct crediting was forbidden except for uses provided for in federal legislation or regulations (3, p. 844).

The expansion of the practice of direct crediting in the investment process resulted in an increase in the mobility of investment resources in the economy and the further enhancement of the development of a capital market in the traditional sense. Both of these results implied some increase in the efficiency of the allocation of investment resources by partially removing the previous barriers that prevented the flow of investment resources within the economy.

Joint Investments by Domestic Enterprises

Closely related to the direct crediting of working organizations was the practice of joint investment in and founding of enterprises by other enterprises that emerged after the 1965 reforms. The dividend or interest payment to the founders of banks on their holdings of bank certificates set a precedent in the economy. This was the first time income was received under legal provisions as a result of financial investments and not for work performed in the traditional Marxian sense. Such action opened the door for the possibility of one enterprise founding or investing in another; a

practice heretofore forbidden on doctrinal grounds and because of its conflict with the Yugoslav's concept of "social property" (12, p. 223).

Before 1967, if an enterprise invested directly in another, the founding enterprise lost all rights to influence the new enterprise after the managing bodies of the new enterprise became operational (12, p. 223). In July, 1967, new federal laws were passed that provided the legal basis for the "expansion of various forms of integration of domestic business organizations" and "their more extensive linkage" with foreign companies. Joint investment ventures of domestic enterprises were permitted on the following principles: (1) joint investment was allowed for production enterprises, trading and service enterprises, and enterprises in the public service sector, (2) investment could be in money or in kind (buildings, equipment, and so forth), (3) joint investment contracts were to provide for the regulation of the joint business operations, investment policy, and organization of work in the enterprise in which capital was invested, (4) no enterprises' working collective could be denied their basic self-management rights, and (5) separate joint investment was allowed in independent departments of an enterprise (143, pp. 43-45).

Under the 1967 laws, it became possible for an enterprise founding another to share in the new enterprise's income. The revenue from such investments was required to be placed in the founding enterprise's "business fund" and could be used only for increasing fixed or working capital assets. In addition, a law passed in 1968, "made it possible for any enterprise to participate in the income

distribution of another in which it had invested money." Constitutional Amendment XV, adopted in 1968, "allowed greater flexibility in the workers' management system" and specifically, made it possible for enterprises founding others to take part in the new enterprise's management as well as in its income distribution (12, p. 223).

As in the case of direct crediting activity, the legal allowance of joint investment ventures by enterprises seemed to imply an expansion of capital funds mobility and an enhancement to further development of a capital market. As such, this action was consistent with the reform intentions of placing primary decision-making power over the use of investment resources in the hands of decentralized units in the economy and specifically, enterprises.

Problems With the New Banking and Credit System

As reflected in previous discussions, the new banking and credit laws intended to give enterprises controlling management rights over bank policy and operations. Along with the expanded volume and freedom of use of their own funds, the new banking and credit system was to lead to the enterprises playing the dominant role in the investment process. But, certain problems arose in the post-reform years that seemed to dampen the real movement of control power in these directions.

One problem concerned the internal operations of business banks. Although enterprises formally had controlling interest (votes) in bank assemblies, the large number of varied interests of the various enterprises often tended to cancel each other and consensus

was difficult. In addition, enterprise representatives often had little understanding of banking, monetary, and credit policy and had to rely heavily on bank experts. These conditions, coupled often with a large indebtedness by enterprises to bank(s) they helped found, severely restricted the actual decision-making role of enterprises within the banking system (12, pp. 222-223).

Other conditions arose that contributed to this problem. As was evident from investment financing data,[13] the role of the banks in the investment process was greatly expanded after the 1965 reforms. In an environment where "investment was still considered to be the easiest escape from all difficulties of current production" (12, p. 139), "chronic excess demand" for investment funds was evident. Added to this were a condition of enterprise uncertainty and economic instability from market exposure after the reform (6, p. 201), a continued tendency for enterprises to avoid the use of their own self-financing funds,[14] and an economic recession that tended to lessen enterprises' income and thus their retained earnings. Under these conditions enterprises began to rely more and more on the banks to furnish them with needed investment funds. Banks "easily assumed a dominant role" in investment financing and "established themselves as a dominant force in the investment market" (80, p. 141).[15] This tendency plus

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[13] See the discussion of investment financing in the following chapter.

[14] This tendency and its causes will be discussed in section I of Chapter V.

[15] A discussion of this matter as it related to the overall investment financing structure is taken up in section I of Chapter V.

the lack of real control by enterprises over bank operations raised concern on the part of the Yugoslav leadership about the protection of enterprise independence as designed in the reforms.

Horvat indicated (82, p. 141) that a possible answer to this growing problem lay in the development of an efficient capital market to allow enterprises access to funds outside the banking system. Movements in this direction, as noted previously, did occur. The direct crediting and joint investment activities implied a foundation for a capital market. In addition, the growing volume of government, bank, and enterprise bonds (the later first appearing in 1968) offered the potential for a stock of financial instruments necessary for a workable securities market. Along these lines, a proposal was made to abolish the capital tax on enterprises to expand their self-investment funds (80, p. 141) and thereby encourage direct crediting and joint investment.

Another major problem in the banking and credit system after the 1965 reforms concerned the status of government investment funds from the previous investment funds system. Under legislation passed in 1963 and 1965, the federal assets of the abolished General Investment Fund were transferred to the three federal specialized banks. This transfer and subsequent accumulations of the Federation that were added to these funds placed these banks in "a more favorable position," relative to other banks under the new system; a situation that was not consistent with the principles of that new system (154, p. 6). Since most investment resources were held by the specialized banks, enterprises were not really free in their choice of banks (26, p. A/24).

At the beginning of 1966, the Bank and Credit Law was amended. Federal funds were removed from the specialized banks' credit funds. A part of these funds was used for direct investment funancing (154, pp. 6, 9). The remainder was returned to banks for their disposal on the "basis of uniform criteria" through investment auctions for fulfilling the obligations of the Federation (154, p. 9; 165, p. 108). Even though all banks competed for these funds, the favored position (reputation and nationwide arrangements) of the former specialized banks allowed them a competitive edge (165, p. 108). In July, 1966, the federal funds were again transferred, under special contracts, to the former specialized banks and placed in a special investment account of the Federation (154, p. 6). In 1967, the volume of the investment funds of the three specialized banks was greater than the other business banks combined (212, p. 36). The favored position of these banks, although somewhat lessened, continued and concern remained over the status of state capital.

In 1969, the Party Congress called for the elimination of "state capital" and the abolishment of direct federal government control over investment resources (80, p. 95). In March, a new regulatory statute again removed all federal funds from the assets of the former specialized banks and placed the funds under "special management" (165, p. 108). The banks acted only as agents of the Federation in extending credits from completely separate accounts and thus the impact of these assets on the operations were reversed with the former specialized banks being placed in an "unfavorable position" relative to the other banks. The federal assets removed

from the former specialized banks amounted to: (1) 87 percent of the former Investment Bank's total resources, (2) 27 percent of the former Agriculture Bank's resources, and (3) 46.3 percent of the former Foreign Trade Bank's resources (165, p. 109). A satisfactory solution to the problem of the status of state capital apparently remained unsolved.

The status of investment funds of the other government levels presented similar problems. Under the 1966 amendment, the distribution of the assets of the former investment funds of republics and communes was left for those government bodies to decide (154, p. 8). The amendment allowed these government bodies to withdraw their funds and to use them in one of three ways: (1) invest them in time deposits of banks with provisions for their use as investment credits to enterprises, (2) lend the funds to banks at agreed rates of interest with provisions for their use as investment credits, and (3) invest the assets in the credit funds of banks (12, p. 225). Under these alternatives, republic and communal governments seemed to retain significant control over the use of their former investment funds and thus some control over bank operations.

Here again, in light of the status of government investment funds plus, as previously noted, the continued direct intervention by government in bank operations, the designed expansion of the influence of decentralized units, particularly enterprises, over the banking and credit system was frustrated to a degree. With the funds of various government levels, especially the Federation, withdrawn from the banks, they were again (like before 1964) "in a position to

decide, through the banks, to which enterprises and for what kind of investment credits should be granted" (12, p. 225).

In addition, "political influences" over allocation of bank funds were apparently still present after the reforms (7, p. A/26). Bićanić (12, p. 123) reported that there was evidence of political pressure on banks from "local political functionaries." The Federal Conference of the Socialist Alliance noted in a meeting in September, 1966, that "very frequently" the banking system was affected by "local interest" (55, p. B/5). Rikard Stajner of the Federal Planning Institute criticized the banks for letting others determine their methods of operations and criteria for behavior and called on the banks to free themselves from political pressures (9, p. A/23).

In general, the problems of the post-1965 reform period indicated that the changing roles of various economic units in the banking and credit system envisaged by the reforms were not fully achieved. The role of the enterprise did not expand and the role of government did not deminish to the degrees outlined in the reforms. In addition, the role of the banks did not move in planned directions. In one respect, the dominant role of the banks in investment financing came to be a matter of some alarm. In another respect, the continued influence of the Federation and other government levels via their former investment funds seemed to block the attainment of the desired degree of bank autonomy over the use of investment resources in the economy.

CHAPTER V

THE "NEW REFORM" SYSTEM OF INVESTMENT

As indicated by the previous discussion, the system of investment was significantly modified by the 1965 reforms. The purpose of this chapter is to determine the exact nature of the new system of investment allocation and financing that emerged during the post-reform period and the effect of the new system on the size and structure of investment spending. An attempt will be made to determine the roles of the major economic actors (government, banks, and enterprises) in the new investment process. In this regard, the analysis may help reveal the nature of the post-reform Yugoslav economy and the role of market and plan in that economy. Throughout the discussion an attempt will be made to distinguish between announced or planned reforms and actual reforms and between desired and actual results of those reforms.

I. THE SYSTEM OF INVESTMENT FINANCING

Introduction

As noted in Chapter III, until 1964, the investment funds system of financing, developed under the NES, provided for the concentration of investment resources mainly in government funds from which allocations were made. The banks, with their limited self-capital and investment decision-making autonomy, served mainly as service organizations for the government in the disbursement of investment funds according to social plans and administrative directives. Enterprises

accumulated their own self-capital but these funds were much smaller than the "socially-directed saving" of the government (95, p. 90). As discussed in the previous chapter, this system contained numerous weaknesses and was, to a large degree, incompatible with the Yugoslav's continued attempt to develop a workers'-managed economy premised on market forces.

In 1964, the abolishment of the GIF marked the beginning of the end to the investment funds system of financing. The 1965 reforms made several changes in the institutional and functional arrangements of the investment financing system that involved all of the major participants (enterprises, banks, government) in that system. The aim of the new system of investment financing was to provide for further decentralized accumulation (76, p. 593) and allocation of investment resources without direct intervention on the part of the government. In this regard, the 1965 reforms were designed to: (1) leave enterprises a larger share of their income for self-financing, (2) reorganize the banking system to provide for the accumulation and disbursement of resources provided by enterprises without the direct guidance of government, and (3) strictly limit the direct role of government in the overall investment financing process. The various reform aspects discussed in the preceding sections, particularly the changes in the income distribution system and in the banking and credit system, were all related elements of the new structure of investment financing.

The new system of investment financing was in line with the overall reform attempt to move the economy toward a greater reliance

on market forces and away from centralized planning and control. The degree of movement in that direction was no greater than in the area of investment financing. Throughout the 1965-1969 period the new system of investment financing was implemented and its nature began to emerge.

The Role of Enterprises and Banks

Under the new system of investment financing the role of the enterprises was greatly expanded. The retained earnings of enterprises were to become "the principle source of investment" (109, p. 215). This was made possible by the changes made in the system of income distribution. The net reduction and/or removal of taxes and contributions levied on enterprises' income resulted in an expansion of funds left at their disposal. Together with the reduction of government restrictions over the use of these funds, these changes greatly expanded the self-financing potential of the enterprises.

In essence, the new system allowed three main uses of investment funds accumulated by enterprises. The funds could be: (1) used in the self-financing of capital assets by the enterprise itself, (2) invested indirectly in other enterprises by placing the funds into the banking system or, (3) invested directly in other enterprises through mutual crediting or joint investment arrangements. The major part of the investment resources of enterprises was to be re-invested in their own operations, while the smaller residual part was to be "voluntarily re-allocated" through the new credit system (including both re-allocation through banks and direct methods) (134, p. 17).

The legal provision for and the growing practice of direct crediting and joint investment by enterprises were important additions to the system of investment financing (68, p. 115). Direct financing by enterprises of another and the placement by enterprises of their residual investment funds in the banking system for indirect reallocation, according to principles of efficient business practices and without territorial limits, resulted in an increase in the mobility of investment resources and in the efficiency of their use.[1]

In addition to the accumulation and allocation of residual enterprise investment funds, the new banking system provided for the depositing of government investment funds in the banks. Some foreign investment loans were also channeled into the banking system. The managerial and operational arrangements of the new banking and credit system expanded the autonomy of banks in the use of their investment resources and direct governmental intervention was replaced, in large part, with indirect quantitative controls. In general, the banking system served as the principle mobilizing force of investment resources in the economy (68, p. 115).

The institutional and functional reforms of the banking and credit system along with the transfer of greater investment financing

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[1]Hauvonen (76, p. 594) explained how the efficiency of investment funds use was to be enhanced under the new system of financing as follows: Enterprises would invest in their own operations only if the expected yield was higher (including the capital tax charge on the business fund) than the yield available in the "capital market," that is, in the banking system and the direct investment avenues. Thus, investment resources would tend to flow to those areas offering the highest yield.

potential and autonomy to enterprises led to "the pooling of investment resources on a wide basis and their application to the most profitable projects with a minimum of administrative intervention" (76, p. 593).

Foreign Investment

An important factor in the new investment financing system was the expanded role of foreign investment. After the 1965 reforms a "new attitude" toward direct investment in Yugoslav enterprises by foreign firms began to emerge (200, p. 208). The principle reasons for attempting to expand business and financial cooperation with foreign economies were as follows: (1) to allow wider application of the results of the world's scientific research in Yugoslav enterprises, (2) to inhance a broader application of advanced work methods, (3) to increase the production capacity of certain economic sectors, (4) to gain inroads into the world market, and (5) to achieve faster modernization of the economies productive facilities. Direct investment and joint "ownership" rather than funds in the firm of credit were deemed to be the best avenue for achieving these objectives (143, p. 44). New regulations in 1967 allowed foreign firms' capital to be directly invested in domestic enterprises. The following year "foreign agencies" were also permitted (12, p. 228).

Various legal provisions regulated the contractual arrangements between foreign investors and domestic enterprises including the rights, duties, and tax obligations of foreign investors. Although joint ventures were to be basically determined by the interests of the business partners, certain rules and constraints were imposed by

the government. No joint investment was allowed in certain areas including banking, insurance, domestic transportation, public utilities, and public services. Exceptions were allowed when it was determined (by the Federal Executive Council) that such investment would contribute to faster development of the economic sector (143, p. 46).

The management of joint operations was to be carried out by a "business committee" with representatives of domestic and foreign affiliates. Representatives of domestic enterpriese would act on behalf of their "working collective" to the degree specified in the joint contract (143, p. 46).

Certain restraints were placed on the foreign investors' property rights and their ability to share in earnings from joint ventures. Foreign partners in joint investment projects could not "own" more than 49 percent of an enterprise's assets. They were required to reinvest a minimum of 20 percent of their profits in the same or another Yugoslav enterprise or bank. In addition, foreign investors had to pay a 35 percent tax on their profits. Tax credits were given if they reinvested more than the 20 percent minimum in the enterprise or if they reinvested in an enterprise in one of the underdeveloped regions (12, p. 228).

Although limited to a substantial degree, these new direct relations between foreign investors and domestic enterprises reflected a marked change in attitude compared to the previous investment funds system of financing. As such, the new arrangements meant a further curbing of state controls in the investment process and contributed

to the development of the self-management principle of organization (110, p. 44).[2]

The Role of Government

As noted and implied in previous discussions, the role of the government, particularly the Federation, under the new investment financing system was greatly reduced. Centralized accumulation of investment funds through fiscal means was "reduced to [a] minimum" (42, p. 3785) and the federal government no longer served as the principle accumulator of investment resources. In addition, concentration of investment resources at the republican and communal government levels was also strictly limited (134, p. 15). The investment resources of all government levels that were accumulated under the previous funds system were transferred in part to the banks under the new arrangements. As a result of these changes the ability of government to directly invest in the economy was sharply reduced. In addition, direct government control over bank operations, specifically their credit operations, was strictly limited. Direct intervention by the National Bank was also modified with a shift in emphasis from qualitative to quantitative control of banks' credit granting operations.

Although limited under the new arrangements, the government continued to play an important role in the investment financing system. The Federation provided funds for the financing of investment projects

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[2]A more detailed survey of the specific foreign investment contractual arrangements and the rights, duties, and tax obligations of foreign investors in Yugoslav enterprises can be found in a study by Radovanović (143).

in underdeveloped regions and for certain infrastructure projects (42, p. 3785). The major role for the Federation was the operation of the Fund for the Development of Underdeveloped Regions established by the 1965 reforms. The use of this investment fund was to "ensure more rapid progress" of underdeveloped republics and regions as provided for in general, in the 1963 Constitution (134, p. 14). Through this fund the Federation distributed close to 2 percent of the National Income as investment funds to underdeveloped regions (80, p. 141). The major source of investment funds for investment in underdeveloped regions was the capital tax on enterprises (42, p. 3785). The Federation also received revenue for this purpose from repayments of previous loans made from the former General Investment Fund and from annual interest revenue paid by borrowers from the new fund. Other sources of revenue were foreign credit loans and investment revenues on capital projects in the underdeveloped regions (134, pp. 14, 24-25).

Selected key projects, "mainly in infrastructure," were also undertaken by the federal government and were financed from "controlled resources" (mainly located in banks) and from the federal budget (76, p. 593). The direct financing of key projects along with the financing of projects in underdeveloped areas provided at least a minimum role for government in the investment process. This minimum level of centralized mobilization of investment resources was apparently deemed necessary for the federal government to assure some degree of adherence to their development objectives.

The investment financing role of republican and communal governments was also greatly curtailed by the 1965 reforms. But,

provisions were made that provided for a limited role for republics. They were authorized by the 1966-1970 Plan to float loans for the completion of power projects begun before December 31, 1965. In addition, major communication projects were "partially financed" in some republics by a supplementary 1.5 percent turnover tax allowed by new legislation in 1966 (134, p. 15).

Patterns of Investment Financing

An analysis of investment financing data in the post-1965 reform period reflects the nature and degree of the changing roles for enterprises, banks, and government in the new system. Table XIX shows the composition of total investment by source of finance for the period 1965-1969. The more noticeable changes during the period were a continued expansion of the share of total investment financed from bank sources [from 31.4 percent in 1964 (50, p. 29) to 49.4 percent in 1969 (44, p. 67)] and the large reduction in the share of investment financed from government sources [from 36.5 percent in 1964 (50, p. 29) to about 16 percent in 1969 (104, p. 67)].

The effect of the new investment financing system was essentially a reversal of roles for the banks and government with the share of enterprises' resources increasing only slightly (80, p. 141). These changes are clearly indicated in Table XX which shows the average annual share of investment financed by enterprises, banks, and government for the periods 1961-1964 and 1965-1969. These trends were recorded in most economic sectors with noticeable exceptions being: (1) the construction, commerce, forrestry, and crafts sectors where

TABLE XIX

TOTAL INVESTMENT BY SOURCE OF FINANCE, 1965-1969

Source of Finance	Year				
	1965[a]	1966[a]	1967[a]	1968[a]	1969[a]
Enterprises	29	39	33	31	38
Banks	37	39	45	47	49
Government	27	16	18	16	16
Other	7	6	4	6	7
Total	100	100	100	100	100

[a]Figures in percentages.

Source: 90, pp. 26-27; 28, p. 623; 44, p. 67; 50, p. 29.

TABLE XX

TOTAL INVESTMENT BY SOURCE OF FINANCE FOR THE PERIODS, 1961-1964 AND 1965-1969

Source of Finance	Annual Average,[a] 1961-1964	Annual Average,[a] 1965-1969
Enterprises	28	32
Banks	11	43
Government	54	19
Other	6	6
Total	100	100

[a]Figures in percentages.

Source: 50, p. 29; 28, p. 623; 44, p. 67; 90, pp. 26-27.

the share of enterprise funds used to finance investment were relatively large, and (2) the culture, welfare, and administration sectors where the government continued to play a dominant role in investment financing. In addition, government funds continued to play a "significant" role in financing investments in housing, agriculture, and certain industrial branches such as electrical power, machinery and equipment, and paper products (28, pp. 623-624). Table XXI shows the composition of investment in main branches of the economy in 1968 by source of finance.

The actual pattern of investment financing in the period 1965-1969, although generally envisaged by the 1965 reforms, apparently differed, to a degree, from that pattern expected under the new investment financing system. There was expressed concern by the Yugoslav leadership over the dominant role of banks in the investment financing process and the lack of a large expansion in the use of enterprise resources for self-financing purposes.

In the first two years of the new investment financing system, 1965 and 1966, the anticipated results of the reform, that is, an expanded use of enterprise and bank funds and a drastic reduction in the use of government funds, were confirmed by actual experience. The share of enterprises' resources used in investment financing rose from about 26 percent in 1964 to about 29 percent in 1965 (50, p. 29), and then rose sharply to 39 percent in 1966 (90, p. 26).[3] The share

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[3]A study by Wilson and Denton (200, p. 209) reported that the reforms were expected to raise the enterprises' share in investment financing to about 40 percent.

TABLE XXI

TOTAL INVESTMENT[a] BY SOURCE OF FINANCE AND BY ECONOMIC SECTOR IN 1968

Economic Sector	Share of Investment Financed By:[b]		
	Enterprises	Banks	Government and Others
Industry	30	55	15
Agriculture	32	46	22
Construction	71	18	11
Transportation	36	34	30
Commerce	48	49	3
Housing	25	54	21
Culture, Welfare, and Administration	1	24	75
Forestry, Crafts, and Others	65	25	10
Share In Total Investment:	31	47	22

[a]Excluding private investment.

[b]Figures in percentages.

Source: 28, p. 624.

of banks' resources used rose from about 31 percent in 1964 to about 37 percent in 1965 (50, p. 29) and to about 39 percent in 1966 (90, p. 26). Over the same period, the share of government resources used dropped drastically from 37 percent in 1964 (50, p. 29) to about 16 percent in 1966 (44, p. 67).

After 1966 the pattern of investment financing changed noticeably. The share of enterprises' resources used decreased continuously to about 28 percent in 1969 (only slightly above their share in 1964) while the share of banks' resources used rose drastically over the same period to about 49 percent in 1969. During the 1967-1969 period the share of government resources used in financing investment remained at around 16 percent (44, p. 67).

There were several factors that apparently caused the changes recorded in the pattern of investment financing during 1965 and 1966. The drastic reduction in the share of government funds used to finance investment was, in part, the direct result of the new system of investment financing which abolished most of the ability of government to accumulate and allocate investment funds. Since the abolishment of the GIF in 1964 had already greatly reduced the ability of the Federation to accumulate investment resources, most of the reduction recorded came at the republican and communal levels of government. In 1964, republican and communal investment funds accounted for about 29 percent of total investment (28, p. 623). By 1966 this share had dropped to about 9 percent (44, p. 67). During the same period the share of investment financed by federal funds fell from about 7 percent to about 4 percent (28, p. 623; 44, p. 67).

The increase in the use of bank resources in 1965 was apparently due to their expanded ability to invest due to the new institutional arrangements and the transfer of government investment funds to their credit funds. Even though the 1965 reforms provided for greater enterprise participation in bank management and the placement of residual enterprise funds into the banking system, these new arrangements were not fully implemented until 1966. Thus the flow of enterprise funds into the banking system in 1965 and part of 1966 was likely very slight and may account for the slower expansion in the use of bank funds for investments in 1966.

The rather rapid increase in the share of enterprise funds in total investment in 1965 and even more so in 1966 seemed to be due to two general factors: (1) the volume of investment spending by enterprises, and (2) the inability of enterprises to rely on external sources of finance. Although total investment spending rose only slightly in 1965 (less than 9 percent) relative to the previous years of the early sixties (202, p. 629), most of this increase was due to investment spending by enterprises.[4] As previously

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[4]The desire of enterprises to maintain or to expand investment appeared to be widespread after the 1965 reform. A recent study by Vanek (177, pp. 246-247) indicated that there was a tendency for enterprises to "step up investment more than proportionately when 'business is good' and vice versa." Thus, those enterprises that were favorably affected by the reforms (through income distribution changes and price adjustments) tended to expand their investment spending. In addition, those enterprises less favorably or unfavorably affected by the reforms continued to invest also. Sirc (158, p. 425) reported that after the 1965 reforms the so called "investment mentality," that is, the attitude of enterprises that the only way to expand production and overcome economic difficulties was to invest more and more, was still very evident in the economy.

noted, government investment was drastically reduced in 1965, particularly, after the reforms.

Because the new banking and credit system was not introduced until 1966 and, as previously noted, was likely not fully operational until well into 1966, and because government funds as a source for investment financing were drastically reduced, enterprises were forced to use a greater share of their own funds to finance their investments. Their ability to do so was enhanced by the income distribution reforms that, as noted previously, expanded enterprises' net income and the volume of their internal funds. In essence, the enterprises were both allowed and forced to rely more on self-financing of their investment spending.

Thus, in 1965 and 1966 the pattern of investment financing moved generally in the directions envisaged by the reforms. The roles of banks and, more importantly, enterprises were expanded while that of government sharply reduced.

After 1966, these directions were drastically altered, as noted previously, with the share of enterprise resources used in investment declining back to its 1965 level and the share of bank resources increasing significantly to near 50 percent. The changes were due primarily, it seemed, to two main reasons: (1) the economic recession after the 1965 reforms and (2) the reluctance of enterprises to use their own funds for investment financing purposes.

Horvat (80, p. 141) and Vanek (177, p. 247) pointed to the post-reform recession as a major cause for the changing pattern of investment financing. With the enterprises more exposed to market

forces, the slowdown in economic activity meant smaller gross and net incomes. Attempts by enterprises to maintain their employment and wage levels resulted in smaller allocations to internal investment funds. The enterprises could not invest more of their own funds because they had none (34, p. 51). And yet enterprise investment plans remained generally intact for reasons noted previously. With a lack of self-financing funds and without the standby aid of the government to call on, as in previous years, enterprises were forced to turn to banks for credit to continue their investment programs.

An added cause for the reduced share of enterprise funds in total investment after 1966 lay in the reluctance of enterprises to use their own funds for investment purposes. Some enterprises were not as seriously affected by the recession as others and, due to the new income distribution system, enjoyed an expansion of net income. Although their potential for self-financing their investment projects was expanded, there enterprises tended to use, according to Horvat, (12, p. 215) their expanded net income for wages while attempting to maintain or expand their investment spending and to use bank credit to finance these programs. The share of net personal income in enterprises' gross income rose from 35 percent in 1965 to 40.4 percent by 1968. During the same period, the share of earnings retained fell from 20.3 percent to 16.3 percent (126, p. 16). A reason for this behavior was given by Milenkovitch (109, p. 220). The rate of inflation in the economy exceeded the rate of interest charged by banks on investment loans to enterprises. Thus, money had a negative price.

To this degree, enterprises were acting rationally by investing heavily and relying on bank credit while simultaneously, not sacrificing a large part of their own current net income.

There appeared to be another cause for the reluctance of enterprises to use their own funds to finance investment. As the new banking and credit system became operational, many enterprises likely found that by placing their funds in the banking system they could earn a rate of return greater than that available from investment in their own production facilities. Under conditions of a growing capital market institutional framework, one would expect market forces to lead to this decision on the part of some enterprises. In addition, the fact that money had a negative price, as previously noted, would contribute to the placement by some enterprises of their internal funds into the banking system and, in turn, this behavior does not reflect irrational behavior of enterprises and is not inconsistent with market oriented behavior. In part, it represents the normal working of a partially operative capital market under the influence of expanded or less restrained market forces.

The tendency of enterprises to not use their internal funds and, more importantly, the general lack of these funds due to the economic recession, coupled with continued efforts of the enterprises to increase their investment outlays, appeared to be the major causes for the reduction in the proportion of investment financed by enterprise sources and the simultaneous increase in the banks proportion in the period 1967-1969.

Decentralization Under the New System

The pattern of investment financing in the post-reform period tends to be misleading in terms of the nature of the new investment financing system it reflected and the degree of decentralization represented in that system. Specifically, the investment financing pattern tends to understate the roles of the enterprises and government and to overstate the role of banks in the new system.

As shown in Table XX (page 187) the share of enterprises internal funds used for investment increased very slightly in the 1965-1969 period relative to the 1961-1964 period. This slight expansion, although well below that envisaged in the reforms, tends to understate the expansion of the role of enterprises in the new system. The major reason for the failure of the share of enterprise funds used in financing investment to expand was, as previously discussed, their inability to accumulate internal funds due to the economic recession. As such, this failure does not imply structural or institutional limits on the ability of enterprises to accumulate and use more of their earned income, but only an effect of a recessionary economy. In addition, the tendency of some enterprises to not use their own funds for financing investment was due mainly to incentives that emerged in the more market-oriented economy and did not necessarily imply institutional constraints on their behavior but, only responses induced by economic forces under the new system of investment financing that allowed such freedom in the use of these funds.

On the other hand, the large increase in the use of bank resources for investment financing tends to overestimate their role and degree of influence in the new investment financing system. Unquestionably, the organizational and operational designs of the new system, plus the course of events after the 1965 reforms, greatly expanded the role of banks in the investment financing process. But, two factors were evident that seemed to limit this expansion. These were: (1) the unclear nature of control and methods of allocation of investment funds used for financing government initiated programs or projects and (2) the status and influence of government capital funds on the banking system.

After the 1965 reforms, the government (federal, republics, and communes) financed their investment projects in two ways. Budgetary grants continued to be used and grants (non-repayable) and loans from special funds, especially the Fund for the Development of Underdeveloped Regions, were channeled through the banking system (76, p. 582). The exact role of the banks in allocating government funds placed in the banks was apparently not fully clarified under the new arrangements. The exact balance between the banks freedom or autonomy and "official pressure" concerning the use of these funds, particularly in the area of loans to underdeveloped regions, was not clearly spelled out in the new bank laws or reform measures (200, p. 210). Specifically, some non-reimbursable government investment credits and investment credits from "part" of the Fund for the Development of Underdeveloped Regions included in bank investment capital were not statistically separately recorded by the banks (87, p. 146).

The status of government capital resources, as noted previously, that were accumulated under the previous "funds systems" and, in particular, the funds of the former GIF, presented a problem for the new banking and credit system. The placement of these funds, as provided by new laws, into the credit funds of banks for investment credit use, with about one-third of these funds controlled under special governmental regulations (76, p. 582), implied a continued governmental influence not readily apparent from the investment financing pattern. As of December 31, 1969, some 22,769 million dinars of former government investment funds assets were in the banking system and were concentrated in the three former federal specialized banks. In addition, government funds obtained from domestic and foreign loans and from "obligatory time deposits" required from enterprises and totaling about 6,660 million dinars were placed in the former specialized banks (154, p. 11). Although, as previously discussed, new provisions were made in 1969 for the separate treatment of these funds, there remained some degree of uncertainty and influence by government concerning these funds.

Vanek reported (179, p. 396) that in 1966, federal funds, in reality, accounted for about one-third of all investment resources allocated. In addition, because "as a general rule" federal funds were used to supplement banks and enterprise funds, the actual influence of federal funds was "considerably greater" than indicated by investment financing data.

These matters of remaining government influence over the banking system are important in the determination of the banks' exact role

in the new investment financing system. In light of the unclear balance of control over government funds and to the degree that government funds were channeled through the banking system under the direct influence of government decisions and controls but without separate accounts showing such influence, the investment financing pattern of the 1965-1969 period, that shows a large share of bank funds used for financing investments, would tend to overstate the banks' and understate the government's true influence in terms of actual control over these resources.

In light of the designs of the 1965 reforms and further modifications, the emerging pattern of investment financing, and the limits to degrees of influence of the major participants (enterprises, banks, and government), there seemed to be certain essential changes in the new investment system that represented a much greater degree of decentralization compared to the previous funds system. The roles of decentralized units (banks and enterprises) were greatly expanded while the role of government sharply curtailed, particularly in terms of direct intervention. There was a marked increase in the mobility of investment resources in the economy with banks and enterprises becoming the principle mobilizers. Finally, there was the beginnings of a capital market that would, when more fully developed, provide even greater mobility for investment resources. Taken together these changes revealed a much more decentralized system of investment financing than the previous funds system.

II. THE INVESTMENT DECISION-MAKING STRUCTURE

Introduction

A focal point of the overall reform effort in 1965, and throughout the latter half of the sixties, was the investment decision-making structure. The continued development of a market-oriented economy required a further decentralization of investment decisions. This, in turn, required a rather substantial reorganization of the system of income distribution, the banking and credit system, the system of pricing, the methods of economic planning, and the system of investment financing. The changes in these areas of the investment process, as discussed in previous sections of this chapter, implied the changing roles of enterprises, banks, and government in investment decision-making. By drawing the major changes in these areas together, the nature of the new investment decision-making structure and the degree of decentralization represented by that structure may be determined.

The Formal Structure

A major element in the reformed investment process was the "[d]etermined effort to lower the role of the government and to transfer its functions to enterprises" (42, p. 3783). The changes made in the various areas of the investment process reflected just such an expansion in the role of enterprises in the investment decision-making structure. The reforms expanded the ability of enterprises to invest by increasing their volume of free funds and lowering restrictions concerning the use of these funds. In this sense, the scope and autonomy of enterprises' investment decisions were enlarged.

The new income distribution system greatly reduced the number and size of taxes and contributions levied on enterprises' income and thereby expanded their retained earnings potential. Restrictions on the allocation of enterprises' net income were reduced thus expanding their autonomy in terms of decisions determining the size of internal funds including investment funds. In addition, the autonomy of enterprises in the use of their investment funds was expanded. The new banking and credit laws allowed the voluntary placement of enterprise investment resources in the banking system to be reallocated within the economy. Enterprises experienced some formal decision-making power over this reallocation through their participation in bank operations. Direct investment by enterprises in others was also permitted on a much larger scale through mutual crediting and joint investment arrangements. In essence, the new income distribution system and the new banking and credit system were intended to make enterprises "the only dominant force in the economy" (177, p. 75). As such, the new investment financing arrangements implied "full autonomy" of enterprise decisions regarding the financing of their investment projects (153, p. 41). The mandatory requirements of the previous system concerning the size of matching funds and minimum levels of participation in investment projects in order to obtain bank credit were greatly curtailed.

In general, the new investment system seemed to require that enterprises bear the "full burden" of the responsibility for accumulating and allocating investment funds in the economy and for initiating

new investment projects and expansions of existing productive facilities. Enterprises, in this regard, functioned as the "sole major investor" and enjoyed "almost complete autonomy" from any "outside model setter or decision maker" (177, pp. 273, 287). In this manner enterprises became the "basic factor" in investment decision-making in the Yugoslav economy (154, p. 1).

Next in importance in the new investment decision-making structure were the business banks (12, p. 122). Under the new banking and credit laws, the banks' autonomy in the investment process was greatly increased. The banks served as the chief mobilizers of investment funds and allocated their investment resources at their own initiative and risk. Direct governmental intervention in the credit operations of banks was reduced to a much lower level than under the previous investment funds system. Qualitative control devices were replaced, for the most part, by quantitative control devices and, as such, resembled the instruments of credit control of other market-oriented economies.

As implied by previous discussions, the role of government in the new investment decision-making structure was greatly reduced. The reforms stripped the Federation and also, for the most part, republics and communes "not only of legal powers but also of most means or funds which were at their disposal for purposes of economic intervention and development generally" (177, p. 75). As a result, the ability of the government to directly intervene in the investment process was noticeably reduced. In addition, the new banking and credit laws reduced the role of the federal government in the allocation

of bank funds while limiting the governments' direct allocations mainly to the control of credits from the Fund for the Development of Underdeveloped Regions and budgetary grants for certain infrastructure projects.[5] Republic and communal governments were also strictly limited in their ability to accumulate and allocate investment funds.

An important part of the reduced role for government in investment decisions was due to the changes made in the planning system. The methodology of planning was significantly altered and detailed annual plans were no longer employed. Long-term development plans continued to be prepared but served only as a guideline for economic behavior of decentralized units in the economy. Comprehensive and directive type investment planning for the specification of development policy, basic investment decisions, and investment fund allocations was abandoned. Direct implementation measures were almost totally eliminated. In general, "no provisions of the economic plan . . . [were] binding for any particular firm." Enterprises conformed to the plan only to the extent that the tools of economic policy were "shaped in such a way as to generate the planned targets" (179, p. 380). Plans served mainly, it seemed, as a basis for governmental agencies action in the investment process. Even in this regard, the new system "left little room for even the most indirect and indicative forms of planning" (177, p. 83).

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[5]Changes in the Constitution in 1967 clarified and restricted further the Federation's investment activity. The Federation could "make no investment decision except by a special federal law" (12, p. 123).

The new pricing system also led to a reduced ability of government to influence investment activity. With the emphasis on market forces in the determination of prices, the government no longer had an active price policy in the sense of trying to adjust prices to affect the structure of investment spending in the economy. The government's control over prices was limited mainly to the aggregate price level.

As a result of these changes in the various aspects of the investment process, the direct coordination of investment activity in the economy was no longer possible at the government level. Except for the influence of direct investment decisions concerning the allocation of state capital still under their control, the governments' implementation of social plans and development policy had to rely solely on indirect measures. The market, the social plans in broad outlines, and production and financial cooperation among enterprises and banks offered some form of investment coordination to replace the void left by the government's withdrawal (68, p. 114).

Although the ability of government, especially the federal government, to directly control the investment process was sharply reduced, this loss of direct control did not imply the lack of any governmental controls over investment. With the reduction of direct control methods there was simultaneously an expansion of indirect control measures which continued to insure the government some degree of influence in the investment decision-making structure.[6] "[L]egal

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[6]In this regard the role of the government came to more closely resemble that of governments in other market-oriented economies. The

regulation" of the general conditions and context of economic activity "remained a responsibility of the state, and in particular, of central organs" (153, p. 42).

A review of some of the indirect measures employed by the government to affect investment reveals the nature and implies the effectiveness of the new control system. Using the apparent incentives of the market-oriented economic organizations, the government, through the use of fiscal measures and special regulations, attempted to channel investment resources in a manner deemed consistent with their development policy. For example, the tax rate levied on the capital funds of enterprises (usually 3.5 percent of the business fund) was reduced to 1.7 percent to serve as an indirect subsidy to increase the investment funds of enterprises in certain sectors deemed in need of assistance. Enterprises in certain branches, particularly those concerned with railway and highway projects, were wholly exempt from capital tax charges (134, p. 22).[7]

Other tax emptions were used in an attempt to induce greater investment in areas of importance to the government. Funds of enterprises and banks in "economically advanced regions" were exempt from all federal tax charges if they invested certain amounts in underdeveloped

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important aspect of that control was its indirect nature. Samardzija (153, p. 42) concluded that the government's attempt "to induce appropriate decisions on the part of economic organizations and not to determine them directly" was one of the most important results of the reforms.

[7]A study by Bajt (4, p. 79) reported "numerous exceptions" to the 3.5 percent tax rate with the average rate for the entire economy of about 2 percent.

areas (134, p. 22). In addition, as previously discussed, tax rebates were granted to foreign investors if they reinvested their profits earned from joint enterprise operations in underdeveloped areas.

Another method used by the government to channel investments was the granting of supplemental interest payments to enterprises and banks that invested their funds in "projects of special interest" to the Federation. A 3 percent supplemental interest was paid on investments in certain economic sectors, particularly in certain areas of agriculture, transportation, tourism, and scientific research, and in underdeveloped areas (134, p. 23). This and the other indirect control measures, supplemented to a degree by the use of direct measures (mainly price freezes and direct investment financing from centralized sources) (4, p. 75), ensured a continued role for the government in investment decisions.

The Locus of Investment Decisions in the Formal Structure

As implied by the previous discussion concerning the changing roles of enterprises, banks, and government in the investment decision-making structure, the locus of investment decision under the new system was noticeably different than under the previous system. The basic element in the new decision-making structure was "autonomous enterprises, linked one to another primarily, and in some respects exclusively, by the market" (4, p. 77). In the new system the main decisions about investments were taken by the enterprises (12, p. 123).

The dominant influence of enterprises was evident at all levels of the formal investment decision-making structure. General investment

decisions concerning the overall rate of accumulation and basic conditions for distribution, determined by the government in the previous system, were determined, in large part, through the aggregated investment decisions of enterprises with the social plan, as reflected in the limited direct intervention actions of the government, playing a very subordinate role. More specific decisions concerning the rate and structure of capital development and the composition of investment between and within economic sectors were also made predominately by enterprises and banks with little government influence. Finally, "individual" investment decisions concerning technological variants were made almost entirely by enterprises and banks (68, p. 113).

Bajt (4, pp. 73-75) described the new decision-making structure as lying somewhere between a "decentralized, autocratic, and indicative model" and a "decentralized anarchic model" with certain centralistic and directive elements preserved. The system was "decentralized" in the sense that central decision-making bodies limited their decisions to those "necessary" to coordinate private preferences. It was "autocratic" because central bodies appropriated autonomous rights for decision-making to enterprises and banks independent of the decisions of these individual economic units and "superimposed upon them," that is, government granted autonomy in decision-making and could presumably retract it. In this regard, the government remained "sole original decision makers" even though it had delegated these autonomous powers in the new reform system. Lastly, the system was "indicative" because, in large part, indirect implementation of centrally made decisions through "regulators" were employed.

The new structure was not "anarchic" because all decisions were not made by decentralized economic units. There were four remaining centralist elements in the investment decision-making structure. These were: (1) central influence of the overall rate of saving and investment, (2) a centrally determined level of economic activity (to the degree of the effectiveness of fiscal, monetary, and incomes policy in achieving full employment), (3) government imposed price freezes, and (4) "some investment objects being financed by centralized sources." The first two were implemented by indirect policy measures while the last two, as previously noted, represented the major remaining examples of direct implementation of government made investment decisions (4, p. 75).

Limiting Factors

Although the formal arrangements of the new investment decision-making structure reflected an obvious decentralization, with enterprises and banks playing a greatly expanded and dominant role, some aspects of the structure, as it appeared "in practice," revealed certain factors that limited the actual degree of decentralization in the new structure. Even though these limiting factors were not part of the formal institutional arrangements, they must be included in this discussion to obtain a more complete understanding of the investment decision-making structure.

At the enterprise level, the actual degree of autonomy in investment decisions did not seem to reach that level indicated by the formal structure. As noted previously, the post-reform economic recission greatly lessened the ability of enterprises to accumulate

investment funds. In an attempt to maintain employment and wage levels while continuing to regard increased investment as a panacea for most of their economic difficulties, enterprises became more and more dependent on banks for investment resources. The increased use by enterprises of bank funds to finance their investment projects implied some degree of expansion of bank power over investment decisions. In the words of one analyst (34, p. 51), he who provides most of the funds "essentially decides what will be built and produced." In addition, as previously discussed, the enterprises came to have a much more restricted role in bank management and particularly, in decisions concerning credit operation, than was designed. In general, enterprises were not as dominant an influence over investment decisions as they appeared in the formal structure.

The actual forms and extent of government intervention in the investment process after 1965, was another indication of less real decentralization in the new investment decision-making structure than reflected by formal designs. Contrary to formal decrees, the government continued to grant special treatment and direct subsidies to enterprises. Pavlowitch (131, p. 300) reported that enterprises were given "large amounts of additional revenue" and obtained credit for goods "yet to be paid for, yet to be sold, or even yet to be produced."

The degree of direct intervention by the government, especially the Federation, in the banking system seemed to exceed, as previously noted, that level prescribed by the new bank and credit laws. This was most true in the government's continued and uncertain direct

allocation of so called state funds. The fact that federal government funds were concentrated mainly in the three former specialized banks only contributed to the government's influence. "Although most investment decisions had been transferred away from the federation" by the 1965 reforms, "they were still concentrated in the hands of a few important banks which were under the influence of various levels of government" (131, p. 306). In addition, there was, as noted previously, some evidence of political pressure on banks from government officials especially at the local level. Such pressure reduced the banks' decision-making autonomy.

In the area of prices, government policy also seemed to run counter to formal designs. The reforms had called for the elimination of all government control over the price structure and overall price freezes were deemed to be only a temporary adjustment device. In reality, as previously discussed, price controls remained in force on a large scale throughout the 1965-1969 period. This policy seemed to eliminate, to a great extent, the ability of market forces to influence the price structure and, as noted previously, led to new distortions and disparities in the structure of investment. Although the government no longer had a direct price structure policy for purposes of influencing the structure of investment, the economic results of the continued freezes on prices on the investment structure were similar, except for their greater degree of irrationality.

Economic planning was yet another area where formal arrangements were not, in reality, practiced. After the 1965 reforms economic planning was greatly curtailed and, "for a time," all formal planning

was all but abandoned. This lack of planning did not reflect a rejection of the principle of planning but, rather the failure of the government to work out a new methodology of planning consistent with the emerging market froces in the economy (177, p. 83). In addition, new methods for plan implementation were not forthcoming and, in general, implementation measures that were used "left much to be desired" (80, p. 95). The 1966-1970 Social Plan was little more than a forecast that was "largely erroneous" and "offered no real guidance to the economy" (177, p. 83). In this situation it was apparent that plans offered little guidance for government action in the area of investment and the guidance that was offered could not be effectively implemented. Bajt (4, p. 75) reported an "absence of efficient coordinating forces" in the area of investment. Thus, not only did the government retain more direct control over investment decisions than the formal structure suggested, but this control was apparently not consistently or effectively applied.

Taken together, these limiting factors imply two important differences between the investment decision-making process as formally structured and as it seemed to work in practice. First, the actual degree of decentralization in the structure appears to have been less than formal arrangements suggested with the government retaining direct control over investment to a degree exceeding the planned level. Second, in terms of the location of dominance in the decentralized sector (enterprises and banks) of the economy, the banks apparently assumed, in reality, a much larger role in investment decisions than forseen by the formal designs. Although the dominance of enterprises

may have been preserved overall, the degree of that dominance (and the fact that it likely did not even exist in certain areas) was clearly not in line with the formal arrangements of the new system. Together, these two aspects reveal an investment decision-making structure that, although unquestionably much more decentralized than that of the previous period, continued to contain strong elements of direct government intervention and a lack, particularly in period of economic recession, of a sole dominance of enterprises over investment decisions.

III. ECONOMIC DEVELOPMENT AND INVESTMENT POLICY

Introduction

The 1965 reforms reflected a marked change in the economic development and investment policy of the Yugoslav leadership and contributed to significant changes in the size and structure of investment spending in the 1965-1969 period. These changes were not only of "great economic importance," but also had "the most profound social and political implications" (200, p. 208).

As noted previously in Chapter II, rapid economic growth and industrialization were the almost obsessive objectives of development policy under the command system of the immediate post-war years. These goals were viewed by Yugoslav leaders to require the maximization of investment spending and called for a fixed order of priority of investment over consumption, heavy over light industry, and industry over agriculture (13, p. 640).

Under the NES, the maximization of economic growth continued to be the main objective of development policy and became "the yardstick

of success" of all economic policy. "It was assumed that economic growth was proportionate to the sum spent on investment" and thus, there was continued emphasis on increased investment outlays (12, p. 121). In the late 1950's and early 1960's there was a growing realization that continued rapid growth would require a more balanced development of economic sectors. More emphasis was given to light and consumer industries. But, "gorwth mania" was still very much evident on the part of Yugoslav leaders (13, p. 640). Although there was a growing concern over development policy, the objective of maximum economic growth remained until the 1965 reforms.

The basic characteristic of economic development in the pre-1965 reform period was its "extensive nature." About 50 percent of the growth rate achieved during the 1961-1964 period was "a function of the increased quantity of labor." The economy contained a rather large reserve of industrial workers as a result of the rapid growth and industrialization in the 1950's and the relative decline in the share of agriculture production in total output. The remaining 50 percent was "a function of increased labor productivity" that reflected the "very high rates" of investment spending (185, p. 419).

The result of extensive development and high rates of investment was the emergence of <u>two</u> basic economic problems. One problem was the persistent and growing inflationary pressures. Final demand expansion in the pre-reform years was excessive and "was greatest in the investment sector" (144, p. 314). Investment spending became the "basic focal point of inflationary pressures" (185, p. 419).

The second problem was the growing inconsistencies and imbalances in the productive capacity of the economy. The structure of investment

was not aligned with the growing market forces. As a result, much inefficiency existed in the form of excess capacity in some economic sectors[8] while others suffered from "inadequate" capacity. Uncompleted and obsolete production facilities were most evident in the economy (134, pp. 27, 30). In addition, "considerable discrepancies began to appear in the structure of production in the economy." These discrepancies were particularly noticeable in the "lagging development of agriculture, power production, transportation and services" and in the inadequate output of "some primaries and industrial materials." There was also a noticeable "lack of export-oriented, internationally competitive, production" (210, p. 3869). Official recognition of these problems was apparent and their correction became the starting principle of the new development and investment policy.

Development and Investment Policy of the "New Reform" System

Apparently due to the nature of the problems in the area of investment, the investment policy of the new reform system had two basic groups of objectives. There were long-run development objectives concerned with the size (as related to productive capacities) and the structure of investment outlays. Secondly, there were short-run objectives of economic stabilization concerned mainly with the total volume of investment spending. This dual nature of investment policy was outlined in the Social Plan for 1966-1970 and in certain reform measures.

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[8] Bićanić (12, p. 139) reported that the policy of continued rapid increases in investment was seriously questioned due to the fact that 40 to 50 percent of industrial capacity was idle in 1965.

The 1966-1970 Social Plan contained, in essence, four long-run development objectives. One goal was the "optimum" modernization of the economy to help offset the results of the "extensive mode of development" of the previous period which had resulted in unused, incompleted, and obsolete production facilities. A second objective was the fuller use of productive assets and a greater emphasis on investments in areas offering comparative advantages in world markets. A third objective was the advancement of power industries, transportation facilities, and water resources management and exploitation to create the "necessary conditions" for further economic development. A final objective was the more rapid development of underdeveloped regions, as called for in the 1963 Constitution, to be achieved primarily through the self-efforts of these regions and aided by government resources (134, pp. 27-29).

The main short-run objective of the new investment policy was the elimination of economic instability due to investment spending (108, p. 32; 185, p. 419). The Yugoslav leadership recognized the need to adjust investment spending to the "real possibilities" of the economy (97, p. 20). The new policy called for a "slower increase in the investment expenditures" (162, p. 3863) and a reduction in the emphasis on the "sheer size of total investment" (200, p. 208). The investment policies of 1965, some of which were started in 1964, reflected a movement in the direction of slower rates of investment. These policies included a cut in investment spending at all levels of government with many investment projects halted (13, pp. 640-641) and the adoption of credit restrictions and price freezes. These

actions indicated a "[d]etermined effort to achieve economic stabilization" (42, p. 3781).

In a broader sense, the entire policy concerning economic development and growth was altered in the new reform system. The goal of maximizing economic growth was abandoned in favor of a goal of "optimum" growth. Optimum was defined in terms of modernization of productive capacities and the development of those areas offering comparative advantages in the world market. In this regard, the policy changed "from one of overall global growth into one of selective growth" (12, p. 121) with the remaining vestages of the policy of autarky being abandoned (69, p. 24). In this regard, the policy of the Yugoslav leadership concerning industrial development changed from one of "global industrialization" to one of "selective industrialization" and the long held idea that all industry was progressive was apparently abandoned (12, p. 81). Investment policy placed greater emphasis on "intensive" growth in order to achieve greater productivity and economic efficiency (185, p. 419). One of the basic premises of the development policy was an increased role for "qualitative factors" in economic growth (210, p. 3874).

Bićanić (12, p. 138-141) explained the reasons for the abandonment of the policy of maximum economic growth in favor of "selective growth" as follows: The immediate reason was the inflationary gap in the economy that was created by continued high investment expenditures. In addition, several structural problems existed that implied a need for selective rather than overall maximum growth. These problems were: (1) substantial idle capacity, (2) a relatively low

level of overall consumption spending, and (3) losses being incurred in several industries.

The short-run objective of stabilization and long-run growth objectives were tied together in the 1966-1970 Social Plan which called for a "relative high growth rate of production" and, simultaneously, for a decrease in the rate of capital formation (210, p. 3876). The Plan envisaged an average annual rate of growth for overall output of 7.7 to 8.5 percent for the 1966-1970 period. Due to the intensive and selective nature of the new development policy, the Plan called for different growth rates for various economic sectors. The planned average annual rate of growth for major economic sectors were as follows: (1) industry (including mining and power production)--9 to 10 percent, (2) agriculture--4.5 to 5.5 percent, (3) construction--6 to 7 percent, (4) transportation--8.5 to 9 percent, (5) trade, catering, and tourism--9 to 10 percent, and (6) skilled crafts--12 to 13 percent (134, pp. 35-36). Concerning investment, the Plan called for a relative decrease in accumulation for investment with its share of national income gradually decreasing to about 21 percent by 1970. Fixed capital investment was planned to grow at an average annual rate of 6 to 7 percent (210, p. 3877).

Continued economic growth and a "more dynamic development" of the economy were expected to result mainly from increases in investment efficiency (108, p. 32). The more intensive mode of development was envisaged to occur in the following manner: By concentrating investments to a greater extent on the modernization of existing productive facilities, labor productivity would be

increased (12, p. 121). This, in turn, would allow the expansion of production and continued growth of output as planned without the continued need for rapid expansion of investment spending. The high rate of investment before the 1965 reforms and the "rational investment policy" after the reform would, according to the Plan, "undoubtedly result in a general increase in production and consumption" (134, p. 35).

Planned Patterns of Investment

In light of the objectives of the new development policy, the pattern of investment foreseen by the 1966-1970 Social Plan differed somewhat from the pattern of the previous period, 1961-1964. In general, the Plan called for a relative reduction in investments in industry and transportation accompanied by a relative increase in investments in areas where comparative advantages were thought to exist such as agriculture, crafts, and trade and catering (210, p. 3893). The planned structure of productive investment by economic sector for the period 1966-1970, as compared to the actual structure of the period 1961-1965, as shown in Table XXII. It was envisaged that the planned structure of investment would be accomplished mainly through the changes introduced in the income distribution system that would allow greater "direct" disposal of investment funds at the enterprise level and through the injection of government funds (210, p. 3894). Policy makers apparently felt that the higher rates of industrial investment recorded in the pre-reform years could not be maintained without government intervention

TABLE XXII

TOTAL PRODUCTIVE INVESTMENT[a] IN FIXED CAPITAL BY ECONOMIC SECTOR FOR THE PERIODS, 1961-1965 AND 1966-1970

Economic Sector	Percentage Share of Investment:[b] 1961-1965[c]	1966-1970[d]	Rate of Growth of Investment[e]
Industry	52.9	50.7	4.6
Agriculture	12.9	14.7	12.1
Forestry	1.6	1.8	9.4
Construction	2.9	2.9	4.8
Transportation	20.5	19.2	8.2
Trade and Catering	7.7	9.0	7.1
Crafts	1.5	1.7	9.2
Total	100.0	100.0	6.7

[a]Excluding non-productive investment.

[b]Based on current prices.

[c]Actual structure of investment.

[d]Planned structure of investment.

[e]Planned rate of growth.

Source: 210, p. 3894.

and would therefore decline while other sectors, especially agriculture, would increase their rate of investment due to their expanded self-financing ability.

Within the industrial sector, the Plan called for a "substantial increase" in the relative share of investment in power industries and base metals in order to expand these sectors' inadequate production capacities. The relative share of investment in processing and manufacturing industries, particularly in equipment production and consumer durables industries, was to be reduced due to existing excess capacity that was obvious in these areas (134, p. 31). Table XXIII shows the planned pattern of industrial investment for the period 1966-1970, as compared to the actual pattern of the period 1961-1965. The realization of the planned pattern of industrial investment was foreseen to depend on: (1) the growth of output in individual industrial branches and their accumulation of investment resources, (2) the pattern of government funds injections into the investment area, particularly in power generating and iron and steel industries, and (3) the receipt of envisaged foreign investment credits for industrial development, especially in the area of non-ferrous metallurgy (134, p. 31).

Although primary emphasis was placed on modernization and reconstruction of existing productive facilities, there was still significant emphasis on new projects in order to achieve development objectives. The Plan called for 27 percent of total investment to be spent on new projects. Within industry, the share was set at 38 percent. The main focus of investment in new projects was in power

TABLE XXIII

TOTAL INVESTMENT IN INDUSTRY BY MAJOR INDUSTRIAL BRANCHES FOR THE PERIODS, 1961-1965 AND 1966-1970

Industrial Branch	Annual Average Share of Investment[a] 1961-1965[b]	1966-1970[c]
Power	28.0	35.1
Metallurgy	15.0	23.4
Equipment and Consumer Durables	14.3	7.3
Chemicals	8.4	10.3
Textiles, Leather, Shoes, and Rubber	9.6	3.5
Processed Farm Products	6.2	4.2
Others	18.5	16.0
Total	100.0	100.0

[a]Figures in percentages.

[b]Actual share of investment.

[c]Planned share of investment.

Source: 134, p. 31.

generation and on capital projects in underdeveloped regions (134, p. 32). This accounted for the larger share of investment in new projects planned for the industrial sector relative to the entire economy.

Development Policy for Underdeveloped Regions

The new development policy placed special emphasis on underdeveloped regions of the country. "One of the basic economic and political targets of the Plan" was the more rapid development of underdeveloped regions (108, p. 34).

Before the 1965 reforms, the policy of the Federation toward the underdeveloped regions had been one of rapid development but, no consistent system or method for the realization of that policy was worked out. Government intervention methods to stimulate development in these regions was basically a matter of direct investment and/or the distribution of supplemental funds and did not include differential treatment for these areas in terms of fiscal and credit policy (14, p. 397).

In 1965, new measures were adopted that specified, as an explicit goal, the achievement of faster development of less developed areas as called for in the 1963 Constitution. The Fund for the Development of Underdeveloped Regions was formed at the federal level and assumed credit operations for purposes of development of these areas. The new policy was "adopted concretely" in the 1966-1970 Social Plan and the distribution of funds were secured and began to be carried out (14, pp. 397-398).

The Plan insisted on "a systematic narrowing of the relative differences in the level of development of individual constituent republics and areas" (162, pp. 3864-3865). Underdeveloped areas were called upon to "devise their own measures to attract the influx of capital" (162, p. 3865) and to work out independently their own development policy and plans (210, p. 3889). The Plan specified government aid to underdeveloped areas in the form of appropriations from the new Fund, budgetary grants, and "other measures" designed to stimulate economic growth in these areas through the "exploitation of definite comparative advantages" (210, p. 3890). The establishment of the federal Fund for granting credit for rapid development of less developed areas, measures taken to assure "constant and lasting resources" for development purposes, and measures introducing more "objective economic criterion" in the distribution process, all combined to create a more "stable and adequate institutional basis" for implementing the policy of rapid development in underdeveloped areas (14, p. 400).

IV. THE SIZE AND STRUCTURE OF INVESTMENT

Introduction

The size and structure of investment spending during the 1965-1969 period reflected the influence of three main forces. These forces were: (1) the stabilization and development policies of the government as demonstrated in government funds allocations, credit policy, and other direct and indirect measures of intervention in the investment process, (2) the new institutional arrangements

of the investment process and specifically, the expanded roles for enterprises and banks in that process, and (3) the aggregate economic activity of the period. The impact of these forces varied in intensity and importance throughout the period to determine the level of investment spending and the structure of that spending. An analysis of investment activity during the 1965-1969 period will reveal the nature and probable causes of changes in the size and structure of investment.

The Volume of Investment Spending

During the first five years of the "new reform" system, 1965-1969, the rate of investment spending slowed, generally. Nominal investment in fixed and working capital and the relative share of investment in these areas in gross material product for each year in the period 1965-1969, is shown in Table XXIV. The distribution of total investment between fixed and working capital in the 1965-1969 period is shown in Table XXV. During the first two years after the reforms, 1965 and 1966, total money investment increased at a decreasing rate. Investment spending rose 18 percent in 1965 and 22 percent in 1966 (in relation to the previous year) compared to a 40 percent increase in 1964. With the economy in the midst of a recession, money investment decreased in 1967 by 9 percent. Investment spending increased slightly in 1968 and sharply in 1969 (an increase of 7 percent and 27 percent, respectively) when the volume surpassed the 1966 level. The average annual rate of growth in total investment during the 1965-1969 period was well below that of the previous period, 1961-1964 (12.6 percent compared to 23 percent). The decrease

TABLE XXIV

TOTAL INVESTMENT[a] IN FIXED AND WORKING CAPITAL, 1965-1969

Type of Investment	Year				
	1965[b]	1966[b]	1967[b]	1968[b]	1969[b]
Fixed Capital Investment	21.8	26.6	30.3	34.9	41.0
Share of GMP[c]	(27)	(27)	(29)	(31)	(31)
Working Capital Investment	10.8	13.2	6.1	4.0	8.3
Share of GMP[c]	(14)	(13)	(6)	(4)	(6)
Total	32.6	39.8	36.4	38.9	49.3
Share of GMP[c]	(42)	(40)	(35)	(35)	(37)

[a]Excluding investment in economic activities not contributing directly to material production such as public administration and defense, personal and professional services, and similar activities.

[b]Nominal figures in billions of new dinars.

[c]Figures represent share of investment in Gross Material Product.

Source: 202, p. 629; 204, p. 48.

TABLE XXV

DISTRIBUTION OF TOTAL INVESTMENT BY TYPE OF INVESTMENT, 1965-1969

Type of Investment	Year				
	1965[a]	1966[a]	1967[a]	1968[a]	1969[a]
Fixed Capital Investment	67	67	83	89	83
Working Capital Investment	33	33	17	11	17
Total	100	100	100	100	100

[a]Figures in percentages.

Source: 202, p. 629.

in total investment in 1967 occurred mainly in investments in working capital (stocks) which fell drastically by over 50 percent. Working capital investment decreased again in 1968 and only slightly recovered in 1969. As indicated in Table XXIV (page 224), money investment in fixed assets increased continuously throughout the period (202, p. 629).

The rate of growth of money investment in fixed assets was only 7 percent in 1965 compared to 29 percent in 1964. The growth rate of fixed capital investment increased in the years after 1965 but remained well below the growth rate of the 1961-1964 period. The average annual rate of increase in fixed capital investment for the 1965-1969 period was about 15 percent compared to 21.5 percent for the previous period. In real terms, the rate of growth of fixed capital investment in the post-reform period decreased even more drastically. The average annual increase in real fixed capital investment in the 1965-1969 period was only 2.2 percent compared to a rate of 10.2 percent in the 1961-1964 period, based on constant 1966 prices (202, pp. 629-630).

The share of gross fixed capital investment in gross material product decreased sharply in 1965 to 27 percent and then rose slightly throughout the remainder of the period to 31 percent in 1969. The average annual share of gross fixed capital investment in gross material product for the 1965-1969 period was well below that of the 1961-1964 period (29 percent as compared to 34 percent). The share of working capital (stocks) investment in gross material product rose in 1965 to 14 percent and then dropped sharply for three straight

years to only 4 percent in 1968 before rising slightly to 6 percent in 1969 (204, p. 48).

The slowdown in the growth rate of investment spending and the reduction in the share of fixed capital and working capital investment in the nation's output was, in general, envisaged by the reforms and the 1966-1970 Social Plan. But, it appeared that the abruptness and degree of such changes, particularly the drastic reduction in working capital investment, the actual decline in investment spending in 1967, and the almost stagnant growth rate of real fixed capital investment, were not foreseen. For example, the average annual rate of growth of real fixed asset investment was about 5.5 percent during the 1966-1969 period; below the 6 to 7 percent rate called for in the Plan (202, p. 630).

The initial slowdown in the rate of investment spending in 1965,[9] was apparently due to a continuation of restrictive credit measures begun in 1964, and to the investment behavior of enterprises, banks, and government under the new reform system. In this regard, the slowdown was the result of an attempt to stabilize the economy and of the structural changes of the economic reforms.

Nominal investment by government decreased about 13 percent in 1965 compared to the previous year (from about 10.11 billion dinars to about 8.8 billion dinars).[10] This decrease in government

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[9]Investment spending slowed drastically during the first five months after the July, 1965, reforms. Real fixed capital investment decreased by 24 percent (42, p. 3791).

[10]These government investment figures are approximations based on the volume of total investment in each year (202, p. 629) and

investment outlays was more than offset by investments iniated by enterprises. But, given the relatively tight credit situation and the lag in the implementation of the reform measures, particularly those affecting enterprises' retained earnings and the enterprises' ability to get investment funds from the banks, enterprises' investment outlays grew more slowly. The net effect was a lower rate (18 percent) of investment spending in 1965, particularly, fixed capital investment.

The low rate of fixed capital investment in 1965 (7 percent) was offset, to a degree, by a rapid increase in working capital investments, as indicated in Table XXIV (page 224), which rose 48 percent over the 1964 level (from 7.3 billion dinars to 10.8 billion dinars) (202, p. 629). The major reason for this increase was apparently a requirement of the reform which forced enterprises to put into the working capital part of their business fund a sum equal to the increase in the value of their stocks due to the new prices (190, p. 55). The increase is also partially explained by the fact that all of the decrease in government investment outlays came in expenditures for fixed capital.

In 1966, the rate of growth in total investment spending, as noted previously, increased slightly to 22 percent. Even though government investment outlays were again reduced, the enterprises, with the new income distribution system and the new banking and credit system fully operational, increased their rate of investment spending.

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data concerning the share of that investment financed directly by government funds (50, p. 29; 104, p. 67) and do not include government allocations from bank sources.

Investments in fixed assets rose 22 percent in 1966 and, aided by a continued high level of working capital investment (13.2 billion dinars), accounted for the increased rate of investment spending.

The actual decrease in the volume of total investment, in money terms, in 1967 was apparently due to a combination of factors. Medenica (108, p. 33) attributed the decline mainly to the slowdown in economic activity and its effect on the investment funds of enterprises. The lower rate of investment spending led to a further slowdown in consumption and output and thus, to a even more reduced investment ability of enterprises. The result was, as noted previously, a 9 percent decrease in total investment spending. But, why did investment in working capital decrease so drastically (from 13.2 to 6.1 billion dinars) during 1967 while fixed capital investment, although growing at a slower rate (14 percent), continued to increase, in money terms?

Before the 1965 reforms, enterprises were greatly dependent on the banks for funds to finance their investment in working capital. Enterprises' own funds accounted for only a small part of the total funds for working capital (18.8 percent in 1964). After the reforms, due to special provisions including the forced investment mentioned previously, the share of enterprise funds slowly rose to about one-third of the total (190, p. 55). But "those responsible for investment" (government, banks, and enterprises themselves) continued to pay much more attention to fixed capital investment. As a result, most enterprises were forced to rely on short-term bank credit as a source of funds for investment in working capital (190, pp. 60-61).

At the end of 1966, the short-term credit policy of the National Bank was revised in an effort to prevent the further expansion of total liquidity which was deemed excessive. The National Bank twice (in January and again in March, 1967) lowered the overall credit ceiling by 12 percent on each occasion. More strict quantitative regulations were imposed on business banks' credit activity. These measures included: (1) a reduction in rediscount limit and availability to banks, (2) a ban on all short-term lending in the first three months of 1967, and (3) reduction in "special credits" (credits to banks above the rediscount ceiling). As a result, short-term credit rose by only 6 percent in 1967 (125, p. 28) compared to increases of 11 and 12 percent in 1965 and 1966, respectively (126, p. 19). On the other hand, long-term investment credits under the new banking and credit system continued to increase in 1967, although at a slower rate. Long-term bank lending to enterprises increased by 26 percent in 1965, 42 percent in 1966, and 23 percent in 1967 (126, p. 19).

The combined effect of the economic recession, the reduction in short-term credit, and the continued expansion of long-term credit was as follows: The recession reduced, generally, the ability of enterprises to accumulate investment funds. As such, they looked to the banking system for funds in order to invest at a planned rate. Given the sharp cutback in short-term credit and the degree of enterprises' reliance on banks for working capital investment funds, and given the continued increase in long-term (investment) credits for

fixed capital investment purposes, it is not surprising to find working capital investment reduced drastically while fixed capital investment continued to increase.

At the beginning of 1968 there was an easing of credit policy by the National Bank. The reserve requirement for banks was lowered by 29 percent. The ceiling on rediscount borrowing was raised and the interest rate charged for "special credit" was lowered from 7 to 6 percent (125, p. 29). Investment spending by government increased, in money terms, in 1968 and 1969. As a result, the economy began to recover in 1968 and by 1969 was expanding rapidly (202, p. 629). Total investment spending, as noted previously in Table XXIV (page 224), rose slightly in 1968 and increased sharply in 1969.

The Structure of Investment

"The most dramatic impact" of the reforms and the economic recession of 1965-1967 was on the structure of investment spending (28, p. 623). The pattern of investment during the 1965-1969 period was substantially different in several respects from the pattern of the 1961-1964 period. Some of the changes in the structure of investment were, in general, foreseen by the 1966-1970 Social Plan while some others were noticeably different from the planned structure in terms of direction and/or magnitude of change.

Investment outlays for capital replacement increased and investment spending for new projects fell, relatively, during the 1965-1969 period. The share of replacement outlays in total gross investment was 76 percent in 1968, compared to 52.5 percent in 1962

(84, p. 42). In 1968 and 1969, investment in new production facilities accounted for about 34 percent of total investment. During these two years, investments for reconstruction, modernization, and expansion of existing facilities accounted for about 48 to 49 percent of the total while replacement and maintenance outlays accounted for about 17 to 18 percent (96, p. 62). This reduced emphasis on investment in new projects was generally in line with the 1966-1970 Social Plan which called for the modernization and reconstruction in the economy as part of an overall drive toward a more intensive mode of development. The increased exposure of enterprises to domestic and world market forces and the reduced emphasis by the government on investment in new projects, as reflected in their direct investments, appeared to be the major causes for these changes.

During the period of 1965-1969, the structure of investment in terms of the relative share absorbed by the various economic sectors was noticeably changed. Most of these changes were quite different from those envisaged by the Plan. The composition of total investment in fixed assets by major economic sectors for the 1966-1969 period is shown in Table XXVI. As is obvious from Table XXVI, the share of industrial investment in total fixed capital investment grew continuously throughout the period 1965-1968, with a slight reduction in 1969. The relative share of investment in the transportation and communications sector also expanded during the 1965-1969 period. Both of these changes were <u>not</u> in accord with the 1966-1970 Social Plan which called for a relative reduction in investment outlays in these sectors (210, p. 3893). The Plan also called

TABLE XXVI

TOTAL INVESTMENT IN FIXED ASSETS BY ECONOMIC SECTOR, 1965-1969

Economic Sector	Year				
	1965[a]	1966[a]	1967[a]	1968[a]	1969[a]
Industry and Mining	36.4	39.2	39.9	40.1	39.0
Agriculture and Fisheries	8.3	8.6	8.5	7.3	7.6[b]
Forestry	1.1	1.0	.5	.6	
Construction	1.6	1.6	1.8	2.2	3.2
Transportation and Communication	11.6	12.5	12.2	12.7	16.8
Trade, Hotels, and Catering	5.2	6.0	10.5	10.0	12.2
Crafts	.9	1.0	1.1	1.0	-[c]
Housing and Public Utilities	24.0	21.0	18.1	18.5	10.5
Cultural and Social Activities	6.7	5.9	5.2	5.4	-[c]
Social and Public Services, Government Agencies, etc.	4.1	3.4	2.2	2.2	-[c]

[a]Figures in percentages and based on current prices.

[b]Share of investment in agriculture, fisheries, and forestry combined.

[c]Data not available.

Source: 87, p. 145; 96, p. 62; 202, p. 636.

for an increase in the share of investment in agriculture, as noted previously, but, in reality, this share gradually fell during the period in question. The one major sector that recorded a changing share of investment in line with the Plan was the trade, hotels, and catering sector which, as called for, rose during this period (210, p. 3893).

Table XXVII shows the average annual composition of total investment in fixed assets by major economic sector for the periods, 1961-1964 and 1965-1969. The increase in the share of industrial investment and the decrease in the share of investment in agriculture in the period 1965-1969, as compared to the period 1961-1964, both in directions opposite from those expressed in the Plan, were most evident. The failure for the share of investment in transportation and communications to fall appreciably was also alien to the planned structural changes.

The decreasing share of agricultural investment in total fixed capital investment during the 1965-1969 period was apparently due to the combined impact of reform measures in the agricultural sector and a slowdown in economic activity that hit particularly hard in the agriculture sector. In essence, the agriculture sector found itself faced with lower demand and output, unfavorable price adjustments, and less self-financing funds. Coupled with a cutback in government sponsored investment, these events led to a relative decline in the share of total fixed capital investment absorbed by the agricultural sector.

TABLE XXVII

INVESTMENT IN FIXED ASSETS BY ECONOMIC SECTOR FOR THE PERIODS, 1961-1964 AND 1965-1969

Economic Sector	Average Annual Share of Investment 1961-1964[a]	1965-1969[a]
Industry and Mining	35.2	38.9
Agriculture and Fisheries	9.6	8.2[b]
Forestry	1.2	.8[b]
Construction	3.4	2.1
Transportation and Communication	13.3	13.2
Trade	5.3	8.8
Crafts	1.1	1.0[b]
Housing and Public Utilities	18.6	18.4
Cultural and Social Activities	6.8	5.8[b]
Social and Public Services, Government Agencies, etc.	4.6	3.0[b]
Total	100.0	100.0

[a]Figures in percentages.

[b]Figure does not include data for 1969.

Source: 87, p. 145; 96, p. 62; 202, p. 636; 86, pp. 3859-3860.

After World War II the agricultural sector, under the command system, was left almost no capital development funds and became greatly dependent on investment grants from the government. In the first four years of the NES, 1953-1956, subsidies were introduced by government to stimulate production that had stagnated in the early years of the new system. Investment funds were still provided in most part by the government (mainly the Federation) but, were in the form of repayable credits. During the later years of the NES, 1957-1964, guaranteed prices and premiums were introduced. Government allocations of investment funds were expanded and prices of agriculture products were more favorably adjusted (agriculture producer prices increased relative to prices in other sectors). These measures were effective in assuring current production but, did not significantly increase the self-financing investment ability of agricultural firms (38, pp. 33-34).

The 1965 reforms in the agriculture sector were intended to more fully integrate the sector into the new, more market-oriented domestic economy and world markets. The agriculture sector was to be more exposed to market forces without government interference in order to more fully develop the organizational principle of self-management. In light of these objectives, the following measures were taken: (1) agriculture producer prices were raised, on the average, by 33 percent in order to correct past imbalances due to government intervention, (2) "special-purpose" investment by government in agriculture was "sizeably cut" and premiums and subsidies were abolished with few exceptions (milk, pork, and fertilizer production)

(37, p. 35), (3) protective import tariffs and export bonuses and premiums were abolished on all but a few products, (4) a capital tax and other taxes and contributions like those paid by other non-agricultural enterprises were introduced (142, p. 65), and (5) individual farms were to become "prime factors responsible for capital investment" from their own funds (the 1966-1970 Social Plan called for 50 percent of fixed capital investment in agriculture to be financed by their own funds) (38, p. 35).

In the first full year under the new reforms, 1966, agricultural output increased sharply due mainly to the stimulative effect on production of the large price increases in 1965 and aided by good weather conditions (37, p. 15). In 1967 and throughout the next year, agriculture output dropped drastically and stagnated at this low level under the influence of the general recession and growing problems peculiar to the agricultural sector. The gross material product and the contribution of the agricultural and industrial sectors to that output for the period 1965-1969, is shown in Table XXVIII. The decline in agricultural output was apparently due to a number of factors. On domestic markets, demand stagnated due to the general slowdown in economic activity and an inadequate distribution network for agricultural goods. Foreign marketing difficulties also appeared which restricted demand. Protective import measures were adopted by some foreign countries (east and west) that were important buyers of Yugoslav agricultural products. In addition, the removal of import restrictions and tariffs in Yugoslavia led to increased imports of agriculture products at "dumping prices" which

TABLE XXVIII

THE CONTRIBUTION OF INDUSTRIAL AND AGRICULTURAL PRODUCTION TO GROSS MATERIAL PRODUCT, 1965-1969

	Year				
	1965[a]	1966[a]	1967[a]	1968[a]	1969[a]
Gross Material Product					
In current prices:	79.5	99.0	103.7	112.0	132.0
Change over previous year[b]	(14)	(25)	(5)	(8)	(18)
In constant 1966 prices:	92.8	99.0	99.8	103.3	114.3
Change over previous year[b]	(1)	(7)	(1)	(4)	(11)
Industrial Output					
In current prices:	33.3	37.9	38.2	42.6	48.4
Change over previous year[b]	(24)	(14)	(1)	(11)	(14)
In constant 1966 prices:	36.4	37.9	37.9	40.0	44.1
Change over previous year[b]	(8)	(4)	(0)	(6)	(10)
Agricultural Output[c]					
In current prices:	18.9	24.6	23.7	21.9	25.7
Change over previous year[b]	(34)	(30)	(-4)	(-8)	(17)
In constant 1966 prices:	21.2	24.6	24.3	23.5	25.9
Change over previous year[b]	(-8)	(16)	(-1)	(-3)	(10)

[a]Nominal figures in billions of dinars.

[b]Figures in percentages.

[c]Including livestock production.

Source: 202, pp. 631-632.

severely lessened domestic demand (142, pp. 68-69). On the supply side, adverse weather conditions lowered production yields (37, p. 15).

The economic position of the agricultural sector was also worsened due to growing price disparities and increased fiscal and other obligations. The prices of inputs of agriculture production rose faster than those of agriculture products thus causing a squeeze on agriculture profits (38, p. 35).[11] The increased fiscal and other obligations of agriculture producers (insurance premiums, interest and repayment of previous credit loans, fixed capital charges, and "contributions" levied on the firms income) greatly reduced their financial position and their possibilities of obtaining necessary credit funds and often led to financial losses for their operations (142, p. 35). In addition, government aid was, as noted previously, sharply cut back. In relation to the 1961-1965 period, funds earmarked for investment in agriculture from the federal budget were reduced by 53 percent in the 1966-1970 period. During the same period premiums and subsidies paid to the agriculture sector were reduced by 33 and 12 percent, respectively (37, p. 36).

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[11]During the years 1966-1969, agriculture producer prices rose by an average annual rate of .7 percent. The prices of machinery and fertilizer that were used as inputs for agriculture production rose by an average annual rate of 1.5 and .3 percent, respectively, during the same period (126, p. 13). By 1970, prices of agriculture products relative to industrial prices were 12 percent "less favorable" than after the 1965 reforms. Relative to the prices of materials used for agriculture production, agriculture prices were 17 percent "less favorable" (37, p. 36).

With output and income declining, production cost rising due to unfavorable price changes, and an increase in fiscal and other obligation, agricultural producers found their self-financing investment potential severely reduced. Add to this the agriculture producers' inability to obtain sufficient bank credit and the sizeable cut in government aid, and it is not surprising that nominal investments in the agricultural sector slowed and actually declined in 1967 and 1968[12] and the volume of real investment almost stagnated during the 1966-1969 period (37, p. 36).

The investment ability of industrial enterprises was, in general, less unfavorably affected by the economic reforms and the post-reform recession. As indicated in Table XXVIII (page 238), the rate of growth of industrial output slowed in 1966 and was zero in 1967 but, unlike agricultural output, never became negative. The average annual rate of growth of real gross material product for the entire economy during the period 1965-1969, was about 4.6 percent. Real industrial output and real agricultural output grew at an average annual rate of 5.6 and 2.8 percent, respectively, during the period.

Unlike the agricultural sector, the net effect of fiscal reforms on the investment self-financing potential of enterprises in the industrial sector was, as previously discussed, favorable. As noted previously, price adjustments during the post-reform period favored the industrial sector. Although their retained earnings were severely limited by the recession, there was apparently no extreme

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[12]Based on estimates from data in Table XXIV (page 224) and Table XXVI (page 233).

pressure on the liquidity of industrial enterprises as was the case in agriculture. In addition, bank credit was apparently more available and on more favorable terms to industrial enterprises.

The result of these less unfavorable influences was a continued expansion, unlike agriculture, in industrial investment spending during the 1965-1969 period. The rate of growth of industrial fixed capital investment fell from 31 percent in 1966 to 14 percent in 1969. During this period the average annual rate of growth in fixed capital investment was about 19 percent compared to a growth rate of less than 13 percent for agriculture.[13] When compared to the more unfavorable effects of the reforms and recession on the agricultural sectors' investment potential and the resultant decrease in investment spending, these changes seem to explain, for the most part, the rising share of industrial investment and declining share of agriculture investment in total fixed capital investment in the post-reform period.

Within the industrial sector, the structure of investment changed during the 1966-1969 period along the general lines envisaged by the Plan. This structure was substantially different from that of the 1961-1964 period. Table XXIX shows the composition of total industrial investment by major industrial sector for the periods, 1961-1964 and 1965-1968, and for 1968 separately. As indicated in Table XXIX, industrial investment continued to be biased toward heavy industry with increased emphasis, as foreseen in the Plan, on investment

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[13] Based on estimates from data in Table XXIV (page 224) and Table XXVI (page 233).

TABLE XXIX

TOTAL INVESTMENT IN INDUSTRY BY MAJOR INDUSTRIAL BRANCH FOR THE PERIODS 1961-1964 AND 1965-1968, AND FOR 1968 SEPARATELY

Industrial Branch	Average Annual Share of Investment[a]		
	1961-1964	1965-1968	1968
Fuels and Power	28	37	41
Ferrous Metals	10	13	11
Non-ferrous Metals	5	7	8
Chemicals	9	8	7
Machinery and Equipment	14	11	9
Wood and Paper	9	6	6
Textiles and Leather	9	5	5
Food and Tobacco Processing	6	5	5
Others	10	8	8
Total	100	100	100

[a]Figures in percentages.

Source: 28, p. 625.

in fuels, power, and nonferrous metallurgy. The share of investment in machinery and equipment industries was "reduced sharply" and the share of investment in light industries (manufacturing and processing) was much lower than in the 1961-1964 period (28, pp. 624-625). In 1962 the share of industrial investment absorbed by the power and raw materials sectors was about 55 percent and the share of manufacturing industries was about 45 percent. By 1968, these shares were about 73 percent and 27 percent, respectively, for these two areas (84, p. 40). All of these changes in the structure of industrial investment, in terms of both their direction and magnitude, were, in general, anticipated in the 1966-1970 Social Plan (134, p. 31).

Although industrial investment spending was, in general, slowed by the economic recession of the post-reform years, the effects of the recession appeared to have affected all industrial sectors almost equally. In addition, certain industrial branches (power and base metals production in particular) were apparently aided by government sponsored investment as called for in the 1966-1970 Social Plan (134, p. 31). As such, these branches were somewhat insulated from the recession and were able to expand along planned lines of development.

The technical structure of fixed capital investment also changed during the 1965-1969 period. Throughout the period the share of construction outlays in total fixed capital investment rose slightly while the share of machinery and equipment outlays fell. The technical structure of fixed capital investment for the period 1965-1968, is shown in Table XXX. Although not shown in Table XXX, the technical structure in 1969 remained relatively unchanged compared to that of

TABLE XXX

TOTAL FIXED CAPITAL INVESTMENT BY TYPE OF CAPITAL GOOD, 1965-1968

Type of Capital Good	Year			
	1965[a]	1966[a]	1967[a]	1968[a]
Construction	55.5	56.0	58.4	59.8
Machinery and Equipment	31.7	31.0	27.8	26.4
Other	12.8	13.0	13.8	13.8
Total	100.0	100.0	100.0	100.0

[a]Figures in percentages based on current prices.

Source: 201, p. 800.

1968 (96, p. 62). The average annual technical structure of fixed capital investment for the periods, 1961-1964 and 1965-1968, is shown in Table XXXI. Compared to the technical structure of the peirod 1961-1964, the structure in the 1965-1968 period showed an increased share of construction outlays and a decreased share of outlays for machinery and equipment.

The new development policy, as reflected in the 1966-1970 Social Plan, placed special emphasis on the more rapid development of underdeveloped areas which in turn called for a greater share of investment spending in these areas. In reality, the envisaged relative expansion of investment spending in underdeveloped regions did not occur and the share actually fell during the 1965-1969 period. Table XXXII shows the regional structure of total investment in 1965 and 1968 by republic and province. As indicated in Table XXXII, with the exception of Kosovo, the share of investment in the less developed republics and provinces fell from 1965 to 1968. The existing enterprises in the underdeveloped areas may have been "too few and too weak (technologically, financially, and so forth) to keep abreast of others" (177, p. 273). Thus, although the recipient of special federal loans and grants, these enterprises were apparently placed in a more incompetitive position by their greater exposure to market forces after the 1965 reforms and, in particular, the economic recession. Their ability to self-finance investment projects was, it seemed, greatly constrained as was their ability to attract outside sources of funds.

TABLE XXXI

TOTAL FIXED CAPITAL INVESTMENT BY TYPE OF CAPITAL GOOD FOR THE PERIODS 1961-1964 AND 1965-1968

Type of Capital Good	Average Annual Share of Investment[a] 1961-1964	1965-1968
Construction	54.1	56.0
Machinery and Equipment	33.9	29.2
Other	12.0	13.4
Total	100.0	100.0

[a]Figures in percentages based on current prices.

Source: 201, p. 800.

TABLE XXXII

TOTAL INVESTMENT BY REPUBLICS AND PROVINCES IN 1965 AND 1968

Republic or Province	Year[a] 1965	1968
Developed:	69.8	71.2
Slovenia	13.6	13.1
Croatia	23.3	21.5
Serbia proper	24.1	27.7
Vojvodina	8.8	8.9
Underdeveloped:	30.1	28.8
Bosnea and Hercegovina	12.9	12.1
Montenegro	3.0	2.6
Macedonia	10.6	9.2
Kosovo	3.6	4.9
Total	100.0	100.0

[a]Figures in percentages

Source: 28, p. 627.

V. ECONOMIC PROBLEMS OF THE NEW REFORM SYSTEM

Aggregate Economic Results

The results of the 1965 reform effort were, at best, disappointing in terms of aggregate economic activity. The growth of social product fell substantially in 1966 and 1967 (12, p. 139). The price level continued to rise[14] and the balance of payments deficit worsened (6, p. 207). The initial slowdown in economic activity was apparently due, in large part, to the disruptive effects of the new reforms and specifically, the drastic reduction in the growth of aggregate investment demand. As noted previously, this initial downturn in economic activity had a feedback effect on investment causing even lower levels of spending and even slower economic activity (108, p. 33).

In order to stabilize prices, the government introduced an even more restrictive credit policy. Although the monetary restrictions adopted were partially successful in reducing inflation, they further dampened economic activity and the employment level (6, p. 209; 61, p. 28). There was a growing exodus of workers to Western European countries (12, p. 229).

From 1965 to mid-1967, the annual rate of growth of industrial output dropped from 12 to minus 1 percent (80, p. 86). The average annual rate of growth of gross material product during the 1965-1969

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[14] As noted previously, Horvat (80, p. 142) explained the apparent paradox of economic recession with rising prices in terms of the peculiar institutional structure of the Yugoslav economy, where enterprises in the face of decreasing demand, attempted to maintain output levels and to accumulate inventories while financing this production by raising prices.

period was 4.6 percent. The rates of growth of output for the major economic sectors were as follows: (1) industrial output (including mining, manufacturing, electricity, and gas) --4.5 percent, (2) agricultural output (including hunting, forestry, and fishing) --3.3 percent, (3) construction--6.3 percent, and (4) transportation and communication--6.8 percent (204, p. 101). With the exception of the construction sector, these growth rates were all well below those called for in the 1966-1970 Social Plan.

In 1968, the economy began to experience a recovery. On the demand side the iniative for rising output "came almost entirely" from increases in the volume of fixed capital investment spending (53, p. 74). Increased investment expenditures were due mainly to increased federal government outlays for major long-term modernization projects in "essential public services" such as the railways and telephone system and to expanded enterprise investment spending in response to easier credit conditions. In addition, there was a rather large increase in government expenditures due to the "military tension" caused by the Soviet incursion into Czechoslovakia. Additional expenditures were also made for purposes of manpower development and retraining (177, p. 79). By 1969, there was a rapid acceleration in economic growth and renewed inflationary pressures were evident in the last half of the year (80, p. 87). The old problem of excessive investment spending was again encountered.[15]

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[15]In a speech before the Congress of Yugoslav Self-Managers in 1969, Tito sharply criticized the "investment megalomania" apparent

A report by the Institute of Economic Studies (80, p. 87), published in 1969, detailed the disasterous economic results of the post-1965 reform period. The major findings of the study were that: (1) even though a stringent deflationary policy was introduced, prices "were no more stable than they were before the reform," (2) the 1966-1970 Social Plan would not likely be fulfilled, (3) price controls covered a larger proportion of national output than in the pre-reform period, (4) the balance of payments deficit was growing larger, (5) the overall rate of saving was declining, (6) losses were being incurred by enterprises and their indebtedness was increasing, and (7) unemployment was higher in 1969 than it had been in twenty years.

Structural Results

In a less aggregate sense, the results of the new reform system were also disappointing. Partially implemented reform measures and unplanned consequences of many measures that were introduced created or contributed to numerous structural problems. In general, the planned restructuring of the economy was apparently not accomplished. Inefficient enterprises still existed, some supported by government aid, while other, more efficient ones in "temporary" difficulty received little or no aid (12, p. 230). The difference in incomes between economic sectors and individual enterprises within sectors widened "strikingly." Under the new arrangements (greater market

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in the economy. In the same meeting, Premier Ribicić strongly complained that a large part of expanded investment spending came from government sources (140, pp. 5-7).

influence, price adjustments and freezes, income distribution changes, and so forth) some industries enjoyed windfall gains while others "experienced great difficulties" (177, p. 76).

The structure of production remained, in large part, unadjusted to market forces and was fragmented and autarchic in character. The increased influence of market forces in the economy were not accomplished by the formulation of an industrial investment policy or a "conception of industrial development" to match long-term market requirements. The result was the continued low level of plant utilization of manufacturing capacity and a simultaneous output shortage in power and basic industries (125, pp. 52-53).

The reforms created an economic environment of uncertainty and instability for the enterprises (6, p. 201). Enterprises found it difficult to define their operational and investment policies in the face of "drastic and sudden" changes and the lack of guidance of even an effective indicative plan. In addition, many enterprises had no effective self-management apparatus to take the place of the void created by the withdrawal of government intervention and support. As a result, they displayed "apparently irrational behavior" in their production and investment decisions (177, p. 77). The fact that these disruptive aspects of the reforms contributed greatly, as noted previously, to the economic recession of the post-reform years is not surprising in light of their impact on the enterprises' business environment.

Problems in the Area of Investment

In the area of investment, many desired results of the reforms were not achieved and numerous problems remained. As previously discussed, enterprises did not achieve the expected degree of influence over bank operations, particularly, investment credit policy, and banks gained an alarming degree of control over the investment financing and decision-making processes in the economy. Direct governmental intervention in the investment process apparently continued to exceed that level envisaged by the reforms. In general, the anticipated dominance of the enterprises over the whole investment process did not materialize.

The degree of the development of a capital market was not sufficient to ensure the flow of investment funds to the most profitable areas of the economy (49, p. 31). The absence of a sufficient volume of financial instruments and the inadequately developed capital market continued to cause "rigidity" in the flow of investment funds and hampered the increase of the efficiency of their allocation (193, p. 577).

The structure of investment that emerged during the 1965-1969 period did not, as previously discussed, conform substantially with that envisaged by the reforms and the Social Plan. The failure of the industrial and transportation sectors to absorb less of total investment outlays and the agriculture sector to absorb a greater share were noticeable points of disappointment. The failure of underdeveloped regions to gain a larger share of investment was also a significant and negative result of the reform system. Complaints

were filed by representatives of these regions that accused banks of not helping to ensure a "sufficient flow" of investment funds to the underdeveloped areas even when attractive and profitable offers were obvious (177, p. 68).

In light of the rather poor results of the new reform system the most obvious question was: What happened? Horvat (80, p. 87) has suggested the following answer:

> Economic growth and institutional changes were too rapid for the government apparatus and other organs of economic policy to be able to cope with efficiently. Almost overnight a backward Balkan country reached a European standard of economic development, and an administrative economy was transformed into a market economy. At the same time responsible authorities often lacked the necessary understanding of how a modern market economy operated. If to all that we add the pioneering in the system of self-government--nonexistent anywhere else in the world--it becomes clear that the complexities of the socio-economic environment have increased enormously and that it will take some time before the organizational framework is adapted, the necessary knowledge is accumulated and the new social system begins to operate smoothly.

It was obvious that the Yugoslav leadership's search for a workable and efficient model of market socialism was far from completion. Although their almost twenty-year experiment had greatly transformed the economy from its initial post-war command form, there was apparently much work to be done if the goals of a fully developed, self-managed economic system were to be achieved.

CHAPTER VI

CONCLUSIONS

A final task of this study is to evaluate the 1965 reforms of the investment financing and decision-making structure in terms of the contribution of these reforms to the achievement of the objectives of the Yugoslav leadership.

I. REASONS FOR THE REFORMS

Before attempting to evaluate the reforms of the investment process, it would be appropriate to summarize the basic reasons for the introduction of the reform measures and the objectives of the reforms as announced by the Yugoslav leadership. This discussion may help show the interrelated nature of the reforms and explain how they were designed to tie consistently together in an attempt to achieve the economic objectives of the reformers.

According to Bicanic (12, p. 41), most economic changes in Yugoslavia since World War II resulted from the "pressure of the events on preconceived ideas" and have generally been "a search to reconcile theory with changing conditions of development . . . [and] political expediency with theoretical concepts." This conclusion appears to have been no more correct than in the case of the 1965 reforms of the investment process. The introduction of the reforms represented a response by the Yugoslav leadership to a combination of factors including: (1) the state of the economy, (2) the state of economic thought, and (3) political considerations.

As previously discussed in Chapter III, certain economic measures were introduced in 1961, that were intended to enhance the development of the organizational principle of self-management and to contribute to the achievement of greater economic efficiency. But, the reforms were poorly planned and inadequately implemented. As a result, the economy simultaneously experienced a slowdown in the rate of growth, intensified inflationary pressures, and a worsening balance of payments deficit. These problems led to a greater degree of direct intervention by the federal government which, although partially successful in alleviating the economic problems, served mainly to reveal the inefficiencies of combining an imperfect market economy with poorly planned and inadequately implemented government controls.

Faced with serious economic problems and a growing awareness of the inefficiencies of their present economic system, the Yugoslav leadership began a reevaluation of the economy and the nature and direction of development implied by that economy. The central point of this inquiry was the role of market and plan with the focus on the investment process.

Although the Yugoslav leadership had continuously (since 1952) tried to strengthen the role of the market in the production and distribution process of the economy, the need to preserve centralized planning and control of the volume and structure of investment activity was deemed essential to help assure the achievement of the goal of rapid industrialization and economic growth. But, in the early 1960's, as the economy reached a higher level of development and market forces

became stronger, the misallocations that resulted from the use of the market apparently became less significant while centralized investment planning began to produce poor decisions which resulted in an inappropriate structure of production in the economy. Inefficiencies appeared in the forms of: (1) excess production capacities in many industries, (2) a wrong assortment of goods as indicated by shortages and surpluses, and (3) production facilities whose location, size and technological variants were due more to political considerations than the application of economic criteria.

As the inefficiencies of the system became apparent to the investment planners and policy-makers, they began to question the long-term objective of rapid and "global" industrialization and economic growth. With excess capacities in many industries, the retention of this objective made little sense. In addition, the policy-makers began to realize that relying more on market forces (domestic and foreign) to guide current operations of the enterprises while simultaneously attempting to centrally determine most investment decisions resulted in an obstacle to correct enterprise decisions. Current and long-term (investment) decisions could not be effectively separated.

In view of these problems, the Yugoslav leadership, as noted previously, abandoned the policy of "global" industrialization and economic growth in favor of a policy calling for "selective" development of the economy. The policy of autarky was no longer a basic principle for industrial development. A new principle was developed calling for the use of the world market as a guide for the development

of those industries offering the greatest comparative advantages. The leadership foresaw the advantages of such a policy as being the inclusion of Yugoslavia into the world market to a degree that would help assure continued economic growth while reducing the chronic balance of payments problem.

Another basic problem with the centralized investment planning system was the inability of the federal government to implement investment decisions. Various direct and indirect measures were introduced but, effective instruments for implementation were never found. Those instruments that were partially effective were not consistent with the goal of developing self-management, because they tended to devitalize the decision-making autonomy of the enterprises and banks. As a result, the development of self-management as the basic organizational principle in the economy was virtually halted.

Perhaps the most critical problem of the centralized investment planning system was the growing inability of the federal government to even make investment decisions due to the lack of political consensus about such decisions. After the 1961 reforms, the role of the republics in the investment planning process expanded (131, p. 300). In addition, there was a growing dissatisfaction and disagreement on the part of both developed and underdeveloped republics concerning the volume and, more importantly, the geographic allocation of investment resources. This disagreement became so widespread that centralized investment planning became almost impossible and seriously threatened the unity of the Yugoslav Communist League.

In light of the problems they faced, the decision by the Yugoslav leadership to abandon the system of centralized and directive type

investment planning becomes understandable. Apparently, the economic and political necessities, at that time, were viewed as outweighing the potential political dangers implied by further decentralization of the economy. There was an essential need to introduce a new system of investment financing and decision-making in order to alleviate the inefficiencies and inconsistencies of the old system and to help achieve the basic economic objectives as determined by the leadership.

Three basic economic objectives for the new investment system were announced. These objectives were: (1) the further development of self-management as the main organizing principle in the economy, (2) "selective" industrialization and economic growth and a greater inclusion of Yugoslavia into the world market, and (3) the elimination of economic instability and particularly, excessive inflation.

The reforms of the structure of investment financing and decision-making that were introduced in 1965, would appear to tie consistently together when viewed from the perspective of the economic and political problems confronting the Yugoslav leadership and the objectives announced for the new investment system.

The objectives of "selective" industrialization and economic growth and the further development of self-management required an expansion in the role of market forces and a reduction in the role of the central government and plan. In order for enterprises to be able to respond to market forces (domestic and foreign), constraints on their investment decision-making power had to be reduced. The funds needed for investment purposes could no longer be entirely centrally

accumulated and allocated. The mobilization of investment resources would be left, to a great extent, in the hands of the decentralized units (enterprises and banks). This called for a removal of direct government control of bank operations. In order to help assure the response by enterprises and banks to market forces, provisions were needed to allow and promote the development of a capital market.

In essence, there was no longer a need or desire to centrally plan and control all investment decision. The federal government needed only to retain enough control to help assure an overall volume of investment consistent with the goal of continued industrialization and to assure an allocation of necessary investment funds to those areas where market forces were not sufficient. These areas included certain economic sectors such as power production and transportation and certain geographic areas deemed relatively underdeveloped.

The reduced role of the federal government in the investment process was also important in two other respects. First, the abandonment of centralized investment planning meant that the main problems associated with such planning could be expected to be partially eliminated. Second, the reduced role of the federation in the investment process would be consistent with a reduced volume of investment spending and could thus help alleviate, to a degree, the problem of excessive inflation.

Thus, the reforms in the system of investment (that is, the system of income distribution, the banking and credit system, investment planning, and the methods of price formation) that were discussed in Chapter IV, may be seen as a unified effort to build a structure of

investment financing and decision-making consistent with the attainment of the Yugoslav leadership's objectives. The reforms appeared to have tied together to provide the means necessary to achieve: (1) greater decentralization of the investment process, (2) the expanded use of the market as a guide to investment decisions, and (3) a lower volume of investment spending. All of these were required in terms of the announced economic objectives.

II. THE SUCCESS OF THE 1965 REFORMS

Throughout the preceding chapter, an attempt was made to describe and analyze the specific changes in the investment process that were introduced during the 1965-1969 period. Emphasis was placed on determining the actual changes in the structure of investment financing and decision-making and the actual roles of the enterprises, banks, and government in that structure. But, one question remains: With what success did the new reforms of the investment process meet?

In evaluating the reforms <u>two</u> general criteria may be utilized: (1) the success of the reforms in achieving the major objectives as determined by the Yugoslav leadership, and (2) the success of the Yugoslav leadership in maintaining the viability of the reform movement. Concerning the first criterion, there were <u>three</u> basic objectives for the reforms of the investment process. They were: (1) the implementation of a structure of investment financing and decision-making consistent with the further development of self-management as the dominant organizational principle in the economy, (2) a volume and structure of investment expenditures consistent with "selective"

industrialization and economic growth as defined by the Yugoslav leadership in the 1966-1970 Plan, and (3) a volume of investment leading to greater economic stability and particularly, a reduction of inflationary pressures in the economy. The success of the reforms in each of these three areas will be discussed in order.

As discussed in Chapter V, there was a rather wide degree of divergence between the structure of investment financing and decision-making that actually emerged in the 1965-1969 period and the structure as foreseen in reforms in 1965. In order to have further significant development of the self-management principle, the decentralized economic agents (banks and enterprises) had to gain a much greater degree of decision-making autonomy. But, this did not happen in reality. The dominance of the enterprises in the investment process that was forseen in the reforms did not occur. The reforms of the income distribution process and the banking and credit system, as designed, were to greatly expand the ability of the enterprises to accumulate and allocate investment funds so that they were to become the major investment decision-makers in the economy. But, the actual role of the enterprises expanded only slightly. The banks emerged as the dominant force in the investment financing process and the intended control by the enterprises of the banks, called for in the reforms, never actually occurred. As a result, the enterprises remained greatly dependent on the banks for providing needed investment funds.

But, the banks were not autonomously dominant over the investment process either. The announced reduction of the role of the

government in the investment process was not achieved as planned by the reforms. The location and control of the investment resources of the former GIF implied a continued significant degree of federal government influence in the banking system. In addition, there appeared to have been a growing degree of local government intervention in the banking system leading in many cases to significant control by these governments over investment credit decisions of the banks.

In the area of prices, federal government control also exceeded the level called for in the reforms. As previously discussed in Chapter IV, price controls, although confined for the most part to the overall control of prices in the form of price freezes, continued to significantly affect the gross revenue of enterprises and thus, their ability to accumulate investment funds. In this manner, the structure of investment spending in the economy was necessarily altered.

In essence, the announced structure of investment financing and decision-making was not realized in the post-reform years. The role of the banks grew too large and the role of government (especially local government) did not deminish to the degree called for in the reforms. The role of the enterprises did not expand as planned. In general, the reforms were unsuccessful in implementing an investment system that increased the autonomy of enterprises to a degree sufficient to achieve the intended development of self-management in the economy.

But this conclusion may be open to challenge. If the announced reforms of the investment system and the degree of decentralized

autonomy outlined by these reforms were not a true reflection of the Yugoslav leadership's objective concerning the locus of real investment decision-making power in the economy, then the investment system that emerged after the reforms may not have been different from that system really desired.

Pavlowitch (131, pp. 289, 308) reported that, although the 1965 reforms were more complete and applied more seriously than the 1961 reforms, "much compromise . . . attended their conception, and much lip-service their carrying out." This could imply the reforms were, generally, a mere politically oriented compromise rather than a serious effort to radically change the economic system. Such an implication begs the question: What degree of control over investment did the central government really desire in the new system and was not the result of the reforms, particularly the retention of a significant degree of federal control over investment decisions, much closer to the actual intentions of the Yugoslav leadership than was apparent? The answer to this question may be found in an analysis of the apparent basic reasons for the structure of investment financing and decision-making that emerged during the 1965-1969 period and the roles of the enterprises, banks, and government in that structure.

As discussed in Chapter V, the major reason for the failure of the enterprises to become the dominant force in the new investment system was the economic recession of the initial three post-reform years. Faced with a greater reliance on market forces, the downturn in economic activity resulted in a reduction of the enterprises' gross revenue and thus funds available for self-financing. In an

effort to maintain their investment programs, the enterprises turned to the banking system for needed funds. As a result, the role of the banks in the investment process expanded greatly.

The post-reform recession was also a major factor behind the continued role of the federal government in the investment process in excess of that level announced and outlined in the reforms. Vanek (177, p. 78) reported that by 1967, when economic activity had reached its lowest level in three years, the Yugoslav leadership was maintaining a sort of hands-off policy concerning the economy. There was apparently a great degree of reluctance on their part to directly intervene in the economy outside of enforcing price freezes on certain product groups. This reluctance was apparently due mainly to the widespread acceptance in the country of the reform movement and particularly, the goal of self-management. In addition, the lesson of the past was that intervention often served to only worsen problems.

When the federal government finally did respond to the economic crisis, it did so by increasing investment expenditures from state controlled funds and easing credit conditions to allow the granting of a greater volume of investment credits by the banks. The government avoided the use of more extensive and direct intervention measures. The official party view, as reported by Pavlowitch (131, p. 330), was that "the answer to all difficulties lay in the full implementation of the reforms including the full implementation of self-management." The reforms were blamed for the economic problems only in the sense that they exposed to a greater degree the consequence of the previous (pre-1965) economic system.

But there were two aspects of government intervention that can not be explained as being due to the response of government to the recession. As noted above, there continued to be a significant degree of intervention by local governments in the banking system. But this intervention was, as discussed in Chapter V, openly and forcefully opposed by the Yugoslav leadership. As such, this intervention was not an indication of any planned or intentional intervention by the federal government but, was the result of the ability of local governments to gain greater power due to the lessening degree of centralized control in the economy after the reforms.

Another form of intervention was due to the status of federal government investment funds accumulated mainly in the pre-1965 years. As noted previously, a focal point of the federal government's role in the new investment system involved the location and allocation of the resources of the former GIF. The size of these funds relative to the total volume of investment funds implied a significant instrument of influence over investment decisions. But, as noted in Chapter V, This does not appear to have been the case. There were several attempts by the government to find a suitable way to neutralize the impact of these funds in a manner consistent with the designs of the new investment system. Although they were unsuccessful and the funds continued to affect the investment process, this does not seem to have represented any deliberate control attempt by the federal government.

In essence, there appears to be little evidence that the actual degree of federal government intervention in the investment

process after the reforms was due to any planned or intentional controls different from those announced in the 1965 reform measures. Rather, such intervention would appear to have been due to the unsuccessful implementation of the reforms and the response by the government to the economic crisis of the post-reform years.

In summary, the structure of investment financing and decision-making that emerged in the post 1965 reform years and the roles of the enterprises, banks, and government in that structure were due mainly to: (1) the effects of the recessionary economy on the investment process and (2) the intervention by the federal government in response to the economic problems that arose. There is little evidence to suggest that the real designs for the new investment system, in terms of decentralized units of autonomy, were any different from those formally announced. Thus, the investment system that emerged in the post-reform period represented a significantly less degree of decentralized autonomy (particularly concerning enterprises) than called for in the reforms and, as such, indicated the failure of the reforms to achieve the objective of substantial further development of self-management in the economy.

In a broader sense, the failure of the reforms to achieve the intended structure of investment financing and decision-making when coupled with an incomplete methodology and ineffective practice of investment planning, may indicate the nature of the economic system after the reform, particularly, regarding investment. Even though market forces were designed to have a major role in guiding investment decisions, enterprises and banks may have lacked the necessary degree

of autonomy in reality to respond to market forces. In addition, as noted in Chapter IV, there emerged only a rudimentary and incomplete capital market. The mobility of investment resources was not greatly expanded and, as such, the allocation of these investment resources could not have effectively responded to market forces.

As discussed in Chapter V, after the reforms, the new planning system became in reality little more than an imperfect forecasting device and offered no real guidance to government agencies for making investment decisions. Investment planning in the new system apparently became planning in name only or "pseudo-planning" in that it did not really exist in the traditional sense of serving as a meaningful guide to decision-making.

It would appear therefore, that due to the ineffective system of investment planning, the intervention in the investment process by the federal government in the post-reform years was not the result of any coordinated policy. In addition, as noted above, the reduced control of the federal government over the investment process allowed a much greater degree of local intervention concerning investment decisions in the economy.

The ineffective planning system, the existence of uncoordinated federal and local government intervention, and the development of a capital market and enterprise autonomy, to a degree insufficient to allow market forces to guide investment decisions, resulted in a combined imperfect market-intervention system of investment. Such a situation implies an anarchistic economic system in the sense of lacking a stable environment for making investment decisions. The

investment decisions by enterprises, banks, and government (at all levels) were apparently neither market oriented to any significant degree nor guided by planning. Thus, there may have been an investment system of even greater ambiguity after the reforms than before.

The reforms were also generally unsuccessful in terms of achieving the objectives concerning "selective" industrialization and economic growth. It would seem appropriate to interpret the investment expenditures called for in the 1966-1970 Social Plan as indicators of the volume and structure of investment the Yugoslav leadership deemed consistent with their objective of "selective" growth. A comparison of the actual volume and structure of investment spending in the 1966-1969 period to those called for in the Plan may serve as a basis for determining the success of the reforms in terms of the objective of "selective" growth.

Concerning the total volume of investment, the Plan called for an average annual rate of growth of fixed capital investment of 6 to 7 percent. During the period 1966-1969, the actual rate of growth was 5.5 percent.

The major changes in the structure of investment called for in the Plan were: (1) an increase in the share of total investment going to the agricultural sector and the trade and catering sector, and (2) a decrease in the share of total investment going to the industrial sector and the transportation and communications sector. Within the industrial sector, the Plan called for: (1) a substantial increase in the relative share of investment going to power production and basic metals industries, and (2) a reduction in the share going

to manufacturing and processing industries, particularly, equipment production and consumer durables industries where substantial excess capacity existed. In addition, the Plan called for an increase in the share of total investment going to underdeveloped republics and provinces to narrow the gap between these and the more developed regions of the country.

With the exception of the investment outlays within the industrial sector, the actual structure of investment during the 1965-1969 period diverged significantly from that called for in the Plan. Instead of declining as planned, the share of investment going to the industrial sector of investment in the industrial sector and the transportation and communications sector increased. The increased share of investment going to the underdeveloped republics and provinces that was called for in the Plan did not occur and, in reality, was actually lower in 1969 than in 1965.

In general, the planned volume and structure of investment spending called for in the 1966-1970 Plan were not realized in the post-reform years. Thus, the reforms were apparently unsuccessful in achieving the objective of "selective" industrialization and economic growth.

The reforms also appear to have been unsuccessful in achieving the objective of greater economic stability. Although the slowdown in the rate of investment in the first three years of the new investment system was consistent (in direction) with the goal of reducing inflationary pressures due to excess demand, the magnitude of the slowdown in spending was apparently excessive. The rather sharp

slowdown in investment spending was a major factor causing the downturn in economic activity in 1966 and 1967. As noted previously, the federal government responded to this situation by easing investment credit conditions and increasing federal investment outlays. This led to a substantial increase in total investment spending and helped stimulate overall economic activity in 1968. By 1969 the recovery became a boom with excessive inflationary pressures again emerging. Thus, during the 1965-1969 period, the reforms apparently contributed little to the achievement of economic stability.

In a related sense, the new system of investment and the volume and structure of investment spending after the 1965 reforms, also failed to contribute to the solution of the problem of excessive unemployment in the economy and may have, in fact, caused the problem to worsen. As noted in Chapter V, the level of unemployment was higher in 1969 than it had been in twenty years. The new system of investment apparently led to a higher level of unemployment to the extent that the initial slowdown in the rate of investment spending after the reforms was a causal factor in the ensuing downturn in aggregate economic activity.

The failure of the new system of investment to lessen unemployment was also apparently due, in part, to the bias of investment decision-makers (enterprises, banks, governments) concerning the technological variants of new projects. There continued to be an emphasis on capital intensive investments. This bias was apparently the result of the opinion of investors that projects with high capital intensity were always superior to labor intensive oens and that

increased labor productivity was always desirable, even in the face of higher unemployment. There appeared to have been little understanding on the part of investors that the choice of "correct" capital and labor intensity depends on the existing volume and quality of productive factor endowments and the given techniques of production.

The bias toward capital intensive projects was likely fostered by the incentives generated by the new structure of investment decision-making. Labor-managed enterprises may have emphasized capital intensive projects in order to help raise the productivity and thereby the wage payments to the current workers. In addition, there may have been a political bias favoring capital intensity to the degree that government officials at all levels attached more prestige and price of accomplishment to projects using advanced productive techniques and automated devices. This appeal of capital intensive projects appears similar to other forms of "pyramid building" for which bureaucrats are often accused.

In summary, the reforms of the structure of investment financing and decision-making were generally unsuccessful in achieving the three basic objectives set for it. The implimentation of the investment system called for in the reforms and necessary for the substantial further development of self-management in the economy was not accomplished. The actual volume and structure of investment spending in the 1965-1969 period diverged significantly from the 1966-1970 Plan. As such, the reforms apparently had little success in achieving the objective of "selective" industrialization and economic growth. In addition the volume of investment spending during the period 1965-1969 did not contribute to greater economic stability as designed.

Apparently, the only major area of success of the reforms was the continued viability of the reform movement, particularly in terms of the Yugoslav leadership's retention of the goal of further developing a self-managed and market oriented economy as called for in the reforms. From the ousting of party members that actively opposed the reforms in 1966 and through the 1965-1969 period with its growing economic and political problems, the Yugoslav leadership continuously maintained the viability of the reform movement. They forcefully resisted a return to more centralistic methods and, unlike during the post-1961 reform years, did not apparently even entertain seriously the idea of abandoning the new reform efforts. This resistance is of particular significance in light of the magnitude and duration of the economic crisis and political pressures of the period, especially the Soviet incursion into Czechoslovakia in 1968.

The continued viability of the reform movement is also significant for other reasons. Although the reforms were generally unsuccessful in achieving their basic objectives during the period 1965-1969, the Yugoslav leadership's willingness and ability to maintain the viability of the reform efforts implies that this time period may be too short to prove the longer-run success of the new investment system. In addition, not only were the reformers attempting to develop a more market oriented economy, but, one with the unique institution of self-management to serve as the basic organizing principle. When viewed in these terms, the continued viability of the reform movement indicated that the Yugoslav leadership's resolve was real and, although

faced with a lack of initial success, their experiment in developing their own special type of market socialism would likely continue in the future.

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