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SUB-COMMITTEE ON SOVIET ECONOMIC POLICY

THE YUGOSLAV ECONOMIC EXPERIMENT

Note by the Chairman

Included Corrig.
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17/4/66

In accordance with the decision of the Sub-Committee(1), the Economic Directorate has prepared the attached draft summary report in the light of the exchange of views on economic development in Yugoslavia held on 24th February, 1966.

2. This draft will be put on the agenda of the next meeting of the Sub-Committee, to be held on 24th March. The Sub-Committee, after having examined it, might wish to forward it to the Committee of Economic Advisers for further consideration.

(Signed) A. VINCENT

OTAN/NATO,
Paris, XVIe.

(1) AC/89-R/78

NATO CONFIDENTIAL

SUB-COMMITTEE ON SOVIET ECONOMIC POLICYTHE YUGOSLAV ECONOMIC EXPERIMENTDraft report to the Committee of Economic AdvisersINTERNAL SITUATION

1. Yugoslavia is, after Poland, the largest country of Eastern Europe both in area (255,800 sq.km.) and population (19.5 million). It is a mountainous land, of which only about 30% is arable. With around one half of the active population occupied in agriculture, it is still one of the least developed countries in Europe and comparable in this respect to Rumania and Bulgaria. National and religious differences are accentuated by contrasts in economic development, especially between the more advanced Northern regions (Slovenia and Croatia) and the still backward Southern ones. To facilitate the co-existence of the various national groups, Yugoslavia has adopted a federal constitution (6 republics and 2 autonomous regions).

2. The break with the COMINFORM in mid-1948 brought to an end the implementation of the first five-year plan (1947-1951) which had been drawn up according to the Soviet model and was based on close economic links with the bloc. After three or four years of economic crisis, important progress was made in the industrialisation of the country; the second five-year plan (1957-1961) was fulfilled one year ahead of schedule. During the period 1957-1960 the annual average rate of growth of the Net Material Product reached 11.8%, that of industrial production 14.1% and that of agricultural production 11.1%. This development took place in a rapidly changing institutional framework.

3. In industry, striking experiments were carried out, not only to overcome the economic difficulties, but also as a result of the concern of the régime to discover a new road to socialism, different from that of the Soviet bloc. The Federal Government retained, in particular through its price and credit policy, considerable control over the economy. On the other hand, there has been since 1950 a gradual development of workers' self-management through elected councils at the level of the enterprise, and of administrative decentralisation: the republics, the communes, and the enterprises were granted a large degree of autonomy. This brought increasing opportunities for market forces to come into play.

4. From 1953 onwards, agricultural policy was also changed. It was recognised that collective farming should be the result of persuasion, not of coercion. Farmers were allowed to withdraw land and livestock from working co-operatives; obligatory sales to the State were abolished; guaranteed minimum prices introduced and land taxation reformed. The peasants who joined general co-operatives were given special facilities to finance investments, which consequently increased. On the other hand, the maximum size of private holdings was lowered from 25 to 10 hectares (15 in exceptional cases). Private holdings - the size of which average 3.4 hectares - account for 87% of total arable land. Such fragmentation seriously hampers modern farming.

5. The third five-year plan (1961-1965) which had started under favourable auspices quickly got bogged down in mounting economic difficulties and was quietly dropped in 1963:

- there was a series of poor harvests; these were mostly due to bad weather, but partly also to vacillations in the policy of the authorities towards private versus collective farming;
- wages were raised by workers' councils at a faster rate than that of the growth of productivity which was dampened by too great equality in wages;
- excessive and ill-distributed investments resulted in simultaneous shortages and gluts of various products;
- unrealistic and arbitrary price fixing (prices are still controlled by the State for 80% of the industrial products) led to inefficient use of productive capacity.

These difficulties were partly due to the fact that Yugoslavia had kept several features of an orthodox Communist economic system, while she was introducing elements of one of a market economy; she had relinquished the corrective of the former system (i.e. coercion) without having fully acquired the corrective of the market forces. In such circumstances, strong inflationary tendencies appeared in the Yugoslav economy; the cost of living index increased by 30% from 1959 to 1962.

6. To correct this situation, the authorities took deflationary measures which were prematurely relaxed or removed when the economy began to feel the pinch. In particular, restrictions on consumer credits and investment were applied in 1962, and again in October 1964, and further measures, including freezing of prices, were introduced in March 1965. Such a policy involved some return to a more centrally run economic system. It did not succeed in stabilizing prices: from 1962 to 1964, the cost of living index rose by 18%. Although it resulted in wide fluctuations in the pace of economic expansion during the period 1961-1964, as a yearly average, the net material product rose by 7.9%, industrial production by 11.3%, but agricultural production by only 2.6%.

7. These short term stabilization measures, were followed in July 1965 by an economic reform, which, in view of its scope and effects, has been considered by some as a revolution. It aims at making market forces play a growing rôle in production and investment orientation. Rather than solving the difficulties inherent in a developing economy by a return to rigid centralization, it fosters the autonomy of the enterprise and relies on competition to introduce a measure of discipline into the economic decisions of the workers' councils. The main steps taken were the following :

- A revision of the tax system, which reduced the share of funds at the disposal of the Federation, the Republics and the Communes, leaving a larger percentage of the profits (71% instead of 51%) to the enterprises for self-financing.
- The chief responsibility for distributing investment funds has now devolved on banks; this is likely to leave more scope for purely economic considerations as the banks may show greater discrimination than the State in their selection of enterprises wishing to expand.
- "Political" prices for raw materials, production bonuses and State subsidies to unproductive enterprises have been abolished.
- Agricultural prices have been increased substantially.
- Workers' councils have been urged to ensure that wage increases reflect a growth productivity, and to admit greater wage differentiation.

8. The first results of the reform seem to be of a somewhat mixed nature. The most spectacular one was a sharp rise in prices which was to be expected, as a result of the upward adjustment of agricultural prices and the abolition of makeshifts such as political prices and subsidies. In October 1965, the cost of living index was nearly 50% above its level of October, 1964, and wages as well as most other personal incomes gradually followed suit. There has also been a rise in unemployment as enterprises laid off redundant labour in an effort to reduce their production costs. This has tended to encourage emigration which, as far as skilled manpower is concerned, may create problems for the Yugoslav economy. The reduction of State funds made available to industry may have sharpened the rivalry between the more developed republics and the less developed ones, the latter fearing for their investment projects, although a special regional fund, comparable to the "Casa del Mezzogiorno" has been created to help them. On the other hand, the authorities have been firm enough to maintain budget expenditure at the same level as that of 1964. The balance of payments has shown favourable signs and in particular the gold and exchange reserves rose from \$108 million at the end of 1964 to \$150 million at the end of November, 1965. Also production has made further progress: industrial output has increased by 8% from July to December, 1965. Although the risk of a relapse into economic and financial difficulties cannot be ruled out, observers consider generally that future prospects are fairly good and that Yugoslavia will be able to stabilize its prices, while maintaining a satisfactory rate of economic growth.

II. EXTERNAL TRADE RELATIONS

9. In 1951 the State abandoned its monopoly of Yugoslavia's external trade; since then there has been a gradual, if slow, relaxation of the many controls and restrictions imposed by the authorities on foreign transactions. In 1961 a single exchange rate (750 dinars = \$1) was introduced as well as a new customs tariff. The economic reforms of July 1965 were a further step towards the liberalisation of external trade. However, at this stage, government control over prices and imports is still fairly extensive.

10. The geographical pattern of Yugoslavia's foreign trade has been strongly influenced by the vicissitudes of its relations with the Communist countries. In the immediate post-war years efforts were made by Yugoslavia to direct as much as possible of its trade towards the COMINFORM countries; in 1947 these accounted for about 54% of total Yugoslav foreign trade. After the break with the Soviet bloc in mid-1948, trade with that area was brought to a complete halt within a year, not to be resumed until 1955. During these years of economic blockade by the Communist countries, Yugoslavia depended heavily on trade with the major Western Powers as well as on their grants, loans and defence aid. Since 1955, commerce with the COMECON countries has grown steadily; from about 10% of total turnover in 1955, it rose to about 35% in 1965.

11. This expansion of trade with other European Communist countries is largely due to an increase of Yugoslav exports. The USSR, for instance, has placed substantial orders with Yugoslav shipyards which otherwise would have been idle and it has helped other local industries by buying their products which could not find outlets in the Free World. However, Yugoslav leaders have stressed the difficulties of trade with the COMECON; it is hard to find a satisfactory method for fixing commodity prices and the non-convertibility of foreign exchange earnings reduces their value. They do not wish Yugoslavia trade with the COMECON to exceed a ceiling of 40% of total turnover.

12. The Yugoslavs have for many years now endeavoured to foster trade with the developing countries by granting credit on generous terms; during the last four years the share of these countries in total exchanges has fluctuated between 15 and 17.5%.

13. One of the main features of Yugoslavia's external trade has been the persistence of a trade deficit (\$430 million in 1964). In 1965, the stabilization policy and the devaluation of the dinar brought about a reversal of this trend; following a sharp rise in exports and a slight drop in imports, the trade deficit narrowed to \$196 million and for the first time since the war the overall balance of payments showed a small surplus (estimated at \$8 million). However, this results mainly from a substantial trade surplus with the COMECON countries; the balance of payments position with the hard currency countries remains strained.

14. Western economic aid has played a great part in Yugoslavia's economic development. The trade deficits, which until 1965 exceeded net earnings from services and private transfers, were financed mainly by grants and credits from the United States, Western Europe, the IMF and the IBRD. The largest contribution came from the United States and amounted to \$1.9 billion for the period 1946 to 1963 inclusive, to which should be added \$694 million worth of military assistance. Other contributors included the United Kingdom, Italy and France. To help in the implementation of the present reforms, Italy, in 1965, extended a loan of \$45 million, and the United States allowed credits in various forms to the amount of \$ 97 million.

15. Communist economic assistance has been modest. Before the break in 1948 only some \$23.7 million had actually been drawn by Yugoslavia on the substantial investment credits extended by the bloc. After resumption of political and economic relations, the USSR granted a loan in foreign exchange amounting to \$30 million and credits totalling about \$40 million tied to purchases of commodities. Poland, Czechoslovakia and Bulgaria also granted some small credits. It is believed that a Czechoslovak tender for a nuclear power station will be preferred by Yugoslavia to Western offers, in view of the favourable credit terms it contains.

16. In the commodity composition of trade in 1964, agricultural produce represented 30% of total exports, raw materials 13% and manufactured and semi-manufactured products 57%. On the import side, the share of agricultural produce equalled 13%, that of raw materials and mineral fuels 21%, and that of manufactured and semi-manufactured goods 66%. In the last few years, manufactured products have found relatively better outlets in COMECON and developing countries than in Western Europe or in North America. This is of significance for the future as Yugoslavia's expanding industry will continue to require new export markets for its production. On the other hand, the possibilities for Yugoslavia to expand exports of agricultural produce to OECD/Europe, its largest purchaser of foodstuff, seem limited by the increasing internal demand accompanying the improvement in standards of living, and by the common agricultural policy of EEC member countries. Yugoslavia has been seeking special arrangements within the EEC and EFTA to facilitate its exports.

17. During the last few years tourism has grown into a major Yugoslav industry. Together with emigrants' remittances (about \$60 million in 1965) it represents a substantial source of invisible revenue. For 1965 receipts from tourism have been estimated at about \$110 million; the Yugoslavs have great hopes that this figure will increase four-fold by 1970. Such a growth, however, involves important investments to improve the tourist resorts which compare poorly with those of Western Europe; with that end in view, the authorities are seriously considering the possibility of encouraging foreign investors to finance a substantial part of their ambitious projects.

18. Yugoslavia is a full member of several free world international organizations; in particular of IMF, IBRD and B.I.S. which have provided it with substantial technical and financial aid. It has a special position in two other international organizations :

- (i) Yugoslavia has been a provisional member of GATT since 1962 and applied for full membership in October 1965. A special working group set up to consider this application has recently recommended that the GATT Council accept it. To receive the full benefits of GATT, Yugoslavia will have to make concessions on tariffs and the use of quotas in bilateral negotiations, which are expected to be completed before the end of the year.
- (ii) Relations between Yugoslavia and the OECD are governed by the Agreement of 30th September, 1961 conferring on it observer status, except in certain fields where it is on an equal footing with member countries: annual examination of economic policies, agriculture and fisheries, scientific research and technical co-operation. It benefits from the organizations's technical assistance projects. Yugoslavia is clearly concerned not to let its participation in the OECD compromise a position equidistant from both the West and the East. During the economic survey of their country, the Yugoslav representatives accept joining in frank discussion with Western experts on their economic problems (1).

19. Yugoslavia has been participating, as from 17th September, 1964, in certain COMECON activities (2). Although it enjoys a restricted member status in certain committees, it cannot attend the meetings of the Executive Committee unless invited to do so. The Yugoslavs do not seem to be fully satisfied with the nature of their links with COMECON. They would like to participate as full members in the activities of the Committees which are of real interest to them (non-ferrous metals and electric power), and withdraw from the other Committees (Iron and Steel, Chemical industry, machine industry, scientific and technical, foreign exchange and finance questions).

III. CONCLUSIONS

20. Both the experiments carried out by Yugoslavia to re-organise her economy and the developments in her foreign economic relations are of great interest to the Alliance and of a nature to encourage helpful Western attitudes.

(1) See AC/127-D/196

(2) See AC/89-WP/155 (Revised)

21. It must be recognised that in several respects Yugoslavia has kept the features of an orthodox Communist system. In agriculture, the size of private holdings is very limited. In industry, collective ownership of the means of production is the rule. Also, the members of the League of Communists continue to hold key positions in the Councils at the various levels where economic decisions are taken. The League of Communists is still, though in a diminishing way, a factor of cohesion in this federal state, where the local communities and the enterprises themselves enjoy a large degree of autonomy. On the other hand, Yugoslavia has relinquished coercion as an instrument of economic administration. It has launched an experiment in industrial democracy in the form of workers' self-management which is unique of its kind. As early as the second half of the 1950's, economic decentralisation had gone far beyond what other Communist countries are now trying out or even contemplating. Although price control has temporarily been retained for many products, it is the intention of the authorities to restore the market mechanism and to submit the Yugoslav economy to the challenge of competition, both at home and abroad. Over the last decade, while these various adjustments were introduced the economic achievements of Yugoslavia have admittedly been uneven. On the average, however, they were rather good. From 1955 to 1964, the annual growth rate of the net material product reached 8.9%; this compared with 9.1% in Rumania and 7.9% in Bulgaria.

22. It is in the interest of the West that the economic reforms now implemented in Yugoslavia should be successful. They are apt to modify the Yugoslav society further in a way which is likely to facilitate economic - and probably other relations - with the West. The success of these reforms is also bound to encourage the Eastern European Communist countries to proceed with their own economic reforms and even to intensify them. Obviously, failure of Yugoslavia's experiment might result in restoring the influence of the hardest elements of the Communist parties, both in this country itself and in Communist Europe.

23. As far as external economic relations are concerned, after a swing towards the USSR and her satellites immediately after the war, there was, after the spectacular break with the COMINFORM in 1958, another swing towards the West, which for some years monopolised Yugoslavia's foreign trade and provided it with abundant financial assistance. Gradually, however, after Stalin's death, economic relations were re-established with the European Communist countries, so that a certain equilibrium between East and West has now been reached. While some people may regret that Yugoslavia re-established to some extent economic ties with her former Communist partners, others may consider that at least the present situation shows that a former satellite need not break completely with the COMECON countries to foster large and fruitful trade with the West. This may encourage the efforts of some Eastern European countries to extricate themselves from the Soviet bloc. Yugoslavia

is conscious of the danger that too heavy a dependence on the Communist countries in the economic field would create; it intends to limit trade with COMECON countries to about 35-40% of its total trade. It has already reduced tariffs and is preparing a further removal of trade barriers to comply with the GATT rules. It intends also to make the dinar convertible by 1970. Such a policy should benefit Yugoslavia's economy and promote closer economic relations with the West.

24. The maintenance of the West's present share of Yugoslavia's trade as well as the success of the economic reforms will, to some extent, depend on the attitude of NATO countries. Until now, Yugoslavia's balance of payments deficit with the Free World has been financed by Western grants, loans and credits. Yugoslavia is unlikely to be able to do without this kind of economic assistance for some time. But, if the debt burden is not to become excessive in relation to export earnings, the West will have to take due account of Yugoslavia's need for keeping substantial, and, if possible, growing outlets for its agricultural produce (maize, beef, pork, eggs, fruit, etc.) and to find ways of accepting a growing proportion of Yugoslav manufactured goods on its markets. In the absence of such developments, Yugoslavia may find itself compelled to seek new outlets in the East at the risk of becoming economically too heavily dependent on the COMECON countries and compromising its non-aligned position. There may even be greater interest for the Alliance in promoting closer economic relations with the West in the case of Yugoslavia than in that of other Eastern European countries. However, such a policy should not prejudice the legitimate trade interests of Free World countries, in particular those in the course of development.