Yugoslavia's Trading Patterns: In Search of Stabilization

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I. Introduction

The Yugoslav economic crisis became obvious in the early 1980's when the economy has suffered from large balance of payments deficits and rising foreign indebtedness. Because the symptoms of crisis were misunderstood as those of trade crisis solely, and because of economic system's development in the past, the institutions which became most involved in economic stabilization were foreign trade and foreign exchange regimes and policies. The whole stabilization was concentrated on the foreign trade sector and the external balance. The program did also include some measures to deal with other distortions in the economy (e.g. high inflation, high unemployment, declining productivity, etc.), but the rise in exports was seen as a panacea. After almost five years of stabilization, with the external balance improved, other evidence of crisis became even more manifest. Instead of curing the crisis economic measures which were obvious being the changed trading pattern of the country.

The purpose of this paper is to analyze the reasons for the shifts in trading patterns as well as consequences of the most recent shift in 1980's (Sections 1 and 2). I shall argue that each subsequent retrenchment from "liberal" trade policy brought new and strong incentives to shift the trade towards the socialist countries and that external factors did not contribute much to those shifts. Ever higher concentration of exports and imports on socialist countries has, I shall claim, contributed a great deal to the deteriorated Yugoslav position in the world trade and to the length of economic crisis (Section 3). As a way out of the existing Yugoslav crisis, an accession to the European Community has been suggested by several prominent Yugoslav economists(1). This paper also includes a discussion on that topic (Section 4) but very much in a summary fashion and in nontechnical terms.

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II. Long-term Evolution of Trading Patterns

The Yugoslav share in world trade has been deteriorating (Figure 1) and this process of ever more autarchic development also has been accompanied by changed trading patterns.

The attempted stabilization policy in the 1980s resulted in a very distinct concentration of exports to only one group of countries with the proportional decrease of the Yugoslav export share in other countries' markets.

The level of concentration of Yugoslav visible exports to socialist countries in general and the CMEA countries, is no doubt too high-the coefficient of the relative importance of these countries for the Yugoslav export is 41.8% higher than their importance for the total world imports. While the Yugoslav exports accounts only for 0.26% of developed countries' imports and 0.34% of the LDCs' imports, it amounts to as much as 2.46% of the socialist countries' imports and as much as 3.19% of the CMEA countries' imports (Table 1).

The trading pattern presented in Table 1 is quite unique for the whole postwar period in Yugoslavia. Immediately following the second world war and until the clash with Stalin in 1948, one half of Yugoslav trade was with the Soviet-block. The trade dropped immediately and sharply to practically zero in the early 1950's but by 1954 was up to approximately 23% in a balanced trade. In the mid 1950s and early 1960s, the years of the fastest growth in Yugoslavia by world standards, approximately half of Yugoslav exports and 2/3 of

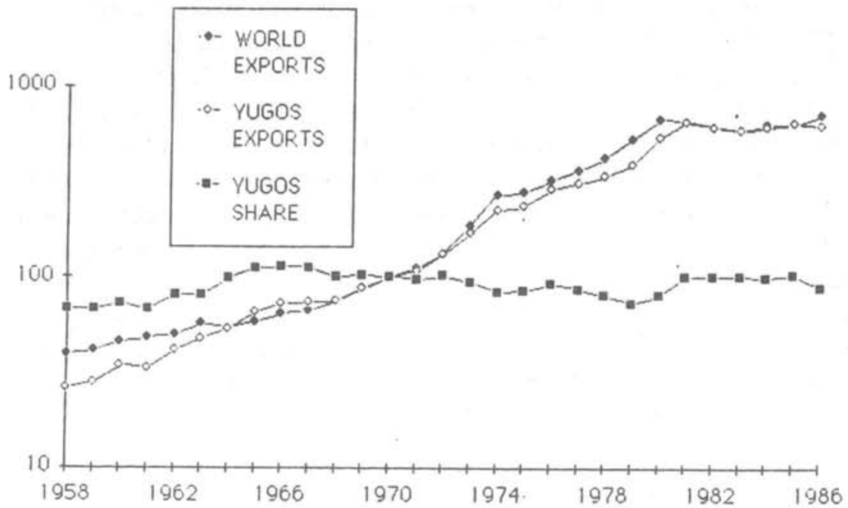

Figure 1.

Table 1. Yugoslav and World Trade (by economic groups of countries in 1985)

Group of countries	Yugoslav exports ($) (1)	Yugoslav exports (%) (2)	Wold imports ($) (3)	Wold imports (%) (4)	Ratios 1:3	Ratios 2-4
Developed	3.7	34.7	1386	67.9	0.27	−33.1
LDCs	1.5	14.3	437	21.4	0.34	−7.1
Socialist	5.4	50.9	220	10.7	2.45	+40.2
CMEA	5.3	49.9	166	8.1	3.19	+41.8

Source: Direction of Trade Statistics, IMF for Yugoslav exports and UN Trade Statistics for World imports.

imports were oriented towards the industrial western countries. The share of socialist-block countries in exports was kept at the level of 30% whilst the share of imports from these countries in total Yugoslav imports declined and in 1961 was only 18.7%. The LDCs were also relatively important trading partners on the export sideapproximately 16-20% of Yugoslav exports were destinated for the LDCs. However, on import side their share was much more modest just little over 10%.

In early 1960's the first of the so-called mini economic reforms took place.(2) It resulted in a greater orientation towards the socialist countries, especially on the export side. As a consequence, the share of industrial countries in Yugoslav exports and imports declined in 1961-65 from 50% to 40% and from 69% to 53.7%, respectively. The economic reform in 1965 induced, as we shall later see, the major trade liberalization which was reflected in a countershift of the trading pattern back to the industrial countries. From 1966 to 1974 the share of industrial countries was increased to more than 50% in exports and 60% in imports but did not catch up with their shares in the pre-reforms period. Socialist countries remained relatively attractive markets for the Yugoslav exporters since their share, though volatile, did not drop under 1/3 of exports. On the import side, their share was decreased from 32.2% in 1966 to 23.6% in 1974 but it was on average still higher than in the early 1960s.

As one of the leaders in the nonalignment movement, Yugoslavia also tried to boost her trade with the LDCs. However, until the mid 1970s which

(2) Section 2 of this paper deals more in detail with the nature of this and subsequent reforms and their impacts on trading patterns. Hence in this section I shall just identify major shifts in trading patterns leaving the reasons for shifts to be discussed in Section 2.

Table 2. Exports

Year	World ($M)	Ind. Coun. Total	EEC(a) Total	EEC(a) FRG	Soc. Count.(b) Total	Soc. Count.(b) USSR	LDCs
1958	441	54.5	39.5	9.5	29.0	8.3	16.4
1959	476	48.8	36.8	9.3	31.3	9.9	19.9
1960	565	48.2	36.9	8.9	32.4	9.4	19.4
1961	553	48.9	39.2	10.0	30.4	8.6	20.5
1962	690	50.1	36.4	10.3	24.3	6.3	22.7
1963	790	52.9	41.2	10.3	27.0	10.9	17.2
1964	893	46.6	36.3	8.9	34.9	13.0	15.2
1965	1092	40.0	31.1	8.8	42.6	17.2	14.5
1966	1220	45.4	34.7	9.4	37.4	15.9	14.1
1967	1252	48.0	36.0	7.7	36.7	17.5	11.4
1968	1264	48.1	36.5	9.6	34.9	16.4	12.6
1969	1475	52.4	40.7	11.0	31.0	14.0	12.9
1970	1679	53.0	43.3	11.8	32.6	14.4	10.7
1971	1812	49.8	38.5	11.6	37.0	14.8	9.9
1972	2237	53.0	39.3	11.8	36.1	14.7	7.0
1973	2873	51.7	38.2	11.2	32.6	14.2	10.0
1974	3802	44.4	28.4	9.6	41.9	17.7	11.7
1975	3980	34.1	24.0	7.8	48.3	24.8	17.5
1976	4878	39.6	29.2	8.7	42.1	23.4	15.6
1977	5254	37.5	28.7	7.4	40.0	21.6	19.0
1978	5671	35.1	26.0	8.3	42.3	24.6	18.6
1979	6491	38.1	28.7	9.2	41.6	21.6	16.4
1980	8978	34.5	26.5	8.7	45.1	27.7	16.5
1981	10940	30.8	23.2	7.9	49.6	33.3	18.4
1982	10284	26.7	20.5	7.0	51.0	33.3	20.7
1983	9914	31.9	23.9	8.1	46.7	27.2	20.2
1984	10254	34.5	25.8	8.7	47.1	27.3	16.6
1985	10700	32.7	24.6	8.1	51.0	31.7	14.0
1986	10353	34.4	25.1	8.6	48.8	30.1	13.7

Source: Direction of Trade Statistics, IMF
Columns might not add to 100% because of nonspecified destination of exports not registered in this Table.

(a) EEC consisting 12 countries.
(b) Socialist countries: the CMEA countries plus China.

Table 3. Imports

Year	World	Ind. Coun.	EEC(c)		Soc. Count.(d)		LDCs
	($M)	Total	Total	FRG	Total	USSR	
1958	684	59.8	34.6	11.7	28.6	8.4	11.5
1959	688	62.1	34.9	14.0	25.1	8.4	12.8
1960	828	57.5	39.7	14.9	25.8	6.9	16.7
1961	899	69.1	43.8	15.8	18.7	3.5	11.8
1962	888	63.0	36.3	11.2	21.8	6.6	10.5
1963	1057	59.7	33.6	9.3	22.8	6.9	13.6
1964	1323	53.7	32.8	9.0	29.1	7.5	13.7
1965	1288	53.7	32.8	9.0	29.1	8.4	13.4
1966	1575	52.6	33.9	9.6	32.2	9.3	11.5
1967	1707	59.4	46.2	16.7	27.1	9.6	9.8
1968	1797	59.2	44.8	17.8	28.5	10.5	8.5
1969	2134	60.5	47.6	18.2	24.1	7.9	11.2
1970	2874	65.3	48.5	19.7	20.7	6.7	10.0
1971	3259	62.7	45.5	18.9	24.1	8.6	9.9
1972	3233	62.6	45.3	18.7	24.9	8.7	9.3
1973	4536	58.1	43.9	18.9	24.7	9.0	12.5
1974	7539	55.9	42.1	18.0	23.6	10.0	16.0
1975	7697	59.6	42.6	18.7	24.8	10.5	14.5
1976	7366	54.0	40.1	16.7	30.6	13.6	14.6
1977	9634	55.9	40.7	16.3	29.1	13.5	14.0
1978	9988	55.6	39.2	18.0	30.0	13.8	13.6
1979	12863	56.4	38.7	17.9	27.6	13.9	15.0
1980	15064	51.9	35.4	16.8	30.1	17.9	17.3
1981	15829	52.1	36.6	15.4	31.4	18.7	15.3
1982	13453	49.3	34.0	13.8	34.4	20.3	14.2
1983	12160	44.8	30.8	13.4	36.9	20.3	17.1
1984	11996	43.3	30.3	13.1	32.7	16.4	22.8
1985	12207	44.9	30.8	13.0	32.2	16.2	21.4
1986	11753	41.2	32.8	14.6	32.7	15.9	18.9

Source: Direction of Trade Statistics, IMF

Columns might not add to 100% because of nonspecified exports not registered in this table.

(c) EEC consisting of 12 countries

(d) Socialist countries: the CMEA countries plus China.

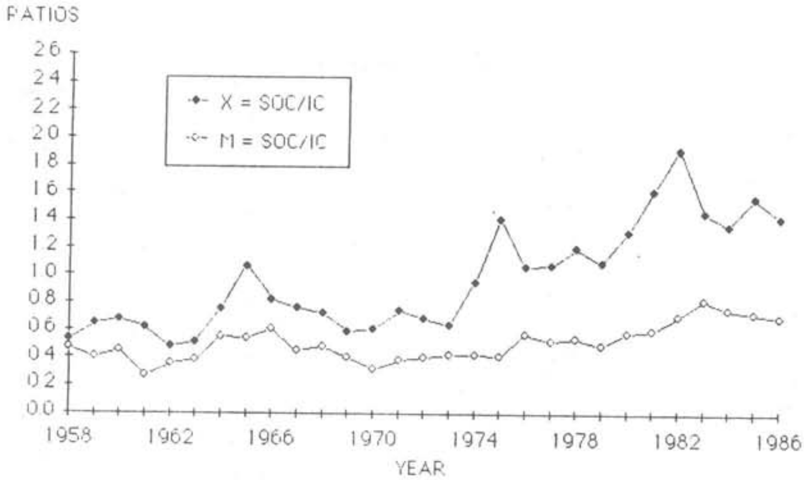

Figure 2

brought the oil shock and commodity price increases, the share of the LDCs in Yugoslav trade was declining. Only from the mid 1970s on did their share start its somewhat erratic rise.

There were numerous reasons for shifting the trade again in the mid 1970s. One is the recession in the OECD countries which caused Yugoslav exports to stagnate. Furthermore, prices of imported oil and commodities were increasing and there was a need to increase exports to these countries in order to close the trade gap.

Institutional changes should also be considered. In the series of laws enacted in mid 1970s, the decentralization was somewhat constrained and liberalization retrenched. Hence, the share of industrial countries in Yugoslav exports stated an accelerating decline after 1975 and in 1986 was only 34.4%. On the import side their share was decreasing too, slowly at the beginning and then very sharply in 1980's reaching the low point of 41.2% in 1986. In contrast, the portion of exports oriented to the socialist countries rose in exports to 48.8% and in imports to 32.7% in 1986. The 1980s also brought sharp decline in the LDC's share in Yugoslav exports but some rise in their share in imports.

These shifts in trading patterns are depicted very well in Tables 2 and 3 and in Figure 2. A X-line represents the ratio of exports to socialist countries to exports to industrial countries. The ratio has never exceeded the level of 1 until 1975 (except in 1965) and thereafter it stayed at higher levels. On the contrary on the import side the ratio of imports to socialist countries over imports to industrial countries (the M-line in the Figure 2) never managed to exceed the one-point level. In other words, Yugoslavia was more oriented to the West in importing than in exporting Until early 1970s these two ratios were moving in almost the same direction keeping the gap between exports and imports almost constant. However, the gap between exports and imports to socialist countries opened up at first in 1974/75 and continued to increase thereafter. It also has to be stressed that in the 1980s imports were falling at the rate of 5.78% annually so the ratio line reflects that imports from industrial countries were decreasing more rapidly than imports from socialist countries.

While the pattern of these trade shares in Figure 2 is somewhat volatile, there is a firm upward tendency in the share of trade with socialist countries, especially for exports. However, this is not true for the period from 1966-74 when that share declined sharply. The change in the economic policy and the economic system in the 1970s shifted trade once again towards socialist countries and this was pushed further in 1980s by the economic crisis and the introduced stabilization measures.

The consequences of this shift are not to be underestimated. As we shall see in section 3 of this paper, most of the trade with socialist countries is in non-convertible currencies so export earnings have been of little help to the balance of payment and debt servicing. However, this is not the only problem arising from Yugoslavia's trade with the East. More often than not exports to socialist countries consist of low quality goods which are not price-competitive in other (Western) markets. Sustained growth of those exports does not sufficiently stimulate a change of composition in both production and exports for producers to keep up with competition from the NICs. Furthermore, as we shall discuss in section 3, the surplus in Yugoslav trade with the socialist block since the 1980s is undesirable not only because it means a depletion of resources(3) but also because it produces large monetary effects pushing up inflation even higher. In brief, we may conclude tentatively that Yugoslavia does not benefit from this trade. What then are the reasons she turns again and again towards more trade with socialist countries?

III. Identifying the Major Determinants of Trading Patterns' Shifts

There are many factors which might influence a country's trading patterns or its geographic distribution of trade and it is not difficult to neglect some of

(3) Especially scarce hard currencies for imported inputs integrated in exports to the East which are in non-convertible currencies.

them. In addition to that, the number of factors and their relative importance differ from country to country as well as from one period to another for the same country. For Yugoslavia, a socialist, labour-managed economy, a list of factors is likely to be even longer than for most other countries at the similar level of development. This is due to the specific position of Yugoslavia in the world today but also in the past. It should be not ignored that one of today's most economically and politically developed regions of the country was an Austro-Hungarian colony, while some other regions were under the Turks for several hundred years. That fact should also be considered in identifying various determinants of regional distribution of Yugoslav trade at present.

Likewise, the leader's position in the nonalignment block was supposed to be reflected in the share of the LDCs in Yugoslav trade. Moreover, the geographic location of Yugoslavia which gives her a bridging function between West and East should not be neglected as its effect on trading patterns has been important. There is a lot of statistical and anecdotal evidence that Yugoslavia has often served only as an intermediary in West-East trade as goods imported from the West were directly reexported to the East. Also, the adverse terms of trade effects, which vary among the different groupings of countries, contribute a great deal to redirecting Yugoslavia's geographic trade flows.

In general, it is neither possible nor necessary to discuss all relevant determinants in this paper. Let me concentrate on these which in my opinion are the most relevant:

1. trade and foreign exchange regimes and policies, and
2. foreign borrowing.

The importance of political relations ought to be stressed. Sometimes they have a stronger impact on geographic distribution of trade than any other factor (good examples are virtually zero trade with Soviet block in 1948-50 and no trade between Yugoslavia and South Korea after the Korean war). Despite their undoubted influence, in this paper political relations will not be specifically analyzed.

1. Trade and Foreign Exchange Regimes and Policies

The Yugoslav postwar trade and foreign exchange regimes were more restrictive than liberal. That fact should not come as a surprise bearing in mind that Yugoslavia is a developing country trying to become an industrial economy in the shortest time possible. Also, with an economy which is neither market-driven nor centrally planned, Yugoslavia tended to pursue strongly inward-oriented import-substitution policies on trade and industrialization. However, there were some attempts to liberalize the trade and foreign exchange regimes and to transform the economy to an outward-looking one.

To study the impact of liberalization one firstly ought to be able to measure the level of trade liberalism/restrictiveness. However, it is generally hard to detemine precisely that level and it is evenmore so when a country has a bias towards using more non-tariff barriers and less explicit trade-related tools. Yugoslavia has been extensively using these kinds of quantity restriction and non-trade related measures so their overall effect is difficult (if not impossible) to measure. Still, on basis of some estimates of effective rates of protection, effective exchange rates and/or domestic resource costs[(4)], as well as on basis of a large consensus among experts in the field, it is relatively easy to identify the major shifts in the Yugoslav trade and foreign exchange policies and their relative importance for trading patterns. Major phases were:

— 1946-1965: Phase of high interventionism and high protectionism which can be divided into three subperiods: 1946-51 (state trading monopoly), 1952-60 (administered trade regime of multiple exchange rates) and 1961-65 (introduction of uniform exchange and tariff regimes),

— 1966-1974: Phase of liberalization of intervention and of protection with a goal of abandoning an import-substitution growth,

— 1975-1982: Phase of decentralized but high ex post intervention also free of systemic ex ante control, and

— since 1983 on: Phase of highly ex post and ad hoc interventionist regime with possibly highly increased protection.

Let me discuss briefly each of these phases and their impacts on trading patterns.

1) Phase of high interventionism and high protectionism: 1945-65

The expulsion of Yugoslavia from the communist block in 1948 marked the beggining of an era in which the country officialy abandoned a central-planning regime and the Soviet industrialization model. However, it took several years before the old mechanisms were replaced by newly developed ones. Until 1952 all foreign trade was under the control of the state and no tariffs and exchange

(4) There were only several attempts to estimate those for various periods. "Efektivna zastita", *Ekonomski institut Pravne fakultete*, Ljubljana, 1972; V. Pertot, *Ekonomika medjunarodne razmjene Jugoslavije*, Informator, Zagreb, 1971; V. Pertot, *Ekonomika valutnih tecajeva*, Informator, Zagreb, 1986; S. Robinson, L. Tyson, "Foreign Trade, Resource Allocation, and Structural Adjustment in Yugoslavia 1976-1980", *Journal of Comparative Economics* 9, 46-70, 1985; World Bank, *Yugoslavia-A Country Study*, 1985.

rates existed as policy tools. In 1952 the first step towards trade liberalization was taken in terms of an easing of state control over foreign trade. The dinar was devalued from 50 to 300 dinars per US $. A limited foreign exchange market was introduced together with a retention quota for exporting enterprises. In addition a set of "exchange coefficients" was established for different categories of goods. Initially there were 12 categories but the number increased repidly up to 35 by the end of period. The coefficients were much higher on the import side (0.5 to 10.0) than for exports (0.5 to 6.0) in order to stimulate import-substitution, especially in the industrial sector. The system was complex, inconstant, inefficient(5) and had a strong bias against exports (notably agricultural goods).

Even though the dinar was devalued again in 1954 to 632 dinars per US $, the existance of multiple exchange rates (exchange coefficients) prevented world prices' influence on domestic price relatives and possible correction of the latter.

This phase of continued highly administered trade policy but eased state control had a strogner impact on the import side than on the export side of Yugoslavia's overall trade orientation.

In next subperiod (1961-65) further steps were taken toward trade liberalization. After Yugoslavia became an observer in GATT in 1956, she advanced to provisional member in 1862 and finally to a full member in 1966. The dinar was devalued again in 1961 to 750 dinars per US $ with no attempt to set up a foreign exchange market. The system of multiple exchange rates was replaced by a uniform exchange rate and tariffs were introduced (18.8% on average). Exporting enterprises were able to enjoy an export premium and a retention quota of 7%. Special import licences or quota restrictions were removed from 20-25% of import value and another 20% of import value was freed subject to a foreign exchange availability quota. But still 55-60% of import value was restricted by quota or similar quantitative barriars. (Flaherty, 1982)

As Figure 2 suggests this liberalization (1960-62) had an immediate effect on decreasing the significance of socialist countries' share in the Yugoslav exports and imports but this effect quickly declined. The rising trade deficit led to a reversion of restrictive policy. In 1964 tariffs were increased to 23.3% and tighter import control was imposed resulting in the fall of the liberalized import to below 20%. (Flaherty, 1982) In order to decrease the trade deficit export

(5) Enterprises were induced to press for an increase in coefficients not to compete on the world market and the whole system provided powerful incentives for "rent-seeking" behaviour (Horvat, 1976).

subsidies were increased to 45% in combination with various other tax rabates (obfuscating again the role of a uniform exchange rate). All of these produced an effect of shifting the trade to the socialist countries in exports but also in imports as is depicted in Figure 2.

2) Major liberalization phase: 1966-74

The 1965 Reform(Which actually was stretched out over a two and a half years period) was supposed to reorient the economy toward export-led growth with exports to industrial countries preferred over the exports to non-convertible currency market. The government devalued the dinar again, reduced restrictions on imports and tariffs to 10.5% and removed export subsidies eliminating "multiple exchange rates". A retention quota of 70% was however kept and in addition foreign exchange accounts of firms (and individuals) were legalized. For the first time firms were ecouraged to initiate foreign investment and joint ventures. The number of liberalized imports was increased to account for 41% in 1966, 45% in 1969 and 71.3% in 1971.

In addition to trade and foreign exchange policies reform, the power of the state was reduced and price-setting was to be decontrolled making it more suitable for the export-oriented economy which was to be built. The freedom of firms to initiate foreign trade transactions and to borrow abroad quite naturally brought a sharp shift in the Yugoslav trading pattern: the share of socialist countries to industrial countries in imports and exports fell to their second-lowest levels — 0.32 and 0.59 respectively (figure 2).

A system of import categories by degree of restrictiveness was introduced in 1967 and the same system was used thereafter to restrict foreign trade in more subtle ways by simply changing the coverage of more restrictive categories (GDK, DK or RK)(6). Also, the category of fully liberalized imports was not always without limitation-very often foreign exchange policy was used to control this category of imports (by controlling the freedom of enterprises to buy foreign exchange from banks). Even though the system was very inconstant and over-administered the underlying trend toward liberalization is obvious.

By 1970 import and export shares of GDP increased to 27.3% and 21.3% respectively reflecting the government's intentions to open up the economy. But this greater openess made the economy more vulnerable to the external shocks which would occur in 1970's. Even though the share of manufactured exports rose to more than half of total exports by 1971, the share of raw

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(6) GDK-import for which retention quota could be used, DK-import quota in dinar value, RK-import quota in unit quantity.

materials and intermediate inputs leaped to 64% in 1971 and the economy was becoming more and more import dependent. On the other hand, it was less capable to amortize sudden external shocks, such as a deterioration of the terms of trade and/or a fall in export volume, because of the underdeveloped economy and macroeconomic policy. All means of macroeconomic intervention which had been available were of a restrictive nature. So when the next more serious balance of payments crisis occured in 1974/75, macroeconomic policy again turned to its "stop" phase continuing its overall stop-go policy nature. As a consequence, by the mid 1970s Yugoslav foreign trade with the socialist countries relative to the industrial countries was on its upward trend (Figure 2) which has not significantly changed since then.

3) Decentralized interventionism: 1975-80

A series of laws enacted in 1973-76 and 1977-78 made the Yugoslav economic system probably the more complex and certainly, as evidence shows, more inefficient than in the previous period. In short, new mechanisms and institutions restrained further advancement of 1960's liberalization efforts and also partially re-centralized the power of federal government (even though those laws were intended to devolve all decision-making power to microeconomic units, called BOALs). Re-centralization was not obvious-it was to be felt only be early the 1980s as ex post interventionism to correct the balance of payments deficit and other distortions which by that time could not be further denied.

The 1970's reform also meant very frequent changes in trade and foreign exchange regulations.(7) The extension of ex post more or less indirect macro economic intervention shows best that there was no systemic ex ante control of foreign economic relations those were left to be determined by the enterprises' behaviour.

The most important change in international trade regulations was the change in the foreign exchange regime by which it was intended to leave all of the export earnings to the enterprises that contributed them which had freedom to disburse those earnings as they chose. This introduced a rapidly widening parallel foreign exchange market at which those who needed foreign exchange but were not exporters bid up foreign exchange price. As the country was approaching the eve of external debt crisis, the shortage of foreign exchange at

(7) From these years on there were several hundred major and/or minor changes in trade and foreign exchange regulations at the federal level all of which were published in Official Gazette of SFR Yugoslavia.

official foreign exchange market was rising and the informal exchange rate followed. Eventually the Yugoslav National Bank had to close the foreign exchange market and to allocate scarce foreign exchange by some kind of informally introudced retention quotas.

In these years Yugoslav enterprises were spurred to balance their exports end imports by a number of indirect and administrative measures as well as by moral of indirect and administrative measures as well as by moral suasion. The result was a sharp shift in both export and import to the socialist countries (Figure 2). Although western economies were in recession in those years, the most powerful incentive for such a shift came from inside in the forms of: 1) fixing imports to past export performances (in dinar value), 2) equalization of exchange rates between the convertible dollar and the non-convertible accounting dollar used in trade with the East, 3) regional non-differentiation in export subsidies.

4) Return to high intervention and protection: 1983 on

By the end of 1982 it was clear that some radical changes were needed to restore the balance of the economy and economic growth. These changes were announced as The Stabilization Program in 1983. The program went much further than the 1960s reform in calling for an export-led growth, a market-driven economy and the like. But the program did not include actual measures to be undertaken-these were left to the government to create and implement. Because of Yugoslav specific macroeconomic decision making, the change called for in foreign trade and foreign exchange regulations were enacted only in 1985/86. The foreign trade regime became more restrictive through the introduction of some (old) categories of import restrictions (as are GDKs). Although tariffs were not increased there was an increase in custom evidence and taz equalisation charge. Also, "free" imports were more often than not iimited by the avialability of foreign exchange. The country was constantly in debt crisis throughout those years and it is clear that little "free" import was actually realized. The best evidence to support this is the negative rate of import growth of 5.78% annually from 1981 to 1986. The new exchange regime meant even more restrictiveness in foreign trade. Foreign exchange accounts of enterprises were abolished and official priorities in payments abroad were announced with the debt service as the highest priority. Direct export subsidies were abolished, too, in the face of large and frequent devaluations of the dinar but some indirect premia were still kept.

Althouh eventually western Europe and the US economies recovered and increased their import demands, Yugoslav exports did not respond very much.

On the contrary, during the strongest import growth in the US, Yugoslavia experienced losses in the US market to the advantage of the NICs. (Mikic, 1986) Yugoslav export volumes to the western industrial countries were virtually stagnant even though exporting enterprises tried to gain some competitiveness by pushing down the export prices.[8] And because the incentives that trade and foreign exchange regimes provided did not differentiate between exports to the industrial countries and to the socialist countries, most enterprises unable to export to the first ones turned over to the latter.

2. Foreign Borrowing

Foreign borrowing is an integral part of a development process and there is nothing wrong in foreign borrowing *per se*: as long as a country uses foreign resources to increase its output capacities to produce goods which could be competetively sold on the world market. However, if a country does not make efficient use of borrowed funds, there is no way it can escape a debt crisis situation and that in a nutshell is what has happened in Yugoslavia. When for the first time the gap between imports and exports to the convertible markets opened up in the mid 1960s there was no need for large amount of borrowing because workers' remittances were just high enough to cover most of the gap. From that time on Yugoslavia depended heavily on workers' remittances as one of its major sources of foreign exchange earnings. But as the gap became wider additional funds had to be borrowed and as early as 1972 Yugoslavia was close to debt crisis. But it was not until early 1980s that the debt situation became really a crisis. During the 1970s, as exports were more and more oriented towards the socialist countries with imports still primarily originating in the industrial countries, gross foreign debt increased almost tenfold. The most important (in addition to import substitution) macro-economic policy response to external shocks in 1970s was additional foreign borowing. According to B. Balassa and L. Tyson[9] during 1974-78 additional net external financing offset three-fourth of the balance of payments effects of external shocks. External borrowing was used to offset large losses in export market shares in Yugoslav trade with the industrial countries and to finance the shift of trade from these to socialist countries. Most exported goods to the East have a high

(8) Domestic demand and import demand of the socialist countries were quite price inelastic so enterprises were in a position to charge higher prices and recover part of the losses in exports to the industrial countries. Furthermore, until recently bankruptcy was out of the question.

(9) "Adjustment to External Shocks in Socialist and Private Market Economies", *World Bank, Discussion Paper* No. DRD61, Nov. 1983.

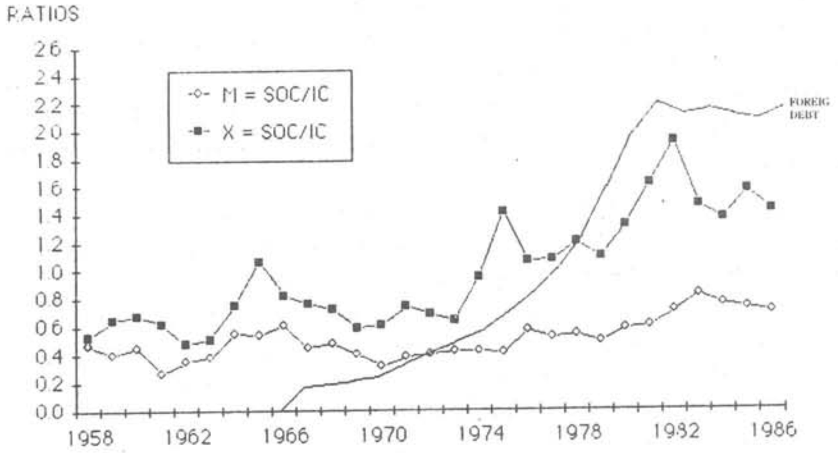

Figure 2A

content of imported intermediates (from the West). As long as foreign banks were willing to meet Yugoslavia's borrowing requirements there was no need to make substantial changes in trade policy or the foreign exchange regime (on the contrary, in those years the Yugoslav dinar has been appreciating in real-terms against the dollar and other western currencies). For that reason foreign economic relations regulation did not experience a large move away from the "liberalized" one of 1960s. But when in 1982 foreign borrowing virtually stopped, strong restrictive measures were required which led both in high interventionism/restrictiveness and to ashift in the trading pattern in favour of socialist countries.

Figure 2A depicts this relationship in the rise of foreign debt and changes in trading patterns. It is obvious that from the mid 1970s, that is, from the time of parting with serious intentions to build a market-driven economy, both foreign debt and trade with socialist countries increased sharply.

IV. Economic Relations with Socialist Countries

1. Visible Trade

After expulsion out of the socialist block in 1948 and years of no or cold political and economc relations, in the 1950s relatoins were again established. From then on, Yugoslavia has maintained very good trade relations with almost all socialist countries in the world. A predominant share of that trade is with the East European socialist countries, that is the CMEA countries, although

Yugoslavia is not a member of the CMEA. Out of nine member countries of the CMEA, with five of them Yugoslavia has trade which is carried out in the framework of bilateral arangements and involves bilateral clearing-these are USSR, Czechoslovakia, DDR, Albania and Mongolia while with other member countries trade is paid for in convertible currencies (Bulgaria, Hungary, Poland and Romania).

Table 4 reflects that almost four-fifth of Yugoslavia's visible trade with socialist countries goes to the bilateral clearing trade and that the trade balance is predominantly determined by the trade with these five countries. From Table 4 and Figure 3 we may see that until 1980 Yugoslavia run trade deficits in this trade, but from 1981 there was an increasing surplus realised by Yugoslavia. As it was fully compatible with the overall economic relations with these countries for Yugoslavia to run deficits in visible trade, it was absolutely non-beneficial for Yugoslavia to realize trade surpluses. These can be used neither in debt servicing nor for imports from other socialist countries and at the time they were created Yugoslavia was in an extremely difficult debt situation. Having in mind that Yugoslavia also has structural surpluses in an invisible trade with these countries, and that overall surpluses create some adverse effects on the Yugoslav economy, one is led to conclude that this trade was not at all satisfactory.

Table 4. Yugoslavia's Trade with Socialist Countries (mil. $)

Year	Total trade			Bilateral clearing			USSR		
	Exports	Imports	Bal.	Exports	Imports	Bal.	Exports	Imports	Bal.
1976	2069	2255	−186	1573	1560	12	1142	1002	140
1977	2151	2801	−650	1574	1989	−414	1138	1301	−163
1978	2442	3003	−561	1895	2020	−125	1394	1375	19
1979	2747	3565	−818	2022	2643	−621	1401	1793	−392
1980	4156	4540	−384	3317	3645	−328	2489	2698	−209
1981	5416	4891	526	4615	4088	526	3644	2966	678
1982	5238	4629	609	4495	3832	663	3431	2743	688
1983	4631	4492	140	3774	3623	151	2699	2463	236
1984	4824	3922	902	3800	3047	753	2797	1964	833
1985	5387	3926	1461	4245	2971	1273	3397	1979	1420
1986	5020	3840	1180	3928	2885	1043	3122	1874	1248

Source: Statisticki godisnjak Jugoslavije

Table 4 also revals that almost three-fourths of Yugoslavia's exports to bilateral clearing countries goes to and nearly as much of its imports comes from the USSR. And again it is the trade with the USSR which determines the

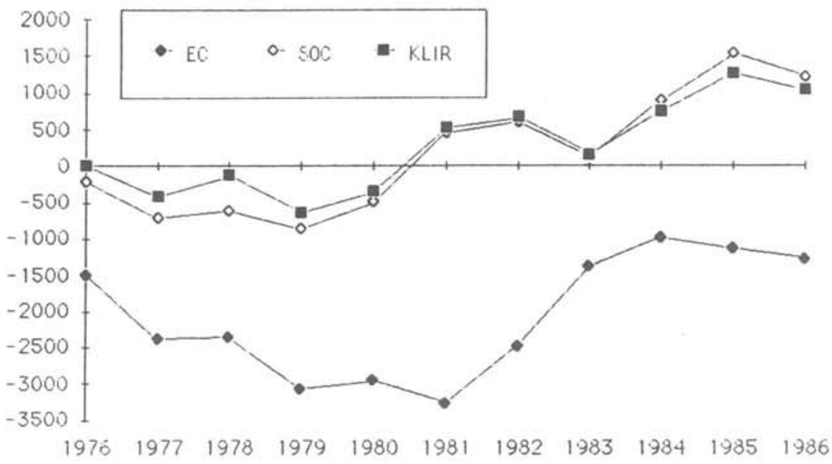

Figure 3. Trade Balance (mil. $)

balance in overall trade with the socialist countries. Moreover, the USSR's place as the largest Yugoslav trading partner was very much "confirmed" during 1980's-the USSR's share in total Yugoslav exports averaged over 30% and in imports it was nearly 18% during 1981-86. In same period Yugoslavia's share in total USSR exports was stable at 4% and in imports it fell down from 5.3% in 1981 to 4.25% in 1984. So the relative importance of the USSR for Yugoslav trade, especially exports, was much greater in face value than the relative importance of Yugoslavia for the USSR. But it should be noted that the Yugoslav share amounted to a level similar to that of the US, Canada, Japan or even West Germany.

The composition of Yugoslav trade is very stable throughout the period and for this reason Table 5 contains data for last three years only. Almost 40% of Yugoslav exports to bilateral clearing countries consists of raw materials and intermediate goods. The rest is equally split on 30% of investment goods and 30% of consumer goods. On the other hand, Yugoslav imports from these countries consists primarily of raw materials and intermediate goods (86-88%) with just a marginal share of consumer goods (4% or less). The trade with the USSR has a very similar structure exports could be divided in three equal parts, each making one third: raw materials, investment goods and consumer goods. Almost 90% of imports from the USSR are raw materials and intermediates. This fact adds to the singificance this trade has to the Yugoslav economy because a large part of it depends on imported energy and other raw

Table 5. Composition of Trade (by final use) in %

EXPORTS			
	1984	1985	1986
Bilateral Clearing	*100*	*100*	*100*
Raw materials	41.9	36.1	40.1
Investment good	25.0	31.7	30.0
Consumer goods	33.1	32.2	29.9
USSR	*100*	*100*	*100*
Raw materials	33.4	27.7	33.1
Investment goods	29.3	36.9	34.1
Consumer goods	37.3	35.4	32.8
IMPORTS			
Bilateral Clearing	*100*	*100*	*100*
Raw materials	88	88	86
Investment goods	8	10	10
Consumer goods	4	2	4
USSR	*100*	*100*	*100*
Raw materials	89.9	90.1	88.6
Investment goods	6.2	7.0	7.6
Consumer goods	3.9	2.9	3.8

Source: Statisticki godisnjak Jugoslavije

materials from the USSR. It might be alarming that in the 1980s the share ofintermediates increased relative to the share of investment goods which is mostly due to the decrease in investment activity in Yugoslavia in general. Intermediates are used predominantly in energyproducing sectors or in heavy industries. Industries with the highest import content from the bilateral clearing countries (primarily the USSR) are electric power, coal production and processing, petroleum, agricultural chemicals, paper and paper products, yarn and textile fibers and motor vechicles.

In other words, imports from this group of countries, especially from the USSR, has a very important role in securing the operation of the heavy-industrial and other manufacturing capacities created through ambitious import-substitution programs over the last three decades. But from 1980s the USSR was not very willing to supply these particular imports (see Table 4) and ready substitutes in the Soviet market are hard to find because Yugoslav industry is somewhat reluctant to import the Soviet equipment and the Yugoslav consumers do not find its consumer goods attractive. As a result imports from the USSR are decreasing in the 1980s. Although the Yugoslav exports were bound to decrease at the same rate (because of the bilateral clearing framework) they failed to do so and as a consequence a rapidly increasing surplus arose.

The next complex problem in regard to this trade is that Yugoslavia pays for its imports from the socialist countries with manufactures. Firstly, these manufactures are highly import-dependent in that they require imported intermediates and often technologies from the convertible-currency region. So, increasing the export of these goods to the bilateral clearing region inevitably has to worsen the balance of payments in convertible currencies. Secondly, because the Soviet market is in a way "a seller's market" (there are shortages in investment and consumer goods), Yugoslav exporters were able to negotiate higher prices than in the western or domestic markets even for the lower quality non-diversified goods. In combination with the high domestic direct/indirect protection this secured these exports isolated even more Yugoslav manufactures from competition in quality and price. There were no incentives to modernise or increase productivity. Furthermore, Yugoslav policy makers added more stimuli to this behaviour by overvaluating the dinar against convertible currencies in 1970s and also by overvaluating the accounting dollar in trade with the bilateral clearing region in the early 1980s. All of these were extremely powerful incentives for the Yugoslav exporters to shift to the socialist countries' market (as shown in Figure 2).

However, reform in the Soviet Union also caused some changes in the trade relations with Yugoslavia. There were pressures to improve the quality of consumer goods and/or decrease prices in 1986 and 1987. As result terms of trade with the USSR deteriorated a little in these years.[10] Yugoslav exports still obtain higher prices there than in the western market but the difference is not big enough for some exporters to cover losses in their overall exports. This produces a really difficult problem because Yugoslavia does not have a sufficiently efficient manufacturing sector to compete with NICs in the western markets. As a result, while great moral suasion and all kinds of political and economic pressures have been exerted and incentives provided to increase convertible currency exports, exports have been stagnant in the 1980s.

2. Invisible Trade

Table 6 reveals two facts: 1) that Yugoslavia runs structural surpluses in its overall invisible trade (despite increasing interest payments on foreign debt), and 2) that invisible trade with socialist countries is several times smaller than total Yugoslavia's invisible trade. It is also true that invisible trade accounts for

(10) According to analysis of ZIT (Bureau for Market Research) from Belgrade.

Table 6. Yugoslavia's Invisible Trade (Net in mil. $)

Year	Nonfactor services Total	Bil. clear.	Remittances Total	Bil. c.	Interest Total	Bil. c.	Inv. trade Total	Bil. c.
1981	3339	337	2042	13	−1710	−32	3671	318
1982	2739	291	1268	17	−1773	−40	2234	268
1983	2412	426	1167	34	−1532	−43	2047	417
1984	2157	275	1189	36	−1638	−43	1708	268
1985	2517	357	1001	16	−1664	−54	1854	319
1986	3300	420	921	16	−1749	−59	2472	377

Source: National Bank of Yugoslavia.

a much larger portion of the current account in Yugoslav total or convertible trade than in its trade with socialist countries. In 1986 the share than in its trade with socialist countries. In 1986 the share of invisible transactions in the total current account with convertible trade was 44% while in the trade with socialist countries invisible transactions amounted to only 9%. Reasons for such a low level of invisible trade could be found in the structure of the services which Yugoslavia exports and in the nature of bilateral clearing trade.

The dominant part of Yugoslav invisible exports are transport, tourism (travel) and construction works in that order of magnitude. Unfortunately, this is the structure of a typical LDC with on new information-based services. And in the trade with socialist bilateral clearing countries almost 8/10 goes to transport and construction works while travel services amount to only a small fraction. This is due to the lack of travel opportunities on the part of socialist countries' consumers.

In spite of the limited number of types of services Yugoslavia is able to offer, the major constraint to more intensive exports to socialist countries is in the nature of bilateral trading. International payments underlying international trade in services and invisible transactions in general are very often bound to internatonal capital flows and bilateral clearing comes as insurmountable barrier to this trade.(11)

Regardless of the low level of invisible trade, it is the positive balance of this trade that matters. And with more pressures in Yugoslavia to incease export earnings as well as with opening up of socialist market for services, it is possible that this surplus will rise even more.

(11) Ante Cicin-Sain, Neven Mates, "Dispariteti cijena iefikasnost ekonomske razmjene Jugoslavije sa klirinskim zemljama", Ekonomski Institut, Zagreb, 1987.

Table 7. Monetary Effects of Bilateral Clearing Trade Surpluses

	1981	1982	1985	1986
1. Net creation of high-powered money as result of surplus in clearing trade (in Bil. dinars)	23.6	26.0	97.5	306.8
2. Total high-powered money creation (in Bil. dinars)	94.0	55.0	664.9	992.2
3. Net monetary effect of clearing surplus (1:2)	255	47%	15%	31%

Source: Cicin-Sain, Mates, op.cit., Statisticki godisnjak Jugoslavije.

3. Monetary Effects of Bilateral Clearing Trade

Every time that the trade between Yugoslavia and bilateral clearing countries is not balanced, monetary effects appear. In the case where the trade balance is in surplus on the Yugoslav side it results in a rise of both the high-powered money and money stock and when the opposite is true, in their decline. Regarding one of the most difficult problems in Yugoslav economy since early 1980s-high inflation-it is crucial to keep control over money supply. But as Table 7 suggests the National Bank of Yugoslavia was partially prevented in doing that task because it could not sterilize the impacts of clearing trade surpluses on money supply.

An uncontrollable inflation is seen as the major cause of the prolonged and deepening crisis of the Yugoslav economy and its inability to gain competitiveness at the world market. For this reason it is obvious why the creation of surpluses in trade with bilateral clearing countries and the resulting monetary effects have to be eliminated as soon as possible.

V. Facing Europe as a Single Market

If by any chance the European Community (EC) could have achieved today's level of integration and number of members ten years ago, Yugoslavia could have been passively watching the creation of unified (Western) Europe. There are at least two reasons for that: 1) ten years ago there were no obvious indications of economic crisis, and 2) Yugoslavia was inclined to look at the EC as the political-economic block. Nowadays, however, Yugoslavia takes notice of the unification process. The understanding of an indispensable relationship with European countries has grown strong, helped by the fact that without such economic cooperation Yugoslavia is not likely to stabilize its economy to solve its external illiquidity problems, high unemployment, decline in productivity, etc. Furthermore, eight years of crisis means that Yugoslavia turns to domestic problems with a proportional lessening of interest for an nonalignment movement. That is not to say that Yugoslavia is ready to walk out of it-only that priorities have been changed.

Although quite a number of ordinary people consider an accession of Yugoslavia to the EC as "the only way out of crisis", one should be more cautious about all the positive and negative political and economic consequences of such an accession.

Clearly, one should not go so far as to see Yugoslav membership as a return to "colonial status within the developed region". Notwithstanding all negative repercussions that might appear from such an integration, a number of positive effects are likely and the net effects are ones that count.(12)

First of all, the process of entry would involve prior changes in Yugoslav economy. These, no doubt, mean stabilization of the economy in addition to many modifications in other major areas (connected with necessarily changes in Yugoslav socio-economic system). It does not necessary mean abandoning socialism but it requires that the system be modified to become one more consistent with market-driven economies of the EC.

An integral part of a stabilization policy is reform of foreign trade and exchange regimes. The policy should be aiming at eliminating distorted regimes and at moving towards a more neutral one (actually it means moving away from anti-export biased trade and exchange policies). Although in the short-run it would involve some costs, in the longer run the steady-state benefits of such a policy shift are: improvement of the allocational efficiency, specialization along the lines of the economy's comparative advantages and an efficient use of resources, increased technical efficiency, relief of the foreign exchange scarcity and of rent-seeking activities and considerable increase in consumer surplus and society's welfare.

By this policy which must be undertaken as a complementary part of overall stabilization policy, some costs would be introduced too. The most obvious are a decrease in production in those activities which would gradually loose protection, a (temporary) unemployment rise, income redistribution thorugh changes in relative prices which if they are large and sudden might induce large positive and negative changes in rents, etc.

Only after that process of stabilization is successfully completed, is the stage set for a possible entry into the EC. And then Yugoslavia would be expected

(12) Economists usually use various analytical models to determine static and dynamic effects of integration. The problem is that in case of Yugoslavia many of necessary data are not available at all or are not consistent nor reliable enough to be used at this stage.

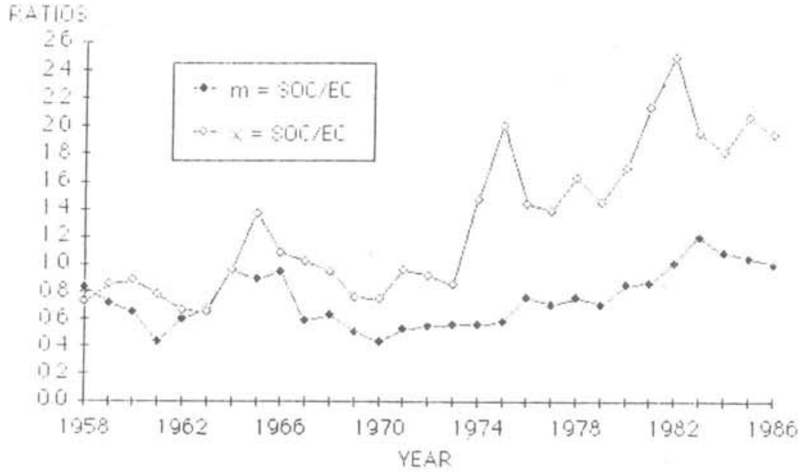

Figure 4

to introduce yet more changes in foreign trade area such as:

— elimination of non-tariff barriers in trade with EC countries and all other countries for which the EC does not apply such restrictions,

— elimination of tariffs on industrial imports from EC countries by some year in the future and a harmonization of tariffs on imports from other countries with the EC tariff structure,

— extention of trade concessions to developing countries in accordance with the Lome Convention and the system of generalized preferences,

— liberalization of foreign direct investment regime and of capital movements (in and out of country).

It is easily understandable why there is a widespread suspicion that the Yugoslav economy will not be able to compete. Implementation of stabilization and the above liberalization measures will leave the Yugoslav economy, especially the industrial sector, with less protection. But even now, before these changes take place and induce a more efficient allocation of resources and increase in technical efficiency, some of industries are competing fairly well at the EC market (textile and clothing, food processing, leather shoes, shipbuilding, electrical machinery, construction works etc.). There is no strong evidence that all of Yugoslav industry would be less competitive than counterpart industries in larger EC countries.

Needless to say, Yugoslavia's accession to the EC will induce some trade diversion because it will result in the reduced relative importance of non EC countries in Yugoslavia's trade. This would have mostly an adverse effect on

Yugoslav trade with socialist countries and would be represented with a sharp fall of both ratio-lines in Figure 4.

From the theory of customs unions we know that the trade creation effects will be larger as the difference between Yugoslav and EC production costs are larger, the difference between EC and existing trade partners of Yugoslavia are smaller and as the price elasticity of import demand in Yugoslavia is higher.(13) The first and second conditions are satisfied (second bacause until recently around 50% of imports came from industrial, mostly the EC, countries). The third condition is somewhat cumbersome to analyze. All ex post elasticity estimates available show analyze. All ex post elasticity estimates available show evidence of low import-demand elasticity. But there is an explanation for that: given the level of trade policy restrictivness in regard to investment and consumer goods imports, consumers had virtually no opportunity to change the quantity of import as import prices changed. Assuming liberalization of imports takes place there would be considerable increases in import demand induced by price decrease (evidence in support is found in rising imports from Western countries whenever in past restrictive measures were somewhat relaxed).

Certainly, there are many important areas in which changes would occur if Yugoslavia entered the EC, e.g. industrial and agricultural policy, financial relations, transportation and other services, labor issues, investment and regional development, etc. and all of them should be considered in order to characterize an overall impact.

VI. Some Concluding Remarks

The Yugoslav road to socialism was founded, from 1948 on the principle of workers' self-management and this principle was the blueprint for industrialization. Constantly trying to reconcile principles of socialist self-management and market, its macroeconomic policy in the foreign trade sector at least was extremely volatile and overall more restictive than liberal. Within that framework when in the 1970s Yugoslavia experienced large external shocks it choose to defend its relatively high rate of economic growth by additional borrowing and more restrictive foreign trade and exchange regulations. That led into two parallel but connected phenomena: debt crisis and a shift in trading patterns in favour of the socialist countries. In the 1980s the concentration of trade to socialist countries is rising even more, producing at the same time

(13) This is of course simplification.

undesireable effects-trade surpluses in the bilateral clearing trade. These in turn have adverse monetary effects in preventing deflationary monetary policy. These surpluses are of little help in general because they cannot be used in debt servicing nor for imports from other countries. In addition, such level of regional concentration in trade makes the country more vulnerable and on the other hand, because of the specific characteristics of these markets, it prevents domestic producers from modernizing, improving quality and productivity, all of which is crucial to compete in other markets. That appears to be of great significance nowadays when the EC is on its way to create a single market by 1992. Although it is too soon to advocate an accession of Yugoslavia to the EC, it is safe to conclude that substantial gains would result from liberalization induced by entering the EC. The negative effects of isolating Yugoslavia from a united Europe would be much larger than the possible costs of Yugoslavia's entry into the EC.