ON DEVELOPMENT

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DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

Regional Conflicts In Yugoslav Economic Development

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
May 1970

INTELLIGENCE MEMORANDUM

Regional Conflicts In Yugoslav Economic Development

Introduction

With the question of presidential succession simmering in the background, the hottest political and economic issue in Yugoslavia today is "republican nationalism." The Ninth Party Congress in March 1969 was filled with warnings: Mitja Ribicic, the President of the Federal Executive Council, warned that "Nationalism is growing on the soil of our socialist relations, ... becoming more aggressive," and Tito repeatedly complained that "economic problems are clad in nationalist garb ... there are certain elements that countenance autarchy and localism, ... such activity is increasing." Since the congress, a number of regional economic disputes have confirmed these warnings and have kept the issue of "nationalism" on the front pages.

Most of these conflicts involve a clash of interest between the most advanced republics -- Slovenia and Croatia -- and the less developed regions -- Bosnia-Hercegovina, Montenegro, Kosovo, and Macedonia. They also reflect a basic conflict between the government's longstanding commitment to spur development in the backward areas and its newer commitment (since 1965) to increased economic decentralization. The development of backward areas requires strong federal intervention in the investment process, and decentralization requires just the opposite.

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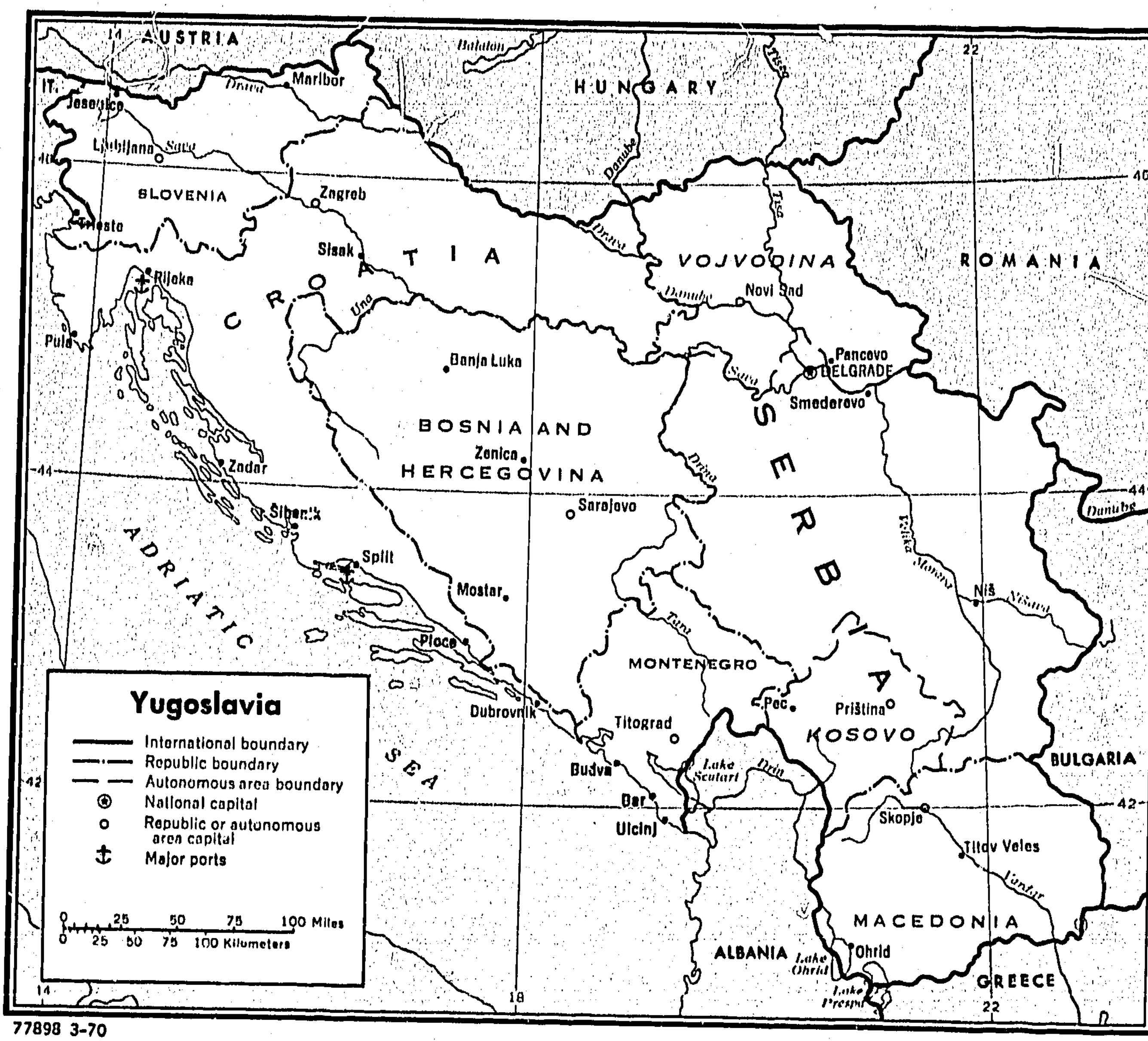
Regionalism in any form raises the question of future political stability, after Tito's unifying influence is no longer present. In the absence of strong political unifiers -- such as an outside threat to Yugoslav independence -- a large role would fall to regional economic interdependence to maintain stability. This memorandum examines the record of regional economic policy and evaluates the obstacles posed by economic regionalism, now and in the future, to Yugoslav development.

Have Versus Have-Not Regions

1. The typical Yugoslav tour director's monologue is likely to begin with: "Yugoslavia contains six republics, in which live five (main) nationalities, who speak four languages, have three different religions, write in two alphabets, but have one desire -- independence."* Economically, Yugoslavia is equally diverse. In the south, the less developed regions of Bosnia-Hercegovina, Macedonia, and Kosovo bear the mark of economic neglect under Turkish rule, which lasted for most of the 15th through the 19th centuries. Agriculture remained primitive and mineral riches were left untouched; the only positive economic legacies were large trading centers, such as Sarajevo, in Bosnia-Hercegovina. Montenegro, although never conquered by the Turks, was just as effectively cut off from the fruits of economic development. Of the lands under Turkish control, only Serbia, the first in the 19th century to free itself, was able to achieve significant development, aided by the return of more progressive Serbs who had fled north to escape the Ottoman invasion.

2. The northern regions -- Slovenia, Croatia, and Vojvodina -- fared better. Under Austro-Hungarian rule for the better part of ten centuries

* *Yugoslavia's six republics are Slovenia, Croatia, Bosnia-Hercegovina, Montenegro, Macedonia, and Serbia. In addition, Serbia is divided into three regions, the two politically autonomous areas of Kosovo and Vojvodina, and the rest of Serbia, generally known as Serbia Proper. For the locations of these eight regions, see the map.*



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until World War I, the economies of these regions were at least exploited, leading to the development of transportation, coal mining, metallurgy, forestry, and textiles. Industry in Slovenia particularly benefited because of its favorable location between the Austrian-controlled seaport of Trieste and the Austrian capital, Vienna.

3. The less developed regions continued to be neglected after Yugoslavia became a separate state in 1918. The new nation was dominated by Serbs -- under a Serbian monarchy -- which inflamed the historical conflict between the Roman Catholic Croats and the Orthodox Serbs. Thus preoccupied, the leadership made no concerted attempt during

the interwar period to modernize agriculture, develop mineral resources, or improve transportation in the backward areas. As a result, the more advanced economies of Serbia, Croatia, and Slovenia continued to outpace the rest of the country, leaving an even wider gulf in living standards than those inherited from the years of foreign occupation.

4. The postwar Communist government, under Tito, gave top priority to the problem of regionalism. Tito stocked the government with solid delegations from all republics, and both the Roman and Orthodox churches were stripped of political power, thereby reducing some of the sources of former political conflict. Finally, Tito's regional economic policy from the outset was dedicated to narrowing the gap between the have and have-not republics.

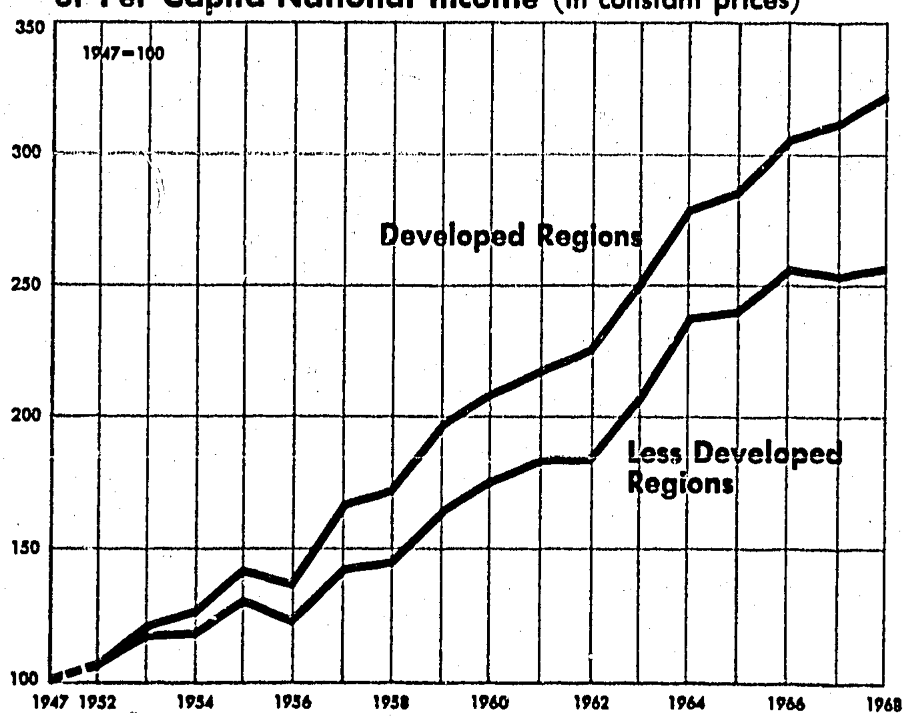
5. This last task proved to be the most difficult in the attempt to solidify the federation. Although it could be seen that Yugoslavia's regions complemented each other economically -- rich raw materials in the south, manufacturing in the north -- disunity had been deeply embedded by foreign rule, sharp ethnic contrasts, and even geographic barriers. These factors had discouraged labor mobility and had stifled any significant movement of capital from north to south. As a result, the gap between the income levels of the have and have-not regions was indeed wide. In 1947 the national income per capita of the less developed regions was 65% of the level in the more developed areas, and the per capita national income of Kosovo -- the poorest region -- was only one-half the Yugoslav average and less than 30% of per capita income in Slovenia -- the richest republic.

6. Boris Kidric, the chairman of the Federal Economic Council, set up an economic plan in 1947 to deal with these disparities, specifying average per capita growth rates of 11%-14% for the less developed regions and 6%-10% for the more advanced areas. To achieve these rates would eliminate the difference in per capita national income by about 1964. Kidric's plan posed a major political challenge. Not only would more new factories be built in the less developed areas than in Slovenia and Croatia, but Slovenia and Croatia would also have

to foot a large share of the investment in other republics. The regime ran the risk of alienating the advanced republics, and possibly stirring up jealousies among the less developed republics which might not be satisfied with their respective shares of federal support once their appetite for growth had been activated. Nevertheless, Kidric's model was put into effect in the first five-year plan in 1947.

7. The regime actively pursued the policy of rapid growth during the 1950s, pushing new capital-intensive investment in the backward areas. The results, however, were just the opposite from Kidric's projection; the gap in per capita national income widened substantially. Moreover, the policy of extensive growth produced severe inflationary pressures and balance-of-payments difficulties. Thus, in the mid-1960s the regime abandoned the forced growth policy and turned to a program which stressed monetary restraint and more efficient allocations of investment resources. Under this new policy, the gap between north and south widened even further, as shown in the accompanying chart.

Yugoslavia: Index of Growth of Per Capita National Income (in constant prices)



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The Widening Gap

8. Between 1947 and 1968, the average per capita income of the backward regions dropped from two-thirds to one-half the average in the more developed areas. Only Montenegro was able to gain any ground on the average national income of the more developed areas, and none of the backward regions was able to gain on the most advanced regions -- Slovenia and Croatia. Kosovo, in fact, fell from 30% to a mere 17% of the per capita national income of Slovenia. The average annual rate of growth of per capita national income during 1948-68 was 4.6% for the less developed regions, compared with 5.7% for the more developed areas, as shown below.

	Percent		
	Average Annual Rate of Growth of Per Capita National Income 1948-68	Percent of Yugoslav Average 1947	Percent of Yugoslav Average 1968
Less developed	4.6	72	62
Bosnia-Hercegovina	4.3	83	67
Montenegro	6.0	71	79
Macedonia	5.6	62	65
Kosovo	3.2	53	34
More developed	5.7	112	121
Slovenia	6.1	175	201
Croatia	6.2	107	127
Serbia Proper	5.5	96	98
Vojvodina	4.8	109	97

9. The lag of the less developed areas also shows up in a slower growth of personal income. Per capita personal incomes in the backward regions grew by 8.6% a year in the 1950s, compared with 12.5% in the more developed areas, and the lag continued in the 1960s, as shown in the tabulation below.

	Percent	
	Average Annual Rate of Growth of Per Capita Personal Income [a]	
	1953-60	1961-69
Less developed	8.6	6.4
Bosnia-Hercegovina	10.4	5.5
Montenegro	13.1	7.8
Macedonia	6.2	8.8
Kosovo	8.5	7.5
More developed	12.5	8.5
Slovenia	13.9	7.3
Croatia	12.2	8.6
Serbia Proper	11.9	10.0
Vojvodina	12.3	5.9

a. *Based on data for the socialized sector.*

Only Montenegro in the 1950s and Macedonia in the 1960s were able to achieve a faster increase than the average for the more developed areas. Similarly, there appears to have been little if any relative improvement in the standard of living of the less developed regions. The average living area of housing per capita in 1968 was less than two-thirds of that in more developed regions; it was the same share in 1950. According to rural surveys, per capita consumption of meat in less developed regions was roughly two-fifths of that in more developed areas in 1958; it is now roughly one-third.

10. Per capita differences have been compounded by the much higher rate of population increase in the backward regions than in the more advanced areas. Population in the poorer regions has increased at an average annual rate of 1.9% since World War II, compared with only 0.9% in the richer areas, as shown in the accompanying tabulation. The rate of population increase has not declined in most of the poorer areas as it has in the richer republics. Kosovo, in fact, has experienced a sharp rise in population growth, mainly because of the influx of immigrants from Albania during the 1960s.

	Population (Thousand Persons)		Average Annual Rate of Growth (Percent)		
	1948	1968	1949-68	1949-60	1961-68
Less developed	*4,827*	*7,091*	1.9	1.9	2.0
Bosnia-Hercegovina	2,564	3,799	2.0	2.0	2.0
Montenegro	377	535	1.8	1.8	1.7
Macedonia	1,153	1,574	1.6	1.6	1.5
Kosovo	733	1,183	2.4	2.1	2.8
More developed	*11,015*	*13,063*	0.9	1.0	0.7
Slovenia	1,440	1,691	0.8	0.8	0.8
Croatia	3,780	4,364	0.7	0.7	0.6
Serbia Proper	4,154	5,079	1.0	1.2	0.7
Vojvodina	1,641	1,929	0.8	0.9	0.6

11. Migration has not been sufficient to ease the problem of population pressure in the backward areas. There has been considerable migration within regions to new centers of industrial activity, but this has aggravated the problems of cramped living space and housing shortages. Intrarepublic migration has been too small to provide much relief, particularly in the case of Montenegro, Macedonia, and Kosovo, which are most separated, culturally and physically, from the richest republics -- Croatia and Slovenia.

12. Most migration from south to north has been from Bosnia-Hercegovina to Croatia, Vojvodina, and Serbia Proper. This is not surprising; Croats and Serbs make up two-thirds of Bosnia-Hercegovina's population, and there is no language barrier between Bosnia-Hercegovina and these areas. There has also been a sizable migration from Kosovo to Serbia, although many of these emigrants simply crossed the border to the poorer parts of Serbia Proper. The smaller number of emigrants from Macedonia and Montenegro have gone mainly to Serbia. Indeed, many of these migrants were Serbs, judging from the slow growth of the Serb population in Macedonia and its decline in Montenegro between 1948 and 1961. Very few emigrants have gone to Slovenia. A rough indication of migration between the census years of

1953 and 1961 is provided by the following tabulation, which shows the increase in the number of persons who lived in the north but were born in the south.

	Slovenia	Croatia	Serbia Proper	Vojvodina	Total
Share of population born in the south	Percent				
1953	0.5	2.3	2.9	8.4	3.2
1961	0.9	3.6	3.6	10.1	4.2
Increase during 1954-61 in number of people born in	Thousand Persons				
Bosnia-Hercegovina	4.8	54.9	19.7	38.3	117.7
Montenegro	Negl.	1.5	5.1	-0.8	5.8
Macedonia	0.6	2.8	5.1	1.8	10.3
Kosovo	0.5	3.1	15.0	2.9	21.5
Total south	*5.9*	*62.3*	*44.9*	*42.2*	*155.3*

Effects of Forced Growth

13. For less developed regions -- in contrast to the more advanced regions -- investment in the postwar period usually equaled or exceeded their contribution to national income. Only in Kosovo, which did not increase its share of investment significantly until the 1960s, can any case be made for economic neglect. On the other hand, the outlays actually required under Kidric's plan to narrow the income gap were well beyond Yugoslavia's capability, unless income parity was to be achieved by stifling investment and growth in the more advanced republics. The sectors of activity chosen for development in the backward areas -- electric power, mining, and metallurgy -- were those with among the lowest yields in growth of output per unit of investment. Because such development could not be undertaken simultaneously in all backward areas, the government tried to alternate investments in these regions.

14. Early in the postwar period, huge funds were poured into coal and ferrous metals in Bosnia-Hercegovina. In 1952, this republic was absorbing

nearly 30% of all Yugoslav investment while generating only about 14% of Yugoslavia's national income. By the mid-1950s, however, the investment boom in Bosnia-Hercegovina was over, and its share of investment fell to 12% at the end of the 1950s, as shown in Table 1. In the mid-1950s, it was Montenegro's turn for a steel mill. This project, together with increased spending in electric power and nonferrous metallurgy, boosted Montenegro's share of investment to 5% in 1956, compared with only a 1% share of Yugoslav national income. The same pattern was repeated for Macedonia in the first half of the 1960s. A new steel mill at Titov Veles, coupled with reconstruction funds to compensate for the disastrous earthquake that leveled Skopje in 1963, raised investment from 6% of Yugoslav investment in 1959 to nearly 13% in 1963-64, when Macedonia accounted for only about 5% of the national income.

15. The main benefit of capital-intensive development in the backward areas was a fairly large increase in labor productivity, often exceeding that in the more developed areas. Except in Bosnia-Hercegovina, industrial output per employee did not begin to rise in the less developed areas until the last half of the 1950s -- in Kosovo, not until the 1960s. Only in Kosovo was the early stagnation of productivity the result of lagging output. In Montenegro and Macedonia substantial increases in output in the early 1950s were swamped by new employment -- in Montenegro, this occurred in coal, nonferrous metals, wood processing, and, of all things, refrigerator production; in Macedonia, in refractories, ceramics, textiles, food processing, and tobacco. Productivity did not increase greatly in these republics until after substantial investments began to be made in electric power and ferrous metallurgy. In Bosnia-Hercegovina, increases in productivity were the highest in Yugoslavia in the early 1950s, but were the lowest in the 1960s, reflecting the shift in priority to other backward areas. Productivity growth in the more developed areas has been far more consistent, as shown in the accompanying tabulation.

	Percent		
	Average Annual Increases in Industrial Output per Employee		
	1952-60	1961-68	1952-68
Bosnia-Hercegovina	6.3	3.8	5.1
Montenegro	1.2	8.2	4.7
Macedonia	1.8	8.0	4.9
Kosovo	0	7.2	3.5
Slovenia	4.3	4.8	4.5
Croatia	3.9	6.6	5.2
Serbia a/	4.4	5.1	4.8

a. Including Kosovo and Vojvodina.

16. High rates of productivity, however, could not outweigh the high costs of investment in the less developed areas. These costs began to show up in the mid-1950s, when Bosnia-Hercegovina's initially high growth rates quickly evaporated, falling even below Kosovo's in the 1960s. The same thing might have happened to Montenegro and Macedonia when it was time to invest heavily in Kosovo and rejuvenate Bosnia-Hercegovina's economy. Moreover, the stress on heavy industry in the south resulted in considerable duplication of northern facilities, particularly in ferrous metallurgy, where capacity often exceeded demand during the 1950s. On the other hand, minimal investments were put into some industries having good growth potential, such as nonferrous metals in Bosnia-Hercegovina, and textiles, leather goods, and food processing in all of the backward areas.

17. Sectors other than industry and transportation were neglected. In fact, the largest part of the lag of the less developed areas was accounted for by the slow growth of agriculture and retail trade relative to the developed areas. As shown in Table 2, the rate of growth of per capita national product in agriculture averaged 2.8% a year during 1953-67 in the less developed areas, compared with 4.5% in the advanced areas. The slow growth of agriculture was a major factor in the lag of personal incomes and retail trade in the have-not areas, the latter growing by only 6.4% a year compared with 8% in the more developed areas.

Table 1

Yugoslavia: Regional Shares of Investment and National Income a/

Percent

	Investment					National Income				
	1952	1956	1959	1965	1968	1952	1956	1959	1965	1968
Less developed	*39*	*27*	*24*	*31*	*29*	*22*	*22*	*21*	*21*	*20*
Bosnia-Hercegovina	29	14	12	13	12	14	13	13	12	11
Montenegro	4	5	3	3	3	1	1	1	2	2
Macedonia	5	6	6	11	9	5	6	5	5	5
Kosovo	1	1	3	4	5	2	2	2	2	2
More developed	*61*	*73*	*76*	*70*	*71*	*78*	*78*	*79*	*78*	*80*
Slovenia	11	13	12	14	13	18	16	16	15	16
Croatia	22	24	23	23	21	26	27	27	26	27
Serbia Proper	25	28	28	24	28	25	25	25	25	27
Vojvodina	3	8	13	9	9	9	10	11	12	10

a. The percentage shares are based on data in current prices. Private investment is excluded. Because investment data were not available for Kosovo and Vojvodina for 1960 to 1964, 1959 and 1965 are used. Because of rounding, components may not add to the totals shown.

Table 2

Yugoslavia: Average Annual Rate of Growth of Per Capita National Product, by Sector a/ 1953-67

Percent

	Industry	Agriculture and Forestry	Transport	Trade and Catering
Less developed	9.5	2.8	7.8	6.4
Bosnia-Hercegovina	8.7	1.8	6.7	6.4
Montenegro	16.1	2.9	15.4	5.0
Macedonia	11.6	4.6	8.3	7.2
Kosovo	6.1	3.5	6.2	6.1
More developed	9.7	4.5	8.1	8.0
Slovenia	8.5	2.6	9.5	9.2
Croatia	9.4	4.2	7.8	8.2
Serbia Proper	10.9	4.5	7.4	7.0
Vojvodina	11.1	6.2	10.2	8.9
Yugoslavia total	9.5	4.0	7.9	7.6

a. The percentage rates of growth are based on constant 1960 prices.

18. Similar misallocations of resources had occurred throughout the economy, contributing to chronic inflation and to an excessive need for imports to feed the industrialization drive. Moreover, the creation of less competitive industries -- particularly in the south -- was tending to make Yugoslavia overly dependent on the less demanding export markets of the Communist countries. Trade with these countries had been cut off in 1949, when Yugoslavia was ousted from the Cominform, and did not resume until the mid-1950s. By 1965, however, the countries of the Council for Mutual Economic Assistance (CEMA) accounted for over 40% of Yugoslav exports. This was dangerously close to the 50% share taken by these countries in 1948, and too high for a country that was trying to achieve an independent position between East and West.

19. If the regime had been willing to continue to incur these costs, it is possible that the gap in per capita national income eventually would

have been narrowed. During the brief period of 1962-64, under conditions of rapid inflation, the south seemed to be gaining on the north. In 1964, per capita national income in the poorer regions increased by 14.5%, compared with 10.9% for the north. Even if this sizable advantage had been maintained, however, the gap between north and south would not have been closed for nearly 20 years.

Reform and Recession, 1965-67

20. Inflation and trade difficulties finally forced the leadership to give up its obsession with rapid growth and concentrate instead on improving the structure and quality of output. Beginning in 1964, the government put tight controls on investment and consumer credit. The next steps, which came in 1965-67, were to revamp the price structure, cutting unwarranted profits in inefficient manufacturing enterprises, and to liberalize imports of many raw materials, metal products, and consumer goods, admitting foreign competition on a larger scale. The immediate result of these measures was a sharp drop in the rate of growth of industrial output, which finally fell to zero in 1967.

21. The poorer regions had suffered most during the slowdowns of 1955-56, 1957-58, and 1961-62. The recession in 1965-67 was no exception. As shown in the tabulation below, the tight monetary policy had its greatest effect on investment, consumer credit, and real personal income in the less developed areas. The hardest hit were Bosnia-Hercegovina and Montenegro, which at the pit of the recession in 1967, experienced declines in industrial output of 4% and 3%, respectively. Industry fared better in Macedonia and Kosovo, so that on balance, the growth of industry during 1965-67 was about the same in the less developed as in the more developed areas, of which only Vojvodina had an absolute drop in output. Industrial employment grew faster in the less developed regions, but still at a slow enough pace relative to population growth to produce a sharp increase in unemployment. Unemployment in 1968 was about 8% in Bosnia-Hercegovina and Montenegro and about 20% in Kosovo and Macedonia. Unemployment in the north -- particularly in Slovenia and Croatia -- was eased somewhat by a migration of workers to Western Europe. Only about one-fourth

of the 360,000 Yugoslavs in Western Europe in 1968 came from the south, and nearly all of these were from Bosnia-Hercegovina.

	Percent	
	Average Annual Rates of Growth 1965-67	
	Less Developed	More Developed
Industrial output	3.8	3.9
Industrial employment	1.8	0.5
Investment (current prices)	6.7	11.9
Real personal income	3.9	6.3
Consumer credit	-13.0	-11.6

22. The structures of industrial output in Bosnia-Hercegovina and Montenegro were the most vulnerable to the new economic policy. The sectors most affected by the recession -- coal and ferrous metals, metalworking, woodworking, textiles, leather goods, and tobacco -- accounted for 70% of industrial production in Bosnia-Hercegovina and 60% of that in Montenegro. The steel and metalworking industries were hurt first by the cutback in investment and later in 1967 by import competition following the import liberalization. The decline of steel output, by 11% in Bosnia-Hercegovina and 8% in Montenegro in 1967, further worsened the position of coal producers, particularly in Bosnia-Hercegovina, which had already suffered from the growing use of oil as a fuel. Textile and leather goods producers also were affected by increased competition from imports as well as by a slowdown in consumer spending. Output fell for much the same reasons in woodworking and tobacco, although these industries also experienced a drop in exports in 1967.

23. In Macedonia, where the lagging industries made up a large share, output was aided by the startup of new capacities for steel and chemicals, and in Kosovo, overall industrial output was benefited by the dominance of nonferrous metals -- an industry favored by the reforms because of its good

export position. The lagging industries represented a much lower share (40%-50%) of output in the more developed regions, except in Slovenia, whose generally more efficient enterprises were better able to cope with the recession.

Effects of Decentralization

24. One of the most important features of the new economic policy was the substantial decentralization of investment. The "social investment funds" of the federal, republic, and local governments were abolished and transferred to a revitalized banking system, more independent of political control. This step gave enterprises, which were now allowed to found banks, a much greater say in the distribution of investment resources.

25. Federal investment fell greatly in the more developed areas, but it still remained a large share of the investment in backward regions. In order to provide for the poorer regions -- which would obviously fare badly without outside support -- a federal investment fund was set up, financed by tax contributions from the more advanced regions and administered largely through the Yugoslav Investment Bank (formerly one of the three special federal banks but now ostensibly more independent). In 1969, federal investment still accounted for about 20% of investment in Bosnia-Hercegovina, 40% in Macedonia and Montenegro, and 50% in Kosovo, compared with an average of only 2% in the more developed areas. In contrast, decentralized investment by banks, though a much larger share of investment than before the reforms, accounted for only 37% of the total in less developed areas, compared with 54% in the more developed, as shown in the following tabulation.

	Percent			
	Less Developed		More Developed	
	1963	1969	1963	1969
Federal government	33	28	17	2
Republic and local governments	30	9	31	6
Enterprises	22	19	35	32
Banks	8	37	9	54
Other institutions	7	7	8	6
Total	*100*	*100*	*100*	*100*

26. The reforms also resulted in more decentralization of authority to enterprises and banks to engage in foreign trade operations. Exporting enterprises were allowed to retain a larger share of foreign exchange earnings, although the bulk of foreign exchange (except in enterprises exporting most of their output) still went to the National Bank. These measures, combined with a devaluation of the dinar in 1965, were intended primarily to promote greater hard currency exports. In addition, large investments were now encouraged in tourism; free customs ports were established along the Adriatic, which permitted foreign enterprises to set up shop on Yugoslav soil; and, in 1967, a law was passed allowing foreign investment throughout the country, providing it was in partnership with Yugoslav firms.*

27. Again, the more developed areas stood to gain the most. These regions account for over 80% of total Yugoslav exports and possibly even a larger share of hard currency exports. A larger share of exports in the more advanced regions goes to Western countries than is the case in the poorer regions. Although Macedonia appears to be an exception, a significant share of its trade with the West has been on clearing account with its neighbor Greece -- usually counted among less developed countries. As would be expected, CEMA and less developed countries account for a larger share of the exports in less

* *The law on foreign investment limits foreign investment to less than 50% of any partnership arrangement.*

developed regions than in more developed republics, as shown in the following tabulation, for 1969.

	Percent			
	Share of Total Yugoslav Exports	Share of Exports, by Republic		
		OECD Countries a/	CEMA	Less Developed
Bosnia-Hercegovina	11	41	35	24
Montenegro	2	41	35	24
Macedonia	4	59	36	5
Slovenia	19	69	22	9
Croatia	28	52	31	17
Serbia b/	36	57	33	10

a. Countries of the Organisation for Economic Cooperation and Development which includes Western Europe, Turkey, Greece, Japan, Iceland, and North America.
b. Including Kosovo and Vojvodina.

28. Moreover, nearly 90% of foreign tourists in 1968 went to the developed areas; Croatia alone, with its near monopoly on Adriatic resorts, including Dubrovnik, accounted for 56% of the number. Almost all the free ports such as Split and Rijeka are also in Croatia. Finally, most of the trickle of joint foreign investment that has been attracted thus far has been in partnership with firms in the more developed areas. One major exception, if it comes about, will be a proposed Kaiser-Energoinvest joint investment in an aluminum combine near Mostar in Bosnia-Hercegovina.

29. As indicated earlier, the liberalization of imports of raw materials and metal and wood products also generally favored the more developed areas, which not only could better withstand foreign competition but now could, if they wished, rely on alternative sources of the raw and semifinished goods produced in the poorer regions. The government did not go nearly so far as the more developed regions would have liked in liberating foreign exchange controls, so that less developed regions still were able to acquire substantial supplements

to their own foreign exchange earnings. Nevertheless, the more developed areas, aided by earnings from tourism and transport, obtain more of their imports from the West and less from the Communist countries than do the less developed areas. Montenegro is the exception here, but its trade in any case is extremely small -- less than 2% of total Yugoslav turnover. The regional distribution of imports in 1969 is shown in the accompanying tabulation.

	Percent			
	Share of Total Yugoslav Imports	Share of Imports by Republic		
		OECD Countries	CEMA	Less Developed
Bosnia-Hercegovina	7	52	39	9
Montenegro	1	73	26	1
Macedonia	5	61	34	5
Slovenia	20	77	18	5
Croatia	26	69	21	10
Serbia a/	31	64	29	7
Multiple destination b/	10	39	12	49

a. Including Kosovo and Vojvodina.
b. Imports associated with firms in more than one republic.

30. Thus, decentralization has drawn an ever sharper line between the richer and the poorer regions. The more developed areas, particularly Slovenia and Croatia, would like less government control, while the poorer regions still need what they can get in the form of price and import protection and federal foreign exchange allocations. Moreover, it is now far easier for the more developed areas to quantify their role in the support given to the poorer regions than it was in the 1950s, when the federal government financed a sizable part of investment in all republics. The richer republics complain that much of the support given to backward areas has been wasted on inefficient prestige projects. They have some grounds for questioning the effectiveness of major projects

and are increasingly disposed to ask such questions in the service of their own economic interests. On the other side, the backward regions often grumble about the inadequacy of federal support. Bosnia-Hercegovina particularly feels slighted -- not one major new project has been started there since 1964.

Recent Conflicts

31. Decentralization brought with it an atmosphere of more open political and economic discussion. It has also opened up new regional conflicts, in which Slovenia and Croatia usually have been pitted against the federal government and the less developed regions. In the most publicized flareup, the Slovene government in 1969 lambasted the federal government for unexpectedly reversing an earlier promise and cutting Slovenia out of funds earmarked for road construction under a proposed loan from the International Bank for Reconstruction and Development (IBRD). The Slovene officials in turn were severely reprimanded for engaging in "republican nationalism." As it turned out, the Slovene roads had not been eliminated but rescheduled under another loan to be negotiated with the IBRD in 1970. Slovene officials in due course made the proper public apologies for the outburst, and repeatedly denied the existence of significant separatist sentiment within Slovenia, but they remain extremely sensitive to such issues.

32. Another issue has been simmering in the more advanced regions since the reform of the foreign exchange system in 1967. The Croats, in particular, have complained that, although import liberalization has made it far easier for importing enterprises to obtain hard currency, the amount of foreign exchange that can be retained by exporters is still too small to encourage them to seek new markets. In fact, a large share of the available foreign exchange goes for hard currency imports of equipment for firms in less developed regions, usually with little hope of return in the form of hard currency exports. As a result, while Croatia accounted for about 28% of all commodity exports (and 38% -- the largest share -- of all foreign exchange earnings including tourism and other services), it accounted for only about 13% of investment in machinery imports in 1967.

33. Duplication of plants also results from regional self-interest. One example is the ambitious plan of local interests in Split, Croatia, to build a giant steel mill on the Adriatic, a plan that Tito has criticized strongly as costly and unnecessary. Apparently, work on blueprints for the project is continuing in spite of Tito's protest and in spite of the probability that it will be difficult to amass the necessary funds anyway.

34. Another instance of regional duplication is reflected in a dispute, under consideration by the federal government since late 1968, between petrochemical and plastics combines in Croatia, Serbia, and Macedonia, which have formulated conflicting long-range plans for development. The Croatian firms -- OKI and INA (the large Croatian petroleum consortium), of Zagreb, and Jugovinil, of Split -- plan to build a large polyester fibers factory, which would be in direct competition with a similar plant proposed by the OHIS firm in Skopje. Moreover, Jugovinil wants to quadruple its present production of polyvinylchloride, in conflict with Serbian plans to build a new polyvinyl plant in Pancevo.

35. The list of recent conflicts seems endless. Croatia and Slovenia complain that the federal government's longstanding refusal to raise rail freight rates has put the railways in financial difficulty and has only served to subsidize marginal enterprises, particularly in the less developed areas. Also working against Croatia and Slovenia is a new federal law limiting the carrying capacity of private trucks to five tons. Private truckers in these republics, with the sympathy of republican officials, have demonstrated against the law, and one public official -- the Mayor of Maribor, Slovenia -- has privately stated that the law is "stupid" and will not be strictly enforced in Slovenia and Croatia.

36. Such conflicts and old ethnic rivalries, revived now and again, as in the "nationalist" demonstrations of the large Albanian minority in Kosovo in 1968, have prompted Belgrade to launch a new attack on regionalism. Beginning in 1969, the leadership pressed for revisions in the structure of government, increasing the authority of the Chamber of Nationalities and bringing some of the

more influential republican leaders to Belgrade to serve in the Federal Executive Council and in high-level economic councils. In addition, a new 15-member Communist Party Executive Bureau was created, staffed by high-level representatives from all regions. The leadership hoped that many potentially explosive regional conflicts could be thrashed out before they surfaced and that key republican leaders, removed from the source of their political power, might develop more of a "Yugoslav" outlook. Indeed, it was Mitja Ribicic, the new head of the Federal Executive Council, and a Slovene, who took the lead in condemning his own republic's stand on the road controversy.

37. An important element in the government's new regional economic policy is the push to integrate enterprises, and especially across republican boundaries. But most intrarepublican mergers thus far have been among firms or banks in the more developed areas. Two important mergers have occurred in Macedonia, where the FIAT-sponsored Crvena Zastava automobile factory of Serbia has established a component parts subsidiary and Rade Koncar of Croatia has absorbed both a refrigerator plant and an electrical equipment factory.

Prospects

38. Tito -- and his successors -- will try to steer a middle course between the competing demands of the north and south, in the attempt to further the national Yugoslav interest. The north will be favored by continued efforts to increase hard currency exports, including the provision of added incentives to enterprises through gradual decentralization. The south will be favored by continued large federal investments and continued efforts to promote mergers with the more established northern firms. Kosovo recently has been singled out for special federal attention, including help in obtaining credits to bail out firms in debt. There will be setbacks to these policies in the short run. The Yugoslav economy still is highly vulnerable to inflation and balance-of-payments crises, which periodically will force the government to step in with deflationary controls on imports, prices, investment, and consumer spending.

39. As in the past, the rich probably will get richer in spite of federal support to the backward areas. Yugoslavia's backward regions are in much the same position relative to Slovenia and Croatia as these republics are in relation to Western Europe. The south, in effect, is a microcosm of most less developed countries, having the same dim prospects of catching up. The north will be favored to the extent to which the government maintains its current stress on decentralization and efficiency. Moreover, the south is particularly vulnerable to recession and stands to be hurt more than the north during periods of retrenchment brought on by inflation and balance-of-payments problems.

40. On the other hand, the incomes of the backward areas will not stagnate. Given the current emphasis on efficiency, investments even in the poorer areas will be allocated to more profitable uses -- agriculture, food processing, and nonferrous metals -- as well as to transportation and housing. A particularly bright spot is Montenegro, where large funds will be spent in developing tourism, supported by large expenditures in agriculture, all as part of the United Nations South Adriatic Project. Moreover, integration and business dealings in general between more and less developed areas really seem to be on the rise.

41. Regional disputes are unavoidable. The north will continue to press for greater liberalization in the struggle to become more competitive. The south, as revealed in recent statements by leaders there, will try to use local resources to create new manufacturing industries, which will continue to encourage demands for federal price and import protection. The government that succeeds Tito, struggling to gain acceptance, probably will have more difficulty in juggling regional conflicts. Moreover, these conflicts are a natural target for any attempt by the USSR to increase its influence in Yugoslavia. [redacted] 25X1

25X1

42. Yugoslavia has come a long way as a state and may have developed the cohesiveness to withstand regional disputes. As the President of the Chamber of Nationalities, Mika Spiljak, puts it, "less than 25 years ago Yugoslavs were killing each other. There are Serbs and Croats in public life today whose relatives were murdered by each other. We can stand these inefficiencies of mixing together for a few years more."

Conclusions

43. In two decades, Tito's Communist regime has tried and failed to narrow the economic gap between the more developed northern part of Yugoslavia and the less developed south. Indeed, differences in output and income per capita have increased, and what is more, the economic objectives of the north and south have diverged. The north is pressing for more decentralization of federal economic control; the south still relies heavily on direct federal support and federal protective controls. Regional economic conflicts, together with the historical rivalry among the several nationalities -- Serb-Croat rivalry is not dead -- pose a challenge to the leadership unique for a country of Yugoslavia's size. With the question of succession becoming increasingly important, regionalism now has become the most publicized issue in Yugoslavia.

44. The attempt made in the 1950s to narrow regional economic differences was just a beginning, and an expensive one, since most investment in the south was in capital-intensive sectors -- road-building, electric power, mining, and metallurgy. A continuation of the forced growth policies of the 1950s, with continued preferential treatment of the south, probably would have eventually reduced the gap, though very slowly, especially in view of the cultural barriers to south-north migration. But this policy had to be given up in the mid-1960s because it had resulted in chronic inflation, severe deficits in the hard currency balance of payments, and excessive dependence on the export markets of the USSR and Eastern Europe. The new deflationary policy adopted in the mid-1960s tended to discourage development in the south. The less efficient, protected industries of the south, such

as steel, could only lose from the steps taken to curtail new investments and encourage hard currency exports, which largely come from the north.

45. Even though the current national policy continues to favor the north, the government will maintain its commitment to help the backward regions. This dual policy -- a political necessity -- will mean slower progress in raising efficiency throughout the economy as a whole, and continued direct federal economic influence and control in the economy. Although federal investment in the south probably will be put to better use, local resources are likely to go into new manufacturing industries which duplicate those in the north and create demands for federal price and import control. The south, in effect, will be an obstacle to northern demands for more decentralization -- particularly a reduction in federal foreign exchange controls which would prod enterprises to export.

46. Tito's unifying influence has so far been sufficient to dampen conflicts that could break up the federation. To provide for the day when he is gone, Tito has set up a strong Party Presidium made up of key republican leaders, hoping that at least some regional disputes can be settled before they inflame public opinion. Nevertheless, the leaders who follow Tito will have far more difficulty in satisfying competing regional demands while moving ahead on national policy objectives. The middle course between efficiency and equalization -- between decentralization and control -- will likely be a winding one.