

DEVELOPMENT LIMITATIONS AND POSSIBILITIES IN FR YUGOSLAVIA

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Introduction

Since its very creation, the Federal Republic of Yugoslavia has been subjected to the effects of highly strong uneconomic factors, which have had a decisive influence on the developments of its economy during the whole decade of the nineties. Firstly, there was the disintegration of the former Yugoslavia, which, with 24 million inhabitants and an achieved level of development of USD 5,500 (measured by the purchase power) in the mid seventies, was one of the most developed countries in the region. Secondly, by as early as the end of 1991, relations between Yugoslavia and the European Union, which was its most significant foreign trade partner, then as it is now, began to destabilise. This deterioration of relations was followed by the imposition of EU sanctions on FRY, the cancellation of the agreement on preferential trade and the banning of the possibility of crediting export arrangements from FRY companies. In 1992 and 1993 the imposed sanctions were additionally expanded and made more severe by the relevant UN Security Council decisions. Such sanctions remained in force more or less until the end of 2000. Thirdly, the warfare on the territories of Former Yugoslavia caused the worst refugee crisis since the Second World War. On the territory of FRY there were, or still are, over one million refugees from Croatia and Bosnian and Herzegovina, as well as internally displaced people from Kosovo and Metohija. Unfortunately, in spite of so many refugees and displaced people, Yugoslavia received the smallest amount of humanitarian aid per person from the international community, which was exclusively the result of pressure exerted by the developed countries. And finally, the fourth, but, as regards its effects on the Yugoslav economy and especially on its infrastructure, very significant factor, was the NATO bombing of the Federal Republic of Yugoslavia from 24 March to 9 June 1999. These stated four groups of uneconomic factors had a decisive influence on the possibilities of economic development in FRY in the nineties and caused, besides the poor inheritance from Former Yugoslavia, FRY to become one of the most underdeveloped countries in Europe and the surrounding region. Certainly, one cannot deny the fact that the political system, which was in power in FRY during the nineties, and which was based on the preservation of an obsolete economic system inherited from Former Yugoslavia, and on state property, was one of the key reasons for such developments and for the present state of the FRY economy. However, it is also true that such a political system had an extensive “support” from factors beyond the FRY in producing the results that are presented hereafter.

Present Situation and Inherited Problems

FR Yugoslavia has inherited from Former Yugoslavia an obsolete and unfavourable structure for the creation of and use of the GDP. With regard to the creation of GDP, the primary and secondary sectors dominate, with a great emphasis on the production of raw materials, energy and food (agriculture), and an over-large share of the state and social sector, plus the domination of huge and inflexible economic systems. In the distribution of the created product consumption dominates, both personal, general and public, which is excessive in comparison with the development level of the country, while the investment share was being systematically reduced until the eighties, creating a bigger and bigger technological gap between the economy of FRY and the economies of developed countries, and the surrounding countries. This resulted in a drastic drop in production and creation of products, as well as

in the fall of total productivity, and all this was followed by a proportionately inadequate reduction of total employment.

During the last decade, the inherited unfavourable structure became even worse, primarily due to the effects of the stated uneconomic factors. Firstly, due to the disintegration of the market and various obstacles to a free trade that the republics of Former Yugoslavia imposed on one another, many goods that were not produced on the territory of the present FRY became deficient. This activated the self-sufficiency ideas realised through the concept of import substitution, which was, however, done in the absence of competition because FRY was isolated, and it was not possible to compare business performance efficiency. The result of this was a production that, frequently, was not competitive, neither in terms of quality, quantity, assortment, nor prices. Such production is doomed to failure the very moment the country opens up to the world.

Table 1. Basic macroeconomic indicator (previous year = 100)

- real rates in %

	1991	1992	1993	1994	1995	1996	1997	1998	1994-1998	1999 ¹	2000 estimate ¹
GDP											
Total	-11.6	-27.9	-30.8	2.5	6.1	5.9	7.4	2.5	4.9	-17.7	8.0
Social sector	-15.6	-32.5	-36.0	-5.0	2.1	7.9	5.1	1.0	2.1
Industry	-14.3	-22.9	-38.1	1.2	4.3	7.7	9.9	3.9	5.3	-24.8	11.8
Agriculture	9.3	-17.7	-3.7	5.9	4.0	1.1	7.0	-2.8	3.0	-1.1	-19.7
Employment											
Total	-3.0	-3.4	-2.8	-2.1	-1.4	-0.5	-1.5	-1.8	-1.5	-2.5	-2.7
Social sector	-7.7	-4.5	-3.7	-2.9	-2.9	-1.7	-3.1	-2.5	-2.6	-3.1	-4.1
Industry	-7.0	-5.2	-2.7	-2.3	-2.7	-2.1	-3.8	-2.9	-2.7	-3.8	-5.5
Labour productivity in social sector	-8.6	-29.3	-33.5	-2.2	5.1	9.8	8.5	3.6	4.8
Exports	-19.1	-46.0	15.0	-49.2	3.3	31.8	32.7	6.8	-23.8	-46.9	15.0
Imports	-25.6	-30.4	-21.4	-37.5	40.5	54.5	17.2	0.5	-27.6	-30.4	12.6
Average net salary	-5.0	-49.0	...	314.0 ²	14.0	1.2	21.2	1.9	9.2 ³	-15.1	6.1
Growth or retail prices	121.0	9.237	116 ⁴	0.0 ²	74.1	93.1	18.5	29.8	51 ³	42.4	75.7
Gross assets in fixed assets	-14.7	-29.9	-37.6	-12.0	-3.7	-5.7	0.8	-2.2	-4.7	-7.8	21.2

Source: Federal Secretariat for Development and Science based on the data from the Federal Institute of Statistics (FIS).

1 Without the data for Kosovo and Metohija.

2 December 1994/February 1994. Since 1994 data related to average net salary were calculated according to the method applied from January 1997. (total salaries/total number of employed).

3 Refers to the period 1995-1998.

4 In thousands of billions.

Note: The basis for calculation of average rates for national products and gross investments in fixed assets are dinar values from 1994.

Secondly, the sheer biological survival of the nation imposed the concept of forcing the production of food, energy and medicines, and these economic branches had the smallest production drop in comparison with the production level achieved in 1990. According to some calculations, it was proved that this conditionally termed "biological" production minimum for bare existence of the nation was at the level of about 32-35% of the GDP achieved in 1990. In the next table the data are presented on the GDP trend in the period 1990-2000, which show that the minimum was nearly reached during the unprecedented hyperinflation in 1993.

Table 2. GDP of FR Yugoslavia 1990-2000

	In mil. USD	In mil. Din
1990	28,390	40,883*
1991	25,754	91,265*
1992	18,696	7,083,591*
1993	13,169	...
1994	14,285	24,119
1995	15,285	44,172
1996	16,477	79,039
1997	18,146	112,355
1998	18,491	154,584
1999 estimate	13,868	198,612
2000 estimate	14,978	376,807

Source: Federal Secretariat for Development and Science based on the data from FIS.

* The data were calculated in Dinars after the denomination of 01.10.93.

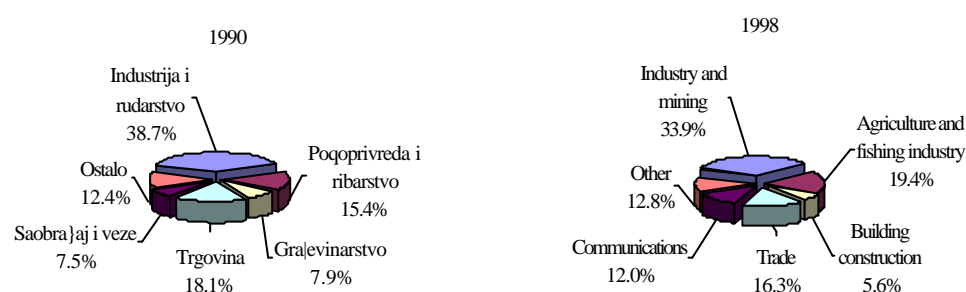
Solving the high budget deficit problem by printing money, which was done in 1992-93, resulted in an unprecedented hyperinflation that culminated in January 1994 at 313 billion percent per month. Printing money was preconditioned by two phenomena: firstly, the mass inflow of refugees and providing funds for their subsistence, which under the conditions of a drastic fall in production and consequently the budget revenues, was practically impossible from realistic sources; secondly, the funding of the various needs of Serbs outside FRY, to cover everything from food to military equipment, which, according to some estimates, in 1993, amounted up to 13% of the GDP, or was nearly equal to the proportion of net investments. The total collapse of the monetary, fiscal and foreign-exchange systems called for the adoption of the Programme of Monetary Reconstruction and Economic Recovery of the country, the implementation of which began on 24 January, 1994 (the so called "Avramovic's Programme"). As to the growth of the GDP and industrial production, positive results were achieved during the implementation of the Programme in the period 1994-1998, while macroeconomic stability was present only in some periods (1994 and 1997). However, in spite of the growth of production, exports and imports, it can be freely stated that, during the whole period of the implementation of the Programme, we had exclusively the phenomenon of economic growth, but not that of the development of the national economy. Namely, the economic structure, the level of market orientation, economic system institutions, the integration of the country in the international economic processes measured by the export and import levels, did not significantly change in comparison with the period before the sanctions and hyperinflation. Practically, due to the very low GDP base level at which the Programme was introduced, we had a plain growth of nearly all macroeconomic indicators while reflecting the same relations as we had had before. This refers primarily to the preservation of the solutions in the property relations based on the presence and domination of semi-state-owned property and big, inefficient and inflexible companies that systematically generate losses; then to the lack of support to small and medium businesses which should be the mainstay of the future development of the country; permanent postponement of serious commitment to the transition process, primarily in the monetary, fiscal and foreign-exchange systems.

The scopes and effects of the Programme were exhausted during the first year of its implementation and after that period it had to be abandoned. The basic problem was that only the monetary policy measures were used for the regulation of all economic developments. As the monetary policy measures in the conditions where there was no foreign support for the implementation of the Programme were insufficient, soon we had an increasing budget deficit, destabilisation of the macroeconomic situation and the general deterioration of performance by the national economy. The production growth that was maintained all the time through the 1994-98 period proved to be a mere illusion of change. In fact, it meant only further generation of the same problems Yugoslavia had been facing, more or less, since the oil crisis at the end of the seventies. The necessary structural adjustment that was not done at that time, and the maintaining of the same solutions in the economic system that had been applied so far, had its far-reaching consequences that are still felt. On the other hand, it has justified the position according to which it is not possible for the Yugoslav economy to come out of the crisis and achieve the characteristics of a country with a permanently sustainable development

without its full integration in all international institutions, accompanied by a radical change of the economic system and abundant international aid.

Various kinds of international aid expected by FRY in the ensuing period, should at least partly compensate the total damage caused within its territory during the last ten years. During the whole of the last decade, FRY was isolated from the world, and its citizens were denied one of the basic human rights stated in the UN Declaration on Human Rights – the right to development. Likewise, humanitarian law was breached through the jeopardy of normal diet and supply of foodstuffs, energy and medicines; the right to communication with the international community and to the international economic, financial, scientific, technical-technological and education-cultural cooperation, the right to education, employment and health care, the right to a healthy environment, etc. The total damage caused on FRY territory can be divided into three groups: (i) damage caused due to the sanctions of the international community; (ii) damage caused because of the disintegration of the common market of Former Yugoslavia and the separation of some of its republics; (iii) damage caused by the NATO bombing in 1999.

Chart 1. Structure of GDP formation per branches – current prices (in %)

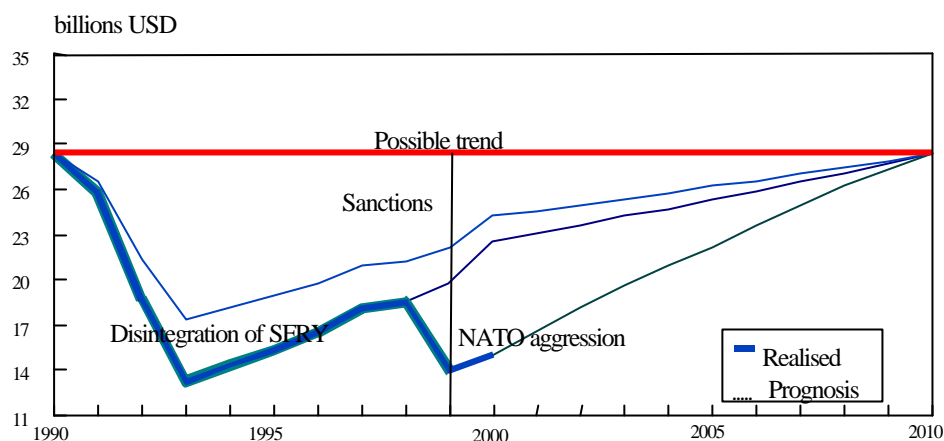


The total damage caused by these three factors amounts to hundreds of billions of US Dollars, and the most important thing is that the consequences are still felt and will be present for decades in the future. The most permanent consequences are those caused by the use of uranium-depleted weapons, which will pose a potential threat for a very long period of time. The next table shows the consequences caused by the three groups of stated factors.

Table 3. Total measurable FRY losses due to international sanctions and the disintegration of SFRY- in billions USD*

	1991-2000	2001-2010	1991-2010
Total measurable losses (a+b)	123.680	32.721	156.401
A. Losses due to USA and EU sanctions (1+2+3+4)	86.083	19.809	105.892
1. Unrealised GDP (industry and other sectors)	73.309	19.809	93.118
2. Financial losses ¹	0.765	-	0.765
3. Foreign funds that could not be withdrawn ²	3.009	-	3.009
4. "Brain drain"	9.000	...	9.000
B. Losses due to the separation of some SFRY Republics (5+6)	37.597	12.912	50.509
5. Unrealised GDP	27.947	7.551	35.498
6. Humanitarian aid	9.650 ³	5.361	15.011

SFRY- in billions USD*

Chart 2. *Losses of Possible GDP of FRY 1990-2010 Realisation and Estimation*

Development Limitations

It was the NATO campaign in spring 1999 that suspended all the recovery processes of the Yugoslav economy and possible positive growth of the GDP and industrial production, though with impaired macro-economic stability. Only in one year did the GDP of Yugoslavia drop by a quarter, or by about 25%, and the economic relations with the international community and the process of gradual reintegration in the markets of European countries were particularly affected. Besides the direct consequences shown through the drop of the GDP, the country sustained extensive destruction of infrastructure facilities and some huge industrial capacities. The damage caused by this factor have not yet been officially assessed by the State Commission for War Damages, but the prognoses range between USD 30 billion (estimates by the Economic Commission for Europe UN, from July 1999) to USD 50 billion (estimates by Yugoslav experts). Besides, the loss of human lives, a large number of wounded and permanently disabled people and the drastically deteriorated psychological state of the nation, should be added to all the damage, as immeasurable, but very significant, losses.

Table 4. Influence of NATO bombing on the significant macroeconomic indicators

	1990	1998	1999	1999/1998
GDP (m.USD)	28,390	18,491	13,868	-25.0
GDP p.c. (USD)*	2,696	1,742	1,306	-25.0
Industrial production (index:1990=100)	100.0	51.0	40.0	76.9
Exports (m.USD)	5,576	2,858	1,498	-46.9-
Imports (m.USD)	6,800	4,849	3,296	-30.4-
Foreign trade deficit (m.USD)	-1,224	-1,991	-1,798	-
Unemployment rate (%)	19.7	25.1	27.2	-

Source: Federal Secretariat for Development and Science

* It was estimated that the number of inhabitants was the same in 1998 and in 1999.

Table 5. Loss in GDP due to NATO aggression (in mil.USD)

	1999	1999-2003	1999-2010
NATO aggression	5,917	30,122	42,247

Source: Federal Secretariat for Development and Science

Looming up, as a particular limitation to the future development of Yugoslavia, is the so-called infrastructure barrier to further fast growth and development of the country. Namely, as already stated, we have had a trend of disinvesting, or decreasing the investment share in the GDP for a long period,

since the beginning of the eighties until now. This phenomenon has particularly affected the infrastructure businesses, which include very costly projects with long periods of construction prior to the return of the investments. In addition, as an aggravating circumstance, we had, during the whole period under the sanctions, a disparity of prices affecting infrastructure businesses, as the government tried to preserve the social peace and the living standard of the pauperised population in this way. This disparity increased from year to year, so that finally, in the period of 1998-2000 the prices of such products and services became totally unrealistic and ceased to be an indication of their availability. On top of this came the NATO intervention and physical destruction of a series of capital roads, railways, energy and telecommunication infrastructures, which brought the already poor and neglected system to the very brink of its existence.

Hereinafter are shown the indicators of the infrastructure development on the territory of FRY over a longer period of time. The data show a long-term trend in decreasing the quality and quantity of the products and services of this branch of the economy, which is a very significant limitation factor in terms of attracting direct foreign investments and any share of foreign capital in the privatisation process in Yugoslavia.

At the moment the infrastructure limitations reflect through: long-term shortage of electric power, and natural gas in the recent period, especially in winter time, resulting in restrictions of consumption for particular consumer groups, which could also affect possible foreign investors; the lack of modern road vehicles which may be present on the territory of the European Union (so called EURO 3 Standard), obsolete and untended roads and railroads; lack of railway engines, passenger and cargo railway cars, which cause frequent failures or regrouping of the lines and cargo and passenger transport, the disastrous state of the railway network and a travelling speed of only 60 km/h on average; and finally the "least critical" telecommunication system, which is also below the standards existing in developed countries, unable to meet the requirements of potential new subscribers neither in the fixed nor mobile telephone networks, particularly in urban places; this will be the most significant for foreign investors, where it is hardly possible to get connected either with the fixed or mobile telephone networks in peak hours or extreme situations.

Besides the already stated limitations, nowadays there are two further limitation groups. They are, firstly, the developing-structural limitations, and secondly, the systemic-institutional limitations. The dominant limitations in the first group are the following: inadequate production structure, and consequently, inadequate exports structure, the lack of capital and insolvency of the companies and banks, with enormous debts and claims among them (approximately 1.4 GDPs), technologically outdated equipment and plant as a consequence of a 20-year long process of disinvesting, and a huge number of unemployed (about 900,000) and fictitiously employed (about 700,000), which makes the number of employed nearly equal to the number of unemployed and fictitiously employed. The aging population is a particular problem as well, occurring for two reasons: firstly, the birth rate in the developed parts of Yugoslavia is too low, while it is too high in the underdeveloped parts of Yugoslavia (Kosovo and Metohija), which means that we have limitations if relying on an educated work force as a factor for future development; and secondly, there is increasing pressure on pension and health insurance funds, which cannot ensure the funding of such a large number of users from such impoverished sources.

The second group of limitations primarily includes the problem of the lack of market economy institutions that should be built or, which is more frequent, selective application of the regulations according to political criteria. The total level of Yugoslav market orientation was considerably reduced in the period under the sanctions and isolation of the country, and particularly in the period of 1997-2000. The retrograde processes reflected through a highly closed economy, with the imposition of various forms of control and regulatory rules, even where there was no justification for it, the increase of fiscal and para-fiscal takings through various types of taxation – taxes, contributions,

Table 6. Development of Infrastructure in FR Yugoslavia 1960-1999

	1960	1965	1970	1975	1980	1985	1990	1995	1999
COMMUNICATIONS									
1. Real length of railways (km)	4630	4635	4161	4294	4101	3863	3959	4069	4058
2. Electrified railways (km/%)	-	-	368/8.8	895/20	1240/30.2	1398/36.2	1342/33.9	1384/34	1364/33.6
3. Density of railways (km/1.000 km ²)	45.3	45.4	40.7	42.0	40.1	37.8	38.7	39.8	39.7
4. Roads (km)	28751	28569	38855	42312	43374	43955	46019	49386	50344
5. Roads with modern pavement	2153	4757	9702	15296	20489	24161	26949	28789	29876
6. - Highways	-	-	9	9	143	282	374	374	374
7. Macadam roads		13236		11656		10095		11222	11512
8. Earth roads		10576		15360		9699		9375	8956
9. Density of roads (km/1.000km ²)	281.4	279.6	380.3	414.1	424.5	430.2	450.4	483.4	492.7
10. Density of modern roads (km/1.000 km ²)	21.1	46.6	95.0	149.7	200.5	236.5	263.8	281.8	292.4
11. Navigable rivers and canals (km)	1191	1230	1230	1360	1360	1360	1360	1360	1360
- Canals	152	191	191	321	321	321	321	321	321
12. Operative coast (km)									
- At sea ports	750	1832	1942	2182	2691	3057	3421	3317	3317
- At river ports	1640	7355	10248	12538	6892	2548	1790	6143	7273
13. Airports	4	7	4	6	4	4	5	5	
14. Pipelines (km)									
- Oil pipelines	-	-	-	45	131	320	320	320	
- Gas pipelines	-	-	-	382	784	889	1223	1361	1277
15. Post offices	1094	1163	1222	1267	1367	1480	1548	1622	1735
16. Number of inhabitants per 1 post office	7283	7282	7362	7292	7199	6944	6764	6502	6119
17. Telephone-Telegraphic network (km)									
- Overhead TT lines		18148		18754		20700	12187	4585	3510
- Cable TT lines		1983		6072		20613	(55093)	53871	74655
18. Local telephone exchanges		1057		1099		1269	1430	1595	1676
- Available connections (000)		128		468		1420	1878	2154	2079
19. Telephone subscribers (000)							1782440	2017091	2190143
20. Number of telephone subscribers per 100 inhabitants							17.0	19.1	20.6
21. Average number of inhabitants by mid year	7968013	8469054	8996545	9243918	9841705	10276745	10471042	10546983	10616886
ENERGETICS									
1. Production of electrical power in GWh at generator		4900		18293		38683		37175	33947
2. Power plants in GWh		4241		12971		26811		29327	27230
3. Power of machines in power plants by the end of the year in MW – generators -		1498		4520		10384		11805	11837
4. Use of capacities in % - designed capacities -									
Electric power industry							77	78.4	80.0
Coal production							89	78.5	72.7
Oil production							83	72.7	57.5

FRY area: 102 173 km², number of inhabitants – estimate in 1997: 10 597 000

Source: Federal Institute of Statistics (FIS) – Communications and Statistical Year-Boo

revenues and excises which has brought the companies to the end of their tether, and made them operate in the area of grey economy. Due to such trends, the country has an insufficient investment and credit rating and a low inflow of foreign private capital, without which there cannot be any serious progress in the transition of the Yugoslav economy.

Development Possibilities

The democratic changes in Yugoslavia that began in October, 2000, marked a radical change in the political system. No more can we speak of the political system as an obstacle and a limitation factor for the development of the country and the economic system in general. This change has contributed to the promotion of the commitments that have been present in this country for a long period of time, and these commitments are the integration into European processes and the exploitation of all positive effects of globalisation. The FR Yugoslavia belongs to the family of European nations, and cooperation with the countries in the SEE region is the first priority on its long way to EU membership. Yugoslavia sees its development opportunity only through full integration in all world political, economic and financial institutions, and through becoming a part of the environment it belongs to, and from which it has been separated for a long period of time for different reasons.

As to the future development, Yugoslavia is committed to a gradual, but full liberalisation of all commodity-related, financial and technological processes, enhancement of the service sector of the economy and information technology creating new values, and full affirmation of a humane and sustainable development concept. The future development must be based on a fast and total integration into the international marketing, financial and technological processes, with the available human, material and natural resources. Starting from the existing economic structure, Yugoslavia has committed to the creation of an open market and export-oriented economy. In this way Yugoslav companies would be able to fully exploit the existing capacities owing to market expansion, specialisation and a better use of the production factors.

In order to start its economic development, Yugoslavia has to be included in the international division of labour and has to have export orientation based on a changed economic structure, higher employment of its capacities and higher economic efficiency, as a basis for better competitiveness and higher exports. At the same time, the inflow of foreign capital is considered an initial requisite for economic development, and export as a key lever of long-term economic growth and of changing the economic structure so as to increase the share of products with a higher level of processing and with a higher share of know-how and technology. The export orientation of Yugoslavia is preconditioned by the very size of her territory, the number of inhabitants and the economic power of her consumers. That is why it is necessary to be consistent in creating an open, export-oriented economy, to have liberalised foreign-trade and foreign exchange regulations and production factors allocated according to the world trade standards. It is especially important for the development of the country to create and better exploit the already existing comparative advantages in economic sectors and businesses that can secure a stable place in international competition.

The long-term development of Yugoslavia is oriented to the achievement of two groups of goals: (a) the goals of economic development related to the dynamics of economic growth, efficient use of human and material resources, the changes in the economic structure and the changes in economic relations with the international community; (b) the goals of a humane development related to the level and quality of the social living standards, the improvement of the allocation of the created product and the involvement of the population, particularly the young people, in an active social life. The long-term economic stability is a precondition for successful implementation of developing processes. Both Yugoslav and international experience show that the activation of the basic developing levers and the implementation of transition processes and market reforms are possible only in conditions of long-term stability of prices, rates of exchange and other macroeconomic indicators. Long-term economic

stability can attract significant foreign capital and activate domestic savings, which practically do not exist in Yugoslavia as present.

Such ambitious development goals can be realised only if they are based on intensive reform processes, which presuppose the functioning of a legal state, privatisation and reform of the financial system, as well as the reform of the system of excessive public consumption. To this end, we shall have to make reforms that are to lead to the creation of reforms, which will be compatible with the EU system and with the systems in the region, so that through full cooperation the participants can realise their advantages in the process.

Yugoslavia has to define the following basic development levers:

- privatisation and restructuring of companies
- recovery of banks and development of financial systems, and
- significant inflow of foreign direct investments.

The basic goal of privatisation is the setting of a clear and transparent property structure of capital, with the elimination of the state property as a relic of an obsolete and inefficient economic system within a relatively short time. Also, we must eliminate through the privatisation process the practice of soft budget limitation and covering business losses from the budget and the social covering of company losses. The third, and very significant goal of privatisation is the filling of the empty state cash box with the money obtained from the sale of companies, which can be used either for a new investment cycle, primarily in the infrastructure, or for social expenditure by the state, which will proportionally grow as the social function is relocated from the companies. Achieving a more dynamic economic growth requires a much more significant role on the part of the private sector and market mechanisms. Therefore the state must provide adequate macroeconomic surroundings and the necessary institutional infrastructure so that companies are encouraged to join the privatisation process. It is most important that the relations between the roles of the public and private sectors are changed through redefining the role of the state. The state should assume the governing functions related to the creation of a legal and macroeconomic environment, ensuring the security of investments and efficient public services, including infrastructure, education and social welfare, and leave to the private sector the initiative and independence of business operation in the market environment. The goal we want to achieve is the elimination of the dependence of businesses on the state and the creation of initiatives for their reliance on the marketing mechanism.

The reform of the financial system must include the restructuring of the banking sector and the development of a financial market. The establishment of an efficient banking and financial sector is essential for the encouragement and generation of domestic savings and the appropriate solvency required for the maintenance of a macroeconomic stability. Of course, it is quite clear that the reform of the banking and financial sector will require financial and technical help from multilateral organisations. In the restructuring process, the banking sector would be exposed to international competition, encouraging the consolidation process, enhancing the control and adjustment of regulations to international business standards. Likewise, risk control must be enhanced and the present practice that bad debtors are the leading shareholders of the banks must be suspended. One of the key goals of the restructuring of banks is their merging through the increase of the capital balances, as well as the implementation of international accounting standards, primarily the implementation of the international forms of financial reports and the rules on data accessibility. In this way, the transparency of the domestic banking sector would be improved for potential foreign investors and for shareholders.

The inflow of foreign capital is highly important for the development of Yugoslavia as domestic savings and investments are only sufficient for the simple reproduction of existing capacities. The inflow of foreign capital, apart from the provision of funds for investments, acts as a catalyst for domestic and foreign investments as it reduces the risk and uncertainty of investments, increases the chances that reforms be implemented successfully, speeds up the development of the institutional infrastructure, and provides support to the process of the corporatisation of domestic companies. The chances of attracting foreign direct investments (FDI) in Yugoslavia are better than the chances

regarding portfolio investments. FDI have much better effects on the total economy of a country than official foreign capital. This is, first of all, because they make an impact on the restructuring of the economy, create the conditions for the transfer of new technologies, increase exports and market expansion, improve the quality of management and, most importantly, domestic and foreign partners share the investment risk if it is a joint venture, or only the foreign partner bears the risk in the case where he is sole owner. In this case the Yugoslav state must guarantee foreign investors will not lose their capital because of a change in the government macroeconomic policy, nor because of political risk or changes. To support such a commitment, we have to ensure a stable GDP growth, inflation curbing and stimulating measures for the development of small and medium businesses, which are the most attractive segment for foreign investors.

As to the institutional solutions that should make for better and more efficient implementation of the reforms, we can define the following: (i) development of market institutions and increase in the efficiency in the use of economic resources, (ii) establishing a market of capital and strengthening the savings practice, (iii) development of a labour market and establishment of a system of collective contracting, (iv) establishment of a legal state, especially regarding financial discipline and abiding by the property and contract rights, (v) development of competition policy and anti-monopolistic regulations.

Under the conditions of creating a completely new or radically changed economic system, it is logical that the state must become more modern and more capable of business operation in the newly created conditions. The following can be stated as the basic functions of a contemporary state in the field of economy:

- creating and maintaining an efficient legal system, and the institutions of the system, which should make a clear and a fully comprehensive framework for each individual to act in the market,
- maintaining a stable and stimulating economic environment which is predictable enough so that entrepreneurs can undertake short and medium term decisions,
- providing regulations and governing through an efficient share of finance to basic social services and infrastructure,
- providing social welfare for vulnerable categories of the population, adequate to the economic strength of the society.

Progress of Reforms and the Implementation of the Economic Policy in 2001

The economic environment has changed considerably during the seven months since the beginning of democratisation in Yugoslavia. Firstly, a realistic rate of exchange has been established and the practice of multiple rates of exchange, which was particularly exercised in 2000, has been eliminated. Most of the foreign currency exchange transactions have been moved from streets into banks and exchange offices, which has enabled efficient control of hard currency and cash flow. On the other hand, hard currency reserves have grown under the conditions of a high foreign trade deficit as a consequence of a positive balance in the exchange transactions, i.e. more purchase than sale of hard currencies to the citizens, who are compelled to sell their money because of the restrictive monetary policy of the National Bank of Yugoslavia and because the practice of paying unearned salaries has been abandoned. The stability of the established rate of exchange and the internal convertibility of the dinar, and the policy of a controlled fluctuating rate of exchange, show that, finally, the rate of exchange has become a real support to economic dealing with foreign countries, primarily in foreign trade. Secondly, we have had significant deregulation in foreign trade relations, a segment that used to be completely controlled by the state before, and import and export regulations, as well as foreign exchange regulations, have been significantly liberalised. Various limitations to foreign trade have been removed, customs protection has been introduced without quotas and contingents, and the licensing of companies to work in this field against the payment of high fees has been suspended. Thirdly, we have had drastic liberalisation of prices, partly as a consequence of the decision of the

outgoing government in October, 2000, to suspend the price control for a significant range of goods, by which they had protected the living standard of the population, and partly as a consequence of such an orientation of the newly-established government of the Republic of Serbia, which is in charge of most of the retail prices. Out of 65% of all the products and services whose prices were controlled through some form of price control, now only the prices of several infrastructure and strategic products and services are controlled. The developments in this sector, together with the correction of the inherited disparity of prices, which has not yet been completed, have led to a significant increase in retail prices during the last seven months.

Table 7. Basic indicators of the current developments. October 2000 – April 2001

- indices, previous month = 100

	2000				2001			
	10	11	12	<u>12.00</u> 12.99	1	2	3	4
Retail prices	126.4	116.9	102.7	213.3	103.0	103.2	100.9	108.6
Cost of living	123.9	111.6	101.7	215.3	103.0	101.4	102.1	110.3
Industrial production	88.5	107.6	99.1	91.4	92.7	102.8	111.3	
Exports	87.7	102.8	100.3	114.7	93.2	97.0	148.0	
Imports	87.5	115.2	95.9	93.3	126.4	95.8	106.0	
Salaries								
- nominal	114.2	111.1	119.4	232.6	94.2			

As to the reform of the economic system, the fiscal reform in the Republic of Serbia has made the biggest progress. A package of new laws has been adopted, the aims of which are: firstly, curbing the grey economy and more efficient collecting of taxes and excises for the republic budget; secondly, more balanced division of the fiscal burden among the population; thirdly, the introduction of progressive taxation in all segments, so that the richest bear the biggest tax burden. Another package of laws in the area of labour law is in the process of being adopted. These laws will drastically reduce the level of social protection and the rights of the employed. Unfortunately, under conditions of such a high level of unemployment and fictitious employment as we have in Yugoslavia, and with a very small number of new working places and employment alternatives, such restrictive legal solutions are accompanied by serious social dissatisfaction. This leads to a very realistic loss of support from significant social strata for further implementation of reforms, which badly require a consensus. Regrettably, we have not gone far with the privatisation segment. The legal solutions from 1997 have been suspended until the new law is adopted in this area. However, as a proposed new law has not been presented to the public yet, we can say with certainty that the first half of year 2001 has definitely been lost for the purpose of privatisation as the most important segment of the transition, while its effects are uncertain in the second part of the year as well. Consequently, besides the hesitation and the loss of momentum by the domestic companies, foreign investors, who base their decisions primarily on stability, are waiting for the final solutions or at least for the initial results of their implementation in order to venture to invest.

On the other hand, it has been clearly stated through the economic policy for 2001 that Yugoslavia needs about USD 2.5 billion in order to close the deficits in public expenditure and the balance of payments. In the event that this money does not come, the results will surely be: destabilisation of macroeconomic processes, increase of prices and the rate of exchange, and we shall again get into the vicious circle we experienced during the previous ten years. At this moment, after more than half a year, the programme of reforms in Yugoslavia is at a turning point very similar to the one the Programme of the Monetary Reconstruction and Economic Recovery was at in 1994. The key, but very substantial, difference is that the mentioned Programme was implemented practically without any support from the international community, and under the conditions of sanctions. However, there is a great similarity in the implementation so far: practically the complete implementation of the reforms is done through the orthodox-monetary sphere, with the focus primarily on the effects of the monetary

and foreign exchange policy, supported by fiscal and foreign-trade policies. The basic commitment is the liberalisation of the economic processes, and it deserves full credit, but it has a limited range. The effects of such policies, at such a level of development as we have in Yugoslavia now, are exhausted very quickly, and in a period of 6-8 months, unless it enters the sphere of structural, industrial and economic policies, the situation will be destabilised by the pressure of the growing social tensions. Certainly, the key support for entering this second phase of the programme is the provision of sufficient funds for investments that are to generate the economic growth and development of the country. The new governments of Yugoslavia and Serbia are facing this challenge, and by the end of 2001 we shall have clear signals as to which tracks we are on: is the history of the Balkans, call it South of South-East Europe if you like, our destiny - which threatens to draw us to the bottom of the European scale; or shall we, together with our neighbours and our immediate surroundings; finally catch up with the developed part of the continent and start using the advantages of globalisation.

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