Mr. L.A. Whittome
Director
European Department
IMF
700 19th Street, N.W.
Washington, D.C. 20431

With the Compliments of the Embassy of Switzerland

Eric Martin

Washington, D.C.,
January 6, 1984

Eric Martin
First Secretary
Economic Affairs

cc: HOS
PM
DR

Bern, December 27, 1983

Re: Financial assistance to Yugoslavia

Dear Sir,

You will remember that at the meeting in Geneva, on November 18, 1983, we had distributed to all participants a table on the status of implementation of the Berne agreement. This table was prepared on the basis of the information supplied by the delegations of the creditor countries.

We had given a certain time to these delegations to write us if they thought that some changes should be made in the table. However, we received no other remarks than the two which were already mentioned in Geneva, that is a change of date for France and an additional note in the margin for Japan.

You will find therefore in the enclosure the final version of the table with the two changes referred to.

Yours sincerely,

J. Faillettaz
Minister
Federal Department
of Foreign Affairs

Final version

BERNE AGREEMENT: status of implementation (in mio US $)

Exchange rates: November 18th 1983

Country	Untied financial credits				Roll-overs/ Refinancings				Tied financial credits / Export - credits					
	pledged	signed			pledged	signed			pledged	signed			probably used until end 83	
	amount	amount	date of signature	date of payment	amount	amount	date of signature	date of implementation	amount	amount	date of signature	cat. of goods	amount	cat. of goods
Austria	40	40	end 83	end 83					60	60	5.7.83	cons. + repro.	0	
Belgium					12	12; impl. 1983: 9	23.9.83	end nov	10	10	23.9.83	repro.	0	
Canada									40	0		commo.	0	
Denmark									13	13	21.10.83	cap.goods + spare parts	Yug. det.	
Finland									11	2	8. 4.83 18. 5.83 27. 6.83	mining + shipping	1	shipping
France									122	94	9.3.83	equip.:18 + repro.	52	equip. + repro
Germany					46	46	8.2.83	implemented	150	150	8.2.83	vital needs	≥ 68 Yug. det.	Yug. det.
Italy					35	35	12.10.83	end 1983	100	100	12.10.83	cons.+ repro.	0	
Japan 1)									35	25	evtl. dec.		0	
Netherlands	25	21	26.4.83	31.5.83 31.7.83					25	25	signed	cap. + repro.	0	
Norway	5	5	14.10.83	28.10.83					18	18	signed	all	8	
Sweden									19	19	signed		0	
Switzerland	50	50	8.6.83	15. 8.83 5.10.83					40	40	8.6.83	Yug. det.	10-15 Yug.det.	Yug. det.
UK	56	56	29.3.83	30.3.83 15.8.83	59	59	soon	14.12.83						
USA					37	155	signed	implemented	235	216	30.12.82 2. 1.83	commo.	216	commo.

1) In addition, Japan has granted to Yugoslavia a short-term credit in the amount of 25 million US dollars

	Untied financial credits	Roll-overs/ Refinancings	Tied financial credits / Export - credits	TOTAL
total pledged	176	189	878	1243
total signed until November 18	132	248	747	1127
total signed probably until end 83	172	307	772	1251
total paid, implemented, used probably until end 83	172	304	≥ 355	≥ 831

cc: HS

Office Memorandum

DEC 29 1983

Dec-30-83

TO : Managing Director

DATE: December 29, 1983

FROM : Hans Schmitt HS

SUBJECT : Yugoslavia - Meeting with Harry Taylor of Manufacturers Hanover

Mr. Taylor will probably emphasize to you that commercial banks are not inclined to pledge new money in 1984 tied to a refinancing operation as in 1983, or in the form of a stand-by operation as suggested by our representatives at the December 6th meeting of commercial banks in London. He may indicate that, if the refinancing operation can be brought to a speedy conclusion, several of the major banks will, on a voluntary basis, increase their exposure with Yugoslavia. At this stage it is still uncertain what form this would take; the likelihood is that it would take the form of short-term trade-related credit lines.

Our case for the need to pledge new money may be summarized as follows. We are currently negotiating a program aimed at achieving a current account surplus in 1984 of US $500 million, to be reflected in an increase in external reserves also of US $500 million. This requires that the capital account should be in balance taking account both of an increase in trade-related inflows--and outflows--of credit. New money will also be needed to cover any leakage in the refinancing of debt falling due. The accounts are therefore very precariously poised even with the assurance of pledged new money from governments and banks, as well as from ourselves.

Commercial bankers have consistently resisted the call for pledged new money, or for a stand-by facility, and appear to have hardened their position recently. According to some reports, they are determined to build down the "forced" lending to which they have had to accede in recent years, and have chosen Yugoslavia as a test case involving the least risk to themselves. They base this judgment on calculations which are compared with our more cautious ones in the attached table. We are in basic agreement on the current account. However, they are much more optimistic on refinancing by governments and banks, and on the likely balance on short-term credits. They have US $500 million more than we on each count. Roughly, half of that substitutes for new money, while the other half is added to the reserves.

If you agree, we would urge you to press Mr. Taylor once more for a medium-term stand-by facility of US $200 million to back up the forecast of new bank credits expected to be extended on a voluntary basis.

cc: Deputy Managing Director
Mr. Whittome
Mr. Finch
Mr. Mentre
Mr. Collins
CED

Table 1. Yugoslavia: Balance of Payments, 1983-84

(In millions of U.S. dollars)

	1983 Estimate	1984 Commercial Bank Proj.	1984 Staff Proj.
Current account	-225	500	500
Medium- and long-term capital	1,175	355	190
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New exercise (Geneva)	[...]	[50]	[250]
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IBRD	350	400	485
Other, mainly suppliers' credits outside government packages	1,064	200	250
Repayments of medium- and long-term capital	-2,450	-2,645	-2,745
Loans extended (net)	-200	-200	-200
Short-term capital of banking system (net)	-600	200	--
Other short-term capital (net), errors and omissions	-750	--	-300
Total	-400	1,055	390
Use of Fund credit (net)	410	120	120
Reserve movements (increase -)	-10	-1,175	-510

1/ Carryover from the 1983 exercise.

cc: HOS
PM
DR
CED

EMBASSY OF THE SOCIALIST FEDERAL REPUBLIC OF YUGOSLAVIA

2410 CALIFORNIA STREET, N.W. WASHINGTON, D.C. 20008 462-6566

December 30, 1983

Mr. L.A. Whittome
Director, European Department
International Monetary Fund
Room 9-120
Washington, D.C. 20431

1AW

Dear Mr. Whittome,

On behalf of the Vice President of the Federal Executive Council of the S.F.R. of Yugoslavia, Zvone Dragan, I have the honor to transmit to you the following message:

"In keeping with our current contacts, I avail myself of the opportunity to acquaint you with some of our assessments regarding the talks conducted hitherto with the mission of the International Monetary Fund, and with the steps that we have recently taken in the sphere of current economic policy measures. Allow me to say that I very much regret any inconvenience I may have caused you by interrupting your holidays with this message.

I was very pleased to learn of your forthcoming arrival in Yugoslavia on January 9th, when we shall have an opportunity to carry out a broader exchange of views on all issues pertaining to our cooperation, as in this message I shall confine myself to several crucial issues only. The Assembly of the S.F.R. of Yugoslavia yesterday agreed upon and adopted a resolution for 1984, accompanying documents of economic policy, as well as amendments and additions to a number of system-related laws, which should yield favourable results in the forthcoming year. We can discuss these documents at greater length in the course of your visit to Yugoslavia, and we shall also have the opportunity to thoroughly brief your mission on the same immediately upon their arrival on January 5th or 6th.

I am convinced, Mr. Whittome, that your mission, headed by Mr. H. Schmitt, has informed You at length of the talks conducted until recently with our delegation in Belgrade. We have achieved significant progress, although the differences on some issues are still so significant that we had to take a somewhat lengthier time-out, in order to enable *both sides to reexamine the proposals put forward in the talks conducted hitherto and prepare a more flexible platform for the resumption of the talks.*

In our view, the major differences arose with regard to the interpretation of the necessary changes in the foreign exchange system and changes in the policy of interest rates in the forthcoming year. Neither of these two issues was acceptable to the Yugoslav side in the form proposed by the mission in the first draft of its letter. On the other hand, the mission had not been authorized to accept our explanations, objections or proposals.

With regard to changes in the foreign exchange law and system, we have in the last few days submitted proposals to the Assembly of Yugoslavia which constitute an improvement upon the existing foreign exchange law. In this regard, I believe, in principle, that the proposed centralization of foreign exchange and its mandatory purchase, entailing the centralization and statism of external financial relations as a whole, would have such significant and long-term implications with regard to the overall export orientation of the Yugoslav economy that it is neither acceptable from the standpoint of the long-term economic stabilization program, nor from the standpoint of our self-management system and market economy. Moreover, on the basis of regulations in the sphere of external economic relations adopted in the period extending from the end of 1982 to July of 1983 we have achieved highly significant results in this year.

The proposal for a drastic adjustment, namely, the tripling of interest rates, also constitutes a fundamental departure from the current realistic possibilities of the Yugoslav economy and, at the same time, from the program of attaining real interest rates, which we agreed upon in the letter to the World Bank on the occasion of the allocation of the Structural Adjustment Loan. Consequently, and especially bearing in mind the measures which we have in recent days taken in the *sphere of prices, pursuing the policy of the structural adjustment of prices, it is our assessment that the question of interest rates may represent one of the key issues in the resumption of our talks with your mission.*

Mr. Whittome, as far as these two issues are concerned, we were unable to discern, in the talks conducted with your mission so far, a direction in which a compromise solution could be sought; with regard to some other questions, there are still significant differences relating to the necessary adjustment measures in the forthcoming year. However, with respect to these questions, with greater mutual flexibility in the next round of talks, we could seek a joint, more acceptable solution.

It is my opinion that the measures that fall within the competence of the Federal Executive Council taken recently to correct the most serious disparities between the raw materials and energy sectors and the manufacturing industry, a one-time increase in certain prices and a six-month freeze on prices, with some accompanying measures, introduce new elements and factors to be considered in the forthcoming talks with the mission.

As a continuation of our joint action to ensure a package for 1984, a meeting of the second working group, set up at the meeting in Geneva, will be held in Paris on January 12. In view of the fact that the International Monetary Fund will be the coordinator of this group at the meeting, we wish to thank you in advance for your support and activity.

In anticipation of our forthcoming meeting, Mr. Whittome, allow me to extend to you my best wishes for a happy holiday season and for your personal happiness."

I avail myself of this opportunity to extend to you, Mr. Whittome, my best wishes for a happy New Year. I look forward to making your acquaintance at an early date.

Respectfully,

Mico Rakic
Ambassador-Designate
of the S.F.R. of Yugoslavia

Office Memorandum

December 30, 1983

MEMORANDUM TO FILES

Subject: Yugoslavia - Mr. Harry Taylor's Visit

Mr. Harry Taylor of Manufacturers Hanover Trust called on the Managing Director to reiterate that no new money would be pledged to Yugoslavia by the commercial banks. However, complete refinancing of maturing debt could be assured, and new money could on a voluntary basis be expected to flow back to Yugoslavia. As a safeguard against mishaps he suggested that the negative pledge on gold collateral be lifted again (especially by Kuwait) so as to allow borrowing against gold collateral in case of need. (The Managing Director seemed receptive [illegible])

In my office afterwards, I stressed to Mr. Taylor that borrowing against gold would undermine one major objective of the stand-by, viz. to raise useable reserves by US $500 million by the end of 1984; he agreed it would. I then asked whether "complete" refinancing could be assured and policed; he thought it could, and I said we might want to explore that further with him in due course. I again raised the question of a stand-by facility from the banks, and the idea was once more categorically rejected.

We then discussed timetables. Mr. Taylor planned to invite Mr. Dragan to New York on January 12 to discuss the commercial banks' financing proposals for 1984. They were aware that the "Geneva" governments would meet in Paris on January 11 and 12, and that a Fund mission would be in Belgrade about the same time to complete negotiations on a stand-by arrangement for 1984. They hoped that the Managing Director would send them the necessary clearance in time to permit the ICC to initiate the refinancing arrangements by January 20. I replied that such a message from us would probably have to wait until after the final meeting of the "Geneva" governments on January 25. They accepted that timetable somewhat reluctantly, because of their desire to complete all arrangements before the end of the standstill period on March 31.

I promised to be in touch again after consulting on these proposals with Messrs. Whittome and Mentre in Belgrade on January 9 and 10.

HS

Hans Schmitt

cc: Managing Director
Deputy Managing Director
Mr. Whittome
Mr. Finch
Mr. Mentre
Mr. Collins
CED

December 30, 1983

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Hans Schmitt

cc: Managing Director
Deputy Managing Director
Mr. Whittome
Mr. Finch
Mr. Mentre
Mr. Collins
CED

INFORMATION COPY

Office Memorandum

TO : Managing Director DATE: December 29, 1983

FROM : Hans Schmitt HS

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1/ Carryover from the 1983 exercise.

Office Memorandum

December 28, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia: Two Conversations with Dobrich

I called Dobrich at Manufacturers Hanover Trust on December 27, 1983 to follow-up on the meeting with bankers we had the week before. I noted an observation he had made to the effect that the process of pledging new money would again take time, perhaps until October, and that no new money would come in while that was in process. Without the need to pledge, on the other hand, new money was ready to flow now. I argued that if bankers were so sure it would flow, what would be the harm in backing that flow with a stand-by credit. Dobrich reiterated that that had been tried, but that only two banks had expressed an interest, and then only if all banks involved in the refinancing exercise would participate on a pro rata basis. There was no chance he said, of a few banks doing a stand-by credit separate from the refinancing.

More importantly, Dobrich reported that major banks (and he included Harry Taylor among the people concerned) have had their fill of "forced" lending, and were determined to start breaking away from it, and Yugoslavia was to them the number one candidate for making that point stick. Bankers had in any case developed a store of resentment against the Yugoslavs, not least because some favored creditors had been paid off during the standstill period last year. He was certain that had been decided at the top policy-making levels in Yugoslavia. I noted that the existence of such an attitude on the part of banks placed doubt on how much new money would in fact go into Yugoslavia on a voluntary basis. Why not a stand-by credit to make sure it would?

Dobrich wondered if the Fund would accept simple forecasts by a group of banks--ten of them were prepared to report their authorizations, which would add up to $100 million. Perhaps another $100 million could be found if the Fund agreed. Dobrich was very anxious the Fund and the banks should reach an agreement on a common line preferably before the meeting with governments in Paris or at least before the plenary meeting with the Swiss on January 25, 1983 in Geneva. Dobrich thought that if the banks could not agree anything with the Fund before that time, they would call on the ICC and the Yugoslavs to negotiate perhaps only a partial refinancing at better terms than would be available otherwise. I told him we would want to look at the whole package together at the end of January.

Dobrich called again the following day, December 28. He had since our talk been in contact again with a series of banks about the possibility of a syndicated stand-by credit for Yugoslavia. He had found "absolutely" no interest in any such credit, even on the part of the two banks he considered favorably inclined towards Yugoslavia. On the other hand, he said, there were those ten banks who were prepared each to authorize $10 million in new loans, and to allow Manufacturers Hanover to report this, as long as they could remain anonymous. Dobrich could tell us unofficially who they would be, but no more. I said we would have to think about all that, and thanked him for his efforts.

HS

Hans Schmitt

cc: Mr. Mentre
CED

cc. PM
CED

December 28, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia

A delegation of commercial bankers comprising Messrs. Dobrich (Manufacturers Hanover), Kopech (Morgan Guaranty), Baranetsky (Morgan Guaranty), Eichler (Bank of America), Evans (Citibank), Buhnemann (Bankers Trust), and Oshima (Bank of Tokyo), came to see Mr. Whittome on December 22, 1983, to discuss the financing package for Yugoslavia for 1984. Also present were Messrs. Schmitt, Hansen, Lewis, and Petersen, and Ms. Ripley.

The main message of the bankers was that they did not want to tie new money from banks to the rescheduling exercise for 1984. They argued that banks would voluntarily put money into Yugoslavia. Mr. Dobrich thus said that he knew for a fact that three banks already had authorization to put in short-term money for US$10 million plus each, as soon as the rescheduling exercise had been finalized. If, on the other hand, the question of new money was tied to the rescheduling operation this would cause considerable delays in the finalization of the package and there would be no new money flowing into Yugoslavia until the last quarter of 1984. The bankers were interested in getting the rescheduling operation finalized as quickly as possible, and they asked the Fund to reconsider its position. There were several problems with the reconciliation of debt data with Peat Marwick and Mitchell, and the banks did not want the questionnaires sent out before the terms and conditions of the rescheduling had been agreed upon. If the Fund insisted on tying new money to the rescheduling it would be impossible for the banks to finalize the rescheduling before the end of the standstill period. Based on the balance of payments figures obtained by the economic committee of the ICC on its visit to Belgrade during the period December 13-16, 1983, which on some points were more optimistic than the staff forecasts, they argued that even if there was no new money from banks, governments or the Fund, there would still be an increase in the external reserves of Yugoslavia in 1984.

The staff representatives argued, on the other hand, that to follow this line would leave no safety margin against unforeseen developments in the balance of payments. Also, it would be more damaging for confidence in the Yugoslav economy, if they did not ask for money now but had to come back and ask for it later in the year. With the level of reserves (and particularly usable reserves) at a bare minimum at the end of 1983 and the problem of short-term debt falling due in January 1985, the staff found that there was an urgent need to build up reserves during 1984 and the figure of US$500 million which appeared in the tables that were circulated, was really a minimum target. The staff said that it might be possible to get by with money being pledged voluntarily, but this would require that banks put together quickly a stand-by facility also.

The bankers were not convinced by this reasoning. They said that if Yugoslavia were to come and ask for money later in the year, they would have no option but to come up with new money. The banks were locked-in. Their fear was that if reserves were being built up in Yugoslavia this would weaken the authorities' resolve to adjust. Also, they again raised the question of the capital outflow under "errors and omissions" in 1983 and said that they would not agree to providing new money until they had firm assurances that there would not be a repeat performance in 1984. Staff explained and quantified some of the reasons for the outflow under this item in 1983 and said that the increase in interest rates which would be a main element in the program for 1984 should result in less outflow in that year. Also, the Yugoslav authorities were taking specific measures to deal with the problem. Anyway, the Fund would establish a reserves test in the program for 1984, which should provide assurances against capital outflows.

There was some discussion of the balance of payments figures for 1984. The main difference was in the short-term capital flows where the staff had an outflow of US$300 million, while the ICC had an inflow of US$200 million; accordingly the ICC had a reserve increase of US$1 billion compared with the staff estimate of US$500 million. Also, the ICC arrived at that figure without much in terms of new money from governments or banks (US$50 million from each). They reckoned with more or less full roll-over of maturities from both governments and banks in 1984. They argued that there would only be very small exemptions from the rescheduling this year. They had thus rescheduling of US$600 million from Berne Accord governments and US$1,500 million from banks. By contrast, the staff had US$500 million and US$1,100 million, respectively. Part of the reason for the discrepancy was that the ICC had different repayment figures than the staff; they had much higher figures for repayments to governments. The source of their figures was the debt statistics which the National Bank of Yugoslavia was producing in cooperation with the World Bank, while the staff had used as a basis the survey which had been conducted at mid year.

Finally, the staff explained the main elements in the program being negotiated with the Yugoslavs.

At the end of the meeting, Mr. Dobrich asked for another meeting before the end of the year to determine finally whether the Fund would continue to insist on new money from banks in 1984. The staff were noncommital on this.

Leif Hansen LH

cc: Mr. Whittome
Mr. Schmitt
Ms. Ripley
Mr. Lewis
Mr. Petersen

c/c L. Watson
Pl copy to Mr Mentré

Office Memorandum

To: Mr. Schmitt

December 28, 1983

From: Arne B. Petersen

Subject: Yugoslavia--Financial Package

The discussion with commercial bankers on December 22 raised some interesting questions.

1. Short-term capital of the banking system. Is it necessarily bad that Yugoslavia reduced its short-term debt by some US$600 million in 1983? If this was due to a voluntary repayment of short-term credit lines which remain open, then, in effect, this repayment constitutes "hidden" reserves which can be used in the first half of 1983. The bankers and Mr. Brainard's draft report indicate that the net outflow of short-term capital was indeed voluntary and not due to closures of credit lines. We would need to seek clarification of this issue in Yugoslavia.

We have chosen to be conservative in our projection for 1984; while on the one hand we assume there will be an outflow of some US$130 million in the process of rolling over the CCF in 1983, we have not made any allowance for the utilization of the remaining CCF funds in 1984.

2. Other short-term capital, errors and omissions. Our estimate of an outflow in 1984 of US$300 million under other short-term capital is a little on the high side, it is actually US$250 million rounded up. Also, if we do succeed in introducing real positive interest rates, we could probably expect some inflow of funds as the lags which were extended in 1983 return to a more normal level. We have chosen to be conservative and should probably remain so.

3. Drawings on medium- and long-term capital. According to Yugoslav figures, public- and publicly-guaranteed debts due to governments amount to US$600 million in 1984 while those due to the Berne government amount to some US$500 million. Debts due to banks, excluding banks partly owned by Yugoslavia and banks in Eastern Europe and China, amount to US$1,562 million. For tactical reasons, and in order to remain cautious, we originally put rescheduling of banks at US$1,200 million and then revised it downward further to US$1,100 million while in Yugoslavia. Refinancing of governments we have put at US$500 million. In theory, however, and as emphasized by the commercial bankers, since both governments and banks are going to refinance, there should be very little scope for excluding part of the maturities; exemptions would seem to be limited mainly to cofinancing with the IFC--US$50 million--,perhaps some deductions for à forfait transactions, and some deductions for bonds held by banks on behalf of other customers. These deductions, including a margin of error are unlikely to exceed some

US$150 million. Accordingly, the sum of rollover by Berne governments and banks is likely to amount to some US$1,900 million with perhaps US$600 million 1/ pertaining to governments, and some US$1,300 2/ to banks. Thus, our present estimate underestimates the likely outturn by some US$300 million.

4. Other elements. Our present estimate of drawings on suppliers' credits outside the government package is also understating the likely outturn, particularly if governments are not going to officially pledge their assistance in 1984. The United Kingdom has indicated that it expects to disburse some US$150 million in 1984, or about the same level as in 1983, and we know that the United States is contemplating additional CCC credits. Other countries are likely to disburse outside the government package as well, so a more reasonable estimate would be around US$500 million.

Even reducing some other elements slightly, we would end up at a slightly higher level of drawings without new money (Alternative II in the attached table) than we are now contemplating with new money (Alternative I). We still have been cautious enough to cover the possibility of some shortfall on the current account and possible shortfalls on the disbursement of Berne credits carried over.

Attachments

cc: Mr. Whittome
Ms. Ripley
Mr. Hansen
Mr. Lewis

1/ Kuwait has been included and the government-guaranteed debt increased somewhat because of the well known classification problems. For this same reason, the refinancing by banks has been reduced.

2/ Corresponds to the estimate given by PMM to Mr. Mentre in November.

12/28/83

Table 1. Yugoslavia: Balance of Payments with the Convertible Currency Area, 1982-84

(In millions of U.S. dollars)

	1982	1983 Est.	1984 Yugoslav estimate	1984 Bank estimate	1984 Alternative I	1984 Alternative II
Exports	5,526	6,300	7,700	7,300	7,200	7,200
Imports	-9,043	-8,450	9,100	8,900	8,800	8,800
Trade balance	-3,517	-2,150	-1,400	-1,600	-1,600	-1,600
Invisibles (net)	2,003	1,925	2,200	2,100	2,100	2,100
Workers' remittances	1,085	1,265	1,440	1,440	1,135	1,135
Tourism	1,224	1,335	1,080	1,050	1,510	1,510
Interest payments	-1,670	-1,690	-1,840	-1,860	-1,890	-1,890
Others	1,364	1,015	1,520	1,470	1,345	1,345
Current account	-1,514	-225	800	500	500	500
Medium- and long-term capital	-117	1,175	-20	355	190	255
Drawings	1,684	3,825	2,825	3,200	3,135	3,200
Repayments	-1,626	-2,450	-2,645	2,645	-2,745	-2,745
Loans extended	-175	-200	-200	-200	-200	-200
Short-term capital of banking system	-506	-600	--	200	--	--
Other short-term capital, errors and omissions	562	-750	--	--	-300	-300
Total	-1,575	-350	780	1,055	390	455
Use of Fund Credit	563	410	220	120	120	120
Reserve movements (increase -)	1,012	-10	-1,000	-1,175	-510	-575

12/28/83

Table 2. Yugoslavia: Drawings on Medium- and Long-Term Debt in Convertible Currency by Creditor

(In millions of U.S. dollars)

	1983 Est.	1984 Yugoslav estimate	Bank estimate	Alternative I	Alternative II
Government packages	831	1,006	1,050	1,100	950
Berne	831	456	400	350	350
Refinancing	(304)	(...)	(...)	(3)	3
New financial credits	(172)	(...)	(...)	(...)	(...)
Suppliers' credits	(355)	(456)	(...)	(347)	(347)
Geneva	...	550	650	750	600
Refinancing	...	(400)	(600)	(500)	(600)
Suppliers' credits	...	(150)	(50)	(250)	(--)
Commercial bank package	1,580	1,100	1,550	1,300	1,300
Refinancing	980	1,000	1,500	1,100	1,300
New financing	600	100	50	200	--
IBRD	350	530	400	485	450
Regular facilities	280	250	250	280	250
SAL	70	280	150	205	200
Other multilateral lenders IFC, EIB and Eurofima	50	... 1/	--	50	--
Suppliers' credits outside Government packages	1,014	189	200	200	500
Subtotal	3,825	2,825	3,200	3,135	3,200
IMF	590	500	400	400	400
Total	4,415	3,325	3,600	3,535	3,600

INTERNATIONAL MONETARY FUND

December 28, 1983

TO : L. A. Whittome

FROM: Patrick de Fontenay

Mr. Dobrich of Manufacturers Hanover Trust called to say that Mr. Harry Taylor would probably meet with the Managing Director on Friday, December 30.

The main topic to be discussed will be the Phillippines, but Yugoslavia was also likely to be brought up. He wanted to give us advance warning.

cc: Hans Schmitt

Mr. Whittome

Office Memorandum

cc: Pl copy to Mr Mentré

To: Mr. Schmitt

December 28, 1983

From: Arne B. Petersen

Subject: Yugoslavia--Financial Package

The discussion with commercial bankers on December 22 raised some interesting questions.

1. Short-term capital of the banking system. Is it necessarily bad that Yugoslavia reduced its short-term debt by some US$600 million in 1983? If this was due to a voluntary repayment of short-term credit lines which remain open, then, in effect, this repayment constitutes "hidden" reserves which can be used in the first half of 1983. The bankers and Mr. Brainard's draft report indicate that the net outflow of short-term capital was indeed voluntary and not due to closures of credit lines. We would need to seek clarification of this issue in Yugoslavia.

We have chosen to be conservative in our projection for 1984; while on the one hand we assume there will be an outflow of some US$130 million in the process of rolling over the CCF in 1983, we have not made any allowance for the utilization of the remaining CCF funds in 1984.

2. Other short-term capital, errors and omissions. Our estimate of an outflow in 1984 of US$300 million under other short-term capital is a little on the high side, it is actually US$250 million rounded up. Also, if we do succeed in introducing real positive interest rates, we could probably expect some inflow of funds as the lags which were extended in 1983 return to a more normal level. We have chosen to be conservative and should probably remain so.

3. Drawings on medium- and long-term capital. According to Yugoslav figures, public- and publicly-guaranteed debts due to governments amount to US$600 million in 1984 while those due to the Berne government amount to some US$500 million. Debts due to banks, excluding banks partly owned by Yugoslavia and banks in Eastern Europe and China, amount to US$1,562 million. For tactical reasons, and in order to remain cautious, we originally put rescheduling of banks at US$1,200 million and then revised it downward further to US$1,100 million while in Yugoslavia. Refinancing of governments we have put at US$500 million. In theory, however, and as emphasized by the commercial bankers, since both governments and banks are going to refinance, there should be very little scope for excluding part of the maturities; exemptions would seem to be limited mainly to cofinancing with the IFC--US$50 million--,perhaps some deductions for à forfait transactions, and some deductions for bonds held by banks on behalf of other customers. These deductions, including a margin of error are unlikely to exceed some

US$150 million. Accordingly, the sum of rollover by Berne governments and banks is likely to amount to some US$1,900 million with perhaps US$600 million 1/ pertaining to governments, and some US$1,300 2/ to banks. Thus, our present estimate underestimates the likely outturn by some US$300 million.

4. Other elements. Our present estimate of drawings on suppliers' credits outside the government package is also understating the likely outturn, particularly if governments are not going to officially pledge their assistance in 1984. The United Kingdom has indicated that it expects to disburse some US$150 million in 1984, or about the same level as in 1983, and we know that the United States is contemplating additional CCC credits. Other countries are likely to disburse outside the government package as well, so a more reasonable estimate would be around US$500 million.

Even reducing some other elements slightly, we would end up at a slightly higher level of drawings without new money (Alternative II in the attached table) than we are now contemplating with new money (Alternative I). We still have been cautious enough to cover the possibility of some shortfall on the current account and possible shortfalls on the disbursement of Berne credits carried over.

Attachments

cc: Mr. Whittome
Ms. Ripley
Mr. Hansen
Mr. Lewis

1/ Kuwait has been included and the government-guaranteed debt increased somewhat because of the well known classification problems. For this same reason, the refinancing by banks has been reduced.

2/ Corresponds to the estimate given by PMM to Mr. Mentre in November.

12/28/83

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12/28/83

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Refinancing	980	1,000	1,500	1,100	1,300
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SAL	70	280	150	205	200
Other multilateral lenders IFC, EIB and Eurofima	50	... 1/	--	50	--
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Subtotal	3,825	2,825	3,200	3,135	3,200
IMF	590	500	400	400	400
Total	4,415	3,325	3,600	3,535	3,600

Mr. L.A. Whittome
Director
European Department
I M F
Washington, D.C. 20431

With the Compliments of the Embassy of Switzerland

Eric Martin
First Secretary
(Economic Affairs)

Washington, D.C.,
December 27, 1983

APPEL GENERAL MOM SVP

cc: HOS
CED
PM
DR

BERN 23.12.83 15H45 URGENT

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AMBASUISSE BELGRADE ET CONSULAT GENERAL DE SUISSE NEW YORK POUR INFORMATION.

RE: FINANCIAL ASSISTANCE TO YUGOSLAVIA

DEAR MR. DOBRICH,
I SHOULD LIKE TO REFER TO YOUR TELEX DATED DECEMBER 21.

AS YOU KNOW, AT THEIR MEETING IN GENEVA ON NOVEMBER 18, THE CREDITOR COUNTRIES DECIDED TO CREATE TWO WORKING GROUPS, THE FIRST ONE, UNDER FRENCH CHAIRMANSHIP, FOR THE CONSOLIDATION OF MATURITIES OF OFFICIAL AND OFFICIALLY GUARANTEED DEBT FALLING DUE IN 1984, AND THE SECOND ONE, UNDER THE CHAIRMANSHIP OF THE IMF, TO EXAMINE THE NEED FOR ADDITIONAL ACTION. THESE TWO GROUPS WILL REPORT TO A COORDINATING GROUP UNDER SWISS CHAIRMANSHIP.

ACCORDING TO THE TIMETABLE WHICH IS BEING ORGANIZED RIGHT NOW, THE TWO WORKING GROUPS SHOULD MEET ON JANUARY 11 AND 12, 1984 IN PARIS AND THE COORDINATING GROUP MOST PROBABLY DURING THE PERIOD OF JANUARY 26 - 28 IN GENEVA.

GIVEN THE AGREEMENT REACHED, ON NOVEMBER 18, ON THE PROCEDURES TO BE FOLLOWED FOR THE QUESTION OF THE CONSOLIDATION, THE YUGOSLAV AUTHORITIES HAVE ASKED US TO SEND TO ALL CREDITOR GOVERNMENTS - WHICH WE HAVE DONE IMMEDIATELY - A REQUEST FOR A STANDSTILL PERIOD FROM JANUARY 1 TO MARCH 31, 1984, SIMILAR TO THE ONE WHICH WAS PRESENTED TO THE COMMERCIAL BANKS.

THIS SAME REQUEST WAS MENTIONED DURING A MEETING IN PARIS, ON DECEMBER 19, AT WHICH THE CREDITOR GOVERNMENTS TOOK PART. NO OBJECTION WAS RAISED BY THESE GOVERNMENTS WHICH ARE NOW AWAITING THE NEGOTIATION ON THE TERMS OF THE CONSOLIDATION FOR 1984. BEST REGARDS

R. PROBST, STATE SECRETARY
FEDERAL DEPARTMENT OF FOREIGN AFFAIRS

23.12.83 16.05

+?

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AMSWIS 64180
23.12.83 16H05 +? MOM SVP

western union Telex / TWX

TO: Mr. Schmitt
Ms. Ripley
Mr. Hansen

December 23, 1983

FROM: L.A. Whittome

SUBJECT: Your Draft for Paris

A. I return the draft with some queries and suggestions (perhaps they might have been dealt with before it reached me?)

B. I agree with you that the text should be silent on the 1984 package and that we should deal with this orally.

C. I wonder whether you should say more on errors and omissions; it is such an obvious point for countries to focus on.

D. I presume that you are satisfied that this note meets the questions formally submitted by Dick Erb?

(Incidentally, please let me have today an acknowledgement of that note).

Attachment

INFORMATION COPY

DRAFT/LH?
12/21/83

Yugoslavia - Recent Developments and Outlook

1. General trends

The stabilization program pursued over the last three years has now begun to show substantial results. In particular, the deficit on the external current account with the convertible area narrowed from a peak in 1979 of US$3.3 billion (5 1/2 percent of GSP) to an estiamted US$225 million (about 1/2 percent of GSP) in 1983 (Table 1). This compares favorably with an original target of a deficit of US$500 million for 1983. Part of this adjustment was induced by a cut in imports related to external financing difficulties. But an active exchange rate policy, which led to a depreciation of the real effective exchange rate by some 30 percent in the course of 1983, combined with a reduction in the surplus with the nonconvertible area from US$1 billion in 1982 to approximate balance in 1983, also played an important role, as reflected in a sizable gain in market shares. Developments in the external balance on capital account have been less satisfactory. As a result the increase in external reserves which had been targeted at the beginning of the year, did not materialize, and the level of reserves at the end of 1983 is estimated to remain uncomfortably low. The main reason for this outturn was a swing in "errors and omissions" from a surplus of US$560 million to an estimated deficit of about US$750 million, which more than offset the increase in export earnings in the course of 1983.

The adjustment in the external accounts was achieved at the expense of a decline in real GSP by about 3 percent. The rate of price inflation accelerated from 31 percent during 1982 to an estimated 50 percent during 1983, in part as the inevitable consequence of a very substantial real effective depreciation and a sharp increase in administered prices. Consumer demand was contained by a 10 percent decline in real personal incomes in the socialized sector. Public finances also contributed substantially to the restraint of demand in 1983, with a decline in public sector revenue of about 5 percent in real terms and the freezing with the National Bank of Yugoslavia of a small amount of excess public sector revenue. Monetary and credit policies were also generally restrictive with the real stock of broad money (M2) estimated to have declined by about 7 percent during 1983. The level of nominal interest rates ~~were~~ was increased significantly in 1983, but with the acceleration of the rate of inflation ~~they~~ interest rate remain negative in real terms. More basic structural reforms to support the adjustment process have also been initiated, but the results have been modest so far.

2. External financial assistance in 1983

In addition to gross purchases from the Fund of SDR 554 million in 1983, agreement was reached in June 1983 on a structural adjustment loan (SAL) from the World Bank for US$275 million, of which about US$70 million is expected to be disbursed in 1983 (Table 2). Disbursements under regular IBRD loans are estimated at US$280 million. Further, at a meeting in Berne in January 1983, representatives of 15 Western countries pledged financial support to Yugoslavia in an amount of US$1.3 billion, the bulk of which was in the form of suppliers' credits tied to exports from lending countries. It is estimated that about US$830 million will be disbursed in 1983. Also, commercial banks agreed to provide US$600 million in new medium-term credits (all disbursed) and to refinance

US$980 million of nonguaranteed medium-and long-term maturities falling due between January 17, 1983, and December 31, 1983, and to roll over an estimated US$880 million short-term debt to January 17, 1985. The BIS provided short-term loans in an amount of US$500 million in 1983, all of which have been repaid.

The ~~impact~~ benefits of the financial package in 1983 ~~was qualified~~ were limited by a slow disbursement of funds. The first advance under the commercial bank credit was made only in late October, and the last disbursement took place early in December. The disbursements under the Berne package were also slower than expected. This was partly due to delays in signing of the individual agreements because of disputes over the commodities covered. ? The main reason, however, were the too restrictive Yugoslav regulations governing the utilization of such credits. This was also the (or 'a'?) reason for the slow utilization of the SAL loan. In order to ensure the availability of foreign exchange to repay foreign credits, drawings were made available only to exporters who supplied proof of export orders in hand, and raw material imports financed by suppliers' credits have had to amount to less than 50 percent of the value of exports into which they entered. Changes have not been made, and sectors other than exporters of goods, such as enterprises rendering services abroad and certain domestic sectors, are now allowed to utilize the credits.

were they? or were they really appropriate & long [illegible] are taken under [illegible] adjustment?

are we aware

?

3. Forecasts and policy issues

Some part of the improvement in the current external account with the convertible area in 1983 was due to a diversion of trade from the nonconvertible area and to an undesirable compression of imports. Neither of these can be continued in 1984. The underlying adjustment, nevertheless, ?

I am sure the conference infers "can" & probably "will" be continued in 84 should permit a further improvement in the external current account to a surplus of about US$500 million in 1984. It is assumed that the level of competitiveness, following the aggressive exchange rate policy in 1983, is now adequate to permit a substantial liberalization of trade and payments and to allow an increase in exports which would permit imports to rise sufficiently to make room for some growth of total output. In addition, particular emphasis will have to be placed on measures to improve the balance on capital account, so as to ensure an increase in official reserves of at least US$500 million in 1984. One central element in achieving a reduction in capital outflows compared with 1983 will be to move to an active interest rate policy. Further, the controls on the repatriation of export earnings will have to be intensified, and penalties for noncompliance increased, for example, by cancellation of credit lines and other credit restrictions.

A central element in the stabilization effort for 1984 will be a liberalization of the foreign exchange allocation system, so as to allow the economy to respond more quickly to exchange rate changes. One element would be a greater surrender requirement to a unified exchange market, or to the National Bank of Yugoslavia, than at present in exchange for dinar cash or deposits that earn competitive interest rates. Another element of the 1984 program will have to be a decisive move to raise nominal interest rates on dinar deposits to levels competitive with the rturn on foreign exchange deposits. This is necessary, first as a means of stemming capital outflow, then as a necessary element in reforming the foreign exchange allocation system, and finally as an important element in stopping the "dollarization" of the Yugoslav economy. Foreign exchange deposits now account for more than 40 percent of broad money (M2).

As in 1983, tight credit and fiscal policies will need to be pursued, including a continuation of the scheme to freeze excess public sector revenue with the National Bank of Yugoslavia. Some restructuring of the tax system is also under consideration; it will entail higher taxation of households combined with a reduction in the tax burden on productive enterprises. The contribution of incomes policy, on the other hand, is expected to be smaller in 1984 than the year before. After a fall of real personal income per employee of 10 percent in 1983 and 25 percent over the last four years, the maximum that could be hoped for would be that the gains in real personal income should not exceed increases in productivity. In particular, incomes policy should take the form of limiting income payments by loss-making enterprises to increase the mobility of labor to more competitive activities. Price determination will be liberalized further in 1984 and administered prices will to a significant extent be adjusted automaticaly, particularly in the area of energy prices. This policy, together with the effects of exchange rate policy, will make only a modest decline in the rate of inflation possible in the course of 1984.

merely read literally "the maximum that the Yugos consider realistic" ?

?

12/22/83

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Short-term debt	-506	-600	--
Errors and omissions	562	-750	-300
Total	-1,575	-350	390
Use of Fund Credit	563	410	120
Reserve movements (increase -)	1,012	-10	-510

1/ Calculated at the statistical exchange rate of US$1 = Din 63.4.

12/22/83

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Subtotal	3,825	3,135
IMF	590	400
Total	4,415	3,535

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

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MRS. G. HOFMANN
NATIONAL BANK OF YUGOSLAVIA
BELGRADE
YUGOSLAVIA

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DEAR MRS. HOFMANN,

AS AGREED DURING OUR LAST VISIT A FUND MISSION WILL ARRIVE IN BELGRADE TO RESUME DISCUSSIONS ON A STAND-BY ARRANGEMENT FOR 1984 ON JANUARY 5, 1984. THE MISSION WILL COMPRISE MESSRS. HANSEN, LEWIS AND PETERSEN, IN ADDITION TO MYSELF AND A SECRETARY. IT WOULD BE GREATLY APPRECIATED IF YOU COULD MAKE RESERVATIONS AT THE INTERCONTINENTAL HOTEL FOR ONE SUITE AND FOUR SINGLE ROOMS FROM JANUARY 4. WE UNDERSTAND THAT THE TYPEWRITER, WHICH YOU PROVIDED FOR OUR LAST MISSION, WAS RETAINED AT THE HOTEL AND WILL BE AVAILABLE TO US UPON ARRIVAL. ARRIVAL TIMES WILL BE AS FOLLOWS: MR. HANSEN AT 12.05 ON LH 360 FROM FRANKFURT, MR. LEWIS AND MR. PETERSEN AT 15.10 ON LH 362 FROM MUNICH, AND I SHALL ARRIVE AT 13.50 ON SR 456 FROM ZURICH. THE NAME AND ARRIVAL TIME OF THE SECRETARY WILL BE COMMUNICATED LATER.

REGARDS,

SCHMITT

IF REQUIRED INITIAL BELOW

SPECIAL INSTRUCTIONS — TEXT MUST END HERE

TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): HANS SCHMITT EXT.: 12/23/83 72933 DEPT.: EUR DATE: 12/23/83

AUTHORIZED BY NAME (TYPE): AUTHORIZED BY NAME (TYPE): **

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

Log

Schmitt

FORM NO. 48 REV 1 11-18-82

Mr. R. Erb December 23, 1983

L.A. Whittome

Yugoslavia

Thank you for your memorandum of December 21, 1983 with suggestions regarding the topics to be discussed at the Group II meeting of "the friends of Yugoslavia" in January 1984. The Managing Director has asked Mr. Guetta, Director of the Fund's Paris office, to chair this group and we have passed on your suggestions to him and asked him to add them to the proposed agenda which has already been circulated. We are also preparing a note on recent developments and outlook for Yugoslavia to be distributed ahead of the Paris meetings. It will to a large extent cover the topics suggested by you.

cc: Mr. Schmitt

INFORMATION COPY

cc: HOS
CED
DR
PM

EMBASSY OF SWITZERLAND
SCHWEIZERISCHE BOTSCHAFT
AMBASSADE DE SUISSE

WASHINGTON D.C. 20008,
2900 Cathedral Avenue N.W.
Telephone 462-1811/7

December 23, 1983

Ref.: 523.0 SD (Jug.) - MA/hu

Mr. L.A. Whittome
Director
European Department
I M F
700 19th Street, N.W.
Washington, D.C. 20431

Financial Assistance to Yugoslavia

Dear Mr. Whittome,

Please find enclosed a letter from State Secretary Probst informing you about a letter received from Minister Janko Smole concerning the questions of maturities falling due to or guaranteed by creditor governments at the beginning of 1984.

Sincerely yours,

David de Pury
Minister

Encl.

cc: - Mr. Paul Mentre de Loye, Consultant, European Department, IMF, Washington, D.C.

RE: Financial Assistance to Yugoslavia

Dear Sir,

I have just received from Minister Janko Smole a letter, dated December 16, in which he confirms to me once more the approval by the Yugoslav Government of the conclusions of the Geneva meeting and refers to the question of maturities falling due to or guaranteed by creditor governments at the beginning of 1984. As you know, this question has already been mentioned during the discussion which creditor governments had in Paris on December 19.

You will find hereafter, for your information, the text of Minister Smole's letter:

"Dear Mr. Probst:

I would like to thank you once again for the most effective way in which you chaired the November 18 meeting in Geneva on Financial Assistance to Yugoslavia.

As indicated in your summing up it was agreed that two working groups will meet as soon as possible. The first working group would deal with the problem of the consolidation of maturities of official and officially guaranteed debt falling due in 1984. The second working group would be entrusted with the more general subjects of the overall economic situation of Yugoslavia, future prospects and the need for additional action. Both working groups would report to the coordination group chaired by Switzerland. The Yugoslav Government fully concurs in this agreement and looks forward to future discussions with creditor governments.

It appears now that the first meeting of the two working groups could take place in the first half of January. In the meantime, and during the period which will

./..

be necessary in order to reach final agreement, there is a need to maintain an orderly process of equal treatment between governmental and commercial bank creditors.

At the ICC meeting in London on December 6, in which the IMF, IBRD and Yugoslav Delegation took part, it was recommended and agreed that the Yugoslav authorities would propose that eligible maturities of principal of Yugoslav external medium- and long-term indebetedness falling due from January 1, 1984 to March 31, 1984, be extended on a provisional basis. Given the agreement reached in the Geneva meeting on procedures to be used to deal with consolidation of medium- and long-term principal repayments falling due to official creditors during 1984, we intend to act in the same way on obligations in principal to official creditors, while fulfilling all interest obligations, with the view to reach as soon as possible, but before end March 1984, an overall agreement. It is understood that the provisional standstill of eligible maturities as mentioned above would not imply the application of penalty interest rates.

I would appreciate if you could inform all interested governments of the above.

Sincerely yours,

Signed: Janko Smole"

Best regards,

Raymond Probst
State Secretary
Federal Department
of Foreign Affairs

APPEL GENERAL MOM SVP

cc: HOS
CED
PM
DR

BERN 23.12.83 15H45 URGENT

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AU FMI

AMBASUISSE PARIS, AVEC PRIERE ENVOYER COPIE, POUR INFORMATION, AU BUREAU LOCAL DU FMI, A L'ATT. M.P. MENTRE

AMBASUISSE BELGRADE ET CONSULAT GENERAL DE SUISSE NEW YORK POUR INFORMATION.

RE: FINANCIAL ASSISTANCE TO YUGOSLAVIA

DEAR MR. DOBRICH,
I SHOULD LIKE TO REFER TO YOUR TELEX DATED DECEMBER 21.

AS YOU KNOW, AT THEIR MEETING IN GENEVA ON NOVEMBER 18, THE CREDITOR COUNTRIES DECIDED TO CREATE TWO WORKING GROUPS, THE FIRST ONE, UNDER FRENCH CHAIRMANSHIP, FOR THE CONSOLIDATION OF MATURITIES OF OFFICIAL AND OFFICIALLY GUARANTEED DEBT FALLING DUE IN 1984, AND THE SECOND ONE, UNDER THE CHAIRMANSHIP OF THE IMF, TO EXAMINE THE NEED FOR ADDITIONAL ACTION. THESE TWO GROUPS WILL REPORT TO A COORDINATING GROUP UNDER SWISS CHAIRMANSHIP.

ACCORDING TO THE TIMETABLE WHICH IS BEING ORGANIZED RIGHT NOW, THE TWO WORKING GROUPS SHOULD MEET ON JANUARY 11 AND 12, 1984 IN PARIS AND THE COORDINATING GROUP MOST PROBABLY DURING THE PERIOD OF JANUARY 26 - 28 IN GENEVA.

GIVEN THE AGREEMENT REACHED, ON NOVEMBER 18, ON THE PROCEDURES TO BE FOLLOWED FOR THE QUESTION OF THE CONSOLIDATION, THE YUGOSLAV AUTHORITIES HAVE ASKED US TO SEND TO ALL CREDITOR GOVERNMENTS - WHICH WE HAVE DONE IMMEDIATELY - A REQUEST FOR A STANDSTILL PERIOD FROM JANUARY 1 TO MARCH 31, 1984, SIMILAR TO THE ONE WHICH WAS PRESENTED TO THE COMMERCIAL BANKS.

THIS SAME REQUEST WAS MENTIONED DURING A MEETING IN PARIS, ON DECEMBER 19, AT WHICH THE CREDITOR GOVERNMENTS TOOK PART. NO OBJECTION WAS RAISED BY THESE GOVERNMENTS WHICH ARE NOW AWAITING THE NEGOTIATION ON THE TERMS OF THE CONSOLIDATION FOR 1984. BEST REGARDS

R. PROBST, STATE SECRETARY
FEDERAL DEPARTMENT OF FOREIGN AFFAIRS

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Office Memorandum

Mr. Whittome

To : Mr. Schmitt December 23, 1983

From : Arne B. Petersen

Subject: Yugoslavia: GATT approval of Export Subsidies

I have searched our files and talked with Mr. Eglin of the Geneva Office and Mr. Anjaria on the above subject. It was impossible to find any elements on which Yugoslav authorities might have based their statement of GATT approval. The only explanation I can think of is that when the GATT secretariat sent a mission to Yugoslavia to study the foreign exchange allocation system, it may not have raised any objections to the system. The secretariat, however, unlike the Fund, is not in a position to extend any approval, only the contracting parties can do so.

Subsidies are covered by Article XVI of the GATT. As part of the Tokyo Round of multilateral trade negotiations within GATT, agreement was reached among a number of countries on the interpretation of Article IV, XVI, and XXIII (the subsidies code). According to Mr. Eglin, the GATT can only be said to have approved the subsidy scheme of a member under the following circumstances. The member must have signed and ratified the subsidy code and no other signatories must have raised objections to the subsidy scheme of the member by invoking the non-application clause of the agreement. Yugoslavia has signed the subsidies code, but has not ratified it, nor has Yugoslavia notified the GATT of the subsidies which it maintains.

The question remains whether Yugoslavian export subsidies are in conformity with GATT rules. According to the attached list, past refunds of indirect taxes (second half of paragraph (h)), and import duties (paragraph (i)) are not considered to amount to export subsidies. Rebates of direct taxes, however, is an export subsidy (paragraph (e)), and therefore not in conformity with the subsidies code.

The question then arises whether the Yugoslav system of contributions (i.e., taxes) from enterprises and personal incomes amount to direct or indirect taxes. The subsidies code defines direct taxes to mean taxes on wages, profits, interest, rents, royalties, and all other forms of income, and taxes on the ownership of real property. The tax on personal incomes is thus clearly a direct tax. The tax on enterprise income is most likely also a direct tax, as our present understanding is that it is levied on a monthly basis on a concept of enterprise income net of certain costs. Depending on how this income is defined, it may perhaps be said to have the character of an indirect tax; for example, if income is defined as the value of sales without any deductions, it would amount to a turnover tax. We would need to clarify this further.

The subsidies code does leave some room for developing countries to maintain export subsidies under certain conditions (Article 14). These are, inter alia, that such subsidies " . . . shall not be used in a manner which causes serious prejudice to the trade or production another signatory," and that " . . . there shall be no presumption that export subsidies granted by developing country signatories result in adverse effects . . . to the trade and/or production of another signatory."

Yugoslavia may rightly say that since it has not ratified the subsidies code, it is not bound by it, but it cannot say that its subsidies have been approved by the GATT, nor can they convincingly say that its subsidies are in conformity with the subsidy code. However, we probably cannot say either that Yugoslavia is in contravention of GATT rules in any legal sense. In this connection, one should note that so far, no member country appears to have raised objections to its scheme.

Given the vagueness of rules and obligations under the GATT, we should probably be careful not to reason in terms of compliance or non-compliance with the GATT.

Attachment

cc:

Mr. Whittome
Mr. Anjaria
Ms. Ripley
Mr. Hansen
Mr. Lewis

Annex

ILLUSTRATIVE LIST OF EXPORT SUBSIDIES

(*a*) The provision by governments of direct subsidies to a firm or an industry contingent upon export performance.

(*b*) Currency retention schemes or any similar practices which involve a bonus on exports.

(*c*) Internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favourable than for domestic shipments.

(*d*) The delivery by governments or their agencies of imported or domestic products or services for use in the production of exported goods, on terms or conditions more favourable than for delivery of like or directly competitive products or services for use in the production of goods for domestic consumption, if (in the case of products) such terms or conditions are more favourable than those commercially available on world markets to their exporters.

(*e*) The full or partial exemption, remission, or deferral specifically related to exports, of direct taxes [1] or social welfare charges paid or payable by industrial or commercial enterprises. [2]

(*f*) The allowance of special deductions directly related to exports or export performance, over and above those granted in respect to production for domestic consumption, in the calculation of the base on which direct taxes are charged.

(*g*) The exemption or remission in respect of the production and distribution of exported products, of indirect taxes [1] in excess of those levied in respect of the production and distribution of like products when sold for domestic consumption.

(*h*) The exemption, remission or deferral of prior stage cumulative indirect taxes [1] on goods or services used in the production of exported products in excess of the exemption, remission or deferral of like prior stage cumulative indirect taxes on goods or services used in the production of like products when sold for domestic consumption; provided, however, that prior stage cumulative indirect taxes may be exempted, remitted or deferred on exported products even when not exempted, remitted or deferred on like products when sold for domestic consumption, if the prior stage cumulative indirect taxes are levied on goods that are physically incorporated (making normal allowance for waste) in the exported product. [3]

(*i*) The remission or drawback of import charges[1] in excess of those levied on imported goods that are physically incorporated (making normal allowance for waste) in the exported product; provided, however, that in particular cases a firm may use a quantity of home market goods equal to, and having the same quality and characteristics as, the imported goods as a substitute for them in order to benefit from this provision if the import and the corresponding export operations both occur within a reasonable time period, normally not to exceed two years.

(*j*) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the costs of exported products[4] or of exchange risk programmes, at premium rates, which are manifestly inadequate to cover the long-term operating costs and losses of the programmes.[5]

(*k*) The grant by governments (or special institutions controlled by and/or acting under the authority of governments) of export credits at rates below those which they actually have to pay for the funds so employed (or would have to pay if they borrowed on international capital markets in order to obtain funds of the same maturity and denominated in the same currency as the export credit), or the payment by them of all or part of the costs incurred by exporters or financial institutions in obtaining credits, in so far as they are used to secure a material advantage in the field of export credit terms.

Provided, however, that if a signatory is a party to an international undertaking on official export credits to which at least twelve original signatories[6] to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original signatories), or if in practice a signatory applies the interest rates provisions of the relevant undertaking, an export credit practice which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement.

(*l*) Any other charge on the public account constituting an export subsidy in the sense of Article XVI of the General Agreement.

NOTES

[1] For the purpose of this Agreement:

The term " direct taxes " shall mean taxes on wages, profits, interest, rents, royalties, and all other forms of income, and taxes on the ownership of real property;

The term " import charges " shall mean tariffs, duties, and other fiscal charges not elsewhere enumerated in this note that are levied on imports;

The term " indirect taxes " shall mean sales, excise, turnover, value added, franchise, stamp, transfer, inventory and equipment taxes, border taxes and all taxes other than direct taxes and import charges;

" Prior stage " indirect taxes are those levied on goods or services used directly or indirectly in making the product;

" Cumulative " indirect taxes are multi-staged taxes levied where there is no mechanism for subsequent crediting of the tax if the goods or services subject to tax at one stage of production are used in a succeeding stage of production;

" Remission " of taxes includes the refund or rebate of taxes.

Office Memorandum

December 22, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia: Revisions to Foreign Trade Data and Other Matters

According to data made available to the mission on the day before its departure, trade data for August-November 1983 have been revised (table attached). The revisions were explained by Mr. Milosevic as being due to errors in loading the basic data onto the computer at the Federal Bureau of Statistics.

Revision to export data were relatively small, but revisions to import data for August and September were substantial and may raise some questions as to the reliability of the official statistics. Overall, exports to the convertible area in the period January-November were reduced by US$28 million, and our export estimate of US$6,300 million is beginning to look somewhat optimistic. On the other hand, imports from the convertible currency area were reduced by US$161 million for the same period, and it appears highly unlikely that our present estimate of imports will materialize. Thus, even should our export estimate not be borne out, the trade balance is likely to register a better outturn than we have estimated thus far.

Unfortunately, the above estimates are not supported by foreign reserve movements. At the end of November, gross foreign reserves of the banking system amounted to US$1,680 million, or only US$15 million more than at the end of 1982. Although Yugoslavia has received some US$150 million in December as the last installment of fresh money from the commercial banks, this is unlikely to lead to any buildup in reserves as Yugoslavia usually incurs a reserve loss in December.

Arne B. Petersen
Exchange and Trade Relations Department

Table . Yugoslavia: Revision to Trade Data, 1983

(In millions of U.S. dollars)

Revisions to exports to the convertible area	Jan.-Aug.	Sept.	Oct.	Nov.	Jan.-Nov.	Dec. est.	Total Year
Revised data	3,914.4	525.6	520.0	509.4	5,469.4	930.6	6,400.0
Previous data	3,914.4	544.9	521.2	517.0	5,497.5	902.5	6,400.0
Change	--	-19.3	-1.2	-7.6	-28.1	28.1	--

Revisions to imports from the convertible area	Jan.-July	Aug.	Sept.	Oct.	Nov.	Jan.-Nov.	Dec. est.	Total year
Revised data	4,590.2	636.8	404.9	628.8	589.1	6,849.8	1,600.2	8,450.0
Previous data	4,590.2	794.4	404.9	633.4	588.0	7,010.9	1,439.1	8,450.0
Change	--	-157.6	--	-4.6	1.1	-161.1	161.1	--

Revisions to exports to non-convertible area	Jan.-Aug.	Sept.	Oct.	Nov.	Jan.-Nov.	Dec. est.	Total year
Revised data	2,257.3	263.6	272.3	289.7	3,082.9	567.1	3,650.0
Previous data	2,257.3	260.9	271.1	282.1	3,071.4	578.6	3,650.0
Change	--	2.7	1.2	7.6	11.5	-11.5	--

Revisions to imports from non-convertible area	Jan.-July	Aug.	Sept.	Oct.	Nov.	Jan.-Nov.	Dec. est.	Total year
Revised data	1,981.9	400.3	475.4	313.8	401.8	3,573.2	426.8	4,000.0
Previous data	1,981.9	242.7	591.5	309.2	402.0	3,527.3	472.7	4,000.0
Change	--	157.6	-116.1	4.6	-0.2	45.9	-45.9	--

cc: HOS
CED

EMBASSY OF SWITZERLAND
SCHWEIZERISCHE BOTSCHAFT
AMBASSADE DE SUISSE

WASHINGTON D.C. 20008, December 21, 1983
2900 Cathedral Avenue N.W.
Telephone 462-1811/7

Ref.: 523.0 SD (Jug.)-MA/hu

Pl copy to
Mr Mentré

Mr. L.A. Whittome
Director
European Department
I M F
700 19th Street, N.W.
Washington, D.C. 20431

Financial Assistance to Yugoslavia

Dear Mr. Whittome,

Please find enclosed a letter by State Secretary Probst, concerning the final approval by all participants of the conclusions which had been accepted ad referendum during the recent Geneva meeting.

Sincerely yours,

David de Pury
Minister

Encl.

cc: - Mr. Paul Mentre de Loye, Consultant, European Department, IMF, Washington, D.C.
- Mr. Arne B. Peterson, Exchange and Trade Relations Department, IMF, Washington, D.C.
- Mr. Donald J. Donovan, Exchange and Trade Relations Department, IMF, Washington, D.C.

RE: Financial Assistance to Yugoslavia

Dear Sir,

On November 23, I had submitted to you the conclusions of the Geneva Meeting concerning the procedures to be followed for 1984, conclusions which had been accepted ad referendum.

I should like to inform you that all participants in the Geneva Meeting have now confirmed to me the final approval of their authorities.

In their answers, some creditor countries have made additional comments regarding, first, the most appropriate dates for the meetings of the two working groups and, second, the question of the relation between the consolidation exercise and the approval by the Board of the IMF of the stand-by program for Yugoslavia.

As these points have been extensively discussed in Paris, on December 19, between the creditor countries and the chairmen of the two working groups, I do not think that it is necessary to come back to them in this letter.

Let me add, however, that one country, the United States, has also made a remark of a different nature. It noted that while the task of the first working group on consolidation was well defined, the agenda of the second working group was more open and suggested therefore that governments should be prepared to make recommendations to the chairman of that group on the issues to be raised. I leave it to you to decide whether you wish to send such recommendations to the chairman of the second working group, being understood that a draft agenda would be submitted, in due course, to all participants.

Yours sincerely,

Raymond Probst
State Secretary
Federal Department
of Foreign Affairs

DEC 22 1983

INTERNATIONAL MONETARY FUND

Dec. 21, 1983

TO : THE MANAGING DIRECTOR

FROM: WILLIAM B. DALE WBD

SUBJECT: Yugoslavia--Back-to-office Report

See V. 2

JR Dec. 27.83

There seems more realism re external targets now than was exhibited by the Yugoslavs in the recent meetings with banks. On the substance of the domestic program, however, there would still seem to be some distance to go.

Office Memorandum

→ KRQ 12/23

DEC 21 1983

To: The Managing Director
The Deputy Managing Director

December 21, 1983

From: Hans Schmitt HS

Subject: Yugoslavia - Back to Office Report

A staff team comprising Messrs. Hansen and Lewis (EUR), Mr. Petersen (ETR), Miss Smith (ADM) as secretary, and myself visited Belgrade from December 5 to 16, 1983 for negotiations on a one-year stand-by arrangement for 1984. Mr. Mentre (EUR) and Mr. Bery (IBRD) joined the mission for part of the period. The mission met with Mr. Dragan, Vice President of the Federal Executive Council, Mr. Makic, Governor of the National Bank of Yugoslavia, Mr. Veljkovic, Deputy Governor of the National Bank of Yugoslavia, and other officials.

After the first week of discussions the mission proposed to the authorities the attached draft letter of intent, which proved unacceptable to the Federal Executive Council and the Federal Parliament. Objections were strongest to the proposals for a reform of the foreign exchange allocation system, the interest rate hike and subsequent introduction of an interest rate formula, and the proposal to limit the payments from the Community of Interest for Foreign Economic Relations to export producers to no more than the customs duty drawback and to channel the excess into the Federal Government's blocked account. Accordingly, it was agreed to call a "time-out" and to resume negotiations on January 5, 1984, so as to give the Yugoslav authorities time to consider the proposals, and the staff a chance to consult in Washington.

The present draft letter contemplates seven performance criteria, as set out in detail in the Annexes to it, in addition to the normal consultation requirements and the requirement on payments restrictions. They set limits (i) on adjustments in nominal effective exchange rates; (ii) on the growth of foreign exchange reserves; (iii) on adjustments in nominal interest rates on deposits; (iv) on the growth of net domestic assets of the banking system; (v) on the net position of the public sector with the banking system; (vi) on the growth of public sector revenue; and (vii) on adjustments in administered prices.

1. The external targets for 1984

Recent developments in the external accounts have led the mission to revise the forecast for the current account with the convertible area in 1983 from a deficit of US$400 million at the time of the October mission to US$225 million now. The target for a current account surplus of US$500 million in 1984, which at the time of the October mission was considered very ambitious, now seems more attainable. The Yugoslavs estimate an even greater improvement in the current account in 1983 and still maintain as a target a surplus of US$800 million for 1984 (see Table 1 attached).

Developments in the capital balance have been much less satisfactory and the increase in reserves which had been targeted for 1983 did not materialize, mainly because of short-term capital outflows totalling close to US$1.5 billion. The necessity of measures to limit further outflows was stressed; these would contribute to an increase in reserves of at least US$500 million in 1984, to be made a performance criterion in the stand-by arrangement, with quarterly phasing.

On the financial package for 1984 there was some convergence of views (see Table 2 attached). The Yugoslav authorities agreed to seek new money from both governments and banks, in addition to a rollover of 100 percent of medium- and long-term maturities falling due in 1984. However, they made it clear that, mainly for reasons of cost, they were not prepared to use the same formula for fresh bank credit as last year. What they had in mind were new loans from a few big banks, perhaps in the form of trade-related financing or of cofinancing with the IBRD or EIB. They had not yet formed an opinion on the merits of a stand-by credit from commercial banks which had been mentioned at the ICC meetings in London on December 6. The authorities stressed that although they had an open mind as to the structure of the financial package, the total amount should be limited in view of the very important policy aim of reducing the overall indebtedness of Yugoslavia. There was some room for flexibility; a financial package of between US$3-3.5 billion would be acceptable, which at the higher end of the range would imply obtaining some new money.

The mission stressed once more that the size of the stand-by arrangement with the Fund would depend in part on the amount of new money obtained from governments and banks. Though aware of this link, the authorities expressed disappointment at the suggestion that the maximum amount might be limited to SDR 370 million, or approximately US$400 million, and entered a strong plea that the Fund raise the amount closer to US$500 million. We now propose that we stick with a minimum amount of SDR 270 million to cover repurchases, but that we go to a maximum of SDR 450 million if a financing package with new money is arranged and if agreement is reached on a program substantially as set out in the draft letter of intent.

Finally, in view of the seasonal drain on reserves expected in the first half of 1984 the mission stressed the possible need of again approaching the BIS for short-term bridging finance. The authorities showed little enthusiasm for this idea.

2. <u>The foreign exchange allocation system</u>

The mission's proposal on the reform of the foreign exchange allocation system is contained in paragraphs 5 and 6 of the draft letter of intent. The Yugoslav authorities claimed that this proposal would require excessive centralization of the management of foreign exchange. Their own proposals retained a three-tiered division of authority. A portion of the foreign exchange received would continue to be surrendered to the National Bank of Yugoslavia to satisfy certain national needs,

though it would henceforth be a single percentage for all exporters rather than several different ratios as at present. The remainder would be sold to commercial banks at the republican and provincial levels. However, groups of enterprises would through "self-management" agreements determine their own import requirements and be entitled to repurchase the foreign exchange needed to cover these. Any excess the commercial banks might retain would be traded in a "unified" market, with the National Bank as the balancing factor. The mission argued that these proposals would still entail excessive reliance on exchange rationing. We now propose to persist in asking for a total surrender requirement of foreign exchange receipts to the National Bank. We would stress again the safeguards already built into our proposal, viz., a flat 15 percent repurchase right to be charged against applications to make "authorized" payments abroad. We would add that criteria for "authorized" payments could be ratified by "self-management" agreements among firms, but would have to be uniform for the nation as a whole. Commercial banks could still establish positions abroad but on the basis of uniform rules agreed among them and with the National Bank.

3. Interest rates

The mission's proposal on interest rates is contained in paragraph 13 of the draft letter of intent, and in the memorandum of understanding on this subject attached to the letter of intent. The Yugoslav authorities agreed that the aim should be to establish positive real rates eventually. The mission insisted on a formula that would guarantee positive real rates from mid-1984; such a formula could be the subject of the usual "self-management" agreements among banks. The authorities argued that drastic changes over a short period would be very disruptive. They preferred to move to positive rates at the pace agreed with the World Bank, viz., by 1986 for some credits and 1987 or later for other credits. The mission stressed the urgency of decisive action to stem the short-term capital outflow, to support the reform of the foreign exchange allocation system, and to arrest the "dollarization" of the economy. We now propose to insist on basing interest rate policy on the proposed formula from the end of the first quarter of 1984, but to extend the period of adjustment to real positive rates to the end of the year. The phased adjustment could be achieved by quarterly reductions in the discrepancy between actual and target interest rates as now proposed. It could also be achieved by paying target interest rates to progressively more classes of depositors, first to exporters perhaps, adding other enterprises, workers' remittances, and finally all household accounts in quarterly stages.

4. Blocking of public revenue

The mission's proposal on blocking excess revenues of the Community of Interest for Foreign Economic Relations is contained in paragraph 17 of the draft letter of intent. It was apparently not well understood by the authorities and they did not argue over much against this

specific proposal. The main point they made was that a surplus in the public sector would withdraw resources from an already overburdened productive sector. The mission argued that the proposed measure would transfer part of export subsidies, which at the present exchange rate seemed excessive, to the benefit of the whole productive sector. It would do so by permitting a larger expansion of domestic credit outside the public sector.

5. Other matters

Other points of disagreement were more on language and on the exact implementation of policies rather than on the policy measures themselves. This was the case for exchange rate policy, for incomes and price policies, and for measures to limit public sector revenue. There was not much discussion of credit ceilings, as the actual numbers would depend on what interest rate policy was first to be agreed. The ceilings were to be defined on net domestic assets of the banking system adjusted for exchange rate changes. There was some objection to establishing a quarterly exchange reserves test, mainly because the authorities feared that showing a decline in reserves over the first two quarters would damage confidence abroad. The mission argued that showing this explicitly and at the same time explaining how this problem would be dealt with perhaps through BIS financing, might have the opposite effect.

Attachments

cc: Mr. Habermeier
Mr. Hood
Mr. Whittome
Mr. Finch
Mr. Mohammed
Mr. Nicoletopoulos
Mr. Van Houtven
Mr. Collins
Paris Ofice
Geneva Office

12.8.83

Table 1. Yugoslavia: Balance of Payments with the Convertible Currency Area, 1982-84

(In millions of U.S. dollars)

	1982	1983 Yugoslav estimate	1983 Alternative	1984 Yugoslav estimate	1984 Alternative
Exports	5,526	6,400	6,300	7,700	7,200
Imports	-9,043	8,450	-8,450	9,100	8,800
Trade balance	-3,517	-2,050	-2,150	-1,400	-1,600
Invisibles (net)	2,003	1,925	1,925	2,200	2,100
Workers' remittances	1,085	1,265	1,265	1,440	1,135
Tourism	1,224	1,335	1,335	1,080	1,510
Interest payments	-1,670	-1,690	-1,690	-1,840	-1,890
Others	1,364	1,015	1,015	1,520	1,345
Current account	-1,514	-125	-225	800	500
Medium- and long-term debt	-117	1,230	1,175	-20	190
Drawings	1,684	3,880	3,825	2,825	3,135
Repayments	-1,626	-2,450	-2,450	-2,645	-2,745
Loans extended	-175	-200	-200	-200	-200
Short-term debt	-506	-500	-600	--	--
Errors and omissions	562	-585	-750	--	-300
Total	-1,575	20	-350	-780	390
Use of Fund Credit	563	410	410	220	120
Reserve movements (increase -)	1,012	-430	-10	-1,000	-510

12.8.83

Table 2. Yugoslavia: Drawings on Medium- and Long-Term Debt in Convertible Currency by Creditor

(In millions of U.S. dollars)

	1983		1984	
	Yugoslav estimate	Alternative	Yugoslav estimate	Alternative
Government packages	839	831	1,006	1,100
Berne	839	831	456	350
Refinancing	(304)	(304)	(...)	(3)
New financial credits	(180)	(172)	(...)	(...)
Suppliers credits	(355)	(355)	(456)	(347)
Geneva	...	...	550	750
Refinancing	...	...	(400)	(500)
Suppliers credits	...	...	(150)	(250)
Commercial bank package	1,580	1,580	1,100	1,300
Refinancing	980	980	1,000	1,100
New financing	600	600	100	200
IBRD	320	350	530	485
Regular facilities	250	280	250	280
SAL	70	70	280	205
Other multilateral lenders IFC, EIB and Eurofima	30	50	... 1/	50
Suppliers credits outside Government packages	1,111	1,014	189	200
Subtotal	3,880	3,825	2,825	3,135
IMF	590	590	500	400
Total	4,470	4,415	3,325	3,535

1/ Included in drawings on the IBRD.

Dear Mr. de Larosière:

1. The stabilization program which we pursued over the last three years, and which was supported by a stand-by arrangement with the Fund, has begun to show substantial results. In particular, the deficit on external current account in convertible currencies narrowed from its peak in 1979 of US$3.3 billion to some US$0.2 billion in 1983. The improvement in the last year alone came to about US$1.2 billion. Some part of this improvement was due to a diversion of trade from the nonconvertible to the convertible currency areas, and to an undesirable compression of imports, neither of which can be continued in 1984. The underlying adjustment, nevertheless, will in our judgment permit a further improvement in the external current account to a surplus in 1984 of at least US$0.5 billion.

2. Developments in the external balance on capital account have been less satisfactory; as a result the increase in external reserves which we had targeted at the beginning of 1983 did not materialize. The most disappointing among the reasons for this outturn has been a swing in transitory items from a surplus of US$560 million to a deficit of perhaps as much as US$750 million, which more than offset the increase in export earnings in the course of last year. Apart from safeguarding the momentum of improvement in current transactions, therefore, our program for 1984 places particular emphasis on measures to improve the balance on capital account, so as to ensure an increase in official external reserves of at least US$500 million.

3. Final domestic demand was cut back by 4 percent in 1983, and though exports began to respond forcefully to the gain in competitiveness during the year, gross social product (GSP) still showed some decline. A further reduction in domestic demand will again be necessary for balance of payments reasons in 1984, but as exports continue their recovery we expect that any tendency for GSP to decline will be reversed. The program we have adopted to reach these objectives is set out below. In support of it we request, on behalf of the Federal Executive Council of the Socialist Federal Republic of Yugoslavia, a stand-by arrangement with the Fund in an amount equivalent to SDR ___ million.

The Exchange Rate

4. An active exchange rate policy was the pivot of our stabilization program last year. The depreciation of the dinar in real terms in the course of 1983 amounted to about 30 percent as measured in terms of relative producer prices, and to about the same in terms of relative unit labor cost. We believe that the level of competitiveness we have now achieved is adequate to permit a substantial liberalization of our trade and payments system without jeopardizing our external objectives. During 1984, therefore, the monthly depreciation of the dinar will reflect the difference only between the monthly rise in producer prices in Yugoslavia and that among her five major trading partners.

5. We have already acted to simplify the foreign exchange allocation system. Starting no later than the beginning of April 1984, all foreign exchange receipts by Yugoslav exporters of goods and services will be

surrendered to the National Bank of Yugoslavia, in exchange for dinar cash or deposits that earn competitive interest rates as specified in paragraph 13 below. The National Bank of Yugoslavia will sell foreign exchange through authorized banks to cover authorized payments abroad. Exporters will have the option of repurchasing foreign exchange at the going rate, uncontested, up to a limit of 15 percent of their sales of exchange; however, such amounts will be charged against applications to cover authorized payments requirements.

6. The expansion, in this manner, of the unified exchange market will in due course make the present law on payments of foreign debt in convertible currencies redundant. We have nevertheless decided to leave it in full effect. According to this law enterprises that cannot service their foreign debts from their own earnings abroad can progressively draw on their associated group of enterprises, their own bank, all banks in the republic or province where they reside, or on a pool established in the National Bank from contributions by enterprises throughout the country. With the new surrender requirement the continued operation of this system may be expected in time to mop up excess foreign exchange holdings outside the National Bank.

Incomes and Prices

7. The depreciation of the dinar contributed to raising the rate of price inflation from about 30 percent during 1982 to about 50 percent during 1983. The gains in competitiveness depended on restraining personal incomes from employment despite the rise in prices, and those incomes accordingly declined by more than 10 percent in real terms in 1983, or by 25 percent over the last

four years. Though further steep declines would now be unacceptable, we are determined that competitiveness be preserved, and that gains in real personal incomes should not exceed increases in productivity. As one means to restrain incomes we have provided that with effect from January 1984, any enterprise that has not met its obligations to creditors on time will pay personal incomes only up to a minimum guaranteed level.

8. Despite the strong incentives provided, the restructuring of the economy towards industries supplying external rather than purely internal markets has been delayed. Limiting personal income payments by loss-making enterprises should hasten the transfer of labor to more competitive activities, and we have therefore decided, with effect from April 1984, to extend that limitation to all enterprises receiving credits or subsidies under rehabilitation programs that have been in effect for more than one year. In addition, total payments into common reserve funds at the communal and republican levels will be kept to the same nominal level in 1984 as in 1983, thereby reducing the resources available for subsidization.

9. Greater progress needs to be achieved in adjusting domestic prices to allow potentially competitive enterprises to be financially viable. To this end we let the selective price freeze lapse last July despite the additional push to inflation that it entailed in the short run. The next major step was taken in January 1984 when last year's system of price control expired. We decided at that time to expand the proportion of industrial output free of price controls from 45 to 60 percent. An estimated 25 percent of industrial output will continue to have its prices

set by self-management agreements that can also be flexible. The remaining 15 percent remains subject to direct controls. The proportion of prices liberalized will not be allowed to shrink in the course of 1984.

10. Controlled prices on key intermediate products are progressively being raised to economic levels. By the end of January 1984 we will have adhered to our undertakings with the World Bank to raise average electricity tariffs by 15 percent in real terms over their March 1983 level, and average railway tariffs by at least 10 percent in real terms over their end-December 1982 levels. Further real increases will follow in due course. Until then we are requiring at least quarterly increases in nominal prices to match increases in the producer price index. We have also agreed with the World Bank to introduce real increases in natural gas prices at least twice a year, towards achieving parity with world market prices by 1987. The domestic price of crude oil has already reached that level.

Monetary Policy

11. Much of the restraint on domestic demand in 1983 was achieved by severely restrictive monetary and credit policies. Thus, while the real stock of broad money (M2) had remained roughly constant during 1982, it is estimated to have declined during 1983 by about 7 percent. This result was in part due to a rate of inflation which, at 50 percent, turned out higher than had originally been assumed. A certain degree of flexibility was provided by the exclusion of valuation changes on net foreign liabilities, and on foreign exchange deposits, from the ceilings on net domestic assets by which monetary policy was defined, but not enough to wash out the restrictive effect of inflation altogether.

12. The accleration of inflation last year also frustrated our efforts to raise interest rates on dinar deposits to positive levels in real terms. Nominal rates on such deposits were increased last February, and again to 30 percent at the end of December, but these increases still left them significantly negative in real terms. By contrast the yield on foreign currency deposits, inclusive of valuation adjustments, rose by substantially more, and the share of such deposits in broad money accordingly increased from 32 percent at the end of 1982 to 40 percent at present. Approximately the same yield differential also provided a powerful incentive to keep money abroad altogether, and supplies a large part of the explanation for the swing from an inflow to an outflow on transitory items in the balance of payments.

13. A decisive move is clearly overdue to raise nominal interest rates on dinar deposits to competitive levels. The percentage difference between them and the yield on comparable foreign exchange deposits at the end of December 1983, including valuation changes, will be halved by the end of March 1984 and eliminated altogether by the end of June 1984, after which it will be adjusted monthly to maintain exact parity between the two. The discount rate and other lending rates of the National Bank will follow after an initial increase by 10 percentage points on January 15, 1984. In the process the interest differential will also shrink between unsubsidized and subsidized credit.

14. Because of the uncertainty regarding inflation, we have chosen to define our monetary ceilings again in terms of the net domestic assets of

the banking system, excluding valuation changes on net foreign liabilities and on foreign currency deposits. In fixing them for 1984 we have also taken into account the probable effect of interest rate increases on the demand for money. On this basis we calculate the ceiling for end-December 1984 at Din billion compared with Din billion a year earlier. There will be a quarterly phasing of the increase through the year. Within each total, allowance will be made for the planned increases, described below, in the net position of the public sector with the banking system.

Public Finance

15. Public finance also contributed substantially to the restraint of domestic demand in 1983. To be sure we had hoped to limit the growth of total public sector revenues, and hence roughly of expenditures also, to 20 percent in nominal terms in 1983. In the event they rose by over 30 percent. In real terms, nevertheless, public sector revenue declined by about 5 percent compared with a decline of less than 3 percent the year before. More significant reductions in revenue and expenditure in the face of rapidly accelerating inflation would have been difficult to implement particularly at the federal level. As it was, a large part of the austerity concentrated on real personal incomes paid by all levels of government.

16. For 1984 limits have again been placed on the growth of public sector revenue to ensure a continued decline in the relative size of that sector in the economy. The growth rate of total public sector revenue will be restricted to four fifths of the percentage increase in the retail price index. To tighten control, limits have been placed on the cumulative

quarterly revenue of the public sector. In order that expenditures, at least at the federal level, will be constrained by this means, we have specified a floor of Din billion for the increase in the net position of the public sector with the National Bank of Yugoslavia between December 31, 1984 and a year earlier, and have phased it quarterly through the year. That increase is to be blocked until the end of 1986.

17. A similar plan to freeze excess fiscal revenue at the National Bank of Yugoslavia in 1983 yielded less than had been planned. For 1984 we have decided to limit overall payments from the Community of Interest for Foreign Economic Relations to export producers to no more than the customs duty drawback, and to channel the excess into the Federal Government's blocked account. Given their competitive position exporters need no special incentives. The accumulation of public sector deposits with the banking system will, on the other hand, release significant amounts of credit to other productive enterprises, within the overall credit ceilings established for balance of payments reasons.

18. A restructuring of our tax system came into effect in January 1984. A main objective was to include in its coverage household incomes other than from employment in the social sector. In particular, interest earned on all financial assets, including capital gains on foreign currency bank deposits, are now subject to a 10 percent withholding tax. Also, the minimum taxable household income was reduced by a third, and rates of taxation on agricultural income, on inheritance, and on property were increased. These increases in the taxation of household incomes have made

it possible to reduce the tax burden on enterprise incomes proportionately more than the general reduction in taxation would already have allowed.

External Debt

19. We expect by these various measures to reach, and even to exceed, our external current account objectives and also to improve our performance on capital account. We are determined to begin reducing our external debt as soon as possible. Gross borrowing last year came to the equivalent of US$4.4 billion; we expect to limit our requirements this year to US$3.5 billion. To secure this amount we have again entered into arrangements with a group of creditor governments and banks to roll over debt falling due, and to provide a limited amount of fresh money to build up the reserves. We will make the quarterly build-up of our reserves, by a total of US$500 million, a test of the success of our program.

20. Despite the scarcity of resources a certain outflow of capital from Yugoslavia is normal and acceptable. However, the outflow in 1983 of roughly US$1.5 billion was clearly excessive. We will spare no effort to reduce this flow to about US$500 million in 1984, and to cover it by an equivalent surplus on current account in convertible currencies. One central element in achieving this reduction in capital outflows is our move to an active interest rate policy. In addition, we have intensified the controls on the repatriation of export earnings. Thus, if exporters fail to repatriate export proceeds within 90 days their credit line for that export will be withdrawn.

21. We have also decided to facilitate an accelerated draw-down on external lines of credit particularly on the supplier credits granted by the Berne group of governments. The administrative regulations governing their utilization proved too restrictive in 1983. In order to ensure the availability of foreign exchange to repay the foreign credits, drawings have been made available only to exporters who have proof of export orders in hand, and raw material imports financed by suppliers credits have had to amount to less than 50 percent of the value of the export into which they entered. In time for the reform of the foreign exchange allocation system on April 1, 1984, we will have broken the close link between imports and exports in the allocation of external credits, so as to allow the financing of imports of more general interest to the economy.

Other Matters

22. The Federal Executive Council of Yugoslavia do not intend to introduce any multiple currency practices or introduce new or intensify existing restrictions on payments and transfers for international transactions or enter into any bilateral payments arrangements with Fund members. A 10 percent premium for tourists paying in dinar-denominated travelers checks has been approved by the Fund until February 28, 1984 and shall have been eliminated by that date. The Federal Executive Council do not intend to introduce new restrictions or intensify existing restrictions on imports for balance of payments reasons.

23. The Federal Executive Council believe that the policies set forth in this letter are adequate to achieve the objectives of its program but will

take any additional measures that may have become appropriate for this purpose. The Yugoslav authorities will review economic developments in 1984 with the staff of the Fund on a quarterly basis. They will consult with the Fund as soon as is practicable after the middle of the year, and in any case not later than August 15, 1984 to agree with the Fund on any modifications in the performance criteria that may be called for. Finally, the Federal Executive Council will consult with the Fund, in accordance with the Fund's policies on consultations, on the adoption of any measures that may become appropriate.

Sincerely,

Agreed Memorandum of Understanding

Subject: Technical Note on the Calculation of the Index of the Exchange Rate

For the purpose of adjusting the nominal effective exchange rate, it is understood that, consistent with the National Bank of Yugoslavia's methodology for calculating the real exchange rate:

(i) The real exchange rate of the dinar is expressed as 0.39 (deutsche mark per dinar) plus 0.24 (Italian lire per dinar) plus 0.18 (U.S. dollars per dinar) plus 0.13 (French francs per dinar) plus 0.06 (Austrian schillings per dinar), with a base of December 31, 1983 equal to 100 for each bilateral exchange rate of the dinar, multiplied by the ratio of an index of the movement in Yugoslavia's industrial producer prices to a weighted index of the movements in industrial prices in the foregoing five countries as specified in section (iii) below. The index of the real exchange rate of the dinar, with a base of December 31, 1983 equal to 100, will be no higher than 100 at the end of each of the 12 months in 1984. /A margin of error of 1 percentage point will be acceptable./

(ii) The index of Yugoslavia's industrial producer prices is the ratio of the price index for the most recent month that is available as of the 15th of each month to the index in the base period which is chosen so as to make the price change cover the same number of months as will have elapsed since December 31, 1983.

(iii) The weighted index of industrial producer prices in the foregoing five countries is defined as 0.39 (index of German prices for industrial products) plus 0.24 (index of Italian wholesale prices) plus 0.18 (index of U.S. wholesale prices for industrial goods) plus 0.13 (index of French prices of industrial goods) plus 0.06 (index of Austrian wholesale prices) with the index for each country expressed as the ratio of the price index for the most recent month that is available as of the 15th of each month to the price index in the base period which is chosen so as to make the price change cover the same number of months as will have elapsed since December 31, 1983.

(iv) Exchange rate and price data used in the calculation of the index of the real exchange rate will be consistent with those published in IMF, International Financial Statistics. No later than 10 days after the end of each month, the following data as of the end of the month will be telexed to the Fund: dinar exchange rates of each of the five foreign currencies, and the indices of the nominal exchange rate, the real exchange rate, Yugoslav industrial producer prices, the weighted average of five foreign industrial price indices, and relative industrial prices, where each index is expressed with a base of December 31, 1983 equal to 100.

Agreed Memorandum of Understanding

Subject: Technical Note on Interest Rates of the Yugoslav Banking System

1. It is agreed that the difference as of January 1, 1984 between the nominal interest rate on dinar deposits of households and enterprises and the yield (including valuation changes) on foreign currency deposits of households, both in the case of sight deposits and in the case of 12-month deposits, will be halved by April 15, 1984 and eliminated by July 15, 1984, after which time interest rates will be adjusted monthly to maintain parity between the two types of deposits. The yield (Y) on foreign exchange deposits, in percent per annum, is defined as

$$Y = 100 \left[\left(1 + \frac{R}{100}\right) X^4 - 1 \right]$$

where R is the nominal interest rate on foreign currency deposits in percent per annum, and X is the ratio of the nominal exchange rate index on a given date to the nominal exchange rate index three months earlier, with each index calculated consistent with the National Bank of Yugoslavia's methodology and expressed in terms of dinars per unit of foreign currency. Accordingly, the nominal rate (R1) on dinar deposits at the end of March 1984 will be increased by $\frac{(Y1 - R1)}{2}$ percentage points by April 15, 1984 (Y1 is the yield on foreign exchange deposits at the end of March 1984), and the nominal rate (R2) on dinar deposits at the end of June 1984 will be increased by (Y2 - R2) percentage points on July 15, 1984 (Y2 is the yield on foreign exchange deposits at the end of June 1984). By the 15th of each subsequent month,

beginning August 15, 1984, the nominal rate (R) for dinar deposits will be adjusted so as to be at least as large as the yield (Y) on foreign exchange deposits at the end of the preceding month.

Further, it is agreed that interest rates on other bank deposits will be adjusted in line with interest rates determined according to the formula described above.

2. It is agreed that the discount rate of the National Bank of Yugoslavia will be increased to 40 percent by January 15, 1984 and on April 15, 1984, brought into equality with the yield on one-year foreign currency deposits of households as of the end of March 1984 determined according to the formula in paragraph 1. On the 15th of each subsequent month, beginning May 15, 1984, the discount rate at the end of the previous month will be adjusted to reflect the yield on one-year foreign exchange deposits of households at the end of that month.

Further, it is agreed that interest rates for selective credits of the National Bank of Yugoslavia will be increased by 10 percentage points by January 15, 1984. Adjustments bz April 15, 1984 and by the 15th of each subsequent month will be the same, in percentage points, as the contemporaneous adjustment of the discount rate of the National Bank of Yugoslavia.

Agreed Memorandum of Understanding

Subject: Technical Note on Public Sector Revenue Ceiling

Public sector revenue for the purpose of this ceiling is defined to comprise revenue of sociopolitical communities plus revenue for collective consumption, which totalled Din 891.667 billion in 1982 and Din 813.764 billion in January-September 1983. Cumulative quarterly limits on public sector revenue will apply for the periods shown below and will be calculated such that the percentage increase in public sector revenue over the corresponding period of the preceding year will be no more than 80.0 percent of the percentage increase in the retail price index over a similar period of time but with a lag of one quarter, as shown below. A margin of error of Din 2.0 billion will be acceptable.

	Periods for which the Percentage Increases in Public Sector Revenue and the Retail Price Index Shall be Calculated	
	Public Sector Revenue	Retail Price Index
First quarter	Jan.-March 1984 / Jan.-March 1983	Oct.-Dec. 1983 / Oct.-Dec. 1982
Second quarter	Jan.-June 1984 / Jan.-June 1983	Average (6 mos. to March 1984) / Average (6 mos. to March 1983)
Third quarter	Jan.-Sept. 1984 / Jan.-Sept. 1983	Average (9 mos. to June 1984) / Average (9 mos. to June 1983)
Fourth quarter	Jan.-Dec. 1984 / Jan.-Dec. 1983	Average (12 mos. to Sept. 1984) / Average (12 mos. to Sept. 1983)

Technical Note on the Balance of Payments Test

The aim of the program is to achieve an increase in the combined reserves of the National Bank of Yugoslavia and the commercial banks of at least US$500 million during 1984. Given the seasonal pattern of the receipts from services and to some extent from exports, the balance of payments is likely to record an overall deficit during the first half of 1984. Nevertheless reserves which are estimated to reach the level of US$1,685 million at the end of 1983 will not be allowed to fall below the level of US$ /‾ . _7 million during the first quarter of 1984 and shall increase to US$ /‾ _7 million by the end of June 1984. Reserves are likely to increase to US$ /‾ _7 million by the end of September 1983 and to US$ /‾ . _7 million by the end of 1983. For the purpose of this calculation any net increase in short-term debt during the period December 31, 1983 to the date in question will be excluded.

ANNEX V

Agreed Memorandum of Understanding

Subject: Technical Note on Price Adjustments

1. By the end of January 1984 electricity tariffs will have been increased to a level such that, on average, they are at least 15 percent higher than the average electricity tariff at the end of March 1983 multiplied by the index of industrial producer prices for December 1983, expressed with a base of March 1983 equal to 100.

2. By the end of January 1984, railway tariffs will have been increased such that, on average, they are at least 10 percent higher than the average level of railway tariffs at the end of December 1982 multiplied by the index of industrial producer prices for December 1983, expressed with a base of December 1982 equal to 100.

3. Additional adjustments will be made to the entire structures of electricity tariffs and railway tariffs such that all of these tariffs, including the various sets of electricity rates applicable to different periods of the year, will be increased from the tariffs established as of January 31, 1984 at least by the percentage increase in the industrial producer price index during the first three months of 1984, no later than the end of April 1984; at least by the percentage increase in this price index during the first six months of 1984, no later than the end of July 1984; and at least by the percentage increase in this price index during the first nine months of 1984, no later than the end of October 1984.

4. The average prices of domestic natural gas, of crude petroleum and of petroleum products (including gasoline, kerosene, diesel oil, fuel oil and LPG) will be increased on a quarterly basis by no less than the percentage increase in the dinar/U.S. dollar exchange rate in the course of 1984, as shown below.

Minimum Percentage Increase in Each of the Domestic Natural Gas, Crude Petroleum, and Petroleum Products Prices Over Those in Effect as of January 31, 1984

Equal to the Percentage Increase in the Exchange Rate, Dinars Per U.S. Dollar, from December 31, 1983 Until:	To be Made Effective No Later Than:
March 31, 1984	April 30, 1984
June 30, 1984	July 31, 1984
September 30, 1984	October 31, 1984

5. A record of the price increases stipulated in paragraphs 1-4 will be published, as they take place, in the Official Gazette of the Socialist Federal Republic of Yugoslavia.

Agreed Memorandum of Understanding

Subject: Technical Note on Domestic Assets of the Yugoslav Banking System

The banking system for the purposes of this ceiling is defined as the consolidated accounts of the national banks and the basic and associated banks. The net domestic assets (NDA) of the abovementioned banks are calculated to equal the sum of the following items in the monetary survey:

	End-September 1983 (In billions of dinars)
Net foreign liabilities	1,004
Plus M2 (money + quasi-money)	2,641
Net domestic assets	3,645

In setting the ceiling for NDA the effects of changes in the exchange rate on net foreign liabilities of the banking system, and on foreign currency liabilities which are included in quasi-money, are excluded by applying a valuation adjustment (cumulative from end-December 1983) to the relevant data.

It is understood that the foreign exchange proceeds of any special assistance will be shown both as an asset and a foreign exchange liability of the National Bank of Yugoslavia.

It is agreed that NDA for the end of December 1984 shall not exceed Din /‾ _/ billion compared with an estimated level of Din /‾ _/ billion at end-December 1983. Further, the authorities will ensure that NDA will not exceed the ceilings established in Table 1 below, or allow the net position of public sector with the banking system to fall below the floors shown in Table 1.

Table 1. Yugoslavia: Credit Ceilings and Floors for the Net Position of the Public Sector with the Banking System

(In billions of dinars)

		Net Domestic Assets of the Banking System	Net Position of the Public Sector with the Banking System
1984	January-March 1/	[ ]	--
	March 2/	[ ]	[ ]
	April-June 1/	[ ]	--
	June 2/	[ ]	[ ]
	July-September 1/	[ ]	--
	September 2/	[ ]	[ ]

1/ Average end of month data.
2/ End-month data.

Office Memorandum

DEC 21 1983

TO : The Managing Director

DATE: December 21, 1983

FROM : L.A. Whittome

SUBJECT : Yugoslavia

In his back-to-office report of today's date Mr. Schmitt makes a number of proposals. I believe that they are acceptable subject to the following understandings:

1. The foreign exchange allocation system

The foreign exchange holdings in convertible currencies of the commercial banks should not represent more than working balances and this should ~~if necessary~~ be safeguarded by limits on both spot and spot against forward transactions. These limits should be known to the mission.

yes

2. Interest rates

yes

The phased adjustment should not be back loaded; if possible it should be front loaded.

3. Public finance

To be effective the approach needs to ensure that a given sum be blocked in quarterly instalments through 1984. This blocked sum should be of an amount that would in itself make the program cohesive without any allowance for any additional sums that might be blocked as a result of the requirements governing revenues and expenditures.

?

4. Official reserves

It is essential that an effective reserves test be incorporated otherwise we have no basis on ~~which to~~ argue with others for a build up of reserves.

yes

Mr. Schmitt tells me that he had indeed intended his proposals to be read in this way.

cc: The Deputy Managing Director
Mr. Collins

DMD

Office Memorandum

To: The Managing Director
The Deputy Managing Director

December 21, 1983

From: Hans Schmitt

Subject: Yugoslavia - Back to Office Report

A staff team comprising Messrs. Hansen and Lewis (EUR), Mr. Petersen (ETR), Miss Smith (ADM) as secretary, and myself visited Belgrade from December 5 to 16, 1983 for negotiations on a one-year stand-by arrangement for 1984. Mr. Mentre (EUR) and Mr. Bery (IBRD) joined the mission for part of the period. The mission met with Mr. Dragan, Vice President of the Federal Executive Council, Mr. Makic, Governor of the National Bank of Yugoslavia, Mr. Veljkovic, Deputy Governor of the National Bank of Yugoslavia, and other officials.

After the first week of discussions the mission proposed to the authorities the attached draft letter of intent, which proved unacceptable to the Federal Executive Council and the Federal Parliament. Objections were strongest to the proposals for a reform of the foreign exchange allocation system, the interest rate hike and subsequent introduction of an interest rate formula, and the proposal to limit the payments from the Community of Interest for Foreign Economic Relations to export producers to no more than the customs duty drawback and to channel the excess into the Federal Government's blocked account. Accordingly, it was agreed to call a "time-out" and to resume negotiations on January 5, 1984, so as to give the Yugoslav authorities time to consider the proposals, and the staff a chance to consult in Washington.

The present draft letter contemplates seven performance criteria, as set out in detail in the Annexes to it, in addition to the normal consultation requirements and the requirement on payments restrictions. They set limits (i) on adjustments in nominal effective exchange rates; (ii) on the growth of foreign exchange reserves; (iii) on adjustments in nominal interest rates on deposits; (iv) on the growth of net domestic assets of the banking system; (v) on the net position of the public sector with the banking system; (vi) on the growth of public sector revenue; and (vii) on adjustments in administered prices.

1. The external targets for 1984

Recent developments in the external accounts have led the mission to revise the forecast for the current account with the convertible area in 1983 from a deficit of US$400 million at the time of the October mission to US$225 million now. The target for a current account surplus of US$500 million in 1984, which at the time of the October mission was considered very ambitious, now seems more attainable. The Yugoslavs estimate an even greater improvement in the current account in 1983 and still maintain as a target a surplus of US$800 million for 1984 (see Table 1 attached).

Developments in the capital balance have been much less satisfactory and the increase in reserves which had been targeted for 1983 did not materialize, mainly because of short-term capital outflows totalling close to US$1.5 billion. The necessity of measures to limit further outflows was stressed; these would contribute to an increase in reserves of at least US$500 million in 1984, to be made a performance criterion in the stand-by arrangement, with quarterly phasing.

On the financial package for 1984 there was some convergence of views (see Table 2 attached). The Yugoslav authorities agreed to seek new money from both governments and banks, in addition to a rollover of 100 percent of medium- and long-term maturities falling due in 1984. However, they made it clear that, mainly for reasons of cost, they were not prepared to use the same formula for fresh bank credit as last year. What they had in mind were new loans from a few big banks, perhaps in the form of trade-related financing or of cofinancing with the IBRD or EIB. They had not yet formed an opinion on the merits of a stand-by credit from commercial banks which had been mentioned at the ICC meetings in London on December 6. The authorities stressed that although they had an open mind as to the structure of the financial package, the total amount should be limited in view of the very important policy aim of reducing the overall indebtedness of Yugoslavia. There was some room for flexibility; a financial package of between US$3-3.5 billion would be acceptable, which at the higher end of the range would imply obtaining some new money.

The mission stressed once more that the size of the stand-by arrangement with the Fund would depend in part on the amount of new money obtained from governments and banks. Though aware of this link, the authorities expressed disappointment at the suggestion that the maximum amount might be limited to SDR 370 million, or approximately US$400 million, and entered a strong plea that the Fund raise the amount closer to US$500 million. We now propose that we stick with a minimum amount of SDR 270 million to cover repurchases, but that we go to a maximum of SDR 450 million if a financing package with new money is arranged and if agreement is reached on a program substantially as set out in the draft letter of intent.

This has to be checked with ETR in the light of our advice of policies and my own comments on your initial brief. The circumstances very [illegible] 450 seems [illegible]

Finally, in view of the seasonal drain on reserves expected in the first half of 1984 the mission stressed the possible need of again approaching the BIS for short-term bridging finance. The authorities showed little enthusiasm for this idea.

2. The foreign exchange allocation system

The mission's proposal on the reform of the foreign exchange allocation system is contained in paragraphs 5 and 6 of the draft letter of intent. The Yugoslav authorities claimed that this proposal would require excessive centralization of the management of foreign exchange. Their own proposals retained a three-tiered division of authority. A portion of the foreign exchange received would continue to be surrendered to the National Bank of Yugoslavia to satisfy certain national needs,

though it would henceforth be a single percentage for all exporters rather than several different ratios as at present. The remainder would be sold to commercial banks at the republican and provincial levels. However, groups of enterprises would through "self-management" agreements determine their own import requirements and be entitled to repurchase the foreign exchange needed to cover these. Any excess the commercial banks might retain would be traded in a "unified" market, with the National Bank as the balancing factor. The mission argued that these proposals would still entail excessive reliance on exchange rationing. We now propose to persist in asking for a total surrender requirement of foreign exchange receipts to the National Bank. We would stress again the safeguards already built into our proposal, viz., a flat 15 percent repurchase right to be charged against applications to make "authorized" payments abroad. We would add that criteria for "authorized" payments could be ratified by "self-management" agreements among firms, but would have to be uniform for the nation as a whole. Commercial banks could still establish positions abroad but on the basis of uniform rules agreed among them and with the National Bank.

3. Interest rates

The mission's proposal on interest rates is contained in paragraph 13 of the draft letter of intent, and in the memorandum of understanding on this subject attached to the letter of intent. The Yugoslav authorities agreed that the aim should be to establish positive real rates eventually. The mission insisted on a formula that would guarantee positive real rates from mid-1984; such a formula could be the subject of the usual "self-management" agreements among banks. The authorities argued that drastic changes over a short period would be very disruptive. They preferred to move to positive rates at the pace agreed with the World Bank, viz., by 1986 for some credits and 1987 or later for other credits. The mission stressed the urgency of decisive action to stem the short-term capital outflow, to support the reform of the foreign exchange allocation system, and to arrest the "dollarization" of the economy. We now propose to insist on basing interest rate policy on the proposed formula from the end of the first quarter of 1984, but to extend the period of adjustment to real positive rates to the end of the year. The phased adjustment could be achieved by quarterly reductions in the discrepancy between actual and target interest rates as now proposed. It could also be achieved by paying target interest rates to progressively more classes of depositors, first to exporters perhaps, adding other enterprises, workers' remittances, and finally all household accounts in quarterly stages.

4. Blocking of public revenue

The mission's proposal on blocking excess revenues of the Community of Interest for Foreign Economic Relations is contained in paragraph 17 of the draft letter of intent. It was apparently not well understood by the authorities and they did not argue over much against this

though it would henceforth be a single percentage for all exporters rather than several different ratios as at present. The remainder would be sold to commercial banks at the republican and provincial levels. However, groups of enterprises would through "self-management" agreements determine their own import requirements and be entitled to repurchase the foreign exchange needed to cover these. Any excess the commercial banks might retain would be traded in a "unified" market, with the National Bank as the balancing factor. The mission argued that these proposals would still entail excessive reliance on exchange rationing. We now propose to persist in asking for a total surrender requirement of foreign exchange receipts to the National Bank. We would stress again the safeguards already built into our proposal, viz., a flat 15 percent repurchase right to be charged against applications to make "authorized" payments abroad. We would add that criteria for "authorized" payments could be ratified by "self-management" agreements among firms, but would have to be uniform for the nation as a whole. Commercial banks could still establish positions abroad but on the basis of uniform rules agreed among them and with the National Bank.

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4. Blocking of public revenue

The mission's proposal on blocking excess revenues of the Community of Interest for Foreign Economic Relations is contained in paragraph 17 of the draft letter of intent. It was apparently not well understood by the authorities and they did not argue over much against this

specific proposal. The main point they made was that a surplus in the public sector would withdraw resources from an already overburdened productive sector. The mission argued that the proposed measure would transfer part of export subsidies, which at the present exchange rate seemed excessive, to the benefit of the whole productive sector. It would do so by permitting a larger expansion of domestic credit outside the public sector.

5. Other matters

Other points of disagreement were more on language and on the exact implementation of policies rather than on the policy measures themselves. This was the case for exchange rate policy, for incomes and price policies, and for measures to limit public sector revenue. There was not much discussion of credit ceilings, as the actual numbers would depend on what interest rate policy was first to be agreed. The ceilings were to be defined on net domestic assets of the banking system adjusted for exchange rate changes. There was some objection to establishing a quarterly exchange reserves test, mainly because the authorities feared that showing a decline in reserves over the first two quarters would damage confidence abroad. The mission argued that showing this explicitly and at the same time explaining how this problem would be dealt with perhaps through BIS financing, might have the opposite effect.

Attachments

cc: Mr. Habermeier
Mr. Hood
Mr. Whittome
Mr. Finch
Mr. Mohammed
Mr. Nicoletopoulos
Mr. Van Houtven
Mr. Collins
Paris Ofice
Geneva Office

12.8.83

Table 1. Yugoslavia: Balance of Payments with the Convertible Currency Area, 1982-84

(In millions of U.S. dollars)

		1983		1984	
	1982	Yugoslav estimate	Alternative	Yugoslav estimate	Alternative
Exports	5,526	6,400	6,300	7,700	7,200
Imports	-9,043	8,450	-8,450	9,100	8,800
Trade balance	-3,517	-2,050	-2,150	-1,400	-1,600
Invisibles (net)	2,003	1,925	1,925	2,200	2,100
Workers' remittances	1,085	1,265	1,265	1,440	1,135
Tourism	1,224	1,335	1,335	1,080	1,510
Interest payments	-1,670	-1,690	-1,690	-1,840	-1,890
Others	1,364	1,015	1,015	1,520	1,345
Current account	-1,514	-125	-225 (400)	800	500
Medium- and long-term debt	-117	1,230	1,175	-20	190
Drawings	1,684	3,880	3,825	2,825	3,135
Repayments	-1,626	-2,450	-2,450	-2,645	-2,745
Loans extended	-175	-200	-200	-200	-200
Short-term debt	-506	-500	-600	--	--
Errors and omissions	562	-585	-750	--	-300
Total	-1,575	20	-350	-780	390
Use of Fund Credit	563	410	410	220	120
Reserve movements (increase -)	1,012	-430	-10	-1,000	-510

Table 2. Yugoslavia: Drawings on Medium- and Long-Term Debt in Convertible Currency by Creditor

(In millions of U.S. dollars)

	1983		1984	
	Yugoslav estimate	Alternative	Yugoslav estimate	Alternative
Government packages	839	831	1,006	1,100
Berne	839	831	456	350
Refinancing	(304)	(304)	(...)	(3)
New financial credits	(180)	(172)	(...)	(...)
Suppliers credits	(355)	(355)	(456)	(347)
Geneva	...	...	550	750
Refinancing	...	...	(400)	(500)
Suppliers credits	...	...	(150)	(250)
Commercial bank package	1,580	1,580	1,100	1,300
Refinancing	980	980	1,000	1,100
New financing	600	600	100	200
IBRD	320	350	530	485
Regular facilities	250	280	250	280
SAL	70	70	280	205
Other multilateral lenders IFC, EIB and Eurofima	30	50	... 1/	50
Suppliers credits outside Government packages	1,111	1,014	189	200
Subtotal	3,880	3,825	2,825	3,135
IMF	590	590	500	400
Total	4,470	4,415	3,325	3,535

1/ Included in drawings on the IBRD.

Dear Mr. de Larosière:

1. The stabilization program which we pursued over the last three years, and which was supported by a stand-by arrangement with the Fund, has begun to show substantial results. In particular, the deficit on external current account in convertible currencies narrowed from its peak in 1979 of US$3.3 billion to some US$0.2 billion in 1983. The improvement in the last year alone came to about US$1.2 billion. Some part of this improvement was due to a diversion of trade from the nonconvertible to the convertible currency areas, and to an undesirable compression of imports, neither of which can be continued in 1984. The underlying adjustment, nevertheless, will in our judgment permit a further improvement in the external current account to a surplus in 1984 of at least US$0.5 billion.

2. Developments in the external balance on capital account have been less satisfactory; as a result the increase in external reserves which we had targeted at the beginning of 1983 did not materialize. The most disappointing among the reasons for this outturn has been a swing in transitory items from a surplus of US$560 million to a deficit of perhaps as much as US$750 million, which more than offset the increase in export earnings in the course of last year. Apart from safeguarding the momentum of improvement in current transactions, therefore, our program for 1984 places particular emphasis on measures to improve the balance on capital account, so as to ensure an increase in official external reserves of at least US$500 million.

3. Final domestic demand was cut back by 4 percent in 1983, and though exports began to respond forcefully to the gain in competitiveness during the year, gross social product (GSP) still showed some decline. A further reduction in domestic demand will again be necessary for balance of payments reasons in 1984, but as exports continue their recovery we expect that any tendency for GSP to decline will be reversed. The program we have adopted to reach these objectives is set out below. In support of it we request, on behalf of the Federal Executive Council of the Socialist Federal Republic of Yugoslavia, a stand-by arrangement with the Fund in an amount equivalent to SDR ___ million.

The Exchange Rate

4. An active exchange rate policy was the pivot of our stabilization program last year. The depreciation of the dinar in real terms in the course of 1983 amounted to about 30 percent as measured in terms of relative producer prices, and to about the same in terms of relative unit labor cost. We believe that the level of competitiveness we have now achieved is adequate to permit a substantial liberalization of our trade and payments system without jeopardizing our external objectives. During 1984, therefore, the monthly depreciation of the dinar will reflect the difference only between the monthly rise in producer prices in Yugoslavia and that among her five major trading partners.

5. We have already acted to simplify the foreign exchange allocation system. Starting no later than the beginning of April 1984, all foreign exchange receipts by Yugoslav exporters of goods and services will be

surrendered to the National Bank of Yugoslavia, in exchange for dinar cash or deposits that earn competitive interest rates as specified in paragraph 13 below. The National Bank of Yugoslavia will sell foreign exchange through authorized banks to cover authorized payments abroad. Exporters will have the option of repurchasing foreign exchange at the going rate, uncontested, up to a limit of 15 percent of their sales of exchange; however, such amounts will be charged against applications to cover authorized payments requirements.

6. The expansion, in this manner, of the unified exchange market will in due course make the present law on payments of foreign debt in convertible currencies redundant. We have nevertheless decided to leave it in full effect. According to this law enterprises that cannot service their foreign debts from their own earnings abroad can progressively draw on their associated group of enterprises, their own bank, all banks in the republic or province where they reside, or on a pool established in the National Bank from contributions by enterprises throughout the country. With the new surrender requirement the continued operation of this system may be expected in time to mop up excess foreign exchange holdings outside the National Bank.

Incomes and Prices

7. The depreciation of the dinar contributed to raising the rate of price inflation from about 30 percent during 1982 to about 50 percent during 1983. The gains in competitiveness depended on restraining personal incomes from employment despite the rise in prices, and those incomes accordingly declined by more than 10 percent in real terms in 1983, or by 25 percent over the last

four years. Though further steep declines would now be unacceptable, we are determined that competitiveness be preserved, and that gains in real personal incomes should not exceed increases in productivity. As one means to restrain incomes we have provided that with effect from January 1984, any enterprise that has not met its obligations to creditors on time will pay personal incomes only up to a minimum guaranteed level.

8. Despite the strong incentives provided, the restructuring of the economy towards industries supplying external rather than purely internal markets has been delayed. Limiting personal income payments by loss-making enterprises should hasten the transfer of labor to more competitive activities, and we have therefore decided, with effect from April 1984, to extend that limitation to all enterprises receiving credits or subsidies under rehabilitation programs that have been in effect for more than one year. In addition, total payments into common reserve funds at the communal and republican levels will be kept to the same nominal level in 1984 as in 1983, thereby reducing the resources available for subsidization.

9. Greater progress needs to be achieved in adjusting domestic prices to allow potentially competitive enterprises to be financially viable. To this end we let the selective price freeze lapse last July despite the additional push to inflation that it entailed in the short run. The next major step was taken in January 1984 when last year's system of price control expired. We decided at that time to expand the proportion of industrial output free of price controls from 45 to 60 percent. An estimated 25 percent of industrial output will continue to have its prices

set by self-management agreements that can also be flexible. The remaining 15 percent remains subject to direct controls. The proportion of prices liberalized will not be allowed to shrink in the course of 1984.

10. Controlled prices on key intermediate products are progressively being raised to economic levels. By the end of January 1984 we will have adhered to our undertakings with the World Bank to raise average electricity tariffs by 15 percent in real terms over their March 1983 level, and average railway tariffs by at least 10 percent in real terms over their end-December 1982 levels. Further real increases will follow in due course. Until then we are requiring at least quarterly increases in nominal prices to match increases in the producer price index. We have also agreed with the World Bank to introduce real increases in natural gas prices at least twice a year, towards achieving parity with world market prices by 1987. The domestic price of crude oil has already reached that level.

Monetary Policy

11. Much of the restraint on domestic demand in 1983 was achieved by severely restrictive monetary and credit policies. Thus, while the real stock of broad money (M2) had remained roughly constant during 1982, it is estimated to have declined during 1983 by about 7 percent. This result was in part due to a rate of inflation which, at 50 percent, turned out higher than had originally been assumed. A certain degree of flexibility was provided by the exclusion of valuation changes on net foreign liabilities, and on foreign exchange deposits, from the ceilings on net domestic assets by which monetary policy was defined, but not enough to wash out the restrictive effect of inflation altogether.

12. The accleration of inflation last year also frustrated our efforts to raise interest rates on dinar deposits to positive levels in real terms. Nominal rates on such deposits were increased last February, and again to 30 percent at the end of December, but these increases still left them significantly negative in real terms. By contrast the yield on foreign currency deposits, inclusive of valuation adjustments, rose by substantially more, and the share of such deposits in broad money accordingly increased from 32 percent at the end of 1982 to 40 percent at present. Approximately the same yield differential also provided a powerful incentive to keep money abroad altogether, and supplies a large part of the explanation for the swing from an inflow to an outflow on transitory items in the balance of payments.

13. A decisive move is clearly overdue to raise nominal interest rates on dinar deposits to competitive levels. The percentage difference between them and the yield on comparable foreign exchange deposits at the end of December 1983, including valuation changes, will be halved by the end of March 1984 and eliminated altogether by the end of June 1984, after which it will be adjusted monthly to maintain exact parity between the two. The discount rate and other lending rates of the National Bank will follow after an initial increase by 10 percentage points on January 15, 1984. In the process the interest differential will also shrink between unsubsidized and subsidized credit.

14. Because of the uncertainty regarding inflation, we have chosen to define our monetary ceilings again in terms of the net domestic assets of

the banking system, excluding valuation changes on net foreign liabilities and on foreign currency deposits. In fixing them for 1984 we have also taken into account the probable effect of interest rate increases on the demand for money. On this basis we calculate the ceiling for end-December 1984 at Din billion compared with Din billion a year earlier. There will be a quarterly phasing of the increase through the year. Within each total, allowance will be made for the planned increases, described below, in the net position of the public sector with the banking system.

Public Finance

15. Public finance also contributed substantially to the restraint of domestic demand in 1983. To be sure we had hoped to limit the growth of total public sector revenues, and hence roughly of expenditures also, to 20 percent in nominal terms in 1983. In the event they rose by over 30 percent. In real terms, nevertheless, public sector revenue declined by about 5 percent compared with a decline of less than 3 percent the year before. More significant reductions in revenue and expenditure in the face of rapidly accelerating inflation would have been difficult to implement particularly at the federal level. As it was, a large part of the austerity concentrated on real personal incomes paid by all levels of government.

16. For 1984 limits have again been placed on the growth of public sector revenue to ensure a continued decline in the relative size of that sector in the economy. The growth rate of total public sector revenue will be restricted to four fifths of the percentage increase in the retail price index. To tighten control, limits have been placed on the cumulative

quarterly revenue of the public sector. In order that expenditures, at least at the federal level, will be constrained by this means, we have specified a floor of Din   billion for the increase in the net position of the public sector with the National Bank of Yugoslavia between December 31, 1984 and a year earlier, and have phased it quarterly through the year. That increase is to be blocked until the end of 1986.

17. A similar plan to freeze excess fiscal revenue at the National Bank of Yugoslavia in 1983 yielded less than had been planned. For 1984 we have decided to limit overall payments from the Community of Interest for Foreign Economic Relations to export producers to no more than the customs duty drawback, and to channel the excess into the Federal Government's blocked account. Given their competitive position exporters need no special incentives. The accumulation of public sector deposits with the banking system will, on the other hand, release significant amounts of credit to other productive enterprises, within the overall credit ceilings established for balance of payments reasons.

18. A restructuring of our tax system came into effect in January 1984. A main objective was to include in its coverage household incomes other than from employment in the social sector. In particular, interest earned on all financial assets, including capital gains on foreign currency bank deposits, are now subject to a 10 percent withholding tax. Also, the minimum taxable household income was reduced by a third, and rates of taxation on agricultural income, on inheritance, and on property were increased. These increases in the taxation of household incomes have made

it possible to reduce the tax burden on enterprise incomes proportionately more than the general reduction in taxation would already have allowed.

External Debt

19. We expect by these various measures to reach, and even to exceed, our external current account objectives and also to improve our performance on capital account. We are determined to begin reducing our external debt as soon as possible. Gross borrowing last year came to the equivalent of US$4.4 billion; we expect to limit our requirements this year to US$3.5 billion. To secure this amount we have again entered into arrangements with a group of creditor governments and banks to roll over debt falling due, and to provide a limited amount of fresh money to build up the reserves. We will make the quarterly build-up of our reserves, by a total of US$500 million, a test of the success of our program.

20. Despite the scarcity of resources a certain outflow of capital from Yugoslavia is normal and acceptable. However, the outflow in 1983 of roughly US$1.5 billion was clearly excessive. We will spare no effort to reduce this flow to about US$500 million in 1984, and to cover it by an equivalent surplus on current account in convertible currencies. One central element in achieving this reduction in capital outflows is our move to an active interest rate policy. In addition, we have intensified the controls on the repatriation of export earnings. Thus, if exporters fail to repatriate export proceeds within 90 days their credit line for that export will be withdrawn.

21. We have also decided to facilitate an accelerated draw-down on external lines of credit particularly on the supplier credits granted by the Berne group of governments. The administrative regulations governing their utilization proved too restrictive in 1983. In order to ensure the availability of foreign exchange to repay the foreign credits, drawings have been made available only to exporters who have proof of export orders in hand, and raw material imports financed by suppliers credits have had to amount to less than 50 percent of the value of the export into which they entered. In time for the reform of the foreign exchange allocation system on April 1, 1984, we will have broken the close link between imports and exports in the allocation of external credits, so as to allow the financing of imports of more general interest to the economy.

Other Matters

22. The Federal Executive Council of Yugoslavia do not intend to introduce any multiple currency practices or introduce new or intensify existing restrictions on payments and transfers for international transactions or enter into any bilateral payments arrangements with Fund members. A 10 percent premium for tourists paying in dinar-denominated travelers checks has been approved by the Fund until February 28, 1984 and shall have been eliminated by that date. The Federal Executive Council do not intend to introduce new restrictions or intensify existing restrictions on imports for balance of payments reasons.

23. The Federal Executive Council believe that the policies set forth in this letter are adequate to achieve the objectives of its program but will

take any additional measures that may have become appropriate for this purpose. The Yugoslav authorities will review economic developments in 1984 with the staff of the Fund on a quarterly basis. They will consult with the Fund as soon as is practicable after the middle of the year, and in any case not later than August 15, 1984 to agree with the Fund on any modifications in the performance criteria that may be called for. Finally, the Federal Executive Council will consult with the Fund, in accordance with the Fund's policies on consultations, on the adoption of any measures that may become appropriate.

Sincerely,

Agreed Memorandum of Understanding

Subject: Technical Note on the Calculation of the Index of the Exchange Rate

For the purpose of adjusting the nominal effective exchange rate, it is understood that, consistent with the National Bank of Yugoslavia's methodology for calculating the real exchange rate:

(i) The real exchange rate of the dinar is expressed as 0.39 (deutsche mark per dinar) plus 0.24 (Italian lire per dinar) plus 0.18 (U.S. dollars per dinar) plus 0.13 (French francs per dinar) plus 0.06 (Austrian schillings per dinar), with a base of December 31, 1983 equal to 100 for each bilateral exchange rate of the dinar, multiplied by the ratio of an index of the movement in Yugoslavia's industrial producer prices to a weighted index of the movements in industrial prices in the foregoing five countries as specified in section (iii) below. The index of the real exchange rate of the dinar, with a base of December 31, 1983 equal to 100, will be no higher than 100 at the end of each of the 12 months in 1984. /A margin of error of 1 percentage point will be acceptable./

(ii) The index of Yugoslavia's industrial producer prices is the ratio of the price index for the most recent month that is available as of the 15th of each month to the index in the base period which is chosen so as to make the price change cover the same number of months as will have elapsed since December 31, 1983.

(iii) The weighted index of industrial producer prices in the foregoing five countries is defined as 0.39 (index of German prices for industrial products) plus 0.24 (index of Italian wholesale prices) plus 0.18 (index of U.S. wholesale prices for industrial goods) plus 0.13 (index of French prices of industrial goods) plus 0.06 (index of Austrian wholesale prices) with the index for each country expressed as the ratio of the price index for the most recent month that is available as of the 15th of each month to the price index in the base period which is chosen so as to make the price change cover the same number of months as will have elapsed since December 31, 1983.

(iv) Exchange rate and price data used in the calculation of the index of the real exchange rate will be consistent with those published in IMF, International Financial Statistics. No later than 10 days after the end of each month, the following data as of the end of the month will be telexed to the Fund: dinar exchange rates of each of the five foreign currencies, and the indices of the nominal exchange rate, the real exchange rate, Yugoslav industrial producer prices, the weighted average of five foreign industrial price indices, and relative industrial prices, where each index is expressed with a base of December 31, 1983 equal to 100.

Agreed Memorandum of Understanding

Subject: Technical Note on Interest Rates of the Yugoslav Banking System

1. It is agreed that the difference as of January 1, 1984 between the nominal interest rate on dinar deposits of households and enterprises and the yield (including valuation changes) on foreign currency deposits of households, both in the case of sight deposits and in the case of 12-month deposits, will be halved by April 15, 1984 and eliminated by July 15, 1984, after which time interest rates will be adjusted monthly to maintain parity between the two types of deposits. The yield (Y) on foreign exchange deposits, in percent per annum, is defined as

$$Y = 100 \left[\left(1 + \frac{R}{100}\right) X^4 - 1 \right]$$

where R is the nominal interest rate on foreign currency deposits in percent per annum, and X is the ratio of the nominal exchange rate index on a given date to the nominal exchange rate index three months earlier, with each index calculated consistent with the National Bank of Yugoslavia's methodology and expressed in terms of dinars per unit of foreign currency. Accordingly, the nominal rate (R1) on dinar deposits at the end of March 1984 will be increased by $\frac{(Y1 - R1)}{2}$ percentage points by April 15, 1984 (Y1 is the yield on foreign exchange deposits at the end of March 1984), and the nominal rate (R2) on dinar deposits at the end of June 1984 will be increased by (Y2 - R2) percentage points on July 15, 1984 (Y2 is the yield on foreign exchange deposits at the end of June 1984). By the 15th of each subsequent month,

beginning August 15, 1984, the nominal rate (R) for dinar deposits will be adjusted so as to be at least as large as the yield (Y) on foreign exchange deposits at the end of the preceding month.

Further, it is agreed that interest rates on other bank deposits will be adjusted in line with interest rates determined according to the formula described above.

2. It is agreed that the discount rate of the National Bank of Yugoslavia will be increased to 40 percent by January 15, 1984 and, on April 15, 1984, brought into equality with the yield on one-year foreign currency deposits of households as of the end of March 1984 determined according to the formula in paragraph 1. On the 15th of each subsequent month, beginning May 15, 1984, the discount rate at the end of the previous month will be adjusted to reflect the yield on one-year foreign exchange deposits of households at the end of that month.

Further, it is agreed that interest rates for selective credits of the National Bank of Yugoslavia will be increased by 10 percentage points by January 15, 1984. Adjustments bz April 15, 1984 and by the 15th of each subsequent month will be the same, in percentage points, as the contemporaneous adjustment of the discount rate of the National Bank of Yugoslavia.

Agreed Memorandum of Understanding

Subject: Technical Note on Public Sector Revenue Ceiling

Public sector revenue for the purpose of this ceiling is defined to comprise revenue of sociopolitical communities plus revenue for collective consumption, which totalled Din 891.667 billion in 1982 and Din 813.764 billion in January-September 1983. Cumulative quarterly limits on public sector revenue will apply for the periods shown below and will be calculated such that the percentage increase in public sector revenue over the corresponding period of the preceding year will be no more than 80.0 percent of the percentage increase in the retail price index over a similar period of time but with a lag of one quarter, as shown below. A margin of error of Din 2.0 billion will be acceptable.

	Periods for which the Percentage Increases in Public Sector Revenue and the Retail Price Index Shall be Calculated	
	Public Sector Revenue	Retail Price Index
First quarter	Jan.-March 1984 / Jan.-March 1983	Oct.-Dec. 1983 / Oct.-Dec. 1982
Second quarter	Jan.-June 1984 / Jan.-June 1983	Average (6 mos. to March 1984) / Average (6 mos. to March 1983)
Third quarter	Jan.-Sept. 1984 / Jan.-Sept. 1983	Average (9 mos. to June 1984) / Average (9 mos. to June 1983)
Fourth quarter	Jan.-Dec. 1984 / Jan.-Dec. 1983	Average (12 mos. to Sept. 1984) / Average (12 mos. to Sept. 1983)

Technical Note on the Balance of Payments Test

The aim of the program is to achieve an increase in the combined reserves of the National Bank of Yugoslavia and the commercial banks of at least US$500 million during 1984. Given the seasonal pattern of the receipts from services and to some extent from exports, the balance of payments is likely to record an overall deficit during the first half of 1984. Nevertheless reserves which are estimated to reach the level of US$1,685 million at the end of 1983 will not be allowed to fall below the level of US$ /‾ _7 million during the first quarter of 1984 and shall increase to US$ /‾ _7 million by the end of June 1984. Reserves are likely to increase to US$ /‾ _7 million by the end of September 1983 and to US$ /‾ _7 million by the end of 1983. For the purpose of this calculation any net increase in short-term debt during the period December 31, 1983 to the date in question will be excluded.

ANNEX V

Agreed Memorandum of Understanding

Subject: Technical Note on Price Adjustments

1. By the end of January 1984 electricity tariffs will have been increased to a level such that, on average, they are at least 15 percent higher than the average electricity tariff at the end of March 1983 multiplied by the index of industrial producer prices for December 1983, expressed with a base of March 1983 equal to 100.

2. By the end of January 1984, railway tariffs will have been increased such that, on average, they are at least 10 percent higher than the average level of railway tariffs at the end of December 1982 multiplied by the index of industrial producer prices for December 1983, expressed with a base of December 1982 equal to 100.

3. Additional adjustments will be made to the entire structures of electricity tariffs and railway tariffs such that all of these tariffs, including the various sets of electricity rates applicable to different periods of the year, will be increased from the tariffs established as of January 31, 1984 at least by the percentage increase in the industrial producer price index during the first three months of 1984, no later than the end of April 1984; at least by the percentage increase in this price index during the firs six months of 1984, no later than the end of July 1984; and at least by the percenta increase in this price index during the first nine months of 1984, no later than the end of October 1984.

4. The average prices of domestic natural gas, of crude petroleum and of petroleum products (including gasoline, kerosene, diesel oil, fuel oil and LPG) will be increased on a quarterly basis by no less than the percentage increase in the dinar/U.S. dollar exchange rate in the course of 1984, as shown below.

Minimum Percentage Increase in Each of the Domestic Natural Gas, Crude Petroleum, and Petroleum Products Prices Over Those in Effect as of January 31, 1984

Equal to the Percentage Increase in the Exchange Rate, Dinars Per U.S. Dollar, from December 31, 1983 Until:	To be Made Effective No Later Than:
March 31, 1984	April 30, 1984
June 30, 1984	July 31, 1984
September 30, 1984	October 31, 1984

5. A record of the price increases stipulated in paragraphs 1-4 will be published, as they take place, in the Official Gazette of the Socialist Federal Republic of Yugoslavia.

Agreed Memorandum of Understanding

Subject: Technical Note on Domestic Assets of the Yugoslav Banking System

The banking system for the purposes of this ceiling is defined as the consolidated accounts of the national banks and the basic and associated banks. The net domestic assets (NDA) of the abovementioned banks are calculated to equal the sum of the following items in the monetary survey:

	End-September 1983 (In billions of dinars)
Net foreign liabilities	1,004
Plus M2 (money + quasi-money)	2,641
Net domestic assets	3,645

In setting the ceiling for NDA the effects of changes in the exchange rate on net foreign liabilities of the banking system, and on foreign currency liabilities which are included in quasi-money, are excluded by applying a valuation adjustment (cumulative from end-December 1983) to the relevant data.

It is understood that the foreign exchange proceeds of any special assistance will be shown both as an asset and a foreign exchange liability of the National Bank of Yugoslavia.

It is agreed that NDA for the end of December 1984 shall not exceed Din [ ] billion compared with an estimated level of Din [ ] billion at end-December 1983. Further, the authorities will ensure that NDA will not exceed the ceilings established in Table 1 below, or allow the net position of public sector with the banking system to fall below the floors shown in Table 1.

Table 1. Yugoslavia: Credit Ceilings and Floors for the Net Position of the Public Sector with the Banking System

(In billions of dinars)

		Net Domestic Assets of the Banking System	Net Position of the Public Sector with the Banking System
1984	January-March 1/	[ ]	--
	March 2/	[ ]	[ ]
	April-June 1/	[ ]	--
	June 2/	[ ]	[ ]
	July-September 1/	[ ]	--
	September 2/	[ ]	[ ]

1/ Average end of month data.
2/ End-month data.

Mr. Whittome

Office Memorandum

To: The Managing Director
The Deputy Managing Director

December 21, 1983

From: Hans Schmitt

Subject: Yugoslavia - Back to Office Report

A staff team comprising Messrs. Hansen and Lewis (EUR), Mr. Petersen (ETR), Miss Smith (ADM) as secretary, and myself visited Belgrade from December 5 to 16, 1983 for negotiations on a one-year stand-by arrangement for 1984. Mr. Mentre (EUR) and Mr. Bery (IBRD) joined the mission for part of the period. The mission met with Mr. Dragan, Vice President of the Federal Executive Council, Mr. Makic, Governor of the National Bank of Yugoslavia, Mr. Veljkovic, Deputy Governor of the National Bank of Yugoslavia, and other officials.

After the first week of discussions the mission proposed to the authorities the attached draft letter of intent, which proved unacceptable to the Federal Executive Council and the Federal Parliament. Objections were strongest to the proposals for a reform of the foreign exchange allocation system, the interest rate hike and subsequent introduction of an interest rate formula, and the proposal to limit the payments from the Community of Interest for Foreign Economic Relations to export producers to no more than the customs duty drawback and to channel the excess into the Federal Government's blocked account. Accordingly, it was agreed to call a "time-out" and to resume negotiations on January 5, 1984, so as to give the Yugoslav authorities time to consider the proposals, and the staff a chance to consult in Washington.

The present draft letter contemplates seven performance criteria, as set out in detail in the Annexes to it, in addition to the normal consultation requirements and the requirement on payments restrictions. They set limits (i) on adjustments in nominal effective exchange rates; (ii) on the growth of foreign exchange reserves; (iii) on adjustments in nominal interest rates on deposits; (iv) on the growth of net domestic assets of the banking system; (v) on the net position of the public sector with the banking system; (vi) on the growth of public sector revenue; and (vii) on adjustments in administered prices.

1. The external targets for 1984

Recent developments in the external accounts have led the mission to revise the forecast for the current account with the convertible area in 1983 from a deficit of US$400 million at the time of the October mission to US$225 million now. The target for a current account surplus of US$500 million in 1984, which at the time of the October mission was considered very ambitious, now seems more attainable. The Yugoslavs estimate an even greater improvement in the current account in 1983 and still maintain as a target a surplus of US$800 million for 1984 (see Table 1 attached).

Developments in the capital balance have been much less satisfactory and the increase in reserves which had been targeted for 1983 did not materialize, mainly because of short-term capital outflows totalling close to US$1.5 billion. The necessity of measures to limit further outflows was stressed; these would contribute to an increase in reserves of at least US$500 million in 1984, to be made a performance criterion in the stand-by arrangement, with quarterly phasing.

On the financial package for 1984 there was some convergence of views (see Table 2 attached). The Yugoslav authorities agreed to seek new money from both governments and banks, in addition to a rollover of 100 percent of medium- and long-term maturities falling due in 1984. However, they made it clear that, mainly for reasons of cost, they were not prepared to use the same formula for fresh bank credit as last year. What they had in mind were new loans from a few big banks, perhaps in the form of trade-related financing or of cofinancing with the IBRD or EIB. They had not yet formed an opinion on the merits of a stand-by credit from commercial banks which had been mentioned at the ICC meetings in London on December 6. The authorities stressed that although they had an open mind as to the structure of the financial package, the total amount should be limited in view of the very important policy aim of reducing the overall indebtedness of Yugoslavia. There was some room for flexibility; a financial package of between US$3-3.5 billion would be acceptable, which at the higher end of the range would imply obtaining some new money.

The mission stressed once more that the size of the stand-by arrangement with the Fund would depend in part on the amount of new money obtained from governments and banks. Though aware of this link, the authorities expressed disappointment at the suggestion that the maximum amount might be limited to SDR 370 million, or approximately US$400 million, and entered a strong plea that the Fund raise the amount closer to US$500 million. We now propose that we stick with a minimum amount of SDR 270 million to cover repurchases, but that we go to a maximum of SDR 450 million if a financing package with new money is arranged and if agreement is reached on a program substantially as set out in the draft letter of intent.

Finally, in view of the seasonal drain on reserves expected in the first half of 1984 the mission stressed the possible need of again approaching the BIS for short-term bridging finance. The authorities showed little enthusiasm for this idea.

2. <u>The foreign exchange allocation system</u>

The mission's proposal on the reform of the foreign exchange allocation system is contained in paragraphs 5 and 6 of the draft letter of intent. The Yugoslav authorities claimed that this proposal would require excessive centralization of the management of foreign exchange. Their own proposals retained a three-tiered division of authority. A portion of the foreign exchange received would continue to be surrendered to the National Bank of Yugoslavia to satisfy certain national needs,

though it would henceforth be a single percentage for all exporters rather than several different ratios as at present. The remainder would be sold to commercial banks at the republican and provincial levels. However, groups of enterprises would through "self-management" agreements determine their own import requirements and be entitled to repurchase the foreign exchange needed to cover these. Any excess the commercial banks might retain would be traded in a "unified" market, with the National Bank as the balancing factor. The mission argued that these proposals would still entail excessive reliance on exchange rationing. We now propose to persist in asking for a total surrender requirement of foreign exchange receipts to the National Bank. We would stress again the safeguards already built into our proposal, viz., a flat 15 percent repurchase right to be charged against applications to make "authorized" payments abroad. We would add that criteria for "authorized" payments could be ratified by "self-management" agreements among firms, but would have to be uniform for the nation as a whole. Commercial banks could still establish positions abroad but on the basis of uniform rules agreed among them and with the National Bank.

3. Interest rates

The mission's proposal on interest rates is contained in paragraph 13 of the draft letter of intent, and in the memorandum of understanding on this subject attached to the letter of intent. The Yugoslav authorities agreed that the aim should be to establish positive real rates eventually. The mission insisted on a formula that would guarantee positive real rates from mid-1984; such a formula could be the subject of the usual "self-management" agreements among banks. The authorities argued that drastic changes over a short period would be very disruptive. They preferred to move to positive rates at the pace agreed with the World Bank, viz., by 1986 for some credits and 1987 or later for other credits. The mission stressed the urgency of decisive action to stem the short-term capital outflow, to support the reform of the foreign exchange allocation system, and to arrest the "dollarization" of the economy. We now propose to insist on basing interest rate policy on the proposed formula from the end of the first quarter of 1984, but to extend the period of adjustment to real positive rates to the end of the year. The phased adjustment could be achieved by quarterly reductions in the discrepancy between actual and target interest rates as now proposed. It could also be achieved by paying target interest rates to progressively more classes of depositors, first to exporters perhaps, adding other enterprises, workers' remittances, and finally all household accounts in quarterly stages.

4. Blocking of public revenue

The mission's proposal on blocking excess revenues of the Community of Interest for Foreign Economic Relations is contained in paragraph 17 of the draft letter of intent. It was apparently not well understood by the authorities and they did not argue over much against this

though it would henceforth be a single percentage for all exporters rather than several different ratios as at present. The remainder would be sold to commercial banks at the republican and provincial levels. However, groups of enterprises would through "self-management" agreements determine their own import requirements and be entitled to repurchase the foreign exchange needed to cover these. Any excess the commercial banks might retain would be traded in a "unified" market, with the National Bank as the balancing factor. The mission argued that these proposals would still entail excessive reliance on exchange rationing. We now propose to persist in asking for a total surrender requirement of foreign exchange receipts to the National Bank. We would stress again the safeguards already built into our proposal, viz., a flat 15 percent repurchase right to be charged against applications to make "authorized" payments abroad. We would add that criteria for "authorized" payments could be ratified by "self-management" agreements among firms, but would have to be uniform for the nation as a whole. Commercial banks could still establish positions abroad but on the basis of uniform rules agreed among them and with the National Bank.

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4. Blocking of public revenue

The mission's proposal on blocking excess revenues of the Community of Interest for Foreign Economic Relations is contained in paragraph 17 of the draft letter of intent. It was apparently not well understood by the authorities and they did not argue over much against this

specific proposal. The main point they made was that a surplus in the public sector would withdraw resources from an already overburdened productive sector. The mission argued that the proposed measure would transfer part of export subsidies, which at the present exchange rate seemed excessive, to the benefit of the whole productive sector. It would do so by permitting a larger expansion of domestic credit outside the public sector.

5. Other matters

Other points of disagreement were more on language and on the exact implementation of policies rather than on the policy measures themselves. This was the case for exchange rate policy, for incomes and price policies, and for measures to limit public sector revenue. There was not much discussion of credit ceilings, as the actual numbers would depend on what interest rate policy was first to be agreed. The ceilings were to be defined on net domestic assets of the banking system adjusted for exchange rate changes. There was some objection to establishing a quarterly exchange reserves test, mainly because the authorities feared that showing a decline in reserves over the first two quarters would damage confidence abroad. The mission argued that showing this explicitly and at the same time explaining how this problem would be dealt with perhaps through BIS financing, might have the opposite effect.

Attachments

cc: Mr. Habermeier
Mr. Hood
Mr. Whittome
Mr. Finch
Mr. Mohammed
Mr. Nicoletopoulos
Mr. Van Houtven
Mr. Collins
Paris Ofice
Geneva Office

bcc: Area Dept Heads
Mr Ungerer
Mission members
Mr. Ungerer
CED

Dear Mr. de Larosière:

1. The stabilization program which we pursued over the last three years, and which was supported by a stand-by arrangement with the Fund, has begun to show substantial results. In particular, the deficit on external current account in convertible currencies narrowed from its peak in 1979 of US$3.3 billion to some US$0.2 billion in 1983. The improvement in the last year alone came to about US$1.2 billion. Some part of this improvement was due to a diversion of trade from the nonconvertible to the convertible currency areas, and to an undesirable compression of imports, neither of which can be continued in 1984. The underlying adjustment, nevertheless, will in our judgment permit a further improvement in the external current account to a surplus in 1984 of at least US$0.5 billion.

2. Developments in the external balance on capital account have been less satisfactory; as a result the increase in external reserves which we had targeted at the beginning of 1983 did not materialize. The most disappointing among the reasons for this outturn has been a swing in transitory items from a surplus of US$560 million to a deficit of perhaps as much as US$750 million, which more than offset the increase in export earnings in the course of last year. Apart from safeguarding the momentum of improvement in current transactions, therefore, our program for 1984 places particular emphasis on measures to improve the balance on capital account, so as to ensure an increase in official external reserves of at least US$500 million.

3. Final domestic demand was cut back by 4 percent in 1983, and though exports began to respond forcefully to the gain in competitiveness during the year, gross social product (GSP) still showed some decline. A further reduction in domestic demand will again be necessary for balance of payments reasons in 1984, but as exports continue their recovery we expect that any tendency for GSP to decline will be reversed. The program we have adopted to reach these objectives is set out below. In support of it we request, on behalf of the Federal Executive Council of the Socialist Federal Republic of Yugoslavia, a stand-by arrangement with the Fund in an amount equivalent to SDR ___ million.

The Exchange Rate

4. An active exchange rate policy was the pivot of our stabilization program last year. The depreciation of the dinar in real terms in the course of 1983 amounted to about 30 percent as measured in terms of relative producer prices, and to about the same in terms of relative unit labor cost. We believe that the level of competitiveness we have now achieved is adequate to permit a substantial liberalization of our trade and payments system without jeopardizing our external objectives. During 1984, therefore, the monthly depreciation of the dinar will reflect the difference only between the monthly rise in producer prices in Yugoslavia and that among her five major trading partners.

5. We have already acted to simplify the foreign exchange allocation system. Starting no later than the beginning of April 1984, all foreign exchange receipts by Yugoslav exporters of goods and services will be

surrendered to the National Bank of Yugoslavia, in exchange for dinar cash or deposits that earn competitive interest rates as specified in paragraph 13 below. The National Bank of Yugoslavia will sell foreign exchange through authorized banks to cover authorized payments abroad. Exporters will have the option of repurchasing foreign exchange at the going rate, uncontested, up to a limit of 15 percent of their sales of exchange; however, such amounts will be charged against applications to cover authorized payments requirements.

6. The expansion, in this manner, of the unified exchange market will in due course make the present law on payments of foreign debt in convertible currencies redundant. We have nevertheless decided to leave it in full effect. According to this law enterprises that cannot service their foreign debts from their own earnings abroad can progressively draw on their associated group of enterprises, their own bank, all banks in the republic or province where they reside, or on a pool established in the National Bank from contributions by enterprises throughout the country. With the new surrender requirement the continued operation of this system may be expected in time to mop up excess foreign exchange holdings outside the National Bank.

Incomes and Prices

7. The depreciation of the dinar contributed to raising the rate of price inflation from about 30 percent during 1982 to about 50 percent during 1983. The gains in competitiveness depended on restraining personal incomes from employment despite the rise in prices, and those incomes accordingly declined by more than 10 percent in real terms in 1983, or by 25 percent over the last

four years. Though further steep declines would now be unacceptable, we are determined that competitiveness be preserved, and that gains in real personal incomes should not exceed increases in productivity. As one means to restrain incomes we have provided that with effect from January 1984, any enterprise that has not met its obligations to creditors on time will pay personal incomes only up to a minimum guaranteed level.

8. Despite the strong incentives provided, the restructuring of the economy towards industries supplying external rather than purely internal markets has been delayed. Limiting personal income payments by loss-making enterprises should hasten the transfer of labor to more competitive activities, and we have therefore decided, with effect from April 1984, to extend that limitation to all enterprises receiving credits or subsidies under rehabilitation programs that have been in effect for more than one year. In addition, total payments into common reserve funds at the communal and republican levels will be kept to the same nominal level in 1984 as in 1983, thereby reducing the resources available for subsidization.

9. Greater progress needs to be achieved in adjusting domestic prices to allow potentially competitive enterprises to be financially viable. To this end we let the selective price freeze lapse last July despite the additional push to inflation that it entailed in the short run. The next major step was taken in January 1984 when last year's system of price control expired. We decided at that time to expand the proportion of industrial output free of price controls from 45 to 60 percent. An estimated 25 percent of industrial output will continue to have its prices

set by self-management agreements that can also be flexible. The remaining 15 percent remains subject to direct controls. The proportion of prices liberalized will not be allowed to shrink in the course of 1984.

10. Controlled prices on key intermediate products are progressively being raised to economic levels. By the end of January 1984 we will have adhered to our undertakings with the World Bank to raise average electricity tariffs by 15 percent in real terms over their March 1983 level, and average railway tariffs by at least 10 percent in real terms over their end-December 1982 levels. Further real increases will follow in due course. Until then we are requiring at least quarterly increases in nominal prices to match increases in the producer price index. We have also agreed with the World Bank to introduce real increases in natural gas prices at least twice a year, towards achieving parity with world market prices by 1987. The domestic price of crude oil has already reached that level.

Monetary Policy

11. Much of the restraint on domestic demand in 1983 was achieved by severely restrictive monetary and credit policies. Thus, while the real stock of broad money (M2) had remained roughly constant during 1982, it is estimated to have declined during 1983 by about 7 percent. This result was in part due to a rate of inflation which, at 50 percent, turned out higher than had originally been assumed. A certain degree of flexibility was provided by the exclusion of valuation changes on net foreign liabilities, and on foreign exchange deposits, from the ceilings on net domestic assets by which monetary policy was defined, but not enough to wash out the restrictive effect of inflation altogether.

12. The accleration of inflation last year also frustrated our efforts to raise interest rates on dinar deposits to positive levels in real terms. Nominal rates on such deposits were increased last February, and again to 30 percent at the end of December, but these increases still left them significantly negative in real terms. By contrast the yield on foreign currency deposits, inclusive of valuation adjustments, rose by substantially more, and the share of such deposits in broad money accordingly increased from 32 percent at the end of 1982 to 40 percent at present. Approximately the same yield differential also provided a powerful incentive to keep money abroad altogether, and supplies a large part of the explanation for the swing from an inflow to an outflow on transitory items in the balance of payments.

13. A decisive move is clearly overdue to raise nominal interest rates on dinar deposits to competitive levels. The percentage difference between them and the yield on comparable foreign exchange deposits at the end of December 1983, including valuation changes, will be halved by the end of March 1984 and eliminated altogether by the end of June 1984, after which it will be adjusted monthly to maintain exact parity between the two. The discount rate and other lending rates of the National Bank will follow after an initial increase by 10 percentage points on January 15, 1984. In the process the interest differential will also shrink between unsubsidized and subsidized credit.

14. Because of the uncertainty regarding inflation, we have chosen to define our monetary ceilings again in terms of the net domestic assets of

the banking system, excluding valuation changes on net foreign liabilities and on foreign currency deposits. In fixing them for 1984 we have also taken into account the probable effect of interest rate increases on the demand for money. On this basis we calculate the ceiling for end-December 1984 at Din billion compared with Din billion a year earlier. There will be a quarterly phasing of the increase through the year. Within each total, allowance will be made for the planned increases, described below, in the net position of the public sector with the banking system.

Public Finance

15. Public finance also contributed substantially to the restraint of domestic demand in 1983. To be sure we had hoped to limit the growth of total public sector revenues, and hence roughly of expenditures also, to 20 percent in nominal terms in 1983. In the event they rose by over 30 percent. In real terms, nevertheless, public sector revenue declined by about 5 percent compared with a decline of less than 3 percent the year before. More significant reductions in revenue and expenditure in the face of rapidly accelerating inflation would have been difficult to implement particularly at the federal level. As it was, a large part of the austerity concentrated on real personal incomes paid by all levels of government.

16. For 1984 limits have again been placed on the growth of public sector revenue to ensure a continued decline in the relative size of that sector in the economy. The growth rate of total public sector revenue will be restricted to four fifths of the percentage increase in the retail price index. To tighten control, limits have been placed on the cumulative

quarterly revenue of the public sector. In order that expenditures, at least at the federal level, will be constrained by this means, we have specified a floor of Din billion for the increase in the net position of the public sector with the National Bank of Yugoslavia between December 31, 1984 and a year earlier, and have phased it quarterly through the year. That increase is to be blocked until the end of 1986.

17. A similar plan to freeze excess fiscal revenue at the National Bank of Yugoslavia in 1983 yielded less than had been planned. For 1984 we have decided to limit overall payments from the Community of Interest for Foreign Economic Relations to export producers to no more than the customs duty drawback, and to channel the excess into the Federal Government's blocked account. Given their competitive position exporters need no special incentives. The accumulation of public sector deposits with the banking system will, on the other hand, release significant amounts of credit to other productive enterprises, within the overall credit ceilings established for balance of payments reasons.

18. A restructuring of our tax system came into effect in January 1984. A main objective was to include in its coverage household incomes other than from employment in the social sector. In particular, interest earned on all financial assets, including capital gains on foreign currency bank deposits, are now subject to a 10 percent withholding tax. Also, the minimum taxable household income was reduced by a third, and rates of taxation on agricultural income, on inheritance, and on property were increased. These increases in the taxation of household incomes have made

it possible to reduce the tax burden on enterprise incomes proportionately more than the general reduction in taxation would already have allowed.

External Debt

19. We expect by these various measures to reach, and even to exceed, our external current account objectives and also to improve our performance on capital account. We are determined to begin reducing our external debt as soon as possible. Gross borrowing last year came to the equivalent of US$4.4 billion; we expect to limit our requirements this year to US$3.5 billion. To secure this amount we have again entered into arrangements with a group of creditor governments and banks to roll over debt falling due, and to provide a limited amount of fresh money to build up the reserves. We will make the quarterly build-up of our reserves, by a total of US$500 million, a test of the success of our program.

20. Despite the scarcity of resources a certain outflow of capital from Yugoslavia is normal and acceptable. However, the outflow in 1983 of roughly US$1.5 billion was clearly excessive. We will spare no effort to reduce this flow to about US$500 million in 1984, and to cover it by an equivalent surplus on current account in convertible currencies. One central element in achieving this reduction in capital outflows is our move to an active interest rate policy. In addition, we have intensified the controls on the repatriation of export earnings. Thus, if exporters fail to repatriate export proceeds within 90 days their credit line for that export will be withdrawn.

21. We have also decided to facilitate an accelerated draw-down on external lines of credit particularly on the supplier credits granted by the Berne group of governments. The administrative regulations governing their utilization proved too restrictive in 1983. In order to ensure the availability of foreign exchange to repay the foreign credits, drawings have been made available only to exporters who have proof of export orders in hand, and raw material imports financed by suppliers credits have had to amount to less than 50 percent of the value of the export into which they entered. In time for the reform of the foreign exchange allocation system on April 1, 1984, we will have broken the close link between imports and exports in the allocation of external credits, so as to allow the financing of imports of more general interest to the economy.

Other Matters

22. The Federal Executive Council of Yugoslavia do not intend to introduce any multiple currency practices or introduce new or intensify existing restrictions on payments and transfers for international transactions or enter into any bilateral payments arrangements with Fund members. A 10 percent premium for tourists paying in dinar-denominated travelers checks has been approved by the Fund until February 28, 1984 and shall have been eliminated by that date. The Federal Executive Council do not intend to introduce new restrictions or intensify existing restrictions on imports for balance of payments reasons.

23. The Federal Executive Council believe that the policies set forth in this letter are adequate to achieve the objectives of its program but will

take any additional measures that may have become appropriate for this purpose. The Yugoslav authorities will review economic developments in 1984 with the staff of the Fund on a quarterly basis. They will consult with the Fund as soon as is practicable after the middle of the year, and in any case not later than August 15, 1984 to agree with the Fund on any modifications in the performance criteria that may be called for. Finally, the Federal Executive Council will consult with the Fund, in accordance with the Fund's policies on consultations, on the adoption of any measures that may become appropriate.

Sincerely,

Agreed Memorandum of Understanding

Subject: Technical Note on the Calculation of the Index of the Exchange Rate

For the purpose of adjusting the nominal effective exchange rate, it is understood that, consistent with the National Bank of Yugoslavia's methodology for calculating the real exchange rate:

(i) The real exchange rate of the dinar is expressed as 0.39 (deutsche mark per dinar) plus 0.24 (Italian lire per dinar) plus 0.18 (U.S. dollars per dinar) plus 0.13 (French francs per dinar) plus 0.06 (Austrian schillings per dinar), with a base of December 31, 1983 equal to 100 for each bilateral exchange rate of the dinar, multiplied by the ratio of an index of the movement in Yugoslavia's industrial producer prices to a weighted index of the movements in industrial prices in the foregoing five countries as specified in section (iii) below. The index of the real exchange rate of the dinar, with a base of December 31, 1983 equal to 100, will be no higher than 100 at the end of each of the 12 months in 1984. /A margin of error of 1 percentage point will be acceptable./

(ii) The index of Yugoslavia's industrial producer prices is the ratio of the price index for the most recent month that is available as of the 15th of each month to the index in the base period which is chosen so as to make the price change cover the same number of months as will have elapsed since December 31, 1983.

(iii) The weighted index of industrial producer prices in the foregoing five countries is defined as 0.39 (index of German prices for industrial products) plus 0.24 (index of Italian wholesale prices) plus 0.18 (index of U.S. wholesale prices for industrial goods) plus 0.13 (index of French prices of industrial goods) plus 0.06 (index of Austrian wholesale prices) with the index for each country expressed as the ratio of the price index for the most recent month that is available as of the 15th of each month to the price index in the base period which is chosen so as to make the price change cover the same number of months as will have elapsed since December 31, 1983.

(iv) Exchange rate and price data used in the calculation of the index of the real exchange rate will be consistent with those published in IMF, International Financial Statistics. No later than 10 days after the end of each month, the following data as of the end of the month will be telexed to the Fund: dinar exchange rates of each of the five foreign currencies, and the indices of the nominal exchange rate, the real exchange rate, Yugoslav industrial producer prices, the weighted average of five foreign industrial price indices, and relative industrial prices, where each index is expressed with a base of December 31, 1983 equal to 100.

Agreed Memorandum of Understanding

Subject: Technical Note on Interest Rates of the Yugoslav Banking System

1. It is agreed that the difference as of January 1, 1984 between the nominal interest rate on dinar deposits of households and enterprises and the yield (including valuation changes) on foreign currency deposits of households, both in the case of sight deposits and in the case of 12-month deposits, will be halved by April 15, 1984 and eliminated by July 15, 1984, after which time interest rates will be adjusted monthly to maintain parity between the two types of deposits. The yield (Y) on foreign exchange deposits, in percent per annum, is defined as

$$Y = 100 \left[\left(1 + \frac{R}{100}\right) X^4 - 1 \right]$$

where R is the nominal interest rate on foreign currency deposits in percent per annum, and X is the ratio of the nominal exchange rate index on a given date to the nominal exchange rate index three months earlier, with each index calculated consistent with the National Bank of Yugoslavia's methodology and expressed in terms of dinars per unit of foreign currency. Accordingly, the nominal rate (R_1) on dinar deposits at the end of March 1984 will be increased by $\frac{(Y_1 - R_1)}{2}$ percentage points by April 15, 1984 (Y_1 is the yield on foreign exchange deposits at the end of March 1984), and the nominal rate (R_2) on dinar deposits at the end of June 1984 will be increased by ($Y_2 - R_2$) percentage points on July 15, 1984 (Y_2 is the yield on foreign exchange deposits at the end of June 1984). By the 15th of each subsequent month,

beginning August 15, 1984, the nominal rate (R) for dinar deposits will be adjusted so as to be at least as large as the yield (Y) on foreign exchange deposits at the end of the preceding month.

Further, it is agreed that interest rates on other bank deposits will be adjusted in line with interest rates determined according to the formula described above.

2. It is agreed that the discount rate of the National Bank of Yugoslavia will be increased to 40 percent by January 15, 1984 and on April 15, 1984, brought into equality with the yield on one-year foreign currency deposits of households as of the end of March 1984 determined according to the formula in paragraph 1. On the 15th of each subsequent month, beginning May 15, 1984, the discount rate at the end of the previous month will be adjusted to reflect the yield on one-year foreign exchange deposits of households at the end of that month.

Further, it is agreed that interest rates for selective credits of the National Bank of Yugoslavia will be increased by 10 percentage points by January 15, 1984. Adjustments bz April 15, 1984 and by the 15th of each subsequent month will be the same, in percentage points, as the contemporaneous adjustment of the discount rate of the National Bank of Yugoslavia.

Agreed Memorandum of Understanding

Subject: Technical Note on Public Sector Revenue Ceiling

Public sector revenue for the purpose of this ceiling is defined to comprise revenue of sociopolitical communities plus revenue for collective consumption, which totalled Din 891.667 billion in 1982 and Din 813.764 billion in January-September 1983. Cumulative quarterly limits on public sector revenue will apply for the periods shown below and will be calculated such that the percentage increase in public sector revenue over the corresponding period of the preceding year will be no more than 80.0 percent of the percentage increase in the retail price index over a similar period of time but with a lag of one quarter, as shown below. A margin of error of Din 2.0 billion will be acceptable.

	Periods for which the Percentage Increases in Public Sector Revenue and the Retail Price Index Shall be Calculated	
	Public Sector Revenue	Retail Price Index
First quarter	Jan.-March 1984 / Jan.-March 1983	Oct.-Dec. 1983 / Oct.-Dec. 1982
Second quarter	Jan.-June 1984 / Jan.-June 1983	Average (6 mos. to March 1984) / Average (6 mos. to March 1983)
Third quarter	Jan.-Sept. 1984 / Jan.-Sept. 1983	Average (9 mos. to June 1984) / Average (9 mos. to June 1983)
Fourth quarter	Jan.-Dec. 1984 / Jan.-Dec. 1983	Average (12 mos. to Sept. 1984) / Average (12 mos. to Sept. 1983)

Technical Note on the Balance of Payments Test

The aim of the program is to achieve an increase in the combined reserves of the National Bank of Yugoslavia and the commercial banks of at least US$500 million during 1984. Given the seasonal pattern of the receipts from services and to some extent from exports, the balance of payments is likely to record an overall deficit during the first half of 1984. Nevertheless reserves which are estimated to reach the level of US$1,685 million at the end of 1983 will not be allowed to fall below the level of US$ /‾ _7 million during the first quarter of 1984 and shall increase to US$ /‾ _7 million by the end of June 1984. Reserves are likely to increase to US$ /‾ _7 million by the end of September 1983 and to US$ /‾ _7 million by the end of 1983. For the purpose of this calculation any net increase in short-term debt during the period December 31, 1983 to the date in question will be excluded.

ANNEX V

Agreed Memorandum of Understanding

Subject: Technical Note on Price Adjustments

1. By the end of January 1984 electricity tariffs will have been increased to a level such that, on average, they are at least 15 percent higher than the average electricity tariff at the end of March 1983 multiplied by the index of industrial producer prices for December 1983, expressed with a base of March 1983 equal to 100.

2. By the end of January 1984, railway tariffs will have been increased such that, on average, they are at least 10 percent higher than the average level of railway tariffs at the end of December 1982 multiplied by the index of industrial producer prices for December 1983, expressed with a base of December 1982 equal to 100.

3. Additional adjustments will be made to the entire structures of electricity tariffs and railway tariffs such that all of these tariffs, including the various sets of electricity rates applicable to different periods of the year, will be increased from the tariffs established as of January 31, 1984 at least by the percentage increase in the industrial producer price index during the first three months of 1984, no later than the end of April 1984; at least by the percentage increase in this price index during the firs six months of 1984, no later than the end of July 1984; and at least by the percenta increase in this price index during the first nine months of 1984, no later than the end of October 1984.

4. The average prices of domestic natural gas, of crude petroleum and of petroleum products (including gasoline, kerosene, diesel oil, fuel oil and LPG) will be increased on a quarterly basis by no less than the percentage increase in the dinar/U.S. dollar exchange rate in the course of 1984, as shown below.

Minimum Percentage Increase in Each of the Domestic Natural Gas, Crude Petroleum, and Petroleum Products Prices Over Those in Effect as of January 31, 1984

Equal to the Percentage Increase in the Exchange Rate, Dinars Per U.S. Dollar, from December 31, 1983 Until:	To be Made Effective No Later Than:
March 31, 1984	April 30, 1984
June 30, 1984	July 31, 1984
September 30, 1984	October 31, 1984

5. A record of the price increases stipulated in paragraphs 1-4 will be published, as they take place, in the Official Gazette of the Socialist Federal Republic of Yugoslavia.

Agreed Memorandum of Understanding

Subject: Technical Note on Domestic Assets of the Yugoslav Banking System

The banking system for the purposes of this ceiling is defined as the consolidated accounts of the national banks and the basic and associated banks. The net domestic assets (NDA) of the abovementioned banks are calculated to equal the sum of the following items in the monetary survey:

	End-September 1983 (In billions of dinars)
Net foreign liabilities	1,004
Plus M2 (money + quasi-money)	2,641
Net domestic assets	3,645

In setting the ceiling for NDA the effects of changes in the exchange rate on net foreign liabilities of the banking system, and on foreign currency liabilities which are included in quasi-money, are excluded by applying a valuation adjustment (cumulative from end-December 1983) to the relevant data.

It is understood that the foreign exchange proceeds of any special assistance will be shown both as an asset and a foreign exchange liability of the National Bank of Yugoslavia.

It is agreed that NDA for the end of December 1984 shall not exceed Din /‾ _/ billion compared with an estimated level of Din /‾ _/ billion at end-December 1983. Further, the authorities will ensure that NDA will not exceed the ceilings established in Table 1 below, or allow the net position of public sector with the banking system to fall below the floors shown in Table 1.

Table 1. Yugoslavia: Credit Ceilings and Floors for the Net Position of the Public Sector with the Banking System

(In billions of dinars)

		Net Domestic Assets of the Banking System	Net Position of the Public Sector with the Banking System
1984	January-March 1/	[ ]	--
	March 2/	[ ]	[ ]
	April-June 1/	[ ]	--
	June 2/	[ ]	[ ]
	July-September 1/	[ ]	--
	September 2/	[ ]	[ ]

1/ Average end of month data.
2/ End-month data.

12.8.83

Table 1. Yugoslavia: Balance of Payments with the Convertible Currency Area, 1982-84

(In millions of U.S. dollars)

	1982	1983 Yugoslav estimate	1983 Alternative	1984 Yugoslav estimate	1984 Alternative
Exports	5,526	6,400	6,300	7,700	7,200
Imports	-9,043	8,450	-8,450	9,100	8,800
Trade balance	-3,517	-2,050	-2,150	-1,400	-1,600
Invisibles (net)	2,003	1,925	1,925	2,200	2,100
Workers' remittances	1,085	1,265	1,265	1,440	1,135
Tourism	1,224	1,335	1,335	1,080	1,510
Interest payments	-1,670	-1,690	-1,690	-1,840	-1,890
Others	1,364	1,015	1,015	1,520	1,345
Current account	-1,514	-125	-225	800	500
Medium- and long-term debt	-117	1,230	1,175	-20	190
Drawings	1,684	3,880	3,825	2,825	3,135
Repayments	-1,626	-2,450	-2,450	-2,645	-2,745
Loans extended	-175	-200	-200	-200	-200
Short-term debt	-506	-500	-600	--	--
Errors and omissions	562	-585	-750	--	-300
Total	-1,575	20	-350	-780	390
Use of Fund Credit	563	410	410	220	120
Reserve movements (increase -)	1,012	-430	-10	-1,000	-510

Table 2. Yugoslavia: Drawings on Medium- and Long-Term Debt in Convertible Currency by Creditor

(In millions of U.S. dollars)

	1983		1984	
	Yugoslav estimate	Alternative	Yugoslav estimate	Alternative
Government packages	839	831	1,006	1,100
Berne	839	831	456	350
Refinancing	(304)	(304)	(...)	(3)
New financial credits	(180)	(172)	(...)	(...)
Suppliers credits	(355)	(355)	(456)	(347)
Geneva	...	...	550	750
Refinancing	...	...	(400)	(500)
Suppliers credits	...	...	(150)	(250)
Commercial bank package	1,580	1,580	1,100	1,300
Refinancing	980	980	1,000	1,100
New financing	600	600	100	200
IBRD	320	350	530	485
Regular facilities	250	280	250	280
SAL	70	70	280	205
Other multilateral lenders IFC, EIB and Eurofima	30	50	... 1/	50
Suppliers credits outside Government packages	1,111	1,014	189	200
Subtotal	3,880	3,825	2,825	3,135
IMF	590	590	500	400
Total	4,470	4,415	3,325	3,535

1/ Included in drawings on the IBRD.

Office Memorandum

To : Mr. Schmitt December 21, 1983

From : Arne B. Petersen

Subject: Yugoslavia: Foreign Exchange Allocation System

This note attempts to summarize the major elements of our discussion yesterday.

Yugoslav enterprises can be divided into two groups, active enterprises which earn more foreign exchange than they need, and "passive" enterprises which earn less. According to the Yugoslav proposal for modifications to the foreign exchange allocation system, foreign exchange receipts of "active" enterprises are divided into three tiers. The top tier goes to the National Bank of Yugoslavia, the middle tier, defined as surplus foreign exchange receipts, goes to the regional banks who in turn are required to offer it for sale in the interbank market, and the lower tier may be used by the enterprises to satisfy its reproduction requirements in the form of imports of raw materials and debt-service payments. The enterprise is supposed to sell on a temporary basis the third tier to its regional bank and to buy back at the prevailing rate when it is required to make foreign payments. This latter tier (also called the socially verified reproduction requirement) is to be determined by self-management agreements among all enterprises, active and pasive, within the Yugoslav chamber of the economy. The passive enterprises are supposed to purchase foreign exchange as determined by their socially verified reproduction requirement from the unified foreign exchange market, which in practice, means out of the second tier of the receipts of the active enterprises.

Our proposal is for all foreign exchange to be surrendered to the National Bank of Yugoslavia, which in turn, will sell foreign exchange to enterprises through commercial banks to cover authorized payments abroad. As a safeguard measure, our proposal would allow enterprises a minimum repurchase of 15 percent.

Seen from the enterprise side, the surrender requirement is not very different and might even be said to be more severe under the Yugoslav proposal since all foreign exchange must be surrendered for dinars, whereas we would allow enterprises to keep 15 percent in foreign exchange whether they need it or not. Seen from the allocation side, however, there is a substantial difference. Under our proposal, all foreign exchange would be allocated by the NBY, whereas under the Yugoslav system, one tier would be allocated by the NBY, one tier by the interbank market, and one tier by the regional banks. There is also a potentially large difference between our concept of authorized payments and the Yugoslav concept of socially verified reproduction needs. Implicitly, our initial proposal was based on a concept of commodity lists administered by the national bank.

The Yugoslav authorities emphasized that a system in which the NBY authorized import payment would run counter to their basic principle of self-management agreements on which their whole society is built. I tend to believe that we should go along with their desire to maintain the present authorization system, not only because of their legitimate concerns of not unduly changing their chosen social system, but also because I think it may be difficult administratively to change it with short notice. Would the National Bank have to hire an army of controllers?

The authorities are clearly also concerned with surrendering regional control over foreign exchange earnings. This would point to a major problem with their proposal--would the interbank market in foreign exchange, which has been nonexistent during the past two years, be revived, or would the regional banks hold on to their foreign exchange. This, of course, also depends on whether there will be any funds in the second tier of surplus foreign exchange.

I think the best solution to aim for would be a combination of our proposal of total surrender to the NBY with their method of establishing the socially verified reproduction needs. We should, however, insist on safeguards which would ensure a speedy determination of the reproduction needs according to objective criteria such as historical import requirements. We may have to make the system a performance criteria to be verified at the time of our scheduled April mission.

Their proposal is clearly unacceptable in its present form, and we should stand firm on our proposal to centralize foreign exchange in the NBY. Should it be deemed impossible to obtain this, and should it on other grounds be deemed desirable to go ahead with the program anyway, then we should, as an absolute minimum, insist on the safeguard mentioned above, as well as on measures which would give the NBY effective control over the interbank market in foreign exchange. This could be done by giving it authority, if needed, to force commercial banks to sell in the interbank market foreign exchange in excess of minimum working balances. There would, of course, be difficulties involved in establishing such minimum balances, but they could be solved gradually once the basic principle was established.

cc: Mr. Whittome
Mr. Mookerjee
Mr. Quirk
Ms. Ripley
Mr. Hansen
Mr. Lewis

IMF OFFICIAL CABLE

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1983 DEC 21 AM 7:54

RCV: @1IM/2.09032 LINE: 2

589453

0616 EST
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cc: DR

I
INFUND 610712F

w cc: HOS
DR

INTERFUND PARIS DECEMBER 21 1983

INTERFUND
WASHINGTON DC

FOR WHITTOME - U R G E N T FOR IMMEDIATE DELIVERY PLEASE

CC: SCHMITT

SUBJECT: YUGOSLAVIA

IT IS NOW DEFINITELY AGREED THAT THE FIRST WORKING GROUP (DEBT) WILL MEET ON THE 11TH AND THE SECOND (NON-DEBT) ON THE 12TH.

WE HAVE GIVEN TO PARTICIPANTS AND SENT TO THE YUGOSLAVS AND TO KUWAIT (SEE ATTACHED) THE PROPOSED ANNOTATED AGENDA YOU HAD APPROVED.

I INFORMED FAILLETTAZ WHO TOLD ME THAT THEY HAD JUST RECEIVED AGREEMENT BY ALL PARTICIPANTS ON THEIR NOVEMBER 18 SUMMING UP (WITH SOME ADDITIONAL REFERENCE TO THE NECESSARY LINK WITH THE FUND TIMETABLE) AND THE YUGOSLAV STANDSTILL TELEX THAT THEY WILL CIRCULATE AND THAT I HAD MENTIONED ALREADY TO THE FRENCH. THE SWISS ARE CONTEMPLATING A MEETING OF THE FULL GROUP ON JANUARY 26/27 IN GENEVA (JUST AFTER MEETINGS IN PARIS ON OTHER COUNTRIES ATTENDED BY ABOUT THE SAME PARTICIPANTS). THIS WOULD MEAN THAT AN ICC MEETING WOULD PROBABLY FOLLOW AND NOT PRECEDE THE SWISS MEETING (DOBRITCH HAD TOLD ME THAT, IF AN ICC MEETING APPEARED NECESSARY AFTER THE JANUARY 11-12 MEETINGS, HE WOULD NEED ABOUT 15 DAYS TO CONVENE IT).

REGARDS,

MENTRE

INTERFUND PARIS

ATTACHMENT:

IMF OFFICIAL CABLE

IT WILL BE RECALLED THAT, ON NOVEMBER 18, 1983, AT THE MEETING ON FINANCIAL ASSISTANCE TO YUGOSLAVIA, IT WAS DECIDED TO SET UP TWO GROUPS, ONE ON DEBT AND THE OTHER ON NON-DEBT ISSUES, TO BE CHAIRED RESPECTIVELY BY FRANCE AND THE IMF. AFTER CONSULTATION AMONG PARTICIPANTS, IT HAS BEEN AGREED THAT THE TWO GROUPS WILL MEET ON JANUARY 11-12, 1984 AT THE IMF'S OFFICE IN EUROPE, 64-66 AVENUE D'IENA IN PARIS.

THE MANAGING DIRECTOR HAS ASKED ME TO CHAIR THE GROUP ON NON-DEBT ISSUES (GROUP 2) WHICH I PROPOSE TO CONVENE ON JANUARY 12 AT 10:00 A.M., OR IMMEDIATELY AFTER THE END OF THE MEETING OF GROUP 1 IF IT WERE TO CONTINUE ON JANUARY 12.

PARTICIPANTS ARE CORDIALLY INVITED TO A WORKING LUNCHEON ON THE PREMISES.

AN ANNOTATED AGENDA IS ATTACHED.

REGARDS,

ALDO GUETTA
DIRECTOR,
OFFICE IN EUROPE

ATTACHMENT:

FINANCIAL ASSISTANCE TO YUGOSLAVIA

WORKING GROUP ON NON-DEBT ISSUES

JANUARY 12 MEETING

PROPOSED ANNOTATED AGENDA

1. STATUS OF NEGOTIATIONS BETWEEN THE FUND AND YUGOSLAVIA

(YUGOSLAV AND FUND REPRESENTATIVES)

A. BALANCE OF PAYMENTS, 1983 (IMF FORECAST OF JANUARY 1983, LIKELY OUTCOME IN 1983, EXPLANATION OF DIFFERENCES) AND PROJECTIONS FOR 1984 AND BEYOND (VALUE AND VOLUME OF EXPORTS AND IMPORTS, INVISIBLES, SHORT-TERM, MEDIUM- AND LONG-TERM CAPITAL FLOWS, RESERVES) (1)

B. RECENT ECONOMIC DEVELOPMENTS AND PROSPECTS (REVIEW OF ECONOMIC ADJUSTMENT IN 1983, PROBLEM AREAS)

C. LETTER OF INTENT

D. TIMETABLE CONTEMPLATED FOR BOARD ACTION

2. NONGOVERNMENTAL FINANCIAL FLOWS

A. WORLD BANK LENDING, INCLUDING POSSIBLE COFINANCING WITH COMMERCIAL BANKS (YUGOSLAV AND WORLD BANK REPRESENTATIVES)

B. LENDING BY EUROPEAN INSTITUTIONS INCLUDING POSSIBLE CO-FINANCING WITH COMMERCIAL BANKS (YUGOSLAV AND REPRESENTATIVES OF EC COUNTRIES)

C. STATUS OF DISCUSSION WITH COMMERCIAL BANKS: IMPLEMENTATION OF 1983 COMMERCIAL BANKS' PACKAGE, CONTEMPLATED FLOWS IN 1984 (YUGOSLAV REPRESENTATIVES AND IMF)

3. GOVERNMENTAL FINANCIAL FLOWS

A. CARRY-OVER INTO 1984 OF THE 1983 BERNE PACKAGE (NATIONAL REPRESENTATIVES)

- COULD REPRESENTATIVES OF CREDITOR COUNTRIES ELABORATE ON MEASURES TAKEN OR TO BE TAKEN TO ENSURE THAT UNUSED COMMITMENTS WILL REMAIN AVAILABLE IN 1984?

- COULD YUGOSLAV REPRESENTATIVES ELABORATE ON MEASURES TAKEN TO SPEED UP THE PROCESS OF USE OF THOSE CREDITS BY YUGOSLAV ENTERPRISES?

B. EXPORT CREDITS MADE AVAILABLE UNDER OTHER ARRANGEMENTS (NATIONAL REPRESENTATIVES)

- COULD CREDITOR COUNTRIES ELABORATE ON SUPPLIERS' CREDITS MADE AVAILABLE IN 1983 AND CONTEMPLATED FOR 1984 UNDER PRE-BERNE ARRANGEMENTS?

C. ADDITIONAL ACTION

- MAGNITUDE OF ACTION JUDGED COMPATIBLE WITH YUGOSLAVIA'S BALANCE OF PAYMENTS AND RESERVE NEEDS (YUGOSLAV AND IMF REPRESENTATIVES)

- SIZE AND NATURE OF COMMITMENTS WHICH COULD BE CONTEMPLATED BY INDIVIDUAL GOVERNMENTS IN THE FRAMEWORK OF AN OVERALL PACKAGE, WITH SPECIFIC REFERENCE TO COMMODITY CREDITS AND EXPORT CREDITS FOR RAW MATERIALS AND INTERMEDIATE GOODS (NATIONAL REPRESENTATIVES)

D. GOVERNMENT-GUARANTEED SHORT-TERM CREDITS (NATIONAL REPRESENTATIVES)

- ATTITUDE OF INDIVIDUAL GOVERNMENTS ON MAINTENANCE AND/OR EXPANSION OF EXISTING SHORT-TERM CREDIT LINES IN 1984.

IMF OFFICIAL CABLE

(1) AS NEEDED AFTER DISCUSSION IN THE FIRST WORKING GROUP.

END TEXT

INTERFUND PARIS

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440040 FUND UI

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TIME: 06:30 12/21/83 EST
CONNECT TIME : 904 SECONDS

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INTERFUND WASHINGTON D.C.
ATTN. MR.WHITTOME, DIRECTOR EUROPEAN DEPARTMENT

WE AREQUOTING BELOW THE TEXT OF THE LETTER, DATEDDECEMBER 16,1983 SENT BY MR. JANKO SMOLE, MEMBER OF THE FEDERAL EXECUTIVE COUNCIL OF YUGOSLAVIA TO MR. PROBST, STATESECRETARY IN THE FEDERAL DEPART-MENT OF FOREIGN AFFAIRS OF SWITZERLAND, IN CONNECTION WITH THE STAND-STILL OF PRINCIPAL PAYMENTS IN THE FIRST QUARTER OF 1984.

QUOTE

DEAR MR. PROBST:

I WOULD LIKE TO THANK YOU ONCE AGAIN FOR THE MOST EFFECTIVE WAY IN WHICH YOU CHAIRED THE NOVEMBER 18 MEETING IN GENEVA ON FINANCIAL ASSISTANCE TO YUGOSLAVIA.

AS INDICATEDIN YOUR SUMMING UP IT WAS AGREED THAT TWO WORKING GROUPS WILL MEET AS SOON AS POSSIBLE. THE FIRST WORKING GROUP WOULD DEAL WITH THE PROBLEM OF THE CONSOLIDATION OF MATURITIES OF OFFICIAL AND OFFICIALLY GUARANTEED DEBT FALLING DUE IN 1984. THE SECOND WORKING GROUP WOULD BE ENTRU-STED WITH THE MORE GENERAL SUBJECTS OF THE OVERALL ECONOMIC SITUATION OF YUGOSLAVIA, FUTURE PROSPECTS AND THE NEED FOR ADDITIONAL ACTION. BOTH WORKING GROUPS WOULD REPORT TO THE COORDINATING GROUP CHAIRED BY SWITZERLAND. THE YUGOSLAV GO-VERNMENT FULLY CONCURS IN THIS AGREEMENT AND LOOKS FORWARD TO FUTURE DISCUSSIONS WITH CREDITOR GOVERNMENTS.

IT APPEARS NOW THAT THE FIRST MEETING OF THE TWO WORKING GROUPS COULD TAKE PLACE IN THE FIRST HALF OF JANUARY. IN THE MEANTIME, AND DURING THE PERIOD WHICH WILL BE NECES-SARY IN ORDER TO REACH FINAL AGREEMENT, THERE IS A NEED TO MAINTAIN AN ORDERLY PROCESS OF EQUAL TREATMENT BETWEEN GO-VERNMENTAL ANDCOMMERCIAL BANK CREDITORS.

AT THE ICC MEETING IN LONDON ON DECEMBER 6, IN WHICH THE IMF,THE IBRD AND YUGOSLAV DELEGATION TOOK PART, IT WAS RE-COMMENDED AND AGREED THAT THE YUGOSLAV AUTHORITIES WOULD PRO-POSE THAT ELIGIBLE MATURITIES OF PRINCIPAL OF YUGOSLAV EXTER-NAL MEDIUM-AND LONG-TERM INDEBTEDNESS FALLING DUE FROM JANUAR-RY 1,1984 TO MARCH 31, 1984, BEEXTENDED ON A PROVISIONAL BASIS. GIVEN THE AGREEMENT REACHED IN THE GENEVA MEETING ON PROCEDURES TO BE USED TO DEAL WITH CONCOLIDATION OF MEDIUM-AND LONG-TERM PRINCIPAL REPAYMENTS FALLING DUE TO OFFICIAL CREDITORS DURING 1984, WE INTEND TO ACT IN THE SAME WAY ON

IMF OFFICIAL CABLE

OBLIGATIONS IN PRINCIPAL TO OFFICIAL CREDITORS, WHILE FUL.-
FILLING ALL INTEREST OBLIGATIONS, WITH THE VIEW TO REACH AS
SOON AS POSSIBLE, BUT BEFORE THE AND, OF MARCH 1984, AN OVERAL AGRE-
EMENT. IT IS UNDERSTOOD THAT THE PROVISIONAL STAND STILL OF
ELIGIBLE MATURITIES AS MENTIONED ABOVE WOULD NOT IMPLY THE
APPLICATION OF PENELTY INTERESTRATES.
I WOULD APPRECIATE IF YOU COULD INFORM ALL INTERESTED
GOVERNMENTS OF THE ABOVE.

UNQUOTE

BEST REGARES
J. KOROSEC, VICEGOVERNOR
NATIONAL BANK OF YUGOSLAVIA

440040 FUND UI

REPLY VIA ITT

?
TIME: 12:26 12/21/83 EST
CONNECT TIME : 583 SECONDS

12/22/83

Table 1. Yugoslavia: Balance of Payments with the Convertible Currency Area, 1982-84 1/

(In millions of U.S. dollars)

	1982	1983 Est.	1984 Proj.
Exports	5,526	6,300	7,200
Imports	-9,043	-8,450	8,800
Trade balance	-3,517	-2,150	-1,600
Invisibles (net)	2,003	1,925	2,100
Workers' remittances	1,085	1,265	1,135
Tourism	1,224	1,335	1,510
Interest payments	-1,670	-1,690	-1,890
Others	1,364	1,015	1,345
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Drawings	1,684	3,825	3,135
Repayments	-1,626	-2,450	-2,745
Loans extended	-175	-200	-200
Short-term debt	-506	-600	--
Errors and omissions	562	-750	-300
Total	-1,575	-350	390
Use of Fund Credit	563	410	120
Reserve movements (increase -)	1,012	-10	-510

1/ Calculated at the statistical exchange rate of US$1 = Din 63.4.

12/22/83

Table 2. Yugoslavia: Drawings on Medium- and Long-term Debt in Convertible Currency by Creditor, 1983-84

(In millions of U.S. dollars)

	1983 Est.	1984 Proj.	
Government packages	831	1,100	
Berne	831	350	
Refinancing	(304)	(3)	
New financial credits	(172)	(...)	
Suppliers' credits	(355)	(347)	
Geneva	...	750	
Refinancing	...	(500)	
Suppliers' credits	...	(250)	250
Commercial bank package	1,580	1,300	
Refinancing	980	1,100	
New financing	600	200	200
IBRD	350	485	
Regular facilities	280	280	
SAL	70	205	
Other multilateral lenders IFC, EIB and Eurofima	50	50	
Suppliers' credits outside Government packages	1,014	200	
Subtotal	3,825	3,135	
IMF	590	400	100
Total	4,415	3,535	

-150 Turkey

+600 Gvts
100 Mks
135 IBRD
50 Eurofima

520

3000

3850
150

cc: HOS
PM
DR
CED

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

EXECUTIVE DIRECTOR
United States

December 21, 1983

CABLE ADDRESS
INTERFUND

cc: HOS

Pl convey these pts to Mentré & confer with him as to how they are to be best dealt with
LAW
22/12

To: L. A. Whittome

From: Richard D. Erb RDE

Subject: U.S. Government suggestions for topics to discuss at Group II meeting of Friends of Yugoslavia in January.

At the recent Friends of Yugoslavia meeting in Geneva, it was suggested that countries submit to the IMF subjects for discussion for Group II when it meets next month. The U.S. Government would like to suggest the following topics:

- Economic Adjustment--goals and objectives, results thus far, future problems/issues and plans for dealing with them especially inflation and lack of positive interest rates.

- Adjustment over the medium term--are we just seeing temporary results in the balance of payments; how to break the inflation/devaluation syndrome; structural adjustment for enterprises and sectors--what is the plan of action.

- Improving management of external finances--the need for legislative/management actions to accelerate repatriation of funds and catch more of those funds; the need to improve accounting records of debt and debt service payments; status of promoting a unified foreign exchange market.

Office Memorandum

December 21, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia

Mr. Korosec phoned this morning. He said that Mr. Dobrich had completed discussions with the National Bank as a result of which the National Bank would send a telex confirming:

(i) the appointment of Manufacturers Hanover Trust as agent for 1984 subject to further negotiations on fees;

(ii) agreement to the appointment of Dobrich as nonvoting Chairman of the ICC; and

(iii) that the expenses of the ICC would be settled on time.

A telex requesting a stand-still would also be sent to the ICC Korosec reminded me that we had also undertaken to support this request and I said that this was already in hand.

L.A. Whittome

cc: Mr. Schmitt
Mr. Mentré
Ms. Ripley
CED

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

DO NOT SOFT ROLL EXCEPT WHEN ALIGNING INTO LINE 23

START ADDRESS IN THIS

MR. PAUL MENTRE
OFFICE IN EUROPE
PARIS
FRANCE

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MARK XX FOR CODE
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START TEXT HERE

1. MANUFACTURERS NOW CONFIRMED AS AGENT FOR 1984.

2. REQUEST FOR STANDSTILL NOW BEING SENT BY NATIONAL BANK TO ICC.

3. MANAGING DIRECTOR'S TELEX TO TAYLOR BEING SENT.

4. PRESUME WORLD BANK ARE AWARE OF MID-JANUARY MEETINGS.

5. PRESUME ALSO THAT WORLD BANK AND EIB ARE AWARE OF CO FINANCING IDEAS AND ARE HOPEFULLY WORKING ON PROPOSALS.

HAPPY CHRISTMAS

ALAN

IF REQUIRED INITIAL BELOW

SPECIAL INSTRUCTIONS — TEXT MUST END HERE

TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): LAWHITTOME EXT.: 73074 DEPT.: EUR DATE: 12/21/83

AUTHORIZED BY NAME (TYPE): L.A. Whittome

AUTHORIZED BY NAME (TYPE): (**)

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SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

Mr. Whittome

December 21, 1983

MEMORANDUM FOR FILES

Subject: Errors and Omissions

During the period January-October 1983 the outflow under errors and omissions amounted to US$745 million. The major reason for this outflow seems to have been a swing in the repatriation of export earnings. As indicated in the attached table, exports according to customs data increased by US$500 million in the period January-August 1983 compared with the same period of 1982. Repatriation of export earnings in the same period however declined by US$645 million. There was no corresponding shift in the payment of imports. Payments on imports in 1982 and 1983 have been substantially lower than imports according to customs data, mainly because of the heavy reliance on suppliers credit in both years and to some extent because of imports under compensatory arrangements.

It has not been possible for the Yugoslav authorities to quantify the various elements contributing to the outflow under errors and omission. The major contributing factor which have been cited are on the export side: (1) a lengthening of the repatriation period for export receipts from 60 days to 90 days; (2) a lengthening in the maturity of medium- and long-term export credits; (3) delays of more than 90 days because of debtors being unable to pay; (4) an increase in exports under compensatory trade arrangements not yet matched by imports; and (5) voluntary delays by exporters in repatriating export receipts to take advantage of the rapid depreciation of the dinar. On the import side there might be cases of early payments of imports; this, however does not seem to be supported by the attached table. Finally, there could be some errors and omissions stemming among other things from balance of payments flows being calculated at statistical exchange rates while reserves are calculated at actual exchange rates.

It is not possible to quantify how much each factor has contributed but one can make some reasonable guesses about some of them. The repatriation period was lengthened from 60 to 90 days with effect from January 1, 1983; that is in 1983 Yugoslavia will receive payments from exports of the last two months of 1982 while it will extend exports for the last three months of 1983. If one deducts the amount of receipts which are financed by medium- and long-term export credits, (roughly 10 percent) and assumes that all other export receipts previously were repatriated at 60 days and now will be repatriated after 90 days then this factor alone would explain some US$350 million out of the US$745 million total. The fact that there was an inflow under errors and omissions in the first quarter of 1982 although the lengthening of the repatriation period took effect January 1, may be explained by some delays in taking advantage of the new scheme and the fact that the incentive to delay repatriation did not become sufficiently strong until after the February step devaluation and the acceleration in the depreciation of the dinar.

The other elements on the export side cannot be quantified. Perhaps some qualitative indication of payment difficulties in destination countries can be deduced from the fact that 32 percent of exports go to developing countries; such exports, however, declined by some 4 percent in the period Jan-Nov., 1983 compared with the same period of 1982 so one must make the assumption that payment difficulties of developing countries increased in 1983 in order to explain part of the outflow by this factor. It may be of interest to note that Iraq, Iran, and Libya are important trading partners accounting for estimated exports of US$650 million, US$135 million, and US$230 million, respectively in 1982, or a total of 18 percent of convertible currency exports in that year.

The errors resulting from the use of accounting exchange rates should not have had much impact in 1983 and would certainly account for less than US$100 million.

Arne B. Petersen

cc: Mr. Whittome
Mr. Schmitt
Ms. Ripley
Mr. Hansen
Mr. Lewis

Table 1. Yugoslavia: Trade Data on Customs and Cash Basis 1981-83

(In millions of U.S. dollars)

	1981	1982	1982 Jan-Aug.	1983 Jan-Aug.	1983 Jan. Sept.
Exports					
Customs data	5,720	5,854	3,401	3,914	4,459
Repatriation	5,961	5,741	3,606	2,961	3,600
Difference	241	-113	205	-953	-859
Coverage (in percent)	104.2	98.1	106.0	75.7	80.7
Imports					
Customs data	10,609.7	9,634.8	6,119	5,385	5,789.5
Payments	10,543.2	8,179.2	5,248	4,205	5,032.5 1/
Difference	-62.5	-1,455.6	-871	-1,180	-757.0
Coverage (in percent)	99.4	84.9	85.8	78.1	86.9

Source:

1/ Payments data for Jan-Sept. was inconsistent with those given previously for Jan.-Aug. and there appeared to be an error in the official data. The September data presented here is a staff estimate corrected for the apparent error but the authorities were not able to confirm these figures.

cc: HOS
DR

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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MR. PAUL MENTRE
OFFICE IN EUROPE
PARIS
FRANCE

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1. MANUFACTURERS NOW CONFIRMED AS AGENT FOR 1984.

2. REQUEST FOR STANDSTILL NOW BEING SENT BY NATIONAL BANK TO ICC.

3. MANAGING DIRECTOR'S TELEX TO TAYLOR BEING SENT.

4. PRESUME WORLD BANK ARE AWARE OF MID-JANUARY MEETINGS.

5. PRESUME ALSO THAT WORLD BANK AND EIB ARE AWARE OF CO FINANCING IDEAS AND ARE HOPEFULLY WORKING ON PROPOSALS.

HAPPY CHRISTMAS

ALAN

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TELEX NO.: CABLE ADDRESS:

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AUTHORIZED BY NAME (TYPE): L.A. Whittome AUTHORIZED BY NAME (TYPE): (**)

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

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48 REV 1
1-18 82

[signature]

Mr. Whittome

December 21, 1983

cc: HOS
DB
WE
be prepared to answer

MEMORANDUM FOR FILES

Subject: Yugoslavia

Mr. Dobrich of Manufacturers Hanover called me this morning to inform who would participate in the meeting in the Fund tomorrow at 9:30. The delegation of bankers would include, in addition to himself and possibly Ms. Mudd, Mr. Larry Brainard and Michael Bunemann, both of Bankers Trust, Mr. Robert Kopeck, Morgan Guaranty, Mr. Cliff Evans, Citibank, and Mr. Gabriel Eichler, Bank of America.

He said that particularly the representatives of Morgan Guaranty and Bank of America would challenge our view that the Yugoslavs should ask for new money. Further, he said that the banks again would ask several questions about the swing in the "errors and omissions" item in the balance of payments in 1983.

Mr. Dobrich had just returned from Belgrade. He said that the Yugoslavs would send the request for a standstill to the ICC on Friday, December 23, 1983 and said that they would want an endorsement telex from the Fund at the same time. I said that we had already a draft of such a telex ready. He confirmed that the telex would only refer to the standstill period and not to the offer of rescheduling of bank maturities. He also asked when the Yugoslavs could expect to have the standstill with governments approved. I told him that this would not be approved explicitly, but that as soon as the Yugoslavs had requested a rescheduling of government maturities a standstill would be tacitly approved. His understanding was that the Yugoslavs had already sent the request to Mr. Probst.

Leif Hansen LH

cc: Mr. Whittome
Mr. Schmitt
Ms. Ripley
Mr. Lewis
Mr. Petersen

Gloalt

Office Memorandum

TO : The Managing Director

DATE: December 21, 1983

FROM : L.A. Whittome

SUBJECT : Yugoslavia

In his back-to-office report of today's date Mr. Schmitt makes a number of proposals. I believe that they are acceptable subject to the following understandings:

1. The foreign exchange allocation system

The foreign exchange holdings in convertible currencies of the commercial banks should not represent more than working balances and this should if necessary be safeguarded by limits on both spot and spot against forward transactions. These limits should be known to the mission.

2. Interest rates

The phased adjustment should not be back loaded; if possible it should be front loaded.

3. Public finance

To be effective the approach needs to ensure that a given sum be blocked in quarterly instalments through 1984. This blocked sum should be of an amount that would in itself make the program cohesive without any allowance for any additional sums that might be blocked as a result of the requirements governing revenues and expenditures.

4. Official reserves

It is essential that an effective reserves test be incorporated otherwise we have no basis on which to argue with others for a build up of reserves.

Mr. Schmitt tells me that he had indeed intended his proposals to be read in this way.

cc: The Deputy Managing Director
Mr. Collins
Mr. Schmitt
Mr. Ripley

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WASHINGTON, D. C. 20431

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MR. PAUL MENTRE

PARIS OFFICE

PARIS

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cc. Ms Ripley

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I SHALL SEND YHANSEN FROM BELGRADE TO JOIN YOU IN PARIS ON JANUARY 11-12.

REGARDS,

SCHMITT

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TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): HANS SCHMITT EXT.: 72933 DEPT.: EUR DATE: 12/21/83

AUTHORIZED BY NAME (TYPE): AUTHORIZED BY NAME (TYPE):

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Schmitt

SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

Office Memorandum

DEC 21 1983

TO : The Managing Director

DATE: December 20, 1983

FROM : L.A. Whittome /LAW

SUBJECT : Telex to Manufacturers Hanover

I attach for your signature a telex to the President of Manufacturers Hanover regarding the standstill for Yugoslavia.

Attachment

cc: The Deputy Managing Director
Mr. Schmitt
Mr. Mentré
Ms. Ripley
Mr. Collins
CED

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WASHINGTON, D. C. 20431

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MR. HARRY TAYLOR
PRESIDENT
MANUFACTURERS HANOVER TRUST COMPANY
NEW YORK
NEW YORK

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cc: Mr. Polak

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WE HAVE BEEN INFORMED BY THE YUGOSLAV AUTHORITIES THAT THEY ARE PROPOSING TO COMMERCIAL BANKS THAT THE REPAYMENT OF THE PRINCIPAL OF MEDIUM- AND LONG-TERM ELIGIBLE MATURITIES, FALLING DUE BETWEEN JANUARY 1 AND MARCH 31, 1984, BE POSTPONED BY 90 DAYS IN THE CONTEXT OF DISCUSSIONS UNDERWAY WITH THE ICC ON A FINANCIAL PACKAGE, WHICH WOULD PROVIDE FOR THE REFINANCING OF UP TO 100 PERCENT OF SUCH MATURITIES. I UNDERSTAND THAT THE ICC INTENDS TO RECOMMEND THAT THIS PROPOSAL BE APPROVED.

YUGOSLAVIA HAS ENTERED INTO NEGOTIATIONS WITH THE FUND FOR A STAND-BY ARRANGEMENT COVERING 1984. AS YOU KNOW, THE ADJUSTMENT EFFORTS OF YUGOSLAVIA HAVE ALREADY LED TO A SIGNIFICANT REDUCTION OF THE CURRENT ACCOUNT DEFICIT WITH THE CONVERTIBLE CURRENCY AREA, WHICH SHOULD FALL TO DOLLARS 200 MILLION IN 1983. THE COMMON AIM OF THE YUGOSLAV AUTHORITIES AND THE FUND, UNDER THE STAND-BY ARRANGEMENT CONTEMPLATED FOR 1984 IS TO OBTAIN A SIGNIFICANT CURRENT ACCOUNT SURPLUS. WHILE THE

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TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): LAWHITTOME LAW — EXT. 73074 — DEPT EUR — DATE: 12/20/83

AUTHORIZED BY NAME (TYPE): J. deLarosiere — AUTHORIZED BY NAME (TYPE):

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CORRESPONDING NEGOTIATIONS HAVE NOT YET BEEN FINALIZED, THEY SHOULD NORMALLY LEAD TO BOARD ACTION IN FEBRUARY OR MARCH AT THE TIME WHEN THE OTHER COMPONENTS OF THE COORDINATED FINANCIAL PACKAGE WOULD HAVE BEEN MORE PRECISELY DEFINED. IN THE MEANTIME, IT IS ESSENTIAL TO MAINTAIN AN ORDERLY PROCESS. THUS IN LINE WITH OUR SUPPORT FOR THE PARALLEL REQUEST PUT FORWARD TO CREDITOR GOVERNMENTS I SUPPORT THE REQUEST PUT FORWARD TO BANKS BY THE YUGOSLAV AUTHORITIES.

REGARDS

J. DE LAROSIERE

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C TELEX NO.: CABLE ADDRESS:

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E AUTHORIZED BY NAME (TYPE): J. de Larosiere — AUTHORIZED BY NAME (TYPE): (**)

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Larosiere

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The Managing Director December 20, 1983

L.A. Whittome

<u>Telex to Manufacturers Hanover</u>

I attach for your signature a telex to the President of Manufacturers Hanover regarding the standstill for Yugoslavia.

Attachment

cc: The Deputy Managing Director
Mr. Schmitt
Mr. Mentré
Ms. Ripley
Mr. Collins
CED

INFORMATION COPY

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WASHINGTON, D. C. 20431

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MR. HARRY TAYLOR
PRESIDENT
MANUFACTURERS HANOVER TRUST COMPANY
NEW YORK
NEW YORK

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cc: Mr. Polak

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REGARDS

J. DE LAROSIERE

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~~MR. HARRY TAYLOR~~
~~PRESIDENT~~
~~MANUFACTURERS HANOVER TRUST COMPANY~~
~~NEW YORK~~
~~NEW YORK~~

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1983 DEC 23 PM 5 02

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cc: Mr. Polak

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REPEAT TO MR. DOBRICH - SEE ATTACHMENT

TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): LAWHITTOME /BW EXT.: 73074 DEPT. EUR DATE: 12/20/83

AUTHORIZED BY NAME (TYPE): J. deLarosiere

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REGARDS

J. DE LAROSIERE

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Mr. Harry Taylor

DISPATCHED IMF

1983 DEC 23 PM 3: 02

REPEAT MESSAGE TO:

Mr. Fulvio Dobrich

Manufacturers Hanover Trust

New York NY

Telex No. 668441 or 668493

INTERNATIONAL MONETARY FUND

KAW.

I have just seen the proposed agenda for the Jan. 12 meeting in Paris, and this comment may come after the fact. However, is idem 1.c not premature at best since HOS and team will still be in Belgrade, and the letter of intent will still be under discussion? Will there be World Bank representation on the January mission, in view of the role foreseen for co-financing?

Duncan M. Ripley DMR

INTERNATIONAL MONETARY FUND

TO :

FROM:

[illegible]

– Exchange rate stabilization (in real terms) is a major concession to the Yugoslav views which might have been offered later

– ~~A little~~ Very weak on foreign exchange allocation, a key issue

– I keep my doubts on adjusted NDA as an operational instrument but it is too late now

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MR. RADOVAN MAKIC

GOVERNOR

NATIONAL BANK OF YUGOSLAVIA

BELGRADE

YUGOSLAVIA

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CC: MR. POLAK

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MAY I TAKE UP YOUR INVITATION TO PAY A BRIEF VISIT TO BELGRADE. I WOULD PROPOSE TO ARRIVE IN BELGRADE BY LH 362 ON MONDAY, JANUARY 9 AT 3.10 P.M. I WOULD STAY AT THE INTERCONTINENTAL. I WOULD NEED TO LEAVE THE FOLLOWING DAY TUESDAY, JANUARY 10 BY LH 363 AT 4 P.M.

IF IT WERE POSSIBLE I WOULD MUCH LIKE TO MEET WITH YOU, MR. DRAGAN, AND IF THOUGHT SUITABLE, WITH THE PRIME MINISTER.

BEST REGARDS

ALAN WHITTOME

INTERFUND

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3. Use 10 pitch type (Pica)

MARYLAND BUSINESS FORMS INC. TIMONIUM MD

Lawrence Brainard, SVP
Bankers Trust

Draft

December 19, 1983

YUGOSLAVIA
Report of the Economic Subcommittee
Visit to Belgrade December 13-16

1. Introduction

Members of the Economic Subcommittee visited Belgrade during December 13-16 for discussions with Yugoslav bank and government authorities. The members of the subcommittee participating in this visit included:

Carlo Boffito, Banca Commerciale Italiana
Steven Popper, Bank of America
Rainer Siegelkow, West LB
Lawrence Brainard, Bankers Trust

The National Bank served as the host of our visit and arranged the meetings requested. A list of the individuals and institutions visited is shown in the Appendix.

The 1983 refinancing agreement provides two mechanisms for updating creditor banks on economic developments in Yugoslavia. One is the preparation of an Economic Information Statement on a quarterly basis. The other is semi-annual visits by members of the banks' Economic Subcommittee for in-depth discussions of current developments and prospects. The first Information Statement dated November 1983 has already been delivered to the agent for distribution to all the banks. This was the first visit of the Economic Subcommittee under provisions of the refinancing agreement. Two prior visits took place in February and June of this year.

The primary goals of our discussions were the following:

a) discussion of the recent Economic Information Statement, with special attention given to:
   - explanation of the large outflow on errors and omissions in 1983
   - reconciliation of debt data with those compiled by Peat, Marwick and Mitchell
   - status of arrears in foreign payments of principal and interest
   - accounting systems being used in the NBY to track current data on debt

b) status of the adoption and legal implementation of recommendations of the special commission on economic stabilization - many of these items form commitments to the IBRD, in the Letter of Development Policy which accompanied the Structural Adjustment Loan signed earlier this year. We asked to focus on three issues:
   - rationalization of investment and resource allocation
   - improving financial discipline in the economy
   - foreign exchange allocation and accountability for foreign debts

c) review of economic results and balance of payments position in 1983

d) discussion of economic trends and balance of payments prospects in 1984

Our visit coincided with that of the IMF, which was engaged in negotiations on the letter of intent for a 1984 standby facility. At the same time, intensive discussions were taking place in the Federal Assembly on the 1984 plan and budget and on revisions to the foreign exchange law. Although we feel reasonably confident in our assessment of the trends in the economy in 1984, specific details in the forecast may have to be altered once the end-of-year data are in and the results of the above-mentioned discussions are known.

It should be remarked that our discussions were greatly facilitated by the Economic Information Statement which presents the data in a convenient format for analysis. In addition, the National Bank has succeeded in computerizing all of the foreign debt data, using software developed by the World Bank. Unfortunately, it is not possible for the NBY to provide specific detail on bank debt and maturities since an unknown portion of these transactions are covered by official export insurance. Nevertheless, the data base permits a wide variety of cross-sections to be made for detailed analysis. Overall, it represents a major improvement in data management.

The Balance of Payments in 1983 and 1984
(Table 1)

During 1983 the trade account with the convertible currency area showed a substantial improvement. In the first eleven months of the year the trade deficit was more than halved to $1.4 billion (1982: -$3.1 billion). Due to seasonal factors (of a statistical nature, as well as higher end of year imports and exports) the December figures are difficult to predict. According to recent official projections the trade deficit for the whole 1983 could amount to about $2.05 billion, a drop of nearly $1.5 billion compared to 1982 (- $3.52 billion). It will be much lower than forecasted by the National Bank of Yugoslavia in June this year (- $2.85 billiony).

The main reason for the better outcome will be a 6.5% decline in imports compared to unchanged imports in the original projections. This was mainly due to the restrictive measures taken this year to cut down imports from the convertible currency area. In addition, the Yugoslav authorities succeeded in changing the direction of trade, i.e. increasing imports from, and slowing exports to, the non-convertible currency area.

Despite more or less stagnating markets in Western Europe the rise in exports will be somewhat higher than projected. This is due to the positive effects of the strong dinar devaluation and weak domestic demand which made exporting more attractive.

As a result of the redirection of trade the trade balance with the non-convertible currency area in 1983 will swing back to a deficit of some $350 million (1982: + $697 million). The surplus in the bilateral clearing balances vis-a-vis the non convertable currency area will thus disappear by end of 1983.

Net invisibles with the convertible currency area are now expected to show a surplus of $1.925 billion, some $300 million less than projected in June. The main reason is a stronger than expected decline in net remittances which was caused by government measures to restrict withdrawals from foreign currency accounts.

The deficit in the current account balance with the convertible currency area will drop from $1.5 billion in 1982 to approx. $175 million in 1983, the major part of the improvement being accounted for by the strong reduction in the trade deficit.

A major problem of the balance of payments in 1983 has been a net outflow of reserves through "errors and omissions" of almost $600 million. About $100 million can be attributed to statistical measurement problems connected with the large changes in the dinar exchange rate. Two additional factors were

- expanded credit terms of Yugoslav exporters (from 60 to 90 days)
- export earnings being repatriated are below exports recorded in the trade account.

The Yugoslav authorities are planning to implement appropriate policy measures to induce a more timely and complete repatriation of export earnings. To which extent this will be successful remains to be seen. However, it seems inappropriate to us to project any negative (or positive) figure for errors and omissions in 1984.

In 1984, the trade deficit with the convertible currency area is expected to decline further to $1.4 billion. Yugoslavia's competitiveness has improved considerably in the course of 1983 due to the strong devaluation of the dinar in real terms. The competitive position will be maintained in 1984 since a further nominal devaluation according to inflation differentials (keeping the real exchange rate unchanged) is envisaged. Also the recovery in the western countries will lead to an increase of demand for Yugoslav exports. However the target of an increase in nominal exports to the convertible currency area of 20% seems to be too ambitious. A rise by 14% (export volume + 10%, prices + 4%) as forecast by the IMF seems more likely. In the official projection imports are assumed to grow by around 8%, mainly for two reasons. Firstly, it will be difficult to cut down further the imports of capital goods after the very large decline (- 22%) in 1983. Secondly, there is an urgent need for imported intermediate goods and spare parts in order to increase production in the export sectors. However, we expect imports in line with a lower export growth to increase by a slightly lower rate. In total the trade deficit with the convertible currency area should drop from $1.95 billion in 1983 to $1.6 billion in 1984 (still some $200 million higher than the Yugoslav projection).

The trade deficit with the non-convertible currency area is expected to decrease only slightly from $350 million to $250 million with exports and imports growing by 8% and 5% respectively.

Net invisibles are forecast by the Yugoslavs to show a surplus of $2.2 billion, $275 million more than the probable 1983 outcome. With the exception of tourism, we would take the target to be realistic. While net receipts in transportation (in line with higher trade volumes) and in other services should increase moderately, net interest payments and net workers remittances (because of a net return of workers abroad) can be expected to deteriorate slightly. The projected 20% increase in net tourism receipts seems to be a bit too optimistic (because the dinar devaluation will show up only partly in lower hard currency prices for tourism). Therefore we expect the surplus in invisibles in 1984 to be by some $100 million lower than forecast by the Yugoslavs.

In total, the Yugoslavian current account vis-a-vis the convertible currency area should again improve considerably in 1984. We expect it to swing into a surplus of some $500 million. (This would be in line with the provisional IMF-target but somewhat lower than the Yugoslav projection of $800 million).

Table 1: Balance of Payments on Current Account with the convertible currency area (in million of US Dollars) *-1

	1982	1983 *-2	1984 *-2	1984 *-3
Current account balance	- 1.513,1	- 175,0	800,0	500.0
Exports F.O.B.	5.526,4	6.400,0	7.700,0	7.300,0
Imports C.I.F.	9.042,5	8.450,0	9.100,0	8.900,0
Trade Balance	- 3.516,1	- 2.050,0	- 1.400,0	- 1.600,0
Remittances (net)		1.500,0	1.440,0	1.440,0
Travel (net)		960,0	1.150,0	1.050,0
Interest (net)		- 1.690,0	- 1.860,0	- 1.860,0
Transportation (net)		800,0	1.080,0	1.080,0
Other (net)		355,0	390,0	390,0
Invisible Balance	2.003,0	1.925,0	2.200,0	2.100,0

*-1 at unchanged exchange rates (1 US Dollar = 63,40 dinar)
*-2 Yugoslav Projection as of 16/12/83
*-3 Economic Committee Projection

1983 Economic Performance

Developments in 1983

The year 1983 has shown a perceptible improvement in the economic situation. Exports to the convertible currency area have increased by 16% over the previous year, and by 27% to the developed West. This will be accompanied by a decrease in convertible currency imports of 6-7%. The estimated year-end convertible currency trade deficit of $2.05 billion will exceed the target of $1.15 billion, but shows a considerable improvement over the 1982 figure of $3.5 billion. A total current account deficit of $175 million is expected as opposed to the 1982 figure of $1.5 billion. A more detailed analysis of the balance of payments for 1983 has been presented above.

A 2% increase in industrial production was planned for 1983. The first two quarters were stagnant but a recovery in the third should lead to an annual increase of 1-1.5%. Due to the continuing import dependence of industry, this upswing was predicated upon a greater inflow of imports so that the year's target for convertible currency capital goods imports of $1.1 billion was reached in October. The year-end total should still be below last year's $1.7 billion.

Although figures are not yet available, the 1983 harvest was favorable and the planned increase in agriculture production of 2.5% should be met or exceeded. The increasing returns to agricultural activity have led to a reduction in the trend of net migration into the cities. This notwithstanding, unemployment is currently 14% and its unequal distribution between regions continues to frustrate the formulation of uniform economic policies on the federal level.

The 1983 plan called for a decline in real domestic demand of 10%. However, the indicator of real retail sales was down only 1.3% in the first nine months over the same period last year. At the same time real personal income, scheduled for a decline of 7%, was down 10% in the first quarter of 1983 and will register a third straight year of decline. It is felt by the Yugoslav authorities that any further compression of consumer imports would be counterproductive in the sense of attenuating incentives to increase production. The official planned falloff in real fixed investment of 20%, which was probably meant more as a bargaining position than as an estimate, will not be realized, but this category will nevertheless show an annual decline of around 10%.

The targets called for an increase in the money supply of only 12.8% which should be met. The policy of restraining total domestic credit extended by banks will keep outlays for fixed investment by banks below the figure for 1982. In order to improve the external competitive position, the dinar continued to be devalued with the real effective exchange rate declining 22%. The target for inflation of 20% proved impossible to acheive. The annual rate of increase in retail prices is 47.6% and 40.6% for industrial prices. This has been fed by a policy of drastic price increases in some sectors, particularly in energy, in order to rationalize relative prices. Currently 45% of all prices are uncontrolled with the proportion being raised to 60% in January 1984. A further 25% will be governed by social compact for which enforcement provisions are lax. Interest rates are scheduled to be increased a further 6% at the end of December. They now largely fall in the range of 22-38%.

Structural Change

While the balance of payments figures for the first eleven months of 1983 and the projections for 1984 give reason to believe that Yugoslavia has succeeded in effecting a significant stemming of its short-term payments problem, the longer term prospects seem less clear. Yugoslavia's recent economic history has been marked by periods of more or less unchecked economic growth followed by necessary periods of retrenchment. This cycle of stop-go development can be traced to cetain systemic factors which need to be addressed successfully if a repetition of the pattern is to be avoided. In the past, the ability of individual groups of interests to argue credibly that specific restrictive measures would affect them adversely in a disproportionate manner has been sufficient to frustrate attempts to deal in a profound way with perceived inefficiencies. While the current economic hardships have led to a wide-ranging scrutiny of the inherent problems of the economic system and even to the detailed formulation of specific proposals for change, it appears that implementation and enforcement of these changes remain, as ever, difficult to effect in practice. Three areas of continuing uncertainty will be briefly described.

The problem of rational allocation of investment remains. There are still many within the country who feel that current interest rates are too high even though they remain negative in real terms. The authorities are committed to acheiving positive real rates of interest via annual or semi-annual increases but they do not envisage attaining this level before the end of 1985. (The IMF is pressing for mid-1984). The main emphasis in directing investment is still placed on tight credit policies and allocation by administrative means informed by a re-drafted set of investment guidelines. The intention of these guidelines is to identify priority sectors for investment (e.g. energy, basic raw materials, agriculture, manufacturing exports and transportation) as well as to develop a system of criteria for evaluating projects. These are to be framed within a social compact to which all potential projects will be bound and which will be monitored by banks and chambers of economy in each republic. It is unclear that this system will provide for more efficient investment or stringent enforcement than has been true in the past especially once the sense of immediate crisis has lifted. Such guidelines are not yet in place in all republics and the early passage of a federal counterpart appears doubtful leaving some concern as to whether the harmonization of local interests with larger social benefits can be effected more easily than in the past. This proposal wouuld not appear to address directly the problem of increasing the mobility of capital across republics and provinces.

Secondly, in order to tighten the financial discipline of enterprises, the principle amendments measure appears to consist of appended to the 1980 law on the dissolution of unprofitable enterprises. The main provision seems to be that a loss-making enterprise must develop a plan for reliabilitation in concert with those enterprises with which it routinely deals. If this cannot be done within 12 months the enterprise is dissolved. It is our understanding that beginning in 1984 the bank of which the enterprise is a customer will become liable for payment of the enterprises' debts. This is a step in the direction of allowing the market to decide the fate of inefficient producers, but there appears to be some potential for maintaining the existance of such an enterprise if it suits the interests of its business associates, for example suppliers who might otherwise be themselves forced to compete in a more difficult market, perhaps in another republic, in order to sell their own output. Regional interests could once again dominate general economic efficiency criteria.

It might also be pointed out that it still appears to be difficult to enforce strict controls on personal incomes paid to employees of enterprises. Such guidelines are formulated on a republic level in order to more closely reflect the local conditions, but instances where enterprises with flagging productivity grant wage increases are not infrequent.

Finally, measures to improve foreign exchange mobility were enacted in 1983 and will be further amended in 1984. The current rule is that foreign exchange-earning enterprises must mandatorily sell approximately 37% of such flows to the National Bank. In practice, there are delays and problems of timing. New proposals are intended to greatly reduce the opportunity of enterprises to retain foreign exchange not needed for payments. Briefly, enterprises will still be obliged to sell mandatory allocations to the NBY, and will be allowed to retain the foreign exchange required for covering the debt servicing, raw material import, and maintenance import costs of themselves and their suppliers. The balance is to be sold on the foreign exchange market to a commercial bank. The information obtained was not sufficient to answer the question of how the enterprises' assessment of its foreign exchange requirements was to be monitored and its adherence to guidelines enforced.

Serious attention must be paid on an ongoing basis to these problems not only by those outside Yugoslavia who retain an interesst in its development, but by the Yugoslavs themselves.

1984 Outlook

The Economic Policy Resolution for 1984 has not yet been passed by the Federal Assembly, nor has a program for next year's economic policy been agreed upon with the IMF. However, we can expect for 1984 a slight increase in domestic production (gross social product should grow by about 2%), brought about by a combined increeasе in external demand and a further decrease in domestic demand. Fixed capital investments will go down by 12% : having decreeased since 1980, in 1984 their volume will be 2/3 of that in 1979. Cuts in investment will compel enterprises to revise their investment decisions bringing to an end projects already started. Through selective credit policy, priority will be assigned to work in progress and new projects which employ domestic resources or are suitable for increasing exports or substituting for imports. Therefore, the main branches selected by investment policy will be agriculture, energy, mining and some transportation. However in spite of the efforts to rationalize investments, we have to mention that in 1983, the only region where investment expenditure rose faster than the index of producer prices was Kosovo.

According to official and unofficial forecasts, both private and collective consumption should go down again in 1984, even more substantially than in 1983. However, the opinion is also widespread that Yugoslavia has already reached a "critical point" and can not allow further decrease in real wages. Up to mow the population has accepted the reduction in the standard of living showing understanding of the situation the country finds itself in. There is, of course, dissatisfaction, but real social tensions are not emerging since the Yugoslavs seem persuaded that these could develop into major domestic conflicts or call forth strong external pressures.

The collective leadership established in Tito's last years did not prove to be capable of taking far-reaching decisions after Tito's death. The rotation system makes the political leaders rely on the republican party orgainizations for their own career, pushing them to support regional rather than national interests. At the same time, at thee federal level they have to reach general agreements about sensitive issues.

Such a political situation contributed to a substantial increase in the role of the IMF, who compelled the Yugoslavs to adopt a drastic stabilization policy. Generally, the policy enforced by the IMF is criticised in its approach (defined as being monetarist), but in the end, it is accepted in its individual points. The Yugoslavs would like the Fund to carry on an economic policy focussed not only on short term problems, but also finalized to reshape the structure of their production system. However, this is a question which must be solved by the new institutional structure the Yugoslav are developing.

In July, the Kraiger commission, made up of the best known Yugoslav economists, presented to the party central committee a long-term stabilization program which does not contain operative proposals, but is very clear in its general political conclusion. The only possibility for the country to develop and even to survive is to establish a real market economy that is able to substitute economic for political decisions.

The most important short-term problem appears to be inflation. Until 1981 it was certainly a demand determined inflation, but after the adoption of the deflationary policy of 1981-83 it turned mainly into a cost-push inflation. Rationalization of investments has not yet brought about a reduction in inefficiency, which, on the contrary, has been raised by an increase in employment enforced through administrative methods. In 1983, in spite of stagnation in industrial production, employment went up by 2,2%, b ringing down productivity of labour by 1.5%. Moreover, costs have been inflated by the strong devaluation of the dinar. All these causes will still be operating in 1984, and their intensity will very much depend on government economic policy. It is difficult to imagine that the Yugoslav authorities will be ready to give up their employment policy; the real exchange rate of the dinar will be kept constant; some adjustments in prices, which can not be postponed, will be a cause of further inflation which, in spite of the reduction in domestic demand, will probably accelerate in the months to come.

Capital Account Transactions

Developments in 1983

Two major differences appear in the data currently available as compared to the figures provided earlier in the year. Total amortization of medium and long-term loans is now put at $2,300 - $2,600m, compared to an earlier forecast of $2,900m in the June Information Memorandum. The other difference reflects a smaller amount of maturities due to banks than anticipated.

The over estimate of total maturities appears to result from the inclusion of certain loans where deferral of repayment is automatic given certain conditions, e.g. maintenance of an IMF program. The same problem is reflected in the 1984 amortizations shown in Table 2.7 of the Economic Information Statement provided to the banks. The best estimate for 1984 maturities is now put at $2,925m, rather than the $3,387m in the table.

The over estimation of maturities due to banks appears primarily to reflect the inclusion of bank claims which in fact have been insured by official export credit agencies. The Yugoslav borrower frequently does not know whether certain transactions have been covered by export insurance. This is also to say that the maturities due to governments were underestimated. Total maturities included in the bank refinancing are expected to be slightly over $1,000m. Peat, Marwick, Mitchell is currently preparing a detailed reconciliation of these data and the figures supplied by Yugoslav banks.

Taking all of these factors into account, a detailed breakdown of 1983 maturities may be derived :

Table 2: Estimated 1983 Medium and Long-Term Maturities

	(Million)
Bank refinancing	$1,000
Excluded debt (a forfait deduction, LHB, bonds, etc)	300
Multilateral agencies	360
Berne Accord governments	650
Non-Berne Accord governments	60
Other unidentified	230
TOTAL	$2,600

These estimates take the higher end of the range being forecast. Since it appears likely that the actual repayments will fall somewhat below this figure, the unidentified figure will be subjected to downward adjustment.

Total drawings of medium and long-term debt are projected at $4,470m. The estimated breakdown of sources is given below :

Table 3: Estimated Drawings - 1983 Medium and Long-Term debt

	(Million)
Commercial banks	$1,600
Multilateral agencies - IMF	620
IBRD, EIB	300
Berne Accord credits	830
Government credits outside Berne Accord and other (LHB rollover, supplier credits, etc.)	1,120
TOTAL	$4,470

Taking the estimated outflow of $200 million on account of net export credits extended by Yugoslavia, the positive balance on medium and long-term capital should be approximately $1,700m.

Net outflows of short-term capital are estimated at $500m. These represent repayments primarily to banks of trade credit, counterpart deposits and financial credits. Although this item appears as a large negative outflow, its effect on the balance of payments is probably less adverse than it appears. Most of the net repayments under trade lines may be re-drawn as needs arise. Banks have committed to a total now estimated at over $700m of trade lines through January 1985. Yugoslav commercial banks that we talked to indicated that their customers were reluctant to draw new short-term credit because of the costs and risks involved; they appeared to be reducing their short-term foreign liabilities by restricting imports and paying cash generated by exports. Thus, the net repayment of short-term trade debt reflects decisions of Yugoslav borrowers rather than withdrawal of lines by banks.

The unwinding of counterpart deposits is estimated very roughly at some $50-100m. Since the net short-term liability position of Yugoslav banks has improved during the year, declining from $341m in December 1982 to $15m in September 1983, the need for these deposits is less. Yugoslav banks reduced their short-term liabilities to foreign banks by $300m in the first nine months of 1983 (from $1,880m to $1,575m) while their short-term claims on banks remained unchanged at $1,270m (see Table 2.6 of the Information Statement).

The overall picture, therefore, reflects a financial restructuring of the balance sheets of the banks and enterprises by a net repayment of short-term debt while maintaining foreign exchange liquidity at previous levels. This must be assessed as a positive development. There is no evidence that the net outflow of short-term debt has created liquidity problems for the banks or enterprises.

Outlook for 1984

The implications of this assessment of short-term capital flows for 1984 are clear. Given substantial unused trade financing committments by western banks, there is no shortage of short-term credit availability in the outlook. Increases in the utilization of these lines will depend primarily on the Yugoslav banks and companies themselves. Given the projected increase in imports, a modest net inflow of some $200m on account of short-term capital appears likely.

Projection for the net balance on medium and long-term capital must be built up from assumptions about refinancing agreements yet to be negotiated. Total repayments are projected at $2,925m. Repayments to creditors outside of any government or bank refinancing may be estimated at about $625m. Maturities due to Berne Accord governments may be estimated at $650m. The remainder of $1,650m represents maturities due to banks and other creditors.

Table 4: Estimated 1984 Medium and Long-Term Maturities

	(Million)	
		519 = 55
Multilateral agencies	465	
Arab governments*	160	810 612
Berne Accord governments	650	1563
Banks and other creditors	1,650	
TOTAL	$2,925	

* Of which, Kuwait approximately $100m.

Estimates of drawings of medium and long-term credits are based on the following assumptions. Total drawings on multilateral creditors are estimated at $800m. Projected drawings on government credits are based on the assumption that 100% of debt outstanding at end 1982 is refinanced; this figure is put at $600m, or 92% of total maturities due to governments in 1984. Drawings on Berne Accord credits are projected at $400m and new export credits are projected at $50m. Bank credits are projected at $1,600m, composed of $1,550m of refinanced credits and $ 50m of new term credit. The refinanced total represents 91% of total maturities. Total maturities are estimated at $23m for bonds and $40m for LHB International Bank. It is assumed that some percentage of the bonds are paid and the LHB claims are extended outside the bank refinancing. A residual inflow is projected, based on new supplier credits and Arab government refinancings.

Table 5: Estimated Drawings 1984 Medium and Long-Term Debt

			(Millions)
Multilateral agencies			
	IMF		400
	IBRD, EIB	regular	250
		SAL	150
Berne Accord governments			
	Berne package		400
	refinancing		600
	other export credits		50
Banks			
	refinancing		1,500
	new money		50
Supplier and Arab government credits and refinancings			200
TOTAL			$3,600

2925 net 675

Assuming a net extention of long-term export credits of $200m, the projected positive balance on medium and long-term capital is $475m.

Overall Balance

We see no reason to project a negative balance on errors and omissions in 1984 since the primary reeason for the lag in receipts was due to a shift in regulations from a 60 day to 90 day limit on repatriation of export earnings. Our projections for the overall balance of payments, together with projections from the National Bank of Yugoslavia and IMF are shown below :

Table 6: 1984 Balance of Payments

	Millions of Dollars		
	Economic Sub-Committee	NBY	IMF *
Trade balance	-1,600	-1,400	-1,600
Current account	500	800	500
Medium and long-term capital	475	200	200
Short-term capital	200	0	0
Errors and omissions	0	0	-200
Change in reserves	1,175	1,000	500

*Based on discussions with the NBY; further changes in the forecast may, of course, be made by the Fund staff.

The primary differences in the forecasts reflect the following factors. We agree with the Fund in making a more conservative projection of the current account. We believe the net balance on long-term capital is underestimated by the NBY, because the amount assumed subject to refinancing is too small. We assume less than 100% refinancing of the bank maturities (i.e. 91%). The NBY assumes 100%. We assume some increase in the utilization of committed short-term trade lines. We assume a zero balance on errors and omissions.

Conclusions

Our forecasts imply a substantial increase in Yugoslav international reserves. There are several reasons why such a surplus may not result. All of the forecasts assume a relatively active use of available credits, which must be activated by individual enterprises and banks in Yugoslavia (e.g. SAL, Berne package, trade lines, etc). If liquidity improves in the direction indicated by all of the forecasts, banks and enterprises will continue to restructure their balance sheets by restricting the drawdowns of new credits and by re-building their own liquidity. The net effect will likely be a smaller increase in debt than projected here.

Rather than forcing the Yugoslav banks and enterprises to draw credits they do not want or need in order to show an arbitrary rise in NBY reserves, we should consider options that encourage the use of the market in a limited way to redirect the allocation of credit resources to the banks and enterprises willing and able to use them. This may be approached by seeking a modest repayment of maturing debt in the range of 5-10% and by encouraging those Yugoslav banks to seek new credits from the banks as needs arise. This enforces a discipline on the Yugoslav banks to service a portion of their debt and gives them an incentive to restore their creditworthiness in the eyes of the lenders.

Tying new money to the 1984 IMF program acts to hinder the efforts the Yugoslav authorities are making to restore the influence of the market in allocating resources internally. It centralizes the monies in the hands of the National Bank and makes them subject to political pressures and arbitrary decisions regarding their use. The position of the NBY would be better strengthened by giving it the ability to enforce greater discipline on the banks. In addition to these considerations, an involuntary new money facility would needlessly delay the signing of a bank refinancing agreement.

We recommend that the banks keep an open mind about the provision of new credits to Yugoslavia, but also that they avoid tying new money to the refinancing agreement.

APPENDIX

Individuals and Institutions Visited by the Economic Sub-Committee

National Bank of Yugoslavia

Dr. V. Dragomanovic
G. Babic
M. Nikolic
D. Ljesevic
M. Sarenac
J. Petrovic
M. Smeljanic

Federal Secretariat for Finance

M. Andzic
E. Padovan

Federal Secretariat for Foreign Trade

A. Milosevic

Federal Institute for Social Planning

M. Miljanic

Federal Executive Council

J. Smole

Meetings were also held with senior representatives of Jugobanka and Udruzena Beogradska Banka.

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CC: SCHMITT
CENTRAL EUROPEAN DIVISION
PETERSEN, ETR

AS AGREED, I ATTENDED THIS MORNING THAT PART OF THE PARIS CLUB MEETING WHICH WAS DEVOTED TO YUGOSLAVIA. IT WAS FINALLY AGREED THAT THE TWO SUB-GROUPS WOULD MEET IN THE FUND OFFICE FROM JANUARY 11 TO 13. THE TIMETABLE WAS, HOWEVER, FURTHER COMPLICATED BY THE DESIRE OF THE PARIS CLUB SECRETARIAT TO USE THIS OPPORTUNITY TO REVIEW SOME PROBLEM COUNTRIES IN ADVANCE OF THE NEXT REGULAR MEETING ON JANUARY 23. SUBJECT TO FINAL CONFIRMATION, I HAVE REACHED AN UNDERSTANDING WITH MR. JURGENSEN, THE CHAIRMAN, ON THE FOLLOWING: MEETING OF THE FIRST GROUP ON JANUARY 11, OF THE SECOND GROUP ON THE 12TH, AND REVIEW OF OTHER COUNTRIES ON THE 13TH. IT IS ON THIS BASIS THAT WE ARE WORKING ON THE TELEX TO BE SENT BY MR. GUETTA TO PARTICIPANTS.

MANY COUNTRIES, NOTABLY SWEDEN, CANADA, JAPAN, AND THE NETHERLANDS, EXPRESSED THEIR RELUCTANCE AT SEEING RESCHEDULING DISCUSSIONS INITIATED BEFORE EFFECTIVE FUND BOARD ACTION. THE CHAIRMAN, SUPPORTED NOTABLY BY THE UNITED STATES AND, WITH SOME QUALIFICATIONS, THE GERMANS, WAS ABLE, HOWEVER, TO OBTAIN AN AGREEMENT ON THE PROPOSED TIMETABLE, WITH THE UNDERSTANDING THAT THE JANUARY MEETING WOULD BE PRELIMINARY AND FOLLOWED BY A SWISS-CHAIRED PLENARY GROUP MEETING, ANY IMPLEMENTING AGREEMENT BEING POSTPONED PENDING EFFECTIVE BOARD ACTION. IN ADDITION, I HAD TO COMMIT OURSELVES TO SENDING IN ADVANCE OF THE JANUARY 11-12 MEETING, A FUND PAPER ON YUGOSLAVIA ANALYSING RECENT ECONOMIC DEVELOPMENTS, MAJOR POLICY ISSUES AND BALANCE OF PAYMENTS PROSPECTS. I DESCRIBED ALSO THE TIMETABLE CONTEMPLATED BY THE MISSION. I AVOIDED A FIRM COMMITMENT ON EFFECTIVE SIGNING OF THE LETTER OF INTENT BEFORE JANUARY 11, BUT EVIDENTLY IT WOULD BE OF HELP.

cc: HOS will you agree with ... [illegible] how this is to be met.

THE ISSUE OF PARALLELISM WITH COMMERCIAL BANKS WAS RAISED BY SOME DELEGATES AND I BRIEFED THEM ON THE CURRENT SITUATION.

IMF OFFICIAL CABLE

THE CHAIRMAN ASKED PARTICIPANTS TO SEND AS SOON AS POSSIBLE AVAILABLE FIGURES ON MATURITIES FALLING DUE IN 1984. HE SAID THAT HE HAD JUST HAD DISCUSSIONS IN PARIS WITH MR. DUMJOVIC, ASSISTANT SECRETARY FOR FINANCE, WHO WILL, NORMALLY, HEAD THE YUGOSLAV DELEGATION. MR. JURGENSEN HAD SUGGESTED TO HIM A CUT-OFF DATE OF END DECEMBER 1982 (THE BERNE AGREEMENT) AND TAKEN NOTE OF THE DESIRE OF THE YUGOSLAV AUTHORITIES NOT TO REQUEST ANY RESCHEDULING OF INTEREST. ON THIS, HOWEVER, THE U.S. REPRESENTATIVE, MRS. CONSTABLE, SAID THAT THE YUGOSLAVS MIGHT WELL NOT HAVE REACHED THEIR FINAL VIEWS ON THE SCOPE OF THEIR REQUEST FOR RESCHEDULING. MR. JURGENSEN FINALLY MENTIONED THAT THE YUGOSLAVS HAVE INDICATED TO HIM THEIR INTENTION TO POSTPONE, ON A PROVISIONAL BASIS, REPAYMENTS ON PRINCIPAL STARTING JANUARY 1, 1984.

OUTSIDE THE MEETING, THE GERMAN REPRESENTATIVE, MR. VON KORF, CONFIRMED TO MR. JURGENSEN THAT GERMANY, WHILE HAVING BEEN APPROACHED BY YUGOSLAVIA, HAD NO INTENTION OF CHAIRING THE SECOND WORKING GROUP. HE MENTIONED TO ME THAT HE HAD RECEIVED FROM THE GERMAN EMBASSY IN BELGRADE ALARMING REPORTS ON ENERGY SHORTAGES IN YUGOSLAVIA AND THEIR IMPACT ON INDUSTRIAL PRODUCTION AND EXPORT AVAILABILITY. THIS CONFIRMED ME IN MY PERSONAL VIEW THAT THE ADDITIONAL OIL IMPORTS FROM THE NON-CONVERTIBLE AREA HAVE NOT EFFECTIVELY MATERIALIZED IN 1983.

REGARDS,

MENTRE

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INTERNATIONAL MONETARY FUND

Minutes of Meeting No. 1

Held at the National Bank of Yugoslavia
Monday, December 5, 1983, at 10:00 a.m.

Yugoslav representatives:

National Bank of Yugoslavia

Mr. Veljković
Mr. Ymeri
Mr. Dimitrijević
Mr. Smiljanić
Mr. Dragaš
Mrs. Hofmann

Mr. Stamenković, Office of Prime Minister
Mr. Ajanović, Assistant Secretary
for Foreign Affairs
Mr. Gardasević, Assistant President
Federal Committee for Agriculture
Mr. Jovičić, Federal Community for Prices
Mr. Milošević, Secretariat for
Foreign Affairs
Mrs. Knežević, Federal Committee for Labor
Mr. Lončar, Community of Interest for
Foreign Economic Relations
Mr. Muršec, Federal Planning Institute
Ms. Golubović, Federal Planning Institute

Fund representatives:

Mr. Schmitt
Mr. Lewis
Mr. Petersen (afternoon only)

Mr. Veljković introduced the meeting on the balance of payments by noting that the Federal Assembly would begin discussions on the draft resolution on December 6 based on the balance of payments projections now provided to the mission. Minor changes could still be introduced and a more definitive statement of the external forecasts could be expected by December 20. The mission was provided with a set of balance of payments tables by Mr. Smiljanić showing the outturn for January-October 1983 and the forecasts for 1983-84, separately showing the convertible and nonconvertible currency areas. Mr. Milošević provided monthly figures for merchandise trade by currency area through the end of 1983 based on the outturn data through November 21, 1983. He also provided some breakdown of trade for the first 10 months of 1983 as requested, including energy imports, and promised to provide outturn data through November later in the week.

Mr. Muršec presented various external data based on the tables provided to the mission, including growth rates of foreign trade shown in the attached

Table . Yugoslavia: Merchandise Trade Data, 1983 1/

(Percentage change from one year earlier)

	Oct.	Nov.	Dec.	Jan.-Oct.	Jan.-Nov.	Jan.-Dec.
Total exports	-2.7	5.0	2.9	0.6	1.0	1.3
Convertible area	7.8	18.1	23.3	14.3	14.7	15.8
Nonconvertible area	-18.0	-12.8	-18.2	-17.1	-16.8	-17.0
Total imports	5.9	18.7	11.7	-6.4	-4.5	-2.3
Convertible area	4.4	4.2	22.9	-12.1	-10.9	-6.6
Nonconvertible area	9.1	49.0	-12.4	7.9	11.4	7.9

1/ Estimates for November 1983 based on outturn data through November 21, 1983; forecasts for December 1983.

table. The primary external objectives for 1984 were that obligations falling due would be honored, though a refinancing was not precluded, and that Yugoslavia's overall foreign debt would not be increased. 20 percent increase in convertible currency exports in 1984 was unchanged since the last staff visit but the current account surplus had been revised downward to US$800 million, largely reflecting the downward revision to the forecast of net service receipts.

Mr. Miloševic explained that trade developments during the last month had led to some minor revisions to the forecasts for 1983. Although the forecast for imports from the convertible area in 1983 had been reduced by US$200 million, even so it would be realized only if trade credits under the Berne package were utilized to the full extent anticipated. Imports in December 1983 would be lower than in November 1983. The sharp increase in

imports of oil and other energy products, accounting for most of the 49 percent increase in imports from the nonconvertible area in November, was not expected to continue in December. In the period January-November 1983 the quantity of crude oil imports was 8 percent higher than a year earlier. While imports of petroleum products had declined, crude oil imports for the entire year were forecast at 8.5 million tons, given the balance of payments constraints. Mr. Milošević forecast the following changes in volume of exports on average in 1983.

	Value in U.S. dollars	Volume Index
	(Percentage change from 1982 to 1983)	
Total exports of goods	1.3	2.3
Convertible currency area	15.8	17.0
Nonconvertible area	-17.0	-16.2

The estimates of volume changes were based on the 1 percent year-on-year decline in export unit values in the first nine months of 1983, and on unchanged import unit values in the same period based on the statistical exchange rate of Din 63.4 = US$1 for both 1982 and 1983. The import forecast was broken down as follows:

	In millions of U.S. dollars
Intermediate goods	6,680
Capital goods	1,300
Consumer goods	470
Total imports	8,450

Finally, he noted that the seasonally high level of exports and imports in December partly reflected the fact that the last two days of November were a national holiday so that some trade crossing the border in late-November was only recorded in December. Also, enterprises would try to boost exports as much as possible before the end of the year so that the income would be reflected in the accounts for the year, hence enabling larger payments of personal incomes to be made. Also, there was normally a seasonally high demand for imports, partly reflecting a "wait-and-see" attitude on the availability of foreign exchange.

The trade forecasts for 1984 assumed a 3 percent growth in export prices and a 4 percent growth in import prices in terms of dollars. Thus, the increase in volume of exports to the convertible currency area was expected to be the same as in 1983, namely 17 percent. Several reasons were offered for the assumed rapid growth of imports, including a pick-up in the growth of export markets, export orders in hand, and indications based on enterprise export programs and on consultations with trade associations.

Invisibles

Mr. Smiljanić explained that September-October was the seasonal peak for foreign exchange inflows from invisibles so that the present forecast for 1983, which had changed little in net terms from the previous forecast for 1983, was reasonably certain since it incorporated the outturn through October. Some reduction in both inflows of workers' remittances and outflows from foreign exchange accounts compared with the forecast of October seemed warranted. Interest payments for 1983 had been revised downward on the basis of a survey of banks in September; interest payments of US$1,900 million included the estimated fees and other costs associated with the external financing package. Earnings from transportation would be boosted in November-December 1983 by the bulge in exports and imports.

Mr. Smiljanić explained that the downward revision for net service receipts in 1984, amounting to US$320 million, reflected greater knowledge about the outturn for 1983 than was available at the time of the preceding forecast. He thought that greater caution in projecting the growth of foreign items was desirable since it would allow for a built-in reserve for the rather unpredictable flows of workers' remittances and earnings from tourism. As with the previous forecast, inflows from tourism and from workers' remittances were not comparable as between 1983 and 1984. On the basis of comparable data, Mr. Smiljanić's forecast indicated a 20 percent increase in earnings from tourism, assuming a 5-8 percent increase in the number of overnight stays and some increase in earnings from the tighter control over exports and imports of dinar banknotes. However, he expected that the increase in dinar prices for tourism would be offset by changes in the exchange rate. 1/

Mr. Schmitt noted that the staff and Yugoslav forecasts of merchandise imports and of net services were of the same order of magnitude and that the different current account forecasts mainly reflected different export forecasts. He suggested that one could agree to disagree on the export and current account targets as long as both sides worked with about the same import figure from which the output constraint would be determined, i.e., the disagreements on the balance of payments forecasts had little policy implication. He warned that the staff's export forecast could be on the ambitious side but proposed to stay with it for the time being. Mr. Veljković initially demurred, hinting that they might want to revise upward their forecast of the invisibles and arguing that the high export forecast was justified by the improved level of competitiveness. But in the course of discussion he did not take issue with Mr. Schmitt's suggestion of proceeding to work out the implications of the more or less agreed merchandise import forecast.

Mr. Schmitt distributed a set of six charts and suggested inferences that could be drawn from the first two of them. From the first chart it could be seen that the profitability of exports was high, causing one to question the need to continue to subsidize exports through the foreign exchange allocation system and through export subsidies. As long as such special incentives to exporters were maintained, it had to be concluded that the exchange rate had not depreciated enough to provide sufficient export incentive, and one would have to be pessimistic in forecasting export growth. From Chart 2 it could be seen that in terms of unit labor costs Yugoslav exporters had become more cost competitive. Moreover, they had increased their profitability relative to other exporters by reducing their relative costs while raising their relative prices in dollar terms. Thus, Yugoslav exporters should have ample incentive both to increase export volumes and to lower dollar export prices.

1/ His statement implied that dollar prices should decline in 1984 and he suggested that this explained the decrease in tourism receipts shown in Table 2. However, the figures for 1983 and 1984 in Table 2 were not comparable because some workers' remittances were allocated to tourism for 1983 but not 1984. How this statement was to be reconciled with a forecast increase in total tourism receipts of US$1.2 billion in 1984, compared with a comparable figure of US$1.0 billion in 1983, remained unclear.

Mr. Milošević took issue with the base period used in calculating the chart. A study undertaken in 1979 had clearly shown that the share of Yugoslav exports in world markets had steadily declined as the economy had gradually turned to production for the domestic market. Therefore, it had become necessary to introduce incentives to exporters. It had been decided that exchange rate policy should be the main policy instrument but it had also been deemed necessary in 1980 to introduce the present system of export subsidies. The improvement in export incentives shown by the chart had only rectified the distortion created in the period from the early 1970s until 1980. Recent surveys of the relationship between domestic prices and world prices showed that only now were exporters achieving close to the same income as that of producers selling on the domestic market. As to export subsidies, they only amounted to exemptions from certain taxes and customs duties. They had been agreed on with the GATT in May 1983 and would furthermore be discussed with the IBRD in December at which time some standardization of subsidies at the republican level might be agreed upon.

Asked by Mr. Veljković about his opinion on the exchange rate policy followed in 1983, Mr. Schmitt replied that the policy pursued had been correct. The question now, however, was whether the real depreciation had gone far enough. Personally he was prepared to accept that the exchange rate should be kept unchanged in real terms in 1984 but only if incentives to exports and restrictions on imports could be eliminated and if the foreign exchange allocation system could be substantially liberalized.

Mr. Veljković replied that apart from restrictions on imported equipment goods, to his knowledge no import restrictions had been introduced. These restrictions, which were not rigorous as could be seen from the substantial amount of equipment still being imported, were designed to better utilize existing capacity in the country. The fact that imports in general had fallen was simply the result of lack of foreign exchange. Other measures, such as gasoline rationing and restriction on travel abroad had also been resorted to in other countries and could not be called exceptional. As to the foreign exchange allocation system, he proposed to postpone the discussion until representatives of the Federal Secretariat for Finance were present. In the present circumstances it would not be reasonable to eliminate these measures. Returning to the subject of export subsidies, Mr. Veljković indicated that the authorities were considering a consolidation of existing rebates that would bring them down to a more reasonable level. He agreed with the mission, however, that exchange rate policy had made exports more attractive and that combined with other existing incentives the present exchange rate would enable the authorities to achieve the export target as well as the current account target for 1984.

In reply to the observation that subsidies might well work against the beneficial effects of the active exchange rate policy by preventing structural adjustment, Mr. Milošević explained that the authorities for some time had been studying the structure and volume of rebates in order to consolidate them. It was their intention not to export everything at any price but only to let efficient producers export.

Mr. Dimitrijević said that for Chart 1 to be convincing, it should also have included the development of other costs of production such as interest rates, imported raw materials and taxes. Mr. Schmitt replied that this was certainly a valid point with regard to measuring the absolute profitability of exporters but it had clearly risen relative to that of producers selling on the domestic market. If despite this improvement exporters still could not cover costs, then there would be a need for a further real depreciation.

Mr. Milošević explained that the customs rebate scheme was, in principle, a true drawback scheme. However, certain groups of enterprises had received more such funds than the amount of import duties they had paid; such subsidies were designed to stimulate exports. In principle, the annual rebates were worked out according to the input-output table from the year before. He added that, when considering the question of import restrictions, it was important to bear in mind that most of the improvement in the trade deficit had had to be achieved by a reduction in imports. In 1983 a substantial increase in exports had been achieved and in 1984 it was expected that the rapid growth of exports would allow an increase in imports for the first time in four years.

Mr. Schmitt then drew attention to the other charts prepared by the mission in which an attempt had been made to find a positive correlation between export growth and various measures of comparative advantage of individual sectors in order to test whether structural adjustment was in progress. Unfortunately the figures did not yet support this hypothesis, not even if—as suggested by Mr. Dragaš—one looked at the growth of exports to the convertible currency area alone. He sought the help of the authorities in finding out what had prevented structural adjustment. He felt that one should focus not only on export subsidies but also on other subsidies to inefficient enterprises. He was in full agreement with the authorities' focus on export growth. In this connection, however, it was important to ensure that the planned export expansion was firmly based and this could only be achieved if the structural change was allowed to take place in response to the exchange rate policy.

Mr. Dragaš in his intervention reverted to the question of the adequacy of the present exchange rate. He noted that if one looked at the balance of payments developments in recent years, in particular on the virtual elimination of the current account deficit with the convertible currency area in 1983, it appeared that the present exchange rate was realistic. This was supported by studies carried out by economic institutes in Zagreb, Ljubljana and Belgrade which showed that prices achieved on export markets were now competitive with those achieved on the domestic market. However, he did not feel that it was an opportune time to eliminate export subsidies. The accelerated depreciation which had been carried out in conformity with the technical annex to the letter of intent, had had regrettable—and according to some, catastrophic—side-effects. It had led to a sharp acceleration in costs of imported raw materials and in the cost of repaying external loans, thus contributing in an important way to the sharp acceleration of inflation during 1983. It was therefore felt that further real depreciation would only be harmful to the economy. Accordingly, in the draft resolution there had been included the intention of maintaining price competitiveness through a "real exchange rate policy" in 1984. This would imply safeguarding the 25 percentage point real depreciation achieved during 1983 but no further real depreciation. Finally, Mr. Dragaš explained that the authorities had considered the recommendation of the currency basket study prepared by the Fund staff and had had no major disagreements with the results. Their choice would therefore be based on that study.

Mr. Veljković then inquired whether it would be possible to say that agreement had been reached in this area. He did not feel it was possible to eliminate export subsidies. As to the foreign exchange allocation system he would like some clarification of the mission's position. But could it be agreed that the real depreciation of the dinar had gone far enough?

Mr. Schmitt replied that the depreciation of the dinar had probably gone far enough but emphasized again that the mission could only agree to maintain the exchange rate unchanged in real terms if at the same time one could substantially reduce, and indeed eliminate, the special incentives to export as well as achieve a substantial liberalization of the foreign exchange allocation system. The first priority in the latter area was to introduce a general surrender requirement but with certification that exporters could obtain foreign exchange when needed. Without giving details Mr. Veljković added that this was close to the proposals contained in relevant legislation currently under discussion.

Finally it was agreed to set up two technical meetings to discuss further the issues of export subsidies and the foreign exchange allocation system after Mr. Bery of the IBRD had joined the mission.

INTERNATIONAL MONETARY FUND

Minutes of Meeting No. 2

Held at the National Bank of Yugoslavia
Tuesday, December 6, 1983, at 9:00 a.m.

Yugoslav representatives:

Mr. Veljković, National Bank of Yugoslavia
Mr. Stamenković, Office of Preme Minister
Mr. Ymeri, National Bank of Yugoslavia
Mr. Dimitrijević, National Bank of Yugoslavia
Mr. Tešić, Secretariat for Foreign Affairs
Mr. Nikolić, Secretariat for Finance
Ms. Golubović, Federal Planning Institute
Mr. Jovičić, Federal Community for Prices

Fund representatives:

Mr. Schmitt
Mr. Lewis
Mr. Petersen

Mr. Schmitt summed up the discussion of the preceding meeting. The stage was now set for working out the implications for the national accounts in volume terms, after which the same accounts would be put in nominal terms on the basis of an inflation forecast. The forecast for inflation would be important for its implications for the exchange rate, the credit ceiling and interest rates. Mr. Veljković observed that the Yugoslav authorities had consistently been wrong on inflation forecasts in the past and it would be no easier to forecast accurately for 1984. Mr. Schmitt pointed to the risks of forecasting too high or too low an inflation rate but proposed to establish a rate of nominal depreciation of the exchange rate in advance and suggested calculation of the credit ceiling gross of the valuation since the exchange rate change would be known.

Mr. Stamenković provided forecasts of GSP in real and nominal terms and noted that the GSP forecast for 1983 had not been changed despite favorable developments since the last staff visit. The upward trend in industrial production, as evidenced by seasonally adjusted data, continued in October 1983, when industrial production was 4.9 percent higher than a year earlier. The increase for the first 10 months of 1983, compared with a year earlier, was 1 percent. Data for November would be available on December 14. Also, he had just heard that there had not been much damage to the wheat as a result of the drought in 1983. Payments for fixed investment in January-October was 14.9 percent higher than the same period of last year according to preliminary figures.

Mr. Stamenković reported the following changes in prices for November 1983: 1/

1/ To be verified; some of the data appear to be incorrect.

	Nov. 1983 over Oct. 1983	Nov. 1983 over Nov. 1982	Jan.-Nov. 1983 over Jan.-Nov. 1982
		(Percentage change)	
Industrial producer prices	3.7	42.0	40.6
Retail price index	4.1	49.4	47.6
Cost of living	5.8	51.3	48.9

He expected the GSP deflator to rise by about 40 precent in both 1983 and 1984, implying an increase in prices of about 30 percent in the course of 1984. He observed that with the acceleration of prices, the growth of personal incomes from employment had also been rising. The increase in total payment of personal incomes for the first 10 months of 1983, compared with a year earlier, was 27 percent; the 12-monthly increase was 32.5 percent in September 1983 and 35 percent in October.

Mr. Stamenković pointed to some of the methodological differences that could account for our different estimates of GSP. First, he had based his figures on historical data of the Federal Institute of Planning which differed from those of the Federal Statistical Office, particularly for gross fixed investment. Secondly, he selected 1982 as a base year which he thought was preferable to 1980 because of changes in relative prices of traded goods. Third, he recalled discussions with the Fund staff in October regarding the coverage of imports of nonfactor services in the national accounts. He thought it preferable to omit foreign exchange withdrawals since he estimated that two thirds of them represented domestic transactions. Fourth, Mr. Stamenković used unadjusted data on receipts from tourism whereas our tables were based on balance of payments data adjusted by Mr. Smiljanić to include a part of remittances from abroad as receipts from tourism. Fifth, different statistical exchange rates had been used in the valuation of external flows for 1982. It had been estimated on the basis of work by the Institute in Ljubljana that a set of statistical exchange rates based on Din 63.4 = US$1 provided a closer approximation to values at market exchange rates for 1982 than given by valuation at the exchange rate of Din 41.8 = US$1. He noted that the Federal Executive Council had discussed the problem of statistical exchange rates several days earlier and had concluded that market exchange rates should be utilized for statistical purposes in 1984. It was agreed that we would base data for 1982 on the exchange rate Din 63.4 = US$1 for the purpose of estimating dollar values of exports and imports. Remaining differences in external flows estimated by Mr. Stamenković and the Fund staff were seen to be as shown in the attached table. Differences remain not only on the estimation of tourism receipts but on other nonfactor service receipts as well.

Exports and Imports of Goods and Nonfactor Services

(In millions of U.S. Dollars)

	NBY Mr. Smiljanić		Mr. Stamenković	
	1982	1983	1982	1983
Exports				
Merchandise	9,923	10,050	9,923	10,050
Tourism	1,363	1,450	764	1,000
Transportation	1,650	1,600	1,650	1,600
Construction work abroad	229	200	229	200
Other nonfactor services	1,214	1,000	1,093	1,000
Total exports of goods and nonfactor services	14,379	14,300	13,569	13,850
(percent change)		(-0.5)		(2.1)
Imports				
Merchandise	12,749	12,450	12,750	
Tourism	99	85	99 1/	
Transportation	780	700	780	
Other	720	600	597 1/	
Total imports of goods and nonfactor services	14,348	13,835	14,225	
(percent change)		(-3.6)		

1/ On December 6, nonfactor services imports other than transportation were put at US$696 million; the discrepancy in relation to NBY data was assumed to relate to "Other" service imports.

Mr. Stamenković provided a table on the basis of which he determined a plausible relationship between growth of imports and growth of industrial production for 1984. He concluded that the targeted increase of 3 percent in production was a reasonable estimate given the assumption of a 2.9 percent increase in imports of goods and services in 1984. Other assumptions for the 1984 forecast were that agricultural output would increase by 2 percent and construction activity would decline by 4 percent. Although investment expenditure would decline by more than 4 percent, there would be some increase in housing investment and construction work abroad, implying a less pronounced fall in construction. Export prices were assumed to increase by 3 percent in dollar terms, implying a 12 percent increase in volume given the targeted 16 percent in dollar value of total exports. Import prices were assumed to increase by 4 percent so that the 5.4 percent increase in value implied a 1.4 percent increase in volume.

Mr. Stamenković noted that it would be possible to project an increase in final domestic demand on the basis of the more modest growth of exports to the convertible area which the Fund staff had forecast, but it would not be good to present such a forecast for demand. It was important to present forecasts showing an increase in GSP, partly because increases in employment were unavoidable in view of the new entrants to the labor force and the return of migrant workers. It was not an inherent feature of the Yugoslav system that redundant labor would be laid off when capacity utilization was low. Moreover, if the economy were depressed further it would not be in a position to allow repayment of Yugoslavia's foreign debts. It would not be acceptable to subscribe to the philosophy that harsh restrictive measures to tighten domestic demand were required to depress production sufficiently to meet the constraints on available imports. Rather, he thought that a preferred approach would be to define the maximum imports given in Table 1 and then to work out what adjustment in the structure of production would make it possible to limit any curtailment of internal demand while at the same time meeting constraints on required imports.

Mr. Schmitt emphasized the broad similarities in approach, pointing out that structural change was the key to the adjustment process and was a prerequisite to limiting the magnitude and duration of temporary declines in output during the transitional period of adjustment. The charts distributed on the preceding day suggested that this structural change had not yet taken place and that it was therefore necessary to proceed with caution in expanding output at the present time.

Mr. Stamenković said that the industrial sector, which had provided most merchandise exports, had grown by an average of 8 percent per annum prior to 1979 but industrial output had essentially been stagnant in 1982 and 1983. For the fourth year in a row, there had been a pronounced curtailment of imports. For both economic and political reasons the shifting of trade between currency areas in 1983 could not be continued indefinitely. The absence of a close link between sectoral output changes and export intensity in 1983 could be explained in part by the shift of exports between currency areas which predominated over any overall growth of exports. He stressed that it would not be possible to expand exports if output were to decline and he could not agree with any statement that total output could be permitted to decline from 1983 to 1984. Mr. Schmitt noted the general agreement with Mr. Stamenković except perhaps on the timing and degree of adjustment. He thought that some renewed expansion ought to be possible at the present time but it should not be so great as to overtake progress with external adjustement. Mr. Stamenković added that the draft resolution for 1984 stated that the increase in industrial output planned for 1984 was based on the plan to expand exports. The 3 percent increase in industrial output was expected to be divided equally between the home market and the export market as was the 2 percent growth of agricultural output. Investment would be restricted to those projects holding promise of a rapid expansion of exports, with certain exceptions, such as increased power generating capacity. Thus, the increase in exports would depend on the increase in output and vice versa. Some expansion would also be needed where there was a possibility of import substitution, e.g., food processing. He also spoke of the need for altering the structure of private consumption and in this context mentioned the possibility of further liberalizing the price system.

Mr. Schmitt suggested that if subsidies had been used to maintain weak industries or enterprises, this might help explain why the charts failed to show evidence of structural change. Mr. Stamenković said that the Government intended to reduce the subsidization of losses in firms that were not fundamentally sound. Such a policy could not be implemented, however, in sectors vital to the economy, e.g., electricity generation. Solving this problem by eliminating price distortions would take time.

Mr. Schmitt explained the logic of Tables 2 and 2a for the programmatic exercise, touching on the purposes to which a cautious or ambitious export target could be put; the obstacles to realizing a rapid expansion of exports in 1984; and the importance for domestic reasons of being able to program some increase for 1984, albeit a small one, in private consumption and GSP. Mr. Stamenković appeared to acknowledge these points but still thought that it should be reasonable to expect the same growth of exports to the convertible currency area in 1984 as in 1983. With an assumed growth in dollar export prices of 3 percent in 1984 and the upturn in the growth of foreign markets expected by GATT and the OECD, exports to the convertible area would rise by 7 percent in dollar terms even without an increase in market shares. In addition, export incentives were only now beginning to be felt.

Mr. Stamenković had assumed an increase in the GSP deflator of about 40 percent for 1984, the same figure as in the tables distributed in late-October. The corresponding growth of prices in the course of 1984 was about 30 percent. Variations in the growth rates of the various deflators for components of domestic demand were not meant to be significant.

Mr. Stamenković asked what the merits were of utilizing a forecast of inflation for the coming year to fix the monthly depreciation of the dinar for all of 1983 in advance. Mr. Schmitt answered that, unless the exchange rate were preannounced, exporters might overestimate the future rate of depreciation and thus keep their capital abroad; an importer might overestimate the depreciation and prices too much; a depositor would be more likely to keep his money in foreign exchange, whether abroad or in a foreign currency account; with a policy of positive real interest rates a bank would want to know what interest rates would need to be in nominal terms; and if the National Bank set credit limits gross of valuation adjustments, preannounced exchange rate changes would provide the needed guidelines for implementing credit policy. Mr. Stamenković thought that exporters and importers were fairly sophisticated and would soon discover how the exchange rate was changing, even without advance announcements.

A revised version of Table 4, Public Sector Accounts, was requested of Mr. Stamenković. He explained that, following the institutional changes that were introduced 10 years ago when the latest constitution was adopted, a coherent set of accounts for the public sector still remained to be developed.

Prices

Mr. Stamenković said that discussions were now taking place on the price policy to be implemented for 1984, particularly the changes in relative prices in certain sectors, including electricity generation, coal, railway transport, steel, and nonferrous metals. Mechanisms for making additional adjustments to these prices in the course of the year were also being studied but whether adjustments would be made two times, or three or more times during the year was undecided. Mr. Schmitt welcomed the Government's intentions to take action in this area, and requested guidance on specific proposals to be included in the letter of intent that would be feasible and sensible. Also, he suggested quarterly adjustments of prices of electricity and other basic inputs to industry on the basis of changes in the exchange rate. Mr. Stamenković expected the details of price policy to be decided upon by the end of December; basic concepts had already been agreed upon at the Federal Executive Council's meeting of November 4. He noted that there were administrative costs to frequent adjustments of prices; for example, electricity meters were read only twice a year, at a cost of Din 100 million per reading.

Mr. Jovicić summarized actions on specific undertakings to adjust prices. Oil prices had been raised prior to October 1 by more than the agreed increase. A working paper on price adjustments for petroleum products was under discussion, and a further increase in these prices before the end of the year had been planned. Natural gas prices were scheduled to rise by 27 percent to 34 percent in January 1984 to world market prices. Relevant data had been given to Mr. Elwan of the World Bank. Coal prices for consumers had been raised twice in the first seven months of 1983.

Those for thermal power generation were raised twice during 1983, in parallel with changes in electricity prices. These prices had been increased by 16 percent in November following the 25 percent increase earlier in the year. Coke prices are expected to be raised again before the end of the year. Other price adjustments would be made near the turn of the year.

There were three objectives of price policy in 1984. First, inflation should be brought under control. Changes in the system of price control would need to be decided by January 26, 1984 since the decision on price control would expire on that date, but a decision might be expected as much as a month before then. Most industrial prices (perhaps some 60 percent) would be freely determined on the market while an estimated 25 percent would be determined through self-management agreements and 15 percent would still be controlled directly. Inflation would need to be reined back through other policies. Second, action should be taken rapidly to eliminate price disparities for the goods and services subject to price control. This could not be done all at once, but a major step could be taken. World market prices could constitute the primary guidelines. It had been agreed with the World Baqk that price disparities should be eliminated by 1987 in the case of electricity prices, and by 1990 for railway transport. Prices of nonferrous metals (e.g., aluminum, copper) were expected to be raised to world market levels in 1984. Prices of skins and hides already exceeded world market prices.

The third area of price policy pertained to sectors where prices were traditionally set though social compacts. For example, many agricultural prices were set in this way (at the level of the Federation for 13 products and at the republican and provincial level for others) and it was thought that these prices could be held down by restraining the growth of agricultural input costs. The Federal Community for Prices had proposed to pay compensation to farmers for some of these costs. This might also help restrain price inflation for other agricultural goods as well, including those on the green market and those exchanged between producers at the wholesale level. Nevertheless, it was felt that higher costs of fertilizer and other imports ought to be passed on into output prices.

Mr. Jovičić added that, in his opinion, effects of changes in administered prices designed to correct price distortions should be excluded from the Yugoslav price index used to calculate the requisite exchange rate change.

INTERNATIONAL MONETARY FUND

Minutes of Meeting No. 3

Held at the National Bank of Yugoslavia
Wednesday, December 7, 1983, at 10:00 a.m.

Yugoslav representatives:

Mr. Veljković, National Bank of Yugoslavia
Mr. Stamenković, Office of Prime Minister
Mr. Željetović, Office of Prime Minister
Mr. Dimitrijević, National Bank of Yugoslavia
Mrs. Knežević, Federal Committee for Labor
Mr. Andžić, Secretariat for Finance
Mr. Petrović, Federal Planning Institute
Mr. Crnak, Secretariat for Foreign Affairs

Fund representatives:

Mr. Schmitt
Mr. Lewis
Mr. Petersen

Mr. Veljković opened the meeting by noting that the Fund's proposals would require careful consideration because of the difficulty in forecasting inflation. He did not find automaticity to be particularly desirable. Mr. Schmitt returned to the lessons to be drawn from the first four charts that had been distributed previously, discussing particularly the probability that domestic prices could face sharp upward pressure in response to the initial sharp upward boost to the relative price of exports to domestic prices in the course of 1983. He suggested that the growth of exports and inflation rate might prove to exceed substantially the forecasts contained in Tables 1-3 distributed at the beginning of the meeting (programmatic exercise). He reviewed the various links and interdependencies amongst the variables within the tables and stressed the uncertainties surrounding the forecast of exports, namely, the implications of having had to reduce dollar prices of exports in 1983; the short-term capital outflow, including errors and omissions which rose sharply in 1983 owing to the divergence between exports and cash receipts for exports; and uncertainties on the supply side, including power shortages and import bottlenecks. If export market shares could be expanded in 1984 only by extending a lot more export credits, additional growth in the volume of exports would not yield commensurately more foreign exchange. This would indicate that exports were being pushed up too fast and some problems could arise on both the supply of, and demand for, exports.

Turning to Table 2a, Mr. Schmitt observed that Yugoslav and Fund staff projections for real domestic demand and GSP indicated broadly the same picture. He cautioned that excessive curtailment of gross fixed investment would adversely affect the supply of exports in the medium term. In the short run, however, a sharper cutback of investment in 1984 would allow more room for the expansion of private consumption.

The table on household income and expenditure (Table 3) was intended to provide a qualitative framework for assessing the policies which might be brought to bear in restricting private consumption to the required level. That the Yugoslav and Fund forecasts both indicated a fall in final domestic demand provided a common basis for such a discussion of these policies. There was similarly a need for an analytical table on the public sector in order to draw out the implications for public consumption and investment as well as disposable income of households of public sector finances in 1984.

Mr. Stamenković agreed that the two sets of forecasts of demand and output were indeed broadly similar but again pointing to the divergent forecast of exports. He asked whether, if the current account surplus now projected by the staff at US$550 million proved not to be feasible and should be revised downward to US$300 million, owing to a higher figure for imports, it should not be possible to raise the programmed level of output. Mr. Schmitt replied that the impact of unanticipated growth of imports on output would depend on why imports had exceeded the target. If the reason were to be found in more buoyant domestic demand than projected, this would indicate a policy failure requiring correction. Mr. Stamenković suggested turning the matter around: if the current account surplus were greater than forecast owing to a better export performance than expected then it would be possible to reduce foreign indebtedness more rapidly and might permit the growth of output to come closer to his GSP forecast. He added that he expected further import substitution to be possible in 1984.

Mr. Stamenković asked about our differences regarding the choice of a scale variable to relate to imports in making projections for 1984. Mr. Schmitt replied that he preferred to relate the imports of goods and services to total demand, but relating this import aggregate to GSP perhaps representated a good compromise. It was pointed out that both sets of forecasts now defined imports of goods and nonfactor services to exclude foreign exchange withdrawals on the implicit assumption that such withdrawals did not finance tourist expenditure abroad. Whether or not this was the appropriate convention to follow depended on whether such tourist expenditure in excess of that recorded in official balance of payments statistics was reflected in the official statistics of private consumption. It was suggested that it would be fruitful to explore the question in greater depth. Also two sets of forecasts had been harmonized to reflect the valuation of exports and imports in 1982 (in dollar terms) on the basis of the statistical exchange rate Din 63.4 = US$1. Mr. Stamenković offered to discuss the results of the study on the biases from using statistical exchange rates; this would be done on Monday, December 12. Mr. Stamenković presented the following estimate of merchandise trade with the convertible currency area in 1982 valued at market exchange rates.

Merchandise Trade 1982

(US$ millions)

Exports		
At current exchange rates	5,621	
At accounting rates, Din 41.8 = US$1	5,854	(+4.1%)
At accounting rates, Din 63.4 = US$1	5,526	(-1.7%)
Imports		
At current exchange rates	9,167	
At accounting rates, Din 41.8 = US$1	9,635	(+5.1%)
At accounting rates, Din 63.4 = US$1	9,043	(-1.4%)

It was agreed that technical aspects of the household accounts table would be discussed on December 12. Mr. Schmitt raised several questions by way of indicating the deficiencies in Table 3 as it now stood. Mr. Stamenković explained that the national accountants had looked at Table 3 and had provided forecasts for 1983-84 on the basis of the historical data provided and suggested that the various questions that had been posed regarding Table 3 might best be addressed in the technical meeting.

Mr. Schmitt asked how the projected increase in savings ratio for 1984 was to be realized. It would seem that drastic measures would be needed to bring this about and one would need to be assured that real interest rates could be raised and could be kept up in 1984 even if inflation were to accelerate. This could be done, for example, by indexing the interest rate to the rate of inflation. Mr. Dimitrijević replied that the banking system was not equipped at present to manage the indexation of interest rates. He preferred to see positive real interest rates realized through reductions in the rate of inflation and suggested that, in any case, the savings ratio would tend to rise with an increase in the real rate of interest even if the latter were to remain negative. Mr. Schmitt also emphasized the importance of interest rate policy for the control of external capital flows. Yugoslav creditors would be looking closely at developments in short-term capital flows and in errors and omissions if they were to continue providing funds to Yugoslavia in 1984. In this context one could ask whether interest rates had been encouraging or discouraging capital outflow. Mr. Veljković argued that short-term debt was known to be too high at the beginning of 1983 and it had been necessary to restructure the foreign debt so as to shift towards more medium-term debt.

Mr. Veljković argreed that exporters waited to repatriate foreign exchange earnings after calculating the gains to their income in dinar terms from waiting. He thought that one should not be pessimistic in forecasting errors and omissions for 1984 since the difficulties in 1983 in realizing payments for exports were not expected to persist in 1984.

Mr. Dimitrijević returned to interest rate policy, explaining that the wide array of deposit rates, the current strategy of affecting lending rates by influencing costs of commercial banks funds and the floor lending rate scheme agreed with the World Bank. He argued that this was an inauspicious time to try to stimulate saving through increases in interest rates since household incomes were declining. He thought that low interest rates did not contribute to foreign capital outflows since both households and enterprises could hold foreign exchange in domestic bank accounts, receiving substantial interest while being protected from exchange rate risk. The expectation of depreciation led to a reluctance to bring foreign exchange home, Mr. Schmitt pointed out, and this could be interpreted as essentially equivalent to capital flight. Mr. Dimitrijević also pointed to the increase in bank deposit rates of several percentage points at the beginning of 1984 which would contribute to a harmonization of interest rates domestically and abroad.

Mr. Schmitt found it easy to agree with Mr. Dimitrijević on almost all points including the need for positive real interest rates, but the import of what he said combined with Mr. Veljkovic's statements on the unpredictability of the inflation rate led him to draw the opposite conclusion from that of Mr. Dimitrijević concerning the need for indexation. Mr. Dimitrijević thought that there were other obstacles to the introduction of indexation of interest rates owing to the seasonal element of price movements. Whether the exchange rate or some price index were used to index interest rates, there could be considerable oscillation in nominal interest rates which would be undesirable. Mr. Schmitt noted that the month-to-month volatility of interest rates or exchange rates could be avoided through the using of moving averages. Mr. Stamenković explained that several gross flows were included in errors and omissions: exports that had not been paid for, goods that had been paid for but not yet imported, imports that had been cleared but not yet paid for, and goods that had been paid for but not yet exported. To a large extent it could be expected that the foreign assets and liability items would offset each other. The movements of net errors and omissions would depend partly on the liquidity in partner countries, not simply reflecting policies in Yugoslavia. A change in the trend of errors and omissions was expected in the last two months of 1983 owing to the probability that some imports would be paid for through commodity credits. Mr. Schmitt commented that when exporters had delayed repatriation and importers tended to prepay imports, there was an indication that in both cases there was a desire to get assets abroad. It was the general experience in many countries that this phenomenon would be found when interest rates were unduly low. Mr. Veljković thought that the problem stemmed not from low interest rates but from the depreciation of the exchange rate. Mr. Schmitt replied that the exchange rate reflected inflation rates and that for the exchange rate policy to be successful interest rates must be at a sufficiently high level; otherwise exchange rate policy would result in subsidies for export of capital. This problem would exist even with a policy of adjusting the nominal exchange rate only for inflation differentials. Mr. Stamenković added that, regardless of the exchange rate policy, exporters had to meet domestic payment and so were limited in their voluntary holding of earnings abroad. Moreover, they would have to justify to the Exchange Control Board any delays in repatriating earnings. For each such delay, an exporter would need to provide extensive documentation to its republican or provincial bank on the reasons for the delay. The national banks would not automatically accept these explanations.

The meeting then turned to a discussion of personal incomes. Mrs. Knežević first explained that personal income payments went up by 35 percent during the 12 months ended October 1983; the corresponding increase in September was 32.7 percent, not 41.6 percent as indicated in the staff's table of economic indicators. The discrepancy was explained by revisions to the 1982 data not taken into account by the Fund staff. The year-on-year increase for the first 10 months of 1983 was 27.1 percent and, taking into account an estimated growth rate of employment of 2 percent, the average nominal wage had increased by 24.5 percent. Deflated by the cost of living index, real wages had then shown a decline in real terms of 11 percent. It was her assessment that personal income would maintain the growth rate of 27 percent through the end of the year.

Although the nominal increase of personal incomes had been somewhat faster than planned, personal incomes had risen at a lower rate than net income of enterprises as seen by the following figures for the first nine months of 1983 compared with the first nine months of 1982.

	(Change in percent)
Enterprise Income per worker	32.4
Net income per worker	26.4
Net personal income per worker	23.9

Mrs. Knežević explained that the Constitutional Court has overruled the regulation prescribing that personal incomes be increased less than net incomes. As a result, some enterprises had increased wages sharply. However, the federal court ruling need not apply to the regional courts. Therefore, it was estimated for the year as a whole the growth rate for net personal incomes would remain below net incomes. For the year as a whole, total incomes of enterprises were projected to increase by 35 to 40 percent.

Mr. Dimitrijević added an explanation of the concepts involved. Net income referred to income available for internal distribution after payments of interests, taxes and contributions. Most of the differences in the growth rate of income and net income were due to increases in interest rates. He added that he had recently heard of an enterprise employing 6,000 workers which had to pay more in interest payments than in wages. Due to the heavy indebtedness of enterprises it would not be possible to carry a higher interest rate burden. Mr. Schmitt admitted that it would be hard on enterprises but it was a matter of choosing between the lesser of two evils. If it was not possible to increase interest rates it would not be possible to increase the savings ratio and then it would be necessary to reduce incomes.

Commenting on incomes policy for 1984, Mrs. Knežević explained that the aim would be to link incomes payments to the work performed rather than to the income of the enterprises. Such rules were in effect to a large extent in Slovenia and as a result enterprises there had registered the largest increase in revenues and the lowest increase in personal incomes during the first nine months of the year. Enterprise income and net income had increased by 39 percent and 32 percent respectively while personal income payments per worker had increased by 19 percent. The social compact on incomes policy would also contribute to restraining incomes. It was supposed to have been signed at the end of 1983 but had been somewhat delayed. Nevertheless, it would be implemented in early 1984 with effect from January 1, 1984. Also on January 1, 1984, amendments to the law on domestic payments would come into effect. The law established a rank order for payments of various obligations which put payments of personal incomes in the sixth place. The law also stipulated that enterprises that were not liquid could not raise personal income payments but only pay the same average personal income as in the previous year. A social compact was also under preparation governing the payment of "extra income;" details were not given. For all these reasons the republican authorities expected another real decline in personal incomes in 1984. According to the Planning Institute, net personal incomes would register a decline of 0.5 percent in 1984 which would be consistent with an increase in private consumption of 0.7 percent only if other incomes declined in real terms or if the savings ratio went up.

Other disposable incomes would be restrained in part by greater taxation of income from services. At present 50 percent of people employed in the service sector paid only a lump sum tax. Consideration was now being given to increasingly relying on taxing actual incomes. Also, a major change was to be introduced in the taxation of the agricultural sector according to which farmers would pay on the basis of actual income rather than a flat rate on the land. A change was also under consideration in the case of the general income tax paid at the end of the year on all household incomes. According to this change, the tax-free deduction of three times average income would be reduced to two times average income.

Mr. Stamenković was not able to given any information about the expected yield of the proposed tax reforms. He explained that they were still under consideration by the republican authorities and might be changed so that, for example, one rate was reduced while another was increased. He was able to give a little more detail, however, on the proposed changes. The tax burden of socially-owned enterprises was three to five times higher than the burden of taxation on individual producers, and one purpose was to make the burden sharing more equal. As to the agricultural sector, there would be an increase in the inheritance tax if the person did not live and work on the farm. Also there would be an increase in the taxation on unutilized land and finally a tax would be set on agricultural activity. At a more general level, it was being considered to make the taxation of all citizens more progressive. Those that earned more should give a greater contribution to the community. It was also being considered to increase the general inheritance tax except for close kin and to increase the tax on income earned from property. General agreement had been reached on these tax reforms but the proposals were now with the republics and provinces, which would introduce their opinions.

Returning to the question of the social compact on personal incomes, Mr. Schmitt asked for more details of its provisions and the date of its implementation. Mrs. Knežević explained that the compact was presently with republics whose views would need to be accommodated. She could therefore not give any details at the present stage. However, the basic elements would be a quantification of the relationship of wages with qualitative results of labor and productivity. This would lead to a better utilization of resources and a faster growth of enterprise net income than of personal incomes.

Mr. Schmitt said that it was indeed desirable from the viewpoint of structural adjustment that enterprises which had uncovered losses would limit personal income payments as was stipulated in the law with effect from January 1, 1984. However, he felt that it would be desirable also to limit personal incomes payments for those enterprises where losses were covered by various transfers and subsidies and sometimes also from tax and interest rebates. Mr. Veljković replied that it was very rare that interest payments were written off by banks; they simply did not have sufficient resources to do so. As to the level of tax rebates and transfers from municipalities and enterprises, it was up to the parties to the agreement to ensure that the resources they contributed were used constructively and they would surely not allow excessive wage increases. Mrs. Knežević added that generally speaking the authorities agreed with the mission that it was important to restrain personal incomes payments so as to limit inflation. That was why the social compact was trying to break the link between personal income and enterprise income. In reply to a question, Mrs. Knežević promised to provide a written paragraph on the wages policy of the authorities.

INTERNATIONAL MONETARY FUND

Minutes of Meeting No. 4

Held at the National Bank of Yugoslavia
Thursday, December 9, 1983 at 10:00 a.m.

Yugoslav representatives:

Mr. Veljković, Deputy Governor, National Bank of Yugoslavia (NBY)
Mr. Dimitrijević, NBY
Mr. Dragmanović, NBY
Mrs. Hofmann, NBY
Mr. Smiljanić, NBY
Mr. Tešić, Secretariat for Foreign Affairs
Mr. Golubović, Federal Planning Institute
Mr. Nikolić, Federal Secretariat for Finace

Fund representatives:

Mr. Schmitt
Mr. Mentré
Mr. Hansen
Mr. Lewis
Mr. Petersen
Mr. Bery (IBRD)

Mr. Veljković first extended a special welcome to Mr. Mentré noting that with his arrival discussion on the balance of payments would now be finalized. He then commented on the basic objectives of the balance of payments which were not to materially increase the external indebtedness of Yugoslavia while at the same time substantially building up external reserves. Secondly, Yugoslavia could and indeed had to ensure that part of the funds required to pay external debt and build up foreign reserves was provided through a current account surplus which was foreseen at US$800 million. The external borrowing target was put at US$3.3 billion and was composed as outlined in Table 2d. With regard to drawings on the government packages, he expected the carryover from the Berne package to amount to US$456 million. The new government package was expected to yield US$400 million in refinancing and US$150 million in drawings on new suppliers credits. They would ask for higher amounts of new suppliers credits but the utilization of them would spill into 1985. As for the commercial bank package, the authorities had estimated refinancing at the same level as in 1983 or at US$1,000 million, but Mr. Veljković conceded that the actual amount might be slightly higher. He made it clear that Yugoslavia would not request new money according to the formula for 1983 according to which all the 600 banks involved in the rescheduling exercise would participate in the new money facility. He suggested that new money could be achieved in some other way by approaching five or six of the leading banks. Mr. Veljković stated that Yugoslavia intended to approach the World Bank to obtain a second SAL on which he expected to be able to draw US$70-80 million; they would also draw the full carryover from SAL 1 of US$205 million. Finally, he counted on US$500 million from the IMF.

Mr. Mentré noted that the Yugoslav authorities had reduced their estimate of utilization of suppliers credits outside the government packages and simultaneously had provided for the utilization of new suppliers credits under the Geneva package. Concerning the Geneva package, he inquired why the Government had put the estimate of refinancing of maturities due at US$400 million when maturities falling due to governments in 1984 amounted to US$600 million according to the special survey conducted in September.

Mr. Veljković replied that the figure of maturities due on government direct and guaranteed debt was somewhat uncertain since Yugoslavia did not in all cases have knowledge of whether particular credits were guaranteed by a foreign government or not. Also during 1983 there had been reservations from some governments about whether to roll over maturities due. They had therefore been conservative in their estimate. The figure did not imply that the authorities planned to request less than 100 percent rollover. The same was true in the case of rollover by banks. The Government intended to request 100 percent rollover but bearing in mind the experience of 1983 when the original estimate of US$1.4 billion had in the end been reduced to US$1.0 billion, they had chosen to be cautious also in this estimate. The actual amount might be somewhat higher but probably not by more than US$100-200 million.

Mr. Mentré noted that the estimate for new money from suppliers credits of US$150 million was somewhat lower than what had been mentioned in Geneva where a new package of US$750 million had been discussed--US$500 million in refinancing and US$250 million in utilization of new suppliers credits. Asked whether the US$150 million estimate referred only to CCC credits, Mr. Veljković explained that it referred also to drawings from other governments. In this connection it should be borne in mind, he noted, that the Yugoslav figures also presumed the utilization of carryover from the Berne package to the tune of US$456 million so that taken together, suppliers credits from governments would amount to more than US$600 million.

In reply to whether the estimate for the utilization of suppliers credits outside the government package--US$189 million--was based on the expected implementation of specific projects, Mr. Veljković replied that the estimate was not as precise as it might seem. Whether it would be US$200 million or US$250 million remained to be seen but it was bound to be substantially lower than what was used in 1983. In that year they had been forced to rely on such credits since government credits were late in being put in place. However, now the pipeline was running low. Also they did not expect to be able to arrange for many more credits since credits would be provided by governments in the framework of the Geneva agreement. The latter statement should be tempered, he added, by the fact that it was difficult to estimate how many credits would be arranged directly between Yugoslavia and foreign business interests. However, if it should be possible to obtain sufficient credits from the government package, the authorities would make a special effort that only advantageous credits outside the government package would be utilized.

Mr. Mentré informed the meeting that bankers in the London meeting had expressed the view that there should not be any net outflow to anybody which, when taking into consideration scheduled payments to suppliers of some US$200 million, would be consistent with the present estimate for the utilization of new suppliers credits outside the government package. He added that in the meeting the question of repayment of hardcurrency debts to Eastern European countries had been avoided but it was likely to be raised at some stage. He inquired what the intentions of the authorities were in this connection. Mr. Veljković replied that the situation in this respect would probably be the same as in 1983 (in which maturities had been repaid when due).

The outcome of the London meeting had been that the banks had proposed to refinance 100 percent of maturities due in 1984 and until negotiations could be concluded to have a standstill period, Mr. Mentré continued. The banks had not felt able, however, to offer any new money. It would be necessary to approach the banks again on this subject after the meetings of the two subgroups scheduled for January 11 and 12. From informal discussions it was clear that bankers would be extremely reluctant to give the same type of new money in 1984 as in 1983 but various ideas were floated such as cofinancing with the IBRD and EIB, special facilities for prefinancing of exports and a stand-by facility of US$200-300 million which would not be drawn on unless the balance of payments developed differently than expected by the Yugoslav authorites.

Asked what types of new money the Government had contemplated when including their US$100 million estimate for this item, Mr. Veljković explained that they had had in mind the extreme reluctance of bankers to arrange new money. Also the procedure for arranging the fresh money in 1983 had not given good results and had been very costly. However, they had taken note of the arguments advanced by the IMF and had therefore included a modest sum. On how to realize the estimates, they had not yet made up their minds but the inventiveness apparent in the suggestions from the London meeting suggested that a way would be found.

Mr. Bery spoke briefly on the prospects for a second SAL. Negotiations would have to await the release of the second tranche of the first SAL and even if, in the best of circumstances, the new SAL could be presented to the Board in the third or fourth quarter of 1984 it was unlikely that any money from it would be disbursed before the end of the year. Unlike in the case of a Fund facility, there would be a lag between the time it was approved and the time it became effective. As to the full utilization of the present SAL during 1984 he felt this would be a realistic estimate.

Mr. Schmitt then explained that in the context of the general Fund budget and in view of the likely development of Fund liquidity, the Managing Director was presently considering to reduce the amount of Fund assistance to SDR 370 million which would amount to roughly US$400 million.

Mr. Veljković expressed disappointment with this development stating that the Yugoslav authorities during all the negotiations had expected a figure of US$500 million. Mr. Schmitt noted that the staff had always explained that the US$500 million was a maximum figure and was dependent on Fund-wide consideration of available resources.

Mr. Veljković then inquired about the possibility of the present negotiations leading to a two-year stand-by arrangement. When Mr. Schmitt answered that the Fund was considering only a one-year arrangement, Mr. Veljković repeatedly expressed the interest of the Yugoslav authorities in obtaining a two-year stand-by. Mr. Schmitt, however, explained that according to present Fund policy this would not be possible.

Returning to the question of the capital account of the balance of payments, Mr. Smiljanić commented on the discrepancy between the present estimates of repayments of medium- and long-term maturities due in 1984--US$2,925 million--and the estimate of US$3,025 million obtained from the special survey. Given the small difference and the fact that the US$2,925 million had been obtained from the data processing center in the usual manner, they believed that the latter figure was more accurate and had chosen to stick with that. 1/ Mr. Mentré explained that there had been a request for obtaining information on the future profile of debt payments and suggested that it would be helpful if the Yugoslav authorities could prepare revised figures for, say, the next five years in advance of the January meetings. Mr. Smiljanić explained that the external debt figures were updated on a regular basis so that the authorities would be able to provide updated and revised data as necessary. However, they would only be able to give data through 1987 as the data processing system only contained data for five consecutive years. When data were shortly prepared on the basis of end-1983, they would be able to give data through 1988. Theoretically it would be possible to give data for later years but practically it was not, since this implied going through thousands of individual loan files. In reply to a question, Mr. Smiljanic explained that each year the data was updated and data for one more year was introduced.

Commenting on short-term debt, Mr. Mentré noted that as of November 20, the outflow of such capital amounted to US$470 million. The authorities' forecast of US$500 million therefore supposed no further outflow during the last one and one-half months of the year. However, this was the period in which the authorities had to repay the continuing credit facility of some US$800 million which could then be used immediately for trade financing. The Fund staff felt that there would be some lag in utilizing the short-term credits and therefore included an additional US$100 million in outflow. The US$800 million was due to be repaid on November 26 but according to some sources Yugoslavia had requested a three-month extension in repaying these

1/ According to a print-out provided to the mission earlier, amortization payments based on debt outstanding at the end of June 1983 amounted to US$3,061 million.

credits. In this connection, he inquired what was the state of play on this issue. Mr. Veljković replied that as far as he knew, Yugoslavia had repaid all that was due but he would consult his experts. Perhaps some Yugoslav banks had approached their counterpart banks on a bilateral basis.

Mr. Mentré explained that discussions had also been held in London on the possible rollover of short-term debts due on January 18, 1985. Mr. Whittome had stressed that something should be done on this issue and some bankers had agreed that it would be important to rollover this amount for another year as the overhang was seriously impairing Yugoslavia's creditworthiness. In the event the banks' offer had not mentioned the short-term debt. Perhaps one could return to this issue also in January. Mr. Veljković replied that the Yugoslav authorities had not considered this issue in that light. Having in mind the volume of trade it was normal to have some short-term trade credit outstanding and he was sure the authorities would find some way of dealing with the problem in due course.

Turning to errors and omissions of the balance of payments, Mr. Mentré noted that it had been a frequent topic in London. The Fund staff had explained the large outflow as due mainly to the discrepancy between the trade balance according to customs data and cash payments. Commercial banks had underlined the delays in repatriation in export receipts as a very weak eleement in the Yugoslav situation and pointed out the need to take action to rectify this problem in 1984.

Mr. Veljković explained that he had elaborated on this issue at great length the previous day. He emphasized that when tradeflows totalled some US$20 billion, US$600 million was a small figure and in his opinion not too abnormal. It should also be borne in mind that exporters had in some cases been forced to extend the credit period on exports. This was partly because trading partners sensed the urgency which Yugoslavia attached to exports and therefore held out to obtain better terms. But it was also because a substantial part of Yugoslavia's exports went to developing countries who had liquidity problems of their own. In reply to why the repayment period had been lengthened to 90 days, Mr. Veljković explained that it had always been at 90 days in the past. In May 1982 however the authorities had thought they could reduce the repatriation period in order to increase foreign liquidity. It had proven impossible to implement, however, and therefore the repatriation period had been extended to 90 days again with effect from January 1, 1983. The authorities were trying to reduce exemptions to the 90-days rule and had also introduced severe sanctions if the period was exceeded. However, in spite of all controls and sanctions there were also cases of exporters waiting to repatriate their proceeds in order to benefit from the rapid depreciation of the dinar. The authorities were mainly using credit policies to put pressures on exporters to repatriate export proceeds and use their hard currency funds. Because of an intensified use of such measures, he expected a reduction of the capital outflow under errors and omissions in the latter part of the year and no outfulow during 1984.

Mr. Mentré observed that under unchanged conditions the mere fact that exports were expanding would result in an extension of 90-day export credits and it was for this reason that the mission had included an estimate of capital outflows under errors and omissions of US$300 million. In reply, Mr. Veljković emphasized that things were changing. The authorities were intensifying the application of credit measures and also he was certain that exporters were becoming more cautions in assessing whether buyers would be able to pay on time. Credit policies would be applied in two ways. If exporters did not repatriate export proceeds within 90 days and had not obtained permission to extend the period, the commerical bank financing the credit operation would withdraw the credit line in question. After the export proceeds had been repatriated the foreign currency proceeds would have to be changed into dinars within 15 days or else all credits extended to the exporter in question would be recalled. This was a new regulation that had been passed recently; the former measure had been in effect for quite some time.

Mr. Veljković explained that other temporary factors had also been in play in 1983. For example, due to arrears of US$17 million owed by Zagrebacka Bank to Algeria, Algeria had withheld more than US$150 million in payments for Yugoslavian exports. When PBZ had paid off the arrears the export payments had been released. He did not expect such cases to occur in 1984. Mr. Dragmanović explained that another reason for errors and omissions was the discrepancy created by calculating trade flows at statistical exchange rates while calculating reserve figures at current exchange rates. This however would account for less than US$100 million.

Mr. Mentré finally mentioned that some banks in the London meeting had said there were still some outstanding arrears and stressed the importance of paying all debt payments when due. Mr. Veljković replied that to his knowledge outstanding payments were within the limits of what could be considered normal commercial relations and were being reduced to the satisfaction of the authorities.

Table 2d. Yugoslavia: Drawing on Medium- and Long-Term Debt in Convertible Currency by Creditor

(In millions of U.S. dollars)

	1983 January - September	1983 Preliminary estimate	1984 Projection
Under Berne Package	525	839	1,006
Rollover of government direct and guaranteed	213 1/	304	400
New financial credits	135 2/	180	—
Suppliers´ credits	177 3/	355	606
Equipment Suppliers´ credits	177	355	606
Bank package	—	1,580	1,100
Rollover of medium- and long-term debt	—	980	1,000
New credits	—	600	100
Outside Berne and ank package	1,368	2,081	1,219
World Bank regular disbursement	190	250	250
World Bank SAL	—	70	280
Other multilateral lenders (IMF)	361	620	500
Suppliers´ credits	817	1,111	189
Total	1,680	4,470	3,325

1/ Of which: Belgium, 12; Federal Republic of Germany, 46; United States, 155.
2/ Of which: Netherlands, 25; Switzerland, 50; United Kingdom, 60.
3/ United States.

INTERNATIONAL MONETARY FUND

Minutes of Meeting No. 5

Held at the National Bank of Yugoslavia
Thursday, December 8, 1983 at 2:00 p.m.

Yugoslav representatives	Fund representatives
Mr. Veljković	Mr. Schmitt
Mr. Jovanovski	Mr. Mentré
Mr. Dimitrijević	Mr. Hansen
Mr. Marković	Mr. Lewis
Mr. Petrović	Mr. Petersen
Mr. Ivanović	Mr. Bery (IBRD)
Mrs. Hofmann	
Mr. Velicković	

Monetary developments

Mr. Petrović briefly described the preliminary figures for monetary aggregates for end-October. The final figures would be ready for the following day. The trend for September had continued into October. NDA adjusted had increased by only Din 0.5 billion and domestic credit by Din 14 billion, but this had been offset by a decline in "other items, net." M1 had increased by Din 19 billion. For the first 10 months of the year dinar credits had risen by Din 238 billion, which compared with the informal ceiling of Din 250 billion for the year as a whole left very little room for the rest of the year. However, as foreign currency credits were much lower than originally contemplated there was plenty of room under the NDA ceiling, and Mr. Veljković asked whether it would be possible to increase dinar credits beyond the Din 250 billion if the increase in NDA was kept below the agreed limit. Mr. Schmitt responded that the only binding ceiling in the stand-by agreement was that on NDA. The ceilings on total credit and dinar credits were self-imposed Yugoslav devices. Asked if the dinar credit ceiling fixed for the fourth quarter of the year had already been broken, Mr. Veljković said that this was not the case, but it was the intention to revise the ceiling for December. In fact, the Board of Governors of the Bank was at this very moment discussing this issue.

It was agreed to wait to discuss the forecast for the outcome on the monetary accounts for 1983 and 1984 until the final October figures had become available. It was also decided to arrange a technical meeting on how interest rate accruals were treated in the end-year monetary accounts.

INTERNATIONAL MONETARY FUND

Minutes of Meeting No. 6

Held at the National Bank of Yugoslavia
Friday, December 9, 1983, at 2:30 p.m.

Yugoslav representatives:	Fund representatives:
Mr. Padovan, Assistant Secretary for Finance	Mr. Schmitt
Mr. Veljković, National Bank of Yugoslavia	Mr. Hansen
Mr. Dimitrijević, National Bank of Yugoslavia	Mr. Lewis
Mrs. Hofmann, National Bank of Yugoslavia	Mr. Petersen
Mr. Crnak, Secretariat for Foreign Affairs	Mr. Bery (IBRD)

Mr. Padovan presented the following data on public sector revenue for the period January-October 1983.

	January-October 1983	
	Billions of dinars	Percentage change from a year earlier
Revenue for general consumption	421.970	31.8
Federal budget	194.506	31.0
Of which: transfers from Republics and Provinces	(76.172)	...
Budgets of Republics, Provinces	76.357	25.0
Budgets of municipalities	70.178	20.0
Community of Interest for Foreign Economic Relations	53.332	71.0
Miscellaneous Funds, unallocated	9.785	...
Receipts accruing to 1982	17.742	...
Revenue for collective consumption	507.317	26.7
Total public sector revenue	929.287	29.0

The growth of public sector revenue for the full year was estimated at 25-27 percent. 1/

Mr. Schmitt inquired what changes in taxation could account for the slower growth of revenue than of nominal GSP. Mr. Padovan promised to provide the mission with a description of changes in taxation during 1983 as well as a list of proposed changes in taxation for 1984 on Monday, December 12. He explained that the more rapid growth of revenue in nominal terms than

1/ The midpoint of this range assumes a one-year growth of revenue in November-December 1983 of 13.4 percent, compared with 45.4 percent in October 1983.

specified in the letter of intent could be explained by unanticipated inflation, adding that revenue for transfers having the character of personal incomes could not easily be restricted. Personal income payments to those working in the public sector had been quite restrained, rising by 18.7 percent so far in 1983 (year-on-year) in the federal administration and by even less in some republics and provinces. 1/ Mr. Padovan was asked whether the unanticipated inflation and the growth of revenue should not have made the undertakings to freeze excess public sector revenue easy to overachieve and he replied that it had proved difficult to reduce expenditure very much in real terms though there had been some real decline. In particular certain requirements of the army had had to be met. Mr. Schmitt asked whether it should not have been easy to freeze surplus revenue of the Community of Interest for Foreign Economic Relations (CIFER), whose revenue consisted of rapidly growing import duties that were earmarked for transfer to exporters. After all, exporters' profitability surely must be ample in view of the depreciation of the dinar. Mr. Padovan seemed not to agree, suggesting that it was a question of ensuring that exporters had sufficient liquidity at home. Commenting more generally on the undertaking to freeze excess revenue, he asserted that it had been explained in discussions with Mr. Whittome in Washington that the undertaking to freeze Din 35 billion by the end of 1983 would be difficult to achieve. Revenues frozen in respect of receipts in the period January-October 1983 amounted to Din 9.444 billion compared with Din 9.066 billion a month earlier. He declined to predict how much excess revenue might be frozen by the end of the year. He explained that until August 1983 some 59.7 percent of customs duties were transferred to the CIFER, the remainder accruing to the federal budget. As of August 1, 1983 the percentage retained by the CIFER was raised to 67.2 percent. In the standard monthly report on public sector revenue, the line "Customs Duties and Special Levies" also included a sum accruing to the CIFER of special import fees (additional to tariff receipts) that comprised some 20 percent of CIFER's total revenue. These import fees were charged in order to provide the CIFER with sufficient revenues, virtually all of which were transferred as subsidies to exporters.

Mr. Padovan said that decisions were taken at the beginning of each year as to the amount of resources that needed to be made available to the CIFER, given trends in the exchange rate and in prices, but did not explain why the percentage of customs duties earmarked for the CIFER had needed to be raised in August 1983. Mr. Bery, referring to an IFC project in Slovenia which was said to have received regional subsidies amounting to some 25 percent of the value of exports, asked whether such subsidies were channeled through the CIFER. Mr. Padovan replied that they were not, adding that transfers to exporters were not allocated according to republic.

1/ The cost of living rose by 37.6 percent in the same period which would imply a decline of 14 percent in real terms.

Mr. Padovan was asked for data on the revised federal budget for 1983 and was asked about the status of the draft federal budget for 1984. He promised to provide the usual breakdown of federal government revenue and expenditure for the first 10 months of 1983 and revised estimates for the whole year. The revised total expenditure in 1983 was put at Din 261.654 billion compared with originally budgeted expenditure of Din 243.9 billion. Asked about reports that additional funds totalling Din 15 billion had been allocated for financing the Yugoslav army, 1/ Mr. Padovan said that this was not the case. Mr. Padovan declined to confirm that the draft budget had been adopted by the Federal Assembly saying instead that several alternatives with different sets of numbers were still under consideration.

It was expected that by the end of the year, or in early 1984, a social compact on public sector finances in 1984 would be signed. A social compact had been proposed by the Federal Executive Council on December 8 and had been sent to the various republics and provinces for their consideration. The proposed compact, reflecting input by the Federal Secretariat for Finance as well as the secretariats for finance in the republics and provinces, provided for a coordination of the various taxes and other levies in the various republics. It was explained that the harmonization of the tax system needed to take place in this way since, except for the rates of turnover tax and customs duties which were determined at the federal level, decisions on tax rates were made within individual republics and provinces. The social compact would provide for changes in taxation that would raise the tax burden for households and lower it for enterprises, at least in relative terms. 2/ He cautioned that the revenue effects of these tax reforms might not be very large because, for example, direct taxation on the household sector accounted for only 7 percent, and taxes on productive enterprises for only 11 percent, of total revenue for general consumption. He added that the Federal Government was also preparing to introduce changes in the turnover tax.

1/ This assertion was based on a newspaper report on December 8 in Politika which said that the approved federal budget for 1984 had been adopted the preceding day either by the Federal Assembly or by some committee thereof, with expenditure totalling Din 374.029 billion. The newspaper article reported that this figure represented a 42.9 percent increase over the revised budget figure for 1983 or, if allowances were made for additional funds to finance the Yugoslav People's Army, an increase of 35.2 percent. This latter figure implied total federal expenditure including all funds for the army of Din 276.654 billion, exactly Din 15 billion more than the figure quoted by Mr. Padovan.

2/ Whenever Mr. Padovan speaks of taxation he refers to budgetary revenue for general consumption. Revenues for collective consumption, comprising more than half of all public sector revenue, consist of mandatory contributions paid out of personal incomes from employment and enterprise income.

Mr. Padovan was asked about reports that the budget of the federation had incurred debts which had cumulated to Din 110 billion since 1976. He explained that most of this amount consisted of unfulfilled obligations, as provided in legislation passed in 1977, to set aside funds for the army, and for less developed areas, and to transfer funds to communities of interest that provided pensions and various benefits to invalids and war veterans, etc. Of this total sum, Din 20.5 billion had been spent by the communities of interest and the Federal Government reimbursed them for Din 10 billion of this amount. The remaining Din 10.5 billion would be paid in three equal annual installments. It was unclear whether the remaining Din 89.5 billion in obligations could be honored in the future.

It was explained that communities of interest for collective consumption had borrowed the Din 20.5 billion mostly outside the banking system. Only some Din 3-4 billion had been borrowed from banks, and only for relatively short periods of time, because bank credits were permitted to be of no more than 30 days maturity and carried an interest rate of 35 percent, more than for alternative sources of credit. The other credits from unspecified sources were also short-term loans. There were no statutory limits on the amount of bank credit that could be taken up by communities of interest or budgets of the various levels of government, provided that such bank credits were extended for no more than 30 days. In some cases the communities of interest would cope with liquidity shortages by delaying payments of pensions and other transfers until the requisite revenue had been received. Mr. Padovan explained that budgets of republics and provinces were not allowed to remain in deficit and that, in the event of budgetary surpluses, funds could be set aside for payment of future obligations.

Mr. Padovan explained that discussions were underway on the proposed federal budget for 1984. 1/ Proposals for taxation of interest and of capital gains of foreign exchange accounts were still under consideration and the Fund staff would be informed when a final decision had been reached. The annual plan resolution for 1983 had stipulated that funds for general and collective consumption should decline by 7 percent in real terms, but in fact the decline was now expected to be somewhat greater. A restrictive approach along similar lines was contemplated for 1984 as well, for it was recognized that enterprises bore too large a burden to supply funds for general and collective consumption (i.e., tax burden in the widest sense). According to one proposal that had to be regarded as still very tentative and subject to modification, general and collective consumption would be linked to national income such that the growth of revenue would be 20 percent lower than the growth of national income in nominal terms in 1984. In analyzing public sector finances for 1984 it was important to bear in mind the specific features of the federal budget. In

1/ That is, he gave no indication of the parliamentary action to approve the draft budget which had been reported in the newspaper.

particular, 20 percent of federal budget expenditure comprised transfers for veterans and invalids and 60 percent of budget expenditure was for the Yugoslav army, and these expenditures were protected from cuts in real terms. However, above average growth of expenditure on these items would be compensated by lower revenue and expenditure for other elements of general consumption. Similarly, pensions and benefits for invalids would grow more rapidly in nominal terms than would other outlays for collective consumption. Similarly, Mr. Padovan left the impression that limits would probably apply to collective consumption in the aggregate. Thus an above-average growth of pensions and benefits for invalids would imply a lower permissible rate of growth of revenues for other elements of collective consumption. He added that legislation providing such limits on the growth of the public sector would be passed for the full year 1984 rather than be extended for six months at a time as in 1983. Agreement on the provisions of this law was expected by the end of December. The 1983 law on freezing excess public sector revenue would be followed by an inclusion of similar provisions.

Mr. Padovan explained that the squeeze on the volume of public sector expenditure implied by his revenue forecast for 1983 was reflected in the curtailment of almost all funds for public investment, a 19 percent limit on the growth of nominal incomes from public sector employment, and curtailment of expenditure on goods for current consumption.

INTERNATIONAL MONETARY FUND

Minutes of Meeting No. 7

Held at the National Bank of Yugoslavia
Monday, December 12, 1983 at 9.30 a.m.

Yugoslav representatives	Fund representatives
Mr. Veljković, National Bank of Yugoslavia	Mr. Schmitt
Mr. Stamenković, Office of Prime Minister	Mr. Hansen
Mrs. Knežević, Federal Committee for Labor	Mr. Lewis
Mr. Božović, Federal Statistical Office	Mr. Petersen
	Mr. Bery (IBRD)

National accounts tables on household sector and public sector

Mr. Stamenković introduced Mr. Božović, Department Head for Economic Balances in the Federal Statistical Office, who discussed the construction of Tables 3 and 4 of the programmatic exercise. Mr. Stamenković provided a revised set of forecasts for Table 3 which were now consistent with the Table 2 forecasts of nominal GSP (attached). Table 3, household income and expenditure, did not properly include capital gains arising from the valuation change in households' foreign currency deposits. It was agreed that, since foreign exchange withdrawals were not reckoned as imports of nonfactor services in the GSP table, they ought to be netted out of transfers from abroad in line 3.8. These figures would partially reflect the valuation effects of exchange rate changes since the withdrawals would be converted into dinars at the current exchange rate. However, capital gains on foreign currency earnings that remained on deposit in banks were not reflected in Table 3 as now constructed. Based on the difference between end-1981 and end-1982 household deposits, as shown in the consolidated balance sheet of commercial banks, foreign currency deposits increased by Din 164.5 billion (reflecting valuation changes) and dinar deposits rose by Din 53.4 billion, for a total of Din 217.9 billion. Thus, the flow figure of Din 145.1 billion for financial savings of households in line 3.17 must be underestimated.

Another omission from Table 3 was interest income. Line 3.6 is a residual and so implicitly might include interest income. Mr. Božović promised to provide annual time series on interest income of households which, to the extent that it exceeded the figures in line 3.6, would be added to the total for household income. Interest earnings were at present included with "other items" in a separate table on household accounts provided by Mr. Božović.

The change in household deposits according to banking statistics for the first 10 months of 1983 indicated an increase in dinar savings of Din. 27.8 billion and an increase in foreign currency deposits of Din 346.8 billion, excluding interest payments which for each type of deposit would be credited at the end of the year.

Line 3.4, social security transfers, consists of pensions, disabled benefits, sick leave benefits, etc., from communities of interest for collective consumption. These benefits are all adjusted in nominal terms in line with the growth of personal incomes in the preceding year, at least in principle. Part of the growth in these transfers is attributable to the rising number of pensioners, which grew by 3.5 percent in 1981, 3.9 percent in 1982 and an estimated 4 percent in 1983; an increase of 5 percent is projected for 1984. It was explained that retirement was mandatory for women who had worked for 35 years or reached 60 years of age and for men who had worked for 40 years or reached 65 years of age. In each case retirement five years earlier was optional, but it would entail a 10 percent reduction in pension benefits.

Line 3.5, other transfers from the public sector, comprised transfers for other noneconomic activities including education, various awards and scholarships, automobile and life insurance benefits etc. Line 3.7, receipts from enterprises to meet collective needs, comprised payments in cash and in kind by working organizations (enterprises) for such things as meals during the work day, annual leave, and other fringe benefits. These receipts only came from productive enterprises and were taken from special funds established by enterprises for this purpose.

Line 3.11, other taxes and fees paid to the public sector, could be disaggregated to show direct taxes separately; Mr. Božović promised to provide such data. Line 3.3., social contributions out of personal incomes from employment, included some contributions from enterprise income. These figures should be reduced by some 10 percent. This entry includes contributions from personal incomes for some 100,000 people who work in the private sector but it does not include contributions from the private agricultural sector. Mr. Božović would try to provide data showing what part of these contributions represented costs associated with employment in the private sector.

The motivation for constructing a table on public sector accounts (Table 4) was briefly explained. Mr. Božović said that the downward adjustment to line 3.3 would also need to be made in line 4.1 and the corresponding amount should be added to line 4.2 which included most (mandatory) contributions from enterprise income. Otherwise, he thought that the Table 4, as constructed, appropriately reflected the resource flows between productive activities and the public sector. He was asked whether it would be possible to disaggregate net personal incomes in line 4.5 in order to include only those personal incomes derived from employment in the public sector. He indicated that this could be done and these data would be provided.

Finally, Mr. Stamenković provided forecasts for 1983 and 1984 for the public sector accounts in Table 4 worked out by the Federal Planning Institute under the assumption of no change in tax policy in 1984. He had been informed that the Secretariat for Finance would not be able to provide detailed estimates of the expected revenue effect of the proposed tax policy changes.

INTERNATIONAL MONETARY FUND

Minutes of Meeting No. 8

Held at the National Bank of Yugoslavia
Monday, December 12, 1983, at 2:00 p.m.

Yugoslav representatives:

Mr. Veljković, Deputy Governor, National Bank of Yugoslavia
Mr. Stamenković, Office of Prime Minister
Mr. Muršec, Federal Planning Institute
Mr. Žikelić, Deputy Secretary, Federal Secretariat for Finance
Mr. Sikimić, Head of Department, Federal Secretariat for Finance
Mr. Nikolić, Federal Secretariat for Finance
Mr. Lončar, Community of Interest for Foreign Economic Relations
Mr. Veličković, National Bank of Yugoslavia

Fund representatives

Mr. Schmitt
Mr. Hansen
Mr. Lewis
Mr. Petersen
Mr. Bery (IBRD)

Mr. Žikelić said he was pleased to report that the proposals and amendments to the foreign exchange law had now been submitted to the Parliament where it had begun to undergo the appropriate procedures. He would, therefore, be in a position this time to clarify all the issues which had had to be left open in the previous meeting in November. He noted that one of the key elements of the November 1982 amendment had been to establish groups of enterprises by activity in which enterprises among themselves would agree on their reproduction needs and establish what should be sold to the unified market as a surplus. It had proved very difficult to establish these groups. 1/ To speed up the process the amendments to this law therefore specified that the groups should be established within the Chamber of Economy which comprises all the enterprises of Yugoslavia. He could not say the exact number of groups which would be established; it would not necessarily be limited to the 19 general associations within the Chamber. As under the previous system, the resolution would specify the surrender of foreign exchange to the National Bank of Yugoslavia (NBY) to satisfy the needs of federal agencies, replenish reserves of the NBY, and pay for imports of energy and essential commodities. This "general social requirement" would be covered by one act and specified as one percentage of exports rather than by several surrender requirements according to various acts as in 1982. The surrender requirement had not been quantified yet since it would depend on the financial support package to be concluded with governments and banks. The groups of enterprises would then, on the basis of what was left over and taking into account OALs who did not generate sufficient foreign exchange,

1/ Only eight had been formed according to a government report.

agree among themselves what were their reproductions needs including raw materials, spare parts, and debt service needs. What was left over would be sold to authorized commercial banks in the unified foreign exchange market. The OALs that generated little or no foreign exchange would buy from the unified exchange market the quota agreed for them within the groups of enterprises. He added that the special law on repayment of loans in foreign exchange would remain in effect.

Mr. Žikelić explained the proposed system by the following example:

	(In millions of U.S. dollars)
Total foreign exchange receipts of enterprise	100
Surrender requirement to NBY	37
To be divided by enterises	63
Reproduction needs of enterprise	(30)
Surplus to be sold to unified market	(33)

The enterprise would have to sell the surplus of US$33 million to the unified market within two days. It was still allowed to pool its resources with ther enterprises, but only within the US$30 million limit reserved for its own reproduction needs. In this way it was assumed that a maximum of foreign exchange was channelled via the unified foreign exchange market. The NBY would take on an expanded role, he added. In addition to the general surrender requirement, the NBY would receive the foreign exchange obtained from the sale of foreign exchange to banks by private citizens and to foreign exchange houses by tourists. The National Bank would also regulate the meetings of the interbank market. On this market banks would offer within five days the surplus foreign exchange obtained from enterprises. The NBY would regulate the market by buying or selling foreign exchange. It was implied that this was the only requirement for forced surrender to the interbank market.

Mr. Žikelić explained that in cases where there was a timelag between the realization of an export receipt and the payment for reproduction needs, the enterprise would be required to sell the foreign exchange to its authorized bank but would receive a guarantee for a repurchase after the agreed time period for the sale. This temporary sale would be enforced by withholding tax rebates and import duty drawbacks on the export in question if the enterprise had not sold the foreign exchange within 15 days. Also, the commercial banks would withhold further credit expansion to the enterprise until matters were regularized.

Mr. Schmitt inquired what type of deposit the enterprise would receive in return for the foreign exchange and at what interest rate. In reply, Mr. Žikelić explained that it would receive a normal dinar deposit at a normal interest rate. The exchange rate would be that of the day of sale while the exchange rate used for the repurchase would be that in effect at the time of repurchase. He agreed that this would result in some loss to the enterprises, given the present circumstances, but the loss would be small given the likely short period involved. Moreover, the enterprise would only receive the export subsidy if it sold the foreign exchange. Asked what rules would govern the foreign exchange presently held in foreign exchange accounts by enterprises, Mr. Žikelić explained that these would not be covered by the abovementioned rules since according to Yugoslav law such rules could not be made retroactive.

Mr. Bery noted that the report on the operation of the foreign exchange allocation system with proposals for 1984 had not yet been made available to the IBRD or the IMF although it was one of the preconditions for the release of the second tranche of the SAL. He feared this might be interpreted adversely in Washington. 1/ Mr. Žikelić explained that the reasons for this were the delays in formulating the proposals and the need to know the balance of payments projections before the retention quotas could be fixed. Rather than present a report to the IBRD which would need to be changed substantially, the authorities had opted for waiting until it was possible to give a firmer view on what should be done in this area in 1984.

Mr. Bery explained that in the IBRD's view one of the major shortcomings of the foreign exchange law as implemented in 1983 was that access for non-exporters to foreign exchange was made very difficult. For example, he knew of a gas producer that could not obtain foreign exchange for the imports of necessary spare parts. What were the specific points in the new legislation that would prevent this from happening again? Mr. Žikelić explained that this problem was exactly what the authorities wanted to solve with the present amendments to the law. Therefore, according to the unified criteria for the implementation of the law, at the same time as it was determined what were the reproduction requirements of exporters, it would be determined what were the requirements of the enterprises that did not export. The latter would buy their requirement in the unified market which would be supplied by the sale of surplus foreign exchange by exporters. The reproduction requirement of each enterprise would be determined within the Chamber of the Economy on the basis of the unified criteria. After approval by the Yugoslav Community of Interest for External Relations, the necessary self-management agreements would be forwarded to the authorized banks of the enterprises. The authorized bank would sell up to the agreed maximum for each enterprise.

In reply to a question, Mr. Žikelić stated that he was of the firm opinion that the necessary agreements would be reached before the end of the year for the system to become operational by the beginning of 1984 and that no temporary arrangements would be needed. He added that as an inducement to a speedy implementation of the system an enterprise which did not reach agreement on its reproduction requirement would only be entitled to 50 percent of the amount it would have obtained if it had signed the agreement.

1/ The report was handed to Mr. Bery the following day.

INTERNATIONAL MONETARY FUND

Minutes of Meeting No. 9

Held at the National Bank of Yugoslavia
Monday, December 12, 1983, at 4:00 p.m.

Yugoslav representatives:	Fund represnetatives
Mr. Veljković	Mr. Schmitt
Mr. Golijanin	Mr. Hansen
Mr. Petrović	Mr. Lewis
Mr. Marković	Mr. Petersen
Mr. Velickovic	Mr. Bery (IBRD)

Monetary developments

Mr. Petrović presented his assessment of the outcome of the monetary accounts for 1983. It was based on the actual outcome of the first 10 months of the year and the latest forecast for the balance of payments for 1983. Assuming an exchange rate of Din 126 per US$1 (the present rate) net foreign liabilities were expected to rise to Din 1,323 billion. M2 was forecast at Din 2,919 billion and unadjusted net domestic assets at Din 4,242 billion. The increase in net foreign liabilities adjusted for exchange rate changes was Din 65 billion. This compared with a decline of Din 11 billion in the first 10 months of the year—a development Mr. Petrović claimed was consistent with the balance of payments forecast. Other items, net, were estimated to reach Din 1,144 billion by the end of the year which would leave total credit at Din 3,098 billion of which Din 2,381 billion (an increase of Din 300 billion compared with 1982) were dinar credits. M1 was forecast at Din 902 billion for the end of 1983, other dinar deposits at Din 793 billion and foreign exchange deposits at Din 1,224 billion. In deriving the latter estimates Mr. Petrović had assumed that about one third of foreign exchange deposits (those of enterprises) were denominated in U.S. dollars at a rate of Din 126 per US$1, while the remaining part of such deposits (those of households) was assumed to be denominated in deutsche marks and converted into dinars at a rate of Din 46 per DM 1.

Turning to the forecast for 1984, Mr. Petrović said that it was based on an assumption that inflation through the year would be 40 percent. Assuming a rate of real growth of 2 percent for GSP, nominal GSP was estimated to grow by 42.8 percent by the end of 1984. The velocity of circulation of dinar deposits had risen very sharply in 1983. It was assumed that such a rate of increase could not continue in 1984; a further rate of increase of 5 percent had been assumed. This would bring M1 to Din 1,226 billion and total dinar deposits to Din 2,301 billion by the end of 1984. In constant dinar terms, foreign exchange deposits were assumed to grow by Din 50 billion bringing the level of such deposits, adjusted for exchange rate changes, to Din 1,274 billion at the end of 1984 and thus M2, adjusted for exchange rate changes, to Din 3,575 billion by the end of the year. Based on the official forecast for the balance of payments in 1984, net foreign liabilities were estimated to increase by Din 48.5 billion, adjusted for exchange rate changes, which would mean that net domestic assets, adjusted for exchange rate changes, would be Din 4,946 billion by the end of the year--or an increase by 16.6 percent. Foreign exchange credits, adjusted for exchange rate changes, were assumed to go up by Din 82 billion, and dinar credits by Din 621 billion to Din 3,002 billion (an increase of 26 percent).

Asked about how firm the inflation forecast used in the computations was, Mr. Petrović emphasized that this forecast as well as the computations made on the basis of this were his personal effort. There were different opinions within the Bank on this assumption and the monetary forcasts he had presented.

INTERNATIONAL MONETARY FUND

Minutes of Meeting No. 10

Held at the National Bank of Yugoslavia
December 14, 1983, at 9:30 a.m.

Yugoslav representatives:

Mr. Veljkovic, Deputy Governor, National Bank of Yugoslavia (NBY)
Mr. Milosevic, Deputy Secretary, Federal Secretariat for Foreign Trade (FSFT)
Mr. Petrovic, FSFT
Mr. Loncar, Community of Interest For Foreign Economic Relations
Mrs. Hofmann, NBY
Mr. Velickovic, NBY

Fund representatives:

Mr. Schmitt
Mr. Hansen
Mr. Lewis
Mr. Petersen
Mr. Bery, IBRD

Mr. Petrovic explained that, in principle, export subsidies were regulated by self-management agreements within the Yugoslav Community of Interest For Foreign Economic Relations (CIFER). However, as enterprises had not been able to reach agreement among themselves, export subsidies were presently governed by a decision of the Federal Executive Council published in the Official Gazette in May 1983. At the federal level, export subsidies were paid in the form of: (1) drawback of import duties; (2) rebates of taxes on incomes and personal incomes; (3) refunds of part of transportation costs; (4) contributions for advertising abroad for tourism and industry; and (5) special subsidies for agricultural exports.

The import duty drawbacks were calculated for 115 branches on the basis of the average actual import duties paid by the branch in question during the preceding year, or, failing availability of data, the year before. The average drawback in 1983 amounted to an estimated 2.18 percent of the value of exports, but varied widely among branches, ranging from 0.9 percent to 10 percent. No changes to the scheme were foreseen for 1984.

The rebates of contributions (i.e., taxes) from enterprise income and personal incomes were, in principle, set at levels which would, on average, offset that part of taxation which was levied on incomes realized from export production. According to the May 1983 decision, these rebates for the 115 branches ranged from 0.7 percent to 7.75 percent of the value of exports; the average was 2.97 percent . The proposals for 1984 had not yet been finalized, but only minor revisions were expected.

The transportation cost refund was based on actual costs paid. The refund was paid at two rates--20 percent for nearby countries, and 30 percent for more distant destinations such as Pacific nations, South America, and Africa. It was paid upon submission of documentation such as bills of lading.

The rebate of marketing costs for industry and tourism was set at 1 percent of the actual current foreign exchange receipts of those sectors in the preceding year. The marketing program was established by the Yugoslav Chamber of the Economy that received the funds from the CIFER on a quarterly basis. The planned level of rebates in 1983 was set at Din 950 million for industry, and at Din 549 million for tourism.

All of the four above mentioned schemes were funded by the CIFER, whose funds in turn were replenished from contributions out of customs and other import duties each year on the basis of projected needs. The scheme was administered by banks at the local level. Upon receipt of substantiated requests from the exporting enterprises, the banks would request the SDK to credit the account of the enterprise and debit the account of CIFER. Mr. Petrovic was not able to give any information on actual payments under the drawback scheme, but promised to provide the data to the mission as soon as possible. He was also unable to give any details on the export subsidy scheme for agricultural exports which was administered by a special Agrofund.

Mr. Petrovic explained that the rules for paying out the export subsidies had recently been changed in connection with the new proposals for modification of the foreign exchange allocation system. In the future, export subsidies would only be paid upon surrender of foreign currency to the banks in exchange for dinars.

Mr. Bery sought to obtain information on the operation of subsidies which were paid at the regional level in addition to those paid at the federal level. Messrs. Petrovic and Milosevic did not give any explanation of such subsidies, but implicitly accepted their existence. They said that the authorities were in the process of preparing unified criteria for such subsidies, and would insist on their standardization in line with their undertaking under the SAL.

INTERNATIONAL MONETARY FUND

Minutes of Meeting No. 11

Held at the National Bank of Yugoslavia
Wednesday, December 14, 1983 at 11:30 a.m.

Yugoslav representatives:	Fund representatives:
Mr. Veljković, Deputy Governor, National Bank of Yugoslavia	Mr. Schmitt
Mr. Andžić, Secretariat for Finance	Mr. Hansen
Mr. Knežević, Federal Committee for Labor	Mr. Lewis
	Mr. Petersen
	Mr. Bery (IBRD)

Mr. Andžic reviewed the status of the amendments of the law on internal payments that were passed in mid-1983 and due to take effect in January 1984. Its most important provision would be to limit payments of personal incomes by enterprises with domestic arrears to the average nominal personal income in the particular republic in the preceding year. Asked about reports that there was resistance to starting implementation of the law in January 1984 as scheduled, he indicated that some exceptions might be made for the first couple of months of 1984 with respect to enterprises that began the new year with outstanding obligations from 1983. There had been unofficial reports that as many as 6,000 enterprises with a total of 1.5 million workers could be affected by the restrictions on personal income payments. According to official data of the SDK as of the end of October 1983, 1,700 enterprises with 400,000 workers had fallen behind in servicing their financial obligations (compared with a total of 30,000 enterprises and 6,000,000 workers for the entire economy). This was the number of enterpises that had been reported by creditors to the SDK, under terms of a law passed in the summer of 1983, as having failed to pay obligations on time. Alternatively, the ceiling would be the republican average for the industrial branch if this were larger than for the republic as a whole. Because of nonreporting, the true number was probably higher; the SDK planned to monitor the data of creditors and more accurate estimates would be available by the beginning of 1984. Apart from this notification requirement, the restriction on illiquid enterprises would be reinforced by a system of fines for organizations and enterprises.

Mr. Schmitt noted that the federal law on restricting personal income payments by illiquid enterprises appeared not to affect the enterprises which had been incurring losses provided that they were undergoing a rehabilitation program and thus had obtained enough special credits to meet their short-term liquidity needs. He asked what limitations applied to the payments of personal incomes for such loss-making but liquid enterprises. Mr. Andžić replied that in such cases limits on payments of personal incomes were set within individual republics and provinces at the level of the guaranteed minimum of personal income. This guaranteed minimum varied by republic, ranging from 60 to 80 percent of average personal incomes in the republic in the preceding year. In any case, the guaranteed minimum was less than the average in the preceding year which in the present inflationary environment implied a substantial cut in real personal incomes. However, it was possible that a loss-making enterprise under a rehabilitation program could receive funds (e.g., from the joint reserve funds at the republican and communal levels) which would permit the enterprise to pay somewhat higher personal incomes than the guaranteed minimum. Of course, many loss-making enterprises under rehabilitation programs would be those affected by the new restrictions effective in January 1984 that were aimed at illiquid enterprises, but there would be some enterprises in each group that did not belong to the other group. The limitations on personal income payments by enterprises undergoing rehabilitation was the Law on Rehabilitation, passed several years ago. Mr. Schmitt asked why, if this law had already imposed discipline on loss-making enterprises, there was such fierce resistance to the new legislation on restricting personal income payments that would be implemented at the federal level. Mr. Andžić replied that there might be many enterprises that did not incur losses but which were illiquid and so would for the first time become subject to limitations on the size of their payments of personal incomes. This was a sensitive issue, partly because enterprises not making losses but nevertheless facing temporary liquidity shortages regarded it as their consitutional right to dispose of income that they had earned.

Beginning in January 1984, each organization of associated labor would be required to submit a statement to the SDK confirming that it had met all payments obligations and should not be subject to restrictions in its payments of personal incomes. Only with such a statement in hand would the SDK effect such payments. Untrue statements would, in principle, lead to the prosecution of the person who signed the statement. Such a statement would need to be assessed each time personal incomes were to be paid, perhaps once or twice a month for each basic organization of associated labor.

Mr. Andžić was asked whether there was any limit to the size of cut in real personal incomes that would be allowed to result from strict application of the new restrictions on personal income payments. He said that he did not have the estimates on the likely impact of the new provisions on total payments of personal incomes in 1984 but he pointed out than an enterrise, after having settled all payments obligations and having again become liquid, could resume normal payments of personal incomes, including retroactive payments. The purpose of this legislation was to enhance financial discipline by reducing the problem of arrears; it was not to be regarded as an incomes policy measure.

Mr. Veljković observed that the full implications of the law on priorities of enterprise payments would not be known until January 1984. Modifications were possible, particularly with regard to the period of time when the law would be in force. The austerity of the law could well be mitigated by altering the timing of its effects. Modifications were possible since up to one third of all enterprises could potentially be adversely affected by this law.

The following points emerged from the discussion on the draft letter of intent, paragraphs 7 and 8. As of April 1984, bankruptcy proceedings would be initiated for those enterprises which had registered a financial loss for a year or more but had failed to include a rehabilitation program with its creditors. At the end of 1984 and in each succeeding year an enterprise would be granted a period of 12 months in which it could incur losses before having to either initiate bankruptcy proceedings or enter into a rehabilitation program. From the discussion it was unclear whether the proviso about limiting personal income payments for an enterprise under a rehabilitation program which was continuing to incur losses was already duplicated by the terms of the existing Law on Rehabilitation.

December 14, 1983

MEMORANDUM FOR FILES

Subject: Meeting with Zvone Dragan

Messrs. Schmitt, Mentré and Hansen were received by Mr. Dragan, Vice President of the Federal Executive Council, on December 9, 1983. Messrs. Veljković and Stamenković and Mrs. Hofmann were also present.

Mr. Dragan opened the meeting by asking when the authorities could expect a draft of the letter of intent. It was important to get it as quickly as possible. He had to give a complete report to the Federal Executive Council and Parliament by Tuesday. Further negotiations with the Fund would depend on the reaction of these bodies to the draft letter. He urged that a work schedule be established on Monday as he understood that the mission wished to leave on Friday. He would expect that the final text of the letter would have to be worked out over the three days Wednesday-Friday. There was, however, a problem with this timetable. All basic documents on the official policy for the Yugoslav economy for 1984 were now before Parliament. The first stage of these discussions would be finalized on December 10. Then the proposals would be discussed on the Republic and Province level before the Parliament would resume the discussions of the documents on December 19. As there were some differences of view between the Government and the IMF on policies it was important that these be presented to Parliament in order that the Government could be authorized to negotiate with the Fund. Mr. Dragan also asked for a preliminary assessment of the discussions so far.

Mr. Schmitt promised that the mission would produce a preliminary draft of the letter of intent by Monday, December 12. On the discussions he said that the starting point was the external accounts for Yugoslavia and the financing possibilities were vital in that respect. This problem was being dealt with through two different tracks: (i) the discussions here in Belgrade to determine the policies that could produce a given current account outcome and (ii) the discussions in Geneva and London on the external financing package for Yugoslavia. During the first week's discussion there seemed to have developed a welcome convergence of views. This could be illustrated by two tables that the mission had produced (and which were circulated to the participants in the meeting) on the balance of payments and the financing picture for 1984. The tables contained the latest Yugoslav estimates and an alternative estimate, which was based on the latest staff estimate on the current account balance and certain assumptions on the external financing possibilities, producing the change in official reserves as a residual.

Mr. Mentré then gave a brief account of the meetings in Geneva and London, and the attitude of governments and banks to a financing package for Yugoslavia for 1984. Regarding rescheduling of medium- and long-term debt both governments and banks had been positive and showed a willingness to consider a 100 percent rescheduling of such maturities. The finalization of such agreements could however only be expected in late January at the earliest and it was therefore important that the Yugoslavs asked for a standstill period. The authorities would receive on Monday a telex from the ICC with a proposal that Yugoslavia asked for a standstill period from banks for a 90-day period starting January 1, 1984. To put into effect a standstill period on government maturities also it was important that the Yugoslav authorities send a letter requesting the meetings on rescheduling of government debt through the Swiss chairmanship of the Geneva group. Mr. Mentré handed over a preliminary draft of such a letter.

On the question of new money he said that this had not been included in the formal proposal from the London meeting. However, both during the meeting and also in discussions with the banks outside the meeting various ideas had been floated--such as cofinancing with the IBRD, EIB, etc. and possibly a stand-by loan from some of the bigger banks. He emphasized that it was very important that the possibility of obtaining new loans from banks should be kept open, and it was important in that connection that the Yugoslav authorities did not accept the banks' proposal on rescheduling before the meetings on government rescheduling had been held in January. The telex from the ICC on the standstill period would also contain the rescheduling proposal, but it should be made clear in the Yugoslav response that the request for a standstill period did not mean acceptance of the rescheduling proposal. Referring to the tables circulated he said that even with a current account target of US$500 million surplus and US$200 million in new money from banks and US$250 million from government the increase in reserves in 1984 would only be around US$500 million. This underlined the need to ask for new money from governments also, and he considered that a pledging session was needed to maintain the flow of suppliers' credits to Yugoslavia. This had been the purpose of establishing the second subgroup at the Geneva meeting.

Mr. Dragan commented that he considered both the Geneva and London meetings as successful, despite the fact that there were still some pending issues to be solved. He felt that the experience of 1983 had been useful in the preparation for this year's meetings. Mr. Smole was now in Paris to discuss some outstanding questions on the work of the subgroup on rescheduling of government debt. There were still many questions to clarify including the terms and conditions of this exercise. He agreed that the work of the subgroup on the suppliers' credits should be intensified and he intended to contact Germany to have them play a greater role in this exercise. There had been some criticism of the implementation of the Berne package, particularly the slow disbursement of the funds. This was partly related to disputes with creditors, who wanted to include credits for equipment goods in the package, while Yugoslavia was only willing to accept credits for intermediate goods and spare parts. There had also been some problems with the Yugoslav law concerning the utilization of such credits, but certain amendments had now been implemented which should result in quicker disbursements in 1984. On the bank package he said that the banks in the London meeting had offered 100 percent rescheduling of medium- and long-term maturities to banks. The Yugoslav delegation had not been authorized to accept this on the spot, In fact, Yugoslavia had only planned to refinance 50-65 percent of the maturities. The refinancing proposal would be discussed by the Government on Tuesday. He understood that the IMF during the London meeting had insisted that banks and governments participated with new money in a 1984 package, and that a compromise formula had been agreed on to the effect that the discussions with banks on this question could be reopened if found necessary.

Referring to the tables circulated b the staff, Mr. Dragan noted the difference between the Yugoslav estimate of a current account surplus of US$800 million and the staff estimate of US$500 million and between the esimtated reserve build-up of US$1 billion forecast by the Yugoslavs and the staff estimate of an increase of US$500 million. Mr. Schmitt emphasized that this latter figure was not a target but a residual given the other assumptions in the tables, and that it was considered by the staff as a very low increase. Mr. Dragan pointed out that in the present Yugoslav forecast some new money from banks was included although considerably less than in the IMF presentation. He added that the authorities were open-minded on the structure of the financial package for 1984, but the overall size of the package was important given the very important policy aim of reducing the overall indebtedness of Yugoslavia in 1984. This was a stance taken by the Government, Parliament and all political authorities. Given that Yugoslavia's external debt was of the order of US$18 billion a margin of error of 2-2 1/2 percent could probably be accepted, i.e., an increase of US$300-400 million. This meant that, taking into account the repayments of debt of about US$3 billion in 1984, an overall package of between US$3 billion and US$3.5 billion would be acceptable. A key point to determine was the current account surplus. The higher that was and the larger autonomous financing flows to Yugoslavia, the less was the need for special assistance from governments and banks. He felt that it was important to commit Parliament and the population to a current account surplus of US$800 million. On the proposal to establish a stand-by facility with the commercial banks he said that the terms and conditions of such a facility were very important. In particular, it should not be a short-term credit; the difficulties with short-term credits were plenty already. Finally, Mr. Dragan said that the question on the necessary build-up of reserves had to be discussed further and had to be kept in mind at all stages of the negotiations. Summarizing the present situation, Mr. Dragan said that the most urgent task was to reach agreement with the IMF and within the next two weeks, to reach agreement on a standstill period for maturities falling due to banks and governments.

Mr. Mentré commented that he was aware of the Yugoslav desire not to increase the level of indebtedness in 1984. However, if Yugoslavia wished to return to a more normal situation in 1985 there was a need to build up reserves during 1984 and he felt that the Yugoslavs should take advantage of present willingness of governments and banks to provide financing. Fortunately, Mr. Dragan had mentioned a figure of US$3.5 billion as a possible size of a financing package and that might just fall within an acceptable range. He added that it was important that the Yugoslavs resisted the temptation to ask for less than 100 percent refinancing from banks (because of the better terms that the banks were willing to offer should that be the case). As experience from 1983 showed, even if one asked for 100 percent refinancing there would be exclusions and leakages. It was extremely important to ask for 100 percent refinancing from governments also. Mr. Mentré felt that there was a need to go back to banks in January or February to ask for new money after the conclusion of the negotiations with the IMF and the meetings of governments. It would be important in such a meeting to deal with the problem of short-term debt falling due in January 1985 (now estimated at more than US$800 million). At the London meeting, Mr. Whittome had suggested that the period be extended for another year, but this had not been taken up by the banks in their proposal. Asked about the further time schedule, Mr. Mentré said that the two government subgroups were tentatively scheduled to convene in Paris on January 11-12 and would report to the full group probably by the end of January. In the meantime there should be another meeting of the ICC as the governments would want to know the final position of banks before having the plenary meeting. Also, the governments would not finally agree to the package until the IMF stand-by had been approved by the Board. Mr. Dragan picked this up and asked when a Board discussion could be expected if agreement with the IMF was reached on December 16. Mr. Schmitt responded that if agreement was reached on that date it would still be ad referendum and the letter of intent would probably not be signed until early January. Then a paper had to be written. It could probably go to the Board by end-January. The Board then needed four weeks to consider the paper, so under the best of circumstances the paper could be discussed in late February. Mr. Schmitt took the opportunity to clarify that what was being negotiated with the Fund was a one-year stand-by arrangement for an amount of SDR 370 million (or approximately US$400 million) but this amount would be available only on the assumption that new money was provided by governments and banks also. Otherwise, there would be only a rollover of repurchases. He added that he had noted the commitment of the authorities not to increase the external indebtedness in 1984 and appreciated the ambition to adjust. However, there were many risks associated with this approach and what was on the mind of the IMF was to avoid a situation in which Yugoslavia was not asking for new money in January but had to do so in July. Mr. Dragan remarked that he understood the interdependence between the new money from the Fund and from governments and banks, and that this was why the authorities had accepted to seek some new money from governments and banks. However, he asked Mr. Schmitt to send the message to Washington that the Yugoslavs would prefer to see the size of the stand-by closer to US$500 million than the US$400 million just mentioned. The latter figure would provide Yugoslavia with only US$120 million from the Fund in 1984.

Finally, Mr. Veljković inquired about the proposed stand-by facility from banks. What was the size that one had in mind and what would be the costs of it, and would it be wise to seek money from banks through more than one channel? Mr. Mentré said that the figure for such a facility should be US$200-300 million. On the costs he said that the Yugoslavs would have to pay a stand-by fee, and then the normal interest rate if it was utilized. It should be a medium-term credit. As to the question of going through different channels he said that the idea of the facility was not to use it. It was considered as a device to improve the management of reserves. He added that in particular the Scandinavian countries had used stand-by facilities of this character in the management of their reserves.

Leif Hansen

Table 1. Yugoslavia: Balance of Payments with the Convertible Currency Area, 1982-84

(In millions of U.S. dollars)

	1982	1983		1984	
		Yugoslav estimate	Alternative	Yugoslav estimate	Alternativ
Exports	5,526	6,400	6,300	7,700	7,200
Imports	-9,043	8,450	-8,450	9,100	8,800
Trade balance	-3,517	-2,050	-2,150	-1,400	-1,600
Invisibles (net)	2,003	1,925	1,925	2,200	2,100
Workers' remittances	1,085	1,265	1,265	1,440	1,135
Tourism	1,224	1,335	1,335	1,080	1,510
Interest payments	-1,670	-1,690	-1,690	-1,840	-1,890
Others	1,364	1,015	1,015	1,520	1,345
Current account	-1,514	-125	-225	800	500
Medium- and long-term debt	-117	1,230	1,175	-20	190
Drawings	1,684	3,880	3,825	2,825	3,135
Repayments	-1,626	-2,450	-2,450	-2,645	-2,745
Loans extended	-175	-200	-200	-200	-200
Short-term debt	-506	-500	-600	—	—
Errors and omissions	562	-585	-750	—	-300
Total	-1,575	20	-350	-780	390
Use of Fund Credit	563	410	410	220	120
Reserve movements (increase -)	1,012	-430	-10	-1,000	-510

Table 2. Yugoslavia: Drawings on Medium- and Long-Term Debt in Convertible Currency by Creditor

(In millions of U.S. dollars)

	1983		1984	
	Yugoslav estimate	Alternative	Yugoslav estimate	Alternative
Government packages	839	831	1,006	1,100
Berne	839	831	456	350
Refinancing	(304)	(304)	(...)	(3)
New financial credits	(180)	(172)	(...)	(...)
Suppliers credits	(355)	(355)	(456)	(347)
Geneva	...	...	550	750
Refinancing	...	...	(400)	(500)
Suppliers credits	...	...	(150)	(250)
Commercial bank package	1,580	1,580	1,100	1,300
Refinancing	980	980	1,000	1,100
New financing	600	600	100	200
IBRD	320	350	530	485
Regular facilities	250	280	250	280
SAL	70	70	280	205
Other multilateral lenders IFC, EIB and Eurofirms	30	50	... 1/	50
Suppliers credits outside Government packages	1,111	1,014	189	200
Subtotal	3,880	3,825	2,825	3,135
IMF	590	590	500	400
Total	4,470	4,415	3,325	3,535

1/ Included in drawings on the IBRD.

December 15, 1983

NOTE FOR FILES

1. At a meeting on December 14 Mr. Lončar provided the following explanation of how the system of "unified criteria" for establishing foreign exchange retention rights might be expected to work. In his presentation Mr. Lončar stressed that he was providing a personal interpretation of how the system might be expected to evolve as discussions were continuing, and the unified criteria could only be finalized once there was a firm balance of payments forecast for the country and after amendments to the Law on Foreign Currency Payments and Foreign Credit Relations had been passed.

2. The unified criteria for 1984 would probably be formulated similarly to those in 1983. Two categories of enterprise would be distinguished: those whose foreign exchange earnings were in excess of their needs (the so-called "active" producers) and those whose foreign exchange earnings were short of their needs (the so-called "passive" producers). For each category of producer a formula would be developed to establish an entitlement to foreign exchange retention on the basis of debt service obligations and average import needs of raw materials and intermediate goods in the recent past. These entitlements would be referred to as the "verified reproduction needs" of each enterprise, and would be calibrated according to the balance of payments forecast for the year. In principle enterprises were only entitled to retain their verified reproduction needs on their own account. The remainder would need to be sold to authorized banks as a source of supply to the unified foreign exchange market. The verified reproduction needs would be established for each enterprise within its respective general association in the Federal Chamber of Economy, after reviewing evidence on debt-service obligations coming due and past import trends. Once verified reproduction needs had been established, enterprises were encouraged to associate with each other to pool their foreign exchange entitlements as they saw fit. This would be regulated by self-management agreements drawn up between enterprises, and certified by the Yugoslav Community of Interest for Foreign Economic Relations.

3. When asked what aspects of the proposed system differed from practice in 1983, Mr. Lončar replied that two provisions were different. First, enterprises were required to sell all amounts in excess of their verified reproduction needs to the banks. This would create a pool of funds to be drawn upon by deficit enterprises. This provision had not existed in 1983. Second, the attempt to organize enterprises into specific and unique groups

for sharing foreign exchange had failed in 1983, and the new provisions would permit any form of cooperation between enterprises in the sharing of their verified reproduction needs. In this connection Mr. Lončar also indicated that encouraging such cooperatin was an explicit goal of the new system and that enterprises which did not choose to share their verified reproduction needs through self-management agreements would be penalized by being provided only half of their v.r.n.

Suman Bery

Suman Bery

December 15, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia: Balance of Payments

Messrs. Lewis and Petersen met with Messrs. Milosević and Smiljanić to clarify certain issues on the balance of payments.

The mission observed that the estimates for trade flows overall seemed realistic but inquired about the basis for the forecast increase in the rate of growth of exports to the convertible area in December 1983. Mr. Milosević explained that the trend during the year had been for the growth rate to increase (see Table attached to Minute of Meeting No. 1).

The mission suggested that a more probable estimate would probably be to put exports at US$6,350 million. Mr. Milosević replied that he did not think it was feasible to forecast exports that precisely but he was certain that whether one took US$6,350 million or US$6,400 million as a forecast, the trade deficit would not exceed US$2,050 million. He reminded the mission that imports had registered a large jump in December of last year because there had been a backlog of goods in customs transit which had been cleared before the end of the year. Such a backlog did not exist this year so the import forecast was probably on the high side.

Turning to the forecast for trade with the nonconvertible area, Mr. Milosević explained that the discussion of commodity lists for 1984 had been largely finished. The intention was to achieve a trade deficit of about US$250 million. Asked about the value and contents of the commodity lists which had been concluded, Mr. Milosević promised that he would provide the mission with the relevant information to the extent possible. In particular, he would make contact with the Federal Secretariat for Energy to obtain information on the projected import requirements for crude petroleum and other energy products distributed according to regions. As to data for 1983, he promised to provide the data within two days. He added that the question on oil imports from the nonconvertible area had not yet been completely clarified. Vice Prime Minister Srebric had just returned from Russia where the question had been discussed and might have further information.

The mission observed that the partial reversal of the shift in the trade account vis-a-vis the nonconvertible currency area (from a surplus of US$691 million in 1982 to a deficit of US$350 million in 1983 and to a targeted deficit of US$250 million in 1984) would have a significant impact on the prospects for expanding exports to the convertible currency area. Therefore, the mission considered its estimate of exports to that area in 1984 of US$7.2 billion (a volume growth of 10.1 percent) to be more realistic than the US$7.7 billion projection of the authorities (a volume growth of 16.8 percent). The mission's projection would still entail a sharp increase in volume terms of total exports from 1.8 percent in 1983 to 8.3 percent in 1984.

Mr. Milosević repeated the usual arguments for the authorities' projection emphasizing in particular that their forecast was predicated on the pick-up in industrial production. He noted that if two percentage points of the 3 percent increase in industrial production was channeled into exports, this would imply a volume growth of total exports of some 15-16 percent. In addition, he expected some contribution to exports from the planned 2 percent growth in agricultural production.

Commenting on the projection of the net services account with the nonconvertible area, Mr. Smiljanić explained that the major reason for the projected decline was that receipts in 1983 had been unusually large. In that year Yugoslavia had registered US$60 million in receipts on account of a Jubilee Agricultural Fair. The mission observed that while this accounted for some decline the numbers would still point to net service receipts of at least US$300 million which would result in a small surplus on the current account.

With regard to the services account in convertible currencies, Mr. Smiljanić promised to provide the mission with a breakdown of the item "other" so as to be able to explain the reason for the projectied decline in the estimate of this item from US$997 million in 1982 to US$700 million in 1983. He explained that the apparent increase of receipts under this item in January-October 1983 over January-October 1982 was misleading since there had been some misallocation among the headings which had not been rectified until toward the end of the year. This explained the apparent sharp increase in receipts under "other" toward the end of 1982. As to transportation, the decline in 1983 was due to the decline in the volume of trade. Similarly the sharp increases projected for receipts and, to some extent, for payments were based on the projected increases in exports and imports. The projection of interest payments for 1984 assumed no change in the average rate of LIBOR, but Mr. Smiljanić agreed that the projected increase in payments seemed a bit on the high side.

Mr. Smiljanić confirmed that the projection of an apparent decline in receipts from tourism was due to the discontinuation as of 1984 of the practice of the National Bank according to which the underrecording of tourist receipts was corrected by transferring part of the receipts from workers' remittances to tourism receipts. Thus, before adjustment, tourism receipts in convertible currencies had amounted to US$960 million in 1983 and the projection for 1984 was based on this amount only. Mr. Smiljanić had not incorporated any special estimate of receipts from the Winter Olympics in Sarajevo. He was not aware, but promised to find out, when the payments for television rights had been or would be made.

Mr. Milosević also promised to ~~prive~~ provide the mission with estimates of exports and imports during January-November calculated at actual exchange rates as well as information on trade flows according to currency. On this subject, he informed the mission that he had just attended a meeting of the Federal Executive Council in which it had been decided to begin calculating trade flows at current exchange rates with effect from January 1, 1984. He seemed to indicate some doubts, however, as to whether this decision would be implemented on time.

Arne B. Petersen

cc: DR

INTERNATIONAL MONETARY FUND

TO : Mr. Whittome

FROM: Hans Schmitt

to the dir in fr

(1) the attached draft telex seems OK to me

(2) the meeting on the 22d is alright, too.

P.S. We did not, in the end, have a discussion with Brainard et al in Belgrade.

[illegible]

12/20

Mr. Whittome

Office Memorandum

cc: Mr. Schmitt

December 16, 1983

(1) OK let're know if draft's OK if it can be sent
19/12

MEMORANDUM FOR FILES

Subject: Yugoslavia--Meeting with Manufacturers Hanover

On December 15 I had a two-hour meeting in New York with Mr. Dobrich, Ms. Mudd, and Mr. Fisher, all of Manufacturers Hanover. Mr. Dobrich said that when the ICC sent a firm offer to the Yugoslavs on refinancing of maturities falling due in 1984, it was the hope of many banks that the Yugoslavs will accept to limit their demand to such refinancing. It was Mr. Dobrich's understanding that while many in Yugoslavia also preferred this course of action, the official Yugoslav line, as determined by Mr. Dragan, was in line with the Fund's attitude, which means leaving open the scope for future negotiations.

(2) Can you let others ... re ... 22nd

If such is the final Yugoslav position, and Mr. Dobrich will be in Belgrade on December 19-20, then the question of the standstill will arise. Some U.S. banks would favor not to recommend any standstill in the absence of an agreement of refinancing. I said that it would run totally contrary to what was proposed by the ICC in the London meeting, and to what has been officially said by the Yugoslavs and by us to creditor governments when proposing to them a parallel standstill. Mr. Dobrich agreed and said that at the very end the common interest to have an orderly process will most probably prevail. 1/ The standstill proposal could be sent to all interested banks around the 21st of December and a telex by the Fund in support of it would be appreciated (see attached draft, to be checked with Manufacturers Hanover).

Mr. Dobrich and his associates then inquired about the status of our negotiations and the timetable contemplated by governments. I elaborated on our latest balance of payments projections: current account surplus of $500 million, total financial package of $3.5 billion, including total refinancing of maturities falling due to banks, estimated at $1.1 billion, and $200 million as fresh money by banks. I stressed that the end result was a much too small projected increase in reserves ($500 million) which made it necessary to have in addition a $200 million stand-by line with commercial banks. If so, immediately disbursed fresh money could be of a voluntary nature through, for instance, cofinancing. Mr. Dobrich said that there were three groups of banks: (a) those basically ready to follow the Fund's advice (basically European banks); (b) those determined not

1/ Ms. Mudd told me on December 16th that it was now nearly agreed with other U.S. banks.

to put any new money in any form (some large U.S. banks); (c) those ready to do something but needing time to assess the figures (other U.S. banks).

It was agreed that to help the third group joining the first one, a contact between the IMF mission in Belgrade and the bankers' economic team also presently in Belgrade, would be useful. 1/

In addition, Mr. Dobrich said that a meeting in Mr. Whittome's office with the Fund mission and a group of bankers could have a positive effect. 2/

On new money, Mr. Dobrich said he would inquire further about cofinancing with the World Bank based on the experience with Hungary. He recognized in addition that a stand-by facility would be the proper answer. He mentioned a possible stand-by fee of 0.5 percent to be paid by the Yugoslav commercial banks or by the National Bank of Yugoslavia and an interest rate libor plus 1 7/8 percent which would have a dissuasive effect on drawings. He agreed that it should be linked with the refinancing, with possiby an exemption for the smallest banks, at least if the facility were not effectively totally used. He said that parallel action by the BIS would probably not be judged essential, since bankers knew that anyway the BIS would have a gold collateral. But evidently the widespread reluctance to commit fresh money would apply to the stand-by concept as well. In addition, there might be a wish, if there were such a stand-by, to link its use to the fulfillment of specific targets on repatriation of foreign exchange or reserves. I said that we should not have two types of conditionality but that some parallelism with phasing of Fund purchases could be contemplated.

I mentioned to Mr. Dobrich that Mr. Whittome was contemplating sending a letter to Mr. Taylor and showed to him a draft of it. He thought it might be very useful, and it was sent to Mr. Taylor on December 16th (see attachment).

P. Mentré

cc: Mr. Whittome
Mr. Schmitt
Ms. Ripley
Mr. Petersen
CED

1/ I transmitted this wish to Mr. Schmitt in Belgrade.

2/ It was later agreed that this meeting would be held in Mr. Whittome's office on Thursday, December 22 at 9:30 a.m.

December 16, 1983

Dear Mr. Taylor,

I would like to thank you for the most effective way in which you and your associates have handled the disbursements under the 1983 financial arrangement with Yugoslavia, now completed, and also started discussions on 1984.

The December 6th ICC meeting in London has been most helpful, for it has shown the positive attitude of banks to refinancing of up to 100 percent of long-term and medium-term maturities falling due in 1984 and has paved the way for an agreement on a three months standstill period.

But clearly we have to go beyond that if we want together to build for Yugoslavia a viable reserve and balance of payments situation. Various ideas were mentioned in London in parallel meetings, such as cofinancing with the World Bank and the European Investment Bank, prefinancing of Yugoslav exports, and a stand-by facility. I would appreciate it if you could think round such ideas with other bankers in the coming weeks. For my own part I wonder whether a mix of cofinancing for about $200 million and of a stand-by facility, also for about $200 million, to be used temporarily in the case of reserves constraint, might not be the best approach.

Evidently, the attitude of banks will partly depend upon the outcome of discussions with governments which is contemplated for the second week of January and we shall be in contact with you after that meeting and with the Yugoslavs. But it is my hope that, in the meantime, you will be able with your usual skills to work out an approach which meets the anxieties of all the parties as you did so successfully last year.

With my best regards,

Yours sincerely,

L.A. Whittome

Mr. Harry Taylor
President
Manufacturers Hanover Trust Co.
350 Park Avenue
New York, N.Y. 10022

INFORMATION COPY

DRAFT TELEX
12/16/83

Mr. Harry Taylor
President
Manufacturers Hanover Trust Company
New York, N.Y.

We have been informed by the Yugoslav authorities that they are proposing to commercial banks to postpone by 90 days the repayment of the principal of medium- and long-term eligible maturities, falling due between January 1st and March 31st 1984, in the context of discussions underway with the ICC on a financial package, including up to 100 percent refinancing of such maturities. I understand that the ICC intends to recommed that this proposal be approved.

As you know, Yugoslavia has entered into negotiations with the Fund for a stand-by arrangement covering 1984. As you know, the adjustment efforts of Yugoslavia have already led to a significant reduction of the current account deficit with the convertible currency area, which should be in the vicinity of $200 million in 1983, and the common aim of the Yugoslav authorities and the Fund, under the stand-by arrangement contemplated for 1984, is to obtain a sizable current account surplus. While the corresponding negotiations have not yet been finalized, they should normally lead to Board action in February at the time when the other components of the needed financial package would have been more precisely defined. In the meantime, there is a need to maintain an orderly process. It is why I support the request put forward to banks by the Yugoslav authorities as I have already supported the parallel request put forward to creditor governments.

Regards,

J. de Larosiere

Mr. Whittome

Office Memorandum

cc. Mr Schmitt

December 16, 1983

(1) OK let re know if draft's OK, if it can be sent

19/12

(2) Can you ... others ... DR ... re ... 22nd

MEMORANDUM FOR FILES

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to put any new money in any form (some large U.S. banks); (c) those ready to do something but needing time to assess the figures (other U.S. banks).

It was agreed that to help the third group joining the first one, a contact between the IMF mission in Belgrade and the bankers' economic team also presently in Belgrade, would be useful. 1/

In addition, Mr. Dobrich said that a meeting in Mr. Whittome's office with the Fund mission and a group of bankers could have a positive effect. 2/

(2)

On new money, Mr. Dobrich said he would inquire further about cofinancing with the World Bank based on the experience with Hungary. He recognized in addition that a stand-by facility would be the proper answer. He mentioned a possible stand-by fee of 0.5 percent to be paid by the Yugoslav commercial banks or by the National Bank of Yugoslavia and an interest rate libor plus 1 7/8 percent which would have a dissuasive effect on drawings. He agreed that it should be linked with the refinancing, with possiby an exemption for the smallest banks, at least if the facility were not effectively totally used. He said that parallel action by the BIS would probably not be judged essential, since bankers knew that anyway the BIS would have a gold collateral. But evidently the widespread reluctance to commit fresh money would apply to the stand-by concept as well. In addition, there might be a wish, if there were such a stand-by, to link its use to the fulfillment of specific targets on repatriation of foreign exchange or reserves. I said that we should not have two types of conditionality but that some parallelism with phasing of Fund purchases could be contemplated.

I mentioned to Mr. Dobrich that Mr. Whittome was contemplating sending a letter to Mr. Taylor and showed to him a draft of it. He thought it might be very useful, and it was sent to Mr. Taylor on December 16th (see attachment).

P. Mentré

cc: Mr. Whittome
Mr. Schmitt
Ms. Ripley
Mr. Petersen
CED

1/ I transmitted this wish to Mr. Schmitt in Belgrade.
2/ It was later agreed that this meeting would be held in Mr. Whittome's office on Thursday, December 22 at 9:30 a.m.

December 16, 1983

Dear Mr. Taylor,

I would like to thank you for the most effective way in which you and your associates have handled the disbursements under the 1983 financial arrangement with Yugoslavia, now completed, and also started discussions on 1984.

The December 6th ICC meeting in London has been most helpful, for it has shown the positive attitude of banks to refinancing of up to 100 percent of long-term and medium-term maturities falling due in 1984 and has paved the way for an agreement on a three months standstill period.

But clearly we have to go beyond that if we want together to build for Yugoslavia a viable reserve and balance of payments situation. Various ideas were mentioned in London in parallel meetings, such as cofinancing with the World Bank and the European Investment Bank, prefinancing of Yugoslav exports, and a stand-by facility. I would appreciate it if you could think round such ideas with other bankers in the coming weeks. For my own part I wonder whether a mix of cofinancing for about $200 million and of a stand-by facility, also for about $200 million, to be used temporarily in the case of reserves constraint, might not be the best approach.

Evidently, the attitude of banks will partly depend upon the outcome of discussions with governments which is contemplated for the second week of January and we shall be in contact with you after that meeting and with the Yugoslavs. But it is my hope that, in the meantime, you will be able with your usual skills to work out an approach which meets the anxieties of all the parties as you did so successfully last year.

With my best regards,

Yours sincerely,

L.A. Whittome

Mr. Harry Taylor
President
Manufacturers Hanover Trust Co.
350 Park Avenue
New York, N.Y. 10022

INFORMATION COPY

DRAFT TELEX
12/16/83

Mr. Harry Taylor
President
Manufacturers Hanover Trust Company
New York, N.Y.

We have been informed by the Yugoslav authorities that they are proposing to commercial banks to postpone by 90 days the repayment of the principal of medium- and long-term eligible maturities, falling due between January 1st and March 31st 1984, in the context of discussions underway with the ICC on a financial package, including up to 100 percent refinancing of such maturities. I understand that the ICC intends to recommed that this proposal be approved.

As you know, Yugoslavia has entered into negotiations with the Fund for a stand-by arrangement covering 1984. As you know, the adjustment efforts of Yugoslavia have already led to a significant reduction of the current account deficit with the convertible currency area, which should be in the vicinity of $200 million in 1983, and the common aim of the Yugoslav authorities and the Fund, under the stand-by arrangement contemplated for 1984, is to obtain a sizable current account surplus. While the corresponding negotiations have not yet been finalized, they should normally lead to Board action in February at the time when the other components of the needed financial package would have been more precisely defined. In the meantime, there is a need to maintain an orderly process. It is why I support the request put forward to banks by the Yugoslav authorities as I have already supported the parallel request put forward to creditor governments.

Regards,

J. de Larosiere

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

12/16

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cc: HOS
DR
CED
PM

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START ADDRESS IN BOX

~~MR. FULVIO DOBRICH~~
~~VICE PRESIDENT AND REGIONAL MANAGER~~
~~MANUFACTURERS HANOVER TRUST COMPANY~~
~~350 PARK AVENUE~~
~~NEW YORK, N.Y. 10022~~

DISTRIBUTION

START TEXT HERE

SINCE YOU ARE LEAVING FOR BELGRADE I THOUGHT YOU MIGHT BE INTERESTED IN THE TEXT OF THE LETTER TO MR. TAYLOR JUST SIGNED BY MR. WHITTOME.

QUOTE. I WOULD LIKE TO THANK YOU FOR THE MOST EFFECTIVE WAY IN WHICH YOU AND YOUR ASSOCIATES HAVE HANDLED THE DISBURSEMENTS UNDER THE 1983 FINANCIAL ARRANGEMENT WITH YUGOSLAVIA, NOW COMPLETED, AND ALSO STARTED DISCUSSIONS ON 1984.

THE DECEMBER 6TH ICC MEETING IN LONDON HAS BEEN MOST HELPFUL, FOR IT HAS SHOWN THE POSITIVE ATTITUDE OF BANKS TO REFINANCING OF UP TO 100 PERCENT OF LONG-TERM AND MEDIUM-TERM MATURITIES FALLING DUE IN 1984 AND HAS PAVED THE WAY FOR AN AGREEMENT ON A THREE MONTHS STANDSTILL PERIOD.

BUT CLEARLY WE HAVE TO GO BEYOND THAT IF WE WANT TOGETHER TO BUILD FOR YUGOSLAVIA A VIABLE RESERVE AND BALANCE OF PAYMENTS SITUATION. VARIOUS IDEAS WERE MENTIONED IN LONDON IN PARALLEL MEETINGS, SUCH AS

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WASHINGTON, D. C. 20431

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MR. FULVIO DOBRICH

PAGE 2

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COFINANCING WITH THE WORLD BANK AND THE EUROPEAN INVESTMENT BANK, PREFINANCING OF YUGOSLAV EXPORTS, AND A STAND-BY FACILITY. I WOULD APPRECIATE IT IF YOU COULD THINK ROUND SUCH IDEAS WITH OTHER BANKERS IN THE COMING WEEKS. FOR MY OWN PART I WONDER WHETHER A MIX OF COFINANCING FOR ABOUT DOLLARS 200 MILLION AND OF A STAND-BY FACILITY, ALSO FOR ABOUT DOLLARS 200 MILLION, TO BE USED TEMPORARILY IN CASE OF RESERVES CONSTRAINT, MIGHT NOT BE THE BEST APPROACH.

EVIDENTLY, THE ATTITUDE OF BANKS WILL PARTLY DEPEND UPON THE OUTCOME OF DISCUSSIONS WITH GOVERNMENTS WHICH IS CONTEMPLATED FOR THE SECOND WEEK OF JANUARY AND WE SHALL BE IN CONTACT WITH YOU AFTER THAT MEETING AND WITH THE YUGOSLAVS. BUT IT IS MY HOPE THAT, IN THE MEANTIME, YOU WILL BE ABLE WITH YOUR USUAL SKILLS TO WORK OUT AN APPROACH WHICH MEETS THE ANXIETIES OF ALL THE PARTIES AS YOU DID SO SUCCESSFULLY LAST YEAR. WITH MY BEST REGARDS,

YOURS SINCERELY,

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MR. FULVIO DOBRICH

PAGE 3

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L.A. WHITTOME. UNQUOTE.

I CONFIRM ALSO THE MEETING IN MR. WHITTOME'S OFFICE ON THURSDAY, DECEMBER 22 AT 9:30 A.M.

REGARDS,

MENTRE

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Mr. Hans Schmitt December 16, 1983

L.A. Whittome

Yugoslavia

May I re-emphasize that if a package of assistance is put together in 1984 to assist Yugoslavia to build up its official reserve position then we must have a reserves test as a performance clause which will monitor and ensure this build up. Despite the difficulties inherent in the seasonality factors, I think that this performance clause should operate quarterly.

cc: Mr. Mentré
Ms. Ripley
CED

INFORMATION COPY

cc: CBD

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ORIG: EURO

BEOGRAD, 15.12.83.
HOTEL INTER.CONTINENTAL
TLX NO 4319/GP

YUGOSLAVIA MISSION
MISSION MEMBERS DEPARTING
BELGRADE AS SCHEDULED.
SCHMITT

NO NOTIFICATION

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BEOGRAD, 16.12.83.
HOTEL INTER.CONTINENTAL
TLX NO 4323/GP

ORIG: EURO

MR. L.A. WHITTOME, EUROPEAN DEPT.
INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

FIRST PHASE OF DISCUSSIONS
COMPLETED. SECOND PHASE TO
BEGIN JANUARY 5. MISSION
RETURNING AS SCHEDULED.
REGARDS
SCHMITT

D.R.
to see
already sent
to CED

440040 FUND UI
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REPLY VIA ITT

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TIME: 05:10 12/16/83 EST
CONNECT TIME : 80 SECONDS

December 16, 1983

Dear Mr. Taylor,

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The December 6th ICC meeting in London has been most helpful, for it has shown the positive attitude of banks to refinancing of up to 100 percent of long-term and medium-term maturities falling due in 1984 and has paved the way for an agreement on a three months standstill period.

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With my best regards,

Yours sincerely,

L.A. Whittome

Mr. Harry Taylor
President
Manufacturers Hanover Trust Co.
350 Park Avenue
New York, N.Y. 10022

INFORMATION COPY

Office Memorandum

TO : Mr. L.A. Whittome

DATE: December 15, 1983

FROM : Paul Mentre

SUBJECT : Yugoslavia--Governmental Meetings

On December 14, I called Mr. Durand, an associate of Mr. Trichet and Mr. de Lauzun regarding Paris Club matters. The French Treasury would propose on December 19 to other Paris Club members to have meetings on Yugoslavia on January 11-12 at the Bank/Fund Paris Office, with a possible extension to the 13th. Some governments have expressed the view that consolidation should not take place before Fund action. I said that the letter of intent should be signed before January 11 and that the implementation of the debt consolidation, after endorsement by the Swiss-chaired coordinating group, could wait for effective Board action.

We agreed that the first group would meet on January 11 with balance of payments and consolidation, and the second on January 12 with adjustment policies and financial flows outside debt refinancing. There would be some flexibility in the timetable between the two groups, if needed. I said we should coordinate further the agenda, and we agreed to meet together immediately after confirmation on December 19 of the meetings.

I have drafted a telex and an agenda to be sent possibly on December 21 on which you might want to react. (the draft attached)

cc: Mr. Schmitt
Mr. Petersen
Ms. Ripley
CED

DRAFT
12/16/83

To: Geneva Participants

From: A. Guetta

After consultation with the participating governments, it is proposed that the two subgroups created by the November 18 Geneva meeting on Yugoslavia meet on January 11-12 in the World Bank/Fund Paris Office (64-66 Avenue d'Iena, 75016 Paris), with, if needed, an extension to January 13. The first group will meet under the chairmanship of France at ________________ on ____________________. The French Treasury is sending to participants a proposed agenda. The second group will meet under the chairmanship of the Fund at ___________________ on _____________.

The attached annotated agenda is proposed for this second meeting, which the Managing Director has asked me to chair.

Regards,

DRAFT
12/16/83

Financial Assistant to Yugoslavia

Working Group on Nondebt Problems

January 12 Meeting

Proposed Annotated Agenda

1. Status of Negotiations Between the Fund and Yugoslavia 1/

(Fund representatives and Yugoslav representatives)

(a) Balance of payments, 1983 (IMF forecast of January 1983, likely outcome in 1983, explanation of differences) and projections, 1984 and beyond (value and volume of exports and imports, invisibles, short-term, medium- and long-term capital flows, reserves) 1/

(b) Recent economic evolution and prospects (review of economic adjustment in 1983; problem areas)

(c) Letter of intent content

(c) Timetable contemplated for Board action

2. Nongovernmental Financial Flows

(a) World Bank lending (World Bank and Yugoslav representatives) including possible cofinancing with commercial banks

(b) European Investment Bank lending (Yugoslav and EEC chairmanship representatives), including possible cofinancing with commercial banks

(c) Status of discussion with commercial banks (Yugoslav representatives and IMF): implementation of 1983 commercial banks' package; contemplated flows in 1984

3. Governmental Financial Flows

(a) Carryover in 1984 of the 1983 Berne package (national representatives)

- Could creditor countries' representatives elaborate on measures taken or to be taken to ensure that unused commitments will remain available in 1984?

- Could Yugoslav representatives elaborate on measures taken to speed up the process of use of those credits by Yugoslav enterprises and to ensure their full use before the end of 1984.

1/ As needed after discussion in the first working group.

(b) Exports credits made available under other arrangements (national representatives)

- Could creditor countries elaborate on suppliers' credits made available in 1983 and contemplated in 1984 under pre-Berne arrangements?

(c) Additional action

- Magnitude of action judged compatible with Yugoslavia's balance of payments and reserve needs (Yugoslav representatives and IMF representatives)

- Size and nature of commitments which might be contemplated in the framework of an overall package, with specific reference to commodity credits and export credits for raw materials and intermediate goods (national representatives)

(d) Government-guaranteed short-term claims (national represenatives

- Attitude of individual governments on maintenance and/or expansion of existing short-term lines in 1984

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MR. HANS SCHMITT
INTERCONTINENTAL HOTEL
BELGRADE
YUGOSLAVIA

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cc: Mr. Polak

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THE FOLLOWING CABLE HAS BEEN SENT TO STATE SECRETARY PROBST OF SWITZERLAND.

I WOULD LIKE TO THANK YOU AGAIN FOR THE MOST EFFECTIVE WAY IN WHICH YOU CHAIRED THE NOVEMBER 18 MEETING IN GENEVA ON FINANCIAL ASSISTANCE TO YUGOSLAVIA.

AS INDICATED IN YOUR SUMMING UP, IT WAS AGREED THAT TWO WORKING GROUPS WOULD MEET AS SOON AS POSSIBLE. THE FIRST WORKING GROUP, CHAIRED BY FRANCE, WOULD DEAL WITH THE PROBLEM OF THE CONSOLIDATION OF MATURITIES OF OFFICIAL AND OFFICIALLY GUARANTEED DEBT FALLING DUE IN 1984. THE SECOND WORKING GROUP, CHAIRED BY THE INTERNATIONAL MONETARY FUND, WOULD BE ENTRUSTED WITH THE MORE GENERAL SUBJECTS OF THE OVERALL ECONOMIC SITUATION OF YUGOSLAVIA, FUTURE PROSPECTS AND THE NEED FOR ADDITIONAL ACTION. BOTH WORKING GROUPS WOULD REPORT TO THE COORDINATINGGGROUP CHAIRED BY SWITZERLAND.

ON BEHALF OF THE FUND, I CONFIRM OUR AGREEMENT ON THESE PROCEDURES WHILE STRESSING THAT A POSITIVE OUTCOME

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OF THE DISCUSSIONS IN THE SECOND WORKING GROUP IS CRITICALLY DEPENDENT UPON THE ATTITUDE OF MAJOR CREDITOR COUNTRIES. IN THIS CONTEXT WE WOULD HAVE NO DIFFICULTY IF GERMANY WAS TO CHAIR THIS GROUP INSTEAD OF THE FUND. WE WILL HAVE TO ASSESS TOGETHER HOW TO ENSURE AN OVERALL RESULT WHICH MEETS THE NEEDS OF YUGOSLAVIA.

SUBJECT TO FINAL CONFIRMATION, IT APPEARS NOW THAT THE WORKING GROUPS WILL MEET IN THE BANK-FUND PARIS OFFICE ON JANUARY 11/12. IN THE MEANTIME, AND DURING THE PERIOD WHICH WILL BE NECESSARY TO REACH FINAL AGREEMENT, THERE IS A NEED TO MAINTAIN AN ORDERLY PROCESS OF EQUAL TREATMENT BETWEEN CREDITORS THROUGH A STANDSTILL APPLIED TO GOVERNMENTAL CREDITS AND COMMERCIAL BANKS' CREDITS.

THE YUGOSLAV GOVERNMENT IS SENDING YOU A TELEX TO THAT EFFECT AND I WOULD LIKE TO EXPRESS OUR FULL BACKING FOR THIS REQUEST.

SINCERELY YOURS

WHITTOME

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SWITZERLAND

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CC: MR. POLAK

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I WOULD LIKE TO THANK YOU AGAIN FOR THE MOST EFFECTIVE WAY IN WHICH YOU CHAIRED THE NOVEMBER 18 MEETING IN GENEVA ON FINANCIAL ASSISTANCE TO YUGOSLAVIA.

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ON BEHALF OF THE FUND, I CONFIRM OUR AGREEMENT ON THESE PROCEDURES WHILE STRESSING THAT A POSITIVE OUTCOME OF THE DISCUSSIONS IN THE SECOND WORKING GROUP IS C CRITICALLY DEPENDENT UPON THE ATTITUDE OF MAJOR CREDITOR

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COUNTRIES. IN THIS CONTEXT WE WOULD HAVE NO DIFFICULTY IF GERMANY WAS TO CHAIR THIS GROUP INSTEAD OF THE FUND. WE WW WILL HAVE TO ASSESS TOGETHER HOW TO ENSURE AN OVERALL RESULT WHICH MEETS THE NEEDS OF YUGOSLAVIA.

SUBJECT TO FINAL CONFIRMATION, IT APPEARS NOW THAT THE WORKING GROUPS WILL MEET IN THE BANK-FUND PARIS OFFICE ON JANUARY 11-12. IN THE MEANTIME, AND DURING THE PERIOD WHICH WILL BE NECESSARY TO REACH FINAL AGREEMENT, THERE IS A NEED TO MAINTAIN AN ORDERLY PROCESS OF EQUAL TREATMENT BETWEEN CREDITORS THROUGH A STANDSTILL APPLIED TO GOVERNMENTAL CREDITS AND COMMERCIAL BANKS' CREDITS.

THE YUGOSLAV GOVERNMENT IS SENDING YOU A TELEX TO THAT EFFECT AND I WOULD LIKE TO EXPRESS OUR FULL BACKING FOR THIS REQUEST.

SINCERELY YOURS

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TO: INTERNATIONAL MONETARY FUND/WASHINGTON, D.C.
ATTN: L.A. WHITTOME/P. MENTRE

RE: YUGOSLAVIA 1984

FOLLOWING IS TEXT OF OFFER TELEX SENT ON BEHALF OF THE ICC TO THE FINANCE MINISTRY OF YUGOSLAVIA YESTERDAY:
QUOTE
TO: MINISTRY OF FINANCE/BELGRADE, YUGOSLAVIA
ATTN: MR. CVITAN DUJOMIC, ASSISTANT FEDERAL SECRETARY OF FINANCE

CC: FEDERAL EXECUTIVE COUNCIL/BELGRADE, YUGOSLAVIA
ATTN: MINISTER JANKO SMOLE

CC: NATIONAL BANK OF YUGOSLAVIA/BELGRADE, YUGOSLAVIA
ATTN: MR. JOZEF KOROSEC

RE: YUGOSLAVIA 1984 FINANCING ARRANGEMENTS

ON BEHALF OF THE INTERNATIONAL COORDINATING COMMITTEE (THE QUOTE ICC QUOTE), WE ARE PLEASED TO CONFIRM THE PRELIMINARY PROPOSA

DISCUSSED WITH YOU AT THE DECEMBER 6, 1983 MEETING OF THE ICC FOR A 1984 FINANCING PACKAGE FOR YUGOSLAVIA. THE PRELIMINARY PROPOSAL, AND ANY STATEMENT OF TERMS AND CONDITIONS OR FINANCING AGREEMENT BASED UPON IT, ARE, OF COURSE, SUBJECT TO REVIEW AND ACCEPTANCE BY THE BANKS AND FINANCIAL INSTITUTIONS TO BE BOUND BY IT.

PURSUANT TO THE PRELIMINARY PROPOSAL, UP TO 100 PERCENT OF THE MEDIUM AND LONG-TERM MATURITIES DUE IN 1984 TO BANKS AND FINANCIAL INSTITUTIONS ON ACCOUNT OF EXTERNAL INDEBTEDNESS INCURRED BEFORE THE CLOSE OF BUSINESS ON JANUARY 17, 1983 WILL

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END OF PAGE ONE/PAGE TWO FOLLOWSPAGE TWO OF TELEX

BE REFINANCED. IN THE EVENT THAT 100 PERCENT OF SUCH MATURITIES ARE TO BE REFINANCED, EACH REFINANCED MATURITY WILL BEAR INTEREST AT A RATE WHICH INCLUDES A MARGIN OF 1-7/8 PERCENT ABOVE THE LONDON INTERBANK OFFERED RATE, FRANKFURT INTERBANK OFFERED RATE OR FIXED RATE FOR THE CURRENCY IN WHICH SUCH MATURITY IS DENOMINATED OR A MARGIN OF 1-3/4 PERCENT ABOVE THE APPLICABLE DOMESTIC RATE FOR SUCH CURRENCY. IN THE EVENT, HOWEVER, THAT THE PERCENTAGE OF SUCH MATURITIES WHICH IS TO BE REFINANCED IS AGREED TO BE LESS THAN 100 PERCENT, THE ICC WILL DISCUSS WITH YOU A REDUCTION IN SUCH MARGINS. THE PRINCIPAL OF EACH REFINANCED MATURITY WILL BE DUE IN INSTALLMENTS OVER THREE YEARS FOLLOWING A FOUR-YEAR PERIOD IN WHICH INTEREST PAYMENTS ONLY WILL BE REQUIRED TO BE MADE. A FACILITY FEE OF 1 PERCENT WILL BE PAYABLE ON THE PRINCIPAL AMOUNT OF EACH REFINANCED MATURITY. THE REFINANCING WILL BE CONDITIONAL UPON A COMPARABLE REFINANCING OF MATURITIES DUE IN 1984 TO, OR GUARANTEED BY, THE BERNE ACCORD GOVERNMENTS. 1 1/4

IN ADDITION, THE ICC WILL, IN LIAISON WITH ITS ECONOMIC SUB-COMMITTEE, CARRY OUT IN THE THIRD QUARTER OF 1984 A COMPREHENSIVE REVIEW OF THE FINANCIAL SITUATION OF YUGOSLAVIA.

IF YOU ARE IN AGREEMENT WITH THE FOREGOING, PLEASE SO CONFIRM TO US IN WRITING. THE PRELIMINARY PROPOSAL IS, OF COURSE, MADE IN RESPONSE TO YOUR CONSIDERED REQUEST AND WITH THE INTENTION OF FACILITATING AN EXPEDITIOUS SIGNING OF A 1984 FINANCING PACKAGE AND AN EARLY RETURN BY YUGOSLAVIA TO THE PRIVATE CREDIT MARKETS. WE THEREFORE LOOK FORWARD TO RECEIPT OF YOUR CONFIRMATION OF THE PRELIMINARY PROPOSAL BY DECEMBER 19, 1983, SO THAT THE ICC CAN PROMPTLY RECOMMEND IT TO THE NATIONAL COMMITEES AND PROMPTLY COMMENCE DISCUSSIONS WITH YOU OF A MORE DEFINITIVE STATEMENT OF TERMS AND CONDITIONS.

BEST REGARDS, FULVIO DOBRICH,
MANUFACTURERS HANOVER TRUST COMPANY
FOR THE INTERNATIONAL COORDINATING COMMITTEE.
UNQUOTE
BEST REGARDS, DOBRICH, MANTRUST, NY

END OF PAGE TWO/END OF TELEX

248331 IMF UR

INTERNATIONAL MONETARY FUND

12/15

Mr. Whittome,

Mr. Mentre asked that this be seen by you before sending to the Managing Director.

Valerie

PM

Page 1 para 3 "the payment period is 3 yrs so "maturity" refers to grace + payment. Not sure MD will grasp for it is ambiguous.

Page 1 para 4 interest is 1 7/8

Page 1 last para perhaps mention possibility of [illegible] claims second group.

/ [illegible]

Office Memorandum

cc: HOS
DR

TO : Mr. L.A. Whittome

DATE: December 13, 1983

FROM : Paul Mentre

SUBJECT : Yugoslavia

You will find here attached: a report to the Managing Director on the outcome of discussions last week; a detailed report by Mr. Hansen on the London meeting, supplemented by a brief review of private discussions with bankers; a memorandum for files giving more details on the discussions with the National Bank of Yugoslavia and Mr. Dragan on the financial package; a memorandum for files on discussions with Yugobanka.

I was in contact this morning with Mr. Canner, U.S. Treasury, who confirmed to me that, subject to the concurrence of other governments on December 19, the U.S. had agreed to meet on Yugoslavia in Paris on January 11-12. He inquired about the second working group chaired by the Fund and suggested we send a telex confirming formally such a meeting. He inquired about the status of negotiations in Belgrade and I said that, normally, if agreement on a letter of intent was not reached in December, it should be possible to obtain it before the January 11-12 meetings. I confirmed to him what I had said to Mr. Trichet, namely that we were expecting that the working groups will come up with precise figures to be endorsed formally later by the full Swiss-chaired group, but that it would be perfectly acceptable to us to have the effective implementation on the agreement dependent upon Board action, around end-February. On this basis I have drafted a telex to Mr. Probst dealing with the procedures and with the standstill. As far as banks are concerned, Mr. Dobrich called me late this evening and we agreed to meet in New York on Thursday on the standstill and future work; I will mention to him that you might wish to send a letter to Mr. Taylor (draft attached).

Mr. Whittome

hos
DR

MEMORANDUM FOR FILES

Subject: Yugoslavia: Meeting of the ICC in London, December 6, 1983

The International Coordinating Committee (ICC) of foreign commercial banks met in London on December 6, 1983 to discuss the financing arrangements for Yugoslavia for 1984. Also present were a Yugoslav delegation headed by Mr. Smole, and IMF and World Bank representatives. Preceding the joint meeting, the IMF delegation had meetings with the Yugoslav delegation, with Manufacturers Hanover and a dinner with a selected group of bankers on December 5, 1983.

1. Meeting with the Yugoslav delegation

At the request of the Yugoslav delegation, a meeting was held with the IMF delegation to discuss BOP figures for 1983 and 1984 on December 6, 1983. The IMF delegation had prepared the attached tables 1/ to circulate to the participants in the December 6 meeting. However, the Yugoslav delegation came with much more optimistic figures for the BOP for both 1983 and 1984. Based on figures for the first 10 months of 1983 the Yugoslavs had prepared the following figures for the balance of payments for 1983 and 1984:

1/ Will be attached later.

Yugoslavia: Balance of Payments

(In millions of U.S. dollars)

	1983	1984
Exports	6,400	7,700
Imports	-8,450	-9,100
Trade Balance	-2,050	-1,400
Invisibles	1,925	2,200
Current account balance	-125	800

In the meeting with Yugoslav delegation Mr. Whittome said that these figures would have to be assessed by the mission that was in Belgrade now, but concerning the meeting with the ICC it was important for the Yugoslavs to ask for 100 percent rescheduling of maturities and some new money from banks. First, there was still great uncertainty about the c/a outcome for 1984. Second, there was a need to build up reserves. Finally, some cushion was needed against unforeseen developments (e.g., against a bad harvest).

Mr. Smole said in response that on the balance of payments outlook as presented by the Yugoslavs there was not a need to ask for new money from banks, but that they were to rely heavily on the advice of the IMF in that respect. The important thing this year was to reduce the costs of the financing arrangement with banks. It was felt that this would be best achieved by having refinancing of maturities only. Mr. Smole also asked if the Fund could help in any way to bring down the costs of borrowing for Yugoslavia. Mr. Whittome said that it was limited what the Fund could do in that respect, and he again said that it was vital that the Yugoslavs asked the banks for new money. Otherwise governments would not provide new money either, and this would put the Fund in a very difficult position, and it might not be possible for the Fund to come up with new money either. Mr. Smole replied that this would be very serious and he emphasized that no final decision had been taken yet on the question of new money.

2. Meeting with Manufacturers Hanover

The IMF delegation met with Mr. Dobrich at his request on the evening of December 5. He said that a problem had arisen. Some small arrears to banks had been discovered. Some 40 banks had reported such arrears in a total amount of about US$2.5 million. Although the problem with these arrears had been handled through an escrow account, it had created serious problems with the banks. A meeting had been held earlier in the day with the Yugoslavs to discuss the problem, and the Yugoslavs had promised to contact Belgrade to get this problem out of the way immediately.

Mr. Dobrich went on to say that Manufacturers Hanover had just had a meeting with Peat, Marwick and Mitchell to discuss the outcome of the 1983 exercise. On medium-term financing the latest figure for rescheduling was US$980 million--more or less as expected--but the figure for the roll-over of short-term debt was now higher than estimated earlier. For short-term credits it was US$200 million and for trade-related credits US$680 million. The higher estimate for trade-related credits was due to a previous underestimate of unused credit lines.

On the scheduled meeting the following day Mr. Dobrich said that there still was a feeling of vindictiveness ~~in~~ among the banks combined with a suspicion about the Yugoslav numbers. A specific problem was the swing of about US$1 billion in errors and omissions from 1982 to 1983. Mr. Dobrich said that the climate was not good for asking for new money. One bank had even suggested that the rescheduling should be for only 75 per cent of maturities.

Mr. Whittome stated the Fund position. First, there would be a need to deal with the question of a standstill. Second, maturities on medium- and long-term debt should be rescheduled 100 percent and the question of short-term debt falling due in January 1985 should be dealt with now also. Third, there was some doubt as to whether new money was needed, but it was the Fund's opinion that this would be required although on a smaller scale than last year. A related question was whether new money could be provided in a different manner than last year, e.g., from the larger banks only. Finally, there was the question of costs of the operation. Would it be possible to reduce the costs to the Yugoslavs?

Mr. Dobrich reacted to this by saying that if there was a need for new money it should be dealt with together with the rescheduling operation.

Otherwise it would be impossible to get banks to contribute. However, this would mean a considerable delay of the whole exercise. One would have to wait for the governments and the IMF. It would be preferable to ask for a rescheduling only. It was felt that new money could be provided through cofinancing arrangements with the IBRD, EIB, etc. Also, if the Yugoslavs were only asking for refinancing it should be possible to reduce the costs, e.g., by a drop of 1/8 percent in the facility fee and possibly an increase in the grace period to four years and in total maturity to eight years, but to get this it was important that the Yugoslavs provided the banks with a maturity schedule for the next four-five years.

3. Dinner with selected group of bankers

Messrs. Whittome and Mentré participated in a dinner given by Manufacturers Hanover for four European banks (Barclays, Société Générale, Westdeutsche Landesbank and Creditanstalt) and three American banks (Citibank, Bankers Trust and Chase Manhattan) in addition to Manufacturers Hanover.

4. The ICC meeting on December 6

The meeting started at 9:00 a.m. with representatives from the ICC only. At 10:45 a.m. the Yugoslav, IMF and IBRD delegations joined the meeting. The Yugoslav delegation was called upon first. Mr. Korocec commented on the situation with regard to arrears, explaining the increased powers of the National Bank to control foreign borrowing and repayment of such borrowing. As to the problem with the small arrears to banks which had recently been discovered he assured that action had been taken and the problem should be solved. Mr. Smole then commented on the performance of the Yugoslav economy in 1983. He emphasized that the current account balance with the convertible area would be much better than expected at the beginning of the year. For the first 10 months a surplus had been recorded. 1/ Industrial production had picked up, despite the decline in imports. For the first 10 months the increase was 1 percent. He also mentioned that new rules had been introduced to speed up the utilization of the Berne package and the SAL-loan. The improvement in the current account had been achieved partly through demand restraint (investment down by 11 percent, private consumption by 2 percent and real personal income per employee by more than 7 percent in the first 10 months of 1983). An active exchange rate policy had, however, been important also, but this had led to an increase in the rate of inflation which had also been fueled by the increase in administered prices and the liberalization of price controls. The aim was to reduce inflation in 1984. Further on 1984 prospects he said that discussions had just started both internally and with the IMF. The main objective for 1984 was to achieve a current account surplus with the convertible area. The actual size was still being discussed. He hoped that this could lead to a more normal situation so that the Government and the NBY did not have to continue to borrow abroad. It was hoped that Yugoslavia could rely more on direct investments, including joint ventures. The rules for this had just been changed. It was also hoped that new money could be provided as cofinancing with the IBRD, EIB, etc.

1/ He did not mention any figure. The previous day he had mentioned a figure of US$300 million.

As to the financial package for 1984, he said that Yugoslavia would ask the banks for a standstill period for 90 days (from January 1 - March 31, 1984) and at the same time ask the governments for this also. Regarding 1984 rescheduling of medium- and long-term maturities, the SDK and PMM would start to work on this immediately. On new money there was a big dilemma. The important question was to reduce the costs of such financing. Mr. Smole did not directly ask for new money. He said that he knew that there were risks in not asking for this and that it had to be discussed further with the IMF before a final decision was made. It was the hope that Yugoslavia could gradually regain access to foreign capital markets. He said, however, that Yugoslavia was firmly against applying the same formula as last year, when the new money was tied to the rescheduling.

There were some questions from the bankers on the rules governing the repatriation of export revenue. It was explained by Mr. Smole that measures were being taken to deal with the problem of delays in repatriation. Exemptions from the 90 day rule were granted by the Republics and Provinces. This policy was now being revised. Another question regarded the level of usable reserves. Mr. Dragomanovic explained that as of November 20 total reserves (including those of commercial banks) were US$1.8 billion. However, excluding gold, long-term bonds and counterdeposits the level of usable reserves was reduced to US$600-700 million, just after the last disbursement of the BK package.

The Fund delegation was then called upon to present its view on the Yugoslav situation. The tables prepared by the Fund were distributed and Mr. Whittome explained that the figures were in no way final. They were presently being discussed with the Yugoslav authorities in Belgrade.

Mr. Whittome went on to say that some progress had been recorded in 1983. This had been achieved through a tight incomes policy, fairly strict fiscal and monetary policies, and active exchange rate and interest rate policies. This had led to an improvement in the current account in excess of what was expected at the beginning of the year. Nonetheless, Yugoslavia would end up with lower reserves than targeted for the year. The reasons were: short-term capital outflow and slower disbursement of government and SAL money. The low level of reserves at the end of 1983 had a bearing on the assessment for 1984. It was the Fund's view that a financial package on the same pattern as in 1983 would be necessary for 1984. There had already been a meeting of governments in Geneva in November, at which it had been decided to establish two groups: one to deal with rescheduling and another to deal with new money. These two groups would meet in Paris in mid-January and report to a joint group of 16 governments headed by the Swiss later in January. Obviously the governments would be very interested in the outcome of the ICC meeting. The Fund had just started the negotiations on a program for 1984. It would include a further increase in interest rates, continued tight monetary and fiscal policy, a review of the foreign exchange allocation system and would also comprise measures to improve the financial discipline of enterprises.

On the balance of payments outlook, Mr. Whittome said that he hoped that agreement could be reached on a standstill period for both governments and banks. There should be 100 percent rescheduling of medium- and long-term debt and he hoped that it would be possible on this occasion to deal with the short-term maturities falling due in January 1985, e.g., to extend these for another twelve-month period. On the question of new money, the Fund did not agree 100 percent with the Yugoslav position. Whether new money was needed would be difficult to judge today. It depended on the current account forecast for 1984. The figure that the Fund had circulated was a surplus of US$250 million. The Yugoslavs were much more optimistic, but for a figure much in excess of US$250 million to materialize exports would have to increase very substantially in 1984. Further, there was a problem with errors and omissions. Also, although it might be decided to reschedule 100 percent of maturities, the actual outcome would be less. There would be leakages as had been the case this year. A safety margin would also have to be built in against accidents. Finally, the level of reserves was very low and there was a need to build up reserves during the year.

There was more than one way to tackle the question of new money, Mr. Whittome added. One could wait and see whether it would be necessary. This would however mean that if it became necessary the question would have to be dealt with in a crisis atmosphere. Mr. Whittome could understand the bankers' reluctance to lend new money. However, if there was no new money from banks there would be no new money from governments or the IMF. Another idea would be for the banks to provide a stand-by credit (or credit line) which would only be used if the less optimistic forecast for the balance of payments were to materialize.

Mr. Kapps of the IBRD briefly explained the situation with regard to the SAL loans and normal disbursements from the World Bank. He also explained that there had just been discussions in London on a confinancing scheme under the World Bank's Schedule B facility for an already existing World Bank loan of US$136 million to Yugoslavia. They were looking for an additional US$40 million to be provided by the banks.

Following these presentations, the Yugoslavs were excused from the meeting, and Mr. Brainard commented that there had been positive elements in the developments in 1983. In particular, he found that the active exchange rate policy had been very beneficial to workers' remittances and tourist receipts. Another positive factor had been the attempts to reduce price distortions. Moving on to the prospects for 1984, he said that there was a need to look at the cash flow numbers for the balance of payments. A repeat performance of 1983 would not be acceptable, and some bankers questioned whether it would be possible to have the balance of payments on a cash basis as a performance criterion. Mr. Whittome replied that this would be unusual, but that a reserves test was built into some programs, and he said that he would instruct the mission now in Belgrade to look into this
if the program had as its objective a build-up of reserves
question. Other factors that the bankers felt should be looked into in 1984 were: further interest action to establish positive real interest rates, a reform of the foreign exchange allocation system, and further reforms in the area of financial discipline including a reform on the banking system. On the question of new money it was the feeling of the bankers that it would be a mistake to provide this now. The only way to get reforms in Yugoslavia was "to keep their feet to the fire." One should keep the option open and maybe discuss it later in the year.

Mr. Whittome responded that these points were well taken. It was fine to put pressure on the Yugoslavs by not providing new money now, but his ~~only~~ worry was that if things went wrong the Yugoslavs would revert to the administrative controls and undo the progress that had been made so far.

Following the lunchbreak the ICC met again for almost two hours before the Yugoslav, the Fund and the World Bank delegations were invited to attend again. Mr. Dobrich summarized the conclusions of that meeting. First, the ICC congratulated the Yugoslavs with the current account performance in 1983. It was recognized that this had been achieved through substantial domestic sacrifices. The ICC urged the authorities to continue their adjustment efforts as this would gradually restore the creditworthiness of Yugoslavia. However, this would depend to a large extent on the actual performance of the Yugoslav economy, and in that connection the ICC urged the authorities to take measures to close the gap between export earning and export receipts. The ICC had agreed to a 90 day standstill period from January 1 - March 31, 1984 and to a 100 percent refinancing of medium- and long-term maturities falling due to banks in 1984, with the same interest rate spread as last year, but with a lengthening of the maturity to seven years and a four-year grace period. Also the front-end fee would be reduced by 1/8 of 1 percent to 1 percent. If the Yugoslavs were to ask for less than 100 percent rescheduling the proposal would be re-examined with a view to reduce the interest rate spread.

Mr. Dobrich added that the banks had decided to put forward a concrete proposal now in the hope that a decision could be taken quickly. A telex would be sent to the Yugoslav authorities early in the following week both concerning the standstill period and the rescheduling proposal, and he stressed that a quick response was needed. He emphasized that the proposal was ad referendum and that it also assumed that other creditors would be treated in the same manner as banks.

Mr. Smole accepted the proposal, but added that it had to be discussed with the authorities in Belgrade. He said that on the question of new money the Yugoslav position was much in line with that of the banks but he had been impressed by Mr. Whittome's arguments and he wanted to discuss this further with the IMF before reaching a final position.

Mr. Whittome expressed disappointment on the ICC proposal on two points: (i) that the question of rolling over short-term debt falling due in January 1985 had not been addressed; and (ii) the fears that the lack of new money from banks would result in a nonviable financial package for 1984. It would mean no new money from governments and no new money from the Fund. He ~~wanted to~~ asked members of the ICC to mention these points specifically in ~~ICC to add this into~~ the report, that they ~~were~~ would be sending to the management of their banks. He asked, and Mr. Dobrich confirmed that this would be possible, that a new meeting of the ICC be called, if this was considered necessary, in late January after the negotiations on a new stand-by arrangement for 1984 had been concluded and the Paris meetings of governments had been held.

Mr. Whittome

Office Memorandum

December 13, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia - December 6 ICC Meeting in London--Supplementary Views of Bankers

Mr. Hansen has reported in a memorandum for files the ICC meetings in London. In addition to the formal meetings, Mr. Whittome and I attended a dinner given on December 5 by Manufacturers Hanover and had a breakfast on December 7 with Bankers Trust Company representatives.

1. Manufacturers Hanover

After presentation by Mr. Smole and Mr. Whittome of the Yugoslav situation, Mr. Dobrich made a "tour de table" to know the views of bankers. European bankers, notably Creditanstalt, West Deutsche Landesbank, and Societe Generale were mostly positive. U.S. banks, notably Citibank and Bank of America, stressed on the other hand the need to get more accurate figures and the difficulty they would have to contemplate fresh money. After dinner we reviewed the situation together with Mr. Dobrich and Mr. Smole and Mr. Dobrich mentioned the various possibilities which had been indicated to him by other banks, notably cofinancing, export prefinancing, and a stand-by facility. Mr. Smole confirmed that the Yugoslav authorities wanted to avoid a formal link between refinancing and new money but expressed an interest in the stand-by idea. As reported in Mr. Hansen's memorandum, none of these ideas were formally presented by banks.

2. Bankers Trust

The Head of the European Division of Bankers Trust, based in Frankfurt, and his representative in Belgrade, wanted to elaborate with us on the type of ideas they had in mind for voluntary lending in 1984.

It should be trade-oriented and be agreed among a small group of large banks in major countries. It could start with Germany, with parallel financing of government guaranteed export credits, eligibility to guarantee of Yugoslav goods re-exported by German exporters and financing of Yugoslav exports to Germany. For instance, credit lines backed by acceptances of German importers could be envisaged, an alternative being multi-currency trade related credit lines. The same approach would be then used in other major countries.

Mr. Whittome said that such ideas were certainly worth exploring but he stressed that many of them would take time to be implemented while Yugoslavia's needs were urgent. Evidently Yugoslavia would adjust to available financing flows but if these flows were not adequate the adjustment will imply restrictive measures on imports which would harm Yugoslavia in the medium-term through an inadequate resources allocation and postponement of the much needed move toward a more market-oriented economy.

Paul Mentre

cc: Mr. Whittome
Mr. Schmitt
Mr. Petersen
CED

cc: Mr. Whittome
Mr. Schmitt
Mr. Petersen
CED

Office Memorandum

December 13, 1983

MEMORANDUM FOR FILES

Subject: Financial Package for Yugoslavia - Discussions in Belgrade, December 8-9, 1983

1. National Bank of Yugoslavia

The National Bank of Yugoslavia has revised its 1983/84 balance of payments figures (see attachment).

The main difference is a downward revision of imports leading to a current account deficit limited to $125 million (staff projection based on lower figures for exports, $225 million). In addition, we were told that errors and omissions for the first 10 months amounted to $745 million. The Yugoslavs continue to hope that the final figure for 1983 as a whole will be lower, due to administrative and credit policy actions on repatriation on export receipts. They did not substantiate much this view and we have kept the present figure on errors and omissions which would lead to no increase in reserves in 1983 (against $430 million reserve increase projected by the Yugoslavs). For 1984 the Yugoslavs project a $800 million surplus against $500 million in our projections. In addition, in order to accommodate our views the Yugoslavs have revised their medium- and long-term capital flows projections and they include now in them fresh money from governments ($150 million against $250 million in our projections) and from commercial banks ($100 million against $200 million in our last projection).

The end result is an increase of reserves of $1,000 million in Yugoslav projections while, due to lower current account surplus and continuous delays in repatriation of exports (errors and omissions projected at $300 million which might prove too optimistic) we have a reserve buildup of only $500 million in our revised projections.

2. Federal Executive Council

On December 9, Mr. Schmitt, Mr. Hansen, and myself met with Mr. Dragan, Mr. Stemankovic, and Mr. Velkovic.

Mr. Dragan inquired about the timetable. Mr. Schmitt said that a draft letter of intent would be made available by the mission on December 12 with a view to finalizing discussions in the following week. He understood

..../2

Mr. Dragan might have to go back to the Federal Assembly and that in addition some figures might have to be finally agreed later on, which could mean final agreement in the first week of January which could be consistent with a Board meeting around end-February.

Mr. Dragan then commented on the financial package for 1984 on the basis of the two attached tables which were given to him. He said that the general guideline was not to increase in 1984 the level of external debt which would mean refinancing $3 billion falling due. However, there might be a margin of 2.0-2.5 percent of total indebtedness ($18 billion) and he finally mentioned an overall figure for the package of $3.0-3.5 billion. I said that only the $3.5 billion figure was consistent with a viable package.

On new money from governments, Mr. Dragan said the Yugoslav authorities will be directly in contact with the U.S.1/, the Germans, and the French--Mr. Smole was at that time in Paris meeting Mr. Delors and Mr. Mitterand will pay an official visit to Yugoslavia on the 15th of December.

On fresh money by banks, Mr. Dragan was in favor of voluntary lending, notably to avoid an excessive cost for refinancing. I stressed that in addition to voluntary lending by banks, possibly cofinancing with the World Bank or the European Investment Bank, there remained a need to protect Yugoslav reserves against unexpected developments in 1984 since we were now projecting a rather limited increase of $500 million. I said that the idea of a stand-by with banks (in the vicinity of $200 million, possibly supplemented by the BIS) has been mentioned in London. Mr. Dragan expressed interest in it, while stressing that short-term credits should not be used to replenish reserves. I mentioned also the threat resulting from the potential repayment on January 15, 1985 of $800 million on outstanding short-term debt and stressed that the Yugoslav authorities in their discussions with commercial banks should at least aim at a one-year postponement of this maturity date.

On fresh money from the Fund, Mr. Dragan said he fully understood the link between fresh money with banks and governments and he expressed the hope that if the discussions with banks and governments were positive, the IMF figure might be revised upward from $400 million to $500 million.

Finally, I gave to Mr. Dragan and his associates a draft telex to Mr. Probst and an outline of a telex to banks on the standstill, stressing the need to leave the discussions open on refinancing.

Mr. Dragan thanked us for the active role played by the Fund in assembling the financial package and said that close coordination between the Fund and the Yugoslav authorities would remain essential for a satisfactory outcome of coming discussions with governments and banks.

P. M.

Paul Mentre

1/ Mr. Schmitt and myself had a brief meeting with Mr. Nichols, U.S. Embassy in Belgrade, who said that a figure of $200 million for U.S. commodity credits in 1984 was a reasonable assessment. In addition he mentioned spontaneously a figure of $500 million for current account surplus in 1984 and inquired about our timetable.

Table 1. Yugoslavia: Balance of Payments with the Convertible Currency Area, 1982-84

(In millions of U.S. dollars)

	1982	1983 Yugoslav estimate	1983 Alternative	1984 Yugoslav estimate	1984 Alternative
Exports	5,526	6,400	6,300	7,700	7,200
Imports	-9,043	8,450	-8,450	9,100	8,800
Trade balance	-3,517	-2,050	-2,150	-1,400	-1,600
Invisibles (net)	2,003	1,925	1,925	2,200	2,100
Workers' remittances	1,085	1,265	1,265	1,440	1,135
Tourism	1,224	1,335	1,335	1,080	1,510
Interest payments	-1,670	-1,690	-1,690	-1,840	-1,890
Others	1,364	1,015	1,015	1,520	1,345
Current account	-1,514	-125	-225	800	500
Medium- and long-term debt	-117	1,230	1,175	-20	190
Drawings	1,684	3,880	3,825	2,825	3,135
Repayments	-1,626	-2,450	-2,450	-2,645	-2,745
Loans extended	-175	-200	-200	-200	-200
Short-term debt	-506	-500	-600	---	---
Errors and omissions	562	-585	-750	---	-300
Total	-1,575	20	-350	-780	390
Use of Fund Credit	563	410	410	220	120
Reserve movements (increase -)	1,012	-430	-10	-1,000	-510

Table 2. Yugoslavia: Drawings on Medium- and Long-Term Debt in Convertible Currency by Creditor

(In millions of U.S. dollars)

	1983		1984	
	Yugoslav estimate	Alternative	Yugoslav estimate	Alternative
Government packages	839	831	1,006	1,100
Berne	839	831	456	350
Refinancing	(304)	(304)	(...)	(3)
New financial credits	(180)	(172)	(...)	(...)
Suppliers credits	(355)	(355)	(456)	(347)
Geneva	...	...	550	750
Refinancing	...	...	(400)	(500)
Suppliers credits	...	...	(150)	(250)
Commercial bank package	1,580	1,580	1,100	1,300
Refinancing	980	980	1,000	1,100
New financing	600	600	100	200
IBRD	320	350	530	485
Regular facilities	250	280	250	280
SAL	70	70	280	205
Other multilateral lenders IFC, EIB and Eurofirms	30	50	... 1/	50
Suppliers credits outside Government packages	1,111	1,014	189	200
Subtotal	3,880	3,825	2,825	3,135
IMF	590	590	500	400
Total	4,470	4,415	3,325	3,535

1/ Included in drawings on the IBRD.

Mr Whittome

Office Memorandum

December 13, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia--Meeting with Yugobanka Officials

On December 9, 1983, Mr. Schmitt and myself had a one hour meeting with Mr. Colanovic, Chairman, Yugobanka, followed by a working lunch with three of his associates.

Mr. Colanovic inquired about existing differences of views between the Yugoslav Government and the Fund and we elaborated on balance of payments projections and financial packages. He said that Yugoslav projections on exports were probably too optimistic since a large part of the increase in 1983 was due to a once-and-for-all redirection of trade from the nonconvertible area to the convertible area. He said also that he did not contemplate much progress in the collection of export proceeds. The difference between exports on a customs basis and exports on a cash basis largely reflected exports under cooperation agreements (barter trade), under which Yugoslav exports were not yet matched by corresponding imports. The Yugoslav Government had accepted such cooperation agreements to maintain an adequate level of foreign orders to the Yugoslav industry, which helped maintain industrial production and employment. He stressed the vital importance of foreign exchange allocation: Yugoslavia had a viable balance of payments situation when it had a unified foreign exchange allocation system; the present fragmented system which reflected political and regional interests was the major cause of present external difficulties.

On fresh money from governments, Mr. Colanovic said that the quite limited use of the Berne credits in 1983 made it more difficult to ask for new credits in 1984. The conditions imposed upon the Yugoslav enterprises to use such credits and notably the typical six months maturity (the three year foreign credits were used internally on a revolving basis) should be revised.

On fresh money by banks, Mr. Colanovic said we should not insist on a link between refinancing and new money since it would mean maintenance of the present spread, which was totally unacceptable when compared with conditions applied by commercial banks to a country such as Poland. He suggested that in the letter of intent the Fund could link its phasing with precise amounts of new money to be obtained from banks by Yugoslavia but leave to the Yugoslavs the detailed negotiations of various types of voluntary bank lending, such as cofinancing.

..../2

During the working lunch, Mr. Colanovic's associates elaborated on discussions underway with the U.S. and Japan, for which Yugobanka is the lead bank. They have reached an agreement with Ex-Im Bank on refinancing of maturities in 1983. Ex-Im Bank representatives were not in a position to offer three year credits on spare parts and intermediate goods as asked for by the Yugoslavs, in the absence of a formal multilateral pledge derogatory to standard OECD rules. An agreement had been reached with the Japanese on a broad list of eligible imports, including capital goods, but Yugoslavia will use up the Berne Japanese pledge for intermediate goods (steel products) and ask later for additional credits for equipment goods.

The foreign exchange market was further discussed with Yugobanka representatives saying that it should be basically a market among the nine largest Yugoslav banks, monitored by the National Bank of Yugoslavia. Presently 60 basic banks were authorized to deal with foreign exchange but most of them were doing it through their associated banks, which amounted effectively to 20 participants, a figure which would be further reduced if an associated bank were created in Croatia. On this issue they said that there had not been recent developments but that the idea was still to consolidate all Croatian banks, including Privredna Bank, Zagreb, into a unified associated bank.

Paul Mentré

cc: Mr. Whittome
Mr. Schmitt
Mr. Petersen
CED

DRAFT
12/13/83

Dear Mr. Taylor,

I would like to thank you for the most effective way in which yourself and your associates have handled the disbursements under the 1983 financial arrangement with Yugoslavia, now completed, and started discussions on 1984.

The December 6 ICC meeting in London has been most helpful, since it has shown the positive attitude of banks to refinancing of up to 100 percent of long-term and medium-term maturities falling due in 1984 and has paved the way for an agreement on a three months standstill period.

But clearly we have to go beyond that if we want together to build for Yugoslavia a viable reserve and balance of payments situation. Various ideas were mentioned in London in parallel meetings, such as cofinancing with the World Bank and the European Investment Bank, prefinancing of Yugoslav exports, and a stand-by facility. I would appreciate it if you could think about them with other bankers in the coming weeks, with special reference to a mix of cofinancing for about $200 million and of a stand-by facility, for about $200 million, to be used temporarily in case of reserves constraints.

Evidently, the attitude of banks will depend upon the outcome of discussions with governments presently contemplated for the second week of January and we will be in contact with you then together with the Yugoslavs. But it is my hope that, in the meantime, you will continue to work on viable solutions with the same dedication as for the 1983 financial package.

Regards,

L. A. Whittome

file

Office Memorandum

TO : Mr. Schmitt DATE: December 13, 1983

FROM : Arne B. Petersen

SUBJECT : Yugoslavia: Proposed Letter of Intent

As discussed earlier, I believe we should include the standard ceiling on external borrowing in the proposed letter of intent. I agree that in the present circumstances of Yugoslavia the ceiling will probably not have much effect since borrowing in any event will be limited by the nonavailability of foreign funds. However, one of the problems that brought Yugoslavia where it is today was uncontrolled foreign borrowing. While the likelihood is small now, it might become a potential problem again, particularly if, as has occurred in other countries, the return to positive real interest rates should lead to a rapid reversal of capital flows. Moreover, a borrowing ceiling would fit in nicely with their own stated policies of reducing external debt and it would not hurt to reinforce them in their intended good behavior. An additional thought, of course, is that the borrowing ceiling by now has developed into a standard performance criterion and questions would therefore be raised in the Board and elsewhere if we did not include it.

cc: Mr. Mookerjee
Mr. Hansen
Mr. Lewis

Office Memorandum

December 13, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia

Mr. Smole telephoned this morning to say that Mr. Dobrich had urgently requested a meeting between the representatives of the Government of Yugoslavia and the banks in London on Monday and Tuesday the 19th and 20th December. The most that Mr. Dobrich had been prepared to concede was one day's delay. According to Mr. Smole, if the Yugoslavs came prepared and authorized to complete the necessary formalities, the rescheduling agreement covering the maturities in 1984 could be rapidly drawn up and the spread could be reduced by 1/4 of one percent to 1 1/2 percent over LIBOR. I advised Mr. Smole to say that he was not in a position to meet such a tight schedule and I also advised him not to succumb to the blandishments of an offer of a small reduction in the cost of the rescheduling operation. He said that his own inclination had been to stand firm but he seemed primarily preoccupied about also securing a reduction in the facility fee and the agency fee rather than showing interest in the possibility of new money.

L. A. Whittome

cc: Mr. Schmitt
Mr. Mentré
Ms. Ripley
CED

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WASHINGTON, D. C. 20431

cc: HOS
PM
CED

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MR. HANS SCHMITT
INTERCONTINENTAL BELGRADE
BELGRADE
YUGOSLAVIA

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AS AGREED YOU WILL FIND HEREAFTER A REVISED TEXT OF THE THREE FINAL PARAGRAPHS OF THE DRAFT TELEX TO MR. PROBST. QUOTE IT APPEARS NOW THAT THE FIRST MEETING OF THE TWO WORKING GROUPS COULD TAKE PLACE IN JANUARY IN THE MEANTIME AND DURING THE PERIOD WHICH WILL BE NECESSARY IN ORDER TO REACH FINAL AGREEMENT. THERE IS A NEED TO MAINTAIN AN ORDERLY PROCESS OF EQUAL TREATMENT BETWEEN GOVERNMENTAL AND COMMERCIAL BANK CREDITORS.

AT THE ICC MEETING IN LONDON ON DECEMBER 6, IT WAS AGREED THAT THE YUGOSLAV AUTHORITIES WOULD PROPOSE THAT ELIGIBLE MATURITY OF PRINCIPAL OF YUGOSLAV EXTERNAL MEDIUM AND LONG-TERM INDEBTEDNESS FALLING DUE FROM JANUARY 1,TO 1984 TO MARCH 31, 1984 BE EXTENDED ON A PROVISIONAL BASIS. GIVEN THE AGREEMENT REACHED IN THE GENEVA MEETING ON PROCEDURES TO BE USED TO DEAL WITH THE CONSOLIDATION OF MEDIUM AND LONG TERM PRINCIPAL REPAYMENTS FALLING DUE TO OFFICIAL CREDITORS DURING 1984, WE INTEND TO ACT IN THE SAME WAY ON OBLIGATIONS IN PRINCIPAL TO

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DRAFTED BY NAME (TYPE) PAUL MENTRE EXT. 73074 DEPT. EUR DATE 12/13/83

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OFFICIAL CREDITORS, WHILE FULFILLING ALL INTEREST OBLIGATIONS, WITH THE VIEW TO REACH AS SOON AS POSSIBLE, AND ANYWAY BEFORE END-MARCH 1984, AN OVERALL AGREEMENT.

I WOULD APPRECIATE IF YOU COULD CIRCULATE A COPY OF THE PRESENT LETTER TO ALL INTERESTED GOVERNMENTS UNQUOTE.

IN ADDITION, MR. SMOLE CALLED MR. WHITTOME TO ASK HIM TO SUPPORT THE STANDSTILL REQUEST BY AN ACCOMPANYING TELEX TO MR. PROBST. YOU WILL RECEIVE A COPY OF IT TOMORROW.

REGARDS,

P. MENTRE.

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~~MR. HANS SCHMITT~~
~~BELGRADE INTERCONTINENTAL~~
~~BELGRADE~~
~~YUGOSLAVIA~~

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I REFER TO THE DRAFT YOU DICTATED TO ISABEL.

A. IT IS UNWISE TO COMMIT YOURSELF ON PARA 4 LAST SENTENCE TO A NEW SYSTEM FOR ALL 1984. PLEASE SEEK A BREAK FOR REVIEW IN MID-1984.

B. THE CHANGES IN THE FOREIGN EXCHANGE ALLOCATION SYSTEM SEEM SOMEWHAT WEAK. SHOULD EXPORTERS RETAIN SO LARGE A PROPORTION? SHOULD YOU CONTINUE THE PRESENT SYSTEM THROUGH 84?

C. PARA 7 LAST SENTENCE, CAN THIS BE PROPERLY POLICED? SIMILARLY CAN THE REFERENCE IN PARA 8 SECOND SENTENCE BE POLICED?

D. PARA 10, ARE WE MAKING THIS A PERFORMANCE CLAUSE? SHOULD WE NOT DO SO OR AT LEAST MENTION IT AS A SPECIFIC ITEM FOR QUARTERLY REVISIONS?

E. PARA 11 AND PARA 14, HAVEN'T WE RUN INTO A LOT OF DIFFICULTY BY EXCLUDING VALUATION CHARGES? CAN THIS BE RETHOUGHT?

F. PARA 13. THIS MUST BE A PERFORMANCE CLAUSE. YOU

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C TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): L. A. WHITTOME EXT.: 73074 DEPT.: EUR DATE: 12/13/83

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MUST BE CAREFUL ON CHOICE OF CURRENCY OF FOREIGN EXCHANGE DEPOSIT.

G. PARA 13, WHY NOTHING ON LENDING RATES?

H. PARA 14, IS IS NOT UNWISE TO FIX CEILINGS THOU THROUGH 84?

I. I CAN'T JUDGE THE PUBLIC SECTOR REQUIREMENTS. AGAIN, IS IT WISE NOW TO FIX THROUGH 84?

J. I PRESUME EVERY ONE UNDERSTANDS THE IMPLICATION OF PARA 19.

K. WE NEED TO BE ABSOLUTELY SATISFIED THAT PARA 20 REQUIREMENT CAN BE POLICED.

BEST REGARDS,

ALAN

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INTERNATIONAL MONETARY FUND

TO : Mr. Whittome 12/13/83

FROM: Isabel

The ? are mine when I haven't been sure of the word. Mr. Schmitt said that there will be six technical notes in the form of agreed memoranda of understanding on various performance clauses that are mentioned in the text. The first one will be on the calculation of the index of the exchange rate; the second will be on interest rate of the Yugoslav banking system; the third one will be on public sector revenue ceilings; the fourth on the balance of payments test, the fifth on ceilings on net domestic assets and the sixth on price policy.

He asked that if you did not agree with any of the points to please let him know.

cc: CED
PM
HS

Dictated by Mr. Schmitt over the phone - December 13, 1983

YUGOSLAVIA

1. The stabilization program which we pursued over the last three years and which was supported by a stand-by arrangement with the Fund has begun to show substantial results. In particular, the deficit on external current account in convertible currencies narrowed from its peak in 1979 of US$3.3 billion to some US$0.2 billion in 1983. The improvement in the last year alone came to about US$ 1.2 billion. Some part of this improvement was due to a difference of treatment from the nonconvertible to the convertible currency areas, and to an undesirable

compression

competition
~~completion~~ of imports, neither of which can be continued in 1984. The underlying adjustment, nevertheless, will in our judgement permit a further improvement in the external current account to a surplus in 1984 of at least US$0.5 billion.

2. Developments in the external balance on capital account have been less set; as a result the increase in external reserves which we had targetted at the beginning of 1983 did not materialize. The most disappointing among the reasons for this outturn has been a swing in transitory items ~~sides~~ from a surplus of US$560 million to a deficit of perhaps as much as US$750 million, which more than offset the increase in export earnings in the course of last year. Apart from safeguarding the momentum of improvement in current transactions, therefore, our program for 1984 places particular emphasis on measures to improve the balance of capital account, so as to ensure an increase in official external reserves of at least US$500 million.

3. Final domestic demand was cut back by 4 percent in 1983 and, though exports began to respond forcefully to the gain in competitiveness during the year, gross social product (GSP) still showed some decline. A further reduction in domestic demand will again be necessary for balance of payments reasons in 1984, but as exports continue their recovery we expect that any tendency for GSP to decline will be reversed. The program we have adopted to reach these objectives is set out below: in support of it we request, on behalf of the Federal Executive Council of the Social Federal Republic of Yugoslavia, a stand-by arrangement with the Fund in an amount equivalent to some SDR ____ million.

The exchange rate

4. An active exchange rate policy was the pivot of our stabilization program last year. The depreciation of the dinar in real terms in the course of 1983 amounted to about 30 percent as measured in terms of relative producer prices, and to about the same in terms of relative unit labor cost. We believe that the level of competitiveness we have now achieved is adequate to permit a substantial liberalization of our trade and payments system without jeopardizing our external objective. During 1984, therefore, the monthly depreciation of the dinar will reflect the difference only between the monthly rise in producer prices in Yugoslavia and that among our five major trading partners.

A

5. We have already acted to simplify the foreign exchange allocation system. Starting not later than the beginning of April 1984, all foreign exchange receipts by Yugoslav exporters of goods and services will be surrendered to the

National Bank of Yugoslavia, in exchange for dinar cash or deposits that earned competitive interest rates as specified in paragraph 13 below. The National Bank of Yugoslavia will sell foreign exchange through authorized banks to cover authorized payments abroad. Exporters will have the option of repurchasing foreign exchange at the going rate, uncontested, up to a limit of 15 percent of their sales of exchange; however, such amounts will be charged against application to cover authorized payments requirements.

B

6. The expansion, in this manner, of the unified exchange market will in due course make the present law on payments of foreign debt in convertible currencies redundant. We have nevertheless, decided to leave it in full effect. According to this law enterprises that cannot service their foreign debt from their own earnings abroad can progressively draw on their associated group of enterprises, their own bank, or banks, in the republic or province where they reside, or on a pool established in the National Bank from contributions by enterprises throughout the country. With the new surrender requirement, the continued operation of this system may be expected in time to mop up excess foreign exchange holdings outside the National Bank.

Incomes and prices

7. The depreciation of the dinar contributed to raising the rate of price inflation from about 30 percent during 1982 to about 50 percent during 1983. The gains in competitiveness depended on restraining personal incomes from employment despite the rise in prices, and those incomes accordingly declined by more than 10 percent in real terms in 1983, or by 25 percent over the last four years. Although further steep declines would now be unacceptable, we are determined that competitiveness be preserved, and that gains in real personal income should not

exceed increases in productivity. As one means to restrain income, we have provided that with effect from January 1984, any enterprise that has not met its obligations to creditors on time will pay personal income only up to a minimum guaranteed level.

C policy

8. Despite the strong incentives provided the restructuring of the economy towards industries supplying external rather than purely internal markets has been delayed. Limiting personal income payments by loss making enterprises should hasten the transfer of labor to more competitive activity, and we have therefore decided, with effect from April 1984, to extend that limitation to all enterprises receiving credits or subsidies under liberalization programs that have been in effect for more than one - year periods. In addition, total payments into common reserve funds at the communal and republican levels will be kept to the same nominal level in 1984 as in 1983, thereby reducing the resources available for subsidization.

9. Greater progress needs to be achieved in adjusting domestic prices to allow potentially competitive enterprises to be financially viable. To this end we let this selective price freeze lapse last July despite the additional push to inflation that it entailed in the short run. The next major step was taken in January 1984 when last year's system of price control expired. We decided at that time to expand the proportion of industrial output free of price control from 45 to 60 percent. An estimated 25 percent of industrial output will continue to have its prices set by self-management agreements that can also be flexible. The remaining 15 percent remains subject to direct controls. The proportion of prices liberalized will not be allowed to shrink in the course of 1984.

10. Controlled prices on key intermediate products are progressively being raised to economic levels. By the end of January 1984, we will have adhered to our undertaking with the World Bank to raise average electricity tariffs by 15 percent in real terms over their March 1983 level, and average railway tariffs by at least 10 percent in real terms over their end-December 1982 levels. Further real increases will follow in due course. Until then, we are maintaining at least quarterly increases in nominal prices to match increases in the producer price index. We have also agreed with the World Bank to introduce real increases in natural gas prices at least twice a year, towards achieving parity with world market prices by 1987. The domestic price of crude oil has already reached that level.

Monetary policy

11. Much of the restraints on domestic demand in 1983 was achieved by severely restrictive monetary and credit policies. Thus, while the real stock on broad money (M2) had remained roughly constant during 1982, it is estimated to have declined (?) during 1983 by about 7 percent. This result was in part due to a rate of inflation which, at 50 percent, turned out higher than had originally been assumed. A certain degree of flexibility was provided by the exclusion evaluation of changes on net foreign liabilities, and on foreign exchange deposits, from the selling on net domestic assets by which monetary policy was defined, but not enough to wash out the retroactive effect of inflation altogether.

12. The acceleration of inflation last year also frustrated our efforts to raise interest rates on dinar deposits to positive levels in real terms. Nominal rates on such deposits were increased last February and again to 30 percent at the end of December, but these increases still

left them significantly negative in real terms. By contrast, the yield on foreign currency deposits inclusive of valuation adjustment, rose by substantially more, and the share of such deposits in broad money accordingly increased from 32 percent at the end of 1982 to 40 percent at present. Approximately the same yield differential also provided a powerful incentive to keep money abroad (?) altogether and supplies a large part of the explanation for the swing from an inflow to an outflow on transitory items in the balance of payments.

13. A decisive move is clearly overdue to raise nominal interest rates in dinar deposits to competitive levels. The percentage difference between them and the yield on comparable foreign exchange deposits at the end of December 1983, including valuation changes, will be halved by the end of March 1984 and eliminated altogether by the end of June 1984, after which it will be adjusted monthly to maintain exact parity between the two. The discount rate and other lending rates of the National Bank will follow after an initial increase by ten percentage points on January 15, 1984. In the process the (inter) differential will also swing between unsubsidized and subsidized credits.

14. Because of the uncertainties regarding inflation, we have chosen to define our monetary ceilings again in terms of the net domestic assets of the banking system, excluding valuation changes on net foreign liabilities and on foreign currency deposits. In fixing them for 1984, we have also taken into account the balance of payments effects of interest rate increases on the demand for money. On this basis we calculated the selling for end-December 1984 at Dinar ____ billion compared with Dinar ____ billion a year earlier. There will be a quarterly phasing of the increase through the year. Within each total, allowance will be made for the

planned increases, described below, in the net position of the public sector with the banking system.

Public finance

15. Public finance also contributed substantially to the restraint of domestic demand in 1983. To be sure we had hoped to limit the growth of total public sector revenues and hence also of expenditures, to 20 percent in nominal terms in 1983. In the event they rose by over 30 percent. In real terms, nevertheless, public sector revenue declined by about 5 percent compared with a decline of less than 3 percent a year before. More significant reductions in revenue and expenditure in the face of rapidly accelerating inflation would have been difficult to implement particularly at the Federal level. As it was, a large part of the austerity concentrated on real personal income paid by all levels of government.

16. For 1984 limits have again been placed on the growth of public sector revenue to ensure a continued decline in the relative size of that sector of the economy. The growth rate of total public sector revenue will be restricted to four-fifths of the percentage increase in the retail price index. To tighten control, limits have been placed on the cumulative quarterly revenue of the public sector. In order that expenditures, at least at the Federal level, will be constrained by these means, we have specified a flow of Dinar billion for the increase in the net position of the public sector with the National Bank of Yugoslavia between December 31st 1984 and a year earlier, and have fixed it quarterly through the year. That increase is to be blocked until the end of 1986.

17. A similar plan to freeze excess fiscal revenues to the National Bank of Yugoslavia in 1983 yielded less than had been planned. For 1984 we have decided to limit overall payments from the Committee of Interest for

Foreign Economic Relations to export producers to no more than the customs duty drawback, and to channel the excess into the Federal Government's blocked account. Given their competitive position exporters needed no special incentive. The accumulation of public sector deposits with the banking system will, on the other hand, release significant amounts of credit to other productive enterprises within the overall credit ceilings established for balance of payments reasons.

18. A restructuring of our tax system came into effect in January 1984. A main objective was to include in its coverage household income other than from employment in the social sector. In particular, interest earned on all financial assets, including capital gains on foreign currency bank deposits, are not subject to a 10 percent withholding tax. Also, the minimum taxable household income was reduced by one third and rates of taxation on agricultural income, on inheritance and on property were increased. These increases in the taxation of household incomes has made it possible to reduce the tax burden on enterprise income proportionately more than the general reduction in taxation would already have allowed.

External debt

19. We expect by these various measures to reach, and even to exceed our external current account objectives and also to improve our performance on capital accounts. We are determined to begin reducing our external debt as soon as possible. Gross borrowing last year came to the equivalent of $4.4 billion; we expect to limit our requirement this year to $3.5 billion. To secure this amount we have again entered into arrangement with a group of creditor governments and banks to roll over debt falling due and to provide a limited amount of inflation, money to build up the reserve. We will make a quarterly buildup of our reserve by a total of US$500 million, a test of the success of our program.

20. Despite the scarcity of resources a certain outflow of capital from Yugoslavia is normal and acceptable. However, the outflow in 1983 of roughly US$1.5 billion was clearly excessive. We will spare no effort to reduce this flow to about US$500 million in 1984 and to cover it by an equivalent surplus on current account in convertible currency. One central element in achieving this reduction in capital outflows is our move to an active interest rate policy. In addition, we have intensified the control on the repatriation of export earnings. Thus, if exporters fail to repatriate export proceeds within 90 days their credit line for that export will be withdrawn.

21. We have also decided to facilitate an accelerated drawdown on external lines of credit particularly on the supply credit granted by the Berne Group of governments. The administrative regulation governing their utilization proved too restrictive in 1983. In order to ensure the availability of foreign exchange to repay the foreign credits, drawings have been made available only to exporters who have proof of export orders in hand and raw material imports financed by suppliers' credits have had to amount to less than 50 percent of the value of the export into which they entered. In time for the reform of the foreign exchange allocation system on April 1st, 1984, we will have broken a close link between import and exports in the allocation of external credits, so as to allow the financing of imports of more general interest to the economy.

Other matters

22. The Federal Executive Council of Yugoslavia do not intend to introduce any multiple currency practices or introduce new or intensified existing restrictions on payments and transfers for international transactions or enter into any bilateral payments arrangements with Fund members. A

10 percent premium for tourists paying in dinar-denominated travellers' checks has been approved by the Fund until February 28, 1984 and shall have been eliminated by that date. The Federal Executive Council do not intend to introduce new restrictions or intensify existing restrictions on imports for balance of payments reasons.

23. The Federal Executive Council believes that the policies set forth in this letter are adequate to achieve the objective of its program but will take any additional measures that may become appropriate for this purpose. The Yugoslav authorities will review economic developments in 1984 with the staff of the Fund on a quarterly basis. They will consult with the Fund as soon as is practicable after the middle of the year and in any case no later than August 15, 1984 to agree with the Fund on any modifications in the performance criteria that may be called for.

Finally, the Federal Executive Council will consult with the Fund in accordance with the Fund policy of consultations, on the adoption of any measures that may become appropriate.

Sincerely,

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WASHINGTON, D. C. 20431

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MR. HANS SCHMITT
INTERCONTINENTAL HOTEL
BELGRADE
YUGOSLAVIA

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CC: Mr. Polak

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THE FOLLOWING CABLE HAS BEEN SENT TO STATE SECRETARY PROBST OF SWITZERLAND.

I WOULD LIKE TO THANK YOU AGAIN FOR THE MOST EFFECTIVE WAY IN WHICH YOU CHAIRED THE NOVEMBER 18 MEETING IN GENEVA ON FINANCIAL ASSISTANCE TO YUGOSLAVIA.

AS INDICATED IN YOUR SUMMING UP, IT WAS AGREED THAT TWO WORKING GROUPS WOULD MEET AS SOON AS POSSIBLE. THE FIRST WORKING GROUP, CHAIRED BY FRANCE, WOULD DEAL WITH THE PROBLEM OF THE CONSOLIDATION OF MATURITIES OF OFFICIAL AND OFFICIALLY GUARANTEED DEBT FALLING DUE IN 1984. THE SECOND WORKING GROUP, CHAIRED BY THE INTERNATIONAL MONETARY FUND, WOULD BE ENTRUSTED WITH THE MORE GENERAL SUBJECTS OF THE OVERALL ECONOMIC SITUATION OF YUGOSLAVIA, FUTURE PROSPECTS AND THE NEED FOR ADDITIONAL ACTION. BOTH WORKING GROUPS WOULD REPORT TO THE COORDINATING GROUP CHAIRED BY SWITZERLAND.

ON BEHALF OF THE FUND, I CONFIRM OUR AGREEMENT ON THESE PROCEDURES WHILE STRESSING THAT A POSITIVE OUTCOME

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OF THE DISCUSSIONS IN THE SECOND WORKING GROUP IS CRITICALLY DEPENDENT UPON THE ATTITUDE OF MAJOR CREDITOR COUNTRIES. IN THIS CONTEXT WE WOULD HAVE NO DIFFICULTY IF GERMANY WAS TO CHAIR THIS GROUP INSTEAD OF THE FUND. WE WILL HAVE TO ASSESS TOGETHER HOW TO ENSURE AN OVERALL RESULT WHICH MEETS THE NEEDS OF YUGOSLAVIA.

SUBJECT TO FINAL CONFIRMATION, IT APPEARS NOW THAT THE WORKING GROUPS WILL MEET IN THE BANK-FUND PARIS OFFICE ON JANUARY 11/12. IN THE MEANTIME, AND DURING THE PERIOD WHICH WILL BE NECESSARY TO REACH FINAL AGREEMENT, THERE IS A NEED TO MAINTAIN AN ORDERLY PROCESS OF EQUAL TREATMENT BETWEEN CREDITORS THROUGH A STANDSTILL APPLIED TO GOVERNMENTAL CREDITS AND COMMERCIAL BANKS' CREDITS.

THE YUGOSLAV GOVERNMENT IS SENDING YOU A TELEX TO THAT EFFECT AND I WOULD LIKE TO EXPRESS OUR FULL BACKING FOR THIS REQUEST.

SINCERELY YOURS

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TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): LAWHITTOME EXT.: 73074 DEPT.: EUR DATE: 12/14/83

AUTHORIZED BY NAME (TYPE): G. Tyler

AUTHORIZED BY NAME (TYPE):

(**)

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SEC 48 REV. 1
11-18-82

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WASHINGTON, D. C. 20431

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STATE SECRETARY RAYMOND PROBST

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SWITZERLAND

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CC: MR. POLAK

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I WOULD LIKE TO THANK YOU AGAIN FOR THE MOST EFFECTIVE WAY IN WHICH YOU CHAIRED THE NOVEMBER 18 MEETING IN GENEVA ON FINANCIAL ASSISTANCE TO YUGOSLAVIA.

AS INDICATED IN YOUR SUMMING UP, IT WAS AGREED THAT TWO WORKING GROUPS WOULD MEET AS SOON AS POSSIBLE. THE FIRST WORKING GROUP, CHAIRED BY FRANCE, WOULD DEAL WITH THE PROBLEM OF THE CONSOLIDATION OF MATURITIES OF OFFICIAL AND OFFICIALLY GUARANTEED DEBT FALLING DUE IN 1984. THE SECOND WORKING GROUP, CHAIRED BY THE INTERNATIONAL MONETARY FUND, WOULD BE ENTRUSTED WITH THE MORE GENERAL SUBJECTS OF THE OVERALL ECONOMIC SITUATION OF YUGOSLAVIA, FUTURE PROSPECTS AND THE NEED FOR ADDITIONAL ACTION. BOTH WORKING GROUPS WOULD REPORT TO THE COORDINATING GROUP CHAIRED BY SWITZERLAND

ON BEHALF OF THE FUND, I CONFIRM OUR AGREEMENT ON THESE PROCEDURES WHILE STRESSING THAT A POSITIVE OUTCOME OF THE DISCUSSIONS IN THE SECOND WORKING GROUP IS CRITICALLY DEPENDENT UPON THE ATTITUDE OF MAJOR CREDITOR

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C TELEX NO.: CABLE ADDRESS:

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COUNTRIES. IN THIS CONTEXT WE WOULD HAVE NO DIFFICULTY IF GERMANY WAS TO CHAIR THIS GROUP INSTEAD OF THE FUND. WE WILL HAVE TO ASSESS TOGETHER HOW TO ENSURE AN OVERALL RESULT WHICH MEETS THE NEEDS OF YUGOSLAVIA.

SUBJECT TO FINAL CONFIRMATION, IT APPEARS NOW THAT THE WORKING GROUPS WILL MEET IN THE BANK-FUND PARIS OFFICE ON JANUARY 11-12. IN THE MEANTIME, AND DURING THE PERIOD WHICH WILL BE NECESSARY TO REACH FINAL AGREEMENT, THERE IS A NEED TO MAINTAIN AN ORDERLY PROCESS OF EQUAL TREATMENT BETWEEN CREDITORS THROUGH A STANDSTILL APPLIED TO GOVERNMENTAL CREDITS AND COMMERCIAL BANKS' CREDITS.

THE YUGOSLAV GOVERNMENT IS SENDING YOU A TELEX TO THAT EFFECT AND I WOULD LIKE TO EXPRESS OUR FULL BACKING FOR THIS REQUEST.

SINCERELY YOURS

WHITTOME

INTERFUND

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TO: INTERNATIONAL MONETARY FUND/WASHINGTON, D.C.
ATTN: L.A. WHITTOME/P. MENTRE

RE: YUGOSLAVIA 1984

FOLLOWING IS TEXT OF OFFER TELEX SENT ON BEHALF OF THE ICC TO THE FINANCE MINISTRY OF YUGOSLAVIA YESTERDAY:
QUOTE
TO: MINISTRY OF FINANCE/BELGRADE, YUGOSLAVIA
ATTN: MR. CVITAN DUJOMIC, ASSISTANT FEDERAL SECRETARY OF FINANCE

CC: FEDERAL EXECUTIVE COUNCIL/BELGRADE, YUGOSLAVIA
ATTN: MINISTER JANKO SMOLE

CC: NATIONAL BANK OF YUGOSLAVIA/BELGRADE, YUGOSLAVIA
ATTN: MR. JOZEF KOROSEC

RE: YUGOSLAVIA 1984 FINANCING ARRANGEMENTS

ON BEHALF OF THE INTERNATIONAL COORDINATING COMMITTEE (THE QUOTE ICC QUOTE), WE ARE PLEASED TO CONFIRM THE PRELIMINARY PROPOSA

DISCUSSED WITH YOU AT THE DECEMBER 6, 1983 MEETING OF THE ICC FOR A 1984 FINANCING PACKAGE FOR YUGOSLAVIA. THE PRELIMINARY PROPOSAL, AND ANY STATEMENT OF TERMS AND CONDITIONS OR FINANCING AGREEMENT BASED UPON IT, ARE, OF COURSE, SUBJECT TO REVIEW AND ACCEPTANCE BY THE BANKS AND FINANCIAL INSTITUTIONS TO BE BOUND BY IT.

PURSUANT TO THE PRELIMINARY PROPOSAL, UP TO 100 PERCENT OF THE MEDIUM AND LONG-TERM MATURITIES DUE IN 1984 TO BANKS AND FINANCIAL INSTITUTIONS ON ACCOUNT OF EXTERNAL INDEBTEDNESS INCURRED BEFORE THE CLOSE OF BUSINESS ON JANUARY 17, 1983 WILL

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BE REFINANCED. IN THE EVENT THAT 100 PERCENT OF SUCH MATURITIES ARE TO BE REFINANCED, EACH REFINANCED MATURITY WILL BEAR INTEREST AT A RATE WHICH INCLUDES A MARGIN OF 1-7/8 PERCENT ABOVE THE LONDON INTERBANK OFFERED RATE, FRANKFURT INTERBANK OFFERED RATE OR FIXED RATE FOR THE CURRENCY IN WHICH SUCH MATURITY IS DENOMINATED OR A MARGIN OF 1-3/4 PERCENT ABOVE THE APPLICABLE DOMESTIC RATE FOR SUCH CURRENCY. IN THE EVENT, HOWEVER, THAT THE PERCENTAGE OF SUCH MATURITIES WHICH IS TO BE REFINANCED IS AGREED TO BE LESS THAN 100 PERCENT, THE ICC WILL DISCUSS WITH YOU A REDUCTION IN SUCH MARGINS. THE PRINCIPAL OF EACH RE-FINANCED MATURITY WILL BE DUE IN INSTALLMENTS OVER THREE YEARS FOLLOWING A FOUR-YEAR PERIOD IN WHICH INTEREST PAYMENTS ONLY WILL BE REQUIRED TO BE MADE. A FACILITY FEE OF 1 PERCENT WILL BE PAYABLE ON THE PRINCIPAL AMOUNT OF EACH REFINANCED MATURITY. THE REFINANCING WILL BE CONDITIONAL UPON A COMPARABLE REFINAN-CING OF MATURITIES DUE IN 1984 TO, OR GUARANTEED BY, THE BERNE ACCORD GOVERNMENTS.

IN ADDITION, THE ICC WILL, IN LIAISON WITH ITS ECONOMIC SUB-COMMITTEE, CARRY OUT IN THE THIRD QUARTER OF 1984 A COMPREHEN-SIVE REVIEW OF THE FINANCIAL SITUATION OF YUGOSLAVIA.

IF YOU ARE IN AGREEMENT WITH THE FOREGOING, PLEASE SO CONFIRM TO US IN WRITING. THE PRELIMINARY PROPOSAL IS, OF COURSE, MADE IN RESPONSE TO YOUR CONSIDERED REQUEST AND WITH THE INTENTION OF FACILITATING AN EXPEDITIOUS SIGNING OF A 1984 FINANCING PACKAGE AND AN EARLY RETURN BY YUGOSLAVIA TO THE PRIVATE CREDIT MARKETS. WE THEREFORE LOOK FORWARD TO RECEIPT OF YOUR CONFIRMATION OF THE PRELIMINARY PROPOSAL BY DECEMBER 19, 1983, SO THAT THE ICC CAN PROMPTLY RECOMMEND IT TO THE NATIONAL COMMITEES AND PROMPTLY COMMENCE DISCUSSIONS WITH YOU OF A MORE DEFINITIVE STATEMENT OF TERMS AND CONDITIONS.

BEST REGARDS, FULVIO DOBRICH,
MANUFACTURERS HANOVER TRUST COMPANY
FOR THE INTERNATIONAL COORDINATING COMMITTEE.
UNQUOTE
BEST REGARDS, DOBRICH, MANTRUST, NY

END OF PAGE TWO/END OF TELEX

248331 IMF UR

Dictated by Mr. Schmitt over the phone - December 13, 1983

YUGOSLAVIA

1. The stabilization program which we pursued over the last three years and which was supported by a stand-by arrangement with the Fund has begun to show substantial results. In particular, the deficit on external current account in convertible currencies narrowed from its peak in 1979 of US$3.3 billion to some US$0.2 billion in 1983. The improvement in the last year alone came to about US$ 1.2 billion. Some part of this improvement was due to a difference of treatment from the nonconvertible to the convertible currency areas, and to an undesirable
competition
completion of imports, neither of which can be continued in 1984. The underlying adjustment, nevertheless, will in our judgement permit a further improvement in the external current account to a surplus in 1984 of at least US$0.5 billion.

2. Developments in the external balance on capital account have been less set; as a result the increase in external reserves which we had targetted at the beginning of 1983 did not materialize. The most disappointing among the reasons for this outturn has been a swing in transitory sides from a surplus of US$560 million to a deficit of perhaps as much as US$750 million, which more than offset the increase in export earnings in the course of last year. Apart from safeguarding the momentum of improvement in current transactions, therefore, our program for 1984 places particular emphasis on measures to improve the balance of capital account, so as to ensure an increase in official external reserves of at least US$500 million.

3. Final domestic demand was cut back by 4 percent in 1983 and, though exports began to respond forcefully to the gain in competitiveness during the year, gross social product (GSP) still showed some decline. A further reduction in domestic demand will again be necessary for balance of payments reasons in 1984, but as exports continue their recovery we expect that any tendency for GSP to decline will be reversed. The program we have adopted to reach these objectives is set out below: in support of it we request, on behalf of the Federal Executive Council of the Social Federal Republic of Yugoslavia, a stand-by arrangement with the Fund in an amount equivalent to some SDR ____ million.

The exchange rate

4. An active exchange rate policy was the pivot of our stabilization program last year. The depreciation of the dinar in real terms in the course of 1983 amounted to about 30 percent as measured in terms of relative producer prices, and to about the same in terms of relative unit labor cost. We believe that the level of competitiveness we have now achieved is adequate to permit a substantial liberalization of our trade and payments system without jeopardizing our external objective. During 1984, therefore, the monthly depreciation of the dinar will reflect the difference only between the monthly rise in producer prices in Yugoslavia and that among our five major trading partners.

5. We have already acted to simplify the foreign exchange allocation system. Starting not later than the beginning of April 1984, all foreign exchange receipts by Yugoslav exporters of goods and services will be surrendered to the

National Bank of Yugoslavia, in exchange for dinar cash or deposits that earned competitive interest rates as specified in paragraph 13 below. The National Bank of Yugoslavia will sell foreign exchange through authorized banks to cover authorized payments abroad. Exporters will have the option of repurchasing foreign exchange at the going rate, uncontested, up to a limit of 15 percent of their sales of exchange; however, such amounts will be charged against application to cover authorized payments requirements.

6. The expansion, in this manner, of the unified exchange market will in due course make the present law on payments of foreign debt in convertible currencies redundant. We have nevertheless, decided to leave it in full effect. According to this law enterprises that cannot service their foreign debt from their own earnings abroad can progressively draw on their associated group of enterprises, their own bank, or banks, in the republic or province where they reside, or on a pool established in the National Bank from contributions by enterprises throughout the country. With the new surrender requirement, the continued operation of this system may be expected in time to mop up excess foreign exchange holdings outside the National Bank.

Incomes and prices

7. The depreciation of the dinar contributed to raising the rate of price inflation from about 30 percent during 1982 to about 50 percent during 1983. The gains in competitiveness depended on restraining personal incomes from employment despite the rise in prices, and those incomes accordingly declined by more than 10 percent in real terms in 1983, or by 25 percent over the last four years. Although further steep declines would now be unacceptable, we are determined that competitiveness be preserved, and that gains in real personal income should not

exceed increases in productivity. As one means to restrain income, we have provided that with effect from January 1984, any enterprise that has not met its obligations to creditors on time will pay personal income only up to a minimum guaranteed level.

8. Despite the strong incentives provided the restructuring of the economy towards industries supplying external rather than purely internal markets has been delayed. Limiting personal income payments by loss making enterprises should hasten the transfer of labor to more competitive activity, and we have therefore decided, with effect from April 1984, to extend that limitation to all enterprises receiving credits or subsidies under liberalization programs that have been in effect for more than one - year periods. In addition, total payments into common reserve funds at the communal and republican levels will be kept to the same nominal level in 1984 as in 1983, thereby reducing the resources available for subsidization.

9. Greater progress needs to be achieved in adjusting domestic prices to allow potentially competitive enterprises to be financially viable. To this end we let this selective price freeze lapse last July despite the additional push to inflation that it entailed in the short run. The next major step was taken in January 1984 when last year's system of price control expired. We decided at that time to expand the proportion of industrial output free of price control from 45 to 60 percent. An estimated 25 percent of industrial output will continue to have its prices set by self-management agreements that can also be flexible. The remaining 15 percent remains subject to direct controls. The proportion of prices liberalized will not be allowed to shrink in the course of 1984.

10. Controlled prices on key intermediate products are progressively being raised to economic levels. By the end of January 1984, we will have adhered to our undertaking with the World Bank to raise average electricity tariffs by 15 percent in real terms over their March 1983 level, and average railway tariffs by at least 10 percent in real terms over their end-December 1982 levels. Further real increases will follow in due course. Until then, we are maintaining at least quarterly increases in nominal prices to match increases in the producer price index. We have also agreed with the World Bank to introduce real increases in natural gas prices at least twice a year, towards achieving parity with world market prices by 1987. The domestic price of crude oil has already reached that level.

Monetary policy

11. Much of the restraints on domestic demand in 1983 was achieved by severely restrictive monetary and credit policies. Thus, while the real stock on broad money (M2) had remained roughly constant during 1982, it is estimated to have declined (?) during 1983 by about 7 percent. This result was in part due to a rate of inflation which, at 50 percent, turned out higher than had originally been assumed. A certain degree of flexibility was provided by the exclusion evaluation of changes on net foreign liabilities, and on foreign exchange deposits, from the selling on net domestic assets by which monetary policy was defined, but not enough to wash out the retroactive effect of inflation altogether.

12. The acceleration of inflation last year also frustrated our efforts to raise interest rates on dinar deposits to positive levels in real terms. Nominal rates on such deposits were increased last February and again to 30 percent at the end of December, but these increases still

left them significantly negative in real terms. By contrast, the yield on foreign currency deposits inclusive of valuation adjustment, rose by substantially more, and the share of such deposits in broad money accordingly increased from 32 percent at the end of 1982 to 40 percent at present. Approximately the same yield differential also provided a powerful incentive to keep money abroad (?) altogether and supplies a large part of the explanation for the swing from an inflow to an outflow on transitory items in the balance of payments.

13. A decisive move is clearly overdue to raise nominal interest rates in dinar deposits to competitive levels. The percentage difference between them and the yield on comparable foreign exchange deposits at the end of December 1983, including valuation changes, will be halved by the end of March 1984 and eliminated altogether by the end of June 1984, after which it will be adjusted monthly to maintain exact parity between the two. The discount rate and other lending rates of the National Bank will follow after an initial increase by ten percentage points on January 15, 1984. In the process the (inter) differential will also swing between unsubsidized and subsidized credits.

14. Because of the uncertainties regarding inflation, we have chosen to define our monetary ceilings again in terms of the net domestic assets of the banking system, excluding valuation changes on net foreign liabilities and on foreign currency deposits. In fixing them for 1984, we have also taken into account the balance of payments effects of interest rate increases on the demand for money. On this basis we calculated the selling for end-December 1984 at Dinar ____ billion compared with Dinar ____ billion a year earlier. There will be a quarterly phasing of the increase through the year. Within each total, allowance will be made for the

planned increases, described below, in the net position of the public sector with the banking system.

Public finance

15. Public finance also contributed substantially to the restraint of domestic demand in 1983. To be sure we had hoped to limit the growth of total public sector revenues and hence also of expenditures, to 20 percent in nominal terms in 1983. In the event they rose by over 30 percent. In real terms, nevertheless, public sector revenue declined by about 5 percent compared with a decline of less than 3 percent a year before. More significant reductions in revenue and expenditure in the face of rapidly accelerating inflation would have been difficult to implement particularly at the Federal level. As it was, a large part of the austerity concentrated on real personal income paid by all levels of government.

16. For 1984 limits have again been placed on the growth of public sector revenue to ensure a continued decline in the relative size of that sector of the economy. The growth rate of total public sector revenue will be restricted to four-fifths of the percentage increase in the retail price index. To tighten control, limits have been placed on the cumulative quarterly revenue of the public sector. In order that expenditures, at least at the Federal level, will be constrained by these means, we have specified a flow of Dinar ___ billion for the increase in the net position of the public sector with the National Bank of Yugoslavia between December 31st 1984 and a year earlier, and have fixed it quarterly through the year. That increase is to be blocked until the end of 1986.

17. A similar plan to freeze excess fiscal revenues to the National Bank of Yugoslavia in 1983 yielded less than had been planned. For 1984 we have decided to limit overall payments from the Committee of Interest for

Foreign Economic Relations to export producers to no more than the customs duty drawback, and to channel the excess into the Federal Government's blocked account. Given their competitive position exporters needed no special incentive. The accumulation of public sector deposits with the banking system will, on the other hand, release significant amounts of credit to other productive enterprises within the overall credit ceilings established for balance of payments reasons.

18. A restructuring of our tax system came into effect in January 1984. A main objective was to include in its coverage household income other than from employment in the social sector. In particular, interest earned on all financial assets, including capital gains on foreign currency bank deposits, are not subject to a 10 percent withholding tax. Also, the minimum taxable household income was reduced by one third and rates of taxation on agricultural income, on inheritance and on property were increased. These increases in the taxation of household incomes has made it possible to reduce the tax burden on enterprise income proportionately more than the general reduction in taxation would already have allowed.

External debt

19. We expect by these various measures to reach, and even to exceed our external current account objectives and also to improve our performance on capital accounts. We are determined to begin reducing our external debt as soon as possible. Gross borrowing last year came to the equivalent of $4.4 billion; we expect to limit our requirement this year to $3.5 billion. To secure this amount we have again entered into arrangement with a group of creditor governments and banks to roll over debt falling due and to provide a limited amount of inflation (?) money to build up the reserve. We will make a quarterly buildup of our reserve by a total of US$500 million, atest of the success of our program.

20. Despite the scarcity of resources a certain outflow of capital from Yugoslavia is normal and acceptable. However, the outflow in 1983 of roughly US$1.5 billion was clearly excessive. We will spare no effort to reduce this flow to about US$500 million in 1984 and to cover it by an equivalent surplus on current account in convertible currency. One central element in achieving this reduction in capital outflows is our move to an active interest rate policy. In addition, we have intensified the control on the repatriation of export earnings. Thus, if exporters fail to repatriate export proceeds within 90 days their credit line for that export will be withdrawn.

21. We have also decided to facilitate an accelerated drawdown on external lines of credit particularly on the supply credit granted by the Berne Group of governments. The administrative regulation governing their utilization proved too restrictive in 1983. In order to ensure the availability of foreign exchange to repay the foreign credits, drawings have been made available only to exporters who have proof of export orders in hand and raw material imports financed by suppliers' credits have had to amount to less than 50 percent of the value of the export into which they entered. In time for the reform of the foreign exchange allocation system on April 1st, 1984, we will have broken a close link between import and exports in the allocation of external credits, so as to allow the financing of imports of more general interest to the economy.

Other matters

22. The Federal Executive Council of Yugoslavia do not intend to introduce any multiple currency practices or introduce new or intensified existing restrictions on payments and transfers for international transactions or enter into any bilateral payments arrangements with Fund members. A

10 percent premium for tourists paying in dinar-denominated travellers' checks has been approved by the Fund until February 28, 1984 and shall have been eliminated by that date. The Federal Executive Council do not intend to introduce new restrictions or intensify existing restrictions on imports for balance of payments reasons.

23. The Federal Executive Council believes that the policies set forth in this letter are adequate to achieve the objective of its program but will take any additional measures that may become appropriate for this purpose. The Yugoslav authorities will review economic developments in 1984 with the staff of the Fund on a quarterly basis. They will consult with the Fund as soon as is practicable after the middle of the year and in any case no later than August 15, 1984 to agree with the Fund on any modifications in the performance criteria that may be called for.

Finally, the Federal Executive Council will consult with the Fund in accordance with the Fund policy of consultations, on the adoption of any measures that may become appropriate.

Sincerely,

RE: FINANCIAL ASSISTANCE TO YUGOSLAVIA

Sent by FM CLOTKZ

Dear Sir,

With reference to our meeting of November 18 in Geneva on Financial Assistance to Yugoslavia, I thought that it might be useful to summarize the result of our discussion on the question of procedures for 1984.

It was suggested by one delegation, who was also speaking in the name of others, that we should create two working groups which would function under the supervision of a coordination group.

The first working group would deal with the problem of the consolidation of maturities of official and officially guaranteed credits falling due in 1984. It would be chaired by France which would also provide for secretariat assistance. The consideration of this question of consolidation being urgent, the group would, if possible, meet already in December.

The second working group would be entrusted with the more general subjects of the overall economic situation of Yugoslavia, future prospects and the need for additional action. This group would be chaired by the IMF. Since this organization has offices in Europe, the necessary relationship between the two groups would be easily established. The second group would also meet as quickly as possible.

./..

Both working groups would then report to a coordinating group chaired by Switzerland.

The first working group would be open, according to usual practice, to countries with maturities in 1984 and possibly to others. The second one would be open to all countries of the Berne Action.

The aforementioned proposal was approved ad referendum by the other delegations as well as by the presidency.

I would appreciate it if you could inform me, in due course, of the final approve of your authorities which I will forward to all participants in the Geneva Meeting.

Thank you in advance.

Best regards,

R. Probst
State Secretary

Mr. Whittome

Office Memorandum

TO : The Managing Director
The Deputy Managing Director

DATE: December 13, 1983

FROM : Paul Mentre

SUBJECT : Yugoslavia--Financial Package: Meetings in London and Belgrade

Some progress was made last week, through meetings with commercial banks in London and with the Yugoslav authorities in Belgrade toward the assembling of a financial package for Yugoslavia in 1984.

1. Commercial banks (London, December 5-6)

Manufacturers Hanover chaired a meeting of the International Coordinating Committee of banks, also attended by a Yugoslav delegation led by Mr. Smole, a World Bank representative, and an IMF team led by Mr. Whittome.

Commercial banks have proposed to the Yugoslavs to refinance up to 100 percent of medium- and long-term maturities falling due in 1984 with a four-year grace period (against three years for 1983 maturities) and a seven-year maturity (repayment over three years after the grace period).

The interest spread would be the same as last year (1 7/8 percent) unless the Yugoslavs were to ask for less than 100 percent rescheduling. Commercial banks also agreed to a standstill to be applied to maturities falling due from January 1 to March 31, 1984.

As far as new money is concerned, it was clear that banks did not want to commit themselves to any medium-term lending of the 1983 type. Various ideas were floated in the meeting itself and in private discussions: a stand-by facility of $200 million to be drawn upon in case of an unexpected evolution of reserves; financing on a revolving basis of Yugoslav export receivables on major markets; cofinancing with the World Bank or the European Investment Bank. But no formal proposal was made, many bankers looking even at an early firm proposal on refinancing as a means to avoid other commitments.

We would, therefore, have to come back to banks later, in the light of discussions with governments, to raise again the issue of new money and of an extension of the period during which short-term debt is rolled over (presently until January 15, 1985). In the meantime, we have asked the Yugoslavs to take note of the commercial banks' offer, to implement the standstill, and to postpone their final answer pending the outcome of discussions with governments.

It is now agreed that the two governmental working groups (one chaired by the French Treasury on debt consolidation, one chaired by the IMF on other flows)1/ will meet in Paris on January 11-12 with a view to report to the full group, chaired by Switzerland at a meeting end-January/ beginning February. It is also agreed with the Swiss and the French that in the meantime the Yugoslavs will apply the same standstill to maturities falling due on governmental and governmental-guaranteed debt.

..../2

1/ We agreed to chair the second group but clearly it would be better to involve a major country. The Yugoslavs are trying to convince the Germans.

While major uncertainties remain on fresh money available, an orderly process is thus underway.

2. Yugoslav authorities (Belgrade, December 8-9)

We had, together with Mr. Schmitt, discussions with Mr. Dragan, Vice Premier of the Federal Executive Counil, the National Bank of Yugoslavia, and Yugobanka, the leading Yugoslav commercial bank, on the 1984 financial package. Since September there had been differences of views between the Yugoslavs, quite optimistic on exports and current account prospects and wanting to limit the financial package to a rollover of existing debt, and us, more cautious on export outlook and stressing the need to get fresh money from banks and governments to build adequate reserves and to protect Yugoslavia against unexpected developments in 1984. This difference was narrowed down in Belgrade, the Yugoslavs having now understood that the Fund would not go beyond maintaining its present exposure (which would mean $280 million purchases in 1984) if others were not increasing their exposure. In their own projections (see attachment) the Yugoslavs are now contemplating fresh money from banks ($100 million) and from governments ($150 million) and Mr. Dragan said that he could contemplate an overall financial package amounting up to $3.5 billion (against $3.0 billion maturities falling due in 1984). Our alternative is consistent with this figure of $3.5 billion with, however, a lower figure for the Fund ($400 million against $500 million in the Yugoslav projection) and higher figures for fresh money by banks ($200 million) and effective refinancing of maturities falling due. We stressed that, in view of our more realistic assumptions on current account and effective repatriation of export proceeds (outflows reflected in the "errors and omissions" line) this higher package would yet lead to an insufficient reserve increase ($500 million). Reserves should thus be supplemented by a stand-by facility with commercial banks, for about $200 million, and possibly from the BIS with a gold collateral for about $200 million. If it proved possible to extract from commercial banks such a stand-by facility, we agreed with the Yugoslavs that other types of new money by commercial banks could be of a voluntary type, notably cofinancing.

But evidently an overall viable agreement is dependent upon a satisfactory outcome of the discussions on the adjustment program, on a positive outcome of the governmental meeting in January, and based on the attitude of governments, on a revision of the present attitude of commercial banks.

cc: Mr. Whittome
Mr. Schmitt
Mr. Collins
Mr. Petersen
CED

Table 1. Yugoslavia: Balance of Payments with the Convertible Currency Area, 1982-84

(In millions of U.S. dollars)

	1982	1983		1984	
		Yugoslav estimate	Alternative	Yugoslav estimate	Alternative
Exports	5,526	6,400	6,300	7,700	7,200
Imports	-9,043	8,450	-8,450	9,100	8,800
Trade balance	-3,517	-2,050	-2,150	-1,400	-1,600
Invisibles (net)	2,003	1,925	1,925	2,200	2,100
Workers' remittances	1,085	1,265	1,265	1,440	1,135
Tourism	1,224	1,335	1,335	1,080	1,510
Interest payments	-1,670	-1,690	-1,690	-1,840	-1,890
Others	1,364	1,015	1,015	1,520	1,345
Current account	-1,514	-125	-225	800	500
Medium- and long-term debt	-117	1,230	1,175	-20	190
Drawings	1,684	3,880	3,825	2,825	3,135
Repayments	-1,626	-2,450	-2,450	-2,645	-2,745
Loans extended	-175	-200	-200	-200	-200
Short-term debt	-506	-500	-600	---	---
Errors and omissions	562	-585	-750	---	-300
Total	-1,575	20	-350	-780	390
Use of Fund Credit	563	410	410	220	120
Reserve movements (increase -)	1,012	-430	-10	-1,000	-510

Table 2. Yugoslavia: Drawings on Medium- and Long-Term Debt in Convertible Currency by Creditor

(In millions of U.S. dollars)

	1983		1984	
	Yugoslav estimate	Alternative	Yugoslav estimate	Alternative
Government packages	839	831	1,006	1,100
Berne	839	831	456	350
Refinancing	(304)	(304)	(...)	(3)
New financial credits	(180)	(172)	(...)	(...)
Suppliers credits	(355)	(355)	(456)	(347)
Geneva	...	...	550	750
Refinancing	...	...	(400)	(500)
Suppliers credits	...	...	(150)	(250)
Commercial bank package	1,580	1,580	1,100	1,300
Refinancing	980	980	1,000	1,100
New financing	600	600	100	200
IBRD	320	350	530	485
Regular facilities	250	280	250	280
SAL	70	70	280	205
Other multilateral lenders IFC, EIB and Eurofirms	30	50	... 1/	50
Suppliers credits outside Government packages	1,111	1,014	189	200
Subtotal	3,880	3,825	2,825	3,135
IMF	590	590	500	400
Total	4,470	4,415	3,325	3,535

1/ Included in drawings on the IBRD.

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1983 DEC 12 PM 6:28

MR. HANS SCHMITT
BELGRADE INTERCONTINENTAL
BELGRADE
YUGOSLAVIA

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(______) CODE

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PLEASE LET ME KNOW WHAT WOULD BE THE REQUIRED ADJUSTMENT SHOULD THE BANKS NOT BE PREPARED TO PUT FORWARD NEW MONEY AND SHOULD THE GOVERNMENTS AND OURSELVES FOLLOW THEIR EXAMPLE.

REGARDS,

ALAN

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MR. HANS SCHMITT

INTERCONTINENTAL HOTEL

BELGRADE

YUGOSLAVIA

DISPATCHED IMF

1983 DEC 12 PM 5 02

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SORRY TO ADD TO YOUR TASKS AND TO STRESS WHAT YOU ALREADY KNOW. BUT YOU WILL HAVE HEARD FROM PAUL ON THE LONDON MEETING AND SO HAVE GOVERNMENTS. THE DESIRE FOR A BALANCE OF PAYMENTS ESTIMATE FOR 84 THAT IS INHERENTLY REASONABLE AND ACHIEVABLE WITH ASSUMPTIONS MADE SPECIFIC IS VERY STRONG AND WE SHALL NEED THIS FOR JANUARY. AS FAR AS POSSIBLE WE ALSO NEED TO GAZE AT 1985.

BEST REGARDS,

ALAN

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C — TELEX NO.: CABLE ADDRESS:

D — DRAFTED BY NAME (TYPE): L. A. WHITTOME EXT.: 72878 DEPT.: EUR DATE: 12/12/83

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MR. HANS SCHMITT
INTERCONTINENTAL HOTEL
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YUGOSLAVIA

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REGARDS,

ALAN

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MR. HANS SCHMITT
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YUGOSLAVIA

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PLEASE ENSURE THAT YOU OBTAIN AS PRECISE A POSSIBLE BREAKDOWN OF THE DIFFERENCE IN 1983 BETWEEN THE CURRENT ACCOUNT OUTTURN ON A TRANSACTIONS BASIS AND ON A PAYMENTS BASIS. PLEASE ALSO ENSURE THAT YOU OBTAIN FIRMEST COMMITMENTS FROM THE YUGOSLAVS ON TIGHTER CONTROL OF REPATRIATION PROCEEDS.

REGARDS,

ALAN

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cc: CED

12085 ICHBEG YU

BEOGRAD, 08.12.83.
HOTEL INTER.CONTINENTAL
TLX NO 4113/GP

ORIG: EURO

INTERNATIONAL MONETARY FUND
WASHINGTON, DC. 20431

YUGOSLAVIA MISSION
HANSEN ARRIVED AS SCHEDULED.
SCHMITT.

+++

440040 FUND UI
??LPOWPIT ICHBEG YU
REPLY VIA ITT

TIME: 06:02 12/08/83 EST
CONNECT TIME : 64 SECONDS

no notification made

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

December 8, 1983

Dear Mr. State Secretary Probst,

I have been examining the Yugoslav situation and I wanted to write to you to underline the importance I attach to the efforts that have been initiated under your chairmanship to organize a satisfactory package of financial support for the continued stabilization efforts of Yugoslavia.

I have written to Secretary Regan and to Minister Stoltenberg to stress the need for governments to commit new export and commodity credits in 1984 in order to provide some cushion against the uncertainties unavoidably inherent in the Yugoslav position. You can be assured that we are determined to work with the Yugoslav authorities to ensure that Yugoslavia will again adhere to a strict adjustment program in order to secure a significant current account surplus in 1984. This is, as you know, the firm intention of the Yugoslav authorities.

I hope that the major governments will provide the support necessary to secure a positive result in time for the meeting of the group of creditor countries that will be chaired by you in January.

With best wishes,

Sincerely yours,

J. de Larosière

State Secretary Raymond Probst
Ministry of Foreign Affairs
3003 Berne
Switzerland

cc: Mr. Martin
to all

December 8, 1983

Mr. Whittome:

David Finch called me this morning on Yugoslavia. He wants you to be aware of the following situation:

1. Collins called him to let him know that the letters going out to the creditor governments asking for help on Yugoslavia had, because of a lack of time, not been signed by the MD. Collins had, however, been asked to give the letters to Erb and Laske unsigned and to indicate that they would be signed later.

2. On receipt of the letter, Erb expressed surprise. This was not the way he understood things were to move. Indeed, he thought this approach to be counterproductive, but would check with his superiors.

3. The Germans have already dispatched the letter to Bonn. But Grosche had indicated that the initiative was not particularly welcome and that they would be happy to treat the letter as a draft.

4. Finch has kept the DMD and Collins informed. Erb hasn't come back to him yet.

Peter Hole

Office Memorandum

December 8, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia

Jack Clark telephoned to ask about the London meeting on Yugoslavia. I explained our position and why we held it. He was rather taken with the stand-by approach and promised to explore further.

L. A. Whittome

cc: Mr. Schmitt
Mr. Mentré
Ms. Ripley
CED

cc: Area Dept. Heads
OED
HOS

Mr Whittome

DEC 8 1983

I am afraid the bankers are unrealistic about new money. We should prepare a scenario with no "new money" from any party. What would that entail in terms of [illegible]?

Dec. 9. 83.

Office Memorandum

December 8, 1983

TO: The Managing Director
The Deputy Managing Director

FROM: L. A. Whittome

SUBJECT: Yugoslavia

1. At a long dinner on December 5, hosted by Manufacturers Hanover Trust, Smole began by emphasizing the great reduction in Yugoslav short-term external debt that had occurred during 1983. He said that they wanted to approach the question of new money very carefully and would not favor new money being linked to rescheduling. Nor were they wedded to 100 percent rescheduling; 90 percent or 80 percent might be sufficient.

I summarized the position as we saw it asking for an immediate standstill; the rescheduling of 1984 maturities; agreement to maintaining the arrangement for short-term debt for one year beyond January 1985; and preparedness to consider new money. The bankers then spoke and in summary their position was:

Barclays: If new money needed would prefer trade credit. Standstill agreeable but essential to keep interest payments fully up to date.

Société Generale: Need just to know conclusions of intergovernmental talks. Rescheduling of 1984 maturities was no big problem. If new money needed would prefer to finance downpayments on government export credits.

Credit Anstalt: Will be more difficult in 1984 than in 1983 to assure 100 percent rescheduling. Want to see Yugoslavs re-entering the credit markets as soon as possible; might begin on a small scale in 1984. Must keep all creditors in line.

Westdeutsche Landesbank: A standstill would be useful.

Bank of America: Request for forced new money would be counterproductive for Yugoslavia's credit standing. Should concentrate on rescheduling and for less than 100 percent. Must avoid being locked into a series of reschedulings. Agree on standstill.

Bankers Trust: Urgent need for structural reforms and until they were in place new money was a red herring. Could be open minded on new money.

Chase Manhattan: Any prolongation of short-term debt must be wholly voluntary. If approached this way short-term credit lines would be increased.

Citibank: No need to find new money now; rather wait until autumn, then reassess. Need an official statement that Yugoslavia needed assistance in 1984 and a standstill. Would support a rescheduling of 1984 maturities.

2. A full meeting of the ICC again chaired by Manufacturers Hanover Trust took place on December 6. We had earlier been able to speak further to the Yugoslav delegation and on this occasion they were much more careful when discussing the question of new money. However, they did not disguise the fact that their main preoccupation was to secure a reduction in the charges they had to pay. They explained that they had come under a lot of criticism on this subject in Parliament.

I then spoke and went through the 1983 outturn, the approach being taken in 1984, the results of the November meeting of governments in Geneva, and the policies and possible outturn for 1984. I stressed that new money was essential to provide a needed safety net against the uncertainties necessarily inherent in the current account evolution in 1984, the risk that the balance would be much less favorable on a payments basis than on a transactions basis, and the certainty that rescheduling would not be 100 percent effective.

In the subsequent discussion on reserves, it seemed eventually to be clear that usable reserves had been no more than some $150 million before the latest disbursement of the banks' $600 million loan.

The bankers asked a number of questions of the Yugoslavs. The main areas on which they concentrated were:

(a) the need to ensure that delays on interest payments were brought to an end;

(b) the need to ensure that export proceeds were fully and rapidly remitted; and

(c) the need to impose financial discipline on enterprises.

yes

The Yugoslavs then left the room and I spoke again on the question of new money, stressing that no new money from the banks would surely mean no new money from governments in which case we were not prepared to be the only provider of new money. My recommendation in these circumstances would be that we should agree to a stand-by of an amount which would approximately cover the repurchases due us (some SDR 270 million). I stressed that this would leave the Yugoslavs in an extremely exposed position and if the banks were sincere in their repeatedly expressed wish to see Yugoslavia's credit restored then this course entailed very large risks. It inevitably implied the possibility of an emergency meeting later in 1984.

The only point made by the banks at this session was that the Yugoslavs would never take the measures necessary unless "their feet were held to the fire."

The bankers then met alone and in the evening the Yugoslavs and we again joined them. Mr. Dobrich as Chairman said that the banks would agree to an immediate standstill and to a 100 percent rescheduling of 84 maturities on marginally more favorable maturity terms than in 1983, e.g., four years' grace instead of three. Dobrich also said that if rescheduling was for less than 100 percent of the amount falling due then the spread and possibly other charges might be reduced. He said nothing on the January 1985 maturities nor on new money. Smole made a generally conciliatory statement but left his reaction less than clear. I said that I thought the offer disappointing. I went again into the argument for new money in front of the Yugoslavs. I repeated that we could not in such circumstances provide net new money.

Later individual bankers gave us their personal impressions and a late meeting with Dobrich also provided some insight. Unfortunately, there is a clear gap between what the bankers individually told us and what they collectively decided. Dobrich described one large U.S. bank as wholly hypocritical, adopting one attitude in front of us and another when only bankers were present.

Finally, I said to all the bankers that we should now have to assess the outcome of the intergovernmental meetings due in January and it might then be necessary to call for another meeting with the banks. I stressed that I hoped that when reporting to their senior managements they would fully report our reservations.

In sum, the meeting was disappointing but it was the first salvo of what will doubtless prove to be another long campaign. Most of the banks tell us that if the provision of new money is divorced from the rescheduling it will prove impossible to corral the 600 odd banks involved, in which case the burden will fall on a few large banks and few of them will be prepared to act. Some thought our suggestion of a stand-by from the banks useful but others emphasized that it would have to be shown by them as an increase in their exposure to Yugoslavia and would not therefore be acceptable.

The next day one large U.S. bank sought to persuade us that a significant sum of new money could be obtained in 1984 from a gradual restoration of trade-related credits. Personally, I am skeptical.

This meeting was another example of how much weaker our position becomes when we cannot ourselves chair the meeting. It also showed how impossible our task becomes when the country's representatives concentrate on the important but minor aspect of charges when the real issue is that of new money. Moreover, by naively disclosing their hand, the Yugoslavs facilitated the banks' sympathetic reference to charges but silence on new money.

We shall now have to assess the January meetings. If governments can be induced to take a strong line, then it might be possible to hold a joint meeting of governments and banks around late January under the chairmanship of the Swiss who are normally amenable to our suggestions. The new money issue could then be reopened.

L. A. Whittome

cc: Mr. Finch
Mr. Schmitt
Ms. Ripley
Mr. Collins

SCHEDULE OF MEETINGS
London, Dec. 4-8

Sunday, December 4	8.30 p.m. 10.0 pm	Joanne Salop Home
Monday, December 5	10.15 a.m.	Mr. Karcz 47 Portland Place W.1
	lunch	Polish Embassy
	5.00 p.m.	Mr. Mentré/Mr. Hansen
	7.00 p.m.	Dinner with commercial bankers and Yugoslavs at Manufacturers 7 Princes Street (*)
Tuesday, December 6	10.45 a.m.	Meeting and luncheon with commercial bankers and Yugoslavs Strand Palace Hotel The Strand (Burleigh Suite) Ph. 836-8080 at meeting
	lunch resume 2.30 pm	
	6.0 p.m.	Mr. Brehmer/Mr. Prust
	8.00 p.m.	Dinner with U.K. mission team and Mr. Dow and Mr. Burns The Dorchester Hotel (Terrace Room)
	8.0 am	B'fast Bankers Trust Claridges
Wednesday, December 7	8.00 p.m.	Dinner with MD and Mr. Totu (Deputy Prime Minister); Mr. Petre Gigea, Mr. Liviu Ionescu; Mr. Stella Marin from Romania The Dorchester Hotel

(*) Mr. Dobrich will be staying at the Churchill Hotel, 30 Portman Sq., telephone 486-5800.

Browns Hotel: 493-6020 (Lynne's room No. 220)

MD Dorchester

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

cc: CED

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MR. HANS SCHMITT
INTERCONTINENTAL HOTEL
BELGRADE
YUGOSLAVIA

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REGARDS,

ALAN

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11-18-82

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Office Memorandum

TO : Mr. Whittome

DATE: December 6, 1983

FROM : Geoffrey Tyler GT

SUBJECT : Yugoslavia

The Managing Director did not sign the letters to Secretary Regan and Mr. Stoltenberg before he left. Mr. Collins will ask him to sign them when he returns on Thursday. If you wish, Mr. Collins would send them by express mail. It has not seemed to me that this would be necessary and I therefore have not myself asked Mr. Collins to take this action.

AMENDED COPIES

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

December 8, 1983

Dear Mr. State Secretary Probst,

I have been examining the Yugoslav situation and I wanted to write to you to underline the importance I attach to the efforts that have been initiated under your chairmanship to organize a satisfactory package of financial support for the continued stabilization efforts of Yugoslavia.

I have written to Secretary Regan and to Minister Stoltenberg to stress the need for governments to commit new export and commodity credits in 1984 in order to provide some cushion against the uncertainties unavoidably inherent in the Yugoslav position. You can be assured that we are determined to work with the Yugoslav authorities to ensure that Yugoslavia will again adhere to a strict adjustment program in order to secure a significant current account surplus in 1984. This is, as you know, the firm intention of the Yugoslav authorities.

I hope that the major governments will provide the support necessary to secure a positive result in time for the meeting of the group of creditor countries that will be chaired by you in January.

With best wishes,

Sincerely yours,

J. de Larosière

State Secretary Raymond Probst
Ministry of Foreign Affairs
3003 Berne
Switzerland

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

December 8, 1983

Dear Mr. Stoltenberg:

As you know, we have started work on a possible IMF stand-by with Yugoslavia for 1984, and a meeting of creditor governments on Yugoslavia was held in Geneva on November 18. Any involvement of the Fund in 1984 depends upon a satisfactory inter-related financial package involving creditor governments, commercial banks, the World Bank, and the IMF.

It was agreed in Geneva that the group of creditor countries chaired by Switzerland will meet again in January to address this issue, and that this meeting should be preceded by a meeting of two sub-groups, one dealing with the refinancing/rescheduling of external debts due to governments and another dealing with the other components of a financial program.

On this second question, I believe it essential that, as in 1983, commitments on export credits and commodity credits be taken by governments in order to provide some cushion against the uncertainties necessarily building up in Yugoslavia's reserves. We estimate that Yugoslavia's freely usable reserves are presently negligible. A continuous flow of new export credits is essential if a viable balance of payments outcome is to be achieved over the next two years.

It is very evident that for its part Yugoslavia will have to adhere to a strict adjustment program designed to secure a significant current account surplus in 1984. In pursuing this objective Yugoslavia will be able to build on the marked improvement already achieved in recent years. The current account deficit narrowed from a peak of US$3,300 million (5.5 percent of GSP) in 1979 to US$1,400 million in 1982, and US$400 million in 1983 (1 percent of GSP) as the result of tight demand management combined with a significant depreciation of the exchange rate. Real personal incomes per employee in the socialized sector fell by more than 10 percent in 1983.

As you know, the question of other financial flows will be looked at in a meeting which will be chaired by an IMF representative. Clearly, however, no positive result can be obtained without the political involvement of major governments. In view of the importance of Germany, especially as a trading partner of Yugoslavia and given its constructive attitude to the provision of financial support to Yugoslavia, I would greatly appreciate it if you could through your contacts with other EC governments, seek to achieve the necessary understanding for a successful result to be achieved. I have asked Mr. Whittome and Mr. Mentré to stand ready to have such further contacts with your associates as might be helpful. I note that Mr. Mentré visited Bonn earlier this month to have a preliminary discussion on this subject. Evidently your personal involvement would be of major importance.

Sincerely yours,

J. de Larosière

Mr. G. Stoltenberg
Minister of Finance
Graurheindorfer Str.
53 Bonn
Federal Republic of Germany

INTERNATIONAL MONETARY FUND
WASHINGTON

MANAGING DIRECTOR

December 8, 1983

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It is my hope that the U.S. Government, which played a most constructive role in the discussions which led to the 1983 package, will be able to play a similar role for the 1984 package. I realize that a lead from a major European country would be very important and I am also writing to Mr. Stoltenberg to seek his help.

Sincerely yours,

J. de Larosière

Secretary Donald T. Regan
U.S. Treasury
Washington, D.C.

cc: CED

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BEOGRAD, 06.12.83.
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TLX NO 4047/GP

ORIG: EURO
CC: ETR
ADM

YUGOSLAVIA MISSION
SCHMITT, LEWIS, PETERSEN ARRIVED SAFELY.

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REPLY VIA ITT

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440040 FUND UI

Note: No individuals called.

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ADM

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CONNECT TIME : 153 SECONDS

Office Memorandum

cc: EP Thanks. For the time being we can leave this issue. I think for it has largely been overtaken by events. We shall need to come back to it in due course. 8/12

TO : Mr. Whittome

DATE: December 6, 1983

FROM : Geoffrey Tyler GT

SUBJECT : Yugoslavia - Use of Fund Resources

The Managing Director has asked about the financing of repurchases (in and?) after 1986. The most recent projections for 1986 that we have been able to find appear to be out of date since the gross use of Fund resources included in them are smaller than those given in your memorandum.

However, I imagine that the short answer to the Managing Director is that basically repayment will depend on a sustained improvement in the current account balance from a deficit of about $0.5 billion in 1983 to a surplus approaching $1.0 billion by 1986. Official assistance will need to continue at levels somewhat less than current provisions but still of the order of $0.5 billion. By 1986, banks may not have to provide new financial credits but they will have to refinance medium- and long-term maturities of around $1.5 billion and roll over $1.5 billion of short-term credits. The World Bank can reasonably be expected to continue lending at current levels ($0.4-0.5 billion). For ourselves, we could hope to have some net repayment by 1986 but, unless the current account improves more rapidly than expected, we would probably be deluding ourselves if we thought that some Fund purchases would not be required.

The above estimates are broadly consistent with the attached estimates made in September last. They may be overtaken by forecasts prepared by the mission currently in Belgrade. We have not been able to find any projections going beyond 1986.

cc: CED

From Mr Harrison's memo of Sept. 1, 1983

Table 1. Yugoslavia: External Financing Estimates for Transactions with Convertible Currency Area

(In billions of U.S. dollars)

	1983			1984	1985	1986
		Staff estimates				
	Original commitments	March 1983 Board discussion	Latest estimates			
A. Gross external financing needs						
Current account balance	-0.5	-0.5	-0.7	--	0.5	0.8
Medium and long-term maturities	-2.6	-2.6	-2.7	-2.7	-2.5	-3.1
Short-term maturities	-1.8	-1.8	-1.8	-1.5	-1.5	-1.5
"Clean-up" of external arrears	-0.4	-0.4	-0.3	--	--	--
Other obligations 1/	-0.2	-0.2	-0.3	-0.5	-0.6	-0.6
	-5.5	-5.5	-5.8	-4.7	-4.1	-4.4
B. External financing sources						
Official assistance	1.3	0.9	0.9	0.9	0.4	0.6
New financial credits	(0.4)	(0.3)	(0.2)	(0.2)	--	--
New suppliers' credits	(0.9)	(0.5)	(0.3)	(0.2)	--	--
Rollover or refinancing of medium and long-term maturities		(0.1)	(0.4)	(0.5)	(0.4)	(0.6)
Foreign banks	4.2	4.2	3.4	3.3	2.9	2.9
New financial credits	(0.6)	(0.6)	(0.6)	(0.4)	(--)	(--)
Refinancing of medium and long-term maturities	(1.4)	(1.4)	(1.3)	(1.4)	(1.4)	(1.4)
Rollover of short-term maturities	(1.8)	(1.8)	(1.5)	(1.5)	(1.5)	(1.5)
Funds for "cleaning-up" arrears	(0.4)	(0.4)	(--)	(--)	(--)	(--)
Other suppliers' credits	0.2	0.1	0.4	0.7 2/	0.7	0.8
World Bank, EIB	0.5	0.5	0.4	0.5	0.5	0.4
IMF	0.6	0.6	0.6	0.3	0.2	0.3
BIS (net) 3/	--	--	--	--	--	--
	6.8	6.3	5.7	5.7	4.7	4.4
C. External reserves change	1.3	0.8	-0.1	1.0	0.6	--

Source: National Bank of Yugoslavia; and IMF staff estimates.

1/ Comprises largely repurchases due to Fund and loans extended to finance Yugoslav capital goods exports.

2/ Includes an estimated $250 million in utilization of suppliers' credits from the 1983 "Berne package."

3/ The $500 million expected to be disbursed during the year is expected to be fully repaid by November 15, 1983.

Mr. Whittome

Office Memorandum

December 6, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia - Use of Fund Resources

Mr. Collins rang me to ask why there was a difference between the two figures given for scheduled repurchases in 1984 contained in the memorandum of December 2, 1983 from Mr. Whittome to the Managing Director. I explained to Mr. Collins that the figure in the text included all the repurchases while the figure in Table 1, as noted in Footnote 1, excluded CFF repurchases. The difference between the two figures is accounted for by CFF repurchases. The difference between the table and text is in fact explained in the final sentence of the memorandum.

GT

Geoffrey Tyler

cc: Mr. Whittome
CED

cc: HOS
CED

Office Memorandum

Mr Finch
Mr. Whittome
DEC 2 1983
We should seek from the banks the most we can. I should have thought that if we pitch our own figure at 500 m. $ the [illegible] will be [illegible] 50-50 [illegible] possible.
Dec. 3.83

TO: The Managing Director

December 2, 1983

FROM: L. A. Whittome

SUBJECT: Yugoslavia - Use of Fund Resources

You asked whether Yugoslavia needed a 1984 stand-by for SDR 450 million.

Our (European Department) preference for SDR 450 million is based on two main considerations and one background thought. First, in preliminary talks with Yugoslav officials we have spoken in terms of figures ranging up to US$500 million, which we would interpret as SDR 450 million. Of course, firm commitments could not have been made, nor were they. However, to reduce the maximum amount for 1984 could, at this stage, risk the appearance that the Fund's resolve to support Yugoslavia was weakening.

The [illegible] is not a good one.

Second, offering as much as SDR 450 million in 1984 would provide us with what we regard as probably the minimum leverage necessary to have a reasonable chance of negotiating a suitably tough program and of obtaining some new finance from both the banks and the governments. We have taken the position that we should be prepared to go to SDR 450 million only as long as new money can be obtained from banks and governments. If these creditors were only to maintain their exposure to Yugoslavia, the Fund should do the same which would imply a stand-by of SDR 270 million for 1984. As you know, without new money there is no realistic chance that Yugoslavia can build up its international reserves which will mean that we can already be absolutely certain that we shall be involved in a new financing package for 1985. The background thought has two aspects. First, given scheduled repurchases of about SDR 270 million in 1984 the figure we would propose implies net lending of SDR 180 million, approximately US$200 million, which is the sum of new money which we hope to get from both the banks and the governments though we shall pitch our initial suggestion at a somewhat higher level. In contrast, under Mr. Finch's proposal the net increase would be SDR 100 million. Second, Yugoslavia would now be eligible to draw on the CFF probably at least SDR 300 million. We would prefer not to see this issue raised but we fear that it inevitably will be if the net lending we are proposing appears derisive.

I don't agree: if we can get more from the banks, we should do [illegible]. ?

You also queried whether the program to be negotiated should be described as tough, given the structural imbalances still prevalent. Perhaps this is partly a matter of semantics. Certainly structural imbalances are likely to persist for some time. But the 1983 program resulted in a reduction of real wages in the socialized sector of 10 percent and by most standards this is surely tough. It is true that other incomes from agricultural plots, the black economy, and interest helped reduce the burden on many households as can be seen from the consumption figures, but certainly some households must have suffered. In 1984, the program we are negotiating implies a further fall in real wages; hopefully we shall also be able to secure the introduction of effective measures to impose financial discipline on enterprises.

Finally, you asked for a medium-term profile of Yugoslavia's use and repurchases of Fund resources. I attach a table showing the sort of the scenario we have in mind. Please note that the table excludes the CFF and therefore shows net purchases of SDR 285 million in 1984.

Attachment

cc: The Deputy Managing Director (o/r)
Mr. Finch
Mr. Collins

Repurchases after 86?
How will they repay?
(your projections on BOP)

Table 1. Yugoslavia: Use of Fund Credit 1/

(In millions of SDRs)

	1981	1982	1983	1984	1985	1986
Purchases	554.0	554.0	554.0	450.0	400.0	?
Repurchases	--	--	44.2	165.4	304.8	343.7
Net purchases	554.0	554.0	509.8	284.6	95.2	
Use of Fund credit, end of period	790.2	1,344.2	1,853.9	2,138.5	2,233.7	
(in percent of old quota)	190.2	323.5	446.2			
(in percent of new quota)			302.4	348.9	364.4	

1/ Excluding purchases under the CFF and oil facilities.

SPECIAL DELIVERY
CABLE

CC: HS (via W. Lewis)
CED

IMF OFFICIAL CABLE

V: 2.08281

RECEIVED
IMF CABLE ROOM

587072

1983 DEC -2 AM 7:48

440040 FUND UI

11574 NARBAN YU
T/35697 BEOGRAD 2 12 83 H 13 05

ORIG: MR. SCHMITT
CC: MR. POLAK

INTERFUND 440040
WASHINGTONDC

FOR MR.H.SCHMITT, EUROPEAN DEPARTMENT.
IN REPLY TO YOUR CABLE OF NOVEMBER 29,1983 WISH TO INFORM YOU THAT
I HAVE ARRANGED REQUIRED MEETING FOR YOURSELF AND MR.MENTRE ON
BOP
PROSPECTS AND EXTERNAL FINANCING POSSIBLITIES FOR THE SUGGESTED
DAYS.
BEST REGARDS, M.VELJKOVIC

NARODNBANKAK JUGOSLAVIJE BEOGRAD

440040 FUND UI

11574 N
REPLY VIA ITT

?

TIME: 07:04 12/02/83 EST
CONNECT TIME : 252 SECONDS

Office Memorandum

December 2, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia

Mr. Mentré telephoned to say that the French Treasury would now propose two of the following three days for the meeting on Yugoslavia, namely, January 11, 12 and 13. It was agreed that the meeting would take place in the Fund's office in Paris.

L. A. Whittome

cc: Mr. Schmitt
Mr. Hansen
CED

The Managing Director December 2, 1983

L. A. Whittome

Yugoslavia

I attach the letters to Secretary Regan and Minister Stoltenberg for your signature. I also attach a draft letter to State Secretary Probst who is I think the proper person for you to write to. In this letter I have not rehearsed past adjustment efforts for these are well known to him.

Attachments (3)

cc: The Deputy Managing Director (o/r)
Mr. Collins

CED

INFORMATION COPY

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

December 1, 1983

Dear Mr. Secretary,

As you know, we have started work on a possible IMF stand-by with Yugoslavia for 1984, and a meeting of creditor governments on Yugoslavia was held in Geneva on November 18. Any involvement of the Fund in 1984 must depend upon a satisfactory inter-related financial package involving creditor governments, commercial banks, the World Bank, and the IMF.

It was agreed in Geneva that the group of creditor countries chaired by Switzerland will meet again in January to address this issue, and that this meeting should be preceded by a meeting of two sub-groups, one dealing with the refinancing/rescheduling of external debts, due to governments and another dealing with the other components of a financial program.

On this second question, I believe it essential that, as in 1983, commitments on export credits and commodity credits be made by governments in order to provide some cushion against the uncertainties necessarily building up in Yugoslavia's reserves. We estimate that Yugoslavia's freely usable reserves are presently negligible. A continuous flow of new export credits is essential if a viable balance of payments outcome is to be achieved over the next two years.

It is very evident that for its part Yugoslavia will have to adhere to a strict adjustment program designed to secure a significant current account surplus in 1984. In pursuing this objective Yugoslavia will be able to build on the marked improvement already achieved in recent years. The current account deficit narrowed from a peak of US$3,300 million (5.5 percent of GSP) in 1979 to US$1,400 million in 1982, and US$400 million in 1983 (1 percent of GSP) as the result of tight demand management combined with a significant depreciation of the exchange rate. Real personal incomes per employee in the socialized sector fell by more than 10 percent in 1983.

It is my hope that the U.S.Government, which played a most constructive role in the discussions which led to the 1983 package, will be able to play a similar role for the 1984 package. I realize that a lead from a major European country would be very important and I am also writing to Mr. Stoltenberg to seek his help.

Sincerely yours,

J. de Larosière

Secretary Donald T. Regan
U. S. Treasury
Washington, D.C.

INTERNATIONAL MONETARY FUND
WASHINGTON, D. C. 20431

MANAGING DIRECTOR

CABLE ADDRESS
INTERFUND

December 1, 1983

Dear Mr. Stoltenberg:

As you know, we have started work on a possible IMF stand-by with Yugoslavia for 1984, and a meeting of creditor governments on Yugoslavia was held in Geneva on November 18. Any involvement of the Fund in 1984 must depend upon a satisfactory inter-related financial package involving creditor governments, commercial banks, the World Bank, and the IMF.

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As you know, the question of other financial flows will be looked at in a meeting which will be chaired by an IMF representative. Clearly, however, no positive result can be obtained without the political involvement of major governments. In view of the importance of Germany, especially as a trading partner of Yugoslavia and given its constructive attitude to the provision of financial support to Yugoslavia, I would greatly appreciate it if you could through your contacts with other EC governments, seek to achieve the necessary understanding for a successful result to be achieved. I have asked Mr. Whittome and Mr. Mentré to stand ready to have such further contacts with your associates as might be helpful. I note that Mr. Mentré visited Bonn earlier this month to have a preliminary discussion on this subject. Evidently your personal involvement would be of major importance.

Sincerely yours,

J. de Larosière

Mr. G. Stoltenberg
Minister of Finance
Graurheindorfer Str.
53 Bonn
Federal Republic of Germany

DRAFT
12/1/83

Dear Mr. State Secretary Probst,

I have been examining the Yugoslav situation and I wanted to write to you to underline the importance I attach to the efforts that have been initiatied under your chairmanship to organize a satisfactory package of financial support for the continued stabilization efforts of Yugoslavia.

I have written to Secretary Regan and to Minister Stoltenberg to stress the need for governments to commit new export and commodity credits in 1984 in order to provide some cushion against the uncertainties unavoidably inherent in the Yugoslav position. You can be assured that we are determined to work with the Yugoslav authorities to ensure that Yugoslavia will again adhere to a strict adjustment program in order to secure a significant current account surplus in 1984. This is, as you know, the firm intention of the Yugoslav authorities.

I hope that the major governments will provide the support necessary to secure a positive result in time for the meeting of the group of creditor countries that will be chaired by you in January.

With best wishes,

Sincerely yours,

J. de Larosière

State Secretary Raymond Probst
Ministry of Foreign Affairs
3003 Berne
Switzerland

Office Memorandum

December 2, 1983

MEMORANDUM FOR FILES

Subject: Yugoslavia

Mr. Mentré said that looking again at the tables put together by Mr. Petersen, he continued to feel there were questions surrounding the outturn in 1983 of the current account balance with the nonconvertible area. In particular there were questions regarding oil imports. He also warned that part of the explanation for the strong export performance to the convertible area in 1983 was the rise in exports of petroleum products which, as far as he knew, was in a significant part due to the re-export of oil imported from Lybia. He warned that this might well prove to be a once for all benefit.

/ Dw/

L. A. Whittome

cc: Mr. Schmitt
Mr. Hansen
CED

Subject

Office Memorandum

TO : The Managing Director DATE: December 1, 1983

FROM : L. A. Whittome

SUBJECT : Debt Charges: Yugoslavia

A. I told you at your meeting this morning that the spread charged Yugoslavs on new money was 2 1/4 percent. I was wrong. The charges for the new money loan ($600 million) were:

a. Spread: LIBOR plus 1 7/8 percent or prime plus 1 3/4 percent at creditors' option.

b. Facility fee: 1 1/8 percent on the amount of each tranche.

c. Commitment fee: 1/2 percent p.a. on the unused portion of the commitment starting from the date of the agreement.

d. Agency fee: $500 p.a. per creditor (some 600 banks involved).

In addition there were "out-of-pocket" expenses including legal costs of banks which the banks attributed to Yugoslavia. (In practice most large banks retain a legal firm for an annual retainer which can be around $2-3 million which is meant to cover all the work done for that bank.)

B. On the medium-term debt that was rescheduled the charges were:

a. Spread: LIBOR plus 1 7/8 percent or prime plus 1 3/4 percent creditors' option

b. Facility fee: 1 1/8 percent of each loan rescheduled.

c. Agency fee: $800 per creditor for the first year; $750 per creditor for each subsequent year.

C. On the short-term debt rolled over the charges were:

a. Spread: LIBOR plus 1 3/8 percent or prime plus 1 1/4 percent creditors' option

b. Stand-by fee: 1/4 percent on amount outstanding.

c. Agency fee: between $800 and $500 per creditor according to the type of facility extended.

In addition, the Yugoslavs have had to pay for the legal fees of their own advisors and for the accounting services of Peat, Marwick and Mitchell.

cc: The Deputy Managing Director; Mr. Finch, Mr. Shaalan; Mr. Tun Thin; Mr. Wiesner; Mr. Zulu; Mr. Collins; CED; HOS

Mr. Clark December 2, 1983

L. A. Whittome

London

In a recent memorandum (November 29th) I informed Mr. Wicks of the discussions with the banks and the Yugoslavs scheduled to take place in London on Decmmber 5th and 6th.

I would now also like to let you know that, although we do not yet have final confirmation, we expect to be meeting with senior Romanian officials on December 6th and 7th in London and to be meeting with the Minister of Finance of Romania on the 7th. We also expect the Managing Director to join this last meeting by flying over from Paris in the afternoon of the 7th.

Finally, I should warn you that the Deputy Minister of Finance of Poland may fly to London and meet with me on December 5th before the talks with the banks and Yugoslavs begin. I would ask for obvious reasons that this be kept confidential.

INFORMATION COPY

IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

DO NOT SOFT ROLL EXCEPT WHEN ALIGNING INTO LINE 23

START ADDRESS IN THE BOX

MRS. G. HOFMANN
NATIONAL BANK OF YUGOSLAVIA
BELGRADE, YUGOSLAVIA

DISPATCHED IMF
1983 DEC -1 PM 8 17

MARK XX FOR CODE
(______) CODE

DISTRIBUTION
MR. POLAK

START TEXT HERE

1. THIS IS TO INFORM YOU THAT MR. SUMAN BERY OF THE WORLD BANK WILL JOIN OUR MISSION FROM DECEMBER 8 TO 14.

2. MENTRE ARRIVING BELGRADE FROM LONDON ON DECEMBER 7 ON JU 211 AT 1800. WOULD BE GRATEFUL IF YOU COULD MAKE HOTEL RESERVATION FOR HIM AT INTERCONTINENTAL FOR NIGHTS OF DECEMBER 7 AND 8.

WITH BEST REGARDS,
SCHMITT

DO NOT TYPE HERE

IF REQUIRED INITIAL BELOW

SPECIAL INSTRUCTIONS ↑ TEXT MUST END HERE ↑

TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): L. HANSEN/V. BALL EXT.: 77270 DEPT.: EUR DATE: 12/1/83

AUTHORIZED BY NAME (TYPE): H. SCHMITT

AUTHORIZED BY NAME (TYPE):

(**)
TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

Log 4210

Schmitt

SIGNATURE (PLEASE KEEP SIGNATURE IN SPACE ALLOWED) SIGNATURE

EC. 48 REV 1 11-18-82

cc: Yugo file

PM P 4,5

Office Memorandum

To : Mr. Whittome

From : Arne Petersen

Subject: Yugoslavia: Various Issues Relating to the Financial Package

December 2, 1983

This note responds to your queries at yesterday's meeting. Mr. Hansen will have provided you with a separate memo on the commercial bank package.

1. Terms of Financial Credits and Rollover/Refinancing Under the Berne Agreement

Table 1 (attached) lists the conditions of loan agreements with individual countries under the Berne Agreement. This data was made available to me confidentially by Mr. Failletaz, who stressed that it should not be made available to anyone else--which I interpret to mean outside the Fund.

With the exception of the two small loans to Norway and Belgium, the terms are fairly similar and do not deviate much from the terms of the commercial bank agreements on maturity and grace period. The weighted average maturity for financial credits is 5.8 years, and the grace period is 3.2 years. The periods for rollover/refinancing are slightly shorter: 5.7 years and 2.5 years, respectively. These figures should be compared with an average maturity of 6 years and a grace period of 3 years for commercial banks' rollover of medium- and long-term debt, and with an average maturity of 5.64 years and a grace period of 2.64 years in the case of "new money."

Data on interest rates is more limited. In most cases, governments have indicated only that they are market related. No data are available on other costs involved in negotiating the agreements. As negotiations for financial credits were conducted with governments or government organizations who do not charge on a cost basis, other costs are likely to be substantially less than for the commercial bank facilities. In most cases of refinancing/rollovers, governments only extended the guarantees involved, and Yugoslav banks subsequently had to enter into negotiations with the creditor banks for the refinancing of due amounts. This is likely to have involved some costs, but of unknown quantity.

2. Utilization of credits under the Berne Agreement, 1983, and carryover, 1984

The attached Tables 3 and 4 (distributed earlier) show the projected utilization of credits under the Berne Agreement, and carryover into 1984. They are based on information given by creditor governments at the Geneva meeting on November 18, and should therefore be fairly firm. There are of course some uncertainties about the drawdown of suppliers' credits during the last 1 1/2 months of the year; the implied projection of US$31 million is probably a conservative estimate.

It should be possible to carry over unutilized credits into 1984. The relevant provision on which this is based is the attached statement by the Chairman, contained in the agreed memorandum of understanding of the Berne meeting. However, at the Geneva meeting a few governments indicated that the carryover might be limited, 1/ and Mr. Probst referred to the attached statement, emphasizing the need to keep the agreed credit lines open in 1984. It may be necessary to emphasize this again in the next round of meetings.

The amount of the carryover actually to be utilized is less certain. Our present estimate is that, of a total carryover of US$507 million, US$420 million will be used. This may be on the high side. Drawings on non-U.S. suppliers' credits in 1983 are estimated at US$140 million. While the low utilization is partly explained by the late implementation of the various agreements, there also seem to be some difficulties on the Yugoslav side in utilizing the credits, once they have been put in place, mainly due to the inflexible criteria for their utilization. 2/ The Yugoslav authorities have stated that they are considering ways to make the utilization more flexible. In the absence of firm evidence to this effect, it would perhaps be preferable to adopt a more cautious estimate of utilization of carryover under the Berne Agreement of some US$300 million.

3. Utilization of IBRD loans in 1983 and prospects for 1984

Our estimate for utilization of normal IBRD loans, as well as the drawings under the SAL in 1983, have been provided to us by the World Bank staff. The same applies to the 1984 projections. The IBRD staff have stated that they stand ready to negotiate a second SAL in the next fiscal year (starting July 1, 1984), once the second tranche of the present SAL has been released. 3/ Even if the second SAL is put in place in the second half of 1984, the World Bank staff estimate that it will be highly unlikely that any disbursements from it will be made in calendar 1984. They feel confident, however, that all of the carryover from SAL I can be utilized in 1984.

275

75 & 83

1/ Belgium indicated drawings could be made until March 31, 1984; Austria stated that credits would be available until end-September 1984; and Canada said the drawdown had initially been set to end on March 31, 1984, but, as agreement is not yet completed, the drawdown period is likely to be extended.

2/ The utilization of the suppliers' credits is tied directly to the production of export goods, with proof of export contracts needed.

3/ Certain problems need to be resolved before the release; one of the preconditions was that the Yugoslav authorities should provide a report on the foreign exchange allocation system, with recommendations for changes to the Fund and the IBRD by September, and that agreed proposals should be implemented with effect from January 1, 1984. Neither they nor we have yet seen such a report.

4. Other multilateral financial institutions

The estimate for drawings in 1983 on IFC, EIB, Eurofima, 1/ etc., is US$75 million, based on actual drawings of US$50 million during January-August 1983. The projection of US$50 million for 1984 may therefore be somewhat on the conservative side.

5. Rescheduling of Government direct and guaranteed debt in 1984

The following reflects my conversation with Mr. Brau yesterday:

a. Timing

He was of the firm opinion that creditor governments would not agree to a meeting with the debtor on the rescheduling of government debt until the program had been approved by the Fund Executive Board. Even though Mr. Jurgenson promised in Geneva to try to arrange a meeting date before Christmas, a consensus would have to be obtained among creditor countries, which would not be possible. The argument that the intended meeting was not a Paris Club meeting, but only a "Paris Club type" meeting was not likely to sway creditors from standard accepted procedures. 2/ In the case of Mexico, where the meeting had been held at the OECD, strict Paris Club procedures had been used.

In addition to the meeting with the debtor, it would probably be necessary to have an informal meeting among creditors, in which they would agree among themselves on the procedures to be followed in the meeting with Yugoslavia (as was done in the case of Mexico); this meeting could be held on the fringes of one of the regular Paris Club meetings before Christmas. A meeting on Zaire is presently expected to be held on December 19-20, and one on Liberia on December 21. If this is decided, Mr. Mentre could address the meeting, or Mr. Brau would be happy to be of assistance.

b. Standstill period

It was accepted--but not official--practice that a debtor country formally requesting a rescheduling of government guaranteed debt stopped payments on such debt from the beginning of the requested consolidation period (in the case of Yugoslavia, Jan. 1-Dec. 31, 1984). 3/ It was important, however, that Yugoslavia remained current on payments until the beginning of the consolidation period. The Fund would not view nonpayment after the beginning of the consolidation period as arrears.

1/ A Swiss-based multilateral institution for the financing of railway rolling stock.

2/ One could perhaps add the argument that, if the Paris Club allowed this, it would see an increase in the number of applications for Paris Club type meetings.

3/ This should not be publicized. Brazil leaked this to journalists, which was viewed as a faux pas by governments.

Thus, Yugoslavia would only need to request rescheduling before the end of the year. The timing of the actual meeting would therefore take on less importance.

c. Format of request for rescheduling

The normal format would be to deliver a letter to Mr. Camdessus requesting his favorable consideration of the rescheduling of debt due to official creditors in the specified consolidation period. It will be essential to specify that short-term maturities will not be included, or normal short-term operations will be stopped immediately. The letter should not state the terms requested by Yugoslavia, as this will be done in later contacts. It would be polite if the letter was delivered by someone of sufficient stature from Belgrade, rather than someone from the Embassy. Mr. Camdessus, in turn, will inform creditor governments, who will then not expect payment from the start of the consolidation period.

d. Terms and other matters

It may be possible to obtain rescheduling of perhaps 90 percent of maturities due for a nine-year period with four years grace. The down-payment of 10 percent could also be stretched out, so that perhaps as little as 2.5 percent had to be paid in calendar 1984. Of course, the Yugoslav authorities could ask for a 100 percent rollover, but this had to date only been given in "basket cases" and was not likely not be granted to Yugoslavia.

Mr. Brau added that it was often difficult to ascertain from the debtor how much was government guaranteed or not, which would have an implication on the burdensharing of the financial package. 1/ I agreed that there was an element of this in Yugoslavia's case, but that the magnitude was much smaller. Our present estimate is that debts due to commercial banks amount to US$1.5 billion, whereas those due to official creditors amount to US$0.6 billion. There may be some misclassification of perhaps US$0.1-0.2 billion. In any event, we have set our estimates at conservative levels so far. Mr. Brau noted that, as a new development, the Fund had, through Mr. Camdessus, requested data from creditor governments on the actual amounts guaranteed in the case of the Philippines. A similar request could be made for Yugoslavia, if it was found necessary.

6. Other matters

The question of how to proceed in the case of Yugoslavia depends on how close to or how far from Paris Club procedures we can and should go. Mr. Brau does not feel it will be possible to deviate appreciably from the standard procedures, although this may be more possible in this case than in Mexico's, since the two subgroups are formally reporting to

1/ Brazil is a stark example--the original estimate of US$2.2 billion was in the event increased to nearly US$4 billion.

the Swiss chairmanship. But, if we do attempt to deviate from the standard Paris Club procedures, the question of the standstill period may become more difficult. Would a letter to Mr. Probst requesting a rescheduling during a given consolidation period have the same effect as a letter to Mr. Camdessus, and would the Swiss be able to pass it on to creditor governments as efficiently as the Paris Club secretariat would? It would probably be in the interests of both the Fund and Yugoslavia to stay as close to Paris Club procedures as politically feasible. It appears to be quite certain that creditors would want to agree among themselves on the procedures to be followed. In this case, it would perhaps be advantageous if the Fund took the initiative.

Should Mr. Mentre need additional information or "nuance," Mr. Brau would be happy to discuss the issues further.

cc: Mr. Mookerjee
Mr. Schmitt
Mr. Brau
Mr. Mentre
Mr. Hansen
Mr. Lewis

Table 1. Yugoslavia: Terms of Financial Credits and Rollover/Refinancing Under the Berne Agreement

(In millions of U.S. dollars)

	Amount	Maturity (years)	Grace period (years)	Interest rate (percent)
Financial credits				
Austria	40	...	...	...
Netherlands	21	5 1/6	2 3/8	8 7/8
Norway	5	5	0	5 3/4
Switzerland	50	7	4	6-mo. U.S. Treas. bills + 1 percent
United Kingdom	56	5	3	market rate
Total	172	5.8	3.2	...
Rollover/refinancing				
Belgium	9	4	1 1/2	market rate - 1 7/8
Germany	46	6	3	...
Italy	35	6	3	market rate
United Kingdom	59	5	2	market rate
U.S.	155	6	2 1/2	based on EXIM cost of funding
Total	304	5.7	2.5	...

Source: Data provided by the Swiss authorities.

Table 3. Yugoslavia: Availability and Use of Credits under the Berne Agreement

(In millions of currency specified)

	Original Pledge: Currency pledged	Original Pledge: U.S. dollars 1/	Revised Pledge 2/	Likely to be Signed by end of 1983	Utilized Jan-Nov.18	Projected Utilization Nov.19-Dec.31	Total 1983	Carry-over 1984
Austria	US$ 100	100	100	100	--	40	40	60
Belgium	BF 1,200	25	22	22	--	9	9	13
Canada	US$ 40	40	40	--	--	--	--	40
Denmark	DKR 125	15	13	13	--	--	--	13
Finland	US$ 10	10	11	2	--	1	1	10
France	FF 1,000	150	122	94	33	19	52	70
Germany	DM 530	225	196	196	114	--	114	82
Italy	US$ 135	135	135	135	--	35	35	100
Japan	US$ 30.5 3/	31 3/	35	25	--	--	--	35
Netherlands	US$ 50	50	50	46	21 4/	--	21 4/	25
Norway	NKR 175	25	23	23	12	1	13	10
Sweden	SKR 150	20	19	19	--	--	--	19
Switzerland	US$ 90	90	90	90	50	10	60	30
U.K.	£ 78	125	115	115	56	59	115	--
U.S.	US$ 300	300 5/	272	371	371	--	371	--
Total		1,341	1,243 6/	1,251	657	174	831	507 7/

420 may be used as max. only 300

Sources: Data provided by the Yugoslav authorities; and Fund staff estimates.

1/ Converted at end-1982 exchange rates.
2/ Converted at exchange rate prevailing at November 18, 1983.
3/ Preliminary.
4/ While the Dutch pledge was given in U.S. dollar terms, the financial credit was granted in Dutch guilder terms, which reduced the amount by US$~~4~~ 25 million at current exchange rates.
5/ The United States pledged to provide 20 percent of the total package up to a maximum of US$300 million.
6/ Differs from the figure of US$1,341 due to the exchange rate and to a reduction in the U.S. pledge from the maximum of US$300 to US$272 to reflect the size of the overall pledge.
7/ Differs from the figure of US$420 used as carryover in the balance of payments table because it is uncertain that all of the pledged amounts are usable.

Table 4. Yugoslavia: Projected Utilization of Credits Under the Berne Agreement in 1983

(In millions of U.S. dollars)

	Untied Financial Credits	Rollover/ Refinancing	Export Credits	Total
Austria	40	--	--	40
Belgium	--	9	--	9
Canada	--	--	--	--
Denmark	--	--	--	--
Finland	--	--	1	1
France	--	--	52	52
Germany	--	46	68 1/	114
Italy	--	35	--	35
Japan	--	--	-- 2/	--
Netherlands	21	--	--	21
Norway	5	--	8	13
Sweden	--	--	--	--
Switzerland	50	--	10 3/	60
U.K.	56	59	--	115
U.S.	--	155	216	371
Total	172	304	355	831

Sources: Data provided by the Yugoslav authorities; and Fund staff estimates.

1/ Minimum amount.
2/ Japan has extended US$25 million in short-term guarantees.
3/ The Swiss authorities estimated US$10-15 million.

Statement by the Chairman

Interpreting Elements of Chapter II paragraph I of the Memorandum of Understanding signed in Berne, Switzerland January 19, 1983

1. It is understood by those signing the Memorandum of Understanding that the reference to the availability of disbursements in 1983 is to ensure that Cooperating States will make credits available in 1983 and does not restrict the disbursement of these funds during 1984 and thereafter pursuant to contracts governed by the Memorandum of Understanding.

2. In reference to the date of January 1, 1984 in subparagraphs (a) and (b), it is understood that, in the case of necessity and if efforts to comply in good faith with the January 1, 1984 date fail, this date could be extended within reasonable limits by agreement of the participants immediately concerned.

Raymond Probst

LAW spoke to Wayne.

Office Memorandum

TO: Mr. Whittome

FROM: W. Lewis WL

SUBJECT: Yugoslavia - Bank Exposure

December 2, 1983

I received a phone call from Mr. Fisher of Manufacturers Hanover this afternoon in response to our inquiry about the share of the largest banks in the medium-term financing agreement for 1983. Although earlier in the afternoon he had promised to provide some information, apparently he was later told by his superiors that any information on the exposure of groups of banks, as well as on the extent of their participation in the 1983 package, was confidential. Manufacturers Hanover would require releases from each of the banks concerned before any such information could be provided to the Fund.

If you would find it useful, we could attempt to make some discreet inquiries in Belgrade as to the contribution of the largest banks in providing new money in 1983.

cc: Mr. Schmitt
Mr. Hansen
Mr. Petersen

The Managing Director	December 2, 1983

Hans Schmitt

Yugoslavia--World Bank Participation

We have accepted Mr. Suman Bery of the World Bank as a participant in the forthcoming mission to Yugoslavia (December 5-16) to discuss use of Fund resources. The Bank will pay his expenses.

cc: Deputy Managing Director
Director of Administration
Secretary's Department

INFORMATION COPY

TO: The Managing Director December 2, 1983

FROM: L. A. Whittome

SUBJECT: Yugoslavia - Use of Fund Resources

You asked whether Yugoslavia needed a 1984 stand-by for SDR 450 million.

Our (European Department) preference for SDR 450 million is based on two main considerations and one background thought. First, in preliminary talks with Yugoslav officials we have spoken in terms of figures ranging up to US$500 million, which we would interpret as SDR 450 million. Of course, firm commitments could not have been made, nor were they. However, to reduce the maximum amount for 1984 could, at this stage, risk the appearance that the Fund's resolve to support Yugoslavia was weakening.

Second, offering as much as SDR 450 million in 1984 would provide us with what we regard as probably the minimum leverage necessary to have a reasonable chance of negotiating a suitably tough program and of obtaining some new finance from both the banks and the governments. We have taken the position that we should be prepared to go to SDR 450 million only as long as new money can be obtained from banks and governments. If these creditors were only to maintain their exposure to Yugoslavia, the Fund should do the same which would imply a stand-by of SDR 270 million for 1984. As you know, without new money there is no realistic chance that Yugoslavia can build up its international reserves which will mean that we can already be absolutely certain that we shall be involved in a new financing package for 1985. The background thought has two aspects. First, given scheduled repurchases of about SDR 270 million in 1984 the figure we would propose implies net lending of SDR 180 million, approximately US$200 million, which is the sum of new money which we hope to get from both the banks and the governments though we shall pitch our initial suggestion at a somewhat higher level. In contrast, under Mr. Finch's proposal the net increase would be SDR 100 million. Second, Yugoslavia would now be eligible to draw on the CFF probably at least SDR 300 million. We would prefer not to see this issue raised but we fear that it inevitably will be if the net lending we are proposing appears derisive.

You also queried whether the program to be negotiated should be described as tough, given the structural imbalances still prevalent. Perhaps this is partly a matter of semantics. Certainly structural imbalances are likely to persist for some time. But the 1983 program resulted in a reduction of real wages in the socialized sector of 10 percent and by most standards this is surely tough. It is true that other incomes from agricultural plots, the black economy, and interest helped reduce the burden on many households as can be seen from the consumption figures, but certainly some households must have suffered. In 1984, the program we are negotiating implies a further fall in real wages; hopefully we shall also be able to secure the introduction of effective measures to impose financial discipline on enterprises.

Finally, you asked for a medium-term profile of Yugoslavia's use and repurchases of Fund resources. I attach a table showing the cost of the scenario we have in mind. Please note that the table excludes the CFF and therefore shows net purchases of SDR 285 million in 1984.

Attachment

cc: The Deputy Managing Director (o/r)
Mr. Finch
Mr. Collins
HOS
CED

cc: Yugo file

Office Memorandum

Fa Linder

To: Mr. Whittome

December 1, 1983

From: Leif Hansen L.H.

Subject: Yugoslavia--The 1983 Commercial Bank Package

1. I spoke this morning with Mr. Fisher of Manufacturers Hanover about the 1983 bank package. (I could not reach Mr. Dobrich or Ms. Mudd.) 1/

About 18 banks had not signed the agreement on new money. The number varied from time to time as new creditors were discovered and others that had previously refused to sign the agreement did so. If all the known creditors had signed the agreement the total amount available according to the rule the banks should provide 8.75 percent of the specified base obligations (as of November 30, 1982) would be US$636 million. The amount available according to this rule for those who had signed was about US$614 million. For the release of the first tranche on October 26, 1983 this rule had been applied and US$366 million (60 percent) had been disbursed. The amount released under the second tranche on November 15, 1983 was US$90 million (15 percent) and the remainder up to US$600 million or US$144 million would be disbursed on December 6, 1983. Of those who had signed the agreement there had only been a problem with Bankers Trust (which was now solved) and a small Swiss a forfait house.

On the short-term debt, as far as Mr. Fisher knew, the estimates were still US$215 million for the short-term credits and US$570 million for the trade related credits. He confirmed what Mr. Dobrich told us on November 23 that according to the short-term facilities agreement, Yugoslavia should repay foreign trade credits one month later than the first advance under the medium-term loan, i.e. on November 26, 1983. However, Yugoslavia had approached banks to have the period extended by another month. This was quite puzzling, since according to the agreement Yugoslavia could immediately restore those credits again. Mr. Dobrich had mentioned a figure of about US$225 million as the maximum possible leakage under this facility--a figure Mr. Fisher did not know about.

1/ Mr. Fisher did nothave figures for the share of the big banks in the new money provided to Yugoslavia. He would try to get it from Manufacturers Hanover's London Office tomorrow and phone it to Mr. Lewis. We have some figures that the Yugoslavs produced before the January 1983 meeting which show that the share of the 24 biggest banks in total debt to banks as of November 30, 1982 amounted to about 50 percent. These figures were very rough estimates, but if they hold it means that the big banks have provided about half of the new money in 1983 or about US$300 million.

2. The terms of the commercial bank package are:

a. Medium-term new money facility

(i) Amount: US$600 million.

(ii) Grace period: 3 years (first repayment June 30, 1986).

(iii) Repayment period: 3 years (final repayment June 30, 1989).

(iv) Facility fee: 1 1/8 percent flat on the amount of each advance.

(v) Commitment fee: 1/2 percent of one percent per annum of the unused portion of the commitment commencing from the date of the financing agreement.

(vi) Agency fee: US$500 per creditor for each year.

(vii) Interest rate: LIBOR plus 1 7/8 or prime plus 1 3/4, at the creditor's option.

b. The refunding and consolidation loan facility

(i) Amount: latest estimate, US$1,020 million.

(ii) Grace period: 3 years (first repayment January 16, 1986).

(iii) Repayment period: 3 years (final payment January 18, 1989).

(iv) Facility fee: 1 1/8 percent flat on the amount of each refunding and consolidating loan.

(v) Agency fee: US$800 per creditor for the first year and US$750 per creditor for each subsequent year.

(vi) Interest rate: LIBOR plus 1 7/8 or prime plus 1 3/4, at the creditor's option.

In addition it is stated for both facilities that "customary arrangements will be included for the obligors to reimburse the agent and the ICC members for all expenses of the ICC, and its economic subcommittee, each national coordinating committee and the administrative coordinator, including legal fees and disbursements of special New York, English and Yugoslav counsel to the ICC, of the obligors, whether or not the transactions contemplated hereby shall be consummated."

c. <u>Short-term facilities:</u>

1. <u>Extension loan facility</u>

(i) Amount: latest estimate, US$215 million.

(ii) Stand-by fee: 1/4 of one percent flat on the amount outstanding.

(iii) Maturity: January 17, 1985.

(iv) Agency fee: US$800 per creditor.

(v) Interest rate: LIBOR plus 1 3/8 or prime plus 1 1/4, at creditor's option

2. <u>Continuing credit facilities</u>

(i) Amount: latest estimate, US$ 570 million.

(ii) Stand-by fee: 1/4 of one percent flat on facility available.

(iii) Availability: Up to January 17, 1985.

(iv) Agency fee: US$500 per creditor.

(v) Interest rate: LIBOR plus 1 3/8 or prime plus 1 1/4, at creditor's option

The stipulations with regard to expenses for the short-term facilities are the same as for the financing agreement.

cc: Mr. Schmitt
Mr. Mentré
Mr. Lewis
Mr. Petersen

Office Memorandum

DEC 1 1983

TO : The Managing Director

DATE: December 1, 1983

FROM : Hans Schmitt HS

SUBJECT : Yugoslavia

We have been informed that the commercial banks are prepared to release the third tranche of their medium-term loan to Yugoslavia on Tuesday, December 6, when they will receive the attached draft telex. The telex should be transmitted tomorrow, December 2, 1983.

telex sent to Communications 12/2 11:00 NB.

Attachment

cc: The Deputy Managing Director
Mr. Collins

DRAFT
Nov.28, 1983

Mr. Radovan Makic
Governor
National Bank of Yugoslavia
Belgrade, Yugoslavia

I refer to the stand-by arrangement for Yugoslavia approved by the International Monetary Fund on January 30, 1981 and to the medium-term external bank financing agreement between Yugoslavia and the International Coordinating Committee. I now wish to confirm:

1. The stand-by arrangement continues to be in effect.

2. As of November 18, 1983, on the basis of the most recent information supplied by Yugoslavia to the Fund, Yugoslavia was observing all applicable performance criteria under the stand-by arrangement.

3. On November 18, 1983 Yugoslavia purchased SDR 129 million from the Fund. Yugoslavia has thus purchased all of the cumulative amounts available to it according to the provisionsof the stand-by arrangement.

4. Yugoslavia has intiated discussions with the IMF concerning a stand-by arrangement for 1984.

A copy of the foregoing message is being transmitted to Manufacturers Hanover Trust.

Sincerely yours,

J. de Larosiere
Managing Director
Interfund

cc: HOS
CED

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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~~MR. RADOVAN MAKIC~~

~~GOVERNOR~~ LIST OF 2

~~NATIONAL BANK OF YUGOSLAVIA~~

~~BELGRADE, YUGOSLAVIA~~

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1983 DEC -2 PM 1:42

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MR.POLAKK
EURO

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I REFER TO THE STAND-BY ARRANGEMENT FOR YUGOSLAVIA APPROVED BY THE INTERNATIONAL MONETARY FUND ON JANUARY 30, 1981 AND TO THE MEDIUM-TERM EXTERNAL BANK FINANCING AGREEMENT BETWEEN YUGOSLAVIA AND THE INTERNATIONAL COORDINATING COMMITTEE. I NOW WISH TO CONFIRM:

1. THE STAND-BY ARRANGEMENT CONTINUES TO BE IN EFFECT.

2. AS OF NOVEMBER 18, 1983, ON THE BASIS OF THE MOST RECENT INFORMATION SUPPLIED BY YUGOSLAVIA TO THE FUND, YUGOSLAVIA WAS OBSERVING ALL APPLICABLE PERFORMANCE CRITERIA UNDER THE STAND-BY ARRANGEMENT.

3. ON NOVEMBER 18, 1983 YUGOSLAVIA PURCHASED SDR 129 MILLION FROM THE FUND. YUGOSLAVIA HAS THUS PURCHASED ALL OF THE CUMULATIVE AMOUNTS AVAILABLE TO IT ACCORDING TO THE PROVISIONS OF THE STAND-BY ARRANGEMENT.

4. YUGOSLAVIA HAS INITIATED DISCUSSIONS WITH THE IMF CONCERNING A STANDPBY ARRANGEMENT FOR 1984.

IF REQUIRED INITIAL BELOW

SPECIAL INSTRUCTIONS — TEXT MUST END HERE

TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): HANS SCHMITT EXT.: 72933 DEPT.: EUR DATE: 12/1/83

AUTHORIZED BY NAME (TYPE): ~~J. DE LAROSIERE~~ AUTHORIZED BY NAME (TYPE): ( )

TYPE ** ON LAST OR ONLY PAGE OF MESSAGE

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IMF OFFICIAL MESSAGE
WASHINGTON, D. C. 20431

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~~MR. RADOVAN MAKIC~~

~~PAGE 2~~

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MR. POLAK
MR. SCHMITT

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A COPY OF THE FOREGOING MESSAGE IS BEING TRANSMITTED TO MANUFACTURERS HANOVER TRUST.

SINCERELY YOURS,

J. DE LAROSIERE

IF REQUIRED INITIAL BELOW

SPECIAL INSTRUCTIONS — TEXT MUST END HERE

REPEAT TO: MANUFACTURERS HANOVER TRUST CO.
NEW YORK, N.Y.

TELEX NO.: CABLE ADDRESS:

DRAFTED BY NAME (TYPE): HANS SCHMITT EXT.: 72933 DEPT.: EUR DATE: 12/1/83

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The Managing Director

Hans Schmitt

Yugoslavia

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INFORMATION COPY

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J. de Larosiere
Managing Director
Interfund

IMF OFFICIAL MESSAGE

WASHINGTON, D. C. 20431

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MR. RADOVAN MAKIC
GOVERNOR
NATIONAL BANK OF YUGOSLAVIA
BELGRADE, YUGOSLAVIA

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cc: CED
W. Lewis

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IF REQUIRED INITIAL BELOW

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C — TELEX NO.: CABLE ADDRESS:

D — DRAFTED BY NAME (TYPE): HANS SCHMITT EXT.: 72933 DEPT.: EUR DATE: 12/1/83

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MR. RADOVAN MAKIC

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MR. POLAK
MR. SCHMITT

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J. DE LAROSIERE

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NEW YORK, N.Y.

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~~MRS. G. HOFMANN~~

~~NATIONAL BANK OF YUGOSLAVIA~~

~~BELGRADE, YUGOSLAVIA~~

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DISTRIBUTION

MR. POLAK

START TEXT HERE

1. THIS IS TO INFORM YOU THAT MR. SUMAN BERY OF THE WORLD BANK WILL JOIN OUR MISSION FROM DECEMBER 8 TO 14.

2. MENTRE ARRIVING BELGRADE FROM LONDON ON DECEMBER 7 ON JU 211 AT 1800. WOULD BE GRATEFUL IF YOU COULD MAKE HOTEL RESERVATION FOR HIM AT INTERCONTINENTAL FOR NIGHTS OF DECEMBER 7 AND 8.

WITH BEST REGARDS,

SCHMITT

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DRAFTED BY NAME (TYPE): L. HANSEN/V. BALL EXT.: 77270 DEPT.: EUR DATE: 12/1/83

AUTHORIZED BY NAME (TYPE): H. SCHMITT AUTHORIZED BY NAME (TYPE):

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Schmitt

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