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Stabilisation policies in Bulgaria and Yugoslavia during communism's terminal years: 1980s economic visions in retrospect

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Editorial

The South-Eastern European Monetary History Network (SEEMHN) is a community of financial historians, economists and statisticians, established in April 2006 at the initiation of the Bulgarian National Bank and the Bank of Greece. Its objective is to spread knowledge on the economic history of the region in the context of European experience with a specific focus on financial, monetary and banking history. The First and the Second Annual Conferences were held in Sofia (BNB) in 2006 and in Vienna (OeNB) in 2007. Additionally, the SEEMHN Data Collection Task Force aims at establishing a historical data base with 19th and 20th century financial and monetary data for countries in the region. A set of data has already been published as an annex to the 2007 conference proceedings, released by the OeNB (2008, Workshops, no 13).

On 13-14 March 2008, the Third Annual Conference was held in Athens, hosted by the Bank of Greece. The conference was dedicated to *Banking and Finance in South-Eastern Europe: Lessons of Historical Experience*. It was attended by representatives of the Albanian, Austrian, Belgian, Bulgarian, German, Greek, Romanian, Russian, Serbian and Turkish central banks, as well as participants from a number of universities and research institutions. Professor Michael Bordo delivered the key note speech on *Growing up to Financial Stability*. The participants presented, reviewed and assessed the experience of SE Europe with financial development, banking and central banking from a comparative and historical perspective.

The 4th Annual SEEMHN Conference will be hosted by the National Serbian Bank on 27th March 2009 in Belgrade. The topic of the Conference will be *Economic and Financial Stability in SE Europe in a Historical and Comparative Perspective*.

The papers presented at the 2008 SEEMHN Conference are being made available to a wider audience in the Working Paper Series of the Bank of Greece. Here we present the eighth of these papers, by Roumen Avramov and Dragana Gnjatović.

July, 2008

Sophia Lazaretou
SEEMHN Coordinator
Member of the Scientific and Organizing Committee

STABILIZATION POLICIES IN BULGARIA AND YUGOSLAVIA DURING COMMUNISM'S TERMINAL YEARS: 1980s ECONOMIC VISIONS IN RETROSPECT

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ABSTRACT

We adopt a comparative view of the stabilization policies designed and implemented in Bulgaria and Yugoslavia during the fatal economic crises of their regimes in late 1980s. The role of the IMF can be better highlighted by comparing "with (Yugoslavia)-without (Bulgaria)" scenarios in a communist context. The authorities' views are discussed and newly accessible archival evidence is presented in the case of Bulgaria. The ruling elites' vision is confronted by that of critical professionals thus permitting a retrospective assessment of the conceptual readiness of the society for the forthcoming transition to a market economy in the early 1990s.

Keywords: macroeconomic stabilization; inflation; communist economy; Bulgaria; Yugoslavia.
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1. Introduction

In the course of the 1980s, Bulgaria and Yugoslavia faced severe economic crises generated in different political contexts but sharing common features and outcomes. For both countries, those disorders were not simply events related to habitual macroeconomic imbalances. They bore the seals of a *fin de reigne* and of the ultimate exhaustion of long-standing societal and economic models. Indeed, Bulgaria and Yugoslavia represented archetypes of the post-war communist extremes. The former was the most orthodox Soviet ally, copying in details the features of its planning infrastructure. The latter, in turn, symbolized for decades the "revisionist" approach to economic policy and successfully played in the no man's land between the Communist block and Western democracies. Thus a comparative view of the stabilization policies designed and discussed in those countries during the fatal economic crises of their regimes offers promising insights.

The timing of the events is not strictly overlapping. Whereas in Bulgaria the 1990 default on foreign debt was the climax of a debacle that provoked the fall of an ailing political rule, in Yugoslavia the 1983 suspension of payments was the starting point in the irreversible decline and eventual (by early 1990s as well) breakdown of the system. The broad frame is also apparently dissimilar, the main distinction being the presence of the International Monetary Fund (IMF) in Yugoslavia. But those differences only underscore that the two cases are basically about the same story: the reluctance to abandon an entrenched economic *status quo* and the disastrous consequences this entails. Indeed the role of the IMF is better highlighted by allowing a comparison between "with-without" scenarios in a communist context.

Part 2 of the paper outlines the character of the crises and enters into details concerning the stabilization policy discussed and adopted by the two Governments. In Yugoslavia, the main points have been debated more or less overtly due to the presence of foreign experts and the conditionality imposed by the IMF. By contrast, Bulgarian policy-making was extremely secretive. Newly accessible archival evidence permits us to explore for the first time the views of the authorities "from the inside". In Part 3, the establishment's vision is compared to that of critical scholars and professionals. The opposition of the standpoints is an exercise in history of ideas and permits a retrospective assessment of the conceptual readiness of the society for the forthcoming transition to a market economy in the early 1990s. Some comparative conclusions are drawn in Part 4.

2. The Ruling Elites' Vision

2.1 Bulgaria: the invisible barriers

From 1985 the Bulgarian economy was trapped in a vicious circle of pseudo-reforms that exacerbated – instead of alleviated – the imbalances in the untouched fundamentals of the centrally planned system in place (Kornai, 1992; Ivanov, 2008). Expanding imports from the West were accompanied by growing exports and credits to insolvent Third World countries, thus building a debt burden in convertible currencies that rapidly attained unsustainable levels. Subsidies to domestic producers were soaring due to widespread inefficiency and soft budget constraints. Credit to enterprises was *de facto* "automatic" (at least for the objectives fixed by the plan), orchestrated and tightly controlled by the monobank. Deepening budget deficits were financed through growing monetization of central bank's resources, large-scale decapitalization of enterprises and extorted "forced savings" of households. The newly created commercial banks (1987) were no more than simulacrum – they rapidly became an additional source of quasi-fiscal resources and generated unmanageable flows of bad credits, which had to be covered by money creation. When the political regime collapsed (November 1989), the country was on the verge of defaulting on its foreign debt (default was actually declared in March 1990). The economy had accumulated a huge inflationary potential that, however, was kept implicit due to the still maintained fixed prices: the reverse side of the phenomenon was hoarding of commodities with the resulting deficits and the flourishing "grey" markets. The basic stylized facts are presented in Table 1 below.

Table 1: Bulgaria 1985-1991 – Basic Indicators
(Annual percentage change)

	1985	1986	1987	1988	1989	1990	1991
GDP	2.7	4.2	6.0	2.6	-1.9	-12.0	-16.7
Exports in convertible currency		-21.8	15.8	-1.9	-8.6	-5.4	-8.8
Current account for transactions in convertible currencies (mn USD)	-85	-715	-773	-840	-1306	-860	-906
Money supply			12.9	13.1	5.2	31.0	244.1
CPI						50.6*	490

Source: BNB Annual reports, 1990, 1991
*1990 CPI: May-December

The scale and character of the crisis were unprecedented for the Bulgarian communist regime. The purely functional dimensions of the events could be reduced to a well-known combination of external payments' difficulties, foreign refinancing shortages and soaring fiscal deficits, i.e. to a mix requiring strong deflationary policies. What made the situation unique was the completely changed context, which did not compare to any previous experience with balance of payment and debt imbalances. Bulgaria had already faced two debt crises (in early 60s and late 70s.), settled through arrangements with the USSR[1], but in the second half of the 80s, an intra-COMECON deal was no longer plausible. The convertible currency debt exposure was to Western banks, the possibilities and willingness of the Soviet Union to perform once more the role of a "payer of last resort" had vanished and the Polish (1981) and Yugoslav (1983) defaults had, *inter alia*, undermined the credibility of the Eastern block. Besides, society was in many respects relatively more open, permeable and informed than in the past – consumerist models accompanied growing economic exchange with developed countries; the Soviet "perestroika" had given impetus to

[1] The first crisis was the result of high indebtedness to London and Paris-based Soviet banks. In fact, these were indirect liabilities towards the USSR. After it became clear that Bulgaria was not in a position to repay the debts out of its foreign exchange reserves, the Party's leader approved in 1962 and 1964 the selling of the gold reserves. (Part of them was pledged as collateral to loans obtained from the Soviet banks). The second crisis was settled after the USSR permitted Bulgaria to re-export Soviet oil and oil products to the Western markets at world prices.

certain (still heavily controlled) intellectual debates; social and interests' structure had became more complex.

All these changes implied that a way out of the crisis could not rely on replicating previous patterns. A globally tinted arrangement was inevitable against the background of a global debt crisis. Welfare had become a highly politically sensitive issue and consumption-cutting macroeconomic adjustment was not as easy as in previous years. The richer social texture produced diverging motivations for reforms. Although everyone verbally acknowledged the need for "radical" changes, the visions differed substantially: the marasmatic party elite developed and launched sets of palliative measures; "reformers" promoted intrinsically inconsistent steps that multiplied the leakages in a yet poorly controlled economy; technocrats were burdened with day-to-day management and were split between opposing lobbyist groups; isolated and increasingly loud intellectuals dug into the roots of macroeconomic distortions. Thus, growing awareness of the situation's novelty motivated an uneven search for new stabilization policies and instruments.

The official positions are well documented in the public rhetoric and in the "visible" decisions taken by the Government. What remained opaque until recently is the extent of the authorities' knowledge, the thoroughness and timing of their assessments and the policy scenarios considered. It is only with the opening of important segments of the communist archives that it became possible to produce a more insightful view on the ongoing debates inside governing circles. The new archival evidence for the period and for the bulk of ex-communist countries (labelled by some historiographers a true "archival revolution" - Gregory and Harrison, 2005) permits a re-thinking of many clichés, a re-formulation of old questions, the display of previously unobservable nuances among the personalities of the regime. It allows for subtler periodisations, reveals hiterto hidden institutional conflicts and tests hypotheses not only on indirect indications but also on historical facts.

In Bulgaria, the opening of the files has proceeded at very different rates. The archives of the Communist Party and of the Council of Ministers were made public a decade ago. Those of key institutions like the Ministry of finance, the Planning commission or the Foreign Trade Bank are still only partly accessible. Of course, the question remains (and probably will remain unanswered) whether the totality of the documents have been transferred to the National Archives.

Without doubt, the most relevant testimonies concerning stabilization policy are to be found in the files of the Bulgarian National Bank (BNB), which used to be an unapproachable territory. They were opened to the public in 1999 with an extremely generous clearance period of merely ten years, thus illuminating the time span of the crisis. As scholarly scrutiny of such a vast depository requires time, the first systematic accounts started to appear only recently. Our findings are based on evidence collected from the bank's archives.

Thanks to its functional place, the BNB was at the very centre of the crisis management. It was directly exposed to the most pressing economic issues and handled key databases. The monobank had a pivotal position in the planning and actual movement of financial flows. While fulfilling its foreign payment and loan rising assignments the BNB operated in the contact zone with capitalist markets where no soft budget constraints existed, and the routine accounting manipulations of domestic agents were excluded. Beside, the management of foreign exchange reserves granted access to one of the regime's economic sanctuaries: since Stalin, foreign reserves had always been an exclusive personal domain of the communist dictators (Gregory and Harrison, 2005, p.744). All those peculiarities granted the BNB (like every monobank) considerable discretionary power, which Party hierarchy monitored closely. The Governor had typically no political weight and the institution was considered a technocratic body. In turn, the bank was permitted to adopt a more pragmatic language, to avoid (to a certain degree) the ideological litany, to focus on practical problems and/or solutions.

The documents reveal how the BNB informed the Communist party leadership about the build-up of foreign debt. It has to be noted that external debt (in rubbles and in convertible currencies) was an issue of the utmost secrecy. Data circulated among an extremely narrow circle of high-level Party and Government officials, while academia (not to say the general public) were completely isolated from any discussion.

Following a series of balance of payments surpluses, a deficit was posted for the first time in 1985. Initially, it was related to an exceptional bad harvest, but very soon, the bank started sending increasingly alarming signals. The prospect of insolvency was uttered almost immediately. In the Annual report for 1986[2], the BNB boldly warned that continuing deficits would unavoidably lead to disruptions in foreign debt refinancing, to stricter roll-over terms and ultimately, to payment disruption. In order to impress the political cupola and to activate self-preserving instincts, the report makes explicit reference to Poland and Hungary whose debt problems – it was recalled – easily evolved quickly into political turmoil. A report to the Prime Minister from September 1987 labels the debt in convertible currencies as "snowballing", while the Annual reports for 1988 and 1989 point out the increased risk premiums charged on Bulgarian loans by the creditors and the gradual exhaustion of fresh funding.[3] In the wake of the ethnic/political crisis during the Summer of 1989[4], the BNB went one step further in assessing the situation. It recognised that Western banks' attitude was a legitimate response to the "incapacity of the Bulgarian economy to adjust", that there was no possibility of finding alternative sources of deficits financing and that the county was heading to insolvency (BNB, 18 July 1989).

Warnings were issued, as well, about the consequences of the growing involvement with heavily indebted Third World countries. Exports to them (mainly armaments) were negotiated through Bulgarian government credits that were eventually never repaid. As early as 1987, the bank criticized the model which effectively consisted in the country importing from developed countries while exporting to insolvent developing nations (BNB, 2 September 1987). This politically motivated scheme led to a true external shock, commensurable to the magnitude of the energy shocks, or to losses of crucial export markets.

On the whole, archival evidence attests to the fact that the central bank (and thus the country's leadership) was well aware of the imminent default. At least three years before 29 March 1990, convincing indications were already evident about the inevitable and irreversible mid-term prospect. The fact that no public debate emerged in such circumstances is one of the essential peculiarities of the totalitarian system.

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[2] Annual reports were distributed to a handful of addressees. The documents, released in April, covered the previous year's events.

[3] The somewhat delayed reaction of the markets could be partly explained by the presumption that Bulgaria, as usual, would be bailed out by the USSR.

[4] The crisis was triggered by the forced assimilation of the ethnic Turks in Bulgaria, which started in late 1984. In May 1989, an important part of the minority was *de facto* deported to Turkey. This produced a massive exodus with strong economic and political consequences. They contributed to the fall of the regime in November 1989.

Thanks to its position, the BNB was also the cashier, the accountant and the evaluator of *domestic* debt accumulation. Reports abound with critical notes on the para-fiscal credits extended to the enterprises. A "State Credit Fund", in particular, was established in 1987 as a source for low return investments. The fund had to be replenished with money from the budget and from the habitual sources of deficit financing – the State saving bank (SSB) and the State insurance company. The goal was to cut off the newly created "commercial banks" from unprofitable credits, which in turn would be confined to the budget. The outcome was quite different, however. Government did not contribute its share to the fund, whilst resources were siphoned from the BNB and households (indirectly, through SSB) in order to finance megalomaniac investment projects, amassing bad debts and losses. Besides, a number of other channels added automatic credit. One of the most important, which was often pointed out by the BNB, was the loans extended by the Bulgarian Foreign Trade Bank (BFTB) to exporters not repaid by their Third World customers. Thus, the growing and uncontrollable real public sector deficit extended far beyond the strictly defined budget account.

Along side these "easy" criticisms, different topics (such as inflationary pressure) started to appear in the late 1980s. The more professional language of the BNB permitted it to bring up new issues completely forbidden in the public debate for decades. Nevertheless, even if the atmosphere had changed with the "perestroika" rhetoric, the BNB staff did not introduce inflation immediately into its agenda. Among the paradoxes of the communist regime is that the monetary authority was able to carry out its policy without ever mentioning the word: no more than a couple of documents using the term were found in the bank's archives from early 1950s to mid 1980s.

By the second half of the 1980s, it became impossible to ignore completely the phenomenon. Official prices were "adjusted" on several occasions, while everyday life provided numerous examples of rising prices in the 'grey" markets. Three bank reports (of course strictly confidential, in only two copies) are particularly explicit in this respect (BNB Annual Report, 1987; BNB Annual Report, 1988; BNB, 7 January 1988). They illustrate the technocratic "monetary thinking" during communism and uncover a clearly perceived institutional interest. The tacit view of the planning agencies that inflation is a simple discrepancy between overall incomes and supplied consumer goods continue to be at the heart of the explanation. Novelties, however, are also introduced. It is recognized that under a system of administrated prices, inflation takes the form of deficits; attention is paid to the biased incentives' structure; rigidities are pointed out. There is a clear effort to adopt a more "modern" discourse and to provide deeper insight.

Actually, the most important "innovation" in this set of files is the direct connection of budget deficits with inflation accounting.[5] Due to the lack of a proper monetary analytical framework[6], monetization is not adequately articulated, and fiscal imbalances are presented essentially as a source of "hollow" revenues. Still, the BNB reports display an almost exhaustive list of instruments utilized by the State to drain funds from the economy and to invest them in priority targets, or simply in keeping ailing enterprises afloat. It is shown how producers were systematically decapitalized through a twisted price structure that benefited the budget; through disproportionate taxation (the average profit tax rate amounted to 75%); or via the overvalued exchange rate. Enterprises were eventually "compensated" with soft crediting that increased the debt burden, made any anti-inflationionary rise in interest rates politically unsustainable and built up huge amounts of bad debts. Negative real interests on deposits, in turn, penalized households' voluntary savings and stimulated borrowing. The overall credits captured by the fiscal authorities from different segments of the monobank as well as from households and enterprises amounted to roughly 15% of national income.

Cataloguing events is one thing but proposing a cure is quite another. There is no doubt that analyses contained in the BNB files from the late 1980s constituted a step forward compared to the traditional approach. When it came to masterminding consistent measures to be taken, however, the texts neatly reveal conceptual obstacles defined by political, ideological and professional barriers. The bank issued clear warning signals that bold stabilization policies were needed. At the same time, actual proposals were extremely limited in scope. The worth of archival documents is precisely in the evidence they provide about this double layer of communist economic thinking.

[5] The only previous explicit mentions of this link were found in documents from 1956 and 1968.
[6] The term "monetization" is never employed. It is simply missing from the notional apparatus of the planning authorities' monetary accounting where money creation is not traced at all.

A first set of decisions was driven by panic. They could be labelled a “debt strategy” that consisted in contracting domestic debt and borrowing abroad with the sole purpose of keeping the economy running. Soft budget constraints on local enterprises are upheld and foreign debt is rolled over at ever increasing costs. There is nothing forward-looking in this policy: the only idea is to survive in the short-run.

The BNB archives document the numerous new streams[7] of automatic loans and bad debts, as well as the series of debt rescheduling and/or forgiveness. As the beneficiaries were state-owned enterprises, the final source of this *de facto* public debt was the monobank. A general settlement of those debts came with the rescheduling agreement between the Ministry of finance and the BNB signed in March 1989. On paper, the maturity of the government’s budget liabilities towards the bank was prolonged to 50 years, starting in 1990, at 2.5% interest rate. This completely unusual formal recognition of non-compliance by the State was equivalent to its default on domestic debt. There was, of course, no announcement. It is curious to note that – symbolically enough – the act preceded by exactly one year the March 1990 default on Bulgarian foreign debt. These events reflected the failure of the two pillars of the instinctive, unimaginative “stabilization” policy followed since 1986.

The BNB was the institution endorsed to implement this policy at the technical level. Although expressing dissent, the bank was not in a position to stop it. The only option was to produce more “sophisticated’ proposals, which however encountered obstacles of a different nature.

Before anything else, the BNB’s influence was constrained by its institutional weight. Even if directly subordinated to the Executive, the monobank was involved in a classical conflict with the Ministry of Finance. As was the rule in those quarrels, fiscal considerations largely prevailed over monetary targets, thus maintaining the *status quo* in favour of the budget and the indebted enterprises. Personal rivalries also played a role. Several documents reveal that key decisions on foreign debt and reserve management were taken without the BNB’s approval, in an inner circle including political figures and BFTB high-level officials. This institutional setting restricted *a priori* the central bank’s influence and did not allow it to become (as would have been natural) the focal point of a comprehensive stabilization policy.

[7] A great deal of them originated from the “commercial banks established ” in the course of 1987. They were owned by industrial enterprises and extended insider loans to their shareholders.

The most "radical" proposals emanating from the BNB were in two directions. As already mentioned, at one level, they consisted of futile appeals to cut down inflationary deficit financing. The second axis was a plea for "correction" of the unrealistic exchange rate vis-à-vis convertible currencies and the elimination of the system of multiple rates. This model was one of the cornerstones of the communist economy: the overvalued exchange rate damped official figures of the foreign debt in Leva, exerted a deflationary pressure, accommodated enterprises' cost inefficiencies and produced effortless fiscal revenues. At the same time, it was patently export-penalizing and import-stimulating, thus contributing to balance of payments deficits and, eventually, to debt build-up. In fact, the exchange rate was adjusted on several occasions, but without challenging the basic principles. When the payment crisis matured during the late 1980s, the issue turned urgent and the BNB was, as would be expected, an advocate of devaluation. The evidence was accepted verbally by a fraction of the Party leadership, even the objective of Leva convertibility was launched publicly. However, there was obviously not enough political will to take the necessary decisions and the central bank remained isolated.

Archives provide rich evidence about the discussion among insiders on the question of devaluation. In fact, the term was never employed even in confidential documents and the debate concerned the adjustment of the foreign exchange "coefficient".[8] The BNB-promoted package for 1989 included a depreciation of the coefficient, the unification of the different rates and the use of the single rate in the balance sheets of the banks. The bank had previously launched the idea for limited currency auctions with the idea that a more realistic rate would emerge from the trading of export remittances.[9] Actually, the measures adopted were much delayed, fragmentized and inconsistent. An authentic foreign exchange market was only started in February 1991, as a key element of the IMF-sponsored stabilization program.

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[8] A complex system had developed historically. Differentiated coefficients served as a bridge between international and domestic commodity prices. Separate coefficients were used for financial transactions and cash exchange. Finally, the official rate served as accounting unit for foreign debt and balance of payment data. On 1 January 1988 the coefficient was raised from 1.5 to 2 Leva per 1 "foreign Leva" (the unit of accounting for external transactions), while the official rate remained unaffected. The BNB considered the move not enough and insisted on 2.20 Leva. Eventually the coefficient rose to 2.50 Leva (September 1989) and 3.00 Leva (proposed for January 1990) but the official rate was kept intact.

[9] Such auctions were organized sporadically, on a very limited scale, from 1988 onwards. On the first one only 6.3 mn. USD were traded. In any event, the obtained exchange rate was much more realistic – an average of 7.9 Leva per USD (minimum of 2.52 Leva and maximum of 16 Leva), compared to the official rate of 2.0 Leva per USD.

The measures put forward by the BNB may seem “radical” in the prevailing context. In reality, they reflected ambiguous thinking and made the deeper conceptual barriers more apparent. Even the more “illuminated” technocrats of the regime were alienated by doctrinal dogmas and taboos, by a lack of the professional knowledge required to design a thorough stabilization agenda, by the missing adequate monetary data and national account framework. The accompanying steps documented by BNB files demonstrate that imagination did not manage to rise above the plan, the dominance of state ownership, the “socialist market” and regulated prices, the (slightly amended) monobank system and the bailing-out of enterprises. Convertible currency “self financing”[10] was not questioned. Convertibility of the Leva remained on the drawing table as a mid-term project (Project on Convertibility Law, 1989) including plenty of regulations, misunderstandings and palliatives. The BNB continued to rely on possible “improvements” of the planning procedures. Defence and security expenses continued to be treated as untouchable.

One of the most constraining clichés was the incapacity to think about economic dynamics in cyclical terms. Communist ideology banned out of political correctness any reference to possible slowdowns. By coincidence, the Bulgarian regime had just adopted Gorbachev’s 1986 slogan about “economic acceleration”. In this context, the BNB (like all the other institutions) embraced a pro-growth rhetoric despite its awareness that the economy was highly import (and thus debt) elastic. Beside, the Party leadership feared instinctively bold economic measures that could provoke social and political unrest. “Preservation of the living standard” also remained top on the list of government priorities despite the fact that such policy was unsustainable. Correspondingly, the BNB’s attitude remained vague – it formulated the classical dilemma between rationing through prices or quantities/deficits, but at the same time, free prices were discarded as a policy response due to the “social cost” they entailed. In the technocrats’ imaginary “socialist” equilibrium, prices were still achievable. The same contradiction was apparent in the attitude vis-à-vis the debt/exchange rate quandary. The bank’s reports accept the unavoidable inflation generated by exchange rate adjustment as an acceptable way to curb soaring foreign debt, just to sustain that what is meant is “controlled price growth”. Moreover, during

[10] The principle according to which imports can be made only to the amount of export proceedings. This technique was introduced during the Great Depression, but proved perfectly suitable to the autarchic communist economy deprived from a foreign exchange market.

the climax of the political crisis in the summer of 1989, the BNB did not refrain from panic reactions. Concerning subsidies, it acknowledges that the real sector is near to financial collapse, but the remedy was seen in terms of more "transparent" assistance and not in the complete termination of bailouts. Finally, even when the prospect of currency reform was mentioned for a while (BNB, 29 June 1989), the illusion remained that it would boil down to the previous "price adjustment" exercises and that incomes and savings would be preserved.

Overall, the economic policy stance (even with the hypothetical inclusion of the bank's amendments) was the opposite of that required given the state of macroeconomic fundamentals, namely restrictive monetary/fiscal measures and a reduction in aggregate demand. The authorities (including the BNB) were neither willing nor prepared ideologically or instrumentally to implement the needed "planned stagnation". What is more, they had a completely schizophrenic view of the reform aim. The bank's archives have preserved the termination of a contract with "Price Waterhouse" (BNB, 1 December 1989), which had been hired to consult the Bulgarian Government on "the *elements* of a market mechanism to be introduced in the planned economy". The rationale behind the decision to interrupt the contract was that "the proposed economic-mathematical model is not suitable" for the purpose and that the American company requires data which "are strictly confidential or are not produced in the country." Even on the very edge of the start of the transition to market economy, the authorities considered market reforms only as the next round (albeit on a larger scale) of planning engineering. The market itself was conceived not as a new social reality, but as a crotch to the plan in a hybrid economy still dominated by the State and the Party.

The outcome was a set of completely incoherent and devastating steps. A year was necessary after the fall of the regime in order to put in place a coalition Government, to bring the IMF in, and to design and articulate the bold January 1991 stabilization package. Archival legacy demonstrate that the economic debacle of Bulgarian communism was not the result of information deficits – the authorities were well informed, often with a convenient lead. The roots are to be traced to the built-in biases and chiefly to *intellectual* deficits. Ruling elites were completely unprepared to design a lucid policy combining consistent goals and instruments. No doubt, this blindness reflected vested political interests, but it was mostly the sign of decades of intellectual isolation which prevented decision-makers from conceptualizing the stabilization problem in an adequate common sense and theoretical framework.

2.2 Yugoslavia: Trying a Ghosts Walk

A "Plutarchian" parallel history could be written about Yugoslav stabilization during the 1980s. The main differences with the Bulgarian case are recognizable without difficulty. The regime in Belgrade was economically and politically more open to the West. Local ideological orthodoxy (self-management) was presented as the alternative to Soviet type planning implemented ritually in Bulgaria. The IMF had been present for years in the country, and this induced a much better structured public debate on stabilization issues. Yugoslavia displayed many institutional peculiarities with direct macroeconomic consequences, the most important being its federal governance.

Yet, despite this clear distinctiveness, the Yugoslav case can be related in a very similar way to the Bulgarian one. It is also reducible to the conflict between stabilization imperatives and political expedience. The same clash of a politically sanctioned doctrine with economic realities is present. Identical mechanisms of bailouts, monetized budget deficits and unrestrained foreign debt building are triggered.

Faced with severe balance of payments problems, in 1983 the Yugoslav Federal Government declared itself in default and entered a process of debt rescheduling (1983, 1984, 1986, 1987). After decades of large, uncontrolled use of external borrowing, the country was isolated from the international financial markets. IMF conditionality called for restrictive policies and for a liberalization of the foreign trade regime. Those measures, however, were implemented for a short period only. As early as 1985, the Federal Government and the National Bank of Yugoslavia (NBY) reversed the policy stance. Expansionary measures were adopted in order to avoid social troubles in an economy suffocated by a lack of external financing. Excessive money creation supported for a while the illusion that the socialist economic system was in a position to provide a way-out from the growing fiscal imbalances and to replenish enterprises' losses. But this situation was clearly unsustainable, and in 1989

Yugoslavia was hit – for the first time in its history – by a classic hyperinflation. The main parameters of the crisis are summarized in Table 2 below.

Table 2: SFRY 1980-1988 – Basic Indictors
(Annual percentage change)

	1980	1981	1982	1983	1984	1985	1986	1987	1988
GDP	2.3	1.4	0.7	-1.0	-2.0	0.5	3.5	-1.1	-1.7
Exports	32.2	39.2	11.8	-7.8	8.4	6.7	-17.9	-13.5	-11.3
Money Supply									
Target	22.0	22.0	17.1	18.5	32.5	42.0	43.0	49.0	95.5
Revised Target	26.0	28.0	16.5	15.5	42.7	36.9	82.0	89.4	115.0
Outcome	23.1	26.6	26.6	20.1	43.1	46.5	109.1	99.8	223.0
Retail Price Index	30	46	30	38	57	76	119	115	225
Rates of Interest (Active)	5.5	6.4	7.5	10.2	13.4	15.3	68.2	42.0	89.3

Source: Dyker, 1990; SZS: SGJ, 1996; SZS: Index, 1989

Until 1989, the ruling elites in Yugoslavia did not consider radical political and economic reforms as a possible response to the unparalleled economic crisis faced by the country. The Federal Government and the NBY presented the state bankruptcy as an episode of “external debt consolidation” and an opportunity “for a breathing space to encourage export promotion to solve the balance of payments problems.” Successive devaluations of the national currency were the only answer to foreign exchange shortages. These palliative measures proved to be unsuccessful and counterproductive. Frequent changes of the exchange rate only aggravated the inflationary pressures in an economy, which was largely dependent on imports and suffering from enduring structural problems.

The archives of the NBY from the 1980s speak for themselves about the negligence of the ruling elite. The system based on “social property” with no clear ownership and with regulations that favoured an ever-growing appetite for external borrowing continued to provoke biased reactions in decision makers. The files reveal that Yugoslav officials did not keep a record of the magnitude and structure of external debt. Within the country, no one knew the figures so that the Federal Government had to pay foreign banks to perform the calculations. In early 1983 one member of the negotiating team revealed that “we still today do not have exact data concerning our foreign obligations" and there had been "various disputes between Central Committee members about some earlier unregistered loans…Where these unpaid obligations are hiding we learned from our foreign partners instead" (Burg, 1986).

The public was informed only on the authorities' awareness of the need for debt rescheduling and this was presented as their own idea and initiative. The only message they were willing to convey was that the Government was following an independent economic policy: an obviously untenable assertion in the midst of severe economic and financial turmoil at the international level and of the urgent necessity for a radical, IMF-supported stabilization program at home.

Faced with chronic of payments problems, the Socialist Federal Republic of Yugoslavia (SFRY) cooperated intensively with the IMF.[11] In the pre-reform period, the country had negotiated 11 Stand-by Arrangements (SBA).[12] The first five of them (of a total of 289.5 mn. SDR) were concluded between 1961 and 1971, at a time when the monetary authorities could still control inflation.[13] The following six SBA (totalling 3046.6 mn. SDR) were implemented from 1979 to 1988, when severe external imbalances, along with high inflation that grew finally into hyperinflation, characterised the economy.

Since 1979, all pre-reform stabilization programs accompanying SBA failed. While the international financial community was able to "help" SFRY dampen deficits (it became quite risky to lend money for imports to an over-indebted country), curbing inflation depended on Yugoslav authorities alone. The IMF representatives urged the implementation of a restrictive monetary policy that would result in positive real interest rates and a realistic exchange rate for the Dinar; a fiscal squeeze in order to reduce the rate of growth of public expenditure; the lifting of administrative price controls and correction of energy price disparities. None of these stabilization goals was reached. The deficit on current account was cut only in 1982 and 1983 due to a sharp fall in imports. The result was a net capital outflow from Yugoslavia to Western

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[11] Yugoslavia was one of the founders of Bretton-Woods institutions in 1944.
[12] The 12th SBA was negotiated with the IMF in 1990, in line with radical changes to the Yugoslav political and economic system. That was the last SBA that the IMF granted to SFRY before state dissolution.
[13] The IMF introduced the credit technique of Stand-by Arrangements in 1952. Yugoslavia did not use this financial facility based on conditionality until 1961 (Stojanovic, 1991).

countries.[14] Inflation persisted, real interest rates remained negative, Dinar devaluations hardly kept pace with inflation, pubic expenditure grew, administrative price controls and distortions remained and external financing was inaccessible. After a decade of intensive albeit unfruitful cooperation with the IMF, in 1988, the IBRD classified SFRY among those countries that "did not want, or could not help themselves" (Jovovic, 1988).

Why did all the IMF-sponsored programs in Yugoslavia during the 1980s fail? It would be unreasonable to think that Federal authorities "did not want" to cope with the problems. A more rational hypothesis is that officials negotiated conditions they were not capable of complying with, or did not have instruments to implement. The domestic institutional background of those SBA was the so-called "agreement economy", introduced in full in the early 1970s. This unique model (self-management agreements, self-managed interest associations, organizations of associated labour) planted in the old economic system was characterized by decentralised decision making that granted federal units and local bureaucrats unrestricted right to obtain money for investments or consumption whenever they found it necessary.

The 1979 SBA was contracted when Yugoslav current account deficit reached its post-WW II peak of 3.7 billion USD and annual inflation (measured by the retail price index) stood at 22%. The gap was financed mainly through expensive foreign financial loans extended by multinational private banks. That was the outcome of changes in the 1970s legislation, which simplified and broadened credit relations with the international financial community. Borrowing abroad became accessible not only to the Federal Government and federal units but to banks and self-managed firms. Any legal entity could obtain foreign loans and use them for any purpose, including its conversion into Dinars to cover current expenditure. Such prodigality led to a situation in which Yugoslavia's total foreign debt grew from 3.4 billion USD (1972) to 20.6 billion USD (1981) in just a decade (Gnjatovic, 1985). The borrowing structure changed drastically in favour of funds that were more expensive from private banks (these amounted to 79.9% of total foreign debt in 1982 compared to 43.9% in 1970). Simultaneously, debt repayment became more risky, the share of unwarranted debt rising from 26.4% in 1970 to 65.1% in 1982.

[14] Between 1983 and 1990, the net outflow of capital from SFRY amounted to 20.5 billion USD (Gnjatovic, 1995). In this respect, Yugoslavia was similar to the debt ridden Third World countries during the 1980s. The successive treatments of their crises were the "Baker plan" and "Brady deals".

As long as the 1979 SBA was within the limits of the first credit trench, the degree of conditionality remained relatively low. Yugoslav authorities issued a document claiming that they were going to make “reasonable endeavours” to overcome the balance of payments problems. In June 1980, the IMF approved the second and third trench of an 18-month SBA, this time with tougher conditionality. During its implementation, at the beginning of 1981, the Polish default occurred and credit flows from private multinational banks to socialist countries started to dry up. The banks needed warrantees that SFRY was still a solvable debtor, so that the IMF granted Yugoslavia a three-year credit of 1.6 billion SDR (2.2 million USD), now within the fourth, highly conditional credit trench (Stojanovic, 1991). This was the largest IMF loan ever and it represented a milestone in Yugoslavia’s relations with the international financial community (Dyker, 1990). In return, the Fund imposed tough constraints on the authorities, which adopted the Economic Development Plan 1981-1985 providing the basis for the 1981 stabilization program.[15]

Very soon, however, the situation deteriorated. By late 1982, large Yugoslav firms had accumulated huge financial losses and were unable to repay their outstanding external obligations. With depleted foreign exchange reserves, the Federal Government could do nothing but declare default, asking foreign creditors to reschedule the debt. Like many Latin American countries, the authorities were obliged to take charge of all external liabilities regardless of their issuer and its reimbursement capacity.

The default deprived the Yugoslav economy from fresh foreign financing. The only way to inject money was by creating it at home. By the end of 1983, the inflation rate (measured by retail price index) reached 30%. The Federal authorities were called upon to control money supply and to maintain the Dinar exchange rate as realistic as possible. However, deprived from their discretionary functions, they found it increasingly difficult: “the history of post-1983 exchange rate policy has, then, been the history of a desperate race by the authorities to keep the rate of devaluation ahead of the rate of inflation” (Dyker, 1990).

[15] The main elements of this Program were: structural adjustment of the economy to redirect investments in agriculture and domestic energy sources and to strengthen exports; reduction of domestic demand with help of restrictive monetary policy; reduction of the current account deficit; the pursuit of realistic exchange rate policy (Jovovic, 1981).

Creditors conditioned the rescheduling negotiations on the adoption of new stabilization measures approved by the IMF. The Fund required explicitly from the authorities to compel banks to set a realistic capital price through positive real interest rates. When the Government committed itself to comply, the IMF unlocked the last tranche of the 1981 SBA. That was a “green light” for debt rescheduling. The final deal involved 15 countries and 583 creditor banks, signed in April 1983 (Gnjatovic, 1987).

The July 1983 Anti-Inflationary Program (part of the Long Term Economic Stabilization Program) stipulated that it was “abnormal to have nominal interests which are not related to the inflation rate … and that it is essential to discontinue the policy of negative real interest rates” (*Antiinflacioni* program, 1983). During the talks with the IMF, Government and NBY representatives insisted on a *gradual* shift to positive rates, not before April 1985. As claimed, a rapid pace would ruin the already over-indebted economy and trigger a new inflationary spiral due to the transfer of interest costs into prices. Initially, the Fund’s position was that transition should be completed in 1984 (Hofmann, 2004), but in April 1984 it accepted the gradual schedule and granted a one-year credit within a new SBA. Even with a rescheduled external debt, the country was short of hard currency to meet the 1984 interest payments and foreign creditors agreed to extend a refinancing loan.

The 1984-1985 rescue operation failed: in April 1985, real interest rates remained negative and annual inflation reached 70%. With the May 1985 SBA the IMF continued to insist on positive interest rates. The target of 1% in real terms was set as the boldest measure against inflation approaching 100%. The Yugoslav economy had been trapped into the vicious circle of foreign debt refinancing, recession and an inflationary spiral. IMF Enhanced Surveillance accompanied another refinancing effort from 1986 to 1988, but exports and GDP were already falling.

In the last pre-reform SBA (1988) conditionality included freeing prices on the majority of products, free imports, monthly indexation of interest rates and a floating of the Dinar. Foreign private creditors considered this SBA as “better than all granted before” (IMF Survey, 1990). However, the targets were not met and the economic situation continued to deteriorate. By December 1989, the threshold of a classical hyperinflation was traversed: price rose by 59% on a monthly and by 1200% on a yearly basis (NBY Annual Report, 1990).

3. Alternative Views

Were there alternatives to Government stabilization policies in the late 1980s? The cases discussed above point out that different options had been discussed among both countries' decision-makers. In Bulgaria, to certain extent, the "innovative centre" was the BNB. As mentioned, the novelty and radicalism of its advice and the influence of the bank were severely limited. In Yugoslavia, in turn, the natural opponent of the Government was the IMF whose dissenting position was overtly expressed. The shaping of stabilization policies occurred during the continuous exchange of arguments that accompanied stand-by arrangements.

The question remains whether there were deeper insights into the origin of the macroeconomic troubles. By default, they could be produced only by experts and academia. What is interesting here is not the disclosure of institutional archives, but rather the publicly presented critical approaches that prepared the ground for future policy choices.

3.1 Bulgaria: Turning Neoclassical

The orthodox communist regime in Bulgaria did not leave much space for critical public discussions of economic issues. Nonetheless, opinions have never been completely uniform and increasing divergences could not be concealed. Society grew in complexity with corresponding nuances of opinion emerging, different groups in the Party's elite were looking for alternative paths in the obviously needed reforms and the professional community became more vocal. Until the early 1980s, the economics profession in Bulgaria was characterized by a dominance of "soviet style" thinking and by an almost complete isolation from contact with mainstream economists (Avramov, 2004). The climate began to change slowly with the onset of the Soviet "perestroika" and the concomitant development of a truly critical stance. Without taking dissident political positions, a few scholars started to question fundamentals of the policy choices. The breakthrough came with a small group of (a new generation) economists that got progressively acquainted with mainstream economics, took a pronounced positivist approach, distanced itself from ideological topics and language, developed an interest in the work of more "Westernized" Polish, Hungarian and Czech scholars, and were charmed by the rediscovered works of Soviet economist from the 1920s.

The first issue was dogmatization of the "inherent to socialism" high growth rates. Although delayed by the specific price mechanism in COMECON economies, the effects of the first oil shock were palpable and – in analytical terms – growth acceleration was no more an obvious choice. Quantitative studies proved the strong import elasticity of the Bulgarian economy and thus the negative balance of payment impacts of a fast track. (Kostov and Hristov, 1981; Antonov, 1986; Kostov, 1989) Import dependence was not unknown to Government technocrats, but its corollary was ideologically unacceptable. Indeed, "critical economists" went a step further by advocating adjustment through a cooling down of the economy and formulating explicitly the "subversive" argument of the innate cyclical nature of communist growth (Antonov, 1987; Antonov 1989a; Antonov, 1989b; Avramov, 1989; Avramov, 1990). What is more, they rejected the dogma that maximazing the rate of growth is equivalent to maximizing welfare: it was shown that in a general equilibrium framework the assertion is true only under unrealistically tight presumptions (Antonov, 1988). The root of this ideologically untouchable "equivalence theorem" – it was shown – lay in early industrialization stereotypes: if transposed into a more advanced economy they lead to intolerable disequilibria.

A clear divide between "informed" elites and "critical economists" appeared in the approach to inflation as well. At about the same moment when the BNB (one of the 'informed' elite) was elaborating a more "neutral" vision, the issue was presented by the latter in a neoclassical framework. The consequences were an analysis that went far beyond technicalities and evidences, to demonstrate the intrinsic link between inflation and the adopted economic policy. In the age of "reformed" communism, prices became a regulator and producers were increasingly motivated by nominal parameters.[16] If the regime, in such a situation, is not able to exert full control over revenues (which has always been the case) inflation is unavoidable and economic policy – despite doctrinal incompatibilities – has no choice but to accommodate it. By the end of the decade, V. Antonov proposed a full-fledged model of communist inflation based on neoclassical principles (Antonov, 1989b; Antonov,

[16] This point has been observed in the overview of the "archival revolution". (Gregory and Harrison, 2005, p. 746).

1990). The core of its diagnosis was that prevailing imbalances were related to the departure of marginal factor prices from factor productivity, and to the absence of an equilibrium price[17] of capital. The model outlined mechanisms, linked them to the conceptual codes of official economic policy, and produced computable estimates of the inflationary potential in the Bulgarian economy.

The emergence of a coherent alternative to the Government's eclectic and inconclusive views had important implications for stabilization policies. The very possibility of reforming the economy in a planned framework was discarded. The history of the previous experiments added to the ongoing evidence that the intents to combine the plan with a degree of decentralization was only increasing the system's entropy. The communist economy functions properly merely in its rigid original skeleton: every reform program had made it less manageable and had given birth to an archipelago of "grey markets". This conclusion was completely in line with the detailed *ex-post* review of the archives, asserting that "the result of partial reforms were if anything worse than those of the unreformed system" (Gregory and Harrison, 2005, p. 755). And with the insight in Janos Kornai's memoirs that "any loosening of the planning system could, as happened after Stalin's death, undermine it…the Socialist system worked less and less well as repression was lifted, because it had no substitutes for ideology and terror" (Skidelsky, 2007, p. 52, 53).

Criticism based on general equilibrium assumptions and empirical research not only exhibited the incompatibility between a planed economy and genuine market-oriented reforms, but also made it obvious that official policies produce profound imbalances, recurrent cycles and structural balance-of-payment deficits. Even if the diagnosis of communist technocrats and of "critical economists" could overlap in regard to certain symptoms, the cure differed in a fundamental way. For the first group it consisted in injecting (often-truncated) *fragments* of monetary stimuli, while for the second the way out was a bold monetization of the *entire* economy. The stabilization corollary of the latter option was (although not yet plainly specified) the forthcoming shock therapy with the corresponding termination of automatic credits, of traditional budget deficit financing and of the habitual expedient of cumulating foreign debt. In the "reformed" communist economy, "money mattered" in isolated pockets and in a biased unsystematic manner. The goal was to make money matter

[17] In fact – the negative discount rate.

consistently. The empirical work performed highlighted the scale of repressed inflation in the Bulgarian economy by the end of the 1980s and consequently revealed the magnitude of the stabilization shock that would be produced by price liberalization.

Looking with hindsight on the ambiance of the regime's final years, it should be emphasised that the voice of the handful of radical proponents of full-fledged monetization remained isolated and that even among them a vagueness about the stabilization policies needed was common. Their strong critical impetus confronted conceptual barriers of different kind. A sense of the "immortality" of the system was widespread despite the evident signs of its decomposition. With yet no clear political alternatives in sight, the invectives were addressed at the authorities, as if they were capable to take rational decisions and/or to correct inadequate choices. Until 1987-1988, it was mainly the structural disequilibria that characterised the Bulgarian economy that were stressed, and only during the closing two or three years that the focus shifted to inflation issues and the financial and central bank aspects of stabilization.

An understanding the pace of the transformation was also relatively slow in coming. The logic of the elimination of the monetary overhang by the lifting of price controls made a "shock perspective" unavoidable. Illusions about possible soft solutions, however, persisted even among "critical economists". It is only when the old regime was overthrown that the dichotomy of "gradualism versus shock therapy" emerged as a political fault line. The gradualist position expressed the mix of professional incompetence, traditional communist reformism and efforts to save time in order to prepare better the expected capture of key economic positions. The alternative view summarized the radical reform agenda by packing measures that – in reality – were to be unevenly implemented (partly by those same critics) during the next several years.

Nowadays, most of the claims against the communist economic system and the Party's policies during the late 1980s might seem trivial. After all, the debate on the feasibility of central planning had lasted for nearly a century, with convincing negative arguments put forward as early as the 1930s Lange-von Mises controversy. It was substantially enriched in the following decades, and – above all – was confirmed by the cascading failures of the communist experiment itself. However, this *ex-post* statement does not account for the very different stock of mainstream economic knowledge among countries. The fact that some Bulgarian economists started to question the basics from a neoclassical perspective only few years before the collapse of the regime reflects, *inter alia,* the long intellectual isolation of the scholarly milieu.[18] Under communism, the most difficult thing was to state the obvious. Criticisms articulated in such an enclosed space became remarkable events, and in a sense, they really were because of the painstaking efforts required to produce what was considered elsewhere as “standard’ knowledge and of the social nonconformist attitudes needed to articulate it. Their real weight was distorted threefold: more often than not, they were overstated; seclusion prevented even the scarce genuine contributions from finding their rightful place in the mainstream debate; there was no adequate local milieu to absorb the messages. In an open society, the input of those economists would have integrated adequately the flow of “universal knowledge”.

Thus, a legacy of a higher intellectual permeability *vis-à-vis* the West is expected to have facilitated the formulation of a sensible stabilization policy. This was, indeed, the case for Hungary and Poland, where the design of the transition programs was not such a dramatic conceptual challenge as in Bulgaria. The Yugoslav experience, however, qualifies this assertion.

3.2 Yugoslavia: Criticizing “Federalist monetary policy”

After WWII Yugoslav economists built a reputation of original judgment with the elaboration of the self-management model, which exerted a visible influence among quite diverse audiences worldwide. The political connotation of the idea has always been strong and − not surprisingly − the model developed into an ideological creed with its own academic establishment.[19]

When the mid-1980s economic crisis struck the country, two main currents prevailed among the profession. The first was led by the protagonists of the self-management system who were reluctant to admit that at the end of the day their

[18] The isolation refers not so much to inaccessibility of books and journals (they were actually accessible), but to the lack of a vivid intellectual exchange with Western counterparts, and/or to the almost nonexistent examples of socialization abroad (Avramov, 2004).

[19] Yugoslav scholars of international renown have made important contributions to macroeconomic issues as well, and in particular to the business cycle theory in a “socialist” context (for example A. Bajt).

invention proved to be quite ineffective. The second urged for a stabilization program, but carried out within the existing political and economic model. Nevertheless, the latter were the first to perform a realistic analysis of the current outlook for the Yugoslav economy and to explain the causes of its poor performance. They were criticized both by the adepts of the self-management system and by the ruling elite. The critiques persisted until the very moment of the implementation of the December 1989 stabilization program, accompanied by a set of reformist legislation.

A focal point in the debate over stabilization policies was the role of the NBY. The split opinions on this issue reflected diverging attitudes towards the fundamentals of the reform agenda.

In the wake of the last pre-reform SBA (June 1988), the IMF representatives argued that negative economic trends were the consequence ‘of an easy going behaviour of Yugoslavia’ (Jovovic, 1987). They pointed out that much of the blame lay with the Central bank, which tried to keep social peace by accommodating subsidies to priority economic sectors and by covering the financial losses of firms. Experts missed out, however, that the NBY was not in a legal position to oppose subsidies and bailing out. Yet, it was clear that such policy would affect negatively the economy that was already in deep crisis.

In 1990, the IMF recognized for the first time that during the 1980s the Central bank of SFRY has been left without almost no monetary authority and control over the commercial banks (IMF Survey, 1990). Until then, neither the Yugoslav political elite, nor the IMF missions had ever questioned the awkward Yugoslav monetary system as one of the causes for the successive stabilization programs failures. They ignored the writings of those Yugoslav economists who stressed that, as a completely dependent institution, the NBY did not have legal power to cope with inflation (Djurić, 1974; Golijanin, 1974; Golijanin 1987; Gaspari, 1988; Kastratović, 1988; Jovic, 1990). Attention was not paid, too, to “critical economists’” emphasis on the negative effects of monetary policy decentralization on macro-economic stability. They did avoid comparative methods simply because the SFRY central banking experience was unique (Golijanin, 1987). Yet, their analyses clearly revealed that the NBY fiasco in the 1980s could be attributed to the so-called Federal central banking system. This view – considered as a truism in the 1990s – was shaped during the previous decades.

A unified Central bank existed in socialist Yugoslavia only until the beginning of the 1970s. The 1971 constitutional amendments and the eventual new Constitution of 1974 gave to the branches of NBY in the federal entities' capitals (later in the autonomous provinces as well) the prerogatives of central banking institutions within a Federal central banking system (Djuric, 1974).[20] Those changes were inspired by the overall political and economic reforms, which initiated the rupture of the common economic space of socialist Yugoslavia.[21]

The new setting affected relations between the central bank and commercial banks directly. The NBY was deprived largely of its regulatory functions, while national banks of federal units and autonomous provinces were in a position to refinance credit institutions operating on their territory. Thus, the so-called *territorial principle* became the basic organizational rule (Golijanin, 1974). Another important feature was that enterprises were the stakeholders of the established commercial banks, but had only one vote regardless of their share in the capital. Bank directors were appointed by the local Communist Party leaders and in the early 1980s the key decision makers were mainly the managers from those business firms that had accumulated substantial losses (Gaspari, 1988).

The Federal central banking system was led by a Council of Governors taking its resolutions on the grounds of consensus. Thus, the "negotiation economy" which contradicted market principles was introduced into the very heart of the Yugoslav monetary model (Jovic, 1990). As each Governor defended the interests of his own territorial unit, and not those of general monetary stability, the Council *de facto* aimed at harmonizing attitudes in a markedly polycentric economy and bureaucracy. Given this very difficult task, the NBY Governor had extremely limited cohesive power. Moreover, the Council did not decide sovereignty on monetary policy targets and discretionary measures. It only *recommended* them to the Federal Parliament and to the Federal Government who took final decisions. Only then, did the NBY choose the appropriate monetary policy tools.

[20] The Federal central banking system institutions were: National Bank of Yugoslavia, National Bank of Slovenia, National Bank of Croatia, National Bank of Bosnia and Herzegovina, National Bank of Macedonia, National Bank of Montenegro, National Bank of Serbia, National Bank of Vojvodina and National Bank of Kosovo.

[21] Western experts based their analyses on the political and economic changes in SFRY during the 1970s on the writings of the above-mentioned Yugoslav economists. See, for example: Dyker (1990) and Koyama (2003).

Critics of the system had pointed out that Yugoslav firms tried (successfully) to create their own *parallel money* in all possible ways by exploiting the advantage of a situation in which the monetary authorities were not in a position to control money supply (Kastratovic, 1988). Enterprises could delay payments of financial obligations towards their suppliers and banks, and/or issue unsecured bills of exchange**.** Such financial indiscipline had the same effects on inflation and consumption as an unrestrained money supply expansion by the Central bank. As the monetary authorities were not able to manage such irregular monetary flows, commercial banks were reluctant to make a move.

Furthermore, “critical economists” outlined how unprofitable firms survived mainly on bank credits. Borrowings were rarely invested: the decade was characterized by a fall in investment activity and by the simultaneous growth of indebtedness. The real sector was permanently in a position of net debtor. The firms’ share in banking deposits dropped (from 54% in 1971 to 21% in 1988) while the share of banking credits to business grew (from 75% to 92% during the same period) (Gnjatovic, 1989). Thus, banks became directly dependent on the real sector’s declining capacity to service its massively increasing obligations.

Faced with insolvent firms, the banks had two options: to stay formally alive by tolerating the financial indiscipline of their clients or to close by declaring bankruptcy. The inflationary option of a generalized bailout was chosen, at least for a short time. In late 1988, the NBY abandoned further intentions to implement a restrictive monetary policy and cancelled credit limits for commercial banks. The accommodating monetary stance was maintained in 1989.

The shortcomings of the system formulated by its critics had to be acknowledged publicly. For the first time, in the last pre-reform SBA (1988) economic liberalization was explicitly identified as the only therapy from harsh inflation. The ultimate SBA with the IMF (March 1990) was negotiated on the basis of a new stabilization program overtly foreseeing radical changes and a transition to a market economy. Within months, the core for the Yugoslav model was officially proclaimed as finished: IMF experts declared that the dismantling of “social property” is “crucial for the progress in economic reforms” (Stojanovic, 1991).

4. Concluding Remarks

Within slightly different periods Bulgaria (1985-1991) and Yugoslavia (1983-1989) experienced severe debt and inflationary crises. They triggered the crash of two different – but in many aspects alike – socialist economic systems (central planning and self-management) suffering from intrinsic inefficiencies. It is no wonder that stabilization policies implemented by the regimes in place proved also to be in vain. The ruling elites remained encapsulated in the confidence that the economy could be stabilized within the existing political and economic framework. “Critical economists”, for their part, came much closer to the roots of the problems and to their macroeconomic features, without being able, however, to design a fully consistent stabilization package before the collapse of the regimes themselves.

In Bulgaria, the lack of coherence reflected to a great extent scarcity of mainstream economic knowledge among ruling elites and the bulk of the professional community, which were unable to overcome old-fashioned dogmas. Those economists who better mastered Western theory and had a deeper understanding of market economies formulated the most insightful assessments. The Yugoslav case was more ambiguous, involving a wider variety of players – followers of an indigenous school (self-management) prized even by some Western economists; political decision-makers managing the short-term stabilization policies; a few economists closer to mainstream economics; the IMF (absent from pre-communist Bulgaria) with its conditionality. This greater openness led to the short-lived implementation of conventional orthodox measures, rapidly reversed, however, by a destabilizing “Third World-style” devaluation spiral and by pro-inflationary policies.

Eventually, coherence came from abroad and/or from the aftermaths of political debacle. In Bulgaria, the early 1990s stabilization program based on the Washington consensus was masterminded only after the fall of the “old guard” communist regime in 1989 and when the country joined the IMF in 1990. The results remained unconvincing for some years due not so much to conceptual shortcomings, but to the slow pace of monetization of the economy and to the untenable coexistence of still dominant state ownership (protracted privatization) with liberalized economic behaviour. In Yugoslavia, the drama of the Federation’s dissolution was needed in order to change fundamentally economic perceptions, at least in the independent successor states that emerged to the West. There the ruling elites and the economic profession reached consensus on the imperative for a quick economic transition. By contrast, Serbian reform-oriented economists remained isolated from the authorities. The international economic sanctions were to become one of the causes, but also the excuse, for sluggish reforms and for the further deepening of economic crisis in this country.

An essential lesson drawn from both cases is that closer contacts with the West (and with mainstream economic thinking) were a necessary, but not sufficient, condition to impose a more coherent stabilization package. While the old regimes (Yugoslavia 1983-1989; Bulgaria 1985-1989) and the strong relics of the communist economic system (Bulgaria 1990-1997) were still in place, political considerations prevailed over economic logic, thus preventing authentic reforms and bold action. Even institutional conditionality was not able to reverse this trend. The neat "with-without IMF" test suggests that when imposed on an intact political, economic and decision-taking status-quo conditionality produces only marginally better results. In 1987-1990, Bulgaria was confronted with the conditionality of the markets and nevertheless ended up with soaring foreign debt and huge inflationary potential. During 1983-1989, Yugoslavia faced the robustly structured IMF machine only to win a short-lived easing: the aftermath was a hyperinflationary crisis prompted by an unmoved economic power structure that continued to generate uncontrolled money creation.

The "parallel histories" of both countries confirms once more that there is no credible economic stabilization without trustworthy political change. These two processes ultimately converged with the introduction of the Currency Board in Bulgaria (1997) and with the emergence of stable political entities out of the former Yugoslav republics. The laborious adjustment was an intellectual challenge as well. Elites in communist countries were unevenly prepared to implement stabilization policies. But there is no doubt that they were overwhelmingly unprepared to imagine and to conceptualize the actual economic, social and political upheaval that was to be generated by the transition from overriding state ("social") ownership to private property.

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