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Yugoslavia:

Background Notes on the Housing Sector in a Reforming Economy

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ECONOMIC OVERVIEW[1]

Organizational Reforms

Yugoslavia's picture is bleak. The country is falling behind economically as hyper-inflation at times in the past year reached upward toward 800 percent. These straits have provided the catalyst for market-oriented economic reforms. However, ethnic tensions and political fragmentation have come to the forefront and threaten to overwhelm the prospect of structural economic reforms. The tensions have contributed to the country's economic problems. The amount of trade among Yugoslavia's republics has declined. One observer noted that Yugoslavia's various peoples are so different that in economic terms Yugoslavia hardly exists.

Yugoslavia is a microcosm of Eastern Europe, located between two regions which may part paths. A northern region includes Poland, Eastern Germany, Hungary, and Czechoslovakia and the southern Balkan region includes Romania and Bulgaria. Two of Yugoslavia's republics—Slovenia and Croatia—seem to be following a course similar to the countries in the north; Serbia and the rest of Yugoslavia seem to be following a course similar to Southern Eastern Europe.[2]

Yugoslavia has forty years of experience instituting economic reform. With its gradual reform it has evolved into a sort of economic socialist state. However, the central government is weak and much economic planning has been at the SOE level. Some planning occurs outside the government—SOE to SOE. As Yugoslavia's political process has become more decentralized the country's six republics have also achieved additional economic discretion.

Yugoslavia is a member of the IMF and World Bank. Its need to borrow from the IMF and World Bank has recently spurred economic discipline and liberalization

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1 Unless otherwise indicated economic data are from EIU (1989a, 1989b).

2 Only, Slovenia and Croatia, the most westernized of Yugoslavia's six republics, have democratic governments. Both defeated communists in elections this spring. Slovenia has declared sovereignty and demands a looser political confederation with Yugoslavia. The "collective presidency" of Yugoslavia has demanded that Slovenia repeal the declaration. Serbia, the largest and more conservative republic, had planned to postpone multi-party elections for at least one year. (Serbia had voted on January 23, 1990 to permit the establishment of a multi-party system.) To silence opposition to the waiting period Serbia called a referendum with six days notice, but it failed. Kosovo, a province in Serbia, which had de-facto autonomy also declared its independence. The Albanians who populate this province and the Serbian government are at loggerheads; many Albanians have been killed by government soldiers. The recent discovery of mass burial sites in Croatia and Slovenia will exacerbate the tensions.

of the economy across the board. Yugoslavia's current reform initiatives favor increasing private economic activity, rationalizing the price structure, and reducing the influence of SOEs.

Yugoslavia's earliest reform efforts began with worker self-management. Self-management was organized within the structure of state enterprises—SOEs; and still persists. Periodic efforts to weaken the enterprises have had limited success. Self-management and worker attachment to an enterprise can motivate activity which is often at cross-purposes with overall economic performance. For example, self-managed enterprises are likely to have more workers than needed. The consensus environment which undergirds self-management makes this type of outcome difficult to curb.

The conventional wisdom is that while Yugoslavia was the pioneer of economic reform, it is also an example of example of how not to proceed. The country is cited to show that the "model" of going slowly does not work.

Private Sector

Yugoslavia has allowed private ownership of homes since the war. Owners can even rent dwellings on favorable terms (and 20 percent do). Dwellings may also be socially owned; living in socially owned homes is based on a tenancy-right which is often granted because of employment in a SOE.

The private agricultural sector is large and by virtually all accounts successful. Yugoslavia has limited the amount of land an individual can own; about 80 percent of the country's land is privately owned and held in small plots. Many plots officially were not to be used but for agriculture but have been. In the last 20 years employment has been unchanged in the socialized agriculture sector; on the other hand, 40 percent of private workers left farming employment. Output data are not reported separately for the private and socialized sectors but employment data suggest adjustment problems—labor surplus—in the socialized sector.

In the past Yugoslavia did not allow individuals to own income-producing property. Small family businesses were allowed, but income-producing property was owned "socially" and administered by self-managed enterprises. Today Yugoslavia is moving to legalize private enterprise ownership (including equity ownership of enterprises). Some social functions—such as housing and welfare—traditionally provided by SOEs are being transferred to local and national government. Enterprise bankruptcy is to be allowed—a major change, as in the past the Yugoslavia economy was notoriously unsuccessful in re-allocating resources from unproductive enterprises.

Yugoslavia's banking system has, for a number of years, served as an intermediary to facilitate enterprise ownership of subsidiaries. Consequently Yugoslavia has some experience with a division between ownership and management. However, this division is often only a paper one since owners are often also the principal borrowers.

Economic Performance

Yugoslavia's economy has been preforming poorly throughout the 1980s and recently the economy has been unstable. In the 1960s and most of the 1970s the Yugoslavian economy appeared to flourish as the economy developed an industrial base.

When energy prices soared in 1979 the Yugoslavian economy faltered. The command economy had priced raw material inputs to industrial firms below market and had difficulty maintaining the subsidies. Inflation and balance of payment problems surfaced, eventually becoming perilous. Yugoslavian economic development slowed and in 1988 stalled. Unemployment, never before a problem, appeared in the 1980s (see Yugoslav Survey (1988) for a discussion of this issue).

Beginning about 1987 Yugoslavia had hyperinflation, increased unemployment and a decline in output. Currently real economic growth is negative but the decline is easing. Table 1 presents data on Yugoslavia's economic performance. The data mask differences in economic performance by region (Flaherty, 1988).

Table 2 (on the next page) presents data that describe the industrial composition of the economy (in terms of proportion of output by sector).

Table 1
Domestic Economic Indicators
(percent change from previous year)

	1987	1988	1989	1990
Real Gross Social Product	0.5	-1.5	-1.2	-0.5
Industrial Production	0.6	-2.5	3.0	2.5
Gross Fixed Investment	2.0	-6.9		
Retail Price Inflation	118	180	850	800
External Debt (US$ billion)	20.2	18.7		
Current Account (US$ billion)	1.1	2.2		

Table 2
Sector Gross Domestic Product

	Percent GDP
Agriculture	11.5
Mining & Manufacturing	45.3
Utilities	2.6
Construction	6.7
Commercial Services	24.3
Public Services	9.6

Population

Yugoslavia's population is about 24 million. Population growth has declined to an annual rate of about 0.7 percent to a in the 1980s form a rate of 1.1 percent in the period 1953 to 1983. The country has become more urbanized over the past 30 years; 28 percent of the population lived in urban areas in 1960 and 47 percent in 1980. In 1960, 50 percent of the population lived in an agricultural area and by 1980 only 19 percent did. Low agricultural prices and subsidized rents encouraged migration to urban areas.[3]

Prices

Inflation accelerated throughout the 1980s. Beginning in 1979 prices were gradually freed from administrative controls and many prices were market determined. Inflation built steadily throughout the 1980s reaching 76 percent in 1985 and 180 percent in 1988. Widespread price controls were re-instituted to combat the hyperinflation. Price inflation has reportedly been easing in recent months (Simoneti, 1990). The government has set a goal to end price controls by the end of 1990.

Fiscal

Yugoslavia used a current account shortfall to finance the economic difficulties which emerged with the oil price hike; the shortfall was financed by increased foreign debt. Trade restriction policies and currency depreciation eventually turned around the current account deficit. The record current account deficit of US$3.3 billion in 1979 was converted to a surplus of US$2.2 billion in 1988. But a debt of about US$19 billion had been accumulated.

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[3] The effect of subsidies on migration is discussed in Popovic (1988).

Yugoslavia also reduced investment in order to maintain consumption. This decision was made, to a large degree, at a microeconomic level as co-operatives reduced investment in order to maintain wages.

Yugoslavia has gone to the IMF and World Bank "well" a number of times recently, borrowing roughly US$3 billion in the past two years. For example, a recent IMF loan was for the purpose of supporting economic stabilization efforts and structural reforms. The conditions, imposed—liberalization directed toward market economics—may provide an example of what other Eastern European countries may expect.

Financial and Banking System

Yugoslavia's banking and financial system is unlike that of the other Eastern European countries. The system is in some ways similar to Western systems but it is underdeveloped. The system is very fragmented and contains much duplication. However, Yugoslavia is moving toward private bank ownership.

Banks in one sense are not state-owned. Banks are owned by "founders": Yugoslavian enterprises which create a bank with their own capital. Worker councils—which are in the spirit of self-management—manage and own banks. A Central Bank, the National Bank of Yugoslavia, operates along Western lines (i.e., manages monetary policy, controls foreign exchange rates and balances, and supervises other banks). An export bank was established in 1976. The banks' operations are guaranteed by the Central Bank.

The banking system is a patchwork of organizations. The system is duplicates services and employees scarce skilled resources. There are dual federal and provincial banking structures. Holding companies (associations) own commercial banks; a single association owns on the order of 20 to 50 banks. Savings institutions—small local organizations—receive deposit funds from individuals. The nation-wide Post-Office Savings Bank also receives individual savings. A comprehensive financial market has not existed to link funds and the organizations have been operated independently. In 1983 the system had 168 basic banks, 183 enterprise and worker banks and 9 association banks. The savings banks are local; these are small and very numerous. Yugoslavia has too many banks; a country of 23 million, it has almost 400 banks and many more savings institutions (Golijanin, 1984).

Banks typically service the enterprises which own them. This kind of self-dealing distorts the allocation of credit. Banks operate on both sides of the balance sheet (i.e, banks take deposits and make loans). The interest rates which banks pay vary widely. Although Yugoslavia has a number of banks, competition is poor because of: (1) the spatial distribution of banks; (2) the ties to particular enterprises; and (3) poor price information resulting from hyper-inflation.

The Yugoslavian government is forbidden to have a deficit by law. Hence it has not issued debt. The government's deficit has in effect been put in the banks' accounts by increasing their reserve requirement with the Central Bank.

Real interest rates in Yugoslavia have been negative for several decades. This is only exacerbated by the self-dealing structure which in effect provides debt service on the Yugoslavian deficit. Interest rates on both assets and liabilities were recently indexed to the retail inflation.

Banking reform is an area of current interest in Yugoslavia. The central bank and commercial banks increase the money supply in the conventional method—by monetizing debt. The Central Bank will need to increase interest rates in line with stabilization programs adopted to obtain loans from international organizations. The bank plans to use the reserve requirement to achieve this. The reserve requirement has played a major role in the Yugoslavian system. However, reserve requirements are already high because, as discussed earlier, the government is not allowed to run a deficit.

One index of the financial system is that co-operative enterprises are currently 80 percent self-financing; to a degree this reflects the lack of an adequate capital market. The self-funding is an indication that many enterprises could not pay a market interest rate; the self funding also makes the Central Bank's task to control the money supply more difficult. In February of 1990 Yugoslavia opened established a stock exchange in Pelgrade, but few issues are traded.

THE HOUSING SECTOR[4]

Housing Stock and Housing Production

Results from the 1981 census indicated that Yugoslavia had 6.13 million dwelling units, about a fifth (1.31 million) of which were in social ownership. Although over three fourths of these were built following World War II, much of the housing is considered inadequate especially in terms of facilities:

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[4] Except where otherwise noted, this section was drawn from Popovic (1988) and Jeerkic et al (1988). There is a considerable amount of overlap between these two sources.

> Less than 60 per cent of the dwellings are completely equipped, while nearly 4 per cent or almost 220,000 dwellings have no public utility installations whatsoever. Bathrooms are found in a little over half of the dwellings, and flush toilets in less than half. About 17 per cent of dwellings are in buildings which are not made of hard material (Popovic, 1988).

The quality of housing, however, varies a great deal among the republics and autonomous provinces. For example, 86 percent of the units in Slovenia were fully equipped compared to only 29 percent of the units in Kosovo. In general, dwellings in rural areas (despite being newer on average because of heavy investment activity) are more poorly equipped and have fewer facilities than those in urban settlements. Furthermore, housing quality is positively correlated with a region's level of economic and social development.

Some housing quality measures have shown constant improvement during the post-war period including fairly recent times. Between 1971 and 1981, the average dwelling floor space increased from 49.6 to 60.7 square meters, the number of persons per dwelling fell from 4.1 to 3.6, and the average floor space per person rose from 12.2 to 16.3 square meters. In 1981, the average size of socially-owned dwellings, at 52.7 square meters, was below the overall average of 60.7 square meters.

Although different definitions for urban areas were in use for the 1971 and 1981 censuses—which prohibit accurate comparisons both over time and between regions—it is clear that Yugoslavia experienced rapid urbanization during the ten-year period between these censuses (by one measure, the share of the population living in urban areas grew from 38.5 to 46.1 percent during this period). Despite this rapid urbanization, only about half of Yugoslavia's population is urban today, making Yugoslavia one of Europe's least urbanized countries (Stefanovic, 1984).

Rapid urbanization is being fueled in part by pricing policies which encourage people to migrate to cities. The prices of agriculture products have been held in check as have the prices of rents and public utilities in cities. Socially owned housing, which is heavily subsidized, is concentrated in the larger cities.

This migration has produced shortages of housing in urban areas, especially in the larger cities, while creating an excess supply of housing in some rural areas (there were 205,675 vacant units in 1981, largely concentrated in rural areas). In 1981, there were approximately 66,000 more households than there were dwelling units. Using an adequacy criteria of one person per room, about 35 percent of all dwellings were overcrowded. In 1981, there was an average of 16.3 square meters of floor space per person; however, over 6.6 million people had less than 10 square meters. Over 67,000 non-residential structures were being used for dwelling purposes; this practice occurs in every republic and autonomous province. Yugoslavia appeared near the bottom of a 1984 list that ranked member countries of the UN Economic Commission for Europe according to the number of dwelling units per 1,000 inhabitants. Yugoslavia had 290 dwellings (slightly more than Poland); in comparison, Hungary had 355 and Bulgaria had 346. Top-ranked Denmark had 470 dwellings per 1,000 inhabitants.

Investment in housing and public utilities as a share of national income fell from 8.0 percent in 1976 to 4.8 percent in 1985. This decrease occurred during a period in which all investments in capital assets fell from over 30 percent to under 25 percent of national income. Investment statistics that list housing as a separate component are available for only a few years: housing investment as a share of national income fell from 6.4 percent in 1980 to 4.1 percent in 1985. The private sector share of housing investment increased from about 58 percent to around 66 percent over this period.

Corresponding to the decrease in housing investment was a decrease in the number of dwellings built. About 140,000 units per year were being built during the late 1970s and early 1980s. During the mid-1980s production was about 130,000 units per year, and, in 1987, production fell sharply to around 120,000 units per year. About a third of the annual production between 1984 and 1987 became part of the socially owned stock—a somewhat lower amount compared to the early 1980s. About 60 percent of all units built since World War II are privately owned. Between 1984 and 1987, public and residential construction made up about 40 percent of the total dinar value of construction; this total does not include the value of building work performed by contractors working abroad, which amounted to 651 billion dinars (US$1.4 billion, assuming 451.60 dinars to US$1) in 1987.[5] The foreign earnings of building contractors make an important contribution to Yugoslavia's economy and have been a major source of funding for housing;[6] however, this source declined in the 1980s as labor demand from oil-producing countries fell and competition from other

[5] These construction value figures are from a statistical annex appearing in *Yugoslav Survey*, Vol. 29, No. 3, 1988.

[6] According to statements made by Dr. M. Simoneti at the World Bank Conference on Housing Reforms in Socialist Economies, Washington, D.C., June 12-13, 1990.

countries increased.

Tenure

Housing in Yugoslavia is obtained in one of two ways: (1) by being granted tenancy rights for a socially-owned dwelling; or (2) by purchasing or constructing a unit with private funds, or with a combination of private and public funds. Tenancy right holders of socially-owned dwellings devote only about 4 percent of their incomes to housing expenditures and only 2.3 percent of their incomes to rent. Low rents have not been high enough to cover true depreciation and, in some instances, current operating costs. Numerous attempts to raise rents have not been successful; however, a new effort is underway. The average annual rent in 1986 was only 0.75 percent of the average cost-based price of a dwelling unit. Retail prices increased over twice as fast as rents during the period of 1980 to 1986.

Tenancy rights are very strong, and include inheritance rights and freedom from eviction. Although tenants in private units and sub-tenants of privately-owned and socially-owned dwellings generally pay market rents, Simoneti (1990) notes that households can acquire tenancy rights in privately-owned units. Thus, it is possible for a tenant to occupy a privately-owned unit nearly free of charge. On the other hand, there are no longer any limits on the private ownership of rental units.

About 78 percent of all dwellings are privately owned, of which about 89 percent are owner occupied. However, in "urban settlements", only 40 percent of the stock is privately owned. Private-owned dwellings can be bought outright for cash or inherited, or can be purchased with a combination of a downpayment and credit.

Housing built without permits is common, especially in large cities (about 170,000 units between 1976 and 1983). Much of this is self-help building with inferior materials; owners of such housing run the risk of having their homes demolished. Cooperatives have also been active in construction in recent years—from 1981 to 1985 they built over 40,000 dwellings.

Housing Finance

Housing construction funds have been the primary source of financing for the construction of socially-owned dwellings during the post-war period. Housing funds receive money from the income of work-based organizations as well as from the net earnings of these organizations. Banks usually do not pay interest on these funds. Previously, they lent these funds to the work organizations or the employees of the work organizations at interest rates of 4 to 10 percent and terms of 15 to 25 years.

However, the revalorization of credit in 1987 (presumably an interest rate adjustment for inflation) has resulted in higher interest rates. Mandatory deposits range from 30 to 50 percent of loan value. Work organizations and individuals holding fixed rate loans not subject to revalorization have seen their housing costs fall in real terms over time. Data from the Bank Association of Yugoslavia indicate that, by the end of 1986, around 90 percent of all housing construction credit (approximately one trillion dinars) was in fixed-rate loans.

Individuals can finance private homeownership by making downpayments and obtaining loans through their work organizations or their banks. (A portion of housing construction funds are set aside for financing private ownership; this is viewed as a way to leverage private funds.)

Mortgage and housing loans are provided by commercial banks. Savings and loan organizations also provide housing and mortgage funds but loans are limited to local clients. Savings and loan association funds come only from deposits. Workers associations generally borrow from the commercial banks which obtain funds from depositors including individuals, workers associations, and financial intermediaries (mainly other banks). The amount of deposits by individuals is increasing more than those by worker associations.

Before the revalorization of credit in 1987, loans with interest rates of 1 to 10 percent and terms of 10 to 30 years were common. Revalorization has put home purchasers at a relative disadvantage compared to the highly-subsidized tenancy right holders. Tenancy right holders are likely to oppose reforms that would increase their housing expenditures while others might support such changes.

Although a separate system is in place to provide for the financing of communal infrastructure (public utilities), in practice, the cost of servicing land is borne by the purchasers in the form of higher prices. A variety of taxation methods are available to the republics and provinces including property taxes. Property taxes are independently set by each republic and province, and the amounts charged are often linked to "excess" living space that exceeds some set social criteria.

Housing Reforms

Yugoslavia has already taken some positive steps to introduce market forces into the housing sector by raising interest rates and removing constraints on the private ownership of flats. Raising rents is a high priority; this is mainly viewed as a measure to recover costs and to maintain dwellings, but is also seen as a prerequisite for any major privatization effort (since low rents reduce the incentives for tenants to buy their units and discourage private investors from developing commercial rental properties).

Currently, rents and utility prices have been frozen as a part of the latest stabilization program. Simoneti (1990), a high-ranking Yugoslavian official, argues that the country should use this opportunity to develop a comprehensive housing reform strategy to tackle the problems associated with: (1) raising rents and protecting low-income households from rent increases; (2) weakening tenancy rights (e.g., transforming tenancy rights into a contractual relationship between owners and renters, and eliminating certain means of eviction protection); (3) strengthening incentives to control production costs; (4) raising and lending housing funds on a competitive basis; and (5) developing a more sophisticated property tax system.

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