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Special Report

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Milica Uvalić (2018)

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Dialogue of Civilizations Research Institute gGmbH
Französische Straße 23
10117 Berlin
Germany
+49 30 209677900
info@doc-research.org

The rise and fall of market socialism in Yugoslavia

Milica Uvalić¹

This paper is dedicated to the Socialist Federal Republic of Yugoslavia (SFR Yugoslavia, hereafter Yugoslavia),² a country that was known for its unique system of 'market socialism'.

Despite retaining a communist one-party political regime throughout its existence (1945 – 1991), Yugoslavia was the first socialist country to attempt far-reaching economic reforms. Because of its early start and frequency of systemic changes, it was considered the most reformed socialist economy. For over forty years, Yugoslavia has tried to develop its own model of socialism based on workers' self-management, ample decentralisation, social ownership and increasing reliance on the market mechanism. The continuous experiments with economic reforms produced an economic system with specific characteristics based on a combination of socialist, self-managed and market features, facilitated by the country's international relations. Another distinctive feature of Yugoslavia was that the socialist model was not imposed from the outside, as in most East European countries that after 1945 became 'satellites' of the Soviet Union, but emerged from a grass-root revolution led by Tito's partisans during World War Two.

Yugoslavia officially ceased to exist in October 1991. Following the popular referenda in Slovenia and Croatia and the subsequent declaration of political independence by the two republics in June 1991, the Yugoslav federation disintegrated into five independent states: Bosnia and Herzegovina, Croatia, Former Yugoslav Republic of Macedonia (hereafter Macedonia), Federal Republic of Yugoslavia (consisting of two republics, Serbia and

¹ I would like to thank Will Bartlett, Božidar Cerović, Jelena Džankić and Mario Nuti for useful comments on an earlier version of this paper. The usual disclaimer applies: any remaining errors are my own.

² This name was introduced in 1963 when the new Constitution was adopted and would remain unchanged until Yugoslavia's break-up in 1991. Initially, from 1946 until 1963, the country was called the Federal Peoples' Republic of Yugoslavia.

Montenegro, hereafter FR Yugoslavia), and Slovenia. Further disintegration took place in the meantime after the split between Montenegro and Serbia in June 2006 and Kosovo's unilateral declaration of independence in February 2008. Only two of Yugoslavia's successor states have joined the European Union (EU): Slovenia in May 2004 and Croatia in July 2013, though all the other countries are aspiring to join.

The main objective of this paper is to evaluate the Yugoslav model of socialism from a longer-term perspective, trying to assess what lessons, if any, have been learnt from Yugoslavia's experience. The paper will first describe the Yugoslav model of socialism: how it was initially developed (section 2), what type of reforms contributed to its distinctive features (section 3) and whether it was effectively a different type of economy with respect to other socialist countries (section 4). It will proceed to reflect on the overall economic results of continuous systemic reforms in Yugoslavia (section 5) and the situation in the country in the late 1980s, when the transition to market economy was starting (section 6). It will also discuss systemic changes in the Yugoslav successor states: the main direction of economic reforms taken after Yugoslavia's break-up in 1991 and the varieties of capitalism that emerged during the past two decades (section 7). An overview of the different outcomes of the transition to a capitalist system in the individual countries will also be given by considering the most relevant economic and social indicators (section 8). The conclusions will point to the main lessons learnt from Yugoslavia's experience (section 9).

2. The birth of the Yugoslav model of socialism

The end of World War Two led to the constitution of the new Yugoslavia (the 'second' or Tito's Yugoslavia), this time under communist rule. The country was fully supported by the Western Allies and was given international recognition in March 1945. The change in the political regime was the outcome of the victory of the revolutionary army – the partisan movement led by Josip Broz Tito – that had liberated the country from Nazi occupation. Although initially, in order to reach a compromise between Tito's partisan movement and the monarchy, a coalition government was formed with a representative of the royal pre-war government appointed as foreign minister, the elections in autumn 1945 confirmed

Communist supremacy and the Federal People's Republic of Yugoslavia was declared on 29 November 1945. The communist regime in Yugoslavia was therefore the product of a grass-root revolution, not imposed by the Soviet Union as in most East European countries, which explains why it had wide popular support. As noted by a known historian: "The difference between Yugoslavia's Communist regime and all its East European counterparts was in the speed with which it had got off the starting line. With its status as an Ally supported by all the powers, and with its revolutionary army, it had a substantial advance in terms of political, economic and social transformation... As such it was the only Communist regime capable of falling out with the Soviet Union. Far from wanting to do so, it first intended to follow and expand the Soviet model..." (Pavlowitch, 2002, p. 165).

The Yugoslav political and economic structure was indeed, initially, set up copying the Soviet model. The 1946 Constitution established Yugoslavia as a multinational federation based on 'democratic centralism', consisting of six republics: Bosnia and Herzegovina, Croatia, Macedonia, Montenegro, Serbia and Slovenia. Serbia also had two autonomous regions, Vojvodina in the north and Kosovo and Metohija in the south, since it was regarded that its larger size with respect to the other republics could be a threat to Yugoslav unity. The economic system also fully reflected the Soviet model, since the main elements that represented the bases of the socialist economic system (Lavigne, 1999) were introduced: party control of the economy, central planning and state ownership of the means of production. During this initial period, the Yugoslav economic system had features of the typical socialist economic system.

The economic concept of socialism in Yugoslavia developed from the Marxist critique of capitalist relations of production and the resulting increasing social inequalities (see Uvalić, R., 1964). According to Marx, the law of value acting through the market mechanism led to the deepening of inequalities, to the polarisation of wealth and poverty, the rich becoming richer and the poor poorer. This criticism was not confined solely to the most outstanding inequalities between the two main classes of society – the capitalists and the wage-earners – but also by various derived inequalities such as inequalities among capitalists themselves,

the disproportionate development of various economic sectors or unequal regional development. At that time in Yugoslavia it was firmly believed that in a socialist society the action of the law of value would be abolished or considerably restricted and that thereby the market would lose its importance. The Yugoslav model also followed Engels, who suggested that the socialist economy should be based on a socially planned regulation of production in accordance with the needs both of society as a whole and of each individual (see Uvalić, R., 1964, p. 140).

For a brief period, the Yugoslav economy was organised along very similar lines as the Soviet Union. It was based on centralised planning, state ownership of enterprises brought about through nationalisation and expropriation of private property, state monopoly over the most important spheres of the economy (investment, banking, foreign trade) and administrative control of most prices. The system ensured full control of the federal political authorities over the economy. During this period, the efforts were directed “especially towards levelling out the market inequalities existing in the distribution of national income under the pre-war system and preventing individuals from appropriating the fruits of others’ labour” (Uvalić, R. 1952, p. 235).

The nationalisation of productive resources and of large economic establishments was carried out in several stages. It began with the confiscation of enemy property after the war and was completed by the nationalisation laws in 1946 that applied to all large industrial enterprises, transport, wholesale trade, banks and insurance companies; and the 1948 law which nationalised undertakings of lesser importance such as small electric power stations, small mines, brick works, mills, hospitals, hotels, cinemas. The land reform in 1945 eliminated the large landowners and the surviving features of the feudal system and limited holdings to a maximum of 75 – 87 acres (lowered further to 25 acres in 1953). There were also limits on private property in real estate and a proportional tax on personal incomes was introduced (Uvalić, R. 1954, p. 236).

All the economic assets expropriated and nationalised came under public ownership, as well as a small fraction of the land, though the greater part was allotted to poor peasants in the form of private holdings. In this way, the state sector held a dominant position in the economy. The 1946–51 Five Year Plan ensured the construction of many important factories in various branches of industry, particularly heavy industry. The principle of a planned economy was adopted in order to ensure the maximum utilisation of available economic resources, intensify economic development and expand the country's productive resources as rapidly as possible. Public ownership was to be the foundation for planned economic development (Uvalić, R. 1964, p. 237).

However, the creation of a publicly owned sector raised the question of the administration and utilisation of public property. During the first phase (1946–50) the problem was solved by entrusting it to the state “as the entity most qualified to represent the interests of society at large, best placed to reconcile the interests of different social groups and classes and of present and future generations, and most likely to achieve rapid development of the forces of production through national economic planning” (Uvalić, R., 1964, p. 237). A powerful state-operated economy was created, centralised in the hands of the state as the representative of the whole nation.

The system of planned administration was developed to the smallest details, and was extended down from the federal plan through the plans of the federal republics and districts, to plans in enterprises and co-operative farms. Though attempts were made to have the draft plans publicly discussed by trade unions and specialised organisations, final decisions were taken by the Planning Commission and the appropriate Ministries. The state was responsible for the allocation of raw materials and fuel, done in accordance with production plans, and also for the distribution of finished products. The plans set permissible production costs, but prices for goods and services were fixed by specialised institutions (Uvalić, R. 1964).

A decisive moment for Yugoslavia's 'third way' was the political split between Yugoslavia and the USSR in 1948. The schism between Stalin and Tito was not the result of ideological differences, but arose mainly, according to the dominant interpretation, out of Tito's extra-Yugoslav ambitions (Pavlowitch, 2002).³ The result was Yugoslavia's expulsion from the Soviet bloc, the removal of its ruling party from the Cominform (the Information Bureau of Communist Parties). These events facilitated the abandoning of the earlier uncritical emulation of the Soviet model although with some delay; thus agriculture was briefly collectivised in 1948 to prove socialist conformity (Estrin, 1983, p. 52).

Nevertheless, a critical re-examination of the centralised economic system emerged soon after. There was growing awareness that a centrally planned economy had a number of flaws (see Uvalić, R. 1954). The system required a highly developed administrative machinery: in addition to the federal, republic, town and district planning commissions, each Ministry had its own planning department. Enterprises in the same industry were united within each republic under a central directorate at the federal level. The main objective of enterprises was to maximise production regardless of costs: "State officials replaced the former owners and capitalists and their employees who had run the undertaking. It seemed to the workers as if no essential change had occurred... There was even conflict between undertakings and the higher state authorities as regards the fulfilment of the plans... In these circumstances assignments were often fulfilled at the expense of quality and variety" (Uvalić, R. 1954, p. 238).

The centralised system of economic administration lacked proper incentives: workers performed the specific tasks set by the plans in return for appropriate remuneration fixed by the state, not being interested in the general success of the enterprise. Furthermore, centralised economic control of firms by the state prevented mistakes being recognised and corrected in due time. In order to meet their obligations regarding quantity, enterprises were compelled to sacrifice quality. Under post-war conditions, with a shortage of goods and

³ There are various excellent sources describing in detail the various issues that contributed to the split between Tito and Stalin, among which there were also major disagreements over economic issues. However, a detailed account of these controversies lies beyond the scope of the present paper.

strong demand, there were no difficulties in selling poor quality goods. There were no incentives for economic development and no competition among enterprises, which could have had beneficial effects on the quality of goods and labour productivity (Uvalić, R. 1954, 238-40).

The early experience of the socialist economy in Yugoslavia led to the recognition that it was necessary to leave some freedom of play to the market, that even in a socialist economy it was necessary to resort in practice to the market mechanism (Uvalić, R. 1964, p. 140). The new economic model introduced in 1950 was to assign the direct management of public property to the workforce of enterprises, as contained in the Basic law on the administration of state enterprises by workers' collectives of 2 July 1950.⁴ This Law brought an end to the centralised economic system and introduced the principle of self-management into the economy. The Law entrusted the administration of state property in enterprises to the workers in most sectors – manufacturing, mining, communications, transport, trade, agriculture, forestry.

The introduction of enterprise self-management was not intended to change the property regime: "The law does not affect the ownership of the property which continues to belong to society as a whole, but it vests the rights and responsibilities of administration in the workpeople of the undertakings, as society's representatives, in place of the State... The staff of the undertaking may unquestionably be regarded a better representative of society and a better defender of its interests than the State" (Uvalić, R. 1954, p. 241). This law was the first step towards ample economic reforms introduced in Yugoslavia during the next decades, that would differentiate its economic model from those in other Eastern European countries.

⁴ "Osnovni zakon o upravljanju državnim privrednim preduzećima i višim privrednim udruženjima od strane radnih kolektiva, 1950 godine", Službeni list FNRJ (Official Gazette of FNR Yugoslavia), no. 43, 1950.

3. Economic reforms: Combining the plan, the market and workplace democracy

From the early 1950s, the Yugoslav government implemented a series of economic reforms that gradually decentralised the economy, introduced elements of the market mechanism and developed workers' self-management. Each decade in post-war Yugoslavia brought a new set of systemic reforms designed to transform the traditional centrally planned economy into a more market-oriented and decentralised system (Uvalić, 1992).

Yugoslavia has been schematised into three economic environments, after the initial period of centralised planning: the 'Visible Hand' period from 1952 to 1965; the 'Market Self-Management' era from 1965 to 1972 and the 'Social Planning' period after 1974 (Estrin, 1983, p. 57). The continuous institutional changes were meant to improve the socialist economic model, producing an economic system with specific characteristics based on the combination of three groups of features – socialist, market and self-managed – that were further sustained by the country's specific international relations. These main pillars of the Yugoslav economy will now be briefly recalled.

(1) Socialist features

The main elements of the socialist economic system were firmly present throughout Yugoslavia's post-World War Two development. Despite continuous economic reforms from the early 1950s in Yugoslavia, the basic features of the socialist economic system, as specified by Lavigne (1999), were retained: party control of the economy; planning in combination with other non-market mechanisms of resource allocation; and collective ownership of the means of production which took the form of social property.

Party control of the economy was secured through the one-party political system, in Yugoslavia in the hands of the League of Communists. The most important objectives considered crucial for the development of a socialist economy were defined by the political authorities. The system of self-management introduced workers' participation in decision-making through representative organs, but political guidance and interference in enterprise

policies remained a constant feature of socialist Yugoslavia. Even at the peak of liberalism there were general rules to be respected by enterprises, for example regarding obligatory minimum depreciation rates or the rules on the distribution of income (as described further below).

Planning was also a permanent feature of the Yugoslav economic system and was used in combination with various other non-market mechanisms of allocation of resources. In the early 1950s the system of centralised planning was replaced by a more flexible system based on the planning of overall targets only, or 'planning basic proportions'. The plan prepared at the beginning of each year no longer fixed the total volume of production, with detailed provisions regarding its structure and distribution (as done previously), only the general outlines (Uvalić, R. 1954, p. 253). Planning was further relaxed in the 1960s by passing to a system of indicative planning (also called 'social planning'), which was mandatory only for sociopolitical communities.

Annual plans were abolished in 1966 and thereafter were replaced by Economic Resolutions, in which the government outlined general features of economic policies in the forthcoming year. From 1975 onwards, Yugoslavia passed to the system of self-management planning, which envisaged the active participation of all agents at all levels – self-management planning within and among enterprises, and social planning among sociopolitical communities. The harmonised plans were to be then codified in legally binding social compacts and self-management agreements.

In addition, mid-term plans, usually for a period of five years, defined the general objectives of economic development and main priorities to be pursued in a given period.⁵ There was also a ten-year plan for the 1976-85 period which did not stipulate obligations, but identified

⁵ The first five-year plan covered the period from 1947 to 1951, the second the period from 1957 to 1961, the third the period from 1961 to 1965, but the economic recession led to its replacement by a revised seven-year plan for 1964-1970 (Horvat, 1970, pp. 27-30). However, this plan had to be abandoned when major economic reforms further liberalised the system in 1965. Another two five-year plans were adopted for the periods 1971-1975 and 1976-1980. Thereafter, as a response to the economic crisis that started developing in 1980, a Long-term stabilisation programme was adopted in 1982 that contained various reforms for addressing the economic crisis (see more below).

the major development problems that needed to be tackled and the main directions of economic development. Other government instruments were also used to channel economic development according to priorities regarded particularly important, including the General investment funds (until 1963) and the Regional fund for the development of the less developed republics and regions which assured a redistribution of resources in favour of the less developed parts of the country.⁶

Systematic social intervention through planning by state authorities, or under their guidance, was considered an indispensable instrument for achieving economic, social and political objectives of a socialist society: “Higher labour productivity in socialism must primarily rest on its social aspects, the advantage which results from better social organisation of production, the planned direction of economic development instead of the anarchy of economic laws” (Uvalić, 1964, p. 144).

A well-organised division of labour had to stimulate the development of those activities that may not have been highly profitable, such as those with a high capital coefficient (e.g., those producing basic materials), or latent resources such as the country’s natural wealth or scientific discoveries. “The plan was to prevent movements tending to increase economic inequalities, which an unrestricted play of market forces would inevitably lead to” (Uvalić, R. 1964, p. 145). Even Branko Horvat, who was a convinced sustainer and promoter of the self-managed variant of socialism, notes: “It is without any doubt that a socialist economy has to be a planned one. This is why it is quite obvious that planning has to include political interests” (Horvat, 1984, p. 9).

⁶ During Yugoslavia’s more recent history, in the 1970s and the 1980s, the less developed parts of the country were three of the six Yugoslav republics – Bosnia and Herzegovina, Macedonia and Montenegro, and one autonomous region – Kosovo. In the earlier periods, however, the definition of the underdeveloped parts of the country was different, thus also of the beneficiaries. While in the first five-year plan (1947-51) it was Bosnia and Herzegovina, Macedonia and Montenegro that were identified as underdeveloped, in the second five-year plan (1957-61) only Macedonia and Montenegro were included, together with the autonomous region of Kosovo and Metohija. The third five-year plan (1961-65) identified the following regions as underdeveloped: the whole of Macedonia and Montenegro; in Serbia, the autonomous region of Kosovo and Metohija and the south-western parts of Serbia; in Bosnia and Herzegovina, the western parts of the republic and parts of Posavina; and in Croatia, parts of Dalmatia, Lika, Banija and Kordun (see more in Uvalic, R., 1962, pp. 13-19).

The *property regime* in Yugoslavia was based on the system of social property, officially defined for the first time in the 1953 Constitution as the property of the whole society. The bulk of the Yugoslav economy was in social property, which gave enterprises the right to use socially-owned assets and to appropriate their product (*usus* and *usus fructus*), but not full property rights, which remained in the hands of the state. Since this was never officially recognised in Yugoslavia, there were endless debates about the real meaning of social property.

In the new 1974 constitution, it was explicitly stated that enterprises were owned by no-one: “Since no one has rights of ownership over the social means of production, nobody – not socio-political communities, nor organisations of associated labour, nor groups of citizens, nor individuals – may appropriate on any legal-property grounds the product of social labour or manage and dispose of the social means of production and labour, or arbitrarily determine conditions for distribution” (The Constitution of the SFRY 1974, III part of Basic Principles, p. 13).

The expansion of the private sector, consisting mainly of agriculture and certain crafts and services, was restricted by law, since private property on a larger scale was considered incompatible with the socialist economic system. The 1953 land reform reduced the limit on the size of private holdings further, from 35 to 25 acres per family, while in other sectors limits were placed on the number of workers that could be employed, usually five workers other than family members. As a result, the social sector remained the dominant part of the Yugoslav economy, in 1989 still contributing 86.2% of Social Product (SP)⁷ Savezni zavod za statistiku, 1991).

There were additional features of the Yugoslav economy that strongly resembled those in other socialist countries. During its post-Second World War Two economic development,

⁷ The main macroeconomic aggregate in Yugoslavia was “Social Product”, corresponding to Gross Material Product: it was the value added of the “productive” sectors of the economy, thus excluding most “non-productive” sectors such as education, health, defence, banking, and other services. In this sense it is similar to the concept of Net Material Product that was used in other socialist countries, but differs from such a concept because it is gross of depreciation.

Yugoslavia also pursued rapid industrialisation, where priority was given to heavy over light industry (at least until the late 1950s) and to very high investment rates, in order to achieve rapid economic growth. The system of remuneration was to respect, as much as possible, the principle of egalitarianism, that would not lead to major inequalities in workers' earnings, but would provide each worker a personal income according to his own contribution. This was to be accomplished through the introduction of wage scales, which were to assure that workers of similar qualifications were paid similar personal incomes (though the system was not effective, particularly after 1965 when there was substantial income dispersion; see Estrin, 1983).

Overall income distribution in socialist countries was more egalitarian than in most market economies, though in Yugoslavia the Gini coefficient was somewhat higher due to wide inter-regional differences in average income (Milanovic, 1998). Nevertheless, the Gini coefficient in Yugoslavia, using the per capita method, ranged between 0.32 and 0.35, while using total household revenue, it ranged between 0.33 and 0.34; these values were relatively stable over the 1973-83 period, placing Yugoslavia among the countries with a moderate level of income inequality (see Milanović, 1990, p. 302). As other socialist countries, Yugoslavia had a strong welfare state that provided free education and health care, social support to citizens in need and specific housing policies that secured the working population a place to live, usually giving them tenants' rights (not privately owned apartments).

The Yugoslav system was also based on principles of solidarity: in order to reduce the differences in the level of economic development, a Federal Development Fund was established to help the development of the less developed parts of the country. From the 1970s onwards, all republics and regions had to contribute a certain percentage (less than 2%) of their respective Social Products to the Federal Development Fund, while the sole recipients were the three less developed republics – Bosnia and Herzegovina, Macedonia and Montenegro – and Kosovo. The financial assistance through the Federal Development

Fund initially consisted of grants, but after 1971 it took the form of loans at highly preferential terms.

Additional instruments were added in the 1970s in order to stimulate direct investment by enterprises in the less developed parts of the country. In addition to the Federal Development Fund, there were other mechanisms of redistribution of income in Yugoslavia, including budgetary transfers through the fiscal system; loans of the National Bank of Yugoslavia extended at highly preferential terms to specific administrative entities or special recipients (exporters, farmers); and the clearing system of payments in foreign trade with the Council of Mutual Economic Assistance (CMEA) countries, which favoured exporters and penalised importers.

(2) The market mechanism

Although the described socialist features of the economy were retained throughout Yugoslavia's existence, the awareness that the operation of the market was necessary even in a socialist economy emerged early on: "The advantages of the market mechanism in relation to its shortcomings will be much more apparent in economic branches which still have a relatively low concentration of production, whose products are intended for general consumption and where without the free play of the market it would be impossible to determine the amount and structure of commodity production which will be in demand... Therefore, the use of the market mechanism as a regulator of supply and demand in such branches has its full justification. However, in those branches where there is a relatively small number of producers and consumers ... supply and demand need to be influenced in a planned way, in order to achieve considerable economies in social labour, also avoiding the unnecessary costs resulting from anarchy in competition on the market" (Uvalić, R. 1964, p. 141).

However, it was also stressed that the market could not be the only and decisive regulator of socio-economic relations, because this would mean a negation of socialism: instead of alleviating inequalities in society, it would increase them. Two areas were indicated, in

particular, where the socialist character of the economy no longer permitted the use of the market: labour remuneration and financial capital (Uvalić, R. 1964).

Regarding remuneration, socialist practice was to find a way of reconciling as much as possible two postulates (Uvalić, R. 1964, pp. 142): (1) since under socialism labour had lost its commodity character, there should be a relatively uniform distribution of personal incomes (no great differences should be allowed for the same amount and same quality of labour) and a lower limit of remuneration must be guaranteed; and (2) the magnitudes of remuneration should be directly dependent on the success of given production units ... and proportional to the contribution of each individual.⁸ It was also recognised that the application of these principles in practice “has run into a host of serious difficulties” (Uvalić, R. 1964, p. 141-2).

Financial capital is another sector in which the market was no longer allowed to function, since a capital market would be in contradiction with the socialist principle or Marxian labour theory that labour is the only source of income: “The creation of a capital market would imply an extension of the rights of economic organisations at the expense of society as a whole ... Instead of alleviating, it would further increase social inequalities, which is certainly not a goal of socialism” (Uvalić, R. 1964, p. 144).⁹

These general beliefs were dominant among the leading politicians in Yugoslavia (if not among all economists)¹⁰ and have strongly influenced the contents of economic reforms implemented thereafter. As will be illustrated below, various reforms aimed at introducing

⁸ This is in line with the ambivalent ideological views on wage distribution in socialist countries in general, as stressed by Milanović: on the one hand, socialist ideology was against wide differences in income; but on the other hand, people were to be paid according to their contribution, at least in theory, which meant that differences in abilities and effort should have been recognised (see Milanović, 1998, p. 34).

⁹ This did not exclude the possibility of workers saving part of their income, on the contrary: “There is even an interest paid on savings as a measure to influence the restriction of consumption and to create additional funds for financing economic development. This rate of interest, however, is not formed through capital demand and supply but is established by administrative measures” (Uvalić, R. 1964, p. 144).

¹⁰ There were economists in Yugoslavia that were in favour of a more liberal option of market socialism, that would have allowed the proper functioning of both a labour and a capital market, but the policy options effectively chosen remained very much in line with these Marxist principles.

elements of the market mechanism in Yugoslavia were directed primarily towards the products market, while the operation of a labour market or of a capital market were firmly rejected as incompatible with a socialist economy and society. The role of the market has always been more important for final demand than for production factors, as fully-fledged capital and labour markets have never been entirely accepted, mainly for ideological reasons (Uvalić, 1992, p. 172-73). Continuous economic reforms from 1950 onwards were aimed at gradually decentralising the economy and introducing some elements of the market mechanism, but without abandoning the basic principles of the socialist economy, including social (non-private) property and planning instruments aimed at ensuring the most important objectives of a socialist society.

The first market-oriented economic reforms introduced in the 1950s included the abolishment of state monopoly of foreign trade with the intention to give more freedom to enterprises in their foreign trade operations; introduction of a single price structure along with some relaxation of price controls; the replacement of state property by social property in 1953; the decentralisation of the banking system by setting up of sectoral banks for agriculture, investment and foreign trade. However, the system of mobilising and allocating investment resources remained centrally directed by the government, through General investment funds.

There was some devolution of the federal powers to the republics and local authorities; thus the responsibility for certain sectors, such as light industry, was transferred to the republics, local political authorities were given some rights to raise revenues through taxation, and the local commune became responsible for the implementation of the social plan, supervision of enterprises and the provision of social and other services.

The economic reforms that were to introduce 'market socialism' in Yugoslavia were first announced in a Program of the League of Communist already in 1958 (Mencinger, 2000, p. 123), to be implemented during the 1963-67 period. These economic reforms were aimed at assigning a major role to the market as a mechanism for the allocation of resources. Price

liberalisation was carried further, though certain prices continued to be fixed administratively; thus in 1969, 40% of prices of industrial goods was still under state control (see Horvat, 1970, p. 37). A two-tier banking system separated the central bank from commercial banking and set up a diversified structure of all-purpose banks. General investment funds were abolished in 1963 and their resources transferred to banks, which were to become the main financial intermediaries. Fiscal burdens on firms were reduced, which left a larger share of income at their disposal and wage controls were substantially relaxed giving enterprises greater autonomy in the distribution of income.

Firms were able to choose their own investment projects, as well as the proportion of profits to be allocated to investment (Uvalić, 1992, p. 7). In order to open the economy to the world market, the system of multiple exchange rates was replaced by a uniform exchange rate, the Dinar was devalued in 1965 as to establish a more realistic rate and import restrictions were reduced. The first Joint ventures law was adopted in 1967, though limiting foreign ownership to 49% and restricting investment in some sectors. The competences of the republics and local governments were further increased.

One of the consequences of the reforms implemented in the 1960s was the concentration of economic power in the hands of managerial elites and technocrats, considered socially and politically unacceptable. Although managers and directors were predominantly members of the League of Communists, their increasing power endangered workers' control and also threatened to deprive the party bureaucracy of political control (Mencinger, 2000, p. 125).

These are the main reasons why the authorities decided to launch a new set of economic reforms in the 1970s which started with the 1971 constitutional amendments and were further developed in the 1974 new constitution and the 1976 Associated Labour Law. These legislative changes were meant to be a remedy to the shortcomings of the previous reforms: they introduced a number of new mechanisms aimed at improving both the system of self-

management and the planning instruments, in an effort to reestablish ex-ante policy coordination (see more in section on self-management below).

The 1970s reforms decentralised the Yugoslav economy further and brought substantial devolution of powers from the federation to the republics and lower-level local political authorities. The 1974 Constitution strengthened the competences of the single republics in many important fields, including prices, income distribution, taxation, employment, welfare policies and foreign trade. Monetary and exchange rate policies remained the competence of the federal government, but had to be based on an agreement between the republican governments which effectively gave each republic veto power. Substantial decentralisation took place in the foreign trade sector after 1977, in order to increase the republics' rights in retaining earned foreign exchange. These reforms towards greater decentralisation were important also for political reasons, in order to give more say to the republics in deciding on economic policies on their territory.

The 1970s reforms also tried to reduce the role of banks. Since the 1965 economic reform increased the concentration of economic power within banks, leading to the problem of 'autonomous' financial capital, something that was regarded to be in conflict with self-management since it implied rental income for privileged classes and the deprivation of workers of a part of income they had produced, the newest reforms were to reinforce enterprises and prevent the concentration of financial resources within banks.

Banks were transformed into 'service' agencies of enterprises operating under their direct control, and new methods of mobilising savings were introduced that would not necessarily require banks' intermediation. A 1971 law on securities diversified financial instruments, introducing both standard instruments (such as bonds, treasury bills and promissory notes) and those adapted to the Yugoslav system (so-called 'pooling of labour and resources' which permitted direct investment of one enterprise into another).

In order to reward workers' investment efforts, a new system of remuneration was also elaborated by Edvard Kardelj. The new system of workers' remuneration was to be based

not only on their 'live' (current) labour, but also on their 'past' (embodied) labour. Kardelj preferred to use the term "past labour" instead of social capital, accumulation, or means of enlarged reproduction, in order to emphasise that such remuneration would not be linked to capital but to labour. However, the scheme was implemented in a rather simplified way, since in practice 'past labour' rewards were predominantly linked to workers' seniority (Uvalić, 1992), while forms of 'pooling of labour and resources' between firms, that could have allowed for various forms of profit-sharing, were reduced to simple credit arrangements.

Following the deep economic crisis which started in 1980, new economic reforms were announced in 1982 aimed again at 'greater reliance on market forces'. Under the pressure of mounting financial problems and the inability of the government to fulfil its debt repayment obligations, several IMF-sponsored austerity programmes were implemented from 1981 onwards. A special Commission of the Federal Social Councils for the Problems of Economic Stabilisation was created in 1982, involving practically the whole economics profession of those times,¹¹ which prepared a very detailed, four-volume, programme of economic reforms. In spite of long discussions and these lengthy policy documents, the reform proposals were not very innovative.

The resulting economic reforms were slow, inefficient, and did not bring any effective changes in the functioning of the Yugoslav economic system. As those in the past, they did not touch upon the most fundamental features of the Yugoslav economic system – socialism, self-management and social property were to remain its basic foundations. Due to the economic crisis, the government had to introduce measures which effectively restricted the operations of the market, such as wage freezes. There were no concrete proposals that would touch upon the most important systemic features of socialist Yugoslavia, particularly the property regime. It is only in 1988-89 that a list of legislative

¹¹ The Working group in charge of preparing the initial text of the programme included some of the most well-known economists of those times, including Kiro Gligorov, Dragomir Vojnić, Aleksandar Bajt, Borisav Jović, Oskar Kovač, Zoran Pjanić, Berislav Šefer, Branislav Šoškić, Rikard Štajner and a few others, while members of the sub-groups that were to prepare concrete proposals of reforms in the various areas were practically all existing economics professors.

changes opened the doors to private sector development on a larger scale (see section 6 below).

(3) Self-management

The third pillar of the Yugoslav model was self-management, from the early 1950s developed in parallel with the described reforms aimed at major decentralisation of the economy and increasing role of the market mechanism. The earlier mentioned 1950 Law gave workers the right to elect members of Workers councils which decided on production, inputs, hiring policies, to a limited extent on prices and income distribution.

The workers' councils became responsible for the election of members of Management boards and for appointing and removing the manager of the enterprise. The workers' councils could have from 15 – 120 members, but in enterprises with less than 30 workers the whole staff and officials constituted the workers' council (Uvalić, 1954, pp. 242-243). Members of the management board were elected from among the workers, technical personnel and other officials, but at least three-quarters had to be workers employed directly in the production units of the enterprise (Uvalić, 1954, p. 243). The Management board was also responsible for preparing drafts of the basic plans, issuing monthly operational plans and the execution of these plans.

In the spirit of self-management, in 1953 state property was replaced by social property. Initially capital was given to enterprises free of charge, but after 1954 they had to pay a small 6% tax for the use of social capital. The introduction of self-management led to a more flexible planning system. The social plan was now to be drawn up by the supreme federal representative bodies and the organs of the federated republics, but with the participation of the newly established councils of producers. During the 1950s, investment resources under the plan included not only compulsory investments, but also free investment resources made available to enterprises in the form of credit.

During this initial period, self-management was rather limited: workers were to take over the managerial function, but in reality both the distribution of enterprise income and the investment decisions remained under strict government control (Mencinger, 2000, p. 122-3). Self-management was aimed to strengthen workers' incentives, but their decision-making rights were subject to strong political influence: "The right of the workpeople to draw up the list of wage scales for the enterprise and to distribute part of the enterprise's net income is a great incentive in the system of self-management... the list is drawn up by the Workers' council with the agreement of the higher trade union bodies; if they do not reach an agreement the matter is decided by state arbitration. The trade unions are called to prevent excessive differences occurring between wages in different undertakings. The wage for each category of workers is fixed according to the volume of planned production and the size of the corresponding wages fund. A 1952 Law laid down the scale of minimum rates below which wages could not be fixed, that were guaranteed by the state" (Uvalić, R. 1954, p. 245).

In order to reduce differentiation in workers' incomes, the portion of the surplus distributed to workers and officials in the form of bonuses was subject to a special progressive tax; this was introduced since "unlimited distribution of such surpluses to the workers would incur the risk of permanent inflation ... considerable differences would occur between wages in different undertakings, independently of workers' efforts" (Uvalić, R., 1954, pp. 246-247).

Already at the first Congress of Workers' Councils held in 1957 requests were made to increase workers' autonomy in the distribution of income. The system was changed in 1958 by adopting a compromise solution: the system of wage scales determining the minimum personal incomes, which had to be approved by the local political authorities and trade unions, was maintained, but a progressive tax was introduced on the difference between earned incomes and minimum wages (Horvat, 1970. P. 61-62).

During the 1960s, self-management was extended to all types of organisations and sectors of the economy. The 1961 and 1965 economic reforms substantially increased workers'

decision-making rights regarding the distribution of income. After 1961, the previously existing progressive taxes on bonuses distributed above the minimum wages were abolished, and enterprises were in principle given more freedom to allocate their net income between accumulation and gross personal incomes. Nevertheless, the use of a substantial part of net income was predetermined by government regulations – such as various taxes and contributions, interest payments and other contractual obligations, obligatory depreciation aimed at preserving the value of fixed assets. Depreciation allowances after 1967 were to remain in the enterprise, instead of being placed on special accounts (as was the case before 1967); and in addition to the prescribed minimum rates, enterprises could now allocate additional amounts to depreciation (Uvalić, 1992, pp. 41-42).

Horvat reports the proportions between gross personal incomes (wages and various taxes and contributions) and gross capital rental (depreciation, interest payments, capital charge) in industry and mining during the 1950s and the 1960s, showing that giving enterprises more autonomy in the distribution of earned income brought to a reduction in the share of gross capital rental, from 54% in 1961 to 45% in 1967 (and to the proportional increase in the share of gross personal incomes) (Horvat, 1970, p. 62). Despite such an increase in favour of gross wages, this shows that even during this most liberal period (that lasted relatively shortly), enterprises in Yugoslavia had to respect a number of general regulations set by the political authorities. Regardless of their contents, as these regulations changed continuously, they imposed certain general rules that had to be respected, limiting enterprises' autonomy in the distribution of income.

Reforms implemented in the 1970s were particularly important for the further development of the self-management system. The charge for the use of social capital was first reduced and finally abolished in 1971. The elimination of the charge on social capital was interpreted by some Yugoslav scholars as the introduction of 'group property', the effective redistribution of property rights in favour of enterprises vis-à-vis the state. Bajt (1968) had pointed out the distinction between economic and legal property, arguing that economic ownership reflected in the system of distribution, such as the right to entrepreneurial income in the Yugoslav

case, need not necessarily correspond to the legal title of property, and consequently that the Yugoslav enterprises behave as if they were the effective owners of capital (though he changed his views later, in 1988 explicitly stating that social property is state property).¹²

New mechanisms of policy coordination were introduced based on self-management principles as to allow the active participation of all economic and political agents in the overall planning process, which is why this period is often referred to as 'contractual socialism'. The 1974 Constitution and the 1976 Associated Labour Act introduced a series of changes at both the microeconomic and macroeconomic level.

At the microeconomic level, in order to facilitate self-management reported as not operating well in very large enterprises, a completely new structure was introduced for the organisation of the economy. Enterprises were split into smaller units, so-called Basic Organisations of Associated Labour (BOALs), each having its own self-management organs and statutory acts. Several BOALs were to be grouped into Organisations of Association Labour (OALs), while these OALS were to be part of Complex Organisations of Associated Labour (COALs). In order to reinforce further the position of enterprises vis-à-vis the banking sector, banks were transformed into non-profit service agencies of enterprises, operating under their direct control. Intra-enterprise investment was to be undertaken through the 'pooling of labour and resources' of several BOALs or OALs, namely investment of one BOAL or OAL into another (see Uvalić, 1992, pp. 8-9).

In 1971, new regulations were introduced on the minimum requirements regarding accumulation linked to realised net income, that had to be in line with the terms set in republican social compacts on income; the social compacts determined either the maximum permissible percent of personal income payments or a minimum savings rate (depending on the republic) (Uvalić, 1992, p. 75-76). In order to introduce a more decentralised and

¹² In his important book that appeared in 1988, in the midst of the lively debate on how to best implement property reforms in Yugoslavia, in which he sought to find a more efficient form of social property, Bajt stressed that social property as institutionalised in Yugoslavia was actually in contradiction with self-management, since it has essentially remained state property, no less than it is in a centrally-planned economy (Bajt, 1988, pp. 164-165).

market-based mechanism of investment by enterprises, in line with the changes introduced by the Associated Labour Law, after 1975 around 20% of the republican quota in the Federal Development Fund could be invested directly in enterprises located in the less developed republics and regions through various forms of 'association of labour and resources'; this was further increased to 50% in 1981 (Uvalić, 1993).

At the macroeconomic level, the 1970s economic reforms introduced new mechanisms of policy coordination – social contracts and self-management agreements – as a response to weakened macroeconomic management that accompanied the 1965 reform. *Social contracts* were to regulate rights and obligations affecting broader economic policies, including the priorities of social plans, the principles and criteria of policies regarding prices, employment and foreign trade, the distribution of income between personal incomes and capital accumulation, to be concluded between enterprises, political representatives, trade unions, chambers of commerce and self-managed communities of interest; once concluded, they had the force of law.

Self-management agreements were also binding agreements, introduced to regulate relations between enterprises and other types of organisations, including banks, in areas of mutual interest such as the creation of firms, investment projects, deliveries, transfer prices, joint transactions and the like. *Self-managed communities of interest* were also created in order to unite the interests of suppliers and final users of various services, initially in the areas of health, education and social insurance, later extended to other areas such as foreign trade (see Uvalić, 1992). These various types of agreements introduced by the 1970s reforms were intended as specific devices of macroeconomic policy, regulating economic activities in a self-managed socialist economy.

(4) Specific international relations

Many of the described economic reforms were to a great extent facilitated by Yugoslavia's specific international relations. Yugoslavia was a founding member of the International Monetary Fund and of the World Bank in 1944. After the Tito – Stalin conflict in 1948 it

decided to develop its own third way, placing itself somewhere between the East and the West. Yugoslavia did not join the CMEA in 1949 (although it did participate, after 1964, in some of its standing committees) nor was it a member of the Warsaw Pact. Together with Egypt and India, Yugoslavia created the non-aligned movement and hosted its founding conference in Belgrade in 1961. From the 1960s, Yugoslavia regularly participated in the trade liberalisation rounds within the General Agreement on Tariffs and Trade (GATT). Yugoslavia also had a special status with the OECD, which regularly prepared the *Economic Survey of Yugoslavia*, the first published in 1963.

Yugoslavia also had a privileged relationship with the European Economic Community (EEC). After having established official relations in 1967, it concluded several trade agreements with the EEC. The initial non-preferential agreement was signed in 1970 covering a period of three years; it was succeeded by a five-year agreement signed in 1973 which was in force until September 1978, when it was tacitly extended. Yugoslavia was also included into EEC's Generalised System of Preferences in 1971. Cooperation was extended to financial matters in December 1976, when the European Investment Bank was authorised to grant loans for financing projects of mutual interest. There were also specific agreements on textile trade after 1976, which provided voluntary restraint in the export of a number of textile products of Yugoslav origin. From 1971 Yugoslavia became an active participant of COST – European Cooperation in Science and Technology – participating in agreements in the field of telecommunications, metallurgy, air and water pollution.

In 1980, Yugoslavia signed the most important broad-based Trade and Economic Cooperation Agreement with the European Community (in force after April 1983), which in addition to preferential trade regulated other important fields of cooperation (energy, transport, technology) and special financial protocols providing financial assistance (see Uvalić, 2010, p. 17-18). Although in July 1990 Yugoslavia was also included in the programme of assistance launched to help transition in East European countries (the PHARE programme), the programme was interrupted due to the mounting political crisis and Yugoslavia's break-up in 1991.

The intention of the Yugoslav government to open its economy to both the developed and developing world had a number of beneficial consequences. One of the most important was that external trade of Yugoslavia was increasingly oriented towards the developed countries, particularly the EEC. At the same time, the non-aligned movement had stimulated the establishment of economic relations with many African and Asian countries. In 1990, just before the disintegration of the Yugoslav federation, Yugoslavia's foreign trade was prevalently with the developed countries: 59.8% of its exports and 63.7% of its imports were with the OECD countries (45.8% of Yugoslavia's exports went to the 12 countries of the European Community and another 6.8% to the EFTA countries, while 44.3% of its imports were from the EC and another 9.9% from the EFTA countries; the rest was trade with the USA and other developed countries).¹³

Thanks to increasing trade openness and joint-ventures legislation, there were major business contacts between Yugoslav and foreign companies, facilitating not only the entry of fresh capital and the creation of enterprise networks, but also the development of local managerial skills and competences. In the 1980s, a number of foreign firms from the EEC countries had undertaken so-called 'outward-processing operations' in Yugoslavia, especially in the textile industry; these arrangements allowed goods to be processed in Yugoslavia and re-imported into the EEC with total or partial relief from import duty. As to the developing world, some of the largest Yugoslav enterprises had important construction projects in various African countries.

Another consequence of Yugoslavia's openness to the West, which also indirectly affected its economy through its impact on society, was in the field of culture. Since the mid-1950s, Yugoslavia experienced the diffusion of capitalist symbols and values typical of the Western consumer society, which was fully tolerated and accepted by the political establishment (Dimitrijević, 2016), particularly in music, film, theater, fashion. Already in the 1950s Yugoslavia started producing *Cockta*, a soft drink very similar to Coca Cola. Posters for concerts of the most popular singers in the 1960s were a replicate of those of Elvis Presley,

¹³ Calculated from data provided in the last Statistical Yearbook of Yugoslavia (Savezni zavod za statistiku, 1991).

while Western rock music was allowed, played and increasingly listened to. In 1969 the premiere of *Hair* was performed in the Belgrade theatre Atelje 212, which in the 1970s also hosted Bob Wilson with his unforgettable 'Einstein on the Beach'. From the early 1970s, the Yugoslav Airways (JAT) introduced direct flights to New York.

4. How different was Yugoslavia?

At the time of Yugoslavia's disintegration in 1991, a chapter of its history was closed without effectively inquiring or fully understanding what were the differences of the Yugoslav model with respect to the socialist firm in Eastern Europe or the workers' cooperative in the West. What remained insufficiently clarified was how different was the Yugoslav economic system?

Yugoslavia's specific economic features based on self-management and increasing reliance on the market mechanism inspired a growing literature on market socialism and the labour-managed economy. Yugoslavia's unique economic system stimulated considerable academic interest for several reasons (Estrin and Uvalić, 2008). First, the Yugoslav experience seemed to indicate the possibility of a third way, a view enhanced by President Tito's global role as one of the leaders of the non-aligned movement following neither the unrestrained capitalism nor the harsh communism of the so-called First and Second worlds respectively. Second, the extension of the principles of democracy in decision-making was viewed by many as an objective for an economic system in its own right; this view synthesised a diverse set of utopian models for the future of the economy, for example that of the cooperative movement with employee democracy but also with private ownership, of syndicalism and of Israeli kibbutzim (Estrin and Uvalić, 2008, p. 665).

A large part of the economics literature focused on the behaviour of the labour-managed firm (LMF), which developed after Benjamin Ward's seminal article on the firm in Illyria. Ward (1958) suggested that an enterprise in which workers have full decision-making rights would

adopt a specific maximand: instead of profits maximised by the capitalist firm, the LMF would tend to maximise income per worker. A growing literature on the LMF followed, stimulated further by Jaroslav Vanek's (1970) *General Theory on the Labour-managed Market Economies* (for a survey of the literature, see Bartlett and Uvalić, 1986).

Although Ward's article was originally inspired by the Yugoslav ('Illyrian') system of self-management, the concept of the LMF has in the meantime been extended to include the workers' cooperative in Western countries, since both types of firms are considered to have some principle features in common: participation of workers in decision-making, an egalitarian system of profit distribution and collective ownership of (at least part of) the firm's capital.

The so-called 'Ward-Vanek-Domar model' suggested that the LMF, in comparison with the capitalist firm, would be plagued with various types of inefficiencies (Ward, 1958, Domar, 1966, Vanek, 1970). The alleged drawbacks of the LMF consist of an inefficient allocation of labour due to the perverse or at least rigid response to changes in product price, technology and capital rental; restrictive employment policies; more restrictive monopolistic behaviour due to maximisation of monopoly profit per man instead of total profit; and the unsuitability of the LMF outside labour intensive sectors and for risky ventures. The LMF will also be characterised by inefficient use of capital and will tend to underinvest, due to limited property rights (Furubotn and Pejovich, 1970). When workers do not have full property rights over the firm's assets ('non-owned' assets), they cannot recover the principal of their investment at the end of their time horizon when they leave the firm, whereas investment in individual savings accounts in banks (or 'owned' assets) ensures the recovery of both the principal and interest. In considering whether to invest earned income in the firm or in personal savings accounts, workers will prefer the latter; thus the LMF will be characterised by underinvestment in comparison with its capitalist counterpart.

Numerous contributions to the LMF literature have shown, however, that the alleged inefficiencies proposed by the Ward model could be reduced or even completely eliminated

under different theoretical assumptions or solutions that would counterbalance the proposed negative features. Moreover, empirical evidence from various developed market economies suggests that workers' participation in decision-making and/or in enterprise results can have strong effects on incentives and labour productivity (see e.g., Estrin, Jones and Svejnar, 1987). Some problems proposed by the literature are still likely to be present in labour-managed firms, as observed in the experience of workers' cooperatives, such as the unsuitability of the cooperative outside labour-intensive sectors and for risky ventures (Nutti, 1992). These features also explain why cooperatives are not the more diffused form of enterprise in Western market economies.

From the outset, however, it was not entirely clear whether labour-management theory was seeking to model the Yugoslav economic system, to analyse in a formal way the behaviour of workers' cooperatives, or was a purely theoretical construct to illustrate the implications of alternative ownership and incentive arrangements, since the single theoretical framework based on Ward's original assumptions underlined all three strands (Estrin and Uvalić, 2008). Despite these ambiguities, for a long time many scholars regarded the 'Illyrian firm' as representing the Yugoslav enterprise, not taking sufficiently into account other features of the Yugoslav economy.

This belief was strongly influenced by the literature on the LMF to which many influential Western economists had contributed to, trying to find theoretical solutions to the 'perverse' response of the LMF (including Evsey Domar, James Meade, Jaroslav Vanek, Jacques Drèze, André Sapir, Mario Nutti). The widespread conviction of Yugoslavia's diversity was additionally sustained by its post-1965 economic development, during which the country experienced increasing unemployment and inflation, and had also opened its economy to foreign direct investment. In reviewing Horvat's 1969 book on Yugoslavia, Mario Nutti asks, "Is Yugoslavia a socialist country? Whatever the answer, it is not to be found in this book" (Nutti, 1970, p. 936).

In an interesting contribution to the literature, in line with Ward's hypothesis, André Sapir (1980) tried to explain Yugoslavia's slowing down of economic growth after 1965. Sapir's empirical analysis led him to conclude that it was workers' policy of maximising income per worker after the 1965 reforms that was responsible for slower growth, as well as for the observed slow labour and employment growth. Aleksandar Bajt (1986) responded some years later, explaining why Sapir's hypotheses were not founded. Bajt sustained that the slowdown was negligible and essentially depended on the periods of comparison; he also argued that the growth slowdown in Yugoslavia was caused by other factors, including the growing power of managerial elites, social unrest due to unemployment and liberalist and nationalist deviations (Bajt, 1986).

Among the loudest critics of Ward's model was Branko Horvat, probably the best known Yugoslav economist. Horvat was a convinced sustainer of the system of self-management and had criticised the LMF literature by pointing to the inconsistency of its main hypotheses with enterprise behaviour in Yugoslavia. In his critical evaluation of Ward's model, Horvat (1967) proposed a different maximand for the Yugoslav LMF, in line with Yugoslav practice. Since in Yugoslavia the Workers' council sets in advance an 'aspiration income', the level of personal incomes it wants to achieve, the target function of the LMF is to maximise total enterprise profits above the specified personal income payments; once the aspiration income has been decided upon, it becomes an obligatory target for management. Mathematically, the equation is identical to the standard neoclassical target function, so the equilibrium conditions will be the same as for the capitalist firm (Horvat, 1967).

Horvat's book on the *Political Economy of Socialism* (1982) elaborated in great detail the advantages of the self-managed economy, based on a somewhat idealised vision of self-management. Similarly, to Vanek (1970), Horvat (1972, 1982) argued that the self-management system has greater advantages than any other economic system, because of its strong effects on workers' incentives and favourable macroeconomic implications: high rates of growth are assured by the higher propensity to invest, due to reduced risk and uncertainty; full employment, by the reluctance of workers to dismiss fellow workers; and

price stability by the absence of the fundamental employee-employer conflict. Horvat was proposed for a Nobel Prize in economics which he never got, but he remained faithful to the idea of the superiority of the labour-managed economy until the end of his days.

A further critical examination of the LMF literature from the point of view of Yugoslavia's experience was undertaken by M. Uvalić (1992), who provided empirical evidence to illustrate why the Yugoslav economy was more similar to the socialist economy than to the labour-managed economy depicted by Western scholars. This is because the literature on the LMF was prevalently based on a hypothetical labour-managed economy operating in a free market economy, but such an environment never actually existed in Yugoslavia given frequent government interventions in the economy and imperfections of both the labour and capital market. Despite self-management and reliance on the market mechanism, Yugoslavia had retained many features typical of other countries in Eastern Europe.

There were a number of similarities between Yugoslavia and the other socialist economies (Uvalić, 1992). Yugoslavia had retained a *non-private property regime*, not permitting the expansion of the private sector on a larger scale. However, social property was effectively a camouflaged form of state property, not able to provide the right type of incentives usually present in a capitalist economy based prevalently on private property. The Yugoslav economy shared additional features of the socialist economy described by the Hungarian economist Janos Kornai (1980) as typical of East European countries – including soft-budget constraints, an 'expansion' drive characterised by high investment and state paternalism (Uvalić, 1992).

Enterprises in Yugoslavia operated under *soft-budget constraints* (Kornai, 1980). Although there were more bankruptcies in Yugoslavia than in other socialist countries, the more frequent measure was the socialisation of losses through the redistribution of resources from profit-making to loss-making firms. The lack of enterprises' financial discipline also derived from the low cost of capital, since interest rates on bank credits remained negative in real terms (Uvalić, 1992). The Yugoslav economy was also characterised by an *overinvestment*

drive (Kornai, 1980), very high investment rates which were realised until the 1980s, rather than by underinvestment as proposed by the LMF literature. In Yugoslavia this was not accomplished through objectives set in central plans, but through more decentralised mechanisms (as described previously).

State paternalism, or the paternalistic relationship between the state and the firm, was very much present in Yugoslavia, since external political interference into enterprise policies remained a constant feature of the Yugoslavia experience. These socialist features of the Yugoslav economy, in combination with the ambiguous system of social property, had a number of negative implications. There was no full risk-bearing by the individual firm, therefore no efficient system of incentives according to market performance. The socialist features of the Yugoslav economy reproduced the inefficiency problem typical of the socialist economic system – the lack of proper incentives that would ensure rewards and penalties linked to enterprise performance, which usually guides enterprise behaviour in a market economy.

Despite these socialist features of the Yugoslav economy, self-management still played an important role in Yugoslavia – if not for the immediate and direct consequences, for the long-term implications (Uvalić, 1992, pp. 214-215). The idea of self-management had the function of a reformist ideal, similar to that of the social-democratic ideals in Western market economies which have progressively modified and enabled a moving away from the model of unrestrained crude capitalism. In Yugoslavia, had it not been for the introduction of self-management in the early 1950s, which effectively initiated and facilitated a long process of economic reforms, many institutional changes would probably not have been introduced.

Such reforms, in turn, have facilitated a higher level of general wellbeing to the peoples in Yugoslavia, as compared to citizens in other socialist countries. Economically, they worked better because the Yugoslav market was not characterised by systematic and persistent shortages, and for those products which were not available on the domestic market, they could travel abroad freely in order to buy them, using foreign currency which they could keep

on private bank accounts. Politically, in spite of communist one-party rule, a decentralised political system led to more democratic procedures; political repression was less pronounced than in most other socialist countries; and whoever did not approve of the regime was free to leave the country and live elsewhere (unless declared to be a 'national enemy' due to subversive activities against the regime).¹⁴

Yugoslavs also worked in an environment which was more democratic than in other socialist countries, because self-management, despite its limitations, for many years did give workers the feeling that they could participate both in decision-making and in enterprise profits (Uvalić, 1992, pp. 214-215). The Yugoslav experience was a concrete and unique example of economic democracy applied to the whole economy; "The Yugoslavs have shown that democratic control of the workplace is feasible" (Estrin, 1983, p. ix).

Workers' participation in decision-making was also an important means for providing checks and balances, for example on managerial power (see Bajt, 1986). Self-management in Yugoslavia, however imperfect, provided workers with a system of economic democracy, which in combination with greater individual freedoms (e.g., passports valid for 5 years after 1965 and visa-free travel to all Western European and many developing countries) and the fact that communism was not imposed from the outside, undoubtedly brought higher popular satisfaction and support of the economic and political regime than in other Eastern European countries.

After Yugoslavia's breakup in 1991, there have been very different interpretations and explanations of the causes of the country's disintegration, sometimes attributing all the ills that had affected the country to the system of self-managed socialism. Also more recently in its successor states, self-management has sometimes been blamed for the remaining lack of discipline of workers, survival of collective principles of solidarity and slow acceptance of new norms of behaviour.

¹⁴ Since the 1950s, the "national enemies" were predominantly, with only a few exceptions, promoters of nationalist ideologies; this could be of some interest and relevance for later events.

The causes of Yugoslavia's breakup are clearly much more complex and have to be viewed in the context of various international and national events of those times. On the international scene, the radical changes in parts of Eastern Europe towards multiparty democracies and market economies, the end of the cold war, the disintegration of the USSR and the dismantling of the CMEA were unprecedented events of such historical importance that the political crisis in Yugoslavia seemed a secondary minor issue; thus the active involvement of the European Union offering major support to Yugoslavia in order to try and prevent its break-up came much too late.

Within Yugoslavia the crucial factor that pushed towards the country's breakup, which was at that time certainly more important than the deficiencies of the economic system, was the renewal and explosion of nationalist sentiment fed by the short-sightedness of political leaders such as Milošević or Tudjman that believed that the key national objectives could be successfully resolved by the disintegration of the federation.

5. Reform blueprints vs. economic outcomes

Despite its innovative features, Yugoslavia's forty years' experience of liberal economic reforms did not produce the expected and desired outcomes. Although important economic objectives had been achieved, the economic model based on the combination of socialist principles, planning instruments, the market mechanism and workers' self-management was not able to avoid problems of either of the two economic systems (Uvalić, 2010, p. 21). As noted by Estrin, "There is little doubt that the Yugoslav economy has suffered for its inventiveness" (Estrin, 1983, p. 52).

Because of the firm determination to remain a socialist country based on a one-party political system, Yugoslav policymakers remained faithful to the key Marxist principles that were to prevent major inequalities within society, and thus retained the most important features of the socialist economic system, including non-private property. Yet the desire to increase the efficiency of the economic system led to continuous economic reforms that introduced

elements of the market mechanism, self-management, ample decentralisation and substantial transfer of responsibilities from the federal state to the single republics.

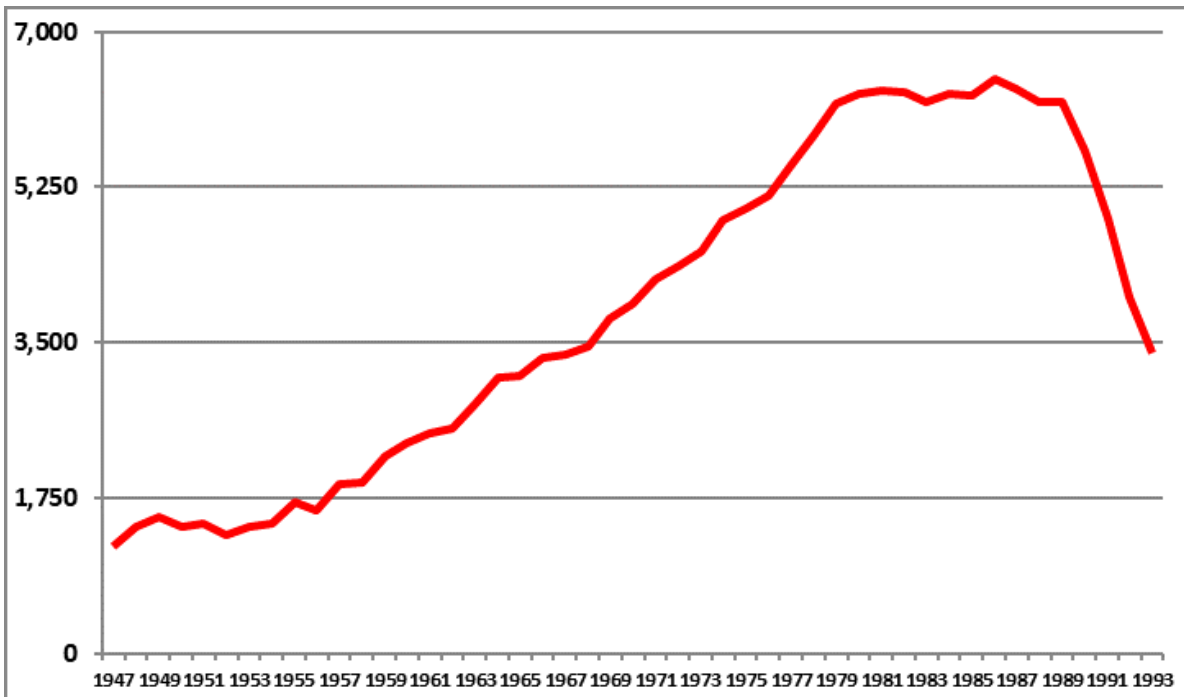
However, these reforms contributed to deteriorating economic performance and economic instability. Already in the 1960s, Yugoslavia experienced problems typical of the capitalist economy – including unemployment, inflation and cyclical instability – while it did not find the right solutions to resolve some of the key problems of the socialist economy deriving from inadequate microeconomic incentives. The Yugoslav economic model thus produced problems present in both economic systems, capitalism and socialism.

Throughout its post-Second World War development, Yugoslavia implemented an ambitious economic growth strategy which, as in other socialist countries, was based on high investment rates that until the 1980s remained remarkable – on average, 32% in 1961-70 and 33% in 1971-80. During the first three decades, the strategy produced impressive results in terms of rapid economic development: The Yugoslav economy registered very high rates of output growth and even higher rates of industrial output growth, which permitted a continuous increase in living standards. Yugoslav GDP growth averaged around 6% during the period between the start of reforms in 1952 and the late 1970s, higher than in the Soviet Union or in the capitalist market economies of Western Europe (Estrin and Uvalić, 2008, p. 666).

Despite the slowdown in the mid-1960s, growth rates still remained close to 6% during the 1966-1979 period. Yugoslavia registered a remarkable increase in Gross Domestic Product (GDP) per capita, from 1947 to 1981 by more than five times, entering a period of stagnation only in the 1980s (followed by an extreme fall registered during the years of its break-up; see Figure 1).¹⁵

¹⁵ The Figure is based on data using the standard macroeconomic indicator of Gross Domestic Product (GDP), which has been calculated for Yugoslavia and its republics during 1952 – 1991, and for the Yugoslav successor states during 1992- 2010, by Branko Milanović for the needs of the Maddison data base.

Figure 1: Trends in GDP per capita (US\$, PPP) in SFR Yugoslavia/successor states, 1947 – 1993



Source: The Maddison-Project, <http://www.ggdc.net/maddison/maddison-project/home.htm>, 2013 version; GDP per capita is expressed in Geary-Khamis (GK) dollars, equivalent to the international 1990 dollar (PPP).

Despite such an impressive growth record, Yugoslavia started having problems of unemployment already from the mid-1960s. The average unemployment rate increased from 6% in 1965 to over 16% in 1990, though there were substantial differences across the republics – Slovenia had practically full employment, while Macedonia and Kosovo had particularly high rates of unemployment. Yugoslavia was also facing increasing inflationary pressures, particularly after prices were further liberalised in the mid-1960s. Average annual inflation increased from 10% in the 1960s to 20% in the 1970s, reaching particularly high levels in the 1980s.

The inadequate instruments of monetary control by the National Bank of Yugoslavia, particularly after 1974, and the maintenance of low nominal interest rates which remained negative in real terms, contributed to excessive credit expansion at all levels. In the 1980s, the attempts of the government to implement a tighter monetary policy were largely ineffective. Enterprises tried to bypass the banking system by using alternative means of

finance (such as issuing promissory notes), which led to the uncontrolled growth in inter-enterprise credit and added further inflationary pressures. The average annual inflation rate progressively increased, from 30% in 1980 to three-digit figures in 1987-88, becoming hyperinflation in 1989 – a rate of 1,252% (Uvalić, 2010, p. 21).

A notable deterioration in Yugoslavia's growth performance was registered particularly after 1979, when a serious economic crisis started developing (see Figure 1). The origins of the economic crisis of the 1980s are to be sought in both internal and external imbalances which accumulated during the 1960s and the 1970s. From the early 1970s, the development strategy increasingly relied on foreign loans and external borrowing. As a result, Yugoslavia's external debt increased from less than US\$ 2 billion in 1970 to US\$ 14 billion in 1979 and, following the second oil shock, to US\$ 18 billion in 1980 (Uvalić, 1992, p. 10-11).

Yugoslavia did not react to the 1973-74 oil shock by lowering domestic spending, but continued with an unbalanced economic growth strategy, relying heavily on imports, external borrowing on international markets and World Bank loans. Structural weaknesses emerged due to insufficient investment in crucial sectors – such as energy and raw materials – and rising dependence of the economy on imported inputs, parallel with excess capacity in other sectors and the duplication of plants of suboptimal size across regions (Uvalić, 2010, p. 24).

The transfer of significant discretionary powers to the republics and autonomous regions, after the adoption of the 1974 constitution, enforced a form of economic nationalism which produced the tendency towards greater self-sufficiency. Increased economic autonomy of the republics/regions led to uncoordinated investment strategies, unnecessary duplication of plants in many sectors, superfluous construction of factories irrespective of effective needs, the concentration of investment, foreign currency and other resources within republican borders, decreasing shares in inter-republican trade, low mobility of capital and labour across republican borders, weak inter-republican integration of enterprises and the fragmentation of the Yugoslav internal market (see Uvalić, 1983, 1993).

It is nevertheless worth noting that for all the Yugoslav republics inter-republican trade remained more important than trade with the outside world. Throughout most of the 1970-89 period, exports to the other Yugoslav republics represented a higher share of overall trade than exports abroad (Uvalić, 1993). The level of economic interdependence among Yugoslav republics was greater than frequently sustained on the basis of purely political arguments.

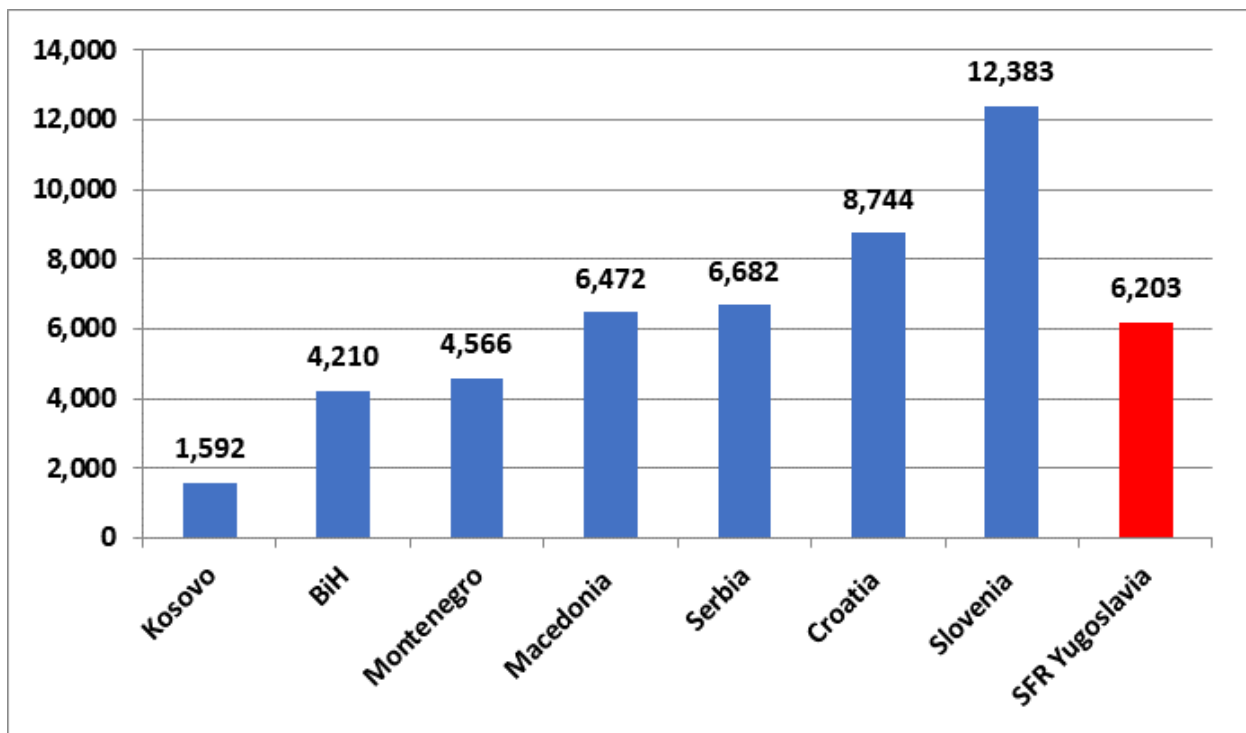
Yugoslavia registered a record trade and current account deficit in 1979 and was no longer able to service its external debt. A stand-by arrangement was concluded with the IMF which required austerity packages implemented after 1981, leading the Yugoslav economy into a profound and long recession – stagnating or declining output, negative rates of investment growth, rising unemployment and increasing inflation. From 1981 onwards, the stop-go character of certain measures – monetary restrictions, price and incomes controls, interest rate policies – had a number of counterproductive effects, especially on prices (Uvalić, 1992, p. 14).

Restrictive income policies in combination with rising inflation led to declining living standards: between 1980 and 1984, there was a 34% drop in real net wages. There were also mounting social tensions, which led the government to relax income controls, which in turn further contributed to rising inflationary pressures. The various stabilisation programmes implemented during the 1981-89 period had been largely unsuccessful, since the economic crisis persisted throughout the 1980s culminating in hyperinflation in 1989 (Uvalić, 1992, p. 13, Uvalić, 2010, p. 25).

Another serious problem of Yugoslavia's economic development was rising regional inequalities. The regional policies implemented in Yugoslavia aimed at bridging the gap between the more and the less developed parts of the country have not brought the expected results. Despite various mechanisms to ensure the transfer of financial resources towards the less developed republics and regions, primarily the Federal Development Fund, the gap between the Social Product per capita of the most developed Slovenia and the least

developed Kosovo actually widened, from 5:1 in 1955 to 8:1 in 1989 (based on official statistics; see Uvalić, 1993). The gap in economic development between Kosovo and Slovenia, of 8:1 in 1989, is confirmed by alternative statistics based on the standard concept of GDP (see Figure 2).

Figure 2: GDP per capita in 1989 (in US\$, PPP) in Yugoslavia and its republics



Source: The Maddison-Project, <http://www.ggdcc.net/maddison/maddison-project/home.htm>, 2013 version; GDP per capita is expressed in Geary-Khamis (GK) dollars, equivalent to the international 1990 dollar (PPP).

The mechanisms of redistribution of resources provoked a long-lasting controversy in Yugoslavia over who was 'exploiting' whom. The more developed republics – Slovenia and Croatia – felt exploited because of the obligatory transfer of resources to the Federal Development Fund which usually remained outside their direct control, or other policies to their disadvantage, like the retention of foreign currency earnings from exports and tourism. The less developed republics felt exploited because of the unfavourable terms of trade deriving from the structure of their economies, namely a large share of basic industries, primarily agriculture, characterised by low efficiency and/or high capital-output ratios, in combination with distortions in relative prices due to more widespread price controls on basic

products rather than on manufactures, which in general implied lower prices for the former. The debate on economic exploitation lasted for decades, without offering clear evidence which republics were actually more advantaged or disadvantaged (Uvalic, 1993).

There was a vivid revival of the debate in the second half of the 1980s, when economic exploitation of Serbia was highlighted in a document prepared in 1986 by a group of intellectuals of the Serbian Academy of Sciences and Arts – the Memorandum on the position of Serbia in Yugoslavia. The authors of the document lamented that Serbia was constantly discriminated against within Yugoslavia, both economically and politically – the type of economic policies implemented had intentionally plunged Serbia into economic backwardness,¹⁶ while existing constitutional arrangements, which created autonomous regions within Serbia, had made it the only republic unable to exercise full sovereignty over its whole territory.¹⁷

This Memorandum contributed to the new wave of nationalism in Serbia in the mid-1980s, which in turn triggered nationalistic sentiments in other parts of the country. The increasing gap in economic development between the republics/regions in Yugoslavia is probably the major failure of the Yugoslav model of market socialism, since it fundamentally contributed to increasing conflicts in the late 1980s (although problems of uneven regional development are clearly not specific to Yugoslavia).

Yugoslavia was also facing growing social and political unrest, particularly after Tito's death in May 1980. Widespread economic and political grievances in the second half to the 1980s resulted in frequent strikes and demonstrations throughout the country, which were used to put pressure on local politicians to increase wages or to resign from office. Social discontent eventually led to the emergence of alternative political parties which, until they were

¹⁶ The Memorandum stressed the presence of a system of “unequal exchange” in Yugoslavia which was highly unfavourable for Serbia because of adverse terms of trade, further aggravated by the “penetration” of the developed republics’ capital into Serbia, making Serbia increasingly dependent on them.

¹⁷ The 1974 Constitution had considerably reinforced the powers of the two provinces: although they were nominally provinces within Serbia, Kosovo and Vojvodina had a very high level of autonomy, comparable to that of the republics.

legalised in 1989, appeared under the form of 'associations'. The unresolved problem of Kosovo, which since 1981 had demanded the right to become a republic, led to increasing nationalist conflicts, ethnic persecution and discrimination, several military interventions and the official reinforcement of Serbia's rights over Kosovo through amendments to the Serbian Constitution in March 1989.

In the meantime, a serious political crisis developed due to continuous conflicts between the republican governments over both political and economic issues, bringing the regional issues to the fore. Whereas Serbian nationalism was disruptive to the delicate Yugoslav balance because of its centralising assertiveness, the Croatian and Slovenian nationalism contributed to the dissolution of Yugoslavia in quite the opposite way, by asking for further decentralisation and reduction of federal authority (Uvalić, 2010).

The Yugoslav system of self-managed market socialism produced apparently a number of contradictions. The desire to respect, as much as possible, the principle of egalitarianism which was regarded important in a socialist society, required continuous political patronage by the party authorities, but this could not be easily reconciled with the principles of the market mechanism that tended to produce increasing inequalities – differences among enterprises' performance, individual workers' remuneration, levels of development of various parts of the country. At the same time, the political regime based on a one-party political system could not be easily reconciled with increasing autonomy of the single republics in economic policy-making.

As noted by Mencinger (2000), the reforms remained half-hearted efforts since they failed to delimit political power from economic power; "... counter-reforms were enacted when the market became too destructive to political monopoly of the Party and to the principle of democratic centralism" (Mencinger, 2000, p. 118). It is plausible that the transfer of economic responsibilities and effective power from the federation to the single republics/regions was a way to compensate for the lack of will to radically change the political system, due to the country's firm determination to remain a socialist country. However,

decentralisation of economic competences was not accompanied by the introduction of an efficient mechanism of macroeconomic management that would have ensured consistent and coordinated policies at the level of the federation.

Particularly during the 1970s, the ill-conceived social compacts concluded at the level of the republics were in no way able to substitute for an efficient system of macroeconomic governance. The Yugoslav model failed to invent alternative governance mechanisms that would have ensured major coordination of economic policies at the federal level, but in line with the different economic interests of its republics and regions.

6. Yugoslavia in 1989: Towards radical systemic changes

A decisive shift from a socialist towards a capitalist economic system took place in Yugoslavia in 1988-90. These changes were influenced by similar developments in Eastern Europe in the late 1980s, but they also came as a response to the deep economic crisis that started developing in Yugoslavia from the early 1980s and rising awareness that the systemic features of the Yugoslav model had to be radically changed.

At that time, in 1989, Yugoslavia had a number of advantages with respect to the Central East European countries. Thanks to market-oriented reforms applied in the past, the Yugoslav economy had already implemented many reforms required by the transition to market economy, including price liberalisation, foreign trade liberalisation, or reforms of the banking system. The economy was highly decentralised, especially since the 1974 Constitution transferred substantial economic powers to the single republics and local authorities.

The Yugoslav government also had more experience with macroeconomic stabilisation policies, given that it had to address problems of rising unemployment and high inflation already starting from the mid-1960s. Major openness towards the outside world and privileged relations with the European Economic Community brought a number of benefits

to the Yugoslav economy, including increasing trade with Western Europe. All this implied that Yugoslavia in 1989 had a shorter reform agenda than the Central East European countries.

Yugoslavia in 1989 also exhibited certain disadvantages. The ambiguous system of social property posed concrete problems in the design of privatisation. Who was to take the decision on privatisation? Would it be workers themselves in line with the system of self-management and the belief that workers were the real owners of their firms, or the state as the effective owner of social capital? And given the ambiguous system of property rights in Yugoslavia to whom would the proceeds of privatisation go – to the enterprise being privatised, to its workers, or to the state?

Another disadvantage was major resistance to change: in comparison with other socialist countries, there was major popular acceptance of the political (and economic) regime in Yugoslavia, which delayed, at least to some degree, more radical economic reforms in parts of the country; thus the victory of Slobodan Milošević's Socialist Party of Serbia at the first multiparty elections in Serbia was a clear sign of the population's desire to see continuity, rather than a radical break with the previous system (Uvalić, 2010). But the most serious disadvantage of Yugoslavia in 1989 was the latent political crisis that intensified particularly in the 1980s, leading progressively towards the disintegration of the Yugoslav federation.

The first steps to fundamentally change the economic system in Yugoslavia, in the direction of private ownership and a mixed market economy, were taken in late 1988 (Uvalić, 1992, p. 182). Starting from November 1988, the government adopted thirty-nine amendments to the Federal Constitution and over twenty new laws which aimed at radically changing of the economic system. Among the announced changes were the removal of existing limits on private property, incentives for the development of the small-scale private sector and the encouragement of entrepreneurial activities through favourable provisions regarding duty-free imports of inputs and technology.

A new law on foreign direct investment improved conditions for foreign investors by offering major protection of foreign partners' ownership and management rights, and abolishing the limits on the share of foreign ownership in firms. Three laws in 1989 introduced major changes in the banking system: the banking law transformed banks from non-profit institutions into joint-stock and limited liability banks; the law on securities introduced for the first time equity shares in the Yugoslav legal system; and the Law on the money and capital markets officially sanctioned the creation of a capital market.

Important systemic changes were introduced by a new Company law adopted in December 1988. The law diversified property forms, adding mixed property – a combination of private and socially-owned capital – to the already existing types of property (social, private and cooperative). This law also introduced the commercialisation of enterprises and diversified the legal forms of enterprise, to include joint-stock companies, limited liability companies, limited partnerships, public enterprises (in sectors of public interest such as transport, energy, telecommunications, postal services) and other standard forms. The law had important implications for self-management, with the intention of replacing collective responsibility of workers by individual responsibility of managers and new capital owners. Only in enterprises in social property would workers' self-management rights remain as before, to be realised through their election of the Workers council as the principal management organ.

In mixed property enterprises, workers' rights were substantially reduced by the introduction of five management organs: the Assembly (including representatives of both workers and shareholders); the Management Board (whose members are nominated by the Assembly); the Supervisory Board; the Workers' Council; and the Director (or Directive council) that was given major responsibilities for the firm's policies. An enterprise in private property was to be managed by its founder, while workers were to realise their self-management rights in conformity with collective agreements. All organisations of associated labour had the obligation to organise themselves in conformity with the new provisions of the Company law by 31 December 1989.

The economic reforms also called for the privatisation of the dominant social sector of the economy. In 1989, social property still represented over 86% of Yugoslav Social Product (SP), without major differences among the republics, ranging from 84.2% in Bosnia and Herzegovina to 89.9% in Slovenia; the only exception was Kosovo, where it contributed only 76.9% of its SP.¹⁸ Privatisation of the social sector was first announced in the Federal law on privatisation adopted by the Yugoslav government in December 1989.¹⁹

The law envisaged the sale of social capital at public tenders to national or foreign legal and physical persons, while the decision to start privatisation was to be taken by the Workers councils. Proceeds from sales were to go to Development Funds to be established by the republics and autonomous regions as public enterprises, though part of the proceeds could also be given to employed workers in the form of shares, up to a maximum value of six-months wages. Since the law implicitly recognised that the real owner of social capital was the state, it had been interpreted as “tacit nationalisation” and by June 1990 no sales under the law had taken place (see Uvalić, 1992).

The Federal privatisation law had to be revised in order to offer major incentives to enterprises to start privatisation. In August 1990, two laws were adopted: the Law on Social Capital and the Law on Personal Incomes. The Law on Social Capital envisaged as the main method of privatisation the sale of social capital at a discount of 30% to enterprise workers, citizens and pension funds, but present and former workers had the right to an additional 1% discount for each year of employment in the firm subject to privatisation, up to a maximum of 70% of the nominal value of shares, to be paid for within ten years. Though several limits on share issues at a discount had to be respected, the law in practice offered extremely favourable conditions primarily to insiders (Uvalić, 1992, pp. 185-86). The part of

¹⁸ The private sector was much larger in Kosovo because of the large share of agriculture and small-scale crafts, both predominantly in private hands. The social sector shares have been calculated according to official statistics, provided in the Statistical Yearbook of Yugoslavia 1991 (Federal Office of Statistics, 1991), Table 205-1, p. 475.

¹⁹ Interestingly, the word privatisation was not mentioned: the name of the law was “Law on the circulation and disposal of social capital”.

social capital not subscribed through share issues to insiders was to be offered for sale to domestic and foreign firms or individuals through public auctions.

Privatisation was additionally stimulated through the 1990 Law on Personal Incomes, that envisaged that workers, in addition to basic wages, could receive an increase in earnings in the form of their enterprise's shares. Thereafter, a number of enterprises throughout Yugoslavia started privatisation according to the provisions of these laws (see Uvalić, 1997).

Parallel with these important legislative changes, in December 1989 the Federal government led by Prime Minister Ante Marković launched a bold macroeconomic stabilisation programme based on 'shock therapy': the exchange rate was pegged to the German Mark, resident convertibility for current transactions was introduced, money wages were frozen at their December 1989 level, there was stricter monetary control, 75% of prices were liberalised (except for public utilities, some metals and pharmaceuticals) and 95% of imports were liberalised. However, already in the second half of the 1990, the stabilisation programme was undermined by a series of negative developments. Under the pressure from the republican governments, there was deviation from originally stipulated policies.

Contrary to federal regulations, most republican governments officially permitted wage increases and failed to respect their obligations concerning the financing of the federal budget and the monetary regulations of the National Bank of Yugoslavia (Uvalić, 1992, p. 14). The relaxation of tight monetary policy led to new inflationary pressures. The fixed exchange rate could not be sustained due to rising inflation, foreign exchange reserves declined due to increasing withdrawals of foreign currency from banks, by autumn 1990 the black market premium had reemerged and resident convertibility was effectively suspended. The positive course taken in 1988-89 was interrupted by a series of disputes between the republics, due to both economic and political reasons.

A major problem in the late 1980s was the lack of consensus on the future organisation of the Yugoslav federation. There were official proposals on how to transform the Yugoslav federation into a confederation or loose political union, the first advanced by Slovenia and

Croatia and the second by Bosnia and Herzegovina and Macedonia, but these proposals were never seriously discussed (Uvalić, 1993).

The fact that a popular referendum was not organised at the level of Yugoslavia was a major failure of policy-makers of those times, since the large majority of the population would probably have been against the country's disintegration. In his recent book, Dejan Jović (2018) provides information on public opinion polls in Croatia, showing that at the moment of the first multiparty elections in Croatia, in 1990, only 15% of ethnic Croatians was for full and unconditional independence, while 64% supported a confederative transformation of Yugoslavia (Jović, 2018, pp. 13 – 14).²⁰ While most republics were in favour of transforming Yugoslavia into a loose confederation, Serbia supported by Montenegro wanted a more efficient and more centralised state. Within the League of communists, Milošević insisted on the principle of “democratic centralism” which meant maintaining his own power, whereas the Slovenes wanted a looser arrangement in which the League of Communists of Yugoslavia (LCY) would be an alliance of national parties. The lack of willingness to find a compromise between these diverging views contributed to the effective dissolution of the Central Committee of the LCY on 20-22 January 1990, when the Slovenian delegation walked out of the 14th Extraordinary Congress of the LCY. This opened the doors to the first free elections organised in all its republics in 1990 (Uvalić, 1992, pp. 15-16).

The first multiparty elections in Yugoslavia were held exclusively at the level of the single republics, all organised from April to December 1990 – first in Slovenia (April), followed by Croatia (April-May), next in most other republics (autumn), and last in Serbia (December) – leading to the introduction of multiparty political systems. The Yugoslav federal government sought to organise multiparty elections for the Yugoslav parliament at the end of 1989, but these elections were never held. Although some of the newly established democracies that emerged from Yugoslavia's split were for long dominated by one party and an authoritarian leader (Milošević in Serbia, Tudjman in Croatia), these elections led to the replacement of

²⁰ Similar public opinion polls in the other republics would probably have indicated an even higher support of the population for a confederative transformation of Yugoslavia, considering the multiethnic composition of the population in all Yugoslav republics (except Slovenia).

the League of Communists of Yugoslavia and the six Leagues of Communists of its constituent republics by multi-party political systems.

By that time, the political crisis had drifted out of control, leading to the effective break-up of the Yugoslav federation soon after. Slovenia and Croatia proclaimed political independence in June 1991, but were asked by the European Community to postpone it until October 1991. The other republics followed, obtaining international recognition soon after or during the first half of 1992. The break-up of the Yugoslav federation was accompanied by military conflicts – initially in Croatia (1991-95), Slovenia (1991) and Bosnia and Herzegovina (1992-95); and later in FR Yugoslavia (1998-99) and Macedonia (2001). The 1990s was a decade of high political and economic instability, which proved to be extremely costly for most countries.

7. Varieties of capitalism in the Yugoslav successor states

The foundations of the socialist economic and political system started being dismantled in Yugoslavia before the country disintegrated, in 1988-90, with the common objective of introducing a political system based on multi-party democracy and an economic system based prevalently on the market mechanism and private property. The radical changes announced in Yugoslavia in the late 1980s marked the beginning of the political and economic transition that would eliminate the main features of both the socialist economic system – party control of the economy, planning and social property – and the system of self-management, although some of these processes were not immediate.

Communist party control of the economy was eliminated with the passage from a one-party to a multiparty political system, following the first multi-party elections held in all Yugoslav republics during 1990. *Planning* and other non-market mechanisms of resource allocation and policy coordination, such as medium term (five-year) plans or social compacts, had already lost relevance in Yugoslavia by the late 1980s. Other institutional features of the socialist economic system were also being changed through a series of new laws adopted in 1988-89, as described earlier. *Property transformation*, aimed at replacing social property

with mixed or fully private property in the bulk of the economy, also started from mid-1990 onwards according to the provisions of the Federal privatisation law. *Self-management* was to be eliminated through provisions of the new company law and through the privatisation process, that was to transfer workers' decision-making rights to the new private capital owners.

At the time of Yugoslavia's break-up, in mid-1991, its five successor states inherited very similar institutional features, but thereafter followed very different trajectories. The free market ideology was to replace the socialist ideology in all countries, but the actual changes were implemented at very different times and with many distinct features. The progressive differentiation in the transition paths of the Yugoslav successor states took place due to major differences in the timing, speed and contents of systemic changes. An interesting question raised by Bartlett (2007) is to which extent do the experiences of the newly created states support the institutional theories of path dependency? Namely, are the emerging capitalisms rooted in the self-management experience, or do they represent a radical rupture with the past?

The timing and speed of implementation of transition-related economic reforms varied considerably across the successor states of Yugoslavia, to a great extent determined by the very different political conditions in each country in the early 1990s. Slovenia proceeded faster than the other countries. The events accompanying the break-up of Yugoslavia had a less profound impact on Slovenia than on the other countries: the 1991 intervention of the federal Yugoslav army aimed at preventing the republic's secession was of very short duration. Although Slovenia was also affected by the loss of a common market and the disruption of trade flows, the effects were relatively quickly absorbed. In most other Yugoslav successor states, on the contrary, involvement in the military conflicts of the 1990s had lasted longer and has had much deeper economic consequences.

Moreover, Slovenia's transition was facilitated by excellent economic conditions. It was the most export-oriented Yugoslav republic, already well placed on foreign markets with specific

products (e.g., Elan skis or Gorenje refrigerators and other home appliances). Slovenia was also the most developed country in Central Eastern Europe, so it did not have to rely on support of the IMF, nor did it need foreign advice (although Jeffrey Sachs did consult the government on privatisation).²¹ Due to such favourable conditions, Slovenia implemented most transition-related economic reforms relatively quickly (although when compared to the Central East European countries, it is usually singled out for its gradualist strategy of transition) and by 1997 had already over-passed its pre-transition real GDP. In 2000, Slovenia had higher scores in the EBRD transition indicators than the other Yugoslav successor states (see EBRD, Transition Report, 2001). Slovenia also benefitted from EU measures of support offered to the Central East European countries, including financial assistance through the PHARE programme and privileged access to the EU market thanks to the Association Agreement signed with the EU in 1996. During the next decade, Slovenia gradually integrated with the EU economy, becoming an EU member state in May 2004.

The other successor states of Yugoslavia implemented transition-related economic reforms somewhat later, primarily due to major political instability. Specific national priorities of governments often gave political issues precedence over the economic ones, even if such choices contributed to military conflicts – in Croatia, Bosnia and Herzegovina, FR Yugoslavia – and implied extreme economic costs, including the loss of many human lives. The unfavourable political environment during the 1990s also influenced the lack of more substantial EU support to this group of countries (which came only after 2000), determining their slower integration with the EU economy and later arrival of foreign investors. Despite these common features, a differentiation can be made between the ‘early reformers’ – Croatia and Macedonia – and ‘late reformers’ – Bosnia and Herzegovina and FR Yugoslavia (Bartlett, 2008).

Due to somewhat less complex political problems, Croatia and Macedonia were able to address certain economic reforms earlier than the other countries. Macroeconomic stabilisation was achieved fairly soon, with inflation reduced to one-digit figures in Croatia in

²¹ The lively debate on privatisation in Slovenia that followed led the Minister of the economy, Jože Mencinger, to resign (see Uvalić, 1992, p. 188).

1994 and in Macedonia in 1995. Various transition-related economic reforms had also been implemented relatively quickly, so by 2000 these countries had, in most areas, higher EBRD transition indicator scores than the other two countries (see EBRD, 2001). Privatisation was also implemented relatively fast, so the private sector in mid-2000 contributed 60% in Croatia and 55% in Macedonia of their respective GDPs. Thanks to the new EU approach developed for the Western Balkans after 2000, Croatia was also able to become an EU member state in July 2013. Macedonia remains an EU candidate, since the dispute with Greece over its name has for years blocked the opening of accession negotiations.

In Bosnia and Herzegovina, transition-related economic reforms were initially delayed by the four-year war (1992-95). The Dayton Peace Accords signed in December 1995 brought peace, but not immediate progress with economic reforms. The country was divided into two entities, the Bosnia and Herzegovina Federation and the Republika Srpska, and the autonomous district of Brčko. The UN appointed High Representative was given wide powers to oversee the implementation of the peace agreement and intervene in political and economic matters. Since most economic policies are decentralised to the two entities, while within the Federation they are further decentralised to the ten cantons, Bosnia and Herzegovina remains in many respects a dysfunctional state. Monetary stability was secured after the end of the war through the introduction of a currency board, but most areas of reform started late and have been slow, including privatisation. In 2000 the contribution of the private sector was only 35% of GDP, though it expanded to around 60% of GDP by the end of the decade. More than twenty years after the end of the military conflict, the country is still facing extraordinary institutional and constitutional problems. Bosnia and Herzegovina is currently only a potential candidate for EU membership.

Transition was also greatly delayed in FR Yugoslavia, created by Serbia and Montenegro in April 1992, due to particularly unfavourable conditions throughout the 1990s. Due to Yugoslavia's break-up and the ongoing military conflicts, FR Yugoslavia registered one of the deepest recessions in the early 1990s and a record hyperinflation in world history, a rate of 116.5 trillion% in 1993 (see Uvalić, 2010). FR Yugoslavia was under severe UN sanctions

throughout most of the 1990s because of its involvement in the Balkan wars (1992 – 96) and its policies in Kosovo (1998-99), which also led to the 11-week NATO bombing in 1999. During those years, some government measures represented reversals of previously implemented market-oriented reforms, such as prohibiting workers lay-offs, rationing of goods due to shortages, or the renationalisation of some strategically important socially-owned enterprises (Cerović, 2000; Uvalić, 2010).

Although Montenegro and Serbia were part of the same country (until 2006), their economic policies were quite independent (and different) already during the 1990s (e.g., regarding privatisation). Particularly after October 1997, when Milo Đukanović was elected president of Montenegro, Montenegro decided to implement its own monetary, fiscal, foreign trade and other policies. Montenegro created its own central bank and introduced the German mark, first as a parallel currency and after 3 November 1999 as the official legal tender, which in early 2002 was replaced by the euro. By distancing itself from Serbia, Montenegro hoped to implement transition-related economic reforms faster (see more in Uvalić, 2010).

In Serbia, it is with the political changes in October 2000, when Milošević was finally overthrown, that economic transition became a top government priority. A new privatisation law was adopted in order to speed up privatisation in Serbia, given that in mid-2000 the private sector contributed only 40% of GDP (EBRD, 2001). Many reforms have been implemented in the meantime, but privatisation has been slow: the private sector in 2010 still accounted for around 60% of GDP. This is primarily due to a large sector of public utilities, many privatised firms that have been closed after privatisation and unsuccessful privatisation (around 30%) that have been returned into state ownership (Cerović, 2014).

FR Yugoslavia has also faced further political instability. The complex relationship between Serbia and Montenegro was finally resolved through their separation in 2006. Serbia's southern region of Kosovo, that was under UNMIK's administration after 1999, unilaterally declared independence in February 2008. The Kosovo-Serbia dialogue over unresolved issues has been difficult and very slow, so the political issues have continued to burden both

governments' agendas. Of the three countries created from FR Yugoslavia's split, Kosovo is by far in the worst economic situation, both because of its very low level of development and late start of transition. Montenegro and Serbia have initiated accession negotiations with the EU and hope to become members in 2025, but Kosovo is only a potential EU candidate.

In addition to the variable timing and speed of the transition, the contents of economic reforms have also been very different, leading to varieties of capitalism in the Yugoslav successor states. The types of economic systems that have emerged and developed during the past twenty-five years have clearly been country-specific, to a large extent determined by the political orientation and priorities of the main political parties in power. As the governing political coalitions have been subject to frequent changes (at least in most countries), their political and economic programmes have also changed accordingly. However, as noted by Bartlett (2007), the forms of capitalism that have developed in the Yugoslav successor states do not fall neatly into the boxes of the varieties of capitalism literature. The Western Balkan countries have relied heavily on international donors' assistance which has very often come on highly conditional terms, involving the transplantation of policies and institutional solutions from a variety of sources, thus resulting in uncoordinated policy advice, or "a rather exotic mixture of economic and social reforms", so the institutional configurations that have emerged have often been neither complementary nor compatible (Bartlett, 2007, p. 3).

One area that has undoubtedly had the strongest influence on the economic and social transformation of Yugoslavia's successor states is privatisation. The way the process of privatisation was organised and implemented after 1991 has determined the very diverse patterns of redistribution of social property, thus also of economic and political power, within societies. Although the Yugoslav successor states have implemented very different privatisation strategies, the various approaches had some features in common.

First, all the successor states of Yugoslavia suspended the implementation of the Federal privatisation law (even before the country's break-up), in order to prepare their own laws

during 1991-94, which unavoidably delayed the process of property transformation. In order to take into account the legacy of self-management, all countries (except Bosnia and Herzegovina) decided to implement privatisation through methods that would enable the sale at privileged conditions (or free distribution) of shares to employed workers and managers (Uvalić, 1997). The conversion of workers' self-management into property rights was implemented using a variety of methods, offering variable discounts and repayment periods and imposing various limits on share issues to insiders, which crucially determined whether majority or minority employee ownership would be established within privatised firms.

In Croatia, discounted shares could be issued to employees, but up to a maximum of 49% of the shares in any one company (Bartlett, 2007). In Macedonia, the main method of privatisation adopted by firms were management and employee buy-outs, with management buy-outs being the most prevalent. In Montenegro employees also had priority in subscribing shares at particularly privileged conditions, while later changes of the law also permitted the free distribution of shares to employees, though limited to up to 10% of the value of social capital (Uvalić, 1997). In Serbia, the laws adopted in 1991 and 1997 were based on voluntary privatisation, both offering privileged conditions primarily to employed workers and managers.

The Slovenian law was a mass privatisation programme, but 20% of shares could be distributed to employees in exchange for their ownership certificates, and another 40% could be bought, under certain conditions, by current and former employees through buy-outs at preferential terms, resulting in many insider-owned enterprises and enabling 'red' managers that were running enterprises before 1989 to remain in charge of their firms. Only in Bosnia and Herzegovina was there no element of employee or management buyouts; the first phase consisted of the sale of small enterprises, while the privatisation of larger firms was based on mass privatisation, with vouchers awarded to all adult citizens, that took place only after a number of Investment Funds had been established (Bartlett, 2007).

Second, these different privatisation strategies also envisaged, in most cases, the quickest possible elimination of social property. In all countries except Serbia, in order to facilitate privatisation, social property was first re-nationalised through its transfer to various government funds, in order to be sold later to potential buyers; or it was freely distributed to citizens in exchange for their ownership certificates (as in Slovenia). Alternatively, after the expiry of the set deadlines for enterprises to start privatisation, unsubscribed social capital was transferred to government funds. In Croatia, enterprises that had not started privatisation within the set deadlines were taken over by the Development Fund, becoming state ownership to be privatised later. In Macedonia, where privatisation was voluntary, small and medium sized enterprises which did not begin privatisation by the end of 1994, and large firms by June 1995, were then subject to compulsory privatisation by the Privatisation Agency (Bartlett, 2007). In Montenegro, the social capital that was not subscribed through share issues by employees was transferred to government funds. In Slovenia, the part of social property that was initially not subject to privatisation became public property.

On the contrary, Serbia retained social property much longer – in the 1990s due to the voluntary nature of privatisation which resulted in its slow implementation, and during the 2000s due to specific policy mistakes. In order to speed up privatisation, the new privatisation law adopted in 2001 was based exclusively on the method of sales, but privatisation has proceeded much slower than expected, delaying enterprise restructuring (Cerović, 2009). Although a number of firms have been sold, also to foreign companies, there were no potential buyers for a number of enterprises in social property that for long remained in the portfolio of the Privatisation Agency (see Uvalić, 2010). There were many unsuccessful privatisations, since the new owners were unable to fulfil their basic obligations (including paying workers' wages), so about 30% of all privatisations have been cancelled (Cerović, 2014). There was also a legal obstacle to the abolition of social property, since the 1990 Serbian Constitution continued to guarantee the equal protection of all property forms (including social property), a provision that was changed only in the new Serbian Constitution adopted in 2006.

The ongoing analysis suggests that the emerging forms of capitalism in the 1990s were rooted quite strongly in the self-management experience, since all countries (except Bosnia and Herzegovina) in their privatisation laws did offer the possibility to insiders to become, to a smaller or larger extent, the new owners of the enterprise. The experience with the Marković privatisation law that led to the first privatisations throughout the country had suggested that the right incentives were necessary in privatising enterprises in which workers for decades had self-management rights.²²

As to the other remnants of the self-management system, the process of privatisation was usually accompanied by the elimination of not only social property (as described earlier) but also of self-management. In all countries except Serbia, Workers councils were formally abolished and replaced by supervisory boards representing the new shareholders. Only in Serbia did self-management survive longer, both due to slow privatisation and the late abolishment of social property (though just formally, due to poor economic performance of many enterprises or the maintenance of formal employment without effective work). According to the provisions of the 1997 Company law, in mixed property firms' decisions were to be taken jointly by the new private shareholders proportional to their capital stakes, and by current employees proportional to the share of social capital (Uvalić, 1997, p. 278). Nevertheless, the government often maintained control in the most important enterprises through the appointment of members of the supervisory board.

Despite these initial features of privatisation, there has been a significant redistribution of property towards more concentrated ownership in the meantime. Typically, in Croatia and Serbia, many small shareholders, primarily workers who had bought discounted shares of their firms, had sold them to managers at very low prices or to outside owners; or managers bought shares from workers using dubious methods, or appropriated the voting rights of the employee share holdings, consolidating majority holdings (Bartlett, 2007; Uvalić, 1997). In Macedonia, the most profitable firms were sold to managers at substantial discounts, often

²² For example, in Serbia during the initial period of application of the Federal Law, in only one year (from August 1990 to August 1991), around 33% of all enterprises in the social sector started privatisation (see Uvalić, 1997, pp. 284-285).

on the basis of severely undervalued asset valuations, while weaker and smaller enterprises were sold to employees, often on the basis of a more inflated valuation of assets (Bartlett, 2007). In Bosnia and Herzegovina, many individuals sold their vouchers on the open market, leading to the accumulation of vouchers in the hands of wealthy individuals based in the different ethnic communities (see Bartlett, 2007). After the initial phase of privatisation, substantial stakes have also remained in government ownership in practically all countries.

In the meantime, there was a further concentration of ownership in the hands of tycoon capitalists (oligarchs), that were frequently close to the political parties in power, leading to the collusion of the economic and political elite. In Slovenia, members of the former elite, such as enterprise managers, retained or even strengthened their position in society and became the winners of the transition (Mencinger, 2017). In Macedonia, former enterprise managers have assumed *de facto* control of the privatised firms and have strengthened their links with ethnically based political parties, providing ample opportunities for distorted practices of corruption and clientelism (Bartlett, 2007). In Serbia, the post-2001 wave of privatisation has benefitted primarily a handful of foreign firms and the new oligarchs, many of which have gained their fortunes much before the overthrow of the Milošević regime, while the situation is not dissimilar in Montenegro. The lack of adequate mechanisms for the control on money laundering and corruption remain serious problems in most countries.

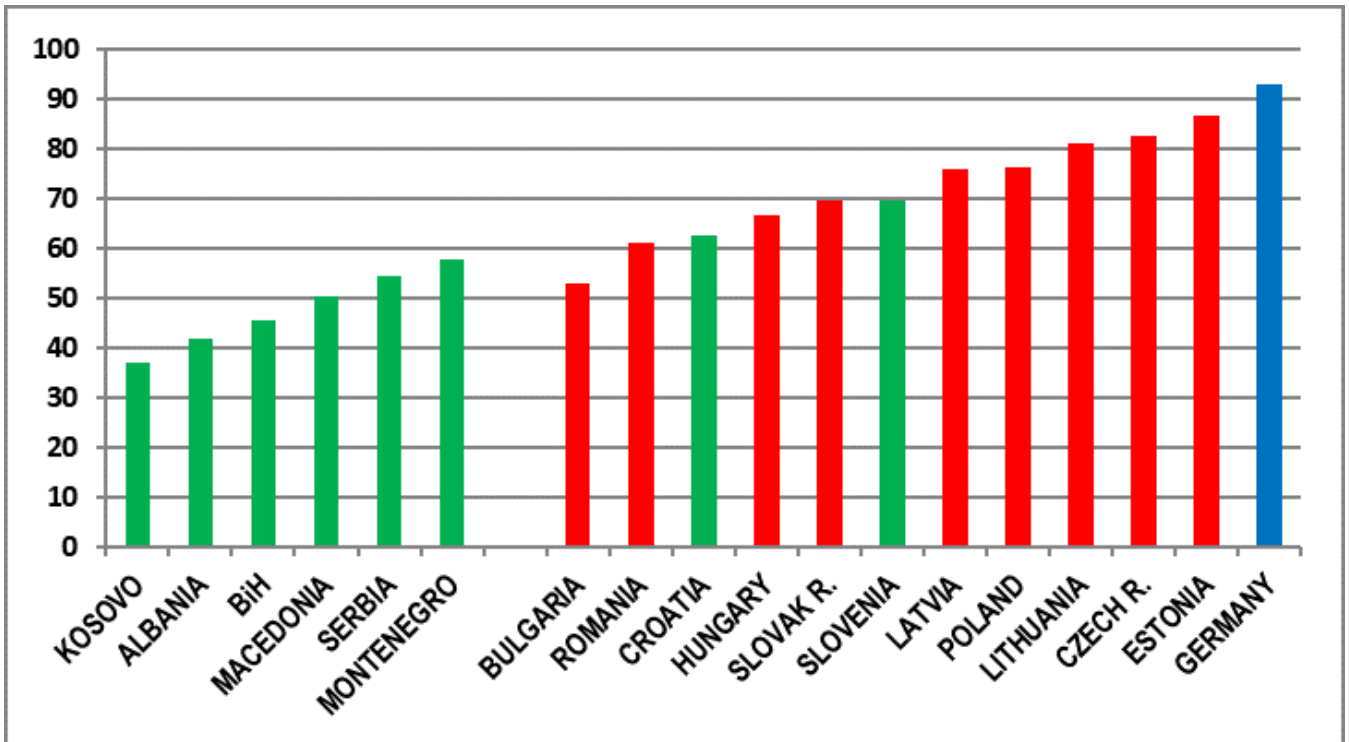
Therefore, the type of capitalist systems that have developed in most successor states of Yugoslavia have also been strongly determined by the failure to establish, early on, adequate government institutions that would perform important functions – such as supervise more closely the privatisation process, provide a proper valuation of enterprise assets, ensure the respect of contracts by the new owners or institute effective corporate governance mechanisms.

More generally, governments (and foreign policy advisers) have underestimated the importance of institutions that would provide appropriate, transparent and fair taxation systems, ensure market competition through anti-trust agencies, fight corruption and

substantially reform the judiciary. Liberalist policies recommended by major international financial institutions and the faith in the market mechanism often led to the neglect of important functions of the state (Uvalić, 2010), thus permitting the emergence of many features of unregulated or laissez-faire capitalism.

We should recall that during the 1990s, the specific circumstances in the Balkans created by wars, international sanctions and isolation have stimulated 'war profiteering', often by individuals close to the economic and political elite, which facilitated the emergence of tycoons that later were able to take over parts of the economy, control the media and strongly influence political processes. The recent experience of the Balkan states suggests that these features of unregulated capitalism are very difficult to dismantle in countries with weak government institutions.

While these conclusions would require much more substantive empirical evidence, an indicator that probably best captures the various failures of the government to perform its normal functions is the Rule of law indicator (as provided by the World Bank). As illustrated in Figure 3, the non-EU countries of former Yugoslavia are substantially lagging behind the EU member states regarding the rule of law, especially if we take Germany as the benchmark. It is not a coincidence that the rule of law has become one of the three pillars of the recent EU enlargement strategy for the Western Balkans, along with public administration reform and economic governance.

Figure 3: Rule of law, 2015

Source: World Bank Governance Indicators, available online.

Of all the countries born from the dissolution of Yugoslavia, Slovenia is probably the only country that has implicitly retained some of the institutional features of the previous economic model. Many Slovenian firms have ended being owned by previous employees and managers. In larger firms, there is representation of workers on company boards, introduced through a Law on co-determination adopted in 1993. Slovenian company law also allows enterprises to offer bonuses linked to enterprise profits, therefore a form of profit-sharing similar to practices in labour-managed firms in former Yugoslavia (though this is not institutionalised but is implemented on a voluntary basis; see Lowitzsch, ed., 2006).

Thanks to high public expenditure, one of the highest among all the new EU member states, Slovenia has been able to maintain practically free health care, free education and a generous pensions system. Slovenia is one of the very few new EU Member States that has not adopted the liberal model of a welfare state: it has strong trade unions, high workers' unionisation rates and an effective system of collective bargaining (Nutti, 2014). Thus in

Slovenia, more than in any other country of former Yugoslavia, we find signs of continuity, rather than of a radical break from the past.

It may seem that Serbia has also preserved some elements of the pre-1989 economic system. Due to the dominant ideology in the 1990s, Serbia has dismantled much later some elements of the previous system, including social property and self-management. However, parallel with this conservation (seemingly) of the old systemic features, there was also a step backwards, through the enlargement of the state sector, more direct state interference in economic life and in enterprise decision-making.

A radical change in the government's orientation took place after the political changes in October 2000, with the intention of definitely breaking away from the previous system. Many economic reforms applied after 2001, also influenced by the strong conditionality of the international financial institutions, have had features of the typical hyper-liberal model, including fast foreign trade reforms, privatisation based on sales, selling off the banking sector to foreign-owned banks and rapid financial liberalisation (see Uvalić, 2010). Parallel with these changes, the government has failed to implement important complementary reforms that would have ensured the enforcement of laws, the efficient collection of taxes, proper supervision of the financial sector, a more efficient judiciary and fight against corruption.

These policy failures have produced many ill-functioning institutions, contributing to major differentiation within the society, increasing income inequalities and to slow economic recovery, with seemingly high growth rates but achieved on the basis of a wrong growth model which was fully revealed during the 2008-09 economic crisis (see Cerović, 2014) – thus quite contrary to what has happened in Slovenia (see section 8 below).

8. Overall account of transition

After almost thirty years of transition to a market economy in the Yugoslav successor states, what have been the overall economic results? One of the main objectives of the transition – introducing a market economy based prevalently on private property – has been mainly achieved, given that the private sector today contributes the dominant part of output in all the successor states of Yugoslavia. However, the transition was also expected to lead to substantial social transformation and to deliver the long-term growth in living standards (World Bank, 1996).

In practice, this objective has been achieved only partially, considering the low level of economic development of most countries, whereas the new course towards capitalism has also produced increasing income inequalities. The social costs of the transition to market economy have been grossly underestimated in all countries in Eastern Europe (see Nuti, 2014), but they have been particularly pronounced in most Yugoslav successor states.

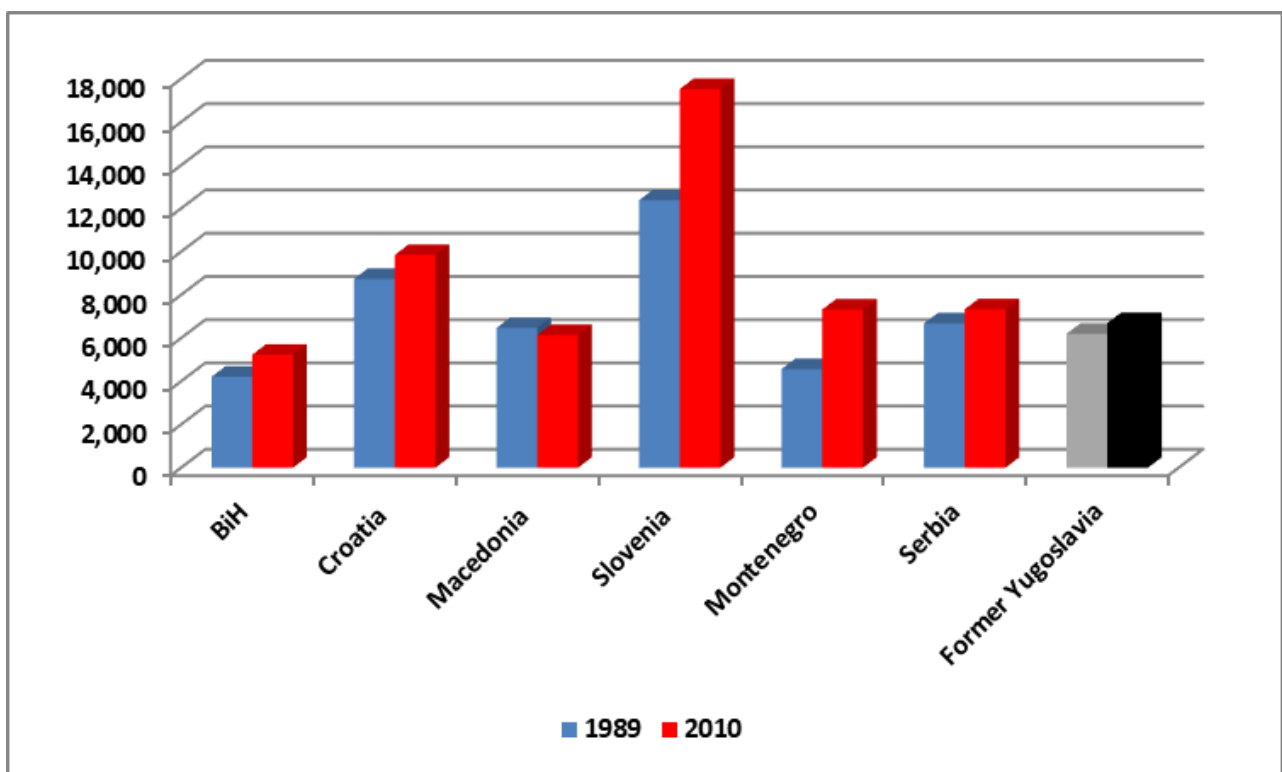
In order to show the modest economic results achieved in most Yugoslav successor states during the past thirty years, several indicators can serve as an illustration. First, various indicators on economic development, including (1) GDP per capita in Yugoslavia and its successor states in 1989 and 2010; (2) the extent of economic recovery by the Yugoslav successor states of their pre-transition (1989) real GDP; and (3) the current GDP per capita with respect to the EU average (in Purchasing Power Standards) (see Figures 4, 5, 6).²³ Next, the inequalities on the labour market can be illustrated by the current unemployment rates which remain remarkably high in some of the successor states of Yugoslavia (Figure 7).

²³ These three sets of indicators on Yugoslav successor states' economic development point to somewhat different relative positions of the individual countries, which should be of no surprise; they are different indicators, calculated by different institutions, using various sources of statistics and based on different methodologies. Although these various indicators could lead to not fully comparable results, particularly in a few marginal cases, the general picture does not change.

Finally, problems of rising income inequality in some countries will be illustrated through recent data on the Gini coefficients, as provided by the EU SILK survey (Figure 8).²⁴

Most Yugoslav successor states have had highly unsatisfactory results regarding economic development. The extreme fall in GDP per capita in the years of the disintegration of Yugoslavia and its further fall in most countries in the second half of the 1990s have in no way been compensated by the relatively high growth rates during the 2001-08 period, while the global financial and economic crisis has led to further setbacks, revealing deep structural weaknesses of the Western Balkan economies. Comparing GDP per capita in 1989 and 2010, most countries have seen a very limited increase in their level of economic development, while Macedonia has even registered a small reduction; the exceptions are primarily Slovenia and in part also Montenegro, that have developed much faster (see Figure 4).

Figure 4: GDP per capita in the Yugoslav republics in 1989 and in its successor states in 2010 (in US\$, PPP)

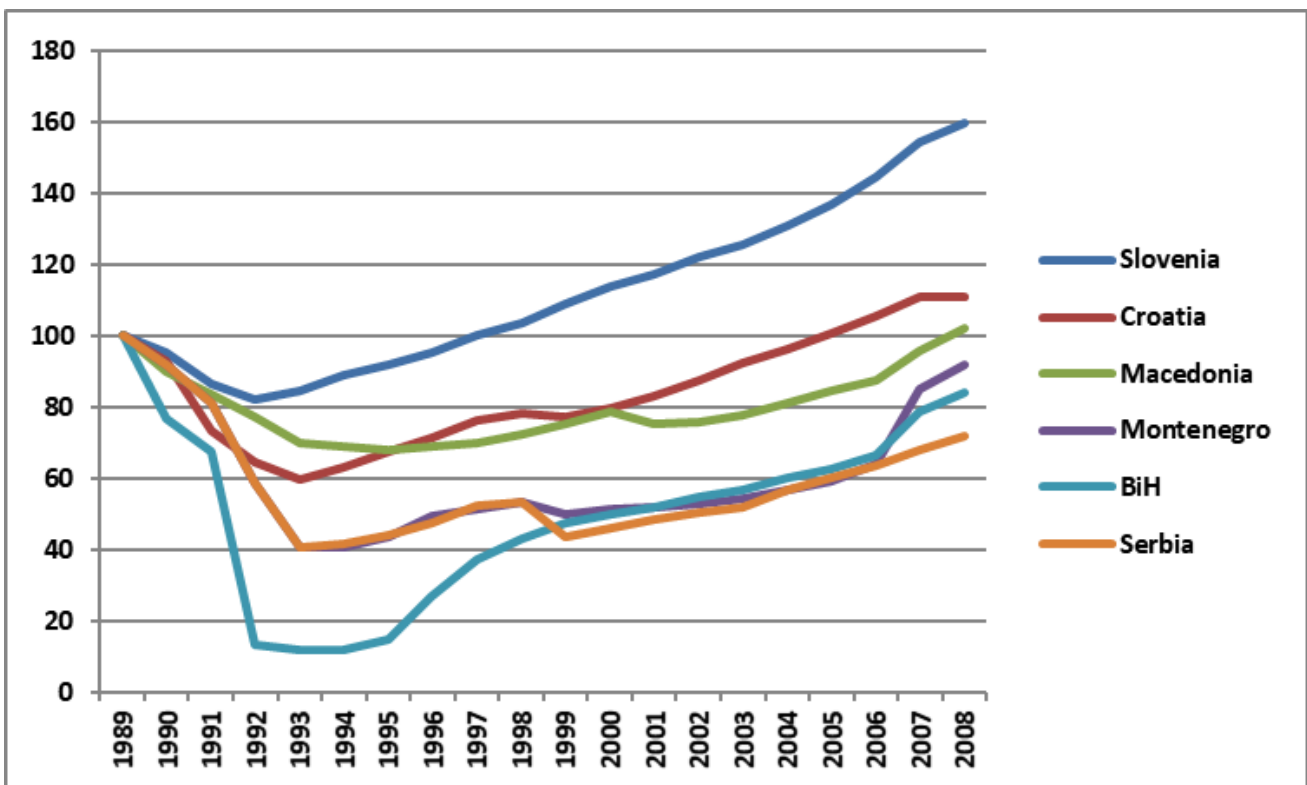


²⁴ Within Eurostat, the SILC survey is the main source for the compilation of statistics on income, social inclusion and living conditions.

Source: The Maddison-Project, <http://www.ggd.net/maddison/maddison-project/home.htm>, 2013 version; GDP per capita is expressed in Geary-Khamis (GK) dollars, equivalent to the international 1990 dollar (PPP).

Another important indicator of economic development is the recovery of the pre-transition (1989) level of real GDP, taking 1989 as the base year (equal to 100). Figure 5 reveals that Slovenia recovered fairly quickly after the strong recession of the early 1990s and surpassed its 1989 real GDP already in 1997. The process of economic recovery has been much slower in most of the other countries. By 2008, just before the strong effects of the global crisis, three countries had still not reached their pre-transition levels of real GDP – Bosnia and Herzegovina, Montenegro, and Serbia (see Figure 5). Serbia has been the slowest in recovering its 1989 real GDP, which can at least partly be explained by the very strong fall in output both in the early 1990s and in 1999 (a 19% drop) caused by the NATO bombing.

Figure 5: Recovery of 1989 real GDP (1989 = 100)

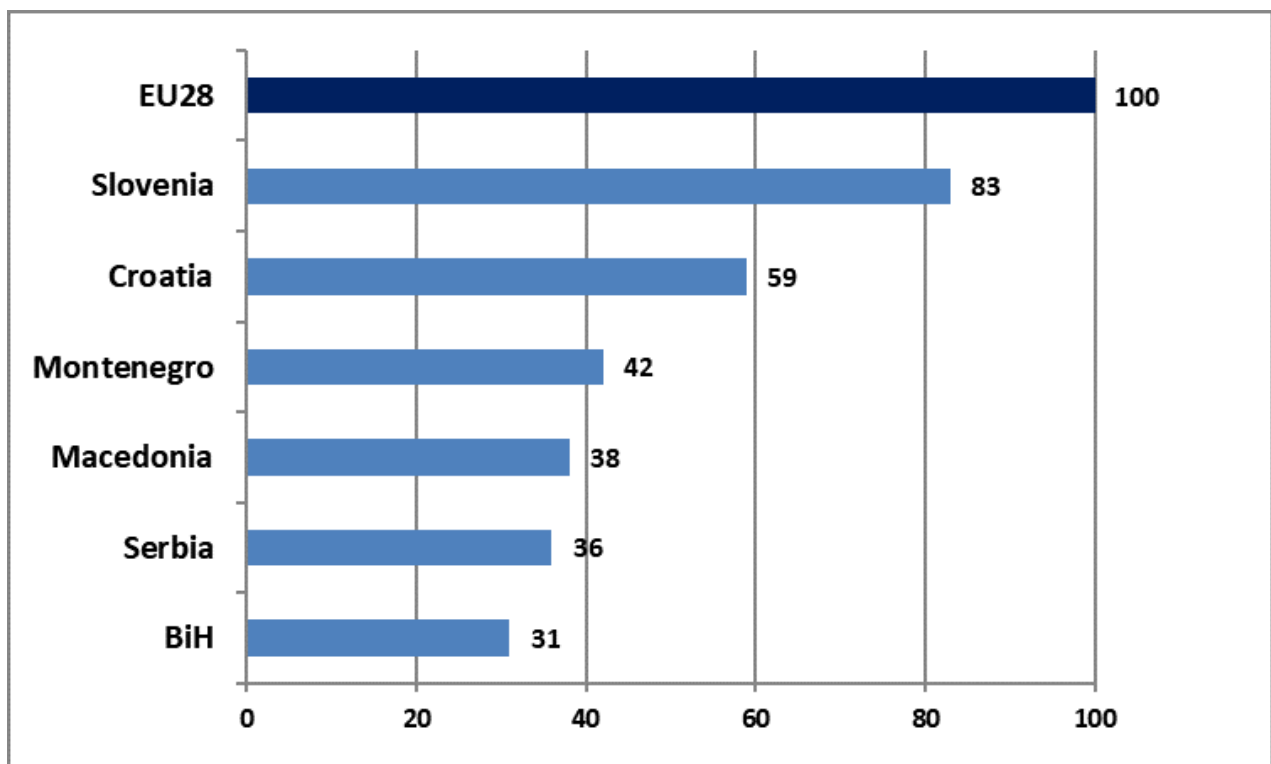


Source: Based on official statistics on real GDP growth rates; see also Uvalić (2010).

If we look at the level of GDP per capita of the Yugoslav successor states with respect to the EU 28 average in Purchasing Power Standards (PPS), the majority of these countries

are today among the poorest countries in Europe. If we exclude Slovenia and Croatia that are already EU member states, the other successor states of Yugoslavia in 2016 had a GDP per capita ranging from 31% in Bosnia and Herzegovina to 42% in Montenegro of the EU28 average (see Figure 6). Kosovo is even less developed, according to some estimates at around 23% of EU28 average GDP per capita.

Figure 6: GDP per capita (in Purchasing Power Standards), 2016



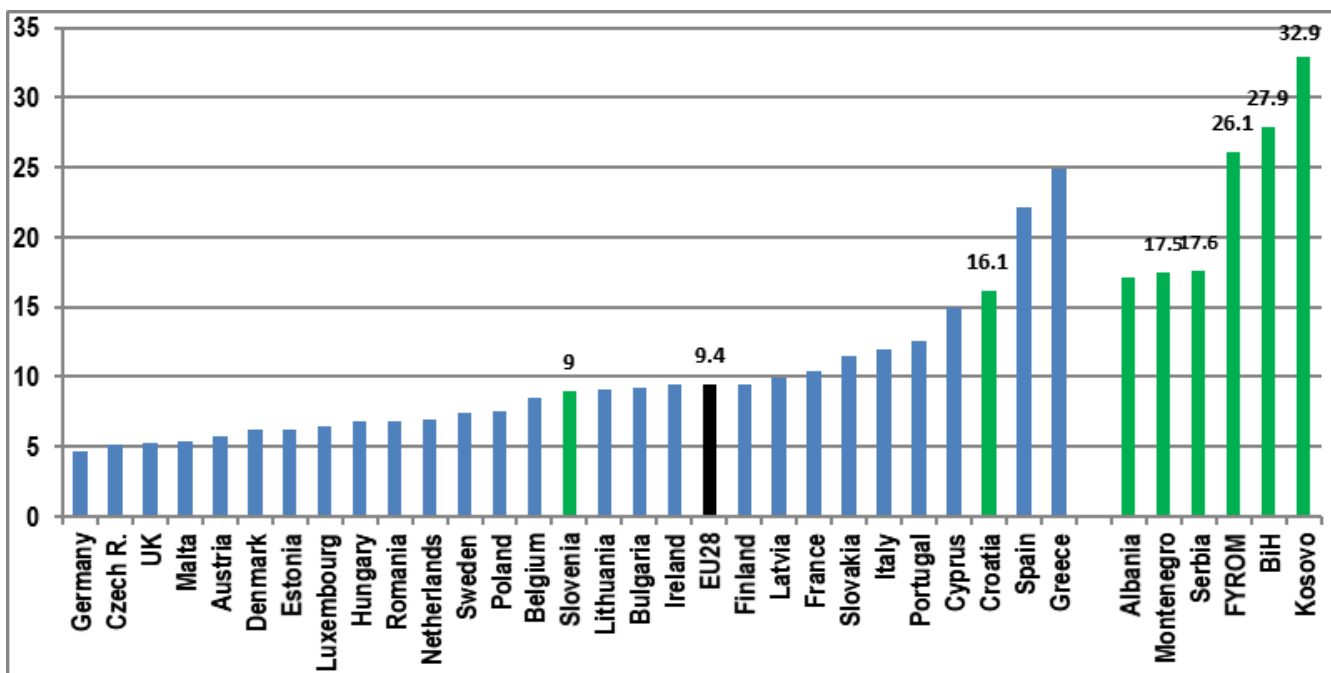
Source: Eurostat data.

An important source of inequalities in the majority of the Yugoslav successor states derives from the different positions of individuals on the labour market. The phenomenon of jobless growth that was typical in the Central East European countries in the early years of transition, has remained a key feature of most Balkan countries much longer. Despite economic recovery in the 2001-08 period, most countries of former Yugoslavia continue to register very high unemployment rates, especially of long-term and youth unemployment, low employment rates, high inactivity of the working age population and a diffused illegal sector. The unemployment rates in the non-EU Yugoslav successor states are much higher than in

most countries in the EU28, especially in Kosovo (33%), Bosnia and Herzegovina (28%) and Macedonia (26%) (see Figure 7).

Governments have been spending very little on active labour market policies, the public employment services have been inefficient, trade unions remain weak and there is no effective system of social dialogue. Moreover, substantial brain-drain has taken place in the last thirty years through massive emigration, especially of the young and best educated individuals, in this way additionally eroding the demographic base. There is also ample evidence on brain waste, the mismatch between labour market needs and qualifications/skills of university graduates; recent unemployment rates of university graduates in the Western Balkans were three time higher (15%) than in the EU (5%) (Bartlett et al., 2016).

Figure 7: Unemployment rates, 2015

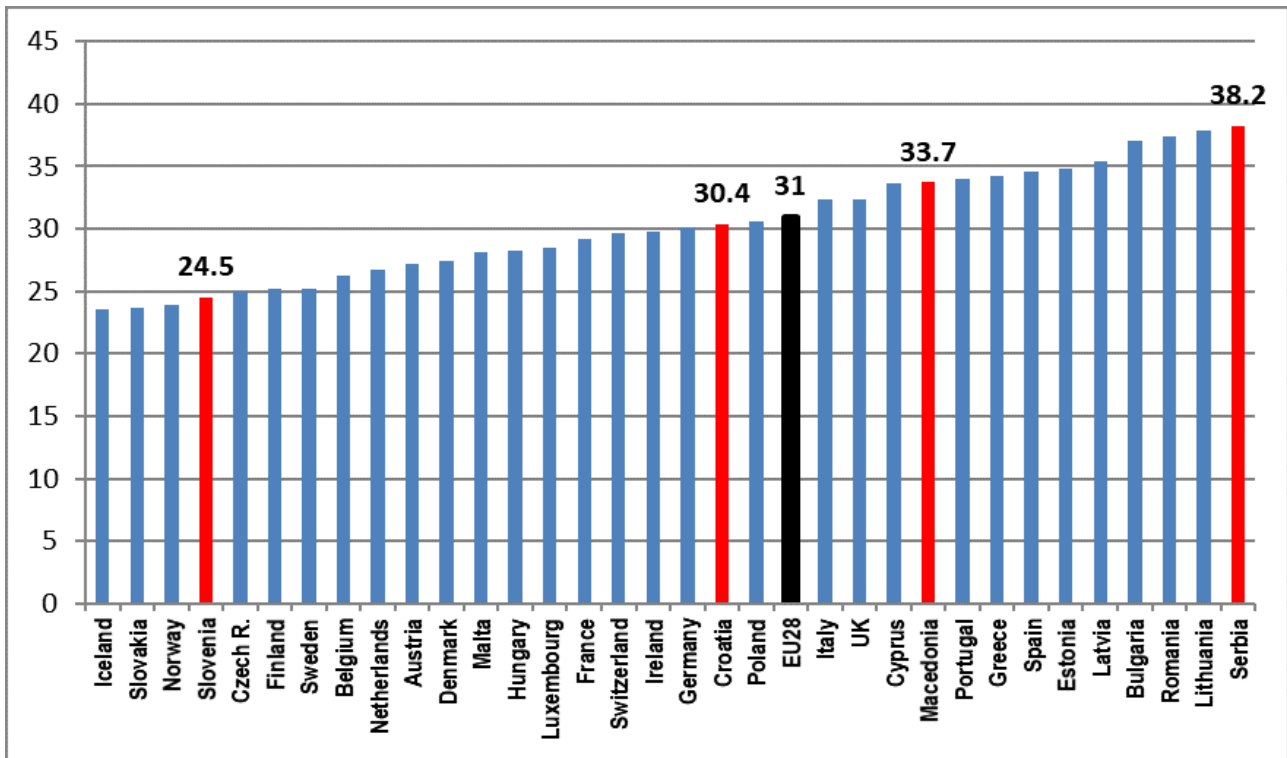


Source: Eurostat statistics, ILO definition.

Most countries of former Yugoslavia have also been registering rising income inequality. According to data provided by the European Commission, Slovenia has a remarkably low Gini coefficient (24.5), the lowest among the countries of former Yugoslavia and among the

lowest in the EU; while Serbia has the highest, among both the successor states of Yugoslavia and all countries in Europe (see Figure 8).

Figure 8: Gini coefficients of equalised disposable income, 2015



Source: Eurostat, EU SILC survey.

A major reason for increasing income inequalities in most countries are inadequate tax reforms. Most countries have introduced a very low personal income tax and a low corporate tax, frequently a flat tax; social security contributions have remained very high (the notable exception is Kosovo); and there is a dominance of indirect taxes (VAT and excises). A property tax has been introduced only fairly recently, it is set at low levels and there is no efficient mechanism of supervision and control. Taxation systems in the Balkans have been evaluated by the ILO in 2011 as being unfair (not sufficiently progressive) and inefficient (since revenues are provided prevalently from indirect, rather than direct taxes). The common assumption behind such taxation systems is that they will attract FDI, thus create jobs, increase wages and facilitate conditions for reducing informality, but such outcomes have been more an exception than the rule. Recent empirical evidence suggests that there

have been limited, if any, spillover effects of FDI in the Balkan region (Estrin and Uvalić, 2016).

Recent studies for Serbia, as the country with the highest income inequality among the countries covered by the EU survey, suggest that the income tax system has significantly less redistributive effects in comparison with the income tax system in the EU. The PISA surveys also suggest that education systems fail to cancel the effects of socio-economic inequalities, since illiterate children in families that are among the 20% of the population with the lowest socio-economic status are behind their peers that belong to highest social classes (Krstić and Žarković-Rakić, 2017).

The ongoing analysis is in line with Branko Milanović's (2014) rather sobering conclusions regarding the 'balance sheet' of transition. By taking into account all countries in Eastern Europe and two main indicators – the recovery of pre-transition income levels (real income achieved in 1990, as measured by real GDP per capita) and income inequality (as measured by the Gini index) – in the bottom group of 'clear failures' are seven countries that also include Serbia and Bosnia and Herzegovina. Most people's expectations on 9 November 1989, that the newly established capitalism in Eastern Europe will result in economic convergence with the rest of Europe, moderate increase in inequality and consolidated democracy, has clearly not materialised in most cases: "The Wall fell only for some" (Milanović, 2014).

9. Conclusions: Lessons learnt

From a long-term historical perspective, five main lessons can be drawn from the forty-five-year experience of socialism in Yugoslavia and the nearly thirty-year experience of capitalism in Yugoslavia's successor states.

(1) It is in principle possible *to reconcile socialist objectives and ideals with key features of the market mechanism*. The Yugoslav experience of market socialism that lasted for four

decades suggests there are ways of combining the most important socialist objectives, such as preventing major income inequalities and ensuring fast economic development in order to provide increasing living standards for the whole population, with elements of the market mechanism and forms of economic democracy meant to ensure major enterprise initiative, motivate entrepreneurial spirit and strengthen workers' incentives. In the Yugoslav case, however, the failure to create a more efficient governance mechanism at the federal level, that would have accounted for the regional diversities and interests of its republics and regions through more adequate macroeconomic, regional and development policies, produced a system that failed to deliver initial expectations.

(2) It is important to have a *political consensus* among a country's constituent parts on the benefits of a political and economic union. The Yugoslav experience illustrates how an economic system based on innovative approaches that combined the best of all possible worlds – socialist principles and planning to attain wider social goals, the market mechanism to increase efficiency and workers' participation in decision-making and profits to strengthen incentives – can be destroyed almost overnight if there is no political awareness and consensus regarding the benefits of maintaining a political and economic union.

(3) The *costs of disintegration* of larger political and economic entities can be extremely high and unpredictable. The break-up of a multinational, multiethnic and multicultural country such as was Yugoslavia can have devastating political and economic consequences, especially if accompanied by extreme political turmoil – military conflicts, international sanctions, displacement of populations, exclusion from international organisations and western countries' donors programmes.

For over forty years, Yugoslavia was a free trade area, a customs union, a common market (which entailed, at least in principle, the free movement of goods, services and factors of production), an economic union with substantial coordination of most economic policies, a monetary union (which entailed coordination of monetary policy by the central bank, a common currency and a common exchange rate policy), and a political union – thus fully

corresponding to Balassa's (1961) concept of "complete integration". Although it was hoped that political independence of the former Yugoslav republics would facilitate the attainment of important political objectives and enable faster economic development, these objectives have in most cases been achieved only very partially.

The break-up of the economic union has resulted in the fragmentation of the region with many negative consequences – the drastic reduction in trade and economic links, loss of economies of scale, destroyed infrastructure, limited interest of foreign investors due to high risk and smallness of markets (Estrin and Uvalić, 2014). Disruptive political events can have extremely profound and long-term economic consequences, which later even the best policies cannot easily compensate for; the most recent estimates of the EBRD suggest that it could take the Western Balkans some 200 years to catch up with the more developed countries in Europe (Sanfey and Milatović, 2018).

(4) *Pragmatic policies based on path dependency and continuity* have higher chances in attaining better overall economic results, than policies based on a sudden rupture with previous institutional arrangements. Most of Yugoslavia's successor states have decided to implement a radical break from the previous model, some immediately and some much later, dismantling most elements of the socialist self-managed economic system. Although the legacies of the previous system were taken into account in the initial privatisation strategies which permitted in most cases the conversion of workers' self-management into property rights, the later concentration of ownership along with the adoption of a liberal model of capitalism typically produced a system with very weak state institutions, which has been detrimental for economic development, labour market adjustments and social inequality.

Slovenia has had a much more successful and smoother transition, pursuing a model based on gradualism and continuity, adopting institutional features built on the previous experience rather than radically breaking with the past, thus preserving some of the advantages of the previous economic system. However, Slovenia had political stability – the main precondition for positive outcomes, not present in the other countries.

(5) The Yugoslav experience points to the importance of *consolidating democracy* in countries that are still young democracies, as are those in the Balkans. The experience of Yugoslavia and of its successor states suggests that in undemocratic regimes governed by authoritarian political leaders, wrong policy choices can easily be made by individuals to the detriment of the population at large, with long-term effects for entire generations.

The current form of capitalism introduced in most countries of former Yugoslavia has brought many undesirable economic and social consequences. Given the unsatisfactory longer-term outcomes, it would be desirable if these countries were to turn towards a more social-democratic model, as has happened to a large extent in Slovenia. If we consider the very high costs of disintegration, military conflicts and international isolation that most of these countries have incurred during the 1990s, and the additional costs of numerous negative consequences of high income inequalities – like greater social tensions, high criminality and poor institutional capacity of the state – these costs could indeed become much larger than the benefits provided so far by capitalism (Popov, 2017). For these reasons, it is to be hoped that a more balanced political and economic system may be established in the Balkan countries in the future.

These five lessons from former Yugoslavia and its successor states are also quite relevant for what is happening today in the European Union (EU):

(1) The possibility to reconcile socialist principles and the market ought to lead to a rethinking of the suitability of the hyper-liberal austerity model to an EU which is still paying lip-service to social solidarity (the Social Pillar of the Council of Gotenberg);

(2) The need for political consensus, which seems to be absent or insufficient within the EU at large, with diverging views about a wide range of issues, from austerity to migrations, from banking to defence and more – see for instance the latest manifesto signed by eight EU countries (Holland, Sweden, Finland, Denmark, Ireland and the three Baltic states) rejecting a Transfer Union, a Eurozone common budget and Ministry of Finance, and demanding stricter fiscal constraints than at present;

- (3) The immense costs of disintegration, in view of Brexit and other possible exits from the EU not only by other member states but also of regions like Catalonia;
- (4) The superiority of continuity with respect to abrupt change (still relevant, though probably not as much as the other conclusions); and
- 5) The need to consolidate democracy, in view of authoritarian temptations present in several EU member states, such as Hungary, Poland and the Czech Republic.

Milica Uvalić

Professor in economics at the Department of Economics, University of Perugia

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