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FINANCING OF SELF-GOVERNING SOCIALIST ENTERPRISES IN YUGOSLAVIA 1/

by

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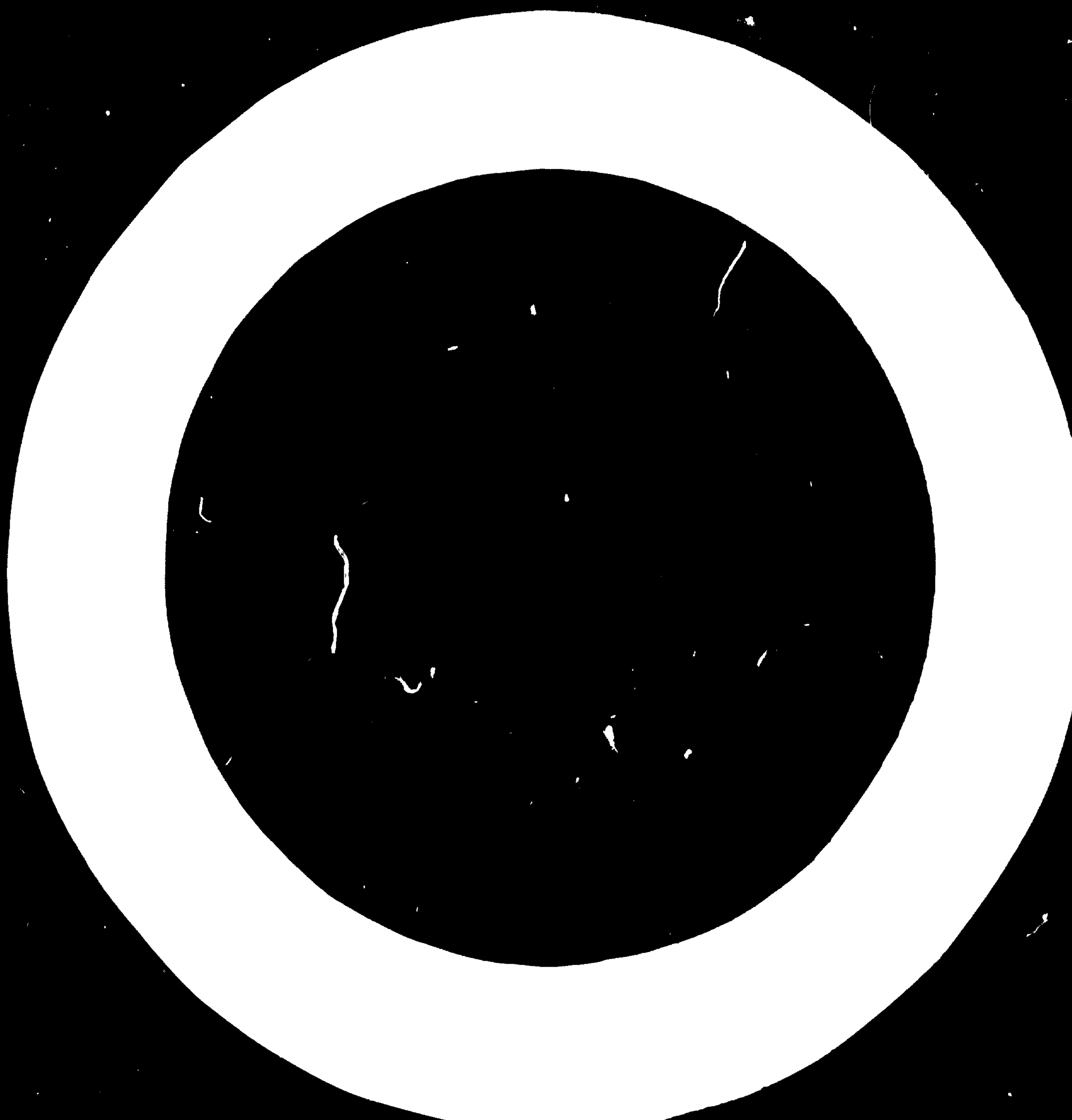

FINANCIN[illegible]

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Introduction

The purpos[illegible] of this paper is to present Yugoslavia's experience in financing its socialist enterprises. In Yugoslavia there are no State or Government owned enterprises, [illegible] of self-governing economic organizations, [illegible] socialist [illegible]. [illegible] peculiar, [illegible].

The organizations [illegible] their activities will be [illegible] paper, to enable an adequate understanding of the [illegible] of financing as well as the relative [illegible], both of which will [illegible].

I. ORGANIZATIONAL [illegible] OF ENTERPRISES

After having in the [illegible] experienced the form of State enterprises, [illegible] period of its socialist development, Yugoslavia [illegible] to [illegible] the present system of economic organizations which [illegible] sub-jects not owned by the State (Government) [illegible] administrative bodies, ministries, secretariats, etc. The [illegible] in most capitalistic countries between [illegible] is not relevant to Yugoslavia. The [illegible] in the Society as a whole, [illegible] of production are not owned by private individuals. The means of production are given to the workers [illegible] with the right to manage their economic organizations [illegible] other bodies. In their decisions, [illegible] in the distribution of the results obtained from the [illegible] of production, – the workers in each enterprise are free, [illegible] within the legal frames.

The Yugoslav enterprises [illegible] every member (individual) of the collectivity of the enterprise has equal rights, [illegible] contract with the firm. Everyone has the right to vote, [illegible] into the managing bodies and to share in the income produced by the enterprise. The firms are ruled by [illegible] bodies: the Workers' Council, the Executive Board or others, if [illegible]. The supreme power of decision making is with the assembly of the whole collectivity, where everybody has one vote, no matter what his position in the enterprise is. The Director is the main executive organ, [illegible] by competitive examination for a period of four years and can be re-elected by the Workers' Council [illegible] to the enterprise.

The Workers' Council constitutes the most important managing body in the firm. All basic decisions are undertaken or approved by it. The power of the Board and of the Director is more of an executive nature, because they implement the decisions and the policy of the Workers' Council.

The income formation in Yugoslav enterprises is somewhat different from that prevailing in other countries. The sum which is left over after deducting all the "material expenses" is called the income of the enterprise. This sum is then subject to the process of income distribution. In other words, after paying all due bills, invoices, the enterprise is free to distribute the result into personal incomes and capital funds. There are no legal stipulations, instruments or other measures which influence this decision. It is accepted that the proportion between personal income and capital be formed according to market forces, which determine the decisions in every enterprise. To note is the fact that the category of wages (salaries) known and calculated in advance, does not exist in such a system. Personal income is known at the end of a financial year and thereby linked with the success of the firm. The possibilities open to enterprises for financial manoeuvring are therefore quite significant.

Since the Yugoslav economic system relies both on market mechanism and on deliberate action of the society, expressed through specific institutions, the position of planning is specific. There exist no more those rigid forms of centralized planning, known in some countries, meaning that the main economic impetus comes from, and the main decisions are taken from, outside the enterprise, the latter being only under obligation to fulfil the decisions transmitted to it administratively. The present Yugloslav "Social plan" represents only a general projection of the future economic development, intending to show the consistency of various sectors and flows and indicating the economic policy necessary to buttress the consistency. The "real" planning is now done on the level of enterprises or groups thereof. The central planning is counted upon to harmonize, correct and influence the behaviour of all economic subjects. The duty of central planning is to establish and propose a policy of coordination, and to suggest measures for safeguarding some general proportions and balances, considered essential at the moment.

The enterprises are therefore not bound by the central plan, unless it were transformed into legal prescriptions passed through the constitutional legislative ways. The policy suggested by the plan comprises various measures undertaken by the Government or the National Bank, the measures being effective in the same way as in any market economy.

The planning of financial requirements consequently rests entirely with the enterprises.[1] A nation-wide planning of financial requirements

1/ It must be noted that the Yugoslav enterprises tend to combine into various kinds of groups. In that case the entire group can be treated as one enterprise.

done by the National Bank and the [illegible] [illegible]. The National Bank had to forecast what the global result of enterprise requirements would be, and adopts the financial policy accordingly. Each enterprise therefore competed with all the others in the financial market.

The planning techniques applied in Yugoslav enterprises do not differ much (or at all) from those observed in other countries. It must nevertheless be stressed that these techniques are still a recent experience for Yugoslav enterprises, because they were not used in the system of fiscal financing, other techniques being suited to the administration being then in operation. Thus, now, [illegible] financial planning is done primarily in progressive and big enterprises, whereas the others tend to catch up gradually.

In the same vein of argument one [illegible] also the fact that Yugoslav enterprises for a long time, paid much more attention to planning the needs of long term capital, than the requirements of short term funds. Planning, and a whole strategy of activities were undertaken in order to get capital for real investments, new facilities, etc. neglecting the needs in working capital.[1] Only gradually, with their growing independence and the obligation to face the financial vicissitudes, have the enterprises adopted techniques to plan needs for short term capital.[2]

The financial plan for long term capital is preceded by an investment project which in its turn is preceded by a market analysis. The enterprises consider all three stages as part of one project and rarely divide them. The market analysis is done along **traditional** lines and the investment project also follows the usual techniques. It is based on the same set of variables ([illegible]) which is taken into consideration by any firm in the world. The enterprises do not usually [illegible] to the social benefit unless it coincides with their own benefit [illegible].

1/ This attitude of enterprises can be explained with the earlier relations in Yugoslav economy, where the system of financing rested with administrative bodies and the [illegible] for achieving the target production with the enterprises. Production being their main goal, the enterprises tended to push capacities always higher up, because the increase in capacities was obviously equal to increase in production.

2/ Even at present (mid 196[illegible]) there is a liquidity crisis in Yugoslavia due to inadequate short term financing.

deemed by them to add to the attractiveness of the project presented for external financing. The safeguarding of the general social interest is expected from administrative, legal and economic activities of bodies whose responsibility is to care for it. The investment project takes into account the prices and quantities of all inputs and outputs, the time schedule and the technique. As measure of profitability the Yugoslav enterprises use predominantly the well known cost-benefit or discounted cash-flow method, but many variations have been encountered in the daily practice.

The plan of financing is based upon the investment project. Both must take into account the same main variables (information). The profitability, represented by the future flow of profits and of depreciation funds as well as other sources of benefits resulting from the investment project is regarded in the financial plan as one of the main elements. The confrontation of these sums with the total needs of funds shows how much must be financed from internal sources and how much from external sources. The prevailing conditions in the capital market, interest rates, availability, fiscal elements, - all contribute to the decision to borrow money.

The Yugoslav experience has shown that the greatest difficulties do not reside in the formulation of the plan, but in its implementation. The rapid structural changes, the quick growth of various sectors and changing relations in the Yugoslav economy, accompanied by frequent transformations of the institutional framework, make exact calculations very difficult, and long term projections almost impossible. Moreover, as the fast growth of the economy was accompanied by inflationary processes, rising prices and incomes, specific norms of behaviour by all economic subjects were created, in the sense that almost every investment was deemed profitable after a more or less protracted period.

The Yugoslav enterprises have developed an ability of adaptation. They became used to unpredictable switches from one source of capital to the other. Even in long term financing they quickly adapted themselves to new situations. Their plans became more flexible, especially in the time dimension, both of projects and of loans.

Nevertheless, the liquidity problem remained unsolved. Too much of short term money has been invested into long term uses. With the liberation of demand after the 1965 Reform, the markets refused to accept everything produced, so that the problem of unsold stocks arose. Much of the capital was employed to finance these stocks. Some enterprises incurred losses which in the first years were financed through credits given upon social and political instigations, in the hope that these enterprises would ameliorate their position subsequently. Some of them did, but in other cases the capital was immobilized for a much longer time than expected. It is easy to deduce that there was in fact no adequate planning of short term needs either in the enterprises or elsewhere.

Cost, pricing and profit policies are generally in the competence of the enterprises. However, until recently, i.e. until the 1965 Reform, some elements in the cost structure were regulated by legal prescriptions. The rates of depreciation, for instance, were set between maximum and minimum levels, some internal capital accounts were made obligatory in every enterprise (the reserve fund, the fund for communal reserve and the workers' common consumption funds). It was once even prescribed how much should be channelled into each of these funds.

In the period of centralized planning and administrative regulating of economic flows, prices were fixed outside the enterprises and kept under control.

In the course of decentralization all those regulations were gradually abandoned. So now, in principle, the enterprises are free to calculate the depreciation rates (although minimum - not maximum - rates are still in vigour, their meaning being to prevent the gross capital formation from falling under a certain level in the interest of competitive strength in the market). The regulation of how much should be put into specified funds of the enterprise has been abolished altogether.

In principle, price formation is also liberalized. But after some unsatisfactory experience with price increases in recent years, some prices (predominantly those of basic items) are still under control. The most frequent way of control consists in imposing the obligation to enterprises to notify any change in selling prices to a special Board, which then has the power to postpone or refuse the rise, referring the case to governmental bodies if needed.

Profit policies of the enterprises show specific elements in that the notion of profit has another meaning than in capitalist economies. The enterprises try to maximize their income (gross proceeds minus total "material" expenses). The income comprises both the total of personal incomes (wages, salaries) and capital accumulation (capital funds in the Yugoslav terminology). There is consequently a problem of distributing the income which is a very relevant indicator of the success of the enterprises from the standpoint of financing. Allocating too much to personal incomes endangers the financial policy of the enterprise. Channelling too much into capital funds jeopardizes the incentives to productivity. Thus the profit policy is actually pursued on two levels: one enterprise can be very efficient when judged by its income and very inefficient when judged by its capital accumulation.

FINANCING OF ENTERPRISES IN YUGOSLAVIA

In Yugoslavia, as in all market economies, there exist only three possible mechanisms of financing of enterprises: self-financing, financing through credit and market operations, and financing through fiscal channels. Since all three must always be present in modern economies, the character of a financial system is determined by the proportion established between these three mechanisms. So the capitalist system is characterized by the predominance of market financing, and the centrally planned etatistic form of socialism by the prevalence of the fiscal one. The discussion of the general financing mechanism forms the first part of the present chapter.

The subjects which take part in financial operations giving or taking funds are always the same: Enterprises, Individual Persons and the State. Banks and other financial institutions play the role of intermediaries, collecting funds where available and allocating them where needed. The same subjects appear on the supply and the demand side in financial transactions, but in different proportions. Therefore, there are net borrowers and net lenders, which continue to be so for a longer period of time. In almost every country (except in the most developed USA and UK) the enterprises are always net borrowers, so that the whole financial system seems to be organized in order to finance their need of capital.

In financing the enterprises, various sources combine or compete between themselves. It is the purpose of the second part of this chapter to discuss the position of every source of financing Yugoslav enterprises.

1. The general mechanism of financing

In order to provide the dimensions of the volume of financial transactions in Yugoslavia, the Table 1. has been compiled.

Table 1.

Non-financial and financial monetary flows

In million dinars

	1967		1968	
Non-financial flows	462.212		445.442	
Financial flows	41.798		64.256	
Self-financing	27.071		33.010	
Percentage of financial to non-financial flows		9,4%		13,9%
Percentage of self-financial to non-financial flows		5,9%		7,4%

Source: National Bank of Yugoslavia Annual Reports 1967 and 1968.

THE PARTICIPATION OF VARIOUS SUBJECTS IN FINANCIAL TRANSACTION (1)

Table 2.

SUPPLY

in million dinars and %

	1958	%	1959	%	1960	%	1961	%	1962	%	1963	%
1. Enterprises	1.761	23	2.220	19	4.327	31	9.468	40	2.168	12	3.414	15
2. Banks	1.446	19	2.148	18	2.674	19	3.553	15	7.316	39	7.588	34
3. Individual Persons	300	4	518	4	540	4	984	4	611	3	1.680	8
4. Administrative and Political Bodies	166	2	302	3	1.500	11	124	0	-118	-1	1.248	6
5. Funds of Administrative and Political Bodies	3.336	44	4.546	38	3.925	28	8.209	33	6.571	36	5.309	24
6. Foreign Countries	570	8	751	6	627	5	1.559	6	1.641	9	1.829	8
7. Undistributed and Errors	-	-	1.353	12	333	2	369	2	294	2	1.269	5
TOTAL	7.579	100	11.868	100	13.826	100	24.301	100	18.483	100	22.337	100

(1) Note: SELF-FINANCING EXCLUDED

Table 2.
(cont'd)

THE PARTICIPATION OF VARIOUS SUBJECTS IN FINANCIAL TRANSACTION (1)

SUPPLY

in million dinars and %

	1964	%	1965	%	1966	%	1967	%	1968	%
1. Enterprises	6.679	22	14.689	43	13.[illegible]72	21	14.[illegible]	36	24.097	38
2. Banks	35.820	120	23.793	70	20.178	30	14.492	35	23.91[illegible]	37
3. Individual Persons	1.716	6	1.068	3	5.423	8	3.731	9	5.238	8
4. Administrative and Political Bodies	756	3	- 571	- 2	371	1	687	2	269	0,4
5. Funds of Administrative and Political Bodies	-17.031	-57	-12.013	-35	23.087	35	3.586	9	6.350	10
6. Foreign Countries	1.786	6	3.266	10	3.061	5	3.026	7	4.384	7
7. Undistributed and Errors	-	-	3.65[illegible]	11	-	-	1.310	3	-	-
TOTAL	29.726	100	33.890	100	66.092	100	41.70[illegible]	100	64.256	100

(1) Note: SELF-FINANCING EXCLUDED

Table 2.

THE PARTICIPATION OF VARIOUS SUBJECTS IN FINANCIAL TRANSACTION (1)

DEMAND

in million dinars and %

	1958	%	1959	%	1960	%	1961	%	1962	%	1963	%
1. Enterprises	4.471	59	7.784	66	7.827	56	14.286	59	5.970	[illegible]	11.557	52
2. Banks	1.446	19	[illegible]	15	2.674	19	3.588	15	7.689	42	7.588	34
3. Individual Persons	91	1	360	3	302	2	506	2	463	3	1.520	7
4. Administrative and Political Bodies	508	7	- 385	- 3	2.240	16	2.211	9	3.098	17	1 710	8
5. Funds Administrative and Political Bodies	190	3	1.448	12	569	5	2.857	12	-	-	-1.237	- 6
6. Foreign Countries	306	4	513	4	214	2	853	3	1.263	6	1.199	5
7. Undistributed and Errors	567	7	-	-	-	-	-	-	-	-	-	-
TOTAL	7.572	100	11.263	100	13.826	100	24.301	100	[illegible]	100	22.347	100

(1) Note: SELF-FINANCING INCLUDED

Table 2.
(cont'd)

THE PARTICIPATION OF VARIOUS SUBJECTS IN FINANCIAL TRANSACTION (1)

DEMAND

in million dinars and %

		1964		1965	%	1966	%	1967	%	1968	%
1.	Enterprises	15.893	53	17.795	52	22.216	34	24.960	60	31.361	49
2.	Banks	11.964	40	11.397	34	36.231	54	11.070	26	22.209	35
3.	Individual Persons	1.265	4	69	-	-.187	-0,3	.305	1	3.465	5
4.	Administrative and Political Bodies	1.490	5	5.649	16	2.097	3	2.380	6	873	1
5.	Funds Administrative and Political Bodies	1.861	- 6	-4.926	-14	.214	0,3	125	0,3	801	1
6.	Foreign Countries	186	1	3.906	12	2.453	4	2.949	7	3.758	6
7.	Undistributed and Errors	789	3	-	-	3.063	5	-	-	1.789	3
	TOTAL	29.726	100	33.890	100	66.092	100	41.789	100	64.256	100

(1) Note: SELF-FINANCING EXCLUDED

The proportion of financial to non-financial transactions (sales, purchases, payment of personal incomes, etc.) is rather low, suggesting the conclusion that the Yugoslav financial system needs further and possibly quicker development. It is difficult to obtain from the impression that for a quicker economic [illegible] financial flows would be necessary.

The detailed survey of financial transactions (self-financing being excluded) in Yugoslavia, is presented in Table 2. It reflects the relative position of all subjects in the system both on the demand and supply side. The already mentioned net borrower position of the enterprises is clearly visible throughout the period considered. Furthermore, the structural changes in the sources of financing are evident, if one compares the first and the second half of the period considered. In the fifties, the fiscal mechanism prevailed whereas the financing through the financial market lagged behind. In recent years however the fiscal mechanism has shrunk considerably.

Among items listed in Table 2. the fiscal mechanism is represented by headings "Administrative and Political Bodies" and "Funds of Administrative and Political Bodies". All others can be regarded as parts of the financing through market mechanism.

Before 1964 the so-called "General and local investment funds"1/ were the main source of capital investments. These funds were centrally governed, fed through fiscal measures and distributed according to decisions taken by bodies outside the enterprises. They were one of the main instruments of the centrally planned economy and they had to fulfil the targets of the central and local plans.

The changing over from these methods of financing through market mechanisms was in Yugoslavia a process lasting for some years. There were several reasons which moved the Yugoslav society and its political bodies to this reform. The fiscal ways of financing had their advantages and disadvantages. It seems unquestionable that they were suitable for the first phase of industrialisation. Yugoslavia being an underdeveloped, predominantly agricultural country, a centralized strong power was needed to start the process of industrialisation. One of the main problems solved by fiscal financing was to mobilize and centralize funds for investment in an economy which was notoriously non-accumulative. The then exisiting capital was inadequate for any great industrialisation move. Fiscal ways of financing made it possible to create not only factories but also the necessary infrastructure.

1/ Included under the heading "Funds of Administrative and Polictical Bodies."

The growth of industries, however, and their increasing interrelations and combinations soon imposed the necessity to decentralise investment decisions because the center was not able to grasp all the opportunities at the micro-level. The progress of workers' self-government included growing numbers of persons into these decisions. All this tended to modify correspondingly the financial system. In the first place the investment funds became inadequate in volume for the growing needs for capital in the enterprises. Furthermore, the investment criteria used in fiscal financing often depended upon non-economic considerations, sometimes upon compromises between various political or regional forces. The criterion of effectiveness was much too often neglected. Factories badly located, with inadequate capacities (frequently greater than needed) incapable to make their way in a non-sheltered market sprang up. It was easily recognized that the same capital could be more profitably used if the system were changed.

The cost of capital and other conditions asked from the borrowers by the State, were in many occasions different from market prices and conditions, and usually more advantageous for the recipient of the capital. Consequently, projects which by normal standards were inoperative received non-deserved priority, distorting the industrial structure and burdening the future generations with non viable factories.

Those were the reasons for abolishing the General and Local investment funds. Their capital was transferred to the banks. The idea at that time was to abandon completely the system of finance through those funds. Their handing over to the banks was thought to enable their gradual transformation into banking capital. However, that transformation proved impossible and the "funds" remained a specific form of socialist capital inadequately but currently named "state capital" in Yugoslavia. A very high proportion of this capital was already engaged in various projects which were not terminated at the moment of their transfer to the banks. The repayments of older investments were determined by conditions and prices prevailing years ago. The procedure to obtain such funds differed from the usual ways of asking for capital in the market. All this tended to perpetuate the specific character of these funds. On the other hand, the Government needed funds for specific purposes: investments in underdeveloped territories, participation in huge projects which were not sufficiently attractive to other investors (irrigation schemes, river dams, oil prospecting, highway building, etc.) or repayments of international loans.

The growth of importance of others, non-fiscal mechanisms of finance, visible from the Table 2., is however motivated not only by the deliberate abolishing of investment funds. The market mechanism adopted in other fields of the Yugoslav economy imposed itself in the financial field too. There is no doubt that financing through the market mechanism enlarges the possibility for expansion. If the enterprises were constrained to use only self-financing or the fiscal mechanism, their growth would be obviously smaller, than if they could rely on capital offered by other economic subjects through the capital market. From the macro-aspect therefore the main reason for developing financial markets is that they enable a faster growth of the economy.

The market ensures greater mobility to capital flows. It is also very efficient in the mobilization of other subjects' savings. Furthermore, the market is supposed to channel the capital into its most rational uses. The financial market therefore plays its basic economic role as a rationalizer of the whole economic process. In Yugoslavia the market imposed the financial discipline to all participants and tended to correct the mistakes made in the investment policy of the previous period.

However in developing countries, of which Yugoslavia is a particularly suitable example, the financial system taken in its entity tends to be under-developed. There are many obstacles, economic, social and political, which must be eliminated in order to create an efficient financial system. Inertial attitudes, inadequate training and lack of skill are slow to disappear. There are still some grave defficiencies in the Yugoslav system of financing but since the Reform of 1965 the process of its perfection is going on. Some financial instruments are lacking (there are no shares, which are incompatible with the self-government of socialist enterprises). The bonus market is not developed. There still exists no variety of financial institutions which is a serious drawback for the smooth functioning of financial markets. Some relations between various subjects in the financial field are slow in their new definition, legally and institutionally still arranged as in the old system. One striking example is the position of banks and their relations to the enterprises and to the administrative bodies. Another example is the not yet fully defined position of the individual savers in the financial market. Their growing importance makes it imperative to solve this problem quickly.

2. <u>Sources of Finance</u>

A. <u>Domestic Sources</u>

The domestic financial sources stem from the same subjects, described above. The Yugoslav enterprises get their financing: (1) from their own accumulation, (2) from other enterprises, (3) from the banks, (4) from individual savers and (5) from State investment funds. The relative importance of each of these can be seen in Table 3.

Radical changes in the structure of financing Yugoslav enterprises occurred in long term loans, with the shift from State investment funds to Bank loans.

(1) <u>Self-Financing</u>

Self-financing is sometimes considered as being outside the proper financial sphere, because there is no transaction between two subjects. But the Yugoslav experience shows that it is much more opportune to include it in the financial system. The decision of the enterprise to invest proper funds should be determined as much as possible in the same way as the decision to invest borrowed money. An enterprise's criteria are of course less severe when investing own capital, but a comparison (at least) with the situation and conditions in the financial market is essential to the rational investment policy.

Table 3. **INTERNAL AND EXTERNAL FINANCING OF YUGOSLAV ENTERPRISES**

		[illegible]		[illegible]		[illegible]	%	1961	%	1962	%
1.	Self-financing	[illegible]	45,6	[illegible]	[illegible]	[illegible]	48,1	6.394	33,0	6.557	53,9
2.	Loans from other enterprises	1.264	16,4	1.501	16,2	1.803	13,4	3.912	20,2	-2.808	-23,0
3.	Bank loans	1.254	16,2	2,559	27,5	1.941	14,4	2.380	12,3	[illegible]	20,1
	- long-term	1.099	14,2	2.341	25,2	1.591	11,8	1,511	7,8	1.932	15,9
	- short-term	-	-	-	-	-	-	-	-	-	-
	- in foreign exchange	155	2,0	218	2,3	350	2,6	369	4,5	514	4,2
4.	State investment funds	1.683	21,8	3.666	39,6	3.253	24,1	6.654	34,5	6.065	49,9
	TOTAL:	7.733	100,0	[illegible]	100,0	13.454	100,0	19.330	100,0	12.160	100,0

Source: National Bank of Yugoslavia, Annual Reports 1966, 1967, 1968.

Table 3.
(cont'd)

INTERNAL AND EXTERNAL FINANCING OF YUGOSLAV ENTERPRISES

		1963	%	1964	%	1965	%	1966	%	1967	%	1968	%
1.	Self-financing	6.770	37,6	10.854	40,7	21.452	55,6	18.317	46,7	17.648	41,2	19.860	38,9
2.	Loans from other enterprises	1.767	9,8	2.974	11,2	5.453	14,1	8.433	21,5	11.388	27,6	10.496	20,6
3.	Bank loans	5.497	30,[illegible]	30.134	112,9	20.072	52,1	13.133	33,5	14.292	33,4	19.099	37,4
	- long-term	3.048	16,8	1.610	6,0	2.680	7,0	2.548	6,5	4.157	9,7	5.378	10,5
	- short-term	2.496	13,8	27.799	104,2	16.201	42,0	8.973	22,9	8.861	20,7	10.391	20,4
	- in foreign exchange	- 47	- 0,3	.725	2,7	1.191	3,1	1.612	4,1	1.274	3,0	3,330	6,5
4.	State investment funds	4.034	22,3	17.292	64,8	8.432	21,8	63[illegible]	1,6	947	2,2	1.580	3,1
	TOTAL	18.068	100	26.670	100	38.545	100	39.265	100	42.[illegible]	100	50.991	100

Source: National Bank of Yugoslavia, Annual Reports 1966, 1967, 1968.

Substantially self-financing and external financing are complementary and it was impossible to set an optimal rate of self-financing in Yugoslavia. In the earlier period of central planning when the enterprise was not allowed to dispose with its accumulation, the rate of self-financing was administratively defined. But now, the Yugoslav enterprise is free to set the proportion between internal and external financing according to its own economic interest. The Plan or the Government stopped intervening in this field.

There are no general rules to evaluate the adequacy of a rate of self-financing.1/ Yugoslav enterprises have no such experience. Since the choice is left to every single firm, many variables influence the rate. First of all, the rate being a result of two elements, its modification can be explained by the dynamics of each of them. So an increased absolute sum of self-invested funds could in fact represent a lower rate if the total financing rose by a higher percentage. On the other hand, a higher rate of self-investment is frequently due to a fall in total financial activities of the enterprise.

Further, the changes in the rate can be partly explained with frequent modifications of the institutional and legal framework. The behaviour of the rates can also be explained by changes in business activity. This is particularly the case with the rates since 1965 which do reflect more the level of investments than the accumulation itself. It is therefore advisable to interprete the rates with reserve and to wait for more experience in order to have solid conclusions about the importance of self-financing.

The tendency to increase the rate of self-financing visible in many enterprises in Yugoslavia can be explained, among other things, by the difficulties in obtaining easy and cheap loans from the banks. A high rate of self-financing leads to greater independence. To an enterprise, own capital may seem cheaper than the borrowed one. Although this may be an erroneous calculation, it is often the prime motive.

1/ The rate of self-financing can be defined as the percentage coverage of yearly investments (in capital goods and stocks) by proper accumulation (yearly increases of all capital accounts plus depreciation fund). This ratio in the last decade moved in the following way:

1958	59%	1964	39%
1959	43%	1965	86%
1960	68%	1966	67%
1961	60%	1967	60%
1962	57%	1968	70%
1963	46%		

Source: National Bank of Yugoslavia, Annual Reports 1966, 1967, 1968.

The ratio differs from the percentage given in Table 3. but leads to the same conclusions.

Furthermore, a high rate of self-financing is a positive argument for getting loans from the banks. Therefore a high rate of self-financing can easily bring about a more than proportional expansion effect. In stimulating the accumulative capacity of the enterprises many countries have been motivated by similar reasoning. The highest rates of self-financing are thus found in [illegible] the most developed financial systems and with the largest capital formation [illegible].

The general policy pursued in Yugoslavia aimed at greater efficiency of invested capital. Greater accumulation is regarded as a sign of success of an enterprise provided that the level of personal incomes were not unduly lowered. Between personal income and capital formation in the enterprises a definite balance is needed. It must namely not be forgotten that higher personal incomes result also in greater capital supply through savings.

(II) Loans from other Enterprises

A considerable part of short-term[1/] financing is provided by loans from other enterprises. This source of credit rose to quite substantial amounts in the years 1965-1968. Such credits are part of normal business practice and their growth in importance can be interpreted as a sign of liberalized behaviour of the enterprises. However, in recent years in Yugoslavia this sort of financing was considered as being - at least in part - the consequence of irrationality and inefficiency of enterprises. These credits masked frequently the lack of liquidity with the borrower. In such cases there was rather involuntary financing between enterprises. Various measures were undertaken to solve the aggravated problem of non-liquidity (e.g. clearing operations, quickening up of court procedures), but the traditional instrument of re-financing such claims with the bank was slow to develop. The lack of suitable financial instruments made it possible to such enterprises to avoid the controls of the market mechanism and to introduce grave excesses into the financial system of Yugoslavia. It is therefore necessary to develop adequate instruments which would guarantee rational behaviour both on the borrowing and lending side.

Financing long term investments between enterprises was extremely rare in Yugoslavia until quite recently. The reasons lay almost exclusively in the institutional system. It is only in the last few years that one particular form of joint ventures developed with some success.

The figures in Table 3. show that enterprises do not use funds of individual savers for their financing. The savings of individual persons, although growing in volume and importance, are still channeled through the banking system. In late 1968 there were some instances where a few big enterprises tried to contact the individual saver directly. This action is still going on and the results are not yet known. This is nevertheless a sign of a new trend in financing.

1/ Very little of such credit were long-term.

(III) State Investment Funds

Government channels of financing (the earlier discussed investment funds) as summarized and presented in Table 3. show a drastic decline from 1964 onwards, with the exception of 1966. The burden of financing long term investment was shifted over to the banks. Nevertheless, this source of financing is very coveted by all enterprises who can have access to it (especially, in the under-developed regions of Yugoslavia). This is so because of the usually cheaper capital obtained from such funds or because of easier conditions, and greater stability than prevailing elsewhere; or even because of the fact that enterprises were for a long time accustomed to ask the administrative authorities for money.

(IV) Bank Loans

Up to 40% of all capital (both short and long term) comes from bank loans. Short term loans have a tendency to grow both in volume and in percentage of the total, in the last few years. The relative scarcity of liquid funds and the constantly growing demand for financing created a situation where short term credits were used for financing a series of needs in the enterprises, ranging from emergency stop-gap financing, to outright long term investments. Short term money was thus often used for long term immobilization. Needless to say that there was the danger that some great distortions could result if this situation lasted for a longer period. The banks reacted accordingly to the market situation in which money was scarce. In order to attract capital they offered very good conditions to savers, they contacted foreign banks or other financial sources and they tried to obtain easier credits from the National Bank. As a consequence the price of capital rose, putting the borrowing position of enterprises in an even more awkward position. The Government had to step in and impose a ceiling on interest rates.

Long term loans from the banks - as can be inferred from the Table 3. - are a fairly new feature in the financing of Yugoslav enterprises. The relevant experience is confined to last three or four years. It must however be emphasized that these were the years when a rather severe policy of investment restriction was pursued in Yugoslavia, so that the figures are hardly representative. On the other hand, a part of the long term needs were covered by short term credits. Furthermore, the possibilities to finance investments with State funds was in some cases still open. In 1966, for example, there was even a rise in this sort of financing, after four years of decline.

B. External Sources

Until very recently foreign capital entered Yugoslavia only in the form of international loans. They were moreover predominantly public loans. In the greatest part these loans were taken by the Yugoslav government and through its channels allocated to the users in the country. Afterwards the Yugoslav banks took an active part in these transactions and served as a transmission belt between foreign loans and the enterprises. The Yugoslav firms also imported foreign capital but almost exclusively in the form of short term, commercial credits.

The liberalization of the enterprises which gradually developed in the sixties and their growing international connections made it imperative to open up possibilities for foreign firms to invest capital directly in Yugoslav enterprises. In 1967 a series of legislative provisions were passed through the National Assembly, legalizing direct, firm-to-firm private foreign capital investments in Yugoslavia. This form of capital import was up to that moment excluded on ideological grounds.

The joint venture is the legal form of such investments. The joint venture must be based on a written contract which fixes the nature and area of activity, each partner's contribution in capital, and the mode of sharing the proceeds. The Yugoslav legislation deemed it important to specify that the foreign capital may not be equal or exceed the total capital of the domestic partner in the joint venture, leaving however the possibility to exception by act of the National Assembly. A registration of such contract is always asked for and done with the Federal Secretariat for the Economy. Registration cannot be refused unless the contract violates federal laws or is contrary to the security and defence of the country.

The foreign investment interest can be transferred or sold by the foreign partner. There are no restrictions concerning the earnings of the foreign partner. The rate or amount of the foreign partner's earnings can be settled by mutual agreement with no interference from any authority. The foreign partner can export his earnings in pursuance of the existing foreign exchange regulations, re-invest it or spend otherwise in Yugoslavia. The law however asks for 25% of the foreign partner's earnings to be reinvested in the same joint venture, in another firm, or deposited in a Yugoslav bank. This provision was motivated by balance of payment considerations. The only tax to be paid by the foreign partner is a flat rate of 35% on earned income which will be gradually reduced in case of re-investment.

These legal regulations must be considered as not yet complete at the present moment. The first two years of their application have already pointed to some amendments or new regulations, in order to cope with situations not envisaged in the first legislative action.

For obvious reasons there are no quantitative informations about the volume of the capital which enters Yugoslavia by way of joint ventures. But the general impression suggests that some of the best Yugoslav enterprises in the internationally attractive industrial branches, have secured such imports of private foreign capital.

3. Capital Cost

Generally, the cost of capital must be determined by its rate of growth, but since the enterprises receive capital from various sources, the cost of capital acquired through different financial means, has different rates. Moreover, the time variable makes it possible for the cost of segments of the capital, to differ even considerably from the cost of total capital in a country.

Although the rate of interest on borrowed capital is a predominantly market category, the market forces are not its exclusive determinants. In every market the rate of interest is directly or indirectly subject to non-market forces.

(I) The cost of capital given by the State was in Yugoslavia in the earlier phase of development determined by the plan. With the changes in system which occurred gradually, the central plan had always less and less influence upon credits given from general and local investment funds. When these funds were abolished and their capital transferred to the banks, the rate of interest tended to approach the rate prevailing in the market. Nevertheless, the capital from these funds was cheaper than capital from the banks. Since quite a lot of long term capital has already been invested in long term projects or is continuing to be invested in such projects under the earlier cheaper rates - the cost of this capital still tends to lower the general average rate of interest. It has been argued that by such practice the demand for capital is overstimmulated and that projects which would otherwise not be sufficiently attractive are nevertheless undertaken. In that way, however, investments which are necessary from the general point of view can be undertaken at lower cost.

(II) The interest rate paid on borrowed capital, both short and long term, is determined by variables shaping the demand and the supply side of the market. This rate is also partly determined by the financial policy of the National Bank and other financial authorities of the country.

The interest which the enterprise is willing to pay for borrowed capital depends: on expected accumulation (profit) from the use of borrowed capital; on the ratio of borrowed to own capital; and on the competitive situation in the demand side of the market. The banks, or other lenders, when offering their capital at an interest rate consider: the financial risks, the time for which they would part with their capital and the competitive situation on the supply side of the market.

The [illegible] [illegible] [illegible] [illegible] [illegible] rate of interest. In [illegible] [illegible] [illegible] there was greater demand than supply of capital. Enterprises, accustomed to capital from State funds at low rates, [illegible] the demand for capital, pushing the market rate even higher. On the other hand, the banks, in order to mobilize and induce savings, were obliged to offer high interest rates, to all that were willing to save money.

Table 4.

INTEREST RATES IN YUGOSLAVIA - 1968

		%
National Bank Discount Rate		6%
Bank Deposits' Rates:		
	call money	0,0 - 3,0
	savings	5,0 - 8,0
	long-term deposits	6,0 - 8,0
Bank Loans		
	short-term	7,0 - 8,0
	long-term	7,0 - 8,0
Bonds (yields)		7,0

Source: National Bank of Yugoslavia.

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