THE ECONOMICS OF STATE-BUILDING IN THE FORMER YUGOSLAVIA

Ivo Bićanić

This working paper examines the economic aspect of state-building in the former Yugoslavia. Its main hypothesis is that during the process of division and in the first four years of economic independence each of the five successor states chose economic policy options which are leading to divergent patterns of economic growth. As a result, after four years, five distinct economies have emerged, each pursuing increasingly diverging growth paths. This divergence is even more striking when we remember that each of the successor states began with the same institutional framework, a common transition path, and a comparable level of macroeconomic instability.

We first consider the role of economic issues in Yugoslavia's decomposition. Two phases of the process are relevant. First, the build-up to disintegration reveals how over time the underpinnings of the Yugoslav economy slowly melted away. Second, the rising popularity of go-it-alone policies then advanced the segmentation of the Yugoslav economy.

We then turn to the paper's central theme, the economics of state-building in the five successor states. Three aspects of the process are highlighted: the way new national economies were set up, the transition paths chosen in each, and the way each tackled the extensive macroeconomic disequilibrium that they inherited or that developed along the transition path chosen.

The Build-up to Economic Disintegration

The build-up to Yugoslavia's disintegration developed over a long period without a clear beginning. During this period, the Yugoslav economy functioned as a unified economic space. There were no formal barriers to the mobility of goods or resources, and a uniform monetary and fiscal system was functioning, as well as a single foreign trade system. As a result, all agents worked in the same economic environment, so that the differences which existed were not systemic. This hardly means that it was a static period. The 1970s and 1980s were characterized by frequent institutional changes aimed primarily at developing self-management, short bursts of economic growth that never evolved into sustained growth, and continuous macroeconomic instability, leading to numerous failed attempts at crisis management. During that initial phase, three elements proved relevant to Yugoslavia's subsequent disintegration: the features of long-term development, the various institutional changes, and the debate among economists. It must be stressed at the outset that none of them was intended to promote the break-up of the economy.

Yugoslavia's Secular Development

Over the years, a voluminous collection of articles and books dealing with Yugoslav economic development has accumulated. Four recent works seem especially important. These are Mencinger (1992), Ottolenghi and Steinherr (1993), Bićanić and Skreb (1994), and Madžar (1993). All of them clearly show that the economy was unable to achieve sustained growth. The few periods of high growth, including the one of the late 1950s which, after careful examination, cannot be considered a "golden period" (Bićanić 1990), all petered out after a few years, leaving the economy in a state of macroeconomic disequilibrium. Furthermore, the cited works point to a secular slowing down in economic growth. The average growth rate in each subsequent period was lower than in the preceding one. While these developmental patterns were experienced by each constituent region, there was also increasing regional differentiation. Over time the range increased, as did most other measures of inequality. Another enduring feature of Yugoslav economic development was continuous macroeconomic instability. Together with instability came a long history of consistently failing efforts of economic crises management. (The first stabilization policy dates back to 1962.) Finally, an important feature of Yugoslavia's long-term development was the economy's virtually unchanged rank on the European development gradient.

Understandably Yugoslavia's secular growth was a disappointment. This growth did not meet the aspirations and expectations of its population (both those nurtured by the regime which promised the "land of milk and honey" and those derived from experience achieved through travel, tourism, and *gastarbeiters*). Slow growth provided an important stimulus for seeking alternative paths to address the long-term economic development.

The Institutional Setting for Division

Yugoslavia was known among economists not only for workers' self-management, but also for its frequent institutional changes. A prominent economist, Branko Horvat, perceptively stated that when the Yugoslav economy faced difficulties, policymakers reacted by changing the institutional framework. The complex and meandering evolution of the Yugoslav economic system lies outside the scope of this working paper.

The final institutional framework is, however, important because it might have acted either as a barrier against or an aid to the division and later break-up. The latter proved to be case. With one notable non-economic exception--the Yugoslav People's Army (JNA) and especially its reorganization in the late 1980s--the institutional framework did not impose significant costs on the establishment of new national economies. In this respect, two aspects of the institutional framework developed by the end of the 1980s are important. The first, of course, is the extent of economic federalism. Second, arguably the most important legislative breakthrough enabling an East European transition took place in Yugoslavia and was thus already in place when the new economies were being established.

Extensive economic federalism grew up in the fiscal, monetary, and payments systems. It was most visible in fiscal relations. Some authors argued that ideological, not regional, decentralization of public finance had eliminated most possibilities for a single fiscal policy. The only direct federal revenues were customs duties. All other taxes were collected by the republics and then transferred to the federal account. By the end of the 1980s, republics were even collecting the notorious "extra-budgetary account" (an account outside the budget which included most economic subsidies and thus income redistribution). In addition republics and communes had a certain scope for an independent fiscal policy. As a result, each individual republic and autonomous province possessed an integrated system for collecting various kinds of fiscal revenue. Similarly, the payments system was organized through the Social Accounting Service based, in turn, on the republic's and autonomous provinces' payments systems. In addition to handling monetary transactions, they monitored and collected data. Even the monetary system, which was least decentralized, had set up a system of republican national banks by the 1980s (Gajić 1989). Even though the independence of the republican national banks was limited, they were more than mere offices of the central bank. They had a some freedom in implementing federal monetary policy in the republics. The Yugoslav federation thus provided a decentralized institutional set-up and, no less important, the know-how and experience required to operate these systems at the republic level. In spite of this extensive decentralization, there is no doubt that the economic system was formally a uniform one. In addition to a single monetary and foreign trade system there were extensive legal provisions preventing barriers to internal trade and market collusion (Gajić 1989). Regional macroeconomic policies had limited scope.

As for the institutional framework, the ideological and political barriers to three important aspects of transition to a market economy had been overcome by 1990. The momentum for reform started in the early 1980s and spawned fours scenarios (in 1983, 1986, 1988, and 1989). Each one proposed a more radical overhauling of the system. By 1989 key legislative changes were under way. First, a privatization scheme had been defined. The legislative and institutional underpinnings it required, including regional ones, were largely in place by 1990 (Uvalić 1993). Second, market freedom, which already existed for goods and services, had been extended by lowering entry barriers, lifting limitations for new private enterprises, liberalizing foreign trade, and introducing the framework for limited factor markets. Third, most of the institutional protection for the "socialized sector" had been removed, and the nascent private sector could compete on an almost level playing field. All the legislative underpinning for transition policies had been passed in a rudimentary form, the ideological breakthrough had been made, and a Keynesian escape from entrenched ideas had largely been effected.

Debates among Economists

While many disputes among Yugoslav economists were bitter, no important ones were resolved, and too many served as proxy discussions for politicians. Four of these disputes were especially important for the break-up.

Discussions concerning the unity of the Yugoslav economy concentrated on the level of economic integration among republics and the way it changed over time. One group of economists argued that the level of integration was decreasing. They typically blamed the 1974 constitution for this, basing their conclusions on data on inter-republican purchases and deliveries. Others pointed to an initially low level of integration and offered other explanations, such as federal policies, oligopolistic behavior, and institutional contradictions, for small subsequent changes. No academic consensus ever emerged.

The second debate centered on the economic role of the federal government. Two widely divergent positions developed over time. The first argued that efficient economic policy requires a strong and independent central government. The opposite side argued for regionally based control over the central government, policies based on consensus, and extensive decentralization. These discussions were at their peak during two periods--the early 1970s and the late 1980s.

The third subject was regional redistribution. Economists from every single Yugoslav republic and autonomous province argued that their region was being drained of resources. The developed northern regions claimed that this was done by the foreign trade system, the exchange rate policy, and biased central government distribution of state trading deals. The less-developed south pointed primarily to their losses from low administered prices, especially for energy, which was their greatest resource. The issues were most intensely discussed in the late 1960s and mid-1980s.

The battle lines for the fourth debate over aid to the less developed regions were not surprising. The developed donor regions argued for better control of aid and its more efficient use, as well as for a downsizing of official transfers in favor of business oriented ones. The southern recipients pointed to rising regional differences and the so-called colonialist approach of the donors. They also staunchly defended their independence in the use of funds. Finally the middle regions believed that they should be left out of the donors' club because of their own lagging development. These discussions reached a peak in the early and late 1980s. The resulting exchanges fostered intricate links between economists and politicians. More than any other event, this last debate led to the intellectual maturing of the idea that Yugoslavia was only an amalgam of regions and ought to be studied as such.

THE ECONOMICS OF DISINTEGRATION

The fracturing of the Yugoslav economy started with the republican constitutional amendments passed from 1988 onward and lasted until the declarations of independence in two of Yugoslavia's successor states--Slovenia on 25 June 1990 and Croatia a day later. These dates do not coincide with international recognition of these countries, which began six months later, but seem more appropriate because from that time forward Slovenia and Croatia definitely started building new national economies. Two dominant economic features operating in opposite directions distinguished this phase--a process of increasing formal economic segmentation and the efforts of politicians to achieve a negotiated recontracting of the country.

Increasing Economic Segmentation

Formal economic segmentation emerged in the late 1980s. These initiatives came from republican administrations, but were publicized and frequently backed by federal propaganda and later backed by legislative decisions. These decisions quickly led to others. As a result, within a short period, institutions, markets, fiscal, and redistribution systems were divided. Understandably, with the formal development of segmentation, informal divisions also increased. The final result was that economic agents in the constituent regions faced recognizably different business environments.

Perhaps surprisingly, institutional segmentation came first with the republican constitutional amendments of 1988. While the Serbian constitutional amendments which abolished the autonomy in the autonomous provinces of Kosovo and the Vojvodina attracted the most political attention, the provisions regulating the generation and distribution of electrical power were the most significant economically. All of the power stations were reorganized into vertically integrated, one-sector enterprises along republican lines. More importantly, republican authorities could now set electricity prices that differed between republic and non-republic buyers. The new pricing system led to predatory redistributions, primarily from the energy deficient northern republics to Serbia, and, to a lesser extent, to Bosnia-Herzegovina. These changes were later declared unconstitutional by the Federal Constitutional Court (Djurović and Kusar 1990), but this did not prevent their further application. In early 1990, the newly elected republican parliaments (federal elections never took place) and governments in office (on both the republican and federal levels) increased institutional segmentation. Each republic started along its "go-it-alone" transition, backed by its own legislation.

This was most visible in their dealings with the federal privatization plan and its relation to the republican privatization options they chose. Each republic sought a different solution. Slovenia froze the application of the federal plan; Croatia outlawed it, making "social ownership" state ownership, and defined its own plan; Serbia dragged its feet when applying it and later replaced it; Macedonia accelerated its implementation, as did Bosnia and Herzegovina albeit at a slower pace.

Serbia created the only formal trade barriers to inter-republican trade, starting in late 1989. An internal tariff was imposed first on Slovene goods and then in 1990 extended to Croatian goods. The tariff on Slovene goods followed a public call from the republic's Socialist Alliance and government for a boycott of Slovene goods by Serbian consumers and industry. The republic also raised other informal trade barriers, especially for investments.

Most republics contributed to the breakdown of fiscal federalism in favor of segmentation. The process took three forms. For a start, the developed republics refused to pay their obligatory contribution to the Federal Fund for Less Developed Regions and the Solidarity Fund. The first to reduce these payments was Slovenia, by the 48 percent that was Kosovo's share among the recipients. This was Slovenia's direct answer to Serbia's internal tariffs. When Croatia and Serbia, each for its own reasons, also stopped paying into the fund, the boycott by the donor republics was complete. Second, republics refused to transfer turnover tax revenue to the federal budget. Finally, they withheld customs revenue, previously the federal government's only independent source of revenue. One republic, Croatia, unilaterally cut taxes on imported goods significantly, with no loss of revenue for itself. The federal government retaliated by imposing a separate tax to support the army.

Perhaps the most dramatic division occurred over the monetary regime. From September to November 1990, the National Bank of Serbia began expanding its money supply beyond its federally allocated limits. Serbian business banks simply received loans out of currency emissions. This major increase in the republic's local money supply led to income redistribution (the inflated purchasing power in Serbia attracted goods) and maintained the local "soft budget constraint." The effects were momentous. Apart from marking a major setback for transition efforts to impose financial discipline, the emissions coincided with republican elections in Serbia and significantly added to the popularity of go-it-alone policies.

Another case of predatory segmentation was the major territorial restructuring of firms. Many of the large firms that had operations in more than one republic found that their enterprises in Serbia were being re-registered in its courts as newly independent firms. The first to experience this were Slovene firms in late 1989 and early 1990, as part of the 1989-90 trade war between Serbia and Slovenia. Other republics' firms, including manufacturing plants, tourist facilities, and retail outlets, followed later. The changes took place without the knowledge or agreement of central offices. Seeing this, many firms with more traditionally educated managers tried to circumvent the process by swapping premises. This kind of swapping involved firms from all republics. The process ended by creating many "one-republic" firms. While the evidence for this is anecdotal, the results were obvious.

During the whole segmentation phase, it must be stressed, a federal government was in office and operating. Indeed one president of the federal executive council, Branko Mikulić, resigned and was replaced by another, Ante Marković. The latter made a last ditch attempt to reform socialism under the banner of "new socialism" (Marković 1989). He moved the whole economy further toward a market-oriented transition and started implementing a macroeconomic stabilization policy. Yet, in spite of these federal efforts, institutional and market segmentation grew. Multiparty elections further accelerated the process. In two republics, Croatia and Bosnia-Herzegovina, neither parliament nor the presidency were won by redesignated Communists; in two, Macedonia and Slovenia, the candidate of such a redesignated Communist party won the presidency and non-Communists controlled parliament; and in two, Serbia and Montenegro, such parties won both the presidency and the parliament in belated elections. In August 1990, events leading to the wars of Yugoslav succession erupted in Croatia. Membership of the federal presidency was changed to reflect the results of local elections, but direct elections for the federal parliament were not scheduled so that through all these changes the Communist-elected parliament of 1986 ran the federal legislature.

Economic Issues in Recontracting Negotiations

In this climate of rising segmentation and disparate election results, the federal presidency initiated talks aimed at renegotiating the Yugoslav federation--that is, redefining the relationships between constituent republics and the central government. Started in early 1991, the negotiations were to be bilateral, multilateral, and plenary. (The documents and proclamation are collected in Documents 1. 1990; Documents 2. 1991; and Documents 3. 1991.) They ended in late spring the same year after reaching an impasse. Two republics, Slovenia and Croatia, thereupon proclaimed sovereignty and, under European Union (EU) pressure, delayed proclaiming independence till autumn. With the proclamations of sovereignty, the shortest war of Yugoslav succession began in Slovenia. It lasted ten days and ended with the Yugoslav army evacuating Slovenia and moving into Serb populated areas of Bosnia and Montenegro. As soon as the Slovene campaign was over, the already-existing conflict in Croatia moved off the back burner and became full-fledged warfare. The war evolved into a low-intensity conflict following a January 1992 cease-fire after which the Yugoslav People's Army retreated from Croatian government controlled areas into Serb populated areas of Bosnia. The strengthening of the cease-fire in early 1994 did not lower the intensity of the conflict. The third war of Yugoslav succession began in Bosnia-Herzegovina in the spring of 1992.

During the 1991 negotiations, two initial proposals and one attempted compromise were tabled. The program of the presidential majority, led by Serbia, argued in favor of strengthening the federal government at the expense of the constituent republics. The second, Croatia and Slovenia's proposal, received equal attention. It argued in favor of a loose confederation arrangement and further decentralization. The third attempted a compromise. Bosnia-Herzegovina and Macedonia proposed an "asymmetric federation," a two-track Yugoslavia with some republics having a confederate relationship and some a federal one.

All of the proposals dealt with economic issues. All argued for a monetary and customs union, but they differed on fiscal issues and policy controls. The confederate proposals saw a central government financed by contributions from the republics and a federal government with no independent revenues. The proposal for a strong federation sought to increase the central government's fiscal independence. As the negotiations progressed, however, economic issues were not the main cause of disagreement.

DESIGNING AND BUILDING NEW NATIONAL ECONOMIES

Economic segmentation stopped on 8 October 1991, when the two northern constituent republics, Slovenia and Croatia, formally declared independence. The EU's Badinter Commission chose that date as the one on which Yugoslavia ceased to exist, rather than the commonly cited candidates, 25 and 26 June, when the Croatian and Slovenian parliaments passed declarations of independence; 15 December 1991, when EU countries decided to recognize two successor states; 20 December 1991, when the president of the Federal Executive Council resigned; 13 January 1992, when the first international recognition of Slovenia and Croatia took place (the Vatican was the first, EU countries followed on 15 January 1992); or even April 1992. The October 1991 date best suits the focus of this paper because from then onward two republics, Slovenia and Croatia, irreversibly launched their national economies. They were later followed by two more, Macedonia and Bosnia-Herzegovina, and finally by the remaining fifth, Yugoslavia (the federation of Serbia and Montenegro).

Despite the staggered declarations of independence and staggered international recognition of successor states (four were recognized over an extended period in 1992 and one remains a international outcast), a duality persisted in that federal institutions continued to operate formally until December 1991, when the president of the Federal Executive Council finally resigned.

Internally, it is difficult to determine a clean economic "cut-off point." For example, Croatia in April 1991 and Serbia in August 1991 passed privatization legislation that was mutually incompatible as well as incompatible with the federal legislation. In March 1991, Slovenia froze the implementation of federal privatization legislation, and in September 1991 Serbia unilaterally set up its own money supply. From the summer of 1991, the federal government operated as usual even though the parliamentary system was disrupted by members from two regions who refused to attend. As an example of dual government, the second phase of the federal macroeconomic stabilization plan began on 24 July 1991--after two republics started proceedings for their independence and two wars were already in progress. Likewise, in the summer of 1991, changes in the federal privatization plan and fiscal legislation were passed by government decree.

Economic Independence

Yugoslavia's disintegration spawned five new economies. None is large--the smallest has two million inhabitants; the largest just over ten million. They are scattered along the middle income range--pre-transition purchasing power parity per capita income ranges between $4,000 and $10,000. Compared to the twenty-two other new economies spawned by the post-1989 transition, they are in no way exceptional in size. Two among the five have fewer than four million inhabitants; another two have between four and six million; and one in the group has between six and eleven million. Regarding level of development, they are in the upper rank, indeed Slovenia may be the most developed of all economies in transition. In comparison with other European economies, they are among the smaller, with limited internal markets. For example, Denmark has the same population as Croatia, but a Gross Domestic Product (GDP) ten times larger. Overall the former Yugoslav economies are in the bottom half of the scale for European development.

The five main aspects of economic independence are monetary and fiscal sovereignty, a coherent business legislation, a separate foreign trade regime, and participation in international financial markets. These aspects are interrelated, but each has some special features.

All of the five new economies spawned by Yugoslavia's disintegration independently introduced a new national currency. Their experience here has been the same as that of all twenty-two new post-transition economies. None of the introductions turned out to be especially costly or prolonged, and none caused major disruptions of economic flows (Slay 1992; Bofinger 1993). Apart from the psychological tonic of monetary independence, there were two other important incentives. The first was defensive--that is, designed to prevent unfavorable income redistributions resulting from different levels of inflation and macroeconomic instability. The second was proactive because monetary policy is an inseparable part of independent economic policy, especially of transition and macroeconomic stabilization policies. With increasing segmentation and the break-down of federal control over the money supply, the successor states needed their own currencies. Achieving monetary independence was in all cases made easier by the general fall in internal and external trade resulting from the break-up and transition crises. Additional circumstances made monetary independence for a disintegrating Yugoslavia even easier. The first was the inherited system of republican national banks, which provided a ready-made infrastructure and supply of human capital and expertise. The second was the

Table 1

Basic Indicators of Yugoslavia's Successor States, 1992

	Bosnia-Herzegovina	Croatia	Macedonia	Slovenia	Yugoslavia*
Population (millions)**	4.4	4.7	2.2	2.0	10.3
Area (mil. sq. km)**	51.2	56.6	25.3	20.3	102.4
Population Density ***	81.0	81.0	74.0	93.0	104.0

* Serbia and Montenegro
Sources:
** *CIA Factbook 1992*, (Washington, D.C.: US Government Printing Office, 1993).
*** Statisticki godisnjak, Socialist Federal Republic of Yugoslavia.

Table 2

Basic Macroeconomic Indicators of Yugoslavia's Successor States before Independence

	Bosnia-Hercegovina	Croatia	Macedonia	Slovenia	Yugoslavia**
GDP (GSP) (1)					
1989 GDP p/c exc. rate (2)	1,609	3,182	1,581	5,675	2,158
1989 GDP p/c, ppp (3)	3,930	6,812	4,010	10,330	4,934
1989 GDP p/c, ppp (4)	3,590	7,110	3,330	12,520	4,630
1990 Unemployment Rate (5)	17.0	9.3	23.5	4.7	18.8*
1990 Inflation (5)	-	136.0	608.0	104.0	693*
Growth 1981-90 (6)	0.2	(0.7)	0.0	0.1	(0.7)

* data refer to Serbia from Nikolić (1992).
** Serbia and Montenegro
Sources:
(1) *Plan Econ* 6, No. 52 (28 December 1991).
(2) Marsenić (1992).
(3) Miljković (1992).
(4) *PlanEcon* 6, No: 52 (28 December 1991).
(5) *European Bank for Reconstruction and Development Transition Report 1993* (London: EBRD, 1994).
(6) Nikolić (1992).

Table 3

New Currencies in Successor States

Country	Currency	Date of Introduction
Bosnia-Herzegovina	five currencies	-
Croatia, temporary	Croatian Dinar	24/25 December 1991
permanent	Kuna	30 July 1994
Macedonia	Denar	26 April 1992
Slovenia	Tolar	6 October 1991
Yugoslavia*	Dinar	-
	new Dinar	24 January 1994

*Serbia and Montenegro

Table 4

Trade among Successor States

	Croatia				Slovenia			
	Exports		Imports		Exports		Imports	
	%	D	%	D	%	D	%	D
1992	-	-	-	-	23	-	20	-
1993	25	-	17	-	16	-36	11	-43
1994	23	0.2	11	-25	15	-2	8	-22

Sources:
Slovenia: Analiza gospodarskih gibanj v Sloveniji v letu, 1994 s projekcijo razvoja v letu 1995, Zavod RS za makroekonomske analize in razvoj.
Croatia: NBC Main Statistical Indicators, various issues.

warfare, which further severed the remaining economic links. The third was the complete breakdown of the federal monetary system. Individual republics began to control their own money supply and use federal foreign currency reserves for "self-service." Differentiated inflation rates between republics followed in late 1991. Three of Yugoslavia's successor states--Slovenia, Bosnia-Herzegovina, and Macedonia--introduced new currencies on independence. Croatia introduced a coupon (signed by the minister of finance and not the governor of the national bank) and later replaced it with a permanent currency when price stability was achieved. Serbia and Montenegro, still called Yugoslavia, introduced a new currency and subsequently denominated it under an anti-inflationary policy, as did Slovenia.

It was relatively easy for the successor states to establish independent fiscal systems. The federal tax regimes were initially kept unchanged, and the successor states simply inherited hyperinflation along with the monetization of their deficits.

All the successor states simply applied federal laws where republican ones did not exist. For business legislation, Yugoslavia was different from many other economies in transition. Firstly, it had an extensive market economy and no central planning or formal commands so that the legal infrastructure was largely in place. Secondly, the successor states inherited legislation underpinning the federal transition path. Of course they later changed and developed it, but they all started with coherent business legislation.

The creation of new states had important consequences for trade. Previously internal trade became international trade, and each successor state lost its protected markets in the former Yugoslavia. Transition-related trade liberalization made this loss even more acute, even though the four successor states that recognized each other (all except Serbia and Montenegro) signed mutual trade agreements. Although varying in technical detail, these agreements attempted to protect established trade links among the new economies by not imposing mutual tariffs and customs and enabling payments through separate "non-resident" accounts. In spite of these efforts, mutual trade among the successor states plummeted in all cases except one--Slovenian and Croatian trade merely contracted. Beyond the loss of market privileges, two other factors influenced this course of events. First, the warfare severed all economic links to Serbia, destroyed the Bosnian economy, and isolated Macedonia. Second, the transition crises led to a general reduction in trade through a fall in production and effective demand. Data collection makes comparisons difficult. Post-independence trade figures do not exist for Macedonia, and only two successor states, Slovenia and Croatia, have published statistics on the mutual trade of Yugoslavia's successor states. These indicate a successful diversion of trade (table 4). Immediately after independence Croatia was Slovenia's main trading partner and vice versa. Four years later, they are each other's third trading partner.

Recognition by the international financial community followed political recognition and United Nations membership. International financial organizations recognized all but Serbia and Montenego during May 1992. The new states were formally recognized as Yugoslavia's successor states, thereby inheriting part of the Yugoslav membership subscription, but did have to go through the procedure of new members.

POST-INDEPENDENCE ECONOMIC DIVERGENCE

Once independent the new economies had to tackle their various economic problems. The most crucial was the choice of transition policies to deal with macroeconomic disequilibrium and inflation.

Divergent Transition Paths

Each of the new economies spawned by Yugoslavia's dissolution inherited the same federal transition path, but it was not a full-fledged one for two reasons. First, it kept a slightly uneven playing field by maintaining some of the privileges for social ownership and not opting for complete privatization (Uvalić 1993). Second, it was not completely backed by coherent legislation. It was, however, an important starting point. Yugoslavia had sufficiently progressed down the road to market transition to have broken down most ideological barriers and had launched the aforementioned liberalization of foreign trade, removal of institutional and federal obstacles to "green-grass privatization," and the introduction of financial markets. The federal transition path had also advanced enough to cause the unavoidable post-transition crises that started in 1989 and were reflected in falling production and real incomes and rising inflation rates and unemployment. Equally important was the fact that this crisis came at the end of a decade of economic decline.

From that common starting point, the successor states chose, developed, and adapted their own independent transition paths. After three years, each of the transition paths is as different from those of other successor states as from those in other economies in transition. This divergence can be seen in both institutional and structural change. Transition is a process that requires major institutional changes such as altering property rights and ownership structures, especially privatization; setting up factor markets; introducing general market regulation; and passing the legislative underpinnings of a mixed-ownership market economy. Since these changes are among the first to take place, they best represent the features chosen for the transition path.

A comparison of the chosen privatization plans reveals some important distinctions. Overall the intensity of privatization is not related to the level of development. For example, Croatia is foremost, while Slovenia lags behind. The state plays an extremely important role in all of the privatization plans, although the level of its involvement varies from quite extensive in Serbia to more minor in Slovenia.

In all but Croatia, the successor states have adopted rigorous limits for the privatization plans proposed by firms (the largest are in Slovenia and Macedonia). Only

Table 5

Privatization Legislation

	Basic Legislation	Changes
Bosnia-Herzegovina	-	-
Croatia	April 1991	6 amendments**
Macedonia	June 1993	-
Slovenia	November 1992	1 amendment
Yugoslavia*	August 1991	2 amendments

* Serbia and Montenegro
**Comprehensive new legislation expected to be passed September 1995.

Table 6

Inflation Rates in Successor States

	Bosnia-Herzegovina	Croatia	Macedonia	Slovenia	Yugoslavia*
1991	na	149	115	247	120***
1992	na	937	1,651	93	8,990***
1993	na	1,150	244	23	180,000***
1994	na	-2.5	54**	16	0.0****

Source:
European Bank for Reconstruction and Development Transition Report 1994: Update (London: EBRD, April 1995).

*Serbia and Montenegro
**estimate.
***Savić (1995).
**** Ekonomska politika 2232 (16 January 1995): 12.

Serbia has designed a path that protects and maintains social ownership. Two--Slovenia and Macedonia--place great importance on prior commercialization. Only Slovenia institutionalizes vouchers, but all of the others envisage significant worker discounts. Only Macedonia has given pension funds a highly prominent institutionalized role. The others have relegated them to minor roles. Only Croatia has given revenue collection the highest priority and connected the revenue thus collected to financing transition costs and a war. Croatia, which was the first to pass a law, has frequently changed that legislation and even now is drafting a new privatization law. All except Serbia and Montenegro have included some form of deadline in order to speed up the process. Finally, only Bosnia-Herzegovina has not advanced along the road to privatization. (For a more detailed survey of the privatization paths chosen by the individual successor states see appendix 1.)

In addition to these differences, there are significant similarities. Many of them are shared with other economies in transition and thus represent the general properties of privatization. In general small-scale privatization has been successful, while large-scale privatization lags, especially in the most difficult cases--large regional employers and the financial sector. These economies have also experienced the abuses common to managerial buy-outs in medium and small firms. As in other transitional economies, vouchers or extensive discounts on the purchase of shares were used to muster public support for privatization. The state has also played a large role in the transition process. Finally, privatization has progressed very slowly. Every economy in transition, and the successor states are no exception, has expected it to go faster. Instead, as the process has progressed, controversy has also accelerated.

Macroeconomic Stabilization

Yugoslavia left all its successor states with extensive macroeconomic instability, largely because of the post-transition crisis. They experienced rising rates of hyper-inflation, falling industrial production and real wages, high and rising unemployment, and unknown government deficits. They were also left a legacy of failed stabilization policies, lasting and imbedded inflationary expectations (during the 1970s there were four waves of inflation), and extensive monetary substitution and de-monetization, with the German Mark acting as the reserve currency. Yugoslavia left another important legacy to the successor states--the failure of shock therapy. In January 1990, the federal government attempted devaluation with internal convertibility, denomination, tight monetary policy, and wage controls which months later ended in hyperinflation.

In addition to the inherited transition crises, macroeconomic instability in all but Slovenia was directly influenced by the wars of Yugoslav succession. Croatia and Bosnia-Herzegovina are involved in the conflict, Serbia and Montenegro face economic sanctions and provide economic supports to rebel areas, and Macedonia faces a Greek trade embargo. Undoubtedly this has helped to generate the large budget deficits whose monetization accelerated inflationary pressures, greater declines in production, very high social costs, and

Table 7

GDP Growth in Successor States

	Bosnia-Herzegovina	Croatia	Macedonia*	Slovenia	Yugoslavia**
1991	na	-14.4	-12.1	-8.1	-16.0
1992	na	-9.0	-14.0	-5.4	-21.3
1993	na	-3.2	-14.1	1.3	-37.4
1994	na	0.5	-7.2***	5.0	7.3
Aggregate Change of GDP	na	76.1	59.8	88.5	47.5

Source: *European Bank for Reconstruction and Development Transition Report 1994*: Update (London: EBRD, April 1995).

* Data refer to Gross Social Product.

** Data for Serbia and Montenegro refer to Gross Social Product. Source: *Ekonomska politika*, No: 2239 (6 March 1995): 34.

Table 8

Unemployement Rates in Successor States

	Bosnia-Herzegovina	Croatia	Macedonia	Slovenia	Yugoslavia**
1991	na	15.5	25.7	8.2	15.7*
1992	na	17.8	27.9	11.1	24.6*
1993	na	17.5	28.7	14.5	24.6*
1994	na	17.4	na	14.0	25.0*

Source: *European Bank for Reconstruction and Development Transition Report 1994* (London: EBRD, 1995).
* Savić (1995).
** Serbia and Montenegro

a dynamic, uncontrolled black market. Governments in two successor states went so far as to use inflation as a policy measure. Croatia did so until early 1993, and Serbia and Montenegro till the end of 1994. In both cases, the regimes introduced anti-inflationary policies only after price increases became counterproductive in raising government expenditure.

Inflation is not a phenomenon that can be left untackled forever, indeed even the governmental advantages--inflationary tax, monetization of the deficit, and seigniorage--are ultimately self-defeating. In addition, inflation is not only a direct consequence of transition strains, but also one of the principal barriers to its continued progress. As a result, each and every successor state has tackled the problem, most of them more than once. (For a brief survey of macroeconomic stabilization policies see appendix 2.)

Macroeconomic stabilization policies have varied among the successor states, as has their success. The disequilibrium was smallest in Slovenia. Croatia and Macedonia started from hyperinflation--Croatia's monthly rates reached almost 40 percent; Macedonia's were over 80 percent. Serbia and Montenegro recorded the second highest hyperinflation in history. Some estimated it at 1 percent a minute. Only Slovenia in late 1992 succeeded in its first attempt at macroeconomic stabilization. Others made halfhearted attempts--Croatia in mid-1992 and early 1993; Macedonia in April 1993; Serbia and Montenegro in 1992 and 1993. These attempts followed the pre-independence pattern of managing to reduce inflation temporarily before a new and higher wave started. All of the states that made halfhearted attempts eventually ended with hyperinflation. Slovenia and Macedonia used a new currency to launch an anti-inflationary policy; Serbia and Montenegro a redenomination; and Croatia introduced a new currency to strengthen an already-achieved price stability. Only Croatia went through an extended period of preparation to support a program; Slovenia only later instituted legal and institutional changes; Macedonia supported its program with minor changes; and Serbia and Montenegro avoided any major attempts to back up their program through legal and institutional change or other policy measures.

The policy options chosen in three cases--Croatia, Macedonia, and Serbia and Montenegro--are heterodox in nature, including tight monetary policy, internal convertibility, and fiscal restraint, but each added some specific element. Slovenia chose a classical policy of exchange rate and income regulation. Slovenia and Serbia did not rely as heavily on income policies as Macedonia, which introduced rigid wage policies, and Croatia, which put a wage fund cap on nonprivatized sector wages. Macedonia introduced explicit price controls for most important prices, while Croatia used moral suasion to control some infrastructural prices. Slovenia and Macedonia relied for a time on dual exchange rate structures, and Serbia and Montenegro did not try to reduce the fiscal deficit. They also reacted to interest rate increases in different ways. Slovenia successfully reduced them by policy measures; Serbia and Montenegro controlled them administratively; and Croatia attempted to control them by fiscal policies, but gave up so that they increased to inhibiting levels.

Table 9

Government Deficit (Percentage of GDP)

	Bosnia-Herzegovina	Croatia	Macedonia	Slovenia	Yugoslavia***
1991	na	5	na	2.6	24.3*
1992	na	3	-5.6	0.2	11.2*
1993	na	1	-6.8	0.5	33.1*
1994	na	0	na	-1.0	25.0**

Source: *European Bank for Reconstruction and Development Transition Report 1994* (London: EBRD, 1995).
* Savić (1995).
** Gligorov (1995).
*** Serbia and Montenegro

Table 10

Basic Macroeconomic Indicators of Yugoslavia's Successor States after Three Years of Independence (1994)

	Bosnia-Herzegovina	Croatia	Macedonia*	Slovenia	Yugoslavia*
GDP 1993 (in bil. US$) (1)	-	10.7	1.9	12.0	9.5
1994 GDP Per captia, exchange rate (2)	1,609	3,182	1,581	5,675	2,158
1992 GDP Per capita, ppp (3)	3,930	6,812	4,010	10,330	4,934
1994 GDP Growth (4)	-	1.0	-7.0	5.0	7.5
1994 Unemployment Rate	-	17.0	23.5	14.5	18.8
1994 Inflation (4)	-	97.5	115	130	0.0**

* Macedonia and Serbia and Montenegro still calculate the Gross Social Product as the basic macroeconomic variable.

** *Ekonomska politika* 2239 (6 March 1995): 34.

Sources:

(1) "The Military Balance 1994-1995," *IISS*, (London: Brassey's, October 1994).

(2) *World Bank Atlas 1995* (Washington, D.C.: The World Bank, 1995).

(3) *CIA Factbook 1992* (Washington, D.C.: U.S. Government Printing Office, 1993).

(4) *European Bank for Reconstruction and Development Transition Report 1994: Update* (London: EBRD, April 1995).

All the successor states experienced the usual results of macroeconomic stabilization policies implemented after a prolonged period of inflation. The intensity varied, however. The economic growth that followed anti-inflationary policies took its usual course--major remonetization (with increased confidence in the local currency, economic agents built up their money reserves), currency re-substitution (German Marks were substituted for local currency), currency appreciation (there was a demand for local currency resulting from re-substitution and tight monetary policy and excess supply of foreign currency), and a budget surplus that eliminated the central government debt.

There are two more important similarities among the anti-inflationary policies undertaken in all successor states. First, none of them had financial support from the international financial community (primarily the International Monetary Fund [IMF]) for their macroeconomic stabilization programs. Support received was at best moral and through expert advice (in Croatia and Macedonia) or absent (in Slovenia and Serbia and Montenegro). Second, in all cases, the lack of hard currency reserves was another serious constraint. Slovenia started with none, and the other three with inadequate reserves to support the policies.

By early 1995, these efforts had a varied track record. In Croatia and Serbia and Montenegro, inflation plummeted, while in Slovenia and Macedonia the reduction was gradual. In the medium term, the results were also different. Slovenia achieved enduringly low levels of inflation, and Croatia price stability with virtually no inflation. Macedonia stabilized price increases at manageable levels. After a period of price stability, Serbia and Montenegro began to experience another cycle of rising inflation.

The continued durability of price stability largely depends on the prospects for further sectoral and institutional restructuring. Croatia and Macedonia envisaged privatization and sectoral restructuring as the second phase. But in both cases these policies have been delayed. As a result, they could not capitalize on the psychological effects of successful anti-inflationary measures, so that their future implementation represents a separate set of policies requiring a new social consensus. The delay in both cases could threaten price stability. Serbia and Montenego and Slovenia did not explicitly combine the two. Slovenia, however, continued with transition policies that provided the backup for maintaining achieved low inflation rates. Serbia and Montenegro took the opposite course and have not proceeded with transition policies, with the result that a new inflationary wave is building.

CONCLUDING REMARKS

This paper has attempted to analyze the economic aspects of state-building in the former Yugoslavia. First it suggested that the final disintegration was preceded by a longer period of rising economic segmentation. Institutional segmentation in the economy started in 1988 with the crucial energy sector. During 1990 multi-republican firms broke up into single-republic firms. Institutional segmentation reached its peak in 1991 with the republican privatization legislation, whose chosen options were both mutually incompatible and incompatible with the federal legislation. Formal trade barriers appeared in 1990 in the form of internal tariffs and asymmetric taxes. The same year, federal economic policy collapsed when both fiscal and monetary discipline broke down with the draining of the federal budget and unilateral monetary policies from republics.

In spite of the segmentation, the five new economies spawned by Yugoslavia's disintegration started with two important common legacies. They inherited extensive macroeconomic instability, hyperinflation, and a track record of failed anti-inflationary policies. They were also on a transition path defined by institutional restructuring, privatization, and the first, and most drastic, stages of the post-transition crises. These common legacies did not prevent each successor state from choosing different policy solutions, policy sequencing, and policy timing to both the inherited economic problems of macroeconomic disequilibrium and the transition.

The policy consequences have led each successor state along a different path. The extent of macroeconomic stability varies from virtual price and exchange rate stability via manageable inflation rates to rising prices and exchange rates and the threat of new inflation. The transition paths have also led to different levels of privatization and sectoral restructuring, even though in this aspect the similarities are greatest.

Thus, after five years of applying different macroeconomic stabilization and transition policies, each of the successor states faces a different economic institutional environment, a different level of sectoral restructuring, and is in a different stage of price stability. As a consequence, the five successor states have diverged sufficiently to make them mutually as different as they are from other economies in transition across Eastern Europe.

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APPENDIX I

APPENDIX I

SURVEY OF PRIVATIZATION SCHEMES ADOPTED BY SUCCESSOR STATES

Bosnia-Herzegovina continued applying the federal privatization legislation by transforming large enterprises into holding companies, but actual privatization never got far. Before the war, privatization legislation was being prepared for parliament, but with the course of events such issues receded into insignificance.

Croatia was the first successor state to pass its own privatization legislation in May 1991--that is, during the segmentation phase--to be applied from June 1991 (Bićanić 1994b). The only idea maintained from the inherited federal privatization plan concerned the discounted sale of shares to workers. Because there was virtually no privatization in Croatia according to the federal plan, this idea had no effect. Since its passage, privatization legislation has been amended frequently (to attract foreign capital, to prevent flagrant abuses, twice to protect small shareholders, to stimulate secondary markets, to reduce public debt, and to enable three reorganizations), but the main features remained unchanged. Croatia opted for a privatization plan that is revenue-oriented (partly a result of wishing to use proceeds to finance a war and transition), state-dominated (the state vetted and monitored the implementation of firms' privatization plans), and accelerated (imposing a one-year deadline for firms to submit privatization plans, with almost 90 percent of eligible firms submitting such plans by then). It offers incentives for small shareholders (loans and discounts and extended grace periods). With virtually no foreign and very little domestic capital from a population that seems to have given greater priority to concurrent privatization of housing, the state, through its health and pension funds, or state-owned firms (most often banks using debt/equity swaps) frequently emerged as the unplanned buyer of last resort and the major enterprise owner. By spring 1995, all small, most medium-sized, and some large firms had transformed their ownership. The main abuses centered on small- and medium-sized firms and the way some, often incumbent managers, attempted to achieve their ownership. The most difficult privatizations remain the large, loss-making firms that are frequently dominant regional employers and the largest banks, many of which are still not rehabilitated.

Macedonia passed its privatization legislation in June 1993 as part of a comprehensive package of laws regulating most aspects of a private ownership market economy (Zec et al. 1994; Wyzan 1993). Previously it had applied the inherited federal privatization plan which was being implemented from 1990 onward. About a third of all eligible firms were privatized by this plan. The dominant method was managerial buy-outs (and hence mostly medium-sized firms), but numerous abuses concerning evaluation and share sales led to a revision of the whole process according to new legislation. The privatization plan chosen by Macedonia gives a prominent role to prior commercialization (there are no "give-away" schemes) and reserves ownership for pension funds (15 percent of assets). It has also meant a slow process of privatization that gives the state a prominent role in vetting and monitoring as well as initiating plans. The plans themselves were highly regulated privatization schemes with many limitations and proportions defined by law. They have provided a special market niche for workers, with discounts of up to 90 percent. In addition, numerous business firms outside the public sector have been excluded from privatization. Non-economic circumstances permitting major progress in accelerating privatization, including large firms, are expected in 1995.

Slovenia passed its own privatization legislation in November 1992, after bitter controversies and two drafts turned down by parliament. The impact of federal privatization had been small because soon after the non-Communist government was elected in early 1991 parliament passed a bill that suspended the further application of federal legislation. The law did enable enterprise reorganization and "green-grass privatization." During the interregnum, before the new law passed but after the inherited one had been suspended, the government tackled the issue of loss-making firms by designing commercialization plans. The privatization law's passage followed an intense and very heated debate along the usual lines of mass and quick privatization with vouchers versus slow privatization involving prior commercialization and little government interference. The result is a compromise that uses a complicated formula to merge the two approaches. The formula sets proportions for the relationship of three privatization methods used ("give-away" schemes organized through vouchers and investment funds, internal discount sales favoring managerial buy-outs, and external commercial sale of shares), decentralized privatization (the plans are submitted by enterprises, without other than the general one-year deadline), state vetting, and monitoring. Privatization got off to a slow start but significantly accelerated in 1994 (over 90 percent of enterprises submitted privatization plans). Furthermore the voucher system did not fulfill the great expectations placed in it. Many vouchers were not even distributed. The major challenges of privatization remain--the large, loss-making firms and bank rehabilitation. IMF conditionality for stand-by loans demands accelerated privatization, and individual firms have been targeted.

Serbia and Montenegro chose different privatization paths. Serbia experienced the most extensive application of the inherited federal privatization legislation, largely through internal shares--that is, manager and worker buy-outs (Zec et al. 1994; Bošnjak 1993). When it replaced the federal scheme with one of its own in August 1991, Serbia chose a system where the state vetted and approved plans and their implementation and evaluated assets. It also protected social ownership and state influence, reduced the scope for internal buy-outs through shares or other means, and did not impose any deadline, thereby opting for slow privatization. The immediate effect of the law was a change from dynamic privatization by federal law to an almost complete halt in privatization applications. There was a small increase in inflation in 1993 because the system was set up so that inflation undervalued assets. But privatization remained a very low priority. In addition, a large state sector of firms not earmarked for privatization has been built.

Montenegro passed its privatization legislation in late 1992 (Zec et al. 1994). The chosen system enables firms to select their privatization scheme under strict state tutelage that prepares firms, evaluating assets as well as monitoring the process. It also provides incentives, such as discounts, for workers. An important feature is that through successful privatization social ownership will be eliminated from the economy. In spite of this legislative and institutional framework, privatization has not gone far. By the end of 1993, only 10 percent of all firms had been privatized. Furthermore the main privatization challenge--banks and large firms, most of which are loss making--remains untackled. The different paths further diverged in early 1995. Serbia revised both completed privatizations and those in progress by revaluing assets bought, thereby annulling past privatization and virtually freezing the process. Passing such laws with retroactive effects will, among other things, further undermine the faith in the rule of law in Serbia. Montenegro decided to accelerate privatization by introducing a 10 percent "give-away" scheme, prolonging loans used for shares, and decreeing that privatization should be completed by 1996.

APPENDIX II

APPENDIX II

MACROECONOMIC STABILIZATION POLICIES IN SUCCESSOR STATES

Croatia used inflationary policies to help finance the war and did so with remarkable success (Bićanić 1994a). There was neither rationing nor shortages, and inflation was kept below 20 percent a month. But when inflation reached hyperinflationary levels, well beyond the level of the inflation tax, in the autumn of 1992, Croatia attempted its first macroeconomic stabilization policy. This policy gave only temporary relief, and a new wave of inflation started in the summer of 1993 leading to hyperinflationary levels by the autumn of 1993. A determined effort to reduce inflation could not be avoided, and a heterodox three-step macroeconomic stabilization policy was inaugurated in October 1994. The policy's first stage centered on inflationary expectations and involved a devaluation with internal convertibility, wage control for the non-privatized sector, tight monetary policies, and tight fiscal policy. The inflation rate plummeted to levels unexpected even by the government. Since December 1994, Croatia has, for the first time in its modern history, experienced price stability. The policy's second stage, planned for 1995, involves further privatization and sectoral restructuring, especially of large regional employers and the finance sector. The second stage is being implemented as an uncoordinated policy with a year's lag. The third stage--active promotion of high sustained growth--remains for the future. The success of Croatia's policies lies in the failures of the previous two macro-stabilization policies. Even though each only managed to contain inflationary pressures temporarily, they prompted important measures that later emerged as prerequisites for success. These were continuous steps to increase central bank independence, preparation of major business laws, the transfer of private, frozen foreign currency savings into the public debt, and the elimination of the general and central government deficit by late 1993. Economic trends following these anti-inflationary policies took a typical course--major remonetization, currency re-substitution, currency appreciation, and a budget surplus that eliminated the central government debt. A stand-by arrangement with the IMF was signed in October 1994.

Macedonia experienced two macroeconomic stabilization policies (Wyzan 1993). Its legacy from Yugoslavia was the loss of subsidies, resulting in an increase in the budget deficit at the time of independence. Monetization of this deficit led to inflation. The first anti-inflationary program started in April 1992, but its implementation was halfhearted. It was a semi-heterodox policy. Its heterodox aspects were a tight monetary policy, fiscal restraint, and an incomes policy, but it also included partial price control and a dual exchange rate system. Even though a new national currency was introduced, the government did not capitalize on the opportunities this step offered. Nevertheless there was some success in lowering inflation and stabilizing the foreign currency market. Once the effects of the stabilization policy waned and inflation began rising, a newly elected government undertook a more vigorous macroeconomic stabilization effort, politely called the supplement to the original plan, in October 1992. This program was supplemented in the summer of 1993 with legislative change in the foreign trade regime. Despite the lack of a comprehensive stabilization policy, price increases were kept at manageable levels that have not changed much over time. The Macedonian economy has not, however, addressed most of the issues causing disequilibrium, such as real wages, parafiscal imbalance, and unemployment. It also confronts an extremely unfavorable external environment of tensions with all but one neighbor, Bulgaria. Greece imposed economic sanctions on Macedonia from 1994 to mid-1995. Albania has developed economic and communication links with Macedonia, but its concern for the large Albanian minority is a source of tension.

Slovenia was the first of the successor states to tackle inflation and succeed (Mencinger 1993; Štiblar 1994). A pragmatic, independent stabilization policy aimed at fiscal restraint and consolidation was adopted in May 1991. Pragmatism was important since many policy instruments, especially monetary policy, were not yet available. After independence in October 1991, economic macrostabilization policies were given top priority. In this way, Slovenia started tackling inflation while rates were reasonably low--under 20 percent per month. Circumstances permitted a more coherent policy, but Slovenia's choices were still limited by the lack of foreign reserves or access to international capital markets. The chosen policy was a classical one--exchange rate and monetary measures. Initially incomes and fiscal policy had no role. Especially important was the reshaping the foreign exchange market. Monetary policy was designed to absorb excessive bank liquidity gradually.

Implementation of the stabilization policy coincided with and significantly benefitted from independence, receiving a major psychological boost from a new currency, the *tolar*. Once inflation was reduced to manageable levels and an institutional framework had been constructed, policies were modified. Fiscal policy provided support through a budgetary surplus, and public sector pricing was made more coherent. But with no effective incomes policy, real wages increased despite some restraint caused by fear of further war. Slovenia succeeded in lowering the inflation rate gradually, and it achieved the targeted level of 2 percent a month in June 1992, just nine month after starting. Slovenia experienced all the usual developments described above--a budget surplus, appreciated currency, and currency re-substitution. The inflation rate was first lowered to manageable proportions, 30 percent a year, and later 16 percent. Because Slovenia was the first to try and achieve lasting price stability, its economy is already experiencing the lasting effects of macroeconomic stability, and economic policies are geared to maintaining moderate inflation levels. This is true in spite of the lag in privatization. Thus the government budget started in surplus and has since developed a manageable deficit due to active economic intervention. The currency appreciated with price stability, and its exchange rate has since remained stable. Real wages have been increasing, much to the alarm of economists who fear for their effects on competitiveness. Future durability still depends on the progress of lagging privatization and an incomes policy that remains the weakest point in Slovenia's macroeconomic stability.

By the end of 1993, Serbia and Montenegro experienced the second highest inflation rate ever recorded, large declines in production, and rising unemployment (Madžar 1993).

Economic sanctions, while not crippling (Palairet 1993; Hanson 1990), imposed major economic costs and promoted an increasing dependence on the black market (Minić 1993). Serbia's government has also continued applying traditional "Yugoslav" stabilization through frequent partial measures dominated by political considerations and ending in failure (Madžar 1993; Dyker 1993). When hyperinflation threatened to replace even the traces of a monetary economy with complete barter, however, macroeconomic stabilization became unavoidable. Adopted in January 1994, it was appropriately called the "program of monetary reconstruction" (Savić 1994 and 1995; Gligorov 1995; Madžar 1995). Again the program offered was complex--monetary reconstruction, stabilization, and partial economic recovery. To anchor the program, a new currency was introduced with internal convertibility and a currency board to monitor it. The fiscal deficit was reduced, while an income policy without administrative controls left room for real wage increases. Prices were left unregulated, except for infrastructural prices and interest rates, which were kept low. It was even expected that the increase in incomes would lead to greater effective demand and then growth.

Initially and through most of 1994 the program succeeded. After monthly inflation rates dropped into the single digits, inflation stayed low. Real incomes increased, and production recovered. As expected, the economy experienced extensive remonetization and currency substitution. But the program was not backed by the necessary legislative or institutional change. Especially important was the burden of the still-huge government sector, officially estimated to account for 40 percent of national income, although some economists place the figure at over 70 percent. The program's success depended mainly on using currency reserves and producing growth from very low initial levels. Once the benefits of the new monetary policy were exhausted, the pressure on prices reemerged, so that by the end of 1994 inflation rates started rising. As a result, the lasting effect of this program seems doubtful. The inflationary pressures of early 1995 put the economy back on the road to high inflation.

Ivo Bićanić is a professor of macroeconomics at the University of Zagreb, Croatia. He completed postgraduate studies at St. Anthony's College, University of Oxford, and a doctorate at the University of Zagreb. A frequent contributor to works on the Yugoslav transition, he was a Fellow at the Woodrow Wilson International Center for Scholars in 1993-94.