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POST-WAR RECONSTRUCTION AND DEVELOPMENT POLICY IN CROATIA

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Summary

This paper presents some possible theoretical and practical policy solutions for Croatian economy. During the war, measures have been implemented and changes have taken place which were supposed to have long term qualitative impact upon the process of transition and restructuring of country's economy. Croatia must devise a new economic system which must not only be complementary to that of the developed European economies but must also be based on full employment of domestic resources and creation of an adequate institutional system. Unresolved long-standing problems of development ask for pragmatic solutions. Policy issues such as the future role of the state, formulation of reconstruction and development policy for the post-war economy, reduction of unemployment, stability of domestic price level and exchange rate, etc. could possibly be resolved looking at the Keynesian solutions.

Key Words: Development, Employment, Keynes, Keynesian, Reconstruction, Restructuring, Savings, Transition

INTRODUCTION

In the last decade, restructuring, privatisation and economic development of Croatia was followed by a sharp decline in production, employment and living standards. Technological backwardness is another feature. The consequences of the central planning and autarchic value system were intensified by the events of the first half of this decade. In fact, the process of privatisation took place in Croatia along with a war.

The following years of this millennium will be those of reconstruction and restructuring.

During 1980-1990 country's economy was stagnant and characterised by a forced high rate of employment, superficial social and political coherence and lack of perspectives for individuals. Indeed, economy was almost like an over-inflated balloon which came to the verge of explosion. When it exploded economic scene was dominated by a high unemployment, partial as well as global inefficiency and an evident disproportion in sectoral and regional structure.

Burdened with the consequences of war, high budget expenditures, direct material damages (approx. \$27 billion), moral and physical suffering of the population (dead, invalids, destroyed homes and families, displaced population and loss of work ability etc.), the transition and restructuring process is going on. It must be mentioned that all transitional economies are passing through a crisis which is reflected in a decline of production, employment and living standards.

This can be termed the short-term cost instead of a long-run qualitative progress. Dynamic of this decrease is different and it is most evident in the countries which had many other tensions (like the ex-USSR and ex-Yugoslavia).

During the crisis the European attitude towards Croatia was limited to humanitarian aid with the aim of alleviation of the catharsis, but real help promoting development, prevention of war and destruction was lacking. From 1990 onwards many developed countries have erected barriers against Croatia (e.g. travel), a fact which negatively influenced the economic condition. The dynamics of further development of Croatia is considerably conditioned by predominance of domestic constraints.

THE KEYNESIAN "MIDDLE WAY"

Reconstruction policy characterising the free-market economies is a model of the modern development of Croatia. This framework should be adapted to economic, social and political conditions. Particular attention need be paid to be property rights problem which is a key factor for individual motivation and overall production efficiency of the economic system.

In Eastern European countries, the transition from a central planning to a management system which allows for more freedom to individuals, groups, local initiatives, innovations and entrepreneurship is the most universal target for any future progress (Malliat, 1995, p. 161-165).

A Keynesian "Middle Way" could also be a possible alternative to the current transition process. In Keynesian sense, a mixed economy of macroeconomic planning by the government and microeconomic market system could be successfully designed as a model for transitional

economies. Transition implies an abolition of state monopoly in economic development. Autarchic development which resulted from the past system not only ruined the previous system itself also created present structural disproportion. Rapidity in creating conditions for the free circulation of goods, services, people and factors is a precondition to success. Entrepreneurial motivation will be a determining factor in building of a new economic structure in the country.

New development policy in Croatia should be based on a proper evaluation of the available resources and compatibility to its European neighbours. Allocation of the growth factors should be based on natural, demographic and production considerations, on one hand and on market criteria on the other.

LIMITING FACTORS IN CROATIAN DEVELOPMENT

In the past the state was the collective entrepreneur leaving very little scope for private entrepreneurship. Today, the process is just opposite. But the war expenditure had substituted for capital investment expenditure. The defence effort in Croatia was financed by diverting resources from public consumption through voluntary and forced savings, rationing of private consumption, price control, rent regulation of public property and the pension funds.

Process of transition and restructuring in Croatia could hardly be called satisfactory since instead of an increase in production, jobs and employment "mercantilism", profiteering, the underground economy and similar practices have flourished and are beyond control. Actually, the country is facing individual and collective misfortunes which are the consequences of the risk, uncertainty and lack of knowledge. Not rarely this is being abused by "talented" individuals who are able to make fortunes out of such conditions.

In war, usually all the available resources are made available for military purposes. So was the case with Croatia. Naturally, this is going to affect the future growth process and economic structure. In addition, capacity under-utilisation is a well-known fact. To this should be added the structural damages in the occupied areas.

Transition from the war to the peace economy is usually loaded with economic consequences of war. In Croatia, surprisingly, it is underlined by an envious economic stability, and rapidly growing free money and exchange market. But let us not forget the fact that at the same time, there are very strong negative pressures also which are caused by unemployment (particularly among demilitarised soldiers) and social care of the suffering population (refugees, invalids, disabled, etc.) Beside, there is the existing military expenditure. Considering the war and the individual consumption constraints, the dynamics of growth in Croatia will be under

considerable pressure of the war damages of infrastructure, buildings, plants and equipment etc.

As the situation stands today, keeping in mind the disposable resources, the most important determinants of the future development of Croatia are:

- a. increase in employment
- b. growth of production within a new economic system
- c. co-ordination of the aggregate supply and demand
- d. decreasing structural dis-proportions and gaps in development
- e. elimination of inequality in income distribution; and
- f. balanced regional development.

The primary goal of the post-war development of Croatia is the creation of employment. Efficient work will contribute to the social and political stability of the whole system. Through wages and other sources of private incomes employment will influence the growth of final demand meeting the basic human needs which will be bigger every day. Multiplier effects which production creates are improving the organisational conditions and promote new initiative and innovations.

In the beginning of 1996 Croatia had 983,000 employed people which is 62 per cent of to pre-war figure. The unemployment rate has surpassed 20 per cent, (Croatian Monthly Statistical Report, No. 3, 1996). Investments and capacity expansion help create employment. In Croatia, the decrease in economic activities and growth of unemployment is not a regular phase of the business cycle but a consequence of structural disproportion (see for detailed analysis Keynes, 1936, Reprinted 1973 p. 313-332).

Unemployment in transitional economies too is caused by a variety of reasons, but predominantly because of the structural disproportion. Structural composition is still dominated by heavy industry, known for its low degree of technological change. The solution lies in developing new industries which would certainly require large investments but will also provide new opportunities for employment.

Structural unemployment in Croatia is a consequence of an autarchic development of the country in the past and of inflexibility of the production factors which has been further worsened by the war. Partly, structural unemployment is also a result of the crisis of the whole economic system.

Wage differences and poor mobility of labour are also causes. Distribution of the national income is highly related to the accumulation of capital or savings. The growing living standard of a very minor part of the population is a result of imperfection in the privatisation system and the war. This intensifies public sensibility to all these issues, negatively influencing growth (initiative, innovations etc.).

In future Croatia needs to pay more attention to regional deployment of resources. Economic and technical progress changes the

structure of the invested capital. In other words capital stock grows. Economic growth and technological development demand an increase in fixed capital in specialised fields which in turn restricts the mobility of labour and capital (for example high-tech industries).

The selection of the future production structure in Croatia must satisfy the criteria of growth in marginal productivity of labour and increase in employment. Otherwise decreasing marginal productivity will reduce investments and thus employment. Decrease in the marginal productivity can be caused by immobility of production factors and cost inelasticity (wages or increased hard-capital expenditure).

In the reconstruction and restructuring process in Croatia an important factor is its international exposure. External financial support will also help in bringing in new technologies for capacity growth which in turn will create new employment opportunities. In the near-post-war period chances of a return to the pre-war economic and social policy are very limited.

After a period of adjustment to peace and transition say after the year 2000, one could expect long term growth in employment. Economic policy has the objectives:

- a. to maintain aggregate demand for the goods and services on a level to assure full employment;
- b. to assure the stability of the system keeping the price level stable;
- and c. to assure the mobility of labour.

Priority fixation is an important factor in maintaining aggregate demand because all final uses do not have the same linear importance. Of special importance is personal consumption, supplemented by public investment expenditure on public goods providing external economies.

In future attention should be paid to the advancement of the private sector. In this context, market oriented capacities should be able to allow export of goods and services which shall cover at same time the imports and enrich our supply in domestic market. In fact, the effort to eliminate the unemployment, usually requires an expansion in activity of the state and allowing the public sector to grow. Activities of the state which steer the national economy toward growth and employment, should not in any way jeopardise private investments.

Besides unemployment, the distribution of the national income is another problem which needs immediate attention in Croatia. Here we are not talking about an egalitarian system but of a society which would ensure equal opportunities of work, motivation, and creativity, and check speculations intensifying differences in the distribution of incomes.

In fact transition and restructuring during in the war year provided wonderful opportunity for speculation and illegal assets grabbing. Unfortunately it was not confined to opportunities only but also became a reality. It resulted in labour-shedding and disproportionate distribution in favour of war profiteers and new owners of the public property. The

differences in income distribution are a result of excessive profits, which could accordingly be smoothed with an adequate price and rent policy. Such a policy would not be any less important for the entrepreneurs and the innovations which can generate growth and progress.

For generating growth and development a government should resort to measures of expansionary money and credit policy. This may temporarily endanger the price stability. But, from a future perspective, expansionary monetary policy is less harmful than the policy of stable prices with zero growth. Any deviation from such policy could provoke inflation and instability. Growth of unemployment usually generates inflation, fall in output and finally, the final demand. That is why it is necessary to caution and allow economic policy to be trapped in a vicious circle.

Achieving full-employment could have negative implications also, which can be reflected in a weakening of business activity as a result of a decline in private entrepreneurial activities and labour mobility. In any country, after the war, employment policy must concentrate on the re-education of demilitarised soldiers and their professional adaptation to new economic structure. That could relax social pressures of unemployment at least temporarily.

The project of providing full employment is a goal reachable in highly industrialised countries only. Such structural approach is imminent for liberal capitalism of the 19th century. Today, there should be more social models in focus which could generate consumption and employment, and where sometimes growth and individual enrichment is traded-off in favour of social welfare.

In case of unemployment it is not only the problem of low productivity of labour i.e. under-utilised or mismanaged labour force. In a nutshell it can be said that it is desirable to employ all the potentials of the society but in an efficient way.

Another goal of development policy is the exposure of the country to entrepreneurial innovations and technological development of new capacities and supplies. To this end all potential possibilities should be mobilised within medium and small size companies. In 1995 in Croatia there were more than 50.000 registered firms of which 90 per cent were small and medium size.

Investment and development of new capacities is usually a complicated process. Increase in investment is closely related to business uncertainty. Investment decisions are usually based on market knowledge which is often imperfect. Thus it is very difficult to predict future events. By shortening the time period of the actual investment process uncertainty is reduced. Small and medium size companies are best suited for such investments.

Due to fierce competition on the market and their modest influence on overall economic and regional events, small and medium size companies, in case of bankruptcy, do not cause any major structural dis-equilibrium.

Elimination of constraints of development through public investment in infrastructure etc. could stimulate the growth of small and medium companies producing goods and services.

A larger number of small and medium size companies creates larger opportunities of employment. Such companies also provide better opportunities for fresh initiatives, innovations, and technological development including the battle against environmental pollution.

State support to small and medium sized companies on regional and national scale is desirable. A complex package of support measures providing necessary professional advice, education and training programmes for the workers, tax relief, financing facilities etc. is welcome.

Development of small and medium sized companies is faced with three basic dilemmas (*Armstrong and Taylor 1993. p.247 - 262*): Whom to help: beginners or to those who have already survived; What to help: primary or service sector; and How to provide help: support the successful or a linear help to all. The first dilemma practically implies best use of resources in the interest of growth and development. The second dilemma is of structural character and of significance for the formulation of development strategy. Croatia, accordingly should in our opinion opt for the production and service sector that generate income such as tourism, finance etc. Instead currently we have over 2/3 companies in retail and wholesale trade. The third dilemma can be automatically solved if the strategy question is resolved.

In the following years more attention should be paid to the support of scientific research and to the elimination of technological gap. Croatia should promote more the product and process innovations. These innovations could directly stimulate technological development and thus profits. Product innovations create new goods and services and better quality of supply in the market.

The third goal of development policy in Croatia should be the regional interest. Natural and demographic factors which are located at the regional level could best be utilised in national interest at that very level. For problems such as pollution, urbanisation, depopulation process in some regions and other specific regional problems could be solved through regional policy.

Environment is a key source in the development of Croatia. Considering the natural diversity, scenic beauty and topography prospects are great. Croatia as a part of Danube basin and as a Mediterranean country has the all the natural benefits for a successful agricultural and service sector. Therefore it essential to develop a complementary model of growth taking into account regional interests and factors.

From an environment protection point of view national parks, geographical parks etc. are on 6.8 per cent of the national territory, which is considerably lower than in other developed countries (which have 13.6 per cent of their territory according to the *World Development Report 1996*,

pp. 906-907) should be given highest priority. Within the framework of spatial policy proper attention should be paid to demographic and urbanisation policy. The locational aspect of industrial and economic development also deserve proper consideration.

Urbanisation and development policy of the cities consist of measures including the factors which are strictly related to the regional and global structure (*Richardson 1969. p. 179*). A very evident concentration of the population and their economic activities in Croatia began in the second half of this century but now it should be transformed into a dispersed pattern. With mechanical migration of the population due to war operations, there has been a tremendous increase in the urban population in the central and coastal areas. Solutions such as geographic distribution of population, establishing cultural and administrative institutions, etc. will have to be devised through measures such as housing policy, rent regulations, transport facilities etc.

The strategy of development involves a choice of fundamental goals which determine the above mentioned factors, production orientation and instruments of the economic policy required to achieve the set goals. This also determines the key production sectors the future economic structure. As we all know, any strategy must respect specific socio-economic conditions in a country and accordingly adapt it to changing circumstances.

In Europe a strong de-localisation process is underway. This process requires a thorough analysis. It is evident that development in Croatia will be conditioned by the trends in Europe. But also on the measure how Croatia will succeed in attracting foreign aid for the reconstruction of the war affected areas.

In 1985 Croatia had a per capita GNP of US\$ 6500. In 1994, according to the World Bank Statistics it had come down to US\$ 2560 (*See the World Development Report, 1996, p. 172*). For 1994 the calculations of per capita GNP take into account the total income of 12.5 billion US\$ and 1991 census population of 4.6 million. But, if the figures are to be corrected for the reasons of war, occupied areas, refugees, negative migrations, black-market economy, etc. the real figure of GNP would be around US\$ 14 billion and population to 4.3 million then the per capita income would be around US\$ 3.500. However, it must be noted that it is not only a matter of consistency of the data but a tendency that shows that Croatia is lagging behind. This shows that Croatia had sufficient productive capacities which are either idle, or technologically obsolete or under-utilised. Evidently, further investment and economic restructuring is required.

According to Keynes, there are "three possible resources which can enable new investment to provide a net addition to the amount of employment. The First source of supply comes out of the savings which we are now disbursing to pay the unemployed. The second source of supply comes from the savings which now run to waste through lack of adequate

credit. The third source of supply comes from a reduction in the net amount of foreign lending" (*J.M. Keynes, 'A Programme of Expansion' in Essays in Persuasion, 1931 Reprinted by Norton 1963, p. 123*).

In Croatia, the current level of domestic savings is low (around 10 per cent of GDP) which should be stepped up to 15 per cent. This is possible through:

- i) reduction of budget and public investment expenditure;
- ii) reduction of unemployment which currently eats-up 1/5 of domestic savings which could otherwise, if released, be mobilised for growth and development;
- iii) stabilising economic system and creating public confidence in domestic banks so that the foreign assets held by domestic population could be attracted back to the country; and finally, and
- iv) a development and growth oriented credit and loan policy.

With a proper allocation of resources (in service sector and light industry) services could generate 62 per cent of GDP. This would mean that the industrial sector will be reduced to 28 per cent, and agriculture to 11 per cent of the GDP. This presupposes a stimulative and stable macroeconomic policy. It is not impossible that Croatia doubles its per capita national income within next ten years. This would require a growth rate of 7.2 per cent per annum. Thus by 2005, Croatia could place itself on the bottom of highly developed countries (around per capita income of US\$ 7000). With a growth of employment by 3 per cent by 2005 the unemployment level could be reduced to bare minimum.

CONCLUSIONS

A dynamic and qualitative transition process in Croatia shall depend upon two factors i.e. solving the long accumulated problems of the previous economic system (such as structural imbalances and relative and absolute decline in production and employment) and specific problems which have resulted as a consequence of war (such as the destroyed man and material potentials and the lost growth). The key to dynamic growth and development of Croatian economy lies in adoption of measures such as: sufficient motivation and degree of freedom at micro level, reduction of gap in income distribution, full employment of labour particularly that of demilitarised men, increasing the levels of savings, stepping up public investments etc. which definitely have their roots in Keynesian economics.

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