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Labor-Managed Firms in Yugoslavia: An Economic and Historical Analysis





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by

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I hereby recognize and pledge to fulfill my responsibilities as defined in the Honor Code and to maintain the integrity of both myself and the College as a whole.

Robert V. Crowe

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R.I.P. 394 E College Street, December 2019

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Abstract

In my project I discuss the system of labor self-management in the country of Yugoslavia and the evolution of this system from the early 1950s to the 1980s. I explain what labor-self management is and give different visions of self-management in society which influenced the architects of Yugoslav self-management. I contrast the envisioned benefits of self-management on the national economy as well as organizational and worker behavior. I conclude that the system failed because the complex web of political intervention in the self-managed economy made it impossible for markets to function properly according to the value proportions of labor and demand, and disincentivized the firm from making decisions necessary for the survival of the firm, such as accumulating funds for research and development and investing in new technology.

Chapter 1: An introduction to my project on Labor-Managed Firms in Yugoslavia

Most firms around the world are managed by an explicit organizational hierarchy, with decisions being made from the top-down. Typically this includes either a CEO / President and possibly a board of directors making decisions about the general direction of the company, with a tier of upper-level managers in charge of different departments in the firm, and often one or two tiers of lower-level managers who deal with smaller-scale decisions and manage the workers, who are at the bottom of the hierarchy. A much less common form of organization is "horizontal" management, meaning that the workers essentially manage each other or elect representatives to do so, as opposed to the traditional capitalist profit-maximizing firm, which is managed "vertically", as in from the top-down. A firm with this horizontal management structure is typically called either a labor-managed firm or a worker cooperative. From the 1950s through the 1980s, Yugoslavia was the only country in the world which mandated that firms be labor-managed.

The concept of the worker cooperative originated in the first half of the 19th century in the latter part of the first industrial revolution. During this time, handmade production techniques were gradually replaced with machines and factories, and the guild system which had been in place for centuries in Europe began to break down. In the guild system, a worker would start off as an apprentice learning under a master craftsman, and would eventually gain greater skills as a journeyman before becoming a master craftsman, as certified under the guild which was a group of workers in a particular trade. When the guild system broke down and the factory system became more common, workers no longer determined their own income, instead they were paid

a wage which was determined by the owners of the factory. The worker cooperative was thus envisioned as a means of pushing back against the exploitative aspects of the wage-labor relationship and returning business power to the wage-earners. Interest in worker self-management resurfaced with the communist revolutions of the first half of the twentieth century.[1]

Yugoslavia in the 1950s morphed into a unique "market socialist" economy where the means of production were, in theory at least, controlled by the workers themselves. This type of economy contrasts sharply with the command-style of communism practiced by the Soviet Union and its allies in Eastern Europe, where production was directed by the government. In Yugoslav firms, each worker is a member of the worker council, which elects committees of other workers who oversee various aspects of the firm, and the workers have the power to override committee decisions by a majority veto. For my senior project, I am examining the effect of the labor-managed structure on individual and organizational behavior and incentives. In this project I analyze the ways in which the real effects of labor self-management on individual and organizational behavior differed from how its proponents envisioned, and the role political disagreements had in sabotaging the ability of the system to work effectively. My thesis is that Yugoslavia's system of self-management disincentivized firms from keeping up with modern technology and cost-reducing trends, and created inefficiencies which prevented markets from functioning properly, ultimately resulting in high inflation and national debt, as well as high prices for consumers and unpredictable wages for workers.

I believe that my project will help provide necessary insight in several ways. I will discuss in my third chapter the various inefficiencies of the labor-managed economy, but in

[1] Wright, Christopher. *Worker Cooperatives and Revolution: History and Possibilities in the United States*, (Washington D.C.: Booklocker.com, 2014), 1-3

short, one could blame the decentralization measures taken to promote the labor-managed enterprise as the primary unit of social organization as contributing to the economic instability of the country in the 1970s and 80s. The decentralization reforms also allowed for greater regional autonomy and created issues with certain republics clustering economic assets all for themselves, leading to destabilizing events such as the Croatian Spring. Furthermore, the constant tug of war between party loyalists and liberal economists in rolling out self-management in the economy created inefficiencies which helped raise unemployment and inflation to unforeseen levels in the 1980s, and rendered Yugoslavia unable to pay their debt.

In my second chapter, I examine the theoretical framework for Yugoslav Self-Management by first examining the ideas of two proponents of self-management from the prior decades and contrasting these with the Yugoslav system. The first is Pierre-Joseph Proudhon, a nineteenth century French socialist who favored the establishment of worker cooperatives over the nationalization of production and pioneered a vision of socialism based on free markets and property rights. The second is Antonio Gramsci, an Italian Marxist from the early twentieth century who wrote about his vision of a utopian socialist society with organizations of producers constituting the main units by which society is built upon.[2] In this chapter I also look at the arguments in favor of self-management by Jaroslav Vanek and Branko Horvat, scholars of self-management writing during the same time Yugoslavia's system of self-management began to unfold. I also utilize essays from the book *Participative Management: Concepts, Theory and Implementation* on the conditions required for democratic decision making in firms to succeed in sustaining high worker morale to help explain some of the ways in which Yugoslav firms may have come up short of expectations. I follow this up by utilizing several studies from economics

[2] Comisso, Ellen Turkish. *Workers' control under plan and market : implications of Yugoslav self-management*. (New Haven : Yale University Press, 1979), 23

journals which help draw conclusions on the ways in which labor-managed firms may act perversely. In the third chapter, I start by examining the causes of Yugoslavia's abandonment of command-style communism in favor of self-managed market socialism, and proceed to describe the development and evolution of the system of self-management from the 1950s to the 1970s. In this chapter I identify most of the fundamental issues with Yugoslav self-management as they relate to my thesis. In the fourth chapter I utilize two case studies of similar large Yugoslav firms which differ in their organizational structure, and draw upon these case studies to infer about the problems Yugoslav-style self-management creates for firms striving to modernize and compete against importers. I then use three articles to analyze the perverse incentives Yugoslav firms face with regard to rising prices and limiting employment, overreliance on external financing, and the market imperfections which prevent Yugoslav firms from behaving how they were intended to. In the conclusion I summarize my findings and relate them back to my central questions.

Chapter 2: The theoretical framework of Yugoslav Self-Management

Theoretical Background for Workers Control of Firms

In *Worker Control under Plan and Market* by Ellen Turkish Comisso, a critic of self-management, the author compares two distinct theoretical outlines for workers control of firms. Gramsci theorizes a system of worker control of industry in a planned economy, whereas Proudhon's proposal gives workers control of enterprise in an economy which is market based but not capitalist. Gramsci advocates for a system based on a precise division of labor, with each worker playing a necessary role in producing. In Gramsci's model, the goal of enterprise is not profits, but rather creating goods simply for the sake of usefulness. Citizenship is contingent upon one's status as a "producer", and everyone is a member of a worker community, with membership in workers' councils being mandatory. The state is centralized but responsible at least in theory to the labor councils. The responsibility for executing decisions for the firm is given to the masses, but some supervisory roles would remain due to the necessity of professional skills in these occupations.[3]

The main issue with Gramsci's model of labor self-management, which is a dilemma faced by any almost any "industrial democracy" is the question of who holds primacy in decision-making, the councils or the appointed administrators either within the firm or in the central planning apparatus. In Proudhon's model it is also unclear who has the final decision, with the relationship between worker councils and the federal government being "contractual", with no designated third party to enforce the rules of the contract aside from possibly the courts.

[3] Comisso, 17

Gramsci also never specifies who the residual claimant is of industry, one can only guess that this would be the state since he did not specify otherwise. While workers may feel good about having a say in their decision making and being an integral part of the production process, they have no incentive to be more productive or find ways to cut costs aside from their own goodwill, and there is little incentive to nor shirk aside from peer pressure.[4]

Proudhon's model of labor self-management is, generally, more thoroughly thought out than Gramsci's. While in Gramsci's vision all property is collective and essentially owned by nobody except the state, Proudhon's model allows individuals the freedom to act as entrepreneurs and engage in free exchange.[5] Workers can form mutualistic associations which can invest in industries. Private property in this model is not abolished, but rather, property is redistributed to allow the individual to possess their own labor and property in equal amounts. This system would, in theory, attain the equilibrium state of perfect competition in the market, with worker-controlled enterprises and credit associations eliminating profits above the worker's opportunity cost of labor and increasing competition on product markets.[6] Proudhon's model is also unlike Gramsci's in that workers are allowed to leave workers' councils and keep what they earned.

A major issue with Proudhon's model is that, despite assured perfect competition among firms, it is inevitable that some firms will become dominant and others will fail due to both external and internal factors, creating monopolies.[7] Some firms will have better access to credit and savings, or they might simply be better managed by their councils. The uncertainties of having a market economy will increase the value of good management, and eventually a greater

[4] Comisso, 15-17
[5] Comisso, 30
[6] Comisso, 23
[7] Comisso, 33-35

amount of power is bound to be delegated to those with the skills to handle quick decision making and execution. With every worker set to lose or gain from the firm's current surplus, firms will inevitably seek to cut costs and be reluctant to invest in new technologies, leaving them at a comparative disadvantage competing with importers from other countries. Comisso also argues that if Proudhon's assumptions of full employment and high rates of investment are both true, then there may be severe inflation of the price level, and the effects of this may be felt quite unevenly in response to external shocks, destroying the relative equality between industries and firms.[8]

Despite being written well before the existence of the Socialist Federal Republic of Yugoslavia, many of the criticisms of Gramsci and Proudhon's ideas by Comisso were reflective of actual economic problems in Yugoslavia's self-managed economy. The most obvious example of this being the inability of firms to respond appropriately to external shocks (i.e. the oil shocks of 1973 and 1979), as well as massive inflation of the price index. These will be discussed further in the fourth chapter. In both cases, the perverse incentive issue created by worker councils being dominated by lower-skilled workers is seen as a problem by Comisso by inhibiting innovation and creating inefficiencies by disincentivizing workers with skills in high demand to work for firms in which they are not maximizing the return on their labor. Some of the sources I previously consulted blame this aspect of labor self-management for contributing to the "brain drain" problem in Yugoslavia, with many of Yugoslavia's college-educated population going to Central and Western Europe in the 1960s and 70s.

[8] Comisso, 30

The case for self-management

Jaroslav Vanek is one of the main scholars of self-management who influenced the development of the Yugoslav system. In the essay "Decentralization under Workers' Management: A Theoretical Appraisal", found in Vanek's collection of essays called *The Labor-Managed Economy*, he makes the case in favor of labor self-management. He begins by establishing that the Yugoslav experiment is "unique and comparatively young"[9], and because of this it is hard to use the limited sample size available to make conclusions on the effectiveness of these firms (Vanek is writing in 1977). Vanek lays out the conclusions of his studies of labor-managed firms, while using other more comprehensive essays to address some of the larger questions and concerns. The articles Vanek bases his conclusions on are by Benjamin Ward and Evsey Domar, economists who published studies on labor-managed firms in the 1950s, which assume conditions for perfect competition.[10]

Vanek argues that while labor-managed firms act perversely by maximizing wages in response to employment, the unemployed will be able to gain employment quicker due to the similarity between firms in the same industry.[11] This again assumes that technology is a constant and market conditions remain perfectly competitive, which is unrealistic. He also states that variations in demand allow for variation in prices but less-so income and employment variations[12], which is supported by some studies such as the one by Prasnikar. Vanek also predicts that even if price levels vary widely, there will be little cause for inflation, which was proven to be horrendously false by the massive levels of inflation in the 1980s.

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[9] Vanek, J. *The labor-managed economy*. Ithaca N.Y.: Cornell University Press. 1977, 16
[10] Vanek, 17
[11] Vanek, 22
[12] Vanek, 24

Vanek's arguments in favor of labor self-management operate on assumptions which are not very practical or realistic, so it is no wonder that the system quickly brought problems. However the question of whether or not self-management succeeded in its goal of encouraging cohesion and cooperation in the firm is difficult to measure. In the following sections of this chapter I will compare the information on the conditions of labor-managed firms given by Branko Horvat with the conditions Martin Patchen, Raymond E. Miles and J.B. Ritchie argue are required for participative management to achieve its goal of high worker morale.

Patchen argues in his essay in Ervin Williams book *Participative Management: Concepts, Theory and Implementation*, that it is not enough to simply let workers have a seat on the council to motivate them to maximize their effort and output. One of the necessary ingredients for workers to accept the goals of the organization, according to Patchen, is that their voice is heard.[13] According to Horvat, worker councils range in size from 15 to 120 members and meet every one to two months. In a worker council consisting of 120 members, or realistically anything above 50-60 members[14], it is simply not feasible for everyone's voice to be heard, especially if they are meeting at such infrequent intervals. On the flip side, I understand why the worker councils would not want to meet more often as it detracts from work time, however this makes it difficult to discuss issues surrounding the firm in appropriate detail so that all possible concerns can be addressed. The management board meets more frequently and is much smaller, consisting of 3 to 11 members, 75 percent of whom must be production workers[15], and these are elected by the workers themselves, so in theory they would serve the interests of

[13] Williams, E. *Participative management: Concepts, theory, and implementation.* Atlanta: Pub. Services Division, School of Business Administration, Georgia State University. 1976, 34
[14] Horvat, Branko. *The Yugoslav Economic System: The first labor-managed economy in the making, Part IV: Labor-Managed Enterprise.* White Plains: International Arts and Sciences Press, 1976, 158
[15] Horvat, 158

the workers, but in reality there is little to no assurance that these elected representatives consult the other workers regarding large management decisions that may not directly affect them. Doing so would make them more able to identify with the goals of the firm.

Even if the councils succeed in serving and representing the interests of the workers, this does not necessarily address the issue of whether or not involvement in the workers' council is high quality. One of the factors which Miles and Ritchie argue increases the motivation to work hard is the establishment of some sort of standard of excellence. This can take the form of time standards such as meeting certain production deadlines, or by some measure of sustained quality of work over time. Patchen argues that workers are generally motivated by some sort of feeling of achievement, which requires a moderate degree of difficulty. If they feel replaceable or if their work can be done by anybody they will not be motivated.[16] This was one of Gramsci's rationales in support of a strict division of labor. According to Horvat, reformers in Yugoslavia saw that the originally mandated firm structure was too rigid and strived to address this dilemma by creating formal economic units of workers who perform the same or similar functions within a firm, as well as allowing firms to have greater freedom in devising their own organizational schemes.[17] Dividing decision making into these units helps to ensure that standards of excellence are appropriate and supported by the workers affected, however in reality the amount of power these units held in a firm varied enormously.[18]

Another problem that is brought up by Miles and Ritchie is "The temperment barrier" in management. Managers may not always be the type of person comfortable with asking their subordinates / fellow workers about the general direction of the firm, or they do not have the

[16] Williams, 50
[17] Horvat, 158
[18] Horvat, 164

confidence that the input of some of their fellow workers is high quality.[19] This is an important dilemma to recognize for labor-managed firms. On one hand, direct election of workers to the management board serves as a check on the power of managers if they fail to serve the interests of the workers. On the other hand, what is in the best interest of the workers is often at conflict with what is best for consumers (i.e. the wage maximization problem), or impedes the ability of firms to make unpopular but necessary decisions for survival in a competitive market. Horvat acknowledges that having a management team dominated by nonprofessionals who do not understand technological trends or markets has a negative impact on efficiency.[20] Proudhon's model of labor self-management helps address this issue by making the workers share in the profits and losses. The ownership controversy of having no clear residual claimant for firms is acknowledged by Horvat as a serious issue impeding the ability of labor-managed firms to succeed in ensuring positive individual worker behavior for the firm.[21] This issue with Yugoslav firms in particular will be explored in greater detail in chapter four.

The Theory of Perverse Incentives in LMF's

I am going to utilize essays from economists writing for scholarly journals to assess the extent to which these perverse incentives are legitimate. Hungarian economist Andrzej Baniak created a model to test the assumption that labor-managed firms will cut sales in an international market if demand increases. The model is necessary because it tests a central assumption in much of the theoretical work on labor-managed firms, that the firm will not hire more workers to increase production because it will cut out of their share of the enterprise's income. It is assumed

[19] Williams, 43
[20] Horvat, 166
[21] Horvat, 169

due to the perverse incentive of wage maximization per worker that production and employment will either stay unchanged or shrink in response to an upward shift in the demand curve.[22] The paper examines an increase in foreign demand of a good produced by a labor-managed firm which produces domestically and internationally and competes with a profit-maximizing firm producing a substitute good in the international market. The model finds that in theory, the firm will increase its sales abroad and decrease its sales domestically, especially if it already has a sizable market share domestically. This model essentially implies, in the words of the author, that "for a multimarket LMF (labor-managed firm), an upward shift in the demand function does not necessarily lead to a perverse reaction"[23]. This contradicts the case study made by Janez Prasnikar in his paper "Behavior of Participatory Firms in Yugoslavia: Lessons for Transforming Economies" which looks at a large sample of Yugoslav firms not engaged in international trade and a smaller sample of firms which were involved in international trade, and finds that the firms which were involved in international trade did act perversely in response to fluctuations in demand in order to maximize wages.[24]

Another paper by Kazuhiro Ohnishi similarly examines situations of competition between profit-maximizing firms and labor-managed firms. The model examines a profit-maximizing firm and a labor-managed firm in a Stackelberg duopoly, meaning that they sell essentially the same product and have the same demand and cost functions. Both of the firms have a wage-rise-commitment as a strategic commitment if they exceed sales goals.[25] What the model shows is

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[22] Baniak, Andrzej. "A Note on Comparative Statics for a Labor-Managed Firm Engaged in Exporting," Journal of Comparative Economics, Elsevier, vol. 28(3), (Fall 2000), 574
[23] Baniak, 576
[24] Prasnikar, Janez, Jan Svejnar, Dubravko Mihaljek, and Vesna Prasnikar. *Behavior of Participatory Firms in Yugoslavia: Lessons for Transforming Economies.* The Review of Economics and Statistics 76, no. 4 (1994): 728-41
[25] Ohnishi, 286-290

that the labor-managed firm will tend to follow the action of the profit-maximizing firm. If the firms act independently of each other and at the same time, the labor-managed firm will not adopt the wage-rise contract. The author uses these results to argue that in mixed-market models labor-managed firms act more as profit-maximizing firms.[26]

In a paper by Norman J. Ireland, the author also compares profit-maximizing and labor-managed firms while assuming a Nash-Cournot equilibrium, this time in an oligopoly. The model suggests that oligopolies of exclusively labor-managed firms price higher on average, and in oligopolies where both kinds of firms exist, the average price is higher the more labor-managed firms are there, but the average price charged by labor-managed firms is still less than that charged by profit-maximizing firms. The author argues that in the long-run equilibrium, the labor-managed firm will not price low because of opportunistic rent-seeking, because they would rather maintain a surplus than hire more workers in order to increase production and their market share.[27] The wage-maximization dilemma is perhaps the most commonly discussed issue with labor-managed firms, and different studies have yielded different conclusions regarding the subject, but generally this is a major reason why labor-managed firms have difficulty competing in a global economy. I will explain the impacts of the wage-maximization dilemma on macroeconomic indicators in Yugoslavia in the fourth chapter.

Findings

This chapter sets the groundwork for some of the main points of contention when discussing labor-managed firms. I believed it was important to try to explain the theoretical basis, advantages and problems associated with this form of management before I went into

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[26] Ohnishi, Kazuhiro. "Wage-Rise Contract and Labour-Managed Cournot Oligopoly with Complementary Goods," *Bulletin of Economic Research*, vol. 64(2), (Spring 2011): 286-290

[27] Ireland, Norman J. (2003) "Random pricing by labor-managed firms in markets with imperfect consumer information," Journal of Comparative Economics, Elsevier, vol. 31(3), (Fall 2003), 573-583

further detail about the ways in which Yugoslav labor-managed firms met or failed to meet their objectives. The comparison of Gramsci's and Proudhon's ideal systems should help provide the reader with some necessary insight into the different ways in which the system could have taken form, and provokes thought into why the Yugoslavs chose the model they did. Vanek's essay shows the assumptions made in the creation of the model and how they did or did not coincide with real life conditions. The essays on participative management allow the reader to hypothesize about the impacts of the Yugoslav firm structure on worker behavior, and Horvat provides insight into the finer details of the firms and how they saw some of the setbacks coming well in advance. The three economic models used later in the chapter should give the reader a more thorough understanding of the wage-maximization problem and its implication on the ability of Yugolsav firms to stay competitive. After reading this chapter, the reader should have a thorough enough understanding of labor-managed firms in order to follow my analysis on how these created economic instability in Yugoslavia.

Chapter 3: The evolution and structure of Yugoslav Self-Management

The origins of Yugoslavia as a Federation

Yugoslavia was a federation of six republics and two autonomous provinces, with a diverse collection of ethnicities and religions with different histories, eventually brought together into one South-Slavic state. The area which would become Yugoslavia had previously been mostly under the control of two separate empires, the Ottoman Empire and the Hapsburg Empire (which would later be known as Austria or Austria-Hungary). During its territorial peak in the 16th and 17th centuries, the Ottoman Empire controlled all of the to-be Yugoslav republics except for Slovenia, which was part of the Hapsburg Empire, and the parts of modern Croatia near the Adriatic coast, which was controlled by Venice until the end of the 18th century.[28] Over time the Ottomans lost more European territory both to the Hapsburgs and newly independent states. Montenegro was the first republic to gain de-facto independence from the Ottomans in 1697, with Serbia becoming a semi-independent state from the Ottomans in 1804. Both Serbia and Montenegro were recognized officially as independent after the signing of the Treaty of Berlin, which greatly reduced Ottoman influence in the Balkans following their defeat in the Russo-Turkish War in 1878.[29] The treaty gave the Hapsburgs control of Bosnia and Herzegovina while retaining Croatia and Slovenia. After the treaty the only areas of to-be Yugoslavia still under the control of the Ottomans were Vardar Macedonia (later simply the republic of Macedonia) and Kosovo (later a province of Serbia). Serbia gained the Ottoman territories of Vardar Macedonia and Kosovo during the Balkan Wars of 1912-1913. [30]

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[28] Sekelj, Laslo. *Yugoslavia: The Process of Disintegration.* Boulder, Colo: Social Science Monographs, 1993, 3-5
[29] Bennett, 12
[30] Sekelj, 13-14

A plan for a multi-ethnic federation of the South Slavs was written by a group of Serb and Croat intellectuals in 1848[31] but did not become feasible until the end of World War I, when Austria-Hungary collapsed. In late 1918, the State of Slovenes, Croats and Serbs was formed out of the portion of Austria-Hungary which is modern Slovenia, Croatia and Bosnia-Herzegovina, while Serbs in the province of Vojvodina near Hungary opted to join Serbia, along with Montenegro which merged with Serbia shortly after.[32] In December 1918, the enlarged Kingdom of Serbia merged with the State of Slovenes, Croats and Serbs, forming the original Yugoslavia, a constitutional monarchy governed in part by an assembly of representatives from regional political parties.[33] Yugoslavia had six republics: Bosnia-Herzegovina, Croatia, Serbia, Montenegro, Slovenia, and Macedonia, and two autonomous provinces in Serbia: Vojvodina and Kosovo, and within the republics there were counties and the below that were cities and towns. [34]In 1941, the country was invaded by the Axis powers and partitioned between Germany, Italy and Hungary.[35]

From Soviet Satellite to the split with Stalin: 1945 to 1949

In 1945, the Yugoslav Partisans led by Tito took back control of the country from the Axis powers, and proceeded to abolish the monarchy and transformYugoslavia into a communist regime. Initially, the Partisan-led government aspired to rebuild the country using the Soviet model of rapid industrialization through state ownership of the means of production. From 1946

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[31] Bennett, 6
[32] Sekelj, 15
[33] *The country's official name was the Kingdom of Serbs, Croats and Slovenes until 1929, when it officially became the Kingdom of Yugoslavia, although it was commonly referred to as Yugoslavia before the official name change.*
[34] Sekelj, 16
[35] Sekelj, 18

through 1948, the state seized all manufacturing, insurance, retail, banking, transportation, and wholesale enterprises. The Federal Economic Planning Law of 1946 entrusted state planning and management authorities, headed by the Federal Planning Commission, with control over the assets acquired by the state. The Federal Planning Commission delegated control over assets to regional, communal and local planning authorities under its control, and devised five-year plans to rapidly industrialize Yugoslavia and bridge the income gap between Yugoslavia's modernized industrial republics in the west and the poorer rural ones in the east.

The single event which can be credited with steering Yugoslavia towards self-managed "market socialism" was the Tito-Stalin split in 1948 and Yugoslavia's subsequent expulsion from the Cominform, Europe's association of communist parties. The reasons for the split were complicated. For one, Yugoslavia was unlike the other communist countries of Eastern Europe in that Yugoslavia was liberated by Tito and the Partisans, while the other countries credited Stalin and the Soviet army for their liberation. Tito, while loyal to Moscow, did not feel that the Soviet bureaucrats had earned the right to dictate specific policy decisions in a country like Yugoslavia which they were not familiar with. In 1948 Tito's cabinet modeled their economic plan following the Soviet example but developing it independently without Soviet input, which escalated tensions quickly. [36]

Tito was concerned with regional relations and stability in the Balkans, and was less concerned with other socialist states which Yugoslavia was not neighbors with. He desired to make Yugoslavia the regional power in Southeastern Europe, to Stalin's dismay. After the end of World War II, Yugoslav forces angered the Western Bloc by annexing parts of Northeastern Italy bordering Croatia and Slovenia, and by shooting down four US transport aircraft between

[36] Bennett, 7-9

1945 and 1948.[37] The Soviets had experienced the heaviest losses in World War II and were wary of entering an armed conflict with the West so soon after, especially when the US had proven nuclear capabilities and the Soviets did not, so they feared Yugoslav aggression would pull them into an unwinnable war. The conflict between the Yugoslavs and the Soviets intensified when Yugoslavia openly supported the Greek communists in the Greek civil war, deploying troops to Albania in case the conflict spilled over. Stalin had wished that the Yugoslavs had consulted him before taking decisive action, as he promised Winston Churchill that he would not intervene directly in the Greek conflict and only support the communist cause there through UN resolutions.[38]

Stalin became aware during this time period that Tito and the Partisan government were in talks with Bulgaria to merge the two countries and uniting the "South Slavic" peoples. Stalin agreed with the principle but felt disrespected that he was not consulted. Soviet intelligence eventually revealed that Yugoslavia and Bulgaria had discussed plans to incorporate / absorb Albania and potentially Greece and Romania to create a proposed "Balkan Federation" encompassing most of Southeastern Europe. This would serve the purpose of placating ethnic groups such as the Albanians and the Macedonians, who were spread out between multiple countries, but more importantly it would create a socialist state large and populous enough to challenge Soviet dominance in communist affairs in Europe.[39] Alarmed, Stalin held a meeting with Milovan Djilas and Edvard Kardelj, two of Tito's most important confidantes who had been spearheading Yugoslavia's policy of socialism independent from the Soviets. According to accounts from Kardelj and Djilas, the meeting was contentious and convinced them that relations

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[37] Bennett, Christopher. *Yugoslavia's Bloody Collapse: Causes, Course and Consequences.* New York: New York University Press, 1995, 11
[38] Cohen, Lenard J. *Broken Bonds: The Disintegration of Yugoslavia.* Boulder: Westview Press, 1993, 21
[39] Bennett, 44

with the Soviets were beyond repair. [40]*[41] The meeting was followed by a tense exchange of letters between the party representatives in Moscow and Belgrade. When the Cominform met in June of 1948, Tito refused to attend, knowing that Yugoslavia would soon be expelled, and his prediction was correct. Even Bulgaria, which had a cordial relationship with Tito's government, was not willing to risk aggravating the Soviets and decided to side with Stalin.[42]

The Informbiro period and re-alignment

Yugoslavia's expulsion from the Cominform marked the beginning of what historians call the Informbiro period, when Yugoslavia had very hostile relations with the Soviet Union and was relatively isolated. Yugoslavia may have ensured its ability to dictate its own affairs free from outside influence, but it was now enemies with both the East and the West and left politically and economically isolated. Tito had been aware that Stalin had been spying on him since as early as 1945, and survived several attempts by Soviet assassins to take his life in the years following Yugoslavia's expulsion from the Cominform. Yugoslavia was also at risk of physical invasion from its Soviet-allied neighbors, who conspired to remove Tito's government from power in 1949 when Romanian, Hungarian and Soviet troops amassed along the country's northern borders.[43] This fortunately did not escalate into an armed conflict, but the events made it certain that Yugoslavia would need to make new friends if it was to survive without the

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[40] *Djilas and Kardelj would go on to become two of the most important architects of Yugoslav workers' self-management, and both served stints as deputy Prime Minister to Tito as well as Presidents of the Federal Assembly. While Dilas tenure in these positions was cut short due to disagreements with Tito and central party leaders about increasing democratic input and lessening the role of Communist Party bureaucrats, Kardelj had a lengthy career as Tito's right hand man (Prout, 17) and is widely considered the primary creator of Yugoslav self-management by many historians.*

[41] Cohen, 22

[42] Cohen, 23

[43] Cohen, 30-31

support of the Eastern Bloc. Yugoslavia had to now find a way to show that it was not simply another communist state in order to ingratiate itself with the West. This need played a major role in facilitating Yugoslavia's transition towards decentralized "market socialism", which would serve a purpose of distinguishing Yugoslavia in the eyes of the West while at the same time remaining as true to the principles of Marx as possible.[44]

The degree to which the "markets" in Yugoslavia were legitimate varied depending on the constantly evolving chain of legislation and bureaucratic power struggles, but what cannot be disputed is that Yugoslavia's embrace of an alternative path succeeded in ensuring aid from the West and thus saving the country from inevitable doom. In 1949 Tito began building up relations with the West and succeeded in securing large amounts of economic aid from the United States. Yugoslavia's uneasy alignment with the west can be credited with preventing a famine in 1950, deterring the threat of invasion from its neighbors, and helping raise living standards significantly during the 1950s. Despite Yugoslavia's refusal to join NATO, preferring to be non-aligned, NATO promised to help defend Yugoslavia from aggression, and Yugoslavia accepted military aid from the United States while it built up its own military infrastructure until 1953. Tito was reluctant to become overly reliant on assistance from the United States and the rest of the West, but nevertheless Yugoslavia had a hard time turning down aid from organizations such as the International Monetary Fund. This addiction to foreign aid and investment would eventually become a serious problem for the Yugosav economy during the oil shocks of the 1970s when it was unable to repay its debts, but at that point the complex web of bureaucratic regulations between communal, local, regional and federal authorities limited the availability of alternatives.[45]

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[44] Cohen, 31-32
[45] Cohen, 25

Kidric's "dual economy" and the transition towards decentralization: 1949 to 1953

The realization that Yugoslavia would not be able to survive following the Soviet model of central control of the means of production did not occur overnight, nor was the decision unanimous. Boris Kidric, who was Chairman of the Federal Economic Commission which managed the Yugoslav economy from 1946 to his death in 1953, addressed the Fifth Communist Party of Yugoslavia Congress in July 1948 less than a month after Yugoslavia's expulsion from the Cominform. He stated that "the ideal type of economic life in a socialist society is state enterprise, with its economic functions exercised by centralized state organs."[46] While the Yugoslavs initially stuck with following the Soviet model of industrialization through forced collectivization, collectivizing all agriculture in 1949, the increasingly harsh impacts of the Soviet economic blockade and physical aggression strengthened the case against the centralized command economy.[47]

The alternative which emerged as a foil to Soviet-style central planning was known as the theory of state capitalism. If the state was to retain control of the means of production, government bureaucrats would retain the surplus value of the workers labor, rather than the workers themselves. Thus, the bureaucrats would become a separate class all in themselves, going against the ultimate goal of Marxism - to create a classless society. The state would become a vehicle of exploitation, and rather than capitalism being eradicated, the bureaucrats would become "state capitalists". This theory led to the conclusion that the only way in which to create an ideal classless society was to have the state itself eventually wither away.[48] The theory

[46] Sekelj, 21
[47] Prout, Christopher. *Market Socialism in Yugoslavia*. Oxford University Press, 1985, 19
[48] Prout, 23

maintained that Yugoslavia was in the transition from capitalism to socialism, and state ownership of economically productive assets was temporarily necessary to ensure this transition, but it would no longer be part of the end goal. The alternative was proposed by Edvard Kardelj in an article written in 1949 titled (in English) *On people's democracy in Yugoslavia*. He argued that the state should give up an increasing amount of decision making power to organizations based upon mass participation. Boris Kidric, while open to new ideas, was more tied to state involvement in the economy and the "Soviet style" of doing things, while he increasingly became more and more open to aspects of mass participation in economic decision making after consulting Kardelj in 1949.[49]

The development of the theory of state capitalism and mass participation marked the beginning of what historians call the period of the "transitional economy" in Yugoslavia, which lasted from 1949 until Kidric's death in 1953. As president of both the Economic Council and the Federal Planning Commission, Kidric pursued what he referred to as essentially a dual economy with characteristics of both capitalism and socialism. There were three types of property relations: state, social-cooperative, and private. Private property was permitted primarily in the areas of commodity production and agriculture, with Kidric abandoning his plan to collectivize all of the country's agriculture. The principle was that isolated production units would be market based, pricing under the law of value as dictated by supply and demand. The law of value in commodity production dictated pricing in both forms of socialist property, social-cooperative and state, and this became one of the primary features distinguishing Yugsolav socialism from Soviet socialism, with the latter not recognizing the law of value in determining

[49] Prout, 24-25

pricing in commodity production until 1956.[50] Within the state sector, firms would be allowed to operate as independent units doing their own accounting. In the capitalist sector, firms as economic units operated independently, only connected through the market, but in state and social-cooperative sectors, firms as economic units were directly connected through adherence to the five-year plan, and planners served the role of managers. In the state and social-cooperative sectors, planners determined the distribution of resources and tasks between branches in the firm.[51]

The transition from command socialism to market socialism was gradual, as the Yugoslav authorities were rightfully cautious to ensure that the transition was well thought out in order to minimize the inevitable economic disruptions which would take place from such a massive change. In the spring of 1950, Dilas met with Edvard Kardelj, Boris Kidric, and the trade union leaders in Belgrade. Under the Soviet-influenced model of the late 1940s, workers councils had existed but were mere consultative bodies with little authority over enterprises, completely at the helm of central planners. When Djilas suggested that the control of factories should be transferred to a free association of producers, giving the workers autonomy from the state in controlling the enterprise, and moving towards the vision of a participatory society free from "state capitalism". Kardelj suggested that the role of workers councils be transformed into a free association of producers. When Tito returned to Belgrade, Dilas and Kardelj persuaded him to speak to the National Assembly and persuade them to pass a bill altering the role of the worker council into a managerial one. Tito was initially skeptical but after being pressed hard was

[50] Milenkovitch, Deborah D. *Plan and Market in Yugoslav Economic Thought.* London and New Haven: Yale University Press, 1971.
, 54-56
[51] Milenkovitch, 57

eventually convinced.[52] On the 28th of June 1950, the Assembly passed the Law on the Management of Government Enterprises by Workers' Collectives, setting the groundwork for the right of employees as a collective to manage the enterprise. The transfer of ownership of the enterprise occurred gradually before being laid out more explicitly in the Constitution of 1953.[53]

With the role of the workers councils now being established, subsequent laws were passed to lay out the new relationship between the central plan and the markets. In January 1951, the Law on the Formulation and Determination of Prices and Consumer Goods was passed, allowing producers of non-rationed commodities to dictate prices freely according to the laws of supply and demand. After this law passed steps were taken over the next two years to free up enterprise determination of prices from local and regional planners, first prescribing autonomy to manufacturers to determine their own prices and then allowing producers of raw materials to do the same, with exceptions made for certain types of raw materials such as steel.

Boris Kidric furthered the liberalization and dismantling of central control of the economy by formulating the Law on the Planned Management of the National Economy, which was passed by the National Assembly in December 1951. The law further laid out how control over the economy by legal and administrative bodies would be transferred to worker collectives over the next two years, giving enterprises greater autonomy. The state planners would no longer issue detailed production quotas for enterprises but retained the ability to plan the "basic proportions" by which the firm operated in terms of investment allocation and distribution.[54] While the central planners still determined how much was invested in different sectors of the economy, allocation of investments were determined by a system of auctions for investment

[52] Milenkovitch, 66-67
[53] Prout, 13
[54] Horvat, 13

loans through the newly established General Investment Fund. Firms which were better suited to pay interest rates and fulfill repayment schedules quickly would win the auctions.[55] Eventually other criteria were added which helped determine which firms would win the auctions within their sector; "the percentage share of participation with the bidders own resources, the shortest period of construction, the lowest cost per unit of output, and regional effects."[56] One of the main problems with the auction system was that applications for credit were costly and time consuming, another reason was that auctions occurred at wide time intervals and often did not line up with the enterprise's needs for funds, and enterprises were often disingenuous on their applications about the rate of interest and timetable they said they could pay just so they could secure the credit. If they defaulted on their payments the authorities in charge of the social investment funds would seldom shut down a firm just because of an unpaid loan.[57] According to Neuberger's survey of Yugoslav investment auctions in the 1950s, no more than one third of capital given to firms was won through auctions, the rest being given directly by governments at the communal, district, regional, and federal level. In the early 1960s, the auction system was essentially abandoned and replaced by an increased reliance on various levels of banks.[58]

The law on the Planned Management of the National Economy gave federal economic planners the power to determine a minimum rate of capacity utilization, while nevertheless giving enterprises power to determine the composition and level of output. The state still played a large role in determining the rate of investment in enterprises, and exercised control in determining the number of workers necessary and the amount of money necessary to pay their wages. The state determined the "average rate of accumulation and funds", which was the ratio

[55] Bicanic, Rudolf. *Economic Policy in Socialist Yugoslavia.* Cambridge: University Press, 1973, 30
[56] Horvat, 221
[57] Horvat, 221
[58] Horvat, 221-223

of total expenditures on investment and social consumption divided by the amount of money allocated for wages.[59] The ratio was used to determine commodity prices and how much the enterprise would be taxed. The Five-Year Plan initiated in 1952 created equivalent investment funds at the republic, district, and local levels, and also specialized funds for various sectors of the economy such as infrastructure spending and agriculture. The goal of these reforms was to increase allocative efficiency while maintaining a fair framework for firms to get funding, and also increasing the availability of funds for lesser developed republics in order to spur industrialization there.[60]

The "New Economic System" and phase one of decentralization: 1953 to 1958

The majority of economic historians consulted for this project consider the third period[61] of economic development in Yugoslavia beginning with the passage of the 1953 Constitution, which was instrumental in two major ways. One, the constitution was rewritten to make self-management its guiding principle. The Constitutional Law on Principles of the Social and Political System of Yugoslavia specified the ways in which business in worker collectives would be conducted, being managed by both managing boards and the worker councils. The employees of an enterprise would vote in members to the workers council via secret ballot. It decentralized

[59] Milenkovitch, 83
[60] Prout, 15-16
[61] *It should be noted that the "New Economic System" devised by Boris Kidric, Edvard Kardelj and other top economic planners in Yugoslavia became operational a year prior in 1952 and lasted until 1960. For this project I consider 1958 to be the start of a different period in Yugoslav economic development and self-management, which lasted until 1963 or so, because in 1958 the League of Communists made sweeping new changes to key aspects of labor-management, which deserve their own section to discuss separately. The years which mark distinct phases in the development of Yugoslav self-management are arbitrary and do not line up exactly with the years of the five-year plans.*

political power and re-organized political bodies into communal, regional and federal levels, each with explicitly laid out powers and relations to the functions of enterprises to ensure that they act in the best interest of society.[62]

The roles of state bureaucrats were greatly weakened and the roles of worker collectives were strengthened, with many administrative functions being transferred over from the former to the latter.[63] This year was instrumental in formulating the power dynamic between proponents of decentralization and party loyalists who were fearful of losing a greater amount of power. Decentralization was not just taking place in the economy, but in the political apparatus itself, with the influence and privileges of communist organizations being reduced, and their roles becoming more explicit, more so at the lower levels than at the top. Top party leaders were often the ones calling for increased liberalization, while the new middle layer of state and party officials, which was created by the power vacuum of political decentralization, began to fight harder and harder to maintain power in the hands of the state bureaucrats.[64] It was this ensuing conflict between economic liberals and party loyalists which would ultimately sabotage attempted reforms to the system of Self-Management in the 1960s and 1970s.

Decentralization of the political apparatus gave communes the power to regulate economic matters which were not explicitly laid out in the constitution as under federal or regional control. This was elaborated on in the Constitution of 1953 but was originally conferred in the 1952 General Law on People's Committees.[65] The business plans of enterprises and most business policy decisions had to be approved by the leadership of the commune, the director of the enterprise had to be agreed upon by both the vote of the workers council and the commune

[62] Milenkovitch, 100-101
[63] Bicanic, 69
[64] Bicanic, 69
[65] Prout, 17

leaders, and the commune leaders could prevent an enterprise from getting loans from local banks if they did not capitulate to their demands. Communes had complete discretion in imposing high local taxes on enterprises, which penalized more efficient enterprises in order to fund the investment projects of inefficient firms. These projects were often poorly executed and overly ambitious, but served the interests of the local politicians. Corruption in giving out loans to enterprises was an enormous problem during this time period.[66] Even if the investment projects were in theory in the best interest of the community, practices like these hurt consumers and hindered innovation. In their plan submitted to commune leaders, enterprises had to explicitly state the industrial sectors which they would be involved in. If the firm tried to diversify and enter into a newer market, the firm could be immediately shuttered. Economic Chambers were established in 1954 and were a collection of firms organized by sector, having power over the firm similar to the commune leaders although less influential. The chambers could scrutinize submitted production and investment plans, with their main goal being to ensure that firms produce as close to the recommended capacity as possible, not over or under. After 1958 the role of chambers were modified to focus less on business policy and more on legal conformance, in order to minimize conflict of interest with the communes. Enterprises in the same sector could also group themselves into associations where they could apply for credit together and use the same production facilities.[67]

The tug-of-war between communist party loyalists and liberal economists helped to sabotage key aspects of the envisioned "market socialist" economy, exemplified by the constantly changing policies with regard to commodity pricing, wage policy and taxes on businesses. The Price Law of 1952 had given enterprises the freedom to charge what they wished

[66] Prout, 17
[67] Prout, 18-19

for commodities which were not on the Federal Economic Council's list of commodities in short supply.[68] Soon after, Yugoslav economic planners saw that many of the workers councils were rewarding themselves with excessive wage increases, and were creating artificial scarcities and holding goods in inventory in order to raise prices to pay for the wage increases. Because Yugoslavia had at this time been mostly isolated from foreign trade, Yugoslav firms were free to engage in monopolistic pricing policy to the detriment of consumers, causing inflationary pressure on the dinar, the national currency of Yugoslavia. In 1953 and 1954 the Federal Economic Council placed restrictions on the proportion of enterprise funds, but these proved to be inadequate in solving the problem.[69] The Federal Price Office was established in 1955 to re-assert some administrative controls of pricing, setting fixed prices for electrical power, transportation, sugar, oil, and salt, and set ceiling prices for various metals, coal, petroleum, and other goods, and also issued minimum and guaranteed prices for staple food products like milk. In 1958 the Price Office instituted a policy of prior price registration, where producers had to notify the office thirty days beforehand of a price increase and giving them veto power if it was not justified. The Price Office reserved the right to place a product under price control if it fell under one of three criteria: "(a) its importance to the standard of living or to production costs of other products; (b) scarcity on the market; and (c) the monopoly position of the producer."[70] Prior price registration was the most effective measure in preventing firms from inflating prices to cover excessive wage increases.

Before 1952, government workers were assigned into categories of wages based upon their skillset, and the highest paid worker could make no more than 3.5 times what the lowest

[68] Prout, 105
[69] Prout, 106
[70] Horvat, 175

paid worker made. Managers had performance incentives for fulfilling the government plan, but aside from that the average worker had little material incentive.[71] This ended up becoming a serious obstacle to efficient production in Yugoslav enterprises, and after 1952 worker collectives began determining workers' wage differentials and incentives, following the recommendations of both trade unions and the economists in order to stimulate productivity. The ratio between enterprise income and wages was determined by what was called the rate of accumulation and funds, which used gross income left after aggregate savings and contributions to the social funds (determined by the social plan) to determine the wage bill, but this system was abandoned in 1954.[72] This was replaced briefly by the profit-sharing system, which divided wages into a wage fixed guided by government policy and a variable wage meant to be used as a material incentive to increase production. Wages came out of a wage-fund determined by the social plan, with the federal government playing having the strongest say in how large the wage-fund was in order to ensure that it gets an adequate share for itself while keeping the workers from over-rewarding themselves in order to maintain funds for the enterprise and simultaneously protecting the workers share from the district authority.[73] After 1955 workers councils gained the ability to set the labor productivity thresholds which determined the variable part of the wage.[74] This wage system helped increase productivity but by design limited employment, and persistent unemployment remained a problem in Yugoslavia not only before the reforms of the wage system but ensuing throughout most of socialist Yugoslavia's history. According to Horvat, the freedom of firms to set their own wages did not significantly exacerbate inequality within firms;

[71] Horvat, 179-180
[72] Biancic, 104
[73] Biancic, 105
[74] Milenkovitch, 106

the average income ratio between the highest and lowest paid jobs inside an enterprise in 1961 was 1 to 4, with only one percent of Yugoslav firms having a ratio of 1 to 9 or more.[75] [76]

The implementation of labor self-management also changed the nature of agricultural production significantly, and starting around 1955 it began to be characterized by high levels of investment in large self-managing agricultural collectives. The tax system was changed to fund federal subsidies for new machinery, fertilizers, pesticides, seeds, and more productive livestock. Smaller individual-owned farms were allowed to continue to operate and were the primary producers of milk, meat, fruit, and potatoes. These kinds of farms still constituted two-thirds of sales in agricultural production by 1960, although following the introduction of worker self-management in agriculture, although data provided by Horvat from a study by the University of Belgrade showed agricultural production rose by 48 percent between 1957 and 1961.[77] Investment in large collective farms relative to production per person was much greater in large collective farms than the individual farms[78], so it is unclear whether the increase in production was due to increased worker input and coordination or due to the combination of increased material investment and the nature of greater economies of scale. Socialist visionaries were willing to tolerate individual farmers outside of the collective, but did not see how they could be incorporated into the ideal socialist society with the withering away of the state. Kardelj suggested in a 1959 paper[79] that the individual peasants who were not part of the cooperatives could still engage different modes of cooperation with the cooperative, offering a win-win

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[75] *Wages did increase faster than productivity after 1958, this will be discussed in the later section.*
[76] Horvat, 180
[77] Horvat, 91-93
[78] Horvat, 90
[79] *The paper's title translates from Slovene to English as "Problems of Socialist Policy in the Village".*

situation where the crops have greater yields, allowing greater tax revenue for the local, regional and federal governments, and giving the individual farmer more revenue as well. There would be tradeoffs, such as if the cooperative engaged in joint cultivation and development of the land, the firm would effectively be the owner and the individual farmer a renter, but this outcome is , in Kardelj's words, "more acceptable than the alternatives; capitalist stratification of the village, expropriation, or Stalinist collectivization."[80]

The 1955 decision to invest more in agriculture was the result of a meeting of several top Yugoslav political leaders in Brioni on the Croatian coast, but the bigger decision made at this conference was to decentralize industry in Yugoslavia. The leaders agreed that now that the foundations of an advanced economy by building up basic industries had been laid in the previous few years, at the expense of investment in consumer goods and agriculture, both of which had been neglected by comparison. Now, the structure of investment would be readjusted to build up industries not by fixed order of priority for the means of production, as had been done before, but by order of simply which would accumulate income the quickest. This would in turn provide the government at each level with the income to build up and develop newer industries. Doing so this would increase the national standard of living and addressing persistent regional inequality between the republics and provinces directly through standard of living increases due to the shift of rural peasants to higher income production jobs, and also through increased tax revenue to go towards the social investment funds.[81] This would also shift the financial burden of setting up heavy industry from the government budget to firms, allowing them to use that money for other projects. Another justification for the shift towards the decentralization of industry was that scarcities in consumer goods had created instability in Western Europe after World War II,

[80] Horvat, 130
[81] Biancic, 76-77

and it was around this same time which unrest in Poland and Hungary partially due to scarcities in consumer goods were starting brew, culminating in near political crisis in both countries the following year in 1956. Biancic argues that the Tito regime may have been able to dodge a bullet by enacting these reforms when they did. Another factor necessitating the change was that the policy of collectivizing agriculture rendered much of the rural peasantry unable to provide enough savings to fund the social investment funds, so this loss in revenue from agricultural workers needed to be made up for by an increase in tax revenue from industry.[82] Furthermore, Yugoslav leaders hoped that decentralizing industry would help correct the disequilibria of supply and demand in sectors of the economy such as consumer goods, agriculture and light industries which had been created under the command and dual-style economies after World War II.

The second phase of decentralization and the failure of the second New Economic System: 1958 to 1964

In 1957, at the First Congress of Workers Councils, the representatives of the workers councils decided to ask the government to give the enterprise greater autonomy.[83] The Third Congress of the Yugoslav Association of Economists convened for the first time to discuss policy in May of 1958, ending with new suggestions for structural reforms to the labor-managed economy, specifically wages, in response to the request from the First Congress of Workers Councils. This year the League of Communists changed their official rhetoric on Yugoslav socialism, implying "social ownership, self-management of the economy, and the absence of nonlabor income and exploitation."[84] The years of the second five-year plan, 1957-1961, saw

[82] Biancic, 77
[83] Horvat, 182
[84] Horvat, 19-20

unprecedented economic growth. In 1961 three major reforms were enacted; for one, the mostly closed Yugoslav economy was opened up to the world market when Yugoslavia became an associate member of the GATT[85], the predecessor to the World Trade Organization. Secondly, the system of banking and investments was overhauled, and third, the enterprise was granted complete discretion in determining wage levels, free from the bureaucratic control of trade unions and commune politicians.[86]

In 1958 the workers system of wages was abolished in favor of a personal income system where the workers council is collectively considered owners of socialist property (as in the means of production), and are thus the risk bearers as well, essentially acting as a residual claimant. The workers council was granted discretion in determining wages as a proportion of the business proceeds of the enterprise, but had to follow wage schedules which had to be approved by local authorities and the trade unions, and enterprises were still subject to progressive taxation on bonus wages,[87] with the government continuing to mandate portions of proceeds to go toward social investment funds and communal taxes.[88] The income of the workers is determined by a points system which was supposed to measure the worth of the worker's efforts to the enterprise, as well as by what unit / department in the enterprise the worker is a part of and that unit's worth to the enterprise, with departments often having their own workers councils in larger firms to negotiate their share of the pie.[89] The government had a guaranteed personal income level which was determined and allocated under the incentive-based points system for workers mentioned previously, with regional governments setting an income range

[85] *GATT stands for General Agreement on Tariffs and Trade*
[86] Horvat, 23
[87] Horvat, 182
[88] Biancic, 107-108
[89] Biancic, 108-109

which firms could choose from. This would be paid out of the reserve funds of the communal budget if it could not be paid by the enterprise, but the enterprise would owe the commune and have to pay the commune back, and failing to do so would result in liquidation bankruptcy. The government also had a second safeguard for workers, a minimum personal income, which was at a fixed basic level for all sectors and firms and would be paid strictly out of the communal budget.[90]

Despite the government providing wage schedules and progressive taxation on wage bonuses, real wages started increasing faster than labor productivity after 1958, this differential growing especially during the economic downturn of 1961 to 1962, and after 1964.[91] The system of set wage differentials and progressive taxation were both abolished in 1961 and the flat tax of 15 percent which replaced the progressive tax was abolished in 1965. The workers councils had complete independence now in distributing income. The principle of wages increasing in proportion to productivity worked in the context of the larger economy but not when applied to individual firms, especially in a rapidly expanding economy like Yugoslavia's before 1965, because some industries expand at vastly different rates, so do rates of growth in labor productivity and thus wages.[92] A 1966 study cited by Horvat from M. Korac, a graduate student at the Institute of Economics in Zagreb, found that "wage rates for the same category of skill in the highest paid and lowest paid industry groups were in a ratio of 2:1."[93] Horvat considers the excess income given to workers in more productive enterprises performing the same duties with the same skills to be a form of rent, what he labels "the rent of technological progress"[94]. A 1971

[90] Biancic, 110
[91] Horvat, 183
[92] Horvat, 183-184
[93] Horvat, 184
[94] Horvat, 184

study by two economists at the University of Belgrade[95], found that these differentials were the biggest source of inflationary pressure in Yugoslavia at the time.[96]

Under the Second New Economic System, the banking system was altered to make it easier for enterprises to conduct a coherent business policy, taking some power away from communal authorities and the national banks. Starting in 1961, a two-thirds majority of the communal banks managing board would be representatives nominated by the workers councils. Regional banks were created to mediate differences between communal banks and communal banks and had to keep 5 percent of their reserve credit in the regional banks, which had the negative consequence of fragmenting the national credit market under the boundaries of the republics with differing business conditions. Joint reserve funds were created the following year to grant credits to underperforming enterprises which would otherwise be ineligible for banking credit.[97]

The new constitution of 1965 and the era of self-government in Yugoslav firms: 1965-1971

The reforms of 1961 which were intended to liberalize the economy have been widely considered by economic historians, including but not limited to Horvat, Milenkovitch, and Bicanic, as an enormous failure, and the failure of these reforms necessitated the formation of a new constitution. In an 18-month period from January 1961 to the summer of 1962, the annual growth rate of industrial output had dropped from 12 percent to 4 percent. The reforms to create a labor-managed decentralized economy had been reached through a series of compromises between proponents of central planning and proponents of the liberal market economy. The

[95] *The paper was written by S. Popov and M. Jovicic and its title translates from Serbo-Croatian to English as "Impact of Personal Income on Price Movements".*
[96] Horvat, 184
[97] Horvat, 211

products of these reforms were neither sufficiently centrally planned or liberal, and this political tug of war between opposing sides continued long after the sweeping reforms of 1965, with proponents on each side blaming the other for the shortcomings of the labor-managed economy. When government officials reviewed reports authored by the nation's top economists to diagnose what was going on, they found that the downturn had been largely contributed to by the economic shocks created by the 1961 reforms. The reforms to the banking system made it harder for firms to obtain necessary funding, and the abolition of income controls allowed wages to increase much faster than productivity.[98]

At the Eighth Congress of the League of Communists in December of 1964, the economic liberals got most of what they asked for and in the following months the Assembly enacted legislation which would hopefully allow the labor-managed market economy to function properly. Over the next year, Tito purged the primary opponents of decentralization from the party to ensure that the new reforms would not be sabotaged. The reform aimed to promote greater economic efficiency by relying more on the market and less on the five-year plan, fix disequilibria between supply and demand in key sectors of the economy, and control domestic inflation. Specifically, direct and indirect subsidies given by the communal and regional authorities were mostly eliminated except in a few specific sectors which were strongly related to transportation infrastructure such as coal, wood and iron. Price controls were overhauled, and communal authorities were removed from investment and financing decisions. The exchange rate for the Dinar was made uniform and restrictions on imports were reduced to allow increased competition from foreign producers. The tax on profits was significantly reduced while the tax on income remained, with the goal of incentivizing the firm to invest its profits more efficiently.

[98] Horvat, 22

Banks were no longer instruments of the investment funds, but were now autonomous enterprises allocating capital from firms and government agencies, which would manage the bank.[99] The reform of 1965 cemented workers management as the main instrument of social control, furthering Yugoslavia along the envisioned process of the state itself eventually withering away in order to achieve a utopian socialist society.[100]

According to Horvat, the ideas of the reform were good but the laissez-faire principles of the reform were applied naively. The reform worked in reducing inflation, but increased unemployment. The growth rate of industrial output, which in 1965 had recovered back from its 1961 slump of four percent up to twelve percent, plummeted to negative one percent by 1967, the first time growth had been negative since the centrally planned economy was officially abandoned in 1952.[101] In a 1967 public debate on the state of the economy in Yugoslavia, economist A. Bajt argued that one of the main causes of the growth rate becoming negative was that the government had squeezed credit in order to stop inflation, which had negated any increased ability of firms to invest in their own production which had arisen from the reduced tax rate and autonomy from communal intervention in business decisions.[102] At the end of 1968, a report issued by the Institute of Economic Sciences exposed the contradictory nature of how these reforms were intended to work versus how they actually ended up working. The report stated that despite the reforms to free up prices, there was administrative control over prices on an even greater percentage of output than before, yet prices were not any more stable. Another

[99] Milenkovitch, 175-177
[100] Prout, 35
[101] Horvat, 23-27
[102] Horvat, 26

noteworthy finding from this report was that the losses and indebtedness of firms were increasing since the reforms of 1965.[103]

One of the most damning statistics of all regarding the impact of the 1965 reforms was that the number of work stoppages in the years following the reforms increased significantly. N. Jovanov completed a study of strikes in Yugoslavia from 1965 to 1969, published in 1970, which found that in "70 percent of the work stoppages involving 60 percent or more of all protesters, the conflict appears to be with the administrators within the representative organs rather than with the representative organs as such."[104] [105]. Prout also cites a 1968 study from Jovanov which found that half of the strikes were against the administration / managers, while only 5 percent were solely against the representative organs / councils.[106] Prout argues that depressed economic conditions after the 1965 reforms increased division not just between the "managerial class" and workers, but between workers from different departments, as over a quarter of work stoppages in Jovanov's 1970 study involved one economic unit / department striking against another.[107]

The fragmentation of government and fixing the broken labor-managed economy: After 1971

The increasing sentiment against the managerial class led to the passage of constitutional Amendment 15 in December 1968, which freed worker collectives to formulate their own management structures, providing that the council itself must not be dissolved, and that the management must still be accountable to the workers councils. While the goal may have been to encourage structures which favored increased democratic participation in decision making , the

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[103] Horvat, 26
[104] Prout, 52
[105] "*Representative organs" meaning worker councils or collectives.*
[106] Prout, 52
[107] Prout, 53

provision got rid of the former requirement that 75 percent of the management board must be production workers.[108] The restricted availability of credit during this time due to the government's efforts to reduce inflation coupled with poor economic conditions domestically, incentivized firms to create more professional management structures. While this may have not been the ideal of the socialist humanists, the workers were interested in increasing personal income more than having a voice in the decision making of the enterprise, and if they had to sacrifice certain aspects of their input in order to have a more professional management structure to increase profits and thus the money available for personal income, that was a sacrifice they were more often than not willing to make.[109]

In 1971, three years after Constitutional Amendment 15, the Federal Assembly under the recommendation of the Second Congress of Self-Management passed Constitutional Amendment 21, which sought to rectify the ideological dilemma cause by Amendment 15 by creating Basic Associations of Organized Labour (BOAL), which replaced the economic unit as the legal definition of a department within an enterprise. Economic units had been an optional way to decentralize larger enterprises, while the official language of Amendment 21 established BOALs as "the fundamental unit of associated labour by which the workers… regulate directly and equally their working relationships".[110] The clause also gives members of a BOAL the right to detach themselves as an autonomous unit with their proportion of the income belonging to them. The language also specified that a BOAL could not be created if it was to "damage the rights of workers in other BOALs nor the interests of the enterprise itself."[111] Distribution of income was regulated by agreements set forth between the trade unions and the Congress of Self-

[108] Prout, 56
[109] Prout, 57
[110] Prout, 59
[111] Prout, 59

Management. Many enterprises refused to introduce BOALs because they would make the enterprise impossible to run, and the government was for the most part unable to force them to comply.[112]

The Constitution of 1974 elaborated on Constitutional Amendment 21 regarding BOALs. BOALs were to include administrators and workers at all skill levels, and suggested that in production divisions it contain between 250 and 400 members, with no more than 700. Prout states that in reality, most firms which were already of this size would convert themselves into BOALs simply establishing a system of self-government and changing their name. The enterprise was legally transformed into a Working Organization of Associated Labor (WOALs), which had very limited legal authority over personal income, hiring and investment decisions of BOALs.[113] The Constitution of 1974 reaffirmed many of the constitutional amendments in 1971. The Law of Associated Labor in 1976 strengthened the power of WOALs, mandated that BOALs could no longer be a stand alone economic unit, and also created Composite Organizations of Associated Labor (COALs), which are used to combine BOALs from different WOALs into one unit, the equivalent of a very large firm.[114]

During the late 1960s, the wave of decentralization spread from the economic apparatus to the political one. In 1967 and 1968, the Federal Assembly increased the powers of the republics, and later in 1968 the Federal Assembly was replaced altogether by the Chamber of Nationalities, which had delegates that had to support the majority view of the republican assemblies. This made consensus in decision-making at the federal level virtually impossible.[115]

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[112] Prout, 60
[113] Prout, 65
[114] Prasnikar, Janez & Jan Svejnar. "Economic Behavior of Yugoslav Enterprises", *Advances in the Economic Analysis of Participatory and Labor-Managed Firms*, vol. 3. Stamford: JAI Press, (1988), 240
[115] Prout, 60-61

The Croatian Spring, which had begun in the late 1960s but boiled over in 1971, highlighted republican differences with regard to the labor-managed economy. The Croats believed that the decentralization measures of 1965 and those which followed after had given Serbian banking enterprises, as well as their foreign trade enterprises, too much control and power. Prout states that "Croatia generated, at that time, 30 percent of Yugoslavia's industrial production and 35 percent of its foreign trade earnings."[116] In short, the Croats felt that economic decentralization in the labor-managed economy had deprived Croatia of the fruits of its own labor. Other republics, specifically Slovenia and Macedonia, were also wary of Serbian firms' dominance in control of the country's economic assets. The Croats pushed to become more and more economically independent, and Tito had had enough, sending in troops to crush the uprising in 1971. Tito and other members of the party, while frustrated by the insolence of the Croatian uprising, were sympathetic to the sentiment that the transition to economic liberalism had occurred too hastily.[117]

The Constitution of 1974 tried to reel in some federal control on enterprises without reducing efficiency. One way it did this was introducing legal directives to force work organizations to comply with the suggested self-management structures. The constitution also included provisions to coordinate investment allocation decisions between firms and the Economic Chambers, incentivizing ex ante competition by mandating contractual planning on investment decisions, rather than before where these competition occurred ex post, after production facilities were built. This served the purpose of achieving efficiency through greater economies of scale and avoiding capacity duplication.[118] The new Constitution also sought to

[116] Prout, 63
[117] Prout, 63-64
[118] Prout, 73

rectify republican deadlock, introducing federal agreements on price policy and investment, and including provisions requiring republican authorities to adopt policies which fell in line with federal guidelines. The Constitution of 1974 also established a committee and a number of special sub-committees pertaining to different sectors of the economy, to help aid in solving republican disputes in policy decisions. [119] These reforms did little to solve the political gridlock faced in Yugoslavia during this time, and after 1974, there almost no noteworthy changes to Yugoslav self-management. What happened in Yugoslavia during this time will be discussed in the conclusion.

[119] Prout, 76-77

Chapter 4: An analysis of aspects of Labor-Managed Firms

Now that I have provided an examination of how the system of labor self-management evolved over a period of time, I will provide a more in depth analysis of some of the problems with Yugoslav firms which were discussed in the previous chapter. The first part of this chapter will discuss the case studies of two anonymous large Yugoslav firms provided by Ichak Adizes in his book *Industrial Democracy: Yugoslav Style: The Effect of Decentralization on Organizational Behavior.* The second part will discuss a few theoretical examinations of some of the problems faced by Yugoslav LMF's discussed in Chapter 3.

Part 1: Organization within the firm: Firm ABC and XYZ in *Industrial Democracy*

The firms studied were largely similar in many aspects except for their leadership patterns, allowing Achides to isolate these differences as the independent variable. The similarities of these firms included but were not limited to the number of workers, technology used, the regulatory policies applied to them by the government and laws determining their organizational structure, and the age of the company.[120] The companies sold to the same markets and used similar distribution methods, and their decision making bodies had a similar distribution of members according to education, training and position in the company. The two companies were both researched during the same time period in the spring of 1967,[121] which is important to note since the regulatory environment concerning labor-managed firms changed so frequently. The two companies, described only as ABC and XYZ, were both involved in textile

[120] Adizes, Ichak. *Industrial Democracy: Yugoslav Style. The Effect of Decentralization on Organizational Behavior.* New York: The Free Press, 1971, 7
[121] Adizes, 6-7

production, with ABC producing cotton fabrics and XYZ producing wool fabrics, but they were not in direct competition with each other. Both were located outside Belgrade, Serbia, with plants only a few miles away from their headquarters.[122]

Before I discuss the differences between the structures of the two firms I must give a clearer picture of the organizational structure of Yugoslav firms under self-management after 1965. The management process is divided into two spheres of functions: administrative and governing. The firm is governed by conventions of workers from the different departments / economic units; these meetings are called Zbors.[123] The general membership elects the central workers council, which elects the governing board and nominates the director and other executives who must be re-elected after completion of a term. The economic units also have their own councils of eleven members, with powers delegated by the Zbors. The executives do the administrating, making suggestions to the workers council and general members (who collectively make up the governing body) and ultimately implementing their decisions. Some functions are explicitly given to the governing body rather than the administrators through various laws, and the governing body of the firm decides the extent of the administrators powers. Some firms are more decentralized than others, but the central workers council is always the supreme decision making body in the firm.[124]

Company XYZ was more decentralized, with more power being given to the various economic units, and its governing bodies on the plant level were much more aggressive in decision making than their equivalents at company ABC. Company ABC on the other hand was more market oriented and had a much stronger headquarters staff, with many more employees in

[122] Adizes, 61-62
[123] Adizes, 32-33
[124] Adizes, 37-39

departments such as personnel, market research, and finance.[125] In the case studies, both firms were under pressure to modernize their production technology. In ABC, pressure came from the plants themselves to modernize in order to compete with imports. After the Director ordered a feasibility study they tried to move in the direction of modernization but were held up by the Production Manager, who could not be fired without legal cause. The Director would dedicate much of his time in the coming months to convincing company administrators and then the workers council, trying to sway their perspective in favor of modernization. At the meeting he was able to convince the workers with almost no disputes or disruptions, handing out a lengthy pamphlet making the case for why they needed the modernization to compete with Italian imports.[126] The most recent modernizations cost the workers around 15 percent of their income for three years, and on top of this modernization of the equipment was made through a loan, which combined with new offices and state of the art technology, cutting further into the workers personal income. The researcher observed that while there was clear discontent among the workers, manifested in work stoppages, cafeteria fights, and neglect of machines, they rarely voiced their opinions in meetings, and the governing board remained silent.[127] Company XYZ experienced difficulties of the opposite nature when it came to modernization. In their case, meetings of the governing board and zbor were contentious and disorganized, with many interruptions and often failing to reach consensus. They were unable to reach an agreement on how to modernize and were still using production equipment from the turn of the century.[128]

Although these specific examples from the case studies cannot be considered totally representative of labor-managed firms, they serve the purpose of illustrating some of the perverse

[125] Adizes, 42
[126] Adizes, 125-126
[127] Adizes, 127-128
[128] Adizes, 129

incentives which face Yugoslav firms due to the mandated structure of self-management. The firm which was more efficiency focused, ABC, had a more hierarchical approach to self-management. In this case, the bodies which were meant to give the workers supreme authority over professional management failed. Why did this happen? In firm ABC, the director dedicated much of his time to finding ways to convince the workers to accept his plans. The workers were generally unprepared to make a legitimate counterargument to the director and management, and those who normally might have spoken up were not equipped to do so. This illustrates the problem of bottom up change; it will only come from the lowest levels up if there is someone who is committed, vocal and passionate about the change to hold up the decision. The workers are often ill-equipped to tell if the director is being deceitful or not, for example the proposals ensured that there would not be firings due to modernization, meanwhile the company used increased disciplinary pressure to squeeze workers out.[129] While the idea behind the modernization was that it would enable the workers to gain higher incomes later on, the researcher observed that the firm adopted the modern technology without knowing how to use it correctly and thus started shipping inferior products, causing incomes to go all the way down to the basic level required by the government for many of the workers.[130] One can also consider the fact that the director has to spend all of his energy not necessarily formulating ideas but marketing them to the workers, as a transaction cost of having labor self-management. This takes up time which could be dedicated to other areas of his job in order to help increase profitability. On the other hand, firm XYZ was unable to move forward because self-management created a set of bureaucratic tape which allowed some workers to filibuster efforts at modernization or

[129] Adizes, 129
[130] Adizes, 127

reaching any consensus on the subject, leaving them stuck with old technology and potentially costing them the opportunity to survive in a changing market.

Part 2: Theoretical Applications to Yugoslav Labor-Managed Firms

Implicit Contracts

Roger McCain draws on implicit contracts theory to help test several assumptions about the behavior of Labor-Managed Firms. Most importantly, he tests Ward's finding that a labor-managed firm will naturally limit employment in response to a rise in price in the short run, but not in the long run. His approach adds state-contingent wage uncertainty to the model, which is important considering that wages in Yugoslavia are a proportion of the firm's revenues rather than a fixed rate, which you can't assume under analyzing a capitalist profit maximizing firm, making wages in every Yugoslav firm thus implicit instead of guaranteed. McCain also argues that implicit contracts theory may be better suited for assessing LMF's than capitalist firms due to the explicit social contract which makes the enterprise pursue the best economic interests of its workers/members.[131] He uses the following definitions in his models.

[131] McCain, Roger A. "The economics of a labor-managed enterprise in the short-run: an 'implicit contracts' approach." *Advances in the Economic Analysis of Labor-Managed Firms*, vol. 1. Stamford: JAI Press, (1985):, 42

The variables of the model are as follows. There are n possible states, i = 1 . . . , n.

q_i is the ex ante probability of state i
p_i is the price of output in state i
M is the number of members recruited ex ante
N_i is the number actually employed in state i
Q_i is output in state i
K is capital installed ex ante
W is the collective net wealth of the enterprise (given, exogenous)
Y_i is enterprise net income per member in state i
a is the best alternative ex post in utility terms, i.e., the utility of the dole or of an alternative employment opportunity net of the (relatively high) transaction cost of ex post reemployment
b is the best alternative ex ante, in utility terms, i.e., the utility of an alternative employment opportunity net of the (relatively low) transaction cost of ex ante employment
U_i is the utility of an employed member of the collective in state i
m_i is the probability of being laid off in state i
r is the rate of interest on borrowed capital [132]

Using these variables, McCain uses the following equation to show the assumption that, "the enterprise will be unable to recruit, ex ante, unless a members expected utility is at least as good as his best alternative."[133]

$$\sum_{i=1}^{n} q_i \left(m_i a + (1-m_i)U(Y_i)\right) \geq b$$

Another equation is given to show the marginal productivity condition. It states that the price of output as a function of the number of people employed will be equal to net income per member minus the difference between the utility of membership in the firm and the next best alternative divided by the utility of membership.

$$p_i f_{N_i} = Y_i - \frac{U(Y_i) - a}{U_{Y_i}}$$ [134]

[132] McCain, 43
[133] McCain, 44
[134] McCain, 47

When the number of members recruited equals the numbers actually employed (M=Ni), the value of marginal productivity can exceed the previous equation but it can't be less. If the utility of membership is equal to that of the second best alternative, then Ward is right that the firm will limit employment in the short run but not in the long run. However, McCain notes that naturally a worker will not want to absorb the high transaction costs of ex post employment, and will instead choose the ex ante option for employment. While Ward assumes risk neutrality, one of the models used by McCain accounts for workers being risk averse, which can be used in the assumption because Yugoslav workers can lose up to sixty percent of their income. Under the conditions of risk aversion and uncertainty, which Ward does not take into account, the firm will act as a profit maximizer in the short run but not in the long run. The proofs go on to show that in a labor-managed firm, risk averse workers will increase employment beyond what it normally would be in the short run, but they will also restrict employment in the long-run, which is the opposite of what Ward predicted.[135]

Capital Maintenance / Investment

Bonin's paper argues that with a Yugsolav property rights framework, firms are incentivized to over rely on debt and default on loans. In Yugoslavia workers/members in a firm are residual claimants to sales revenues minus expenses. Since Yugoslav law states that the worker may collect and withdraw from their savings account and their personal investment in the firm with interest and principal whenever they decide to leave the firm. Therefore, the worker will only invest their own funds in the company if the riskless return is much greater than the interest rate on savings.[136] In the models used by Bonin, he shows that in a labor-managed firm

[135] McCain, 55-57
[136] Bonin, 56

workers will not make efficient investment decisions, and that the system of heavy reliance on pure rentals and external financing doesn't work, because it creates an agency confrontation.[137]

The effect of the behavior of the firm on the allocation of resources, factor productivity, and distribution of income

Prasnikar and Svejnar in their paper *Economic Behavior of Yugoslav Enterprises* look at the decisions and constraints of Yugoslav LMF's, especially with regard to how resources are allocated, factor productivity, and the distribution of income. The authors come up with several conclusions. For one, Yugoslav firms tend to borrow a lot of capital and limit the use of labor in production. They blame this on three policy-related incentives as well as two related to the system of self-management itself. One is the easy access to low cost capital and thus overreliance on borrowing production technology. The second is the legal obstacles to firing workers, and the third enterprise taxes on incomes/wages.[138] The systemic forces are opportunistic rent seeking by wage earners made possible by distortions and imperfections in the market created by political-economic conflicts of interest, as well as excessive borrowing by managers in order to gain promotions, without thinking about the negative side effects of excessive borrowing. Another conclusion they came to which was discussed by Bonin as well was that the negative incentives for firm entry and exit has a very negative impact on economic efficiency, allowing large WOALs and COALs to dominate concentrated markets and divide product markets into

[137] Bonin, John. "Labor Management and Capital Maintenance: Investment Decisions in the Socialist Labor-Managed Firm" *Advances in the Economic Analysis of Participatory and Labor-Managed Firms*, vol. 1, (1985), Stamford: JAI Press,, 64-66
[138] Prasnikar / Svejnar (1988), 250 to 252

noncompeting zones. The authors go on to conclude that the combination of limited entry of firms and free price setting by workers will lead to excessively high prices and low output.[139]

[139] Prasnikar and Svejnar (1988), 295-296

Chapter 5: Conclusions and Final Thoughts

After the reforms of the 1974 constitution, people were optimistic about the direction of the country, but persistent inflation and unemployment did not disappear overnight, and at this point it could be considered too little too late in some respects, as the world economy in the 1970s experienced a series of shocks related to oil. This rendered the Yugoslavs completely unable to pay off their debt, forcing creditors to squeeze enterprises even more, forcing more layoffs and lowering productivity even further.[140] The decentralization of government decision making which culminated between 1971 and 1974 made coming to a consensus on how to address persistent problems with the economy, coupled with increased global competition and the foreseeable doom of communism in the 1980s, caused the country's economy to start to spiral out of control.[141] The other republics became more wary of Serb control when they were able to achieve a seat on the presidency council for each of their two provinces, Kosovo and Vojivodina. The appointees were loyal to Serbia, and coupled with the loyalty of Montenegro, the Serbs had now had four out of the nine seats on the president's council. In 1990, when the Serb delegation who favored proportional representation and saw increased federal power as the solution to Yugoslavia's economic problems, clashed with the Slovene and Croat delegations who favored a return to greater republican independence, this was the beginning of the end.[142]

The lessons from the Yugoslav experiment in labor self-management can be summarized as follows. Many of the literature surrounding labor-managed firms cannot be accurately applied to Yugoslav firms because of the complicated intertwining of political considerations in ability

[140] Bennett, 179
[141] Sekelj, 40
[142] Bennett, 181

of firms to make their own decisions. Cronyism by political leaders led to favoritism in the allocation of government funds, creating imperfections in the market and artificial monopolies. Another reason for these imperfections in the market was that in Yugoslavia it was very difficult for firms to enter and exit the market, which much of the literature on labor-managed firms does not account for. This helped feed into cronyism by leaving consumers with few alternatives aside from the firms with friends in high places. The Yugoslav system of self-management led to wages increasing much faster than productivity, which helped fuel inflation of their currency. The system of borrowing capital and technology from banks incentivized firms to behave irresponsibly and request loans knowing that they would not be able to pay them back, and also disincentivized firms to adopt modern technology, which caused them to lag behind firms in other countries which made it harder to export. The overreliance on debt of Yugoslav firms also created unnecessary stress on the national banks, forcing them to borrow from NGO's which ended up becoming a major problem after the oil shocks in the 70s when they could no longer pay back the debt. Lastly, the mandated structure of self-management failed to prevent conflict between workers and higher ups, as evidenced by the increase in strikes after the decentralization reforms of 1965. Self-management also it difficult for firms to change, and when they did change they were still ill-equipped to compete with imports.

The Yugoslav experiment in labor self-management was bold and unique; it strived to do what had never been done before, put factories into the hands of the worker, removing the main contradiction behind conventional communism, the state capitalist who achieves prosperity and power off the backs of the masses, by creating an apparatus where the state eventually withers away and the main form of social organization becomes the enterprise itself. The Yugoslav experiment was supposed to create an ideal egalitarian society which unlike many of its

counterparts in the Eastern Bloc, recognized the differences in skills and abilities of people, not seeking to minimize differences between people but incorporating them into a more functional utopia. The experiment failed because the visionary ambition in which it was founded was impossible to successfully implement while pleasing the often-conflicting goals of the many parties involved.

It was never that the Yugoslavs didn't recognize or chose to ignore the problems the labor-managed economy created when they had arisen. Rather, it was that they could never achieve a sweet spot in fixing the problems caused by the system of self-management. Often by trying to fix a problem with the system, authorities would end up overcorrecting and cause a new wider array of problems. If they didn't do this, they would try to fix the problems associated with rapid decentralization with more decentralization, which often was no better implemented the second time around, for example the 1965 reforms which were made to correct the failed 1961 reforms. If the economy had stayed strong, perhaps the country may have stayed together, but this would be impossible as long as the politicians had conflicting agendas, some loyal to the old ways of central planning and others wanting to go towards further economic liberalization. Another argument often made by historians, such as Bennett and Cohen, suggests that the Yugoslav system could have worked if society itself was based on democratic principles, rather than just the economy. This was the viewpoint given by Milovan Dilas which caused him to be purged from the party. Ironically, the dissolution of the country may have proved him right after all.

Illustrations

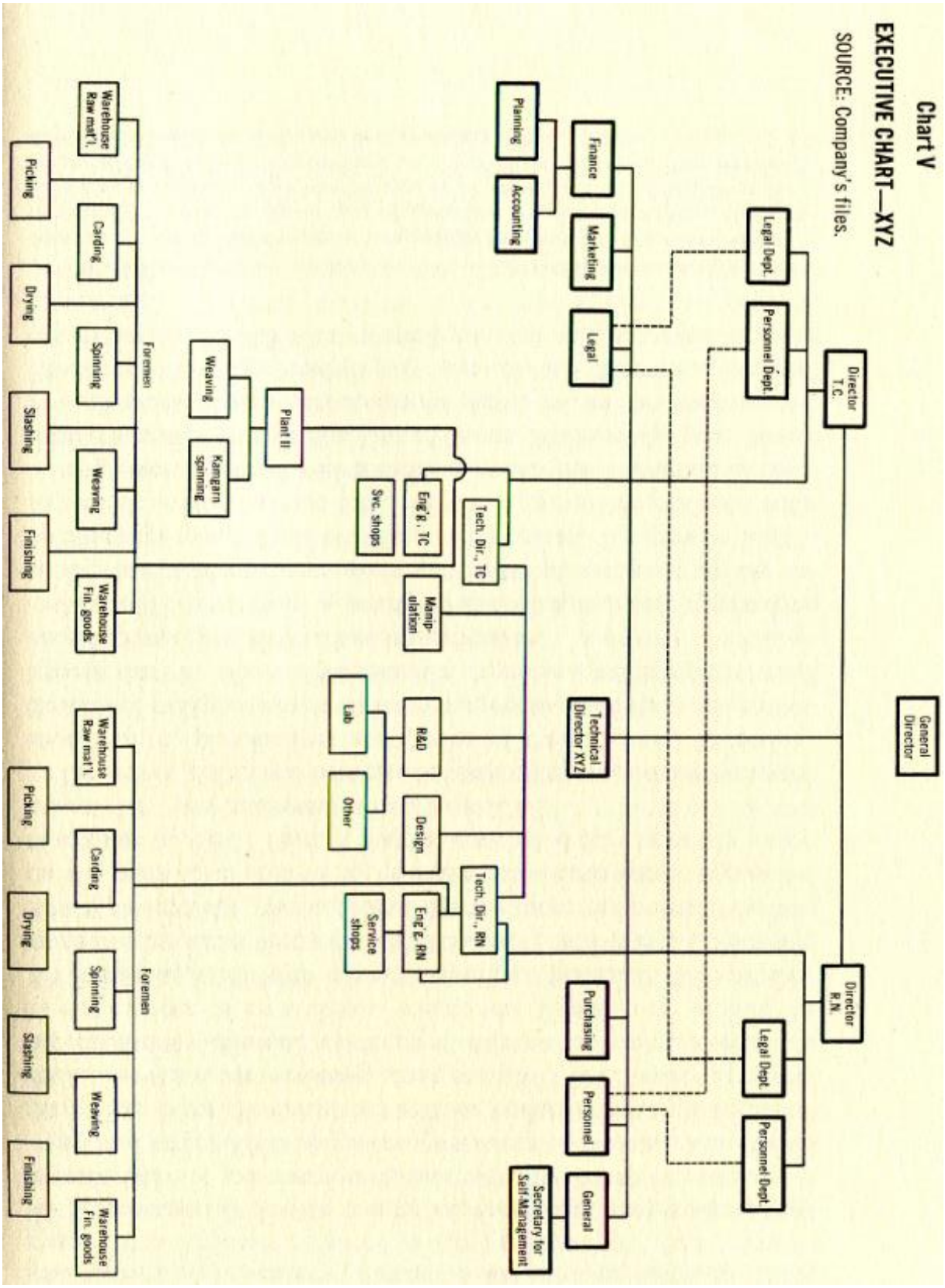
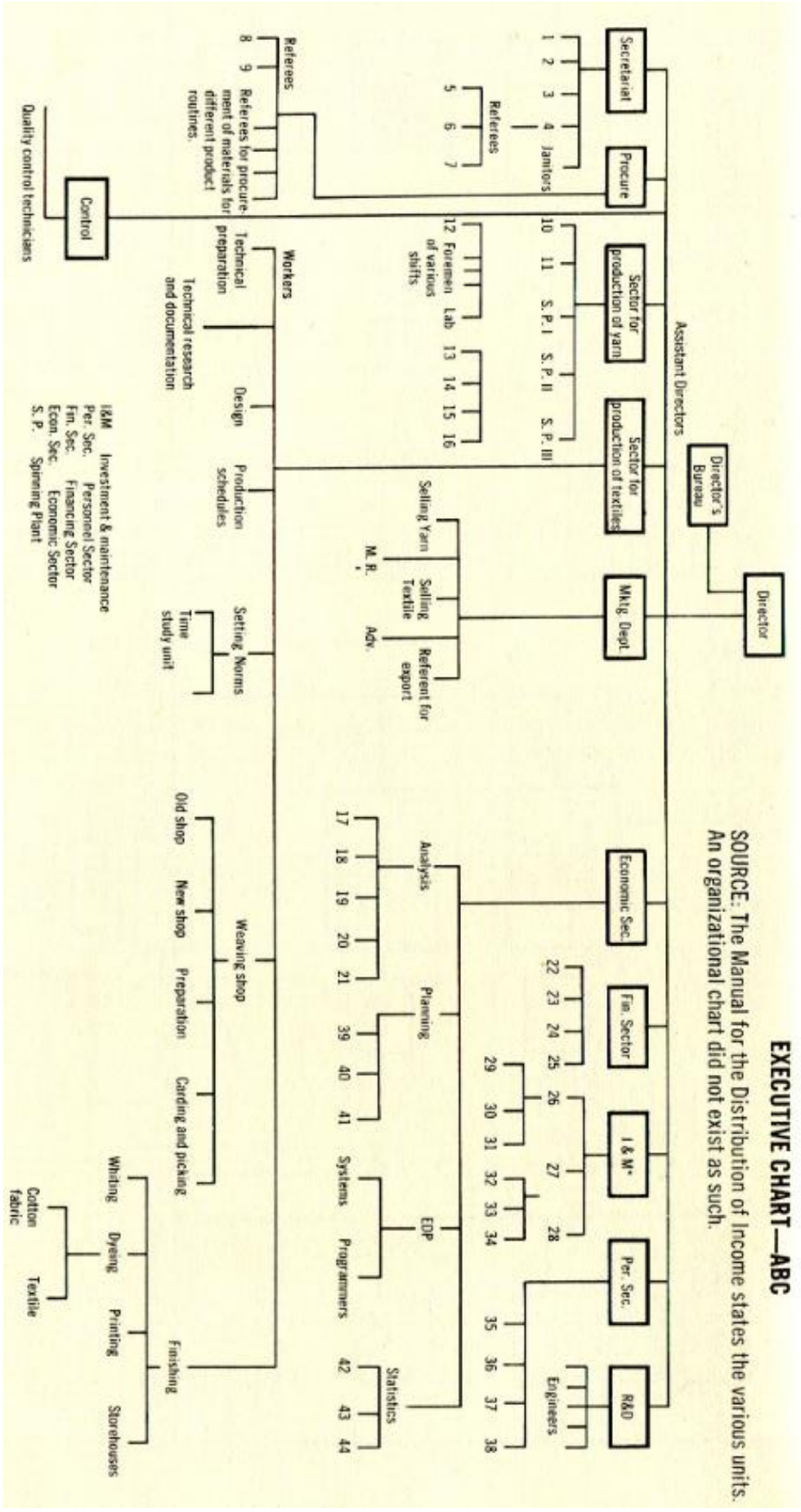


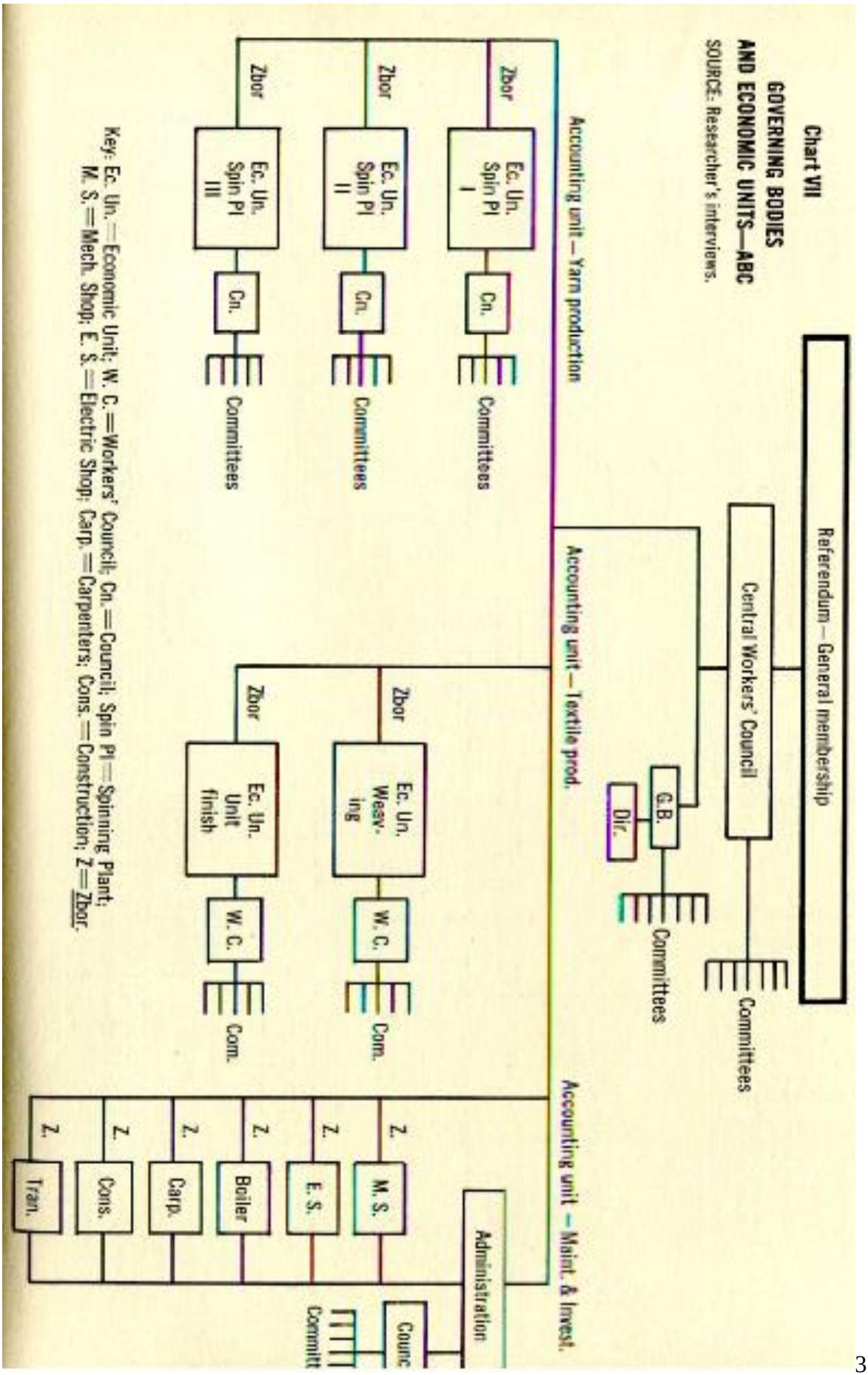
Chart VI

EXECUTIVE CHART—ABC

SOURCE: The Manual for the Distribution of Income states the various units. An organizational chart did not exist as such.



2.

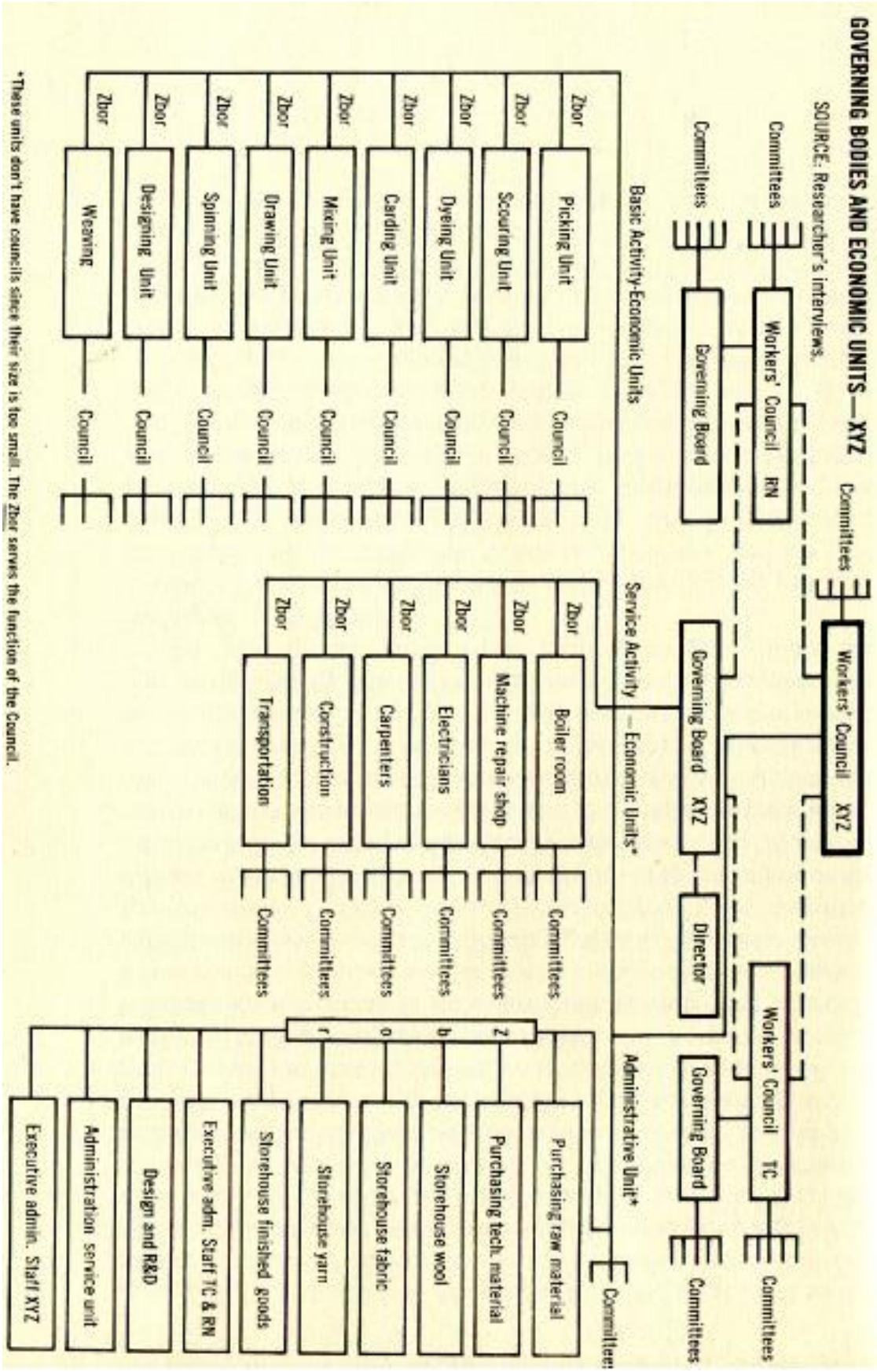

Chart VII
GOVERNING BODIES
AND ECONOMIC UNITS—ABC
SOURCE: Researcher's interviews.
Referendum — General membership
Central Workers' Council
Committees
G.B.
Dir.
Committees
Accounting unit — Yarn production
Accounting unit — Textile prod.
Accounting unit — Maint. & Invest.
Zbor
Ec. Un. Spin Pl I
Cn.
Committees
Zbor
Ec. Un. Spin Pl II
Cn.
Committees
Zbor
Ec. Un. Spin Pl III
Cn.
Committees
Zbor
Ec. Un. Weav-ing
W. C.
Com.
Zbor
Ec. Un. Unit finish
W. C.
Com.
Administration
Counc
Committ
Z.
M. S.
Z.
E. S.
Z.
Boiler
Z.
Carp.
Z.
Cons.
Z.
Tran.
Key: Ec. Un. = Economic Unit; W. C. = Workers' Council; Cn. = Council; Spin Pl = Spinning Plant;
M. S. = Mech. Shop; E. S. = Electric Shop; Carp. = Carpenters; Cons. = Construction; Z = Zbor.

3.

Chart VIII

GOVERNING BODIES AND ECONOMIC UNITS—XYZ

SOURCE: Researcher's interviews.



*These units don't have councils since their size is too small. The Zbor serves the function of the Council.

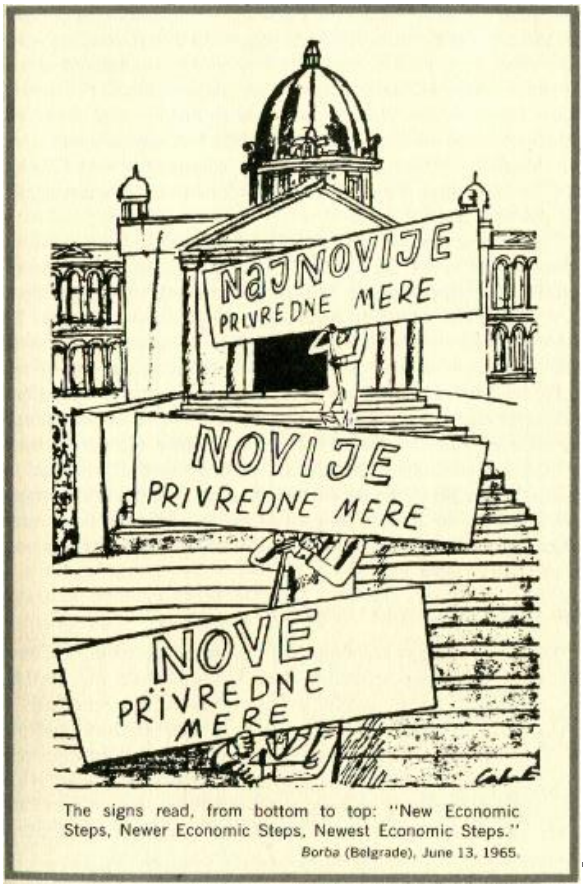


5.[144]



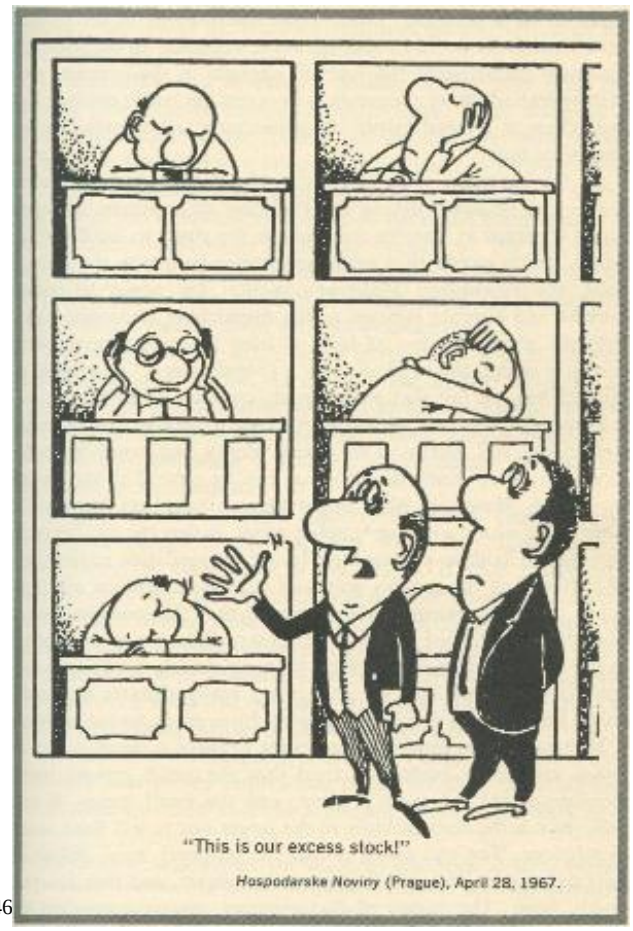
6[145]

[144] Adizes, 122
[145] Adizes, 24



The signs read, from bottom to top: "New Economic Steps, Newer Economic Steps, Newest Economic Steps."
Borba (Belgrade), June 13, 1965.

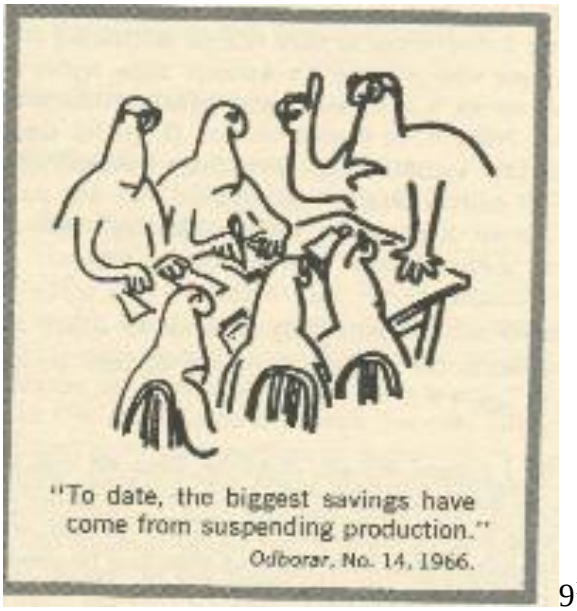
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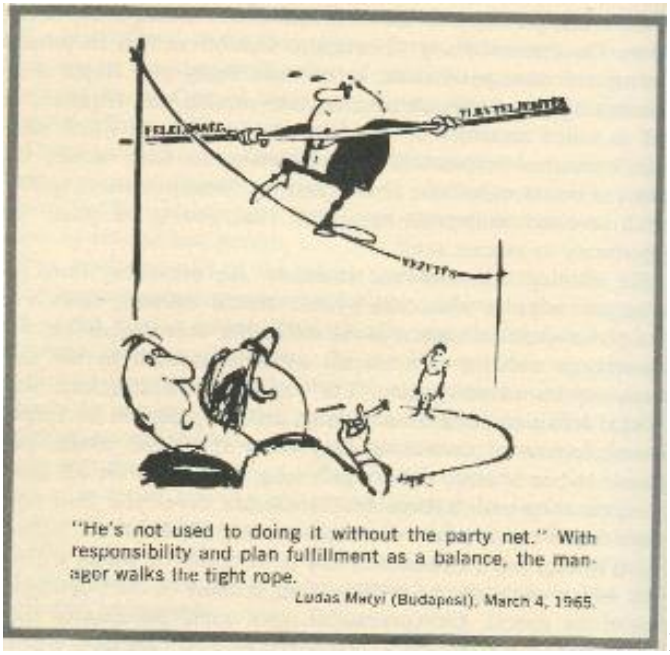
"This is our excess stock!"
Hospodarske Noviny (Prague), April 28, 1967.

8[147]

[146] Adizes, 25
[147] Adizes, 119



9[148]



10[149]

[148] Adizes, 148
[149] Adizes, 202

Description of Illustrations

Illustrations 1 through 4 are diagrams of the leadership and organization of firms XYZ and ABC from Adizes' case study. As you can see in illustration 2, with firm ABC only two of the administrators under the director help direct the actual production units, and this structure gives the more technical departments like planning, analysis and statistics greater weight, reflecting the more vertical nature of firm ABC. In illustrations 3 and 4, you can see that the governing bodies are organized similarly except that XYZ is divided into more economic units, which could help explain why they had a hard time coming to any consensus. Illustration 5 is from a Polish newspaper which is making fun of Yugoslavia's system of self-management after the decentralization reforms of 1965. The sign in the middle says the polish word "odpowiedzialność", which means responsibility or onus, and the Yugoslav workers are pointing to the next man. The joke is that under the central command economy, it was very clear who was in control, the economic planners and party leaders, but after those reforms the party in theory at least became divorced from the affairs of the firm, and in many Yugoslav firms directors were at the disposal of the workers council, which may have not necessarily been thinking about leaving the firm in a better place when they are gone by making necessary changes. Illustration 10 also pokes fun at this dilemma, with the director walking a tightrope between two unreadable words, a play on the reality that the director has to assert authority in order for the company to perform well, without being able to lean on the party anymore, while at the same time appeasing the workers who may not see the benefits of technological advancement or research and development especially when it cuts out of their slice of the pie. Illustration 6 shows the republic leaders failing to follow the instructions of only cutting once, instead they all cut the fabric at the same time. By my guess, this is a commentary on how when drafting the new constitution and

incorporating aspects of self-management, different people in leadership wanted different things in the constitution, resulting in a complex web of new methods and rules which were nearly impossible to enforce or follow as planned. In illustration 8, the signs read “new economic system”, “newer economic system”, and “newest economic system”, making fun of the transient and constantly changing nature of self-management, with each new “system” or wave of changes aimed at solving existing problems, these changes end up creating new challenges while failing to address the pre-existing ones. In Illustration 8, an artist from a Czech newspaper is likely commenting on the high rate of unemployment in Yugoslavia due to self-management. Yugoslav law made layoffs more difficult than in other countries but it could be talking about layoffs. In Illustration 9 is likely making fun of the fact that Yugoslav production is simply inefficient, and many firms were incentivized to operate at a loss because they knew that the government was very reluctant to let firms fail even if it seemed inevitable.[150]

[150] *These are all my interpretations of the drawings, Ichak Adizes does not explain any of the drawings in the text.*

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About the Author

The author, Robert Vincent Crowe, is a native of Arlington, Virginia. Growing up Rob was an avid Swimmer, swimming for the Knights of Columbus Holy Mackerels swim team for several years during the summer, as well as swimming in the winter for his middle and high school teams. He was also interested in the outdoors and went on many camping trips with Boy Scout Troop 624 in Arlington, obtaining the rank of Eagle Scout in 2014. When he started at Allegheny, Rob was initially a History major, but became interested in Economics and switched to a History and Economics double-major with three semesters remaining. At school Rob was previously involved in the Student Alliance for Prison Reform and played in the intramural basketball league. Rob served as the Vice President of the Phi Delta Theta Fraternity at Allegheny in 2019. After obtaining his diploma Rob would like to become a Financial Advisor in Pittsburgh.